

Best Practices in Compensation

■ 3 Key Steps to Building a Pay-For-Performance Culture SuccessFactorsS3

Increasingly, successful companies are tying compensation directly to employee performance to drive incredible business results...

■ Why Pay-For-Performance Can Work at Last Halogen Software Inc.S4

'Pay-for-performance' is not new, yet organizations still struggle to implement it effectively. There are two reasons why things are getting better...

■ Corporate Governance, Compensation and Accountability in a Post-TARP World WorkscopeS5

"It is apparent that the governance model and mindset of all commercial enterprises must shift from keep us out of trouble to make our business better and more sustainable."...

■ Differentiated Compensation Programs— A Business Imperative Taleo CorporationS6

In his research bulletin titled "Enterprise Compensation Solutions," Josh Bersin of Bersin and Associates cites the statistic that compensation represents 60% to 70% of all expenses in most organizations...

■ Automating Incentive Compensation for Increased Productivity and Immediate Cost Reduction Varicent Software Inc.S7

As organizations re-evaluate their compensation strategies in order to adapt to the recent changes in the economy and business landscape, incentive compensation is now top of mind for many HR professionals...

PREMIUM SPONSORS





We did it, again.

Workforce Management receives top honors and industry accolades with five *more* awards from the American Society of Business Publication Editors.

NATIONAL AWARDS

SILVER: Best Overall Headline Writing
Toby Hill

SILVER: Best Technical Article
Ed Frauenheim for *Retrain the Brain*

REGIONAL AWARDS

GOLD: Best Editorial/Editor's Letter
John Hollon for *The Last Word*

SILVER: Best Feature Article
Ed Frauenheim for *HR 2018*

BRONZE: Best Individual/Organizational Profile
Ed Frauenheim for *Pulling No Punches*

Workforce Management is proud to be selected, again this year, by the ASBPE—with one of the most competitive awards for business, trade, association and professional publications—for our unmatched journalism covering the business of human resources.

Workforce Management delivers the best for our readers with the highest standards of editorial excellence. We are recognized, year after year, with more industry awards for this excellence than any other HR publication.

Award-winning coverage.

No other HR publication even comes close.

Visit workforce.com to subscribe today to ensure you receive *Workforce Management's* entire suite of award-winning news products. You'll be glad you did!

Workforce
MANAGEMENT

3 Key Steps to Building a Pay-For-Performance Culture

SUCCESSFACTORS

Increasingly, successful companies are tying compensation directly to employee performance to drive incredible business results. Originally believed only for sales professionals, pay-for-performance is proving to be effective at all levels and in all functions of an organization. Building a pay-for-performance culture may seem like an abstract vision for some companies; however, it's considered a top tool by senior executives for achieving better financial results. And for good reason: a strong pay-for-performance culture has the ability to unlock employee performance potential, keep your "superstars" happy, and ultimately drive a healthier bottom line.

Key business benefits of pay-for-performance include:

- **Increased Motivation**—A pay-for-performance system is a key element in getting employees to excel at maximum levels. How? By combining clear direction, quality feedback and tangible rewards, and recognition—key components to job satisfaction and employee dedication.

- **Improved Retention**—It's no secret that the key to retaining the best and brightest is recognizing and compensating top performers. According to Giga Information Group, retention can be improved by meritocratic management—or pay-for-performance—by up to 27%.

- **Cost Savings**—Companies can waste literally thousands of dollars a year in overcompensation: rewarding individuals whose performance doesn't help achieve key business objectives. The ongoing accountability in a P4P culture helps avoid this pitfall.

Three Key Steps to Building a Successful P4P Culture

Step 1: Compensation Planning

The first step to implementing a true pay-for-performance system is developing an overall compensation plan for the company. Most successful companies base it on a "structured incentive scenario"—one in which employees understand ahead of time the precise relationship between performance and the incentive reward. A survey of companies across industries reveals two common approaches:

- 1) **Annual bonuses and merit increases**, based on a typical review cycle with performance ratings linked to organizational goals; or

- 2) **Goal-driven incentive plans**, which fall outside the annual review process and are tied to achievement of specific time-based goals. Whichever you choose, the key is that the policies are fair, consistently followed, controlled, and subject to review and oversight.

