

WORLDATWORK 50TH ANNUAL CONFERENCE & EXHIBITION

Filling in the Blanks:

1. What's on Tap for the Rewards Profession?

By – Jay Schuster and Patricia Zingheim

2. Incentive Goal Setting in the New World

By – Douglas Wilson and Lynn Joy



1. What's on Tap for the Rewards Profession

- Code of Ethics
 - Current Environment
 - Predictions
- Predictions
 - Executive Compensation
 - Performance Culture
 - Performance Management
 - Pay for Performance
 - “Superkeepers”
 - Competitive Compensation
- Role of Reward Professional
 - Current Environment
 - Predictions



Code Of Ethics

- **Environment**
 - Consultants and practitioners in news for wrong reasons
 - Rewards profession not a “licensed” profession
 - Other professions would censor unethical behaviour and breach of code of conduct



Code Of Ethics

- **Predictions**
 - Start self-monitoring or government will regulate
 - Initiate process
 - Gather practitioner/consultant opinions
 - Extent to which they believe issues of ethics exist
 - Confidential study of pressures, issues, and incidents of ethics problems
 - Create a panel of peers to consider how to deal with it
 - Studying issues will bring attention and moderate inappropriate behaviour



Executive Compensation

- **Predictions**
 - Total compensation focus-all elements
 - Fewer piecemeal recommendations
 - Less discretion, more performance-based and market-based
 - Performance-based compensation
 - Beyond time-based restricted stock to
 - Performance shares / performance-based restricted stock
 - A bit more moderated pay in long run



Performance Culture

- **Predictions**

- Successful organisations use all tools
 - **Leadership:** Selection, development, people accountabilities, goal setting and results accountability
 - **Organisation structure:** Design, levels, teams, customer focus
 - **Work processes:** Streamline, automate, performance metrics, empowerment, continuous improvement
 - **People:** Flexibility, skills/competencies, development and performance management
 - **Rewards and recognition:** Clear link to and differentiation based on results, variable pay, link with performance management



Performance Management

- **Predictions**

- Goal setting will intensify-organisations with goal setting at team/individual level find:
 - Employees feel more connected/involved
 - More likely to accomplish organisational goals
- Business competitiveness means raising the performance bar
 - Next focus: calibration of performance levels
 - If most employees are high contributors, probable that performance bar should be raised
 - Adjust size of outstanding performer population
 - Guideline of 10% - 15% of population
- Involvement as strategy for engagement



Pay For Performance

- **Predictions**

- Pay decisions taken out of individual manager's hands
 - Managers reporting to higher-level manager meet to discuss performance and value added and pay changes of employees reporting to them
 - Manage budget at higher organisational level
- Focus on base pay after adjustment and dollar amount of increase, not percentage increase, to determine overall value
 - Meeting expectations may not result in salary increase
 - Gift that keeps on giving base pay increase is forever
 - Must continue to increase value to get increase



Pay For Performance

- **Predictions**

- Acknowledge base pay as serving many roles in determining an individual's ongoing value and varies depending on situation
 - Sustained performance over time
 - Competitive labor market
 - Skills/competencies
- When labour demand greater than supply, provide additional budget for special high performers
- More and more variable pay
 - Justify results/reward relationship



“Superkeepers”

- **Predictions**

- As move to high-performance culture, develop/use tools to retain superkeepers
 - Identify superkeepers based on business strategy/plan
 - Competencies/skills core/critical to organisation
 - Value added-current and predicted future
 - Keep superkeepers informed of future opportunities
 - Actively develop superkeepers for future roles
- More creativity in addressing rewards
 - Making sure total cash compensation reflects increasing value-don't lag
 - Long-term compensation to encourage retention



Competitive Compensation

- **Predictions**

- Real-time, up to date survey data: more automation
- Total reward focus to counteract single pay element
- Competitiveness will vary based on closeness to organisation's core/critical competencies (strategic valuing)
- Skills/competencies, not jobs, will provide definition to market in 5 years
 - Skills/competencies being gathered on Internet by a few companies
 - Future labour shortages will drive skills/competencies, not jobs
 - Easier skills/competencies application in future



