

*The "Learn & Earn" Series™*

May 19, 2011

# "10 Steps to Building an Effective Incentive Plan"



THE VISIONLINK  
ADVISORY GROUP

Today's Presenter:

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# Next Public Webinar:

## “Do Incentive Plans Really Work?”

To be held on:  
Tuesday, May 24, 2011

# 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

- 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



# 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
- Create a unified financial vision for growing the business
- Multiply wealth for all stake holders

# Common Questions



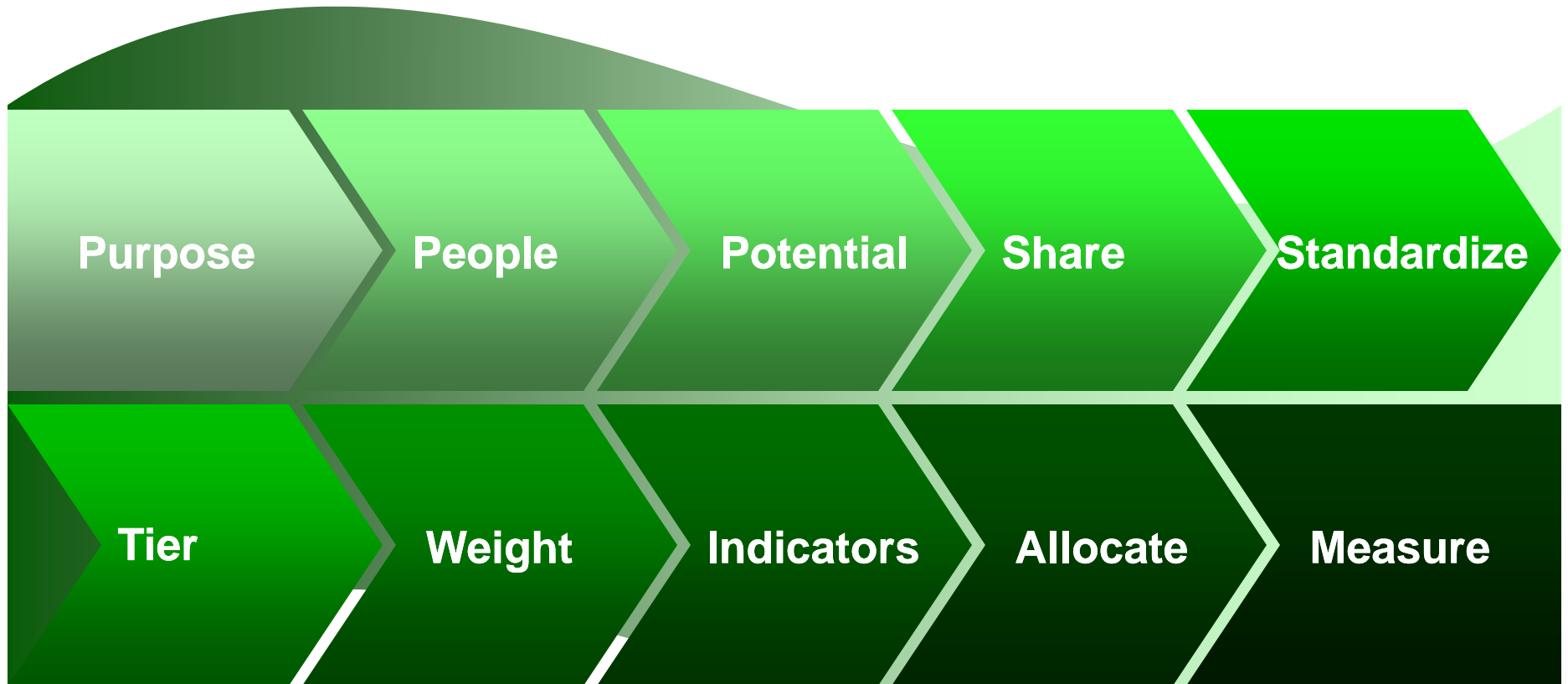
- How much to award?
- Who should participate?
- What balance between company, department and individual performance?
- When is it paid?

