

Budgeting for your Salary Review – How to get the most ‘bang’ for your buck.

Bubbles have burst spectacularly at the start of 2008, and as we observe the messy remains, we will be fascinated to see if remuneration levels follow suit. It's the time of year when many companies review their remuneration spending and plan their budgets. This year, this process is occurring against a background of wall-to-wall reports of low quality lending exposure and consequent CEO departures. This serves as a sobering reminder that knowing the difference between your income and your expenditure is more important than following market trends.

It's easy for employers to get caught up in the frenzy of a tight labour market and be tempted to increase salaries to match, or to better, the market. Like constant price-cutting, constant remuneration increases may make the business unsustainable in the longer term. Salaries should not be determined by market pressure alone. Managers need to ensure (and ensure their employees understand) that salaries are tied to performance, productivity and profits.

While there are still plenty of positive indicators, there's no doubt that many businesses are facing tougher economic conditions. Some are already experiencing the credit crunch first hand, and while exporters may see some benefit from a slight easing of exchange rates, our high interest rates suggest it's unlikely there will be a large dive in the near future. Internally, employers once again face increased compliance costs, with the 1 April start of compulsory KiwiSaver contributions.

So, as many companies contemplate their first or second quarter salary reviews, what are the key issues being faced and how should you plan and budget to best address them?

Key Issues

To recap then, the key issues currently facing organisations are:

- The labour market continues to be tight, putting pressure on remuneration levels and market movements
- The consequence sees new recruits coming in at levels above existing employees, and, in many cases, with less experience, skill and demonstrated performance
- The cost of recruiting and training puts pressure to pay above the market in an effort to retain staff
- The economic environment is becoming tougher, with many industries and companies facing potentially lower returns over the next twelve months
- The cost of compliance is soaring, with compulsory KiwiSaver contributions being the latest in what seems like a long line of legislative policy which ultimately hits employers in their back pocket.

To summarise a difficult situation... there is pressure from employees with high salary expectations in a tight labour market. This is in direct opposition to the pressure on companies from their board/shareholders/stakeholders to continue to thrive and perform financially in increasingly challenging conditions.

To get the most ‘bang for your buck’ from your 2008 salary review budget, your company needs to look seriously at how your remuneration budget will be distributed through the employee population. If everyone in the business (or the majority at least) is awarded market movement there simply won't be the budget left to truly differentiate the top performers. Nor will you be able to address the internal equity disparities which may have arisen by bringing new employees in at too high a level.

The undeniable reality is that we will have to start ‘robbing Peter to pay Paul’.

In general, there is a tendency to pay out at salary review times (and with incentives) for fear of people leaving, but the critical issue of affordability needs to be considered and addressed. The questions which should be asked by Boards and CEO's are “have performance levels actually increased, and do they warrant a pay out/increase in salary levels?”

The underlying principle here is that your remuneration spend should be self-funded through improvements in productivity or company performance.

Therefore, in preparation for your salary review – apply some common sense principles, e.g. if your company performance decreased from last year, you should probably decrease the budget below market ‘average’ levels. It’s not sustainable to keep increasing costs to keep pace with the market if the company is struggling to survive.

What else can be done to ensure both a successful and affordable review?

Top Tips:

1. Use a realistic budget that is affordable and reflects company performance
2. Consider productivity levels and performance over and above market relativity (*Do you have ways of measuring each staff member’s productivity/How much they are worth?*)
3. Focus your salary review spend on taking care of the high performers in the first instance
4. Plan and build a promotional budget to reflect anticipated employee career moves
5. Consider your company’s likely commitment in terms of additional salary costs due to the new KiwiSaver legislation. (*This shouldn’t be blindly added on top of your existing salary review budget*). You should plan how/whether this will impact your review budget and how you will manage this
6. Provide refresher training to managers and remind them that to manage effectively, means not always being the ‘good guy’. There is a need to differentiate review outcomes based on performance.

You may need to consider using forced rankings or forced distribution to achieve a genuine spread that is truly reflective of performance levels. Particularly when managers can’t provide evidence to support performance ratings (which is very common) this approach can be very valuable.

Managers should know what good performance looks like and how to measure it for each job in their team. The more direct the link between an individual’s performance and their pay, the more a ‘pay for performance’ philosophy will outweigh the traditional market relativity exercise.

In summary, leading into your salary review, the determination of your review budget and criteria for how that budget should be divvied up are absolutely key. If you adhere to a strict pay for performance structure, then you will overcome any market pressure. Performance evidence is a much stronger foundation on which to build a remuneration policy than market conditions.