

# Should you Re-evaluate Your Incentive Compensation Plans?

Bob Lemke

Principal

Human Resources & Compensation Consulting

December 2018

Every organization faces unique challenges and opportunities when it comes to making the workplace work better.



**Competitive  
Job Market**



**Disruptive  
Technology**



**Increased  
Healthcare Costs**

# Your Workforce Investment Portfolio: Tools You Have to Differentiate



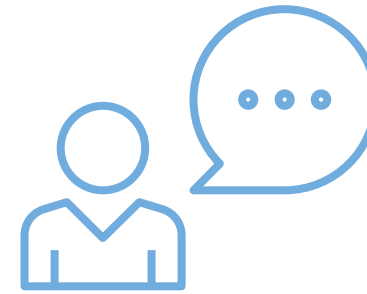
Benefits



Compensation



Retirement



Employee  
Communications



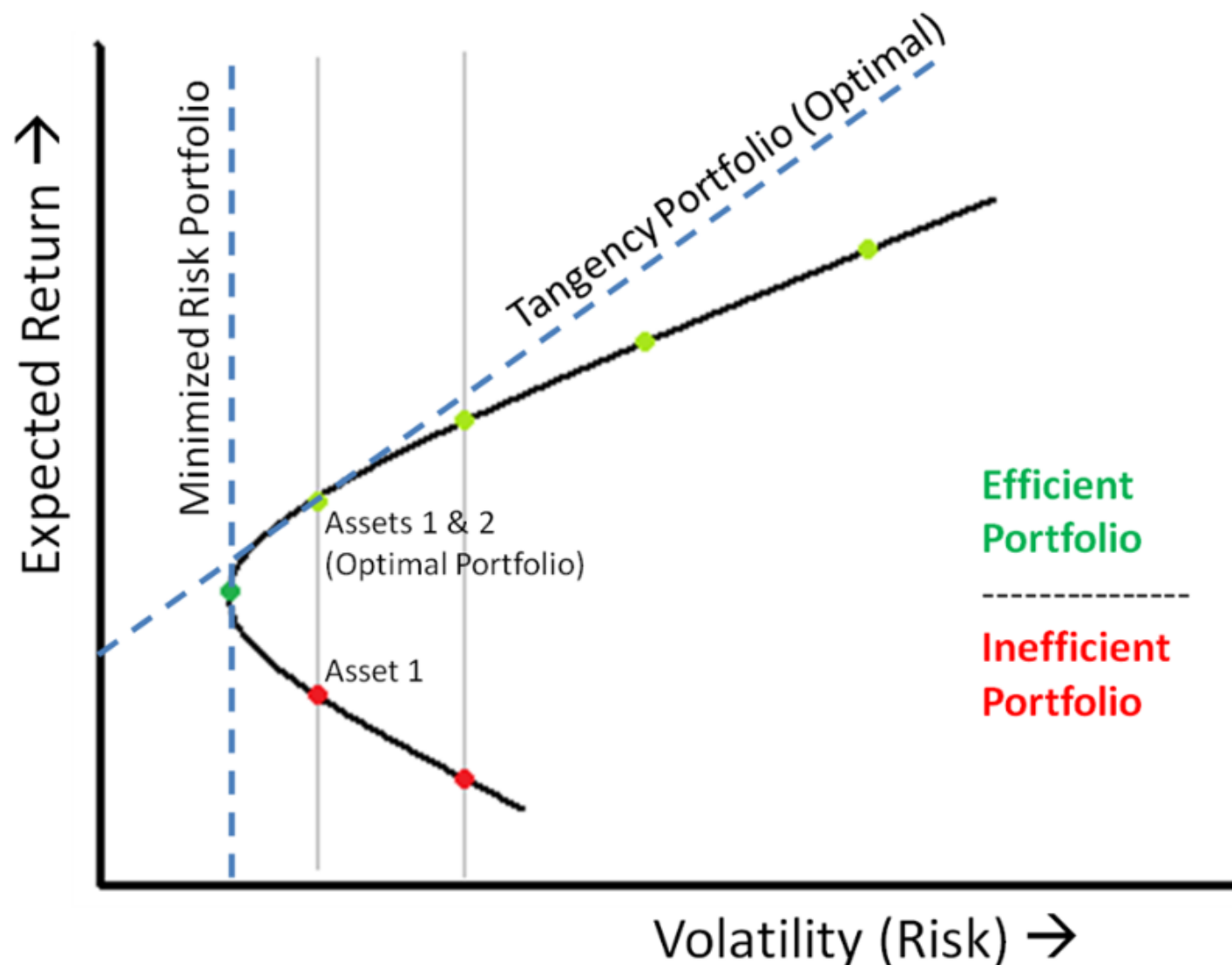
Workplace  
Culture



Gallagher

Insurance | Risk Management | Consulting

# Portfolio Managers: Risk and Returns



## Efficient Frontier:

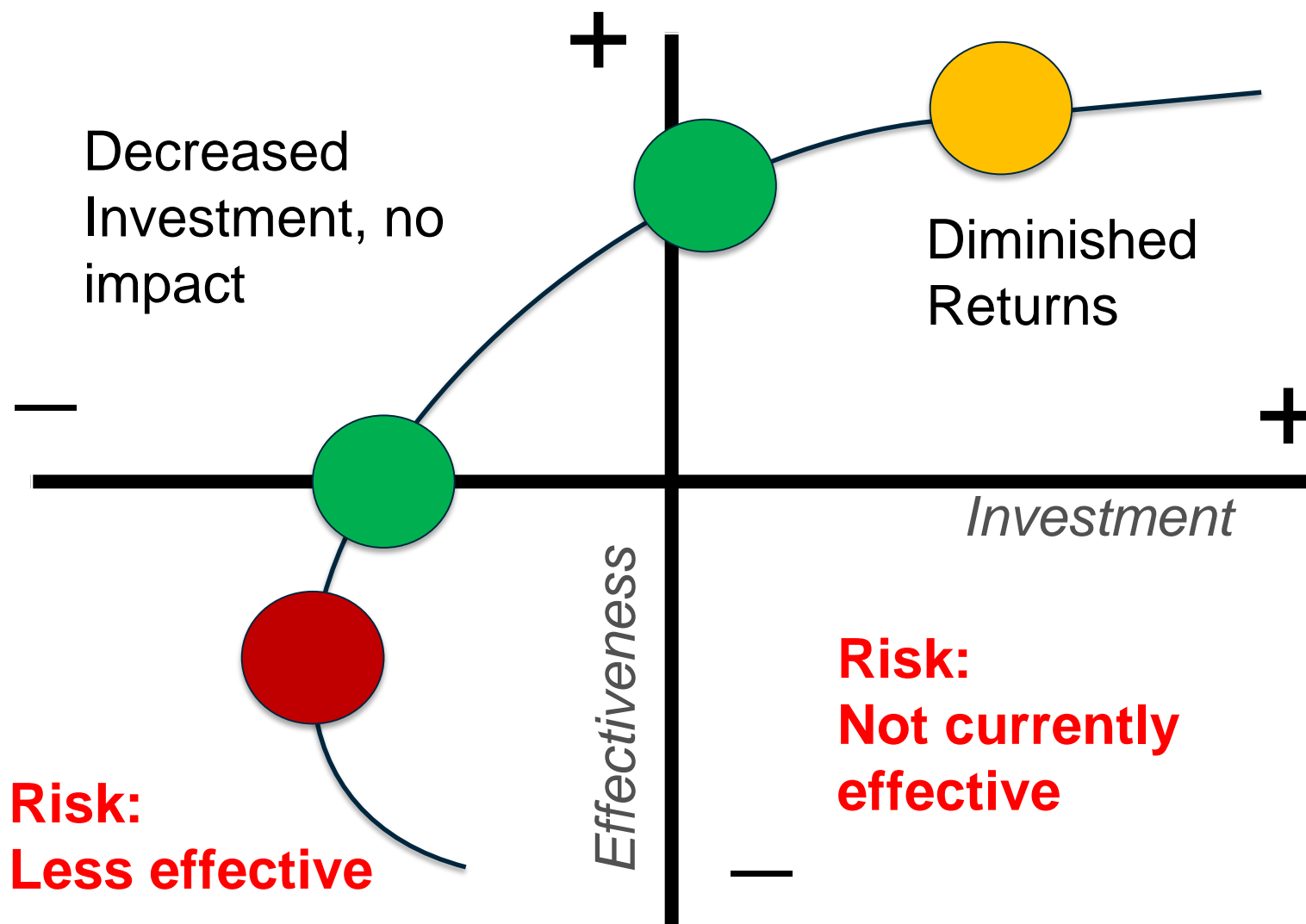
What diversification strategy will generate the optimal return for the desired level of risk?



Gallagher

Insurance | Risk Management | Consulting

# HR Leaders: Portfolio Re-Balancing



## Desired Impact:

What mix of compensation, benefits and other programs will generate the optimal return for the desired level of investment?



**Gallagher**

Insurance | Risk Management | Consulting

# Shared Vision for Success

## **Focus on Incentive Compensation**

- Methods to evaluate your incentive plan strategy
- Explore different incentive plans
- Design considerations for successful outcomes

## **Move From Insights to Action**

- Should you re-evaluate your incentive compensation plans?

# My Perspective: Compensation Advisor



Insurance | Risk Management | Consulting

- Defined total compensation philosophy
- Competitive total compensation
  - Base, incentives, employee benefits
- Aligned incentives, meaningful rewards for meaningful results
- Administrative practices
- Sustainable communication and leadership practices
- Ongoing advisory support



**Gallagher**

Insurance | Risk Management | Consulting

# Learn from Each Other

STOP	START	CONTINUE
<b>What's not working?</b>	<b>What might give us better results?</b>	<b>What is working well now, that we should keep on doing?</b>
Practices that should discontinue, or at least consider retiring over time.	Investments, practices that we should begin to build or start doing right away.	Investments, activities that are highly valued and should continue.



# Evaluate Your Incentive Strategy



Insurance | Risk Management | Consulting

## Discretionary Bonus vs Incentive

- Bonus compensation is a systematic approach to providing variable rewards in exchange for value delivered.

