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Geographic Pay Differentials

When the term “geographic pay differentials” is used in the context of compensation, there is often a misperception that geographic pay differentials are the same as the cost of living. However, cost of living and geographic pay differentials are actually two different indices, used for different purposes. In this Scoop we’ll discuss how geographic pay differentials compare to cost of living, how they are derived, and how they are used.

GEOGRAPHIC PAY VS. COST OF LIVING DIFFERENTIAL

Geographic pay differentials reflect the cost of labor, or the local demand for (and supply of) labor. In fact, geographic pay differentials are sometimes referred to as the cost of labor.

Cost of living, on the other hand, reflects the local demand for and supply of goods and services. It is a measure of the cost to live in a particular location. Different factors affect the supply and demand of labor than those that affect the cost of goods and services.

Research done by the Economic Research Institute has shown that the two indices often move in the same direction, however their magnitudes can be very different. For example, in urban centers, cost of living differentials tend to be much higher than geographic pay differentials.

A well-known example is San Francisco, California where the cost of living is significantly higher than much of the country, while the geographic pay differential is just incrementally higher than the rest of the country.

SOURCES FOR GEOGRAPHIC PAY AND COST OF LIVING DIFFERENTIALS

Various organizations publish either cost of living data and/or geographic pay differentials. The most recognized source of cost of living data is the Consumer Price Index published by the Bureau of Labor Statistics. The Bureau of Labor Statistics and similar organizations perform analytics on actual housing data, consumer costs and tax rates to determine the cost of living in various locations.

In contrast, geographic pay differentials are compiled from multiple salary survey sources and measure the pay differentials for various salary levels by geographic area. The Economic Research Institute is a well-known source for geographic pay differentials.

APPLICATION OF DIFFERENTIALS

Some organizations use cost of living as a factor to determine pay adjustments between multiple corporate locations, but the majority use geographic pay differentials as the primary factor to determine pay differences between geographic locations.

Approaches that organizations use to compensate employees for differences in geographic locations include:

- A separate salary structure for different locations
- Individual adjustments to base salaries based on location of the incumbent
- Supplemental geographic pay differential payments (for example, when an employee is on a temporary assignment in a higher paying geographic area)
- Adjusting survey data that is displayed on a national, regional or local level to a desired geographic area

HOW TO APPLY GEOGRAPHIC PAY DIFFERENTIALS

In applying geographic pay differentials, the base location (often the corporate office) is considered to be at 100, and differentials are expressed in relation to that base. For example, if a particular location's differential is 101 it means that particular location is 1% above the base location. If the differential is 92.0 it means that particular location is 8% below the base location.

Below is a common scenario used for cooperatives with multiple locations.

Your corporate office is located in Elk River, Minnesota and you have a retail location in Sartell, Minnesota. You want the salary structure in Sartell to reflect the cost of labor in that location, rather than the cost of labor in Elk River. Elk River is your base location and you apply a geographic pay differential to your structure for Sartell.

> *For example, if the geographic pay differential for Sartell is 90.9, it means that Sartell is 9.1% below Elk River, and you would adjust your corporate office salary structure down by 9.1% to equate to Sartell. (100 - 90.9 = 9.1)*

MARKET TRENDS

Geographic pay differentials are applied more frequently to professional, technical, and support roles, as directors and executives are primarily compared to the national market. This is a best practice in most industries.

Geographic pay differentials are applied more frequently in larger organizations with operations in more than one location.

SUMMARY

A cooperative's compensation strategy should drive the decision to use, or not use, geographic pay differentials. Cooperatives may also need to take into consideration local economic and labor market conditions to determine if applying geographic pay differentials will increase their ability to attract and retain employees in local markets.

Foundations Consulting helps organizations create compensation philosophies and practices to ensure accurate and meaningful compensation market data.

Contact Beth Ostrem for more information. She has extensive experience consulting on compensation strategy and market compensation analysis.

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