A Guide For Adjusting Wages and Benefits for 2008

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The start of a new year is a natural time to review company compensation programs. This review process is exactly what many contractors are now involved in as they hammer out their 2008 business strategy. If you happen to be one of those contractors, this PAS guide is timely. It focuses on the factors that go into a thorough compensation evaluation, the current state of contractor compensation and what the industry anticipates doing in 2008.

Key Factors

There are two components to a company's compensation program. One component is wages and the other is benefits. Together these two components comprise a company's compensation package. For a contractor, that package can represent 50 to 85% of the business' costs. Hence, at least a yearly evaluation of a company's compensation program is really essential if that company is to remain competitive.

The factors that usually go into this evaluation process are as follows:

1. The rate of inflation
2. The general increases in the cost of employment
3. The market value of key positions
4. Individual performance of employees
5. The overall performance of the company
6. The economic outlook for the coming year
7. The company's pay philosophy.

CPI & ECI

All compensation programs must respond to the current economic environment. That environment involves the value of money and the cost of employment. Chart 1 gives a graphic representation of these two pieces of the economic pie. The first factor is commonly known as inflation. What's a dollar worth or better, how much has the dollar eroded during the year past? The Bureau of Labor Statistics measures this inflation factor and calls it the Cost of Living Index or CPI. Compensation packages that do not keep up with inflation reduce employee buying power.

For example, $100 dollars in 1993 would buy as much as $128 in 2003. So an employee's wage would have to be 28% more in 2003 than in 1993 just to maintain the same standard of living. *Tip: The Bureau provides a handy inflation calculator to assist in determining just how much or how little inflation impacts current wages. The URL for this calculator is http://data.bls.gov/cgi-bin/cpicalc.pl.*

The second factor to which a contractor's compensation program must respond is the cost of employment generally. This is called the Employer Cost Index (ECI). Like the CPI the ECI is an index that measures the increase in employer payroll costs (wages and benefits). This index tells the contractor how much payroll costs are increasing across all industries as well as within the construction industry. Both the CPI (inflation) and the ECI (payroll increases) are important benchmarks to examine when evaluating the adequacy of a company's compensation package. As shown in Chart 1, as of September, 2007, the annualized increase for employment costs in construction is 3.8% and the rate of inflation as of September 2007 is 2.8%. Since employment costs are rising faster than the rate of inflation, most contractors will use the ECI as the benchmark for increases in their overall payroll.

Benchmark Positions and Individual Performance

The next two factors that need be considered are market value and individual performance. Market value is simply what contractors pay in the aggregate for particular positions common in the industry. For example, Project Manager, Superintendent and Estimator are common in function and responsibilities among contractors. These common titles are referred to as benchmark positions because the industry's range of pay for these positions is readily available from various public and private industry surveys. This range of pay is the position's market value. For a compensation program to be competitive, a company must pay close to this market range or take the risk of losing valuable people or, in the case of paying in excess of the market, carrying too much overhead.

Once the current market value of a position is established then there is the consideration of individual performance. How well did the individual employee perform the duties and responsibilities of the position? Whether there is an objective or subject measure of performance, consideration is usually given to the merits of an employee's efforts and individual pay increases are distributed accordingly.

Table 1 shows the average increases for construction staff pay in 2002 through 2007 and projected 2008. The comparison is derived from the 2007 PAS *Construction & Construction Management Staff Salary Survey* and the WorldatWork *2006-2007 Salary Budget Survey*. These increases include companies that gave or are giving zero percent increases (about 11% of the participating companies in both surveys).

Company Performance and the Economic Outlook

The outlook for 2008 is “choppy” according to the Conference Board, a leading research group for private industry. Some areas of the economy are strong while others are showing signs of weakening. A slow down in economic activity, however, will not likely impact construction. Construction activity with the exception of residential housing will likely remain strong through 2008. That means that construction personnel will be in relatively high demand. That translates into wage increases well above the 4% level for most types of construction professionals.

In Summary

Pay Philosophy and Pay Trends

Pay philosophy is the way a company chooses to balance base wage, variable pay and benefits together in a total compensation package. Here are the trends of the past five years.

It continues to be popular with many construction companies to emphasize variable pay over base wage. These are variously known as employee incentive programs and are usually in the form of bonus or profit sharing. In some cases, companies have used these programs to increase variable pay (bonus primarily) up to 100% of base pay. *Caution:* This emphasis has a serious downside. If companies are not paying market as a base wage, they may be fooling themselves into thinking their fixed costs are low. They aren't. As soon as the company falls on hard times and bonus monies evaporate, their employees will seek jobs with companies that pay a higher base wage. In addition, the company simply will not be able to attract new hires.

A second trend is the rise in the importance of carefully crafted benefit programs. In 1988, voluntary benefits (health care, retirement, vacation, etc.) amounted to only 19% of payroll costs. In 2007 that figure is 25%. Obviously, the benefits a company offers are both more important as a competitive advantage in hiring and maintaining a skilled workforce and, at the same time, more expensive.

As an important footnote to company benefits is the soaring cost of health insurance. Health insurance now over 8% of payroll and companies are struggling with ways to keep health insurance available to their employees. For example, 89% of construction companies in 2007 use alternative providers (PPO, HMO, POS) instead of traditional indemnity insurance. There is more cost sharing with employees, higher out-of-pocket limits and deductibles. As we have reported previously we are now seeing a growing number of companies institute premium caps.

