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Corporate Incentive Review Guide

This document presents a suggested general approach to reviewing a global corporate annual cash-based incentive programme or practice. This is not recommended for long-term incentives, sales compensation, locally-driven practices or not-for-profit scenarios which involve different considerations.

General project phases

- I. Planning & Direction Setting
- II. Current State Assessment
- III. Design & Development
- IV. Approval
- V. Implementation & Communication

The above five project phases can be completed as formal project or informally (where time is limited or if there is no history of formal incentive reviews.) The list can serve as a mental checklist, to ensure you know what problem you are fixing (phase I), understand what is out of alignment whether internally or externally (phase II), make changes that will give you better results (phase III), gain firm support from leadership (phase IV) and make it a reality, achieving the business results you need (phase V.)

Detailed Activities for each Phase

Potential activities in each phase include:

Phase	Step	Description
I—Planning and Direction Setting	Executive interviews	<p>Changes to compensation are extremely sensitive and stressful to people. It is absolutely essential to have the whole picture when seeking to address a business need by changing compensation.</p> <p>Interview 3 or more key leaders (region or SBU heads, COO, function heads, etc.) for input. Two extremes to avoid: not enough interviews (you will miss important information and those not heard may resist changes) or too many interviews (this is a lesser risk, but it can lead to higher expectations that all concerns and wishes will be reflected in the new design.)</p>

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Phase	Step	Description
		<p>Prepare an interview guide for the interviews, starting with an introduction (purpose of the incentive review and purpose of the interview), and listing 6-10 general questions, such as:</p> <p>“Are you satisfied with the current incentive plan?” “Are the right people getting paid the most (or least)?” “Do we have the right balance between global, regional (or SBU) and country/local and individual performance? Is there too much/little weight on any of these? Should the weightage vary by level, etc.” Why? “Do you feel our incentives are competitive for our industry? What about our total cash compensation? Do we need to change the mix of fixed and variable pay?” (You should benchmark to answer these questions, but perceptions are equally important and will help you plan communications.) “Looking at eligibility, should we increase or reduce the groups/levels/locations/units that are in this plan? Should certain groups be carved out and put on a different incentive?”</p> <p>Remaining questions should focus on specific issues you (or your boss or CEO) feel are not working well, such as “how do you feel about managerial discretion on the individual multiplier” or “should we put customer service back on a sales incentive?”</p> <p>The executive interview summary will include some current state information, as well as desired state and advice on approval criteria, implementation or communication.</p> <p>Consider getting input from heads of quality and safety and legal. Why? Incentives can sometimes lead people to cut corners...</p>

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	Project Objective (or project charter)	<p>A written summary or problem statement, stating clearly the expected incentive review outcomes. For example, this could be a single PowerPoint slide entitled “Expected outcomes” and listing the specific outcomes, such as better alignment between pay and business results, more focus on team and unit results, shifting more pay to at risk, etc.</p> <p>A project charter is more formal and represents the official mandate from management to complete the project. It includes a purpose statement and lists key objectives, key milestones, project team members and other information regarding the project.</p>
II—Current State Assessment	Benchmarking	<p>Calculate the total annual cost of the incentive programme. Then determine what benchmark data you need and determine what % of your annual incentive spend the benchmarking data represent. If your annual incentives cost the company \$6 million per year and benchmark surveys will cost \$15,000, you are asking for one-quarter of 1% of the cost of the incentives, in return for ensuring your \$6 million is actually helping get desired business results.</p> <p>Apart from “big firm” data, benchmarking also includes getting ideas from your network, from consultants, even from competitors or similar industries. Talk to your contacts and seek out ideas.</p> <p>WorldatWork or other HR association websites often provide white papers on incentive practices.</p>
	Payout Review	<p>Gather and examine performance results, calculations and payouts for the past year or two. Who got the biggest payouts? The lowest? In both cases, was it deserved? Did high payouts support retention of key performers? Did high payouts retain low performers (who got lucky by being in a high performing SBU, for example)? Did low payouts put good people at risk? Did they leave the</p>

