1 | 10
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How to Make Your Compensation Plan Work in the Reset Economy

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QUICK LOOK

- The new normal will require different approaches to salary management and greater alignment of variable pay to employee impact on organization performance.
- With more combined jobs and fewer solid survey matches, using market pricing will become increasingly unreliable, and job evaluation will return as the principal means of sorting out job worth.
- Greater compensation transparency will be demanded and will require effective program design and communication to multiple audiences.

General Electric CEO Jeff Immelt is widely credited with coining the term "the reset economy", which refers to the notion that we are going through more than a cycle, and that the global economy and free enterprise will be reset in important ways. "I think this environment represents an opportunity of a lifetime," Immelt said.

If, as Immelt suggests, businesses need to examine their fundamentals, overhaul their priorities and adjust their expectations and behavior to a new postrecession world, then compensation professionals need to do the same.

To understand how the economic recovery and the fundamental shift in the theory of business will affect compensation programs, the authors spoke with several business leaders, human resources professionals, academicians and consultants.

The Fairy Tale of Wide Salary Ranges

Near-term salary increase budgets are likely to be the lowest we've seen in years; one to two percentage points lower than has been the norm for quite some time. Smaller increase budgets are forecast due to an expected slow economic recovery, continued high unemployment and low inflation. In the short term, employees probably won't complain; they have somewhat limited employment alternatives for now. The lasting impact of low or no salary increases now on both employees and employers will be determined by how well employees are engaged overall.

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The notion of the traditional 50-percent salary range (with minimum at 80 percent of midpoint and maximum at 120 percent) needs to be questioned. For a new employee hired in the lower portion of the range, limited salary increase budgets means it will take many years to get anywhere near the middle of the range. Furthermore, high-performing employees will not be in the same job or grade long enough for that to happen. Promising employees that they will achieve range penetration commensurate with performance level is increasingly unrealistic. Quite possibly the 50-percent salary range fairy tale is over. Perhaps more and narrower ranges are in order. We definitely need more thoughtful processes to determine initial positioning in range and more proactive processes to move salaries over time.

Use Variable Compensation Better

Increased emphasis on variable compensation may offer an effective way for organizations to deal with smaller salary increase budgets and find more ways to engage employees. In effect, employees will receive higher levels of compensation when the organization attains its goals. The advantages are clear: increased variable compensation links employee and company interests, reduces the company's fixed costs and shares success with employees in the form of additional pay for meeting targets. Employees receive a historically modest salary increase but potentially can do much better if goals are reached than they would have under existing programs.

At the same time, recognize that variable compensation cannot be simply deferred base salary, a complaint often heard from employees. Organizations must use measures that are clearly linked to desired outcomes and that the employee clearly impacts — the line of sight from the employee to the end result needs to be clear. Measures also need to be clearly aligned with the organization's values and strategy.

Job Structures Will Change

Executives have indicated that jobs won't come back in the same numbers as prerecession. The question then is how work will get done. One solution will be to create more combination jobs, combining aspects of several positions under one individual. This creates at least two challenges.

First, there is the difficulty of recruiting individuals with the breadth of skills and experiences to fill blended positions. For example, at a manufacturing facility, manufacturing engineering could be combined with quality and environmental responsibilities. Without finding an individual who has all three skill areas, it is possible that a person with one or two will be appointed to the position. The expectation would be for the individual to then gain the necessary required skills and have the competency to master several accountabilities. This will place an increased demand on the organization's employee development services. A result to the job holder is that the job becomes enriched and more interesting although more demanding and perhaps more stressful.

Second, market pricing will be more difficult as high-quality survey matches will not be possible. During the past few years we have already seen deterioration in compensation survey information due to lower survey participation levels and less attention to verifying contributor job matching. Without matches of 70 percent to 80 percent of job content, market information becomes much less robust. In addition, with the merger of Watson Wyatt and Towers Perrin, it is conceivable that the merged organization will rationalize its survey operations and number of published surveys. The result may well be to cut back on the number of survey sources available for conducting competitiveness analysis.

