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ADVISORY GROUP

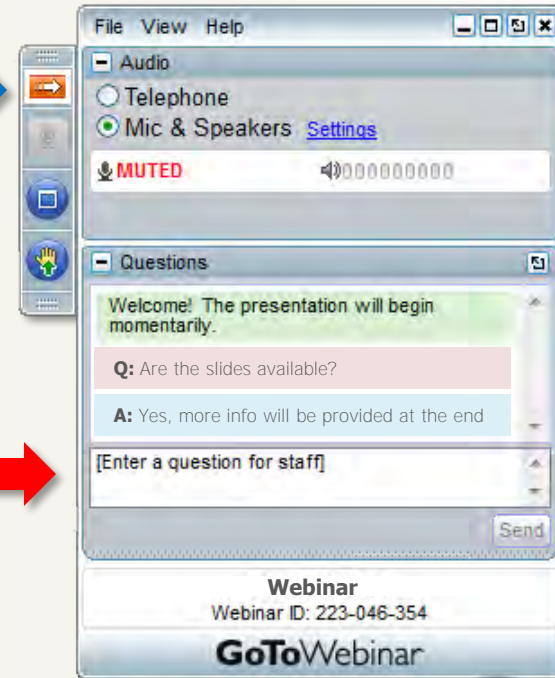
# “Why Your Bonus Plan Isn’t Working”



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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Today's Presenter:

***Joe Miller***

*Senior Consultant*

*(949) 265-5708*

*jmillervladvisors.com*



**Special  
Opportunity  
Announced  
at end of  
Broadcast.**

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**SURVEY**



# Special Offer



One hour consulting call  
with a VisionLink principal  
at no charge

Indicate interest on  
final survey





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

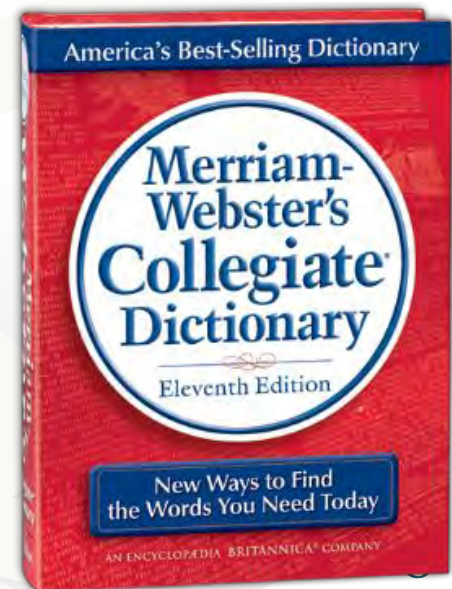
# Lets define variable pay...

- Variable pay programs have conditions which must be met to earn rewards
  - Company
  - Organizational (Department)
  - Individual
- Typically defined as
  - Bonuses (Spot Awards, Sign-On, Retention)
  - Commissions (Sales)
  - Incentives (Performance)



# 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 love for you to just give them money
  - Is that always a wise use of company dollars?
  - What is your ROI?
- **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



# Bonus Awards

## Should Employers Continue to Provide Bonuses?

- **Sign On – Please join me**
  - Effective way to sweeten the deal
  - Aren't baked into base pay
  - Should be considered if candidate is walking away from a cash award in current agreement



