Do You Know the *Five* Essentials

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As unique as your organization is, it shares certain fundamental objectives with other companies, regardless of whether those companies are within your niche or are highly dissimilar in their service, product,

# of Pay for Performance?

structure or culture. Every organization has goals to meet, stakeholders to satisfy and a strong need to continually attract and retain talent, all of which must be accomplished while carefully maintaining balances of short-term and long-term compensation and variable versus guaranteed reward.

Knowing the performance goals an organization wants (and needs) its workers to meet, and the financial outcome that will be achieved when the result is attained, the company is then positioned to translate its projections into an amount that represents *an increased shareholder value.* The parameters of who, how much, and in what form performance pay is administered are the questions a company can only address accurately when it incorporates the **five essential keys of pay for performance**.

Understanding

Pay for Performance Implementation

For a pay for performance plan to be effective for a company, its shareholders, and the participating employees, the company must have a solid understanding of the key essentials required for its success. The corporate climate must also support a culture in which the process can function as intended. An organization must create, maintain and even nurture an environment in which pay for performance initiatives can thrive.

To know if you have laid the groundwork, establishing the essential environmental conditions, consider these questions:

- Does everyone involved understand that a tactically planned, well balanced pay for performance strategy drives a company in hiring, motivating, and retaining the best of the best, reinforcing the values, vision and goals of the company?
- Is there a clear **line of sight** so that everyone involved understands where the company is going, how it will get there and what is needed from each person in order to achieve the objective?
- Most significantly—do all involved understand how the company, shareholder and they themselves individually benefit from reaching the goal?

An organization's pay for performance plan engages employees and sustains vibrancy, only when the five key conditions are maintained:

1. visibility and viability 2. balance 3. relevance

4. shareholder return; and 5. alignment with corporate values.

Visible and Viable Achievability

Don't overcomplicate this important key to pay for performance success; it is as simple as this: employees must see how their performance impacts their pay and they must believe that they have, within their function, skill and talent, the capability to achieve the identified goals and earn the associated rewards.

Employees recognize the difference between meaningful pay for performance and dangled carrots almost as quickly as they notice that their peers at other companies are being rewarded in ways that are not being offered by their own organization. Nothing speaks any more strongly to the significance of a clear line of sight than the concept

that employees must always be able to correlate corporate goals and strategic expectations with their own viability to move the ball forward, strengthening the company while simultaneously attaining personal compensation.

Balanced Compensation

Inasmuch as we live in a culture that is “instant gratification oriented,” multiple studies verify that long-term concerns about retirement security also weigh heavily on the minds of today’s workers. Moreover, these concerns are not limited to workers approaching retirement age, but are equally shared by Millennials and other worker demographics who are still decades away from exiting the workforce.

Companies are challenged to find the effective balance between short-term and long-term incentives, including, but not limited to: salary, bonus, long-term cash incentives, equity or phantom equity, retirement, core benefits and executive benefits. Much like putting together a balanced but diversified investment portfolio that maximizes return while minimizing (or mitigating) risk, a well-balance mix of short and long-term compensation elements effect a relational equilibrium between: 1) increased productivity; 2) enhanced satisfaction quotient (the fulfillment of both employee and organization needs); and 3) attained retention goals.

Growth oriented companies recognize that the optimal balance can be, not only tricky to achieve and maintain, but more importantly, indiscernible to those closest to the problem, including HR executives and executive compensation committees. Experienced professionals equipped to offer targeted analysis and a suite of strategic solutions can provide the perspective and expertise needed for achieving the desired balance.

Top Quartile Companies

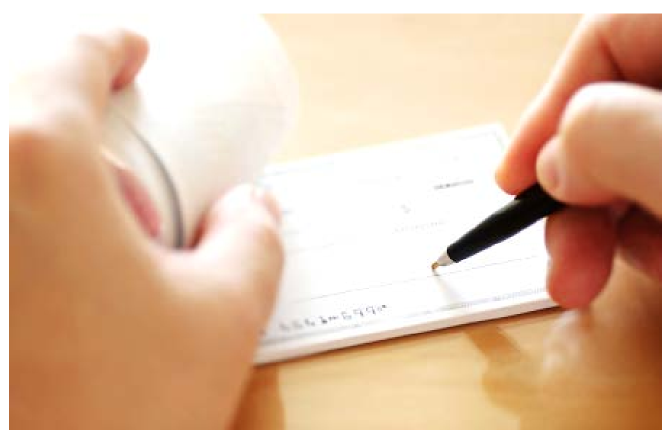
- Placed a greater amount of compensation *at risk*: 66% vs 52%