# Poll #1



# Building an Incentive Plan

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:



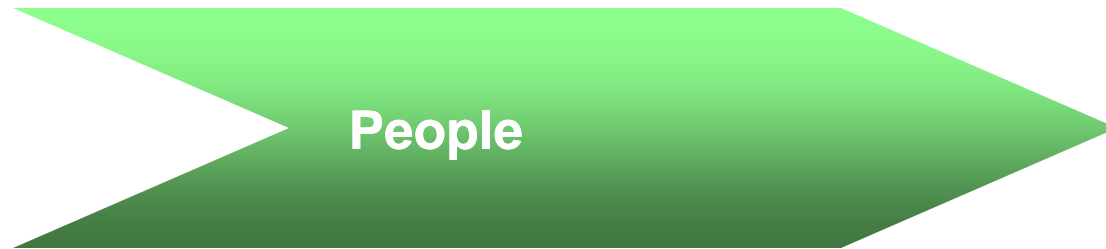
- Annual Revenue Growth - 15%
- Net Income Target - 17.5%
- 5 Year Goal - Double Revenue





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





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



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



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:



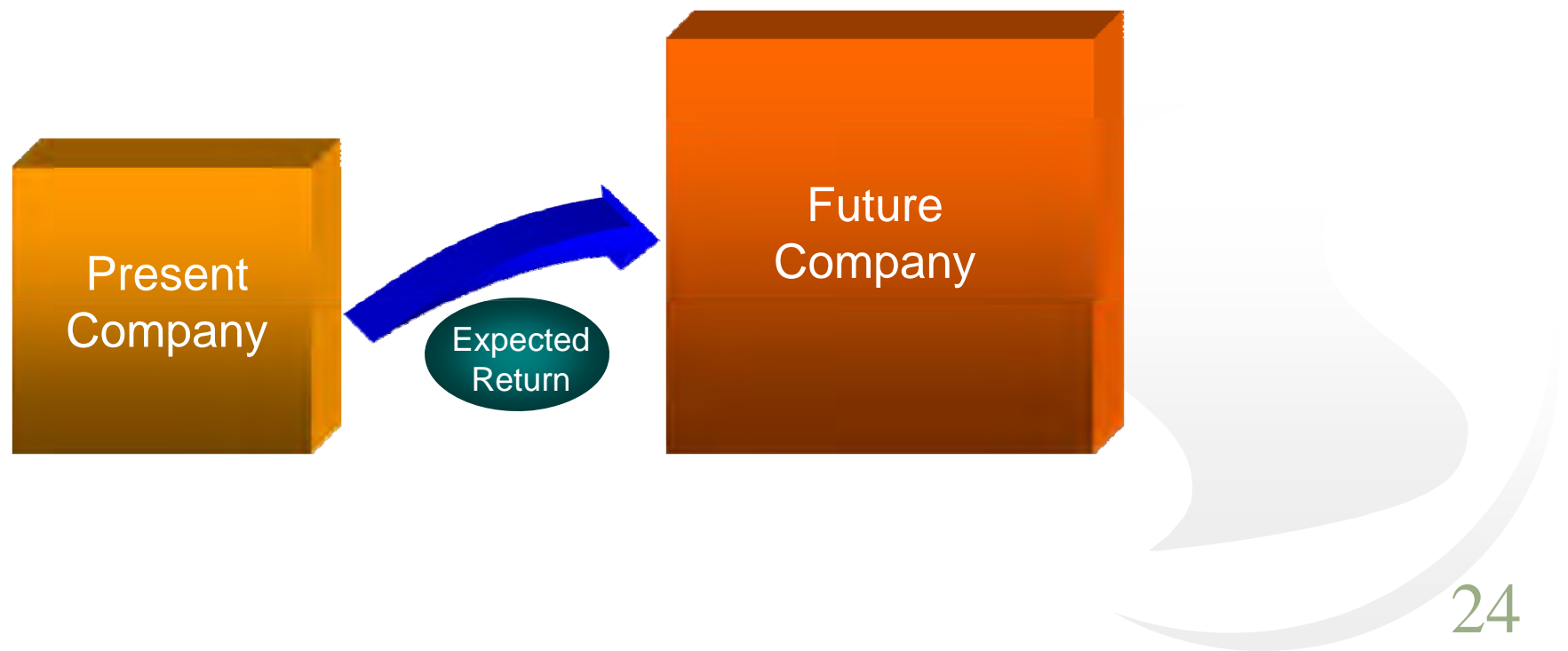
- Double Revenue in 5 years = \$20 million of new value for shareholders



