Designing Pay Levels, Mix and Pay Structures
Learning Objectives
After studying Chapter 8, students should be able to:

1. Explain all of the steps in designing and administering a pay survey.

2. Discuss the importance of defining the external relevant labor market in a pay survey.

3. Explain how the market pay line combines internal job structure with external wage rates.

4. Discuss the use of pay grades and ranges and their relationship to internal alignment and external competitiveness.

5. Discuss broad banding as a flexible alternative to pay grades and ranges.
Determining Externally Competitive Pay Levels and Structures

External competitiveness: Pay relationships among organizations

Set Policy → Define Market → Conduct Survey → Draw Policy Lines → Merge Internal & External Pressures → Competitive Pay Levels, Mix and Structures

Some Major Decisions in Pay Level Determination
- Determine pay level policy
- Define purpose of survey
- Define relevant labor market
- Design and conduct survey
- Interpret and apply results
- Design grades and ranges or bands
Salary Survey

- A *survey* is the systematic process of collecting and making judgments about the compensation paid by other employers.

- Surveys provide the data for setting the pay policy relative to competition and translating that policy into pay levels and structures.
Set Competitive Pay Policy

- Adjust Pay Level – How Much to Pay?
- Adjust Pay Mix – What Forms?
- Adjust Pay Structure?
- Special Situations
- Estimate Competitors’ Labor Costs
Define Relevant Market Competitors

- Employers who compete for the same occupations or skills required.
- Employers who compete for employees within the same geographic area.
- Employers who compete with the same products and services.
### Relevant Labor Markets by Geographic and Employee Groups

<table>
<thead>
<tr>
<th>Geographic Scope</th>
<th>Production</th>
<th>Office and Clerical</th>
<th>Technicians</th>
<th>Scientists &amp; Engineers</th>
<th>Managerial Professional</th>
<th>Executive</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Local:</strong> Within relatively small areas such as cities or MSAs</td>
<td>Most likely</td>
<td>Most likely</td>
<td>Most likely</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Regional:</strong> Within a particular area of the state or several states</td>
<td>Only if in short supply or critical</td>
<td>Only if in short supply or critical</td>
<td>Most likely</td>
<td>Likely</td>
<td>Most likely</td>
<td></td>
</tr>
<tr>
<td><strong>National:</strong> Across the country</td>
<td>Most likely</td>
<td>Most likely</td>
<td>Most likely</td>
<td>Most likely</td>
<td>Most likely</td>
<td></td>
</tr>
<tr>
<td><strong>International:</strong> Across several countries</td>
<td>Only for critical skills or those in very short supply</td>
<td>Only for critical skills or those in very short supply</td>
<td>Sometimes</td>
<td></td>
<td></td>
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</table>
Design the Survey

- Who should be involved in the survey design?
- How many employers should be included?
- Which jobs should be included?
- What information to collect?
Which Jobs to Include?

- Benchmark Jobs Approach
- Low - High Approach
- Global Approach
- Benchmark Conversion Approach
- Market Basket Approach
Characteristics of Benchmark Jobs

- The contents are well-known, relatively stable, and agreed upon by the employees involved.
- The supply and demand for these jobs are relatively stable and not subject to recent shifts.
- They represent the entire job structure under study.
- A majority of the workforce is employed in these jobs.
Which Market Jobs Match Which Company Jobs?

- Any match between an organization’s jobs and survey jobs must be done on job content rather than on the basis of job title only.

- Apply your job evaluation system to the survey job descriptions.
Data Elements to Consider for Surveys

- **Nature of the Organization**
  - Financial performance
  - Size
  - Structure

- **Nature of Total Compensation System**
  - Cash forms used
  - Non-cash forms used

- **Incumbent and Job**
  - Date
  - Job
  - Individual
  - Pay
## Advantages and Disadvantages of Measures of Compensation

