

Incentive compensation plans that work

> Advice from experts: Keep the plans straightforward, and don't let them become a substitute for good day-to-day management.

When devising an incentive compensation plan, some firms tie results to the overall performance of the company, others put a greater emphasis on employees' professional development, and all stress the importance of plans that are straightforward and easy to understand.



Ian Rusk, President and CEO, ZweigWhite.

Many firms, says Ian Rusk, ZweigWhite president and CEO, "over-engineer" their plans, "which, I guess is to be expected when dealing with AEC professionals. The problem is that, in that effort to create a matrix or formula that fairly weights the relative performance of all participants, they create a plan that few can understand, and that will inevitably fail to meet the fairness objective."

To keep his firm's plan as straightforward as possible, Sam Kain, chief financial officer of Orchard, Hiltz & McCliment (Livonia, MI), a 150-employee consulting engineering and architecture firm, emphasizes clear revenue and expense benchmarks. But no individual goals are as important as the overall profitability of the firm, Kain says.

"It's not about individual performance first; it's about company first. If the company isn't profitable, you had a bad year," he says.

To make good years more likely, Kain recommends plans that take into account the assets of a company that individual firm members employ, and how they use those assets to increase the value of the firm. "If a project manager is working on a \$500,000 project, he has that much in assets—accounts receivable and the cost

of work in progress. That's money I'm paying out before I get paid," he says. "If you're looking for a 20% return on investment, the manager has to generate \$100,000 in profits—you need to cover that carrying cost.

"First, the manager has to hit that goal. But if, through his behavior, he generates more profit, it makes sense to share the extra value created," Kain says.

While Orchard, Hiltz & McCliment's incentive compensation plan is tied directly to the bottom line, goals are tailored to individual employees.

"You have to have different parameters," Kain says. "You identify the things the individual has control over. That same project manager has control over the time that's charged to the project, but probably not much control over the number of projects we do in a year. You have to have a little bit of variability."

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Firms are smart to take that approach, says Rusk, because "you cannot use the same yardstick to measure all staff. ... That said, common metrics include sales of new work—business development—utilization, and profitability of projects, divisions or offices under the individual's management."

Professional development incentives

Profit is not the only factor measured at Traffic Planning and Design Inc. (TPD) in Pottstown, PA, a 135-person transportation planning, design and engineering firm, says principal Shawn Glick.

"TPD's incentive plan runs contrary to other approaches where, for instance, staff may only receive a bonus if the company is profitable," Glick says. "Even if TPD makes no profit or loses money, both of which could very likely happen as

a result of the current historic financial crisis, our staff receives rewards for meeting incentive plan goals."

But, Glick says, company performance still plays a role in the size of the bonuses.

"If employees meet their goals at the end of the year, such as achieving their chargeability and chargeable hour goals, then TPD contributes a predefined amount for that employee. If the company achieves its goals, such as meeting or exceeding revenue targets, an aggregate chargeable hour goal and a chargeability goal, then TPD matches each individual's amount," Glick says.

In addition to revenue, chargeability and chargeable hour goals, TPD's seven-criteria plan includes rewards for professional development. "We view the incentive plan as a reflection of TPD's corporate culture and strategic planning," Glick says. "Our staff's development is directly aligned and dependent upon TPD growing. As such, TPD staff are committed to achieving company goals through participation in individual goals."

While the plan has remained unchanged during the recession, Glick says its structure has allowed the firm to cope with the economic downturn. The company has met its goal of avoiding layoffs and still covering the expense of paying bonuses for individual goals, "so even if TPD makes no profit or loses money, our staff still receives a bonus."

Workers vs. shirkers

Whether they're tying their plans to profitability or promoting professional development, firms should carefully consider their view of incentives and their effectiveness, says Corey Rosen, executive director of the National Center for Employee Ownership.

"The way economists have thought about incentives, is talking about disincentives for shirking," Rosen says. "Their view of the workplace is pretty much based on

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the industrial assembly line model, and that's not how they view their own work."

A realistic look at a professional workplace, Rosen says, demonstrates the limits of incentive compensation plans. Many employees work as hard as they can regardless of a firm's bonus structure—workers he describes as "incorrigibly good"—and some will be "incorrigibly bad," no matter what incentives exist. "How many people are there that will actually work harder, and how many hours will they work harder? Not many. Your incentives may not have much of an effect," Rosen says.

More effective plans, he says, examine what behavior is being rewarded, and why. "If you get people to create ideas—bring in new information and identify new opportunities—you can make quantum leaps forward," he says.

Rusk agrees there are limits to the effectiveness of incentive plans. Managers, he says, "should not fool themselves into thinking they will substantially influence employee behavior with an incentive compensation plan of any type."

"We view the incentive plan as a reflection of TPD's corporate culture and strategic planning."

That's not an argument in favor of eliminating incentive compensation plans, Rusk says, but a warning to firm leaders not to let the plans become a substitute for good management.

"The managers' job is not simply to reward the high performers with big bonuses at the expense of the low performers," he says. "Their job is to train, coach and mentor all staff to perform at the desired level, and if necessary get rid of the ones that can't or won't rise to that level." ■