FMI

COMPENSATION PLANNING

FOR ENGINEERING AND CONSTRUCTION FIRMS

2016 FMI Industry Survey

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Executive Summary

In today's economic climate, finding and retaining employees is becoming increasingly challenging for U.S. engineering and construction (E&C) firms. The E&C industry is now in its ninth consecutive year of growth, a phenomenon for companies familiar with an average cycle of seven years between downturns, but construction spending still falls short of pre-recession levels. Continued demand has strained the labor pool, particularly for specialized jobs. As a result, companies have sought innovative and unique approaches to hiring and retaining top talent. Naturally, employee compensation has become a key focus area for these companies.

FMI's 2016 compensation study was conducted with these objectives in mind:

- Identify key industry trends related to incentive compensation plans.
- Highlight prevalent practices and new or unusual employer strategies aimed at employee attraction, retention and motivation.
- Compare incentive practices provided by companies today with those reported by companies in the 2013 study.
- Recommend action plans to address challenges noted by companies in the study.

The study's results demonstrate that E&C employers clearly acknowledge the need for sound compensation practices. However, in many instances, coordinated strategic planning for pay plans is infrequent—

if it occurs at all. A strong preference for discretionary incentive compensation persists, despite the indication that many firms don't achieve desired outcomes through such pay methods. Discretionary plans remain popular, and—as noted in interviews—give owners a mechanism for risk management and ultimate control over the awards.

The key findings of the compensation study can be categorized within two areas:

1. Alignment of compensation plans with corporate strategies

- Almost 60% of respondents do not tie their compensation plans to corporate strategies.
- Almost 30% of respondents are spending less than 5% of their operating incomes on incentive compensation.
- Respondents with a strategic plan, compensation philosophy or budgeting process were more likely to consider their compensation plans extremely effective.

2. Effectiveness of compensation plans

- The shift toward incentive compensation plans continues, yet more than 50% of respondents still find their compensation plans either ineffective or just moderately effective.
- Almost 75% of survey respondents offer discretionary incentives, which appear to be distinctly less effective compared to structured incentives.
- About 25% of respondents with monthly progress reports regarding goals perceive their plans as extremely effective.
- Long-term compensation plans are viewed as an effective way to retain executives or high-potential employees.

According to the 2016 study and FMI's ongoing observations, the following considerations are imperative in designing and maintaining the most motivating, cost-prudent and results-oriented compensation plans:

1. **Get structured.** Use a structured incentive plan. Discretion often fails to incent performance.
2. **Be competitive.** Survey the applicable labor market to ensure incentive awards are in line with peer practices.
3. **Get strategic.** Align incentives with corporate strategy.
4. **Fund the plan.** Establish funding that can be budgeted and understood.
5. **Set goals.** Set goals that encourage and empower employees.
6. **Communicate.** Communicate current performance and potential outcomes regularly.
7. **Pay for performance.** Exceptional results should maximize rewards.

Key Findings

The findings of the 2016 incentive compensation study illustrate the ongoing challenge many E&C companies face in today's tightening labor market, where the use of incentive compensation is rising and additional bonus opportunities—beyond firm wide pool-based incentives—are emerging. Compounding the issue of effective talent management is the tenuous balancing act employers must play in weighing competitive compensation with the need for strong financial performance.

Two broad trends were observed among the study's participants:

1. **Compensation plans are not necessarily developed and evaluated with consideration for corporate goals and strategies, and vice versa.**
2. **Despite the growing prevalence of incentive compensation plans in recent years, they are frequently cited as ineffective, particularly among firms with discretionary incentive awards.**

Evidence of these trends is detailed below, along with suggested action items that address the issues frequently resulting from such practices.

Finding 1. Compensation plans are not necessarily developed and evaluated with consideration for corporate goals and strategies, and vice versa.

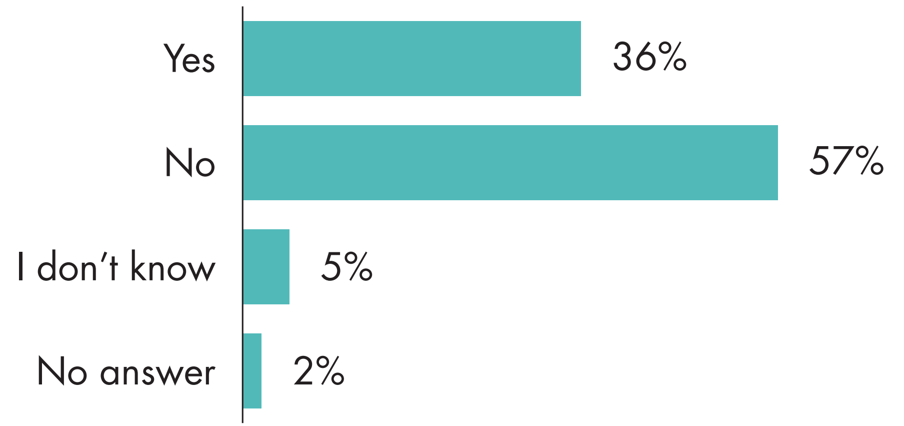
Although payroll consistently ranks among the highest costs in the corporate budget, many companies report that compensation plan design is not aligned with broader strategic goals. Without a complete picture of company objectives, many firms are left guessing what effective incentive compensation means (e.g., increased profitability, revenue growth, reduced costs, etc.).

a) Almost 60% of respondents do not tie their compensation plans to corporate strategies.

While 71% of the study's participants report having a strategic plan, the majority of respondents do not consciously link incentives to corporate strategy (Exhibit 1). Interestingly, 47% of those companies with a strategic plan are not tying their compensation plan to the strategic plan. As a result, there may be a significant missed opportunity to support and drive strategic initiatives through incentive plans that align employee behavior with the overarching company strategy.

If plans are not aligned with broader corporate goals, the basic existence of a strategic plan has no bearing on whether or not incentives promote favorable results. Misaligned incentive plans may instead foster confusion and frustration because incentives may be paid when critical, organizational objectives are not met. Conversely, few, if any, incentives may be awarded when the company attains key accomplishments successfully. As you can see in Exhibit 2, firms that tie compensation to a strategic plan consider those plans to be "extremely effective"—three times more often than companies that don't take this step.

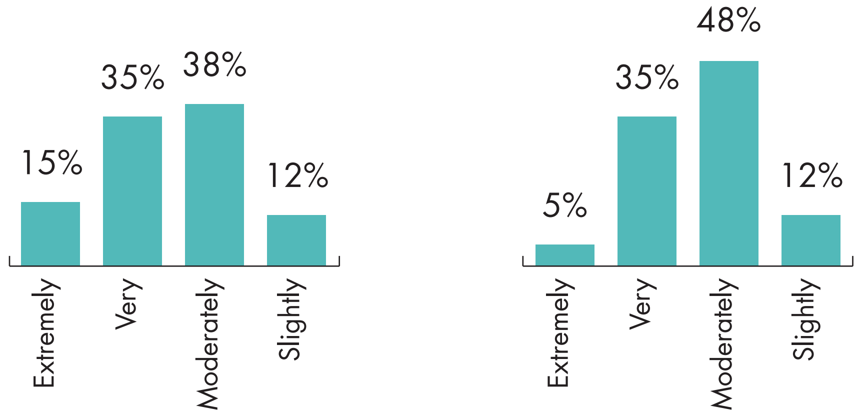
Exhibit 1: Is your company's short-term incentive tied to a strategic plan?



