Why You Should
Stop Paying Incentives

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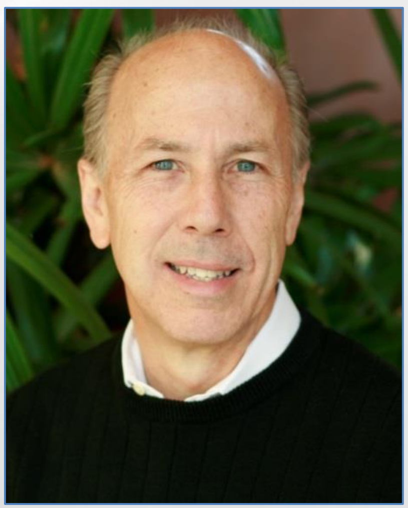

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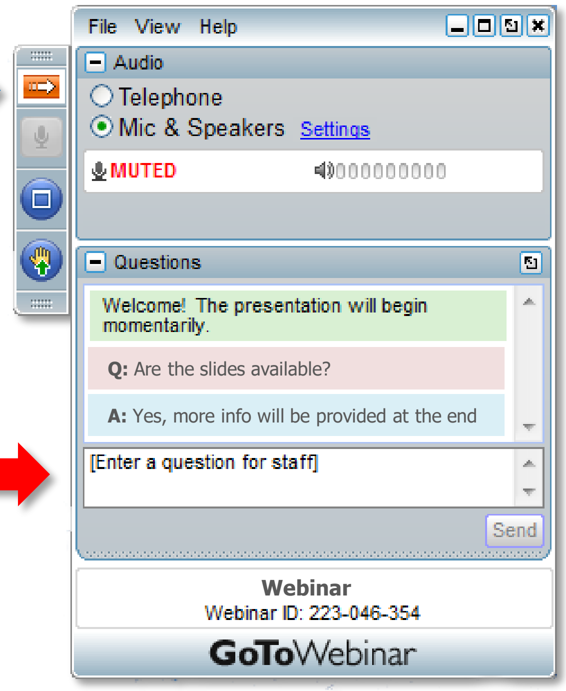

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Post Webinar Intro

THE VISIONLINK ADVISORY GROUP

5 Minutes:

- Who We Are
- What We Do
- How We Do It

The VisionLink Advisory Group

- Headquartered in Irvine, CA
- Founded in 1996
- Over 450 clients throughout North America

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VisionLink's Focus: Help Business Leaders Build and Sustain a High Performance Culture

Accelerate performance through pay strategies that transform employees into growth partners.

If you do that…

- Quality of talent will improve.
- Employee engagement will expand.
- Performance will be magnified.
- Business growth will be accelerated.
- Shareholder value will increase.

The Incentive Plan Issues

- How many times have you revised your incentive plan in the last five years?
- What does your incentive plan cost?
- How is your incentive plan paid for?
- How do you measure the success of your incentive plan?
- How much of your incentive dollars reward short-term performance and how much rewards long-term?
- What metrics drive the value of your incentive plan?
- What ROI are you getting on your incentive plan?

Why You Should Stop Paying Incentives

A 21st Century Reality

Incentive plans, as traditionally designed, are not the best way to reward employee performance.

The Evidence

Survey Results

Only 10% of responders indicated they felt their annual incentive plan was effective. (World at Work 2016 Survey)

Why?

Four Key Reasons

Number One: Most plans are built on the wrong premise

The Wrong Premise

Influence Behavior Through Careful Selection of Plan Metrics

- Reward your employees for achieving results that are as close as possible to their job duties.
- “Select the best metrics” for each employee or at least for every department.
- Assume that all the collective mini-improvements will roll up into shareholder value creation.

When the plan isn't effective . . .

- Most employers re-double their efforts to find the "right metrics"
- More metrics (KPIs) are added to the plan formula to focus employees on behavioral outcomes
- Employees focus on the KPIs rather than the big picture

“Let’s change behavior”

“…when financial incentives are applied to increase…motivation, intrinsic motivation diminishes. A meta-analysis of 128 independent studies conclusively confirmed this effect.”

(“Stop Paying Executives for Performance,” HBR, February 23, 2016)

Metrics Focus

8 Problems

1. Impossible to link every metric to true value creation.
2. Multiple KPIs create confusion and sap motivation.
3. A focus on behavior incentives can lead to the opposite behavior.
4. Difficult to find metrics for every position.
5. Results may be manipulated or loopholes exploited.
6. Impossible to equalize metrics across individuals and departments.
7. Unintended and unanticipated negative consequences.
8. Pursuit of “perfect” metrics is a time waster.

Outcomes, not Methods

"You cannot hold people responsible for results if you supervise their methods.“

(Stephen R. Covey)

Corollary:

"You cannot hold people responsible for results if you *pay them* for their methods.“

Solution #1: Transition from Incentives to Value Sharing

The premise should be to promote value creation and value sharing:

- "When you help us create value you participate in that value"
- Define value creation around the shareholders' most important goals

Shareholder’s Most Important Result

Sustainable and growing profitability

Key Metric

Focus on One of These:

- Profit
- Increase in Profits (% or $)
- (Sometimes: Revenue Growth)

Not Just Profit but Productivity Profit

Productivity profit is that surplus that can be attributable to the productivity of your people, not just your capital at work.

