

The "Learn & Earn" Series™

May 16, 2013

The Future of Compensation: *What's Next and Why?*



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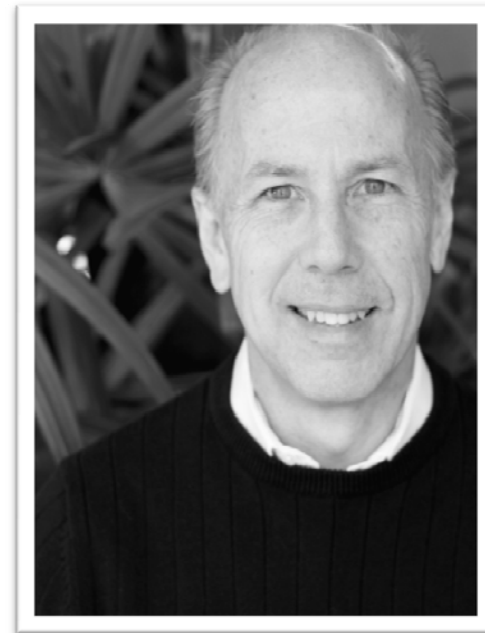
Today's Presenter:

Ken Gibson

Senior Vice President

(949) 265-5703

kgibson@vladvisors.com



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

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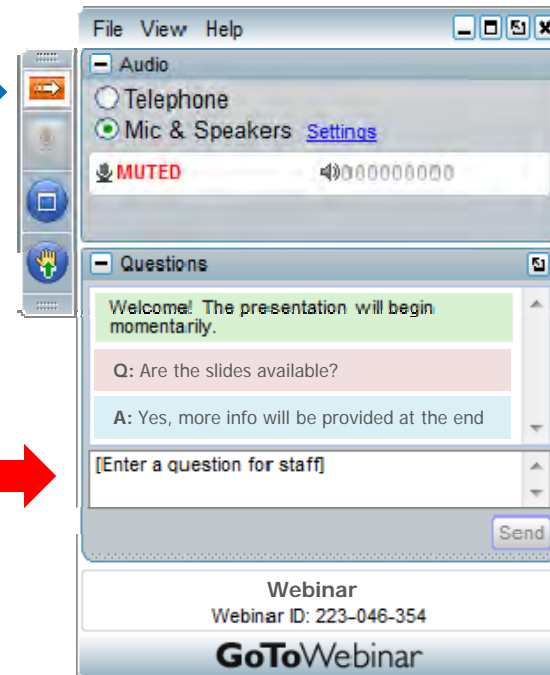
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Course Objectives

- Identify future pay trends in the context of business trends
- Provide insight into the compensation “landscape” in which pay strategies are being developed
- Understand how current and emerging business trends will impacting the market for talent
- Define the value propositions that will allow companies to compete for the “right” talent

Key Concepts



- Compensation trends will follow business trends
- The compensation landscape is divided into two philosophical approaches
- A performance framework is needed to determine which approach suits a company
- Both innovative, new strategies and tried and tested programs will need to be integrated into cohesive approach to pay
- It will be more about “how” someone is paid than “how much”

Key Questions

- Where are growth-oriented businesses headed?
- What kind of talent will those businesses need?
- What kind of value proposition will attract and retain that kind of talent?



Where Business is Headed

Focus on Innovation



The Business Landscape

The New Corporate Garage

...Apple's inventiveness is no anomaly; it indicates a dramatic shift in the world of innovation. **The revolution spurred by venture capitalists decades ago has created the conditions in which scale enables big companies to stop shackling innovation and start unleashing it.**



Harvard Business Review, September 2012

Three Trends Behind Shift

1. Increasing ease and decreasing cost of innovation create **short-term pressures for start-ups**; they get some success, then have to race against dozens of copycats with larger resources.
2. **Large companies** are embracing open innovation and **are integrating entrepreneurial behaviors** with their existing capabilities.
3. Although innovation has historically been product- and service-oriented, **it increasingly involves creating business models that tap big companies' unique strengths.**



What Type of Innovation?



Business Model Innovation

Whereas the inventions that characterized the first three eras were typically (but not always) **technological breakthroughs**, **fourth-era innovations are likely to involve business models**. One analysis shows that from 1997 to 2007 more than half of the companies that made it onto the Fortune 500 before their 25th birthdays—including Amazon, Starbucks, and AutoNation—were business model innovators.

What Kind of Talent?

