CAPITAL H
The compensation conundrum:
Principles for a more human approach

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David Mallon: Welcome to the Capital H podcast, where we explore topics and trends that focus on putting humans at the center of work. I'm your host, David Mallon, chief analyst with Deloitte Consulting's Human Capital Research and Sensing team. You might recall that this season, we're exploring our 2020 Global Human Capital Trends research. In this episode, I'm excited to continue this exploration, and today's topic is the compensation conundrum. We want to attract and reward and retain our best people. We ourselves want to be fairly

rewarded for our work, to provide for our basic needs now, prepare for whatever might come tomorrow, hopefully maybe make our dreams come true for us and ours. Seems straightforward enough, but in an organizational context, compensation has been anything but straightforward. It represents our largest workforce cost and yet, even with the tremendous innovation and disruption and performance management, you know, appraisals and the like over the last few years, most organizations remain vexed by how best to pay their people, every few

years, calling out the need for reinvention and then ending up essentially where they started. To talk about this conundrum, I'm joined today by three of my Deloitte colleagues. Jason Flynn. He's a principal in our Human Capital Workforce Transformation practice, and he leads our Global Rewards practice. Hi, Jason.

Jason Flynn: Hey, David. Great to be here.

David: Melanie Langsett is a principal in our Workforce Transformation practice.

She's also our U.S. leader for our offerings in Rewards and Wellbeing, as well as our U.S. Workforce Experience leader. Glad to have you with us, Melanie.

Melanie Langsett: Great to see you, David.

David: And Andrew Erhardt-Lewis, he's the Deloitte Global leader for our Performance and Pay Initiative. Welcome, Andrew.

Andrew Erhardt-Lewis: Hello. Welcome from London.

David: Great. So, Andrew, I'm going to start with you. Let's think about the problem itself. Why is figuring out how to best compensate our workforces so challenging?

Andrew: So, you started off with a big question there. So, what I would suggest is there might be three reasons, if I'd put it into a bucket of what the real challenge is. The first one is work. Work is changing. In Deloitte, we've been talking about the future of work for several years. Expectations of people have been changing. How we do work has been changing, but compensation, traditional compensation hasn't really changed for decades. Things like, "Pay never goes down. It only goes up." Things like, "My job changes. I evolve, but I still expect more." So, the first one is the pressure on it is that work is changing.

Second issue is that I think for many of our professional colleagues and clients who focus on compensation, they are compensation specialists, whereas if we look at it from an employee lens, they don't necessarily think of only the pay. They think about the broader context. So, there's a little bit of a disconnect there between our obsession with getting compensation correct, which is right and proper because it's money and our peers in finance want to make sure we're actually spending it wisely. However, the disconnect is more between the expectations of people. The third pillar that I would suggest with some compensation strategies are the difficulties, the current environment in which we find

ourselves. What I mean by that is I'm not specifically referring to COVID or Black Lives Matter or the Me Too Movement but kind of everything. It is very, very difficult to often play the game where you're looking at, what is the immediate need and the pressure you have on you whilst you're also looking down the pitch, and you're thinking about what might be coming in two or three years. Most business strategies are always three to five years out. Compensation strategies should match that. However, if we look at the current environment and you turn on the news, there's a huge amount of things happening right now. So, how do you balance that longer term need with the short-term demands? And that creates challenge.

Jason: I'll just jump into that, Andrew. I think one of the other things, and I think a lot of our research the last few years has shown this, is one of the biggest places folks struggle with this is continuing to align the compensation strategy with the business strategy. Often, there's very little linkage, and so I think that's led to a lot of tinkering and reactive changes over time. So, I think the business is expecting compensation to evolve, and as you mentioned, it's been slow to react. There's reasons for that. There's regulatory. There's other considerations. It's very personal to every employee. But I think we're really seeing now where that disconnect between kind of the compensation and broader rewards strategy with the business strategy is really, really coming to the forefront and causing some challenges more and more for employers.

David: Jason, I'm going to stay with you. So, I can only imagine we've got to have seen some progress and maybe particularly because of now, disruptions we're seeing, the COVID pandemic, the focus is on issues of equity and social justice. Are we seeing any movement? Are we seeing any inspiration to think about this problem differently?

