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Supporting Culture Through Compensation, Recognition, and Reward Systems

Editor's Note: Pearl Meyer is a strategic content partner for the National Association of Corporate Directors (NACD). Pearl Meyer is an active participant each year on the NACD Blue Ribbon Commission (BRC) and contributor to its annual BRC reports—signature publications that propose new principles and practices to address the most critical boardroom issues. The following article was published as an appendix in the 2017 BRC report Culture as a Corporate Asset.

The role that compensation and incentives play in developing and nurturing a successful corporate culture is an emerging topic on compensation committee and board agendas. Yet in many boardrooms, that conversation is incomplete: directors must step back and think about the broader context first, before diving into the specifics of pay-plan design. While the board's primary focus is on the management team, it's important to have a strong sense of the forms of recognition—monetary and otherwise—that matter to and motivate employees, and how those factors influence culture across the entire organization.

Creating a culture of performance begins with the people—hiring, retaining, developing, and rewarding the right talent. It requires empowering that workforce with the opportunities and resources that create strong engagement, as well as the formal and informal recognition programs that help satisfy the needs for achievement and affiliation. It also requires performance management systems or processes that help define and track progress against business goals and career development plans. Under that umbrella, boards can then examine the *total* reward systems, including compensation programs and other levers that motivate ongoing success.

Directors and members of management want to attract the right talent to the organization to achieve their business goals—talent that is motived by the desire to develop and grow, become more skillful, and earn greater responsibility over time. Given that premise, there are two key questions boards should ask related to the talent development, career progression, and reward systems that can help define a company's culture. The first is how do people get ahead in the organization? The second, and perhaps more important, is what stalls or derails careers? Are these "rules" (whether written or unwritten) well-known,

well-understood, and applied consistently?

The fact is a company can have a carefully designed compensation program, and employees may be able to recite all of the right mantras about corporate values, but if the way one gets ahead is not by their achievements but by political maneuvering, brute force, or excessive risk-taking then *that* is what will define the true culture. And that climate will be much more powerful than any pay program.

For that reason, boards and compensation committees need a complete picture of the relationship between compensation as it relates to corporate culture: one that includes both financial and non-financial rewards, and that goes beyond the board's statutorily-defined responsibility for oversight and compensation of CEO and NEO talent. To support a performance-based culture that drives value, the board must have a clear understanding of how talent below the C-suite is developed and rewarded. It must evaluate and determine if this culture supports the company's long-term business and leadership strategies and if so, must then ensure there is alignment between compensation programs and other forms of recognition and accolades (see sidebar, Rewards and Recognition), not only in the C-suite, but throughout the organization.

