

How to Create an Effective Incentive Compensation Plan

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The Ensemble Practice

Keys to Effective Compensation

- Supports the strategy of the firm
- Seen as fair and motivating by everyone in the firm
- Supported by a well-articulated and understood logic
i.e. compensation philosophy
- Connected to the market for skills and talents required
- Administered in a fair and consistent way
- Economically beneficial to the firm
- Supports the progression of careers and responsibilities



Forget Everything You Know About Bonuses

Common Misconceptions

1. *People are motivated by money.*

NOT TRUE — They are motivated by rewards. Not all rewards are monetary.

2. *Bigger bonuses drive bigger changes.*

NOT TRUE — The consistency and frequency of the reward is relative to the behavior matter more than the size of the award.

3. *A bonus formula can be designed to be fair.*

NOT TRUE — Fairness is always perceived, never absolute.

4. *A bonus has to be objective.*

NOT TRUE — Subjectivity should be welcome, not excluded.

5. *Bonuses will manage behavior.*

NOT TRUE — Bonuses are never a substitute for management.

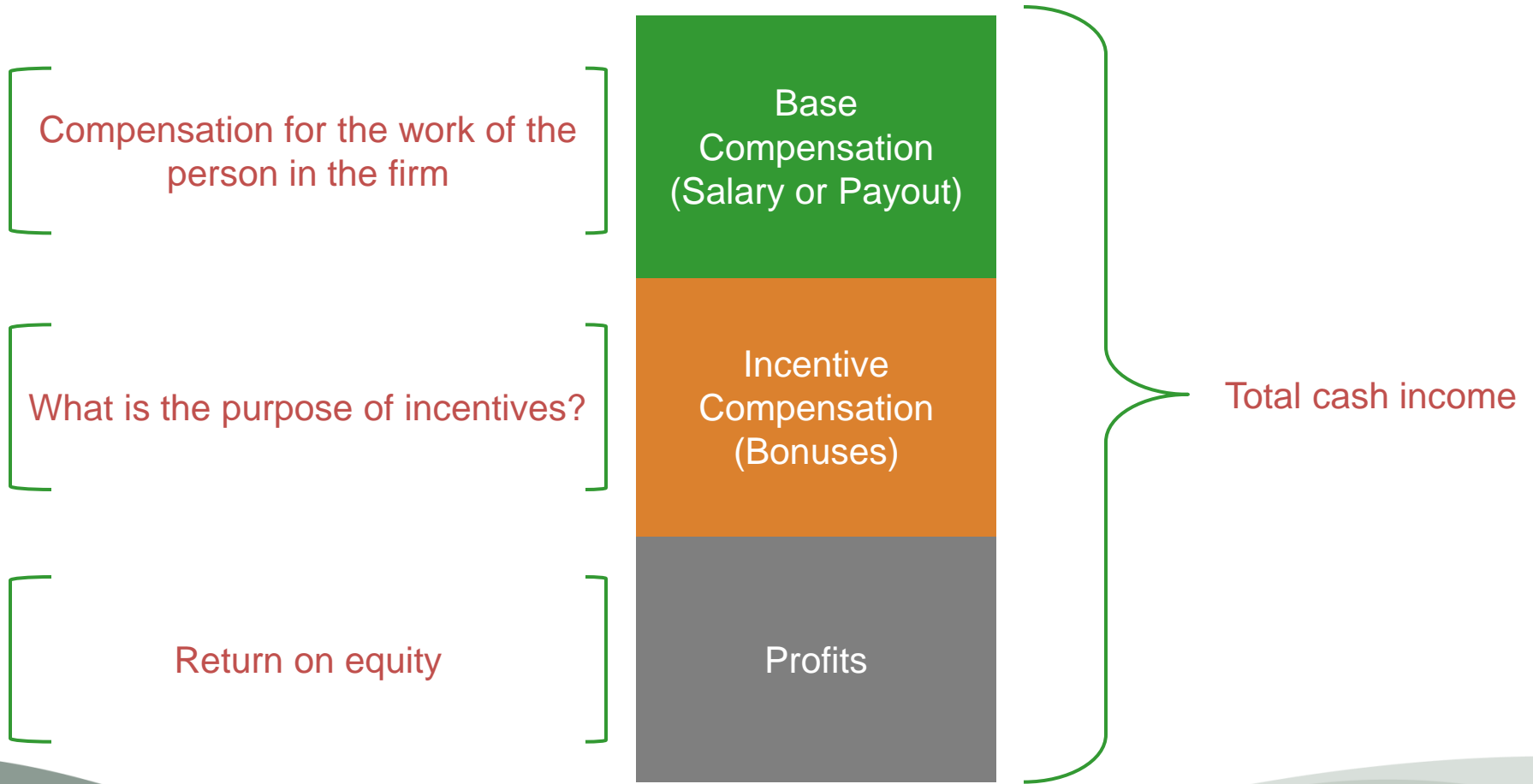
6. *Complex calculations allow you to capture more metrics and drive behavior better.*

