



Compensation
Best Practices
and Trends

Four Predicaments in Compensation

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Compensation might seem like one of the most cut and dried areas in human resources, but it deals with some of the toughest predicaments in the profession. Staying sane in compensation requires having a good handle on the roots of these predicaments and an ability to work with managers and employees who may not be appreciative of the subtleties.

This paper discusses four of the central predicaments of compensation. By their very nature predicaments have no solutions; however we can mitigate the difficulties once we are fully aware of the predicament.

Being subjective, appearing objective

In my paper Cloud Objects in HR¹ I wrote: “People trained in science and engineering think about the world in terms of real objects where we can use precise numbers and statistical objects where we deal in likelihoods. However, there is another type of object common in management that I call a cloud object. Cloud objects have different properties than real or statistical objects. If you try to analyse a cloud object the way you would analyse a real object then you get into trouble.”

The ‘right’ job evaluation or the ‘right’ pay level is a cloud object. It is not that anything goes or that thoughtful analysis does not lead you to a better answer; but it is true that there is always a substantial dose of ambiguity. “With clouds we can’t say exactly where the centre is, where the edges are, nor what the precise volume is. Similarly, there really is no precise answer to the question of job size: you can get some sense of the size, but no amount of analysis will provide an unambiguous answer.”²

The predicament in compensation is that we cannot pay employees an ambiguous amount; we are forced to come up with a precise answer. Worse, even though we know there is a good deal of ambiguity we have to forcefully defend compensation decisions as being ‘right’. Of necessity, we must pretend to do what is impossible.

The way to mitigate the problem is to mix a thoughtful data-driven analysis (the sort of thing compensation professionals are good at) with an authoritative judgement making process. While the analysis cannot give us a precise answer it can get us close and provides a fair amount of defensibility. The next step is to have people with the authority make the final call. Pay decisions are much like the decisions a baseball umpire makes on whether a pitch is a ball or a strike. What the umpire decides is right by definition. Similarly the people making the final compensation decision do so from the basis of authority guided by analysis but not controlled by it. The pay is what it is (rather than a thousand dollar higher or lower) not because an unambiguous analysis put it there, but because someone in authority made that judgement.

The need to mix heavy duty analysis and subjective judgement on an emotional matter is a difficult thing to do and an even tougher thing to explain. It is and will remain a core predicament of compensation.

¹ Creelman, David; Cloud objects in HR, Thought Leaders 2010, vol. 3.04, www.creelmanresearch.com

² ibid

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Being reasonable, holding the line

You will hear managers providing proof of how stupid the people in compensation are by saying things like “I have the authority to buy a piece of equipment that costs half-a-million dollars but I’m not allowed to give my top operator a five thousand dollar salary increase.”

It would be easy to give the operator the five thousand dollars. It might even be the right thing to do. However, there is one big difference between the expensive machine and inexpensive operator. When you spend half-a-million on a machine; the other machines don’t complain. Give one person a five thousand dollar raise, an extra couple of weeks off, or even a fancy new chair and suddenly all the other people will be up in arms.

The truth about pay is that in an important way all the salaries are connected; loosely connected to be sure, but connected nonetheless. An ad hoc raise for one person, not rationalized within the system, creates pressure to give raises to all—a price that makes the half-million spent on a piece of equipment look like small potatoes.

This fact about salaries is not something managers really want to grapple with when faced with the immediate problem of retaining an employee. Worse, as we have discussed in the first predicament, compensation is a cloud object. It is not there are no limits, but, exactly what one person gets is a matter of judgement. Trying to explain this may not be helpful because the manager will leap on this as an excuse to ‘judge’ that the employee deserves the big raise. Yet, compensation professionals are well aware that as soon as one starts using convenient judgement instead of your genuine best call, the system goes out of whack.

I recall consulting to a company that dealt with exceptions by labelling the pay as “personal to holder”. This signalled that it was a one-off, and not to be used as a basis for comparison that would upset the integrity of the compensation system. The only trouble was that about half the jobs had become “personal to holder”. The compensation person who appears to be playing the petty bureaucrat in holding the line on compensation decisions is often the wise visionary who understands the danger posed by a small leak in the dam.

What’s the solution? As with all predicaments there is no solution, only tactics for managing the tension. The tactics here are to be able to quickly move the discussion from the individual case to the systemic implications. If we can find 20 other jobs with equally good cases for a significant raise then the decision quickly goes from the easy “Let’s pay this one person more” to a much more difficult decision to change many salaries.

