

The Modern Approach to Managing Compensation for Strategic Near Shoring Locations

A McLagan White Paper

June 2016

Introduction

Cost of labor does not always align to the cost of living.

0%

pay differential between IT professional level salaries in Dallas, Houston, and Chicago.

Skills drive compensation.

≤ 10%

pay differential across locations for the manager level Architecture Role.

**Think local.
Act local.**

- ✓ Local market data
- ✓ Local compensation strategies
- ✓ Local peer group perspective of the industry

In recent years financial services firms have increased their focus on deployment of their workforce to strategic near shoring locations to help manage compensation and other expenses. As a result of exponential growth of the near shoring centers and increased competition from industries outside of financial services, firms have been facing new challenges in managing pay for support staff and applying regional differentials appropriately.

Traditionally, firms have relied primarily on cost of living differentials as a way to manage pay for regional locations. In practice, firms would traditionally use national market data in order to set salary / compensation structure and adjust based on the cost of living of identified locations. This approach is one of the most common pitfalls in managing pay for these locations as cost of living is not always aligned to local market pay.

Our experience shows that firms often fall into several traps with their regional pay practices - our data highlights the drivers that influence local pay dynamics and we offer a more modern approach on how firms can evolve their back office pay programs for their strategic near shoring locations. As our clients face these and many other challenges, we help firms answer questions like:

- “How do we develop and manage near shoring location specific reward pay and policies programs?”
- “How do we remain competitive with other industries to attract and retain talent?”
- “How do we develop structure around our strategic deployment workforce plan to manage cost and productivity?”

Pitfalls to Avoid: Myths in Managing Regional Pay

Myth 1: Utilizing discounts / premiums to national data aligns you to location specific market data

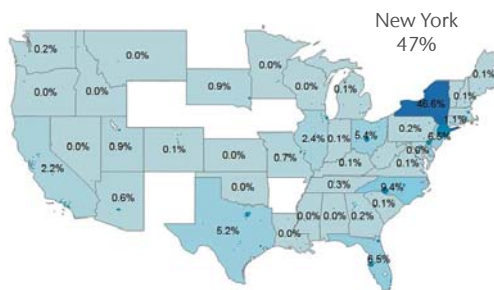
Country data is comprised of data from all cities (both high and low cost) across the country, and applying discounts / premiums to this would have different results based on a functions footprint.

In the past this approach worked well because the market headcount was Metro New York centric and it was easy to manage a common regional pay differential approach across functions. However, recent initiatives to move jobs to near shore locations have changed the location mix by division / function for many firms, which makes it difficult for compensation professionals to determine regional differentials that align the national data with local market pay. National results are already partially discounted as a result of diverse footprint.

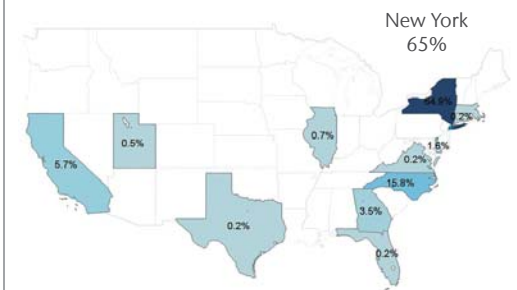
From an administrative perspective, it is becoming complex for compensation professionals to evaluate the national data at a role / job level while considering all the factors that might impact local pay. Moreover, the continued expansion of near shoring centers changes the location mix often which will result in re-evaluating the regional differentials on a regular basis. 2014 large bank headcount distribution analysis shows that the location mix varies considerably by function. Treasury and Finance headcount remain to be Metro New York centric with approximately 50% or more headcount based out of New York, where as IT and Operations headcount is spread across US states.

