

The secrets to setting salaries

With the skills shortage now well and truly taking hold, wage pressures rising and another interest rate almost certain, employers across the country have been forced to face one of their most difficult tasks – deciding how much someone is worth.



"Setting salaries is an incredibly difficult decision," says Randstad human resources director Tiffany Quinlan. "Not only do you need to take the market into account, but you need to look at external factors like the skills shortage as well."

This means businesses in skills shortage-affected industries, such as the hospitality, engineering or health sectors, need to be alert on pay issues.

And while many businesses would simply rely on market surveys to determine salaries and subsequent increases, there are plenty of factors to take into consideration.

Pay rises, non-financial benefits and salary packaging are remuneration elements that don't necessarily make it into every salary review sessions – an omission, experts say, that can cost you.

"Employers should be across all the different benefits in terms of packaged-content, but also non-financial benefits as well," says Australian Institute of Management research and HR consulting manager Matt Drinan.

"If someone is negotiating a pay increase, particularly smaller businesses might be quite strapped in what they can provide in pay increases. So it's really up to the employer to decide what type of benefits they can offer."

But these types of remuneration don't just apply to new hires or pay rises. With the Government cracking down on executive pay, it's now a good time for business owners to take a step back and think about how they're calculating their own salaries.

With that in mind, how should businesses navigate the tricky business of not only paying their employees, but themselves as well?

The new hire

Setting a salary for a new hire is perhaps the easiest task out of these categories. The majority of the time, a market-based survey will do the trick.

"Market-based tools are among the most used here," says AIM's Drinan. "There are many that don't rely just on position descriptions, but within that use point-based systems to determine the exact nature of the job."

Drinan says that when you're recruiting someone new, it's fairly easy to look up a similar role in other organisations and find out how much they're paying. This gets a little trickier when you're hiring someone in a unique type of role, but Drinan says there are solutions for that too.

"That's where you'd use role evaluation tools. You want to look at the individual parts of the position, their responsibilities. You don't want to just be reliant on the position name."

These experts also point to surveys released by various recruitment companies, which actually now assign value to positions based on individual responsibilities. These are called "point-based" salaries, and are becoming more popular among a number of industries, including IT, as different roles come with different responsibilities regardless of job title.

For other roles less connected to direct income, Quinlan says you need to look at how much value that person is bringing to the company and their responsibilities with respect to other employees.

"Obviously you look at external factors, but salary is commensurate with a skillset. We try and look at the overall picture, and think about what value that person is bringing to the business. What is the role doing within the company, and how does it contribute?"

While there are a number of different revenue-multiple models for determining how much someone is paid, Drinan says these only really relate to a few separate industries, such as advertising, where a salesperson may be expected to bring in five or six times their gross salary.

A research assistant may not necessarily bring in a huge amount of revenue based on a multiple of their salary, so the same expectations of a salesman cannot be crossed over to other industries.

Kye MacDonald of Skye Recruitment says it's also worth considering establishing a commission-based system, depending on the industry. Although this might mean your business is out of sync with some others in the industry, it also means that you're able to identify key performers.

Rob Bebbington, head of Mercer's human capital consulting business says employers really need to understand what the job represents in terms of aggregating duties and responsibilities.

"The traditional school is that you match the role with jobs in the market. But more people are looking at the value of a job, and are using points systems that evaluate individual factors."

Dealing with headhunting

Many employers become nervous when employees reveal they've been headhunted by a competitor. But Quinlan says she takes a different view.

"I always say, 'That's great!' Because it shows they are a valuable commodity."

But when it comes to trumping an outside offer, the issue of headhunting becomes more difficult.

"Historically most companies will have said they can't afford to lose particular staff members and throw money at them. But after six months they're gone anyway because the problem is something deeper."

Drinan says you need to be very careful in what you're prepared to offer that employee.

"You need to understand the culture of the organisation, because the competitor might be expecting them to work several more hours."

"Particularly with Gen Y, you need to look at flexibility and what their work/life demands are. Pay is an important factor but only half of people cite pay as a key reason why they leave."

Quinlan says while salary is important in these types of discussions, and matching the offer is definitely a consideration, you should also consider moving that employee to a different department, or perhaps offering new benefits in the way of training.

Market-based surveys are also a great tool here, these experts say, and can provide justification for offering an increase or not.

Kye MacDonald says his employees receive a bonus if they can convince their head-hunter to come in for an interview.

"If they are good enough trying to poach one of my guys, then they're good enough to get our interest."

The top job

Of all the pay challenges facing businesses right now, perhaps the most contentious is that of executive remuneration. With new executive pay laws in effect, boards must be extremely careful to ensure they don't trigger a spill and potentially cause some turmoil within their business.

While many salary experts say a larger business is able to provide their chief executive with more remuneration, there are definitely some metrics you can follow that you might not be able to with an entry-level employee.

