Viewpoints

Q&A

How to make pay for performance more than just a tagline

Carole Hathaway, Global Practice Leader, Rewards

Robert Mustich, Managing Director, Rewards

Amy Sung, Talent Business Leader for Metro New York

Lara Paukovits, Senior Consultant, Communication and Change Management

Jenn Kelly, Product Leader, Compensation Planning Software

Companies are under growing pressure to strengthen the link between pay and performance for their executives as well as the broader employee population. In a recent roundtable, senior consultants from Willis Towers Watson discussed how to best diagnose the health of a company's pay-for-performance programs in order to deliver the optimal return on investment.

The panelists emphasized the need to adopt a holistic perspective to ensure that all programs are aligned strategically and that pay for performance is embedded in the organizational culture. They also stressed the importance of focusing not only on program design but also on delivery, which is critical to the employee experience.

Q Hathaway: We're hearing a lot about the increased scrutiny of pay practices and the need to assess the effectiveness of pay practices. What's driving this current focus?

A Sung: In recent years, there has been more scrutiny of executive compensation practices. And companies regularly conduct a risk assessment to affirm that their compensation programs do not incent excessive risk taking.

Yet, despite this type of assessment, problems still persist, as we saw recently in the Wells Fargo case where incentives were blamed for driving bad employee behavior. Now we see some companies adopting a broader view of pay for performance that goes beyond just the program mechanics.

Boards are very concerned about this issue, too. Compensation represents a significant investment for most organizations, and it is critical to ensure that employers are getting the most value from this investment, while managing risks that can have significant impact on a company's health and brand.

The recent flux of pay equity legislation and an increased focus on inclusion and diversity initiatives have also put pay practices into the limelight; these are prompting organizations to take a more comprehensive view of pay practices overall.

Q Hathaway: Why are we spending so much time discussing whether pay-for-performance programs are effective? Some organizations appear ready to give up on pay for performance while others remain committed to this strategy.

A **Mustich:** In many organizations, pay-for-performance philosophy is just a tagline with little rigor and few guiding principles. This makes designing and assessing the effectiveness of programs very difficult, which is what prompts some companies to give up. Others hear "the noise" from employees and managers about pay for performance not working and think the answer is to scrap the program without first understanding the root cause of the issue.

While pay for performance has been fairly well implemented at the executive level, there is often not a connection between what is done at the executive level and the broader employee population. This becomes a source of frustration for employees and managers.

Q **Hathaway: Our surveys show that employees do not understand their pay and bonus programs and how they're linked to performance. It seems like something is broken.**

A **Kelly:** Managers have a key role to play in helping employees clearly understand how their individual performance impacts their pay and/or bonus increases. This starts with giving managers the right knowledge and training in what "good" performance looks like in their organization. Managers may have different views of what performance means across the organization. And they may not have the necessary skills to differentiate among the different performance levels or ratings, if used. However, with the right skills, guidelines and data, they can make better decisions and explain to employees in a clear manner how their performance impacts their pay.

Technology can play a big role in facilitating transparency here. By outlining business and individual objectives at the start, identifying how those objectives are linked with pay and regularly communicating feedback on performance throughout the year, employees will be able to make a clear connection between their individual performance and pay.

Q **Hathaway: Rob, I'd like to ask you to address the issue of why boards should care about pay for performance generally across the organization when that might involve tens of thousands of employees across all different businesses.**

Abandoning pay-for-performance programs can have a detrimental effect on the business as well as employee engagement.

A **Mustich:** It's really a governance issue. The median operating income spent on incentives is 10%. And incentives are just one component of pay-for-performance programs. In addition, these programs can have unintended consequences as we have seen with recent accounts in the media regarding inappropriate and unethical behavior.

So boards need to be proactive in understanding what programs are out there, the principles behind these programs, the investment, the risk and the overall effectiveness of the programs.

Q **Hathaway: We know that pay is the number one driver of attraction and retention, and how performance and pay are linked is important. Why should organizations not give up on pay for performance? Should they perhaps be taking a broader view?**

A **Sung:** Organizations can't afford to give up on pay for performance because under an environment where everyone is rewarded the same, many high performers (who are often critical talent) will feel that their efforts and contributions are not being fairly rewarded compared to others in the organization, and they may decide to leave.