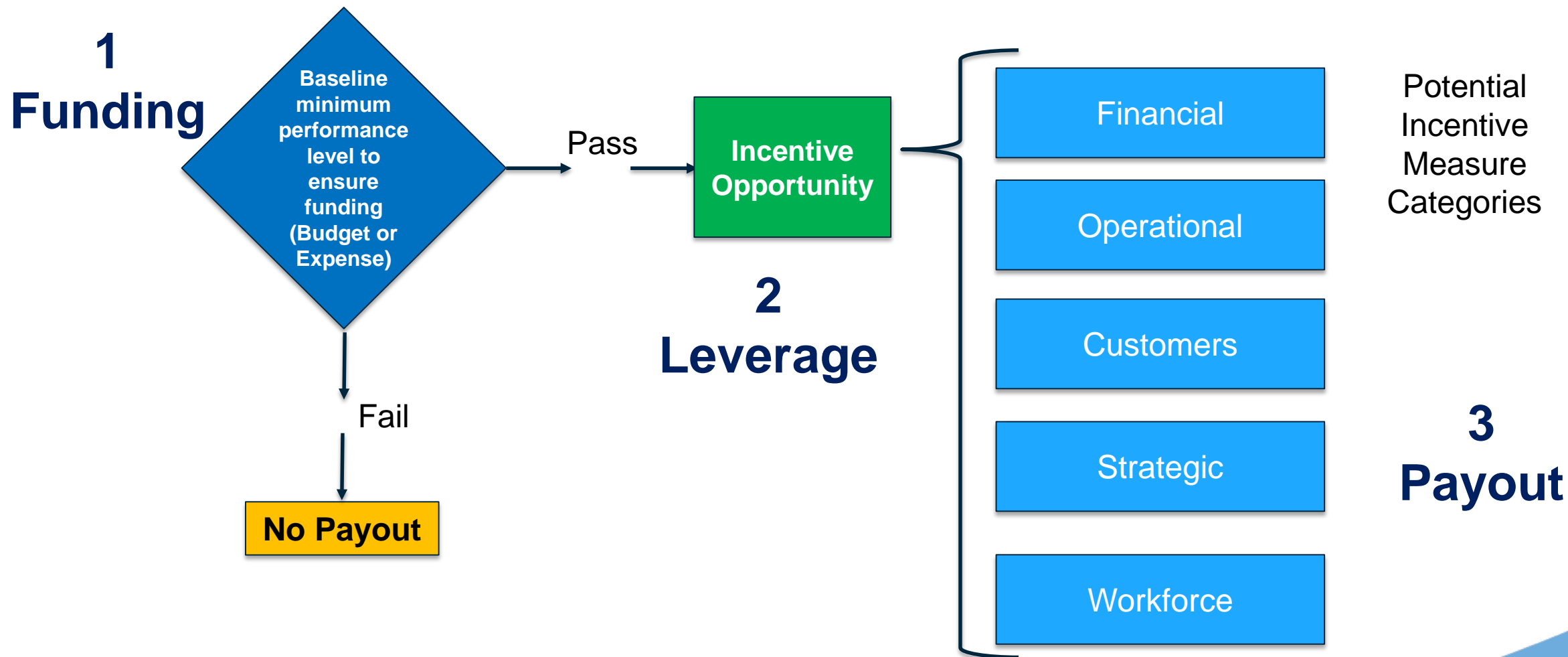
### Discretionary Bonus:

Form of variable pay where requirements, and timing are not typically disclosed in advance and usually based on general overall job performance. This is determined by Leadership if they believe there is a reason to award a bonus.

### Incentive:

**Intended to provide payment based on achievement of short-term performance goals established.**

# Opportunities to Evaluate Incentives



# Pre-Event Survey



Insurance | Risk Management | Consulting

What one area of your incentive programs gives you the most frustration each year?

Most joy?

# Overall Effectiveness



**Gallagher**

Insurance | Risk Management | Consulting



Performance Linkage

Level of Award  
Opportunity

Type of Performance  
Measure



Risk-Reward Trade-off

Goal Setting

Level of Discretion

# Program Objective = Program Evaluation



# Sales Incentives: Strategic Alignment



Insurance | Risk Management | Consulting

## Cost of Sales

- ✓ Payouts based on a percentage of volume
- ✓ Sales people get a piece of the action for each sale
- ✓ Pay typically not calibrated with external market

