



Seeing the Forest Through the Trees

Evaluating the Effectiveness of
Incentive Plans

Who We Are



- Terry Newth
- Executive Pay Advisor
- 10 years of experience
- Works with a broad array of clients



- Aria Glasgow
- Consults on Employee and Executive Pay
- Experience in corporate and consulting settings

About Pearl Meyer & Partners

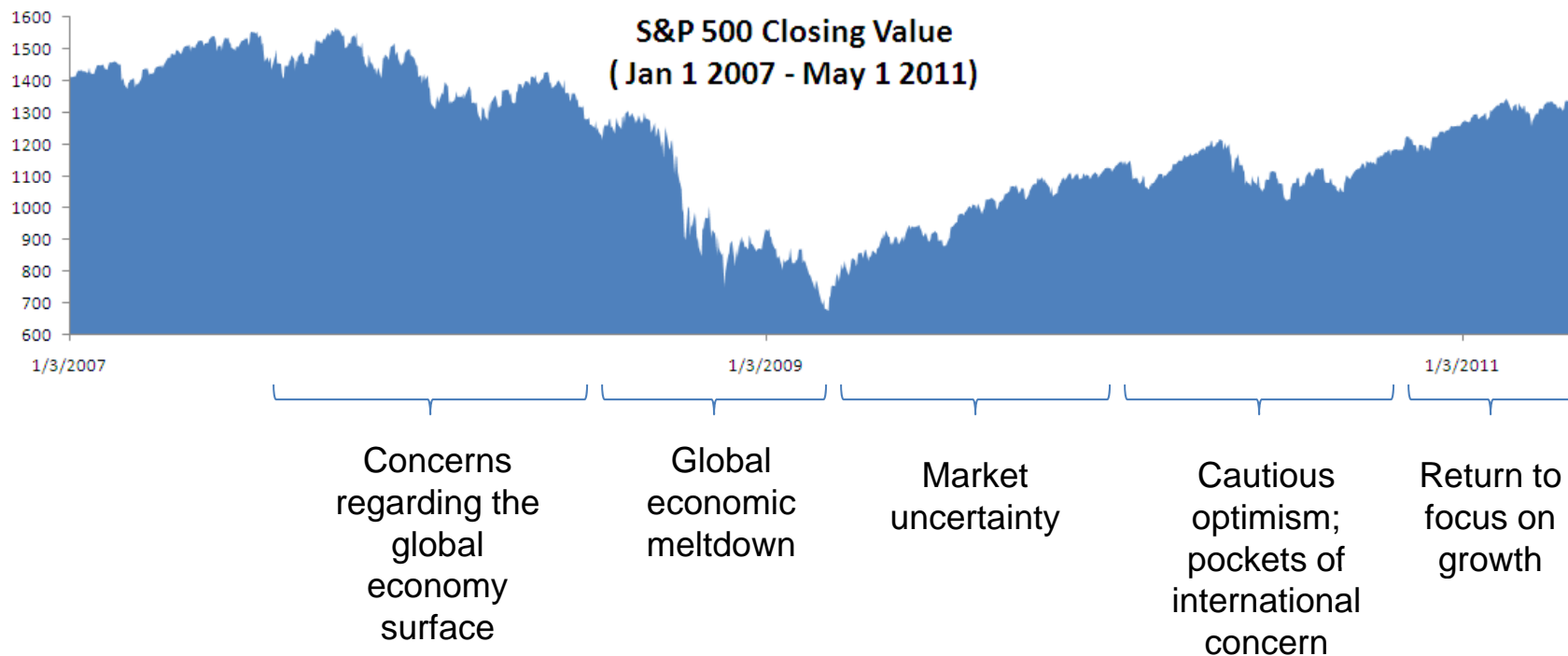
- Pearl Meyer & Partners (PM&P) is a leading compensation consulting firm serving as trusted advisor to Directors, senior management and Human Resources in the areas of compensation governance, strategy development and program design.
- Founded in 1989, PM&P works with a wide range of clients - from start up to *Fortune 500* firms.
- The firm maintains offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, Los Angeles and San Jose.

