Aon Hewitt
Talent, Rewards & Performance

Implementing a Market Pricing Methodology

A Strategic Guide to Effective Compensation

About This Report

Market pricing is the most common methodology used by organizations to evaluate jobs. But as a compensation leader, you know market pricing can be much more than that. You design compensation plans and pay structures based on market pricing, make pay recommendations and even guide employee career choices based on market pricing. Your use of market pricing influences the single largest operating expense for any organization. You also drive the organization's ability to meet its long-term human capital strategy by ensuring your organization can attract and retain the talent needed

When done well, market pricing can be a distinct competitive advantage to your organization's human capital strategy.

If you're like most compensation professionals, you've racked up plenty of practical experience with market pricing compensation, but the degree to which there has been a thoughtful, well-documented approach to the choices being made varies.

The purpose of this report is to provide a strategic guide for when you are implementing a market pricing methodology or just looking to enhance your existing programs.

Strategic Context for Market Pricing

The most basic definition for market pricing is that it is simply a method for valuing jobs. We look to the external labor market and use salary surveys as a way to make sure we are paying our employees competitively. But there is a more strategic role that market pricing can have that goes far beyond that simple definition.

To lay the foundation for how market pricing can be more strategic, it is important to understand the context in which market pricing has evolved. Over the last 15–20 years, there have been several transformations related to human capital, but three in particular have helped set the stage for the surge in the significance of market pricing.

- **The war for talent**
- **The changing social contract, and**
- **Availability of data**

The War for Talent

The term 'war for talent' describes challenges organizations increasingly face because of shortages in the availability of workers having the needed skills. Shifting demographics and the aging workforce have changed the supply side of the labor market equation. At the same time, technology and our relentless push for productivity improvements have driven changes on the demand side of that equation.

Employers are now more creative and aggressive in attracting in new talent with needed skills. Assessing talent and managing the existing workforce has also taken on new meaning.

Engaging in this war for talent means organizations want more flexibility to make the business decisions about new hire salaries or top pay for existing talent. Business leaders argue that the economics of paying the salaries needed to attract and retain the top talent offsets the business risk of lost business opportunities caused by talent shortages.

The Changing Social Contract

The notion of 'employment for life' is long gone. No longer do workers start and end their careers at the same company. In some respects, our labor market now operates much like a free agency labor market like the one we see in professional sports.

Employees are much more likely to change companies and maximize their own career opportunities, and pay. No longer can an organization rely on company loyalty for its workers to stay even when wages are less than competitive. Workers will seek to maximize their career and earnings potential and jump ship if they perceive disparities in their pay.

Availability of Data

Not long ago, salary surveys were published annually in hard copy only. Access to the data was limited to just the company and even within the company, only a handful of compensation professionals would ever see the survey results.

Advancements in technology make it easier for companies to both participate in salary surveys and analyze published survey results. Survey sources are more plentiful. Companies now have many more choices on data sources.

But this availability of data can be a double-edged sword. Not only do organizations have easier access to survey data, but also employees themselves can now freely access a variety of data sources all from the convenience of a mobile phone. The accuracy and validity of free data sources is always subject to debate, but the point is that now employees have access to data like never before. Employers now face increasing pressure to be more transparent in their communications about pay. Getting in front of conversations about the pay data in a more transparent way creates a more trusting and engaged workforce.

We believe that these transformative changes are here to stay and will continue to evolve. Organizations will continue to have even greater market data needs and will continually refine the alignment of their market pricing methodology with their human capital strategies.

Market Pricing and Your Business Strategy

The range of decisions you'll need to make when defining your market pricing methodology all stem from your organization's strategic planning process. You should ensure there is a clear connection between your market pricing initiatives and your overall human capital strategy, as well as the strategic objectives for the business.

There's no single right answer for whether or how to implement market pricing. Instead, you'll need to carefully consider the range of options and decide what fits best for the strategic business scenario. To illustrate this point, here are three hypothetical organizations in different industries and facing different types of business and HR challenges.

Company / Industry	HR Challenges	Typical Market Pricing Implications
• Established manufacturing company in a stable industry. Modest growth	• Low turnover • Long tenured staff • Increasing globalization to offshore production	• Uses traditional grades / bands • Evaluates jobs using both internal evaluation and market pricing • Uses market data to ensure overall structure is competitive • Needs to establish global job leveling framework
• Young high growth services business in an expanding market.	• Moderate turnover • Jobs & career paths evolve rapidly • Acquisition of industry competitor	• Relies exclusively on market pricing for job leveling and pay recommendations
• Large employer in service industry (retail, hospitality, call center, restaurant, etc.)	• High turnover • Geographically dispersed • Labor intensive business • High percentage of low wage workers	• Market priced pay structures • Highly focused on start rates • Geographic differentiation

Market pricing in the established manufacturing firm above is most effective if you recognize that an organization with low turnover, modest growth and long tenured staff most likely just needs to validate that their overall pay structure is competitive. Applying a pure market priced approach and removing ranges/bands all together is not a good fit with the business needs in that scenario.

