Agency Management Institute Bonus Structure

When an agency shows a profit, one of the first inclinations of the agency owner is to pay a bonus to the staff. I applaud that instinct. But I don't think you should do it simply because you have a little extra money. I believe you should have a bonus program that serves your agency every single day, whether you pay out any money or not.

The goal of your bonus program should be:

- Reward your team for their hard work
- Share the spoils of the agency's success
- Align every employee with the goals of the agency so you are all pulling in the same direction
- Teach your employees how to help you achieve the agency's financial goals every single day
- Keep your employees focused on and motivated by the agency's goals every single day

I think there are several elements of a successful bonus program:

- They should not be an end of the year thing. They should influence the employees to behave in ways that serve the agency year round
- It need to be simple and explained over and over (every month/quarter)
- It should be used to teach employees to think like agency owners (focused on the same metrics you do)
- It should be based on one or two metrics that accurately measure the financial health of the agency
- The metrics should be measured/achieved or not every month
- The metrics should be set in a way that your team hits the goal more often than misses (should be a stretch but a reasonable stretch…ideally they'd hit the metrics at least 7 or 8 months of the year)
- Bonuses should be paid quarterly (with most of the $ accumulate for a end of year payout) to keep everyone motivated/focused
- The owners should hold an all agency meeting every month to report on financials/success on bonus program for the month/YTD

At AMI, we have a specific bonus program that we teach in our workshops, owner peer networks etc. It's based on AGI and if you want – you can add a profit margin percentage factor as well.

The big number in our opinion in terms of an agency's health is AGI (Adjusted gross income). AGI is the only money you actually get to spend — so that's the only money that matters to you. You should set a monthly AGI goal and that should be the first number your team has to reach to be eligible for any bonus money to be paid out/banked for a year end pay out.

Here are the nuts and bolts of the AMI bonus program.

First, you need to set a monthly AGI target. Review the last twelve months' financials. Look at your gross billings and subtract your cost of goods (all hard costs including any freelance or contractor fees)

What's left after you subtract the COGS from the gross billings is your AGI. Your AGI is the money you actually get to spend and in a typical agency, it's spent on three things.

Salaries: All W2 income including owners, all costs related to having a person on staff -- any and all benefits, payroll taxes, perks, etc.)

Overhead: Everything from rent, supplies, travel, entertainment, insurances, etc.

Profit: What's left over and usually gets spent on taxes, re-investing in the agency, owner distributions/dividends and employee bonuses

Ideally, your AGI is being spent in these ratios: 55% salary, 25% overhead and 20% profit. To see if your current AGI is aligned with those ratios and to set your AGI goal -- take the monthly total of your loaded salary costs (all salaries, all costs related to having a person on staff -- any and all benefits, payroll taxes, perks, etc.) For this example, let's say that is your monthly loaded salaries cost is $55,000.

$55,000 is 55% of 100,000. You'd have to make an AGI of that amount to justify the $55,000 salary spend.

Which means you should have a monthly overhead nut of about $25,000 and a monthly profit of $20,000.

Your monthly AGI goal should be that number or a little over the $100,000. But you want to make it attainable. You want them to hit it more often than they miss it. Let's say you set it at $110,000K a month. Or you could choose to just make it $100K if that's a stretch for you today, given your client load and anticipated work.

(Note -- if you tend to run closer to 60% for your payroll costs...adjust accordingly. The 55/25/20 is a guideline, not an absolute.) But use your actual salary number to calculate how much AGI you need to earn to stay in balance.

The keys to this working are:

- Set a monthly AGI goal every quarter (revise it every quarter as things change in the agency).
- Make the goal very public. Share it in every staff meeting. Keep people updated on the monthly progress ('it's March 15th and we're only at 65% of our goal…get those jobs closed and let's watch scope creep.")
- Teach and re-teach your team how they can each influence AGI by working to estimates, managing overhead expenses, etc.
- Celebrate individuals who helped you achieve the goal every month by managing projects well, by upselling, by holding down overhead etc.

This does require that you share at least the AGI goal and actual AGI for the month. So there's a certain amount of transparency required here. Quite honestly – those of you who are worried about your staff knowing how much the agency (and you) make – are crazy if you think they're not already making assumptions about that. And their assumptions are much more generous to you than reality is. Trust me on that.

You can start this any time of year but most people kick it off in January so it aligns with your fiscal year.

Basically, when your team hits the AGI goal for the month, there is a reward in it for them. Even if your ratios are off and you overspend in overhead or the profit % isn't 20% -- you still pay out on the profits you made, <u>as long as you hit the AGI goal</u>.

The rewards play out this way:

Every month that your team hits the AGI goal -- they get a small reward (bring in pizza for lunch or everyone gets a $25 gift card, etc.) or you can what I do -- $100 bill. If they hit it the 2nd month, you up the ante a little. You could double the $100.

No actual bonus money is paid out until the end of each quarter. At that time -- you would pay out a portion of the profits and save the rest for the end of the year bonus.

