

Innovations in Compensation

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Amidst a slowing economy and turmoil in financial sectors around the world, leading companies are finding innovative compensation strategies increasingly important as they seek to ensure high performance and high retention. This paper outlines challenges companies are facing in the area of compensation and innovations they are deploying in order to stay afloat as the business environment becomes more and more volatile. In collaboration with compensation experts from Goldman Sachs, Hallmark, Pfizer, Royal Bank of Scotland, and Procter & Gamble, we outline five key challenges leading organizations face today, and six innovative compensation solutions they are using to surmount the challenges.

CHALLENGES IN COMPENSATION

Equity

Line of Sight

Talent Mobility

Short Term v. Long Term

Total Rewards Integration

INNOVATIONS IN COMPENSATION

Temporary / One-Off Rewards

Employee Choice

Statistical Regression on Retention Variables

Rigorous Performance Management

Strategic Communication

Creative Redefinition of Long Term Rewards.

Five Key Challenges in Compensation:

1. Equity

The first challenge that surfaced was maintaining equity, and broke down into three main categories:

a) In creative markets, there are often short-term needs for niche or highly technical skills. To attract the best talent from the outside, these specialized skillsets have to be compensated at much higher rates than their peers within the organization. However, after technological needs/crazes pass, these skills often become less relevant, thus resulting in overly compensated employees whose positions managers find difficult to justify, despite the realization that employees in these positions may still add significant value to the organization. Balancing the right base / variable pay / other pay can be very difficult.

b) As emerging markets grow and required skillsets become increasingly scarce, wage inflation becomes a problem and star performers, or even star teams move from one company to the next for relatively small increases in pay. In the meantime, people with the same positions in different geographies will often have vastly different compensation packages based on different pay systems and cultural expectations. Ensuring equity across geographies becomes a great challenge, especially in the increase of information sharing across continents.

c) The third challenge HR Leaders face relating to equity occurs when two associates in similar jobs, but different business units within one company, receive different compensation due to the differing success of their respective businesses. Ironically, this often occurs among Human Resource professionals, where two HR Generalists performing identical job duties receive different pay as

one works in a declining sector and the other works in a high growth sector

2. Line of Sight

Another constant balancing act for compensation strategists is setting the right line of sight between employee compensation and business performance. Deborah Beckmann explained that Goldman Sachs has several junior top performers who are jittery in the current economic downturn. They have never experienced a down cycle and their compensation is suddenly sharply down, even when their individual performance hasn't changed significantly. Leaders struggle to find the right balance of compensation mix for base, individual variable, division variable, and company variable such that employees stay focused on their individual responsibilities, while seeking to drive growth for the company as a whole.

3. Talent Mobility

Traditionally, one of the key aims of total rewards systems is to improve retention. Leading companies are finding that they are losing people in emerging markets, despite the fact that they are paying three times the salary of their competitors. This may seem illogical, but many employees (especially gen X and gen Y) are much more loyal to their social networks than the companies they work for. Often, when one key employee leaves, he / she will take an entire group with him / her. HR Leaders are challenged with finding rewards packages which will overcome, or even leverage, social networks to retain and engage key talent.

4. Short Term v. Long Term

During the dot.com bubble, the compensation pendulum swung far to the long-term extreme as employees sought equity and expected high growth returns. From 2000 to 2006, the pendulum swung back to center with a fairly even balance between long-term compensation benefits and short-term cash. In the last eighteen months the pendulum has moved again towards more short-term rewards as employees seek cash and other liquid benefits in a volatile market. Meanwhile, the tough economy has left many companies short on cash and with stocks underwater. Senior executives aren't as interested in stock options and manufacturing employees in emerging markets also seek cash rather than long-term benefits due to volatile market conditions. Participants reported that finding means to fund an increasing appetite for short term com-

ensation, and creating the right balance between short and long term compensation for employees at all levels is an increasingly difficult challenge to meet.

5. Total Rewards Integration

The final challenge discussed is not a new one. Our HR leaders discussed the challenge of ensuring the employees grasp the full value of "return" they get as employees of P&G. They find that especially when the media is crying "recession", good employees can get pulled away by head-hunters when offered a few more dollars by a competitor without considering the entire worth of their employment package. In addition to traditional compensation and benefits, P&G is working to ensure that employees consider future opportunities to learn, grow, and take on more responsibility as part of the employment package.

