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In Compensation Philosophy

How Prominent Is Your Company's Pay?

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Of all the questions around pay, and specifically incentive pay, there is one that should come first: How prominent is pay at your company?

Yet for many companies, this question is never explicitly asked. As a result, most companies are not getting the most out of their pay programs. We argue that the prominence question is critical — the "launch point" when considering significant program change or major design decisions.

What do we mean by prominence of pay? Pay prominence addresses how pay is used within the organization: (1) a front-end driver of performance — higher prominence; or (2) an after-the-fact affirmation of performance — lower prominence. Where pay is highly prominent, the overall pay program and incentives, in particular, are used to message and reinforce where employees should focus today, tomorrow, and going forward. Where pay has low prominence, programs are more oriented to confirming a job well done, while the task of defining day-to-day actions is addressed outside of the pay programs.

It is useful to note here that pay prominence does not speak directly to the competitiveness of pay opportunities — high- or low-prominence programs can pay similarly in a given period and over time. Pay prominence is less about "how much do we pay," and much more about "for what do we pay."

Pay prominence is heavily contextual — whether or not your company has or should have a high- or low-prominence pay program ties back directly to your specific business needs and cultural orientation. The challenge for many companies is that they cannot chart a fresh course — their approach to pay is anchored by a series of incremental decisions made over time. Still, the question of pay prominence — are we high or low? — can be a useful compass to check course and guide significant decisions going forward. Absent a clear sense for how prominent pay is and needs to be, companies are at risk of sub-optimizing their pay programs, and worse yet, introducing dysfunction.

Pay programs are most effective where prominence is clearly determined and linked to the principal inputs to and outputs of the overall pay for performance system.

Many companies we work with begin with the intent or desire to have high pay prominence. That said, implementing and executing a high-prominence approach is hard to do, and harder still to do well. High-prominence programs are most effective when coupled with rigorous performance management systems that are credible to employees. In large part, this credibility can only be established over time — employees have to see the system work, and see it work over time, to truly believe in it.

Further, the individual focus and competitiveness inherent to high prominence must fit with the business needs and culture. High-prominence pay doesn't play well where collaboration is crucial, or where leaders have a more egalitarian ethos. Where high prominence is practiced, we generally observe the following:
(1) a high degree of individual differentiation in pay; and
(2) performance goals specific to the individual.

To this first observation — significant individual differentiation: providing greater pay to higher performers and lesser pay to lower performers is 'true north' for high-performance cultures. This differentiation primarily comes through annual incentive payouts and/or equity grants. As an example, one company we work with only grants equity to its highest performers, and further still, grants are adjusted within this high-performing group by relative individual performance.

To the second observation above — individual performance goals: high-prominence programs are typically weighted heavily to quantitative measures within an individual's direct control. The most effective programs will cascade these individual goals directly from the company's strategic plan. This helps to actualize the overall strategy, making real for individuals what is expected of them in their role and establishing a clear line of sight from these expectations to overall company results.

As an example, we recently helped a company develop performance scorecards for each of its business units. These scorecards tie back to overall corporate objectives, and now serve as the basis for annual incentive funding at

HIGH prominence of pay		LOW prominence of pay
• Individuals carry significant accountability for business results • Managers have the capabilities and resources to effectively assess and differentiate based on individual performance • As an example: capital raisers within a financial services organization	Works best where…	• Business results are dependent upon systems and collaboration across units/teams • Culture is less oriented to individual performance, and more so to shared initiatives and responsibilities • For example: product development group within a manufacturing company
• Specific, quantifiable goals by individual (e.g., dollar-based targets for new investor capital)	Performance inputs to pay	• Overall company goals, with some role for team performance (e.g., company-wide revenue growth, with consideration to new design wins)
• Highly differentiated annual incentive payouts and equity grants by individual, based on formulaic incentive determinations (e.g., basis points on capital raised by individual) • More timely/immediate linkages of pay with performance delivered (e.g., payment at the time capital is committed)	Pay outputs based on performance	• Fairly limited differentiation of pay for a given period, based on company and team goals (e.g., target opportunities by employee level, with variation from targets based on company and team achievement) • Less immediate linkage of pay to performance delivered (e.g., payment at year-end, or even years later)

the unit level. Available incentive dollars are then paid to individuals based on their specific performance objectives, which in turn tie back directly to the business unit scorecards. Over time, individuals drive the needed unit performance, which in turn delivers the needed corporate results.

Low-prominence programs, by contrast, typically base incentives on overall company performance, commonly without unit-level objectives, and certainly absent goals by individual. Company performance generally takes the shape of "all for one, and one for all" —often using operating earnings or EPS—where all employees share a common fate. This approach can be very effective in fostering teamwork and collaboration—the overall intent is for all employees to row in the same direction, toward a shared destination.

As an example, we recently helped a company transition to a company-wide pay-for-performance framework from its previous unit-level approach. Today, units are more actively sharing customers, programs, and processes, with lesser regard to unit and individual performance and pay outcomes than under the company's prior approach. Further, with a more limited role for individual performance in determining pay, the company is at lesser risk of pay becoming a flashpoint in the performance management system.

We also note that your company's orientation to pay prominence can, and arguably should, change over time. As the business needs evolve and the culture shifts over time, pay prominence should follow suit, in turn dictating changes in the pay program.

In practice, we find most programs are closer to the low-end of the prominence scale—pay is more so an end-of-year reflection of performance delivered, rather than a beginning-of-year course map for performance expected. In our view, this is neither an indictment of high-prominence programs nor an endorsement of low-prominence, but more simply a reflection of pragmatic management. Many companies have not focused explicitly on pay prominence—should we be high or low, and why?

Absent this focus and intention, pay programs more naturally fall towards the lower end of the prominence scale, regardless of "best fit" with the business needs and culture. As a result, many companies are not getting the most out of their pay programs. For 2013 and moving forward, we argue companies should be more deliberate with considerations of pay prominence. Whether addressing known pressure points or considering new programs, the first question becomes: how prominent is pay at your company?

For more information, visit us at WWW.SEMLERBROSSY.COM, *or please contact:*

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