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Alternatives to Paying Big Bonuses?

Are big bonuses the most effective way for financial services firms to attract and retain talent?
In recent months there has been a lot of debate and controversy about bonuses in the financial services industry. But beneath all of the headlines is an even more fundamental question: do big bonuses actually work? Do they drive tangible improvements in performance, and enable financial services firms to retain critical talent and motivate behavior that is good for the business? Or would firms be better served by other approaches to talent management and retention? Here are some thoughts that might not have made it to the headlines:

Here's the debate:

	Point	Counterpoint
Rely on big bonuses to motivate and retain talent *"Use large bonuses as the primary means to retain employees and drive desired behavior."*	The financial services business requires smart, aggressive people who are willing to put in a super-human effort that is not required in other industries. Big bonuses are our best way to motivate them.	Big bonuses promote short-term thinking, inappropriate risk-taking, and a me-first attitude. Is that really what's best for our business?
	Our people want to make a lot of money fast and are willing to kill themselves to do it. That's a conscious choice they made. If we don't deliver big bonuses, we'll lose them.	With a bonus-driven system, our people start jumping ship the moment we can't pay. That's no way to build a sustainable enterprise.
	Big bonuses are how we get people to work 16-18 hour days. It's like getting two full-time equivalents (FTEs) out of every employee.	Wouldn't it be cheaper to hire two employees who work regular hours and then pay them just a little more than other industries do?

	Point	Counterpoint
Apply a range of talent management strategies – not just bonuses. *"Apply a variety of people strategies -- such as career path customization, learning programs, and flexible work arrangements-- to retain and manage talent. Use bonuses only selectively."*	A varied approach to talent management and retention enables us to promote the behaviors we want – teamwork, collaboration, long-term value, managed risk, and a company-first mindset.	Although such behaviors are politically correct, they are simply not that important in businesses such as investment banking and securities trading.
	Many people are more interested in work/life balance than money. A varied approach is better able to meet their needs.	A large number of Wall Street employees aren't looking for balance or a sustained career; they want to make money fast and then get out.
	A varied and balanced approach builds loyalty that will help sustain us through tough times when our profits are down and we can't pay big bonuses.	Loyalty and retention only matter if we get the kind of talent we need in the first place; that requires paying people what they expect.

My take

Steve Hatfield, Principal and Human Capital Financial Services Industry Leader
Deloitte Consulting LLP

As financial services firms recover from the recent turmoil, they are likely to face a sharp increase in voluntary turnover. During the financial crisis, the harsh reality of layoffs and the negative side of a rewards structure that was strongly tilted toward bonuses became very real for many on Wall Street. Loyalty and big bonuses have been pushed aside, changing, perhaps forever, the relationship between employers and employees. In addition, regulatory and market changes spurred by the crisis will require new operational and talent management strategies, which will include an increased focus on risk management, transparency, long-term performance, and accountability that will fundamentally alter the rewards structures of the past.

I don't believe bonuses alone will be sufficient to address employee morale and talent gaps created by the financial crisis. Financial services leaders will likely need to better understand the talent requirements to deliver on their business strategies, and then find new ways to attract, retain, and grow people. A myopic focus on money and bonuses can often promote the wrong behavior and create excessive churn across sectors.

Looking ahead, financial services firms may need a more balanced and comprehensive talent strategy that includes a variety of talent management and retention practices. Examples to consider:

- **Develop a people strategy.** Different parts of the business have different needs and can benefit from different strategies. The same goes for different types of people. When it comes to managing and retaining talent, one size does not fit all. Develop a variety of customizable people strategies to increase success of attracting, retaining, and developing the right talent to drive the business.
- **Differentiate your recruiting pitch.** Instead of focusing heavily on bonuses and compensation, emphasize softer benefits such as teamwork, independence, and work/life balance. Not everyone is only interested in making a quick buck.
- **Emphasize learning and growth.** Offer people early exposure to senior executives and high profile assignments. Accelerated involvement and development is particularly appealing to Gen Y'ers and Millennials, who want the opportunity to make a fast impact.

- **Base part of the bonus on shared goals.** Replace part of your individual bonus structure with a bonus based on shared goals. This can help promote teamwork and can help reduce the me-first mind-set.
- **Establish multiple career paths.** Instead of forcing everyone to put in extraordinary effort for extraordinary rewards, allow some people to choose an alternate path of reasonable effort for reasonable rewards – without dismissing them as slackers.

Bonuses clearly have a place in the financial services industry. But they aren't the only way to attract, retain, and motivate talent. Financial services firms should carefully consider all of their strategic options and not resort to paying big bonuses just because they have always done so.

A view from the wall street perspective

Robert Dicks, Principal, Human Capital Deloitte Consulting LLP and Linda Quaranto, Director, Human Capital, Deloitte Consulting LLP

Big bonuses have driven compensation on Wall Street for years and employees don't expect this to change any time soon. For traders, bankers and other customer facing roles, bonuses will likely stay the primary driver of retention, but in many cases, firms have depended on bonuses too broadly when other retention strategies may be more suitable. To drive performance and a more appropriate culture, firms should consider:

