



Validation of  
incentive pay

Ensuring contribution to  
business results

# The purpose of incentive pay

- To ensure that business results is achieved 'because of the incentive scheme and not in spite of it'
- Behaviour explains 34.5% of the variance in business results. Incentive pay must ensure that behaviour is leveraged to the full

# The health of incentive pay in RSA

- $\pm 8\%$  of the payroll is paid as incentive pay
- 20% of it does not influence business results
- 50% of schemes will benefit substantively from an improvement in their constructs
- It is estimated that incentive pay equals about 2,5%-3% of GDP

# What do we promise?

- Analysis are backed by empirical research
- Project whether investment in incentive schemes will effect business results , thus allow business to change or withdraw schemes before commitments are made
- Provide feedback during the operational life of the scheme, thus allowing business to rectify weaknesses before any unfounded payout is due
- Analyse whether the scheme added value to business, thus ensuring proper governance practice

# Benefits

- Assess whether the existing/entrenched scheme is adding value to business results.
- Exposes the strengths and weaknesses of the scheme, allowing designers to make improvements.
- Provide strong empirical arguments about areas for improvement. It enables management to negotiate changes to weak designs and motivates improvements.
- The empirical basis on which the analysis is done removes subjectivity and unsubstantiated arguments.
- The analysis can be used as expert evidence during arbitration or court cases.

# Operational application

Validating should be applied:

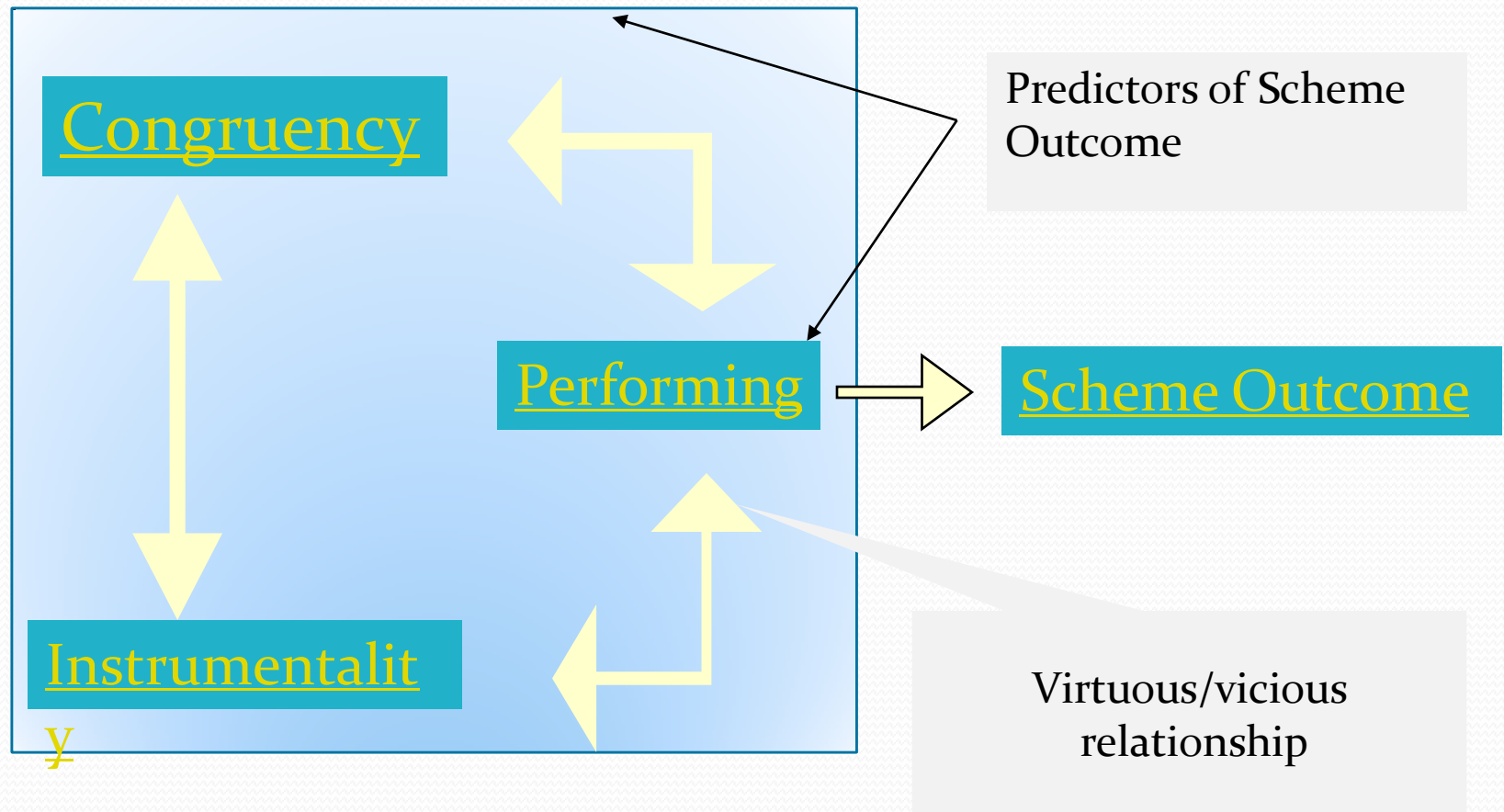
- To existing schemes that has become stale and doubtful
- To newly designed schemes
- During the life cycle of schemes
- After the payout of schemes
- To ensure proper governance; conformation of prudent incentive pay practice and approval of contracts and payouts