Understanding Labor Markets

Labor markets represent the sources for where you compete for talent. Since you are using a market priced approach to attract and retain talent, it makes sense to understand "Where do candidates come from?" and "Where do people go when they leave?" The most common way to define a relevant labor market is to answer those questions along three dimensions:

- **Industry**
- **Geography, and**
- **Size**

While using those high-level dimensions works fine for most jobs, defining the labor market for the most senior level executive positions involves naming specific peer groups of named competitor companies. Still, the rationale for picking the set of named peer companies uses those same three dimensions.

Labor markets will vary inside an organization based on groups of jobs, such as by job level or functional area. For example, the following illustration shows an example used at large manufacturing company located in a city in the southeast United States.

	Industry	Geography	Size
Executive	Manufacturing	Nationwide Global	Revenue $10B–$40B
Management	Manufacturing	Nationwide	Revenue $10B–$40B All Companies
Professional	All Industries Manufacturing	Southeast US Region Nationwide	All Companies
Nonexempt	All Industries	Metropolitan	All Companies

For more information on executive level peer groups, see our **PeerBuilder tool** inside CG Pro.

As shown in this illustration, the specific industry matters most for senior level jobs in the organization. This is particularly true for the line operations types of senior leaders such as Engineering, Operations and Supply Chain. Senior leaders of staff support functions (eg., Finance, HR, IT, etc.) may also be industry specific, but it's common to find the labor market for those executives to be linked to the other dimensions, such as size.

Geography may come into play at the senior executive level as we start to see more companies expanding globally. The talent market for senior level executives has been expanding beyond just a nationwide perspective.

Geography is much more important at the lower levels of the organization when thinking about the labor market for production workers and support staff. At these lower levels, the rationale for the labor market definition revolves around the distances we expect workers would likely travel to get back and forth to work.

Size of the organizations in the labor market is the third common dimension used to define labor markets. In the illustration provided, the labor market for the management and executive level jobs is between $10 billion and $40 billion in revenue. Developing a range of revenue size is a common way to think about the size of the relevant peer companies. When developing a range of size that is reasonable, many organizations will look at other firms that are at least half their own size and no more than twice their own size. In the example of the manufacturing company above, we can assume that they are approximately $20 billion in revenue based on the range used of $10B–$40B.

Keep in mind that the matrix that you put together is general grouping. There will be functions or even individual jobs where the relevant labor market needs to be different in order to be able to attract and retain the talent you need.

Survey Data Sources

Once you have mastery of the relevant labor markets, it's time to think about the best sources of survey data. The market for survey data is mature and there are many well-established survey vendors. When selecting survey data sources, you should consider multiple criteria factors.

Aon Hewitt provides a broad collection of compensation surveys to serve your relevant labor markets

Participants	How well does the participant profile from the survey vendor match up with your industry peers where you compete for talent?
Jobs	Does the survey have the breadth of benchmark jobs? Is there a good hierarchy of jobs?
Quality	What is the experience level and reputation of the survey vendor? Can you trust that your data will be safe? Do you know the data auditing process the vendor will follow to ensure high quality results?
Service	Will the survey vendor help you with questions you may have on job matching or interpreting the results? Will they provide insights and observations that help you use the results more effectively?
Compensation components	What components of pay are included in the survey? With the trend of incentive pay going deeper in the organization, it is critical to get a clear picture of the total compensation package when evaluating market data.
Geographies covered	Whether you need global data or micro markets within the U.S., you should ensure the survey has the geographical representation of your relevant labor market.
Reporting options	How much flexibility will you have to slice and dice the published survey results?
Cost	Think about the amount of your payroll budget that is influenced by the insights the survey provides; does the cost of the survey deliver good business value?

Survey Job Matching

The process of matching your jobs to the benchmark salary surveys serves as the foundation for getting the pay recommendations right. Job matching can even have a direct impact on your success in getting buy-in from both frontline managers and their employees. Because of this, you should carefully decide the roles that various stakeholders will have in the job matching process. It is important to decide on who will be involved in the job matching process, i.e.,

- **compensation only,**
- **include HR generalists,**
- **include line management**

There is no single, “right” way for you to address who should be involved. The challenge is to pick the approach that fits best with the HR and business strategy. Here are some likely trade-offs of the pro’s and con’s at either end of the spectrum of involvement.

