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Not your parents' incentive plans

By SCOTT T. ROLLIN

Employees born in the "millennial period" are no longer the new kids on the block. They have begun to transition into middle-management and other key employee roles in businesses all around the country.

Couple this with the fact that the top concern of companies today is hiring and retaining qualified employees and you have a scenario where business owners must worry about how to compensate this newest generation of key employees. And the tried-and-true methods of long-term incentive compensation that worked with baby boomers might not fit as well in this environment.

This new generation of key employees (whether millennial, Gen Z, or whatever other label you might attach to them) is driven by different goals and desires than many traditional incentive compensation plans are built to recognize.

For instance, some plans pay for "loyalty" to the company, i.e. "stay with us for many years and we will reward you for that long service." Loyalty looks different to this new generation.

The notion of staying with the same company and/or job for five to 10 years will become more of the norm than the 30-year careers of our parents. Their career decisions are also going to be heavily influenced by things like current compensation and cash flow, work-life balance, a sense of doing good and helping others, and flexibility in work schedules, etc.

They are going to want to understand the "why" of what their work means to the company and all of its stakeholders — not just the customers.

Some recent studies have shown that loyalty is still important to these generations, just in a different way than those who've come before. The chance to experience new things (new jobs, new places, new ideas, etc.) is a major part of developing loyalty in today's corporate environment.

However, there is also a pragmatism in this generation — and those members who are now progressing into key business roles know that the "rubber still has to hit the road" in order for the business to be profitable and support everything it is trying to do. So what is a business owner to do? How do you link this new generation to the long-term results of the business?

One thing isn't changing — how businesses are valued.

Owners still need reliable (and growing) profits to create long-term value for themselves — and all of the company stakeholders. Buyers (or equity markets) will only pay a certain amount for the value that a business generates — and profits is how it is measured.

Therefore, a business owner who wants to connect this long-term creation of value to key employee compensation plans still needs to be able to pass along this longer-term risk to those key employees. Otherwise, the very definition of long-term incentive begins to erode, and the compensation plan gets skewed.

In other words — if key employees aren't willing to share in the longer-term risk of potentially growing the value of the company (and being paid more if it grows), then owners will simply keep the risk and not pay those key employees more at all.

But not taking this compensation risk creates a different risk to this new generation of key employees: if owners are "cornered" into keeping all of the risk — more of them will be enticed to simply cash in and sell the entire business at some point.

For anyone who has lived through the sale of a privately held company to a bigger company (or an investment/private-equity firm), they will attest to the fact that such a sale will bring changes that many current employees aren't going to be happy with (think layoffs, restructuring, closing of locations, etc.)

So how can companies bridge the gap between the older strategy of simply paying at retirement for long-term growth in business value — to address the needs and desires of this newer generation — without having to outright sell the business? A developing trend we are seeing in the marketplace has a few main themes:

1. Long-term now includes the concept of "off-ramps" or partial payouts at various points during the career/life cycle of the plan.

2. Options for how the money can be paid back to the key employees abound (paid over four to five years to help pay for college education, a lump sum to help make a down payment on a home, etc.)

3. There are likely to be some qualitative factors in the plan formula (compared to a strictly quantitative financial formula) that determines the ultimate payout.

None of these concepts is really new. Rather, they are being employed in creative ways with the goal of matching the newer generation's needs for flexibility and current rewards — with the overarching goal of business owners to keep key employees linked to the growth in the value of the business ... which is how owners ultimately get paid.

Because some of the long-term risk is removed from the employee side of the ledger, these plans will pay less in terms of total dollars to the key employees (due primarily to the time value of money), but that serves to compensate the owners for keeping more of the risk than in previous generations.

Younger employees who recognize this risk-shifting (and are motivated by sharing in some of that risk) will demonstrate to business owners that they really are the kind of thinkers — and leaders — who will take companies to the next level as we baby boomers begin to retire.

Smart business owners need to be aware of these and other generational changes and continue to devise creative ways to make the incentive compensation link to key employees.

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