"Guaranteed vs. Incentive Pay: What's the Right Balance?"

THE VISIONLINK ADVISORY GROUP

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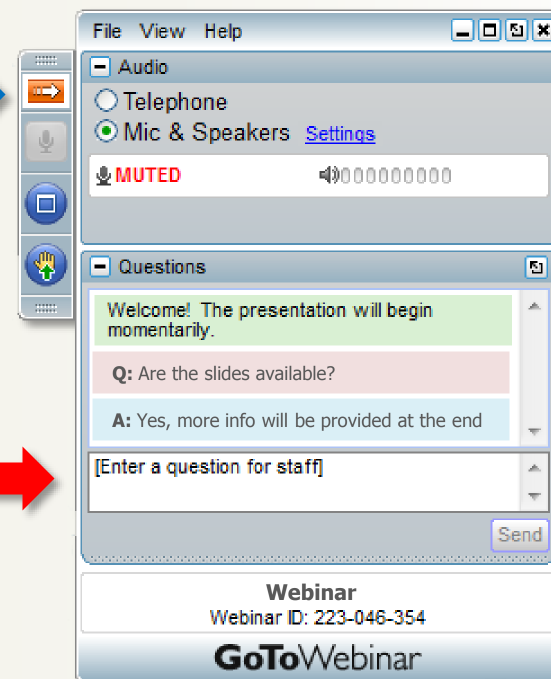

THE VISIONLINK ADVISORY GROUP

Today's Presenter:

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- Founded in 1996
- Over 450 Clients in North America
- Focus: Compensation design and management that drives growth

Balancing Guaranteed vs. Variable Pay

- What is the right mix of pay between salaries and incentives?
- It can be a juggling act
- Too much focus on salaries carries a high company cost with no promise of performance
- Too much focus on incentives may be perceived as too risky for employees

Balancing Guaranteed vs. Variable Pay

- What is wrong with traditional views on incentives?
- Why do traditional bonus plans fail?
- How to design a plan that is geared toward the "average" employee?
- What is the difference between short-term and long-term incentives?

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?

What is Your Pay Mix?

- Most companies aim to pay "at market"
  - What is "at market" pay?
  - If everyone paid the exact same way would that give you a competitive advantage in hiring and retaining talent?
- What is it about your pay programs that make you unique?
- What might be right for you may not be right for others

Sample Pay Mix

- Lets assume an Accountant should be paid between $45,000 and $47,500
- How much of that should be salary and how much should be variable should be decided internally

Professional Accountant	Base Salary	Incentives	Total Cash Comp
Option A	44,000	1,000	45,000
Option B	42,500	4,000	46,500
Option C	40,000	7,500	47,500

- Are either of these company less “competitive” than any other?

Sample Pay Mix

- **Option A - Conservative**
  - Has an advantage around base salary
  - Has higher fixed costs

Professional Accountant	Base Salary	Incentives	Total Cash Comp
Option A	44,000	1,000	45,000

- **Option B - Moderate**
  - Middle ground for both salaries and incentives

Professional Accountant	Base Salary	Incentives	Total Cash Comp
Option B	42,500	4,000	46,500

- **Option C - Variable**
  - Has a competitive advantage around incentives and Total Cash Comp
  - Risk when no incentives paid

Professional Accountant	Base Salary	Incentives	Total Cash Comp
Option C	40,000	7,500	47,500

Conservative Pay Profile

Profile	Base Pay	Short-Term Incentives	Long-Term Incentives	Core Benefits	Profile
Conservative	High	Low	Moderate	High	Moderate

Provides a high degree of employee security at the expense of variable pay
High base salaries and low incentives
Generally offers high level of core benefits
Cash friendly stable organization
Generally attractive to a younger employee population
Can inhibit the hiring of “high performers”
Rewards performance through merit/promotion
Retains executive leadership through moderate long-term awards

Moderate Pay Profile

Profile	Base Pay	Short-Term Incentives	Long-Term Incentives	Core Benefits	Retirement
Moderate	Moderate	Moderate	Moderate	Moderate	Moderate

Provides a middle of the road approach to pay
Base salaries at middle of market
Some upside incentive potential
Performance rewarded moderately
Attracts a diverse employee population
Rewards performance through multiple facets
Tries to provide a balanced approach without any distinguishing element of pay

Variable Pay Profile

Profile	Base Pay	Short-Term Incentives	Long-Term Incentives	Core Benefits	Retirement
Variable	Low	High	High	Moderate	Moderate