	Compensation only	Compensation + HR Generalists + Line Managers
Pros	Fast implementation	Highest degree of buy-in
Cons	Lack of buy-in	Costly to train and implement

An organization that strategically intends to push towards greater pay transparency should plan to engage line management in the job matching process. This is a far more time consuming way to go, but this approach pays dividends down the road as their participation in the job matching process becomes the first wave of communication / education about market pricing.

On the other hand, an organization that is using market pricing to validate the overall competitiveness of the pay structure can be better served by a more expeditious route of simply having compensation make all the necessary job matches.

Regardless of the approach you take and who you involve, there are some job matching guiding principles you should articulate before you head down the patch of job matching. The table below lists some of the guiding principles along with thoughts to consider for how you might address.

How many survey job matches are needed?	The advice from most consultants is that you should always try to have two or three job matches. Having multiple sources does provide a larger sample and should give you more confidence in the outcome. Multiple sources will also smooth out anomalies that may exist in the data. Conversely, some firms are adopting the approach of only a single job match. They align the job match to the best available survey and then spend their energy on recommendations of how to 'fit' against that single data source. The belief is that a single match is easier to communicate as it eliminates the need to do any manipulation to the data. One of the dangers of setting a standard of always using multiple matches is that you may find yourself having one good match identified, but then you are compelled to attach a second match, regardless of its quality, in order to satisfy the objective of having multiple matches.
How accurate does a survey job match need to be?	The general rule of thumb is to look for at least a 70% match. This is consistent with the guidance from most salary survey vendors during survey participation. This way, the survey jobs is describing the vast majority of your internal benchmark job. An alternative point of view on this question though is to think about the quality of the job match in terms of how well it describes the labor market in which you are competing for talent. Is the survey job summary reasonably similar to an advertisement that one of your staffers would apply to? Does it describe a candidate that you would consider for an interview?
How do you match hybrid jobs?	Organizations are increasingly combining traditional benchmark jobs and creating hybrid jobs. While this may be good for streamlining and organizational productivity, it makes survey job matching of hybrid jobs difficult. All the more reason to consider the approach described above. Think less about how closely the words of the survey describe what your person actually does. Think instead of what jobs in the external labor market best reflect the talent pool in which you compete.

If more than one match is used, how should you handle the issue of weighting?	The most common practice of weighting surveys is to simply have them all weighted equally. Equal weighting makes sense when the various surveys are relatively equal to one another in terms of the overall quality of the survey, i.e., job match, participants, data scrubbing, etc. There are times when it makes sense to place a heavier weighting on one survey over the others. For example, one survey used may have all of your direct industry competitors whereas the other two sources provide a broader collection of general industry participants. You want to consider a 50% weighting on the one with the greatest industry representation and then 25% on the two remaining.
Dealing with your jobs being bigger / smaller than what the benchmark job summary?	The words of the survey job summary seem to describe your benchmark job, but the scope of the role either seems too big or too small. The more common approach to dealing with this scenario is to attach either a premium or discount to adjust the survey data up or down. An alternative approach is to not adjust the data, but rather have a point of view about how your incumbents should be positioned relative to the data. Coming up with the best answer for your situation requires you to consider which alternative is going to fit best with your strategic objective of the market pricing approach. If you need to create market composites and validate the competitiveness of the pay structure, the premium / discount approach is best. If you're more concerned with employee communications of the details of market pricing, then fewer calculations to adjust the data may be easier to communicate.

Handling jobs where there just isn't a good survey job match?	If the organization is implementing market pricing on top of a graded or banded structure that already has established pay ranges, then the answer is much easier. In those structures, you simply need to find the range where this job in question best fits. Organizations using a **job leveling methodology** are able to place jobs in the competitive pay range without having to attach a survey job match to every job. Organizations that are adopting pure market pricing will address this from the perspective of the labor market and ask again, where are the candidates coming from? And where are they going when they leave? You can then look for a benchmark job that reasonably describes the relevant labor pool instead of trying to match to the job duties.
How often should survey job matches be re-validated?	Survey job matches should reassess anytime there is a significant change to the job. Other indicators that it might be time for a reassessment is if turnover spikes higher than normal and/or attracting new qualified candidates is unusually difficult. Aside from those event-driven reasons, you should establish a set schedule for job match validation, every 3–4 years. One way to handle this is to conduct job match annual reviews for portions of the organization. For example, if you complete one-third of the organization every year, you would be reassessing the survey job matches every three years.

Using Survey Data

While the use of salary survey data may seem tactical, there are strategic choices you should make to not only ensure consistency but also to ensure the best alignment with the objectives of your market pricing program. Market pricing, as we have seen thus far, allows you to be flexible and creative in your approach. You just need to be aware of the trade-offs along the way and decide what will provide you with the competitive advantage in the war for talent.

