

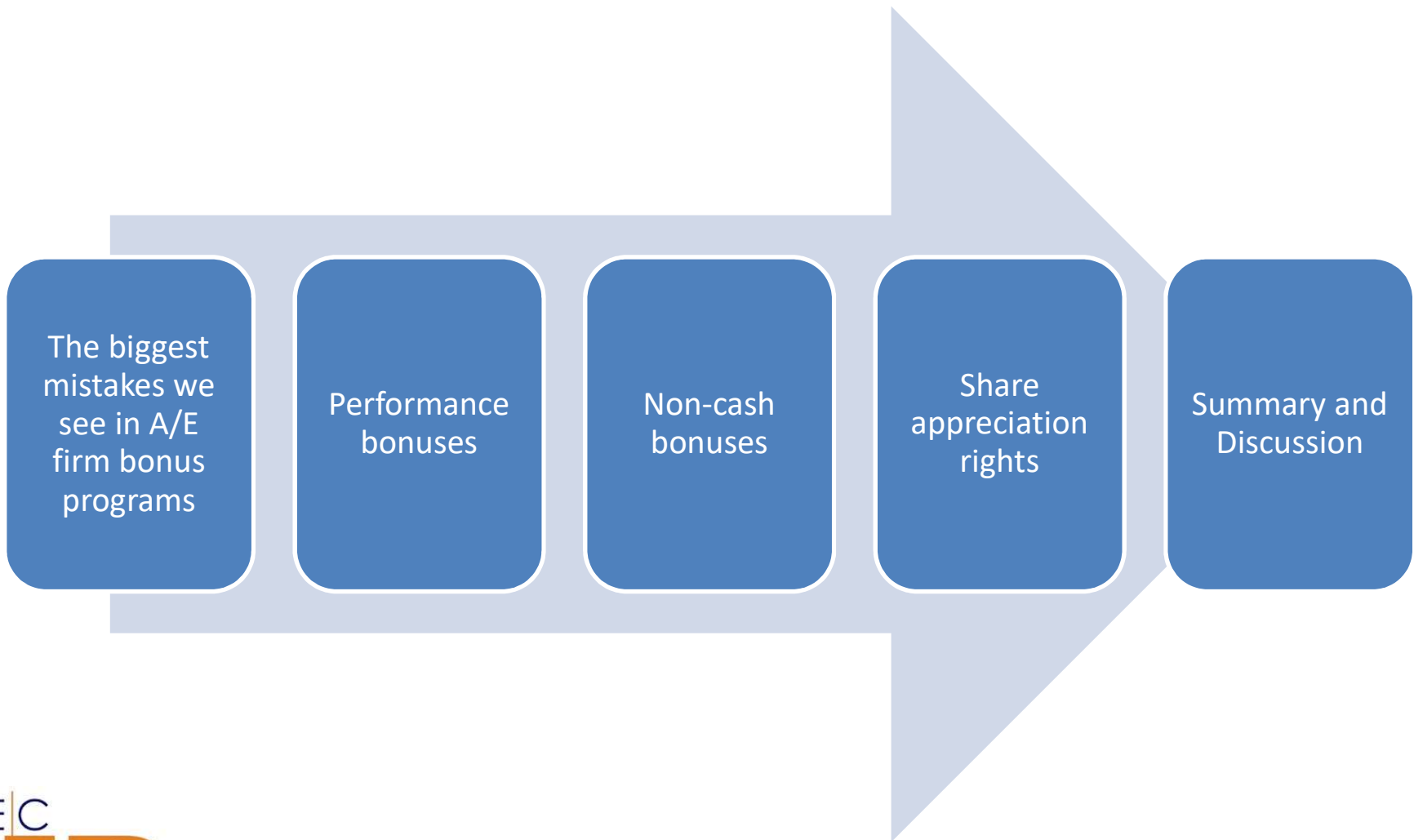
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# Establishing a Bonus Program That Works for Your Firm, Not Against It

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# Agenda



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**The biggest mistakes we see in A/E firm bonus programs**

Performance bonuses

Non-cash bonuses

Share appreciation rights

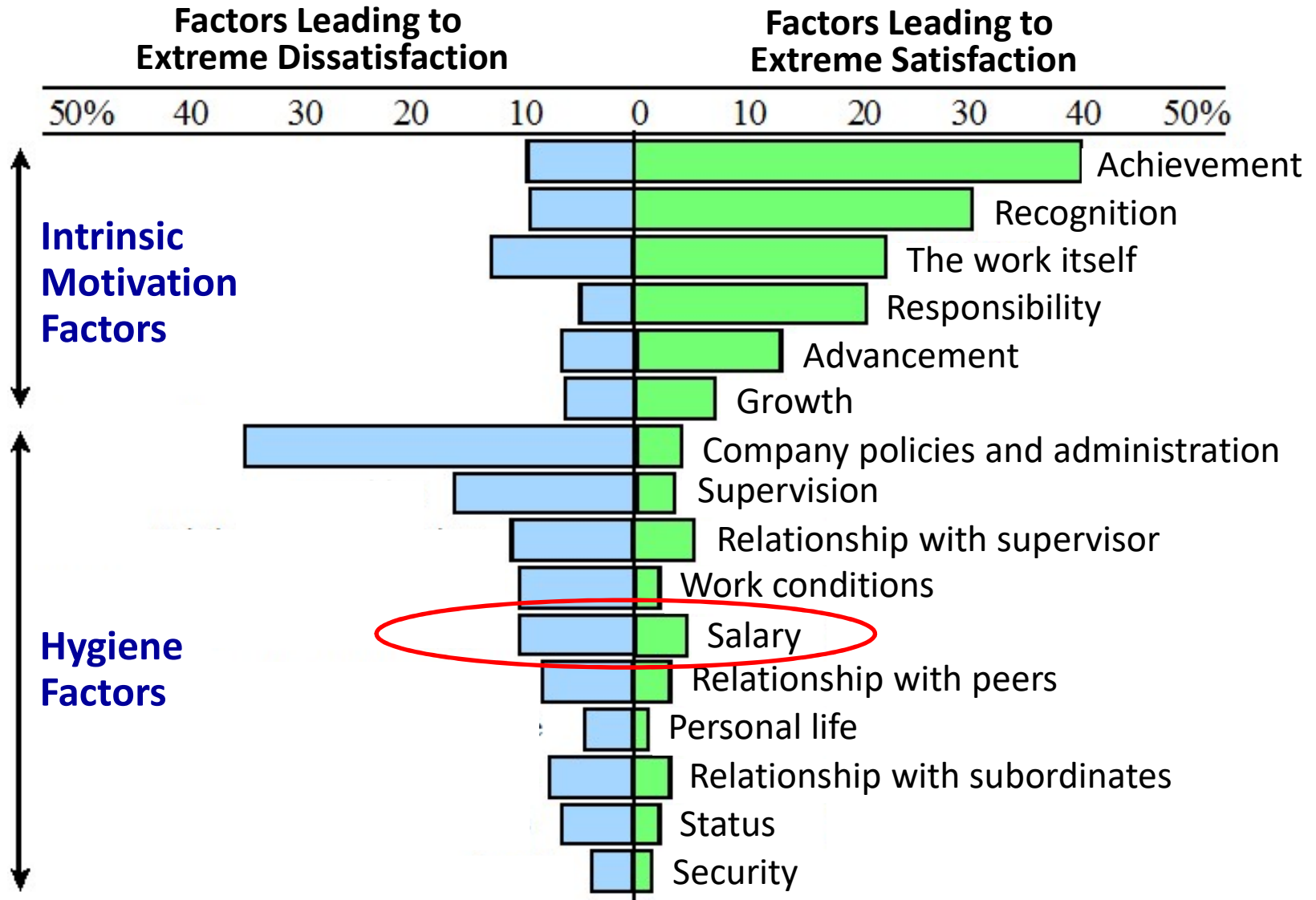
Summary and Discussion



A|E|C  
**HR** 2018  
SUMMIT

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# According to Frederic Herzberg...



