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The State of the Compensation Practice

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The first edition of *The Compensation Handbook* was a snapshot of the compensation practice as it had evolved prior to 1972. Each subsequent edition was a time capsule containing a rich trove of information representing the cumulative successes of its predecessors as well as the best new practices, issues, procedures, and processes that would be useful in the future. This sixth edition extends this evolution of knowledge to the current time. It shows that today's successful compensation practice has evolved into five blended elements:

1. Expertise
2. Codified methodologies
3. Decision-making tools
4. Databases
5. Monitoring

Expertise

Expertise refers to a particular knowledge or skill in specific practices or disciplines. Every organization needs a designated group of people with a sufficient level of expertise in compensation practice to develop and implement or outsource effectively their pay programs. This group could include any combination of compensation professionals, human resources generalists, and line managers.

Because most organizations in the United States are small firms, the overwhelming number of people involved in directing compensation programs are line managers.

Level of expertise can be classified in many ways, including basic, operational, tactical, and strategic.

1. *Basic*. Knows the fundamental principles, terminology, concepts, issues, applications, and vendors associated with the compensation discipline. This is the minimal level of expertise expected for a line manager.
2. *Operational*. Able to implement compensation programs provided by, and with guidance from, others with higher levels of expertise. This is a realistic level of expertise for most managers, entry-level compensation professionals, and human resources generalists.
3. *Tactical*. Develops and implements compensation programs with minimal assistance from outsiders. Can coach others in implementing a compensation program. This is the expected level of an experienced compensation professional.
4. *Strategic*. Creates, implements, provides guidance, troubleshoots, and answers questions related to the compensation discipline. This is a recognized expert in the compensation discipline.

Over the course of time, the various editions of *The Compensation Handbook* have shown that readers have been seeking guidance in moving toward the strategic level of expertise. The chapters in this book seek to provide a context relevant to all four levels of expertise.

The expansion of formal and disciplined knowledge in the compensation practice was accelerated by the growth of WorldatWork, particularly its certification programs. It did so through workshops, seminars, webinars, and formal credit and noncredit courses. WorldatWork programs were supplemented by additional offerings conducted by consulting firms, universities, software companies, and other organizations with stakeholders associated with the compensation practice.

Chapter 5, written by WorldatWork professionals Brian Moore and Sue Holloway, outlines six professional training and technical skills that represent the building blocks for growth in the profession:

1. Designing and administering base-pay programs
2. Designing and administering variable-pay programs
3. Integrating compensation programs with business strategy
4. Complying with legal and regulatory requirements
5. Communicating compensation information
6. Designing and administering other total rewards programs

The "WorldatWork 2012 Total Rewards Professionals' Career Census" revealed eight key differentiators of top total rewards performers:

1. Technical mastery
2. Strategic business understanding
3. Analytical skills and attention to detail
4. Communication and connection

5. Adaptability and flexibility
6. Passion and proactivity
7. Continuous learning
8. Development support system

Collectively, the six building blocks and eight differentiators create a framework for viewing the role of compensation practitioners. The four levels of expertise descibed previously can be applied to this framework to generate a profile of the level of compensation practioner required by the organization.

Codified Methodologies

Codified methodologies are the documented processes, practices, and policies that enable organizations to define, replicate, adapt, and effectively implement compensation programs. Codification emerged from the experience of the successful compensation programs of the organizations themselves; the shared best practices of several organizations, consulting firms, and associations; WorldatWork publications; and materials produced by vendors. Codified methodologies embrace and combine within one place the goals, objectives, programs, processes, databases, and analytical and decision-making tools associated with specific compensation goals, strategies, and outcomes. Since the first edition of *The Compensation Handbook*, the most codified methodologies include job evaluation, market pricing, and salary administration. Chapters addressing these issues can be found in Part II of this book.

Each new edition of *The Compensation Handbook* has reflected only small changes in codified salary administration practices. Since the last edition, one important change in this edition, noted by Michael Armstrong in Chapter 8, is that "progressively … the original concept of broad banding was eroded as more structure was introduced and job evaluation became more prominent to define the structure. . . . Job evaluation was used not only to define the boundaries of the band but to size jobs as a basis for deciding where reference points should be placed in conjunction with market pricing."

