

Variable Pay – The New Normal?


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If employers were trying to be funny and make a joke about the economy and its impact on employees, the joke might go something like this...The word “Salary” is taken from the Latin for salt. Many employers appear to have decided to reduce the intake of their employees.



According to the WorldatWork, 80% of organizations say that they have some form of Pay for Performance whether it is part of their base pay or incentive plans. However, in recent surveys, less than 35% of employees say that there is any performance aspect to their pay determinations, and most of them say they don't know what performance considerations get them more money.



Variable Pay is the new “pay for performance.” It is a trend that has been emerging for the past 7-10 years.

Some History... Base Pay

- 20 years ago, the average pay increase was 5.5% of base pay
- 10 years ago, the average pay increase was 4.2%
- Today, the average increase, IF YOU GET ONE, is 2.5%

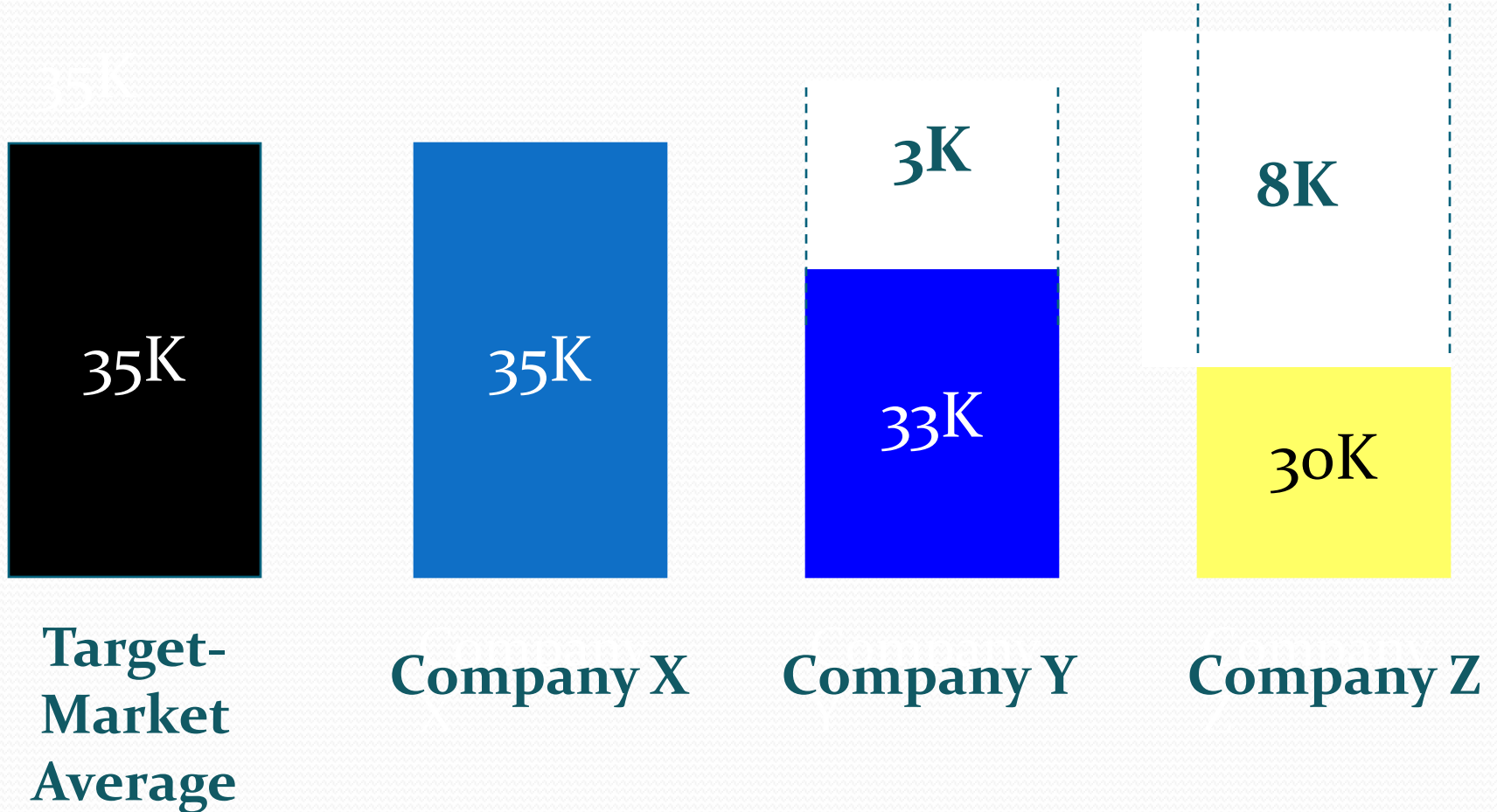
Hewitt and Associates 2010

Some History...Variable Pay

- 20 years ago, variable pay budgets were 4% of base pay
- 10 years ago, variable pay budgets were 9.5% of base pay
- Today, variable pay budgets are 12% of base pay

Hewitt and Associates 2010

Direct Compensation Mix: Base vs. Variable



What's Driving Variable Pay?

- Increasing competition is partly responsible for a shift in compensation practice
- The economic downturn has forced new thinking about what organizations pay for
- Traditional systems of annual base pay increases do not effectively link performance/contribution to organizational results
- Desire to reduce fixed costs
- Trouble with pay ranges and movement to maximum

Variable Pay Characteristics

- Ensures the focus is on organizational or unit success
- Is something that can be paid to any employee
- Is outside the base pay program
- Can be used to drive specific results
- Can include or exclude individual contribution

Variable Pay requires:

- **Commitment by executives and managers**
- **Clear and unambiguous goals/targets**
- **Measurements that employees understand**
- **Clear and transparent communication**
