Netflix

First, Netflix changed how America rents movies. Now it is revolutionizing how companies manage their employees. Reed Hastings is Netflix's innovative CEO leading the charge. Netflix employees are treated very well—high salaries, unlimited vacation, and empowerment to structure their compensation packages.

In return for these perks, employees are expected to work hard, not play games—there are no ping pong tables or Friday beer bashes. In addition to the favorable vacation and compensation packages, Netflix offers the other basic employment benefits—medical, dental, etc. However, the philosophy is that the employees are adults, they know when to work, they know when to play, and they do not need someone to tell them when and how to do either.

Hastings calls this approach "freedom and responsibility." The Netflix environment is a high-performance driven work place, so while employees are given a lot of freedom, the underlying culture is one in which each person is responsible for growing the business. Steve Swasey, director of corporate communications, recently was quoted as saying, "Netflix has changed a consumer behavior, and every department contributes to that."

To this end, there are no "key employees" or "president's clubs," where employees are classified into groups that matter and those that do not. All Netflix employees are seen as key employees. Further, Netflix embraces turnover. If an employee is just a so-so performer, rather than getting an okay review and basic cost-of-living increase, the person is shown the door. To further treat all employees like adults, any laid-off workers are allowed to leave with their dignity intact and given a healthy severance payment. This policy also helps managers, who might otherwise feel too guilty to let someone go.

Let Them Eat Cake (or just a cupcake)

Compensation at Netflix is neither tied to performance reviews nor limited to a set dollar amount but rather to the job market. Historically, stock option grants were viewed as a way for companies to engender a feeling of ownership. Adding in vesting schedules, they can also act as an enticement to stay with a company. Most companies base grant size on performance evaluations, like a raises or bonuses. But given the Netflix philosophy of hiring the best, letting the ones who do not fit leave, and paying at the top of the market, where do stock option grants fall in the compensation package? The answer is that Netflix empowers employees with the freedom to choose annually how much of their compensation they want in cash vs. stock.

How does the program work? Each November, employees have their performance evaluations and are notified of their salaries for the next year. Then, in December, each employee makes an election to receive a portion of compensation in stock options. 2007 is the first year that employees have been allowed to choose 100% salary. In the previous three years in which this program has been in place, employees were allowed to choose between 5% and 50% of their compensation in the form of stock options. This is the first year where the company has not had 100% participation in the stock option plan. In December 2006 only 60% of the employees chose to receive a percentage of their compensation in the form of stock option grants. However, this figure does not take in to account the employees who participate in the appealing employee stock purchase plan, which allows a 15% discount from the beginning or ending stock price over a six-month period.

Since Netflix sees grants and salary as an employee's total compensation, the company has taken the more conservative route in viewing that in taking the stock option grant in lieu of cash salary, an employee is actually deferring compensation. This is why the employees make their stock vs. cash elections in December to comply with Internal Revenue Code Section 409A. The philosophy that both grants and cash are compensation fits with the revision of accounting standard FAS 123 into FAS 123(R), which forces employers to expense stock compensation against net income. Netflix was an early adopter.

There are a couple other areas with its stock option grants where Netflix has strayed from the norm. Rather than granting all of the options on one day, the company grants them monthly so the employee has the benefit of dollar cost averaging. This minimizes some of the risk that the employee will receive his or her entire grant for the year at the highest (or lowest) price for the period. Further, since these grants are seen as a deferral of compensation, there is no vesting schedule—all stock options are 100% vested at grant. In the Netflix's employment model, if an employee does not want to be there and contribute fully, Netflix does not want them to stay—the company does not want golden-handcuff employees.

This unique program empowers the employees to make their choice based on what is best for them, their lifestyle, risk tolerance, and stage of life. With the challenges of an increasingly competitive marketplace, Hastings believes that the Netflix culture will continue to boost the company's market share and competitive advantage.