

*The "Learn & Earn" Series™*

July 22, 2010

# “Creating Effective Metrics and Measures for an Incentive Plan”



THE VISIONLINK  
ADVISORY GROUP

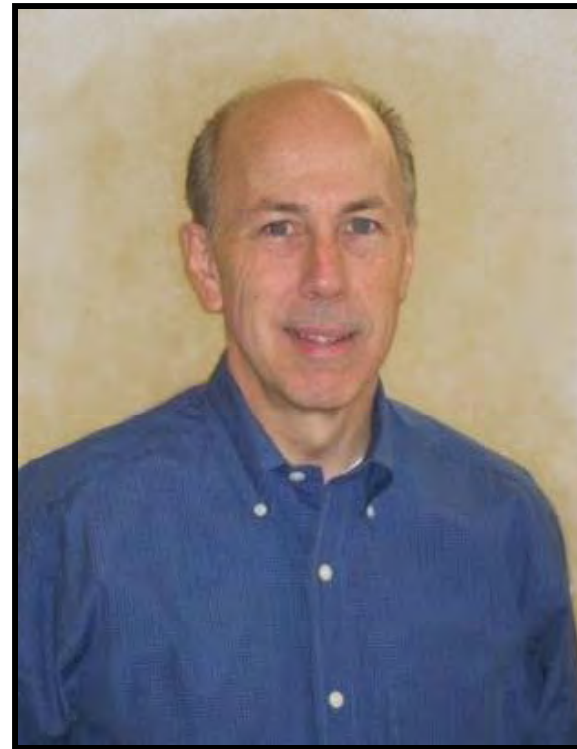
Today's Presenter:

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# Course Credit

Per State Requirements:

To receive CPE credit for today's course, you must respond to at least 75% of the monitoring events – given in the form of polls.

Each person taking the course must respond to the monitoring events from their own computer. You may not share a computer when taking the course

We're happy to provide a copy of today's slides, course syllabus/summary, and a CD of the presentation. Information will be provided at the close of the presentation about requesting these.

**For questions during today's presentation:**

Use the question panel  
To the right of your screen

# Course Objectives

- Examine what factors influence performance
- Learn the two basic approaches to building metrics for an incentive plan
- Understand the concept of return on total rewards investment
- Analyze how a company determines whether incentives are working

# Key Concepts



- The primary purpose of an incentive plan is to:
  - Focus employees on a company's most important goals
  - Create a sense of partnership
- Selecting the right metrics can significantly alter behavior among key employees
- There are two core approaches to selecting metrics – each with pros and cons
- The effectiveness of your client's performance management system should be considered before selecting from the two approaches
- What is VisionLink's "Best Practice" approach?

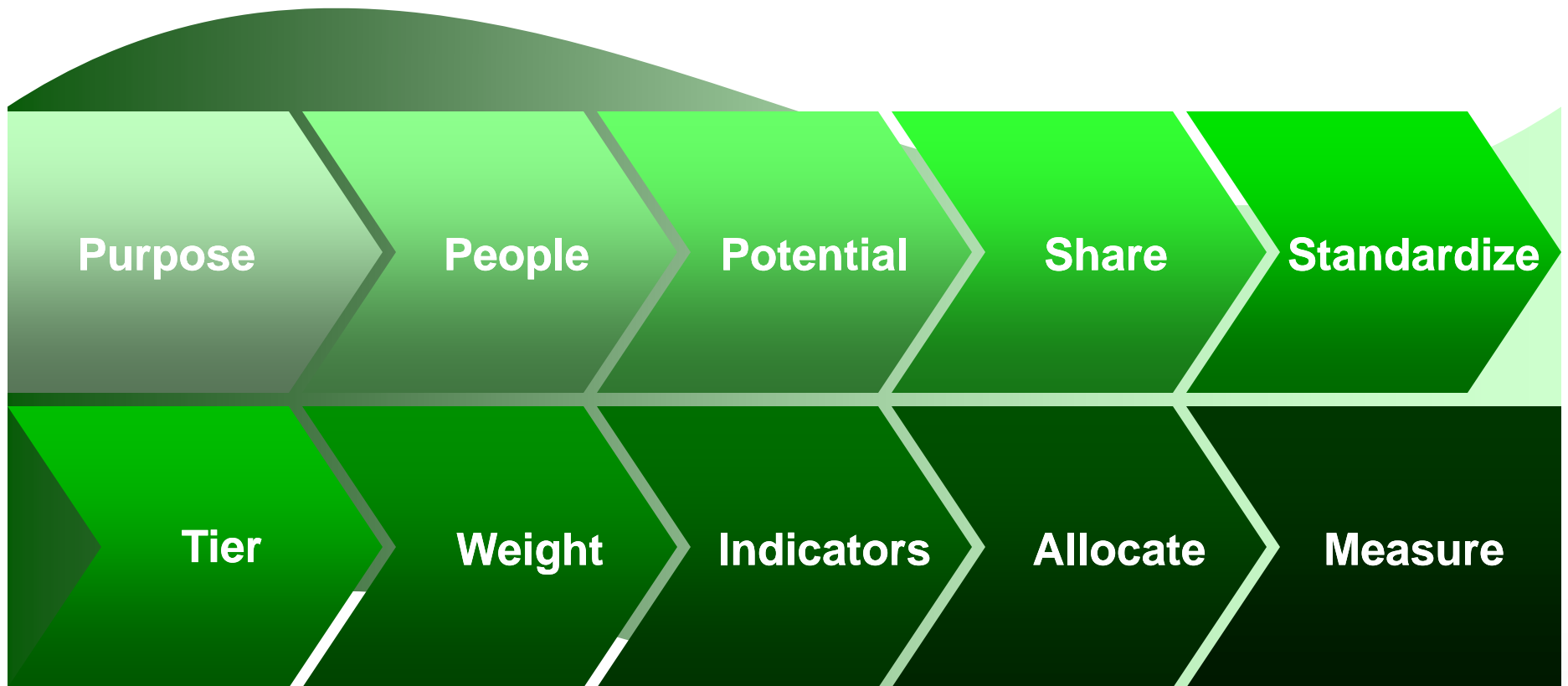
# Pay For Performance Objectives

- Create a unified financial vision for growing the business
- 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



