Top CEO Challenges in 2013: The Human Capital and Reward Agenda

*Tom McMullen and Vincent Milich, Hay Group**

This year's Conference Board study on CEO Challenges contained some dramatic findings for reward professionals. As opposed to previous years, CEOs report they are less concerned about external business environment factors, many of which are outside of their control. Instead, corporate leaders are squarely focused on their human capital strategies to drive performance and counter slowing economic growth (see Figure 1 below). Are you ready to help your CEO get the most out of your people?

Human capital concerns are woven through most of the top ranked challenges facing CEOs in 2013 (see Figure 1 below). Challenges such as operational excellence and innovation have obvious connections to the type of talent you attract and develop, how their performance is managed and measured, and how they are rewarded.

Figure 1: CEO Top Challenges in 2013

Challenges	2013 Rank	2012 Rank
Human capital	1	2
Operational excellence	2	NA
Innovation	3	1
Customer relationships	4	7
Global political/economic risk	5	3
Government regulation	6	4
Global expansion	7	5
Corporate brand and reputation	8	9
Sustainability	9	8
Trust in business	10	NA

Source: Conference Board (2013)

Managing in a slow growth environment presents a particular set of challenges. It involves doing more with less, coaxing higher levels of productivity and efficiency from current staff, and ensuring that customer service focus is maintained. This all requires an engaged and

**TOM MCMULLEN is North American Reward Practice Leader for Hay Group based in Chicago. VINCENT MILICH is a Senior Principal for Hay Group based in Metro New York.*

enabled workforce, with a strong linkage between performance and reward. Leaders recognize this need, and the reward profession needs to be ready to help.

In addition to identifying the top challenges, the Conference Board also identified the most prevalent strategies in place to address these challenges (see Figure 2 below). There are several recurring themes noted in these strategies. These themes include:

1. a significant focus on engagement
2. development and retention of critical talent
3. improvement of performance management processes
4. alignment of human capital systems to business strategy

Once again, reward needs to be a strategic partner to help address these challenges. Given that this column is entitled "Reward Strategy and Practice," we thought it would be useful to present our perspective on the role the reward profession can play in addressing CEOs top challenges and strategies for meeting these challenges.

Figure 2: Top Five Strategies to Meet Top Five Global Challenges

	1. Human capital	2. Operational Excellence	3. Innovation	4. Customer Relationships	5. Global Political and Economic Risk
1	Grow talent internally	Raise employee engagement and productivity	Apply new technologies (product, process, information)	Enhance quality of products and services	Integrate long term risk recognition into strategic planning
2	Provide employee training and development	Focus on reduction of baseline costs	Engage in strategic alliances with customers, suppliers and other business partners	Sharpen understanding of customer / client needs	Reduce exposure to risky countries / regions
3	Raise employee engagement	Break down internal silos	Find, engage and incentivize key talent for innovation	Engage personally with key clients / customers	Implement contingency plans for crises (e.g., geographical, political, relocation of
4	Improve performance management process and accountability	Continual improvement (six sigma, total quality improvement)	Create culture of innovation by promoting and rewarding entrepreneurship and risk taking	Increase speed of products and services to market	Manage currency risk
5	Increase efforts to retain critical talent	Seek better alignment between strategy, objectives, and organization capabilities	Develop innovation skills for all employees	Use competitive intelligence to better understand customer / client needs	Establish crisis management teams and procedures

Source: Conference Board (2013)

1. FOCUS ON ENGAGEMENT AND THE ROLE OF REWARDS

The data indicates that the primary human capital priority for senior executives is the focus on improving employee engagement. It is a key plank in addressing the top three challenges noted by CEOs.

Organizations around the world are recovering from the worst global recession in decades. Employees have been through much over the past four years, having experienced wage freezes, lost bonuses, increased work demands, and downsizing. CEOs recognize that top talent may leave for other opportunities as the economy stabilizes, and this has created a renewed emphasis and white-hot spotlight on "employee engagement."

