Compa ratio: Basic guide

Author: Nolwazi Mlala . March 2022

The compa-ratio is a metric that expresses current pay rates as a percentage of the target pay position, which can be external or internal. The compa ratio reveals whether the individual is paid below, at, or above the target comparison point.

Compa-ratios assist employers in compensation and pay management. It guides how far a pay is from a target comparable point. It aids the organization in determining the pay competitiveness of people, grades, and any employee category group. An organization risks losing high-quality employees and attracting low-quality talent if employee compensation is inadequate.

Calculating Compa Ratios

The compa-ratio is derived by dividing an employee's current salary by the current market rate as established by the company's competitive pay policy. Compa-Ratios are specific for each position. A pay range exists for each position, with a minimum, a midpoint, and a maximum. A compa-ratio of 1 or 100% implies that the firm is paying a rate that it considers competitive in the external labor market, based on its compensation plan. Values less than 100% may imply the employees are new , but they may also signal that the firm is underpaying employees. If the compa-ratio is more than 100%, the company is paying over the target market rates.

An internal grade midpoint salary or a target market position could be used as the target reference salary. When computing the compa-ratio against the market, the comparison point of interest should always be a target point, such as the market median. When comparing it to an internal pay system midpoint it might alternatively be the grade midpoint. These comparisons aim to determine the relative position of your salaries in relation to the reference point.

A Compa-Ratio Calculator can determine the compa-ratio targeted at the grade's midpoint and any of the following market positions (25th, 50th and 75th percentile). You can evaluate the compa-ratio against any market percentile by using the formula. The target market position can be the 25th percentile, median/ 50th percentile, or 75th percentile. When you use the compa-ratio, you're trying to figure out how competitive the salaries are compared to the market. Organizations' pay plans vary; some aim to pay at the median, while others aim for the 75th percentile.

Individual Compa Ratio

Individual compa-ratio describes an individual's pay position in relation to the market reference point.

Compa Ratio = Actual Pay Rate / Range Midpoint

For example, the employee's salary is $47,200, while the salary range's midpoint is $52,000. The following is the compa-ratio:

Compa Ratio: 47,200 / 52,000 = 0.908 = 90.8%

Group Compa Ratio

The group compa-ratio is a metric that measures the relationship between practice and policy for a whole company or a specific demographic group (function, department, occupation, or job family). It's a formula that divides the sum of actual pay by the sum of job reference point rates. It can be used to determine how to pay policies have been implemented in general and detect discrepancies

Group Compa Ratio = (Sum of Actual Pay / Sum of Job Reference Point Rate)*100%

For example, let's look at the following four employees who all have the same job title. Assume that the company's competitive pay policy is the midpoint.

Employee	Midpoint	Salary	Compa Ratio
A	$ 25,000	$ 22,500	90%
B	$ 25,000	$ 33,000	132%

C	$ 25,000	$ 27,000	108%
D	$ 25,000	$ 30,040	120%
Total	**$ 100,000**	**$ 112,540**	**113%**

Group Compa Ratio = ($112,540/ $100,000)*100% =113%

A lower than average group compa ratio could indicate a shorter employment tenure, which could be attributable to:

- Higher resignations as a result of economic or financial decisions to forego merit raises
- faster promotions as a result of rapid expansion
- more transfers prompted.

A higher than usual group compa ratio could indicate a longer tenure due to:

- Lack of promotion opportunities.
- Progress in keeping but not promoting people who don't have management skills but perform well, or market forces that demand higher pay rates.

Average Compa Ratio

The average compa-ratio is calculated by dividing the sum of each individual's compa-ratio by the total number of people. As a result, it differs from a group compa-ratio, which is based on the relationship between the amounts of actual pay rates and the sums of job reference pay points. According to the spread of individual compa-ratios at different work sizes, the average compa-ratio can differ from the group compa-ratio. More often than not, the group ratio is applied.

Average Compa Ratio = Sum of Individual Compa Ratio / Number of Individuals

For example, considering four employees in the same grade and assuming that the company's competitive pay policy is the midpoint.

Employee	Midpoint	Salary	Compa Ratio
A	$ 25,000	$ 22,500	90%
B	$ 25,000	$ 33,000	132%
C	$ 25,000	$ 27,000	108%
D	$ 25,000	$ 30,040	120%
Total			450%

Average Compa Ratio = (450% / 4) = 113%

Good Compa Ratio

A compa-ratio of 100 means that an employee is paid at the market median, which in this case is the target market position. This compa-ratio implies that the employee is paid a competitive salary compared to the market. Between 80% and 120% is the ideal compa ratio.

Individual Salary	25,000	Compa-Ratio
Grade Midpoint	30,000	83%
25th Percentile	18,000	139%
50th Percentile/Median	25,000	100%
75th Percentile	50,000	50%

The compa- ratio determines how competitive an individual's compensation is compared to target positions in the grade or market positions such as the 25th, 50th, and 75th percentiles. Compared to the market, this compa-ratio indicates that the employee is paid a competitive salary. It's worth noting that a compa-ratio of 100% is only given to employees who perform above average. Paying low achievers at roughly 100% compa-ratio is not a sensible business strategy. A compa-ratio of more than 120% indicates that the employee is most certainly overpaid. A compa-ratio of less than 80% that the employee is underpaid compared to the target market position. New employees who are still learning the ropes are frequently compensated in the 80% to 90% compa- ratio range.

Conclusion

A compa-ratio study is a great way to keep track of a company's salary competitiveness compared to the market and internal pay structure. The compa-ratio analysis can be considered as a company's risk monitor. Employees with a compa-ratio of less than 80% compared to the market median are at significant risk of quitting the company. As a result, compa-ratios assessments are necessary regularly, both against the market and against internal pay structures. Compa-ratio dashboards must be generated regularly and provided to executive management and the board of directors so that they may make better compensation decisions.

Nolwazi Mlala is a Business Analytics Consultant at Industrial Psychology Consultants (Pvt) Ltd a management and human resources consulting firm.

Phone +263 4 481946-48/481950/2900276/2900966

Cell number +263 779538172

Email: nolwazi@ipcconsultants.com or visit our website at www.ipcconsultants.com

https://thehumancapitalhub.com/articles/compa-ratio-basic-guide-