Step 2: Goal Alignment

After the compensation strategy is determined, company leadership must establish organizational goals through a clear mission.

Many organizations fail to communicate these goals to individual contributors. In fact, leading industry analysts estimate nearly 95% of workers are unaware of their company's top objectives.

Establishing a formal review process that creates relevant goals for each employee and maps them back to corporate objectives is crucial for establishing a true pay-for-performance culture. When managers and employees see the goal plan and understand how their efforts fit into the company's business objectives, a pay-for-performance system begins to thrive and directly contribute to bottom-line results. For the "superstars" in your organization, this means making sure goals are aligned with activity within their control—not solely on functions they cannot directly influence. Keep in mind that your success in aligning employee and company goals requires an open dialogue with upper management. This is the only way to ensure business strategy is woven into all HR efforts.

Step 3: Performance Management

The final step in developing a pay-for-performance system is establishing a system to continuously measure and manage employee performance in a quantifiable way. Many companies fail to take this last step and end up with an arbitrary or subjective review process. Performance reviews are critical to maintain a level of performance management that will support a thriving pay-for-performance culture. However, reviews have to be regarded as more than just an "annual event." This can be achieved by formalizing a process of performance reviews on a monthly, quarterly, or project-by-project basis. This will inevitably create a better dialogue between employees and managers.

By integrating these elements into your HR processes, your company can establish a true pay-for-performance culture. The result: energized and engaged employees who clearly understand how their contributions affect overall company success, and know they're being compensated fairly for their efforts. The overall business results can be enormous: retention of top talent, higher levels of performance throughout your company, and greater revenue and profits. ■

ABOUT SUCCESSFACTORS

SuccessFactors delivers easy-to-use technology that helps businesses of all sizes align, develop and motivate employees. With a suite that includes solutions for goal alignment, performance management, compensation, succession planning, learning, recruiting, and workforce analytics, SuccessFactors offers the most innovative HR technology available today. To learn more, please visit www.successfactors.com.

Why Pay-For-Performance Can Work at Last

DAVID CREELMAN, CEO CREELMAN RESEARCH AND
DAWN MACKAY, DIRECTOR OF PRODUCT MANAGEMENT | HALOGEN SOFTWARE INC.

Pay-for-performance is not new, yet organizations still struggle to implement it effectively.

There are two reasons why things are getting better: technology is addressing the administrative barriers that made it hard for managers and HR, and our understanding of pay-for-performance has improved. We are moving beyond a mechanical mentality, to a more sophisticated view of how to inspire performance.

Understanding How Pay Motivates Humans

Pay-for-performance includes the management of both salary increments and bonuses, based on individual, group or company performance—or a combination of these.

While some people are motivated in simple, mechanical ways by pay, to boost the performance of most employees, we need a psychological and social approach that considers how they will react to financial incentives.

Nails in the Coffin for the Mechanical Model

How will someone react to a bonus? Will they be highly motivated or quit in anger? Dr. Gary Latham, from Toronto's Rotman School of Business, says it depends on the circumstances.

In a real case, while admitting that \$900,000 was a lot of money, an investment banker quit in anger because he couldn't understand why his bonus was just short of seven figures.

Or consider a team of five employees, one of whom gets an excellent bonus based on her performance. The employee with the bonus may be motivated; the others may be angry.

How people react to pay depends on how they interpret its meaning. Managers need to spend time making sure pay is sending the right message.

Adopting a Non-Mechanical Perspective

To be successful, we need to focus on the human side of pay-for-performance—a rich and complex area.

Manage Expectations

One of the biggest problems organizations have with pay-for-performance is that employees are often disappointed with the results. To avoid this you need to manage expectations. If employees understand how their performance impacts pay, there will be no surprises. HR needs to teach managers to manage expectations, keeping their employees apprised of their performance level and its impact on rewards.