In addition, companies are instituting disease management programs, health savings accounts, health reimbursement accounts and flexible spending accounts. All of these programs are to help sustain a workable shared cost system to insure that employees and their dependents have adequate health insurance coverage.

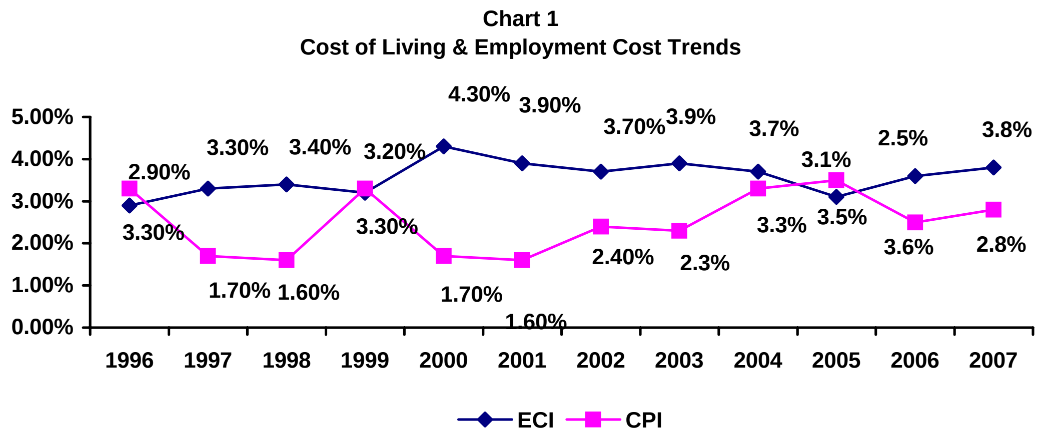
Summary and Conclusion

Inflation is still not a significant player in wage determination but something to watch. For sure the cost of employment within the construction industry is on the rise with the 4.8% aniticipated wage increases for construction personnel being the most poignant factor to weigh in determining current wages. The cost of employment for private industry as a whole is 3.1% as of September, 2007. The economic outlook suggest there may be bad weather in the forecast. In short, a prescription for construction wage determinations in 2008 is *pay the going rate but don't overindulge*.

Therefore, in evaluating your company compensation package for 2008, consider setting your total payroll budget to increase no more than the ECI currently at 3.8% for construction and your wage structure adjustment at 3.2% the projected structure increase for contractors. Make sure you have defined your key benchmark positions within your company and have reviewed the market range for those positions using a reputable and representative salary survey. Adjust base pay so that it stays relatively close to the current market range. Use an employee appraisal of some kind to fairly distribute merit increases among your hardworking staff. Consider the companies prospects for 2008 and the fact that contractors in general are anticipating wage increases of around 4.8% on average. Balance your base wage, variable pay and benefit programs to optimize the return on your payroll dollars. Incentive programs work for you if you maintain base pay at market rates. They work against you if your base wages fall below market rates. Your company benefit package (the voluntary portion) is a very important and expensive attractor of high performing employees. Make sure that the benefits you offer fit your employee needs and especially scrutinize your health care program. We suggest looking into the new efforts at reducing healthcare cost not just health insurance premiums.

Sources

The sources drawn upon for the data presented in this is review include: the WorldatWork (previously the American Compensation Society) *2006-2007 Salary Budget Survey*, an across industry survey of employee wages; the 2007 *Construction/construction Staff Salary Survey*, the most current PAS information on actual and anticipated wage increases; the Bureau of Labor Statistics *CPI and ECI*, cost of living and the cost of employment measures for 2007; the 2007 *Benefit Survey for Contractors*, a PAS survey of employee benefit plans; and lastly, *Contractors Compensation Quarterly*, a summary of construction wage and benefit trends over the past 20 years.



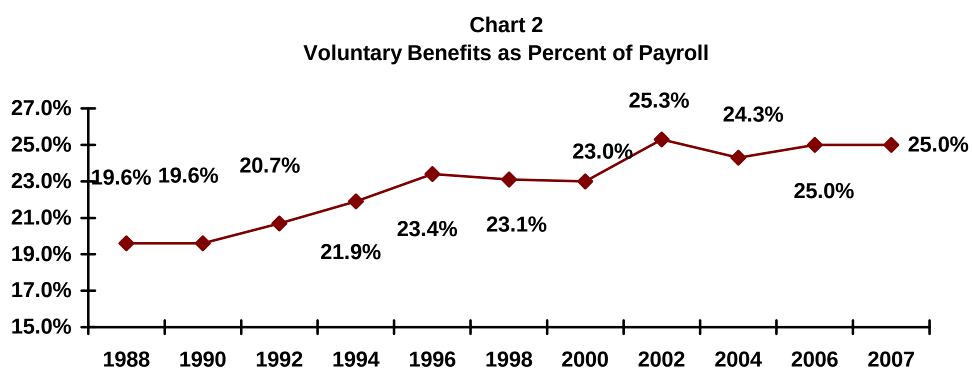


Table 1
Construction Staff and Exempt Staff Nationally

Yearly Increases	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Construction Staff	5.1%	4.6%	4.0%	3.7%	3.7%	3.9%	4.4%	4.4%	4.8%
All Exempt Salaried*	4.6%	4.6%	3.9%	3.6%	3.6%	3.7%	3.9%	3.9%	3.9%