**Creating a Pay Structure**

**Why bother creating a formal pay structure?**

There are a variety of reasons why a formal structure makes sense for companies of all sizes. Many smaller organizations argue that they need more flexibility, but flexibility without guidelines or goal alignment is not supportive of good business practices. Organizations run into many of the following issues when their pay structures are arbitrary:

* Recruitment Issues:
	+ Your applicant pool is low (if you post pay) or applicants back out of job offers, and you believe the reason might be that your pay is not competitive.
	+ You unintentionally perpetuate wage disparities between men and women by basing pay not on experience or market rate but based on their pay at a previous job.
	+ You can’t advertise your positions with a pay rate internally or externally because you worry someone will be upset at the disparity between their pay and the vacant position.
* Internal Equity Issues:
	+ You pay on a negotiation basis – Some people demand and get more; others are less vocal and therefore get less. Your pay is not based on the job or on merit, but instead on caving to applicant and employee demands.
	+ When you want to promote someone, you find they are already paid more than their boss.
	+ You can’t price your positions to market because some are at-market, some are above market, and some are well below market (and you have no clearly defined business purpose for the inconsistency).
* Liability Concerns:
	+ You find that someone in a protected class has – for whatever reason – failed to keep up with pay increases like other staff and you have no idea how to defend your organization in the case of a discrimination claim.
	+ You have one very important person whose pay continues to rise because you “can’t” lose them, and now their pay is very out of line, putting you at risk.
* Morale/Turnover:
	+ Employees gossip and complain to one another about pay but you cannot speak to their concerns because there was no original logic behind the process and the system is now very hard to correct.
	+ You continue to have people note pay or lack of pay transparency on their exit surveys as the reason they are leaving your organization.

To summarize, you need a pay structure to help you be consistent, fair, and transparent. This will help you attract and retain staff and will build trust and engagement with your team.

**Now that I know why a formal pay structure is important, what do I do?**

1. Make sure you have the support of the executive team in the form of a clear “go ahead” with a commitment to review and act on the findings. As compensation is a sensitive topic and requires a financial commitment and tough decisions, it is often a project that gets dropped once executive staff realize the scope of the project and the work it entails.
2. To develop a pay structure, you must understand your organization’s strategic goals related to pay so that you can ensure your structure supports those goals.

Ask your executive staff what they consider your total rewards strategy to be (to include pay, benefits, training, incentives, etc. – all the ways that you reward and incentivize staff.) This may be a new concept in some organizations, but the goal is to help your team align your pay philosophy and total rewards strategy with your company culture, the outside competition, and your strategic goals. Without a sense of direction, you cannot move forward on your project.

Some questions to ask internally as you consider your strategy might be:

* Can the company afford to pay at market or above market for the area or marketplace where you compete (or are your finances limited, and are you considering paying below market)?
* How difficult is it to recruit in your area and how important is it to get the best employees?
* Is pay vital to your recruiting and talent plans?
* What are your benefits – Do they allow you to stay at market with pay and still give you an edge?
* How will your benefits need to change to continue attracting the talent you need?
* Surveys of employees – what do they say is important to them?
* Are there growth opportunities in your organization or are people in their current role long-term?
* Do your working conditions supplement or detract from your pay and benefits?
* What is your culture/mission/values and how should those apply to your philosophy?
1. Review this document in full and present a project plan to the executive team so they understand the process and the timeline. This will also allow them to question or object to the program if it is not in line with the company goals at the time. (For example, if you feel that you need an outside resource for surveys or market data, it is important to get the buy-in for the cost of the consultants and for the timeline on which they will execute. If executive staff needs to be present at meetings or make decisions at certain points in the project, make that clear as well.)