Perhaps the newest tweak adopted by some organizations is alternative merit pay plans. Performance increases under these plans are not frozen into base pay each year but rather are earned annually. These "variable merit" plans more heavily incent and reward employee achievement and/or the demonstration of success competencies. They are budgeted as part of an affordable merit increase pool. The acceptance of this type of pay plan, described by Dorothy Berger in Chapter 4, is evolving gradually.

The evolution of the compensation practice indicates that a successful compensation practice must codify three major elements: philosophy, strategy, and administration.

1. Compensation Philosophy

A compensation philosophy contains a widely publicized set of core principles, values, and mutual expectations that are the foundations of employee pay. It is the basis of an organization's pay strategy. Organizations align their compensation philosophy with their business and human resources requirements. Most commonly, an organization's compensation philosophy focuses on delivering pay, based on institutional affordability, in a way that enables the organization to attract, retain, and reward employee performance in an equitable, competitive, and legal way.

2. Compensation Strategy

Compensation strategies tell the organization how it will allocate employee pay based on its compensation philosophy. Tom Wilson in Chapter 3 writes, "A strategy helps to focus goal setting, guidelines, policies, practices, behaviors, and investments." Steve Gross and Mandy Rook in Chapter 2 describe compensation strategy as the allocation of total rewards in both holistic (recognizing all the tools in a rewards toolkit) and customized (using the right tool for the right job) approach. A typical compensation strategy consists of five codified components. They are affordability, pay markets, competitive level, mix of compensation elements, and employee contribution.

> *Affordability.* Every organization must determine the overall level of base pay and all other forms of compensation that it can afford to pay in at least two successive years based on its current and projected growth level. Two-year intervals are always selected to gauge the multiyear impact of changes in proposed annual compensation adjustments. Because base salaries represent the largest amount of employee pay, the aggregate cost of base salary midpoints (the salary structure) is the starting point for the determination of affordability. Once this is accomplished, the organization can establish the potential funding pools for annual salary increases and for variable pay programs.
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> *Pay markets.* In order to determine the competitiveness of pay associated with a given position, an organization must survey its talent market. A talent market consists of incumbents who have been or can be a source of recruitment for or candidates for "pirating" by other organizations. Surveyed compensation for people in benchmark (commonly found) jobs in a chosen talent market should be the basis for an organization establishing pay. The best surveys are those that accurately measure a pay market derived from current and projected sources of recruitment and exit interviews. Positions within a talent market that have no survey counterpart can derive their value from a comparison of relative internal organizational worth with the jobs that can be surveyed. Note that talent market competitors may not necessarily be in the same business as your company. Most companies will have multiple talent markets. Chapter 11 describes the use of surveys in pay market measurement.
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> *Competitive level.* Within each market and within the organization as a whole, management must determine the competitive level of total human resources costs the organization can afford and is willing to pay to attract, retain, and reward employees. Competitive level is generally expressed as a percentile level of pay in positions in surveys associated with a given talent market (25th, 50th, 75th). The total affordable pot of money is the basis of pay allocation. It is possible that the characteristics of different pay markets (supply and demand) will necessitate different pay structures and competitive levels.
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> *Mix.* The percentage of total pay targeted for each pay component (base salary, annual incentives, and long-term incentives) defines its mix. Furthermore, within a total pay package, there may be different competitive levels targeted for base pay, annual incentives, long-term incentives, and total compensation. The mix of compensation, as well as competitive level, could be different for different pay markets. The greater the amount of variable or nonbase pay, the more leverage (upside opportunity) or risk (nonguaranteed pay) becomes a factor in an employee's compensation package. In general, the level of risk or leverage decreases in employee

pay packages as an organization evolves from that of a precarious startup to that of a secure establishment. Within an organization, the amount of leverage in a pay package also reflects the risk and accountability associated with a given position. Senior management and line positions typically have more variable pay than staff positions. Generally, codified methodologies for risk-oriented variable pay also have evolved slowly since the first edition of this book. Part III of this edition covers codified methodologies for variable pay.

