PayScale

CFO'S GUIDE TO COMPENSATION BEST PRACTICES

2020 EDITION

EXECUTIVE SUMMARY

As the CFO of your organization, your job is to create long-term value by generating returns that exceed your investment decisions. However, the volatile markets and economic conditions looming in 2020 don't make this easy.

There's one cost, however, that you *can* control: **your compensation**. When finance and HR work closely together to create collaborative strategies on your workforce, your organization can thrive in any scenario.

This CFO guide to compensation can help you align your vision for finance with the mission of HR, so you both can create long-lasting value together.

Here are a few key takeaways:

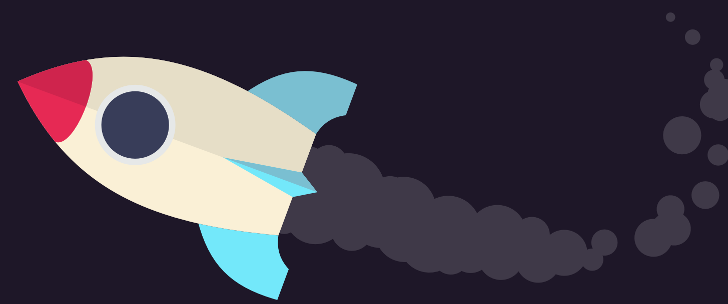
You can, in fact, control for uncertainty.
Because labor costs are your largest expense, smart compensation strategies could be your best financial lever in what looks to be a turbulent 2020.

Turnover costs you big bucks.
Losing an American worker could cost you up to $15,000. By increasing your pay brand, you can be seen as a leader in providing generous financial incentives to their top performers in return for longer-term loyalty and satisfaction.

Using compensation effectively makes your budget more efficient.
Develop a smart, holistic compensation strategy over the next cycle to be much more efficient with labor budgets for better "returns" with fewer resources.

Among many compensation strategies, there are good ones and bad ones.
Many employees feel empowered to leave their current employers for better-salaried opportunities elsewhere, with the next generation continuing the trend. One strategy to combat this trend is variable pay.

We believe with the right compensation strategies backed up with reliable data, you can better navigate volatile markets to thrive through 2020 and beyond.



Remember, it's not about cost-control — it's about value creation through compensation.

CONTROL FUTURE UNCERTAINTY.

As a CFO, you feel concerned about how your organization will respond to market dynamics in 2020. With a tightening labor market, trade and immigration worries, geopolitical tensions and fears of recession, you'll certainly have your hands full navigating financial forecasts.

Add onto that the cultural shifts changing traditional businesses like inequality and wage gaps between different ages, races, genders and cheaper, outsourced labor — not to mention compliance pressures from regulatory agencies and legislature.

For example, in the past year, we saw multiple well-known brands suffer financial losses when their employees and/or regulators exposed their biased pay, hiring, and promotion practices. Employees at Google and Nike organized public protests and even filed lawsuits against their respective employers for allegedly unfair pay practices and discriminatory policies. In a recent legal filing by the Department of Labor, attorneys alleged Oracle shorted women and minority workers $400 million in wages by paying them less than other employees and steering them into lower-level positions.

In today's climate, organizations need to proactively examine their pay practices to limit their financial — and reputational — losses.

The year 2020 will test every CFO on the planet.

To brace for this uncertainty, what are your best strategies? Should you decrease your labor costs to increase cash reserves, or invest in longer-term assets like automation technology, or should you invest more in your employees to slow retention and retain better talent.

We'll get into some of this in the next few pages. Because labor costs are likely your largest expense, smart compensation strategies could be your best financial lever in 2020.

TURNOVER COSTS BIG.

In our annual research report called the Compensation Best Practices Report (CBPR) this year, we found that even more organizations (66 percent) called out employee retention as a major concern than they did in 2018 (59 percent).

Despite those concerns, however, most organizations aren't allocating more to their base pay increase budget. This could be a mistake that ends up costing your organization big bucks.

