The HR Professional's QuickGuide to Compensation: Three Key Concepts

Total Rewards | Compensation Structures | Merit Pay

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Global Total Rewards: Establishing a Framework
by Pam Krebs, BCR Consultant

In an uncertain world economy, global companies face challenges in having an effective global total rewards program. Global companies strive to develop total rewards programs that help them attract, motivate, engage and retain the right talent at the right cost, across the globe.

Any total rewards program should seek to meet specific goals rather than being an abstract series of principles, and must recognize the diversity among countries. Organizations need to avoid the one-size-fits-all approach and evaluate which rewards should be global in policy, governance and orientation as opposed to regional or local.

Developing an effective total global rewards framework is a fundamental element to having an effective global total rewards program.

A total rewards framework can help global companies meet cost, talent and governance challenges to adapt to changing needs across economies and geographies. **An effective framework supports the organization's strategy, motivates ethical business behavior and success, and seeks to aid in appropriate recognition and retention of talent.**

Some key questions to address are:

- Where does the company want to competitively be in each of its markets?
- Will that differ by business?
- Will that differ by country or region?
- Will that differ by scarcity of talent?
- Will that differ by position level?
- Will that differ by compensation component: base vs. incentives?
- How important is internal consistency vs. local market fit?
- How much cost can the company afford?

The value of a total rewards framework lies in its ability to help organizations meet their strategic goals.

Factors Impacting the Framework

Any global total rewards framework should take into consideration both the environmental and competitive factors that impact total rewards.

The various **environmental factors that must be considered when establishing a total global rewards framework** include the following:

- Global Outlook
- Condition of Local Markets and Economies
- Political/Social Unrest
- War and Global Threats
- Employee Demographics and Employment
- Organization's Business, Culture and People

Consider how environmental factors may impact total rewards. When looking at the condition of local markets and economies, examine the differences in environment between the U.S. and various other countries.

For instance, the U.S. has seen high unemployment and low turnover after the economic recession, yet companies are having difficulty attracting and retaining high-performing employees with critical skills. Contrast this to Germany where the economy is stronger but in a recovery mode. Companies there are facing long-term growth issues and a challenging regulatory environment. In Asia Pacific, economic growth continues, thereby continuing the need for a robust labor market and the availability of skilled and technically qualified individuals. These varying challenges must be considered when developing a framework.

Companies need to have an overriding compensation philosophy in place and reflect upon company-specific design considerations such as:

- The company's global culture
- Global and local market practices
- Country-specific legal, accounting and tax regulations
- The local labor environment

These will impact the link between total rewards and performance management and how these are all packaged in a communications framework to employees.

Competitive factors, such as those shown below, also impact total rewards:

- Pressures from global competitors
- Industry consolidation
- Market pressure to maintain a global footprint
- Pressure on margins due to production costs or competitive prices
- Employee demographics and employment
- Off-Shoring replaces outsourcing

An example of a competitive factor impacting total rewards relates to the pressure global companies are facing in terms of increased competition in Asia Pacific from fast-growing Asia-based companies. The reward programs of Asia-based companies may be more focused than those of many global companies in addressing total rewards in the region. Organizations in Asia Pacific must compete in a hypercompetitive talent market where salaries sometimes exceed the market median – a level where many global companies target pay from a philosophical perspective.

To compete in this region, global companies need to develop a framework that provides a strategy to meet both the business and employee needs of the specific region. Showing an openness to local adaptation and reflecting that within the context of a total rewards framework is necessary. Again, a one-size-fits-all approach is to be avoided.

Areas to Address When Developing a Framework

There are **six key areas** to address when developing a **global total rewards framework**:

1. **Global Program Governance:** Determining and balancing what should be globally consistent and what should be locally customized.

2. **Knowing What You've Got:** Conduct a global inventory of both monetary and non-monetary rewards.

3. **Comparing Yourself to the Market:** Collecting, validating and analyzing market data around the world.