Provides a high degree of upside earning potential with higher level of risk

Base salaries at low end of the market

Rewards tied directly to business performance

Entrepreneurial mindset – less cash friendly

Attracts high performers, frightens risk averse

Rewards performance through incentive pay

Promotes high level of value sharing

Attracts entrepreneurial leadership through long-term awards

Pay Mix Considerations

Demographics

- Younger/Nonexempt employees value predictable pay
  - Prefer higher salaries and lower total cash compensation
- Entrepreneurial/Mature employees want upside pay potential
  - Will accept lower salaries with higher total cash opportunity
  - Usually seek both short and long-term incentives
- Diverse employee populations may require different focus on pay at different levels
  - Usually accommodated within compensation structure/salary ranges

Pay Mix Considerations

Owner/Shareholder attitudes on pay

- Public vs. Privately held companies tend to have different pay mixes
  - Privately held companies tend to place more pay in variable programs
  - Public companies have the capital to pay higher salaries
  - Public companies may offer equity to offset salary or incentive pay
  - Public companies can be limited to additional shareholder/fiduciary concerns around pay
  - Nonexempt organizations also share restrictions around pay mix

Pay Mix Considerations

Capital

- High salaries provide ease in hiring talent but carry heavy fixed costs
  - During poor performance years, high salaries can be a heavy burden
- High incentives offers a way of self-funding compensation based on company performance
  - When performance objectives are not hit and no incentives are paid, this philosophy carries a big turnover risk
- Ultimately, your pay mix needs to correspond to your business plan

How is Your Investment Allocated?

What does your total pay mix look like? Does it link employees to your business plan?

- Why is your compensation budget allocated the way it is today?
- Is your total compensation allocation producing unintended consequences (spiraling compensation expenses, turnover, inability to attract talent, etc.)?
- Is there a more cost efficient way to manage your compensation dollars while aligning more tightly with your business objectives?
- **The mix of incentives is usually the easiest place to start correcting your mix**

Incentive Plan Self Evaluation

How well is your bonus plan working?

- Are there unintended consequences of your plan?
- Is the plan helping to drive the business? Or is it just a necessary evil to stay competitive?
- Is the plan too rich or is it not meaningful enough?
- Do plan payouts seem random or tied to strange hard to understand metrics?
- Are there elements of the plan left to chance?
- Is the plan too discretionary or not discretionary enough?
- Do employees/executives complain about your plan?

What's Can Go Wrong With Variable Pay Plans?

Chuck is the leading salesman in the company, and as a result is one of the highest paid employees in the company. However, Chuck only does what is "required" in order to get paid. During difficult quarters, Chuck rarely "pitches in" and appears to be self serving in everything he does.

What’s Can Go Wrong With Variable Pay Plans?

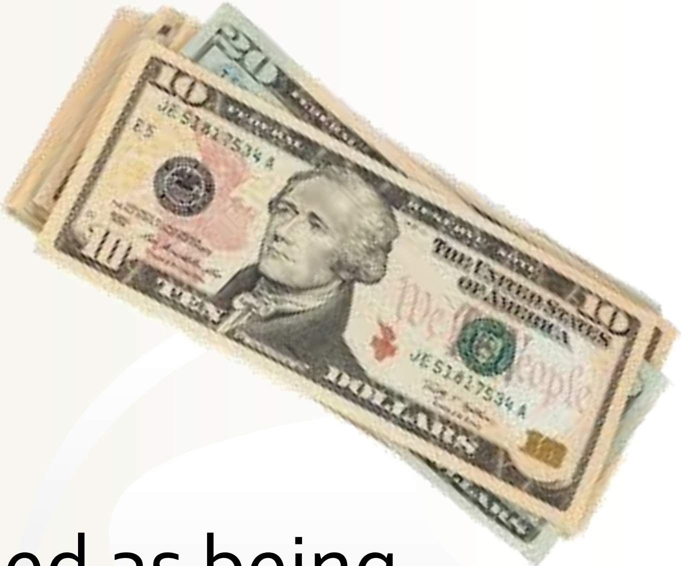
Beatrix is a hard working and dedicated employee. Every year her manager lays out 25 things that she needs to do to earn her incentive. Even though her leadership has helped transform the company, she is not able to achieve every metric on her incentive plan and usually has a reduced plan payout. Beatrix does not like her incentive plan.

What's Can Go Wrong With Variable Pay Plans?

Eugene has been with the company for 20 years. Over the past few years it seems like his performance has dropped. However, because of his tenure, Eugene receives a generous bonus every year.

What is Variable Pay?

