Rethinking Compensation
Philosophies

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In an age when competitive advantage is often tied to differentiation or industry disruption, many organizations focus on providing a unique value proposition to shareholders through their business strategy. But what about the role human-capital strategy plays? Can an organization’s approach to leadership development and talent management also be a driver of growth and differentiation? We say yes.

Does your organization’s philosophy on compensation deliver?
Unfortunately, when it comes to compensation philosophy and strategy, distinctiveness is frowned upon and seen as risky. In an effort to ensure that compensation programs are based on a purpose-driven foundation, the same central tenet to compensation philosophy is adopted across multiple industries and company profiles: attract, retain and motivate (ARM). ARM goals endorse the concept that a compensation philosophy should be focused on meeting an employee's basic needs. In meeting those needs, the assumption is that an organization's business objectives will be realized. However, the accepted idea that ARM goals should be central to the development of an appropriate compensation philosophy neglects to address whether the means to merely attract, retain and motivate employees is effective in achieving a strategy that supports leadership development and unlocks untapped value creation. Additionally, the near-universal adoption of the ARM construct brings to light two fundamental questions:

1. Can a compensation program centered on “pulling levers” support and sustain an organization’s competitive advantage?
2. Does using ARM principles provide a meaningful basis for engaging high-potential employees?

A review of multiple studies of employee behavior and engagement exposes the shortcomings of a compensation strategy based solely on an ARM construct. To fully appreciate the impact of these findings, it’s important to address each lever individually:

**I Attract.** Let’s be clear. Compensation programs do not attract employees to organizations. Yes, competitive pay is important, but it is rarely a defining factor.

**I Retain.** Likewise, compensation is rarely cited as the main reason for an executive’s departure or overall employee turnover. A compensation strategy anchored to retention assumes security and maintenance of the status quo are critical imperatives for all organizations.

**I Motivate.** This is an antiquated concept that was derived in an era when less complex and multifaceted jobs dominated the labor market. In today’s environment, intrinsic motivation is a stronger predictor of job performance than extrinsic motivation. In other words, if organizations are not hiring the right people, compensation cannot be exclusively relied on to influence value creation.

**Engaged and Aligned**

Combined or viewed independently, continuing to structure compensation programs centered on ARM goals may be appropriate to address the essentials for rank-and-file employees. But for future leaders and high-potential employees, this plain vanilla approach does not catapult an organization’s focus from addressing...
basic needs to creating and sustaining a competitive advantage through talent management. Instead, organizations would better serve shareholders and critical employee talent if compensation philosophy and derived programs were rooted in the tenets of engagement and alignment.

An engagement-centered compensation program design focuses on the following principles:

❙ Expanding ARM goals by being attentive to both the current and evolving needs of future leaders or high-potential employees as they advance within an organization (via age or position).

❙ Developing a holistic view of compensation that draws on an organization’s unique culture and incorporates both monetary and recognition-based awards.

❙ Incorporating a true long-term view of compensation that extends beyond typical three-year time frames, realizing that internal factors (business strategy and culture) carry more import than external factors (market data and advisory firm policies).

An alignment-centered compensation program design focuses on:

❙ Using compensation elements that are engineered to efficiently unlock long-term shareholder value creation. (Large annual equity awards to major internal stockholders are not an efficient use of equity.)

❙ Adopting a compensation pay mix that encourages necessary risk while delivering payouts that equitably share in the upside/downside.

❙ Resisting the desire to breach the corporate governance mandates of your shareholder base.

❙ Accepting that shareholders have a rightful say in how compensation should be structured.

Chief among the principles of engagement and the key to unlocking an organization’s human-capital competitive advantage is an acceptance that compensation philosophy is a product of an organization’s culture, not something that exists in a vacuum. A deep understanding of organizational culture informed by employee engagement surveys or town hall-like discussions provides decision-makers with the ability to develop a compensation philosophy and program that is highly customized and more adept at fostering employee commitment to the organization as a whole.

**Do Compensation, Culture Click?**

For example, if individual autonomy is a strong cultural strain within an organization, does a compensation program that disallows choice represent the values of the organization and its employees? Furthermore, does an organization that values innovation appropriately recognize the role of failure when it rigidly pursues achievement against predetermined financial, operational or stock-price goals?

Although increased customization may seemingly run counter to shareholder interests, crafting a compensation program that is intimately linked with an organization’s DNA of culture and people will provide significant value-creation opportunity for the long-term shareholder. An engagement focus transitions pay from being an external influencer to an extension of an individual’s everyday functions within the organization.

Not surprisingly, in today’s heightened environment, organizations tend to be more alignment oriented than engagement oriented, driven primarily by a need to justify compensation decisions versus directing compensation to work for an organization. This singular focus on alignment can result in compensation programs that are market driven, but poorly received. A philosophy structured around the mutual dependence of both tenets is the key to building a compensation program that is more effective at navigating the uncertain waters of value creation and promoting strong leadership development.

**High-Touch Approach to High-Potentials**

For high-potential employees, the importance of evolving from an ARM-centered compensation philosophy in favor of one that is engagement...
and alignment driven is even more acute. A focus on retention only answers the question of how to keep the individual in the organization, not the more important question of whether this individual is right for the career path the organization has in mind. Moreover, an emphasis on motivation also misses the mark because by definition these high-potentials are already clearly motivated. Given that high-potential employees are likely critical to an organization’s succession plan, a strategy stressing the importance of engagement throughout the grooming process becomes increasingly important.

Investing the time up-front to understand the specific needs, strengths and weaknesses of critical talent allows organizations to identify areas in the succession plan that may be more appropriate to fill with external hires. Unlike high-potential internal candidates, the most successful external hires are ones that are brought in to fill specific holes within the organization’s leadership strategy or for a specific skill set. Internal candidates, with their significant company-specific knowledge and ability to navigate the organization’s decision-making process, tend to fare better, assuming there is a corporate support structure that is fully engaged in their development.

In practical terms, this means adopting a high-touch strategy akin to what you would cultivate with your most-valued customers. Characteristics of a high-touch leadership development strategy include, but are not limited to, an understanding of:

- Personal motivations for commitment to the organization
- Risk tolerance
- Appetite for growth opportunities
- Goal versus task orientation
- Desired degree of autonomy
- Comfort level with accountability
- Long-term wealth creation goals as well as current diversification of wealth
- Short-term compensation needs.

The cultivation of an in-depth understanding of your high-potentials provides the necessary foundation for structuring a compensation program that is able to serve the dual purpose of addressing a recipient’s needs and goals and aligning with long-term value creation. From this solid foundation, organizations can implement a more effective succession plan and adopt a customized compensation strategy to ensure the continued enthusiasm of key employees and bolster an organization’s competitive advantage.

In summary, the key takeaways are:

- Don’t rely on ARM-centric compensation philosophies because they limit an organization’s ability to unlock the value creation potential of its critical talent.

- Develop compensation philosophies centered around employee engagement and shareholder alignment throughout all levels within the organization.

- Pay particular attention to engagement issues with your high-potentials by adopting a high-touch strategy of understanding their needs and motivations.

- Unlock the hidden potential for your organization’s human capital to serve as a competitive advantage.

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