



Workstream | Compensation

Making Pay-for-Performance a Reality

Enterprise Compensation Management Solutions for Today's Dynamic Environment



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I. Executive Summary

“Workforce alignment” – the concept of aligning the contributions of individual employees with corporate goals – is one of today’s hottest business topics, on the mind of every business manager from the CEO to the HR director. Gartner, Inc. proclaims, “Alignment of the workforce to business strategy is critical for enterprise success.”¹ Yet for all of the urgency associated with workforce alignment, many organizations are stymied in their attempts to achieve it. Indeed, Gartner estimates that by 2007, HR organizations will drive strategic workforce management in only 30 percent of enterprises (0.7 probability).²

Pay-for-performance plays an essential role in achieving workforce alignment. This compensation management discipline is practiced – with varying degrees of success – by many leading companies, which typically annually rate their managers on a bell curve, assigning an overall performance rating from “Exceeds objectives” to “Does not meet objectives”. At many companies, the “Does not meet objectives” generally have to go, while others are awarded bonuses, raises and stock option grants commensurate with their rating.

Which behaviors do companies care about in evaluating their employees? According to global compensation specialist George Milkovich, the simple answer is that employers want employees to perform in ways that lead to better organizational performance. He says, “The way people are paid affects the quality of their work; their attitude toward customers; their willingness to be flexible or learn new skills or suggest innovation.... This potential to influence employees’ behavior, and subsequently the productivity and effectiveness of the organization, is another reason it is important to be clear about the meaning of compensation.”³

Compensation authority Edward E. Lawler III adds, “Right now we’re in a period of ‘back to basics’ – the challenge for companies is to deliver a fair salary and effectively administer bonuses and merit pay, and relate those clearly to the person’s performance, in order to spend compensation dollars wisely. Companies are zeroing in on key issues such as, ‘Do we use our dollars well, do we get a fair return on our dollars, are we delivering merit increases and bonuses effectively?’”

The broken link between pay and performance

Unfortunately, while most organizations profess to subscribe to pay-for-performance philosophies, many simply can-not execute – there is a broken link between senior executives’ desire to differentiate pay based on performance, and line managers’ ability to do so. Relating compensation to individual performance for tens or hundreds of thousands of employees, across large global companies, is today a nearly impossible task. Complexity in compensation processes – often cobbled together by non-stop mergers and acquisitions – creates apathy among managers, who do not see themselves as compensation experts and instead take the path of least resistance.

¹ “Strategic Workforce Management: Critical Key Issues,” J. Holincheck, Gartner, Inc., October 16, 2002.

² Ibid.

³ Compensation, Seventh Edition, George T. Milkovich, Jerry M. Newman and Carolyn Milkovich, 2001. In this quote, Prof. Milkovich references material from Edward Lawler’s book Rewarding Excellence, 2000

Hence, the “peanut butter” approach to compensation distribution, or the spreading of merit increases, bonuses and/or stock options equally across the employee population. Top performers are not given rewards commensurate with their contributions, and under-performers are over-compensated.

Shockingly, the “peanut butter” approach is used in company after company, where employee-related compensation spending consumes up to 80 percent of each operating expense dollar, according to Ed Lawler. This reality practically screams for a pay-for-performance solution that keeps compensation expenditures in line with the allocated budget – a system that makes managers compensation experts and, above all, makes them believe in the pay-for-performance process, and take ownership of it.

Executing on pay-for-performance: Technology as catalyst

Enterprise Compensation Management (ECM) applications such as Workstream Compensation play a critical role in supporting pay-for-performance initiatives that ultimately lead to workforce alignment. Workstream Compensation provides the structure, processes and knowledge required to make pay-for-performance initiatives a success at all levels of the organization. The Workstream solution provides numerous compelling benefits:

- **Employee differentiation:** This concept is central to Workstream Compensation, putting an end to the “peanut butter” style of compensation disbursement.
- **True Manager self-reliance:** Managers get a high-performance system – complete with drill-down analytics and situation-specific advice and guidance – that helps them become self-sufficient and confident in administering their group’s compensation. In turn, this boosts their ownership of the pay-for-performance corporate mandate.
- **Situation-specific advice and guidance:** Far more sophisticated and personalized than previous-generation knowledge management technologies, Workstream’s KnowledgeManager™ provides the infrastructure to harness and share knowledge within the enterprise, delivering it on an individualized basis – which is a key enabler to workforce alignment, according to Gartner.⁴
- **Strong, direct return on investment (ROI):** Workstream delivers ROI that travels straight to the bottom line. Because compensation consumes such a large portion of corporate budgets, administering it can significantly improve process efficiency. This in turn can result in better profitability and productivity, as dramatic amounts of time and effort are saved.