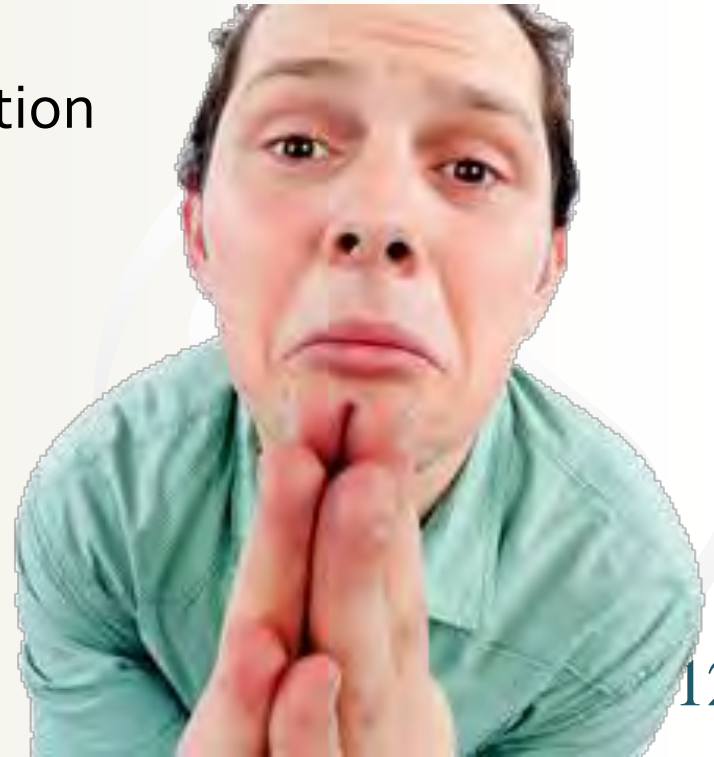
**Answer:**  
**Use When Needed**

# Bonus Awards

## Should Employers Continue to Provide Bonuses?

- **Retention awards – Please don't leave me**
  - Hold an employee in place temporarily. They will leave you eventually
  - Communicate a sense of desperation
  - Frequently abused

**Answer:  
Use Sparingly**





# Bonus Awards

## Should Employers Continue to Provide Bonuses?

- **Spot awards – Thanks for working so hard**
  - Send a positive message to employees going above and beyond
  - Should be a nominal lump sum
  - Should not be used as a carrot/behavioral motivator



**Answer:  
Frequently**

# What's can go wrong with commission plans?

## CHUCK

Chuck is the leading salesman in the company, and as a result is one of its highest paid employees. However, Chuck only does what is “required” in order to get paid. After his monthly sales quota is met, he shows up late and leaves early.



# Commissions

## Should Employers Continue to Provide Commissions?

Short Answer:  
Probably

- Commission plans are commonly subject to abuse
- Often reward employees for doing what's in their best interest and not in the best interest of the company
- Many companies now adopting an incentive plan format for sales employees



# Should commission plans be considered?



- Not all sales commission plans are bad
- Need to be structured appropriately
- Should be reviewed and adjusted regularly
- Limited to true sales employees
- Commission programs rarely provide employees with a sense of shared purpose



# Most Prevalent Plan...

- Annual Performance Incentive Plan
  - Performance based pay
- Employee assigned KPI's, Goals, or Objectives
- Interacts with performance management process
- Intends to award those employees who align their behaviors with stated objectives



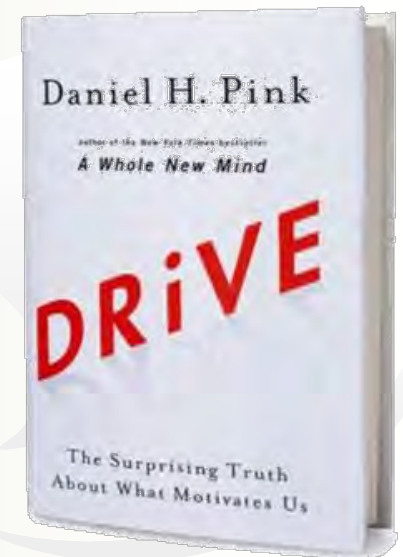
# Market Compensation Trends



- Incentive programs are more common than ever
- 2014 World at Work study showed that 99% of publicly traded companies have incentive plans
- Between 2011 and 2013 private companies with incentives plans have grown from 95% to 97% prevalence

# Incentive Research

- For over 40 years, social psychologists have studied the effects of rewards on behavior and motivation
- In his book *Drive*, author Daniel Pink summarized the effects of over 128 behavioral experiments that proved that rewards have a substantially **negative** effect on intrinsic motivation and behavior.
- “External rewards and punishments – both carrots and sticks – can work nicely for algorithmic tasks. But they can be devastating for heuristic ones.”  
– Teresa Amabile



# Incentive Research



- Sam Glucksberg tested the effects of behavior and incentives using the Candle Test
- In the experiment participants were asked to attach a candle to the wall. To do this they are provided with a box of thumbtacks, a candle, and a matchbook.
- Took incentivized employees 3 and half minutes longer



# Question

- If the most common purpose of incentive plans is to drive performance, and they do exactly the opposite, why do we use them?
- Why are they so common?
- Should we cease to use them?