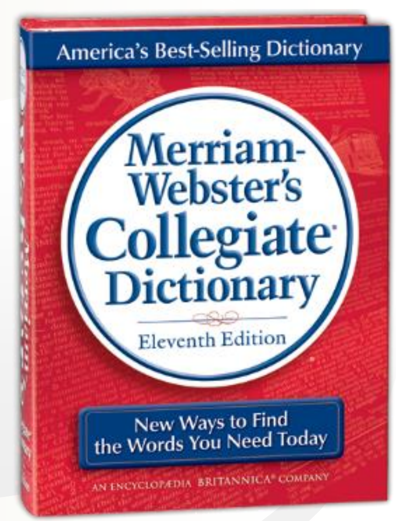
- Variable pay programs have conditions which must be met to earn rewards
  - Company Performance
  - Organizational Performance
  - Individual Performance



- Typically variable pay is defined as being either bonuses, incentives, or commissions

Merriam-Webster Definitions

- **Bonus** – An extra amount of money that is given to an employee
- **Commission** – An amount of money paid to an employee for selling something
- **Incentive** – Something that incites or has a tendency to determination or action



Employee Opinions on Variable Pay

- **Bonus** - Employees would like you to just give them money
  - Is that a wise use of company dollars?
  - How is it applied fairly (Pay For Performance)?
- **Commissions** – Most employees don't have the risk appetite for commissions
  - Unless your employees have intentionally chosen a career in sales, average employees are not interested in sales

Employee Opinions on Variable Pay

- **Incentives** – Incentive plans can be perceived as manipulative
  - Seek to change behaviors
  - Incentive plans often micromanage employee output
  - Do not always reward for making the right decision

Are these the only forms of variable pay?

Traditional View of Incentives

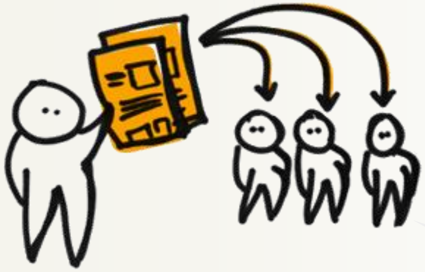
- "If I put a carrot in front of you, you will do what I want you to do"
- At its heart, when structured inappropriately, incentive plans are perceived as manipulative
- Employees agree to be manipulated for money

A Better Approach

- "We are part of a team. If we all work together we will generate greater success. That success will be shared with everyone in our incentive plan."
- When structured appropriately, incentive programs should be perceived a partnership.

Annual Value Sharing Program

- In reality, the best variable pay programs seek to reward everyone for helping the organization to succeed!
- When the company wins, everyone wins.
  - Money is not handed out indiscriminately (bonuses)
  - Awards are not rewarded only for sales activities (commissions)
  - Rewards are not predicated on behaviors that may or may not be in the best interest of the organization (incentives)
- Incentives are tied to company performance first, and then subsequently to sub-organizational and individual performance



Basic Plan Outline

Plan Funding Company Performance		
Minimal Performance	**Target Performance**	**Superior Performance**
Reduced Funding	Target Funding	Increased Funding

Company must perform to fund the plan
Plan has minimal funding goals (reduced funding)
Target performance aligned to company forecast
Superior performance increases plan funding

	Salary Range	Minimal Payout	Incentive Target	Superior Payout
Accountant	$42,000 - $48,500	2.5%	5%	7.5%

All employees have an incentive opportunity tied to plan funding

Basic Plan Outline

- Pool allocation to plan participants contingent on:
  - Company performance – Employees should have all or a portion of their bonus based on company performance
  - Sub-Organizational Performance – a portion of an employees bonus can be allocated based on department, location, division, or business unit
  - Individual performance should be used as a plan modifier

