



Insuring the Effectiveness of Variable Pay

May 2018

Prepared by Talent, Rewards & Performance

Presentation to WorldatWork 2018 Total Rewards Conference & Exposition



Today's Discussion Topics

- Context for Variable Pay As the Preferred Pay for Performance Choice
- Insuring the Effectiveness of Variable Pay Plans

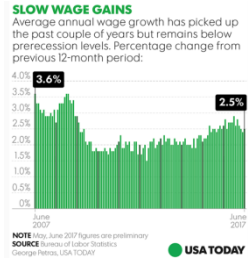


Context for Variable Pay As the Preferred Pay for Performance Choice

The Latest Headlines

USA TODAY

Your next big raise? Don't hold your breath, some economists say



The Wall Street Journal

Sorry, you are probably not getting a raise next year



The Washington Post

Your chances of getting a bigger raise or bonus in 2018 just went down



24/7 Wall Street

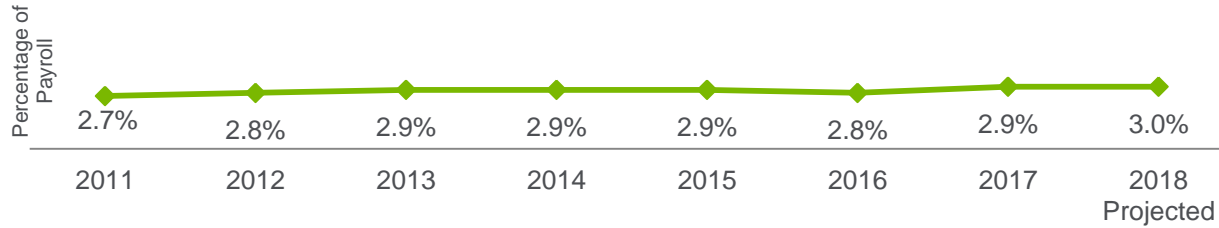
Many Workers Will Get Tiny Raises in 2018



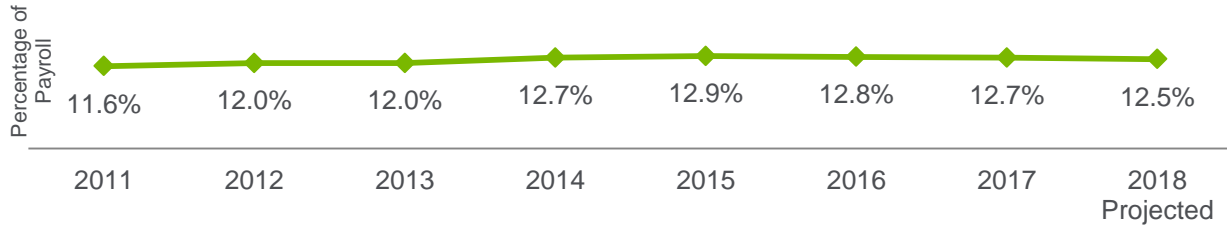
2018 Compensation Planning Snapshot

Salaried-Exempt Employees

Salary Increases



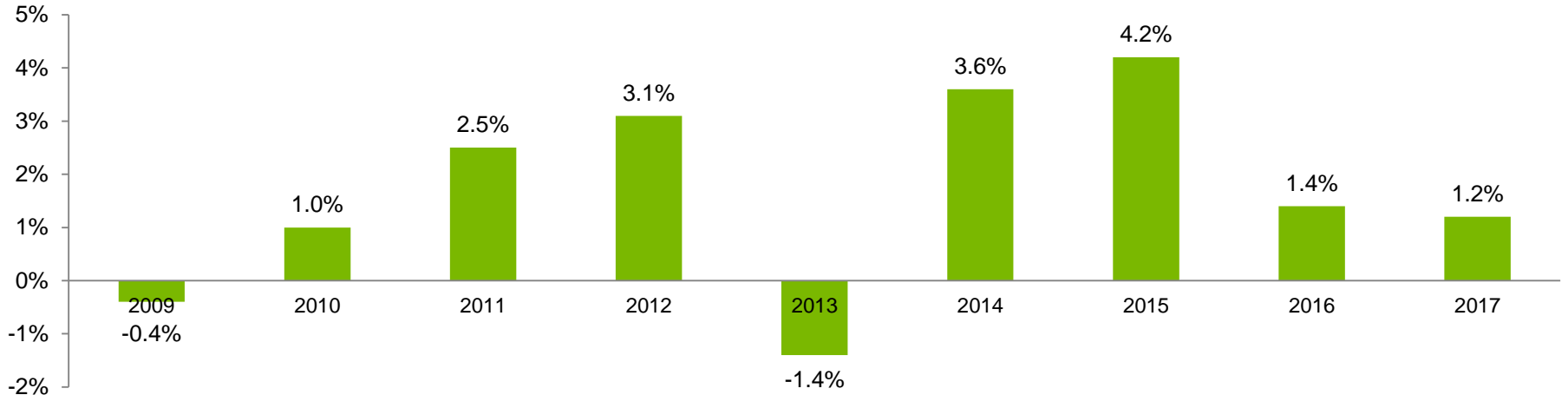
Variable Pay



Source: Aon Survey—U.S. Salary Increases 2017/2018.

Disposable Income Growth

Historical Real Disposable Personal Income Growth Rates



Source: Bureau of Economic Analysis

Impact of The Tax Cut & Jobs Act?

Public Companies Announcing Compensation or Benefit Changes



- **120+** companies announced cash changes
- **70%+** provided one time bonuses, from \$500-\$5,000
- **40%+** announced/ paid \$1,000 bonuses
- Nearly **40%** increased wages, most common to \$15 per hour



- In addition, **nearly 20** announced changes to retirement plans
- About **50%** are permanent increases to match formula
- Other **50%** are discretionary/ one time changes
- **50%+** are in the financial industry
- 1 provided benefit via cash balance vehicle

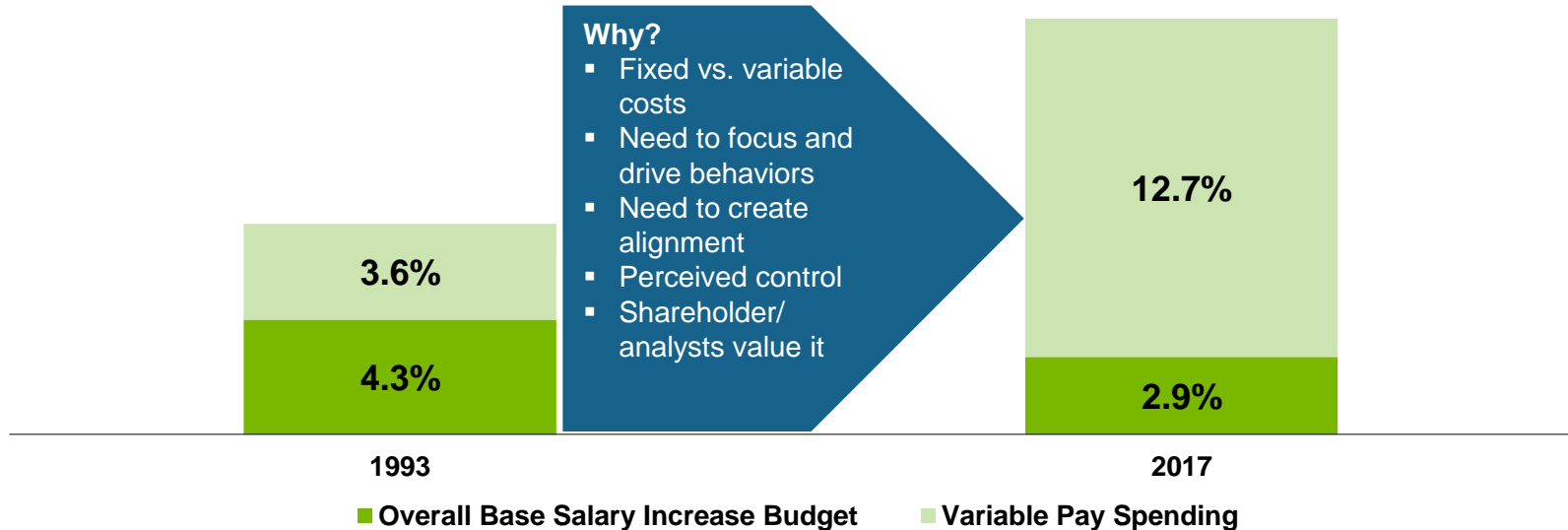
Other

- Other announcements to fund pension, reduce rates at utilities, charitable contributions, and stock