As forward-thinking companies move to execute pay-for-performance strategies to gain workforce alignment, ECM applications like Workstream Compensation will be the catalyst for their deployment, acceptance and ultimate success.

⁴ Op.cit.

II. Compensating for Performance

If you want people to produce specific results, you reward them accordingly. This fact seems so obvious that it shouldn't need saying. Yet many corporations do such a poor job of linking rewards to performance that there's little correlation at all. They don't distinguish between those who achieve results and those who don't, either in base pay or in bonuses and stock options.

– Larry Bossidy and Ram Charan, *Execution: The Discipline of Getting Things Done*

Today's uncertain environment provides a stark backdrop for the ongoing disconnect between corporate performance and individual compensation. Unfortunately, in all too many companies, “workforce misalignment” is the norm. Despite strong commitment from senior executives to differentiate pay based on performance, managers throughout the organization have a difficult time doing so.

Meanwhile, myriad economic pressures are conspiring to force organizations to do more with less; as compensation funds shrink, how are limited resources best used? Every day newspapers are filled with the latest news on lower-than-expected earnings, mergers, acquisitions and corporate restructurings, all of which beg the question: which employees will be chosen to stay, which will go, and how shall the remaining ones be motivated?

The broken link between wanting, and achieving, pay-for-performance

Compensation based on pay-for-performance, which rewards employees for achieving specific, pre-determined goals – is a popular strategy for answering this question. It has been pursued for many years by many organizations, with varying degrees of success.

Most companies continue to struggle as they strive to link pay to performance throughout their organizations. Despite significant investments in compensation policies, procedures, consultants and training, there is surprisingly widespread poor execution on the operational level as line managers attempt to link pay to performance.

Many organizations profess that a pay-for-performance philosophy is the cornerstone of their compensation system. Such a system hinges on a clear and documented link between policy and practice. However, this link is frequently broken, rendering the notion of merit-based pay meaningless for the simple reason that in a merit system, managers must be able to make expert compensation decisions, even when they are not experts. Moreover, managers must take ownership of their decisions especially when having tough discussions with their under-performers.

Many organizations have implemented performance management, which the consulting firm Towers Perrin describes as “the process designed to align employees’ actions and behaviors with the company’s goals. This helps to effectively measure and manage individual performance and clarify the link between employee results and behavior, and the company’s overall success.”

However, performance management does not always succeed in aligning goals because it sometimes does not include a compensation connection. Without a connection to compensation, performance management lacks the element of execution – how can companies ensure that employees will actually be financially rewarded for meeting performance objectives? Adding compensation to the equation brings the required element of execution to performance management, ensuring that it is a true pay-for-performance strategy that can deliver tangible business results.

Reducing complexity: Essential in achieving pay-for-performance

Mapping compensation to individual performance for tens or hundreds of thousands of employees, across large global companies, is today a nearly impossible task. Complexity in compensation processes is one of the key wedges between a company's desire for workforce alignment, and its inability to achieve it.

Large companies are geographically distributed, have multiple lines of business, and are typically assembled over the years through mergers and acquisitions. This creates a multitude of compensation processes within the same company, for example:

- **Bank A** merges with **Bank B**.
- **Bank A** has a focal review process that entails performance reviews and raises for all employees on March 1.
- **Bank B**, for the most part, does anniversary-based planning. However, several of its divisions also do off-cycle pay adjustments, promoting branch managers as others leave the company.
- One year later, **Bank AB** merges with **Bank C**, a super-regional bank that treats each of the states in which it operates as a separate line of business, some of which do anniversary-based planning, and others a focal review process.

Clearly, there are no common, company-wide common denominators for compensation practices, let alone guidelines or systems for implementing them. Faced with this constant state of flux, many managers quickly give up on attempting to become compensation experts, and instead muddle their way through the compensation planning process as quickly as possible, to “get it over with.”

“Getting it over with” does not constitute the proper respect due to employee-related compensation, on which up to 80 percent of each operating expense dollar is spent. What's needed is a system for implementing pay-for-performance that keeps compensation expenditures in line with the allocated budget – a system that makes managers' jobs easier and, above all, makes them believe in the pay-for-performance process, and take ownership of it.