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# The Biggest Mistakes Firms Make in Paying Bonuses to Owners

## Why are these so bad?

- Paying bonuses based solely on share ownership
- Paying bonuses based solely on performance

# Divide the CASH into 3 pools

1. Determine how much, if any, you want to set aside for **retained earnings**:
  - a. Compute your current equity per employee
  - b. Determine your target equity per employee

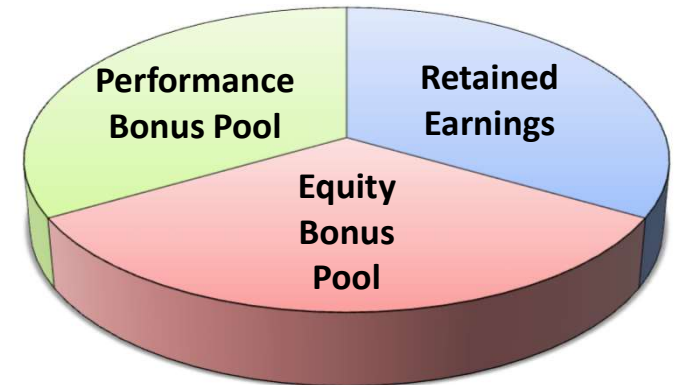
## 2017 A/E Industry Data

Lower Quartile = \$21,900 per FTE

Median = \$35,500 per FTE

Upper Quartile = \$52,100 per FTE

- c. Compute the amount needed to achieve your target (could be a negative value)
2. Determine how much goes into your **equity distribution pool**, apportioned to shareholders in proportion to their ownership:
    - a. Determine your desired Return on Equity for shareholders (usually 20-35% per year)
    - b. Subtract the return from this year's share appreciation
  3. Whatever is left goes into your **performance bonus pool**, distributed to each employee according to performance (regardless as to whether the employee is also a shareholder)



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# How To Do the Math

- A. Cash available at year end
- B. Current shareholder equity (excluding this year's distributions)
- C. Target equity/staff
- D. Current staff size (FTEs)
- E. Current equity/staff =  $B/D$
- F. Retained earnings =  $D \times (C - E)$
- G. Target ROI
- H. Share appreciation this year
- I. Equity distribution pool =  $B \times (G - H)$
- J. Performance bonus pool =  $A - F - I$



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# Example Calculation

Your firm just completed your fiscal year. Here are your year-end results:

- Cash available for distribution = \$900,000
- Current shareholder equity = \$1,400,000 (excluding this year's distributions)
- Current staff size = 50 FTEs

It's time to distribute bonuses. Here are some relevant conditions:

- Your target equity is \$35,000 per FTE
- Your target Return on Equity for stockholders is 25%/year.
- Your shares increased in value by 10% this year.

Current Equity per Staff =  $\$1,400,000 \div 50 = \$28,000$

Retained Earnings =  $50 \times (\$35,000 - \$28,000) = \$350,000$

Equity Distribution Pool =  $\$1,400,000 \times (25\% - 10\%) = \$210,000$

Performance Bonus Pool =  $\$900,000 - \$350,000 - \$210,000 = \$340,000$

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The biggest mistakes we see in A/E firm bonus programs

