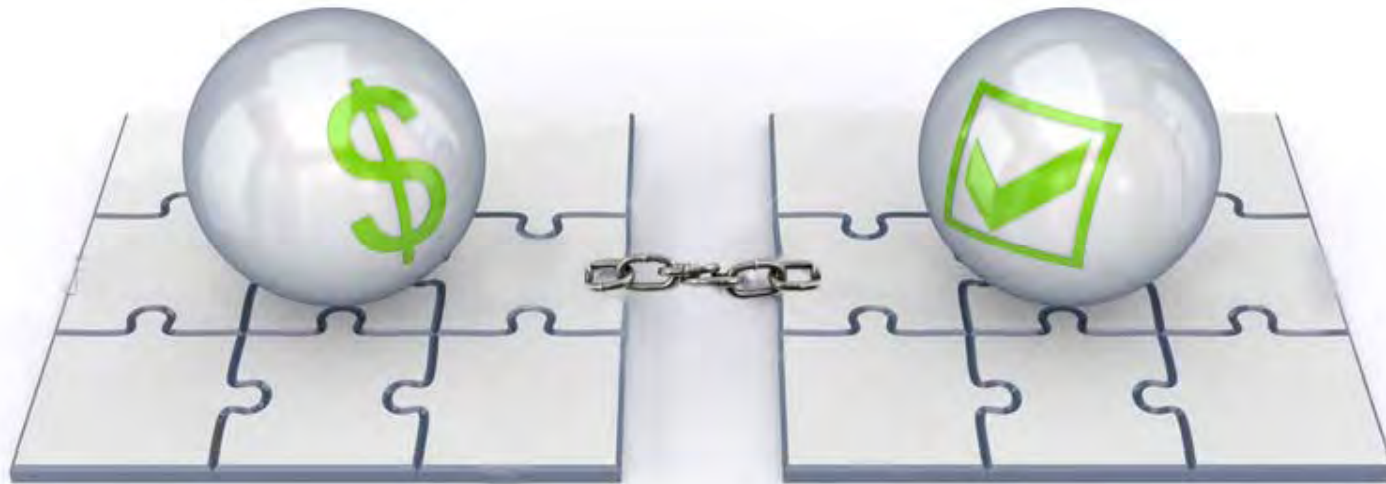


April 22, 2014

How to Effectively Link Compensation to Results





THE VISIONLINK
ADVISORY GROUP

Today's Presenter:

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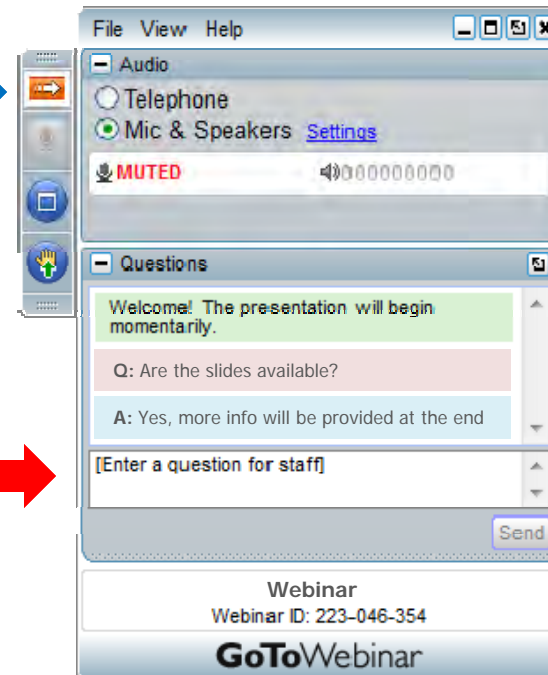
kgibson@vladvisors.com



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

To open or close the control panel: 
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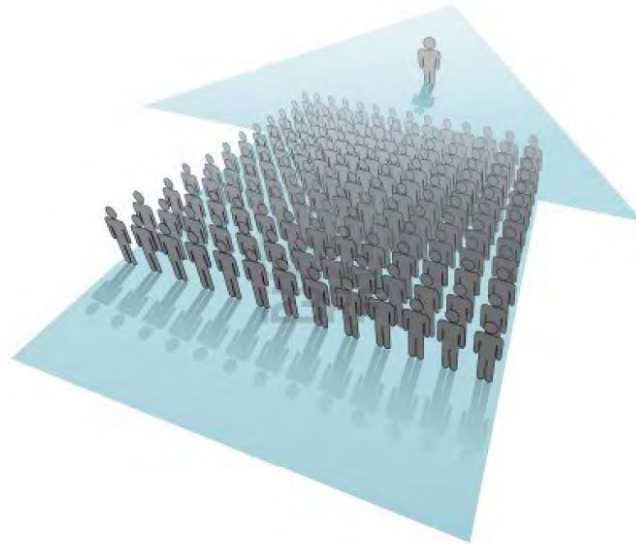


Key Question

Is “Pay for Performance” just a nice theory or does it translate into real results for actual businesses?