Data from Work Institute's 2019 Retention Report show that the average cost of an employee quitting is conservatively around $15,000, costing U.S organizations over $600 billion per year in voluntary turnover. Think about how much money could be walking right out the front door and it's no wonder why CFOs urgently work with HR to keep retaining top talent top of mind.

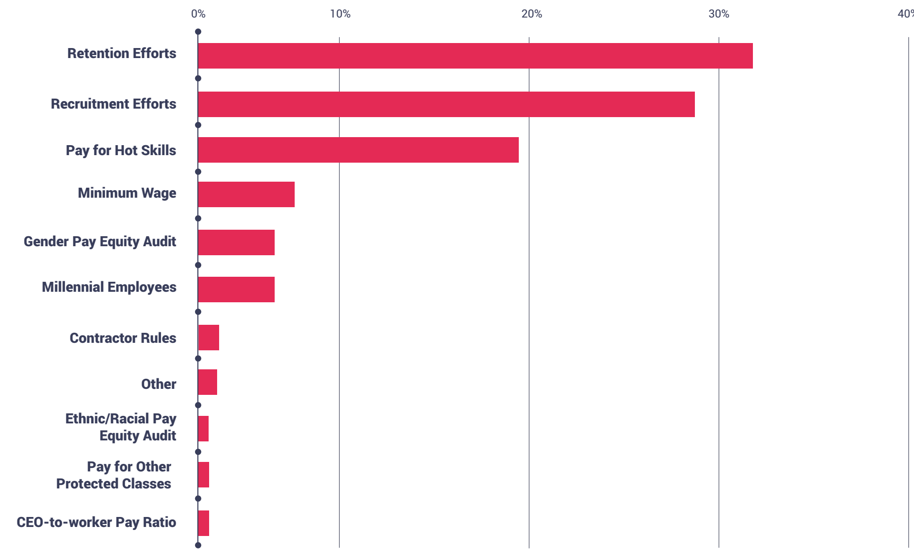
Additionally, workers were job-hopping in record numbers in 2018, and this trend will likely continue. Over the last several years, data from the Bureau of Labor Statistics (BLS) shows that voluntary quits rate for non-farm payrolls has been steadily increasing every year, with millions of workers quitting this year alone.

What does this mean for your organization? Your employees feel more empowered than ever to leave their jobs for more attractive opportunities, and you must use compensation strategies to retain them.

What Can You Do to Retain More Workers?

Increase your pay brand.

TOP REASONS ORGANIZATIONS ADJUST COMP STRATEGY



Data from the 2019 Deloitte Millennial Survey and our own research suggest that the next generation looks for higher pay above all else when considering leaving their employer.

In our own research, we found that organizations are differentiating pay based on performance to retain high performers, and they use a variety of tactics to do so. The most popular retention tactics from our CBPR are the merit-based pay plan (used by 61 percent of organizations), learning and development opportunities (59 percent) and the discretionary bonus plan (34 percent).

In short, organizations that increase their pay brand want to be seen as a leader in providing generous financial incentives to their top performers in return for longer-term loyalty and satisfaction. Over time this aligns your organizational goals to your compensation strategies for more efficient labor spend.

USE COMPENSATION EFFICIENTLY.

You know that the cornerstone of corporate finance is return on invested capital, where you can “create value by investing capital from investors to generate future cash flows at rates of return exceeding the cost of that capital,” according to McKinsey’s book on the subject Like any other investment, you want returns on your labor investments.

By using compensation efficiently, you can decrease your operating costs and increase your net income. With such a huge slice of your fiscal pie in this area, efficient spend here may be the best financial lever you can pull in 2020.

Pulling that lever will be increasingly more important over the next decade. Economists in the Bain & Company Labor 2030 report argue that “the era of plentiful labor is ending.” Three factors have contributed to plentiful labor in the last half-century, according to these researchers: “women entering the workforce, the opening of China and India, and the baby boomer generation.” However, these forces are largely mature, and “their positive boost to macro conditions is now fading.”

