HARRT 2014 Retreat
Session 8
Saturday, November 8, 2014

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Agenda
What we'll cover today

- Panel objectives and introductions
- Snapshot of performance management practices (2013 Mercer global survey)
- Opening statements by panelists
- Linkage of performance management to pay
- Small group discussions (including break)
- Large group dialogue on key themes and implications

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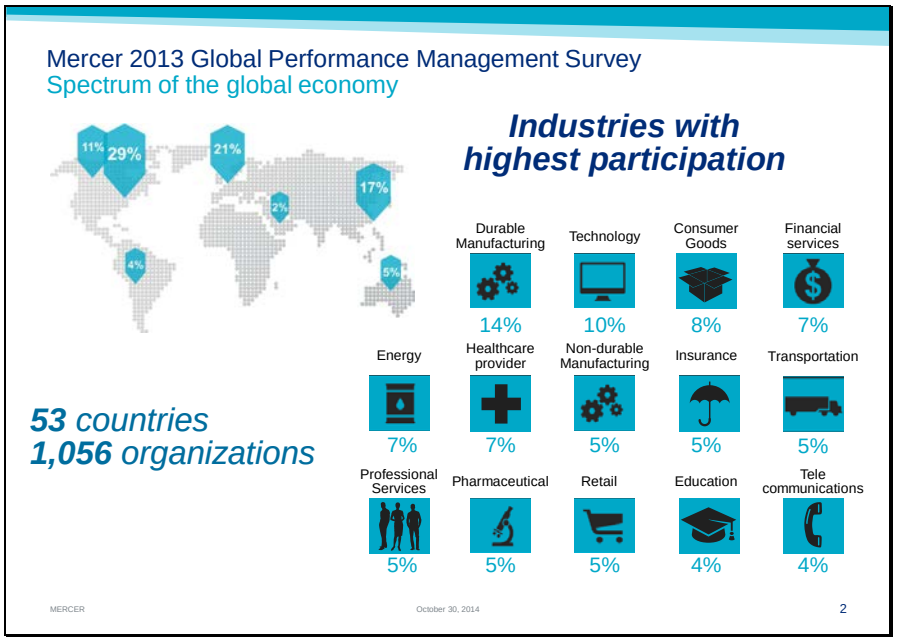
Mercer 2013 Global Performance Management Survey
Spectrum of the global economy
11%
29%
21%
17%
2%
4%
5%
Industries with highest participation
Durable Manufacturing
14%
Technology
10%
Consumer Goods
8%
Financial services
7%
Energy
7%
Healthcare provider
7%
Non-durable Manufacturing
5%
Insurance
5%
Transportation
5%
Professional Services
5%
Pharmaceutical
5%
Retail
5%
Education
4%
Tele communications
4%
53 countries
1,056 organizations
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October 30, 2014
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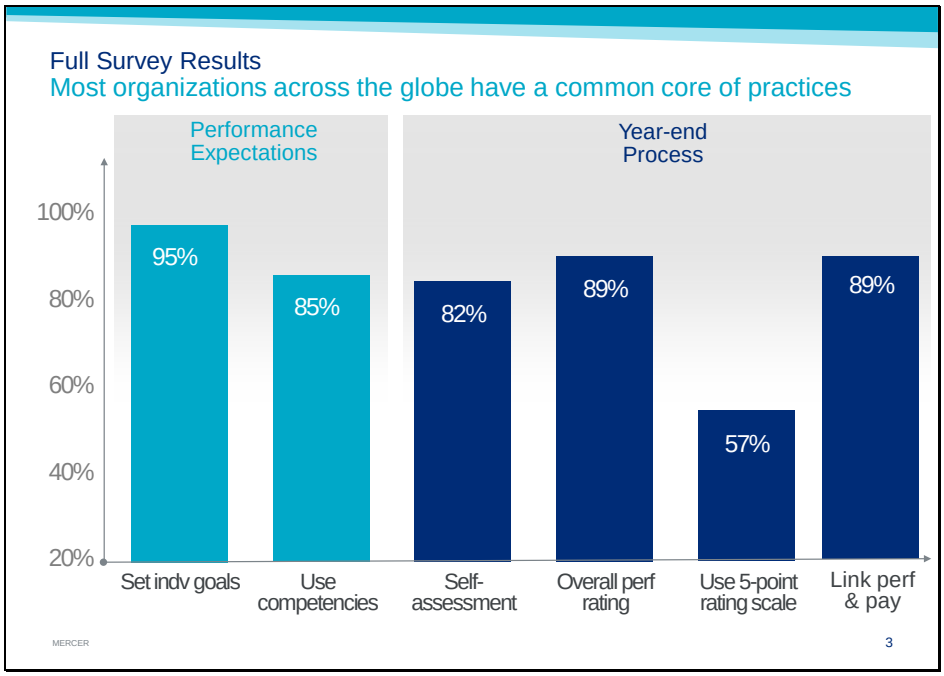
Full Survey Results
Most organizations across the globe have a common core of practices
Performance Expectations
Year-end Process
100%
80%
60%
40%
20%
95%
85%
82%
89%
57%
89%
Set indv goals
Use competencies
Self-assessment
Overall perf rating
Use 5-point rating scale
Link perf & pay
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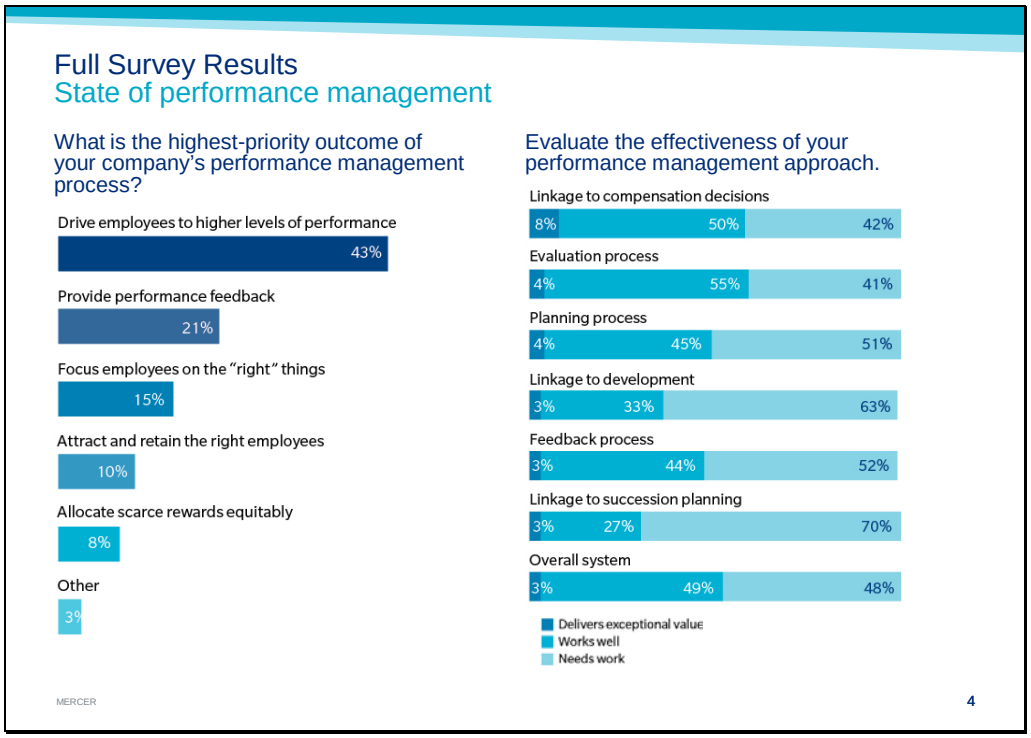
Full Survey Results
State of performance management
What is the highest-priority outcome of your company's performance management process?
Drive employees to higher levels of performance
43%
Provide performance feedback
21%
Focus employees on the "right" things
15%
Attract and retain the right employees
10%