Setting Expectations



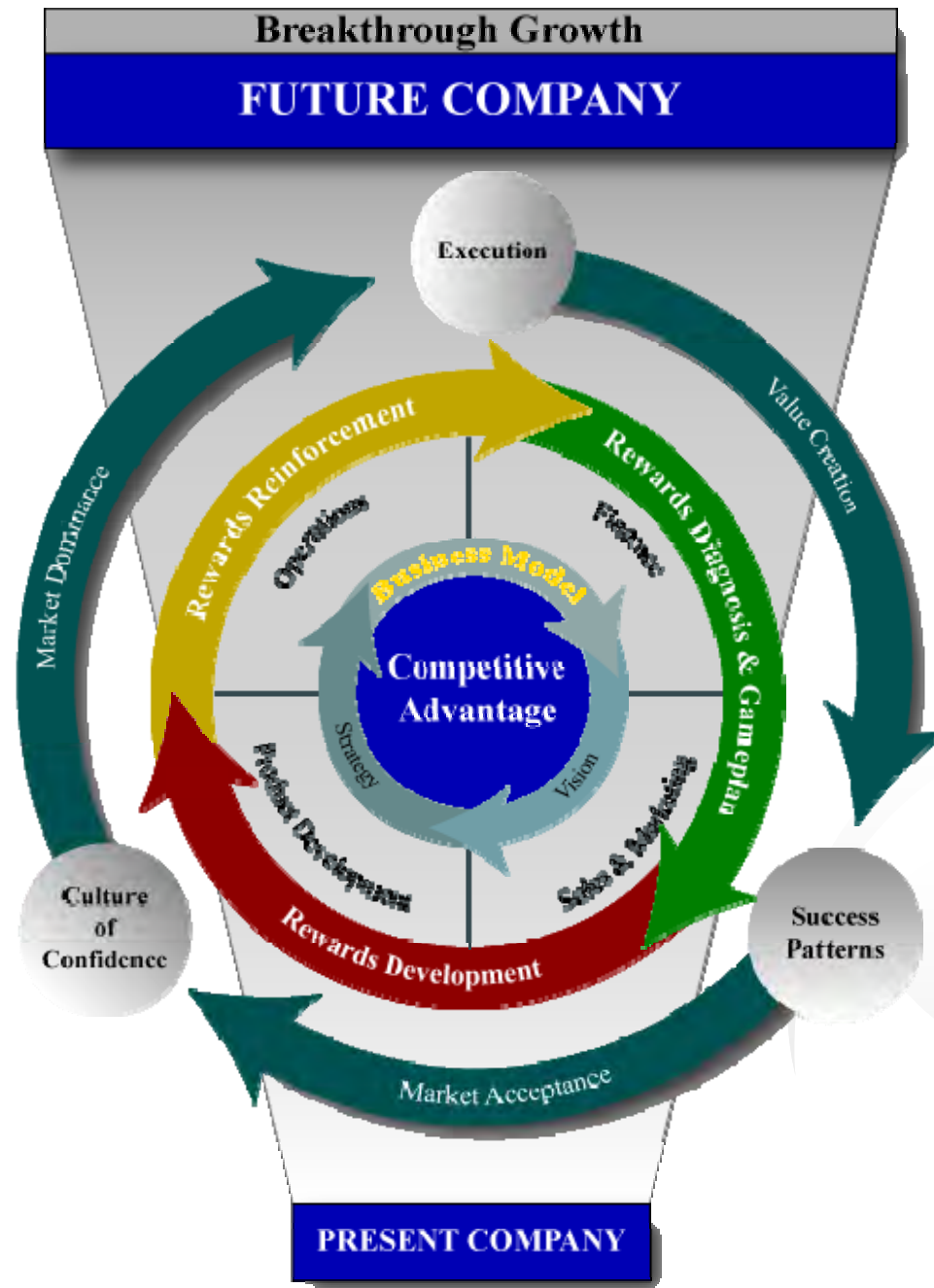
If you implement a new compensation strategy—and it “works”—what does that mean? What’s different or better in the company when rewards are “working”?

If it is linked to results it should...

1. Solve a problem
2. Remove a barrier
3. Encourage a superior outcome
4. Reinforce a pattern or cycle
5. Focus efforts

Unleash Growth





Profile Cases

- Plumbing Supply Company
- For Profit Education Company

Case Study #1: Plumbing Supply Company

\$180 million in annual revenue
500 employees

Primary Growth Barriers

- Inability to attract and retain premier talent
- No broad-based commitment to strategic goals
- Productivity per employee was sub-par



Primary Compensation Issues

- Pay did not reinforce the company's growth goals and strategy
- No employee stake in optimizing future values
- Short-term focus—salary plus bonus



Barrier By-Products

- Employees pulling company in wrong direction strategically
- Company “stuck” at a performance threshold
- No “shared ownership” in the future

CONSEQUENCES

Solution

Phantom Stock Plan—provided meaningful upside potential for key people

- Established incentive “budget” based on base, targeted and superior performance levels
- Established a formula value for phantom shares that could be calculated and communicated quarterly
- Employees granted shares on an annual basis at full value
- Established payout periods every 5-6 years
- Instituted internal valuation process so that changes in value could be communicated to employees
- Communication plan
 - Regular updates on key value indicators
 - Enable employees to estimate the value of their value today and in the future

Intent

- Protect and reinforce shareholders' vision and interests
- Keep employees "interested" by helping them realize payouts as company succeeds
- Create alignment between shareholder and employee wealth accumulation goals
- Create a higher sense of stewardship among employees



Real Life Results

Over a Five-Year Period

- Greater focus (among employees) on key growth indicators
- Strengthened recruiting message and ability to attract top talent
- Turnover reduced by 35-40%
- Employee survey indicated a significant improvement in engagement and ownership mentality
- **Company earnings tripled** (in less than five years)

Case Study #2: For Profit Education Company

\$200 million in annual revenue
400+ employees

Primary Growth Barriers



- Flat revenue growth
- Attracting good not great talent
- No alignment between shareholder and employee goals
- Low survey scores related to “mindset” issues—employees not fully engaged

Primary Compensation Issues



- Current compensation programs not synchronized with company short or long-term goals
- Bonus plan deemed an entitlement
- No long-term plan tied to growing shareholder value

Barrier By-Products

- Compensation viewed as an expense to be “contained” rather than an investment to be allocated
- Innovation and creativity were not evident
- Tension between shareholders and employees

CONSEQUENCES

Solution—Part One

Compensation GamePlan

- Reviewed all elements of existing compensation programs
- Interviewed ownership and key employees
- Performed market pay assessments
- Established a compensation philosophy statement
- Provided key recommendations for changes in existing compensation structure including short-term incentive plan
- Recommended establishment of a Stock Appreciation Rights (SAR) plan for key people
- Created mechanism for initiating and reviewing compensation strategies