## Cost of Labor

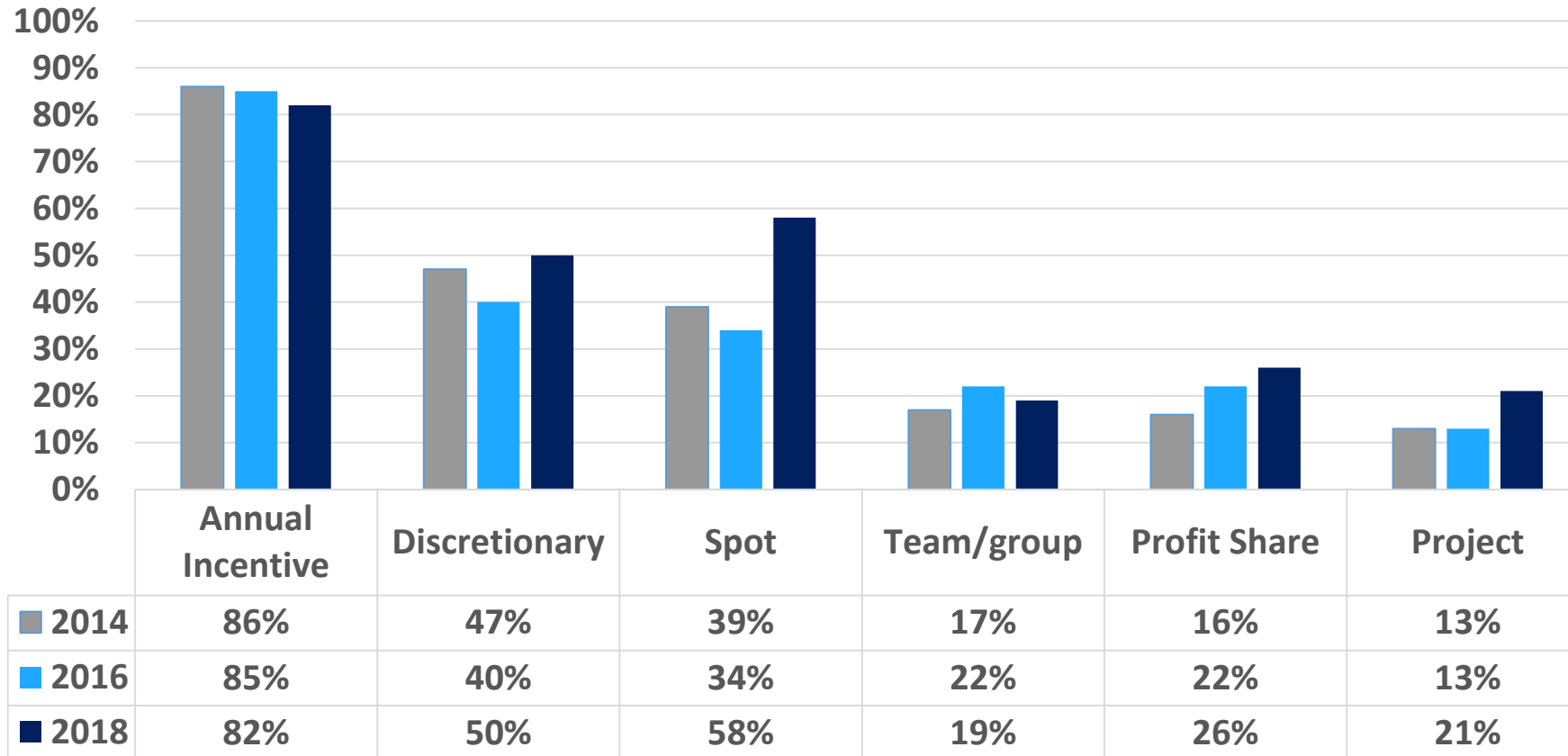
- ✓ Payouts based on competitive market rates
- ✓ Target pay levels established for each sales role
- ✓ Pay is calibrated off of target based on performance

# Evaluation Criteria to Consider

Evaluation	Conventional	Future
What is the opportunity?		
Who is eligible?		
What measures?		
How many measures?		
What is minimum performance to fund?		
What is desired performance?		
How/when should we communicate?		
<b>How will we know whether our incentive program is effective?</b>		

# Types of Incentives in Private Companies

## Short Term Incentive Arrangements



Source: World at Work Private Company Incentive Pay Practices Surveys 2014, 2016, 2018

### Observations:

- Structured, annual incentive arrangements continue as the most prevalent form of incentives in privately-held organizations.
- Various forms of discretionary, performance based arrangements also exist within organizations that manage structured, annual incentive programs.



