Performance & Pay Part 1: Trends in business lending positions

First in a five-part
HR series from Crowe Horwath

By Jason V. Bomers, Patrick J. Cole, SPHR, and Timothy J. Reimink. For more about the research project that articles in this series came from, and about the authors, please see the
end of this article.

The most recent Financial
Institutions Compensation & Benefits Survey by Crowe Horwath LLP
indicates that incentive compensation is not being used as effectively as
possible in the commercial lending function. The survey findings (see the end for survey background) also suggest significant opportunities exist for motivating higher performance through the
use of financial incentives.

With financial institutions experiencing margin pressure and
slower growth, achieving higher return on investment and growth from commercial lending is a management imperative. Better use of incentive compensation, through motivating and recognizing higher performance, can be an important tool in
achieving this goal.

Commercial lending staffing

and salary trends

Comparing survey responses from 2008 and 2012 provides insight into the recession's impact on variable compensation for key positions.

One initial observation is that overall commercial lending staffing levels did not change significantly between 2008 and 2012. Collectively, the total number of staff members in the commercial lending function averaged 7.1 staff members per institution in 2008, versus 7.2 in 2012.

Although total average staff size remained relatively stable, the composition of the workforce changed. The average number of people employed as "staff commercial lenders" doubled between 2008 and 2012, and the number of commercial loan officers increased by roughly 25%.

On the other hand, the average number of commercial loan processors and administrative assistants dropped by more than 30%--probably reflecting the growing use of software that allows officers and lenders to perform administrative functions themselves.

The survey found that average base pay increased for all but the very top commercial loan manager's position. The largest average base pay increases were awarded to commercial loan officers, staff lenders, and commercial credit department managers.

For a larger version of this table, click on the image or click here.

Trends in incentive pay

Trends in incentive pay also reflected the changing makeup of commercial lending departments.

From 2008 to 2012, the percentage of staff lenders who earned incentives increased from 49% to 75%, but the proportion of administrative personnel who earned incentives dropped from 48% to 25%. Similarly, the average dollar amount of incentive earnings increased for staff lenders, but decreased for most other positions.

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There was a general decrease in the role of incentives as a percentage of total compensation. For staff lenders the portion of compensation that was made up of incentives stayed relatively flat, but for most other positions relative incentive earnings actually dropped, in some cases significantly. Virtually identical trends are seen when comparing incentive earnings as a percentage of base pay.

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Overall, loan officers increased their earnings more than management and administrative support personnel. Except for staff commercial lenders, however, most increased earnings came from base salary increases rather than incentive earnings.

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Implications for Lenders - What to Make of the Survey Data

Several important trends can be discerned by comparing the 2008 and 2012 surveys:

- • Base pay has increased by an average 2.9% per year during the past four years, but incentive pay has decreased by an average 3% per year over the same period.

- • The net effect has been a 2.7% per year increase in total cash compensation. This means the average commercial lending operation is spending more in total compensation to the same size staff, in support of the same level of total assets. In other words, there have been no net gains in overall productivity.

- • The portion of the staff earning incentive pay has remained roughly the same (55%), but the amount of incentive pay being disbursed has decreased by about 3% per year. This means institutions are spreading fewer incentive dollars among the same total number of people. In general, incentive pay produces a more positive result under the opposite scenario: more incentive dollars being spread among fewer people.

A significant conclusion: These trends suggest incentive compensation is not being used as effectively as possible and that the motivational capabilities of incentive pay are not being realized. For example, overall incentive earnings represented 12% of total cash compensation in 2012. While this is significant, it might not be enough to motivate higher performance.

Research shows that the smallest meaningful pay increase--the amount needed to have a motivational effect--is 7%.* Yet the greater the amount of pay at risk, the more focus there will be on modifying behavior to meet goals that produce higher income. Thus, increasing the percentage of total cash compensation that comes from incentive earnings would be expected to have a greater motivational effect.

Various types of incentive compensation are possible in the commercial lending function, including annual discretionary bonuses, profit-sharing plans, commissions, and individual or team incentives. A variety of metrics can be used in support of incentives, including new loans made, referrals, total portfolio growth and profitability, and various credit quality metrics.

Whatever specific incentives are offered, making a direct connection between daily activities and payouts is essential to changing behavior. It is also important to differentiate between average and above-average performers by a meaningful amount and to publish the relative performance metrics regularly.

* Frank Giancola, "In Search of the Smallest Meaningful Pay Increase," Workspan--The Magazine of WorldatWork, March 2009.

Series highlights comp trends and strategies

Crowe Horwath LLP is proud to offer the results of its 2012 Financial Institutions Compensation Survey.

With responses from 405 financial institutions on 201 job positions, the 2012 survey offers details on the compensation and HR approaches for the entire banking enterprise. The analysis in this article and others in the series draws on results from past surveys as well to identify key industry trends in the following areas:

• Compensation, incentive pay, and benefit packages

• Salary increases and comparative analysis

• Employee turnover rates and hiring forecasts

• Cost-cutting strategies

• Board and director compensation packages

• Equity-based compensation

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