

7 June 2007

Gail Kettle
Commercial Support Services Manager
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PO Box 242
Wellington

Dear Gail

RE: REVIEW OF STRATEGIC PAY LIMITED SUBMISSION(S) TO THE INDEPENDENT REVIEW OF THE RELATIONSHIP BETWEEN PHYSIOTHERAPISTS AND ACC (INDEPENDENT REVIEW)

We have received instructions from the Accident Compensation Corporation (ACC) to undertake a critical assessment of the submission(s) of Geoff Summers of Strategic Pay Limited (SPL) to the Independent Review.

In conducting our review we are in receipt of copies of the following:

- New Zealand Society of Physiotherapists (NZSP) response to Deloitte Second Draft Physiotherapy Pricing Report (which contains Mr. Summers' original report dated August 2006);
- Submission of Geoff Summers dated April 2007; and
- Day Four transcript of proceedings of Public Hearings (during which Mr. Summers' oral submission was made dated 14 to 17 May 2007).

While this letter does not constitute a submission to the Independent Review we understand its contents may be forwarded to Mr. Goddard, QC (Chairman) and other parties to the Independent Review. Accordingly we have included a brief biography of the author, Mr. Matt Ballard, as an attachment to this letter.

We believe that careful consideration of the data and opinions presented by SPL and NZSP is due in the following areas:

- The strategic pay methodology and its application;
- The context of job evaluation and salary survey usage in relation to the occupation of physiotherapy, and in relation to small business generally;
- The remuneration practices of small private businesses in New Zealand;
- The relevance of DHB pay scales, remuneration data from Collective Employment Agreements (CEA's), and remuneration levels from the public sector; and

- NZSP adoption of the 75th percentile position.

Our observations and comments follow in identical order the list above (the headings vary slightly for formatting purposes).

The Strategic Pay Methodology and its Application

A points based job evaluation (JE) system is, in the simplest terms, a way of measuring jobs or roles by breaking down the work carried out into elements. The JE process results in a score or value which is ascribed to the particular job. This score or value is then compared with scores for other jobs to ensure fairness and equity within a pay system. JE can also be used to establish equal pay for work of equal value although this level of comparison can be fraught with issues and is not an approach often seen outside of the public sector globally.

JE is a widely used methodology however its currency is undoubtedly in decline and globally many large organisations have moved away from its use for at least some occupations or professional levels. The key reasons for this are:

- The systems inherent administrative burden;
- The focus the process places on the contents of the role held versus the breadth of capabilities and future professional potential of the job holder;
- The rigidity the systems can reveal when organisation are looking to hire new staff in a competitive labour market and distortions that very often appear between newly hired staff and existing personnel; and
- A general trend away from the often long and relatively rigid pay grade structures that formal JE systems tend to support.

An intermediary approach to dumping JE altogether that is now promoted by many remuneration consultants in order to retain some of their larger clients is to adopt an approach known as 'job families'. This approach is somewhat of a concession by the consultants on their pure JE systems that allows for clustering of occupational groups at similar professional levels such that the organisation can test for general market relativities without the need for the detail frequently associated with a formal job evaluation process that covers all occupational levels.

In its own right the SP10 JE system used by SPL is a robust example of points based job evaluation methodology that is time tested and validated across a statistically significant number of organisations. Mr. Summers' has employed his expertise in this instance with considerable care and insight, using widely accepted approaches to data compilation and analysis.

We would add that we concur with Mr. Summers' that re-engineered factor adjustment of job evaluation score lines, as is touched upon on page 15 of his submission (April 2007), is a fraught practice that would not produce internally consistent and therefore valid outcomes.

It is noted that the make-up of the focus group session used by Mr. Summers' to gather his baseline job content data, while undoubtedly representative of the occupational group being evaluated, might have

been rather 'loaded' as it contained only NZSP representatives and their Barrister advisor, and it was the NZSP who commissioned the work.

