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Refining the Employee Value Proposition

By Warren Rosenstein and Brian Dunn
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OVERVIEW

Over the last 18 months, a number of forces—regulatory reform, firm economics, share availability and public perception—have forced large-scale shifts in the form, level and mix of compensation in financial institutions. Many of these changes were made in haste and out of necessity. As competition for talent heats up, firms are under pressure to define, benchmark and optimize what they use to attract, engage and retain employees—their Employee Value Proposition.

SOME DOLLARS ARE MORE EQUAL THAN OTHERS

Survey providers, the media and regulators (e.g. the SEC) have perpetuated the myth that a dollar (or pound, yen, euro, etc.) of compensation has the same value regardless of delivery vehicle. Firms have done this as well by emphasizing a “Total Compensation Philosophy” or, in some cases, a “Total Rewards Philosophy”. Instinctively, we know that this is not true—but in the current environment of such disparate salary levels, bonus levels, deferral plan structures, benefits programs, etc., quantifying the value of what a firm offers can seem overwhelming.

As a starting point, most of us would agree on certain truisms:

- Money received today is worth more than money received in the future
    - The longer the deferral the less valuable it is
- Guaranteed/fixed compensation is worth more than variable compensation
    - The higher the uncertainty of receipt the less valuable it is
    - The less control the individual has over the outcome the greater the discount
- Cash is more valuable than equity
    - Restricted shares are worth more than the Black Scholes value of options
- The lower the total compensation, the more fixed compensation is valued over variable compensation

Our next step is to organize these truisms into a system of assessing and valuing a compensation plan. Further into the article, we will discuss the process of using employee feedback to weight the elements of the Employee Value Proposition—a critical part of the process.

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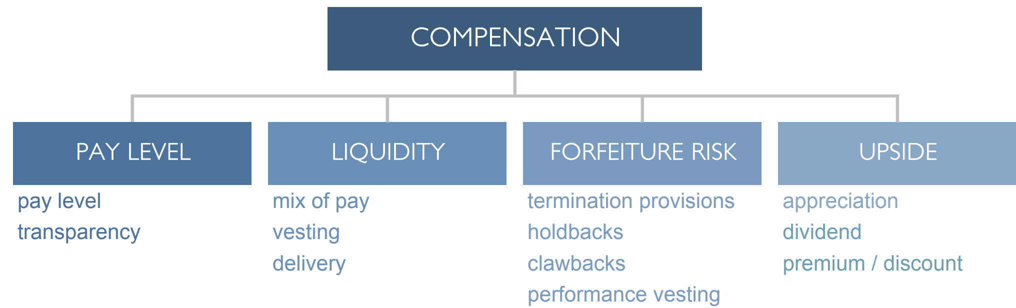

COMPENSATION

As noted earlier, the current set of compensation plans seems more disparate than ever. Firms have had shifts in mix, salary increases, holdback provisions, clawback provisions, performance vesting, time vesting and a whole host of new provisions. We have constructed a lowest common denominator model that allows each plan to be measured in a consistent fashion.

PAY LEVEL

This element of the Employee Value Proposition (hereafter EVP) is the most self-explanatory. Further in the article, we will illustrate that while all employees value higher pay levels, this means different things to different people.

A clear line of sight from an employee's production or performance to their compensation remains a very powerful feature of any EVP. Issues like commission / formulaic vs. discretionary pay; cross-funding vs. stand alone funding; weighting discretionary pay on firm vs. group vs. individual performance are all in play here.

LIQUIDITY

While there has been much discussion about higher salary levels in the abstract, longer vesting schedules and multi-year measurement / reward, these are all really subsets of the topic of liquidity. Our experience has indicated that it is more valuable to focus on the overall liquidity an employee is provided vs. hyper-focusing on one aspect of this. A firm may have lower salaries, but defer less compensation or vest the deferral more quickly—these variables must be considered together.

FORFEITURE RISK

If we were discussing this category a couple of years ago, there would not be a great deal to say. We would have focused on some of the nuances of "good leaver treatment" (whether an employees who resigns still gets their deferral award if they do not compete with their former firm), or whether a discount or premium award is forfeitable under different scenarios.

For many firms and employees, this is THE key issue of 2010 and a factor in the EVP that almost cannot be over-weighted. Almost all firms have introduced some level of incremental forfeiture risk in 2010. This has ranged from provisions that seem largely symbolic and are very unlikely to have a material impact on the rank and file, to provisions that put all deferral awards across the firm at risk, if certain performance hurdles are not met.

