Reward Program Centralization in Multi-National Corporations

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Oscar Wilde once said that "consistency is the last refuge of the unimaginative," yet consistency and centralization in reward programs is toward the top of the list in terms of areas of focus of today's reward leaders in multi-national corporations (MNCs). Most organizations struggle in terms of finding the right balance between global consistency vs. local freedom in reward program strategy, design and execution. This paper examines this issue, provides current research data on organization practices and provides the reader with some tools to consider in finding the right balance.

ECONOMIC BACKDROP

The recent global economic downtown acted as a catalyst for many organizations to centralize more aspects of their reward programs. While cost reduction and risk mitigation were primary drivers, organizations also did this to more rapidly focus on achieving key corporate business objectives. The downturn caused organizations in developed economies to take an intense focus on cost containment and productivity enhancements in most sectors and many companies have already reduced employment costs as much as they can through redundancies, restructuring, limiting compensation growth and restrictions to internal investments.

The focus for many is now on centralization and rationalization of business and management processes, including reward processes. In stagnant or slow-growth markets, effective leverage of corporate assets and management processes continues to be critical to survival; but even those organizations who continue to grow are taking the opportunity to reassess their cost base, optimize their management processes and put their operations on a more sustainable course for the future.

The pace of globalization intensified as organizations more aggressively sought out markets where they saw opportunities to achieve growth. Markets such as Brazil, India, China, Middle East, Central and East-

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ern Europe and Southeast Asia have continued to grow and have proved fairly resilient against the long-term effects of financial crises. And organizations in these high-growth developing markets are working even harder to bring themselves up to international standards—and they see current economic conditions as a welcome opportunity to gain some spacing from the intense pace of change.

IMPACT OF ORGANIZATION OPERATING MODELS

The degree of centralization and consistency of management processes (including reward processes) cannot be made in isolation of the organization's operating model and the role of the corporate center. Essentially, the role of any corporate entity is to enable and support organization growth and adding value to its customers over time. It achieves this by focusing on three areas:

- **Leveraging the center's resources:** includes providing cheaper sources of capital, making use of economies of scale and leveraging existing best practices across the organization via standardization.
- **Creation of synergy:** includes integrating and sharing organization resources and ensuring compliance by business units with pertinent regulations.
- **Formulation of new knowledge**: includes a search for solutions that are already present in the organization, organizing knowledge for the organization and facilitating R&D processes.

The corporate center must ensure that each of its strategic business units (SBUs) realizes its biggest advantage: its capability to create a learning organization. Through the formal practice of codifying and rapid dissemination of company best practices, the center can ensure that its SBUs learn to avoid their mistakes and repeat their success.

As shown in figure 1 below, there are different models of the role of the corporate center based on the degree of diversity in the SBUs and the way in which the corporate center entity adds value to the business. Moving from left (Investor) to right (Functional/Business Manager), the degree of diversity in the nature of business entities in the organization portfolio transitions from very high to very low (or none).

The nature of the value add and the main activities of the corporate center also change from one of primarily financial portfolio management (Investor) to a heavily integrated center (Functional/Business Manager), which directly steers operating businesses and globally coordinates operations and functions across regions, products and business units. The reward orientation—and indeed the entire human capital orientation—of the corporate center will legitimately vary from inconsistency to consistency moving across this spectrum of operating models

Figure 1: Corporate Operating Models

	Investor	Holding Company	Strategic Architect	Shared Service / Operator	Functional / Business Manager
Description	• Partial ownership of a variety of businesses, funds or alternative investments	• Diversified, unrelated business with limited or no synergies • Large number of holdings • Little need for corporate control	• Semi-related / complementary business units – often created during acquisitions • Require some level of corporate control / governance	• Single industry or synergistic companies with strong links across business units • Require cross-functional management direction at BU level	• Single business company
Key Corporate centre Activities	• Manages portfolio and provides / allocates capital	• Reviews strategic plans and allocates capital to business units	• Sets overall direction; focus is on gaining synergies across business units	• Is accountable for all operations; functions are centralized under a single corporate centre	• Actively manages business units' operations

Figure 2 (below) provides a useful set of criteria to help determine where an organization should be placed along the continuum of corporate operating models. These factors serve to decode the characteristics of these operating models and also provide guidance as to the degree of centralization and consistency of management processes in general and reward processes in particular. It would be foolish to provide a highly consistent and centralized set of reward programs in an Investor or Holding Company as it would be to provide a highly variable set of programs in a Functional/Business Manager Model.

