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Retention Pay

How and how much do you pay to retain your key talent?

Whether reducing turnover costs is a top strategic focus or not, all organizations have critical employees. This column examines a few examples of forms of compensation that may incent workers to stay longer than they otherwise might.

End-of-Season Bonuses

In many seasonal jobs, such as store clerks during the holiday shopping season, retention is about employers wanting as little employee turnover as possible during the small window they have each year to earn a big part of their profits. In many vacation-focused communities, the customer base swells in the summer, and Labor Day weekend is the last big-revenue weekend of the year. Many of these summer service workers are high school or college students who either have to go back to class before Labor Day or want a bit of vacation themselves before summer's end. What's an employer to do to hold on to this key talent?

One way seasonal businesses might persuade workers to stay is with some sort of cash bonus paid for staying until the season's end or by paying a substantially higher wage at the very end. The latter incentive is what was offered to my 16-year-old son this year to stay at his job on Cape Cod as a beach guard until the bitter end of Labor Day. Another tactic is to impress upon workers that staying is part of the (implicit) contract — the employer gives the student a job with the understanding that the job extends all the way through the Labor Day holiday. This is hard for employers to enforce directly. But, employers can use an enforcement threat: You won't have a job here for the next summer if you leave your post before this summer ends; or, other local employers will learn that you left before the season was over, making it hard to get a different job elsewhere, too.

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Big Kinks

It is interesting to think about big kinks that retention payments can create in some cases. (In my March 2013 column, "Massive Kinked Bonuses," I discuss adverse incentives of kinked bonuses in general.) I remember more than 10 years ago reading the contract of a college football coach. In addition to his salary, media compensation, etc., he was guaranteed an average of $200,000 for each year he stayed at the university, but it was only payable all at once after five years — if he stayed a day less than five years, he wouldn't get a dime. A football coach who waits five years to earn the $1 million bonus or the employee who "maxes out" on his pension may be more likely to exit the organization at precisely those focal moments. This isn't an issue for the seasonal employer whose need for the employee ends when the bonus is paid. But in the case of key talent not defined by the seasons, does that mean we may need a second stay-bonus when the first one expires? And, when is the optimal time to negotiate such an extension?

One of the many reasons employers like to give stock options to employees is their long-term retentive value.

Stock Options

While the summer beach of Cape Cod may feel worlds away from the corporate office (that is the point of the vacation escape after all), the need to consider retention strategies for key employees is universal. Sometimes the retention horizon can be long term, or very, very long term. One of the many reasons employers like to give stock options to employees is their long-term retentive value. Consider the case in which an employee has a large number of stock options that are "in the money," the current stock price being well above the strike price of the option. This means that on paper the employee has quite a bit of money in the company. However, if the stock options have not yet vested, the employee would lose that money if he/she left the firm. The incentive is to stay, at least through the vesting date.

Retirement

An example of a very, very long-term retention incentive is that provided by some forms of defined benefit pension programs. At my previous employer, had I stayed and, ultimately, retired from that job, the retirement benefit could have been up to 75 percent of the average of my three highest-paid years paid per year for the rest of my life. And it would have been indexed to inflation. This is precisely the form of incentive that can keep folks at their employer perhaps longer than they would have with a more portable retirement benefit. (Though, in my case it didn't win out over the strong pull from the offer to move to Cornell University.)

The length of the retention that these incentives create can be manipulated with some vesting period. For example, imagine a defined contribution plan for which the worker contributes a fraction of his/her pay and the employer matches it, but the employer match is subject to vesting. That is, if the employee leaves, he/she can take the employer match only after a vesting period of employment had ended.

Edward Lazear offers an extremely clever discussion of the idea of mandatory retirement in the context of retention pay ("Why Is There Mandatory Retirement?" *Journal of Political Economy*, 1979, 87(6), 1261-1284). He shows situations in which employers paying less than workers produce when new to the job and more when they are more senior, serves to retain employees and makes the idea of mandatory retirement efficient. But, an important note: Efficiency is not legality. In all but a limited number of situations, mandatory retirement is illegal in the United States under the Age Discrimination in Employment Act.

It's Not All About the Money

Compensation practitioners may want to be careful not to focus too much on very specific and detailed forms of pay that may have retentive value. And they should be careful to always consider the unintended consequences of particular pay practices and be aware that some question whether, in the end, an employee who stays on only for the money will be the most engaged and productive employee. Providing interesting, challenging and meaningful work with excellent and supportive colleagues can be an extraordinary way to retain employees. And that approach to retention may have the added and always sought-after benefit of increasing productivity along the way. ws

got a question

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