



# How to Develop an Organization Pay Policy



Use this guide to develop an organization pay policy for decisions that set competitive and reasonable pay ranges for each job in the organization as they relate to salary structures. In the process of evaluating different pay strategies, consider which may be appropriate in the context of your total rewards strategy and how they can affect your business performance.

## TYPES

The organization's strategy toward the labor market requires a salary-level policy decision which involves determining how competitive the organization wishes to be. There are three common organization pay policies:

### LAG THE MARKET

In this strategy, update the salary survey data to the current date and then apply the new salary structure.

If a change in the labor market of 10% is assumed for the next year, then the only time the organization will be competitive with the market is at the beginning of the year.

By the end of the year, any decisions based upon the salary structure will be 10% behind the market.

### LEAD-LAG

Here the organization takes account of the 10% estimated change in the market but wishes to be on average with the market.

You can do this by starting the year at 5% above the market rate.

Provided the increase is steady over the year, this strategy will place the organization ahead of the market in the first half of the year and behind it in the second half.

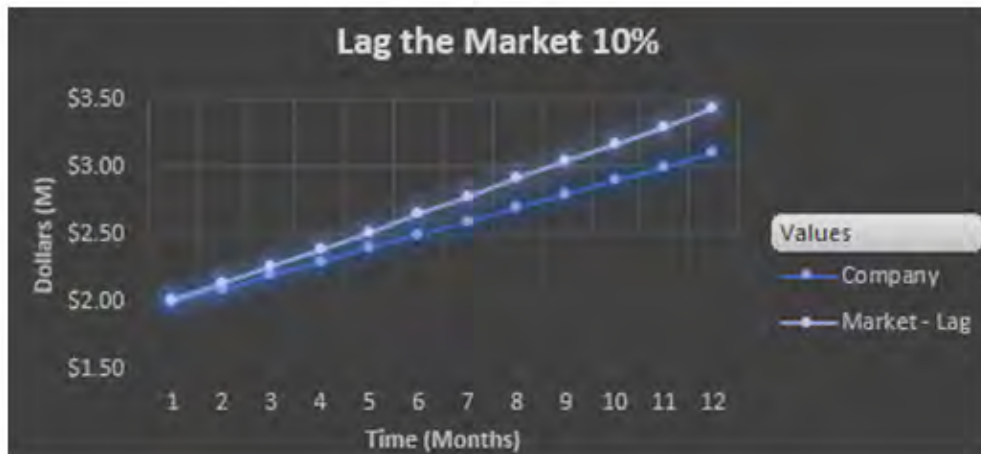
### LEAD THE MARKET

In this strategy, the organization wishes to pay above the market rates.

Start the year at 10% above the wage survey data.

By the end of the year, the organization will be paying the market rate.

These three approaches are illustrated below:



## INPUTS

In order to determine the appropriate organization pay policy, you must establish the pay policy line. This is developed based upon a holistic, current state assessment of internal factors (such as current pay rates and job relationships) and external factors (such as labor markets, industry trends and laws).



## INTERNAL JOB RELATIONSHIPS

Start by evaluating all jobs in the organization. Determine which jobs represent most of the total labor costs, since policy changes that directly affect these jobs significantly impact the bottom line and largely determine the competitive salary level of the firm. Salary relationships are built around these labor costs. See "[How to Conduct Job Evaluations.](#)"

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## CURRENT MARKET RATES

Once the jobs are evaluated, [market rates](#) are relied upon to determine the competitiveness of the current salary levels in the organization. This means the use of [salary surveys](#). Here is an example of market rates for commercial banking jobs in the [Tallahassee, Florida](#), labor market:

#	Job	10th Percentile	25th Percentile	Mean	75th Percentile	90th Percentile	Actual Salary	Market Index
1	Branch Manager Banking (Major Branch)	61,324	66,035	72,329	78,773	85,264	57,134	79
2	Mortgage Loan Officer	42,011	44,471	47,824	51,025	54,362	49,415	103
3	Credit Analyst	41,455	43,864	47,151	50,284	53,553	42,575	90
4	Branch Assistant Manager Banking (Major Branch)	44,118	46,942	50,733	54,503	58,378	41,388	82
5	Customer Service Representative Financial	29,353	31,945	35,415	38,473	41,616	25,906	73
6	Loan Processor	31,818	34,367	37,755	40,730	43,862	34,480	91
7	Loan Officer	40,849	43,402	46,856	50,219	53,694	46,777	100
8	Teller Bank	23,959	25,185	27,143	28,743	30,645	20,140	74

Reviewing the Loan Processor market rates, the 10th, 25th, survey mean, 75th and 90th percentiles are displayed. The actual salary is also entered to calculate the market index, in this case, 91%. That is, the Loan Processor internal salary rate of \$34,480 is 9% lower than the market rate.

