

June 18, 2013

# How Does Compensation Impact Performance?



THE VISIONLINK  
ADVISORY GROUP

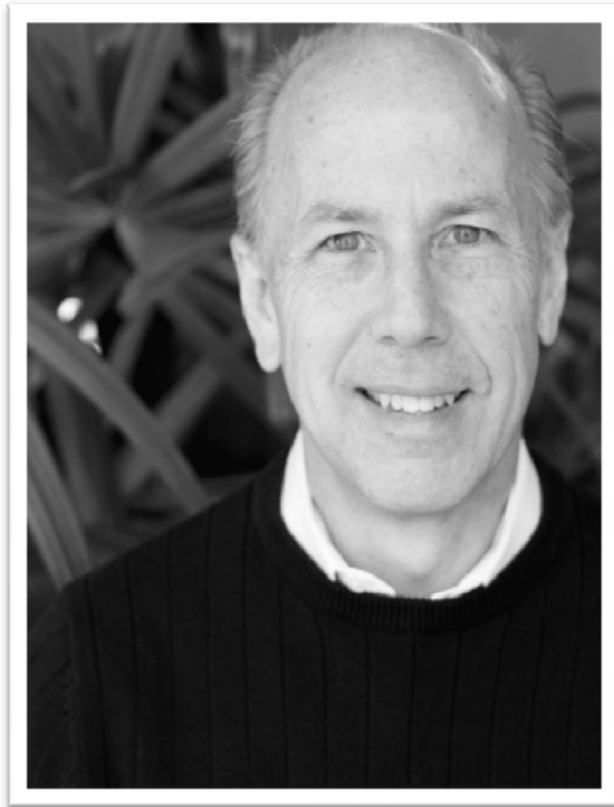
Today's Presenter:

***Ken Gibson***

*Senior Vice President*

*(949) 265-5703*

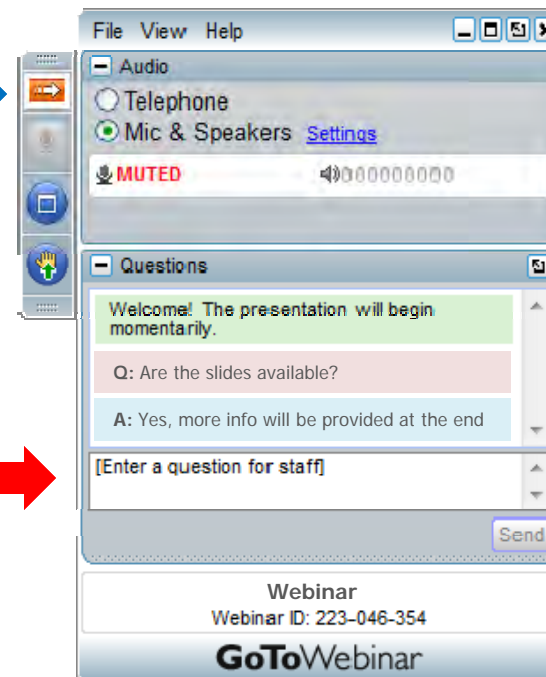
*kgibson@vladvisors.com*



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:** →  
Click the red arrow

**For questions during  
today's presentation:** →  
Use the question area  
on your control panel



# Key Questions:



## Can a Company Buy Performance?

- Do incentive plans really work?
- Can pay change behavior?
- Does how much you pay make a difference?

# Buying Performance



## Client

- Tried to buy performance by paying salaries at 90<sup>th</sup> percentile.
- Theory—If I pay more than my competitors...
  - I'll attract better talent
  - That talent will produce better results

# Buying Performance

News Flash:

- It didn't happen
- Result—frustration and confusion



# Can a Company Buy Performance?

In a word.....



# Client: Why didn't it work?

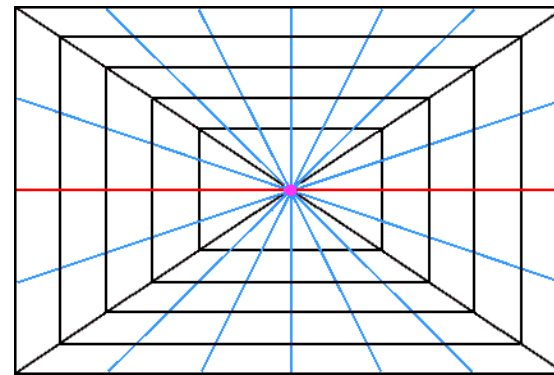


It's not about *how much*.  
It's is about *how*.



