TAMING THE COMPENSATION MONSTER

Using Freight Broker Compensation to Drive Urgency, Performance, and Profits

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Table of Contents

SECTION I: The Monster Problem for Freight Brokers 1

Chapter 1: What's Wrong with Traditional Freight Broker Compensation? 3

Chapter 2: Top Six Compensation Mistakes 7

SECTION II: Getting to Know the Nature of Your Beast 17

Chapter 3: First Step: Define Goals and Roles 19

Chapter 4: Understanding Compensation Psychology—Increase the Size of Your Toolkit 29

Chapter 5: Selecting the Right Pay Mix: A Question of Prominence 33

Chapter 6: But How Much Should We Pay? Using Compensation Surveys to Set Target Total Compensation 37

Chapter 7: Using Leverage to Maximize Motivation 41

Chapter 8: Selecting the Right Performance Measures for Your Incentive Plan 45

Chapter 9: Assigning Weights to Your Performance Measures 47

SECTION III: The Care and Feeding of Your Beast 53

Chapter 10: Moving from Measures to Design Details. 55

Chapter 11: Understanding Goal and Payment Options 59

Chapter 12: Selecting Scope of Measure and Identifying the Ideal Crediting Point. . . 63

Chapter 13: Performance Periods and Pay Frequencies: More Options Than You Can Imagine 69

Chapter 14: Keeping Things Under Control: Capping, Qualifying, Modifying, Kicking, Gating and Linking 75

SECTION IV: Taming and Training Your Beast. 79

Chapter 15: Incentive Compensation Mechanics. 81

Chapter 16: Modifiers and Matrices: Two May be Better than One. 87

Chapter 17: To Bounty or Not to Bounty—That is the Question 91

Chapter 18: Linear Incentives—The Bedrock of Solid Plan Designs 95

SECTION V: Ensuring Your Beast Remains a Loyal and Faithful Companion 103

Chapter 19: Economic Modeling—No Surprises 105

Chapter 20: Goal Setting—The Art and the Science 111

Chapter 21: Change Management Lessons from the Compensation Front-Lines . . . 115

Chapter 22: Document Your Plans to Prevent Costly Confusion 121

Chapter 23: Beyond Cash Compensation: Motivation and Morale on a Tight Budget 125

Chapter 24: Getting Results that Last 129

APPENDIX A: Does Incentive Compensation Really Work? 133

APPENDIX B: About the Author 139

APPENDIX C: Acknowledgments 141

APPENDIX D: Index 143

SECTION I

The Monster Problem for Freight Brokers

Chapter 1

What's Wrong with Traditional Freight Broker Compensation?

Freight brokers are companies that act as intermediaries in the moving of freight throughout the United States. They agree to move freight for a shipper for a fee and then find a carrier who will move the freight for an amount that is less than the fee the shipper is paying the broker (hopefully). You can think of this as buying capacity from a trucking company at a low price, then adding value-added services to that capacity and selling it to a shipper at a higher price. Brokers collect money from shippers (revenue) and pay money to carriers (purchased transportation) and retain the difference (margin/profit) to run their businesses. Generally, a broker owns no assets (trucks) but may be connected to an asset provider, or they may own a few assets. The roles used as examples in this book are those found at typical non-asset, spot-market brokerage organizations. Companies that provide asset-based services or full transportation management services, such as full LTL (Less Than Truckload) shipping management, TMS (transportation management system) services, and freight bill auditing, will certainly find the material herein valuable, but some adaptation will be needed to apply these concepts to those types of roles.

Many of the original brokers used a cradle-to-grave organizational model (one person managed all aspects of the buying and selling of capacity) and often were paid using a 100 percent variable, straight-commission model. So, what's wrong with this approach for paying your employees?

Nothing wrong at all. That is, if every employee has the same opportunity, the same skills, the same training, and all your freight is from the spot market, where each day is a new day and no one knows for sure what's coming his or her way.

