



Validation of
incentive pay

Ensuring contribution to
business results



The purpose of incentive pay

To contribute to business results: “Its 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

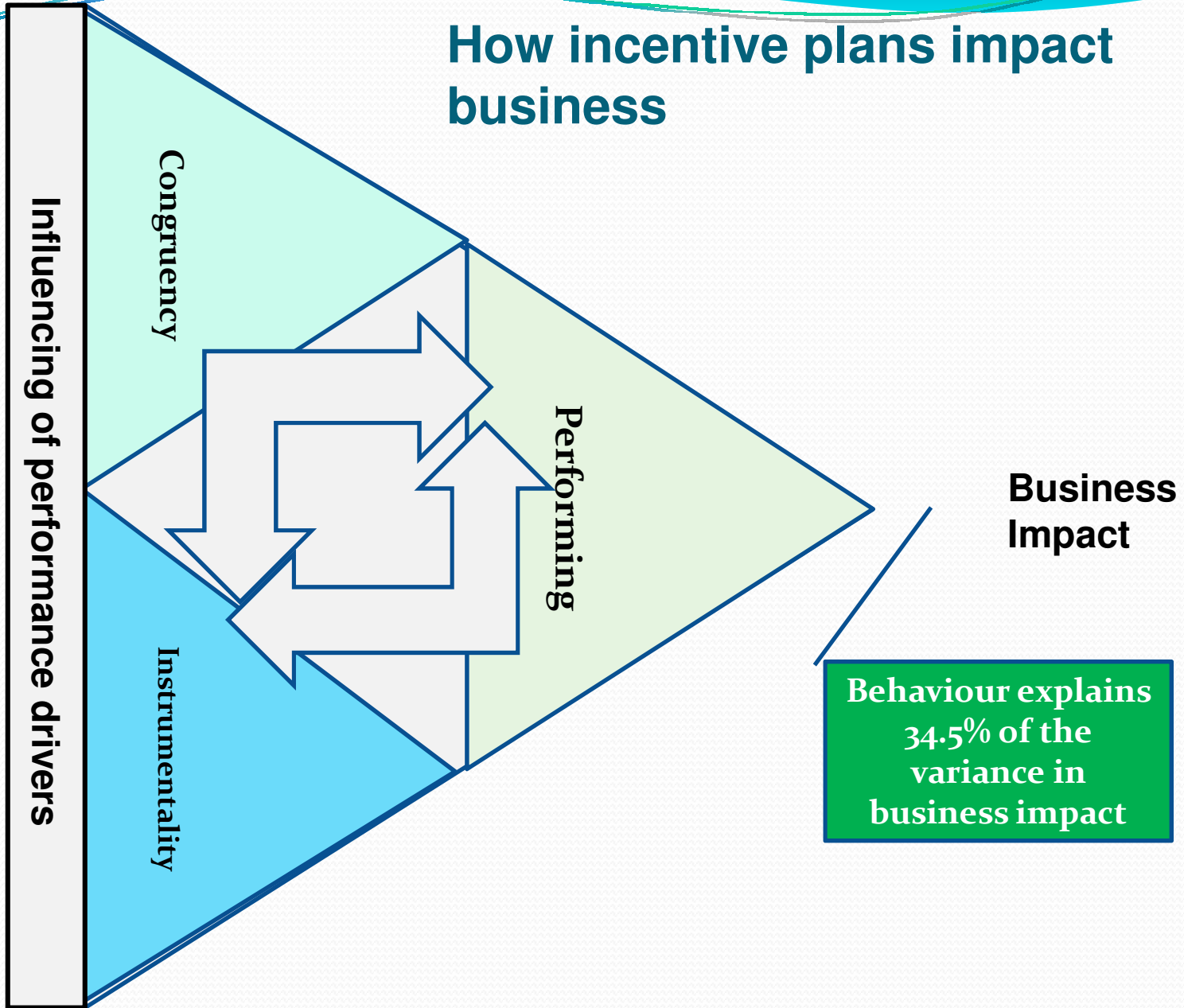
±8% of the payroll is paid as incentive pay

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

How incentive plans impact business





Principles of Incentive pay

Incentive pay is not only about pay. It is about behaviour and the many things that happens around incentive pay that influences behaviour. “Things” includes the environment, competition, the organisation, leadership, performance enabling, understanding, communication, risk taking, governance and incidentally also pay for performance. Only when all “things” work in unison, incentive pay accelerate business results.