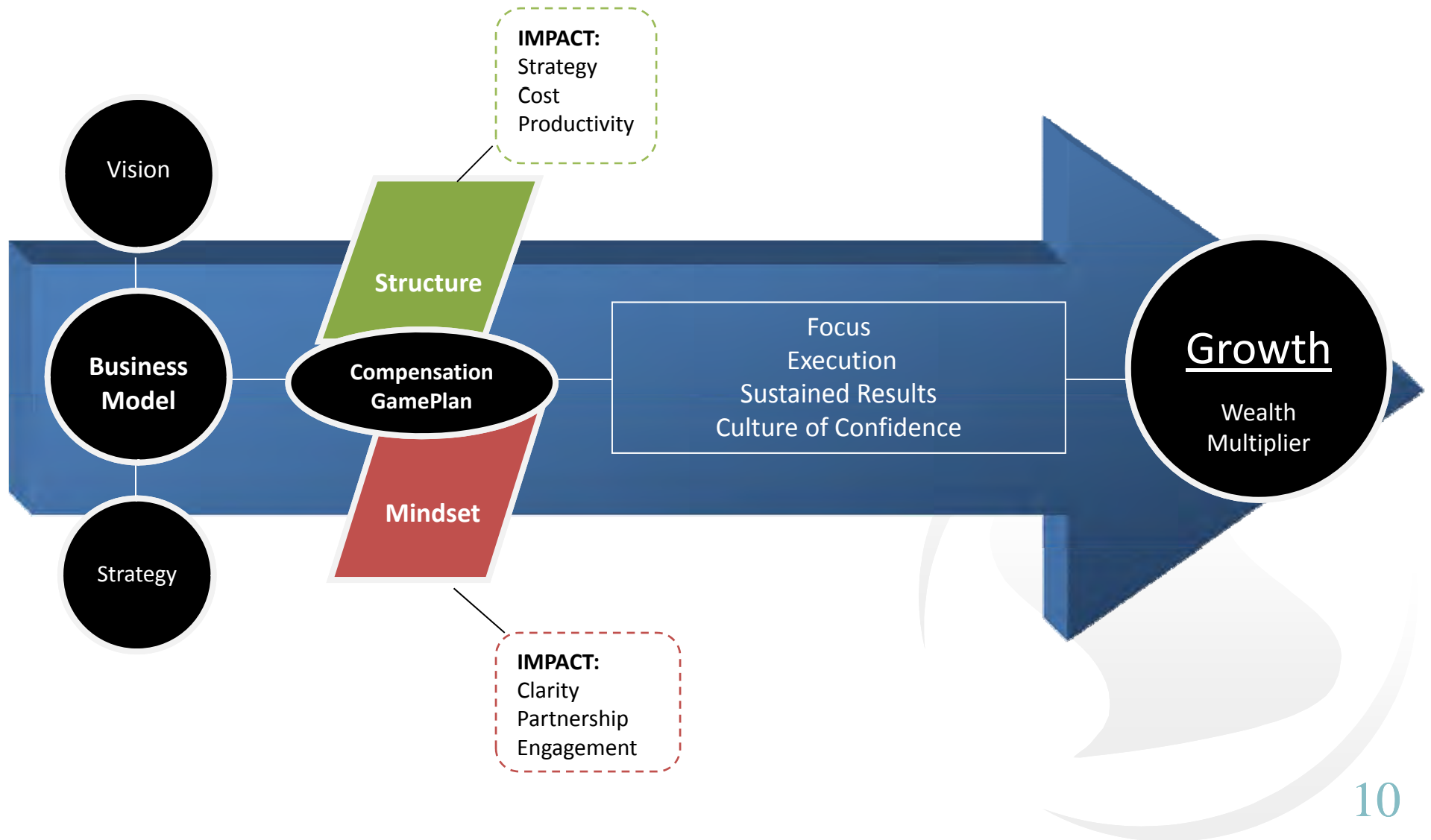
# Proper View of Compensation

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



# Framework:

## Building a Unified Financial Vision for Growing the Business



# 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



# Given the present business landscape...

...which approach makes the most sense?