However, as this industry has matured, many freight brokers have found the traditional approach no longer works for them. This is especially true in organizations with substantial business from contracted or long-standing "house" accounts, or those moving toward more sophisticated organizational structures (such as using strategic account managers, strengthening the use of outside selling roles, and/or splitting the organization between teams of "freight finders" and "truck finders," who may or may not be tied together in shared dependency).

Identifying the Compensation Beast

The compensation beast can rear its ugly head in many ways. But generally, compensation problems for freight brokers come from what I call the "four employee lacks":

- Lack of urgency
- Lack of motivation
- Lack of good decision-making
- Lack of alignment with company objectives

The purpose of this book is to provide better compensation information for transportation and logistics providers to help them create a sense of urgency, inspire motivation, promote better decision-making, and give rewards that align with company objectives.

The challenge many brokers face when managing their compensation arrangements is to accomplish these objectives within a system that is "fair." If you use a highly variable plan delivered via a flat commission rate, is it fair to pay an employee the standard commission rate for moving freight for a large contracted account they didn't land? What about for freight that is generated by an outside salesperson—shouldn't there be a reduced rate on these loads? What if you are using a team approach that generates a shared pool, but now you need to add people to the team? Or you need to move your best team leader to another group that is substantially smaller because you know he or she will be able to grow it?

In each case, if you stay wedded to using a highly variable commission-only approach, you will find yourself creating "special deals" in which certain accounts are paid a lower (or higher) rate than others, in which you are administering cumbersome calculations to deduct the "lead generation" fee before calculating the commission, or in which you are creating temporary "deals" with employees as you reorganize your staff or your accounts. You may find yourself spending more time trying to remember the different compensation arrangements you have for Joe, Sally, and Fred, and what the rates are for accounts A, B, and C, than you spend building relationships with your customers.

Using the traditional, highly variable, straight-commission approach for incentive compensation is appealing on many levels: it's simple, easy to understand, it's economically "pure" so you don't have to worry that you're going to spend all your profits on incentives, and it's easy to administer (at least at first). For busy business leaders, this approach feels like it should be a "fix-it-and-forget-it" solution. In addition to these benefits, the commission mechanic (regardless of how much pay is at risk in the plan) is a powerful tool that creates an intensity of focus you generally don't find with other compensation mechanics.

For these reasons, using a highly variable pay plan, with a commission mechanic to calculate pay, is perfectly appropriate for some selling roles and in some selling situations, especially for pure new-business-hunters in start-up companies or high-growth divisions of established companies. These types of roles have what is called "high prominence," which

means, in plain language, that they have a high degree of control over the outcome of their sales efforts. (I would still suggest using an escalating or de-escalating commission mechanic even for these roles, however, as it's rarely appropriate or advisable to base an entire incentive plan on a single, unchanging commission rate.)

Where the traditional highly variable commission-based approach does not make sense, however, is for companies that have developed a substantial book of regular business, are building strong brand awareness in the marketplace, or are using multiple internal resources to land and grow accounts. In these cases, most of the employees are "less prominent" in the sales process; they are a cog in a much larger wheel that includes marketing and advertising campaigns, outside sales resources, and long-standing company relationships with customers.

Using the traditional approach can hinder management from making the right changes for their business (shifting customers or load volume around) because it would be "taking pay" away from one employee and "giving it" to another. In these circumstances, the better approach is to shift your pay mix more toward base salary (at least 50/50) and to make at least part of the incentive plan dependent upon attaining defined goals.

What is a Goal-Based Incentive Mechanic (aka "Bonus")?

Commissions pay for volume ("the more you sell, the more you make"). Goal-based bonuses pay for attaining a predefined goal ("if you beat your goal, you make more money"). Using goal-based incentive mechanics can provide more flexibility for managers to run their business to meet customer needs, target strategic objectives beyond gross profit, and manage employee pay as a motivational tool.

An example might help illustrate the difference.

Joe, who has been given a large volume of mainly long-standing accounts, generates $30,000 in profit in this month. This is down 25 percent from what he did the last month.

Sally, who is still developing her book of accounts, generates $15,000 this month, which represents 150 percent growth over what she did the last month.