Allocate scarce rewards equitably
8%
Other
3%
Evaluate the effectiveness of your performance management approach.
Linkage to compensation decisions
8%
50%
42%
Evaluation process
4%
55%
41%
Planning process
4%
45%
51%
Linkage to development
3%
33%
63%
Feedback process
3%
44%
52%
Linkage to succession planning
3%
27%
70%
Overall system
3%
49%
48%
Delivers exceptional value
Works well
Needs work
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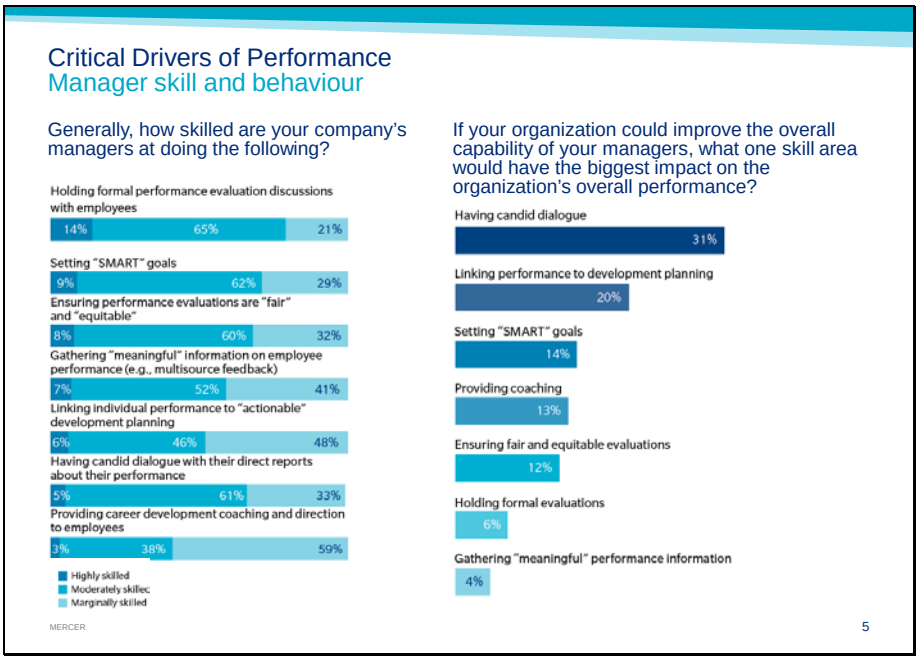
Critical Drivers of Performance
Manager skill and behaviour
Generally, how skilled are your company's managers at doing the following?
Holding formal performance evaluation discussions with employees
14%
65%
21%
Setting "SMART" goals
9%
62%
29%
Ensuring performance evaluations are "fair" and "equitable"
8%
60%
32%
Gathering "meaningful" information on employee performance (e.g., multisource feedback)
7%
52%
41%
Linking individual performance to "actionable" development planning
6%
46%
48%
Having candid dialogue with their direct reports about their performance
5%
61%
33%
Providing career development coaching and direction to employees
3%
38%
59%
Highly skilled
Moderately skilled
Marginally skilled
If your organization could improve the overall capability of your managers, what one skill area would have the biggest impact on the organization's overall performance?
Having candid dialogue
31%
Linking performance to development planning
20%
Setting "SMART" goals
14%
Providing coaching
13%
Ensuring fair and equitable evaluations
12%
Holding formal evaluations
6%
Gathering "meaningful" performance information
4%
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Critical Drivers of Performance
Manager skill and behaviour

When it comes to manager skills, what elements have the most impact on overall success?