Leave Room for Judgement

Once we realize that pay-for-performance cannot be a purely mechanical system, we stress the importance of judgement. Managers must also put a value on how a goal was reached, and reward hard to measure attributes like teamwork. Judgement allows a manager to give rewards they consider fair, providing a strong basis for conversation with employees around performance.

Don't Set Rewards Too High

Men's Wearhouse CEO George Zimmer believes in the power of small incentives. In *Hidden Value* by Jeffrey Pfeffer and Charles O'Reilly, he argues that large amounts can “overwhelm the intended spirit” of a reward. The award should not be so large that people depend on it or are encouraged to do the wrong thing.

The point is to signal what is important and to celebrate success. Pfeffer argues we rely too much on pay. Pay should simply reinforce what the manager is already doing. One of the main goals of a pay-for-performance strategy should be to facilitate conversations between managers and their employees.

Build a Foundation of Trust

Training managers about pay-for-performance must include the importance of trust. Trust involves keeping promises and demonstrating a commitment to fairness. Research shows that both the process and outcomes need to seem fair, and offer an opportunity to appeal decisions.

Overcoming Barriers with Technology

Normally we consider how HR technology helps the HR department; we also need to consider how it helps managers. Managers can make or break a pay-for-performance system; technology that helps them can transform its effectiveness.

Organizations face three barriers when it comes to pay for performance:

- **Decisions Need Data:** Managers need information for making pay decisions, including: salary history, employee performance history, salary comparison data, etc.
- **Paper is a Pain:** Simple to use tools make pay decision easier and give managers more time to communicate them effectively.
- **Day-to-Day Disconnect:** Pay-for-performance programs need to connect to day-to-day work, clearly linking goals, performance and pay.

Pay-for-performance programs often fail to adhere to policy, undermining business objectives and fairness. Technology enables transparency and can enforce policy.

Any technology solution should free HR from administration so they can focus on making talent management strategies work. This ultimately contributes to overall organizational performance.

Summary

By taking a non-mechanical view of pay-for-performance, and supporting it with technology, organizations of all sizes can make pay-for-performance work. Companies that adopt the right infrastructure and mindset will have a competitive advantage that keeps them ahead of competitors. ■

For more information please visit www.halogensoftware.com

Corporate Governance, Compensation and Accountability in a Post-TARP World

STEVEN GOLDBERG | COMPLIMENTS OF WORKSCAPE

“It is apparent that the governance model and mindset of all commercial enterprises must shift from *keep us out of trouble to make our business better and more sustainable.*”

The job of compensation staffs and other HR professionals has become considerably more difficult, and that trend will apparently continue for the foreseeable future. Simply stated, how do you effectively attract, motivate, reward and retain key talent when (according to a March 2009 Human Capital Institute Study entitled “Where We Stand...”) 60% of 300+ companies surveyed have frozen or reduced salaries, 40% are cutting jobs, 1 out of 5 will be laying off entire departments or divisions, and roughly half of the companies surveyed will be significantly reducing bonus payouts?

Adding to these people-management challenges, SEC rules established in mid-2006 require public companies to file a Compensation Discussion and Analysis (CD&A) of their executive compensation policies and decisions in their annual proxy statement, explaining the rationale and methodology underlying compensation decisions. Indeed, the pressure seems to be getting to CEOs, as 1,484 of those heading-up U.S. firms headed for the exits in 2008... or an average of six CEOs every business day.

The current level of scrutiny placed upon executive compensation, bonus programs and accountability in general have the potential to become a “Sarbanes-Oxley 2.0”; but broader in scope than the sweeping “SOX” compliance framework, the current business and economic climate—and public activism it has spawned—portend fundamental changes in the compensation strategies and talent management approaches of all commercial enterprises.

Many organizations (TARP recipients first, others to follow) will now be focusing on adjusting compensation practices to comply with recent legislation and Treasury guidelines—particularly with respect to increased accountability and transparency.