***Is there a smarter and more effective way of establishing bonuses and incentives?***



# Traditional View of Incentives



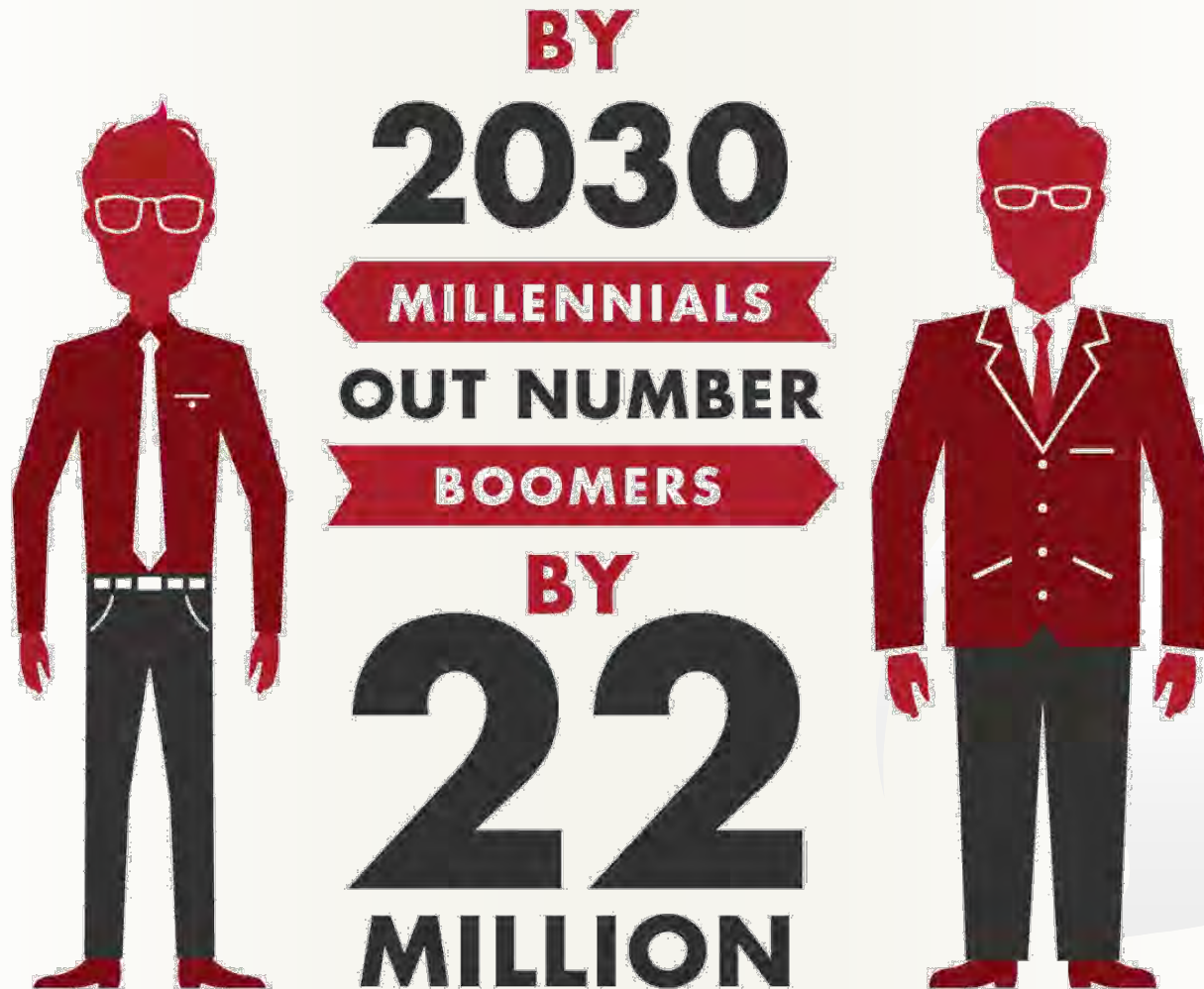
- “If I put a carrot in front of you, you will do what I want you to do”
- At its heart, when structured inappropriately, incentive plans are perceived as manipulative
- Employees agree to be manipulated for money

# Effectiveness



- Can be marginally effective at rote tasks
- Do not require thinking or creativity
- Focus on short-term performance
- Assembly line jobs
- Tasks that will be performed by robots soon if not already

# Your Workforce



# Who are Millennials?

Pew Research Center analysis of U.S. Census Bureau data:

- 1/3 of Workforce
- Ages 18 to 34 in 2015
- 24% of the US population (77 million individuals)
- The median income:
  - Younger Millennials--\$25k
  - Older Millennials \$48k





# Millennial Myths

"...studies have started to dispel the myth of the itinerant millennial. Using data from the U.S. Bureau of Labor Statistics, for example, the website FiveThirtyEight.com has shown that millennials change jobs less frequently than gen Xers did at the same age.

"...at least 40 percent of millennials see themselves staying at their current organization for a minimum of nine years — a much longer period than the 16 months to three years that's often reported."