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

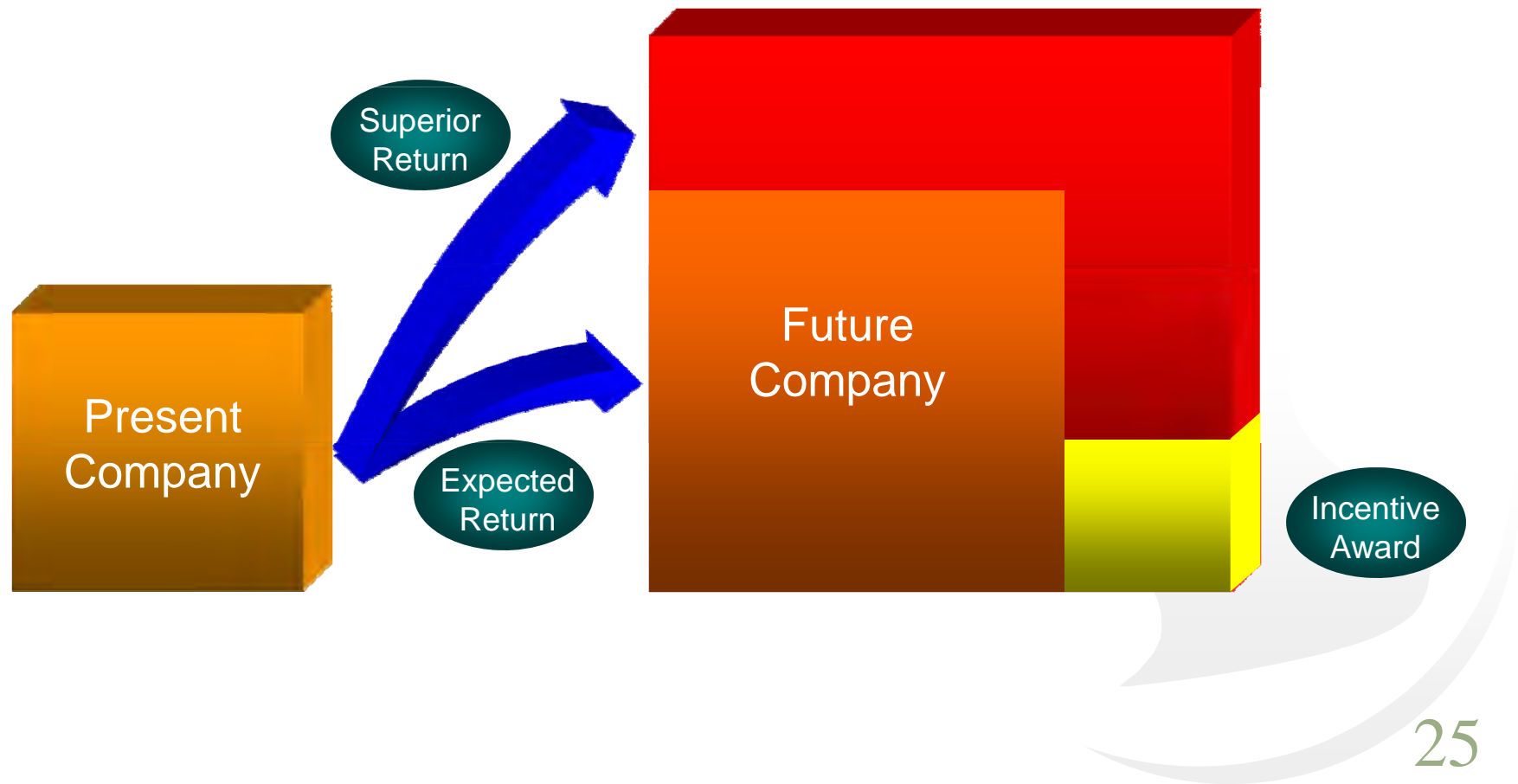


# How should we think about compensation as an investment?





# How should we think about compensation as an investment?





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



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



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 #2





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







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

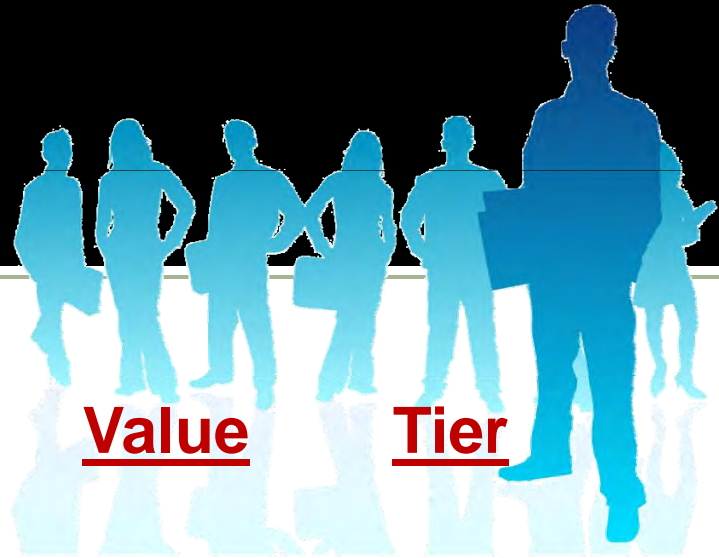
E.g., the highest tier (executive management) might have a target incentive of 80% of salary. The next tier of management might have a target of 60%.

# Rules of Thumb

## Incentive plan targets (combination ST/LT)

- 60-100% of salary for top managers