Solution—Part Two

Stock Appreciation Rights Plan--provided meaningful potential long-term value for key employees

- Established participation level at 25-30 key employees
- Established targeted budget to share 8-10% of the increase in share value from plan inception
 - Each employee's value expressed as a fixed number of units
 - The higher the earnings value the greater the participation (payout commitment)
- Instituted internal valuation process so that changes in value could be communicated to employees
- Communication plan
 - Regular updates on key value indicators
 - Enable employees to estimate the value of their value today and in the future
- Established executive benefit guidelines for all key executives

Intent

- Create a guiding philosophy for making compensation decisions
- Reduce the sense of entitlement
- Create a predictable and “budgetable” strategy for the compensation investment
- Create more “stability” in guaranteed and other short-term compensation
- Create alignment between shareholder and employee wealth accumulation goals
- Create a higher sense of stewardship among employees

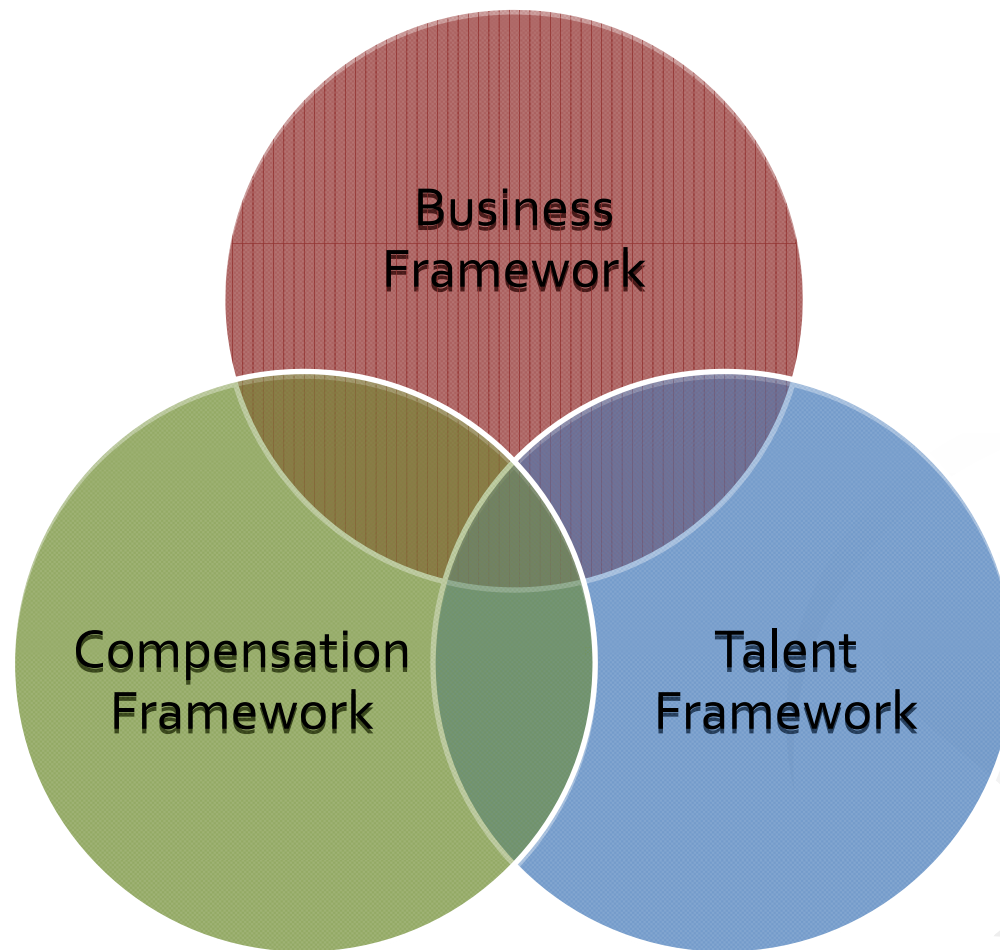


Real Life Results

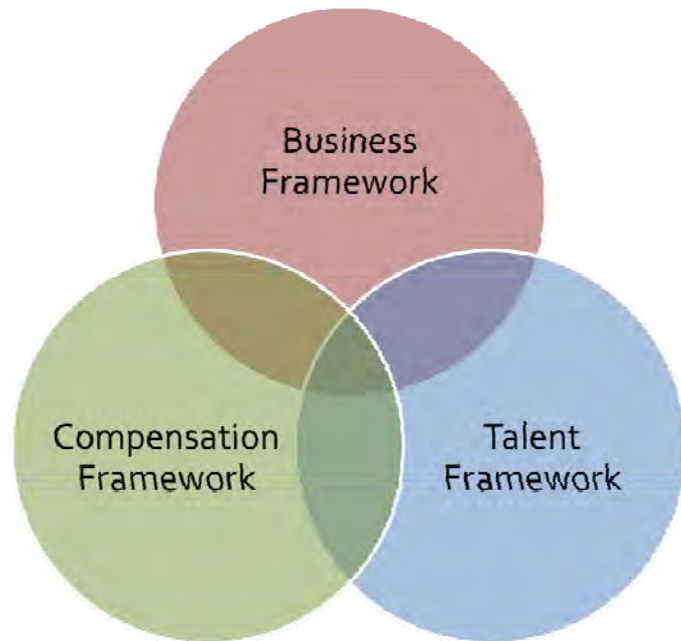
Over a Five-Year Period

- Greatly reduced sense of entitlement among employees
- Stronger recruiting message and higher caliber employees attracted to the company
- Greater focus (among employees) on key growth indicators
- Employee survey indicated a significant improvement in engagement and ownership mentality
- **Company share value grew at a compounded rate of 75%**

