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The High Cost of Good Talent and the Value of Retention

By: NFP Executive Benefits

How would your bank fare if your top-performing lenders left tomorrow?

A bank succeeds because of its employees who grow the bank and keep it safe. The departure of these employees can impose massive costs to a bank in lost relationships and the effort to find new personnel. Has management at your bank adequately assessed the financial cost and risk of losing its key employees? What would be the financial impact to the bottom line and shareholder value if a key employee is not retained?

The direct cost of replacing a high-performing employee is up to 213% of the annual salary associated with the position, according to research by the Society for Human Resource Management. Total costs can rise to as much as 400% when considering indirect expenses. Direct costs include screening, interviewing, acquisition cost, onboarding and training, while indirect costs include lost productivity, short-staffing, coverage cost and reduced morale.

The following are hypothetical examples that help illustrate both the costs and risks associated with replacing a key employee at a bank:

Example 1: A lender in their early 40s who maintains a $40 million loan portfolio with a 4% margin joins a competitor bank. The estimated earnings on the lender's portfolio were $1.6 million. If 30% of the portfolio moves to the competing bank, that would create an annual impact of $480,000. The bank stands to lose $1.4 million in three years. Assuming this lender generates $10 million in new loans annually, that adds another $400,000 in additional lost income. Losing this one lender results in lost annual revenue of almost $900,000.

Now imagine the bank has seven lenders with similar portfolios and margins. If the entire team left, the lost revenue potential could be over $6 million annually.

Example 2: A bank loses its compliance officer. In addition to the direct financial costs of replacing the officer, this could cause both short- and long-term regulatory and financial risks and challenges. If the officer had a salary of $90,000, the cost to replace them is between $191,700 and $360,000, using the 213% and 400% of base salary replacement cost assumptions. There could also be additional costs associated with potential outsourcing the compliance services until the bank can hire a new compliance officer.

Fortunately, in both of these examples, management preemptively responded by strategically designing compensation programs to retain the officers. Quantifying the lost revenue and costs to replace the employees demonstrated the substantial risks to the bank, and convinced executives of the inadequacies of the compensation plan in place.

It is critical that banks design and implement competitive compensation plans that provide meaningful benefits. Some compensation committees believe a salary and an annual performance bonus are adequate to retain key employees. But based on our experience, banks with higher retention rates offer two to four types of compensation plans, in addition to salary and bonus. Examples include employee stock ownership plans, stock options, restrictive stock, phantom stock, profit sharing, salary continuation plans and deferred compensation plans. These plans provide for payments either at retirement or while employed, or a combination of pre- and post-retirement payments. Banks can strategically design and customize these plans in ways that incentivize strong performance but fit the demographics and needs of the key personnel. There is no one-size-fits-all plan.

Additionally, nonqualified executive benefit programs such as supplemental executive retirement plans (SERPs) and deferred compensation plans (DCPs) can help your key employees accumulate supplemental funds for retirement. Their flexibility allows them to be used alongside other forms of compensation to enhance your bank's overall executive benefit program by offering additional incentives and incorporating special features intended to retain top performers who may not be focused on retirement. For example, a deferred compensation plan with payments timed to when the officer's children are college age can be highly valued by an officer fitting that demographic.

The significant potential financial impact when your bank loses key employees quantifies and underlines the value and importance of retention, so it is paramount that executives meaningfully and competitively compensate these employees. Banks without a strong corporate culture and a competitive compensation plan in place are at a higher risk of losing key employees and may have an emerging potential retention problem.

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