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A Compensation Top-10 List

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When it comes to compensation programs, their effectiveness must be measured by how well they drive desired business and operational results for your organization and assist in hiring, growing and retaining talented employees. But are there some universal compensation design and administration principles linked to program success that transcend organization and industry? We at 3C think there are, and we've outlined our picks in this Compensation Top-10 List.

1. Align program design and administration with the organization's culture and its goals and objectives.

Organizations might look to copy the successes of other well-regarded entities, but the reality is that compensation program success is relative and linked to the program's ability to support your organization's culture and serve as a tool in meeting desired goals and objectives. Use market-defined "best practices" to influence, not dictate, the design of your compensation programs. While a compensation program might work very well for one organization, it could fail miserably for another if the fit is not there. This is an essential.

2. Take a total compensation view and integrate all compensation programs.

An organization's total compensation system encompasses all aspects of compensation: base pay, variable pay, benefits, work environment, training and development and non-cash rewards. These all add up, and the value of working at your organization is the total of all these programs combined. While it is a good idea to keep each compensation component within a market competitive range, some organizations might counterbalance below competitive offerings in one area with above competitive offerings in another. Offering a target pay opportunity that is below market might be balanced, for example, with a full-time work week of 35 hours, not the typical 40, strong benefits or a variable pay program that exceeds competitive offerings. We only get the full story by looking at all compensation programs combined.

It is also important to integrate all components of your total compensation system so that they are not working against each other or double-compensating individuals for the same results or contributions. For example, tenure is typically recognized using benefit programs like retirement plans and vacation. If it is also recognized through the base pay program, this could very well dilute an organization's link between pay and performance. An organization's compensation philosophy should clearly state the role of each compensation component; plan design and administration should support this role.

3. Don't overpay.

The best-paying organizations are not always the best employers, and pay only goes so far when a work environment is bad, a manager is difficult or the organization's leadership does not value its employees. It is not necessary to set pay targets above competitive rates; in fact, this practice can put an employer at a cost disadvantage and should not be adopted without a thorough review of related implications. Alternatively, we recommend targeting competitive pay for expected performance and paying above the competitive rate for performance that exceeds expectations.

4. Look to the external market to establish pay opportunity and then review and address internal equity.

We think market-based pay systems are easier to maintain than those focused on internal equity and also more relevant to today's workforce, given that the typical employee is likely to stay with one organization for three to seven years rather than 30 years, which was a fairly common tenure just a generation ago. 3C recommends that pay rates be established to reflect the organization's desired pay position compared to the external marketplace (below, at or above competitive rates). After external rates are established, look internally within a discipline to make sure the pay rates are fair. If adjustments are needed to ensure internal equity, make them, but don't lose sight of the external market.

It is also a good idea to revisit the definition of internal equity for your organization. In lieu of one common approach to compensation program design and administration, maintaining separate and unique programs and administrative practices that recognize the differences in roles, responsibilities and contribution levels within your organization is typically a fair and fiscally prudent approach.

5. Put some pay at risk and create strong employee line-of-sight.

Well-designed and implemented variable pay programs often help employers meet their financial and operational goals by focusing employees on behaviors and results that make a positive difference. For all incentive programs (including profit sharing plans), establish a strong line-of-sight, or a clear understanding of each employee's contribution toward achieving the organization's goals and objectives. This is an important component of both incentive plan design and communication. It is also necessary to fully engage employees in the plan and related objectives.

6. Take care of your high performers.

You should do whatever you can within reason to keep these employees happy and challenged—it is worth it. Their contributions and results should be recognized and rewarded appropriately using both cash and non-cash compensation programs. But remember that present, not cumulative, performance levels are what should be considered in identifying high performers.

Also keep in mind that the contribution levels of your organization's top performers might not waiver significantly regardless of their satisfaction levels. It is important to be pro-active with this group and let them know their value to the organization and future growth opportunities, as well as your organization's desire to keep them.

7. Communicate effectively and often.

Studies indicate that employees who are paid competitively might still have negative attitudes about their compensation and consider it to be unfair if they do not understand the organization's compensation system or how their pay rates are determined. Effective communication (verbal and written) that identifies what the organization values and is willing to pay for and explains how the compensation program works and how employees influence their pay rates is very important and often leads to more productive and satisfied employees.

8. Keep it simple.

Program design and administration should be straightforward and easy to explain and understand. When compensation programs become too complicated, they almost always become less effective as well. Apply the five-minute rule—you should be able to explain your total compensation system to an employee and outline all of its programs in five minutes or less.

9. Measure compensation program success by fairness and consistency.

It is hard to keep employees consistently happy about their pay unless you are paying them too much, which has its own set of issues (see number 3 above). Instead, strive for fairness and consistency in pay opportunities, which will enhance employee satisfaction in the long run, anyway.

10. Continually assess program effectiveness.

Review each component of your total compensation system on an annual basis to make sure it is meeting your organization's needs and aligned with its objectives. Be careful about implementing constant changes to your compensation programs, which can become distracting, but also avoid the mistake of not monitoring these programs and missing opportunities for fine-tuning at the risk of their becoming unresponsive.

In Closing

While this is not a comprehensive list of effective compensation program design and administration elements, we've highlighted the ones we consider to be the most important. Appropriate design is a necessary component to compensation program success, but it must be combined with effective roll-out and communication, as well as an ongoing commitment from managers to make fair and reasonable pay decisions.

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