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MMA Cash Compensation Survey p. 10

Exit Planning p. 4

Manufacturing Execs on loan p. 8

MIOSHA Appeals Board p. 13

Human Resources Q&A p. 15

Employee Compensation Steadies, Corrects and Readies for the Future

By Edmund B. Ura

Slow and steady wins the competitive race, at least in terms of long-term pay increases. A company that was competitive in 1992, and provided increases averaging 3.4 percent per year for the past 10 years, should find itself competitive again today. An economic recovery, an economic boom and an economic slump seem to have averaged out when it comes to employee compensation.

The eleventh annual *HRInfoSeries*™ *Cash Compensation Survey* of manufacturing employers' pay programs, conducted by Management Resource Center, Inc. (MRC) for the Michigan Manufactur-ers Association (MMA), provides both an in-depth look at current compensation levels and a study of 10 years of trend data.

Regardless of their current business conditions, employers need to plan for the long term and see how the decisions they make today will impact them years down the road. As the recent history of pay trends illustrates, above- or below-average adjustments need to be remedied at some point, and a consistent approach is more likely to yield higher job satisfaction and less disruptive turnover.

Participation in the 2003 Cash Compensation survey increased to nearly 190 companies. The participant group represents a broad spectrum of the manufacturing community and includes a greater number of larger employers than in recent years. Not surprisingly, survey participation tracks economic performance and as companies' business conditions improve — and manufacturers find themselves competing for employees once again — they will look to published studies as a guide for their own planning.

Exhibit 1

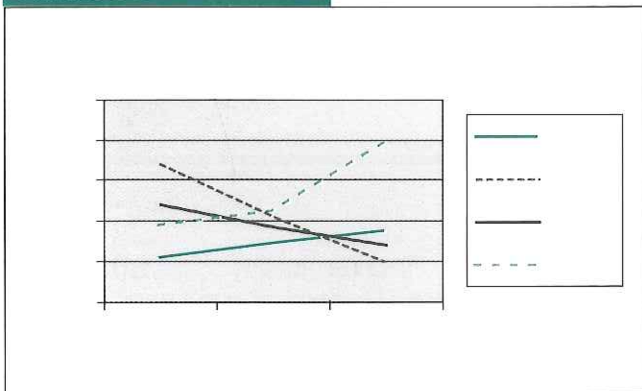
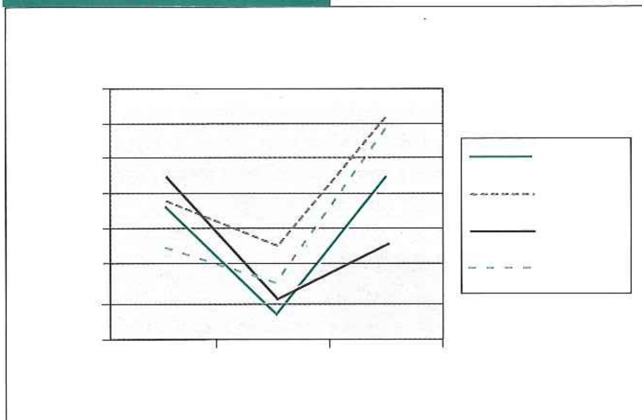


Exhibit 2



Actual market rates increase about three percent

Overall, labor market rates increased about 3.1 percent from 2002 to 2003, compared to 2.5 percent from 2001 to 2002. As in prior years, there are broad variations in pay increases by job family. This year, the leading gainers were Human Resources, Quality and Skilled Trades jobs, where the average increase was more than eight percent. In the generally quick-to-respond labor market, these three job families were among those with the lowest increases in the prior year. Continuing the "correction" trend, the only decline in market rates was in the Office/Clerical job family (-5.1%), which had shown the largest increase (10.3%) last year.