Source: Aon analysis of public sources March 2018

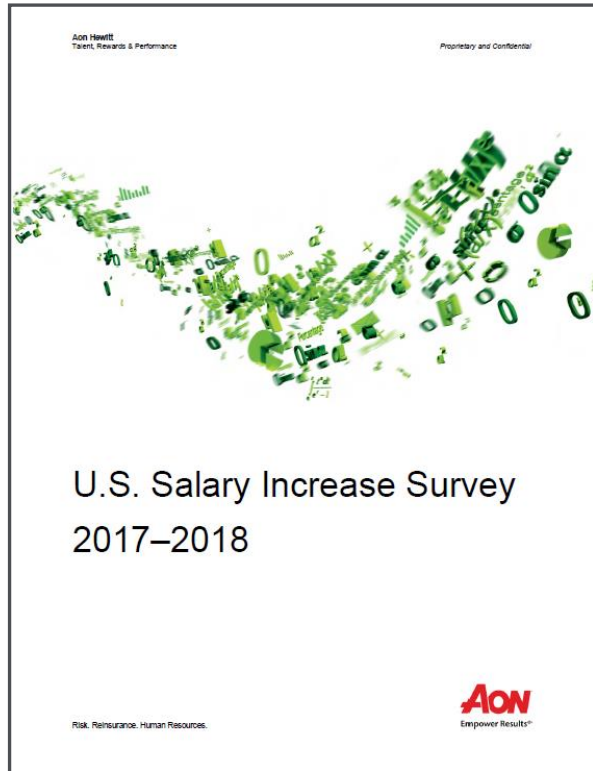
A Dramatic and Ongoing Shift in Pay Mix

Change in the Total Compensation Budgets and Spending for Salaried-Exempt Employees (1993–2017)



Source: Aon Survey—U.S. Salary Increases 2017/2018.

About Our Sources



SIS

- Aon U.S. Salary Increase Survey 2017 and 2018
 - 41st annual report
 - Fortune 1000 companies
 - 1,062 participants in 2017
 - Merit/overall salary increases
 - Salary structure movement
 - Variable compensation
 - Pay practices
 - Data effective as of June/July 2017

About Our Sources



VCM

- Broad-Based Plans
- Created in 1996
 - More than 240 cash variable pay plans
 - 38% of participants have more than 20,000 employees and only 5% of participants have less than 1,000 employees
 - 44% of participants have a revenue scope of up to \$3 billion and 56% of participants have revenues o \$3 billion or more
- Plan characteristic driven database
 - Prevalence
 - Effectiveness

Prevalence of Broad-Based Variable Pay

- Broad-based variable pay is a key component of companies' total compensation programs
- Use of broad-based variable pay is widespread and stable

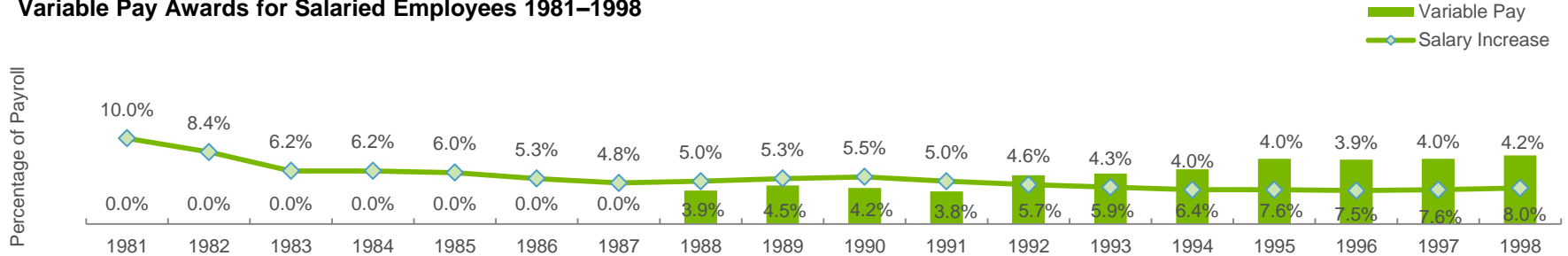
Organizations With at Least One Broad-Based Variable Pay Program



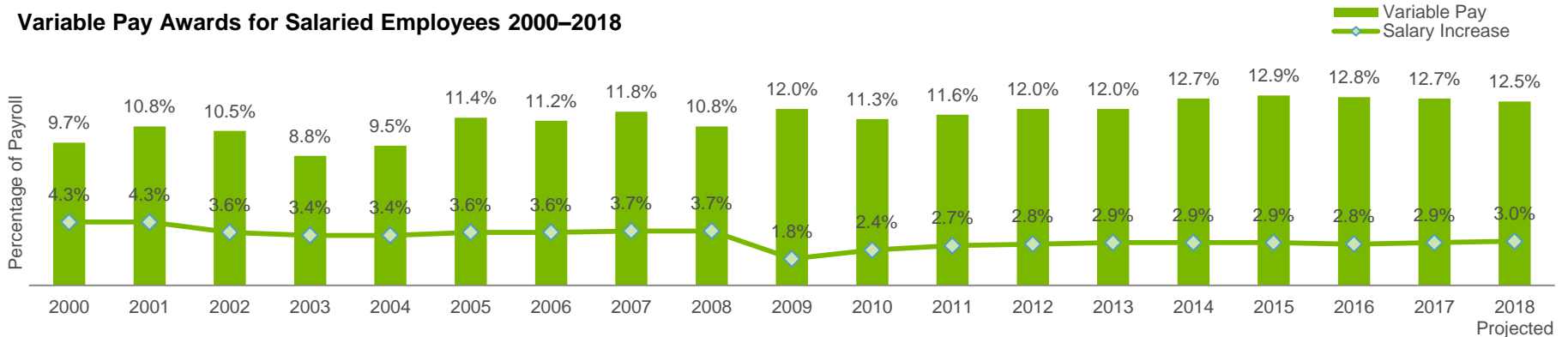
Source: Aon Survey—U.S. Salary Increases 1992–2017.

Dramatic Shift in Pay Mix

Variable Pay Awards for Salaried Employees 1981–1998



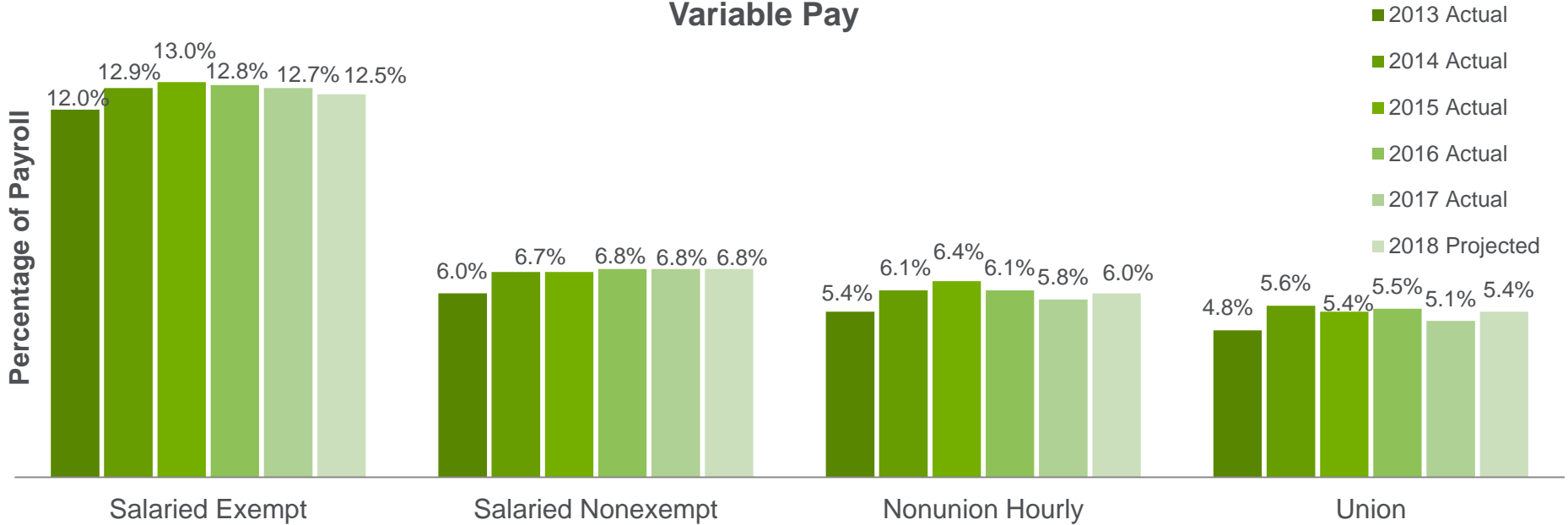
Variable Pay Awards for Salaried Employees 2000–2018



Source: Aon Survey—U.S. Salary Increases 1980–2018.