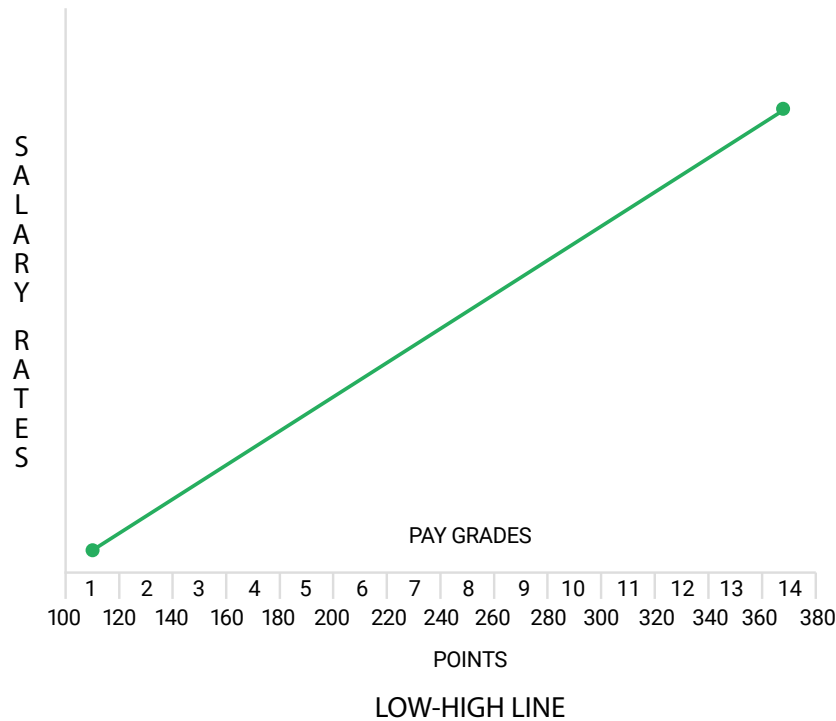
## PAY-POLICY LINE

Now you can define a pay-policy line by plotting points reflecting the jobs in your organizations based on two dimensions: compensation value and a job ranking (or job evaluation result). Then you “fit” a sloped line from the lowest value to the highest value using one of three methods:

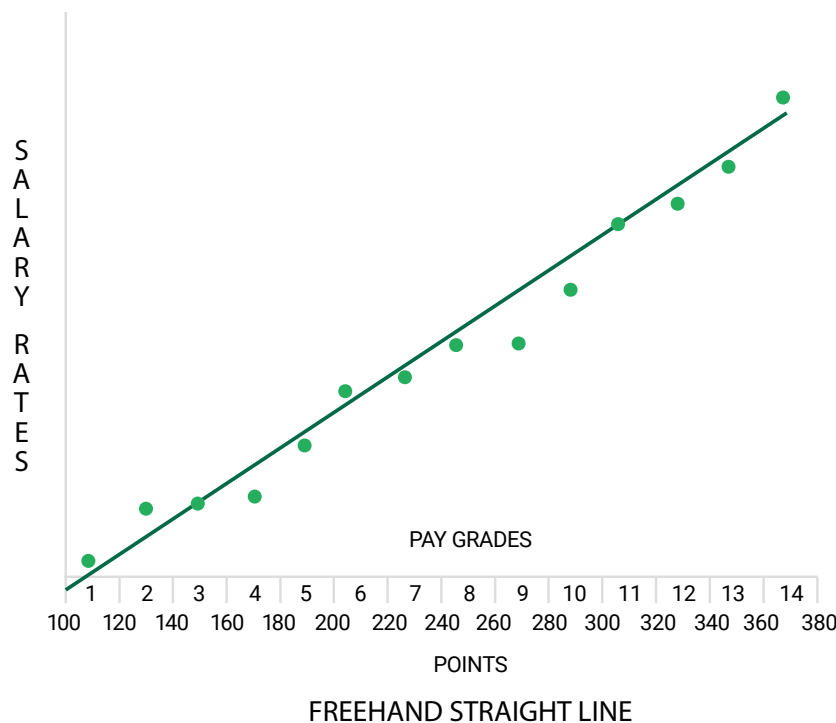
- Low-high
- Freehand
- Least-squares

The method you use will depend on the budget and resources (time and talent) allocated to compensation analytics processes in your organization.

