

Salary Compression: Will it Be Your Next Pay Challenge?

Changes in staff at CPA firms and the continued trend toward mergers means that salary compression is going to be a challenge CPA firm leaders will be dealing with more frequently—as if you did not have enough compensation and other staff issues to contend with!

Salary compression refers to when there is an unusually small pay differential among positions with various skills and responsibility levels, or where people at lower-level jobs are paid as much or more than those in higher-level jobs.

Salary compression can create issues of resentment and lower productivity, put pay planning off balance, and lead to the departure of key talent. It can also be an encouragement to staff to look elsewhere for employment as the economy recovers if they believe their salaries are unfair.

The opportunity to "unfreeze" wages is yet another reason to consider the ramifications of salary compression (for a look at the anticipated trends in compensation this year, see the accompanying sidebar).

Why you need to pay attention to salary compression. From a risk management perspective, it's important to address pay disparities, said Ron Seifert, senior consultant at the Hay Group. Firms also need to make sure they're not running afoul of the Equal Pay Act and other laws.

Firms can take steps to remedy salary compression, according to Seifert. He addressed the issue during a recent IOMA webinar on salary compression. Other speakers were Linda Ulrich of Buck Consultants and Nicholas Johns, associate consultant at the Hay Group.

How salary compression occurs. Pay imbalances can be caused in a professional services environment when firms need to find specialized talent—and must pay a high price for doing so. When staff come in at that higher rate, they may outpace even those at the level ahead of them.

Mergers are another instance that can create tension from salary compression, since it often happens that one merger firm's pay scales are just not as high as the other firm's. And with the trend toward establishing non-partner track careers at many firms, there is likely to be a population of staff that "top out" in the pay ranges for their position if the firm can't figure out other ways to reward these long-time staff.

Pay freezes and reductions because of the recession can exacerbate the effects of salary compression. If your firm only gave raises to the stars this year, you need to look hard at salary compression issues.

If the causes of compression are not addressed openly, and staff find out about pay differences, the situation can lead to emotional issues such as resentment, depression, and disengagement. Staff may feel their tenure and experience are not valued.

Compression may also send the wrong message about performance. Even though a staff person may be a good worker, his or her salary may be eclipsed by a new hire or someone who comes in via a merger. It can also discourage staff from striving to excel if there's not much incentive to advance. Another factor is that staff earning higher salaries may not respect their supervisors if they're aware of salary compression.

Possible solutions. One of the best solutions to the compression challenge is to establish a salary structure, which should be regularly updated and act as a guide when setting compensation levels. There should be enough wiggle room to award increases for superior skills and service.

Smaller firms may not go through a formalized process. Ulrich said, "Even if it's not that formal, if you have guidelines, you can work from them and with management and human resources to make sure that everyone is pretty much in sync with what the salary offers should be."

The panel noted that, unfortunately, in this economy, many solutions to salary compression require money. As tight as funds are, your firm should try to build even minimal increases into your annual budget.

For example, if your firm can allot 3 percent for salary increases, Ulrich suggested splitting that amount up into 2.5 percent for merit raises and 0.5 percent to alleviate compression.

Even if your firm does not have the funds to completely eliminate compression, the panel emphasized that it's still important to address the issue. For example, if your firm needs to hire new staff, a formal hiring rate should be established to ensure your salary offer is appropriate for the ranges you established. That's why it's important to keep pay ranges up to date, the panel noted.

Salaries should be benchmarked regularly to ensure they're keeping pace with market rates. If salary compression is not widespread but is limited to certain staff, the firm may be able to offer nonfinancial options—a special assignment or prestigious role—which might ameliorate the situation.

A clear career path also helps ease tensions created by salary compression. "If people accept that they have the opportunity to advance, they may accept being paid a little bit less for the time being with the knowledge that they're establishing a career and moving up," said Ulrich.

Career paths, complete with established requirements, ensure that your firm gets value out of every staff person. And they encourage staff to develop, reducing the firm's cost of having to recruit and train new hires.

For staff who are already at the high end of their pay range, review periods may be stretched past the typical 12-month span. This will essentially slow the rate of pay increases for these staff, yet they are likely to still feel as if they're receiving their usual merit raise.

Another option with those who are at the higher end of their pay scale is to give lump-sum amounts instead of an increase in salary. New staff may be offered a hiring bonus instead of a higher starting salary.

Compensation Trends to Watch This Year

While many employers plan to increase pay this year, it still isn't clear what those adjustments will amount to—or whether employers will be able to bring employees back to former levels of compensation.

However, fewer employers are planning salary freezes and wage reductions for this year, which is a positive sign that improvements are indeed unfolding in the market.

Insights from three major consulting firms about what lies ahead provide more indicators of what you can expect to see at your firm and at your clients' companies:

- Hewitt Associates surveyed 555 large employers and found that base salary increases for salaried exempt, salaried nonexempt, and nonunion hourly employees are expected to be 2.5 percent in 2010, down slightly from companies' original projections of 2.6 percent. The declines in projections are smaller than those last year.
- The median salary increase for employees, excluding those who will get no raise, will be 3 percent in 2010, according to Towers Perrin. The average overall salary increase for executives was forecast to be lower, at 2.5 percent.
- Sibson Consulting's research projected salary budget increases for exempt employees in the Sibson survey at 2.2 percent. The actual 2009 increase was 1.6 percent, down from the projected 3.9 percent.
- Towers Perrin found that 10 percent of employers planned to increase 401(k) contributions in 2010. Among those who cut back their contributions during 2009, 35 percent of companies plan to increase them this year.