Figure 2: Factors that Drive Corporate Operating Models

	Investor	Holding Company	Strategic Architect	Shared Service / Operator	Functional / Business Manager
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Recent Hay Group research of 19 large multi-national organizations found that there is a significant emphasis on centralization across most functions (see Figure 3 below). There is significant centralization in certain staff functions such as legal, finance, information technology, R&D and external relations and to some degree, human resources. Supply chain, manufacturing, marketing and sales tend to walk the middle path with greater levels of flexibility to meet local needs. Implementation and execution is significantly more distributed and decentralized with sales and manufacturing in particular. Some functions like R&D, Legal and External Relations favoring centralization and HR, supply Chain and marketing treading the middle ground. This data further reinforces the intensity of focus for HR and reward leaders in finding the right balance between centralization and decentralization in both strategy and execution.

Figure 3: Degree of corporate function centralization

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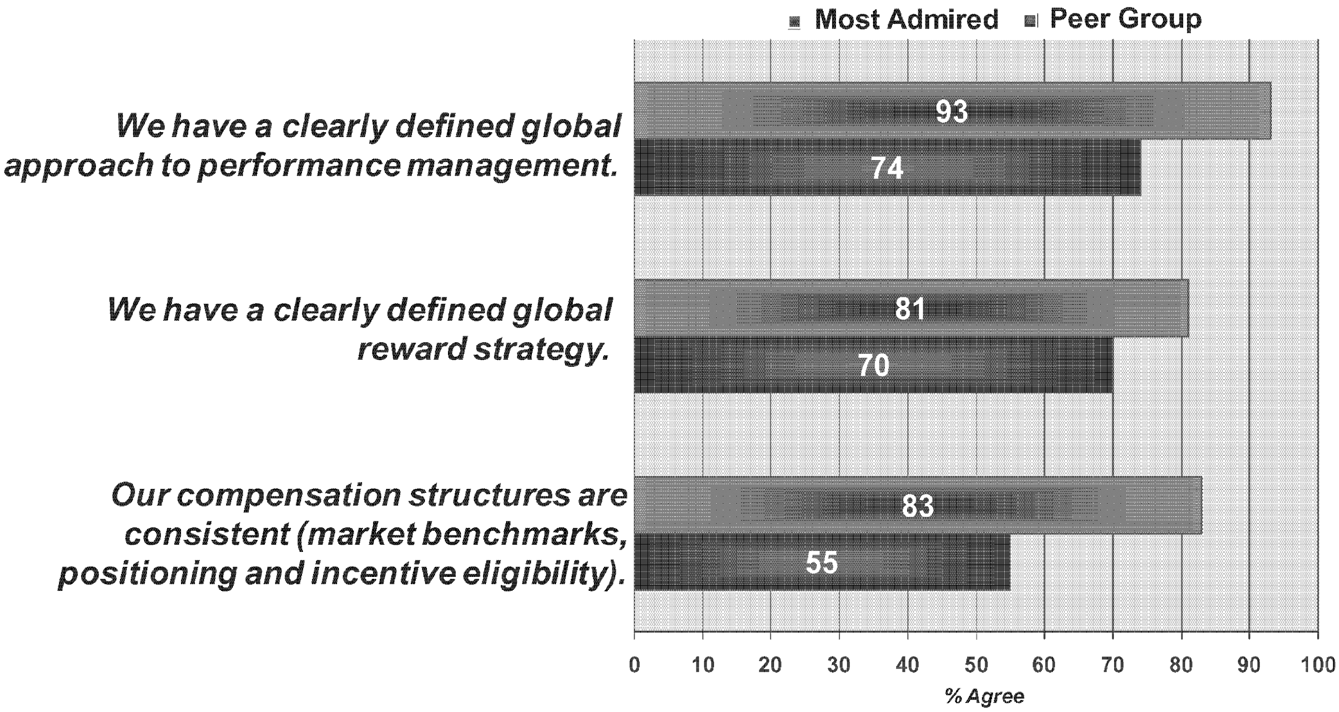
	Strategy and Policy Design			Implementation/ Execution of Services		
	Centralized	In-Between	Decentralized	Centralized	In-Between	Decentralized
Finance	84%	16%	0%	37%	53%	11%
Human Resources	58%	42%	0%	17%	61%	22%
External Relations	74%	21%	5%	58%	26%	16%
Info. Technology	74%	26%	0%	42%	53%	5%
Legal	89%	11%	0%	58%	37%	5%
R&D	72%	28%	0%	44%	28%	28%
Supply Chain	44%	50%	6%	11%	67%	22%
Manufacturing	39%	39%	22%	17%	39%	44%
Marketing	42%	58%	0%	21%	53%	26%
Sales	26%	42%	32%	16%	21%	63%

