Fall 2013

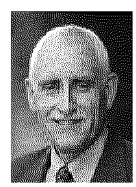
Rewards Next Practices: 2013 and Beyond

K. Dow Scott
Loyola University Chicago, dscott@luc.edu

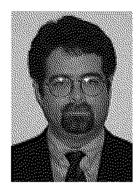
Thomas McMullen

WorldatWork journal
Fourth Quarter 2013

Rewards Next Practices: 2013 and Beyond



Dow Scott, Ph.D.,
Loyola University Chicago



Tom McMullen
Hay Group

The 2008 and 2009 economic downturn resulted in employee layoffs, frozen or reduced wages and salaries, substantially lower or nonexistent bonuses, and underwater stock options. In short, carefully formulated rewards philosophies and strategies were suspended as organizations struggled to survive.

Today, the economy has improved, and the recovery is marked by lower unemployment rates, healthier stock markets and increased consumer spending. This recovery has also witnessed increased competition for talent with corresponding increases in salaries and wages for this talent. Employees are demanding their share of the increased profits and earnings showing up on corporate balance sheets, and these demands are again muddying rewards strategies and programs. In fact, a 2012 Society of Human Resource Management (SHRM) survey of HR executives identifies "retaining and rewarding the best employees as their No.1 challenge" (Minton-Eversole 2012). Further, a 2013 Conference Board survey ranks human capital concerns as the No.1 concern of CEOs (Conference Board 2013).

Economic changes present challenges and opportunities for rewards professionals. One such opportunity concerns redefining the way employees are paid to more effectively drive organizational success in what appears to be the "new normal." This "new normal" may very well be one in which economic surges and troughs are common, but even if not, recent experiences have caused employers and employees to become more cautious about the future. To take advantage of this opportunity to refocus, rewards professionals must first understand how rewards strategies, programs and policies have changed and then consider the direction rewards programs will take in the future. Simply relying on benchmarking of current pay practices to confirm the viability of rewards strategies, policies and programs is not enough. Anticipating how rewards programs are likely to change is a prerequisite for managing rewards and adapting them to the uncertain world of business and labor markets.

This study detailed in this article was designed to discover how the thinking of rewards professionals has been transformed by recent economic changes, as well as where rewards professionals expect to focus their efforts in the future. Specifically, the study examines their thinking from four perspectives:

1 | Rewards strategy and program objectives

2 | Rewards program effectiveness

3 | Rewards differentiation, communication and line-manager involvement

4 | Consistency of rewards strategies and programs across the organization.

Finally, the study examined the influence of company ownership, size and global scope to determine how these factors influence current and future approaches to rewards issues.

DATA COLLECTION AND SAMPLE CHARACTERISTICS

Invitations to participate in the survey were sent to a sample of WorldatWork members – primarily senior-level rewards professionals because the authors believe senior level rewards professionals have one of the best vantage points to evaluate their organizations' current rewards strategies and programs and provide substantial insight into the future direction of these programs. The survey required 10 to 15 minutes to complete and was open for approximately a month. A reminder to complete the survey was sent halfway through the period and again just before the survey closed. Of those invited to participate, 301 responded.

The rewards professionals responding to the survey represented diverse organizations. Twenty-five percent (25%) of organizations had fewer than 999 employees, 30% had 1,000 to 4,999 employees, 13% had 5,000 to 9,999 employees, 13% had 10,000 to 19,999 employees and 19% had 20,000 or more employees. A variety of industries were represented, including high-tech (16%); financial services (14%); services (11%); health-care (11%); industrial goods (5%); and oil and gas (5%). The "other" designation was assigned to the 37% of respondents from industries that made up less than 5% of the total sample.

The sample also was diverse in terms of ownership, including publicly traded (43%), privately held (32%), not-for-profit (21%) and government sector (4%). Finally, in terms of global scope, 32% of respondents were from domestic companies (i.e., companies located in only one country), 15% had operations or facilities in two-to-four countries, 19% were located in five to 19 countries, 16% were located in 20 to 49 countries, and 18% reported having company locations in more than 50 countries.

