

Compensation 101



HR Florida Conference & Expo
August 16 – 19, 2009

Presented by: Joseph F. Kager, CCP

Presentation Outline



- ✓ Business strategy – the critical link
- ✓ Goals of a sound reward strategy
- ✓ Reward system design objectives
- ✓ The base salary component of total rewards
- ✓ The variable compensation component of total rewards
- ✓ Evaluating reward systems

Understanding the Business – The Critical Link



Balancing The Drivers

Financial Measures

Revenue & EBITDA

- Revenue
- Direct Margin
- Direct Expense
- EBITDA

Service Excellence

Critical to Today's Success

- Customer Retention
- Customer Satisfaction
- Customer Response Time

Operational Excellence

- Total System Availability
- System Response Time
- Revenue per FTE
- Asset Turnover

Organizational Excellence

Enables Near Term Success

- Growth & Recruiting
- Retention
- Integration/Development

Strategic Initiatives and Projects

- Product Development
- Product Bundling
- Functional Strategies
- Acquisitions & Partnerships

Grounded in Market Realities

Accountability for Performance

Responsibility for Sustainability

Basic Reward System Goals



- ◆ Attract and retain the caliber of employees required to meet the organization's strategic and tactical goals
 - Competitive marketplace
 - Internal equity
- ◆ Motivate employees to operate at productivity levels that allow the organization to achieve its objectives
 - Cost worth the benefit
 - Meaningful rewards
 - Tie to the business
 - Well communicated

Other Reward System Goals



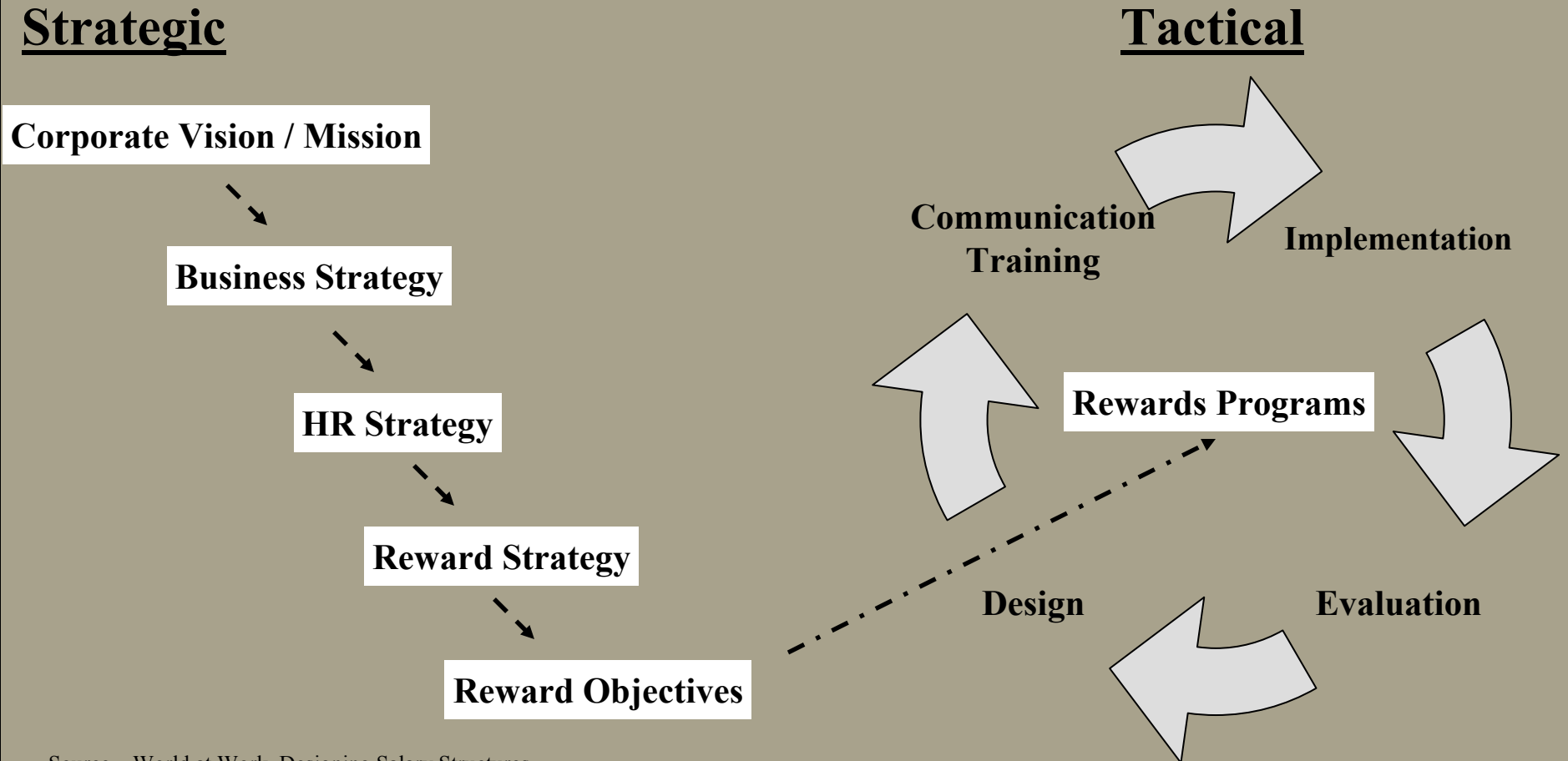
- ◆ Tax effective delivery
- ◆ Protect the welfare of employees and their families
- ◆ Promote some type of company value
 - Teamwork
 - Individual excellence
 - Growth of skills / competency
- ◆ Conserve short-term cash
- ◆ Decentralized decision making
- ◆ Simple to administer, communicate, and understand
- ◆ Promote a cultural / management / business change