A pure-commission mechanic would pay Joe twice as much as Sally, even though his business is shrinking and hers is growing. Arguably, Sally is doing a better job than Joe, even though (and I can hear many of you saying it) "Joe is still bringing more money into the company." Yes, he is. But, once a company grows beyond the point of living hand-to-mouth in start-up mode, management needs to think strategically in terms of what behaviors and results should be rewarded for the long-term growth of the company. Sally could very well be a better long-term asset, but she may not stay around too much longer if her pay is below market-competitive levels (and also

very likely perceived by her as being "not fair" compared to what "that slouch, Joe" is making).

Using a pure goal-based mechanic, Joe might be given a monthly goal of $35,000 per month in profit, and Sally a goal of $12,500. Management would make this determination based on previous-period performance, opportunities for growth, and the overall numbers that must be hit by the organization. At 100 percent of goal, each would make $1,000 for the month. A well-designed goal-based plan has a range around goal (called a performance range) which allows for payout both below and above goal, with different escalation rates. At $30,000, Joe would be at 85 percent ($30,000/$35,000) of his goal, and he might be paid 77.5 percent of his target incentive, or $775. At $15,000, Sally would be at 120 percent ($15,000/$12,500) of her goal, and she might be paid 140 percent of her target incentive, or $1,400. This provides a payout that is determined by the individual's ability to meet and exceed the goal that management has set for him/her. Next month, when management decides that Sally might do a better job managing one of Joe's accounts, Joe's goal would be reduced and Sally's would be increased to reflect this shift in accounts. Each of their incentive targets would still be $1,000 for 100 percent of goal attainment. Management can make this decision purely based on what is in the best interests of the customer and the company, without fear that this kind of change is taking pay from Joe and "giving it" to Sally. Instead, the discussion is entirely about who is best suited to manage and grow this particular account.

For those of you who may feel that the pure goal-based approach is not quite right for your business, or it's too much change to take in one step, there is the comforting fact that there are hundreds of different ways to design incentive plans. One of these options is to use a goal-based commission mechanic in which the commission rate increases when the individual's goal is attained. This provides a blend of reward for volume and reward for goal-attainment. Another option is to divide the incentive into two (or three) elements, one of which is paid using a commission mechanic, and the other of which is paid using a goal-based mechanic. Some companies elect to transition by using the goal-based mechanic on a lesser-weighted team measure, leaving the commission mechanic on a more heavily weighted individual measure. The possibilities are truly endless, and by moving beyond the traditional broker method for compensating their employees, many companies are finding answers to some of their most vexing compensation problems.

Chapter 2

Top Six Compensation Mistakes

What are the ways the compensation beast will bite you? Let me count the ways.

I am often asked, "what is 'the right way' to pay?" But there is no easy answer to this question. The "right way" depends on a variety of factors particular to each company. But there are some definite wrong ways to pay, and this chapter will outline the six most common compensation mistakes I've seen in my work with hundreds of companies in a variety of industries ranging in size from small, privately-held companies to multi-billion-dollar global giants.

MISTAKE #1: Not Realizing That Compensation Is Part of a Complex and Interconnected System

There are two variations of this mistake. In the first, managers fail to understand that compensation both supports and reflects a company's unique objectives, strategy, structure, and culture. When leaders want me to just "tell them the answer," or "tell them how XYZ broker pays," or when they think they can "just use the plan from their last company," they are making this mistake.

