SALARY FORMULA

$$S = \left\{ \frac{\sqrt{\dfrac{\sum_{i=1}^{C} \dfrac{(T^{i}-L)^{2}}{(A \times P)}}{W}} \times \sqrt{\dfrac{E \times G^{2}}{\pi \int \dfrac{t^{\alpha}\,dt \times S}{M \times e^{K} - N}}}}{\sum_{i=0}^{\infty} \left[\dfrac{\int_{e}^{P} f(E)\,dx\,H}{f(G)\,dx\,T} \right]} \right\}$$

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> No price is too high to pay for the privilege of owning yourself.
>
> **Friedrich Nietzsche, German philosopher (1844–1900)**

Money is a sensitive topic, therefore, payment of employees must be treated carefully. A good compensation plan is not only fair, but also supports the culture of the organization. A salary formula can help you keep the trust, prevent demotivation, and pave the way to total transparency.

Furious could be the best word to describe how I felt when I discovered that the project managers were being paid, on average, more than the software developers. For years, I had been responsible for the development teams, while project management was somebody else's territory. But after struggling with better software development practices in this particular organization for a while, I successfully argued that we could only achieve real improvement if I could also help transform the project management department. When top management finally extended the scope of my control, one of my first tasks was to look at the compensation plans that were negotiated individually with the project managers. I got the salary list from human resources, and with my master's degree in Microsoft Excel, I compensated for age, years of service, education levels, waist lines, and several other relevant factors to reverse-engineer people's monthly salaries to a small set of baselines and factors for both software developers and project managers. I hoped to arrive at a secret formula that would serve as a guideline in any upcoming salary negotiations. It wouldn't turn lead into gold, but I was sure it would help me turn applicants into employees. To my surprise, I discovered that, everything else being equal, project managers earned, on average, at least 10 percent more than software developers, on average. I was shocked! Even though I assumed the discrepancy that had sneaked its way into the financial pyramid wasn't intentional, I didn't like the idea that nobody, not even top management, seemed to know about this problem. Or was there a problem? Is payment unfair when nobody knows about it and nobody complains?

Compensation is a difficult topic. The term can refer to hourly wages, monthly salaries, commissions, bonuses, stock options, insurance plans, retirement packages, and many other benefits that people earn for their contributions to an organization. The whole shebang is often called an **employee compensation plan**, which is a bit of a misnomer considering that *planning* often has very little to do with the outcomes achieved. Still, I believe it is important to perform just enough planning to ensure there is fairness and consistency in the way people are being paid.

In this chapter, I want to focus on people's salaries. Retirement packages and all those other employee benefits can be very interesting topics, but this chapter is not intended to be a primer for human resource managers or financial planners. Employees and managers are primarily interested in consistently fair monthly salaries. Let's see how we can achieve that. Once we can figure that out, the rest should be easy!

Compensation Plans

Like the discussion with your kid after having picked him up from the police station, the discussion around a compensation plan will probably start with the question, "Why?" You might think that the answer is obvious, but if you really think about it, there seem to be multiple answers to this question. I can list at least five reasons for a well-defined approach to a salary structure:

1. We want a good compensation plan so that everyone knows *we pay people fairly* for the value they create for the organization.
2. A good plan enables us to *attract and keep the right people* (and maybe get rid of the wrong ones too).
3. A compensation strategy can help us navigate the organization through an *uncertain environment*, in good times and bad times.
4. Money influences motivation; therefore a good compensation plan helps ensure we *don't inadvertently destroy people's joy and productivity*.
5. With a good plan, we are able to *reinforce a culture of trust*, instead of feeding a dysfunctional one full of distrust.

As you can see, there is quite a bit more involved in compensation plans than merely negotiating a salary that both parties can agree to.

No matter what an organization says about its values and its purpose, how it compensates is a form of "walking the talk." Nothing saps motivation more quickly than the perception that the compensation system is unfair and rigged.

Mackey and Sisodia, *Conscious Capitalism* loc:1591

We have five requirements for good compensation plans: fairness, recruitment, flexibility, motivation, and trust. I keep calling them *plans*, because money is a sensitive topic, and treating this topic delicately requires some thought, foresight, and organization. We usually call that *planning*.

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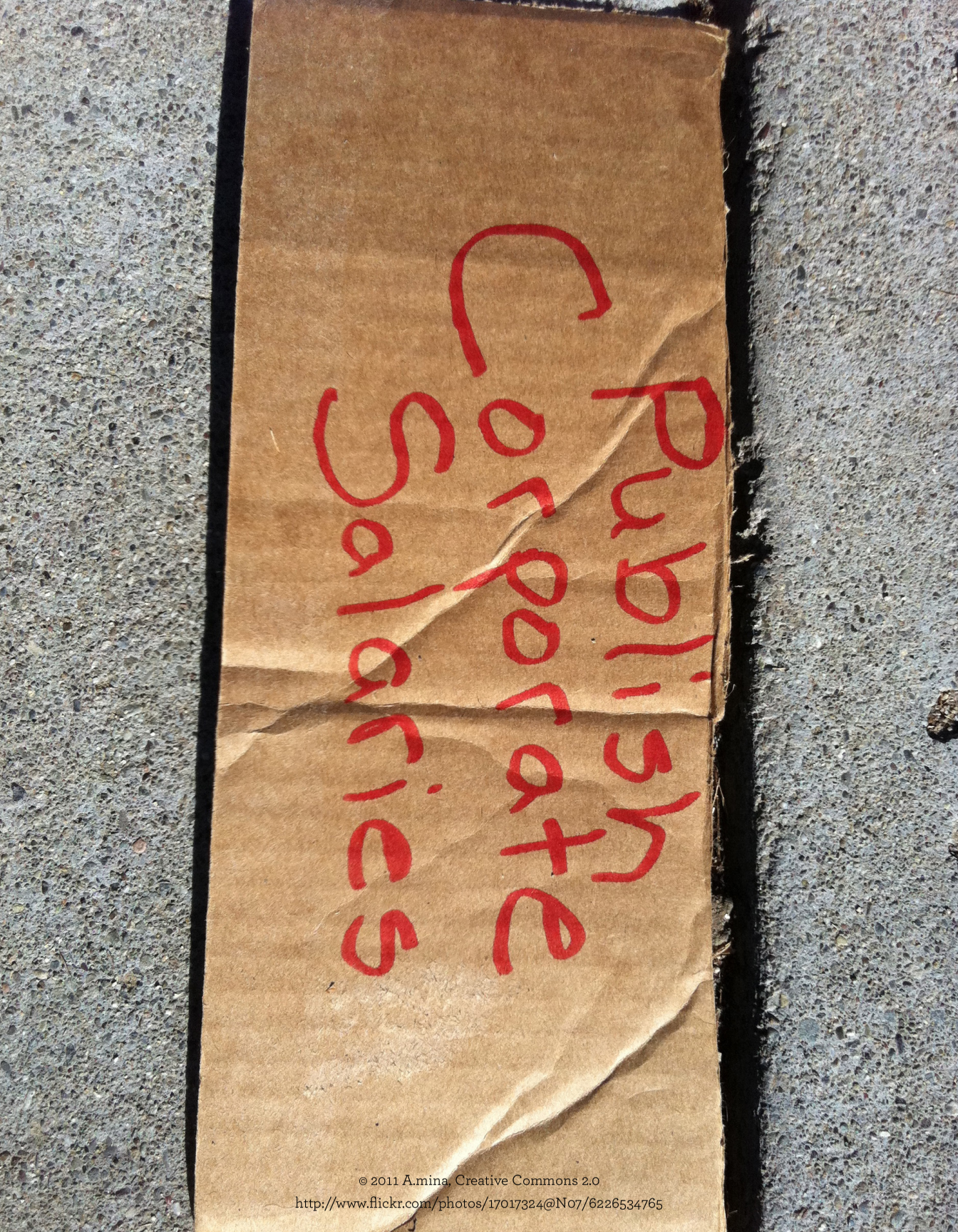
But wait, there is one more requirement we should not forget about!