**Expansive**

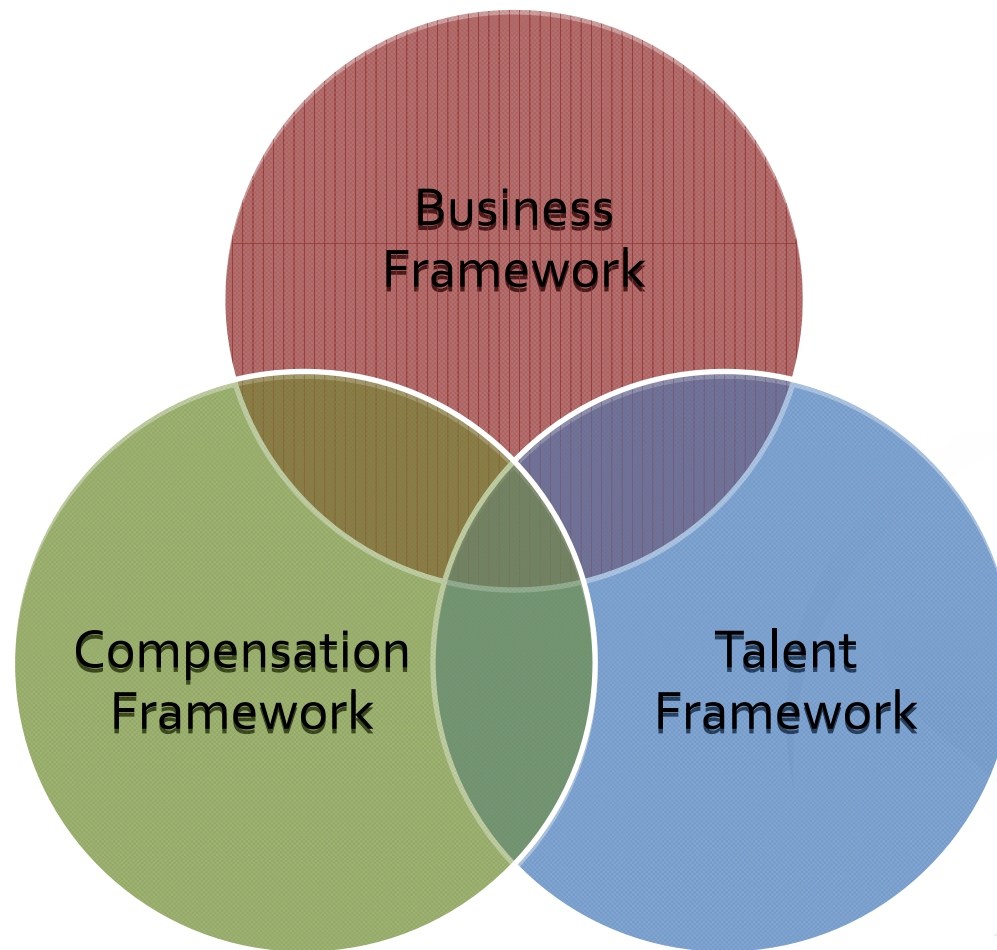


**Selective**

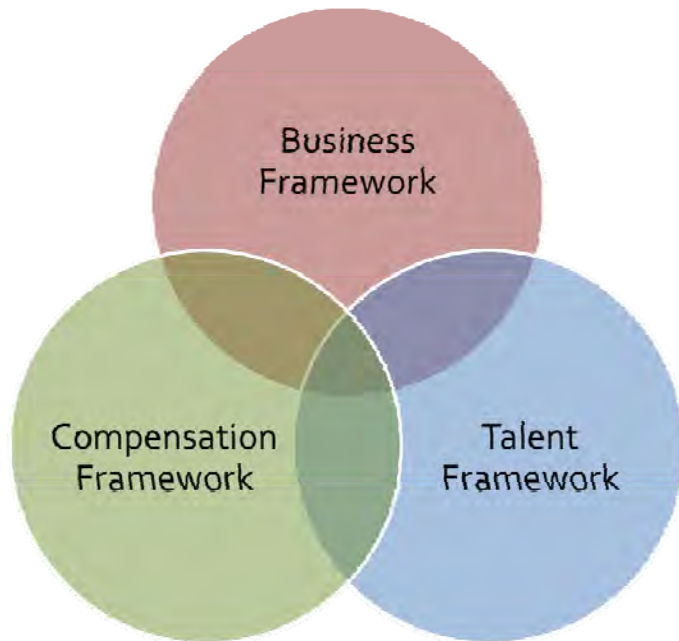




# Establish a Performance Framework



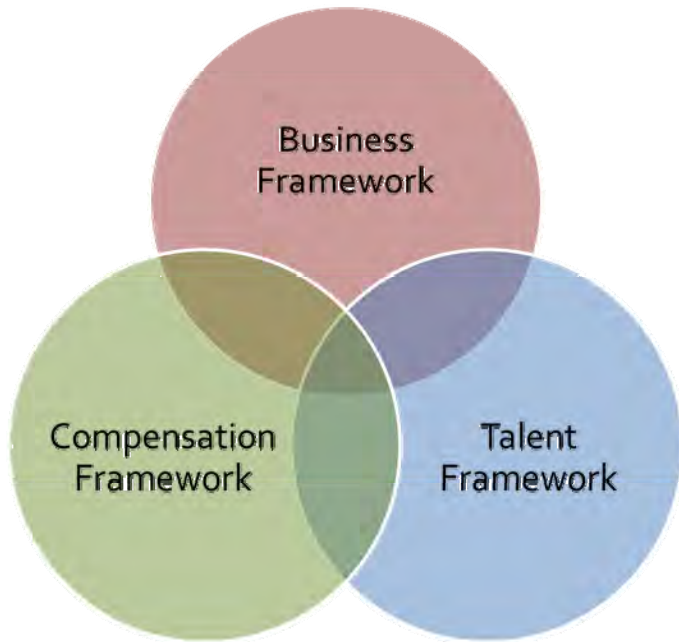
# Establish a Performance Framework



## 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

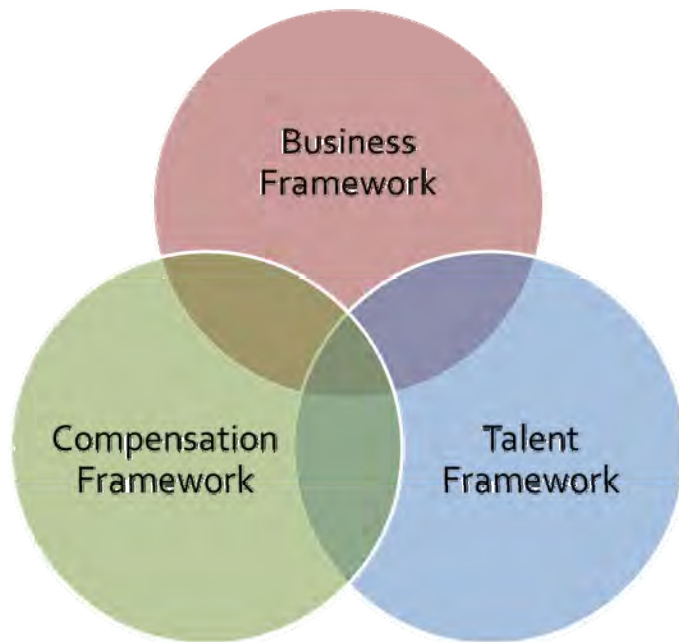
- Establish a pay philosophy
  - Expansive vs. Selective—or Hybrid
  - Define what the company is willing to pay for
- Engineer a pay strategy
  - Structure
  - Mindset
- Adopt a “Total Rewards” Approach

# 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

# Lessons from the Sport's World

**Fast Company Blog:**  
**"Superstar Athlete" Compensation**  
Article by Kevin Kruse

The logo for Fast Company, featuring the words "FAST COMPANY" in a white, serif, all-caps font. The text is centered within a black rounded rectangle. To the right of the rectangle is a large, light gray, stylized arrow pointing to the right, which also serves as a background element for the page number.

