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Workforce Retention, Pay and Rewards Practices in Tough-Market Cities: Implications for Public-Sector Organizations

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Traditional retention, pay and rewards programs in the public sector are not working as well as they did in the past. Because of numerous statutory regulations, union agreements and traditionally highly structured civil-service systems, the public sector was, and is, notably slower in changing policy and practice in pay and rewards than the private sector. But public-sector organizations face new and pressing challenges in attracting and retaining scarce talent, particularly people who have employment opportunities in both the private and public sectors, as traditional public-sector retention, pay and rewards practices are no longer matching their interests.

Research studies show that scarce-skilled people who reliably translate these skills into value for the organization want to be rewarded for their skills and performance, want competitive pay as a foundational element and want growth/development and career opportunities (Frincke 2006; O'Neal and Gebauer 2006; Zingheim and Schuster 2007). The public and private sectors now compete for many of the same best-performing and scarce-skilled people. People with many employment alternatives are less interested in the advantages offered by public-sector organizations — job security and, unless they are near retirement age, retirement after a one-employer career. And even with the advantage of retirement benefits for the baby boomer generation, public-sector organizations are now having difficulty retaining valuable employees who can retire and take a second career in the private sector.

What is the root cause of differences between public-sector practices and scarce-talent preferences related to workforce retention, pay and rewards programs? Public-sector retention, pay and rewards solutions have their foundation no later than the 1920s when most jobs and work were unique to public-sector organizations. Now these organizations must compete broadly with many businesses outside the public sector for talent in engineering, computer science, medicine and health care, science and finance. Even vehicle mechanics have skills in short supply. And competition includes the more agile, flexible private sector that has proven its willingness to innovate and adapt to generational differences and to respond to the needs of high performers and scarce talent.

At least two important opportunities present themselves: (1) Organizations with more progressive workforce retention, pay and rewards solutions than the public sector can selectively take the best people from the public sector, or (2) Wise public-sector organizations can transition to workforce retention, pay and rewards programs that respond to what top performers and people with scarce, critical skills in demand in both the private and public sectors want. Both opportunities appear to be happening now. Given this current problem with the public sector's traditional value proposition for scarce talent, what is a

sample of public-sector organizations doing with pay and rewards to address this challenge and improve the retention of scarce talent?

STUDY OF “TOUGH MARKET” CITY WORKFORCE PRACTICES

Forbes identified the 100 “Best Cities for Jobs” based on economic and market information on larger cities in the United States, including unemployment rate, job growth, income growth, median household income and cost of living (Clark 2007). This means talent is scarce in the top-ranked cities and most organizations, not only public-sector organizations, need this talent. For this paper, Schuster-Zingheim and Associates Inc. sampled and studied 20 of these city governments, including 11 of the top 20 cities, with all study participants in the top 41. These 20 cities were willing to be telephonically interviewed in depth for an extended period, answer the authors’ questions based on a patterned interview, and provide the detailed information needed for a thorough understanding of what they do to retain, pay and reward scarce talent. In exchange for detailed information, the authors agreed to not publish the specific list of cities participating. However, all were in the top 50 percent in the *Forbes* article as “tough job markets” for talent.

City governments were targeted to test the effectiveness of traditional public-sector retention, pay and rewards practices for scarce talent in tight labor markets. As cities face challenges that are similar to other types of governments, the study findings may apply to other public-sector organizations. The key study findings show that cities are taking the following approaches to address scarce talent:

- Pay competitively consistent with the labor market and value-added. Pay salaries competitive with the private sector for scarce talent with skills that are needed by both sectors.
- Provide training and development to enable career opportunities and prepare employees for changing organizational needs.
- Pay the best-performing people with essential scarce skills the most. Reward results and skill acquisition and application.
- Address total compensation. Understand the advantages and limitations of public sector’s employee benefits.
- Communicate and move forward. Enhance communications, experiment and do not give up on implementing retention, pay and rewards programs for scarce talent.

The highlight of the findings is that the cities in tough labor markets for scarce talent and skilled professional talent are experimenting with customized retention, pay and rewards programs and do not give up because it is hard to change. They are focused on moving forward and testing possible solutions rather than on extensive and expensive studies to try to find the ideal solution before trying anything new. Most solutions are not citywide, the ultimate goal, but are focused on one or more scarce-skilled workforces. And the change processes are still in progress — cities continue to refine, improve and evolve programs and gain broader acceptance.