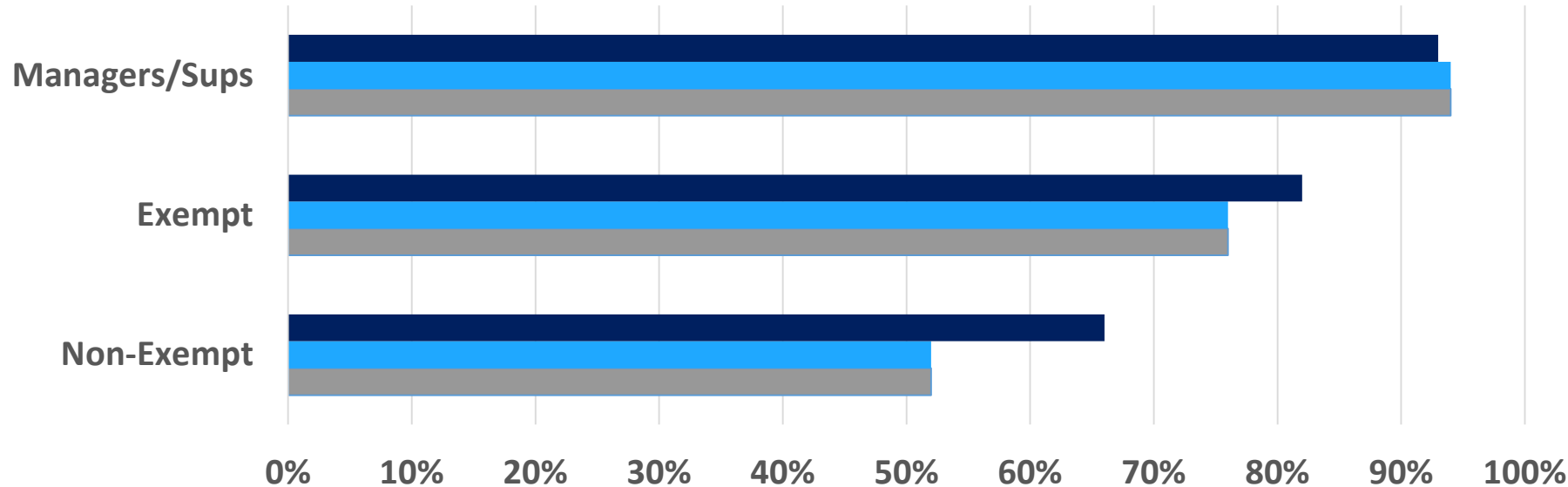
# Eligibility



**Gallagher**

Insurance | Risk Management | Consulting

## Annual Incentive Eligibility



	Non-Exempt	Exempt	Managers/Sups
■ 2018	66%	82%	93%
■ 2016	52%	76%	94%
■ 2014	52%	76%	94%

### Observations:

- AIP eligibility has increased across nearly all position levels across time.
- Data corroborates a widening trend of extending incentive participation broadly to all employees.

Source: World at Work Private Company Incentive Pay Practices Surveys 2014, 2016, 2018

# Pre-Event Survey



Insurance | Risk Management | Consulting

Has your organization made changes to its management incentive plan as a result of tax reform?

What incentive design features have you deployed that addresses retention risk of critical workforce segments?

# Right Results?

## Financial

- ☐ Profitability or earnings
- ☐ Revenue/revenue growth
- ☐ Return measure (ROE, ROA, ROI)
- ☐ Cash flow/cash-flow growth
- ☐ Economic profit
- ☐ Other financial objectives
  - ✓ Credit quality
  - ✓ Return on sales
  - ✓ Expense management
  - ✓ Working capital
  - ✓ Loan and deposit growth
  - ✓ Operating expenses
  - ✓ Payroll-hours control

## Operational

- ☐ Customer satisfaction
- ☐ Operational efficiency
- ☐ Service/quality
- ☐ Safety/occupational injury
- ☐ Customer retention
- ☐ Increased customers/members
- ☐ Employee satisfaction/engagement scores
- ☐ Other operational objective
- ☐ Balanced scorecard
  - ✓ Innovation
  - ✓ Company strategic goals
  - ✓ On-time delivery
  - ✓ Cost containment
  - ✓ Reduce delinquencies
  - ✓ Industry ranking