**Performance bonuses**

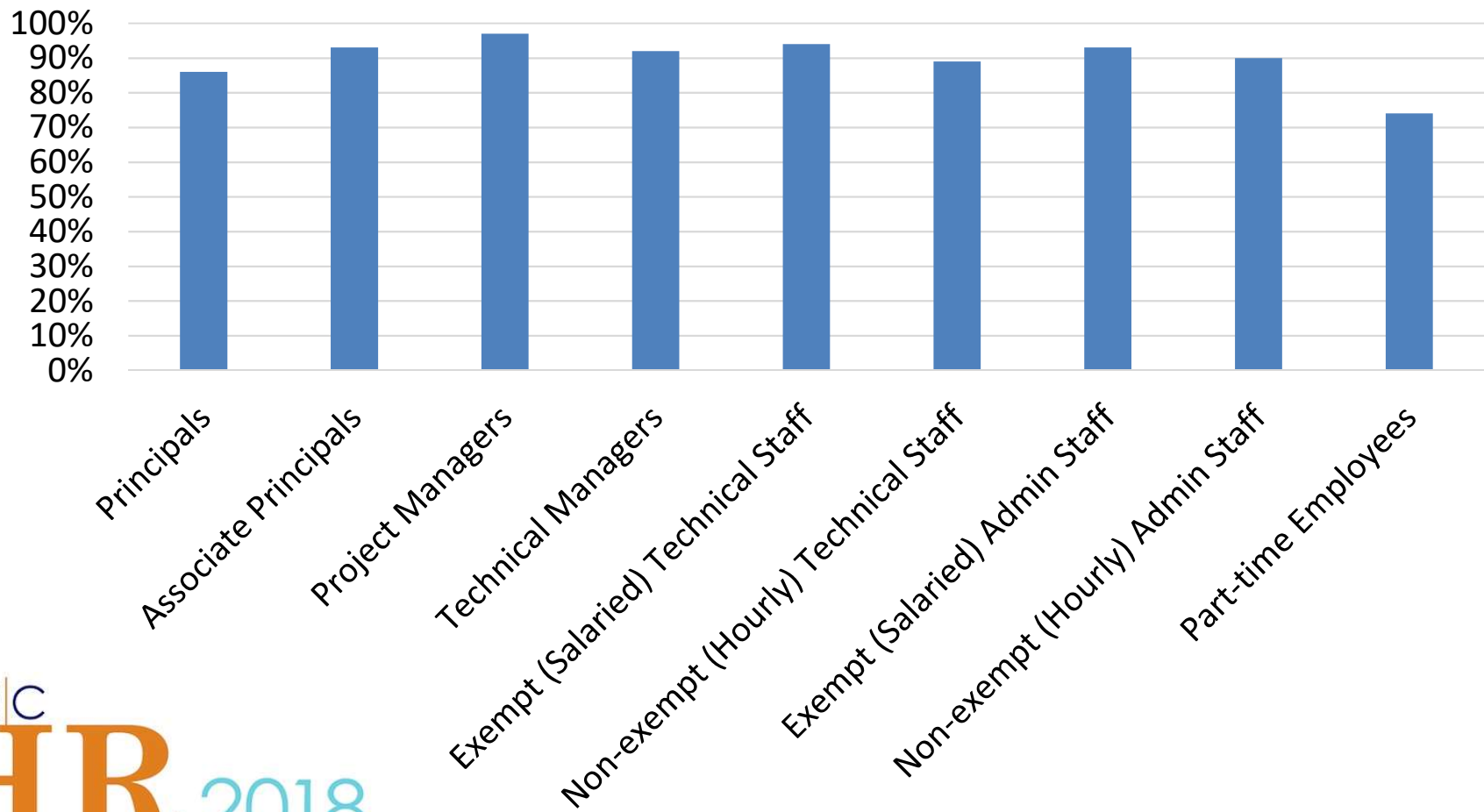
Non-cash bonuses

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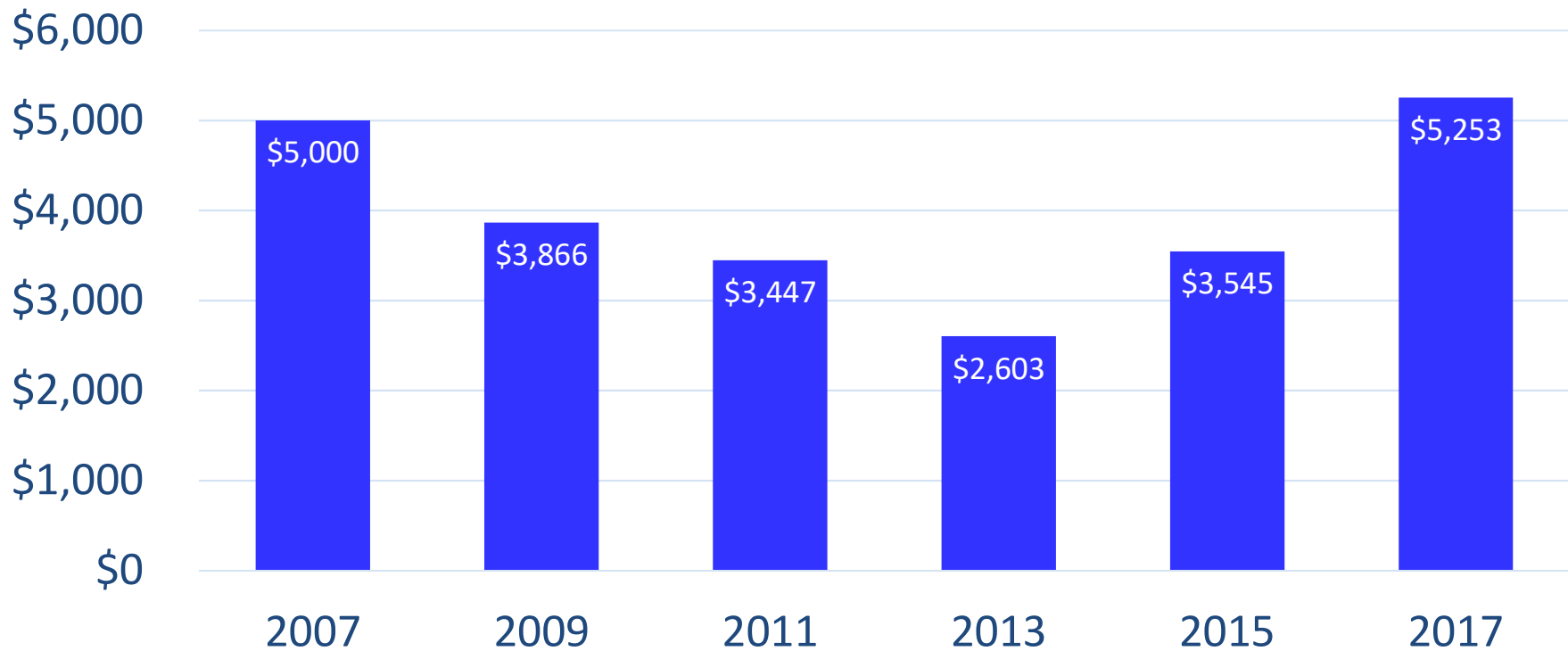
# Most A/E firm employees are eligible for performance bonuses

