# TRENDLINES

*The Employers' Association's monthly whitepaper on essential Business/Human Resources practices*

The Employers' Association (TEA) delivers reports for businesses that contain relevant and up-to-date information based on our work with hundreds of employers each month. TEA is known to produce a number of essential benchmark survey reports every year and we also compile data and observations that provide organizations practical perspectives on important business trends.

## Effective Compensation Administration Practices That Promote Internal Equity

### What you should know

Recent studies have found that employee dissatisfaction is at an all-time high, and that, surprisingly, pay is NOT one of the top reasons employees leave an organization. The way people interact with peers, the way they are treated by management, and their overall satisfaction with the job are far more critical than pay (and/or benefits) in regards to employee retention. Our own Employee Engagement Surveys as well as other nationally recognized surveys consistently point out that culture, opportunity to contribute to an organization's growth (and the ability to grow individually) and a strong work/life balance are all more important to most workers than compensation as long as the way individuals are paid is fair, internally consistent and recognized people for what they contribute.

### What we know

Having developed and implemented more than 650 Compensation Administration programs throughout the country, we have found that:

1. ***Internal equity is much more important than external competitiveness when it comes to creating a satisfied workforce.*** Some of the best organizations pay employees slightly below market averages BUT they underpay ALL employees (including their management team) in a similar manner. Dissatisfaction (causing high turnover, negative employee relations and difficulty in hiring new employees) almost always results when one group of employees is paid differently in relation to market than another.
2. ***Strong merit pay systems tend to attract and retain high performers (and over-achievers) while tenure-based systems tend to attract risk-averse employees and retain mediocre employees.*** When definitive goals and objectives can be established ***AND FULLY COMMUNICATED*** to employees, potentially linking additional pay and/or bonus to the accomplishment of those goals, employees willing and able to go the extra mile will step forward.
3. ***Organizations without an objective means to establish a job's value or worth (linking that value to defensible compensation practices) tend to pay employees more based on who they are than what they contribute.*** Whenever employers make pay decisions based on who is in the job rather than on what the job does for the organization, favoritism and inequity (whether real or imagined) will begin to destroy internal employee relations.
4. ***Effective Compensation Administration is 70% communication and 30% structure.*** When employees are involved in the development of a system, are told what is happening along the way, understand

what is being measured and feel invested in the process they are much more apt to believe in the fairness of a system than if they are kept in the dark throughout the program's development.

5. ***Consistency is more important than equality.*** When employees know (and trust) that you will be fair and equitable (not necessarily equal) in the way they are paid they will become a big part of the organization's ongoing success. When employees doubt management credibility, or see the inconsistent application of policies or practices, they become more a part of the problem than the solution. When employees see that everyone is being treated the same (regardless of their level of contribution) those that are "driving the train" will either back off or leave while those that are coasting will be more than happy to continue enjoying their free ride.
6. ***Pay is only a part of the equation when it comes to compensation administration.*** Benefits, working conditions, flexibility, autonomy and the freedom to learn from mistakes are far more critical in creating an environment that will attract quality employees and retain a highly competent workforce. While the emerging workforce may SEEK a better work/life balance, anything that an employer can do to implement a better quality of life will benefit ALL employees and help to retain a diverse mix of ideas, talents and perspectives that will contribute to overall success.
7. ***Business HAS NOT established a "new normal" in regards to paying people at reduced rates.*** While many news sources point out that **AVERAGE PAY** for many positions has gone down the past several years, they fail to mention that higher paid "boomers" are retiring and being replaced by lesser experienced employees. As individuals move into new jobs they often experience strong income growth but may not be compensated at the same level someone doing the job for 15 to 20 years may have earned. Look at "the story behind the numbers" if you want to understand what is really happening in regards to competitive compensation practices.
   - We have seen significant increases in base pay (typically in the 3 – 4% range for each of the past 3 – 5 years) for entry level workers – many now receiving much more than the minimum wage of $9.65 per hour (particularly within the manufacturing sector where starting wages are in the $12.50 to $13.50 per hour range) in order to attract talent within our strong economy.
   - We have also seen annual increases of 3 – 5% within upper management (idea generators, visionaries, business creators and leaders) in order to retain strong and proven leadership.
   - Within the mid-level of organizations the average increases have been smaller BUT individuals within these groups have experienced strong earnings growth which has been "masked" by promotional growth (as individuals are promoted or move to new jobs, internal candidates receive promotional increases but may be paid "on average" less than the individual leaving the position thereby causing jobs to seemingly receive smaller percentage increases. Even though individual employees received significant increases in pay due to promotional growth, the end result in terms of "average pay within a job title" would make the reported average reported rate of pay appear to be less than anticipated. This masking effect tended to impact pay range adjustments by reducing the percentage that mid-level ranges have increased during the past 3 – 5 years (2 to 2.5% on average) but not the individual annualized pay these workers received.
8. ***Blanket adjustments rarely have the desired effect.*** Organizations that adjust ALL RANGES within their compensation structure the same "cost of living" amount have found that they are having difficulty attracting entry level talent and retaining highly qualified leaders while potentially overpaying their mid-level employees. This is caused by the "masking effect" noted above.
9. ***Compensation Administration IS NOT a static science.*** Pay ranges should be updated regularly to reflect changing market conditions AND should be tempered by an organization's ability to pay. In order to effectively administer compensation organizations must realize that pay ranges are market driven but that pay adjustments should reward individual employee performance.
10. ***NEVER expect discretionary "gifts" to change or modify behavior.*** Link bonus / incentive programs to performance (individual and corporate), letting employees know what they must do to earn a bonus (and what could lessen their bonus), rather than giving spot cash rewards that are not linked to profits, performance or expectations. Like most change, incentive bonus pay should be the result of