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What We Intend to Cover

- Environment surrounding pay
- Implications on incentive compensation
- Principles and components of incentive pay
- Evaluating current incentive plans
- Best practice plan features
- Q&A

Environment Surrounding Pay



Labor market
Implications

Companies cut 'fat, muscle, then bone'

Maintain

Limited Hiring

Environment Surrounding Pay

	Then	Now
Salaries	Most freeze pay; some reduce	Salary frost almost gone; 2.5-3% salary budgets the norm in 2011
Incentive Pay	No bonuses or limited pools; dramatic cuts in incentive payout levels	Shift of fixed pay to incentive pay intended to track with company performance
Benefits	Employers cut 401(k) matches; 'all costs on the table'	401(k) matches reinstated; many program cuts will never come back

Implications on Incentive Pay

Theme	Implications on Incentive Pay
Return to focus on growth; cash generation and expense management concerns alleviate	» Incentive metric determination is key
Continued market volatility and international economic concerns	» Challenges with goal setting and calibration
Most companies have reduced their workforce to 'above average' employees only	» Challenges with payout differentiation; need to ensure pay and performance are linked
Risk-taking under the microscope at companies	» Need to ensure a company's incentive programs do not motivate excessive risk taking

3 Principles of Effective Incentive Plans

Alignment

Program places attention on the “right” priorities in the “right” manner



- Strategic Focus
- Cultural Consensus
- Performance Alignment

Enablement

Program allows for both participant and Company to maximize return on investment



- Resource Commitment
- Policy Governance
- Plan Comprehension

Engagement

Program motivates people to perform and drive over-achievement



- Performance Distribution
- Program Competitiveness
- Payout Differentiation

Understanding the Program Objectives

It's critical to gain agreement on what the incentive plan is intended to achieve...



Incentive Plan Components

Plan Type

- Goal and Target
- Pool and Allocation
- Discretionary
- Reward and Recognition

Performance Focus

- Corporate / Organization
- Division / Team
- Individual

Performance Measures

- Financial
- Operational
- Strategic
- Discretionary

The Plan Type and Performance components should support the organization's culture and specific objectives

Incentive Plan Components

Variation on Performance

- Significant
- Moderate
- Little

Relative importance can depend on role, level, and organizational strategy

Bonus Amount

- What percentage of Base Salary is appropriate?
- Different percentages based on position level?
- Impact on total compensation levels?

Bonus Scaling

- Should the plan be scaled (minimum, target, maximum)?
- *How* should the plan be scaled?
- Is there a standard minimum performance level to achieve?
- Is there a cap to payment?

Deep Dive

- Metric Determination
- Goal Setting
- Pay Differentiation / Pay for Performance
- Incentive Plan Risk

Metric Determination and Goal Setting

Specific

- Focuses on a particular situation and defines specific actions or tasks

Measurable

- Includes specific levels of accomplishment and ways to determine when the goal has been reached

Achievable

- Goal is challenging but within reach (STRETCH)

