Linking Total Compensation to Performance

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Abstract

Employers hope that this is the year that things finally return around, and that includes increases in hiring and compensation. Still, budgets are tight and companies need to get the most productivity possible from their compensation programs. That is fueling an increased interest in total compensation management, in which compensation is used as a carrot to drive desired behavior. The goals are to identify top performers, create more like them, and have employee performance best meet business goals.

Keywords

pay for performance, performance management, behavioral analysis, predictive behavior, employee engagement, total compensation management

> Organizations need to squeeze as much productivity as possible from staff, but in a way that doesn't burn out workers or drive them away. Total compensation is an effective carrot for leading employees in the direction of increased productivity, and making deserving workers feel singled out for their efforts. Everyone expects to be paid fairly; but some deserve to be paid more fairly than others.
>
> —*Total Compensation: Taming Costs and Rewarding Employees*, Aberdeen Group

Introduction

Many workforce experts expect this to be the year that the economy finally turns things around. That means more jobs, of course. But for many organizations, it also means making up for lost wages and benefits. After all, employees in many industries and at all levels have been asked to do more, and often for little or no additional reward.

Still, budgets are tight, and companies need to get the maximum productivity possible. This is driving an increased focus on total compensation management programs.

Successful total compensation programs pay off in three significant ways:

1. They help identify the top performers in the organization and the traits they exhibit and encourage more such behavior throughout the staff.
2. They better match appropriate compensation to individual and team performance.
3. They increase productivity and profitability by aligning performance and compensation with specific business needs.

To do all that, employees need to know what they are being measured against, how compensation is determined and what they can do to increase the rewards. And at the heart of it all is clear and constant communication.

The Ideal Total Compensation Management Program

Rather than reward employees after-the-fact for having worked hard, total compensation management identifies the desired behaviors needed to meet specific business goals and proactively drives employees toward those behaviors.

Boston-based research firm Aberdeen Group defines the elements of a total management strategy as follows (*Total Compensation Management: Taming Costs and Rewarding Employees*, Aberdeen Group):

- A total compensation program determines who gets what, in which amounts and for what accomplishments.
- The well-constructed program tracks all of these elements against performance, retention and

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budget metrics to align the right compensation with the right people for the right reasons.
- The ideal program enables managers to model difference compensation scenarios and to analyze compensation data for budgeting and scheduling purposes.

Total compensation management takes its cue from the traditional sales incentive compensation model. Incentive compensation involves a pay-per-performance model, where employees are rewarded based on their volume of sales achieves. But total compensation goes far beyond rewards pay, and it also involves the entire organization, not just the sales department.

A total compensation management program includes all awards and rewards for each employee—including merit raises, bonuses, on-the-spot rewards, tuition reimbursement, training, perks and benefits, gift certificates or vouchers and stock programs.

Growing interest in total compensation isn't surprising. After all, organizations that have implemented successful programs have reported increased productivity, profitability and employee job satisfaction. The last point is especially important as we emerge from a tight economy. Many employees who felt trapped to stay in a job may finally feel inclined to leave if they think they were overworked and undercompensated during these tough times.

"Make sure that everyone is covered by the program," says Charles "Chuck" Baker, director of compensation, benefits and fleet services at GAF/ELK.

"It's hard not to fall into the biggest pitfall: the desire that the high-flying talent is rewarded, and to let everyone else suffer," Baker says. "If you're only rewarding the top people, you're forgetting the real producers."

Creating a Total Management Program

"Compensation plans are normally designed around single entities, or job roles," says Teanne Spence, director of compensation at Salary.com (a division of Kenexa), in Waltham, Massachusetts. "They don't look at the overall compensation plan as a strategic tool."

The first steps in creating a total compensation management program are to assess your business needs and set goals you want to achieve that affect the bottom line.

Next, determine who are the employees in your organization who have the greatest impact on the business—these are your top performers.

"You can isolate your impact workers," says David Foote, principal of Foote Partners LLC, an IT and workforce research firm in Vero Beach, Florida. "You can use their profile as a model to build on. You can put a price on it."

Evaluate what traits or behaviors these top performers have in common. Foote says that the questions to address include the following:

- Who are your best employees?
- How do you define what makes them good?
- Why do you think those individuals have more impact?
- How do you best align their skills and knowledge to tasks?