- **Identifiable linkage between employee performance and monetary results**

In some respects it is very simple...if we accomplish X, then we all participate in \$. If we do not accomplish X, then we will receive no amount beyond the market adjustment, if there is one.





Let's take a closer look at some of the options and issues....

Types of Variable Pay Plans

- **Individual**
 - **Piece rate**
 - **Sales/Other Commission Plans**
 - **Project Awards**
 - **Etc.**

Types of Variable Pay Plans

- **Individual**
 - **Piece rate**
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 - **Project Awards**
 - **Etc.**
- **Necessary Plan Elements**
 - **Objective determination of individual performance**
 - **Opportunity for independent work**
 - **Hiring of success-oriented employees**

Types of Variable Pay Plans

- **Group/Unit**
 - **Gainsharing**
 - **Quality Improvement**
 - **Cost Reduction**

Types of Variable Pay Plans

- **Group/Unit**
 - Gainsharing
 - Quality Improvement
 - Cost Reduction
- **Necessary Plan Elements**
 - Need for cooperation must be acknowledged
 - Work allocation must be fair
 - Employee input is critical
 - Progress must be visible

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- **Organization-Wide**
 - Profit Sharing
 - ESOPs or other stock plans
 - Deferred Compensation
 - Cash Distribution based on measures other than profit

Types of Variable Pay Plans

- **Organization-Wide**
 - Profit Sharing
 - ESOPs or other stock plans (including Phantom)
 - Deferred Compensation
 - Cash Distribution based on measures other than profit
- **Necessary Plan Elements**
 - Clear targets/Goals
 - Ongoing communication about results/status
 - Capital investment exempted
 - Line of sight evident from every job

Variable Pay Measure Options

- **Lead Measures**
 - Predictive of success – examples would include new customers, market share, increased # of services/products purchased, referrals, etc.
- **Operating Measures**
 - Cycle time, productivity increases (revenue per employee), throughput/output, reduction in returns or customer dissatisfaction
- **Lag Measures**
 - Typically identified through the accounting system – examples would include EBITDA, return ratios, net income or excessive revenue, etc.

