YOURBOARD

CREATING A HIGH-PERFORMANCE ORGANIZATION AND COMPANY CULTURE

Executive Overview for:

A General Discussion Regarding Compensation

"Couldn't we all work just because we like to? Unfortunately, our motives for work obviously include covering our responsibilities to support ourselves, and our families, and to meet our savings and retirement objectives and of course our personal goals for entertainment and pleasure.

The two basic principles we are driven to follow regarding compensation are created by two primary factors: First, what dollar value range does the industry place on each category of skill set & experience level for each position. Secondly, what level of skill and experience do each of your associates demonstrate and then where does that place them within the industry range.

While fairness is important from a general philosophical standpoint, in order to be competitive in the marketplace your goal as a company owner or senior leader is to know what the industry compensation range is for each of the key categories of roles and be certain that your associates are being paid based on the skills and experience that each individual bring to their position within that range. If you pay an individual at the high end of the industry range and they're not performing, you are overpaying and will not be able to be competitive in the market.

If you are paying at the high end of the industry scale, your associates also better be performing at the top of that scale. As stated before, senior leadership is responsible for setting the performance bar. It is also important to provide compensation that is consistent with the skill set and experience you are trying to attract. Another important consideration is location. The same position within the same Industry will have a different compensation range if you are in New York or Omaha.

The base compensation, for each individual's performance ranking within the industry range, is paid for the degree of skill and experience applied to their work. Special incentives and bonuses are paid for individual results that contribute to profits.

Compensation of employees is more than likely at the top of your SG&A company expense list. That means it should warrant some time as it relates to understanding the respective industry pay ranges. At some point, within the current competitive market for high performing human talent, your company will have to adopt the industry range. Your leadership challenge is to be certain each individual is placed in a position within that range in accordance with their skill sets and experience so that you are paying fairly for the performance demonstrated and the results generated." - YourBoard.US.

Note: YourBoard.US will offer its members confidential benchmarking on the topic of compensation ranges for each position within your general Industry.

1. General discussion regarding Compensation
2. Base Compensation
3. Wage Increases
4. Bonus Potential
5. Long-term Incentives

Compensation has been made extremely complicated. It is a long way from the original philosophy of "fair pay for a good day's work." Everyone has a different understanding of what "fair" means and everyone clearly has a different opinion of what a "good day's work" encompasses. The one thing that remains the same, just like the prices of your products and services, is that compensation is market driven.

Base Compensation

We should set up a system for every Position and Role to have a range of value as it relates to compensation. That compensation range is developed based on:

A. The competitive rate that has been assigned by the industry or by the position for the value that a particular position/role brings to a company
B. Or the competitive range that you have assigned to that position/role based on your experience in drawing quality people to fill the role in the past. This brings a geographic and regional element to your compensation ranges. Your compensation requirements will be different for the same position in New York vs. Omaha.
C. The size of the company can have some impact but, over time, the price of the best talent, even if you have developed your own talent, will be driven by the industry value placed on each skill set. The identification and valuing of great talent has become more global and the talent themselves have become more mobile over the last decade.

Within the "compensation range" established for each position/role, where will you place each associate?

A. **For a New Associate**: The compensation point within your established range for each position is based on determined skill level and experience (or aptitude to learn if the person is new in the workforce) with a potential for a 90-day increase based on the successful completion of the 30-60-90 day "on-boarding" Development Program. This is generally market driven by industry, position and geographic region.

B. **For Current Associates**: The point in the range that you will pay is based on actual performance and accomplishments of objectives and implementation of initiatives. Current associates get paid based on meeting and exceeding the result goals laid out in the individual Position and Performance Agreement. Again, the initial compensation range that is developed for each position is based on skills, experience, Industry and geographic location.

C. If you are paying less than market by more than 10-20%, one of three things is happening:

- The associate does not have the skill sets, attributes, attitude or passion to warrant "Industry Level" pay. This could mean you have an underperformer in your ranks which will need to be addressed quickly to prevent the "performance bar" from dropping and your High-Performance Company Culture from being impacted.
- The individual associate came up from within and does not know their value on the market.
- The associate is so loyal they are much more concerned with where they work and who they work for than being paid at the top level of the industry scale.

Wage Increases – and how they generally occur

Generally, on an annual basis, the owner or senior leadership establishes the planned overall annual company percentage wage increase for the next year as a percent of the overall company payroll. This is done for budgetary purposes. That percent increase on the overall payroll will represent the average performance raise for the organization. The supervisor, based on an individual's review and rated performance during the course of the year would determine and discusses the increase that would be awarded to each person within the overall budgeted average.

Example: If the company budgets a 4% overall wage increase, some associates may get 1% and some may get 7%. Each manager should start with an overall dollar amount for raises within his area of responsibility and then, based on individual reviews and rated performance, allot individual raises from their allotted pool of "raise" money.