FAST COMPANY

# Fast Company Article



## Michael Vick Comp Package:

\$100 million

*Made him the highest paid athlete in the NFL, however...*

# Fast Company Article



## Michael Vick Comp Package:

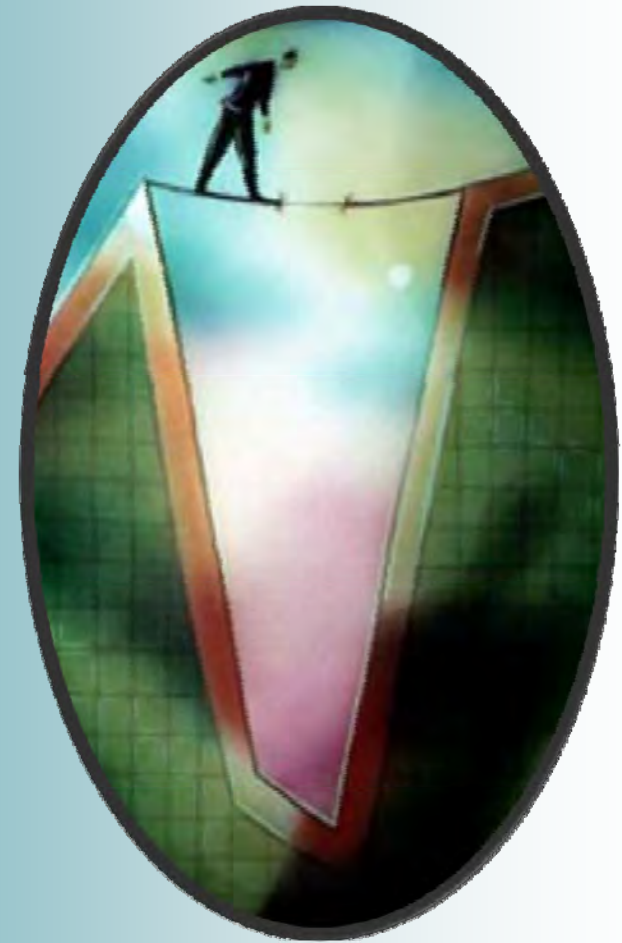
\$100 million over six years

- *\$40 million guaranteed*
- *\$60 million at risk, based on performance*

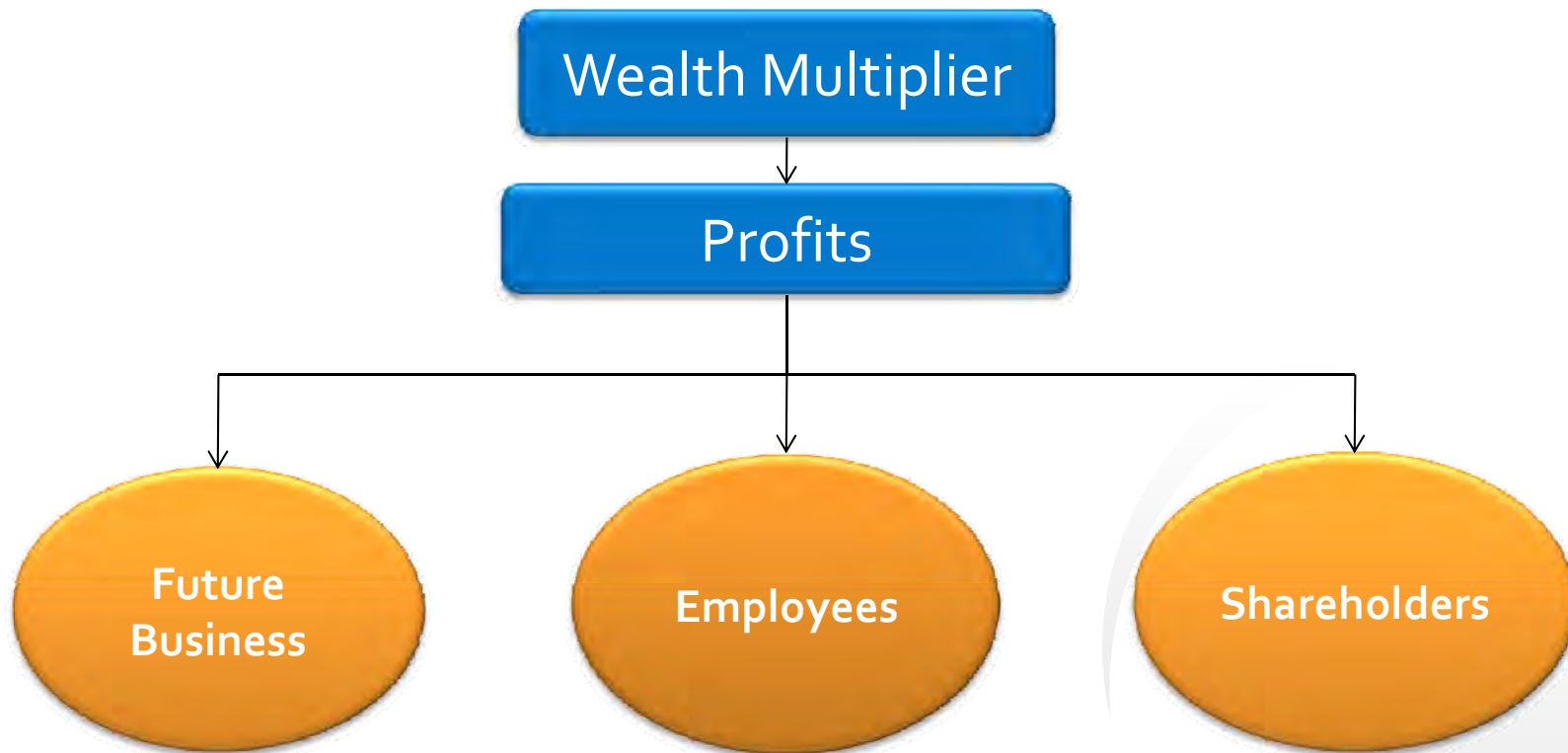
For every \$1 of base pay Vick can earn an extra \$1.50 based on results



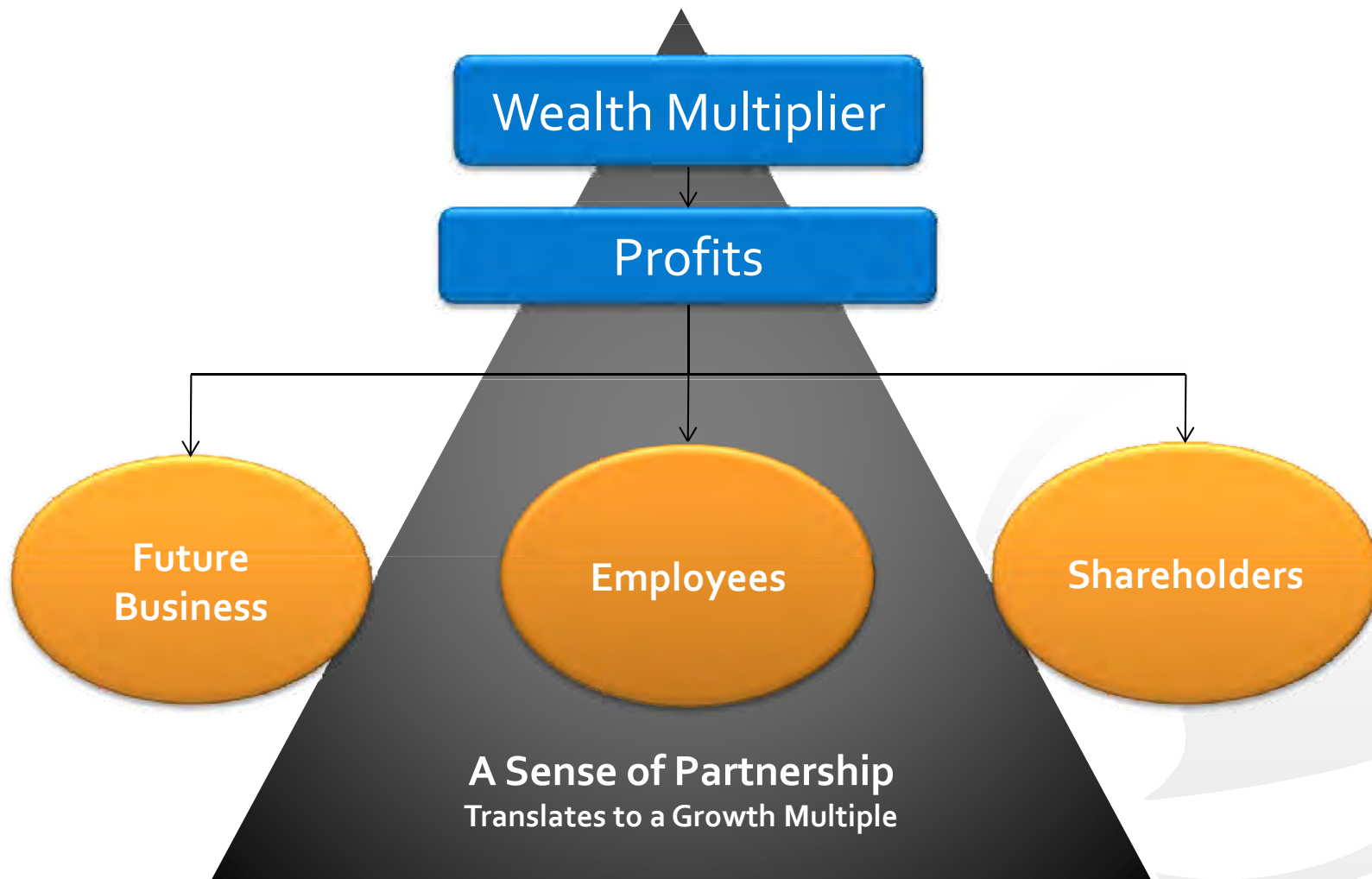
“This ratio provides the proper risk versus reward for both parties. Vick will earn his whopping \$100 million only if he stays healthy enough to lead the team for the next six years and only if he achieves certain on-field results. The variable amount in his contract must be ‘re-earned’ each year. **This demonstrates that organizations are willing to pay a high premium for great performance.”**