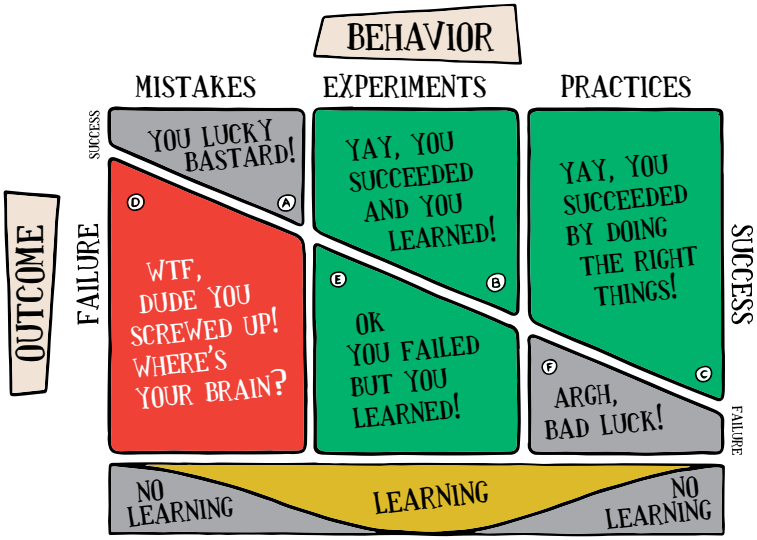
Deliberate Practice

Before we create a compensation plan for our employees, the very first matter to discuss is what our compensation will be based on. We have three options:

1. We can pay people for the *time* they make themselves available, and leave it to their managers and peers to get the most out of their presence.
2. We can pay people for the *results* they generate for the organization, and leave it to managers and peers to provide them with useful input.
3. We can pay people for the *effort* they put into their work, and leave it to managers and peers to turn that effort into successful results.

The first option is the default position in many traditional organizations and for all time-billing consultants. Workers are merely required to show up. It is their employer's duty to squeeze as much productivity as possible out of the available time and to make sure everyone is doing something useful and not simply watching YouTube videos.

The second option is common in results-only work environments and is used by most freelancing creatives. Workers can do whatever they want, but they only get paid when their work has a successful outcome, perhaps bounded by a deadline or a list of requirements. Management is mostly concerned with defining the criteria for success first, and then interpreting them as broadly as possible later.



Unfortunately, both of these options easily lead to dysfunctional behaviors in many organizations. This can be illustrated with the celebration grid diagram. Successes are ***usually*** achieved when people seek and follow good practices (right column); they are ***sometimes*** achieved when people run experiments (middle column); and they are ***rarely*** achieved when we make mistakes (left column). However, learning and innovation mostly happen when people run experiments with a good mix of successes and failures (middle column), and little learning takes place when people merely follow good practices (right column) or just make stupid mistakes (left column). (You can read more about this diagram in the "Yay! Questions and Celebration Board" chapter.)

In summary, organizations need two things: repeatable successes (do more of what already works) as well as learning and innovation (find new things that work). The diagram shows that we need to focus on the green areas: a combination of running experiments with optimal learning and following good practices with repeatable successes. The habit of relentlessly pursuing new things that work *and* intensively repeating things that already work is called **deliberate practice**. [Barr, "Deliberate Practice"]

The problem with a compensation plan based on option one (paying people for their time) is that workers are not pulled toward the right places on the diagram. We all know stories of employees who don't seem to care at all about either personal learning or organizational successes. This should come as no surprise, because you get what you pay for. With option one you pay people to walk all over the map, while management is expected to keep everyone in the right corner.

The problem with option two (paying people for results) is that it motivates workers to aim for the upper half of the diagram. That means that most will prefer to follow good practices (with guaranteed results) over running experiments (which have unknown outcomes) because only successes lead to paychecks. The result is reduced learning and innovation. There is also some unfairness in this approach because those who are lucky enough to get good results, despite their bad behaviors, get rewarded, while those who are unlucky because of unexpected failures, despite having followed good practices, are not rewarded and they feel they are being punished.

In my opinion, the best approach to a compensation plan is option three (paying people for effort). Unsurprisingly, it is also the hardest one to implement. After all, it is fairly easy to measure people's contribution in the form of available time. It is harder, but still possible, to measure their contribution in the form of successes. But how can we measure people's *efforts* at both running experiments and following good practices? The short answer: we can't. It is simply not possible for a computer, or a manager with a checklist, to measure effort using a scale of one to ten. However, our colleagues are often fine observers of each other's behaviors! Therefore, we must rely more heavily on social pressure and a culture that favors deliberate practice.

We must rely more heavily on social pressure and a culture that favors deliberate practice.

Never forget that you get what you pay for. Therefore, the final requirement for a compensation plan needs to focus on a culture of good behaviors.

A good compensation plan helps everyone to focus on experimental learning and deliberate practice.

Job Categories

Now that we've established six requirements for our compensation plan, we can start working on its construction. Most literature offered by human resource experts suggests starting with a *job analysis*, which is a thorough investigation into the work of all employees. This exploration should result in the classification of the type of work done by employees and, preferably, a job description for each person in the organization. The job description will include an employee's job title, an overview of the tasks and responsibilities for that position, a description of the context of the work, and a list of required skills and competences. [Burke, "Designing a Pay Structure"]

I disagree.