- **Focusing bonus payouts on client-facing functions.** Firms can direct a substantial amount of their bonus pools to client-facing and client support positions, while aligning positions that are less unique to the financial services industry – such as those in HR, IT, Finance, and Legal – to compensation structures closer to their non-Wall Street counterparts. The latter require skill sets that are more common and can be motivated with rewards that are less variable. For these roles, a broad package of financial and non-financial rewards is more appropriate.
- **Linking rewards to long-term stock price appreciation and better addressing risk related to compensation.** When firms offer "life altering" levels of compensation to employees who control other people's money, risk and conflict of interest can become major issues. Compensation decisions should reflect whether an employee's decisions were (1) reasonable and appropriate (2) aligned with firm and department objectives, and (3) not motivated by short-term personal gain at the expense of long-term business and client objectives. Moving from cash bonuses to stock-based bonuses or stock options can help better align the behavior of individual employees with the long-term interests of the business. Over time, employee behavior can be better aligned with shareholder objectives through long-term performance criteria, equity grants, and multi-year claw back provisions. As employees increase their tenure and allegiance to the firm and make effective risk-informed decisions, they will be better positioned to reap the rewards generated by their loyalty and performance.
- **Reducing the firm's overall cost structure by aligning bonuses to profit levels.** Transform the operating model and client approach. Limit super-sized compensation packages to roles that are mission critical. Use system and process improvements -- such as off-shoring and new technologies -- to maintain or improve service levels with fewer resources at lower cost providing opportunities to fund bonuses where necessary to help improve performance.

Wall Street will always need to provide compensation packages that recognize the skill, commitment, and drive of their top performers. But alongside those packages, firms should consider other strategies to influence behavior, drive performance, and align with shareholder interests.

A view from the banking perspective

Hope Hughes, Director, Human Capital, Deloitte Consulting LLP

Although they don't make the headlines as often as large investment and securities firms, banks (including mid-size and regional banks) and other financial institutions are still very much affected by the bonus bonanza. These banks vie for top-tier executive talent and are often forced to offer large compensation packages in order to be competitive. Yet, because they sometimes have less revenue and fewer resources to draw from, these institutions must also find creative ways to recruit and retain the talent they need. Here are some valuable practices to consider.

- **Re-engage the workforce.** Identify critical talent and provide them with new challenges. Engage and empower leaders to solve problems created by the downturn. Offer employees opportunities to learn and develop new skills such as designing new products, developing new services or implementing new business models.
- **Increase focus on customers.** The financial crisis raised customer concerns about the safety of their investments and future services they would receive. Trust has been broken with many. Thus, customers often take their frustrations out on bank employees. This stress can have a trickle-down effect on employee morale and employee retention. Banks should actively educate consumers about new products and programs designed to better protect investments. They should also bolster customer service training for employees. These tactics can help ease strain on employees and can help with retention.
- **Re-balance the reward structure.** Banks and other financial institutions can counter the hefty bonuses that investment and securities firms pay by offering their employees other valuable rewards, such as flexible work arrangements, career path customization, and enhanced fitness/wellness programs.

Mid-size banks and other financial institutions can't afford to engage in a bidding war with their larger counterparts. But they still have a lot to offer -- beyond compensation. They just need to be creative and flexible in finding ways to attract and retain top-tier talent.

A view from the insurance perspective

Tina Witney, Senior Manager, Human Capital, Deloitte Consulting LLP

In the past, insurance companies could count on significant investment income to help fund their talent strategies. But not any more. Also, insurance companies now find themselves under increased scrutiny from regulators and consumers, which requires greater transparency into compensation and bonus programs. Factor in an aging workforce and rapidly retiring executive base, and it's clear that insurance company Chief Human Resource Officers will likely need to leverage a variety of talent management strategies to attract and retain star performers in the current environment. Here are some things insurance companies should consider doing in support of their efforts to attract and retain talent:

- **Rebuild the company's image.** Insurers need to win back the confidence of both their consumers and employees. This should include a proactive media plan to restore the company's brand, reputation, and value proposition. Part of the plan should focus on the industry's important role as a social and economic stabilizer, and on the company's many philanthropic contributions to charity, education, and the arts. These actions can go a long way to building back employee pride and reconnect them to the organization.
- **Focus on work force segments critical to the strategy.** Insurance companies face a major shortage of actuaries, underwriters, and sales agents. To fill the gap, insurers must develop new recruiting, training, and talent strategies specifically targeted at these critical job families. Future underwriters and actuaries need to be sourced early in college and developed through on the job mentoring and accelerated development programs. Organizations should be seeking to build a diverse sales force to mirror the consumer base and need to look beyond traditional labor pools to find and develop new talent. One size does not fit all and specific talent strategies need to be developed and deployed to serve each segment.
- **Keep retirees engaged.** The retiring workforce is one of the greatest resources for an organization. Employees in key specialties and leadership roles could be asked to continue to mentor staff, build expertise in others, and transfer knowledge in the years following retirement. Given the anticipated talent shortages in certain job families, this workforce can serve as an interim solution to bridge the gap as new talent is developed or other operational solutions are implemented.

For further information, please visit: www.deloitte.com/us/debates/Bonus Alternatives.

For further information about this debate, please contact:

Steve Hatfield
Principal and Human Capital Financial Services Industry Leader
Deloitte Consulting LLP
sthatfield@deloitte.com

Robert Dicks
Principal
Human Capital
Deloitte Consulting LLP
rdicks@deloitte.com

Linda Quaranto
Director
Human Capital
Deloitte Consulting LLP
lquaranto@deloitte.com

Hope Hughes
Director
Human Capital
Deloitte Consulting LLP
hopehughes@deloitte.com

Tina Witney
Senior Manager
Human Capital
Deloitte Consulting LLP
twitney@deloitte.com

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