

# Designing Pay Levels, Pay Mix and Pay Structures

4BE3

Week 7

# Learning Outcomes

- Describe the decisions involved in setting externally competitive pay and designing the corresponding pay structure.
- Explain the steps involved in survey design.
- Describe what is meant by updating survey data.
- Explain the difference between a market pay line and a pay policy line.
- Discuss how pay grades are created, the relationship of pay ranges to pay grades, and the concept of broadbanding.
- Explain how to adjust a pay structure to balance internal and external pressures.

# Determining Externally Competitive Pay Levels and Structures

## Major Decisions:

- Specify the employer's competitive pay policy
- Define the purpose of the survey
- Select relevant market competitors
- Design the survey
- Interpret survey results and construct the market line
- Construct a pay policy line that reflects the external pay policy
- Balance competitiveness with internal alignment through the use of pay ranges, flat rates and, or bands

# Specify Competitive Pay Policy

- ❑ Translating an external pay policy into practice requires information on the external market.
- ❑ Surveys provide the data for translating that policy into pay levels, pay mix, and structures.
- ❑ A survey is the systematic process of collecting and making judgments about the compensation paid by other employers

# The Purpose of a Survey

- Adjust pay level—how much to pay?
  - Based on the changing rates paid by competitors
- Adjust pay mix—what forms?
  - Base, bonus, stock, benefits relative to that offered by competitors
- Adjust pay structure?
  - validate job evaluation results; establish internal structures
- Study special situations
  - To analyze specific pay-related problems
- Estimate competitors' labour costs
  - “competitive intelligence”

# Select Relevant Market Competitors

- Relevant labor markets include employers who compete in one or more areas:
  - the same occupations or skills,
  - hiring employees within the same geographic area, or
  - the same products and services.
- Fuzzy markets
  - new organizations and/or organizations with unique jobs may fuse diverse factors making relevant markets fuzzy.

## Exhibit 8.2 Relevant Labour Markets by Geographic Scope and Employee Groups

Geographic Scope	Production	Office & Clerical	Technicians	Scientists & Engineers	Managerial/Professionals	Executive
Local: When relatively small areas such as cities or census metropolitan areas	Most likely	Most likely	Most likely			
Regional: When a particular area of the province or several provinces (e.g., the wheat-producing region of western Canada)	Only if in short supply or critical	Only if in short supply or critical	Most likely	Likely	Most likely	
National: Across the country				Most likely	Most likely	Most likely
International: Across several countries				Only for critical skills or those in very short supply	Only for critical skills or those in very short supply	Sometimes

# Design the Survey

- Who should be involved?
- How many employers to include?
- Which jobs to include?
  - benchmark job approach, low-high approach, benchmark conversion/survey leveling
- What information to collect?
  - organization data, total compensation data, information about incumbent and job and HR outcomes

#### EXHIBIT 8.4 Possible Survey Data Elements and Rationale for Inclusion

BASIC ELEMENTS	EXAMPLES	RATONALE
<b><i>Nature of Organization</i></b>		
Identification	Company, name, address, contact person	Further contacts
Financial performance	Assets, sales, profits (after taxes), cash flow	Indicates nature of the product/service markets, the ability to pay, size, and financials
Size	Profit centres, product lines Total number of employees	Importance of specific job groups to business success Impact on labour market
Structure	Organizational charts	Indicates how business is organized and how important managerial jobs are
<b><i>Nature of Total Compensation System</i></b>		
Cash forms used	Base pay, pay increase schedules, long- and short-term incentives, bonuses, cost of living adjustments, overtime, and shift differentials	Indicates the mix of compensation offered; used to establish a comparable base
Non-cash forms used	Composition of benefits and services, particularly the degree of coverage and contributions to medical and health insurance and pensions	
<b><i>Incumbent and Job</i></b>		
Date	Date survey data in effect	Need to update rates to current date
Job	Match generic job description	Indicates degree of similarity with survey's key jobs
	Number of employees supervised and reporting levels	Describes scope of responsibilities
Individual	Years since degree, education, date of hire	Indicates training and tenure of incumbents
Pay	Actual rates paid to each individual, total earnings, last increase, bonuses, incentives	

(continued)

# Possible Survey Data Elements – Organization

Basic Elements	Examples	Rationale
Identification	Company name, address, contact person	Further contacts
Financial performance	Assets, sales, profits (after taxes), cashflow	Indicates nature of the product/service markets, the ability to pay, size and financials
Size	Profit centres, product lines	Importance of specific job groups to business success
	Total number of employees	Impact on labour market
Structure	Organizational charts	Indicates how business is organized and how important managerial jobs are.

