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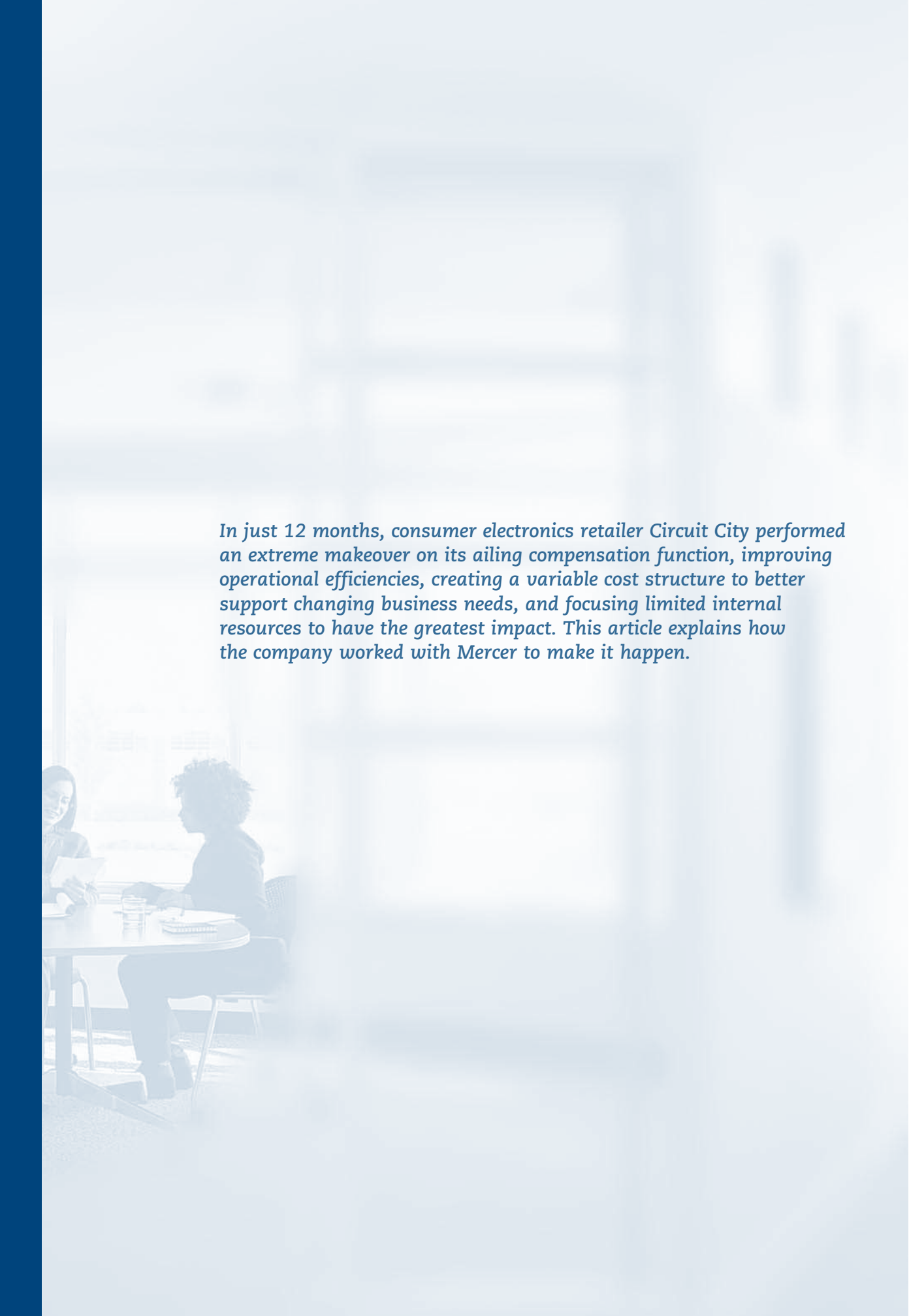
MARSH MERCER KROLL
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The challenge of change

Transforming business through
better human capital management



Consulting. Outsourcing. Investments.



In just 12 months, consumer electronics retailer Circuit City performed an extreme makeover on its ailing compensation function, improving operational efficiencies, creating a variable cost structure to better support changing business needs, and focusing limited internal resources to have the greatest impact. This article explains how the company worked with Mercer to make it happen.

Tactical to strategic in 12 months: A compensation management co-sourcing success story



By Susan Haberman, David J. Hilborn and Mark Oliver

It all started on the back of a napkin. Mark Oliver, at the time head of compensation for consumer electronics retail giant Circuit City, had recently inherited an ailing corporate compensation function, and was describing the myriad challenges he faced to HR consultants from Mercer.