	Perceived impact on organization	Actual driver of organizational impact	Percentage of managers with marginal skills
Having candid dialogue	**1st** (perceived highest impact)	3rd	33%
Linking performance to development planning	2nd	**1st** (skill with highest impact)	**48%** (lowest skill level)
Setting "SMART" goals	3rd	2nd	29%

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Key Questions for our Panel Today
Examining ways to drive performance

- What are the business outcomes you are most trying to achieve in your performance management process?
- How does your design address potentially competing objectives?
  - Development and engagement of employees
  - Goal alignment and achievement
  - Pay for performance
  - Integration of performance management with other talent processes
  - Legal compliance
- Where have you been and where are you going with performance management?

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Realized and Realizable Pay

Pay for performance disclosure was supposed to become mandatory but has been delayed; ISS updated guidelines on realized pay

- The 2010 Dodd-Frank Wall Street and Consumer Protection Act requires the SEC to provide guidance on pay for performance alignment
  - SEC originally gave a timeframe of one year to implement its new regulations post Dodd-Frank passage; however, SEC has delayed implementation with final date TBD
  - To date, many pay-for-performance analyses have emphasized "granted" over "realized" pay, focusing on target compensation of NEOs based on theoretical or target equity compensation values
  - To better tell their pay-for-performance story and rebut proxy advisers' pay-for-performance analyses, a growing number of companies are supplementing the required disclosures with "realized" and "realizable" pay[1]
- ISS has revised its qualitative approach to evaluating pay-for-performance alignment in response to both institutional and issuer feedback
  - ISS will now calculate **realizable pay** for large cap companies (S&P 500) as part of their qualitative review for those companies that merit a "medium" to "high" concern rating upon initial quantitative screen
  - ISS will calculate amount of total realizable pay based on amounts paid or earned, gains realized, or the current value of ongoing incentive grants made, over three fiscal years (based on subject company's fiscal year)

(1) Approaches to calculation of realizable pay currently vary widely by company

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Overview of ISS Realizable Pay Methodology
Observations

- Grant date valuation of compensation truly reflects the decision of the company (compensation committee to grant a level of compensation)
- Grant date valuation reflects intent
- Grant date valuation does not reflect reality
- Consider premium priced stock options
  - 10,000 options
  - Exercise price $5.00
  - FMV at date of grant $1.00
  - Value only if stock appreciates 500%
  - Black Scholes Value at grant: $.08 or $800
  - Perceived value at grant: $0
  - Five Years Later / Post IPO: $50/share or $450,000 (Realized Value)
  - Important to consider both in designing a compensation program

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Overview of ISS Realizable Pay Methodology

ISS uses the following methodology to calculate realizable pay for S&P 500 companies

Calculating Realizable Pay

- Actual base salary
- Actual bonus paid
- Other short-term awards reported as Non-Equity Incentive Plan Compensation
- Long-term cash awards granted during the 3-year period
  - Actual amounts paid during the period
  - Target value for ongoing cycles
- Restricted stock and performance shares granted during the 3-year period
  - Value of shares granted using the stock price at the end of the period
  - For performance shares, the number of shares will reflect actual payouts for completed cycles or the target number of shares for ongoing cycles
- Stock options granted during the 3-year period
  - The actual realized value of exercised stock options
  - The re-calculated Black-Scholes value of unexercised options at the end of the period
- Change in Pension Value and Nonqualified Deferred Compensation Earnings
- All Other Compensation

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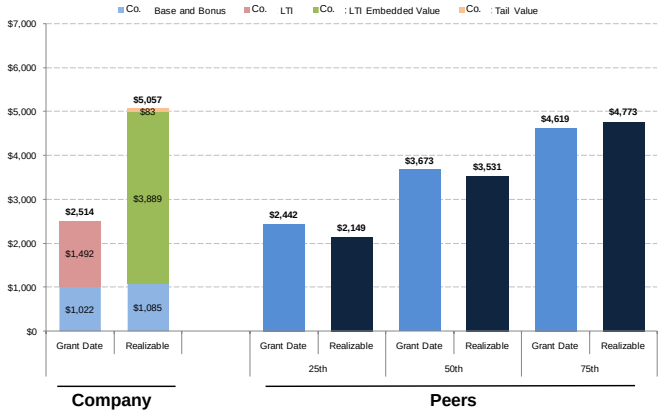
Overview of ISS Realizable Pay Methodology
Company example: CEO vs. all peers

CEO grant date TDC was near the 25th percentile. Each year, compensation committee tried to increase all levels of compensation to be closer to 50th percentile. At end of five year period, his realizable TDC falls above the 75th percentile

Company vs. All Peers
Grant Date vs. Realizable Pay (5-year Average)



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Overview of ISS Realizable Pay Methodology

Company example: 5-year grant date and realizable TDC (FY09-FY13)

Five Year Grant Date and Realizable TDC (ISS Methodology)