## Eligibility for Participation in Firms' Bonus Pool

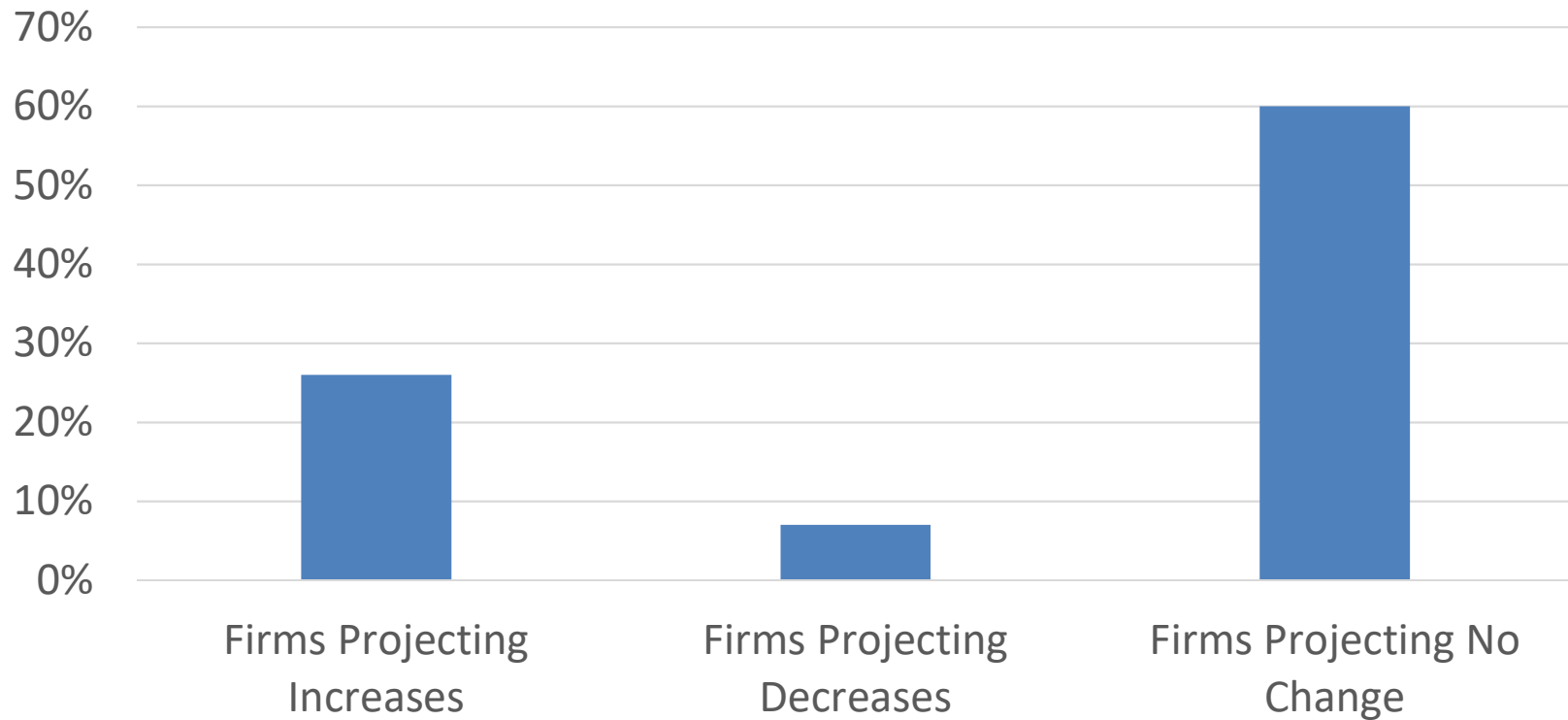


# Bonuses have recovered from The Great Recession

## Median Bonus per Total Staff



# Bonuses were expected to increase or stay the same in 2017



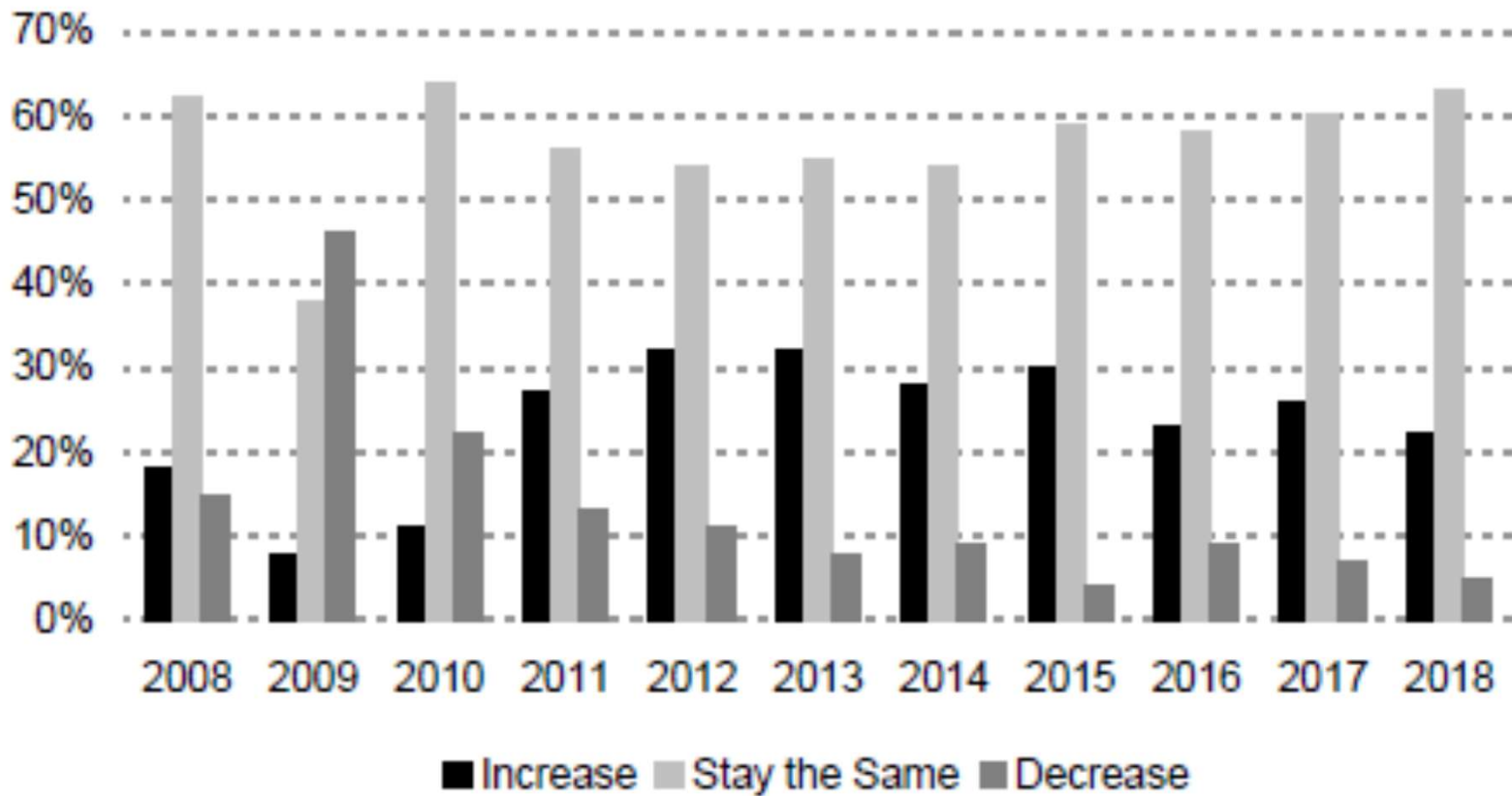
# Bonuses Did Increase for Most Positions

Position:	Relative Change in Bonus
Chairman of the Board	12.9%
Chief Executive Officer/President/Managing Partner	13.7%
Chief Operating Officer/Executive Vice President	14.8%
Senior Vice President/Senior Principal	-5.3%
Other Principals and Partners	15.7%
Director of Finance/CFO	8.5%
Controller	7.1%
Business Manager	-8.2%
Director of BIM Services	26.3%
Director of Operations	-35.8%
Director of Business Development	93.2%
Director of Marketing	28.6%
