

# Overcoming the Challenge of Aligning Skill-Based Pay Levels to the External Market



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A key challenge to the administration of a skill-based pay (SBP) system is determining the market competitiveness of the pay levels. While SBP systems have existed for a long-time, this challenge may be one possible reason why they are not more widely employed. At this time, no well-established and accepted methodology for assessing the competitiveness of SBP levels exists, yet, knowing the competitiveness of current pay levels is critical for attracting and retaining resources and for assessing labor costs. In an interview with the author, Jay R. Schuster, Ph.D., (2007) indicated that he sees this lack of methodology as the single largest problem with SBP systems. This paper outlines a new approach for developing an external market assessment of an SBP system.

The importance of calibrating SBP with the external market is underscored by the results of a 2005 survey (by Gerald Ledford Jr., Ph.D. and the author) of nine companies with mature SBP plans (Ledford 2008). For setting their SBP rates, participants indicated that:

- Pay rates of nearby employers were moderately to very important (78 percent)
- Pay rates within their industry were moderately to very important (78 percent).

The primary roadblock to pricing SBP systems is that most published compensation-survey data are role-based, rather than skill-based. This is confirmed by Stern and Borcia (2006): "... survey providers have attempted to offer this information (compensation levels based on skills) ... but most have discontinued the effort." An alternative approach for determining the market rate for SBP is seldom, if ever, addressed in the literature. This paper presents a framework for assessing the competitiveness of compensation for SBP systems.

## THE CHALLENGE

The challenge at hand is how to draw a relationship between pay levels and skill sets. One could use the standard tools of the profession such as a published survey. However, most SBP systems are based on internally defined rather than market defined skill sets. Thus:

- 1 | Each company has a customized set of skill requirements and definitions.
- 2 | Many skill sets may not be directly transferable to a position at another company.
- 3 | A nationally accepted standard or test to assess skill achievement does not exist.

This situation is in contrast to some professional career ladders such as for actuaries and computer technicians. For these professions, pay levels are typically linked to nationally defined tests and certifications, and the knowledge/skill sets achieved through the educational process is/are directly transferable from employer to employer.

One might also expect that a new SBP-specific system survey could be developed. However, in addition to the issues just listed, it is a challenge to develop a list of appropriate companies to include in the survey. This can be problematic for any survey, because it is important to consider factors such as industry, the geographic labor market (is it local, regional or national?), union versus nonunion and so on. For SBP companies, finding comparators is exacerbated by the narrow universe of companies with SBP systems. According to Stern and Borcia (2006), "A few leading-edge survey providers ... discovered that the methodological complexity of gathering and analyzing the data was daunting, the results were disappointing, and the demand didn't justify the investment."

Finally, one may choose to construct a process to benchmark SBP positions to other internal positions for which there is competitive market data. Using this methodology, the market rate for the SBP position is based on the position to which it is linked. While this may work in theory, the internal value may not truly reflect the external value. In addition, there may be challenges to gaining the acceptance of this methodology by the SBP participants.

To determine external competitiveness for a skill-based pay system, this paper previously described three potential approaches. The three have pros and cons. These are summarized in Figure 1 on page 20. In the absence of a traditional methodology to link skill sets to pay, another approach must be employed.

This paper describes an approach that uses published survey data to price the *skill-based pay ladder* as a whole rather than attempting to first define and price *specific*

**FIGURE 1** Assessing the External Competitiveness of an SBP Plan

Potential Approach	Pros	Cons
Use traditional role-based published compensation surveys	<ul style="list-style-type: none"> <li>■ Reflects the market for role-based positions (typically the predominant market for talent)</li> <li>■ Can be fine tuned to capture a specific industry</li> <li>■ Can use career ladders or maturity curves to compare to skill growth</li> <li>■ Easily explained to employees</li> </ul>	<ul style="list-style-type: none"> <li>■ No direct linkage of pay with specific skill sets</li> <li>■ May not reflect local market for talent</li> <li>■ SBP employees may feel more valuable than their role-based counterparts</li> </ul>
Conduct custom survey of other SBP plans	<ul style="list-style-type: none"> <li>■ Allows the sponsor to define the comparator companies, the skills and definitions</li> <li>■ Likely to be understood and accepted by employees</li> </ul>	<ul style="list-style-type: none"> <li>■ Cost is high</li> <li>■ Time commitment is high</li> <li>■ The risk that the invited organizations may not be willing to participate</li> <li>■ Additional issues, as discussed above (e.g., comparability of skill definitions)</li> </ul>
Benchmark to other internal positions: <ul style="list-style-type: none"> <li>■ For which external market pay data is available</li> <li>■ That are considered of equal internal value</li> </ul>	<ul style="list-style-type: none"> <li>■ Provides for internal equity</li> <li>■ Provides some linkage to the external market</li> </ul>	<ul style="list-style-type: none"> <li>■ Linkage with the external market is weak</li> <li>■ May not be internally accepted</li> </ul>

*positions* individually. In other words, this approach uses survey data to help price the entire pay system; the primary focus thus, is on the forest rather than the trees.