Millennials Play the Long Game, Strategy+Business, Jennifer Deal and Alex Levenson





# Partnership

- Millennials do not value the traditional “employee” and “employer” relationship
- Perceived as a subservience model
  - “Do what I say and I will pay you”
- Prefer a sense of “Partnership.” working together towards a common goal
- Partners rewarded differently than employees



# 21<sup>st</sup> Century Rewards

- Rewards priority will shift from productivity, efficiency, and automation to creativity, ingenuity, and new product development
- Variable pay will continue to be an important form of pay for employers
- Pay programs will reinforce partnership relationship between employee and employer
- We are working towards a common goal and will win and lose together
- This mindset has been creeping into incentives over the past decade



# Why Do Incentive Plans Fail?



- They seek to change/set behaviors
- They rob employees of their creative input
- They reward for completion of small tasks instead of achieving big picture results
- They aren't tied to overall company results/lack line of sight
- They are either too discretionary or too quantitative

## **BOTTOM LINE:**

**Traditional Incentive plans are philosophically broken.  
They are not perceived as empowering a partnership mentality**

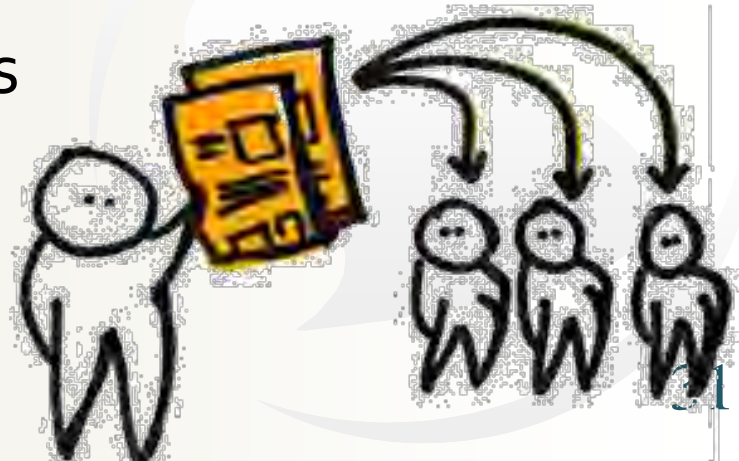
# Value Sharing Philosophy



- “We are part of a team. If we all work together we will generate greater success. That success will be shared with everyone if the company succeeds.”
- When structured appropriately, value sharing programs are perceived a partnership.

# Annual Value Sharing Program

- 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)
- Payments are focused on achieving bigger picture objectives than every day menial tasks
- Requires strong communications



# Basic Construct

- The key factor to plan funding is overall company success
- Employees should be focusing on what they can do to make the company successful
- Focus on big picture success rather than smaller metrics
- Reinforce partnership mindset through continual education and communication





# Basic Construct

- All employees are told they will share in the creation of company value
- Every employee has a defined incentive opportunity aligned to forecasted company results
  - Base – Minimum performance
  - Target - Forecast
  - Superior - Overachievement

	Base Financial Performance	Target Financial Performance	Superior Financial Performance
Company Profit	\$ 45,000,000	\$ 50,000,000	\$ 55,000,000
% of Target	90%	100%	110%
% of EE Salary	5.0%	10.0%	15.0%
\$ Opportunity	\$ 3,750	\$ 7,500	\$ 11,250

# Incentive Calculation

- Depending on how the company performs an actual incentive can be calculated for each employee
- If company results are halfway between Base and Target. Incentives will be calculated halfway between Base and Target
- Actual Results = \$47,500,000
- Calculated Incentive = \$5,625


	Base Financial Performance	Target Financial Performance
Company Profit	\$ 45,000,000	\$ 50,000,000
% of Target	90%	100%
% of EE Salary	5.0%	10.0%
\$ Opportunity	\$ 3,750	\$ 7,500

# Individual Performance

- Should employee performance be taken into consideration?
- 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
- Value Sharing – Sharing of wealth
- If performance was deemed “Unacceptable” discretion should be utilized to eliminate incentive payment



# Org Unit Performance

- How should departments, business units, or locations be taken into consideration?
  - Overall company performance should be **primary objective**
  - Org Unit performance can be a **secondary objective**
- 
- Some of the best incentive plans in the world are only tied to company performance
  - Org units should be utilized when employee line of sight is singular focused on the org unit

# Plan Weighting/Allocation

- Pool 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



# Plan Weighting/Allocation

- Make overall company performance the primary objective (e.g. ~60 - 100%)
- Organizational unit success should be secondary objective (e.g. ~40 - 10%)
- Weight the overall incentive:

