

Hiring & incentivising your new MD

Last month's article on succession planning led to several questions around hiring and incentivising a new Managing Director.

What comes first – the MD or the strategy?

Tough call. You can either undertake strategic planning and then hire an individual with the skills and experience to achieve the prescribed goals and vision. Or you can recruit the MD and get the benefit of fresh thinking and additional firepower at subsequent strategy sessions. I prefer the former but am currently advising a client to do the latter.

Show them the money

How much is enough? While every situation is different I suggest starting from the standard base salary + performance bonus of up to 50% of base + equity. The MD should have full P&L responsibility so consider linking the bonus to budgeted net profit. Achievement of 80% of the net profit triggers the bonus payment – below 80% and any payment is completely at the Board's discretion. For achievement in excess of budgeted net profit you may want to implement a second tier bonus. An example would be paying 5% of net profit out as a bonus from 80% to 100% of budgeted net profit and then, say, 7% of net profit paid out for anything achieved over and above the budgeted net profit.

Such a method obviously requires a robust and formalised budgeting process at the start of each financial year (not a bad thing).

Fair Equity

Over the years I've seen many hours wasted negotiating equity plans prior to an individual starting. Pointless! In reality the Company only has an informed hunch of how successful the new MD will be. Similarly the MD has little idea of the true worth of the organisation – even a generous % of not much is not very much.

Include in the offer letter a paragraph outlining the Company's intention to share ownership with the new MD and a timeframe for when this will be negotiated (I suggest the 12 month anniversary). The paragraph should also include an acknowledgement that any valuation will be based on the start date of the MD to avoid an obvious disincentive: the more successful the MD makes the Company the greater the cost it will be for them to buy in.

If the individual is uncomfortable with the level of trust required in such an arrangement it may be a red flag for the appointment overall.

Should I sell or should I gift now (*apologies to The Clash*)

Another tricky one. I often advocate a combination of x% of shares available for purchase after 12 months combined with x% of options to vest over a 5 year period. This allows the MD to have an ownership stake in the business that is



Simon Telfer
Stimulus Consulting Limited

+64 21 321 901

simon@stimulusnz.com
www.stimulusnz.com

meaningful. Putting their hands in to their pocket gains a higher level of commitment and can be a welcome release of capital for the owner. The vesting period of the options also helps promote tenure.

Exit, stage right

The incentive of equity can falter and fade if there is no defined path for it to be realised. Discussions with any new GM or MD should include a frank discussion about plans and timeframes (if any) for a sale or other means of realising a capital gain from the investment.

GM or MD?

The title to be given to the new hire will depend on their capability and experience. Often they may begin as the GM with their one year anniversary triggering equity participation, formalising their role on the board and giving them the title and additional responsibility of Managing Director.



