



Compensation Philosophy – A Foundation for Decisions



What is a Compensation Philosophy?

A compensation philosophy is a description of the objectives, guidelines and principles on which compensation policies, programs, systems and practices are based. It answers why a compensation program is designed or functions as it does or will in the future. It forms the foundation for making decisions and communicating them internally and externally.

In addition to cash compensation, which is defined as a variety of salary and variable cash compensation programs, it may include employee benefits and services, equity participation, and special recognition and awards. If so, the statement is then called the Total Rewards Philosophy.

The total rewards philosophy is an important construct for the organization's executives and Board of Directors. Executive rewards can have significant and often highly visible impact (especially in not-for-profit and public organizations) and need to follow governance standards defined by the Board of Directors.

Why is it important to have one?

A compensation philosophy provides clarity and guidance to management in making decisions about:

- the ongoing effectiveness of programs and practices
- new or unexpected situations within and outside of the organization
- issues with talent acquisition and management
- changes to the economic and market conditions and regulatory environment
- unusual employee situations and issues

When consistently translated into actions through policies, programs, systems and practices and communicated to employees, it enhances employee pay satisfaction. If the philosophy statement doesn't impact how pay programs are designed and managed, it is just rhetoric. Therefore, at its best, the compensation philosophy influences desired behaviors (and performance) of employees.

What is included?

1. A statement that describes the organizational context for the compensation philosophy. This may include situations where the organization is facing challenges, has implemented a fundamental change in the way programs have been managed in the past, or is preparing for an IPO, acquisition, spin off or another event.

2. A description of how the compensation programs support or reinforce the core mission, values and critical success factors of the organization.
3. A definition of the key elements of the programs Including:
 - a. The purpose of each element
 - b. Employee eligibility to participate
 - c. Employee access to information or transparency
4. The importance of these programs to the company's ability to attract and retain talent, as well as develop and reward desired performance, and why they are important, such as:
 - a. The competition for talent
 - b. A definition of the talent markets and any differences by geography, major business unit, job function or level
 - c. The target competitive position of the organization compared to the market and how it applies to each element of the pay (or total rewards) program
 - d. Internal equity
 - e. Corporate/unit/individual performance
 - f. The needs and expectations of employees

What are some examples?

Check out these websites:

<https://case.edu/finadmin/humres/compensation/compphil.html>

http://www.citigroup.com/citi/investor/data/comp_phil_policy.pdf

<https://cardinalatwork.stanford.edu/benefits-rewards/compensation/staff-compensation/our-compensation-philosophy>

For more related to this topic, see:

Wilson, T., "Total Rewards Strategy: Translating the Vision into Reality", The Compensation Guide, W. Caldwell, editor, Thomas Reuters/West.

Wilson, T., "Total Rewards Strategy: What's Your Philosophy?" The Compensation Handbook, fifth edition, L. Berger, and Dorothy R. Berger editors, published by McGraw-Hill, New York, 2008.