Case Study

Core Changes

Shift from “Incentives” to “Value Sharing”

- Took away local measurements driving management incentive plans—all paid on same metrics
    - “We live together and we die together”
- Aligned everyone behind company success
    - “I call it ‘pay the company first.’ ”

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

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.

Example:

Item	Amount
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™ Return on Total Rewards Investment	30.4%

(ROTRI™ = Productivity Profit/Total Rewards Investment)

Example:

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ROTRI™	30.4%

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

(ROTRI™ = Productivity Profit/Total Rewards Investment)

Setting Payout Thresholds

- Base
- Target (budget)
- Superior

What's Base?

- Base is the threshold amount of profit that justifies employee bonuses
- Begin sharing value above that threshold
- Below Base = No bonus
- You should expect to achieve Base performance 4/5 years

What's Target?

- Target is the amount of profit that is expected to be achieved
- Bonus values at Target should be your "Market" opportunity
- You should expect to achieve Target performance 3/5 years

What's Superior?

- Superior is the amount of profit that is achievable assuming exceptional performance
- Bonus values at Superior should be impressive
- You should expect to achieve Superior performance 1/5 years

Other Metrics

Minimum profit thresholds must be met first. Then…

- Department or team metrics
- Non-correlated factors (customer retention, customer or client increase, etc.)
- Individual performance metrics

Solution #1 leads to . . .

Every employee understanding:

- The importance of sustainable profits
- How those profits are generated
- How they can contribute to the generation of profits
- That bonuses are not guaranteed (they're based on value creation)
- How their variable pay programs work

Four Key Reasons

Number Two: Most plans mis-manage the role of individual employee performance

Ways to treat individual performance

- Component of the allocation
- Discretion
- Modifier

Component of Allocation

- Allocation to plan participants contingent on:
  - **Company Performance** – Employees should have all or a majority portion of their bonus based on company performance
  - **Org Unit Performance** – A portion of an employee's bonus can be allocated based on department, location, division, or business unit
  - **Individual Performance** – A portion of the bonus is allocated to Individual Results

Problems

- Unless the slice is big, many employees will pay little attention to it
  - “I can still get 75% of my bonus without worrying about that piece”
- Performance management score may not be trustworthy
  - “I hate to give him a low score because it will reduce his bonus”

Problems

- Full (or even partial) discretion may lead to charges of unfairness or even discrimination
  - “Why was he paid more than me?”
- Lengthy list of employee goals may be hard to track fairly or accurately
  - “I didn’t get that done because you asked me to focus on something new”

Performance Management Revolution

Business Basics Career Finance Human Resources Marketing Technology

Times Are Changing: The Future of Performance Management and Reviews

BY BUSINESS.COM EDITORIAL STAFF

Business.com / HR Solutions / Last Modified: February 22, 2017

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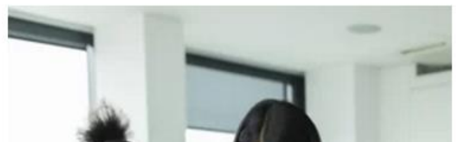

More big name organizations scrapped traditional performance appraisals and it's expected that significant changes will continue in 2016.

Harvard Business Review

Reinventing Performance Management

SUMMARY SAVE SHARE TEXT SIZE P

ASSESSING PERFORMANCE

Reinventing Performance Management

by Marcus Buckingham and Ashley Goodall

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Performance Ratings Will Continue to Disappear

Placing employees on a number scale just doesn't work. It breeds competition and leads to a less productive workforce overall. Instead, more businesses will evaluate their staff by how successful each member is at working toward company goals. In a similar vein, business leaders should resist the temptation to make management decisions based on people analytics, CIO.com said. While this data can provide insight into skill levels, it doesn't mean much in the way of engagement. Instead, business leaders s on increasing employee satisfaction to deliver better long-term results.

ersations Will Replace Annual Reviews

izations have already realized yearly assessments are an inefficient way of measuring . Business.com expects even more to come around in 2016. Annual reviews mean an as about one hour of discussion to see how they're doing, then approximately 364 days to

Deloitte.

Search

Se

Insights

Performance management is broken

Replace "rank and yank" with coaching and development

Individual Performance

- Trend is to disconnect performance from incentive pay
- Performance Management is still important
- Managers more likely to be honest about performance if incentives are not directly correlated to performance rating
- If performance is deemed "Unacceptable" discretion should be utilized to eliminate incentive payment

Solution: Spot Bonuses

What about employees who made special contributions over the course of the year?

- Create a discretionary reserve inside of plan funding
- Reserved for “exceptional” performers only
- Point to clear contributions (the reason for the award)
- Immediate recognition (not end of the year)
- Nomination process
- Budget a “reserve” to fund these awards
- They don’t have to be big ($500).

Solution #2 leads to . . .

