Focused Compensation

The economic pressures businesses face today mandate a keen focus on compensation to help ensure that talent is properly motivated, rewarded and retained.

What role does compensation play in employee motivation? According to the work of Frederick Herzberg, clinical psychologist and pioneer of 'job enrichment,' an employee is demotivated if compensation is thought to be inadequate. If the employee perceives their compensation to be adequate, however, compensation is not a sustaining motivator. What is “adequate” compensation? Employee assessments typically include a reference to the pay they might earn by taking their skills into the market.

Motivation is both complex and individualized. Intrinsic motivators are also very important in motivation. We have experienced this first-hand when we ask employees what would cause them to leave their company. Compensation is seldom ranked in the top three responses. Those slots are generally occupied by intrinsic motivators: work product no longer being appreciated, work not being challenging or interesting, and lack of opportunity to grow skills.

Are you doing enough to ensure compensation in your company is not a demotivator? Start by answering this question: “Is your compensation strategy attracting and retaining the human capital you need to power your business today and tomorrow?” If your answer is “yes,” you are probably fine. If your answer is “no” or “not so sure,” you should consider the following steps.

Take a look at the market for the labor pools in which you operate to ensure you have the total annual compensation of key employees properly positioned to attract the talent needed to power your business. This is different for every company, so remember to link human capital strategies (including compensation) to overall business strategies.

What tools do you utilize to perform this type of market assessment? Our experience is that privately-held companies usually determine compensation competitiveness by way of periodic market surveys. However, using such market surveys is easier said than done. Few positions within a company are exact matches to the survey data. In order to have an “apples to apples” comparison, you often need to blend surveyed positions to match actual employee responsibilities more closely.

Moving into the realm of long-term compensation, the survey data gets spotty. However, such compensation is of vital importance to a company. Why? You don’t want key employees to focus only on the results of the current year. Investments that benefit future operations often negatively impact current results, especially when you consider the cost of time spent pursuing these opportunities. Unless you invest in the future, you run the risk that such options are ignored, and the company suffers stagnation and decline.

In addition to helping sustain a focus on the future, long-term compensation plans can enhance employee retention when properly structured. Important structuring considerations include how the amounts vest. If the employee leaves prior to vesting, they forfeit accrued amounts. We are consistently amazed at how many companies have all of the money for key employees on the table; nothing is forfeited in the event of their departure. Will such forfeitable amounts prevent all departures? Of course not, but it will help.

If you are considering long-term compensation for key employees, you will likely enter the world of non-qualified compensation, which means that such compensation plans are not covered by

ERISA (Employee Retirement Income Security Act). Therefore, plans can discriminate in favor of key employees. This allows you to efficiently provide laser-focused compensation, versus spreading it over the entire employee base. These types of plans offer an almost endless variety of solutions. Ah, but there is the rub! If you aren't crystal clear on exactly what you're trying to accomplish, it's easy to craft a design that doesn't add value.

The design difficulty of non-qualified plans comes from the need to balance both simplicity and complexity. You need to have a plan in which participants understand what they must do and how they must behave in order to "win" or you've wasted your money. However, seldom does just one measurement provide an appropriate measure of long-term success. We have seen companies add so many measurements to their plan that employee understanding is seriously impaired. If you already have a non-qualified compensation plan, ask participants what they must do to have both the company and themselves win. You might be surprised by the response.

Tax and asset protection issues must also be considered when adopting a long-term plan. While there are many regulations and nuances involved, the general rule is that the company deducts long-term compensation when the employee recognizes the amounts as taxable income (generally ordinary income). As to the asset protection concerns, the individual to whom payments are due remains a general creditor of the company, and such accruals are at risk throughout the accrual period.

If you haven't recently explored these compensation issues within your company, now might be the time. The loss of talent is a serious blow these days; good people are hard to find. Properly focused compensation is an essential ingredient of success!

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