

VisionLink

Ten Steps to Building a Great Incentive Plan

Building Unified
Financial Visions



THE VISIONLINK
ADVISORY GROUP

October 28, 2008

Today's presenter

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We're happy to provide a copy of today's slides. Information will be provided at the close of the presentation.

For questions during today's presentation:

*Use the question panel
to the right of your screen*

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Next Online Seminar:



**“Selecting the Right Performance Measures
for Your Incentive Plans”**

Metrics & Motivators, Dos & Don'ts

To be held on:

Tuesday, November 25th, 2008

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Webinar Objectives

- Understand the current environment
- problems, challenges
- Define clear steps to creating an effective incentive plan
- Describe the outcomes that can flow from this process

Key Concepts

- Compensation is an investment
- Incentives are the outgrowth of a pay for performance philosophy
- Knowing what performance you want to impact is critical in creating an effective incentive plan
- Creating an incentive plan is a kind of “reverse engineering” process
- Ultimately, an effective incentive plan should generate a positive return on the total rewards investment



Quick Review of Pay for Performance Principles



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Pay For Performance Objectives

- Recruit and retain highest quality employees
- Communicate and reinforce the values, goals, and objectives of the company
- Engage employees in the organization's success
- Reward contributors for successful achievements

The Five Essentials

1. Must tie performance awards to shareholder financial objectives
2. Must employ the proper mix of compensation elements
3. Must result in meaningful dollars
4. Must embrace performance that employees can impact
5. Must effectively communicate and reinforce

Common Problems



- How much to award?
- Who should participate?
- What balance between company, department and individual performance?
- When is it paid?

Poll

QUICKPOLL

Does your company currently operate under an effective pay for performance philosophy?

Please select one:

Yes

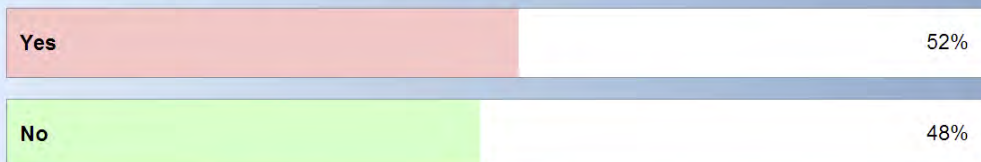
No

Submit

QUICKPOLL

Does your company currently operate under an effective pay for performance philosophy?

Poll Results (single answer required):



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A Unique Process





Purpose

- What is the result you are seeking?
- This is the *Strategic* step in the process



Purpose

Identify the specific goals that are to be achieved.

For example, are you looking for increased sales, specific margins, higher profits, improved customer retention or a combination of two or three factors?

FoxHill:



Annual Revenue Growth - 15%

Net Income Target - 17.5%

5 Year Goal - Double Revenue

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People

Who are the people who will be
essential to the fulfillment the plan
Purpose?



People

Think through the layers of people within the organization and identify those who will have direct impact on the achievement of the strategic objectives.

FoxHill:



- Randy - President
- Donna - CFO
- Stan - VP Marketing/Sales

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Value

What economic value will be created for shareholders if the Objectives are achieved?

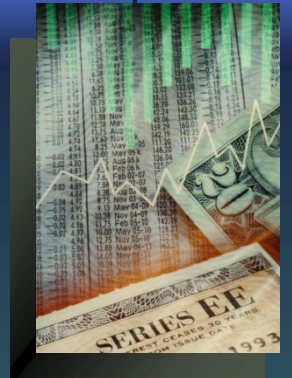


Value

Establish a way of measuring the value to be created for the shareholders if the Objectives are achieved. This will typically require a spreadsheet projection with the ability to alter and simulate different levels of performance.