So what actions are needed for corporations to prevent—or significantly minimize—another economic time bomb in the future? For one thing, a multi-pronged approach is needed relative to talent management strategy and related programs. It is also apparent that the governance model and mindset of all commercial enterprises must shift from “keep us out of trouble”... to “make our business better and more sustainable.”

To that end, here are 4 key actions to consider:

1. **Add greater visibility into the compensation process for the entire company**, not just for executive-level compensation decisions. Employees at all levels should have an opportunity to review, discuss and ultimately acknowledge the final set of criteria driving their bonus award.

2. **Technology implications and considerations...** Compensation systems should enable the type of flexibility needed during rapidly changing economic times; e.g., is there flexibility to recalibrate guidelines and awards based on budget fluctuations—including real-time snapshots of all compensation commitments and liabilities? The more flexibility offered by a compensation technology solution, the easier it is for an organization to treat compensation planning as a year-round exercise.

3. Clearly, in a business climate where perceived “compensation take-aways” are quite prevalent, there is an immediate need to launch **effective communication and change management initiatives (even year-round programs)** to explain how the “greater good” is served by adjusting compensation and total rewards downward when it is necessary for the health of the business.

4. **Routinely add customers (internal and external) to performance evaluation processes...** To illustrate why this is important, consider the professional services firm that pays bonuses mostly based on consultants achieving a high percentage of billable hours. This still prevalent practice obviously creates a serious disconnect, particularly when the customer is not very satisfied. ■

Steven Goldberg’s perspective on compensation was formed by designing and managing the bonus process for four Wall Street firms in the 80’s and 90’s, and serving as Global Head, HCM Product Strategy for PeopleSoft. He is the Global Director of Advanced RPO at KellyOCG, and continues writing and speaking as a global HCM thought leader. He can be emailed at: SBGConsultingLLC@gmail.com.

To read Mr. Goldberg’s full paper “Corporate Governance, Compensation and Accountability in a Post-TARP World,” visit: www.workscape.com/workforce.

Differentiated Compensation Programs— A Business Imperative

MATTHEW RICE, DIRECTOR OF PRODUCT MARKETING | TALEO CORPORATION

In his research bulletin titled “Enterprise Compensation Solutions,” Josh Bersin of Bersin and Associates cites the statistic that compensation represents 60% to 70% of all expenses in most organizations. This fact would be somewhat unremarkable if organizations executed on compensation management with the rigor they typically apply to supply chain management and capabilities seen as more “core” to the business. It is a given that each year companies invest heavily in compensation increases for their employees. Successful companies recognize the critical need to tightly manage this investment.

Effective compensation management is difficult to execute even at a basic level because of the two distinct domains it encompasses. On one hand, cash (and some non-cash) compensation programs are about paying employees for work performed on behalf of a company. This “payables and budgeting” viewpoint places the execution of compensation management in the finance department’s realm.

On the other hand, these same compensation programs have tremendously deep ties to overall Talent strategies, placing execution responsibility on human resources and executive management. Key to a successful Talent strategy is a focus on the linkages between compensation, productivity and retention of high-performing employees.

Companies that “get it” have found a way to balance these two domains, with standout business performance as the end result.

If Performance Levels Differ, Why Shouldn’t Compensation?

To highlight the frequent disconnect between pay and contribution, noted author Dr. Marshall Goldsmith asked more than 2,000 corporate managers about the difference in contribution between a top performer and a below-average performer of the same grade. The average answer was “over 100%.” When asked about the typical pay difference, the answer was “5% to 10%.”

Numerous research studies show a strong correlation between company performance and differentiated compensation programs for high-performing employees. The challenge with this type of compensation approach is that it introduces an extraordinary amount of complexity. Few compensation technologies provide the necessary flexibility to accommodate the myriad variables that need to be accounted for. Companies need compensation solutions that will focus compensation investments to the business areas where it will drive the most value.