FINDINGS AND IMPLICATIONS

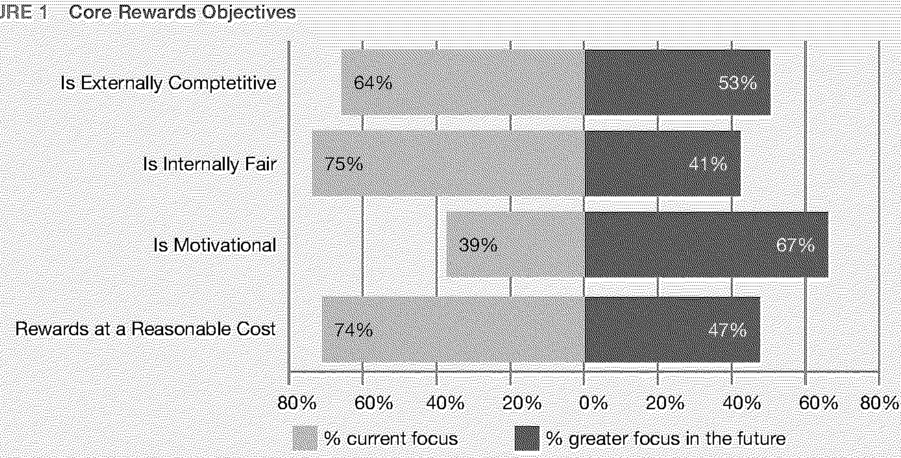
Rewards Strategy and Program Objectives

The first set of survey questions asked rewards professionals to what degree their organization's rewards system met its objectives. For example, was the rewards system externally competitive, internally fair, motivational and linked to individual performance? Then they were asked which of these objectives would receive greater or less attention and focus during the next two to three years.

Figure 1 reports the findings on four core rewards objectives. The green bars indicate the percentage of respondents who agreed or strongly agreed that this dimension is a current focus within their organization. The gray bars on the right indicate the degree to which respondents reported that dimension would receive more focus over the next two to three years. All the following figures report data in the same format.

As shown in Figure 1, most respondents agreed their rewards programs focused upon external competitiveness, internal fairness and rewards at a reasonable cost. However, only 39% of respondents agreed their rewards programs were motivational and 67% percent of respondents indicated they were going to focus more on enhancing the motivational value of their rewards programs. Furthermore, the findings indicated a shift in focus over the next two or three years from internal fairness to external competitiveness. This makes sense because 75% of respondents agreed their rewards programs were currently internally fair and fewer agreed their pay programs were externally competitive.

FIGURE 1 Core Rewards Objectives



This shift from internal fairness to external competitiveness is not new, as is evident from the increased emphasis placed on pay surveys as related to job evaluation during the last two decades. This increased attention may be the result of the inability to adjust or increase wages during the recession. Now, with the recovery underway and attracting and retaining talent becoming more difficult, rewards professionals are renewing their efforts to become externally competitive.

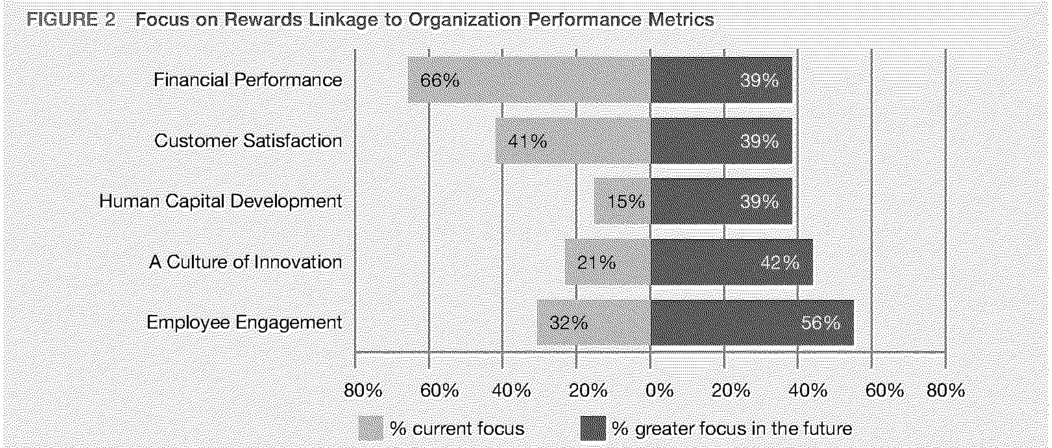
Linking performance with rewards has long been an objective of rewards professionals. Findings indicated that success has been modest with only 51% believing rewards are linked to overall corporate performance, 41% to business unit and team performance and 45% to individual performance. Responses to the survey's open-ended questions further indicated that rewards professionals faced significant challenges linking rewards and performance.

