Stock Appreciation Rights Overview

What Are Stock Appreciation Rights?

Stock appreciation rights (SARs) are a type of employee compensation linked to the company's stock price during a preset period. Key leaders helping the company grow realize a benefit when its stock price rises, which makes them similar to employee stock options. However, employees do not have to pay the exercise price with SARs. Instead, they receive the sum of the increase in stock or cash. *The primary benefit of stock appreciation rights is that employees can receive proceeds from stock price increases without buying stock.*

Example

You award an employee 100 SARs units as a performance bonus, and the SARs mature after a period of two years. The company's stock increased by $25 a share over those two years resulting in the employee receiving $2,500 (100 SARs x 25 = $2,500) in additional compensation. Most SARs agreements have a vesting period, and some include a claw back provision should an employee leave before the end of the specified period.

Think of it as today's pension plan to build a long-term payout for key employees who help the company grow. To keep employees engaged and working towards common company goals, we suggest a long vesting period for the total payout of shares and prorated vesting if the company is sold prior to employees becoming 100% vested.

It is NOT a bonus or 401K match; however, you can also do 401k matches and annual bonuses tied to each leader's key initiatives, in addition to a SAR award.

A SAR program is compensation for key leaders; however, in some businesses, like non-manufacturing services, this program could be an incentive for all employees.

How Does the SAR Work?

You set the valuation – we suggest you use an easy-to-track gross margin number. Using gross margin as your metric helps drive efficiencies for a business to make higher margins. We typically don't suggest tying it to operating income, as employees can't control all costs, and owners typically don't share the actual operating income. Seeing the operating income number may make some employees feel like they should earn more of your dollars. *Regardless of the metric tracked, the key is using the same valuation method annually.*

For example: In one case, the SAR program was funded with 10% of the owner's stock (growth value*). In this case, the owner's number of shares was increased, so the share price was lower, and the owner could give more shares vs. a higher price and a low number of shares. *Stock growth value does not mean an owner offers current stock value; it is only the increase in share price the owner receives in the future, not the value it is worth today.

In the same case, the owner had 10 million shares less the 10% of the shares earmarked for the SAR program. The 10% yielded 1 million shares the owner could award as Stock Appreciation Rights reward. The shares were awarded annually based on company performance. If the company hit its agreed-upon goal, the direct reports involved in the growth work got a higher amount. Other options could be to award equal amounts based on other metrics, roles/responsibilities, tenure, etc.

Funding

Funding for the number of shares is accrued annually. Typically, an owner creates a balance sheet account to fund payouts. If someone leaves before they're vested, their share value can be transferred out of the fund to a company charity account, if desired, and then the number of stock shares goes back into the available share pool for a future award.

Each year recipients get a number of shares if you achieve your goal, and when the recipient leaves, you can either payout in a lump sum OR create a payout schedule over 60 months. Using the payout schedule, the award becomes a short-term pension for the employee and helps with cash flow for the company. You can set whatever vesting schedule you want. Or you can do lump sum stock award or annual payout, whichever you want to manage. **The goal is to keep it simple and easy to understand and maintain.**