



Restoring the Culture / Reward Link

By Warren Rosenstein, Ephraim Edelman and Charles Lempert
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OVERVIEW

Firms are trying to do more with less regarding compensation but two powerful, conflicting forces are affecting how they manage reward. Diminished business performance is increasingly driving firms to customized solutions, with the focus less on conforming to market practice, and more on what is optimal for survival. Regulation is a powerful force in driving firms toward more standardization. Even firms that are operating outside the regulatory crosshairs are influenced by what they are seeing in the larger, more regulated marketplace around compensation. In the midst of trying to tailor plans to be unique and practical, as well as aligned with regulatory guidelines, the linkage between a firm's culture and reward is often falling by the wayside.

GROUP THINKING

Ideas that are becoming more frequently discussed, if not yet implemented, often lack strong linkage to firms' specific and unique needs. They include practices like these:

- Reduction / elimination of incentive pay for infrastructure roles with no incremental mechanism to recognize and encourage performance;
- Elimination of incentive pay for control functions instead of seeing these as staff focused on taking safe AND profitable risk;
- Multi-year measurement of performance for all producers regardless of capital commitment / time horizon for transaction settlement;
- Increasing base pay for analysts / associates instead of understanding why PE / Hedge Funds / Technology firms seem more attractive to employees and candidates.

OUTLIERS

Not all firms are simply following the herd, and conforming to "what the Street" is doing. Rather, we are seeing clients daring to think about how they reward people in unique ways, and pushing to make reward a precise tool, tailored to support their unique objectives. In recent projects we have seen firms make bold links between their reward strategy and their desired culture. For example:

- A Latin America-based bank that ranks employees and places them into four categories of performance. Each has completely different rewards and benefits based on which quartile they are slotted into. The culture is a meritocracy and there is uncommon transparency around who the performers are and what they get.
- A boutique investment bank that pays out compensation for all levels of staff on a long-term horizon, heavily linked to individual performance and longevity with the firm. The CEO wants to reward loyalty and consistent long-term performance and his pay program reflects this.
- A trading firm that is minimizing the use of corporate titles because of their belief that a flatter organization will encourage more innovation. This is strongly aligned to their desired culture and business objectives.



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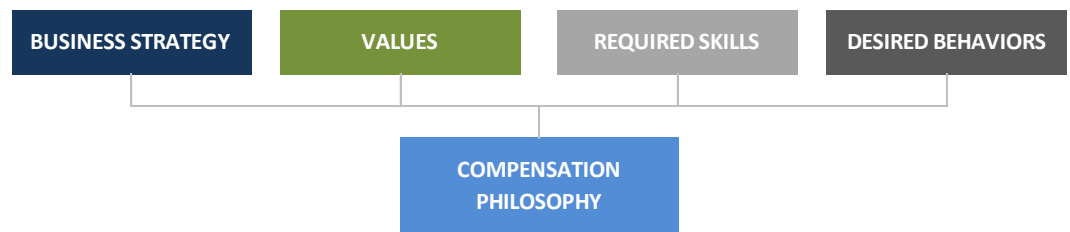
So, how are firms doing this? What are the tactical steps in building a Compensation Philosophy that is unique and impactful?

COMPENSATION PHILOSOPHY

A critical step for aligning a firm’s culture with their reward strategy is the creation of a Compensation Philosophy that both articulates for employees and candidates how the firm thinks about pay, and also serves as a guide for management / the remuneration committee in making decisions around pay. When done properly, a Compensation Philosophy is often the critical link in ensuring that a firm’s culture is vibrant and visible to employees throughout the reward cycle. Developing a proper Compensation Philosophy means doing more than simply recycling clichés like, “We align employee and shareholder interests”.

INPUTS

There are four key inputs into designing almost any reward or human capital management structure: business strategy, values, required skills and desired behaviors. Understanding these inputs and integrating them into the solution will ensure the best possible outcome. We often use these inputs to build a formal Compensation Philosophy – let’s consider them individually for a moment.



Business Strategy – A deep understanding of the business’ strategy is integral to designing an appropriate compensation strategy. Consider the design of a commission plan. Without accounting for the business strategy for the overall firm, or the division, the plan could easily go awry. Smaller firms looking to gain market share / relevance, and build a reputation in a given product may want to design a plan that pays out on gross revenue or number of transactions, since the strategy is growth and not profitability in the near-term. Conversely, a mature platform may be seeking to optimize profit and would be better served with a plan that rewards profit and not revenue. Without considering the strategic objectives, conforming to common market practice could easily produce an adverse outcome.