This means your compensation strategy over the next cycle needs to be much more efficient, squeezing out more “returns” with fewer resources.

What Can You Do to Compensate More Efficiently?

Develop a smart, holistic compensation strategy.

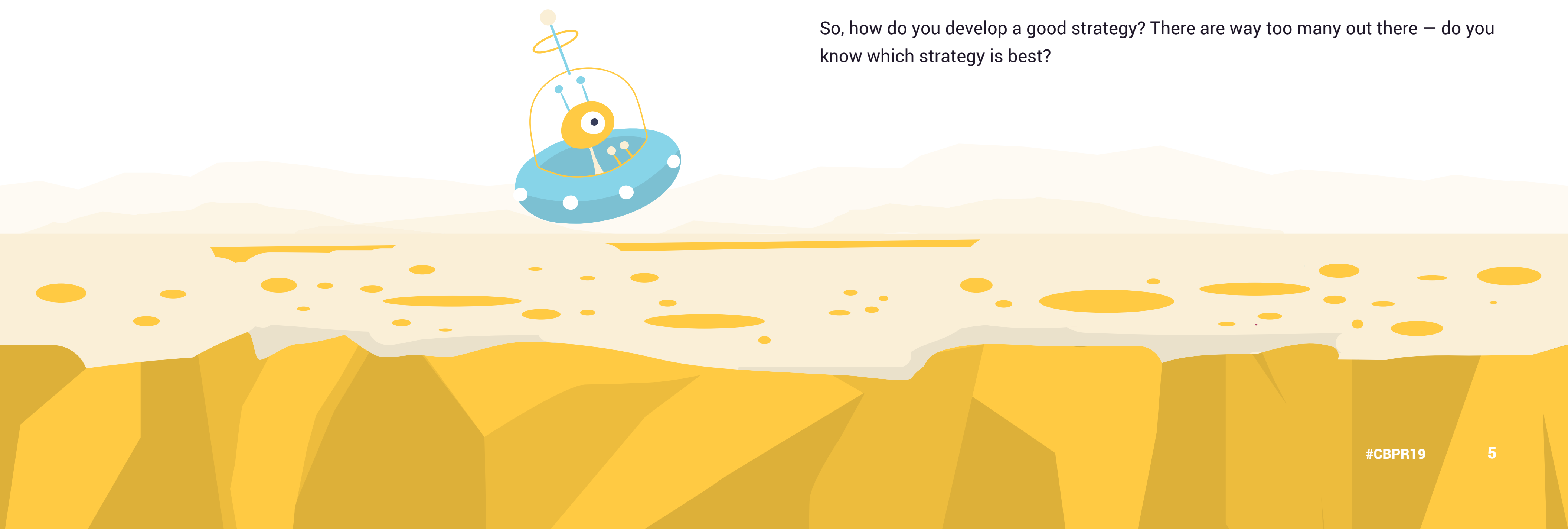
In our CBPR research, we saw that organizations continue to get smart about compensation. Of those organizations who participated in our survey, 62 percent agree or strongly agree that compensation is becoming more important to their executives (up 4 percent from the previous year).

Organizations are turning their concern into action: 31 percent of organizations have a compensation strategy and another 39 percent are working on developing one.

What is a compensation strategy?

A compensation strategy forms the core of your compensation plan. It aligns all your compensation resources to accomplish your business goals. It helps you decide where you want to compete, how competitive you need to be and what you choose to reward. With the backbone in place, organizations can quickly make good choices about compensation. We’ll look at three areas where organizations can make smart choices: competitive jobs, tough-to-fill jobs and retention.

So, how do you develop a good strategy? There are way too many out there — do you know which strategy is best?



WITH MANY PAY STRATEGIES, WHICH ONE IS BEST?

Like we said earlier, many employees feel empowered to leave their current employers for better-salaried opportunities elsewhere, with the next generation continuing the trend.

