Guest,

Welcome to:

The Keys to Using Performance Incentives

Presented by
Lighthouse Consulting Services, LLC

To print program slides, click here:

Featured Guest:
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The Keys to Using Performance Incentives

U.S. Employment Market

U.S. Population Growth by Age Segment

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Money & Performance

What is your philosophy about human capital? Do you view people as integral to your competitive advantage?

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The Strategic Importance of Performance Pay

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The Business Problem

- Preceding the recession, the average merit increase was 4%*. With a flat economy, employment costs escalating faster than profits is a zero sum game.

- Employers with inflexible compensation systems were forced to lay off workers during the downturn.

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Limitations of Traditional Compensation Models

- Do not allow for modifications during economic fluctuations (such as 2008-2009 downturn).
- Places all the burden of such fluctuations solely on the employer.
- Subjective evaluation puts the employer at risk.
- Does not reinforce accountability.

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Initiatives that Deliver Greatest Financial Returns

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Top Financial Performers – Best Practices

<table>
<thead>
<tr>
<th></th>
<th>Bottom 10%</th>
<th>Top 10%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales per employee</td>
<td>$158,101</td>
<td>$617,576</td>
</tr>
<tr>
<td>Market value to book</td>
<td>3.6</td>
<td>11.1</td>
</tr>
<tr>
<td>% whose merit increase or incentives tied to performance</td>
<td>2%</td>
<td>87%</td>
</tr>
<tr>
<td># of hours training-new employees</td>
<td>35</td>
<td>117</td>
</tr>
<tr>
<td># of hours training-experienced employees</td>
<td>13</td>
<td>72</td>
</tr>
<tr>
<td>% of employees-regular performance appraisal</td>
<td>4%</td>
<td>95%</td>
</tr>
</tbody>
</table>

*The top and bottom financial performers in a survey of 2800 companies. Source: The HR Scorecard

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Challenges in Implementing Performance Based Pay

- The proportion of incentive must be sizable enough to motivate staff. Once base pay is established it is hard to unwind.
- Must be supported by a credible system of measurement.
- Requires management to be thoughtful in the creation of a bonus pool.
- Financial incentives alone are ineffective - must be coupled with other PM tools.
A Powerful Combination Scorecard Performance Based

- Scorecard provides a framework for universal measurement and teamwork.

- Creates organizational alignment. Rewards and reinforces desired behaviors.

- Promotes clear goal setting and removes subjectivity.
Keys to Instituting a Scorecard

- Be a derivative of the strategy.
- Balance customer, financial, operational and learning and growth measures.
- Creates organizational alignment. Rewards and reinforces desired behaviors.
- Predictive in nature.
- In public view.
- Real time (daily, weekly or monthly).
- In public view.
Scorecard Example

<table>
<thead>
<tr>
<th>Measure</th>
<th>Q1 Target</th>
<th>Jan.</th>
<th>Feb.</th>
<th>March</th>
<th>%Attained</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receivables 60 Days in arrears</td>
<td>$85,000</td>
<td>$103,000</td>
<td>$90,123</td>
<td>$84,000</td>
<td>33%</td>
</tr>
<tr>
<td>Margin Custom Shipments</td>
<td>55.0%</td>
<td>52.5%</td>
<td>53.5%</td>
<td>55.1%</td>
<td>33%</td>
</tr>
<tr>
<td>Sales per CS representative</td>
<td>$50,000</td>
<td>$44,154</td>
<td>$47,234</td>
<td>$47,388</td>
<td>0%</td>
</tr>
<tr>
<td>Monthly shipments Custom</td>
<td>$300,000</td>
<td>$284,000</td>
<td>$304,000</td>
<td>$312,000</td>
<td>67%</td>
</tr>
<tr>
<td>Average Custom Shipment</td>
<td>$75.00</td>
<td>$71.00</td>
<td>$72.44</td>
<td>$73.05</td>
<td>0%</td>
</tr>
<tr>
<td>Call Center Inbound Calls</td>
<td>25,000</td>
<td>23,500</td>
<td>23,750</td>
<td>27,400</td>
<td>33%</td>
</tr>
<tr>
<td>CS Upsell Rate</td>
<td>50%</td>
<td>55%</td>
<td>52%</td>
<td>52%</td>
<td>100%</td>
</tr>
<tr>
<td>New Customers Acquired</td>
<td>300</td>
<td>312</td>
<td>333</td>
<td>340</td>
<td>100%</td>
</tr>
<tr>
<td>Net Adopter Score</td>
<td>40%</td>
<td>38%</td>
<td>38%</td>
<td>40%</td>
<td>100%</td>
</tr>
<tr>
<td>Custom Cycle Time</td>
<td>3</td>
<td>3.7</td>
<td>2.9</td>
<td>2.9</td>
<td>67%</td>
</tr>
<tr>
<td>Volume Manufacturing Cycle</td>
<td>2</td>
<td>1.9</td>
<td>1.9</td>
<td>1.8</td>
<td>100%</td>
</tr>
<tr>
<td>Equipment Uptime (hours)</td>
<td>24</td>
<td>23</td>
<td>16</td>
<td>9</td>
<td>100%</td>
</tr>
<tr>
<td>Shipping Error Percent</td>
<td>1.0%</td>
<td>2.0%</td>
<td>0.5%</td>
<td>0.4%</td>
<td>67%</td>
</tr>
<tr>
<td>Learning and Growth</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% Performance Reviews on Time</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>67%</td>
</tr>
<tr>
<td>Lost Time Injuries</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>67%</td>
</tr>
<tr>
<td>Training Hours for FTE Upsetting</td>
<td>4</td>
<td>0</td>
<td>1</td>
<td>4</td>
<td>67%</td>
</tr>
<tr>
<td>Total Score Achieved</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>58%</td>
</tr>
</tbody>
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Example Pay for Performance Calculation

Tom Jones

Beginning: 04/01/2012
Ending: 03/31/2013
Base Salary: $100,000
Allowable Bonus %: 10%

Weighting of Bonus Potential

- Financial Indicators: 50%
- Scorecard Indicators: 25%
- Job Performance Indicators: 25%

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# Example Pay for Performance Calculation

<table>
<thead>
<tr>
<th>Financial Indicators (Actual Bonus Calculation)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weight</td>
</tr>
<tr>
<td>EBITDA % Increase</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Scorecard Indicators (Actual Bonus Calculation)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weight</td>
</tr>
<tr>
<td>Customer Service Up sell percent</td>
</tr>
<tr>
<td>New Customers Acquired</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Job Performance Indicators (Actual Bonus Calculation)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weight</td>
</tr>
<tr>
<td>Integrate with cost system by 06/01/12</td>
</tr>
<tr>
<td>Hire 5 qualified CS reps and train by 12/01/12</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Bonus Achieved</th>
</tr>
</thead>
<tbody>
<tr>
<td>$3,750</td>
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</tbody>
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Assumptions

- The following steps assume:
  - Salaries are within the industry norm
  - Performance reviews are performed consistently
Steps to Creating a Performance Based Pay System

1. Gain agreement on strategic direction.

2. Create a scorecard that measures strategy. Institute a scorecard culture first.

3. Analyze the costs and benefits of an incentive plan.

4. Conduct a salary survey (you may need to freeze salaries).
Steps to Creating a Performance Based Pay System (cont.)

5. Establish a pay for performance system with 2-3 buckets.

6. Budget for a bonus pool favorable to the bottom line and a win for employees.

7. Gain buy-in.

8. Implement a performance review cycle. In the distribution of bonuses, a fixed performance cycle works best.

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