The Technology Talent Demand Convergence

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OVERVIEW

It wasn't so long ago that information technology (IT) was a back office function at most firms and, while companies would look at Apple or other innovators with envy or admiration, information technology was seen primarily as a way to execute or operate more efficiently – particularly at financial services and consulting firms. While there were pockets of innovation and firms dabbled with client-facing technology solutions, the overall IT focus was on automating repetitive tasks, storing and analyzing data, and running communication systems. As a result, the market for technology talent at financial and professional services firms was a relatively soft one. Save for small groups in banks building trading platforms and algorithms, the overall appetite for bringing the best and the brightest technologist on board was limited. Technology and internet firms were viewed by tech talent as the employers of choice for a variety of reasons, including long-term upside, culture, and ability to have impact.

Fast forward to 2015 and we see a good deal of the innovation at retail banks coming from technology. Consulting firms, whose operating models relied almost exclusively on giving clients advice, are now offering technological solutions directly to their clients across all industry groups, and developing more in-house solutions to enable their consultants to better advise. A burgeoning financial technology industry has begun to take shape. Most firms have some interaction with finance, and virtually all new firms are looking at how to utilize technology as one of the means to differentiate themselves within an increasingly competitive marketplace. As a result, the mandate of financial tech firms is broadening almost daily as financial and consulting services firms struggle to identify what can make them different, better, and faster.

Many of McLagan's clients are actively trying to create new reward programs and talent management solutions for their IT staff. Should their focus be on compensation, or working environment, or location? What are the winning strategies to recruit and retain tech talent?

McLagan and Radford are launching a series of Alerts that will focus on best practices in rewards strategy, cost control and culture across these client segments. The following is an overview, to frame some of the key issues, particularly in reward.

IT IN FINANCIAL SERVICES

Information technology is the largest support function in banks, representing close to 50% of the total infrastructure spend at some of the largest firms. Top banks spend billions of dollars per year on technology, including internally developed software, vendor packages and hardware. In fact, Chief Technology Officers at medium and large banks are managing technology businesses that could rival many publicly traded technology firms in both size and complexity.

Technology leaders often have dual mandates – to be innovators / business enablers on one hand and cost cutters on the other. Successfully competing for and managing talent is critical to be successful at both.

Deployment to lower cost locations is one of the major tools used to manage compensation expenses

45.8% of IT staff sit outside of high cost locations. In 2012 top 10 banks on average had 39% of IT staff outside of high cost locations.

55.6% of IT personnel including outsourced staff sit in low and medium cost locations at banks.

75.8% non-officer comp savings in low-cost locations. Even onshore medium cost locations offer substantial savings. Non-officers compensation is on average 21.6% lower when they are located outside of major hub cities.

53.4% differential between low and high cost locations for VP / Director level staff, and 12.8% differential between medium and high-cost locations.

As cost cutters, technology leaders often look to move staff to lower cost locations, completely outsource particular functional areas, or get greater efficiencies from existing staff by controlling headcount and pay levels. It is accepted that many of the more basic functions within IT, such as application maintenance, network and system administration, can be performed in offshore centers. But as organizations become more sophisticated in using offshore locations, technology leaders continue to look across their organizations to find even more cost saving opportunities. As a result, most undifferentiated IT jobs are subject to either being moved to lower cost locations or being outsourced. Since internal staff is well aware of this trend, managing smooth transitions is absolutely paramount.

On the other hand, IT is also a key enabler for the business, supporting the development of new products and markets. Successful platforms or applications are often crucial to being competitive. Algorithmic trading, risk management, treasury management and mobile banking are just some of the areas where technology has effectively driven the business. Talented developers with these highly specialized skills are at a premium and hard to find. Another area where tech drives the outcomes and talent is scarce is Big Data – applying analytics to massive datasets to generate new insights, identify target customers, prevent fraud or identify compliance violations.

Beyond enabling business and cutting costs, technology leaders are increasingly tasked with acting as guardians of the enterprise. Highly publicized hacking scandals have highlighted the need to use the most sophisticated technology to ensure complete IT security. Faced with increasingly complex threats, banks are rapidly expanding their security departments and are again looking to bring in top-talent, which is often scarce.

