Pay for Talent: The Next Generation of Talent Management Strategy

EXECUTIVE SUMMARY

While pay for performance is an accepted compensation model for many organizations, it alone may not be the most effective approach for driving short- and long-term business success. Given the prevailing economic climate and job market conditions, organizations are looking for ways to drive the right employee behavior and retain key talent. This requires a compensation strategy that recognizes past performance while tying factors like potential, critical skills, risk of loss, and future corporate goals and needs into the overall reward process.

This white paper will examine some advanced concepts around paying for talent, including:

- The Pay for Talent model, its impact on an organization, and the keys to its success

- The links between performance, succession, and compensation

- Keys to successful implementation, including cultural considerations, change management, and overcoming potential obstacles

The paper will also discuss the importance of aligning your organization's corporate objectives to your talent management strategy — all the way down to your compensation plan— and using Pay for Talent to drive business success both today and into the future.

INTRODUCTION

In today's business environment, the widely accepted Pay for Performance compensation model may prove to be shortsighted. Why? Even as unemployment rates hover in the high single digits[1] there is a marked shortage of job candidates with the key skills required to help organizations drive business results and succeed into the future. According to participants in a recent Aberdeen Group survey, six out of the 10 top challenges for achieving business goals are HR related and span all aspects of talent man-

agement, including recruiting, performance management, succession planning, and compensation.[2] What's more, recent research shows that many companies are struggling to fill critical jobs — whether by recruiting external candidates or promoting internal qualified candidates — due to a lack of the necessary job skills.[3]

As these statistics suggest, retaining key talent is more important than ever for driving competitive advantage and bottom-line results. Compensation is a lever that organizations can use to not only reward past performance, but to incent high-potential employees who have the skills and desire to become the organization's future leaders.

That's what Pay for Talent is all about: driving differentiation in compensation to ensure that the organization rewards those employees who offer the most value — based on past performance, critical skills and experience, and future potential — to support achievement of current and emerging business goals. Gone are the days when organizations can approach compensation planning, performance management, succession planning, and employee development as separate and distinct HR processes. Pay for Talent requires organizations to examine these talent management processes within the context of their unique culture and integrate them in a way that optimizes their compensation spend and drives business results.

"…We are entering a new era of unparalleled talent scarcity, which will put a brake on economic growth around the world, and fundamentally change the way we approach workforce challenges."[4]

"Global Talent Risk: Seven Responses"
World Economic Forum, 2011

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1 US Bureau of Labor Statistics
2 Aberdeen Group, *"Quarterly Business Review Survey,"* 2011, 1.
3 Bersin & Associates, *"TalentWatch,"* Q4 2011, 4.
4 World Economic Forum, *"Global Talent Risk: Seven Responses,"* May 2011.

BEWARE EMPLOYEE DISENGAGEMENT

According to a 2011 Mercer report, 32 percent of employees are planning to leave their current jobs.[5] While reasons for this trend are manifold, the role of employee engagement — or the lack thereof — cannot be overlooked. Employee engagement is at the lowest level in years, with at least one in four employees describing themselves as actively disengaged and another one in four employees describing themselves as only moderately engaged.[6] Some of these disengaged employees are not performing up to expectations and some may even be negatively influencing the performance of those around them. But if that 32 percent includes some of your top talent, the impact on the organization can be profound.

Research also shows that organizations with a deliberate and defined process for identifying high potential staff are seven times more effective at delivering business results[7], so there is a huge financial payoff to using a defined process with solid criteria to identify, manage, develop, and reward the top talent of the organization. Given these findings, the prevailing levels of employee disengagement, and the scarcity of job candidates with in-demand skills, retention of key talent should be a top priority for today's organizations.

IDENTIFY CRITICAL JOBS AND KEY TALENT

To best leverage the workforce for achieving business goals, organizations must first identify key staff, a process that is increasingly being addressed through assessment and calibration. The first step is to define the criteria for key elements, such as high performance, high potential, critical roles, and more. Once the managers have assessed the organization against the defined criteria, HR will then facilitate calibration sessions to ensure alignment and adoption of the criteria by asking questions like:

- Does high performance mean the same thing to Manager A as it does to Manager B?