“...**entrepreneurial individuals, or ‘catalysts,’** within big companies are using those companies’ resources, scale, and growing agility to develop solutions to global challenges in ways that few others...”



The Compensation Landscape

Workspan (World at Work)—
May 2012
The War for Stars

Two Approaches to Retaining
Employees

- Expansive
- Selective



Expansive Approach

Strives to retain virtually every employee under the theory that everyone is needed or they wouldn't be there. Largely egalitarian.

“Why upset our harmonious culture by creating an elite group that receives special treatment? All our employees are critical and perform well, and most are not going to leave.”



Expansive Approach

- Easy to administer
 - Managers don't have to identify exceptional contributors
 - Managers don't have to differentiate performance messages and rewards
- Does not usually support an organization's efforts to raise overall performance
- Discourages and disengages high performers

"Although I contribute more, I get treated like everyone else. Why bother?"

Selective Approach

Identifies, nurtures and works to retain the high performers at all levels of the organization.

Seeks to produce a cycle that, in the long term, will not only retain existing high performers, but create and attract more high performers and generate ever-improving standards of performance and organizational results.



Selective Approach

- Sets high performance standards
 - Appeals to high performers; high performers want to “win”
 - Organization wins through improved results and continued retention of high performers
- Acknowledges the company is in a war for stars
- Recognizes high performers always have an opportunity to move



Poll #1



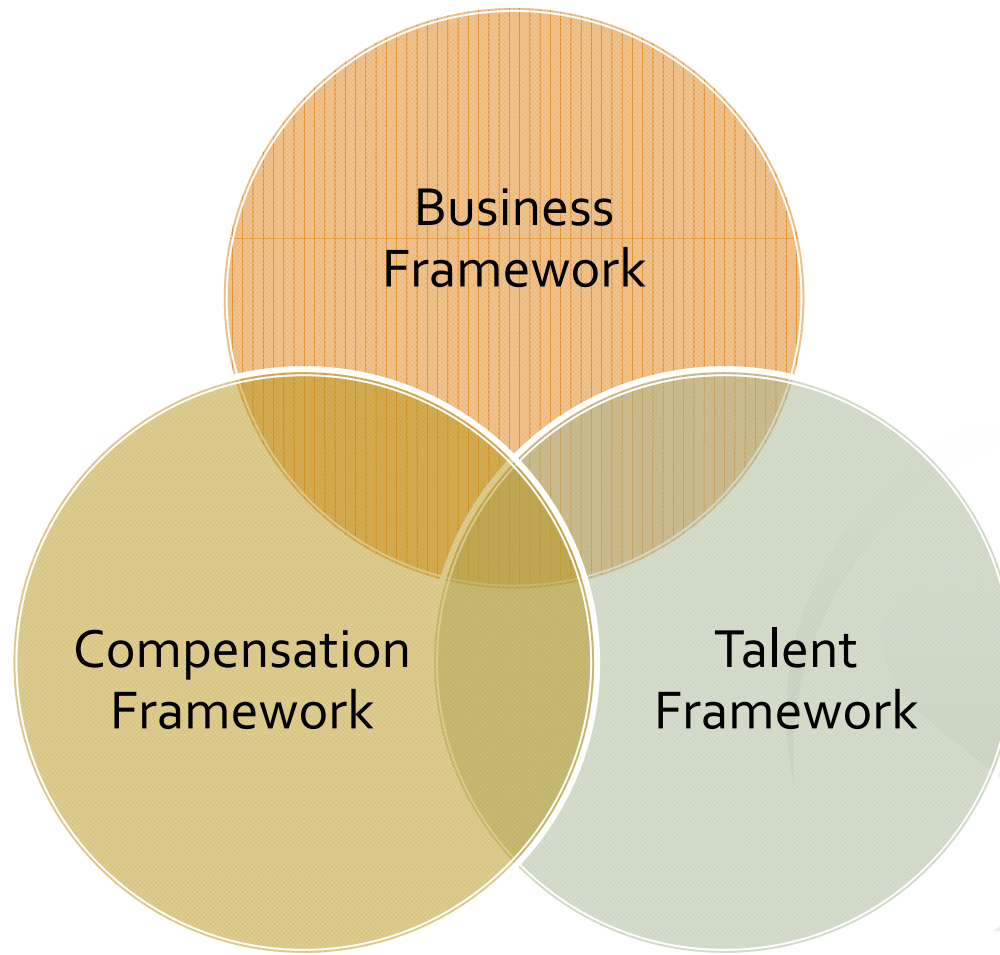
Given the present business landscape...