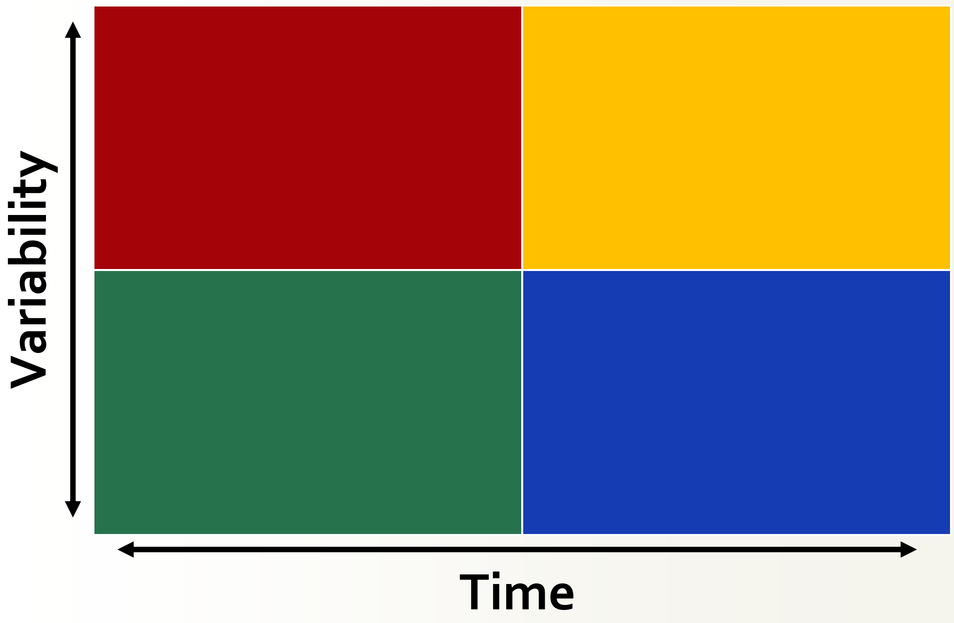
Basic Construct

- Regardless of individual or departmental performance, the key factor to plan funding is company success (instead of tenure, strange metrics,
- Individuals not given a list of objectives to perform with the promise of payout.
- Individual modifier allows for recognizing superior or sub-par performance
- Employees should be focusing on what they can do to make the company successful to ensure maximum payout