# Possible Survey Data Elements – Total Compensation

- Cash forms used: base pay, pay increase schedules, long- and short-term incentives, bonuses, cost of living adjustments, overtime and shift differentials
- Non-cash forms used: composition of benefits and services, particularly the degree of coverage and contributions to medical and health insurance and pensions

## Exhibit 8.5 Advantages and Disadvantages of Various Measures of Compensation

	Advantages	Disadvantages
Base pay	Tells how competitors are valuing the work in similar jobs.	Fails to include performance incentives and other forms, so will not give true picture if competitors offer low base but high incentives.
Total cash	Tells how competitors are valuing work; also tells the cash pay for performance opportunity in the job.	Not all employees may receive incentives, so it may overstate the competitors' pay; plus, it does not include long-term incentives.
Total compensation (base + bonus + stock options + benefits)	Tells the total value competitors place on this work.	All employees may not receive all the forms. Don't set base pay equal to competitors' total compensation.

# Possible Survey Data Elements – Incumbent & Job

Basic Elements	Examples	Rationale
Date	Date survey data in effect	Need to update rates to current date
Job	Match generic job description	Indicates degree of similarity with survey's key jobs
Individual	Number of employees supervised and reporting levels  Years since degree, education, date of hire	Describes scope of responsibilities  Indicates training and tenure of incumbents
Pay	Actual rates paid to each individual, total earnings, last increase, bonuses, incentives	

# Possible Survey Data Elements – HR Outcomes

Basic Elements	Examples	Rationale
Productivity	Revenues to employee ratio, revenues to labour costs ratio	Reflect organization performance and efficiency
Total labour costs	Number of employees x (average wages and benefits)	Major expense
Attraction	Yield ratio, number accepting offer to number of job offers ratio	Reveals recruiting success
Retention	Turnover rate; number of high or low performers who leave to number of employees ratio	Reveals outflow of people
Employee views	Total pay satisfaction	Reveals what employees think about their pay

# Interpret Survey Results

- Verify accuracy of match
  - If a company job is similar, but not identical, use the benchmark conversion / survey leveling approach.
  - Multiply the survey data by some factor judges to be the difference between the company job and the survey job
- Verify anomalies
  - Does any one company dominate?
  - Do all employers show similar patterns?
  - Are there outliers?

# Statistical Analysis

- Frequency distribution – unusual shapes may reflect:
  - Employers with widely divergent pay rates
  - Anomalies or outliers
- Central tendency – measure to describe a set of date
  - mode, mean, median and weighted mean
- Variation – degree of dispersion of data
  - standard deviation, quartiles and percentiles

# Update the Survey Data

- ❑ Wages paid by competitors is constantly changing, so a survey is outdated before it is available.
- ❑ Aging or trending refers to the process of updating pay data to forecast the competitive rates for the future when pay decisions are implemented

# Construct a Market Pay Line

- A market pay line links a company's benchmark jobs on the horizontal axis with market rates paid by competitors on the vertical axis.
- Approaches to constructing a market pay line:
  - Free hand approach
  - Regression Analysis
- Can then be used to set pay rates for non-benchmark jobs

# Combine Internal Structure and External Market Rates

- Merging the two components:
  - Internally aligned structure - Horizontal axis
  - External competitive data - Vertical axis
  
