

Understanding Market Pricing

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Bottom Line	Pay programs based on market valuations provide managers with the information necessary to determine competitive pay levels that will attract, retain, and motivate the talent needed to achieve business objectives.
Subjects	Market pricing defined, job documentation and evaluation, job pricing, salary surveys

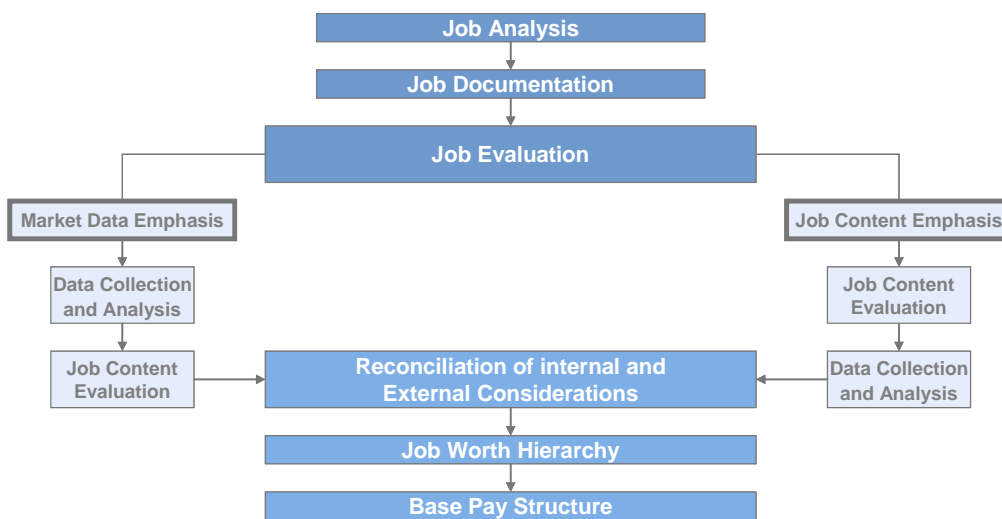
Market Pricing Overview

Managers need timely and accurate market compensation information to compete for talented employees in the labor market. Market pricing is the process for determining the external value of jobs, allowing you to establish wage and salary structures and pay rates that are market sensitive. Market data provides a basis for negotiating pay rates with individuals and groups, allowing for an objective logic check which ensures internal equity and external marketability. This process also allows you to track market movement over time, giving you insight into market changes and trends.

A job's "value" or "worth" within an organization is determined during the job evaluation process. There are two approaches to developing a job worth hierarchy: market data emphasis and job content emphasis.

In the market data approach, benchmark jobs within an organization are first identified. These jobs are priced using survey data and are each assigned a relative value based on market pay levels. All other jobs are positioned in relation to the benchmark jobs.

The job content approach uses an internal equity job evaluation methodology (e.g., point factor job evaluation system) to first determine the relative worth of each job. The results are then "tested" against the market. The following chart summarizes these two approaches to determining relative value:



Source: WorldatWork, 2007

Market pricing is a formal process for determining the external value of jobs.

A benchmark job is a job that is easily defined, commonly found in many organizations (and therefore reported in compensation surveys) and represents key or heavily-populated jobs in your organization.

Compensation philosophy defines the organization's competitive pay position in relation to the market and identifies what it values in terms of how it will reward the work needed to achieve its business objectives.

Regardless of the approach taken, data collection, both internal and external, is an extremely important part of the job evaluation process. When using either approach, conflicts between internal equity and external competitiveness must often be addressed before finalizing the organization's job worth hierarchy.

Different organizations take different approaches to integrating the use of market data in the job evaluation process. Employers are either market aware, market focused or market driven in their approach. Again, each approach takes data collection into consideration but the extent to which external data is relied upon varies. The chart below highlights the differences between these three focuses.

Market Spectrum		
Market Aware	Market Focused	Market Driven
Internal focus	Internal/external focus	External focus
Reactive use of market data	Evolving use of market data	Proactive use of market data
Set of benchmarks; constant survey portfolio	Periodic review of benchmarks and surveys	Regular review/assessment of benchmarks and surveys
Process "owned" by corporate compensation	Shared "ownership" between compensation and line	Shared "ownership" between compensation and line
Training for corporate compensation only	Limited management training/communication	Broad management training
5 - 10 surveys	10 - 25 surveys	25 - 50 surveys
15% to 25% of jobs are market-priced	30% to 40% of jobs are market-priced	Over 50% of jobs are market-priced

Adapted from Bentson & Hand: "Getting the Biggest Bang for Your Survey Buck"

Your organization's compensation philosophy determines where you are in this spectrum. There is no right or wrong focus, merely a correct focus for your particular organization contingent upon its compensation philosophy. Some factors that influence an organization's compensation philosophy include the industry in which you operate, the size of your organization in terms of employee population and/or revenue, and geographic location. You should also consider your target market position for salaries, specifically, will you pay the market mean (or average), are you a below-market payer (in which case you might target the 25th percentile), or do you wish to pay aggressively and position yourself at the 75th or higher percentile?

Market Timing

Companies may choose one of three approaches to their market timing methodology; lead, lag, or lead/lag.

- Lead companies set pay at the anticipated market level at year-end and will lead the market throughout the year, reaching equilibrium with the market at the end of the year.
- Lag companies will consciously set pay equal to current market levels at the beginning of the year and will therefore continue to lag the market as the year progresses.
- Companies may choose to lead/lag whereby they set pay at the mid-year anticipated market level. They will lead the market for the first half of the year and will then lag the market for the second half of the year. This approach balances the need to compete with the need to control costs.