Aon U.S. 2017/2018 Salary Increase Survey— Variable Pay Budgets by Employee Group

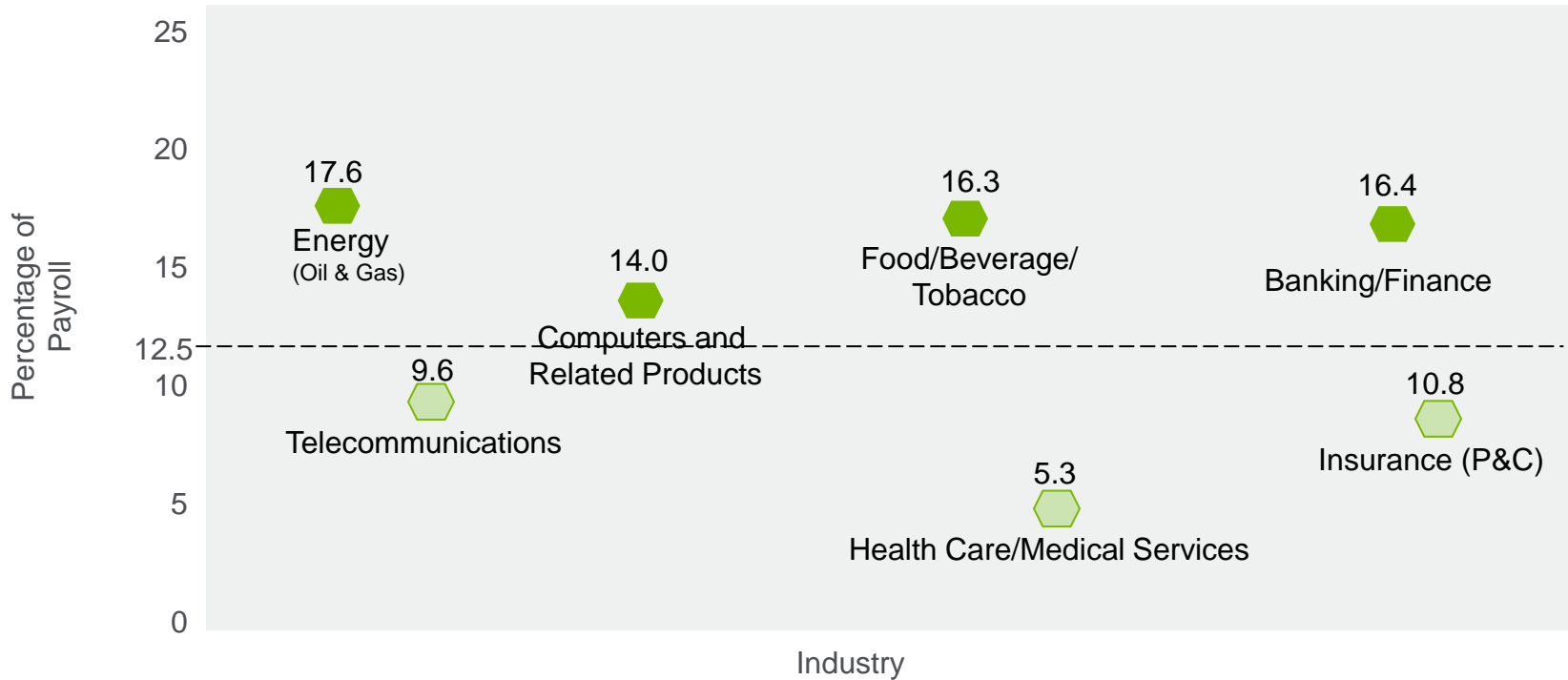
Variable Pay



Source: Aon Survey—U.S. Salary Increases 2017/2018.

Industry Variable Pay Outlook for 2018

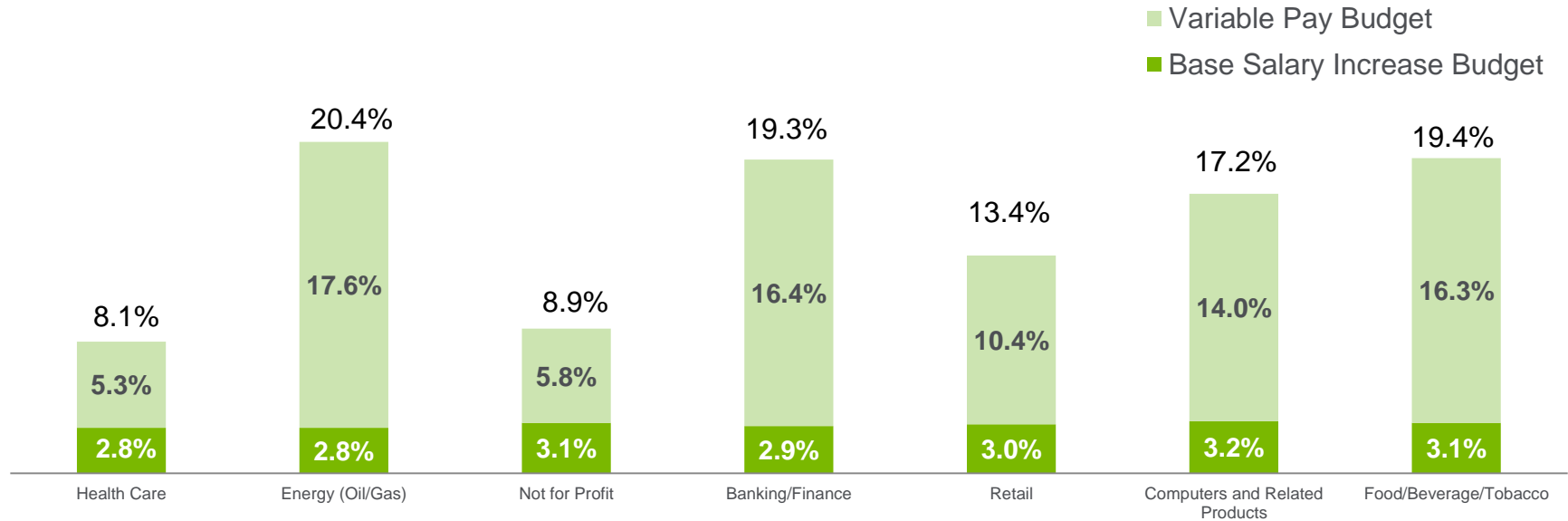
Salaried-Exempt Employees



Source: Aon Survey—U.S. Salary Increases 2017/2018.