Every employee understanding:

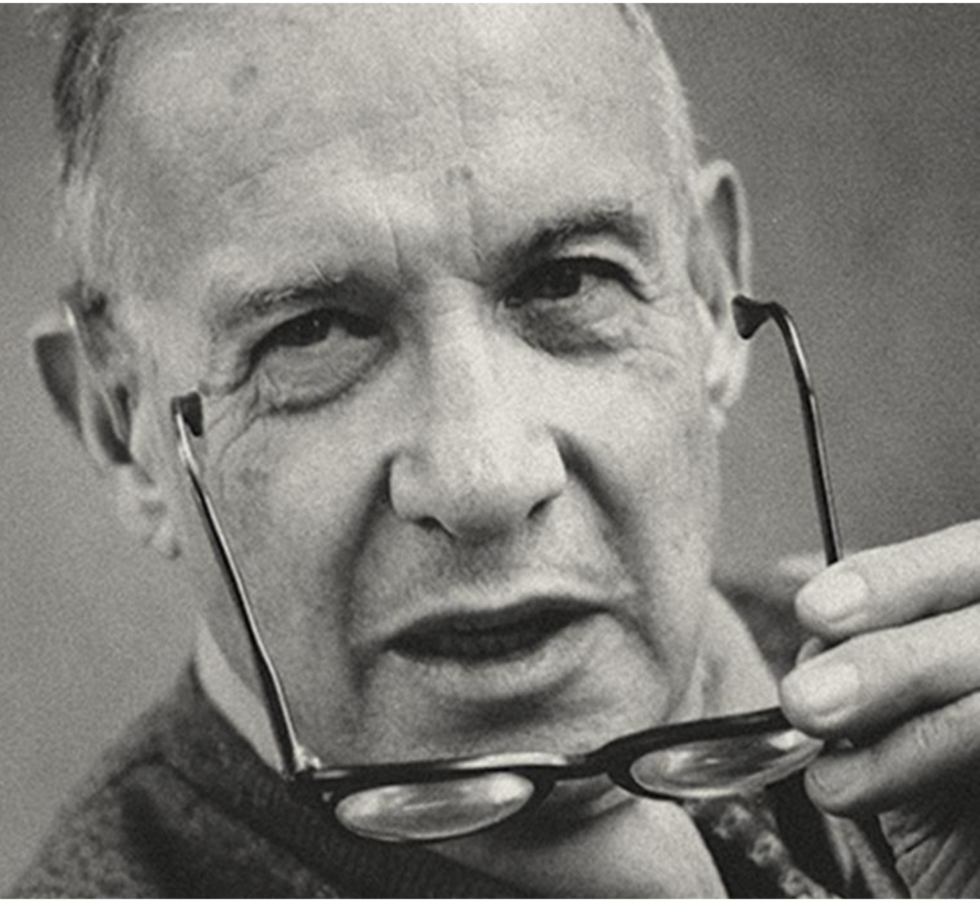
- How individual performance can influence variable pay
- That end-of-year awards are a celebration of team results

Four Key Reasons

Number Three: Most plans don’t balance rewards for short-term and sustained performance

Dual Focus

Peter Drucker once wrote that the manager's job is to keep his nose to the grindstone while lifting his eyes to the hills. He meant that every business has to operate in two modes at the same time: producing results today and preparing for tomorrow. (Ken Favaro, Strategy+Business)



Solution: One Philosophy, Two Performance Periods

Wealth Multiplier Philosophy

We want all stakeholders to participate in the wealth multiple they help create.

