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before budgeting:

tips for compensation planning

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Before budgeting: tips for compensation planning

As an HR or compensation professional, you're well aware that the definition of compensation planning is changing. With the global pandemic, economic challenges and related government assistance program, many questioned what, if anything might change in terms of planning and budgeting for 2021.

Now that most organizations have moved on, understanding that we're in a new reality for a while, they are turning toward re-invention of their business and looking toward the future. While salary increase budgets might look different this year, the planning and guidance needed for employees and managers will still need to be created. Sometimes, the hardest question of all is, "Where do I begin?" Organizing your inputs and understanding your desired outcomes are key to a successful planning process.

If you want your department to keep a prime seat at the strategic-planning table, you should approach each and every year's annual planning process as an opportunity to make highly informed pay management recommendations that your executives will truly value. After all, your company's payroll is undoubtedly one of its largest expenses. Your annual planning recommendations and guidance should seek to optimize the effectiveness of that significant portion of the company's resources.

Here, you'll find a practical, step-by-step guide to streamline your compensation planning through a multi-perspective, data-driven approach.

Understand your budget-approval process

Annually, compensation professionals are asked, "What should our annual increase (or merit) budget be for next year?" Though the merit increase number has hovered around 3% for several years, depending on your industry and economic situation you now may be considering a lower number. In addition, the funds you do set aside may be serving a purpose other than merit increases. Today the more relevant question may be "What should our total increase budget be?" Promotional, market and equity adjustments may be where you place your emphasis in the coming years, but no doubt some portion of the population will still be merit eligible. But, a lot of that will depend on your ability to understand the objectives of your own organization as well as what your competitors are doing.

It's important that you are comfortable with the budgeting process, timeline, and the stakeholders involved in order to have the desired influence on the outcome. You and your team should consider the following questions in order to ensure you fully understand the budgeting process in your organization:

How much input do you ultimately have?

Is compensation/HR a key stakeholder in determining the total increase budget with a significant amount of influence on the outcome? Or, is the proposal set forth by compensation and HR merely one of many inputs into determining the final budget number?

In some companies you will be tasked with developing a proposal for the increase budget, which may include separate budgets for annual increases, promotions and/or development increases, and presenting the supporting documentation or business case to the leadership team. In other organizations you may be asked to validate a proposed increase budget that has been developed by leadership. In either case, you need to be able to confidently support your position on the proposed budget with solid data and reasoning.

Understand your budget-approval process cont...

What is the budget timeline?

Being fully aware of your company's budgeting process, timeline, and steps will prevent you from scrambling to meet tight deadlines throughout the planning process (especially during the later phases). One of the key inputs to developing an increase budget, as well as a salary structure adjustment proposal, is to have access to 2-3 sources of reputable compensation planning data, such as the **US Compensation Planning Survey**. This survey and other sources of HR data have their own participation and publication dates which should be factored into your overall compensation planning timeline.

