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Pivotal moments for family enterprises
Long-term incentive planning

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EDITOR'S NOTE

Like a great work of art, family enterprises are unique, crafted over time, and highly valued. While no two family enterprises are the same, they are united by a series of pivotal moments—opportunities to grow, evolve, or transform—and preparation is essential for fully seizing those opportunities. This is the fourth article in a series exploring the eight foundational elements that can help family enterprises maximize the opportunities that arise. Because, with the right canvas, family enterprises can craft a business that supports its evolving vision, interests, needs, and values for generations to come.

Many companies describe talent as their most valuable asset. **Today, with the demand for talent outpacing supply, many employers are prioritizing attracting and retaining a high-performing workforce.** However, the Great Resignation continues to impede companies looking for top talent, with seven in 10 employers globally saying they are struggling to find workers with the right mix of technical skills and human capabilities.¹



¹ Manpower Group, "Global talent shortages reach 15-year-high as workforce transformation reshapes in-demand skills," press release, June 1, 2021.



Today's top talent has an advantage, and they know it. With so many job options, candidates are empowered to dictate where they work, how they work and—of course—what they're willing to work for. And if you think public companies are the only ones struggling with this, think again.

Redefining compensation for the changing talent landscape

Many family enterprises are also feeling the strain of today's tight labor market. In the past, these organizations might have promoted talent from within their own ranks. Today, many family enterprises are competing with publicly traded companies for candidates as successive generations consider opportunities outside the family business. Likewise, some family enterprises are choosing to look externally—such as to executives from adjacent industries—as the operational needs of the business become more complex. These factors, in part, have driven many family enterprises to create more comprehensive compensation packages, specifically award programs.

"Fifteen or 20 years ago, if family enterprises offered a deferred compensation plan to help save for retirement, or offered a few shares of stock, that might be enough," says Blaise Kah, a partner in Deloitte Tax LLP's Global Employer Services Rewards practice.

"The whole market has changed. Now, family enterprises are competing for talent nationally with public companies—and people have shorter attention spans."

Done well, award programs can not only help incentivize top talent to join the ranks and stick around, but also help drive employee performance and align shareholder interests with management behavior to help drive increased shareholder value. So, the benefits are mutual to the employer and the employee—and are potentially quite substantial. What type of plan can meet all those objectives? Let's explore long-term incentive (LTI) plans and the value they can add for family enterprises.

In a world where instant gratification has become commonplace, LTI plans can help family enterprises counteract short-term thinking and focus the business and its employees on meeting long-term goals. As a leading practice, LTI plans should be based on increasing shareholder value,



with talent acquisition and retention as another significant benefit. To get started, family enterprises can design the LTI plan that works best for their organization by thoroughly thinking through three core components: award structure, payout timing, and award type.

Core components of an LTI

To encourage performance, LTI plans can specify cash or equity to be awarded to participants after the achievement of financial goals—this is a performance-based structure. Sales growth, profit margins, and cash flow are among the financial and strategic metrics organizations can set as performance measures when designing LTI awards. Companies can also decide whether executives must meet threshold, target, or maximum goals on a performance curve, as well as how the individual metrics are weighted when conferring the award.

For instance, 45% of an incentive reward could be based on revenue, 45% based on profitability, and the remaining 10% on individual performance, says Kah.

To encourage future-focused thinking and retention, family enterprises can elect

to create plans based on the passage of time—this is a time-based structure. Many family enterprises have determined that three years is the sweet spot for LTI plans—it provides enough time for leaders to generate momentum in their roles, put their personal stamp on enterprise initiatives, and achieve predetermined performance goals. Family enterprises can even leverage a combination of performance- and time-based awards to help maximize output.

“The three-year time frame most family enterprises abide by helps support retention, while also allowing for robust goal setting in the case of performance-based plans,” says Ian Dawson, principal and HR strategy leader at Deloitte Tax LLP, who has advised organizations on their reward strategies, including executive compensation and incentive design.

Consider the pros and cons of each award structure, and balance them as needed



Time-based

Consider a company that offers \$100,000 in cash that vests at the end of three years, with no performance upside. While simple and easy to understand, the real value at grant is less than \$100,000 because of inflation over the vesting period. Likewise, time-based awards don't have any influence on performance, which is a disadvantage to the employer.



Performance-based

Consider how performance-based metrics could be hampered by factors beyond an employee's control, such as global supply chain issues, and determine KPIs that truly measure the employee's individual performance.



As for the type of award, companies should consider if they want to confer equity rights or offer phantom stock, also known as tracking stock. Real equity is typically offered on a very limited basis in family enterprises because it may inherently dilute ownership, which can become a challenge when managing the interests of existing shareholders who are often family members. More commonly, many family enterprises prefer to offer phantom stock and performance-based cash incentive plans, which are like a bonus with performance measured over a specified period. This award type tracks value of the overall company like real equity would, and helps employees participate in value creation, but it's not real ownership, so owners don't dilute their equity stake.

Making a good plan work even harder

Once a family enterprise identifies the award structure, timing, and award type that's best suited for its goals, the next step is to consider ways to make the LTI plan work even harder by using it to help reinforce the organization's mission, purpose, and company culture.