While a number of definitions can be found, employee engagement is usually characterized as encompassing high levels of discretionary effort and employee commitment to the organization. Engaged employees are passionate about their work and are more willing to help each other and the organization succeed, to take on added responsibilities and to invest more effort in their jobs, share information and collaborate with other employees, as well as to remain with the organization than employees who are less engaged. In Hay

Group's Employee Effectiveness framework, we see the following six factors as key drivers of employee engagement (see Figure 3 below)

Figure 3: Employee Engagement Drivers

If we assume a "reward" is anything that the organization provides the employee of perceived value, then rewards go way beyond cash compensation. And when it comes to rewards and engaging your employees, it is often your non-financial rewards that speak louder than money. Hay Group's research, in partnership with WorldatWork and Dr. Dow Scott at Loyola University Chicago,[1] shows that long-term career growth, non-financial recognition, meaningful job designs and equitable pay practices lead to higher levels of employee engagement and retention than do cash compensation programs—i.e., base cash, short term incentives, and long term incentives (see Figures 4 and 5 below).

Figure 4: Impact of Financial Rewards on Engagement

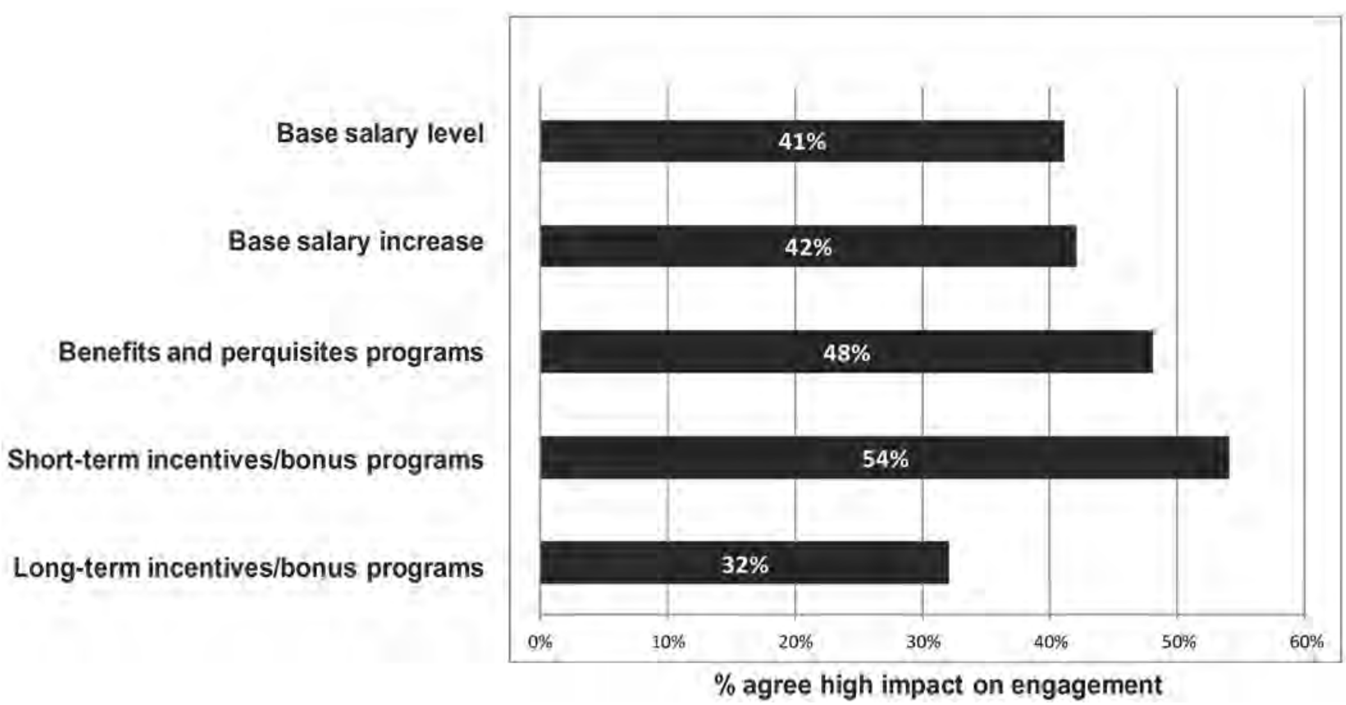
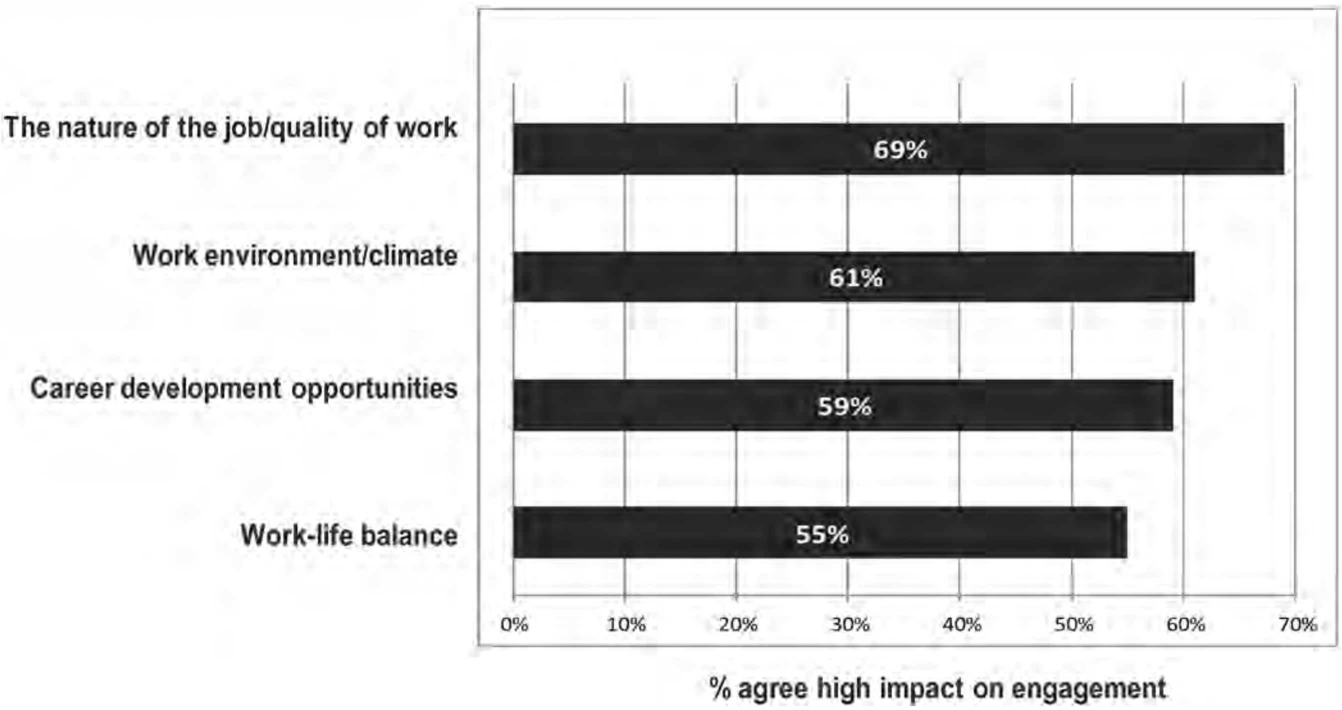


Figure 5: Impact of Non-Financial Rewards on Engagement



The key here is to create a framework that ties all these rewards—financial and non-financial—together into a coherent whole, so that your fast-track management development program isn't sending a different message to employees than your incentive program. In our experience, many organizations can be overly fixated on ensuring competitive pay via external benchmarking and they don't adequately focus on attracting and retaining talent by emphasizing the value of the total reward package and the array of key non-financial rewards. We have seen pay packages that are at the 90th percentile of the market, with disengaged employees and increasing undesirable turnover. On the other hand, we have seen well designed and communicated reward programs, tightly linked to both the company strategy and the needs of employees, which succeed even though they may not be above market median.