- How are managers assessing individuals in key jobs versus the critical talent? Is the definition of each clear?

- How are managers assessing impact of loss—on a department basis or at the overall organization level?

This approach benefits the talent management process by aligning managers around consistent criteria and generating quality discussions about people, roles, contributions, performance, and potential as well as how all these factors affect the organization's ongoing success.

Forward-looking organizations must not only consider which employees are critical to long-term success, but which roles will remain relevant to driving key business objectives. Why is this important? You may, for example, have a high-performing employee who is vital to a particular department because he has a critical skill. That department, however, may not be especially vital to the organization's mission in the coming years. In this case, an above-average performer in an increasingly vital department may actually be more valuable to the organization in the long run.

RETAIN YOUR KEY EMPLOYEES

Once you've identified key talent in critical roles across your organization — those employees that you simply cannot afford to lose — you need to find ways to retain them. There are three primary paths to retaining your most valuable associates:

Effective management: The most fundamental path to retention involves making sure that managers are doing their job. Are they actively managing direct reports by setting clearly defined goals that align corporate objectives, providing ongoing feedback, and helping them pursue new opportunities — whether they are new projects within their current role or completely different positions within the company? Effective management goes a long way toward keeping employees motivated, satisfied, and engaged.

Mobility & Development: To keep key talent motivated and engaged, HR departments must work with managers to foster an environment in which employees can move vertically, horizontally, or both to positions where they add the most value to the overall organization and can grow and develop into future leaders. This requires that managers help employees develop new skills and/or tackle new challenges that will better prepare them for mobility opportunities that may become available. It also requires that managers avoid hoarding talent within their own departments and do what is best for the employee and for the organization as a whole.

5 Mercer Inc., *"Inside Employees' Minds,"* 2011, 2.
6 Mercer Inc., *"Inside Employees' Minds,"* 2011, 2.
7 Bersin and Associates, *"The Art and Science of Building a High Potential Strategy,"* November 2011, 5.

Compensation: The bottom line is that people work to earn a living, so compensation is a key factor in successful employee retention. Organizations can and should use compensation as a lever in both the short- and long-term to keep employees on the job and performing at their peak.

USE COMPENSATION AS AN EFFECTIVE LEVER

When it comes to compensating employees, you want to get the most bang for your buck. This means optimizing your compensation spend in a way that rewards and incents key employees for performance that drives business results — past, present, and future. As important, you want to make sure you are compensating the workforce fairly based on clearly defined criteria and benchmarks to ensure employee engagement and minimize compliance risk. The organization needs to ensure they pay people fairly for doing similar work, meeting similar expectations, and adding similar value to the organization. This doesn't necessarily mean, however, that everyone gets the same increase in pay. These are the tough decisions the organization needs to make to use compensation as an effective lever for driving continued success.

Reward for past performance: In the traditional pay-for-performance model, organizations compensate employees based on demonstrated progress toward individual goals that align with strategic priorities. With the Pay for Talent model, which uses compensation as one lever, managers work with employees to define annual performance goals, discussing and adjusting them throughout the year so there are no surprises on their evaluations. This discussion should also address the value the individual and his work are adding to the organization to help set employee expectations. At annual review time, the manager assesses the employee's progress and uses compensation matrices to reward the employee via:

- Merit increase

- Bonus for overall performance

- Stock allotment

Improve compensation fairness: As U.S. and international legislation continues to increase in the area of compensation, it is critical that your organization pay employees fairly. This means you need to pay two people performing the same job fairly based on their demonstrated performance and the markets in which they work. Similarly, you need to promote people based on fair, consistent, and documented criteria. Otherwise you risk costly litigation or significant penalties for noncompliance.