Design Objectives



1. Fit to the business
2. Competitively positioned
3. Internally equitable
4. Cost is worth the benefit

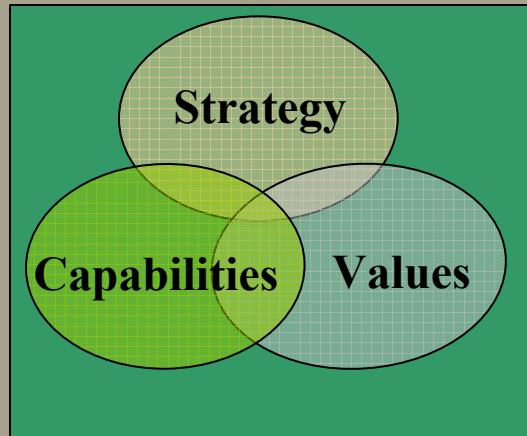
Design Objective 1: Fit with the Business



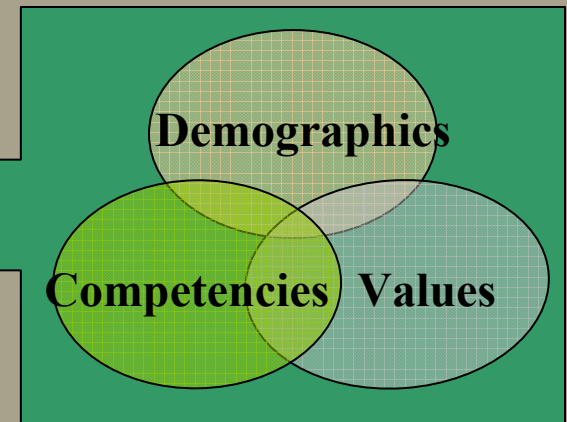
Factors Influencing the Reward Strategy



**Employer Perspective:
Increasing shareholder value**



**Employee Perspective:
Meaningful, rewarding work**



**HR
Strategies**

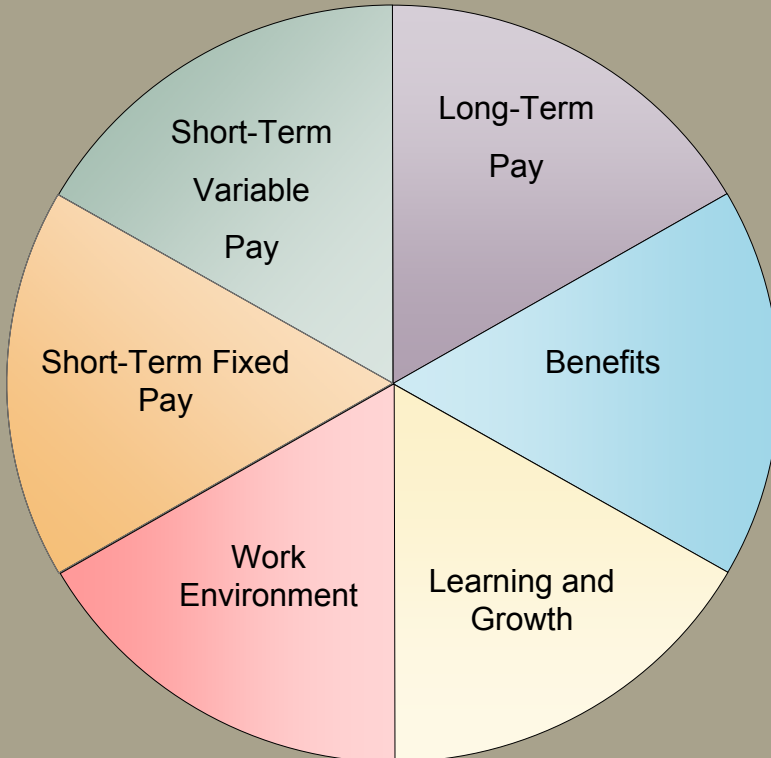
**Total Reward
Strategy**

External Influences

Internal Influences

**Improved business results
and aligned employee behavior**

Strategic Reward Components



Short-Term Fixed Pay – The foundation of most all reward systems.

Short-Term Variable Pay – Encourages pay for performance differences by providing the opportunity for a piece of the action.

Long-Term Pay – True ownership motivation and behavior. The American dream realized.

Benefits – Many variables with limited options. Consider further segmenting to H&W, retirement, executive. Minimum level generally provided. May create different benefits for different employee classes – needs analysis.

Learning and Growth – Feedback systems – performance management, coaching and mentoring. Also development systems of skills and competency training, career development and succession planning.

Work Environment – Organizational factors such as climate, leadership style, and work / life balance. Also the specific work itself – challenge, variety, autonomy, etc.

Top Five Reasons to Adopt a Strategic Reward Approach



5. The program de jour is less likely to be brought up
4. The \$%*&# department that always complains and gets their way – data and results always wins over opinions
3. Cost does not become the sole issue to consider
2. Planning and consensus building will lesson the crisis management response
1. Actually our pay, benefits, and career development systems are working to meet the strategy of the business – WOW!

When to Consider a Strategic Change to Rewards



- ◆ Shift in business strategy
- ◆ As a change leader system
- ◆ Response to external changes

Design Objective 2: External Competitiveness



- ◆ Comparison outside the organization to competitors for talent
- ◆ Take into account size of company, industry, and geographic differences
- ◆ Valid job matching to assure comparisons made to similar positions – job titles not sufficient
- ◆ Related to the ability to recruit and retain employees

Surveying External Competitiveness



- ◆ Broad in sample
- ◆ Data based – static
- ◆ Survey – response
- ◆ Answers the question of “what”
- ◆ Generally obtained through consulting firms, industry groups, business groups

