

X-R7 Consider a bonus program for senior level management at Kentucky-American.
(Refer to Finding X-F11)

Compensation packages should be competitive in order to *attract* and retain qualified individuals. The compensation must be sufficient to retain **individuals** who hold key positions in Kentucky-American at a time in their careers where they can be seriously courted by other companies. It is generally important to companies to **maximize** their investment in those individuals and maintain continuity in the leadership of their organizations.

In an attempt to hold down operating expenses while providing competitive compensation packages for executives, many **utility** companies are following the example of other industries and offering a combination of fixed compensation and incentives.

An incentive plan for management personnel allows Kentucky-American to achieve the following three important objectives:

- Provide higher levels of potential total compensation for key management employees while maintaining or decreasing fixed payroll costs.
- **Provide** a mechanism by which members of management stay focused on the Company's priorities as stated in the organization plan. **Tying** larger incentives to particular goals sends a clear message as to their importance and priority.
- Motivate employees.

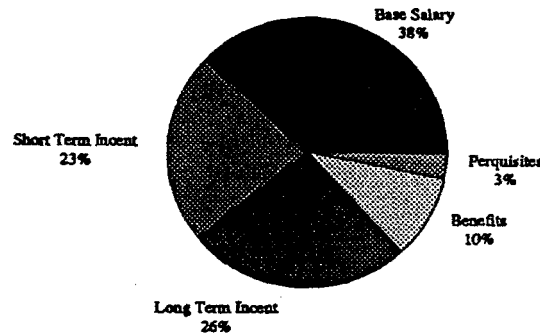
Additional benefits include:

- Long-term incentives provide the opportunity for capital accumulation through **tax-deferred** stock options.
- Short-term incentive bonuses are paid only upon the achievement of specific objectives and save the Company money because they do not have associated benefits costs.

In 1989, **Ernst** and Young conducted a study of the anticipated breakdown of compensation packages across **all** of industry for the 1990s. Exhibit X-15 illustrates the findings.

**Management Audit of Kentucky-American Water Company
Exhibit X-15**

General Industry Compensation Packages for the 1990s



In the utility industry specifically, more than half of the senior managers are bonus-eligible. Exhibit X-16 delineates the percentages of the incumbents holding management positions who are eligible to receive bonuses, along with the percentage of their base salaries that is available in additional bonuses.

**Management Audit of Kentucky-American Water Company
Exhibit X-16**

General Industry Bonus Eligibility

	<u>Eligible</u>	<u>% of Base Salary</u>
Chief Executive Officers	61.8%	36.8%
Top Executives	60.7%	23.5%
Senior Management	53.8%	17.2%
Middle Management	29.0%	11.8%

For a bonus program to work for Kentucky-American, it must be inclusive. The executives at American Water Works Service Company, the Southern Region office, and Kentucky-American should all be eligible.

While it **may** appear that the installation of a bonus program **would** result in significant costs to Kentucky-American, those must be balanced by the recruitment, hiring, and training costs associated with the replacement of a senior level employee. The amount of the increased costs would depend upon the type of bonuses and level of availability. Some of the initial costs can be offset by reduced merit increases tied to the base salary.