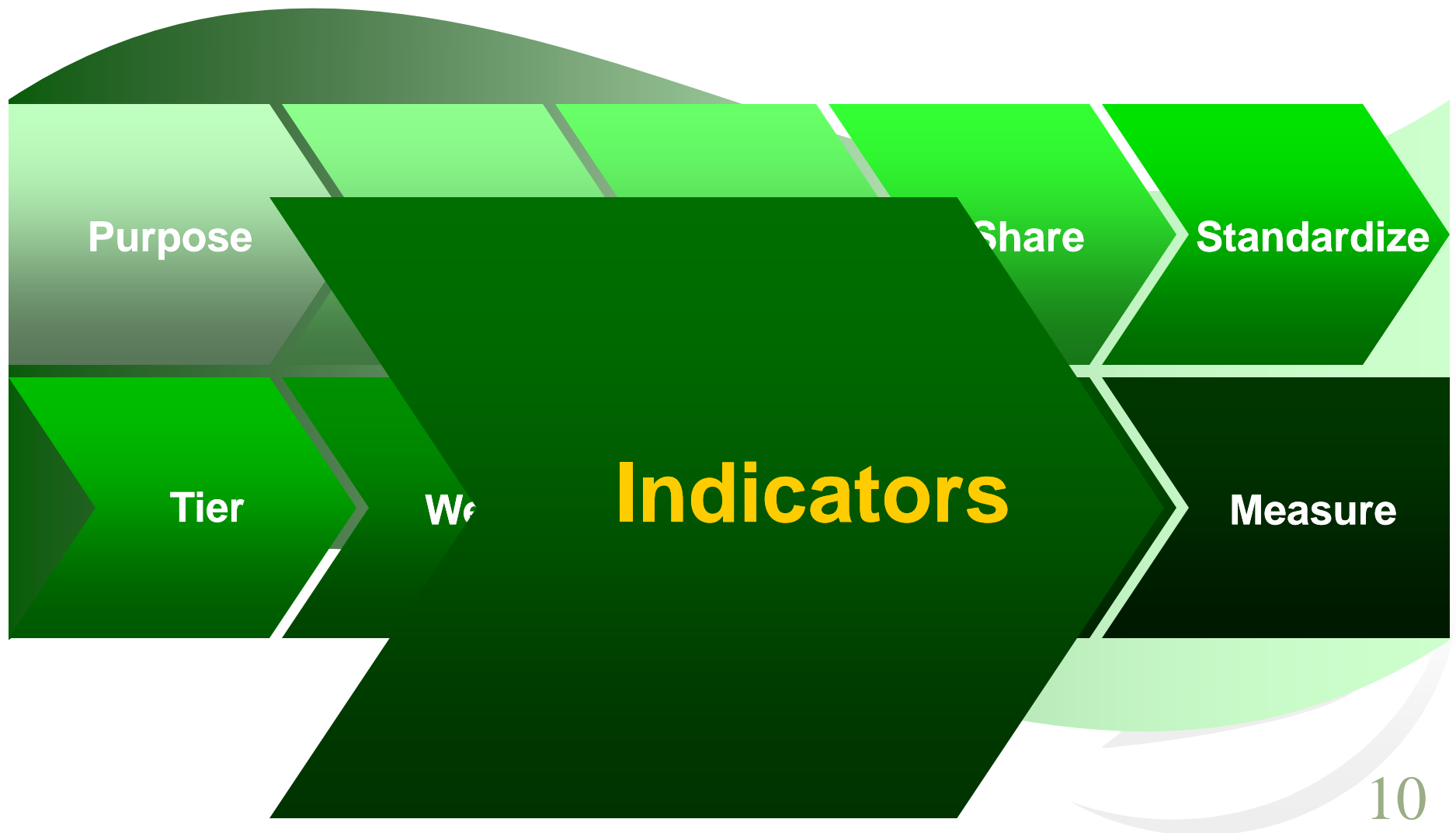
# Building an Incentive Plan

A Unique Process



# Building an Incentive Plan

A Unique Process



# Indicators:



- Measurable
- May or may not be in financial statements
- Track progress towards strategic objectives
- Reflect improvement in productivity

# Indicators:



- Could be a number or a percentage
- Could be tied to budget (i.e., % of budgeted target achievement)
- Could be an improvement over prior period
- Could have a minimum threshold
- Could be tiered