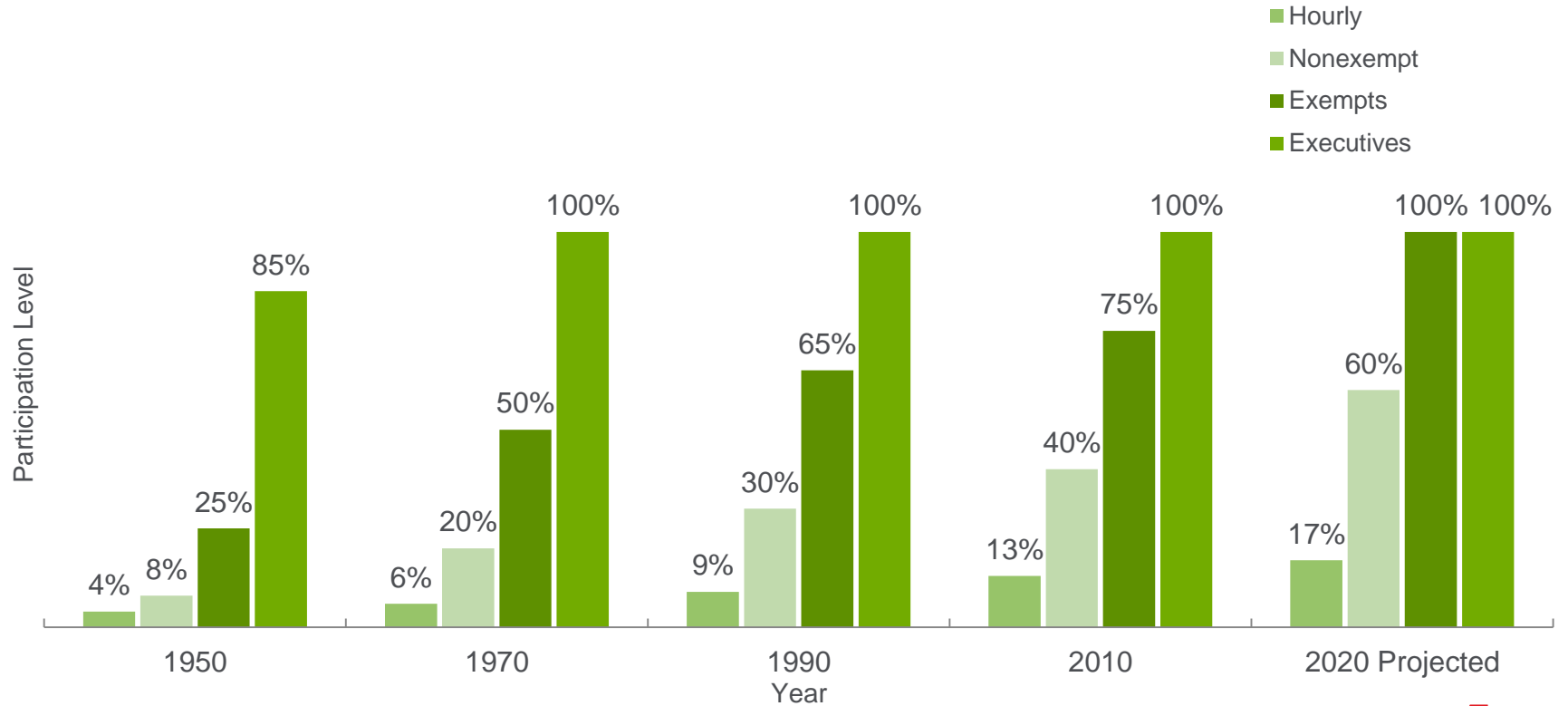
Industry Comparisons

2018 Total Cash Compensation Budgets



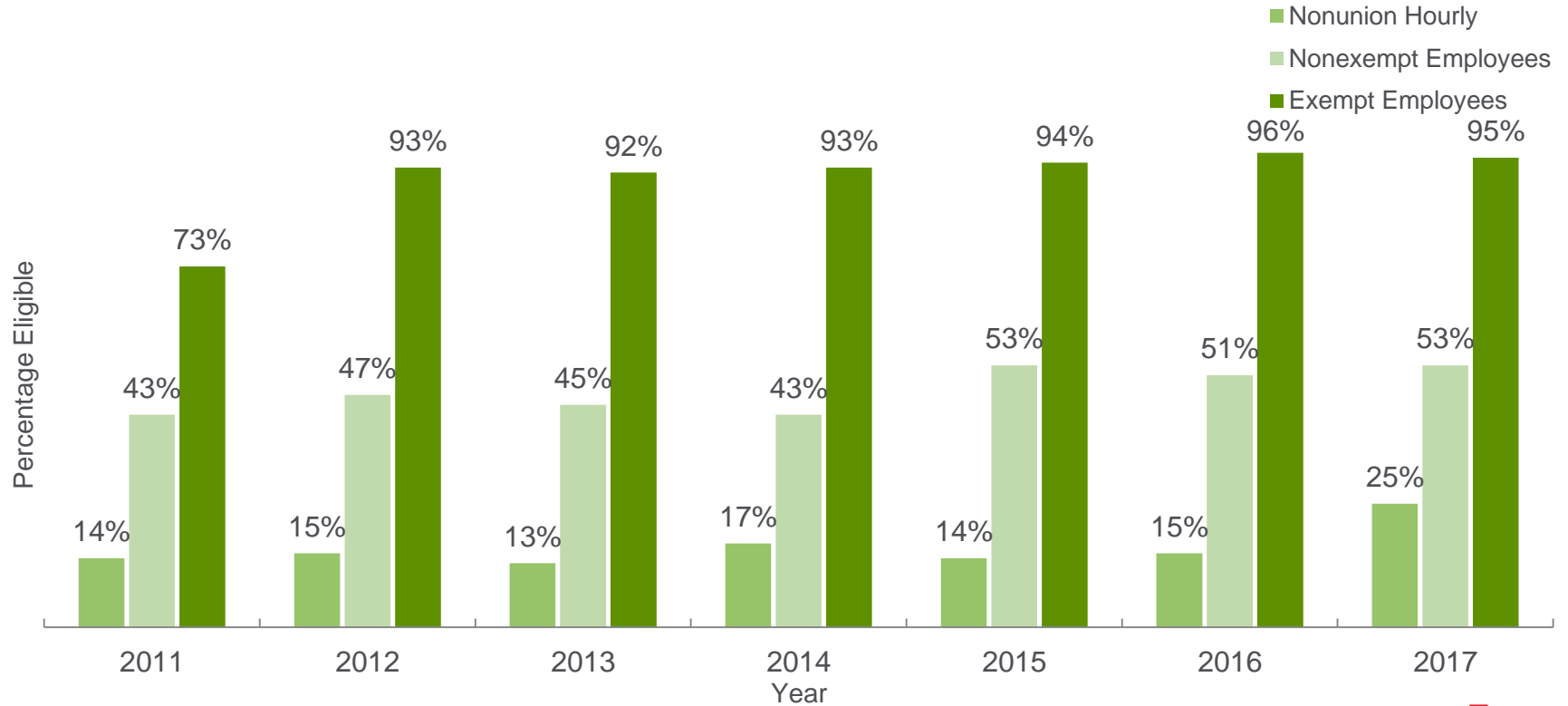
Source: Aon Survey—U.S. Salary Increases 2017/2018.

