Using Compensation Benchmarking to Win the War for Talent

By Mike Rose
Tight labor markets demand accurate and timely compensation practices. Benchmarking enables you to make informed decisions to ensure competitive pay.

The continuation of tight labor markets, combined with escalating payroll costs, highlights the reality that the construction contractor’s war for talent is in full force. The pay required to attract talent continues to rise, particularly in highly competitive markets. FMI is seeing an average base salary increase of 21% across the top 10 MSA areas alone. Yet, pay is moving in unexpected ways within critical skill areas and/or driven by geographies. For example, in Milwaukee, Wisconsin, the job with the highest average base pay increase was project superintendent - level 3, increasing about 53% over 2017, whereas in San Francisco the top job was business development – Level 1 increasing 26%. The message is not that everything is increasing, but rather pay rates rely critically on local markets and job skills. For example, FMI is seeing a “cooling” within the business development skill areas in Tampa, Florida. Understanding market pay trends allows leaders to plan more accurately for the future and adapt to important developments that are fundamentally reshaping the industry.

When it comes to compensation, pay too little and you risk turnover and potentially losing some of your most valuable employees. On the other hand, if you pay too much and risk bottom-line profitability, you could wind up facing some major difficulties—not the least of which will be going out of business. An analysis of 27,000 construction professionals’ pay revealed about 7,000 were paid $112 million (3.7% of total base pay) in excess of the market while 6,600 were paid $62 million below market. The job family that was most out of market (i.e., highest percentage of incumbents below and above market) was business development at 54%; that is, 54% of employees in this job family were either above or below market, leaving 46% at market. Of the five benchmark operations job families (project manager, superintendent, field engineer, estimator and general foreman), estimator was most out of market. The job family with the most pay out of market is project controls. How can an organization navigate these challenges? Undergoing a formal benchmark process and leveraging FMI’s Benchmark Tool.

What Is Benchmarking
Basically, benchmarking means comparing some small sample (i.e., a company’s employee data) with a set of statistics based on the larger population. This helps companies understand exactly where the sample set is with respect to the larger population, which serves as a reference point. For compensation, the labor market serves as the reference point and comprises all employee pay data competing in the construction industry. Salary benchmarking involves comparing each individual employee’s pay with the market and understanding how that incumbent compares to the market. In general, this means understanding whether an employee is above market, within market range or below market.
By benchmarking pay data, an organization can understand the degree to which it is at risk at both the employee level and the organizational level. Thus, salary benchmarking is an essential tool in maintaining a successful competitive position. The development of a successful plan requires more than just the number; you must also consider the following:

**Compensation philosophy.** What is our compensation philosophy? Where do we want to be in the market? Where do we want to be with respect to base and bonus? A compensation philosophy is an understanding of where the organization wants to be in the labor market. For example, an organization may want to target the median for total cash. In doing so, it may want to pay at the 60th percentile in base salary but at the 40th percentile in bonus, so that total cash comes out at the median.

**The corporate culture.** When considering a compensation philosophy, an organization should consider the corporate culture as well as the culture it is trying to build. For example, an organization may say, “We pay well, and we pay fairly, but we pay for performance. And as a result, we want to de-emphasize base salary targeting the 45th percentile and emphasize performance bonuses targeting the 55th percentile.”

**Pay transparency.** Another question an organization may want to consider is how transparent it wants to be with its compensation practices. Some questions to think about might be:

1. Does your organization tell employees when and what to expect on their paychecks?
2. Does your organization share market information with employees?
3. Do you have performance-based compensation plan in which employees know what they must do in order to earn?
4. Do you share pay ranges with employees?

While pay ranges and employee information are most likely not available to all employees, a reasonable amount of transparency can increase employee trust in the organization.

**The labor market itself.** Know the labor market, both nationally and locally. Does your organization rely on statistically valid surveys or word of mouth for pay information? Is pay information available right down to the metropolitan area? What would you have to pay to replace a valuable PM if he left, and what could that person command if he went out looking for a job? Paying competitively means paying at the market level. FMI considers market level to be between the 25th and 75th percentiles for the population under consideration.

**Industry focus.** When thinking about the labor market, consider not just your immediate competitors for business but also those organizations that might be competing with you for highly qualified talent. When choosing an industry for labor analysis, the key question to ask is, would employees most likely stay within the industry, or could they, if offered sufficient pay, migrate to an adjacent market. Would a project manager migrate from commercial retail construction to highway construction?

**Job descriptions.** In addition to these key elements, you also must understand that you must have a consistent understanding of the jobs and related duties. Having well-designed job descriptions is critical to organizational effectiveness. Utilizing survey data requires matching
organizations’ jobs to survey-defined positions. To do this effectively, you’ll have to understand what the job in question entails. This is an important step because it also helps an organization focus on the job and not the person.