We do not have the detail of information gathered by Mr. Summers' on which to conduct a comparative evaluation using a competing methodology to that employed by SPL. However we have examined the 'score lines' produced and carefully assessed Mr. Summers' expert opinions in his reported notes and consider on face value that a similar conclusion, in terms of overall equivalency to other roles and professional levels, would most likely be reached if the alternative job evaluation methodologies we know were adopted.

The Treatment of Job Evaluation and Salary Benchmarking Information in the Current Context

It is very important for those who are considering the SPL report and the associated NZSP position to place the use of a formal job evaluation process and linkage to salary survey information in the current circumstance into the correct context. The overall approach as applied to roles within small specialist businesses in New Zealand could only be described as extremely rare. Therefore the overall conclusions drawn need to be treated with considerable care.

The core premise of formal job evaluation based remuneration approaches is (a) it allows defensible consistency in the way that jobs are sized and thus remunerated; and (b) it allows organisations who participate to rigorously test pay levels in comparator organisations for comparator roles. In larger systems the process accepts a degree of profiling risk (inconsistent 'matching' between participant organisations) and a degree of time based lag (some remuneration surveys adjust for time lag by applying a common percentile adjustment in line with general or industry specific trends).

It is widely accepted that the JE system is at its most robust where sufficient organisations within a sector or industry are participating and further that within those organisations there are sufficient roles in specific occupational groups to allow a combination of organisation type and role content type comparison. It is commonly accepted by senior remuneration professionals globally that large industry or occupation specific exercises are by some distance the most valid approach. Remuneration professionals pay very close attention to the matching quality of salary survey data and would usually discard as irrelevant any role specific matching where a minimum of ten clearly related comparative roles are not in evidence.

The further a comparative approach moves away from having either a statistically valid number of like organisations in the sample, and/or a statistically significant number of like occupational roles the less valid the end outcomes of the process become.

Moving to the current exercise - SPL have assessed a single occupational group, the physiotherapists, whose roles can be considered relatively highly specialised. SPL have then taken the job sizing outcomes of the job evaluation exercise (which in their own right are derived with high quality and skill) and compared it to a salary database that contains no occupational specific matches (physiotherapists) and very few organisational matches (being organisations of a personnel size of say 3 – 10 staff). Thus it is that Mr. Summers finds himself matching an owner physiotherapist with for example a divisional manager in an engineering firm.

In an occupational sense essentially what the exercise ends up doing is evaluating how the pay of physiotherapists compares to other occupational groups in New Zealand as matched at differing levels of professional progression. This is an equity matching exercise and not an occupational or organisational specific one. This does not robustly reveal the competitive dynamics within the physiotherapy profession

in and of itself and is in effect an attempt at occupational matching. Occupational matching is a process that over time has been fraught with difficulty (think nurses versus fire fighters).

In an organisational sense our view is that the data has very low reliability and enhances the remuneration prospects of private sector physiotherapists beyond that which would be revealed if a comparative organisational sample was available drawing together a range of owner/operator businesses in specialised niches in a size range of for example 3 to 10 employees. If we had such a sample we would at least be able to concede that the organisations in question would be dealing with the overall similar organisational constraints and risks faced by small businesses. As stated earlier, and noted on several occasions by Mr. Summers, this is not possible as the vast majority of small businesses in New Zealand do not entertain these methods.

The Remuneration Practices of Small New Zealand Businesses

Mr. Summers' has openly and correctly noted on several occasions that the data going to owner/operators and small business specific matching needs to be treated with care.

We have some concern however that the NZSP position, as we understand it from the documentation we have to hand, does not reflect the care needed in the treatment of the data it has commissioned and is in itself not a reflection of the general practices of small business remuneration in New Zealand.

Our experience in working with a very wide range of small businesses in New Zealand is that formal JE of the type employed by SPL, or of various other types available on the international and national market, is used extremely rarely. This does make the process of context very difficult.