Given the importance senior management is placing on the alignment of rewards systems with performance, it was not surprising that more than 50% of rewards professionals were going to give increased attention to this linkage during the next two to three years.

That said, however, compensation professionals had very different perceptions as to the degree to which their rewards programs reinforced short-term (66%) and long-term objectives (25%). This discrepancy seems to indicate that rewards programs are substantially more effective at rewarding short-term over long-term objectives. This could be indicative of problems associated with underwater stock options and the decrease in stock values experienced during the economic crisis. The disappointment in long-term incentives may be reinforced by shareholder beliefs that recent large increases in stock values may not be reflective of executive efforts but rather of improvements in the economy. In any event, compensation professionals expected to focus more attention on developing long-term rather than short-term incentive programs.

Findings shown in Figure 2 indicate the majority of compensation professionals believed their rewards programs to be strongly linked to financial performance. However, the factors that drive that financial performance were not nearly as well

FIGURE 2 Focus on Rewards Linkage to Organization Performance Metrics



reinforced as were financial outcomes, i.e., customer satisfaction (41%), human capital development (15%), a culture of innovation (21%), and employee engagement (32%). Although the future focus on linking rewards to employee engagement is commendable, one might wonder why improvement in the linkage between rewards programs and human capital and a culture of innovation is not receiving more attention.

Rewards Program Effectiveness and Future Focus

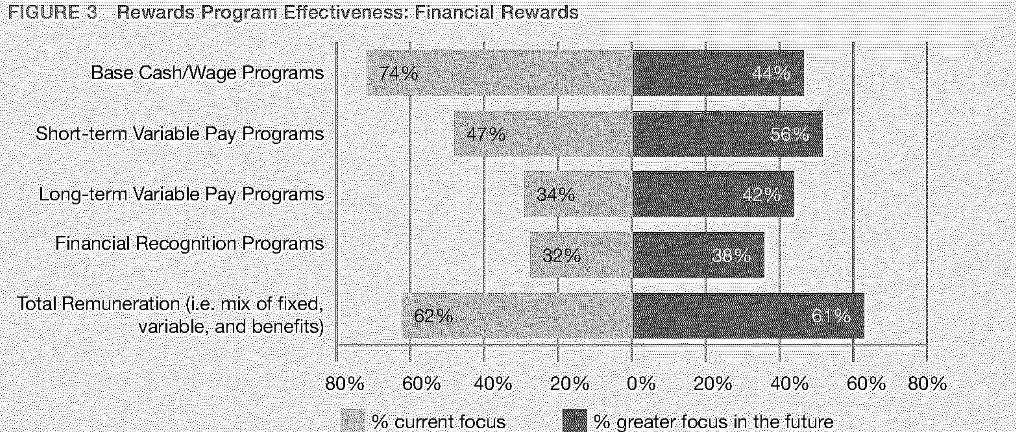
This section of the survey asked respondents to rate the effectiveness of the rewards programs offered by their organization. They were then asked to indicate if they would give these programs more or less attention in the next two or three years.

Figure 3 shows how respondents rated the effectiveness of their major types of financial rewards programs. Seventy-four percent of respondents rated their base cash/wage programs effective. However, fewer than half rated their incentive pay programs effective, i.e., short-term variable-pay programs (47%), long-term variable pay programs (34%) and financial recognition programs (32%). The low rating given to long-term variable pay programs was consistent with the low rating respondents gave to the dimension that indicated rewards strategy and programs were not meeting long-term organization objectives.

While far fewer respondents indicated short-term and long-term incentive programs were more effective than their base-pay programs, 62% of respondents still believed total remuneration was effective. Given that incentive programs are major elements of total remuneration, it was surprising that total remuneration would be rated effective by such a large proportion of respondents. Furthermore, if total remuneration was rated so effective by so many respondents, why was the future focus on this dimension so high?

