

Chasing Your Own Private Equity - By Christian Anklin

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HVS Executive Search explains the logic of granting equity to key executives, especially for startup scenarios or takeovers.

Private Equity - it has been quite the buzz word over the last two years. At times reminiscent of the corporate raiders of the eighties, private equity funds have been aggressively buying up hotels, hotel portfolios and even hotel companies in Europe, with the principals of these funds standing to gain substantial wealth when they divest. More recently, as the U.S.-originated credit crunch casts a growing shadow over the lending, and in turn the transaction market in the UK and Continental Europe, the momentum for such deals seems to be decreasing somewhat. Regardless of how this scenario plays out, the words "private equity" now conjure up all sorts of associations, and the attraction of equity as a means to wealth creation remains.

Base salaries are spent on essentials, an ever growing list of items including food, clothing, rent/mortgage, schooling etc. Bonuses are often spent on presents, holidays and mortgage down payments. A significant slice of equity in a growing company can be a means of gaining wealth in a way that a pension fund cannot. If you are in a position to personally and positively influence the growth of that company, this can be the ultimate motivational tool.

According to a recent global survey by PricewaterhouseCoopers, equity compensation is becoming an increasingly popular tool among multinational companies who are looking to attract, motivate and retain their top executives. While there are a myriad of different and ever changing ways of granting equity, the principle remains the same: a non-cash form of compensation that represents an ownership interest in the company. The effects are to align the employee's interests with those of the company and to bind the employee to the company by offering an incentive to loyalty. The continued rise in the popularity of equity compensation can be attributed to a growing realization that the fight for talent affects the bottom line. Many recent publications have cited the difficulty in attracting and retaining quality employees as one of the prime threats to business success.

At HVS Executive Search, we are continuing to see a strong demand from hotel ownership groups for Asset and Acquisition Managers this year. In addition, as more players have been entering the hospitality real estate market, we are also being asked to search for CEOs for start-up scenarios or takeovers. In new ventures, the granting of significant equity slices to the key decision makers can serve as a means of attracting top talent by offering them the chance of true wealth creation.

The typical candidate for such positions will be a highly accomplished individual who is happily working in an organization that remunerates him/her well and offers long term incentives for staying. This candidate would be taking on a substantial risk by joining a new and unproven company. Often, the only way to counter that risk is to offer the candidate a relatively large percentage of the company. The allure of wealth creation should not be underestimated. At times, candidates will even accept a significant cut in their base salary in return for an equity stake in the firm. Those more entrepreneurial hotel executives recognise the opportunity to build a retirement nest egg which a traditional salary and bonus cannot match.

While many principal investors may be instinctively opposed to giving up any ownership stake in their new venture, this should really be a no-brainer for them. In addition to making the position attractive to the very best candidates, aligning the new executives' interests with those of the company, and ensuring greater loyalty, the granting of equity to key executives will also save them costs in the short term at a time when the company needs all its capital for growth. The above mentioned benefits, including a possible reduction in negotiated base salaries, will cost the new company next to nothing as the value of the equity is yet to be created. The equity slices of around 1-3% that we have seen can make all the difference in attracting the right candidate.

Some companies have great difficulties in attracting the type of star player who could ensure that their new venture turns into a success, simply due to their unwillingness to compromise on the question of equity. They may want to take some pointers from the publicly listed hotel companies who have long recognized the value of tying a large part of an executive's compensation to long term business results by granting a high percentage of long term incentives (LTIs) to their CEOs and other executive directors.

| Company | Choice Hotels International | Hilton Hotels | Marriott Intl, Inc. | Starwood Hotels & Resorts |
|--|-----------------------------|---------------------|----------------------|---------------------------|
| Name | Ledsinger, Charles A. | Bollenbach, Stephen | Marriott, Jr., J. W. | Heyer, Steven J. |
| Position | CEO | CEO | CEO | CEO |
| Total Compensation | \$4,918,727 | \$12,229,367 | \$12,596,808 | \$9,963,426 |
| LTI | \$2,826,358 | \$8,720,247 | \$9,771,341 | \$6,385,292 |
| LTI as % of Total Compensation | 57.46% | 71.31% | 77.57% | 64.09% |
| Market Capitalization | \$2,478,900,000 | \$13,263,400,000 | \$17,462,800,000 | \$14,786,200,000 |
| LTI as % of Market Capitalization | 0.11% | 0.07% | 0.06% | 0.04% |

Source: 2007 Hotel Edition of CEO/CFO Compensation Report:

<http://www.hvs-executivesearch.com/ExecutiveSearch/2007HotelCompStudy.pdf>

by Keith Kefgen, President and Founder of HVS Executive Search

Looking at the 2006 salary breakdown of a selection of CEOs from large international hotel management companies, we can see that all of them receive well over 50% of their salary in the form of long term incentives. Of course, in companies of this size the LTI element of the CEO's salary makes up far less than 1% of the market capitalization, but the nominal value is large enough to act as a key motivator in terms of performance and retention.

In structuring their CEO compensation, start-up companies may want to follow the example set by these large public entities. Naturally, the size of a company will determine how much they can offer as a long term element of salary but also how much of an ownership stake in the company this LTI element represents.

While much has been made in the press lately of purportedly overpaid and overvalued company executives, there is a real danger of underestimating the value of a good CEO, especially for organizations in their infancy or undergoing some form of radical change. We have seen new businesses falter solely due to the inability of companies to attract the right CEO. These leaders can make or break a company and investors should pay heed to this fact.

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