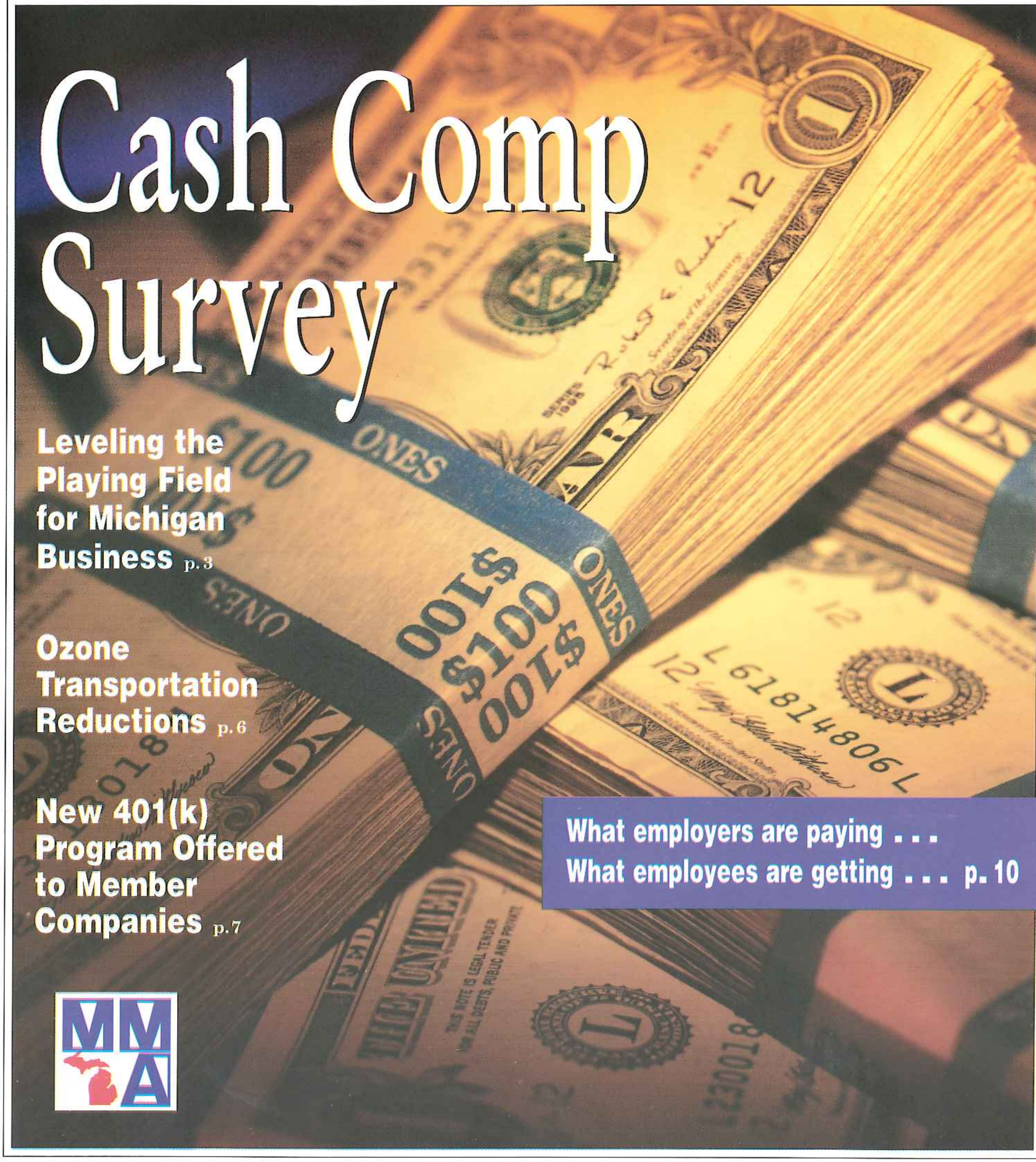
ENTERPRISE

Newsmagazine for Members of the Michigan Manufacturers Association

January 1999



Cash Comp Survey

Leveling the Playing Field for Michigan Business p. 3

Ozone Transportation Reductions p. 6

New 401(k) Program Offered to Member Companies p. 7

What employers are paying . . .
What employees are getting . . . p. 10

MMA

Full-Employment Situation Impacts *Compensation Levels* in Michigan

By Edmund B. Ura

"Ed, I know what these pay ranges are and how they were developed. And I know what the MMA Cash Compensation Survey says, but there is no way on Earth that I'm going to be able to find the product engineer I need for $45,000."

