

## **Future Pay – Pay in the year 2020 - What would it look like?**

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*Innovative executive remuneration practices have taken off in the last decade. But, the best is still to come. In this article the possibilities until the year 2020 are explored.*

### **Context and Background**

The demand for transparency, internationally and especially in South Africa has been on the increase. This is particularly true when it comes to Executive Remuneration. Every-one wants to know “what the boss is earning” and more importantly what does she do to earn a cell phone number long salary?

In many countries across the globe, organisations are compelled to reflect their top director’s salaries, bonuses and share options. Even the formula for the bonus scheme is sometimes shown. The media too are baying for blood, and our Executives are burning out faster and faster. When has one earned “enough” and are the pay levels fair for the effort going in to it? Remuneration committees are debating this question and perhaps we need to look to new forms of organisation structure and pay, for the answers.

Variable pay took centre stage this decade as the single most popular trend in Executive Remuneration. Organisations have tried to hold their guaranteed pay steady and leverage their variable pay. The logic is sound – tie your onerous salary and wage bill to the fortunes of the business. Our surveys show that the variable pay budget has doubled in real terms over the last 7 years. The average Executive bonus for the last year was 35% of guaranteed pay in South Africa. This compares poorly with the USA who is often seen as leaders in the field.

This may not be enough in the year 2020.

### **Knowledge takes over in 2020**

By the year 2020 we have evolved to the knowledge wave and it is nearly 25 years ago that a knowledge worker became the world’s richest man. Before that it was the oil tycoons, and now they do not even come into the top 250. It is also over 20 years ago that the market value of Microsoft exceeded General Motors. Accounting for employee knowledge is now well entrenched in financial statements and has formed part of GAAP. Marketing one’s human capital to the highest bidder is now the norm and it is well over 35 years ago that one had a “job for life”. This ties closely with the “high risk high reward” theory.

### **Employee scenarios in 2020**

In 2020 two thirds of the workforce will be outside the organisation. They could be called affiliates (part-time, temporary, casuals, brokers, contract, leased, consultants etc). The one third inside the organisation could be called associates. Affiliates are paid according to contracts and associates are paid for added value.

Leaders are not prophets or commanders, but designers of a responsive organisation to change. Nearly 90% of all workers in advanced economies are knowledge workers. Their life span consistently reaches well over 90. Amongst many, this has implications for retirement dates and Medical Aids.

### **Individual pay strategy in 2020**

Paying for the person and not only the job will be the norm in 2020. Person-based-pay has reached its ultimate evolution and we will be exploring something else by then. The elaborate

lists of competencies developed in the late 90's and early 2000's will be seen as an administrative burden (and anyway – you can now get them on the Internet). By 2020 competencies have been rejected as too time consuming for little added value. Salary surveys focus on the cost of major portions of work or functions or job families. Organisation's study total affiliate costs and associate costs relative to other organisations rather than analyse individual pay. Pay is not based on surveys, job evaluation or competencies – rather a reasonable share of value created.

### **Associate pay strategy in 2020**

Associates will draw against incentives based on the individual economic value they create for their organisations. The organisation will require a compulsory deferral of a portion of the annual incentive into the retirement trust and the company will match the amount with shares. Associates are encouraged to elect a further portion of the incentive into company shares. A larger portion of wealth is shared since companies do not finance pension plans.

### **Wealth sharing in 2020**

Variable pay for Executives now constitutes 90% of total earnings. At the lower levels Total Packages comprise:

- 40% variable pay
- 60% fixed pay delivered as a draw against **total** value added (the draw reduces as employees contribution declines)

Most organisations in 2020 avoid broad based employee share options and rather pay shares into career investment trusts. Technology has now transferred power to the workers and the people who supply the money cannot pretend to own their brains.

### **Pay implications of 2020 scenarios**

There are distinctly different remuneration arrangements for associates and affiliates. It is now 20 years ago that we had “one size fits all” as a remuneration strategy. Pay for associates is based on value added, not responsibilities and it is based on the individual not the job. Wealth sharing throughout is the norm. Pension and Provident funds are replaced with portable “retirement trusts” – individualised, defined contribution savings. We will not own our employees. They will lend us their intellectual capital and we must pay a fair return or they will re-deploy their capital elsewhere.

### **The way forward**

The timeline to 2020 is as close as 1990 is to us. Some of our organisations still have pay practices that were designed in the 1950's. Setting fair Executive pay will be an issue for the next 20 years, but, we can no longer afford Executive pay to go up whilst company performance may be going down. We need to get better at determining a fair salary for our Executives whilst delivering a fair return to our shareholders.

We are a long way off the 2020 scenario and shown in the table.

**Table 1: Current Vs 2020**

<b>Current</b>	<b>2020</b>
Pay for the job	Pay for the individual
One size fits all	Taylor made
Guaranteed pay Variable pay ratio 60:40	Guaranteed pay Variable pay ratio 10:90

Retirement fund contributions (7.5% - 12.5%)	Self funded portable trusts matched with shares
Survey individual salaries	Survey job family costs
Financial accounting according to GAAP	Knowledge accounting is the norm
Many levels (up to 25 in some SA organisations)	Between 2 and 5 levels
Pay mostly secret	Pay part of the financial statements

The future for remuneration is going to be challenging and we have seen some organisations move in this direction. It is not that pay is the most important thing in organisations, but it is a lot more important than whatever comes 3<sup>rd</sup> or 4<sup>th</sup>!