Establish a Performance Framework



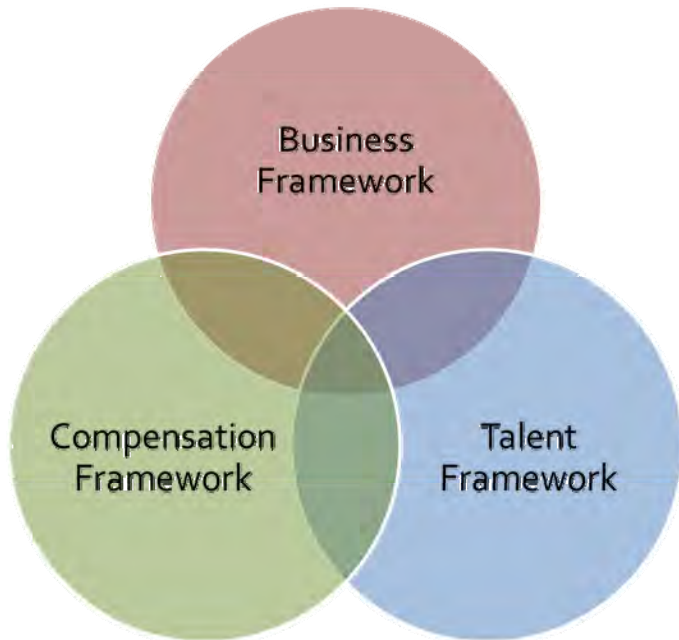
Establish a Performance Framework



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



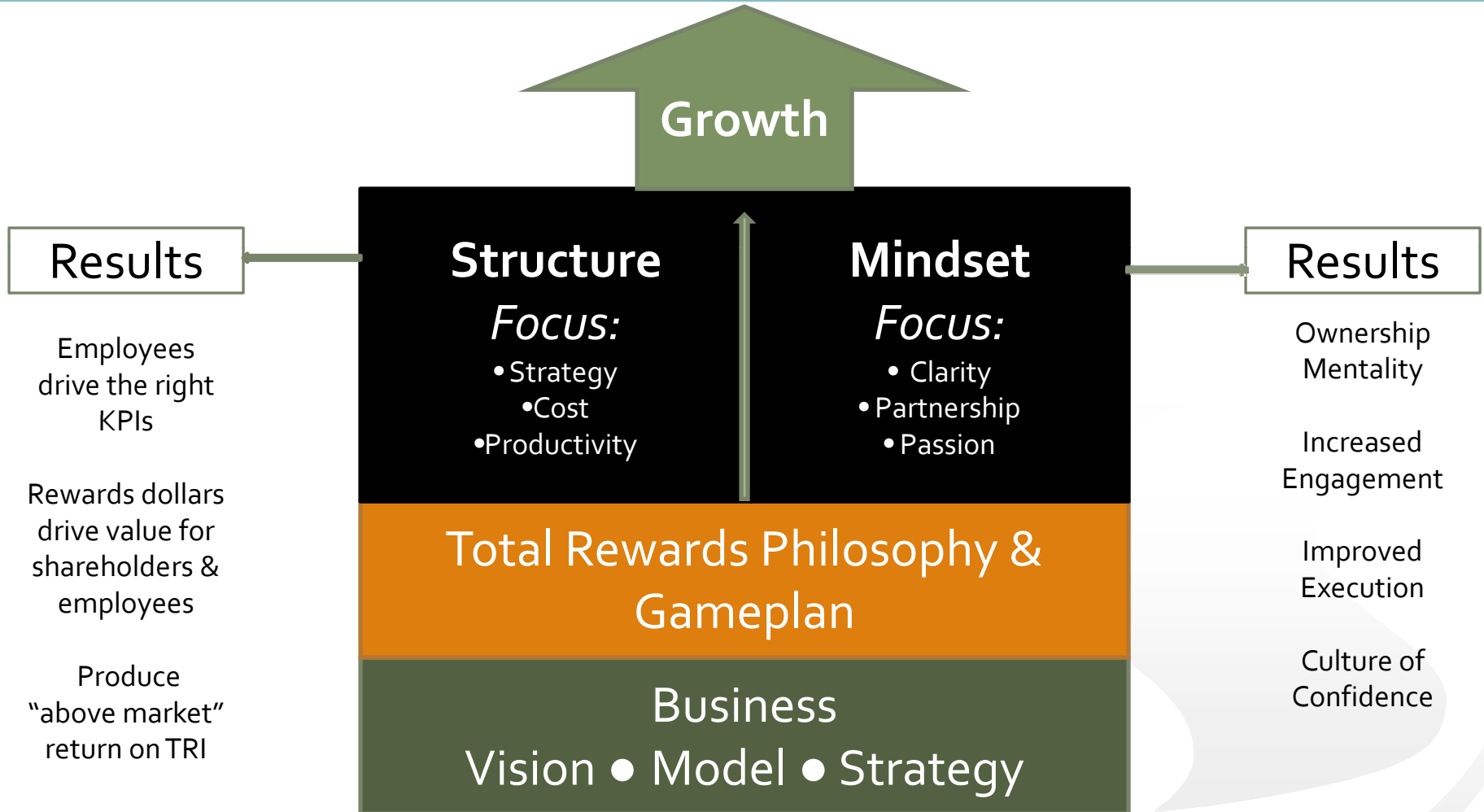
Phase Two—Compensation Framework

- 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



The Compensation Framework



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

Key Differentiator

View of Business Growth:
Wealth Multipliers vs. Wealth Creators



Slightly different mindsets

Wealth Creators

- Profitability focus
- Recruit to skills and experience
- Comp is an important expense to be managed
- Salaries and total pay should be “at market”
- “Pay-for-performance”

Wealth Multipliers

- Growth focus
- Recruit premier talent that relates to the culture
- Comp is an investment that should produce a growing return
- Salary benchmarking can be helpful but pay should be tied to positional value
- “Share value with those who create it”