Given the cost of health and welfare benefits and the reported struggles to control these costs, it is interesting that a huge majority perceived these programs as effective (72%). One might expect the future focus on health and welfare benefits to be higher, given the changes the Patient Protection and Affordable Care Act is requiring in the delivery of these benefits. Although defined benefit

FIGURE 3 Rewards Program Effectiveness: Financial Rewards



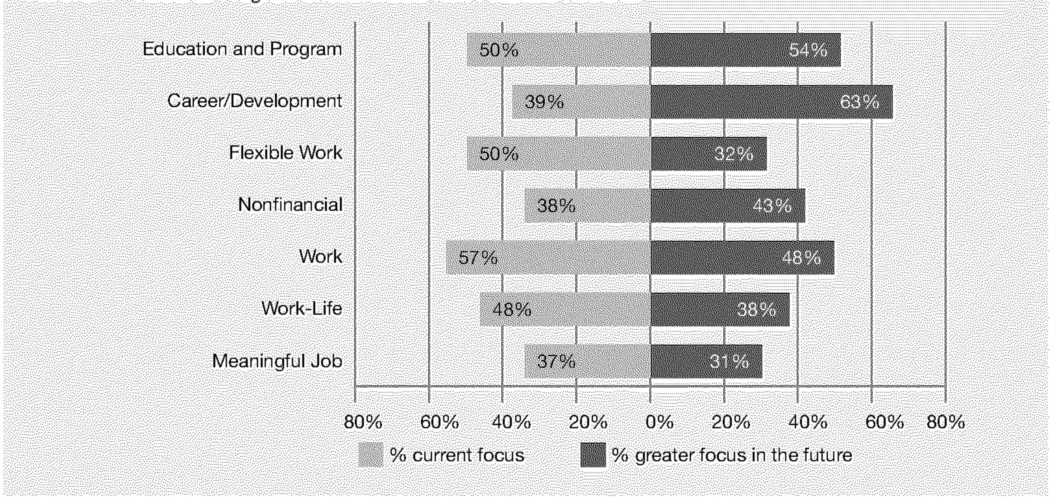
(DB) plans were considered effective by about half of the respondents (46%), the percentage was hardly surprising, given the general phase-out of DB plans that only 14% of respondents agreed they would be focusing on during the next two to three years.

Defined contribution (DC) programs were considered effective by most respondents (59%) but only 30% agreed they would be focusing on this program in the future. Although the structures of DC programs are not complex as DB programs, the authors wonder about the ramification of the low saving rates reported in the popular literature. How are organizations going to respond to older workers who do not have the resources to retire?

The study found mixed results regarding the effectiveness of key rewards processes. Market pricing was perceived as effective by the largest number of respondents (62%), but half of respondents saw themselves focusing more on market pricing in the future. Approximately half of respondents saw job leveling and grading processes as effective, and slightly over half (53%) intended to focus more on job leveling and grading during the next two to three years. Finally, 41% of respondents saw performance-management processes as less effective than the other core processes, but 69% intended to give these more attention during the next two to three years. This was reassuring since performance management has been identified repeatedly in the authors' previous surveys of compensation professionals as being problematic. A performance management process that does not provide credible, timely data undermines incentive pay programs that focus on performance.

Figure 4 shows the perceived effectiveness of nonfinancial rewards programs and the attention these programs will receive in the future. Although education and training programs (50%), flexible work arrangements (50%), work climate/culture (57%), and work-life balance (48%) were seen as effective by approximately half of the respondents, career/development opportunities (39%), nonfinancial recognition (38%), and meaningful job design (37%) were seen as substantially

FIGURE 4 Rewards Program Effectiveness: Non-Financial Rewards



less effective. Rewards professionals are focusing most of their future attention on education and training programs (54%), career and development opportunities (63%), and work climate and culture improvement (48%).

In summary, the programs rewards professionals perceived as being most effective were base-pay and wage programs, health and welfare benefits, defined contribution programs and market pricing processes. Programs viewed as being least effective by rewards professionals were long-term incentives, nonfinancial recognition, career/development opportunities and performance management processes. Total remuneration levels, job leveling and grading processes, performance management processes, and career and development opportunities were the programs rewards professionals intended to give the most attention to during the next two to three years.