...which approach makes the most sense?

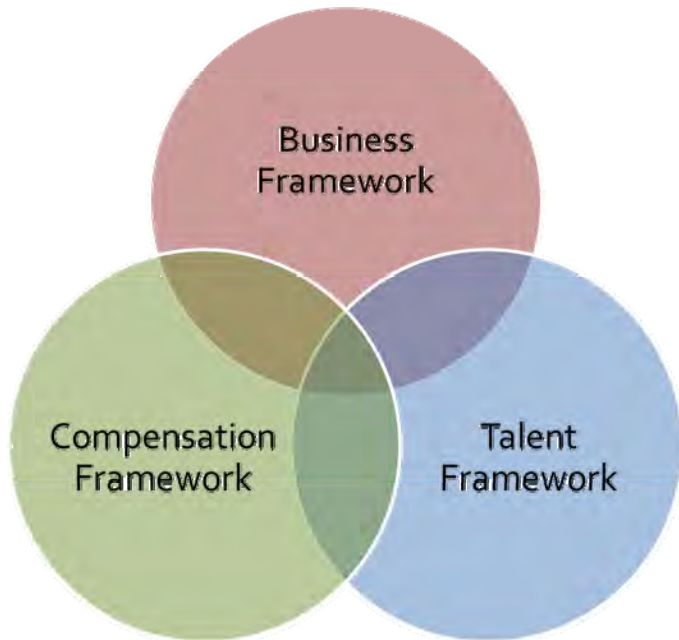
Expansive  **Selective**



Establish a Performance Framework



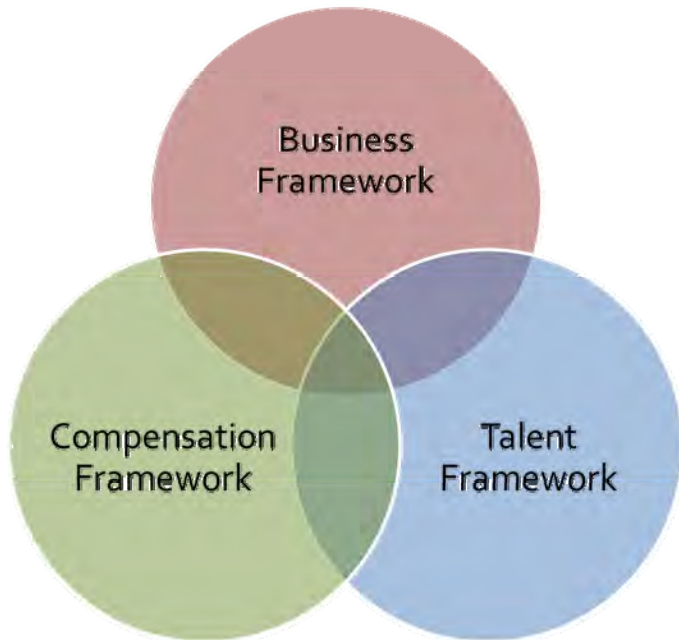
Establish a Performance Framework



Phase One—Business Framework

- Define Growth Expectations (Vision)
 - Key outcomes that must be achieved
- Define Business Model and Strategy
 - Performance Engine
 - How the company will compete
 - Where are growth opportunities?
- Identify Roles and Expectations
 - Establish Performance Criteria
 - Define “Success”

Establish a Performance Framework



Phase Two—Compensation Framework

- Establish a pay philosophy
 - Expansive vs. Selective—or Hybrid
 - Define what the company is willing to pay for
- Engineer a pay strategy
 - Structure
 - Mindset
- Adopt a “Total Rewards” Approach

Total Rewards Approach



Establish a Performance Framework

Phase Three—Talent Framework

- Identify Key Producers
 - Meeting “success” standards
- Identify Talent “Gaps”
 - Recruiting Strategy
- Communicate Expectations
 - Define success
- Communicate Rewards
 - Philosophy
 - Programs
 - Value Statement



Future Criteria for Pay Strategies

- Must attract top talent (particularly entrepreneur-oriented people)
- Must promote and reinforce innovation
- Must be flexible
- Must be tied to driving business value
 - Reinforce leverage points of virtuous cycle
- Must minimize guarantees
 - Share the risk
- Must provide large “upside” to key producers
- Must employ value creation and sharing philosophy and practices



