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How Attractive is Your Compensation Plan?

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There is no end to surveys proving that people change jobs for a variety of subjective and objective reasons, most of which have nothing to do with pay.

All that having been said, executive recruiters know one great truth: While candidates have been known to decline high-paying jobs, few will accept low-paying ones.

Many employers, nonetheless, find it increasingly difficult to offer superior candidates superior salaries. That's because salary ranges have fallen victim to disappearing merit budgets, the flattening of corporate organization charts and the growing emphasis on pay-for-performance incentives in place of high base pay.

Hiring managers and HR professionals can address this challenge by keeping three compensation principles in mind: (1) there is more to compensation than salary; (2) not all components of compensation serve the same purpose; and (3) different kinds of organizations need different kinds of compensation plans.

ADDING UP TOTAL COMPENSATION

Total compensation consists of 4 main elements – fixed pay, variable pay, special awards and benefits.

Fixed pay (Or base salary) has fallen victim to a combination of corporate cost-cutting, the growing suspicion in many companies that "merit" increases have become too automatic, the resulting use of merit budgets as basically cost-of-living adjustments and the emerging belief that pay should be viewed as a reward for the achievement of specified objectives – as opposed to an entitlement based on position and years of service. Moreover, as organizations have become more horizontal (with fewer opportunities for promotion), the number of position levels has decreased. The resulting salary compression does little to excite either job candidates or incumbents, unless offset by other remuneration.

Variable pay (*AKA* bonus or incentive compensation) was once viewed as a means of motivating selected employees, such as sales representatives, to meet production targets or quotas – and to reward higher levels of executives whose individual performance could impact the company's bottom line. When the bonus was considered to be achievable and tied to the employee's own performance, it became a true reward; when the bonus was tied to ever-shifting targets or to the achievement of poorly understood corporate/divisional performance ratios, it became a *dis*incentive. But whether seen as positive or negative, the bonus was in many cases a relatively insignificant portion of total compensation.

More recently, a number of companies have begun to introduce organization-wide pay-for-performance programs. These are designed to replace what these companies view as a flawed merit-increase system with a new incentive pay plan that freezes or reduces base salaries (except for cost-of-living adjustments) and ties a substantially increased bonus pool to defined improvements in individual and small-group performance. Often, 25 percent or more of potential cash compensation is placed at risk. In theory, each and every person will earn what he or she deserves.

Special awards include hiring bonuses, stock options, stock grants, profit-sharing distributions, non-cash awards, etc. When recruiting new employees, they can be used to offset other limitations (*e.g.,* providing a hiring bonus to compensate for the lack of an attractive relocation package), to create long-term incentives (as in the case of stock options) or to provide great reward for great risk (*e.g.,* the use of mega-stock grants by high-tech start-ups). Also, devices such as restricted stock (which cannot be sold before a specified date) and interest-free loans (forgiven after X years on the job) can be used as the tie that binds.

Last but not least, ***benefits*** should always be viewed as part of the company's total compensation package. The existence of a wide range of benefits, a particularly flexible cafeteria plan, a liberal vacation policy or generous retirement and savings plans add up to real dollars in the employee's pocket (not to mention real expenses to the employer).

USING THE RIGHT COMPONENTS TO SELL THE JOB

Pay for performance was designed to send employees a message: An ever-increasing salary is a privilege, not a right – and will be based upon your contributions to the performance of your department or team. Earn it or lose it.

While a number of well-known companies have used this message to awaken their workforces, it may have somewhere between a neutral and a negative impact on prospective employees.

Stripped of all artifice, the act of changing jobs requires trading the devil one knows for the devil one doesn't. That in turn prompts the candidate to ask, "What am I getting for what I'm leaving behind?" The more tangible and immediate the reward, the easier it is to take the risk.

The promise, therefore, that "You'll earn what you're worth," or, "The sky's the limit," is not terribly reassuring to the potential new hire.

When it is impossible to offer a significant improvement in base salary, throw in a tangible, calculable reward in the form of cash or stock – even if distribution restrictions apply. Add up the dollars and cents improvement in the benefits you provide. And, if variable pay will be a substantial component of the total compensation package, supply specific formulas by which it will be calculated.

TAILORING COMPENSATION TO YOUR NEEDS

Last but not least, no one size fits all when it comes to compensation plans.

Traditional organizations, with their rigidly defined functional lines (such as manufacturing, marketing and sales) and highly vertical reporting relationships, adapt least well to pay-for-performance models based upon the accomplishments of cross-functional teams or the achievement of ever-changing short-term goals. In the traditional organization, salary generally should remain the principal component of the compensation package.

By contrast, companies whose success is tied to an ongoing series of time-sensitive accomplishments (for example, winning new contracts and completing them on time and under budget) can make great use of sophisticated variable pay programs. The same is true for organizations seeking significant progress in some critical aspect of their operations (such as customer service and responsiveness). When performance improvement is crucial, rewards should be commensurate.

In similar fashion, blue-chip companies such as General Electric, Microsoft and Procter & Gamble have relatively little difficulty attracting and keeping top talent, so the basic objective of their compensation programs is to remain competitive with other good companies. (In essence, the place of work becomes its own reward.) Conversely, the blue-chip executive joining a high-risk start-up may need lavish remuneration – and, as recent news reports have shown, is likely to receive it.

Unfortunately, company owners and corporate executives sometimes view their fiefdoms through rose-colored glasses and have an unrealistically low expectation of what it takes to compete for talent in the personnel marketplace. If your compensation program is totally out of sync with the outside world, the wisest course of action may be to engage a compensation and benefits consulting firm. Often, however, a good first step is to have a frank discussion with a knowledgeable, trusted executive search consultant who deals daily with clients and candidates in your industry. This can provide an objective comparison of your company's total compensation program to the industry at large and, as an added bonus, may yield helpful intelligence on innovative programs at other companies.

Employees these days want compensation plans that recognize their achievements. As a famous athlete said when asked why he earned more than the President of the United States, "It's because I had a better year."

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