# The Value of Profit



# The Value of Profit



# 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



## 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%

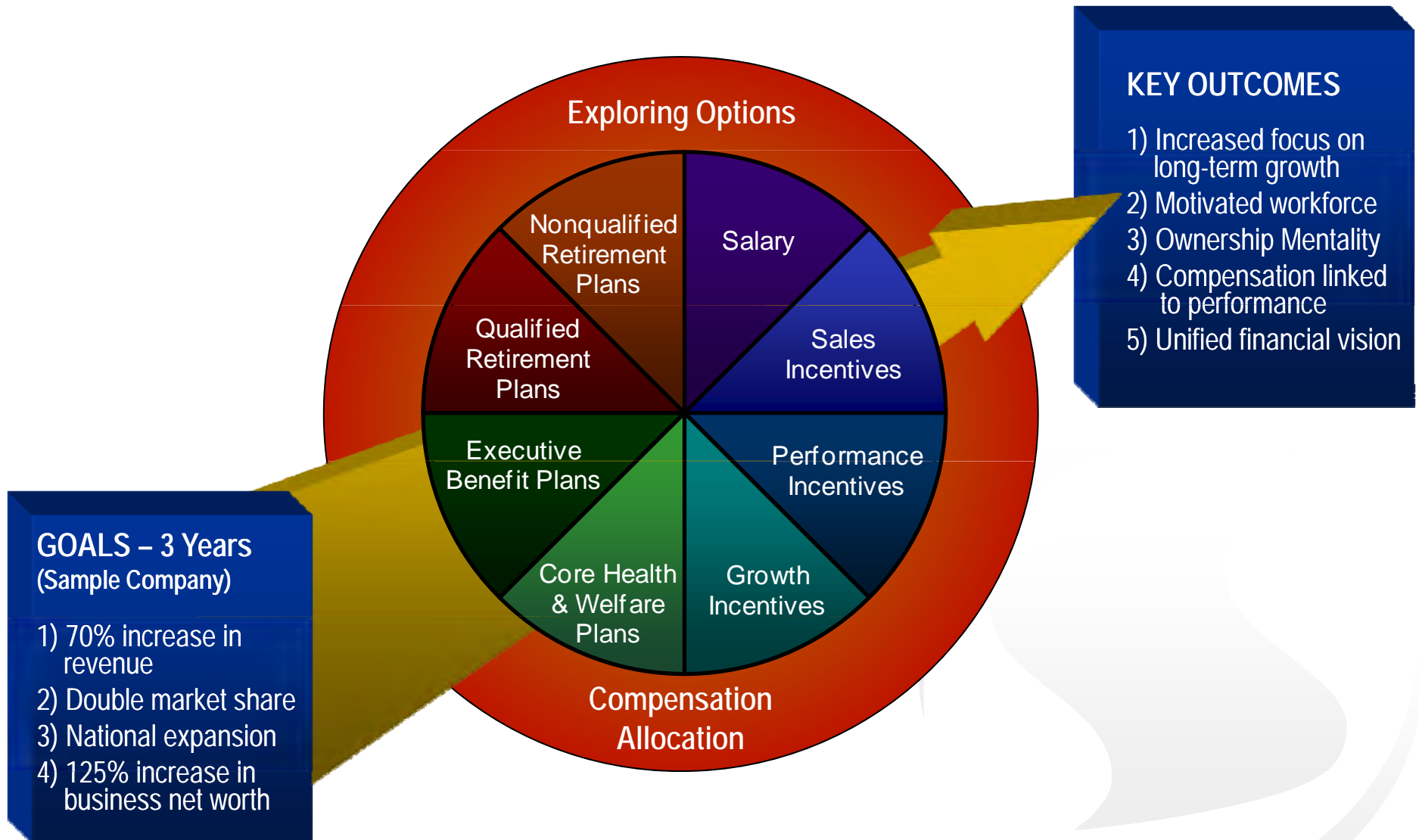
( $\text{ROTRI}^{\text{TM}} = \text{Productivity Profit} / \text{Total Rewards Investment}$ )

# ROTRI™ Example:

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

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

# Examine Alternatives





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%

# Adopt a Total Rewards Philosophy



# Link Company & Employee Goals

## Employee “Hierarchy of Needs”

5 Wealth Accumulation

Wealth Multiplier Philosophy

4 Value Sharing

Short & Long-Term Incentive  
Plans

3 Retirement Planning

Qualified & Executive  
Retirement Plans

2 Risk Protection

Comprehensive, Flexible  
Benefits Plan

1 Cash Flow & Living Standard

Salary & Bonus

Clear Pay Philosophy

# Market a Future



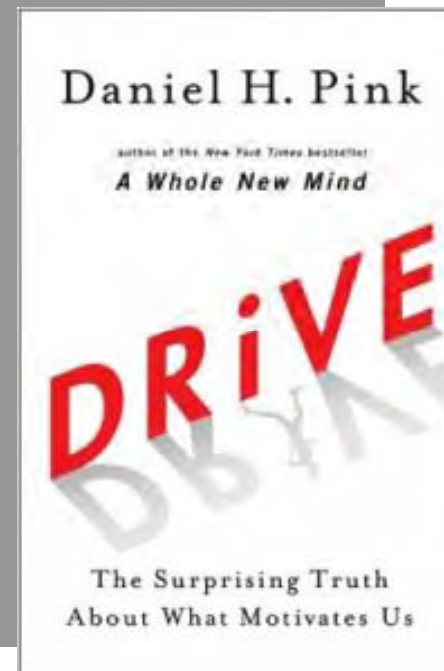
- Think transformation, not just change
- Build a sense of partnership
- Demonstrate commitment
  - To the future business
  - To key contributors
- Promote don't just communicate
- Be consistent

# Employee Value Statement

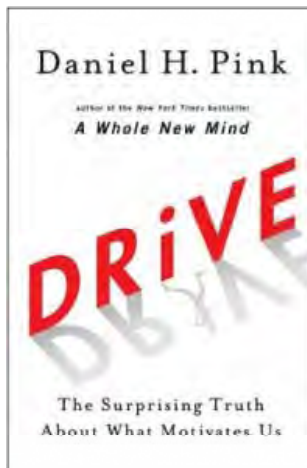
Year	1	2	3	4	5
<b>5-Year Plan Achievement Level</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Current and Inflated Salary</b>	<b>\$ 160,000</b>	<b>\$ 166,400</b>	<b>\$ 173,056</b>	<b>\$ 179,978</b>	<b>\$ 187,177</b>
<b>Cash Incentives Paid at Target</b>	<b>\$ 64,000</b>	<b>\$ 66,560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

# Do incentives work?

Most recent “discussion prompt”: Dan Pink’s book—Drive



# Drive—“instead of incentives...”

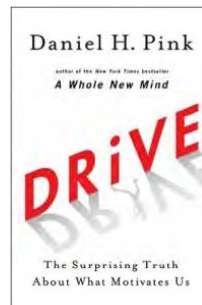


Use intrinsic rewards

- Autonomy—directing our own lives
- Mastery—getting better at something that matters
- Purpose—doing what we do in the service of something larger than ourselves

# Drive

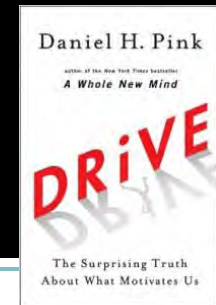
“Pay people adequately and fairly,  
get the issue of money off the table,  
then give them lots of autonomy.”