Poll #2



Future Pay Trends in Business

- Performance Agreements
- Opt-In Plans
- Internal Venture Capital
- Long-Term Value Sharing Plans



Performance Agreements



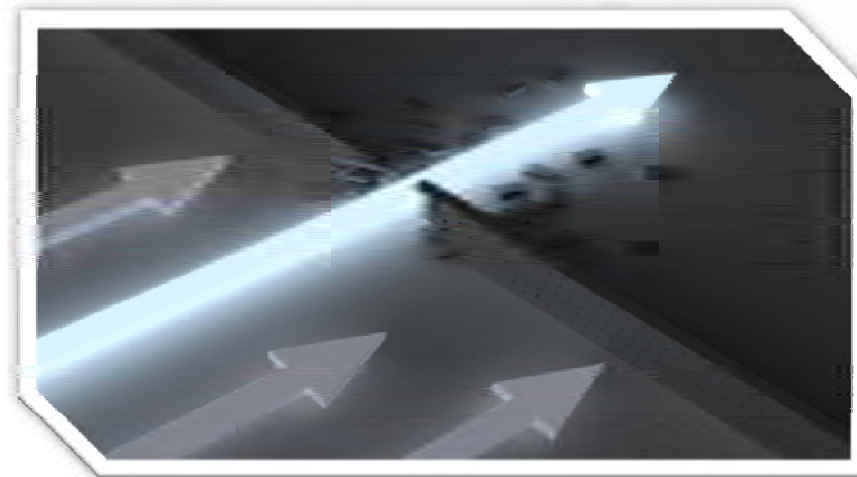
Prominent Media Company

- High performers excluded from company's "egalitarian" profit sharing-type incentive plan
- Negotiate annual "deal" with COO & CFO
- Deal memorialized on a "deal sheet"
 - Defines financial, operational & leadership expectations
 - Defines value of the award that could be generated
- Quarterly self-evaluation against performance expectations with COO & CFO

Performance Agreement

Outcomes:

- Threshold for compensable performance is very high
 - Small or even \$0 payouts can occur
- High-risk, high-reward—high upside
- Self-evaluations create a mentoring environment
- High performers think and feel like owners in the company's success
- Because no competitors offer this opportunity, high performers rarely leave



Opt-In Plans



Start-Up Environment

- Opt for:
 - “Higher” salary plus modest incentives
 - “Low” or no salary and high upside through short and long-term value sharing
- Opt-In payments tied to a revenue or profit-sharing formula
- Volatility: payments lowered &/or deferred
 - Deferred payouts made when economics permit
- Opt-In periods may differ
 - Quarterly, semi-annual, annual

Opt-In Plans

Outcomes

- Employees feel more in control
- Owners can limit guaranteed payouts
- Highly flexible—can adjust to rapidly & frequently changing economics
- Provides a “shared” entrepreneurial experience
- Promotes an ownership mindset
- “Self-identifies” key performers



Internal Venture Capital



Highly Entrepreneurial Approach

- Most common in larger organizations
- Venture capital account established
- Criteria for access is defined
- Innovative ideas “funded” and financed through venture capital account
- Performance criteria set
- Value sharing plan tied to performance criteria
- Performance agreements or “opt-in” comp plans sometimes used

Internal Venture Capital



Outcomes

- Attracts entrepreneurial employees
- Creates a “start-up” environment within larger organization
- Places a large emphasis on innovation
- Creates ability to move quickly with new ideas
- Allows mini-entrepreneurs to leverage resources and scale of larger organization

Long-Term Value Sharing Plans

Broad Application

- Used in every size organizations
- Can be tied into any of the previous approaches
- Creates “wealth multiplier” mindset
- Ties employees to vision and business plan of the company



Why Long-Term Value Sharing Matters

1. Value sharing attracts the best talent and magnifies results
2. Value sharing plans (effectively designed) reinforce the company's business model
3. Value sharing protects against bad profits and promotes good profits
4. Value sharing promotes an ownership mindset
5. Value sharing builds trust and accelerates results



Value Creation and Sharing

What Does it Really Mean?

Case Study

(Source: Chief Executive Magazine, May/June 2012 Edition)



**Underwriters
Laboratories**

Keith Williams



Pay the Company First



“Basically, up to the company’s operating profit target, all of the profits go to the company; and only after that target is met, do we start funding the incentive pool.”