THE FINANCIAL SERVICES VALUE PROPOSITION FOR IT

Short-Term Pay	Long-Term Pay	Culture / Lifestyle	Advancement	Industry Prestige
▲	◀ ▶	▼	◀ ▶	▼
Pay is competitive, while historic premium is seen as eroding.	Long-term pay is less valued, as firms tend to have less upside.	Perception is that environment is stuffy, with limited work / life balance.	Technology roles are well-established and career path / progression is defined.	Industry has taken several black eyes, and is no longer seen as employer of choice, particularly for young people.

RECOMMENDED FINANCIAL SERVICES KEY STRATEGIES

- Separate out key technology roles, and re-establish pay premium for these, while continuing location / alternative sourcing strategy for commoditized functions.
- Consider modifications around culture, particularly in IT central locations, where more informal environments may add value.

IT IN PROFESSIONAL SERVICES

Technologists and other specialized employees, such as data analysts, have begun to play an increasingly valued role at consulting firms over the past few years. Virtually all firms expect the hiring of technologists to grow exponentially over the next five years. Firms that have historically delivered pure advisory solutions now require the ability to deliver complex data and technology-driven solutions to their clients. Even if the final deliverable is not a pure technology play, consultants building a non-tech result often rely on technology to develop their final solution.

Given how significant the competition is for information technologists outside of the consulting services industry, it is interesting to note that while some firms have built out clear career paths and development tracks for technologists, a larger number of consulting firms have not yet made substantial organizational changes to create an environment that is enticing to them.

While career path may be the most critical piece to get right, another key question for many consulting firms is how to pay technologists. Most firms have not developed differentiated pay programs, and instead simply pay at rates linked to levels established for their consultants. For traditional consultants, the carrot is typically rapid progression in seniority and fixed pay, and not a large annual incentive. In a typical year, consultants receive on average 7% increases in base pay and in a promotion year up to 30%. The model also assumes the consultants will be promoted every 2-3 years or move out of the organization. Technologists are often not given the same opportunities for rapid advancement. In fact, some firms have scaled back annual increases to prevent compression issues – resulting in annual increases in base pay closer to only 3% on average.

A final, but key point from a morale perspective is that the goal of many employees at consulting services firms is to make Partner. However, at many firms, only those employees focused on business development receive this opportunity, effectively barring technologists. Without a clear career path, slower opportunity for progressive pay and a cap on possible seniority, consulting firms are placing themselves at a significant competitive disadvantage in being able to recruit, retain and engage tech talent.

THE PROFESSIONAL SERVICES VALUE PROPOSITION FOR IT

Short-Term Pay	Long-Term Pay	Culture / Lifestyle	Advancement	Industry Prestige
◄ ►	▼	◄ ►	▼	◄ ►
Pay is competitive, with slow growth to eventual higher levels.	Limited to no long-term upside.	Perception of reasonable work / life balance, but lacking the glitz of high tech.	Hard to see career path, as firms are just building this, and path to Partner exists haphazardly, if at all.	Industry is viewed favorably, but not as a first choice for technologists.

RECOMMENDED PROFESSIONAL SERVICES KEY STRATEGIES

- Create clarity around career path and long-term growth for IT staff.
- Consider pay constructs that allow clearer line of sight to the reward for the value created.
- Consider fragmenting digital groups and creating pay programs that have long-term upside, such as options, for groups building products or services where profitable outcomes are easily measured.

NEW MARKET ENTRANTS – FINANCIAL TECHNOLOGY FIRMS

The emergence and subsequent growth of the financial technology sector brings unique new challenges for both the financial services and high-tech industries, especially when it comes to sourcing and retaining key talent.

Pay differentials are often nuanced between competitors for talent.

30% of total comp at a tech firm in London may be in long-term incentives (stock options, restricted stock / units, performance stock / units).

35% total comp premium would be typical for a Head of Development at financial services vs. West coast tech firm.

20% total comp premium for mid-level roles would be paid at tech firms over financial services in the Bay Area.

56% of employees are eligible for a long-term incentive award in tech companies compared to financial services, where equity is restricted to mid / senior levels.

13% of the employee population are in officer roles at tech firms in London, versus 25% for Financial Services.

The traditional battleground between the two sectors has been heated, sometimes even acrimonious, with banks offering generous reward packages to lure tech talent, and the tech sector promising the innovative and relaxed working environments often sought after by those with technology backgrounds. Financial services firms often struggle to meet the needs of top tech talent within a sector perceived as too formal to allow creative minds to flourish.