Reward effectiveness comes not from offering rewards of greater financial value, but from doing a much better job of communicating, enabling line managers and branding the value that your rewards do offer and ensuring that employees really understand their value.

A few ideas on improving the engagement of employees via your rewards program:

- Survey employees to understand their needs and preferences in rewards. Do you know the financial and non-financial rewards that employees value the most and the least?
- Tie your total rewards strategy to your employee value proposition (or employer brand) and connect your human capital programs to your integrated reward framework. This requires an integrated effort between reward, talent management, staffing and employee relations staff.
- Communicate the value of your total rewards program creatively and consistently. Consider providing total reward statements which provide employees with a picture

of the value of their individual total reward package

2. DEVELOPMENT AND RETENTION OF CRITICAL TALENT AND THE ROLE OF REWARDS

Economic recovery in developed economies has been sluggish the past several years and yet competition for talent has become very intense with many predicting that talent shortages will increase well into the next decade. Talent shortages are the result of several factors—"baby boomers" retiring, slower population growth, increasing specialization of organizations and jobs and increased global competition for the best talent. Retention of critical talent—those employees who are the strongest performers, have the highest potential, and/or are in critical jobs or in roles where there are acute shortages of talent—is even more important during economic recoveries when organizations compete even more aggressively for market share and labor. Critical talent often become your future leaders so they disproportionally contribute to current and future organization performance.

Current Hay Group employee opinion norms indicate that 20% of employees plan to seek a new job in the next two years and another 20% plan to leave their organizations within the next five years. These trends suggest a certain degree of unrest, if not significant discontent, in the workforce. Advances in information sharing via social networking platforms also make it more challenging to retain talent, as awareness and access to other opportunities has been heightened. Sites like LinkedIn.com, Glassdoor.com, salary.com, vault.com and facebook.com openly promote the capabilities and successes of key talent as well as the organizations who aspire to employ them.

CEOs have cited retention of critical talent, along with the development of internal candidates, as a core strategy in 2013. While organizations 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. Leading organizations are focusing on differentiating their reward programs by offering clearer career paths, more meaningful work experiences, increased job mobility and targeted development in addition to the potential for increased monetary (and non-monetary) rewards.

Going forward, we see several key areas of focus that would benefit organizations in terms of improving their critical talent management programs and how they reward their critical talent:

1. Clearly define what you mean by "critical talent" and "high potential" within the organization. The answers between the two may be different.

2. As important, identify the key pivotal roles in the organization. These are jobs where you cannot afford to have a gap in your organization or your business objectives would be at risk. The real focus of your efforts should not be developing all "high potentials"; it should be ensuring that you have a plan and the bench strength to fill these key roles.

3. Define and clarify your communications strategy for critical talent program management. A key question to consider is how to communicate the nature of participation in the program—which would surely be seen as a reward—while not raising expectations for additional rewards or definitive, ongoing "membership" in the key talent program.

4. In terms of reward program management for critical talent, organizations would be well served to

clarify their reward strategy, principles, design and related reward communications for this group. In addition, the intended degree of differentiation in rewards vs. other employee groups should be understood. The level of reward differentiation for the critical talent group would include the following:

- More upside potential across all cash compensation elements
- Differential treatment across non-financial reward programs (e.g., development opportunities, training programs, coaching opportunities, access to executives, special projects)
- Assessment of reward differentials on both a current year and multi-year basis and tracking "career income" (e.g., income over 5 years, 10 years).

If not doing so already, organizations might consider some structured flexibility in their base salary increase programs and restricted stock grant programs to provide for additional wealth creation opportunities for key talent. Off-cycle increases and special programs for key talent can go a long way in reinforcing the value and importance of these resources to the organization. Assuming a relatively small population (e.g., 10-20% of employees) these critical talent compensation programs should not be too costly, yet will help safeguard against a premature exit of these most valued human capital assets.

We've all had the experience of having key staff leave the organization resulting in lost productivity, added search expense, and the likelihood that we wind up paying more for a newly recruited person who still has a long learning curve. It would serve organizations well—it would literally "pay for itself"—to be more conscientious about processes for identifying key talent and ensuring the rewards offered are commensurate with their performance and their promise for your organization. If you don't, it's likely that others will!

