

HEALTH WEALTH CAREER

# BEFORE BUDGETING: TIPS FOR COMPENSATION PLANNING



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As an HR or compensation professional, you're well aware of how complex annual compensation planning can be and the various influences that need to be considered. Even for the most seasoned practitioners, getting started can be a daunting task, and sometimes, the hardest question of all is, "Where to 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?” Additionally, more and more companies are allocating portions of the budget for promotional and “other” increases to ensure more accurate and effective management of payroll dollars. 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 budget result. 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 annual pay 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 annual increase budget and presenting the supporting documentation or business case to the leadership team. In other organizations you may be asked to validate a proposed annual 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.

## 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 annual 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 budget timeline.

## UNDERSTAND YOUR BUDGET-APPROVAL PROCESS CONT ...

Additionally, 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 annual salary 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 annual 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 annual salary 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:



The company perspective.



The external perspective.



The employee perspective.

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? In 2018, only 1.2% of organizations are expected to freeze salaries and not provide increases, according to the [2018/2019 US Compensation Planning Survey](#). However, if your organization is facing financial difficulties, it would be prudent to understand this prior to proposing a salary increase budget.

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# 1.2%

of organizations are expected to freeze salaries and not provide increases in 2018.

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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 to correct any misalignment.

For example, base salaries for entry-level social media communications 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 annual increase, 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 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.

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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?”

## THE COMPANY PERSPECTIVE: “WHAT OUTCOMES DO WE NEED?” CONT ...

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 [Salary Benchmarking 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 annual increases? In most scenarios, your overarching goal will be to match or exceed their budget so that you maintain or increase your positioning as an attractive employer.

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.

However, 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.

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 the high-tech versus the general industry projections that were around 2.9% for 2018.



## **THE EMPLOYEE PERSPECTIVE: “WHAT DO OUR EMPLOYEES VALUE?”**

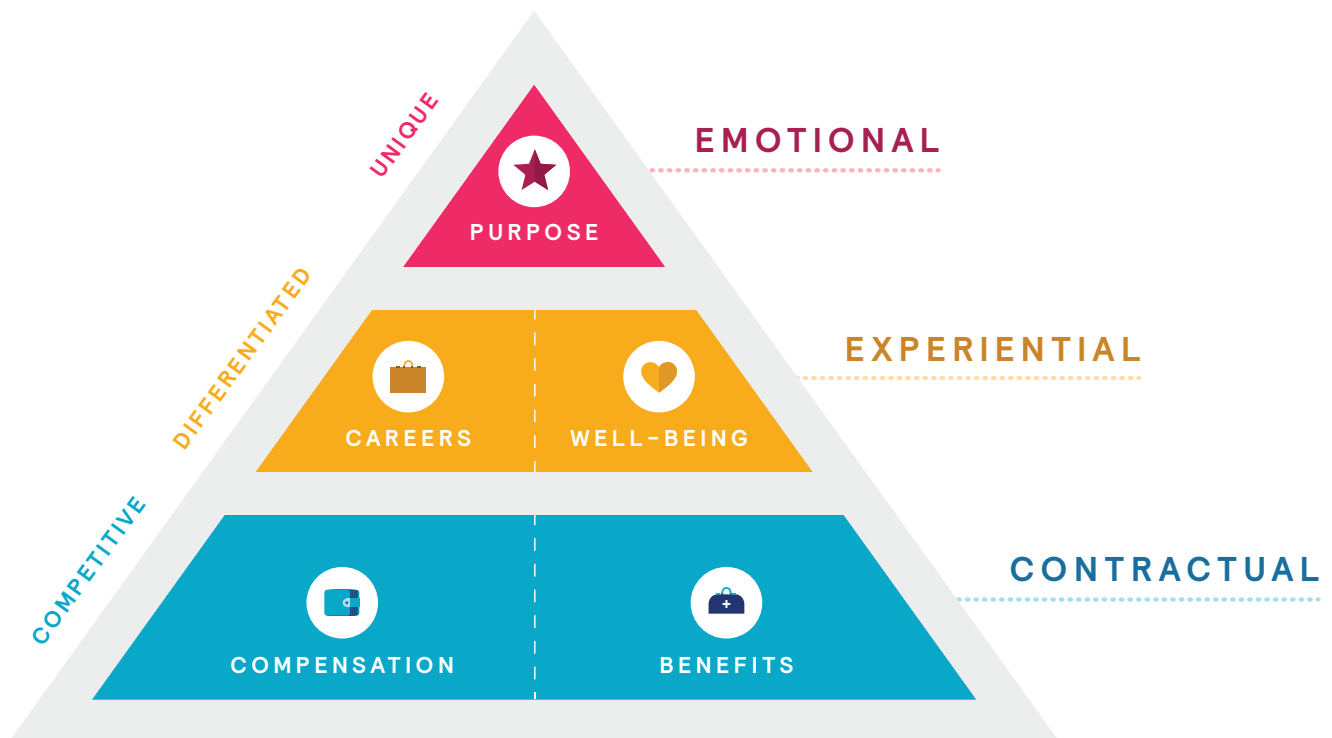
Most HR professionals already have huge amounts of compensation data related to general market movements, trends, and so on. However, this objective data cannot fully explain how a particular workforce actually thinks or feels about their total rewards. At the end of the day, the employee has to understand 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?” CONT ...

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 2018 Global Talent Trends research showed that 51% of today’s employees want more flexible work options, while 78% of employees would be happy to work on a contract 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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# COLLECT DATA ON BOTH PAY-INCREASE BUDGETS AND SALARY-STRUCTURE 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. 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 population that is over 75% and/or a compa-ratio over 110% could be a sign that you need to adjust your pay structures.



## COLLECT DATA ON BOTH PAY-INCREASE BUDGETS AND SALARY-STRUCTURE INCREASES CONT ...

### When did you last adjust your salary structures?

Typically organizations adjust pay structures every 2-3 years, but many factors can influence that frequency.

### 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 2.9% annually, as projected by [2018/2019 US Compensation Planning 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?

[CONTACT US](#)



## CONTRIBUTING AUTHORS:



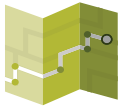
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Rebecca has been with Mercer for over 10 years, specializing in compensation philosophy and strategy development, broad-based employee pay, job evaluation, and career architecture development. Her experience as a consultant, and previously a compensation 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.

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## ABOUT MERCER

Mercer delivers advice and technology-driven solutions that help organizations meet the health, wealth, and career needs of a changing workforce. Mercer's more than 22,000 employees are based in 43 countries, and the firm operates in over 130 countries. Mercer is a wholly owned subsidiary of Marsh & McLennan Companies (NYSE: MMC), the leading global professional services firm in the areas of risk, strategy and people. With more than 60,000 colleagues and annual revenue over \$13 billion, through its market-leading companies, including Marsh, Guy Carpenter and Oliver Wyman, Marsh & McLennan helps clients navigate an increasingly dynamic and complex environment. For more information, visit [www.imercer.com](http://www.imercer.com).



# 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.

START

## □ 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

## □ MAY-JULY

- Project work:
  - Targeted market pricing for particular groups

## □ 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



# ANNUAL COMPENSATION PLANNING CHECKLIST

*continued*

## □ 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:
  - [Annual 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

## □ 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

## □ 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

FINISH