HR's Guide to Setting a Compensation Strategy

Lattice

Introduction

Attracting and retaining employees is only getting harder. And while employee engagement, career development, and flexibility are certainly important factors, compensation may be the biggest. One survey found that 52% of employees viewed potential merit increases as their lead reason for staying with their companies, ahead of factors like culture and work relationships. And according to a recent LinkedIn study, businesses rated highly on compensation also have 56% lower attrition rates.

While money isn't everything, "comp" directly impacts engagement and performance and is closely intertwined with career development. But at most organizations, the decision-making process around pay can feel arbitrary, shrouded in mystery, and even subject to bias. When asked, only 24% and 27% of employees and HR leaders, respectively, believe their compensation processes are transparent or easy to understand.

If compensation strategy isn't already a core part of your People practice, it should be. In this ebook, we'll address the big questions you need to answer before that can happen. From identifying your comp "philosophy" to designing salary bands that integrate with job levels, we'll go through what you need to know for a more holistic, transparent, and equitable approach to employee pay.

Defining Your Compensation Philosophy

What's your company's unique take on compensation? What differentiates your approach from other companies competing for the same talent? If you're looking to build out your strategy, you need to start by identifying your philosophy.

A compensation philosophy is a document outlining your position and goals for employee compensation. In other words, think of it as both your mission statement and handbook for all things related to employee pay. The first half of that might look something like the below.

> **Sample Philosophy:** *"Reward people fairly for meaningful work and pay competitively to similar work at companies like ours."*

If that sounds straightforward enough, remember that there's more that goes into building out a compensation philosophy than an inspiring tagline. Using statements like the above as a roadmap, you'll need to answer more involved questions like:

- What counts as employee compensation?
- How should we structure our salary bands?
- Should performance be considered?
- How transparent should the process be?
- How can we drive greater pay equity?
- How does compensation integrate with our existing programs?

Having clear answers to these questions doesn't just ensure comp is handled smoothly, it's critical to addressing bias and pay inequities down the road. We'll go through each of these questions to help you arrive at a compensation philosophy that works best for your organization and people.

6 Questions Driving Your Compensation Philosophy

1. What counts as employee compensation?

Comp is about more than salary. Employee benefits, workplace culture, office location, access to remote work, scheduling flexibility, and other non-monetary offerings play an undeniable role in attracting hires and fostering loyalty among employees.

Employee total rewards combine the monetary and non-monetary benefits an employee earns at a company. In addition to gross pay, a total rewards package includes offerings like traditional benefits (e.g., health, vision, and dental insurance), voluntary benefits, retirement plans, vacation time, equity or stock options, pensions, and more.

> ⊘ **Tip:**
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> If you're unsure of which total rewards will resonate, just ask. Conduct a company-wide survey to determine whether your current program meets employees' needs. Doing so at least six months before the open enrollment period will give you ample time to evaluate new offerings.

Using Total Rewards Statements

Most HR teams view these offerings as compensation because they know the associated costs. For example, according to the Kaiser Family Foundation, employers spent an average of $7,188 to insure just *one* employee last year — and $20,576 to insure those with dependents. For companies that cover most or all of their employees' premiums, the costs are even higher.

The less that employees know about costs like these, the less inclined they'll be to view their compensation as competitive. That's where total rewards statements come in. These itemized one-pagers highlight all the ways you're compensating individual employees, in dollars, pounds, or euros. Companies that provide their employees with total rewards statements do so at least once a year. Statements typically list out offerings like:

- Salary
- Bonuses
- Commission
- Retirement benefits

- Stock options
- Paid time off
- Profit-sharing
- Employer-paid premiums for health, vision, and dental insurance
- Stipends
- Disability and life insurance
- Employer-paid Social Security and Medicare taxes

The value of each of these is calculated on a total rewards statement, which is then shared with employees during performance or compensation reviews.

2. How should we structure our salary bands?

Salary or pay bands refer to the minimum and maximum amounts a company is willing to compensate someone within a job level. In other words, if job leveling helps you set up a career path hierarchy for individual contributors and managers, banding serves a similar purpose for compensation

Let's go through an example. Let's say a level 1 HR professional might be eligible to earn between $50,000 to $70,000 at your company. Meanwhile, a level 4 employee, like an Associate Director of HR, may have a salary band ranging from $100,000 to $130,000, as visualized below. Having these bands defined and communicated allows employees to understand their current earning potential and what a future promotion might bring. We've visualized this below:

Example Salary Bands

HR Level 1	$50K - $70K
HR Level 2	$60K - $90K
HR Level 3	$80K - $110K
HR Level 4	$100K - $130K
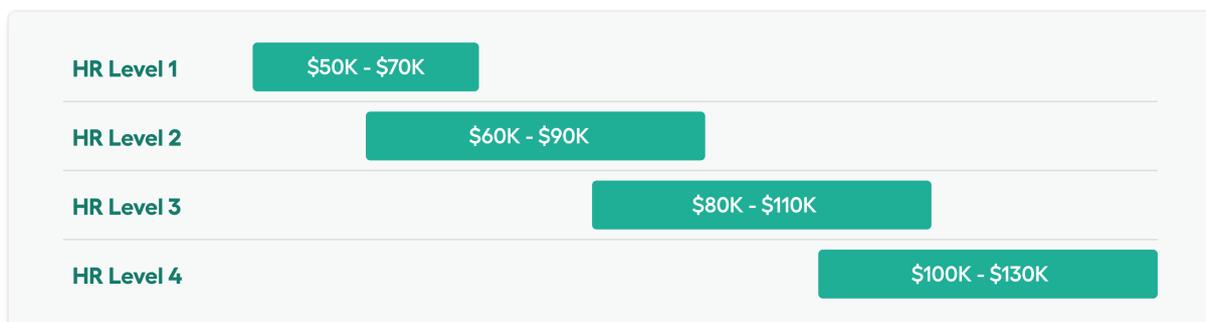
The Benefits of Using Salary Bands

Pay bands like these serve an essential role in your company's compensation strategy. From a strictly financial standpoint, they're critical for budgeting. Without bands, companies wouldn't be able to forecast overhead, plan for growth, or reward top talent without risking the company's financial health. Having concrete minimum and maximum ranges also helps account for any cost creep associated with bonuses or merit increases.

But pay bands also serve an additional purpose. In conjunction with levels and competencies, they're used to facilitate career development and pay conversations. For example, when managers have easy access to reports' current and adjacent pay bands, they can use that information as either a motivator or reality check — depending on their employees' salary expectations.

Just as importantly, minimum-maximum ranges can dispel some of the mystique surrounding employee pay and help People teams identify and prevent pay disparities. Similar to how thoughtfully designed performance reviews can promote equity, compensation strategies can serve as a counter against bias.

Structuring Salary Bands

A range of factors should influence your company's salary bands. Role expectations, education, experience, and geography play a role, each backed by market research. Other factors, even those impacting the broader economy (like inflation or the cost of living) impact a job's market rates. Because tracking these factors can quickly overwhelm smaller People teams, many opt to work with outside pay consultancies, like Radford and Mercer.

In addition to market rates and geography, take a close look at each role's skills and influence. While one might assume that leadership roles warrant higher salaries than those of individual contributors, that isn't always the case. Having in-demand skills that tangibly affect the business often changes the calculus. For example, at software companies, it's not uncommon for even junior or mid-level engineers to outearn managers in other departments.

Lastly, structure your salary bands so that they have *some* degree of flexibility. Overlapping pay bands (as shown in the earlier visual) gives managers the flexibility to strategically grant merit increases. For example, suppose a level-two employee warrants recognition but isn't quite ready for a promotion. In that case, their manager can still award an increase on par with the next level's starting salary because the pay bands overlap.

3. Should performance be considered?

In a compensation model with merit cycles, employees receive pay raises based on past performance. Performance-based compensation models like these are common, particularly for sales roles. But they're also divisive, with some HR leaders believing that they hinder more robust conversations around growth and performance.

Linking the two is a weighty decision, and ultimately your company will need to make the call. But performance-based compensation models are increasingly popular, and most studies on the subject have found that they both push employees to grow and ultimately drive business results.

