

Five keys to getting remuneration right

Paying for what matters in the new world of work

A cautious economy, key talent risks and cost pressures are three critical elements impacting Australian and New Zealand remuneration strategies. Given many companies who participated in this research operate in both countries, it may be appropriate to look at how Australia's Hayne Royal Commission influences the way they approach risk, culture and remuneration. Not addressing external changes on the rapidly-evolving work ecosystem could affect the ability of companies to attract and retain critical employees.

Remuneration programmes must address a growing range of often conflicting objectives, from market competitiveness for critical roles, to pay fairness and equity, resulting in a complex decision-making process that requires greater use of technology. These and other findings from the Getting Compensation Right Survey reveal the scope of the task confronting employers as they attempt to optimise their limited remuneration budgets and communicate the results in a highly dynamic global work environment. In response, organisations are starting to think carefully and deliberately about what it is they're paying for and why. Many are taking a more future-focused approach to performance management and remuneration decisions. At the same time, issues of pay transparency and equity are gaining traction globally, all of which are prompting organisations to take a broader view of their pay practices.

This research aims to provide a deeper understanding of the current state of pay programmes globally, employers' plans over the next three years and the best practice breakthroughs essential to getting remuneration right.

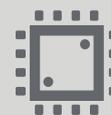
Our findings examine five elements critical to developing relevant, high-impact remuneration programmes.



Identify the factors that determine base pay



Improve differentiation of incentives



Make effective use of technology



Prioritise fair pay



Build a culture of pay transparency



1 Identify the factors that determine base pay.

The issue: Base pay is not effectively driving performance.

It's time to rethink merit pay, the mainstay of traditional remuneration programmes. Almost a third of employers (31%) say that base pay programmes are effective at driving higher individual performance. In fact, one out of four strongly disagree with this statement. And 72% of employers indicate that limited budgets are a challenge to reflecting performance in merit pay.

A closer look at the factors used to determine base pay reveals a complex decision-making environment with many organisations reporting that six or more factors affect base pay increases to a great extent. These findings suggest that some companies may be considering too many factors in making certain pay decisions and that the role of base pay needs to be redefined for today's changing workplace. While employers understandably need to take into account a range of factors in determining base pay, they will likely not be able to consider all factors to the same extent for all employees.

Currently, employers focus primarily on the concerns over their market competitiveness (84%), final rating in most current year-end performance review (63%), criticality of role (66%) and penetration in pay range for current role (58%) when deciding pay increases (Figure 1).

Some companies may be considering too many factors in making certain pay decisions. Our findings suggest that the role of base pay needs to be redefined for today's changing workplace.

Figure 1. **Organisations are operating in complex environments when it comes to factors affecting base pay decisions.**

To what extent does each of the following factors affect individual employee base pay increases in the current design?



While market competitiveness (84%) will continue to remain a key factor in pay decisions over the next three years, there will also be a stronger focus on skills critical to future success and future potential (53%) and gender equity (45%).

Interestingly, as many of these determining factors become more important in the next three years, few of today's determining factors will become less important, adding to the complexity of making pay decisions.

Companies have indicated that demonstration of knowledge and skills required in current role and penetration in current pay range (82%), perceived potential, achievement of individual goals, concerns over internal equity (66%) and achievement of team goals (71%) will remain as important as currently. (Figure 2).

Consider how these findings play out across key areas:

- **Current versus future requirements.** As employers confront shifting requirements in the new world of work, a greater emphasis will be placed on possessing the skills necessary to achieve future business objectives.

While 60% of employers report that demonstration of knowledge and skills required in the current role influences base pay increases to a great extent today, over half of respondents (53%) say that possession of skills critical to the future business model will become more important over the next three years. But at the same time, 82% also say that knowledge and skills required in the current role will remain just as important going forward as they are today, highlighting employers' competing priorities.