Circuit City needed to align its compensation function with a rapidly transforming business, which had expanded to include multiple distribution channels – each with its own unique needs: bricks and mortar; online and call center retail; and the new, rapidly growing *fire dog*SM home technology services division. From a compensation perspective, the company needed to react more quickly to market shifts, paying competitively and securing the right talent for its evolving business strategy.

Aggressive timeline

Oliver had one year to develop a flexible, sustainable compensation function that could support each of Circuit City's distribution channels and be both cost-effective and relevant whether the consumer electronics market was up or down. Oliver needed a model that would:

- Streamline compensation processes
- Get accurate data to internal business partners more quickly and efficiently
- Enable the compensation group to partner more closely with the business

Ideally, Circuit City's corporate compensation team would act as strategic consultants for the organization's managers, providing up-to-date data and tools that would help line managers make effective reward decisions.

'Chewing gum and baling wire'

When Oliver started the process, the existing compensation function was an overstressed and overworked transaction shop that was unable to operate in a consultative capacity for its internal clients. Driven by changes at the senior HR level, reduced budgets and a culture of do-it-yourself, the compensation function was plagued by lack of staff, gaps in critical skills, weak data and woefully inadequate technology.

According to Oliver, "Our technology was equivalent to chewing gum and baling wire. We were tracking data manually, using Access databases and archived Excel files, paper printouts and calculators." In contrast, other functions in the business were using current technology to drive business results.

Internal inequities

To complicate matters, two years earlier Circuit City had introduced an internally driven salary system, placing higher value on jobs that directly drove revenue versus those that provided internal support. On the face of it, this made good sense. But the model would break down when one support group was able to convince the compensation team that it



drove business results and was worth significantly more than other support groups like IT or HR. Consequently, some jobs were priced above market and others below market.

It didn't take long for Circuit City associates to spot the inequities, which severely damaged the integrity of the system.

Blueprint on a napkin

While Oliver's dinner companions from Mercer were listening to all this, they started to work on the napkin. This napkin became the rough blueprint for Circuit City's compensation function. Oliver needed built-in sustainability and flexibility – a scalable compensation function that could move with and adapt to the organization's ever-changing needs. He wanted:

- An internal team of compensation consultants aligned with Circuit City's distribution channels (stores, Web, call center and technology services)
- Readily available data and analytical tools the team could use to advise their internal business partners
- Built-in variability around costs, allowing Circuit City to use extra compensation resources when necessary and not pay for them when they weren't needed
- Sustainable capacity to allow for ongoing, strategic consulting rather than reactive, transactional work, and the ability to keep the compensation function running smoothly even in cases of high turnover

The blueprint on that dinner napkin formed the basis for Circuit City's compensation operating model, which needed to address four key areas:

- **Scope and level of service:** What services would compensation provide?
- **Sourcing:** Who would do the work?
- **Infrastructure:** How should Circuit City set up people, processes, technology and infrastructure to handle the compensation work?
- **Governance:** How should the compensation function be led and how should its investments be managed?

Aligning business and compensation strategies

Circuit City approached the redesign of its compensation function with the end goal in mind, focusing first on how the compensation function and its human capital strategy could help drive business results. These questions were key to setting the redesign plan in motion:

- What must I do from a people perspective to have an impact on the business strategy?
- How should I pay my people to drive the business strategy?

As Circuit City's business strategy shifted in response to marketplace changes, the compensation function needed to be flexible enough to support these shifts. The company needed to address how it would secure, manage and motivate a workforce that could execute the business strategy – and how it should pay its people to drive that strategy.

Business direction drives compensation

Circuit City's new *firedog*SM home technology services division raised questions about which skills, competencies and incentives would be necessary to make this business work. Suddenly, the company needed to hire skill sets that were new to the industry, such as design consultants who visited customers' homes to plan and customize home theater systems. And this wasn't the only business line that was changing.