Results Oriented

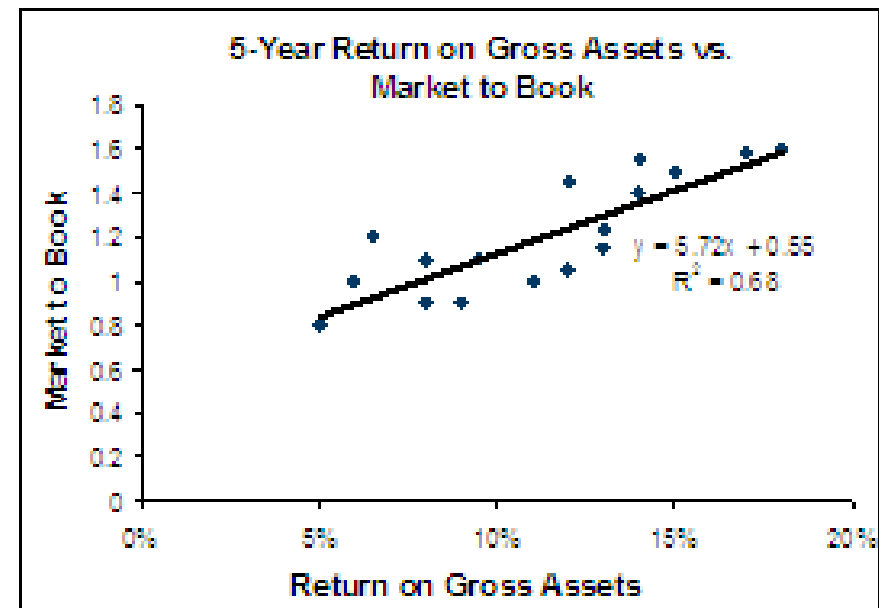
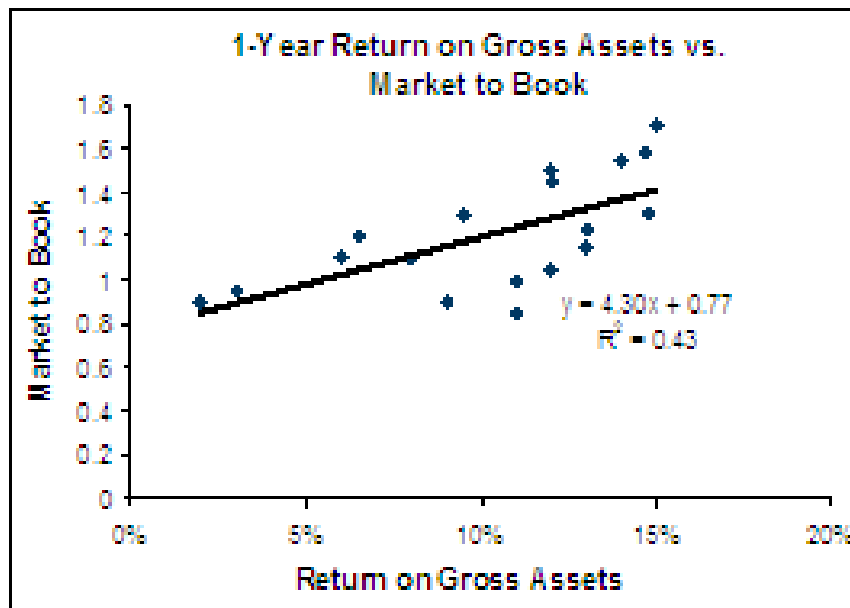
- Goal focuses on achievement of critical objectives

Time Based

- There should be a clear timeline or deadline for completion

Analysis to Evaluate Current Metrics

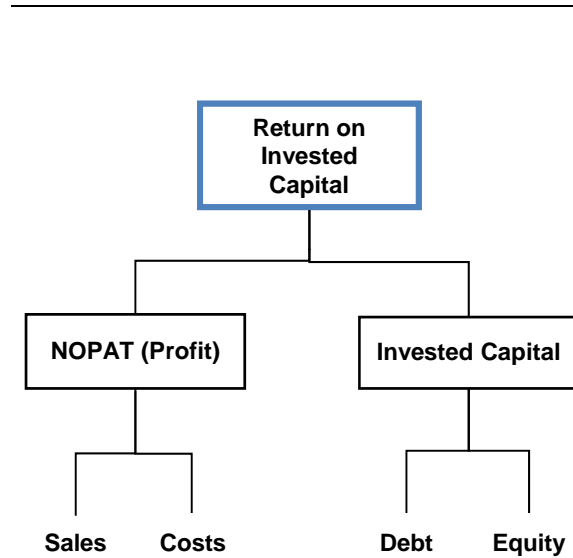
An analysis the current incentive plan measures and their correlation with shareholder value (creation) can help in determining if the Company is using the right metrics



Analysis to Evaluate Current Metrics

Value driver analysis can assist in breaking down the drivers to complex financial measures, creating greater line of sight...

