

---

## COMPENSATION

# The compensation system

The compensation system adopted by a design firm is one of the main engines driving its business. Compensation is a very expensive engine to maintain and can be the firm's number one expense. Payroll and other compensation issues, such as insurance and other benefits, however, form a major part of how the firm is perceived in the market and how it operates as a business. When a design firm decides how much to pay its employees and establishes pay scales, awards bonuses, and offers other incentives, it can profoundly affect the quality of its designs, its work, and its ability to attract and retain good employees.

It is good practice for a design firm to set a basic wage policy that is based on a strategic system that has a constant eye toward the needs and goals of the firm. Many of the established salary practices of the past, such as automatic pay increases for the amount of time you are at the firm, have given way to new systems such as project-oriented, performance-based pay. An effective compensation system should ensure the following results.

- *The firm's compensation policies are in line with state and federal laws involving minimum wages and job classifications.*
- *The firm's compensation policies are competitive enough to keep pace with the changing climate of today's labor market, particularly in recruiting and retaining top design talent, who are in very strong demand.*
- *The firm's pay scale for the various positions (project manager, lead designer, associate, principal, etc.) reflects the relative importance of the position and the skills that performing those positions require.*
- *The firm's payroll costs are in line with the overall financial health of the company.*
- *The firm's basic philosophy is clearly understood and strongly supported by all employees.*

No matter whether their HR practices are traditional or cutting edge, all design firms must meet basic legal requirements applicable to compensation

and benefits. Before the firm sets its salary policies and wage structures, it should be sure to consult with an attorney and get advice on state and federal wage laws and other mandates. Some basic items to remember about state and federal wage laws is that they require that employers pay wages on time and at regular intervals, and there are regulations regarding what can be deducted from an employee's paycheck. Most states permit employers to deduct only withholding taxes, Social Security, unemployment taxes, and state disability payments. All other deductions, such as medical insurance premiums, life insurance premiums, 401(k) contributions, or other employee-paid benefits, require the advance written consent of the employee.

The design firm's compensation policy should take into account the firm's mission and strategic goals. For instance, if the firm's strategic goal is to become the dominant firm in the industry within the next three to five years, it will have to offer attractive wage and benefit packages to attract the right people to fuel its growth. It may also need to pay highly talented people more than their market value today so that it can benefit from their contributions three to five years from now. If the firm's goal is to improve productivity, effectiveness, and efficiency, it will want to tie compensation to performance and productivity metrics that can be measured in a periodic manner.

A design firm's compensation system should preserve the firm's financial health. A good rule of thumb for establishing the firm's compensation system is to determine the firm's cost/revenue ratio. The key feature of this ratio is what profit margin the firm realizes on its services. Although profit margins in some industries are high enough, upwards of 50 percent in some cases, to absorb higher payroll costs, in the design industry, profit margins tend to run in the 12–15 percent range. Consequently, payroll in most design firms runs around 30 percent of total revenues, including benefits and taxes.

Many design firms spend considerable time and effort designing a pay system, then leave it to the paycheck alone to communicate employee value and firm philosophy. To succeed, the firm must not only create a fair system, but also ongoing communication about the firm's financial condition to managers and between principals. This will help to effectively explain, administer, and support firm pay policies to all employees. If there are any changes to