	Base Financial Performance	Target Financial Performance	Superior Financial Performance
% of EE Salary	5.0%	10.0%	15.0%
\$ Opportunity	\$ 3,750	\$ 7,500	\$ 11,250
% Company - <b>75%</b>	\$ 2,812.50	\$ 5,625.00	\$ 8,437.50
% Department - <b>25%</b>	\$ 937.50	\$ 1,875.00	\$ 2,812.50



# Plan Discretion

- What about employees who made special contributions over the course of the year?
- Create a discretionary reserve inside of plan funding
- Utilize a nomination process:
  - Reserved for “Exceptional” performers only
  - Discretionary pool held at the top of the organization (not cascaded down to individual managers)
  - Essentially funded Spot awards



# Employee Perspective

- Appreciates being treated like a “partner”
- “I’m not just an accountant. I’m tasked with making this company successful!”
  - Recognizes everything employee does to contribute to success
  - Employees do not feel micromanaged
- Understands the link between pay and performance
- If the company doesn’t perform there is no expectation around pay



# Employer Perspectives



- Defers a portion of pay to overall company performance
  - Self-Funding
- Not simply focused on doing what the job description requires
- Encourages managers to be honest about their performance evaluations
- Removes the headache/traditional power hierarchy associated with distributing rewards
- Egalitarian in nature

# Performance Management

- Not intended to replace strong performance management system
- Performance still best determinant for promotion and merit
- Pay for performance Philosophy (Individual & Company)
- Employees with exceptionally poor performance issues need to be excluded from plan payment



# Communications

- 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 typically 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”



# Communication Statement

- Provide an annual Total Rewards Statement
  - Software tools
  - Mail merge also works
- Communicates incentive opportunity in context of total rewards
- Creates a sense of transparency and “partnership”

FakeCo, Inc.

## Personal Statement of Total Compensation 2016

Dear Stephanie,

We are pleased to provide you with this personalized total compensation statement for 2015.

In addition to the compensation that you receive in your regular paycheck, FakeCo, Inc. provides you with a competitive total compensation package. This statement provides you with a summary of all elements of your personal total compensation.

Sincerely,

John Smith, CEO

*Please note that the information on this statement is intended to provide an overview of your current compensation at FakeCo, Inc. It is not intended to guarantee future payments.*

### Personal Data for Stephanie Jones

Please contact the Human Resources Department if any of the following is incorrect:

Employee Number:	12345	Date of Hire:	11/18/08
Title:	HR Generalist		
Grade:	3	FLSA Status:	Exempt

### Estimated Total Compensation Package

Annualized Salary	Grade <u>Mid Point</u>	2015 Incentive
\$98,744	\$100,000	\$7,234

Incentives Opportunity 2016		
Incentive Opportunity (Base)	Incentive Opportunity (Target)	Incentive Opportunity (Superior)
10%	15%	20%

Employee Benefits		
EE Health and Dental Contribution	401 (k) Contribution	2015 Cell Phone Allowance
\$3,796	\$2,532	\$800



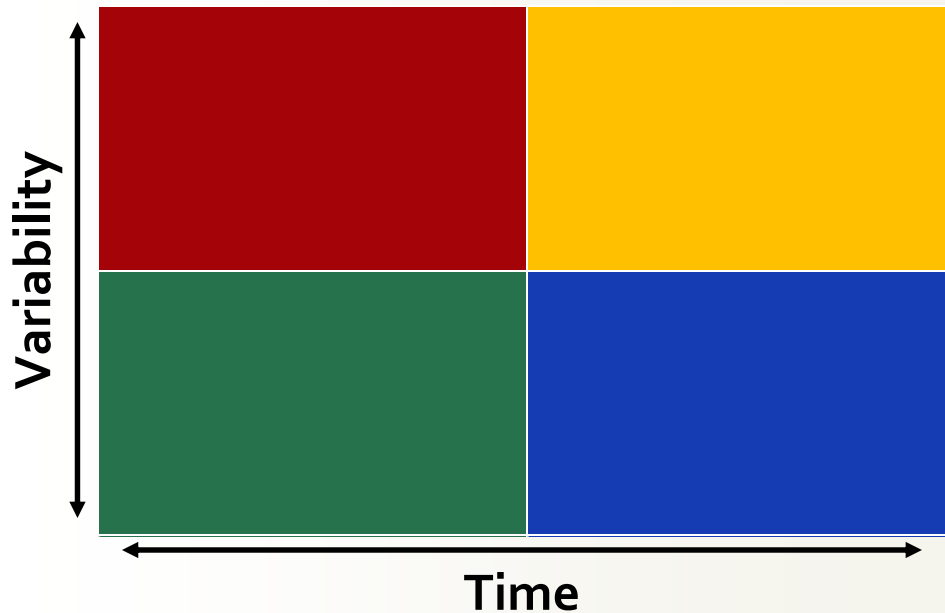
# Is Something Missing?

