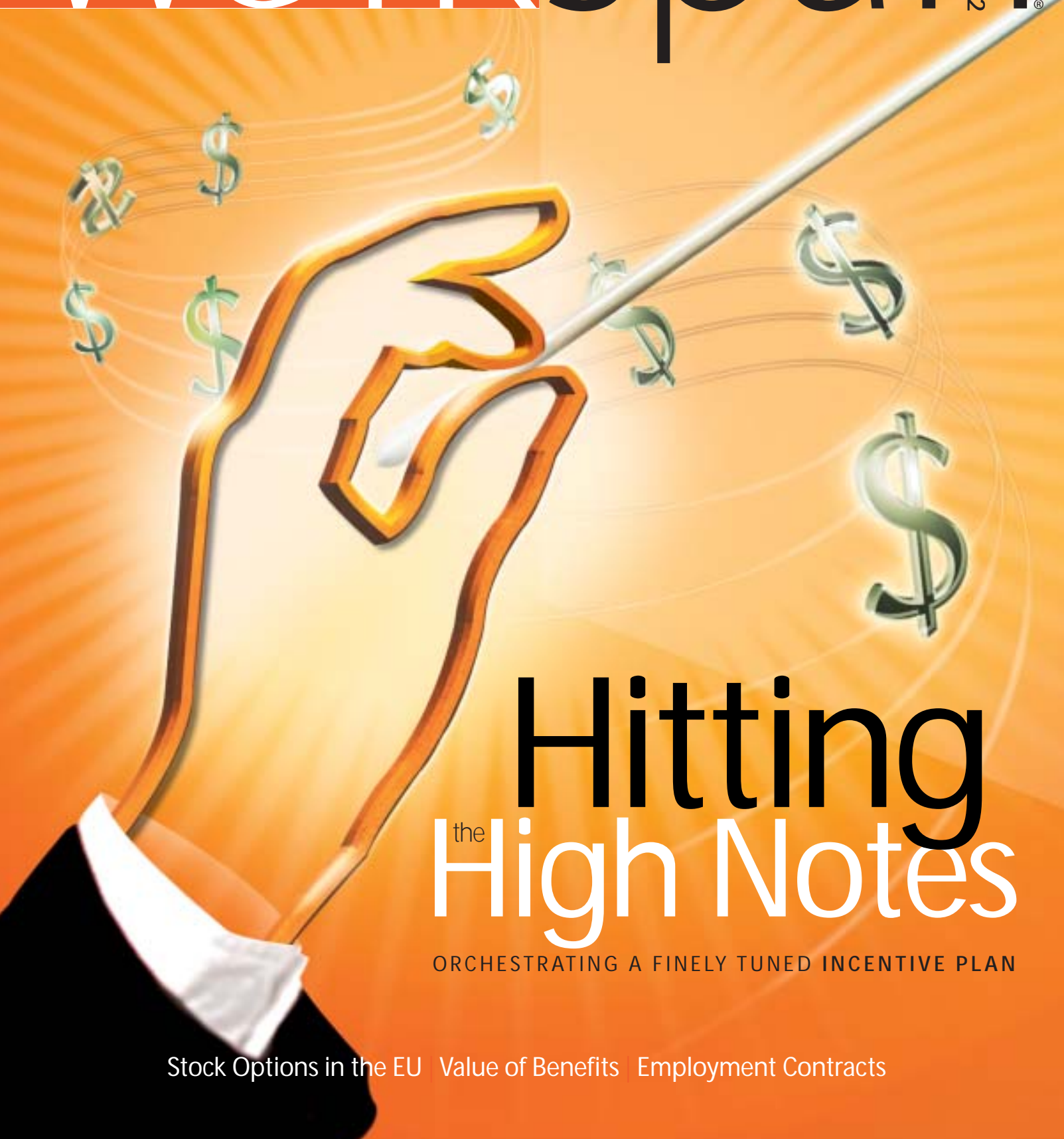


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Hitting the High Notes

ORCHESTRATING A FINELY TUNED INCENTIVE PLAN

Stock Options in the EU | Value of Benefits | Employment Contracts



Effectively conducting a new incentive compensation plan doesn't take a song and dance, just **advance planning** and **solid communication**.