Industrial Sector



Keys ways to increase

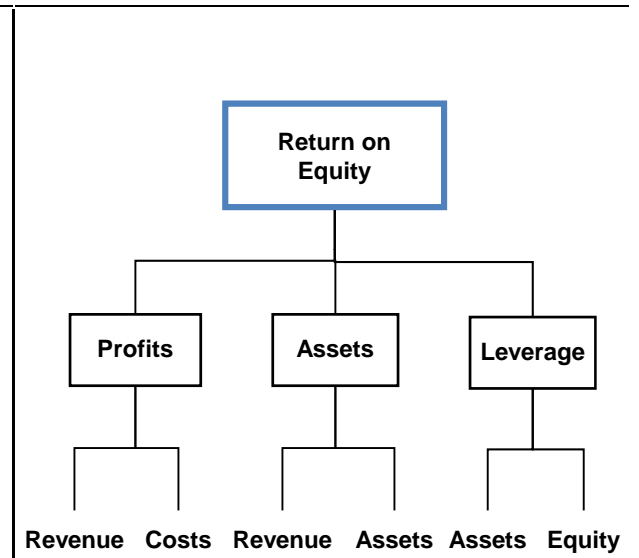
NOPAT (Profit)

- Increase Sales
- Decrease Costs
- Invest in R&D and Sales Force

Invested Capital

- Reduce Working Capital % of Sales
- Reduce Fixed Capital % of Sales

Financial Sector



Keys ways to increase

Profit

- Increase Net Income/Revenue Ratio

Assets

- Increase Revenue/Assets Ratio

Leverage

- Increase Assets/Equity Ratio

Goal Setting

Threshold

- Represents reasonable performance; likely to occur most years

Target

- Represents expected performance; includes some 'stretch' in performance; likely but not guaranteed

Stretch

- Represents superior performance; requires high level of performance; not as likely to achieve

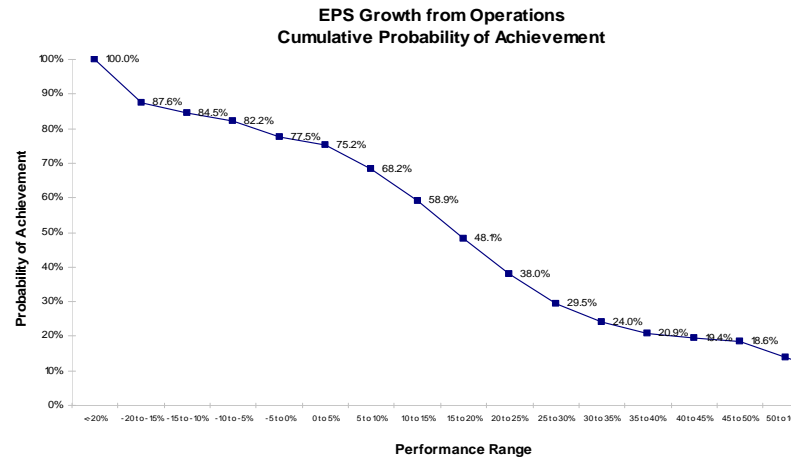
A starting point for goal setting...

Performance Level	Performance Goal (as % of Target)	Probability of Achievement	Reward Payout
Below Threshold	< 80%- 90%	100%	0%
Threshold/Minimum	80% - 90%	> 80%	50%
Target / Goal	100%	60% - 70%	100%
Stretch / Maximum	110% - 120%	<10% - 15%	150%

Analyses to Evaluate Goal Setting

Historical data can help facilitate goal setting for certain types of measures...

