Best Practices in Compensation

The Road to Total Compensation Management

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As competition for the most skilled professionals gets tighter, keeping employees happy has never been more important. Employers make it a priority for their HR departments to continue seeking tangible and measureable methods for retaining their best and brightest. At one point, the idea of a Pay-for-Performance (P4P) model for an entire company, similar to that used in sales organizations for management of commission-based pay, seemed like a plausible, concrete way to meet this challenge. Incentive compensation has been used for years to motivate sales professionals. Yet, initial solutions, like those implemented in the early 1990s[1], fell short of desired results. In the last decade, talent management solutions have come a long way toward filling those initials gaps. The road has now been opened, clearing the path for P4P and making it a reality.

P4P: A Bumpy Start

The idea of a company-wide compensation program is a road that many organizations have already been on for a while. By 2005, 75 percent of all U.S. companies had connected at least part of an employee's pay directly to performance measures.[2] When it comes to compensation programs, most people think of traditional sales incentive models, where rewards are linked directly to sales performance in the form of bonuses or commission. Total compensation management takes the concept of the sales incentive program and expands it to the entire organization. Aberdeen Group defines it as "much broader [than a sales incentive program] and involves entire staff, awards, rewards—including merit raises, bonuses, on-the-spot rewards, tuition reimbursement, and stock programs—that each employee receives."[3] The goal of total compensation management is to directly align employee performance to business objectives, demonstrating real value to both the business and to each employee.

To accomplish this, in the early 1990s organizations began using Pay-for-Performance as an incentive strategy for motivating employees to reach certain business targets. It became apparent, however, that something was missing. Inaccurate data and unlinked systems stifled total compensation management with high costs. And the bumps encountered in early P4P implementations were due to disparate information and activities—similar to starting a road trip without a map.

On the Road Again in 2008

A Pay-for-Performance strategy is most successful within the context of an integrated talent management solution, which was not entirely possible until recently. Today, organizations are getting back on the road due to advances in talent management technology. With linkages to development and performance data, including competency assessments, goal achievements, key performance indicators (KPIs) and succession plans, organizations can now realize the full promise of P4P and create a culture of meritocracy based on performance.

Pay-for-Performance only works when accurate performance data is readily available at the moment key compensation decisions are made. Couple accurate data with automated processes, and now managers have the ability to access up-to-date performance appraisals and goal management data within the context of compensation planning. The ability to immediately produce embedded, inline reports to model compensation allocations makes decision-making easy and precise.

While an integrated total compensation management system will improve staff performance, job satisfaction and employee retention, results are dependent on how the program is structured within the organization's culture. Bersin & Associates recommends that organizations first consider their process when looking at a talent management solution. If organizations focus on clearly defining processes, then it will be clear which solutions are right for them.[4] Employee input also is necessary, as well as visibility into the organization's total compensation management program.

Destination: Creating a P4P Culture

The road to real Pay-for-Performance is smoother today, thanks to integrated talent management platforms that can bring vital processes and data together in one place. The key behind effective P4P is enabling compensation decision-making that is informed by accurate and timely performance data. Your compensation program needs to include open communication with employees, so they clearly understand the program elements and how to achieve performance goals. Rewards also must be determined objectively to ensure compensation remains fair. Once you have these components in place, your organization is well on the road to creating a Pay-for-Performance culture where employees are satisfied—and satisfied employees lead to satisfied customers.

For more information about how to link performance management and compensation planning for a real Pay-for-Performance culture, contact Cornerstone OnDemand at +1 888 365 CSOD or at www.cornerstoneondemand.com. ■

[1] *Martha Lagace, "Pay-for-Performance Doesn't Always Pay Off," Harvard Business School, Working Knowledge, http://hbswk.hbs.edu/item/3424.html, 14 April 2003.*

[2] *John D. Donahue and Joseph S. Nye, For the People (Brookings Institution Press, 2003), 239.*

[3] *David Weldon, "Total Compensation Management: Taming Costs and Rewarding Employees," Aberdeen Group Report, April 2008.*

[4] *Josh Bersin, "The Business Case for Performance Management Systems", Bersin & Associates Research Report, January 2008.*

3 Key Steps to Building A Pay-For-Performance Culture

SUCCESSFACTORS

Increasingly, successful companies are tying compensation directly to employee performance to drive incredible business results. Originally believed only for sales professionals, pay-for-performance is proving to be effective at all levels and in all functions of an organization.

Building a pay-for-performance culture may seem like an abstract vision for some companies; however, it's considered a top tool by senior executives for achieving better financial results. And for good reason: a strong pay-for-performance culture has the ability to unlock employee performance potential, keep your "superstars" happy, and ultimately drive a healthier bottom line.

