PAAR, MELIS & ASSOCIATES, P.C.

SESCO management consultants

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The Importance of Compensation Administration
(Minimum Wage, Pay Compression, Labor Cost, External Equity)

In today's competitive labor market, an employer, regardless of size, must implement a defined system to administer compensation. Unfortunately, we find few of our clients regardless of size, throughout all industries have failed to implement an effective compensation system. The result is by not knowing what the appropriate value of a position (not incumbent) should be, often times a decision is made to pay employees based solely on what is being transpired in the marketplace or negotiated at time of hire. There will always be higher and lower rates in your marketplace and an incorrect decision can be detrimental to your organization as your labor cost and the management thereof is the difference between a profitable or failing business. Accordingly, all employers must understand how to identify the **"right price"** of all positions within the organization and subsequently communicate to employees how to obtain the job value based on defined expectations and position requirements.

We at SESCO have developed a **simple** but effective approach to helping our clients solve this dilemma. We understand the basic tenets of compensation that must be acknowledged for a program of administration to be effectively developed. Additionally, with understanding employee behavior, we provide the important insight that is often missing from other consultants.

As we consider compensation and subsequent realities, please consider:

Over Our 76-Year History, the Single Most Common Problem Discussed by Our Clients is:

Employee Job Performance or Lack Thereof

These problems of poor employee performance are primarily attributable to the failure of...**management hasn't provided the basic foundation and systems to manage performance**.

The Five Management Steps for Successful Employee Performance

- Define what needs to be accomplished
- Successfully articulate performance expectations to employees, preferably in writing via a job description or related performance plan.
- Train and mentor employees on the organization's unique and successful way of accomplishing the defined tasks.
- Hold employees accountable for the completion of the tasks.
- Reward employees properly and effectively for accomplishing expectations or effectively coach and counsel employees to meet expectations. If not, the employee should be separated as it is not a good fit nor fair to the employee him or herself, the organization or, most importantly, other employees who show up, work hard and do a good job.

If management can do these five (5) things, then your organization should be profitable as you are ensuring an effective return on your largest controllable expense, your labor cost.

The Fundamentals of Pay

Understanding the basic fundamentals of an effective compensation program is critical. We, at SESCO, identify these at three (3) separate levels:

- **Responsibilities/action of organization owners and officers**
  - Make the important determination of how much of your revenue dollars (gross sales) should be spent on payroll and benefits.
  - Identify the positions and subsequent number of staff needed to perform the tasks.
  - Conduct a survey of your market and confirm competitive levels of wages and benefits.
  - Determine the best utilization of the organization's buying power (labor costs) to match the market value to the best of your affordability.
  - Develop a system of equitable administration and distribution of compensation to include not only external equity, but also more importantly internal equity and affordability.

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COMPENSATION ADMINISTRATION

- **Responsibility/action for first-line managers and supervisors**
  - Recruit, screen, hire, orient, and train applicants needed to fill functions/positions
  - Effectively communicate wage and benefit opportunities to applicants and subsequent employees
  - Monitor constantly employee behavior and performance and provide change and/or support coaching with effective performance appraisals
  - Provide ongoing evaluation, training and leadership to help employees individually and collectively aspire to optimum levels of contribution and job satisfaction
- **Responsibility/action for employees**
  - Recipients of a compensation system that readily explains position duties and responsibilities, standards of performance and their compensation opportunities available to them
  - Have knowledge, confidence and belief that their employer has a credible and equitable system of compensation administration and performance evaluation
  - Possess a high degree of job satisfaction and self-esteem as derived from the psychological and monetary rewards of good job performance
  - Understand that every effort is being made to provide the best in long-term opportunity and success to them, the fellow workers and the organization itself

Pay Compression and the Minimum Wage

The first minimum wage was implemented in 1938 under the Fair Labor Standards Act. It was the first time the federal government stepped into establishing a standard pay for employees. It was at that time $.25 per hour.

Since, the minimum wage has increased 22 times since its inception and is currently $7.25 per hour on a federal basis. The Biden administration would like to implement a minimum wage of $15.00 per hour. In fact, many states across the country have implemented their own minimum wage standards much higher than the federal to include a $15.00 an hour minimum. As you can imagine, the results of this mandated $15.00 an hour minimum wage has been devastating to not only businesses but also entry-level workers.

So, what is the minimum wage? Frankly speaking, the minimum wage is an arbitrary number identified by the government regardless of cost of living, industry, profit or loss, benefit package or other realities of the free marketplace. And as we employers and employees know, it's an employee's marketplace and if an employer is not competitive based upon the market (it is not an arbitrary federal minimum wage) employers will not attract and retain a high quality of employee.

What are the real effects to business and employees when raising the minimum wage? Most will argue against raising the minimum wage due to potential job losses that will result from businesses absorbing costs. A recent report from the Congressional Budget Office (CBO) estimated 1.4 million jobs would be lost by the time federal minimum wage reaches $15.00 an hour. The reality is the compensation pie for any employer is only so big. When there is an increase in minimum wage, which also affects other current compensation practices within the employer, employers simply cannot absorb the wage hikes. The result is reducing staff, reducing fringe benefits and/or increasing cost of goods and services (easier said than done).

One of the primary concerns of increasing the minimum wage is the fact that it creates pay compression within an employer's compensation practices. When entry-level or low-level positions receive automatic pay increases based on the minimum wage, other employees who are above the minimum wage, regardless of how much, ask the same question of their employer - where's my increase? As such, whenever the minimum wage is increased, optimally all jobs within the organization should be reviewed and increased based on the same percentage. However, again given labor costs are employers largest single controllable cost, most all employers simply just do not have the budget to do this.