It is in fact very uncommon practice for owners of small personally held private businesses to do any of:
(a) have their role or that of their staff submitted to job evaluation for the purposes of market comparison;
(b) draw remuneration for themselves only based on market comparison where any comparison is actually made;
(c) submit remuneration information to benchmarking surveys or databases;
(d) pro-rata any remuneration paid to themselves by any notion of either part-time working commitment or more than standard FTE working commitment (if in fact such a standard exists in professionals roles today).

In our experience it is common for the owners of the business to draw profits from the company on an annual basis either in the form of salary, management bonus or dividends. Often a nominal salary only is paid with profits being distributed to the owners based on profit sharing and differential taxation. Other more complicated mechanisms are sometimes employed for various reasons, however the principle intent remains that the remuneration benefit which flows to the owner(s) is based on withdrawing final profits upon the completion of annual accounts, although the mechanisms used vary and the primary driver for amounts taken is very often the minimization of taxation.

Most successful entrepreneurs have a history of periods of disproportionately low and disproportionately high total remuneration yields (salary and profits taken together) across the business cycles of their ventures, with remuneration often determined by the level of equity risk that they took in the ventures – often they will have been involved in multiple ventures and often not all of those ventures have been successful. This in part explains why it is common practice to take all the available profits in the years that good profits are available – tax matters aside.

Salary benchmarking has the inherent effect of creating an averaging of remuneration outcomes. In the case of small business owners the financial outcomes of their ventures are likely to be anything but equivalent as they are at the end of the day businesses operating in a competitive environment. Profit

(remuneration) outcomes can be impacted by any or all of the following factors (the following is not an exhaustive list):

- Reputation and customer satisfaction
- Brand awareness and marketing effectiveness
- Location of premises
- Scale and operational efficiency
- Management of costs
- The level of equity owned (versus borrowed or shared with other business owners).

The Relevance of Comparative DHB Data

In his original report to NZFP, Mr. Summers' made observations about the applicability of DHB remuneration levels as derived from multi-employer collective agreement(s) (MECA's). It is indicated that collective bargaining outcomes bear little relation to real marketplace levels of remuneration.

We believe that this view is very open to challenge and debate. The current legislation governing the conduct of collective bargaining (The Employment Relations Act 2000 and amendments) has the express intent of promoting collective bargaining in New Zealand workplaces because it is believed that collective bargaining will result in more equitable pay settlements than would otherwise be the case. Schedule 1B of Employment Relations Amendment Act (No 2) 2004 provides for a further specific enhancement of collective bargaining for the public health sector namely the *Code of Good Faith for Public Health Sector*. Among the purpose and effect of this schedule is to further enforce the role of collective bargaining in the public health sector and most commentators would observe that the 'code' enhances the bargaining strength of unions representing public sector health workers.

On the representative numbers alone (approximately 27% of physiotherapists are employed in DHB's¹) it cannot sensibly be concluded that remuneration levels are not reflective of the 'market'. Furthermore it would seem very unlikely to us that the Government would be predisposed to directly or indirectly funding remuneration levels for private sector physiotherapists while putting aside the relative pay levels in the public sector.

There are several sections of Mr. Summers' report and the resulting NZFP reply to Deloitte's version two report that are important and relevant – namely the discussion going to the real total remuneration view for physiotherapists employed by DHB's. This is the correct approach to take that total remuneration will include base salaries, allowances, penalty payments, and any other entitlements that flow to total annual GROSS remuneration. It would be very difficult to assess these matters precisely as shift configurations etc differ across the DHB's as do personal circumstances. However in summary it is reasonable and proper that a total remuneration view on comparative DHB physiotherapy roles be taken albeit that some estimated effects will need to be made.

