Presenting Salary Budget Recommendations

Enhancing Your Salary Budget with Merit Planning

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 and the compensation strategy should be designed to implement and administer the compensation program to deliver these packages to your employees.

Your 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 yourselves in the coming years, to gain or regain your own market competitive position.

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 your desired competitive position.

The salary range increase is relatively easy to decide as this is based on the market data movement. This year the range increases are expected to be very conservative on average around 2.0% to 2.2%.

The salary budget recommendations are influenced by more factors. Does your organization have to budget more or less aggressively to regain ground after a salary freeze following the recent economic situation? Is there a need to adjust compa-ratios to align with the market? Do you want to be a market leader? Establishing a 2014 salary budget should, of course, be based on financial resources available and current market position.

The salary budget increase projection for 2014 is 3.1% for all industries. Using that knowledge, begin your process by reviewing the organization's compa-ratios and develop a merit increase plan that is consistent with the organization's compensation strategy. Note any exceptions, wages that are above maximum or below minimum.

Once you have identified the 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 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 should reach the mid-point (100% compa-ratio) within 2 years.
- Middle level nonexempt positions should reach the mid-point within 3 years.
- High level nonexempt or entry level exempt positions should reach the mid-point within 4 years.
- Middle level exempt positions should reach the mid-point within 5 years.
- High level exempt positions 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 minimum and maximum for their job grade. Such inconsistencies typically are not resolved by reducing an employee's current base salary or by making adjustments to increase base salary. As an alternative, the following method is suggested:

- Under range minimum – Using your merit increase plan, 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 above the range minimum, the regular merit increase schedule you have defined will resolve the exception and restore the market wage.
- 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 the 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.

Remember:

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.

Suggested Starting Percentages for 2014 Merit Planning Matrix

Merit Percentages

Base Merit Increase (Market Rate %)	2.00%
Performance Level %	2.50%
Position in Range %	3.00%

Please remember these percentages are subject to what you can afford and will be dependent on several different circumstances. For instance, if you have a number of employees who have low compa-ratios without the balance of employees who have high compa-ratios, the increase might be higher than the overall budget projection of 3.1%. Conversely, if you have an unusually high number of employees who are performing at high performance levels, this will also affect your numbers.

Expected Average Merit Increases

Merit increases have continued to grow in popularity where performance can be tied to pay. The budget for these remains fairly static at 3%. Payouts for 2014 merit budgets have shown:

- Highest performers receive a merit increase of 4.1%
- Competent employees receive a merit increase of 2.7%
- Low performers receive a merit increase of 0%

The differentiation between high performers and competent performers has seen the percentage increase over the past three years. There was a dip in 2010 to 1.48 times, but it is now back to the 2009 level, approximately 1.52 times more.

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 if they are receiving an above average increase, if this is the case. The message needs to be the annual 4% and 4.5% increase of 10 years ago is gone, and may not return.