FoxHill:

Double Revenue in 5 years = \$20
million of new value for
shareholders

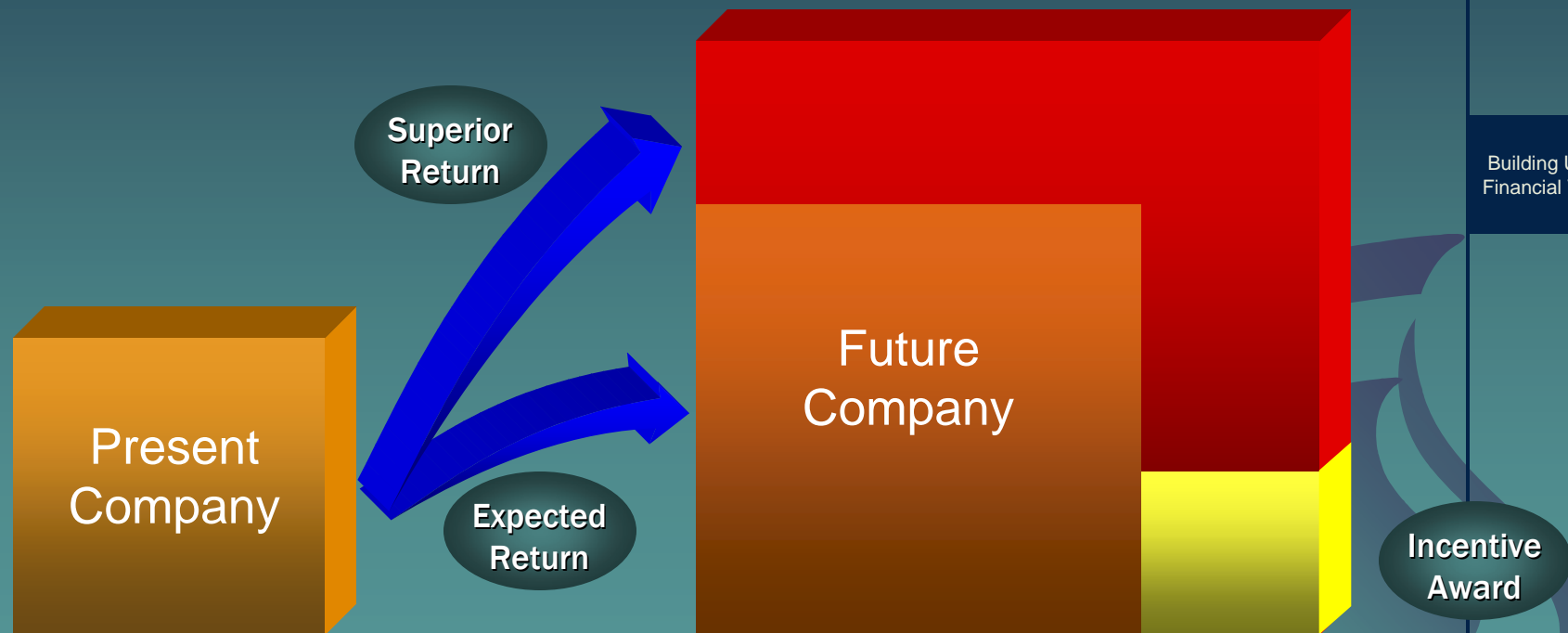




Share

What amount of the increased value
should be shared with the people
who helped create it?

How should we think about compensation as an investment?



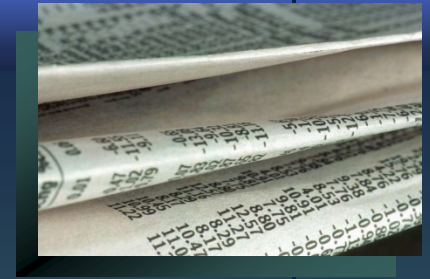


Share

Determine how much of the new value should be shared with the people who help create it. This should be reduced to a percentage of the total potential value (e.g. 10%).

This percentage becomes a target goal for planning purposes.

FoxHill:



- Randy, Donna and Stan - 6-8% of growth in value
- 8% of \$20mm = \$1.6 million



Standardize

**What standard can be used to
express the potential value of the
award in current terms?**

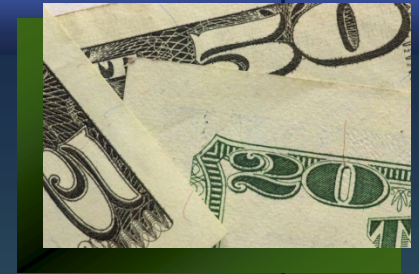


Standardize

Typically, the potential award will be expressed as a percentage of each participant's current salary.

FoxHill:

- Randy - \$ 250,000
- Donna - \$180,000
- Stan - \$160,000



Poll

QUICKPOLL

What percentage of salary do you currently pay out as an incentive award?