This sharp reversal in increases within some job families supports the long-term approach to compensation planning and also points out the need to look beyond the industry for long-term answers. As noted later in this article, the Michigan manufacturing labor market is notorious for reacting quickly to supply and demand conditions, regardless of economic conditions. Unfortunately, from a statistical standpoint, this may cause knee-jerk reactions among those who don't look at the long view.

Consider *Exhibit 1*, showing year-to-year increases for several job families since 2000. Four years of data show that in these non-industry specific job families there are definite, and consistent, trends.

Over the years, manufacturers have trimmed their non-production payrolls and have also learned that the market for these jobs extends far beyond their industry. As a result, trends follow the more general market trends.

On the other hand, *Exhibit 2* illustrates the last four years' increases for various manufacturing jobs.

Employers should look carefully at the real labor market for each of their jobs, consider the data they are using and look beyond today's headlines.

Economic recovery spurs compensation recovery... for some

As many organizations recover, even slightly, from their financial performance over the last few years, managers are beginning to, once again, budget for increases in their employees' compensation. However,

this year's survey highlights a very atypical distribution in approaches. Simply put, employers appear to be planning on either no increase at all or average increases in the three-to-four percent range. Regardless of economic conditions, previous studies of companies' increase experience and budgets have shown a distribution of changes that resemble the statistical "normal curve." That is, there is an average increase (typically about 3.5 percent), with most increases between three and four percent. On the "fringes" of the distribution will be a smaller number of employers below three percent and a comparable number above four percent.

Every year there are "zero increase budget" employers but in the past they have been offset by those with higher increase plans (i.e., more than five percent). In 2003, however, there is no such distribution — those who are increasing their pay will be at or about 3.5 percent, and the rest will be making no adjustments. This produces a deceptive 1.5 to 2.0 percent average expected increase; an amount which describes the actual plans for almost no company.

While employers that base their plans on such published results may be tempted to follow that "trend," it is likely that they will suffer as a result. Two important factors suggest companies should do otherwise: (1) employees tend to regard smaller increases as "insulting," preferring (at least while they are complaining, rather than when they are spending the increase) to claim they would rather have nothing than a mere one to two percent increase, and (2) over the long-term, small budgets will need to be made up by larger budgets, and if you can afford it now, the compounding effect over time will reduce the need for large corrections in the future.

Evening things out over time

In one sense, compensation management is similar to trading in the stock market. While some who "day trade" can profit, most find themselves behind or no better off than if they had put their money in safe mutual funds. The same can be said of the prices employers pay for skill sets. Over the course of the last ten years, there has been virtually no difference between overall increases in pay between job families. Within most professions, there has been less than a 0.1 percent variation per year, based on the 10-year trends. There have been short-term sharp increases in the market rates for engineers, information systems personnel and even office staff, however, in the long run, the message remains the same for those who manage compensation: wait it out, don't do anything drastic and things will average out over time.

The labor market — particularly one that is relatively narrow, such as the market for manufacturing jobs in Michigan — is remarkably elastic and responsive to economic conditions. Increased coverage of pay in the media, the plethora of Internet pay information services and the aggressive marketing of post-secondary schools advertising the success of their graduates has an almost instantaneous impact on the supply of most professions.

The cycle for most professions runs about six years, and is easy to describe. A shortage of skills results in an increase in the market rates as employers bid for talent. The media reports the shortage of workers. Schools attract new students by marketing the high pay that graduates will receive. Inevitably, undecided high school graduates choose such a career and others shift their focus slightly to take advantage of better opportunities. Four years later, schools graduate more professionals and the supply situation eases. After two or three graduating classes (and an ample supply of students in the system) there are more than enough new professionals in the field, the market adjusts accordingly and eventually the news filters down to those about to enter the workforce.

"Flat" labor markets continue because there is no corresponding "hype" when there is an excess of talent as when there is a shortfall. The media typically does not report a "flat" market, that is, unless there are layoffs, there is nothing interesting to report.

Similarly, schools do not advertise that the market for their programs has dropped off. As a result, the belief that a market is "hot" often continues far after the shortage is gone.

