



***Pay for Performance:
What Makes Variable
Pay Work?***

Presented by

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President

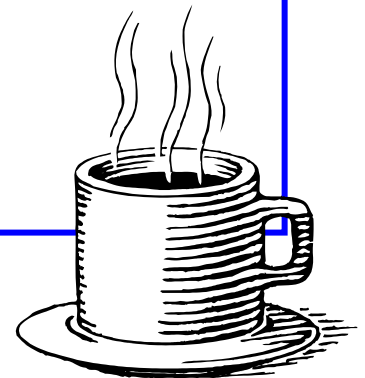
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Wilson
GroupTM

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Presentation Agenda

- I. Background and Session Overview**
- II. Review of Current Conditions in Pay for Performance**
- III. What Makes Variable Pay Plans Work**
- IV. Key Characteristics of Successful Variable Pay Plans**
- V. Conclusions and Open Discussion**



I. Background and Overview

Session Overview

Why This Is Important:

- ❖ The success of every organization is largely determined by the actions of their people – Behaviors (a.k.a. Performance).
- ❖ There are few systems that drive performance as well as variable pay plans.
- ❖ This is “the right time” to make changes.

An old saying:

***“If you always do what you’ve always done,
You’ll NOT get what you’ve always gotten.”***

I. Background and Overview

What Are Variable Pay Plans?

Definition:

Variable pay is a compensation payment contingent on achieving pre-determined objectives or performance criteria within a fiscal year (or an established time period).

This includes:

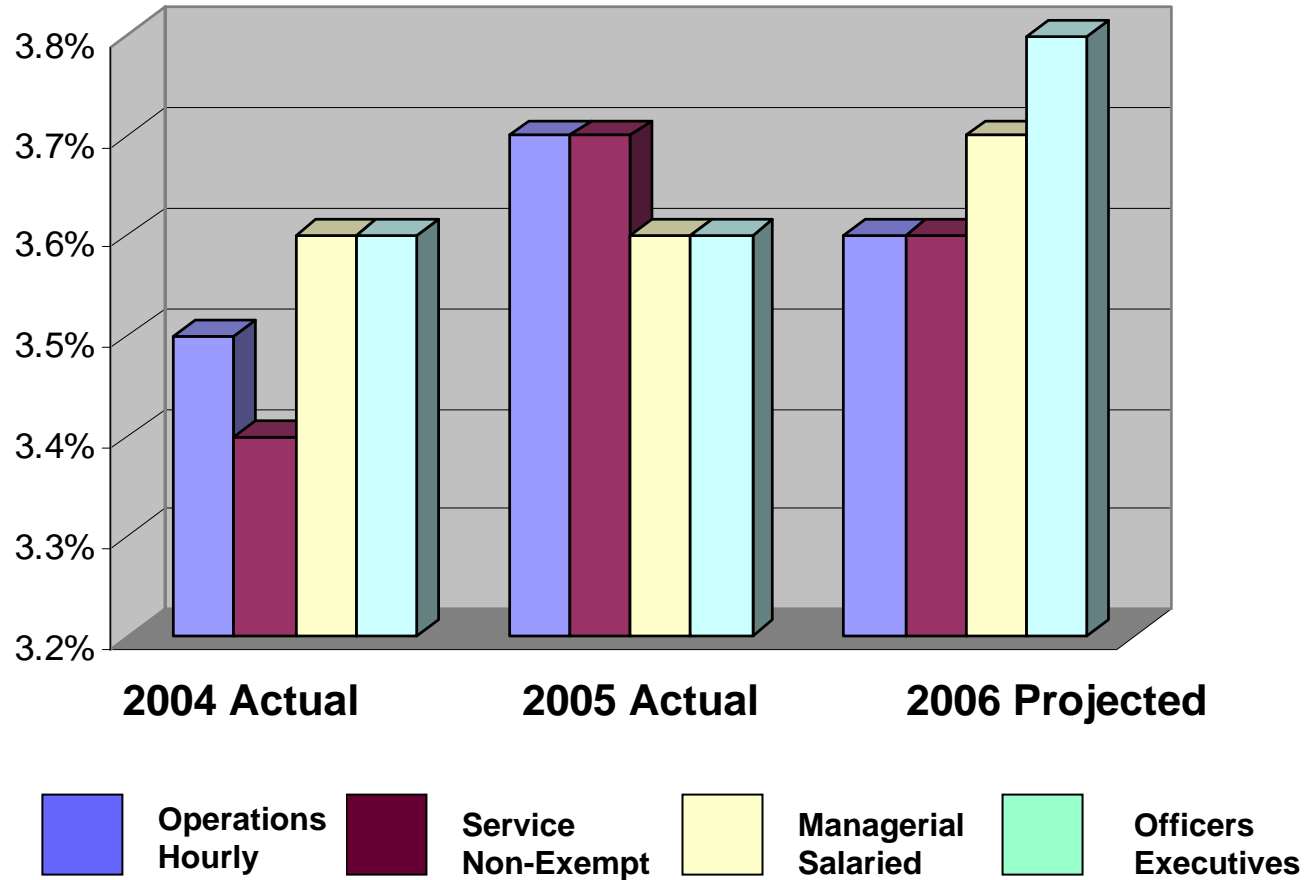
- ❖ Bonus plans
- ❖ Incentive plans
- ❖ Team/Group incentives
- ❖ Cash paid profit-sharing
- ❖ Sales incentives

This does NOT include:

- ❖ Salary increases (including merit)
- ❖ Profit-sharing for funding retirement plans
- ❖ Recognition awards

II. Review of Current Conditions

Salary increases are very limited.



II. Review of Current Conditions

Equity based compensation is becoming significantly more limited.

Changes Being Implemented in Equity Compensation:

Level:	Using No Change	Starting/Increasing	Decreasing/Eliminating	Still Considering
Stock Options	19%	12%	44%	12%
Time Restricted Stock	25%	37%	0%	12%
Perf. Restricted Stock	20%	20%	0%	20%
Restricted Stock Units	13%	26%	0%	12%

Source: Wilson Group Survey Report: "Changes in Equity Compensation for 2006 - 2007"

II. Review of Current Conditions

Employee loyalty and engagement continue “at risk.”

44% of employees understand their organization’s goals

56% do not!

19% have clearly defined goals for their jobs

81% do not!

