BANK SALES COMPENSATION

by Steve Brown

A recent study from Ryerson University (Canada) looked at 3 different incentive structures to determine which one helped drive the most sales and which resulted in the most manipulation. The topic is of particular importance as "becoming more sales-centric" ranks in the top 5 for strategic initiatives at community banks for 2011 in many surveys. In particular, the common question is - how do banks better motivate staff to bring in business?

The study looked at the following 3 structures. 1) Target-based: Pays if a certain goal is achieved, such as opening 50 checking accounts in a quarter garners a $10k bonus. Here, if you open 49 accounts, you are out of luck and if you sell 100, you still only get $10k. 2) Tournament-style: Similar to target-based, but sets goals on a relative basis. Those in the top 25% of sales for the quarter would get a $10k bonus. 3) Linear pay for performance: Uses a graduated reward system. This would pay $200 for each retail checking account with no specific target.

Now let's analyze each structure to see what can be achieved and what the possible side effects are. The good news is that in each case, the reward system motivated the desired outcome. This is clear enough, but bankers have a habit of laying out their strategic goals, but not adjusting rewards accordingly. The opposite is also true, in that banks sometimes create a reward system and get exactly what they reward for. Loan volume is a classic example. If you reward for loan volume only, that often comes at the expense of profitability and credit quality, while increasing risk. Volumes are attained, but not much else.

The bad news is that the study found each structure motivated some employees to "cheat" in some fashion, by manipulating sales. Manipulation happens in any number of ways, not all of which are nefarious. For instance, the loan officer that argues extra hard for a credit may truly believe it is a good one (and it may be), but management must understand the inherent bias and potential risk of any incentive program. In terms of structure, the target-based approach was found by the study to consistently promote the most manipulation by a factor of 2.5x more.

Other lessons from the study include going to a tournament-style incentive had the advantage of most consistently motivating sales staff in light of a changing environment. If fixed goals become too easy or too hard to achieve, a target-based system would rob some salespeople of motivation. The variable structure of the tournament style takes this into account, as the goals are relative. However, the downside is that it is basically grading on a curve, so outstanding sales people set the bar high and lower producing staff lack motivation. This may be OK sometimes or it may present a management issue, depending on the employee. Another aspect of the tournament-style incentive was that it was harder to game. Here, manipulation was made more difficult, as participants didn't exactly know where they stood, so the decision to manipulate sales occurred less frequently (as the true risk or reward could not be clearly understood).

The final takeaway is that the study confirmed the perverse effects of target-based goals and suggested tournament-style and linear pay for performance bonus structures may be better. Of the 3, while linear structures cost the bank more, they also produce the best results over a variety of conditions.

Of course, you are not limited to any one methodology. In our organization for instance, we have found that combining a linear payout with a target-based incentive seems to get the best mix of risk/reward/motivation.

BANK NEWS

Business Tax Change

The IRS issued a rule effective 1/1/2011 that discontinues a program allowing taxpayers to present paper coupons and checks to bank branches for federal tax payments. The Treasury Department will no longer maintain the paper coupon system, so all payments (except for those under $2,500) will have to be made via electronic funds transfer starting in a few weeks. Banks should not accept coupons after 12/31/2010.

CU M&A

First Tech CU ($2.3B, OR) and Addison Ave Federal CU ($2.4B, CA) have announced a deal to merge, the largest deal in the US. The combined CU will operate 38 branches.

Gov't Gone

The Treasury is reporting that it has sold the last of its Citigroup Inc. common shares for a profit of $12B on their $45B investment in the bank.

Dividend

The CEO of Bank of America said he will target a dividend to shareholders of 30% of earnings next year, as soon as it passes Fed stress testing requirements.

Case Settled

Bank of America paid $137mm to settle a suit brought by the SEC that accused the bank of bid rigging and other anti-competitive practices in the sale of the derivatives to states, municipalities, school districts and non-profits.

FHLB Pressure

A report by Moody's indicates FHLB advances have fallen 21% in the 3Q compared to the same period last year. The data shows banks are taking out fewer advances because they are carrying large amounts of excess liquidity and are seeing lower loan demand. The number of banks holding advances has reached its lowest level in 10Ys.