Ticker Symbol	Company Name	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
A	Company A	5.8%	9.5%	6.6%	9.0%	134.2%	-1.9%	3.2%	-6.1%	-0.5%	12.6%
B	Company B	42.1%	7.7%	7.6%	20.4%	24.1%	22.7%	27.9%	6.9%	17.2%	11.8%
C	Company C	10.7%	7.2%	11.8%	11.0%	13.1%	17.1%	8.2%	11.4%	9.8%	13.1%
D	Company D	-14.1%	-42.9%	130.4%	19.9%	18.5%	11.0%	10.7%	8.7%	10.0%	15.1%
E	Company E	78.9%	1.3%	2.6%	0.7%	12.4%	3.2%	-14.6%	-1.4%	-1.1%	0.1%
F	Company F	18.1%	20.2%	23.2%	39.1%	28.5%	17.5%	1.3%	4.4%	9.7%	2.6%
G	Company G	24.0%	26.3%	23.7%	25.1%	27.2%	19.0%	17.1%	8.8%	11.3%	12.8%
H	Company H	4.3%	5.2%	5.5%	6.2%	60.8%	8.0%	2.2%	3.3%	3.9%	4.9%
I	Company I	15.8%	21.6%	17.9%	20.8%	29.9%	18.1%	17.7%	19.8%	16.4%	18.2%
J	Company J	1.6%	10.2%	28.5%	0.5%	3.6%	-2.0%	0.5%	1.1%	-45.0%	3.6%
K	Company K	20.1%	28.0%	63.2%	11.9%	4.8%	8.8%	4.5%	4.2%	5.1%	1.3%
L	Company L	4.9%	5.3%	30.2%	8.9%	17.9%	10.8%	7.3%	-5.5%	9.7%	0.8%
M	Company M	1.0%	-9.3%	2.4%	4.6%	6.7%	3.1%	-2.4%	-14.9%	-24.4%	-15.3%
N	Company N	10.3%	7.9%	9.4%	11.5%	8.9%	9.5%	8.1%	10.1%	9.7%	-2.7%
O	Company O	12.6%	13.3%	13.5%	14.5%	16.5%	18.9%	16.1%	16.5%	13.3%	15.4%
	25th %ile	4.6%	5.2%	7.1%	7.5%	10.6%	5.6%	1.8%	-0.2%	1.7%	1.0%
	50th %ile	10.7%	7.9%	13.5%	11.5%	17.9%	10.8%	7.3%	4.4%	9.7%	4.9%
	75th %ile	19.1%	16.8%	26.1%	20.2%	27.8%	17.8%	13.4%	9.4%	10.6%	12.9%
XYZ	XYZ Company	13.5%	12.0%	12.5%	16.7%	20.3%	15.9%	13.8%	12.3%	4.8%	11.3%

