Compa ratios - Everything you need to know

Author: Nyasha Mukechi . August 2020

Compa-ratio, what does it stand for?

A compa-ratio, or comparative ratio, is a ratio that compares the salary of an employee with a specific comparative pay target. The compa ratio can be calculated in comparison to an external reference point or an internal reference point. For example, a compa ratio can be calculated versus specific market reference points such as market median, market average, and market 75th percentile. The compa ratio can also be calculated versus an internal reference point in an internal pay structure, usually the salary grade midpoint. Moreover, for best and error-free calculations for compa ratios, calculator-online.net has designed and proposed a free-to-use ratio calculator that will let you compare numbers in a matter of seconds. In all cases, the compa-ratio assesses the relative position of a particular salary in relation to a reference point. The compa-ratio is always expressed as a percentage. The range for a compa-ratio is between 80% and 120%.

The compa-ratio is used in the management of remuneration and pay in general. It helps the organisation assess pay competitiveness for individuals, grades, and any employee category group. It is a tool that every compensation professional should know and use. In one study, the compa- ratio was used to assess gender bias in faculty salaries.

How to calculate compa-ratios?

The compa-ratio is calculated by dividing an employee's salary by the reference target salary. The target reference salary could be an internal grade midpoint point salary or a target market position. When comparing to the market, the comparison in calculating the compa-ratio should always be a target point of interest, such as the market median. It could also be the grade midpoint when you are comparing it to an internal pay structure midpoint. All these comparisons aim to assess the relative standing of your salaries versus the reference point.

Related: Compa ratio calculator

Compa- ratio formula

As explained above, the formula for the compa-ratio is as follows

1. *Compa-ratio=Employee's salary/Target market position * 100*
2. *Compa-ratio – Employee's salary/grade midpoint * 100*

You can use this Compa-Ratio Calculator to calculate the compa- ratio targeted at the midpoint of a grade and any of the following market positions (25th, 50th and 75th percentile). You can use the formula to calculate the compa-ratio against any market percentile of your choice. The target market position can be the 25th percentile, median/ 50th percentile, or 75th percentile in the first formula above. The pay strategies of organisations differ as some target to pay at the median, and others target to pay at the 75th percentile. When you are using the compa-ratio, the aim is to answer the question: how competitive are the salaries we offer versus the market per role or grade?

See below an output from an automated compa-ratio calculator.

My Compa-Ratio Scores

Individual Salary	4,000	Compa-Ratio
Grade Midpoint	6,000	67%
25th Percentile	3,000	133%
50th Percentile/Median	7,000	57%
75th Percentile	8,999	44%

The ratio can also be expressed as a percentage.

*Compa-ratio as percentage=Employee's salary/Market midpoint*100%*

Interpreting the compa-ratio

The ideal compa –ratio is from 80% to 120%. A compa-ratio of 100% means that an employee is paid at the target market position, in this case, the market median. This compa-ratio is indicating that the employee is paid a competitive salary when compared to the market. It is important to note a compa-ratio of 100% is reserved for employees performing at least above average. It is not a wise business decision to pay poor performers at around 100% compa-ratio. A compa-ratio above 100% means the employee is paid above the target market position. A compa-ratio below 100% means that the employee is paid below the target market position. New employees still on a learning curve are often paid around 80% to 90% compa- ratio. In this range, you also find poor performers. If top performers stay too long with the lower range compa-ratio, they leave the organisation looking for more competitive salaries.

Consider the following five employees with the same job titles. Suppose the company's competitive pay policy is the median.