Ten Steps to Successful Market Pricing

To ensure successful market pricing of the jobs in your organization, we recommend ten steps to the process which will put you on the right path.

1.	Analyze company jobs to determine internal function, responsibilities and knowledge/skills requirements
2.	Develop brief job descriptions
3.	Identify benchmarks (i.e., common jobs within a recruiting market)
4.	Select survey or surveys
5.	Identify appropriate job matches
6.	Choose appropriate market scopes and determine market value
7.	Adjust data based on credibility of the source and degree of match
8.	Age the survey data based on organization's market timing methodology (lead, lag, lead/lag)
9.	Slot non-benchmark jobs based on comparable worth
10.	Analyze variance versus current practice

It is extremely difficult to market price a job if you do not have current, up to date job descriptions. In our experience, we have found that many organizations do not have reliable job definitions upon which to base a successful comparison to the market.

- When documenting a job, it is important to consider the major functions of the positions in your organization and carefully document the knowledge, skills and abilities required to perform those functions.
- A thorough understanding of organizational levels and reporting relationships will assist you in further clarifying the positions in your organization.
- You can use “capsule” job descriptions to help facilitate the job matching exercise, but they should not replace full job descriptions which should be on file and available to position incumbents.

Once jobs are documented, you will need to identify benchmark jobs. Benchmark jobs should represent a broad cross section of the employees in your organization. It is unrealistic to expect that you will be able to find market data for every job in your organization. Assuming you can find matches to the majority of the benchmark jobs, you will be able to slot non-benchmark jobs into the final job hierarchy with relative ease.

Job matching is an essential part of the job valuation process that should never be rushed. Be sure to use all the information that is available to you including job descriptions and organization charts. Never rely on job titles alone to match jobs. Make sure you fully understand the scope and responsibilities of the job you are trying to match to the marketplace. When possible, try to price as many levels as you can within a job family to ensure consistency and accuracy. As a general rule of thumb, if a survey job matches 85% to 115% of your job's duties, it is considered a good match.

When compiling data from your survey source(s), follow your “recruiting net” – that segment of the market you go to when recruiting new hires into the organization. This establishes your ideal scope. Bear in mind that a narrow scope may not yield enough data, so you may need to broaden the scope to obtain a large enough pool of relevant data.

All survey data should be weighted depending on the credibility and reliability of the data, and assigned premiums or discounts based on the strength of match to your organization’s job. You should also age the survey data to the current date taking into consideration the organization’s market timing and methodology (i.e., lead, lag, or lead/lag).

Once benchmark jobs have been valued and non-benchmark jobs have been slotted into the job hierarchy based on comparable worth, you will need to analyze the variance between the market and what you are currently paying for jobs in your organization. Decisions will need to be made regarding how to best reconcile pay differences to ensure internal equity and external competitiveness. These decisions will also be influenced by your organization’s compensation philosophy.

A Practical Guide to Surveys

Evaluate survey quality by considering how old the survey is as well as who conducted the survey. Are they a reliable source and is the data current enough to be relevant? Ask yourself if there are a reasonable number of participants who represent your organization’s labor market. Does the survey include data on jobs that are comparable to jobs in your organization? Also look to see if there is a consistent participant base from year to year.

Any survey that you use must comply with Safe Harbor Guidelines issued by the U.S. Department of Justice and the U.S. Federal Trade Commission. These guidelines stipulate that:

- The survey must be conducted by a third party
- Data reported must be at least three months old
- Each disseminated statistic must have five companies reporting data
- No individual company’s information can represent more than 25% of each disseminated statistic

When selecting the surveys you will be using, avoid using surveys with wild fluctuation in participation. If a published survey displays a page of data for each participant or individual lines of data for each participant it is likely that safe harbor guidelines were not taken into consideration. In general, telephone or e-mail surveys conducted among compensation or HR “friends and colleagues” are not good choices for data collection. They can open participants up to possible anti-trust violations.

There are several data elements included in published compensation surveys. You should understand what they mean so you can be certain that you are comparing similar types of data.

- Base salary is the annual, fixed portion of pay.
- Bonus or short-term incentive – A bonus is a cash award, defined after the fact, based on some judgment of performance. A short-term incentive is a one time cash award based on achievement of goals as part of an incentive plan covering a period of one year or less.
- Total cash compensation is the sum of base pay plus bonus or short-term incentive.
- Salary range is the range of pay offered to a particular job with minimum and maximum amounts and a midpoint which represents the half way point of the range.
- Incentive eligibility information provides clarification of eligibility criteria necessary for participation in an incentive plan. Factors usually include base salary, organization level or salary grade.
- Long-term incentives represent awards of cash or stock based upon achievement of goals as part of an incentive plan covering a period of more than one year.

Finally, how much data is enough data? The answer to this can vary depending on your survey budget and survey availability in your particular industry. It is possible that one robust survey may provide you with the majority of the data you need. Generally speaking, the larger the population in a particular job and the higher paid an individual incumbent is, the more surveys you will need in order to capture a true picture of what is going on in the market for that particular job.

Takeaway

- **Market pricing allows you to answer the question, “Are we paying competitively?”** Understanding your recruiting market and having access to good survey data makes it easier to develop a pay program that is aligned with your organization’s compensation philosophy. This in turn makes it easier to negotiate pay rates with current employees and new hires.
- **Availability of surveys can vary by industry, function, and location.** In some cases you will be able to find many surveys, other times you will not. However, one robust survey is more valuable than multiple surveys of inferior quality.
- **The critical first step to market pricing is making sure you have up to date, accurate job definitions.** It is impossible to properly compare your organization’s jobs to the market without a thorough understanding of your jobs.

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