

January 25, 2011

# “The Eight Fatal Compensation Mistakes”



THE VISIONLINK  
ADVISORY GROUP

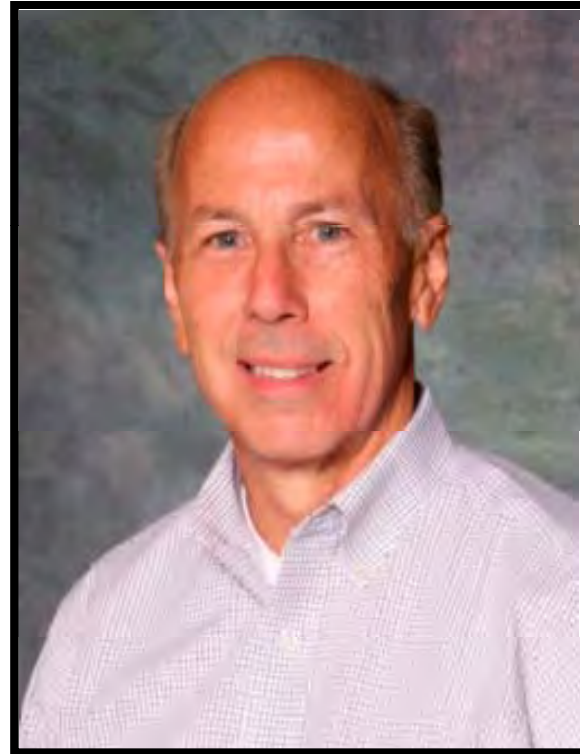
Today's Presenter:

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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

# Purposes of Pay for Performance Compensation Plans

- Build a sense of partnership between ownership and the workforce--yes
- Communicate and reinforce the values, goals, and objectives of the company--yes
- Engage employees in the organization's success--yes
- Reward contributors for successful achievements--yes
- Create a unified financial vision for growing the business--yes

However...

# The “Must”

It **must** reinforce the logic of the business **model**, not just the business strategy

**What are you trying to do  
when you introduce a new  
compensation plan?**

**Communicate what's  
important so execution will  
align with the business model**

# Business Model vs. Business Strategy

## Model

- Refers to the **logic** of the company—how it defines, operates, creates and captures value for stakeholders
- It defines **policy choices**, **asset choices** and **governance choices** (how the company will address decisions over the other two choice issues).

## Strategy

- A plan that relates to activities the company will engage in to create a unique and valuable position in the marketplace.

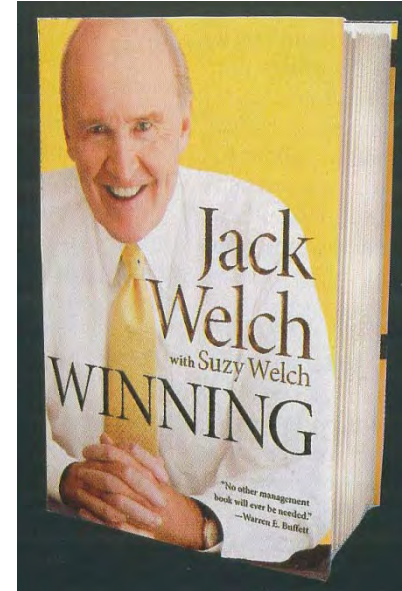
# Foundational Premise

Compensation should support the company strategy, but if it does not reinforce the business model of the company, it will fail.



# Jack Welch

in his book *WINNING*



“Show me a company’s various compensation plans, and I’ll show you how its people behave.”

