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What are Geographic Differentials and why should I care?

The employee sitting across from your desk is staring at you, a puzzled look on their face. Strange, but that's not the look you expected, and *nothing* like how another employee reacted at your earlier meeting.

Fade back a few hours . . . .

Your business has reorganized, and in the course of redefining new positions several opportunities have opened up that offer the possibility of outstanding career moves for the right candidates. You like giving good news, and have offered two high performing employees the chance of a lifetime.

This morning you offered a San Francisco employee a promotional opportunity in Jacksonville, FL. The new position carried with it a 20% base salary increase. As expected, the employee was thrilled, and your arm quickly became sore from the eager handshaking that followed.

However this afternoon, when you offered a Jacksonville employee a similar promotional move to San Francisco, with the same 20% increase, she at first stared at you with a puzzled frown then turned you down flat. No handshaking here. She even mumbled something like "no way", and then said you would "have to do better."

There are two challenges at work here; 1) how to structure pay for jobs located at diverse locations across the country, and 2) how to deal with the pay adjustment issue when asking an employee to move from one location to another.

Should everyone in your company be paid on the same scale, regardless of where they work? Do all companies pay the same rate for identical jobs across this great land of ours? Can $100 buy the same amount of goods and services, no matter where you are making the purchase?

The answer is no.

Test yourself: if you were offered a modest promotion and salary increase, would you be interested in moving from San Francisco to Jacksonville, FL? How about a move from Jacksonville to San Francisco? Likely you'd have different reactions, wouldn't you? Just like the employees in the above scenario. Perceptions are supported by statistical data that indicates pay and living costs are higher in certain areas of the country, and similarly are lower in other areas.

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It's a fact that companies pay differently for the same work between San Francisco, Topeka, KS, and Jacksonville. Companies pay differently because the competitive market for those salaries is different. However, we need to distinguish this reality from the cost of living, which is a horse of a different color. Remember that companies react to and provide for changes in the cost of labor, *not* the cost of living.

Changes in living costs usually <u>follow</u> changes in labor costs, which is why employees tend to confuse the two and over time have presumed the two metrics move in lock-step. They do not. There are many other factors besides labor that impact the cost of living: housing, taxes, transportation, food, fuel, education etc. (the government's breadbasket of goods that is rated for the Consumer Price Index – CPI).

You also have the anomaly of certain attractive locations (i.e., Boston and Denver) where cost of living increases have outpaced increases in the cost of labor.

Have you ever tried to tell an employee that their $100 will buy them more in Jacksonville vs. San Francisco, so that they do not <u>need</u> a pay rise? Your logic would be right on the mark, but to the employee that gives them an "optics" problem – it just doesn't "look" right to them. They will still want more money to make the move, regardless of whether it is a promotional or a lateral move.

When you move an employee from San Francisco to Jacksonville, if you offer no change in salary because the Jacksonville area is a lower cost of living area, what is your strategy should you want the employee to move back? Likely they have absorbed whatever they gained in purchasing power from their first move, and will now want more to return to the "high cost" San Francisco.

While in Jacksonville your employee adjusted their standard of living from San Francisco to their new environment. Moving back to a much higher cost of living San Francisco would likely not allow them to maintain their current and accepted style of living. They will look to you to fix the problem (provide more compensation), or they would prefer to stay put!

Companies make a determination for each location as to how that location relates to the national average – and adjust their pay scales accordingly. The trick isn't between Jacksonville and San Francisco, which everyone can see is a stark contrast, but between Topeka and Pensacola, FL. A difference there might generate an argument.

For companies with multiple worksites it makes sense that the salary ranges associated with each location are pegged to reflect competitive pay practices at that location. Using a national average for all locations would increase costs for lower paid areas and shortchange those areas where higher pay levels are commonly provided.

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The decision to use three, four or even five geographic pay structures varies among companies, and is typically based on the range of relative wage costs data among the different locations (i.e., 87% of national average for small, rural locations up to 123% for a select few major metropolitan areas), and how much of a percentage differential a company wishes to have between structures. Differentials usually are at least 5% apart, but it is not unusual to see 10% (or more) when only three structures are used.

So the challenge for HR is to be aware of both the differences between cost of living and cost of labor (can you test yourself and repeat out loud the differences?), but also to the employee perceptions that you will be dealing with. It's one thing to provide geographically based salary structures to reflect differences in the cost of labor; it's another to move employees from one location to another and deal with the cost of living.

Several of my clients contacted me because they confused the two, with the subsequent cost, equity and employee relations issues creating quite a mess.

Be careful out there.