



COMPENSATION MANAGEMENT

CHAPTER 8 (Study unit 7)

Designing pay levels, mix and pay structures

Chapter Topics

- Major Decisions
- Specify Competitive Pay Policy
- The Purpose of a Survey
- Select Relevant Market Competitors
- Design the Survey
- Interpret Survey Results and Construct a Market line
- From Policy to Practice: The Pay-Policy Line

Chapter Topics (cont.)

- From Policy to Practice: Grades and Ranges
- From Policy to Practice: Broad Banding
- Balancing Internal and External Pressures: Adjusting the Pay Structure
- Market Pricing
- Review

Exhibit 8.1 Determining Externally Competitive Pay Levels and Structures

EXHIBIT 8.1 Determining Externally Competitive Pay Levels and Structures



Some Major Decisions in Pay-Level Determination

- Specify pay-level policy.
- Define purpose of survey.
- Specify relevant market.
- Design and conduct survey.
- Interpret and apply result.
- Design grades and ranges or bands.

Specify Competitive Pay Policy

- A survey is the systematic process of collecting and making judgments about the compensation paid by other employers
- Surveys provide the data for translating policy into pay levels, pay mix, and structures

The Purpose of a Survey

An employer conducts or participates in a survey for a number of reasons:

- Adjust the pay level in response to changing rates paid by competitors
- Set the mix of pay forms relative to that paid by competitors
- Establish or price a pay structure
- Analyze pay-related problems
- Estimate the labor costs of product/service market competitors

Select Relevant Market Competitors

- Relevant labor market includes employers who compete
 - For same occupations or skills
 - For employees in same geographic area
 - With same products and services
- Fuzzy markets

Design the Survey

- Who should be involved?
- How many employers?
 - Publicly Available Data
 - “Word-of-mouth”
 - Where are the standards?
- Which Jobs to include?
 - Benchmark-job approach
 - Exhibit 8.6: Benchmarks
 - Low-High approach
 - Benchmark conversion approach

Exhibit 8.6: Benchmarks

EXHIBIT 8.6 Benchmarks

Managerial Group	Technical Group	Manufacturing Group	Administrative Group
Vice Presidents	Head/Chief Scientist	Assembler I Inspector I	Administrative Assistant
Division General Managers	Senior Associate Scientist	Packer	Principal Administrative Secretary
Managers	Associate Scientist	Material Handler Inspector II	Administrative Secretary
Project Leaders	Scientist	Assembler II	Word Processor
Supervisors	Technician	Drill Press Operator Rough Grinder	Clerk/Messenger
		Machinist I Coremaker	

Design the Survey (cont.)

- What information to collect?
 - Organization data
 - Total compensation data

Exhibit 8.7: Possible Survey Data Elements and Rationale

EXHIBIT 8.7 Possible Survey Data Elements and Rationale

Basic Elements	Examples	Rationale
Nature of Organization		
Identification	Company, name, address, contact person	Further contacts
Financial performance	Assets, sales, profits, cash flow	Indicates nature of product/service markets, ability to pay, size, and financials
Size	Profit centers, product lines	Importance of specific job groups
Structure	Total number of employees	Impact on labor market
	Organizational charts Percent of employees at each level	Indicates how business is organized Indicates staffing pattern
Nature of Total Compensation System		
Cash forms used	Base pay, pay-increase schedules, long- and short-term incentives, bonuses, cost-of-living adjustments, overtime and shift differentials	Indicate the mix of compensation offered; used to establish a comparable base
Noncash forms used	Benefits and services, particularly coverage and contributions to medical and health insurance and pensions	
Incumbent and Job		
Date	Date survey data in effect	Update to current date
Job	Match generic job description	Indicates degree of similarity with survey's key jobs
	Reporting levels	Scope of responsibilities
Individual	Years since degree, education, date of hire	Indicates training tenure
Pay	Actual rates paid to each individual, total earnings, last increase, bonuses, incentives	
HR Outcomes		
Productivity	Revenues/employee	Reflect organization performance and efficiency
Total labor costs	Revenues/labor costs Number of employees × (averages wages + benefits)	Major expense
Attraction	Yield ratio: Number accepting offers/Number of job offers	Reveals recruiting success, a compensation objective
Retention	Turnover rate: Number of high or low performers who leave/ Number of employees	Reveals outflow of people, which is related to a compensation objective
Employee views	Total pay satisfaction	Reveals what employees think about their pay

Exhibit 8.8: Advantages and Disadvantages of Measures of Compensation

EXHIBIT 8.8 Advantages and Disadvantages of Measures of Compensation

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 (base + bonus)	Tells how competitors are valuing work; also tells the cash pay for performance opportunity in the job	All employees may not 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. Be careful: Don't set base equal to competitors' total compensation. Risks high fixed costs.

