Why Is Pay Transparency Important?
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The vast majority of total rewards and compensation philosophies incorporate the guiding principle that compensation structures should be competitive and fair. The challenge today for organizations is to show employees in a meaningful way how their programs uphold these standards. Why? Essentially, organizations have to “get pay right” before employees can really be engaged in their jobs and feel that they are being treated fairly. Pay is the largest carrot that employees initially focus on, and also the largest line item on financial statements. The traditional secrecy in making pay decisions has far reaching consequences, such as new laws that empower employees with pay transparency (see DOL Pay Transparency for more information). This whitepaper will review the business drivers for pay transparency and various considerations in creating a transparent compensation program to accelerate employee engagement.

Pay is a “hygiene factor,” according to Frederick Herzberg, which must be reasonable before an employee can be motivated to accomplish higher level business outcomes. Most individuals will make peer and external pay comparisons relative to their personal individual contributions, capabilities, and needs. If an employee believes that he or she is paid less for doing the same work as another person, this often leads to resentment as a result of cognitive dissonance that the employee wants to resolve. (Cognitive dissonance is the state of mental discomfort that occurs when a person’s attitudes, thoughts, or beliefs conflict.) An employee may resolve this type of conflict in one of three ways: by reducing the importance of the conflict, by adding a new behavior, or by removing or changing behaviors. For example, an employee may reduce his or her effort on the job in a discretionary manner to make the job seem fair. In addition to less effort, the employee may even steal, misuse company resources, or express dissatisfaction on social media sites like Glassdoor.

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Organizations that are “talent magnets” develop their HR programs in step with the changing demands of their workforce. By sustaining relationships with employees, long-term costs are lower, and employer brand value has a greater ROI. Retaining high performing employees requires a holistic perspective of the total rewards program, including financial and non-financial components. Evaluation of total rewards programs should be an iterative process as there is no silver bullet. Consider these two lagging indicators that pay may not be properly aligned:

- **Turnover**: If turnover is increasing, get exit interview information and identify what the new employer is offering to prompt resignation. Often, you will learn it is more than just compensation. When employees perceive that the broader attributes of the job are not aligned with the pay, turnover will increase.

- **Time to Fill**: If the quality and quantity of resume submissions decrease for open positions, try reposting the jobs without pay references or perhaps include a wider pay range with low and high values. Attracting candidates to the company requires a comprehensive employer value proposition that includes competitive compensation.

Attracting employees purely through above-market compensation programs may lead to an employee-employer relationship with little emotional connections to the job and the company. Companies without a diligent process of environmental scanning (e.g., external market conditions and internal employee feedback) may be forced to raise salaries to prevent turnover in a reactionary manner. This is usually a short-term solution as there is generally some other driver triggering the employee to look outside of the company (e.g., the number one reason for turnover is dissatisfaction with a supervisor). The hard costs of total rewards programs include the compensation and benefits offered, retirement plan matching, profit sharing, paid time off, and vesting over time. The softer costs relate to internal equity, career development opportunity, recognition, job autonomy, effective leadership, collaborative peers, and overall culture.

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Like any other business function that requires on-going assessment and alignment, high performing organizations with engaged workforces have transparent compensation communications that reflect the realities of balancing compensation. These employers are proactive and guide the employees through information and communications on a decision framework, explaining the complexities of compensation decisions in a user-friendly, intuitive manner. The explanations focus on how the programs align the employee needs based on their demographic preferences and the business imperative to have standardization of scale that enables effective talent management.
It is important to participate with your employees in a discussion about how well they understand the pay programs and explain that companies set a baseline approach and then tailor the final outcome to the facts and circumstances of the individual employee, the job impact on the business, and external market conditions. No two employees have the exact same level knowledge, skills, abilities, experience, and individual performance. Couple these factors with employee preferences based on their demographics, labor market conditions, and business performance, and it is no wonder that pay levels for similar positions are not necessarily the same at any given point in time.

In these discussions with employees, HR should explain that the market is all about matching supply and demand and tailoring compensation to attract and retain the best people. Employers pay employees different compensation partly because of supply and demand. It is a conversation between labor market participants, the job seekers (sellers) and employers (buyers), about a price they both are willing to accept. The starting point is the benchmark price that the internal recruiter has for attracting the right talent and the current compensation of the applicant. Employers are getting more flexible with budgeting and benchmarking jobs by allowing a broad range of compensation depending on the right talent. These price points are baselines. Worth noting is the concept of pay rigidity that is unique to labor markets. Although the markets go up and down, in any kind of individual exchange, we tend to expect the terms of our own employment to stay the same. In reality, they may remain flat, but rarely are they reduced. Employers can opportunistically leverage the lower labor market conditions by hiring more employees at lower rates.
Do your employee stakeholders receive or have access to transparent communications that explain the overall process of designing competitive compensation structures? Depending on your organization, the process of creating compensation programs generally entails the following:

- **Set and Align Compensation Strategy**: Define the competitive positioning of your pay programs, which could be above the market, below the market, or at the market.