Employee contribution. Compensation strategies typically consider the actual and projected levels of employee contribution. Compensation philosophies and strategies state the organization's approach to allocating pay packages that it judges to be best to incent, engage, ensure retention, reinforce advancement, and facilitate recruitment of employees who are high achievers, deemed to have high potential, and/or are backups for key positions. Once compensation is allocated to employees in these critical categories, it is distributed for the remaining employee population. Employees in this group must at least meet organizational expectations for performance. Andrew Rosen in Chapter 7 and Myrna Hellerman and James Kochanski in Chapter 9 link employee contribution to pay programs.

3. Salary Administration

Salary administration is the packaged set of policies, methods, and procedures that guides professionals and line managers in the implementation of their compensation strategy. Salary administration elements that characteristically have been codified include compensation philosophy (discussed previously), responsibilities of compensation professionals and managers in salary administration, employee communication, and basic components, including

1. Position descriptions
2. Job evaluation
3. Salary surveys
4. Salary structures
5. Performance evaluation
6. Merit increases
7. Promotions and promotional increases

The details of each component of codified salary administration programs are covered in Part II.

Regardless of the reader's approach to codification, Tom Wilson in Chapter 3 provides a useful lesson. He recommends that every reward program must have a stated purpose that must answer three critical questions:

1. Why does the program exist?
2. Why is it meaningful to employees?
3. How does it give the organization a competitive advantage?

Decision-Making Tools

Decision-making tools enable compensation practitioners to determine the kinds of processes that will best help them to develop, implement, and monitor their own compensation philosophy, strategy, and administrative and monitoring programs. Decision-making tools have become integral to selecting appropriate compensation methodologies and to converting information in "big databases" to high-value accurate, quick, and timely decisions. They are also critical to monitoring the actual outcomes of targeted compensation programs.

In Chapter 33, Martin Wolf helps readers to make a choice of the best performance appraisal methodologies for their organization. Michael Armstrong and Paul Thompson, in Chapter 10, describe the best options in job evaluation methodology, whereas Linda Amuso, in Chapter 15, and Erin Packwood, in Chapter 16, cover requirements for selecting different types of variable compensation programs. Dorothy Berger, in Chapter 4, helps readers to identify the pay plans that are useful for supporting desired organizational culture, whereas Deborah Rees, in Chapter 39, suggested novel compensation approaches based on type of employee.

This book is replete with other decision-making tools that will help practitioners to select and use methodologies to determine the type of compensation program that is best for their organizations.

Databases

Data have been central to the compensation practice since its inception. Data on jobs, employee pay, market pay, and numerous other areas of talent management have now exploded with the advancement of technology and data-collection devices into what we refer to as *big data*. Big data combines multiple data elements into a cogent process that enables better compensation decisions faster and more accurately. It is now easier to combine business, culture, talent management, and compensation data elements into understandable decision points. Although big data is becoming an integral part of business operations for a growing number of organizations, many compensation practitioners and line managers find it to be ambiguous, confusing, and intimidating. It appears to them that big data is an insurmountable barrier. This barrier, however, is not insurmountable, and Part IX of this edition is designed to help readers find and use the level of big data that is appropriate to their organizations.

In Chapter 46, I suggest that most organizations can use big data simply by linking readily available information on compensation policies and practices and business data to talent management and/or employee culture data. Every organization can develop a scorecard that will tell it whether

1. Organization-wide employee evaluation and total salary increases based on performance appraisal systems correlate with organization and unit performance.
2. Compensation is appropriately distributed to critical groups (high performers, high potentials, backups for key positions, and employees with demonstrated high levels of key competencies).
3. Pay is not a cause of turnover in critical employee groups.
4. Pay is perceived as fair and consistent with organization values.
5. Compensation strategies are administered effectively.

According to David Turetsky (Chapter 48), "'big data' leverages the 'small data' and the 'data' platforms to build a more complete picture of the enterprise. It leverages disparate system data together to form a union of unlikely confederations into a symphony of knowledge and intelligence. The value of the big data effort is greater than the sum of the parts of the lower-level interconnections." Turetsky also talks about the role of big data in analyzing outcomes such as those identified in Table 1.1.

