



Appendix 4: *Managing and rewarding the performance of senior managers*¹

INTRODUCTION

The principles described throughout this book are equally applicable to the senior management group. The application of those principles in designing and implementing workplace coaching is, however, significantly different.

To begin with, the manner in which a CEO is managed by the Board has a whole different set of dynamics to it. While we will discuss this role in respect to leadership behaviour, when we talk about the code of conduct (read ethics and governance), they are the driver of performance improvement programmes across the whole organization and, in a sense, the ‘head coach’ for the senior management team. They themselves (the CEOs) are not coached. They are quite rightly held accountable for the performance and behaviour of the organization in keeping with the strategic decisions and directions of the Board.

Whilst this is not a book about performance-based remuneration, it is impossible these days to talk about managing performance of senior managers without talking about the link to remuneration packaging. But first some words about the performance management system itself. We have preferred to call this a ‘performance improvement programme’ (rather than performance management per se) because of the emphasis at this level on

self-management and the very high levels (at least theoretically) of accountability and responsibility.

SENIOR MANAGEMENT TEAM CODES OF CONDUCT

Many senior managers will have problems with the idea that they should be subject to a code of conduct. We don't care what you call it, but once again we would say the name of the game is clarity of expectations. We would argue that you have to have a statement of what the organization believes in, regarding:

- ethical behaviour;
- governance;
- behaviour in the workplace.

Senior managers should be brought into the organization with a crystal clear understanding of those three areas, as well as performance results, time-frames and the manner in which rewards and performance are to be linked. Organizations could save themselves a lot of time, money and frustration (particularly with shareholders) if they thought about some of these things prior to drawing up the contract of employment. This would ensure that if the Board were dissatisfied with the CEO, or the CEO with another senior manager, there is a basis to terminate the contract which is fair to both the manager and the shareholders. At the moment it is all one way. Managers can behave in an unethical manner, fail to deliver on results, behave abominably towards other managers and staff, and even engage in illegal behaviour, yet walk away with millions and, on occasions in Australia, hefty performance bonuses.

We are not suggesting that in this day and age you can recruit (poach) good quality managers into the organization and have them sign a contract stating that if the Board don't think they are performing they leave with nothing, or a couple of month's pay. Rather, we simply need to draw a few lines and set some standards that ensure that a manager who breaches a 'code' in any serious way, or fails to deliver totally, is not rewarded to the same extent as an executive who leaves an organization having fulfilled his or her part of the contract completely.

CODES OF BEHAVIOUR

It is important that the organization deals with this issue by ensuring that the ethical standards, governance requirements and general conduct/behaviour are set out in a clear manner for all incoming executives. If we had a criticism of what we have seen in these areas, it is that they are less than definitive as a guide to what is acceptable or unacceptable. We would suggest that this can be achieved without a bureaucratic or 'political correctness gone mad' approach. A concise but meaningful statement on these areas is not impossible.

From a risk management perspective, it is absolutely essential that lines are drawn between:

- friendly relations and communication with competitors versus cartel (price fixing) behaviour;
- prudent destruction of sensitive business documents versus the shredding of everything and anything that might be used in a law suit;
- managing risks in a business-effective way versus exposing the company, its shareholders, the employees and the community to loss and/or injury of their financial or personal well-being.

We could go on for hours. We could put up a hundred case studies but we don't think we need to. The following points are made:

- As with any other 'relationship', clarity of expectations and early intervention are essential to building and maintaining a strong relationship and dealing with any conflicts immediately they arise.
- The inclusion (or reference to) a code of conduct/behaviour in executive contracts is essential to ensure that both parties agree what is expected.
- The ethical standards and governance policies should be a joint Board/senior executive document, which is designed to encourage modelling of ethical decision making and governance 'best practice'.
- The code of conduct/behaviour in the workplace should be developed for the executive group and be quite specific where appropriate.
- Early intervention is just as important at this level (or more important) than at lower levels of the organization because, while the risk of breaches may be less, the impact can be destructive to an organization's reputation, even to the extent of its demise (Enron in the USA, HIH in Australia, Parmalat in Italy are some examples).