Jason: I would say yes. I mean, I think as I noted, I think we've seen a lot of companies looking at their compensation strategy, right?

I think that came out in our trends data pretty strongly. I think it was almost 80% of the organizations had looked at this or were looking at it over the last few years, but I think the data also showed that they're going to continue to look at it. So, it continues to be a challenge for them.

So, I think as we look at some of the progress, I think it's in spots. I think that some organizations have started to realize that they need to take a little bit more of a transformational view of this topic and not the tinkering, so we are seeing some organizations start to take a little bit more of a view from the employee or workforce angle, so starting to think about the needs of the workforce and not so much focus on what everybody else is doing and just focusing on benchmarks. So, I think there's a lot of, well a lot is not the right word, but we're seeing some progress in that area of bringing a little bit more of that workforce lens to this. And I think that's where we're starting to see probably more progress than we had over prior years.

Melanie: If maybe I could add a little bit to that as well, I think as Andrew spoke about, the acceleration of the future of work and our clients are seeing the different types of skills and capabilities, the enduring human capabilities that are going to be so critically important to their businesses as they move forward through this series of disruptions and those that are likely to come in the future, the focus on skills and the way that individuals are compensated or remunerated for the different skills that they are able to bring to the table and develop is another consideration that we see rising in conversations with our clients in the way they're thinking about transforming, as Jason spoke about.

The other is really through the lens of, I'll call it diversity, equity, and inclusion because that additional perspective around equity includes things like transparency. It's not just about what is everybody else paying, but am I being remunerated fairly for the impact that I'm making? And organizations are really

struggling with, how do you determine that effectively? If we move past the traditional definitions of diversity and inclusion to those that we're likely to see as organizations come out of the current environment and move beyond responding to some of the disruptions into recovery and thriving, we run the risk of influencing or embedding new biases around the way we think about pay and remuneration and rewards. Differentiated perspectives of those who continue to work outside of a workplace and those who are returning into a workplace, as an example.

So, this issue is not going to get any simpler, I don't think, and I think we're seeing that in all of our conversations with our clients as we're trying to help them navigate the current environment and prepare for the future.

Jason: I would just add to that a little bit. Some of the other areas where we've seen some progress around maybe some more innovative approaches, some more choice-based approaches to compensation around more focused on recognizing the impact of teams. So, as we're changing the way we work we're seeing more organizations reflect team-based aspects of compensation.

I think we're going to continue to see those really accelerate now. I think that we've seen dabbling in those areas, probably 10, 20% of companies are doing that. In my conversations, lots of companies are really starting to think about, they've got to really look at some of these things very differently, right? Whether it's the pandemic or everything else going on right now, it's really changed the environment.

And so again, this need for a little bit more of a transformational view of compensation is really emerging. And I think we're going to start to see a lot of these more innovative, and I'm not sure they're super-innovative, but they're innovative relative to what's happened in the past. I think we're really going to continue to see those accelerate.

Andrew: I'll just add a couple of thoughts, hopefully more from a global lens here. And that is, so, in society there seems to be a connection between government expectations and businesses and what they provide to people. Well, maybe not a connection, but at least there's a confluence of them.

But in doing so that we're seeing more compensation strategies start to be a little bit more in line with what is expected from society as a whole. What I mean by that is, so in the UK, we have gender pay regulations. France has them. There's other countries that are coming online. And if I just use that as one example in talking to what Melanie had referred to, we're starting to see this more transparency and more expectations of society on the business to pay fairly and in a way that is expected by the societies in which we live.

And so therefore the businesses that we consult with, who seem to really get this point and are taking it forward, I would suggest, David, that they are seeing more innovation, better results, better productivity, things that every business actually wants from their workforce or in their relationship with the workforce. And so, it is to Jason's point, 10, 20%. It is starting and I think there's some really interesting things that are happening out there and long may they continue.