Is Something Missing?

- Should all rewards programs be focused on short-term company performance?
  - Merit Programs
  - Variable Program
  - Benefits Programs
- How should rewards programs balance short-term vs. long-term?

Fixed vs Variable
Long vs Short



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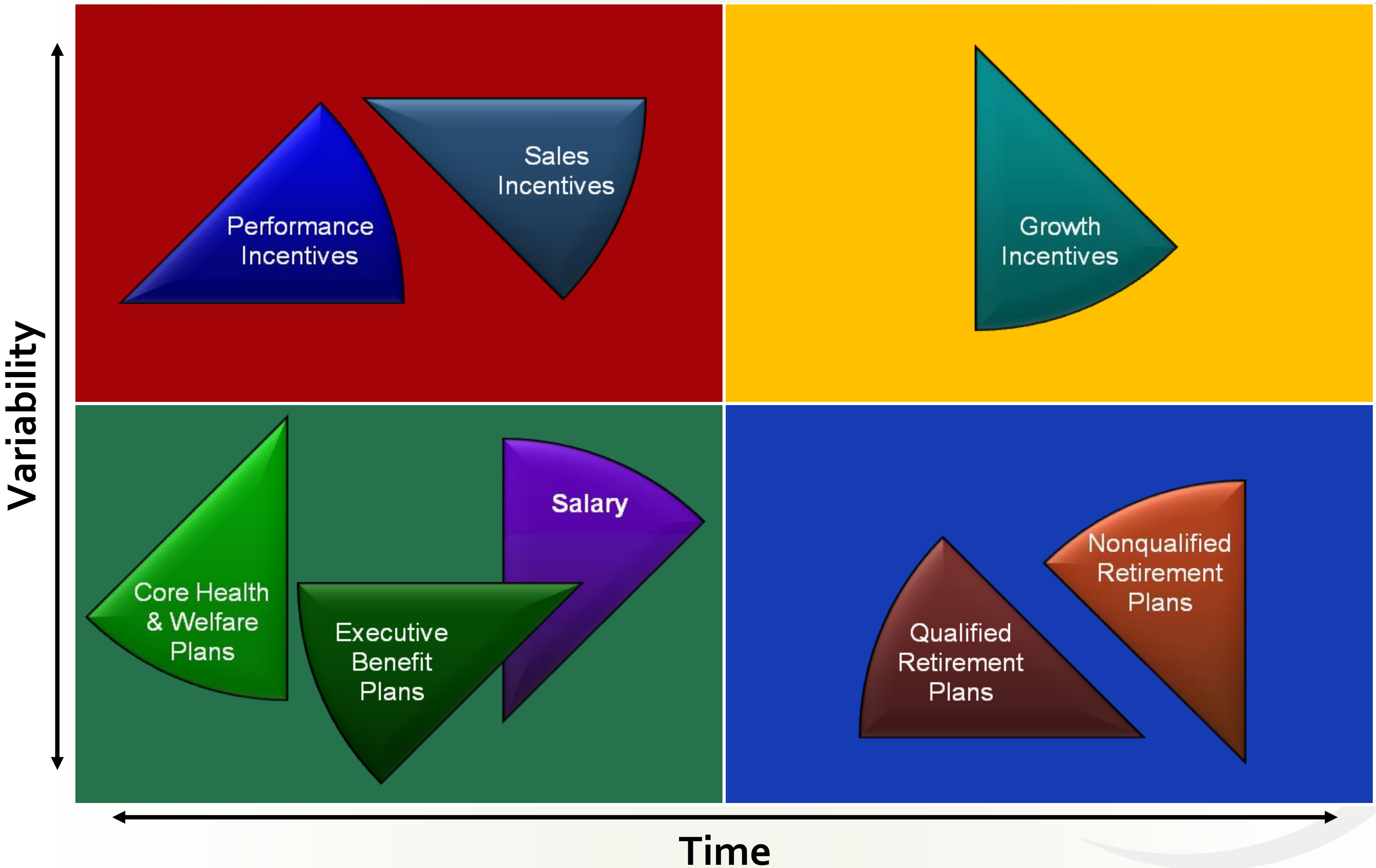
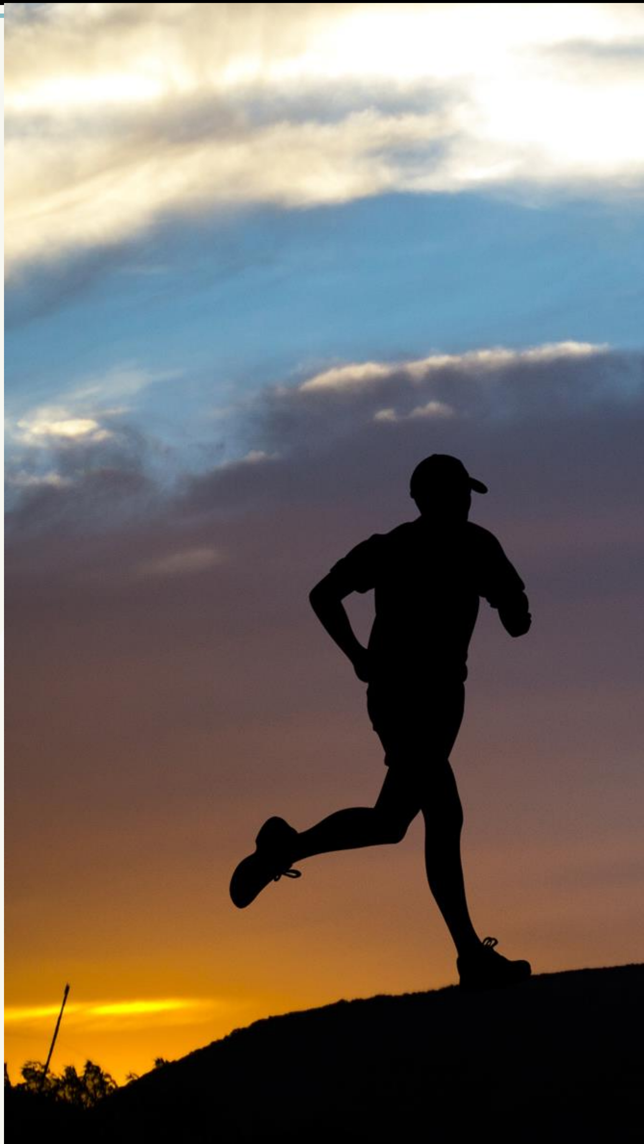
Long vs Short