In order to develop the "right" plan for your company, you are going to have to do some work—there is no easy answer. Here are just some of the questions you need to answer *before you even begin to think about a commission rate*:

- Define your business objectives and strategy:
  - What are your specific financial goals for the next year and the next five years?
  - How are you going to succeed? What has worked in the past? What has not?
  - What is your competitive advantage? Do you offer a low-cost solution or a high-service solution? Do you have a technological advantage or a relationship advantage?
  - What do your clients think of you? What do you want them to think?
  - Are you focused on short-term growth or long-term stability?
  - Are you positioning for acquisition, developing a legacy, or do you need to think about a future change in control?
- Define the optimal organization structure and roles for your organization:

  - What is the right business flow?
  - How much interdependency exists (or should exist) between people, roles, groups, and divisions?
  - What risks come from different structures (**TIP:** Some organizational structures make it easier for employees to leave and/or start their own brokerage than others).
  - What structures will allow for clear and focused incentive plans? (**TIP:** If you have more than ten people and every person has a different incentive plan, or everyone has the same incentive plan, you don't have role clarity and need to do more work in this area—chapter 3 can provide some guidance.)
- Define your organization's optimal culture:
  - Do you want a culture of competition, of cooperation, or someplace in between?
  - How much control does management need or want to have over the way things are done?
  - How much variation in pay is optimal for your culture?
  - How paternalistic is the company?
  - Does your organization allow people to take risks and learn from their mistakes, or are there many rules that control choices?
  - Does the organization promote a higher purpose than simply making money? (**TIP:** None of your employees are going to be enthusiastic about work if they know the only reason they are working is so you can buy your next luxury car or your next vacation home.)
- Define your competitive position in the labor market:
  - What do current and potential employees think about the organization? What do you want them to think?
  - What benefits do you offer?
  - Is the company well-regarded, or does it have some reputational issues?
  - How well-trained and regarded are the managers?
  - Is there a good training program for the employees and opportunity for continuous learning?
  - Is the environment high-spirited and fun, somber, relaxed, or professional?
  - Does the company use a performance management system allowing for salary increases? When was the last time you gave raises?

– How are successes celebrated? How are failures managed?

– What career advancement opportunities exist?

(**TIP:** if your company scores high on many of these questions, then you may be able to pay a bit below market rates in your cash compensation plan; if you score low then you will literally need to overcompensate.)

The answers to these questions will provide a picture of your company that is unlike any other, and your compensation plans should reflect and support your unique strengths and help to overcome any weaknesses you identified. Chapter 3 will give you more insights into helping you define your goals, and chapter 19 will ensure you use these goals when testing the economics of your new compensation plans.

The second variation of this mistake is to develop compensation plans for highly interconnected roles separately from one another. I am often asked for a plan for sales, or for carrier coordinators, or for account managers because that may be a particular pain point at the moment. It is likely, however, that a change to the incentive plan for any one of these roles will have a ripple effect on the other roles. It's not easy, but the right way to develop new incentive plans is to consider *all* of the roles in your organization at once so you can be sure the plans encourage people to work together and not against each other.

Also, it is essential to do the economic modeling for the full system at once to be sure the total cost of compensation lands in the right range for where your company is in the life cycle and the type of freight you have. (**TIP:** 33 percent is often cited as the "right" cost of compensation as a percent of gross profit, but it is not the only answer, nor is it the right answer for all companies; companies with a large volume of contract or EDI (*electronic data interchange*) freight could be much lower than this, while start-ups, small companies or companies dealing in over-dimensional, heavy-haul or other "high-touch" or specialized freight could be higher and still be perfectly healthy.) Chapter 19 goes into detail on what you can learn through economic modeling that will help you fine tune your compensation plans for maximum return-on-investment (ROI).

MISTAKE #2: Thinking about Compensation as Only an Economic Deal with the Employees

Compensation is about more than money, and those who think about only the math are missing at least half of the point. I tell clients that using an incentive plan is like putting a megaphone on your business strategy. Whatever is in the incentive plan will get a disproportionate amount of attention from employees, so isn't it sensible to spend some time thinking about the message being sent? The plan shouts to employees the company's priorities, ethics, team philosophy, how valuable they are (or aren't) to management, and how many opportunities they have for growth and advancement. Getting the psychology of incentives right is at least as important as getting the math right.

