There Is No “Merit” In Base Pay Merit Increase Programs

So...What Are The Alternatives?

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Using Compensation Programs To Help Successfully Attract And Retain The Best And The Brightest...

Can this be accomplished by using a Base Salary “Merit” Increase Program as a primary reward vehicle?
Where’s The ‘Merit’?

‘It’s a zero-sum game --- and it’s not enough!’

‘It’s all relative’

‘They all exceeded their performance objectives --- now what?’

‘Base salary increases are forever!’

‘Is Old Joe motivated?’
So What Are The Alternatives?

True Pay-For-Performance
In a Comprehensive
Incentive Compensation
Program

But Are You Ready?

The Objectives and
“The Ten Criteria
For Success”
Incentive Compensation Program

**Objectives:** We Want to Create and Support...

- Employees who are focused on adding value to the business by meeting/exceeding performance expectations.
- True employee “ownership”.
- Retention and motivation of productive employees.
- A good “sell” to top candidates; a compelling reason to join the company.
- A marked distinction between those who go “above and beyond” and those who do not.
- An environment that discourages the entitlement mentality.
- An appropriate mix between base salary, incentive opportunities, and all other components of the total rewards strategy.
1. **A Successful Program Is Aligned With Organizational Culture/Values**

Culture and values must support an incentive framework: instilling a “Sales Mentality”

Senior management must allow the incentive program to work

Should have “Pay By Example” at the top of the organization
2. A Successful Program Is Fair to Employees

Must be internally equitable and externally competitive

Performance criteria must be discernible, valid and understandable

Program must deliver what is promised on time and fairly
3. A Successful Program Is Fair to the Organization

Should work towards self-funding

Organization should be relatively profitable when the program is initiated

Program design should guard against “windfall” payments
4. A Successful Program Sets Total Compensation Integrated With Total Rewards

Compensation policy must be aligned with total rewards and strategic objectives.

Incentive pay should be directly tied to performance criteria achievement: direct line-of-sight.

Consider re-defining what is meant by a base salary increase.
A Successful Program Yields Financial Returns to Employees

Incentive opportunities must be perceived as “substantial” enough to motivate performance.

Timing of incentive payments should be as close as possible to the qualifying event.

If designed properly, payouts to employees will yield “slices from an expanding financial pie”
6. A Successful Program Yields Financial Returns to the Company

A well-designed and executed incentive compensation program can improve the organization’s bottom line.

Measurable benefits can include improved:

- Morale
- Productivity
- Quality
- Customer Service
- On-time Performance
- Work Methods
- Etc., Etc., Etc.
7. A Successful Program Involves Employees And Managers

Middle managers will make or break the incentive compensation program

Must get buy-in from employees

Should involve employees and managers in the plan design, including identification of performance criteria

Build trust!
8. A Successful Program Uses Internal And External Data

Collect and analyze accurate and valid competitive data

Build the incentive program from a “rational” base pay foundation

Base salary serves as the anchor in total compensation/rewards planning
9 (a). A Successful Program Sets Forth Clear Performance Goals

Performance criteria in successful programs are:

- “cascading”
- a combination of quantitative and qualitative measures
- simple to understand
- supported by valid data
- monitored through strong controls
9 (b). A Successful Program Sets Forth Clear Performance Goals

Aligning rewards to performance requires the following:

- a clear (and clearly-perceived) relationship between pay and performance
- predictable measures of performance
- visible benefits to the employees and the organization
- regular formal and informal performance feedback
10. A Successful Program Achieves Clarity Through Communication

Communication mega-objectives:

- to ensure understanding
- to change perceptions  
  (get buy-in)
- to motivate behavior

Even the most elegantly-designed incentive compensation program will **not** achieve the desired results unless employees and managers understand and, ultimately, buy into the program
**INCENTIVE PROGRAM ‘FRAMEWORK’**
(Can Be Tailored To Your Organization)

