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CRAFTING



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Crafting an employee compensation plan

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A township moves into a new arena of competition when it's faced with hiring its first employee. Competing with other employers requires officials to attract, retain and motivate people, and the compensation provided is crucial to successfully execute these tasks. This article explores employee compensation issues, such as gathering and interpreting data, to help township officials craft effective pay programs.

Why is compensation such an important issue?

The first compensation questions township officials might ask are: "What's the big deal with compensation?" and "Why can't we just pay the lowest salary we can get away with?"

There are two critical reasons compensation is important:

1. You get what you pay for!

At no time in recent history has this statement been as true as it is today. With unemployment virtually nonexistent, employers in all segments of the economy struggle to find ways to attract employees. One group of potential employees includes people who are unemployed by choice. Perhaps they're just taking some time off, don't need the income or are looking for a new type of employment opportunity. Then there are those who lack even the most basic skills to function in a work environment. When people in the first group decide to go to work, they will have their choice of jobs. As for those in the second group, no matter how tempting it might be to hire the person who asks for the lowest pay or is willing to work for noncompetitive wages, most employers quickly regret hiring someone with minimal skills. There is value in paying talented people a good salary.

2. Turnover is expensive!

Turnover costs are one of the most ignored costs in any organization—private or public. In today's economy, turnover is high, and paying below-market wages is a guarantee that a township will experience more turnover than it would have otherwise.

Turnover includes three major costs:

- Direct costs include paying to advertise job openings and hiring employment agents to find suitable applicants. Today's "headhunters" look to hire everyone from top executives to clerical workers. One of the fastest growing businesses is recruiting clerical employees. This may make it more difficult and expensive for townships to recruit suitable employees.

Officials may also need to hire a temporary employee to quickly fill a vacancy. These employees come at a premium because employers often pay a temporary agency far more than they would directly pay an employee.

- Soft costs are costs that all accountants are aware of but can't find a place for on a financial report. For instance, soft costs include the time spent searching, screening, interviewing, checking references, conducting orientation and training new employees. Every hour spent on these activities is an hour not spent on regular job duties.

Another soft cost is the price a township must pay when work is not done because there is no one to do it. Of course, one could argue that a township does not lose anything in this instance because it isn't paying any compensation when there is no one to do the work. However, tell that to the citizen banging on the desk demanding to know when a permit will be approved, a zoning complaint investigated or the cemetery markers repaired.

- A third—often ignored—cost is that of the inefficiency caused by turnover. When an employee leaves, those left behind struggle with the additional workload. When a new person is hired, employees and officials' time is often spent training and coaching the new hire. It may take months, or even years in some jobs, until a new employee is proficient.

While some turnover can't be avoided, employers don't want to push people out the door with low pay. No one likes to discover that, after finally getting an employee up-to-speed, the person is moving on to a better paying job. In effect, a low-paying employer is often only a trainer—saving the next employer time and money.

How can employers determine competitive wages?

All employers compete for talented employees. To be competitive, a township must offer a salary consistent with the skill level it's trying to attract and keep. Most employers aim to offer a salary that falls in the middle of the relevant labor market.

The middle of the market means that township officials are not paying salaries that are too high or too low for the experience and skills received. For instance, if a township employee leaves to work for another company offering more money, the township can lure a similarly skilled employee from another company that is paying a lower wage.

Keep in mind that offering salaries in the middle of the market tends to attract "average" talent. If a township wants to draw a higher skill or experience level, it will likely have to pay more than a mid-range salary.

How can a township determine what employees with particular experiences and skills earn? For each job opening, officials should think about the three factors that enter into labor market analysis: geography, industry and size.

How does geography affect the relevant market?

To determine appropriate salaries, officials should begin by identifying the geographic area in which the township has to compete for the types of employees needed. To determine an appropriate geographic area for each position, draw a circle on a map around the township, defining a reasonable commuting distance to and from work each day. Generally, the circle size is proportionate to a job's level or responsibility, with high-level employees being more likely to commute further to work.

For some jobs, particularly professional and management positions, a township may need to recruit people to move into the community. If so, the geographic circle should expand to cover all areas where a potential employee might work. While the township may not consider relocating a secretary, the board may have to hire a township manager or other professional from hundreds of miles away. In general, the relevant labor market is larger for high-level employees.

How does industry affect the relevant market?

When a township looks at competition, it should include industries in addition to government. Consider how many township positions actually require government experience, and how many employees leave government service for the private sector.

Often, it does not matter whether a new employee has government experience. For instance, secretarial and administrative skills are easily transferrable from industry to industry, as are those in maintenance and trades. Accounting and information system employees may benefit from government experience, but if they have the basic skills, it shouldn't take long to apply them in a township environment. MTA offers numerous educational workshops and publications to assist new officials. Townships should be careful not to limit their labor market to government employees.

For each job for which a township seeks an employee, officials should make a list of the industries where appropriate candidates may work. It helps to include the industries where a current employee may look for a new job.

How does size affect the relevant labor market?

The most challenging part of determining the relevant labor market for a particular job is understanding the impact of an organization's size. In general, the bigger the organization, the more it pays its employees. This holds true in everything from Major League Baseball to automotive manufacturing to farming industries.

All industries have salary trends—banking and insurance industries tend to pay lower wages than manufacturing, and the healthcare industry pays even less. "High-tech" firms often pay more than other organizations for employees with the same skills. As a general rule, governmental units tend to pay on the high side for clerical and administrative positions, and much less than other industries for management and executive positions.

The trick to defining relative market size is to select a range of competitors who are reasonably comparable in terms of complexity and resources. That means finding governmental units that have similar resources and provide like services.

