

Strategy, Structure, Cost and Risk

How an effective compensation strategy is central to organisational success

Climate

The current business environment is dominated by the impact of the recession which has served to create particularly challenging market conditions. It has also ramped up the pressure on businesses to innovate and change, e.g. in terms of products, processes and structure. There are high levels of competition in the market place for all of us as we seek those ideas and developments that will give us a competitive advantage over everybody else. There is also significant competition for the most able people in what has been described as 'the war for talent'.

This paper is set against this backdrop and considers the case for taking a strategic approach to reward and how organisations can deliver on their strategy.

The Business Case

There are various statistics available regarding the overall costs of the extrinsic elements of reward, e.g. they represent at least 60% of the operating costs of the business, alternatively they may be as high as two thirds of revenues. Whichever way you look at it reward is a serious and significant issue for businesses as it has a direct impact on the bottom line. You need to be able to harness the power of reward to be able to support delivery of your business strategy and ensure that you are getting maximum value for money out of this substantial and ongoing investment. Given the direct costs involved and the impact that it can have on your business, the question you need to answer is 'Why wouldn't we review our reward strategy?'

The importance of having an effective reward strategy is increasingly being recognised by businesses. There have been some particularly telling examples of the potential consequences if you do not, the most obvious of which is in Financial Services. A significant contributory factor behind the recent problems in this sector is perceived to be the design of bonus schemes which lead to individuals taking unacceptable risks around products that were not clearly understood. Clearly the picture is more complex than this, but it should serve as a salutary lesson about the consequences of getting reward strategy 'wrong'.

Reward has to be seen in its proper context as it must serve the needs of the business and support delivery of the overall business strategy. In terms of achieving these aims the greatest value can be delivered when all the elements of the reward strategy are effectively integrated, i.e. that an organisation's strategy for extrinsic rewards is directly linked to other HR strategies concerned with intrinsic rewards such as role structures, performance management, employee development/talent management, recruitment. These in turn need to be allied to and work in conjunction with other business strategies such as products, sales/marketing and operational strategies (illustrated in Fig 1 below).

