

# ALIGNING PERFORMANCE AND COMPENSATION

One of the most important things that a manager does is align performance and compensation. Often times it helps to bring in an outside expert.

- A consultant can look at a company's performance objectively and design specific measurable goals that will help motivate stronger performance.
- A consultant can help determine the stretch objectives (for which more bonus compensation is warranted), and the business-as-usual objectives (for which no bonus compensation is warranted).
- Consultants can make sure the objectives are consistent from manager to manager and avoid the distrust that can arise around poorly designed compensation schemes.

## Management by Objectives

Management by Objectives (MBO) is an effective, proven way to motivate people to achieve specific goals. This tool describes how it works, talks about some mistakes people make, and suggests strategies for getting the most out of an MBO system.

The MBO system awards financial bonuses based on achieving specific goals over a set period of time. The mechanics are fairly simple. You decide on a specific percent of base salary as the potential bonus. Objectives are assigned points, with the total points equaling 100. For example, if the potential bonus is 20 percent of base salary, a manager earning \$50,000 could earn a \$10,000 bonus. A manager might have 5 objectives, each worth 20 points. If he only achieves four of the objectives, then he would receive 80 percent of his potential bonus.

Let's work through an example. A marketing manager might list the following objectives:

1. Generate 2 million sales for new product – 30 points
2. Build 80% customer awareness of new product, measured by survey – 30 points
3. Make website available in 8 new languages – 20 points
4. Open new customer service center – 20 points

After the marketing manager develops this initial list, he shares it with his boss. She might say: "These look good. But I think you should earn 15 points for generating 2 million sales, and 15 points more for generating 3 million sales. Otherwise, these all look fine to me." The marketing manager would make that change, both parties would sign the list of MBOs, and both would keep a copy.

In most cases, MBOs are either quarterly or 6-month objectives

At the end of the period, the marketing manager sits down with his boss, presents evidence to show whether the objective was achieved, and the boss determines the total points awarded. For example, if sales were 2.8 million, the boss might say: "You

certainly got 15 points here, but you missed getting the full 30.” Assuming the other goals were achieved, the marketing manager’s total points would be 85 and his bonus would be 20 percent multiplied by the compensation for that period multiplied by 0.85.

So where can this system go wrong?

In the first place, each objective must be measurable, and both parties must agree on the means of measurement. If the objective is too vague, like “open a new market in Europe,” then determining success will be difficult and contentious. In a similar vein, objectives should not be too easily attainable. The key to success is putting the onus on the employee to present a draft list of objectives, along with the means of measuring them, and then honing the list until the objectives are both meaningful – i.e. requiring significant effort with import to the company – and measurable.

The last point is key – to be meaningful, the management by objective system has to set a high bar for success. No one should routinely get 100 points. Some objectives might be relatively easy, but some should truly be “stretch” goals. A good rule of thumb is that good employees should regularly earn 50-85 points. Earning 100 points – and the full bonus – should be an exceptional case.

Lastly, it’s worth pointing out that the MBO system has built-in flexibility for the organization, because each manager’s bonus can be set differently. Senior-level managers might earn 80 percent of their base salary in the form of bonus compensation. Lower-level employees might be eligible for a bonus compensation of 10 percent. It’s entirely appropriate for a CEO to have a base salary of \$100,000, with bonus compensation of 1,000 percent, based on achievement of specific objectives. The system, if done right, can truly be designed to help motivate success and generate significant returns to the organization.

If you’re interested in learning more about how to develop an MBO system in your company, please call (800) 598-7662. LRI can advise you on setting it up or help you both implement a customized system and train your managers in how to manage it effectively.