Six Innovations in Compensation:

1. Temporary / One-Off Rewards

To address challenges with equity, Hallmark is looking for approaches where they can pay people a premium in the short run without securing fixed costs in the long run. For example, when dealing with specific skill sets that are in high demand, such as SAP programmers, they offer limited premiums, renewable on an annual or bi-annual basis which extend for the duration of the demand. In a similar manner, the Royal Bank of Scotland aims to keep a level base for its employees year over year, and uses its annual effect on payroll to provide variable compensation which truly rewards the high performers or specialized skills. Additionally, many companies, like Pfizer, are offering signing bonuses of cash plus restricted stock, which can be called if the employee leaves before three years. For retention measures, they step the vesting periods in six month increments to encourage employees to stay during each time period. While benefits like these can often be bought out by poaching competitors, identifying a critical temporary or one-off reward that matches the company strategy can be highly effective.

2. Employee Choice

To address the issues associated with equity and with long-term versus short-term balance, P&G is getting much more flexible with choices they allow their employees to make. Expanding the philosophy of cafeteria benefits plans, P&G offers its employees multiple compensation

choices as well, allowing people at all levels to choose how they will be compensated. For example, they can choose restricted stock, cash, pet insurance, additional vacation, or support in retirement planning. With this wide range of managed choice, employees find much more value in the total rewards they receive than they would have otherwise. In fact, in several situations, P&G has been able to reduce the total cost of compensation year-over-year, while increasing employee satisfaction with compensation. People feel a greater benefit from fewer dollars being spent, because they have the choice to spend where they will.

3. Statistical Regression on Retention Variables

Another innovation noted was the concept of detailed modeling of retention. By analyzing the large variety of variables which impact an employee's decision to leave an organization, companies like Pfizer and P&G have been able to predict about 80% of their attrition in North America. P&G identified all the variables, and then took them to a team of IT analysts to run the regressions and identify which variables had the greatest impact on employees staying or leaving. With these new insights the HR team was able to identify those individuals who were most at risk of leaving and develop specific interventions targeted at them—such as inviting them to a career workshop to renew their personal vision/goals and how the company could enable achieving it.

4. Rigorous Performance Management

Goldman Sachs discussed using their extremely rigorous performance management system to inform and ensure a successful compensation strategy. Employees at all levels engage in 360 degree reviews with at least 15 reviewers on a regular basis. These reviews are used to differentiate high performers and identify eligibility for one-off rewards. Goldman has found that the time and resources they invest in performance management greatly enhances their ability to reward their employees more effectively. As they face difficult economic times, they continue to return to rigorous performance management to ensure that the right people are being compensated in the right way.

5. Strategic Communication

P&G and RBS both discussed the importance of issuing a “Total Rewards Statement” to their employees on a regular basis. To address the challenges of line of sight, equity, and ensuring both short- and long-term rewards, these

two companies have found it extremely helpful to explicitly ensure employees know the actual value of all the benefits they receive. On the Total Rewards Statements, employees see YTD compensation, company contributions to retirement plans, the fees the company is paying in health care benefits, any stock options, the value of paid time off, including vacations, holidays, and sick leave, and the value of other benefits such as day care, counseling, product discounts, etc. Additionally, P&G provides benchmark data so that employees can compare their “package” with their peers in other companies in their geographic region. The result is that people are using these statements when approached by head hunters and more often stay with P&G because they see the total value of their employment. In a similar way, RBS has been providing these types of statements for five years and reports higher employee satisfaction feedback as a result. Because it can be very difficult to pull all of the information together, the costs incurred are primarily IT costs; however, both companies report that benefits far outweigh the costs.

6. Creative Redefinition of Long Term Rewards

The final innovation discussed was around the challenge of long-term rewards. To address underwater stock options, Pfizer and other companies discussed the creative ways they have redefined these rewards to ensure that employees see the value. For example, for some employees, Pfizer identified what the long-term benefit should have been (assuming stock wasn't undervalued), took 25% of that number, and then paid employees in cash dividends. The goal is to help employees liquidate or adjust the portfolio of the real value of employees' long term benefits such that they still see and feel the value and are therefore more committed to improve their own competence and perform at high levels.

In sum, while the discussion could have lasted several more hours, each participant agreed that they picked up at least one significant new idea during the call. From increasing strategic compensation communication to improving employee choice, there is certainly no lack of opportunity to capitalize on in leveraging compensation to drive high performance and improve retention.