

Compensation Philosophy

How Do You Intend To Reward Your Employees?



By: **Boluwaji Apanpa** (Senior Manager) & **Busola Farinmade** (Senior Advisor), Compensation & Benefits

Compensation Philosophy is the bedrock of how organisations reward the talent required to achieve business objectives. At the very least, it provides guidance on where a company aspires to anchor its pay within a comparator group and what compensation elements will be covered. Organisations typically communicate their Pay Philosophies via annual reports, proxy statements, remuneration reports, websites, amongst others. Managers and supervisors are critical change agents that organisations can leverage to also communicate their Pay Philosophy.

A well-articulated and communicated Pay Philosophy can go a long way in ensuring that employees perceive the employer and reward process as transparent, fair and equitable. It, therefore, engenders a culture of trust and openness between the employer and employee.

Being a strategic reward tool, a Pay Philosophy, therefore, should be carefully defined, after taking into consideration certain pertinent factors, such as:

- **Business strategy:** A company's Compensation Philosophy is never a standalone mantra. Rather, it should be reflective of the HR strategy and the bigger picture of organisational goals. A company's Compensation Philosophy can be likened to the 'seconds' hand of a clock, moving consistently to achieve the goals of the minute and hour hands, which represent the company's Reward and HR Strategies, respectively. A proper fit between these three elements is essential to drive business strategy.
- **Single versus multiple pay philosophies:** For companies that operate in one location or have only one line of business, it is easier to adopt a single- "one size fits all" - approach to

compensation. However, many organisations carry on businesses from multiple locations across continents or have subsidiaries operating in diverse sectors. These multinationals or conglomerates require even more details in defining their Compensation Philosophies to ensure alignment between HR strategy and peculiar local market/industry practices. Adopting multiple Pay Philosophies may have the advantage of addressing peculiarities in different business segments or jurisdictions and helps to address the needs of specific talent markets. However, this is not a prevalent practice. Multinationals typically adopt a single harmonised philosophy that aligns with their global business and HR strategy. However, they usually make flexible provisions for exceptions to recognize peculiarities and local relevance. This is reinforced by the findings from a survey of compensation programs and practices conducted by *WorldatWork* in 2015. 82% of the respondent indicated that their Compensation Philosophies are uniform across subsidiaries and do not vary across countries.

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- **Reward focus:** It is important to define the focus of reward. A company's objective may be to focus more on pay-for-performance, rather than guaranteed pay. Another organisation may focus on benefits and work-life initiatives. The reward focus should form part of the Compensation Philosophy. Also, defining the reward focus enables companies answer the question of whether they will like to be competitive on guaranteed pay and less competitive on benefits and vice versa. The reward focus should ultimately be driven by the business and HR Strategy.

A key aspect of an organisation's Compensation Philosophy is a defined pay market where the company wishes to play in rewarding its employees. The defined comparator group will form the basis of remuneration benchmarking exercises to monitor market positioning and track market movements. It is, therefore, critical that the pay market is properly defined to ensure relevance to the business. The following are typical factors to consider in deciding on a comparator group:

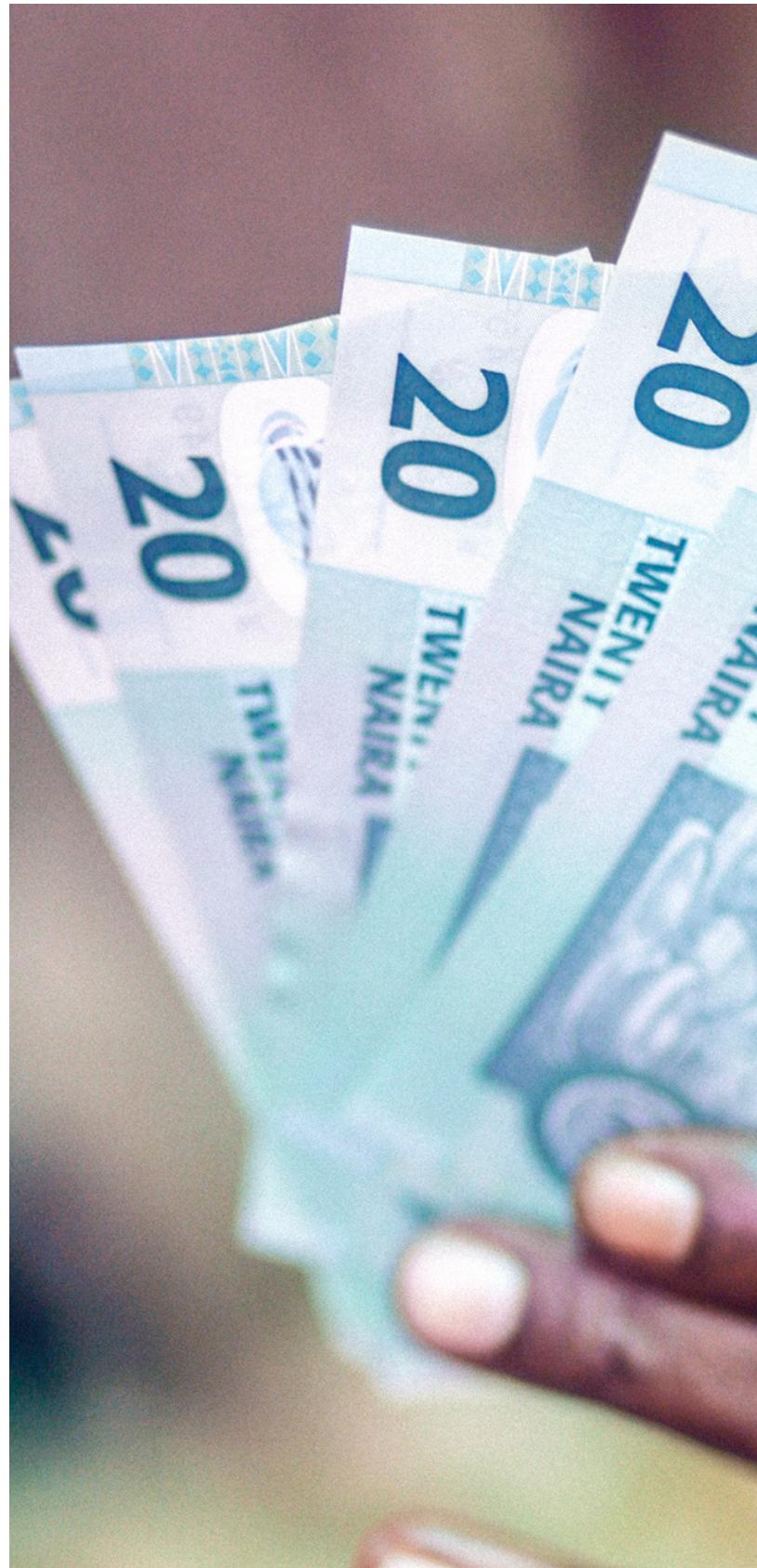
- Companies with similar or comparable businesses
- Companies to which an organisation is more likely to lose talent as well as attract talents from
- Companies operating within the same geographical spread or jurisdictions
- Companies of similar size in terms of business, staff strength etc.
- Companies of similar structure and complexity e.g. holding companies