David: Melanie and Andrew, you both hinted at some of the things that are in our global human capital trends study in the chapter on compensation this year. We talk about the need to apply principles of human-centered design to this question. I think you both hinted at a couple of them, which is this notion, for example, of fairness. This notion of perhaps what might be a living wage and how might we know that that's true. Melanie, unpack that for us, what are some of these principles that we're talking about and give them a bit more detail and some examples of how they can be applied. If we wanted to apply a principle of distributive procedural fairness, for example,

what does that actually mean? If we wanted to truly reward people for the values that they create, what does that mean, and so on?

Melanie: Yeah. So, thank you, David, for that question, because Deloitte, our point of view on workforce experience is that you have to put the human in the center. Whether you're creating a customer experience for your external customers or a workforce experience for your internal customers, which is what the workforce really is to the organization. You have to use human-centered design in order to make sure that you are creating that experience. And that experience is important because it does result in differentiated business outcomes. Andrew spoke about improved engagement and Jason talked about improved productivity, and those are two measures, but there are others as well in that equation that clearly articulates that an organization that delivers a better workforce experience will have more loyal customers and will have differentiated financial results. So that's why it matters and why we think it's so important to use human-centered design approaches, whether you're designing compensation strategies in isolation or more holistically, total rewards or total relationship strategies. So, as you said, David, we previously talked about a couple of those, but one that we haven't touched on that I really would like to highlight is that purpose and meaning in this year's trends report. Purpose and meaning rose to the very top. And belonging and the concept of the compensation strategy may not have always felt like they were aligned, but with the democratization of data, with individuals being able to determine what they believe is fair for the job that they're doing. What we're now seeing, though, is that pay for jobs is being challenged as jobs are changing so rapidly. And thinking about then what are those skills and competencies and capabilities, not just about a job or time in the role or time in grade, as influencers to the way in which people are paid. That's taking into account the human perspective and

understanding what an individual, or what the workforce, is willing to give up in order to get. Interestingly, we've already seen from the current environment that we are in that individuals who would prefer to continue to work outside of their traditional workspace, whether that's work from home or work from anywhere, are willing to trade down pay in order to retain that flexibility. So, some of the research that's coming out right now has indicated that individuals are willing to give up as much as 10% of their pay in order to retain the right to work from home. But I think what our client organizations are also going to be challenged with is that pay strategies have historically taken into account geographic differentials, being willing to pay more, not just for the job, but for the geography in which the job is done. The focus on pay differentials based on geography is likely to come under a microscope as organizations are considering not returning 100% of their workforce into workplaces and opening up the opportunity for individuals to live in lower-cost areas.

So, putting the human in the middle is understanding what they need and what they're willing to trade off in order to get. That's a philosophy that we use across all of the research and the design that we encourage our clients to think about and look at it while they're considering both strategies and the execution of those strategies. And I think it's going to become even more important as our clients are thinking about how they move from the historic approaches to what the workforce of today and the future is now, and how they're going to respond in order to be able to attract and retain and get the highest engagement out of the workforce that they need.

Andrew: There's something in there, when you talk about employee experience, and I know this is a little bit controversial if I think about whose ears this is going to fall to, but we've always talked about pay for performance. That's always been almost a cornerstone of every compensation strategy. But pay for performance is a very company-

centric, shareholder-driven concept. And if we say that the future is really employee experience or a more balanced relationship between the worker and the workplace or the company, that pay for performance that we've been living and breathing for 40 years suddenly starts to be questioned. And is that really an employee-centric concept? And I might suggest it isn't.

And if we're willing to change that language and that tone, then I think compensation strategies as a whole will start to emerge differently. I think the thing that, David, you and Melanie quoted with the trends and the focus on purpose, that will start to—maybe that starts to replace the pay for performance concept with something different. But ultimately, the equation is still two plus two equals five, hopefully, and that we have a good employer experience in the sense of the shareholder gets what they expect, we have a good employee experience and it's balanced and they're having a great time and they're learning and growing, et cetera. And then, ultimately, the final equation there, the five, not the four, is what the shareholder is actually after.

