Volume 6, No. 4 – Q4/2008

Nolan Financial Report

Effective Executive Compensation
"The Common Sense Three- Legged Stool"

.Introduction

Nolan financial is pleased to introduce one of its contributing authors, The Supplee Group LLC. John Supplee brings over 25 years of human resource experience to address the unique issues and concerns in your organization. His personal experience as a senior executive and consultant in Human Resources covers a wide range of industries worldwide.

He earned an MBA with academic distinction from The University of Toledo and was an associate faculty member in the school of business at Purdue University.

E-Mail john@suppleegroup.com
Website www.suppleegroup.com

We asked John to give us his insight into the design components of a well-drafted and executed executive compensation program.

This is John's perspective:

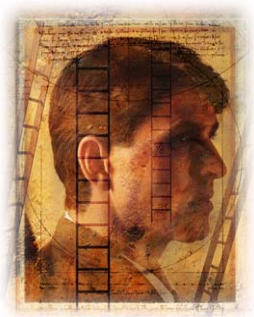
Countless articles have been written about executive compensation programs and how they work and why they are "effective" in leveraging individual and team performance towards the achievement of organization objectives! Each one contends that it is the optimal solution!

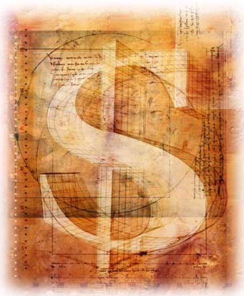
In reality, there is no one single-dimension silver bullet solution! But the good news is that there are common sense pragmatic best practices that will enable organizations to implement multi-faceted executive compensation strategies that are effective and also attractive to plan participants!

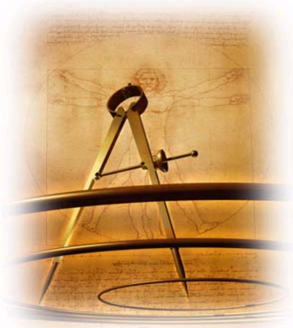
Organizations irrespective of industry need to address several critical questions. Are we really paying for performance? Does the short-term (1 – 3 years) executive incentive compensation program motivate and reward the right kinds of action and behavior? Is the overall compensation program attractive with high perceived value and thus effective in attracting, retaining and rewarding executive talent over the longer term? Each factor in this discussion is a discrete point yet they are totally inter-related, much like the pieces of a jigsaw puzzle! Properly connected they form a total picture of executive compensation!

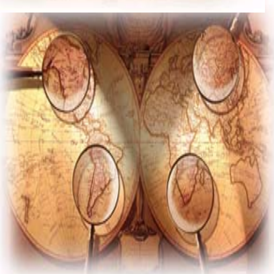
On the question of are we really paying for performance, one must look at the total compensation program. Is it competitive? What is the mix of base salary (fixed compensation) and incentives (variable compensation)? In addition there may be equity/ownership considerations depending on the nature of the organization. Too much or too little of any of these building-blocks of total compensation can influence the "pay for performance"!

For example, too much emphasis on base salary can pressure the organization with fixed costs that are not conducive to aggressive albeit sensible risk-taking. Conversely too much emphasis on short-term incentives to augment a low base compensation can lead to performance for short-term gains that do not benefit the organization for the longer term.









The astute organization that wants to truly pay for performance will carefully manage the “mix” of total compensation. This includes the blend of base salary, short-term incentive compensation, longer-term incentives and any equity or ownership components. At this point, executive compensation becomes more of an art than a linear exercise! The critical factor however is that the picture that is “painted” must be consistent with the business plan!

There is an old cliché that says “that what gets measured gets done”! This is very true, so as a result it is imperative that the right things get measured in the construction of a short-term incentive compensation program! The “metrics” in other words those things that get measured are critical! Measure and reward the right ones and the program can effectively influence the right kind of executive action and performance. Measure and reward the wrong ones and turmoil results!

Remember the dot.com era in the late 1990’s and early 2000’s? It was all about revenue and market share! Profit or margin was deemed irrelevant! That’s why that era is now referred to as the “dot. bomb era”! A more current example is the glut of worthless mortgage-backed securities! The wrong metrics were measured and the result was as we know woefully wrong!