Please select one:

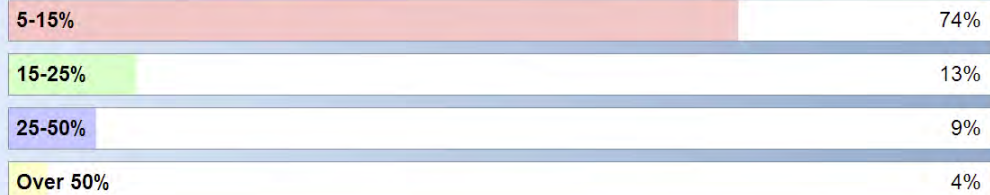
- 5-15%
- 15-25%
- 25-50%
- Over 50%

Submit

QUICKPOLL

What percentage of salary do you currently pay out as an incentive award?

Poll Results (single answer required):



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Tier

Should all the people who help
create the value benefit equally?



Tier

Establish different tiers of participants in order to reflect greater potential value for those who are likely to have the greatest impact.

E.g., the highest tier (executive management) might have a target incentive of 80% of salary. The next tier of management might have a target of 60%.

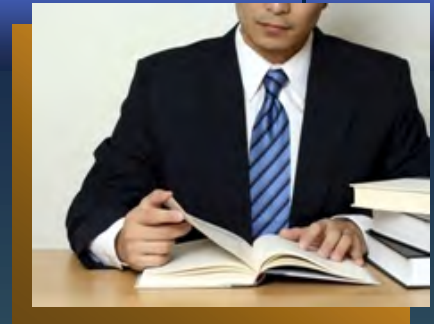
Rules of Thumb



Incentive plan targets (combination ST/LT)

- 60-100% of salary for top managers
- 40-80% for 2nd tier managers

FoxHill:



<u>Exec</u>	<u>Salary</u>	<u>Target</u>	<u>Value</u>	<u>Tier</u>
Randy	250,000	80%	200,000	1
Donna	180,000	60%	108,000	2
Stan	160,000	60%	96,000	2

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Weight

What percentage of the reward
should be earned for achieving
Company, Department and
Individual goals?



Weight

Based on an individual's level of responsibility determine how much of the incentive should come from these three areas.

E.g., 25% Company, 50% Department, 25% Individual.

FoxHill:



<u>Tier</u>	<u>Company</u>	<u>Department</u>	<u>Individual</u>
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1	75%	-	25%
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2	25%	50%	25%
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Indicators

What specific and measurable indicators will best reflect the improvements desired?



Indicators

Identify the indicators that will be used to measure performance in each area.

For example:

Company - Revenue growth and Net Income;

Department - Improvement in Customer Retention goal; Collections rate; Employee Productivity factor;

Individual - performance goal achievement

Poll

QUICKPOLL

What performance indicators do you use in determining awards under your curent incentive plan(s)?

Please select all that apply:

- Personal (individual) performance objectives**
- Team performance metrics**
- Company performance metrics**
- Other**

Submit

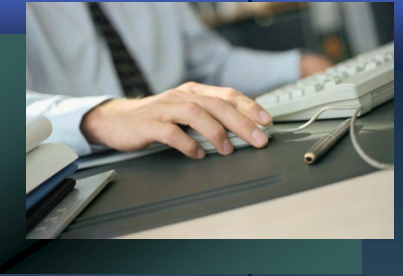
QUICKPOLL

What performance indicators do you use in determining awards under your curent incentive plan(s)?

Poll Results (multiple answers allowed):



FoxHill:



		Base	Target	Superior
Co	Rev Growth	12%	15%	18%
	Net Margin	16%	17.5%	19%
Sales Dept	Sales Vol/Cust	95,000	100,000	105,000
	Gross Margin	68%	72%	76%

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Allocate

**When will the rewards be made
available to the participants?**



Allocate

Determine if the awards, once earned, will be paid at the end of the quarter, end of the year or at a future date.

Typically a percentage will be paid annually, and a percentage will be paid in the future.

FoxHill:



<u>Tier</u>	<u>Short-Term</u>	<u>Long-Term</u>
1	50%	50%
2	70%	30%

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Measure

How will the long-term portion of the incentive be measured over time?