Position	FY 2009		FY 2010		FY 2011		FY 2012		FY 2013		Average	Average	% of
	Grant Date	Realizable	Grant Date	Realizable	Grant Date	Realizable	Grant Date	Realizable	Grant Date	Realizable	Grant Date	Realizable	Grant Date
	($000s)	($000s)	($000s)	($000s)	($000s)	($000s)	($000s)	($000s)	($000s)	($000s)	($000s)	($000s)	
CEO	$2,328	$4,665	$2,191	$8,077	$2,351	$5,655	$2,688	$3,572	$3,011	$3,315	$2,514	$5,057	201%
SVP and GM, Wireless & Sensing Product Group	$925	$1,900	$882	$2,389	$1,103	$2,273	$1,264	$1,653	$1,148	$1,270	$1,064	$1,897	178%
SVP and Chief Financial Officer	$1,022	$2,021	$941	$2,586	$1,101	$2,391	$1,249	$1,631	$1,031	$1,137	$1,069	$1,953	183%
SVP and GM, Protection, Power & Hi-Rel Product Groups	$948	$2,035	$864	$2,389	$1,045	$2,224	$1,171	$1,536	$1,259	$1,456	$1,057	$1,928	182%
SVP, Worldwide Sales and Marketing	$898	$1,786	$828	$2,213	$989	$2,066	$1,080	$1,403	$1,079	$1,204	$975	$1,734	178%
SVP and GM, GPG	-	-	-	-	-	-	-	-	$1,978	$2,260	$1,978	$2,260	114%
VP and GM, Advanced Communications Product Group	-	-	-	-	-	-	$532	$673	$1,272	$1,449	$902	$1,061	118%
SVP, Quality & Reliability	$910	$1,882	$696	$1,797	$797	$1,647	$852	$1,102	$777	$860	$807	$1,457	181%
SVP, Strategy and Systems Innovation Group	-	-	-	-	$283	-	$375	$375	$1,106	$1,256	$588	$816	139%
VP, General Counsel & Secretary	$375	-	$659	$1,665	$774	$1,572	$823	$1,059	$723	$795	$671	$1,273	190%
VP, Information Technology & CIO	-	-	-	-	$330	-	$360	$360	$811	$902	$500	$631	126%
VP, Worldwide Operations	-	-	-	-	$280	-	$812	$1,045	$1,073	$1,223	$722	$1,134	157%
VP, Human Resources	-	-	-	-	-	-	-	-	-	-	-	-	-

