



## *Linking Variable Compensation to Performance*

### INTRODUCTION

Rutherford International ESG distributed an opinion piece entitled “Critical Real Estate HR Challenges 2002 – 2010” to a number of senior industry executives. The complete text of this article may be downloaded from the North American Real Estate Review section of [www.rematrix.com](http://www.rematrix.com). The article identified four human resource issues, which commercial real estate owners and managers will need to address now and over the balance of the decade. Abbreviations of the points made in the article were:

1. **Compensation:** The link between incentive pay and performance is weak and not necessarily connected to measurements reflecting long-term shareholder value creation,
2. **Education:** Companies have long recognized the importance of staff development and education, but few have placed sufficient funds at the disposal of HR departments or business unit managers to adequately fund internal or external programs,
3. **Knowledge Retention:** Current workforce stability is more the result of industry compression than workforce contentment. The medium term (five years) will be less stable, as experienced managers and executives begin to “gear back,” however the predicted shortages will not be measured in the loss of human assets but more so in the loss of knowledge assets.
4. **Business process** within the commercial leasing profession – at both the owner and broker level is undergoing a state of structural change; this flux is an early indication of what the industry will face in general terms over the next eight years.

The following is representative of their views on the importance of linking compensation to performance using measurements that have a direct impact on increasing shareholder or unit holder values. The architecture of performance-based compensation is systemic, beginning with the janitor and ending with the CEO.

Compensation design didn’t seem to be an overriding concern for respondents, however I believe a discussion on the linkage of compensation to short and long-term performance measures have never been more vital. It’s becoming a question of governance. I’ve used antidotal evidence to highlight the potential for abuse when bonuses are heavily weighted to short-term financial results.

It’s not my intention to signal out asset managers (the comments seemed to flow in their direction), however it’s clear that there is a dichotomy within this industry function in terms of short and long-term priorities.

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*“The concept of pay for performance is widely accepted in the real estate community, however the link between incentive pay and performance is weak and not necessarily connected to measurements reflecting long-term shareholder value creation.”*

### Respondent Perspective

- “What do I care about values five year’s from now – I won’t be here!”
- “Rewards are short-term driven versus long-term interests...”
- “Our compensation is balanced relative to asset, fee and industry performance...we have clear measurements based on quantifiable and qualitative goals...”
- “Institutions have greatly influenced compensation ranges...”
- “We participate in a compensation study every year, we’re competitive within the industry...”

### Rutherford International ESG:

- *Short-term performance measurements versus long-term results*
- *Tactical Asset Decisions Supplanting Strategic Goals*

The majority of respondents are relatively content with current compensation arrangements, however it’s clear that there are some fundamental flaws in current design which place greater importance on short term results versus long term share holder value creation. Being market competitive with respect to compensation is not enough. With “corporate governance” having become a top-of-mind issue, management may want to ensure that their compensation architecture, and that of their employees provides the Board of Directors with some degree of assurance that benefits, base compensation, perquisites, bonuses and long term incentives are aligned with corporate goals and market realities. A compensation program should be designed in a manner, which induces behavior that the corporation needs to move forward to achieve superior shareholder value.

Compensation design has not caught up with the realities of an industry where non-corporate officers are able to commit their firms to significant liability, or influence asset values with tactical rather than strategically grounded decisions. A majority of the current structures are overly dependant on short-term financial performance measurements, and do not adequately contribute to long term organizational effectiveness.

A few examples, which provide antidotal evidence of this fact, are:

1. Many of the under-performing loans written in the late eighties and which subjected the industry to a “death of a thousand cuts” through the nineties, were sourced by commercial loans officers and authorized by loan committees who’s short term bonus plans were based on volume rather than quality;
2. A financial services firm seeking to lease-up an office building decided to bring on staff two former leasing brokers. Their bonus plan was tied to new lease deals. By the time the asset manager realized his error, the van to remove the final twenty year tenancy was parked at the loading dock;

3. An asset manager turned down a lease deal with a major tenant, which would have given the asset a locked in accretive value for fifteen years. His reason for saying “No” – the deal had no direct impact on his current year’s bonus.

The asset manager in example two should probably be terminated for stupidity, whereas the asset manager in example three should have his head mounted on a pike and placed on top of the building in question, surely that or on a pensioner’s wall – for what he perpetrated in the name of “self interest” was equal to picking the pensioner’s pocket. The question that needs to be put to his employer is, “Was this a lone act of moral impropriety, or was it reflective of corporate performance measurements that are strictly financial and short term in nature?”

Rewards based solely on short-term performance foster tactical decisions. When the tactician supplants the strategist in decision-making, questions related to “governance” by stakeholders are sure to follow.

Achieving superior returns over time relative to an industry index of performance is the ultimate goal for company stakeholders. Designing a compensation plan that drives superior performance at all levels of the company is a powerful message to stakeholders and/or clients about the firm’s aspirations.

## **Our Services**

If you don’t have an internal human resource department to provide you with strategic and candid advice, to oversee implementation of best practices and processes, oversee recruitment, conduct independent candidate assessment or review your compensation strategy – you might want to consider outsourcing this requirement to our Strategic HR Advisory Group. Unlike search, these services are charged by the hour or per diem.

If you need an executive search team that approach their assignments from a perspective of solving organizational problems, brings candid insight, conducts thorough research, provides rigorous assessment, works internationally as well as nationally – then you need to speak to Rutherford International ESG at 416-250-6300. Electronic Brochure: [www.rutherfordinternational.com](http://www.rutherfordinternational.com)

We welcome your comments, and would be pleased to forward you additional information on the scope of our services and/or methods. My email is: [Rutherford@rutherfordinternational.com](mailto:Rutherford@rutherfordinternational.com)