# How do you know a Rewards System is not properly focused?

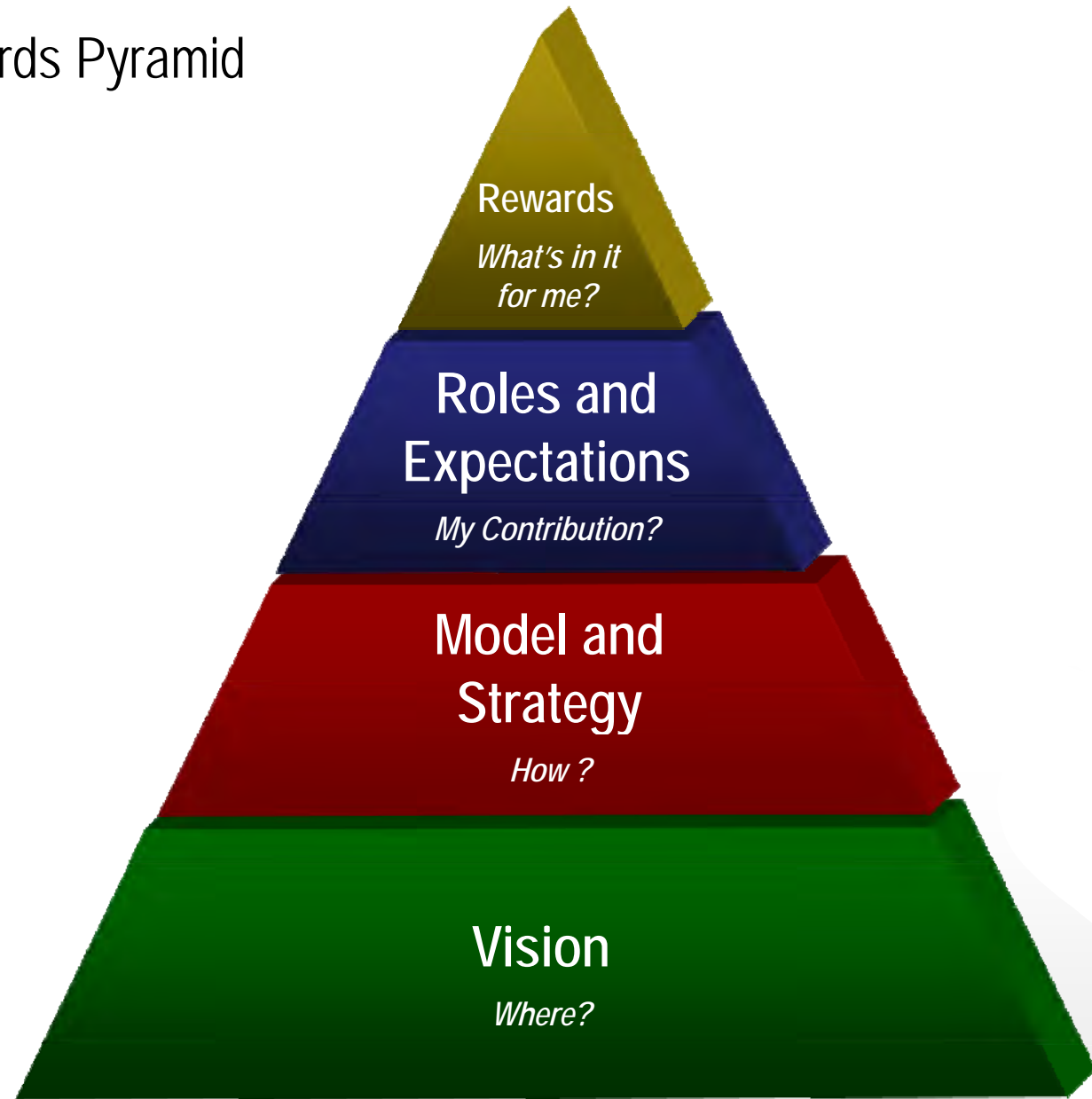
- Key employees think short-term when you need them thinking long-term - or vice versa
- Premier talent leave for a better value proposition elsewhere—greater opportunity
- Compensation programs such as bonus plans are reinvented frequently

# How do you know a Rewards System is not properly focused?

- Key employee performance is not improving despite the talent you know is there
- Employees don't seem to understand and/or appreciate their rewards programs
- Key people cannot clearly articulate the expectations and rewards associated with the fulfillment of their roles in the organization

**How do you know a Rewards  
System is properly focused?**

## The Rewards Pyramid



**What are the biggest mistakes  
employers make when building  
compensation programs?**

# VisionLink Experience



- Over 100 years of combined experience
- Been in thousands of businesses
- Lots of good plans, lots of bad plans
- Common complaints, concerns and frustrations
- Many, many questions

# Questions



- Repeat themselves
- Represent the frustrations and anxieties business owners have about the success/failure of their rewards programs



# For example:



- What's the best way to make a bonus program reward for something other than annual profits?
- What are the rules of thumb for the amount of bonuses that should be paid to middle managers?
- How big should you be before you put in some type of long-term incentive plan?
- What are the differences between stock options and phantom stock?

**What do all these questions  
have in common?**

**They all imply that the specific details of a plan type are the keys to its success.**

The better questions address the process of insuring that any plan designed will be creative, well-managed, sustainable, flexible and support the business model.

# Two Issues to Balance

## Structure

- “What processes will ensure that every decision made relative to compensation will have the proper **impact on strategy, cost and productivity** in support of our model?”

## Mindset

- “What specific pay programs will ensure that our **employees take ownership** (stewardship) of our business model and its support strategy?”

# Potential Dangers

## Structure

- Employees take the company in the wrong direction (at odds with its business model)
- Company spends rewards dollars that don't necessarily drive value for shareholders and employees
- The company does not produce an "above market" return on its total rewards investment (capital could have been better invested elsewhere).

## Mindset

- Employees see incentives as entitlements
- No ownership mindset is in evidence
- There is a general lack of clarity about the future of the business
- The company is unable to unlock the full passion and focus of its workforce.

**Eight key questions  
(and their answers)  
to help avoid fatal mistakes  
with your rewards programs**

# Step One

## Plan Purpose

**“How can we ensure a Plan design that will positively contribute to the fulfillment of our company’s vision and business model?”**

**Mistake avoided:**

***No strategic context for the plan***



# Step One

## Plan Purpose

- Plan purpose?
- Link between pay and performance?
- Line of sight?
- Shareholder value?
- Employee value?



# Step One

## Plan Purpose

- Requirement: full attention of senior management
- Result: written summary document
- Each plan: specific purpose (strategic contribution, expectations, broad measurements, timetable, etc.)

# Step One

## Plan Purpose

### Bad Examples

- Plans built based on recommendation of peer firm
- Plan adopted following persistence of a good sales person
- Bonus payments based on end-of-year employer discretion
- No long-term incentive plan to reinforce company's growth goals and sustained business model

# VisionLink's View of Compensation



# Step One

## Plan Purpose

### The Strategic Blueprint

1. Clearly identify the two visions
2. Periodically review market pay data
3. Periodically assess the proper balance between the eight pay components
4. Contrast current plans against ideal models
5. Create a written “game plan” for implementation and execution

# Step Two

## Plan Construction

**“What will ensure the Plan will properly address all financial and legal considerations without forfeiting creativity and innovation?”**

**Mistake Avoided:**  
***Lack of creative value***

# Step Two

## Plan Construction

**With all due respect, please don't  
have your attorney design your  
compensation plan**

# Step Two

## Plan Construction

- Sources of creative and visionary input?
- Role of legal and accounting resources?
- Process for balancing creative issues with technical requirements?
- Documentation?