Melanie: If I could just add one more thing, Andrew, to that, because I think this speaks to our point of view as well, and what we're seeing in the marketplace around the balance of the various aspects of wellbeing. So, workforce experience is influenced by my personal wellbeing as an individual. My wellbeing is influenced not only by my financial wellbeing, which is where pay has historically fit, but it's also my mental wellbeing. And if I don't have the financial means to support my family, my basic human needs, then my mental wellness is impaired. If my mental wellness is impaired, my physical wellness will be impaired.

But what I wanted to bring all this back around to is your point about purpose, and the finding in the trend is that financial wellbeing, physical wellbeing, and mental wellbeing are only three of the four pillars of wellbeing. And

connection to purpose, so my connection to the purpose of the work that I'm doing inures value to me, and it is part of my perspective of my overall remuneration, or my relationship with my employer. And it has not been part of the conversation. So back to your point about pay for performance, I would rather, I think most humans would rather know that what they do matters and get that intrinsic value in addition to feeling like they are being paid fairly for the contribution that they're making and the impact that they're delivering.

Jason: One other area I'd just throw in that I think really highlights some of the human-centered design aspects, and I think that we're going to continue to see really take shape here over the coming years is the focus on skills. We've talked about jobs are changing, and jobs have always been the foundation for how you figure out somebody's compensation, and those jobs, as they evolve, and the skills you need to do them are changing rapidly. There's an element of fairness that enters this. And so, I think many employees are thinking they're requiring new skills or need new skills, and why isn't my pay reflecting that? So that's an element where I think organizations are starting to react to that.

And then also just a need to actually incent or allow for people to grow and look at career mobility. And certainly the current pandemic's going to drive this even more, the need for people to be able to move and shift into new roles and acquire new skills and reskill quickly. So I think organizations are really starting to, I think, pay attention to that and recognize that they've got to find ways to incent and allow for kind of maybe some lateral moves, maybe some backwards moves, but some ways to allow people to move into different roles, compensate them in a fair way, and pay for skills that they're going to need going forward.

So, I think the whole element around paying for skills as part of paying for the job is going to continue to play out here. We see that whole idea of growth in entrepreneurialism and people wanting to own their careers

and go in different directions, and so I think compensation is going to have to help be a facilitator of that. We're starting to see that dialogue much, much more, particularly over the last few months.

David: I'm going to start to wrap up the conversation and ask each of you to maybe give us some sense of where organizations can go from here. Maybe first steps, advice, guidance, what have you. But I'm going to start with just reacting to, I think, a couple of things that I've heard in the conversation just now. You mentioned, Melanie, for example, the sort of democratization of data. That pressure that's come from an increased transparency, we talk about that in this year's study. And how that drives to maybe what Andrew's talking about in terms of, I would say one of the challenges with pay for performance so far has been that that assumes that we actually know what performance is and we can actually describe it well, and that we all trust the ways in which performance is evaluated and adjudicated, and then checking back to something you just said, Jason, which is, I've heard companies in the past talk about pay for potential as an alternative, which paying for the possibilities that people can grow and develop. And that some people just seem to be more efficient learners, for example, than others. But in all of this, there is this notion of sort of how data and how we use analytics and how we're using our abilities to understand what's going on because of that data, into the work itself with our workforces, what they want, how the work itself is changing.

I'm going to ask you to, as you think about advice and guidance to our audience, to start with this question of data and analytics and sort of how that's playing in understandings of fairness and compensation. Understandings of transparency and compensation. And just ultimately understanding, giving Melanie that line of sight to the purpose and the value that you provide. Andrew, since I led off with you at the start, I'll lead on with you here as well. What would you give in terms of advice and

guidance going forward, particularly maybe starting with this question of how we're using data and analytics in new ways?

Andrew: I'm going to start off with a way that is probably not what anyone would expect, which is I hate external data. And the reason being is that so many companies are just rushing towards the media and who cares what the other person pays, if you can't afford it, or if the other person that you're competing against, or your supposed competitors are paying less than you. Does that mean you're going to drop pay? So, data, when I said, "Who cares about data?" my specific focus or concern is obsession with external market data.

