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# Driving Compensation Strategy Alignment: Using Analytics to Benchmark Practices from European Normative Data

Rewards constitute a significant investment for all organizations. Thus, it is important to strategically leverage this key investment most effectively. This includes formalizing rewards programs to help drive employee attraction, retention and behavior — all of which, in turn, drive business objectives. However, such strategy most often is informed by informal or qualitative evidence (e.g., relying on surveys) to benchmark practices.

This article offers an objective approach to investigate differences in practice from norms and inform areas of focus. It uses a unique application of predictive analytics to measure strategies for employee rewards at a country level, taking advantage of incumbent-level data collected for pricing jobs. Statistical tests can then assess how a company's strategy varies from the country norm.

Key differences are shared across a set of European countries, and a blinded example illustrates the value of looking to company-specific differences. From the latter, important insights related to compensation imperatives are emphasized, including the:

- Extent to which organizations pay for performance

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- Value of general versus company-specific experience
- Degree to which pay differs by gender after accounting for other relevant factors.

Steps companies can take to generate related insights from archival, employee-level data also are highlighted.

## METHODOLOGY: APPLYING PREDICTIVE ANALYTICS

Mercer collects extensive data to help organizations benchmark pay rates and other aspects of the rewards package. Data on thousands of companies is maintained in the firm's "Total Remuneration Survey." To date, the use of this data primarily has been for benchmarking: to understand typical pay outcomes in an appropriately defined market or for a given role. This helps companies track what happens outside their walls.

Mercer also has engaged with organizations to drive workforce strategy from hard data, using predictive analytics to analyze administrative information stored in their Human Resource Information Systems (HRIS) and related platforms. The intent of this work is to understand which employee experiences or contributions the organization actually rewards through pay and progression. It is also possible to measure how employees value different aspects of the employment experience through parallel analysis of employee engagement and retention.

For more than 20 years, Mercer has proven predictive models to be highly effective in helping organizations understand how practices play out on the ground. This type of analysis looks at what happens inside an organization, addressing the effectiveness of an organization's programs relative to its unique priorities.

The structure of the survey data allows for the marriage of these two approaches, applying predictive analytics to assess compensation philosophies at an economy-wide level, leveraging employee-level data across thousands of companies. Further, it can be used to drill down on differences between economy-wide practices and those of a specific company.

In summary, the analysis can compare typical practices outside the organization with what occurs inside it, and from that, focus on what appear to be alignments or misalignments with desired practice. For example, when looking at an organization focused on pay for performance, a relatively weak association between pay and above-average performance would recommend deeper-dive examination and, potentially, programmatic changes.

The analysis presented in this article is based on extensive incumbent-level data for seven European countries and encompasses approximately 640,000 employees across 1,750 organizations in 2012. (Note: More recent data are used to support the investigation of specific issues posed by Mercer clients.) The predictive algorithm is a linear regression for each country to identify economy-wide drivers of total cash compensation (TCC) (i.e., base pay rate plus, where applicable, the most recent bonus).

Furthermore, the analysis tested for organizational differences from economy-wide effects related to each explanatory factor in Mercer's model by using "interaction terms." Interaction terms allow Mercer to estimate, for a given company, a separate effect related to each variable in the model. Furthermore, interaction terms provide the opportunity to test the statistical significance of each difference from the economy-wide norm. The method provides for greater statistical power in identifying differences when such interaction terms are considered one at a time, especially in the case where a given company has a small number of employees.

All models account for basic items to address a critical set of issues:

- **Age and tenure.** In comparing these effects, the analysis can assess, on a relative basis, whether the organization is more focused on general experience (proxied by age, once tenure is taken into account) or firm-specific experience. Essentially, the analysis assesses whether the organization is more focused on paying for outside experience or building and retaining home-grown talent.
- **Gender.** The analysis can identify whether the organization is at risk with regard to pay equity.
- **Pay for performance.** The analysis identifies employees who have received an above-average bonus (which proxies for having achieved an above-average performance level) in the most recent year. This explores the relative strength of the organization's pay-for-performance practice.

Models also include factors not detailed in this article, including:

- The class of the job based on Mercer's International Position Evaluation (IPE) methodology, to consistently account for differences in career levels between jobs
- The location in which the employee works, to account for differences in pay across markets
- Organization-specific effects, to account for differences in pay-to-market philosophies that generally transcend industry affiliation.

The goal is to continually tap the Mercer data to help organizations be more strategic in setting compensation policies.