<table>
<thead>
<tr>
<th>TIER</th>
<th>TARGET OPPORT.</th>
<th>RANGE: OF TARGET</th>
<th>PERFORMANCE WEIGHTINGS</th>
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<tr>
<td>1 – Officers</td>
<td>35.0%</td>
<td>0 – 52.5%</td>
<td>70% 20% 10%</td>
</tr>
<tr>
<td>2 – Directors</td>
<td>25.0%</td>
<td>0 – 37.5%</td>
<td>40% 50% 10%</td>
</tr>
<tr>
<td>3 – Managers</td>
<td>15.0%</td>
<td>0 – 22.5%</td>
<td>30% 50% 20%</td>
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<tr>
<td>4 – Profess.</td>
<td>10.0%</td>
<td>0 – 15.0%</td>
<td>20% 20% 60%</td>
</tr>
<tr>
<td>5 – Support</td>
<td>8.0%</td>
<td>0 – 12.0%</td>
<td>10% 20% 70%</td>
</tr>
</tbody>
</table>
“Cascading” Performance Management

- Corporate criteria are always **quantitative**: measures how the organization defines financial/operational success (2 or 3 criteria).

- Also, develop “**Qualitative**” Corporate Goals (QCG’s): organizational-wide business & operational objectives for the upcoming performance period.

- QCG’s are used to “cascade” Departmental and Individual/Team Goals.

  **Departmental and Individual/Team Goals** should be both **quantitative and qualitative**:

  - Criteria must be valid, discernible and measurable and, if applicable, with milestone dates.
  - No more than four to six criteria per category.
  - Narrative rating scale can be used to assess qualitative criteria.
**INCENTIVE PROGRAM Performance Criteria (example)**

Corporate criteria (Quantitative): **NET INCOME**  
(% growth over previous year)

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Payout</th>
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<tbody>
<tr>
<td>MAXIMUM &gt;=17%</td>
<td>150%</td>
</tr>
<tr>
<td>TARGET 12%</td>
<td>100%</td>
</tr>
<tr>
<td>THRESHOLD 9%</td>
<td>50%</td>
</tr>
<tr>
<td>&lt;9%</td>
<td>0</td>
</tr>
</tbody>
</table>

(Interpolate for points in-between)
Consider Adding More “Pay at Risk”

- Remove performance considerations from base salary increase decisions – pay for performance within the incentive program framework.
- Re-define base salary increases as across-the-board market adjustments only, determined by competitive position analyses.
- The difference between the base salary “merit” budget and the market adjustment factor can be used to partially fund the incentive program. (May not be fully-funded the first year; requires an “investment” on the part of the organization)
- On-going “fixed” expenses can be considerably reduced due to the compounding effect of base salary increases.
- Incentive compensation is paid in lump sum only when performance warrants: “pay at risk”.
The Ten Criteria For Success!

A SUCCESSFUL INCENTIVE COMPENSATION PROGRAM...

1. Is Aligned With Organizational Culture/Values
2. Is Fair To Employees
3. Is Fair To The Organization
4. Sets Total Compensation Integrated With Total Rewards
5. Yields Financial Returns To Employees
6. Yields Financial Returns To The Company
7. Involves Employees And Managers
8. Uses Internal And External Data
9. Sets Forth Clear Performance Goals
10. Achieves Clarity Through Communication
Seven Steps Guaranteed To DIS-ENGAGE Your Talent And Send Them Fleeing From Your Organization

1. Be sure no one quite knows what his/her job is
2. Keep selection criteria and career paths vague
3. Insist on a one-size-fits-all total reward strategy
4. Be vague about how successful performance is defined and measured
5. Keep salary ranges, increase percentages, incentive compensation guidelines, and most components of total rewards secret
6. Surprise employees with a bigger paycheck or lump-sum award
7. Be defensive when asked to explain and defend human resources and total rewards actions