Similarly, as Circuit City focused more heavily on customer service, the compensation function needed to support this shift by making compensation

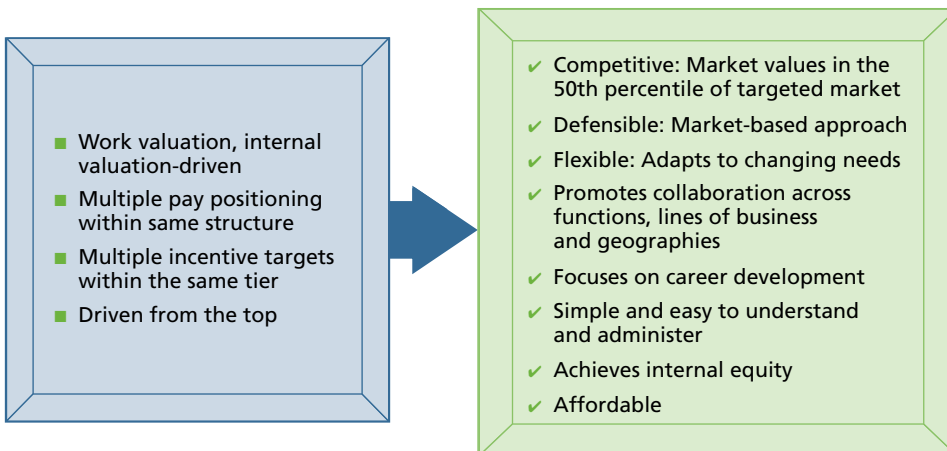
simpler and easier to execute in a complicated retail environment. It became increasingly important for store managers to stay on the sales floor driving customer service rather than being in the back office administering pay. And because so many store managers were new and relatively inexperienced with compensation, Circuit City wanted to provide a pay system that was simple to understand and easy to communicate to its employees.

Business-focused pay

Circuit City designed its new base pay system to support these business objectives, reflecting a drastic shift in philosophy and practice. (See Exhibit 1.)

Exhibit 1

Circuit City new salary structure



Is compensation management co-sourcing right for your company?

Compensation management co-sourcing could be a good solution for your organization if you check most of these boxes:

- Your compensation staff spends too much time on transactional work, such as market pricing and survey management.
- You currently do not have a compensation management tool to track data, plans and programs, or do not have people trained in using the tool.
- You experience unplanned turnover in your compensation department.
- Your other HR processes have been outsourced or are in the process of reorganizing.
- You do not have enough of the right talent at the right time to support your compensation priorities.

This shift to a market-based approach highlighted the need for current market data and tools that would allow Circuit City's compensation staff to quickly price jobs and analyze cost structures so they could make sound recommendations to their internal business partners.

Co-sourcing as a turnkey solution

Oliver and his team of Mercer consultants mapped out a turnkey, co-sourced solution based on Circuit City's business strategy and Oliver's vision for the compensation function. To support the business strategy, the compensation structure needed to:

- Leverage existing compensation programs and staff
- Provide flexible capacity that could scale to meet the changing needs of the organization, such as a major hiring wave or a layoff
- Offer this flexible, scalable capacity with few fixed costs

The co-sourcing solution gave Circuit City and Mercer simultaneous access to data and technical tools, leveraging resources from both organizations. This approach provided built-in flexibility for costs with the sustainable advantages of an external team that could scale back when not needed and ramp up at a moment's notice when necessary.

Key co-sourcing elements

Collaborating closely, Oliver and the Mercer team developed a co-sourced compensation model that consisted of four critical layers. (See Exhibit 2.)

Working together, these critical layers allowed Circuit City's compensation team to:

- Immediately fill staffing gaps
- Provide scalable capacity to meet the organization's changing needs
- Provide a sustainable compensation function in a constantly shifting retail environment

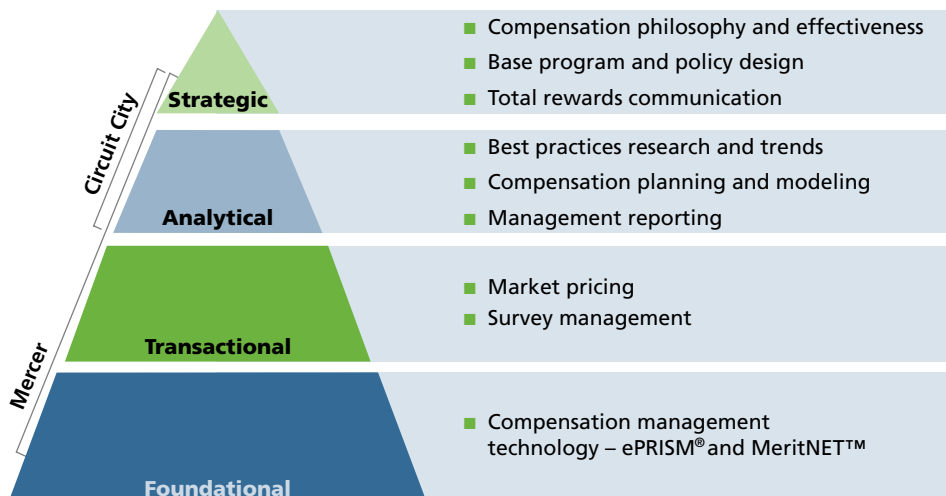
Most important, this model reduced the amount of time the team had to spend on iterative work, freeing them to interact strategically with their internal business partners and function with greater credibility.