- 40-80% for 2<sup>nd</sup> 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



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



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:



Tier      Company      Department      Individual

1              75%              -              25%

2              25%              50%              25%



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



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



# FoxHill:



		<b>Base</b>	<b>Target</b>	<b>Superior</b>
<b>Co</b>	Rev Growth	12%	15%	18%
	Net Margin	16%	17.5%	19%

<b>Sales Dept</b>	Sales Vol/Cust	95,000	100,000	105,000
	Gross Margin	68%	72%	76%

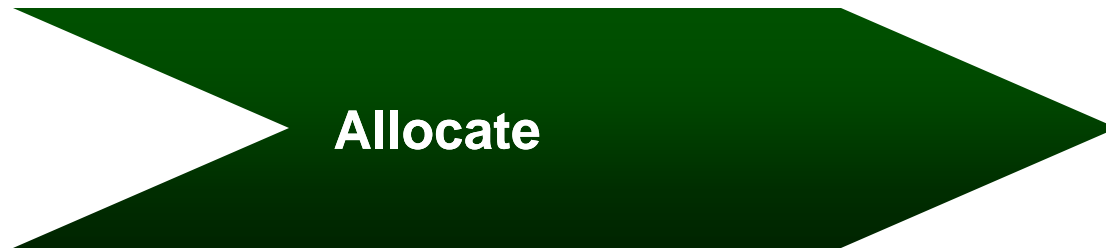
# Poll #3





When will the rewards be made available to the participants?