Long-Term Incentives

- What are long-term/growth incentives?
  - Variable pay program that focus on long-term performance of an organization
- In public companies typically in the form of restricted stock or stock options/SARs
- In private companies, typically they are cash based programs (Phantom Stock, PUP, Strategic Deferred Comp, etc.)

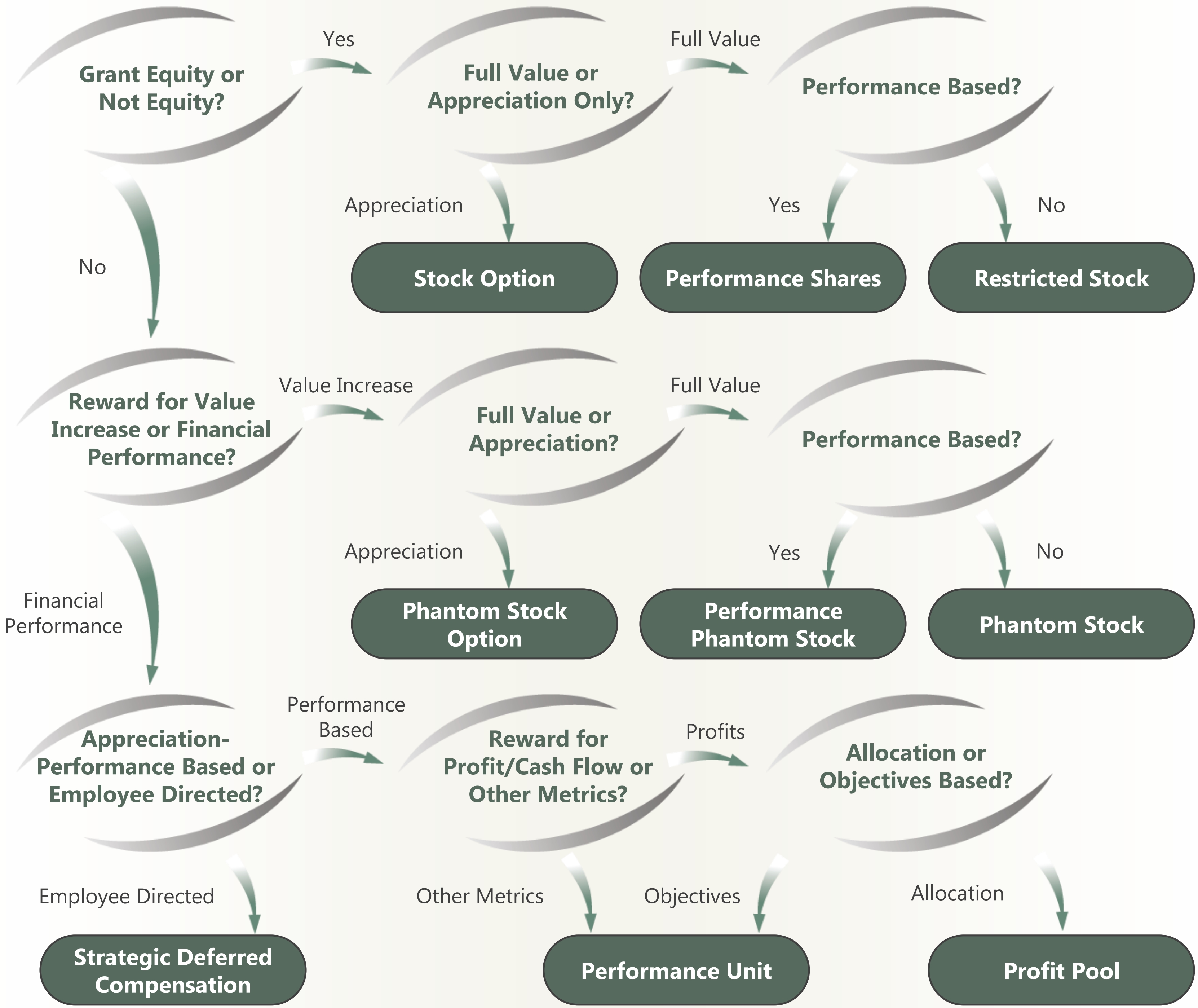


Why is it Important to have Long-Term Incentives?

- Ensures that key employees and decision makers have the best long-term interest of the company at hand
- Serves as a strong retention tool (plan vesting)
- If well structured, long-term incentives can be self funding (only awarded if plan/company objectives have been met)
- Becoming an inevitable part of most companies rewards package
- Long-Term Incentives have replaced pensions as company provided retirement for senior employees

Long-Term Focus

- An executive needs to hire 3-4 more positions this year in order to get started on an important long-term project
- However, he is aware that if he hires these positions he wont "hit" his budget numbers this year which will impact his annual bonus payment
- Delaying the hire will put him behind schedule with the project but will ensure he has a nice incentive payment
- How do we ensure that the executive puts the best interest of the company first?



Grant Equity or Not Equity?
Yes
Full Value or Appreciation Only?
Full Value
Performance Based?
Appreciation
Yes
No
Stock Option
Performance Shares
Restricted Stock
No
Reward for Value Increase or Financial Performance?
Value Increase
Full Value or Appreciation?
Full Value
Performance Based?
Appreciation
Yes
No
Phantom Stock Option
Performance Phantom Stock
Phantom Stock
Financial Performance
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

