HR INSIGHTS

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Wage Compression

Wage compression refers to the situation where there is only a small difference in pay between employees regardless of their skills, experience or seniority. Wage compression most often occurs in the following two scenarios:

1. A new employee is paid almost the same amount as an experienced employee for the same job.
2. A lower-level employee is paid almost the same amount as a higher-level employee, like a manager.

In extreme cases, wage inversion, where newcomers are paid more than experienced workers, may occur. If left untreated, wage compression can become a significant internal equity issue and can even lead to pay inequities that violate equal pay laws.

Factors Leading to Wage Compression

Wage compression stems from a variety of causes, many of which are sustained over a few years. The most common causes include the following:

- Overlooked and outdated HR pay regulation policies that result in new hires being paid more than experienced workers
- Improper integration of employees and pay following a merger or acquisition
- Departmental differences in salary increases and adjustments, promotions and bonuses
- Outdated internal compensation structure that is out of alignment with the external market data

Consequences of Not Dealing with Wage Compression

Wage compression creates pay differentials that are too small to be considered equitable and can lead to widespread dissatisfaction among employees causing salary to change from a motivating to a “demotivating” force. This can impact productivity and lead to increased turnover, as well as decreased employee morale and potential resentment among co-workers.

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How to Deal with Wage Compression

Most organizations should conduct an annual wage analysis to detect wage compression. There are a few analyses you can conduct to determine if it is an issue and to identify areas of concern.

- **Analyze the compa-ratios within each salary grade and the employees' time in a position**. A compa-ratio refers to the percentage obtained by dividing the actual salary paid to an employee by the midpoint of the salary range for that position. If newer employees' pay falls in the third or fourth quartiles and longer-service employees' pay falls within the first two quartiles, there is cause for concern.
- **Analyze how subordinates' salaries compare to their supervisors' salaries.** If a subordinate's salary is more than 95 percent of his or her supervisor's salary, there is cause for concern. If a subordinate's salary is between 80 and 95 percent of his or her supervisor's salary, it is an issue that should be closely monitored.

If you suspect that wage compression is an issue at your organization, there are a few strategies you can use to remedy or minimize its effects.

- Revise your organization's salary grade structure.
- Review and rewrite job descriptions as duties, roles and responsibilities, and then reassess the salary grade and range for the job.
- Make "equity adjustments" to increase pay levels of long-tenured or high-performing employees.
- Consider merit bonuses instead of pay raises.
- Ensure a compensation or HR manager has oversight over new hire salaries.

To prevent wage compression in the future, organizations should regularly review market changes and salary trends for positions at your organization, as well as monitor wage and hour changes enacted through legislation and rulemaking to ensure that they make the necessary adjustments before it becomes an issue.