- Two aspects of pay structure:
  - Pay-policy line
  - Pay ranges

# From Policy to Practice: The Pay Policy Line

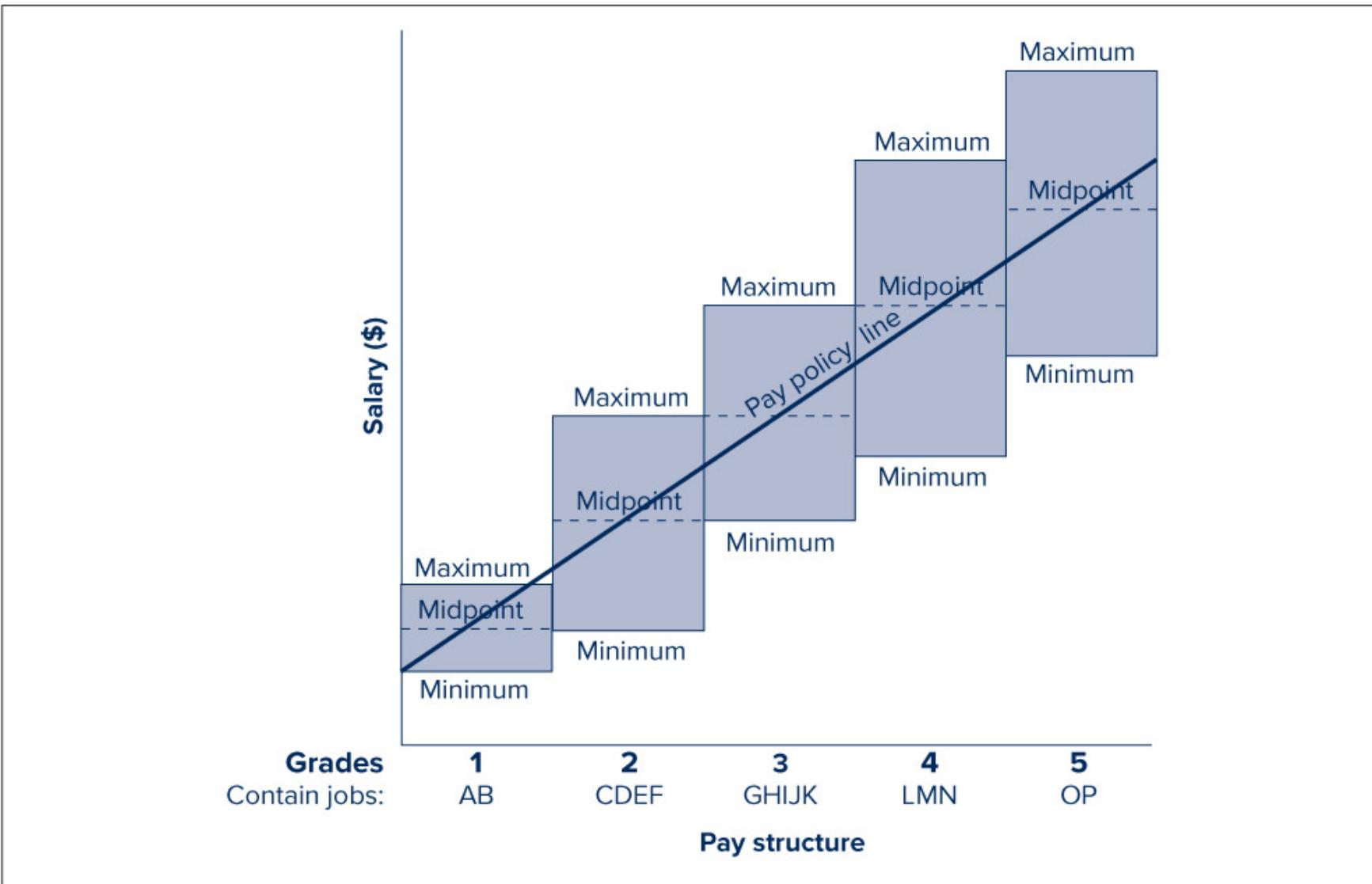
Ways to translate external competitiveness policy into practice.