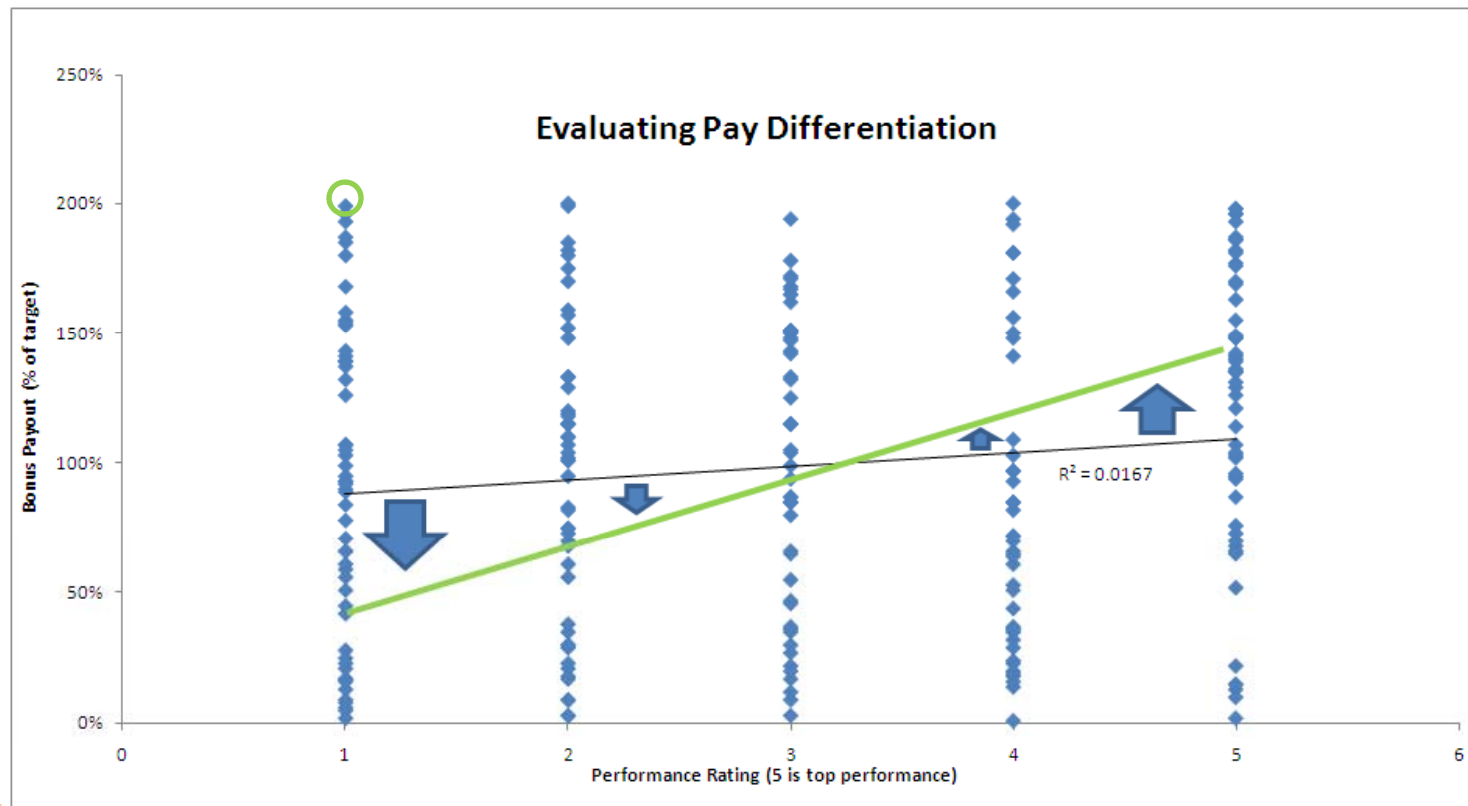


Pay Differentiation and Pay for Performance

- Pay differentiation is an area of great frustration for managers, particularly in recent years
 - Most companies are extremely lean
 - Employees remaining are typically ‘average or better’
 - Bonus pools have been low in recent years, making differentiation more challenging
- Pay for Performance has been an area of great focus over the past decade
 - Most philosophically say they ‘pay for performance’
 - Shareholders are keenly interested in ensuring executives are paid for performance
 - The SEC will be putting in place pay for performance disclosure rules for US public companies

