

Feature Story



Point Plan

Five steps
to developing
a long-term total
compensation plan

BY ELLIOT DINKIN

Employers today are facing some of their most difficult decisions when it comes to one of their most important asset: their employees. Layoffs, salary and retirement plan freezes, pay cuts, healthcare benefit reductions — nothing is off the table in this recession as companies look to cut costs.

Unfortunately, when faced with difficult decisions like this, employers too often focus on one facet of total compensation instead of making a total analysis. Despite the constant barrage of bad economic news, our economy will rebound. To emerge strong and retain their best people, companies need a total compensation strategy that rewards top performers while effectively allocating limited financial resources.

In good and bad times, our experience has shown us that a five-step approach to developing valuable total compensation plans will yield the best long-term dividends.

1

Take inventory

The first step for employers is understanding their existing employee and retiree population. Ask:

- Which strategic areas that drive profitability are improperly staffed?
- What is the age and years of service of your employee population?
- Do you have the necessary talent to meet customers' expectations?

2

Analyze base compensation

Base compensation too often is tied to market practices, when it should focus more on performance and future opportunity. Top performers' career opportunities and base compensation should be linked to their performance.

Pay grades also should be examined and changed as needed to better match business models and operations. If a company sells technological innovation, it must pay higher base salaries to those who can deliver those innovations. Once adjusted, pay grades should be increased periodically and strategically.

Too often during difficult times, base compensation is frozen across the board,

unfairly penalizing top performers that a company needs as it struggles to improve. Treating these key employees well during difficult periods may enhance loyalty when the company's fortunes turn.

3

Examine incentives

Short- and long-term incentive opportunities also are critical components of a total compensation analysis.

Incentives should be in place at all times. In fact, if base compensation increases are limited, incentive opportunities should be increased. They should be objective, focusing on company results and other factors that are within an employee's control. Eligibility generally should be limited to a select group of employees who can drive performance.

True incentive plans provide meaningful compensation opportunities tied to achievement of predetermined goals and often require a threshold level of performance before any rewards are provided.

Although annual incentive plans are often eliminated during difficult economic times, employers should consider a clearly communicated compensation philosophy that provides reasonable and competitive base compensation and meaningful annual incentive opportunities during better times.

Long-term incentive plans are a way to deliver meaningful rewards for sustained long-term performance. These plans should

be limited to a very select group of key employees who can drive longer-term performance of the company.

Creating plans with a combination of time- and performance-based vesting is an approach to achieving a balance between performance and retention. LTIPs create a real opportunity to provide a link to pay and performance for a select group of key employees.

4

Scrutinize health benefits

Active and retiree health benefits are vital to the attraction and retention of employees, yet the associated costs are making them more difficult to provide. Ensuring access to cost-effective, quality care for employees and retirees is a top concern among employers.

When considering the makeup of their health benefits plan, employers should:

- Establish a reasonably priced, competitive core program that reflects the company's commitment to health care.
- Provide alternate plans that allow employees to buy up or trade down.
- Understand the true drivers of health care costs and develop plan design strategies to contain these areas.

5

Reassess retirement benefits

Retirement programs are significant

issues for employers. Recent legislative changes, including the Pension Protection Act of 2006, as well as accounting reform, significant costs, and changes in retirement patterns and employee demographics have further complicated retirement programs.

Companies that sponsor defined benefit plans should operate them like a separate line of business. Formalized cash flow, expense and balance sheet impacts should be modeled over a three- to five-year rolling time period under a variety of scenarios. As a parallel course, companies should review whether these programs still make sense given their own employee demographics. If an employer decides to stop providing a DB plan, it must analyze the consequences to employees.

As DB benefit accruals have been frozen, employers have shifted to defined contribution plans. An analysis of estimated cash flow and expense over a three- to five-year time frame must also be completed and should extend to participant-level benefits. How meaningful are these programs to employees? Should they continue to be in the form of matching contributions, contributions as a percentage of salary or tied to profits? The operation of these plans has become even more vital given the ability to provide participant-level investment advice.

Case study

A manufacturing company with which we work has approximately 900 active employees and approximately 1,900 retirees. It is struggling with a drop in orders and pricing. With very technical products, the company needs to retain experienced engineers and production employees to service existing customers. It also needs these employees, who have demonstrated value and can lead an eventual return.

As outlined (see chart), the company analyzed its total compensation package to develop a comprehensive strategy for cost control and employee retention instead of making drastic changes to particular components of compensation. In doing so, it is better managing the operational issues it faces today and better positioning itself for the eventual economic rebound. **-E.B.N.**

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Historical approach	New approach
Curtail benefits and introduce more drastic employee contributions	Identified cost savings in plan designs in existing active medical and prescription drug plans, disability, life, and programs relating to plan designs
May have done nothing or totally eliminated benefits	Altered existing retiree medical benefits for former salaried and union retirees, while still providing core benefits and reasonable access
Early retirement window may have eliminated wrong personnel or just reduced head count	Designed an early retirement window and retention program to balance head counts and needs for experienced personnel
Total freeze of compensation with potential loss of high performers who have demonstrated value and can lead a return	Altered historical approach to salary cost-of-living increases to a comprehensive merit program and new salary ranges