Compensation Structures

Overview

- A compensation (pay) structure is a series of ranges or grades, each with a minimum and maximum pay rate
- Well designed and properly maintained structures are essential for effective pay administration
- Topics covered in this presentation
  - Compensation structure design
  - Financial impact analysis
  - Structure implementation
  - Hiring scales
  - Employee pay assessment
  - Structure adjustments
  - Annual maintenance activities

Importance of Pay Structures

**Drive Business Outcomes**
- Attract and retain talent needed to achieve objectives
- Support operations leaders
- Optimize compensation spend

**Increase Employee Engagement**
- Foster internal equity
- Link pay and performance
- Clarify communication

**Enhance Human Resources Service Delivery**
- Equip business partners to consult with leaders on pay
- Unify pay decisions
- Promote administrative efficiency
Number of Structures

- Organizations may elect to have more than one structure
  - Usually in response to differentiation among job groups
  - Based on function or job level
  - Allows flexibility in design and maintenance
- Recommended practice is to have the fewest possible structures needed to effectively administer human resources programs and unify pay practices

Pay Grade/Range

- Range minimum – lowest financial value a job has to an organization
- Range maximum – highest financial value a job has to an organization
- Range midpoint – midway point between minimum and maximum, often the target financial value
- Jobs with similar internal and external worth grouped together in ranges
- Grade assignments based on:
  - Benchmark data
  - Strategic impact
  - Internal equity: job family/organizational level

Range Spread/Width

- The width of a pay range from minimum to maximum, expressed as a percentage ((max – min) / min)
- Range width is critical to establishing competitive pay rates at all experience levels
- Factors to consider when determining range spread
  - Tenure needed to reach full proficiency in role
  - Career trajectory or expected time in job
Midpoint Progression/Differential

- Difference between midpoints of adjacent grades
- Calibrate midpoint progression with job levels in organization
  - Target promotional increase
  - Job families
- WorldatWork guidelines
  - 5% to 12% between grades for clericals/production
  - 8% to 15% between grades for professional/management
  - 15% to 25% total midpoint differential between supervisor and subordinates
  - 20% to 35% midpoint differential between grades for executive levels

Pay Structure Illustration

<table>
<thead>
<tr>
<th>Grade</th>
<th>Minimum</th>
<th>Midpoint</th>
<th>Maximum</th>
<th>Range Spread</th>
<th>Midpoint Progression</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$20,000</td>
<td>$23,500</td>
<td>$27,000</td>
<td>35%</td>
<td>--</td>
</tr>
<tr>
<td>2</td>
<td>$21,600</td>
<td>$25,380</td>
<td>$29,160</td>
<td>35%</td>
<td>8%</td>
</tr>
<tr>
<td>3</td>
<td>$23,328</td>
<td>$27,410</td>
<td>$31,493</td>
<td>35%</td>
<td>8%</td>
</tr>
<tr>
<td>4</td>
<td>$25,194</td>
<td>$29,603</td>
<td>$34,012</td>
<td>35%</td>
<td>8%</td>
</tr>
<tr>
<td>5</td>
<td>$27,210</td>
<td>$31,971</td>
<td>$36,733</td>
<td>35%</td>
<td>--</td>
</tr>
<tr>
<td>6</td>
<td>$29,387</td>
<td>$34,529</td>
<td>$39,672</td>
<td>35%</td>
<td>--</td>
</tr>
<tr>
<td>7</td>
<td>$31,737</td>
<td>$37,292</td>
<td>$42,846</td>
<td>35%</td>
<td>--</td>
</tr>
<tr>
<td>8</td>
<td>$34,911</td>
<td>$41,021</td>
<td>$47,130</td>
<td>35%</td>
<td>10%</td>
</tr>
<tr>
<td>9</td>
<td>$37,602</td>
<td>$45,123</td>
<td>$52,643</td>
<td>40%</td>
<td>10%</td>
</tr>
<tr>
<td>10</td>
<td>$41,363</td>
<td>$49,635</td>
<td>$57,908</td>
<td>40%</td>
<td>10%</td>
</tr>
<tr>
<td>11</td>
<td>$45,499</td>
<td>$54,599</td>
<td>$63,698</td>
<td>40%</td>
<td>10%</td>
</tr>
<tr>
<td>12</td>
<td>$50,049</td>
<td>$60,058</td>
<td>$70,068</td>
<td>40%</td>
<td>10%</td>
</tr>
<tr>
<td>13</td>
<td>$55,054</td>
<td>$66,064</td>
<td>$77,075</td>
<td>40%</td>
<td>10%</td>
</tr>
<tr>
<td>14</td>
<td>$60,559</td>
<td>$72,671</td>
<td>$84,782</td>
<td>40%</td>
<td>10%</td>
</tr>
<tr>
<td>15</td>
<td>$65,113</td>
<td>$81,391</td>
<td>$97,669</td>
<td>50%</td>
<td>12%</td>
</tr>
<tr>
<td>16</td>
<td>$72,926</td>
<td>$91,158</td>
<td>$109,390</td>
<td>50%</td>
<td>12%</td>
</tr>
<tr>
<td>17</td>
<td>$81,678</td>
<td>$102,097</td>
<td>$122,516</td>
<td>50%</td>
<td>12%</td>
</tr>
<tr>
<td>18</td>
<td>$91,479</td>
<td>$114,349</td>
<td>$137,218</td>
<td>50%</td>
<td>12%</td>
</tr>
<tr>
<td>19</td>
<td>$105,201</td>
<td>$131,501</td>
<td>$157,801</td>
<td>50%</td>
<td>15%</td>
</tr>
<tr>
<td>20</td>
<td>$120,981</td>
<td>$151,226</td>
<td>$181,471</td>
<td>50%</td>
<td>15%</td>
</tr>
<tr>
<td>21</td>
<td>$139,128</td>
<td>$173,910</td>
<td>$208,692</td>
<td>50%</td>
<td>15%</td>
</tr>
</tbody>
</table>