4. **Understanding Local Labor Market Customs, Rules and Regulations:** Customs, laws and regulations vary by country and can make the U.S. look easy by comparison.

5. **Analyzing Pay for Performance around the World:** Knowing when "target" means "stretch" versus when it means "threshold" (versus when it means "target").

6. **Implementing Change:** How to swallow an elephant: one bite at a time.

The illustration below will serve as a basis to help guide decisions for developing a global total rewards program.

Design Feature	Overall Framework	Business Unit Flexibility
Position Level Structure	Create a consistent position level structure to be utilized across the company: broad position bands (e.g., Country Head, Sr. Manager/ Director, etc.)	Slot corporate and business unit positions into appropriate levels.
Comparator Market Data	Establish two sources for competitive market data to be used across the company: Mercer and Watson Wyatt.	Supplement with local survey data, as needed.
Conduct Market Review	Corporate: Review Director level and above.	Provide tools to conduct and analyze market position below Director level.
Market Competitiveness	Balance between internal equity and external market.	Establish pay levels and mix based on competitive market by position/industry/geography.
Competitive Pay Targets	Base: 50^{th} – 60^{th} %ile Short-term Incentive: 60^{th} – 75^{th} %ile Total Cash: 55^{th} – 65^{th} %ile	Business unit defines competitive levels within ranges based on competitive market.
Establish Salary Band Structure and Changes	Create band structure and guidelines.	Adjust based on local market conditions.
Performance Management System – 4 Level Rating System: **4 = Exceeds Expectations** **3 = Meets Expectations** **2 = Partially Met Expectations** **1 = Did Not Meet Expectations**	All staff positions. Differentiation based on 4 performance levels and distribution: 15/60/20/5. 6-month and annual reviews.	Conduct performance reviews using performance management system.
Variable Pay	• Overall model. • Menu of measures. • No more than 3 to 4 measures in a plan. • No measure weighted less than 20% (discretion, no more than 20%). • Performance period – annual for management and staff. • All plans funded by clearly articulated metrics. • Pay mix and leverage across similar positions.	• Business-specific performance measures and definitions. • Latitude in weighting of performance measures within guidelines. • Performance period: Production and sales positions set by business unit. • Payout formulas tailored to business characteristics and priorities. • Payout frequency based on business and selling cycles.

A well-designed total rewards framework that takes a holistic approach is critical to executing a global total rewards strategy. Successful execution of a global total rewards strategy positions organizations for strengthening employee engagement and improving business results.

How Well Do You Know if Your Total Rewards Program is Working?

By Barb Manny, BCR President and Consultant

To be a business leader, HR and compensation professionals must utilize a C-Suite approach to decision support – one based on data and facts. That translates to metrics.

Metrics are a simple way to quantify, measure and track key performance indicators. Some examples of the type of decisions metrics can support are:

- The type of compensation programs that make sense
- The linkage between program costs and results
- The allocation of financial resources

Metrics typically describe the current situation, compare current numbers with previous years' or with a competitor's position, and quantify goals and measure progress. By measuring the current situation compared with quantifiable goals, business leaders can make data-driven decisions.

Components of a Good Metric:

- Quantity and/or Quality
- Time
- Cost
- Customer Satisfaction

It is difficult to know what this quantity, time and cost metric means without a measure of quality – did we hire the right people measured by job performance after one year? In addition, to really understand the story behind the numbers, we need to compare these results with a benchmark that might include prior experience, similar statistics from a competitor, or internal goals.

Key Considerations for Choosing What to Measure:

- Use data that are readily available and can be gathered at regular intervals.
- Use the ratios, formulas, key performance measures, and language used by business leaders.
- Don't limit the focus to costs, but include measures of results and quality.
- Tie metrics directly to the key challenges facing the business and the results that must be achieved.
- Stop using metrics that don't add value in making decisions.
- Keep it simple; metrics don't have to be complicated.
- Identify and compare results with key competitors whenever possible.
- Measure ROI, cost/benefit ratios, and impact on problems identified by business leaders.
- Avoid soft metrics based on feelings or intuition.