Role Of Reward Professional

- **Environment**

- Good time to be in the pay and rewards “hot seat”
 - CEOs are demanding more value from compensation expenditures
 - Financial management of compensation expenses represents major cost of doing business
- Internet and Intranet tools increase efficiency
- Trend is outsourcing administration-particularly benefits
 - Time to decide about outsourcing compensation
 - » Easier to outsource if focus is competitiveness
 - » Harder if rewards are used as strong communicator of directions, goals and values



Role Of Reward Profession

- **Prediction**

- Several ways organisations will go

- Require HR to make programs relevant to the organisation's business-linked, aligned, integrated

- Strategic partner

- Effective translator of business direction into HR programs

- Proactively propose ways and follow through to get stronger linkage

- Engage leaders with an effective business case

- Educator/communicator: engage people

- Outcomes research



Role Of Reward Professional

- Adopt practices that better match how business values people
 - Performance culture: lead the charge to brand the organisation in terms of high performance
 - Paying for performance: metrics from business and tools to deliver honest and differentiated pay for performance
 - Superkeepers: top 10%/20% of the workforce need to get enough of rewards to make ranking at the top worthwhile
 - Educate leadership on ethical issues
 - Think longer term to position HR for future



2. Incentive Goal Setting in the new world



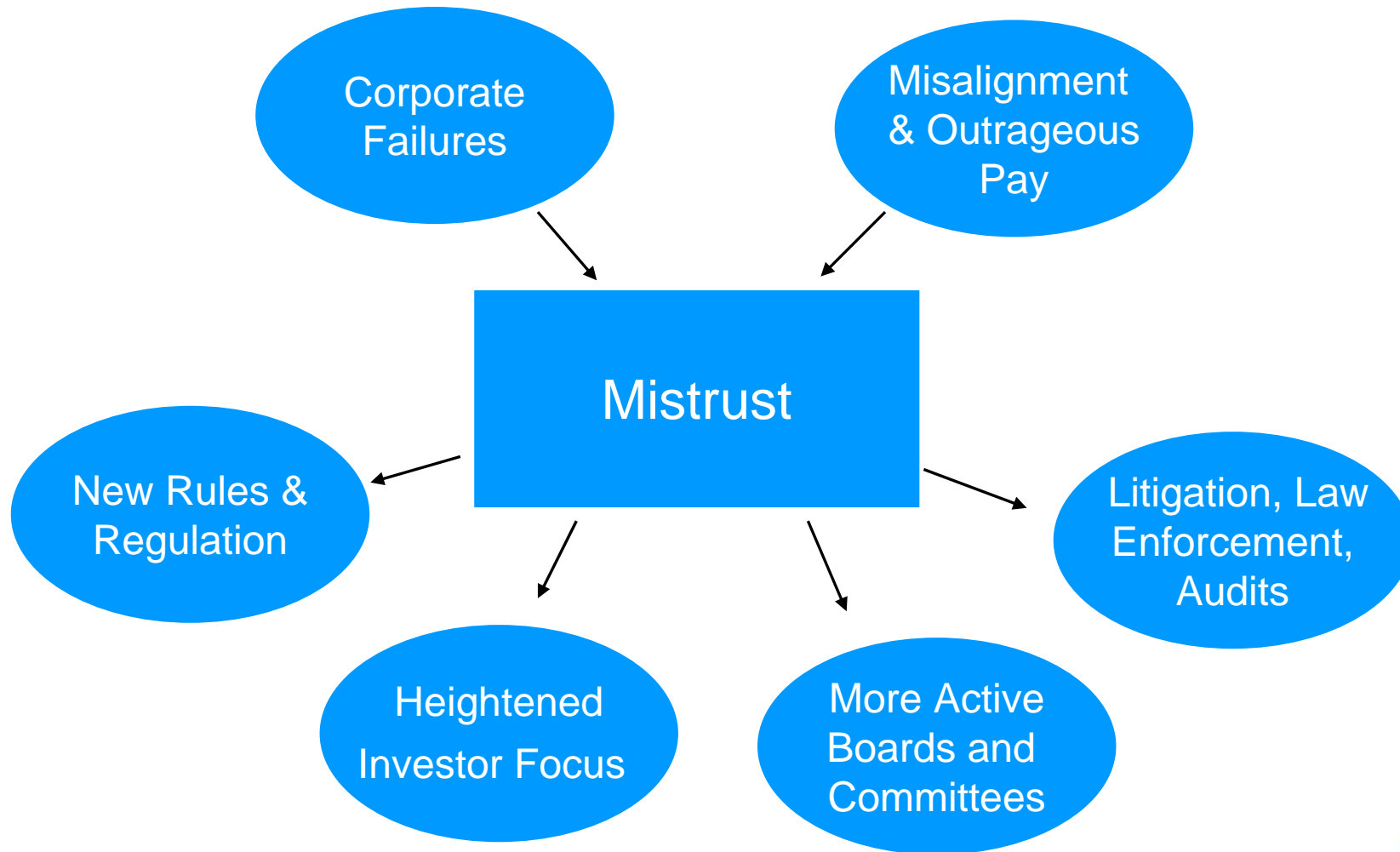
2. Incentive Goal setting in the new world