Orchestrating

a Finely Tuned Incentive Plan

By Beth Burkholder, Towers Perrin

Scenario One: *You've just spent a significant amount of time and money designing a new incentive plan, but when you announced it to the line managers, it received such a negative response that it must either be radically altered or scrapped altogether – and the new plan year starts in two weeks.*

Scenario Two: *A year ago, you spent significant time and money designing a new incentive plan, and now you're reviewing disappointing performance results. You knew there were some rocky points during the year, but you can't understand why the plan didn't motivate the participants. Will you need to redesign the plan? But you know the plan is good!*

These situations represent a problem common to new incentive plans, which often fail not because of poor design, but because they are not well implemented. There are several strategies and tactics for improving implementation.

Harmonizing Change Management

First, develop a clear picture of the desired change and why it is desired. Is the goal to improve business performance, reduce fixed compensation expense, or both? For which functions will the change occur?

After identifying the plans to be changed, determine the level of change management required for each function. Why spend the time and money on large design and implementation teams if it's not necessary? Using a change assessment scale, similar to the one in Figure 1, on page 18, can help differentiate which functions are high or low change. Then, it is possible to establish processes to match the needs of each function.

In incentive redesign projects, several organizational change management levers can positively affect implementation (see Figure 2 on page 18):

- **Leadership.** By showing strong leadership throughout the design and rollout, employees will understand this plan is

not optional. Also, leadership is needed when distributing the first incentive checks, because there may be significant winners and losers.

- **Involvement.** Allowing involvement will let people feel that their voices are heard.
- **Technology.** Solid technology will support the plan, including accessing baseline data for goal setting and generating regular performance reports throughout the plan year – not to mention calculating payouts accurately and on time.
- **Communication.** When the plan is designed, during rollout and throughout the plan year, communication is critical. People get nervous when they feel they are being kept in the dark about upcoming changes.

QUICK LOOK

- ⇒ Many incentive plans don't fail because of poor plan design, but because they are poorly implemented.
- ⇒ Several organizational change management levers can positively affect the implementation of incentive redesign projects.
- ⇒ Implementation activities take time and resources, and they add to the cost of a new incentive plan. But a plan that does not help employees become receptive to change is far more costly.

FIGURE 1: DETERMINING THE LEVEL OF CHANGE MANAGEMENT

Determine the level of change management required for each function being considered.		
Change Assessment	Function R&D	
Criteria	Low Change	High Change
How many people are affected?	Less than 10	More than 50
How radical is the anticipated change in plan?	Tweaking only	Very different
How critical is the performance of this group?	Moderate	High
What is the tension level between HR/finance and line management with regard to compensation?	Low	High
Is the incumbent group highly visible, vocal and/or hard to retain?	No	Yes

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- **Measurement.** Monitoring the plan ensures it functions as intended, lets participants know how they are doing, and gauges the impact plans have had against the stated objectives.

Ensemble Effort

Good implementation actually starts before the new plans have been designed and ends when employees have internalized the plans and changed their behaviors to maximize their pay.

Chartering teams so each change lever has at least one champion is one way to maintain focus on implementation. For a high change project, this may need to be a larger, cross-functional team. For low-change projects, it may be possible to have one or two people acting as implementation champions. For smaller organizations with scarce resources, good

FIGURE 2: FIVE LEVERS OF CHANGE

Leadership	<ul style="list-style-type: none"> • Provide vision of a successful implementation • Act as project and implementation champions
Involvement	<ul style="list-style-type: none"> • Foster buy-in and commitment through employee involvement in the process
Technology	<ul style="list-style-type: none"> • Develop supporting structures for accurate goal setting • Ensure the ability to generate accurate reports and payouts
Communication	<ul style="list-style-type: none"> • Give clear and consistent messages throughout the process • Rollout clear and comprehensive plan documentation
Measurement	<ul style="list-style-type: none"> • Provide feedback to participants on their performance • Ensure plans are meeting stated objectives, and course-correct as necessary

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implementation results can be achieved by following the strategy outlined for low-change projects, which typically requires fewer people. (See Figure 3 on page 20.)

Leadership

Whether high change or low change, the Steering Committee:

- Directs the overall efforts of the process
- Provides continuity and leadership
- Establishes compensation guiding principles
- Sets the direction for change.

The Steering Committee should be comprised of senior leaders, such as division heads, the COO, CFO and head of compensation and benefits, and should have final authority for approving new incentive plans.

Involvement

To maximize employee development, the Design Team needs cross-functional representation, including line management, HR, finance, information technology and/or payroll, along with representatives from specific functions that may be affected by the performance of the function receiving the new plan.