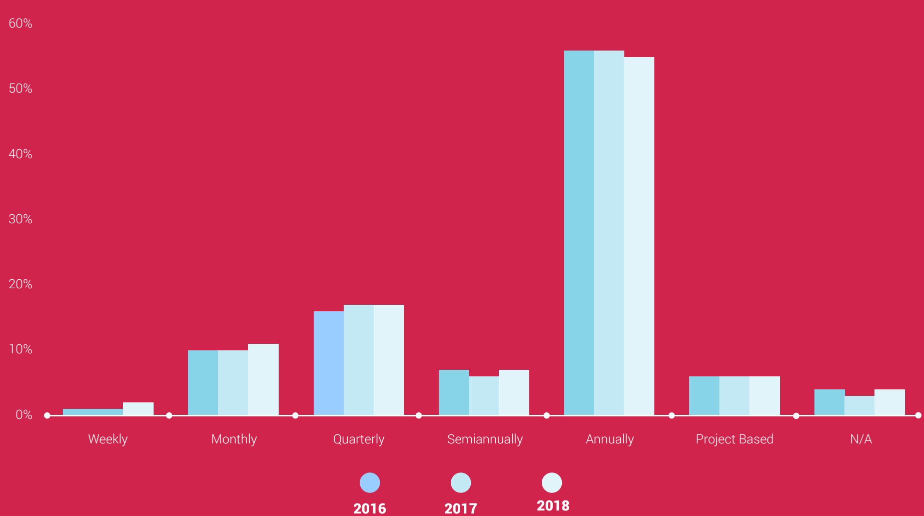
One strategy to combat this trend is **variable pay**. We see variable pay in top-performing organizations occur in two categories: **frequency of pay** and **type of pay**.

Frequency of Pay

Our data show that most organizations prefer to give annual bonuses or incentives, but top-performing organizations do things a little differently.

For one thing, top-performing organizations give bonuses and incentive pay to employees more frequently (34 percent of top-performing organizations give bonuses or incentives at least quarterly vs. 30 percent of typical).

TOP REASONS ORGANIZATIONS ADJUST COMP STRATEGY

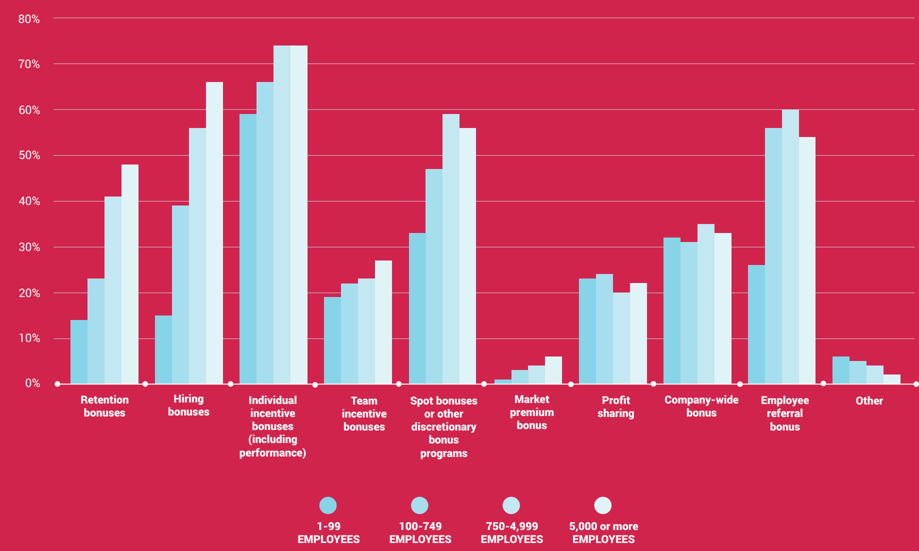


Type of Pay

There are many different ways to "pay" your employees, as you know. Although many organizations reward their high-performing employees with cash by giving larger pay increases to those with better performance, base pay is just one tool among several.

In our research, we found that organizations are rewarding top-performing employees in a variety of ways, including bigger base pay increases (58 percent, up from 54 percent the previous year), promotions (48 percent), career development (35 percent), informal bonuses or incentives (34 percent) and awards/recognition programs (31 percent, up from 29 percent the previous year).

