payscale Compensation quick guide

Evaluating and managing pay compression during times of economic uncertainty

As a concept, pay compression is not new. Compression is the result of numerous issues and typically flares up in times of high economic uncertainty. With recent regulatory requirements around pay transparency, compression has become an even hotter topic as more organizations are now required to post their salary ranges. Not only can employees see these ranges, but today's **Gen Z workers are much more open** to talking with fellow employees about what they earn.

There's a lot of aspiration toward solving pay compression issues, but limited budgets or lack of awareness can make it difficult to take action. While addressing compression may be a difficult endeavor, avoiding the issue can lead to trouble recruiting new talent and increased turnover. The perception of pay inequalities that coincide with pay compression will also negatively impact engagement and can potentially lead to lawsuits if protected class inequities do exist.

In this quick guide, we share insights about taking action on this issue, as well as five best practices that can help organizations get started.

Pay, wage, or salary compression occurs when the pay of one or more employees is very close to the pay of more experienced employees in the same job. Or, it can refer to when employees in lower-level jobs are paid almost as much as their colleagues in higher-level jobs, such as with managers and direct reports.

Salary inversion is when newer staff make more than experienced staff.

Pay compression is one of today's top HR issues

Three recent factors creating pay compression in organizations include increases in the minimum wage, pay transparency legislation, and rapid inflation.

Minimum wage increases

Depending on local minimum wage laws, employees with less experience may receive a pay bump to meet updated wage requirements while those with more experience remain at their current levels. For example, a tenured cashier may currently be making $15.75 in Washington state. Beginning in 2023, the state's minimum wage will rise from $14.49 to $15.74. At that point, new cashiers will be hired at nearly the same rate as the tenured cashier. Due to the minimum wage increase, pay compression becomes an issue.

Pay transparency legislation

New pay transparency legislation is also impacting pay compression because many organizations are now required to publish pay ranges in job postings. Current employees may look at those ranges and question their own pay rates. **Research from Harvard Business Review** indicates that supervisors assume a self-protective approach when this happens and "take steps to reduce differences in compensation within the same job level." As a result, pay can become compressed between tenured and less tenured employees.

Rapid inflation

In 2022, inflation climbed to the highest it's been in 40 years. High rates of inflation over a short period of time mean employees' "buying power" as consumers shrinks. As they see prices for everyday goods increase, employees naturally expect their wages to increase at a similar rate. Among the 5,000 U.S. workers who responded to the **State of Work in America report**, 40 percent said they expect pay increases of greater than 6 percent this year. When organizations increase pay in lower-earning segments of the workforce in response to inflation, compression may result.

Learn about other factors that create pay compression **here**.

52% **of companies said addressing pay compression was more important than in previous years**

Source: Compensation Best Practices Report 2022

Practitioner perspectives

Addressing and controlling pay compression

Payscale recently **hosted a panel** of compensation professionals to learn more about how they've seen a variety of organizations handle this prevalent issue.

Even if the amount of budget needed to correct pay compression is significant, it is typically less expensive to address pay inequities up front than to continue to lose the organization's best talent to the competition.

It's also essential to proactively address pay inequities that might result in legal trouble, such as a gender pay gap or racial pay gap.

Adjust pay structures

"It's common to have compression issues arise in the few first few entry-level pay ranges. One approach to address this is to change the way you design and use lower-level structures. In these situations, you can create tighter spreads in lower pay grades and hire closer to the midpoint within in those ranges. That way, you're competitive within the market but not overly inflating pay range maximums and further fueling compression."

Jill Langhals

Manager of Compensation Services

Inform and educate hiring teams

"Having worked with different CHROs across different industries in both small and large companies I've seen it work best when you give more information to the people involved with hiring. Have the adult conversations upfront with your recruitment team. Ideally, they review pay equity before you even get to the offer stage. Once a new hire gets in the organization, it makes it a lot harder to remedy pay compression situations."

Minde Stone

Director of Total Rewards

Empower managers

"In any company that I've worked with, it's been key for frontline leaders to have a high level of comfort in talking about compensation. One of the easiest ways I think to kind of address this is manager education — not only around your compensation philosophy, but the fundamentals of compensation and how managers can translate that to explain an employee's pay."

Melissa Sebald

Manager of Compensation

Five compensation best practices for evaluating and controlling pay compression

Pay compression is a tough issue for any organization, but it's also an opportunity to **review, adjust, and implement agile compensation strategies** and processes. These five best practices will help you get started.

1

Take action during the budgeting process.

If you wait too long to broach the topic of pay compression, you're more likely to encounter issues if organizational and departmental budgets have already been finalized. Instead, engage with leaders from the start of the budgeting process. Consider any external market challenges, the labor outlook, and plans for growth. Then, level set across the organization to select which market salary data sets and compensation tools you'll use to assess compression.

2

Use updated salary market data.

Using current salary data, complete an analysis and ask three key questions:

- What is the market for your company, organization, or entity?
- Have you put ranges in place for all job roles?
- How are people sitting compared to market?

If you find pay compression issues exist, promptly address those that require immediate action. For non-urgent issues, provide a good, better, and best recommendation for the organization's next steps in making pay adjustments. Payscale offers **validated, continually refreshed data** directly from employees, employers, and trusted publishers to ensure you have updated salary information for timely and competitive benchmarking.

3

Provide total rewards statements.

Communicating about the full value of total rewards (e.g., bonus eligibility, stock options as well as health and discretionary benefits can help temper pay compression conversations. Using total rewards statements, remind employees that base salaries are only part of their compensation package. Provide as many details as possible — including monetary value of all rewards and benefits — to inform and engage employees about what their individual package includes. **Total rewards statements from Payscale** can be tailored to specific employees or groups of employees.

Learn about other ways Payscale customers are tackling compensation challenges.

Learn more →

4

Support managers with tools to have pay conversations.

With pay compression being a hot topic, pay adjustments become more frequent. When pay changes happen more than once a year, it puts more pressure on managers to be able to articulate the reasons behind someone's pay. To confidently have those complex conversations, managers need training, tools, and resources they can reference at any time. In terms of training, managers need to know about the organization's pay philosophy, salary structures, and the impact of tenure and experience on pay. At the individual level, they should be educated regarding how to explain the rationale behind an employee's placement on the salary range. Should you need help, **the Payscale services team** offers customized compensation training for managers.

5

Conduct a total rewards survey.

Distributing a survey to collect feedback every few years helps an organization gain an understanding of how much employees engage with their rewards. Additionally, gathering employee feedback can help the organization learn about other types of benefits that are of interest or would have more impact. Depending on the questions asked, surveys can also provide insight regarding overall perceptions about pay transparency and equity in the organization.

About Payscale

As the industry leader in compensation management, Payscale is on a mission to help job seekers, employees, and businesses get pay right and make sustainable fair pay a reality. Empowering more than 50% of the Fortune 500 in 198 countries, Payscale provides a combination of diverse and dynamic data sources, compensation services, and scalable software to enable organizations such as Angel City Football Club, Perry Ellis International, United Healthcare, Vista, and The Washington Post to make fair and appropriate pay decisions.

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