Large Banks 2014 Headcount Distribution by State and City

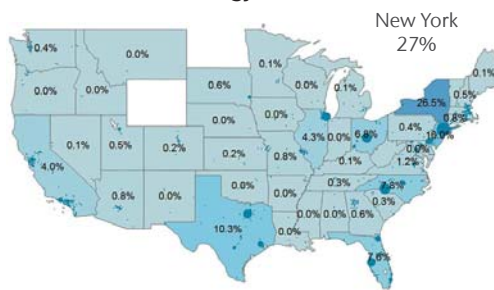
Finance



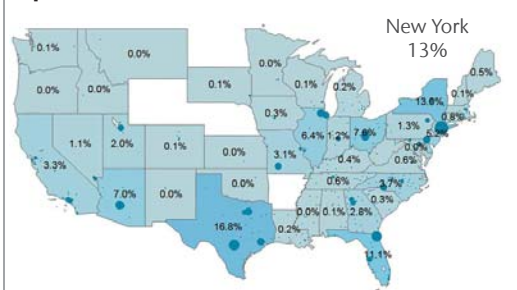
Treasury



Information Technology



Operations

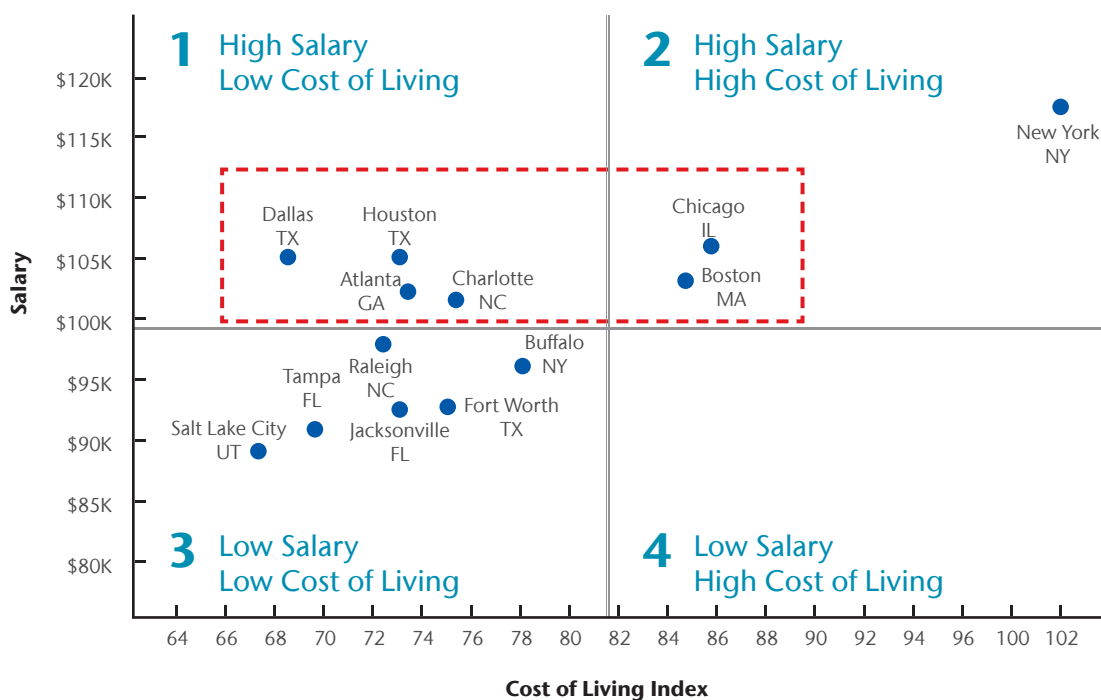


Myth 2: Regional differentials are mainly driven by cost of living

When we analyzed Information Technology Intermediate Professional salaries across major US cities, we found that cost of living was not well aligned to local market pay. Salaries in lower cost of living cities like Houston, Dallas, Charlotte, and Atlanta was on par with higher cost of living cities like Boston and Chicago. If cost of living was well aligned to pay, we would expect cities with high salary and low cost of living to fall under the category of low salary and low cost of living.

