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# Compensation Planning for 2014: Salary-Increase Budgets Remain Stable

By Jason Adwin

Sibson Consulting's analysis indicates that salary-increase budgets for 2014 will rise only slightly from the previous year, continuing a trend that is now three years old. With inflation and the economy showing slow growth, it appears merit budgets have settled into a “comfort zone” of approximately 3 percent.

## Sibson’s Annual Compensation Planning Analysis

Sibson’s Annual Compensation Planning Analysis of projected and actual salary-increase budgets and structure salary-range adjustments provides data for three broad job classifications — executive, exempt and non-exempt, in 11 distinct industry groups — banking and finance, education, health services, information services/telecommunications, insurance, manufacturing, nonprofit, retail, services, transportation and utilities.

## Salary-Increase Budgets Inch Higher

In 2013, actual salary-increase budgets were 2.9 percent for all job classifications, still well below pre-recession levels, which were typically in the 3.5 to 4.5 percent range. For 2014, executive and exempt employee classifications have projected salary-increase budgets of 3.0 percent, while non-exempt employees have slightly lower projections of 2.9 percent. (Figure 1 below shows projections for 2012–2014 as well as actual increases for 2012 and 2013.) These modest year-over-year increases mirror the slow pace of the U.S. economic recovery and reflect business leaders’ conservatism on financial forecasts and relatively low demand in the labor market.[1]

**Figure 1: Average Increases in Salary-Increase Budgets for All Industries by Broad Job Classification**

| | 2012 Projected | 2012 Actual | 2013 Projected | 2013 Actual | 2014 Projected |
|---|---|---|---|---|---|
| Executive | 2.9 | 2.8 | 2.9 | 2.9 | 3.0 |
| Exempt | 2.8 | 2.8 | 2.9 | 2.9 | 3.0 |
| Non-Exempt | 2.7 | 2.7 | 2.9 | 2.9 | 2.9 |

[1] The unemployment rate was 7.2 percent as of September 2013.

The gap between executives and other employee populations has closed over the past year. Historically, executives typically enjoyed a greater salary-increase budget than other populations, usually by 10 to 30 basis points (bps).[2] The exception to this trend is in times of extreme hardship when executives may forgo salary increases and/or decrease their fixed compensation.[3] While annual increases to executive base pay are now in line with the rest of the business on a percentage basis, executives are eligible for much more robust performance-based incentives.

## Salary-Range Adjustments

Salary-range adjustments are also expected to rise slightly in 2014, by 10 bps to 2.0 percent for executives and 1.9 percent for exempt and non-exempt populations. (See Figure 2 below.) Salary-range adjustments in 2013 were largely forecast correctly at 1.9 percent. Salary-range adjustments typically lag salary-increase budgets by 1 percent or more. This helps organizations manage their structural compensation costs. The difference mostly affects new (and less-experienced) hires at the low end of the range and caps employees at the higher end of the range.

**Figure 2: Average Increases in Salary-Range Adjustments for All Industries by Broad Job Classification**

| | 2012 Projected | 2012 Actual | 2013 Projected | 2013 Actual | 2014 Projected |
|---|---|---|---|---|---|
| Executive | 1.9 | 1.7 | 1.9 | 1.9 | 2.0 |
| Exempt | 1.9 | 1.7 | 1.9 | 1.9 | 1.9 |
| Non-Exempt | 1.8 | 1.7 | 1.9 | 1.8 | 1.9 |

## Industry-Specific Data

Key industry-specific findings from Sibson's Annual Compensation Planning Analysis include:

- Industries with the lowest 2013 actual salary-increase budgets and salary-range adjustments were education, nonprofit and transportation. Salary-increase budgets for these industries were 10 to 40 bps lower than the cross-industry average for all employee segments. (See Figure 3 on the next page.)

- Industries with the highest 2013 actual salary-increase budgets were utilities, manufacturing and banking and finance.

[2] Ten basis points equal 0.1 percent.

[3] This last happened in 2009 when executive increases were 1.3 percent while the increases for exempt and non-exempt populations were 1.6 percent and 1.7 percent, respectively.

## Figure 3: Average Increases in Salary-Increase Budgets and Salary-Range Adjustments by Industry and Broad Job Classification