As companies adopt a more future-focused approach to pay programmes, perceived potential grows in importance with roughly one quarter of employers (26%) indicating that this factor will become more important over the next three years. Moreover, organisations must use appropriate tools and robust methodologies to document the measurement and impact of potential on pay in order to ensure this factor doesn't have an adverse effect on the pay of women and minorities due to incorrect subjective perceptions of potential.

- **Market competitiveness.** Reflecting a tightening labour market, market competitiveness is and will continue to be a critical factor in making pay decisions. At present, market competitiveness is a key factor for (84%) of employers. Over the next three years, 60% indicate that this factor will become even more important.
- **Gender pay equality.** While it's critical that organisations pay all employees fairly, relative to the market and each other, gender pay gaps merit special attention. At present, almost half of Australian organisations say that gender pay equality is a key factor in making base pay decisions (44%), and 45% say it will grow in importance in the next three years.

Figure 2. **Base pay decisions will only get more complex as emerging, future-focused factors become more important.**

How will the importance of each of the following factors on individual employee base pay increases change over the next three years in the design of your base pay programs?



In addition, other often competing priorities such as the importance of individual versus team goals and flexible versus rigid 12-month review cycles, add to the complexity of making pay decisions to varying degrees.

Facing an increasingly complex decision-making process, 11% of the respondents have already taken action and roughly 58% of organisations are planning on or considering changing the criteria for merit increases. More than a quarter of the organisations have also indicated that their biggest issue until now has been that they have been too backward looking when it comes to remuneration (27%).

Breakthroughs that matter!

Clearly define the role of base pay.

To define the role of base pay, it's essential to identify the mix of key factors that will guide an organisation's decision making. The extent to which an organisation can differentiate pay using a range of factors will depend largely on its budget.

- In organisations with tight merit budgets, in mature markets like Australia and New Zealand which have lowinflation, it's critical to segment – that is, divide employees into different groups using such variables as critical skills, future potential and team/network – and simplify by reducing the number of factors that should determine base pay for each of these different groups.

For instance, some organisations might be paying certain groups for future potential instead of rewarding last year's performance. For other groups, current contribution might be the key determining factor.

- Organisations with more substantial budgets may decide that having a larger mix of determining factors will improve the effectiveness of their base pay programmes. In fact, our research shows that companies that perceive their base pay decisions as effective are more likely to take into account a wider range of factors in determining merit increases.

But for these options to work, companies must invest both in the tools that will support a complex decision-making process and in equipping managers to understand their role in the process.

What are employers' top challenges in delivering effective pay for performance?

Limited budgets

72%

Manager capability

42%

Limited differentiation

34%



2 Improve differentiation of short-term incentives.

The issue: Employers miss opportunities to differentiate incentive payouts to top performers.

Though many companies have more than one form of short-term incentive programme, the two most prevalent types are the organisation-wide performance with individual payouts determined by individual performance (47%) and the individual incentive-like sales or commission plans (54%).

Organisations are missing opportunities to increase the incentive differentiation for top performers. Consistent with our previous research, almost one fifth (18%) of companies pay incentives to employees who do not meet expectations. Organisations intend to pay top performers about 21% above target when funding levels are normal/on target, and in those situations, they are generally doing so. However, our findings suggest that when actual funding differs from target funding, incentive payout differences are compressed at the top end.

When actual incentive funding levels fall below target, nearly a fifth (19%) of employers reduce the payout to top performers by a greater percentage than they do the payouts to other employees and over half reduce it by the same percentage as for other employees. When payouts are above target funding levels, those to top performers are also compressed.