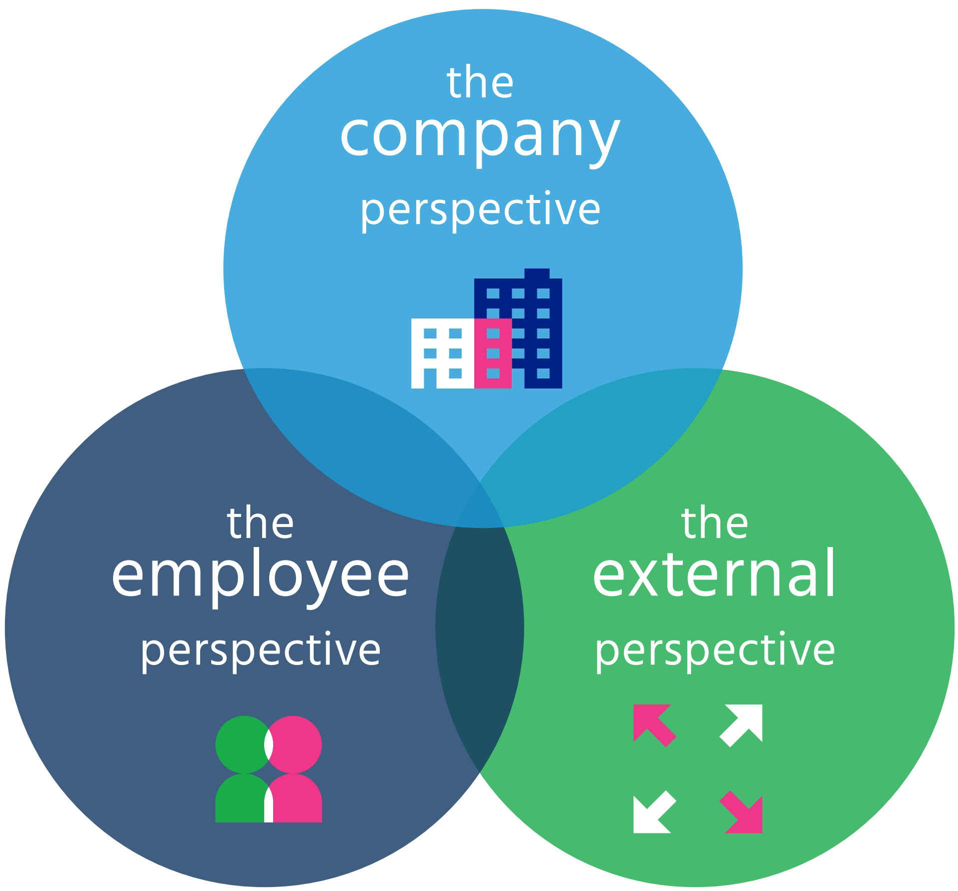
As merit increases lose their effectiveness to differentiate pay, other increases such as market adjustment, equity adjustments and promotions become more critical to delivering pay effectively. You'll need time to evaluate whether or not certain jobs and functions within your department are truly aligned with your company's compensation philosophy. To do this (and be prepared in time for budgeting), you'll need to establish a plan to market price the relevant jobs in the organization throughout the year. At least every 3-4 years a company should do a comprehensive job evaluation market pricing activity — capturing 70%-80% of the unique roles in the organization — in order to assure both market alignment of the compensation structure and internal alignment. In other years, you can plan to market price jobs that are high-priority or tend to experience quicker market movement and also include less volatile job groups as time permits. On an annual basis, this approach allows you to proactively identify and plan for any significant pay changes with funds incorporated into the total increase budget.

The goal of proactive market assessment of jobs is to minimize any misalignment, and never let any job stray too far from the market. But this approach takes planning and discipline. By sticking to a compensation activity plan for the year, you'll be prepared to provide a comprehensive proposal for total increases, including merit, promotion and other increases when budget season hits.

Need help developing your annual activity calendar? Skip to the **last page** of this document for an example to get you started.

Analyze your annual compensation plan through multiple perspectives

To develop a sound total increase budget, as well as create truly effective pay strategies, you must understand the various elements that go into them. For starters, effective pay strategies have to be targeted, data-driven, and multi-perspective. In this case, those multiple perspectives are:



Read on to learn how to approach each of these key perspectives.

The company perspective: "what outcomes do we need?"

From a company perspective, start by understanding your organization's financial standing. How does your current financial standing impact the annual increase plan? Do you anticipate any impact on the budget? According to the October version of the **2020 US Compensation Planning Pulse Survey**, 68% of companies will establish a similar budget for 2021 as they had in 2020. However, if your organization is facing financial difficulties, it would be prudent to under-stand this prior to proposing a salary increase budget.

In October of 2020, when we asked companies how their budget may change from 2020 to 2021:

3%
will increase the budget

68%
said it would stay the same

3%
don't know or are unsure

26%
expect to lower their budget

Next, be conscious of how you want to position your organization within your market. For example, does your company choose to pay at the median rate, below it, or above it? Depending on whether you need to meet or exceed market standards may influence your organization's philosophy on this topic. Additionally, you may need to vary your pay positioning based on individual segments for increased flexibility or to meet particular labor market demands.

To be effective, you will need to stay knowledgeable on any particular challenges within the organization — either specific departments, jobs, or other employee segments.