Historical and Projected Participation In Variable Pay



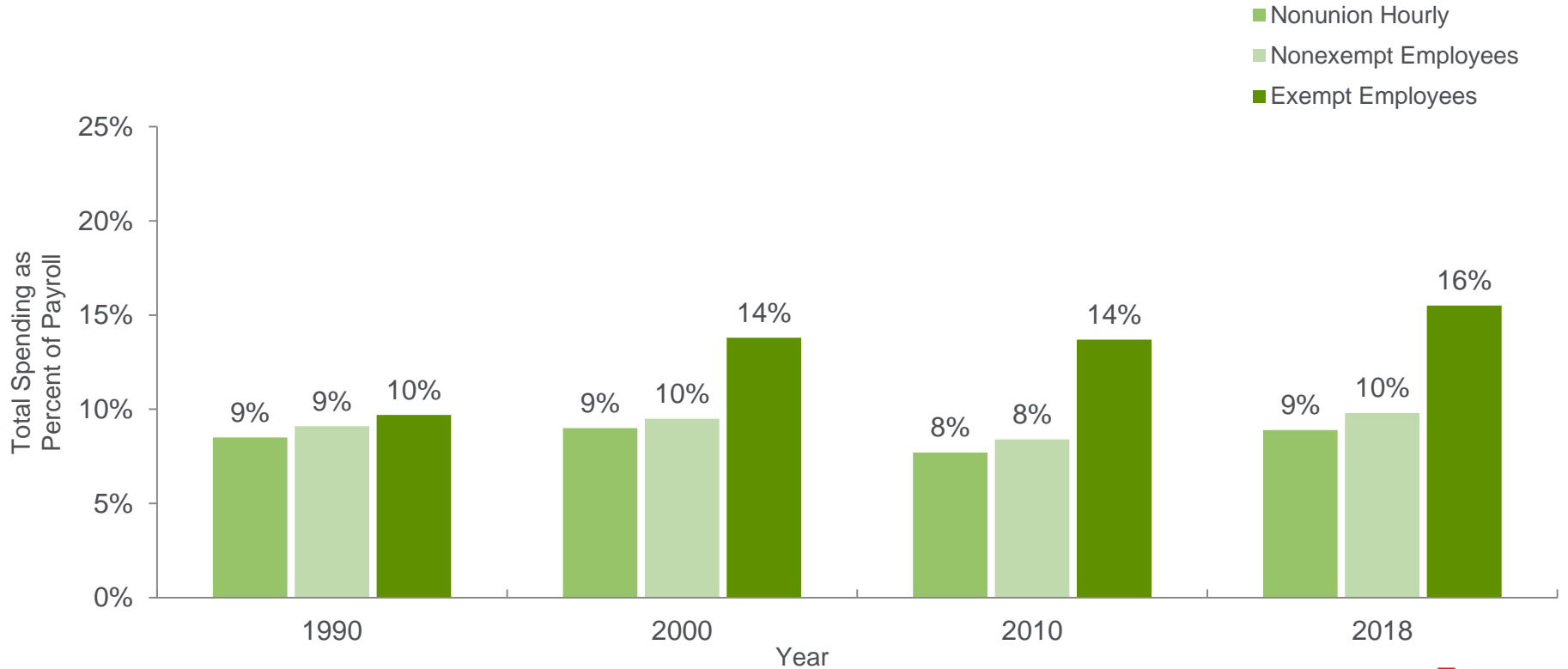
Source: Aon Historical Data.

Eligibility for Variable Pay



Source: Aon Survey—U.S. Variable Compensation Measurement™ (VCM™) 2017.

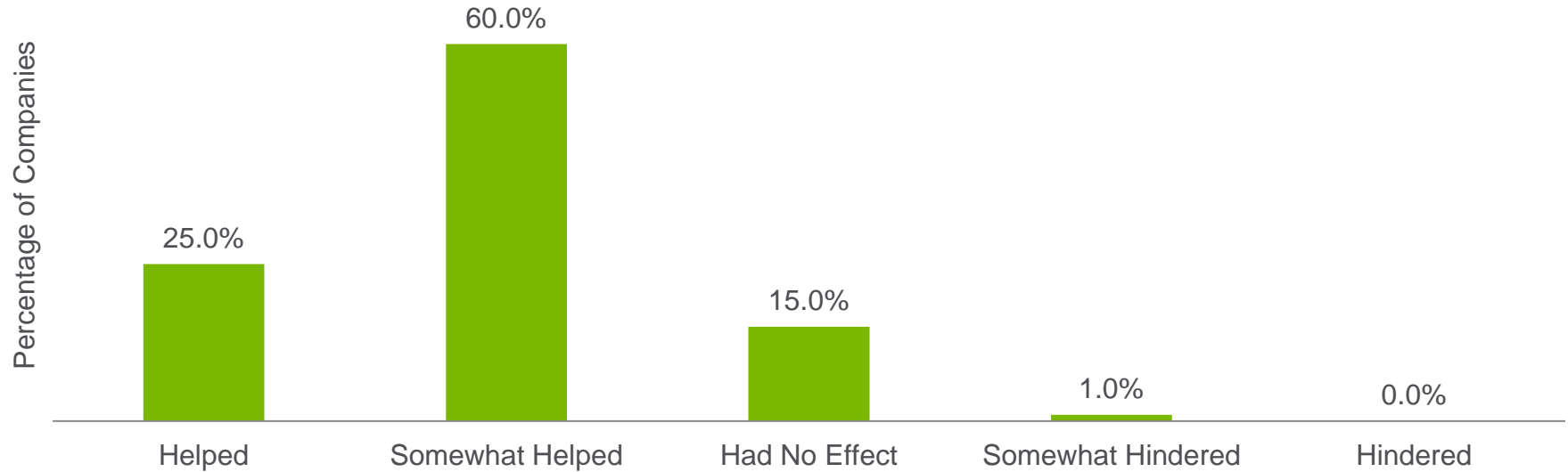
Growth in Total Compensation Spending



Source: Aon Survey—U.S. Salary Increases 1990–2018.

Impact of Variable Pay on Business Results

Impact on Business Results



Source: Aon Survey—U.S. Variable Compensation Measurement™ (VCM™) 2017.

Prevalence of Variable Compensation Plans By Type

	1996	2006	2017
Business Incentives —Plans with combined financial and/or operating measures or company, business unit, department, plant, and/or individual performance	55%	81%	81%
Cash Profit Sharing Plans —Plans that make equal payment (as a flat-dollar amount or percent of salary) to all or most employees based on organizational profitability	22%	15%	15%
Individual Performance Plans —Plans whose payouts are based solely on individual performance criteria; payout amount typically varies from one individual to another	17%	28%	18%
Gainsharing/Productivity Plans —Plans designed share a percent of cost savings of a group, unit, or organization; the gains are typically shared uniformly among all participants	16%	6%	3%
Team Awards —Plans that provide incentives to individuals on a project or work team	13%	8%	7%
Special Recognition Plans —Plans that are designed to recognize special individual or group achievements with small cash awards or merchandise	44%	53%	50%
Stock Option Plans —Plans under which stock options are granted to employees below the executive level	21%	34%	*
Patent Awards —Award given to an individual or group of employees involved in developing an idea, product, or invention that received a patent	*	*	14%

*Broad-based stock option plans were significantly reduced in prevalence and as a result were removed from the survey starting in 2010

Source: Aon Survey—U.S. VCM 1996–2017.

Impact of Pay For Performance

Academic research studies tell us...

- There is overwhelming evidence that incentives drive behavior and that the effect is substantial
- Organizations placing more emphasis on pay for individual performance perform better on average
- High individual performers are more likely to join and stay with organizations that more strongly pay for individual performance

Design With Strategic Intent



Strategic Impact By Plan Type

Plan Type	Incentive Effect	Sorting Effect	Bonus	Incentive	Behaviors	Results	Individual	Group
Business Incentives	Primary impact			Primary impact		Primary impact		
Cash Profit Sharing			Primary impact	Primary impact		Primary impact		Primary impact
Individual Performance	Primary impact			Primary impact	Primary impact		Primary impact	
Gainsharing				Primary impact		Primary impact		Primary impact
Team Awards				Primary impact				Primary impact

 = Primary impact



Evolution of Variable Pay

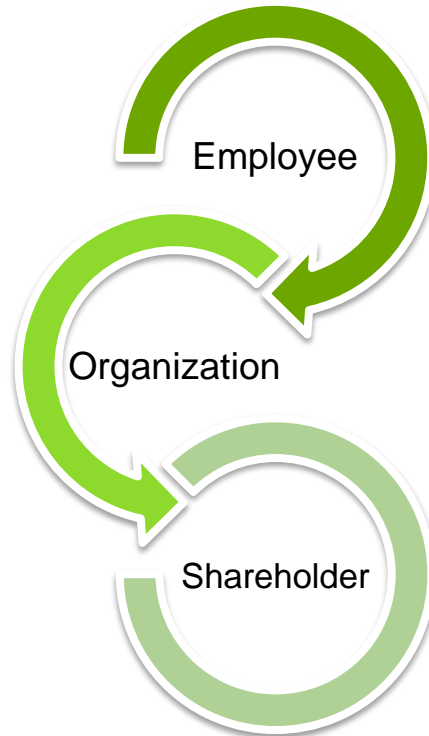
- Break away from a one-size-fits-all approach to broad-based variable pay that includes a common set of metrics and weights for all covered employees
 - More plans that have a small common enterprise-wide measurement component and varying measures and weights intended to better measure the performance of a business unit, function, or department
- Calibrated plans that are more tailored to the needs of the business will take the place of homogenous plans
- More “winners” and “losers” within the same organization based on different levels of achievement
- Greater use of qualitative measures
- Almost all broad-based variable pay plans will provide a way to increase or decrease bonus payouts based on individual performance achievement