The information systems profession is a perfect example of this part of the cycle. Television commercials still tout the financial attractiveness of technology degrees despite the fact that most companies have little to no problem finding qualified individuals looking for work and that the rate of increases have been steadily declining over the last four years.

Supply/pay discrepancies

If government statistics and the trade educational communities are to be believed, the most significant shortage in employment skills is in skilled trades positions and high-level administrative and clerical roles. However, this shortfall has not been reflected in what employers are willing to pay for these skills. Employers continue to complain about the shortages and the inability to hire but the survey results are unassailable — pay for skilled trades has increased no more than in the overall market and office/clerical positions have increased at the lowest rates of all of the major job families studied.

It is likely that part of the cause of the stagnant pay growth among the paraprofessions is caused by market forces in play in the professional levels. In the past, a large percentage of the population graduated high school and entered the workforce. Those going to college were perceived as the "cream of the crop" but there was a large segment of the workforce that was just as productive but not highly educated. The engineering field serves as an example. Most of the "engineers" in the 1950s and 1960s

were not graduates of a college. They started in entry-level technical positions and grew into their professions.

As the percentage of high school graduates entering college increases, the number of qualified individuals available to fill the paraprofessional roles decreases. Normally, the labor market would adjust. However, in this case, the same market forces that keep professional pay levels from spiraling out of control limit the possible increases employers can provide. Employers are unwilling to pay non-college graduates more than graduates, regardless of the state of the market. This would be perceived both as internally inequitable and in violation of common sense.

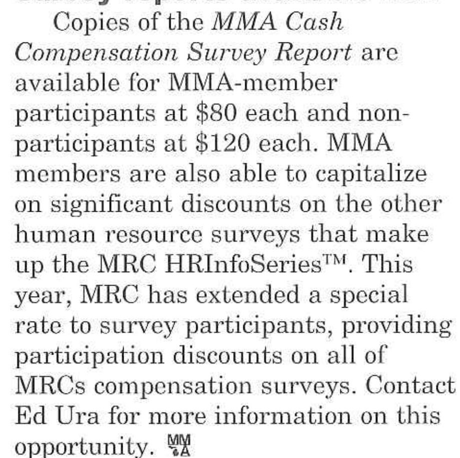
The reality, however, is that this keeps the market from adjusting. There should be an increase, making the paraprofessions more attractive, but employers refusal to increase rates keeps this from happening. The solution? Make these jobs more attractive in ways other than simply providing higher base pay.

It should be no surprise to students of the labor market that the companies that are identified as "the best to work for" are also those lauded for being "woman-friendly." These companies have identified a segment of the labor market that has been under-served and have reacted not just by offering more money, but by making their workplaces more flexible and responsive to the needs of their workers. It is likely that traditional manufacturers will need to find similar "attractive" features beyond compensation if they are to fill the shortages in this crucial segment of the workforce.

Incentive compensation continues on the rise

Participation in incentive and other bonus plans continues its long-term trend upward, as more than 60 percent of employees studied are incentive plan participants. Nearly three-quarters of managers are bonus eligible, and close to 70 percent of professionals have incentive opportunities. This year, there was only one position in which less than 40 percent of employees could receive a bonus and less than 10 in which half were eligible.

Incentive payments for 2002 performance also inched up slightly, primarily caused by organizations which had plans, but made no awards, for the prior year. As a result, with base pay movement relatively stable, incentive payments make up a greater share of total cash compensation. Incentive compensation represents about five percent of base pay when only incentive-eligible employees are considered. When all employees are studied, incentives represent only about three percent of base pay.



Survey reports available now

Copies of the *MMA Cash Compensation Survey Report* are available for MMA-member participants at $80 each and non-participants at $120 each. MMA members are also able to capitalize on significant discounts on the other human resource surveys that make up the MRC HRInfoSeries™. This year, MRC has extended a special rate to survey participants, providing participation discounts on all of MRCs compensation surveys. Contact Ed Ura for more information on this opportunity.

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