# Communicating Salary Budget Recommendations to the C-Suite

*Examining Factors Influencing Compensation Decisions*

Compensation strategy is a key component of any organization's compensation program. In order to make a salary budget recommendation, one of the first considerations is to ensure the executive team knows and understands the organization's compensation strategy.

The compensation strategy should align with the organization's overall mission, business goals, and objectives. Today's compensation packages encompass pay, benefits, and work-life balance. A strong and solid compensation strategy should be designed to implement and administer the compensation program to deliver these packages to employees.

The executive team's support of the compensation strategy is important to proceed with the salary budget planning process. If you have a formal compensation strategy in place, you can determine the desired competitive position your organization wishes to adopt. Where no formal compensation strategy exists, you have the opportunity to develop one and position yourself in the coming years to gain or regain your own market competitive position.

The past few years some organizations have experienced severe economic difficulties. Organizations have had to refocus their compensation strategy on keeping pay competitive, evaluating pay increases, and containing compensation costs.

The most common factors influencing compensation decisions are:

- Attraction/recruitment concerns
- Retention concerns
- Need to strengthen the performance-based culture and deliver pay-for-performance
- Desire to provide career mobility and advancement opportunities
- Concerns regarding employee engagement levels

**What Employees Want**

The emerging pay practice is the continued emphasis on the "whole compensation package" offered to employees, not simply base salary, benefits, and variable pay, but the rewards that can be tailored to the individual employee, such as more time off with pay, flex time, and work-from-home opportunities. This doesn't add as much to the actual salary budget figures, but can still give employees extrinsically valuable rewards that are practical and also communicate the organization's resolve to retain their top talent.

This is especially important as you add to your workforce mix the differences in the generational needs. With Baby Boomers nearing retirement, they may appreciate more time off in preparation for it. This enables them to pass on their knowledge while working a reduced schedule. Generation X employees are looking for the opportunity to perhaps work flex hours to help with school-aged children, allowing them to attend school functions during the normal work day. Whereas the Generation Y employees are looking for engaging work practices and variety at work.

Another consideration are the top performers who want to know advancement opportunities exist and the company will support their educational and training efforts to reach the next level within the organization. Training can be a part of the "whole compensation package" in the sense that employee aspirations may be realized through helping them attain promotions from within and can be a great retention tool to keep these high performing employees interested in the company while strengthening and adding depth to the company’s workforce.

**Budgetary Guideline Considerations**

In the salary budgeting process there are two areas of focus: the **salary range increase** and the **salary budget increase**. Both support the compensation strategy, and in the long term, achieve the desired competitive position.

The salary ***range*** increase is relatively easy to decide as this is based on the market data movement. For 2015, the range increases are expected to be very conservative and on average around 2.0% - 2.2%.

The salary ***budget*** increase recommendations are influenced by more factors, though. The following questions are designed to help analyze your organization’s goals that affect the salary budget and to determine the proper course to meet those goals:

- Should our organization budget more or less aggressively to regain ground after a salary freeze following the recent economic situation?
- Should compa-ratios be adjusted to align with the market?
- Does the organization want to be a market leader?

The salary budget increase projection for 2015 is 3.1%. To establish a workable 2015 salary budget, organizations must consider their financial resources available and current market position.

Over the past few years, most companies have remained steady in their goal of having a compensation philosophy that includes paying their employees close to market. WorldatWork figures show very little variance in these figures from 2009 to 2014. However, there does appear to be a definite focus from organizations to keep pay competitive.

The majority of organizations plan on paying at market, with approximately 86% of organizations projected to pay at this level for **nonexempt and exempt positions**. There is a slightly lower number projected for **executive positions** at 77%, which generally are more weighted on variable pay packages. Both numbers are an increase from last year’s categories.

Some of the influential factors for budget allocation apart from performance are:

- Position in salary range (compa-ratio)
- Market competitiveness for specialized positions, requiring higher education and/or training**.**
- Performance of a department or the organization as a whole
- Broader economic conditions

However, there remains the problem of dealing with a small salary budget increase and the challenge of making small increases meaningful to employees. Communication is key. Employees need to know how they are being rewarded, especially if the numbers are low. They need to be able to put relatively small increases into perspective and see they are receiving an above average increase, if that is indeed the case.