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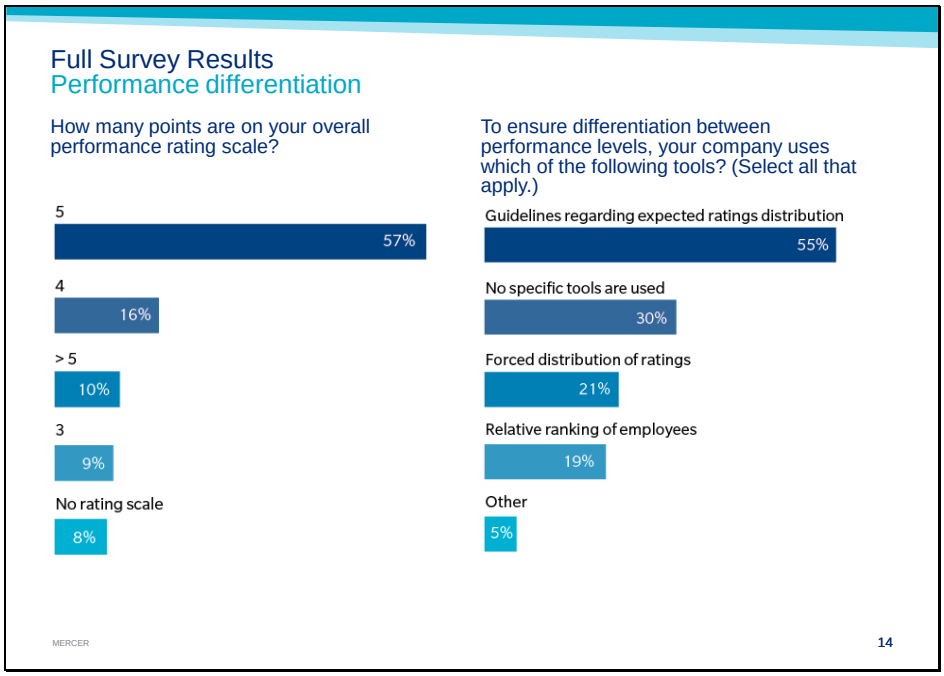
Full Survey Results
Performance differentiation
How many points are on your overall performance rating scale?
5
57%
4
16%
> 5
10%
3
9%
No rating scale
8%
To ensure differentiation between performance levels, your company uses which of the following tools? (Select all that apply.)
Guidelines regarding expected ratings distribution
55%
No specific tools are used
30%
Forced distribution of ratings
21%
Relative ranking of employees
19%
Other
5%
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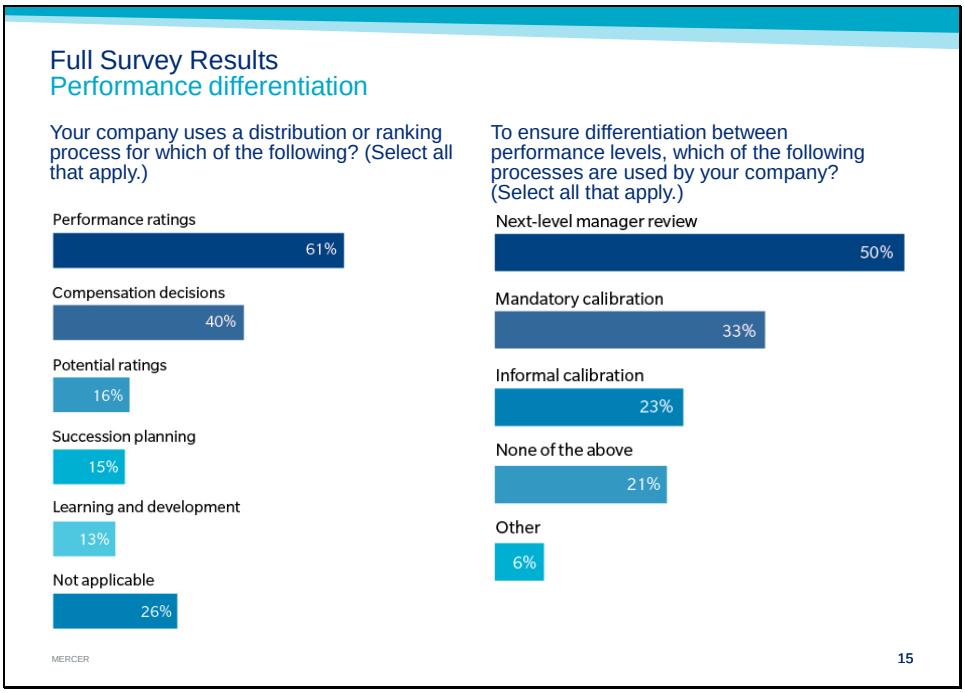
Full Survey Results
Performance differentiation
Your company uses a distribution or ranking process for which of the following? (Select all that apply.)
Performance ratings
61%
Compensation decisions
40%
Potential ratings
16%
Succession planning
15%
Learning and development
13%
Not applicable
26%
To ensure differentiation between performance levels, which of the following processes are used by your company? (Select all that apply.)
Next-level manager review
50%
Mandatory calibration
33%
Informal calibration
23%
None of the above
21%
Other
6%
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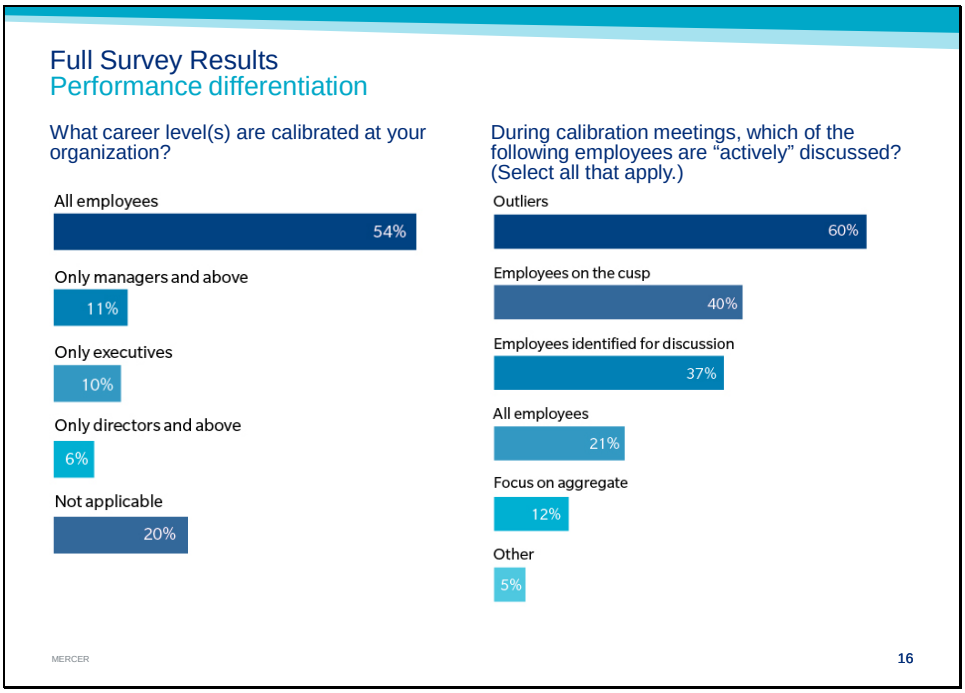
Full Survey Results
Performance differentiation
What career level(s) are calibrated at your organization?
All employees
54%
Only managers and above
11%
Only executives
10%
Only directors and above
6%
Not applicable
20%
During calibration meetings, which of the following employees are "actively" discussed? (Select all that apply.)
