“Guaranteed vs. Incentive Pay: What’s the Right Balance?”
We’re happy to provide a copy of today’s slides. Information will be provided at the close of the presentation.

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Q: Are the slides available?
A: Yes, more info will be provided at the end
Today’s Presenter:

**Joe Miller**
Senior Consultant
(949) 265-5708
jmiller@vladvisors.com
- 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?
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
Let's 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.

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

### Sample Pay Mix

<table>
<thead>
<tr>
<th>Professional Accountant</th>
<th>Base Salary</th>
<th>Incentives</th>
<th>Total Cash Comp</th>
</tr>
</thead>
<tbody>
<tr>
<td>Option A</td>
<td>44,000</td>
<td>1,000</td>
<td>45,000</td>
</tr>
<tr>
<td>Option B</td>
<td>42,500</td>
<td>4,000</td>
<td>46,500</td>
</tr>
<tr>
<td>Option C</td>
<td>40,000</td>
<td>7,500</td>
<td>47,500</td>
</tr>
</tbody>
</table>
**Sample Pay Mix**

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

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

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

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<td>7,500</td>
<td>47,500</td>
</tr>
</tbody>
</table>
## Conservative Pay Profile

<table>
<thead>
<tr>
<th>Profile</th>
<th>Base Pay</th>
<th>Short-Term Incentives</th>
<th>Long-Term Incentives</th>
<th>Core Benefits</th>
<th>Profile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conservative</td>
<td>High</td>
<td>Low</td>
<td>Moderate</td>
<td>High</td>
<td>Moderate</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Profile</th>
<th>Base Pay</th>
<th>Short-Term Incentives</th>
<th>Long-Term Incentives</th>
<th>Core Benefits</th>
<th>Retirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Moderate</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Profile</th>
<th>Base Pay</th>
<th>Short-Term Incentives</th>
<th>Long-Term Incentives</th>
<th>Core Benefits</th>
<th>Retirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable</td>
<td>Low</td>
<td>High</td>
<td>High</td>
<td>Moderate</td>
<td>Moderate</td>
</tr>
</tbody>
</table>

- **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
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.
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
- **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
“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.
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.
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

<table>
<thead>
<tr>
<th>Salary Range</th>
<th>Minimal Payout</th>
<th>Incentive Target</th>
<th>Superior Payout</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accountant</td>
<td>$42,000 - $48,500</td>
<td>2.5%</td>
<td>5%</td>
</tr>
</tbody>
</table>

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
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

Variability

Time

Salary
Performance Incentives
Sales Incentives
Growth Incentives
Core Health & Welfare Plans
Exec Benefits
Q Retire
NQ Retire
Fixed vs Variable Long vs Short

- Performance Incentives
- Sales Incentives
- Growth Incentives
- Core Health & Welfare Plans
- Executive Benefit Plans
- Salary
- Qualified Retirement Plans
- Nonqualified Retirement Plans
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 won't "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?

Yes

Performance Based?

Full Value

No

Stock Option

Yes

Performance Shares

No

Restricted Stock

No

Appreciation

Value Increase

Full Value or Appreciation?

Yes

Performance Based?

Full Value

Performace Shares

No

Restricted Stock

No

Appreciation

Value Increase

Full Value or Appreciation?

Yes

Performance Based?

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How to Build Pay Strategies that Increase Shareholder Value

To be held on:
Tuesday, June 23, 2015

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How to Achieve a Competitive Advantage in Pay

To be held on:
Tuesday, September 8, 2015
## Upcoming VisionLink Online Seminars:

<table>
<thead>
<tr>
<th>Topic</th>
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<tr>
<td>Compensation as a Wealth Multiplier</td>
<td>June 23rd</td>
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<tr>
<td><em>How to Build Pay Strategies that Increase Shareholder Value</em></td>
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<td><em>How to Share Value without Diluting Equity</em></td>
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<td>The 3 “Habits” of Highly Effective Pay Plans</td>
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<td><em>How to Ensure Your Rewards Programs will Succeed</em></td>
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<td>How to Achieve a Competitive Advantage in Pay (HR Audience)</td>
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<td>The 4 Secrets to Retaining Top Talent</td>
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<td><em>How to Solve the Key Performer Retention Problem</em></td>
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<td>I’m Paying My Top 4 People $1 Million -- What am I Getting For It?</td>
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<td><em>How to Measure the Return on Your Compensation Investment</em></td>
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<td>How to Build and Manage a Total Compensation Structure (HR Audience)</td>
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White Paper

Executive White Paper

The Total Compensation Structure
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