Whether these are categorized as forfeiture provisions, holdbacks, clawbacks or performance vesting, they all have a similar impact from the employee perspective—putting money that has been "already earned" at risk. Firms that create significant risk in this area from an employee perspective need to be mindful of scoring high in other categories in order to have a competitive EVP.

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UPSIDE

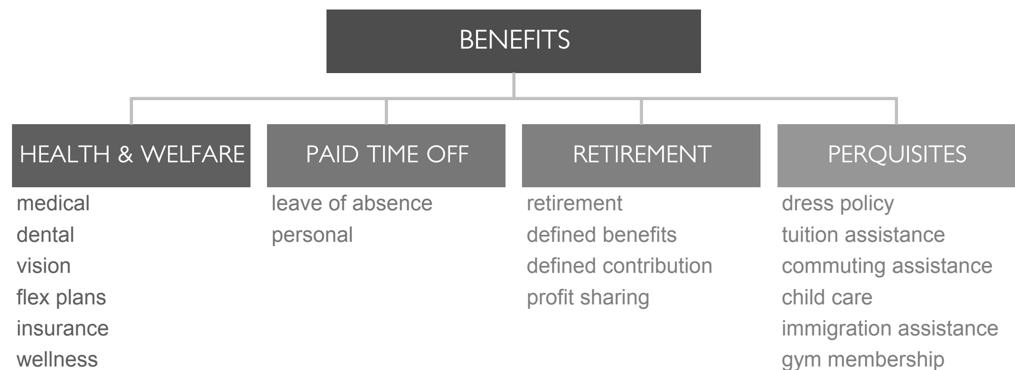
Similar to forfeiture provisions, this is another category that has grown in complexity. In previous years, this would have focused primarily on whether awards were linked to share price or to LIBOR.

Multiple firms have implemented plans where employees are now exposed to additional metrics beyond share price. Assessing the value of deferral dollars in these plans becomes more complex: how likely is share price appreciation? Does the plan provide appreciation or only downside risk? Is the upside capped or unlimited?

While not as critical as forfeiture risk, it is essential to balance this element with the others. And firms that do provide significant upside based on firm performance certainly seem to be doing exactly what a good comp plan should—aligning the employee's interest with that of the shareholders.

BENEFITS

While changes in benefits plans may not grab the headlines in the same way that compensation numbers do, this is a critical part of the EVP. We will not explore the components individually in this article, but want to highlight that it is critical to our proprietary process to value these side-by-side with the compensation elements.



The good news is that this work does not need to be executed based on speculation. The next level of measuring EVP is to query the employees themselves. We have a variety of tools that have been perfected in the academic world and refined in consumer market testing. We can offer people paired choices and forced distribution selection to get a handle on relative value. If we control for demographic and personal perception factors, we get a good handle on how to value the eight components of EVP.

When assessing the data gathered in this process, it is critical to consider and group the employee responses by:

- roles within the company (i.e., front vs. back office)
- disposable income
- time horizon at the company (i.e., how long they plan on being there)

VALUE OF WORK

Since we anticipate increased regulatory pressure, increased competition for talent and limited financial resources, it will be critical for firms to use these resources with as much impact as possible. Transitioning away from making a variety of ad hoc decisions about pay delivery into a model where each element of EVP is optimized for maximum

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impact will give firms a significant competitive advantage. The first to embrace this methodology will become a more attractive place to work where perceived pay is maximized. With the best people, performance will inevitably improve, thereby providing more total compensation to deliver in the most efficient manner. This will in turn raise stock returns, attracting more shareholders (and capital) and even better employees. The virtuous cycle of pay, performance and prosperity will be ensured.

Warren Rosenstein is Head of Client Business Analysis at McLagan. Mr. Rosenstein works with clients to develop customized analysis strategy across compensation, staffing and productivity. He has provided solutions for a variety of client needs, including compensation plan design, organization structure and salary strategies.

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Mr. Dunn's articles have been published in *Benefits & Compensation Digest*, *Chief Executive*, *American Banker*, *Personnel*, *ABA Banking Journal*, *Compensation Planning Journal*, *Bankers Magazine*, *AsiaBanking* and *Equities Magazine*.

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