To do so, the enabling system must meet managers' steep requirements – to be easy to use, and to help them become compensation experts by presenting the knowledge they need, at the right time, in the proper increments. ECM systems fulfill these requirements, and more, as examined in the next section.

III. Executing on Pay-for-Performance: Technology as Catalyst

Edward Lawler believes that technology plays an important role in creating and managing a pay-for-performance system. In his book *Rewarding Excellence: Pay Strategies for the New Economy*, he prescribes an ECM application that “gives senior management an overview of what’s happening, and allows them to see if their pronouncements about pay-for-performance are actually appearing in employees’ paychecks. Without some kind of system that looks at the compensation treatment of people, it’s very hard, particularly at a senior level, to make sure that a company is getting the pay-for-performance it wants.”⁵

Implementing pay-for-performance systems with Web-based applications

The goals and objectives for automated compensation analysis and delivery systems – which enable Lawler’s technology vision – are the same as those for any other mission-critical application: to bring the needed information to those who must make pay decisions, and do so quickly, accurately, and in the form in which they can best use the information. Web-based ECM applications do all of this better than any other previous system.⁶

Allen P. Jackson, principle at Towers Perrin, describes the following capabilities and features of Web-based ECM applications to be used to implement and administer pay-for-performance programs. These include:

- **Getting ready – Determine the manager’s population:** Before a manager can administer the compensation plan, the population must be determined. Because it is role-based, the Web-based application must “know” who is a manager and to whom he or she directly reports.
- **Getting ready – Rating employees:** The manager now accesses the rating that was generated during the performance management process or, if that process was not Web-enabled or the data are not in machine-readable form, enters the appropriate performance rating into the application for each employee. The system then automatically generates graphics that depict the distribution of the ratings – both the actual distribution for the manager’s employee population and the desired distribution.
- **Compensation planning – The performance versus position-in-range matrix:** This useful tool contains a list of performance categories and increase percentages, and highlights one employee. The guidelines in the range quartiles show the suggested percentage increases that could be given by a manager to an employee depending on the employee’s position in the range. A wide variety of variables, including market rates, traditional evaluation methods, and newer competency-based approaches, as well as minimum and maximum guidelines, ensure that managers are properly prepared to plan actual compensation changes.

⁵ “Rewarding Excellence: Pay Strategies for the New Economy, Edward E. Lawler III, 2000.

⁶ *Web-Based Human Resources: The Technologies and Trends That Are Transforming HR*, Alfred J. Walker, Editor, Towers Perrin, Editor, 2001.

- **Planning new base salaries:** When the performance rating versus position-in-range matrix is finalized, the manager can proceed with compensation planning, entering either the per-centage increase provided by the matrix or the actual dollar amount.
- **Planning new variable compensation:** In a fashion identical to that used for base salaries, each employee who is eligible for variable compensation is now reviewed and a suggest amount of compensation is calculated.
- **Planning stock compensation awards:** The manager can then decide on the award of any stock (typically stock options) that is part of the total compensation package. When this step is completed, managers can generate statistics for their own work group and, under cer-tain conditions, determine where they stand in relation to other groups. In addition, reports are available showing roll-ups and grouped departmental or line of business statistics.
- **Approving compensation plans:** After a manager submits a compensation plan, it is acces-sible to the approving manager for review and approval. The manager can then “roll up” for an aggregate view of pay-for-performance and “drill down” to examine any one individual's pay plan. Group-level analytics provide visibility at each level in the management hierarchy before compensation actions are taken.

Key additional requirements to ensure maximum efficacy

In delivering these capabilities, the ECM application must support corporate requirements for a predictable total cost of ownership (TCO) and for likely high levels of return on investment. Changes in objectives must therefore be easily incorporated into the pay-for-performance system, to keep up with frequent modifications to corporate objectives and compensation plans. The application must provide flexibility for constant tuning and substantial change, or it will need to be essentially re-deployed on a frequent basis – at a significant cost of both time and money. System deployment needs to be carefully reviewed to monitor and measure expected ROI.

To support a broad user base, the ECM system must also have an outstanding capability to deliver situation-specific advice and guidance to line and senior managers. The advice and guidance management system should offer tailored support, instructions and learning for each company based on corporate-defined compensation objectives, employee compensation records, and compensation market survey data. Just-in-time, situation-specific advice and guidance should be delivered to each line manager when they need it, and must be relevant to the situation under review by the manager, helping to shape manager behavior and effect more appropriate and consistent pay decisions.