The key here is to be able to document the shared traits and behaviors of top performers, so that you can create more like them, Foote says. Determine which of these traits or behaviors can be encouraged in other employees, and build training programs to address those behaviors.

Match the desired performance goals to specific business goals, Foote stresses. Model your rewards programs to identify and properly reward those performers. And communicate to the entire organization the type of performance that will earn the best rewards, and how each employee can get there.

Compensation Trends Overall

The traditional reward system for sales professionals is the incentive compensation plan, where the individual earns a certain percentage of fixed pay, or base pay, and the remainder in commission-based earnings based on hitting specific quotas. Total compensation management arose out of incentive compensation.

Even incentive compensation programs are undergoing change, according to Spence. "Employers are raising the rates at the lower end to make up for what they had taken away," Spence says.

But, as with total compensation, the primary driving force is the need to better align performance with corporate goals, Spence explains.

Current trends involve the design of compensation plans using more evidence-based data modeling, according to Jan Rose, an analyst in the human capital management practice at Mercer.

"With smaller budgets, the need has been to make sure that the proper rewards go to the top performers," Rose says. This has increased interest in performance assessment and management applications.

"There is a lot of focus on segmenting the workforce now, that is, by generation, by geography, etcetera, and pinpointing compensation strategy based on those segments." Rose says.

Aligning Performance With Goals

To achieve your goals, you need to encourage the type of behavior that will lead to high performance. As previously discussed, total compensation management is a forward-driving behavioral strategy. It is not an after-the-fact rewards strategy.

There is in fact some disagreement among compensation experts on how much attention should be focused on top performers. Some argue that those are the key employees who will help take your business to the next level. They should be rewarded accordingly, regardless of the impact on the overall compensation budget.

Top performers would be those in critical roles that have a direct impact on business results, job roles that are especially difficult to fill should a person leave and job roles that are stepping-stone positions to important leadership positions, Rose says.

Others argue that too little focus on the rest of the staff will result in low morale, declining motivation and reduced retention—exactly the opposite impacts the plan is trying to achieve in the first place. It is a delicate balance: rewarding everyone fairly but rewarding some more fairly than others.

It is also important to realize that every manager has a different style and evaluation process. An employee assessment can look very different, depending on who is doing the evaluation, Rose says. That is why it is critical that employee assessments be standardized, and clearly communicated. Rose also says the assessment program should be directly tied to the organization's compensation program in such a way that all employees know

- How am I being evaluated?
- Against what measures?
- What is my earned compensation based on?
- How can my compensation amount be affected by changes in my performance?

To accomplish the above, David Almeda, vice president of human resources at Kronos Inc., in Chelmsford, Massachusetts, advises that a manager set goals beyond the individual's job. He calls these "stretch goals"—goals that are clearly aligned with the organization's overall success.

In fact, Almeda says that at Kronos, each manager works with his or her reports to establish goals for an employee. Those goals are then sent one level up for approval, "to be sure they are in line with corporate goals."

The Role of Predictive Behavior

For many leading organizations, "the new focus is on behavioral pay and predictive behavior—combined with rewards strategy that adds a layer of contingent learning theory (how people learn, why they behave the way they do)," explains Robert O. Buckley, president of R. O. Buckley Consulting in New York. Buckley is a compensation management consultant who has designed a leading total compensation management supplication.

"Behavioral pay and predictable behavior is so important because it gets to the understanding of what motivates and excites people," Buckley says. "There are a series of behaviors that can be measured and compensated in this model."

Unfortunately, according to Buckley, "Companies do pieces of it, but nobody does it holistically. Most companies still only link their compensation tool to a performance management system. That helps with documenting performance, but it doesn't predict behavior."

Rose agrees with the importance of behavioral predictability. "Most companies look at what you have done in the past as the best way to predict what you are likely to do in the future," she says. "You assess a person's behavior against a computer model, to determine if that person would behave the same way in the future."

The Role of Engagement

With all this interest on performance is coming a growing interest in employee engagement.

"Engagement is not to be confused with employee satisfaction, which is all about the needs of the individual being met through their affiliation with the organization," explains Mollie Lombardi, research director in the human capital management group at Aberdeen Group in Boston. "Engagement is defined by its impact on improving alignment and results. And it has also proved to be a driver of retention."

