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Characteristics of Successful Employee Bonus Plans

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Too often, owners discover that the compensation plans they've put in place for key employees are sadly inadequate only when those key employees leave their companies for greener pastures. The departure of one or more of these key employees can not only complicate your daily business life, but it can slam shut the door on your exit plans. Without experienced management in place, it may be unlikely that you will be able to leave your business in style. In fact, you may not be able to leave it at all. Key employees are aptly named not only because they are key to the efficient and profitable operation of your business; **they are also key to your departure**. No one will want or be able to run your business without you, unless key management remains after your departure.

How, then does an owner manage to keep his key employees on board? Short of tying them to the mast, many owners install an Employee Incentive plan that motivates them to stay. In doing so, an owner also works with the goal of ensuring his own successful exit.

Of course, there are many successful Employee Incentive plans and successful businesses but many share four common characteristics. Successful bonus plans:

- Are specific, not arbitrary, and are in writing
- Are tied to performance standards
- Make substantial bonuses
- Handcuff the key employee to the business

Let's look at each briefly.

The most basic characteristic of a successful plan is that it is communicated clearly by the employer and understood thoroughly by the employee. Therefore, successful plans are in writing and are based on determinable standards. To be successful, employees must know that the plan exists and how it works. Plans should be explained to employees in face-to-face meetings, often with the owner's advisors present to answer any questions.

The second characteristic is that the bonus is tied to performance standards. An owner often works closely with his advisors to determine which performance standards should be used — perhaps net revenues or taxable income above a certain threshold — for which employees.

The standards of performance that the owner chooses must be ones that the employee's activities can influence and that, when attained, increase the value of the company. Let's look at how one owner accomplished exactly that.

Duke Manning was struggling to keep his renowned, yet temperamental, chef in line. Henri always wanted more money even though the profits of the restaurant, specifically the kitchen, were uneven. Since Chef Henri controlled both the food costs and the labor costs Duke and his advisors designed an incentive plan to encourage Henri to keep both items in line, but not too low.

The incentive plan worked as follows: If quarterly food costs were no greater than 26% and no lower than 22% (a range we believed necessary to keep food quality high) Henri would receive incentive compensation equal to 1% of the restaurant revenues. Similarly, if quarterly labor costs stayed between 25% and 21%, Henri would receive another 1% or a possible total of 2% of the revenues. Duke determined that if the kitchen could not stay within these ranges, profitability or the reputation and quality of the restaurant would suffer. If the restaurant prospered, revenues could be in excess of $3million and Henri could earn as much as $60,000 dollars.

Further, because Duke wanted to keep Henri for the long term, half of Henri's bonus was paid currently and half deferred and subject to a vesting schedule. Of course, if Henri left before he was vested he would forfeit half of his bonuses.

Third, the size of the bonus must be substantial enough to motivate the employee to reach his performance standards. As a rule of thumb, a plan should create a potential bonus of at least 10 percent of the key employee's compensation. Anything less may not be sufficiently attractive to motivate the employee to modify his behavior to make the company more valuable.

Finally, a successful plan handcuffs the key employees to the business. The goal of this element is to keep the employee with the company the day after and even years after the bonus is awarded. Owners typically use several techniques to create "golden handcuffs" for their employees.

Your advisors have a host of other tools in their bonus plan arsenals to help you design a successful bonus plan for your employees and ultimately, for your successful exit plan.

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