Benchmarking External Competitiveness



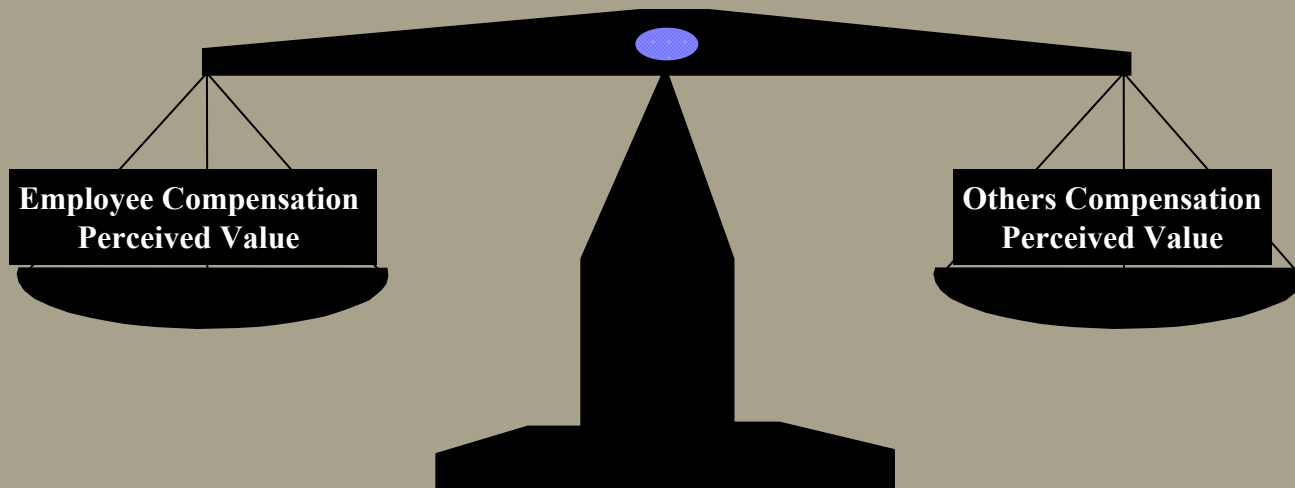
- ◆ Narrow in sample
- ◆ Relationship based – ongoing with others
- ◆ Multiple data sources
- ◆ Addresses the question of “how” and “why”
- ◆ Can be facilitated through personal contacts, networking groups, consultants

Factors Influencing External Competitiveness



- ◆ Quality of external information – survey data or company specific experience
- ◆ Application of information to the organization – competitive position
- ◆ Willingness of company to keep pace with the market – affordability
- ◆ External sources of information available to employees – recruiters, internet, newspaper, cousin Joe

Design Objective 3: The Perception of Internal Equity



- ◆ When the employee perceived value is less than others, employees perceive themselves as under compensated and dissatisfaction results
- ◆ When the employee perceived value is more than the others, employees perceive themselves as over compensated and dissatisfaction results
- ◆ Most individuals perceive their contribution higher and value less than others

Factors Influencing Equity Perceptions



- ◆ Involvement of competent insiders in design
- ◆ Openness of pay system communication
- ◆ Training of employees and managers
- ◆ Guidelines for consistent administration
- ◆ Mechanism to determine reward allocation
- ◆ Integrity of plan administration

Plan Plans = Communication Tools



- ◆ Philosophy of the reward system
- ◆ Values of the organization
- ◆ Origin of the information
- ◆ Process to evaluate level of reward/pay
- ◆ How the system will be maintained and administered
- ◆ Day to day guidelines
- ◆ What is in it for me?

Design Objective 4: Cost is Worth the Benefit



- ◆ Budget
- ◆ Expected return for \$ spent
 - Sales compensation
 - Gain sharing / Success sharing
- ◆ Other returns beyond output
 - Goodwill
 - Retention
 - Support of the company culture

Cost and Benefit Perceived Differently by Different Parties



- ◆ Human resources
- ◆ Finance
- ◆ Sales and marketing
- ◆ Executive management
- ◆ General workforce

Know your audience and deliver the benefit that fits their lens!



Base Pay Component of Total Rewards

Typical Base Pay Project Steps



Total Reward Strategy Development

Philosophy and strategy serve as the foundation

Job Analysis & Job Description Development

Cornerstone of many HR processes including base pay analysis

Design Job Evaluation Approach

Industry, company philosophy, internal equity considerations

Determine External / Internal Value of Jobs

Strong tie to the competitive external market through pay surveys for all positions
Also considering internal equity as deemed important

Implementation And Communication

Broad communication of approach and processes

Salary Admin Process Development

Consistent approach across the co. to ensure fair and equitable admin.

