Creating Incentive Programs That Drive the Right Results

By Margaret Kane

Few topics in the retail banking business generate as much controversy as incentive compensation (IC). Deciding how to compensate branch employees beyond their base pay, and for what, is a key part of running an effective retail bank. Yet few executives integrate their plans with their profit and sales objectives. They should: A poorly designed IC plan can result in vast amounts of wasted activity and foregone revenues. A successful one, by contrast, can provide a huge tailwind to a branch network's profitability.

In my experience, the following guiding principles can yield superior results.

1. Start by identifying your strategic profit drivers.

Too many IC plans fail simply because they don't incent employees to perform activities that are profitable for the branch. "Unit–based" plans in particular often cause employees to push products that customers don't need and won't use. That's a mistake that should be easily avoided. How banks make money isn't that complicated, after all. Branch managers should be incented to grow balances, increase loans outstandings, and add to their base of core customers. Banks that focus on these things consistently establish themselves as winners in the marketplace, quarter after quarter. But don't make the profit equation *so* complicated that employees can't translate it into action, nor so specific that it creates a singular focus at the expense of customer needs.

2. Keep it simple.

If your employees don't understand how their activities will translate into higher variable comp, you're spending money needlessly. The best plans use just 4 or 5 components, such as deposit growth, loan growth, new household acquisition, and unit sales. If you make it much more complicated than that, your front-line staff will have trouble keeping track of how its performance relates to its compensation. Worse, you might be incenting employees for activities that they don't know are a part of their variable compensation.

3. Tie individual compensation to branch performance.

Too many companies pay platform employees for their individual sales, regardless of whether those sales are truly profitable, or whether the branch is successful. Other banks only incent salespeople when the branch overall reaches its performance targets, regardless of individual achievement.

Neither approach works well. Rather, we have found that the best systems tie individual and branchwide incentives together through a matrix. The payouts for an individual's unit sales go up if the branch does well on comparable branchwide measures versus its goals. Such a plan can help align the interests of the individual with the organization: individuals are rewarded for their own accomplishments, but in relation to the branch's profitability. Thus everyone stays focused on the team's goal--profits.

4. Provide regular, accurate reporting of results.

Simply put, don't incent what you can't track. Too often incentive plans reward the right results--but management doesn't have the ability to report these results at regular intervals, to let employees know how they are doing. Assuming that you are paying incentives quarterly, you must be able to provide "progress reports" at least monthly. Weekly is even better.

5. Don't let incentive compensation be a substitute for management.

Years ago, as an executive at a large bank, I knew that my incentive plans had run amok when a successful personal banker complained that she still had to notarize customers' documents even though we had taken notary services out of her incentive plan. Egad! Notary service is the sort of basic, everyday activity that never should have been in the plan in the first place! It was simply part of her *job*.

The lesson: IC programs should be designed to reward superior results, not merely the performance of day-to-day duties. If you want employees to sell more of a particular product, hold them accountable for their performance. Don't assume that you have to pay them to do it.

6. Test, evaluate, refine.

Like many management tools, IC plans should be evolutionary. Each quarter, the results of the plans should be carefully evaluated. Were the overall payouts appropriate in relation to the overall performance of the bank? Is there a clear-cut correlation between top-performers and top - earners"? Does a decile analysis by job classification show a reasonable distribution of payments, with, say, the bottom 30% receiving no IC and the top 30% earning approximately 70% of the total payouts? Overall, is the percentage of incentive compensation in relation to total compensation in line with the company's overall objectives? Plans should be altered each quarter slightly to address key issues and questions, but employees shouldn't feel as if the plans are created from scratch every time. Finally, make sure all changes are announced before the quarter begins.

Effective incentive plans translate broad strategic and profit objectives into goals and desired outcomes for individual branches and employees in a way that motivates the staff and creates a superior customer interaction. Well-executed IC plans can have a dramatic impact on the institution's performance and growth, and you should expect nothing less.

© 2002 by Margaret Kane, President and CEO of Kane Bank Services, a management consulting firm specializing in the development of sales cultures and retail bank strategies. Margaret can be reached at margaretkane@earthlink.net or at 916-488-0660.