



## Paying the Right Amount – The power of the almighty dollar

**Are you paying too much or too little for your most important asset?** There is perhaps nothing more sensitive and impacting to employees than what and how you pay them. You can pay someone as little as 5 cents less than another co-worker performing a similar job and it can create perceptions of unfairness, reduce morale, decrease productivity and even cause someone to leave an organization.

Employees equate how much we value their work and effort, not only by what we pay, but how we justify and explain pay differences between employees. It is imperative that that you create a logical systematic approach and rationale to determine new hire pay amounts, pay increases and promotional amounts. If this process is haphazardly done, not only do you risk perceptions of fairness challenges, but you may create legal risks as well if you are found guilty of inadvertently discriminating against women or minorities.

Arbitrarily deciding pay amounts can result in the sin of paying too much or too little. If you pay too much, this costly mistake increases your overhead reducing profit margin and negatively impacting product cost. I used to think that my objective was to try to pay the least amount possible so I could keep costs down. Boy was I wrong. Paying too little impacts the quality of employee talent you receive, can decrease motivation, cause dissatisfaction and result in costly turnover. The goal then is to pay the right amount. The right amount depends on whether your pay strategy is to lead, meet or lag the market. Depending on your targeted competitor positioning, you may lead for some positions and lag for others. In most instances, meeting the market is the safest approach.

**Compensation Objectives-** Most organizations have pay objectives like the following to guide their pay program and practices.

- 1) **Externally Competitive:** Compensate employees competitively compared to similar employees working within their labor market.
- 2) **Internal Equity:** Pay employees fairly in relation to one another based on the value of the job and the employee's overall performance.

3) **Pay for Performance:** Reward employees appropriately for the overall value of their contributions and results.

4) **Legal Compliance:** Complying with all applicable laws and regulations.

### Base Pay Development Process

**Job Analysis** - The starting point is to analyze your jobs to determine their function, and the tasks, responsibility, discretion, knowledge, skills, ability, and experience necessary to perform those functions at an acceptable level. Employees and supervisors contribute to the analysis through surveys and interviews. The end results of this analysis are job descriptions used to explain the differences between jobs and to compare them with market survey information to establish pay guidelines.

**Job Evaluation** -Using the information from the job descriptions, jobs are evaluated and compared to one another to establish a job hierarchy or structure with higher valued positions at the top to form the basis and justification for pay differentials among jobs (job structure). The ranking can be based on such compensable factors as position impact, skills, effort, responsibility, and accountability required for each position. Emphasis is given to job requirements, needed skills, and the value of the job's contribution to achieving corporate objectives. There are a number of different evaluation approaches such as ranking, job classification and point factor systems. In the job evaluation, the position, not the individual, is evaluated to align pay with a job's contribution to the organization.

**Market Pricing** - The next step is to purchase salary surveys or conduct your own survey to determine the going rates for each position. Comparative wage information is obtained by matching similar market positions to establish competitive references for each position that are set to the going market rate, called the midpoint. Jobs that cannot be clearly matched to market positions are

priced using rates from similarly valued jobs and from positions next to them in the job hierarchy structure. Select your match comparison based on your pay strategy. If you are trying to meet the market, use the average, weighted average or 50<sup>th</sup> percentile as your comparison. For a lead strategy, an organization may use the 70<sup>th</sup> percentile from the compensation data.

**Salary Ranges (Min, Mid and Max)** - Using market survey information, jobs are assigned a salary midpoint that reflects the going market rate for similar positions for targeted pay strategies. A salary range minimum and maximum are also assigned to help guide compensation decisions so we don't pay too much or too little for needed talent. The minimum is the least amount we will pay for a position and the maximum is the targeted highest pay rate. Depending on the position, there may be a 20% to 40% difference between the midpoint and the minimum and maximum pay guidelines. Once employees hit the maximum pay, they may be restricted on increases to their base pay. Supervisors use the salary ranges to guide pay decisions taking into account individual differences in experience, qualifications and performance.

**Variable Pay** - What we pay for and how we pay can drive desired behaviors and business results. It is important to define desired behaviors, performance and results to guide pay practices. Where possible, try to tie some of employee's compensation to company, team and individual performance measures. There are a number of effective techniques and programs that can help you create a fair and highly motivating overall system.

It is also important to have an effective performance management system where you define, track and measure results to show a connection between employee's work results and their pay.

**Communication** - The achievement of your compensation objectives is influenced by how well you communicate the approach used and obtaining employee buy-in. Some organizations utilize a compensation committee to involve them in the process leading to greater perceived fairness. It is important that employees understand the market comparison and surveys used in setting midpoints. Some national surveys like Salary.com are an easy comparison for employees yet creates an inflated perception of their true market value. When possible, use local surveys and communicate the guiding midpoint comparison. It is not a good idea to share the minimum and maximum guidelines until someone hits the maximum for their position. When you communication compensation,

focus on total compensation and the system used to create and differentiate wages.

**Total Compensation** - Total compensation includes benefits (medical, dental, life, disability, retirement, vacation, holidays, etc.). This can be an additional 20% to 35% of an employee's wage depending on benefit levels. It is useful to provide employees with a total compensation statement that reflects the real value that the company provides.

There are other rewards and non-economic benefits for working at your organization. Strive to help employees see and understand them to further create true total compensation perception. Such things as a sense of achievement, training opportunities, recognition, social interaction, teamwork, and pride all add value to your total compensation package.

**Pay Policy** - Create clear pay guidelines for how new hire wages are determined, base pay increases are given, equity adjustments are addressed and promotion pay increases administered to help ensure consistency, fairness and the achievement of your compensation objectives.

**Conclusion** - Although effective compensation management takes concentrated effort, paying the "right amount" is worth the investment, and provides a foundation that drives desired behavior and results at your organization. Poor pay practices not only hinder your ability to attract and retain high quality employees, but can decrease employee satisfaction and motivation.

*By: Ken Spencer, SPHR, MHRM, CEO, and Sr. Human Resources Consultant for HR Service, Inc.*

**Need Assistance?**

HR Service, Inc. specializes in helping organizations pay the right amount for employees creating perceptions of fairness, and developing competitive pay ranges and practices. For assistance call: (801) 255-6166, or E-mail: [Ken@hrserviceinc.com](mailto:Ken@hrserviceinc.com).