



WILL THIS YEAR BE: BIG, BIG BONUS OR BYE-BYE BONUS?

Last week on one of the talk shows, a commentator made a glib comment about this year's bonuses for financial service professionals that had the phrase "bye-bye bonus" in it and it got me thinking about the fact that so many investment professionals take their bonus as an expected piece of their compensation whether or not the firm has given them a "guarantee" of a certain bonus.

This time of year is always an interesting one in the recruiting market because, for mid and senior level professionals, we're past the half-way mark in the year and the decision about whether to take another job often hinges on the candidate's view of the amount of bonus that will be "left on the table" at the firm they are leaving compared to the amount of bonus that could be earned in the new firm. Last week, we had a senior level candidate decline an offer because the new firm wasn't going to make him "whole" on his bonus with the firm he was leaving. Another candidate complained to us that an offer he received wasn't "market comp" and that he'd rather stay where he was and collect his year end bonus and then move next year. A pre-MBA Analyst candidate said that he would only take a private equity firm's offer if they matched the 3rd year bonus he anticipates he'll get by staying on at the bank for the next year – the firm declined, instead suggesting that the candidate get a reality check of what his imaginary bonus next year might really be given the market.

Our annual compensation issue will be in our firm newsletter in September and is one of the most regularly requested pieces of information. Candidates always want to know what our studies show bonuses will be this year as we get closer to year end because everyone wants to know what they "should" be getting as their bonus this year and how it compares to what everyone else is getting and whether they're being treated fairly.

It made me reflect on the issues of compensation and bonuses generally. Where did bonuses come from, what are they based on now and what makes a bonus "fair"? And, finally, how do we know what is "market" compensation?

Traditionally, in this industry and others, professional level employees were paid an annual salary (unlike secretarial staff who were often paid hourly). Over time, it also became customary for all employees (professional level and secretarial) to receive bonuses and, in recent years, for the bonus to be a substantial amount of the employee's total compensation package.

The law defines "salaried employees" as "those regularly paid the same amount each week no matter how much work they do or how many hours they work. They must receive a full salary for any week in which they perform any work without regard to the number of days or hours worked." I suppose that's often because if we divided our salary

by the number of hours we actually work, many of us would not choose to work for that hourly wage! The Department of Labor says that salaried employees' compensation cannot be reduced because of lack of work or variations in the quality or quantity of work performed.

By contrast, Webster's Dictionary defines a "Bonus" as "*something given or paid in addition to what is usual or expected, such as a sum of money or an equivalent given to an employee in addition to the employee's usual compensation.*"

Years ago, the traditional bonus was distributed by employers around the year-end holiday period. It might be cash, a turkey, or some other token sign of appreciation for a job well done. Over time, the bonus became both more than a token and more than unexpected. In fact, for many in this industry, the bonus has become an essential component of the employee's total compensation, although few firms offer "guaranteed" bonuses.

I'd venture to say that most of you reading this right now expect that you will earn a substantial bonus at year end. Also, that most of you expect it to be greater than the number you earned last year. And, that even fewer of you have clear guidelines about how your bonus was calculated last year or what you need to do to earn the greater sum this year or are aware of how uncertain your bonus is at all.

Humor me in a quick recollection of Chevy Chase's character, Clark Griswold, in National Lampoon's "Christmas Vacation". If you remember, it's Christmastime, Clark's extended family begins arriving (including a hilarious Randy Quaid as his wife's cousin, Eddie, in a crazy motorhome) and Clark is generally getting through the drama of the visiting family by looking forward to his big surprise gift for his family – a new swimming pool he's going to have built using his year-end bonus. He's worked really hard this year and is looking forward to what he expects will be a big Christmas bonus, so he's already put down \$7500 toward the pool. The film has lots of other hilarious twists and turns (including a maniac squirrel hidden in the Christmas tree that terrorizes the family), but the relevant point is that Clark is terribly disappointed when his boss has decided to cut out bonuses and has, instead, enrolled Clark in the "Jelly of the Month" Club. As most of us would at that point, Clark kidnaps his boss (played by Brian Doyle-Murray) and helps his boss to see reason on the bonus issue.

I'm not advocating kidnapping your boss in the event you don't get your anticipated year-end bonus. What I do advise, though, is realizing that your bonus is discretionary unless it's guaranteed. If you know precisely what your "bonus" will be and what you need to do to earn it, it's really more like "commission" which is tangible and which, over time, has traditionally become payable at year end, rather than as it's earned. In fact, several firms have recently begun to implement multi-cycle earnouts (meaning that your 2007 "bonus" is payable in installments throughout 2008 to keep you engaged with the firm over time, leaving more "on the table" should you opt to leave after the bonus is declared but not yet fully paid.) That, unlike an undeclared bonus, is a tangible amount being left

on the table. The rest is speculation and wishful thinking about the bonus amount you hope to receive this year.

Bonuses are based upon a combination of the profitability of the industry, the profitability of the particular financial institution or firm you work for and your performance. Interestingly, the phrase “market comp” has completely lost the sense that the market drives the comp. That means the individual’s performance as well as the firm’s performance has something to do with what you’re paid. If the firm isn’t as profitable as it anticipated being, your bonus is going to be affected. Somehow the phrase “market comp” got confused with a notion that bonuses would always rise every year and that there would be a “Street wide standard” for bonuses that everyone would be entitled to, regardless of their performance or that of their firm or of the industry as a whole.

Many of you are old enough to remember the recent hiring cycles of ’88-’89 with substantial layoffs, ’92-’93 again with substantial “downsizing” and, most recently, the significant RIF’s of ’01-’02 where many candidates were told their “bonus” was that got to keep their jobs - they weren’t among the groups of employees who were let go as firms suffered tremendous losses in profitability.

The key drivers for profitability for the banks (cdo’s, clo’s, M&A, and lending) are likely to be severely impaired for this second half of the year. Anyone reading the papers these days can see that the profitability of the industry is going to be seriously hampered compared with the last several years and that will, undoubtedly, have an impact on bonuses this year across the board. Even if the market experiences a rebound, it may not be enough to warrant matching the bonuses of recent years and is not likely to support increased bonuses this year.

The market for investing and for hiring is experiencing some subtle and, not so subtle changes which have the potential to seriously affect bonuses this year and next. As I hear candidates talking about the amounts they’ll be “leaving on the table” and how they expect a new firm to “make them whole” when they move mid year, it reminds me that bonuses which are guaranteed are salary, bonuses which are not guaranteed are gifts. You shouldn’t confuse the two when planning for your economic future or evaluating a prospective opportunity. In this market of financial uncertainty, even your continued employment may not be guaranteed.

What you may actually be “leaving on the table” may be a turkey.

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