The second tactic is that in all matters of compensation you need to have the authority of top management behind you. It has to be clear that the decision to give or withhold an exceptional increase is not being made by a compensation bureaucrat but by a senior leader. This sounds like it will take the pressure off the compensation professional however the problem is that senior leaders frequently do not appreciate the importance of the integrity of the system. They too may be inclined to make an exception “just this one time”. So not only does the compensation manager have to clearly draw authority from the top; it must also lobby, persuade and cajole top management into handling compensation decisions professionally.

The third tactic gets right into the heart of why compensation is so riven with predicaments. You also need to be able to flex. There are times when you should support a pay decision that is at odds with what the system would generate simply on the basis of pragmatism. You allow the small leaks in the dam when you decide the danger they pose to the integrity of the system is less than the danger posed by trying to fight the pressure.

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When do you hold fast? When do you bend? When do you trust senior leaders to back you rather than backing the apparently easy way out? These are the tough decisions that require wisdom and courage—two skills not enhanced by expertise with spreadsheets.

Rewarding performance, keeping it simple

Organizations often end up with complex reward schemes that are difficult to manage and have as many harmful unanticipated consequences as planned positive ones. With rewarding performance we find there are two predicaments wrapped together. One is the tendency in staff departments, and HR is no exception, to complicate things. The other is the desire to use the sledgehammer of compensation for any issue in the organization. Put these two tendencies together and compensation can get involved in creating large numbers of fiendishly complex compensation schemes to reward retention, performance, teamwork, increases in the stock price, promoting the right product mix and whatever else is on management's mind at the moment. The issue is a predicament because compensation often does need to be fairly complex and sledgehammer or not, it is invariably an important element in motivation for work.

One way to mitigate the problem is for the compensation function, every year, to tackle the question of whether they can make the system simpler. Can you reduce the number of different incentive plans? Can you reduce the number of measures? The number of unique jobs? The number of pages on the performance appraisal form? Simpler isn't always better, but given the natural tendency to complicate matters we need an unnatural countervailing force to keep things balanced.

Another way to reduce the problems caused by complicated attempts to reward performance is to resist using compensation as a tool to drive behaviour except as either a last resort or a small component of a larger intervention. Pay is a poor tool for managing behaviour, it is like those drag race cars you see on television; yes it has a big powerful engine but it has terrible steering. Jobs are complex with a subtle and changing mixture of objectives. Compensation can supercharge the focus on one sliver of an objective but only at the expense of ruining the fine-tuned navigation that keeps the work on the twisting track of the real world.

All of which leaves us needing to use compensation to motivate performance and needing fairly complex schemes because the organization is complex, but knowing that we may be driving some bad aspects of performance and creating damaging complexity. At best we can work to keep things from spiralling out of control and respect that this predicament is inherent in our work.

Everyone is wrong

One thing employees know with certainty is that someplace, someone doing the exact same job as they are, is getting twice as much money. Rumours and misunderstandings, deception and wilful ignorance pollute employees' perception of what other people get paid. As a result everyone is convinced that the organization in general, and more specifically the people in HR, are keeping them down.

This is not entirely a bad thing. If people believe that they are not in it just for the money, and that they could in fact make more money someplace else, then it implies a kind of commitment

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to the work and the organization. It is certainly better than having people feeling miserable because they are trapped in the job they can't afford to leave.

But it does leave the compensation professional as the continual target of unfair pressure. It gets worse when an employee's boss believes the same thing based on what they think they heard the neighbour's nephew is making at some other company. Compensation people may think of themselves as a kind of technical expert but the job requires the skills of a monk to impart wisdom when people are not keen to be wise.

The management of this predicament requires letting people believe that "Yes, they could probably get more elsewhere, but not as much as they might think. Remembering that overall the value proposition is pretty good here and we appreciate them, even if it doesn't always show. And, by the way, if they really feel they need the extra money let us know and we'll arrange a going away party."

Perhaps the key is simply a sympathetic smile and a thick skin. Employees will always want to believe HR is leaving them underpaid. It is not something you can ever resolve nor is it something you can ignore to the point where it becomes toxic.

Wrapping up

Compensation is a technical discipline that calls for a lot of analytical skill. Yet the analytical skill ceases to be the answer when you run up against the deep predicaments that are inevitable in compensation. One cannot wish these predicaments away and you can never solve them. Compensation professionals need to embrace the predicaments just as they embrace the technical demands of the job. That is why they get paid the big bucks (of course, not the same big bucks as someone else doing exactly the same job someplace else).