- Choice of measure: a company can use a specific percentile for base pay and another percentile for total compensation.
- Specify a percent above or below market line an employer intends to “lead” or “lag”, or simply “match”

# Develop Grades

- The first step is to group different jobs considered substantially equal for pay purposes into grades. The objective is for all jobs similar for pay purposes to be in one grade.
- Grades enhance an organization's ability to move people among jobs with no change in pay
- All the jobs within a single grade will have the same pay range.
- If evaluation points are close and fall on either side of grade boundaries, the difference in salary may be out of proportion to the difference in the value of the job content.

## EXHIBIT 8.12 A Pay Structure



# Pay Ranges

- A range has three features:
  - A midpoint where the pay-policy line crosses the center of the grade, a minimum and a maximum.
- The size of the range is a judgment about how the range supports career paths, promotions, etc.
  - Larger ranges in the managerial jobs reflect the greater opportunity for performance variations in the work.
  - Some firms use percentiles as maximums and minimums while other establish them separately.

# Pay Ranges

Pay Ranges provides managers with the opportunity to deal with:

Internal pressures

- Recognize individual performance differences with pay,
- Meet employees' expectations that their pay will increase over time, even in the same job, and
- Encourage employees to remain with the organization.

External pressures

- Differences in quality among individuals applying for work,
- Differences in the productivity or value of these quality variations, and
- Differences in the mix of pay forms competitors use.

# Range Overlap

- High grade overlap and low midpoint differentials indicate small differences in the value of jobs in adjoining grades.
- The size of differentials between grades should support career movement through the structure.
- Overlap ought to be large enough to induce employees to seek promotions.
- Not all employers use grades and ranges.
  - Skill-based plans establish a single flat rate for each skill level, regardless of performance or seniority.
  - Many collective bargaining contracts establish flat rates per job.
  - Increasingly, broad bands are being adopted for greater flexibility

# Broadbanding

- Involves collapsing salary grades into a few broad bands, each with a minimum and a maximum
- Advantages over traditional approaches.
  - Provide flexibility to manage career growth and administer pay – broad banding encourages employees to seek growth by moving cross-functionally;
  - Support organizations that have eliminated layers of managerial jobs;
  - They foster cross-functional growth and development; and
  - Helps manage the reality of fewer promotions in flat organizations.
- Broad bands may be combined with traditional practices by using midpoints, zones, or other control points.

# Adjusting the Pay Structure

- A job structure orders jobs on the basis of internal factors
  - Reflected in job evaluation or skill certification
- Pay structure is anchored by the organization's external competitive position
  - Reflected in its pay-policy line
- Reconciling differences
  - May entail a review of : job analysis, job evaluation and market data
  - Differences may arise due to shortage of a particular skill, driving up market rate.

# Market Pricing

- Market pricing emphasizes external competitiveness and deemphasize internal alignment.
- Sets pay structures almost exclusively on external market rates. Pure market pricing at its extreme ignores internal alignment
- Pay structure aligned with competitors'.
  - Unique or difficult-to-imitate aspects of the pay structure are deemphasized.
  - Fairness is presumed to be reflected by market rates.

# Summary

- The decisions involved in setting externally competitive pay and designing the corresponding pay structure are specify the employer's pay policy, select relevant market competitors, design and conduct the survey, determine pay policy line, design grades and ranges or bands.
- The steps involved in survey design are deciding who should be involved, how many employers to include, which jobs to include, and what information to collect.
- Survey data reported will become out-of-date when pay is increased at various organizations at various points throughout the year. Therefore, data need to be updated to forecast competitive rates for the date when the pay decisions will be implemented.
- A market pay line links a company's benchmark jobs on the horizontal axis (job evaluation points) with market rates paid by competitors (market survey) on the vertical axis. A pay policy line represents external competitive position in the market (i.e., lead, match, lag).
- Pay grades are created by grouping jobs that are worth a similar number of job evaluation points. Pay ranges provide an upper and lower limit for pay for all jobs in a pay grade. Broadbanding is the practice of establishing large bands of jobs containing several pay grades.
- Pay structures are often adjusted to balance internal and external pressures by reviewing job analysis, the job description, and the job evaluation or market data for the job in question.