If You Want Results … Show Them The Money! Incentive-Based Management.

8a Magazine

By John M. Collard

Would you share the wealth with those who were required to help you create it? Of course you would!

Business owners willing to invest in realistic incentives that reward achievements accomplished by managers and employees, reap the proceeds. The key to success is to: 1) set realistic goals and timeframes; 2) hold managers accountable for performance; 3) communicate measurement and reward methodology — then step back and let them perform. Always be sure to reward positive results when goals are achieved … but never give a reward when goals have not been accomplished. If goals are met, the cash will be there to pay bonus.

First, set the directive and goals … THEN … set the incentive structure to achieve them. The goal setting process clarifies direction and eliminates confusion, unclear motives, and misguided efforts. When you use an independent resource to guide the process, they often add credibility and subjectivity.

Incentive Plan

When employees can see dollar signs and goals are clearly stated, their mindset changes and they become more creative. Include as many employees as possible as part of an incentive-based structure. Incentive Compensation (IC) should reward performance and teamwork, which produces results.

The ultimate goal of the motivational plan is to improve the equity value of the company. Share profits in proportion to the risks being taken. Owners accept risk when entrusting operations to the capability, judgement, and decision making of the people who work for them.

When an employee's income is based purely on performance, as it is in sales, the risk-to-reward scenario is much greater than for a salaried employee. An employee working under an agreement or union contract governing work behavior and performance will receive less bonus by comparison for achieving their goals. If they want the rewards, they should share the risk.

Develop an Incentive Pool based on the amount of Gross Margin (G/Mgn) and distribute bonuses based on a weighted average to the team. When the company does well, G/Mgn improves thereby increasing the size of the Bonus Pool, and IC is greater. Tie the incentive at budget to a percent (%) of salary to help the weighting average calculation. Managers will have to control several components to achieve results without loosing sight of the end goal.

Pay management incentive compensation based 50% on what the employee is directly responsible for, 30% on how their performance impacts other key departments (i.e. how sales can improve production throughput, or how operations and project management can improve sales), and 20% on their ability to improve equity value or other elements within their control. The intent is to measure performance, and as importantly, cooperation between departments and personnel.

Structure a bonus payment scale in accordance with 'Worst', 'Likely', or 'Best' scenarios. In 'Worst' case, few bonuses should be paid because goals were not met. In 'Likely' case, pay 40% to 60% of the full bonus rate. In 'Best' case, pay maximum bonus rates. The scale is clearly weighted toward higher bonus for greater performance. Communicate progress early and often.

Incentive Payments

Distributions should be on a year to date (YTD) calculation, paid quarterly. So the company doesn't take all of the risk, pay 2/3 of the YTD bonus at the end of the first quarter, 75% at the end of the second quarter, 85% at the end of the third quarter, and the remainder at the end of the year. This reserve within the company will avoid early payout for exceptional results without sufficient catch-up period if these results don't continue. Employees can share in the rewards as they occur rather than waiting until year-end, an added incentive.

General Management

Direct the General Manager (GM) to guide the value of the company in terms that an investor or potential purchaser would use to measure the company value. The real entity value is based on market value of assets, their ability to produce economic value, the ability of the management team to produce cash and profits on a recurring basis, the ability of the company to produce quality products and maintain customers on a consistent basis, and the ability to build firm contract backlog.

The GM will drive volume and throughput well beyond breakeven levels, and will support their managers to achieve results. If all managers make their goals, the GM will make his/her goals because the equity value will increase.

Support the Selling Process from Start to End

Emphasize interdepartmental coordination. Sales can support Production by seeking jobs that fit the plant with flexible delivery schedules if needed. Production can support Sales by over-recovering rates and delivering quality products on time and under budget. Project Management can support the company by bringing the contract to completion under budget. Pricing/Estimating can support the whole process by improving the win ratio of jobs bid and by leveling the load to stabilize throughput, thus driving volume. If workflow through the plant is level then overhead as a percentage of sales is reduced, producing greater profits or more competitive rates.

Put salespeople on a tiered commission structure to reward for new customers and value-added sales. Reward higher commission % for jobs from customers added in their first year with the company, and on a declining scale thereafter. Put Customer Service on an incentive override above salary to drive revenue growth and retention from existing customers.

Sales must focus on helping the throughput in the plant. Focus on flexibility and load leveling will serve to fill part of the valleys in slow periods. By the way, sales during off-peak times are more likely to be produced, while sales during peak may not.

Incentive-Based Management | Plan Specifics

		Incentive		
Function	**Focus On:**	**50%**	**30%**	**20%**
General Manager	Company Value	Equity Value Improvement	Earnings Per Share (EPS)	Employee Motivation
Sales	Sales Revenue	Profitable Revenue Generated	Consistent/ Flexible Work Flow	EPS/ Net Profit
Estimating	Profitable Work	New Business Win Ratio	Consistent Work Flow	EPS/ Net Profit
Production/ Project Mgt.	Throughput Project Profit	Gross/Margin Resource Utilization	Billing Rate Over-Recovery	EPS/ Net Profit
Human Resources	Employee Relations	Employee Motivation	Employee Satisfaction	Low Rate of Turnover
Finance	Financial Cash Flow	Timely Accurate Information	Overhead Cost Control	Cash Availability

Maximize Production Throughput

The best measure of plant throughput is hours worked versus hours billed, those hours on all of the timecards compared to hours invoiced to customers. The closer this ratio is to a one for one (1:1) relationship ... the better the productivity ... the throughput ... the profitability. When they go over on one job, they will be incentivized to go under on another to balance the overall ratio for the period.

The whole issue of 1:1 accountability will bring out issues regarding accuracy of estimating standards, justifying department costs, scheduling inequities, flexibility, and the need for volume. It will rebalance the rates and force flex scheduling to meet throughput demands.

Murphy created his laws for a reason . . . things do go wrong. When there is flexibility in delivery time, and you avoid 'just -in-time' preparation, you drive profitability. The ability to slot another job into production while problems are resolved will maximize yield, and eliminate standing around a quiet machine.

When Work Order hours are out of balance obtain an adjustment or change order if possible. Customer approved change orders generate more hours against which to charge time, a benefit to the 1:1 ratio in the plant. If no change order, certainly flag each first occurrence for pricing to factor in —and don't make the same mistake next time.

Conclusion

Tie employees to your goals to create focus. Motivate the entire work force, allow creative thinking, and gladly pay the bonus when the results improve the equity value of your company. When the equity value increases, share price improves the value of the investment for shareholders, you can pay dividends, or reinvest in the growth of your company. Reinvestment often yields greater returns.

Incentive-based management is a catalyst toward improving direction and value creation.

About the Author

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