

The Many Steps to a Sound Compensation Program

A Guide

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Bob Nadel
Nadel Consulting/HRSpectrum, Inc.
rsnadel@nadelgroup.com
914-761-7771

Some Background:

- > Consultant “on purpose” for 35 years.
- Independently elected external director of a publicly traded technology company with global sales.
- Member of the Comp Committee.
- Sarbanes-Oxley
 - The behaviors and expectations of Board members are vastly different
 - Gives a whole new perspective to what HR should and should not do for the company. (spills over to all companies)
- Served as an expert witness and expert report writer to support litigation in many cases.
- Juries, Judges and Opposing Attorneys have more finicky ways of assessing just how good our HR practices are compared to HR management and Top Management.
- I wish you could all have that experience sooner than later to see the implications

Background: Issues

>We have debated for years about how to get a seat at the table, does the person or the job get to the table, etc.

>Whether you know it or not you are always at the table and sometimes get launched into prominence (bad thing)

>For example...the head of HR at the NY stock Exchange was also named in the law suit brought against his chairman. His role...he was the internal recommender of the pay and retirement levels for the chairman. Was he "at the table?"

>Comp people and HR people as well have a new role.

>They must deliver compliance, sensibility and prudent business like thinking. Gone is the goal of "easy to administer and communicate"...more in the forefront is keep me out of court and keep me out of jail.

>We must stand up to top management to be sure they hear what we believe, how to retain people, how to reward them, how to have management continuity, how to stay out of court and out of jail. The board wants all that and would be FURIOUS if you didn't remind the CEO of his/her obligations to the company and its employees.

Background: More Issues

- > The board wants performance. New boards don't understand how "93 % of all employees are rated at substantially above expectations and the company grew at _ of 1% last year."
- > The board wants revenue growth and increased market share. We also now know that these metrics are linked to customer loyalty and satisfaction.

As we proceed with the program, test each concept of what makes for a sound comp strategy against these factors in your own company.

Or,

HOW DO I WANT TO RUN MY COMPANY?

Some Additional Compensation Principles and Rules:

- >Every business is in more than 1 business stage at any given time. Therefore there may be the need for multiple approaches to compensation.
- >Think of everything as an alternative!
- >Find the business question beyond the comp question.
- >Do not take other peoples medicine AND DO NOT FALL FOR FADS.
- >Educating Top management is sometimes 110% of the problem.
- >Understand the purpose of your Incentive Plans:
-reduce costs? -drive revenues? -drive new mix of business?
(Each requires a different set of measures)
- >Never pay incentives on unrealized gains.

Additional Principles and Rules, Continued

>Never develop incentives to correct a bad pay plan or bad business strategy.

>Never use the same measures in your annual plan as in your long-term plan.

>It is impossible for everyone to pay at the 75th percentile!

>Understanding jobs and their purpose in your organization is the primary building block of a comp program. It is also your first line defense against regulation and legal action.

>Be careful how you use survey or anecdotal data.”

>I can prove any point you want to make with any one piece of data, one time...but not representative of the true data.

Let's define Compensation

- **Base Salary (and it' administration)**
- **Annual or other Short Term Incentives**
- **Long Term Incentive (Strategic 3+ years)**
- **Health and Welfare Benefits**
 - Life
 - Disability
 - Health Insurance
- **Retirement Benefits**
 - **Defined Contribution (and matching)**
 - **Defined Benefit (getting rarer)**
 - **Supplemental Executive Plans (Execs)**
- > **Alternative Compensation**
- > **Perquisites**
- **Performance Link**
- **Communications**

FIFTEEN STEPS YOU NEED TO TAKE

1. Understand the business issues behind the comp problem !!!

a) internal pressures

- earnings pressures**
- revenue growth**
- turnover/retention**

b) external pressures

- labor market issues**
- inflation**
- product/service acceptance**
- compliance/regulation**
- competition**

2. Do your own HR “360”

View of Top Management

View of Functional Management

View of Employees

View of Customers/Vendors

3. Know where you want to Go with this Problem

- Discuss and Get Top Management Approval**
- Select Method to study and develop plan**
- Inventory internal and external resources to assist**

4. The role of HR has changed

- **Don't ask for seat at Table. Act As if You ARE at the Table.
(New Rule)**
- **Prevent Compliance Problems**
- **Don't Get caught Pleasing the "Boss" if you think it's the wrong thing to do.**
- **Have a "point of view"**
- **Understand the business question...prepare the "case"**

5. Internal Fairness Still Rules

- **Find a way to put your jobs in some orderly “system” without backbreaking effort.**
- **Use end results oriented approach**
- **Be prepared to DEFEND it.**

6. External Market Analysis is Critical

- **not necessarily your business competitors**
- **where did you recruit your last fifty people from?**
- **Where did your last 50 people who left go?**
- **Multiple markets for multiple lines of Business.**

7. Ingredients of a Base Salary Program

- a) Job Descriptions and Supervisory review (Don't use \$100 computer systems)**
- b) Make Sure Descriptions give you
 - ADA reasonable accommodations**
 - ability to assess FLSA requirements****

Note: good job descriptions are a building block for:

- a) Recruiting**
- b) selection**
- c) training**
- d) promotion to the next job**
- e) performance management**
- f) succession planning**
- g) career development**

7. Ingredients of a Base Salary Program, Continued

- c) A grading system using a defensible method of job analysis**
- d) System should focus on job end results**
- e) External market Pricing for your grades**
- f) Separate Market pricing for special job families**
- g) Salary ranges**
- h) Salary admin guidelines**
- i) Link to your performance management system**

Note: Be sure to keep:

- a) jobs current**
- b) market analysis current**

8. Before designing ANY incentive plan know the basic principles of incentives!!

a) to build corporate results?

b) to build specific division or product results?

c) to build personal performance?

d) based on “realized gains” !!!

