



# COMPENSATION DICTIONARY



# INTRO

This is your crash course in the compensation language. Find all the terms you need to master any compensation conversation. You'll be 'comp'letely fluent in no time.

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# SECTION 1: COMP 101



# PAY PHILOSOPHY

## Definition

High-level documentation on what you are trying to achieve with your compensation plan.

## Why it matters

Your pay philosophy statement is typically something all employees can access (either in the employee handbook or via an intranet) and answers the question of why you have a plan in the first place. Because everyone can read it, the explanation is usually pretty high-level and includes statements like “to attract, retain, and motivate employees” or “intended to be fair and simple.” The philosophy statement should also address what you plan to reward with compensation (performance, tenure, acquisition of skills, etc.).

# PAY STRATEGY

## Definition

Identifying the market you compete in for your talent and how competitively you wish to pay in that market.

## Why it matters

Your pay strategy is a little more micro than the pay philosophy. It defines how you intend to enact your philosophy—the “plan of attack” to ensure you achieve the goals outlined in your philosophy. Often included are details around how you define your talent market (who you compete with when hiring employees) and how competitive you plan to pay to the market (your target percentile). As such, the strategy is often seen only by the executive team, though companies who choose a higher level of transparency may decide to make this information public.

# PAY POLICIES

## Definition

Statements on how you intend to administer the [compensation plan](#). Organizations who prefer the less formal terminology may refer to these as guidelines.

## Why it matters

Your policies tell executives and managers how certain compensation-related transactions should take place. How and when will increases be determined? How do you plan to address employees who are paid outside of their range (red and green circled)? How are promotions, demotions, or transfers handled? Written guidelines or policies ensure the compensation plan is carried out as intended and, more importantly, that compensation is administered fairly.

# PAY TRANSPARENCY

## Definition

The level of information that is shared with employees regarding the organization's compensation plan.

## Why it matters

More and more companies across all industry sectors are shifting toward an increased level of [pay transparency](#) as it can result in higher job satisfaction and higher intent to stay from employees. If you're responsible for making recommendations to your leaders on what information to share with employees, it's important to note that transparency is not an on/off switch. There are varying levels at which an organization can be open about their compensation plan—this could include sharing information on your pay strategy, your market studies, pieces or all of your pay structure—without going so far as to publish all employees' salaries.

The key with pay transparency is consistency. Whatever you decide to allow managers to share with their employees, make sure they are all providing the same amount of detail to their staff. If one manager shares more with their team, than employees may start to question the fairness of the plan (in addition to how uninformed their manager may be if he/she is not sharing the same information).



# BASE PAY vs VARIABLE PAY

## Definition

Base pay is the fixed compensation an employee receives at regular intervals. Variable pay is compensation at risk, fluctuates based on employee performance/ results achieved, and is typically a one-time payment that must be re-earned each performance period.

## Why it matters

The fixed base pay (salary or hourly) is the guaranteed compensation your employees receive for their work performed. [Variable pay](#) is just that—it varies. Not just the amount, but the payout period, who is eligible for what, the metrics the employee is measured against, and so forth. Compensation plans can include both a base pay structure and a variable pay structure and there is a trend toward offering more “at risk” pay to employees to incite better performance and employee ownership of their compensation. Typical variable pay includes incentives, bonuses, commission, and profit-sharing.



## Definition

Total Cash Compensation (TCC)

## Why it matters

This is the combination of an employee's base (fixed) pay and any variable pay they might receive including incentive payouts, commissions, bonuses, or cash profit sharing. As the name implies, TCC only applies to [monetary compensation](#) and should not include non-monetary items like employer contributions to benefits (including 401k matching), a car allowance, or cell-phone plan. Think of it this way: if the employee sees it in their paycheck, then it's cash compensation. If your organization has a high mix of base and variable pay for employees, it's a good idea to evaluate your TCC to market TCC in addition to the typical base pay evaluation.

