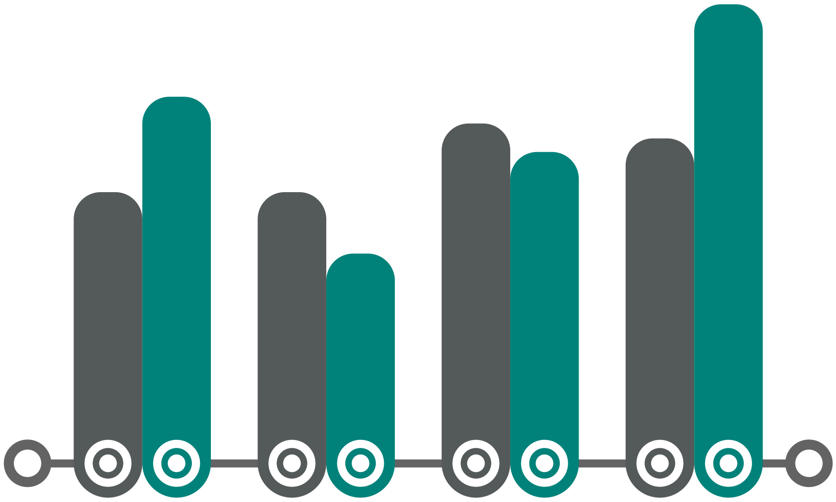


Geographic Differentials and Remote Working Arrangements

A Time to Re-Evaluate

May 2021

Remote working has been an incredibly hot topic lately, fueled by the COVID pandemic and many battlefield decisions companies have made to move their workforce remote. Companies have done an admirable job of adapting to this necessity and the pandemic has driven many to either accelerate remote working trends or consider permanent solutions that would have been unthinkable for them only a couple of years ago.

As always, a well-thought plan which anticipates implications and potentially unintended consequences is critical. How to pay these individuals is a vital piece of such a comprehensive plan although for many companies this has been more of an afterthought with status quo/no changes as the default solution.

The specific question at the center of these conversations is which geographic pay scale we should be tying individuals to. In the context of U.S. remote working arrangements, geographic differentials have historically been used to enable companies to provide locally competitive pay in each of the geographic areas in which they operate. **But what happens when the hard coding of job to geography is permanently broken?**

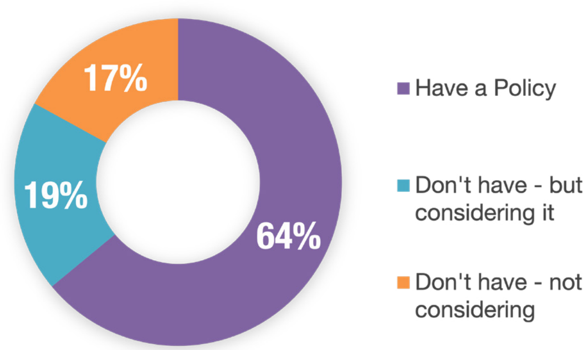
We will explore the most appropriate solutions in various situations, but first let us talk about the use of U.S. geographic differentials and recent trends in the context of increased remote working arrangements. To be sure though, this is one area where competitive practices should not necessarily be confused with best practices.

Geographic Differentials – A Forced Re-Think

According to an April 2021 World at Work survey, roughly two-thirds of companies already had geographic differential salary policies prior to the pandemic. Nearly half of the remaining companies were considering adopting such a policy, given the increase in remote working arrangements. Among the companies with an existing policy, nearly half have either already made changes or are anticipating doing so for the same reason.

It is very interesting to note that the changes appear to be moving in different directions, with roughly equal portions of companies expanding the use of geographic differentials (38%) versus consolidating or even eliminating geographic differentials (41%). This would suggest that some companies feel the need to match compensation levels wherever their employees reside, while others are starting to view their labor markets on a more national basis and thus reducing or eliminating geographical pay differences.

Other surveys have indicated that about two-thirds of companies either currently provide or are considering providing geographic differentials to remote based employees. Amongst these companies, over a third either manage the changes on a case-by-case basis or are unsure about how exactly they will manage pay in such cases. Practices range from paying entirely based on employee physical location to automatically placing all on a national pay scale. As we will explore further, this may or may not be appropriate based on the role and based on company's strategic intent.



About half of companies do not differentiate practices whether the shift to remote was at the employee's election or driven by the company.

Geographic differential policies are generally applicable below the executive level. Two-thirds of companies report that these policies apply to salaried non-exempt employees, 80% indicating that they apply to hourly non-exempt (non-union), and 94% applying differential policies to salaried exempt positions. Only a third of companies apply their differential policies to executive positions which is understandable because these roles are commonly seen as having a national market for talent.

So, while there is a lot of information out there suggesting there are a large portion of companies rethinking their approach to U.S. geographic differentials and what changes they are considering, the optimal approach should be primarily driven by company strategic considerations. And the need for a well-defined policy is essential – the large number of companies that are unsure of their policy or continuing to manage moves on a case-by-case basis are missing an opportunity to provide clarity and consistency that balances both the costs and employee impact or remote working arrangements.

What Makes Most Sense for My Company?

To the extent that shifts in workforce are temporary and individuals are expected to eventually return to the office there is really nothing much to consider other than taking advantage of an opportunity to simplify or clarify existing policy. As more permanent remote working scenarios are considered, there is a definite need to build a coherent and thoughtful plan that is based on guiding principles and ties back to the key drivers of remote work.