**What is a pay philosophy?**

A pay philosophy describes your strategy for the use of pay in incentivizing, rewarding. and engaging staff. It doesn’t just include how frequently you price to market or how you manage your annual increase process – it also includes how transparent your process will be, and how important it is for your pay structure to encourage growth in the organization or encourage retention without growth opportunities being available. As you can imagine, this philosophy is unique to your organization and sometimes needs to be specific enough to address certain positions or divisions within the organization.

The questions in the section above can help your executive staff better understand the goals that need to be met with pay and total rewards. Determining goals will help to create a philosophy specific to your organization that addresses those goals and needs.

One of the key pieces of your pay philosophy is to determine how you will “price your positions” – to include which region, industry, and job title will be matched to each role. You will need to determine which of the following options you may decide to follow in pricing your positions (or, of course, you may choose somewhere in between).

* Lead the market (matching the salary at the 75th percentile or above in salary surveys)
* Match the market (around the 50th percentile)
* Lag the market (around the 25th percentile)

Often a pay philosophy may refer to the total rewards philosophy as well. Here is an example of a pay philosophy for a cutting-edge technology company: “We want to be a market leader in innovation, so we are 25% above market rate for most positions. We believe in rewarding and retaining top talent, so we have a detailed and rigorous individual review that provides large incentive bonuses annually for top performers, a company bonus based on overall performance, and a universal cost of living increase of up to 3%.” The overall total rewards strategy might also include putting money into tuition reimbursement to keep skills sharp, for example.

Here is an example of a pay philosophy for a family-run business with stable, low-skilled workers in a non-competitive market environment: “We believe that our employees are family and deserve to be paid the market rate for their roles. While our pay may not lead the market, our employees find great pleasure in working here because they appreciate our comprehensive medical and disability protections as well as the robust 401k contributions.”

Pay philosophies can change over time and should be reviewed periodically. As an example, if the family-run business described in the example above projects a large number of people retiring in the next few years, they will have to look at the available talent in their area and what that talent is seeking in a job. If it is younger talent, the medical and retirement benefits might come second to higher pay.

A good pay philosophy addresses those headaches we mentioned at the beginning of this article, by focusing on:

* Equity
* Any liability concerns
* Competitiveness to market
* How exceptions will be handled (someone long-term who is maxed out on their pay grade, as an example).
* Transparency
* Entry pay and flexibility for attracting talent
* Financial incentives and rewards – how you motivate and retain talent

**How do I go about building a pay structure?**

This will depend based on your company’s size, complexity, and administrative capabilities. Small companies may simply price out individual positions. Even mid-sized organizations may have a limited number of jobs and see no need to create complex job bands.

If you are seeking to create a more complex structure, it is ideal to have an outside partner. A more complex structure might include developing competencies and arranging positions into different competency levels in order to price out groups of positions with aligned competencies. In this case, outside support may be needed to ensure that the process is accomplished efficiently. Remember that your executive team will likely have an emotional response to some of the pay review findings. They will not want to address issues such as a direct report who is significantly overpaid. Your judgment may be right on track, but having an outside professional who has experience in compensation analysis sometimes provides the “outside expert” that you need to gain an acceptance of that fact.

Sometimes those who are new to structuring compensation begin by looking at salary survey data (discussed later) just to see where the company currently sits with its competition in the marketplace. If you do so and you haven’t had a true philosophy for your pay in the past, you may find yourself becoming confused as you see different parts of the organization behaving in different ways, either due to manager philosophy or due to different divisional needs. Remember that all pay structures are not the same. Consider the difficulties of your organization and think through what structure might help you to resolve those obstacles administratively. Here are some examples of ways of the kinds of issues that might come up, and how you might decide to address them.

1. Your company has one division staffed by remote workers who are in high demand. You are competing nationally and sometimes internationally for a limited pool of talent. The rest of your organization is based in a small city with a low cost of living and high unemployment.

In this case, you might choose to have two different salary structures. The high-demand structure might be a “market leader” targeting the 75th percentile of salaries for each job and might even base that percentile on a larger city/region’s salary data. The remainder of the company might be at or above market for the region where it is located.