Outliers
60%
Employees on the cusp
40%
Employees identified for discussion
37%
All employees
21%
Focus on aggregate
12%
Other
5%
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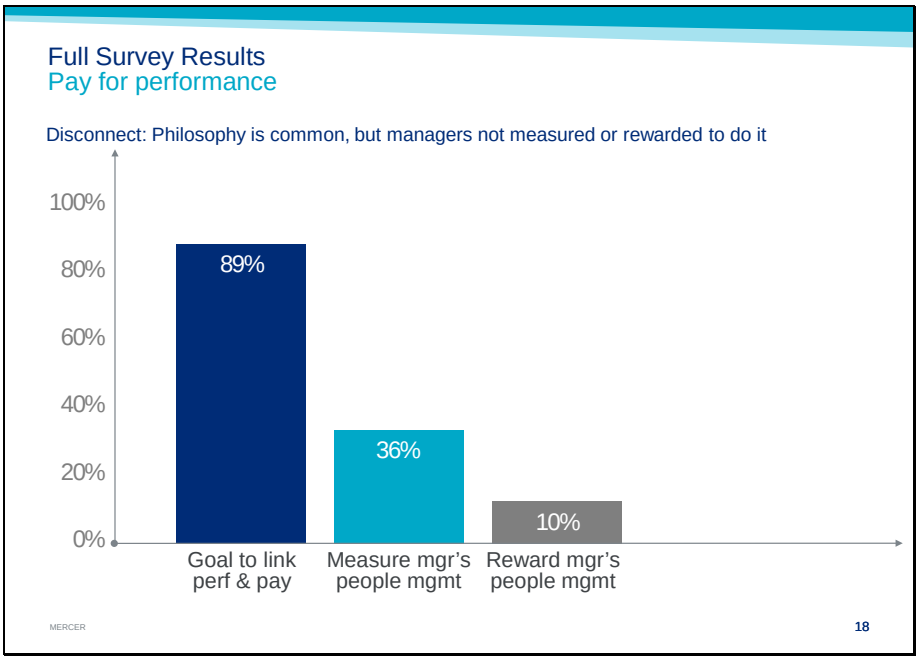
Full Survey Results
Pay for performance
Disconnect: Philosophy is common, but managers not measured or rewarded to do it
100%
80%
60%
40%
20%
0%
89%
36%
10%
Goal to link perf & pay
Measure mgr's people mgmt
Reward mgr's people mgmt
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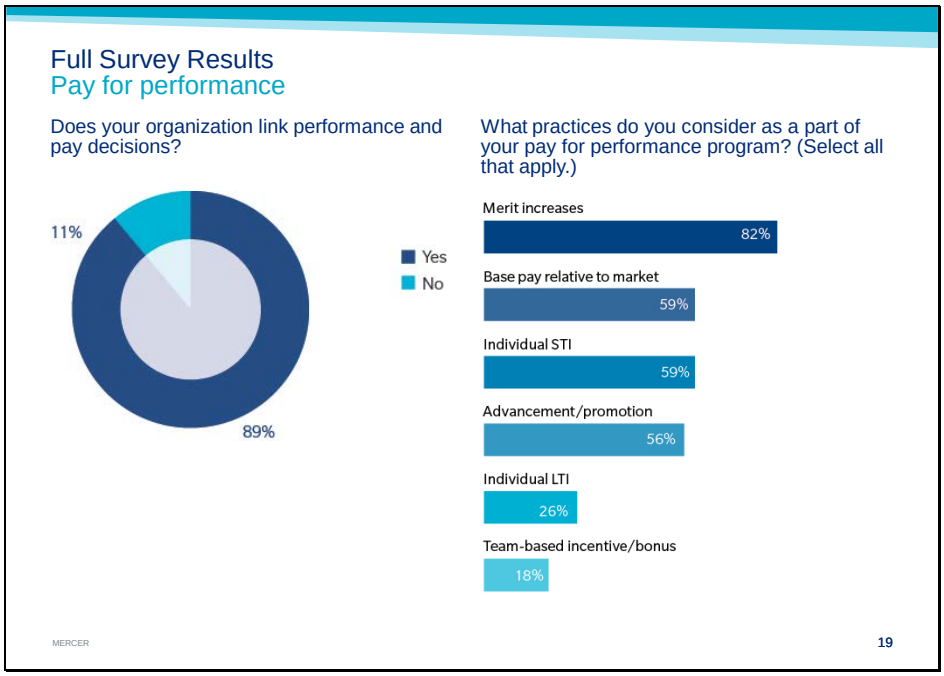
Full Survey Results
Pay for performance
Does your organization link performance and pay decisions?
11%
89%
Yes
No
What practices do you consider as a part of your pay for performance program? (Select all that apply.)
Merit increases
82%
Base pay relative to market
59%
Individual STI
59%
Advancement/promotion
56%
Individual LTI
26%
Team-based incentive/bonus
18%
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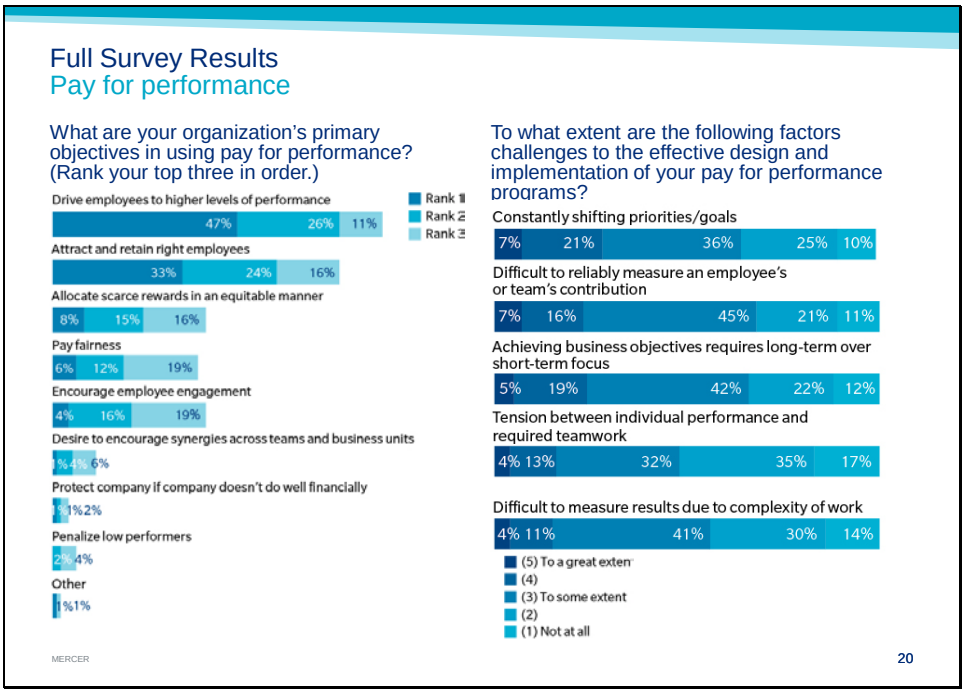
Full Survey Results
Pay for performance
What are your organization's primary objectives in using pay for performance? (Rank your top three in order.)
Drive employees to higher levels of performance
47%
26%
11%
Attract and retain right employees
33%
24%
16%
Allocate scarce rewards in an equitable manner
8%
15%
16%
Pay fairness
6%
12%
19%
Encourage employee engagement
4%
16%
19%
Desire to encourage synergies across teams and business units
Protect company if company doesn't do well financially