# In all cases:

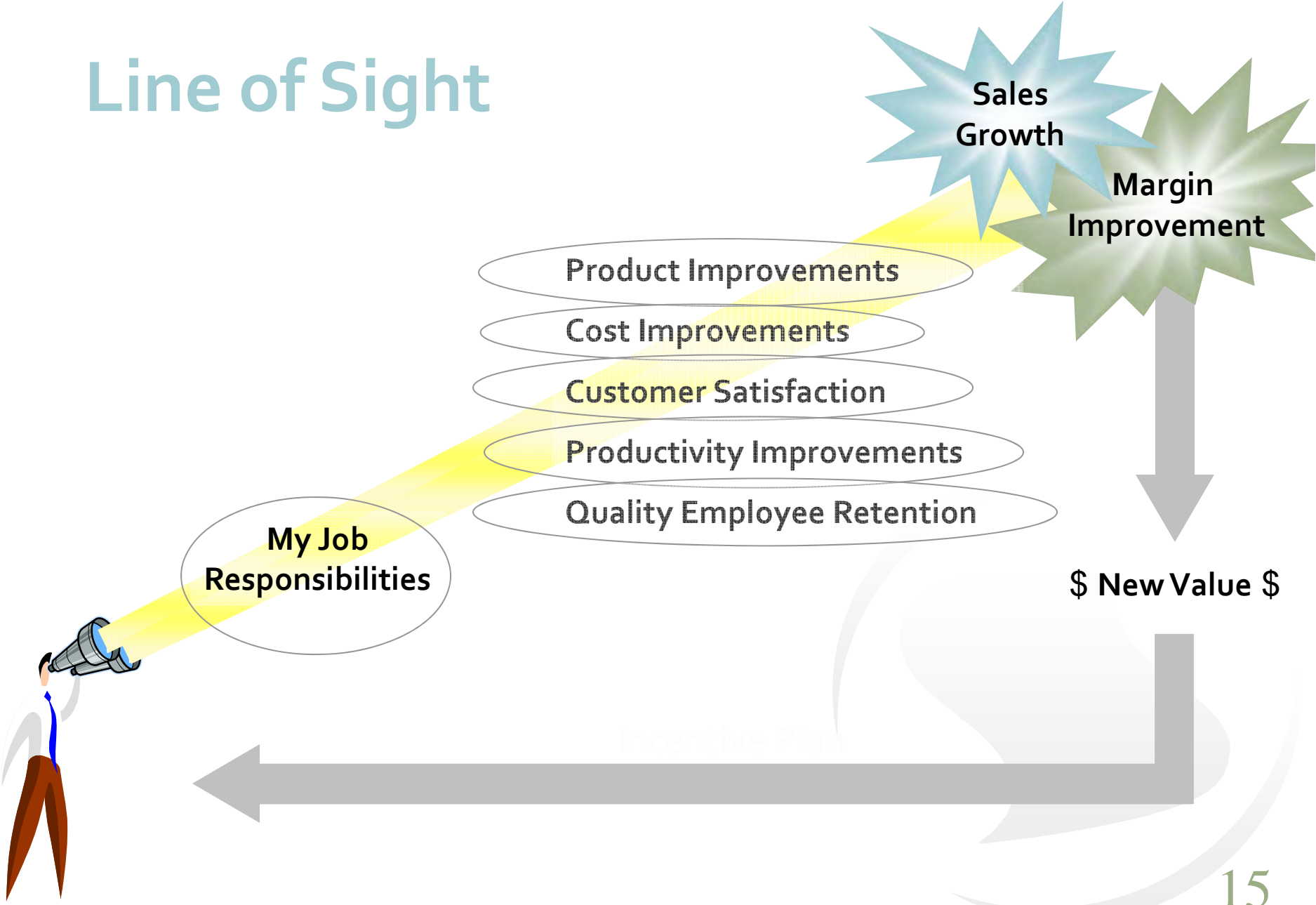


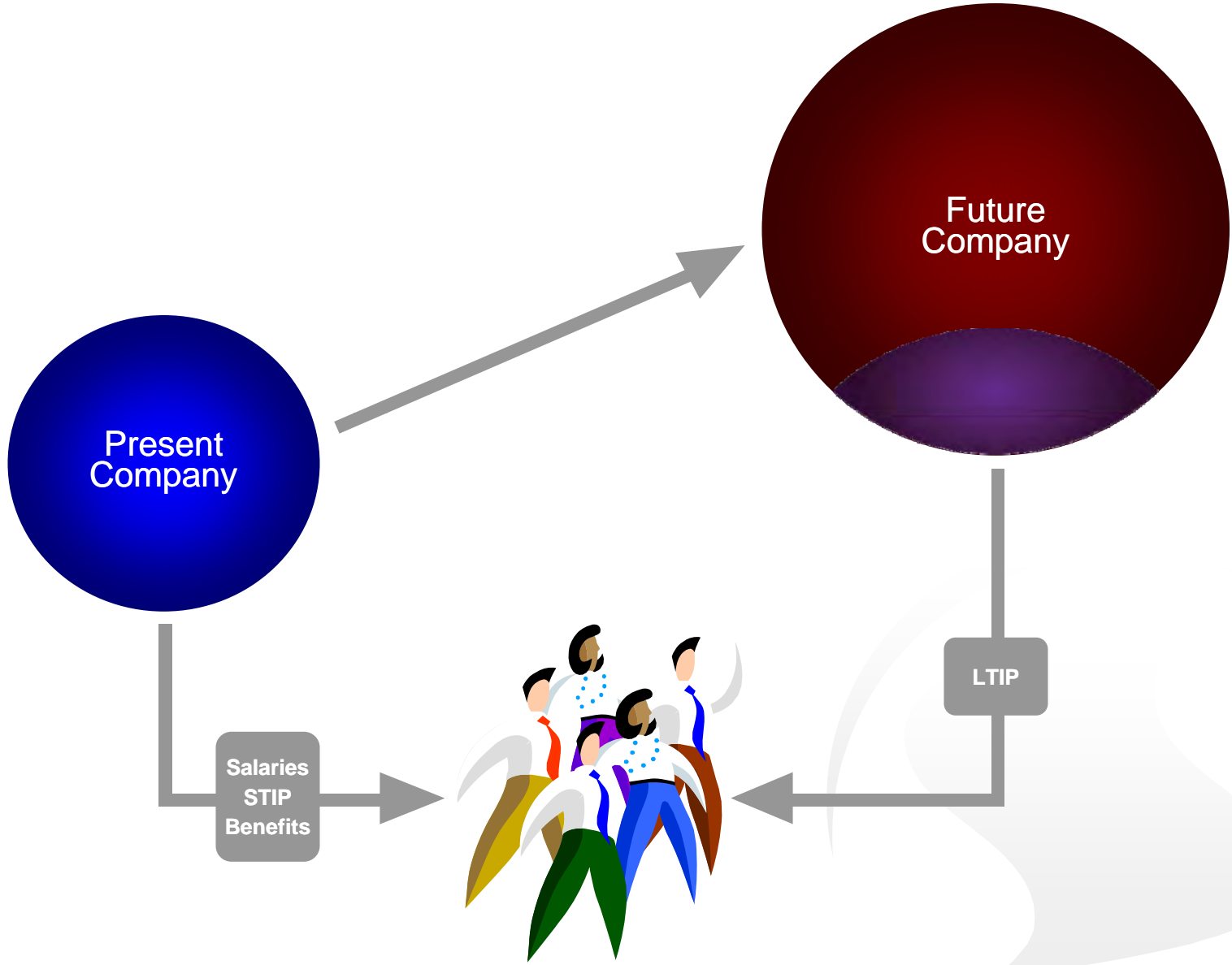
- Seeking to improve performance
- Seeking to influence behavior
- Not trying to “motivate”
- Trying to “focus” through communication and reinforcement
- Trying to reinforce an ownership culture