Metrics Generally Measure One of the Following:

- Increased job performance (e.g., new variable pay program resulting in performance results based on quantifiable metrics that are 15% higher than under the old program)

- ROI (e.g., new commission plan resulted in $100 of increased sales for each additional commission dollar paid)

- Impact of a program on revenue

- Decreased costs

It may be that a series of single metrics when viewed together tell the story. The use of several individual metrics to measure a function is often referred to as a "dashboard" and will provide a more complete story.

Metrics for Compensation Programs:

- Compensation costs per dollar of profit
- Compensation costs per dollar of revenue
- Analysis of performance and production levels of employees paid in the top 30% of their salary range
- Total compensation costs as a percent of total company operating costs
- Analysis of compensation levels to the marketplace and key competitors
- Forecast of compensation needs based on future plans
- Compensation mix, meaning fixed salaries versus performance-driven compensation

Metrics Should:

- Give the whole picture, including quantity, quality, time, cost, and effectiveness
- Focus on key areas where change is necessary
- Develop a benchmark to use for evaluating progress toward goals
- Set goals and establish metrics for measuring progress
- If possible, be compared to metrics with similar measures from key competitors
- Use the language of the business leaders, including ratios and measurements they know

Finally, don't be afraid of data or of measuring results. **Metrics can add to your professional credibility and garner support for your programs.**

Compensation Structures: What Are They Good For? (Part 1)

A three-part series by Jennifer Ottolino, BCR Consultant

At BCR we work with a lot of companies, both for-profit and not-for-profit, that are going through growing pains. What was once a small, intimate company has grown in scale to a much larger organization. What could once be accomplished informally now needs structure and process. Structure is required to facilitate a growing number of customers, revenue streams and employees. And, as with most changes, there is resistance.

An HR Executive is hired into the organization to manage the growing number of employee concerns and quickly becomes harried at their inability to pay people effectively. Titles have no meaning. Employees performing the same work are paid differently, creating huge variances in pay that can't be explained or justified. There is no consistent approach to attracting talent because one manager wants to pay under market and one manager wants to pay above. The HR Executive recommends implementing a compensation philosophy and structure and is promptly asked the following question:

We've never had a compensation structure in the past, why do we need one now?

Well, here's your answer. At its most basic level, a compensation structure allows an organization to carry out its compensation philosophy in a fair, consistent, and equitable manner. **A formal compensation structure creates fairness among employees and protects the organization from federal law violations, while allowing the company to attract and retain key talent.**

That's at the basic level, but **what are the other benefits?**

Benefit	How does it help?
Streamlines the Process	It makes it less cumbersome and frees managers up to focus on growing the business and making it more productive.
Standardizes the Process	It creates clear and consistent guidelines for all compensation decisions.
Creates a High-Performing Work Environment	It tightly aligns decisions on compensation to the achievement of critical business goals by linking performance management with compensation administration (*pay for performance*).
Enhances Career Development	It encourages employee development by creating clear job expectations and a well-defined path for professional growth.
Facilitates Business Planning	It creates a consistent compensation structure that facilitates business planning.

Hopefully, these benefits will help you build an effective business case that will get the conversation started about why this is important. At BCR, we recommend taking each of these benefits and applying a business case scenario that has directly impacted your organization to sell each point.

Compensation Structures: What Structure is Right for Your Company? (Part 2)

Before determining what type of structure might be a good fit for your company, some important questions to think about that will facilitate the decision include:

- What is your compensation philosophy?
- What is the goal of the compensation program?
- What role does market data play into pay decisions?
- Are employees compensated for seniority or performance?
- How sophisticated are your managers at making pay decisions?
- Are your managers comfortable having pay discussions with employees?
- How robust is your performance management system?
- Does your organization have the right human resources and technology needed to administer it?