DELIBERATE and INTENTIONAL CONSIDERATION starting with what you hope to accomplish then working backwards to how best to bring that goal to fruition. An effective bonus program should be able to change behavior, motivate performance and reward individual (or group) contributions to the bottom line. Gifts are nice but do not meet these criteria so, while appreciated for a short time they do not typically translate to increased productivity, better quality, improved performance, a safer work environment, better customer satisfaction or higher profitability.

## What it means

All employees will rise to the level that is communicated, expected and rewarded. Developing a strong Compensation Administration Program that recognizes these basic tenants will allow organizations to attract, retain and reward exceptional employees. Be intentional in your compensation practices – profitable and productive business models are not accidental.

1. Having experienced several election cycles during the past three decades, 2020 should start well (strong earnings and high competition for employees), slow down to “survival mode” during the second and third quarters as the election hype moves into full swing and employers (consumers and business) take a “wait and see” attitude, then return to moderate growth after the election regardless of who wins (as having a game plan allows business to react and respond). We see some softening of the current employment market but would anticipate that it will return to its current state towards the end of the year.
2. We see that transparency is critical – not that everyone needs to know what everyone else earns but individuals must know what is expected of them, how their performance is measured and how their results are rewarded. Organizations operating without defensible compensation administration programs may find themselves working with “what is left” in a depleted labor market rather than leveraging a strong talent pool to become an employer of choice.
3. Employers that treat everyone equally (rather than equitably based on what they contribute and how well they perform) will find they have created a safe haven for mediocre workers. Exceptional talent seeks recognition and appropriate rewards for their individual contributions. Marginal talent provides as little as management will allow and is happy to accept as much as they are provided.

## What you can do

Organizations should develop and communicate a Corporate Compensation Philosophy that can be shared with employees. Publishing a set of standards and expectations helps to “cement” employees in place by defining how their organization pays in relation to “market,” what employees must do in order to be recognized and receive a greater reward and what opportunities might exist within their organization to allow growth. We see more organizations “growing their own” talent as qualified workers are already working so talent must be developed rather than hired. In order to retain this talent employers will have to provide competitive pay, benefits, an exceptional culture and opportunities for advancement. Training is becoming an investment into an organization’s future rather than a response to an isolated employee’s request for knowledge. In order to attract and retain talent you must honestly say what you intend to do in regards to total compensation and do what you said you were going to do. As soon as an employer says one thing and does another they open the floodgates that are difficult to close. Good employees NEED to respect their employer, feel they are valued and know they are rewarded fairly. Anything less is NOT a good foundation for effective Compensation Administration – rather it is the foundation for becoming a great training ground for other employers who are more than happy to leverage your trained and talented employees for their greater good.