- Annual incentive provide short-term alignment to pay. As do the majority of rewards programs
  - Value Sharing Programs
  - Salary/Merit Programs
  - Benefits Programs
- How should rewards programs balance short-term vs. long-term?



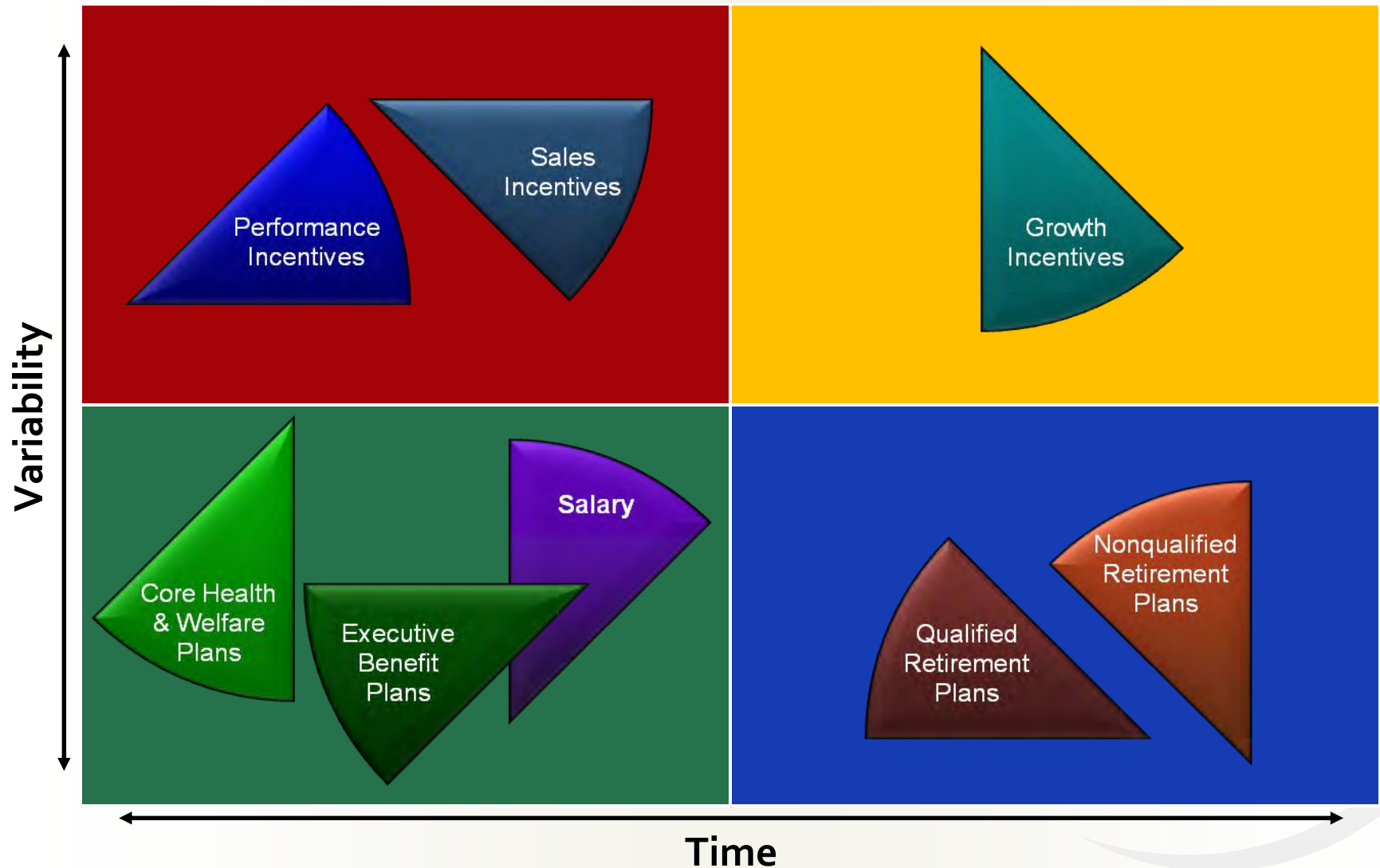
# Fixed vs. Variable

## Long vs. Short



# Fixed vs. Variable

## 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.)

# Long-Term Focus

- Short-term incentive plans do not provide line of sight to long-term company objectives
- Like short-term incentives, long-term incentive should be self funded
- Typically more selective participation (Executives & Directors)
- A strong short-term plan is not an excuse for ignoring long-term incentives



