Is Market Pricing the Preferred Method to Determine Pay?

The traditional approach to developing wage and salary programs has been to utilize both internal equity and external competitiveness as the basis for creating market competitive pay structures.

In response to changes in the competitive environment, which has resulted in organizational need for greater flexibility and responsiveness to competitive market pressures, compensation professionals have moved away from their traditional approach of utilizing both a highly structured and time intensive approach to determining internal equity (point-factor or factor comparison job evaluation), as well as utilizing a time intensive approach to determining external competitiveness to the marketplace. The "fix" for internal equity has been to transition to whole job ranking aided by the participation of departmental supervision and/or management, for their areas of responsibility, in determining the ranking of positions within the organizational unit.

Since the process of determining internal equity has become less rigorous, as compared to point-factor and factor comparison job evaluation, it follows that an increased emphasis will be placed upon determining external competitiveness utilizing as much competitive market data as is readily available. Consequently, the importance of up-to-date and accurate job documentation has increased, as the impact of job matching has increased, with the growing prevalence of market pricing in determining pay rates and pay structures.

External market pay rates are an important gauge of the competitiveness of internal pay targets and actual pay rates. Studies suggest that this external comparison is gaining strength as the major determinant of pay for most organizations.

The movement toward market-based systems has occurred for several reasons:

- There is a greater focus on organizations' ongoing needs to offer competitive rates of pay to hire, motivate, and retain staff.
- Market pay systems are easy to understand and to explain and are more flexible in responding to changes that can impact an organization and its industry.
- Today's typical employer/employee relationship is clearly shorter than in the past and more focused on "now" rather than expectations for long careers experienced by workers in the past. Employees are, therefore, much more focused on their worth in the market.

What Is Market Pricing?

Market pricing is the process of gathering and interpreting external salary survey data to establish the worth of jobs, as represented by the data, based upon the "scope" of the job (company size, industry type, geography, etc.). Market pricing has become the most common method of valuing jobs. Surveys show that more than 80 percent of companies use market pricing as their primary job evaluation method. Job rates are set based on the organization's best estimate of the "going wage rates" in the external marketplace.

External competitiveness is determined by comparing current pay rates and pay structures to current competitive market data. Whether a set of market data is appropriate to use for this purpose is a function of the positions being priced, the companies participating in the survey data collection, the geographic area from which position incumbents are recruited, and the industries represented by the survey participants.

- Monitoring the market provides important information, such as an understanding of when a shortage of talent drives up pay levels. Organizations can also monitor industry changes by observing benchmark job changes over time. This information strengthens the link between an organization and its relevant labor markets and averts the risky business of ignoring competitors and making decisions with blinders on. A growing number of research studies suggest that the kind of employees that succeed in our more complex and technology-driven work world are those that are driven by career mobility and development, acquire marketable skills, and continue to learn and adapt. These employees are more driven by market competitiveness than internal equity.
- The Internet has had a huge impact on pay and pay communication. Employees have easy access to compensation data on the Web (though it is often less than accurate), which leads to more assertive questioning about their pay levels.

The best approaches to valuing jobs are those that achieve a balance between internal and external value. Internal equity connects with an organization's culture and strategy. Market pay levels establish an important point of reference. The blend of both provides the information you need to make sound strategy decisions for compensating your employees.

Why We Can't Abandon Internal Equity

The primary reason for organizations to be concerned with internal equity is that employees are concerned about it. They want to ensure they are paid fairly compared with co-workers as well as in relation to the market. Research indicates that employees often leave an organization because of fairness-related issues, not external competitiveness. It is important to manage internal fairness within an organization—even in very competitive organizations and industries.

Employers who focus solely on market pricing are actually encouraging employees to do the same. If the employer communicates that the company does not control compensation policy but that the market does, good employees always will be looking outside.

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