# Navigating Payroll Hikes

## A new labor market requires that employers scrutinize a host of variables.

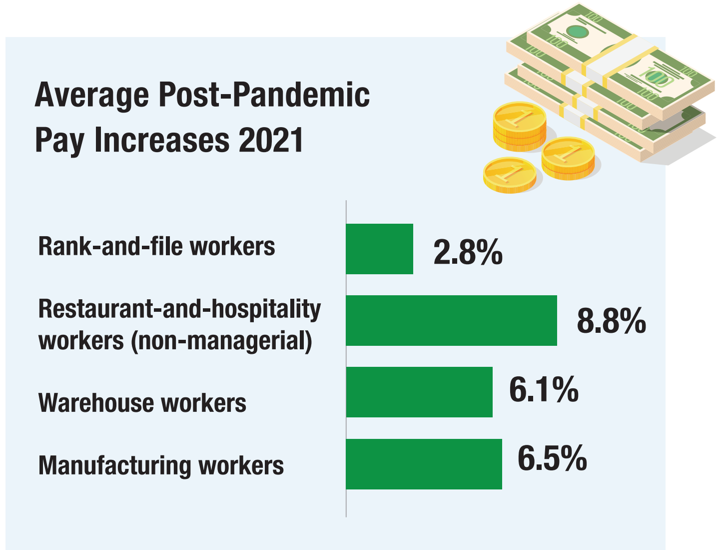
Employers are facing a new reality. The population at large has been aging, and now the pandemic has introduced new levels of fear and peril to workforces that are operating within fast-transforming markets. Add in the technological advances that have contributed to worker empowerment, and the ever-present challenges of recruitment, retention, and productivity loom larger than ever before.

## What's Going On?

Many businesses say they can't find enough workers. Meanwhile pay is rising rapidly. Many stores and restaurants are posting "please be patient, we're short-staffed" signs. But, according to the U.S. Bureau of Labor Statistics, it is not at all a uniform phenomenon: Whether the openings are in high-contact industries such as buffets and movie theaters, or other industries that were initially hard hit—such as RV dealers, car washes, breweries, and appliance stores—some have enjoyed nearly complete comebacks as consumer spending on many goods and services have recovered, while others remain mired in ongoing dislocations. This uncertainty has only been exacerbated by the unpredictability of COVID-19 variants.

The competition has been particularly fierce for employers trying to fill lower-paid positions. Many former service employees are refusing to return to a sector that typically demands long hours, grueling shifts that can require interaction with customers, and increased exposure to the virus. Low pay with high stress is a challenge for all parties.

The current situation is very different from what followed the Great Recession, when the ranks of the unemployed far exceeded availabilities in most sectors for many years. As of September, according to a report in *The Washington Post*, average pay for rank-and-file workers had risen 2.8% in less than half a year, the fastest rate of increase since 1981. More specifically, the same period saw pay rise 8.8% for non-managerial workers in the restaurant and hospitality sector and 6.1% for warehouse workers. (Of the 3.1 million jobs gained since March, almost half are in hospitality—though that stalled with the advent of the delta variant.) Elsewhere, wages for manufacturing workers leapt up 6.5% in early 2021, compared to the previous year, and show few signs of abating.




Resignations are the highest on record—up 13% above pre-pandemic levels. Likewise, as CNBC has reported, retirements have spiked, with some 3.6 million employees leaving the workforce during the pandemic, roughly 2 million more than otherwise would have been expected. According to research by Microsoft, some 40% of the global workforce are considering leaving their employer this year. Equally troubling, the U.S. Bureau of Labor Statistics recently reported that the ranks of long-term unemployed have climbed, with 37.4% of the currently unemployed having been out of work for at least six months.

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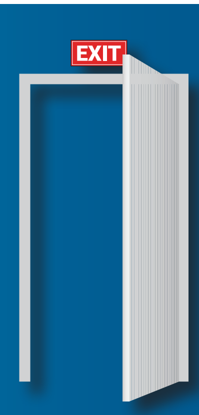

Other shifts in the environment present challenges because, according to the September article in *The Washington Post*, many jobs do not exist in the same occupations—or locations—where people worked before the pandemic. For example, professional and business services count 1.8 million openings, while fewer than 925,000 individuals can list their most recent job as being in that sector. Something parallel exists in education and health services, where 1.7 million openings align with only 1.1 million people whose last job was in that sector. Labor Department data further reveals that workers in that sector have quit at the highest rate on record, dating back to 2002. As employers know, such staff losses are more than inconvenient: Recruiting and training totals roughly 16% of a typical low-wage worker's annual salary. And the burden can be worse for smaller operations that often do not enjoy the same margins, resources, or timelines as larger companies.

