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Compensation should be viewed as a strategic asset, not an expense

Many growing companies view compensation as a necessary expense.

Strategic leaders treat compensation as a critical asset that, if managed effectively, can generate enormous value for the company.

What's the difference?

BUILDING BUSINESS

BILL BOYAR

Organizations that consider compensation a mere expense do not leverage the relationship between compensation systems and job performance. They often focus on reducing the investment in their employees and reducing costs.

Companies that utilize compensation as a strategic asset often inspire behavior that produces valuable results and furthers the mission, values and strategy of the company.

Simply put, if you want to stimulate certain behavior, pay for it.

To better understand a strategic approach to compensation, let's look at the two key components: Systems of compensation and performance reviews.

SYSTEMS OF COMPENSATION

All compensation systems consist of one or more of the following components: Base salary, annual cash bonus and long-term incentives.

Depending on the nature of the business and where the business is in its development, there is often a mix of components.

Early-stage companies that are burning cash typically try to use long-term equity incentives to reduce base salary and annual cash bonus outlay. More mature companies will often be more aggressive with cash compensation and less generous with long-term equity incentives.

Cash bonus programs are often tied to either enterprise or individual performance against goals. A typical enterprise-wide plan would be tied to target earnings before interest, taxes, depreciation and amortization, or EBITDA. In an EBITDA plan, employees receive a bonus of a certain percentage of base salary. Certain EBITDA plans incorporate a sliding scale for increased bonuses if enterprise performance exceeds targets. Plans that are tied to individual goals are most prevalent for sales, where there are objective, measurable targets.

Long-term equity programs are typically in the form of restricted stock, options and profits interests. The choice of plan depends on the structure of the company and the attendant tax implications of issuing the equity interests to the company and the participants and requires thoughtful planning.

COMPENSATION AS STRATEGY

In determining which combination of compensation components makes the most sense, the crucial consideration for ownership is whether the system will stimulate behavior that is consistent with the mission and core values of the company and further its overall strategic objectives.

In this regard, how the compensation system is designed and implemented will influence whether the staff is aligned with management's strategic plan.

The threshold question is: Will this system cause our people to operate consistent with our mission and core values and execute our strategic initiatives to achieve our targeted outcomes?

If the answer to this complex question is yes, then the system can contribute to alignment between ownership and employees and help further the strategic objectives of the company. This is the beginning of establishing compensation as a strategic asset.

If the answer is no, then the conflict between strategic intent and the compensation system will more likely create misalignment and dysfunction. People will be more likely to work in silos and at cross purposes with the key strategic initiatives, and the systemwide results will likely be disappointing.

PERFORMANCE ASSESSMENTS/REVIEWS

A critical second step in creating a strategic asset is the process for performance assessments and performance reviews.

Growing companies often neglect performance assessments and reviews with the excuse of being too busy or too focused on other more important things. Nothing could be further from the truth. No company can be truly effective and build an aligned team without having an effective performance assessment and review process.

Two key elements of performance measurement are culture and job performance. By culture we mean, does the person operate consistent with the mission and core values of the company? By job performance, we mean, does the person meet or exceed expectations in the performance of his or her work, including objective, quantitative measures and subjective, qualitative measures?

Furthermore, any effective assessment process must have written tools and include a 360-degree assessment -- input from people in the organization who are senior, junior and parallel on the organization chart to the person being assessed. These assessments should be weighted by both the value placed on these two areas by the ownership and the level of interaction by the people doing the assessment.

Once the assessments are completed, responsible leaders should communicate the results accurately and assist in developing action plans for improvement. These action plans should be tied to specific goals, which should be tied directly to the company's compensation system, which, in turn, should be tied to the company's mission and strategic initiatives.

THE LESSON

Weave a thread from mission and core values, through strategy and action, through a compensation system that rewards performance consistent with such mission, values and strategy.

By doing so, enlightened leadership can effectively convert an expense to the most valuable asset of the organization -- effective people working smart, doing valuable work and accomplishing important objectives consistent with the strategic initiatives of the organization.

BILL BOYAR is chairman of law firm Boyar & Miller in Houston.