The severe contraction in the global economy brought by the economic crisis will have profound and lasting implications for the way organizations use their employee reward programs to help deliver their business strategy. Hay Group recently conducted The Changing Face of Reward research to better understand the factors driving changes in reward strategy, design and implementation, and how organizations are responding to those changes to meet the challenges of the new business environment. This research is the first study of this decade to identify the drivers in reward that now dominate the thinking of Boards and senior executives in the post-recession world.

ABOUT THE RESEARCH

The research was conducted in late 2009 to early 2010 via face-to-face and telephone interviews using a set of open-ended questions designed to draw out the issues which were ‘top of mind’ for senior HR and reward leaders around the world on the topics covered. A thematic analysis of the responses then identified the common themes. Almost half of the 230 respondents were based in Europe, 25% in Asia, 20% in North America and the remainder in other geographies. Organizations participating in the study have revenues totaling $4.5 trillion and 5 million employees.

THE CRISIS AS CHANGE ACCELERATOR

The survey participants were clear that the recession will leave a lasting legacy: there will be no return to ‘business as usual.’ Those organizations that survived the immediate challenges of a deep and wide-reaching downturn have emerged to a changed landscape—one which is more cost-conscious and performance-oriented. Fundamentally, the recession has accelerated the pace of existing macroeconomic changes. The emphasis in multi-nationals towards emerging markets has become even more pronounced as markets such as Brazil, India, China, Eastern Europe and the Middle East have continued to grow and proved resilient against the long-term effects of the financial crisis. The speed of change, as well as globalization, has increased across all industry sectors as organizations innovate to protect their positions and find new opportunities.
As demand has ebbed, companies are focusing heavily on customer retention and maintaining client relationships while they wait for market conditions to improve. As a result, cost containment is a major issue. Most companies have already cut employment costs as much as they can via layoffs, organization restructurings, pay freezes and curtailing internal investments. The focus has now turned to the centralization and rationalization of business and management processes. In stagnant or slow-growth markets, cost management continues to be critical to survival; but even organizations that continue to grow are reassessing their cost base and optimizing their management processes to position themselves for a sustainable future.

Organizations are emerging from the recession leaner and focused on activities that bring the greatest returns to the organization—i.e., “don’t waste the opportunity a recession gives you to make needed changes.” Difficult choices are being made as available money has to be earned via performance and allocated to those areas (and people) most critical to business success. While the focus remains on the bottom line, increased efficiencies will be a core driver of profit growth going forward.

**PERFORMANCE IS THE NEW MANTRA**

In a boom market, many organizations are prepared to achieve growth at the expense of the bottom line in anticipation of seeing future returns from increased market share. In contrast, organizations now want to demonstrate a verifiable return on investment from any activity—and with employment costs representing up to 70 per cent of an organization’s cost base, this clearly includes reward. The dominant theme from most respondents is ‘doing more with less.’

As well as addressing the efficiency of organizational structures and human capital processes, there is a strong focus on the alignment of team and individual performance to corporate goals. Leadership has also come under the spotlight as organizations ensure that their management has the strength and skills needed to lead the organization out of the recession. Leading organizations, however, are already focusing on execution and building a strategy to position them for growth. Recognizing that an excessive focus on short-term shareholder return was one of the root causes of the financial crisis, the best leaders are keeping an eye on long-term strategy as well as the role their organizations play in society in general. Performance is being redefined, and with it reward.

**KEY RESEARCH THEMES**

Three dominant human capital and reward related messages emerged from the research:

1. **The recruitment and retention of key talent continues to be an important strategy; with the market for these individuals remaining strong despite the downturn, the focus is on motivating, engaging, and rewarding high performers in key roles.**

2. **Companies are looking for ways to balance the need to reward employees with its cost and the need to pay for great talent in an increased regulatory environment.**

3. **The focus on pay for performance has never been greater. The effective design and execution of variable pay programs is a critical lever for motivating performance and employee engagement, and providing the needed flexibility in the reward cost base.**

**RECRUITMENT AND RETENTION OF TALENT**

In this tough market, a talented, engaged and motivated workforce is even more critical to success. Employment relationships have been redefined—the old loyalty-for-security contract has been cast aside and the connection between individuals and organizations has become more tenuous—and demand a different approach to talent management.

The emphasis on retaining and rewarding high performers emerged as one of the dominant themes of the study. Organizations of all sizes in every sector cited the recruitment and retention of key talent, along with the development of internal candidates, as a core strategy. While companies are increasingly channeling their limited financial rewards to these key employees, many of the individuals in these roles are often motivated by far more than money. As a result, organizations are focusing on differentiating their reward programs for their key talent by offering clearer career paths, more meaningful work experiences, global mobility and targeted development in addition to the increased monetary awards.

