Reward strategy: Ten common mistakes

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A Holy Grail?

Employee reward has been described as the field of HRM that can boast the widest gap between rhetoric and reality. All too often, reward strategy underpins grand plans for business improvement or cultural transformation, only to collapse into under-performance or PR disaster. As Kessler (1995) has argued, reward policy and practice have been characterised less by clarity of purpose than by whim and '*ad hocery*'.

So, to what can we attribute this spectacular and almost uniform record of under-delivery? Is it that the concept of reward strategy is too grand, or conceptually flawed? Is it that employers fail to make a sufficiently explicit link between business strategy and reward strategy? Or does effective reward strategy design tend to collapse once it comes to be implemented on the ground?

At IES, we have almost ten years' experience of research and consultancy work in the field of reward. During this time, working with a wide variety of employers from all sectors, we have formed our own views about the factors associated with the under-delivery of reward strategies. This paper identifies ten of the most common mistakes made by employers as they seek to formulate and implement reward strategy. Before exploring these in detail, however, let us first critically examine the idea of reward strategy.

Reward Strategy 'Theory'

Implicit in the notion of reward strategy is that of over-arching coherence. That all the parts of a reward strategy (the underpinning reward philosophy, the pay structure, its market positioning and its progression rules) join together in a mutually supportive way. In addition, we might reasonably expect a reward strategy to support the business strategy from which it is derived. Other characteristics might include:

- Integration with other HR policies and practices - performance management, training & development, career progression *etc.*

- An impact on the culture of the organisation and on the behaviour of individuals.
- High potential for individuals to gain a clear Line of Sight (Lawler, 1990), whereby reward lubricates the connection between individual efforts and improved corporate performance.

Reward strategy also implies that the dominant business strategy an organisation adopts should be supported by an over-arching approach to reward, supported by other HR policies and practices. Thus, a business pursuing an innovation-led strategy might wish to encourage creativity, risk-taking and collaborative behaviour. To reinforce these behaviours, the firm may choose a mixture of collective and individual rewards focusing on medium-term performance, supported by broadly banded jobs together with high investment in learning and development. Of course, differing business strategies will require alternative approaches to reward and HR.

All in all, having a reward strategy these days sound like rather a tall order. After all, to stand a chance of success, theory dictates that it should:

1. Support and be derived from the business strategy
2. Drive sustainable improvements in business performance
3. Bring about and reinforce cultural and behavioural change
4. Integrate with the rest of HR policy and practice
5. Keep the paybill under control

Little wonder, therefore, that so many employers under-perform in the design and delivery of a truly strategic approach to reward - if such a thing exists.

10 Common Mistakes

In what follows we will explore some of the factors that commonly contribute to the under-performance of many reward strategies. They boil down to mistakes of design or delivery in the following 10 areas:

- starting at the end
- having no success criteria
- trusting the business strategy
- equating complexity with flexibility
- confusing speed with haste
- focusing on excellence
- ignoring pay architecture

- failing to get real buy-in
- having too much faith in line managers
- failing to integrate reward with the other strands of HR

Let us examine each of them in turn.

Starting at the end

Many organisations decide on the precise kind of reward system that they wish to use and then work backwards. This is often driven by a desire to respond to the actions of competitors. For example, it is common for organisations to decide that they wish to introduce incentive pay, or individual performance related pay, or team bonuses without being clear about the kind of employee behaviour which will be demanded by the business strategy. This means that organisations often set up project teams to design and deliver reward systems to a pre-determined deadline before being clear about the strategic contribution which these systems are expected to make. This allows little or no scope for reward systems to be aligned with business strategy. The result may well be a pay system which rewards individual contribution, while the organisation is seeking to promote team working. Organisations which start at the end are frequently ignoring their own recent history of pay system successes and failures.

Having no success criteria

A key element of having a reward system that contributes to the delivery of business strategy is the existence of a clear set of principles that underpin the approach being chosen. Many organisations embark on the process of designing a new reward system without articulating their underlying reward philosophy or objectives. Above all, this usually means that the organisation has no systematic way of knowing how it will judge how well the resulting reward system is performing. In addition, the absence of even a simple list of success criteria increases the likelihood of inherent inconsistencies in the objectives of the pay system.

Trusting the business strategy

Having placed so much emphasis on business strategy, it is perhaps paradoxical that many organisations are poor at making their business strategy explicit, or communicating it in a way which allows it to be interpreted for the purposes of HR system design. One common problem is that the average time between changes in business strategy is getting shorter. Organisations are changing their structures or are merging with others with increasing frequency. An average pay system often takes two years to bed down: in many organisations this is too long a period to wait. This makes the process of aligning business strategy and

reward strategy all the more difficult, especially if the business strategy is either unclear, poorly articulated or subject to radical changes in direction.