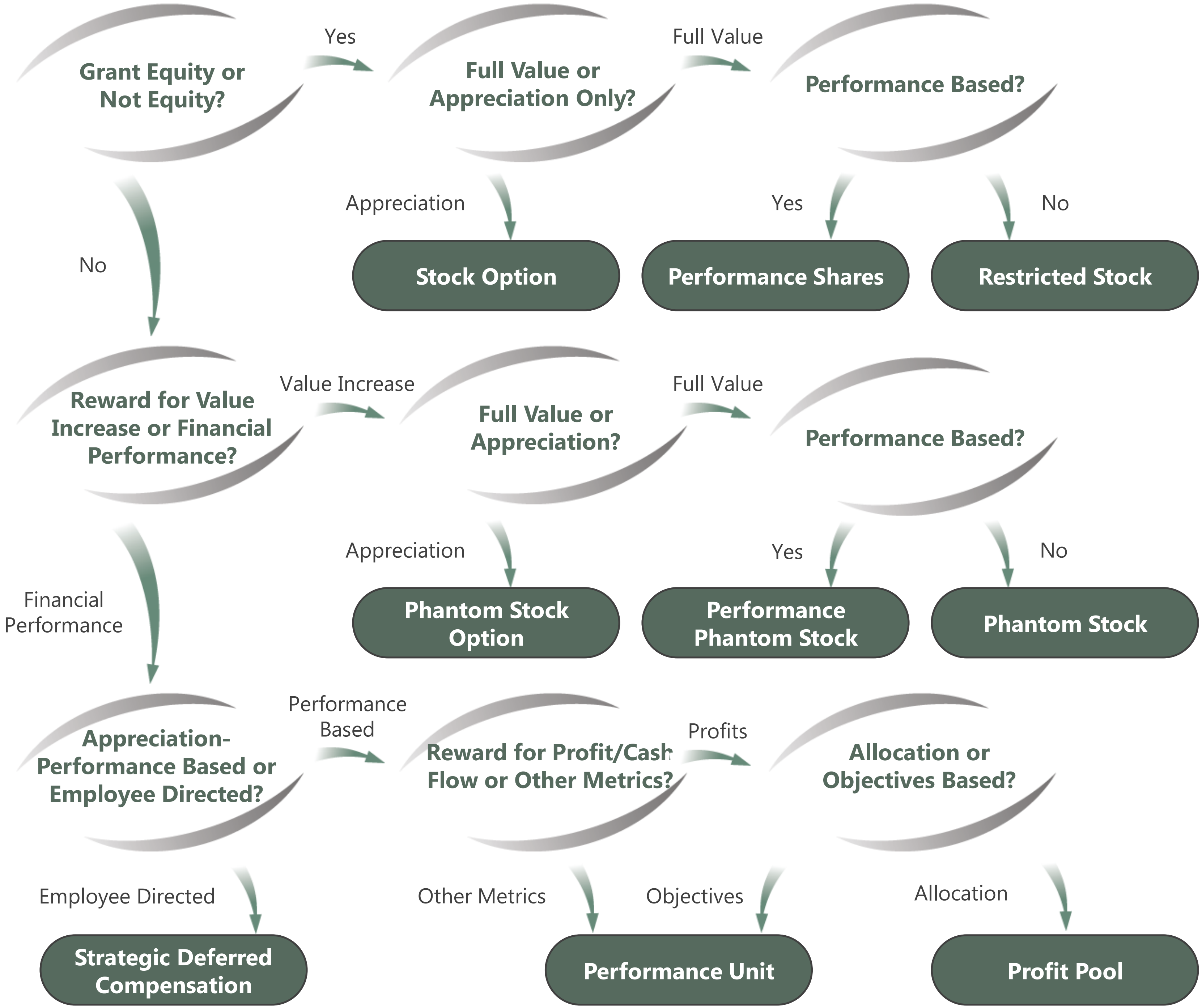
- Fair
- Prudent

Rewards Orientation

- Short-Term focuses on rewarding profit
- Long-Term focuses on rewarding business value increase

9 Long-Term Value Sharing Alternatives

- Restricted Stock
- Phantom Stock
- Profit Pool
- Performance Shares
- Performance Phantom Stock
- Performance Unit
- Stock Option
- Phantom Stock Option
- Strategic Deferred Compensation


Grant Equity or Not Equity?
Yes
Full Value or Appreciation Only?
Full Value
Performance Based?
No
Appreciation
Yes
No
Stock Option
Performance Shares
Restricted Stock
Reward for Value Increase or Financial Performance?
Value Increase
Full Value or Appreciation?
Full Value
Performance Based?
Financial Performance
Appreciation
Yes
No
Phantom Stock Option
Performance Phantom Stock
Phantom Stock
Appreciation-Performance Based or Employee Directed?
Performance Based
Reward for Profit/Cash Flow or Other Metrics?
Profits
Allocation or Objectives Based?
Employee Directed
Other Metrics
Objectives
Allocation
Strategic Deferred Compensation
Performance Unit
Profit Pool