# Step Two

## Plan Construction

### Bad Examples

- Corporate attorney crafted phantom stock document from prototype software
- Document became the center of the plan
- Employees didn't understand the plan
- Plan required a costly formal appraisal each year
- Restrictions on distributions practically eliminated almost all payouts
- Result: employees were confused and cynical

### Find the Right Balance

- Creativity
- Uniqueness
- Imagination
- Simplicity
- Clarity
- Motivational
- Inspiring
- Financially responsible
- Legally compliant
- All details considered
- Properly documented

# Step Two

## Plan Construction

### The Performance Framework

1. Insist on developing a plan that is fresh, compelling and visionary
2. Seek professional help
3. Identify precise financial targets; model effectively
4. Follow a process that won't sacrifice quality for expediency
5. Use legal and financial advisors to solve problems and clear hurdles

# Step Three

## Plan Launch

**“How can we know that the Plan rollout reinforces the company vision and business model while building participant confidence and enthusiasm?”**

**Mistake Avoided:**

***Lack of employee buy-in and enthusiasm***

# Step Three

## Plan Launch

- The employees must understand the plan
- The employees must be able to communicate the plan to others
- The employees must appreciate the plan
- The plan should create line-of-sight

# Step Three

## Plan Launch

- The employees must know what outcomes are expected of them to maximize the plan value
- Rewards must be meaningful enough to impact the desire to achieve optimum results
- The employees must believe and trust the underlying assumptions and data
- The employees must know when and how additional information will be made available

# Step Three

## Plan Launch

### Bad Examples

- Plan is communicated in writing only
- Written communication is legalistic and lengthy
- CEO/President not involved in launch
- No investment in quality of materials or preparation
- Presentation is deemed shallow and manipulative

# Step Three

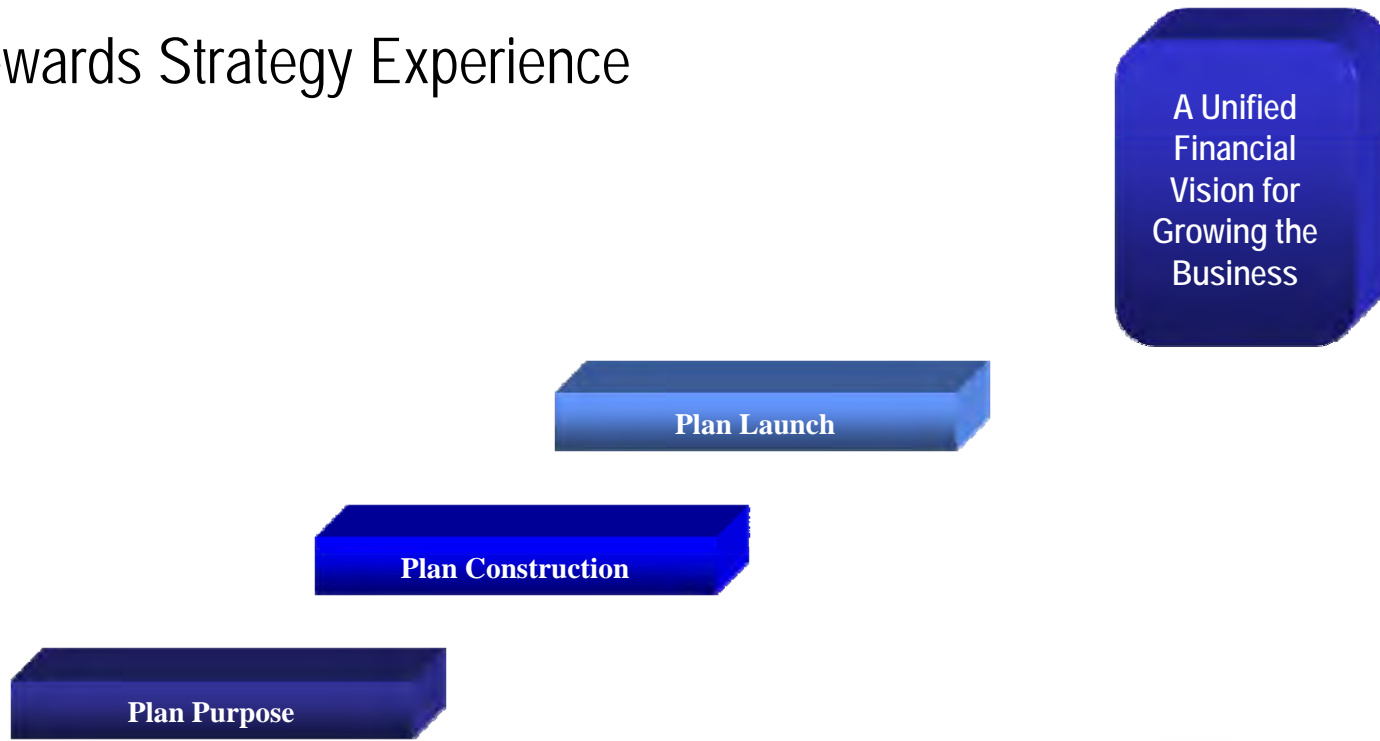
## Plan Launch

### The Strategic Launch

1. Customized invitation/announcement
2. Group and/or person-to-person presentations
3. CEO involvement
4. Provide context for the plan (Vision → Business Model → Rewards)
5. Clear overview
6. Attractive written summary
7. “Where to go for more”
8. “What to expect from here”



# Rewards Strategy Experience



# Rewards Strategy Experience



# To Be Kept in Orbit Everything Must Be Either...



- Delegated fully to internal personnel
- Validated by an outside professional after being developed by internal personnel
- Outsourced to other professional firms

# Step Four

## Operations Management

**“What can be put in place to assure effective internal communication and administration of the Plan?”**

**Mistake Avoided:**

***Unnecessary burden on company's administrative team***

# Step Four

## Operations Management

- Job impact?
- Internal oversight?
- New responsibilities and duties?
- New processes?
- Unnecessary burden?