In recent months, COVID-19's variants have exacerbated the situation, with pandemic-related hospitalizations in late August reaching their highest point since January, 2021, according to the U.S. Department of Health and Human Services. At a macroeconomic level, this has resulted in a recovery that, while ongoing, has proceeded in fits and starts. The Brookings Institution and other observers were surprised, for example, that the government counted only 194,000 jobs added in September, yet simultaneous rises in durable goods orders augured longer term recovery. Go figure.

Early data from The Conference Board anticipates that in 2022, companies are projecting median salary increases of 3% for all categories of employees, which has been the trend for more than 10 years. Although that might well strengthen prospective employers' value propositions for candidates, many workers reacting to these multifarious stress points, are reassessing what they want from their lives. That includes what they do for a living and for whom they do it. As a result, employers continue to confront daunting challenges on both the retention and recruitment fronts. Many also reacted to the shutdown by reducing their hiring infrastructures. Having shed like crazy back then, many seek to rebuild like crazy right now.

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## New Realities Require New Responses

To attract enough candidates—let alone land the prospects—companies might need to bite a few bullets or at least exercise some creativity in employee relations. This is not only due to macro changes in market realities. Individual candidates and workers are using new tools that are changing the landscape for hiring and retention. Candidates expect greater transparency and with visibility into compensation increased by the likes of Glassdoor and PayScale, they can often achieve those insights independently of whatever the employer provides. (That said, see caveats on the next page.)

In response, some employers are providing more robust information on pay up front. This can reduce the number of candidates who are frustrated by a long hiring process that culminates in offers that they perceive as providing inadequate remuneration. (Such expectation gaps, of course, can come at a cost to both prospect and employer alike.)

Kroger Co., Chipotle Mexican Grill Inc., and Under Armour Inc. all pushed up hourly wages during 2021 to stanch hemorrhaging of their workforces. Others, such as Starbucks and Drury Hotels, have begun offering hiring bonuses, while CVS Health Corp. has dropped its requirement that candidates have high-school diplomas. Some employers also are handing out off-cycle merit increases and one-time bonuses, particularly for those who missed such adjustments during 2020.

Precision can yield better outcomes than blanket policies. Employers would be wise, for example, to allocate pay hikes according to specific categories in which talent demand exceeds supply. That could result in more sustainable targeting going forward. Various categories are worth an examination: hard-to-fill and high-turnover positions; jobs that are truly integral to the bottom line; and positions that have seen significant inflation in market pay rates.

Another obvious area of concentration is remote work, which has created new career paths for higher-skilled professionals. Concerned about losing day-to-day interactivity, some employers have responded by reviving stay bonuses and real-time salary adjustments for this cohort. As with the likes of special bonus awards and equity payments, these stratagems can give employers a short-term solution without burdening the enterprise with greater fixed costs. Meanwhile, other employers have created arrangements that, while temporary, are not exactly ad hoc; they can provide pay increases based on time cycles (e.g., at the six-month or two-year mark) or newly certified skills. Other responses can include improved benefits, better hours, perks or discounts, and flexible workforce solutions. The prospect of new and improved training programs offers another area for engagement. Separately or in parallel, enticements to change careers can appeal to some candidates and existing employees; making that succeed is often easier said than done, of course, especially in fields that mandate licensure.

One other development has caught the eye of analysts. Although pay hikes can appreciably improve a worker's standard of living, standard of lifestyle can be equally important. Depending on the demographics of the workforces in question, employer-provided benefits can prove just as important to certain workers as the amounts on their pay stubs. As the pandemic has revealed, one such benefit is reliable childcare, which can prove sticky for retention and magnetic for recruitment.

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## Reflect Before Reacting

In responding to these new data and dynamics, time is of the essence. But so is reflection. Overall, those who lost jobs lost during the pandemic have collectively experienced a rollercoaster, depending on their sector. Many analysts forecast that all jobs lost might be restored by mid- to late-2022, a two-year rally that would significantly surpass the six-plus years that it took for the labor market to recover after the Great Recession.

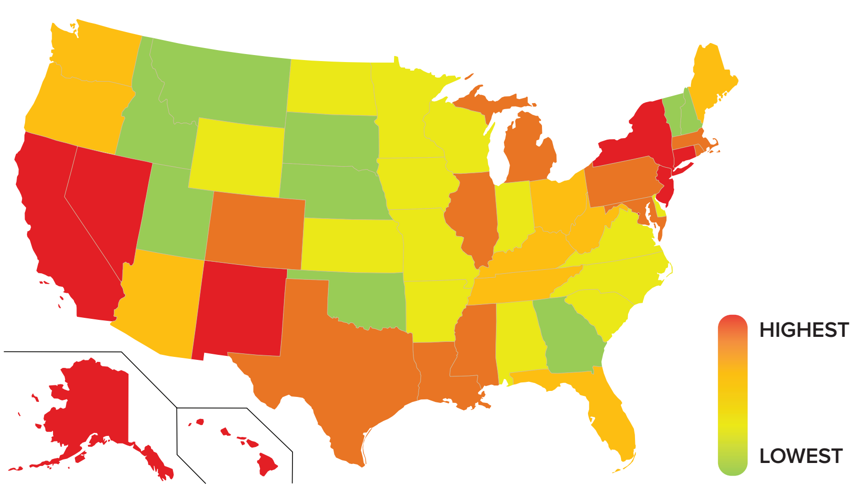
Or not.