In truth, it is the business model, not the reward package that is the root cause of the banks' challenges in recruiting tech talent. Historically, the technology arms of financial service institutions have been predominantly "information providers". Digital platforms, whether web-based or mobile apps, are little more than on-screen displays showing balances and transactions. Of course, there have been attempts to break this mold with various new applications that make transactions quicker and easier, while retaining the much-needed security. The tech sector on the other hand has been defined by disruptive technology. More than just a buzz word, disruptive technology has led to the existence of most of the applications and products we use and love today. Up until now, the financial services industry has not seen the same level of disruption, with many of the technologies and systems still largely the same in concept to those developed decades ago.

Enter financial technology firms which sit squarely in the middle of these developed sectors. They aim to bridge the gap between the respective industries and provide clients with a full range of products and services tailored to meet their individual needs. A growing number of FinTech startups have been attracting key talent to work on innovative ways to improve upon existing product offerings across a broad range of businesses including capital markets trading, risk / security solutions, data management, payment solutions, and more. These firms are uniquely positioned and capable of drawing top talent by offering a balance of competitive pay along with a more relaxed, innovation-driven work environment.

While the old guard of traditional financial services and the high-tech industry are showing positive signs in terms of innovation and increasing pay-levels, when it comes to finding top talent, competition is clearly heating up.

COMPENSATION COMPARISON

Compensation practices differ between sectors in terms of both mix and quantum. For an information security analyst, financial services firms pay a ~20% premium over technology companies in base salary. From a total compensation standpoint, the gap is smaller, and the premium over tech moves to ~15%. Consulting firms tend to pay less, particularly at the more junior levels; however, since there is less structure and consistency around how these roles are paid, it is harder to accurately measure.

As a general rule, financial services pay will typically exceed total compensation for comparable roles in the technology space, with the exception of some key roles, such as database and project management roles, and specific locations, such as the West Coast.

We note from our work with clients that financial services or consulting firms will often pay significant premiums above internal staff to attract key talent from the technology sector. This has led to some confusion around the differences in pay levels between the sectors and created the impression that the technology sector positions salary, total cash and total compensation at levels in excess of the normal banking levels. This reflects the “star” phenomenon, where key technology sector hires are made at a significant premium to market rates, and/or the need to compensate for several factors, including:

- **Legacy and obsolete technology** ─ Banks have added layers onto old tech systems, rather than starting from scratch. This makes it harder to attract top tech talent.
- **Regulatory versus entrepreneurial environment** ─ Regulation restricts what banks can do. This does not encourage young, bright minds to come up with new ideas when they are working within regulatory confines.
- **Corporate culture versus an innovative culture** ─ Many tech companies pride themselves on a start-up vibe, which allows for failure and where innovation is encouraged. Stereotypically, the banking environment is a more staid / corporate one. The work life balance is increasingly important to people and tech companies are viewed as offering a better balance of the two.

The higher pay levels in the Bay Area are well known. For example, for specialist development roles, technology companies actually hold up to a 30% premium over financial services firms in the same geographic area for senior roles, with limited differentiation at more junior levels. On the East Coast, financial services total compensation levels are still higher than their technology peers at senior levels.

In London, financial service firms also still hold a premium over tech companies. While the UK has its own technology hub, the Silicon Roundabout, the long established financial district maintains its hold in terms of pay, with significant premiums paid at the senior levels.

In addition to quantum, there are interesting observations around the structure of compensation. Technology companies push variable cash compensation lower in the organization relative to most banks, globally. More significantly, equity participation, through options or restricted and performance-based stock is also pushed lower into the organization. This aligns a greater proportion of employees’ reward with the overall performance of the company.

This difference between the sectors is an important point. By adopting more creative approaches to long-term incentives for specific units or locations (such as captive technology businesses within the bank), a technology-oriented compensation model can become a key driver of a digital strategy. This could involve cash or phantom equity plans linked to key value creation drivers.

CONCLUSION

The competition for technologist talent is growing at a feverish pace, and the competitors are no longer just banks and high tech firms. As innovation and automation continue to become a greater focus across financial services, consulting services, and financial technology, all firms will need to take a deeper look at their employee value propositions, and actively manage their offerings in order to attract and retain the talent required to succeed. Compensation will continue to be a primary driver, but form of compensation, equity plans, culture, advancement, career path, work environment, and the perceived prestige of these organizations will continue to play meaningful roles in how candidates choose their employers.

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