1. You have a wide range of roles with most roles being priced within the same geography and lead/lag philosophy. However, your roles don’t seem to fit from a salary range perspective. You have attempted to create ranges for similar roles, but the ranges are becoming too wide, and while you might be able to narrow it down by specifying which jobs take up which part of the range, it seems confusing and divisive. Therefore, you choose to split your ranges into three divisional categories which require just a few simple grades in each one. These are often called **“job families.”**

**How do I go about “pricing” my positions?**

1. **Review Job Descriptions:** Make sure your job descriptions are clear and up to date. To price positions, you must be able to match job duties to outside salary surveys. Titles vary, so duties are the real test of a “match.”
2. **Decide on the jobs** **you’ll price:** Sometimes instead of pricing each job, it makes sense to choose a representative benchmark job for a job group. Generally, it is important to benchmark at least 70% of the employees and to have the total number of jobs priced between 50 – 65% of the total job titles. However, the key is accuracy.

Remember that the job description you use as your benchmark should be the job in that area that encompasses the most similar tasks across jobs and is most representative.

1. **Find surveys relevant to your organization:** These may be regional surveys, such as Catapult’s (free to members) or national surveys (Catapult participates in those as well). Avoid using survey data that does not include a large sample or is a free “survey” from the web with little back up information on how the survey was conducted. Try to have two surveys at a minimum so you can have at least two data sets for each job. However, if you can only find one survey with the job on it, and there are plenty of relevant participants, you may have to do your best with what you have. In addition to Catapult salary surveys, Catapult [offers members](https://letscatapult.org/membership/membership-overview/) [access](http://access) to PayScale’s real-time, local and national data.

Look for data specific to your industry and to your region. An HR Manager at a plant in Alabama is going to be paid differently than an HR Manager at a high-tech company in New York City. Industry and professional organizations are great places to go for specific data.

1. **Match your benchmark jobs to the jobs in the surveys:** Make clear notes about which jobs you matched and why; it may be important for the next step, and for any challenges that may come your way as you discuss the numbers with your executive team. For example, if a job seems to be at a lower level than yours because of the scope of the role, the size of the companies participating in the survey, or simply because your company is fairly unique as to the number of sites covered or complexity of data, you should note this.
2. **Verify and correct data:**
	1. Look for odd data. For example, if you have three surveys and one survey indicates that a job is paid 30% higher than both other surveys, try to figure out why and adjust. Generally, companies look at the 50th percentile and average upon that data point, but you might choose higher or lower in the case that you are choosing to lead or lag the market. Some ways to adjust include:
		1. Throwing out the data from one survey if it seems completely irrelevant (low number of participants or incorrect industry). For example, if you are a small non-profit and most of the participants in your non-profit surveys are hospitals that traditionally pay more than smaller non-profits, you might choose to throw out the data point altogether.
		2. Adjust the data: If your data is from another region of the country, determine the cost-of-living variables between the two regions or cities and decrease or increase the salary point appropriately.
		3. When you tagged jobs for a match, you will have noted anything that seemed “off” or “mismatched.” This is a good time to review your notes and the salary data points. You may choose to make some minor adjustments up or down based on those notes (generally if you are exceeding 20% above or below the data point, you need to choose another piece of job data.)
		4. Average data from multiple surveys: You may choose to weight as a simple average with the number of employers or employees in the survey, or if you feel one survey is extremely relevant, you might weight it double in the average.
		5. Age data – Sometimes the only survey you can find that seems relevant is also out of date as compared to the other surveys. If it is more than a year or two old, you may simply want to not use the data. However, you can choose to age the data over a year or two by determining the number of months between the dates of the surveys and assigning that percent of an annual aging factor to be added to the older data. That factor could be COLA, CPI, or internal average increases.
3. **Compare current pay to market data:**

Using current pay for your employees, determine the outliers. Typically, you will specifically target those over or under 20% below the data point you have used as your average. This should give you an idea of whether you have selected a good match or not. If all your employees (throughout the company) are below market, that shows consistency. You are especially looking for cases that are outside the norm for your company so that you can investigate further – is it a survey issue or an internal issue?