# NON - EXEMPT vs EXEMPT

## Definition

Non-Exempt employees are those who are subject to the minimum wage and overtime pay provisions of the [Fair Labor Standards Act](#) (FLSA). Exempt employees are those who are not subject to FLSA minimum wage and overtime provisions.

## Why it matters

As an HR Professional, you probably already know that getting FLSA classifications right is critical if you want to avoid potential legal issues. Remember that under the FLSA there is no limit to the number of hours that an employee may work, either daily or weekly. It simply requires that overtime pay must be paid at a rate of no less than 1½ times the non-exempt employee's regular rate of pay for hours worked over the maximum in a workweek. Jobs classified as exempt do not have the same regulations in place and therefore must meet specific criteria to qualify for exemption status. These jobs are typically paid on a salaried basis.

Changes are currently being considered regarding what types of jobs can be classified as exempt or non-exempt under FLSA—set to go live in 2016. Don't assume that all your hourly jobs are non-exempt and your salaried jobs are exempt. If you are conducting an FLSA audit as part of developing your compensation plan, it's a good idea to connect with an employment lawyer to confirm your classifications are correct.

# SECTION 2: MARKET PRICING



# MARKET STUDY

## Definition

The process by which you compare the pay for your jobs against what other companies with similar jobs are paying.

## Why it matters

How do you know if your pay is competitive? One of the most tried and true methods is by conducting a market study. Gather external data and evaluate that information against how you are paying internally. The study can be done through your own research or in partnership with a consultant or salary survey provider. [Survey providers vary](#) so it's important to research your selected data source and their data collection methodology before using that information to guide your decisions on pay.

# BENCHMARK JOB

## Definition

A job commonly found in the market.

## Why it matters

Often misunderstood, but a very critical part of evaluating compensation, is the [benchmark job](#). A benchmark job is what you use to compare pay at your organization with pay in the market. ‘Commonly found’ is defined as a job that exists across a variety of companies and in a variety of industries. The reason the benchmark job is so important is that it allows you to evaluate your pay against other companies with a shared point of comparison. For example, most companies—regardless of their line of business—employ an Accounts Payable person. At least 50% of the jobs in a business should be benchmarked in order to get an accurate idea of how the company pays compared to the market. Most traditional salary survey providers have a limited number of jobs titles to choose from when benchmarking. Other data providers, like [PayScale](#), offer more than 15,000 job titles so the percentage of jobs benchmarked will likely exceed 50%, offering a more precise picture of your pay to market.

# COMPENSABLE FACTORS

## Definition

The details about a job that influence how the job is paid.

## Why it matters

When comparing your pay to the market, it's important to outline the factors that influence how jobs are paid to make sure those factors are consistent between your job and the benchmark. The most common compensable factors include years of experience and education, though other equally important factors include skills, certification requirements, management responsibilities, travel percentage, and so forth. Don't forget the details about the market, like industry and organization size, as they will also influence how a job is paid. Before completing a market study, it is important to identify the compensable factors for your benchmark jobs and your market.

# LABOR MARKET

## Definition

The labor market is the industry, the size of the organization, and the location where you compete to hire employees. Also called the Talent Market.

## Why it matters

Companies often talk about paying fairly to “market” but neglect defining what “market” actually means. Avoid the common mistake of defining your market based on your business competitors—while sometimes true, more often than not, organizations compete for employees with organizations outside of their industry, size, and even location.



# PERCENTILE

## Definition

A point on a rank-ordered scale, found by arranging a group of data points in order of magnitude from lowest to highest. The first percentile approximates the very lowest number found, while the 100th percentile is the very highest.

## Why it matters

Your target percentile is the exact point in the market where you intend to pay proficient employees. When evaluating your pay ranges to market data, the target percentile is what you will compare your midpoints against to determine if your pay ranges are competitive.

