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Deferred compensation units: New lure for executives

Devices are similar to stock options

By DIANE STAFFORD
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Much has been made lately of soaring executive compensation and multimillion-dollar CEO stock options. Even though many workers decry the growing compensation gap, such executive incentives aren't likely to disappear.

The reason is that stock options perform as designed: They help attract and keep top-caliber talent.

Historically, stock options have given publicly owned companies an edge over privately held ones. Family-owned or closely held companies typically lacked a similar rewards and retention tool.

That's where Kansas Citian Thomas McCoy's "deferred compensation units" come into play.

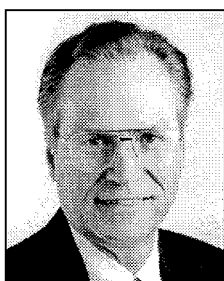
McCoy, a management and performance improvement consultant, has created and marketed an executive compensation plan that gives private companies something other than cash bonuses to offer key executives.

"We needed a means to provide long-term incentives for our executive team," said Chuck Churchwell, chief financial officer at one of McCoy's client companies. "Until we implemented the DCU plan, there was nothing but loyalty to keep us."

McCoy's deferred compensation units mirror public company stock options in one way: They're both financial vehicles with the ability to appreciate in value over time.

But there's a big difference: The value of stock options is tied to stock market performance, both for the company and for the market.

While the value of stock options may rise or fall, the value of deferred compensation units is a dollar value that is awarded and will not fall.



McCoy

Under McCoy's plan, the value of the deferred compensation units may grow – if both the company and the executive meet set performance goals – over a 10-year period, at which time the units must be redeemed. "Deferred compensation units are issued for annual performance," McCoy explained. "You get them. They are yours. But they also can appreciate from year to year, for up to 10 years. That's why it's a motivation and retention plan."

At Churchwell's company, a \$500 million privately owned chain of building supply centers based in Texas, the plan has been in place since January 1998. Seven longtime vice presidents and one new one are participating.

"The owners here realized that they can't get from point A to point B without others helping," Churchwell said. "They needed others to buy in. We were there. We helped. This compensation plan was the avenue to get everyone focused on ramping up."

"Without it, the owners faced a real problem for any privately held company. They didn't have a great mechanism to compete for talent in the marketplace. Now they have incentives for the players they want to retain."

McCoy said he recommended a combination of short-term cash incentives (bonuses) and long-term incentives for any company seeking to retain its core executives. To be effective, he said, per-

formance expectations must be clearly set for the individual and the company.

"We set up a department scorecard that states expectations and then pays out based on annual achievement," McCoy said.

McCoy thinks his compensation plan reduces conflict inherent in many incentive systems.

"Bonus plans tend to force short-term decisions, and long-term equity incentives can become separated from company performance," McCoy said. "A reward system should link today's results and tomorrow's continuous improvement."

McCoy calls his plan LeaderShare. He says it eliminates the need to reprice stock options when the market goes down, and it isn't affected by value gains, unrelated to company performance, that occur when the market goes up.

"Each \$1 in DCUs I earned in 1998 could be worth, say, \$50 in 2008," Churchwell said. "A DCU has the ability to appreciate. But it could also be worth \$1 if things don't go well. The important thing to me is that I don't lose it entirely. ... Obviously, we have the incentive to grow that value."

McCoy developed the compensation plan to respond to a need discovered through his national consulting practice.

In addition to consulting, McCoy has written two books: *Compensation and Motivation: Maximizing Employee Performance With Behavior-Based Incentive Plans*, published by Amacom in 1992, and *Creating an "Open Book" Organization - Where Employees Think and Act Like Business Partners*, published by Amacom in 1996.

Additional information about the deferred compensation units plan is available by calling T.J. McCoy & Associates at 816-333-1261.

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