

**Question:** We want to develop a market-based pay structure. How do we go about this and what are the advantages and disadvantages?

**CompDoctor:** So, you actually want to pay your employees what the market is paying them? What a radical idea. While we were thinking that the best way to figure out how to pay people was to look at how much money was available after we funded the mayor's low income housing program and the new aquarium, you went out and thought employees should get paid for the value of the work that they do. We have been in this business for 25 years, and this is the first we have heard of this. The very idea! Have you been going to seminars or talking to European trade unions? I guess we will have to cut your training budget because such radical ideas have got to stop!

Actually, this is what private sector employers and many public sector employers have been doing for some time. Your question really gets to the heart and soul of compensation planning. And the question is...should we base our pay on internal equity or market parity?

And the answer is...yes. You need to do both, but the real dilemma is how much of each do we need to have one or the other. This is very simple. If you want to have a market-based pay system, you need to have market data on more than 50 percent of the jobs that you have in your organization. The data that you need has to cover about 75 percent or more of your employees. If you have data on fewer than 50 percent of your job titles, then you really have a pay system that is *influenced* by the market, but is more dependent on internal equity.

Both are very important, and the toughest part of your job is deciding which is the most important in your organization. If you are the largest employer in your labor market or you are located in East Nowhere, then a market-based system will not work. Why? Because in the former case, you are the market and any comparison will be to employers that probably do not have the same type of jobs as you do, nor may they have the capacity to pay as you do. Thus, you may have trouble finding enough meaningful salary data. In the latter case, you are the only employer. Where else would employees go to work?

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# Comp Doctor™

Again, in the latter case, you will have trouble finding enough data that can be useful to you to define the market.

But, let's say that you actually are not the largest employer, and you are not in East Nowhere. What is involved in setting up a market-based system? Here are the steps involved. What you might call the Betty Crocker recipe for a successful market-based salary structure.

**First:** Identify the benchmark jobs on which you need salary data. These benchmarks should be from all major occupational groups,

requirements, who (not by name of course but by organizational level or job title) they report to and who they supervise, if any (again, not by name but by the type and level of jobs supervised). You need to do this so that others know what kind of job you need data on.

**Third:** Identify the organizations from which you want salary data. These organizations should represent whom you — and your employees — define as the labor market. We discussed this in an earlier CompDoctor article and we have reprinted the main material in **Table 1** for your reference.

to be. A good starting point is about 15 percent, although we have seen as low as 5 percent or so. One way to figure this out is to decide how much of a pay difference, on average, you want supervisors to be from their subordinates. A good guideline is about 10 percent or more. Once you decide this, then just halve this number to get the percent difference from midpoint to midpoint.

Let's say that you have decided that the ranges should be 10 percent apart. With the lowest ranked salary (from step four) divide this median by 110 percent. For example, if the lowest median you have is \$24,000, then this divided by 110 percent (1.10) is \$21,818. This becomes the midpoint of your first range. The midpoint of range two is 1.10 times \$21,818, or \$24,000. Then the midpoint of your third range is \$24,000 times 1.10 or \$26,400, and so on, until you exceed by at least one range the maximum salary from the market. Once this is done, you have the start of your new market-based pay structure.

All you need to do now is decide how wide you want the ranges to be from minimum to maximum, and you will have your salary structure. For guidance on how to calculate minimum and maximums, go to our Web site at <http://www.foxlawson.com/compTools/index.cfm?selectedtab=3>.

**Sixth:** Go back to the jobs on which you have market data. Assign each job for which you have market data to the pay range whose midpoint is the closest to the market data. This becomes the pay range of the job.

**Seventh:** Hope for a miracle! This is the tough part. What do you do with the jobs that you don't have any market data on? Here are some options. You can use an internal equity tool called job evaluation to determine the best range or you can slot each job into

**Table 1. Labor Market Definition by Job Type and Level**

Market	Job Type		
	Executive/ Management	Professional/ Supervisory/ Technical	Clerical/Trades (Non-exempt)
Industry	Government	Private/ Public Sector	Private/ Public Sector
Organization Type	Similar Programs	Similar Size	Similar Size
Geography	National/ Regional/ Local	Local Regional	Local

represent all departments and functions, represent many employees and represent the jobs that are likely to be found in other organizations. For example, if you have a job called Engineer, that would be a good benchmark, but Pothole Engineer-Gravel Roads, may not be. Why? Because you may have the only Pothole Engineer-Gravel Roads in the country, so you won't find any data on it anyway. Don't waste ink on a job that no one else has.

**Second:** Describe these jobs in summary form. That means that you will need to describe their main features in about four or five sentences, identify their educational, experience and licensing

**Fourth:** Collect the data and make sure that it is good data. Make sure the matches are good, eliminate the outliers (those that are 15-20 percent or more away from the trend) and make sure the data is consistently reported in hourly, monthly or annual figures. Average the data for each job. It is best to use the median because it represents the most stable number and it is the halfway point in the data you have collected. In other words, half of the employees are paid more and half are paid less. Arrange the jobs from lowest paid median to highest paid median. Now the fun begins.

**Fifth:** You have to decide how far apart you want the salary ranges

CONTINUED ON PAGE 22

The CompDoctor™ is the team of Jim Fox and Bruce Lawson of Fox Lawson & Associates LLC, a compensation and human resources consulting firm that specializes in assisting governments in fixing their compensation and classification systems. They are seriously irreverent about their specialty. You may find them on the Web at [www.foxlawson.com](http://www.foxlawson.com). If you have a question you would like to have them answer, please write to them at [jfox@foxlawson.com](mailto:jfox@foxlawson.com) or [blawson@foxlawson.com](mailto:blawson@foxlawson.com). They will try to include it in the next issue of CompDoctor™. —*N*

the structure based on a ranking or whole job evaluation process. The job evaluation tool is more rigorous but it means that you will have to evaluate all of the jobs. The slotting or ranking process involves using the following guidelines. For jobs where you don't have any market data, slot them based on their:

1. Relationship to other jobs in their same occupational group. Look at jobs that are both "more difficult" and "less difficult."
2. Relationship to their supervisor or subordinates, if any. The typical guideline is that you want to have a minimum of two-range difference between supervisor and his or her subordinates. Supervision is defined as having performance evaluation authority over the subordinate job.
3. Relationship to other jobs that require the same level of complexity and difficulty, or similar education and experience requirements.

**Eighth:** Stand back and admire your work. You have just created a market-based pay structure. Beautiful isn't it?

Oh, by the way, you may have to bend a few guidelines or rules now and then because you will come to the conclusion that some jobs appear to be "overpaid" based on your sense of internal equity or past history. Some may actually look "underpaid" for the same reasons. Get over it! This is one of the difficulties of market-based pay systems. The pay actually represents the market! But this may conflict with your sense of internal order. Somehow, you will need to resolve this. You would have had the same difficulty if you focus mostly on internal equity, but that is a topic for another article.

Finally, you will need to update your market data on a periodic basis. This could be every year or every other year. Use the same process of collecting the data, and use the same jobs and same comparable organizations as much as possible. When you get the data back and have it all cleaned up, you will need to redo steps Six through Eight all over again. If you

do this, then you will always have a market-based system, even though some jobs may move up and some jobs may move down in the range structure. Remember, this is a market-based system. No one ever said it was fair (but neither is life). But again, that is a topic for another time.

Of course, it goes without saying that employees will still question their pay range because you used the wrong comparables or didn't survey their exact job, or you "cooked the books." Welcome to the wonderful world of compensation.

Until next time, keep your numbers in order.

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