



Construction Financial Management Association
2021 Buckeye Conference

Developing a Successful Compensation Program

September 22, 2021

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Objective:

To provide a basic understanding of the core principles employed in developing compensation plans



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True or False?

Compensation management is more of a science than an art



3



False

Just the reverse - compensation management is more of an art than a science



4



Many elements influence compensation decisions:

- Job duties
- Market value
- Organization's pay philosophy
- Salary budget and financial condition
- Individual qualifications & performance
- Company performance



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True or False?

The best employees are not attracted, motivated and retained solely by money



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True

Many reasons why people accept a job, are happy in their work and choose to stay with an organization

| | | |
|-------------------|---|------------|
| Pay | → | Attraction |
| Benefits | | Motivation |
| Career | | Retention |
| Work/Life Manager | | |

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Goal of a compensation plan - the 3 R's:

1. Ability to **recruit**
2. Ability to **reward**
3. Ability to **retain**

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Components of a compensation plan

- Base Salary
- Short-Term Incentive Pay
- Long-Term Incentive Pay

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Major steps in developing a base salary plan

1. Job analysis
2. Job evaluation
3. Market analysis
4. Pay ranges

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What is a job analysis?

- It is a systematic method for gathering information
- It focuses on work tasks, and outcomes
- It identifies the qualifications necessary to perform the job and the conditions under which work is performed

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Primary sources of job information

- Job descriptions
- Interviews
- Questionnaires

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Job Evaluation

- Process to determine relative worth of positions
- Techniques/tools: range from simple whole job ranking to point-factor systems

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Job Evaluation, cont'd

- Typical factors considered:
 - ✓ Education, experience and skill requirements
 - ✓ Interpersonal/Communication Skills
 - ✓ Job Complexity
 - ✓ Judgment/Independence of Action
 - ✓ Supervisory or Managerial Responsibility
 - ✓ Impact of Actions/Consequence of Errors
 - ✓ Working Conditions
 - ✓ Physical and Mental Demands

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What is market analysis?

Determining the worth of similar jobs in the market

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Sources of data

- Government (Bureau of Labor Statistics – www.bls.gov)
- Industry groups/associations
- Area surveys
- Consultant surveys

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Defining the market

- Consider
 - Where do we lose people?
 - Where do we recruit people?
- Geographic area
- Industry
- Size

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Rules of thumb

- Use care in selecting published surveys
 - Reputable survey administrator
 - Survey job descriptors
 - Sufficiently large sample
 - Effective date
- More is better
- Data at the median (50th percentile)

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Pay Range Parameters

- # of Salary Grades/Levels
- Size of Grade/Level Differentials
- Width of Salary Ranges
- # of Steps (If Utilized)
- Size of Step Increases (If Utilized)

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Approach to developing pay ranges

- Integrate job evaluation and market analysis results
- Align range midpoints to market (at median)
- Typical range widths (minimum to maximum) vary between 20%/25% to 40%/50%

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Overview of Pay Progression

Types of pay increases:

- General increases
- Promotional increases
- Merit increases

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Base Salary Progression Merit Increase Matrix

| Overall Performance Rating | Position in Salary Range | | | |
|----------------------------|--------------------------|---------------|---------------|---------------|
| | 1st Quartile | 2nd Quartile | 3rd Quartile | 4th Quartile |
| Outstanding | 2.50 x Target | 2.25 x Target | 2.00 x Target | 1.75 x Target |
| Exceeds Expectations | 2.00 x Target | 1.75 x Target | 1.50 x Target | 1.25 x Target |
| Meets Expectations | 1.50 x Target | 1.25 x Target | Target | 0.75 x Target |
| Needs Improvement | Target | 0.75 x Target | - 0 - | - 0 - |
| Unsatisfactory | - 0 - | - 0 - | - 0 - | - 0 - |

Notes:

1. "Target" is determined each year as the desired salary increase to provide to employees with "Meets Expectations" performance ratings and salary levels in the third quartile, and is based upon the Company's ability to pay (financial resources) and the "market" (salary increase trends).
2. Any portion of the base salary increase, which would result in the new base salary level exceeding the salary range maximum for the position, will be paid in a lump sum and not kided into the base salary.