Penalize low performers
Other
To what extent are the following factors challenges to the effective design and implementation of your pay for performance programs?
Constantly shifting priorities/goals
7%
21%
36%
25%
10%
Difficult to reliably measure an employee's or team's contribution
7%
16%
45%
21%
11%
Achieving business objectives requires long-term over short-term focus
5%
19%
42%
22%
12%
Tension between individual performance and required teamwork
4%
13%
32%
35%
17%
Difficult to measure results due to complexity of work
4%
11%
41%
30%
14%
(5) To a great exten
(4)
(3) To some extent
(2)
(1) Not at all
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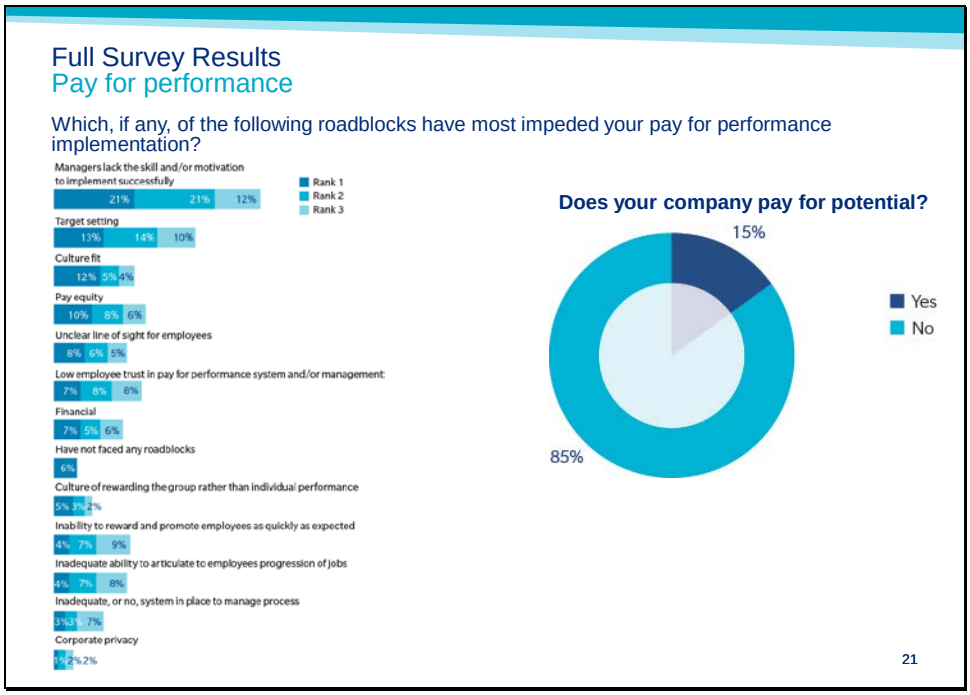
Full Survey Results
Pay for performance
Which, if any, of the following roadblocks have most impeded your pay for performance implementation?
Managers lack the skill and/or motivation to implement successfully
21% 21% 12%
Target setting
13% 14% 10%
Culture fit
12% 5% 4%
Pay equity
10% 8% 6%
Unclear line of sight for employees
8% 6% 5%
Low employee trust in pay for performance system and/or management
7% 8% 8%
Financial
7% 5% 6%
Have not faced any roadblocks
6%
Culture of rewarding the group rather than individual performance
5% 3% 2%
Inability to reward and promote employees as quickly as expected
4% 7% 9%
Inadequate ability to articulate to employees progression of jobs
4% 7% 8%
Inadequate, or no, system in place to manage process
3% 3% 7%
Corporate privacy
1% 2% 2%
Rank 1
Rank 2
Rank 3
Does your company pay for potential?
15%
85%
Yes
No
21

