



## Exit Planning

# NAVIGATOR

Exit Planning Strategies for the Entrepreneur

Issue 48

## Incentive Plans For Key Employees

(First Of A Two Part Series)

Experts and laymen agree that one constant of successful companies is a stable, motivated management team. This quality not only contributes to corporate success, it is also key to the business owner's successful business exit.

Should you decide to sell your business to a third party, you'll discover that potential buyers place significant value on the strength of your management team—if that management team can be expected to remain after you have left the business. Similarly, if you contemplate selling the business to family (or to employees), the likelihood of being paid for the business after you've left is entirely dependent on the strength of your remaining management team.

In short, capable management remaining with the company is *the* key to getting top dollar for your business. Without such management your exit is impossible, or at least imperiled.

One of the many factors involved in creating, motivating and keeping good management is the creation of a properly designed incentive plan for key employees. To be successful, an incentive plan must motivate the management team to increase the value of the company in a measurable way. Only by increasing company value do employees receive the incentive (ownership or cash).

Successful plans share four basic elements:

First, the plan is *specific*. Employees know, in advance and in writing, what standards need to be met to receive the incentive.

Second, the incentive is *substantial*. For many years, a bonus of at least 10 percent of annual compensation, (again in stock or cash) was the minimum necessary to motivate a key employee. But today, the minimum *potential* incentive has risen to 25 percent of annual compensation, and sometimes more. This substantial amount is only earned and paid upon the attainment of a performance standard that you set. (The next issue of **The Exit Planning Navigator**® will describe various performance standards in more detail.)

Third, the plan *handcuffs* management to the business. Employees are motivated to stay with the company in the short term as well as (and more importantly) after you've left it.

Fourth, the key employee earns the incentive bonus based on a *performance standard*, that, when attained, *increases the value of your business*.

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*(continued)*

This fourth element is critical to a properly designed incentive plan.

Management incentive plans are based upon the assumption that the plan provides incentive. What is often less clear is exactly what the incentive motivates the employee to do. Effective incentive plans motivate employees to act in ways that increase business value. Remember, your ultimate goal is to build enterprise value that you will someday convert to cash.

The next issue of **The Exit Planning Navigator®** will discuss specific performance criteria that can be used to motivate employees to increase the value of your company.

*Subsequent issues of The Exit Planning Navigator® discuss all aspects of Exit Planning.*

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