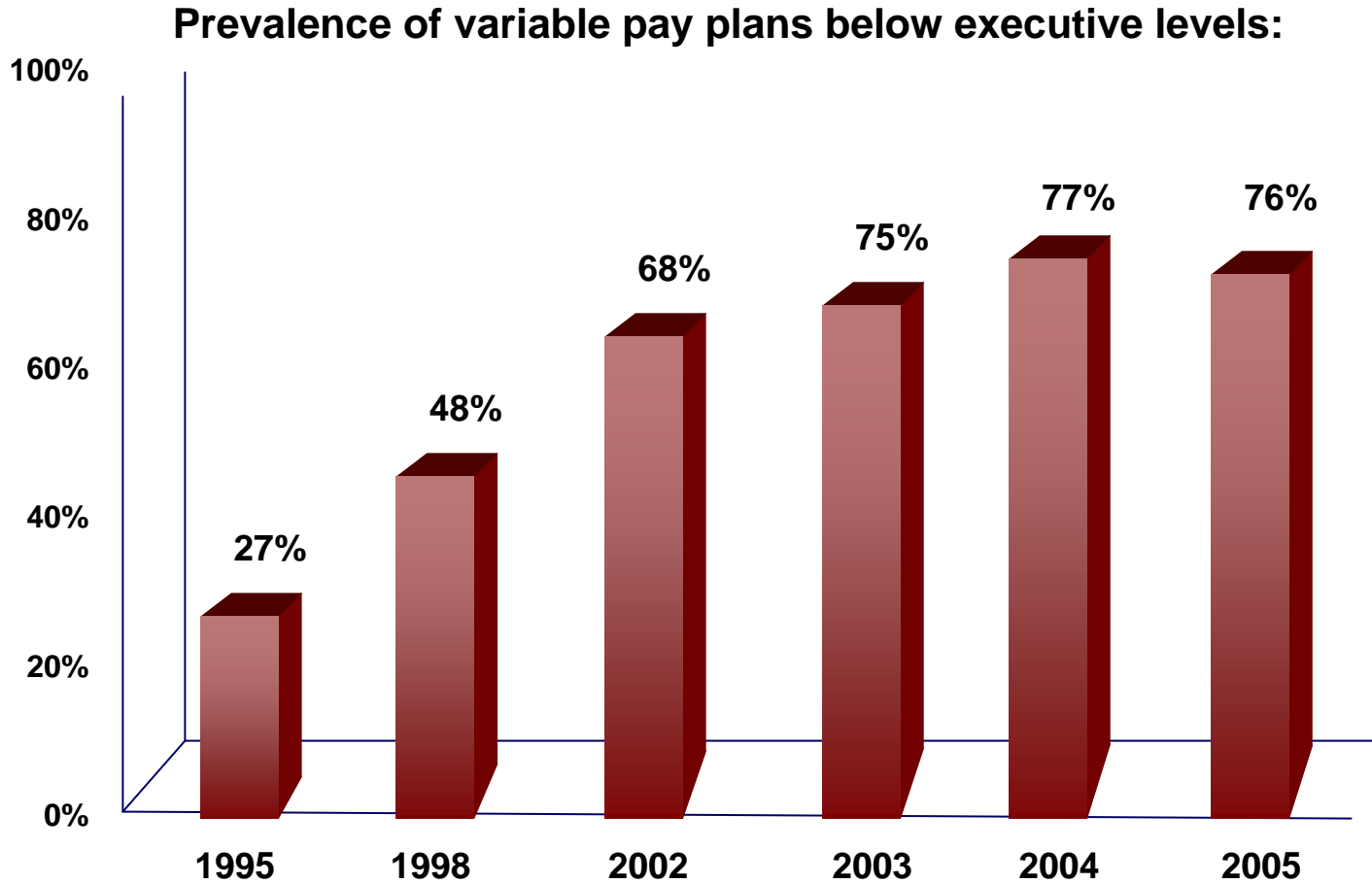
9% of employees believe their work has a strong link to the organization’s top priorities

91% do not!

Source: Gallop Organization, Survey of Employee Opinions

II. Review of Current Conditions

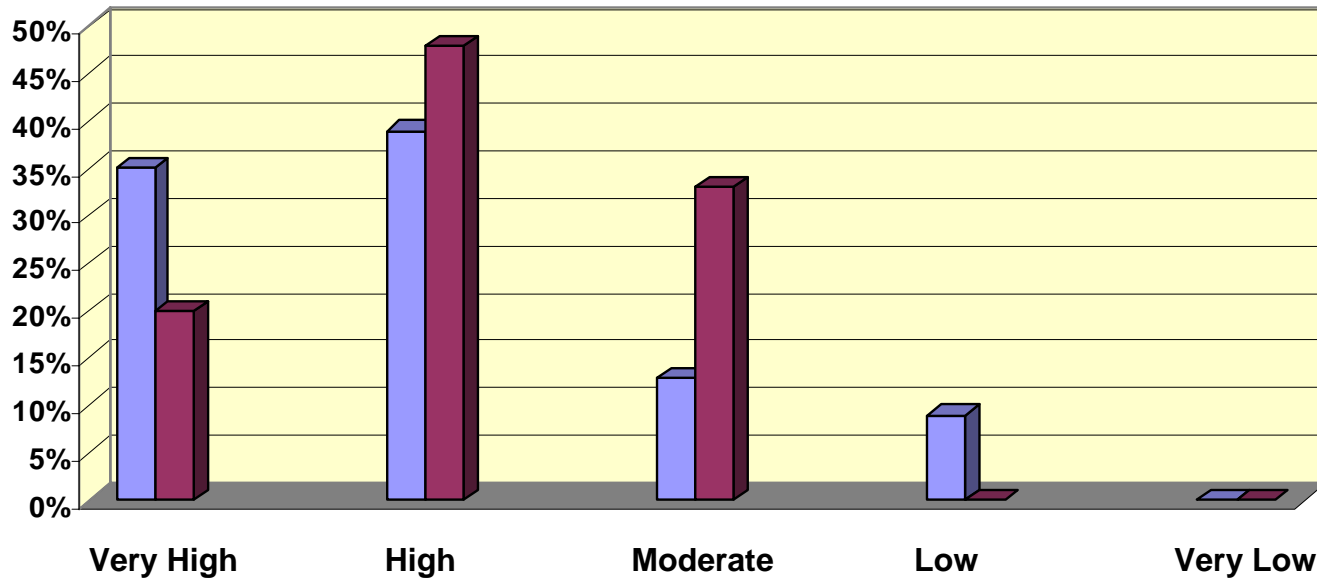
Variable pay plans continue to be used by most companies.



Source: WorldatWork, 2004-2005 Total Salary Increase Survey

II. Review of Current Conditions

Their importance is greater than their perceived effectiveness.



How important are variable pay plans to top executives?



How effective are they at producing desired results?

