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# GEOGRAPHIC DIFFERENTIALS IN A NEWLY REMOTE WORLD

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## Overview

One of the biggest changes sparked by the COVID-19 pandemic has been a dramatic shift to remote work across all industries. According to the recent Global Work-From-Home Survey (published by Iometrics and Global Workplace Analytics), 88% of office-based workers began working from home on a regular basis during the initial months of the pandemic, compared to just 31% before the pandemic. Even more interesting is the fact that 68% of employees and 70% of managers report that working from home has had no impact, or has even improved, the team's work performance overall.

Given that productivity has not declined significantly, many organizations are now considering putting permanent remote work policies into place even after the pandemic has resolved. For many HR professionals, this raises a new issue of how to equitably pay employees that are working remotely. This article reviews four common approaches to handling remote worker pay and provides guidance on setting a course for a remote working future.

**Four Ways to Handle Remote Worker Pay**

1. Align pay with company headquarters
2. Use cost of labor to apply premiums by employee location
3. Develop a geographically differentiated salary structure
4. Set market pay by position and location

## 1. Align Pay With Company Headquarters

Perhaps the simplest approach for organizations to consider is setting employee pay based on the company headquarters location. The reasoning behind this pay philosophy is that a given position has the same value to your organization, regardless of where the employee is located. It also had the added benefit of being easy to administer and explain to employees. A downside, however, is that pay competitiveness could become an issue for employees in high cost of labor areas (who will have discounted pay overall) and low cost of labor areas (who will have a premium to pay).

Another common strategy, which blends this approach with approach 2 below, is to pay local labor rates for employees at the company HQ, but national labor rates for all remote workers.

***Cost of Labor or Cost of Living?***

Most people are familiar with the term cost of living, but often only compensation professionals regularly deal with the term cost of labor.

*Cost of living* measures the costs to a consumer living in a specific area, reflecting the price of food, housing, transportation, and other living expenses.

*Cost of labor* measures the difference in pay for a job in one location compared to the same job in another location. In other words, it is the local "going rate" for that job.

Although somewhat related, in many cases cost of living rates can be significantly higher than cost of labor rates. In general, 3C recommends applying differentials using a cost of labor approach, as this is directly linked to the competiveness of position pay in that region.

## 2. Use Cost of Labor to Apply Premiums By Employee Location

Under this approach, organizations set pay at a baseline level (typically using national rates or the company HQ market) and use cost of labor at individual locations to adjust pay for remote employees. This approach is

also relatively easy to administer, as it simply requires applying a premium or discount to employee pay based on location. As shown by the table below, an accountant working in a cost of labor region that is 93% of national would receive an adjusted salary that is discounted down 7%.

| Job Title | Salary | Local Cost of Labor (as % of national) | Adjusted Salary |
|---|---|---|---|
| Accountant I | $55,000 | 93% | $51,150 |
| Accountant I | $55,000 | 100% | $55,000 |
| Accountant I | $55,000 | 98% | $53,900 |
| Accountant I | $55,000 | 106% | $58,300 |

This approach offers pay adjustments that are highly individualized to each employee, while still remaining simple to administer and easy to communicate. One potential downside is that tracking individual geographic differentials might work well for organizations with a small remote workforce, but could quickly become burdensome at a large scale.

**3. Developing A Geographically Differentiated Salary Structure**

With this strategy, an organization once again sets a baseline for pay (we can call this salary structure B). Then the organization creates multiple geographically differentiated salary structures based on the competitiveness of pay in different markets. Salary structure A, for example, might be set to 95% of salary structure B, while salary structure C is set to 105% of B. Then, employees are slotted into a relevant salary structure, depending on the cost of labor of their given work location. In this example, an employee living in a city with a cost of labor that is 103% of the national average would assigned to salary structure C, since that is the closest range.

| Job Title | Salary | Local Cost of Labor (as % of national) | Salary Structure | Adjusted Salary |
|---|---|---|---|---|
| Accountant I | $55,000 | 93% | A (95% of national) | $52,250 |
| Accountant I | $55,000 | 100% | B (100% of national) | $55,000 |
| Accountant I | $55,000 | 98% | B (100% of national) | $55,000 |
| Accountant I | $55,000 | 106% | C (105% of national) | $57,750 |

The strength of this approach is that it still differentiates pay by location, but only requires the organization to manage a handful of structures, instead of assigning pay by each individual location. This creates a flexible approach that is still easy to administer and communicate to employees.