We now move to performance improvement plans for senior managers as the vehicle for performance feedback and the 'executive' coaching model.

PERFORMANCE IMPROVEMENT PLANS (PIPS)

Our approach to this area of performance management consists of a number of key steps. Some are common practice in most systems—some may be quite different:

1. Identify key performance areas (KPAs).
2. Develop a key performance objective for each area (KPO).
3. Determine key performance indicators for each of those areas (KPIs).
4. Determine the performance targets for each indicator (target).

These steps are common to most of the systems we have observed in our dealings with a wide range of organizations. The remainder of our approach is, as far as we are aware, quite different:

5. For each of the KPAs, determine the performance timeframe. This will generally fall out of the strategic plan. Don't assume every KPA is going to be treated as something that magically is achieved over one year.
A good example here is the level of share prices as a target with rewards based on one year. It is possible that one can maximize the share price for one or two years by undertaking activities (or failing to undertake activities) that severely damage the company's long-term earnings and indeed long term-valuation.
6. Have each individual manager examine their key performance objectives and develop a series of actions (tactics) to move the organization towards the achievement of the objective.
7. Bring the senior management team together to share the tactical responses and build on them as a team and finalize the organization's business plan.
8. Have the senior managers individually prepare their draft performance improvement plan based on the business plan, but incorporating:
 - what is to be done;
 - when it is to be completed by;

- frequency of review;
- by whom it is to be undertaken.

On the final point, it could be the manager alone, the manager with other managers, or with subordinate managers, in which case these tactical actions will be replicated in the others' PIPs to ensure it is recorded as a joint activity.

Set out over the next few pages are extracts from some actual PIPs for the positions of Chief Financial Officer (CFO) and Human Resources Manager (HRM). Some of the 'tactics' have been removed as they are organization-specific and therefore 'business in confidence'. There are, however, enough to allow us to review the structure, layout and rationale behind our approach to performance feedback and executive coaching.

1. Key performance areas (KPA's)

Typically, financial performance overwhelms everything else. This is understandable up to a point but remember what we said earlier – this is managing to improve performance over time and it requires a balance. We would say that six to eight key performance areas should be ample but must cover the spectrum of delivering outcomes regarding the people side (customers, shareholders, employees and community) and the compliance side (OH&S, environmental, financial, regulatory, etc) as well as a specific category dealing with growing the business.

In the example shown for the CFO, it can be seen that the key performance areas include risk management, compliance and funds management. For the HRM, occupational health and safety, and training and development are the two examples we will follow through the process.

2. Key performance objectives (KPO's)

These are like any other objectives. As we used to be told when we first started writing objectives, they must be measurable and they must be achievable. From the point of view of measurability, we have to be realistic in terms of the cost effect associated with measurement. We subscribe to the old maxim (Peter Drucker we think) 'What isn't measured, doesn't get managed' (or, 'If you can't measure it, you can't manage it'). For the most part this is true – we just have to ensure a balance between cost and the level of 'calibration' we seek.

Let us look at some of the key performance objectives included in the extracts from the point of view of measurability and achievability.

CFO

Risk management	Manage risk situations to achieve zero losses to the company at the least cost.
Compliance	Ensure compliance with all relevant government legislation/regulations (taxation, superannuation, etc).
Systems management	Ensure systems are developed and implemented in accordance with the strategic plan, to meet the needs of both internal and external stakeholders.

HRM

Occupational health and safety	Manage OHS to achieve zero lost time injury (LTI).
Training and development	Develop and deliver a training plan that continuously improves the skill profile of both new and existing employees.