The advice and guidance management system is a hallmark of an emerging class of applications designed to help managers become experts in subjects they are not. A knowledge-based compensation application can help managers expand their purview in key areas including organization expertise, business knowledge, financial expertise and communication skills.

Finally, a Web-based ECM application that supports managers with a situation-specific, knowledge-based administration approach helps them become experts in the art of compensation, and fosters manager ownership of the resulting decisions. Although these managers are focused on their particular fields of expertise – whether it is sales, engineering, manufacturing, distribution or finance – they are looked to by their employees as compensation experts during the annual corporate compensation planning process. As a result, it is critically important that the company striving to realize a pay-for-performance culture provide a best-in-class ECM application that supports managers each step of the way. The system must provide information for both decision-making and employee explanations, thereby giving managers competence, confidence and ownership in their abilities and knowledge to administer effective compensation plans.

Workstream Delivers Fast, Measurable ROI

Workstream performed an extensive ROI study with five of its long-term clients: Dow Jones, The Gap Inc., Mitel, Qwest and Wells Fargo, proving Workstream Compensation's rapid and significant return on investment. Composite results include:

Average payback (cost savings to offset the cost of deploying Workstream Compensation): 327 days, or 0.9 years.	Year 1 ROI: 107%
	Year 2 ROI: 254%
	Year 3 ROI: 386%

Across these five companies the average total per-company ROI in dollar amounts was:	Year 1: \$ 1,243,110
	Year 2: \$ 2,380,200
	Year 3: \$ 2,380,200

Over a three-year period, each company received an average of \$6M in ROI, confirming the strong value that Workstream Compensation delivers.

IV. Workstream Compensation: Aligning Corporate and Individual Performance with Rewards

Workstream Compensation is a total ECM solution that helps companies acquire, manage, and optimize human capital. It is used by industry leaders including Bank of America, Dow Jones, Dupont, The GAP, Kaiser Permanente, Kellogg, Longs Drugs, Qwest, Washington Mutual and Wells Fargo in helping these organizations to realize workforce alignment.

Workstream Compensation is a best-in-class, Web-based ECM application, providing a complete, configurable environment that manages the complexities of salary, variable/incentive pay and stock. It streamlines all aspects of compensation planning and implementation, including plan configuration, modeling and budgeting, line manager planning, approval, reporting, and export to payroll or other systems of record. Throughout the process, Workstream Compensation provides deep visibility into and control over the compensation budget.

Total support for managers' knowledge needs

Workstream Compensation offers line managers secure, direct desktop access to historical and current compensation, performance data and company policies. The software walks a line manager through the steps of compensation planning in sequence. At each step along the way, the patented Workstream KnowledgeManager™ supports managers' information needs with context-sensitive exception alerts, guidance and options.

A cornerstone of Workstream's technology, Workstream KnowledgeManager is an extremely easy-to-use reasoning system that provides situation-specific help and guidance. Fully integrated into Workstream Compensation, Workstream KnowledgeManager pulls its expertise from a combination of industry best practices, corporate-defined compensation objectives, employee compensation records and market survey data to dynamically deliver "just-in-time, just-for-me" advice and instructions. Workstream Compensation empowers managers to make strategic, equitable, policy-based compensation decisions, giving them confidence in their abilities, and fosters their ownership of the company's pay-for-performance strategies. Employees are rewarded for performance, increasing retention of key employees and allowing companies to readily realize true workforce alignment.

Easy to deploy and configure

Workstream Compensation functions over any industry-standard browser, making it easy to install and cost-efficient to maintain. The Workstream application is compatible with all ERP and Web-based HRMS systems of record, and can be deployed in as few as eight weeks. Because it is an enterprise-class application, Workstream Compensation has been engineered to scale to serve the needs of even the largest organizations.

Equally important, the Workstream system is easy to configure – a necessity in today's fast-changing environment, where corporate objectives can quickly change, or where mergers and acquisitions can happen overnight. Its configurability allows compensation managers to change and customize plans on their own, further lowering the TCO.

V. Summary

Because pay matters so much to most of us, it is sometimes too easy to become fixated on techniques: Sharing and examining so-called "best practices" becomes the end in itself. Questions such as "What does this technique do for (to) us?" or, "How does it help achieve our objectives?" are not asked. So before proceeding to the particulars, think about how pay might support a business strategy.