In strategies for both recruitment and retention, employers would be wise to heed the recent observation of Federal Reserve Chair Jerome H. Powell, who called the recovery “vigorous but uneven.” Job losses remain steepest for Black and Hispanic women, as well as all Americans without a college degree. Note too that the faster shrinkage of low-income positions compared to other categories might have distorted the picture, magnifying the appearance of aggregate wage increases and pressuring employers to raise wages to satisfy a perception that does not necessarily comport with the reality on the ground.

The situation can vary markedly by location. Unemployment rates are nearing all-time lows in Idaho and Utah, but other states have been less fortunate. Hawaii, for example, is still at 12% unemployment, New York is 9%, and tourism-dependent Nevada is at 7%.

Take care, too, in reacting to the new demand for transparency. Opening the books on compensation might require finesse. Employers do not want pay workers more than the value of a given role. What’s more, such revelations might make pre-existing employees feel undercompensated. The danger also exists that competitors could exploit the information or that an excellent candidate might be dissuaded from applying due to the pay range that is posted. On the other hand, Colorado recently passed a law requiring such postings for certain sectors. Meanwhile, California and Maryland mandate that such information be provided upon request and, as of this fall, Connecticut now requires pay transparency for open positions.

**UNEMPLOYMENT RATES BY STATE — as of November 2021**




Source: US Bureau of Labor Statistics — Local Area Unemployment Statistics

A possible way to square that circle: Consider displaying a pay range, with the proviso that the salary might be subject to negotiation. And, as referenced above, employers must remember that candidates and legacy workers might have access to certain information, whether the employer volunteers it or not.

If the ongoing labor shortage is a transitory result of lingering pandemic effects and uncertain market activity—as opposed to being a more enduring phenomenon—employers who increase compensation frameworks might well find that they have locked themselves into fixed costs without establishing a countervailing return on spending. Labor inflation, after all, typically endures for decades; monetary inflation, by contrast, changes quarter-to-quarter.

That said, the new workforce dynamics might compel employers at least to temporarily increase raises within their pay structures. For example, they might need to hike pay for workers in particular roles, at the 60th percentile instead of at the median. Towards that end, employers should also strive to avoid "fighting the last war"—that is, they must apply real-time market intelligence to ensure that the landscape has not shifted in material ways from the last time they checked in. Additionally, although passing through higher costs by increasing prices or cutting overall workforce hours are obvious options, the former can weaken a customer base while the latter might lead to higher turnover.

## Final Takeaways

Talent shortages come and go, but today's scarcity has so far proven more widespread than that found in other cycles. The big differences now: Changes in demographics, uncertainty borne of the pandemic, and the reality that entry-level, hourly employees have more and better cards to play than before.

To become or remain a best-in-class employment brand requires diligence and flexibility, explains **Brian Cotter, President of PSG Global Solutions.** As a diagnostic matter, that means real-time research. "In this candidate-constrained environment, we've found it particularly important to use data to guide hiring decisions," he says. "For example, one of our clients had customer service experience as a must-have requirement for certain roles they were hiring for, which eliminated about half of incoming candidates. We tested that requirement using machine learning and showed that candidates with customer service experience performed worse than candidates without that experience. This convinced the client to remove the requirement, and effectively doubled their candidate funnel."

Other adjustments by some employers will likely be required. "Remote work has allowed employers to pull from a much broader candidate pool," says Cotter. "To take advantage of that, we're using machine learning to guide our clients' remote hiring efforts. For example, for one of our clients we've found that there are double-digit differences in retention rates for candidates from locations with a specific set of characteristics, versus other locations. Based on that, we are refocusing our sourcing efforts on high-retention rate locations and deprioritizing low retention rate ones."

Some cardinal principles for employers facing this new reality:

- Stay current. Get real-time, frequently updated information—whether the factors are sectoral inflation rates or pandemic variants—the environment can change monthly, if not weekly.
- Be as transparent as the market demands and your business model will allow.
- Go remote as much as possible. Properly administered, this can actually offer employers net cost savings in workforces that are both more content and more productive.
- Stay balanced. Management and rank-in-file alike benefit from clarity, candor, and consistency.

Employers that follow these precepts—especially when guided by relevant legal and data expertise—stand a chance to emerge from today's uncertainty with new efficiency and greater resilience. ■

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