# Technical characteristics of the model

# Behaviour that influences results

## Participant Involvement



# Principles of Variable pay

#1: Variable remuneration carries performance, its **not** a creator of performance

- A performing business is a prerequisite for variable pay to be successful
- it requires performance management practices and
- a performance culture

# Principles of Variable pay

## # 2: Participants must control the funding and distribution of payouts

- If participants are not able to influence the funding and the distribution of the variable pay plan, the plan outcome happens in spite of the presence of the plan
- Not all jobs/roles are programmable, in other words suitable for variable pay

# Principles of Variable pay

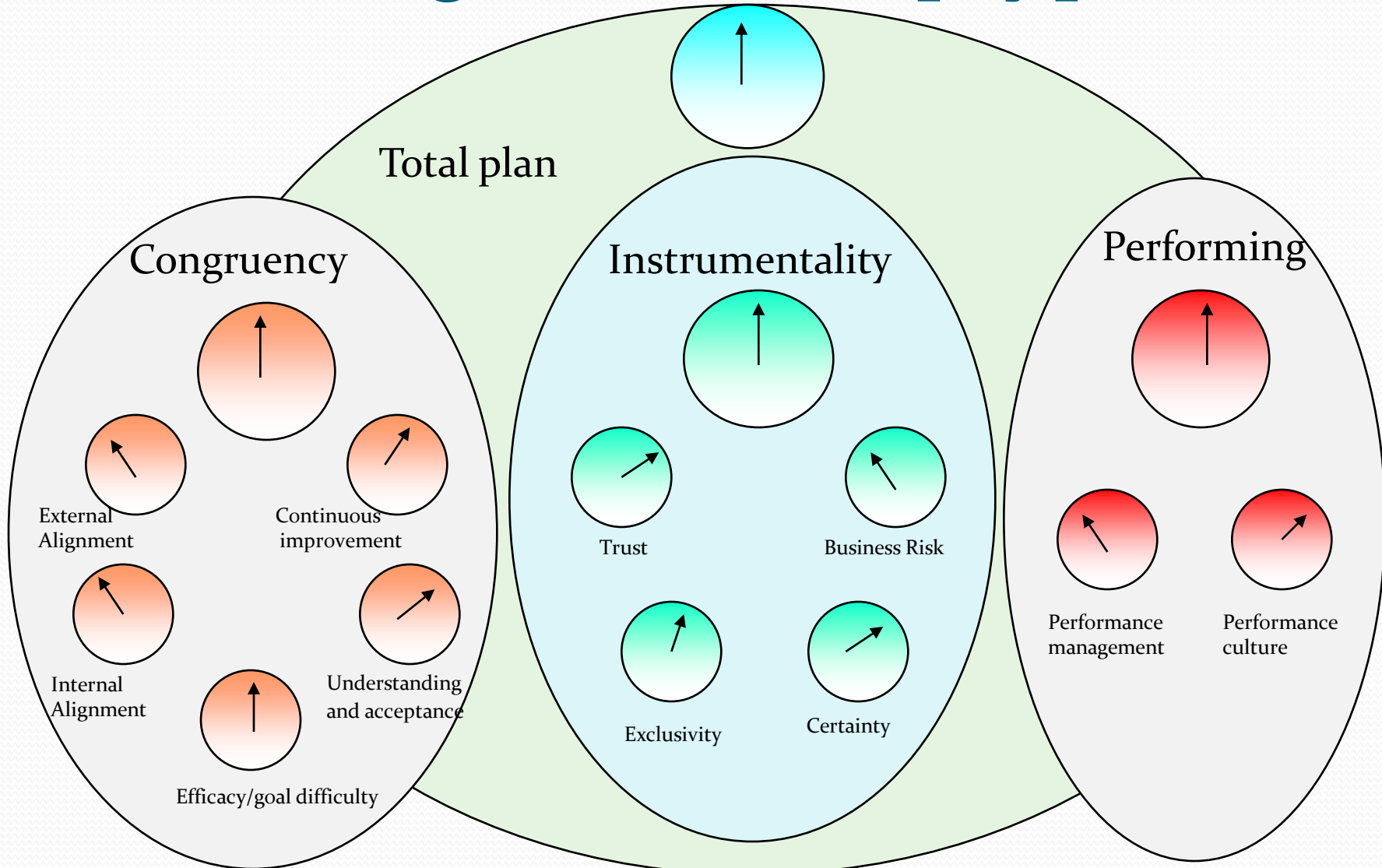
## # 3: A virtuous/vicious relationship exist between the Constructs and Dimensions of variable pay