In a scene replayed dozens of times this fall, I wearily take out my dry erase markers, go up to the white board and explain to a frustrated human resources manager how the survey data and "real life" anecdotal experiences cannot only be reconciled, but actually make a lot of sense. But before we examine some reasonably complex economic and philosophical issues, we should take a look at some of the more obvious findings from the 12th edition of the survey, and determine how they impact our frustrated H.R. manager's situation.

COVER STORY

- ***While pay growth on average has been slow or nonexistent throughout the state in virtually every job category, pay growth has been rapid in the Detroit area, where average pay rates exceed the statewide average even more than in previous years.***

Employers often focus, and rightly so, on data specific for their industry, or for their company's size (revenue being the best predictor of pay). In Michigan, however, it is virtually impossible to discount the effect of Detroit and the auto industry on the cost of labor—at any level. While large metropolitan areas generally pay more than outlying communities, the Detroit area has traditionally paid upwards of 10 percent more than the national average, therefore creating greater disparity between Southeastern Lower Michigan and the rest of the state (Table 1).Often unrecognized by potential employees is that the higher average pay and lower cost of living makes the state and the Detroit area an attractive place to work and live.

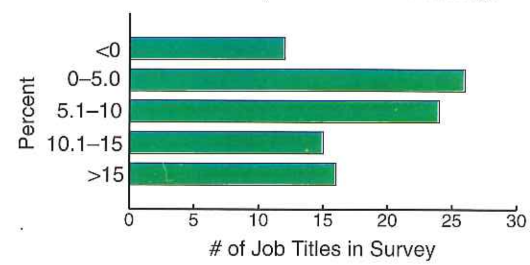
While pay growth statewide has been generally low and inconsistent this year, pay growth in the Detroit Metropolitan Area has been rapid—particularly in technical professions such as information systems and engineering. This is not surprising considering that the population and workforce are declining in numbers, and the need for multi-talented, cross-trained individuals in newer, leaner organizations has climbed quickly.

The result?

A classic supply and demand situation, resulting in escalating pay levels.

Our frustrated H.R. manager who is looking for an engineer in the Detroit area is a "victim" of the market. Although median annual pay statewide for product engineers is $45,140, the Detroit area median ($50,252) is more than 11 percent higher. And as expected, the more experienced individuals garner even higher base pay. For example, the Detroit market for senior product engineers is a median of $67,293—nearly 18 percent higher than the statewide median of $57,075. It's not just Detroit-area companies that must consider these statistics; those in adjacent geographic regions (i.e., Flint, Jackson, and Lansing) must also realize that they often share common recruiting areas.

TABLE 1. Percent Detroit Pay Exceeds State Average



- ***Companies MUST understand that whether they have a variable compensation plan or not, they must be competitive not just in terms of base pay but also total compensation.***

If your company offers some type of bonus or incentive plan, you'll need to make sure it's competitive. This year's MMA Cash Compensation Survey results show not only a dramatic increase in the percentage of companies providing some type of variable pay to their employees, but also increases in the amount of these payments.

While it may have been possible to ignore the situation in the past, when less than 10 percent of companies had plans that paid less than 10 percent of base compensation, it's hard to ignore the fact that over 20 percent of companies now have incentive opportunities for all of their employees, and that many of those plans generate more than 10 percent of base pay.

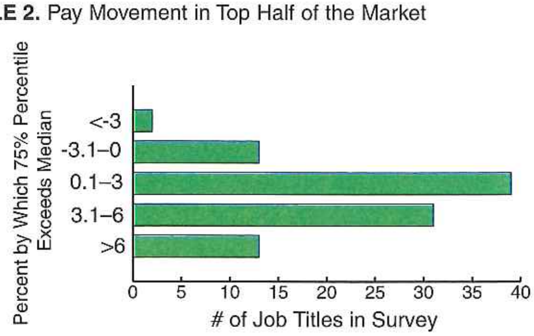
The net effect is that variable pay plans now show a statistically noticeable impact, making "total cash compensation" a key number to watch.

● ***Users of the 1998 MMA Cash Compensation Survey need to reexamine the statistics they base their pay decisions on because the growing difference between the "average" and the median shows the effect of the unusual labor market on pay.***

Most of the dramatic activity between the 1997 and 1998 surveys is at the upper end of the statistical spectrum. In most cases, there has been little to no change at the market median. However, at the 75th percentile and at the average, pay has increased.

In a perfect statistical world, the median and average should be about the same, because there will be an even distribution of pay around the middle, and high payers will average out the low payers. In our current full employment labor market, however, employers who take care of their employees are doing so in a reasonably big way. The "below average pay" employer no longer averages out the "above average payers." This can also be seen by examining the percentile statistics provided in the survey. The 75th percentile is typically farther from the median than the 25th percentile, both in terms of dollars and as a percentage (Table 2).