Base Salary	Incentives	Pay Equity
• Is our merit increase program effective? • If we increased our merit budget by 1percent, can we expect a 1 percent increase in performance?	• Are we rewarding the right behaviors? • Do our goals reflect the organizational objectives?	• Do we pay too much for certain roles? • What does pay equity mean for our organization?
Market Position	**Succession**	**Grades/ Structures**
• Do we know how much it would cost in salary and incentive to get everyone to the market on total cash compensation? • Do the reward programs, as currently designed, achieve the goals of the organization?	• Are our high potentials on track to be able to achieve the minimum of the range for the job for which they are successors? • Are we compensating the right people?	• Do our grade levels represent the appropriate groupings of job responsibility and impact to the organization? • Do our salary structures represent the market for the current job market?

Table 1.1

Dan Weber, in Chapter 47, suggests that compensation professionals will continue to be called on to respond to business inquiries. To prepare for these types of inquiries, such professionals should be familiar with four areas:

1. Where and how the business currently generates value (current operations)
2. Where the business anticipates growth, expansion, and change (strategic plan)
3. The data currently available within company compensation and human resources information systems (HRIS)
4. External sources of data, such as market surveys, government agencies, and other organizations

Weber also suggests that readers consider three approaches to big-data issues:

1. Understanding the issues to be addressed, including the potential for big data to solve an issue, specific desired outcomes, and the perceptions and concerns of stakeholders
2. Understanding the full range of forces that can influence the desired outcome

3. Thinking beyond the numbers because many decision factors cannot be easily tracked or accounted for in a statistical analysis

Ezra Schneier, in Chapter 49, states that big data can help an organization to achieve three broad goals:

1. Enhanced engagement and retention
2. Better alignment of individual efforts and organizational goals
3. Improved business results

He cites the following big-data processes that can help to achieve these organizational goals:

- Evaluating compensation along with other elements of rewards to determine what matters to employees
- Increasing the frequency of evaluating compensation and the mix of factors considered in determining compensation levels and awards
- Communicating total rewards and walk-away value to improve retention and engagement

It is clear from the big-data section that the expansion of big-data technologies and their pervasive adoption by organizations of all sizes and practitioners at all levels will be an integral component of state-of-the-art compensation practices in the future.

Monitoring

Monitoring compensation practices means anticipating, creating, and/or responding to change triggers that can affect compensation programs. These change triggers include business, environmental, cultural, and talent-management factors. Monitoring compensation practices is a change-management program.

Steve Gross and Mandy Rook, in Chapter 2, allude to the need for clearly defining the organization's total rewards principles in order to assess their current and future state against these principles. A gap analysis then can be conducted to assess misalignments between the existing rewards programs and the desired overarching principles. A blueprint then can be created to define the extent of change management required to migrate to the desired state. When an organization seeks change, it may be a difficult undertaking. Systems, processes, and people must adapt. Compensation management systems may need to accommodate multiple base pay and incentive programs, compensation, training, and development; recruiting may need to make tradeoffs across historically siloed budgets, and managers will need to handle more challenging conversations about an individual's compensation, benefits, and career. Once an organization has changed, it must be prepared to change again. Business strategies evolve continuously. If the total rewards strategy does not keep pace, costly misalignments can occur, hindering business progress and diminishing return on investment. Maintaining the total rewards principles and frequently reviewing their appropriateness, effectiveness, and applicability are suggested preventive measures to avoid having an established total rewards program become disconnected from the internal requirements (both employer and employee) and the external market. When programs are disconnected, they threaten the competitive advantage of the organization that was created initially with the development and implementation of its total rewards strategy. Overcoming these challenges, according to Gross and Rook, requires leadership support, pragmatic segmentation (recognizing meaningful differences in workforce segments), and comprehensive implementation and communication change management with an eye on both the present and the future.

In Chapter 6, Joe Martocchio talks about anticipating compensation issues that are "a mix of complex economic, social, and demographic dynamics. Each of these challenges will require that compensation professionals anticipate policy and compensation system design features that will serve the interests of shareholders and employees."

Organizations should have a formal audit program that uses credible, high-quality, reliable, timely, and cost-effective information to assess whether their codified metholdogies, decision-making tools, and databases are yielding the targeted business, culture, and talent-management outcomes.