Defining a Compensation Philosophy

There are several approaches to defining a Compensation Philosophy. Some companies adopt the less scientific approach of looking inwards at the business and defining a Philosophy based on perception, experience and intuition. For organisations that prefer a more objective basis, one (1) or a combination of the following two (2) widely accepted approaches is used:

Market practices: Market intelligence on what other companies of similar operations and size are doing and how it has worked for them is usually a good indicator defining a Compensation Philosophy. It also provides insights on peculiarities in a company's business that may render the most prevalent market practice unsuitable. This method is often used in conjunction with other analysis to define a Pay Philosophy.

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Financial size and efficiency (FS&E) analysis:

When used in conjunction with the market practice approach, the FS&E analysis seals the deal in determining a suitable pay market and desired market anchor point. The FS&E is premised on the general assumption that bigger and/or more efficient companies are able to pay higher than smaller and/or less efficient companies. On this basis, the FS&E analysis is one of the crucial indicators of ability to pay and consequently, helps to indicate a suitable anchor point amongst a carefully selected comparator group. Given the relationship between pay and financial performance, if a company is ranked at the 65th percentile based on the results of a FS&E analysis, this could be an indication that the company can afford to anchor pay within the third quartile (i.e. between the 51st and 75th Percentiles).

Scope of a Well-Defined Compensation Philosophy

A company's Compensation Philosophy statement should be precise and provide answers to the following:

- Desired market position
- Comparator Group
- Compensation mix
- Reward focus
- Pay review process
- Mode of pay differentiation

Companies must bear in mind that a Pay Philosophy is aspirational and the extent of its delivery or actualization is a function of what the business can support. Also, the Compensation Philosophy should be flexible enough to reflect the continuously changing business environment and focus. On the other hand, excessive flexibility could question the relevance of the Compensation Philosophy. Therefore, Management and HR professionals need to strike a balance on how much rigidity or flexibility is appropriate for the business.

In conclusion, it is extremely critical for businesses to have a well-defined and communicated Pay Philosophy. This will not only engender a culture of trust and transparency between the employee and employer, it will also help provide a focus for the rewards strategy and ensure alignment with corporate objectives. There should be a balance between ensuring consistency and allowing for sufficient flexibility in order to make the Philosophy continually reflective of market and business realities. To ensure relevance, the Philosophy must align with the business and HR strategies, as well as consider economic realities and what the reward focus will be. Given that the Pay Philosophy provides direction for the rewards strategy, it is important that organisations that are serious about attracting, retaining and motivating top talent must have in place a well-defined approach to how it wishes to remunerate employees for value creation.

Links for further reading

- [2015-2016 HR Reward Practices Survey Report](#)
- [Compensation Strategies in a Recovering Economy](#)
- [Embracing a Global Clawback Policy](#)
- [Emerging Trends in Remuneration Practices](#)
- [Findings from 2015 KPMG Remuneration Survey](#)
- [How do you know your employee incentive scheme is working ?](#)

- [Improving Employee Value Proposition during a Pay Freeze](#)
- [Optimizing People Costs in an Economic Downturn](#)
- [Pay Equity - Deriving Value from an Effective Pay Structure](#)
- [Severance Pay Policy – A Must Have for Directors](#)
- [Trends in Executive Compensation](#)

For further enquiries please contact:

Nneka Jethro-Iruobe

Mobile: 080 8313 3012

nneka.Jethro-iruobe@ng.kpmg.com

Nike Yomi-Faseun

Mobile: 0803 402 1044

nike.yomi-faseun@ng.kpmg.com

Boluwaji Apanpa

Mobile: 070 6417 1642

boluwaji.apanpa@ng.kpmg.com

Adewale Ajayi

Mobile: 080 3402 1014

adewale.ajayi@ng.kpmg.com

kpmg.com/socialmedia



kpmg.com.ng

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