TABLE 2. Pay Movement in Top Half of the Market



Full-Employment Considerations

"Alright Ed. If I buy into what you say about Detroit, and I look at total compensation, I should be looking at total pay of about $53,000. But I employ kids just out of college who are making over $40,000, and the engineers I'm interviewing start out costing about $60,000—and they want company cars on top of that!"

I wipe the dry erase board clean, starting on Round Two of dealing with our current challenge: hot jobs in a full-employment labor market.

While much of my discussion within this article is directed at my Detroit-area H.R. manager who is seeking a product engineer, many of the principles apply to virtually any job. The principles discussed below aren't just a result of this year's study, but are based on six years of conducting pay and benefit surveys for MMA and 15 years of helping Michigan manufacturers determine compensation levels for their employees.

The problems our H.R. manager is experiencing require an understanding of the dynamics of a labor market with nearly full employment, where demand actually exceeds supply in many cases. However, economic theory doesn't always work in its purest sense when applied to employment situations, and the "human" aspect of labor force economics provides additional complexities. Let's consider two problems inherent with using survey data itself.

● ***A survey may only cover one, or exclude several, of the actual "markets" for a job.***

A survey that looks only at corporate environments may exclude a significant number of the most highly-paid and talented individuals employed in a given field. For instance, contract houses (which employ a significant part of the labor force

During the last six years, over 1,000 MMA corporate members have utilized one or more of MMA's labor market surveys.

in engineering and information systems) typically have compensation structures dramatically different from corporate environments. Companies often find it virtually impossible to attract young graduates, particularly in the engineering fields, because these individuals can sometimes earn twice as much as their corporate counterparts by working long, overtime-compensated work weeks.

Contract houses often provide higher pay at the expense of benefits, which may not be perceived by this type of employee to be of value anyway. The "Catch-22" that these employees find themselves in is that when they do choose to settle into a corporate environment, they have created a lifestyle commensurate with their incomes, finding it difficult to accept the pay offered by the very companies for which they desire to work.

The key concern from the perspective of human resources managers is that data on pay for this segment of the workforce is simply not available, since contract houses—which are highly competitive—tend to keep pay information confidential. Anecdotal data, or information from your purchasing department on how much you are paying for your contract employees, may be of help in formulating a strategy if this is a problem.

Another consideration involves making sure that other major employers who would not be part of a normal survey process are considered in determining the current labor market. For example, employers in Lansing must appreciate the fact that three of the largest employers in their area (General Motors, the State of Michigan, and Michigan State University) do not participate in the MMA survey. Astute managers will take this into account when determining pay levels, particularly in clerical and administrative positions.

- ***A company's perceived "problem" may be the result of not looking at the "right" job in the survey.***

One company may refer to a position differently than another company. For instance, a "product engineer" may be what another company calls a "senior product engineer." When lines are blurred between jobs, there is the potential for misinterpreting legitimate survey results.

Assuming that we can make accommodations for understanding how the survey data works, let's move on to some significant full-employment issues that impact cash compensation.

What is "Fair Market Value"?

The economic pressure of a full-employment environment requires some illustration. For purposes of the following scenarios, consider a micro-labor market for a theoretical position that we'll refer to as "Position X." In a normal mature labor market with typical unemployment rates, the supply of labor will generally equal demand. For purposes of illustration, let's assume three things: (1) we have a "normal distribution" of employers by size; (2) the pay philosophy of our hiring organization is targeting the average of the market; and (3) there are 10 employers that employ individuals in "Position X."

- ***In periods of full employment, the real market "average" for hiring purposes is higher than the "average" in our cash compensation survey.***

In a situation with "normal" unemployment, the hypothetical universe will have 11 potential employees for 10 jobs. The "average" will be the sum of pay for the 10 employed individuals, divided by 10. The "average"—for purposes of hiring, however—is the sum of the 10 employed individuals plus zero for the unemployed individual, divided by 11. This is not just a theoretical difference; employers know that they have more leverage in making salary offers to employed individuals when an unemployed individual is in the running for a job.

Full employment changes the relationship of "real" averages to "survey" averages. Taking the zero figure out of our employment mix then, increases the average so that the two numbers meet. It also, therefore, takes away the emotional leverage that the unemployed individual provides.

- ***Full employment means that more employees are "satisfied" with the material aspects of employment and are therefore less likely to be actively seeking other work or be "available."***

Particularly in "hot skill" jobs or positions that are currently filled by talented individuals, employers are aware of the risk of losing staff and will take whatever actions they can to avoid unnecessary turnover. While this not always possible, employers generally focus their efforts on key employees, whether it is through pay adjustments, enhanced benefits, or some other type of flexibility that makes continued employment attractive. When trying to recruit new employees, potential employers must offer a more attractive package. Without a history, or the ability to prove a more favorable work environment, potential employers are often left with monetary inducements.

