

Aligning Pay with Business Strategy to Attract and Retain Talent



What is your compensation strategy?

Many organizations would say “Our compensation strategy is one that aligns with our business strategy” with the underlying assumption that it will attract and retain talent. But does it really?

Most of us would agree that organizations with well-thought-out, metrics-driven, clearly articulated and communicated business strategies are typically more successful than businesses that do not engage in the strategic planning process. However, this can be challenging as many managers may not understand their business strategy, or the strategy might be frequently changing and not consistently executed.

Senior leaders of these organizations must make the connection on how important it is to communicate the business strategy to the individuals who are responsible for making compensation decisions—whether that is a compensation professional, a human resources business partner, or a line manager.

Cost Leadership

Cost Leadership is identified by features such as high volume, high technical efficiency, repetition, predictability, and minimal cost of operations. Wal-Mart fits this business model. To successfully deploy this model, fixed costs must be reduced or minimized. Typically, an organization’s largest expense is payroll. Therefore, logic dictates that a company following a cost leadership business strategy would lag the market when it comes to compensation. Surprisingly, research indicates the opposite to be true—successful cost leaders actually lead the market in compensation to attract talented employees that help them find ways to optimize the unit cost of labor through technical efficiencies.

Differentiation

The characteristics of the Differentiation model are: market followers versus market leaders, maximization of quality and customer service, concern for doing work well versus the amount of output. Lexus is an example of this business model as it is known for great quality and exceptional customer service. You might expect differentiators to pay at the higher end of the market assuming a higher profit margin, but they are the least aggressive in setting pay levels and have a tendency to focus on variable pay to drive employee contributions towards achieving organizational goals.



The compensation strategy should be planned and discussed at the same time the business strategy is being developed. This critical step is typically where most companies stumble and fall.

Business strategies are generally categorized under three basic principles—cost leadership, differentiation, and innovation.

Do you know your company's long-term or short-term business strategy?

Innovation

Companies whose business strategies are driven by Innovation look for new market opportunities, encourage risk-taking, focus on speed and agility, anticipate new customer needs, and promote creativity to maintain a competitive advantage. An example of an innovator is Apple, which has revolutionized music and smart phones, and created a whole new industry. As one would suspect, they are market leaders when it comes to compensation. These organizations are willing to pay top dollar for trained specialists, diversity of skills, and creativity and they make use of variable pay to reinforce their strategy.

Companies may have several different business plans for multiple business units especially if the business units are in different growth stages or have different market positions. In that case, it is reasonable to have multiple compensation strategies within an organization. It is also possible to have different compensation strategies in different departments. For example, the Innovator approach might be used for critical-to-success positions (e.g. engineers, designers, sales) while using the Differentiator strategy for support positions (e.g. HR, finance, IT). The challenges in using multiple compensation strategies are administration, “the messaging,” and consistent application of the strategies for each respective area.

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Some companies employ more than one business and compensation strategy.




There is no clear-cut, right or wrong, compensation approach for each of the business strategies. If you are responsible for making compensation decisions in your organization, you must make sure you understand the business strategy from your senior leaders and align the compensation strategy. After you have made your determination, will you then lag, lead, or be at market? Once these decisions are made, it is prudent to periodically analyze and evaluate how effective your compensation program truly is in attracting and retaining your top talent.

Need help with your compensation strategy?

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