BONUS TYPE BY ORGANIZATION SIZE



Modern organizations use an even wider range of innovative perks and benefits solutions to retain their top talent, including student loan benefits, paid parental leave, unlimited PTO or flexible and remote opportunities.

To decide which strategy is best for your organization, you need reliable compensation data. So, where do you get reliable data?

GET RELIABLE COMPENSATION DATA.

You need to get accurate, reliable data for your compensation strategies. Why is choosing the right data important? Because the data you select need to make sense for your context. Your context includes things such as your organization's total rewards philosophy, your target candidate profile, the competitors you're up against, your company stage, size, industry and what you can afford. There simply isn't a one-size-fits-all strategy.

What types of data are available?

Free Data

Free data lack that important context. Is it specific to your location, industry or company size? Is the data fresh? Free data typically don't answer those questions.

Many organizations admit to seeking free online data (about the same amount as last year at 63 percent). The advantage of reviewing the free online sources is you're able to see the same sources your employees may be looking at. However, they are not packaged for business use, and they don't always have the same rigor of validation applied.

Data Sources Vetted for Business Use

On the other hand, there are data sources that have been thoroughly vetted for business use. Unlike free data, data publishers of these sources will publish key characteristics for each data cut, including which organizations contributed to the dataset; breakdown of organizational sizes, industries and locations included in the dataset; and even when the data was collected, so you can evaluate whether the source is appropriate for your organization.

In our latest CBPR survey, we found four types of common, vetted data sources.

Traditional third-party surveys
33%
up from 29 percent last year

Government data
32%
up from 29 percent last year

Paid online data sources
33%
up from 28 percent last year

Industry surveys
30%
up slightly from 29 percent last year

How many data sources do you need? It depends. As a rule of thumb, the more jobs you have and the more talent markets you compete in, the more data sources you will need to cover all your jobs.

In this survey, we found the vast majority of organizations use two or more sources of market data (86 percent, up from 82 percent the previous year). Fourteen percent of organizations use five or more sources of market data.

Now that you have the right data from the right sources, how do you use it? What are some of the compensation best practices that top-performing organizations use to stay competitive?

HERE ARE COMPENSATION BEST PRACTICES

We asked top-performing organizations what they do regarding their compensation strategies, and this is what they said.

Compensation Is A Year-Round Conversation.

Top-performing organizations tend to consider pay to be an ongoing dialogue with employees, not an annual event that comes and goes. Top-performing organizations complete market studies more frequently (58 percent of top-performing organizations have completed a market study within the past year vs. 53 percent of typical), give bonuses and incentive pay to employees more frequently (34 percent of top-performing organizations give bonuses or incentives at least quarterly vs. 30 percent of typical) and obtain market data for individual jobs more frequently (42 percent of top-performing organizations get market data for individual jobs at least monthly vs. 34 percent of typical).

Build Pay Brand With Values and Culture in Mind.

Top-performing organizations are also more likely to have a compensation strategy that is aligned with their company values. These organizations are purposeful about how they spend their compensation budgets and they're more likely to have a formal compensation strategy (33 percent vs. 27 percent of typical).

Top-Performing Organizations Are More Likely to Pay More for Competitive Jobs.

Only 19 percent of top-performing organizations do not complete full market studies. They are also more likely to let the data drive higher pay for competitive jobs (58 percent vs. 51 percent of typical).

Top-Performing Organizations Are More Likely to Use Variable Pay.

Eighty-three percent of top-performing organizations were likely to use variable pay in 2018 (vs. 73 percent of typical).

Last but not least, top-performing organizations use more tactics to reward high performers

Sixty-four percent of top-performing organizations use bigger base pay increases (versus 58 percent of typical). Fifty-four percent of top performers use promotions (versus 48 percent of typical) and 38 percent of top performers use career development (versus 35 percent of typical).