Solution No. 1: Pay Competitively

All reported that the traditional public-sector classification system that internally values jobs is not working in competitive markets for high-demand, short-supply talent. Using internally focused job-valuing systems and not setting market values based on scarce skills overpays skills that are “less scarce” and underpays scarce skills. They comment that the public-sector retention, pay and rewards solutions were not intended to be effective in competing for the scarce-skilled talent whom every organization wants but were designed primarily for talent with skills that are unique to the public sector. So internal equity once worked but does not now, given tight talent markets. Now cities are including more private-sector compensation survey information to determine the labor market for jobs where they compete with the private sector for people with scarce, critical skills.

Pay progression is a serious challenge for study participants as it relates to scarce talent. Traditional public-sector systems focus on tenure and years of experience, so some study organizations have added progression based on growth in job-relevant knowledge and skills and how these are applied to achieve results. Instead of just providing cost-of-living adjustments and across-the-board increases, cities are reallocating or allocating budget to accelerate pay movement for people with scarce skills. Some cities are moving more of the general increase budget for the skilled-professional area to scarce-skill talent. These cities are taking actions to compete for scarce talent with the private sector as paying scarce talent competitively is less expensive than the cost of the cities' turnover. Figure 1 illustrates this trend.

FIGURE 1 Competitive Base Pay for Scarce Talent in Tough-Market Cities

Feature	Traditional Practice	New Objective
Salary structure	Classification system based on job descriptions, years of experience and educational requirements	Flexibility: Work around classification system, special scarce skill classifications, exceptions; include essential skills and skill growth
Job valuing	Internal equity: overpays less scarce skills and underpays scarce skills	Labor market, including private sector and high payers for best people with scarce, critical skills
Job value increases	Length of service and years of experience	Knowledge-based/skills application and results
Pay movement	Cost-of-living, across-the-board increases	Accelerate pay movement for scarce skills through pay budget

Solution No. 2: Provide Training and Development to Enable Career Opportunities

Study participants think that the public sector develops and trains employees in the rules and regulations that these employees must follow and apply consistently and accurately to perform their jobs. But they lose scarce-skilled talent because they have been unable to accelerate career growth. So the cities studied are now working to provide attractive career paths and career opportunities so people with scarce skills will stay after the city has invested in their training. These cities do not want to be the training ground for other organizations.

Training solutions currently involve more in-job development of new contemporary skills and refreshing and updating existing skill sets. The focus is to provide scarce talent with career growth based on acquiring and demonstrating essential skills, not simply following job descriptions. Study organizations are providing the opportunity for scarce-skilled people to assume more responsible value-added roles with increased accountability and without just adding people-management responsibilities, and to be paid accordingly. The managers' role is being redefined to include coaching and nurturing scarce talent to reinforce acquiring and applying skills.

City participants said in the past they provided training specifically focused on current job responsibilities and duties like every other public-sector organization. Now they are providing training and development to keep people's skills fresh and current and to prepare people with new skills and capabilities based on changes in work and technology. They are providing the development opportunities that scarce talent wants to stay with an organization and add value throughout their career.

Solution No. 3: Reward Skills and Results

Several leaders participating in the study said, "Pay for performance' are often fighting words." Fourteen of the 20 cities studied (70 percent) have performance-based pay of some form for a portion of its workforce. Performance-based pay most often applies to either the scarce-skill professional workforce (who may or may not be in a union) or the broader nonunion workforce. The cities' approach is to experiment thoughtfully with a program, keep what works and continue to improve it rather than study the issue for a long time never reaching implementation.

Sixteen of the 20 organizations (80 percent) evaluate some combination of an individual's skills and results with a performance scorecard by measuring skill/competency acquisition and application, results on goals or objectives, and/or performance compared to standards. These cities report the issue is not measuring and evaluating performance; in fact, they effectively identify poor performance and those who are not growing in needed skills. Rather statutes, regulations and union resistance often make it difficult for these cities to implement performance-based pay.

To address the “fighting words” challenge, city leaders are developing and communicating a “case for change” explaining why the organization is paying for skills and results and how that benefits employees to form the “win-win” with the community customer and the city government. Some cities started by rewarding scarce talent for enhancing scarce skills in terms of acquisition and application, keeping up-to-date in specific skills, and acquiring more advanced, broader or deeper skill sets that are difficult to hire and retain. Other cities reward outstanding performance or also solid performance of either the scarce-skilled professional workforce or, more broadly, the entire skilled professional workforce.

Figure 2 summarizes the solutions the cities studied use to pay for skills and results without creating a “lightning rod” for concern relative to performance-based pay.