A Difference in Perspective

Wealth ***Multipliers*** fundamentally view the role of compensation differently than Wealth ***Creators...***

Wealth ***Multipliers*** understand that multiplying the economic value for all stakeholders increases the likelihood their own wealth will increase

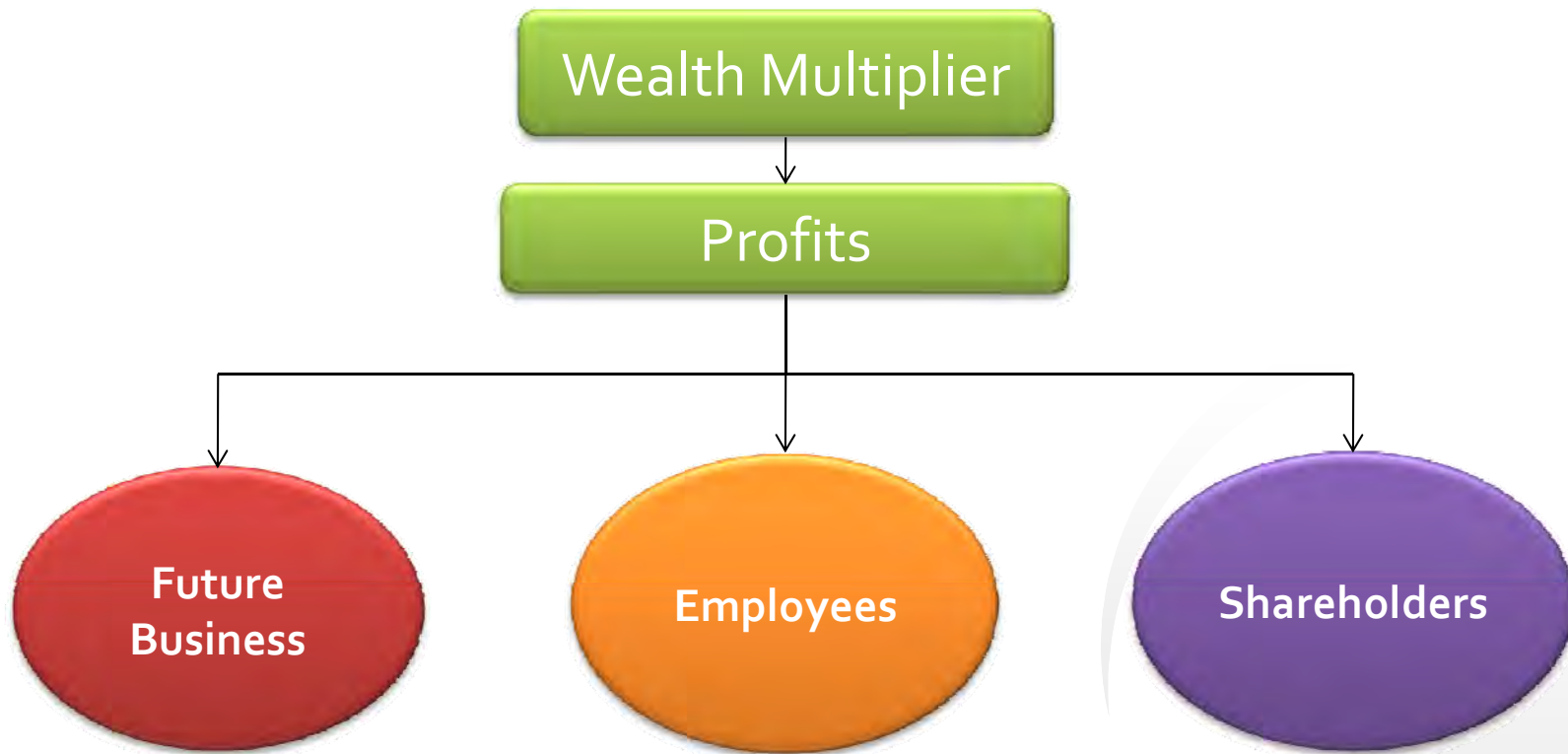


Wealth Multipliers and Profit

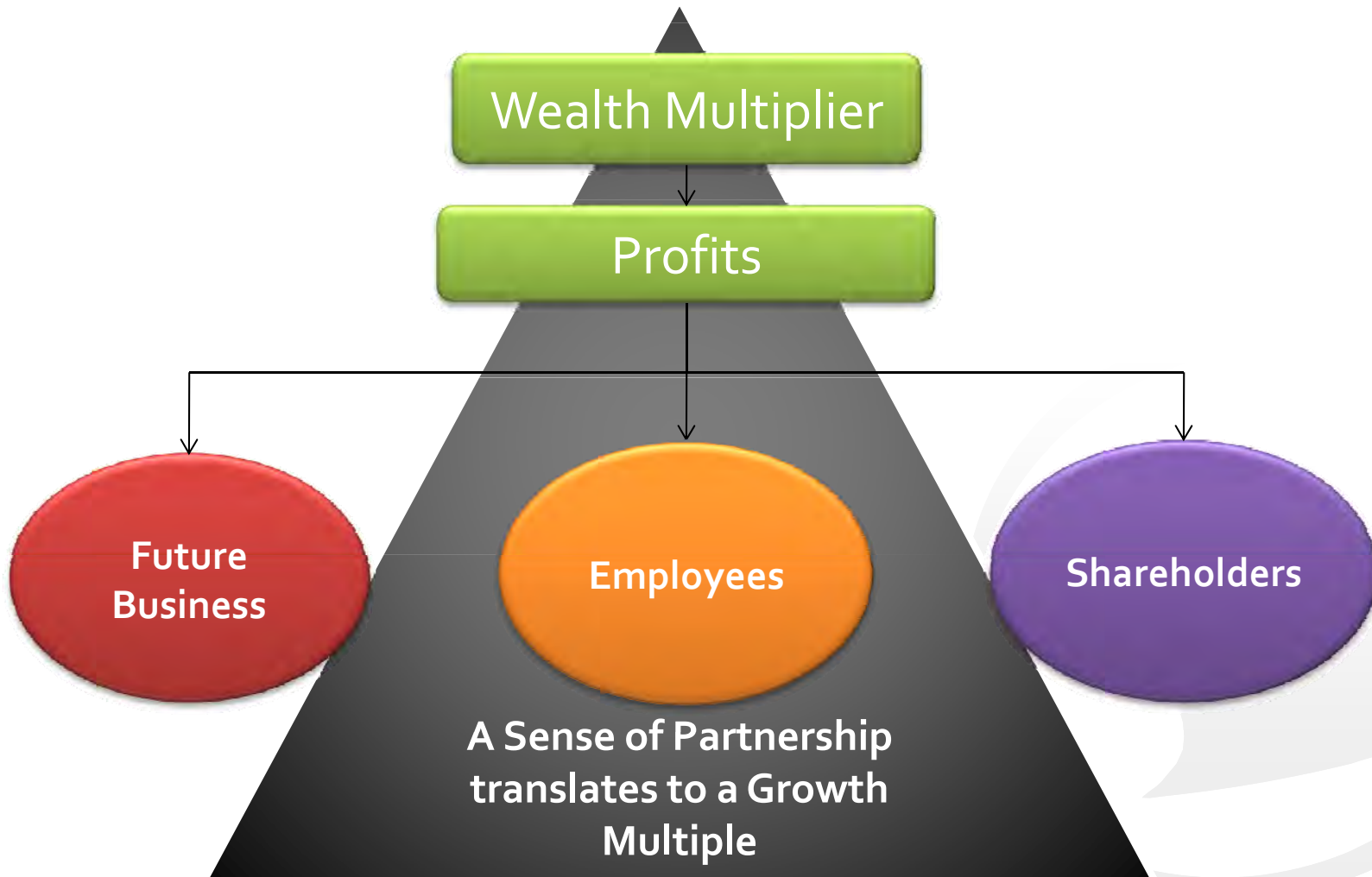
What is the Value, Role and Application of Profit to a Wealth Multiplier?



The Value of Profit



The Value of Profit



Why Growth?

- What level of growth do you seek?
- What will that growth support?
- What will increased profits allow you to do that you're not doing now?
- Do you want to be a *Wealth Creator* or *Wealth Multiplier*?



Compensation Strategy

Systematic way of investing profits in employees in a way that multiplies productivity and growth. In the process, create a sense of partnership with those on whom our future growth depends.



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.” (Keith Williams, CEO)



**Underwriters
Laboratories**

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



ROTRI™

Return on Total Rewards Investment™

Measuring the return on your compensation investment



How much is the Total Rewards Investment?

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



ROTRI™ Example:

Capital Account	\$ 20,000,000
Cost of Capital	12%
Capital Charge	\$ 2,400,000
Operating Income	\$ 10,000,000
Productivity Profit	\$ 7,600,000
Total Rewards Investment	\$ 25,000,000
ROTRI™	30.4%

(ROTRI™ = Productivity Profit/Total Rewards Investment)

ROTRI™ Example:

Capital Account	\$ 20,000,000
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<u>Productivity Profit</u>	<u>\$ 7,600,000</u>
Total Rewards Investment	\$ 25,000,000