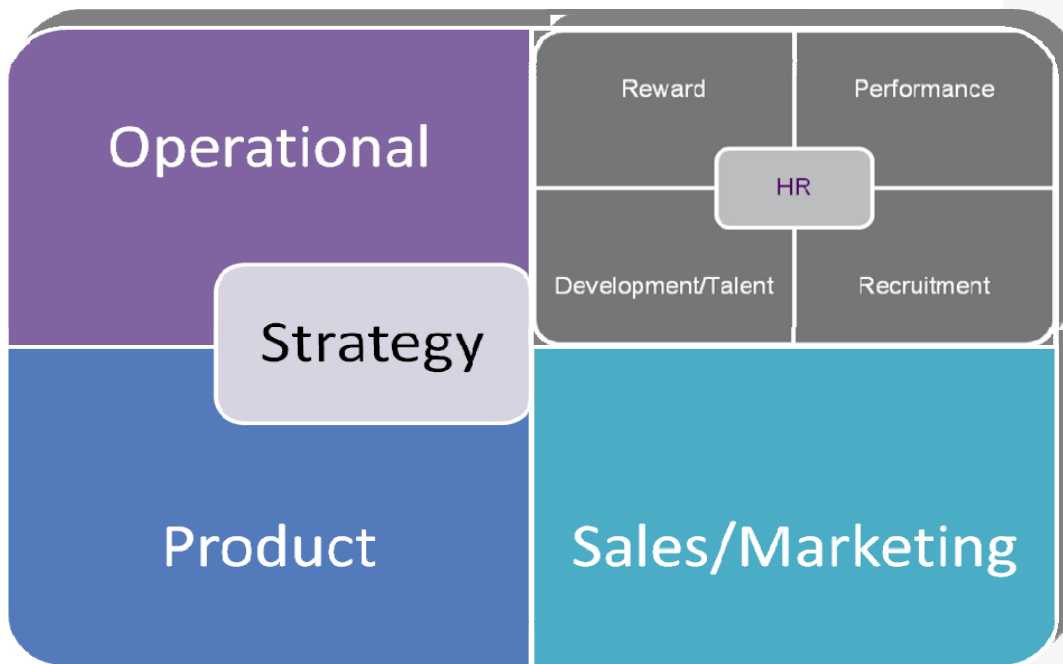


Fig 1: Integrated strategy model

It is worth noting at this stage that segmentation within HR usually means that some of these issues are not traditionally within the remit of Reward Practitioners. Some organisations have responded to this by bringing these issues together under one umbrella, such as Employee Engagement.

Reward Strategy – What does it look and feel like?

This is something of a rhetorical question. There are any number of examples of reward strategies available in the published literature. However, a cautionary note – these will have been developed to suit the circumstances, culture and characteristics of each particular organisation. Therefore, whilst you may find it instructive to look at some of these examples and helpful in guiding the development of your own strategy, you should be aware that adopting a ‘cut and paste’ approach to applying another organisation’s strategy in your own organisation is unlikely to be a success.

Whilst there is no single reward strategy, there are some common principles that apply:

- Reward should be looked at in the round bringing both extrinsic and intrinsic factors together in an integrated way.
- The reward strategy must be designed to support the organisation’s business strategy.
- The strategy needs to be cost effective and sustainable.
- The strategy should take into account and minimise the potential risks to the business.

- The mechanisms for delivering the reward strategy need to be in place; these mechanisms should provide the means to an end rather than becoming an end in themselves.
- The strategy must be owned by the business and sponsored by managers rather than being seen as another HR initiative.
- The strategy needs to be clearly communicated and understood by all stakeholders.

Developing Your Strategy

It is not appropriate to simply adopt another organisation's strategy and to expect that it will work for you.

The process set out below outlines the steps in developing your own reward strategy.

- Identify and engage with the key stakeholders.
- Ensure that there is a clear and common understanding of the overall vision and strategy for the business, the prevailing culture of the organisation and the desired state, how the organisation is structured, what the critical factors are that will drive success and the key performance indicators for the business and any constraints such as budgetary limits.
- Ensure that due account is taken of external considerations such as the economic climate, trading environment, competitive position of reward in the market, regulatory/legislative environment affecting reward matters such as the requirements of the Equal Pay Act and the Combined Code on Corporate Governance.
- Build an understanding of the risks that the organisation faces, e.g. escalating payroll costs resulting from poor reward structures and ineffective management controls, unscheduled costs because of poorly designed incentive programmes, exposure to potential equal pay claims, lack of understanding of reward amongst managers and staff.
- Define the philosophy and guiding principles that will underpin reward. What does the organisation value? What does it wish to reward? How do these things link to business success?
- Analyse the alignment of the current approach to reward and the delivery mechanisms with the key business and external factors outlined above and the desired reward philosophy and guiding principles. Identify the changes that are necessary to achieve alignment. The key questions that you need to answer at this point are 'Where is reward today?' and 'Where does it need to be?'.
- Establish the priorities for change, assessing the potential risks and examining the feasibility of different initiatives taking into account the possible costs and potential benefits.

- Set up an implementation plan – communication will be an essential component of any such plan as it will be important to take people with you on this journey.

It is important to appreciate that strategy should not be carved in tablets of stone. Organisations are dynamic entities that need to be able to respond rapidly and adapt to meet changing circumstances such as the current recession. The reward strategy needs to be equally flexible and support these changes rather than being rigid as it will then be more of a hindrance. Therefore the strategy is something that should be kept under review and tested periodically to assess whether it is still valid or if it needs to be 'retuned' in any way.

Delivering the Reward Strategy

Having developed the strategy, it mustn't be left on a shelf gathering dust.