FIGURE 2 Rewarding Skills and Results in Tough-Market Cities

Feature	Approaches for Performance-Based Pay for 20 “Tough-Market” Cities
Number of organizations	<ul style="list-style-type: none"> • 14 of 20 reward skill growth and/or results
Eligibility	<ul style="list-style-type: none"> • More frequently nonunion
Metrics	<ul style="list-style-type: none"> • Skill acquisition and application, especially scarce skills • Results or performance on goals • Performance on responsibilities
Reward	<ul style="list-style-type: none"> • Outstanding performance only (10%-15% top performers) • Acceptable and higher performance
Form of award	<ul style="list-style-type: none"> • Cash lump-sum payment most common (13 of 14 with performance-based pay) • Salary increase • Choice of cash lump-sum award, time off, merchandise, payment toward child care/elder care
Award determination	<ul style="list-style-type: none"> • Supervisor using performance scorecard and/or point system • Review/evaluation/selection team or committee
Frequency	<ul style="list-style-type: none"> • Annual

The most-common reward for performance-based pay is a lump-sum award or payment (13 or 93 percent of the 14 cities with performance-based pay and 65 percent of all 20 cities studied). Study organizations typically do not force “merit salary increases” based on individual performance because of the “noise” and limited salary increase budgets available for differentiating performance. A few started with recognition plans and evolved them, using as the foundation recognition focused on skills and results rather than nonperformance-related events (like service). Another started with merchandise awards and evolved to lump-sum cash awards based on results and skill acquisition. Study participants continue to refine and improve the performance metrics to enhance program acceptance and to ensure the reward-determination process is most effectively measuring and rewarding accomplishments aligned with performance objectives.

The study organizations do not typically use prospective incentive plans, which are prevalent in the private sector and are based on prospective goals and award opportunity for individual, team or organizationwide results. Rather, lump-sum cash awards are linked to a performance scorecard or the performance-management process. They also consider lump-sum payments for specific scarce-talent situations, including rewards that acknowledge successful outcomes related to project completion, cost

objectives, and customer objectives, with a preference for rewarding improvement over prior performance periods. Common are a performance bonus for scarce talent or recognition awards for significant contributions.

In the cities studied with variable pay, the variable pay budgets range from 1 percent to 3 percent of the payroll budget. Awards range from 0.5 percent to 10 percent of base pay, and the most common awards are 3 percent to 5 percent of base pay. Lump-sum awards are attractive as they are not fixed cost and must be re-earned and reusable dollars encourage continuous growth in skills and continuing to add value by achieving results on goals.

Study participants view their recognition programs as having less influence now than in prior years and less retention value than other rewards alternatives. Their reasons include people and organizations becoming fatigued with recognition programs, people wanting something more substantial, and the high incidence of recognition programs in other organizations.

Solution No. 4: Address Total Compensation

City leaders believe that the advantages of public sector's strong employee benefits can be better communicated to scarce talent during recruitment. They most often mentioned their flexible scheduling and time off as advantageous benefits in attracting and retaining scarce talent relative to other organizations. Six of the 20 cities studied (30 percent) have or are considering offering child-care and elder-care allowances to address different generational challenges to retention.

The cities studied, however, are now finding that the scarce-skilled talent they need will not join an organization merely for strong benefits and an attractive retirement program. People with essential skills want the organization to offer a great career and rewards during the time they work and not just make it attractive for people to stay an entire career to have a solid retirement plan and good benefits.

City participants view public-sector retirement as a "double-edged sword" as it relates to scarce and skilled professional talent. Although it is a valuable benefit as a reward for an entire career with the city, it is viewed as less valuable to younger scarce-skilled talent who do not expect to spend an entire career with one employer. Also cities with relatively young normal retirement ages find that they lose critical people who retire when they are often most valuable to the city and then have a second career in the private sector or another public-sector organization.

To stem the tide of these retirements, two of the 20 cities studied (10 percent) provide a lump-sum payment each year that scarce-skilled, retirement-eligible employees work for the city beyond normal retirement eligibility. The payment is not eligible compensation for calculating retirement benefits. Most participants said that the public sector will have to address the heavy taxpayer burden of retirement cost but are focused now on retaining essential people beyond their eligibility for normal retirement. Study participants believe the total compensation budget is not being spent in a way that most effectively attracts, retains and rewards scarce talent. Figure 3 summarizes the study results for employee benefits and work-life balance.