## CAVEATS: SELECTION AND CAUSATION

Two important caveats are an issue for any use of such data. First, as is typically the case with survey data, the sample is not random; therefore, it is not fully representative of an economy. Organizations select whether to provide data to Mercer and, furthermore, whether to provide data for all of their employees in a country. Figure 1 on page 42 provides information on the size of participating organizations and their representation across countries and industries for the reader's consideration.

Second, the models presented in this article cannot account for a high level of organizational specificity. For example, similar models run at the organizational

**FIGURE 1** **Organization Demographics**

This figure represents the distribution of industries within countries included in the dataset used for the analysis. This article focuses on the United Kingdom's economy as an example.

| Industry | Distribution: Finland, France, Germany, Italy, Sweden, Switzerland | Distribution: United Kingdom |
|---|---|---|
| Durable | 29.6% | 26.2% |
| Consumer Goods | 23.5% | 24.0% |
| Nondurable (excluding Consumer Goods) | 13.3% | 9.7% |
| High-Tech | 8.3% | 7.0% |
| Services | 6.4% | 10.5% |
| Retail/Wholesale Trade | 3.6% | 4.9% |
| Energy | 2.4% | 4.3% |
| Insurance | 0.8% | 0.5% |
| Finance/Banking | 0.7% | 1.6% |
| Other | 11.5% | 11.3% |

level to address gender pay equity would account for actual pay grades (which, of course, vary greatly across organizations), performance rating histories, job histories and other differentiating information about an employee's role. While the analysis presented in this article is a useful starting point to raise areas of concern and jump-start a strategy discussion, the authors recommend that it be followed by a more detailed analysis that relies on a company's own, more detailed workforce data.

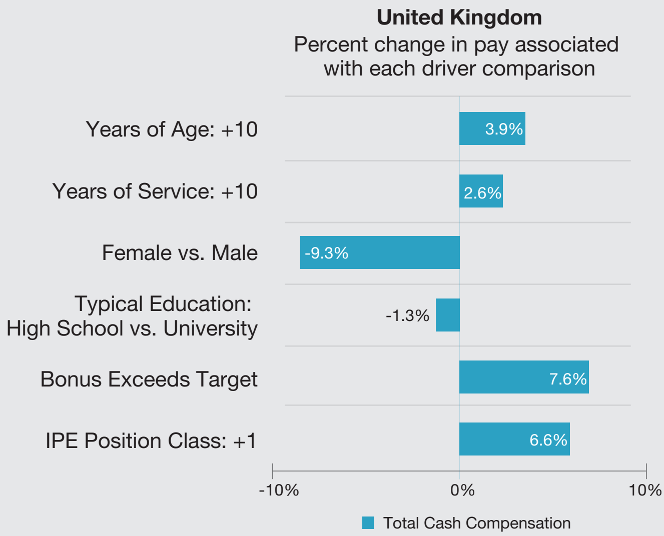
## ECONOMY-WIDE RESULTS

The analysis focuses on seven countries: Finland, France, Germany, Italy, Sweden, Switzerland and the United Kingdom. First, consider the results from the United Kingdom in order to focus on the results of one economy before placing the results in the context of other economies.

### Relative Value of General Experience vs. Company-Specific Experience in the Economy

As an economy, the United Kingdom generally appears to modestly value both general and company-specific experience, though there is a tilt toward valuing general experience more so than firm-specific knowledge. Every 10 years of additional general experience, proxied by age, is associated with a 3.9% higher TCC. Compare this to the same amount of firm-specific experience, proxied by tenure, which is associated with only a 2.6% increase in TCC. This is all

**FIGURE 2** Pay Drivers in the United Kingdom




The bars show the effects of various drivers on TCC. For example, in the United Kingdom, 10 years of additional general experience (proxied by age) is associated with a 3.9% increase in TCC, after controlling for factors such as years of service, Mercer IPE "position class" (a consistent, cross-company leveling variable) and educational attainment.

N=81,068, reflecting 325 companies

after controlling for other relevant pay-related factors (e.g., job size, job family, educational attainment, geographic location).

### Extent to Which Women Are Falling Behind on Pay

There is potentially a significant gap. Women appear to be paid 9.3% less than men who are in similar jobs and locations, with similar educational attainment and experience. There may be additional legitimate factors within each organization that can explain some of this disparity. However, the size of the gap is concerning (relative to past research using similar methodologies at the country level) and suggests an economy-wide issue.

### Extent to Which Performance Is Rewarded

As an economy, the United Kingdom tends to pay for performance. An employee whose bonus exceeds his/her target (a proxy of a high performer) is paid better on TCC by 7.6%, on average, after controlling for other relevant factors.

Putting these findings for the United Kingdom in the context of other nearby economies, there are some important points of distinction. (See Figure 2.)