The supervisor plans, in advance, each person's raise, based on their performance, to be certain the total allotted "raise money" pool for his or her area of responsibility are within the planned budget. During the review process, and again based on performance, people will receive different raises based on merit. In a small and mid-size company, I believe you keep "cost of living" changes year to year in mind when developing the overall average budgeted payroll increase for the year but it does not become an automatic increase on an individual basis.

In a small and mid-size merit based company within a High Performance "Recognition Based" Company Culture all raises are based on individual performance results and nothing else.

As with anything, there are always extenuating circumstances and special situations where the owner or senior leader can approve monies either beyond the total average wage rate % increase or beyond the Position- Role compensation range.

The reviewer also has to be cognoscente of rewards for successful milestones reached on a multi-year initiative. Results are why you financially reward both merit increases and bonuses but always make sure you recognize excellent work that has resulted in a milestone being reached on a longer-term plan.

Bonus Potential

There are certain Position Roles that should quality for a performance bonus based on a combination of the individual's contribution and the amount in the bonus pool which is governed by the profit after tax of the company. The people and positions who participate in special incentives and bonuses vary significantly industry to industry and company to company.

Some small businesses, with few employees, may award everyone a Christmas Bonus which is an older, more traditional method of distributing a bonus. I have never been a fan of the idea that Christmas warrants a bonus, but instead performance. A Christmas bonus is merely a Christmas gift because it is not based on an individual's performance but instead only because an individual is an associate. Existing bonus plans are hard to change. Changes to the bonus plan should be adjusted over several years to ease the transition pain for longer term employees who have become accustomed to certain practices and count on the money each year. A lot of pre-communications far in advance of a changing bonus or incentive event should also take place with all associates.

Some small companies have never started the bonus tradition. Mid-size companies generally have a Performance Bonus Program of some type.

There is a broadly used philosophy that 33% of the before tax profits go to the stockholders (owners), 33% is reinvested into the business and 33% goes to the bonus pool to be awarded to the associates, managers and leaders based on performance. After taxes, the bonus pool normally represents about 20% of profits. It's a lot like manure…when it sits in a pile in the driveway it looks huge…but when you spread it out it doesn't seem to go very far.

I believe and have observed within small and mid-sized companies over several generations that fancy, complicated bonus and incentive formulas do not work. No matter how hard you try, there is not a formula in the world that can take into consideration all of the variables that result in some getting more than they deserve and some not being treated fairly. Many bonus plans cause confusion and result in a distrust of the formula. They become a source of negative feelings rather than a positive reward. Poorly developed bonus plans generate a lot of unintended consequences.

The practice I have observed over 40 years that seems to work best is for the owner and senior managers to award the allotted bonus money to the individuals based on each area supervisor's summary presentation of each individual's performance within their position-role. The owner first awards bonuses to the leaders and managers. Then the leaders sit with the managers and award bonuses to the supervisors and in some companies the associates, all based on performance.

When the performance bonus check is awarded to the individual, there is a perfect opportunity to bestow appreciation and recognition and also a perfect opportunity to coach the individual on what will be needed to be awarded a greater performance bonus the following year.

While the entire bonus process is said to be confidential, and requested to be so with each individual, the performance and recognition based culture will always award different amounts to different people and word will get out. What is important is that every leader, manager and supervisor have a conversation that goes along with the bonus award even if it is "0". There should be a clear logical connection between the bonus amount and the individual's performance assessment and the results achieved. The worst thing you can do is not use the bonus process as both a motivator and an example of how important individual performance is to the company's profitability each year.

The entire team in a general sense, drives the amount in the bonus pool that is accumulated each year because it is based on profitability. It is up to supervisors and managers to attempt to spread the bonus pool based on the contribution to profitability made by each eligible person.

Long Term Incentives

Historically, long term incentives in companies with revenues under 100 million are very rare, with the exception of some Senior Leadership positions that do not also include ownership. In the case of senior, non-family senior leader, often some type of phantom stock or stock appreciation plan with extended vesting period is established. This is critical to assure that key senior people who are considered "keepers" are rewarded fairly based on the long-term value appreciation of the company. All of this has to be within the laws with a standard & consistent formula for determining a value for the company.

These types of long term incentive programs, with longer vesting periods, also serve as a motivator for senior managers to stay with the company and benefit from the ultimate reward they deserve to receive for creating value for the company.

There are outside firms that specialize in long-term incentives like phantom stock that can be engaged if you wish to go in that direction.

Business Development Associates

There are a set of different base and commission compensation rules and options that generally apply to those associates involved in the selling process. This is touched upon in Part IV "Building a Bridge to your Targeted Customers".