A good way to think about percentiles is to harken back to your high school days and your SAT score. A score at the 90th percentile means 10% of the country scored higher than you and 90% scored lower. The 50th percentile—a favorite among comp professionals—is the exact middle (or median) of the market. Half of companies pay more and half pay less. When someone says they want to “meet the market” they are usually referring to the 50th percentile. It is important to note that there cannot be a percentile greater than 100. So if your executives say they want to pay at 105% of market, that doesn’t mean the 105th percentile. Instead, what they likely mean is they want to pay 5% above meeting the market (assuming that 100% is meeting the market).

# MARKET - RATIO

## Definition

The comparison of internal pay to the market pay rate for a job. Calculated as  $\text{Pay Rate} \div \text{Market Rate at Your Target Percentile}$ .

## Why it matters

Market ratio is often used to evaluate how closely an organization is paying to where it is targeting to pay in the market. Companies usually strive to have a majority of their employees paid within close proximity to their target percentile, though there are cases where it makes sense that employee pay may be higher or lower than your target (in the case of newer employees still in training or more tenured employees performing above proficiency). A ratio of 1.00 means that the employee is paid at the target percentile. Ratios above 1.00 indicate employee pay exceeds the market value for their job and ratios below indicate employee pay is below the market value for their job. For example, a ratio of 1.07 means employee pay is 7% above the target and a ratio of .93 means employee pay is 7% below the target.

# SECTION 3: PAY STRUCTURES



# PAY RANGES, PAY GRADES, & PAY BANDS

## Definition

A pay range is the upper and lower limits of compensation, typically including a minimum, midpoint, and maximum. A pay grade is an identifier of a range and multiple jobs can be grouped into the same grade. A pay band is the broadest grouping and often includes several grades and ranges with a spread of 100% or more between the minimum value in the lowest range to the maximum value in the highest range.

## Why it matters

A pay range is really the starting point for any pay structure—it identifies what spread of pay can apply to a given job. Some companies will build out a range for every job, referencing the market value for each job and building a range around that market value. This is a good approach if your organization has less than 20 positions. Any more than that and administering and maintaining your ranges can be a bit of a challenge. Not to mention that if you have more than 20 jobs, you will probably start seeing some patterns in your ranges (several jobs having roughly the same range of pay). At that point, a good option to ease up on administration demands as well as allow for more flexibility is the creation of grades and ranges. Jobs with similar internal and market value are assigned the same range of pay and in the same grade. Using this method means jobs with no market value can be placed in the structure, grouped with jobs that have a similar internal value. Some organizations prefer to use broad pay bands, where multiple grades and ranges are grouped together in a pay band. While this practice was common in the 80's when there was budget to allow for large wage growth in a single band, it is a less common practice today.

# RANGE MIDPOINT

## Definition

The exact middle of the range, equidistant to the range minimum and range maximum, and aligned to the market value for the job.

## Why it matters

The midpoint of your range is probably one of the more important details in your compensation plan. The range minimum and range maximum are built around the midpoint. If you are building pay ranges for your jobs, then your [range midpoint](#) should be the same as the market value for your job at your target percentile. In a grade and range structure, all jobs of a similar market value are assigned to a grade with a range midpoint that is closest to the average market value. The midpoint is also considered the proficiency point for the job. Employees should be hired in at the range minimum and as they gain proficiency, their pay should approach the midpoint. The midpoint should be evaluated annually and is the point in your ranges that you would adjust to keep your structure competitive with your pay strategy.

# RANGE WIDTH OR SPREAD

## Definition

The distance between the minimum and the maximum salary values in a range.

## Why it matters

The range width is built around the range midpoint and is used to ensure your structure is mathematically sound (and therefore legally defensible). The width of a pay range reflects the extent of salary opportunity for the jobs in the range. Wider ranges are usually for higher level jobs where there is a greater need to differentiate how incumbents in that range are paid. Narrower ranges are more common for jobs where there is not a lot of variance in how the market pays that job and there is less need to differentiate between how incumbents in a single job are paid. While there is no hard and fast rule on what range spreads should be, it is common to use 30-40% for hourly administrative or production positions, 40-60% for entry to mid-level professional or managerial positions, and 60-70% for executive positions.