In adopting Mr. Summers' opinion in this area the NZFP make the related observation that "...It is also well recognised that there can be a significant pay-premium between public sector and private sector jobs" (p.28 NZFP Response to Deloitte Second Draft Physiotherapy Pricing Report dated August 2006). This view might have been correct historically in New Zealand however it is factually questionable in the

¹ Based on data from the 2004 Ministry of Health Workforce Survey, of those who reported their employer, 64.7% worked for private organizations, with 57.2% specifically reporting either employment or self-employment in a dedicated private practice setting. 27.8% of Physiotherapists worked for DHB's, with another 7.5% working for either University/Polytechnic, Schools, or other government or department agencies.

contemporary environment. It has been widely reported in recent times that Public Sector pay outcomes are in fact trending at higher levels than those in the private sector. One of New Zealand's most prominent remuneration surveys, administered by Sheffield Reward Consulting, found that the median total salary package of a public sector CEO is higher than equivalent roles in the private sector. Sheffield is quoted as saying: *"This is a significant finding and reflects the fact salaries have needed to increase in order to attract top talent to public sector organisations. It clearly puts paid to the myth that if you want to earn good money, you need to work in the private sector"* (Jarrod Moyle, Sheffield, April 2007).

Many health sector commentators, and The Reserve Bank Governor, Alan Bollard, have recently expressed concern at the level of fiscal churn in the health sector moving in part to remuneration settlements in the absence of noticeable productivity improvements. Meanwhile the level of industrial disputation in the health sector is at an all time high as health sector unions aggressively pursue remuneration settlements that are well in excess of average settlement levels currently seen in the private sector.

NZSP Adoption of the 75th Percentile

In our experience only organisations (typically large private sector companies) who aim to lead the marketplace for the most talented professionals adopt a benchmarked position at or above the 75th percentile of the market. It is much more common in our experience for organisations to adopt the 50th percentile of the market as the benchmark position for a salaries or for the mid point level for a broad band pay system where higher performers can progress towards higher percentile equivalents.

The NZSP's contention that the 75th percentile position could in any way be construed as conservative is challenged.

Concluding Comments

This is a very complex issue and we understand the approach NZSP have taken in their attempt to evaluate the relative market position for remuneration for physiotherapists. However the results need to be carefully considered and reconciled for the reason we have outlined above.

It is noted that ACC has a high degree of influence on the funding physiotherapists businesses and each business's relative financial performance will be variable. It is the level of financial performance of each physiotherapists business that will ultimately determine the levels of remuneration that the business can afford to pay.

We trust that this letter addresses the core areas of contention and we would be happy to receive any questions of clarification.

Yours sincerely



Andrew Gibbs
Partner



Matt Ballard
Associate Director

Attachment One**BIOGRAPHY OF MATT BALLARD, ASSOCIATE DIRECTOR**

Deloitte is the second largest provider of human capital services globally and has over 2000 practitioners. Deloitte's human capital services include remuneration strategy under our international approach known as Total Rewards.

Matt Ballard has been an Associate Director with Deloitte since January 2005 leading Deloitte's New Zealand Human Capital practice. Matt and his team undertake human capital development projects for a wide spectrum of New Zealand private and public sector organisations.

Prior to joining Deloitte, for approximately ten years Matt held various senior level human resources and employee relations roles with Royal/Dutch Shell Group based in Australia and Europe. For a period Matt was responsible for international remuneration strategy for Shell's global IT businesses comprising around three thousand staff in many differing geographic regions. Matt is a certified user of the Hay Group Method of job evaluation and is experienced in the use of a range of other approaches.

Prior to embarking on his business career Matt was a Research Fellow and briefly an Assistant Lecturer in employment relations at the University of Otago. Matt is the author of several refereed academic research publications.

Matt holds a Master of Business Administration (MBA) from Henley Management College in the United Kingdom, a Master of Employee Relations from the University of Otago, and a Bachelor of Commerce with Honours (First Class) from Otago. Matt also holds a Certificate in Advocacy from Melbourne Law School.

Matt is a Board member and Trustee of the For Trades Apprenticeship Training Trust.