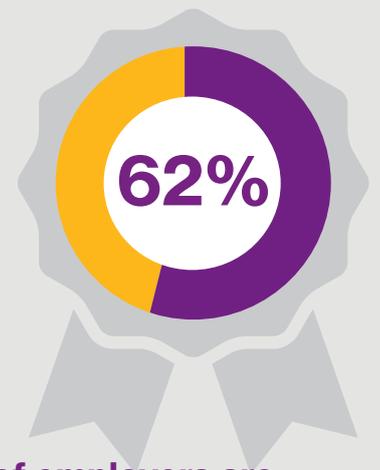
These missed opportunities to differentiate bonuses could help explain why more than half (58%) of organisations are planning or considering changes to the design of their annual incentive plans. We also see that as past performance becomes less of a key factor in base pay decisions, the importance of reflecting this factor in annual incentive plans becomes more important. In fact, 41% of the respondents indicated that they have plans to change their performance frameworks to include performance achievement and future potential.

Breakthroughs that matter!

Differentiate enough to make it meaningful.

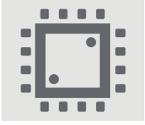
To better allocate finite short-term incentive budgets to high-value talent, decide which positions should have considerable pay at risk, and ensure the incentive payouts deliver appropriate upside to the right employee groups. Lastly, once an organisation's bonus pool funding level is set, it's important for that organisation to review its funding targets at all performance levels to ensure it is optimising opportunities to reward top talent.

Recognition programmes gain traction



of employers are planning on or considering developing new types of recognition programmes.

In addition to their low cost, these programmes offer a quick way to support emerging skills and changing workplace practices, and provide immediate, personalised rewards, particularly appealing to employees seeking instant gratification. And these benefits are realised without increasing fixed costs such as base pay.



3 Make effective use of technology to improve decision making.

The issue: Complex pay decisions can become all the more challenging due to inadequate technology.

As companies take more factors into consideration in making base pay and incentive decisions, they need intuitive technology, data and analytics to support their decision making. The right decision support tools are also critical to ensuring fair pay. While over half of organisations use software beyond spreadsheets to support the implementation of base pay, only 31% do so for short-term incentives.

Compared with organisations using sophisticated software for administering base pay and short-term incentive programmes, those still relying on spreadsheets are more than twice as likely to say that not having the right technology (21%) is a challenge to delivering effective pay for performance.

Thirty-one percent of organisations that identify technology as a challenge are planning to introduce new technology this year. However, about 51% of those who don't identify technology as a challenge are also planning to introduce new technology this year, suggesting that they need to make this investment to stay ahead of the pack.

Breakthroughs that matter!

Prioritise the use of remuneration software and decision support tools.

To support the remuneration function in helping managers make better pay decisions, organisations must ensure they have access to the latest software with global job leveling, benchmarking, and robust reporting and analytics capabilities.

Willis Towers Watson offer a range of solutions to help organisations in their decision making. To learn more about what we do and how we can help you, speak with a Willis Towers Watson consultant.

Why are employers considering making changes to their pay programmes?



66%

Manager feedback



62%

Cost



59%

A changing market



65%

Feedback from employees



40%

Change in business model/strategy



4 Prioritise fair pay.

The issue: Despite having formal processes in place to prevent bias or inconsistency in hiring and pay decisions, many employers fall short when it comes to fair pay.

Fair pay is an essential element of an effective remuneration programme and an integral part of the employee experience. In addition, there is a growing concern over internal pay equity due to a combination of increasing employee expectations and formal legislation. Most organisations give themselves high marks when it comes to having formal processes in place to prevent bias or inconsistency in hiring and pay decisions (Figure 3), however, the results are far from universal.