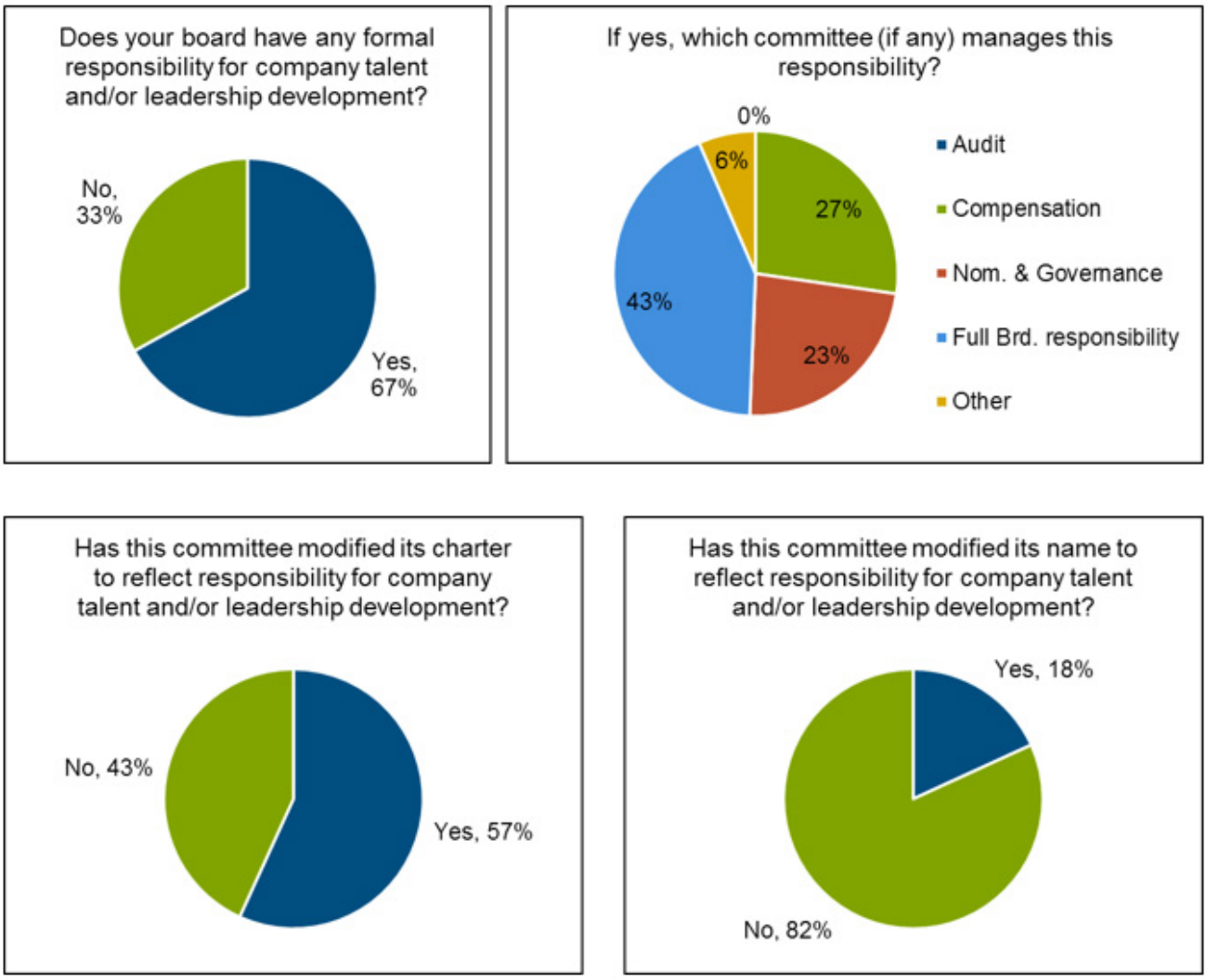
With this level of knowledge and oversight of how the company's talent management is practiced, the board will then be in the best position to determine supporting compensation philosophies and programs. We believe at that point, in order to support culture, the focus should be on the *foundational goals* of compensation: attract, retain, and motivate—and then reward.

Boards must ask the right questions to understand what an organization is doing to identify the top performers, develop them as future leaders and to ensure that the employees themselves understand what it takes to be successful and how the organization supports their career progress. On a growing number of boards, compensation committees are taking the lead on these important responsibilities for talent strategy oversight.

In the "2016-2017 Director Compensation Report," a comprehensive research study conducted by the NACD and Pearl Meyer, it was found that among more than 1400 public companies 17 percent have expanded the name and scope of the compensation committee. These names include: Compensation and Leadership Resources Committee, Compensation and Talent Management Committee, Compensation and Leadership Development Committee, and even the Culture and Compensation Committee. Changes to committee names and charters can send a powerful top-down message about the board's focus on talent development across the organization.

Further, a recent global survey, "Are Boards Creating a Leadership Culture," conducted by Pearl Meyer and the WomenCorporateDirectors Foundation asked if boards had delegated formal responsibility for leadership and/or talent development to the committee level. Among those who had, 57 percent had taken the additional step to modify the committee's charter and 18 percent had modified the committee name to reflect this broader scope of

oversight.



The 2017 NACD Blue Ribbon Commission has outlined four attributes of a healthy corporate culture: alignment, accountability, transparency, and resiliency. We believe a strong, unified talent development and compensation philosophy that serves a healthy culture also has those characteristics.

Here we align questions for the full board and the compensation committee to review with three of the major corporate elements identified in the graphic *Culture as a Unifying Force* on page 10 of the report: talent and leadership development, recognition and reward systems, and goals and targets. We believe these are the areas that can be most directly affected by compensation. If pursued, each of these questions can help the board achieve a clearer picture of how compensation can influence the organization's culture. (See sidebar for examples of cultural "red flags" related to compensation, recognition, and

rewards.)