A recent Citi report, which examined the remuneration of the top 100 companies on the ASX, found that overall pay relates to company size, but to individual metrics pay a key role in determining executive pay.

The Citi report references three distinct types of models for coming up with an executive pay amount: total shareholder return, average earnings per share and average return on equity.

The majority of the companies referenced in the report use total shareholder return as the basis for determining pay, while many also use earnings per share.

There were a few companies whose chief executive were actually underpaid – Telstra's David Thodey was one, along with the chiefs of Fortescue (Andrew Forrest), Foster's (John Pollaers) and JB Hi-Fi (Terry Smart). All of these CEOs performed well over all three measures.

However, Citi points out that executives need to keep in mind their short- and longer-term incentives as well, which need to be tied to some sort of metric. While many businesses use the previous three models, there are plenty that take an unusual approach.

Ansell requires 10% of any long-term incentives to be reinvested in share which are held for 10 years, while Commonwealth Bank actually uses customer satisfaction rankings.

ConnectEast connects longer-term pay to EBITDA per car trip, while Westfield includes the level of development project starts. Resources companies often use production and resource growth targets for short-term incentives, with some often using safety targets as well.

But whatever the method, Citi makes it clear that executives should ensure their pay is correlated with their performance.

"In an ideal world," it says, "we'd suggest a combination of relative TSR (total shareholder return) against an industry-specific peer group (where one exists), and some internal/financial metrics".

It also points out that these choices need to be "clearly explained" to shareholders.

Awarding pay rises

By far the most challenging salary-related discussion employers will have this year is the pay increase for existing employees.

With so many external factors to consider such as inflation, utility costs and even the carbon tax, these experts say you need to take into account the overall economic situation rather than just how your business is performing.

"We take into account CPI, but then obviously you need to look at the importance of that individual, and that role, and whether that person has performed really well," says Quinlan.

"I tend to say, think of the person as a percentage of the business, and then think of the job they have performed."

Drinan also says you need to consider what you would pay if you needed to go on the market for that type of position, and the associated costs. However, MacDonald goes even further and says you need to consider how much it would cost to totally replace that person altogether.

"You take into account the salary of bringing someone on, but what about those other costs after that. How long would it take someone to bring them up to speed? What is the underlying cost of that?"

Quinlan says the entire process will be easier if you put some science behind it.

"We start at CPI, link that to performance, and then compare with the industry. That's how we arrive at our point. It's a really transparent process and people feel like they're a part of it."

But these experts say you don't need to just think of financial benefits in terms of payment, with Quinlan saying you should also consider providing a one-off bonus.

"A \$10,000 bonus will mean more to someone than if they have an extra \$30 or \$40 a week in their pay. It can motivate them more."

MacDonald agrees, saying that bonuses are a great way of rewarding staff without having to worry about an ongoing cost.

But he says he's happy to give his employees a pay rise, and has a great way of calculating the amount – the employees decide.

"I ask them to tell me why that expense is worthwhile. And that goes for everything in the business, if an employee wants a piece of equipment that is worth \$10,000, I need them to justify it."

"My view is that they need to be pricing it themselves, they need to come in and say the reasons behind that increase, and justify that particular amount."

Providing compensation

Of course, pay increases don't have to be just about salary. These experts say you should consider providing some sort of non-financial rewards as an alternative to pay increases, as you may find that your employees appreciate that more.

"It really does pay for employers to be across the entire offer. That way, even if competitors are able to offer more money, you have a culture that is quite different, and they cannot offer the same sorts of things."

Mercer says the workplace has now moved away from a situation where 20 years ago, workers would just ask about salary. Now, he says, there are different conditions and compensation expected.

"Over the last 10 years there has been an erosion of the expectation for advantage in pay. What we are seeing more and more of is the great nature of the entire value proposition. It goes beyond financial pay."

"If an organisation wants to achieve a circumstance where it is the top two or three employers in its field, then there is a certain value that employees attach to that."

These experts say when you're hiring a new employee, you ought to examine the total amount you will pay them, and then toy with that figure by putting some pay into non-financial benefits. Many of these elements won't cost you much in the long run, Drinan says, such as flexible start and finish times, and many employees appreciate them more.

Quinlan says you need to examine what that person will value most.

"A working mother might want to attend the kids' sports days without any questions asked. They might want a car-parking space, or something like that."

"When you're talking about salary, you're talking about the whole value proposition. Base salary, super, and so on. If you're adding a non-financial compensation, consider the cost, because parking and six weeks' annual leave becomes expensive."

Drinan says you shouldn't fall into the trap of just throwing money at a new employee, or even during a pay increase.

"Gen Y is equally attracted to a long-term career that provides the variety and flexibility that they are looking for, rather than just having money thrown at them."

(2011). *The secrets to setting salaries* Available:
<http://www.smartcompany.com.au/managing-people/20110728-the-secrets-to-setting-salaries.html>
Last accessed: Friday July 29, 2011