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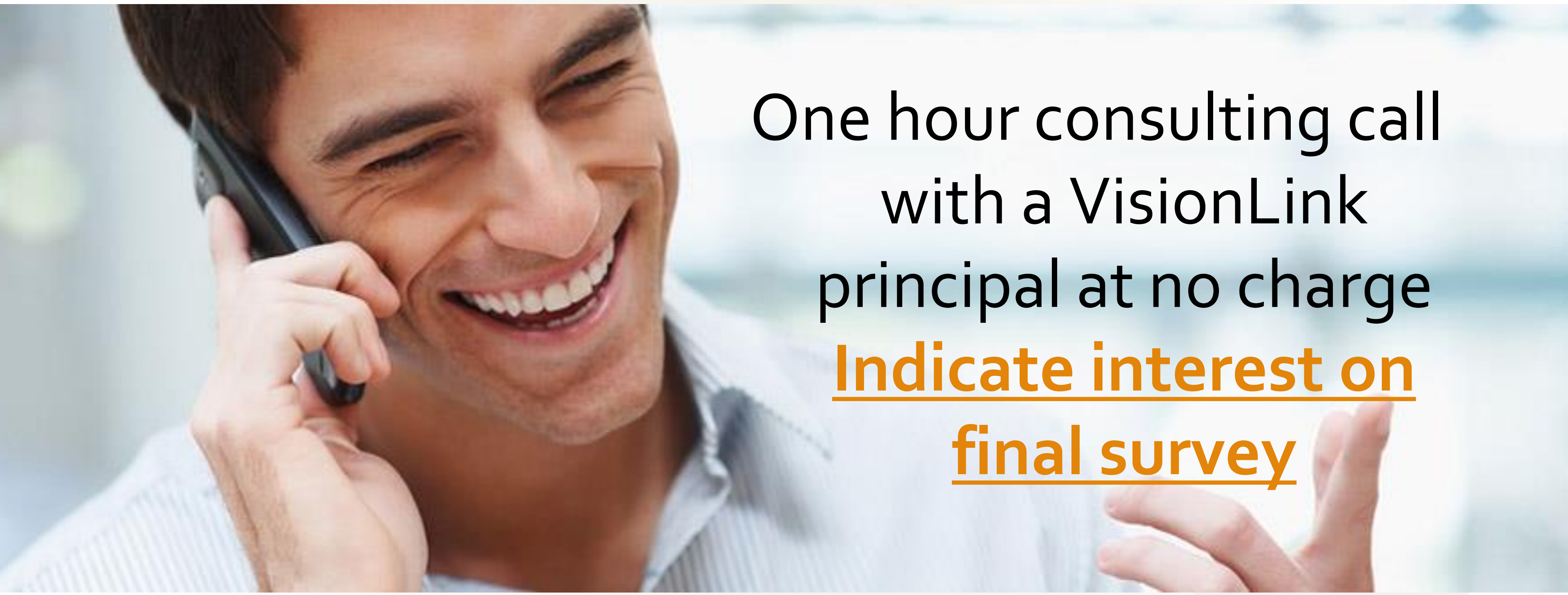
Type Your Questions

Special Offer



One hour consulting call with a VisionLink principal at no charge

Indicate interest on final survey

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Request a copy of our slides, white paper and a complimentary consultation.

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Compensation as a Wealth Multiplier

How to Build Pay Strategies that Increase Shareholder Value

To be held on:
Tuesday, June 23, 2015

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Next Online Seminar :
(for HR specific audience)

How to Achieve a Competitive Advantage in Pay

To be held on:
Tuesday, September 8, 2015

Upcoming VisionLink Online Seminars:

Compensation as a Wealth Multiplier ***How to Build Pay Strategies that Increase Shareholder Value***	**June 23rd**
4 Alternatives to Sharing Stock *How to Share Value without Diluting Equity*	**July 28th**
The 3 "Habits" of Highly Effective Pay Plans *How to Ensure Your Rewards Programs will Succeed*	**August 25th**
How to Achieve a Competitive Advantage in Pay (HR Audience)	**Sept 9th**
The 4 Secrets to Retaining Top Talent *How to Solve the Key Performer Retention Problem*	**Sept 22nd**
I'm Paying My Top 4 People $1 Million -- What am I Getting For It? *How to Measure the Return on Your Compensation Investment*	**Oct 27th**
How to Build and Manage a Total Compensation Structure (HR Audience)	**Nov 11th**

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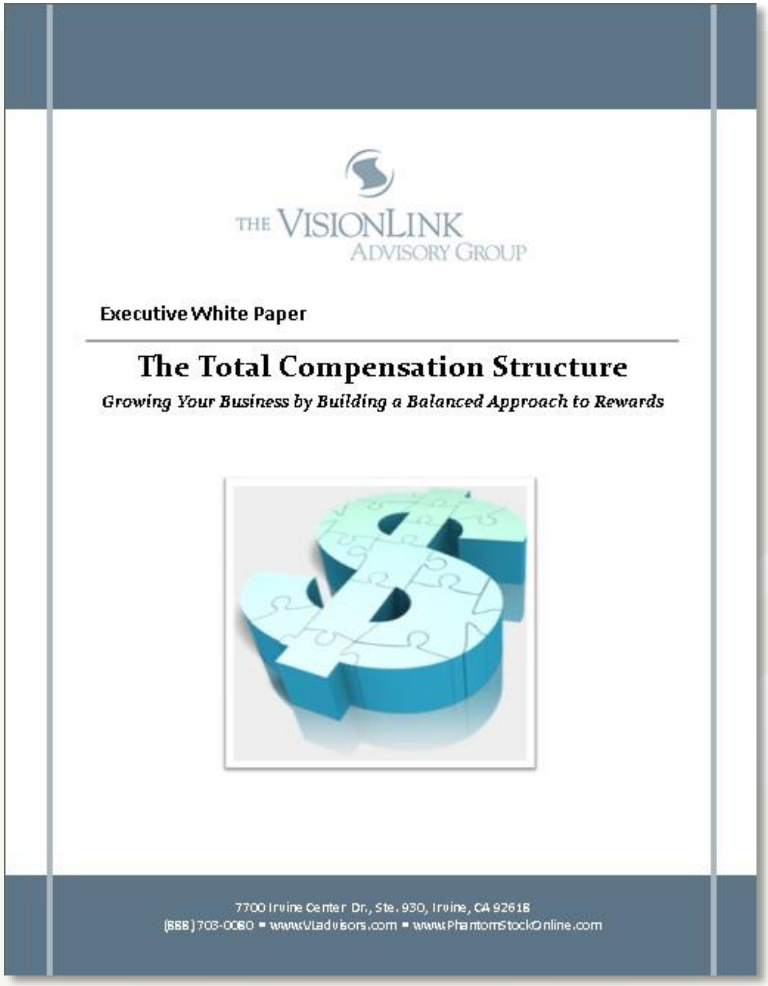