Salary vs. Cost of Living by City for Intermediate Professional Staff in IT

All participants



Key Drivers That Influence Regional Pay

Skill and talent availability

Discrete jobs pay is primarily driven by skills required. For example, analysis of Architecture jobs within the Information Technology division shows that manager level salaries are closely aligned across locations irrespective of cost of living with only single digit premiums / discounts to Metro New York.

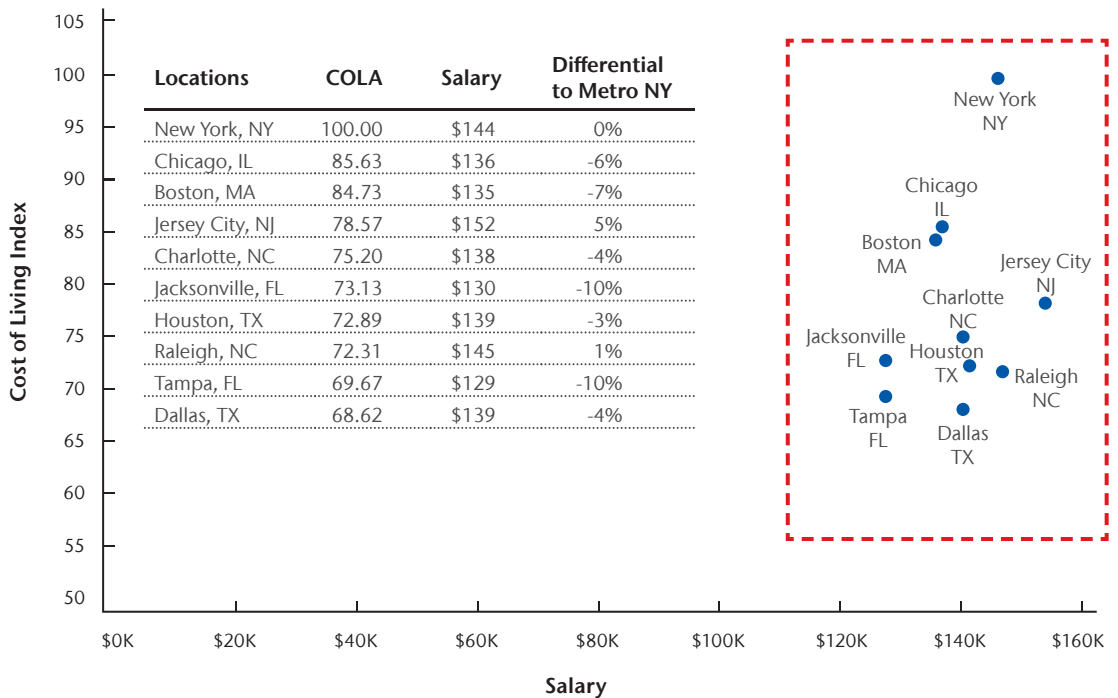
Even more, the availability of talent with the knowledge of specific regulatory requirements of the financial industry often leads to premiums in the market. We've seen evidence of this in hot areas like CCAR, Audit, and Compliance - these are key areas that often receive premiums over other roles in an organization.



"Required job skills and industry knowledge can be an influential driver of pay, leading to premiums across regions."