When looking for comparable municipalities, it's more important to try and match budgets than it is to match population or state equalized value. The budget reflects how much money the township has to spend on salaries and services. Just like geography, it's important to make the range of comparable municipalities wide enough to be realistic, and it's better to have more data than less.

Putting it all together

It is possible to define a relevant labor market for just about any job in terms of geography, industry and size. For example, a township might define the relevant market for a secretary as: all employers within a 60-mile radius of the township, in any industry, with revenues or budgets that match the townships by plus or minus 20%. A relevant labor market for a township manager might be defined as: a governmental unit providing services directly to a local population within the Great Lakes region, with a budget/population/SEV of plus or minus 30% of the township's statistics.

Every township seeking to hire an employee should write a similar definition of the relevant labor market. This exercise makes it much easier for officials to effectively conduct an employee search.

Apples to apples


Once a township has defined the labor market, the board should start looking at data. There are two types of data sources in compensation research:

1. "Direct" research requires a township to collect information from other employers in a relevant labor market. This is a wonderful source of data in that, as an organization, a township board can discover what other employers pay and know exactly what they're up against. With direct research, a township can also make sure that

their job titles and duties correspond with those in other organizations.

However, direct research can be difficult because collecting information is time consuming and private sector employers are not required to provide compensation information. In fact, they are highly unlikely to do so if it will put them at a competitive disadvantage. This makes it difficult for municipalities to compare salaries with other industries.





Realistically, unless a township has a large staff or dedicated volunteers with plenty of time, direct research will probably be limited to examining other governmental units and not other organizations.

2. "Published" research is information gathered and summarized by another organization, such as an industry association or private sector consulting firm. Published research only provides restricted access to raw data; most organizations only participate in salary studies if their individual data is kept confidential. Also, there may only be a few sentences describing a job, making it difficult for a township to determine if it is comparing apples to apples.

The Michigan Townships Association has an extensive salary compensation database. For more information, see page 13.

Using data effectively

There are basically two keys to using published research effectively. First, it is important to find a compensation survey or database that will be available in a similar form year after year. Employers should know what the market is now and how it compares to what it was previously.

The number of participants in a survey is also a crucial to effective labor market research. Statisticians often say that a sample needs at least 30 pieces of data to be reliable. Collecting less data means that the results can be affected by many factors including very high or low paying organizations or unusual factors such as one company having a few long-time employees or a lucrative contract settlement. Collecting data from numerous organizations minimizes the impact of any one organization.

To understand the impact the amount of data has on a survey, consider this example: A township board determines that it needs to hire a full-time file clerk. Board members look at eight comparable organizations and discover that five have file clerks. The salaries for the file clerks are \$10,000, \$12,000, \$13,000, \$15,000 and \$30,000.

It appears that all five have similar job descriptions. However, common sense indicates there's a reason one clerk earns \$30,000. Unfortunately, the board has no way to account for this and decides to simply take the average of the five salaries to get a "comparable" rate of \$16,000—which is higher than all but one of the salaries in the sample. The board realizes this is not an effective way to determine an appropriate salary.

This is a good conclusion because the following year, the clerk earning \$30,000 could retire and be replaced by a new clerk who is only paid \$12,000. The new salary average would suggest that the market actually *decreased* over the course of the year.

While other statistical measures, or a complex formula, could account for the salary differences, it is much easier to worry less about how perfect the comparables are and instead expand the sample to include 30 or more participants so the impact of a single organization will be less of a problem. Imagine how much less of an impact the \$30,000 salary would have when it's averaged with 29 other salaries, instead of just four.

What exactly is "the middle?"

Many organizations aim to offer a salary that falls in the middle of their relevant labor market. However, it is not always easy to determine "the middle."

Most people understand the middle to be the average. To calculate the average salary, all salaries are added together and divided by the number of salaries. Some employers may determine a "weighted average," which places an emphasis on salaries from employers with more employees in the job being researched. The advantage of using any type of average is that it takes into account every piece of information. The major disadvantage was illustrated in the previous example: If the sample is small, one or two high or low salaries can distort the results.

Another measure of the middle is the median. This is the number in the middle of a series of numbers listed from low to high: half of the numbers are higher and half are lower than the median. In the previous example, the median is \$13,000. This seems like a better description of the middle of the five salaries than the average provided; however, if that \$30,000 salary was legitimate, the median statistic really didn't take it into account.

Calculating the average or median of a *large* sample will more accurately indicate the middle. Township officials then need to determine how far from the middle a salary can be and still be competitive. This requires an understanding of the characteristics of a range of data, which refers to a certain part of a series of numbers. A typical range for purposes of compensation analysis is the middle 50% of a series of numbers. This is calculated by throwing out the highest and lowest quarter of the sample. What remains indicates the salaries that about half of the employers are paying.

While the file clerk example does not provide enough information to realistically calculate ranges, it can provide a very rough estimate. If the highest and lowest of the five salaries are thrown out, the middle 50% range is \$12,000 to \$15,000. This indicates that a township would be competitive if it offered a salary in this range. Like averages and medians, ranges become more accurate and useful as the size of the sample increases.

Compensation programs can become complex

As townships continue to grow, boards will face additional compensation issues. For instance, a township with several employees must ensure that there is "internal equity"—meaning that jobs with the same value to the township are paid comparable salaries. Townships may also have to determine whether it is appropriate to pay different rates for the same job, and a procedure must be established to address how pay should increase each year. Offering an appropriate salary during the hiring process is only the tip of the compensation iceberg. ♦

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