Director of Human Resources	21.4%
Director of IT/Computer Operations	6.8%
Branch Office Manager	3.5%
Department Head	0.0%
Senior Project Manager	7.1%
Project Manager	21.8%

Source: Comparison of 126 firms participating in both the 2017 and 2018 PSMJ Management Comp Survey

# Modest Increases Are Expected for 2018

## Yearly Bonus Projections



Source: PSMJ 2018 Management Compensation Survey

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# How do you distribute performance bonuses?



Reward Program



Incentive Program



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# Reward Programs vs. Incentive Programs



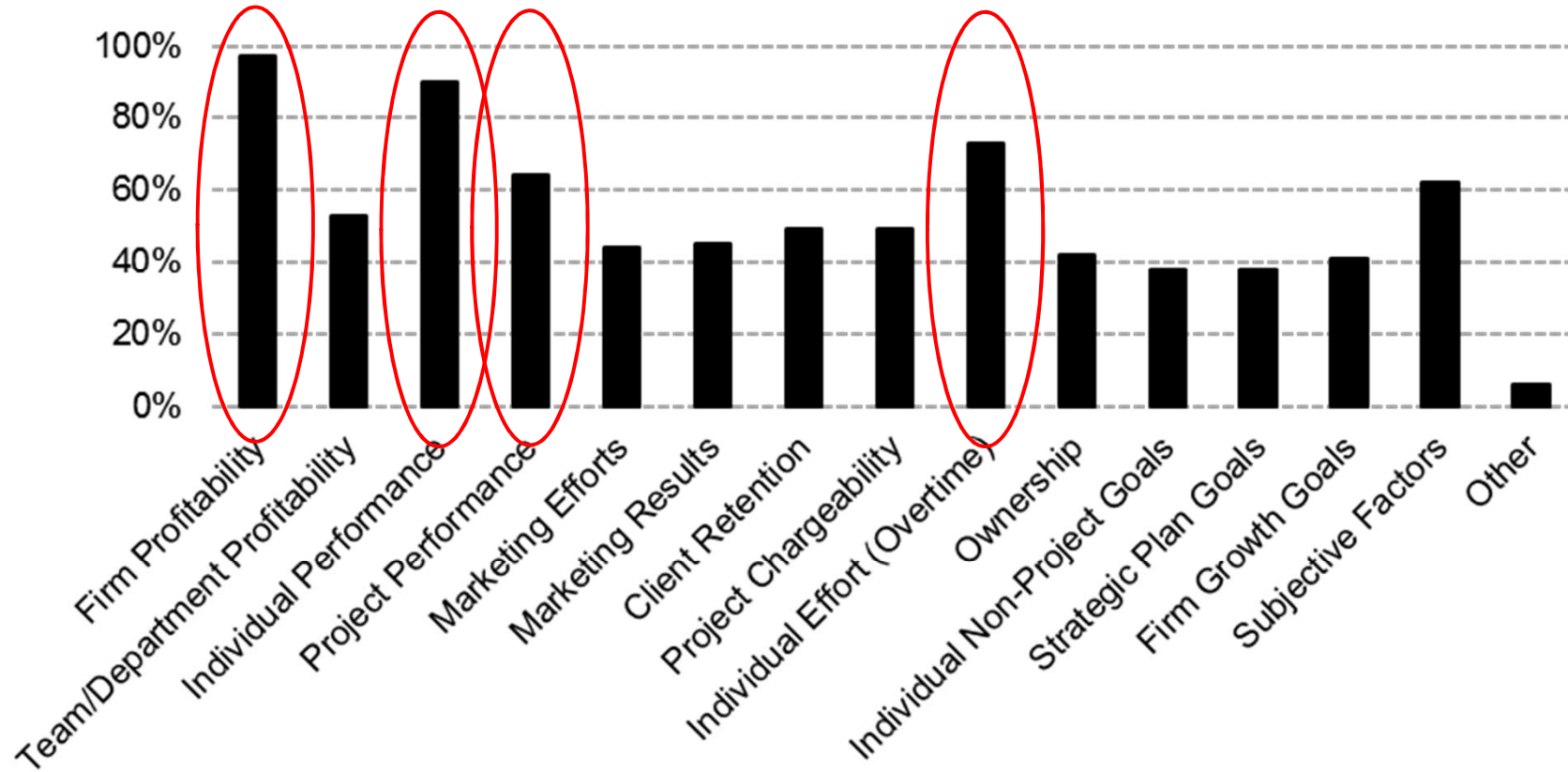
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# Some Advice Based on Others' Experience