3. IMPROVEMENT OF PERFORMANCE MANAGEMENT PROCESSES AND THE ROLE OF REWARDS

Achieving a step-change in workforce engagement and productivity will require a significant focus on performance management. In our research,[2] over half (52%) of business leaders plan to implement more rigorous individual performance management processes. But effective performance management is more than just boosting the performance of individuals—it's about improving the performance of the *entire* organization, clarifying the organization's performance model and building a culture of organization-wide performance so the entire organization can deliver on its performance commitments. Business leaders know this. Most (64%) agree that performance management is an important driver of the overall success of their business and about half (43%) believe it makes a measurable difference to the bottom line.

However, organizations have a difficult time putting these beliefs into action. Many view their existing performance management procedures as a bureaucratic HR procedure, focused on process rather than business outcomes. Almost two fifths of business leaders (37%) describe it as primarily an administrative tick-box exercise, and about the same percentage believe their managers do not actively support their organization's performance management processes.

As a result, CEOs lament the time it takes to execute their strategies. They ask: "We have a strategic plan and have taken the time and effort to communicate it clearly. So why isn't it being carried out? And where are the results we expected?" The answer isn't necessarily new, but it is obviously takes time, energy and tenacity to implement. Only a quarter of companies (27%) studied by Hay Group align their performance management approach to their company's business strategy. To compound the challenge, our research revealed that the connection with strategy alone is no longer enough. While nine out of 10 business leaders (91%) stressed that organization culture has an important influence on the effectiveness of performance management, less than a quarter of firms (24%) align their performance management processes to their company culture. And compounding this, only 13% of organizations align their performance management programs to their business strategy *and* work culture.

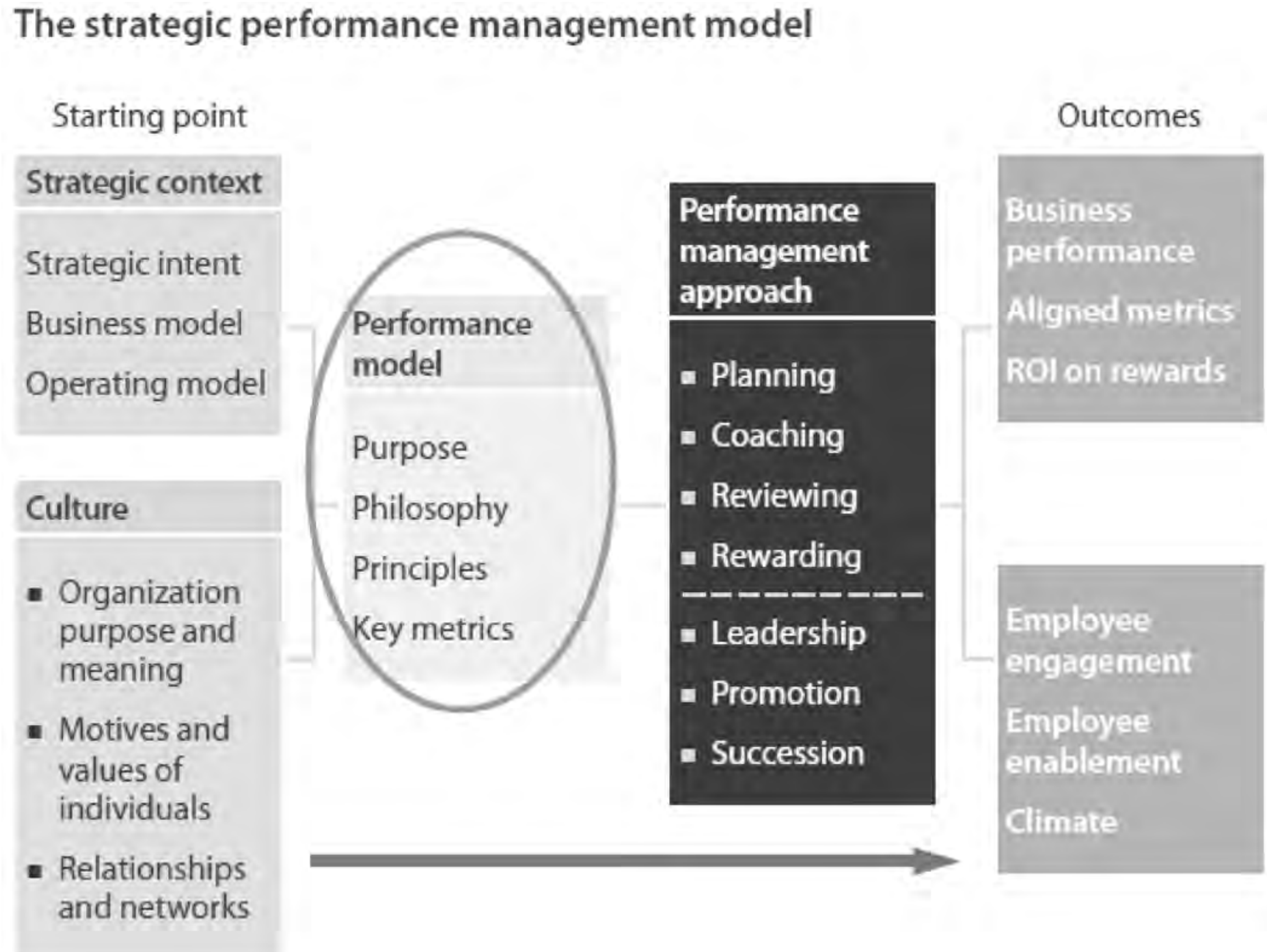
What these findings demonstrate is that there are in fact two 'dimensions' of performance management:

- understanding and leveraging the organization's "performance model" as it relates to the achievement of business strategy and the alignment of its target work culture
- aligning this performance model with the downstream performance management functions of individual performance planning and goal setting, coaching and feedback processes, performance assessment and linkage to reward systems.

So how do companies reinvent performance management? The critical and often missing link is the connection between the 'hard' (i.e., the business strategy) and the 'soft' (i.e., organizational culture). By connecting three elements—people, strategy and culture—organizations can improve their effectiveness, enhance employee productivity and increase the likelihood of achieving ambitious business objectives.

The link between the hard and the soft can only be strengthened by the development of a unique performance model, arguably the most significant step in performance management design (see Figure 6 below). A well-designed process should build in a deliberate pause for leaders to articulate and agree upon conscious definitions of key performance elements before charging ahead to the tactics. This process forces leaders to think about the reason for performance management, the character they want the system to reflect, the rules of the game, and the primary metrics that will steer employee behavior. It is important to build a coherent set of systems and processes, and the performance model is a critical starting point. Without this level of clarity, how can an organization ensure that both strategic intent and culture will be hardwired in the design of its processes, tools and practices? It can't.

Figure 6: Hay Group Strategic Performance Management Model



With the foundation in place, work can begin on alignment between the performance model and the more traditional "downstream applications" most people think of when they think about managing performance.

1. **Performance Planning:** This planning—sometimes called goal setting- is about what needs to be achieved and how. It should result in clarity about where the business needs to go, what individuals must do to get it there, and how the organization expects employees to behave in the pursuit of those accomplishments. And while cascading goals down as part of the planning process is important, organizations must first ensure the leadership team is aligned with the CEO's objectives. Otherwise, functional leaders tend to get caught between the priorities for their function and the priorities of the businesses that they support and the resulting focus on strategic goals ends up being not clear and imbalanced.

2. **Coaching Performance:** Performance coaching is something different from the personal coaching someone can receive on personal effectiveness which is not linked to the job itself. Performance coaching should be about

making employees more effective in their jobs and helping them to realize their objectives during the year. It is the daily/weekly round of observation and listening, feedback, feed-forward and follow-through.