Another mistake in this category is to think about incentive compensation only from the perspective of "how much can I afford to pay." In the sales compensation world, this is called a "cost-of-sales" philosophy. As organizations mature and cash flow becomes less of a concern, management recognizes that knowing the market value of a job is important to attract and retain the type of talent they want. This is called a "cost-of-labor" philosophy and is used by all sophisticated companies once they reach a certain maturity and size. It is at this point that compensation surveys become very important as companies look to the market to understand what is required to pay a competitive wage (and what isn't). Chapter 6 will give you more insights into the proper use of compensation surveys. In some cases, companies will find they are overpaying the market due to legacy issues from the plans they put in place during their start-up phase (see Mistake #3). Developing an understanding of what other companies are paying for the same roles can give management the confidence needed to make adjustments.

Another economic mistake is to think that if a little incentive is a good thing, then a lot of incentive must be better. It is rare that paying 100 percent variable pay to employees (e.g., 100-percent commission plan) is a good thing. Employers lose almost all control when an employee has no salary. The employees may engage in practices that are detrimental to the company's business, customers, carriers, and ethics. The employees are also more likely to jump ship with "their" customers (excuse me, whose customers?) and go for a better offer or start up their own brokerage based on the training, marketing, and technological support *you* gave them.[1]

While a bit of hunger can be a good thing to drive performance, desperation is rarely an effective motivational tool for the long term. If you want your employees to act like used car salespeople, or to run your business the way subprime mortgage brokers ran theirs, then by all means, use a 100-percent variable approach. (**TIP:** AIG and Lehman Brothers were big success stories once upon a time and everyone wanted to know their secrets (see Mistake #1). One of those secrets was a highly variable and highly leveraged incentive plan that rewarded excessive risk-taking and was a proximate cause of the economic collapse of 2008.) If you want an organization with more class than a used car dealership and less risk than a subprime mortgage brokerage, then you will likely need to have some part of your employees' pay coming in the form of a fixed salary. Chapter 4 will give you more insights into the varied psychology behind compensation, and chapter 5 will help you work through the options for selecting the proper pay mix for your different roles.

Companies also get so focused on the economics of compensation that they will spend dollars to save pennies, losing sight of psychological costs and benefits. The best example of this is the development of expensive administrative systems to track adjustments and short

[1] I'm aware of the existence of non-compete and non-solicitation agreements that are used widely in this industry. However, they are costly to enforce, create an adversarial relationship with employees, and you are not guaranteed you will win your case.

pays. Provided you have systems in place to prevent egregious errors, there are usually better solutions than holding back, charging back, clawing back, or otherwise demotivating your employees while trying to satisfy some overly heightened sense of fairness and economic precision. (**TIP:** In some states these practices are actually illegal. See Mistake #5.) You are losing hundreds, maybe thousands, of dollars in lost opportunities tracking and arguing over these issues. Would you rather have your employees on the phone getting new customers, or in your accounting department asking to reconcile every load on their last check? Chapter 12 will help you consider options for the appropriate crediting point to optimize the balance between financial risk and employee motivation.

Related to this point, companies often struggle with paying incentives when the company has not hit its profitability goals. This requires a shift in thinking from incentive pay as "profit-sharing" or a "bonus plan" to an integral part of your employees' total compensation package. For incentives to be motivational, they must become part of the expected pay package and employees must be able to predict their pay in advance and be able to affect the outcome through their own efforts. Just as your employees' base salary is not dependent upon your company hitting its EBIT goals, neither should their incentive compensation (except for the highest levels of management). Incentive compensation is a strategic investment made to get results, and if you withhold that pay from your top performers in a down year, then it is likely that your results will be even worse the next year because you will have taught your key people that working hard and getting results doesn't matter.

MISTAKE #3: Not Considering Short-Term and Long-Term Unintended Consequences

Short-term consequences from ill-designed incentive plans typically involve damaging customer and/or carrier relationships and damaging employee interactions. For example, if a plan puts too much pressure on profit percent, you might find your employees negotiating too hard with your customers or carriers and costing the company current business, and worse—the opportunity for future business. Likewise, if a plan rewards only individual performance, then employees may work against each other to maximize their own paychecks. Some familiar examples are carrier reps not letting their colleagues know about available trucks (truck hoarding) or changing the code on a load to their own. I've even heard of reps "paying each other" for loads. If *any* of these things are happening in your office, you have a problem with your incentive plan.