# Poll #1

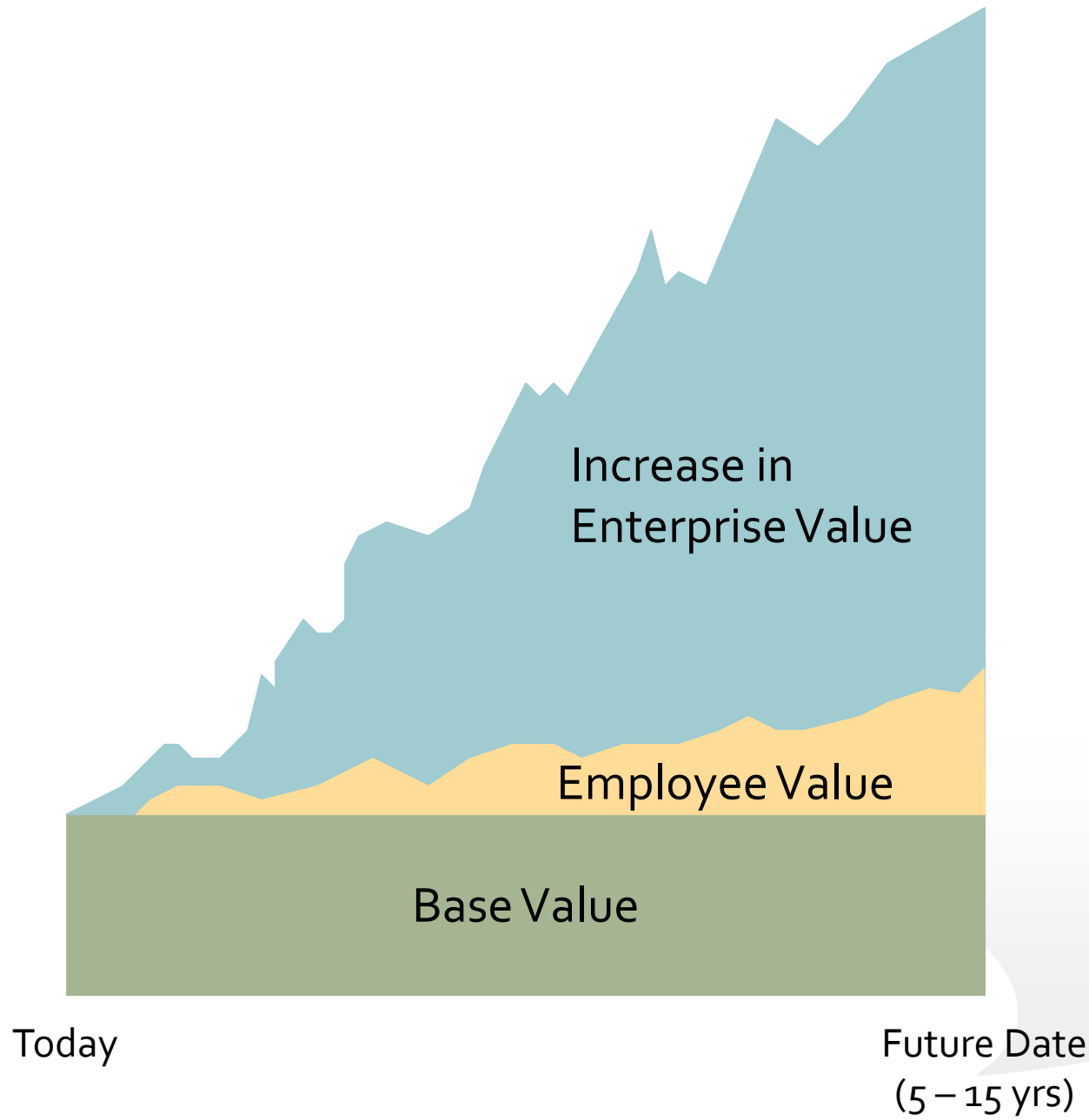


# Line of Sight









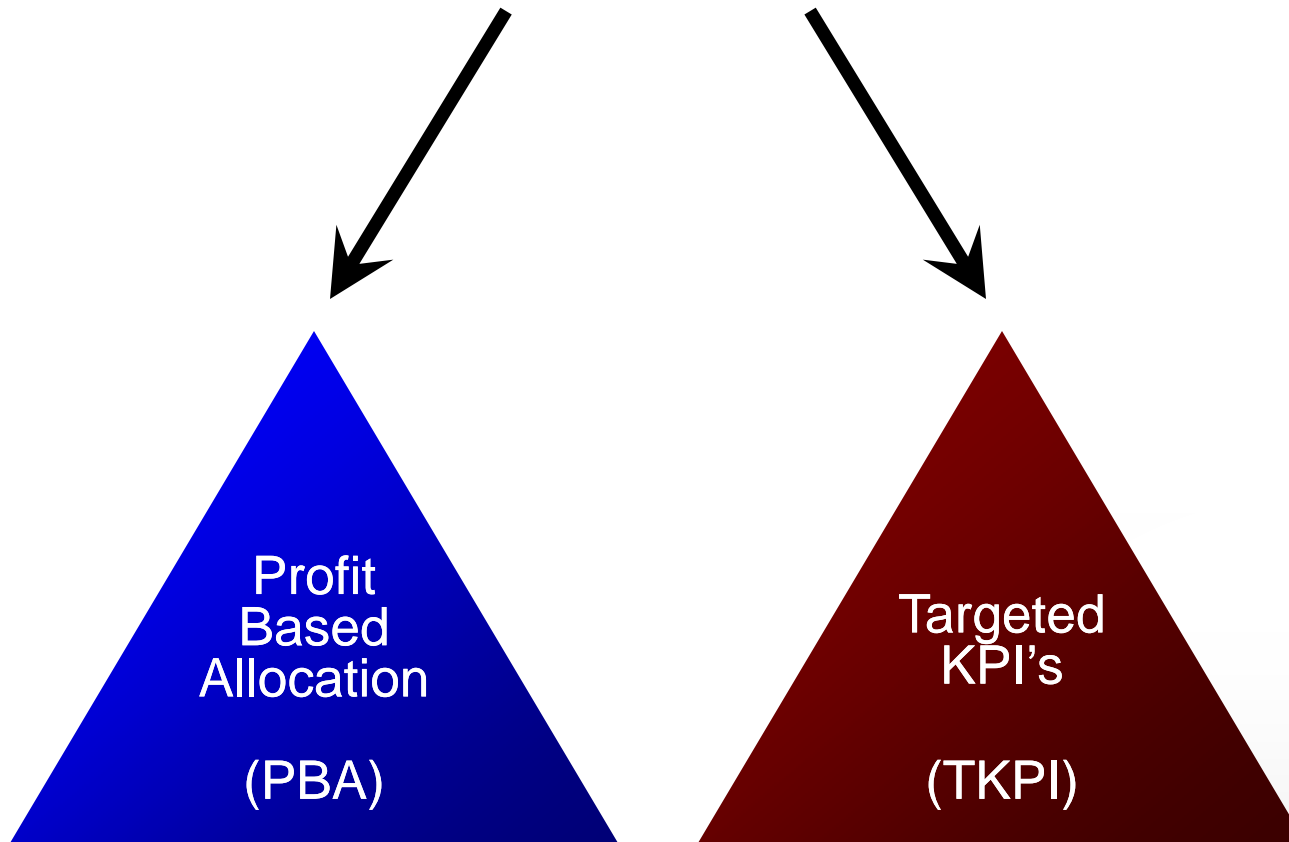
# Why?



- Treats employees like true partners
- Allows for values to grow and mature
- Creates ownership mentality
- Strengthens both recruitment and retention
- Self-financing



# Two Core Approaches



Profit  
Based  
Allocation  
  
(PBA)

A percentage of  
annual profits awarded  
to employees

The award amount  
is divided among  
employees based on a  
pre-determined formula

Paid at year-end

Targeted  
KPI's  
  
(TKPI)

Employees assigned  
a "targeted" incentive  
value – often based  
on a percentage of salary

