How Both the Company and Employee Benefit From Higher Pay; Higher pay isn't just a cost. The data shows that the employers that pay the best outperform their peers.

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FULL TEXT

As the economy has lurched forward during the pandemic, many businesses have found themselves forced to increase workers' pay to fill openings—and not everyone is thrilled about it.

After the latest U.S. jobs report, which showed that wages in September rose a robust 4.6% compared with the prior year, Plante Moran Financial Advisors called the trend "a detriment to employers." In fact, some are "hoping wages return to the pre-pandemic status quo," noted a report from the Society for Human Resource Management.

But our most recent research is a good reminder that higher pay should be looked upon not simply as a cost but as an investment that can bring myriad benefits to a company.

Our findings are derived from the Management Top 250, an annual ranking produced in partnership between the Drucker Institute and The Wall Street Journal. Built on the core teachings of the late management scholar Peter Drucker, it measures a company's "effectiveness," which Mr. Ducker defined as "doing the right things well." The 2020 list was published last December, and the 2021 list is set to be published this December.

In all, we examined 886 large, publicly traded corporations last year through the lens of 33 indicators that fall into five categories: customer satisfaction, employee engagement and development, innovation, social responsibility and financial strength.

For our rankings, firms are compared in each of the five areas, as well as in their overall effectiveness, through standardized scores with a typical range of 0 to 100 and a mean of 50.

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A grocery delivery in New York. Good pay for front-line workers may indicate a company is more likely to manage its operations effectively. PHOTO: Amir Hamza for The Wall Street Journal

Pay differentials

With all of the news on wage growth, we set out with our latest study to determine what statistical relationship, if any, might exist between how much a company pays and how well it performs in each area in our rankings. To do so, we divided up the companies in our universe into quartiles using a "pay differential" figure that is supplied by Payscale, a compensation software and data provider.

Pay differential quantifies the typical percent difference between what employees make at a given company, based on information crowdsourced from workers, and what they earn in the broader market accounting for job title, skills, years of experience, location and several other factors. It is one of six indicators that we use in our employee engagement and development category. (Payscale was able to calculate this metric for 660 of our 886 companies.)

The outcome of our inquiry was crystal clear: Across every area of our model, those companies that pay the best outperformed their lowest-paying peers.

In employee engagement and development, the average score for those firms in the top-paying quartile, using our 0-100 scale, was 57.5. For those in the bottom quartile it was 42.9. The spread was also substantial in overall effectiveness, stretching from 56.5 to 45.8. In social responsibility, it went from 53.7 to 48.0 and in financial strength from 52.7 to 48.2. The smallest span was in customer satisfaction: 52.5 vs. 50.1.

This same pattern held true from quartile to quartile, with one modest exception: In customer satisfaction, the average score for companies in the third quartile on pay matched that of those in the second quartile, at 51.1.

Pay and performance

It is possible, of course, that companies that can afford to pay their workers well also have the wherewithal to invest in other areas, and that's what is lifting their scores across the board. But we suspect that there is a direct connection between pay and performance.

Indeed, our results support other research demonstrating that a well-compensated workforce is likely to be more productive and have low turnover, which can spur innovation and lead to higher customer satisfaction.

"There's no doubt there's a virtuous cycle," says Scott Torrey, Payscale's chief executive. "When you take care of your workers, they take care of the business."

Sarah Kalloch, executive director of the Good Jobs Institute, says that companies that are inclined to pay well, especially when it comes to their front-line workers, are also more likely to manage their operations effectively in order to leverage that investment. "If you're paying your teams more," she says, "you're also probably paying more attention to what you're asking them to do and how they're doing it, looking at operations and job design to drive productivity, contribution and motivation."

To be sure, not all businesses are able to keep up with their peers that pay at the high end of the scale. And for many workers—even as they try to make up for decades of wage stagnation and attempt to keep pace with the cost of living, which has also been going up of late—pay isn't everything.

Ms. Kalloch points out that for hourly workers, having schedules that are predictable and contain adequate hours is crucial. So is having a voice in how the business is run, so that employees can help foster continuous improvement and shape their own personal and career growth.

Mr. Torrey says that, along with the level of compensation being offered, executives should also focus on "the culture you create and the mission you pursue," because lots of employees care tremendously about these attributes. (How workers feel about a company's culture and values is captured by a separate indicator in our employee engagement and development category.)

Meanwhile, with job gains having tapered off over the past couple of months, it's uncertain how long the pressure to keep pay climbing will remain. A new survey from the National Association for Business Economics portends wages rising further. But Korn Ferry, the organizational consulting firm, suggests that companies are now poised to "evaluate whether they want to rein in the salaries that they've been paying out to new hires."

Even if the labor market loosens, our analysis leaves little question: For companies that want to be more effective in all phases of the business, higher pay pays.

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