But, companies need to be cautious about focusing exclusively on high performers to deliver their business results. There is a danger that ‘solid’ performers—who make up the vast majority of the employee population—can find themselves ignored in the rush to reward top talent and weed out...
poor performers. And in most organizations, shifting performance in this middle category is what will really make a difference in surviving the recession and performing in the upturn. Organizations need to keep this critical set of staff motivated, engaged and adequately rewarded for the positive contribution they make.

In a challenging global economy where organizations are running lean, tapping into the discretionary effort of engaged employees is imperative. Our research has shown that organizations in the top quartile on employee engagement demonstrate revenue growth 2.5 times more than that of organizations in the bottom quartile; and those that score highly for both engagement and enablement have revenue growth 4.5 times higher. Maintaining this engagement is challenging when the recession has left many organizations with a disaffected and worried workforce who are pessimistic about their future. While many employees are focusing less on job security in the current environment, organizations are acutely aware that, come the upturn, this will not last.

Many organizations have also cut back on some of the most significant drivers of engagement, such as training and career development. In this environment, leaders need to help employees understand that an organization has a coherent strategy that will allow it to succeed and that all employees have a role to play in helping the organization carry out its plans. An urgent need for more stringent succession planning was raised by many survey respondents. With the Baby Boomers nearing retirement, identifying and preparing the best leaders for the future is a real concern. The challenge for many, though, lies in meeting the different demands of a younger generation of workers. Generation Y expects a patchwork career, does not routinely demonstrate loyalty to a single employer, and expects to be in charge of their own career path. More and more employees are looking for an environment where they feel they are contributing in a positive way to something larger than themselves.

**BALANCING REWARD COSTS, RISK AND TALENT MANAGEMENT**

The natural tension between reward cost containment, managing risk and talent management is a very strong theme arising from the research. Organizations are concerned about employee retention and motivation, particularly for top performers, high potentials and those with scarce skills. However, the option of paying more for retention or performance is often no longer available and companies are increasingly focusing more on total rewards (including such areas as motivational leadership and work climate, challenging work, impact-ful project opportunities, career development and recognition) to boost engagement.

Risk is an inherent element of reward, but has not always been clearly articulated, understood or managed by organizations. The global financial crisis and subsequent recession have prompted many governments and regulators to seek to control and monitor reward more closely, particularly at the executive level. One of the many consequences of this has been an ongoing evolution in the role of the compensation committee, which is increasingly expected to oversee not only the pay of executive directors, but also variable pay arrangements across the organization, particularly from a risk perspective.

But, these restrictions create artificial constructs that come with risks of their own. Some organizations, for instance, have sought to circumvent pay caps by increasing pension payments to key employees—despite the fact that pension packages often have very limited motivational value and limited links to corporate performance. Others have increased fixed pay to compensate for the deferral of bonus payments. Regulation, in other words, is a blunt tool and its effectiveness in terms of risk management is limited. The sheer volume of regulatory activity has arguably prevented organizations in the financial services sector, particularly, from focusing on developing a more strategic approach to reward.

We believe the most effective solution is for governments and organizations to take a holistic view of reward to ensure that organizations’ reward programs can reasonably be expected to drive long-term, sustainable performance. What’s more, that performance should not be defined solely by shareholder returns. It is also about trust and social responsibility. In practical terms, this means organizations should be able to demonstrate that behaviors created by an organization’s reward programs are aligned with the long-term interests of all its stakeholders.

We term this ‘responsible reward’ and, at its best, it is a strategy that promotes a spirit of partnership to sustain the business, moderates excess, and reduces risk. Hay Group’s research suggests that a successful responsible reward strategy:
Enables the long-term sustainable success of the organization and rewards performance over the same time horizon that business value is created.

Does not enrich management and employees to the detriment of shareholders and considers the extent to which performance is driven by external factors beyond management or employees’ control.

Is linked to a few performance measures that reflect the impact of the activity not only on shareholder value but on a broader definition of value.

Achieves an appropriate balance between individual, team and corporate performance and encourages rational thinking about the unique combination of economical and societal responsibilities of the organization.

Is competitive enough to attract and reward the talent the business needs via multiple and differentiated rewards, but does not unnecessarily overpay for talent.

Is actively, effectively and repeatedly communicated to employees and stakeholders.

Recognizes that total rewards goes beyond pay and benefits.

FOCUS ON PAY FOR PERFORMANCE

A relentless focus on performance is a recurring feature of the study, as organizations seek to reverse some of the sloppy performance management practices that crept in during the boom years when retention of employees was the priority. The first step in this process is ensuring that employees understand what performance looks like. The uncompromising, performance-oriented, post-recession world into which organizations are emerging has far-ranging implications for reward. Performance will be a key driver and total rewards—which are more closely tied to performance—will play a crucial role in allowing organizations to compete in the new environment. Variable pay, differentiated rewards and performance metrics will all play a vital role in any new strategy.