And even more dangerous is the potential for disengagement. If these employees choose not to leave, they may become disengaged. They will be physically present but will not be working toward the company's or their own personal goals. So abandoning pay-for-performance programs can have a detrimental effect on the business as well as employee engagement.

In many companies, executive programs are reviewed distinct from broad-based programs. But consider that all the efforts and contributions of all employees roll up to how executives and leaders are measured and the organization performs.

This is why it is important to take a holistic and enterprise view on pay for performance. Otherwise, you end up with siloed programs and an over-emphasis on plan mechanics instead of a pay-for-performance culture sustained in the organization. Pay for performance is most effective when it's no longer perceived as a program owned by HR, but rather as a part of an organization's culture and how it does business.

It's critical that an organization commit to embedding pay for performance in its culture. It can't just be an HR initiative or one program focused only on executives.

And with a changing workforce and preferences, it's also important to broaden how we reward for performance beyond just pay. We know from our Willis Towers Watson research that employees also value additional time off, philanthropy and other benefits. Perhaps we can start a movement and rename this to be reward for performance instead pay for performance.

A **Hathaway:** Recently, I used our diagnostic tool to do an assessment of all of a client's programs, including their recognition program, which they had not regarded as part of their pay-for-performance program.

We found that employees greatly valued the opportunity to have their efforts recognized in a public way. It's important that we look at paying for performance from a comprehensive perspective and ensure that the program components are aligned and contributing to the overall business strategy and culture.

A **Paukovits:** It's critical that an organization commit to embedding pay for performance in its culture. It can't just be an HR initiative or one program focused only on executives.

In doing a diagnostic of pay for performance in organizations, it's important not to limit the assessment to simply reviewing what reward programs are being offered and how they are designed. It's essential to focus also on delivery and culture. We need to take into account such issues as communication practices, how technology supports the pay-for-performance experience and finally, governance. This is how the experience comes to life for employees.

A **Kelly:** Technology can play a key role in providing employees a clear line of sight between their individual goals and the broader corporate goals. Through analytics and tracking tools, employees will be able to see how their daily performance contributes to the achievement of the organization. It will also allow managers to provide regular feedback to employees on what they are doing well and/or where they need to focus. This transparency will make the year-end pay-for-performance discussions more effective because employees understand how they've directly contributed to corporate performance throughout the year.

Q **Hathaway:** **We're also seeing companies wanting to make changes around their performance management programs. And a growing number of them are considering going rating-less or have already done so. Amy, can you share with us some of the changes you're seeing in how companies are defining performance management and how they're linking performance management programs to compensation programs?**

A **Sung:** We see many organizations continue to tweak the design or mechanics of their performance management and compensation programs. And the debate about going rating-less is just one example of this. Organizations think that once they get rid of performance ratings, their pay-for-performance programs will work perfectly, as if the ratings were the only reason for ineffective outcomes in the first place. However, just as we know that great people managers exist under both rating and rating-less programs, we know organizations with effective performance management also represent those with ratings or rating-less programs. The simple truth is that doing away with ratings will not help your managers become better at differentiating performance, coaching employees or having tough conversations if they are not skilled at doing so in the first place.

Rather, ratings are just one aspect, and a comprehensive approach is needed for performance to be sustained over time, starting with clearly defining and articulating performance – that is, is it just about last year's performance or also values, behaviors and/or future potential? Are managers skilled at describing performance and coaching on performance? It's been a recent trend to encourage managers to have more regular "check-ins" and ongoing dialogue with their reports. Often we find that managers are not clear on what to discuss during performance conversations, and more problematic is when the discussions do not align with the compensation outcome at year-end. Whether the program is with ratings or without ratings, it is critical to upskill managers to understand and coach absolute and relative performance. For example, some managers set easier goals for their people, so as to avoid having challenging discussions throughout the year. However, on a relative basis, their people may not been performing to as high a degree and this may ultimately come back to hurt versus help.