Your answers are important to keep in mind while examining the different structures and determining the recommended structure to present to the executive team.

Once you've assessed your organization's readiness, the needs of the organization, and taken a good look at your management's strengths and weaknesses, you can assess the various types of compensation structures.

There are several approaches for handling organizational hierarchies and pay guidelines, from point-factor systems to market pricing to job family or career path systems. All of these systems use market data to develop salary grades/ranges or pay bands.

Point-factor systems were developed more than fifty (50) years ago, but were fairly staff-resource intensive and somewhat confusing to employees. These systems seemed to work in environments where the organization was more stable, which is certainly not the case today. As market data became more prevalent and accessible, companies moved more to market pricing. Jobs are placed into a grade structure based on the competitive pay for a job. Where there is no market data, jobs are slotted into a level based on the similarity to other jobs at that level.

Today, **some of the most common compensation structures** are:

Traditional Structure: Traditional structures have numerous pay grades with generally small differences between each salary range. It is a hierarchal system conducive to promotions between pay grades.

Why companies use it:
- The organization is hierarchical and compensation is based more off of seniority than performance.
- Managers are unaccustomed to making compensation decisions.
- The organization is more focused on internal equity versus market competitiveness.

Job Family Structure: This is a market-based approach that defines discernible steps in a set of jobs in a functional area which reflect the natural progression in an organization.

Why companies use it:
- Creates a consistent compensation structure, administration processes and compensation metrics for the entire organization.
- It's tailored to the organization's way of doing business.
- It encourages movement from one functional area to another.
- Managers find it easy to understand, explain and defend.

Career Path Structure: This is also a market-based approach that focuses on career levels with defined scopes, skill sets, and responsibilities. There are typically two to four levels per career path.

Why companies use it:

- Most employees and managers can readily understand and communicate a career path framework.
- It reflects the market, yet allows for internal considerations in "ranking" jobs.
- Relatively quick to develop and implement and relatively easy to maintain.
- Recognizes the fluid nature of jobs and roles in today's workplace.
- Relates naturally to the number of position levels that employees and managers see as reasonable.

There are other structures to review – from a broadband structure to a point factor system – but the ones listed above are the most common. **Remember there is no right or wrong structure and what's right for your organization depends on many factors. The important thing is to pick a structure that will best meet your organization's needs, while compensating employees fairly and equitably.**

Compensation Structures: Implementation (Part 3)

After selecting the type of compensation structure that works best for your organization, it's time roll up your sleeves and get to work.

At BCR, we design compensation programs for all types and sizes of organizations. The project planning steps BCR typically follows to ensure the structure is developed and communicated on time and within budget are highlighted below:

1. First and foremost, if you haven't done so already it's time to **develop a compensation philosophy.** It's important to understand the organization's pay practices before you benchmark positions. The organization's market position (i.e. targeting the 50^{th} % versus the 75^{th} %) impacts both your benchmarking and structure development.

2. **Develop a project plan with key milestones** to keep track of your progress. The typical milestones for the project might include:

    a. **Information Gathering:** Compile the job descriptions you'll use for benchmarking against the market; run various data cuts of your employee population by job family, by department, by role, by employee demographics, etc.; determine possible trouble spots by speaking with department managers; talk to either your company's in-house or outsourced recruiters to determine any hot skills that may require premium pay, etc.

    b. **Structure Development:** Benchmark positions using appropriate industry and specialized position salary surveys and compare the organization's internal pay to the external market. Based on the market data and regression analysis, develop salary structures and run various analytics to determine how your employees fit within the new structure. Identify outliers and remedial action plans.

    c. **Executive Approval:** Review the new structure with the management along with findings, program costs, and communications approach.

    d. **Implementation:** Work with the appropriate departments (such as the HRIS team, Payroll, Finance, Communications, and Employee/Labor Relations) to ensure a smooth implementation of the new program.

    e. **Communication:** Develop a comprehensive communication plan to disseminate the new compensation structure. It's important to consider the level of transparency expected by your organization.