Structure Implementation & Analysis

Determining how the new structure and competitive data fit the workforce

Salary Structure Development

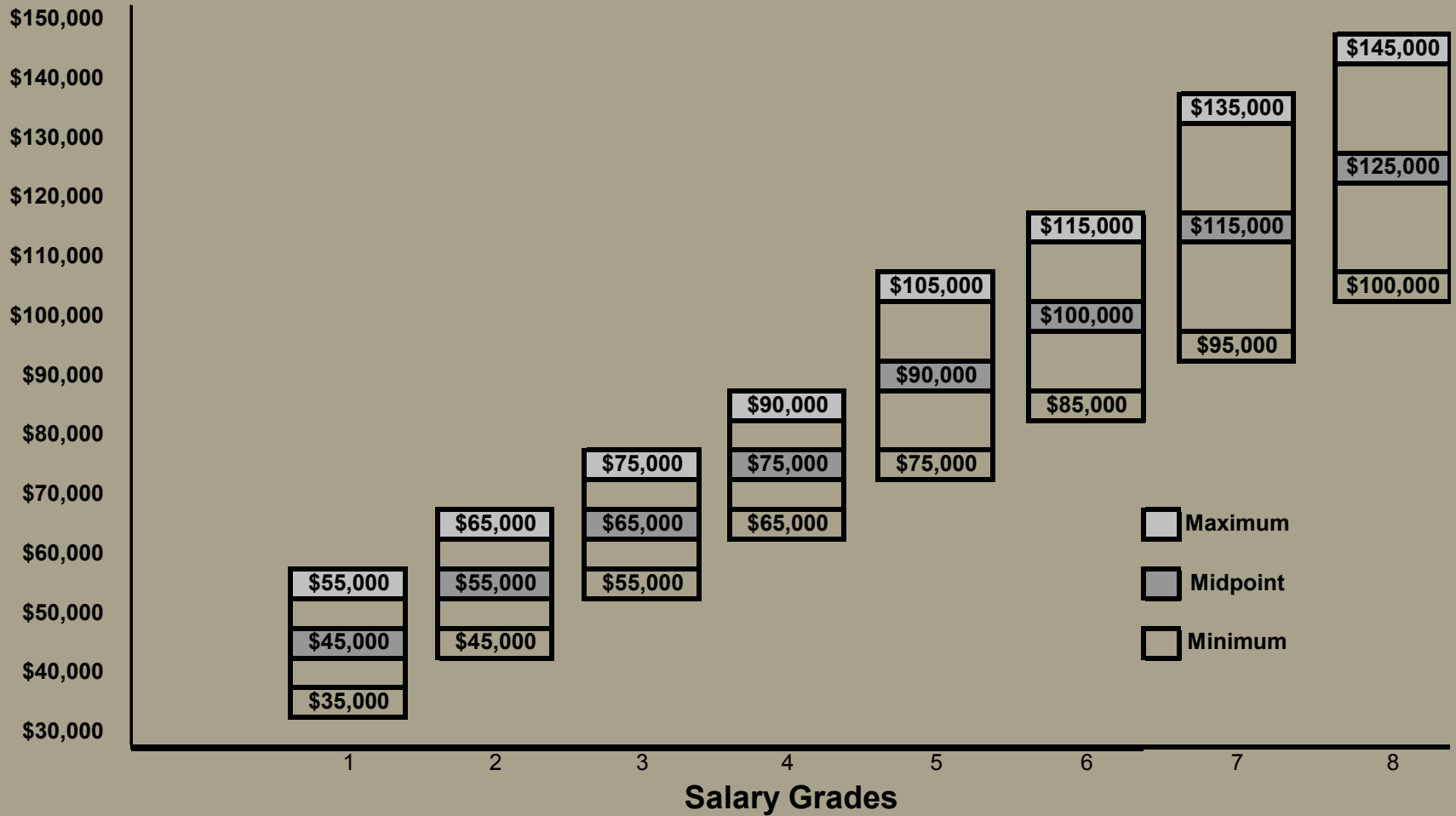
Creating the framework to manage base pay with cultural objectives

