Compensation Planning 2013: Planning for Performance
September 24, 2013

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Today’s Topics

• Context for planning
  – Economic outlook
  – Talent context
  – Total rewards context
  – Pay equity concerns gaining momentum

• Current state of pay for performance

• 2012/2013 in review

• Pay for performance forecast for 2014
  – Base salary increases
  – Short term incentives
  – Promotions and careers
  – Recognition

• Call to action for 2014

Submit questions at any time:
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Section 1

Context for Planning
Economic Context for Compensation Planning

Economic recovery continues to be slow, but steady

<table>
<thead>
<tr>
<th>Exports not growing as fast due to mixed sentiments over an uncertain world economy</th>
</tr>
</thead>
</table>

More signs of economic improvement

- Steady employment and somewhat higher wages
- Job growth remains weak but steady
- Salary freezes down from 2012 and projected to decline further in 2014
- Households benefiting from low interest rates
- Residential construction market in the midst of a healthy upswing

Overall, US economy in a more robust condition than in 2011-2012, and is holding its own
Economic Outlook
GDP growth steady, unemployment below 8%

Sources: Economist Intelligence Unit
US Department of Labor Bureau of Labor Statistics
* Quarter Forecast – Economist Intelligence Unit
Talent Context
“Talentism is the new capitalism”

• Organizations are investing more in talent, but is it paying off?

• Key talent issues
  – Sustaining an adequate pipeline of leaders and critical talent
  – Attracting and retaining key talent and critical skills
    (Buyers of talent still outweigh builders)
  – Engaging employees to maximize business performance
  – Aligning rewards with business priorities
  – Effectively managing costs of HR programs
  – Governing people risk

• Accelerators of talent—education, wellness, careers

Source: Klaus Schwab, Founder and Executive Chairman of the World Economic Forum
Total Rewards Context
Most employers set pay strategy in a total rewards framework

- Rewards aligned with employee value proposition
- Market strategies
  - 73% target pay and benefits at median
  - 11% target above median
  - Remaining below median, offset with other components
- Focus on delivery to maximize value

Source: Mercer’s 2013 Pay for Performance Survey (Preliminary Results)
Pay Equity Concerns Gaining Momentum
OFCCP revised its investigative protocol in the Spring

• The OFCCP and EEOC are deploying more compliance resources

• OFCCP’s new protocol looks for “systemic” concerns, then at smaller units
  – Addresses a broader definition of compensation (base, incentives/commissions, LTI, access to overtime pay and benefits)
  – Considers the equity of practices driving pay differences
  – Requests broader data in investigations
  – No protocol for evaluation: OFCCP will seek to make the best case
  – Regression still endorsed, and still legal standard

• Two recent BOA/Merrill Lynch settlements for $160 and $39 million
Section 2
Current State of Pay for Performance
Current State of Pay for Performance
Half of employers say their performance management needs work

MIXED MARKS FOR PERFORMANCE MANAGEMENT

The vast majority of employers worldwide have performance management programs in place, but only 3% say their program provides exceptional value. Half say their program needs work, with linkage to succession planning and development cited as the two most common problem areas.

OVERALL APPROACH TO PERFORMANCE MANAGEMENT

Current State of Pay for Performance
Most organizations say they pay for performance...

PHILOSOPHY, YES; MEASUREMENT, NO

Organizations in Mercer’s survey overwhelmingly say they adhere to a pay-for-performance philosophy. Yet far fewer track and measure the alignment between performance and compensation decisions.

PERCENTAGE OF RESPONDENTS

89% SAY THEY LINK PERFORMANCE AND PAY DECISIONS

42% ACTUALLY TRACK AND MEASURE THE ALIGNMENT BETWEEN PERFORMANCE RATINGS AND COMPENSATION DECISIONS TO EVALUATE EFFECTIVENESS OF THEIR PROGRAMS AND PROCESSES

### Current State of Pay for Performance

The objective is to drive higher levels of performance…

What are your organization’s primary objectives in using pay for performance?