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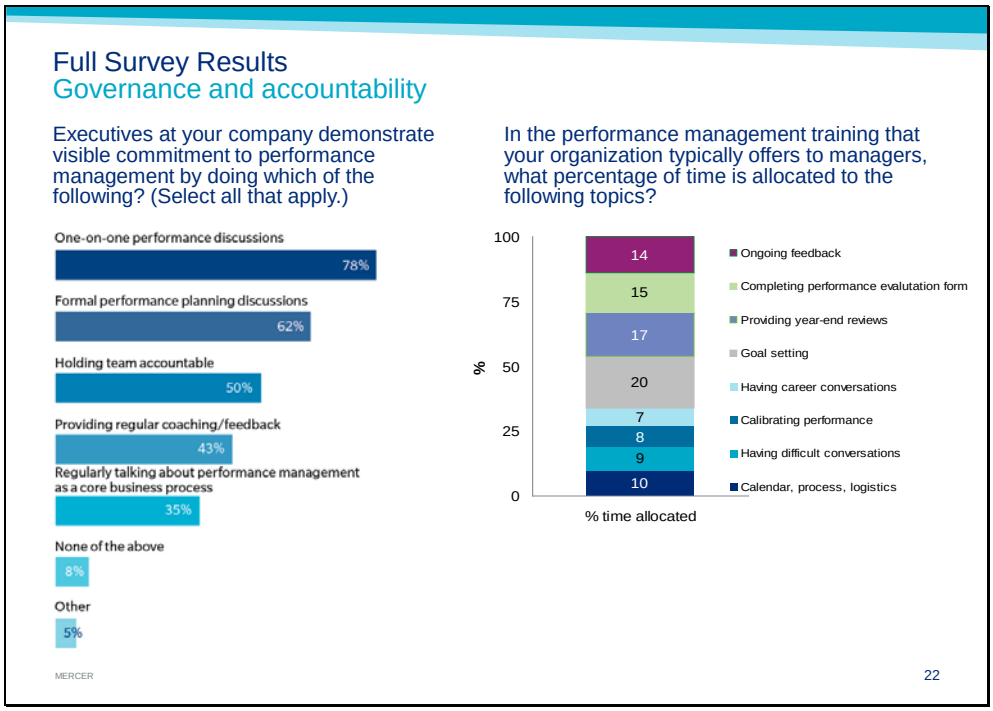
Full Survey Results
Governance and accountability
Executives at your company demonstrate visible commitment to performance management by doing which of the following? (Select all that apply.)
One-on-one performance discussions
78%
Formal performance planning discussions
62%
Holding team accountable
50%
Providing regular coaching/feedback
43%
Regularly talking about performance management as a core business process
35%
None of the above
8%
Other
5%
In the performance management training that your organization typically offers to managers, what percentage of time is allocated to the following topics?
100
75
50
25
0
%
14
15
17
20
7
8
9
10
% time allocated
Ongoing feedback
Completing performance evalutation form
Providing year-end reviews
Goal setting
Having career conversations
Calibrating performance
Having difficult conversations
Calendar, process, logistics
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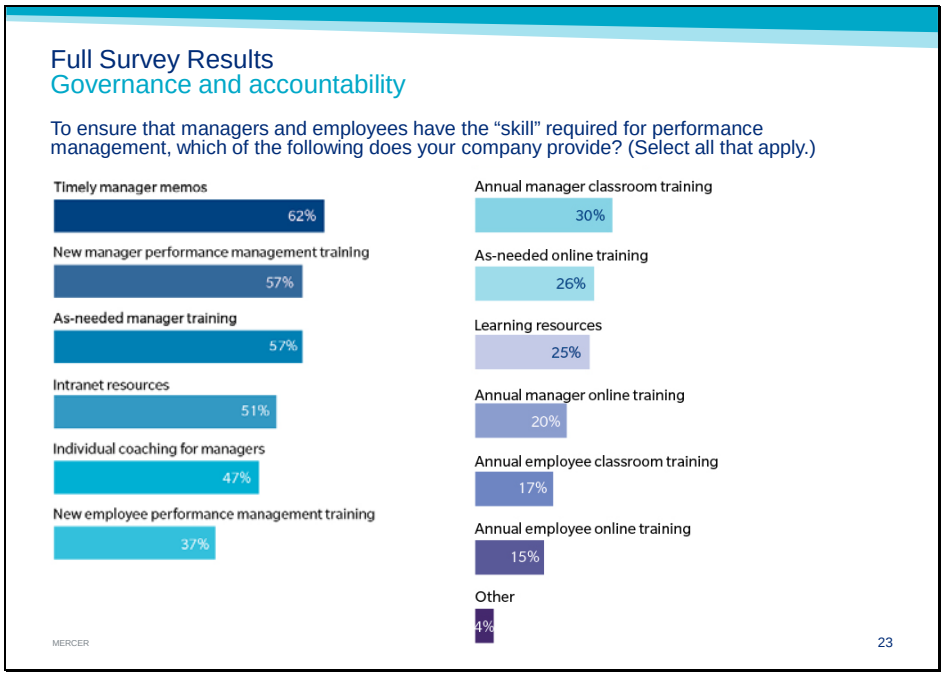
Full Survey Results
Governance and accountability
To ensure that managers and employees have the "skill" required for performance management, which of the following does your company provide? (Select all that apply.)
Timely manager memos
62%
New manager performance management training
57%
As-needed manager training
57%
Intranet resources
51%
Individual coaching for managers
47%
New employee performance management training
37%
Annual manager classroom training
30%
As-needed online training
26%
Learning resources
25%
Annual manager online training
20%
Annual employee classroom training
17%
Annual employee online training
15%
Other
4%
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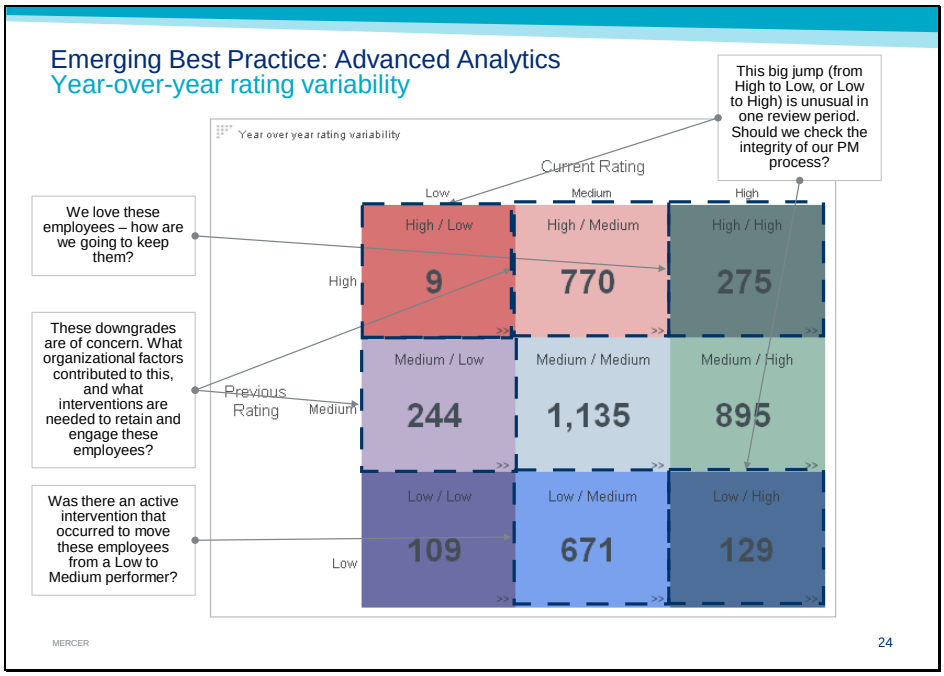
Emerging Best Practice: Advanced Analytics
Year-over-year rating variability
This big jump (from High to Low, or Low to High) is unusual in one review period. Should we check the integrity of our PM process?
Year over year rating variability
Current Rating
Low
Medium
High
We love these employees – how are we going to keep them?
High
High / Low
9
High / Medium
770
High / High
275
These downgrades are of concern. What organizational factors contributed to this, and what interventions are needed to retain and engage these employees?
Previous Rating
Medium
Medium / Low
244
Medium / Medium
1,135
Medium / High
895
Was there an active intervention that occurred to move these employees from a Low to Medium performer?
Low
Low / Low
109
Low / Medium
671
Low / High
129
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