II. Review of Current Conditions

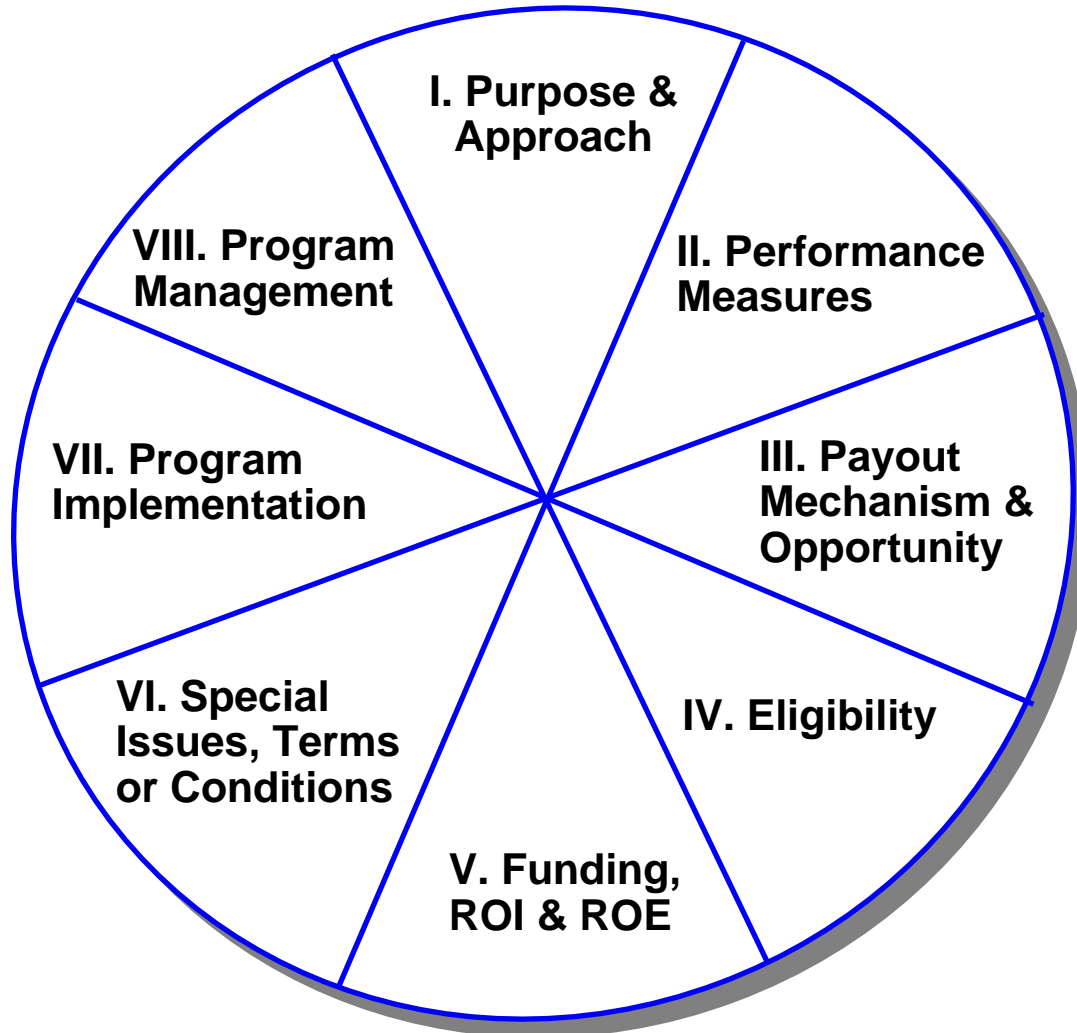
Conclusions:

1. *Competition* is growing more intense – for both new business and people.
2. *People* – their talents and their actions – are critical to the success of most organizations.
3. Many people are *questioning* whether “this” is the right organization.
4. *Traditional forms of rewards* – salary increases, promotions, stock options are more limited.
5. Variable pay programs *can have a high impact* on performance, commitment and enhance one’s competitive advantage.

III. What Makes Variable Pay Plans Work?

Key Assessment and Design Factors for Variable Pay Plans

There are over 100 decisions in the design of a variable pay plan.



III. What Makes Variable Pay Plans Work?

Define Your Purpose and Approach

- What is your primary purpose?

- ***What are the key objectives of program?***
 - Improve performance
 - Achieve specific business goals
 - Attract and/or retain critical talent

- ***What themes do you want the program to reinforce?***
 - Financial results – revenues, costs, profits
 - Customer loyalty – satisfaction, share of their spending
 - Operational improvements – productivity and quality
 - Capability improvement – competencies and work process

- **What is the approach that will work best for your organization?**

III. What Makes Variable Pay Plans Work?

Why Variable Pay Programs Are Important: Key Objectives



Source: Wilson Group Survey -- Variable Pay: Trends and Practices 2004

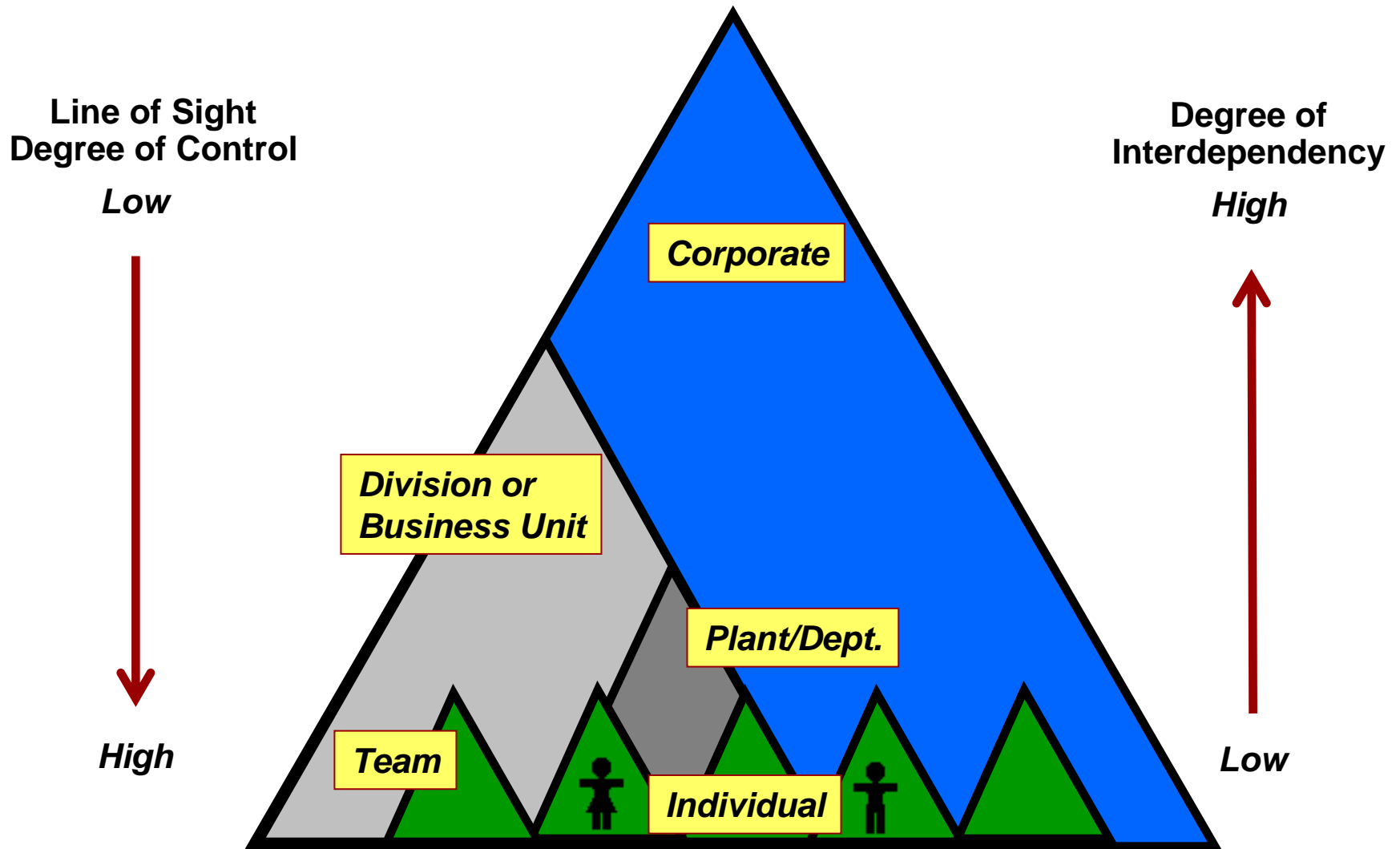
III. What Makes Variable Pay Plans Work?

Determine the type of plan that best fits with your objectives.