Technology as an enabler

Before it could address compensation strategy and program redesign, Circuit City needed to establish a solid foundation of accurate data and efficient technology that would eliminate the administrative burden. The organization needed to benchmark more than 500 jobs and load 25 surveys. To complicate matters, Circuit City had previously downsized its staff when it outsourced some of the transactional work a few years earlier – but it had never stopped doing that work internally. Now the compensation team was doing twice as much work with fewer people – just two for 43,000 employees.

Circuit City was able to eliminate much of the time-consuming, iterative work by implementing state-of-the-art technology to automate compensation management tasks, and by

Exhibit 2
Scope of services





outsourcing the transactional work to its co-sourcing partner. The technology-based foundational layer did two critical things:

- Managed data and performed analytics
- Automated year-end merit transactions

Self-service tools

Two technological tools – Mercer’s ePRISM® and MeritNET™ – were key enablers to the rest of the compensation structure. With ePRISM, compensation staff could quickly and accurately price jobs and model cost and pay structures. MeritNET enabled Circuit City to automate its year-end processes, giving line managers easy access to budgets, historical pay and a user-friendly desktop tool for pay decisions. This tool eliminated the back-and-forth time between line managers and compensation staff and reduced compensation errors.

Together, these foundational technology tools simplified work for Circuit City’s compensation team, freeing them to perform quick analyses and make strategic recommendations based on solid data. Establishing a technology suite for the foundational layer enabled the other layers to function.

Sustainability and flexibility

Having the foundational elements in place made it possible for Circuit City to sustain its function even with high turnover. Because Mercer had simultaneous access to the data in ePRISM, Circuit City was able to plug in well-informed Mercer staff when it needed to ramp up work and remove those variable resources when they weren’t needed.

A key benefit to the co-sourcing model can be found in the top two layers: analytical and strategic. These two

Why invest in compensation?

One of the biggest challenges Oliver faced was convincing Circuit City’s executive management to upgrade the compensation function’s capabilities. As a retailer in a highly competitive environment, Circuit City needed to carefully choose where to invest and where not to invest. Because Oliver connected his vision for compensation execution with the company’s business strategy, he established a solid business case for the value of this change relative to the cost. The co-sourcing model promised drastic improvements in a short period of time with few fixed costs.

What about cost?

Co-sourcing often results in neutral or reduced costs. Many companies can avoid filling open positions or reduce headcount for transactional roles, relying instead on their co-sourcing partners.

Most fixed costs in the co-sourcing model cover technology and, to a great extent, outsourcing, mitigating the need to add analysts and support staff. Variable costs are driven by the level of analytical and strategic consulting services an organization uses.

layers represent the most variable dimension of this compensation structure, allowing Circuit City immediate access to high-value consulting advice when necessary. For example, Circuit City was able to use Mercer resources when it needed to hire for the new *firedog*SM home technology services division. Many of these service-related positions were new to the consumer electronics industry, and Mercer was able to quickly provide benchmark data and best practices to Circuit City as a result of the co-sourcing structure.

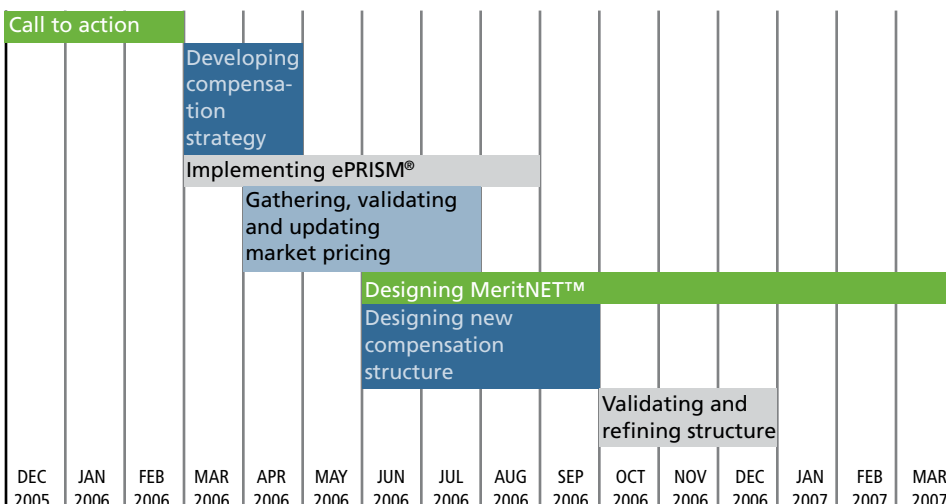
This built-in flexibility and variable cost structure allows Circuit City to consistently provide high-value strategic help to its internal business partners without having to go through staffing fluctuations. Co-sourcing has given Circuit City tremendous bench strength with few fixed costs.

