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Is it Time to Ditch Your Salary Structure for Market Pricing? We Debate the Pros and Cons.

As some technology companies consider moving away from salary structures, we examine the pros and cons of market pricing, including the experiences of some of our largest clients.

For most companies, base salaries are their largest annual cash outlay. Therefore, it's of great importance that they find methods for salary administration that allow them to effectively manage this expense as they grow and mature. Taking a systematic approach to assigning compensation levels for groups of similar jobs streamlines the salary-setting process, helps managers and human resources professionals rationalize compensation decisions, and enables a cohesive approach to delivering total compensation.

There is more than one way to successfully approach the salary-setting process. While the majority of our consulting and survey clients have some type of formal salary structure in place, with grades and ranges, an impressive number of technology companies are forgoing structures for single job market pricing. Market pricing is an approach in which there are no defined grades; instead, there are individual market rates for each job within an organization. The going market rate is determined through competitive benchmarking surveys, such as the **Radford Global Technology Survey**.

To get a sense of how popular market pricing is in the technology sector, we surveyed some of our largest technology clients headquartered in the United States (US) in 2014. Among the 46 companies surveyed, 37% use single job market pricing, with the remaining 63% using some form of salary grades or a hybrid approach. Most companies that use market pricing say they update their compensation data on an annual basis.

In this article, we will examine the details of a market pricing system, including how to implement this approach successfully and what makes a company a good candidate for using market pricing. Subsequent articles in our series will explore traditional salary structures and the global leveling approach to salary management. But first, as a quick reference point, the table below displays how the most common approaches to salary administration compare to one another across a number of factors, including, system focus, leveling, range spreads, managing pay and job evaluation.

Salary Administration Approaches and Characteristics

Design Characteristics	Market Pricing	Salary Structure Models	
		Traditional	Global Leveling
Focus	External	Balance between internal and external	Primarily internal, with an external view
Number of Levels	No levels; rather each job has its own reference range	Many grades (up to 20)	Fewer grades (10-12)
Range Spread	Anywhere from +/- 5% to +/- 20% around a market data point	50%-60%	60%-100%
Managing Pay	Uses guidelines to manage pay around or within the range	Uses minimum, midpoint, maximum (or divides grades into thirds)	Uses functional pay ranges
Job Evaluation	Uses market data supported by job matching	Uses market data supported by whole job slotting	Uses career levels to slot jobs

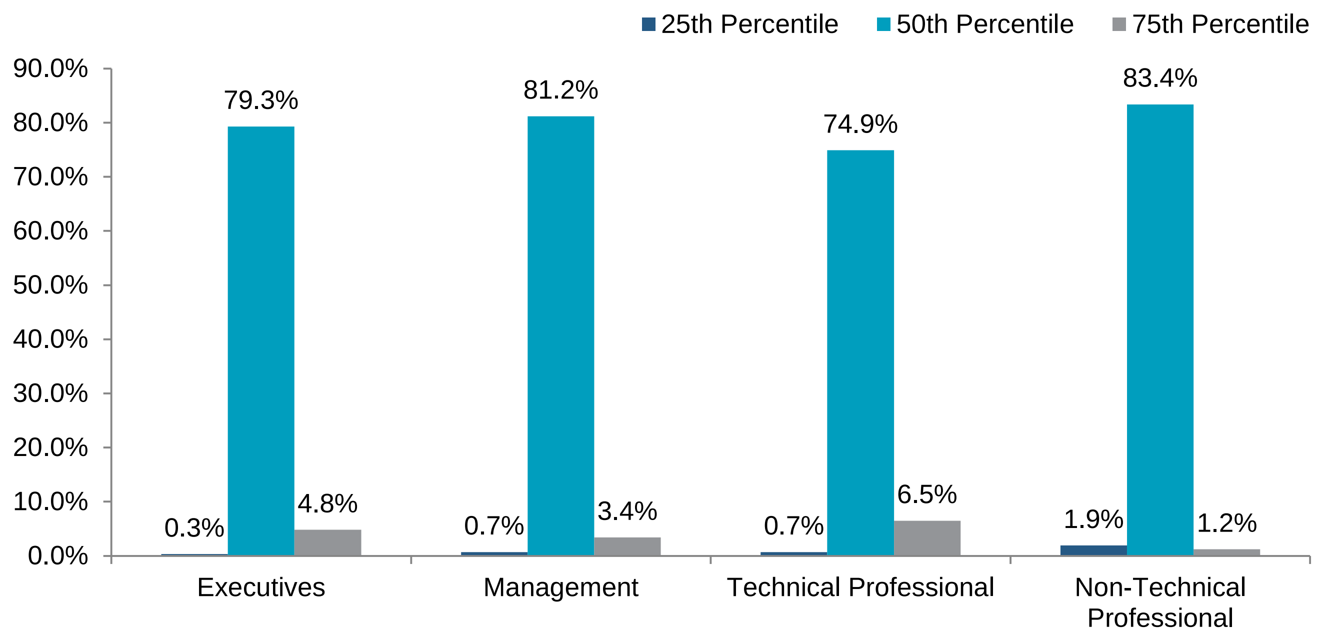
How Do You Market Price Jobs?