ROTRI™	30.4%

Variable Pay Plans (Value Sharing) are financed from Productivity Profit

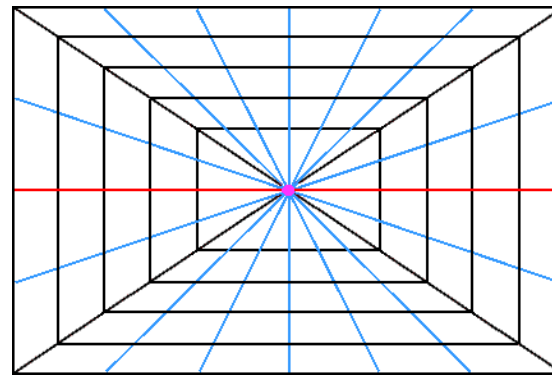
Current Equity Value	EOY	10% GR (Threshold)	11% GR	12% GR	13% GR	14% GR	15% GR
25,000,000	1	27,500,000	27,750,000	28,000,000	28,250,000	28,500,000	28,750,000
	15	104,431,204	119,614,737	136,839,144	156,356,759	178,448,449	203,426,541
	Incremental increase in value		15,183,533	17,224,407	19,517,615	22,091,690	24,978,091
	Cum Value Increase Above Threshold		15,183,533	32,407,940	51,925,555	74,017,245	98,995,336
	% Shared		10%	15%	20%	25%	30%
	\$ Shared		1,518,353	4,861,191	10,385,111	18,504,311	29,698,601
	Net Increase for SH		13,665,180	27,546,749	41,540,444	55,512,934	69,296,736
	New SH Value		118,096,384	131,977,953	145,971,648	159,944,138	173,727,940
	IRR		10.9%	11.7%	12.5%	13.2%	13.8%

Tally Sheet

Year	1	5	10
Value Created for Shareholders	\$ 5,000,000	\$ 35,000,000	\$100,000,000
Cash Incentives Paid to Employees	\$ 350,000	\$ 2,650,000	\$ 9,750,000
LTIP Vested Value for Employees	\$ 0	\$ 1,950,000	\$ 5,680,000
Total Paid or Vested for Employees	\$ 350,000	\$ 4,600,000	\$ 15,430,000
% of Value Created Paid or Vested	7%	13%	15%

Proper View of Compensation

- Strategic Tool
- Not One Dimensional, it's Multi-Faceted
- Define:
 - Role
 - Outcomes
 - Financial Partnership
- Communicate:
 - What's Important
 - Priorities



Eight components of pay

Benefits

- Core benefits
- Executive benefits
- Qualified retirement plans
- Supplemental retirement plans

Compensation

- Salary
- Short-term incentives
- Long-term incentives (cash)
- Long-term incentives (equity)



An Aligned Compensation Strategy

Salaries

Competitive with market standards?
Tied to strong performance management process (merit)?
Managed within a flexible but effective structure?