3. **Select positions for benchmarking.** Not every position in your organization needs to be benchmarked depending on the design of the compensation structure. Select a comprehensive list of positions that span all departments and cover at least 70% to 80% of the positions in the organization. If a unique position cannot be benchmarked it can be slotted into the new structure based on pay and comparable skill. If your organization doesn't already have job descriptions, you'll need to work with managers to create them or at least thumbnail descriptions. If at all possible avoid benchmarking jobs based off titles, which are often inflated and not reflective of the position's true scope and responsibilities.

4. **Market price positions using established compensation surveys, applicable to your industry and revenue scope**, based off the market position detailed in your compensation philosophy. Compare the average pay of your positions to the market rate. Typically, we consider the position market competitive if they fall within plus/minus 10% of the market rate. Outliers should be reviewed by HR and management to determine proper benchmarking and if any corrective action is needed.

5. **Develop the structure.** This is a complicated subject and requires significant research. But, in simplest terms, typically your structure's midpoints or mid-market zones are created off of the market average of like positions. The minimums and maximums are determined off the chosen range spreads, which can run from very wide (70% - 80%) to very narrow (50% - 40%). If a specific example is needed, please feel free to contact BCR and we can help point you in the right direction.

6. **Reporting.** Comprehensive data analysis is needed to determine the impact of the program: comparing individual employee pay to the new structure; identifying outliers; costing the program; and, completing an impact analysis to determine that there is no potential pay discrimination hiding within your organization.

7. **Executive Approval.** Present the findings to your executive team for approval.

8. **System Implementation.** Work with your HRIS or IT group to implement the new structure into your HRIS system.

9. **Communication.** Your communication plan depends on the level of transparency desired within your organization. But some typical steps include:

    a. Manager Training: Depending on how familiar your managers are with managing pay programs a "Compensation 101" is never a bad idea. This should cover the compensation philosophy, key terms, explanation of the structure and program, and talking points for discussions with employees about their pay.

    b. Communication Materials: Program information sheet and FAQs for both employees and managers.

    c. Employee Compensation Statements: This is a good time to highlight the company's total rewards philosophy and demonstrate to employees that rewards include more than base pay.

    d. Success Factors: Establish metrics before the new structure is implemented to determine the success of the new structure. Did it do what you thought it would?

    e. Follow Up: After the program is implemented, it's always a good idea to check the pulse of the organization to determine how the program is being received.

10. **Celebrate!** At BCR, we've helped hundreds of organizations implement new compensation programs and understand that it can be a long, sometimes painful process. So, don't forget to pat yourself on the back for a job well done.

Merit Pay – Is it Worth It?

By Barb Manny, BCR President and Consultant

Most of us have been challenged over the years to find the best way to appropriately reward above average and exceptional performers. **Many believe pay is the single most important motivator of performance. Yet, when employees are surveyed, they claim they are not motivated by pay** and their pay system has little influence over the way they behave on a daily basis.

The concept of merit pay has been around for decades. The original merit increase matrix was designed back in the '60s for an ACA (now WorldatWork) course on Audit and Control Statistics. This was done well before computers or other forms of electronic media.

The objectives of a merit pay system are to:

- Attract, retain and motivate
- Develop a method to distribute pay equitably based on performance
- Use of merit increase guidelines tied in with objective performance measures

The majority of companies today use some form of merit increase guidelines as a manner of distributing salary adjustments throughout their companies.

The current economic outlook doesn't provide much hope for higher merit increase budgets:

- Inching up of consumer price index that will affect inflation
- Jobless claims are slightly down but doesn't capture under employment
- Lack of job expansion
- Lack of economic expansion
- Consumers' confidence is low
- Organizations are hoarding cash but not spending
- Employee engagement is at an all-time low
- High potentials are at risk

Given the current economic outlook, **the news around what's projected for merit increases is on a downward trend for most industries.** A survey conducted by Towers Watson last year indicated that on a 5-point scale with 5 being the highest, top performers being rated a 5 received an average increase of 4%, next level performers received an average of 3.4%, and those who met expectations received a 2.5% increase. Not much differentiation, is there? As inflation rises will those merit increases even be noticed?

