

what's the perceived value of your incentives?

How do employees assign value to their incentive pay, and how much does it really matter? On one hand, the knowledge can help employers develop compensation plans that deliver maximum impact for an equal or lower cost. On the other hand, implementing programs with higher perceived value will likely have a positive influence on behavior and be a more effective tool for retaining key talent.

This article explains the strategy for assessing the “currency value” participants assign to their compensation using the simple survey. The need for this analysis is especially relevant with

By Steve Harris, CCP, and Laura Clements, CCP, Mercer Human Resource Consulting

QUICK LOOK

- ⇒ LTI design is undergoing a sea of change, as organizations grapple with stock-option expensing, pressures on share dilution, the push for a closer link between pay and performance and more.
- ⇒ Using the employee survey is a thoughtful approach—one that takes into account competitive and cost pressures, as well as internal views of the rewards system.
- ⇒ The data from an internal survey provides a powerful message to shareholders about the rationale underlying incentive design features.



Stock market volatility, industry trends and a company's financial health are just a few of the factors that can influence how attractive a particular form of pay may be to executives.

regard to long-term incentive (LTI) pay. Indeed, LTI design is undergoing a sea of change, as organizations grapple with stock-option expensing, pressures on share dilution, the push for a closer link between pay and performance, and demands for increased transparency of compensation programs.

In response, companies have been experimenting with various forms and combinations of equity and cash rewards. They have tended to take a trial-and-error approach in diversifying their LTI programs, relying on some data mixed with a heavy dose of guesswork. But there is a far better solution.

Using the employee survey is a more thoughtful approach—one that takes into account competitive and cost pressures, as well as internal views of the rewards system. It can ensure that program changes appropriately reflect the interests of the company, its shareholders and employees.

Value Volatility and the

Survey Solution

How participants value LTI has been something of a decade-long roller coaster. In the mid-'90s, many high-tech companies granted large numbers of stock options, which had no accounting cost at the time, in lieu of cash compensation. Because employees perceived stock options as highly valuable, this form of compensation was a powerful attraction, retention and motivation tool. But as the technology boom waned in the new century, so did the appeal of compensation packages heavily weighted with stock options. And today it's hardly surprising that major airlines use more cash than options because the volatility of their equity translates to a low perceived value among participants.

Just as industries and markets fluctuate, it's no surprise that the currency value of various forms of compensation also changes over time and, therefore, needs to be periodically monitored. Stock market volatility, industry trends and a company's financial health are just a few of the factors that can influence how

attractive a particular form of pay may be to executives. The impact these forces have on participant views of the pay program can help determine how much emphasis to place on one compensation component versus another.

Employee surveys have been around for a long time, and many employers have relied upon them to learn what their employees *think* and *understand* about their compensation programs. The difference today is that employees are asked to value various incentive alternatives and, in today's environment of option expensing, those values can be compared to the company's costs.

Today's technology means that gauging participant perception of executive remuneration programs doesn't have to be complex or time consuming. (See *The Guiding Principles of a Successful Survey*, on page 23.) Online tools are available that make the process fast and relatively inexpensive. As such, it's important to survey currency value periodically—a short, targeted survey every 12 to 18 months—to keep track

of shifting perceptions, as influencing factors (noted below) may change.

Value Factors

Currency value is influenced by many factors. When segmenting survey respondents, one may expect to find some of the following patterns:

- **Demographics may influence perceptions.** In some organizations, late-career employees demonstrate a lower risk profile than more junior employees. Therefore, they may place a higher currency value on restricted stock or cash than they do on options. Similarly, an organization may find that the currency values vary among business units or geographies, causing reconsideration of a “one size fits all” strategy.
- **Past is prologue.** Employee experience significantly influences currency value. Employees who have enjoyed share price gains through prior stock options may place a higher value on them than those employees who have endured stagnant or declining markets. For many companies, a history of underwater options means the currency value of options is far lower than their accounting cost.
- **Career opportunity could be an influencer.** If employees think they are likely to stay with the company long enough to vest in their awards, they will place a higher relative value on the award than employees who don't see a long-term future. The survey tool may offer insight into the tipping point for vesting: long enough to support retention but not so long as to have the award perceived as having no meaningful value.

Using the Results

A mere handful of effective questions can help develop a compensation program that accounts for the key dimensions of cost and competitiveness, shareholder value and participant perception. Having

The Guiding Principles of a Successful Survey

Think about the following pointers when planning your survey to improve the completion rate and capture the critical insights that will make your compensation investments more tactical and appreciated.

1. Keep it short, simple and straightforward.

- Design your survey the way you would want to take it (short, clear and with a minimal time commitment).
- Don't dilute or distract the survey's focus with questions about other subject matter, like overall employee satisfaction.
- Isolate the particular areas of interest and ask pointed questions.

Example: “Do you understand how stock options work?” is clearer and more focused than “Do you understand how stock options and restricted options work?”

2. Use technology.

- Take advantage of the many online survey tools that are available at a nominal cost.
- Look for survey tools that are intuitive and user friendly for the participant and for the administrator. These tools should be easy to set up and customize. As an added bonus, they often provide real-time reporting.

3. Manage expectations.

- Be clear about your goals.

Example: Help survey participants understand that your primary goal is to learn how well they understand the current program, not necessarily to make changes based on what they want.

