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MANAGING TOTAL COMPENSATION TO ACHIEVE MULTIPLE OBJECTIVES

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Article published in *MWorld*, Spring 2008, Volume 7 No. 1, pages 37-40.

Companies are at a war for talent but lack limitless funds to win that war. Increases to total compensation costs are spread thin to accomplish multiple objectives—reward high performers, keep competitive with the labor market, and provide health insurance as the percent increase in healthcare cost rises more rapidly than that of base pay.

Complicating this are four generations of workers who may have different interests in pay and rewards—although all want more. How, then, do organizations prioritize total compensation expenditures to gain the most value and performance from dollars spent?

The stronger performing the organization, the more competitive it can be in the total compensation provided to employees because the organization can best afford the cost. A “Catch 22” exists because organizations that are less-effective performers need stronger performers but have more difficulty affording them and thereby helping improve performance outcomes.

To achieve or sustain solid performance and thus afford to reward employees for this performance over the long term, wise organizations must create a performance culture that, in fact, rewards performance. They should create not only a win-win where employees win when the organization wins but also a link between business results and total rewards when the organization is less successful. High performers at all organizational levels must also be rewarded to retain them since some say that 20% of the employees are responsible for about 80% of the results. With limited funds, a workforce of fewer higher-skilled employees is preferable while ensuring those employees receive total rewards commensurate with their performance.

MACRO PERSPECTIVE

Even high-performing organizations should be thoughtful about their compensation expenditures. To be able to provide competitive total rewards and reward performance, organizations must take a macro perspective first to ensure they have:

- An appropriate headcount for the work that needs to be accomplished—too many employees, especially in non-mission critical roles, mean less compensation available per person.

- A solid match between people's skills and the skills needed by the organization. Organizations that do not have the people who can be successful performers because of a skills mismatch will be less efficient.
- The opportunity for less-than-satisfactory performers to develop and improve their performance for a specified time period—they must improve to meet expectations consistently to remain employed because “one bad apple can spoil the whole barrel.”

INFORMATION SHARING AND TOTAL REWARDS

Information sharing has enhanced compensation transparency and brought compensation to the forefront of the employee/employer relationship. The increase in readily available information began several years ago when websites started providing salary and total cash compensation for jobs, enabling people to compare their pay with the labor market. Now social networks have expanded, with people sharing not only total compensation information but also feedback on other aspects of their employer—leadership, work environment, training and development opportunities.

Extensive sharing of compensation information on the Internet means that employers must think in terms of total rewards. Organizations may not be able to continually compete on salary, total cash compensation, or total compensation alone because people can usually find an organization that pays higher. Organizations must think in terms of total rewards—the entire employee value proposition—what the employee gets for providing their time, effort, and talent to accomplish accountabilities, produce results, and add value to the organization. Total rewards include not only total compensation but also individual growth, a positive workplace, and a compelling future.

PRIORITIZING TOTAL COMPENSATION ELEMENTS

Organizations cannot be everything to everyone from a total compensation perspective. Companies that have a low ratio of employees to revenue (e.g., oil companies) may have an easier chance of doing this. But most organizations must prioritize how they will allocate total compensation elements (base pay, incentives/bonuses, benefits) to “get the most bang for the buck.”

- **Base pay:** Fixed cost must be reasonably competitive because it is typically the price of admission for attracting people to the organization. With search firms actively recruiting on the Internet, employers must stay reasonably up-to-date in this largest compensation element for most of the workforce and ensure that the consistently high performers earn higher base pay than the lesser performers in the same/similar job.
- **Incentives/bonuses/variable pay:** Variable cost with “reusable” dollars varies based on performance, and rewards outstanding performance in one year without building in fixed compensation costs. This flexible compensation element has increased over the last 15 years and continues to increase—more organizations are providing variable pay, a greater percent of employees are eligible to participate, and incentive award opportunities are increasing.
- **Healthcare benefits:** Currently, to contain premium cost increases, benefits coverage is being changed or reduced and organizations are providing employees greater choice in the types of coverage—consumer-directed health plans (high-deductible health plans linked to tax-favored health savings accounts), HMOs, PPOs, “minimized” plans (limited health coverage for part-time workers)—to make the sharing of premium cost increases more affordable to employees.

Cost is being shifted to employees. Some companies are dropping healthcare benefits or do not cover part-time employees while a few provide cash for employees to purchase their own insurance.

- **Employee benefits other than healthcare:** The goal is overall reasonable or marginally competitive benefits with the labor market for the specific talent needed by the organization.

- **Work-life benefits:** This is contingent on performance—e.g., flexible scheduling and telecommuting require the individual to continually and consistently meet performance expectations for the benefits to continue.
- **Recognition:** One inexpensive type—verbal and written recognition (like a simple “thank you” or other words of appreciation for specific accomplishments and contributions)—can increase in any organization although some organizations may need leadership training to make recognizing and celebrating strong performance and business results the natural “way things are done here.”

Organizations must consider not only the competitive labor market in determining total compensation but also their ability to pay based on business results and what they want total compensation to communicate and emphasize. For example, some companies’ objective is to reward performance strongly so they emphasize total cash compensation, including variable pay, to engage employees, communicate important business goals, and reward results. In contrast, governmental organizations tend to have lower base pay; small, if any variable pay; and very competitive benefits. These differences attract different types of workforces.

Healthcare costs are consuming more of the dollars that are annually added to compensation budgets. The annual percentage increase in health insurance premiums is significantly higher than that of base pay. For example, healthcare costs double every 7-plus years at a 10% annual increase while the average worker’s base pay doubles every 24 years at a 3% annual increase. With these percent increases, employee healthcare costs will exceed average salary/wage cost in the next 10-15 years.

GENERATIONAL DIFFERENCES

Many employers are looking at generational differences in rewards preferences even though significant individual differences exist within generational groupings.

- **Generation Y:** High financial expectations, immediate performance feedback, work contributions that are meaningful to the individual, repeated job changes.
- **Generation X:** Work/life balance, recognition of individual contributions, flexible schedules.
- **Baby Boomers:** Recognition of hard work, healthcare and retirement benefits.
- **Traditionalists:** Flexible work arrangements, recognition of expertise and experience, benefits.

The Millennials will follow. Rather than trying to respond to everyone, many employers are being more selective in understanding the total rewards preferences of the high performers, people possessing the organization’s core competencies (e.g., product development people in a high-technology company), and people in organizationally critical jobs below the executive level. This means customization of rewards for these employees, provided they continue to produce business results.

SUMMARY

Only successful organizations can offer total compensation that matches the expectations of the best people with key skills, and high performers from any generation are engaged by compensation designs focused on their preferences. So the total compensation “horse” must be put in front of the employee performance and skill “cart.”

Aligning total compensation planning with the annual business planning process leads to more effective management of and greater value from compensation expenditures. All compensation elements should be reviewed together to see the holistic “forest” as well as the “individual trees.” This enables tradeoffs (e.g., shifting base pay to variable pay, more efficient benefits customized to employee needs, shifting benefits costs to healthcare costs as employees continue to share in healthcare cost increases.)

Performance must be a prominent focus of all compensation discussions because, without business results, organizations cannot sustain their total rewards program. Every organization can move successfully in this direction with some thoughtful and creative total compensation strategizing and planning.

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