

AIG - Retention Bonuses vs. Performance Bonuses (3/20/09)

The President, the Congress and the average American on Main Street are outraged at the top business story of the week which is: “AIG pays \$165 million in bonuses to employees.” Why is everyone outraged? Well, to date, the United States government has given AIG \$182 billion to keep the company from collapsing. This fact has some asking, “why are bonuses being paid at a company that is being bailed-out?” The answer might not be so simple.

When the media reports on the AIG bonus story, it calls them bonuses. AIG, on the other hand, calls the bonuses in question “retention bonuses.” You might ask “What is a retention bonus and what’s the difference?” Let’s define the word bonus first. A general definition for the word “bonus” could be an additional reward for a job well done. However, in the area of employee compensation there are different types of bonuses. In this article, we will consider two types of bonuses: Performance-based and Retention.

Performance-based bonus: This type of bonus rewards accomplishments and is typically what most would think of as a bonus. For example, the company, the department or the individual has performed well and that performance is rewarded with additional compensation (cash, stock options, stock awards, etc.) paid in addition to base salary. However, even within this broad category of bonuses there are sub-categories: Formal and Discretionary:

Formal Bonus/Incentive Plan: These plans tie bonus/incentive payments to specific pre-determined performance goals. These goals may apply to company, department, team, individual or a combination. In these formal plans, ideally the company and the employees can calculate the amount of bonuses based on whether they have achieved the stated goals. The goals should be measurable and clearly defined and often are set around performance metrics such as: revenue growth, net income growth, new system implementation, expense reduction etc. The key is to select performance measures that if achieved result in improved performance.

Discretionary Bonus Plan: Some companies prefer to have more latitude over bonus/incentive payments. In these organizations, management determines bonus amounts or percentages based on its perception of how the company, department or individual performed. In this approach bonuses are usually determined after the fact and it is more difficult to predict what bonus one may get.

Retention Bonus: This type of bonus, sometimes called a stay bonus, is not performance based. Rather it is used to get an employee, or group of employees to stay with a company for a specific time period. . These bonuses are discussed in advance and are often stated in a formal agreement or contract. Martha Glantz, a senior director with Total Compensation Solutions (www.total-comp.com) has seen retention bonuses used in several ways.

“In my experience they are used in the following cases:

- » *A Company is being sold and it wants certain employees to stay until completion of sale.*
- » *A Company/division/department is moving and it wants certain employees to stay until the move is completed.*
- » *For a special project: a company may offer retention bonuses to keep people through the end of the project. This is often critical because completing the project means their jobs will end.*
- » *A Company is in financial trouble and it needs certain employees to stay to improve the business.*

In the above cases, often the employee will get a retention bonus and severance, but if the employee voluntarily leaves before the end date, severance and retention bonuses are forfeited. There is nothing odd about a retention bonus; companies use them all the time.”

There are conflicting reports about who in the government knew about the AIG retention bonuses before they were paid out and who did not. Some are even saying that the bonuses were a small price to pay to retain people who can help sort out the financial matters at AIG. Regardless of how you feel about the AIG retention bonuses, Total Compensation Solutions thinks it is worthwhile to point out the different types of bonus payments being used generally and the bonuses paid specifically in the AIG story.

In the coming months we may hear about other types of additional compensation, or bonuses; e.g., a hiring bonus, sign-on bonus, referral bonus. These bonuses are used to attract employees to a company where the future might be questionable. Like retention bonuses, these are strategies that a company might use to help it attract, retain, and motivate top flight candidates for open positions.

If you have any questions regarding this article or bonus/incentive plans in general please call or email Tom Bailey at Total Compensation Solutions at 914-730-7300 or tbailey@total-comp.com