Values – Firms often have a set of formal values (e.g., Client Service, Integrity, Innovation) that live in the abstract, but are not integral to how the firm does business. Reward systems, promotion criteria, and performance management processes are ideal vehicles to make these values come alive. If your firm values innovation, where in the incentive plan is the measure for it? In your promotion criteria? In your salary structure? Accounting for a firm’s values in these plans and structures is a powerful way to “operationalize your culture” – take values out of the realm of abstraction and make them tangible and ubiquitous.

Required Skills – Identify the skills the firm needs to carry out the business strategy. Who are the people who have these skills? What kind of reward and human capital tools does the firm need to recruit, engage and retain these people? Consider a firm that over time is more reliant on technology. They need programming skills in a way they have not in the past. Perhaps the firm’s approach to reward, or job structures, or performance management needs to be tailored to attract the candidates that have



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these skills. If we are a bank competing for talent with Facebook or Amazon, do we need to think differently about how we reward people, in order to make our firm an employer of choice in this competitive market?

Desired Behavior – This is really the intersection of the business strategy and the values – what is it that we want people to do, and how do we want them to do it? If we need to build innovative technology solutions – if that is specifically what we want people to do, how do we as a firm communicate that goal? How do we reward it? What is the downside for people who do not deliver? Is it clear? Does every step in the human capital process chain (i.e., goal-setting, performance reviews, salary increases, incentive pay processes, promotion process) remind and reinforce this?

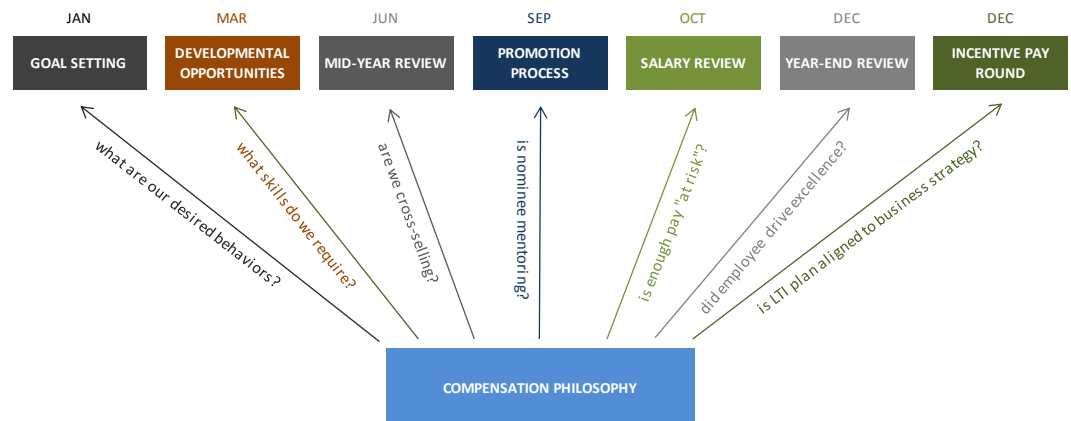
SYNTHESIZING THE PHILOSOPHY

As we consider the organization of these inputs, it is critical to link these concepts back to practical application. How do we take these concepts and articulate them in a way that employees and even job candidates will understand and respond to? Useful topics to consider and address in the Compensation Philosophy include:

- Do we focus on current year versus long-term?
- Do we focus on individual or group performance? In what balance?
- Do we focus on profit or revenue?
- Do we approach pay from a discretionary, formulaic or blended approach?
- All firms claim to be a “meritocracy” – are we really one? How so?
- All firms want to “align employees and shareholders” – what does this mean for us?
- Do we commit to market pay positioning?
- How do we address risk?
- Do we reward acquiring new revenue or retaining existing revenue?

CULTURE

For some, the term culture might seem abstract, or a nice-to-have – perhaps a luxury to enjoy when business is going well – but not something we can really afford to focus on today. Of course, this could not be farther from the truth. Culture informs who the firm is, how we do business, how we interact with our colleagues, what we value, what we reward, how we respond when business is good, and more importantly, how we respond when business is not so good. Consider the hypothetical diagram below, and see just a few of the places where a Compensation Philosophy will help a firm “operationalize” their culture – there are truly dozens more:





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THE POWER OF BEING DIFFERENT

Firms willing to go beyond a cookie-cutter Compensation Philosophy send a powerful message to their employees about what to expect, what their culture is, and how to succeed. They may also send a powerful message to candidates which may even scare off a candidate who is not a good fit. And that is a good thing.

Firms that care about culture don't just talk about it – they bet on it. They dare to be different, they dare to be clear, and they don't hedge. They often get results.

ABOUT THE AUTHORS

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