- **Conduct Job Analysis**: Evaluate jobs to update job descriptions that serve as input to the next step.

- **Create Internal Hierarchy of Jobs**: Evaluate jobs to determine the relative value of a job in comparison to other jobs within the organization based on compensable factors defined for the needs of the organization (see ERI’s Distance Learning Center course #33 Conducting Job Analysis for more information).

- **Analyze External Marketplace**: Market price your benchmark jobs to the surveys available in the marketplace.

- **Create the Salary Structure**: Define the number of grades, midpoints and progression, and grade width/spread.

- **Develop Compa Ratio Report**: Evaluate the new salary structure to the internal workforce.

- **Obtain Approvals**: Finalize the plan and obtain top management approval.

- **Communicate the Program**: Inform, educate, and provide tools to managers and employees to use the new compensation program.

- **Administer, Evaluate, and Keep Aligned**: Maintain a dynamic compensation program that evolves and responds to market and organization needs and conditions.
Let’s expand upon transparent communications to train, inform, and educate (TIE) your employee stakeholders about market pricing. Most companies will use salary surveys to set pay levels: national or global surveys for executive jobs, regional salary surveys for benchmarking middle managers and semi-skilled jobs, and local surveys to determine what to pay non-exempt or hourly workers. When benchmarking pay, consider evaluating new data sources to validate your pay levels as well as enhance the robust data model for your organizations.

Commissioning a salary survey for a particular industry, job class, and labor market and then sharing those results with employees is one way that companies provide information and transparency about the fairness or competitive pressures of effectively managing total rewards. This process serves as input to stakeholders about allocating financial rewards and human resources in alignment with actual business performance and market conditions.

How is the pay range set for a job posting to attract top talent in the organization? Consider this example of information that a recruiter may receive for requisition of a budgeted, approved position:

- Internal Job Title: Sr. HRIS Analyst
- Job Requirements: 5-8 years of experience
- Industry: Manufacturing
- Location: Charlotte, NC
- Benchmark range: $62,000 to $110,000

The compensation team provides this information based on comprehensive benchmarking using two to three sources of data. A range spread of $48,000 reflects a wide variation of talent in the market for this job. What is the operating framework to develop this benchmark range?

Communicate the process as noted earlier, highlighting these key steps:

- Confirm that the internal job description is current.
- Job match the open position using various competitive benchmarking survey tools.

It is important to explain that, during job matching, the focus should be on job content and not the title. Most benchmark tools will not have the exact job title that organizations assign to a job in the survey. The internal job descriptions will be specific to the organization needs and used to provide realistic job expectations for external candidates and internal staff. Below are two examples of survey descriptions for the Sr. HRIS Analyst benchmark job.
Compensation leaders should inform and educate job incumbents, applicants, and business leaders about the job matching process to avoid confusion about any differences in titles and benchmark job descriptions. This is an opportunity to enhance transparency and inform stakeholders about how the organization jobs are matched to compensation surveys. Some surveys may have more detailed jobs descriptions, while others will be more abbreviated.

After explaining job matching and confirming agreement on the match, review the actual benchmark data used to price the job. A common mistake is providing benchmark data without informing the employee how the job was matched or data derived. Depending on how jobs are evaluated, ranked, and leveled in the organization, the data used will need to be aligned to the specific job characteristics, such as years of experience, job level, industry, and geography (see ERI’s Distance Learning Center course #33 Conducting Job Analysis). Continuing with this example, let’s take a look at two types of benchmark data results for the HRIS Analyst: by years of experience and by level.
Image #3. Source: ERI’s Salary Assessor, Salaries by Experience/Size

Image #4. Source: ERI’s Salary Assessor, Salaries by Level
Having external data that is segmented and reflects how the organization values the job can simplify the communication and enable transparency.

Many companies have adopted these strategies to reflect the realities of compensation practices:

• Communicate how competitive positioning is set. Some companies are articulating their practices with such statements as, “target base salary pay at +/- 10% the salary grade midpoint.”
• Explain how compensation is managed and planned by sharing compensation grids and explaining how pay grade midpoints are derived from market rates (yet are not the exact same values). For jobs that cannot be benchmarked, explain the slotting process that most organizations use to align unique jobs to an internal job worth hierarchy to determine the market rate.

Summary

Compensation must be fair and appropriate before organizations can focus on engagement. Some organizations are deficient in their efforts to train, inform, and educate employees about compensation programs, in which case employees may feel that decisions about compensation are arbitrary. It is important to educate your employees about how the organization balances standardization with employee contributions and needs. Unfortunately, satisfaction or dissatisfaction with compensation is often determined by how employees feel their current compensation stacks up against their peers. Employers can proactively curtail the negative impact of such comparisons by providing total rewards or total compensation information. Explaining the total rewards strategy and methodology will go a long way in gaining employee trust. Effectively communicating a transparent compensation program is the key. For more information about robust and flexible compensation benchmarking tools, contact ERI Economic Research Institute today.

Please email Linda Cox at linda.cox@erieri.com with questions or comments.

Why Is Pay Transparency Important?

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