Example: If UL’s target is \$80 million--

- 100% of first \$80 in profit goes to company
- The next \$20 million goes to the incentive pool
- From there on, 50/50 between company & incentive pool

Pay the Company First



Create economic value beyond that produced by the company's capital at work and we'll share it with you.
UL's definition of value creation.



Pay the Company First



Once value creation is defined, compensation can follow a formula for sharing value in a way that aligns key producers with the company's business plan and priorities.

Poll #3



Select the Right Plan Type

Phantom Stock
Option

Restricted Stock

Profit Pool

Performance Shares

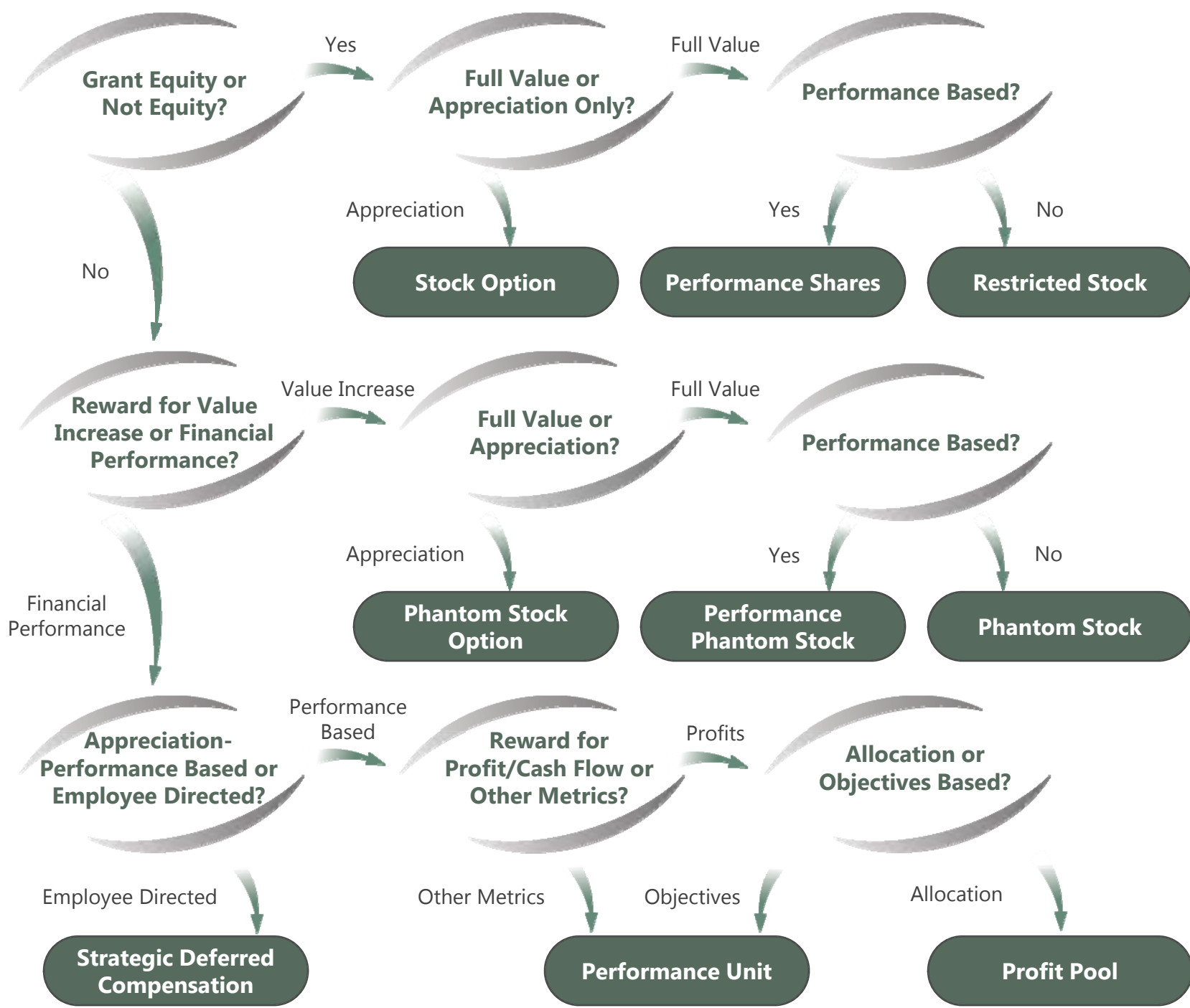
Phantom Stock

Strategic Deferred
Compensation

Performance
Phantom Stock

Stock Option

Performance Unit



The CEO Mindset



PwC's 2012 Global CEO Survey

(reported in Chief Executive Magazine, November/December 2012 Edition)