Achievement of award is tied to  
multiple specific measurements  
or "metrics." Metrics  
can vary person to person.

Typically paid at year end,  
but may be quarterly.

Profit  
Based  
Allocation  
(PBA)

Focus

Solely annual profits

Value

May be open-ended

Design

Relatively simple

Essential

Strong Performance  
Management System

# PBA—Best Practices

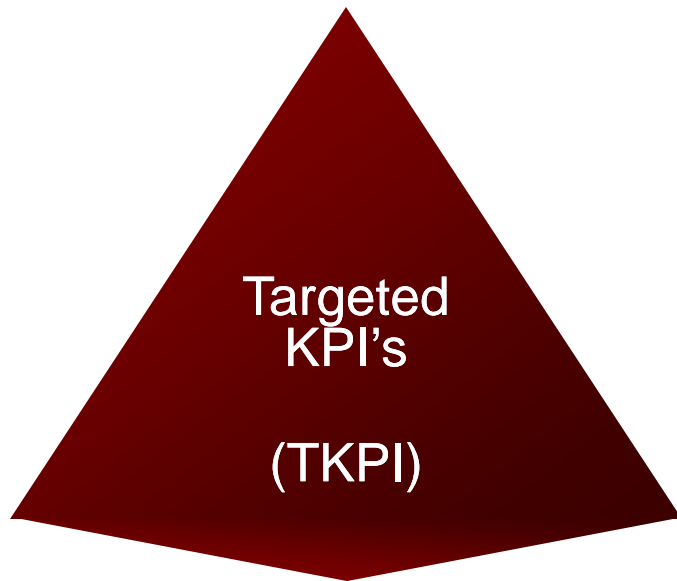


- Define profits
- Select “benchmark” or “growth” approach
- Identify threshold
- Select percentage to share (fixed or tiered)
- Select allocation formula
- Determine whether employee awards will be influenced by personal performance