FIGURE 3 Employee Benefits and Work-Life Balance in Tough-Market Cities

Feature	Traditional Practice	New Objective
Time off	<ul style="list-style-type: none"> • Attraction/retention advantage 	<ul style="list-style-type: none"> • Continue
Flexible scheduling	<ul style="list-style-type: none"> • Attraction/retention advantage but less advantageous now because more organizations provide 	<ul style="list-style-type: none"> • Continue
Retirement	<ul style="list-style-type: none"> • Attraction/retention advantage for employees planning a full career with the organization • Otherwise not an advantage as resources could be used to greater attraction/retention advantage 	<ul style="list-style-type: none"> • Scarce talent only: If affordable, lump-sum cash payment each year scarce talent stays instead of retires beyond normal retirement age; part-time employment after retirement • Not add to or improve retirement benefits • Eventually address best use of total compensation resources

Solution No. 5: Enhance Communications

As employees often resist change, communications is an important responsibility of the entire leadership team. Constant, consistent communication informs the workforce why the organization must periodically evolve and make timely changes and why scarce-skill talent must be retained in a competitive labor market. These cities are involved in culture changes often driven by the inability to keep critical skills. The aim is to create an enabling culture of community and customer service that values customers and high performance and that attracts and retains scarce talent and solid and top performers.

Communication acknowledges that the old way was good then but is not now. Messages address traditional job security by communicating the need to provide value to the city and the community and address entitlement by evolving the mindset from what the community and city can do for employees to what employees can do for the city and the community that they serve.

The culture change also involves moving to a growth-oriented, agile culture that the scarce-skilled and best performers want. “You matter” is the clear message to people who can find work anywhere but are critical workforce assets to the cities studied. The study organizations are moving to a new employment brand that communicates to scarce-skilled people what is attractive about working in the city and engenders pride in working for an organization that serves the entire community. These cities are focused on providing a balanced and integrated total rewards program based not on entitlement but on engagement that rewards how people add value. Figure 4 summarizes the culture changes described by the study organizations.

FIGURE 4 Communicating Culture Change in Tough-Market Cities

From	To
Entitlement	Service culture: serve the community
Employees as “cog in organization wheel”	Pride in making organization excellent
Structured enforcer of rigid rules	Enabling: customer service, customer response time, customer downtime, reduction of errors, safety

STUDY PARTICIPANTS’ ADVICE TO PUBLIC-SECTOR ORGANIZATIONS

The five solutions have been successful to varying degrees, but were considered worth the effort and believed to be improving workforce retention, pay and rewards programs. Leaders reported these solutions helped them compete with private-sector employers for scarce talent as demonstrated by improved turnover statistics in the scarce-talent areas of the workforce and improved retention of

essential skills. The cities view this as part of a journey to create a high-performance culture and provide attractive careers for the most scarce and demanding talent by changing traditional public-sector pay and rewards practices and adding value to extend careers beyond retirement.

These actions are focused on scarce talent, and these organizations are using pilot programs and experiments. Nothing in this study suggests a complete overhaul of the public-sector pay and rewards systems in these cities. Leaders suggest the solution is to customize a total rewards model to be unique to the organization and not a public-sector clone. It must communicate to scarce talent “what it is like to work here,” that the organization pays competitively and not only based on internal comparisons, and that skills and performance are the name of the growth game in the organization. They strongly propose addressing training, development and career opportunities for scarce talent having essential capabilities, so it is worthwhile for them to stay with the city.

The focus is not “one size fits all.” It is on scarce talent and not on everyone based only on service. A premium is placed on communicating the need to change and how everyone benefits from the city being able to keep scarce talent and the best performers. City participants suggest not surveying other public-sector organizations but rather benchmarking and adopting or adapting successful private-sector practices.

ACTIONS TO BUILD AND REINFORCE PERFORMANCE-BASED PAY

The cities studied are experimenting with solutions to enable them to retain, pay and reward scarce talent with critical skills in tough labor markets. Public-sector organizations may also want to consider the following generally accepted practices to move their performance-based pay culture forward:

- Improve Performance Management
- Think Total Cash Compensation
- Affordability of Total Cash Compensation
- Reward Performance with Base Pay
- Variable Pay and Lump-Sum Awards.

Improve Performance Management

Performance management is much more than designing new forms and procedures. Making performance improvement an organizational goal and performance management a tool to help is essential. Focusing on cascading goals and results aligned with operating/strategic plans and the budget makes the performance plan and the goal-setting process for the organization more meaningful and potentially engaging. Involving people, especially those with essential and scarce skills, in the performance process facilitates them becoming part of the solution and making it work on a practical level — particularly in engaging them in how to accomplish the organization’s goals. Ongoing feedback and coaching are what performance improvement and management are about. The objective is making this part of the broader organizationwide ongoing performance management process rather than a one-time individualized annual event. Communicating to people when they join the organization about what to expect reduces entitlement.