- Kick it up a notch
- The ingredients
- The Recipe
- The Cooks
- The Cooking
- Avoid the Flat Soufflé



KICKING IT UP A NOTCH!

Pay for performance – a management mantra for years, is now suddenly more in vogue



KICKING IT UP A NOTCH!

Given the size of the investment, incentives get comparably little corporate scrutiny

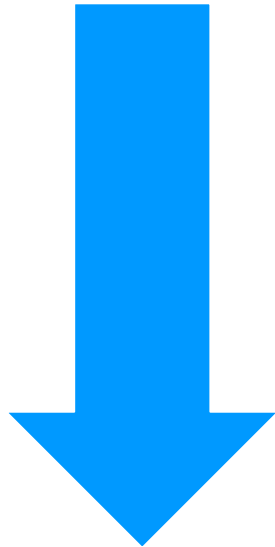
Questions to consider:

1. How much do you spend on incentives each year?
...\$10 million, \$20 million, \$50 million?
 - Annual bonuses
 - Long-term cash plans
 - Equity plans
 - Profit sharing
2. What enhanced financial results (i.e., incremental benefits) do incentives generate?
3. What is the actual return on investment of incentives?
4. Do you look at incentives as % of financial performance results?
5. Would you be comfortable to explain your incentive programme to a wall street journal journalist



THE INGREDIENTS

Conceptual basis for incentives – incentives should be all about strategy execution



Strategy Level	Description
Global Corporate Strategy	<ul style="list-style-type: none">• Grow/return bias• Optimal business portfolio, gap analysis• Organic vs. acquired growth
Operational or Business Strategy	<ul style="list-style-type: none">• Market segment strategy – customer needs analysis• Offering strategy – product, service, solution• Sales/marketing approach – channel strategy
Workforce Strategy	<ul style="list-style-type: none">• Structure – geography vs. industry vs. offering• Roles – job definition, organisational structure• Succession planning, career paths• Selection – recruiting, managed turnover
Rewards Strategy	<ul style="list-style-type: none">• Compensation, incentive design• Benefits and retirement• Learning and development• Performance management• Communication

- The best and worst thing about incentives is that they work – you get what you pay for
- Incentives do not motivate – they focus behaviour
- Incentives are about strategy execution.



THE RECIPE

Companies take risks if they don't live up to what they publish in their proxy

Typical Compensation Philosophy Statements:

“...target financial performance goals to usually correspond to superior performance.”

“...enables total compensation to rise industry norms in years when Company performance exceeds that of its...peer group.”

“...performance exceeds that of its peers, total compensation should be paid...commensurate with the level of success achieved.”

“...and offer bonuses that reward superior performance.”