CENTRALIZING REWARD PROGRAMS

Hay Group research has found that found that Fortune magazine Most Admired Companies do a better job of ensuring that their reward programs are clearly aligned with their organization's goals, strategy and culture and they tend to take a more centralized approach to reward strategy, compensation structures and performance management programs. In seen in Figure 4 below, these organizations are more likely than their peers to say they have centralized compensation structures that emphasize internal consistency in market comparators, market positioning strategies and clear criteria for incentive eligibility.

Figure 4: Consistency in Reward Management



One of the key reasons for more global consistency in reward programs is that international experience is viewed as a key factor for advancement to senior leadership positions. Many global companies make use of planned career assignments to more rapidly develop this global experience. In global companies, moving up is likely to involve "moving around" to develop a broad base of international experience. Staffing leadership positions in business units and subsidiaries through temporary project assignments (i.e., short term assignments focused on the achievement of specific goals), expatriate assignments (i.e., assignments with clear plans to repatriate managers at some point in the future) and international transfers to different business units is a proven approach. Without a consistent platform for evaluating performance across the organization, it is difficult to align people with global job opportunities based on what the roles require and the appropriate development plans for individuals.

Organizations are investing heavily in ensuring that their performance management and reward processes work to drive the performance they define. This often means introducing more aligned, efficient and consistent processes utilizing a consistent technology platform. But most recognize that these systems and processes will only work if they are aligned with the organization's operating model, culture and management's capabilities to support these programs. While a desire to cut costs and reduce risk has led many organizations to centralize much of their reward programs, advancements in technology cannot be overstated in terms of its role in enabling a greater degree of centralization and consistency in reward strategy, design and administration and this trend is becoming even more pronounced.

While centralization has many benefits, the danger is that centralized programs and policies can contradict sharply with local demands and practices, and may disengage local management if they are too restrictive or fly in the face of local practices. That said, organizations are continuing to allow for variations in business units or locations if it makes sense to do so. For many, the concern is striking the right balance between global consistency and local adaptability, and allowing for proper recognition of varying local practices such as tax legislation, social benefits and regulation.

COMMON REWARD PRACTICES

Hay Group has undertaken two recent global research initiatives to better understand the degree to which there are globally consistent practices in managing executive compensation in MNCs. A total of 50 MNCs participated in these two studies. Several key findings from these studies include:

- A majority of multi-national corporations (MNCs) report a fairly centralized approach towards managing their global executive compensation framework. The four most common executive compensation processes indicated by the surveyed organizations that are governed centrally at the corporate center are:
    - Job evaluation processes
    - Compensation benchmarking comparators and pay positioning
    - STI plan design
    - LTI plan design, target levels and administration
- A majority of respondents (60%) have one global STI & LTI program for their executives.
- The stated main purpose on the rationale for centralizing executive compensation decisions in these organizations is as follows:
    - Strengthen governance and control over the executive compensation program: 65% of participants
    - Provide a strong and consistent linkage between compensation and performance: 52%
    - Support global mobility and talent management: 35%
    - Improve internal equity in pay: 23%
    - Better program cost management: 16%
- Most respondents view their HR centers of excellence (COE) to be effective:
    - The COE works well in supporting entire organization: 61% of participants
    - We are considering creating a COE as we do see its value: 23%
    - We are not considering a COE: 10%
    - Not sure how it could support our organization: 6%
- Benefits and payroll administration which require little or no parent company's involvement have been identified as the most common decentralized global executive compensation processes.