Performance Incentives

Tied to productivity gains?
Clear, achievable and meaningful?
Self-financing?

Sales Incentives

Challenging yet achievable?
Reinforcing the right behaviors?
Differentiating your offering?

Growth Incentives

Linked to a compelling future?
Supporting an ownership mentality?
Securing premier talent?

Core Benefits

Responsive to today's employee marketplace?
Allocating resources where most needed?
Evaluated to eliminate unnecessary expense?

Executive Benefits

Flexible enough to address varying circumstances?
Communicating a unique relationship?
Reducing employee tax expense?

Qualified Retirement Plans

Giving employees an opportunity to optimize retirement values?
Operated with comprehensive fiduciary accountability?
Avoiding conflicts and minimizing expenses?

Nonqualified Retirement Plans

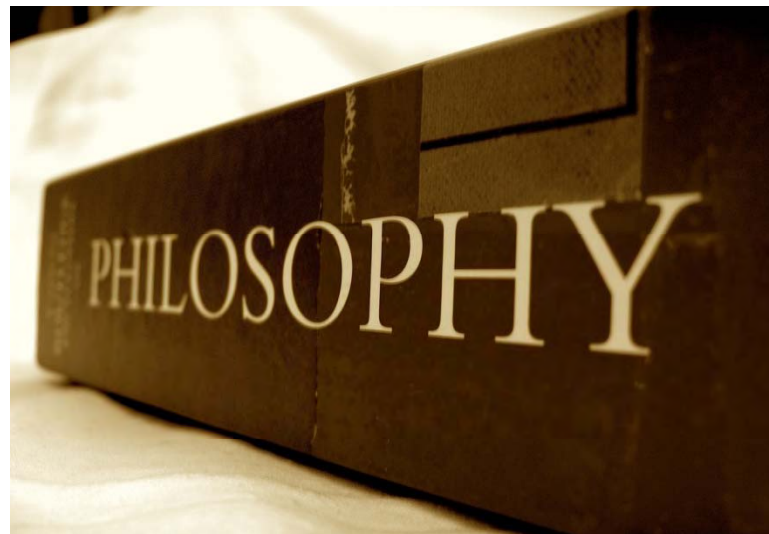
Optimizing tax-deferral opportunities?
Aligning long-term interests of employees with shareholders?
Structured to receive best possible P&L impact?



Form of Pay	Purpose	Standard	Investment	ROI
Salaries	Provide for the current cash needs of our executives	40-50th percentile for peer group	\$500,000	Achieve ROA standard of 0.75%
Short-term Incentives	Enhance current cash payments to executives for achieving top and bottom line annual goals	30-40% of base salary	\$168,000 (Target)	15% revenue growth and 12% margin
Long-term Incentives (Cash)	Retain execs; focus them on long-term earnings growth; align with shareholder interests; meet wealth accumulation needs	15-20% of base salary	\$84,000 (Target)	Long-term growth in earnings (double earnings = share 13% of new value)
Long-term Incentives (Equity)	Retain execs; focus them on long-term earnings growth; align with shareholder interests; meet wealth accumulation needs	15-20% of base salary	\$84,000 (Target)	Long-term growth in earnings (double earnings = share 13% of new value)
Core Benefits	Meet basic security needs of the executives	50th percentile for peer group	\$25,500	ROA of 0.75%
Executive Benefits	Enhance basic security needs and meet market standards for perquisites	50th percentile for peer group	\$24,000	ROA of 0.75%
Qualified Retirement	Provide wealth accumulation opportunity for executives	40th percentile (3% of salary)	\$15,000	ROA of 0.75%
Supplemental Retirement	Strengthen rewards value proposition to help recruit and retain executives; meet wealth accumulation needs	30th percentile compared to banks that have plans	\$135,000	ROA of 0.9%

Fundamental Philosophy

Fair salaries, strong benefits, great upside for short- and long-term growth and profitability. We share the economic value our employees help create.