No real argument here, but...



# Drive



- Not so easy in real life:
  - Do you set salaries at the same level that formerly reflected total pay?
  - How do you handle pay management for people of clearly different skill levels?
  - How do you budget for total compensation without anticipating self-financing elements?
  - How do you tell people, “don’t worry about pay; enjoy the intrinsic awards”?

# The Obvious Question

Can we develop a culture that supports intrinsic motivation and offers extrinsic rewards?



# Purposes of a good incentive plan

- Demonstrate a financial partnership with employees
- Communicate the outcomes and results most valued by the organization
- Create flexible means of rewarding high performers and recognizing special circumstances and achievements
- Build a unified financial vision for growing the business



# Force

# Reinforce

This is the behavior that's expected and rewarded.

These are the results that are valued and rewarded.

Do these things whether you like them or not (they're a necessary part of the job).

As you can see the outcomes we're striving for, determine the best ways to get them done. Here are our standards, patterns, expectations.

Our bonuses are reflective of our "market pay" analysis for your job classification

Our bonuses reflect the way we share value that you help create.

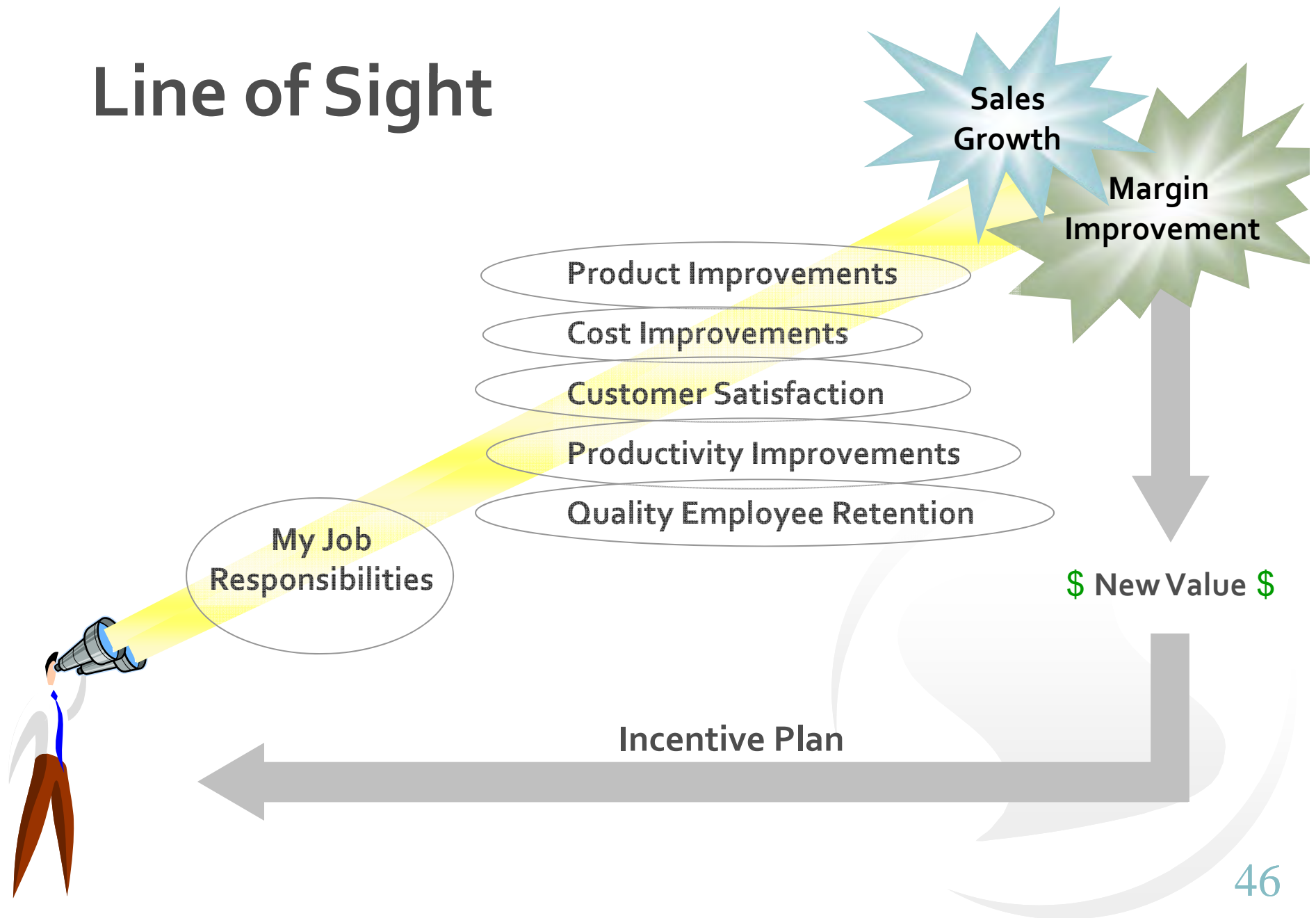
**Bad profits**

**Good profits**

This is fundamentally about fulfilling a commitment to reward people fairly (generously) for helping to fulfill the mission and business model of the organization. When quality people understand and believe in this commitment you **reinforce their intrinsic desire** to deliver on your business plan.



# Line of Sight



# Rewards to Results



# What makes a compensation strategy successful?

The measure should be whether or not it is fulfilling its role





# Key Questions—Value Creation

- Before designing the plan, did the company clearly define value creation?
- Does the plan include metrics consistent with that definition?
- Does value sharing occur out of productivity profit?

*If the answer is yes, then it means the plan is only paying out value when value has been created—it's self financing. This also suggests that during periods of economic decline or stagnation, the plan is self-restricting in its payouts. That's a successful approach.*



# Key Questions—Philosophy

- Does the company have a clear philosophy statement?
- Is the pay philosophy communicated effectively to employees?
- Are the company's compensation strategies consistent with the pay philosophy?

*If you answered affirmatively to each of those questions, then the company is being clear about what is willing to "pay for" and is implementing plans that follow that rule. This again must be considered a successful approach.*



# Key Questions—Market Pay

- Does the company compare its pay strategies to market pay standards?
- Does the philosophy statement define where the company wants to be relative to market pay?
- Is an “internal equity analysis performed?

*If this is the approach being adopted, then the company is using some outside metrics to determine if it is over or underpaying for certain functions. If it likewise offers significant upside potential relative to the market, within defined value creation/sharing parameters defined in the first bullet point, then it knows it has a competitive advantage in attracting key producers. That's also a successful approach to pay.*



# Key Total Rewards

- Does the company market a future?
- Is there a clear & compelling vision?
- Is there a positive work environment?
- Are there opportunities for personal and professional development?
- Is the financial partnership clearly defined?