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		<p>company? Did low performers leave the company (a good outcome)? Was the plan self-funding, when you compare incentive costs with business results? Are financial measures sufficiently weighted to ensure the plan is reasonably self-funding? Are non-financial measures important enough to include even though they may not fully or directly fund the payments? Does non-financial performance (such as risk management or safety) have a clear and important benefit to the company that will lead to long-term financial strength?</p> <p>Look at payouts to new employees? At what point are they eligible to participate? Did new employees have sufficient time with the company to have impact on results warranting payouts?</p>
	Employee input	<p>It can be risky to invite broad input from employees on compensation, as it tends to raise both fears and expectations. Better to take a low key approach in gauging employee attitudes about the current incentives. There are a few actions that can be taken without stirring up gossip:</p> <ul style="list-style-type: none"> • Check employee engagement survey scores—it is unlikely your engagement survey asks about incentives specifically, but look at the questions relating to rewards and recognition, to see if there are any clues • Employee focus groups – focus groups can be very effective for getting input. May be best to broaden a focus group to <u>all rewards</u>, not just incentives. It's ok to ask what types of pay, recognition or benefits people would like to see <i>more of</i>, but it's even better to ask people what they are willing to have <i>less of</i>, in return. This is referred to as conjoint analysis when done through a quantifiable formal survey.
III—Design and Development	Problem Definition	<p>This step is important. Without clearly understanding what is broken (or what needs to be better aligned), there will be a lot of wasted effort trying to fulfill everyone's wishes and you will end</p>

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		<p>up with an over-engineered scheme that is less effective than your current plan.</p> <p>Carefully review the executive interview inputs and identify common or important inputs or themes. Summarise these key points in writing and work with your project team to articulate the problem as clearly and completely as possible. The primary objective of the incentive review will be to address the main problem. All other “wish list” items that are unrelated to the main problem should be listed as secondary objectives.</p> <p>Be sure to include general objectives such as helping attract and retain talent, aligning pay with performance, ensuring fairness and consistency within the company and keeping it simple.</p>
	New Incentive Design	<p>This step involves ideation, the creative open-minded process of generating ideas for solving the problem(s) defined. HR should avoid playing expert, and try to be a facilitator as much as possible, as others from non-HR areas contribute their ideas.</p> <p>Address all key areas of incentive design:</p> <ul style="list-style-type: none">• Plan objectives• Plan type (profit sharing, performance sharing, etc.)• Eligibility• Performance measures• Performance metrics, targets, thresholds, etc.• Funding• Payment frequency and distribution
	Plan Development	<p>Once specific design ideas are identified, development is the actual creation of the plan based on those ideas, and includes drafting plan documents, cost modeling and worked examples.</p> <p>Generally, it is a good idea to seek “directional approval” of the design ideas prior to developing</p>

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		the plan in detail. Otherwise, you risk spending resources on something that doesn't get approved.
	Modeling and Impact Analysis	<p>Modeling is a simulation exercise in which you apply the new plan design to last year's performance to see how the payouts would differ. If possible, you can model against current year to date performance to estimate how payouts would look if the plan were already in place.</p> <p>Important: modeling is done to answer the question "Would the new incentive plan have better supported business needs last year than the current incentive plan?" Be careful to look at more than cost impact. Look at performance impact, which means consider how the new plan design would have supported better business results. We are assuming that incentives impact behaviour and results. So a change in the plan design should impact performance, not just rewards. Try to reach consensus about how the new plan would impact behaviours, and therefore results.</p> <p>Impact analysis is part of modeling, and addresses three specific questions regarding impact:</p> <ol style="list-style-type: none">1. Cost impact—how do design changes impact costs, overall and on a micro/department level?2. Employee impact—who are the "winners and losers" as a result of the changes? Who will have a lower incentive target or maximum? Who will have less line of sight? Who will have negative perceptions, even if the changes are technically neutral?3. Adverse impact—this is done to determine whether negative impact is happening mainly to females, minorities or other groups, whether or not they are legally protected against pay discrimination. If the workforce is 50% female, but modeling the new plan indicates a lower incentive payout for 80% of females and higher payouts for most males, you'd better