- ***Full employment means that there is an extra "premium" employers must pay—on top of survey market rates—to hire the skill set that employers want.***

For years, career advisers have told us that we should never leave a job for less than a 15 percent raise—better yet, 20 to 25 percent. As employers, we must remember this. If our market for talent consists of employed individuals, we must pay the "average" rate *plus* the employee's premium. When employment is full for all job categories, employers have several options, including:

– Pay a premium above average for "average" employees. Keep in mind, however, that this generally translates to an internal equity problem, as new employees with similar skills are paid more than current employees.

– Hire less-qualified individuals, so that the starting rates do not exceed current pay. This will also result in inequity, although it may not be perceived to be as offensive to current employees.

– Change the expectations of the company's "needs" to meet the compensation level that the company is willing to pay.

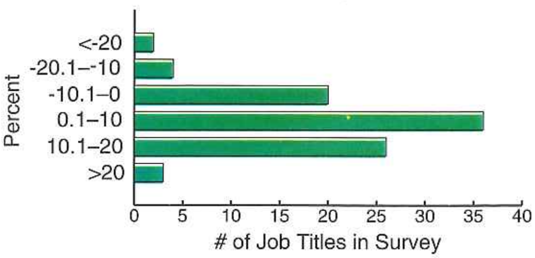
What Do We Do?

"All of this is fine and good, Ed ... but I still don't know what to do."

In any situation, you're better off knowing everything than not knowing anything. And even better yet, you're better off applying a consistent approach to everything. Some of the most useful methods for dealing with this situation, as well as any other ongoing compensation issues, include:

• implementing a compensation system that is less "reactive" to the market (i.e., grouping similarly valued jobs into pay grades and using composite labor market data, rather than just that of one job or job family);

TABLE 3. Percent Change in Base Pay Statewide, 1997-98



• keeping current employees' pay competitive, not as low as possible, particularly in the crucial first few years of employment;

• focusing on developing internal candidates, not just in periods of crisis, but throughout economic cycles.

The compensation decisions made in response to any situation stay with you for the "employment life" of both the employee and those around him or her. Because of this, compensation decisions should never be taken lightly.

To deal with the current "crisis," consider the following:

• Before recruiting for any new or unfilled position starts, examine the potential range of rates you may have to offer, and look at the pay of current employees to see what impact there may be. Based on that investigation, consider redefining either the duties or requirements for the new position, or recognize that the cost of the new hire may include adjustments to current employees' compensation package.

• Carefully consider, especially during a reorganization of a department or functional area, whether the new job requirements are for ongoing administration of programs/systems, or for the development of new programs/systems. If the development will be a "one time" situation (typically requiring higher, more expensive skills), consider contracting the development and hiring the administration. This may have a higher short-term cost, but may be more cost-effective in the long run.

• Examine the critical skills, duties, and responsibilities of a new or unfilled position. Look at how many of these tasks could, even temporarily, be assigned to other employees, pushing as many more routine or less complex duties farther down into the organization as possible. When the remaining critical skills have been identified, determine whether they can be contracted out, or whether retaining a consultant in that specialty will suffice.

• Where you do have to spend more, get more mileage for the additional expense. Consider adding more high-level duties and responsibilities to the new job or position. This may allow to differentiate the new individual from incumbents, minimizing potential internal strife caused from a new hire's higher pay.

• Buckle down to reality, recognizing that if the labor market rates are consistently higher, your current employees may be targeted by other employers. This may involve making pay adjustments that are either outside your normal budgeting process, or taking a critical look at how your organization structures pay and pay increases.

There is no simple solution to the full-labor market dilemma, or for any compensation situation. However, proper planning, along with an honest, fair and consistent approach to employee compensation, will minimize bumps on the road to success.

To learn more about base pay and total compensation lev0els in Michigan, consult the 1998 MMA Cash Compensation Survey Report. This publication provides detailed compensation information on nearly 100 "benchmark" jobs that appear in typical manufacturing firms. Data is summarized for all the 270 participants, as well as for seven revenue groups, 10 industry classifications, and eight geographic regions. Information on the automotive industry is also provided. Combined with the MMA Executive Compensation Report and the MMA Employee Benefits Report, the MMA survey program provides the most comprehensive information about Michigan's labor market. Order your reports using the attached form.

To learn more about base pay and total compensation levels in Michigan, consult the 1998 MMA Cash Compensation Survey Report.

Ed Ura is president of Management Resource Center, Inc. (MRC) in Troy, Michigan. MRC is an independent consulting firm offering business and compensation strategies along with planning, research services, and management consulting. For more information, call 248/362-6746.