5

Easy Steps to a Smart COMPENSATION PLAN

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5 Easy Steps to a Smart Compensation Plan

How to Create and Maintain a Compensation Plan

How smart is your company? Smart companies have up-to-date compensation plans that support their business objectives and ensure their long-term success.

As the HR leader at your organization, it's important that you can efficiently lead your company through either developing or updating its current compensation plan.

With all that in mind, we've created a succinct, step-by-step guide to compensation planning and salary benchmarking. Whether you are creating a formal compensation plan for the first time or updating an old one, the following series of checklists will help you through the process.

Steps for Developing a Formal Compensation Plan
Step 1: Plan Ahead

1. Get buy-in from company leadership. Include input from key players at your company. You can send out a questionnaire or hold meetings with certain groups or individual decision makers.

2. Complete your job descriptions. Make sure you have written job descriptions for everyone in your organization. They don't need to be 100 percent complete, but they will be essential for matching skills, responsibilities and experience to each job position.

3. Develop your compensation philosophy. Decide how competitive your organization wants to be, e.g. lead the market, meet the market or lag the market. Consider your company's organizational profile; i.e. are you a small start-up; a medium-sized, growing company; or a large, established entity.

Step 2: Perform Salary Benchmarking

1. Select sources of salary market data.

- Published, traditional surveys – These come from the government, associations or consulting firms and offer a broad perspective, though they may not be entirely up-to-date or match your organization's structure, location or size.

- Internet surveys - Since the advent of Web 2.0, there are now online resources that offer self-reported salary data from employees. These sources are very up-to-date, easy-to-use and inexpensive options for comparison. PayScale is an example of this sort of online tool.

- Custom surveys - Several firms are available who can custom design a survey for your business. These types of surveys are often very accurate and very expensive.

Ideally, you'll want to have at least two sources to work from to guarantee the accuracy of your results.

2. Choose positions to benchmark. When selecting your benchmark jobs, start with those positions that are standard across different industries, such as HR generalist, accountant and administrative assistant. Next, choose industry-specific positions that are standard at your company compared to positions in other organizations within your industry, such as civil engineer, registered nurse and assembly line worker. Avoid using positions that are a blend of two or more positions. For example, if you have a position which is a

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receptionist 40 percent of the day and a project coordinator the other 60 percent, this would not be a job to benchmark.

You will have remaining positions in your company that will not be benchmarked externally. What should you do with non-benchmark positions? Don't force matches to market data for non-benchmark positions. Instead, use your job evaluation tool to slot the position within a pay grade, or use your own internal assessment of comparable positions within your organization with similar skill, scope, decision making and responsibility.

3. Age your data. Choose a multiplier from a source such as www.worldatwork.com and following the steps below:

			2.9%						
	Effective Date	Target Date		Source 1	Source 1 Aged	Source 2	Source 2 Aged	Source 3	Source 3 Aged
Buyer II	12/2/12	6/2/13	1.47%	$38,500	$39,064	$41,000	$41,601	$43,000	$43,630
Marketing Coordinator	12/2/12	6/2/13	1.47%	$31,000	$31,454	$32,000	$32,469	$33,000	$33,484
Accountant 2	12/2/12	6/2/13	1.47%	$54,000	$54,792	$56,500	$57,328		

1. Choose the weight you will assign to each source.

2. Use the aged data from that source.

3. Multiply the source data by the weight assigned to that source.

4. Come up with your weighted average.

4. Weigh your data. If certain sources are likely more accurate, you want to make their data have more influence over the final salary ranges you come up with. You can weight different sources more or less than other sources on a position-by-position basis. For example, if you have an industry specific salary source, you may weight your data more heavily for that survey for positions that are highly influenced by industry. You can weight your sources with the following steps:

Position	Source 1	Weight	Source 2	Weight	Source 3	Weight	Weighted Average
Buyer II	$39,064	0.25	$41,601	0.5	$43,630	0.25	$41,474
Marketing Coordinator	$31,454	0.25	$32,469	0.5	$33,484	0.25	$32,469
Accountant 2	$54,792	0.5	$57,328	0.5			$56,060

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Step 3: Establish Your Pay Grades and Salary Ranges

1. Create pay grades. It's important that you choose the right number of pay grades. You'll want to select a number of grades that allows you to appropriately distinguish between the different difficulty levels of the jobs. However, you will not want to have so many that the distinction between the pay grades is too insignificant. Unfortunately, there is no magic answer, and it is going to depend on how many employees and positions you have within your organization. More than 25 pay grades may be difficult to administer, and fewer than 5 will create very broad bands.

Formal salary ranges help ensure that you have internal pay equity and give you a reference point from which to negotiate offer letters and changes in compensation with managers and employees.

2. Calculate the midpoint of each salary range. The market midpoint is the median value of the aged, weighted market data for the position or positions. It is useful to find because it will help you set your minimum and maximum salaries for a particular pay range.

To find the market midpoint you average the market data for all the positions within the pay range. Be mindful of any data points that would be considered "outliers." This would be a data point that significantly changes the value of the mean.

