

THE EXIT PLANNING REVIEW™

Issue 266

October 1, 2013



Bonus Incentive Plans For Employees: What's The Point?



This issue brought to you by:

Clarke Langrall, CEPA
Forecast Strategic Advisors
clarke@forecastadvisors.com
<http://www.forecastadvisors.com>

When I ask business owners about the possibility of installing an employee incentive plan, I often hear one of two responses:

- “I would like to do something to reward my key employees for their performance.” OR
- “You know, one of my best employees left last week for a company for more money. I think I'd better do something to stay competitive in the marketplace.”

May I suggest that these two motives are not nearly self-serving enough? The purpose of installing a bonus plan for your employees is **to motivate them to help you reach your exit goals.**

While owners differ about when they want to leave their companies or how they wish to leave, the underlying ownership goal is consistent: to leave the company in style. No matter what type of employee incentive plan you create, it should be designed to support your fundamental exit goals by motivating your key employees to stay with your company and build its value.

Consider the following realities:

- Few owners will take an extended vacation much less cut back on their involvement without leaving capable management in place to run the business.
- Most sophisticated buyers will not seriously consider a company that lacks a good management team;
- Many, if not most companies, are sold to key employees; and
- Transferring a business to children can be especially risky in the absence of key employees who will remain with the new owners.

Whether your goal is to sell to a third party, transfer the business to children or to employees, the success of your strategy depends on the presence of motivated key employees.

We measure the effectiveness of an employee incentive plan in part by how well it motivates key employees to increase the value of a business. Effective plans necessarily reward employees as they increase the value of the business.

Usually, this means that owners (and their advisors) must develop an incentive formula that links increases in the income or cash flow of the business to the employees' rewards. In its simplest form the incentive plan gives the key employee a cash bonus. Part of the bonus is paid currently and part is subject to vesting thus handcuffing the employee to the business.

Let's look at how one fictional owner set up his company's incentive plan.

◆
◆
The Exit Planning Review™
is published by
Business Enterprise Institute, Inc.
◆

After meeting with his advisors, Mel Houston decided to give two of his key employees 30 percent of the company's pre-tax income above \$100,000 (the company's historic performance level). After Mel installed this plan, the company's pre-tax income increased to \$300,000 so his key employees shared 30 percent of the excess income (\$200,000) or \$60,000.

Because Mel wanted to retain his key employees over a long period of time, he decided to pay half of this bonus after the company's year end, and subject the other half to a non-qualified deferred compensation plan with vesting over several years.

Mel's plan (like yours should) provides that as the cash flow of his business increases (and thus the value of the business increases), he rewards his key employees accordingly. In doing so, both he and his key employees attain their goals.

Keep in mind that the formula you and your advisors create for your company can and should reflect the specific characteristics of your business. The head of the sales department might be rewarded for increasing the adjusted gross profit margin. A chef in a restaurant might be rewarded for reducing food costs (without affecting the quality of the meals served). Whatever factor you identify as a key to increasing the value of your company can be incorporated into your key employee incentive planning.

If you would like to discuss your options for installing employee incentive plans to support your exit goals, please contact me.

Subsequent issues of [The Exit Planning Review](#)[™] provide balanced and advertising-free information about all aspects of Exit Planning. We have newsletter articles and detailed White Papers related to this and other Exit Planning topics. If you have any questions or want additional Exit Planning information, please contact us.

© Copyright 2013 Business Enterprise Institute, Inc. All Rights Reserved