There are a variety of tools and techniques available to ensure that the philosophy, principles and values enshrined in the strategy can be delivered in practical terms and in doing so ensure that the power of reward can be harnessed to drive the business forward.

- **Roles and Role Structures:** This links to both intrinsic and extrinsic reward factors. At the heart of this is job evaluation, which is experiencing something of a rebirth in the UK. More organisations are beginning to appreciate the real power of an effective job evaluation system and how to use it:
 - as a cornerstone of reward providing the foundation for reward structure design and fair and equitable pay decisions;
 - to support organisation development and job design;
 - to identify appropriate career paths with links to competency;
 - to provide a solid platform for performance management;
 - to promote employee development;
 - to provide a basis for recruitment.
- **Reward Structures:** Most organisations will already have a structure or structures in place. Therefore, having identified where you are and agreed where you need to get to, this is about how you manage the changes required to get you there. However, this should not be change for the sake of change and it may be that some of the existing processes can be encapsulated in any new design.

In design terms you will need to consider what the component parts of the structure(s) should be, e.g. base salary, variable and fixed elements of the package and the appropriate balance between them taking into account external market pressures. You will also need to ensure that these are aligned with business objectives and reward principles and that they provide the flexibility to accommodate future changes, e.g. in roles and/or role structures, as the organisation continues to evolve.

- **Costs:** We have already considered how much organisations invest in reward and how this can impact on the bottom line. You will need to look at the benefits that the organisation might accrue and both the short term costs of making the changes and the long term costs of the new structure to ensure that these are affordable and sustainable. This is an important issue as these are factors that can subsequently be used when assessing how effective the changes have been.
- **Total Rewards:** There is some research to suggest that on average employees undervalue their reward packages by as much as 30% which is a significant finding. It is important that employees understand the full value of the reward package that your organisation has to offer if it is to realise the benefits of its investment in reward. One way of achieving this is through the use of total reward statements produced on an annual basis. This can also be a precursor to other initiatives such as flexible benefits.
- **Flexible Benefits:** An area of reward that is attracting a lot of interest at the present time. Employees are becoming increasingly sophisticated in terms of their expectations and increasing awareness of the segmentation in the employee population (e.g. based on age, length of service, gender, level of responsibility and/or lifestyle) means that there are no 'one size fits all' solutions. Using flexible benefits can help organisations leverage value from their overall spend by providing employees with a degree of freedom to construct a reward package that they value and which can be changed at appropriate times to suit their changing circumstances. This is an important consideration in terms of satisfying the psychological contract and answering the question that employees will ask themselves –'Is what I get back worth the effort that I put in?'.
- **Managing Risk:** The potential risks that organisations face were identified earlier in this paper. Utilising the reward management techniques outlined here to deliver the strategy will help mitigate these risks. For instance a sound role and reward structure built on an appropriate job evaluation platform will provide you with the tools to control payroll costs and prevent unjustified salary and grade drift. This is a significant benefit when you look at the scale of the investment involved in reward. Similarly it will also provide you with the information that you need to objectively justify differences in reward should you be challenged to do so either through internal processes or following a referral to an Employment Tribunal.
- **Communication:** This is a critical process in reward management and a lack of or ineffective communication is one of the top reasons why reward initiatives fail to realise their potential benefits. When seeking to change reward it is important to engage with people and take them with you. In doing so you will create expectations so it is important that you are able to deliver.

To Conclude

We currently face some very challenging times and it is important that we maximise the return on the significant investment that we make in rewards. This will mean understanding what drives organisation success, ensuring that the way that reward is structured and delivered supports these key drivers, that individual employees feel fairly rewarded for their contribution to the organisation and by comparison with their peers. This does not necessarily mean a root and branch review of everything that you do, but at least you will need to critically appraise your reward strategy and delivery mechanisms to see where improvements need to be made.

The challenge for you is to harness the power in reward in the most effective way and to deploy the available resources to maximum advantage.

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