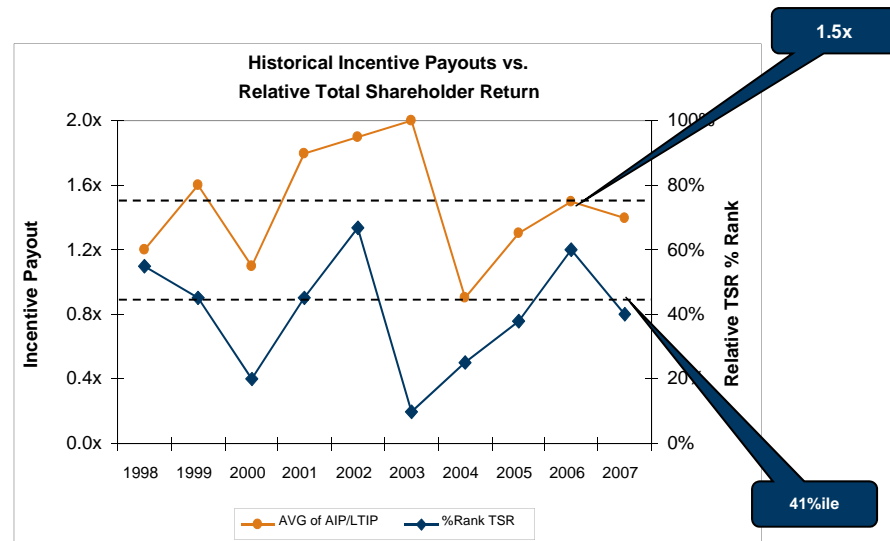
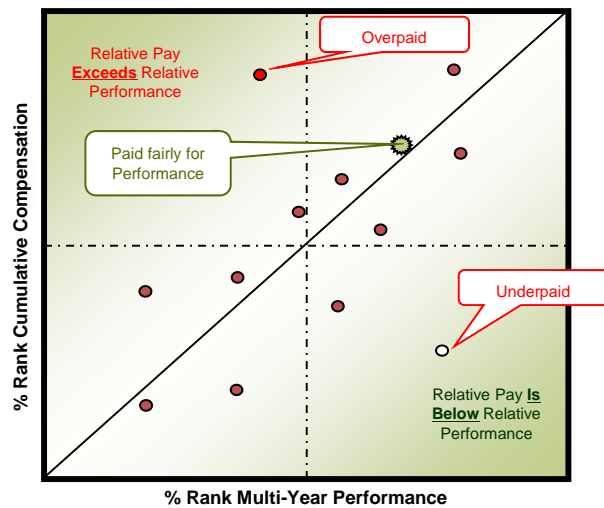
Evaluating Current Pay Differentiation

Analytically assessing pay differentiation can help understand if a company is “walking the walk” on pay for performance



Evaluating Pay and Performance

Pay for performance can be assessed at the individual level for executives, as well as at the aggregate level for company incentive plans



Evaluating Incentive Plan Risk

LOWER RISK

HIGHER RISK

PAY MIX

At least half of compensation in base salary
Most of compensation paid based long-term, sustained performance

Majority of compensation in incentive pay
Most of compensation paid based on annual, short-term results

PERFORMANCE MEASURES

Balance of performance measures:

- Financial, operational, quality
- Short and long-term
- Company and Individual
- Absolute and relative
- Formula and discretion

1 (or too few) performance measures
1 (or too few) performance perspectives (e.g. all top line metrics without accounting for quality)
Same performance measures used for short and long-term incentives

DESIGN FEATURES

Cap/maximum payout
Appropriate performance-payout curve
Multi-year performance period (or hold back/deferral if focus on short-term)
Discretion allowed
Clawback
Ownership/holding requirements

No cap/unlimited upside
Threshold/target set too high
Quarterly or single year performance without some focus on longer-term
Formulaic calculation
No clawback
No ownership/holding requirements

Evaluating Incentive Plan Risk

Key Questions for Consideration

- Do incentive plan metrics reflect the company's business strategy?
- Is there an appropriate balance and mix of performance metrics?
- Is the leverage (upside and downside) appropriate?
- How much focus is placed on short-term performance? Is it appropriately reflecting the time horizon of the risk taken?
- Is there appropriate focus on long-term performance? How is long-term defined?
- Is there accountability at the Board and management level to assess risk and monitor compensation?
- Do the payouts align with shareholder interests?
- Do the payouts align with market practice?
- Who designs the plans? Who approves the plans?
- What is the level of oversight by finance, human resources, senior management?