### Bad Examples

- Announcing to the HR manager that a new plan has been created—“here you go!”
- Advising payroll personnel of an adjustment 2 days before it goes into effect
- Adopting a plan with financial statement impact without assisting the accountant with journal entries
- Creating a bonus plan that requires timely job appraisals without giving line managers the necessary assessment tools

# Step Four

## Operations Management

### The Backstage GamePlan

1. Meet with impacted personnel to clarify responsibilities and determine what will be outsourced
2. Advise Department Heads of impact of plan on their management responsibilities
3. Coordinate enrollments and terminations, internal plan communication and participant interaction
4. Coordinate payroll deductions (if applicable) and data reporting
5. Coordinate funds remittance (if applicable) and plan distributions

# Step Five

## Communication and Marketing Management

**“What can be done to ensure meaningful, ongoing communication of the value of the plan to participants... and reinforce its relevance to the business model?”**

**Mistake Avoided:  
Disenchanted or misdirected employees**



# Step Five

## Communication and Marketing Management

- Ongoing maintenance?
- What methods?
- Who will be responsible for communication?

***Without a serious, top-down commitment to this step the Plan will certainly fail to live up to its potential!***

# Step Five

## Communication and Marketing Management

### Bad Examples

- Nothing communicated unless asked (and then it's a hassle)
- Letter from HR once/year
- Letter from legal department!
- First indication of amount—in the paycheck
- No explanatory back-up
- Completely forgotten until years later

# Step Five

## Communication and Marketing Management

### The Communication Solution

1. Internal meeting to establish and commit to an ongoing marketing campaign to effectively communicate total rewards throughout the year
2. Quarterly letter and statement mailed to home (with current and projected plan values)
3. Internet access to account information and assistance (where appropriate)
4. Personal contact to top managers to offer assistance

*more*

# Step Five

## Communication and Marketing Management

### The Communication Solution

5. Semi-annual information newsletter sent to home
6. Financial planning assistance to validate and enhance plan value
6. Annual meeting with participants to review plan and announce changes

# Step Six

## Compliance Management

**“How can we be sure that we are fulfilling all legal and regulatory responsibilities for the Plan?”**

**Mistake Avoided:  
Legal or regulatory error and costly penalties**

# Step Six

## Compliance Management

- Maintain regulatory responsibilities
- Fulfill statutory duties
- Avoid costly legal remedies
- Maintain up-to-date documents
- Maintain up-to-date records and procedures
- Catalog decisions and supporting records

# Step Six

## Compliance Management

### Bad Examples

- Failure to file DOL letter on nonqualified plan
- Documents not brought up to date with new tax law
- Failure to pay attention to 409(A) issues
- Failure to pay FICA/FUTA taxes on deferred compensation, SERP or other nonqualified plans
- Reduction in plan benefits without employee consent

# Step Six

## Compliance Management

### The Compliance Manager

1. Designate internal manager responsible for oversight of regulatory and compliance functions
2. Identify outside resources to serve as advisor to company (consultants, attorneys, accountants)
3. Set meeting dates (once or twice per year) to review compliance issues on all compensation plans

*more*



# Step Six

## Compliance Management

### The Compliance Manager

4. Create written and electronic documentation process for decisions made and supporting reasons
5. Produce annual senior management report identifying actions taken and pending

# Step Seven

## Financial Management

**“How will we ensure the Plan is being managed financially and is producing an appropriate return on investment?”**

***Mistake Avoided:***  
***Poor financial return on  
compensation investment***

# Step Seven

## Financial Management

- Specific financial targets and expectations?
- How and when will performance be measured?
- Tracking financial data?
- Recommending course corrections?

# Step Seven

## Financial Management

### Bad Examples

Failure to ...

- ...understand cash flow impact of the plan
- ...understand earnings impact of the plan
- ...fund a long-term plan
- ...anticipate needed financial data in advance

# Step Seven

## Financial Management

### The Financial Monitor

1. Set clear financial expectations (base, target, superior)
2. Build an effective financial model
3. Establish periodic review dates (e.g., quarterly)
4. Identify responsible internal parties
5. Identify third parties needed to provide information

# Step Seven

## Financial Management

### The Financial Monitor

5. Set expectations for delivery of financial data by all parties
6. Periodically contrast actual results with projected
7. Involve senior management (CEO/ President) in annual meeting to evaluate and consider changes

# Step Eight

## Strategic Management

**“How will we be sure to keep the Plan in line with the evolution of the company vision and business model?”**

***Mistake Avoided:  
Plan moves off course  
(no line of sight)***

# Step Eight

## Strategic Management

- Frequency of review?
- Assessment of options?
- Accountability for drawing conclusions?
- Responsibility for alterations or termination?



