How to determine pay raises for employees in 2022

The new year often brings a new budget, new goals, and in some states a new minimum wage. That means it's a great time to start thinking about pay raises.

Pay raises are particularly important going into 2022 as turnover rates continue to soar. Employees put off job-hopping during the height of the pandemic, but now, as they begin to resume the effort, they are acutely aware of how much they're worth and what they want from an employer now. Employees that feel undervalued or underpaid will not stick around long, so do your best to provide annual salary raises.

How to determine pay raises

There are a number of ways to go about determining which employees should get a pay increase and how large that increase should be.

Pay raises can be given as:

- An hourly wage increase.
- A salary increase of a specific dollar amount distributed across pay periods. For example, an employee earning 50,000 may receive a $2,500 pay increase resulting in approximately an extra $96.15 pre-tax per biweekly paycheck.
- A salary increase with a chosen percent pay increase. 2.5-3% is an average salary increase in many sectors, including the government sector where federal employees will receive a base pay increase of 2.7% in 2022. In more competitive private sector fields 3-5% may be more fitting. Due to inflation and labor shortages, the average private-sector salary increase is expected to be 3.9% for 2022.

Which one of the above you should choose will depend on the employment type and which factors you choose to determine whether an employee will receive a pay raise. Here are some common options for determining when to give raises.

Company performance and funding

Bonuses are often tied to company performance, as companies may be unable to pay out end-of-year bonuses during unprofitable years, but company performance may also be a factor in pay raises. This is particularly true for start-ups or smaller companies.

Many start-ups wait until after major funding rounds to give pay raises. Often raises are given for the first time

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after the first successful funding round or major investor acquisition. While it's not ideal to wait, this can be a way to ensure that the company can afford large-scale pay raises.

Performance reviews

One of the most common factors that raises are tied to is performance reviews. Many employers grant their annual raises during or after employee performance review meetings. Employees that obtained satisfactory or above reviews typically will earn a pay raise for the year.

This approach is a classic and practical one. It incentivizes employees to work hard and attain results. It also allows you to reward and recognize your highest achievers. When tied to performance reviews, a pay raise feels like a form of recognition or reward, rather than an automatic process as it may with inflation raises.

There are, however, some concerns with tying compensation to performance reviews as it can make the performance review process a higher-pressure and less collaborative experience for employees. Employees may feel less comfortable offering honest feedback if they worry that it may hurt their chance of getting a raise.

Time with the company

Rewarding performance is important, but you may also want to reward loyalty. According to the Bureau of Labor Statistics Employee Tenure Report, the average employee has been with their employer for 4.1 years. While it was once common to stay with one employee for the majority of one's career, employees tend to move around more frequently now.

Some employers provide PTO based on length of service, providing employees extra weeks of PTO when they reach milestones such as 5 or 10 years with the company. Providing pay raises at significant milestones is also a great way to show appreciation to long-term employees. It's no longer expected to remain with one employer for 5 years, so try to give employees a pay bump to show your appreciation at significant milestones, especially if additional PTO is not offered for longer lengths of service with your company.

Compensation benchmarking

Compensation benchmarking involves researching trends and averages for your region and industry and comparing them to your organization's compensation data. The purpose of this exercise is to understand whether you are paying employees below or above average in relation to employees with similar duties and skills in similar locations and companies.

If you find that you are providing average pay or competitive pay, you should still give out some pay raises, but they may be modest. If you find that some or all of your employees are being paid lower than average, you'll want to give larger pay raises (if the budget allows) to try to get them close to average. Employees will eventually realize, if they haven't already, that they are being paid below average and could earn more by switching to a different company, so try to make pay adjustments prior to this happening.

Inflation

Some companies give small pay raises across the board each year to account for inflation and changes in the cost of living. The raise is generally a percentage increase that is equal to the rate of inflation.

Cost-of-living adjustments (COLA) are another option. The federal government uses COLAs to provide a small increase to benefits such as SSI and SSDI so that recipients have the same buying power year-to-year. Some private companies also use this model to increase salaries.

Market conditions and labor scarcity

When you're in a labor shortage, such as the one going on right now, you'll want to be more generous with your pay raises in order to encourage employees to stay.

Factor in how difficult it would be to replace an employee, including how scarce their specific skill set is. It can be quite expensive to hire and train a new employee, so employers are often better off providing larger pay raises to keep employees satisfied. Often skill scarcity comes into play with specialized STEM fields and job roles. However, right now service and food industries are also experiencing a huge labor shortage. As such, many major companies have had to raise their pay rates to attract and retain staff.

You also may need to provide a pay raise in order to retain employees that get another offer. These pay raises will be unpredictable compared to normal annual pay raises.

Pay adjustments for minimum wage

The minimum raise is set to rise in 2022 in 26 states. If you employ low level hourly workers, look at their hourly wages and ensure they are compliant. Even if they are making above minimum wage right now and you are not legally required to offer a pay increase, an increase in the minimum wage will change what is considered a competitive or appropriate pay rate.

If an office assistant was hired at several dollars above minimum wage but is now only slightly above minimum wage due to yearly increases in the minimum, they may feel undervalued. Even though their pay hasn't necessarily changed, their wage in relation to the minimum wage has changed. Lawmakers in several states have approved gradual minimum increases over the course of several years, so be sure to check on this at the start of every new year.

Keep Your Pay Raise Processes Fair

Large companies sometimes pick one or more of the above factors and create a standardized process or formula for determining pay raises. This is ideal as it keeps things fair across the board. When the pay raise process is informal, there can be discrepancies due to favoritism, implicit bias, or simply due to some employees not asking for as much or negotiating as well.

It’s a good idea for the HR department to conduct their own compensation benchmarking and compensation analysis. The compensation benchmarking will verify that your employees are being paid around the appropriate market rate. If you are paying your employees significantly below the going market rate, or the market has shifted and employees in similar roles have experienced significant wage growth since you last performed benchmarking, employees are likely to be tempted to leave in order to secure a higher salary at one of your competitors.

Compensation analysis should be done before and after pay raises. You should look at how your employees are being paid in relation to one another to look for any patterns that suggest diversity, inclusion, and equity concern. For example, you’ll want to compare how women in your company are being paid to the compensation of men with similar job titles in your company. It’s also helpful to conduct analysis after pay raises to check that the average raise and average pay are similar across different demographics including gender and race. If the average increase was lower for women or POC than for men or white employees, you may need to dive deeper into the analysis and course correct.

Pay raises should be a fair and positive experience for all parties. While employees may not want to pay more, the investment is worthwhile as a pay raise can encourage higher retention rates, employee satisfaction, and incentivize employees to work hard to earn a raise again next year.

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