



TenStep Supplemental Paper

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At-Risk Compensation Policies

At-risk pay presents some interesting scenarios - some very good and some very bad. On the surface, these seem like a very good way to gain employee buy-in to the common goals and objectives of the company. If the company objectives are met, then the individual's pay objectives will be met as well.

Let us first put together an at-risk pay scenario and then discuss its implications. Let us say that we are moving from a traditional compensation plan to one where some portion of the pay is at risk. In our example, let us assume that 20% of the total salary is at-risk, but there is also a 10% additional pay incentive available for high achievers. Just so we can use round numbers, we take an individual that currently makes \$100,000 per year. We sit down with them and say that they are now making \$80,000 guaranteed, with an additional \$30,000 paid to them if they achieve a certain set of objectives (or these could be a combination of personal and company objectives. For instance, half might be based on the company achieving its revenue numbers). So, it is possible that the person might lose up to \$20,000 from their salary, but also possible that they could end up making an additional \$10,000 that they did not make before. This provides a very powerful positive incentive to achieve the stated objectives.

Things to Consider

Here are some things to think about in the at-risk pay scenario described above. These same questions should be asked of your program if you consider going to this type of compensation approach.

1. Before you begin, make very sure that you know what objectives or problems you are trying to resolve. The at-risk motivation must directly affect the goals and objectives of your organization, or it must be trying to resolve problems or barriers to your success. If the at-risk rules do not line up with critical success factors of your organization, then the whole thing is flawed.

In other words, let us say that in one organization, they are trying to improve the quality of the manufacturing process. If you end the year with no improvement shown, then the policy was badly designed. It may be that the employees in that area did not achieve their at-risk pay, but that is not the point. The point was that you were trying to increase quality and you failed. Now, you have a situation where your quality is still unacceptable and your employees are disgruntled and upset as well.

2. Be careful whose pay is at-risk. This can work for managers and sales staff. It may not work for an entire organization. People need to feel that they have control over making the at-risk pay. If they are too low on the organization chart, they may feel they have a limited ability to control their own fate. For a typical staff member, a model that provides for base salary, plus an additional bonus that is tied to performance and profit, is more common.



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3. Define whether you have an all-or-nothing plan, or are there degrees of success? For instance, if you have 20% at-risk, can you achieve 10% or 15%? Or must you achieve all their objectives to hit the full amount, or else you get nothing.
4. Make sure you have meaningful and quantifiable objectives that strike a balance between being stretch objectives, yet ones that are within the employee's control. People may feel like objectives that are based on company performance are not directly in their hands. This is normally fine when you are talking about incremental bonuses. But if people see their base salary cut and don't feel they can control getting the money back, there may be problems. There are always problems associated when there are differing opinions as to whether the objectives were met or not. This will also be heightened if people feel they have to fight to get their base compensation back. Make sure that your success criteria are sound and that they are communicated ahead of time.
5. You would need to look at the skillsets of the people. If their skillsets are in demand in the market, they may or may not have a tolerance for putting base pay at risk. If it looks like they are not going to make the money they need, they will just go somewhere else.
6. Remember that people have cash-flow needs. People may have monthly obligations that take all of the take-home pay. Not everyone can absorb a lower monthly salary, in the hopes of coming out whole (or ahead) in the end. If people cannot afford to live at the reduced pay level, they may leave and not stay around to see if they can prosper more under the new plan.
7. You still have to account for annual merit and promotion increases. Annual merit increases usually reflect the additional skills and value a person provides to the organization. You should also take into account internal promotions. Promotions reflect performing at a higher level as well.
8. Make sure you know what financial and non-financial risks the company is undertaking. First, everyone could achieve the highest compensation possible. Hopefully, this is a good thing. However, it will also mean more expense for the company. Company risk could include bad morale, increased turnover, confusion, and resentment. You may have a perception problem in that it appears that the people are taking too much risk and the company is not taking enough. .

Summary

At-risk pay programs can be innovative and bold. Of course, there are risks as well that must be overcome. Each company that looks at at-risk pay needs to decide if the potential benefit to the company is worth the potential risk, or if you would be better off leaving base compensation alone and tying an incremental bonus into the at-risk program.