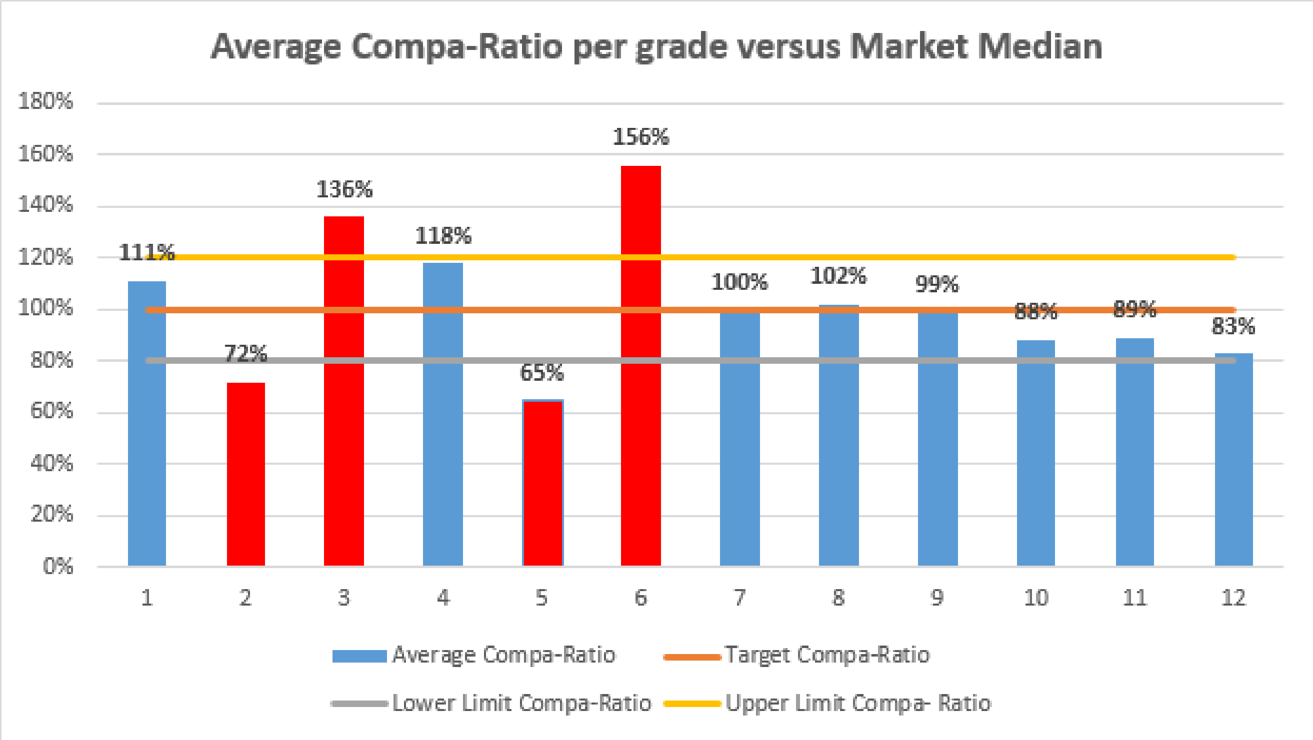
	Employee Salary	**Market 25th Percentile**	**Market Median**	**Market 75th Percentile**	**Compa-Ratio (Median-based)**
Employee A	$7,500	$6,500	$10,000	$14,590	75%
Employee B	$9,900	$6,500	$10,000	$14,590	99%
Employee C	$10,000	$6,500	$10,000	$14,590	100%
Employee D	$10,100	$6,500	$10,000	$14,590	101%
Employee E	$16,000	$6,500	$10,000	$14,590	160%

In the example above, it is clear that employee A is earning below the target market as they are at 75%

compa-ratio. The first decision is to move that employee to at least 80% compa-ratio. Any further movement of employee A should depend on their performance. In the same example above employee E, has a compa-ratio of 160%, meaning that they are above the normal compa-ratio range by 40%. The normal compa-ratio range is 80% to 120%. No employee should be paid in this kind of compa-ratio range unless there are exceptional reasons for doing so. Such reasons include the employee possessing rare skills that will cost the company money should the employee leave. Suppose the employee is not a top performer and they do not possess rare, and hard to find skills; in that case, you can bring them back into the normal range by awarding them minor salary adjustment whenever you make salary adjustment as they are already paid competitively. All the other employees in the example above are within the normal compa-ratio range. Besides just looking at using the compa-ratio to check the competitiveness of internal salaries versus the market, I recommend that you check if those earning at higher compa-ratios are justified. A similar assessment should be done for those making at the lower compa-ratios. If your organisation is performance-focused, the only acceptable variation in compa-ratios should be performance.

Another way to interpret the same results above is as follows; An employee earning a salary at 0.8 or 80% compa-ratio means that the employee is paid 20% below the market rate. Employees earning salaries at this rate or lower may be at the risk of seeking employment with companies offering higher salaries, which may be seen to be more equitable. Employee A is at risk of being lured by a better offer from other companies. A compa-ratio of 1.2 or 120% means that the employee is paid a salary that is 20% greater than the market rate. Companies may need to justify salaries above this level, as in the case of Employee E.

Besides looking at compa-ratio for individual roles as per the example given above, it is also very useful to look at compa-ratio per grave. You calculate compa-ratio for each individual in a grade and calculate the average compa-ratio for each grade(See example below)



The grades highlighted in red are all problematic. Grade 2 and 5 have compa-ratios below the lower control limit of 80%, and grades 3 and 6 have compa-ratios above the upper control limit of 120%. There is a risk of higher turnover for grades with an average compa-ratio below 80%. As for grades 3 and 6, unless these grades house hard to find skills, the situation can generate inequity complaints from the other grades and bring disharmony within the organisation.

What is an acceptable compa- ratio?

An acceptable compa-ration is primarily dependent on the target market position the organisation aims to achieve. As outlined earlier, some organisations target a market position around the median while others target the 75th percentile. Again this compa-ratio targeting depends on the organisation's overall compensation strategy. This compensation strategy can be driven by the supply and demand of the critical skills. Those organisations that operate in very competitive markets could target to pay their top performers at above 100% compa-ratio. Too often, there is no acceptable blanket compa-ratio. Instead, compa-ratios can be varied depending on the scarcity of skills in each grade or role.

The acceptable compa ratio also depends on a combination of the job, the budget and other workplace benefits on offer. For example, a company providing top-class benefits may be able to neutralise the risk of paying salaries less than the market media, i.e. compa ratios of less than 1 or 100%. In cases where a company operates a sales commission or commission-based salary, a company may set the basic pay at a level where the compa-ratio is less than 1 or 100% against other employees in non-commission roles. However, companies keen to get the very best talent may set salaries at compa-ratios above 1 or 100% to attract the best talent.