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%

## Measure

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

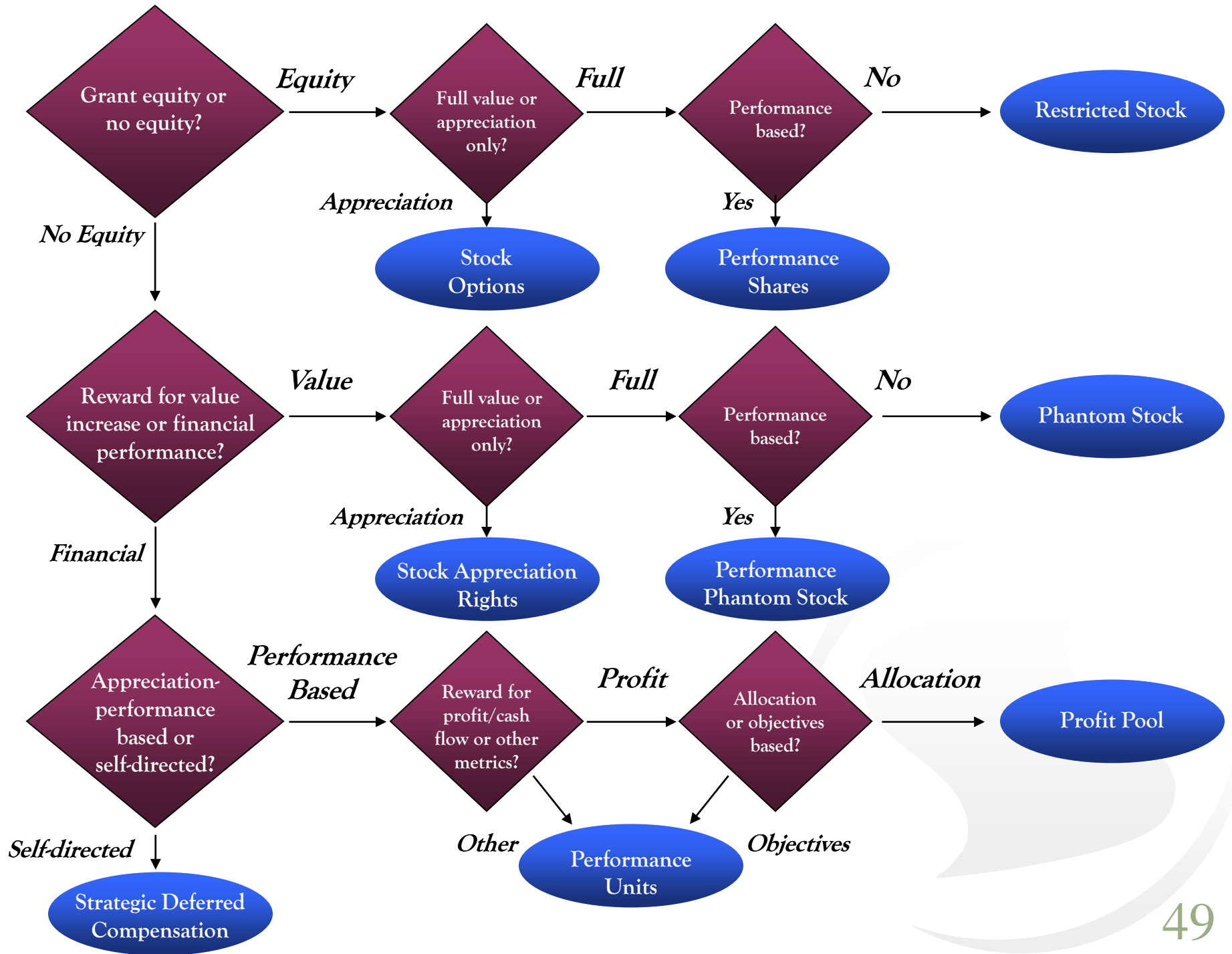
## Measure

**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





# FoxHill:



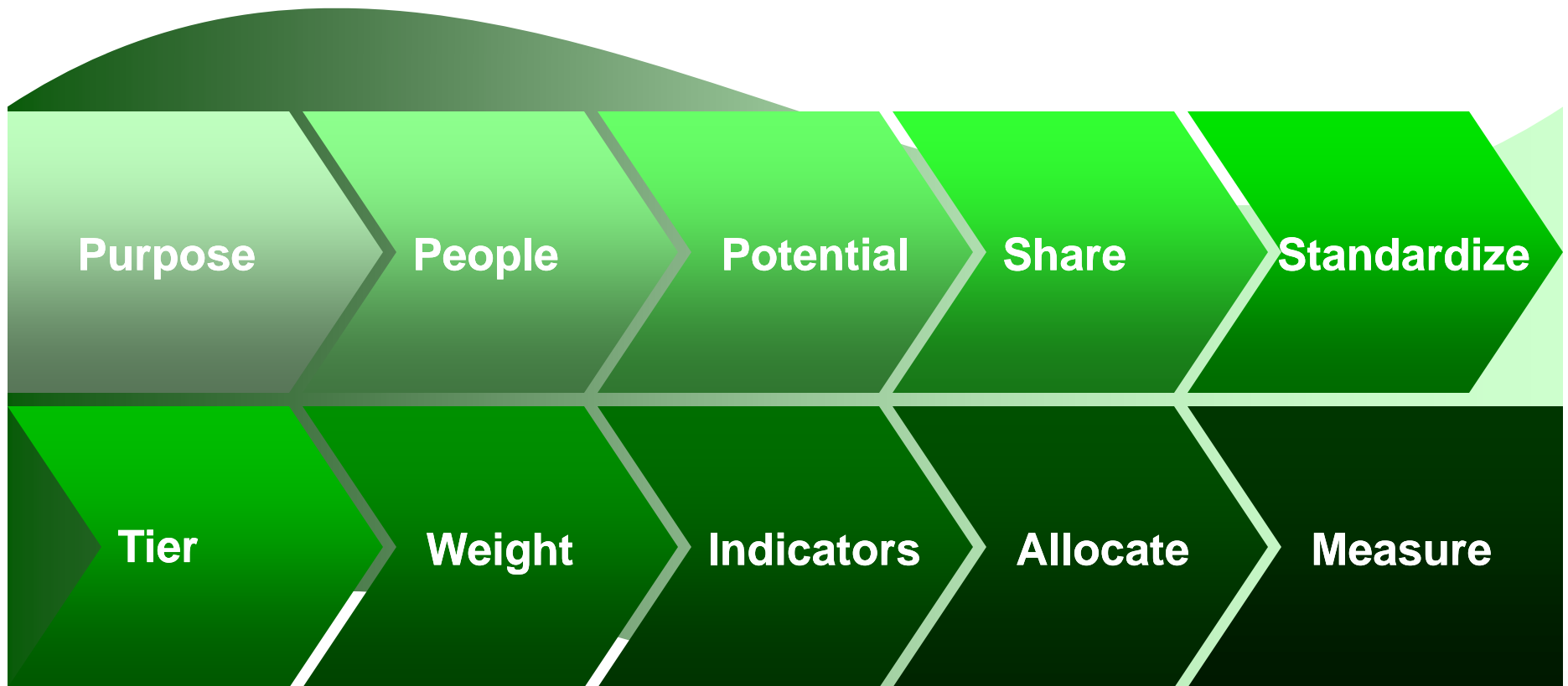
## Donna and Stan:

Goal—Reward for future performance (as opposed to giving full value today)

Plan—Phantom Stock Appreciation Rights

# Building an Incentive Plan

A Unique Process



# Next CPE Course:

## **“How Much is Enough Compensation... or is That Even the Right Question?”**

To be held on:  
**Thursday, June 16, 2011**

If you have three or members that can attend, we will make a specific presentation just for your firm on a mutually agreed upon date.  
(Indicate interest on survey.)

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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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