Changes in actual salary increase budgets versus projected salary increases can be caused by various reasons:

Primary reasons for ***lower*** budget:

- Response to economic uncertainty
- Change in base salary strategy or competitive positioning to market
- Business performance weaker than expected
- Shift in budget dollars to other reward elements
- Change in business strategy

Primary reasons for ***higher*** budget:

- Greater competition for workforce or anticipated labor shortages
- Business performance stronger than expected
- Change in base salary strategy or competitive positioning to market
- Accounting for salary freeze or delayed increases in previous years
- Change in business strategy

Below are some generally accepted best practices to guide the process:

To build a pay-for-performance compensation plan, an organization must first review their compa-ratios and note any exceptions that will need to be addressed in order to develop a merit increase plan consistent with the organization's compensation strategy. A review and analysis of the following three areas typically offers the best opportunity to identify any base pay outliers:

- List compa-ratios from highest to lowest, which makes it easy to select jobs at either end of the spectrum for review.
- Each job grade will typically have a compa-ratio between 80% and 120%. Any job grade compa-ratios that fall outside the range should be reviewed to ensure job grades that are higher or lower than the range are evaluated correctly.
- Identifying employees with compa-ratios that do not seem to match their time in the position should also be noted.

After identifying compa-ratio exceptions, these parameters may be useful in determining any needed adjustments:

- As a general rule, most or all employees should be paid between the minimum and maximum rates established by the salary range.
- In a pay-for-performance system, employees are ultimately paid at a rate that is comparable to their long-term performance. A useful rule-of-thumb is that compa-ratios:
    - *Between 80% - 90%* are considered entry rates. New employees are generally hired at these rates.
    - *Between 90% - 97%* would be considered appropriate for employees who are not yet fully trained and qualified for the position.
    - *Between 97% - 103%* would be considered appropriate for employees who are fully qualified for the position and who, over time, consistently perform at an acceptable level.
    - *Above 103%* would be appropriate for employees who are fully qualified and who, over time, consistently perform above acceptable levels.

These general guidelines may help determine how employees are positioned from a pay perspective assuming acceptable performance levels:

- Entry level nonexempt positions (grades 1-5) should reach the mid-point (100% compa-ratio) within 2 years.
- Middle level nonexempt positions (grades 6-8) should reach the mid-point within 3 years.
- High level nonexempt or entry level exempt positions (grades 8-10) should reach the mid-point within 4 years.
- Middle level exempt positions (grades 11-12) should reach the mid-point within 5 years.
- High level exempt positions (grades 13-14) should reach the mid-point within 6 years.
- Executive level positions should reach the mid-point within 7-10 years.

Expect to find some employees who are currently being paid outside the range limits for their job grade. Some will be below the range minimum and some will be above the range maximum. Such inconsistencies typically are not resolved by reducing an employee's current base salary or by making adjustments to increase base salary.

HR Performance Solutions **Comp***ease* online salary administration system can help your organization gain a competitive edge. Using the Merit Matrix Planning tool, the following method is suggested to remedy the out of range salaries:

- Under range minimum - The **Comp***ease* Merit Matrix recognizes any out-of-range situations and will make adjustments to the recommended merit increase to address the problem. Below range conditions may require more than one merit increase cycle to resolve. Once inside the range limits, the regular merit increase schedule will take effect.
- Over range maximum - Employees paid at or above the maximum of their salary range should still receive a merit increase based on the normal merit increase schedule. However, instead of being added to base salary, the merit increase is often given as a lump sum payment.

Other information that can enhance the outcome of your salary budgeting process:

- Job grades and evaluations should ideally be reviewed at least every three to five years or more often if material changes are made to numerous jobs.
- If the overall company compa-ratio is below the expected 97% (an overall company compa-ratio of 96% to 97% is typical for most companies), consider establishing a plan that will move the company closer to market within a prescribed period of time.
- Utilize the Merit Increase Planning Module to quickly build potential merit increase budget scenarios to address any issues identified in the review exercise discussed above.

It is notable that almost 70% of organizations are focusing on high performance merit distinctions. To facilitate this, consider adjusting the company's matrix model to increase the merit component for high performing employees. By reducing the average merit increase slightly, merit increases for high performers can be given while maintaining the overall merit budget at an acceptable level.

Executive teams generally respond favorably to an overview of the considerations behind the compensation budget recommendations. It is important to illustrate the connection between having a fair and competitive compensation strategy, including a pay-for-performance plan, and the savings of the reduction in turnover and recruitment costs. Such communication results in an executive team that values human capital and will support the budgetary requirements to meet the organization's compensation strategy. Remaining market competitive takes some planning and the **Comp***ease* system can help you do just that. With expert guidance and superb reporting features, let HR Performance Solutions **Comp***ease* program assist you with presenting your salary budget recommendations!