While it's a leading practice to identify KPIs that help drive financial results, LTI plans don't always have to be rooted in financial

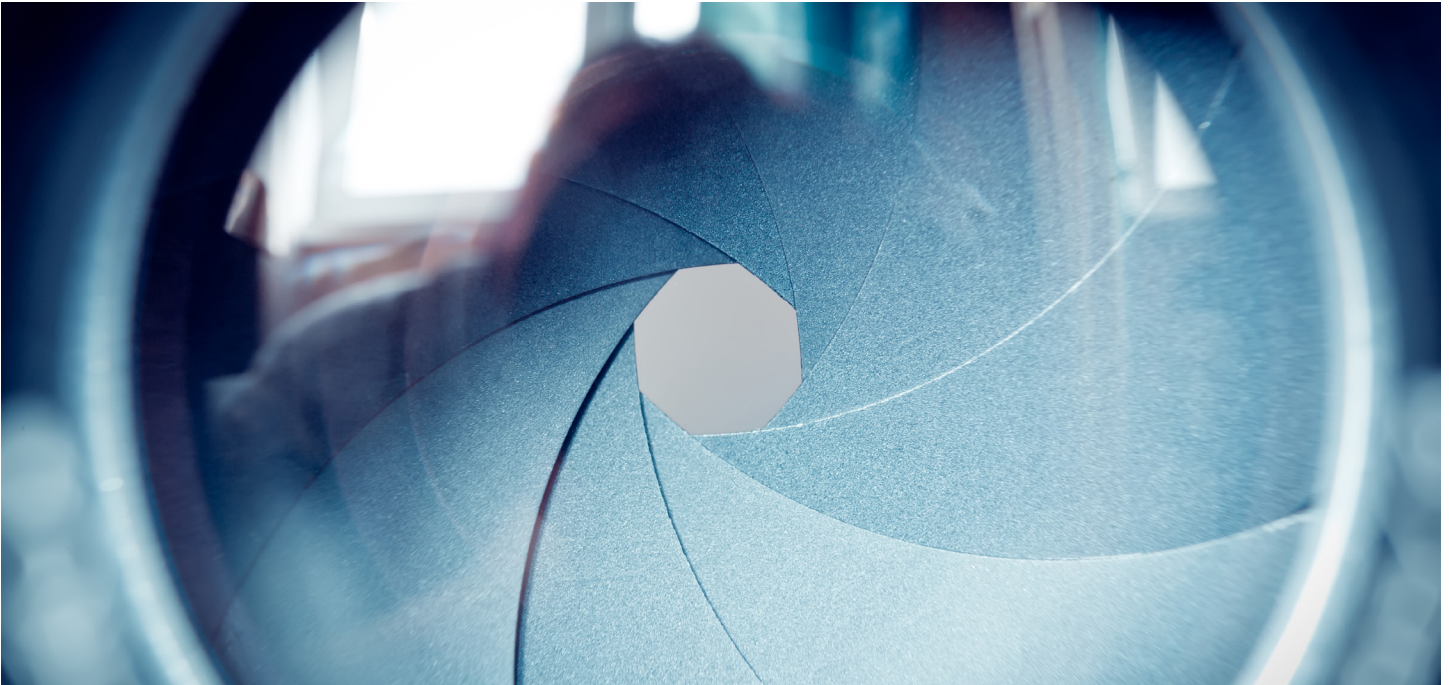
metrics. To help elevate the value of the plan, consider including nonfinancial metrics such as the fulfillment of quality and safety measures, customer satisfaction, and community impact.

Creating clear parameters across the executive suite in areas such as operations, strategy, HR, and hiring can allow companies to stay directionally focused across all leadership functions. "This helps get everybody rowing in the same direction so they're collaborating instead of competing," Kah says.

Designing an optimal LTI to attract and retain talent, drive employee performance, and align internal functional groups can be rewarding yet complex, and a board of directors can play a valuable role in the development and governance of an LTI plan. Working with management, an independent board can help by sharing its expertise and views on the plan design. Subsequently, the board can help ensure the LTI plan continues to align to the culture and strategy of the enterprise, while also supporting its risk and compliance needs, which are key value-adds of any well-functioning board. Additionally, the board can add value when it comes to compensation of family members working in the business.

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Blaise Kah, partner, Deloitte Tax LLP



Lynn Nowicki Clarke, an independent director who was named Private Company Director of the Year in 2021 by the National Association of Corporate Directors, points out, “The intersection of family interests and business interests makes transparent communication critical for family enterprises. Whether it’s designing a CEO compensation package or creating a

long-term incentive plan that may benefit family members working in the business, an independent board can provide insight and perspective that aligns interests and ensures equitable outcomes.”

No matter how a family business chooses to structure its LTI plan, a well-thought-out plan can yield significant value for the

enterprise and its many stakeholders. For family businesses looking to increase shareholder value, sustain top talent and incentivize their performance, and align internal functions, it’s no longer a question of “if” there should be an LTI strategy, the question should be “how do we get started?”

Where to start

If you’re considering LTI plans as part of your company’s compensation plan, or already have begun the process, it can help to think through the following set of questions:

1. Which leaders should be included in our LTI plans?
2. How will we factor in design considerations—timing of award, type of award, value of award?
3. What, if any, performance measures will we put in place?
4. How will a LTI affect my bottom line, and what are the tax implications?
5. Is the board initiating a discussion on LTI plans as part of its executive compensation and governance agenda?

NEXT UP IN OUR SERIES

To come

“Legacy assessments” will discuss how proper planning can position and prepare the family and/or associated business for continuity and provide a clear understanding of the leader’s wishes upon their passing.

GET IN TOUCH



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