<u>Key Objectives of the Plan:</u>	Profit Sharing	Individual Perf Plans	Unit Focus Perf Plans	Multi-Meas Plans
1. Increase revenues and/or profitability	H	M	M	H
2. Increase operational productivity	M	L	H	M
3. Improve customer service and satisfaction	L	L	M	M
4. Encourage individual initiative/performance	L	H	M	M
5. Foster teamwork and collaboration	M	L	H	H
6. Increase the competitiveness of total compensation (i.e., attract and retain)	L	H	M	M

III. What Makes Variable Pay Plans Work?

Determine the primary “unit of focus” for the variable pay plan.



III. What Makes Variable Pay Plans Work?

Determine the performance measures – the most critical task

Externally Drives	<p>Financial</p> <ul style="list-style-type: none"> -- Revenue growth -- Profit margins and dollars -- Actual expenses to budget -- Economic value-added -- Cash flow -- Return on equity/assets -- Return on invested capital -- Total shareholder return 	<p>Customer</p> <ul style="list-style-type: none"> -- Availability -- Price-value -- Lead time to delivery -- Product mix -- Marketshare -- Customer Experience -- Share of the customer's \$\$\$ -- Customer retention -- Customer referrals
	<p>Operational</p> <ul style="list-style-type: none"> -- Unit productivity -- Product/service quality -- Process quality/variance -- Accuracy/error rates -- Reliability/rework -- Inventory utilization -- Revenues/Sales per employee -- Cost per transaction -- Safety rates 	<p>Capabilities</p> <ul style="list-style-type: none"> -- Employee loyalty & engagement -- Turnover: voluntary, in key jobs -- Knowledge and skill capabilities -- Succession plan -- Training and development -- Team effectiveness -- Internal communication -- Process optimization -- Cultural responsiveness

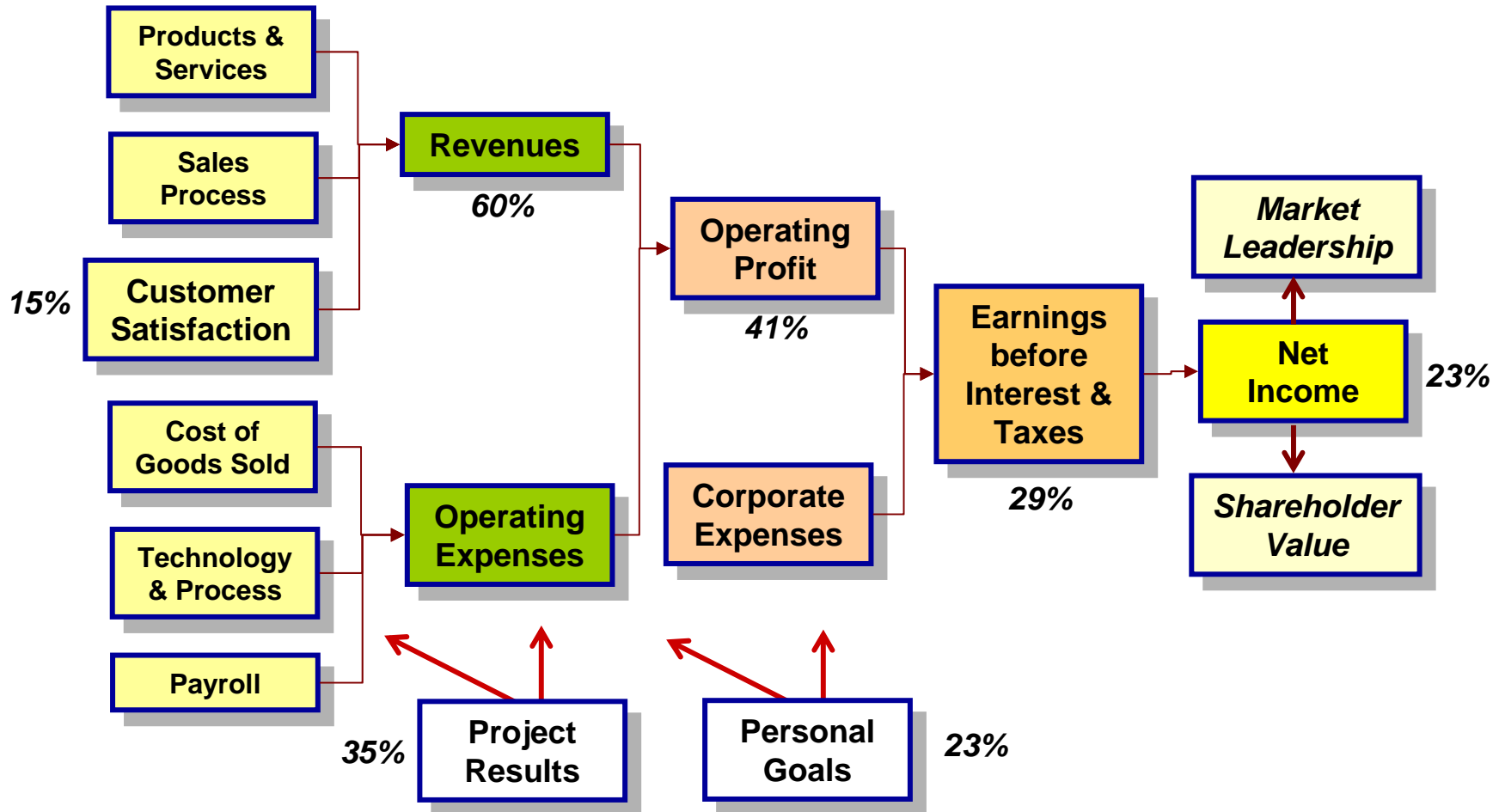
Quantitative Measures

Qualitative Measures

III. What Makes Variable Pay Plans Work?

Measures become “drivers” of business success.