Aligning Compensation with Culture: Index of Questions for Boards and Compensation Committees

Talent Strategy and Leadership Development

Key Questions for the Board to Ask Management	Impact on Culture
Is there a stated talent development philosophy for the company? Is it consistent for both the executives and the broader workforce?	Alignment ▪ New hires are well-suited to the long-term needs of the business and careers are developed in accordance with strategic goals ▪ The board has a clear plan for how it will develop and maintain a consistent leadership pipeline
Does the organization's talent recruitment profile—from the C-suite throughout the organization—map to the business strategy?	
Does career progression track to the achievement of long-term strategic goals?	
Is there a process to identify bench strength below the NEOs and is there agreement on how succession planning will be managed?	
Are the positive things that employees do to be recognized and rewarded the same types of actions that result in moving up within the organization?	Transparency ▪ Employees believe the system is fair and they understand what the rules and expectations are to advance their careers
How does a person's own performance, independent of team or business unit performance, affect their pay in a given year?	Accountability ▪ Creates trust by applying discretion when needed and recognizing individual star performers ▪ Ensures programs are having intended results—motivating teams to be successful
Have our pay programs and how we administer them created a winning team and if so, how?	

Performance Management, Rewards, and Recognition Systems

Key Questions for the Board to Ask Management	Impact on Culture
Is there a natural progression from lower-level pay programs to key executive compensation plans?	Alignment ▪ Maintains consistency for rewarded behavior at all levels of the organization ▪ Helps develop a culture of pay-for-performance
How are key rewards (e.g., raises, bonuses, promotions) tied to the performance management process?	
Is there clear communication at all levels about performance expectations, assessment methods, actual performance, and pay outcomes?	Transparency ▪ Ensures incentives and merit increases are paid more in accordance with stated business objectives and goals, rather than on a discretionary or "favoritism" basis ▪ Ensures all parties understand the path to achieving success on a quarterly/annual, etc. basis
Are there circumstances in which actions that run counter to the company's stated values are rewarded?	Accountability ▪ Avoids inadvertently rewarding rogue behavior ▪ Expectations, assessments, and rewards are based on a common understanding
When, what, and how is the management team presenting the board with tangible data on the outcomes of the performance management, rewards, and recognition systems?	
Is there opportunity to use discretion in rewarding individual contributors?	
Are there accurate sources of information on key business metrics (e.g., customer satisfaction, product reliability, etc.) and does the information play a role in performance management?	

Key Questions for the Compensation Committee to Consider in Plan Design	Impact on Culture
Have we designed a comprehensive executive compensation plan that maps to both the long-term business and talent management strategies?	Alignment ▪ Performance measures are important to the company's success, and goals are challenging but reasonable, as compensation plan rewards behavior that drives company growth over the long-term ▪ Helps the organization avoid undue emphasis on quarterly results ▪ Rewards positive behaviors that build and sustain the right culture for the organization ▪ Avoids excessive risk-taking
Have we incorporated the measures most associated with our financial success over time? Do we periodically test whether those measures continue to be important?	
Have we identified the non-financial goals that are critical to the current and future success of our business? How can their achievement be measured?	
Are short-term results over-weighted in the total rewards program?	
Are incentive goals unduly aggressive?	
Is our long-term compensation philosophy well-known at all levels of the organization?	Transparency ▪ The compensation philosophy is understood and viewed as a key and positive component of the company's culture; understanding tends to create trust in the system ▪ Reward opportunities are well-understood and perceived to be consistently applied
Have we provided a clear explanation of the executive compensation program to participants?	
Do we provide acceptable rationale for any use of discretion in plan payouts?	
Do current pay levels fall within the competitive range?	Accountability ▪ The compensation committee is strongly committed to its mission of aligning executive pay with corporate performance ▪ The compensation committee knows how to avoid risky or problematic pay design practices ▪ There is a healthy balance between the goals of the leadership team and long-term value creation on behalf of shareholders
Are payout maximums too high or uncapped?	
Are vesting periods appropriate for realization of the company's long-term goals?	
Is our committee charter current with respect to our goals and responsibilities?	

Key Takeaways

- The role of the compensation committee is evolving to encompass greater responsibility and oversight for talent and leadership development and a degree of stewardship of corporate culture.
- Compensation programs that provide the most effective support of corporate culture are created in the context of the organization's talent management philosophy.
- The most effective compensation programs are also resilient in all aspects—they are sufficiently flexible to accommodate evolving strategy, but are stable enough to achieve long-term objectives.
- The companies known for successful, vibrant, performance-based cultures and the long-term value creation that follows have an organization-wide compensation philosophy that aligns with their integrated business and talent strategies.
- These companies recognize that while incentives are incredibly important, the best compensation programs are holistic and serve to more broadly develop talent, not just push business-based goals.
- The boards that are best supporting their organization's performance-based culture ensure there is alignment between how talent is managed and rewarded, not only at the executive level, but throughout the company.

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.