Compa-ratio when comparing with the market (External)

In practice, most companies would want to pay above the market median. The market median is the most referenced target market position. The assumption, therefore, is that every company desires to at least pay above the market median. An average compa-ratio of below 100% is not necessarily a problem if the company can not afford to pay above the market median. There are howver costly consequences for paying below the market median. The most common costs are related to failuire to attract and retain top talent. This may end up costing the organisaiton more money in the long term. The key factors in considering where to position your compa-ratios veraus the market median are affordability and sustainability.

For those intending to pay at compa-ratios below 100% when compared to the market median, you would need to come up with other innovative remuneration strategies to counter the likely effects of paying below 100% compa-ratio.

Ultimately, lower salaries are more likely to reduce employee engagement as well as lower retention levels. It is understandable that companies may not afford higher pay levels and will then have to settle for lower remuneration levels. Ultimately, for survival, companies need to be able to afford and sustain the pay levels chosen. Some companies may find that perhaps their compa-ratios are lower because they hire many recent university graduates with little to no experience. An innovative approach may be developing a rigorous training and development program to counteract potentially high turnover. Another strategy is to ensure that other retention strategies are put in place beside the salary. Such strategies could include a very supportive culture and enriching jobs. Unfortunately, even the best corporate cultures with exciting perks and benefits could still experience high turnover rates.

Compa-ratio when comparing other employees within the company (Internal)

Compa-ratios within internal pay ranges should be calculated regularly. It is an excellent way to evaluate whether the company is following its compensation strategy. Suppose the approach is to pay at the midpoint, but compa-ratios are regularly higher or lower than 1 or 100%. This could indicate a mismatch between the company's compensation strategy and what is implemented. The other benefit of tracking compa-ratios versus the internal pay structure, especially the grade midpoint salary, is that it allows the organisation to assess whether those at higher compa-ratios are justified. In the same breath, it will enable the organisation to evaluate whether those at lower compa-ratios deserve to be there. The only plausible justifiable reason for individuals variation in compa-ratios for people in the same grade is individual performance. A proper assessment of internal compa-ratio movements over time allows the company to monitor pay equity. Having no employee paid below or above the acceptable compa –ratio range of 80% to 120% enhances the credibility of the job grading structure.

This metric will also shine a spotlight on pay equity. Recent gender and racial pay gap movements have shone a spotlight on pay equity, and organisations are being expected to correct it. This can be done by taking into consideration the compa-ratios for employees in the same positions. If the compa-ratios are different among employees working within the same role without justification, this may raise equity issues. This, too, would warrant further investigations to ascertain the root cause of the inconsistencies. Finding the root of the pay inequity will enable solutions to be developed and structures to be put in place to rectify the position and prevent similar problems in the future.

Common Compa-Ratio Use in Pay Structure Practices

When administering salaries, the most common practice is to have a grade minimum with a compa-ratio of 80%, a midpoint with a compa-ratio of 100% and a grade maximum with a compa-ratio of 120%. The salary range can then be split into categories that take tenure, experience and performance into consideration.

Generally, new and inexperienced employees will earn salaries with a compa-ratio of between 80% and 90%. Employees who are not performing very well and are only meeting the minimum acceptable performance level are usually assigned to this category. As employees gain experience, skill, and performance improve, they will move along the pay range. Consistently good performers can receive salaries in the compa-ratio range of 95% to 110%. Only with rare skills should be accommodated within the scope of 110% to 120%. At the midpoint, employees will be experienced and fully qualified individuals that consistently perform well.

Compa-Ratio Use in Merit increases

Compa – ratios can be a handy tool when implementing merit increases. A Metric increases matrix often considers an individual's performance rating and position in relation to the midpoint of their grade(compa-ratio). The aim is to ensure that employees who perform well but are below 100% compa-ratio are rewarded more to earn competitively. Remember, the 100% compa-ratio is a competitive target position whether the reference point is an external market position or the salary midpoint of an internal grade. Using the same logic, people who are top performers and are on a compa- of about 110% get a smaller merit adjustment because they are already being paid competitively. The use of compa-ratios in merit increases is a very useful approach to addressing equity issues within the organisation.

In conclusion, a compa-ratio analysis is an excellent tool to monitor the competitiveness of a company's salaries versus the market and internal pay structure. The compa-ratio analysis can be viewed as a risk monitor for the company. All employees below 80% compa-ratio versus the market median are at high risk of leaving the organisation. Therefore periodic compa-ratios checks are required both against the market and also gainst the internal pay structures. Compa-ratio dashboards must be prepared periodically and presented to executive management and the company board to enable them to make more informed compensation decisions.

This article was written by Nyasha Mucheki, a consultant at the Industrial Psychology Consultants, a management and human resources consultants company. It was updated by Memory Nguwi on the 16th of August 2021

Phone +263 4 481946-48/481950

Email: nyasham@ipcconsultants.com

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