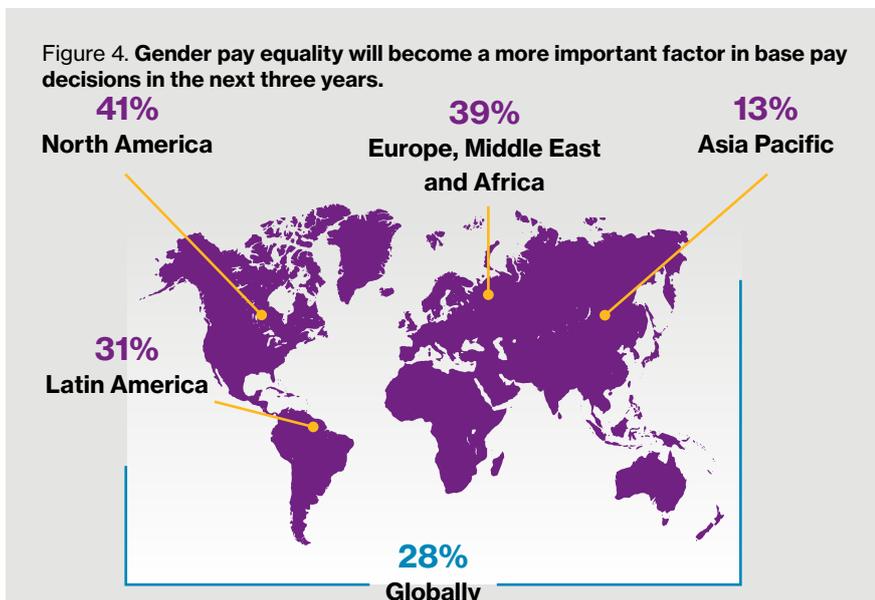
Twenty-seven percent of companies don't have formal processes to avoid bias in base pay; as the reward component includes more variable and discretionary elements, this proportion rises. Alarming, 58% of companies don't have a formal process for ensuring no bias in long-term incentive eligibility and receivership and 76% don't have processes for *ad hoc* monetary recognition.

But are these formal processes actually delivering fair pay? New Zealand seems to be doing better than many other developed nations. According to figures published by Stats NZ, the gender pay gap was 9.2% in the June 2018 quarter, the second-smallest gap since the research began 20 years ago. The lowest on record was 9.1% in 2012, while the gap was 9.4% in 2017. The gender pay gap shows the difference in median hourly earnings for men and women. For the second year in a row, the gap reflected that median hourly earnings for women, from wages and salaries, increased faster than for men, up 3.2 and 2.9% respectively. Workplace Gender Equality Agency figures from February 2018 show Australia's gender pay gap is 15.3%, based on full-time average weekly earnings.

Figure 3. **My organisation has a formal process in place to ensure there is no bias or inconsistency in:**



Figure 4. **Gender pay equality will become a more important factor in base pay decisions in the next three years.**



There are notable regional differences in the extent to which companies are using or planning to use annual pay increases to address gender pay equality issues over the next three years (Figure 4). More broadly, when it comes to promoting diverse talent and an inclusive culture, globally over one in three (37%) organisations have formally structured and managed diversity and inclusion programmes. These typically target gender (87%), people with disabilities (61%), racial and ethnic groups (53%), age groups (55%) and sexual preference (41%).

Within these programmes, organisations are more likely to have already emphasised:



65%
Flexible work arrangements



61%
Internal networks



55%
Maternity support/
return to work programmes

Common target areas for this year and the next three years are:



43%
Re-evaluating recruitment and promotion processes/succession plans



41%
Analysing changes in pay differentials between job levels over time



30%
Increasing communication of policies and benefits promoting an inclusive culture

Notably, fewer are planning or considering initiatives that involve introducing recruitment and/or promotion targets (18%).

Breakthroughs that matter!

Conduct a diagnostic to formally assess the progress of the fair pay agenda in your organisation and whether further actions are needed.

A more effective base pay programme will also enable organisations to address pay equity issues that they may be facing. Conducting pay equity diagnostics can help employers understand the current landscape as it relates to fair pay and target actions to address any areas of concern.



5 Build a culture of pay transparency.

The issue: Many employers are unprepared to meet growing expectations of pay transparency.

A combination of generational preferences, legislation and publicly available comparative data is contributing to today's heightened expectations with regard to pay transparency. Yet, there's still a relatively low-level of pay transparency, which involves providing clarity around how pay decisions are made as opposed to disclosing employees' actual salaries.