# PBA—Dangers

- Failure to create line-of-sight
- Apathy
- Morale
- Lack of strong performance management system





Focus

May include company, dept,  
team & individual metrics

Value

Typically capped

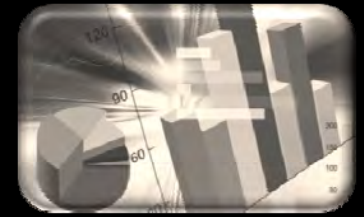
Design

Can run from  
basic to complex

Essential

Selecting the  
right metrics

# TKPI—Best Practices

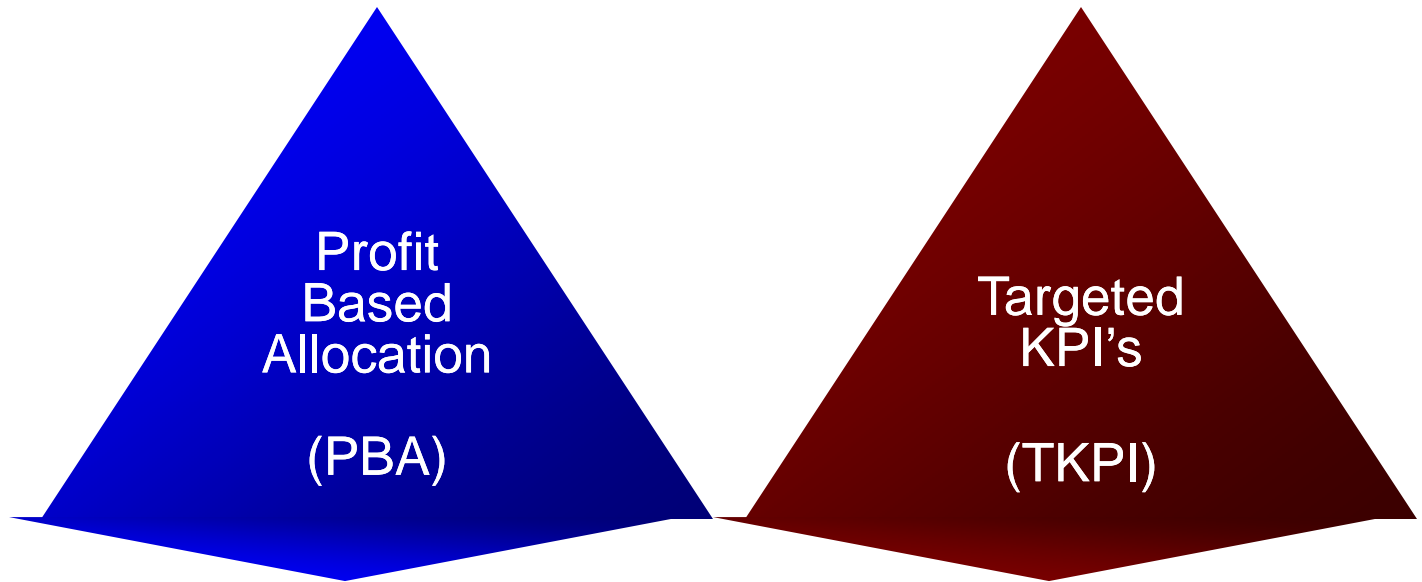


- Select range of targets
- Select components
- Select drivers (metrics)
- Select performance tiers (eliminate all-or-nothing)
- Set up measurement systems

# TKPI—Dangers



- Miscalculation
- Gaming
- Sandbagging
- Misalignment



Profit Based Allocation  
(PBA)

Targeted KPI's  
(TKPI)

Focus

Solely annual profits

May include company, dept, team & individual metrics

Value

May be open-ended

Typically capped

Design

Relatively simple

Can run from basic to complex

Essential

Strong Performance Management System

Selecting the Right metrics

# Indicators:



## Selecting Indicators for a TKPI Plan

# 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

# 2009 Performance Matrix

<b>Loans</b>					
36,000	<b>100%</b>	<b>115%</b>	<b>130%</b>	<b>140%</b>	<b>150%</b>
33,000	<b>80%</b>	<b>100%</b>	<b>115%</b>	<b>130%</b>	<b>140%</b>
30,000	<b>60%</b>	<b>80%</b>	<b>100%</b>	<b>115%</b>	<b>130%</b>
27,000	<b>45%</b>	<b>60%</b>	<b>80%</b>	<b>100%</b>	<b>115%</b>
24,000	<b>30%</b>	<b>45%</b>	<b>60%</b>	<b>80%</b>	<b>100%</b>
	\$81,000	\$85,000	\$90,000	\$94,500	\$99,000
	Deposits				

## Company Indicators

Return on Equity  
Return on Assets  
EPS  
Gross Sales  
Net Income  
Earnings Before Incentives  
EBT, EBIT, EBITDA  
Economic Profit (Productivity Profit)  
Revenue per employee  
Profit per employee  
Customer satisfaction indicators