Insuring the Effectiveness of Variable Pay Plans

Variable Pay Value Proposition

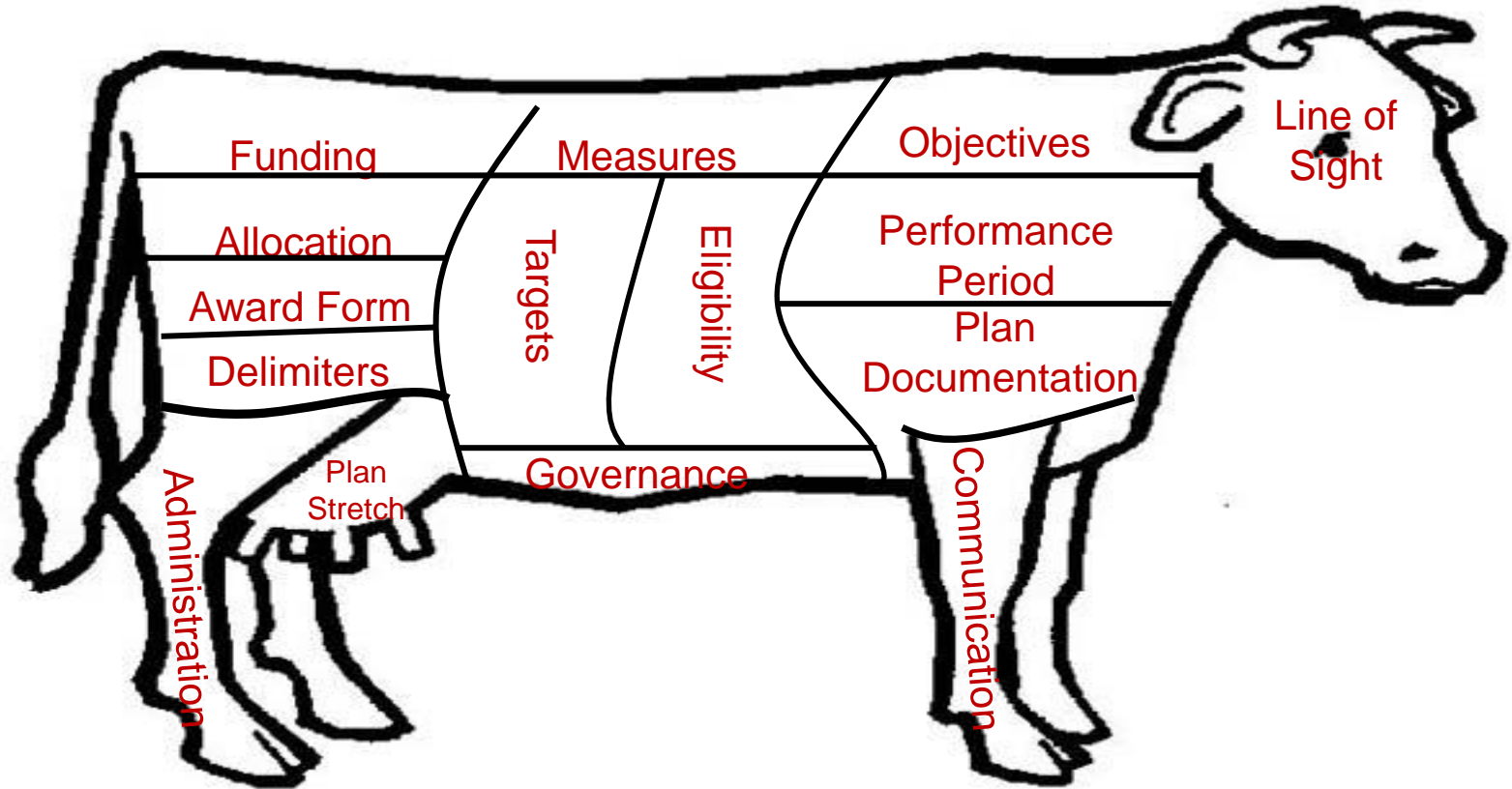
- Enhanced pay for performance
- Enhanced cost control—shift from fixed to variable expenses
- Focus employees' on desired behaviors
- Market competitiveness



- Additional earnings opportunity
- Greater control over rewards
- Clarification of expectations
- Market competitiveness

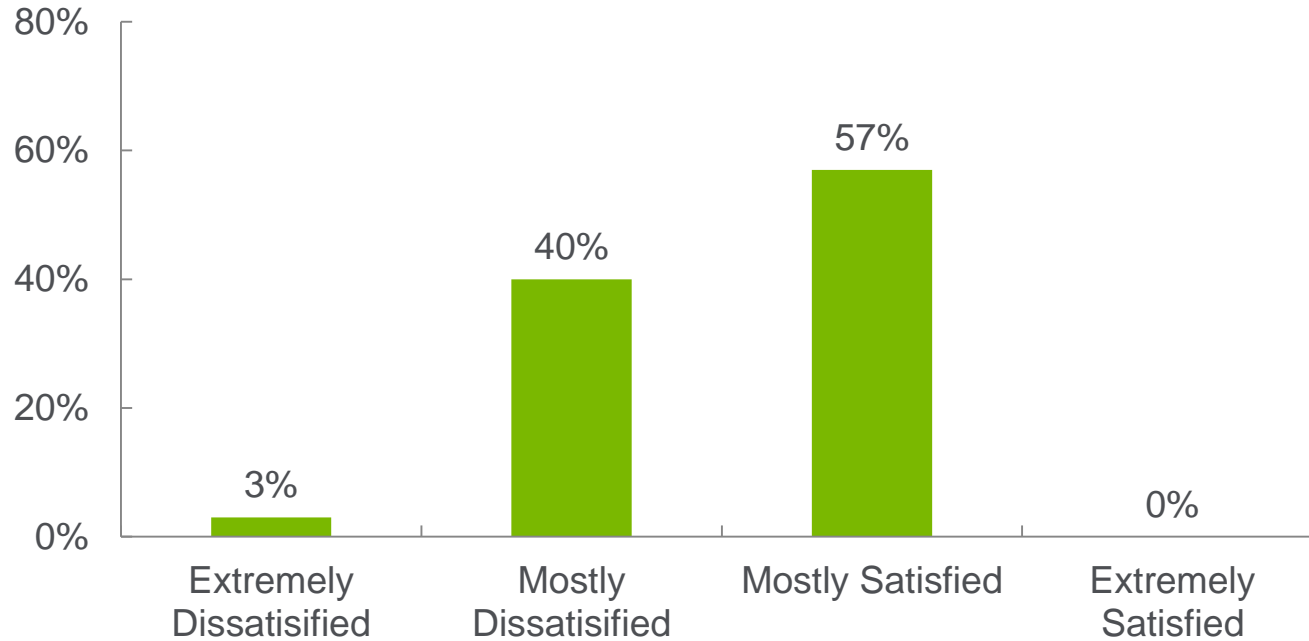
- Companies with lower fixed costs (e.g., with variable pay) are more attractive investments
- Employees aligned with shareholder interests