Lombardi says,

> "By focusing specific engagement efforts on high-performing and high-potential individuals, organizations have a better chance of keeping them on board and grooming them as future leaders. Engagement is so intertwined with driving performance, and the tools, processes and organizational capabilities required to manage both are so similar, it is impossible to talk about one without the other. And together they form a powerful equation to improve business results." (*The Engagement/Performance Equation*, by Mollie Lombardi, Aberdeen Group, July 2011)

"Engagement is all about aligning individuals with the organization, which is exactly the aim of goal setting. When people know what is expected of them, it becomes easier for them to execute against that," Lombardi says. "And when they do, and start to reap the rewards of meeting and exceeding those goals, they want to do more of it—simultaneously improving engagement as well as performance."

"Engagement and performance must be driven down to a one-to-one level to be effective," Lombardi says. "Without ongoing follow-up between managers and employees, without ongoing communication of overall strategy, cascading that to the individual level, and translating it into guidance for day-to-day execution, initiatives to improve engagement and performance will be stymied."

The Importance of Communication

One area in which all compensation experts agree is the need for clear, and constant, communication about a compensation program and how it will be managed.

Executives need to be clear on the business mission. Also, "Sincerity and genuineness is very important," Almeda says. "Executives should get involved in the recognition process."

Managers need to be clear on each employee's role in that mission. Managers need to be trained on how to align and manage job roles to meet business needs and how to measure those metrics.

Training should be provided to ensure managers know how to effectively use all applications that play a role in capturing job performance, compensation, training, skills development, retention and employee engagement data.

Performance and compensation plans must be clearly explained to all on what is expected of each worker, how they are measured in their performance and how that performance determines compensation.

Salary.com's Spence advices that the employer explain to each employee:

- What is it I have goals set against?
- How much can I earn if I meet each goal?
- How much can I earn if I exceed my goals?

Challenges to Managing an Effective Program

Despite the growing interest in total compensation management, clearly it is not easy to get it all right. Organizations surveyed for Aberdeen's report *Total Compensation Management: Taming Costs and Rewarding Employees*, cited the following challenges to managing a total compensation program:

- 30% report unequal salary parity across agencies, divisions or facilities.
- 26% complain of the time required to design or change a compensation program.
- 23% indicate they have an overly complex system for awarding bonuses.
- 22% cite poor employee morale or job satisfaction among staff.

Compensation experts agree that the goals for individual employees must be clearly defined, and obtainable. An effective plan with measurable and obtainable goals should motivate employees. A confusing program with unrealistic goals will frustrate and anger staff.

"Make the goals really obtainable," Spence insists. "That really helps with motivation and retention."

One point on which there is disagreement is whether top performers should be told who they are.

"I worry about the majority of people that we haven't really talked about—the capable, competent, majority of the company that are really the heart and soul of the company," says Almeda. "They are only one notch below the top performers."

Almeda says it definitely makes sense if the top performers are individuals that the organization would like to groom for advancement—you don't want to lose them.

Action Steps for Success

Success with total compensation management requires a good compensation program to start with. It then requires an effective total compensation system—which can include numerous applications. The effort must have buy-in and support at all levels of the organization. And most important, it requires clear and effective communication.

Compensation experts recommend the following steps to ensure success with a total compensation program:

- Survey the local market to be sure your compensation is competitive.
- Standardize the processes for collecting compensation data.
- Document the proper procedures for collecting compensation data.
- Automate the process of collecting compensation data.
- Integrate compensation management with other human capital applications.
- Define compensation policies clearly.
- Communicate compensation policies to employees.

- Involve employees in creating or expanding a total compensation program.
- Provide managers with visibility into the total compensation program.
- Train managers on how to use compensation analytics tools.
- Review the effectiveness of compensation programs at least every 6 months.
- Evaluate employee performance at least every 6 months.

Parting Advice

In conclusion, a total compensation management program holds the promise for increased productivity and profitability for many organizations. But success with such a program requires buy-in, support, commitment and communication.

To be truly effective, a total compensation program requires accurate standardized data, collected from a variety of applications that are integrated, easy to use and easy to analyze. Managers need authority to access that data in order to model compensation plans with it and make changes to compensation models to ensure the best match to corporate needs.

Aligning performance requires engagement, as Lobardi notes. It also needs feedback, reward and recognition programs. Feedback should be frequent, and flexible—since everyone wants feedback in a different way.

And the program depends on holding individuals and managers accountable for goal attainment, Lombardi says. "You can't really succeed if someone in your team is falling down."

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