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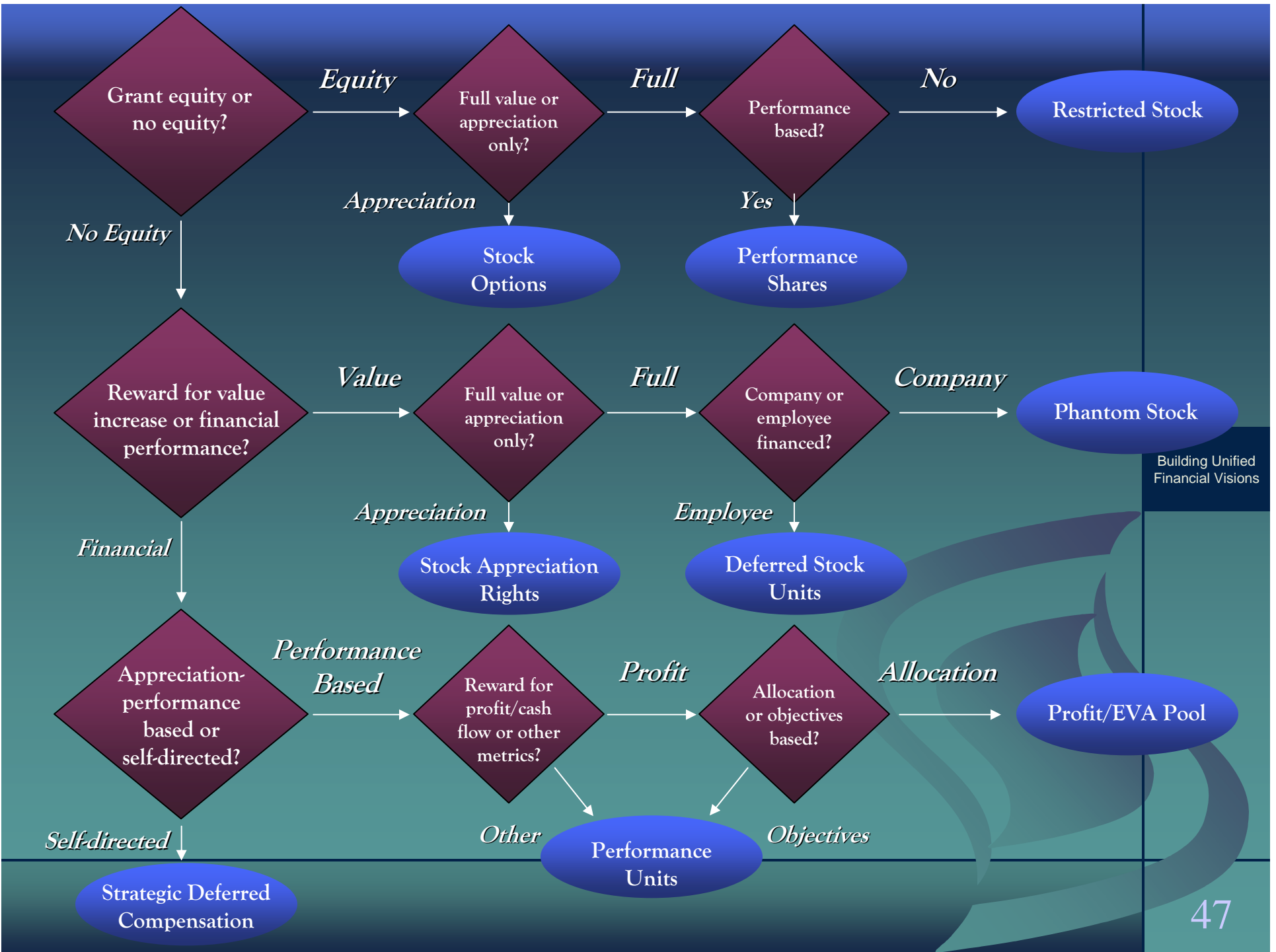
Measure

Establish the form of the long-term benefit by determining if it should be

- a) held in a pool
- b) credited with interest or investment earnings
- c) treated as a stock or phantom stock incentive

Long-Term Incentive Plan Decision Tree

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FoxHill:

Phantom Stock Appreciation Rights

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A Unique Process





Where do I begin?

Make a clear assessment of where you stand with your employees and the impact of your current rewards strategies.

First two things to measure

- 4F condition
- Motivation value of your incentive plans

Leadership

The VisionLink Diagnostic

Indicate the degree to which you agree or disagree with the statements below. Once you are finished, total your score.

