

Incentive Programs for the New Decade



INCENTIVE PROGRAMS ARE a critical part of managing a bank. The objective should be two-fold: first, the program should clearly communicate what are the desired selling, retention and other customer service priorities, and second, it should specifically reward for these desired behaviors – so that front line sales/service staff understand what they are expected to do. They should see a clear link between the bank's overall performance goals and the specific priorities and rewards in the incentive program.

Sounds simple and straightforward, right? Not always, and the problem is that we find that most banks don't have incentive programs which directly link financial performance and CEO/C-level compensation with the incentive programs for sales and service staff, leaving a

real gap. The critical variables at the CEO/C-level are typically about the income statement, while the incentive program for front-line sales/service staff is typically about volume production and other measures that do not directly impact the income statement. This disconnect is not healthy. While the CEO/C-level executives focus on the bottom line, the sales/service staff focus on volume production for new accounts, new customer acquisition, cross-sales, balance sheet growth, market penetration, and customer satisfaction/quality of service. These are important components to measure (and indirectly impact future earnings), but they need to be directly tied to the income statement, so that the compensation plan at the CEO/C-level and the incentive program at the sales/support level are not at

odds (which they often are). They should both focus on providing shareholder value through increased earnings.

Why does this happen? Why the disconnect? Because it's very hard to translate overall bank financial performance down to individual sales/support employee level and his/her specific contribution to the income statement. Without the ability to do this, banks rely solely on production and satisfaction/service quality measures for sales/support. Some banks include overall bank financial performance as part of the sales/service incentive program, but typically only on a very high-level basis, where the sales/service officer cannot see the direct connection between his/her activities and bank earnings. This is often frustrating to the CEO and C-level executives, as they want their people to focus on earnings, but they don't know how to measure or incent it on a sales/support employee-by-employee basis.

This has to change. Well-crafted incentive programs should be consistent throughout the bank, at all levels, where each individual's impact on the income statement is front and center.

How do banks do this successfully? They begin by understanding profitability and measuring profitability at the account, customer, and officer level. That's right – measuring the unique profitability contribution of every account (new and existing), every customer (new and existing) and every sales/service officer. By understanding the unique contribution each account, customer, and officer makes to the income statement, only then can an incentive program be properly built.

Here are some examples of "best practices" for incentive program that we've built for our clients:

continued on page 24

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continued from page 21

- Focus on rewards for “up-selling” and not “cross-selling” to existing customers, so that staff is incented to up-sell for increased and incremental profitability, not just for more accounts or more balances/outstandings.
- Focus on rewards for new accounts and new customers that are based on profitability, so that staff is incented to bring in new accounts and new relationships that are incrementally profitable from the get-go, and not those that bring in negative profitability.
- Focus on rewards for retention in which the total profitability contribution is highest among those retained, so that staff is incented to work on retention among the most profitable customers, and not among those that are negative in profitability.
- Bring in other criteria, such as customer satisfaction and service quality as part of a balanced approach, and focus these measures for customers that are the most profitable.

When this occurs, the incentive program can produce quality earnings results. We have clients who have seen significant increases in their earnings as a result of implementing a profitability-based incentive program. Results can be dramatic, where clients report experiencing 25 percent increases in earnings because of the incentive program. What’s interesting is that often the “top volume sales producer” is not necessarily the “top profitability sales producer” and the profitability-driven incentive program re-aligns rewards with direct impact on the bottom line. And isn’t that what banks should be doing in this new decade – focusing on improving earnings and shareholder value.

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