NOT TRUE — If you need a spreadsheet to explain it, it won't work.

Things to Remember

- 1. Be Consistent**
Consistently reward behaviors you want to encourage through praise, attention, access to opportunities and bonuses.
- 2. Reward Often**
Frequency matters.
- 3. Clarify Your Values**
Clearly articulate the values that should be driving your culture.
- 4. Set an Example**
Support your values and culture through your own behavior.
- 5. Tie Bonuses to Your Values**
And they will be amazingly powerful.

Total Income





What is the purpose of bonuses?

Why Do We Offer Bonuses?

- To reward work and effort that goes above and beyond.
- To share the success of the firm.
- To send a message.
- To encourage or discourage behaviors.
- To introduce employees to the risk of running the company.
- To create high compensation without fixing the result.

Are People Motivated by Money?

“Emotional well-being levels increase with increases in salary up to \$75,000 but plateau afterwards.”

– Daniel Kahneman and Angus Deaton

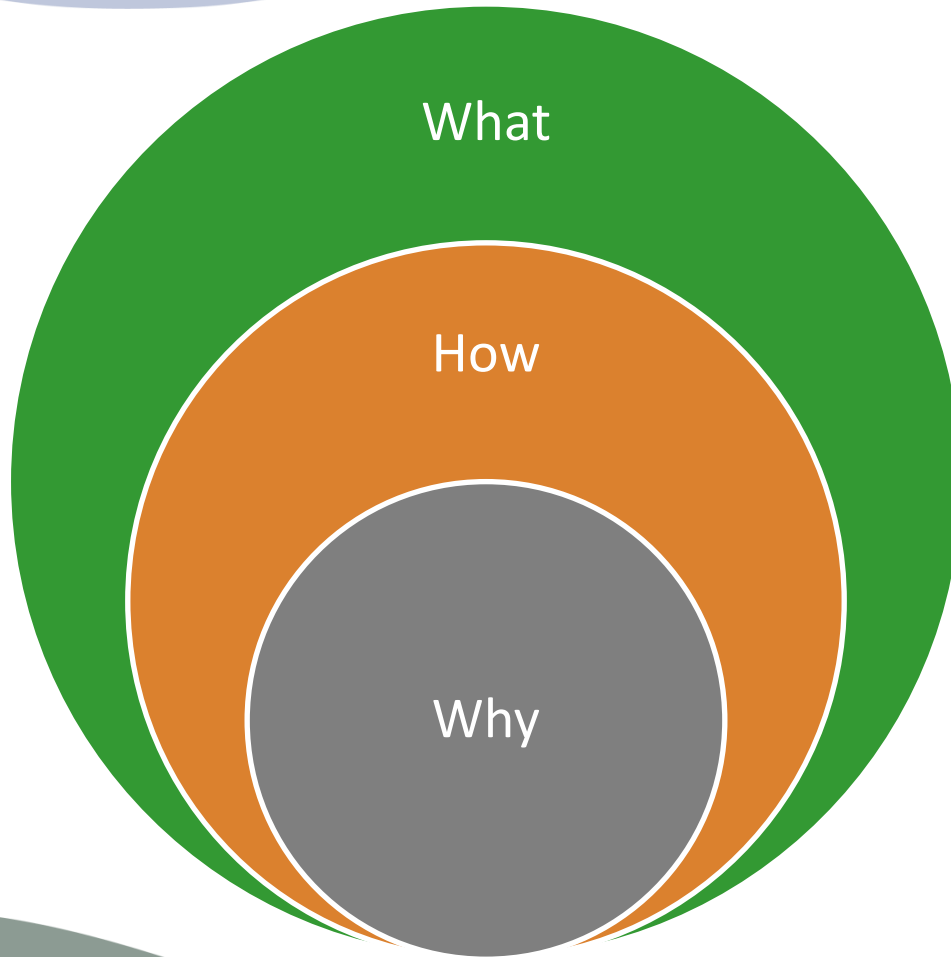
“Money doesn’t make you happy. I now have \$50 million, but I was just as happy when I had \$48 million.”