For low-change projects, the Design Team could consist of a member of HR or finance and a line manager. It is a common – and often fatal – mistake for HR or finance to design new incentive plans without input from line managers because, no matter how technically perfect the design, buy-in and support from the ultimate arbiters of plan effectiveness will not have been gained.

For high-change projects, a Challenge Team can really help. This team typically includes top performers affected by the new plans, who can help practice the rollout pitch and provide guidance on how to most effectively communicate the new plans. For low-change projects, a trusted top performer can review the plans and give feedback in a one-on-one session with a Design Team member.

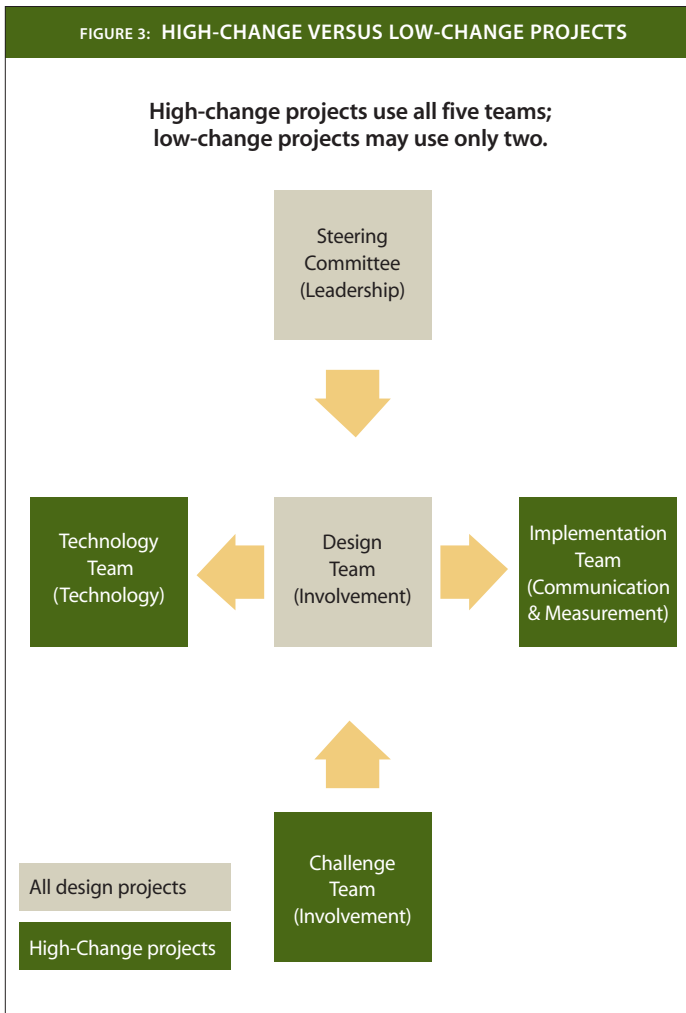
Technology

High-change projects likely will need a Technology Team, though the size and diversity of this team depends largely on the flexibility and health of current incentive administration systems. Even low-change projects can add technological stress. It's important for a member of the Design Team to check with the accounting or IT staff to ensure the current system can track and report on any new performance measures.

Communication and Measurement

The Implementation Team serves a number of purposes, and several of its members also may be on the Design Team.

FIGURE 3: HIGH-CHANGE VERSUS LOW-CHANGE PROJECTS



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Primary implementation activities include setting goals, communicating the new plans and measuring results.

Whether the project is high change or low change, the most vital team member is the internal change agent, who has responsibility for behind-the-scenes communication about the plans and should work the internal system to smooth the way for the new plans. When questions or problems arise, the change agent can talk to the various parties “off-line” to help craft a workable solution for all. The internal change agent can be a member of HR, finance, a line manager or other respected party. This person should be passionate about the need for change, yet open-minded about various methods for bringing about that change.

Other members of the Implementation Team are responsible for:

- Producing rollout presentation, executive presentations and plan documents
- Holding manager training sessions and goal-setting workshops

- Developing question-and-answer documents
- Creating earnings calculators
- Working with the Technology Team to design and publish regular performance reports
- Measuring the results at regular performance intervals.