3. Key performance indicators (KPIs)

Remember that these are *indicators*, that is, they need to be indicative of performance. The calibration will not always be that precise and the parties need to accept this. They also need to accept that the indicators are not as critical as the performance improvement plan itself, which, by its very nature, will have a more strategic, longer-term perspective than measurement for one year. Finally, KPIs are *after* the event; our model requires performance to be managed *during the event*. Intervention as close to the event as possible is still the message, but at this level it is possible (and advisable) to develop 'before the event' indicators – an early warning system. This is akin to people leaving the same part of their meal in a restaurant or not ordering a dish – you know something is wrong *before* the numbers ('bums on seats') fall.

Let us review the KPIs in our extracts and see how well they deliver the outcomes we seek.

CFO

Risk management	Incidents/near misses.
Compliance	Breaches reported.
Systems management	Implementation of performance improvement plan.

1. SYSTEMS MANAGEMENT	KPI and Target: Implementation of Performance Improvement Plan			
	Key Performance Objective: Ensure systems are developed and implemented in accordance with the strategic plan to meet the needs of both internal and external stakeholders.			
WHAT	WHEN	BY WHOM	FREQUENCY OF REVIEW	COMPLETED
5.1 Undertake review of current systems (including Survey of Users).			Monthly	
5.2 Seek input for systems improvement – identifying gaps.			Weekly	
5.3 Develop System Improvement Plan.			Monthly	
5.4 Submit for budget consideration FY2005/6.			Quarterly	

Figure A4.1 CFOs – systems management

HRM

Occupational health and safety Lost time injury.
 Training and development Implementation of performance improvement plan.

4. Performance targets

As with the KPIs, the targets are important but not as important as the *analysis* of the result. What did we do that made it move in the right direction? We need to know so we can do it again! In other words, sustainability and continuous improvement is the message, *not* simply hitting a target.

The relevant targets in the extract are of two words: *quantitative* (a numerical measure) and *project-based* (the successful implementation of a particular ‘tactic’). We don’t need to go through all of them, but the zero breach (CFO, systems management; see [Figure A4.1](#)) and the zero LTI (HR, OH&S; see [Figure A4.2](#)) are examples of quantitative targets. Examples of project-based targets would be the systems review and improvement project that are set out as below.

5. Performance timeframe

This requires an analysis of the strategic objectives (three to five years), as well as the business plan, to come up with a realistic timeframe and to attach to the period under review those tactical and operational activities that have to be undertaken to achieve the overall objective.

1. OCCUPATIONAL HEALTH AND SAFETY	KPI and Target: Lost time injuries – zero			
	Key Performance Objective: Manage occupational health and safety to achieve zero lost time injury (LTI).			
WHAT	WHEN	BY WHOM	FREQUENCY OF REVIEW	COMPLETED
5.1 Line Manager training in occupational health and safety.			Monthly	
5.2 Coordinate OH&S Risk Analysis project.			Weekly	
5.3 Undertake management education programmes in relation to equal opportunities, sexual harassment and bullying in the workplace.			Quarterly	
5.4 Develop plans to achieve a discrimination-free and harassment-free workplace.			Monthly	

Figure A4.2 HR – OH&S

In the extracts we have provided above, the OH&S and systems improvement projects are excellent examples of ‘tactics’ designed to deliver short-term outcomes that are linked to a longer-term strategic outcome.

6–8. Developing the tactics, the plan and PIPs

This section deals with Steps 6 to 8, which are areas where organizations are going to do their own thing to a certain extent. In determining the best way to approach this in your organization, it will be necessary to have the business planning group work with the HR people to eliminate any duplication that might otherwise occur.

The starting point is the strategic plan. It is assumed that an organization has some sort of plan to cover the next three to five years or longer. It is also assumed that this will be the vehicle for the development of triennial, biennial and annual business plans. If these documents are of good quality (and kept up to date) they will speed up the development of the PIPs considerably.