Rewards Differentiation, Communication and Line-Manager Involvement

Most organizations aspire to having rewards systems that differentiate high performers from average performers, and that is theoretically what merit pay increases and variable pay programs are designed to do. However, most compensation professionals who responded to the survey did not believe their organizations were successful at pay differentiation. Only 21% respondents agreed their base salary increase programs created a significant variation between top and average performers. Further, only 30% believed their short-term incentive programs created a significant variation in incentive payouts between top and average performers. Even though the effectiveness of differentiating performance is problematic in most organizations, only half or fewer of respondents indicated they planned to give increased attention to differentiating merit increases (50%) or incentive payouts (44%) in the next two to three years.

These findings indicated a very different reality from the expressed importance placed on pay differentiation by consultants, academicians, and practitioners and the effectiveness of pay systems to deliver on this expressed goal.

Like pay differentiation, effective rewards communications has long been an expressed goal of rewards professionals. These findings indicated this goal is far from being achieved. Only 30% of respondents agreed their employees understood and appreciated their total rewards programs; only 21% agreed leaders regularly sustained rewards and performance communications; and only 38% even provided individualized total rewards statements. Still, improving communications seemed to be a major priority in the next two to three years as evidenced by the significant increase in the percentage of respondents reporting they were going to focus on this dimension in the future; i.e., employee appreciation of total rewards (64%) and leaders who sustained rewards and performance communications (62%).

Although involving line managers in communicating rewards programs has long been a priority of rewards professionals, compensation professionals believed these efforts have been relatively unsuccessful. Only 11% of respondents agreed managers effectively implemented and communicated total rewards to employees, and only

15% agreed managers effectively managed the overall pay-for-performance relationship with employees. Rewards leaders acknowledged this was a significant outage in their organizations and well over half the respondents (61% and 57%) intended to give this area much more focus in the next two to three years.

Finally, rewards professionals were asked if they regularly measured the return on investment (ROI) of their total rewards program. Only 11% of respondents indicated they did so. This is an important issue, as it gives insight into how rewards are perceived within the organization. If pay is perceived to be a cost, then organizations attempt to minimize it. Conversely, if pay is perceived as an investment, organizations try to optimize it, investing more in programs perceived to provide a greater return for the amount invested. In any event, without some kind of ROI assessment an organization is unable to assess whether rewards programs are meeting their objectives and what needs to be done to improve them if they fall short.

Consistency of Rewards Strategies and Programs Across the Organization

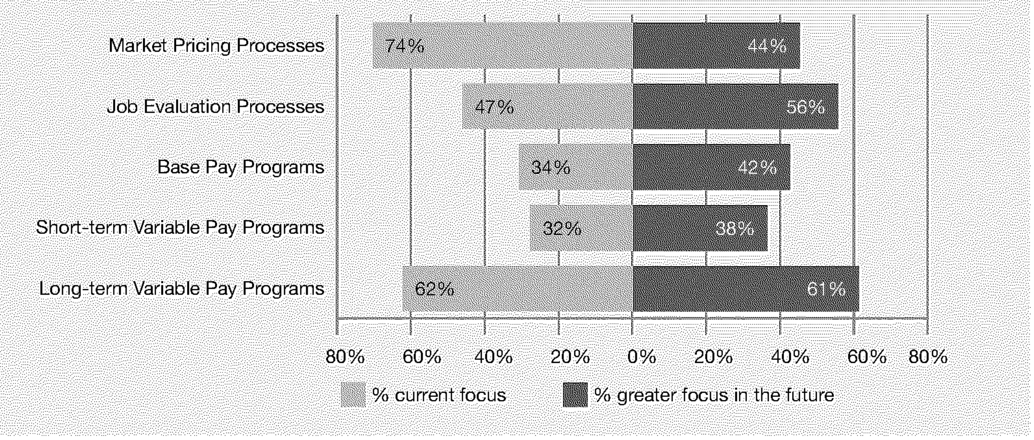
The decision to make rewards programs more consistent or to differentiate rewards for unique business situations is a trade-off rewards professionals often struggle to balance. In that regard, respondents were asked to indicate the degree to which their rewards strategies and programs were consistent across their organization. Researchers also asked respondents if they planned to try to establish more consistency on rewards programs across the organization during the next two to three years.