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		<p>find out why this is happening and some adjustments to avoid this.</p>
IV—Approval	Directional Approval, or “socialization” of the ideas	<p>To this point, you have completed executive interviews, identify key themes about what needs to change, done some benchmarking and generated initial ideas about the new plan design based on those inputs.</p> <p>This is the time to seek directional approval of those initial ideas from key business leaders who may or may not be actual approvers of the final plan. Socialise the ideas with these leaders to sound them out, get their reaction, pick up additional inputs to help refine the plan design.</p> <p>Summarise the problem, key inputs, baseline facts on payouts and impact on outcomes, plus initial ideas. Present these ideas either one-on-one with the same executives you interviewed at the start, or at a management team meeting.</p> <p>Remember the four types of stakeholders: RACI (R—organisationally Responsible; A—Accountable for the project task; C—should be Consulted; I—should be Informed.) Even though the senior management team may far outrank you as the C&B manager, the goal is to inform them and consult them. Do not ask their approval unless they are in fact responsible for the corporate incentive plan! In most organisations, HR is responsible, and the approvers are therefore the head of HR and probably the CEO or MD for the eligible entity.</p>
	Formal Approval	<p>The directional approval discussions will yield further input on the design, enabling you to finish the work, conduct the modeling and prepare for implementation and communication.</p>
V—Implementation & Communication	Implementation Policies	<p>How will changes impact individuals? Will changes be immediate (current year in progress) or in the following year? Will people getting a reduced target incentive receive a base salary adjustment? Will anyone be grandfathered on current terms (shield</p>

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		them from the changes, at least for a period?) How will changes to the individual component weighting impact star individual performers? If you have decentralized incentives, how do you manage people moving from one location or unit to another where targets are higher or lower? Does the new target apply only to the relevant portion of the year, or do you base the full year incentive calculation on the year-end status and location/unit?
	Communication Planning	<p>A well-prepared communication plan can help ensure the new incentive scheme will have the desired impact on behaviour and business results. Experience reward professionals know that incentives only work effectively, if the message is clear regarding business results that are expected. An incentive plan is not a substitute for clear communication. Communication however, can be effective without an incentive plan to support it. At best, incentives can <i>reinforce</i> what management is communicating. Incentives <i>cannot replace</i> management communication.</p> <p>The communication plan lists the various audiences: management team, line managers, eligible employees, ineligible employees, union members, etc. For each audience, the plan specifies what messages and content are needed, and why. The communication channel(s) and timing/sequence are specified as well. Often, incentive plan changes are communicated top-down through a cascaded process.</p>
	Project Management	<p>Project management cuts across all project phases, but it is listed here as it is closely related to implementation and communication.</p> <p>This involves setting up a project team, a project plan (phases, steps, actions, accountabilities, etc.) and milestone dates. The project team should include someone from finance who is familiar with the plan and who can provide data on financial or</p>

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		<p>operational performance (past and current year) for modeling purposes. Good to include a few department heads from key areas, including operations and staff functions. Set strict ground rules. Inclusion in the project team (or advisory board, to keep it less formal) is based on agreement to maintain confidentiality regarding potential changes to the incentive scheme. Team members are not representing their areas, only themselves. Therefore, there is no obligation or right of open communication with one's department-mates. Project membership should require approval by the member's boss prior to approaching them, in part to ensure the member can handle sensitive information properly, think creatively and be open and respectful of the ideas of others. Avoid people new to the company who may not know how the business works, but also avoid people who may feel the best way is "the way it's always been done."</p> <p>File sharing protocols, project team updates/calls, member roles and accountabilities should be specified upfront, as part of good project management.</p>