– Arnold Schwarzenegger

A Gallup survey found that **52%** of employees are not “engaged” in their job, and **19%** are “actively disengaged.” The results did not vary by pay level or income.

Well-established research on the over justification effect shows that rewarding an intrinsically interesting activity results in lowered, not improved performance.

The “Why Theory” – Simon Sinek



“If you hire people just because they can do a job, they’ll work for your money. But if you hire people who believe what you believe, they’ll work for you with blood and sweat and tears.”

- Simon Sinek

Some More Theory



Social Interaction

- Reciprocity applies
- Desire to belong is powerful
- Altruistic motives
- Driven by relationships

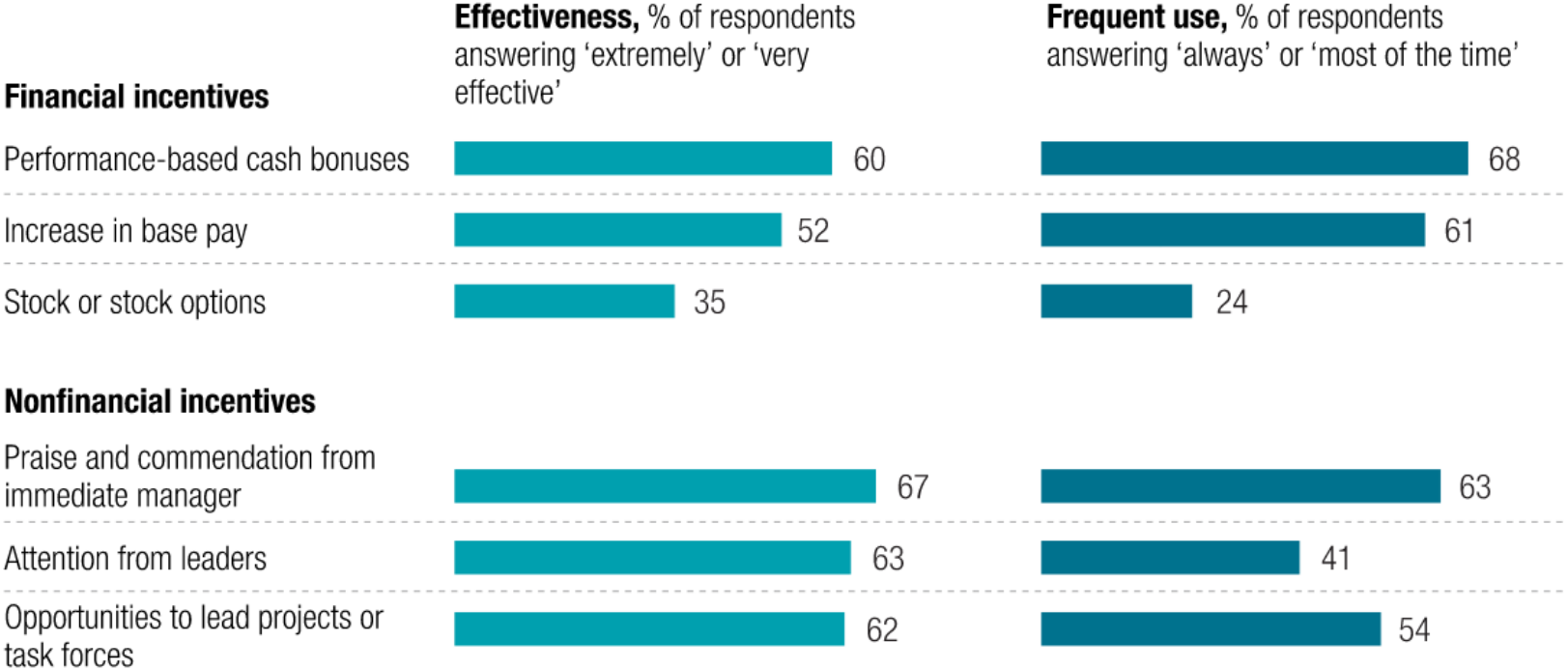
Market Interaction

- Profit-seeking
- Trading and bargaining is expected

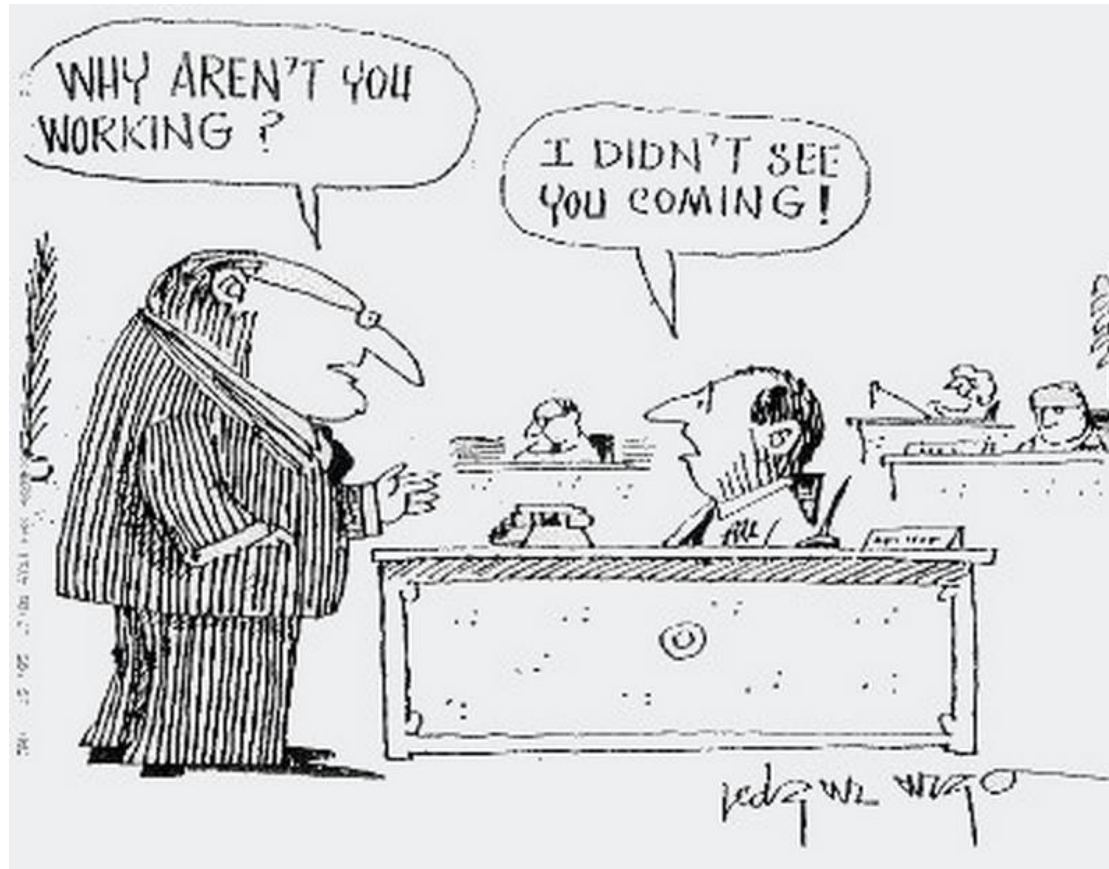
How People Perform

	Pay	Effort
Money	High	High
Money	Low	Low
Candy	High	High
Candy	Low	High
No Pay	None	High

Can You Push Buttons with Money?



Source: June 2009 McKinsey global survey of 1,047 executives, managers, and employees from a range of sectors
“Motivating People: Getting Beyond Money” by Martin Dewhurst, Matthew Guthridge, and Elizabeth Mohr
(McKinsey Quarterly, November 2009)



Mission Statement

**Respect,
Integrity,
Communication
and Excellence!**



How Do We Evaluate Performance?



How Do We Balance Team vs. Individual?



Who Has Input?



How Much Risk is Appropriate?