Regardless of the challenge that this poses for companies, those who have been successful have seen 20% or greater revenue and profit than comparable companies.

The War for Talent Is Still Here...

With today’s record unemployment levels, one would think that there is an abundance of talented resources for the choosing. However, it is important to understand that there are two classes of workers in the market. “Commodity Workers” who are not highly skilled or specialized are typically placed in non-critical positions. This does not mean that these workers are not important, but that these workers can be replaced far more readily than “Pivotal Talent”. Pivotal Talent has the skills and competencies that make them critical to a company. This category of worker is always scarce and in demand. It is important to note that Pivotal Talent varies by industry and company, such as the actuary in an insurance company or the airport station manager for an airline.

Differentiated compensation programs are a critical component in the overall Pivotal Talent retention strategy. This differentiation is woven into the base pay for these positions, but a comprehensive performance-driven rewards program for Pivotal Talent will mitigate the risk of vacancies in these critical positions. Companies who wish to execute on these types of programs will blend process with technology to identify these positions, and will focus a significant portion of the company’s overall compensation budget on this group.

The Future of Compensation

Most business professionals have heard of or been part of a Pay-for-Performance culture at their respective companies. More recently introduced are Pay-for-Contribution (compensation for value added beyond the employee’s job objectives) and Pay-for-Potential (rewarding employees for the potential of significant value-add in the future). These programs add additional complexity to the compensation process that needs to be planned for when implementing a compensation strategy.

Companies who execute differentiated pay programs must communicate the rules of the game to employees or risk having these programs become a disincentive. Nirvana is having each employee understand prospectively (not looking in the rearview mirror) what they can do to max their own earnings.

A critical facet of the compensation management strategy is technology. As mentioned earlier, there are few compensation solutions available that have the design and architecture to deliver the needed flexibility and scalability to administer these complex plans. Companies need to be mindful to probe potential vendors on whether their technologies can model the precise compensation plans being designed and implemented, and should absolutely demand that the vendor show these capabilities.

While the management of differentiated compensation is complex, companies have achieved standout business performance as a result. ■

Automating Incentive Compensation for Increased Productivity and Immediate Cost Reduction

PAULSON LAN, PRODUCT MARKETING MANAGER | VARICENT SOFTWARE INCORPORATED

As organizations re-evaluate their compensation strategies in order to adapt to the recent changes in the economy and business landscape, incentive compensation is now top of mind for many HR professionals. Companies are trying to reduce the errors, overpayments and amount of effort it takes to manage their compensation processes while also implementing new and different plans that drive the 'right' behavior. When incentive plans are managed through complicated and disparate spreadsheets, and the organizational structure, territories and plans are constantly changing, just getting an accurate view of payout results is difficult enough. Gartner's estimate of 8% overpayment on bonuses and commissions due to these manual processes doesn't seem to be at all overstated.

A recent survey conducted by Varicent in partnership with *Workforce Management* revealed that 65% of the survey recipients currently calculate commissions using spreadsheets, and 90% of them admitted that they were dissatisfied with this method. The problem with spreadsheets is that it is a manual process, which is slow and prone to error. When senior management is asking to review and modify incentive programs, compensation administration costs shoot up as more manual processes and spreadsheets are layered onto a broken backbone of compensation systems.

Making Incentive Compensation Fast, Accurate, and Easy

Incentive Compensation Management (ICM) applications are now being deployed across organizations of all sizes and industries to automate calculations and incentive payment processes. Just eliminating the manual number crunching and spreadsheet confusion has a huge immediate impact on reducing time, cost and risk for any incentive compensation process. There is another huge added benefit. Delivering timely, accurate and trustworthy compensation data to the sales reps, managers and executives of an organization significantly reduces the lost time on their part trying to jostle their data, freeing them up for more time selling and meeting with customers. Additionally, with accurate payout results and comprehensive sales statistics, managers are able to directly correlate compensation and performance metrics in order to better understand and drive employee behavior.

What Does Automation Involve?