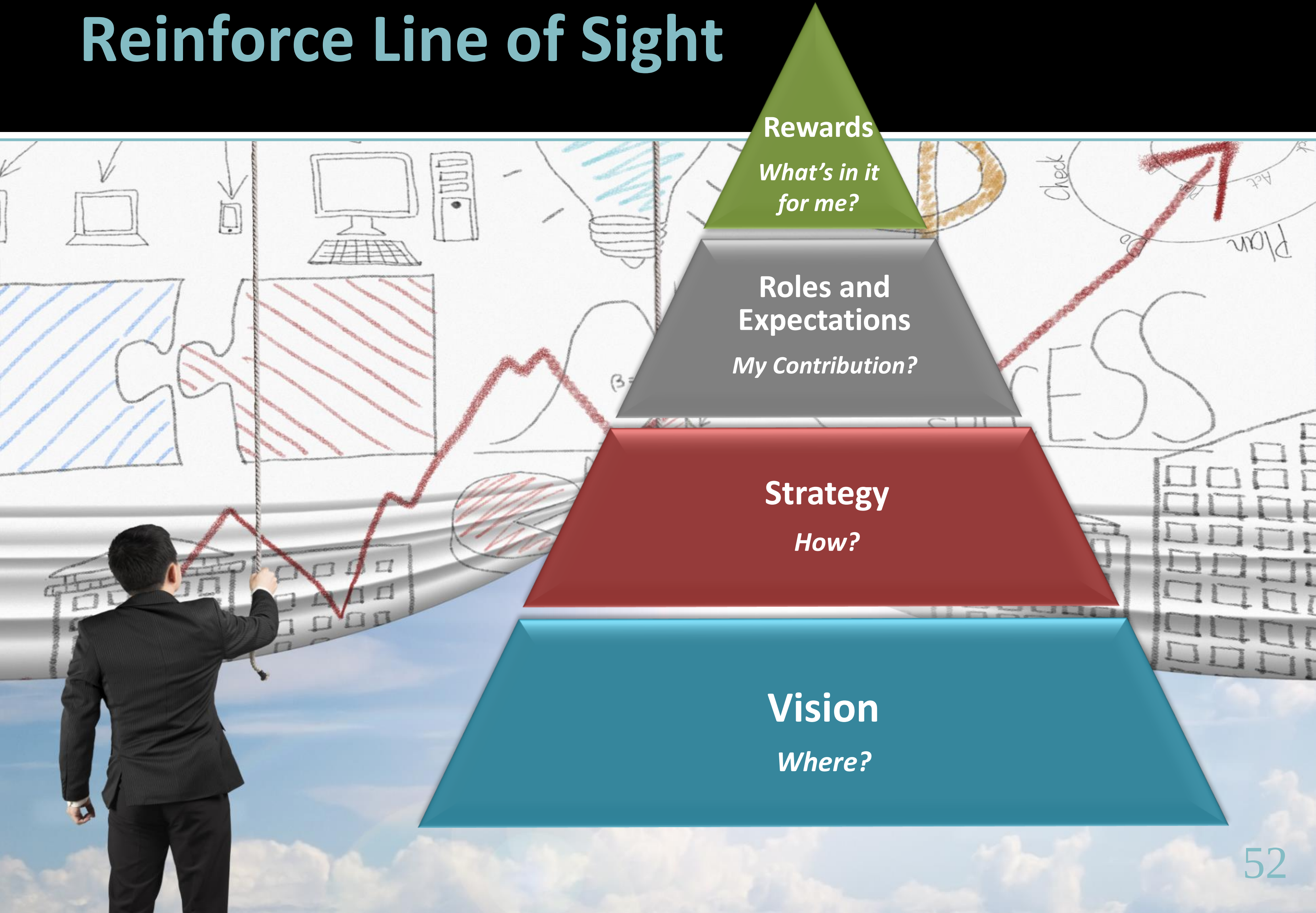
Four Key Reasons

Number Four: Most plans are not properly communicated and reinforced

View Employees as Growth Partners

Engage employees in a conversation about the contributions they can make to profitable growth.

Reinforce Line of Sight



Communication

- ***The Key*** to the success of the plan
- Employee communication statements should communicate incentive target opportunity
- Regular performance updates during the plan year
- “Partners” understand basic company performance
- Private companies don’t always disclose all financial information to all employee “Partners”:
  - Financial performance in private companies communicated via percentage against target
  - “After Q1 we are tracking 95% against our ‘Target’ financial performance”

"Help me understand how the plan works"

"Help me understand what has to happen to optimize the value of the payout for me"

"Help me believe that we can achieve those results"

"Let me know how we're doing regularly so I can make a difference"

"Talk with me about how I can contribute to those results"

Market a Future that's Relevant

- Here's our future.
- Here's how we're going to get there.
- Here's the role we picture for you.
- Here's how we encourage our people to grow and contribute.
- Here's our philosophy about pay and rewards.
- Here are our specific pay programs.
- Here's how our pay programs will work for you if we achieve our plan.

Employee Value Statement

Year	1	2	3	4	5
Targeted Results	100%	100%	100%	100%	100%
Salary	$160,000	$166,400	$173,056	$179,878	$187,177
STVS	$64,000	$66,560	$69,222	$71,991	74,871
LTVS (EOY)	--	$74,000	$186,000	$311,000	$448,000
401(k) @7%	$17,120	$36,123	$57,169	$80,428	$106,086
Total Cash	$224,000	$232,960	$242,278	$251,970	$262,048
Wealth Accrual	$17,120	$110,123	$243,169	$391,428	$554,086
Total Value	$241,120	$567,083	$942,407	$1,342,636	$1,767,343

Solution #4 leads to . . .

Every employee understanding:

- That they are being treated like partners in the success of the business
- What they can do to improve the value of the business and . . .
- How that aligns with their own rewards
- Everything more regularly (no surprises)

Why You Should Stop Paying Incentives

A 21st Century Reality

Incentive plans, as traditionally designed, are not the best way to reward employee performance.

Replace incentives with value-sharing.