4. Boil it down to trade-offs.

- Use the survey to foster an understanding of how pay and performance are linked to shareholder value.
- Focus on trade-offs to get a quantifiable idea of how employees value different components of their compensation.

Example: “I'd prefer five options versus one restricted stock unit.”

5. Report back.

- Fulfill your end of the bargain and remember to tell employees about the survey findings and any next steps that will or won't be taken and why.
- Use this opportunity to build credibility with employees and continue to educate them on the purpose of incentives.

6. Survey periodically.

- Keep your finger on the pulse of employee opinion by conducting a short, focused survey every 12 to 18 months, rather than a costlier, more cumbersome multitopic climate survey every two or three years. A lot can change in a short period of time, and conducting a short, single-topic survey can help you stay aware of internal perceptions.

a clear measure of all of these dimensions will show the trade-offs. Knowing the trade-offs enables the organization to proceed with a plan design that is known to have a perceived value commensurate with the cost to the company.

Proposed disclosure rules for U.S.-based plans are likely to require compensation committees to describe in much greater detail how they make decisions and what factors they consider when designing pay plans and determining awards. The data from an internal survey provides a powerful message to shareholders about the rationale underlying incentive design features, including the mix between cash and equity, the choice of one equity vehicle over another and the number of shares allocated under the plan.

The survey can also show how much

complexity employees can tolerate and how well they understand the alternatives in the marketplace. This can provide the basis not only for rethinking program design but also for developing a responsive communication strategy.

Conclusion

Employees like being heard. A simple survey is an opportunity to solicit valuable feedback, build credibility and increase their understanding of the meaning and purpose of incentives. But remember—asking employees for feedback is only half of the equation. The other half requires reporting back the survey results and making it clear what, if anything, is changing and why.

Finding out what employees think about their compensation plans will

help identify the distinct compensation components that have the greatest impact for the organization (See Case Studies: Currency Value in the Real World). This information, combined with an understanding of how the incentive programs align with the business strategy, provides a richer foundation for making compensation decisions than simply knowing where the company stacks up against peers. The additional information may also be useful in explaining to both employees and shareholders how the compensation programs are tailored to reflect the unique business and human-capital context.

Ultimately, the variables affecting currency value are wide-ranging, diverse and unique to the organization. Understanding how employees

Case Studies: Currency Value in the Real World

Every company is unique when it comes to organizational culture, demographics and employee perceptions of currency value. For example, employees of a large pharmaceutical company had become accustomed to minimal change. This well-established company had firmly entrenched policies and rarely asked for employees' opinions. Yet over the years, the organization had become increasingly diverse in its employee mix, and the risk profile and historical compensation experiences of long-service employees contrasted markedly with new hires.

Recognizing that its employees likely had different needs and preferences, the company interviewed a number of executives to get a quick read on its LTI programs. When asked how well they understood and valued their incentives, employees' answers varied significantly. In response, the organization introduced a "flexible" incentive program: participants could choose the incentives they preferred and make trade-offs based on those preferences.

Rather than come up with a blanket solution that would cost tens of millions of dollars to enhance the competitive market value of the program, the company allocated existing dollars more effectively based on executives' preferences. The resulting individualized LTI plans appealed to key segments without increasing program costs.

In another example, a large chemical company's shares had been underperforming in the stock market for years, while benchmarking indicated that the total compensation package was below industry practices. With pressures on margins requiring that compensation expenses be contained for the foreseeable future, management was concerned about the company's ability to attract and retain high performers.

To maximize its existing investments, the organization surveyed its LTI-plan participants to find out what they valued most. Survey participants placed a much higher value on restricted shares and performance shares than stock options with equivalent accounting cost. Based on this information, the company decided to change its mix of incentives to increase the perceived value—and, therefore, the incentive and retention value of the plan—at no additional cost.


As an added benefit, the organization also discovered that particular groups of participants did not have a clear understanding of performance shares. To improve the effectiveness of the plan, the company developed targeted communications to educate participants on how the performance share plan operated and how outcomes are tied to performance results.

Knowing the trade-offs

enables the organization to proceed

with a plan design that is known to have
a perceived value commensurate with the

cost to the company.

value their compensation allows for redirection of limited resources to the incentives that are most likely to retain top performers and motivate desired behaviors—improving the likelihood of enhanced financial performance and shareholder value creation. 

ABOUT THE AUTHORS:

Steve Harris, CCP, is a worldwide partner with Mercer Human Resource Consulting and represents the executive compensation function in the United States. Harris is a faculty member at WorldatWork and can be reached at steve.harris@mercer.com or 404/442-3524.

Laura Clements, CCP, is a principal in the executive compensation practice of Mercer Human Resource Consulting. She can be reached at laura.clements@mercer.com or 404/442-3528.

RESOURCES PLUS

For more information related to this article:

Go to www.worldatwork.org/advancedsearch and:

- Type in this key word string on the search line:
Long Term Incentives and employee survey.

Go to www.worldatwork.org/bookstore for:

- *Granting Stock Options: An Approach to Designing Long-Term Incentives for Employees*
- *Pay to Prosper: Using Value Rules to Reinvent Executive Incentives*
- *Stock Options and the New Rules of Corporate Accountability: Measuring, Managing and Rewarding Executive Performance-Second Edition.*

Go to www.worldatwork.org/certification for:

- C12: Variable Pay: Incentives, Recognition and Bonus
- C6A: Advanced Concepts in Executive Compensation.