The Importance of Defining Your “Compensation Philosophy”

Louisiana SHRM Annual Conference
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According to the Bing and Merriam-Webster Dictionaries, “philosophy” is the...

1. Examination of basic concepts
2. System of thought or doctrine
3. Guiding or underlying principles and concepts
4. A set of ideas about how to do something
Compensation Philosophy…

A system of thought and/or principles that guide an organization’s decision-making with regard to the composition and distribution of formal rewards.

It results in a unified set of policies, practices, systems and perhaps a set of plans.

A well stated philosophy will address:

• What?
• Why, or on what basis?
• How?
• How Much?
• How Often?

AND,
do so in a way that best supports attainment of the organization’s mission, vision, and strategic objectives.
Learning Objectives

Addressing the compensation philosophy and approach options for at each of the following:

1. Base pay/salary structures

2. Premium pay and overtime offsets

3. Bonuses, incentives and contingency-based reward programs

4. Retirement programs and other employee benefit plans
Base Pay/Salary Structures
Why Use Pay/Salary Structures?

A salary structure defines the relationship between the “internal value” placed upon jobs within the organization relative to the “external value” found in the market place.
1. **Ranking Method:** Too simplistic for growing organizations with multiple jobs

2. **Classification System:** Very complex and used only by very large/complex organizations (i.e., federal, state & municipal governments)

3. **Factor-Comparison Method:** Complex and rarely used today as most employers have abandoned this approach in favor of the Point-Factor approach

4. **Point-Factor Method:** Heavily used by larger private or publicly traded business organizations, particularly where there is scarce “benchmark” data and/or the need for discrete differences between jobs. Requires validated “job evaluation plan” and ongoing committee involvement to ensure integrity and acceptance of process

5. **Standard Salary Table:** Very suitable to small and mid-size employers as well as larger organizations that have an abundance of reliable market data for comparable jobs in comparable organizations
Competitive Pay Practices & Strategies
The Anatomy of a Pay Range

- **Minimum**
- **1st Quartile**
- **2nd Quartile**
- **3rd Quartile**
- **4th Quartile**
- **Midpoint**
- **Market Minimum**
- **Market Mean/Median ("Going Rate")**
- **Market Maximum**
“Market Competitive” Strategy

- Maximum
- Midpoint
- Minimum

Market Minimum
Market Mean/Median (“Going Rate”)
Market Maximum

1st Quartile
2nd Quartile
3rd Quartile
4th Quartile
“Lead” Strategy

- **Maximum**
  - 4th Quartile
  - 3rd Quartile
  - 2nd Quartile
  - 1st Quartile

- **Midpoint**

- **Minimum**
  - Market Maximum
  - Market Mean/Median (“Going Rate”)
  - Market Minimum

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“Lag” Strategy

- Minimum
- Midpoint
- Maximum

- 1st Quartile
- 2nd Quartile
- 3rd Quartile
- 4th Quartile

- Market Minimum
- Market Mean/Median (“Going Rate”)
- Market Maximum

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“Broad Band” Strategy

Maximum

4th Quartile

Market Maximum

Midpoint

3rd Quartile

Market Mean/Median (“Going Rate”)

Minimum

2nd Quartile

Market Minimum

1st Quartile
Normal Progression within a Pay Range

- **Minimum**
- **Midpoint**
- **Maximum**

- **1st Quartile**
- **2nd Quartile**
- **3rd Quartile**
- **4th Quartile**

- **Market Minimum**
- **Market Mean/Median ("Going Rate")**
- **Market Maximum**
Normal Progression Issues

Common Modes of Normal Salary Progression (aka “raises”):

1. Step Progressions (Defined Intervals)
2. Cost of Living Adjustments (COLA)
3. Competitive General Increases (Across-the-Board)
4. Straight Merit Increases (Individual Performance)
5. Matrixed Merit Increases (Individual Performance AND Current Pay)
6. Competency Increases (Based Upon Attainment of Individual Competencies)

*Question:* Which approach, or combination of approaches, will you use?
# Maintaining the Structure

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| Annual                  | a) Adjust pay ranges based upon forecasts of what other employers will be doing during the next year  
                          | b) Establish and implement salary increase budget based upon forecasts concerning the type and amount of increases to be granted by similar employers  
                          | Both these activities will normally involve the use of Salary Budget Surveys, the ECI and CPI |
| Every 3 to 5 years      | Complete restatement of salary structure                                             |
Premium Pay
&
Overtime Offsets
Premium Pay: Additional pay that an employer may, or may not, grant in exchange for performing services at less favorable times, or under less favorable conditions.

Common Forms of Premium Pay:

- Shift differentials
- Holiday differentials
- Weekend differentials
- Premium for working back-to-back shifts
- Stand-by pay

Note: As a general rule, any premium pay greater than or equal to \( \frac{1}{2} \) of the normal hourly rate is excludable from the overtime base rate, AND can be used to offset any overtime payment the employee may be due to receive.