*If a company adopts this framework, it is not expecting remuneration to be the sole issue upon which attracting and retaining key producers is based. If it pays attention to each of those questions, and works hard to ensure evaluation and implementation in all categories, it will become more successful at becoming a magnet for the "right talent." Hence, a total rewards approach is a successful one.*



# Can You Buy Performance?

- No, if “buy” means you can positively improve results by trying to manipulate behavior
- Yes, if “work” means you can forge a partnership relationship with employees towards creating a unified vision for growing the business





**Type Your Questions**

# Special Offer

---

One hour consulting call with a VisionLink  
principal at no charge

(CEO or other senior leader)

Indicate interest on final survey

# Next Online Seminar:

## **“What Does an Effective Bonus Plan Look Like?”**

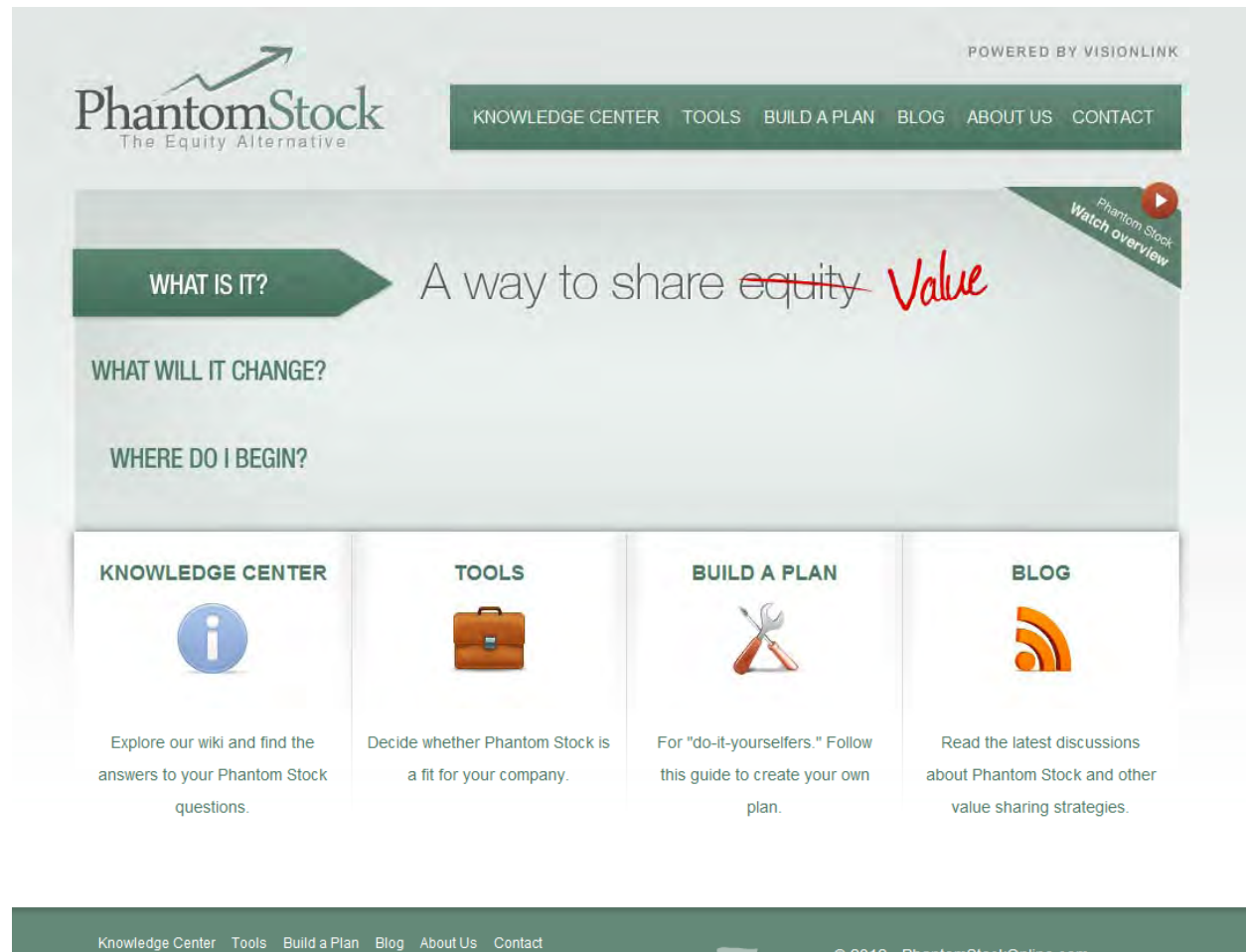
To be held on:  
Tuesday, July 23, 2013

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

[www.VLadvisors.com](http://www.VLadvisors.com) ♦ [www.PhantomStockOnline.com](http://www.PhantomStockOnline.com)

