6 Steps to a Better Compensation Strategy

Barley

COMPENSATION MANAGEMENT SOFTWARE

If you get compensation wrong, nothing else matters

Why would someone who is talented, motivated, and skilled want to work at your company? There could be a lot of reasons, ranging from what they've heard about your awesome culture to the interesting problems they'll get to tackle.

But at the most fundamental level, a person takes a job in order to make enough money to live comfortably, take care of their loved ones, and enable them to pursue the things that they value in life. They are looking for a fair return for the value they create by investing their time and energy with your company.

Your success as a business comes down to how you hire and how you inspire your employees to do their best work. And compensation is one of the main factors that impacts the relationship between your company and your employees.

Compensation is one of your biggest expenses as a business, but it is also your biggest investment in your people and your culture. A great compensation strategy can be an incredible asset that supports your business goals and lays a foundation of trust between your company and your employees.

Whether you already have a compensation strategy in place or you're building one from scratch, this guide will help you level up your approach.

32%

of employees believe that their pay is fair

Gartner Research, 2022

64%

of employees are planning to look for a new job in 2023

PWC Pulse, 2022

72%

of job-seekers are motivated by comp as a top 3 factor

Hired, 2022

How to Create a Winning Compensation Strategy

1 Write down your **compensation philosophy**

A compensation philosophy is the formal written document that outlines the principles of your approach to compensation. As you work through the following steps, keep in mind that documenting your plan in a clearly articulated comp philosophy is vital to create shared understanding and accountability across your organization, and to evolve your approach over time.

2 Define your **employer value proposition**

Your employer value proposition is the set of advantages that you bring to the table for current and potential employees. No two companies are exactly alike. Every company offers a unique mix of compensation, learning opportunities, career growth, work-life balance, culture, and mission. Your employer value proposition is how you tell that story.

3 Build the right mix of **total rewards**

Your total rewards package is the actual mix of compensation, benefits, incentives, and perks that you offer your employees. Think of the different types of monetary and non-monetary compensation as levers you can pull to build a total rewards package that reflects your employer value proposition and aligns to your business goals.

4 Establish your **market position**

Your market position is how competitively you want to pay compared to other companies that are hiring from the same pool of talent. Whether you pay above, below, or at market is a strategic decision that impacts the type of candidates you attract and how you retain your employees, as well as your overall budget.

5 Decide how to approach **location-based pay**

With the rise of remote and hybrid work, many companies are re-evaluating the question of whether to anchor pay to a particular city, region, or country. Each approach has its pros and cons, especially when it comes to how difficult it might be to administrate.

6 Define your level of **pay transparency**

Pay transparency has the potential to deliver real value to a business, as well as improve employee morale and close pay gaps. To find the right level of transparency for your business, consider the legal requirements, strategic goals, and impact on employees and candidates.

1. Compensation Philosophy

How and why you pay your employees tells a story about your company's goals, values, and intentions. If you don't intentionally craft this story, it is likely to be created for you.

Your compensation philosophy articulates "why" you pay the way you do.

You're already making decisions about pay that form your compensation philosophy in action, whether or not you've written them down.

So as you work through the pillars of compensation strategy, keep in mind that the end goal will be to create a document to serve as your source of truth going forward.

It starts at the top: with your leadership and executive teams. Start by setting a meeting with your leadership team to align on your business priorities and figure out how your compensation strategy can support these goals.

According to the Society for Human Resource Management (SHRM), a good compensation philosophy should be able to pass the following quality test:

- **Is your compensation philosophy equitable?**
- **Is your compensation philosophy defensible and perceived by employees as fair?**
- **Is your compensation philosophy fiscally sensitive?**
- **Are the strategies included in the compensation philosophy and policy legally compliant?**
- **Can the organization effectively communicate the philosophy, policy and overall compensation programs to employees?**
- **Are the compensation programs the organization offers fair, competitive and in line with the compensation philosophy and policies?**

2. Employer Value Proposition

Your employer value proposition (EVP) is the unique set of benefits and values that a company offers to its employees. This can include things like competitive salaries and benefits, but it can also include opportunities for growth and development, a positive work environment, and a meaningful mission.

Having a unique EVP helps your company to differentiate itself from other employers and attract top talent.

Clearly defining and articulating your EVP can also help to retain employees and improve overall morale and job satisfaction within the company.

These positive impacts arise from one simple fact: when you are clear about what you bring to the table as an employer, it allows your potential and current employees to understand and enthusiastically sign on to participate in that set of values and benefits. They know what they're getting and they've bought in, and this drives increased trust and satisfaction.