- Just 12% of CEOs finding it easier to hire today
- 25% reported being unable to pursue a market opportunity or being forced to cancel or delay strategic initiatives because of talent challenges
- 31% feared they would not be able innovate effectively going forward because of skill shortages
- More CEOs plan on changing their talent management strategies this year than adjusting approaches to risk or capital investment—or any other corporate strategies

Key Statistic

A majority of CEOs surveyed by PwC—68% global; 71% U.S.—wish they could spend even more time than they do focused on developing the leadership of their business and their talent pipeline.



Key Implication

In the future, it's likely that while the human resources chief will report directly to the CEO, it is the latter who will have to drive strategy.

"The biggest mistake CEOs can make is to delegate the talent strategy to HR. HR is the enabler of the strategy, but CEOs need to think of themselves as the chief talent officer of their organizations." (Ed Boswell, PwC's U.S. advisory services people and change practice leader.)



Key Conclusions



- Businesses need to innovate to remain competitive
- Companies need to attract “entrepreneurial talent” to meet innovation demands
- Counter intuitively, marketplace has a scarcity of *skilled* talent
- Businesses will have to compete for *premier* talent
- Innovative employee value propositions will be needed to compete
- CEOs must become the chief talent officer of the company

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“What do you do When Your Employees Act Entitled?”

To be held on:
Thursday, June 20, 2013

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Next Public Webinar:

“Compensation and Succession Planning: an Integrated Approach”

To be held on:
Tuesday, May 21, 2013

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FOLLOW THE RIGHT PROCESS
Success in compensation development depends on a process that addresses both structural issues

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Listen to experts. Here's the latest thinking of two of VisionLink's growth strategy leaders. Tom

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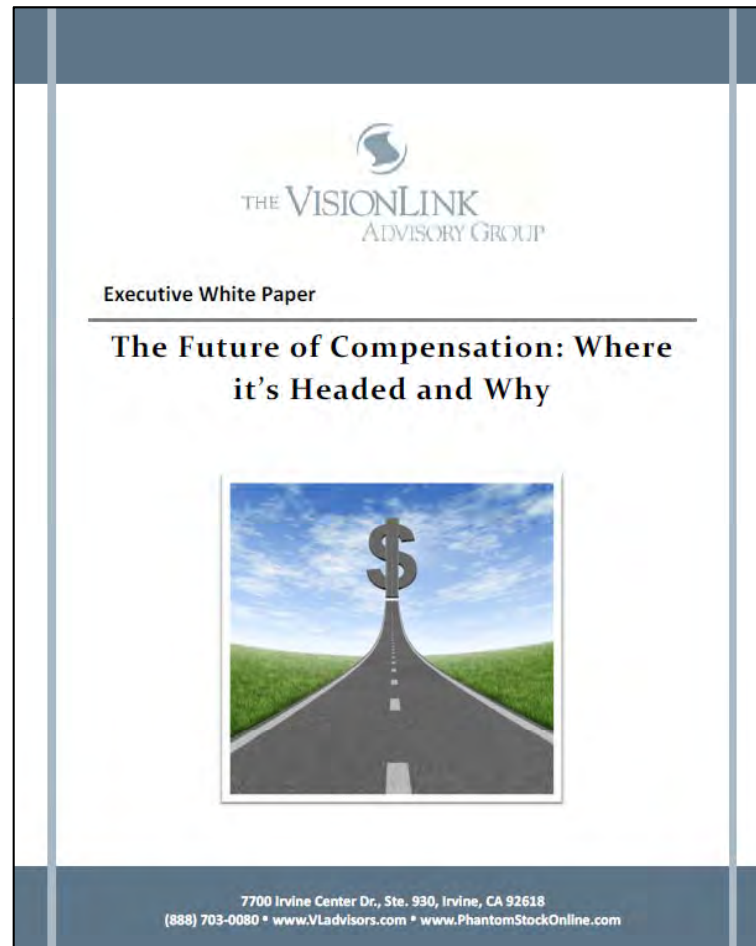
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Ken Gibson

Senior Vice President

(949) 265-5703

kgibson@vladvisors.com



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