<table>
<thead>
<tr>
<th>Measure</th>
<th>Advantage</th>
<th>Disadvantage</th>
</tr>
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<tbody>
<tr>
<td>Base Pay</td>
<td>Tells how competitors are valuing the work in similar jobs</td>
<td>Fails to include performance incentives and other forms, so will not give true picture if competitors offer low base but high incentives</td>
</tr>
<tr>
<td>Total Cash (base + bonus)</td>
<td>Tells how competitors are valuing work; also tells the cash pay for performance opportunity in the job.</td>
<td>All employees may not receive incentives, so it may overstate the competitors’ pay; plus, it does not include long-term incentives.</td>
</tr>
<tr>
<td>Total Compensation (base + bonus + stock options + benefits)</td>
<td>Tells the total value competitors place on this work</td>
<td>All employees may not receive all the forms. Be careful; don’t set base equal to competitors’ total compensation. Risks high fixed costs.</td>
</tr>
</tbody>
</table>
Analyzing Survey Data (1 of 2)

- No single best approach
- Check accuracy of data
- Two pieces of data on each benchmark:
  - Survey data - dollars
  - Our own data - job evaluation points
- Scatterplot shows relationships
Analyzing Survey Data (2 of 2)

- Frequency distribution organizes data
- Measures of central tendency
  - averages or means
  - weighted means
  - medians
- Measures of distribution, or dispersion
  - standard deviation
  - percentiles and quartiles
  - range spread
Combine Job Evaluation and Market Survey Data (1 of 2)

- Scatterplots: for each benchmark job there is a distribution of wages paid by survey companies.
- Each of these distributions has means, ranges, etc...
- Scatterplots are useful to see what the data look like.
Combine Job Evaluation and Market Survey Data (2 of 2)

- Summarize the data further by fitting a linear curve to it.
- Can “eyeball” data, use midpoints, or other mathematical approaches.
Scatterplot with Linear Curve

Survey monthly salary ($000)

PAY

Line of Best Fit

Our Job Evaluation Points
Lead the Market:

- pay level should be above the market for the year and equal at year end
- update factor will be equal to the projected market increase
Adjust The Data to Reflect Organization’s Pay Policy (2 of 3)

Match the Market:

- Pay level will be above the market for the first half of the year and below for the second half.
- Update factor will be half of the projected market increase.
Lag the Market:

- pay level should be below the market for the entire year
- *no adjustment* will be made to account for the projected market increase
The equation for a straight line will be used, since most pay distributions approximate a straight line.

This equation is:

\[ Y = a + bX \]

where

- \( Y \) = actual pay rate (from survey data)
- \( X \) = evaluated points for org’n jobs
- \( a \) = \( Y \) intercept when \( X \) is zero
- \( b \) = slope of line of best fit
Developing a Pay Policy Line

Line of Best Fit: using market-survey data (updated and aged to reflect pay policy)

Survey monthly salary ($000)

Our Job Evaluation Points
Why Bother with Ranges?

External Pressures:

a. Quality variations (KSAs) among individuals in the external market
b. Recognition of differences in the productivity-related value to employers of these quality variations

Internal Pressures:

a. The intention to recognize individual performance variations with pay
b. Employees’ expectations that their pay will increase over time
A grade is a horizontal grouping of different jobs that are considered substantially equal for pay purposes.

Grades enhance an organization’s ability to move people among jobs within a grade with no change in pay.
The objective is for all the jobs that are similar for pay purposes to be placed within the same grade.

How many pay grades?

- number of jobs
- organization hierarchy
- reporting relationships
Pay ranges refer to the \textit{vertical dimension} of the pay structure.

Each pay grade will have associated with it a pay range consisting of a midpoint and a specified minimum and maximum.
Constructing Ranges: Establishing Midpoint, Minimum, and Maximum

- Midpoints correspond to the competitive pay policy.
- The point where the pay policy line crosses each grade becomes the midpoint of the pay range for that grade.
- Midpoints are the control point of the range.
- The midpoint represents base pay for a seasoned employee.
Constructing Ranges: Establishing Midpoint, Minimum, and Maximum

- The midpoint can be determined as soon as the pay grade limits are set.
- Find the job evaluation point value in the center of the pay grade.
- Substitute that point value for $X$ in your equation of the pay line.
- Solve the equation for $Y$; this value is the midpoint of the range.
Constructing Ranges: Establishing Midpoint, Minimum, and Maximum

- **Range spread** is based on some judgment about how the ranges support career paths, promotions, and other organization systems.
- Range spreads vary between 10 to 150 percent.
- Desired range spread is what makes good sense to the employer.
Once the **midpoint** (based on the pay policy line) and the **range spread** (based on judgment) are specified, minimums and maximums are calculated.