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Guidelines for compensation plan administration

- Each employee should be paid within the range
- Setting salaries for new hires:
 - Minimum or close to minimum of range if no prior experience
 - Credit for prior experience up to the midpoint
 - Consider internal equity
- Midpoint = market and indicates employee who is fully trained and proficient in the role

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Guidelines for compensation plan administration (cont'd)

- Above midpoint (above market) reserved for high-performing employee(s) with years of service
- Employee who reaches range maximum considered "red-circled"
 - No further increases until range is increased
 - Can consider lump sum awards
- Promotional increases 5 - 15%
- Lateral transfer (same market value) - no increase

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Guidelines for compensation plan administration (cont'd)

- Demotions may result in reduction in pay
- Track changes in market and adjust pay ranges as appropriate to remain competitive
- Document guidelines for administration to assure consistency

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STI Plan Development

1. Plan Goals and Objectives – What are you attempting to accomplish? Achieve?
2. Plan Participation – Who should be included in the plan? When should they be eligible for incentive awards?
3. “Readiness” of the Organization – Is management prepared for such a program? How will employees react? Can the program work?

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STI Plan Development, cont'd

4. Current Pay System – How competitive are your compensation levels with respect to the market? How equitable are your internal pay relationships? Are changes first required to your base wage and salary levels?
5. Magnitude of Potential Incentive Awards – How much compensation should be at risk? How large should the incentive awards be to impact behavior and performance?

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STI Plan Development, cont'd

6. Incentive Awards Parameters – Should a threshold financial requirement be established? Should incentive award goals, expressed as a % of salary, be established for each position?
7. Basis of Incentive Awards – Will the awards be based upon company, organizational unit or individual performance?

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STI Plan Development, cont'd

8. Performance Factors - What performance standards should be utilized (e.g., profitability, productivity, sales growth, customer service/satisfaction)? Can individuals control the performance standards and affect results (“line of sight”)? Can the performance standards/targets be measured readily and efficiently. How are performance results correlated to actual incentive award payouts?

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STI Plan Development, cont'd

9. Plan Administration – Who will oversee and manage the program? What monitoring procedures will be required.
10. Plan Implementation – How will the program be communicated to staff? What implementation strategies are required?

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LTI Plan Development

- Similar considerations as STI plans but can be more complicated (ERISA, IRS Section 409A, tax and funding implications)
- Typical options for privately-held companies
 - Phantom Stock
 - Deferred Compensation – Defined Benefit Model
 - Deferred Compensation – Defined Contribution Model
 - Long-Term Incentive Compensation Plan

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Phantom Stock

- Utilized to treat non-owner executives as owners in the company
- Can be full value or appreciation only
- Requires ongoing valuation of the company
- Awards can be granted one-time or periodically
- Typically includes vesting
- Awards can vary among participants based upon salary or other relative value of the positions

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Phantom Stock, cont'd

- Awards can be tied to achievement of specific company performance targets
- Payouts tied to retirement with other provisions for death, disability, separation from the company prior to retirement, change-in-control
- Payouts forfeited for prohibited activities (competing, soliciting employees, disclosing confidential information)

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Deferred Compensation – Defined Benefit Model

- Typically benefit is established in relation to final average salary computation over a specified time period and is paid over a specified time period (e.g., 25% of salary per year for 10 years, 50% of salary per year for 5 years)
- Include incremental vesting and vesting reduction for each year executive separates prior to a specified age (e.g., 65)
- Vesting can be tied to achievement of company performance targets

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Deferred Compensation – Defined Benefit Model, cont'd

- Provisions for death, disability, voluntary separation, termination for cause, change-in-control, etc.
- Payouts would begin at specified date (e.g., age 65) and/or event
- Payouts would be forfeited for prohibited activities

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Deferred Compensation – Defined Contribution Model

- Company provides contributions on an annual basis to an account established for each executive participating in the plan
- The contribution amounts can be correlated to the short-term incentive plan bonus (e.g., equal to the bonus or some percentage of the bonus) as the short-term incentive bonus is a strong proxy for the executive's experience, performance and role, and Company performance

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Deferred Compensation – Defined Contribution Model, cont'd

- The funds in the executives' accounts may adjust annually based upon the increase or decrease in the value of the Company
- Vesting of the contributions to the executives' accounts will be incremental (e.g., 20% per year for five years)
- All contributions will be 100% vested upon the executive attaining a specific age, death, disability or change-in-control

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Deferred Compensation – Defined Contribution Model, cont'd

- The value of the executive's account will be distributed upon retirement from the Company on a scheduled (e.g., monthly) basis over a specified number of years
- Distributions are forfeited for defined prohibited activities

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Long-Term Incentive Compensation Plan

- This model can be similar to an STI plan with features such as threshold financial performance requirements and incentive award goal targets (% of salary)
- May include the same performance measures as an STI plan
- Alternatively, other "longer-term" performance measures could be added or replace the STI performance measures

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Long-Term Incentive Compensation Plan

- Would establish a longer time horizon (e.g., 3-5 years) for measuring performance and similarly, payouts could be spread out over multiple years
- Provisions are included for separation from the Company prior to retirement and impact of prohibited activities upon separation from the Company

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