Real-World Employer Value Propositions

Emphasis on Good Work-Life Balance

Hubspot, a CRM software, has an EVP that is summed up in the tagline, "work and life should fit together". This is reinforced by benefits that allow Hubspot employees to achieve great work-life balance, like unlimited vacation, a "global week of rest," a paid sabbatical and bonus after 5 years, parental leave, egg-freezing benefits, and paid time off for volunteering. Here's how they tell the story of their EVP: "we're building a company where employees (and their families, pets, and passions) grow."

Emphasis on a Building a Healthy Team

Strava, a fitness platform, leans on an EVP that supports the mental and physical health of employees with a team-based lens. Their robust wellness benefits include annual stipends for gear and gym memberships, team workouts, and on-site fitness rooms with showers and towel-service. They support their diverse workforce by offering employee resource groups and matching donations to anti-racist non-profits. Their EVP in their words: "we are intentional about hiring and supporting a diverse team that represents the athlete community."

Emphasis on Culture and Creativity

Spotify, a music streaming app, puts their EVP into a playful manifesto: "Here at Spotify, we like to think of ourselves as a band. Like a band, we're dependent on each other to create the best audio experience. Like a band, we need to be in sync. And like any successful band, we have a set of rules, a band manifesto, that keeps us focused on where we want to go and guides how we get there." In this example, the unique EVP is a culture that appeals to people who are passionate about music and promises to make them feel like a rockstar.

3. Total Rewards Package

Total rewards refers to the combination of all the cash and non-cash pay, perks, and benefits that an employee receives.

If your employer value proposition is a promise that you're offering employees, then your total rewards package is one of the ways you actually deliver on that promise.

It is typically composed of the following elements:

Base Pay

The salary or hourly wages that an employee is paid.

Variable Pay

Any incentive compensation that is based on performance or discretion, such as a bonus, commission, or profit-sharing.

On-target earnings (OTE) is the total amount of money that an employee can earn if they reach their performance goals or quotas. It is a combination of base pay and variable pay, and the ratio of base pay to variable pay is known as the **pay mix**. Companies can adjust their compensation strategy and pay mix to motivate employees and encourage specific actions. In many roles, the pay mix tends to be heavily weighted towards base pay, but in some cases, such as in software sales, the pay mix may be more evenly split between base pay and variable pay.

Equity

A long-term incentive that gives employees a direct or indirect ownership stake in a company, such as stock options or restricted stock units (RSUs).

Paid Time Off

This can include vacation days, personal days, holidays, bereavement leave, voting time, and any other type of paid leave from work.

Benefits

Includes health and dental insurance, retirement plans, short-term and long-term disability, relocation reimbursement, and any other benefits.

Perks

This runs the gamut from catered meals to fitness programs, daycare benefits, and paid time off for volunteering. These perks speak to your company's culture and values, and also remove friction from your employees' lives so they can be most productive.

25 - 40%

The value of an employee's total compensation can be 25 - 40% higher than their gross salary

CNN, 2021

There are infinite ways to tailor the right mix and drive results, which is why a well-designed rewards program can be an absolutely vital pillar of a winning business strategy.

When building your mix of total rewards, consider the following questions:

- What is your balance between base pay and other incentives?
- How does this balance align with your business objectives?
- What kind of benefits will appeal most to your current and potential employees?
- What kind of performance or behavior are your incentives going to drive in the short-term?
- What kind of benefit or incentives will help you retain employees in the long-term?
- How does your total rewards package reinforce your unique employer value proposition?
- How will you help current and potential employees understand the full value of their total compensation beyond base pay?

4. Market Position

When hiring talent, companies compete with each other for the best candidates. So the market, in this context, refers to the labor market or the cost of labor, where the "going rate" of pay for a job is determined by how much your competitors pay for similar roles.

These are not necessarily competitors to your business or product, but they are competitors for talent who are hiring from your labor pool. They might be companies in the same industry or companies that are similar to yours in terms of location, size, stage of growth. In the current climate, where remote work is becoming more common, organizations may also find themselves competing for talent with companies in other countries.

Deciding how you want to pay relative to the competition - your position in the market - is a key pillar of your compensation strategy.

Meet the Market Approach

The most common approach to setting pay is to match the midpoint of the salary range offered by competitors.

This allows you to offer a competitive wage without going above the market rate. By not offering top dollar, you may also free up some budget for other perks or benefits that can differentiate your company from others, such as a generous leave program or incentive plan.

This strategy is generally a safe approach for most companies that are not experiencing significant hiring or retention challenges. In a highly competitive field, it may make it more difficult to attract top talent and can increase the risk of losing top-performing employees to better offers.