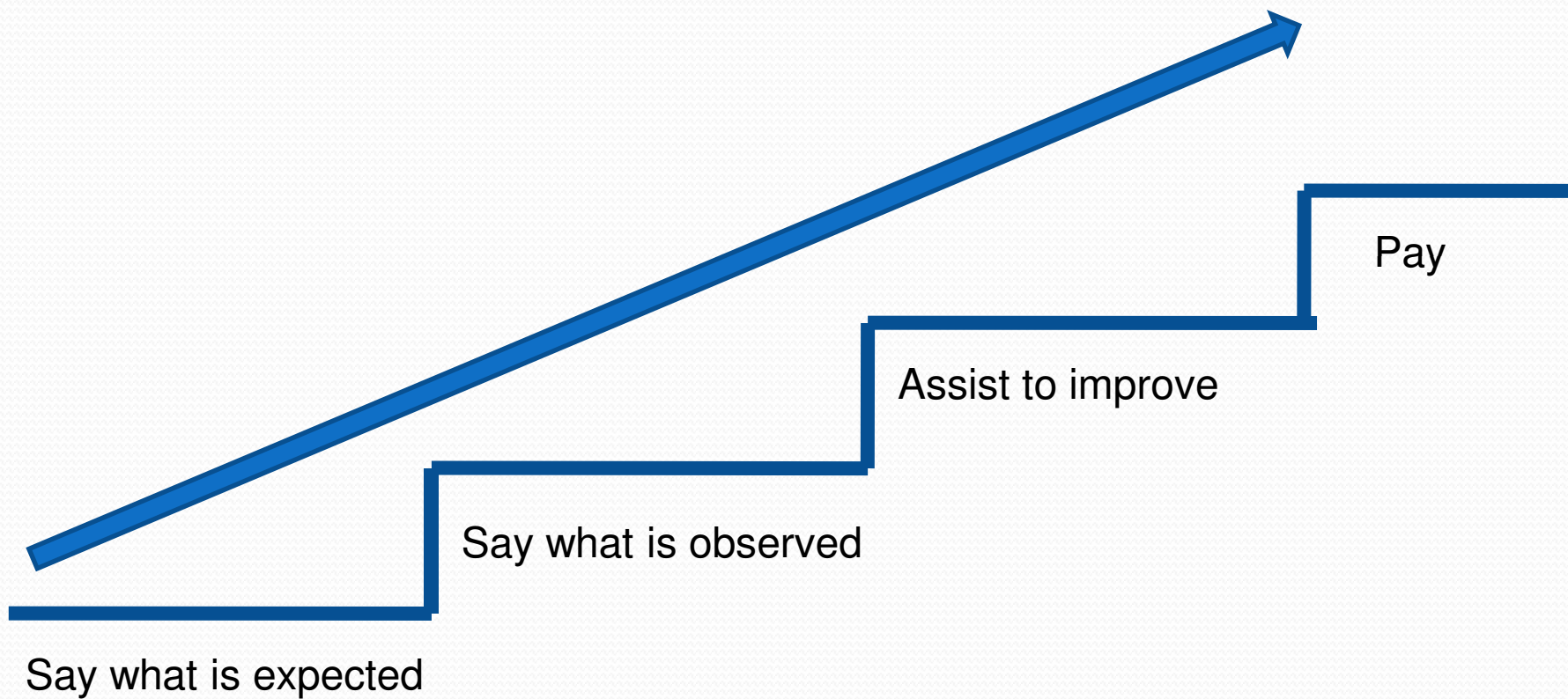


Principles of Incentive pay

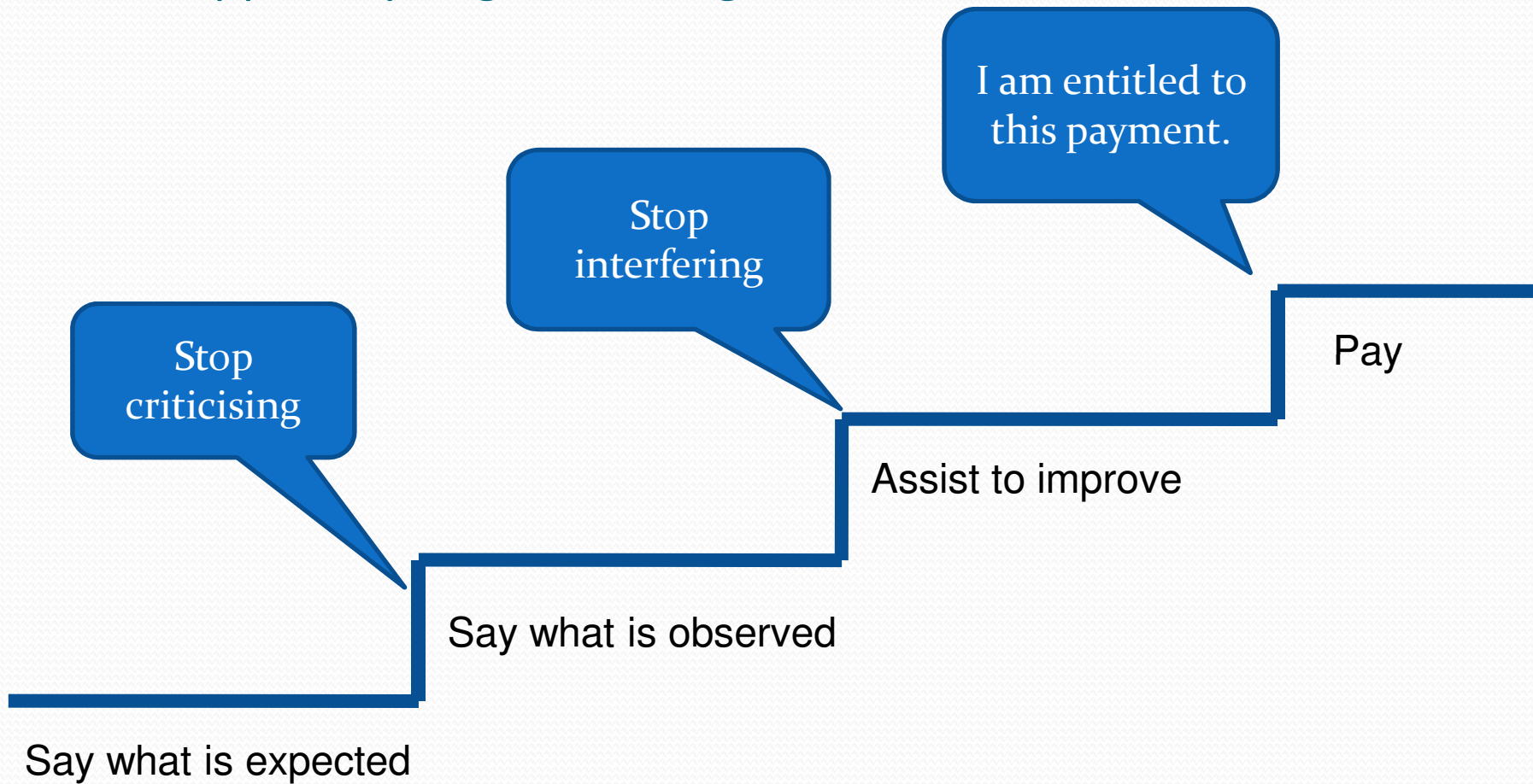
#1: Incentive pay carry performance, its **not a** creator of performance

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

Steps in performance acceleration



What happen if you get it wrong?





Principles of Incentive 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 incentive pay, business outcomes happens despite of the presence of the plan

-Not all jobs/roles are “programmable”, in other words suitable for incentive pay



Principles of Incentive pay

3: A virtuous/vicious relationship exist between the constructs of incentive pay

- If any of the constructs of variable pay are weak/strong, it influences the rest of the constructs
- 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 it work in practice

The model allows one to predict whether an incentive plan has, is or will affect business results.

Typical applications includes:

- To challenge whether entrenched incentive plans add value
- Evaluate new schemes before commitments are made and thus reduce unjustified spending



How it work in practice (Continued)