The reasons for this lack of transparency vary. In some cases, an organisation's remuneration system may be so complicated that it's difficult to clearly explain the decision-making process. In other cases, the results may be embarrassing – for example, an organisation may have a substantial gender pay gap.

While one-fifth (21%) of companies have already taken action to increase the level of transparency around pay decisions, another 27% are planning to take action this year and 29% are considering taking action over the next three years (Figure 5). The task of increasing transparency becomes more challenging with the growing complexity of pay decisions.

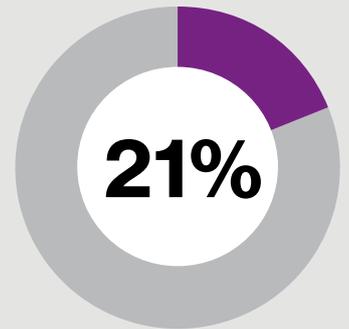
Breakthroughs that matter!

Establish a clear and future-focused reward strategy to help explain remuneration decisions.

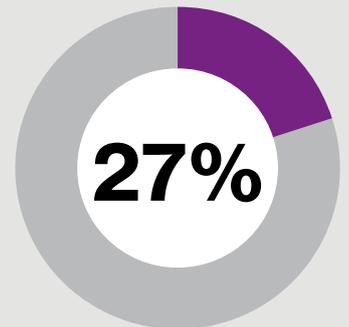
Before employers can be transparent about their pay decisions, they need to get their houses in order and be able to clearly explain the mix of factors influencing pay decisions as well as the reasoning behind the results – especially in countries where organisations must meet pay disclosure regulations. A transparent pay culture starts with the communication of a clear total reward strategy and accompanying pay philosophy.

A reward and career framework can serve as the foundation for open conversations about pay decisions and facilitate communications about the skills and other factors required to be successful. It's also essential to equip managers with the necessary training and tools to explain the basis for pay decisions in the context of the broader reward mix.

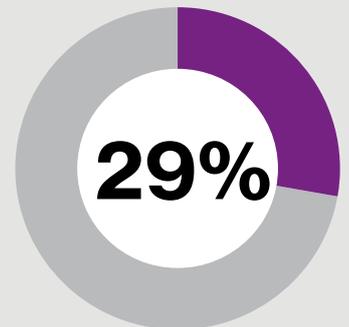
Figure 5. Companies are taking action to increase the level of transparency around pay decisions.



Already taken action



Planning to take action this year



Considering taking action over the next three years

Putting it all together

The following practices should underpin an organisation's efforts to develop remuneration programmes that have clear objectives, and deliver value to employees and employers:



Refocus decision making from a look back at past performance to an increased emphasis on the knowledge and skills that support future business models as well as the perceived potential of the employee.



Target your spend by using segmentation to better understand the roles and functions that deliver the most value, and the factors that should drive the spending in those roles/functions.



Ensure your technology keeps up with changing programme requirements and supports decision making.



Build manager capabilities. Managers must have the tools to make complex pay decisions and the ability to explain the decision-making process. In some cases managers may be a step ahead of HR when it comes to deciding how factors should be weighted in pay decisions.

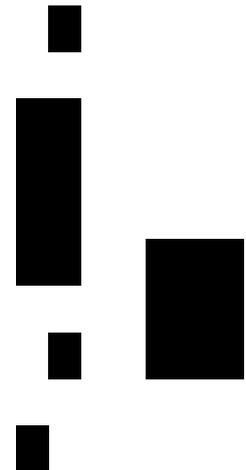


Develop a robust communication programme that promotes transparency and clarifies the role each component of an organisation's remuneration package plays in the overall talent value proposition.

Effective remuneration programmes are an important part of the talent value proposition and as such are linked to increased attraction and retention of top talent, improved employee engagement and higher levels of financial performance.

About the survey

The Willis Towers Watson Getting Compensation Right Survey fielded in March and April 2018. It includes responses from nearly 2,000 participating organisations in 48 countries. The participants represent a wide range of industries and geographic regions.



About Willis Towers Watson

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