FINDLEY perspective

February 23, 2015

Retention Compensation Plans – Please Stay!

By Rob Rogers

One component of executive and senior leadership compensation that has seen significant growth over the last several years is the implementation of retention compensation. On its face, retention compensation strategies are another form of long-term deferred compensation; but it is different in that retention rewards are typically in place because of a specific event or set of circumstances triggering the need.

What is Retention Compensation?

The concept is simple—the organization provides a payment to a key person which is tied to continued employment for a specific period of time. The need for retention incentives typically result from:

1. An anticipated or pending sale of the business/organization.
2. A significant reorganization and/or restructuring.
3. The planned succession of new leadership into the business/organization.

The most common use is where there is an anticipated transaction which requires leadership and key talent continuity in order to maintain the ongoing value of the enterprise. It can be critical to ensure that key talent is retained, operating functions are held intact and that relationships are maintained during these times of transition. We have seen growth in the use of retention arrangements within the health care industry as a result of the recent and expected future consolidation of hospitals and health systems.

Do Retention Plans Work?

If the goal is to merely retain someone without regard to performance or engagement, they can be successful. However, if it is the only vehicle in place, such plans can be merely giveaways for tenure. One key question—does the bonus payment really keep them in place? By itself, our view is that the retention bonus is typically not large enough for key talent to stay in place—if the opportunity is great enough, the loss of bonus will not be an issue.

We have to remember that the key to the employment relationship is engagement so that the financial reward alone will usually not be enough. A recent study by Hay points out that 20% of employees plan to look for a new job in 2 years and another 20% plan on definitely leaving their current positions in at least 5 years. As a result of the more tenuous nature of the employment relationship, turnover has become a more prominent aspect of organizational life. We would suggest that as with all components of rewards, pure dollars are never the ultimate driver.

Both Towers Watson and WorldatWork have surveyed large numbers of domestic and international organizations to understand what makes a retention strategy successful when tied to a transaction. Some findings include:

1. Select candidates who are really key talent—those who could really impact value in the short term. That means that the selection might not be an entire class of leaders but rather individuals from critical areas where interruption through turnover could be costly.
2. Identify these candidates as early in the process as possible and communicate clearly the parameters of the program. It is important that the leaders of the acquiring organization personally contact these individuals as soon as practicable.
3. Recognize that the actual bonus itself is not enough—emotional connections to the new organization need to be established early in the transaction. Just as important will be early participation in task forces related to integration and constant contact with the new decision makers.

4. Ensure that the current compensation and levels of incentive reflect high performance expectations. It may be appropriate to institute pay adjustments and bonus target increases as an alternative or in conjunction with some ultimate service-based award tied to a transaction or event.

5. Link the ultimate award to an appropriate time period. While it is important for the transaction to be completed, the real goal is a successful integration of the new entity. In our view, the real reward should occur 12 months or so after the actual transaction. The real value of the combined entity will be measurable once the combination occurs, not at the time of closing. It may also be appropriate to have performance metrics as part of the retention bonus. For example, 50% of the award could be based solely on continued service but the other half based upon pre-determined metrics tied to the integration.

Estimates of normal turnover range from 50% to 200% of salary depending upon the type and level of position. Where key talent leaves during a period of business and/or leadership transition, these costs multiply. Putting together a strategy that addresses real engagement with the organization will include a thoughtful mix of financial and non-financial incentives.