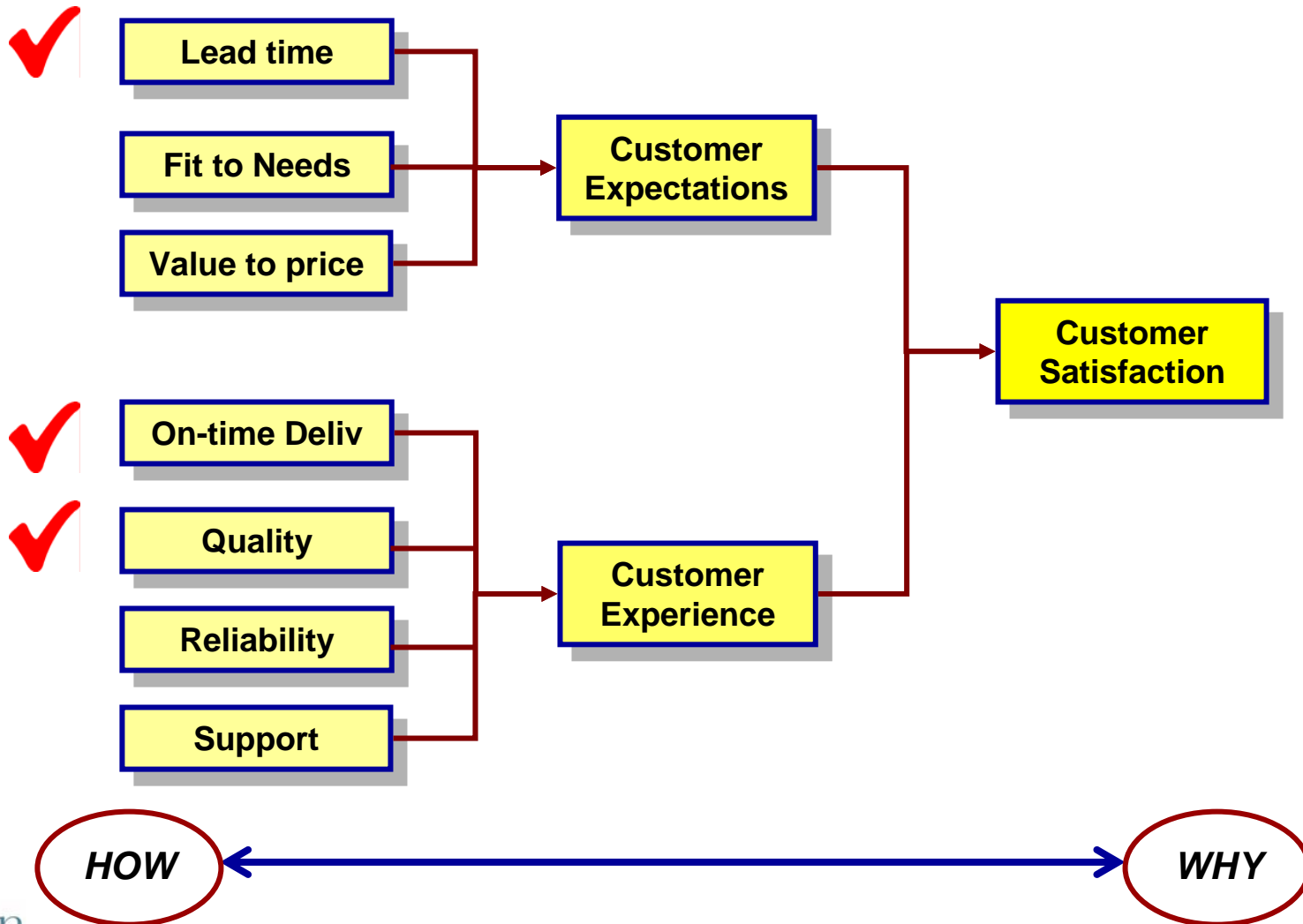
The prevalence (%) of performance measures used in Variable Pay Plans:



Source: Wilson Group Survey -- Variable Pay: Trends and Practices 2004

III. What Makes Variable Pay Plans Work?

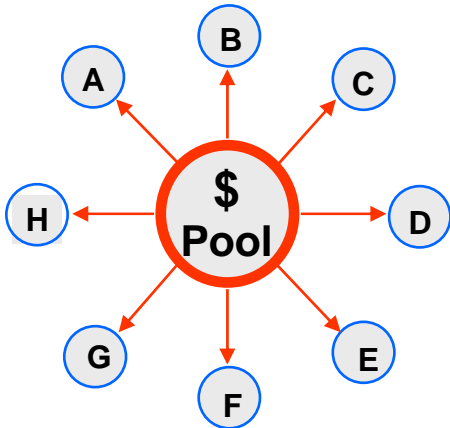
Determining the leading indicators or drivers of performance.



III. What Makes Variable Pay Plans Work?

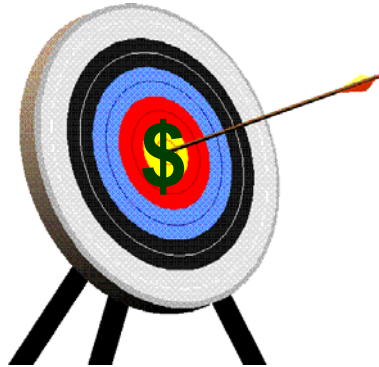
There are three (3) common payout mechanisms:

Pool Sharing Variable Pay Plans



Prevalence:
14%

Objectives based Variable Pay Plans



46%

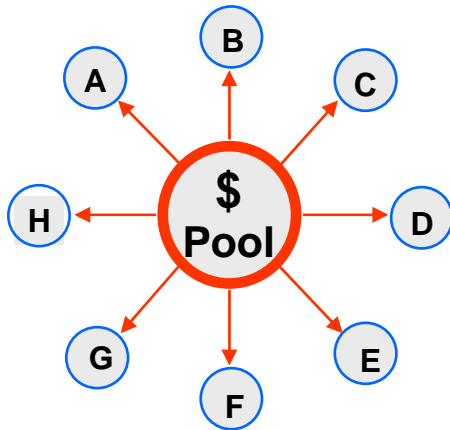
Multi-measures Scorecard based Variable Pay Plans

Measures	Wght	80	90	100	110	120
Revenue	30%	10M	11M	12M	13M	15M
Oper Mgn	30%	10%	12%	14%	16%	18%
On Time	20%	88%	90%	92%	94%	97%
Cust Satis	20%	85%	90%	93%	95%	98%

27%

III. What Makes Variable Pay Plans Work?

Pool Sharing:



Characteristics:

1. Uses one simple, financial metric, with a formula to determine the payouts.
2. Usually involves a threshold, may have a maximum.
3. % portion is retained by the company and % is shared to eligible participants.
4. Individuals may receive a % portion of the pool or the pool may be used to “fund” bonus type variable pay plans.
5. May involve a “modifier” to the payouts.

Examples:

Profit Sharing
Sales Commissions
Revenue Sharing

III. What Makes Variable Pay Plans Work?

Objectives Based Bonus Plans:

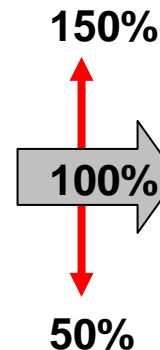
Characteristics:

1. Utilizes 3 to 5 (or more) specific performance objectives – best if they define clear outcomes or achievements.
2. May be based on individual or group/business unit performance.
3. Individuals usually have a target payout.
4. Funding is based on either budgeted dollars or a “share of the bonus pool.”
5. Payouts may have a range of 50% to 150% of target payout.



Personal Objectives:

1. Accomplish XXX
2. Implement YYY
3. Achieve ZZZ
4. Do lsdjfsdljdlkfj
5. Do fdsas and ldkjfsd



III. What Makes Variable Pay Plans Work?

Multiple Measure “Scorecard” Bonus Plans:

Performance Measures	Weight	Threshold		Target		Exceptional		Score
		50	75	100	125	150		
Business Unit Revenues	40%	\$10M	\$12M	\$15M	\$18M	\$20M	40	
Gross Margin Performance (Actual Expenses/Revenues)	30%	10%	12%	15%	20%	25%	23	
Quality of Products and Services (score)	15%	80%	85%	90%	95%	99%	19	
Lead time from order to delivery	15%	14 days	10 days	7 days	5 days	3 days	19	

Characteristics:

1. Multiple measures (types & units)
2. Weighted
3. Define range of payouts
4. Linked to target payout \$
5. Payout based on total score

Person A Illustration:

Annual earnings: \$80,000

Target Payout (10%) 8,000

Actual Payout % 101%

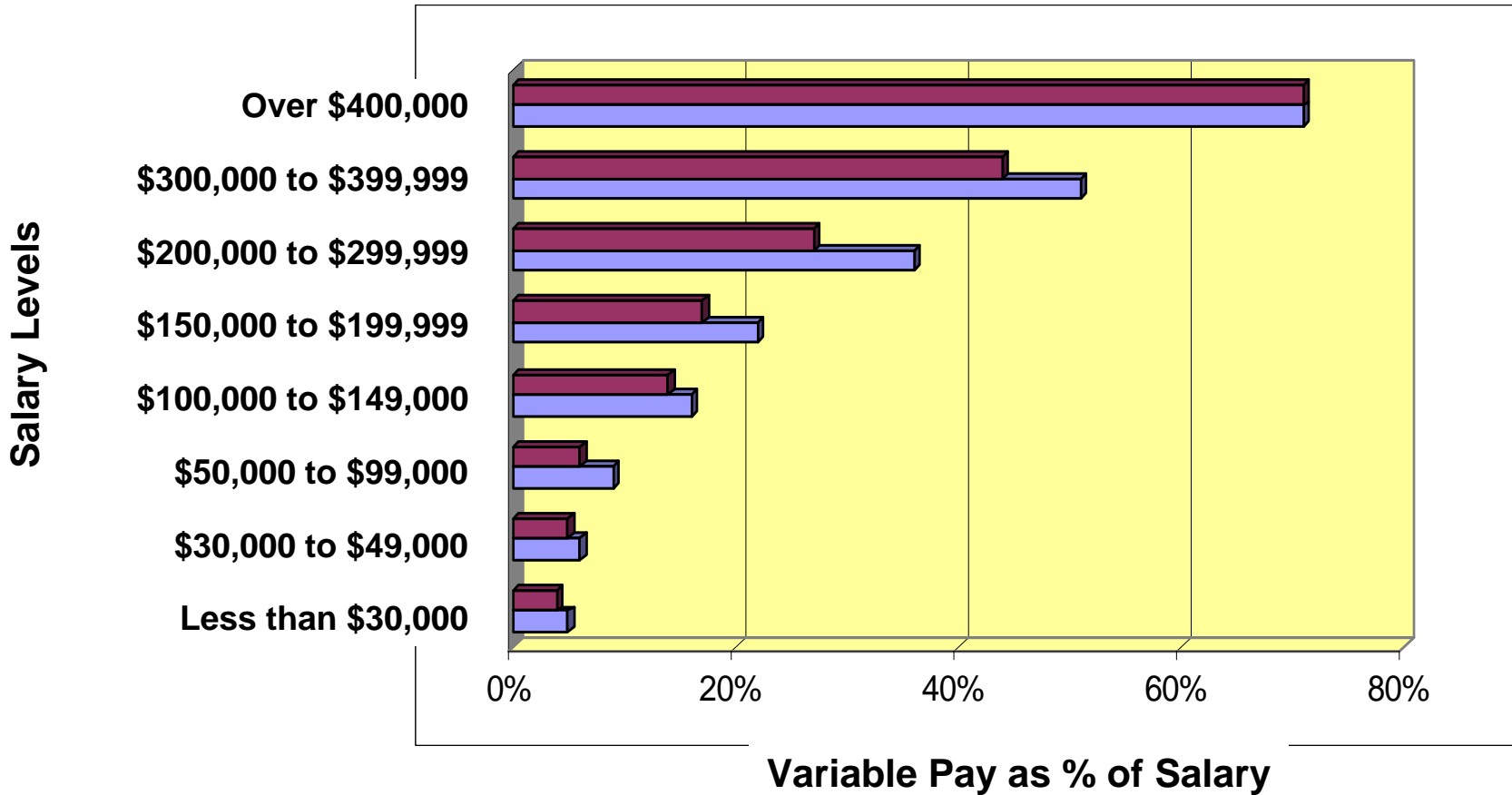
Scorecard payout: \$ 8,080

101%

↙ Total Score

III. What Makes Variable Pay Plans Work?

How much people receive: Target payouts vs. Actual payouts:



Source: Wilson Group Survey -- Variable Pay: Trends and Practices 2004

Target Payout **Actual Payouts**

III. What Makes Variable Pay Plans Work?

Determine the costs and ROI of variable pay programs.

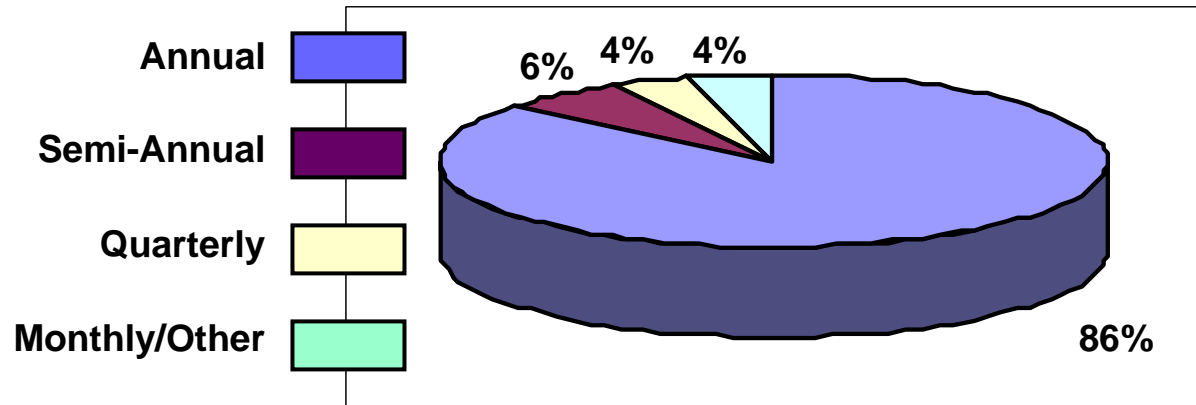
	<i>Low</i>	<i>Median</i>	<i>High</i>
Of Revenues:	0.3%	0.7%	3.7%
Of Net Income:	1.1%	12.4%	64%
Of Payroll:	1.2%	7.6%	78%

Source: Wilson Group Survey -- Variable Pay: Trends and Practices 2004

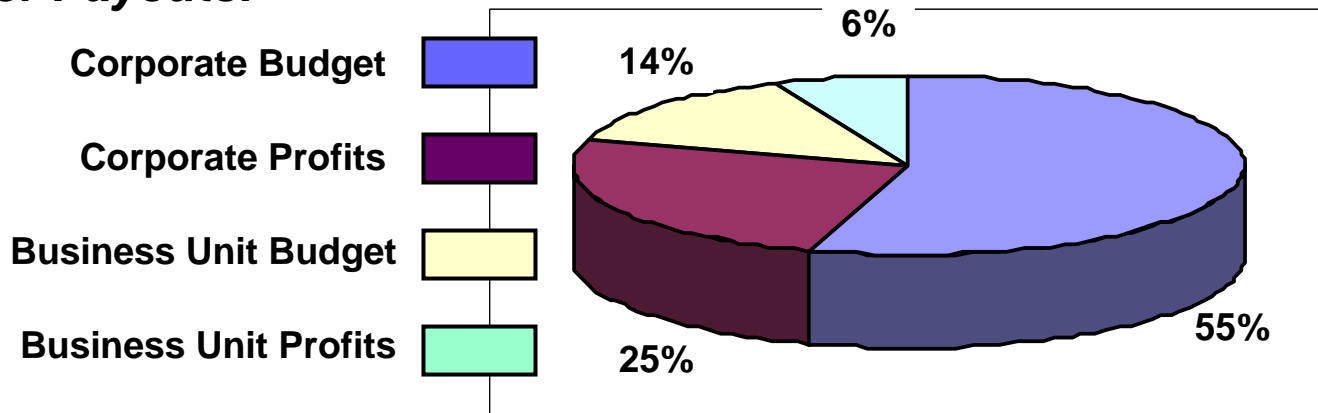
III. What Makes Variable Pay Plans Work?