Equating complexity with flexibility

With increasing workforce diversity, many businesses have assumed that their pay systems should contain many components. For example, over recent years we have seen an expansion in the use or flexible benefits systems (*eg* cafeteria benefits) which have been introduced based on the assumption that employees attach value to a higher degree of choice over elements of their pay. This, often mistaken assumption, has given rise to a considerable expansion of over complicated pay systems. As a result, organisations pursuit of flexibility has a frequently resulted only in complexity, or in carefully crafted 'flexibilities' for which there is little real demand and which, subsequently, wither on the vine. This can also manifest itself as seeking to build in too many features within a limited paybill (*eg* cost of living, performance pay, progression and team bonuses). The major problem with over complicated pay systems is that they violate the simplicity principle. Simplicity in pay system design is critical if an organisation wants its employees and line managers to make the psychological link between performance and reward. Experience has shown that pay systems that are not easy to understand or operate are the most likely to fail.

Confusing speed with haste

In today's fast moving business world it is very common to find that organisations are seeking to introduce pay systems to often-impossible deadlines. This results in firms trying to do too much too quickly: a problem that can be compounded if they are doing the **wrong** things too quickly. This mistake is most commonly associated with 'starting at the beginning'. Unfortunately, cutting corners in pay system design (*eg* by minimising on consultation or pay modelling) frequently results in cultural, financial and employee relations problems which can take many years to resolve.

Focusing on excellence

The majority of senior managers in organisations harbour a belief that a reward system should focus on the top 10 per cent of their employees. This is often prompted by an understandable desire to promote excellence in the organisation. However, it is an approach that ignores the fact that the success of the organisation depends upon the efforts of the 80 per cent of employees who are performing satisfactorily. Ideally, reward systems should allow the organisation to reward improvements in performance among the majority, rather than excellence among the minority. Nothing

is guaranteed to alienate this majority more than making them feel ignored in favour of the high-flying whizz-kids in the elite who can, by and large, look after themselves.

Ignoring pay architecture

Especially when reward is linked to performance, employers frequently spend 95 per cent of their time debating how they will spend five percent of their salary bill. Most often, this results in endless debates about performance rating or box markings. Making this mistake can mean that the organisation is not paying proper attention to its grading structure or its pay architecture.

Failing to get real 'buy-in'

Other than in exceptional circumstances, most senior and line managers have unsophisticated views about reward. They see the paybill primarily as a cost, and are keen to keep its growth under strict control. Yet, given their influence over the culture of the organisation and the contribution and motivation of individuals, these managers also need to understand what a powerful tool reward can be. When organisations fail to achieve leverage over culture and contribution through reward, it is often because they have failed to win sufficient 'buy-in' or commitment from senior and line managers. Effort focused on winning buy-in from this key group of stakeholders early in the process of pay system design is usually repaid many-fold.

Too much faith in line managers

Most large organisations have spent much of the last decade or more pushing accountability for 'people management' down to line managers. In the context of reward, this has meant that they have had to operate as the 'end-user' of many reward systems and associated mechanisms (such as performance management). Despite protestations to the contrary, line managers often find making differential judgements about staff performance (resulting in pay consequences) very difficult and uncomfortable. There are many examples of performance pay 'pots' which, rather than being targeted at good performers, have been shared out on a virtually equal basis. Part of the problem is that line managers do not like giving bad news, nor do they have a very good understanding of pay. An unfortunate combination. A key rule here is to avoid designing a pay system that is beyond the capacity of the average line manager. A persuasive argument for simplicity.

Failing to integrate reward with the other strands of HR

An important theoretical benefit of reward strategy is that it should allow reward to be effectively integrated with other HR processes. Thus, appraisal, competencies, job design, career progression *etc.* should each line up alongside reward as part of a coherent approach to managing people effectively. All too often, this level of coherence is difficult to attain. One reason may be that these processes were **not designed** to be coherent, possibly because 'ownership' of each in the organisation is split between different functions, or because they were introduced at different times or because pay, performance management and employee development are pulling in different directions. Another may be that they have become incoherent through misuse, often by line managers who have not been trained or supported effectively. Whatever the reason, the impact is usually the same: under-performance of the pay system. This can manifest itself either as mild frustration that reward is not leading to anticipated results or, in the worst cases, as a 'lightning rod' for disillusionment and anger about a range of wider organisational issues.

Conclusion

Most organisations can tolerate the consequences of making one or two of these mistakes as the journey along the path towards coherence in pay strategy. However, making several of them at the same time may seriously impede the extent to which a pay system can meet the objectives that have been set for it. Indeed, there may also be serious morale, motivation, cost and employee relations consequences.

Of all of the 'mistakes' described above, our experience is that two of them are most commonly associated with underperformance (at best) or system meltdown (at worst).

The first is to over complicate things. It is so easy to become embroiled in the complexities and technical details of pay system design and to lose sight of the 'big picture'. Many pay systems fail because they violate the 'simplicity' principle.

The second is to leave behind your line managers. No matter how elegantly designed the pay system, if the folk who bear the brunt of making it work find doing so beyond their capability then it is 'dead in the water'.

Pay systems have the dramatic potential to be one of the biggest positive influences on employee behaviour and performance. Organisations placing reward at the foundation of their HR strategy need, however, to ensure that this foundation can bear the weight of all that is built upon it.

References

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