Long-term consequences are harder to anticipate because, by definition, the effects do not manifest themselves for months or even years. The most common long-term consequence is sacrificing long-term growth for short-term gain. This is often found among Branch Managers whose incentive plans pay a percentage of profit. Branch Managers may resist hiring employees under this type of plan, as they will inevitably take a short-term hit in their incentive compensation while they train the new employee. Everyone will agree that

in the long run the branch will increase in performance, but managers rarely have the kind of long-term vision as entrepreneurial owners; they are worried about their mortgage and the next car payment. Owners are more willing to take risks than employees, and they are more likely to see the long-term benefit from making "investment" decisions. *Hint: If your employees were willing to take these kinds of risks, they wouldn't be working for you.*

Another long-term consequence is the creation of annuity pay. While it may seem perfectly sensible to arrange a "forever" deal with an outside sales rep who brings new customers (say, 10 percent of all gross profit from that customer for as long as it remains your customer and the rep works for you), five years from now this deal will not make as much sense. For starters, the once-superstar hunter will spend more and more time on nonworking activities (like golf) and your flow of new customers will have dwindled to a trickle. Most importantly, the economics of the deal will no longer make sense because in the intervening years you will have invested in a better Transportation Management Software (TMS) system, a better Customer Relationship Management (CRM) system, support resources, and marketing, all of which make the job *easier* for your sales rep. And yet the sales rep is making the same percentage that he or she made when the job was considerably harder. You must have a system which ensures that your cost of compensation as a percentage of gross profit *decreases* over time, or your business will not thrive. Chapter 15 will give you some alternatives to a straight commission approach that will help you achieve this economic balance.

MISTAKE #4: Not Clarifying Goals to Enable the Shift from Transactional to Growth-Focused Plans

A common complaint from transportation and logistics business owners is the inability to grow. It's no wonder when (1) no one in the organization (including the owner) can articulate a specific growth goal and (2) the compensation plan pays only on a transactional (load-by-load) basis. I say it all the time, but it bears repeating: *"More is not a goal."* You need to make your growth goals clear, to yourself and your employees. There must be accountability when you fail to reach the goals and celebrations when you do. You also need to pay using performance expectations, as this will drive employees to higher levels of performance. At a minimum, you need to use three levels: Threshold, Target, and Excellence.

Threshold is the minimum level of performance required to earn an incentive. If your employees have a base salary, there should be a minimum level of performance before incentives kick in. However, it's rarely a good idea to make this an explicit function of their salary (though I'm well aware many brokers do this, and so do many banks). Effective compensation design actually separates salary and incentives into two different categories of compensation. Salary increases should be earned for teamwork, punctuality, attitude, and any number of other intangibles that differentiate a good employee from a problematic one. Incentives should be used to reward performance in areas that are objective, measurable, relevant to the business, and controllable by the employee. Many brokers miss this

opportunity to reward (or correct) the intangibles by never giving salary increases, tying salary increases only to productivity, or by tying incentive thresholds to salary (which actually makes any salary increase feel like a punishment). This is not to say that there should not be an economic relationship between the cost of someone to the organization and their expected productivity—there absolutely *must* be a connection in an aggregated way between the cost of compensation for the employee population and the company's gross profit. But there will be fluctuations in this number over time, and between employees, as some employees provide value that goes beyond pure productivity.

As a good rule of thumb, 90 percent of your employees should be at or above threshold in any pay period, and payout at threshold should be anywhere between 1 percent and 50 percent of the target incentive. If this figure is not being achieved, your incentive plan is not providing much in terms of motivational value.