Source: 2016 FMI Compensation Study

When the key objective is to improve profitability, the correlation between the corporate strategic plan and the incentive plan is significantly more likely, as shown in Exhibit 3. Because we have found that many E&C companies target profitability as an essential measure for funding and paying out awards in accordance with their incentive plans, it's no surprise

Exhibit 2: Effectiveness of short-term incentive program in achieving objectives if compensation is/isn't tied to a strategic plan



Compensation is tied to a strategic plan

Compensation is not tied to a strategic plan

Source: 2016 FMI Compensation Study

that when profit growth is an element of the strategic plan, the alignment between corporate goals and incentive practices increases exponentially. Profitability metrics also tend to be easily calculated and can be interpreted quantitatively, with little risk of subjectivity. Consequently, these metrics can strengthen the correlation between defining success companywide as well as within the confines of compensation plans.

Profitability is frequently a critical element of determining incentive compensation, but it should rarely be the single determinant. Incentive plans tend to be most meaningful when there is transparent alignment between plan metrics and corporate strategies while maintaining "line of sight" for each employee. This helps everyone better understand how individual work contributions impact broad organizational goals.

The effectiveness ratings leave little question that companies need to do more work to ensure the connection with objectives. When there is little connection between plan objectives and the incentive award payouts, as is true for many discretionary bonus plans, a company may experience diminished or even negative returns on the investment in incentives and observe confusion or indifference among employees. These factors obviously weigh heavily against effective plan features.

Action Item/Takeaway:

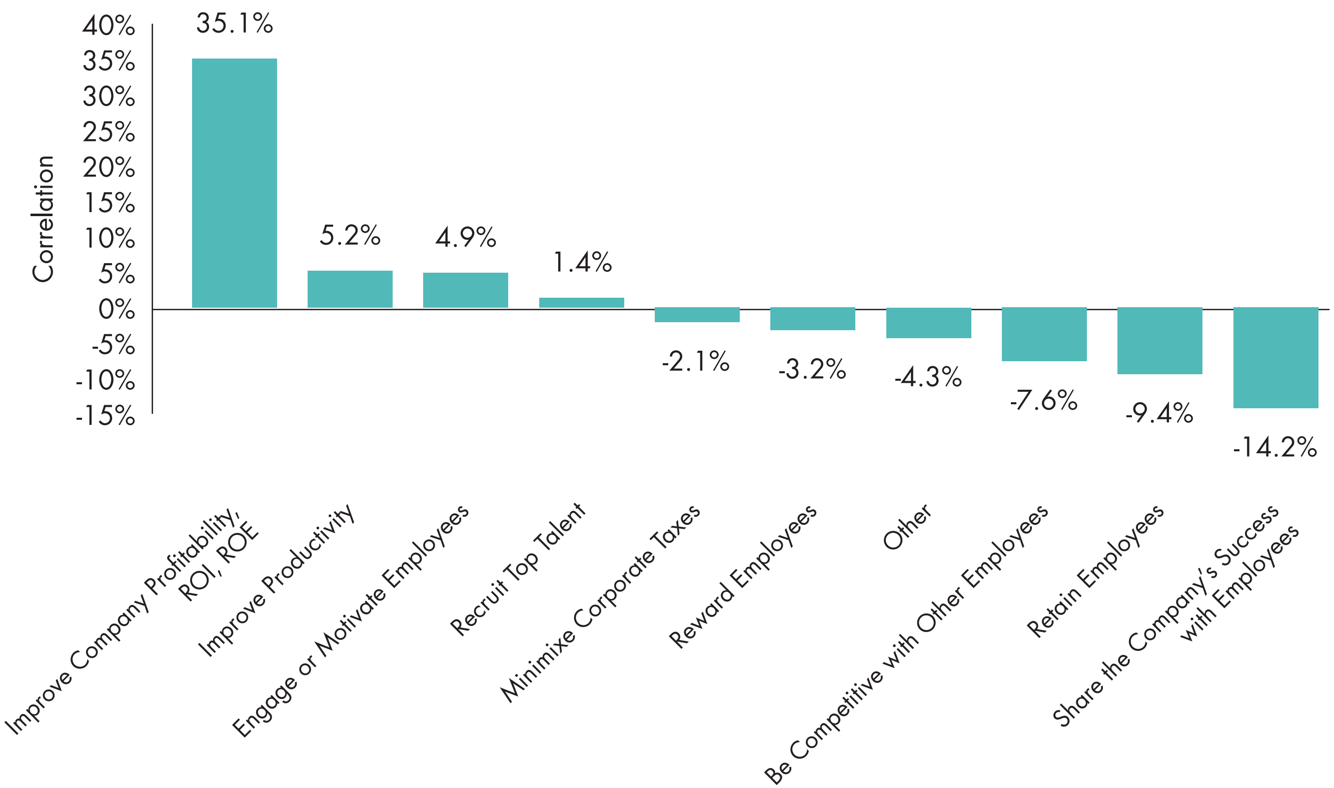
In FMI's consulting practice, we often see companies either tie all incentives to one measure or create a scorecard of too many measures to evaluate and reward performance. In the first case, it is all or nothing. In the second case, staff struggles to identify focus areas among many variables and cannot excel at all components. The best practice is to allocate a portion of the incentive award to the overall success of the company—to be determined based on the strategic organizational objectives—while the remaining portion depends on an individual employee's achievements. Larger contractors that have multiple divisions, business units or regions may add a third component to incentivize business unit or group performance.

b) Almost 30% of respondents are spending less than 5% of their operating income on incentive compensation.

Study results indicate that E&C firms are cautious about allocating operating income to incentive compensation: Nearly one-third of study participants (29%) report that less than 5% of the prior year's operating income was spent on incentive compensation (Exhibit 4).