A compensation plan requiring all jobs in an organization to be described in detail is unsustainable in a business world that is more complex and volatile than ever. When anyone thinks he has a complete picture of what is going on and what part is doing what in the system, he is probably under the illusion that he is operating a forklift truck instead of caring for a community. You would be wise *not* to let such people mess with money, the lifeblood of the organization.

Paying everyone the same salary is not an option for most organizations. Some differentiation is needed, and one area to differentiate between employees is their primary position in the company's business model. Some people are *founders* of the startup, but most people are not. Some employees mainly *create* things, while other employees mainly *manage* things. Some workers *sell* stuff and others *procure* stuff. Listing tasks and responsibilities for everyone is next to impossible, but it's not that hard to identify, in broad terms, the areas of an organization's business model where the employees contribute the most.

> **It is virtually impossible to delineate roles and responsibilities in the dynamic growth environment that startups [and most other organizations] operate in. Moreover, the last thing you want to encourage in a startup [or in other organizations] is for employees to restrict themselves to a set of narrowly defined tasks.**
>
> Deshpande, "Here's a Powerful Tool for Startups"

When I was Chief Information Officer, I had so many things on my plate that I couldn't even enumerate my own tasks and responsibilities, not to mention the skills and competences required to perform them. (I'm sure some of the other employees also wondered what the #$&@ I was doing.) A detailed description of my job was impossible. There was basically only one thing that everyone could agree on: I was a member of the *management team*. Aha, a subgroup! That gives us something concrete and stable to work with.

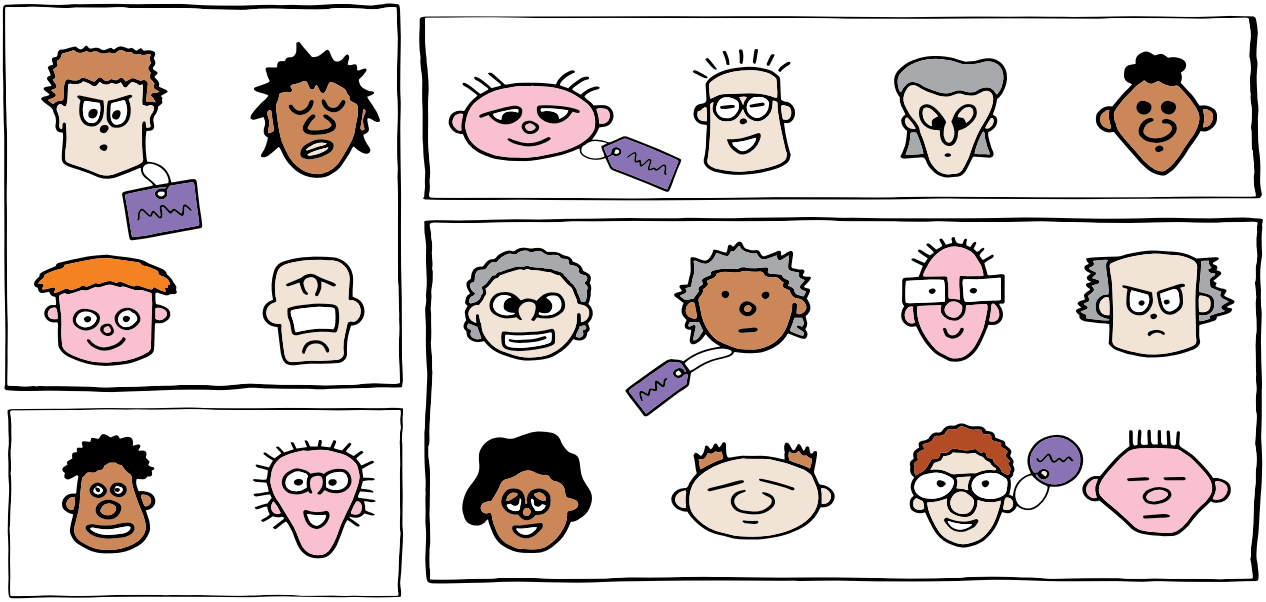
The first step toward a compensation plan is to broadly identify groups of people. Or better, we should define *categories* and *tags* for all jobs in such a way that there are *as few as possible* and that those are only based on their strategic value for the organization. For example, creating separate categories for developers and designers makes no sense when they more or less get the same

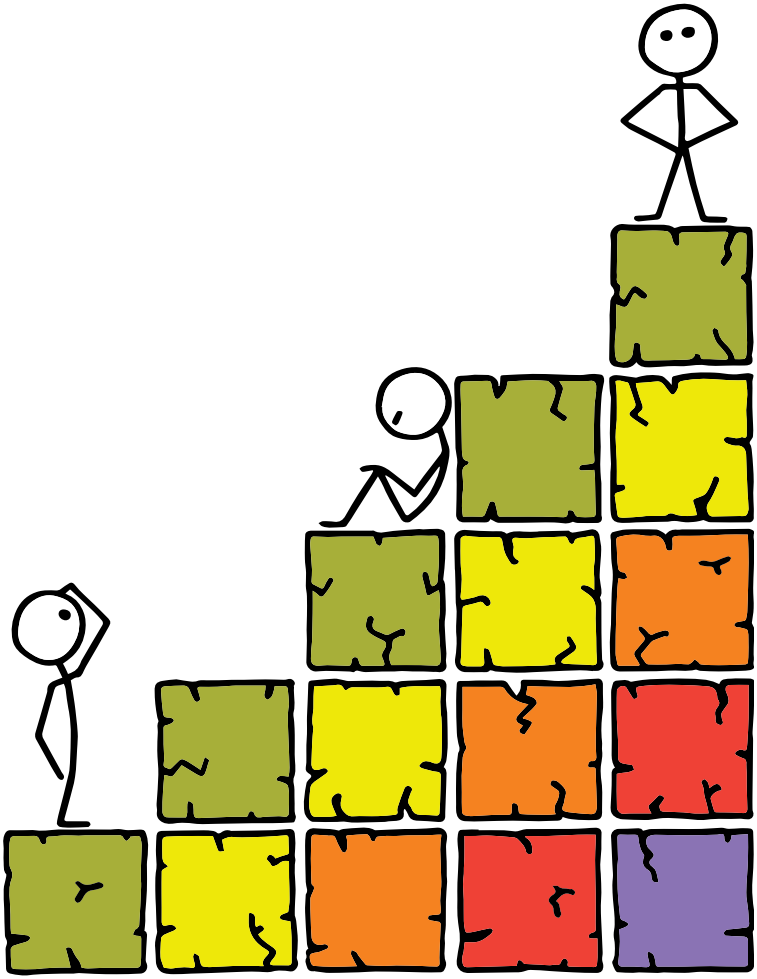
salaries and make similar contributions to the business model. In that case, it's best to create one category called *creative*. This also enables you to include writers or sculptors in the creative category when the environment calls for a change in the type of products the organization makes.