About half of respondents believed their organizations had consistent philosophies, strategies and designs for rewards programs; performance management; and talent management programs, 49%, 53% and 44%, respectively. By the same token, approximately half intended to enhance the consistency of rewards programs, performance management, and talent management, 50%, 50% and 53%, respectively, during the next two to three years.

More specifically, Figure 5 shows that respondents believed market pricing processes were highly consistent across the organization (74%) and job evaluation and grading process less so (47%). Respondents indicated they would give more attention to job evaluation and grading process in the next two to three years (56%) relative to market pricing processes (44%).

Long-term variable-pay programs were considered more consistent (62%) than base-pay programs (34%) and short-term variable-pay programs (32%), likely because the focus of these programs was on executive roles where few people and substantial amounts of money were involved. Even so, respondents intended to give long-term variable pay programs more attention in the next two to three years (61%), greater than base-pay (42%) or short-term rewards (38%). It is interesting that long-term variable pay was considered consistent by the majority of participants, but few found long-term objectives linked to performance, as discussed earlier.

FIGURE 5 Consistency of Rewards Programs and Processes



Impact of Organization Ownership, Size and Global Scope

The data collected were examined to determine if ownership of the organization, size or global scope was associated with how compensation professionals responded to the survey. With the exceptions of the areas noted below, researchers did not find appreciable differences in the findings relative to ownership status, size or global scope.

Ownership. First, respondents represented organizations with four different types of ownership, i.e., government, not-for-profit, private publicly traded, and privatelyowned. As would be expected, government and not-for-profit organizations did not perceive a strong linkage between rewards programs and performance at the individual, team/work unit or organization level, when compared to private publicly traded and privately owned organizations. Second, rewards professionals representing public-sector and not-for-profit organizations indicated that cash and wage programs, short-term variable-pay and long-term variable pay were less effective than in private, publicly owned and privately owned organizations. Finally, the not-for-profit and public-sector organizations did not have as consistent a rewards program philosophy, strategy and design, performance management strategy and design, and talent management strategy and design as privately owned and private, publicly traded organizations.

Global scope. Since most public-sector and not-for-profit organizations were located in only one country and had unique economic pressures, they were taken out of this part of the analysis. The data revealed no meaningful relationships associated with the number of countries in which respondent organizations were located and rewards strategies, policies and programs examined. In other words, the perceptions of organizations with limited global scope and those with many global locations had the same views, assessment and focus for the next two-to-three years.

Organization size. Finally, the size of the organization, as measured by the number of employees, seemed to have limited influence on the current assessment of strategies and programs and almost no impact on where respondents intended to focus their attention in those two to three years. Respondents representing larger organizations believed their rewards programs were more motivational and had stronger links with overall corporate performance, and business-unit and team performance, but not in terms of individual performance than organizations with fewer employees.

Respondents in larger organizations had stronger agreement than those in smaller organizations that their pay programs were more motivational, had stronger links between rewards programs and overall corporate performance, and business-unit and team performance. Respondents of larger organizations are less likely than those of smaller organizations to rate their market-pricing and job-leveling programs as effective.

Organization size, sector and global scope offered little additional insight to the data. This can be considered good news in the sense that the findings are just as relevant for organizations of any size, for any sector or for varying levels of global scope.

Conclusions and Recommendations

So what are the lessons learned from respondents in terms of the rewards strategies, programs, and processes needed to drive organizational effective and competitiveness in the future?

Rewards strategy and program objectives. Apparently, there is considerable variation among survey respondents as to how well their basic rewards programs meet their objectives. Specifically, only 39% of respondents agreed their rewards strategies and programs were motivational and rewards programs are not believed to reinforce long-term objectives. Furthermore, fewer than half the respondents believed their rewards program linked to performance drivers, such as human capital development, culture of innovation and employee engagement. These findings indicated that considerable work needs to be done to ensure rewards programs are delivering results for which these programs were intended, particularly in terms of motivation and engagement.

Rewards program effectiveness. The findings indicated that the perceived effectiveness of rewards programs varied considerably. As mentioned above, effectiveness of long-term variable-pay was rated low, but so were financial-recognition programs, the performance-management processes, career-development opportunities, nonfinancial rewards and meaningful job design.