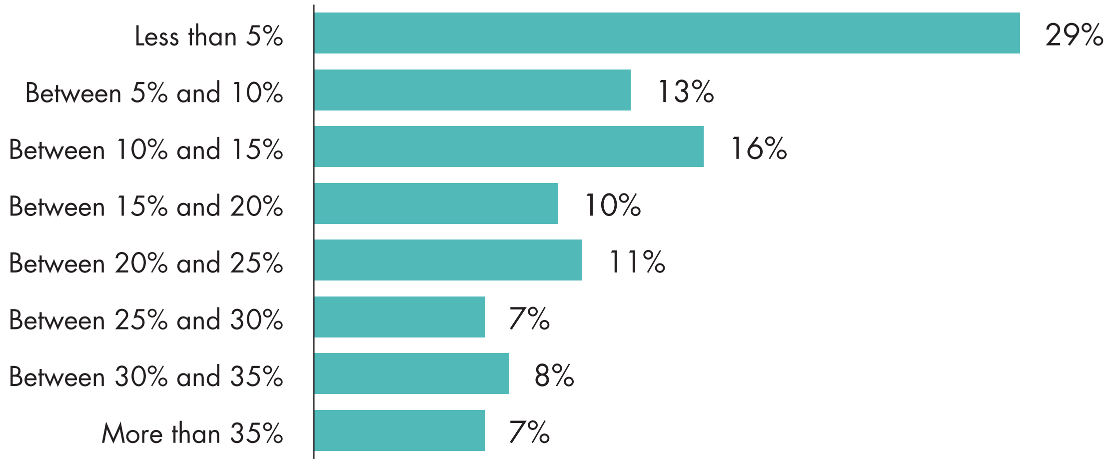
A conservative approach to incentives is tightening purse strings on incentive compensation payouts. E&C companies are not ignorant of the risks of market downturns, future management transitions and other variables that caution against draining profits as opposed to reinvestment and cash preservation. However, it is important to note that, in interviews conducted with select study participants, companies providing decreased incentive compensation relative to recent prior years composed a small minority.

Exhibit 3: Short-term incentive plan tied to strategic plan correlated to objectives of short-term incentive plan



Source: 2016 FMI Compensation Study

Exhibit 4: What percent of last year's operating income did you spend on incentive compensation?



Source: 2016 FMI Compensation Study

Action Item/Takeaway:

Companies must keep a pulse on compensation practices throughout the E&C industry, but incentive spending should be largely determined by organizational financial performance and individual incentive plan metrics. Each company is uniquely positioned to measure financial success, the contributions of staff in achieving corporate performance results, the expected shareholder returns and reinvestment, and so forth. Therefore, we anticipate fluctuations in how operating income is allocated to incentive compensation programs over time and across different E&C companies.

"Our bonus programs have been in place since 2007. Incentives have always been paid and are always higher (than the prior year)."

-Compensation Study Participant

c) Respondents using a strategic plan, compensation philosophy and budgeting process were more likely to consider their plans very effective.

While strategic planning is critical to the success of any organization, thinking through the link between strategy and compensation, creating a compensation philosophy, budgeting for incentives and understanding plan costs are all key elements in creating effective incentive compensation plans.

Exhibit 5 illustrates that organizations with a compensation philosophy consider their plans more than three times as likely to be extremely effective than otherwise. In addition, Exhibit 6 shows that respondents who cost model incentives consider their plans extremely effective more often. This is also true for respondents who budget for incentives.

Action Item/Takeaway:

An essential element in compensation design must include the strategic planning process and its implications for compensation planning. Companies can better forecast and plan for incentives when there is a documented process in place for determining the incentive pool. When profits are flush, this may be viewed as less important to overall firm performance. During leaner times, employers must reasonably predict potential incentive payouts within the broader budget and communicate probable payouts (if any) in a timely and effective manner.

Monitoring market trends is imperative when determining individual incentive award payments. Overspending on incentives can breed entitlement and diminished returns on investment, while under spending can lead to turnover.

Setting incentive award targets based on market-competitive rates for each position also enables a streamlined approach to budgeting for variable pay. The incentive plan budget may simply be the product of all plan-eligible employees' salaries and their respective target incentives (as a percent of salary). This bottom-up funding approach assists owners and executives in evaluating the cost of incentive plans against the expected return resulting from an incentivized workforce.

Finding 2. Despite the growing prevalence of incentive compensation plans in recent years, firms frequently cite such plans as lacking effectiveness, particularly those that award incentives on a discretionary basis.

Supporting feedback from study participants indicates that the industry is in a reactive situation. While there is a recognized need to address the war for talent, employers may lack clarity on the best approach for success.

a) The shift toward incentive compensation plans continues, yet more than 50% of respondents still find their compensation plans moderately effective or ineffective.

The 2016 study suggests large gains in the prevalence of incentive compensation among E&C companies from as recently as a few years ago. A full 97% of respondents indicated that incentive compensation is offered in comparison to 88% in 2013. Nonetheless, many employers continue to report that their incentive compensation plans lack effectiveness. As shown below, only 9% of organizations find their short-term incentive plans to be extremely effective (Exhibit 7).

Of interest to FMI is that, pursuant to interviews conducted with study participants, employers neither routinely nor comprehensively evaluate incentive compensation plans for effectiveness. Without a strong framework for assessing relevance and outcomes related to incentives, it may be difficult for employers to accurately measure how well an incentive plan promotes and achieves employee behaviors expected to drive company goals.

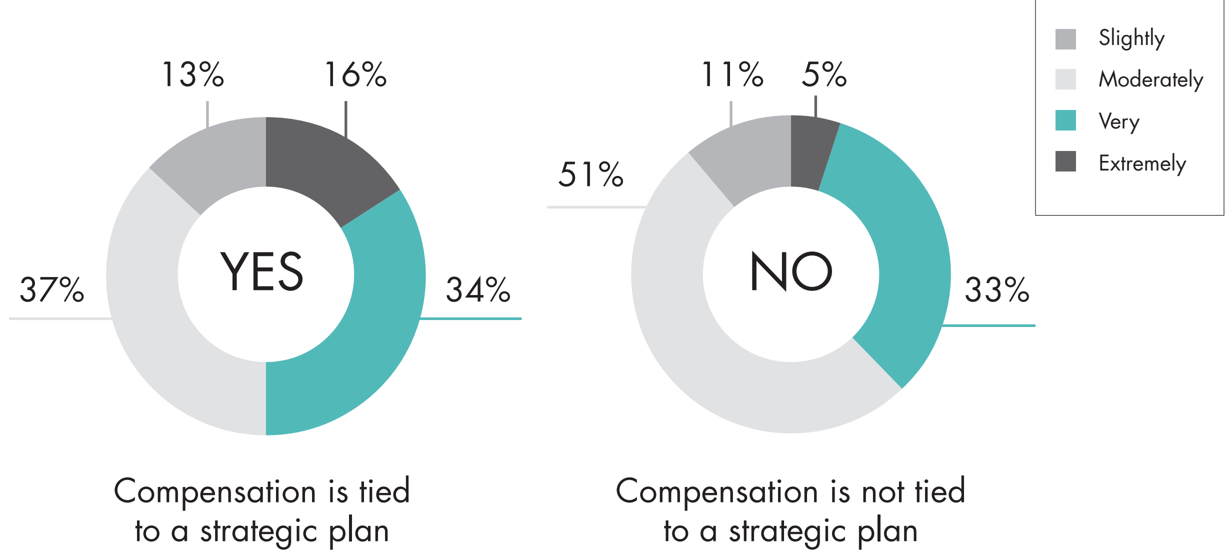
Action Item/Takeaway:

Incentive compensation can be an extremely effective tool in motivating employee behavior. Thus, we expect to see E&C firms continuing to establish and maintain incentive plans. A number of the study's respondents indicate that the primary reason for offering incentive compensation is to recognize employee contributions to corporate financial performance. "[The company wants] to reward good employees for profitability," said one study participant.