Anatomy of Variable Pay



Variable Compensation Management Pulse Survey

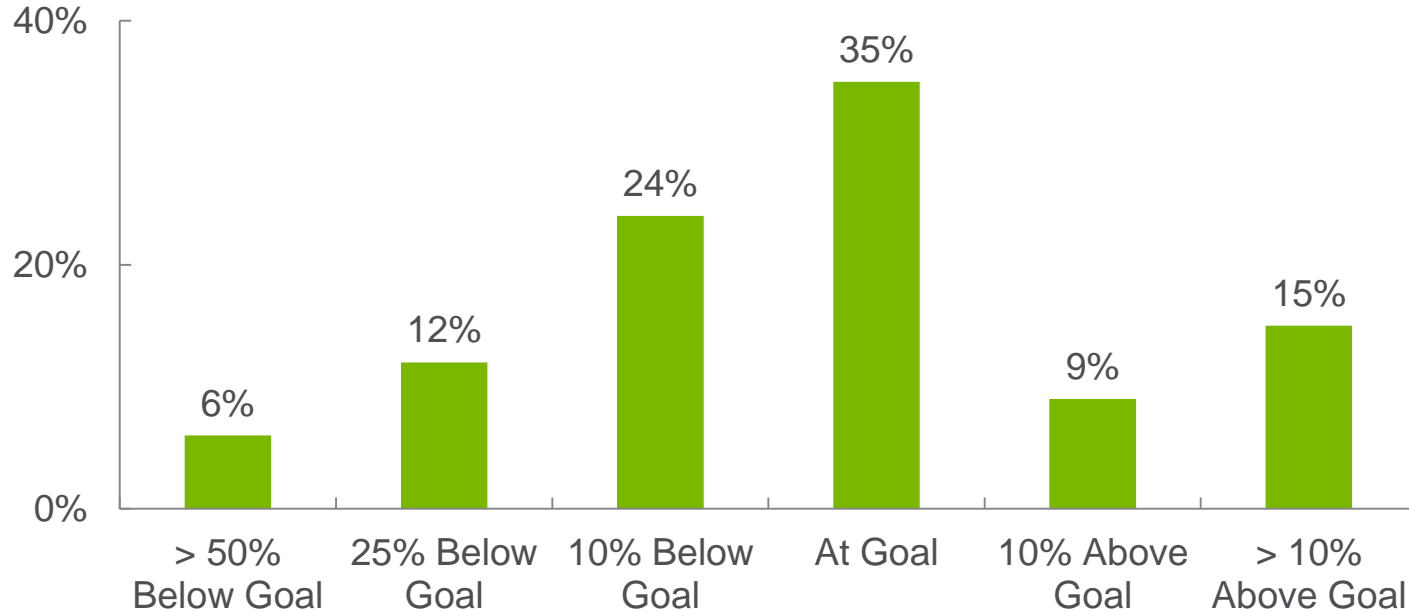
- How satisfied is your company with how well the current short-term incentive plan(s) performed?



Source: Aon Pulse Survey.

Variable Compensation Management Pulse Survey

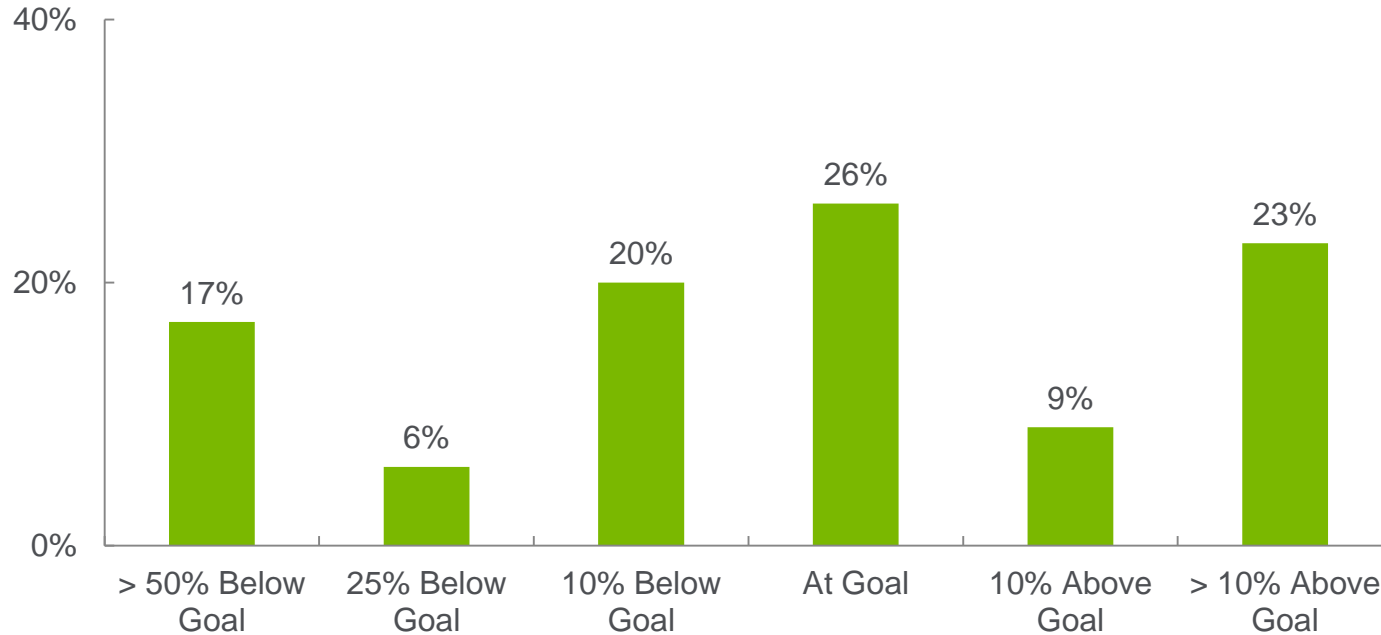
- How did your company perform against its goals?



Source: Aon Pulse Survey.

Variable Compensation Management Pulse Survey

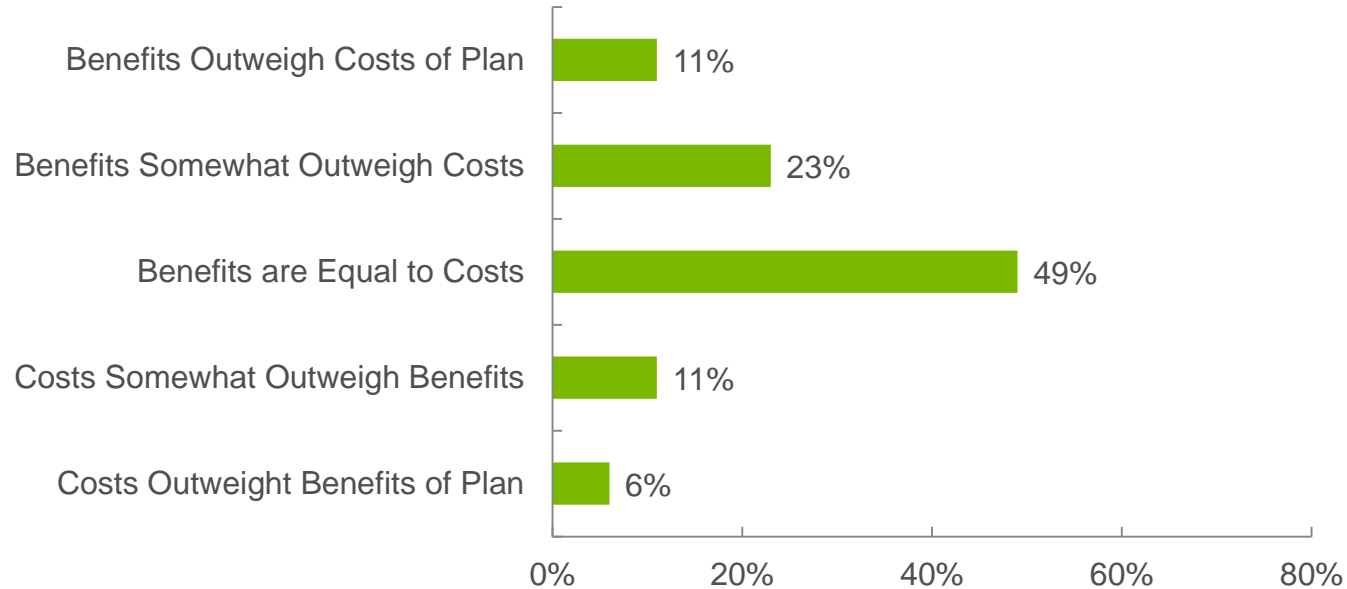
- What was your average award payout as a percent of payout target?



Source: Aon Pulse Survey.

Variable Compensation Management Pulse Survey

- How do you rate the relationship between the benefits of the plan and the costs?



Source: Aon Pulse Survey.