- Minimum = Midpoint / [1 + (1/2 range spread)]

- Maximum = Minimum + (range spread x minimum)
Constructing Ranges: Overlap

maximum rate grade A - minimum rate grade B
maximum rate grade A - minimum rate grade A
Our Job Evaluation Points

Pay Policy Line

Our monthly salary (000)

PAYGRADE STRUCTURE

<table>
<thead>
<tr>
<th>Grade</th>
<th>Points</th>
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<tbody>
<tr>
<td>I</td>
<td>100</td>
</tr>
<tr>
<td>II</td>
<td>150</td>
</tr>
<tr>
<td>III</td>
<td>200</td>
</tr>
<tr>
<td>IV</td>
<td>250</td>
</tr>
<tr>
<td>V</td>
<td>300</td>
</tr>
</tbody>
</table>

[Graph showing the relationship between job evaluation points and monthly salaries, with pay policy line.]
Broadbanding

- Use of job clusters or tiers of positions into bands
- Purpose is to manage career growth and administer pay
- An alternative to traditional salary grade structures
- Collapses the number of salary ranges within a traditional salary structure into a few broad bands
Contrasts Between Ranges and Bands

Ranges Support:
- Some flexibility within controls
- Relative stable organization design
- Recognition via titles or career progression
- Midpoint controls, comparatives
- Controls designed into system
- Give managers “freedom with guidelines”
- To 150 percent range-spread

Bands Support:
- Emphasis on flexibility within guidelines
- Global organizations
- Cross-functional experience and lateral progression
- Reference market rates, shadow ranges
- Controls in budget, few in system
- Give managers “freedom to manage” pay
- 100 – 400 percent spreads
A large technology company reduced the number of grade levels for their exempt professional employees from 12 to 3.

The levels were defined as:

- basic, entry-level contributor
- seasoned contributor or team leader
- business unit / team manager or senior professional contributors
Within these levels, managers hired and calibrated pay levels based on market information for individuals with similar backgrounds and responsibilities.

Managers given market and charged with the responsibility of making salary adjustments as appropriate to attract, retain, and reward their staff.
Broadbanding:
How many bands to create? (1 of 2)

◆ Determine the number of distinct levels of employee contributions within the organization that actually add value

◆ For example:
  - professional positions
  - management positions
  - technical positions
  - clerical positions
Broadbanding: How many bands to create (2 of 2)

For example:

- entry level positions
- contributor level positions
- leadership level positions
Broadbanding: Placing individual jobs or roles in bands

Example:
- Basic
- Proficient
- Mastery
Pay Compression

- Results when wages for those jobs filled from outside the organization are increasing faster than the wages for jobs filled from within the organization.

- As pay differentials among jobs become very small, the traditional pay structure becomes compressed.

- Compression is an issue in professional work when new graduates command salaries almost equal to those of professionals with 3 - 5 years experience.
Summary

- Most organizations survey other employers’ pay practices to determine the rates competitors pay.
- An employer using the survey results considers how it wishes to position its total compensation in the market:
  - To lead
  - To match, or
  - To follow competition
- This policy decision may be different for different business units and even for different job groups within a single organization.
The policy on competitive position is translated into practice by setting pay policy lines. They serve as reference points around which pay grades and ranges or bands are designed.

The use of grades and ranges recognizes both external and internal pressures on pay decisions.

- No single “going rate” for a job exists in the market;
- Instead, an array of rates exists.

Internally, the use of ranges is consistent with variations in the discretion present in jobs.

Pay ranges permit employers to value and recognize these differences with pay.
Review Questions

1. Which competitive pay policy would you recommend to an employer? Why? Does it depend on circumstances faced by the employer? Which ones?

2. How would you design a survey for setting pay for welders? For financial managers? Do the issues differ? Will the techniques used and the data collected differ? Why or why not?

3. What factors determine the relevant market for a survey? Why is the definition of the relevant market so important?
Review Questions (continued)

4. What do surveys have to do with pay discrimination?

5. Contrast pay ranges and grades with bands. Why would you use either? Does their use assist or hinder the achievement of internal alignment? External competitiveness?