Financial Impact Analysis

- Draft structure, assign jobs to grades
- Estimate cost of implementation by employee
- Modeling scenarios
  - To grade minimum
    - Least expensive
    - Compression concerns
  - To current position-in-range
    - Highest cost
    - Keep employee ‘whole’
  - To current position-in-range, capped (e.g., at midpoint)
Structure Implementation

- **Budget**
  - Determine cost of preferred approach
  - Establish relationship to annual adjustments
    - Separate action
    - Combine merit and structure adjustments
- **Timing**
  - Establish go-live date
  - Adjust all employees to minimum at or before implementation
  - Budgetary constraints may extend timeline – recommend no longer than 18 months
- **Communication**
  - Managers and employees
  - Recruiting

Hiring Scales

- Current pay ranges are the foundation for hiring scales
- Mechanics vary by job type
- Considerations
  - Is experience the primary determinant of starting rate?
  - Can years-of-experience be consistently calculated?
  - In what other ways are candidates assessed?
    - Education
    - Certification
    - Experience type
      - Industry
      - Leadership
  - Does the organization set maximum hire rates?

Hiring Scale – Years of Experience

- **Assumptions**:
  - Experience is primary determinant of starting rate
  - Interrater reliability of experience rating
- **Mechanics**
  - Starting rate is equal to range minimum
  - One starting rate per experience year
- **Design considerations**
  - Adjustments (education, certification)
  - Maximum hire rate
  - Calibrate hiring scale to annual increase budget
- **Note that exceptions disrupt internal equity**
Hiring Scales – Level of Qualification

• Assumptions
  – Combination of factors determine hiring rate
  – Hiring managers and recruiters can consistently categorize level of qualification

• Mechanics
  – Divide pay range into portions
  – Establish upper and lower offer limits for each
  – Hiring offer based on qualifications, within guidelines

<table>
<thead>
<tr>
<th>Level</th>
<th>Novice</th>
<th>Intermediate</th>
<th>Advanced</th>
</tr>
</thead>
<tbody>
<tr>
<td>Range Minimum</td>
<td>$40,000</td>
<td>$50,000</td>
<td>$60,000</td>
</tr>
<tr>
<td>Range Maximum</td>
<td>$60,000</td>
<td>$70,000</td>
<td>$80,000</td>
</tr>
<tr>
<td>Range Midpoint</td>
<td>$50,000</td>
<td>$60,000</td>
<td>$70,000</td>
</tr>
</tbody>
</table>

Employee Pay Assessment

• Establish target pay levels
  – Linear progression through pay range
  - Minimum to maximum
  - ‘Hockey stick’ – targets moderated in top part of range
  - Compa-ratio (Employee pay rate / Grade midpoint)

• Determine individual targets
  – Experience rating
  – Organizational tenure
  – Career assessment

• Identify employees below target pay rate
  – Determine cost to adjust
  – Budget for key increases

Structure Adjustment

• Identify update strategy
  – Consider annual movement
  – Small, frequent adjustments are easier to implement

• Determine adjustment amount
  – Market data
    - Compensation planning surveys
    - Year-over-year base pay movement
  – Calibrate structure adjustments to annual increase budget
Maintenance Activities

• Annual
  – Update market pricing
  – Adjust structures
  – Confirm grade assignments
  – Assess employee pay levels

• Ongoing
  – Implement policy and practice to assign new jobs to grades
  – Link promotion guidelines to structure design
  – Establish governance and process for off-cycle pay adjustments

Structure Maintenance