Strategic value to the business model should be the primary factor in any distinction between jobs. In a top-rated design firm, the design aspect of the work is obviously of strategic importance. It makes sense to distinguish between designers and developers and therefore add more weight to design. Obviously, in a top-rated software development firm, it could be exactly the other way around!

Strategic value to the business model should be the primary factor in any distinction between jobs.

Employees should belong to exactly one category. They either (primarily) do marketing or they (primarily) do network administration. They probably don't do both. But workers can have any number of additional tasks, memberships, or responsibilities in parallel to their regular job. That's what tags are for. Management team members, company founders, team leaders, and union or works council members can be given an extra tag because they have some additional responsibilities *besides* the regular work that they do. Notice the difference between categories and tags: each worker is in one category and has zero or more tags.





Job Levels

The second step often suggested in human resources literature is ***job evaluation.*** This step involves judging the relative value of all jobs in an organization and ranking them in a hierarchy. The purpose of the evaluation and ranking is to build a payment structure that the employees will consider fair. [Burke, "Designing a Pay Structure"]

Again, I see things differently.

When we have a good set of job categories and tags, we will obviously need to assign different weights to them, but that doesn't imply the need for a hierarchy. Nobody disagrees with the notion that the weight of the tag ***founder*** will usually be higher than the weight of the tag ***team leader***. And if your organization is in the business of making animated videos, it makes sense for the ***animation*** category to be valued higher than the ***catering*** category. But stacking jobs to build a pyramid? I see no reason why this needs to be done.

I've seen some successful compensation plans address people's desire for ranking in a different way. It makes a lot more sense to me to rank employees ***within each job category***. One of the few good decisions I ever made as a CIO was to get rid of the implied hierarchy of jobs where software developers were perceived by some to be at a "lower" level than project managers. Instead, I introduced five ***levels***, called ***Trainee, Junior, Medior, Senior,*** and ***Master,*** and each employee was assigned one of these levels within their own category. Both the software developers and the project managers adopted this ranking.

Explanation of Job Levels

A distinction between job levels is best done within each job category and tag. For example, you can have junior, medior, and **senior** account managers in parallel to junior, medior, and senior business consultants. This arrangement allows for the most flexibility in the design of your compensation plan. There is no need to create a hierarchy in your salary structure. The combination of categories, tags, and levels gives you all the options you need for a wide variety of salary formulas.

There is no need to create a hierarchy in your salary structure.

I find it is common to have four or five levels per job category. In our case, the **trainee** level was reserved for interns. The **junior** level was for young employees, fresh from college or university. The **medior** level was what everyone automatically achieved if we didn't fire them within a year. The senior level was reserved for employees who had built up a track record and who had proven to need little or no supervision or coaching. The **master** level was reserved for superheroes. Sadly, we never hired a person like that.

Average Salaries

Now that we have job categories, tags, and levels, we need some example data to arrive at sensible values for people's salaries. *Pay survey analysis* is the process of gathering data from other employers in a labor market to see how much they pay their employees. Human resource experts consider this step essential to keep an organization's salaries competitive within its industry. [Burke, "Designing a Pay Structure"]

Will it surprise you when I say I disagree?

There are three things fundamentally wrong with the assumption that a company should match salaries paid by its competitors. The first problem is that of treating people like replaceable cogs in a machine. A video artist in one animation studio is not simply replaceable with a video artist from the studio next door. As a writer, I know perfectly well that I cannot simply drop my keyboard at this point and have someone else finish this chapter. Yes, it is useful to know how much a competitor's employees earn. But that's not the same as using their salaries as a baseline for your own. Your employees are, in all likelihood, different people with different jobs and different projects, despite the similarity in job titles.

The second problem is the fear that people will apply for a job at another company for a mere 10% salary increase. When this fear is justified at your organization, you apparently have a bigger problem than just an uncompetitive compensation plan. Research confirms that creative networkers are motivated in the first place by their work, their peers, and their employer's purpose. If you pay them enough, the money becomes only a minor concern. [Pink, *Drive* loc:1054] You can tweak salary baselines until your fingers turn blue, but no compensation plan will compensate for the lack of a compelling culture and meaningful work.

You can tweak salary baselines until your fingers turn blue, but no compensation plan will compensate for the lack of a compelling culture and meaningful work.

The third problem is the idea that one can calculate the average salary for any kind of job. In the creative economy, the pay scales of creative people often do not conform to a standard bell curve with a nice big blob in the middle and a tail on either side. There is no meaningful average income for Hollywood actors. Most actors earn very little, while a few of them make millions. The average doesn't make sense as a comparative figure. Likewise, there is no minimum, midpoint, or maximum income for a writer or a football (soccer) player. Averages make sense for people whose jobs are commodities. Do you want the work in your organization to be a commodity? Or do you want the people in your organization to be special?

Despite these issues, I agree it is useful to know how much others are getting paid. It gives you something to compare yourself with, but I suggest you do things your own way. As a public speaker, I find it very interesting to know how much other speakers earn, so I know where I stand with my own pricing. But I won't price my services at the "competitive" midpoint between Bill Clinton and my aunt Betty.

Compensation Calculation

It was years ago that I created my salary formula to pursue fair compensation for software developers and project managers. At that time, I had to work backwards from their actual salaries to find a reasonable set of variables, constants, and multipliers that would forecast salaries for new employees. Unsurprisingly, I did this all in an environment that called for confidentiality and secrecy.

Nowadays I'm glad to see that fair calculation of salaries is heralded as the next big thing for management and human resources. Of course, it now works the other way around. Instead of negotiating individual salaries and then working *backwards* to check if they made any sense, it seems like a good idea to *start* with a set of variables, constants, and multipliers, and to calculate forward and settle on salaries that everyone can agree on.

We already have three variables: job categories (**C**), job tags (**T**), and job levels (**L**). The categories and tags represent what some people would call strategic role or job type. [Gascoigne, "Open Salaries at Buffer"; Spolsky, "Fog Creek Compensation"] And the job level is sometimes referred to as maturity, seniority, or competence. [Deshpande, "Here's a Powerful Tool for Startups"; Elmer, "After Disclosing Employee Salaries"] The semantics don't matter much. You can use the term that suits you best, as long as you don't go overboard with hundreds of categories and tags. Only distinguish categories and tags that are necessary to differentiate compensation levels of (large) groups of workers.