Lead the Market Approach

Leading the market means setting pay rates above those of your competitors. This approach establishes your company as the one to beat when it comes to attracting top talent, and so can significantly improve recruitment and retention. Companies that choose this approach often also offer excellent benefits in order to further enhance morale and productivity.

However, this tactic comes with high payroll costs and often requires high pressure revenue goals and performance expectations to match.

It may be suitable for companies in highly competitive industries, organizations that are highly profitable or well-funded, or companies with aggressive growth goals. If a company has the financial resources to support this costly strategy, it may be a worthwhile investment.

Lag the Market Approach

A lag the market approach is when a company purposely sets its pay rates below the market midpoint.

This is the least common strategy, because lower pay can make it more difficult for the company to attract and retain top talent, and may have negative effects on employee morale and productivity.

However, this approach may be suitable for organizations in the public or non-profit sector, where other factors such as good benefits and work-life balance may compensate for lower pay.

This highlights the importance of the overall employee value proposition. If an organization offers opportunities for meaningful work, a good work-life balance, interesting perks, or significant career growth, then lagging the market in pay can still be a successful strategy.

Align Your Approach to the Needs of the Business

Some companies use one approach to market position for the entire organization, whereas others use a mix of meet, lead, and lag market positions to better align compensation to business strategy.

For example, some companies chose to lead the market on designated “premium” or “mission-critical” roles that will have an outsized impact on the organization’s success. Alternatively, you may choose to lag the market in geographic areas where there is an oversupply of a certain kind of talent.

If you’re segmenting by group, make sure that you have clearly defined reasons and that compensation is structured consistently within that group in order to avoid creating pay inequity.

This is where your compensation philosophy adds so much value: documenting your approach allows you to pay people differently but fairly. It shows that there is a process for determining pay and that the organization is applying that process consistently.

5. Location-Based Pay

Location-based pay refers to a system in which an employee's pay is determined, in part, by the location in which they work. This type of pay system takes into account the cost of living in different locations, as well as other factors such as the local job market and the demand for certain skills.

The rise of remote work has brought the question of location-based pay to the forefront for many employers and employees. Should compensation be the same no matter where someone works, or should it change based on where they live? If someone works from home, does that mean they can work from anywhere?

Even companies that claim to be location-agnostic when it comes to pay are likely still using market data from a particular location, whether that's the city where they are headquartered or a national average for the country where they are based.

There are four common approaches to location-based pay and it's important to consider which one is right for your company.

Location-Specific

In this approach, pay is based on the market rates in a specific location: a zip or postal code, city, state, or province. This was the most common approach to setting employee compensation before the rise of remote work, when pay was based on the market rate at the company's head office location and other offices. The offices were often located in major cities, with higher rates of pay that would allow employees to live close to their place of work. As a result, many companies currently have a location-specific approach to pay.

This approach can be optimal from a cost perspective, because it allows you to pay salaries that are competitive in each location (according to your compensation philosophy and market position). However, implementing this approach requires a significant investment of time and resources to gather salary benchmarking data for each market, which may offset any cost-savings.

With location-specific pay for remote workers, you may also find yourself adjusting compensation more often through the year as employees move around. If employees who move to a new location are required to take a pay cut, it could lead to negative reactions and high turnover.

Geographic Pay Zones

In this approach, you establish geographic zones with similar labor costs and group them together into "pay zones".

For each zone, research the local market data to inform your pay structure. The employees reporting to the San Francisco office might be in one pay zone. The employees reporting to the Boston office might be in another. The employees reporting to the Chicago office might be in a third pay zone, or you might find that the market rates of Chicago and Boston are similar and group them together into one zone.

The advantage of this approach is that it allows for some differentiation in pay based on location, while still remaining competitive in each market. It requires good benchmarking data for each geographical area and may be more complex than using a single global rate, but it's also simpler than aligning to each employee's local market.

National Rate

It has become increasingly common in the world of remote and hybrid work to align pay to one rate for an entire country. This may mean anchoring to a national average, or to a specific location (even a premium location like San Francisco), and applying that for all employees across the country.

This allows you to implement a consistent pay strategy for your organization within each country, regardless of whether you have an office or where your employees are located.

This strategy is simpler to manage, because it eliminates the need to adjust pay when an employee moves within the country. You may need to adjust pay if they move to a different country, but that's an easier discussion since you may be paying in a different currency with different taxes and other requirements.

Global Rate

In this approach, you would pay a single global rate for a role, regardless of an employee's location. This global rate may be tied to the rates of pay in the country or city where the company is headquartered, but it could also be based on any location or national average that you deem appropriate for your employees. You may choose to pay everyone in one currency or convert each salary to a local currency.