Good implementation typically takes as long or longer than designing the plan and, if resources are scarce, more time should be allowed. It can be helpful to dedicate a staff member with strong organizational skills and a penchant for detail to manage the implementation effort, as there can be numerous logistical and administrative challenges along the way. It is best if this person is included in the Design Team from the outset of the project to ensure understanding of why decisions were made.

The Education, Motivation and Communication Tune

The Implementation Team has three primary objectives: Communicate, educate and motivate. (See Figure 4 on page 21.)

Communication

Participants need to hear what the new plans will involve, what the changes are and why this will benefit them. Next, they need time to absorb and ask questions. Then, the plan should be explained again – this time in more detail, as there will be much that was not grasped the first time.

Hold training sessions to introduce managers to their own plans (if they have been changed) and to prepare them to answer questions about subordinates’ plans. Managers will be much more supportive of subordinates’ new plans if they recognize plan alignment and realize that their own pay depends in some way on their subordinates’ accomplishments.

The rollout meeting is the first formal communication about the plans. Regardless of group size, take extra care in preparing the documents and presentations that describe plans and the manner in which the information is presented. Participants need to be told how and when their incentive plans will change, and why the changes are being made, along with knowing how the new plans will benefit them. The rollout presentation should start with the case for change, explaining:

- Why the new plans are necessary
- How they will benefit top performers
- How the new plans differ from the old plans
- What has not changed
- How the plans work – at a high-level.

It is critical to have one or more respected members of each function present the new plans. Senior executives whose primary responsibility is to show their support for the new

FIGURE 4: EDUCATION, MOTIVATION AND COMMUNICATION

Major Implementation Step	Goals of Step	Audience	Tools
Manager Training Session	<ul style="list-style-type: none"> • Introduce managers to their own plan • Explain subordinates' plan • Ensure managers are comfortable explaining the plan and answering questions 	<ul style="list-style-type: none"> • One to two levels of management above the level receiving the new incentive plan 	<ul style="list-style-type: none"> • Detailed manager plan information • Subordinate plan overview presentation • Draft subordinate Q&A document
Rollout Presentation	<ul style="list-style-type: none"> • Provide participants with high-level information about the new plan • Ease their concerns about change • Ensure a consistent message is delivered and heard 	<ul style="list-style-type: none"> • Employees who will be affected by the new incentive plan • Team leaders who have responsibility for the employees (if applicable) • One to two levels of management above employees 	<ul style="list-style-type: none"> • Rollout presentation • Demo of earnings calculator, if desired
Goal-setting Workshop	<ul style="list-style-type: none"> • Set individual performance goals • Ensure a common methodology and fair process is employed • Gain manager support through involvement 	<ul style="list-style-type: none"> • Finance representative • Design Team representative • Managers 	<ul style="list-style-type: none"> • Automated target-setting tool • Historical performance data by employee • Written process instructions, including guidelines for handling difficult cases
Manager One-on-one Meetings	<ul style="list-style-type: none"> • Provide plan documents and individual goals to each employee • Provide a less threatening atmosphere for employees to ask questions about the plan • Show manager support for the plan 	<ul style="list-style-type: none"> • Managers meet directly, one-on-one with each employee 	<ul style="list-style-type: none"> • Plan documents • Q&A document • Individual goal sheets • Earnings calculator to demonstrate
E-mail to Participants	<ul style="list-style-type: none"> • Deliver additional details about the plan • Provide employees with earnings calculator 	<ul style="list-style-type: none"> • Employees affected by the plan • CC their Team Leaders and managers 	<ul style="list-style-type: none"> • Revised Q&A document based on results of one-on-one meetings • Earnings calculator

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plans also should be involved in the presentation. Above all, be enthusiastic: Good incentive plans are good for top performers, and the goal is to have those top performers know it's good for them.

Details on calculation methodology – unless critical to the field's understanding of the new plan – should be left for later. Participants should begin to accept the big issues before grappling with details. If the setting permits questions and answers, it can be particularly helpful to have members of the Challenge Team – either formally or informally – help to answer questions.

Sometime between the rollout meeting and the official start date, goals will need to be set for each participant. For best results, incentive plans with a set payout calculation methodology should follow a few general standards:

- 90 percent of participants should earn some money under the plan
- 50 percent to 60 percent of participants should hit their goal
- 10 percent of participants should reach the excellence level that has been set.