The research confirms that many organizations are working to align their reward, performance and business strategies, either because their business strategy has changed or because alignment was not already optimized. In practical terms, this means ensuring that:

- The right performance metrics are used and that reward programs are closely tied to those metrics
- Performance and rewards are appropriately differentiated
- Supporting performance management processes are in place
- Leaders have the capability and commitment to implement and communicate reward programs effectively.

The ‘right’ performance metrics: Organizations report seeking to realign their performance metrics to their business strategies and goals. There is increasing recognition of the need to manage risk by driving the ‘right’ performance—behaviors as well as outcomes. While there are no easy answers and different approaches will be adopted for different reasons, the overall instinct is to find a better balance between short and long-term metrics, between corporate and individual performance, and between financial, operational, customer and human capital metrics.

Some organizations will continue to place more emphasis on financial measures in rewarding performance. Times are tight, and organizations want to know that they are going to get a return on the money they invest in their reward programs. However, this emphasis on financial measures is at odds with what we know Fortune’s Most Admired Companies do. While peer companies apply performance metrics to executives that are focused on operational excellence, profits or revenue, the Most Admired go further by adding measures around long-term goals, building human capital and customer loyalty. There is a risk that a predominate concern for bottom-line performance may drive some companies to ignore the risky side effects that come with an over-focusing on narrower short term performance goals. Whatever goals are set, it will never take away the need to arrive at a ‘holistic’ view of an individual’s performance over a given period that takes into account financial impact, impact on customers, behaviors and organization values.

Differentiating performance and rewards: Organizations in all sectors are striving to forge a closer link between performance and rewards. While this is nothing new, many survey respondents talked about a general shift from a culture of ‘entitlement,’ ‘paternalism’ and ‘comfort’ to one of ‘performance.’ In practical terms, this is leading to a greater differentiation of reward based on individual performance.
The limited reward increase budgets that are available are being channeled increasingly to high-performers and key roles that are seen as critical to the business. Hay Group’s research into the reward strategies of Fortune’s Most Admired Companies has shown that the best organizations carefully target their use of differentiated rewards. When bonuses are taken into account, senior managers in the world’s top organizations can earn 20 per cent more than their peers. They are being rewarded for their ability to deliver and ensure that their organizations stay at the top of their sector—they are driving the strategy and motivating their people.

**Performance management processes:** Organizations report that they are ensuring their performance management systems and processes work to drive the performance they define. This may mean introducing more efficient systems and processes, and centralizing or automating various aspects of this process. But, most recognize that those systems and processes will only work if they have the right culture, focus and management skills to support it. The focus for many, as a result, is on building skills around performance management, and on ensuring transparency and more effective execution of the performance management process.

While responsibility for defining performance rests with leaders, the responsibility for managing performance in accordance with that definition rests with line managers. Line managers are ideally placed to help employees understand and commit to organizational expectations. The other side of the coin is an increasing need to address low performers—to lift them up, or manage them out. Low performance may have been tolerated in the past but few organizations can afford to ‘carry’ anyone anymore. There is a general recognition that addressing poor performance is often a more challenging task than dealing with high performers, and organizations are looking to better equip line managers to have those difficult conversations.

Part of this renewed focus on pay for performance is the increased spotlight on variable pay programs. A clear trend as organizations emerge from the recession is a shift in focus from fixed to variable pay. This is partly cost-driven, as those organizations with higher proportions of variable pay (and therefore the flexibility to cope with economic volatility) have often been better placed to survive without shedding jobs. Variable pay is also a critical lever for motivating performance and aligning and engaging employees in the organization’s goals and priorities. The best organizations are using variable pay to enable their performance management strategy, not purely as a cash flow tool.

**Say what you need to say:** The new trends in reward strategy cannot succeed without a solid foundation of good communication, based on strong leadership. At every stage—the drive towards variable pay, a closer link between performance and reward, differentiation of high and low performers, retention of talent and a trend towards total reward—there is a risk that the return on investment will be lost if leaders and managers have not clearly communicated the organization’s intention and strategy and made this real for employees.

Hay Group’s research into Fortune’s Most Admired Companies revealed an emphasis on promoting the total rewards view—the best organizations do not necessarily offer higher levels of rewards than their peers, but they do a much better job of communicating what they do offer and ensuring employees understand its value. The best organizations develop a course of action that weaves the reward program messages into the fabric of the organization; ensuring core messages are clearly communicated and reinforced frequently; using total reward statements, and engaging line managers, early and often.

The reward ‘to do’ list:
1. Review reward strategy to ensure that it supports business strategy.
2. Clarify what performance really means and reassess performance criteria so reward is linked more closely to goals that clearly reflect the vision and strategy of the organization.
3. Balance the mix of variable and fixed pay as well as the mix of individual, team and enterprise targets for variable pay to ensure it is right for the company culture and for business needs.
4. Introduce multiple and differentiated rewards (tangible and intangible), increasingly channeled to top performers and high potentials in key roles.
5. Communicate the true value of your reward package, and how it supports the goals of your business.
7. Closely assess and measure the return on investment from reward programs and strategy.