Don't forget to identify the funding sources.

Frequency of Payouts:



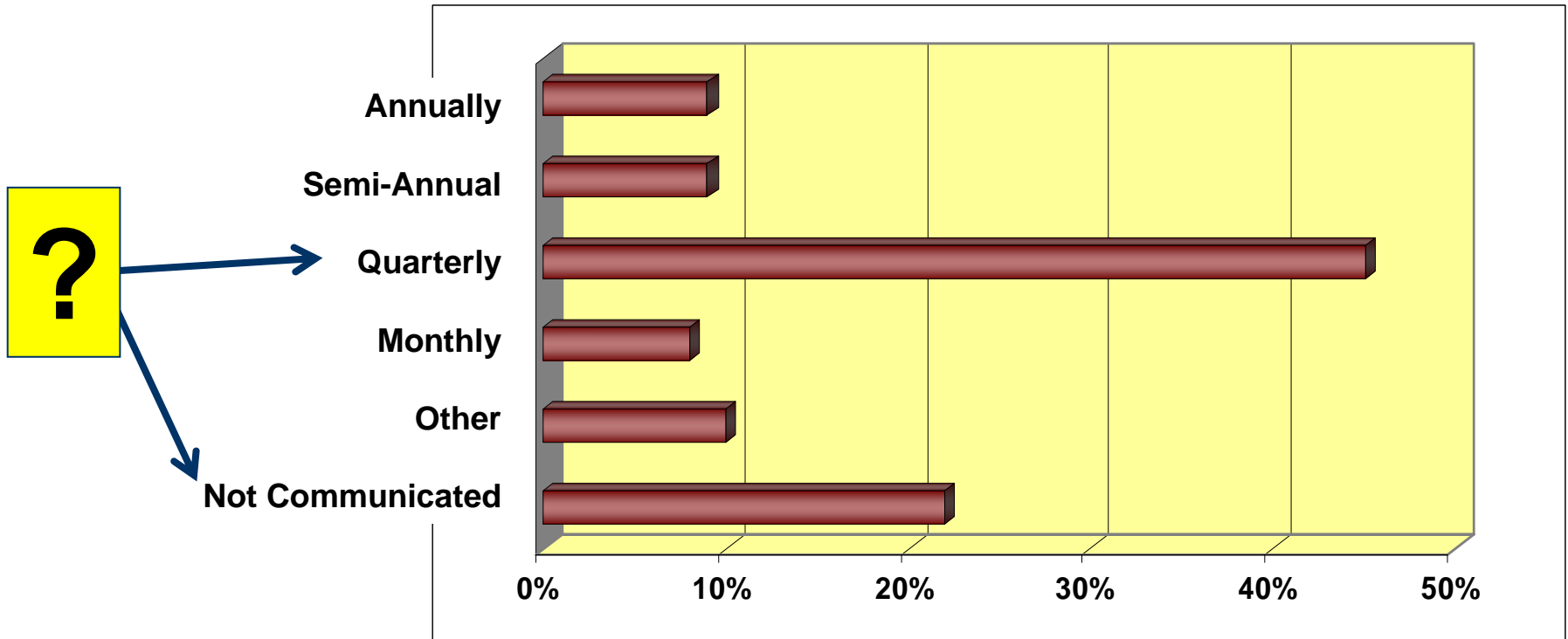
Funding for Payouts:



Source: Wilson Group Survey -- Variable Pay: Trends and Practices 2004

III. What Makes Variable Pay Plans Work?

Understanding the plan is good, but performance feedback is better.



Source: Hewitt Associates 2003 Survey of Variable Compensation Management

Hint: People need 3 to 5 “data points” during the performance period to be able to adjust their actions.

III. What Makes Variable Pay Plans Work?

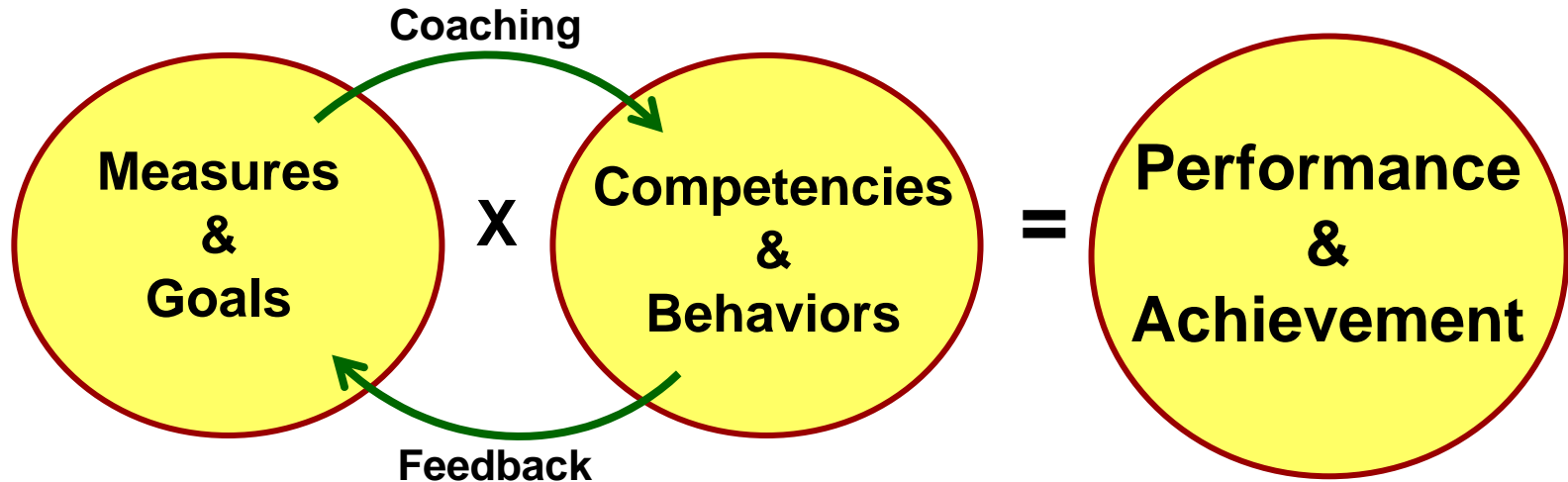
Effective communication, involvement and recognition are key to success.

<u>Key Factors:</u>	<u>Low Perform Companies</u>	<u>High Perform Companies</u>	<u>Difference</u>
3 yr. Avg. Total Shareholder Return	-21%	+27%	
Communicates plan targets	11%	89%	= 78%
Sets realistic goals	54%	83%	= 29%
Uses appropriate measures	44%	67%	= 23%
Provides updates on progress	60%	87%	= 27%
Uses 1-1 meetings	38%	61%	= 23%
Provides monthly/quarterly updates	40%	52%	= 12%
Recognizes individual efforts	56%	68%	= 12%

III. What Makes Variable Pay Plans Work?

Engage people “during” the game to achieve desired performance.

