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MANAGEMENT | OCTOBER 10, 2008

Firms Try to Shore Up Incentive Pay

Special Bonuses, Retention Efforts Try to Counter Rout of Incentive-Pay Programs

By PHRED DVORAK

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As plummeting stock prices and profits pummel companies' incentive-pay plans, many firms are considering extra measures to reward employees.



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A September survey of 151 U.S. companies by Deloitte Consulting LLP found nearly three-quarters had implemented or were considering such measures, including stock awards or special bonuses. Respondents said they were worried about keeping key workers and boosting morale in the turbulent economy.

Deloitte's survey highlights how the weakening economy threatens to sap employees' spirits by eroding bonuses and wealth. The Dow

Jones Industrial Average has fallen about 39% over the past year, decreasing the value of equity grants that companies rely on for long-term rewards. Meanwhile, many economists say the U.S. is heading into a recession, which could push down results -- and the annual incentives typically tied to them.

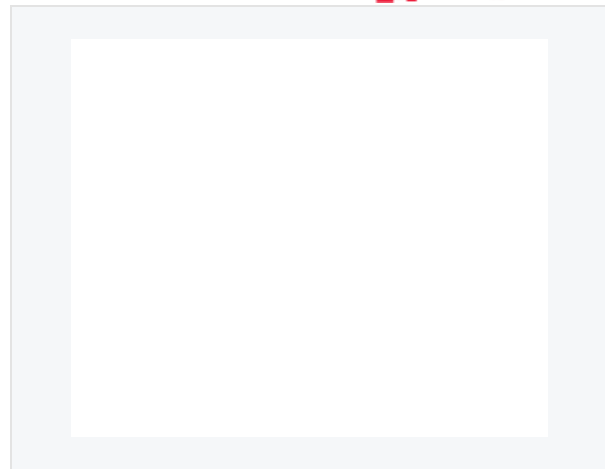
"The last thing [companies] need now is for employees to throw in the towel and say, 'I'm not going to work so hard,'" says Michael Kesner, the head of executive-compensation consulting for Deloitte.

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Of course, some experts say that in today's economy, workers are less likely to jump ship. Industries that rely heavily on stock and bonus compensation -- such as technology and financial services -- may be harder hit by a meltdown in incentive pay than others. Some companies can't afford extra rewards even if they want to give them, says John

Radford, a senior vice president at Radford Surveys & Consulting, which specializes in tracking compensation at technology and life-sciences companies. Mr. Radford says he has been deluged with calls from clients during the past few weeks asking for advice about incentive plans.



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VMware Inc.(VMW)	20.63	▲1.90	11:01a.m.

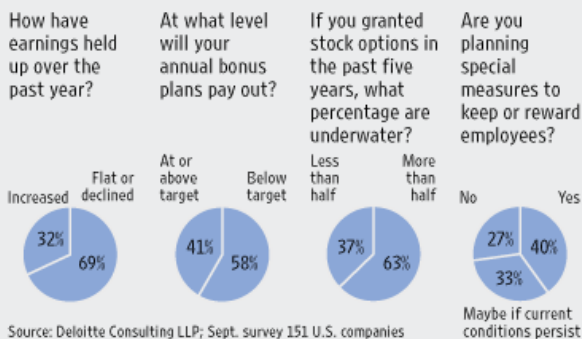
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The Deloitte survey, which covered companies of all sizes and industries, found that more than two-thirds said earnings declined or were flat over the past year, and 58% predicted their bonus plans would pay out less than their targeted amount; 10% were expecting no bonus payouts at all. Bonus plans generally pay eligible employees if companies meet preset targets such as earnings per share.

Almost two-thirds of companies that granted stock options said half or more of their grants from the past five years were now "underwater," or could only be redeemed at prices that were above current market prices. The situation has likely worsened, because share prices have plunged since the survey was conducted last month, Mr. Kesner says.

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To alleviate the pain, many surveyed companies said they were thinking of tweaking bonus plans to increase their chances of paying out, and modifying long-term incentive programs to "improve the value" for workers. Nearly a third said they were considering additional programs to keep key employees -- often special payments to supplement regular bonus pools.

One controversial remedy some companies are considering is swapping underwater options for stock, or for options with lower exercise prices. Such swaps can hurt earnings, and often require shareholder approval, which make them tough to do.

Compensation-tracker Equilar Inc. found more than 20 companies that implemented option exchanges so far this year, including home builder [Toll Brothers Inc.](#) and software company [VMware Inc.](#)

Pharmaceutical-development company [MannKind Corp.](#) in July offered many of its 600 employees the chance to exchange two stock options for one share of restricted stock. The company was pushing workers hard to file a new drug application, yet the options it had relied on to motivate staff were so far underwater they weren't working, says general counsel David Thomson. Exercise prices generally ranged from \$7 to \$25; MannKind's stock was trading at around \$3.

Options are "part of what we use to get people to perform," says Mr. Thomson, so "when our equity compensation goes kaplooeey, we don't stack up well." About 83% of eligible employees swapped their options for stock, he says.

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