- **Reviewing Performance:** Although coaching may have picked up some aspects of reviewing during the year, reviewing performance is both an ongoing process and the completion of the cycle set up by planning/goal-setting. The process needs to both identify whether objectives and competencies have been achieved and to what extent. Many organizations conduct calibration sessions to review individual performance assessments for members of their teams against benchmark employees or standards. The process of calibration works best if it starts during the time of planning, to make sure expectations are set consistently. An effective performance review discussion aligns performance with career development and succession planning.

- **Rewarding Performance:** Rewards are a primary reinforcement tool for the performance management program. Rewards should be aligned with performance measures that are appropriately balanced between:
  a) The hard and the soft measures (financial, customer, operational and human capital measures)
  b) Short-term and long-term objectives
  c) Individual, team and corporate objectives

The organization's performance model and reward strategy—as opposed to external market reward practices—should drive the money, mix and messages of rewards. The degree of differentiation between rewards for high and low performers will be dictated by the principles established in developing the performance model.

4. THE ALIGNMENT OF HUMAN CAPITAL AND REWARD SYSTEMS TO BUSINESS STRATEGY

Money doesn't talk . . . it shouts. Reward programs are one of the most powerful mediums to reinforce your organization's business strategy, values and culture. As leaders, getting reward programs right is vital since it sends perhaps the loudest messages about what the organization really views as important.

Over recent years shareholders, employees and regulators have become more sensitive to reward issues, placing more pressure on organizations to find the optimal balance between contribution and reward. Competitive, equitable and cost efficient reward programs creates a win-win situation for the organization (and its shareholders) as well as its employees, and supports sustainable success for the organization. "Responsible reward" programs are key to building employees' confidence and assuring them that they are receiving an appropriate return on their investment in the organization. This trust is core to retaining talent and inspiring employees to apply discretionary effort towards achieving business objectives.

Organizations that align their reward systems with their business strategy—and reward responsibly:

- achieve a better balance between individual, team and corporate performance and rewards over the same time period that business value is created

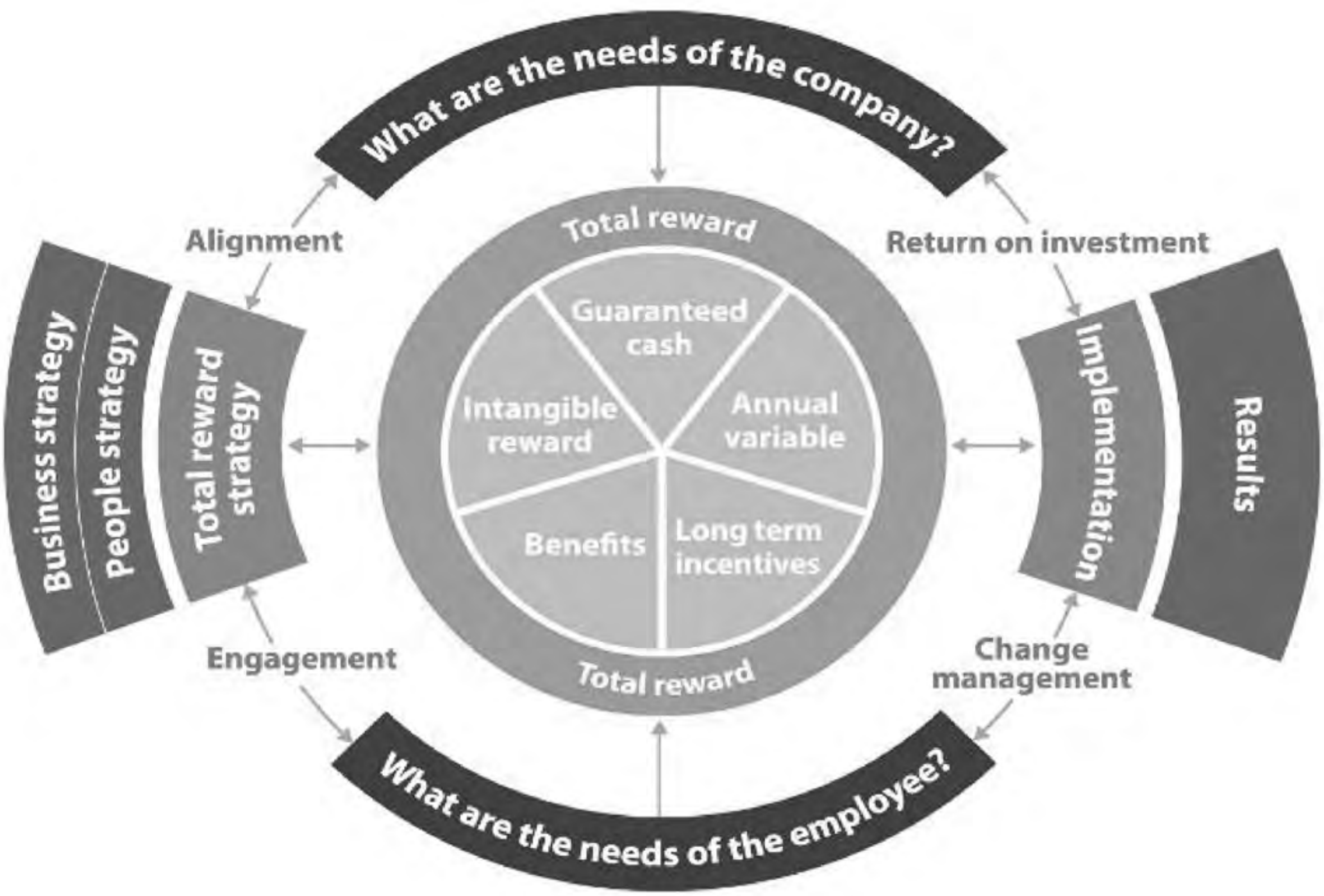
- clarify line of sight between performance outcomes and rewards to ensure that programs are understood and perceived as just