<table>
<thead>
<tr>
<th>Objective</th>
<th>Rank 1</th>
<th>Rank 2</th>
<th>Rank 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Drive employees to higher levels of performance</td>
<td>47%</td>
<td>26%</td>
<td>11%</td>
</tr>
<tr>
<td>Attract and retain right employees</td>
<td>33%</td>
<td>24%</td>
<td>16%</td>
</tr>
<tr>
<td>Allocate scarce rewards in an equitable manner</td>
<td>8%</td>
<td>15%</td>
<td>16%</td>
</tr>
<tr>
<td>Pay fairness</td>
<td>6%</td>
<td>12%</td>
<td>19%</td>
</tr>
<tr>
<td>Encourage employee engagement</td>
<td>4%</td>
<td>16%</td>
<td>19%</td>
</tr>
<tr>
<td>Desire to encourage synergies across teams and business units</td>
<td>1%</td>
<td>4%</td>
<td>6%</td>
</tr>
<tr>
<td>Protect company if company doesn’t do well financially</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>Penalize low performers</td>
<td>2%</td>
<td>4%</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>1%</td>
<td>1%</td>
<td></td>
</tr>
</tbody>
</table>
Current State of Pay for Performance
But does it deliver?...less than 60% say it works well

Evaluate the effectiveness of your performance management approach.

<table>
<thead>
<tr>
<th>Area</th>
<th>Delivers exceptional value</th>
<th>Works well</th>
<th>Needs work</th>
</tr>
</thead>
<tbody>
<tr>
<td>Linkage to compensation decisions</td>
<td>8%</td>
<td>50%</td>
<td>42%</td>
</tr>
<tr>
<td>Evaluation process</td>
<td>4%</td>
<td>55%</td>
<td>41%</td>
</tr>
<tr>
<td>Planning process</td>
<td>4%</td>
<td>45%</td>
<td>51%</td>
</tr>
<tr>
<td>Linkage to development</td>
<td>3%</td>
<td>33%</td>
<td>63%</td>
</tr>
<tr>
<td>Feedback process</td>
<td>3%</td>
<td>44%</td>
<td>52%</td>
</tr>
<tr>
<td>Linkage to succession planning</td>
<td>3%</td>
<td>27%</td>
<td>70%</td>
</tr>
<tr>
<td>Overall system</td>
<td>3%</td>
<td>49%</td>
<td>48%</td>
</tr>
</tbody>
</table>
Current State of Pay for Performance

Top roadblock to effective pay for performance is manager skill

Which, if any, of the following roadblocks have most impeded your pay for performance implementation?

<table>
<thead>
<tr>
<th>Roadblock</th>
<th>Rank 1</th>
<th>Rank 2</th>
<th>Rank 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managers lack the skill and/or motivation to implement successfully</td>
<td>21%</td>
<td>21%</td>
<td>12%</td>
</tr>
<tr>
<td>Target setting</td>
<td>13%</td>
<td>14%</td>
<td>10%</td>
</tr>
<tr>
<td>Culture fit</td>
<td>12%</td>
<td>5%</td>
<td>4%</td>
</tr>
<tr>
<td>Pay equity</td>
<td>10%</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>Unclear line of sight for employees</td>
<td>8%</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td>Low employee trust in pay for performance system and/or management</td>
<td>7%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Financial</td>
<td>7%</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>Have not faced any roadblocks</td>
<td>6%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Culture of rewarding the group rather than individual performance</td>
<td>5%</td>
<td>3%</td>
<td>2%</td>
</tr>
<tr>
<td>Inability to reward and promote employees as quickly as expected</td>
<td>4%</td>
<td>7%</td>
<td>9%</td>
</tr>
<tr>
<td>Inadequate ability to articulate to employees progression of jobs</td>
<td>4%</td>
<td>7%</td>
<td>8%</td>
</tr>
<tr>
<td>Inadequate, or no, system in place to manage process</td>
<td>3%</td>
<td>3%</td>
<td>7%</td>
</tr>
<tr>
<td>Corporate privacy</td>
<td>1%</td>
<td>2%</td>
<td>2%</td>
</tr>
</tbody>
</table>
Current State of Performance
Ranking and calibration processes complement manager input

Your company uses a distribution or ranking process for which of the following? (Select all that apply.)

