Four ways controllers can ensure the best ROI for incentive-pay programs (Quick code 071303)

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If incentive-compensation plans are not properly designed and managed, organizations can end up paying people too much for the wrong things. In other words, they can fail to "pay for performance."

"Controllers can make a big difference when it comes to developing incentive plans that yield the best return on investment (ROI)," says Juan Pablo Gonzalez, partner, Axiom Consulting Partners. They can help to:

1. Ensure accurate measurement. "Since controllers are accountable for measuring and reporting the performance of the organization, they can ensure that incentives for performance are aligned with accurate measures of financial results," says Gonzalez. "Bonus dollars are wasted if incentives do not drive the behaviors and results that support the organization's strategic goals."

"A simple principle is to align payout curves with organizational expectations. Controllers are in a great position to test payout calculations and performance curves against different assumptions about the company's performance. Doing so ensures that plans pay out as intended, and importantly, mitigates the risk of unintended consequences," explains Gonzalez.

2. Balance short-term and long-term incentives. Working with HR and legal, controllers can help determine the proper mix of short-term and long-term incentives. "Short-term incentives are usually linked to annual revenue and profitability objectives, whereas long-term incentives are more likely linked to create shareholder value over a longer period of measurement," says Gonzalez.

3. Promote compliance. "Incentive plans have implications for financial reporting and the expensing of compensation costs," says Gonzalez. "Plans must be designed in such a way that they maximize tax benefits for the company (and its employees) and do not violate any IRS rules."

Further, since the Securities and Exchange Commission ruled that public companies must provide shareholders a "say on pay" vote, investors have been paying closer attention to the compensation packages of key company executives. Even private companies are under greater scrutiny from investors in regard to what they are paying their executives. Therefore, private companies must also be mindful when designing incentive pay plans.

"Investors want to know how their interests will be served when executives receive bonuses," Gonzalez points out. "Controllers are the go-to executives in ensuring that incentive plan payouts are aligned with performance."

4. Keep the plan workable. Compensation plans that are overly complex can be impossible for participants to understand, rendering them ineffective. It is best to keep goal setting and award calculation simple and to minimize the number of metrics (to between three and five) that drive awards.

"A controller can provide valuable input in establishing what those metrics should be, according to business priority. For example, the metrics might be a measure of revenue growth, profitability, or market share," says Gonzalez. "In looking at profitability metrics, the controller might suggest that division leader incentives should be tied to profitability, thus motivating executives to look for more efficient ways of delivering the same revenue, such as reducing labor or supplier costs.

"The important thing is that performance goals are tied to ways a person can actually drive company performance," he continues. "Corporate financial executives might be paid a component of their incentives based on cash flow, although this measure might not be present in divisional incentives or at lower levels (while it is a critical measure of financial health, a limited number of employees can directly influence it)."

"No one in the organization is better qualified than the controller to ensure the compliance and financial efficiency of an incentive program," says Gonzales. "Controllers can make sure the numbers used for establishing incentive pay are the right numbers to drive individual and organization performance."

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