A second set of variables can be identified when you take into account an employee's age (**A**), the period of time you have employed her (**P**), the years of work experience she had before you hired her (**W**), and the years of relevant education (**E**). These variables are all optional. Whether or not you want to use them depends on the kind of organization you have and the culture you want to support with your salary formula. A startup business might value education and young creative minds, while a mature organization might put more emphasis on the wisdom that is implied with a higher age or longer employment. It's your business, so it's your call.

But wait! We're not there yet. Keep in mind that salaries fluctuate, depending on the geographical areas where people live. Employees working in Sweden require higher pay than those in Spain, for the obvious reason that life in Northern Europe is more expensive (and less exciting) than in Southern Europe. But even within one country, you might want to keep an eye on the differences in cost of living between regions. [Spolsky, "Fog Creek Compensation"] This could give you an extra variable representing location or geographic area (**G**).

Finally, you can make adjustments to take into account whether employees prefer to have part of their monthly income replaced with stock options (**O**) [Gascoigne, "Open Salaries at Buffer"]; whether they participate in a bonus or merits system (**M**); and whether you wish to give special consideration to superstars, such as Nobel-prize winners or writers of management books (**N**). You could even consider a public metric, such as a Klout score (**K**), which indicates how well connected a person is on social networks. After all, when we value creative networkers for their creative skills, education, and work experience, why not compensate them for their social skills and networking abilities?

Do Not Include a Performance Metric!

Some experts suggest that you should include an individual performance metric into the set of variables of your salary formula, but I am strongly opposed to this idea! [Case, "When Salaries Aren't Secret"; Cheng, "The Salary Dilemma"]

Scientific literature on worker motivation is virtually unanimous on the effects of individual performance targets when tied to rewards. The verdict in one word: disastrous. It almost always leads to dysfunctional behaviors. [Kohn, *Punished by Rewards*] It doesn't matter whether the performance metric covers time, results, or effort. People will try to game the system instead of focusing on their work (also see the chapter "Metrics Ecosystem").

There are better ways to compensate employees for their contributions (efforts and results) to the organization's total performance. This is covered by the Merit Money workout practice (see next chapter). This chapter is focused specifically on people's steady monthly income, and our salary formula should only include variables that cannot be easily gamed on a month-by-month basis. For most people, it is hard to grow several years older in just one month.

With a good set of variables, you should now be able to play with a spreadsheet and create your own formula. Money is such a sensitive topic for many people that I've decided not to give you any serious examples in this text. **S = (C x T x L + A + P + W + E) x G + O + M + N + K** From experience, I know what will happen: people will start analyzing, discussing, and criticizing the examples, instead of thinking deeply about their own context and performing their own calculations. So let's not go there.

One thing I want to emphasize is that there's *no* one best salary formula. You *must* make sure to experiment with calculations and keep the formula easily adaptable, with small iterations. [Heaps, "Ten Steps for Building a Salary Structure"] Expect that some people *will* try to game the system. Their behaviors are complex, while your formula can only be complicated. No spreadsheet can withstand human ingenuity when it comes to influencing results. Therefore, focus on a culture of trust and allow the formula to evolve together with people's behaviors. You should also have a clear policy that addresses people's current salaries whenever the formula changes. At the same time, before introducing any new salary formula, don't forget to make financial projections and compare them with your internal budget constraints. [Heaps, "Ten Steps for Building a Salary Structure"]

A salary formula, which everyone understands and gets to learn about before accepting a job, is a great step toward a compensation plan that pays people fairly for the value they create in the organization. Quite coincidentally, this happens to be our *first requirement* 1 for a good compensation plan.

No Variables for Gender or Race

When people discuss salaries, one topic that pops up again and again is the discrimination against women and, a bit less often, minorities of a certain color, heritage, or other background. In other words, **equal pay.** [Coy and Dwoskin, "Shortchanged: Why Women Get Paid Less than Men"] Experts commonly end up in endless discussions about whether this discrimination is actually common practice or not. [Tobak, "The Gender Pay Gap Is a Myth"].

In my opinion, it's easier to simply circumvent the whole debate. When you work with a salary formula, the potential for discrimination and unequal pay should vanish like Dutch customers at the end of a free trial period. None of the variables I listed previously are about gender, race, or any other physical or mental attribute. And that's how it should be!

Compensation Levels

Comparing your salaries with what is offered in the outside world is one aspect in the creation of a compensation plan. As I said before, many jobs do not allow for an easy comparison of averages, but it's still useful to know the range of salaries at other companies, and the values around which most of them are clustered. It is then up to you to decide how you want to position your business against the competition. Remember that job candidates *will* have a look at salaries before they get to know about your amazing company culture, your awesome products, and your high-tech lounge chairs. Deciding whether an organization wants to lead, lag, or meet market standards is called *pay policy identification*. [Burke, "Designing a Pay Structure"]

However, determining compensation levels is not just about evaluating market standards. On the contrary, an explicit decision *not* to have your salaries be dictated by the market could be an expression of your company culture. For example, it is well known that movie director Woody Allen pays his actors only modest fees, even when they are the biggest stars. Maybe you can pull a Woody Allen too? Any compensation policy will select the kind of employees (or actors) who like that policy, and it will deter the kind of people who don't appreciate it. There's nothing wrong with that, as long as you make this part of your strategy. Attracting and keeping the right people—and getting rid of the wrong ones—happens to be our *second requirement* 2 for a good compensation plan.

According to our *third requirement* 3 for good compensation plans, our salary structure should help us steer the organization through good times *and* through bad times.