Interpret Survey Results and Construct a Market Line

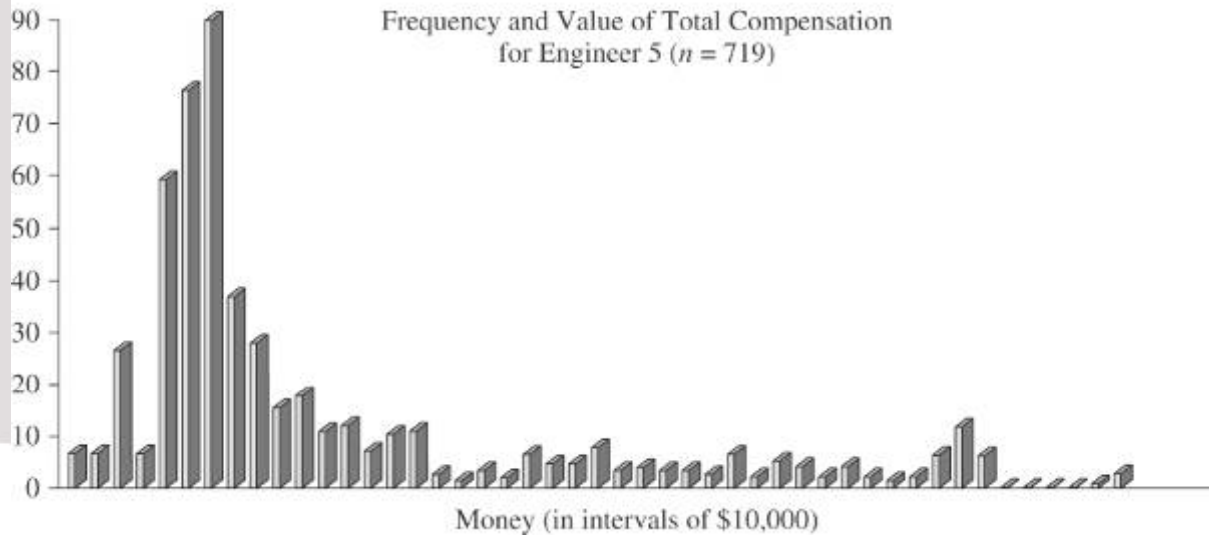
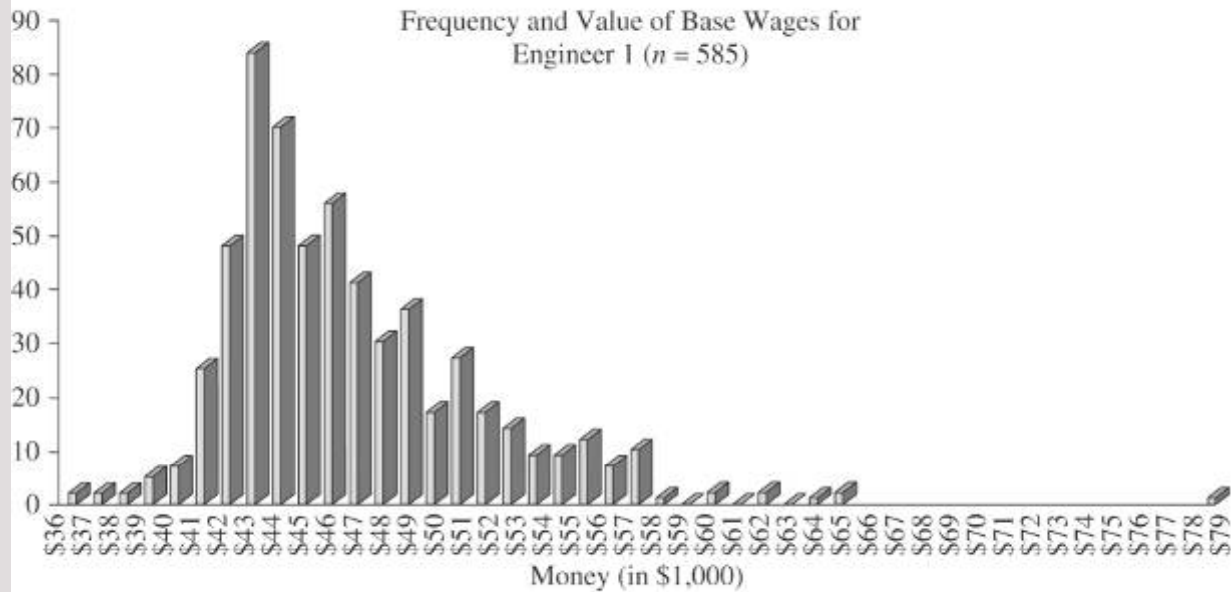
- Verify data
 - Check accuracy of job matches
 - Survey leveling
 - Check for anomalies
 - Does any *one* company dominate?
 - Do all employers show similar patterns?
 - Outliers?