Determining a Job Evaluation Approach



- ◆ Market based
 - Market pricing and slotting
 - Emphasizes external competitiveness
- ◆ Job content based
 - Point factor and compensable factor
 - Emphasizes internal equity and external competitiveness
- ◆ Competency based
 - Skill based pay, career pathing
 - Emphasis on employee skill, knowledge development

Building Pay Structures



Salary Structure Example

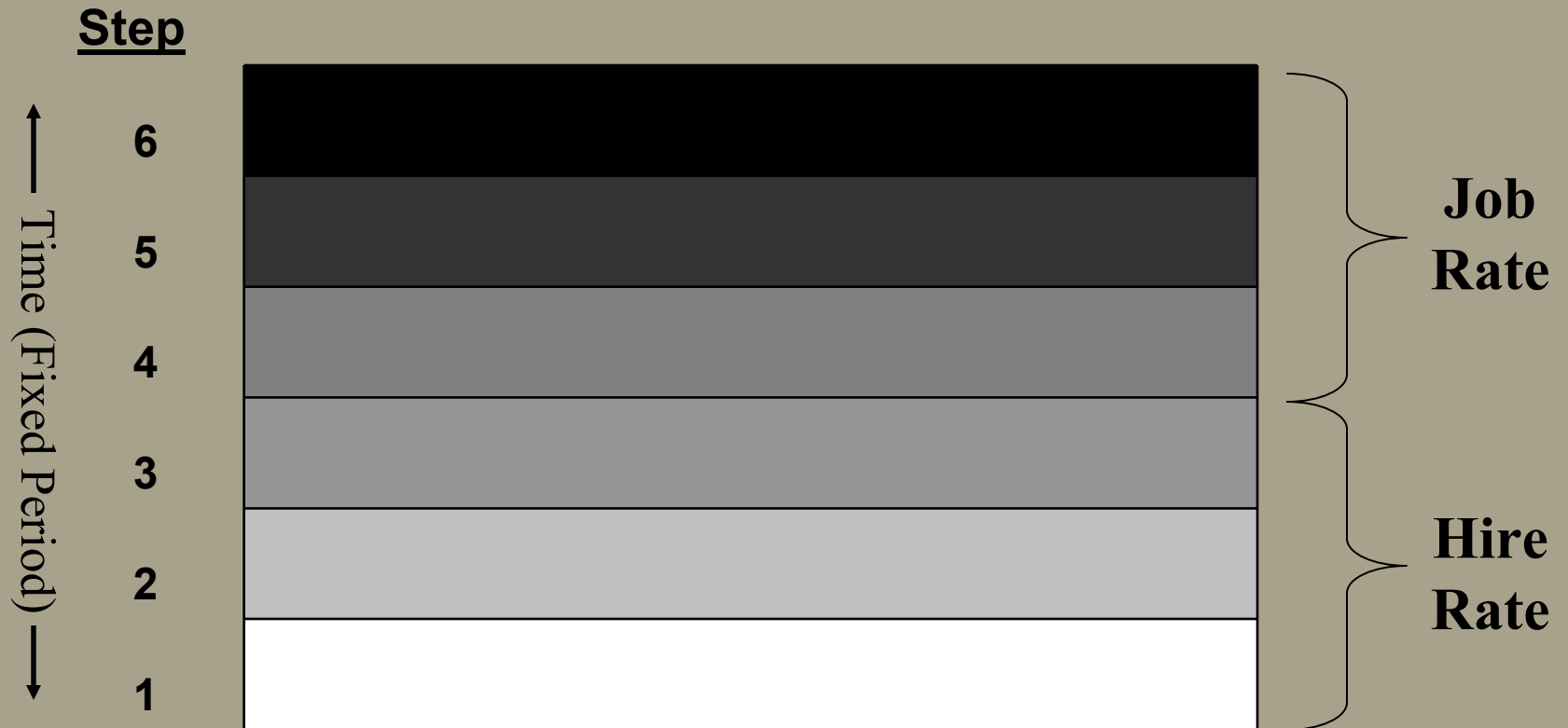


Grade	Developmental Zone		Intermediate Zone			Advanced Zone	
	<u>Minimum</u>					<u>Maximum</u>	
11	\$20,400		\$23,700		\$30,350	\$33,700	
12	\$23,500		\$27,300		\$35,000	\$38,800	
13	\$27,100		\$31,500		\$40,300	\$44,800	
14	\$31,100		\$36,200		\$46,300	\$51,400	
15	\$35,800		\$41,600		\$53,300	\$59,100	
16	\$41,300		\$48,000		\$61,400	\$68,200	
17	\$47,400		\$55,100		\$70,600	\$78,300	
18	\$54,600		\$63,500		\$81,200	\$90,100	
19	\$62,800		\$73,000		\$93,500	\$103,700	
20	\$72,300		\$84,000		\$107,500	\$119,300	
21	\$83,100		\$96,600		\$123,700	\$137,200	
22	\$95,700		\$111,200		\$142,400	\$158,000	

Min to Max Spread: 65%

Grade to Grade Progression: 15%

Step Increase Approach



Variable Step Increase Approach



Performance Rating

Pay Action

Exceeds Expectations



Meets Expectations



Partially Meets



Unacceptable



Two Step Increase

One Step Increase

No Increase or Increase with Delay

Corrective Action

Merit Matrix Approach - Performance Only



Performance Rating	Fixed Increase Amount	Discretionary Increase Range
Exceeds Expectations	6%	5% - 7%
Meets Expectations	4%	3% - 5%
Partially Meets	2%	1% - 3%
Unacceptable	0%	0%

Merit Matrix Approach – Perf. and Position in Range



Performance Rating	Position In Salary Range		
