Does Geographical Location Matter For Managerial Compensation Design?

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Abstract
Geographical location is a primary factor used in benchmarking pay rates and developing salary ranges for most executive jobs. Most organizations today have employees working at more than one location, raising the question of whether to pay differently in different places. Invariably, and particularly when the conversation is driven by employees, the response focuses on differences in living expenses. Companies use geographic pay differentials to design salary programs and manage differences in pay among locations.

Keywords
Benchmarking, Differentials

Introduction
Employee compensation refers to the assistances (cash, vacation, etc.) that an employee gets in exchange for the service they offer to their employer. Employee reward is generally one of the largest costs or expenses for any organization. Approximately 84.5% of the working population in India is made of employees earning compensation from their employer. There are many different types of compensation paid to employees. The following are a few examples of the compensation paid to employees:

- Cash compensation consisting of wages or salaries
- Retirement plans (employer contributions)
- Employer-paid health insurance
- Life insurance
- Paid leave for vacation and sick days
- Disability insurance

Location is a primary factor used in benchmarking pay rates and developing salary series for most nonexecutive jobs. Companies use geographic pay differentials to design salary programs and manage differences in pay among locations.

Geographic Pay Differential Defined
A geographic pay differential is additional compensation paid to an employee to account for variations in cost of labor and/or cost of living between locations. Some companies use cost of living (e.g., cost of goods and services) as a factor to determine geographic pay differentials. However, most companies use cost of labor (e.g., compensation) as the primary factor to determine pay differences among locations.

Use of Geographic Pay Differentials
Seventy-one percent of surveyed companies with employees in more than one location reported that they provide geographic pay differentials or adjust pay rates based on location (Table 1). However, as companies increase in size, they are significantly more likely to use geographic pay differentials.

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<th>(Companies with operations in more than one location)</th>
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There are 5 Essential factors through which a company can determine the compensation of an employee:-

1. Years of experience and education level
It probably goes without saying, but the more experience and education a candidate has, the higher their expected compensation. So, if you’re hoping to attract job seekers with master’s degrees or more than 5 years’ experience, you need be ready and willing to compensate accordingly.

2. Industry
Workers with similar, or even the same job title can expect vastly different wages depending on what industry they’re in. There are many reasons for this discrepancy – in some cases their job function may be critical to a particular industry, or it may simply be a matter of one industry being considerably larger than the others.

3. Location
Cost of living, a major factor to consider when determining compensation, is largely dependent on location and, more specifically, the cost of housing. This is at least partially why salaries in large urban areas are generally higher than salaries for similar positions in more rural locations.

4. In-demand skill sets
When it comes to determining compensation, key skills may be an even more reliable metric to compare against than job title. After all, different companies may have very different definitions of the
same job title. On top of that, many skill sets can apply to a wide variety of roles – all of which are effectively competing for the same talent. That’s why it’s important for employers to consider the value of key skills when determining compensation.

5. Supply and demand
It’s crucial to be aware of the availability of relevant talent in the geographic region where you’re recruiting. If you’re recruiting in an area where the demand for a certain skill sets and experience outweighs the supply, you should expect to pay more in order to attract talent.

Methods to Assign Locations to Geographic Pay Differentials

Nearly two-thirds of companies with geographic pay differentials use data for individual cities to assign locations to geographic pay differentials.

Market pricing jobs by city is widely considered a best practice for assigning locations to geographic pay differentials. However, it is not always practical or possible to use market data for city locations.

As an alternative, just over 16 percent of companies create geographic pay differentials using a particular state or region, while almost 19 percent of companies create geographic pay differentials by grouping locations with similar market rates (e.g., Geographic Pay Zones).

Geographic Pay Differentials by Job Level

Most companies with geographic pay differentials provide them to employees below the executive ranks. Executives are less likely to be eligible for geographic pay differentials than nonexecutive employees.

Types of Data Used as Basis to Determine Geographic Pay Differentials

More than 86 percent of companies with geographic pay differentials use salary surveys (cost of labor) to determine geographic pay differentials. Just over one-quarter of companies use cost-of-living data as a basis to determine geographic pay differentials.

However, most companies that use cost-of-living differentials also use cost-of-labor data from salary surveys. Only 6 percent of companies use cost-of-living data as their primary source to determine geographic pay differentials. At the same time, more than 75 percent of companies that reported using two or more types of data use cost-of-living differentials.

Conclusion

The goal for a compensation program is to set a competitive wage range for a given position, and pay the people who perform that job within the salary range. Complications arise, though, when your workforce is spread from city to city, state to state, or country to country. There can be substantial differences between the cost of labor (average employee compensation level) and the cost of living (average cost of the bucket of goods utilized by a typical consumer, including things like housing, groceries, etc.) in a particular location.

For Bangalore, India, salaries (cost of labor) are 119% of the India average, while cost of living is 165% of the India average.

For San Francisco, California, salaries (cost of labor) are 124% of the U.S. average, while cost of living is 180% of the U.S. average.

For Manhattan, New York, salaries (cost of labor) are 119% of the U.S. average, while cost of living is 218% of the U.S. average.

Geographic salary differences tend to vary by income level (and so, frankly, can cost of living estimates, but I’m not going to go there...); for example, the “differential” can be different at a Rs. 100000 level than it is at Rs. 55,000 and than it is at Rs. 35,000.

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