Salary Analysis by City for IT - Architecture Job - Manager Level

All Participant



Job level

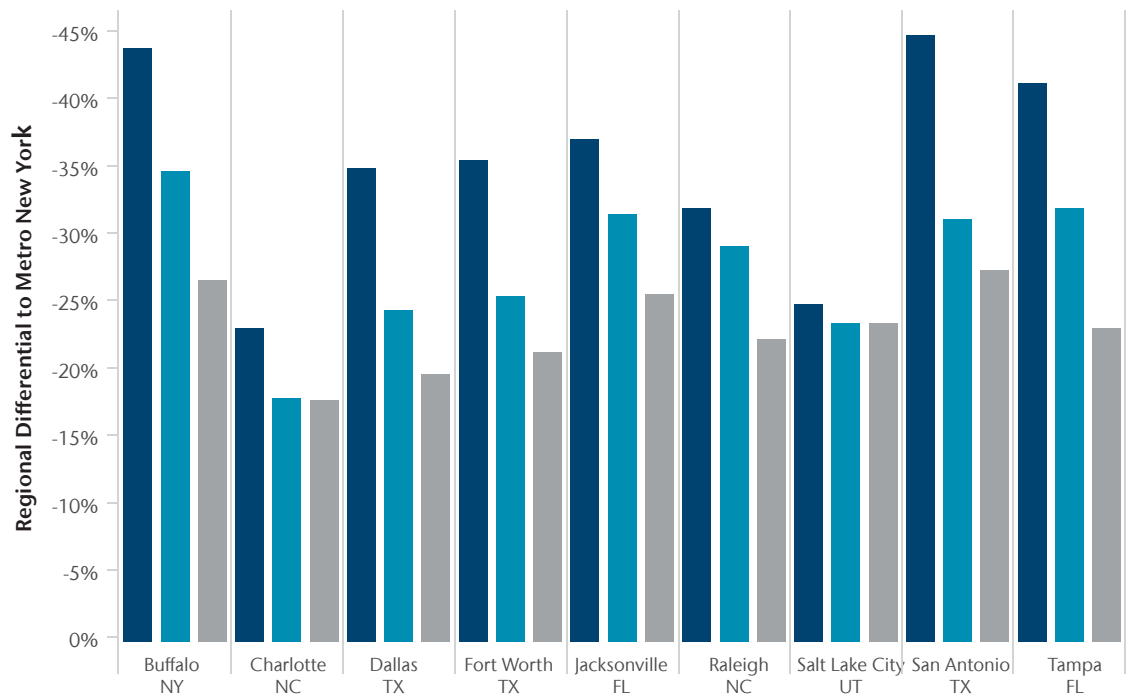
Regional pay differentials are directly proportional to job level. Junior Professionals see the highest regional pay differential to Metro New York and with seniority the regional pay differential reduces. This is evident where we have analyzed the operations regional pay differential against Metro New York. Junior Professionals see the highest regional pay differential followed by Intermediate and Senior Professional.

We believe that senior position pay is driven by scope and size of the business they manage while intermediate / junior positions are mainly driven by location and other factors discussed in this paper.

Operations Function Salary Regional Pay Differentials to Metro New York by Location and Level