THE RECIPE

We recommend using multiple perspectives in developing targets

- Year-over-year improvement
- Historical company and per group performance
- Analysts' performance expectations for the company, peer group, and industry
- Shareholder expectations for the company and peer group
- Company's annual budget and three-/five-year plan; market communications
- Absolute benchmarks such as a company's cost of capital
- Statistical Technique
- Consistency with other company messages



THE RECIPE

- Looking at the distribution of historical results gives you one perspective of expectations
- Targets should reasonably balance performance expectations with levels of difficulty



THE RECIPE

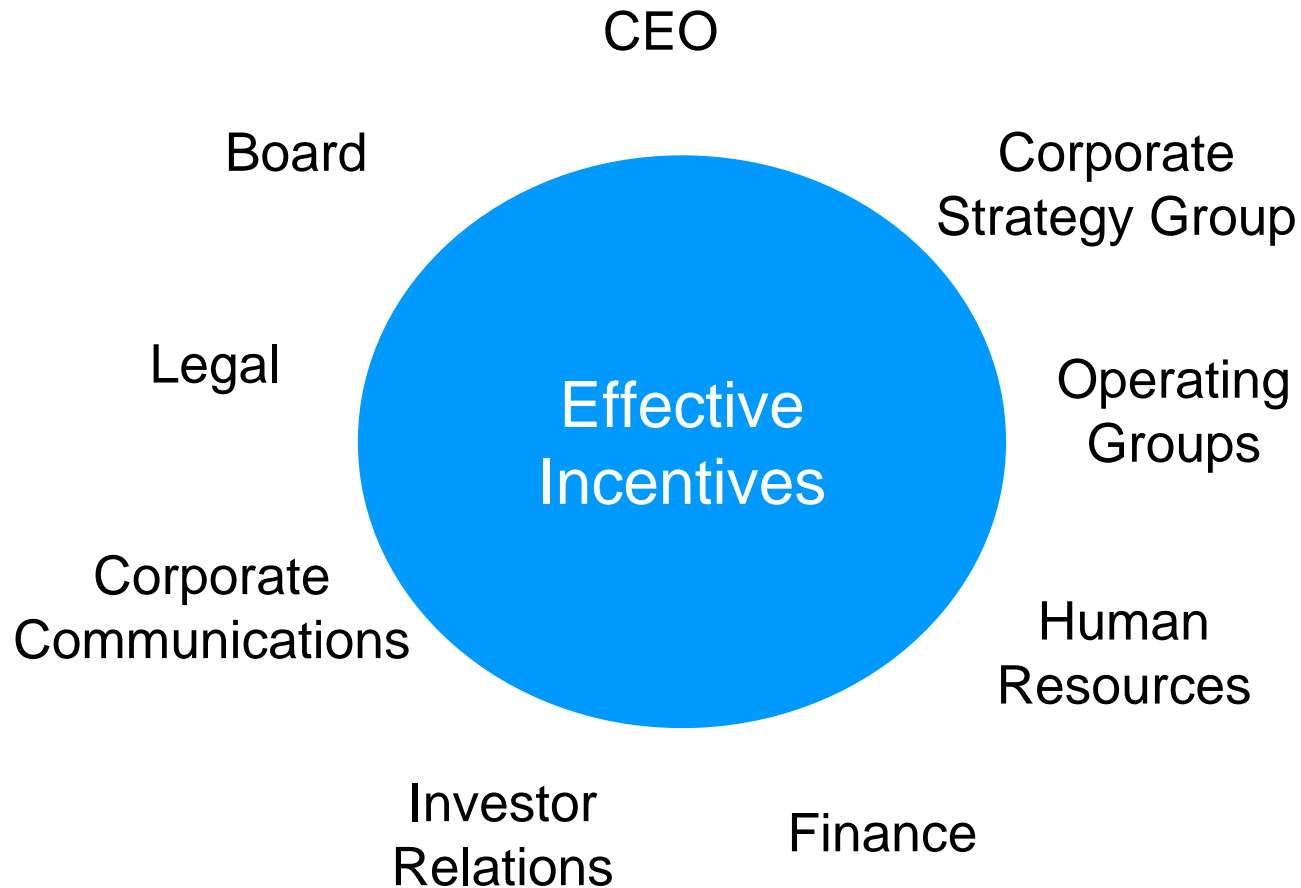
Pulling the different perspectives takes judgment