# 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)
- Like short-term incentives, long-term incentives should 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







# 21<sup>st</sup> Century Rewards

- Incentives are a critical tool for 21<sup>st</sup> Century Rewards
- Time to move away from 20<sup>th</sup> Century mindset
  - Beginning of 20<sup>th</sup> Century, most “employees” worked in factories
- Have your rewards kept up with changing economy?
- Workforce has changed as well
  - Growing Millennial population
  - Not Employees – Partners
- To win the talent wars, you will need pay programs that help attract, reward, and retain your employees





**Type Your Questions**

Take our  
**SURVEY**



*Please complete our brief survey immediately following our presentation.*

*We value your input.*

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



# BonusRight



**Let's define your plan**  
You might wind up with multiple plans within your company, or just 1

**? Here's how we define a plan**  
As you can see there are four things to capture. Tell us a little about each. You can easily change any input at any time.

PEOPLE  

METRICS  

METRICS  

DESIRED RESULTS  

**15% PLAN COMPLETE**

**NEXT** 

- New SaaS tool
- Build and manage your bonus plan online
- Exclusive introduction to clients and webinar participants
- **Indicate on survey if you would like to be invited to rollout webinars.**

# Next Online Seminar:

## **Pay & Stewardship**

### ***How to Get Employees to Own Results***

To be held on:  
Tuesday, February 23<sup>rd</sup>

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

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# Upcoming VisionLink Online Seminars:

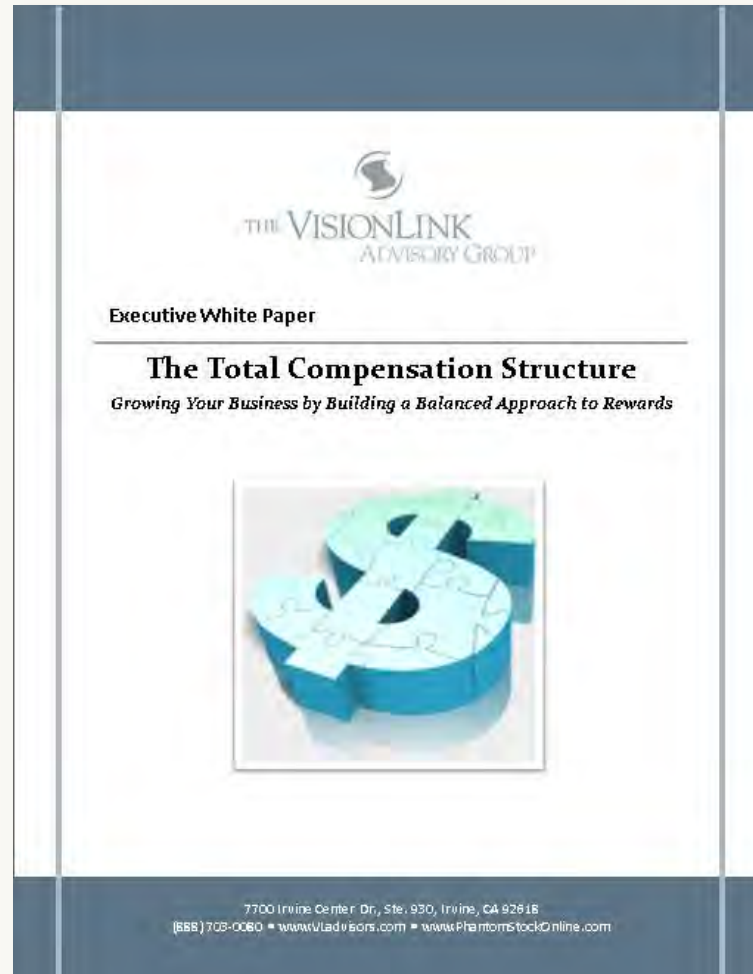
<b>Pay &amp; Stewardship: How to Get Employees to Own Results</b>	<b>February 23<sup>rd</sup></b>
<b>"To Share Equity or Not to Share Equity, That is..."</b> <i>How to Decide Whether You Should Share Stock</i>	<b>March 22<sup>nd</sup></b>
<b>Who You Should be Hiring and How to Pay Them</b>	<b>April 26<sup>th</sup></b>
<b>Guaranteed vs. Incentive Pay: What's the Right Balance?</b>	<b>May 24<sup>th</sup></b>
<b>Rules for Keeping Pay Competitive</b> (HR Specific Webinar)	<b>June 14<sup>th</sup></b>
<b>Pay's Role in Performance Culture</b>	<b>June 28<sup>th</sup></b>
<b>What Millennials Want in a Pay Plan</b>	<b>July 26<sup>th</sup></b>

