Harry Franzheim—an HR/OD Practitioner for over 30 years—has published this newsletter to bring you careful insight into reducing costs and unlocking employee potential.

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Keeping Costs Down and Productivity Up

WINTER 2013

AT ISSUE

Giving employees an automatic annual pay increase sounds like the ticket for keeping everyone motivated and happy. In fact, the opposite is usually true. There are better pay strategies to consider.

Motivated, Not Entitled, Employees

HR Fact:

The Myth: 89 percent of employers believe that employees leave because of money.

The Reality: 88 percent of employees leave because of things other than money.

Top 5 Reasons Employees Quit:

1. Limited career opportunities
2. Lack of respect
3. Money
4. Lack of interesting/challenging job duties
5. Lack of leadership from supervisor

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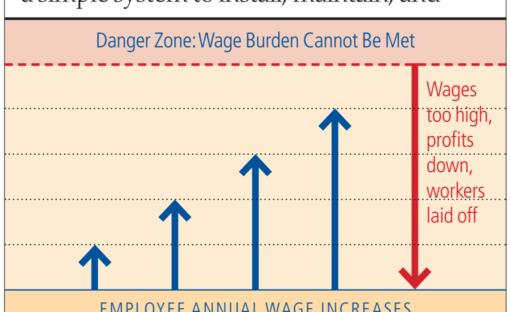
Money is not a good long-term motivator, but it can be pretty effective over the short term. In fact, Herzberg concluded about salary (i.e., money, earnings, etc.):"Viewed within the context of the sequences of events, salary as a factor belongs more in the group that defines the job situation and is primarily a dissatisfier."Annual increases to base wages is the worst way to "motivate" a workforce and likely the fastest way to drag down profits. Your pay strategy is your single greatest opportunity to reduce costs, increase productivity, and retain top talent. Done correctly, the pay system can engage employees to think like business owners.

Companies that give employees yearly salary increases will soon find that labor costs have skyrocketed. Annual increases are like annuities—they cause labor costs to grow exponentially without anything in return to offset them. Often companies will hand out the annual increases until the weight of the salary structure is too big of a burden and layoffs will be required. And you know whom companies target for layoffs? Yep, that's correct; the higher-paid employees because you get more cost reduction per laid-off head.

Of course you have to have a competitive wage structure and employees need to have enough money to make a decent living, but the annual salary bump is a road to ruin and a relic from the past. What if there were a simple system to install, maintain, and explain to employees that provided for a competitive income and that created a work atmosphere where employees felt they were part owners? There is such a system and we outline the components in this issue.



But first, there is a term you should know: "Total Compensation." Total compensation is the "whole package" of salary, bonuses, rewards, and benefits to an employee. Insurance, paid time off, holidays, rewards, events … all cost the employer and are part of the Total Compensation package. Employers will "design" their total compensation system in a way that will allow them to attract and retain the talent needed to accomplish the business objectives.

Our Pay Strategy / Four Components

A better pay strategy includes: 1) base wage, 2) health and welfare benefits, 3) a retirement plan, and 4) a quarterly profit share or gain share program. On the following page is a description of each.

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BASE WAGES

The only goal for the pay system is to attract and retain the right employees. That's it, period. Pay is not used to motivate or to punish; its sole purpose is to attract and retain. With that in mind, the prevailing market wage for any employee is equal to the amount of money you have to pay at the point of hire. Once on board, the base wage stays where it is for at least four years or unless the nature of the employee's job function changes. If the employee takes on additional responsibilities, the base wage can be adjusted upward. If the employee takes on fewer responsibilities, the base wage can be adjusted downward. But if the employee simply does the same job function year after year (even if they get really good at it), then the base wage should stay the same for four years. At some point you will want to conduct a quick salary survey to see if the base wage is too low and if the total compensation package has slipped to a point where the employee could find a better paying job doing the same thing for another employer.

HEALTH & WELFARE BENEFITS

Employee health and welfare benefits are the fastest growing expense for every company that offers them. Why do we offer this to our employees? So that they can be healthy and come to work more often? Hardly! It's because our competition does, and if we want to attract and retain the right employees, we need to offer it. The cost of insurance is huge and getting bigger. So much so that employers are now "sharing" the premiums and devising clever ways to get out from under the weight with co-pays, deductibles, co-insurance … This cost shift is eroding the total compensation package as employees may actually take home less pay each year because of the rate of increased costs and the amount of cost shifting.

We recommend that the insurance package be designed and structured so that the employee has reasonable deductibles (no more than $500), reasonable co-pays ($20), and a buffer from big costs with a 10% cost share of services and co-insurance and out-of-pocket maximums. Dental, vision, and Rx plans are important as well. Health and welfare benefits are of value only when needed. An employee who is not a user will not likely appreciate this part of the total compensation package. We also recommend using a Section 125 plan, which allows the amount of the premium the employee pays to come out before payroll taxes.

RETIREMENT PLANS

These are fairly simple to install and to maintain and can really sweeten the package, especially when the employer matches some (or all) of what the employee contributes. Because employees can have contributions deducted automatically from their paycheck, their contribution is seldom "seen" and banking the money is not as painful as writing a check. Contributions to these plans also lower the taxable income to the employee. It doesn't take much for the nest egg to grow and they get a good feeling knowing that they are saving for their future.

PROFIT SHARE OR GAIN SHARE PROGRAM

Here is where we provide the opportunity for employees to act like owners. The idea behind either a profit share or a gain share program is to provide a bonus for employees for the achievement of reaching some business target(s). In a profit share program the target is "profit." We structure the program to include the top line and the portion of the expenses that employees have some reasonable control over. In a gain share program there may be several targets like safety, quality, and productivity, each with clear definitions, dollarized and measured. As results are achieved and pass the agreed "hurdle," then the gain share pool begins to grow.

Splitting up the pool or the profits should be done quarterly; monthly makes too much work and yearly is too long. There are two methods to split the pool: 1) equal share (pool /head count) means everyone gets exactly the same amount, and 2) percentage (pool/wages) means that those that make more money get a bigger bonus. We like the second method!

Carefully Designed and Effective

Employer pay systems should be carefully designed to attract and retain talent. Annual salary increases done automatically, just for showing up for one more year of service, is nuts. I have heard employees say, "I have been here four years and I am making the same as when I started"—when in fact they have been at the company one year, four times! In other words, standing still does not merit more pay. Properly designed systems can keep a company from going broke and can help to unlock the potential of any workforce. ne

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