A member of finance who also is part of the Implementation Team can drive the goal-setting process, but the process

should include the Design Team and line managers who have to communicate and live with the goals set for their employees. Although it may make the process longer, it will create better goals and a more committed management team if line management is involved. Using an automated goal-setting tool and a goal-setting workshop can help ensure that managers understand and follow a common process.

Education

Education starts with the plan documents provided either at the close of the rollout meeting or during manager one-on-ones that should be scheduled shortly after the rollout meeting. One-on-ones offer an opportunity for more candid questions and answers, but make sure managers are familiar with the plans and the goal-setting process before setting the dates for these meetings. A solid question-and-answer document can help to ensure that consistent answers are given to common questions.

The look and tone of the plan documents should fit the corporate culture. However, communicating a new plan that takes a big directional turn from a prior plan calls for a plan document with a whole new look and feel. Also, consider

consistency issues across the organization. A good plan document should have:

- A statement about the corporate compensation philosophy
- General provisions – the standard legal language found in all of a company’s incentive plans
- Plan schedules – this is where plan families can be grouped into one plan document by common features, if needed
- Plan provisions – specific details applicable to this plan family can include measurement element definitions, details on calculation methodologies, credit splitting procedures, special payouts that are not part of the main plan, etc.
- Receipt acknowledgment
- Individual quotas or goals
- Question-and-answer appendix and any other applicable appendices.

The plan schedule should be logically organized and provide enough information without being overwhelming. Most start with an overview of the compensation plan, then describe each element in more detail, following a consistent structure for each element.

