Many community banks are devoting significant energy and resources to develop and execute business and leadership strategies that will grow enterprise value. Executive pay can be an effective tool that supports and enhances each bank’s unique strategy. However, alignment to strategy may require straying from market prevalence or moving beyond simply “checking the box” on compliance best practices. It’s important to ask: Does our compensation structure reinforce or unintentionally undermine our strategy?

The Lure of One-Size-Fits-All

There’s a certain amount of safety in following the herd. If your bank pays its key people in amounts and through program designs that reflect the practices of the masses, you may reduce the likelihood that the bank will be criticized or get into trouble about its compensation arrangements from a regulatory perspective. This approach is also fairly easy to explain to current executives and recruits as the compensation program is familiar and consistent with industry peers. But before placing undue weight on what others are paying, the latest design trends or regulatory hot-buttons, your board of directors will best serve shareholders by looking first at the business strategy to gauge
the effectiveness of your executive compensation design. Without a doubt, gaining a clear understanding of executive pay levels and incentive structures at peer organizations is a necessary step in the process of making informed compensation decisions for your bank. However, competitive advantage comes from differentiation, not conformity—it’s hard to lead from the middle of the pack.

**Be Careful What You Ask For**

Compensation programs are designed to encourage executives to prioritize those activities that are rewarded by incentives. The programs act as clear signals, driving particular behaviors and reinforcing them through monetary reward. As a result, if your organization conforms its compensation practices to market norms, there’s a good chance that the executive team will be focusing their energy on activities that support something other than your bank’s *unique* business strategy. On the other hand, if your board exercises the discipline to view all compensation decisions through the lens of the bank’s business strategy, not only can the right behaviors be motivated to grow franchise value, but there is increased likelihood that you will attract and retain the executive talent best suited to achieve the bank’s goals.

**Developing Strategy-Driven Compensation**

Developing strategy-driven compensation is a holistic process. It must be grounded in the business and leadership strategies that are so carefully crafted and then embraced by the board and top management. Once the foundation is solidly in place so that board and management agree on the clear direction for the organization, certain structural compensation pillars can then be evaluated to determine whether they build on that foundation or serve to weaken the overall structure.

- **Mix of fixed and variable pay:** Would our business and leadership objectives benefit from significant leverage in the total compensation structure, or is it far more important to focus our people on ensuring stability and efficiency in the coming years (or somewhere in between)?

- **Time horizon:** What do our strategic initiatives say about the right balance

- **Communication and messaging:** Is our compensation philosophy and strategy communicated clearly internally throughout the organization and externally? Does the messaging ring true for all constituents including investors, board members, management, employees regulators and the community? How can we engage with constituents to enhance understanding and buy-in?

**The Road Less Traveled**

It is easy to understand how two banks that are vastly different might benefit from dissimilar approaches to compensation. But among peers, to walk the road less traveled takes greater courage and discipline. A bank board is wise to pay attention to trends in the marketplace and stay abreast of regulatory expectations related to compensation practices. Wiser yet is a bank board that recognizes this information as helpful context, but looks first and foremost to the bank’s own business and leadership strategies when charting the course for executive compensation.