



# How to Build a Winning Executive Compensation Strategy





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## Introduction

Understanding how to appropriately compensate your leadership team can be tricky. Unlike other positions within your workforce, base salary typically plays the smallest part in the compensation of top executives. Executive compensation is different than your typical hourly employees or salaried professionals in that the pay is heavily geared towards rewards for actual results. Ultimately, a leadership team member's salary must be strategically designed to properly incentivize this individual to meet both short and long-term company goals.

Some of the things you must think about include:

- Aligning executive compensation with your overall budget
- Putting together an attractive total compensation package that will help you land and retain top-quality executive candidates
- Creating appropriate incentives that retain leadership long-term and align them with long-term company objectives
- Including appropriate incentives that make leadership take both short and long-term company goals into account
- Developing KPIs (key performance indicators) that can be used to determine performance-based objectives

This guide we'll explore the different components that make up an executive salary, and how to properly proportion these components to incentivize your leadership team to meet company goals. We'll cover:

- Components and composition of an executive compensation package
- Base salary
- Short-term incentives
- Long-term incentives
- Benefits
- Executive Perks
- Contingent pay





## Executive Compensation Components

In general, salary is divided into two categories: guaranteed income and at-risk income. Guaranteed income includes base pay, benefits, and any other compensation that is not dependent upon employee performance. At-risk income is all other compensation that is dependent upon employee performance. What makes executive compensation unique is that unlike other employees, their pay is a majority at-risk with a smaller portion being guaranteed. The reason for this is because executives must be highly motivated to meet performance objectives.

There are four key components that make up an executive salary:

- Annual base salary
- Annual incentives or bonuses tied to short-term key performance indicators
- Long-term incentives tied to long-term performance indicators and/or financial objectives
- Benefits plan

Additionally, the following elements are optional but are often also included in executive compensation packages:

- Executives perks: extra perks not offered to other employees (such as access to a company vehicle)
- Contingent pay: severance coverage in the case of involuntary termination

Now that you understand the components that make up the plan, the next step is to determine the composition of each of these components.

When it comes to designing the total compensation package, a standard composition would be 30% base salary, 20% annual incentives, 10% benefits, and 40% long-term incentives.

Compensation package composition creates a strong correlation between company performance and executive pay. Beyond target annual bonuses, strong compensation packages usually include manage-by-objective bonuses rather than goals based solely on financial performance.



# Structuring Executive Base Salary



The base salary for executives varies widely depending on the industry, geography, and desired years of experience. To determine a suitable base salary range, you'll first have to pin-down the qualifications and experience level you want in your incoming leadership team member.

When considering salary, it can help to structure it with signing bonuses. If you think an executive salary might be outside your budget, you might consider offering staggered or deferred signing bonuses to increase the base salary amount without incurring all the costs up front. For example, instead of offering a \$20,000 signing bonus you might offer four quarterly bonuses at \$5,000 each.





## How to Structure Short-Term Incentive Plans

Short-term incentives, typically paid in the form of an annual bonus, help motivate your leadership team to achieve immediate company goals or milestones. Of course, these goals will be specific to your company, but some examples include:

- Increasing revenue
- Improving profit margins
- Implementing a new strategy
- Developing a new product
- Expanding into a new market
- Completing a critical project

An annual bonus is typically paid as a percentage of the executive's base salary. You might consider structuring the short-term incentive with "target" goals and "stretch" goals. A target goal is the team member's expected performance, while the stretch goal would require extraordinary results for the maximum incentive to be paid. This structure can help incentivize your team to achieve aggressive objectives.





## How to Structure Long-Term Incentive Plans

Long-term incentives make up the largest portion of a leadership team member's salary. The purpose of long-term incentives is to motivate your executive team to achieve long-term company objectives that maximize the company's value. Based on your organization's unique financial position the long-term incentive can be structured in various ways:

- Cash bonus
- Stock, stock options, or restricted stock
- Equity

The performance evaluation period for long-term incentives is usually between three and five years, with executives not receiving any of the incentive until the end of the determined time period.

Long-term goals vary from company to company but typically revolve around the company's financial health and/or total company valuation.

Similar to short-term incentives, long-term incentives typically have target and stretch goals to promote exceptional performance.

# Build an Executive Benefits Package

Your executive team will take advantage of the same benefits package you offer the rest of your team. It's important to make sure you're offering your team a robust benefits package that's attractive and adds substantial value to their total compensation.



Of course, your benefits package must include the basics such as:

- Vacation time
- Sick days
- Life insurance
- Medical insurance
- Short- and long-term disability
- 401k/retirement plan

However, to make your benefits really stand out and be attractive to top executive candidates you may consider going above and beyond the standards benefits package.







## Types of Executive Perks

Although not required, executive “perks” may help add additional value to your leadership team’s package. Executive perks are special add-ons not offered to the rest of your team. Some examples of perks include:

- Travel
- Security
- Housing
- Financial planning
- Company car

These perks make up a small amount of the total compensation for leadership and should be considered “add-ons,” rather than core components of the package. For companies whose budget limits the base salary you can offer, adding several attractive executive perks to your package may help land top candidates.



# What is Contingent Pay?



Contingent pay is essentially a guaranteed severance agreement in the case of involuntary termination for the employee. Contingent pay agreements generally do not cover termination for cause. In the case of hiring an executive from outside the company, a contingent pay clause is important to entice them to leave their existing organization.

You might also consider adding a change-in-control agreement. These agreements compensate executives for a loss of job due to company merger or sale. Having this clause in place will incentivize your leadership team to always act in the best interest of the company, without being overly concerned about the potential impact on their career.



# Key Takeaways

Creating high-impact executive compensation packages that align with your organization's budget and long-term goals isn't easy. However, by understanding the components and composition of an executive compensation plan, you're one step closer to properly compensating your leadership team. Some key takeaways from this guide include:

- Your executive compensation plan should attract top talent, and align them with short-term and long-term organizational goals
- An executive compensation package is usually made up of base salary, short-term incentives, long-term incentives, and benefits
- Long-term incentives make up the largest part of an executive compensation package



# Expert Guidance on How to Structure Your Executive Compensation

Figuring out how to effectively compensate your leadership team isn't easy. Our consultants are here to help you design executive compensation plans that align your leadership team with long-term organizational goals.



**Attract, motivate,  
& retain with the  
right compensation  
strategy**

Connect with our team today to learn more about how we can help you develop a performance-based executive compensation structure aligned with your long-term company goals.

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