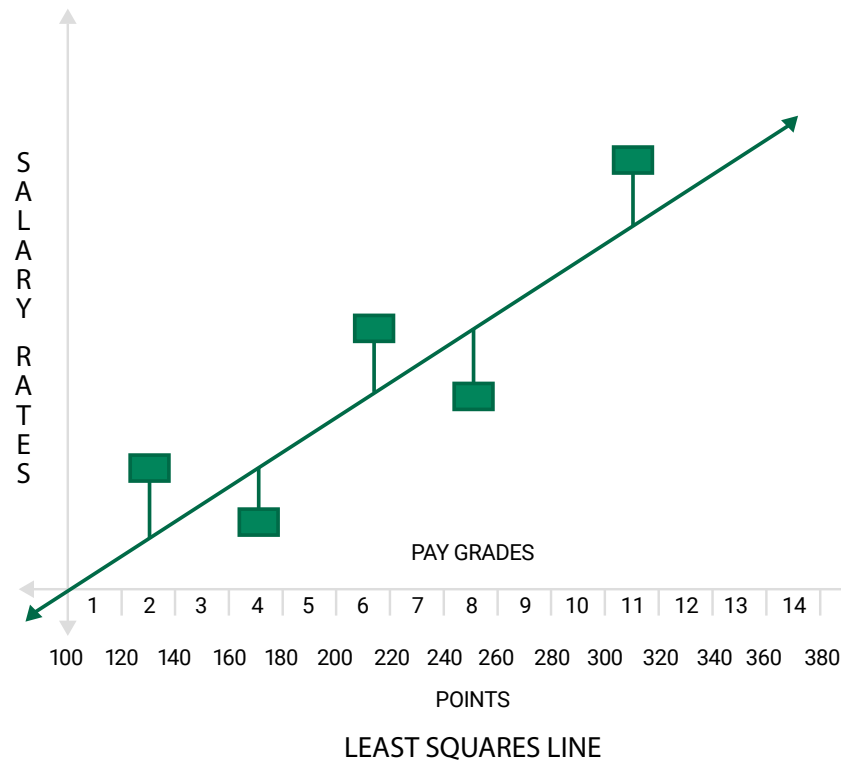
**Low-high line:** This is a straight line connecting the highest and the lowest of the plotted points (often called anchor points). The rates of all intervening jobs are made to fall on the line. Below is an example of a low-high line.



**Freehand line:** After you plot the points, you can often easily visualize the trend of the data. In this case, it is possible for you to draw a freehand line that best describes the plotted points. In drawing such a line, follow the principle that vertical deviations from the line are minimized if the line follows the obvious slope of the data. Although the line may be curved, a straight line has the advantages of being easy to plot and simple to explain. Below is an example of a freehand straight line.



**Least-squares line:** The least-squares line mathematically minimizes the overall vertical distance from the points to the line. Spreadsheets and other software can automatically add such trend lines, or the slope and intercept of the least-squares can be calculated from the points and the resulting line plotted.



## WHICH LINE SHOULD YOU USE?

For those organizations with limited resources, a low-high (anchor-point) line or a freehand line may achieve sufficient accuracy in developing a pay policy line that will serve as input to a [competitive pay strategy](#). Depending on the organization culture, however, HR practitioners may prefer a salary line calculated by least-squares.

## BUSINESS IMPACT

By evaluating the pay policy line relative to overall [total rewards](#) strategy, you can establish an organization pay policy which evaluates any salary differentials, and their relative business impact, which vary.

Consider the varying business impact in these scenarios:

- Low-salary organizations may experience greater differentials.
- Organizations employing largely semi-skilled workers and promoting from within have smaller differentials than organizations employing many highly skilled workers who must be hired from the outside.
- If there is high unemployment in the local labor market, there will be smaller differentials between market rates and evaluated rates, even in low-salary organizations.
- Geographically isolated organizations or those with large numbers of unique jobs experience less conflict.

Organizations will generally have some intended and/or unintended salary differentials with market rates. A common approach is for an organization to minimize differentials by paying at or above the market for strategic core competency jobs that drive competitive advantage, while paying the non-strategic jobs at or below market rates, requiring separate pay policy lines for each category of jobs.

## SUMMARY

This guide has provided a framework to develop a competitive pay strategy relative to overall total rewards and HR strategy. Organizations looking to compete effectively need to keep their HR and related programs aligned with business objectives. For more information on this and related topics, visit [www.eri.com](http://www.eri.com) or call 1-800-627-3697.

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