Target is the level of performance expected from an average performer (sometimes called "quota" or "goal") and should bear some relationship to the growth goals of the organization (the sum of the targets for all employees should equal or slightly exceed the overall company goal). I often refer to a concept called Target Incentive Compensation (TIC). This is the amount of incentive pay earned when target performance is attained. When added to salary, this becomes Target Total Compensation (TTC).[2] When you look at what an employee actually earned in a year (salary plus all cash incentive payments), this is called Actual Total Compensation (ATC) and is the only number that should be compared across companies. Some companies pay more in salary and less in incentive than others. Some companies use a pure-commission approach; others use a commission combined with team incentives, bounties, or other payout mechanics. Comparing just the base salary misses any pay from incentives. Likewise, comparing just the commission rate does not factor in the salary or whether any pay is coming from other components, such as a quarterly team payout. Be wary of companies who report inflated Target Total Compensation figures. A true Target Total Compensation figure should be achievable by 50-60 percent of the employee population. If a company is telling prospective employees (or competitors) that their Target Total Compensation is a figure that has only been achieved by 1 employee in the last five years, they are deceiving themselves, prospects, and the market at large.

Excellence is a bit trickier to define, but a good rule-of-thumb is to look at the top 10 percent of your performers and tie Excellence to the level of productivity they achieve. In Excel, the formula for this is =percentile(*array*,.90) where *array* is the list of performance (such as monthly gross profit) achieved by your employees and .90 represents the 90th percentile, or top 10 percent. (By the way, using =percentile(array,.60) to find the 60th percentile would give you a really good idea of where to set the target productivity level, as this would skew your goals 10 percent higher than the median or 50th percentile actually attained.) Then check to

[2] Some compensation consultants refer to this as OTE (On Target Earnings).

see if the sum of targets equals the company goals; if not, then consider how you are going to close the gap (Chapter 20 will give you more advice on how to set and manage goals).

Once you've determined the Excellence level of performance (yes, this is odd grammatically, but it's how compensation consultants talk about it), you then need to determine the appropriate leverage factor. The leverage factor is the multiple of the target incentive earned at Excellence. Typically, it should be 2–3× target, with higher leverage for roles that have more pay at risk. The payout above target should be steeper than it was leading up to 100 percent. This makes sense from the company perspective also, as once an employee has hit target, all fixed costs should be covered and the company can afford to share a higher percent of the profits. See chapter 7 for some additional details on maximizing the motivational value of your plan through the proper selection of mix and leverage.

MISTAKE #5: Not Understanding the Legal Ramifications of Incentive Compensation

Most business owners are (or should be) aware that the misclassification of an employee as exempt from overtime pay can have significant legal and financial ramifications for your company, but some may not be aware that there are also rules that govern incentive compensation as well. For starters, if an employee is nonexempt (paid overtime) and on an incentive plan, then his or her incentive pay needs to be factored into the rate used to calculate his or her overtime pay. Your payroll company should be doing this for you automatically, as this is common knowledge. Of course, for exempt employees who are not paid overtime, this is a nonissue.

Many states also have rules about the handling of certain calculations which are common in commission plans, and you should check with local legal counsel that specialize in labor laws in any state in which your employees work. Of particular concern are "holdbacks" or "chargebacks." Some states frown on the notion that an employee can have "earned" an incentive, but the company is holding that pay pending the completion of some future act (such as payment for a load by a customer). It is far better to simply say that the incentive has not been earned until that act actually happens. Chargebacks can also be problematic, as you are now taking money away that was already paid. Likewise, some states have rules about how and when employees (or agents) may be entitled to pay after they separate from the company. If you think that you are not liable for payments after an employee leaves the company, you may find out the hard way that is not the case if your plan documents have not been worded carefully. (See chapter 22 for additional guidance on documenting your incentive plans.)