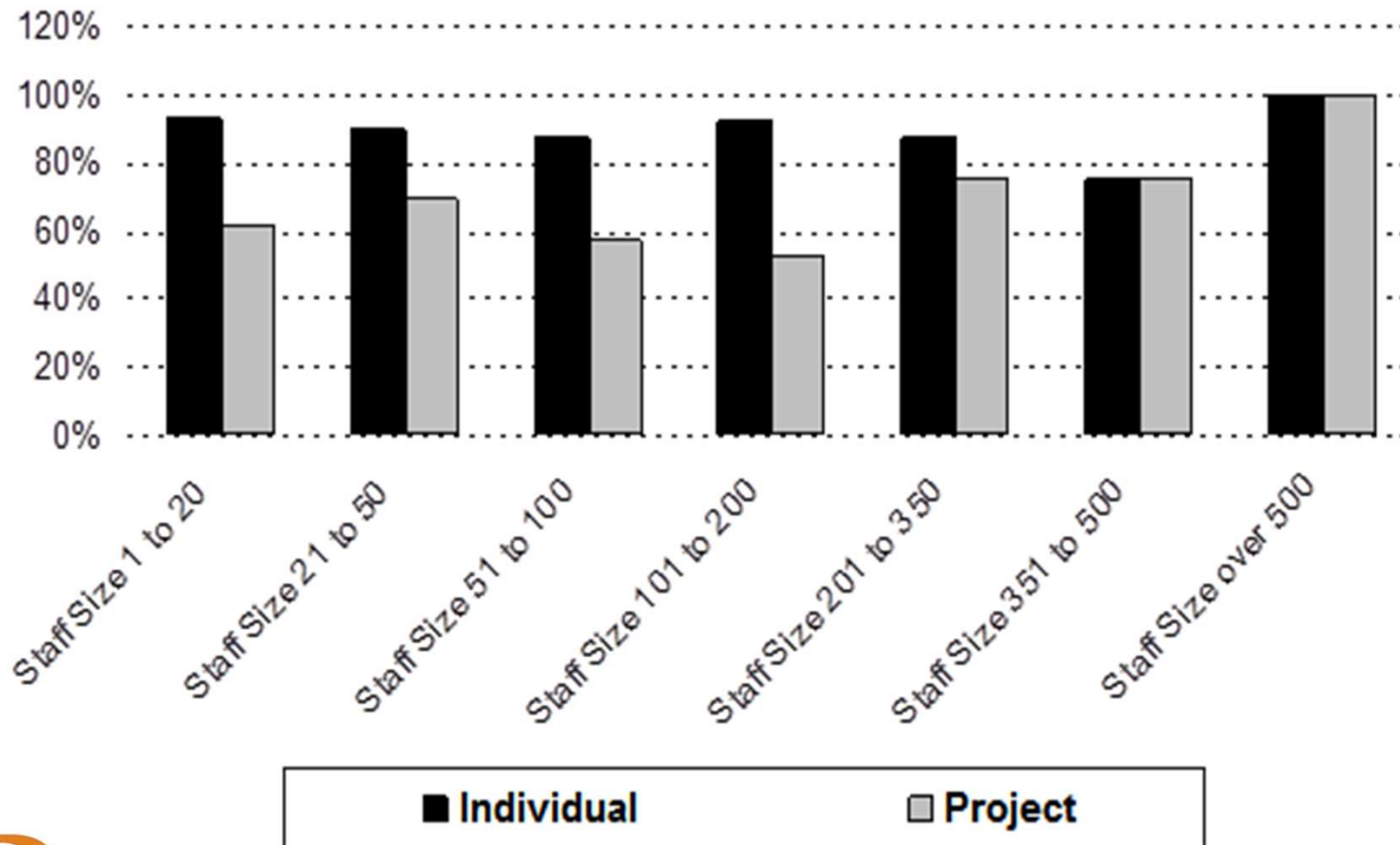
- A good incentive program is better than a reward program
- A poor incentive program is worse than a reward program
- Bonuses based on formulas promote gamesmanship

**Best practice:** Define the behaviors that will create a bonus but don't use formulas to determine bonus amount.

# Factors Affecting Incentive Bonuses



# Larger firms place more emphasis on project performance



# What makes the best performance bonus plan?

	<b>Best Bonus Plans (100% Highly Satisfied)</b>	<b>Overall Survey (21% Highly Satisfied)</b>
Total Bonus Dollars per Staff	\$6,697	\$5,253
Bonus as Percentage of Salary: Low to High	3% - 28%	2% - 16%
Percentage of “Very Satisfied” Firms:		
Bonus Plan Provides Fair Rewards	90	31
Bonus Plan Rewards Desired Performance	81	27
Bonus Plan Motivates the Staff	55	14
Bonus Plan Easy to Administer	81	28
Staff Growth	9.3%	4.3%
Percentage Staff Turnover	9.8	12.3
Profitability (% of Net Revenue)	21.6	15.3

# Homework:

## How effective is your bonus program?

Ask each of your principals and key employees to rate your bonus program using the following scale:

- 5 – Very satisfied
- 4 – Satisfied
- 3 – It's OK
- 2 – Somewhat dissatisfied
- 1 – Very dissatisfied

Then average the results and compare them with PSMJ's survey data.

Bonus Program Elements	Your Firm	A/E Average
Overall bonus plan satisfaction		3.7
Is bonus plan fair to our staff?		3.8
Does bonus plan reward performance desired?		3.6
Does bonus plan motivate our staff?		3.6
Is bonus plan easy to administer?		3.6
Does bonus plan meet the firm's needs?		3.6

Source: 2017 PSMJ Bonus & Benefits Survey

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The biggest mistakes we see in A/E firm bonus programs

