Interview: Professor Luis Gomez-Mejia

Introduction
I am Professor Luis Gomez-Mejia at Texas A & M University and I have been doing compensation related research during the past 30 years.

What is the background to this book and why did I write it?
There is a lot of research that has been done on compensation and rewards during the past 80 years.

Originally most of that work was done by industrial and organisational psychologists and human resource practitioners; but during the past 20 years or so, compensation issues have been examined across a wide variety of fields, including not only management, but also accounting, finance, marketing, sociology, anthropology and such.

Our goal, our work has been to integrate this material into a single volume. In particular, there was a need to link isolated strands of research with a focus on how compensation at both the employee and executive levels influence firm performance.

My co-authors, Pascual Berrone and Monica Franco were very helpful in bringing their own unique backgrounds to this endeavour. In particular, Monica has spent many years as a consultant in the area of compensation and rewards and hence her practical insights were very helpful to this book. Also she wrote her doctoral thesis on performance measurement and this was also an important contribution to this book.

What ideas would I like the reader to take away after reading the book?
There are two key ideas that underlie the book:

- **Compensation is an important cost**
  
The first is that the compensation system is the single most important cost item in organisations, so how it is used can make a huge difference in the success or failure of the firm. Compensation can help determine who you attract and retain and, perhaps most importantly, to what extent individuals from the top executive down to the lowest level employees are motivated to achieve the firm’s strategic objectives.

- **Many compensation choices, with far-reaching implications**
  
The second key point to the book is that organisations have many choices in how they might decide the compensation system in terms of, for instance, variable pay, types of variable pay, pay differentials and the like.
Considerable thought needs to be given to the implications of the choices that organisations make. For instance, a firm that rewards short term results means that this is the type of outcome they are likely to get. And eventually this may have a negative influence on the long term performance of the firm.

Short term results may also lead to gaming and corruption of data in order to meet those short term goals and objectives, perhaps at the expense of long term results.

Executive pay in banking

There has recently been a lot of controversy surrounding executive pay in banking, so what is our perspective on this?

Even though executive pay reflects market forces and the firm cannot afford to lag too far behind what other firms are paying for similar calibre CEOs, otherwise the firm would lose its best executives and fail to attract the best ones.

There is a need to maintain a sense of fairness and integrity when it comes to executive pay, otherwise the firm loses legitimacy, risking public backlash and become subject to political risks such as inviting government interference and closer monitoring.

Two major strategic compensation patterns

Two major strategic compensation patterns have emerged from this research; they involve [patterns we have termed] experiential and algorithmic. So what insight does that give us?

• The traditional compensation system- the algorithmic

The traditional compensation system- the algorithmic- with pay linked to job titles, with line and job evaluation, with a high degree of bureaucracy may have worked well for many firms in the past, but in a rapidly changing global environment there is much greater need for flexibility and adaptability.

• Experiential system

Hence a more experiential system, with greater tolerance for the regional differences in pay, with more variable remuneration, with greater sharing as such is more likely to be appropriate for the vast majority of organisations nowadays.

In conclusion

In closing, compensation is a critical cost element and a fundamental resource in most firms:

• It can serve as a motivational tool, to orient employees and executives toward achieving the firm’s long term strategic objectives.

• Or if used improperly, it may lead to counter productive behaviours, such as gaming the numbers, maximising short term
results at the expense of long term objectives. It may lead to the disruptive competition of employees and conflicting goals among the organisational levels and the like.