back to basics

11 | 2016

workspan
The Magazine of WorldatWork©

Tips for Managing Pay Compression

There are two kinds of compensation professionals: those who have had to deal with a pay compression situation and those who will.

It's one of the most common problems and affects organizations both large and small. Pay or salary compression occurs when there are small differences in pay levels between employees but significant differences in their skills, job level or qualifications. It can be as isolated as two workers or can affect many employees throughout the company. There are many causes of pay compression. Some of the more common reasons and ways to address them are:

Rates of Pay for New Hires

The required salary offers to attract new hires for certain positions can increase at faster rates than that of current incumbents. Compression can also occur if an organization has begun to recruit a higher level of experienced talent or is seeking to improve the caliber of the workforce by recruiting from more prestigious schools or training programs. Consider providing signing bonuses, which allow base pay to remain consistent with current incumbents. Also in certain job families, individual contributors will advance periodically along a fairly well-defined track of promotional steps as their experience and skills increase. This is another method for maintaining pay distance between new hires and tenured staff.

Nonexempt Staff and First-Level Exempt Supervisors

Nonexempt employees who regularly earn overtime pay can push up against or even exceed pay levels of their supervisors. This can often be traced back to an inadequate promotional increase when the supervisor was promoted. If the increase is based on base pay alone and does not take into consideration typical overtime worked, then a compression situation will likely be the result. The promotional increase should take into account base pay plus an additional amount to reflect some of the overtime pay. Another alternative is to include supervisors in an incentive plan that nonexempt staff do not participate in, or if all employees participate, set the target payout levels for supervisors higher to increase the pay difference.

Mergers and Acquisitions

Mergers and acquisitions (M&As) of two organizations with disparate pay philosophies represent a unique challenge because large numbers of employees are immediately affected. In the case of an acquisition, the acquiring company will generally set the tone for how compensation is to be administered. It is critical that the business strategy behind the M&A be front and center in mapping out a total rewards implementation plan to ensure that a methodical approach is carried out. This plan must include how pay levels are to be integrated and over what time frame. If certain staff need to be retained but only for a certain period, then what incentives can be provided to retain them? If pay levels vary widely between like functions and the intent is to retain everyone, then a transition plan must be put in place.

Even with the best planning and administration policies, compression is difficult to eliminate entirely. However, these situations can be minimized and managed when the conditions that lead to compression are anticipated. ws

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