Compensation 101: Compensation Philosophy

By Michael F. Maciekowich

The compensation philosophy is the foundation for all compensation decisions an organization makes. Developing a compensation philosophy, however, is not always an easy task. There are a number of questions that an organization's leaders must explore in order to ensure that the compensation philosophy helps the organization to achieve its goals.

What is the purpose of a compensation philosophy? What elements are included in the compensation philosophy? Does the compensation philosophy vary by employee group, department, or other category? How frequently must it be updated? These are critical questions that need to be answered by Human Resource professionals, no matter the organization. In this issue article we discuss the ins and outs of compensation philosophies and their importance.

What a compensation philosophy and why is it so important?

A compensation philosophy, in short, is the formal statement or commitment an organization creates in regards to the compensation of their employees. The transparency of this commitment benefits both the employee and the organization when it comes to pay strategy and salary negotiations. Compensation philosophies usually are developed with teamwork between human resources and executives. The key factors to be considered when creating a compensation philosophy can include the:

- Organization's financial position,
- Size of the organization,
- Type of industry,
- Organization's objectives,
- Salary comparisons with the competition, and
- Level of talent currently in place and needed for success.

The main goal of a compensation philosophy is simple: attract, retain, & motivate employees. In order to do this, the compensation decision making team should mix Base Pay (salaries based on survey insight), Incentive Pay (cash or non-cash awards), and Benefits (non-financial awards) in accordance with the organization's resources. For example, private sector organizations would want to develop a pay philosophy that includes competitive pay, whereas an organization in the public and non-profit sectors may want to develop a pay philosophy that is more rounded to also include a heavier emphasis on work/life benefits. Developing a philosophy can be a challenge, as many organizations have varied circumstances. The organization's unique circumstances can make creating a competitive compensation philosophy difficult, no matter the level. A careful balance of resources must be considered.

How often should the compensation philosophy be reviewed?

With this question we explore the on-going *"Lead/ Lag Tango".* Many organizations review salaries once or twice a year. However, despite the annual or bi-annual salary review, market values change continuously. As a result, an organization is likely to be at market value once or twice a year. Consequently, the compensation team has to decide when they would like to offer raises. Should your organization **lead the market at the beginning of the year**, following the *lead-lag* approach? Or **lead at the end**, following the *lag-lead* approach? What if an industry or position requires new college recruits at different intervals of the year? What if different positions have different recruiting seasons? These

are personal decisions that must be considered for your organization's needs. Planning reviews a month or two before an industry / position recruiting season is an approach for successfully navigating this dance.

How important is consistency?

Consistency is very important. Salary.com gives the wary example on the importance of consistency: "…suppose a company established a flat rate of $9.90 per hour for nonexempt employees in a customer service role. The department had 200 percent turnover. Despite the published flat rate, some employees with college degrees successfully negotiated for $10 per hour or more, while employees with 20 years of experience faithfully assumed the flat rate was non-negotiable. Soon, three women over 40, a protected class under age discrimination laws, were earning less than three men who had just graduated from college. The manager's defense when confronted with the disparity was that the women never asked for more." This is a sobering reminder of the importance of staying consistent to a dedicated compensation philosophy.

How important is communication?

A sound compensation philosophy can create a sense of fairness in organization. As a result, it is important that a pay philosophy be communicated to all employees and even job candidates. It is much easier to mention in salary negations the market rate in relation to an organization's salary offer, rather than dealing with complications down the road.

How do I know my compensation philosophy is of quality?

SHRM offers the following questions to test your compensation philosophy:

- Is the overall program equitable?

- Is the overall program defensible and perceived by employees as fair?

- Is the overall program fiscally sensitive?

- Are the programs included in the compensation philosophy and policy legally compliant?

- Can the organization effectively communicate the philosophy, policy, and overall programs to employees?

- Are the programs the organization offers fair, competitive, and in line with the compensation philosophy and policies?

Founded in 1999, Astron Solutions is a New York-based consulting firm dedicated to the delivery of human resource consulting services and supportive technology focusing on compensation, employee retention and web-based talent management strategies. We work nationwide to develop and implement human resource programs that support the strategic direction of organizations through the creation of a positive employee relations environment. For more information contact us at http://www.astronsolutions.net/contact.asp. You may also contact Michael F. Maciekowich, National Director, at 212-792-8886 or michaelm@astronsolutions.com.