Interpret Survey Results and Construct a Market Line (cont.)

- Statistical analysis
 - Frequency distribution
 - Measures of central tendency
 - Mode
 - Mean
 - Median
 - Weighted mean
 - Measures of variation
 - Standard deviation
 - Quartiles and percentiles

Exhibit 8.11 Frequency Distributions

EXHIBIT 8.11 Frequency Distributions

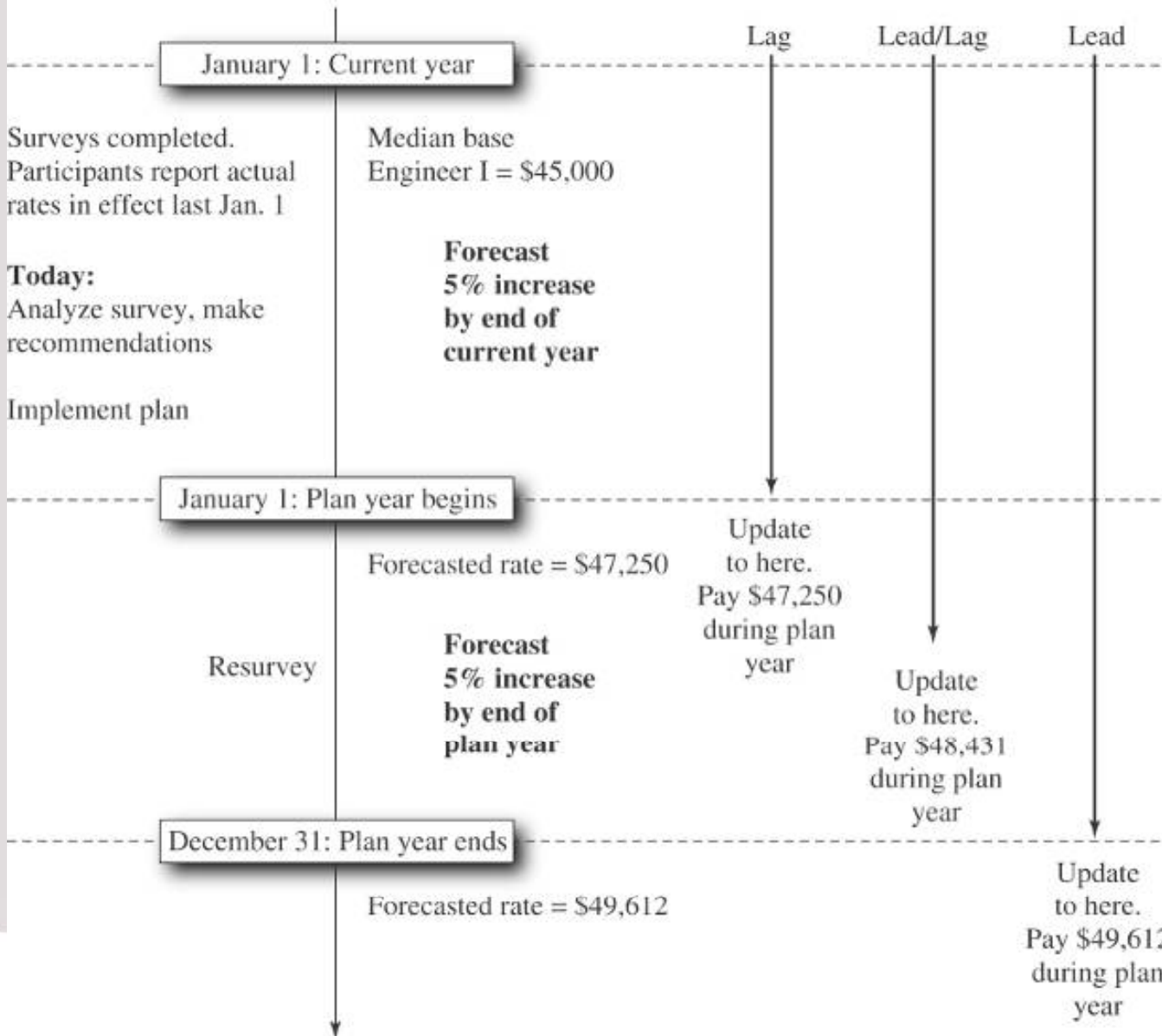


Interpret Survey Results and Construct a Market Line (cont.)

- Update the survey data
 - Aging or trending : Pay data is updated to forecast the competitive rates for the future date when the pay decisions will be implemented