Benefits of Linking Performance and Compensation

There's no denying that comp can be a powerful motivator. A study published by Harvard Business Review supports that, finding that performance-based bonuses and raises are linked to greater employee satisfaction, trust in leadership, and motivation.
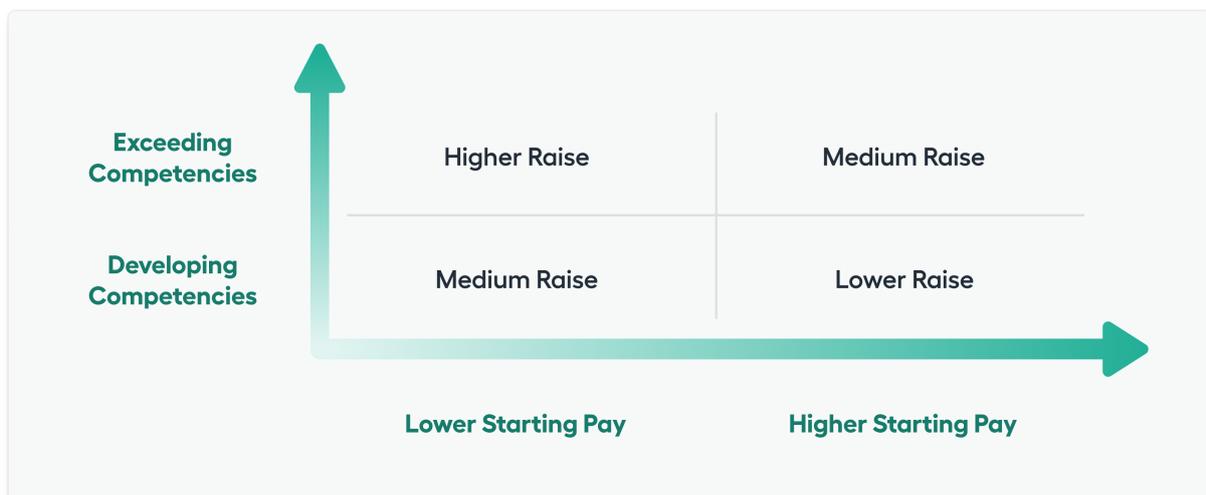
Linking compensation and performance may also help your employees see, in a tangible way, the benefit they bring to your company. Consider an employee who regularly meets or exceeds their goals. While that success might contribute to the growth for the business, under a pay-for-performance model it also benefits individuals. Without this connection, team and company objectives and key results (OKRs) may seem arbitrary or disconnected from employee needs.

Structuring Pay-for-Performance

While performance-based compensation models may be increasingly popular, a lack of transparency into how they work can frustrate employees. If you're going to adopt a pay-for-performance model, be clear about your rationale for doing so.

In practice, that means having a member of the HR team outline the company's approach to merit increases at a company-wide meeting. Given the personal nature of compensation, invite anonymous questions before the session and follow-up via email with clarifying points. Being clear about pay-for-performance also means equipping managers with talking points they need to field questions from their direct reports during one-on-ones and performance discussions.

Timing may be just as important. Critics of the pay-for-performance model say that comp can distract employees from having meaningful conversations about performance. To counter this, limit merit increases to specific quarters so they don't overlap with performance reviews. Separating the two will also give employees and managers time to process how they've performed against job competencies. Managers will need that context when deciding whether to approve a higher or lower increase, as illustrated below.

|	Lower Starting Pay	Higher Starting Pay
Exceeding Competencies	Higher Raise	Medium Raise
Developing Competencies	Medium Raise	Lower Raise

4. How transparent should the process be?

When it comes to compensation, employees' most common complaints aren't necessarily related to numbers. Understanding the calculus behind pay decisions is a prerequisite to trusting the process and believing it's equitable. "Lack of transparency" consistently ranks as employees' chief complaint related to compensation, with a select minority of workers actually understanding how pay gets determined. In one survey, HR leaders were asked to rate how well they believed employees understood their compensation philosophies:

- Virtually no employees understand it. (11%)

- Most do not understand it. (48%)

- About half of employees understand it. (27%)

- Most employees understand it. (19%)

- Virtually all employees understand it. (3%)

That lack of confidence wasn't exclusive to individual contributors. Over 70% of HR teams also didn't believe managers were equipped to have conversations about employee pay.

That's where **pay transparency** comes in. Pay transparency refers to the approach companies take in communicating their compensation philosophy. Transparency isn't necessarily about employees knowing how much their peers earn, though that approach might be favored by companies including Whole Foods and Buffer. Pay transparency falls on a spectrum, ranging from that very open model to a closed one, as illustrated below.

Comp Transparency Spectrum
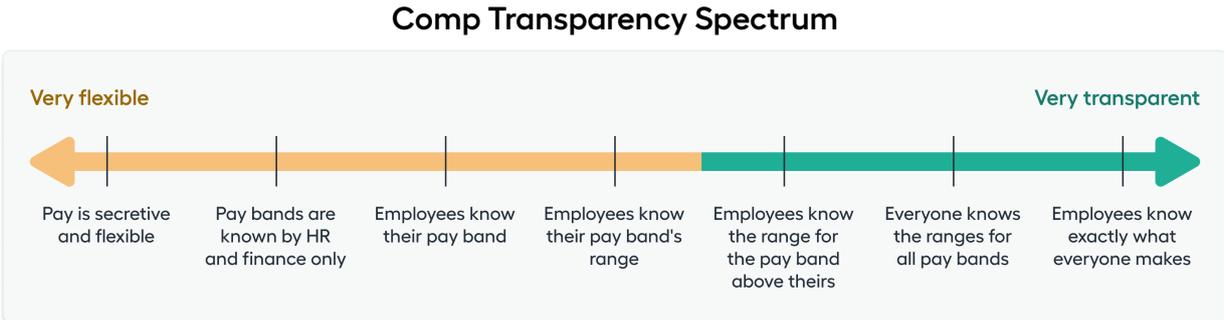
As you move further to the left of this spectrum, compensation processes tend to be looser. While that grants HR and finance teams greater flexibility, it also leaves your compensation strategy vulnerable to runaway disparities. On the flip side, hyper transparency may lead to *less* flexibility to make changes, as the entire process is exposed to employees at large. That lack of flexibility could make it difficult to adjust compensation to attract or reward key talent.