Companies also want to do a better job of attracting and retaining talented employees. As such, it is understandable that many companies assess the effectiveness of incentive plans based on the degree to which financial results improve and undesired job vacancies and turnover decline. At FMI, we encourage firms to monitor these trends on an ongoing basis. We also advise them to first confirm the distinct link among the plan objectives, performance measures and outcomes. For example, if profit growth is the goal and rationale for creating the plan, then profitability should also be a key determinant for funding the plan and awarding individual bonuses. That way, employees will be rewarded for achieving the corporate goal.

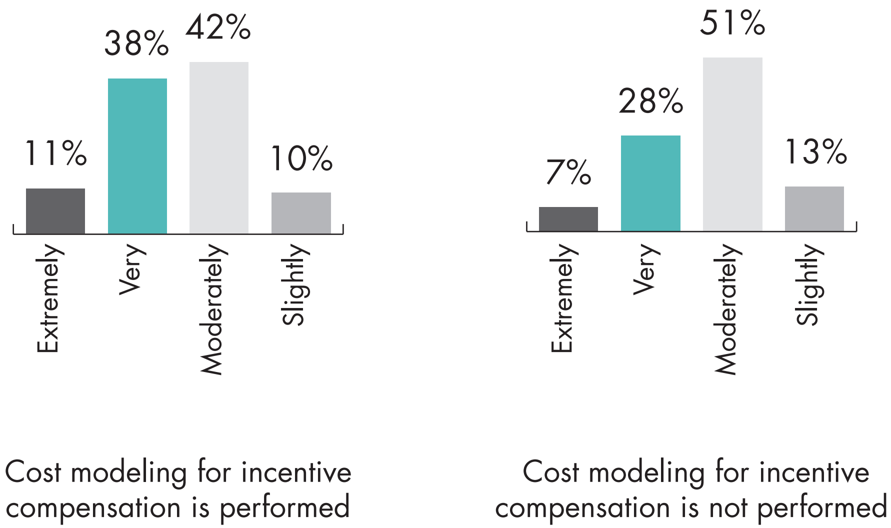
An incentive plan that lacks measures and produces results that are not rooted in the plan's original intent could become irrelevant for employees. Staff may appreciate the incentive payouts, but will either grow to expect them or view them with great skepticism. Unfortunately, this is often the case within well-meaning companies that provide incentives for the primary purpose of showing general appreciation for employees.

Exhibit 5: Effectiveness of short-term incentive program in achieving objectives if incentive pay is/isn't tied to an overarching compensation philosophy



Source: 2016 FMI Compensation Study

Exhibit 6: Effectiveness of short-term incentive program in achieving objectives if cost modeling for incentive compensation is/isn't performed



Source: 2016 FMI Compensation Study

b) Almost 75% of survey respondents offer discretionary incentives, which are distinctly less effective compared to structured incentives.

Although by no means unique to the E&C industry, there are two primary incentive plan approaches to which companies continue to apply significant discretion: plan funding and individual award payouts. As one participant stated, "The owners determine a percent of excess profits to fund bonuses—there is no formula—and individual awards are 100% discretionary."

Approximately 73% of our study participants provide a discretionary incentive plan to employees (Exhibit 8). This is almost at the same level as in 2013 where 75% of participants offered such a plan. There is inherent simplicity in this approach, which tends to be a key driver in establishing and maintaining discretionary incentive plans. A company's board or executives simply determine some portion of pretax profit be allocated toward employee incentives each year, unrestricted by any formula or predetermined measures.

In addition to following a flexible approach in determining the incentive compensation pool, individual award payouts are also frequently based on management subjectivity. E&C companies report that incentive amounts are set with consideration for anecdotal statements and observations of industry peers and competitors as well as feedback obtained during the recruitment of key positions. Some employers rely on compensation surveys produced by trade associations, local business/civic organizations as well as consulting and placement firms, but this more data-driven tactic is less common. In 2013, just 25% of respondents reported the use of surveys in determining appropriate incentive amounts.

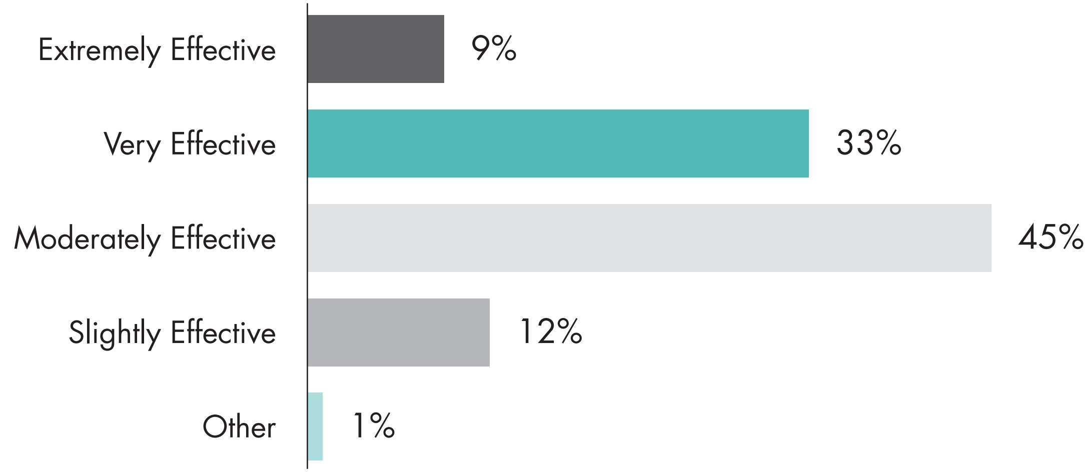
As one study participant confirmed, "I determine incentives based on historical payouts to employees and each individual's impact on the company."

As with any investment, employers should expect to realize positive financial and/or non-financial gains from an incentive compensation plan. A plan that does not assist in improving a company's position (in terms of financial performance, employee satisfaction and engagement, talent acquisition, etc.) requires immediate re-evaluation.

The percentage of study participants reporting that their plans are not particularly effective is quite remarkable. As revealed in Exhibit 9, just over half of those with an Annual Incentive Plan/Short Term Incentive Plan stated that the plan is extremely or very effective. Conversely, fewer than 2 out of 5 organizations offering discretionary bonuses, project bonuses or spot bonuses said their plans were similarly effective.

One study participant described the company's plan simply as "good judgment trumps metrics." While giving employees an opportunity to arbitrarily share in the profits of the company is a noble theme among E&C firms, an ineffective plan generally does not benefit owners or employees in the long run.

Exhibit 7: Level of Effectiveness of Short-Term Incentive Compensation Plan



Source: 2016 FMI Compensation Study

A new statistic in the 2016 study was the perception held by more than half of respondents that holiday pay supplements are highly effective (Exhibit 9). This practice is perhaps the most common way in which E&C firms show appreciation for employees in compensatory form. Firms that provide a holiday bonus typically have done so for many years, and though they acknowledge the staff entitlement that has ensued, they continue to support the practice as a means of conveying the value each employee brings to the organization.