One of the difficulties we have encountered is the expectation that HR or Finance will individually do all the work to set up the PIPs. It won’t work; this has to be a team effort. A small group of senior managers who are well informed about the strategic direction of the organization will need to work together to produce the right results in terms of KPAs and generic objectives. Senior managers are best placed to then develop position-specific objectives, indicators and draft targets for discussion with their managers.

Many organizations do not share these details amongst the senior management group. We recommend it and indeed, find performance objectives that apply to more than one manager need to be carefully managed in terms of determining the roles and responsibilities – even more so where it is a project team that has responsibility for a particular tactic.

Once the senior management team have their PIPs in place, they can begin to apply the tactics to their departments and set up PIPs for their direct reports, establishing clear expectations of the contribution expected from them.

For example, if we were first to look at the CEO performance improvement plan we would see how their tactics/actions link with the next level of management. In the financial area, an expenditure-reduction programme would be included in the CEO's PIP as part of a Board-driven strategy, would then reappear in the CFO and finance manager's PIP.

Another example in the human resources area is OH&S and the completion of all risk analyses, which would then in turn appear in the PIPs of the HR manager, OH&S manager, operations manager and the floor supervisors. In other words, in this system we can see the linkages between the *tactical responses we have planned to achieve our strategic outcome* and the operational performance outcomes needed to deliver these within the relevant timeframe.

THE EXECUTIVE COACHING MODEL

The main difference between the 'executive' coaching model and the coaching model described in the body of this book is that early intervention is only likely to be achieved by a greater level of planning and formalization of the reporting processes on the outcomes/progress of the individual manager's PIP. At this level of the organization the approach has to be quite different to that at the operational level but the principle remains the same. People may see the difference as being the physical and time separation between the CEO and the actions of their managers, but this is only part of the story.

Even at the operational level there is an expectation that team members will perform to standards and conduct themselves appropriately in the absence of the line manager/supervisor. With senior management groups, the fact is that the level of activity and diversity of projects they are involved in means that the PIP has to identify the *frequency of review* (this is included in the draft extracts shown earlier in [Figures A4.1](#) and [A4.2](#)). This greater level of structure doesn't cause problems as long as the frequency of the review is appropriate to the activity (that is, not all things need to be reviewed weekly or even monthly) and the reviews are 'exception' reviews – we will

only spend time on those tactics with which there is a problem. The congratulations can still be there for those that are doing well, but we do not need to analyse all those things that are working well – there is time for that later.

INCENTIVES AND REWARDS FOR SENIOR MANAGERS AND THE EXECUTIVE TEAM

As we said at the start of this appendix, the issues associated with managing the performance of senior managers and Boards and the nature of incentives and rewards provided to these groups, requires a book of its own (which we have made a start on). However, this book would not be complete without some reference to the incentives and rewards provided to senior managers as part of their contract of employment. (We will not deal with Board remuneration in this appendix as it would be too lengthy and whilst related to the topic at hand, has some quite different elements to it on the governance side.)

Where do we start? We have golden handshakes, golden handcuffs, performance bonuses based on share price increases, market share, turnover and anything else you can think of; options that may be free or discounted and which can be taken up in a good year and sold off when the manager feels like it. Some people suggest that this is an appropriate motivator for a leader who is employed to maximize the long-term wealth of the shareholders.

I think where we start is to go back to 'square one'. What should senior management remuneration be about? What are the objectives that we should be trying to meet? Obviously an organization needs to pay what is necessary to recruit and retain quality managers. It is therefore a matter of negotiation to strike the right levels. We do not want to get into minutiae of the process of recruiting senior managers, but simply repeat that clarity of expectations is critical to a successful relationship, which means that the measurement, management and rewarding of performance need to be clearly articulated at the point of hire.

The other principles we would urge be embodied in the measurement, management and reward of senior managers are set out below:

- Key performance areas need to reflect a 'Balanced Score Card' approach and not rely on one or two annual financial measures to drive bonuses and/or options.
- Where quantitative measures are employed to reflect reward for growth/increases, the lower parameter should also be stated, that is, the point at which we would expect a dismissal to occur or the events that would trigger a termination of the contract.