Think Total Cash Compensation

The study organizations are experimenting with lump-sum cash awards as part of the focus on scarce skills and high-performance organization designs. This means shifting communications to total cash compensation where base pay is not the only element of cash compensation. Organizations that reward outcomes/results in fact retain the best talent, and rewarding with variable pay renews the focus each performance period on the needed outcomes/results. Consistently communicating total cash compensation opportunities and total cash compensation as the sum of base pay plus variable pay or lump-sum awards facilitates the shift in thinking and the acceptance of variable pay.

Affordability of Total Cash Compensation

What are the current staffing levels in the organization compared to the optimum balance of needed roles/competencies? Is staffing sufficient in the core skill areas that are scarce in the labor market and necessary to make the organization achieve successful outcomes? Does the organization have the right types and number of jobs and the people with the right skills performing in these jobs? If not, the organization may need realignment, which may involve skills training, attrition and outsourcing when people have not updated skills to fill the needed slots or people's skills are no longer aligned with the organization's needs. People in unnecessary jobs or obsolete roles means fewer total pay dollars available for scarce and critical skills.

Public-sector organizations may need to reallocate dollars from one area of the workforce to another to retain top talent with scarce skills. An example is setting aside some portion of the overall funds for total cash compensation to scarce talent for lump-sum cash awards to retain critical skills and to compete with the private sector for essential talent.

Reward Performance with Base Pay

Study organizations believed base pay was more likely to be aligned with factors other than results or skills; tenure and years of experience were the most commonly mentioned predictor of base-pay levels. To reward performance with base pay, consider the following:

- Allocate any increases in base pay available based on the movement in the labor market by job function (e.g., information technology versus accounting versus clerical) to be most efficient with limited compensation budgets. This moves dollars to critical or core skills and competencies and where the best outcomes can be realized. It means no longer spreading around pay increases evenly without concern for the organization's skills or needs.
- Involve more than the immediate manager and his/her manager in determining pay adjustments to calibrate performance levels, evaluation criteria and pay decisions and to get a solid, balanced reading on where money should be allocated. Make it a collaborative management process and take advantage of multiple inputs.
- Focus on an individual's absolute base-pay dollar level compared to the value that the individual adds to the organization when making base-pay decisions. When people consider base pay in making employment decisions, they consider their absolute base-pay dollar level so organizations cannot focus solely on the percent increase in base pay. Allocating pay increases as a percentage of base pay may not result in allocating dollars based on value (for example, higher-paid people who may or may not be adding the most value receive a larger absolute dollar increase than lower-paid people adding the same value with the same percent increase).
- Emphasize results more than behaviors in the performance process. Results are the end product; consider behaviors only when they visibly and obviously facilitate or hinder the achievement of results.
- Use lump-sum cash payments to differentiate total cash compensation based on results or critical skills. Alternatively allocate the base-pay increase budget such that a small portion goes only to reward high-skilled people or the best performers.
- Hold managers accountable for performance management. If they are unwilling and unable to manage performance effectively, they should not be managers.

Variable Pay and Lump-Sum Awards

The stage is set for lump-sum cash awards and variable pay in the public sector. Eighty percent of U.S. organizations, including nonprofit organizations, have some form of variable pay (excluding variable pay for management and sales employees) (WorldatWork 2008). Not only do more organizations use variable pay each year, but the percent of eligible employees within an organization is increasing and the

award opportunities are increasing as well. More variable-pay plans are including rewards for individual results. The proof of the value of variable pay over other alternatives is demonstrated in terms of return on investment. Variable pay delivers 1.2 to 4 times the return on investment in employee payments for average to higher-return plans, respectively (McAdams and Hawk 1992). No other human-resource initiative or program generates this rate of return.

CONCLUSIONS AND RECOMMENDATIONS

The public sector can no longer compete for skilled and scarce talent with traditional public-sector retention, pay and rewards strategies and programs. People, especially scarce talent with key skills and high performers, want meaningful, rewarding career opportunities. They want pay and rewards consistent with the value they add, not based on service and entitlement. This study suggests the participating organizations are taking concrete steps to remedy their situation.

Change is difficult, but these organizations are not quitting their pursuit of excellence in talent attraction and retention. They are trying new things, piloting and testing new solutions. This is clearly “heavy lifting,” but the solutions that have survived for decades are not working for the talent the public sector must compete broadly to retain. Timing is important as new skills are continually evolving and not enough people possess these skills to go around. The competition for scarce-skilled talent continues to increase. These cities are taking steps to get ahead of the challenge and be proactive in developing solutions. If an organization faces any of these issues, some learnings from these study organizations may be worth considering.

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