| | Salary-Increase Budgets | | | | Salary-Range Adjustments | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 Actual | 2013 Projection | 2013 Actual | 2014 Projection | 2012 Actual | 2013 Projection | 2013 Actual | 2014 Projection |
| **Banking and Finance** | | | | | | | | |
| Executive | 2.6 | 3.0 | 2.9 | 3.0 | 1.2 | 1.9 | 1.8 | 2.0 |
| Exempt | 2.7 | 2.9 | 2.9 | 3.0 | 1.2 | 1.9 | 1.8 | 2.0 |
| Non-Exempt | 2.6 | 2.9 | 2.9 | 3.0 | 1.3 | 1.9 | 1.8 | 1.9 |
| **Education** | | | | | | | | |
| Executive | 2.4 | 2.5 | 2.6 | 2.7 | 1.3 | 1.6 | 1.6 | 1.7 |
| Exempt | 2.2 | 2.4 | 2.5 | 2.6 | 1.5 | 1.5 | 1.7 | 1.8 |
| Non-Exempt | 2.1 | 2.3 | 2.5 | 2.5 | 1.4 | 1.7 | 1.6 | 1.6 |
| **Health Services** | | | | | | | | |
| Executive | 3.1 | 3.2 | 3.0 | 3.2 | 1.8 | 1.9 | 1.4 | 1.9 |
| Exempt | 2.8 | 2.9 | 2.7 | 3.0 | 1.6 | 1.8 | 1.5 | 1.9 |
| Non-Exempt | 2.7 | 2.8 | 2.6 | 2.8 | 1.6 | 1.8 | 1.5 | 1.9 |
| **Information Services/Telecommunications** | | | | | | | | |
| Executive | 2.8 | 3.1 | 2.9 | 3.0 | 1.1 | 1.2 | 1.3 | 1.5 |
| Exempt | 2.8 | 3.0 | 2.9 | 3.0 | 1.6 | 1.7 | 1.8 | 2.0 |
| Non-Exempt | 2.8 | 3.0 | 2.8 | 2.9 | 1.5 | 1.7 | 1.6 | 1.8 |
| **Insurance** | | | | | | | | |
| Executive | 2.9 | 3.1 | 2.9 | 3.0 | 1.7 | 1.9 | 1.9 | 1.9 |
| Exempt | 2.8 | 3.0 | 2.9 | 3.0 | 1.7 | 1.9 | 1.9 | 1.9 |
| Non-Exempt | 2.8 | 2.9 | 2.9 | 3.0 | 1.7 | 1.9 | 1.9 | 1.9 |
| **Manufacturing** | | | | | | | | |
| Executive | 3.0 | 3.0 | 3.0 | 3.0 | 1.9 | 2.0 | 1.9 | 2.0 |
| Exempt | 2.9 | 3.0 | 2.9 | 3.0 | 1.9 | 2.0 | 1.9 | 2.0 |
| Non-Exempt | 2.8 | 2.9 | 2.9 | 3.0 | 2.0 | 2.0 | 1.9 | 2.0 |
| **Nonprofit** | | | | | | | | |
| Executive | 2.6 | 2.6 | 2.8 | 2.9 | 1.5 | 1.5 | 1.2 | 1.6 |
| Exempt | 2.3 | 2.5 | 2.6 | 2.8 | 1.5 | 1.5 | 1.6 | 1.7 |
| Non-Exempt | 2.2 | 2.3 | 2.5 | 2.7 | 1.5 | 1.4 | 1.4 | 1.6 |
| **Retail** | | | | | | | | |
| Executive | 2.8 | 3.0 | 2.9 | 3.0 | 1.6 | 2.0 | 1.4 | 1.7 |
| Exempt | 2.8 | 2.9 | 2.9 | 2.9 | 1.6 | 2.0 | 1.7 | 1.9 |
| Non-Exempt | 2.7 | 2.9 | 2.8 | 2.9 | 1.6 | 2.0 | 1.6 | 1.9 |
| **Services** | | | | | | | | |
| Executive | 3.0 | 3.0 | 2.9 | 3.0 | 1.8 | 1.8 | 1.7 | 1.9 |
| Exempt | 2.9 | 2.9 | 2.9 | 2.9 | 1.7 | 1.9 | 1.8 | 1.9 |
| Non-Exempt | 2.8 | 2.9 | 2.8 | 2.9 | 1.7 | 1.9 | 1.7 | 1.9 |
| **Transportation** | | | | | | | | |
| Executive | 2.4 | 2.9 | 2.7 | 2.8 | 1.4 | 2.0 | 1.5 | 1.9 |
| Exempt | 2.7 | 2.8 | 2.8 | 2.9 | 1.3 | 1.9 | 1.4 | 1.9 |
| Non-Exempt | 2.4 | 2.7 | 2.7 | 2.8 | 1.4 | 1.8 | 1.4 | 1.7 |
| **Utilities** | | | | | | | | |
| Executive | 3.0 | 3.1 | 3.1 | 3.1 | 1.9 | 2.0 | 2.0 | 2.0 |
| Exempt | 2.8 | 3.0 | 2.9 | 3.0 | 1.9 | 2.0 | 2.0 | 2.0 |
| Non-Exempt | 2.8 | 2.9 | 2.9 | 3.0 | 1.9 | 2.0 | 2.0 | 1.9 |

## Inflation

While organizations are primarily concerned with the cost of talent rather than the cost of living, in January through September 2013, the Consumer Price Index for All Urban Consumers (CPI-U) rose 1.5 percent over the same period in 2012. This compares to a 2.1 percent increase for the same period between 2011 and 2012. The current rate of inflation remains low. Because inflation is lower than last year, the actual 2013 salary-increase budget of nearly 3.0 percent means employees' purchasing power has increased modestly.