	Disagree	Agree
1. Our people understand and believe in the organization's future. They find it compelling.	1 2 3 4 5 6 7 8 9 10	
2. We have a fundamental compensation philosophy that is consistent with our business strategy and is intended to build shareholder value.	1 2 3 4 5 6 7 8 9 10	
3. We have established clear compensation standards relative to market pay and best practices; and we follow them.	1 2 3 4 5 6 7 8 9 10	
4. Our rewards programs clearly focus our people on desired results.	1 2 3 4 5 6 7 8 9 10	
5. Our people understand and believe in the core components of our business strategy and plan.	1 2 3 4 5 6 7 8 9 10	
6. Our compensation plans are designed to insure our ability to (a) recruit the people we need and (b) keep them here.	1 2 3 4 5 6 7 8 9 10	
7. Our company effectively balances short and long-term compensation and guaranteed versus "at risk" pay.	1 2 3 4 5 6 7 8 9 10	
8. We consistently communicate and reinforce the value, meaning and potential of our rewards programs.	1 2 3 4 5 6 7 8 9 10	
9. We clearly define roles and opportunities within the organization. Our people are motivated by opportunities for personal and professional growth.	1 2 3 4 5 6 7 8 9 10	
10. The value and clarity of our wealth accumulation opportunities engender a passionate ownership mentality.	1 2 3 4 5 6 7 8 9 10	
11. Our compensation system is driven by a "pay-for-performance" process that is founded on solid economic models and forecasts.	1 2 3 4 5 6 7 8 9 10	
12. Our employees see a relationship between how they're paid and the results they produce.	1 2 3 4 5 6 7 8 9 10	

TOTAL SCORE

As I consider the effectiveness of our compensation and rewards program, the area I am least comfortable with is:

Name: _____

Title: _____

Company: _____

E-mail Address: _____

Phone Number: _____



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Associates

The VisionLink Diagnostic Associates

Indicate the degree to which you agree or disagree with the statements below. Once you are finished, total your score.

	Disagree	Agree
1. I understand and believe in the organization's future. I find it compelling.	1 2 3 4 5 6 7 8 9 10	
2. The company has a fundamental compensation philosophy that is consistent with its business strategy.	1 2 3 4 5 6 7 8 9 10	
3. The company has established clear compensation standards relative to market pay and best practices; and it follows them.	1 2 3 4 5 6 7 8 9 10	
4. The company's rewards programs keep me focused on specific desired results for which I am responsible.	1 2 3 4 5 6 7 8 9 10	
5. I understand and believe in the core components of our business strategy and plan.	1 2 3 4 5 6 7 8 9 10	
6. Our compensation plans are effective at recruiting great people and keeping them here.	1 2 3 4 5 6 7 8 9 10	
7. Our company's blend of short and long-term compensation and guaranteed versus "at risk" pay is well balanced and makes my priorities more clear.	1 2 3 4 5 6 7 8 9 10	
8. The company consistently and effectively communicates and reinforces the value, meaning and potential of my rewards programs.	1 2 3 4 5 6 7 8 9 10	
9. The company clearly defines roles and opportunities within the organization. I am personally motivated by opportunities for personal and professional growth.	1 2 3 4 5 6 7 8 9 10	
10. The value and clarity of the company's wealth accumulation opportunities for employees have engendered within me a passionate ownership perspective.	1 2 3 4 5 6 7 8 9 10	
11. Our compensation system is driven by a "pay-for-performance" process that is tied to the real economics of our business.	1 2 3 4 5 6 7 8 9 10	
12. I see a relationship between how I'm paid and the results I produce.	1 2 3 4 5 6 7 8 9 10	

TOTAL SCORE

As I consider the effectiveness of our compensation and rewards program, the area I am least comfortable with is:

Name: _____

Title: _____

Company: _____

E-mail Address: _____

Phone Number: _____



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VisionLink Compensation Snapshot for: FoxHill State Bank

February 22, 2008

4F: 10-11-9-10



Successful banks employ great systems to envision, create and sustain their total rewards programs. Their plans are aligned with the shareholders' vision, built on clear philosophical principles, engineered according to sound financial practices, and sustained through integrated ongoing management systems. Programs based on these fundamentals engender confidence, bolster leadership efforts, and create a true pay-for-performance culture.