> **We want [employees] to be comfortable enough and not worry about money. I would hope that salary is not the highest, the key thing for people. In a way if they got a higher offer and that was something that swayed them, I would be happy to say good luck and thank you.**
>
> **Elmer, "After Disclosing Employee Salaries"**

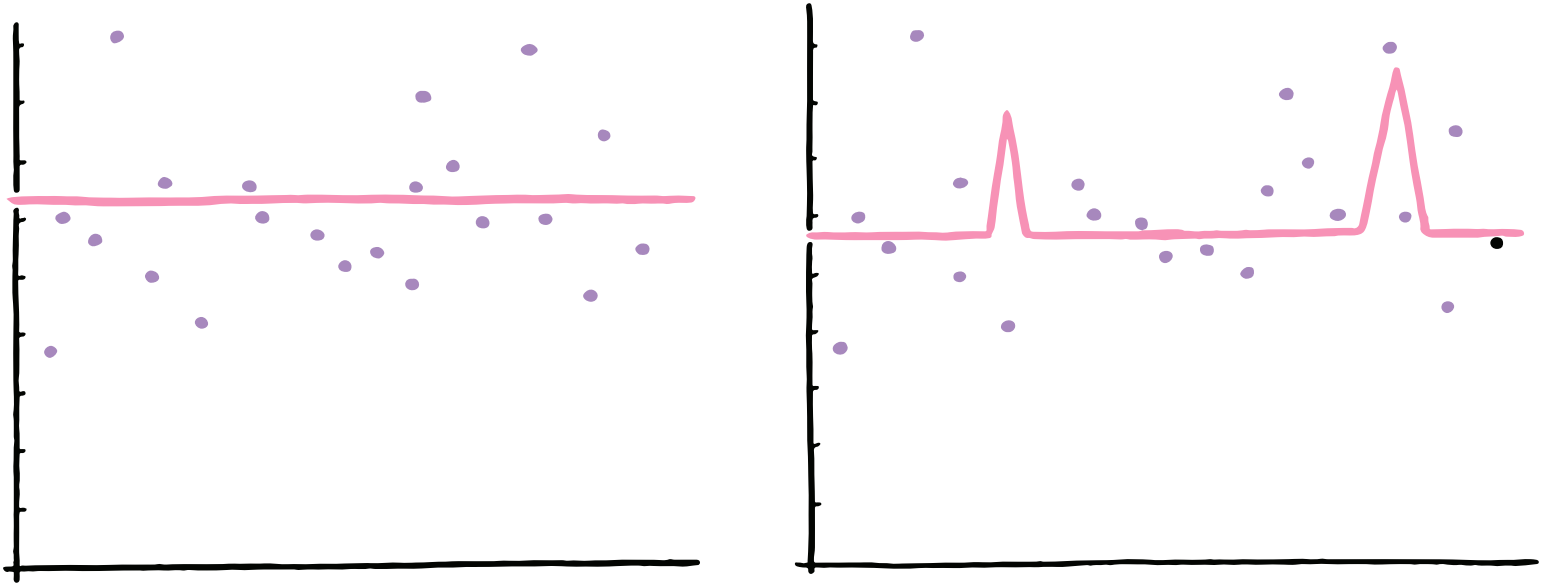
Paying all employees a fixed salary slightly above market—if there is such a thing—sounds like a great thing, if your internal budget can bear it.  But it could become a major problem when the environment changes and your budget becomes a bit tighter. An employee can be quite happy with a safe and steady monthly income, just above market. But from the perspective of complexity thinking, such income is more vulnerable to large shocks that could make the employee's income suddenly drop to zero, "plus some unemployment benefits if he resides in one of the few welfare states." [Taleb, *Antifragile* loc:1672]

In my opinion, employers and creative networkers are wise to follow the income strategy of artisans (carpenters, musicians, tailors, etc.), whose incomes are more volatile, but are also more able to handle unexpected bad events that would cause regular employees to lose their jobs, or their employers to go out of business.

Try to be conservative with your monthly salaries and convince your peers to participate in a merit money plan (see the next chapter). Monthly salaries should be paid for people's efforts, including learning, innovation, and following good practices. The merit money plan could kick in to share in any successes your joint efforts are able to generate.

Employees' risks are hidden. Thanks to variability, these artisanal careers harbor a bit of antifragility: small variations make them adapt and change continuously by learning from the environment and being, sort of, continuously under pressure to be fit.

Taleb, Antifragile loc:1659



A little above market (left) and a little below market, with spikes (right)

Compensation Ranges

The final step in the formation of a compensation plan is called *pay structure creation*. The suggestion in human resources literature is usually to turn your findings (internal metrics and external market rates) into a complicated structure of pay grades, pay steps, pay ranges, pay scales, and pay whatevers. [Burke, "Designing a Pay Structure"] This can involve discussions about bottom rates, top rates, market medians, overlap of classifications, allowable pay raise percentages, broadbanding, and percentage midpoint progression. [Ojimba, "Pay Structures"] The resulting structure is then used to plot people neatly onto a financial grid which, supposedly, reduces salary negotiations and, supposedly, makes the playing field "fair".

I disagree.

Maybe you guessed that already?

One big problem with pay grades and pay ranges is that once people are assigned their (often arbitrary) starting position on the scales, it is extremely hard for them to ascend the payment pyramid more quickly than others. Holding onto a financial growth norm for everyone (for example, no advancement of more than two pay steps at a time, and no raise of more than 5 percent per year) with the argument that otherwise "things would not be fair" is the most effective way to send your best people elsewhere.

You pay the salary the formula tells you to pay, and you get back to work.

A salary formula is what it is. When you insert someone's input variables, and the formula calculates her payment, then that's what you pay her. No discussion, no arguments, no negotiations, and no normalization to grades, steps, and ranges. You pay the salary the formula tells you to pay and you get back to work so you can deal with more interesting problems.

My interpretation of *fair* is not requiring that people negotiate individually with their managers about pay steps and pay raises (a ritual that always favors the more socially savvy employees). My view on *fair* is that all employees can see what the formula is; everyone can calculate what they get, given their history and circumstances; and everyone knows what to do to earn more. Psychologist Frederick Herzberg famously observed that money is rarely a motivator. But it acts as a demotivator when someone believes she is not being treated fairly, for example, because of gender bias. A salary formula takes away the pain from negotiations, discrimination, and the pay scale race. It also reduces the chance that employees will feel underpaid compared to their co-workers. And not demotivating people is our *fourth requirement* 4 for good compensation plans.

Compensation Transparency

If only things were always transparent! It took me years of building a reputation as a technical leader and a track record as a development manager before I was allowed to take over responsibility for the project management department, only to discover that during all that time, the project managers had been paid more than the software developers.

While researching literature on the topics of compensation plans and salary structures, I came across one article that contained strong advice for human resource managers to "keep the salary ranges in the strictest confidence". Yes, that makes total sense if you don't want anyone to find out they're being screwed! Fortunately, not all companies follow this advice. In fact, depending on where you live, demanding confidentiality probably isn't even legal. [Meyer, "Appeals Court Says Employees Can Openly Discuss Wages"]

In the interest of fairness, Fog Creek's compensation policy is open, public, simple, and accountable. Many companies try to obfuscate the rules they use for determining compensation in hopes that they won't get caught paying some people too much and others too little.

Spolsky, "Fog Creek Compensation"

Why should we make a fuss about people finding out how much we earn?

