THE CEO'S ROLE IN BUILDING A PAY STRATEGY

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Exit Strategies—Compensation Solutions

It is not unusual for a chief executive to rely on human resources to manage the compensation programs of the business. The CEO doesn't want to get involved in the minutia of who is getting a wage increase this year or what salary band every group of employees falls in. It's not his role and a focus on such details would divert his attention from more critical strategic priorities. However, there are certain pay issues that *only* the company's primary business leader can properly address.

Those issues include plans and decisions that influence how an organization's employee value proposition will impact matters such as:

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- The ability of the business to attract premier talent.
- The company's effectiveness in retaining key producers.
- The alignment the company is able to achieve between its vision, its business model and strategy, employee roles and expectations, and financial rewards the workforce earns for fulfilling those expectations.
- Performance accountability.
- The ability of the company to improve the ROI on its compensation investment through improved profits attributable to employee productivity.
- Nurturing a culture of high performance and confidence.
- Building an organization where all stake holders benefit from the wealth multiple the business generates.

In short, most CEOs probably need to devote more attention to the strategic dimension of compensation design than they usually do. There are at least four key issues that chief executives should focus on to ensure pay positively impacts the company's employee value proposition.

1. Establishing a Performance Framework. An organization's performance framework has three dimensions: The Business Framework, The Compensation Framework and the Talent Framework. These three parts are separate but interdependent. Within the business framework, a chief executive must articulate the company's growth expectations (vision), define the business model and strategy, and identify roles and expectations. In constructing the compensation framework, the company leader has to identify a clear pay philosophy, insist on pay strategies that reflect that philosophy and then enable a total rewards approach to the development of a compelling employee value proposition. The final piece in the performance framework is talent. This level of CEO planning has to do with identifying key producers already within the business and then defining where potential talent gaps might exist so a recruiting strategy can be formed. With both existing talent and that being recruited, it includes establishing success criteria and performance expectations, and then defining the kind of rewards that should be attached to meeting those standards.

2. Defining a Value-Creation and Value-Sharing Model. Growth-oriented CEOs view and treat all non-guaranteed compensation as value-sharing. This term is important because it eliminates the idea of "cost" from the pay equation and replaces it with a focus on compensation as an investment. Corporate "wealth sharing" is a function of value creation. It requires an organization's leader to be precise about how value *creation* is defined within that specific enterprise and what thresholds have to be reached before value *sharing* can occur. For example, one company defined value-creation and value-sharing this way:

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- The first $80 million of net operating profit goes back to the company and shareholders to fuel future growth.
- The next $20 million of net operating profit is shared with employees and is split between short and long-term value-sharing programs.
- After that, all profits are divided 50/50 between company investment and employee rewards (further value-sharing).

Your definition of value-creation may be different, but the principle is that rewards (in the form of value-sharing) are not a cost but an investment that is intended to fuel growth. Whether profits are applied to future capital acquisitions or to reward the individuals driving growth, every dollar invested must be accountable for improving shareholder value.

3. Defining a Partnership. A partner is someone who sees the future of the business the way you do and is willing to take ownership of that vision and do what it takes to make it happen. As a result, CEOs must be able to articulate a compelling vision to their people and then persuade them to become growth partners in its fulfillment. One of the ways business leaders achieve that is by defining what the financial dimension of their partnership will look like within the context of the company's performance framework talked about earlier. The starting point in defining a financial partnership is establishing a compensation philosophy. The philosophy describes how the company defines value-creation and how that value will be shared with growth-enablers.

Ultimately, that philosophy must be translated into individual pay plans that link the shareholder and employee financial visions—thus forging the partnership. At a minimum, this means a CEO must spend time figuring out what the right balance is between guaranteed versus variable compensation and between short and long-term value-sharing. However, the chief executive must also think beyond that and look for unique ways of aligning pay with the transformative results he or she seeks.

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4. Measuring Results. Compensation is one of the largest deployments of capital a business consistently makes and yet many CEOs don't measure it as they do other capital investments. If a company leader wants pay to be a growth contributor, then he or she needs to be able to calculate and track the productivity profit of the business. This simply means the organization's chief executive can identify that portion of the company's net operating income that is attributable to the productivity of his or her people—and not just other capital already at work in the business. Measuring productivity profit also helps a business identify its value-creation threshold.

CEOs that are focused on measuring results make sure that specific value-sharing plans employ metrics that are tied to ROI Factors. Bonuses, for example, are only paid if employee performance has contributed to increased revenues, better margins or lowered costs. This usually requires some effort to align specific roles and duties with ROI criteria. It also means that CEOs spend time discussing ROI and value-creation with their employees, so line of sight is reinforced and a unified financial vision is forged.

The business environment of the 21st century is more competitive than ever before. If a company expects to come out ahead, it must attract the best talent, create sustained performance and drive consistent profitability; and do it better than everyone else. In such a context, compensation—along with the rest of the organization's employee value proposition—has to be approached *strategically*. As a result, the CEO's need to be intimately involved in driving a strategic direction for the company's pay programs is only going to increase.

> "The CEO must be the standard bearer in enabling a unified financial vision for growing the company."

Therefore, if you lead a company, you will want to get comfortable with the three key issues we just discussed. You can still use human resources to help you implement all that's been outlined here; but make no mistake, you must be the standard bearer in enabling a unified financial vision for growing your company. And approaching pay design strategically is the only way such a vision can be realized.

Are you ready for a plan?

If you lead a business and are struggling with developing an effective compensation approach, it might be the right time to have a conversation with an Exodus Complink consultant. To discuss the rewards issues you are facing, email Tom Jordan at tom.jordan@exoduscomplink.com or call us at (210) 872-1055.

About the Author

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Thomas J. Jordan specializes in the design, implementation, funding and the administration of executive and key employee incentive plans. As part of his exit planning advisory services he has developed stay bonuses, stock appre- ciation rights, phantom stock plans, executive deferred compensation plans and performance- based incentives for hundreds of organizations.

Tom has spent over 20 years as a leader in the compensation industry, serving as President and Chairman of the Executive Compensation Institute, a Senior Advisor on Compensation Strategy with M Financial, and as a Strategic Advisor to The VisionLink Advisory Group. He has helped over 400 companies create compensation programs as a critical component in his development of their transfer and succession strategies.

Thomas J. Jordan is the founding President of The Exit Planning Institute of South Texas. He holds a Bachelor of Arts degree in Economics from Millsap College and a Masters of Science degree in Financial Services from the American College of Financial Services. He is also a Certified Exit Planning Advisor.