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## White Paper



Express interest on the final survey

# VisionLink Website

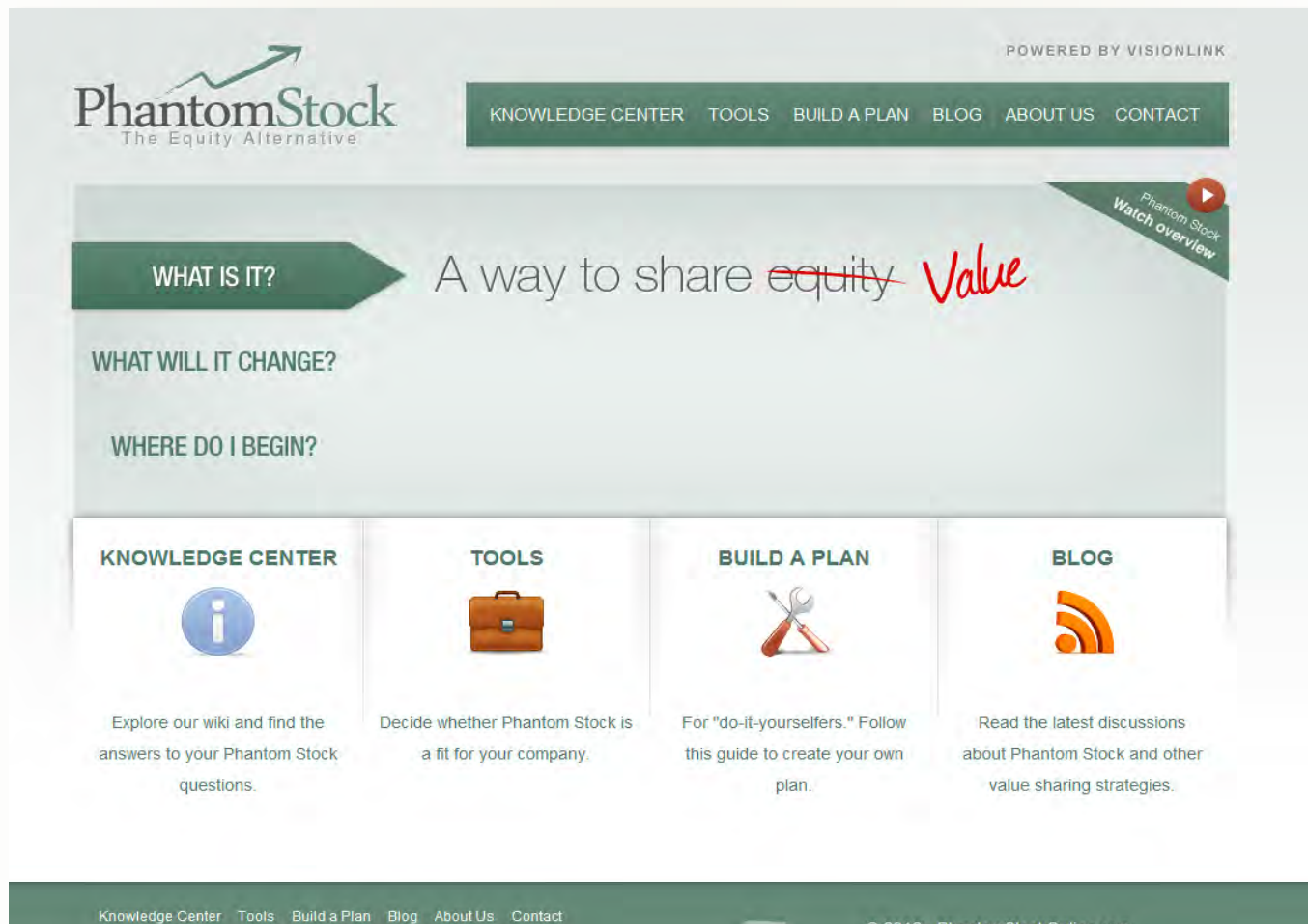
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You can also subscribe to our blog

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# Q&A



Thank you!

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