The benefits of automation can be best seen by following the entire compensation process:

- **Data Collection**—In order to calculate incentives and commissions, sales orders or performance results must first be collected along with the personnel information for the employees subject to variable pay. Typically, this information is stored in multiple, disparate data sources, and is collected and collated manually. Automation not only gathers and combines this data quickly and accurately, but also ensures the most up-to-date information from sales, finance and HR.
- **Calculating Incentives**—Compensation analysts often go through a rigorous and time-consuming process to verify the accu-

racy of calculations every pay period and after modifying any formulas in a spreadsheet. Automating this step is likely to incur the most cost savings in terms of overpayment and manual labor from calculation errors and reconciliation.

- **Payout Distribution**—A significant amount of manpower is required to personalize and deliver commission statements and payout results. Traditional spreadsheet-based systems avoid this hassle by releasing only the minimal information. Eliminating these tedious chores enable payees to receive detailed payout results down to the transaction level in order to reduce payment disputes and shadow accounting.

- **Workflows**—Plan sign-offs and approvals, inquiries, and disputes no longer rely on individual emails or phone calls. Rather, all documents or communications are centralized and automatically routed to the appropriate parties. An added benefit of automating this process is that each event is traceable for better visibility and compliance.

Building for the Future

Although the short-term benefits are usually the main drivers of automating incentive compensation, the long-term usability of an ICM application almost always outweigh the immediate cost savings and productivity gain. Since calculations are constructed with simple, consumable components and not embedded within complicated spreadsheets, compensation analysts are able to quickly and easily modify plans for the upcoming quarter or half year. Also, with a complete and accurate view of sales performance versus incentives paid, managers have access to the critical business metrics that help them drive employee behavior to support the strategic goals and objectives of the enterprise.

Taking Control of Compensation Spend with ICM

At a time when cost reduction and employee efficiency are the top priorities, automating incentive compensation offers perhaps the highest return in the shortest time. Eliminating calculation errors due to manual processes reduce compensation overpayment and generate immediate cash flow for the organization. Productivity is drastically increased for not only the compensation and benefits team, but also all employees receiving variable pay as payouts are accurate and traceable. Most importantly, corporate performance can be linked directly to compensation in order to analyze and improve variable pay and incentive programs. ■

ABOUT VARICENT

Varicent is a leading provider of Incentive Compensation Management (ICM) and Sales Performance Management (SPM) solutions. Organizations around the world such as Manpower, Waste Management, and Starwood Hotels rely on Varicent to automate the process of calculating and reporting variable-based pay and align sales performance with strategic objectives through pay-for-performance.

Best Practices in Compensation

For more information on the companies that contributed to this white paper, visit their web sites, or contact them directly at:

**SUCCESSFACTORS**

1500 Fashion Island Boulevard, Suite 300
San Mateo, CA 94404
Phone: (650) 645-2000
www.successfactors.com

**HALOGEN SOFTWARE INC.**

495 March Road, Suite 500
Ottawa, ON K2K 3G1
Canada
Phone: (866) 566-7778
info@halogensoftware.com
www.halogensoftware.com

**WORKSCAPE**

123 Felton Street
Marlborough, MA 01752
Phone: (877) 975-7227
www.workscape.com

**TALEO**

4140 Dublin Boulevard, Suite 400
Dublin, CA 94568
Phone: (888) 836-3669
www.taleo.com

**VARICENT SOFTWARE INCORPORATED**

36 York Mills Road, Suite 200
P.O. Box 330
Toronto, ON M2P 2E9
Canada
Phone: (416) 480-9825
Fax: (416) 480-2840
info@varicent.com
www.varicent.com

For information on participating in upcoming Best Practice White Papers, contact:

Jason Asch, Advertising Sales Director
(212) 210-0112 ■ jasch@workforce.com

Irvine Headquarters
4 Executive Circle, Suite 185
Irvine, CA 92614-6791
(949) 255-5340
www.workforce.com

Workforce
MANAGEMENT