# COMPA - RATIO

## Definition

How an employee pay rate compares to the midpoint of their range.  
Calculated as  $\text{Pay Rate} \div \text{Range Midpoint}$ .

## Why it matters

The *compa* (or comparative) ratio is often used to evaluate how closely an organization is following its compensation plan. While there are often several exceptions, companies usually strive to have a majority of their employees paid within close proximity to the midpoint. Reviewing your compa-ratios can help you assess if you are in fact doing so, and/or if some employees are too high or too low in their range. It is not possible to know your compa-ratio without first knowing your range midpoint. A ratio of 1.00 means the employee is paid at midpoint. Ratios above 1.00 mean the employee is paid above midpoint—so a ratio of 1.10 means the employee's pay is 10% above the range midpoint. Ratios below 1.00 mean the employee is paid below midpoint – a ratio of .80 means the employee's pay is 20% below the range midpoint.

# RANGE PENETRATION

## Definition

An individual's pay compared to the complete pay range, or how far into a pay range an employee's pay has progressed. Calculated as  $(\text{Pay Rate} - \text{Range Minimum}) \div (\text{Range Maximum} - \text{Range Minimum})$ . Also known as position-in-range.

## Why it matters

Range penetration is another way of evaluating how well the organization is adhering to its pay plan. Usually expressed as a percentage, a range penetration of 30% means that an employee is 30% of the way into his/or her range and has 70% more of that range to move through. This can be a useful measure to assess overall if your employees are mostly in the lower parts of their range and have a lot of room before they reach the maximum or if there are certain employees or groups of employees who are being paid toward the top of the range, which could become a problem. A range penetration of 0% means the employee is paid at range minimum, a range penetration of 100% means the employee is paid at range maximum, and a range penetration of 50% means the employee is half way through the range—at midpoint.



# GEOGRAPHIC DIFFERENTIALS

## Definition

The percent difference between pay for the same job in two or more locations.

## Why it matters

Due to the demand for and supply of labor, an employee may be paid more or less depending on where he or she physically works. Generally speaking, jobs in [major metropolitan areas](#) tend to pay more than jobs in rural areas, but that is not always the case. Consider that areas which require further employee travel may be compensating people more to get them to make the commute. If you operate in more than one location, it's a good idea to evaluate the geographic differential between your two (or more) locations and adjust your pay structure accordingly.

# SECTION 4: PAY

## CONCERNS & PAY RAISES



# INTERNAL vs EXTERNAL EQUITY

## Definition

Internal equity exists when employees at an organization perceive that they are being rewarded fairly according to the relative value of their jobs. External equity exists when an organization's pay rates are equal to the average rates in the organization's market or sector.

## Why it matters

How employees perceive their pay compared to their coworkers and others doing similar work at other companies can have a huge impact on retention, job satisfaction, and morale. Internal inequities can have legal ramifications for the organization so it's a good idea to evaluate internal pay practices within and between departments on a regular basis to identify any large, unexplainable disparities. If you have external inequities and find your pay is low compared to market, you likely have flight risks, higher turnover, and difficulty recruiting. If the external inequity is due to internal pay being higher than market, then you likely have a compensation budget problem. And while turnover may be low, the employees sticking around might be doing so for the wrong reasons.

# COMPRESSION

## Definition

Wage compression is a phenomenon that occurs when a new hire is paid the same as or more than employees with more seniority in the same job.

## Why it matters

[Compression is one of the more challenging issues in compensation.](#) A common culprit is the “hot job,” where candidates start asking for rates that exceed those of your current employees in that same job. Due to supply and demand of talent, the rate being sought by candidates is likely fair given the current market conditions. That said, paying new employees at the same rate (or higher) than incumbents can cause some real and ongoing compensation problems, including morale issues. The best strategy to avoid compression is to be proactive rather than reactive to market changes. Listen to candidates and recruiters as that can indicate a need to market price a job out of cycle. Review internal pay spreads—jobs with multiple incumbents who are all paid the same (or similarly) can indicate compression issues.