What I would say, David, to answer your point directly, what would be the hints and tips that I would put forward, is look at your internal data. When people are considering some of the concepts that we've talked about here in terms of fairness and am I paid correctly, I'm not necessarily concerned with what I'm paid in another company, because I'm not there. And if I'm going to go there, then maybe that's the right answer for my career, or my family, or my personal circumstances. I'm worried about what is Joe Blogs next to me getting paid. Or what does Susie Sample get in the other department, because I'm quite personally competitive with her.

There's an element of starting with the internal equity and making sure that's being addressed. One is it will address some of the big challenges we've talked about here in terms of pay fairness, pay equity, and transparency. But secondly is treat your internal talent market as something you actually want, as opposed to just this logistical thing that I chuck some money at them once a pay period and I'm done with it, and I consider myself job done. I think if our colleagues in compensation, as they develop strategies, start with recognizing most companies' workforces are pretty darn good and you want to hold on to them, start there as your starting point in terms of where you're going to compare, where do you think

you could do better? Where can you invest time and money? And I think you might have a very different answer as opposed to always focusing on the external.

Jason: And I'll jump in there, and I think we alluded to this a few times during the conversation, really understanding what your workforce wants and getting very direct and asking them. We've seen some organizations start to introduce choice-based compensation, where you get to choose how you want to receive portions of your pay between, say, restricted stock, or cash, or equity. Again, these are not mainstream by any means, but we're starting to see this element of let's ask people. That's one very direct way of doing it.

Another way is just, again, starting to understand the trade-offs Melanie mentioned earlier, what we're seeing around people's desire to potentially take less pay in exchange for working remotely or having more flexibility in their schedules. So this whole idea of, again, the employee as customer and treating them as such, and understanding their wants and needs, that doesn't mean you're going to put a system or a compensation structure in place that allows full flexibility and everybody gets to select everything they want, because that's probably not administratively feasible. But it does, one, it starts an exchange. It starts to build some trust. It shows that you're asking and interested in what they're looking for, and you start to design around that and find the right levers and right ways within the context of your culture and what's right for your organization to make that work. You still need to understand what the competitive marketplace is, but that shouldn't be the focus. It should be much more on what your workforce is looking for.

Melanie: You all are a difficult pair to follow, but maybe to put a fine point on points that you both just raised is that understanding what motivates your workforce. And that may not be ubiquitous across the entire group of employees or workers. And being

willing to think in a differentiated way about how you address those motivators. That would be one of my recommendations. And I think I would close with moving beyond looking at pay, particularly base pay, as a reward. It's remuneration in exchange for skills, capabilities, and outcomes that an individual is delivering. What makes people feel rewarded is generally what comes outside of their base pay. So, we've said it before, that pay needs to feel that it is equitable and it is fair, but what's going to motivate someone to bring their best work, their highest degree of innovation, the things that are really going to help shareholders, to Andrew's point, are well beyond compensation. So, using a broader perspective, I think, is the one piece of advice that I would give.

David: Thanks, Melanie. I think that's a great place to end. I want to thank all three of my panelists today for the wonderful conversation. And thank you to the audience for joining us today.

I hope today's conversation shed some light on how organization can use human-centered design principles to craft compensation strategies for a new world of work, which is more focused on equity and transparency than ever before. Remember that in addition to tuning into our podcast series, you can also find the 2020 Global Human Capital Trends report online at www.deloitte.com/HCtrends. Let us know what you think of Capital H, rate us at whatever service you used to find us and look us up on social media. We'd love to hear from you. Thanks for listening. We hope you'll join us next time as we explore more topics and trends that focus on putting humans at the center of work.

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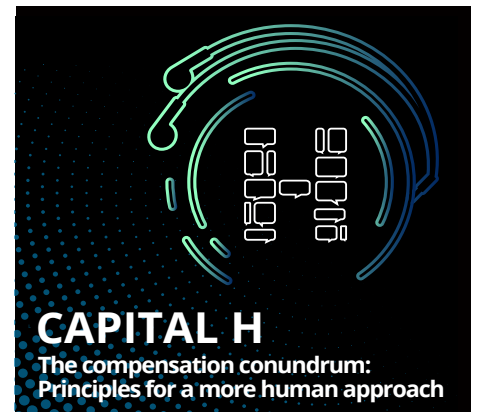
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