	Bottom Third of Range	Middle Third of Range	Top Third of Range
Exceeds Expectations	8%	6%	4%
Meets Expectations	6%	4%	2%
Partially Meets	4%	2%	0%
Unacceptable	0%	0%	0%

Factors Influencing Individual Base Pay



Developmental Zone \$	Intermediate Zone \$	Advanced Zone \$
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Minimum

Maximum

Experience: No Experience or Minimally Experienced Fully Experienced Fully Experienced

Skills and Competencies: Does Not Fully Possess All Required Skills / Competencies Fully Possesses All Required Skills and Competencies Possesses Skills and Competencies Beyond Those Required

Performance: Needs Improvement or Beginning to Fully Meet Expectations Fully Meets Expectations (May Occasionally Exceed) Regularly Exceeds Expectations

In addition to the factors described above, managers must also be aware of internal equity considerations in managing pay.

Performance Based Base Pay – Success Factors



- ◆ **There must be differences in individual performance**
- ◆ **Performance differences must be significant enough to merit the time and effort required to measure them**
- ◆ **The organization's performance appraisal system must be sound and perceived as fair by employees**
- ◆ **Supervisors and managers must be trained in performance appraisal and planning**
- ◆ **Pay ranges must be of sufficient width to allow for adequate differentiation of pay based on performance**
- ◆ **An organization's linkage of pay to performance must be sound, and it must be recognized and understood by employees**
- ◆ **Management must be committed to and willing to make distinctions between employees based on performance**