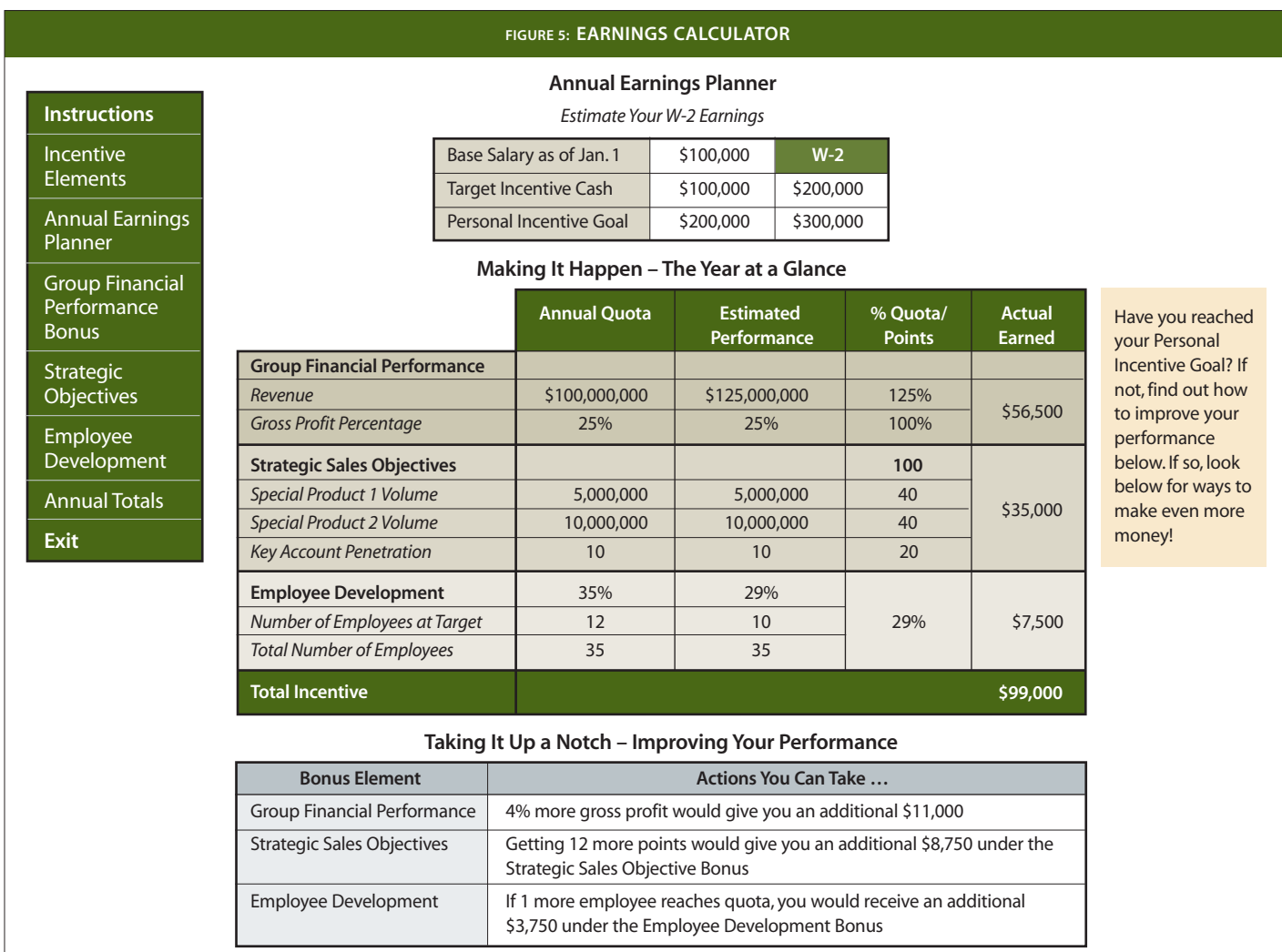
Motivation

Spreadsheet-based earnings calculators often are overlooked, but they are critical to educating and motivating employees about the new plans. When used properly, they can help to generate even higher return on the incentive investment. Also, because they answer basic calculation questions, they relieve compensation administrators from a time-consuming duty. Earnings calculators are tools for employees to model their performance and predict their pay under the new plan, and are important companions to the plan document by motivating participants through “what-if” scenarios.

Earnings calculators can be simple or complex. For bonus-oriented plans, calculators help employees internalize their goals and predict their pay under a variety of performance scenarios. For commission-based incentive plans, employees can use an earnings calculator on a daily basis to calculate their potential payouts for anticipated transactions. (See Figure 5.) Earnings calculators often include:

- An *information page* to gather individual data, such as base salary and established goals

FIGURE 5: EARNINGS CALCULATOR



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- A one-page *annual earnings planner* that offers a view of the whole plan and where the employee can model his or her performance and get suggestions for improvement
- *Components pages* to provide detailed calculation information for each plan component. The employee can enter his or her performance and track their progress. If the plan is transaction-oriented, consider including a comparison tool so employees can see how changing certain transaction characteristics changes the payout
- An *annual totals* page that is a summary of the components pages, showing the year-to-date total incentive pay. This page also can include annualization calculations and allows employees to predict the effect of constant, improving or declining performance on the estimated year-end final payment
- *Graphs and charts* that increase motivation. These should be used frequently to supplement performance tables. Note that earnings calculators are not replacements for incentive or payroll software and, therefore, should not be used to calculate paychecks.

Measurement and **feedback** are both important for motivation, and should be emphasized throughout the year.

Measurement and feedback are both important for motivation, and should be emphasized throughout the year. Quarterly reports, posted results, earnings calculators and, ultimately, incentive compensation payouts provide motivation. However, be prepared for motivation levels to peak only after the first full pay cycle, when participants see the results and understand how to modify their behavior to maximize payouts in the next cycle.

Staying in Tune


New incentive plans should go through a stringent assessment after the first full plan year to ensure they function as expected. (See Figure 6 .) The Implementation Team should

FIGURE 6: TOP 10 IMPLEMENTATION TIPS

1. Segment and prioritize your functions based on expected value of change; know why you are making a change.
2. Know what kind of change effort is required for each functional redesign and structure accordingly; pick your battles.
3. Spend time on involvement and consensus building.
4. Use the five levers of change: Leadership, involvement, technology, communication and measurement.
5. Allow line management a hand in design and communication.
6. Allow enough time for implementation (one to two times the time it took to design).
7. Find an internal change agent (or be one yourself).
8. Use a challenge team to test your plans and craft communications.
9. Roll out hierarchical plans from the top down.
10. Communicate, educate, motivate.

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measure the plan's impact on business performance and report these results back to the Steering Committee and the Design Team. The assessment should include quantitative analysis of results and qualitative feedback from plan participants and managers. The Implementation Team, Design Team and Steering Committees should determine whether any changes are needed. Because incentive design is a process that evolves as business strategies change and measurement and tracking systems improve, regular review is important.

Implementation activities take time and resources, and they add to the cost of a new incentive plan. But a plan designed without opening the door for employees to become receptive to the change is far more costly. When employees are given the instruments to understand a new plan, and feedback motivates them to achieve the highest possible performance, new incentive programs get standing ovations. 

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