At a basic level, market pricing jobs involves gathering market data for each job from a selected peer group and determining the low, median and high points of base salary. Unlike salary grades, which use data to create salary ranges around job levels and job families, market pricing targets specific pay for individual job titles. Whereas salary structures can result in ten or more grades with ranges, market pricing will often result in hundreds of market reference guidelines— one for each job and geographic region.

In order to create market reference points for each job, begin by matching your company's jobs to like positions in competitive compensation surveys. Most companies start with their job descriptions or interview line managers to confirm their understanding of each job and then determine the "best fit" jobs in a survey. Job descriptions in Radford surveys summarize the primary responsibility of each job. In general, if your job content matches a survey job by 75% or more, it can be considered a good match.

Next, decide which group of companies best represents your competitive market for talent. For positions below the executive level, industry and geography factor most prominently into determining pay levels. The goal is to identify a comparator group that is specific enough to have credibility within your company and robust enough to provide solid external benchmark data. The final step in market pricing is to determine where to position your company's pay relative to the market data you collect. Although most companies will say they target median market levels, there are valid arguments for **aiming higher**, or for holding fixed pay lower than the median. The bar chart below shows the prevalence of pay positioning for technology companies across the globe.

Target Pay Positioning for Base Salary



Source: Radford Global Technology Survey, Workforce Trends Report: Q1 2015

Why Choose Market Pricing?

Market pricing isn't right for everyone. Before deciding if it makes sense to adopt a marketing pricing approach at your company, first consider the pros and cons listed below:

Benefits:

- Arguably a more "precise" approach compared to grouping multiple jobs into broader grades
- Pinpointing specific pay levels provides greater flexibility to respond to changing markets (e.g., hot skills related to certain jobs, local labor market supply/demand pressures)
- Internal equity or "pay compression" issues are less likely if you are managing to precise market prices updated annually

Challenges:

- The maintenance of numerous reference points year-over-year, particularly for companies that use multiple salary surveys, is time-consuming
- Puts excessive emphasis on each survey data point to represent "the market," sometimes ignoring that survey data may be more or less robust from market to market
- Requires all jobs to have a benchmark match, often resulting in forced matches

- A job-by-job salary target is relatively simple to explain to managers and employees

- Can create internal inequities in pay throughout career ladder progressions
- Not conducive to a complete system tying base, bonus, and LTI

While market pricing is arguably more precise, it can be time-consuming to manage and often requires more internal resources. The approach has been lauded for its fairness, but at the same time, some managers worry that it puts too much emphasis on pay. Individual job market pricing also doesn't lend itself to the consistent delivery of incentive pay levels, where equity grants and bonus targets are linked to salary grade.

Client Case Study

Large Hardware Company Debates the Merits of Market Pricing

This US-based multinational company has used different pay-setting approaches throughout its history. While they currently use market pricing, the firm is contemplating adopting a more structured approach. With continued diversification of their business, the company has used this opportunity to discuss whether they can implement a system that will still yield accurate and current pay data, while being less labor intensive.

The technical foundation upon which the company was founded has fostered a workforce that values precision and accuracy. These values align well with a market pricing model. However, as the business has diversified, the company's job structure has expanded, making market pricing a far more involved process than it once was. Says one compensation leader: "It's just too much work to do, and, at a certain level, it does not present the same level of accuracy we thought it would give us." Furthermore, the client is finding limited external data sources in some of its regions, making its singular pricing strategy more difficult.