This is perhaps the most common approach to managing pay across multiple locations. According to WorldatWork, 60% to 65% of organizations with salary structures report that they vary their structures by geographic region with four to five geographic pay structures being most typical.

**4. Set Market Pay for Each Location and Position**

Under this approach, an organization uses local compensation data to market price positions at each geographic location and sets pay accordingly. The advantage of this approach is that it can capture important differences in pay by position, rather than using a one size fits all approach. For example, it is possible that a given city might have a cost of labor that is 110% of the national average across all positions. Software

developers in this city, however, might have pay set at 120% of the national average due to a tight labor market for that position. Using a pay structure set at 110% of national to pay for software developers would result in underpaying at this location and could create competitiveness issues.

The downside of this approach is that market pricing each job at each location is time and cost intensive, requiring the purchase of many local compensation surveys. Additionally, some locations might lack reliable local data, requiring organizations to invest in collecting compensation data themselves. This approach could work well situationally, but is difficult to administer for a large and geographically dispersed workforce.

**Which approach is right for my organization?**

In 3C's experience, developing a geographically differentiated salary structure is a flexible approach that works well for most organizations, balancing ease of administration while still recognizing local differences in pay. Every organization has different needs however, and all approaches should be considered.

Roughly 25% of smaller organizations report that they do not have multiple pay ranges based on geography. For these organizations, setting pay equal to company HQ or using a simple cost of labor adjustment approach in setting pay within a range might work well. For larger organizations with multiple locations, creating a differentiated salary structure or market pricing positions in several key locations might make more sense. As your organization works to develop a formal remote work policy, it is key to find an approach to pay that fits well with your business plan.

**Communication and Administration**

So, you have decided which approach you will follow and created a formal plan—what comes next? As with most HR initiatives, the most important step when making plan changes is to communicate with employees clearly and often. To head off potential objections, explain the reasoning behind your choices and be frank with employees. If your organization is unable to pay large premiums for employees in high cost of labor areas, communicate this up front so that remote workers can plan their living situation accordingly.

Beyond this, here are some other key considerations:

- In order to stay current, plan to review cost of labor rates annually. In most cases, rates remain relatively stable from year to year, but in high cost of living areas annual variation is not uncommon.
- In 3Cs experience, geographic differentials work best for employees at the manager/director level or below (salaries less than ~$150K or $175K). Talent markets for senior leaders and executives are often at a national level, and, as such, are often benchmarked to US national cost of labor rates.
- For low cost of labor regions, be mindful of local minimum wage laws. Applying a blanket discount to employees at the bottom of the salary structure could result in below minimum wage pay in some cases.
- Organizations located in a high cost of labor areas face particular challenges when implementing new remote work policies because employees transitioning to remote work may need a pay reduction to meet local cost of labor rates. One approach some organizations are considering is a "gainsharing" plan for salary reductions, which evenly splits reductions between the company and employees. For example, an employee that would normally have a $10,000 pay reduction to meet local cost of labor, would instead receive a $5,000 reduction. This creates a win-win situation where the employee receives pay higher than local rates, while the organization still reduces employee pay across the board for remote workers. In later years, once remote working is fully established at the organization, the gainsharing plan could be reduced or phased out entirely.

- Finally, another approach organizations are considering is providing a short-term bonus to employees that are transitioning to remote work in a lower cost of labor region. Under this scenario, the employee would receive an immediate salary reduction, but have this loss made up with one or two years of bonuses, to ease the transition to lower salary. After the employee has worked remotely for a year or two, the bonuses are phased out.

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