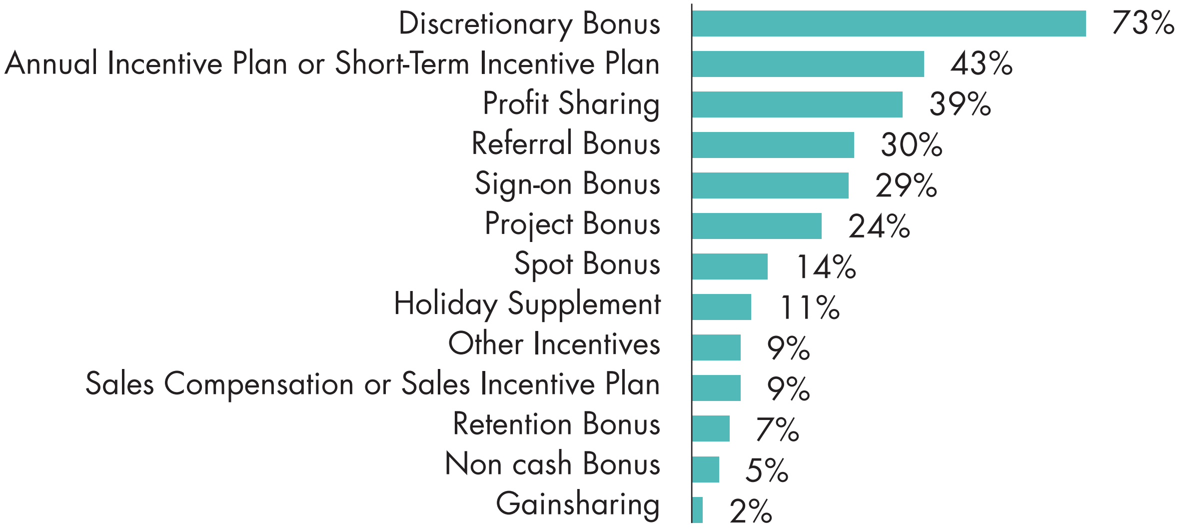
It's important to note that holiday pay supplements do little to improve talent management (i.e., attract, motivate and retain) or positively affect financial performance. However, employers that provide these supplements tend to view effectiveness in terms of employee morale and staff cohesion. An alternative approach to offering additional pay is to shift the timing of incentive payouts so that employees receive incentive awards in December, rather than during the following year.

Action Item/Takeaway:

Migration from discretionary incentive plans toward structured plans has been gradual, despite consistent reports that such plans have proven less effective. In supporting FMI clients, we have found that companies that adopt formula-driven incentive plans benefit from clear gains in employee understanding and comprehension. This, in turn, can lead to higher levels of productivity, efficiency and long-term engagement.

Employers must measure their incentive plans for effectiveness on a regular basis, with the expectation that changes will be made if plans are not achieving desired outcomes that correspond to stated objectives.

Exhibit 8: Type of Incentive Compensation Plans Company Currently Offers

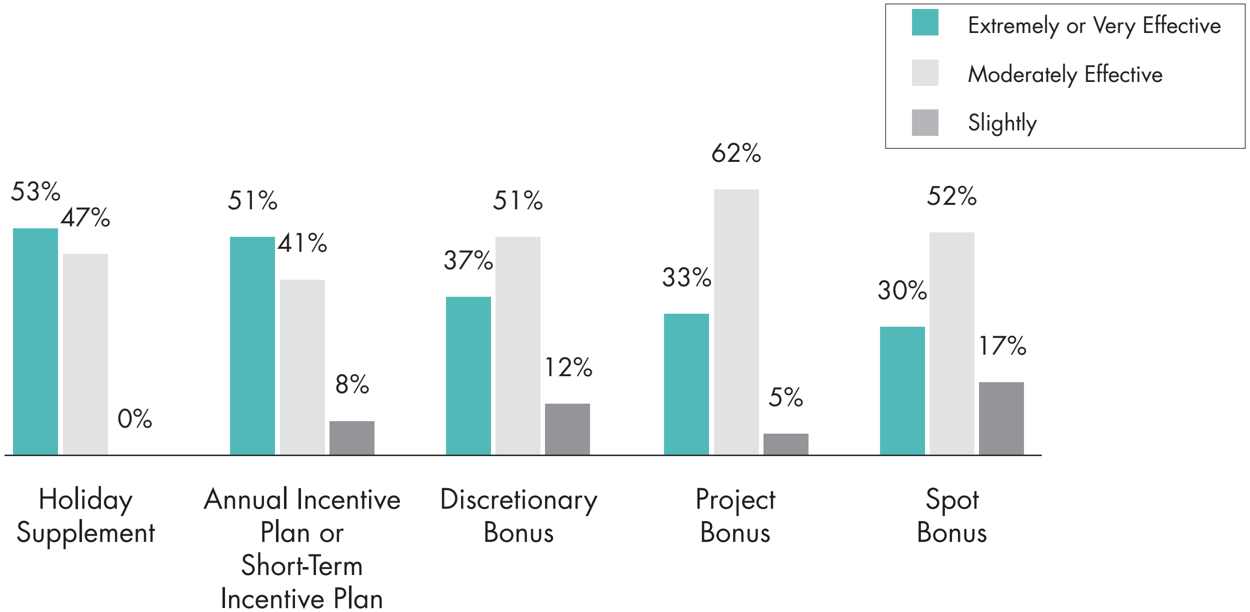


Source: 2016 FMI Compensation Study

c) The importance of communication and goals cannot be overstated. FMI's experience shows that the goals set at the individual level are critical to translating objectives into behavior that produces results.

Exhibit 10 illustrates the relationship between effectiveness and frequency of communication regarding progress toward goals. As shown, the more frequent the communication, the greater the number of respondents who reported their plans as extremely or very effective. Monthly communications were perceived as more than twice as effective than quarterly or less frequent progress reports.

Exhibit 9: Respondents Finding These Compensation Plans Effective



Source: 2016 FMI Compensation Study

Action Item/Takeaway:

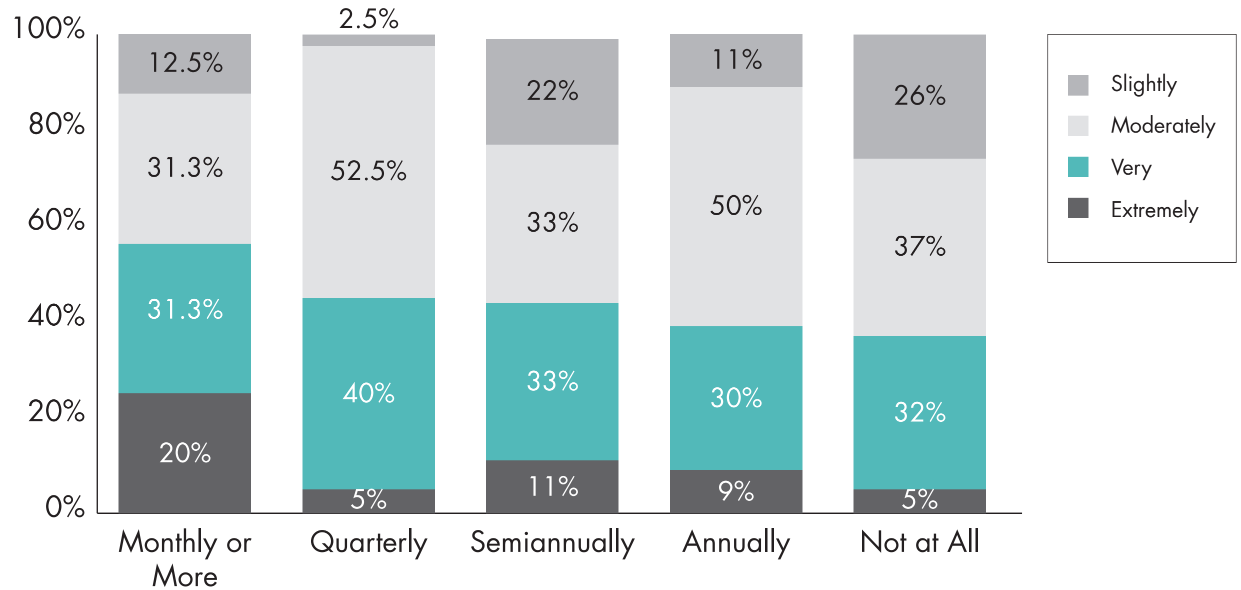
Effective communication starts with rolling out the plan clearly and explaining its objectives, mechanics and payout scenarios. At the individual level, each participant should receive a plan document that clearly explains the mechanics of the plan and what he or she needs to do to be successful. This includes clearly stated SMART (specific, measurable, achievable, relevant and timebound) goals tailored to the position and individual. But it does not stop there: Throughout the year, plan participants should receive feedback regarding progress toward their goals on a monthly basis (if possible) or each quarter (at a minimum). For participants who are falling short, managers should coach and mentor their reports on what kinds of activities and behaviors will increase their progress toward goals. Goals and associated communication are key elements in reinforcing corporate objectives and ensuring plan effectiveness.

d) Long-term compensation plans are viewed as an effective way to retain executives or high-potential employees.

Much of the 2016 study focused on short-term incentive compensation plans; that is, plans designed to pay out awards annually (or more frequently). However, we have observed growth in the creation of long-term incentive plans among E&C firms, particularly as we see management transition mirroring the shift in the nation's workforce demographics. In this study, 44% of respondents indicated using some form of long-term compensation (Exhibit 11). This percentage offering long-term incentives is noteworthy in that it exceeds the prevalence reported in the 2013 FMI Survey (30%) and may indicate a trend toward offering more long-term incentives. Cash is by far the preferred vehicle. This is not surprising, given the closely held nature of many E&C firms.

As the baby-boomer generation exits the labor market, many firms' ongoing operations hinge on the ability to identify, develop and retain the next generation of leaders. This last element in sound succession planning—retention of future executives—is overwhelmingly cited as the primary objective of a long-term incentive

Exhibit 10: Incentive Plan Effectiveness and Frequency of Communication



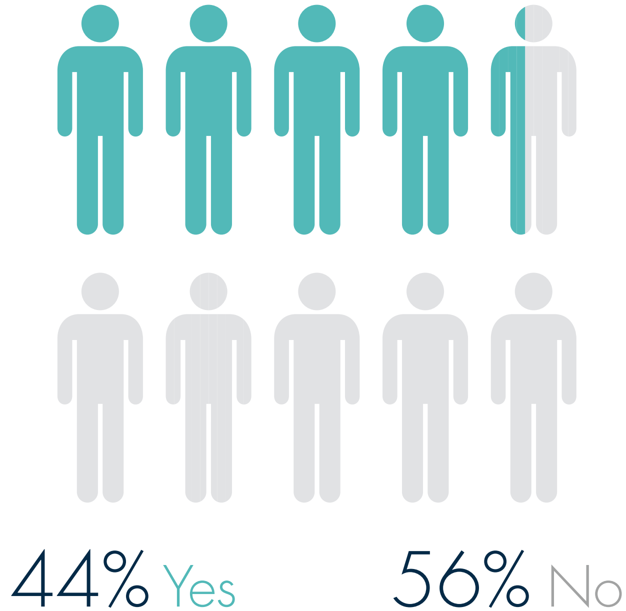
Source: 2016 FMI Compensation Study

plan (Exhibit 12).

The prevailing emphasis on retention as the driver of long-term incentive plans should enable firms to efficiently evaluate the performance of the plan. Plainly stated, a plan is working if participants remain with the company. Accordingly, firms must assess competitive long-term incentive plan features to ensure that their plan awards are in line with prevalent practices. Features that should be routinely analyzed include:

Vesting Period: This describes the number of years from the date of the award that an employee must remain with the firm in order to be eligible to receive the incentive payout. As displayed in Exhibit 13, respondents most often select vesting periods in the three- to five-year range with five years being most often selected. The length of the vesting period must balance organizational needs to retain executives with the participants' desire to realize a payout in a reasonable length of time. It appears that in this study, five years struck the correct balance. Note that only a few firms selected very long vesting periods (i.e., those greater than 10 years or lasting until retirement).

Exhibit 11: Does your company have a long-term compensation plan?



Source: 2016 FMI Compensation Study

Plan Type: Long-term incentives can take many forms, ranging from cash to synthetic equity to actual shares in the company. As stated above, cash was by far the preferred vehicle.

Payout Timing: Once the long-term incentive award vests, there is a predetermined schedule for paying out the award, which may allow for additional deferrals. Payment time should motivate employees to stay. A short period may be insufficient to keep employees on a long-term basis, while a long period may set unrealistic retention expectations. The most common vesting period for long-term incentive awards is three to five years, with the payout of the award occurring soon after vesting.

Plan Measures: Long-term incentive plans are often focused on rewarding executives for accomplishments that correspond to the owners' goals. It is very reasonable, then, to establish performance-based awards that are tied to financial results or key corporate qualitative initiatives. Long-term measures typically do not duplicate short-term measures but balance them, such as balancing a short-term measure like net profit with a long-term measure like enterprise value. The potential gains through long-term incentive plan awards—in the form of wealth generation or ownership—often serve as an effective recruitment tool in addition to enhancing retention of existing employees.

