

Setting Salaries using the CPI: It's just not the best option

Sometimes, business leaders need to spend a minute or two thinking through some of the automatic reactions they have, based on years of repeated practice, and ask “why do we do it that way?”.

To me, one of the most staggering automatic assumptions in the usage of CPI figures when setting employee pay increases.

CPI measures the cost of the goods that a consumer buys. It has but one link into wages growth, which we'll look at later in this article.

A basic assumption of business is that remuneration is a return on investment; the performance and productivity of each individual produces a return that is greater than the cost of having them within your team.

Yet business after business is prepared to make remuneration decisions based not on the value of the employee, but on what it might cost them at the checkout.

There are severe problems with the simple “add CPI and smile” remuneration review. A simple one is bracket creep. The increase you have just given someone may have been swallowed up by bracket creep. Given our non-linear tax system, a 4% increase in overall salary does not equate to a 4% increase in take-home pay in many cases.

Also, which CPI do you use? Many firms use the national figure, though one for each state is available, and they can vary considerably. And if you use a state-based one, what about parity between employees in different states? If you move a team member from Sydney to Tasmania, do you drop their pay?

From an employee perspective, knowing that the company has spent thirty seconds on your remuneration doesn't always wash.

And keeping your wages constant in real terms is an interesting idea to an employee who is one year more experienced; one year more productive.

If one is tempted to read the Australian Bureau of Statistics' CPI Technical Manual – and it's not exactly thrilling – you'll see that the ABS doesn't exactly see the CPI as a tool for measuring wages growth.

If the question occurs to you – “what do they suggest?” – then you might be surprised to learn they actually have a statistical product actually designed to do just that. It's called the Labour Price Index (LPI) and despite being designed exactly for that purpose, few firms use it.

Why not? Ignorance of its existence seems to be a big reason. And it's often higher than the CPI.

Unions, who obviously would have a clear advantage in using LPI as a starting point, seem oblivious to it when collective bargaining.

So, if you're going to risk losing employees because your remuneration reviews take thirty seconds – and I don't recommend that – then at least use the LPI, not CPI.

Earlier in the article I mentioned one link into wages from CPI. It's this: so many firms use the CPI as a basis for remuneration reviewing; it's bound to have a correlation with wages growth. It's just not a fair or smart way to go.

(c) 2008 Morton Philips Pty. Ltd. For personal use only. Not to be distributed without permission