This is also a good time to have a follow-up conversation with your executive team. Are they surprised by the data? What are their initial reactions? This will help them begin absorbing the results of the survey and begin thinking about next steps. Often you may get pushback at this time stating that you must have your numbers wrong. Make sure you have your backup with you and reiterate that you have followed the standard procedure of identifying matching jobs by job duties and discuss how you have adjusted the data to match.

1. **Group the jobs into grades and consider if multiple job families are necessary.**

If your jobs are radically different from one another in separate divisions of the company, you might choose to have separate job grades for certain job families. (For example, Administrative and Operations could each be a job family with their own set of job grades and pay structure.

There are many ways to group jobs together. The most complicated and least used is the Point-Factor Method, which is best facilitated by an outside organization. **Contact Jackie Esposito, Compensation Advisor, jackie.esposito@letscatapult.org if you need assistance evaluating your pay strategy, or cost of labor for multiple locations.**

If you are performing the analysis yourself, you may consider simpler methods, such as:

* Ranking jobs by perceived value in relation to the other jobs at the company. For smaller companies, this may be easy to do. As the organization gets more complex, division heads and executives may have a more difficult time coming to an agreement and will tend to perceive that the jobs relevant to their own success, and those which they understand the complexities of, are more important.
* Setting up some pre-determined skill and responsibility levels to create a set of grades, then classifying your jobs based on their job description. This process should involve factors that you determine as a company, and HR staff should individually assist managers in the process so that they can ask questions and try to ensure common decision-making between management. Final decisions may be run by the compensation committee to discuss any areas of concern.

All these methods require agreement from the organization on what factors are important as it can be easy to argue that one job should be bumped to the next grade level, significantly changing the role's pay. None of these methods take market pay levels into account, so there may need to be additional discussions if there is a job with market pay that is outside the general grade for the level of responsibility and skill.

1. **Create pay ranges for each job grade:**

The pay range for a position will depend on how precise the job grade is (how many jobs it encompasses and what differentiates those jobs), the amount of growth or longevity in a particular role, the length of time that it takes to become proficient in the role (complexity) and the range of decision-making and expanse of responsibility of the jobs within a role.

Keep the considerations above in mind when considering the following decision points:

* **Midpoint:** This is the point that you will determine using the appropriate percentile in your salary surveys (lagging, meeting, or leading the market). The midpoint is the point at which someone has become proficient at the job. For many jobs, this may be 2-3 years. Some individuals with experience may come into a particular role close to this level, only needing another year of relevant industry/company experience to be proficient in their role.
* **Minimum and** **maximum of range:** This is not set based on market data as the midpoint may be, as the market data can vary and result in arbitrary ranges. Ranges vary based on the grade. As an example, for a role that is entry-level and takes only a few months of experience to become proficient, the minimum may not be far below the mid-point of the range, and the maximum that you are willing to pay may not be much above the mid-point. For that reason, lower-level, less complex roles generally have a narrower range.

However, more senior positions may have a wide range, and the job duties, knowledge, and responsibilities may vary greatly. For example, a VP of HR has responsibility for overall company compliance and direction, whereas a VP of Sales may have a more limited scope (the sales processes). Two different division directors may manage divisions of varying size and complexity. Sometimes the job grades may differ, the ranges may be wider to encompass all required roles. It is part of your job to talk with the executive team about the structure that makes the most sense for your organization – Multiple pay structures per division? Wider ranges? Additional job grades?

Salary range spreads (min to max) can vary from 30 – 60%.

To find a minimum and a maximum when you already have your midpoint, decide a target for the width of your range, then use the following calculations:

Minimum = Midpoint

 (1 + (width/2))

Example: if your midpoint is 25K, and you want a 30% spread, you would divide $25K by (1 + 30%/2), or 1.15.