# Step Eight

## Strategic Management

### Bad Examples

- Plan rewards for results no longer compatible with company goals or shift in business model
- Employees see no connection between role, expectations and incentive plans
- Size of awards no longer meaningful (goals outgrew the plan)

# Step Eight

## Strategic Management

### The “Line of Sight” Review

1. Set an annual review period for all compensation plans (3 months before end of fiscal/calendar year)
2. Senior management review and assess integrity and consistency of all compensation plans

*more*

# Step Eight

## Strategic Management

### The “Line of Sight” Review

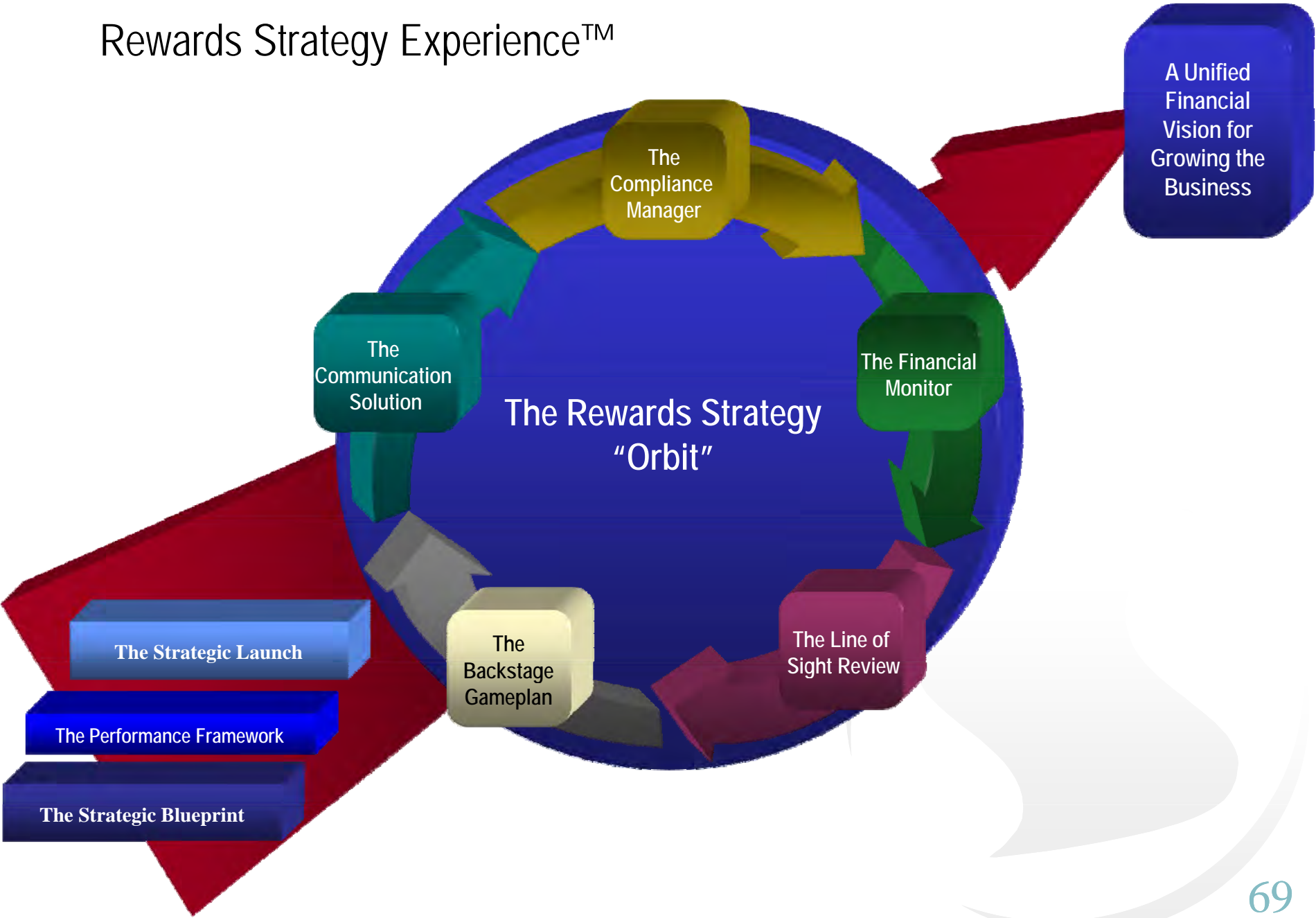
3. Written evaluation of each plan that analyzes:  
(a) employee value perception, (b) connection to vital company goals and business model, and (c) consistency with company compensation philosophy
4. Action plan with responsibilities, timetable and accountable parties for adoption and implementation of agreed upon changes

VisionLink’s Alignment Appraisal™

# Rewards Strategy Experience



# Rewards Strategy Experience™



# 8 Fatal Outcomes

1. No strategic context for the plan
2. Lack of creative value
3. Lack of employee buy-in and enthusiasm
4. Unnecessary burden on company's administrative team
5. Disenchanted employees
6. Legal or regulatory error
7. Poor financial return on compensation expenditure
8. Plan moves off course (no line of sight)

# First Step

- Alignment Appraisal™
  - A focused look at your current practices with a comparative eye on whether your company is building a “Unified Financial Vision for Growing the Business”
  - Process—online employee survey