Provide incentives for the future: Use compensation to motivate and retain key players, including your future leaders. For example, if your organization is expanding into the Pacific Rim, those employees who are native Japanese or Chinese speakers become more valuable than they were before the expansion plans materialized. By offering incentives like cash bonuses or stock options, you can better retain those employees who provide:

- Critical skills and competencies

- Key talent for driving short- and long-term business strategy

- Potential and desire to meet future organizational needs

REWARD VS. INCENT	
Reward	**Incent**
Awards given for past performance	Awards given for future actions

PAY FOR PERFORMANCE VS. PAY FOR TALENT

Over the past several years, talent management has taken on greater strategic importance as organizations strive to better leverage their most valuable asset, their employees, for achieving competitive advantage and maintaining profitability. As they take a closer look at their talent

management process, organizations are realizing that pay for performance — where employees are rewarded based on past performance — addresses only one component needed to retain top talent. That's where Pay for Talent comes into play.

PAY FOR PERFORMANCE VS. PAY FOR TALENT	
Pay for Performance Process	**Pay for Talent Process**
Drives differentiation in compensation to ensure the highest perform-ing employees are rewarded appropriately	Drives differentiation in compensation to ensure the organization rewards those employees who provide the most value in terms of performance, contribution, potential, critical role, and key talent

With the Pay for Talent model, organizations identify who and what is most valuable to the organization — both today and into the future — and then reward and incent employees appropriately to retain top talent and drive progress toward short- and long-term business goals. Successful Pay for Talent programs broaden the discussion of employee retention to encompass a number of talent management processes, including:

- Assessment of talent against key future leadership criteria

- Succession planning

- Performance management

- Employee development

Why is this multi-dimensional approach so important? If your organization, for example, has a high-performing employee with the potential to deliver even more value in the future, you need to not only reward that employee for past contributions, but incent him for future actions. Otherwise, you risk losing that valuable employee to another company in the war for talent.

As Pay for Talent gains traction among HR leaders, the Pay for Performance approach is actually becoming a sub-component of the newer, more encompassing model. Most organizations will do a combination of both: reward for past performance and incent for future action in order to retain key talent, drive higher performance, and align the workforce toward achieving corporate goals. Each organization must strike the right balance based on organizational culture and overall compensation strategy. For example, if you have an emerging skill set within your organization for which you know there will be a huge market demand, you may want to focus more on pay for potential than an organization with a more mature skill set. It all comes down to optimizing your compensation spend to support achievement of corporate goals not only today, but for the next several years.

"'Pay for potential' is a compensation philosophy that tries to level the playing field based on what each employee brings to the job and how well he leverages those competencies. It's a new concept that gets rid of 'the more years you work, the more money you should make' mentality, and recognizes individual talent and potential. While it is challenging for the Boomers to accept a new way of thinking about compensation, pay for potential is far and away the best plan to connect and engage with Millennials."[8]

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8 Jim Finkelstein, *"'Pay for Performance' Doesn't Work for Generation Y,"* PC Member Blog, Fast Company Online, www.fastcompany.com/1783489/pay-for-performance-generation-y-pay-compensation-asking-for-a-raise

Factoring Potential into Compensation Awards

In a system that recognizes multiple dimensions (see diagram below), the actual increases will be higher for employees with comparable performance who offer much more potential value to the organization.

POTENTIAL	% INCREASE		
Performance	**Good**	**Great**	**Rock Star**
Superior	6	10	15
Exceeds	4	6	10
Meets	2	4	6

"Good" potential performer could expect to receive merit increases of 2-6 percent based on "traditional" pay for performance programs. This is about the limit in most "reward for past performance" compensation systems. On the other hand, in a pay for potential system, the employee with superior performance and "Rock Star" potential could receive as much as 15 percent increase.[8]

ASSESS YOUR TALENT: KNOW WHO YOU NEED

The success of a Pay for Talent program depends heavily on your organization's ability to effectively assess its talent. Your talent assessment process should include a discussion of factors critical to executing your organization's strategies. These factors might include:

- A critical skill or experience

- Risk of impact of loss

- Key customer or vendor relationship

In addition to normalizing scores and ratings, calibration can often lead to broader discussions about the value people add to the organization and how to reward and assess them appropriately. As your business strategy changes, calibration criteria will change, too, so calibration discussions really need to happen every year. Especially in dynamic, fast-paced markets, the skills critical to an organization today may not be the critical skills 18 months from now. As a result, your organization may need to consider compensating employees differently based on the skills that are emerging.