Real-life results

The entire compensation redesign was completed in 12 months, from the initial call to action to the final structural refinements. (See Exhibit 3.) This timeline worked for several reasons:

- Oliver started with a clear vision linked to his company’s business strategy.
- He took the necessary time up front to secure buy-in and support from key executive management – and continued by leading a compensation calibration committee that comprised key executive stakeholders across the organization.
- Circuit City had a solid relationship and good two-way communication with its co-sourcing partner – it could get an immediate response by calling Mercer or by sending questions to a dedicated e-mail address.

Exhibit 3
Implementation timeline



Better credibility, strategic focus

The co-sourcing model drastically improved Circuit City's compensation function, giving the team greater credibility and elevating the function to the level of strategic business partner rather than reactive administrator. In turn, the HR structure has transformed to fit the new compensation model, improving the organization's ability to compete for top talent and making compensation-related integration activity for mergers and acquisitions easier.

Healthier culture

Compensation and career paths are more transparent now that Circuit City is using objective, market-based job valuations. And employees have a better understanding of why they're paid what they're paid. According to Oliver, "The market-based system took away the mystery around compensation and made it a transparent process. It's great to see people focused on their jobs and careers."

Because market-based pricing is so easy to defend, Circuit City reports that there is greater emphasis and interest in career development and less scrutiny of compensation. Career paths are logically structured, with career development aligned to monetary rewards.

Technology a boon

The technological tools have drastically improved the compensation team's credibility with internal business partners. Simultaneous access to data through ePRISM allows Circuit City to operate smoothly and efficiently with its Mercer partners, enjoying improved reporting capabilities. And the manager self-service tool, MeritNET, has simplified the merit process, making it easier to manage costs. This tool allows the compensation team to manage compensation spend in real time by monitoring manager decisions and their adherence to budget and guidelines.

Circuit City's line managers like the new compensation structure, especially MeritNET. On the retail side of the business, store directors report that they can complete the company's merit increase process in much less time than it used to take – and they are confident that they can keep within their budget and guidelines.

Sustainability through infrastructure

During the redesign process, Circuit City experienced high turnover in its compensation department. According to Oliver, "Having solid infrastructure in the system made life a lot more tolerable when people left. We were able to continue to provide services without losing institutional knowledge."

“The market-based system took away the mystery around compensation and made it a transparent process. It's great to see people focused on their jobs and careers.”

A combination of robust technology, good data and the way the data was housed allowed the Mercer co-sourcing team to help its Circuit City partners in times of high turnover, functioning as an informational anchor. Mercer was able to answer historical questions because it had been so closely involved in building the function – and it had real-time access to the same data Circuit City saw.

The co-sourcing approach has allowed Circuit City’s compensation department to have a direct impact on business results, improve the company’s culture and become a strategic partner, influencing business direction and operations. When done right, this approach can help companies transform into results-driven, high-performance organizations.

Lessons learned

Circuit City’s Mark Oliver shared valuable lessons from this compensation management redesign process:

- Starting off with your end goals in mind makes it easier on everyone involved with the project.
- Building an open and honest relationship with the team and your key account contact helps eliminate any confusion regarding direction.
- Don’t be afraid to give each other direct feedback – it provides for a better final product.
- If you’re the lead for the company, stay involved – don’t allow one side or the other to influence decisions too much.
- Understanding your company strategy and direction allows you to use the co-sourcing model at a much higher level.

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About Mercer

Mercer is a leading global provider of consulting, outsourcing and investment services, with more than 25,000 clients worldwide. Mercer consultants help clients design and manage health, retirement and other benefits and optimize human capital. The firm also provides customized administration, technology and total benefit outsourcing solutions. Mercer's investment services include global leadership in investment consulting and multi-manager investment management.

Mercer's global network of 17,000 employees, based in more than 40 countries, ensures integrated, worldwide solutions. Our consultants work with clients to develop solutions that address global and country-specific challenges and opportunities. Mercer is experienced in assisting both major and growing, mid-size companies.

Mercer's human capital business helps organizations globally to optimize their performance by meeting their most critical needs in three related areas:

- Managing, rewarding and engaging talent to drive business performance
- Ensuring responsible executive remuneration
- Enhancing HR effectiveness

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