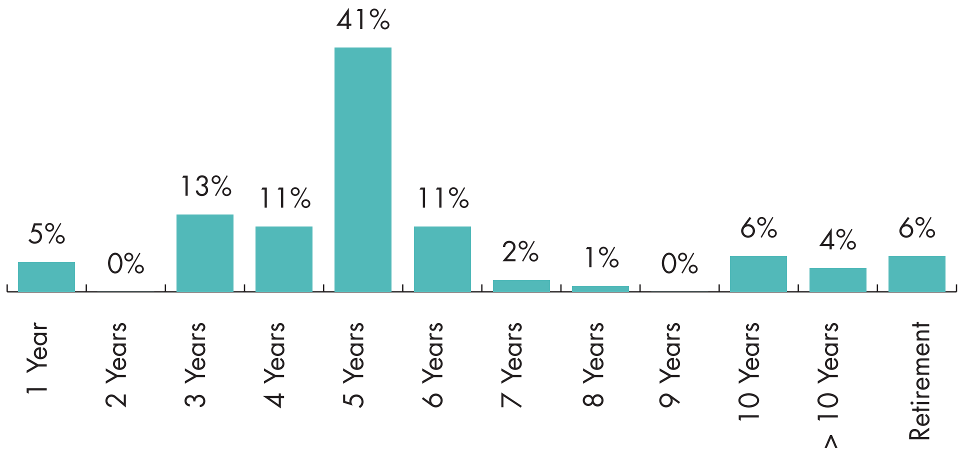
Exhibit 12: What result do you expect from your long-term incentive plan?

Source: 2016 FMI Compensation Study

Action Item/Takeaway:

Given the generational transition underway in the U.S. workforce, companies should evaluate their short- and long-term executive talent needs. Long-term incentive plans can be an effective tool to ensuring coverage in mission-critical areas and retaining key successors. A firm's corporate structure, ownership allocation, executive team composition, strategic plans and financial performance should heavily influence the terms of such a plan.

Exhibit 13: Length of the vesting period



Source: 2016 FMI Compensation Study

Recommendations

The findings of the 2016 incentive compensation study suggest that many E&C companies continue to face largely the same challenges observed in recent years within the current dynamic business environment. Pressure to attract, motivate and retain essential high-performing talent is high, yet many companies struggle to provide compensation that supports their talent management goals.

Based on the study's results and our own experiences in providing compensation consulting services to companies throughout the industry, we propose the following broad recommendations:

1) Get structured. Discretion often fails to incent performance. The study's respondents reveal that discretionary bonuses are not perceived to be as effective as structured short-term incentive plans. The ability to move beyond a "trust me" plan is critical for employee understanding and motivation and for communicating the value of total compensation to prospective employees. Companies with structured plans report that their programs are not only fairer to plan participants, but also easier to administer and budget. Furthermore, structured plans are clearer to the employer and employees if the incentives are awarded based on data that the firm tracks and makes available to its employees. According to the survey, firms offering nondiscretionary structured plans are more likely to indicate that their incentive programs are effective in comparison to those that offer only discretionary incentives or a combination of discretionary and structured incentives.

2) Be competitive. Survey the applicable labor market to ensure incentive awards align with peer practices. Companies that set arbitrary payouts are quite obviously at risk of missing the mark regarding employee pay expectations and potential incentive opportunities among competitors. Those that only consider the company's historical practices are similarly prone to paying too little or too much. To improve both employee attraction and retention, companies should follow an incentive benchmark strategy, using market data to ensure incentives are competitive and meaningful for the participants and within reasonable and prudent corporate budget guidelines.

3) Get strategic. Align incentives with strategy. Incentive compensation should never be provided in a vacuum without consideration for the broader goals and initiatives of the company. Employees are generally most incented to perform when they feel their work is in step with "the big picture."

4) Fund the plan. Establish funding that can be budgeted and understood. Many privately held companies intentionally remain silent on detailed financial results and on specific funding formulas used for incentive compensation. At a minimum, we have found it beneficial for companies to provide an overview of corporate performance to manage expectations. An overt majority of American employees indicate a desire for regular, ongoing feedback. As such, establishing a funding framework that can be communicated among employees on a regular basis should lead to improvements in engagement and understanding among staff.

5) Set goals. Set goals that encourage and empower employees. Regardless of whether performance measures and goals are set at the corporate, business unit/team or individual level, they should be set in the often-cited "SMART" format:

- Specific
- Measurable
- Achievable
- Relevant
- Timely

6) Communicate. Regularly convey current performance and potential outcomes. As suggested previously, and explicitly supported by the study's findings, regular communication is critical to managing employee expectations, behaviors and resulting performance.

7) Pay for performance. Exceptional results should maximize rewards. The study's interviewees stated a clear desire for employees to share in their companies' successes. Therefore, an exceptional year, as determined by established performance measures, should result in a significant incentive award for contributing employees.

Looking Ahead

In today's engineering & construction environment, where skilled labor and expertise are critical, an effective incentive compensation plan can mean the difference between employee engagement and desertion, directly affecting business success or failure. With the steady growth of the industry since 2009 and improvement of general economic conditions, opportunities available to engineering and construction workers are expanding. **Therefore, the importance of developing structured compensation plans composed of measurable criteria and centered on employee performance and development will only increase in the coming years.**

Though engineering and construction companies have long embraced the pay-for-performance culture, our new research findings show that the typical compensation model across the industry remains predominantly discretionary. In fact, surprisingly little has changed since we last surveyed the industry in 2013. **The results of our study indicate that engineering and construction companies may soon find they are at a tipping point and may seek to establish incentive plan features identified as more effective or lose ground relative to competitors in the war for talent.** The potential benefits of a properly structured incentive plan are great: Companies frequently cite an improved return on investment as well as long-term employee engagement and company performance.

For incentives to be highly effective, clarity and communication are imperative. Employees should know in advance what their bonus opportunities are and what it takes to achieve those targets. This is particularly important for attracting and retaining both specialized professionals and younger workers who often have a broad range of job opportunities to choose from and are looking for a compelling value proposition when selecting a new employer.

As one survey participant commented, "What we're trying to do is to increase the transparency of the process. With regular communication to employees about company financials, the impact on the bonus pool, the target bonus percentages that employees have for their role—all of that is designed to keep people up-to-date as to what's going on and give them some idea of what the rewards are going to be if everybody is successful."

Industry leaders are taking charge to increase company performance through well-defined incentive awards that are linked to corporate strategic goals. The alignment of employee performance with corporate strategy helps ensure that staff behaviors are consistent with the company's overall mission and vision. A well-defined incentive compensation plan also differentiates top performers and high potentials from other employees in a tangible manner, which supports long-term retention efforts for these critical staff members.

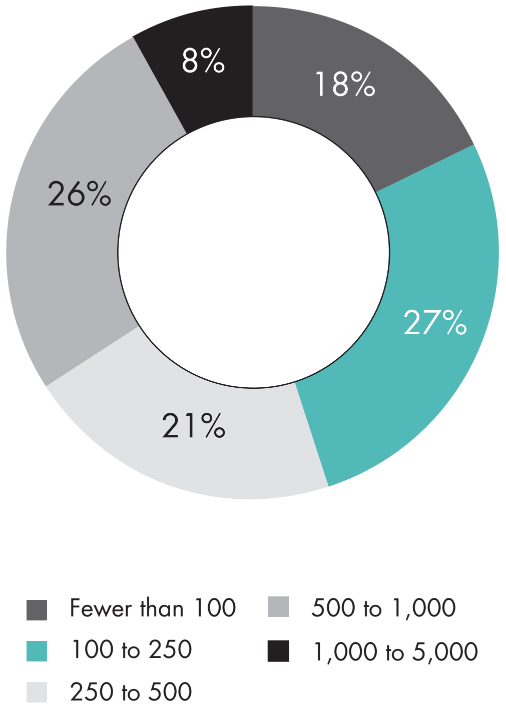
With the right combination of clear direction, quality feedback, ongoing communication and monetary rewards, employees become more engaged and satisfied with their jobs as a result of sound incentive programs. This, in turn, helps to create a win-win situation where employees are inspired by management valuing their efforts, which leads to higher employee engagement and performance over time. Without purposeful linkage to the company's strategy, incentive plans could promote behaviors that are irrelevant or, worse, contradictory to the stated strategy.