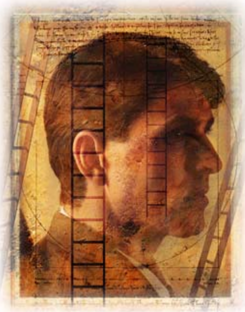
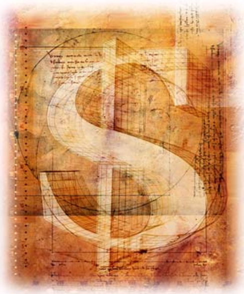
The critical question when deciding what metrics to measure is: are they the ones that are aligned with the organizations business objectives? Irrespective of the industry or organization ownership structure, there are key metrics that drive the business. They can also vary from year to year. There is a wide range of metrics including revenue, profit, gross margins, market share, return on investment, income distribution to partners, earnings per share and the list goes on! So the critical part of this piece of the total compensation puzzle is to identify and measure the appropriate metrics! They need not be complex and certainly don’t have too many of them. Three or four critical metrics are enough to accurately measure organization performance and they can be measured at the individual and team level!

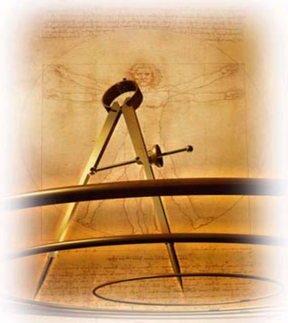
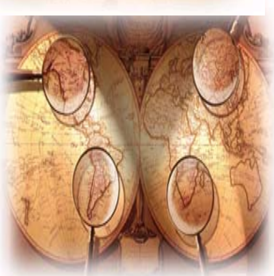
The third imperative in crafting an effective executive compensation program is the issue of attraction and retention of talent over the longer term. Executive talent is human capital! There is a shortage of this in every industry and the problem will worsen as the first wave of baby boomers commence retirement. The organization that can use effective longer term executive compensation in combination with other factors including base compensation, short-term incentives and intangibles such as company culture, will have a competitive edge in recruiting and deploying a high performance executive team!

Given the critical nature of attracting and retaining executive talent, any longer-term executive compensation program must also have high perceived value in the eyes of the participants! Simply throwing money at executives is a poor solution that has a very short shelf life of effectiveness!

Program characteristics for longer-term incentives that can provide high perceived value for an executive include:

- A long term focus as they are beyond subsistence.
- Leverage that produces results.
- Protection from market vagaries such as those that can impact stock options.
- Tax effectiveness.
- Wealth building opportunities.
- Retirement income as many conventional pensions and 401K plans do have limits that result in executives being penalized relative to their retirement funding.
- Flexibility in how money can be withdrawn.


A good means of developing and implementing an effective longer-term component of total compensation for executives at either the individual or team level is through the use of a non-qualified deferred compensation program. This becomes the third leg of the stool that is the "effective executive compensation program"! The advantages of a Non-Qualified Deferred Compensation and Supplemental Executive Retirement Plans include:

- The ability to selectively choose participants.
- Designing a SERP or a Performance Unit Plan so that the annual contribution is tied to long-term performance metrics.
- Leverage by enabling 100 cents of every dollar to work on behalf of the executive.
- Funding can be tied back to the organizations key operating metrics.
- Wealth building opportunities.
- Tax effectiveness as tax is deferred into the future.
- Supplemental retirement funding.
- A unique tool to attract and retain critical executive talent.
- High perceived value in the eyes of the executive.

To recap the characteristics of the building blocks of a successful program for executive compensation the components are:

- Competitive (not excessive) base compensation
- The correct metrics that drive specific performance through short-term incentives.
- Longer-term incentives with high perceived value that promote attraction and retention of critical talent.

This is the common-sense three-legged stool of an effective executive compensation program…an effective multi-faceted solution

SUMMARY

Nolan Financial supports this premise and is prepared to help organizations design, fund and administer their nonqualified plans. This is an ideal time to introduce a Performance Unit Plan.

If you have any questions or interest in regard to designing, funding or administering a nonqualified deferred compensation or SERP plan,

Please contact:
Michael E. Nolan
Nolan Financial
President and CEO
Phone: 866-610-6442
E Mail – NolanM@Nolanfinancial.com
Michael.Nolan@lfg.com

NOLAN FINANCIAL
Turning your financial vision into reality.