Summing it up: Effective Plan Features

- Performance measures reward the “right” things
 - Business strategy/critical goals
 - Consider multiple perspectives
- Target performance goals raise the bar, but are realistic
 - Stretch goals should be challenging
 - The challenge with traditional growth measures
 - Look at each year/performance cycle independently (too much fluctuation)
- There is “Balance”
 - Company/team vs. individual performance
 - Absolute vs. relative performance
 - Formulaic vs. discretionary
- Plans are simple and focused
 - No more than 5 goals per individual
 - Consider line of sight
 - Are they a “screen” for behavior/action?
 - Is there a “balanced” view of performance?



Summing it up: Effective Plan Features

- Payout Variation
 - High performance = high payouts
 - Low performance = no payouts
 - More risk/more reward
- Careful use of triggers
 - Plan trigger vs. performance goal triggers
 - Understand pros and cons
- Reward incremental improvement
 - “On/Off” or big steps can be demotivating / incent excessive risk taking
- Ensure payout-performance relationship
 - Model payouts at target to ensure they can be funded by company performance
- No entitlement allowed
 - Incentives must be re-earned
 - Manage expectations

High performing companies show the greatest variability and leverage in their pay programs. More risk – more reward!

Summing it up: Effective Plan Features

- Don't lose sight of good business judgment
 - Formulas aren't perfect. Consider the "big picture" (i.e. windfalls or downfalls)
 - Recognize factors outside management control, but don't ignore Executives share in the same risk/reward as investors
 - Ensure high performers are rewarded even in difficult times
- 95% of success is implementation and communication
 - Ensure proper systems in place to measure/track results and progress
 - Provide ongoing communication/updates/feedback to employees

Questions



About the Speakers

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Terry Newth is a Vice President in the Boston office of Pearl Meyer & Partners, where he consults on the design, development and assessment of executive compensation programs that support each organization's business objectives, long term business strategy, and organizational culture. His clients range from Fortune 500 organizations to pre-IPOs to private and family-owned companies in a wide range of industries.

Mr. Newth's areas of expertise include pay strategy and philosophy development; market-based pay studies; incentive plan design; severance and CIC arrangements; outside director pay; transaction-related compensation; CD&A and supporting table disclosures; corporate governance; and share plan authorizations

Before joining Pearl Meyer & Partners, Mr. Newth was a Senior Consultant in the executive compensation practice of Towers Watson. He also has served in compensation-related positions at American Power Conversion and Thomson Financial, where he was responsible for the analysis, development, and implementation of global compensation programs.

Terry holds a BBA from Providence College and a M.S. in Labor Relations / Human Resources from the University of Rhode Island.

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Aria Glasgow is a Vice President with Pearl Meyer & Partners. Ms. Glasgow's areas of expertise include broad-based compensation design and administration for employees at all levels, variable pay design, total compensation competitive analysis, performance management, and total rewards program design. Ms. Glasgow's clients represent a variety of industries including financial services, not-for-profit, technology, healthcare, retail, and professional services.

Prior to joining Pearl Meyer & Partners, Ms. Glasgow was a Senior Manager of Compensation and Benefits at Investors Bank & Trust, with responsibility for compensation and benefit program design and implementation. Before Investors Bank & Trust, Ms. Glasgow held positions in compensation, financial analysis, and accounting at Liberty Mutual Insurance and Fidelity Investments.

Ms. Glasgow holds an MBA from Babson College and a Bachelor of Business Administration from the University of Massachusetts at Amherst. Ms. Glasgow is a Certified Compensation Professional and a peer reviewer for WorldatWork publications. Ms. Glasgow speaks at professional conferences and has written for industry publications.