Paying a single rate around the world is appealing to many people, who believe that you should get paid the same rate for the same work, regardless of where you live. Though this seems simple at first glance, it comes with its own internal equity challenges. An employee in a low cost of living area, like India or Nigeria, would derive a very different net benefit and standard of living from an employee living in a high cost of living area, like the UK or US. In this case, equal pay creates an inequitable benefit.

In addition, each country has its own tax rules. In a global pay approach, even if you pay everyone the same gross salary, they may take home a different amount after taxes.

6. Pay Transparency

It is a common misconception that pay transparency means posting all your ranges or sharing the salaries of every employee openly.

Pay transparency is actually a spectrum composed of actions that a company takes to communicate its compensation philosophy and practices to employees, candidates, and the public.

The least transparent end of the spectrum is when a company shares very little about the “why” and “how” behind pay. Employees know only their own salary. For candidates, the salary for a role is disclosed at a later stage of the recruitment process, such as when they get a job offer.

The most transparent end of the spectrum is the kind of radical transparency where all salaries are shared openly with the public. The majority companies never reach this end of the spectrum - and don’t want to and wouldn’t actually benefit from this extreme kind of transparency.

Most companies fall somewhere in between these two extremes. They may share salary ranges within departments, without sharing the salaries of individuals. They may share some aspects of their compensation philosophy, such as their approach to location-based pay, but not share other aspects, such as their position in the market.

When it comes to your compensation strategy as a business, your goal is to find the right level of pay transparency for you. This is the amount of transparency that optimizes your ability to recruit great candidates, empower your employees, compensate everyone fairly, and comply with legislation.

To Find the Optimal Level of Pay Transparency:

Consider the legal requirements

Most countries have laws that mandate a certain level of pay transparency. For example: in the United States, New York and California have recently mandated that employers must include salary ranges on job postings, in addition to other requirements. So a good place to start is by understanding any regulations that might apply to your company in any of the locations where you operate.

Align to your employer value proposition

Pay transparency can have a big impact on company culture. Some companies define themselves by prioritizing diversity, equity, and inclusion. Increasing the level of pay transparency has been shown to close pay gaps and improve morale, especially for women and people of color. If this is an important value for your company, then a higher level of pay transparency can be one of your unique advantages.

A good lens on pay transparency is to ask to what extent increasing pay transparency will benefit your potential and current employees.

Focus on your employees, both current and future

It's important to consider the preferences of your employees when it comes to pay transparency. In some industries, pay transparency is usual and expected. Government workers often have clearly defined salary ranges and may even have their salaries published annually. In tech, there is a growing movement towards sharing anonymous salary and equity data on online crowd-sourced salary websites. In other industries, pay is still an extremely taboo topic. Ultimately, you want to increase pay transparency to the extent that it will have a positive impact on your potential and current employees.

Factor in your business goals

Pay transparency can have positive effects on employee engagement, retention, and productivity. Improving transparency helps employees understand whether they are being paid fairly. When they feel fairly compensated, they feel that their contributions are properly valued, which leads to increased job satisfaction, lower turnover, and more motivation to learn and grow with the company. More transparency builds trust and improves communication between employees and management. It can also close pay gaps, leading to a more equitable and inclusive workplace.

Keep it practical

It's important to consider the feasibility of implementing pay transparency in your organizations. This might include factors such as the size of your company, the complexity of your pay structure, and the resources required to communicate pay information to employees. How will you train managers to answer questions? How will you respond if employees are unhappy with what they learn about their salary range or the pay of others? Increasing pay transparency can lead to a more positive and equitable workplace, but it does require some effort and resources to implement.

Building a great compensation strategy requires thoughtfully considering six key steps:

Compensation Philosophy

Employer Value Proposition

Total Rewards Mix

Market Position

Approach to Location-Based Pay

Level of Pay Transparency

By carefully evaluating each of these elements and how they align with your business goals and values, you can create a comprehensive and effective compensation strategy that attracts and retains top talent, supports employee satisfaction and retention, and aligns with your overall business strategy.

Remember: a great compensation strategy is not a one-time effort, but rather a continuous process of review and evolution to ensure that it stays relevant and effective in meeting the needs of your business and your employees.

About Barley

Barley is a compensation management software that helps companies structure, analyze, and manage compensation - and keep a pulse on changing pay trends. Barley's platform gives forward-thinking businesses the tools to make smart, consistent, and fair pay decisions, while saving time and optimizing budgets.

Learn more at barley.io

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