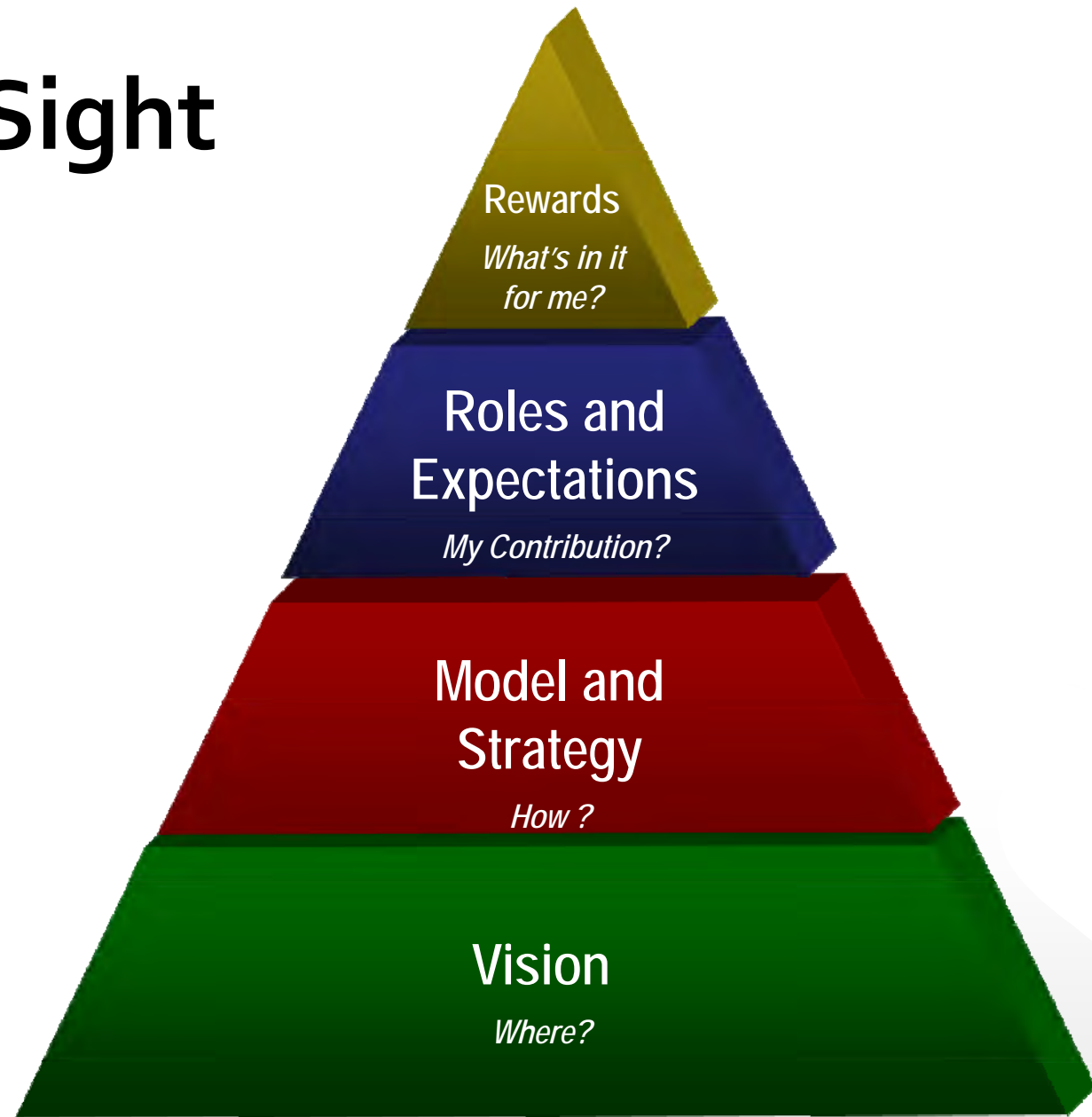
Employee Value Statement

Year	1	2	3	4	5
5-Year Plan Achievement Level	100%	100%	100%	100%	100%
Current and Inflated Salary	\$ 160,000	\$ 166,400	\$ 173,056	\$ 179,978	\$ 187,177
Cash Incentives Paid at Target	\$ 64,000	\$ 66,560	\$ 69,222	\$ 71,991	\$ 74,871
LTIP Vested Value at Year End	\$ -	\$ 74,000	\$ 186,000	\$ 311,000	\$ 448,000
Retirement Plan Value (at 7%)	\$ 17,120	\$ 36,123	\$ 57,169	\$ 80,428	\$ 106,086
Total Cash Received	\$ 224,000	\$ 232,960	\$ 242,278	\$ 251,970	\$ 262,048
Total Wealth Accumulation	\$ 17,120	\$ 110,123	\$ 243,169	\$ 391,428	\$ 554,086
Total Paid or Accumulated	\$ 241,120	\$ 567,083	\$ 942,407	\$ 1,342,636	\$ 1,767,343

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



Line of Sight





Rewards to Results





Type Your Questions

Special Offer

One hour consulting call with a VisionLink principal at no charge

Indicate interest on final survey

Next Online Seminar:

The Eight Fatal Compensation Mistakes

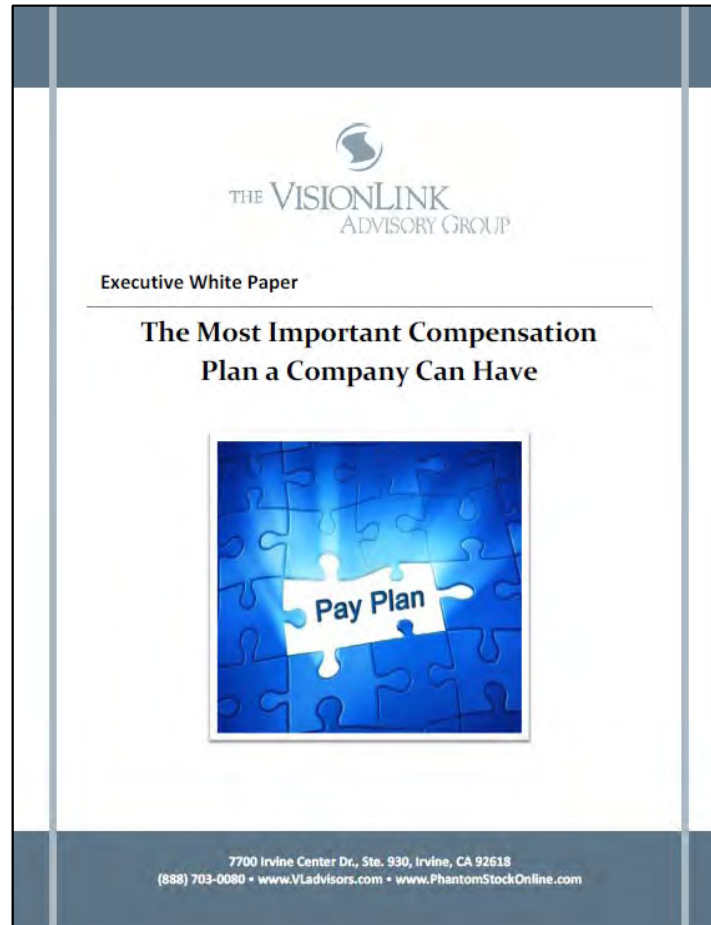
To be held on:
Tuesday, May 20, 2014

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Q&A

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, white paper and more information about the complimentary consultation.

Thank you!



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