- are competitive in the external market—they differentiate adequately to attract and retain talent and reinforce internal equity

- are fiscally prudent—carefully crafted reward programs appropriately flex compensation costs with performance, while effectively reinforcing motivation.

In our experience, "best practices" are not about sophisticated strategies or what most companies are doing, they are about what works best for the organization given its unique combination of business strategy, priorities, values and culture. Great execution, as opposed to elegant design, is often the key differentiator in effective reward programs. Aligning and balancing the needs of the organization and the needs of employees in the reward program, and communicating the rationale and value of programs consistently to employees are at the heart of reward program effectiveness (see Figure 7 below).

Figure 7: Hay Group Total Reward Framework



Getting these critical elements right plays a key role in ensuring that reward levers are working together and mutually reinforcing your business strategy, not acting against it. In terms of optimizing the effectiveness of reward program implementation, we advise organizations to:

- develop a reward strategy with elements most aligned to your business strategy, culture and operating model
- design and implement an objective and rigorous basis for reward—identifying relevant performance metrics and reward linkages that are credible and easily understood
- develop a comprehensive reward communication and implementation program that is informed by managers and employees
- evaluate the perceptions of effectiveness of your reward programs with key stakeholders on an ongoing basis.

CONCLUSION

CEOs are setting ambitious targets in a challenging economy, and asking more from their employees to achieve them. Fortunately they recognize the need to place a greater focus on the human capital and reward management processes to drive business results. They can no longer afford to view this as an afterthought, or the domain of the HR department. There is a recognized need for human capital and reward management to become a core component of the corporate change agenda and align with the organization's business priorities and work culture, as opposed to mimicking common or "best" practices from other organizations. Human capital and reward management are seen as powerful levers by the CEO to achieve the organization's business strategy, but significant time, energy and focus are required to get there.

NOTES:

[1] The Role of Rewards in Building Employee Engagement, WorldatWork Journal, Dow Scott, Ph.D., Loyola University Chicago; Tom McMullen, Hay Group; Mark Royal, Ph.D., Hay Group, Fourth Quarter 2010, 29-40.

[2] The New State of Performance Management, Journal of Compensation and Benefits, Brooke Green and Tom McMullen, Journal of Compensation and Benefits, Tom McMullen, November/December 2012, 29–37.