**Gallagher**

Insurance | Risk Management | Consulting

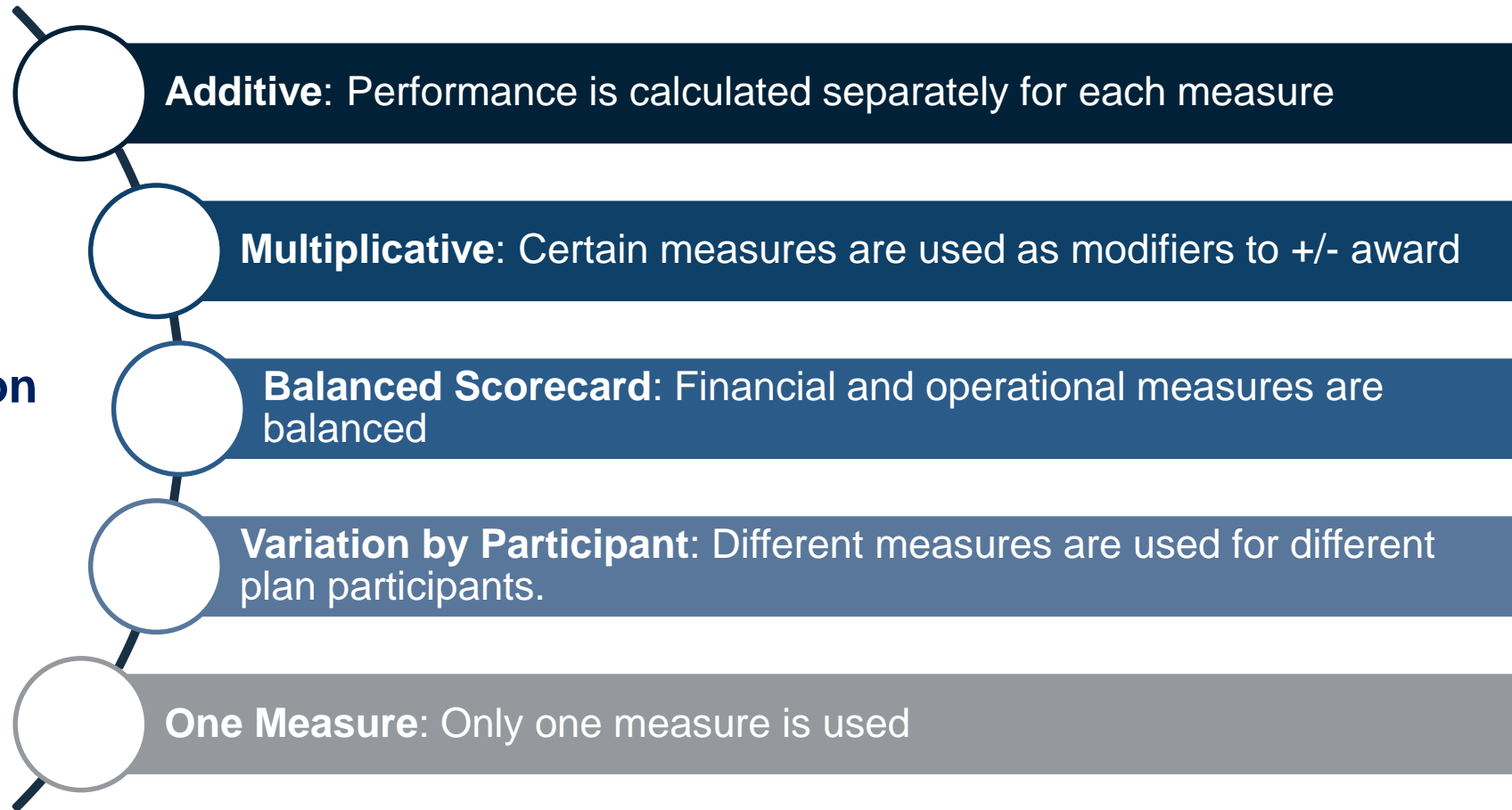
# Pre-Event Survey: Right Results

## Measures Used?

- Financial
  - GAAP
  - Non-GAAP
- Non-Financial

# Payouts and Award Determination

## Incentive Measure Combination Strategies



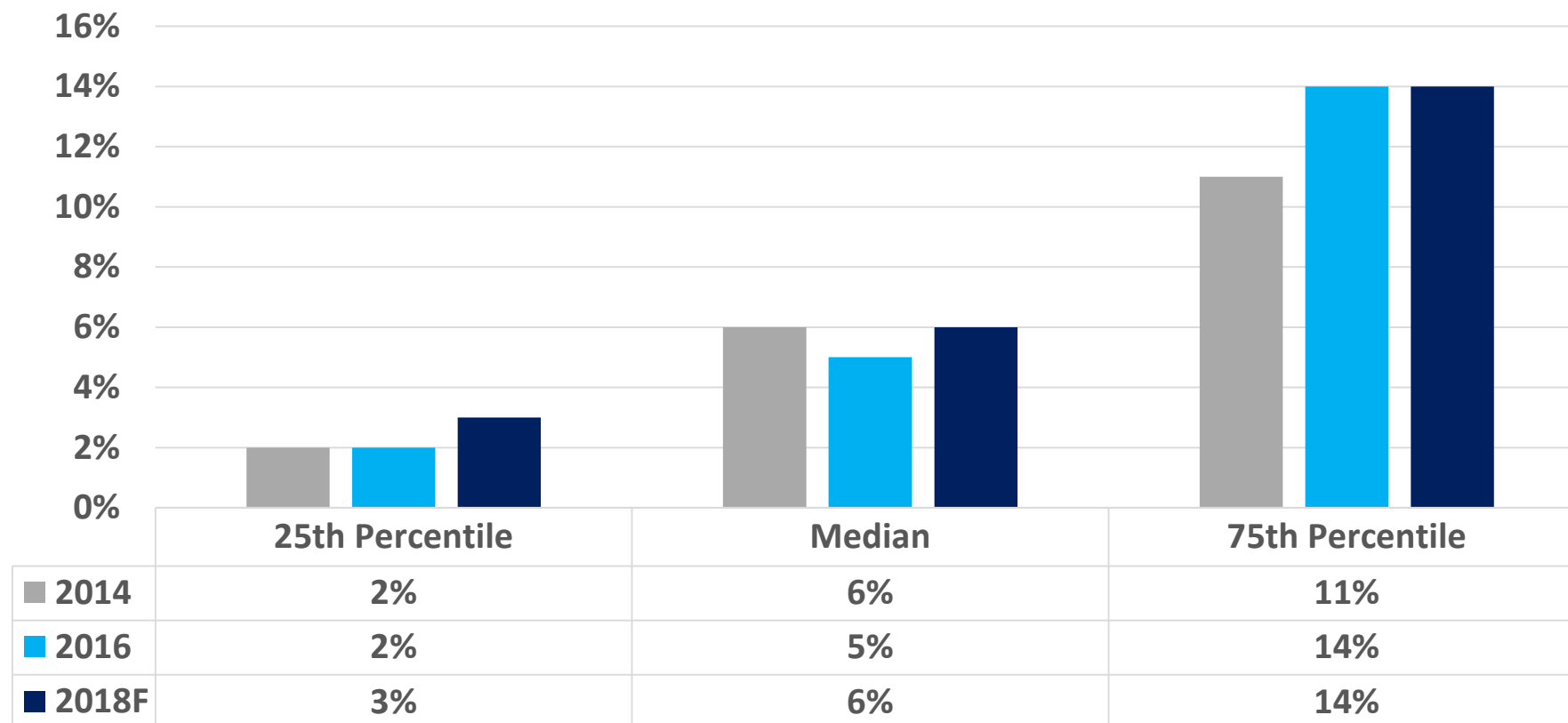


**Gallagher**

Insurance | Risk Management | Consulting

# Funding Short Term Incentives

## Percent of Operating Income Budget



### Observations:

- Organizations report that up to 14% of operating income was used to budget all types of short term incentive programs, a slight increase over prior years.
- Typical budgets for all forms of short term incentives have been around 5% to 6% of operating income.