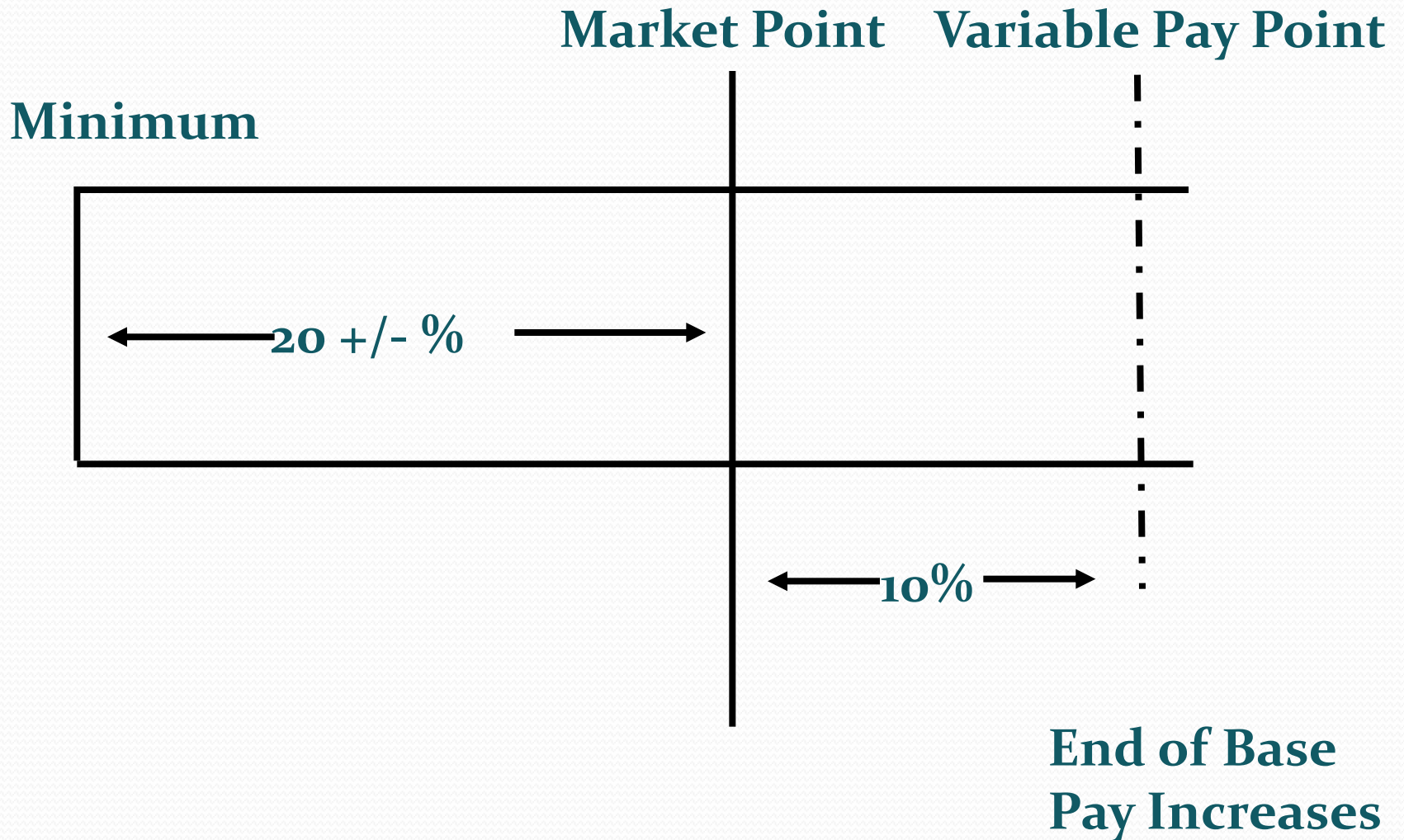
Variable Pay Measure Info

- Typically don't want to use more than five specific measures
- Usually one measure would come from each category
- It is fine to alter measures year to year to keep plan fresh and employee interest high
- Measures must be in line with organizational goals

Implementing Variable Pay

- Determine the level of base pay risk, if any
- Define organizational goals/targets
- Communicate intentions
- Determine what type of plan will be most effective
- Involve employees in design
- Identify impact on use of pay ranges

One Approach to Variable Pay



Summary

Variable pay is a legitimate option that can connect employees' pay to organizational success – and more importantly, it gets the employees' attention!



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So let's talk....

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