## Department Indicators

New Loans  
Deposits  
Net Interest Spread  
Gross Sales  
Gross Margin  
Overhead Percentage  
Average Daily Room Rate  
Average Daily Occupancy Rate  
Contribution Margin  
Expenses to Budget  
Production Quotas  
Employee Retention Percentage  
Registrations  
Client Referrals  
Alpha  
Number of MBOs met



# Poll #2



# Critical step:

## Sensitivity Testing

# Sensitivity Testing



- Tie incentive plan to annual budget projection
- Test highs and lows
- Test each matrix
- Show ROTRI™
  - Open up the incentives to be as high as possible

**Is it possible for the shareholders to  
get their highest return by paying  
unlimited incentives?**

# **ROTRI™ - Return on Total Rewards Investment**

# How much is the Total Rewards Investment?

- Salaries
- Commissions
- Bonuses
- Deferred award accruals (LTIP)
- Core benefits
- Executive benefits
- Retirement contributions
- Payroll taxes

**What return do you get on that investment?**

\_\_\_\_\_%



# ROTRI™ Example:

Capital Account	\$ 2,000,000
Cost of Capital	12%
Capital Charge	\$ 240,000
NOPAT	\$ 1,000,000
Productivity Profit	\$ 760,000
Total Rewards Investment	\$ 4,500,000
<b>ROTRI™</b>	<b>16.9%</b>

(ROTRI = Productivity Profit/Total Rewards Investment)



# PBA Allocation Schedule

Productivity Profit	Award %
First \$500,000	10%
Next \$500,000	15%
Amounts over \$1,000,000	20%

# ROTRI™ Table

NOPAT	Productivity Profit	Award Amount	Owner's ROTRI (\$\$)	Owner's ROTRI (%)
\$1,000,000	\$ 760,000	\$ 89,000	\$ 671,000	14.9%
\$1,500,000	\$1,260,000	\$177,000	\$1,083,000	24.1%
\$2,000,000	\$1,760,000	\$277,000	\$1,483,000	33.0%
\$3,000,000	\$2,760,000	\$525,000	\$2,235,000	49.7%

# Poll #3



**Last thought:**  
**Motivation**

# Developing the Right Success Factors

-  Partnership  Do our employees feel like participating partners in our business successes?
-  Clarity  Do we effectively communicate and reinforce our organizational standards and the value of our total rewards opportunity?
-  Engagement  Do we achieve a crucial level of employee commitment, passion and engagement?
-  Practices  Do we follow best practices in managing our compensation investment?
-  Productivity  Do we conscientiously measure and manage employee productivity?

# Case Study

**\$30 million business wanting to grow to  
\$50 million in next three years.**

## Alignment Appraisal™

June 22, 2010



7700 Irvine Center Drive, Suite 930 ♦ Irvine, CA 92618 ♦ 949-852-2288

# The Alignment Appraisal™ Purpose

- Measure effectiveness of compensation relative to “World Class” standards
- Identify the areas of greatest vulnerability
- Position the business to create a clear Compensation Philosophy and GamePlan
- GamePlan should then lead to the creation of specific rewards strategies that will be key drivers of growth in the business

# Methodology

The Alignment Appraisal consists of the following steps:

1. Assessment
  - Leadership Profile Questionnaire
  - Executive Committee Assessment Survey—99 statements (scale of 1-10)
  - Employee Assessment Survey—68 statements (scale of 1-10)
  
2. Compilation and Evaluation
  - VisionLink compiles all data
  - Appraisal is “scored”
  - VisionLink consultants produce written analysis and commentary
  
3. The Alignment Appraisal Presentation
  - Recommended attendees: CEO, CFO, HR (and any others on the executive committee that will influence decisions about compensation)



# Critical Goals

The Chief Executive Officer of Sample Company has identified the following goals and concerns:

## Business Growth

- Grow business to \$50 M in revenues with corresponding growth in EBITDA (3 yrs.)
- Grow market share

## Performance

- Create greater cooperation between sales and operations teams—overcome “who owns this?” issues
- Improve incorporation of technical strengths into sales process
- Create a more efficient and effective sales process
- Achieve a more systematic approach to selling, supporting, and serving Sample Company’s clients

## Talent/Culture/Compensation

- Maintain family-like culture and prepare for the next phase of growth
- Create a pay system that aligns rewards with the achievement of company goals
- Secure key talent in the following areas: sales, customer service, technicians, analysts

# Alignment Appraisal Index

## Alignment Appraisal Index (1 to 100)

- An Index of 85 or higher indicates that the Total Rewards Program (TRP) is at or near “world class” standards and is **driving** sales and profits
- An Index of between 75 and 85 indicates that the TRP is **supporting** sales and profit growth
- An Index below 75 indicates that the TRP is **hindering** (reducing) sales and profits

## Net Appraisal Score (-10 to +10)

- A Net Score of 7 or higher indicates that **most** employees are strong promoters of the Company as an employer of choice.
- A Net Score greater than 3 but less than 7 indicates that a **majority** of employees are promoters of the Company as an employer of choice.
- A Net Score of less than 3 indicates that too many employees are **unwilling** to promote the Company as an employer of choice.