The company perspective: "what outcomes do we need?" cont...

Are there any departments or positions that have been challenging in the past year?

If hiring challenges and high turnover rates have been recurring issues with particular departments or jobs, you might want to assess whether or not those roles and employees are properly aligned to your compensation philosophy. If they are not, now is the time to consider asking for additional funds as part of the total increase budget to correct any misalignment.

For example, base salaries for IT security professionals have steadily risen at a higher-than-normal rate throughout the past few years. So, if you happen to employ this same position, you'll want to ensure your pay rates are aligned with your company's overall pay philosophy while also being able to allocate additional funds for other increases, if necessary, to keep pace with the market. If you noticed high turnover or hiring issues for this position within your company, it might be an indication that there's some sort of misalignment to the market leading to these attraction and retention hurdles. And, even if you aren't

And, even if you aren't experiencing hiring or turnover issues with this group, the risk is still there.

The company perspective: “what outcomes do we need?” cont...

experiencing hiring or turnover issues with this group, the risk is still there. In this case, the Employee Perspective (discussed below) will help you determine the severity of the situation and how you might be able to address it.

One of the ways to identify where there may be challenges is to speak with the HR representatives, or business partners that represent the various departments in your organization. Make it at least an annual process to sit down and ask, “What challenges are we experiencing in terms of compensation? What do we expect to be challenging next year?”

Additionally, having a sound benchmarking process that takes place annually, prior to the annual budget planning process, will provide you with an effective way to identify any jobs or departments that may be misaligned. For more on salary benchmarking fundamentals, see **Market Pricing 101**.

The external perspective: “what are our competitors doing?”

The next step is to collect data that will give you a comprehensive external perspective — what are your labor market competitors budgeting for increases? How will your increase budget position you going forward — will you continue to be competitive or possibly lose ground?

In order to understand the external labor market, you must first identify your labor market competitors, which are oftentimes distinct from your business competitors. Additionally, more sophisticated compensation management programs now consider that labor market competitors vary based on employee segment. For example:

> *A video game development company, based in Canton, Ohio, wants to hire the “best-and-brightest” graphic designers and therefore competes against high-tech companies in Silicon Valley, even though they are located in Canton, Ohio.*
>
> *That same company has a small support staff providing overall office management, including human resources, finance, and logistics. When they have a job opening in these areas, they are comfortable with the applicants they find locally and therefore don’t need to compete with the higher, more aggressive, pay practices of the high-tech companies in Silicon Valley.*

However, this paradigm has shifted in the past year or so — many jobs once thought to be tied to an office are now working remotely. What does that mean about the labor market? If someone can do the job from anywhere — what will you pay them? Companies are having to consider this shift and the impact on their population and finances now. Using the example described above, the video game development company would need to consider whether to propose a salary increase budget that met the higher projections of Silicon Valley from some jobs as well as a more average or nationally based (work from anywhere) budget going forward.