**Tracking Labor-Constrained Pay Trends**

The current labor market remains tight with the unemployment rate across the construction industry having declined from 4.7% in June of 2018 to 4.0% in June of 2019. For employers this represents a continued tightening of the overall labor market as the industry continues its march toward full employment. The overall continued downward trend drives pay rates to increase. Although total construction employment has rebounded to 7.5 million workers\(^1\), it is still below its peak of 8 million workers in 2006.

Given the competitiveness of the industry and its rapidly changing nature, contractors must understand the reality of the current labor market (not rely on anecdotes from past years.) Those who don’t perform market research and pay salary benchmarking are in effect putting their companies at risk.

Companies will need to consider the changes taking place in local markets. The average base pay for construction professional jobs (all jobs averaged across the Metropolitan Statistical Area) can exceed 20% above the national average (see Figure 1). Note that the most competitive markets, with some exceptions, tend surround major US coastal cities. Similarly, less competitive markets can be up to 20% below market.

**Figure 1- Geographic Differential from National Average**

In today's tight labor market, contractors are engaged in a war for talent, with rapidly changing conditions creating unique challenges for all companies. Compensation pay benchmarking provides an understanding of the associated risks. As outlined, the most competitive markets have pay levels over 40% higher than less competitive markets. Growth rates in some markets are also on the order of 50%. As a result, pay levels change rapidly, and pay levels six months ago are outdated.

Given these trends, organizations face significant challenges keeping up with the dynamic marketplace. Benchmarking employee compensation regularly, and at the local level, and remaining competitive with your closest competitors are vital in staying ahead of rapidly changing market trends.

Leveraging Benchmarking to Empower Employers

It's time to ask yourself questions like, do I have a precise understanding of today's intense labor market (versus a gut feel). If the answer is no, you could be at risk of loss of key personnel, overpaying for those employees, and/or putting organizational profitability at risk. Losing a critical project manager or general manager, for example, can force an organization to forego a project, lose out on big opportunities, or place crucial projects at risk.

For an organization that has never done compensation benchmarking, the results can be eye-opening. According to Jay Fayette, CEO of PC Construction, “We had no formal salary system in place. Pay discussions were arbitrary and unstructured and not based on the market. The process was transformative for our organization.”

Now FMI has streamlined the benchmarking process with the introduction of the FMI Benchmarking Tool. This system leverages over 700,000 records of incumbent data and then reports on how job families, positions and actual incumbent employees are paid (base salary, total cash and total compensation) against the market (25th to 75th percentile) to determine whether that element of pay is below, within or above the market.

Figure 2, Geographic Differentials from National Averages, tracks the wide swings that can occur in pay across the country -- shown here is the project superintendent – level 4 survey title (professional capable of managing projects over $100 million and with at least 15 years of total experience). The most extreme example is in New York with 32% above the national average whereas pay in Phoenix, Arizona, is 13% below the national average, accounting for a total swing in pay of 45%.
The system allows us to identify both below- and above-market incumbents as well as provide specific market delta amounts (highlighting just how vulnerable they are to turnover). Seeing data within given markets, positions or families (See Figure 3) gives you the information on exactly who’s impacted, allowing decision makers to make key decisions in the overall adjustments in pay plans. Having the ability to further refine the benchmark data across geography, revenue band, industry, etc., gives you necessary information to make informed decisions specific to the actual market/person. Companies that do benchmarking for the first time are often confronted with the question of what to do with its below-market employees. The first thing to do is to understand what percent of the total payroll the pay that is below market represents. In the FMI Compensation platform, this is shown on the summary page as “Incumbent Base Pay Below Market as a percentage of total pay.” Is this number below 3% (the given typical amount for the annual merit increase)\(^1\)? If the answer is yes, then it is possible to make up the difference in a single merit cycle. Invariably though there will be employees that are far below market. It is not to be expected to make up the gap in a single merit cycle. A good strategy is to prioritize employees in terms of their skill level and come up with a plan to move the employee to market within a three- to five-year time frame.

In summary, pay benchmarking provides an understanding of the risks associated with compensation. In today’s tight labor market, contractors are engaged in the war for talent. Rapidly changing dynamic markets have created unique challenges for contractors. Ask yourself, “Do I have not just a good feel for, but a precise understanding of today’s intense labor market?” \(^*\)Why take on those risks when tools are available to avoid these risks and focus energy on the corrective action necessary to win the war for talent.

Learn more about the Benchmark Tool as part of FMI’s Compensation platform

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