Common Principles to Guide Geographic Pay Differential Policy

- Provide clarity to existing and prospective employees,
- Ensure consistency in treatment of affected employees,
- Maintain pay competitiveness to ensure attraction and retention,
- Align to specific company rationale for establishing remote working solutions, and
- Encourage or discourage specific employee remote working behavior

Strategic Intent/Typical Drivers of Remote Working Solutions (can be multiple)

- Broaden labor pool (attraction of employees wherever they may be),
- Enhanced employee engagement (retention),
- Improved employee productivity,
- Reduced real-estate costs, and
- Reduced labor costs

Building a Policy Based on Best Practices

The best solution for any company will be one that adheres to established guiding principles but also reflects the key drivers of the expansion of remote working arrangements. Several companies are wisely using the recent workforce trends to re-think their geographic differential policies altogether. So not just answering the question of how to handle remote working arrangements, but using the opportunity to make sure the entire differential policy is best suited to company needs. Below are some best practice considerations in conducting this policy re-assessment:

- **The Simpler the Better** – These policies can tend to bring out our inner engineer, but this is something we must resist. There is significant diminishing return by adding differentials beyond the first 3 to 5. A simple yet sufficient structure could include a "National" rate plus 2 to 4 more differential categories depending on the number and geographic dispersion of physical work sites (offices/plants).
- **Assign Geographic Differentials Based on Job Location, Not Employee Location** – This sounds intuitive, but there are many companies increasingly focused on remote employees' physical location when they choose a remote working arrangement. This is a rat trap that wastes lots of energy and invites several unwanted conversations with employees. With very limited exceptions, jobs that are fully remote should simply be considered "National" – and employees should not be rewarded or punished for choosing to live in a higher or lower cost location. If the shift to remote work was purely driven by the desire to expand the labor pool, this approach may not make as much sense, but to the extent costs are a concern it certainly will.
    - ***Carefully Consider Exceptions to this Rule*** – Again, fully remote jobs should be considered on the "National" pay scale with a very limited number of exceptions. One such reasonable exception would be remote (outside) sales representatives who are tied to and required to work in a specific geography. So, while they may not be occupying office space, drawing from a specific geographic pool of talent requires us to consider any differentials that may be required to ensure we remain competitive. There may be others, but they should be easy to discern and to proactively consider.
- **Consider Talent Pools** - There also may be a handful of critical jobs (think technology) that have talent pools that are disproportionately centered in specific geographies (e.g., Bay Area). If this is truly the case the company should consider either continuing to allow for these geographic differentials for specific jobs or to put the role on national structure and elevate the market pay level of the role(s) – whichever is more administratively feasible.
- **Do not Forget your Physical Locations** – Most companies will still have a very substantial portion of their workforce tied to physical company locations. For these companies it would be wise to continue to utilize geographic differentials that are pertinent to labor costs in those locations. That said, it would still be wise to look for opportunities to simplify and potentially reduce the number of different geographic structures in use.
- **Avoid Need to Differentiate Employer vs Employee Initiated Moves** – A well-crafted policy should avoid this conversation altogether. To the extent the company is requiring an individual to move to a specific geographic location, it would essentially say the role is tied to geography and thus should fall under the relevant geographic differential. Absent this location requirement, the role is essentially flexible and thus more appropriately placed on the national structure.

- **Reflect Strategic Intent/Drivers of Remote Working Arrangements** – Any discussion around these types of policies involves balancing of cost impact to the company and employee engagement, retention, and attraction. This is more of a sliding scale versus a binary choice but the impetus for shifting to remote working is typically more heavily influenced by one factor versus the other. When costs are the primary driver (labor and/or real estate), there are generally far fewer roles maintained in higher cost geographies and the implementation of lower wage rates tends to be more quickly implemented. On the other end of the spectrum would be efforts to broaden the labor pool which would more likely drive a company to link wage rates more directly to employee physical location versus more generally to job requirements. Of course, this comes with a potential cost impact a company may not be willing to bear.
- **Do not let Difficult Implementation Considerations Thwart Good Policy Design** - Quite often the optimal go-forward solution will be passed over out of concerns that the near-term implementation challenges are seen as too great or too disruptive to consider. We consistently advise companies to suspend judgment here until we have also crafted the corresponding implementation plan. In scenarios that have the potential to be disruptive to individuals, we generally have different levers available to eliminate or soften impact to existing cases while quickly moving to the new solution. Examples would include full grandfathering, delayed implementation, or even partial "buyout" of lost benefits. Just like the end-state solution, the implementation plan should be guided by the key drivers of the remote working solution.
- **Ensure Simple Administration** - The best policy will be one that is simple and easy to explain to employees, but also does not place a huge administrative burden on the compensation team. Much will be determined by the HRS system utilized by the company with many of the newer systems allowing flexibility in managing different arrangements, but each different policy will still come with significant differences in amount of time required to support.
- **Maintain Transparency** – The biggest benefit of having a well-articulated policy is the ability to communicate it proactively to employees so that all parties know exactly what to expect. Any well-principled policy can confidently be communicated to employees so that they can factor any policy aspects into their decision-making process.

Parting Thoughts

While companies have recently revamped or are considering adapting their geographic differential policies to the realities of the new ways of working, there are still a large number that manage on a case-by-case basis and otherwise have an ill-defined policy. And while competitive practices may be informative, the best crafted policies tie back to the strategic drivers specific to each company.

If you would like to discuss your company situation and potential policy implications with an Insightory expert, please contact us.