

Key Employee Incentive/Retention Plans – The New Paradigm

By

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With the onslaught of Covid-19, our country went from a period of record employment to record unemployment. Since January, our business community has experienced a flip in talent demand unlike anything it has ever seen before. Key talent was in demand and could essentially name their price when making a career move. Everything has changed.

The sudden change has created both obstacles and opportunities for businesses. While some companies have succumbed to layoffs others have seen the shift as a chance to secure high-performing talent for whom they could not have competed for just a few months ago.

For those familiar with EOS (*Entrepreneurial Operating System*) and who is not these days, business owners often own the role of “visionary” within their organization. A Visionary™ is a person who has lots of ideas, is a strategic thinker, always sees the big picture, has a pulse on their industry, connects the dots, solves the big, ugly problems and is great at closing big deals. Visionaries are the creators of everything. Visionaries NEED Integrators™ to complete their vision.

An Integrator is the person who is the filter for all the Visionary’s ideas: harmoniously integrates the Leadership Team and helps to remove obstacles and barriers. They are the tie-breaker for the leadership team, the glue for the organization, holding everything together, driving results, accountable for the P&L results, executes the business plan, holds the Leadership Team accountable, and is the steady force in the organization.

That said, an organization has a Visionary about 50 percent of the time. It MUST have an Integrator 100 percent of the time.

The pandemic has afforded many owners’ unplanned time for strategic contemplation. Contemplation on how to emerge stronger and better and/or how to ready the company for their ultimate departure. Either requires focus on operational efficiencies, value enhancement and training/recruitment of key talent. Each, more critical than ever.

Owners looking to hire an integrator, to take the company to the next level, or to motivate one internally, to focus on desired results, may be wondering what they need to do now. Especially since there is more of this talent available, given the flip in talent demand. Salary, short term bonuses, benefits, culture, enthusiasm, etc. are important. However, owners looking to recruit/retain key talent today need to focus on innovative Long-Term Incentive Plans (LTPL).

A New Paradigm

The new paradigm in Long Term Incentive Plan design requires a shift in perspective and focus.

1. Focus on Value-Creation

First, instead of key talent being hired to fill a position, they are now being recruited to perform a role, i.e. “integrator”. As such, they are not being paid for their behavior (*time spent, duties fulfilled, actions accomplished*), rather they are being paid for achieving a desired result—for

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producing a targeted outcome. This has led to a shift away from the idea of “incentivizing” towards a philosophy of “value-sharing”.

Value-sharing is directly linked to value creation. Once key performers understand how value creation is defined for the business and what their role is in creating and sustaining it, they understand how reward is earned. And the more they help create, the more they share in what they produce. They become “growth-partners”. They develop a sense of stewardship about protecting shareholder interests and apply an ownership mindset towards decision making. A mindset shift that creates a unified financial vision for growing the company. Thereby negating the familiar “entitlement” mentality that often accompanies ill-designed incentive plans.

2. Simplicity is a Must

The incentive plan must be easy to understand first and foremost. For long term plans, paid for annual performance, reward should be tied primarily to profit. This is the measurement that not only aligns everyone’s efforts toward the only variable that fuels growth, but also has a direct link to enterprise value.

There are nine different incentive plan types that owners can employ to reward long-term value creation. Three of them are ways to share equity, three are different types of phantom stock plans and three are reward approaches that are tied to other financial measures (*which impact business value*). Many organizations need help determining which type of plan is suitable for their companies. This is the role of an independent consultant hired to direct the process and see it through implementation. And to keep plan construction simple.

3. Meaningful & Deferred Payout

Incentive award must be meaningful, if not compelling. When it comes to value-sharing opportunities, owners need to adjust their thinking if they expect to attract/retain great talent and treat them like partners. Today’s marketplace indicates that incentive award *potential* must reach at *least* 25% of key performers salary. With 50%+ being commonplace, after a fair return on shareholders capital. Less than these thresholds are more consistent with discretionary or periodic cash bonuses. Which elude the “growth partner” mentality necessary to influence behavior and/or recruit key performers. Mentality where owner and key performers are working in sync toward a shared financial vision. And as partners, apply an ownership mindset toward all their decision-making.

Ideally, your key performers compensation package is made up of short term (ST) incentive-based pay, along with long term (LT) incentive-based pay. Both tied to the attainment of predetermined financial benchmarks. Benchmarks that again, reflect metrics an owner wants to focus on. Those benchmarks may even be identical, with a portion of the annual award payed in cash (ST) and the balance (*a majority in this author’s opinion*) at some point in the future, determined by the owner. Time for a reality check. If given the choice, most key performers would prefer cash to a future promise of compensation. Here is where an owner must share a compelling vision for the company’s future. As a retention tool, long term incentive plans (4+ years) are critical. A design element often overlooked.

4. Communication

As important as previous design elements are, this one is likely even more so. How an owner communicates both the purpose of their incentive plan as well as the mechanics, cannot be

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underestimated. If plan benchmarks and performance expectations are not understood or believable, the plan will fall flat. All the modeling in the world will not make any difference if key performers do not believe the results can be achieved. And with it, their financial participation in that journey.

Final Thoughts

As owners (*and their Advisory Teams*) contemplate the challenges and opportunity brought about during this Covid economy, they are likely reevaluating business strategy and their own value proposition. They are also cognitive of the need for prudence via cost-containment measures without strangling their ability to move forward with confidence. All this plays into both the kind of talent that is needed and when a business can “afford” to hire those people.

Long Term Incentive Plans, rooted in value-creation, offer a “self-financed” solution. They benefit shareholders by creating a unified financial vision, reinforce roles, outcomes, strategic priorities, and ultimately value creation. They benefit key performers by putting them in control of their earnings while simultaneously sharing in the value that they help create.

During a time when competition for top talent is at a zenith, creative pay structure must not only be compelling, it must be irresistible. As a result, making the shift from incentives to value-sharing not only makes sense, it is strategically urgent.