Specifically, the analysis reveals that the United Kingdom:

- Values firm-specific experience more highly relative to general experience than other countries examined
- Has a larger, unexplained gender gap
- Pays significantly more for performance than the other countries examined.

**FIGURE 3** **Percent Change in TCC Associated with Each Driver Comparison**

| Driver comparison | Finland | France | Germany | Italy | Sweden | Switzerland | United Kingdom |
|---|---|---|---|---|---|---|---|
| Years of Age: +10 years (general experience) | 5.7% | 8.1% | 5.4% | 9.5% | 4.4% | 6.8% | 3.9% |
| Years of Service: +10 years (firm-specific experience) | N/S | 1.0% | 2.6% | -1.3% | -0.4% | 0.7% | 2.6% |
| Female vs. Male | -6.1% | -4.1% | -6.7% | -3.4% | -4.1% | -5.8% | -9.3% |
| Bonus exceeds target (performance) | 5.9% | 6.2% | 5.7% | 7.3% | 7.0% | 6.7% | 7.6% |

A comparison of the drivers of pay, TCC, across seven European economies. "N/S" implies an effect is not statistically significant at conventional levels.

N=637,844, reflecting 1,753 organizations.

Interestingly, similar analyses looking at IT employees in India show much greater value than any of these countries linked to general experience, and significant negativity associated with years of service. In India's IT sector, which has been rapidly developing, employees who sit still are penalized.

## COMPANY SPECIFIC FINDINGS: IMPLICATIONS FOR STRATEGY

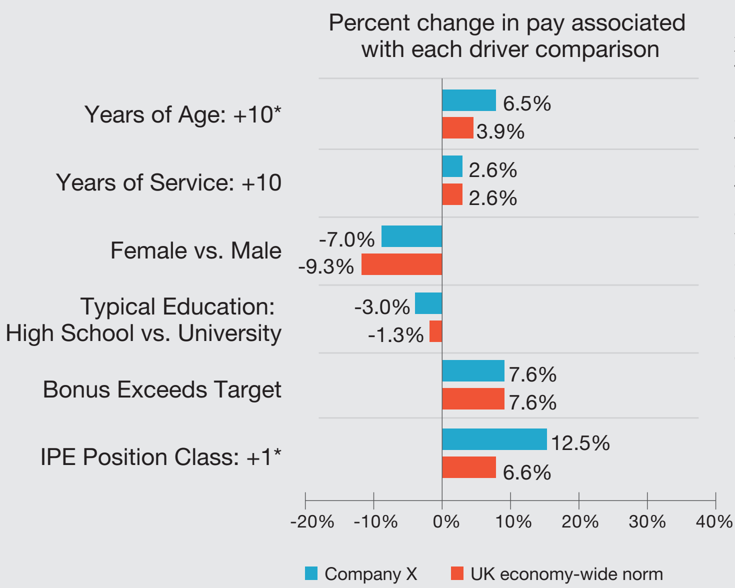
Consider analysis for Company X (Figure 4), a multinational consumer goods organization with headquarters in the United States and more than 100,000 employees globally. Here, the focus is on results for Company X's less than 5,000 UK employees and relevant strategy questions:

1 | **Focus.** General experience, proxied by age, is paid 66 percent more at Company X (6.5% vs. 3.9% for every 10 years in the UK), making it almost three times more valuable than firm-specific experience. Strategy question: Should Company X be more focused on paying a premium for outside experience than its local peers?

2 | **Pay equity.** Women are less underpaid at Company X than they are in the average UK economy, but there remains a significant difference that is concerning. Strategy question: Can Company X improve the value proposition to its female talent and act to minimize compliance risk by engaging in pay equity review?

3 | **Pay for performance.** Pay is rewarded highly, but is on par with other companies in the United Kingdom.

**FIGURE 4** Company X vs. UK Norms




Pay drivers for Company X in comparison to the United Kingdom. Percentage increases are after controlling for factors such as years of service, IPE position class (a consistent, cross-company leveling variable) and educational attainment. The asterisk (*) next to a factor indicates that the effect is statistically significantly different from the norm.

Strategy question: How strongly should pay vary with current-year performance? How should pay-for-performance sensitivity vary across key workforce segments?

## USING ANALYTICS TO GAIN A DEEPER VIEW

Organizations can gain great value from using predictive analytics to assess how their rewards practices play out and, from that, in questioning whether those practices are optimized. Data once solely used for benchmarking pay levels can now be used, leveraging predictive analytics, to benchmark the efficacy of practices. Furthermore, data that sits in the HRIS and supporting systems can be harnessed to support more thorough diagnostics. Indeed, an increasing number of organizations are tapping into the value of such data to support fact-based compensation strategies.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