

HOW TO STRUCTURE A RETENTION BONUS

WHY OFFER A BONUS?

When business owners decide to sell, one of their concerns is how to retain their key staff during the divestment process, and ultimately, how to encourage those staff to want to remain in the business with the new owners.

Key staff retention and integration is usually high on the priorities for intending new owners, so they need to be involved in the sale process and meet the intending new owners at some stage. For more information on this aspect, refer to an article on Supertrac's website called "Who to tell when you're going to sell".

Employees handle uncertainty regarding their futures in different and sometimes unpredictable ways. Some leave prematurely, often to less satisfying roles with other organisations.

Despite the inevitable uncertainties during the sale process, it is usually in their interest to stay with the business and the new owners. New owners are often larger firms offering broader services, new opportunities, growth plans, capital, promotional opportunities, scope for travel and diversity. The new owners are likely to be more dependent on key staff than the previous owners were, so they now have an opportunity to shine through. It makes sense to encourage key staff to remain committed during and after the sale.

So how does a business owner achieve staff retention during and after the sale? One way to encourage key employees to stay during a sale process and afterwards with the new owners is to offer a retention bonus.

The aim of a retention bonus is to align the interests of each of the 3 key stakeholder groups and enhance value for all involved:

Sellers - want to sell and exit, so having key staff in place makes the business more valuable and saleable, and also allows them to shorten their post-sale handover period;

Buyers - want to retain knowledge and expertise, relationships with customers and suppliers, overall capacity, and have a smooth transition with minimal disruption to the business. Having the key employees incentivised to stay gives both the employees and the new owners encouragement to work together and manage through changes and any unsettling times.

Employees - new ownership usually offers upside for key employees. They are in the spotlight and may become the 'experts' in the absence of exiting working owners; new owners usually herald opportunities ahead, growth plans and removal of previous handbrakes to growth. The extensive opportunities can often be masked to employees by the inherent perceived uncertainties throughout the process, and additional encouragement may be needed to see the full picture. This is normally an exciting period for those who stay on.

The retention bonus should be transparent to all 3 parties and is generally financial in nature.

PAY SOME NOW, SOME LATER

It is important to structure the bonus effectively. There is no point paying it all out as soon as the sale occurs or staff may then leave. Knowledge of this arrangement structure would normally be enough to jeopardise the sale as far as the buyer is concerned and so would be self-defeating.

The recommended structure of a retention bonus is to pay one component on settlement and a second contingent component after an agreed period of time (eg. after 12 months) provided the staff member is still employed at the business.

The rationale for offering a retention bonus is also important. A cynical view would be that it is to bribe employees to stay and work to the seller's and buyer's agenda. However a more positive view is to consider it as a 'thank you' for contributing to enhancing the value of the business over time, for participating in the sale process and agreeing to assist new owners settle in.

When preparing to offer a retention bonus, you should consider the tax structure of the deal and how to optimise this for both the payer and payee. Any payment is likely to be taxable income to the recipient, but if the company shares are sold, it may or may not be deductible to the seller. So you should obtain advice from your accountant/tax specialist as to how best to structure these.