

Building a Compensation Philosophy That Works for Your Company



Compensation is often a large part of company expenses so developing and communicating an effective compensation strategy is key. Start by developing and communicating a compensation philosophy that supports the organization's mission, vision, and values while complementing your company culture. When building a compensation philosophy there are two areas to consider:

- Internal Equity or Consistency
- External Equity or Competitiveness

Examine the performance review process and rating scale.

Internal equity describes how jobs compare to each other within the organization. It may also be referred to as internal hierarchy. An internal equity system allows a company to compare similarities and differences in job content of required knowledge, skills, and abilities. In addition, the system should compare the job's relative contribution to the organization's overall objectives. There are a number of alternatives available to set up and determine pay equity internally.

External equity refers to pay in relation to the labor market. In other words, it is the relationship between pay for a particular job in a company compared to the same job in a similar market outside of the company. Company goals, objectives, and culture will dictate whether to emphasize internal or external equity or a combination of both.

In addition to your organization's pay philosophy—whether internal or external equity prevails—there is also an individual component that influences compensation. Individual performance impacts each employee's pay rate, so an organization's performance management system should complement both the compensations strategy and the compensation philosophy. Typically, high performing employees are paid more than average or low-performing employees in the same job. Consider the timing of performance reviews and merit increases and how they fit with company objectives. Review employee compa-ratios (employee base pay divided by the midpoint of the salary range) at least annually in order to maintain a competitive position for high-performers, in particular.



Compensation Strategy

Once the compensation strategy and philosophy have been determined, it is critical to communicate effectively. A lack of understanding of compensation can lead to employee misperceptions. Employees should understand the company's pay philosophy and how their compensation is determined in order to fully appreciate the value of their pay.

When developing a compensation communication plan, consider your audience and tailor your messages accordingly. For example, managers should understand the link between the corporate mission, vision, and values to the compensation philosophy and programs.

Compensation communication to employees is most effective when delivered by managers. Managers should deliver key compensation information directly to employees because managers are directly responsible for employee performance, growth, and the pay decisions. Executives should understand the compensation components in a general sense. Compensation messages to executives should emphasize the strategic implications of the compensation strategy.

Various tools can be helpful to managers and leaders responsible for communicating compensation information and ensure consistency across all areas of your organization. Some examples of these tools are:

- Meetings—large, small, or manager/employee sessions.
- Presentations with key compensation messages.
- Brochures or booklets.
- Customized statements.
- List of frequently asked questions (FAQs)

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Using this information as a guide to develop an effective compensation strategy and philosophy will improve employee satisfaction and impact company performance. An annual compensation review will ensure that your company's compensation strategy and philosophy are in alignment with your mission, vision, and values. Following these guidelines will allow your company to attract, retain, and grow the best quality employees that leads to improved company results. Need help training your employees?

Need help with your compensation strategy? MRA's [Compensation Services](#) department can help you!

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