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Employee Pay and Bonus Plan Eligibility Increase in 2000

By Edmund B. Ura

It pays to work for a Michigan manufacturer — about five percent more than last year. While increases (and even some apparent decreases) vary by job and job family, the results of the 2000 MMA Cash Compensation Survey indicate that employers are paying an average of five percent more than they paid for comparable workers in 1999. On top of pay increases, there's been a sharp jump in the number of employees eligible for participation in bonus plans. The importance of these increases is significantly greater than the numbers themselves, for several reasons.

First, the pay and bonus plan eligibility increases illustrate the impact of the current tight labor market on employment costs. Survey participants reported that the average employee received an increase of about four-and-a-half percent last year; the higher total increase suggests that departing employees were replaced at pay rates far exceeding the original incumbents' pay.

Second, the data illustrates the inadequacy of relying on competitive, projected increase budgets over the reality of actual pay rates for planning purposes — those who only paid what others budgeted last year find themselves lagging the market.

Finally, report data suggests that unless manufacturers can increase their prices to meet increased labor market costs (and how many can?), employers will need to create "smarter" and more efficient work processes, and take good care of their employees to help stem the tide of high turnover costs.

The 2000 MMA Cash Compensation Survey, conducted in the late summer of this year, provides users with the opportunity to plan for the upcoming year with the most up-to-date information available.

More than 180 employers participated in the survey, with total employment of over 170,000, and Michigan employment greater than 34,000. Actual pay data was provided for more than 17,000 Michigan employees, illustrating the value of this survey, which provides users with competitive rates for more than half of their employees.

The most significant change in the history of this report was made for 2000, with the addition of full statistical coverage of "total cash compensation" in addition to base pay rates. With more than half of Michigan employees now "bonus-eligible," this statistic provides an important measure of the competitiveness of an employers' compensation program.

Actual increases to incumbents *exceeded* budgets in 2000

Employers provided employees average increases of 4.5 percent in 2000 — more than half a percent higher than what was projected for this year in the 1999 survey. This data is important not just for the absolute amount, but because it represents a higher percentage than was expected, an unusual result in compensation analysis.

In a "typical" year, the overall actual increase in payroll is lower than the planned average adjustment. This comes about because higher paid employees retire or are promoted, and are replaced by entry-level employees at lower pay rates. Thus, the payroll at the end of the year includes not only those receiving the "average" budgeted increase, but a number of new employees earning less than what the original incumbent was earning at the beginning of the year.

This budget "reality" is often used to "save" payroll dollars. Knowing that turnover will result in a reduced rate for many employees, the "real" growth in payroll will be less than the planned increase budget. Most surveys show that the actual increase in payroll, in a typical year, is about a half to a full percentage point below the planned increase. Apparently this illusory "surplus" was not only tapped into, but exceeded, for 2000.

The cost of turnover: higher rates to employee replacements

The average employee received about 4.5 percent in increases, and the average increase in reported rates was about five percent — a situation new to users of this survey, who will recall that the average actual increase by job (for most jobs in most years) is typically less than the reported budget increase. As noted above, this comes about because of the entry of new, lower-paid employees who replace those who retire or are promoted.

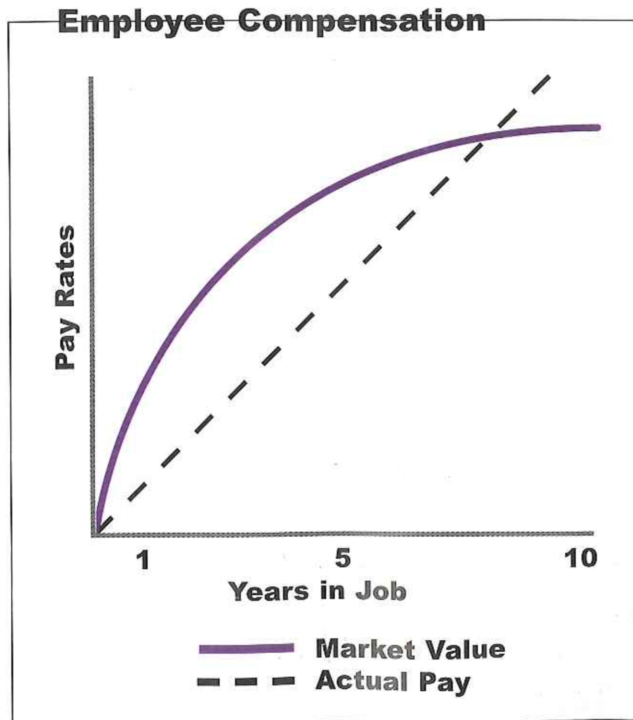
While a number of theoretical reasons can be suggested for this particular reality, one fits perfectly with the experiences of human resource managers at Michigan manufacturing firms — employers are paying *more* to replace employees who leave, regardless of the reason for the departure. Those who leave due to retirement are typically long-service, higher-paid individuals — enough so that their departures (as well as other turnovers) typically save companies about one percent in payroll per year. Apparently, the replacement cost of these individuals has increased significantly.