Alignment Appraisal Index =  $72^*$  /  $-0.2$

\*Scale of 100

Leadership Appraisal

65

Employee Appraisal

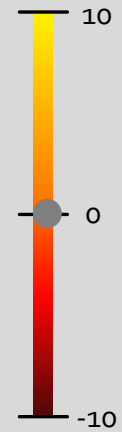
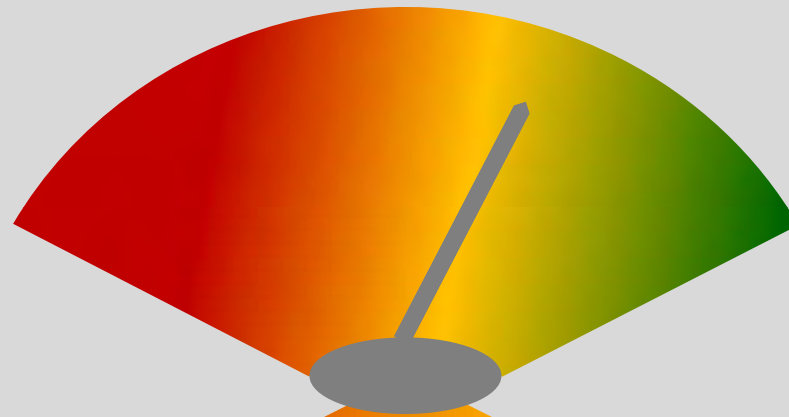
72

Variance

7

Net Score

-0.2



Partnership

7.4

Clarity

7.6

Engagement

7.5

Practices

6.5

Productivity

6.9

# Diagnosis

The Alignment Appraisal process reveals the following areas of strength and opportunity.

- The company has effectively communicated its mission and ownership's vision of the future. This creates clarity of direction and purpose.
- The company has created a culture where employees feel a sense of family and trust. This communicates a commitment to employee interests and not just company goals.

Note: This strength can become a liability if an overall pay for performance philosophy isn't adopted. An entitlement mentality can emerge and create a barrier to an ownership mentality.

- Employees believe in the business plan of the company. This strengthens the company's ability to create a unified financial vision once it links pay to performance.
- Employees generally find purpose and meaning in their work and appreciate the company's work environment. This strengthens the company's ability to educate its workforce and improve productivity.
- There is a foundational "stewardship" mentality in place in the organization that can be nurtured into a more complete "ownership" mentality. This removes a common barrier to a corresponding pay for performance approach.

# Diagnosis

The Alignment Appraisal™ process reveals the following areas of concern.

- The company does not have a clear and purposeful compensation philosophy that effectively supports the business plan. This creates a lack of focus and stifles execution.
- The company does not currently employ best practice options in the design, implementation and communication of its rewards programs. This is inefficient and erodes profitability.
- The company does not yet effectively measure and manage improvements in productivity. This slows growth and creates a deficit of accountability.
- There is not a strong link between improvements in productivity and rewards. This impedes ambition and initiative—which in turn slows growth.
- There is not yet a clear path of professional opportunity and growth within the organization. This weakens a unified vision and restrains commitment.
- Overall, the appraisal shows there are many employees that are not yet promoters of the company as an employer of choice. This diminishes the company's ability to attract and retain premier talent.

# Related Outcomes

Until these issues are addressed and corrected the shareholders of Sample Company should expect the following:

1. Lower than desired sales revenue
2. Lower margins
3. Some difficulty in recruiting and retaining premier talent
4. Limited increases in employee productivity
5. Diminished sustainable competitive advantage (reduced shareholder value)

# Developing the Right Success Factors

-  Partnership 

Do our employees feel like participating partners in our business successes?
-  Clarity 

Do we effectively communicate and reinforce our organizational standards and the value of our total rewards opportunity?
-  Engagement 

Do we achieve a crucial level of employee commitment, passion and engagement?
-  Practices 

Do we follow best practices in managing our compensation investment?
-  Productivity 

Do we conscientiously measure and manage employee productivity?

# Conclusions

- Select the right type of plan based on your organization's culture, business model and goals
- Select an approach (PBA or TKPI) and stay with it (polish and perfect over time)
- Measure the return on the plan's effectiveness through ROTRI™
- Measure and track your employees' engagement (NMS)



# Next CPE Course:

## **“Becoming an Employer of Choice: The Role of Compensation”**

To be held on:  
Thursday, November 4, 2010

# Next Online Seminar:

## **“Show Me Your Company’s Pay Programs and I’ll Show You How Your People Perform”**

To be held on:  
Next Tuesday, July 27, 2010

Check out our website:  
[www.VLadvisors.com](http://www.VLadvisors.com)

The screenshot shows the homepage of The VisionLink Advisory Group. At the top left is the logo, which includes a globe icon and the text "THE VISIONLINK ADVISORY GROUP". To the right of the logo is a "CLIENT login" section with fields for "User:" and "Password:", a "Login" button, and a phone icon with the number "(888) 703 - 0080" and an RSS feed icon. Below the logo and login section is a navigation menu with links for "Home", "About Us", "Client Profile", "Information and Resources", "Client Locations", "Events", "Blog", and "Contact Us". The main content area features a large banner image of a man in a suit pointing at a line graph on a screen, with several people seated in front of him. Overlaid on the banner is a large question mark and the text "Do Incentive Plans Really Work?". To the left of the banner are three vertical buttons: "Incentive Plans", "Think Like Owners", and "Top People Management". Below the banner is a registration form for a webinar invitation list, with the text "Join our webinar invitation list: Please enter your email address:" and a "Join" button. To the right of the form is the text "Strategic Compensation Development and Management Firm" and a partial sentence "VisionLink enables mid-market companies to achieve".

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# Questions?



# Thank you for attending

Please complete our survey form immediately following our presentation.

**This will be counted as a monitoring event.**

You may also request a copy of the slides, course syllabus/summary and a CD of today's presentation

# Thank You!



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