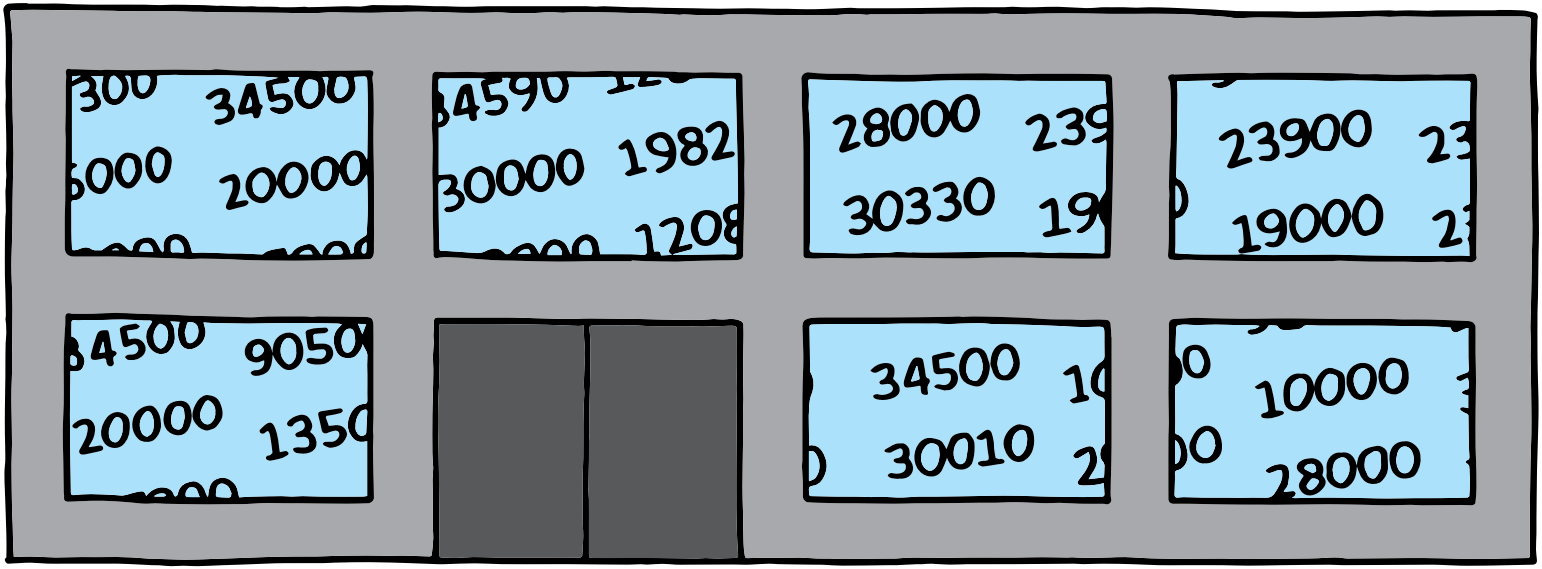
We live in a different age now. With the rise of the Internet and social networks, more and more people have become accustomed to the idea of sharing (almost) everything about themselves. On Twitter, we let people know where we are; on Instagram, we show what we eat; on Amazon, we publish what we read; and with AirBNB, we even rent out our homes to complete strangers. Why should we make a fuss about people finding out how much we earn? [Gascoigne, "Open Salaries at Buffer"]

I see more and more companies switching to transparency of finances and publication of their compensation plans. Research confirms that pay secrecy only hurts a company's culture and results in negative morale, decreased performance, and higher turnover. [Belogolovsky and Bamberger, "Secret Salaries Hurt Worker Performance"] Therefore, defaulting to transparency and making everything publicly available, perhaps even to outsiders, can be a smart move. Yes, everyone will be able to figure out what everyone else earns. Why is that a problem? A transparency policy is a good thing because it forces management to be fair to everyone. [Griswold, "At Whole Foods, Employees Can Look Up Other Employees' Salaries"] When a few employees don't like that, the problem resides more likely with personal attitudes or with unfair salaries than with the transparency policy itself. A ban on secrecy has a tendency to scare away people with a bad attitude toward trust and fairness which helps to reinforce a good culture instead of feeding a poisonous one. [Elmer, "After Disclosing Employee Salaries"] And that is our *fifth requirement* 5 for a compensation plan.

Will there be discussions when you open the books on salaries? Of course there will! [Nisen, "Why You Should Reveal Everyone's Salaries"; Silverman, "This Is What Your Co-Worker Is Paid"] But these discussions will reveal the problems that are already in the system; and by dealing with them, you stop them from festering and poisoning your company's culture. Of course, it requires that you have a fair compensation plan in place that is able to *explain* what everyone's salary is. When nobody can easily explain it, that's a good reason not to show it!

The executive looked at me with alarm. "We could get over a lot of things here—insider trading, financial scandals, and the like—but if everyone knew everyone else's salary, it would be a true catastrophe. All but the highest-paid individual would feel underpaid—and I wouldn't be surprised if they went out and looked for another job."

Ariely, *Predictably Irrational* loc:395



When you announce your plan for a transparency policy and people respond with alarm and even threaten to quit their jobs, I would just let them go. I would even open the doors for them. Thank you and goodbye! At the same time, I would leave the doors open for the many people outside who learn about the new policy and want to get in.

Buffer received 2,886 applications for job openings in the month since the Dec.19 news of its salary transparency showed up on its blog, compared to 1,263 in the 30 days beforehand.

Elmer, "After Disclosing Employee Salaries"

The move toward transparent compensation plans is a global trend. Some even say companies don't really have a choice. [Silverman, "This Is What Your Co-Worker Is Paid"] Obviously, I don't mean to say that you should start posting everyone's individual salaries on your company's public website tomorrow. Experiment, take small steps, and think about where you want to go. Use your compensation plan to reward people for the right behaviors. That means no politics, no secrecy, and no hidden agendas. Instead, have experimental learning and deliberate practice, which is our *sixth and final requirement* 6 for a good compensation plan.

Why not let employees set their own salaries?

Indeed, why not? In some (rare) organizations people set their own fees, which they may negotiate with their peers. [Semler, *The Seven-Day Weekend*] That sounds great! After all, I also define my own fees for workshops and public speaking.

However, it is very useful to have a formula that calculates an indication of what is a reasonable fee. Yes, I also have a formula to calculate my own fees! I've noticed it is very hard to just pluck a magic number out of the air. And a fair formula reduces people's urge to negotiate, which (in my opinion) is a waste of my time. For organizations it's no different.

When you've already established fairness of compensation, a salary formula covering everyone in the organization, and transparency of finances, then allowing employees to self-organize with regard to their salaries could be the final logical step toward an empowered workforce.

