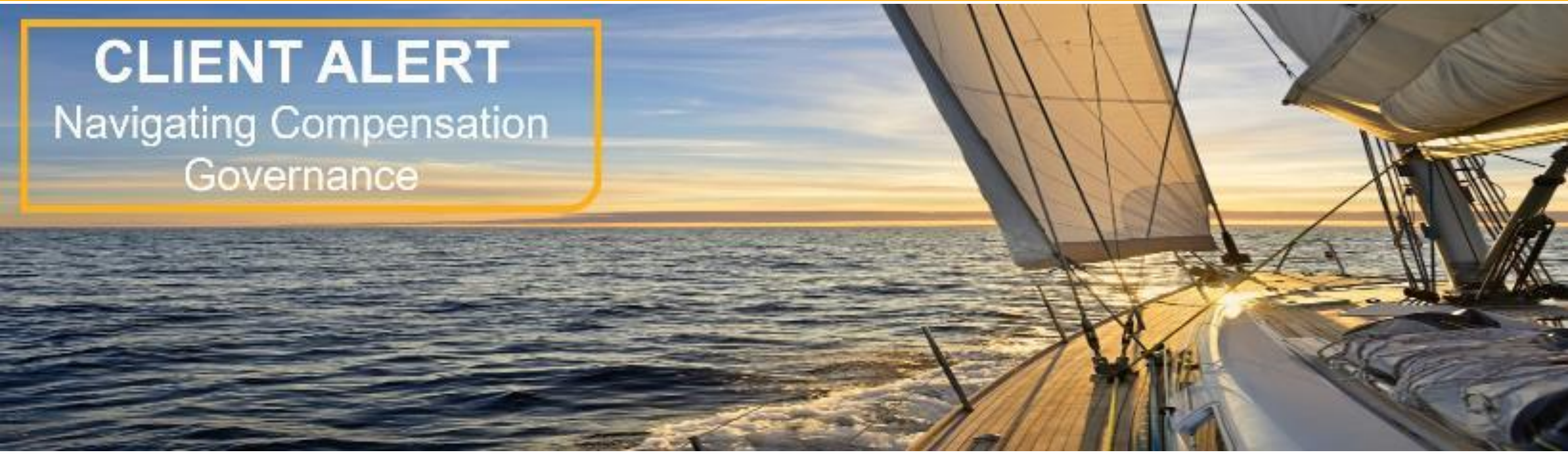


Building Resilience Through Thoughtful Incentive Design

Introduction

In today's business landscape, resilience has emerged as a key characteristic of organizations that navigate uncertainties and thrive in turbulent times. While companies often focus on adapting their strategies and operations, incentive plan designs should be resilient themselves. Incentive plans are designed to motivate executives and employees and drive organizational performance. They can falter in the face of unexpected disruptions if not carefully crafted. In this article, we explore the importance of designing resilient incentive plans and provide insights into the essential elements required to ensure incentive design durability and effectiveness.

Understanding Resilience in Incentive Plans

Resilience in incentive plans involves creating structures and mechanisms that can withstand shocks and adapt to changing circumstances while still driving desired behaviours and outcomes. At its core, resilient incentive design is about ensuring alignment with strategic goals while building appropriate flexibility and process into the fabric of incentive programs. Resilience in incentive design differs from one company to the next and is based on the nature of the organization and its compensation philosophy. There are philosophical tradeoffs and design principles to consider, including simplicity v. complexity, uniqueness v. market alignment, precision v. judgment.
A resilient design will need to balance these tradeoffs.

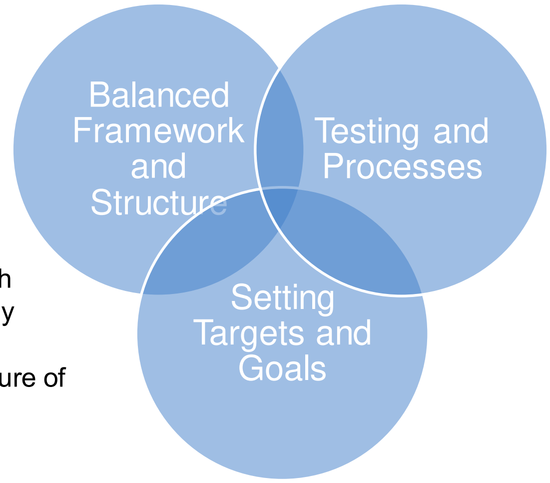
> **“**Changing incentive programs annually, ‘fixing’ them for past issues, or engineering them for a desired outcome is *reaction*, ***not*** *resilience*.**”**

Three key areas to consider building resilience are discussed below:

1. Balanced Framework and Structure

Assess both short- and long-term incentive vehicles and metrics to determine their diversification and counterbalancing. Diversification ensures that a single event does not render all incentives ineffective, while counterbalancing ensures that different metrics react differently to external factors, reducing overall risk. For example, a single metric incentive plan may be more “brittle”, while a company that includes multiple financial and non-financial metrics in its incentive plan may provide a more balanced approach to performance evaluation that will be more resilient. A company that opts not to diversify performance measurement might create resilience in other ways, such as increasing the role of judgment in assessing outcomes *by design*, and not simply as an override feature.

Most companies incorporate discretion judiciously, to provide flexibility in recognizing exceptional performance or mitigating external challenges. When used on an exception basis, discretion should be guided by clear criteria and applied consistently.



A minority of companies use discretion as a required element over performance evaluation and pay delivery. Used this way, discretion can be effective to promote resilience in program design, but at a cost of being less aligned with external perceptions of good governance, and a risk of inadvertently “paying for failure”. At all times, incentive plans should reflect the company's fundamental values and expectations, reinforcing a culture of accountability and integrity in performance management.

2. Setting Targets and Goals

The establishment of targets and goals is another crucial aspect of building resilience into incentive plans. Targets should be ambitious yet attainable with effort, reflecting the company's strategic direction while considering industry benchmarks. Striking the right balance between stretch goals and feasibility is essential to maintaining employee motivation and confidence in the incentive program from all stakeholders.

3. Testing and Processes

Constant revisions to plans, and needing to step outside the stated pay philosophy, are two indicators incentive programs are not resilient. A more formal pay for performance alignment analysis can indicate resilience. Retention and regrettable turnover of high-potential or high-performing employees, when compensation is cited as the reason for the departure, are other indications that the plans are not resilient.

Conclusion

Designing resilient incentive plans require a holistic approach that considers organizational principles, alignment with strategic goals, diversification, target setting, and overlays of stress-testing/back-testing and thoughtful discretion. By investing in the resilience of incentive programs up front, companies can ensure that they remain effective tools for driving performance and motivating employees, even in the face of uncertainty and adversity. As businesses continue to navigate an increasingly complex and volatile environment, resilient incentive design will play an ever more critical role in sustaining success and achieving long-term growth.

For more information on resilience in incentive design, please see our recent podcast with Andrew McElheran, Enhancing Resilience in Executive Compensation Design - Meridian Compensation Partners (meridiancp.com), **and the interview with Matt Seto on Diligent’s *Inside Today’s Boards***, Designing Resilient Compensation Programs - Meridian Compensation Partners (meridiancp.com).

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