All Participant

■ Junior Professional ■ Intermediate Professional ■ Senior Professional

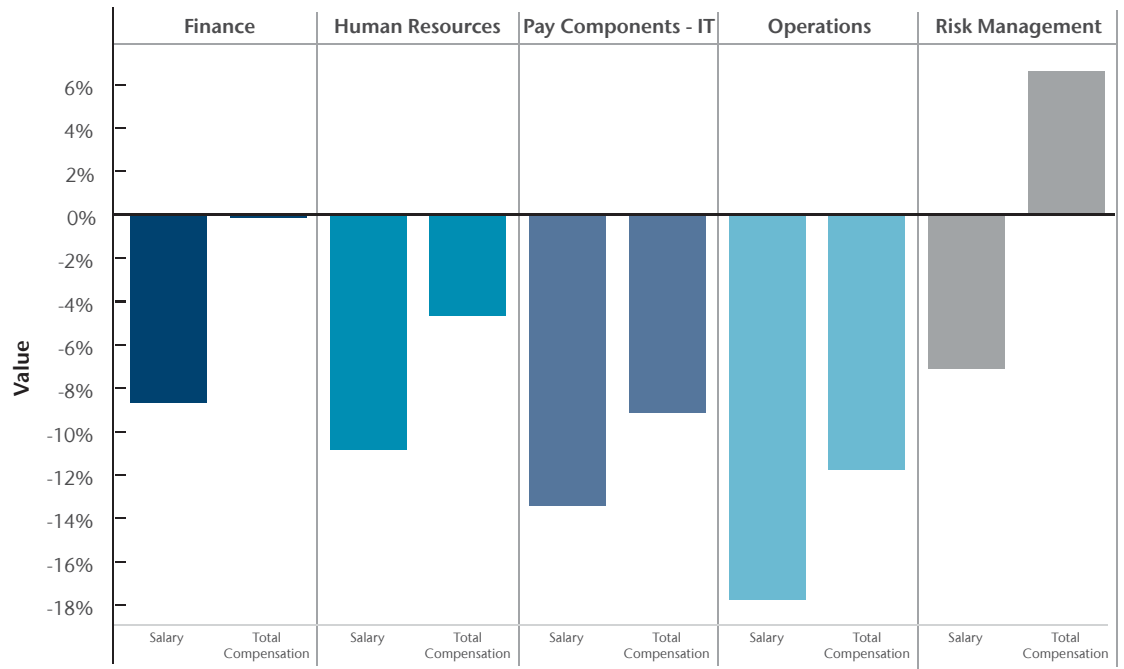


Components of pay

Every firm has their own compensation philosophy and strategy with some evaluating themselves by total compensation and others by salary. While evaluating the regional pay differential, looking at all components is important as looking at only salaries might be misleading. In Charlotte, salary level data is discounted to Metro New York across all infrastructure functions, while the story differs by total compensation. Firms are paying a premium for Risk Management functions and are at par for Finance when compared to Metro New York.

Charlotte Total Compensation and Salary Differential to Metro New York at Intermediate Professional Level

All Participant



The Modern Approach: The Constant Evolution of Financial Industry Back Office Broad Based Compensation

In recent years firms have increased their focus on near shoring initiatives to help reduce cost, but this has not been easy given the added complexities of effectively managing support staff compensation. As a result of the above dynamics, firms are essentially creating new markets within countries that require firms to be flexible in how they manage compensation, which may include developing new compensation strategies / policies for strategic near shoring locations.

We recommend that firms should move away from only evaluating market data at a country level and instead evaluate market data at the Metropolitan Statistical Area level (MSA). This approach would help firms get an accurate perspective of the local market. In addition to benchmarking to a local market, firms should also consider developing specific budgets or compensation policies for these markets. Near shoring locations often have different competitors / industries (compared to hub locations) and firms should align their compensation strategy to these competitors to increase their attractiveness to potential employees. These strategies may include different salary budgets, different variable compensation policies, and different salary ranges / structures.

Support Staff Pay – Key Considerations



Key Considerations for Support Staff Pay

Focus	Traditional	Current	Modern / Future
Geography	Country	Country	Metropolitan Statistical Area (MSA)
Peer Group	Business and Industry Aligned Firms	Business and Industry Aligned Firms	Job and MSA Aligned Firms
Compensation Philosophies / Strategies	One Country One Market	Regional Discounts COLA Driven Country Level Salary Structures	Driven by Local Markets and Competitors

We're here to empower results

Prior to starting any client engagement we partner with our clients to ensure we understand their final goal and understand any potential barriers they may face. In order for us to provide the clients with a holistic approach to regional salary management we would leverage both our internal data bases as well as collecting qualitative data for the appropriate peer groups.

We provide location specific survey reporting

Benchmarking done based off specific Metropolitan Statistical Area (MSA) with a defined peer group appropriate for selected locations. We can assist in development of location specific salary structures and compensation policies.

Our regional pay differential report is market driven

Report reflecting pay differentials by function and level across various locations.

Our analysis is cross industry

Conduct compensation benchmarking across multiple industries to insure local competitive market is properly identified. Analysis would be normalized to align functions and levels as needed.

McLagan has the ability to provide normalized reporting

All reporting can be customized / normalized to reflect firms reporting structure and leveling.

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About McLagan

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