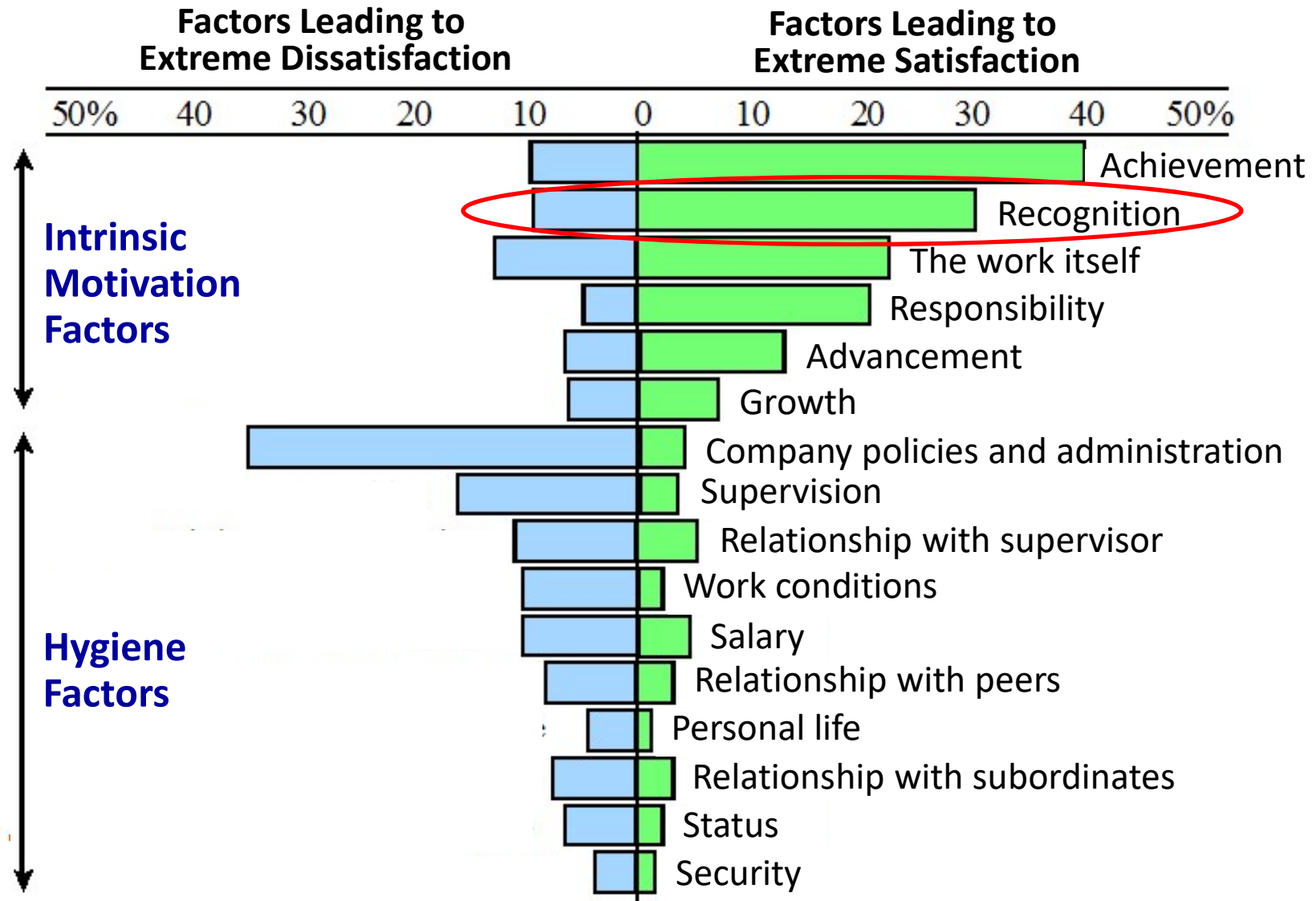
Performance bonuses

**Non-cash bonuses**

Share appreciation rights

Summary and Discussion

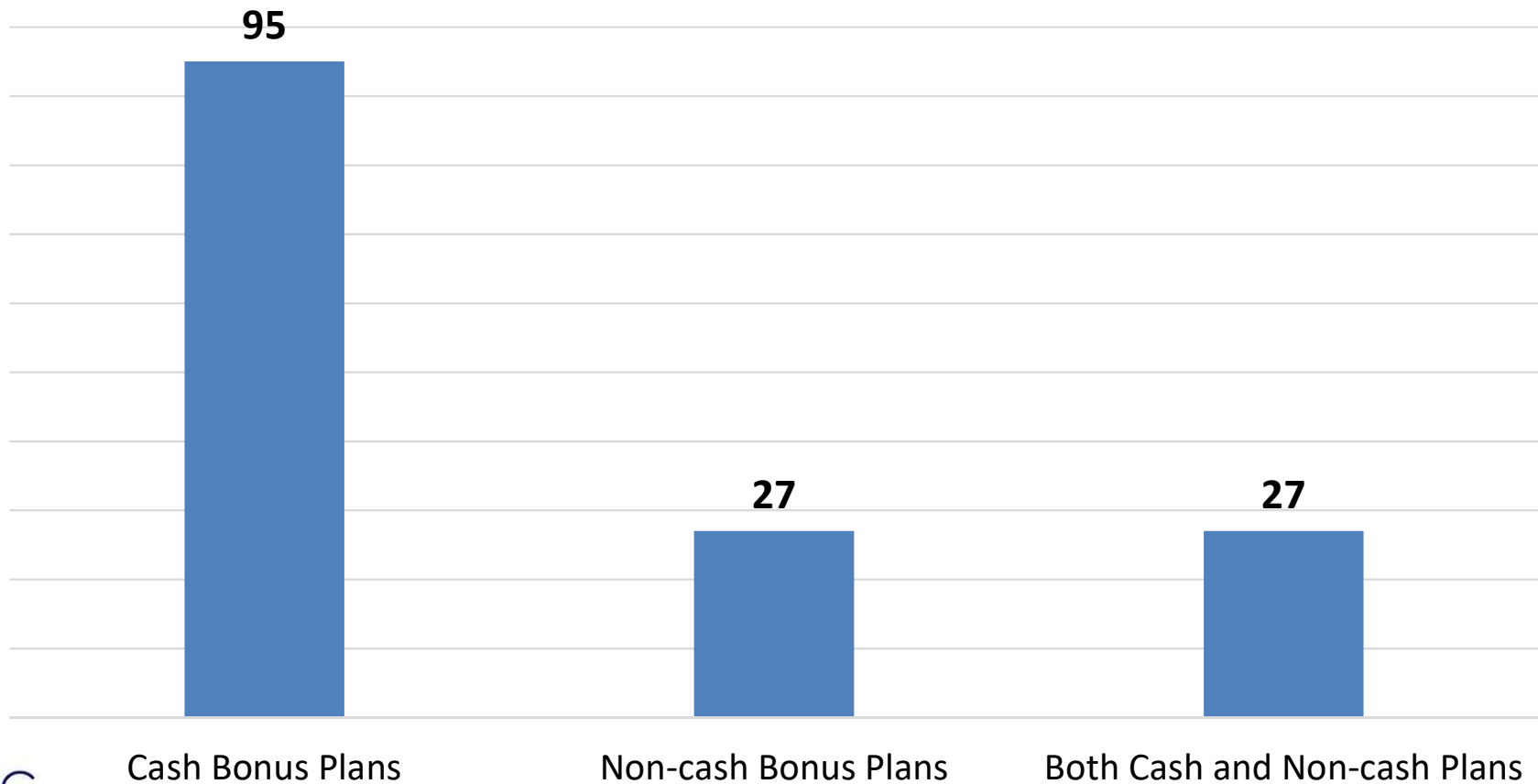
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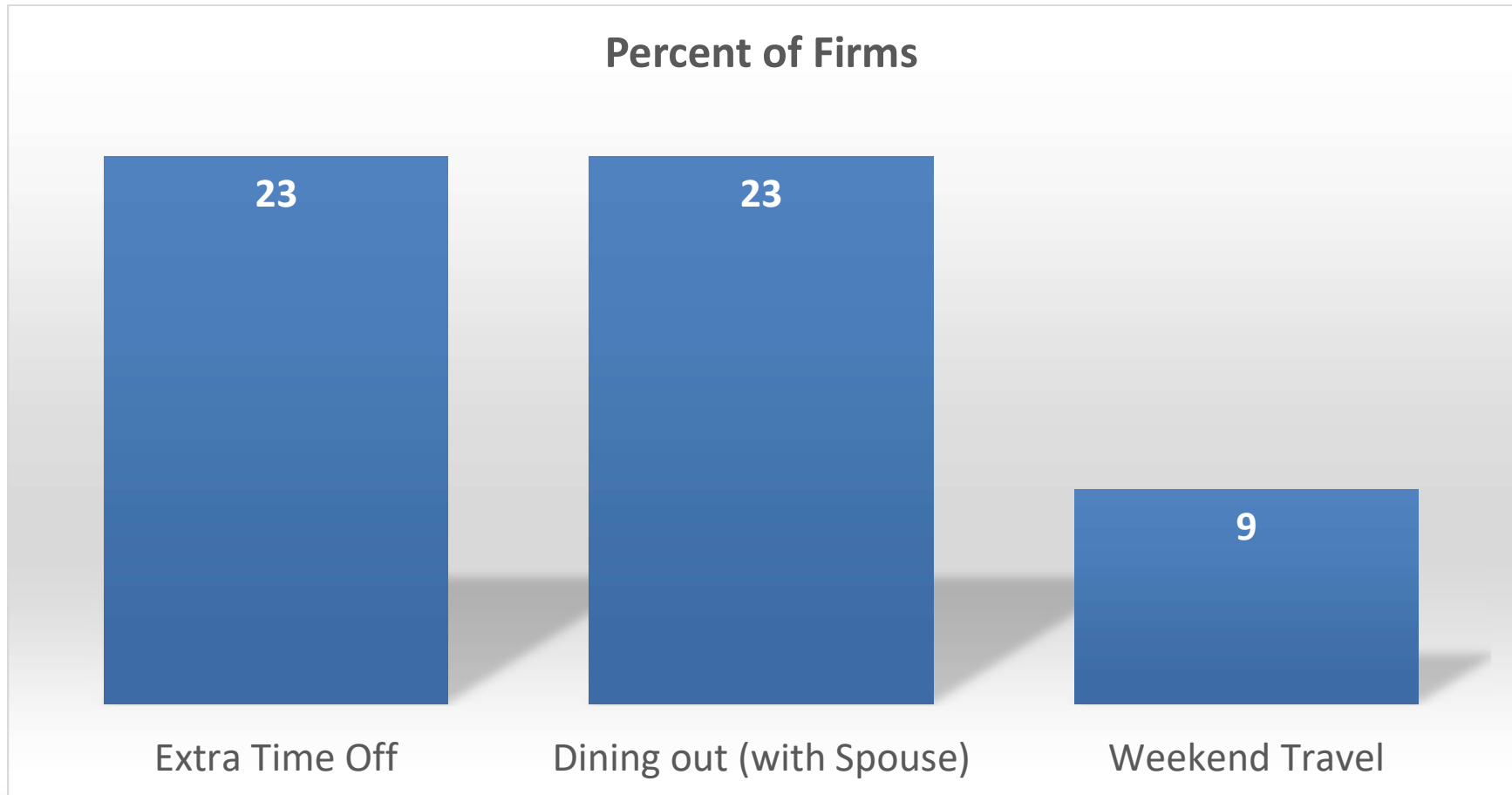