1. *Translate measures into actions*
2. *Report progress frequently*
3. *Reinforce desired actions frequently*
4. *Discuss, learn, coach – engage*
5. *Adjust goals and plans, but retain the integrity*



III. What Makes Variable Pay Plans Work?

The funding formula should examine costs and return on investments.

Elements of the Funding Analysis:

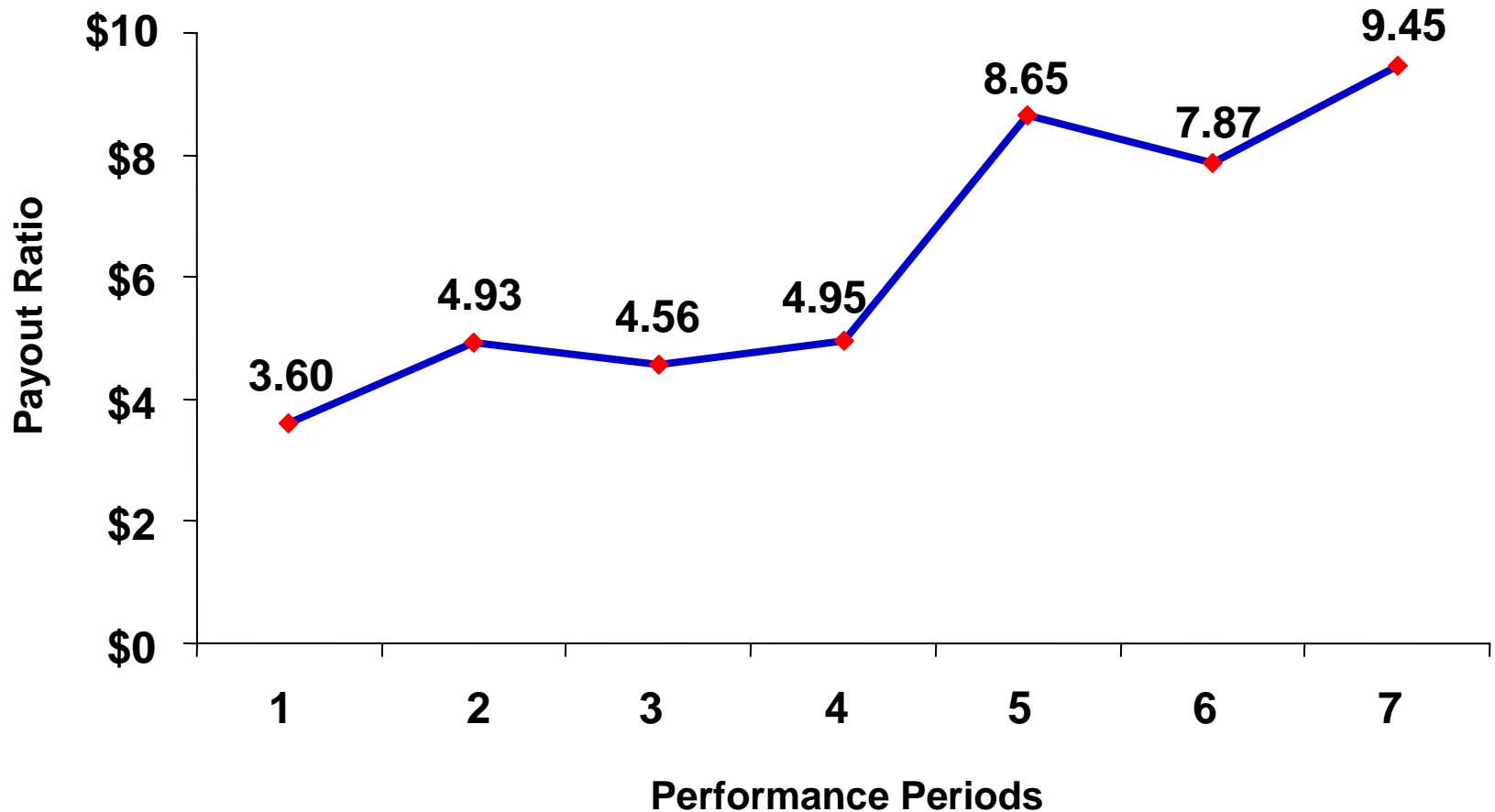
1. The philosophy about the source of funding for variable pay plans.
 - a. “Share” of a pool
 - b. Budgeted dollars
 - c. Self-funded through reductions in other costs (including merit increases)
2. The total anticipated payouts at target and other levels of performance.
 - a. Planned dollars allocated as \$X of profits
 - b. Total of salaries x payout % at target
3. The probability of achieving this payout and the “expected payouts.”
 - a. X% will likely achieve “target” payouts
 - b. Y% will likely achieve minimum payouts
 - c. Z% will likely achieve maximum, high level payouts
4. Determine the performance metrics that will fund the payouts.
 - a. Company or business unit profitability
 - b. Operating expense reductions
 - c. Payroll expense budget
 - d. Others?

III. What Makes Variable Pay Plans Work?

Determine the costs and ROI of variable pay programs.

One company's return on investment from their variable pay plans:

Ratio of increased profits to payout dollars.



IV. Key Characteristics of Successful Variable Pay Plans

Top 10 Characteristics of Highly Effective Plans:

1. Clear business strategy and well defined framework for metrics.
2. Strong, active support by senior management.
3. Performance measures (or criteria) directly reflect the critical success factors and core values of the organization.
4. The performance goals are challenging and achievable, and reflect important improvements in performance.
5. People are able to translate these goals into personal actions – they know WHAT to do.

IV. Key Characteristics of Successful Variable Pay Plans

Top 10 Characteristics of Highly Effective Plans:

6. Data is timely so people can track progress frequently -- active discussions, displays and corrective actions to achieve desired results.
7. Efforts to achieve progress are reinforced and celebrated often. Barriers are eliminated or resolved quickly.
8. Payout opportunities are meaningful to both the individual and the organization. Payout celebrations increases the value of the awards.
9. Program is simple to understand, manage and operate.
10. Program improves and adapts over time.

A thought to remember:

***“Measures give rewards relevance,
and rewards give measures meaning.”***

-- Thomas B. Wilson
*“Innovative Reward Systems
for the Changing Workplace”
(McGraw-Hill, 2003)*

And Now Time for Questions and Discussion



Our mission and our cause:

“To strengthen the competitive advantages of our clients by aligning all performance based reward systems with the strategies they need to succeed.”

- Develop Total Rewards Strategies to focus time and money
- Link Executives with the Strategy and Shareholders
- Utilize Sales Incentives to Build Market Leadership
- Build Performance Driven Incentive Programs
- Create Performance/Competency Focused Base Pay Programs
- Make Special Recognition Special
- Re-engineer the Performance Management Process

Available resources:

Innovative Reward Systems for the Changing Workplace (McGraw-Hill, revised 2003).

Rewards that Drive High Performance: Success Stories from Leading Organizations (1999).

Special Report: Changes in Equity Compensation – 2006 - 2007

Variable Cash Compensation: 2004 Survey of Trends and Practices

Special Report: Changes in Variable Pay Programs - 2005

Indexed Stock Options: Is It Time to Link Price and Performance?

FAS 123R: What Does It Really Mean?

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