Identifying Your Level of Transparency

For good reason, the trend is toward more, not less, transparency. There are benefits to even a modest degree of visibility: When employees understand how salary bands work and what factors influence pay, they're more inclined to believe in the process. Buffer's internal research suggests that opting for greater transparency also made its company more productive, and others believe a similar approach could be crucial to combatting gender and racial pay inequities.

But full transparency might not be right for all organizations, especially those without fully-developed compensation strategies. For example, while full transparency may help expose discrepancies, it does so in front of the entire company. HR teams and managers will want to sensitively address these situations since disparities might be based on legitimate factors, like tenure, geography, or education. At companies without salary bands, pay-for-performance models, and other formalized structures, it's extremely common to run into legitimate and problematic pay discrepancies.

> ⊘ **Tip:**
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> Communication is an essential component of transparency. In advance of performance reviews or upcoming compensation cycles, HR teams should reiterate their compensation philosophy, including their approach to transparency, to employees across the entire company.

A more practical level of transparency might involve employees knowing their current pay band's range *and* the one directly ahead of theirs. Under this model, individuals understand their role's earning potential, giving them a realistic set of expectations during comp discussions. Additionally, knowing the pay bands they *could* slot into via a promotion or role change serves as extra motivation for the next performance or developmental review cycle. That's also valuable information for the report's manager to have, as they'll be responsible for coaching them along the way.

5. How can we drive greater pay equity?

It's no secret that gender and racial pay gaps exist. Today, women working in the U.S. are paid just 82 cents for every dollar earned by men. The disparities are even greater when comparing Black and Latina women's earnings to those of white men: Just 63 cents and 55 cents to the dollar, respectively. At the current rate of progress, it's estimated that it could take up to 400 years for women to achieve pay equity.

People teams and managers are uniquely positioned to close the gap, making equity a must-have component of your compensation philosophy. Fortunately, many of the processes already discussed can be used to champion equity and prevent runaway pay disparities from happening.

How Compensation Strategies Drive Equity

"Trust the process" carries additional meaning in People strategy. Take performance management, for example. Research shows that organizations that lack formal review processes are more likely to exhibit bias against women and people of color. Without the right systems in place, managers are prone to fall back on their "gut instinct" when making decisions about roles and (you guessed it) compensation. Simply having compensation, performance, and merit increase policies gives you a head start in the fight for pay equity.

Salary bands reinforce your commitment to pay equity in more obvious ways. Without minimum and maximum earnings assigned to each role, HR and finance teams don't have a stopgap to protect against out-of-control disparities. For example, two employees might have comparable roles (or even the same role), but one will earn more because of factors that aren't immediately clear. While the gap might be due to deliberate or unconscious bias, it could result from less nefarious circumstances — like an inexperienced manager recommending more generous merit increases for their team. In either scenario, pay bands provide clear guidelines to follow, giving managers only so much flexibility when determining pay.

Tip:

If you're looking to identify disparities, consider a third-party pay equity audit. If you use a compensation tool to house your HR data, you should be able to cross-reference compensation with employee demographics like age, gender, and ethnicity.
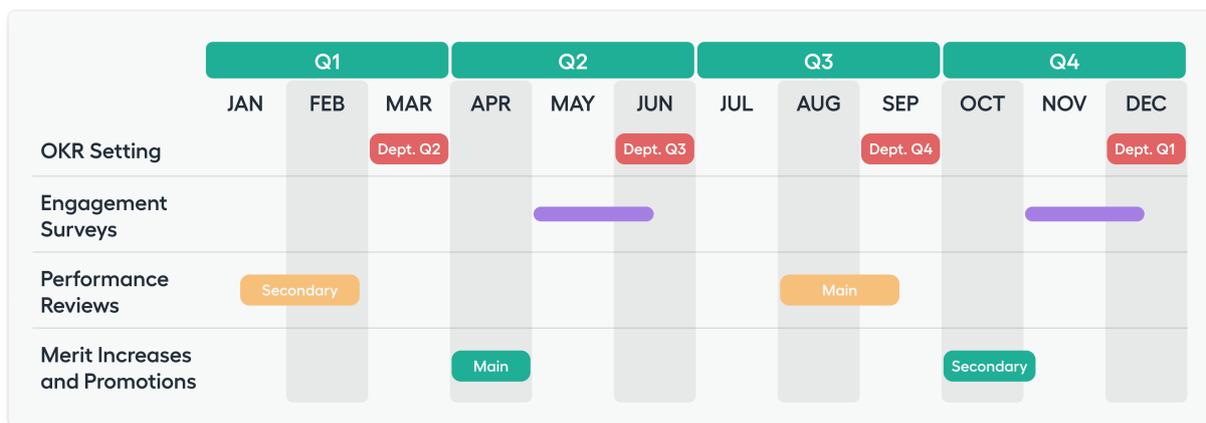
While pay bands help curb disparities within the same job level, they don't stand in the way of biases that can skew evaluations and future promotions. If your organization opts to link performance and compensation, rooting out inequities in reviews becomes critical.

One of the most impactful steps you can take is to incorporate performance calibrations into your review cycle. With these, managers come together for a discussion (moderated by HR) to discuss their reports' performance ratings. Because managers may have differing interpretations of what constitutes a high or poor rating, these sessions help smooth over these differences, challenge managers to explain their thought process, and get everyone to follow the same standard. You can learn more about how to run a performance calibration session here.

6. How does comp integrate with our existing programs?

Compensation is a big part of how you attract, retain, and engage talent, but it's just one of several pillars. Performance reviews, goals, engagement surveys, manager check-ins, and development conversations are critical levers that need to be part of your company's repertoire of people programs.

Getting all of these programs to work in harmony means taking a thoughtful approach to timing and execution. For example, companies often opt to schedule performance reviews and compensation decisions in alternating quarters, so conversations intended for self-reflection and growth don't get sidetracked. This staggered approach also gives employees and managers time to set growth plans and potentially deliver on them in time for a promotion or merit increase. See below for a sample people programs timeline.

	Q1			Q2			Q3			Q4		
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
OKR Setting			Dept. Q2			Dept. Q3			Dept. Q4			Dept. Q1
Engagement Surveys					▬▬▬						▬▬▬	
Performance Reviews	Secondary							Main				
Merit Increases and Promotions				Main						Secondary		

Similarly, you need tangible criteria to base employee ratings and merit increases decisions on. In other words, what supporting evidence will employees use to make their case for a raise? That's where OKRs and other goal-setting frameworks come in. We've visualized these above in red. Goal-setting data from the 2,000 companies that use Lattice shows that over half of all OKRs are set on a quarterly basis, perhaps because they give teams the right mix of flexibility and accountability ahead of reviews and merit cycles.

Lastly, running engagement and pulse surveys year-round provides you with insight into your total rewards strategy and whether you're meeting employee expectations. Remember: While your approach to compensation is structured, it isn't set in stone. Employee feedback can and *should* influence how you approach compensation over time.

Conclusion

Compensation isn't just about dollars, pounds, or euros — it's a critical part of people management. Employees want to be rewarded for the hard work they're doing, and they want to know their colleagues are, too.

But without the right structure or tools in place, it's easy to lose faith in the process. Teams without compensation philosophies will struggle to articulate answers to key employee questions. At best, the relationship between performance and salaries may seem opaque or the result of closed-door calculus. At worse, unclear comp philosophies can breed distrust, suspicions of bias, disengagement, and ultimately turnover.

Lattice believes it takes a holistic investment in engagement, development, performance management to build an award-winning "best place to work" where employees thrive. Compensation is just as critical to the employee experience, which is why we're making it a core part of our suite of people management tools moving forward. To see our solution in action, schedule a demo today.

About Lattice

Lattice is a people management HR software company that aims to help companies drive and retain engaged, high-performing teams.

Lattice's product offerings include a continuous performance management suite as well as engagement surveys and analytics. With Lattice, it's easy to launch 360 reviews, share ongoing feedback and public praise, facilitate 1:1s, set up goal tracking, and run employee engagement surveys.

By combining performance management and employee engagement in one solution, HR teams get powerful analytics that leads to actionable insights. Lattice is the only company that offers both of these tools in one solution.

Lattice works with companies who aspire to put people first and see people as part of how they'll be successful. Whether redefining the beauty industry or building self-driving cars, all of our customers have one thing in common: they value their employees and want to invest in the development and success of their people.

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