Key business benefits of pay-for-performance include:

- **Increased Motivation**—A pay-for-performance system is a key element in getting employees to excel at maximum levels. How? By combining clear direction, quality feedback and tangible rewards, and recognition—key components to job satisfaction and employee dedication.
- **Improved Retention**—It's no secret that the key to retaining the best and brightest is recognizing and compensating top performers. According to Giga Information Group, retention can be improved by meritocratic management—or pay-for-performance—by up to 27%.
- **Cost Savings**—Companies can waste literally thousands of dollars a year in overcompensation: rewarding individuals whose performance doesn't help achieve key business objectives. The ongoing accountability in a P4P culture helps avoid this pitfall.

Three Key Steps to Building a Successful P4P Culture

Step 1: Compensation Planning

The first step to implementing a true pay-for-performance system is developing an overall compensation plan for the company. Most successful companies base it on a "structured incentive scenario"—one in which employees understand ahead of time the precise relationship between performance and the incentive reward. A survey of companies across industries reveals two common approaches:

1) Annual bonuses and merit increases, based on a typical review cycle with performance ratings linked to organizational goals; or

2) Goal-driven incentive plans, which fall outside the annual review process and are tied to achievement of specific time-based goals. Whichever you choose, the key is that the policies are fair, consistently followed, controlled, and subject to review and oversight.

Step 2: Goal Alignment

After the compensation strategy is determined, company leadership must establish organizational goals through a clear mission. Many organizations fail to communicate these goals to individual contributors. In fact, leading industry analysts estimate nearly 95% of workers are unaware of their company's top objectives.

Establishing a formal review process that creates relevant goals for each employee and maps them back to corporate objectives is crucial for establishing a true pay-for-performance culture. When managers and employees see the goal plan and understand how their efforts fit into the company's business objectives, a pay-for-performance system begins to thrive and directly contribute to bottom-line results. For the "superstars" in your organization, this means making sure goals are aligned with activity within their control—not solely on functions they cannot directly influence. Keep in mind that your success in aligning employee and company goals requires an open dialogue with upper management. This is the only way to ensure business strategy is woven into all HR efforts.

Step 3: Performance Management

The final step in developing a pay-for-performance system is establishing a system to continuously measure and manage employee performance in a quantifiable way. Many companies fail to take this last step and end up with an arbitrary or subjective review process. Performance reviews are critical to maintain a level of performance management that will support a thriving pay-for-performance culture. However, reviews have to be regarded as more than just an "annual event." This can be achieved by formalizing a process of performance reviews on a monthly, quarterly, or project-by-project basis. This will inevitably create a better dialogue between employees and managers.

By integrating these elements into your HR processes, your company can establish a true pay-for-performance culture. The result: energized and engaged employees who clearly understand how their contributions affect overall company success, and know they're being compensated fairly for their efforts. The overall business results can be enormous: retention of top talent, higher levels of performance throughout your company, and greater revenue and profits.

About SuccessFactors

SuccessFactors delivers easy-to-use technology that helps businesses of all sizes align, develop and motivate employees. With a suite that includes solutions for goal alignment, performance management, compensation, succession planning, learning, recruiting, and workforce analytics, SuccessFactors offers the most innovative HR technology available today. To learn more, please visit www.successfactors.com. ■

Can Pay Really Make the Difference?

LISA HARTLEY | TALEO

Most HR professionals know the key reason employees leave is due to a bad manager, right? But if this is the case, why do we spend so much time on compensation? Next to interpersonal relationships, feeling undervalued is the number one reason people and groups underperform. HR professionals will tell you that their major headache today is operating within very constrictive limits when trying to make pay as motivating as they can for their employees. How do you design a pay program that not only contributes to employee retention but directly impacts employee motivation as well?

The Way It Works Today

Traditional merit systems that include pay, stock, and bonuses have dominated the workplace for the past four decades. However, except in a few instances, most companies are not satisfied with these tools. In a time when overall turnover in the US is hovering around 40%, it's clear that talent is restless and the current programs really aren't working. One telling statistic is that merit increases between average and top performers are about 2%—even though top performer output is typically five times that of the average performer. Ouch! It's clear that merit programs are not a good tool to motivate employees to change behavior. And it also becomes challenging organizationally since a 1.25% merit increase can be virtually meaningless to an individual, but can be an enormous sum of money in an organization with 20,000 employees.

Pay-for-Performance

A better approach is to target what an employee should be paid based on performance with specific emphasis on the tie to organizational outcomes. It's also important to keep an eye on market pay so you can do a market based gap analysis. People are more likely to leave if they feel like they're not paid what they're worth, rather than because they didn't get a merit increase. With Salary.com and other providers, it's very easy for professionals to do their own homework. Pay for Performance involves:

- Determining what someone should be paid based on their performance against clearly defined goals.
- Calculating the difference between target pay and current pay.
- Allocating the budget based on the amount of difference.
- Using variable pay plans to reward goals based performance (but not necessarily adding to base pay in perpetuity).
- Factoring in knowledge, skills, and experience as it increases over time.
- Growing the employee's salary as new skills are acquired as long as they are tied to business outcomes.