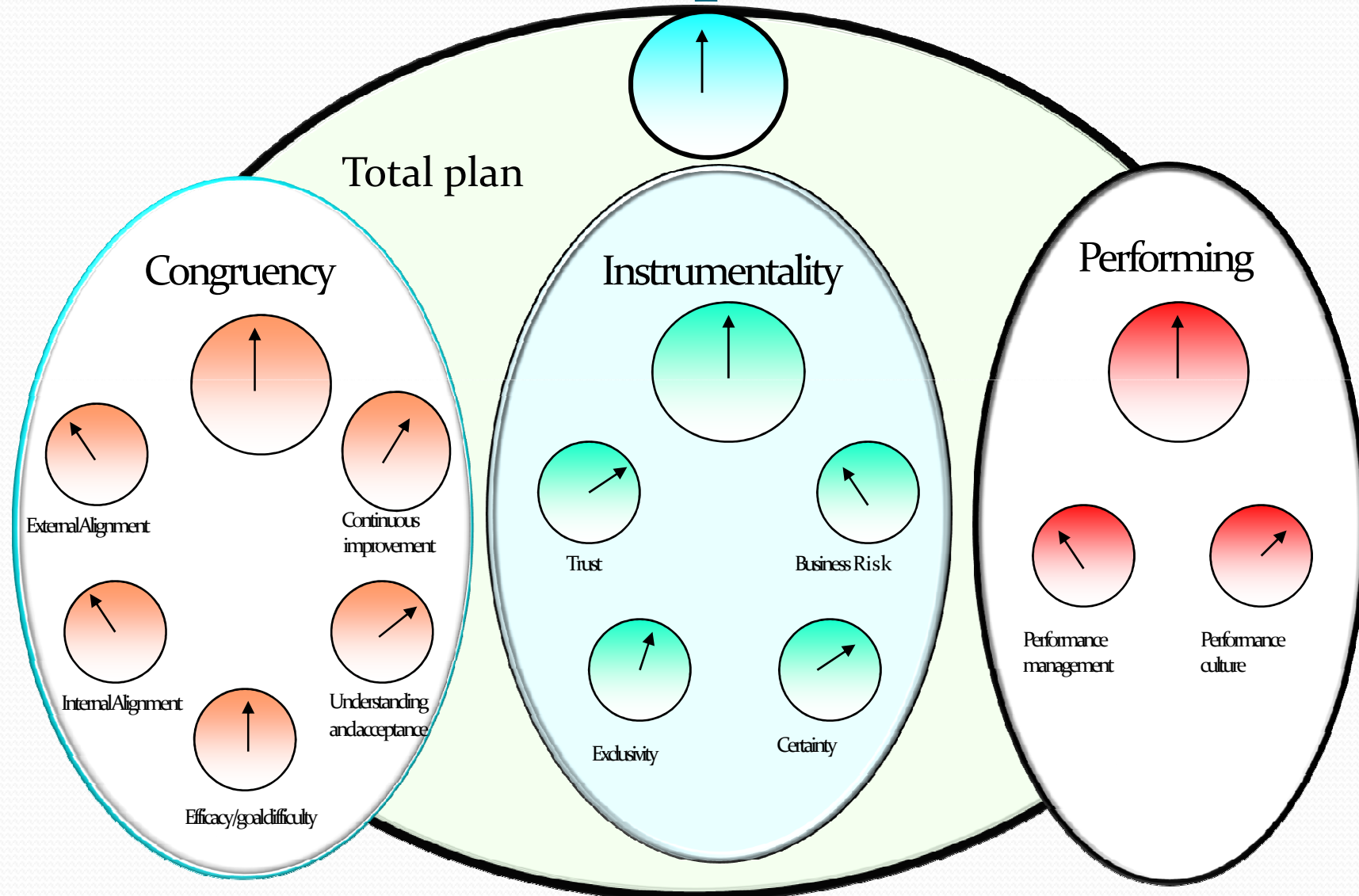
- Provide feedback during the operational life of the plan, allowing business to rectify weaknesses during the life of the plan
- Ensuring governance by determining whether a plan added value to the business results and justify whether payout is appropriate
- Objective feedback to stakeholders. Did the incentive plan influences business results?



What are the benefits?

- Exposes the strengths and weaknesses of the plan, allowing designers to make improvements.
- Strong empirical evidence enables reward practitioners to negotiate changes to weak designs and motivates improvements.
- The empirical basis removes subjectivity and unsubstantiated arguments.

The incentive plan dashboard





Thank you



Technical characteristics of the model



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

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



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

Predicting Plan Outcome

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

Calculating Plan potential

Formula 2: PLAN POTENTIAL = (Congruency X Instrumentality X Performing)^{1/3}

where:

Congruency = (External Alignment X Internal Alignment X Efficacy/Goal Difficulty Alignment X Understanding and Acceptance X Continuous Improvement)^{1/5}

Instrumentality = (Trust X Certainty X Exclusivity X Business Risk)^{1/3}

Performing = (Performance Management X Performance Culture)^{1/2}

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?



How do we collect information

- Qualitative approach:
 - Before or during implementation
 - 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