	Min? 25th	Target 50th	Max? 75th
Historical Peer Group	3.3	6.9	11.9
Historical Company	3.7	7.5	10.7
Budget		7.7	
Weighted Average Cost of Capital		7.2	
Industry Expectation		n/a	
Investment Analyst Consensus		n/a	
Monte Carlo Simulation	2.8	7.3	10.9
Consensus	3.3	7.3	11.2



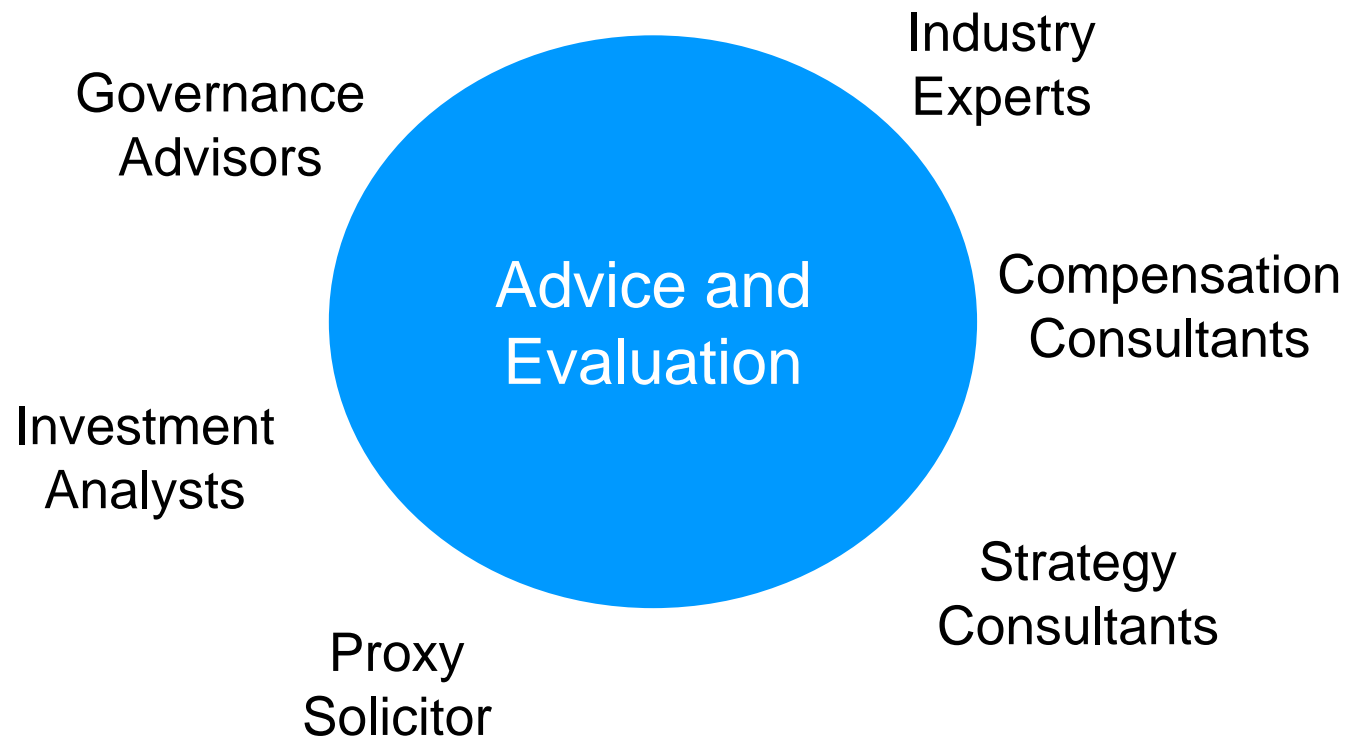
THE COOKS

Effective incentive design requires the coordinated contribution of many players



THE COOKS

External partners can provide useful information at the outset and evaluation at the end

