

Executive Insight >> Thought Leaders

Time for Change

Today's Pay Practices Won't Get You There

A recent study of 750 companies by Towers Perrin found 58% of corporate respondents, "engaged in comprehensive strategic reappraisal (of pay systems) and concluded " that traditional compensation infrastructure and practices are still the rule at most of our respondent companies". "There is a lot of searching going on", they added.

Four years later the same consultants, in a subsequent study, found that "many companies' rewards strategies are not aligned to address...key business goals" and add, "a lot of companies pay lip service to the notion of alignment, but few take the necessary steps to ensure that their rewards strategy is linked to business goals".

Is no progress being made? It would appear not. Certainly this is our experience as we analyze the companies that we come across in both our work and our research. Indeed, by-and-large Corporate America hasn't changed pay practices that much since the heyday of Ned Hay (pun intended) in the 1950s.

Recent years have seen the introduction of "broadbanding" and experimentation with gainsharing and other large group incentives, neither of which have fulfilled their promise.

Our view is that there is something wrong with our entire pay system paradigm and this issue of Executive Insight serves to explore some of the underlying issues and to offer some alternatives and solutions. The most fundamental issue is one of philosophic conflict. Forever, in "human resources school", we have been taught that you center serious pay design on the position and it's relative "value" to other positions in your company (internal equity) and the marketplace (external equity). Yet the real world has a feverish war for talent going on where the individual rules and knowledge and skill application counts.

So at least two things happen. We hope our merit systems (the process that differentiates the better performers from the rest, and are typically handcuffed by the archaic 3% merit-budget mindset) will allow the cream to surface so we can pay them more, and secondly, when this fails (as it frequently does), we contrive to make sure that we do not lose our stars by deviating from increase guidelines or creating ill-conceived bonuses, frequently throwing money at key employees as they have one foot out of

the door. This results in bad systems, disaffected employees and little strategic business pay-off for the investments made, together with accusations of favoritism and unfairness.

Indeed another recent study, this time by Sibson of a nationally representative survey of 2,250 full-time US workers, reports, "The most important factor in determining employee commitment or intention to leave (a company) is not pay, but the pay system. That is, employees who are more satisfied with the system and the process used to determine their pay are less likely to leave and are more committed to their employer". Moreover, they report only one third of respondents (32%) were satisfied with how their raises are determined and less than one-fourth (22%) were happy with the system used to assign their jobs to pay grade. Something clearly is not working.

Before its demise Enron has taken to assigning titles at senior levels to individuals not to positions. They become portable, so a vice president attached to a project team is still a vice president, irrespective of the role he or she should play in this particular assignment.

In today's world, this makes a lot of sense. We lament the intense competition of the war for talent. But our pay processes still center predominantly on positions and breed transparency, rather than focusing upon how to best reward those talent warriors that will drive our business success. If our business performance centers on the cumulative capabilities of talented knowledge workers, who, to draw again from Sibson's study, are crying out, "pay me for the value I bring to your enterprise", then a fundamental reexamination of how we pay is surely called for.

We are not encouraging "rugged individualism" (integral to the new paradigm should be the requirement to share not store knowledge and to excel at collaborative endeavor), but we are suggesting a significant philosophic shift in how we pay from one centered on positions to one centered on individual value and contribution.

Traditionally we have hidden behind job descriptions that generically describe responsibilities and position scope, and narrow pay ranges that restrict rather than reward high performers. We divvy up a meager merit pool in such a way that the differentials between the stars and the also-rans is but a very few percentage points. We compound all of this with highly ineffective and at times suspect performance appraisal systems, cautious managers and control-oriented HR professionals who strive to maintain equilibrium rather than create demarcation.

We should transform to methods that clearly differentiate for value and contribution, and pay individuals based upon the market worth of their skills and the success by which they deploy these skills for the greater good of the business.

The bottom-line: If your business strategy call for talent-rich individuals, steeped in the knowledge, skills and personal attributes that will collectively create competitive advantage for your business, then design your reward strategies to accomplish this.

This means:

- Establish clear definitions of expectations and requirements (knowledge, skills, personal attributes, deliverables)
- Create a valid measurement process to assess value and contribution
- Center pay application on contributed value
- Design performance review and development processes that support the continuous improvement of those who add (or who have the potential to add) value to your business, and which expeditiously evaluate and transition those without the capabilities or wherewithal to make a difference out of the business
- Shift from pay grade based compensation ranges to skill indices which price and then award income based upon the value of applied skills and knowledge

For in this intensifying war for talent, we can no longer afford to pay people for showing up every day, because of an annual anniversary date, or because the CPI has risen 3.1% over the last twelve months. We have to pay employees for the value they bring and the contribution they make, and set the pay levels at truly market competitive rates otherwise rivals will conspire to steal the best talent away.

The transition has to be to a market driven strategy from one based on internal equity.

Yes, this causes issues. It certainly means you have to have real credibility in your assessment methods. Accusations of favoritism or unfairness are always damaging, and this will intensify unless your practices are impeccable. It means you have to have strong leaders who can make good decisions and stand behind them. It means that you cannot spiral into a financial free-for-all where irresponsible pay awards bring you out-of-whack with reality or the marketplace. And it means you have to face tough decisions and move out those who do not contribute to corporate performance at the level you need them to.

Moreover, we are not suggesting a move away from incentive or variable pay. Somewhat the opposite. We would recommend that you increasingly shift the fixed-variable mix in favor of the latter, but instead of all-employee, group or team incentives, design incentives and factor payouts based upon individual contribution to the cause. As the risk (or variable) element increases, so should the reward potential to allow your employees the opportunity to share the wealth they create.

Anita Roddick, founder of The Body Shop once urged, "Be courageous, it's the only place left uncrowded". In matters of pay strategy, we think this is highly appropriate advice.



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