Exhibit 8.13 Choices for Updating Survey Data Reflect Pay Policy

EXHIBIT 8.13 Choices for Updating Survey Data Reflect Pay Policy

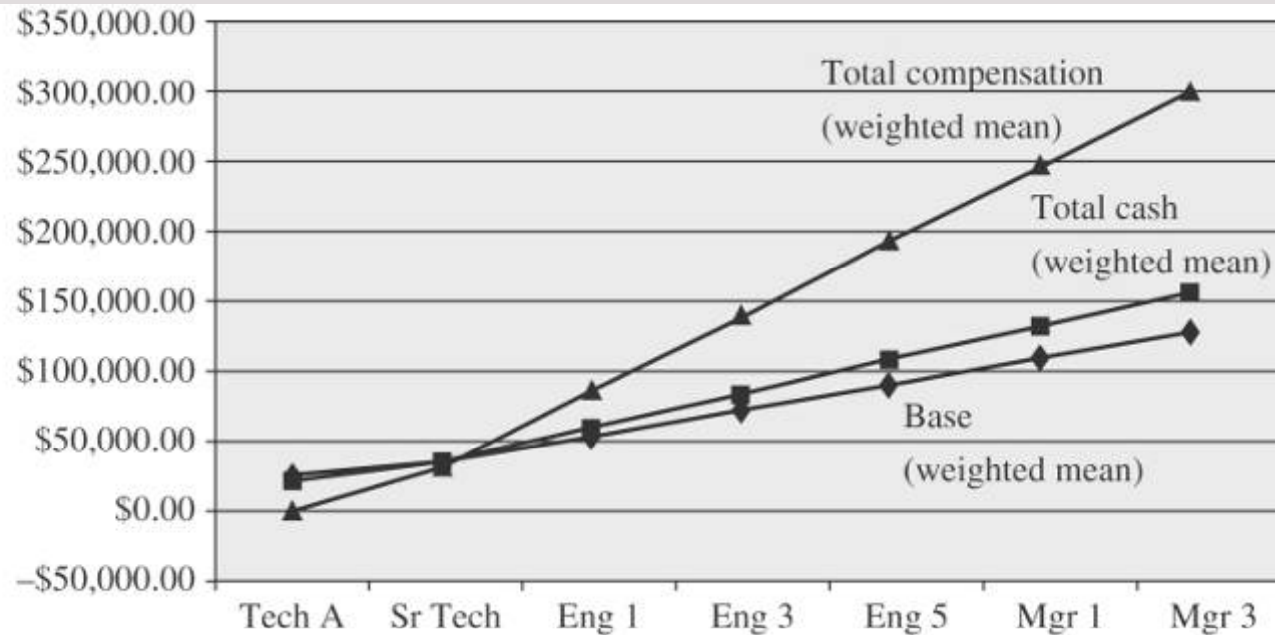


Construct a Market Pay Line

- A market line links a company's benchmark jobs on the horizontal axis with market rates paid by competitors on the vertical axis. It summarizes the distribution of going rates paid by competitors in the market
- Approaches to constructing a market pay line
 - Free hand approach
 - Regression Analysis