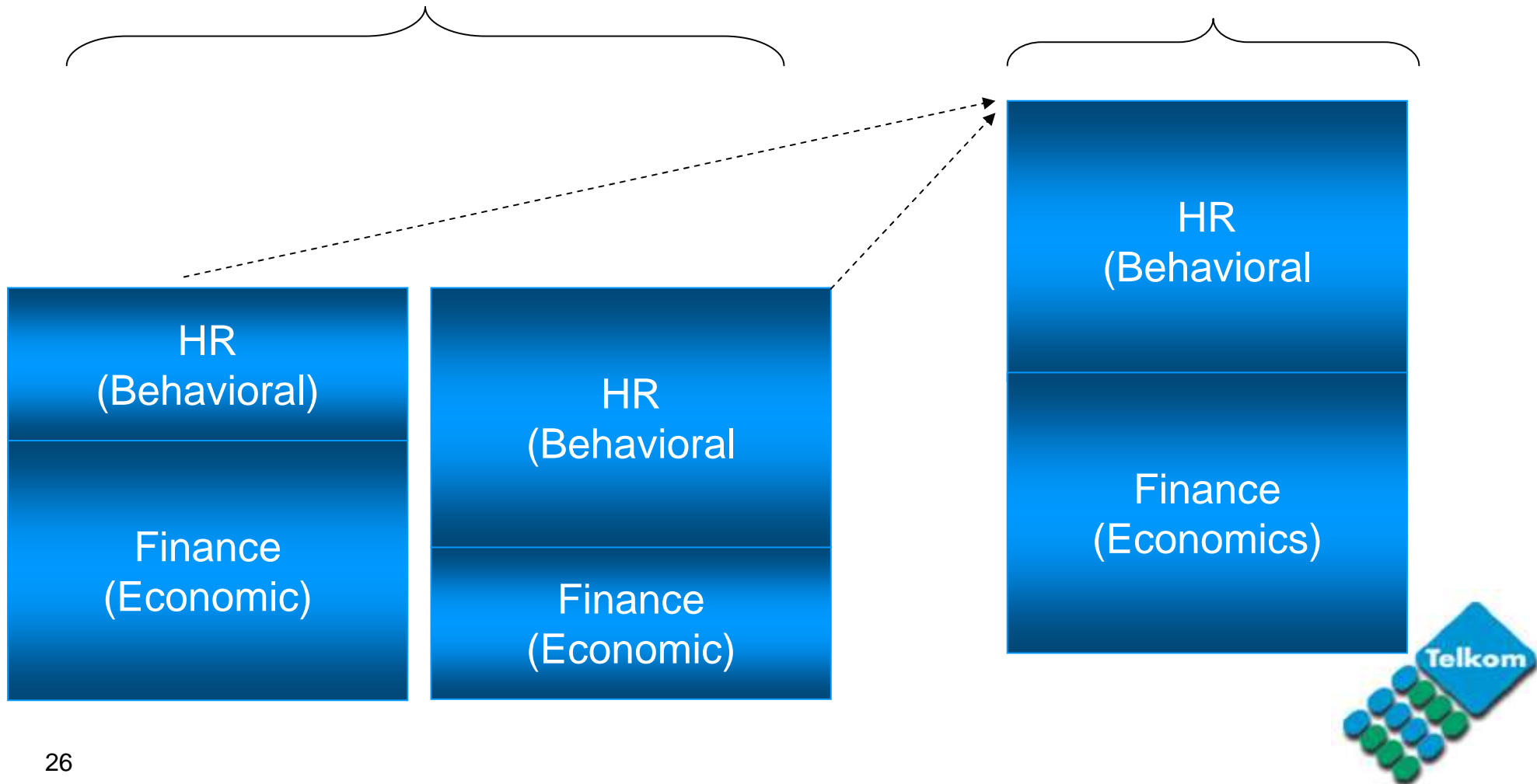


THE COOKS

Going forward, Boards will look to both HR and Finance to be accountable for plan design