Job Evaluation Will Be Needed

With more combined jobs and fewer solid survey matches, using market pricing will become increasingly unreliable, and job evaluation will return as the principal means of sorting out job worth. In evaluating combination jobs, one has to be aware that they can become either larger or smaller depending on the requirements placed on the combined role. For example, if the amount of tactical work of a combined job makes it impossible for the incumbent to spend time in strategic thinking, the combined job may be smaller than the previous jobs were. On the other hand, if the combined job requires broader skill sets or higher levels of skills or experience, the combined job may be larger.

To become viable in many companies, however, job evaluation needs to become a less bureaucratic process and instead become more transparent. Both managers and employees need to understand the underlying considerations and how decisions on position rankings are determined.

Compensation Transparency Will Be Demanded

The scrutiny on executive compensation is unprecedented and likely to continue and even increase. The scrutiny has already gone beyond cash and equity compensation, and is also focused on executive benefits and perquisites. For public companies, greater transparency is required through continuing expanded proxy disclosure, direct involvement where the federal government has made an investment, and likely soon-to-be passed say-on-pay legislation. Shareholders, employees, regulators, lenders and the public are increasingly interested in examining how and how much executives are paid. Furthermore, there appears to be increasing emphasis on measuring results over a longer timeframe, with a focus on paying rewards over extended periods (including clawback provisions) and a continued movement toward restricted stock and away from stock options.

Scrutiny of executive compensation for private companies is, of course, less focused. However, investors, lenders and employees are increasingly interested in executive pay levels. Many of the compensation delivery trends noted for public companies also seem prevalent in private concerns.

Not-for-profit organizations are coming under greater scrutiny in some of the same ways as public companies. IRS Form 990, which calls for information regarding executive pay, has been dramatically revised. Now the IRS wants to know not only what salaries and other remuneration are paid, but additionally the process used to determine compensation. As a result of greater disclosure, an organization's stakeholders become the enforcers as states, the media, employees, donors and others are provided the information to regulate informally.

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Steps to Adjust to Reset Compensation

1. Examine how your company is adjusting to the postrecession recovery.
2. Understand how business changes will alter the organization's compensation programs.
3. Develop and articulate a compensation strategy as a key foundation of compensation transparency.
4. Reassess the balance between use of job evaluation and external competitiveness, including use of compensation surveys.
5. Develop new communication strategies for the company's compensation programs.
6. Prepare for more developmental jobs and more employee development needs.
7. Examine the use of salary ranges, initial placement in the range, movement through the range and range width.
8. Consider expanded use of variable pay.
9. Get ready to design combination jobs.

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One logical response to increased scrutiny is to provide increased clarity to stakeholders as to the rationale that has determined the design of executive compensation. This includes competitiveness targets, selection and mix of rewards methods and payment methodology. If an organization's current compensation rationale is not something it would like to publish, the organization will need to develop a rationale it will be proud to have known.

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There Is a Lot That We Need to Do

There are at least several ways compensation professionals need to recognize and respond to the fundamental changes that are happening. First, compensation professionals should recognize how the profession is changing. The extent to which the availability of tools such as surveys, software, the Internet and job evaluation expands or contracts will impact how this group supports its employers.

Second, and more important, companies will make fundamental changes as to how they satisfy their customers, including product development, supply chain, distribution and financing. Compensation professionals need to become a lot more clued in to what and how changes are being made to the enterprise.

Finally, compensation professionals need to align their thinking with businesspeople, not just other HR professionals. After all, their job is not just to be experts in compensation; they only succeed if they understand what their organization's operating executives are trying to achieve and use their expertise to help them reach those objectives. They need to understand the strategy of their organization and its strengths, weaknesses, opportunities and threats. It is necessary but not sufficient to become certified in their profession; they also need to study business more broadly.

An MBA may be as important for a compensation professional as a CCP. Reading the business press (*BusinessWeek*, *Fortune*, *Forbes* and others) is as important as reading *workspan* and *WorldatWork Journal*.

A number of areas have been highlighted here that need examining. Recognize that decisions about one facet will interact with another. They all need to fit together. Most of all, one size doesn't fit all. Seek compensation approaches that suit your organization. The question is: Can you afford not to look at how the reset economy affects compensation programs at your company? WS

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