Questions:

1. Will you provide premium pay? To whom? For what?
2. Can employees earn multiple forms of premium pay simultaneously?
3. Should the employee work overtime, will you offset the premium pay against overtime liability?
Bonuses, Incentives and Contingency-Based Rewards
Problems with Pay-for-Performance

1. Salary increases (aka “rewards”) are often non-existent or meaningless during periods of economic stagnation or decline

2. Erosion of the rewards/gains \((via \text{ normal inflation and other economic factors})\)

3. Inherent “zero-sum game” (i.e., grading on a curve) associated with employee ranking, forced distributions, and other forms of “robbing Peter to pay Paul”

4. Subjectivity of performance reviews where “above average” is usually the real average with most performance reviews

5. Always add to “fixed cost” which is compounded year-over-year
Final Pitfall…

By design (and by law), base pay programs for both exempt or non-exempt, compensate employees…

- **Not** for production,
- **Not** for results,
- **Not** for achievement,
- **Not** for service,

But for **TIME**, including LENGTH OF SERVICE and LOYALTY!!!
Advantages of Variable Pay Strategies

- Supplemental to base pay/salary programs

- Structured appropriately, only payable when the organization can afford to provide the rewards (i.e., “trigger” criteria)

- Can be structured to reward individual, team, unit or organizational accomplishment, as well as individual growth & development

- Can be structured to capitalize on the “surprise” factor

- Generally do not add to “fixed cost” if renewable each year

- Can be used in combination to reward “different” but “important” behaviors

- Create “win/win” scenarios involving “upside inducements” with minimal “downside risk” or “fixed cost” to either the employer or to its employees

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1. Using salary as the exclusive formal reward system adds to “fixed cost” in the provision of services to constituents and the community.

2. Incentive pay and other variable compensation is not just a pay system or process to extract value. Rather it is a management tool that ought to produce greater value to the organization and those it serves than to the recipients.

3. Incentive pay is not “extra pay” but a different form of pay conditioned upon outcomes and adding value to those being served.

4. Nonprofits often compete with for-profits for talent and leadership. Incentive pay offers a means of offering competitive total compensation without adding to the fixed expense burden.

5. Structured appropriately, variable pay programs need not violate the private benefit and inurement prohibitions for nonprofits.
Selecting the Right Approach

1. Determine the behaviors you want to encourage, reinforce and reward

2. Select the program, or a combination of programs, that would best reward those behaviors. In making these selections, consider the following:

- The approach selected should “supplement” your base pay and salary administration strategy, and not “replicate” rewarding the same behavior

- Be sure your approach does not undermine the desired behavior or culture!

- Select an approach that is “affordable”! When in doubt…modesty works best!!!

- Consider using a “multi-level” approach to spread the inducements across numerous desired behaviors. *Guard against overlap, there is no sense in rewarding the same thing multiple times, and in multiple ways, while letting other desired behaviors go unaddressed*
Retirement Programs & Other Employee Benefit Plans
Total Remuneration

Relative Value

How do we best appropriate for our workforce?

What do they value?
- Paid time off
- Security (Insurance)
- Retirement
- Straight Cash???

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In putting together the compensation philosophy for your organization, be sure to consider things from multiple perspectives!

THINK LIKE A...

- Recruiter/Retainer
- People Developer
- Production Manager
- Marketing & Business Strategist
- Controller/CFO
- Chief Executive Officer/Board Member
Questions/Comments ???
Jim offers seasoned experience as a strategic and organizational planning consultant, change agent, and executive. He has assisted numerous clients implement the organizational architecture, structure, infrastructure, and strategic plans required to achieve their visions and goals. In addition, he has assisted other organizations build strategically-focused and highly successful compensation, reward and other human resource management programs by introducing forward thinking approaches to talent management.

Jim currently serves as the Human Resource & Professional Development Officer for the Louisiana Legislative Auditor (LLA). For the twelve years immediately preceding his association with the LLA he maintained an independent consulting practice under the umbrella of JT Stodd & Associates, a firm specializing in organizational planning, change management and human resource management, and continues to maintain a part-time consulting practice with select organizations.

In addition, Jim served on the consulting staffs of several prominent firms including Ernst & Young, LLP, the Hay Group, and First Transitions, as well as served as chief human resource officer of three other prominent organizations each of which were undergoing a period of rapid and pervasive change during the course of his tenure.

Throughout his career Jim has also been active both as a teacher and speaker. He has taught classes in Organizational Leadership and Human Resource Management at Louisiana State University, the University of Louisiana-Lafayette, and for eight years taught at the University of California-Irvine where he received UCI’s “2010 Distinguished Instructor” award.