# RED-CIRCLED & GREEN-CIRCLED

## Definition

A red-circled employee is one whose pay has exceeded the maximum of the range for their job. A green-circled employee is one whose pay is below the minimum of the range for their job.

## Why it matters

Employees who are paid outside of range can indicate a misalignment between the organization's pay practices and pay structure. In general, employees should be paid somewhere between the minimum and the maximum of their range. Outliers are common when rolling out a compensation plan for the first time. Without a structure to guide your pay practices, it is likely you will have employees who are paid above the maximum or below the minimum of your new created ranges. Make a plan to address outliers at implementation of the plan as well as create a policy around handling outliers on an ongoing basis. [Red-circled employees](#) are common in companies where a standard 3% across-the-board increase is given every year, with little attention to a job's market value or the pay range (if established). Green-circled employees are common in companies where pay has been frozen for several years due to budget cuts and now the market has outpaced employee wage growth. It is important to identify outliers and develop a plan to bring them in range. Freezing pay for red-circled employees and offering a performance-based bonus will help retain top performers without compounding your problem. Allocating budget to bring green-circled employees up to the minimum of the range is recommended, though if the cost is too high to increase everyone at once, consider spreading the increases over several budget cycles.

# COLA

## Definition

Cost of Living Adjustments. An across-the-board salary increase or supplemental payment intended to bring pay in line with inflation in a geographical area.

## Why it matters

Many companies will go through the process of adjusting employee pay based on the Consumer Price Index and the cost of living in their given area. Want to really impress the CEO with your compensation savvy? Educate executives on why [COLA is a thing of the past](#) and what you should really be focusing on is Cost of Labor. Cost of Living is what consumers pay for a basket of goods (milk, gas, clothing, etc.) whereas Cost of Labor is what an organization pays employees to do a job/produce work for said organization. What's the connection? The only connection is that both track supply and demand. Cost of Living tracks goods and Cost of Labor tracks people. The key here is that trying to pay Cost of Living could put the organization at risk of over or underpaying employees relative to competitors in the area. Cost of Labor, on the other hand, ensures your rates remain competitive with the going rate for that type of work. Before budgeting for COLA increases, ask yourself, are you intending to reimburse employees for their living expenses (Cost of Living) or are you intending to pay employees competitive to the local market (Cost of Labor)?

# MERIT INCREASES vs MARKET ADJUSTMENTS

## Definition

A merit increase is a performance-based raise to an employee's pay. A market adjustment is an increase to the employee's pay based on market movement.

## Why it matters

It's all about how you communicate the increase(s) to the employee. A market study may reveal that some employees are paid well below the market value for their job and are potential flight risks. When that is the case, some companies will opt to adjust the base pay up for those employees as way to achieve better market alignment. This increase is and should be treated differently than a merit increase. Why? Because if an employee receives both a market adjustment and a merit increase, without distinguishing between the two, the employee may expect the same amount next year. For example, if the market adjustment brings the employee up 5% and you are allocating a 3% increase on top of that, you don't want the employee to conflate the two and expect an 8% increase next year.

# MERIT MATRIX

## Definition

A pay-for-performance tool used to determine pay increases for individuals based on their performance and position in range (or range penetration).

## Why it matters

The merit matrix is a straight forward way of allocating your budget across your employee population. Merit matrices support pay-for-performance by accelerating high performers' movement through their range and slowing or halting the movement of pay for poor performers. In a merit matrix, performance ratings are plotted along the vertical side of the matrix and the position-in-range options along the horizontal side. For more information on building a merit matrix, see our post on [5 Steps to Creating a Merit Matrix](#).



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