Getting the Line of Sight on Target

In many companies, employees don't know how their performance contributes to overall corporate success. Besides, it becomes increasingly difficult to define individual performance objectives that merit an incentive as one goes further down into the organization. But establishing lines of sight clearly showing linkages between job performance and corporate goals can rectify such problems.

Using emerging technologies, it's fairly easy to establish goal based processes that can be flexible to fit the culture of the organization. Some goal plans will cascade from the top. Others will boil up from the bottom. The key is linkage. By clearly linking goals management with performance management, the line of sight between corporate goals and individual contribution is clear.

Determining fair and appropriate compensation becomes a byproduct of the goal setting and performance process.

The Real Payoff

For those organizations that have made the shift from old-school merit pay to real pay for performance, the results can be striking.

For example, four years ago Western Digital (WDC) decided to go global to get more competitive. They moved their major production facilities to Asia, hired 30,000 new employees, and added a slew of new products to their portfolio.

Critical to their success was maintaining the strong Pay-for-Performance culture and incenting their employees to demonstrate behaviors directly tied to company success. WDC is now widely recognized as one of the leaders in the flash memory space.

Research by Bersin & Associates shows pay-for-performance initiatives can also be extremely timely for organizations undergoing transformation. The US federal government or companies in turnaround are good examples. One major retailer made pay for performance a cornerstone of their transformation strategy and found their retail sales performance increased by over 15%.

Conclusion

Key to both companies success was a technology infrastructure that tied corporate goals with individual performance and flexible incentive programs. The right rewards—tied to meaningful goals—are the secret sauce for motivating employees and sustainable behaviors.

If you want to know more about Taleo's pay for performance approach and read more about pay-for-performance as a talent management imperative, please visit www.taleo.com/pay. ■

Selecting A Compensation Management Solution

WORKSCAPE

With compensation at the heart of employee rewards strategy—and one of the largest expenses for most businesses—selecting the right solution for your organization is challenging. Taking a strategic view helps to ensure the selected solution will position you for growth; engage, develop, and retain top performers; and improve corporate performance. We'll explore eight considerations for organizations selecting a solution.

1. Align with your talent management strategy

A compensation platform is a link in the overall talent-management chain that that includes performance management and succession planning. Properly executed, a pay-for-performance compensation program supported by the right system improves retention, optimizes organizational performance, and increases employee motivation.

2. Link Compensation Results To Performance

High-performing organizations have incorporated pay-for-performance into their talent management initiatives to improve individual performance and overall corporate results. Align performance and compensation by integrating performance-based scoring metrics with compensation—by linking rewards to performance and shifting award spending up the performance ladder, you can focus incentives on the organization's top performers, and drive higher employee satisfaction and retention, and foster a culture of accountability.

3. Drive Consistency and Alignment with Reporting and Analytic Tools

Management teams need reports for planning, budgeting, and compliance. An effective compensation solution provides detailed analytics, modeling tools, graphics, and summary statistics to support strategic decisions. It also must provide dynamic update and drill-down capabilities for real-time visibility into the planning process to identify and resolve issues proactively.

4. Verify Information Security

Employee and compensation information is a tempting target for hackers, disgruntled subordinates, and nosy coworkers. Can your technology partner demonstrate the frequency, depth, and strength of its third-party auditing methods? What security measures are in place to prevent data interception and corruption?

With sensitive compensation data, you must ensure your vendors, partners, and employees meet company and industry standards for security.

5. Establish Project Ownership

Capital expenditures have significant approval hurdles, so you need an executive-level champion—from IT, finance or HR—who can secure stakeholder commitment across departments.

That champion must achieve consensus on required functionality and clearly communicate those requirements to the technology partner. Be sure to address the needs of line managers, whose commitment is key to the success of the new solution.

6. Understand the IT Perspective

You need to be able to leverage and maintain existing IT investments while deploying a more robust and functional compensation planning system. Will data from your existing solutions integrate with the new compensation software? Can the solution integrate data from disparate sources? Will the partner commit to implementation benchmarks? How does the system synchronize data with your HRIS systems? The solution partner should simplify implementation and adoption.

7. Work with a Partner, Not a Vendor

Choose a partner who can identify and resolve gaps in process, strategy, program definition, system implementation, and staffing. The right partner prepares readiness assessments and helps compile requirements for the new compensation system. And, above all, your partner must confirm implementation fees and the deployment timetable, and help build the business case to secure commitment from stakeholders.

8. Manage the Change

Selection and implementation of a compensation solution is only part of the process. You also need to communicate the benefits of the new system to increase user adoption. The best systems should be intuitive, easy to navigate, and require little training. However, managers still need instruction in using the new system, and communications describing the coming changes and why the system will benefit them. With the appropriate communications and training, the learning curve for new users is short and payback is accelerated.

Ask The Right Questions

Selecting the appropriate compensation solution means asking the right questions and establishing proper expectations of all stakeholders. As part of a total talent management solution, compensation management can have a major impact on the bottom line through improved employee productivity, engagement, and retention.

For more information about Workscape, visit www.workscape.com/tm or call 877-975-7227. ■

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