The profit should be divided in four equal parts:

- Taxes
- Bonus for owners
- Bonus for employees
- Re-investment in the agency

Quarter One Example:

Month 1 — you have a profit of $22,500 (overhead was light that month)
Month 2 — you miss the goal and you only have a profit of $5,000 (which you do not include in the bonus pool because you did not hit the AGI goal)
Month 3 — you have a profit of $17,500 because your overhead was a little high that month

You have a bonus pool of 40,000. Divide that by 4. Put $10K away for taxes. Put $10K away for the owner/s. Put $10K away for new computers or whatever you need. So you have $10K for your quarterly bonus. Put two thirds of it away for the year-end bonus. You now have $3,333 to divide among your staff this quarter. I recommend you divide it equally among your entire team for the quarterly payouts and then add a discretionary element for the year-end pay out (I elaborate later in this document.)

Note: When I say you put the money aside (in the case of taxes, agency owner bonus, 2/3 of the employee portion and reinvestment) — I mean you really do bank it somewhere. Don't keep it in your regular checking account or you'll end up spending it and not having it for taxes, owner bonuses or employee bonuses. This is a promise you are making to everyone, so you have to be sure you can honor it.

Quarter Two Example:

Month 4 — you miss the goal and only have $2,000 profit (don't include in the bonus pool)
Month 5 — you have a client walk and you miss the goal by a lot. You actually have a loss of $2,500 by the time you pay salaries and overhead
Month 6 — you regain ground and have an awesome month — you end up with a profit of $32,500.

You have a bonus pool of $30,000 (32.5K minus the $2500 you lost in month 5). You put away $7500 for taxes. Put away $7500 for owners. Put away $7500 for reinvesting in the agency and you have $7500 for staff bonuses — put away two thirds for year-end and you have $2,500 to divide among the employees.

Quarter Three Example:

Month 7 — you rock it and make $25,000 in profits
Month 8 — clients cut way back on projects and you miss the goal. You have a loss of $5,000
Month 9 — you re-gain some ground and have a profit of $5K but.... but you fell short of your AGI goal. So you do not pay a bonus on this. Everyone is only eligible for bonuses on the months you make your AGI goal.

You have a bonus pool of $20,000 (25K minus the $5000 you lost in month 8). You put away $5000 for taxes. Put away $5000 for owners. Put away $5000 for reinvesting in the agency and you have $5000 for staff bonuses — put away two thirds for year-end and you have $1,667 to divide among the employees.

Quarter Four Example:

Month 10 — it's a good month and you hit the goal. Your profit is $18,500
Month 11 — clients really crank it up — profits of $22,000
Month 12 — Your clients go dormant for the holidays and you only make $1,000 in profits. You clearly didn't hit AGI goal and the $1,000 is not part of the pool.

You have a bonus pool of $40,500. You put away $10,125 for taxes. Put away $10,125 for owners. Put away $10,125 for reinvesting in the agency and you have $10,125 for staff bonuses.

You're now at yearend. Hopefully, here's what you have:

$32,625 for taxes
$32,625 to distribute to owners
$32,625 to re-invest in the agency. You may spend some of this during the year, which is okay.
$25,125 for year end bonuses to be divided among your team because you already distributed $7,500

For the year-end bonus, you can handle this in many ways but I recommend that 1/3 of the bonus pool be paid out equally among all the employees. Remember – you are trying to motivate every one of them to care about your AGI goal.

You must define the criteria for how you will distribute the other 2/3rds if you are going to make it discretionary. They need to understand your expectations and the rules of the bonus program. Many agencies opt to just pay out equally for all portions of the bonus. That's your call. Just be clear and transparent.

Because you have been accumulating the bonus money throughout the year, most agencies have the cash on hand to pay out the 4th quarter bonus at the end of the 4th quarter – which is beneficial from a tax perspective. But you can wait until the next month if you need to.

Here are some key elements to keep in mind:

You bank the money because you may have to use the reinvestment pool and your owners pool if you get into trouble and you don't adjust your headcount fast enough. <u>You cannot use the employee's bonus pool for that. You made them a promise...and you need to keep it, even if the business falters in later quarters.</u>

You also must subtract a loss in the profit column from the months you earned a profit before you determine that quarter's bonus pool. You can't go in the red to honor the bonus program. Also – even if you make some money in a particular month but don't hit the AGI goal, you do not include that profit in the pool.

If your tax bill is lower than expected or higher — you may have to shift dollars around. But...this gives you a basic framework.

An optional criterion that could be added:

Some agencies also want to set/achieve a minimum acceptable profit margin before they pay out any bonuses. So you could modify the program to require that the agency reach/exceed the AGI goal AND a minimum profit margin of 5% or 10%.

I don't think this is necessary if you set your AGI goal properly. If you use your actual salary numbers to determine the AGI you need to earn to keep your salaries at the 55% (or whatever you operate at) and you adjust it every quarter as things change – everything else falls into place. But it's an option.

Remember – the goal with this is to keep it simple enough and top of mind every single day/month so your team can all be motivated to help you achieve the agency's goals.