Example Calculation of Salary Range

Let's say that your organization is deciding to target the 75th percentile of the compensation market data because you want to lead the market in order to attract top tier talent. If you are a small start up or a company experiencing rapid growth, you will need this top talent.

If you are using a straight market compensation strategy, you'll calculate the midpoint of a salary range using the 75th percentile from your market data for each position. If you are creating salary grades that include many different positions you'll want to aggregate the 75th percentile from the market data for all of the compensation benchmark positions that make up the salary grade. These numbers become your salary range midpoint. The salary range midpoint should be adjusted annually or on some other regular interval to ensure your organization can stay competitive with its pay strategy.

Once you have established the midpoints for the positions, you'll want to create a range. If you are adopting a straight market pricing strategy, you may decide to create a salary range from the percentiles of your market data for each position. As an example, you may use the 75th percentile as your midpoint, the 25th percentile as your minimum salary and your 90th percentile as your maximum salary rate.

Another approach to using percentiles to develop salary ranges is to build salary range widths from your midpoint. You'll create a salary range around your midpoint.

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3. Determine salary range widths by position. Like most things in compensation there is no hard and fast rule here. You'll want to do what is best based on the goals for compensation within your organization. Generally, the wider the salary ranges the more opportunity there is for employees to move up in salary. You may want a broader salary range width if your organization has employees with a lot of longevity or you want to encourage employees to stay in their positions for a long time. Generally, you will want to consider having wider ranges for higher level positions, where the expectations is that employees will have more longevity (or you want to encourage longevity). As a general rule, the following salary range spreads can be used:

- Nonexempt positions – 40%

- Exempt positions – 50%

- Executive positions – 60%

4. Calculating the minimum and maximum of each salary range. The final step to creating a salary range is determining the minimum and maximum for the range. After you calculate the midpoint for the salary range you'll be able to complete this final step.

Calculate the Minimum

- Divide your range spread percentage in half. Then, take your midpoint and divide it by 1.xx (xx = half of your range spread).

- For example, if your midpoint is $30,000 and you want your width to be 40%, then you would divide $30,000 by 1.20. This equals $25,000. $25,000 is your minimum for the range.

Calculate the Maximum

- Take your minimum and multiply it by 1.xx (xx = your range spread).

- For example, if your minimum is $25,000 and your width is 40%, then you would multiply $25,000 by 1.40. This equals $35,000. $35,000 is your maximum for your salary range.

For the example above, your full salary range would be $25,000 - $35,000 with a midpoint of $30,000.

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Step 4: Complete Compensation Analytics

1. Analyze employee pay. Once you have created formal salary ranges, you want to make sure that you compare your employees' or incumbents' pay against the typical salary range. Most importantly, you will want to determine if you have any employees who fall below the minimum of the salary range (called green-circling) or over the maximum of the salary range (called red-circling). If you do have this situation, you'll want to include an implementation plan for how to deal with the employees that fall outside of your typical salary range.

2. Choose who to green or red circle. It may be necessary and advisable to bring any employee below the minimum of the salary range up to the range minimum, unless there are justifiable, business reasons why the person is below the minimum. Second, you may want to consider implementing a red-circle policy for freezing the salaries of those individuals who are over the top of the typical salary range, until the salary market catches up with them. Being prepared to deal with these implementation issues will be crucial in getting buy-in to create formal salary ranges. Without addressing these compensation issues, your business leaders may feel uncomfortable with moving forward.

Step 5: Be Consistent and Schedule Regular Updates

Once you have established your formal compensation plan and are putting it into practice, consistent compliance to your documented pay practices and policies, as well as regular updating, is your best defense against charges of pay inequity from employees and outside agencies. Wherever your company's compensation policy is not followed, document the justifications for the decision with relevant information. And, continue to communicate with employees about how the company is working towards pay equity.

By formalizing your compensation strategy, you elevate your company to one that is working to be the best in its industry in every way. That is a great message to send potential employees and your competitors.

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Compensation Plan Checklist

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4. Weigh your data.

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2. Calculate the midpoint of each salary range.

3. Determine salary range widths by position or grade.

4. Calculate the minimum and maximum of each salary range.

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Simplify Your Compensation Planning

Recruit and retain top talent

Improve employee job performance

Be confident about compensation discussions

Creator of the largest database of individual compensation profiles in the world, PayScale provides an immediate and precise snapshot of current market salaries to employees and employers through its online tools and software.

PayScale's products are powered by innovative search and query algorithms that dynamically acquire, analyze and aggregate compensation information for millions of individuals in real time. Publisher of the quarterly PayScale Index™, PayScale's subscription software products for employers include PayScale MarketRate™ and PayScale Insight™. PayScale's 2,200 corporate customers enjoy access to 35 million current employee profiles, accounting for 250 compensable factors for more than 13,000 unique job titles.

For more information, visit www.PayScale.com.

We can help you with your compensation benchmarking and make setting salary ranges easy.

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