RESTAURANT FINANCE MONITOR®

Volume 36, Number 12 • Restaurant Finance Monitor, 2808 Anthony Lane South, Minneapolis, MN 55418 • ISSN #1061-382X

December 17, 2025

New Thoughts Regarding Employee Participation

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A lot has been written and discussed about tried-and-true concepts for incentivizing employees as it relates to their participation in the growth and increased value of the company. But, there are also some new ideas that are a little more creative. This doesn't mean the established options aren't still beneficial, such as appreciation rights and deferred compensation.

The first of these newer thoughts is specifically relevant to multi-unit operators: When you have a general manager or someone key to an individual store, you want to keep them motivated and also give them a reward for their hard work. One way is after a given period of time, give them the right to buy significant ownership in an individual store. This can be tricky if it's a franchise, but in many cases, you can accomplish it by establishing a reasonable price, or a slightly under-market value for the company using a multiple of EBITDA and then giving an option to buy into the unit. The owner sells it on an installment note where they do the financing. The beauty is if something goes wrong, you can always take it back, but it gives key employees the incentive to grow the store so they can end up owning something. I have seen this work in restaurants and other hospitality companies. The classic example is the incentive program that was put in place about 30 years ago by Outback Steakhouse.

The second is co-investing: Owners encourage their employees, particularly key management, to come up with ideas for new restaurant concepts or new related businesses. The owner then agrees to invest in the employee's idea by providing some of the funding, but often the employee is asked to fund some of the venture, either through personal funds or getting a loan. In most cases, the ownership would agree to put the majority of the equity in, and it's usually structured so they get their money back first until a stated return is reached, such as 10%. The key employee gets to develop their business, and the employer receives the benefit of a new idea and a sound employee-generated concept. This, in turn, creates a culture of creativity and moving things ahead in a positive manner.

Some employees want to focus on longevity. For instance, if an employee has achieved a predetermined tenure, they receive a significant bonus, depending on how successful the company is and how they want to share. This encourages deep commitment to the company and lessens turnover.

Another approach is rewarding employees for extraordinary performance. They receive their normal bonus, plus an additional one, which is more lucrative. If they really knock it out of the ballpark, they obtain a second tier with a higher percentage.

A concept that's gaining traction is providing non-cash benefits. This includes benefits such as college tuition reimbursement for family members. One employer I'm aware of provides cars as an incentive, which is taxable, of course, and some have provided vacations and other in-kind items. Find out what benefits would incentivize your managers.

Participation in a management company is another incentive. If you have multi-unit stores and a management company to oversee individual stores, provide key employees ownership within the management company. This can provide significant participation in the growth of the company overall. The actual ownership of the overall operations is still controlled by the original owners but does provide managers with the profit that the management company may achieve from the individual store operations. This management company approach can also allow for accumulation of earnings for future distribution to the management team, and if a C-corp is used, it may provide lower taxes on the accumulated earnings.

For another concept similar to the management company, and assuming it's not a franchisee, is the ownership and intellectual property being put into a separate entity and the ownership distributes a portion of that intellectual property entity to the key management. This creates a long-term royalty stream which key employees share. It's tax efficient because the license fee is deductible and provides another source of income for the management team. There usually is a buyout to the management team if the owners want to sell.

The last idea is an employee-stock ownership (ESOP). We don't see a lot of ESOPs in the restaurant world, primarily because turnover is so great with the vesting, qualifications, filings and valuations which makes it complicated. It can serve as an effective tool for succession planning because the sale to an ESOP can have great tax benefits. It also provides the company with tax deductions for contributions to the ESOP. The real key value for the ESOP accumulation of wealth for the employee participants and an incentive to stay with the company.

Whichever vehicle you use to compensate employees is a personal decision based on the profitability of your company, but it's always a good idea to share your restaurant's numbers with key staff and reward them for keeping the trains running on time.

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