Q Hathaway: This again suggests that we need to take a very broad view in evaluating all the aspects of pay for performance in order to determine the source of ineffectiveness. Is it in the program design? Is it in the goal setting? Is it part of performance management? Is it the way that managers are delivering this? Is supporting technology helping?

Rob, can you help us think through how organizations get started in identifying the sources of their problems with pay for performance?

A Mustich: A diagnostic can help an organization get started in taking a more comprehensive approach. It's important to step back and start at a high level. Identify your strategy and principles, take an inventory of your programs and assess how well these programs are aligned. Next, you should examine how you deploy rewards for the different types of jobs across the organization. Are the rewards aligned with performance management? Next, assess how well you are delivering your reward portfolio and whether your culture supports it.

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We've worked with clients to develop well-designed incentive plans. But if employees don't understand the plan and how it works, and the culture doesn't support it, pay for performance will not work very well.

It can be very daunting to do a program-by-program assessment without a road map and tool such as our diagnostic. With the diagnostic, gaps in programs can be identified and corrected from a holistic perspective. It's important to understand the implications of a given program change against the full portfolio of programs since they can be interdependent. We have found that organizations that assess their programs in this way get better results.

Q Hathaway: It's been my experience that reward professionals have a tendency to dive straight into design regardless of the issue with reward programs. In fact, design is not always the issue. Many of the best-designed programs fall short due to ineffective delivery.

Communications is a big part of the delivery. Lara, can you help us understand what best practice looks like and what organizations should think about in communicating pay for performance?

A Paukovits: Employees today expect their employers to provide a consumer-grade employee experience. So we need to keep this in mind in thinking about how to communicate pay for performance. This doesn't have to be a terribly daunting task. It comes down to the basics of identifying who your stakeholders are, what mindset and behavior changes you want to drive, and how you can best engage and influence them.

First, identify the stakeholders you are trying to reach. Think about segmenting your audiences, which enables you to adapt the design and delivery of your programs and processes to the needs and desires of different groups.

Next, know what motivates your employee segments and think about how you can personalize the pay-for-performance experience for them.

Finding ways to interact with employees that feel more personalized, consumer-grade and integrated is important. Having a holistic brand helps employees perceive all communications as seamless and connected. For example, the look, feel and tone of communications about compensation should be the same as that of performance management. Otherwise, there's going to be a disconnect.

Through all of this, we need to be thoughtful about engaging employees at the right time, so they will have a complete understanding of how their performance will be evaluated and how that will link to pay. And we should be engaging employees in ongoing conversations to support pay for performance throughout the year and throughout their careers.

Q Hathaway: Technology is becoming increasingly important in HR activities. Jenn, can you help us understand how we can use technology to improve the effectiveness of our programs or lessen the pain or become more efficient?

A Kelly: Technology allows companies to take a consistent global approach to deploying pay-for-performance programs. However, in delivering the programs, employees expect a personalized experience. So organizations need to deliver programs in a way that makes sense for the organization but still provides a personalized experience for the employees.

Your compensation planning software can help you get started. You can provide managers with all the data they need in one place at the right level and at the right time, which will help them make better decisions and more effectively communicate those decisions to their employees.

Managers also need to ensure they know what's important to their employees. Not all employees want to be rewarded in the same way. Some may prefer a flexible schedule, training opportunities or even the chance to participate in creative activities, such as a hackathon, rather than a cash reward. Managers can obtain information on employee preferences either via employee engagement surveys or by collecting data within an existing solution – for example, career or performance management software.

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Organizations can use their online Total Rewards statement to communicate to their employees the value of all their rewards. Cash is only one part of their total compensation package.

All these tools are enabling employers to get the information into the hands of their managers in a more efficient way. Ultimately, this creates greater transparency, provides a better employee experience and helps employees appreciate the value of their work.

A Hathaway: In summary, for organizations to improve the effectiveness of pay-for-performance programs and truly get the desired return on their investment, they need to take an enterprise-wide view. It's not appropriate to just look at the executives or the sales team, nor should they look at the bonus plan in isolation.

A thorough diagnostic review will ensure that all programs that are linked to performance, cash and non-cash, are evaluated – that they are assessed against the strategic aims of the organization, its culture and values and that the way the programs are delivered aids their effectiveness.

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