LOCAL CONSIDERATIONS

The most frequent point of conflict in implementing a global reward strategy lies between the corporate philosophy and design components and the local country operations. Local regulations, practices and cultural expectations play a significant role in reward, but can be lost or ignored in a centralized strategy. Brazil, for example, is one of the most sophisticated markets in the world when it comes to short-term incentive programs. According to Hay Group research, 99 per cent of Brazilian organizations have a short-term incentive program for their employees and foreign competitors have frequently struggled to keep up. The emphasis on short-term incentives lies in Brazil's history of hyperinflation but continues to be actively encouraged through the country's tax and legal systems.

Russia, by contrast, is an environment where incentive-based rewards has rarely been taken seriously (although many MNCs are working hard to address this). Their experience of past economic crises and bank failings means that many Russian employees prefer the security of base pay to uncertain bonuses. As an added complication, many Russian organizations overpaid and over-promoted workers during the boom years, leading to a weak and haphazard link between pay and performance. While many organizations are working to introduce a performance-based pay strategy, many challenges remain. Imposing a global policy on variable pay without an understanding of the different markets is obviously not workable.

These challenges played out in our survey research. When asked about the key challenges in relation to Executive Compensation for the HR Center of Excellence, 38% of surveyed organizations mentioned that having access to reliable international rewards pay level and pay practice data is one of the primary challenges faced by the global COE. Managing local accounting and tax regulations stood out as the other key challenges faced by the global COE.

Surveyed organizations also told us that China and South America are the most challenging markets in regards to developing executive compensation programs. Some of the challenges faced by the surveyed organizations in these markets include high employee turnover, lack of reliable quality data, high cost of living and undervaluing of long term incentives in these emerging markets.

CONCLUSIONS / RECOMMENDATIONS

A reward strategy is a concise blueprint of the intent of the reward program. It should force choices and differentiate. It should not consist of platitudes and motherhood and apple pie statements. A robust global reward strategy should consider all of the elements as depicted in Figure 5 below. A previous Journal of Compensation and Benefits article "Time to Take a Fresh Look at Your Reward Strategy (March/April 2010) provides more detail on each one of these 15 reward strategy elements.

Figure 5: Reward Strategy Elements

Program objectives	Purpose of each reward element	Job analysis and evaluation	Labor market definition	Segmentation and consistency
Target competitive position	Mix / use of leverage	Link to performance	Compensation administration policies	Ability to pay
Internal and external values	Intangible rewards	Communication and stakeholder involvement	Governance	Evaluation and review

Hay Group's research and client experience has identified these key steps for the successful implementation of a global reward strategy:

1. Gather input on a global reward strategy with balanced input from stakeholders—senior leadership, managers, employees, HR, customers, key shareholders.

2. Develop the strategy in sufficient detail. Ensure that it is more than a mission statement and has clarity around all non-negotiable areas.

3. Explain the global strategy to all local countries and test it with them to identify in advance any unintended consequences that may result from local taxes, culture and employment practices.

4. Work with local HR and management to translate the global strategy into local implementation plans.

5. Clearly spell out the strategy and supporting rationale for local employees, managers, senior leaders and HR.

6. Continually measure and test the program via employee engagement surveys and against local market practices and adjust as needed.

Once a global reward strategy is in place it is prudent to develop and communicate a process to ensure that it remains relevant to the changing business environment and that any changes can be made without going back to the drawing board. A key issue to be determined here is to identify levels of authority for each of the key reward processes in the organization. A simple and effective way to do this is to consider a typical multi-national business with local, regional and corporate HR teams. Each reward policy or program can be classified to determine who has primary authority or ownership over which policies and who needs to be consulted or informed. A simple inter-accountability matrix can aid in this approach. The key point to focus on when considering governance of global reward programs is the clarity of the decision making process and it is of utmost importance that all key players understand who has the authority to sign off on existing programs.

Of course, the ultimate success of the reward program is the degree to which the organization can use it to globally attract, retain and engage people it needs to be successful. The balance between global consistency and local autonomy is a key component of the program that needs to be thoughtfully considered to ensure ongoing effectiveness.