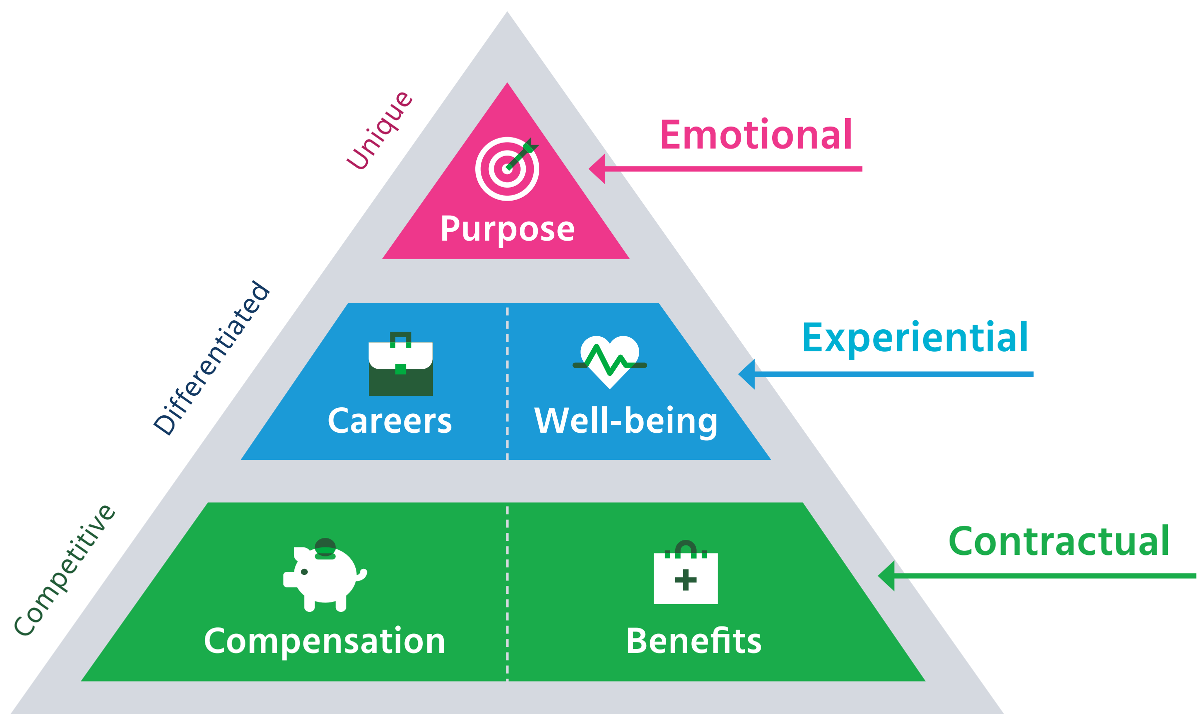
The employee perspective: "what do our employees value?"

Most HR professionals already have huge amounts of compensation data related to general market movements, trends, and so on. However, this objective data cannot fully explain how a particular workforce actually thinks or feels about their total rewards. At the end of the day, the employee has to understand and be satisfied by the perceived value of promotions, increases, and other elements of his/her rewards package. In other words, this employee perspective is heavily impacted by more subjective emotional factors, such as affinity, pride, and purpose. And while these emotional aspects are much different than contractual elements like rewards, they still play an important role in employee motivation, and subsequently, retention.

For example, if choosing between additional bonuses or a more attractive medical plan, determine which of these incentives would be most appreciated by the largest number of your employees. However, keep in mind that either one of these incentives would likely necessitate a lower annual salary increase, which some of your workers might not be willing to sacrifice. This would certainly be another factor worth getting a feel for. Of course, it's nearly impossible to satisfy every employee all the time, but when you demonstrate that you're willing to put in the extra effort to listen to your employees' points of view, you're showing that their perspective matters — and that's beneficial for everyone in your organization.

The employee perspective: “what do our employees value?”

As illustrated in the pyramid, **contractual elements are still the foundation for attracting and motivating employees**, but diverse new **holistic rewards are also extremely important**. For example, many of today’s employees expect increased workplace flexibility, benefits individualization, and similar perks. In fact, **Mercer’s Global Talent Trends 2019** research showed that 82% of today’s employees would consider work on a freelance basis. With base pay increases only being one piece of the rewards package, you’ll need to align your annual salary increase budget proposal with your organization’s total rewards philosophy.