Much as companies compete with one another to sell products and services, they also go head-to-head for the best and most talented employees. A competitive pay strategy that corresponds to broader corporate objectives serves as the very cornerstone of any good human capital investment approach.

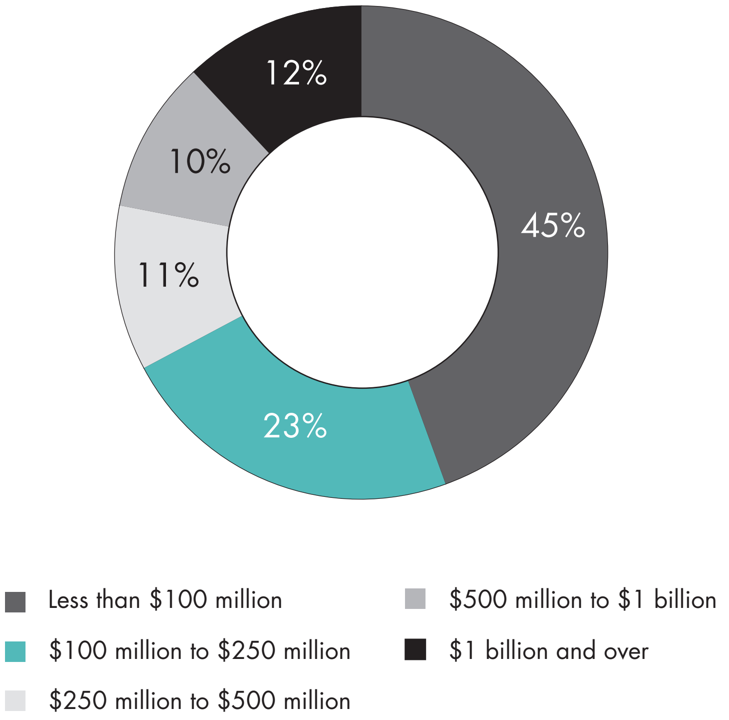
As you've read throughout this report, continuing with a "business as usual" approach is no longer good enough. With firms recognizing that their compensation plans lack effectiveness, there's no doubt that high-performing employees (both current and prospective) recognize this too and may ultimately seek greener pastures. Your company's best response is to get strategic about your compensation programs, thereby bolstering the likelihood of great corporate success both for the near future and the long term.

Survey Methodology

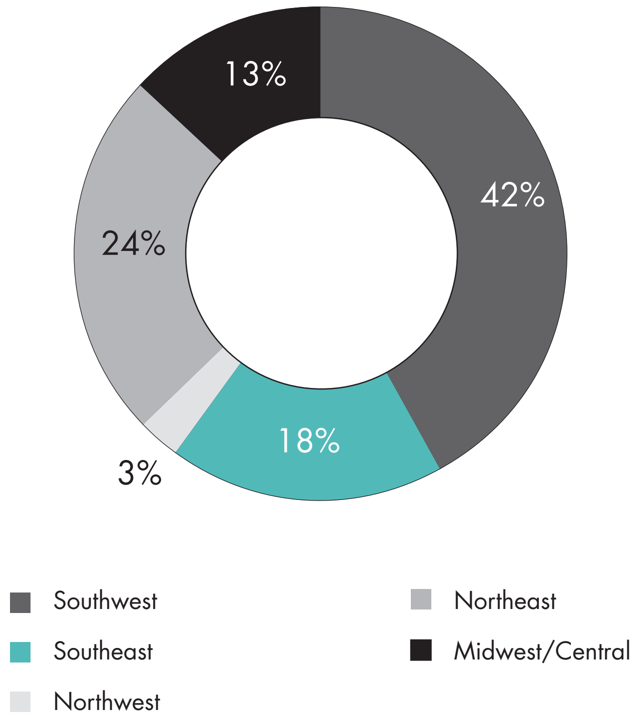
Firm Size in Terms of Total Number of Employees



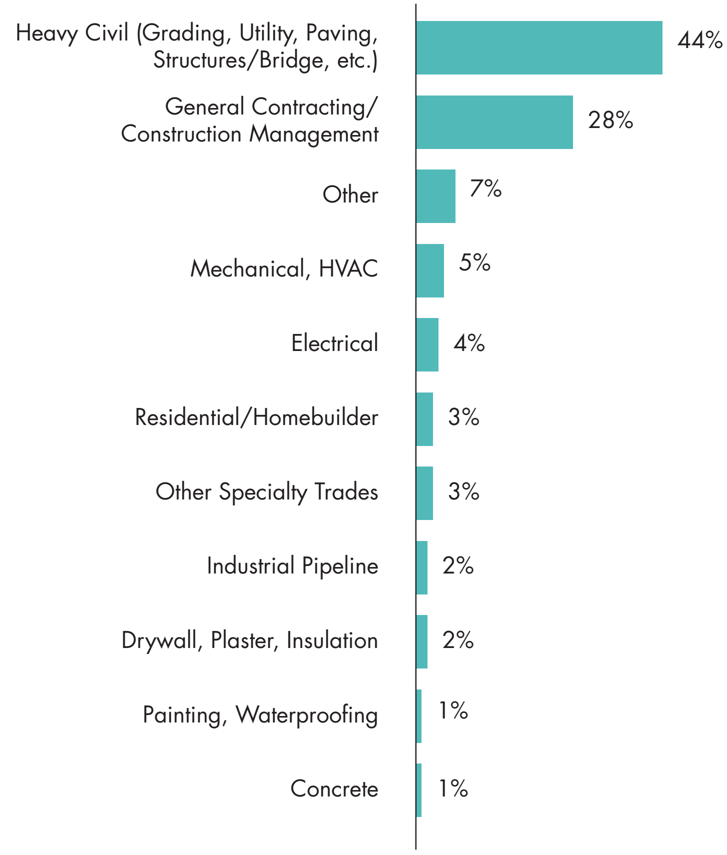
Firm Size by Annual Revenues



Location of Respondents' Firm Headquarters



Market Sectors Served



About the Authors

Priya J. Kapila is the compensation practice leader with FMI Corporation. Priya is responsible for leading the compensation consulting practice of FMI Compensation. Services provided to clients are primarily focused on the areas of executive compensation, organization-wide salary structure development, and administer short-term and long-term incentive plan design.

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