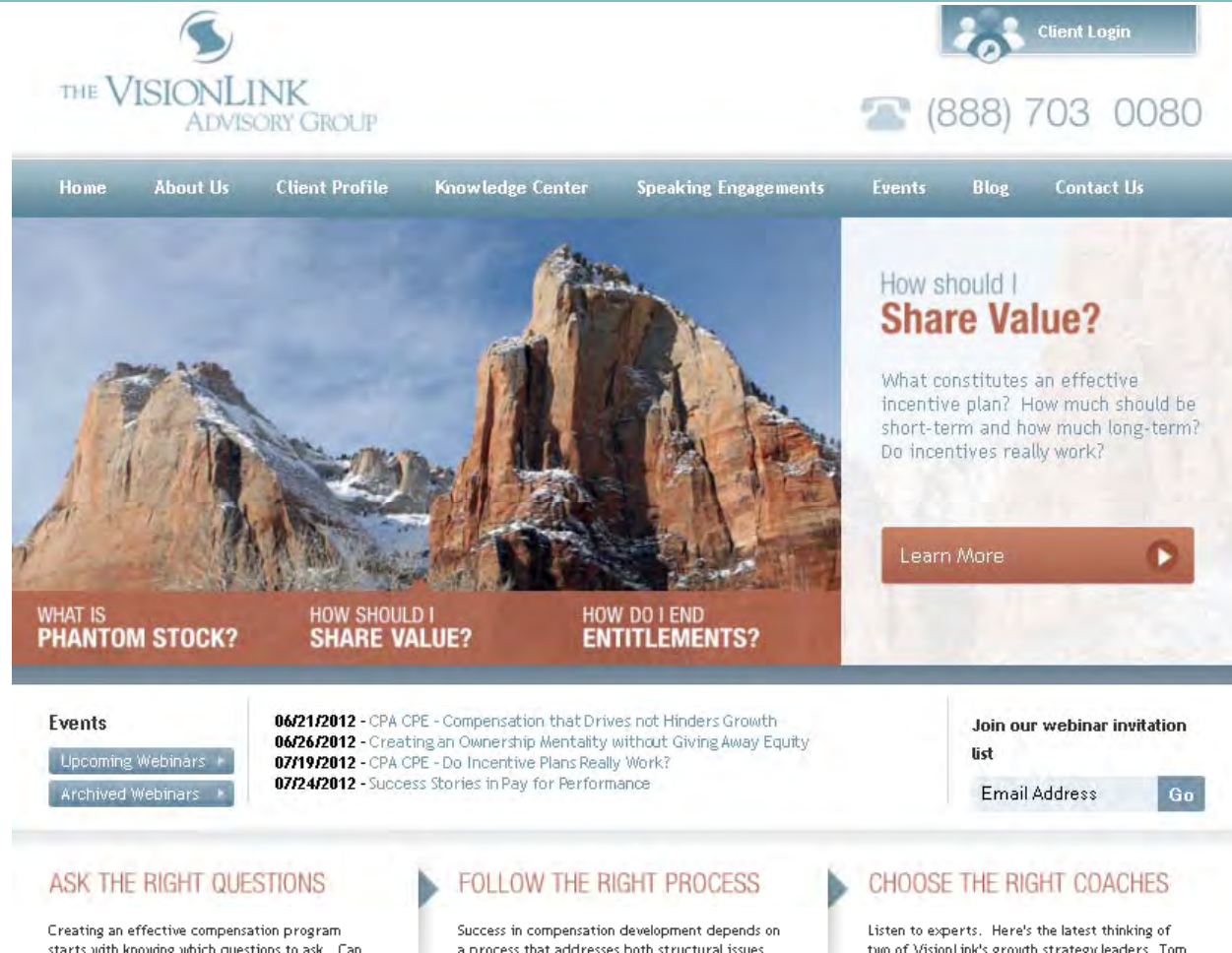


[www.PhantomStockOnline.com](http://www.PhantomStockOnline.com)



You can also subscribe to our blog

[www.VLadvisors.com](http://www.VLadvisors.com)



The screenshot shows the homepage of The VisionLink Advisory Group. The header includes the company logo, a 'Client Login' button, and a phone number (888) 703 0080. A navigation bar contains links for Home, About Us, Client Profile, Knowledge Center, Speaking Engagements, Events, Blog, and Contact Us. The main content area features a large image of a rocky mountain peak with snow. To the right of the image is a featured article titled 'How should I Share Value?' with a 'Learn More' button. Below the image are three smaller article teasers: 'WHAT IS PHANTOM STOCK?', 'HOW SHOULD I SHARE VALUE?', and 'HOW DO I END ENTITLEMENTS?'. The 'Events' section lists upcoming webinars with dates and topics. A 'Join our webinar invitation list' form is also present. At the bottom, there are three columns with the headings 'ASK THE RIGHT QUESTIONS', 'FOLLOW THE RIGHT PROCESS', and 'CHOOSE THE RIGHT COACHES', each with a brief description.

THE VISIONLINK  
ADVISORY GROUP

Client Login

(888) 703 0080

Home About Us Client Profile Knowledge Center Speaking Engagements Events Blog Contact Us

How should I  
**Share Value?**

What constitutes an effective incentive plan? How much should be short-term and how much long-term? Do incentives really work?

Learn More

WHAT IS  
PHANTOM STOCK?

HOW SHOULD I  
SHARE VALUE?

HOW DO I END  
ENTITLEMENTS?

Events

Upcoming Webinars

Archived Webinars

06/21/2012 - CPA CPE - Compensation that Drives not Hinders Growth  
06/26/2012 - Creating an Ownership Mentality without Giving Away Equity  
07/19/2012 - CPA CPE - Do Incentive Plans Really Work?  
07/24/2012 - Success Stories in Pay for Performance

Join our webinar invitation list

Email Address Go

ASK THE RIGHT QUESTIONS

Creating an effective compensation program starts with knowing which questions to ask. Can

FOLLOW THE RIGHT PROCESS

Success in compensation development depends on a process that addresses both structural issues

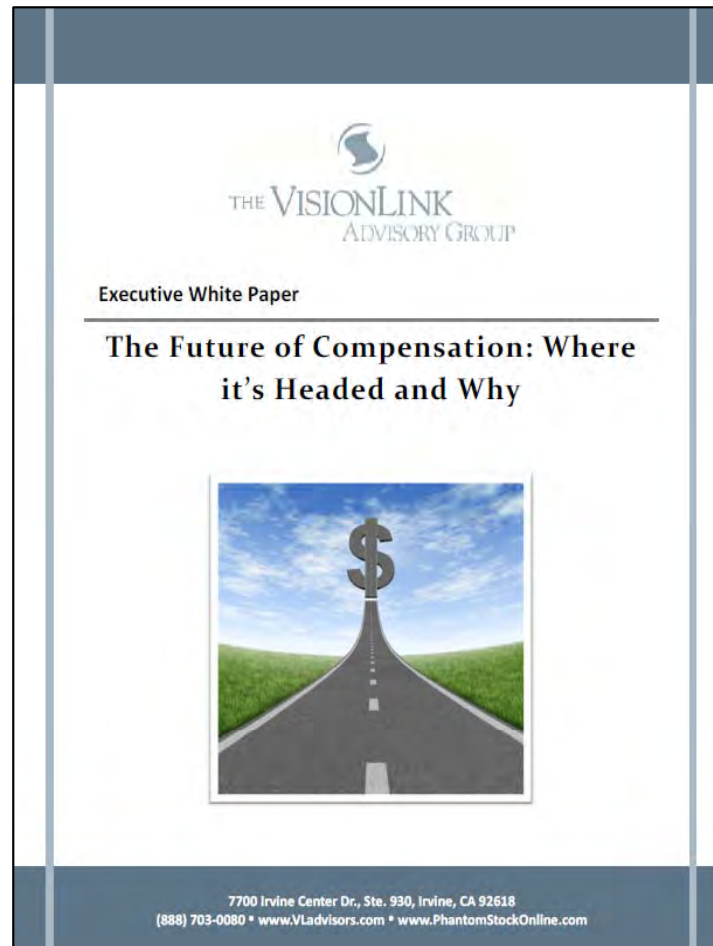
CHOOSE THE RIGHT COACHES

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

You can also subscribe to our blog

# NOW AVAILABLE!

## New White Paper



Express interest on the final survey



follow us on  
**twitter**  
@VLadvisors



[YouTube.com/VisionLinkAdvisors](https://www.youtube.com/VisionLinkAdvisors)

# 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 the 1-hour free consultation time with one of our principals.*



# Q&A

# Thank you!

## **Ken Gibson**

Senior Vice President

(949) 265-5703

kgibson@vladvisors.com