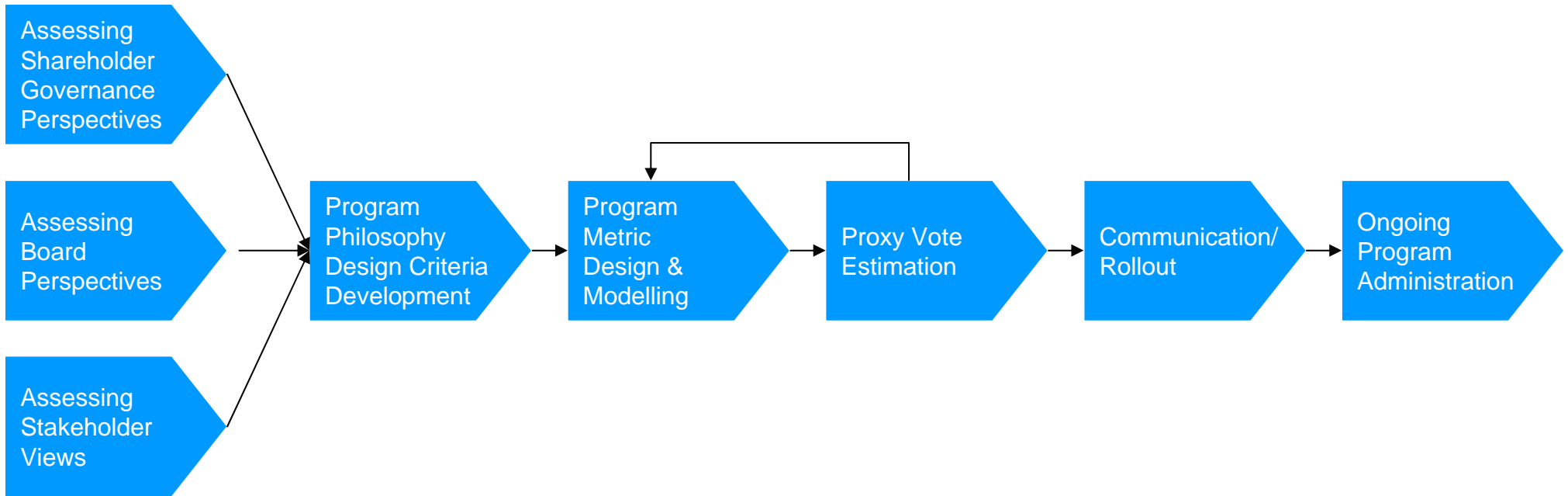
Typical Current

Future Expectation



THE COOKING

Process planning points



Proxy Preparation and Solicitation for Shareholder Approval, Where Necessary

Communication and Implementation Strategy Development and Execution



AVOID THE FLAT SOUFFLE

Companies infrequently look at the corporate and behavioral risks of incentives

- Sending conflicting performance messages
- Short-term/quarterly focus to the detriment of long-term corporate well being
- Getting paid for doing things that one shouldn't
- Paying twice or three times for the same performance
- Getting paid for shrinking the business (unless that it a stated objective)

Or the inadvertent messages sent when plans are changed:

- Changes to short-term plan goals that imply pay-delivery rather than pay-for-performance
- Changes to long-term plans that imply a short-term performance horizon



AVOID THE FLAT SOUFFLE

Golden Rules of Metrics and Incentive Design

The “DOs”

- Keep it simple
- Pay for results, not activity
- Limit yourself to three or fewer metrics
 - Ensure each measure is meaningful – at least 20% of total incentive
 - Consider the target \$ associated with each component
- Be true to your incentive philosophy

The DON'Ts”

- Do not use incentives to replace management
- Do not tinker with the metrics or targets once they are set
- Do not insulate executives from certain market events
- Do not “short-term” your long-term plans



THE END

