845 Third Avenue, 6th Floor
New York, NY 10022

Phone: (646) 290-5129
Fax: (646) 290-5001
Online: www.grahall.com

A White Paper

MID-TERM INCENTIVES
AN EXCELLENT ALTERNATIVE

Mid-term incentives are best used on an *ad hoc* basis. Sometimes they focus on all employees, sometimes they focus on one key individual, and still other times they focus on a group of individuals. By their very nature, mid-term incentives give the total rewards strategy designer a little freedom to solve important—often unique—issues necessary for the success of the organization. The length of the performance period is anywhere from one to five years, a period of time critical to most companies' success

A LITTLE BIT OF THE HISTORY

Mid-term incentives came onto the scene in the 1970s. Essentially, these types of programs were designed for individuals—and teams—who accomplished specific goals that carried with them significant financial consequences. Since their modest beginnings, what are now known as mid-term incentives—or sometimes special incentives—have become an important component of the overall executive total reward strategy. Mid-term incentives can be used to address a variety of business challenges—challenges like bankruptcies, mergers, or other specific business missions that are generally non-recurring or that need to be addressed within a certain time frame. Used correctly, mid-term incentives are extremely motivating—and effective.

WE HATE TO STATE THE OBVIOUS.….

Mid-term incentives are designed to reward executives for the execution aspects of the strategic plan. The most challenging responsibility of organizations and their executive teams is to execute the long-term strategic plan when every investor is focused more on short-term results. Figuring out how to execute the strategic plan over an extended period of time is really the challenge of how to break down the key drivers of the long-term strategic plan into operational factors, and then determine how those drivers will be incorporated into an incentive program that has the right amount of money to encourage the right behavior. Done correctly, mid-term incentives provide exceptional value to both the organization and it's shareholders.

WHY MID-TERM INCENTIVES ARE LIKE NAVY SEALS

Mid-term incentives can save the day in ways that other variable reward strategy components can't.
If an organization has a fire to put out right away—let's say the company is planning an acquisition or merger and one of the main goals is to ensure that the company stays afloat during the transition, then the mid-term incentive is the way to ensure that executives feel the heat and rise to the occasion. When an organization needs to find a new approach that is so basic it affects or changes the fundamental vision, mission, or values, we believe that instead of asking the imbedded reward system to do the heavy lifting, it's much more effective to create a mid-term or special incentive program to create a sense of urgency and uniqueness.

IT'S ALL ABOUT EXECUTION

Mid-term incentives can be used to shore up the gaps and ensure that the things that need to be executed are executed. A mid-term incentive ensures that an executive working outside of his comfort level is a little more *comfortable*.

In our opinion, mid-term incentive plans of anywhere from three to five years speak loudest when it comes to execution, which is why we are such big fans of them. For most large organizations, execution of major goals that have a long-term positive effect on both the organization and the shareholders usually comes in three- to five-year periods.

CHOOSING WISELY

Mid-term incentives *should be* targeted at specific organizational strategies or capability gaps within the organizational structure, process, or culture and at those particular portions of the organization and those executives who can truly have an impact or make a contribution over a three- to five-year period of time. In addition to specific departments or groups within an organization, mid-term incentives can also be targeted at specific organizational processes—processes like decision making, or planning, allocating, and monitoring.

Mid –term incentives are versatile and a good choice in a variety of situations. These plans go by various names like project-based incentives, challenge grants, milestone incentives, and success fees.

MAKE AN IMPACT – OR COME HOME ON YOUR SHIELD

Project-based incentives are specific to unique and identifiable projects, so they should be designed to motivate key groups of individuals. They are also very unique because they can include not only the executive that's in charge of the project, but also the entire team that influences the project's outcome. These incentives are designed to ensure that a critical initiative is accomplished through the cooperation of a group with many different talents. But what happens if our corporate Green Berets aren't successful? Not to be grim, but just like the real Green Beret's they should be prepared to come home on their shields.

RISING TO THE CHALLENGE

Challenge grants are a favorite mid-term incentive for us—as they can be targeted toward all employees, toward an individual, or toward a specific group like management. Eligibility can be different, the objective can be specific to the circumstances associated with the organization and its five-year goals, and the amounts can be dramatically different. The only rule with challenge grants is to make sure they are significant in proportion to the overall total executive reward strategy. Other than that, be creative.

AH, SERENDIPITY…..OR NOT

Sometimes a particular goal that is critically important to the success of an organization and its shareholders is not easily tied to a time period. Milestone incentives are a unique category of mid-term incentives designed to address this. Rather than artificially tying a goal accomplishment to a standard period of measurement—like a single year or three years—the goal is determined and a reasonable date for its accomplishment is set. To the extent that the goal is accomplished sooner or later than the set date, the executive receives more or less in proportion to the benefits that accrue to the organization's earlier or later accomplishment of the goal.

GEORGE WASHINGTON WOULD HAVE GOT ONE, AND BEN FRANKLIN TOO

A success fee initiative is used for executives who tackle goals outside of their normal responsibilities. Success fee initiatives are a special category of milestone incentives in which a block of incentive is put aside and paid only when the objective is completed. It doesn't matter if it takes one year or five—the incentive is paid *only* when the assignment is completed. However, success fee initiatives can be abused if an executive is awarded a hefty success fee for something that is, by rights, part of his job description.

GETTING REWARDED FOR BRINGING IT IN

Development or royalty incentives pay based on revenue from a particular creation. Basically, those who are critically involved in the development of a new product or service share a small amount of the revenues that result from their creations. The incentive is generally a decreasing proportion of revenues paid over a five- to 10-year period.

GETTING BACK ON THE HORSE

There are all kinds of reasons why a company goes into a state of decline. The reasons can be internal, like an unproductive workforce, poor decisions, or rising costs. They can be external, like new competitors, a changing market, or a declining market. Or they can be a combination of both.

A turnaround is designed to reposition the company. A turnaround incentive can mean the difference between a viable company and one in bankruptcy. Turnaround incentives may be targeted at cutting expenses, or they may focus on repositioning the company to better meet the needs of the marketplace. In a situation like this where time is of the essence and creativity may be one of the keys to keeping things afloat, mid-term incentives are a good choice.

BACK FROM THE BRINK

When a company enters bankruptcy it has one goal in mind—to keep creditors at bay while attempting to return the organization to a profitable state. If an organization can't bring itself back from the brink, it will go out of business. So it just makes sense that top executives would receive some fairly substantial mid-term incentives to ensure this doesn't happen.

Mid-term incentives are often "tipping point" incentives. That is, a little money, mixed well, can carry a lot of messages and provide a huge "return on incentives" for shareholders.