Progressive organizations are seeking out alternative pay methods to both maintain cost controls and increase employee performance. We've even coined a new word "incentivize" – a particular process as a way to increase employee motivation.

Current Economic Outlook

The current economic environment has produced an era of employees happy to have a job accompanied with an attitude of distrust and disenfranchisement, and an unwillingness to align their efforts with organizational goals.

So for organizations, we are asking our employees to do more with fewer resources and not provide much of a reward from a base pay perspective. We are expecting employees to work harder and longer, both in the office and outside with virtual office hours, with no real downtime to meet minimum work standards.

Motivating By Pay

We have Victor Vroom to thank for the Expectancy Theory and others like Lawler and Milkovich have explored these concepts further.

The idea behind merit increases is to reward those employees who have differentiated their performance above others in their work group, department or division.

The components of using pay to motivate performance lies within its *instrumentality*, *valence* and *expectancy* from the employee's perspective.

Component	Description
Instrumentality	The relative pay received is higher for high performers than low performers. Pay distribution is ***contingent*** on high-performance.
Valence	The differential between low performance pay and high performance pay is **significant** to the individual.
Expectancy	Good performance is **clearly defined** and under the influence/control of the individual.

We should review our own merit increase systems to see how they'd score on these three components.

Conditions for Success

The conditions for a merit increase program being successful are based in part on the elements of the Expectancy Theory. Merit pay plans motivate individuals to perform extra role behavior when they desire increased pay. They believe that the relative size of pay raises is contingent on good performance, and they believe they are capable of good performance.

Condition	Impact	Results In
Value	Individuals must value increased pay more and be willing to work harder or spend more time meeting performance goals (Valence).	Higher performance.
Differential	The differential in raises for high performance should be substantially higher than that awarded to average or low performing individuals (Valence).	When differential is high, increased effort is warranted.
Clear Communications	The criteria for good performance should be clear and communicated to employees (Expectancy; Role Expectations).	Employees don't need to guess what they need to do to get good performance reviews.
Trust	Employees must trust managers. There must be trust in the evaluation system so that employees do not perceive favoritism (Expectancy) and trust in the allocation system (Instrumentality).	Higher level of performance equals a higher raise.
Non Zero-Sum	Everyone who meets high performance expectations receives a high increase.	When systems are zero-sum, only the best employees receive the highest raises. So middle and lower ranked employees lose instrumental motivation because even if they improve performance they don't believe they'll be rated higher than the "stars".

Design Flaws in the Merit Increase System

The potential issues with merit pay systems are the opposite of the Conditions for Success in the grid above.

A zero-sum system, given a 3% budget, puts a manager in a position of giving each employee a 3% raise. Or, if he/she wants to give a higher raise like 5%, someone else has to get 1%. If employees' performance fits a normal distribution it might work, but if the manager takes the easy way out and gives everyone a 3% raise, it turns into a COLA.

In most merit increase programs, adjustments are granted annually. The issue is timing. Many managers, even with two review cycles, don't assess performance across the entire year, they rely on observations of performance in the few weeks or months preceding the performance review (recency effect).

Most merit increase systems call for annual performance evaluations and pay adjustments contributing to the annuity and entitlement feature of these systems.

To sum it up, the design flaws in Merit Increase Systems are:

- Zero-sum feature
- Timing – annual performance evaluations and pay adjustments
- Annuity feature disconnect
- Small differentials between average and exemplary performance
- Inequity
- Breakdown in group cohesiveness and cooperation

We spend a lot of time and effort on the distribution of merit pay. It may be time to change our ways.

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