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PAY TRANSPARENCY is the NEW BLACK

Why a good communication plan is key to explaining salaries

By Sharon Podstupka, Pearl Meyer & Partners

It's a dark day for managers, employees and HR when the annual pay discussion goes awry and the person on the receiving end sitting in the boss's office is blindsided by the news. This situation arises even when employees think the company has been doing well and they've been doing all the right things. Yet, a low single-digit merit increase and lower-than-target bonus leave them frustrated and feeling like Charlie Brown trying to kick that darn football. What makes it seem even worse is that based on the company's proxy statement, the top of the house seems to be doing just fine. Heck, executives even have equity grants. Maybe it's time to call the head hunter.

This scenario is common. While compensation committees have been sweating say on pay and HR teams are tackling time-consuming issues like the Affordable Care Act, strategic compensation communication hasn't been a priority. At the same time, the media continue to hype-up pay inequality, giving everyone an opportunity to form strong points of view how they are being compensated by their employers.

The result? An alarming number of people — 50 percent according to a recent industry survey — say they do not believe they are paid fairly within their companies. And there's one regulation that is about to make this even more challenging.

Joe Employee Earns What?

Under the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, there is a yet-to-be-finalized rule that will require all publicly traded companies to disclose the ratio of the CEO's salary compared the median salary of all employees at the company. The proposed rule, commonly referred to as the "CEO Pay Ratio," is expected to be finalized by the end of 2015.

The CEO pay ratio has been considered burdensome and an expensive administrative headache, forcing companies to gather payroll and benefits information to both determine their median-paid employee and to calculate the median total pay of that employee. The calculation must include part-time and seasonal workers, as well as employees in all corners of the world. The mandate all but ensures an inaccurate reflection of total pay according to position, location and many other factors, leading many to brand it as a useless number that bears little to no value for investors.

The simple fact is CEO pay is a required disclosure. Employees can open their company's proxy statement today and do some simple arithmetic to calculate the ratio between their pay and the big boss, though most do not. For example, if an employee's total pay (including benefits) is $50,000 and the CEO's total pay is $10 million, it's not difficult to calculate that the CEO's pay is 200 times that of the employee. Within that single data point lies the easy headlines, stoking the pay inequality topic and many hot debates.

The issue is brewing if we go beyond the surface of the CEO pay ratio and the challenges it will bring. Many grumble about top executive pay packages that appear to be in the stratosphere and lament their own number in comparison. Yet, most can rationalize the difference between what they earn and what the most senior people at their company earn, even if they don't fully understand why the figures are so different. What we haven't seen before is public access to the median pay of all employees. This number and its questionable value are new factors that change visibility and the pay communication game completely.

A Basis for Unhealthful Comparisons

While intended to highlight CEO pay, the ratio will give every employee the ability to see the difference between what he or she earns and what the median employee earns at his or her company. This may seem like a realistic basis for comparison; however, people will begin to compare themselves with Joe Employee: Who is Joe Employee? What does Joe Employee do? Where does Joe Employee work? How is Joe Employee's job different from mine? Why does Joe Employee make more (or less) money than I do? *Is that fair?*

The danger is that without a baseline education across the workforce about how salaries, merit increases and incentive payouts are determined — and how they rightfully differ among job roles, responsibilities and geographies — these inevitable comparisons are likely to be unrealistic. There is real risk of heightened employee disengagement and erosion of trust in the employer. Further complicating the issue is the need to go beyond the baseline. People need assurances that their pay is set and delivered according to fair governance policies and well-thought-out processes that are aligned with the business strategy. It's the only way employees will have a better and more accurate understanding of where they fit into the structure of their company and how they can affect the right drivers of performance.

The Best Defense Is a Good Offense

Even without the CEO pay ratio looming, we know there is room for improvement in how companies are communicating about pay with their workforces. A recent Pearl Meyer & Partners OnPoint survey called "Creating Engagement Through Executive Compensation Communication," reports less than 70 percent of employers felt employees had a good understanding of their pay programs and only about half of those 70 percent say their employees would rate the value of their pay programs as high. And while most companies — about 90 percent — focus key messages on pay for performance, information about how pay is set and the decision-making process is lower on the priority list.

Given the looming changes in disclosure rules, the latest industry research and the full-court press in the media about pay inequality, HR leaders are in the best position to refocus the conversation by communicating information in three key areas:

1 | **Base salaries** — Having a clear explanation of how base salaries are derived for your industry (e.g., benchmarking, market pay position) is an important starting point. It gives employees a baseline for apples-to-apples comparisons. It also helps to share internal pay ranges and how they work (e.g., job families, geographic differences, career tracks). Giving people an understanding of where they fit within the company (for example, Human Resources) and how their role is valued (for example, a generalist versus a compensation analyst) helps fill in some of the mystery.

2 | **Incentive plans** — Regardless of the form of the award (cash or equity), communication should include clear summaries for the performance measures and targets of the plans and ways that employees, based on their respective roles within the organization, can have a positive impact on results (often called "line of sight" to business objectives). It's important to be clear about how bonus pools are funded.

3 | **Governance** — Employees need to know who is making decisions about their pay and when, as well as all the factors that contribute to the decision. This applies to merit increases and incentive payouts, especially if discretion is a part of the equation.

Sharing this type of information, with the right level of detail and delivered by the right sources, makes it less likely employees will make uneducated comparisons about how they are paid relative to their internal peers. Of course, this requires developing and implementing a comprehensive pay communication strategy and education plan that outline your audiences, key messages, timing and methods of communication delivery.

So maximize your runway. Use this valuable time between now and the end of the year to map out your plan, develop your materials and train the right people. You can get ahead of your next round of pay discussions, your company's proxy statement disclosure and the CEO pay ratio.

We've all been there at one time or another and there's nothing worse than having an annual pay discussion with your manager and being disappointed. An underwhelming single-digit merit increase and lower-than-target bonus leave you feeling like you could have done more, yet wondering what exactly. As HR professionals, one of the best approaches is ensuring no one in your company has this question. A solid communication plan is an excellent place to start, the timing now is just right. ws

Sharon Podstupka is a principal at Pearl Meyer & Partners in New York. She can be reached at sharon.podstupka@pearlmeyer.com.