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Go beyond annual increases

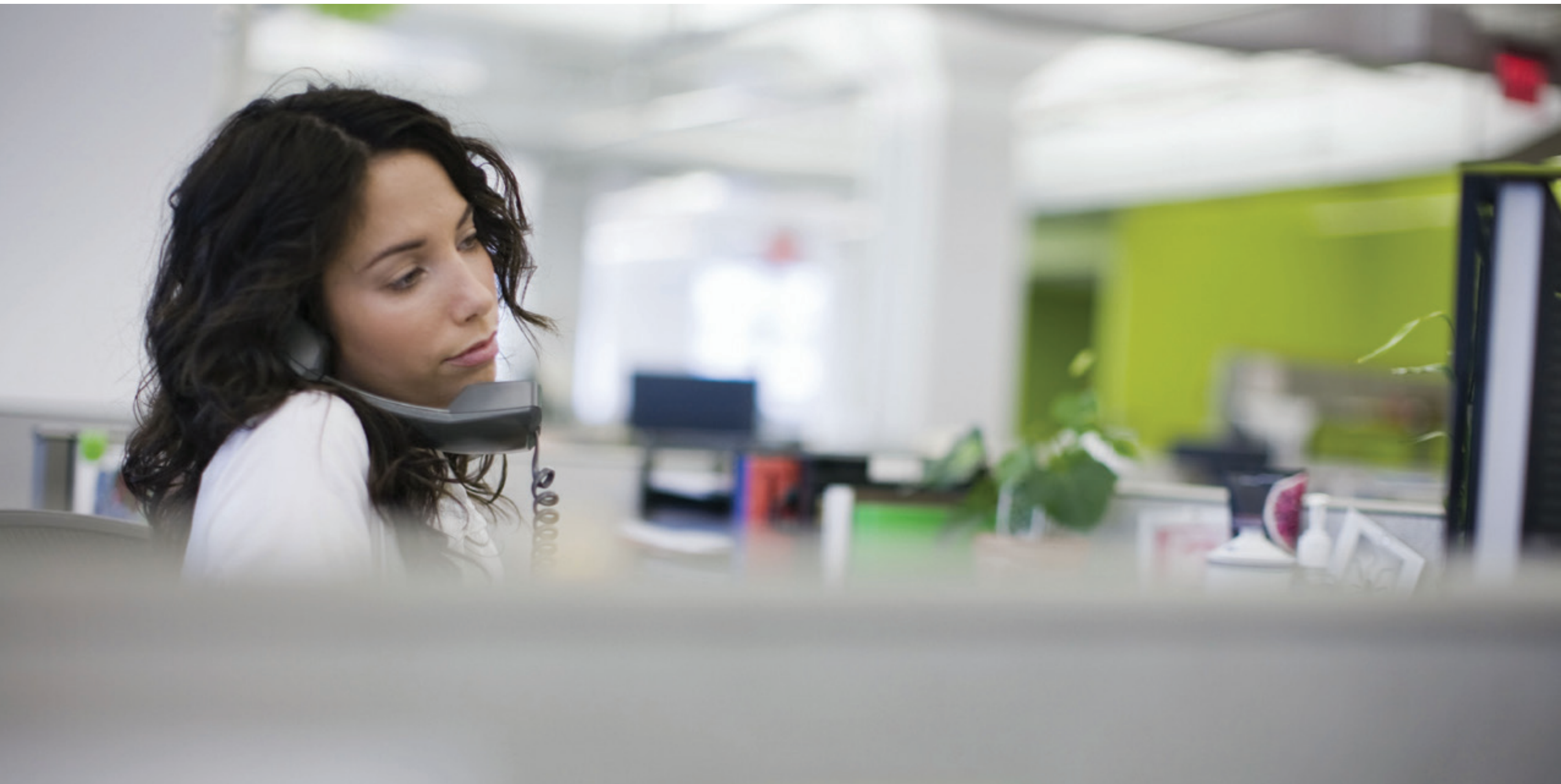
Proposing an annual salary increase budget is just one step in putting forth an annual plan. As mentioned previously, many companies now manage pay by developing a “total increase budget” that consists of a portion for annual salary increases, promotional increases, and other increases such as for achieving development milestones. Beyond salary increase adjustments, you can typically rely on the same published data sources to find information around what percentage to adjust salary structures. However, just finding the projected increase percentage is not enough. Does your company need to adjust structures this year? How do you know? Find the answers to these questions:

How are your employees paid relative to the minimum, midpoint, and maximum of the pay ranges?

By calculating your range penetration and compa-ratios you can gauge how well your pay structure is fitting your employee population. An average range penetration that is over 75% and/or a compa-ratio over 110% could be a sign that you need to adjust your pay structures.

When did you last adjust your salary structures?

Typically organizations adjust pay structures every 1–2 years, but many factors can influence that frequency.



Go beyond annual increases

cont...

Are you providing above average merit increases or promotional increases?