# Quantitative and Qualitative Assessment

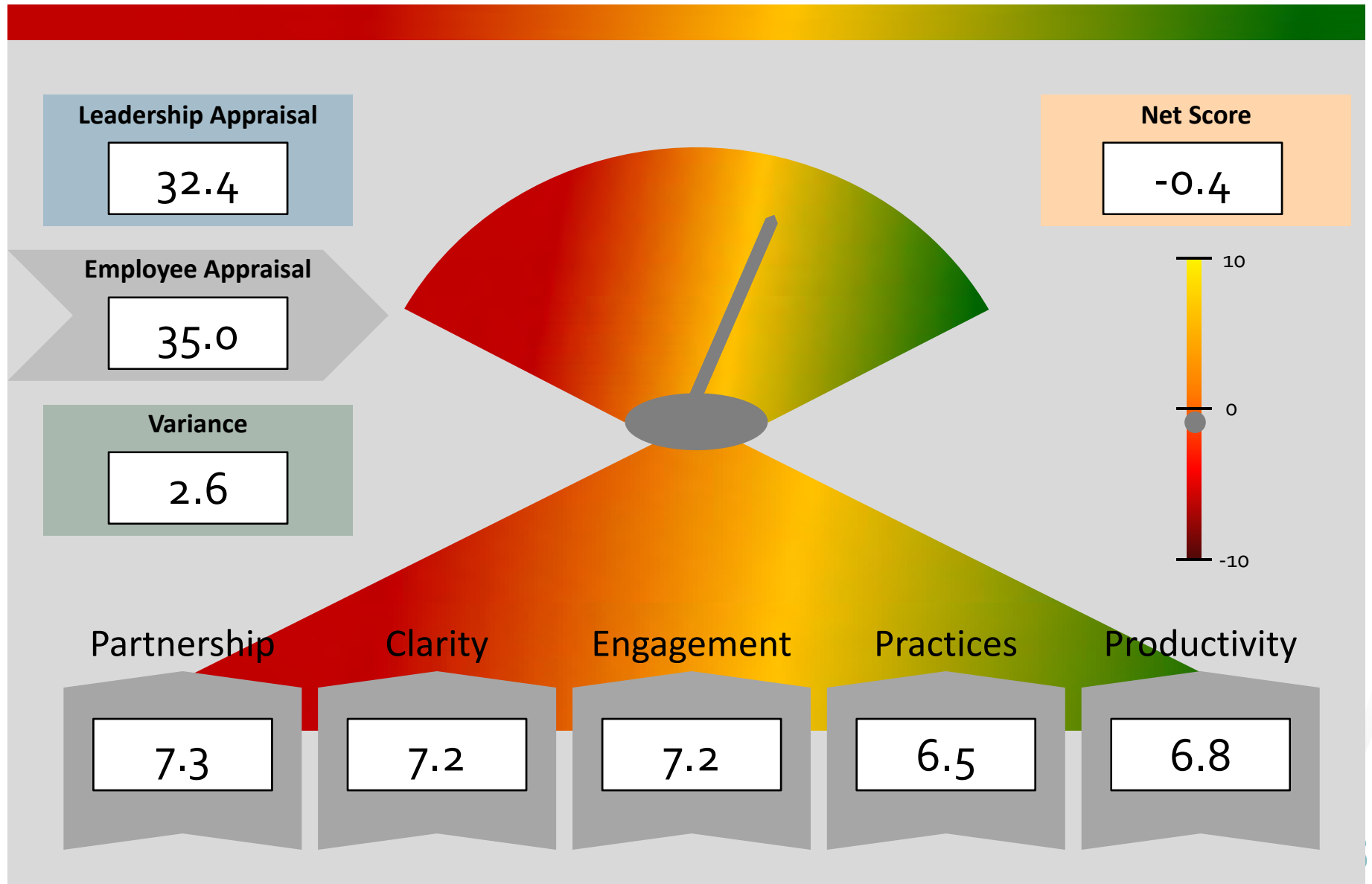
## The Alignment Appraisal™

Partnership	▶	Do our employees feel like participating partners in our business successes?
Clarity	▶	Do we effectively communicate and reinforce our business model and how our total rewards opportunity is linked to it?
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?



# Alignment Appraisal Index = $70^*$ / $-0.4$

\*Scale of 100



# Next Online Seminar:

## “How to Build Long-Term Value for Key Contributors”

To be held on:  
Tuesday, February 22nd, 2011

*Look for an email invitation or  
Register on our website at [www.vladvisors.com](http://www.vladvisors.com)*

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# Thank you for attending

## ***New Webinar Addition: The VisionLink Profile***

*Please complete our brief survey immediately following our presentation.*

*We value your input.*

*You may request a copy of our slides and more information about the Alignment Appraisal™.*

**Questions?**



# The VisionLink Profile

## World-Class Compensation Development



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# The Compensation Framework