**Note: pay employees as owners and managers.
(company achievement plus individual achievements)**

**Note: develop proper mix of:
Corporate
Business Unit
Individual Goals**

8. Incentive Principles, Continued

- a) For achievement of strategic objectives?
(Do you have a planning and measurement process???)**

- b) To attract and Retain?
(How competitive is your company, do you have unwanted turnover, are you losing best talent?)**

- c) To Change Culture?
(will management permit change, do you have the right employees to accept change...will they accept change?)**

- d) Control costs?
(will you empower employees to act, can you transfer financial risk to employees?)**

Note: Incentives Can Not:

- fix a bad strategic plan**
- fix a bad comp plan**
- be an instant success**

9. Annual Incentives

- >Time Frame is traditionally one year**
- >Measures Operating, not strategic results**
- >Measures Contribution to infrastructure**
- >Goals should be measurable and controllable (“line of sight”)**
- >Determine:**
 - who participates**
 - target award**
 - funding pool**

10. Long Term Incentives

- **Measurement period is typically 3-5 years**
- **Measurement and payout is made at end of period...no “in-betweens”**
- **Designed for the achievement of strategic end results**
- **Participants are fewer, usually those who impact vision, growth, change and survival of company**
- **ABSOLUTELY ONLY REALIZED GAINS**

“Align with stakeholders”

“Don’t measure same as Annual Operating Incentive Plans”

11. Role of Benefits

- **Entitlement is/has been Dead**
- **Shared Cost is increasingly hurting the employee**
- **Benefits must be measured on VALUE, not COST**
- **Mix of Benefits is trade-off to Cash Pay**
- **Mix of Benefit Programs should be based on Demographics of employees**
- **Benefits require their own strategy**
- **Employee Preferences and “Consumerism” is new philosophy**
- **By 2010 employees will pay for 90% of out of pocket expenses for care with premiums, deductibles and co-pays (and the practice of discounting for reasonable and customary)**

11. Benefits, Continued

Questions for employers?

- a) pay for individual vs. family?**
- b) How much cost passed to employee?**
- c) Demographics?**
- d) Do you know employee preferences?**

Choices?

Health and Welfare:

**. health . prescription drugs . dental . mental health .vision
. elder care . long term care .pre-tax . FSA's . short term disability
.long term disability. life insurance .spousal life**

Retirement

. defined contribution .match? . defined benefit .what formula?

Other

**.vacation .sick leave .combined personal leave all reasons . severance
.tuition reimbursement .sabbaticals .pet insurance**

11. Benefits, Continued

- a) Medical Benefits most costly of all. Differ in value to employee by employee usage!!!**
- b) Based low inflation, rise of benefit costs are not offset by salary increases, or tax rebate checks**
- c) Employees do not understand benefit plans or reimbursement (reasonable and customary, etc)**
- d) Use of Consumerism and Defined Benefit Plans (Individual choices)**

HR Role:

- a) Strategy based on company economics, demographics and employee preferences**
- b) Review admin options**
- c) Educate employees**

12. Special Labor Market Pay Practices

- **Short skills**
 - **set up pay differentials**
 - **do not increase grade to get the \$**
 - **most skill shortages disappear**
 - **maintain pay practice as long as needed**

- **Broaden definition of labor market**
 - **seniors**
 - **ADA defined disabled**
 - **Internships**

- **Outsource???** Dirty word or strategic solution? Don't confuse with offshoring?

- **Use sign on bonuses, project completion bonuses, tuition to keep skills current, career management**

13. Alternative/Complementary Comp

- **Fix a strategy for your company**
 - flex time, part time, split time may be good for the business
 - work/life balance
 - *what do the kids think?(Refer to Ellen Galinsky)*
- **Management style**
 - more people leave for issues of boss/subordinate relations than for compensation reasons...by far.
- **Use:**
 - skills training
 - technology upgrades
 - career counseling and development
- **Value Performance:**
 - tell them
 - spot rewards
 - special assignments
- **Chocolate Bars, full fridges and pizza do not play the same role they did from 1998-2000**

14. Administrative Processes

- **The absence of written policies is not the definition of a flexible, entrepreneurial company.**
- **Rather it is the definition of a company that has NO guidelines to say Yes or No!!!, and**
- **It is the definition of a lawsuit waiting to happen.**

- **However, DO NOT publish any HR policy manual without the advice of an external employment lawyer.**

- **Internal admin procedures should be like a self audit:**
 - Check:**
 - **the market**
 - **your own job definitions**
 - **the measures you use for performance**
 - **salary budgeting**
 - **employee perceptions**
 - **your vendors**
 - **performance management effectiveness**
 - **compliance: ADA, EEO, FLSA etc.**

15. Communicate, Communicate

- **Not reserved for a special time**
- **Honestly (really) is the best policy**
- **Communications helps in goal setting**
- **Communications helps in performance management**
- **Communication sets the tone for what the company values**

16. Pay programs do not stand alone.

They are management tools along with other tools:

- > Recruiting Strategies**
- > Use of Alternative Labor Pools**
- > Work Arrangement Programs**
- > Work Life Balance Programs**
- > Diversity Management**
- > Management Style and Culture**
- > Job and Organization Style Strategies**
- > Global Management**
- > Alternative Pay**

Finally, Pay communicates to all employees what the company values, and how management chooses to “RUN ITS COMPANY”

Thank You.