Post Webinar Intro

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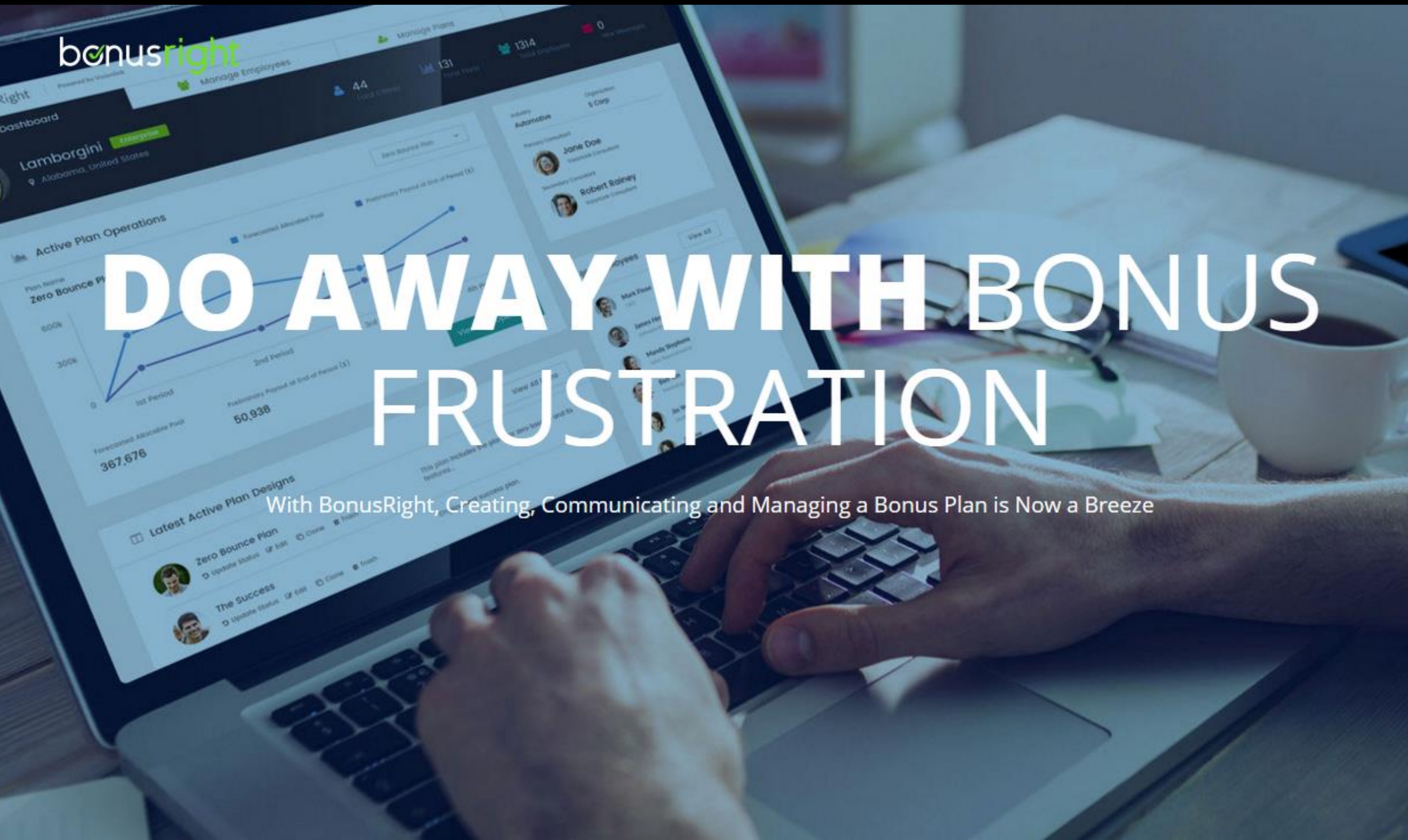

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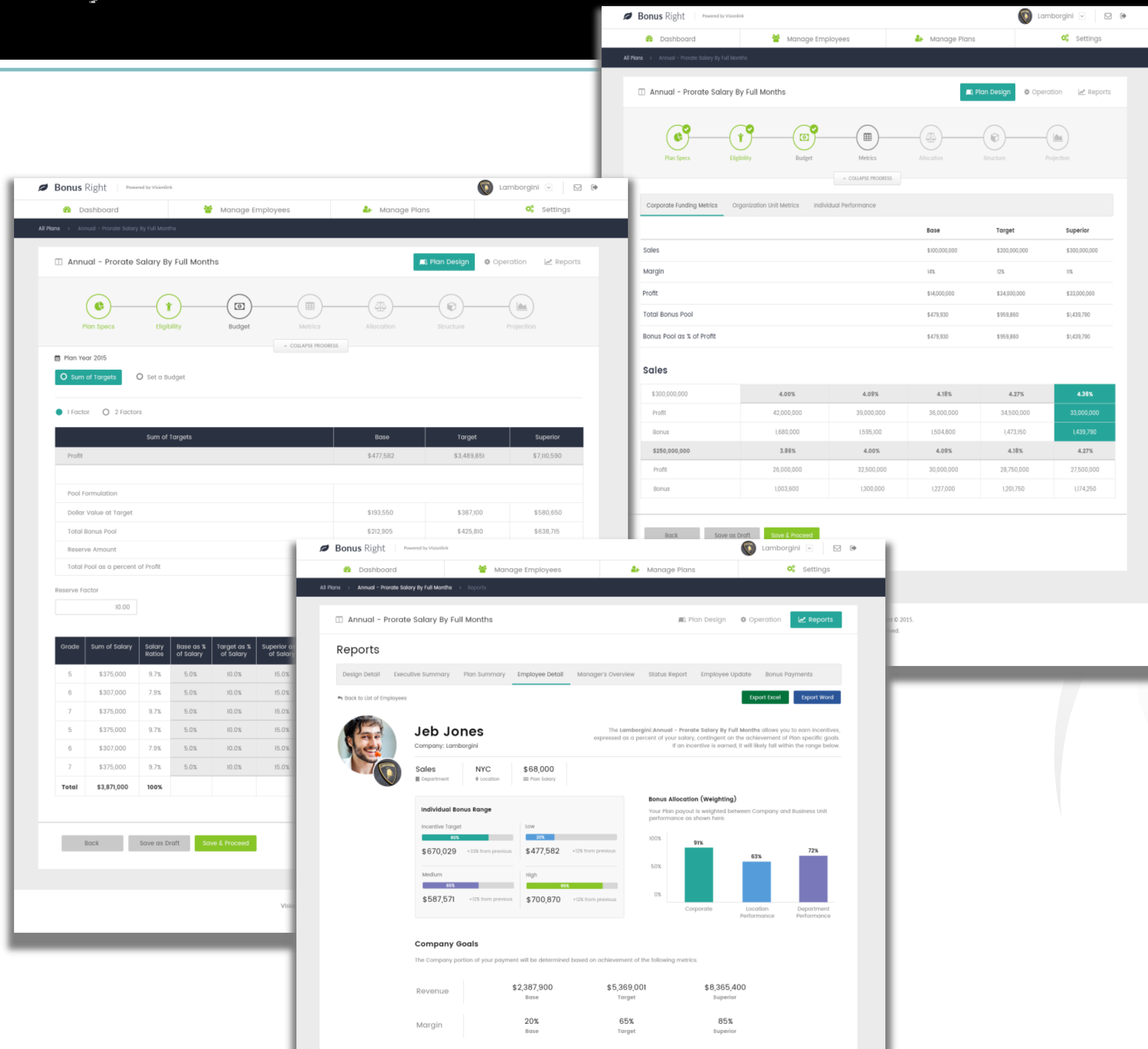