In addition to minimum wage increases, sometimes the market creates pay compression by escalating starting salaries for highly-desired positions (RN's and LPN's, automotive technicians, electricians, engineers, bankers, and many, many others). When the market rate for starting salaries increase faster than organizations can afford to increase existing employees, wage compression results and creates significant inequity. As prescribed by SESCO, a good rule of thumb to remember is generally direct reports shouldn't exceed **90%** of their supervising manager's salary.

Another common issue creating wage compression are the inconsistent pay practices over time due to employers not developing and maintaining an effective compensation program.

Not only do market forces drive companies to pay higher wages but also individual employees or applicants may demand increases and as such, to avoid losing a good employee, the employer meets the pay expectations/demands.

Finally, today's employees are aware and educated when it comes to internal and external compensation equities. Employers and managers try to prevent unrest by developing policies stating

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COMPENSATION ADMINISTRATION

that employees will be terminated or disciplined for discussing pay. Of course, employees under the National Labor Relations Act have the right to do this and further, this type of policy is simply not realistic. By having a compensation administration program, employees will have trust in their employer that the plan is fair and equitable and that the plan and their employer has credibility.

How to Combat Pay Compression

Wage compression is a significant and very challenging issue and resolving it, frankly, is not simple. SESCO recommends various steps that employers can take beginning with identifying appropriate pay rates by using three (3) sources of data: 1) market survey, 2) internal pay rates, 3) affordability = your right price.

So here are some suggestions to address internal pay compression and inequities:

1. **Assess current pay practices to include:**
   - Do your current pay practices reflect market demand?
   - Are there obvious wage inconsistencies between managers and staff and within job families?
   - Do your pay levels reflect your company's vision and goals?
2. **Market conditions**

   When considering external labor factors, look at:
   - Minimum wage laws
   - A tight skilled worker supply
   - Rapidly escalating wages for high demand jobs
3. **Encourage collaboration between human resources and financial staff**

   Adjustments in pay is obviously extremely expensive, especially if they haven't been accounted for in the organization's budget. That's why HR and finance professionals need to work together. Typically, human resource professionals state that we need to match the market and financial professionals state that we can only pay what we can afford to. These two (2) professionals must come together and develop a plan utilizing the basic tenets as noted above.

Develop a Plan of Action

For most organizations, these pay inequities creating pay compression cannot be addressed in one fell swoop. As such, given budget considerations and the developing of your right price, create a system over time, which may be up to two (2) or even three (3) years, to get employees to where they need to be. Subsequently, communicate, communicate, communicate your system and plans to employees. If you do not communicate, **employees will fill the void of communications with negativity, rumors, backbiting and subsequent separation**. Turnover is extremely costly and on top of pay compression and other challenges is the last thing that an employer needs to experience. If employees know and understand their roadmap and subsequent opportunities, most will appreciate the opportunity.

In Summary

All employers know or should know that their labor costs are the largest single controllable costs and as such, need to be on top of these costs. Further, employers cannot say to an applicant, "Come to work, do a good job and we'll take care of you." Today's employees are well informed of market rates, benefits and other business realities. If you as the employer do not have a story to tell the applicant with some formal compensation opportunities, an employee handbook and job descriptions, then you will have a very difficult time in hiring and subsequently retaining good employees. Finally, developing an effective compensation program protects yourself from yourself. It prevents you from paying based on applicant or employee demand, fear of someone leaving, pay based on someone's personal experience and history versus the position's value and your defined budget.

Just know that the Compensation and Administration Program that we implement for our clients is very simple, effective and easily maintained.

SESCO Clients Feedback

"Hi Joel, I hope all is well at SESCO. March 14th will be my 27th year anniversary here. I am looking forward to retirement. I wanted to thank you and Bill for being my support down through the years. I wish you the very best." ~ Beulah Couch, HRCI, Human Resources/Site Manager - Frontier Nursing University

Special Thanks to New SESCO Clients!

Jones-Wynn Funeral Home & Crematory
Villa Rica, GA

Weeks Funeral Homes
Buckley, WA

Berglund Farrell Management Group
Roanoke, VA

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Chattanooga, TN

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Corona, CA

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Alcoa, TN

Matchbox Realty and Property Management
Harrisonburg, VA

Hampton Textile Printing
Johnson City, TN

Hoffman Funeral Home & Crematory
Carlisle, PA

SESCO
management consultants
P.O. Box 1848
Bristol, TN 37621
(423) 764-4127 • FAX (423) 764-5869
www.sescomgt.com
email: sesco@sescomgt.com

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SESCO's 2021 Spring Webinar Series

- April 21: How to Find and Keep Good Employees - $35/person
- May 5 & May 19: Understanding Ourselves and Others: DiSC Personality Profile Assessment (Part 1 & Part 2) - $125/person
- June 2 & June 16: Performance Management (Part 1 and Part 2) - $70/person

Tuition:

$35.00 per person, per 1 day webinar

$125.00 2-day DiSC Personality Profile Series *Includes Assessment*

$70.00 2-day Performance Management 1 & 2

Schedule:

Every Other Wednesday, beginning April 2021 - June 2021

11:00 am-12:30 pm EST

For additional information or to register, please contact Trisha Thompson at 423-764-4127 or via email at trisha@sescomgt.com.