PLAN FOR SUCCESSION: MAP OUT CAREER PATHS

Pay for Talent is not just a compensation process; it integrates all the various HR processes, including succession and talent assessment. Development of a succession planning process provides the opportunity to discuss critical questions around employee value, mobility, and development such as:

- Who are the people we cannot afford to lose and why?

- Who could add more value by taking a new opportunity?

- Who are our future leaders and how should we invest in their development?

Identifying those with future potential must be one component of the succession discussion. As your organization plans for the future, it is important to pinpoint those employees who have both the potential and the desire to take on a bigger role and then to determine what training and development they need to be successful. Why is desire important? Your inside sales representative, for example, may have the skills and competencies needed to move into a regional sales representative position, but he may not consider the 50 percent travel requirement be a desirable feature of the job. In this case, he has the potential, but not the desire, making him a less-than-ideal candidate for that succession path.

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[8] Jim Finkelstein, "'Pay for Performance' Doesn't Work for Generation Y," PC Member Blog, Fast Company Online, www.fastcompany.com/1783489/pay-for-performance-generation-y-pay-compensation-asking-for-a-raise

IS YOUR ORGANIZATION READY FOR PAY FOR TALENT?

Not all organizations are ready to implement a full-scale Pay for Talent program right out of the gate. After all, Pay for Talent integrates a number of talent management processes, including talent assessment, performance management, and succession planning. A recent Talent Management Survey conducted by ADP Research Institute[9] found that:

- Only six out of ten large US enterprises (those with 500+ employees) identify and track high-potential employees within their organizations.

- Of the 410 enterprises surveyed that did identify and track high potential employees, only 213 reward these employees for their contributions.

- Only 41% of organizations have Key Performance Indicators (KPIs) that measure individual contributions versus overall goals below the manager level.

In order to determine whether your organization is ready for Pay for Talent, give careful consideration to the following questions:

- Do you have defined, consistent criteria for rating performance and for identifying key talent, critical roles, and employee potential?

- Do you know which attributes your organization values most?

- Do you have an organizational culture that supports open and frank discussion?

- Which attributes of Pay for Talent best fit your culture?

- Do your managers have the skills needed to assess criteria like potential, risk of loss, and impact of loss?

PUTTING PAY FOR TALENT INTO PRACTICE

When it comes to implementing Pay for Talent, there is no right or wrong process to follow. You need to assess what works within the culture of your organization — both today and as you prepare for the next generation of workers. Development of a Pay for Talent roadmap will help you set milestones for implementation, each of which will bring you closer to the ideal program for your organization. Your high-level roadmap might include the following milestones:

Year 1	Define and successfully execute talent assessment process
Year 2	Initiate discussions to establish criteria for rating employee performance and identifying key talent, critical roles, impact of loss, and more.
Year 3	Add Pay for Potential to your compensation strategy
Year 4	Implement Pay for Talent model enterprise wide

Your HR team can pick and choose which components they wish to implement and decide how to roll them out based on your organization's unique culture and state of readiness.

CONCLUSION

Pay for Talent enables organizations to use compensation as a key lever across all talent management processes to drive achievement of strategic objectives. To ensure success, do the up-front work required to understand the impact of Pay for Talent on the organization in both the short- and long-terms. Have the necessary discussions around performance, key talent, critical roles, potential, and success to align managers and support informed decisions based on consistent criteria. Design a program that will work with your current compensation strategy and overall business goals and re-evaluate the program each year as strategic priorities change. Most important, implement the Pay for Talent model within the context of your organization's culture to optimize your compensation spend, achieve competitive advantage, and meet key business goals —today and into the future.

[9] ADP Research Institute, "Talent Management in 2011: Perceptions and Realities," 2011, 9.

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