Are We Willing to Not Pay a Bonus?





Examples

Simplest Bonus

Administrative assistant receives 1% of all GDC of the practice.

- Requires the assistant to be licensed
- Can be modified for targets, e.g., 1% if under chairman and 1.25% if the practice makes chairman

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- Tied to revenue and growth
 - Keeps staff interested in the generation of new revenue
 - Kind of a team bonus

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- Pays regardless of individual performance
 - Requires a license
 - May pay even if revenue declines, but can be adjusted with target



Individual Performance Evaluation

Each staff member receives a performance evaluation from the firm and bonuses are based on evaluations.

- Overall evaluation is on a scale of 1 (very poor) to 5 (excellent)
- Paid once a year
- A firm performance can be added, e.g., if the firm hits target goals, the bonus is increased by 5% of base salary

Score	Bonus
Under 3.0	No bonus
3.0 – 3.5	5% of base salary
3.5 – 4.0	10% of base salary
4.0 – 4.5	15% of base salary
Over 4.5	20% of base salary

Performance Evaluation

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- Great tie to individual performance
 - A good performance evaluation is a very comprehensive reflection on all aspects of performance
 - Easy to understand
 - Can be tied to firm performance, too
- Can be seen as subjective
 - Only as good as the evaluations
 - Can be a little too individualistic

Pool and Balanced Scorecard