Characteristics of Effective Performance Appraisal Systems

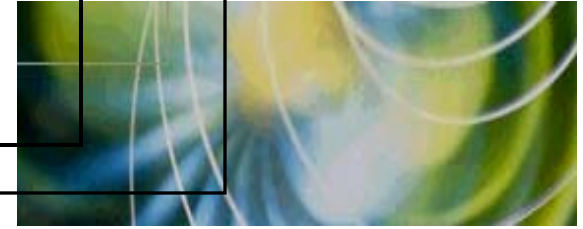


- ◆ **Performance criteria are as objective and quantifiable as possible so that rater interpretation is minimized**
- ◆ **PA is based on direct measurement of job related results as opposed to personality traits.**
- ◆ **Each performance appraisal criteria is weighted for relative importance**
- ◆ **Performance standards are established for different levels of performance**
- ◆ **Performance standards are communicated at the beginning of the measurement period and are reviewed and updated periodically for relevance**
- ◆ **Supervisors and managers are trained in the concepts and processes of PA**
- ◆ **Appraisals are conducted by raters who are knowledgeable about individual employee performance**
- ◆ **Appraisals are committed to writing and reviewed with the employee**
- ◆ **A process exists to reconcile significant differences between rater and employee perceptions of performance**
- ◆ **The appraisal instrument and methodology are reviewed periodically to eliminate potential problems and make improvements**



Variable Compensation Component of Total Rewards

Questions to Ask When Considering Variable Pay



- ◆ What is critical for the organization to be successful?
- ◆ What key behaviors are needed to fulfill these success factors?
- ◆ Who can carryout these key behaviors?
- ◆ How does the organization best encourage and reinforce these actions?
- ◆ Is variable pay a competitive component of total compensation?

Reasons to Consider Variable Pay



- ◆ Cost is variable not fixed
- ◆ Variable rewards tend to have higher motivation than changes to base salary
- ◆ Ability to tie rewards to specific business outcomes
- ◆ Provide a piece of the action
- ◆ External competitiveness

Variable Pay Design Considerations



- ◆ Funding mechanism for the incentive
- ◆ Payout mechanism for the incentive – What are we paying for!
- ◆ Mix of base pay and incentive pay
- ◆ Participants – all or a select few
- ◆ Individual vs. team
- ◆ External market
- ◆ Program effectiveness evaluation

Types of Variable Pay Plans



- ◆ Group based plans
 - Profit sharing
 - Gain sharing
 - Small group / team incentives
- ◆ Individual based plans
 - Piece work
 - Skill or competency based
 - Management incentives
 - Sales / customer service incentives
 - Executive incentives

Plans can combine group and individual measures

Base Pay System Audit Elements



- ◆ Compensation strategy
- ◆ Pay polices
- ◆ Job design, descriptions, and specifications
- ◆ Job evaluation plans
- ◆ Job pricing
- ◆ Pay structures
- ◆ Performance evaluation
- ◆ Individual pay decisions
- ◆ Administrative procedures

Incentive Plan Audit Elements



- ◆ Link to the business plan – key drivers
- ◆ Measures within participants control
- ◆ Participant understanding
- ◆ Correlated with other measures of performance
- ◆ Administrative procedures
- ◆ Plan documentation

Indicators Your Reward System May Need Realignment



- ◆ Reward elements are managed separately, particularly if you have several elements to consider (i.e., multiple incentive plans, independent benefit decision-making processes, decentralized training and development programs, and so on).
- ◆ Reward programs are designed primarily based on competitive, industry, or “best” practices.
- ◆ Reward programs send mixed messages.
- ◆ Delivery of rewards is not tied to program intent (i.e., everyone in a division gets the same percent bonus payout even though the plan calls for dispersion based on performance).
- ◆ There is difficulty in attracting and retaining key talent.
- ◆ Pay, benefits, and career programs are not well integrated, (i.e., there is no cohesive strategy)

Joe Kager – Managing Consultant



- ◆ National management consulting firm est. in 1997
- ◆ Clients range from small firms to the F500
- ◆ Areas of Expertise
 - Executive compensation strategy and design
 - Total reward consulting and system development
 - Performance assessment and feedback systems
- ◆ Practice Emphasis
 - Strong customer service through client relationships
 - Full service in our areas of expertise
 - Sharing of knowledge to build client capabilities

www.poegroup.com kager@mindspring.com (813) 661-3111