A true pay-for-performance culture gives the bank a real competitive advantage.

Your Analysis: 10-11-9-10 (Each area of evaluation has a potential (perfect) score of 30)

Future: A compelling future that links shareholders and employees

Your score of 10 suggests that the bank's future has either not been clearly defined or it has not been articulated and accepted by your employees. When employees buy in to a compelling future they are more likely to take ownership of it—particularly if they clearly see how they can fit in and grow. You should examine ways to clarify the bank's opportunities and express them as part of a concise business plan. Employees should be engaged in identifying the key strategic initiatives that need to be launched or maintained. Then, employees can visualize potential future roles and opportunities.

Foundation: A philosophy that drives an ownership mentality

Your score of 11 indicates that the bank has probably not drafted and adopted a written compensation philosophy statement. This should be a top priority. You sense that your plans do a reasonable job of helping with recruiting and retention but they are not tied directly to short-term and long-term goals. In addition, employees are not yet motivated by long-term wealth accumulation opportunities. The bank probably needs (a) a meaningful long-term incentive plan and (b) a value statement that illustrates to employees the financial attractiveness of the bank's overall rewards program.

Framework: Financial standards that produce an economic return

Your score of 9 supports the need for stronger systems for the design of your incentive plans. Salary programs may be adequate but incentive structures are lacking. The bank would benefit from creating a financial forecast (3-5 years) that highlights potential shareholder returns. Then an important discussion should be held about how much new value should be shared with employees. This would lead to the development of a new incentive arrangement that would consistently support a pay-for-performance culture. To fulfill its full potential, the new arrangement must include both short- and long-term rewards.

Focus: Consistent reinforcement that sustains line-of-sight

Your score of 10 suggests relatively soft alignment between personal job responsibilities, organizational goals and individual rewards (line-of-sight). Good compensation systems tell employees what to focus on to produce the desired results. Employees show up at work with a clear picture of what tasks will mean the most to the bank and to them (there should be no difference). Focus can only occur when the incentive plans have been carefully linked to measurable performance indicators. You should try to (a) tie incentive plans to critical success factors and (b) establish creative methods of communicating the present and future value of the bank's rewards proposition.

This snapshot is based strictly on a single Diagnostic completed by a bank employee. A more exhaustive analysis would be needed before deeming the conclusions and recommendations to be complete. Contact a VisionLink consultant for more information.

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Leadership
Diagnostic

Associate
Diagnostic

Compensation
Snapshot

4F Assessment

Future

13

Foundation

19

Framework

12

Focus

14

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Future

- Are employees and leaders in synch on where the company is headed and how it is to get there?
- Do employees and leaders agree that future opportunities for employees are clearly defined?

Foundation

- Do employees and leaders see the connection between the business strategy and the compensation programs?
- Is the company committed to following clear and acceptable standards for pay decisions?

Framework

- Does everyone recognize and respect the process for determining the form and value of rewards offerings?
- Does everyone appreciate the balance between short- and long-term incentive opportunities?

Focus

- Does everyone understand how and when they will be paid under all the rewards programs?
- Does everyone agree that the rewards programs support both shareholder and employee goals?

Complimentary Offer

VisionLink invites you to participate in a 4F Assessment:

- Shareholder/Owner Survey (up to 3 owners)
- Employee survey (up to 10 people)
- VisionLink will provide you a summary report and hold a phone conference.

Indicate interest on final feedback form

What have we accomplished?

1. Defined clear targeted objectives
2. Determined potential plan participants
3. Calculated the amount of value to be created for shareholders if the objectives are achieved

What have we accomplished? (cont)

4. Established the amount of new value to be shared with executive team
5. Set standards for the incentive plan as a percentage of salary
6. Established target incentives in groups (or tiers)

What have we accomplished? (cont)

7. Weighted the target benefit calculation based on Company, Department, and Individual goals (by tier)
8. Identified specific, measurable goals for the Company and each department

What have we accomplished? (cont)

9. Allocated the award between short-term and long-term payment schedules
10. Determined a means of measuring the long-term awards

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Metrics & Motivators, Dos & Don'ts

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Questions?



Thank you for attending

Please complete our brief survey immediately following our presentation.

We value your input.

*You may request a copy of our slides and the
“4F” Assessment.*

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Thank You!



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