- Set aside 20% of the profits of the firm in a pool to be paid for bonuses.
- Each employee participates in the pool based on the number of points he or she has earned.
- Points are earned as follows:
 - Productivity score: maximum of 30 points
 - Sales score: maximum of 30 points
 - Teamwork score: 20 points
 - Client service score: 20 points
- Points are given by the supervisor(s)/owner(s).
- Positions and salaries don't matter—the score does.

Pool and Balanced Scorecard



- The pool based on profits ties bonuses to profitability
 - Very team oriented, yet competitive
 - A good scorecard can be a powerful performance measurement tool
 - Bypasses hierarchy
- Can be seen as subjective
 - Only as good as the scorecard
 - Can become overly competitive
 - It may be difficult to score given differences in positions and jobs

Sales Bonuses

- A sales bonus can be implemented separately from the performance bonus.
- For new business brought in by employees or referred:
 - 20% of the fees in the first year
 - 10% of the fees in the second year
 - 5% of the fees in the third year
 - Paid each quarter
 - 50% of one-time commissions, if licenses allow

What to Remember

- Bonuses will not change behavior by themselves.
- A good bonus will work with the culture of the firm to reinforce behavior.
- Answer the difficult questions.
- Be fair and transparent.
- Performance evaluations are always a good idea to tie to bonuses.
- Do not be afraid of some subjectivity.



THANK YOU!