Watch for the annual **salary increase surveys** to get the insight needed for your aging factors

What are the objectives of the use of salary survey data?	Organizations that want competitive salary ranges for their job grade structures will have different objectives than those companies who plan to adopt a pure market-priced approach to job evaluation. When you are building a competitive salary structure, you will tend to focus more on having precision in the calculated market composites. Pure market priced organizations that also push for full pay transparency place a higher value on being able to communicate about the data.
Aging of data?	The aging of the market data is necessary in order for you to project forward the survey results from its effective date in the past to some point in the future. The question of how far forward you should be projecting this data depends on the pay philosophy of your company.
Which components of pay are most important?	This largely depends on the level of job being market priced. Executive level positions are heavily leveraged with both short- and long-term incentives that you really must evaluate their competitiveness across all components of pay. The remaining broad-based jobs should also be evaluated across all pay components, but we commonly see the focus on base pay for the specific job analysis and then using short- and long-term incentive data to analyze competitiveness by job level and functional grouping.
Deciding on the pay statistics to use?	Historically, this decision would depend mostly on the pay philosophy of the organization. You would pick the statistic that aligns to stated compensation philosophy of where you are trying to position the company in the marketplace. An alternative approach is to include an array of the pay statistics, such as the 25th – 50th – 75th percentile values. While you may have a single objective of where the company should be paying overall, you may also look at the individuals' pay relative to the array of market statistics to determine what's appropriate.

What survey scope cuts are the best?	The right answer typically is to find the scope cut that most closely resembles the relevant labor market you've defined. You should however also be cautious of not slicing the market data up so finely that the sample size gets so small that the results are less reliable.
Dealing with year over year trending of results?	Salary survey vendors are mindful of the year over year trending of pay data and use that as one of the quality auditing factors. Still, there are times when the survey results will rise or fall significantly from one year to the next. This is one key reason why consistent participation and annual analysis is so important for your success with market pricing. You should have a plan on how you will address big swings up or down. Some alternatives you could consider include: • Setting caps for how much single year movement you'll recognize • Using multi-year trend data • Setting aside a current year result and using the prior year's data, or • Do nothing to adjust, but monitor the results over time.
Who will have access to the survey results and how will they access it?	Depending on how far you plan to go with communicating salary survey data, one other factor to consider is what level of understanding will managers and employees have with not just the compensation terminology, but also the compensation data statistics. Be prepared to invest in communication on the use of survey data if you have plans to go deep with pay transparency.

Communications

Effective communications about the market pricing program can greatly impact the likelihood of success. The 'best' compensation program design can fail miserably if employees don't understand it. Conversely, you can be highly successful with a modest compensation program by ensuring a common understanding throughout the organization through a strong communication plan.

You should create your communications plan at the time of developing the market pricing strategy. Don't wait until all the job matching and analysis work is done to start thinking about how this will be communicated. What and how you plan to communicate your market pricing approach can indeed influence the market pricing plan design choices.

Audience	Start by knowing what both your management teams and employees want and need to understand about market pricing. Does your organizational culture expect a more open dialogue about sensitive issues like pay? Or does a more top-down approach fit better with your culture?
Message	The depth of content you plan to communicate to various stakeholders can directly affect how you go about implementing your market pricing approach. A culture that supports the concept of full pay transparency will expect more message details compared to organizations whose culture is more closed. For example, in a highly transparent culture, you might include information about survey selection, job matching, pay analysis, etc. in your messaging. By knowing this up front, you can establish 'simplicity of communication' as one of your guiding principles in the design stage.
Messenger	Define the communications delivery roles for key stakeholder groups up front. What role do you expect from each of these groups? **Executives · Front line managers · Human resource generalists** Here again, overlay the realities of your organizational culture and assess the readiness of each group to be able to carry out your plan. Is there work to be done to improve their readiness? Or, would changes to your market pricing implementation plan allow for a better fit with your culture?
Media	What methods of communication do you need to use to implement and sustain your market pricing implementation? To increase the organizational awareness of market pricing, avoid the tendency of treating compensation communications as a once a year event that gets packaged up in a slide deck presentation to management. To make market pricing a more integral part of your management and employee communications, you should plan for messaging that uses a variety of media channels on an on-going basis.

Conclusion

Using market pricing as a strategic lever in your human capital strategy has the power to drive growth and talent outcomes within your organization. Getting the most benefit though from your market pricing implementation requires careful consideration of the process and choices that will best align with your business objectives.

Aon Hewitt partners with clients to provide leading compensation data and the strategic insight needed to make the data actionable. Our clients look to us to provide them with the survey data they need, but also to help with the insights needed to make the data actionable. We work with organizations around the world and across industry sectors to be their preferred source of market intelligence.

Reach out to your **Account Executive** to learn more about how our market pricing data and insights can help you improve the effectiveness of your compensation strategies.

About Aon

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