$25,000 divided by 1/15 is 21,739.13 which would be the minimum of your range.

Maximum = Minimum \* 1 + width

In this case 1 + width would be 1.3), so 21,739.13 multiplied by 1.3 is the maximum of the range: 28,260.87

* **Range overlap and Midpoint progression:**

**Range overlap:** Ranges that are closely related tend to overlap. For example, a new lead retail salesperson may make less than someone who has been a retail associate for 5 years. Too much overlap and it may not encourage advancement; too little and it can artificially inflate the value of the related position.

Although you may have already built salary ranges, you might choose to tweak the minimum and maximum to adjust the range spread or overlap.

**Midpoint progression** indicates the distance between midpoints.

Midpoint Difference (expressed as percentage) = Higher Midpoint – Lower Midpoint

 Lower Midpoint

Compensation analysts have different philosophies on midpoint progression, some advocating that all midpoints have the same differential. In the case that is your goal, it may mean having “empty” salary grades which can be confusing if you are trying to be transparent about your salary structure. However, it can also be confusing when grade differentials are significantly different from one position to another (why did Juan get a 45% increase for a change to a new pay grade when I only got a 20% increase)?

Other experts believe midpoint progression should be based on the level of the job, ranging from 5 - 30% depending on the level of the role. Consider your goals with your plan and choose the method that works best for you. No matter what you decide, running the numbers each time to review and update your grades is a good quick check to identify potential concerns.

1. **Review your internal findings and adjust ranges if needed.**

Run your current staff pay against the ranges to find any outliers. Make sure when doing so that you compare apples to apples (if someone works part-time, make sure the pay is expressed as full-time for comparison). Here are some good points of data to review:

* Under midpoint or above max? (If this occurs for a significant number of staff in one area, you may want to review your strategy and survey information again.)

**Under minimum:** Consider a strategy to adjust (immediately or over time) anyone who is below the midpoint to the appropriate area of the range.

**Over max (or close to it):** Consider a strategy to avoid the pay issue increasing over time with additional annual increases. For example, consider no longer providing annual increases, and instead providing a lump sum bonus to avoid increasing the base pay rate until your wage range shifts in future salary reviews.

* **Compa-Ratio:** Run the compa-ratio for your staff (their individual salaries divided by the midpoint of the salary range multiplied by 100), and sort by hire date. How do the two line up? Compa-ratio is an expression of where your staff fall in the pay range: .9 to 1.1 for a proficient individual is generally a target. New employees would have a lower compa-ratio, and more experienced staff a higher one. (Range Penetration and Market Index analyses are other options to identify your staff’s relationship to the market rate or to the midpoint of your range.)

Identify areas of concern to review and correct with executive staff. Remember to make notes as you analyze each situation so that you will remember your logic and recommendations.

If you are in a situation where your company has determined they want to meet the market and finds they are lagging by 10%, it may not be in the budget to adjust everyone at once. The analysis of how to react will be complex. You can certainly raise starting pay, but this will cause pay compression for staff members who have been in place for longer and are now underpaid compared to newer staff.

You might choose instead to target a rate two years out (the rate can be reviewed based on salary trends each year) with a number of smaller increases to entry pay and adjustments to overall wages, hoping that your aged rate will bear out when you review salaries in the future. Remember that salary planning is an evolving process that must line up with your evolving goals and strategies and which must be continually reviewed considering market conditions and wage trends. For this reason, you should review salary to market regularly (many companies choose to do this annually).

While the initial salary planning and wage analysis process is a difficult and frustrating one, the ongoing review is much easier, and if you maintain your philosophy in line with strategic goals, you will have a clear path to achieving the targets you have set out for yourself. In addition, your strategy will be clearly defined, well researched, and more transparent to your staff.

Written by a Catapult Advisor.