# Non-cash Bonus Plans Aren't Common in the A/E Industry

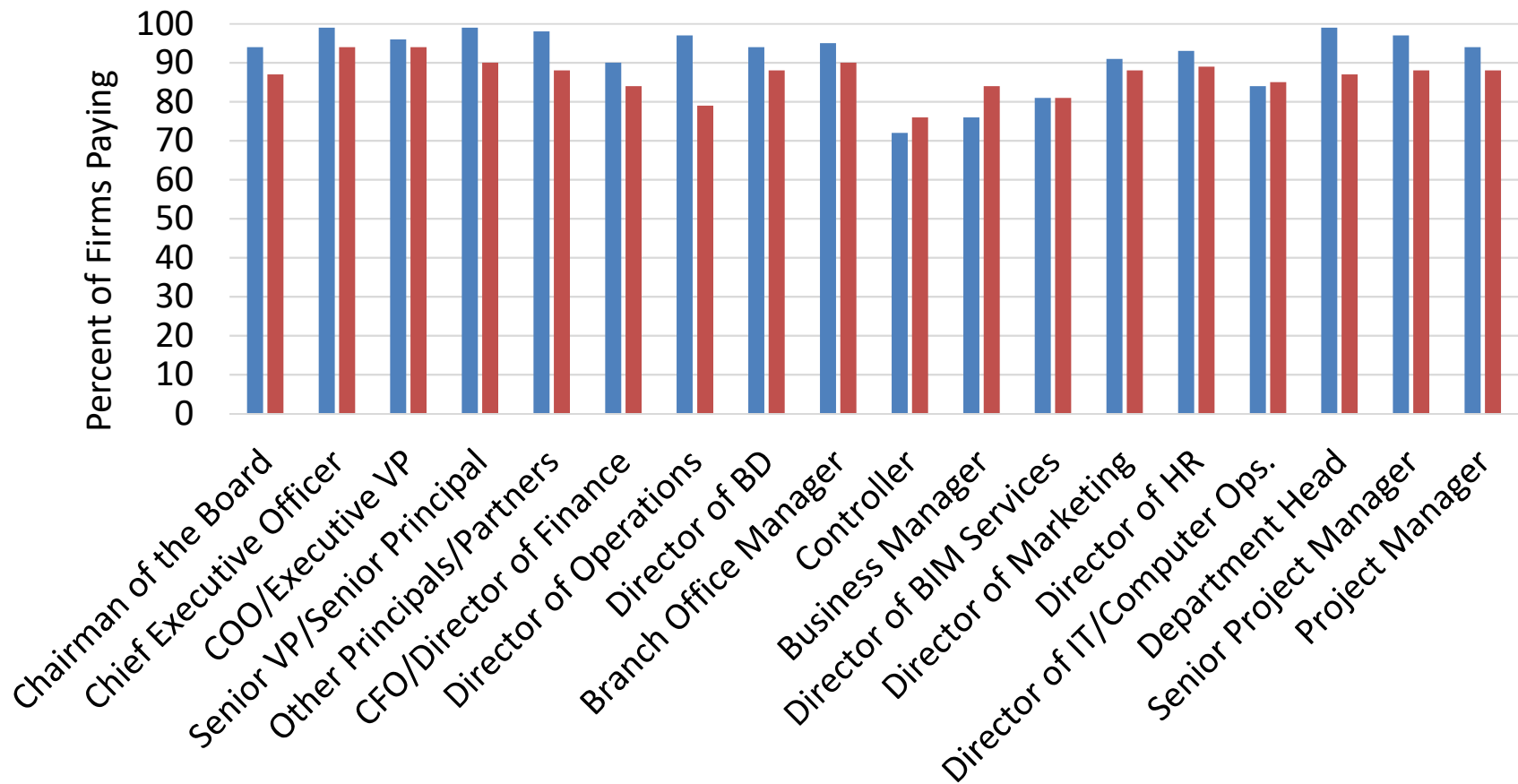
Percent of Firms



# Most Popular Non-cash Bonus Plans

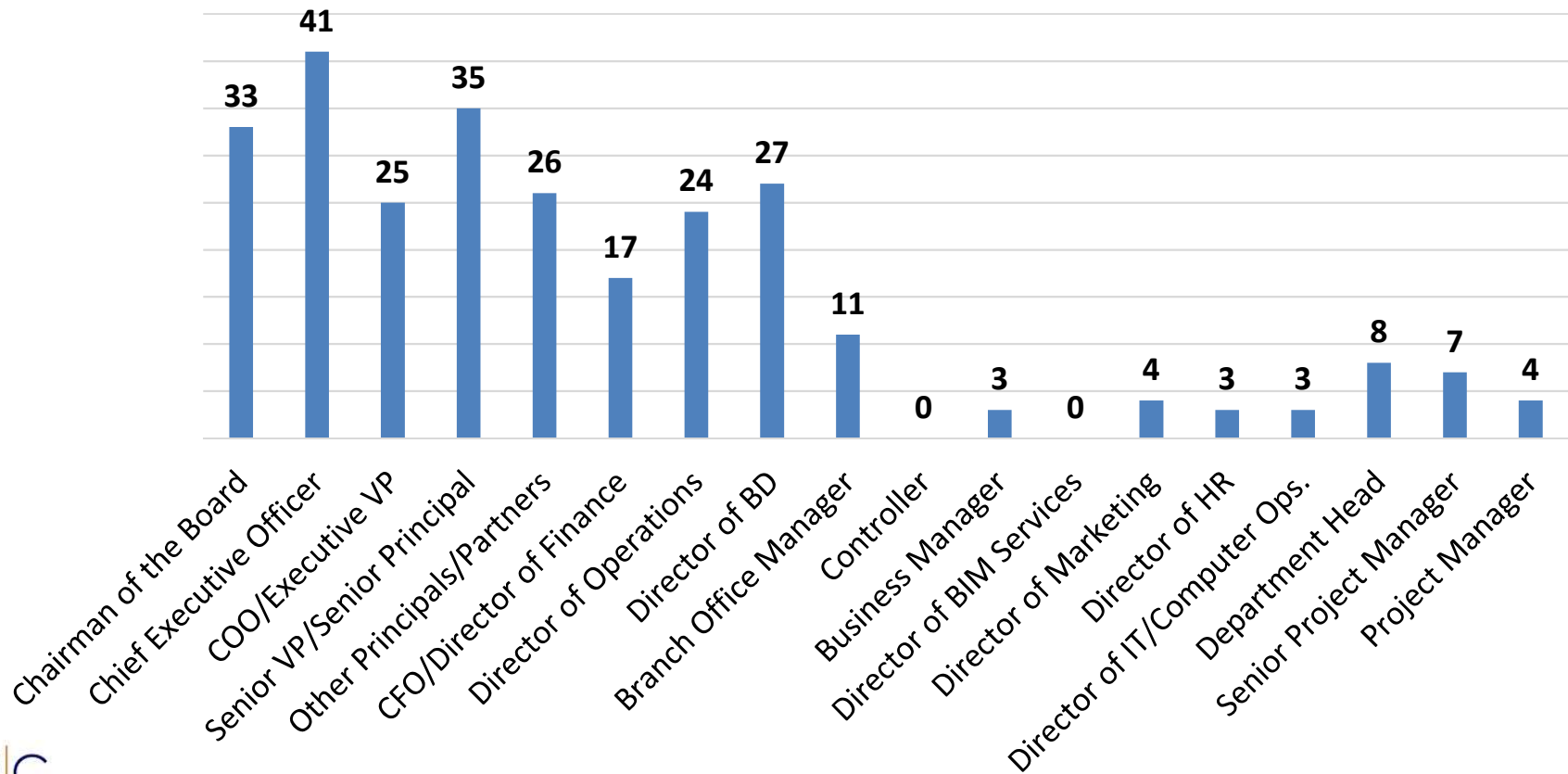


# Most Firms Pay Professional Dues and Education Expenses for all Managers



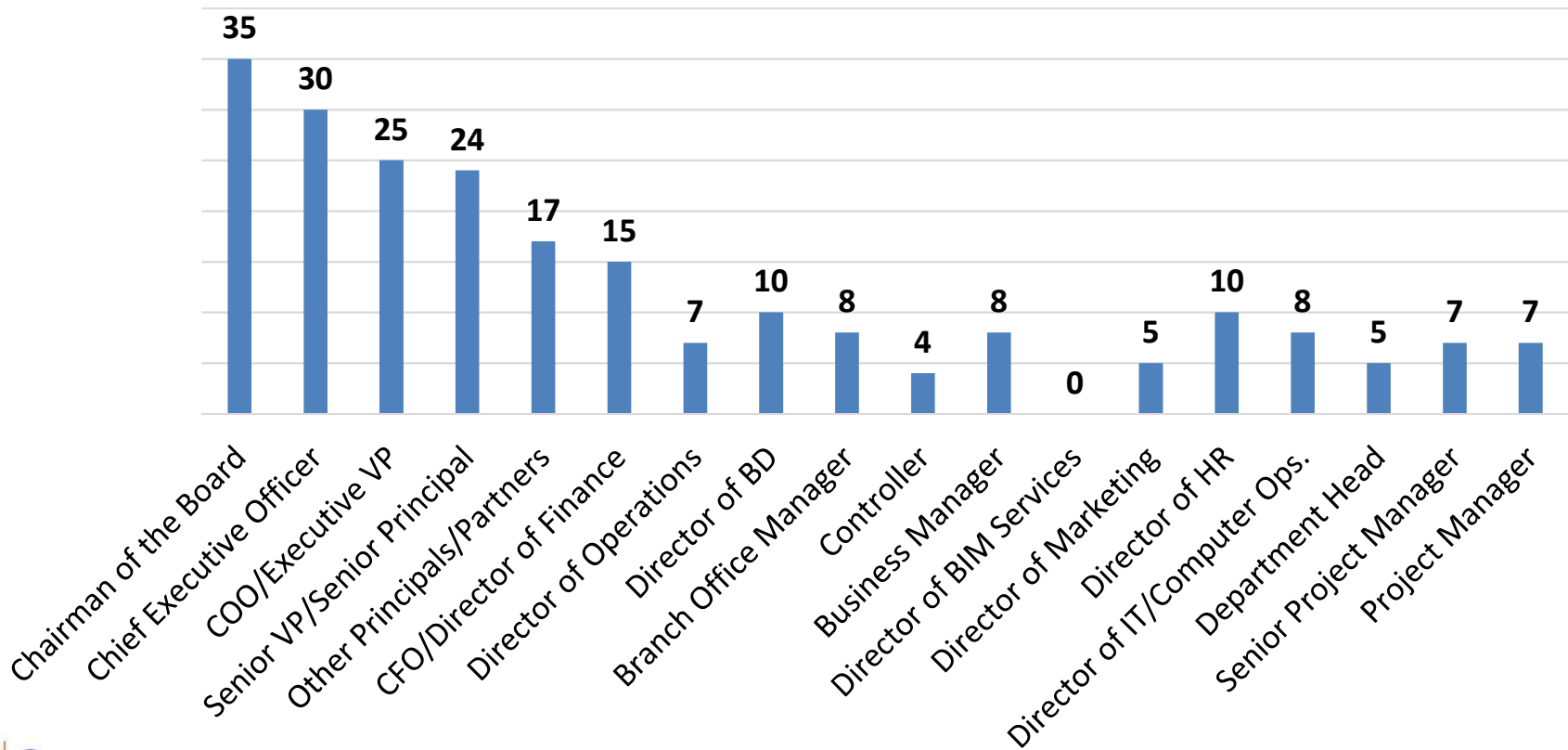
# Some Firms Also Offer Company Cars to Senior Managers

Percent of Firms Offering Company Cars



# Some Firms Also Pay for Legal/Financial Assistance

Percent of Firms Paying for Legal/Financial Assistance



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**Share appreciation rights**

Summary and Discussion

# Have you considered Phantom Stock?

## How They Work

- Similar to stock options
- Shares awarded annually
- Value based on share value when received
- Vesting period ~ 3 years
- Cash out based on share value after vesting
- Sometimes can be convertible to real stock

## Benefits

- Ties compensation to increase in company value
- Provides something of value when you're short on cash
- Serves as "golden handcuffs"
- Matches cash outflow to company's ability to pay
- Doesn't dilute ownership

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**Summary and Discussion**



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# Workshop: How Can Your Firm Improve Its Bonus Program?



Questions or Comments???