Too late

"When I first joined the last company, the recruiter asked me about my salary expectations. I told her that I didn't want to earn more or less than anyone else in the same role. It was meant as an honest statement.

After four months, I discovered that some colleagues (in the same role) earned quite a lot more than I did. Apparently, the company hadn't been honest with me since day one. After six months on the job, and after having been praised constantly for my good work, I received a job offer from a rival company. During all that time I had not received any salary revisions. When I saw that the job offer was far superior (in terms of both salary and role) I decided to quit my job. My employer immediately wanted to match the rival company's offer, but I told them I was not negotiating and I was leaving regardless of any money they offered me to stay.

They lost a good employee because they were not in a hurry to pay me in a fair manner. When they woke up, it was too late."

Pedro Gustavo Torres, *Portugal*

What now?

Changing the salary structure in a business is not easy, but you have to start somewhere. As with many other workout exercises, it's probably best if you start easy and make it as painless as possible. This is what you can do:

1. Make a set of job categories and tags that represent all people's jobs in the organization.
2. Add any optional variables, for age, tenure, education, or other things that are valued in your organization's culture.
3. Look up what your employees currently earn.
4. Keep an eye on what employees earn at other companies with comparable business models.
5. Create a salary formula that approximately calculates people's current salaries from the variables you identified. Keep improving the formula until the only differences with people's actual salaries are either minor and unimportant, or big and inexplicable.
6. Start planning to erase the differences between what the formula says people *should* earn, and what they actually earn now.
7. When you have a plan to get people's salaries back on track, in line with your salary formula, it will be time to start planning for transparency.

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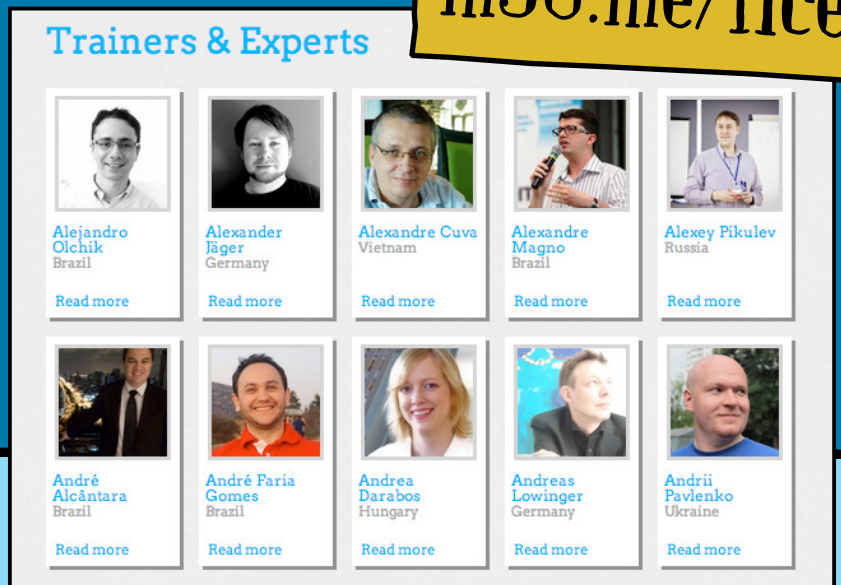

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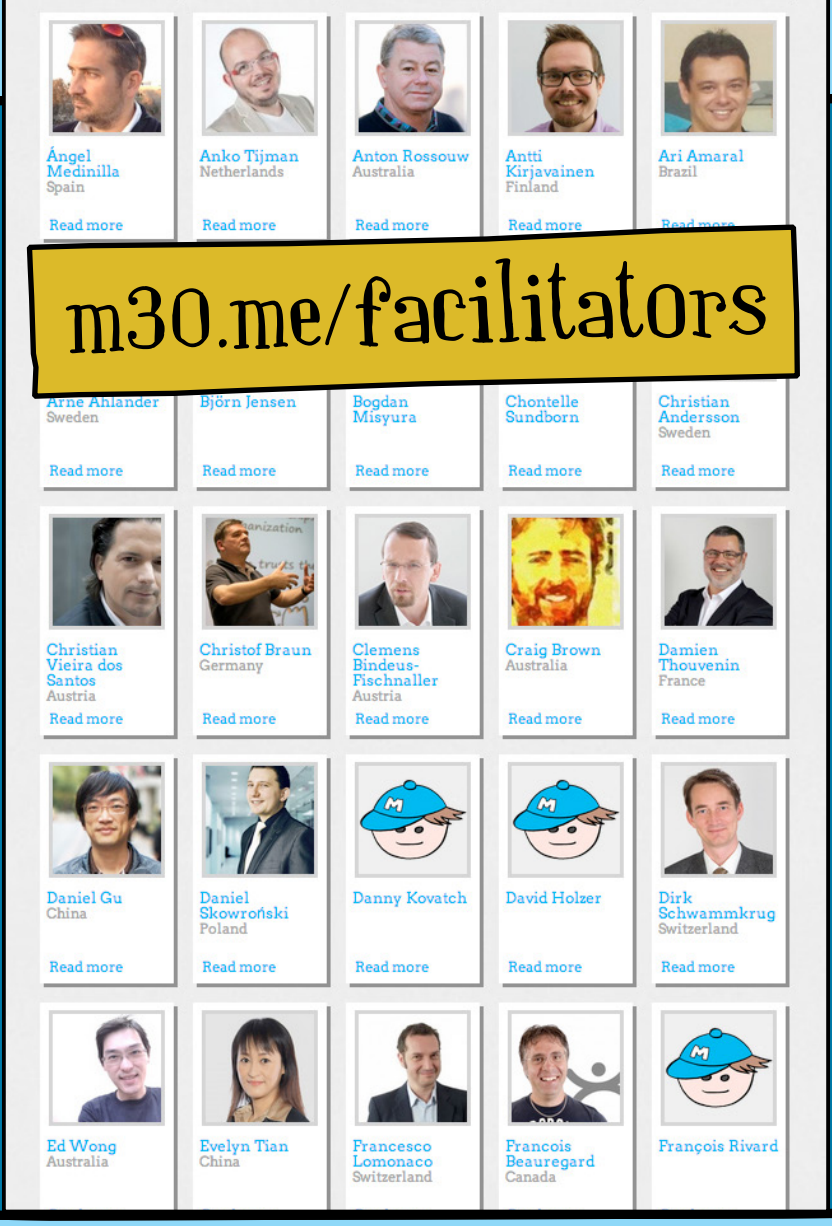

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