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3 Ways Your Value Proposition is Impacting Recruiting and Retention

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When you are speaking with a potential new employee, does the subject of compensation ever come up? Or when one of your key people announces she is taking an opportunity at another company, is pay ever mentioned as a factor? Okay, forgive the insulting questions. But with all that has been written in recent years about how small a role a rewards strategy plays in an employee's performance, engagement and loyalty, I just thought I would ask what your "real life" experience has been. I imagine the truth is that compensation is a huge factor in recruiting and retaining the kind of talent you want. For most business leaders,having a compelling value proposition can make or break their ability to secure the people they are trying to attract--or keep. So let's stop pretending it's not a big issue and examine how your compensation approach is impacting your competitiveness in today's talent market place.

How Do You Make Incentive Plans "Self-Financing?"

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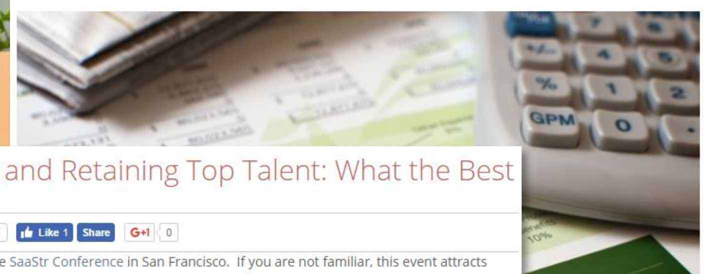
CEOs and business owners are always concerned about costs—because costs diminish profits. As a result, if you lead a company, one of the first questions you likely ask when an incentive plan is proposed is this: "What is it going to cost?" The question is understandable and appropriate; however, it starts a discussion about the merits of incentive plans on a wrong premise. In theory, an incentive plan shouldn't "cost" the company anything. Let me explain.



Attracting and Retaining Top Talent: What the Best Expect

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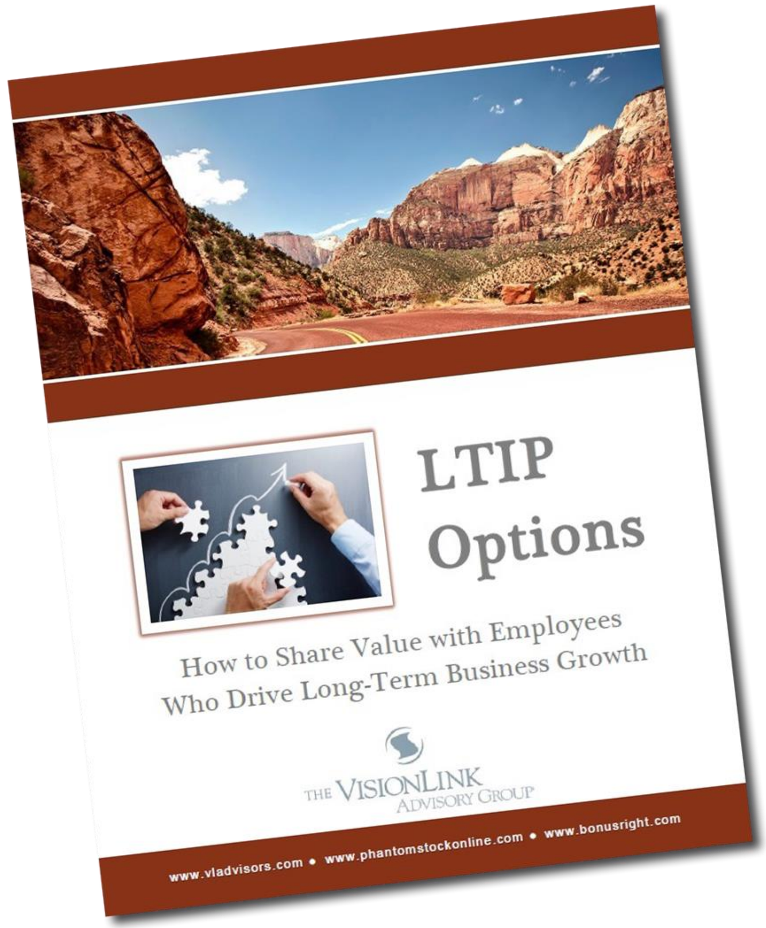
Last week I attended the SaaStr Conference in San Francisco. If you are not familiar, this event attracts about 10,000 attendees from the technology world to hear and learn from some of the industry's most successful SaaS company founders and leaders. These are individuals who have had to attract and develop talent in a highly competitive environment—and have succeeded in doing so on their way to building valuable companies. However, the principles and practices they apply in attracting and retaining top talent are not unique to their industry. They are what every successful organization does. So, let's learn from them, shall we?