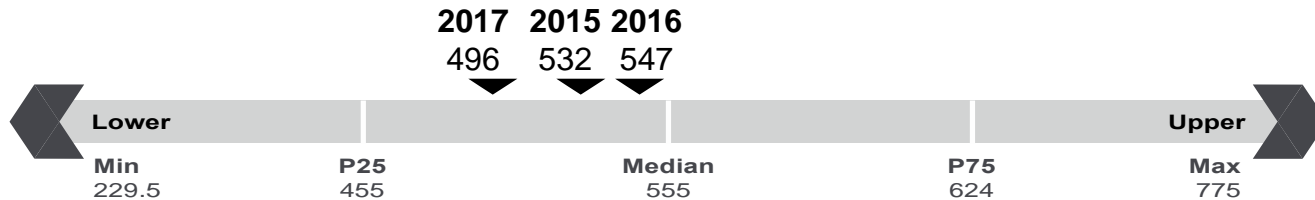
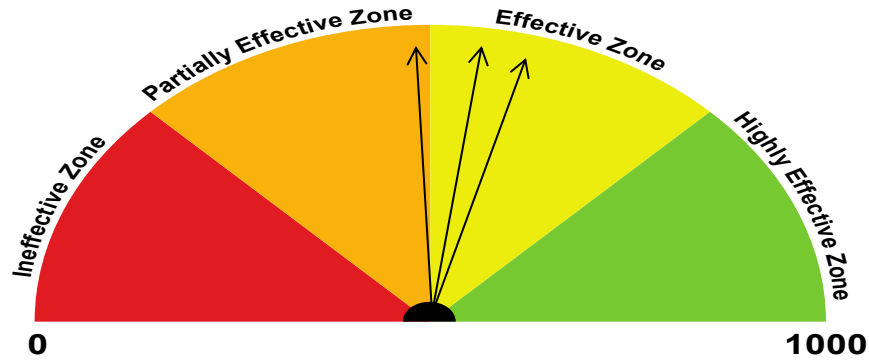
High-Level Definitions of Design Elements

Measuring Plan Effectiveness	Measures	<ul style="list-style-type: none"> Identifies factors (financial, nonfinancial, and individual) to determine performance Must be controllable and relevant to business
	Eligibility	<ul style="list-style-type: none"> Considers eligibility for both exempt and nonexempt employees Be as inclusive as possible
	Funding	<ul style="list-style-type: none"> Means of funding and spend on variable pay as a percent of key financial parameters Should be accrued, reflective of actual business results and sufficient
	Alignment	<ul style="list-style-type: none"> Determines the degree of inclusiveness across all employee groups Checks for common goals and clear linkages
	Line of Sight	<ul style="list-style-type: none"> Analyzes ability of the individual to impact the performance measures As much direct influence on outcomes as possible
	Plan Mechanics	<ul style="list-style-type: none"> Evaluates levers on which the plan operates Reflective of pay philosophy and culture, balanced between realistic, and challenging
	Targets	<ul style="list-style-type: none"> Assesses payout targets and degree of stretch built into target level of performance Competitive with appropriate pay at risk given line of sight and role
	Participation Requirements	<ul style="list-style-type: none"> Explores clauses associated with a variable pay plan Clauses under which participation and payouts can be denied
	Communication	<ul style="list-style-type: none"> Considers frequency, methods, and details of plan features that are communicated Understandable and communicated goals, timing, and updates
	Plan Administration	<ul style="list-style-type: none"> Time required to evaluate performance, payouts, and frequency of review Should include assessment of continuous improvement

Overall Effectiveness of VCM Database Plans

- Ineffective | 0-250
- Partially Effective | 251-500
- Effective | 501-750
- Highly Effective | 750-1000

2015 to 2017 Overall Effectiveness Scores



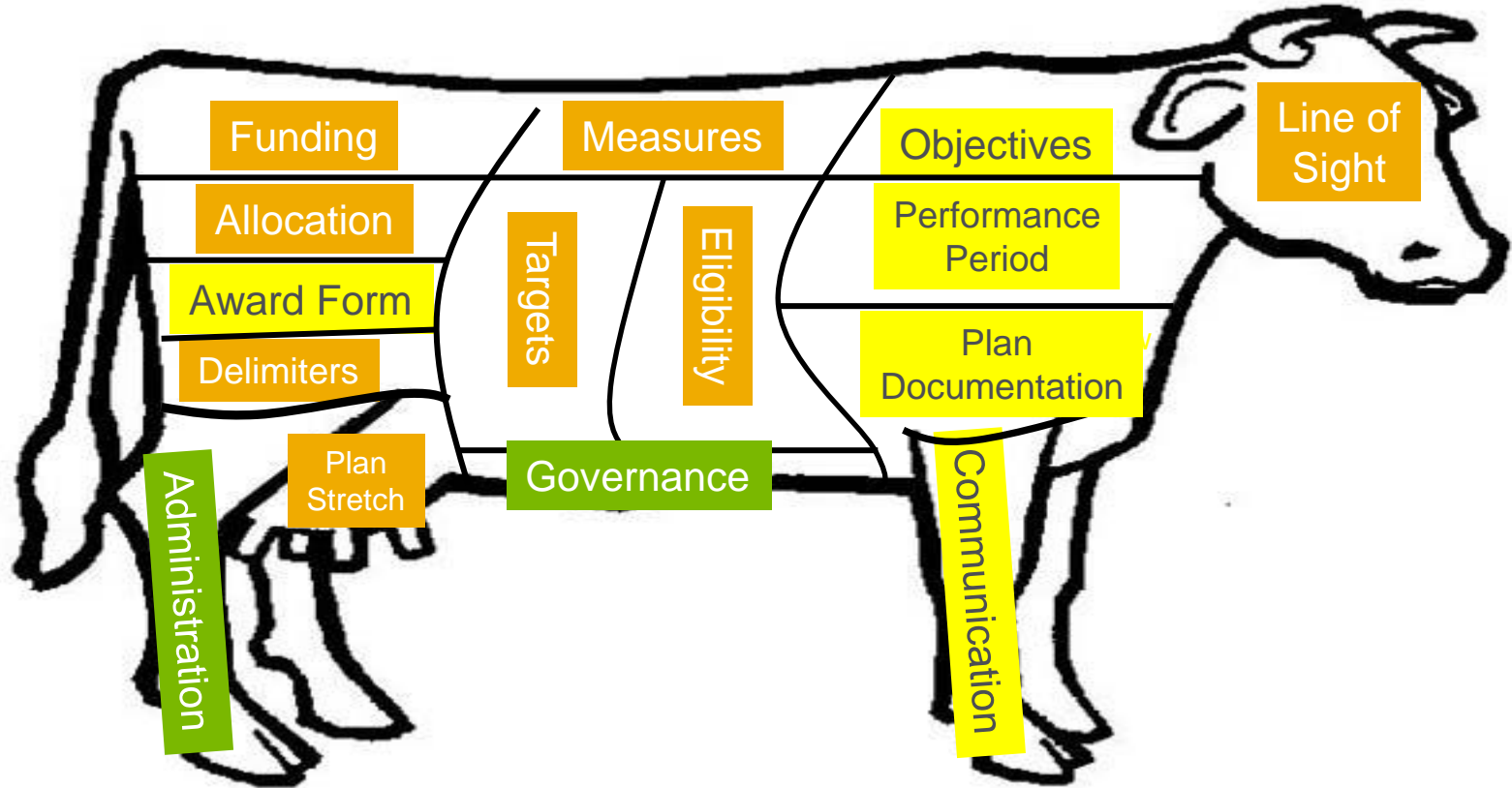
Average Database Score

Overall Effectiveness of the Plan by Component

Variable Pay Index™ Scorecard	2015	2016	2017	Maximum Score
Measures	69	76	69	150
Eligibility	59	68	55	100
Funding	51	53	44	100
Alignment	51	63	57	100
Line of Sight	49	45	38	100
Plan Mechanics	30	33	32	100
Targets	49	38	27	100
Participation Requirements	64	67	59	100
Communication	64	57	61	100
Plan Administration	45	47	46	50

Source: Aon Variable Pay Index™ (VPI™).

Opportunities For Insuring Effectiveness





Questions

For Further Information

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About Aon

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