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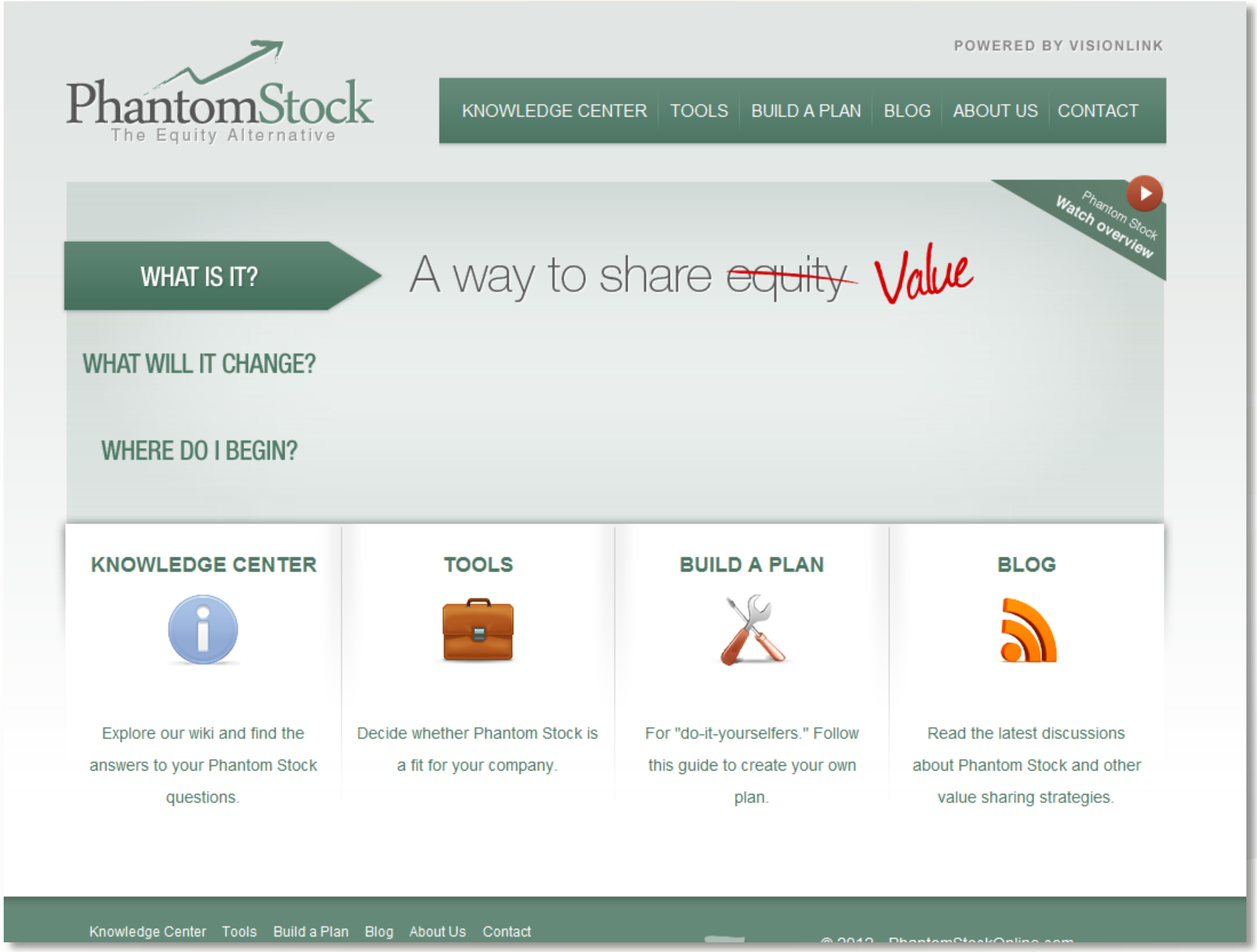

Q&A

Thank you!

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