- If any of the Constructs or Dimensions of variable remuneration are absent, the total plan has no impact on the plan outcome
- A systemic approach to the implementation of all the different Constructs and Dimensions is required. This means that a minimum standard per Construct and Dimension is necessary for the plan to be effective.

# How do we collect information

- Qualitative approach:
  - Before the plan is implemented to determine go or no go
  - Less reliable and based on assumptions about the implementation and leveraging
  - Diagnose the dimensions
- Quantitative approach:
  - After at least one cycle of the plan.
  - Determine if it added value, should be continued
  - Diagnose the dimensions

# Assessing the variable pay plan



# Calculating Return on Payout (ROP)

$$\text{ROP}^* = \frac{(\text{Return-Payout})}{\text{Payout}} \times \frac{100}{1}$$

\*However, is it because of or in spite of the plan?

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# A Closer look at Congruency

**Congruency** is the extent to which participants understand, believe in and practice behaviour that leads to the achievement of business and variable remuneration goals.

## Dimensions:

- **External alignment** is the extent to which the different elements of the business and leadership align with the scheme
- **Internal alignment** is the extent to which the day-to-day behaviour of the participants are aligned

## A Closer look at Congruency (Continue)

- **Understanding and Acceptance** is the extent to which information about the scheme and performance against the scheme criteria is communicated and made transparent, and is understood and accepted by the participants.
- **Continuous Improvement** is the extent to which the scheme is continuously reviewed and improved.
- **Efficacy/Goal Difficulty Alignment** is the self-belief of participants that they will be able to achieve the contracted goals

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# A closer look at Instrumentality

**Instrumentality** is the extent to which participants believe that they will be rewarded if they perform as agreed.

## Dimensions

- **Certainty** is the extent to which the game rules are certain
- **Trust** is the extent to which a trusting relationship exists between the participants and the custodians of the scheme. Where trust is high, the participants believe the promises made, and accept them in good faith

## Instrumentality (Continue)

- **Exclusivity** is the extent to which participation in the scheme is reserved only for people who make a material contribution to the outcome of the scheme.
- **Business Risk** is the extent to which uncontrolled business risks prevent desired scheme outcomes

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# A closer look at Performing

**Performing** is the extent to which high-performing leadership and performance management practices exist in a business

## Dimensions:

- **Performance culture** which is the extent to which the business is managed and led to deliver successful outcomes
- **Performance management** is the extent to which performance management principles are practiced in the business

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# Predicting Plan Outcome

**PLAN OUTCOME = -131.209 + 51.765  
(Independent Variable: Performing) +  
18.462 (if Participants are involved,  
alternatively, 0).**

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# Calculating Plan potential

**Formula 2: PLAN POTENTIAL = (Congruency X Instrumentality X Performing )<sup>1/3</sup>**

**where:**

**Congruency = (External Alignment X Internal Alignment X Efficacy/Goal Difficulty Alignment X Understanding and Acceptance X Continuous Improvement)<sup>1/5</sup>**

**Instrumentality = (Trust X Certainty X Exclusivity X Business Risk)<sup>1/3</sup>**

**Performing = (Performance Management X Performance Culture)<sup>1/2</sup>**

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