At the start of 2013, California legislation Assembly Bill 1396 went into effect, stipulating that any commission plan must be documented and signed by the employee and the manager. California draws a clear distinction between the terms "commission" and

"bonus," and it's helpful for employers to do the same to reduce confusion and potentially unnecessary legal scrutiny. "Commission wages are defined as compensation paid to any person for services rendered in the sale of an employer's property or services *and based proportionately upon the amount or value thereof*."[3]

While the world at large tends to use the word *commission* to mean *any variable pay paid to a sales rep*, and *bonus* to mean a *discretionary year-end payout*, compensation consultants use the word *commission* to mean a mathematical formula that determines payout as a percentage of revenue or profit. A *bonus*, or a goal-based incentive, is *a formula that determines a payout based on actual results in relation to a defined goal*. Under a commission plan, someone who sells more makes more. Under a goal-based bonus plan, the person who exceeds his or her goal by the greatest percentage will make the most. For whatever reason, state labor laws scrutinize the structure and rules of goal-based bonus plans less than they do commission plans. Therefore, I recommend using the word *commission* only when it means exactly what state legislatures interpret it to mean (a percent of revenue or profit), and using the term *incentive compensation* when talking about variable pay of any sort. This just helps keep things from getting messy. Why would you want to be scrutinized on your *commission* plan if it's not technically a commission?

MISTAKE #6: Not Communicating and Supporting the Plans, and Not Following Up with Solid Tracking and Feedback

I have saved the worst for last. If you've managed to avoid all of the other mistakes but you still make this one, then you will be no better off than when you started. In fact, you may be worse off because now you will have lost credibility with your staff. When you launch a new incentive plan, you need to back it up. You need to explain it, explain it again, and then explain it again. People have numerous preconceived ideas about incentive compensation based on what they have seen in the past, and they will see any new incentive plan through this lens. It can be very difficult to change this mindset, and you may not realize the points of miscommunication until after you've made the first or second payout under the new plan. It takes two to three pay cycles for employees to truly internalize a new compensation plan. It's only at this point that you will really start to see lasting change in behavior. If you have not reinforced the plan, shown employees performance results, and discussed how they can improve the next time, then you will not get the gains that you need from your plan.

The communication approach to incentive compensation should be as methodical as the design approach. First, you need to be sure your leadership team is onboard with the new design and will support the change. This includes managers and team leaders who will likely be the first line of defense for dealing with complaints (and there *will* be complaints). Bring them into the process early to get their input and buy-in. Then, consider a phased approach for communication.

[3] Source: http://www.californiaworkplacelawblog.com/2011/11/articles/legal-articles/california-ab-1396-requires-employers-to-reduce-commission-agreements-to-writing/

Start with a high-level rollout for larger groups of employees. This allows everyone to hear the same thing at once and reduces the amount of "telephone" that is played around the office about the details of the plan. Then set up one-on-one meetings with each employee to give them their goals or performance expectations and explain how they can succeed under the new plan. The focus should be on how they can make more money than they have in the past. They may need to do things differently, but the opportunity for gain should be there. After one-on-one meetings, deliver plan documents that explain how the calculations work in detail and provide examples so the math is crystal clear. Chapter 21 can provide some additional insights to make your communication event a success.

When you write your plan documents, put some thought into how exceptions will be handled. You will not be able to think of everything, but some common points of contention are:

- Vacations or days off: Will employees cover for each other? Will you guarantee a payout?
- New hires: Is there a probationary period or a guaranteed payout during the first few months?
- Terminations: When is the last payment on the incentive plan?
- Transfers: How would you prorate between plans?
- Splitting credit (**TIP:** Avoid it if at all possible.)
- Disciplinary action: If someone is under a performance warning, will they get an incentive?
- Gaming the system (**TIP:** Do not tolerate this at all; terminate immediately.)

Even now, you are not done. You need to provide regular performance reports so employees can monitor their results ahead of their payouts. You will gain nothing if they only find out if they did a good job or a bad job on the day they get their check. They should know ahead of time so they can adjust. The best managers provide constant coaching and feedback and the incentive plan is a perfect excuse to do this. You want them to make as much money as possible, don't you? (You should, if your plan is designed well, because then the company is also making a lot of money. Your interests should be directly aligned with their interests.) By coaching employees and communicating with them about their incentives, you will be working together to maximize their results. They will be happy and your company will see motivated employees driving profitable growth for the company. Chapter 24 will guide you on the things you must do to ensure you get lasting results from your compensation plans.

Now, let's begin our journey as we learn how to tame the compensation beast.