Make Your Staff Think Like an Owner

By Michael Neidle, Purple Squirrel, November 2000

Did you ever feel that the organization was not on the same wavelength in trying to make the company successful? Could it be helpful if the staff thought like an owner? The corporation and its employees have a very different relationship today from what existed five or 10 years ago. This is particularly true for IT and dot-com staffing companies, which are the leading edge of the industry in terms of growth and profit, and have a large fraction of younger, Generation X and Y employees. These people tend to be different from other generations and typically want more immediate rewards, and value flexibility more then security.

The role of the company is no longer to provide long-term employment. It is to perform a given job for as long as it is advantageous for both parties and, at best, to try to keep the employee marketable.

A sensible owner wants to maximize the value of his company. Everything that he does in one way or another is to accomplish this goal. Profit sharing, company-sponsored events, contributing to charities, or throwing a holiday party are all aimed at this goal, even if indirectly or unconsciously. This also means making profits today and making a greater profit tomorrow. The higher the profit and the faster that profit builds, the more the company is worth. Thus, one should reward the staff accordingly.

There is, of course, more than cash to make the staff think like owners. There is pride in the company, participation in management, ego satisfaction, job flexibility, and work environment, just to name a few. The best-managed companies recognize this and cater to their staff in these areas and don't have to compete for their talent on dollars alone. But economics come first. Without cash there are few choices to make.

What is the difference between the mindsets of an owner and an employee? A sensible owner does not distribute all of the profits, but retains a cash reserve. He has a game plan as to where he intends to be in several years. A smart owner does not take too many risks, as he understands the laws of probability. A committed owner worries about legal and financial liabilities and will have sleepless nights if he pledged his house as collateral. An employee tends not to worry much about these things. So how can we encourage him to do so, at least in part?

The answer is to reward performance, not just effort. Most compensation programs have a base salary and commission tied to margin. To this, a deferred component is added to make the staff think like an owner. This is based on profit and/or equity. A typical program for a manager may include 40 percent of one's total annual compensation in base salary, 20 percent in commission, and 40 percent in profits. For a staff person this might be 25 percent in salary (sometimes even a draw against commission instead of salary), 50 percent in commission and 25 percent in profit. The numbers provided here are only illustrative. Many companies have in fact eliminated the base and instead have a very rich incentive schedule, with a draw against commission.

A manager should have more of the compensation tied to the bottom line, as he or she has control of fixed costs (selling, general, and administrative costs) and does not direc-ly generate business, as does the individual staff member. He should have most of his compensation tied to production, as this is his main function. Ownership may be reluc- tant to disclose true profit because of confidentiality or privacy issues. How-ever, there are ways to provide sufficient information about profits without getting into areas that are uncomfortable.

The equity portion of compensation can either be in terms of real stock or quasi equity–RSQE. Quasi equity has all of the financial rewards of stock, but doesn't have the legal rights of a shareholder. If this sounds "risky," it is, but all rewards do involve risk. When done properly, however, RSQE both maximizes profit and works as "golden handcuffs" retaining the services of key employees. The question is how much RSQE should be awarded. One should ap-proach this from the standpoint of balancing how much would be meaningful in motivating the employee versus being affordable to the company.

The value of a company is typically determined as a multiple of its adjusted annual price to earning ratio (P/E). The P/E value is in turn a function of many factors, including the quality of the company, its line of business, and its growth rate. Realizing this value is achieved either by selling the company, by launching an IPO, or by the company's cashing out its RSQE participants. The annual price to earning rate tends to be higher with IT and dot-com companies than with traditional staffing companies. A $10 million IT or dot-com company with typical results may have a P/E of 5 or 6 (vs. 4 for traditional staffing). If that company had a 10 percent adjusted profit rate and a P/E of 5, it might be worth $5 million. Thus, each 1 percent RSQE share would be worth $50,000. For a person earning $125,000, a 5 percent RSQE would yield $250,000, or two years' worth of compensation. Many owners would be willing to provide 10 to 30 percent of RSQE to participating staff, if results warranted. In this example, that would allow for two to six staff members.

In practice, these calculations are more involved, as other factors come into play, including running out various scenarios, but this example provides the basics. In structuring a program to encourage employees to act as owners, the company should limit eligibility lest it dilute everyone's value. Financial rewards and a desirable work environment should push Generation X and Y employees to maximize profits and stay around for the long haul. Economics can be blended with lifestyle choices. It does not have to be an "either/or" situation.

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