## CONDUCTING THE ASSESSMENT

Pricing the SBP ladder requires additional analysis beyond what is typically employed for assessing the market rate for directly comparable, or “benchmark,” positions. The balance of this paper describes this approach. To illustrate the process, the paper discusses the steps required to assess pay levels using a specific case study. The example is a large paper products manufacturing plant (See: “A Paper Plant Adopts SBP” on the next page).

### Step One: Map the Defined Skill Sets to Jobs in Surveys

Step one is to map the defined skill sets to jobs found in published surveys. This requires several substeps.

- 1 | Identify the key organizational areas to be assessed. In the case described in this paper, four areas of the manufacturing plant were examined: manufacturing, maintenance, finishing, distribution.

- 2 | Analyze the pay-for-skills plan to fully understand the types of activities, responsibilities and accountabilities characterizing the pay-for-skills requirements within each area.
- 3 | Compile a list of “jobs/positions” that would exist if the areas were organized along traditional lines. As a test, explore the types of jobs the employees might come from if they were hired from another firm, or where employees might look for a position if they were to leave the plant. This step potentially could be quite rigorous, for example, by reviewing historical hiring patterns and exit interviews.
- 4 | Identify jobs from published surveys that most closely align with the position list compiled in substep three. To test the list, cross reference the tasks and responsibilities from the survey job descriptions to the activities and responsibilities identified in substep two.

A sample of the positions identified for the case example is provided in Figure 2 on page 22.

#### Step Two: Align the Skill Levels to the Survey Levels

Step two is to align the plant’s skill levels to the levels in each published survey. The first and most important step is to define and match the lowest and highest SBP system level to the external surveys. For this example, the entry-level and first-level supervisor were examined. Entry level can almost always be based directly on market data. This is the compensation level needed to bring employees of the appropriate level of skill and experience into the system. These positions are typically outside hires and have not gone through any company-specific training, thus an entry-level

### A PAPER PLANT ADOPTS SBP

The case is based on a large, unionized paper products manufacturing plant with several hundred employees, situated near a metropolitan area. The organization adopted SBP as part of a comprehensive set of high-performance work-system changes in the mid 1990s. When the system was implemented, wage rates were based on internal historical levels rather than market rates. An assessment of the market competitiveness of pay levels had never been undertaken at the plant. Pursuant to a clause in the collective-bargaining agreement of this plant, management and union leadership asked for help in assessing the external competitiveness of their SBP.

Gerald Ledford and the author worked with an internal task force comprised of leaders of union

and management. The process for calibrating pay levels based on the market pay data from published surveys, as described in this paper, was employed. The resulting market values were compared to the plant’s pay levels. The results indicated the plant generally paid a high premium, especially at the more senior levels.

The results were viewed as credible and accepted by the plant management and the union leadership as reflecting the market positioning of the existing SBP plan. The results have been used since in negotiating changes in pay rates at the plant. Key success factors were (1) involving both management and the union in the entire process and (2) creating an analytically rigorous and sound process that everyone could accept.

**FIGURE 2** Sample of Jobs/Positions Priced Using Published Survey Sources

Manufacturing	Maintenance	Finishing	Distribution
Capacity Planner	Calibration Technician	Crater/Packer	Dispatcher
Machine Operator	General Maintenance Repair Worker	Machine Operator	Expediter
Manufacturing Technician	Instrument Technician	Packager, Machine	Forklift Operator
Production Technician	Machinist	Production Technician	General/Warehouse Laborer
Production Processing	Maintenance Electrician		Inventory Control
Tool Crib Attendant	Maintenance Mechanic		Materials Control/Schedulers
	Maintenance Plumber		Materials Handlers
			Mechanic, Auto
			Order Fillers/ Clerks
			Shipping/Receiving

position from a published survey is a fairly reasonable benchmark. The system’s top end often can be based on the next hierarchical level in SBP systems. SBP systems are used most commonly in delayed organizations, and often there is no traditional supervisor. Rather, these duties are assumed by those who play a quasi-supervisory role such as team leader, or by fully qualified employees who divide the role. Thus, the top level of the often-appropriate SBP system corresponds to the first-line supervisor role in traditional pay systems.

Next, the analyst must identify the additional levels that need to be benchmarked. Surveys typically have multiple levels for specific positions that imply increased skill, experience and responsibility (for example, Machinist I, Machinist II and Machinist III). In many cases, the SBP systems may have a different number of levels than what exists in the surveys, and the SBP levels may not match the survey definitions even if the number of levels is the same. In the case study, the SBP plan had six levels, and the surveys typically had fewer. To align the levels from the surveys with the SBP levels, survey levels were interpolated to develop the six corresponding market levels, as illustrated in Figure 3. For this case example, the result of Steps one and two was the collection of compensation data for more than 130 jobs from published surveys, categorized by functional area and level.

### Step Three: Developing the Market Consensus

Step three is to develop a market consensus for each level in each area. This consensus can be a straight average of the data, or in some cases, it may be appropriate to weight each survey match based on the relevance, importance or percent of job responsibility.