Source: World at Work Private Company Incentive Pay Practices Surveys 2014, 2016, 2018

# Communication: Critical Linkages



Insurance | Risk Management | Consulting

## How

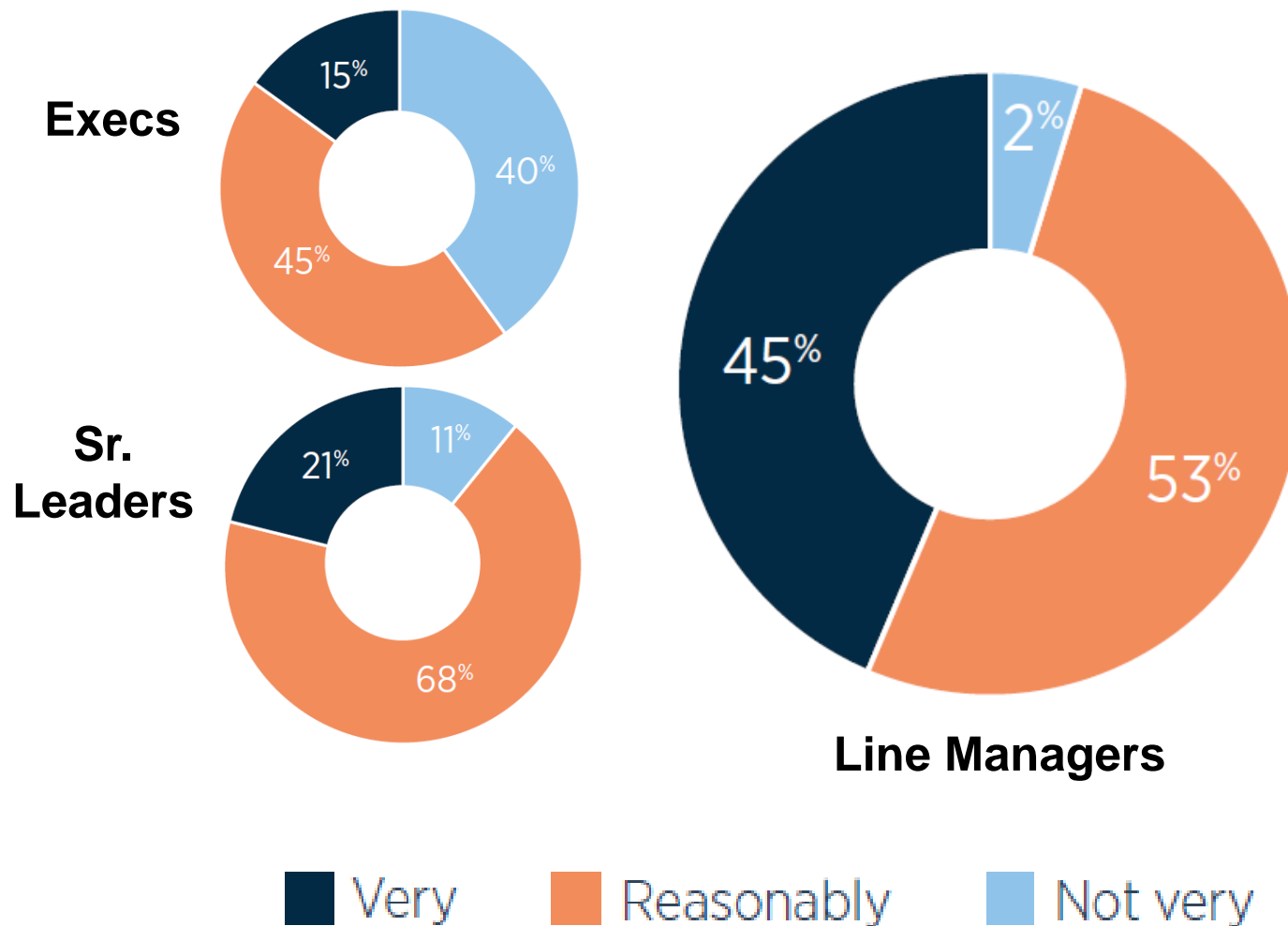
- ✓ Verbal from HR or Supervisor through individual communication
- ✓ Periodic updates on progress by Company leaders
- ✓ Written plan document via email or intranet
- ✓ Annual communication of performance targets, links to strategy or annual goals



**Gallagher**

Insurance | Risk Management | Consulting

# Evaluate Impact: Credible Voice



Most respondents consider executive team members and senior leaders “excellent” (55%) or “good” (45%) communicators, but only 17% of line managers received these same high marks.