– George T. Milkovich, *Compensation, Seventh Edition*

In these uncertain times, compensation has once again risen to front-and-center for both corporations and their employees. As available compensation funds shrink, how are limited resources best used? Which employees will be chosen to stay, which will go, and how shall the remaining ones be motivated?

Compensation experts, executives and corporate HR practitioners agree that pay-for-performance is an ideal means to address all of these questions, by linking individuals' pay with ongoing business performance in an accurate, timely manner. However, implementation of pay-for-performance policies has frequently been stymied by the complexity of a patchwork of compensation policies, and lack of line manager buy-in, the latter driven largely by lack of tools and situation-specific support that link the manager to overall corporate compensation policies and practices.

ECM applications such as Workstream Compensation play a critical role in forging a link between corporate goals and individual performance. Workstream helps organizations achieve workforce alignment by supporting pay-for-performance initiatives with the structure, processes and knowledge required to make pay-for-performance initiatives a success at all levels of the organization. As companies implement pay-for-performance, which often starts with incremental efforts, applications such as Workstream Compensation are often the catalyst for their deployment, acceptance and ultimate success.

Biographies

Edwards E. Lawler III is a Distinguished Professor of Management and Organization in the Marshall School of Business at the University of Southern California. He is also Director of the school's Center for Effective Organizations. After receiving his Ph.D. from the University of California at Berkeley in 1964, Ed Lawler joined the faculty of Yale University as Assistant Professor of Industrial Administration and Psychology. Three years later he was promoted to Associate Professor.

Ed Lawler moved to the University of Michigan in 1972 as Professor of Psychology and also became a Program Director in the Survey Research Center at the Institute for Social Research. He held a Fulbright Fellowship at the London Graduate School of Business. In 1978 he became a Professor in the Marshall School of Business at the University of Southern California. During 1979 he founded and became the Director of the University's Center for Effective Organizations. In 1982 he was named Professor of Research at the University of Southern California.

Ed Lawler has been honored as a major contributor to theory, research and practice in the fields of human resources management, compensation, organizational development and organizational effectiveness. He is the author and co-author of over 300 articles and 30 books, including *From the Ground Up: Six Principles for Creating the New Logic Corporation* (Jossey-Bass, 1996) and *Rewarding Excellence* (Jossey-Bass, 2000).

George T. Milkovich is the M. P. Catherwood Professor at the ILR School, Cornell University. Recently Ljubljana University in Slovenia and Zhejiang University in China elected him to their Faculties.

Understanding employment relationships and employee compensation has been George's interest for over 35 years. He studies and writes about how people get paid and what difference it makes. His research has resulted in numerous publications. Four have received national awards for their contributions. George's books, *Compensation*, coauthored with Jerry Newman, now in its 7th edition, and *Cases in Compensation*, coauthored with Carolyn Milkovich, are the most widely adopted books about pay in the world.

George has received many awards, including the Keystone Award from the WorldatWork Association (formerly the American Compensation Association) for lifetime achievement and the Distinguished Career Contributions Award from the Academy of Management HR Division. George is a Fellow in both the Academy of Management and the National Academy of Human Resources, chaired the National Academy of Sciences Committee on Performance and Pay and the Federal Joint Labor-Management Committee on Pay and Performance, and is a founder of the Center for Advanced HR Studies at Cornell, a research and development partnership of leading corporations and the ILR School. George has also received three Outstanding Teacher awards, and recently he designed a Global HRM course using distance-learning technologies.

George has been a Visiting Professor at several leading international universities, including London Business School, Hong Kong University of Science and Technology, Charles University in Prague, Comenius University in Bratislava, and University of California in Los Angeles, and is on the advisory board of five academic/research centers in the U.S. and China

About Workstream

Workstream provides enterprise workforce management solutions and services that help companies manage the entire employee lifecycle - from hire to retire. Workstream's TalentCenter provides a unified view of all Workstream products and services including Recruitment, Benefits, Performance, Compensation, Rewards and Transition. Access to TalentCenter is offered on a monthly subscription basis under an on-demand software delivery model to help companies build high performing workforces, while controlling costs. With 12 offices across North America, Workstream services customers including Chevron, Eli Lilly Canada, The Gap, Home Depot, Kaiser Permanente, Motorola, Nordstrom, Samsung, Sony Music Canada, VISA, and Wells Fargo.

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