Top Quartile Companies

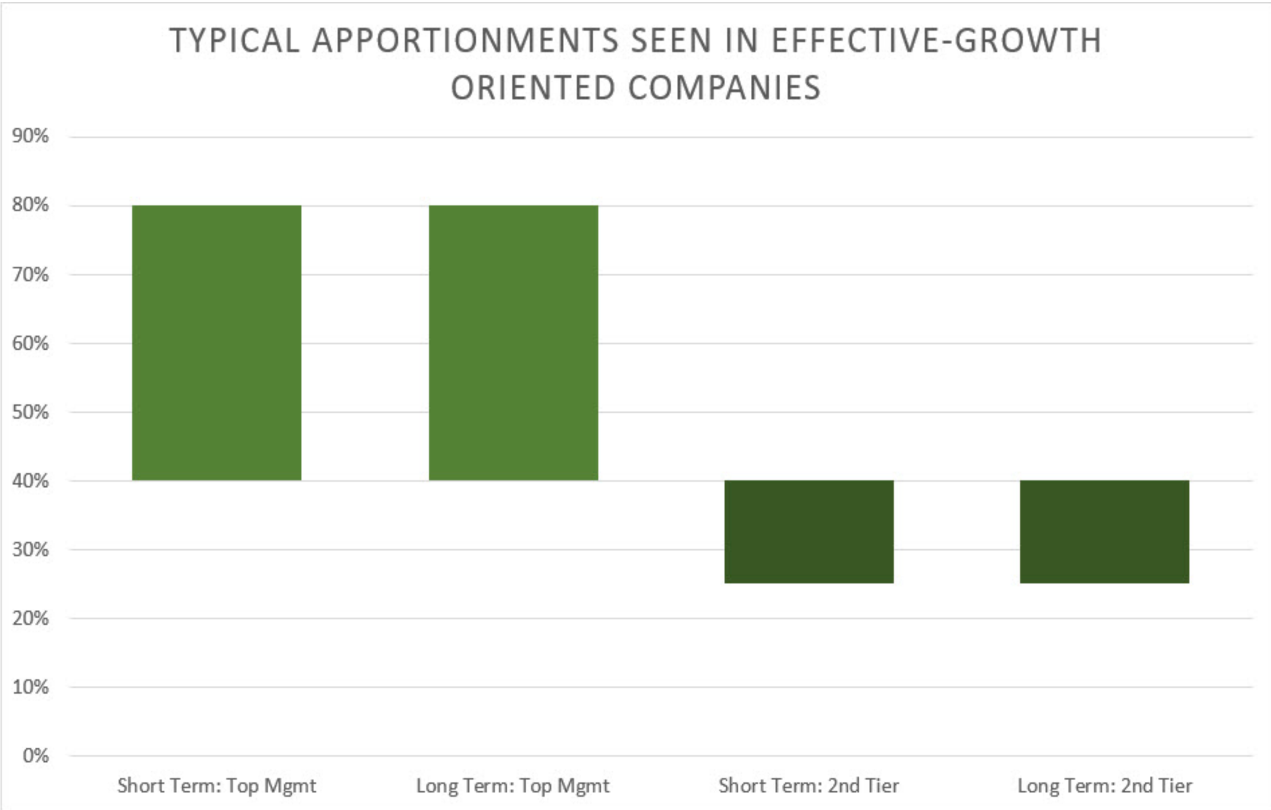
- Placed a greater *emphasis* on long-term awards: 42% vs 33%

Meaningful Dollars, *Relevant* Reward

Motivation does not happen unless the “prize” is both achievable and significantly meaningful. The goal of pay for performance is to stimulate employees to achieve at a higher level. For the organization, however, meaningful does not, and logically cannot, mean a *blank check*, no matter how much the company would like to compensate and motivate its workforce.



Compensation must be sufficient to stimulate performance and at the same time remain in line with shareholder (financial, structural and organizational) goals and expectations. The following percentages represent typical apportionments seen in effective-growth oriented companies.



When companies build financial models that project low, mid and high growth rates, they can then carve out long-term plan projections for specific, identifiable dollar payouts for each of those levels. With these projections in place, an assessment of individual dollar values should be made, reviewing these amounts while considering shareholder return, employee expectations and generally accepted pragmatic guidelines.

Shareholder *Return*,
Understanding the Real "Cost"

Every company is responsible and accountable both ethically and economically to its stakeholders. Compensation, like any other investment by the company, should be evaluated in terms of the financial outcomes (return) shareholders expect. In evaluating that compensation, companies must consider:

1. Does the incremental investment in this plan contribute to the company's financial success?
2. Is that contribution measurable in hard dollars, including profits, revenues, cash flow and stock value?
3. Do we measure the return in soft dollars, such as increased retention, higher productivity, improved client service and other gains that may be difficult to calculate? Is it a combination of both?

When compensation is recognized as an investment, you immediately realize that it is being paid for out of superior return. In other words, compensation is tied to higher performance levels that would not likely have been reached without the presence of performance incentives.

With this perspective, you can say that performance compensation doesn’t actually “cost” the company as long as it is aligned with the values and objectives of the shareholders.

Alignment with Corporate Values

Performance compensation can go a long way in communicating and reinforcing the values of the company. By strengthening long-term focus and commitment to the organization, compensation rewards serve to remind employees of both the goals and why they individually and collectively benefit by striving for these goals.

Each rewards program becomes a kind of covenant between the employer and the employee, defining an area of stewardship, establishing expectation levels for that area and providing a conditional incentive for its fulfillment.

Corporate communications techniques including letters, modeling tools, online access to account values, and personal financial planning can motivate and stimulate momentum toward the achievement of the organization's goals.

Unlocking

Successful Pay for Performance Plans with these Five Keys

Compensation strategies call for evaluation, study, assessment, strategy, modeling and integration. They must be tailored to your company and its unique needs, objectives and culture and carefully consider behaviors, rewards, activities, and motivations for a well-engineered and effective process. With guidance from experienced professionals in facilitating a strategic plan that is viable in the eyes of employees, with balanced long and short-term incentives and meaningful rewards, and tied to both shareholder return and corporate values, your organization can implement an effective pay for performance plan.▫▫▫

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