For the manufacturing plant, a consensus for each of the six levels in each of the four functional areas (for a total of 24 market values) was developed. Because the jobs in each match were a strong representation of the skill sets required, a straight

average was used. In actuality, the pay levels for most selected positions were closely aligned. Weighting them, in the case example, would have yielded little or no change to the results, while adding an additional level of complexity to the analysis and communications.

#### Step Four: Determine a Geographic Pay Differential

Step four is to determine a geographic pay differential. This is the same issue that is addressed when market pricing role-based positions and a similar methodology is applied. The purpose is to ensure external competitiveness with the appropriate labor pool. For establishing compensation levels, the author suggests using national benchmark data rather than geographic data because the data set is more robust, and there tends to be fewer anomalies. A geographic differential to the national benchmark data could then be applied. The author has found the geographic data from Economic Research Institute’s database to be robust and considered by some to be an industry standard.

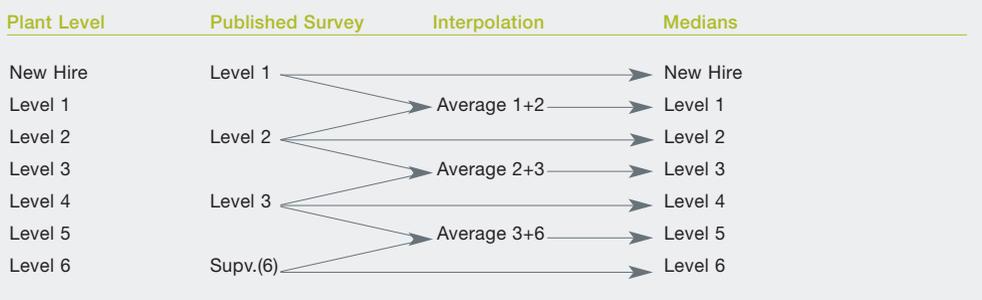
#### Step Five: Determine the Premium Size to be Applied to the Market Data

Step five is to determine the size of the premium to be applied to the market data. Most SBP systems have key differences between the skill-based jobs and the role-based jobs found in published surveys. Potential differences include:

- Broader skill base and flexibility to fill multiple functions
- Ability to perform additional support work (e.g., operators performing minor maintenance, material handling and setup)
- Ability to operate in self-directed work teams—reducing the number of supervisors and managers.

In the study of nine SBP plans, management was reduced by as much as 50 percent (Ledford 2008). These differences in job content and accountabilities make the skill-based jobs more valuable than the more narrowly defined role-based survey jobs. Based on the author’s experience, the multiskill premium is in the range of 10 percent to 15 percent more than the market median. This is consistent with other recommendations. Gerald Ledford Jr. (2007) indicates that, in his experience, a multi-skill premium

**FIGURE 3** Schematic of the Competitive Assessment Interpolation by Level



## RESOURCES PLUS

For more information related to this paper:

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- Type in this key word string on the search line:  
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- *Designing & Conducting a Salary Survey: How-to Series for the HR Professional*
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- *Mastering Market Data: How-to Series for the HR Professional.*

[www.worldatwork.org/education](http://www.worldatwork.org/education)

- C17: Market Pricing—Conducting a Competitive Pay Analysis
- C2: Job Analysis, Documentation and Evaluation
- Pricing Critical Skills and Unique Positions (One-Day Seminar).

is most often 10 percent more than market median. Another professional (Coil 2006) indicated “a 15-percent multiskilling premium is not unusual when blended jobs are in place.”

The analysis should consider whether the same percentage premium is appropriate for each level of the SBP system, or whether a different premium is appropriate at different points in the SBP ladder. The most common arrangement is a premium that is similar across levels of the ladder, but this is not the only method. In this case example, union and management had revised the SBP plan to make a steeper ladder in the finishing area compared to other areas.

This difference was because the first

two levels on the SBP ladder in finishing were not seen as requiring an exceptional level of skill compared to traditional jobs, while the top levels (including the team leader role) were quite demanding and required an entirely new set of skills, justifying a relatively higher premium.

## CONCLUSION

Determining competitive market rates for SBP systems has historically been a mystery to many compensation professionals. This paper proposes several options and provides a framework for using a common tool—published compensation surveys. This method of determining the external competitiveness of the SBP ladder as a whole can be explained to employees and provides internal equity with the other jobs in the organization that may be purely market-rate driven. By providing the compensation professional a tool for pricing SBP levels, a major roadblock may be removed, enabling more SBP systems to be adopted. ■

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## AUTHOR

**Judy Canavan** has two primary areas of focus: One is helping companies tie their compensation programs to overall organizational strategy, and the other is developing and implementing custom compensation research and surveys. She has worked across a broad array of industries including health insurance, reinsurance, utilities, engineering, food processing, higher education and not-for-profits. Canavan is managing partner of HR+Survey Solutions (HRSS), a consultancy that provides compensation consulting and custom survey development. Prior to founding HRSS, she was associated with Sibson Consulting since 1983. During that time she served as a compensation consultant. She earned a bachelor's degree in economics from Skidmore College, where she graduated with departmental honors and was a member of the Periclean academic honor society and Omicron Delta Epsilon. She has been published in *Directors and Boards* as well as in *workspan*. She is a member of WorldatWork and the Society of Human Resource Management.

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