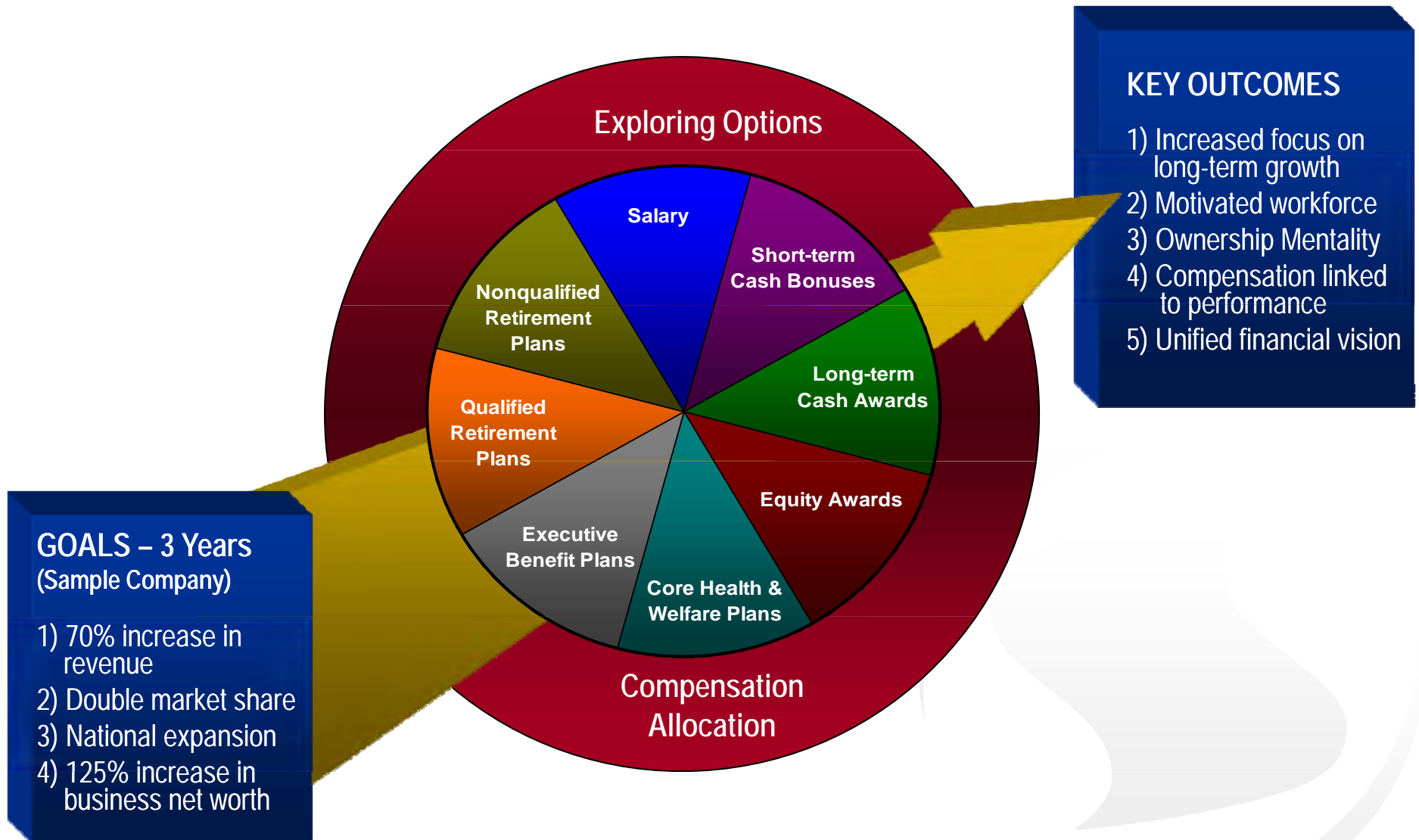


# THE VISIONLINK SOLUTION™



1. ENVISION	2. CREATE	3. SUSTAIN
Envision how compensation strategy can positively impact the fulfillment of your strategic growth plan	Engineer compensation plans that effectively align roles and expectations with your company vision and strategy	Sustain the focus and motivation of key talent on the performance factors that will lead to the fulfillment of your company's growth goals
WIN THE TALENT WARS	● FOCUS ON KPI'S	● RETURN ON COMPENSATION INVESTMENT