Another factor explains this higher replacement cost — the cost of replacing relatively short-service employees. In most cases, the most dramatic growth in the value of an employee to ►

a company occurs in the first few years of employment. After all, if an employee is not "up to speed" on the job in three years, most would consider the employment decision to have been a mistake. Unfortunately, as most human resources managers will attest, their pay increase programs cannot bring an employee up to their real market value in the same amount of time that the employee actually moves from "entry-level" to "fully-functional."

The graph below illustrates this concept, and points to an area of "risk management" in compensation programs — whenever an employee's real market value is greater than their pay, they will find it easy to leave and earn their real value elsewhere. An employer can always hire another entry-level individual (thus creating a "training ground" for other employers) or hire a comparably-talented individual, resulting in a real increase in payroll cost.

While not all turnover is regrettable, most employers would prefer not to lose staff solely because their pay is noncompetitive. Few would argue that it pays to be a training ground for other employers, and that more than just absolute hours are lost when an experienced employee leaves. The results of this survey suggest that employers are paying more to bring in new talent than they would by providing larger increases to their existing staff.



An explanation for apparent reported decreases

Those who read the survey results in detail will find that base pay rates for a number of jobs appeared to decrease from 1999 levels. A plausible explanation would be the increase in participants from the prior survey. This can generally be discounted, however, as the distribution of participants, by both region and size, is similar to prior years. Careful examination of the results suggests two explanations.

- Smaller companies are hiring more professional managers, but at rates commensurate with their resources. Many smaller employers are hiring, for the first time, "professional" managers in areas such as human resources, thus upgrading their internal capacity and sophistication. Overall, this trend means that smaller companies are reporting an increasing proportion of the managers within each job category.

  Because compensation levels are closely tied to company resources (usually measured by revenues), and because management pay levels are the most closely tied to this measure, the overall rates appear to decrease. When compared by revenue groups, compensation levels tend to increase as expected.

- Employers are reporting their data more accurately. This year, descriptions for jobs in the MMA Executive Compensation Survey were included in the reporting form. This information allowed those completing the questionnaires to look not just at the description provided for the Cash Compensation Survey, but to decide whether the data should, more appropriately, be reported in the Executive Compensation Survey. A comparison of questionnaires from prior years suggested that many companies decided to report their higher paid "managers" as "executives" this year.

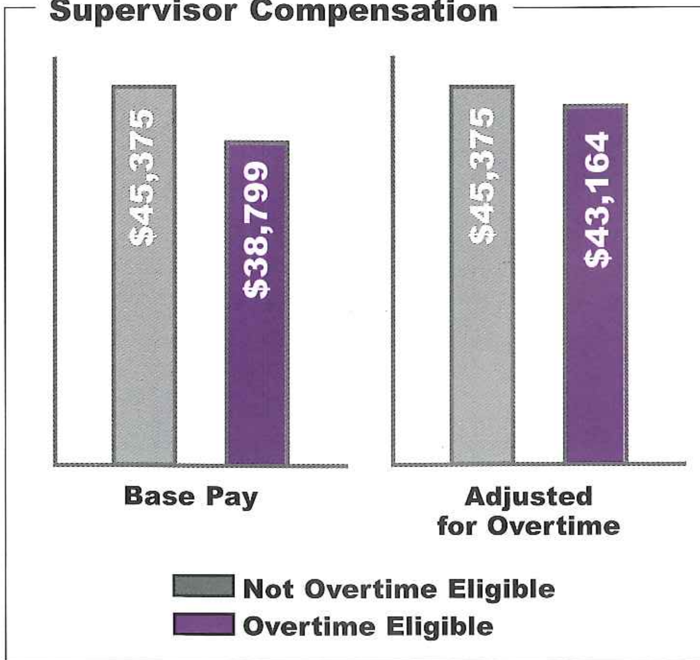
Those who plan are paying what they expect

Companies appear to be paying what they expect to pay, despite the apparent rapid increases in market rates and the difficulty of finding qualified employees in a very tight labor market. For the first time this year, survey participants were asked to provide their range midpoints or target rates as well as their actual rates of pay. About a third of the participants reported this new information, and indicated that, on average, actual pay was plus or minus three percent of their targets.

