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Are You Spending Your Company's Compensation Dollars Wisely?

Dow Scott, *Loyola University Chicago*

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Special Report
On Assessing Pay Programs. . .

Are You Spending Your Compensation Dollars Wisely?

Compensation costs are the largest single expense most organizations have—ranging from 15 to 20 percent in manufacturing to well over 80 percent in the human services industry. Recognizing the strategic impact of compensation, senior executives want to know if these dollars are being spent effectively. However, few organizations systematically evaluate their pay programs or only do so in the most rudimentary fashion.

Some assessment does occur. Traditionally, the human resources department evaluates the compensation package to compare with what other organizations are paying. A chief financial officer must evaluate the compensation system in terms of affordability to ensure the organization has the cash flow to pay both direct and indirect labor costs. The CFO has to consider this issue along with other opportunities or demands on revenues such as investments, discounts to customers and dividends for stockholders.

Although both the CFO and the head of human resources are evaluating the pay programs from two important perspectives, their assessment provides limited insight into the plan's strategic contribution and ability to motivate employees.A more complete and systematic way to evaluate an organization's pay program needs to be developed to document how well it works.

Template for Review

An organization's pay system is composed of multiple programs, such as base-pay, incentives and benefits, directed toward diverse employee populations.

Over many years employee development experts developed evaluation approaches which I have now adapted for evaluating pay programs. This framework asks four basic questions.

■ **Reaction:** Do employees and managers perceive the pay program as fair, just and consistent with company values? Opinion surveys and in-

terviews are typically used to collect this information.

■ **Understanding:** Do employees and managers understand the pay program, how it affects them and what they need to be positively rewarded by the program? While interviews can be used, simple on-line tests work best.

■ **Behavior:** Does the program drive employee behavior consistent with the values of the company and goals of the program? Behaviors often are measured by observation of behavior or by creating work process measures. For example, pay programs designed to reward obtaining new customers are measured by increased sales calls and visits.

■ **Result:** Does the program accomplish the desired results? If pay is designed to encourage sales people to generate business from new customers, then are there more sales to new customers? Results can be framed based around the individual, work group, department, business unit, or organization as a whole.

Few employers effectively evaluate their pay policies.

Multiple perspectives are important because if the pay system is not having the desired results, only by having other perspectives can you narrow down to why it is failing.

Information to evaluate a pay program must be both reliable and valid, and should not be anecdotal. Simply keeping ones "ear to ground" can be misleading; the most vocal employees do not necessarily represent the majority nor do they often offer actionable information. This why a rigorous methodology or process for evaluating pay programs must be established and followed.

To obtain valid, reliable and timely information, a systematic process must be established to collect, analyze and report information from the

multiple perspectives outlined above. This includes specifying pay goals consistent with the business' strategy and aligned with the firm's pay philosophy.

Next, measurable criteria must be determined for each pay program goal. This can include measuring the perception of a program's fairness or the effectiveness of an increased sales goal.

A research design then must be established so the data collected is reliable and conclusions drawn from the data can be considered valid. Care must be taken to insure that mistakes are not made in data collection and data coding. Corrupt data falsifies findings which erode the effort to evaluate the pay programs.

Finally, the findings must be interpreted correctly and reported such that information is coherent and can be used to make decisions to improve or abandon pay programs.

To evaluate pay systems such that they can be systematically improved or abandoned requires integrating multiple perspectives with a rigorous evaluation process. Although program evaluation is fairly straight forward, consider using an outsider to conduct evaluations or at least to provide assistance in designing the process. Compensation programs are major organization expense that, if designed properly, can provide a competitive advantage. A relatively small investment in evaluation can determine if a program is doing what it was designed to do and can provide meaningful feedback for improvement

By DOW SCOTT, PH.D.

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