Pearl Meyer

ADVISOR BLOG | OCT 2020

A Key Step in Engaging Your Workforce: Develop Appropriate Performance Management and Pay Systems

Lianne Richardson (Chew)

PRINCIPAL

An organization's discussion of its business strategy should trigger a simultaneous discussion of its talent strategy. Companies that are best positioned to succeed in our increasingly complicated business environment are focusing on their workforce and ensuring the right talent is available to implement their long-term objectives. These organizations have identified their internal sources of future leadership and developed mentoring and training programs to grow from within and foster engagement. Those steps are important, but alone are not enough.

Everyone—from HR to management to the board—should question whether or not the right performance management systems, total rewards programs, and retention systems are in place. The recent report "Work Has Changed: How Boards Navigate Disruption and Drive Human Capital Transformation" looked specifically at the issue of employee engagement. Building on that piece are specific actions below that can better position a company to attract, retain, and engage at all levels in the organization.

Performance Management

- Increase your focus on an individual's potential (e.g., learning agility), with a corresponding de-emphasis on pure results.
- Have career coaches in the HR organization charged with helping individuals navigate career paths and required learnings for success.
- Include learning goals as part of an individual's key performance indicators (KPIs) and provide monetary or reputational recognition for learning achievement or successful completion of a purpose-driven project.
- Ensure greater transparency regarding opportunities across organizations, and skill identification to match individuals with those opportunities.
- Allow broader input on performance from outside an individual's direct manager or division to encourage learning agility, skill development, and cross-functional teams.

Total Rewards

- Accommodate greater compensation differentiation based on potential and learning achievement for similar roles (e.g., an expansion of pay bands and structures).
- Tailor your total rewards by understanding the wants, needs, and motivators among targeted groups within your workforce. This can be uncovered via interviews, surveys, etc. and can pay off. Recognize that there are differences in what drives the various generations (see chart below) and your total rewards strategy should evolve to address the needs of your changing workforce. Customizations can include:

- Flexible work schedules and locations;
- Loan repayment and/or continuing education allowances;
- Flexibility to exchange monetary compensation for time off;
- On-site childcare or daycare cost benefits;
- Free financial counseling for staff to reduce money-related stress; and
- Customization of benefit/retirement selections.

		Generational Breakdown		
	Total Workforce	Millennial (ages 20-37)	Gen X (ages 38-53)	Baby Boomer (ages 54-72)
401(k) Match	56%	47%	63%	67%
Health Insurance	56%	48%	54%	71%
Paid Time Off	33%	37%	33%	24%
Pension	31%	16%	34%	54%
Flexible Work Hours	21%	26%	15%	15%
Working Remotely	15%	17%	16%	12%
Student Loan Forgiveness	15%	19%	13%	8%
Additional Skills Training	14%	19%	13%	6%
Tuition Reimbursement	11%	12%	14%	6%
Paid Parental Leave	7%	11%	7%	2%

Source: "Americans Favor Workplace Benefits 4 to 1 Over Extra Salary," AICPA, November 2018 https://www.aicpa.org/press/pressreleases/2018/americans-favor-workplace-benefits-over-extra-salary.html

Retention

- Understand senior employees' current stock ownership (if any) and determine whether any special equity retention grants or cash bonuses might be needed in the near-term (note: publicly-traded companies should keep in mind proxy advisory firm policies, potential CD&A disclosure, and overall optics if any special grants are provided to the CEO or other NEOs).
- Explore equity choice plans which allow a broad participant base, or a subset of participants, to select the composition of their equity awards—all stock options, all restricted stock, or a mix. The goal of an equity choice program is to provide employees with ownership over their compensation, and to maximize the perceived value of long-term incentives (LTI) through personalized customization based on the individual's unique needs, life, career stage, and risk profile. These programs also cater to different generational preferences, and while the prevalence of these programs is small, interest in implementing them is on the rise.

To the extent a company has changed its business strategy and wants to consider the challenges the senior team is facing, look at the actions other companies have taken to align their executives' short- and long-term incentive programs to business transformation efforts. Pearl Meyer recently researched how some companies manage their STI and LTI programs in periods of change. Six examples are summarized in the chart below. Overall, we found that practices vary, as companies choose designs specific to their current circumstances and strategic intention. The various alternatives adopted include, among others:

- Emphasis on strategic/milestone goals;
- Changes to incentive metrics;
- Addition of modifiers;

- Special retention grants; and
- Changes to LTI mix.

Company	Transformation Activity	Plan Design
Company A	Grow new segment as another segment in decline	• AIP: Equal weighting to the growth (new) business segment as the segment in decline • PSU award based on 33% new business EBITDA; later removed when metric not appropriate
Company B	Grow revenue and profitability for energy storage and power delivery solution	• AIP: 40% weighting on stipulated strategic goals • CEO awarded special strategic milestone-based RSUs which vested 33% on entry into a partnership for a specific product and 67% on a confidential strategic milestone
Company C	Pivot to servicing other loan types	• AIP: Modifier of +/- 15% for strategic milestones; following year was a revenue target • LTIP: PSUs based on net income from core business; modifier of +/- 20% from three-year strategic growth of net income from products/services in existing and new business lines targeted for long-run growth; replaced with 20% weighting on strategic objectives
Company D	Lost major customer	• AIP: Over two years adjusted targets to address growth and in year two, added MBOs • LTIP: Additional PSUs (50%) tie to transformational agenda and three-year earnings goals
Company E	Declining sales in North America; expand globally	• AIP: Paid discretionary bonus in 2017 for retention • LTIP: Retention RSU excluding CEO in 2017; changed mix from PSUs and performance options to 50% PSUs and 50% RSUs; 2018 move to one-year performance period for PSUs; two-year performance period in 2019
Company F	Focus on long-term growth consistent with five key strategic priorities	• AIP: Added sales (67% financial = 25% sales, 75% EBIT and removed EVA; 33% MBO); year two, financial weighting to 80%; 20% customer experience score card • PSUs: Adjusted components with 75% of award on three-year change on market share, relative EPS growth, relative ROIC; 25% PBRSUs – three-year TSR; added price-hurdle options for retention exercisable after three years and on a 20-day average price of $75 (40% premium on grant date price) – seven-year term

AIP - annual incentive plan
PSU - performance stock unit
EBITDA - earnings before interest, taxes, depreciation, and amortization
RSU - restricted stock unit
LTIP - long-term incentive plan
MBO - management by objective
EBIT - earnings before interest and taxes
EVA - economic value added
EPS - earnings per share
ROIC - return on invested capital
PBRSU - performance-based restricted stock unit
TSR - total shareholder return

Establish Accountability

Finally, establish accountability, which should be felt across the organization. The "Work Has Changed" report suggests establishing an internal and interdisciplinary human capital committee, co-led by HR and the CEO, with representatives from various management levels across all business units and/or departments. Charge this team with talent management across the organization and consider asking for a board member to participate or provide guidance. This provides a natural channel for report-outs to senior management and the board on an ongoing basis and may result in lasting change to the corporate culture.

About the Author

Lianne Richardson a principal at Pearl Meyer, joined the firm in 2002. With over 15 years of experience, Lianne specializes in providing compensation consulting services to public and privately-held clients, including compensation market benchmarking, proxy analysis, incentive plan design, executive compensation strategy and philosophy development, and non-employee director compensation. She has worked with clients in the manufacturing, energy/utility, aerospace/defense, hospitality, insurance, banking, medical device, and healthcare sectors.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.