- Performance incentives must be structured within an appropriate time-frame.
- Termination of the contract must be written in ways to ensure that poor performers leave with no more than their payment for notice.
- Research should be undertaken with quality recruitment and remuneration experts to justify the base salary incentive arrangements and termination provisions in relation to market norms.

We will now provide a brief explanation of these points.

Balanced Score Card approach²

This is not new and is basically common sense. The old days of reporting just profit after tax, earnings per share and the dividend, are long gone – just look at any Annual Report these days. You would think that the left hand and the right hand of an organization were operating independently when you see some of the incentive plans. Increase market share! The more you increase it, the bigger the bonus. No need for balance, so we just cut prices, reduce margins, increase market share at a phenomenal rate and potentially go broke in the process! Suffice to say, the incentives must also reflect balance – not only what targets you need to hit, but how you go about it. It is not ‘hit a single target and ignore the ramifications for other key performance areas’.

Include ‘unacceptable’ performance parameters

It is all about managing risk. So why shouldn’t the senior managers understand the punishment as well as the reward? ‘Increase market share but it needs to hold for x quarters and net earnings must not fall below y’ is more appropriate in setting expectations than, ‘Here is the target – go for it!’

Timeframe

We cannot tell you what this should be as it will depend on the circumstances. What we can say is that annual bonuses as the ‘be all and end all’ of incentive schemes are often totally inappropriate. If it was decided to have an ‘at risk’ component in the salary of a senior manager who was developing a mine over a three to five year period, and we decided to provide incentives for ‘rapid completion’, two major issues arise. First, we could pay out a lot of money for a mine that never operates profitably (for whatever reason). Secondly, we are saying to a manager effectively, just get this thing finished within budget as quickly as you can. If the senior manager’s incentives are

reflected downwards in the organization (as they often are) we are rewarding performance/outcomes that could lead, in the long term, to fundamental flaws in the operational capacity (not to mention OH&S and environmental considerations), which is the antithesis of what performance incentive schemes should be about.

In this mine construction example the incentive scheme should perhaps be graduated upwards over three to five years and impacted by other relevant performance criteria in terms of the construction phase and the operational start-up. Whatever the reward system, it must reflect the strategic, long-term outcomes we seek, not just 'this for this fixed period' as they so often do.

Termination provisions

This is really one for the lawyers. The point is that over the last 10 years shareholders, the community and even governments have expressed their dismay over the fact that senior executives can 'mess up' so badly that they are to have their employment terminated, and still leave with millions, often in the guise of performance bonuses. It shouldn't be too difficult to write a contract that provides for a manager who is dismissed for poor performance (or conduct) receiving nothing in excess of his or her basic entitlements.

Recruitment and negotiation of terms

We don't need to repeat ourselves. Enlist some external experts and have them produce solid evidence of market rates for remuneration (or do it yourself) and then design the 'at risk' component in accordance with these principles.

In conclusion, we hope this appendix gives some managers (and directors) something to think about. In some countries it is not beyond the realms of possibility that in future years corporate law may make it illegal to pay amounts in excess of basic entitlements to senior managers who are being dismissed for poor performance or whose company finds itself in financial difficulty. Something certainly needs to happen and we can help by ensuring that senior managers are themselves performance-managed with clear performance targets and clear expectations of their conduct, both in the corporate world at large and in their own organization.

NOTES

1. This will be the subject of a future book, tentatively entitled *Managing the Managers. Management incentives – stop rewarding the guilty.*
2. Originally developed in the early 1990s by Drs Robert Kaplan (Harvard Business School) and David Norton. They named this system the 'Balanced Score Card' as it provides a clear prescription as to what companies should measure in order to 'balance' the financial perspective.