# GamePlan Development



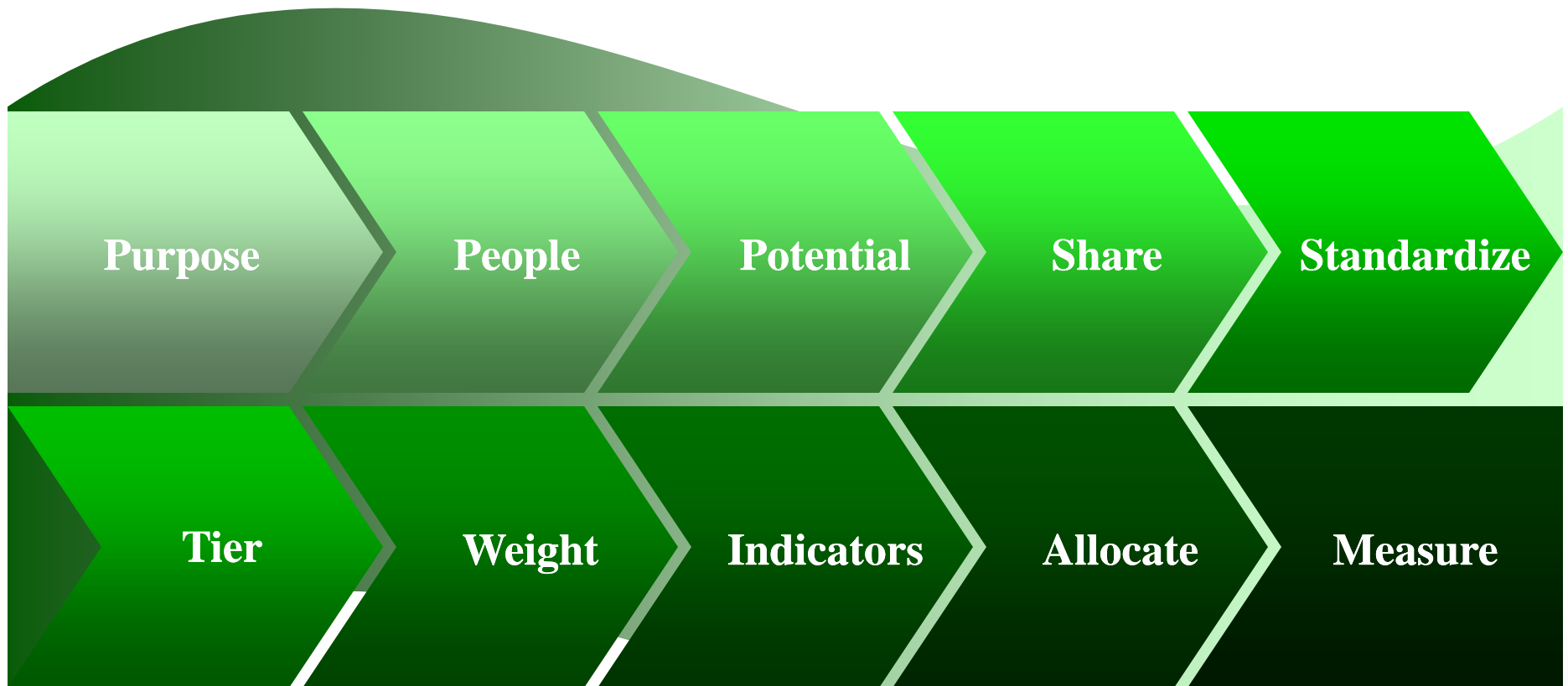
## Build the Compensation Strategy

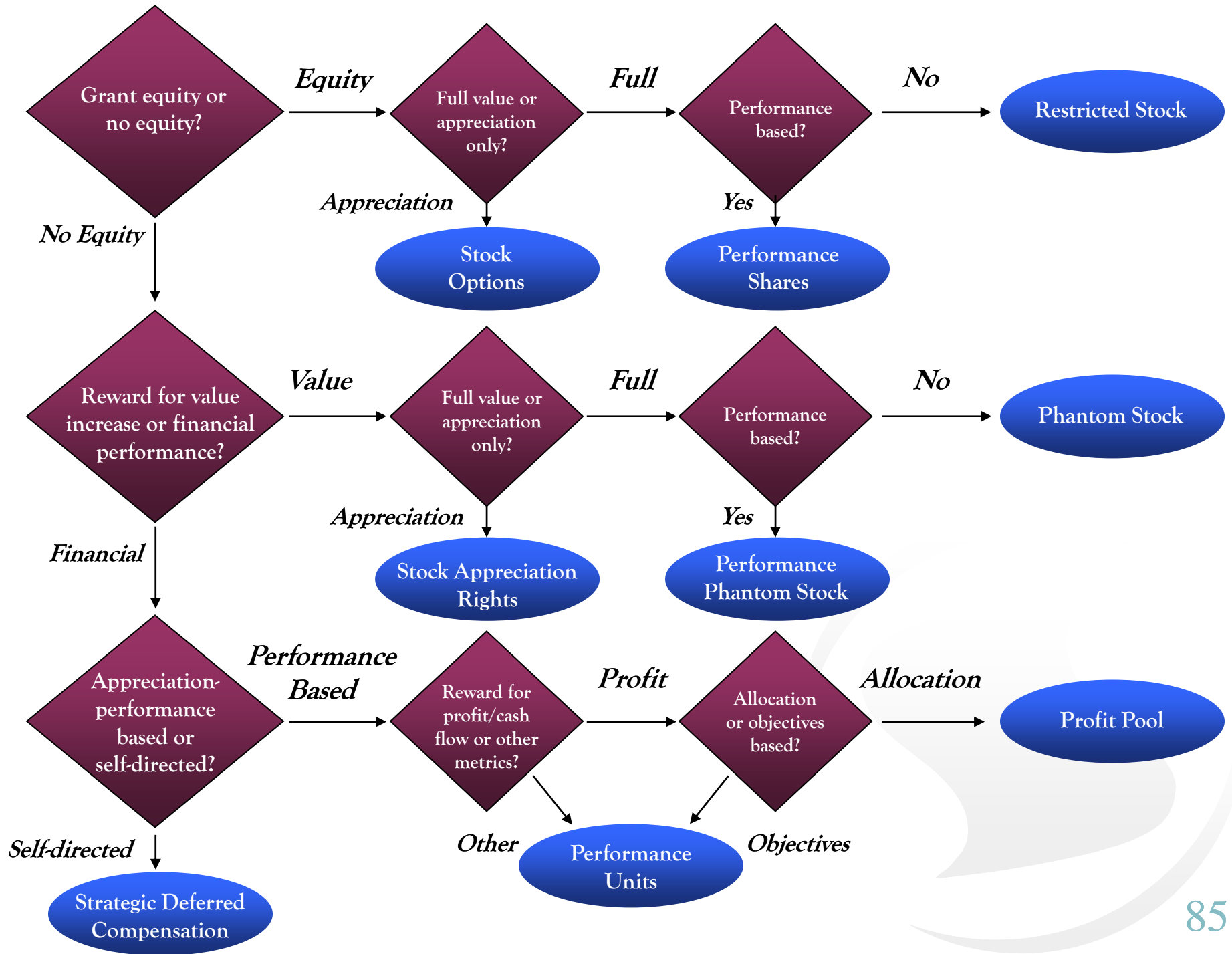
The steps for the development and implementation of a successful plan include the following:

1. <b>Concept</b> —Envision the plan design	2. <b>Purpose</b> —Construct the parameters of the plan and build consensus	3. <b>Financial Specifications</b> — Build financial models, seek feedback and fine tune
4. <b>Specifications</b> —Propose plan specifications for how and when payouts will occur; seek feedback and fine tune	5. <b>Documentation</b> —Create appropriate legal documents and participant plan descriptions	6. <b>Launch</b> —Present the plan to participants in a manner that builds confidence and enthusiasm

# Building an Incentive Plan

## A Systematic Process





# VisionLink's Involvement

- The Alignment Appraisal
- Proposal
- Sequence
  - Diagnostic and GamePlan
  - Plan Designs and Launch
  - Rewards Reinforcement Strategy
  - Rewards Management Plan

# Thank you!



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