It's official! Bonus eligibility hits 50 percent

According to the information reported by participating companies, half of all employees are now eligible for some type of annual incentive award. This data represents a dramatic increase of almost 50 percent from last year, when just under a third of all employees were bonus eligible. Roughly two-thirds of management employees participate in bonus plans, between half and 60 percent of professional-level employees participate, and about 40 percent of production and clerical employees are bonus-eligible.

Interestingly, employees are slightly more likely to participate in bonus plans among smaller companies, with 55 percent of employees at firms with $20 million in revenues or less eligible for some type of bonus award. Only about 45 percent of employees at firms with revenues between $20 and $500 million are bonus eligible. Automotive industry employers are also slightly



more likely (52 vs. 48 percent) to provide incentive awards.

Actual bonus awards grew slightly in the last year, as a percentage of base pay, but still make up less than 10 percent of total annual compensation. The average bonus earned by a survey employee is approximately seven percent of base pay; management and some professional positions exceed 10 percent of annual pay. Considering all employees — those who receive bonuses and those who don't — approximately five percent of total cash compensation comes in the form of incentive payments.

Production supervisors: overtime does make the difference

For as long as most managers can remember, there has been an ongoing debate concerning production supervisors and overtime. Technically, many, if not most, true supervisors can be considered "exempt" under the Fair Labor Standards Act, and therefore, their employers need not compensate them for overtime hours.

The problem, of course, is that some supervisors are paid overtime and some supervisors can end up earning less than their subordinates if they aren't paid overtime, leading to the all too common question: "Why should I take a pay cut to take on the headaches of supervision?" Regardless of the philosophical choice made on the overtime issue, employers need to know how to compare pay rates to information such as that provided in the MMA survey.

The market, of course, adjusts for all these issues given enough time and a large enough sample. A small majority (55 percent) of the reported supervisors are eligible for overtime payments. On average, supervisors *not* eligible for overtime have base pay rates about 17 percent higher than their overtime eligible peers, at $45,375 and $38,799 respectively. While overtime payments do not completely make up the difference, it's likely that they bridge most of the gap.

When reported workweeks are considered, and hourly overtime is assumed to average 1.5 times base pay, overtime-eligible supervisors earn an additional $4,365, bringing their total annual base pay to $43,164. The result is that, with overtime considered, noneligible supervisors earn only about five percent more than those who are eligible. Given the margin of error in a calculation like this, it's probably safe to assume that overtime payments make up most, if not all of the difference.

Cash compensation reports are now available

Copies of the full 2000 MMA Cash Compensation Survey Report are now available from Management Resource Center, Inc., either individually or as part of the now-completed H.R. InfoSeries™ program, which also includes the Executive Compensation Survey and Employee Benefits Survey reports. The Cash Compensation report provides base pay and total compensation information on more than 100 distinct jobs, including both staff and operational functions. The information is summarized by:

- the total sample of nearly 200 companies;
- eight revenue groups;
- three major industry groups;
- five industry groups within durable goods manufacturing;
- eight regional groups; and
- automotive vs. nonautomotive industry.

The data is provided on a single page for each job, giving users the opportunity to compare the results by all the factors relevant to their organization, all at the same time. For each job, the following data are provided for both base pay and total annual compensation:

- mean – the average of all of companies surveyed;
- median – the "middle case" in the sample; and
- 25th and 75th percentiles – the middle 50 percent of the sample, excluding the highest and lowest 25 percent of the reported rates.

Users of the report will also find information on incentive eligibility and payments, midpoints and pay targets, as well as pay increase trends since 1992. Information on actual 2000 and projected 2001 pay adjustments is also summarized.

To purchase a copy of the report, contact Dan Fisher, of Management Resource Center, Inc., at 248-362-6745, or by email at dlfisher@mrc-consulting.com. Or fax the form found on the back page of this issue of *Enterprise*.

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