- Performance ratings: 61%
- Compensation decisions: 40%
- Potential ratings: 16%
- Succession planning: 15%
- Learning and development: 13%
- Not applicable: 26%

To ensure differentiation between performance levels, which of the following processes are used by your company? (Select all that apply.)

- Next-level manager review: 50%
- Mandatory calibration*: 33%
- Informal calibration*: 23%
- None of the above: 21%
- Other: 6%

*31% of companies discuss compensation decisions in calibration meetings
Current State of Performance
What are the implications for pay for performance?

- Be very clear on your performance differentiation philosophy
- Know manager capability and calibration makes a real difference
- Consider programs in the context of others
  - Performance management, pay levels, incentives, supervision, and leadership development all reinforce one another
- Test whether programs are getting you the desired returns
  - Use analytics to measure progress
- Understand what is holding you back
  - Design or implementation issues?
  - Skill or “will” gap?
Section 3

2012/2013 in Review
2012/2013 Compensation Movement in the Mercer MBD

- Base pay increases tracked below forecast for individual contributors
- Increases and incentives varied by industry, with energy and mining tracking high, and government, education and healthcare low
- Increases and incentives did not vary significantly by region
- Percentage of eligible employees earning an incentive payout declined for all groups except executives
- Similar to 2012, payouts were below target for all groups except executives
- Incentive payouts were down for all career levels and categories of performance except for the highest performing managers
- Proportion of eligible employees receiving LTI was up in 2013

Mercer’s 2013 Mercer Benchmark Database represents data from over 3,000 organizations and for 2M employees
Section 4
Pay for Performance Forecast for 2014
Mercer’s 2013/2014 US Compensation Planning Survey

- Represents data from 1,500 organizations and over 13 million employees
- Organizations represent a range of industries and sizes
Pay for Performance
Rating distributions remain consistent over the last three years

Pay for Performance in Base Salary Increases
Base increases are set to remain steady into 2014

* All averages exclude 0’s

Pay for Performance in Base Salary Increases
Oil and gas increases are poised to lead the market again

Pay for Performance in Base Salary Increases
Companies plan to give top performers higher increases

Pay for Performance in Incentives
Incentive payouts for top performers are expected to be higher than for average performers across career streams.

Pay for Performance in Promotions
5 to 7% of employees likely to be promoted in 2014—promotional increases range 6%-8%, up since 2012

Pay for Performance in Promotions
Career pathing and leveling is gaining prominence

Pay for Performance in Recognition
Recognizing results is the rationale behind key contributor awards

Section 5
Call to Action 2014
Call to Action
Where to focus for 2014?

1. Confirm your organization’s pay for performance strategy
2. Build manager skills in making pay decisions
3. Communicate to realize the value of rewards delivered
4. Assess and assure readiness for pay equity challenges
5. Confirm the right technology to support rewards
6. Enhance your pay for performance analysis
Emerging Best Practice: Pay for Performance Analysis
Align philosophy with measurement and rewards

- 89% Say link perf & pay
- 42% measure pay for performance link
- 36% Measure people mgmt
- 10% Reward people mgmt

Source: Mercer’s 2013 Performance Management Survey
Emerging Best Practice: Performance Management Analysis
Critical questions answered

**New Employee Segments**
- Which employees received high performance ratings both this year and last year?
- Which employees have received high performance rating over the past three to five years?
- Which employees received low performance ratings more than three times in their past five reviews?

**Reward for Performance**
- Over time, do we really reward our employees who consistently receive high performance ratings through: Greater pay increases; bonuses; promotions and career opportunities?
- How do we handle pay outliers, e.g., employees who have received a low performance rating but an above median pay increase?

**Downgrades and Upgrades**
- What are the characteristics of employees that upgraded from a medium to high performer?
- What are the characteristics of employees that downgraded from a high to a medium performer? From a medium to a low performer?

Source: Mercer’s 2013 Performance Management Survey
Emerging Best Practice: Performance Management Analysis
Sustained performance ratings and right link to rewards

- Identify employees that have "Sustained High Performance" over a longer period e.g., 3, 4, 5 years.
  - We want to ensure that these employees have a substantially different employment experience (through pay, performance etc.) compared to the rest of our employee population.

Source: Mercer’s 2013 Performance Management Survey
Questions & Answers
Questions and Contacts

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