The company says its legacy of market pricing has created a culture where managers sometimes overthink market guidance. And managers can become too focused on compensation precision.

Furthermore, as more technology sector companies also contemplate changes to their performance rating systems— often to focus less on the quantitative and more on the qualitative— our client says it's logical that compensation reviews would move in a similar direction.

So where does the market pricing approach work best? For companies in highly competitive, fast-moving talent markets, like we see in much of the technology space, this level of specificity often resonates with managers. They can feel confident their job offers are exactly pegged to the market and have a lower likelihood of running into pay compression, which is where new hires are paid at or above the levels of long-standing employees. Often, small or start-up companies use this approach for a few years but outgrow it when they reach 250 to 500 employees and need something more comprehensive that links all compensation elements— base, bonus, equity— in a more comprehensive and easier-to-manage system.

It should be noted that most companies with formal salary structures for their broad employee populations still use the market pricing approach for sales jobs because the pay mix for sales positions is so different from other jobs, they don't logically fit into traditional salary structures. In addition to sales positions, many companies use market pricing for legal jobs or other families that are outliers relative to the broad population, either from a pay level standpoint or from a pay movement point of view. For example, hot jobs where demand is high but there are not enough qualified people to fill the growing number of positions. In these cases, market pricing each individual position renders more precise data for companies to recruit finite talent.

While a market pricing approach creates customized and precise pay data for each individual job, it's not without its challenges. Though the entire concept of market pricing is antithetical to structured systems, companies can take steps to lay a solid foundation upon which market pricing can be optimized. Here are three things we believe companies should do to ensure effective implementation:

1. **Dedicate resources.**
   Market pricing is time consuming and if a company doesn't have the resources to maintain and monitor market data, the system breaks down and data can quickly become stale.

2. **Have a contingency plan.**
   For positions where adequate market data cannot be found, compensation teams must identify internal jobs that can serve as a proxy or use alternative market data sources that will have credibility internally.

3. **Think about careers.**
   Market pricing single jobs does not ensure logical salary progression within a given job family or across functions. In-family or lateral promotions require close attention to ensure appropriate pay progression is possible. Certain jobs and locations will have limited market data no matter which external benchmarking source you use. In these cases, it's important to consider alternative data points (see our article, *The Art & Science of Benchmarking: What Happens When Pay Doesn't Progress?*, for more information).

Client Case Study

Diversified Tech Company Dedicates Resources to Market Pricing

This multinational, diversified technology company has used a market pricing strategy for all of its job positions over the past ten years. The pricing strategy gives managers confidence that the value they assign to their jobs accurately reflects the market. The approach is easy to communicate to managers and appeals to the company's large population of technical employees who prefer the precision of market pricing.

However, there are drawbacks. On its own, market pricing can't incorporate the internal value or importance of a particular position that might not be reflected in the broader marketplace. Non-traditional or emerging job positions are also harder to assign a value to; meanwhile, the cost of market pricing each job can't be ignored. Still, our client says they would only contemplate a move toward a more structured pay approach if the change would still result in market-aligned competitive pay that all parties feel is fair.

The firm imparts the following advice to companies contemplating a market pricing strategy: (1) Clearly define your objectives and pay philosophy; (2) understand your organization, including its size, job levels and positions; and (3) evaluate the pros and cons of market pricing for your organization, including the cost of implementing the pricing system compared with your current system.

Next Steps

When it comes down to it, the decision to use competitive salary data to design your compensation system is a question that is deeply dependent on your company's pay philosophy, workforce characteristics and internal resources. Your human resources and compensation managers should start the decision making process by asking questions like:

- Is pay competitiveness to the external market more important to us than internal equity?
- Do we have a technically strong compensation team with the bandwidth to update market pricing at least annually?
- Can our compensation administration system support hundreds— if not thousands— of market reference points easily?

If the answer is yes to some or all of these questions, then market pricing jobs could be an approach that works well for your company.

While we see a slight preference in the marketplace right now for formal salary structures, there are many leading companies that find market pricing to be the right approach for their business. We believe the market place will always allow room for multiple approaches to salary administration.

Stay tuned for the second part in our series on salary administration that will focus on the use of traditional salary structures.

To speak with a member of our compensation consulting group about your company's approach to salary administration, please write to consulting@radford.com.

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About Radford

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