Golden handcuffs

Chris Mayor explores the meaning of the concept.

The term golden handcuffs first originated in 1976 on Wall Street and resulted in bankers' salaries vastly outstripping those of average private sector workers. 'Golden handcuffs' were more than just about base salary. Often packages were loaded with stock options, annual bonuses and benefits stacked into the six figures or more.

They were used by business owners to persuade employees to continue in a business for the long haul. They are often applied to employees with unique and valuable abilities to stop them leaving for a competitor.

Rewarding employees for 'milestones' is a common method of applying the 'golden handcuffs'. This involves rewarding employees for completing tasks or reaching financial goals over time as they reach milestones. Regardless of how much money an employer may invest in these kinds of incentives they are much less expensive than the costs associated with that person leaving the business and having to be replaced.

Many buyers of dental practices apply the same strategy to the principals whose practice they are about to purchase. The buyers and their lenders are keen to take steps to guarantee the patient base is managed and retained. The buyers are keen to ensure that ongoing financial targets are met in order to service loans and meet profitability goals. They are intended to ensure all parties have 'skin in the game' to mitigate risk and ensure a seamless transition to the new owners.

The length of time the vendors remain in the practice is something to be agreed. Corporate buyers are motivated to maintain the patient base, clinical excellence and leadership of the practice. Corporate buyers are looking for vendors to

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to stay on for two to five years. Private buyers who are intending to work in the practice will also be considering if there are enough clinical hours to go round, the capacity of the practice and the impact on profits of the vendors staying on.

Being flexible and meeting the needs of the incoming owners is going to add value to your business. A tie in and an earn out are different. A tie in is an agreement to stay at the practice for a period of time to work alongside the new owners and support the transition. In this scenario it is likely the vendor will have received the full purchase price on completion. An earn out or deferred consideration is more the 'milestone' strategy where an amount of the purchase price is retained by the buyer until certain financial goals are met. This is more applicable in practices where the vendor is staying in a leadership role. Even then we work on our client's behalf to ensure the milestones relate more to their own performance rather than to metrics they do not have full control over.

Our experience of deferred payments is that Principals will get a higher total consideration if they are willing to stay on in line with the expectations of the purchaser. The standard for Corporate deals is now for 30 per cent of the purchase price to be deferred. They are becoming much less flexible on negating on this than they were. We are also starting to see some independent purchasers propose deal structures where there are deferred payments. Of course, we ensure the deferred monies are available and ring-fenced to pay over to the vendor at the agreed times.

The terms of a vendors associate agreement can often be a point of negotiation. Associate agreements are typically 40 per cent of fees earned. Some vendors instinctively resist this in order to maintain their income from the business. It is possible to swap some of the purchase price for enhanced income. However, it is likely that vendors will always be better off taking the higher sale price rather than more income. Simply because you need to factor in the fact that money you receive now can start to work for you now and money received in the future is likely to be eroded by inflation.

We all understand the concept of golden handcuffs and why buyers offer them to vendors to stay engaged and maintain the value of the business they are selling. Your broker will be able to contrast, compare and advise on the best option. As the offers you receive will be structured differently.

Other discussion areas can be around agreeing annual leave expectations and how goals will be met in the event you are ill. Finally avoid agreeing an arrangement where it is advantageous to the purchaser if the goals are not met.