Since the data is provided through September 2013 only, results may change in the fourth quarter. Factors that could lead to changes in the CPI-U include volatile energy and food prices and interest rate changes.[4]

## Employee Prioritization and Differentiation

Organizations should continue to consider salary-increase budgets as an investment in talent and prioritize allocations to their top performers.[5] Prioritization is even more crucial in difficult times when organizations still need to reward their best employees, but have a relatively small pool of money with which to work.

Organizations should not give up on pay differentiation, even if budgets are small. One approach is to provide salary increases only for certain segments of employees, such as top performers, employees in critical jobs, or those whose compensation is below market. A second approach is to carve out a portion of the budget and deliver that exclusively to the highest-performing employees. This ensures that the organization makes a premium investment in those employees who truly create value.

Sibson research indicates that top-performing pay-for-performance organizations are nearly twice as likely to give their best employees merit increases that are double what they give their average employees. Over the past few years, when merit increase budgets were approximately 2.5 percent or less, top performers at these organizations were twice as likely to see increases of 5 percent of base salary or more. This shows that while differentiation may be difficult, it is possible.

## Executive Compensation Implications

Projected 2014 executive salary increases are nearly equivalent to those for the exempt and non-exempt populations. This is the third consecutive year in which executive salary increases have mirrored the broader employee population suggesting a longer-term trend that organizations are transitioning away from the pre-recession practices in which executive salary increases outpaced those for other employee segments. The reason for this may be traced to overall sensitivity to executive compensation levels and the way the media portrays compensation differentials between executives and average employees. Increasingly, compensation committees responsible for approving executives' salaries are reviewing proxy advisory firms' assessments and managing how executive pay, including salary increases, is perceived.

4 Any tapering of the Federal Reserve's current quantitative easing policy may result in increasing interest rates and lower inflation.

5 For real-world strategies for optimizing investment decisions, see the articles "Reducing the Sense of Entitlement: Pay for Performance for 2010 and Beyond" (www.sibson.com/publications/perspectives/volume_17_issue_2/entitlement.html) in the July 2009 issue of *Perspectives* and "Small Packages = Big Bucks: Making Merit Matter" (www.sibson.com/publications/perspectives/volume_15_issue_1/making_merit_matter.html) in the January 2007 issue of *Perspectives*.

Future increase budgets may be influenced by the recently prescribed Securities and Exchange Commission (SEC) requirement that companies disclose the average worker's compensation compared to that of the CEO (*i.e.*, the CEO pay ratio).[6] After much discussion and debate about the validity of, and the process for, developing such a metric, it is expected to be implemented in 2015 public company proxy statements after final guidance is confirmed following the ongoing comment period.

Identical CEO and "average" employee percentage salary increases will actually expand the pay ratio gap over time. The reason for this is that executive base salaries are multiples higher than those of the "average" employee, resulting in much larger pay increases on an absolute dollar basis.

### The Role of Communication

A sound communications plan is a vital component for relaying key messages to employees and ensuring their continued engagement. Employees who have a good understanding of the compensation process and think decisions are made "fairly" are substantially more satisfied with their compensation outcomes, even if the increase levels are lower. This highlights the importance of managing communications and creating transparency in the compensation system.

The implication is that organizations that fail to openly manage compensation face problems with regard to pay satisfaction. Conversely, those that communicate their pay philosophy and their rationale for pay decisions and place appropriate context on how they arrive at individual decisions are more likely to have employees who are satisfied with their compensation.

Organizations can better satisfy their workforce with a smaller investment in increased compensation if the process is communicated clearly and administered consistently. This holds true both when salary-increase budgets are high and when they are low. Many employees, especially top performers, look not only at the absolute amount of pay delivered, but also at pay increases relative to peers.

### Outlook for the Future

Actual salary-budget increases for the last three years (2011[7]–2013) have approximated Sibson's projections. As long as organizations maintain confidence in their financial forecasts and there is general stability in the global economy, this trend is likely to continue. Salary-increase expenditures could quickly be derailed, however, by volatility generated by hot-button issues. These include lingering concerns over the economy, government-influenced instability (*e.g.*, future government shutdowns) uncertainty regarding U.S. tax policy, and the impact of continued high unemployment.

Organizations have shown that if any of the above factors affect their growth and profitability forecasts, they will not hesitate to reduce or eliminate their salary-increase budgets. A lesson learned from 2009 is that the amount that is budgeted may not be the amount that is spent.

[6] See the SEC's announcement, Providing Context for Executive Compensation Decisions (www.sec.gov/News/Speech/Detail/Speech/1370539813937).

[7] The actual 2011 salary-budget increases for all industries by broad job classification (which are not included in Figure 1) are executive, 2.7 percent; exempt, 2.5 percent; and non-exempt, 2.5 percent.

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