There was commitment among the respondents to focus on career/development opportunities which certainly expands the scope of what have traditionally been defined as rewards programs. The assessment of total rewards program effectiveness was highly evaluated, but respondents still indicated they were going to give it much more attention over the next two-to-three years.

Rewards differentiation, communication and line-manager involvement. Respondents indicated they were not successful at differentiating both base pay and incentive pay between average and top performers. Pay differentiation has been a challenge for rewards professionals for decades. One interpretation may be that current incentive programs by themselves are ineffective in helping to achieve this goal. For example, competitive markets place severe restrictions on how much base pay can be increased. As such, does the concept of merit increases make sense for all organizations? For some organizations without a strong performance management system, it may be better to adjust pay increases based on market rates and place larger amounts of money into short- and long-term incentive plans that are not rolled into base pay.

Rewards communications is another area which has long been reported as a challenge for rewards professionals. Although survey findings indicated that WorldatWork members were going to give this area more attention, will those good intentions again end in disappointment? Do rewards professionals need to rethink what employees need to know about rewards and what they are trying to accomplish by communicating information about the rewards program? Rethinking the basics may help develop better methods and strategies for communicating rewards information and determining what information is valuable and important to communicate.

Effective involvement of managers in rewards programs is a challenge and a reported area of focus in the future. The data in this research raises two questions: 1) Do managers understand how the rewards system works, and 2) do managers believe rewards systems can be used to leverage employee performance? Line managers may believe sharing rewards communications just creates conflicts among employees and does not fundamentally help them get the performance they need from their employees.

Although many rewards professionals acknowledge the importance of evaluating the effectiveness of their rewards programs, few actually conduct these evaluations. This finding is consistent with previous research. Evaluating rewards programs in terms of ROI reinforces the idea that pay is an investment rather than simply a cost. Thus, pay should be examined in terms of how it supports and advances the strategies and goals of the organization. Since more than half of respondents indicated they intend to give evaluation much more attention during the next two to three years, this suggests more rewards professionals understand the importance of determining the payoff of rewards programs.

Consistency of rewards strategies and programs across the organization. In general terms, rewards professionals deemed consistency as a positive virtue pertaining to a rewards system unless they were designing compensation programs for employees in different industries or with very different pay traditions. However, while the survey data indicated rewards professionals believed their base wage/salary programs were effective (74%); at the same time only 34% agreed that base-pay programs were consistent across their organization. Furthermore, short-term variable pay programs were also seen as inconsistent. Finally, long-term variable pay programs were seen as consistent (62%) but not all that effective. The idea of consistency is obviously complex. Rewards professionals need to determine in some detail where consistency is important for their operations and where consistency is ill-advised.

This study provides a candid examination of the current state of rewards strategies, programs and processes, and attempts to identify the rewards priorities of organizations over the next two or three years. Although several themes have been identified, it is apparent from these findings that considerable diversity exists in current compensation practices and the directions that rewards professionals will take in the future. Thus, the most important lesson to be learned here is the appreciation of this diversity and the opportunity to see the numerous strategies that pay professionals will follow in the future. ■

AUTHORS

Dow Scott, Ph.D. (dscott@luc.edu), is an HR professor at Loyola University and a management consultant. Scott helps business leaders create high performance organizations and teams, design effective compensation and incentive plans, hire high performing employees, control costs, develop leaders and evaluate the effectiveness of HR programs. He is a prolific writer with more than 100 publications and has spoken at numerous WorldatWork and Chicago Compensation Association events.

Tom McMullen (tom_mcmullen@haygroup.com), is the North American Rewards Practice Leader for Hay Group and is based in Chicago. He has more than 25 years of combined HR practitioner and compensation consulting experience. His work focuses primarily on total rewards and performance-program design, including rewards-strategy development and incentive-plan design. Prior to joining Hay Group, McMullen worked for Humana Inc. and Kentucky Fried Chicken Corp. in senior compensation analyst roles. He holds bachelor's and master's degrees in business administration from the University of Louisville.

REFERENCES

Conference Board CEO Challenge. 2013. Research Report R-1511-13-ES. www.confernceboard.org.

Minton-Eversole, T. 2012. SHRM Poll: Some Industries Shaking Off Recession Woes. March 22.