In the end, we believe that top-performing organizations use their pay practices to enhance their people practices.

CONCLUSION

When you get your compensation right, your organization can thrive no matter what the future holds. You've seen how the best organizations use compensation strategies and data to outperform their peers and the market by efficiently using such a large category of their operating expenses.

However, at the end of the day, compensation is about more than just dollars and cents.

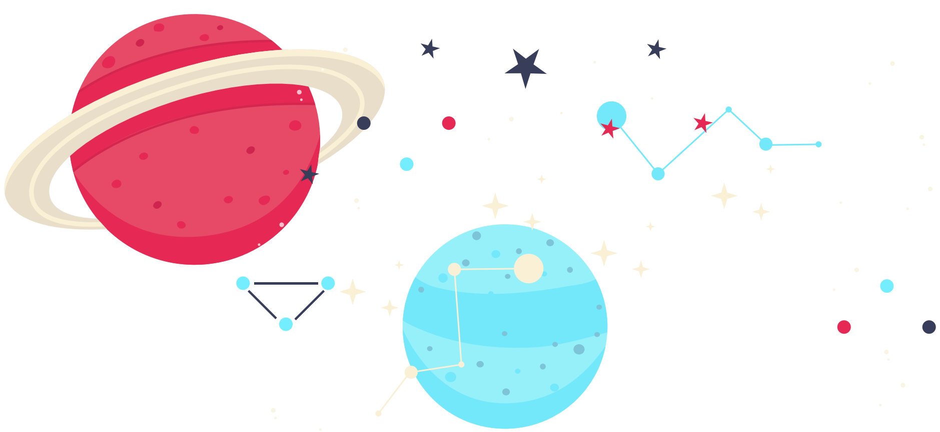
The Pay Business Is Really People Business.

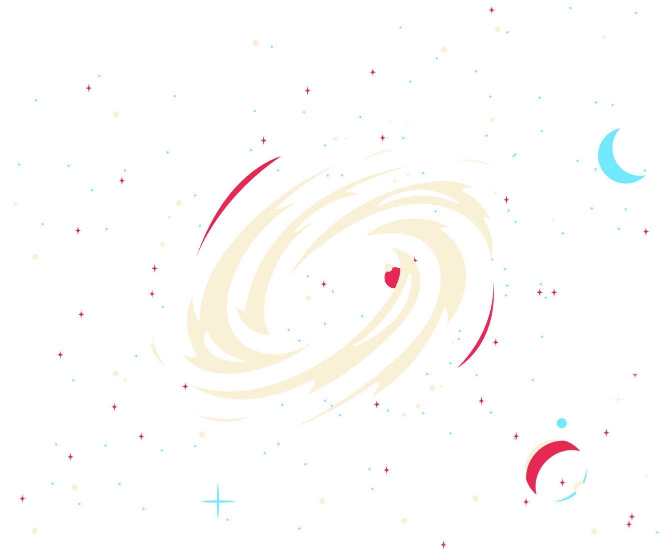
TRANSPARENT
Tell them the truth.

FAIR
Pay them right.

MODERN
Comp for today and tomorrow.

The best organizations use compensation to communicate their values, align their employees, and drive results — tangible and intangible — for years to come. They show their values in their budgets by providing **transparent, fair** and **modern** compensation strategies.





That's why we built the best compensation data and technology on the market.

We are the change agent that seeks to transform comp, to pull it out of the shadows and into the future, where people know their worth, transparency fosters trust and employers know that paying people right is good business. We're armed with data that's strong and continually improving. Our products are people-centric, built to help organizations excel.

Our mission is clear. Bring pay forward.

We want to help you bring pay forward in your organization to thrive in 2020 and beyond. Let's get to work.

ABOUT PAYSCALE

PayScale offers modern compensation software and the most precise, real-time data-driven insights for employees and employers alike. Thousands of organizations, from small businesses to Fortune 500 companies, use PayScale products to power pay decisions for millions of employees.

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PayScale on Twitter: http://twitter.com/payscale

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