



## **Incentive Compensation Plans that Work**

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Pay policy plays a significant role in helping firms achieve organizational excellence. A carefully designed, well executed incentive compensation program will enable a company to attract, motivate and reward top-notch employees; sustain a creative, performance-driven work environment; and support behaviors that align with the organization's business objectives, marketing goals and overall strategies.

An effective incentive compensation program not only measures and rewards desired behaviors, but it also takes into account the firm's business processes and financial/accounting practices. The best incentive comp programs are rational, clear and transparent to both the incented employees and those who oversee and administer the program.

### **Setting up a successful incentive compensation program**

Developing an effective, workable incentive comp program that is right for an organization is a job for a team that includes representatives from executive management, line management, human resources, sales and marketing, and finance/accounting. A well designed plan is:

- Aligned to the company's strategic, marketing and development strategies
- Compatible with the organization's base pay salary program
- Based on measurable, quantifiable results
- Linked to a clear payout formula and timeline
- Calculated using readily available data
- Paired with a communication plan that conveys the structure and purpose of the program to employees
- Consistent with other company benchmarks and performance metrics
- Straightforward and easy to execute in a timely manner

It is not always easy to identify the actions and measure the behaviors that truly align with corporate strategy. In many industries, these are shifting targets, and compensation policies may be challenged to keep them in sight. For example, meeting overall sales quotas may seem like a clear, simple way to measure sales performance. But if quotas are met by selling low margin products while the company is looking to expand margins, there is a strategic disconnect. If the business is trying to grow new accounts, the incentive comp scheme must somehow take into account the industry sales cycle and the time and effort required to develop new business, as well as the needs of existing customers. A company may want to encourage a focus on new product lines, new brands, new services, new verticals or new territories, in which case the sale of legacy products and services would not be rewarded at the same level as sales of these targets. An effective incentive comp program needs to take such strategies into account in a rational manner without becoming overly complicated and convoluted.

### **Other Corporate Objectives**

Moreover, in addition to sales and marketing objectives, incentive compensation programs often link to various other company and HR strategies, such as creating a culture of ownership, promoting teamwork, boosting unit productivity, accelerating special initiatives, incenting quality outcomes, and supporting customer service standards. Certain departments or individuals may have part of their compensation tied to profit sharing bonus structures or milestone incentive schemes that support special projects or development objectives. Incentive compensation is even used in some industries to offset stagnant base salaries through contingent pay programs, discretionary bonuses, skill-based pay, and unit-based pay. In these situations, commissions are based at least partially on subjective assessments rather than productivity or a proportional share of ownership.

In fact, for most individuals and groups, including executives, managers, sales reps, service people, and non-customer-facing employees, profit sharing and incentive compensation programs generally include a qualitative component such as customer/employee feedback, service evaluations, or achievement mileposts.

### **Simplicity and Transparency**

Whatever goals and objectives underlie an incentive comp program, the plan needs to be set up in a way that does, in fact, incent the stated deliverables and make sense from both a payout and an implementation standpoint. The best, most efficient plans make clear to employees what goals they are to achieve, how their commissions are computed and when they will see the bonus money in their paychecks.

Equally important, plans should be structured so that payouts can be calculated accurately and easily using data that comes straight out of the accounting system in an automated way. Implementing a complex, convoluted system that requires additional work or even guesswork by HR and/or accounting is costly, inefficient and time-consuming. A creative, well-intentioned plan that is overly complex to execute will inevitably result in delayed payouts, miscalculations, ambiguity and confusion. In addition to being frustrating, demoralizing and de-motivating, this often makes it easy to game or manipulate the incentive comp system.

Taking the guesswork out of the incentive compensation plan reduces ambiguity and frustration, provides clear marching orders to employees, and makes the accounting/payroll process smooth and efficient. It also lets incented employees track their commissions and see the link between their performance and the company's overall success.

Finally, it is important to emphasize that an incentive comp plan, even a superbly designed one, is no substitute for good management. Motivating employees and maintaining a committed, fully energized workforce that produces at a high level is a function of good leadership and strong management. Successful employee incentive plans can support management in this goal and underscore a company's culture, strategic goals, and business imperatives while communicating what the company needs to do to succeed.

### **Summary**

Forward thinking executives interested in developing and executing best-practice compensation plans will align plans with the following three general guidelines:

- Incentive compensation plans should align with a company's strategic, marketing and development strategies and should incent stated deliverables.
- Effective plans make sense from both a payout and an implementation standpoint. Payouts should derive from data that comes directly from the accounting system in an automated way.
- Maintaining a motivated workforce is ultimately a function of good leadership and strong management. Employee incentive plans – even very good ones – are no substitute for good management.

It is up to the CFO and the financial/accounting plan development participant to ensure that all performance data needed to execute the company's incentive comp plan is systematically available. As part of the implementation process, it is also important to detail how questions and conflicts pertaining to the program will be resolved. An outsource provider with knowledge and experience in implementing successful incentive compensation programs can be invaluable in this regard.

### **About CFO Edge**

CFO Edge is a leading Southern California provider of outsourced CFO services. Based in Los Angeles, we are a group of experienced chief financial officers who engage with CEOs and CFOs on demand to address strategic planning, business management, and day-to-day financial operations challenges. Our seasoned professionals deliver services as interim CFOs, part-time CFOs, project-based CFOs, recruitment-to-permanent CFOs and interim-to-permanent CFOs. At CFO Edge, we're passionate about helping our clients create, grow and sustain value. For more information, visit [www.cfoedge.com](http://www.cfoedge.com) or call 626.683.8840.