If you are lucky enough to be in an organization that is increasing base salaries more rapidly than the 2.5% annually, as reported in the October **2020 US Compensation Planning Pulse Survey**, or aggressively promoting employees, then you may need to adjust pay structures more frequently. Periodically assessing employee pay against midpoints will prepare you to determine whether or not pay structures need to be adjusted for the coming year.

What type of salary structures, or other pay management mechanism, do you use?

The design of your salary structures and other management mechanisms will greatly influence how often you need to make adjustments. For example:

Market reference points

Where each job is assigned a particular reference point and mini-range, often requiring annual market pricing. In these instances, they would not collectively require overall adjustments.

A traditional pay structure

Where jobs with similar market data are grouped into salary ranges, may not be market priced annually and, as a result, can then benefit from occasional structure adjustments.

Broadbands

With much wider salary ranges than in traditional structures, can stand up to longer periods of time without adjustment (depending on other compensation practices).

From budgets to strategy

Knowing how to tweak your budget to respond to new or ongoing market trends is just as critical as establishing one in the first place. With all these considerations in mind, you're now one step closer to refining your annual salary-increase budget, and you're also more prepared to make company-wide strategic recommendations around compensation best practices, should the opportunity arise.

Just remember that, by leveraging the right data, surveys, and other HR solutions, you empower yourself to make more strategic benchmarking decisions throughout every step of your annual compensation planning process. At the same time, you'll be able to more appropriately reward your employees and measure your company's performance against different businesses, industries, and key competitors.

Want to know more about compensation budgeting and planning?

Our client service team is ready to talk to you!

Contact us at 855 286 5302 or surveys@mercer.com.

Contributing author:

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Rebecca has been with Mercer for over 10 years, specializing in compensation philosophy and strategy development, broad-based employee pay, job evaluation, and career architecture development. Her experience as a consultant, and previously a compensation manager at various companies, spans many industries over 18 years, including but not limited to: hospitality, healthcare, hi-tech services and products, education, and telecommunications. In her prior role as a career consultant with Mercer, Rebecca oversaw and managed workforce rewards projects for clients in the Washington, DC, Maryland, and Virginia regions. In her current role, Rebecca shares her vast HR knowledge and experience with HR professionals through published articles and other content initiatives.

About Mercer

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Compensation activity calendar and checklist

Being strategic about the activities you complete during the year — what and when — will give you a leg up when it comes to proposing an annual increase budget and ensure you are using time and resources effectively throughout the year.

January – February

- [ ] Performance reviews and annual increases:
  - Set up systems and tools
  - Communicate timelines
  - Train your managers and other key stakeholders
- [ ] Participate in **compensation survey data** collection and submission

February – March

- [ ] Administer and support these processes:
  - Performance management
  - Annual increase
  - Bonus allocation
- [ ] Participate in **compensation survey data** collection and submission

March – April

- [ ] Develop reporting of annual salary and bonus planning
- [ ] Process payouts
- [ ] Communicate pay changes to managers/employees
- [ ] Participate in **compensation survey data** collection and submission

May – July

- [ ] Project work:
  - Targeted market pricing for particular groups

Compensation activity calendar and checklist

cont...

August – September

☐ Begin annual planning in preparation for budgeting process:

- Plan compensation department budget (tools, surveys to purchase the following year)
- Map out next year's compensation calendar, adjust based on lessons from this year

☐ Meet with leaders and HR partners to discuss opportunities for improvement

☐ Collect HR survey data regarding:

Total increase budgets and structure adjustments

☐ Incorporate **new survey data** into benchmarking tools and assess current alignment

- Pay structure to market, jobs/employees to pay structure

September – October

☐ Work through budgeting process to develop:

- Proposal for annual increase budget
- Model annual increase matrix
- Model incentive payouts

☐ Present budget for leadership approval, revise as needed

November – December

☐ Finalize budgets for:

- Annual increases
- Incentive payouts (current year)

Finalize incentive plan designs for next year:

- Produce plan documents Communicate to employees/managers

☐ Prepare tools/spreadsheets for performance management and annual increase process