Free Report:
HOW TO SHARE VALUE WITH EMPLOYEES WHO DRIVE LONG-TERM BUSINESS GROWTH



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Q&A

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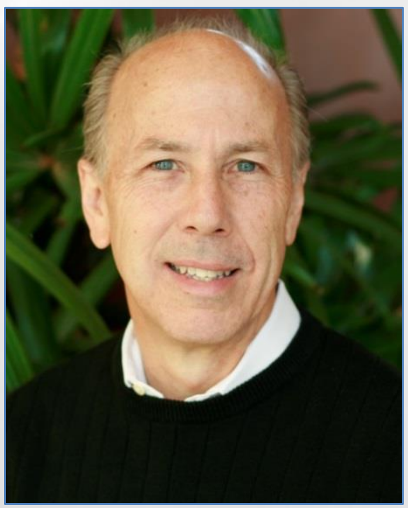
Thank You!



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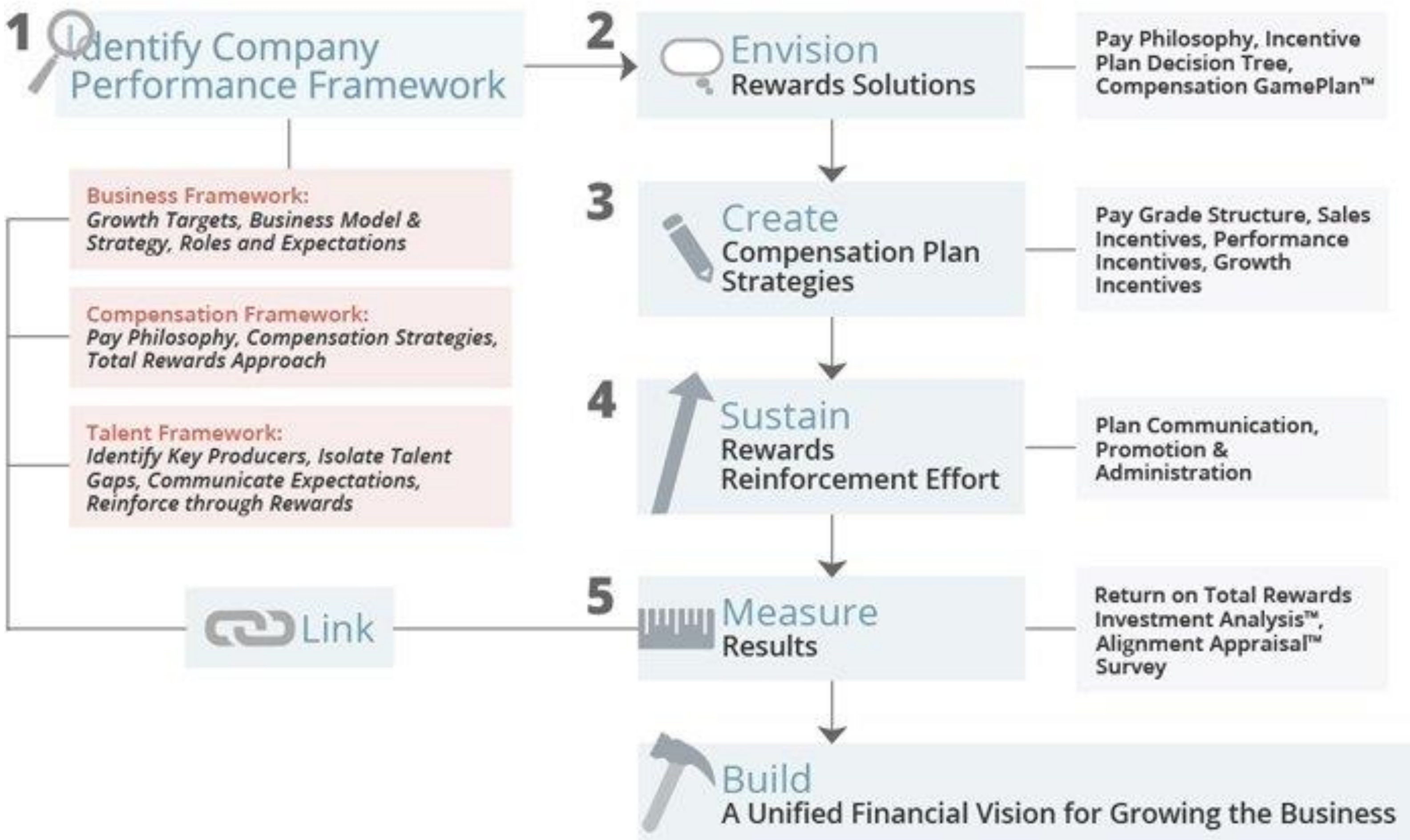
1
Identify Company
Performance Framework
Business Framework:
Growth Targets, Business Model & Strategy, Roles and Expectations
Compensation Framework:
Pay Philosophy, Compensation Strategies, Total Rewards Approach
Talent Framework:
Identify Key Producers, Isolate Talent Gaps, Communicate Expectations, Reinforce through Rewards
Link
2
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