



UK Executive Pay & Governance

Short-term Incentive Design

Short-term incentives (“STIs”) – often referred to as annual bonuses – have for many years played an important role on senior executive remuneration. However, as with many other aspects of executive pay, STIs have become the subject of greater investor scrutiny, with the design of annual bonus plans becoming far more sophisticated than was once the case.

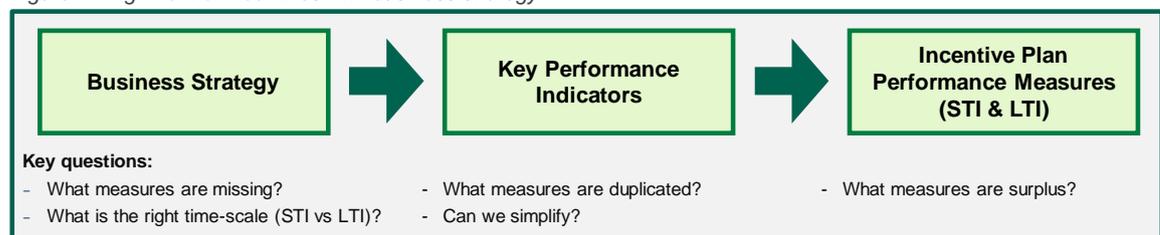
At Korn Ferry Hay, we have a specialist team of highly experienced, partner-level consultants that can guide a company through the establishment and ongoing annual operation of annual bonus plans, with the primary aim of ensuring that they are directly supportive of our clients’ underlying strategy.

To achieve this, we support our clients in addressing all the key issues that are raised during the STI design process:

- **STI opportunity** – what bonus opportunity should be made available for delivering a “target” level of performance, and what bonus should be payable at threshold and maximum? Our pay databases allow us to advise clients on typical market rates of bonus opportunity for different levels of executives
- **What bonus conditions should be applied?** – this is perhaps the most important design feature of annual bonus plans. Traditionally, only financial metrics such as profit before tax were used. However, we are seeing a trend towards the use of a broader range of metrics. For example, “personal” performance can often determine up to 30% of the overall bonus payout and, in addition, it is now common for a blend of 2-3 financial metrics to be used.

When considering the choice of performance metric for an STI it is important that it is aligned with and drives the business strategy. We work with our clients to ensure that the choice reflects their business priorities

Figure 1: Alignment of incentives with business strategy:



- **How should targets be set?** – targets should ideally be “SMART” in nature. It is also key to strike a balance between incentivisation and achievability considering the level of payout at threshold, target and maximum performance levels.
- **Should a portion of the bonus be deferred into shares?** – it is now common for a portion of a listed company’s executive director’s bonus to be paid in deferred shares that are received 2-3 years later subject to continued employment but no further performance conditions. However, should share deferral be extended further down the organisation?



- **How should disclosure of the STI be approached in the Annual Report?** – there is increasing pressure from shareholders for listed companies to provide full retrospective disclosure of the financial targets used in the prior year, together with a clear explanation of the personal targets used. We can assist our clients in how best to provide clear disclosure without prejudicing commercial confidentiality
- **How should the executive directors’ STI structure be cascaded down through the organisation?** – it is too often the case that, due to the regulatory/best practice requirements that apply executive directors’ bonuses, their bonus arrangements become detached from the STIs of other senior executives and the wider workforce. We work with our clients to ensure that there is as much alignment as possible in the STI structure throughout the entire organisation
- **Should bonuses be capable of clawback?** – most STI plans now allow for bonuses to be forfeited/reclaimed in certain unusual “negative” circumstances (e.g. misstatement of accounts, misconduct etc). We ensure the relevant provisions in plan rules are robust while also again providing flexibility
- **How should we consult with our shareholders?** – as noted above, investor focus often now falls on bonus design and pay-outs. Therefore, it is vital that a company engages with its investors regarding the design and operation of its STI where appropriate. Our partners have many years of experience in guiding clients through shareholder engagement exercises as they relate to annual bonuses, particularly in advising clients on when it is actually necessary to consult
- **Can we learn from sector experiences?** Our database of annual report disclosures enables us to analyse and present how other listed companies in the same sector have selected performance measures, weightings and targets

Figure 2: Annual bonus performance metrics in “gaming” sector:

Company	Market cap. (£m)	Profit	Revenue	Individual / strategic
Paddy Power Betfair	£6,975m	Weighting: 50% • EBIT	Weighting: 50% • Revenue	
William Hill	£2,400m	Weighting: 60% • Operating profit	Weighting: 20% • Net revenue	Weighting: 20%
Ladbrokes Coral	£2,250m	Weighting: 80% • PBIT		Weighting: 20%
GVC Holdings	£2,125m		Weighting: 100% • Net gaming revenue growth (CFO only)	
888 Holdings	£875m	Weighting: 100% • Adjusted EBITDA growth		
Sportech	£175m	Weighting: 70% • Adjusted EBITDA		Weighting: 30%

As noted above, our aim is to work with our clients so they operate STI plans that genuinely are supportive of the company’s strategy and that provide executives with a fair reward for executing that strategy.

Want to know more?

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