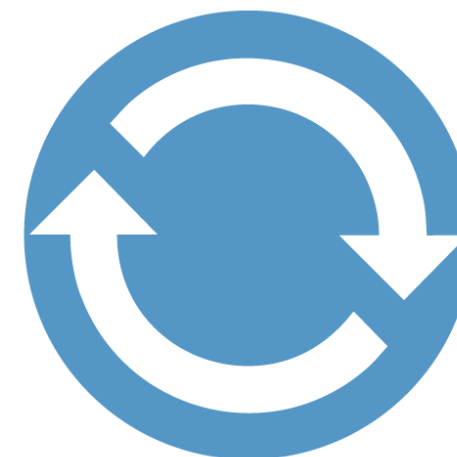


**Gallagher**

Insurance | Risk Management | Consulting

# Engage: Key Influencers

- **Desired Outcome:** Continuous improvements, communication themes
- **Alignment:** Business and Sales Leadership
  - Current performance
  - Business direction
  - Expectations of the program / desired future state
- **Incentive Brand:** Target Workforce Segments
  - Differentiation
  - Positive word-of-mouth messages to *drive performance* and enhance engagement
  - Change to *enhance brand value*



# Wrap-Up: From Insights to Action

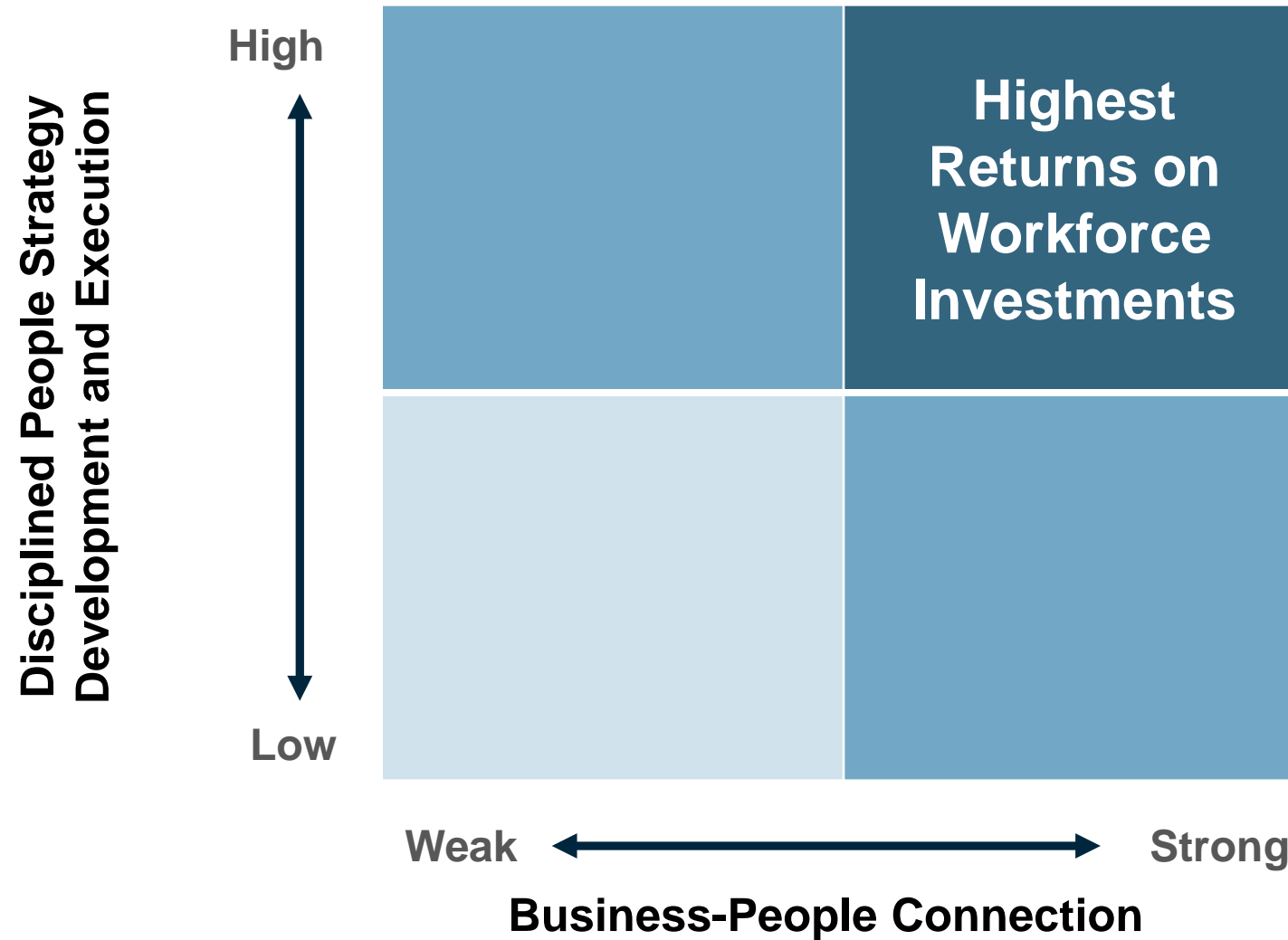
One takeaway from today that you can immediately act on?

One takeaway from today that has good potential but requires more evaluation?

# From Insights to Action



Insurance | Risk Management | Consulting



# Thank you!



Bob Lemke, CCP, SPHR  
Principal  
Human Resources & Compensation Consulting  
Bob\_Lemke@ajg.com  
224-399-4565