Exhibit 8.14: From Regression Results to a Market Line

EXHIBIT 8.14
From
Regression
Results to a
Market Line

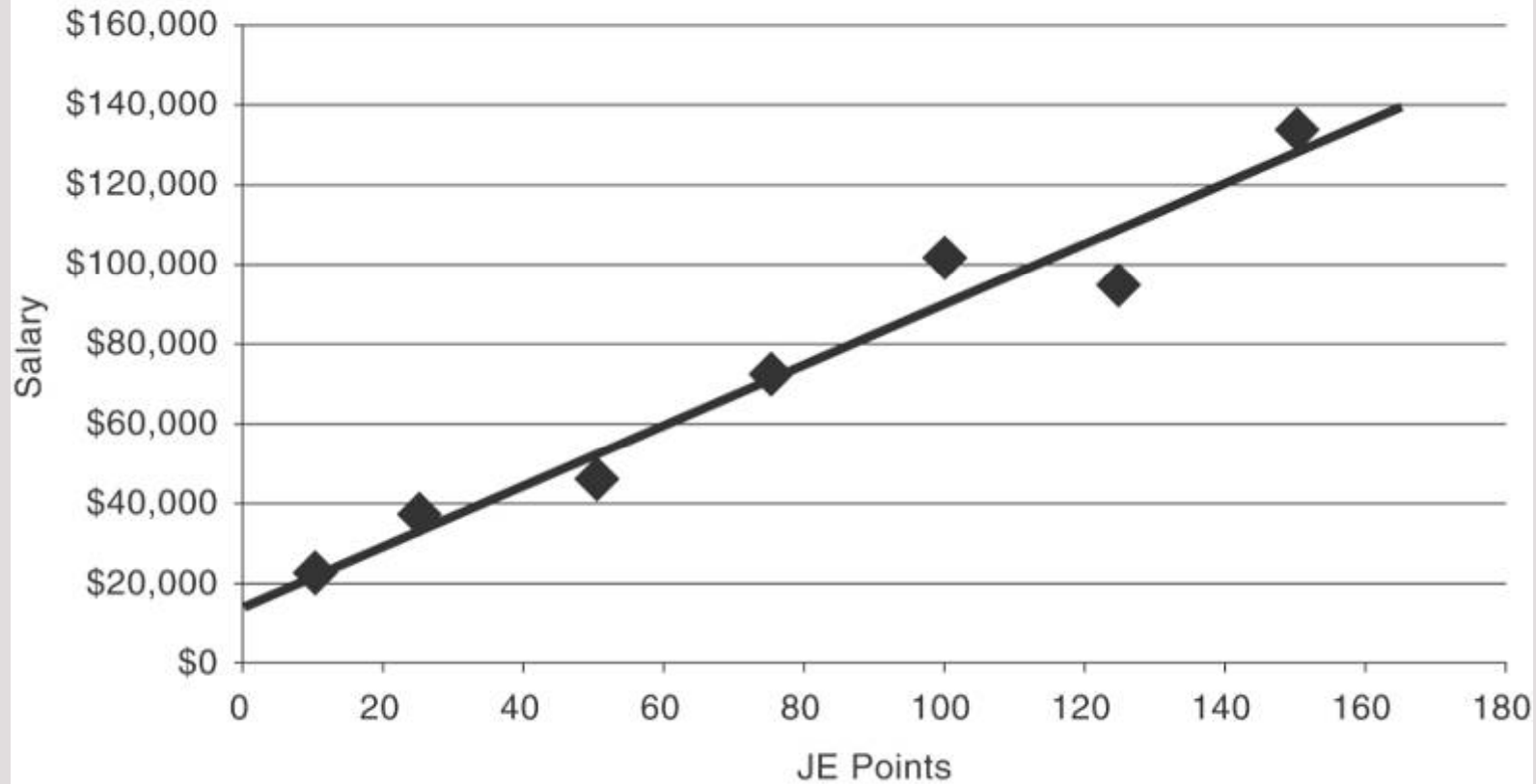


JOB

Job	JEPTs	Predicted Base, Wtd Mean	Predicted Cash, Wtd Mean	Predicted Total Comp
Tech A	10	\$23,057.96	\$20,543.71	-\$1,330.36
Sr Tech	25	\$34,361.06	\$35,116.51	\$31,172.24
Eng 1	50	\$53,199.56	\$59,404.51	\$85,343.24
Eng 3	75	\$72,038.06	\$83,692.51	\$139,514.24
Eng 5	100	\$90,876.56	\$107,980.51	\$193,685.24
Mgr 1	125	\$109,715.06	\$132,268.51	\$247,856.24
Mgr 3	150	\$128,553.56	\$156,556.51	\$302,027.24

Exhibit 8.15: Understanding Regression

EXHIBIT 8.15 Understanding Regression



Tech A	Sr Tech	Eng 1	Eng 3	Eng 5	Mgr 1	Mgr 3
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Market measure
Equation
R-squared

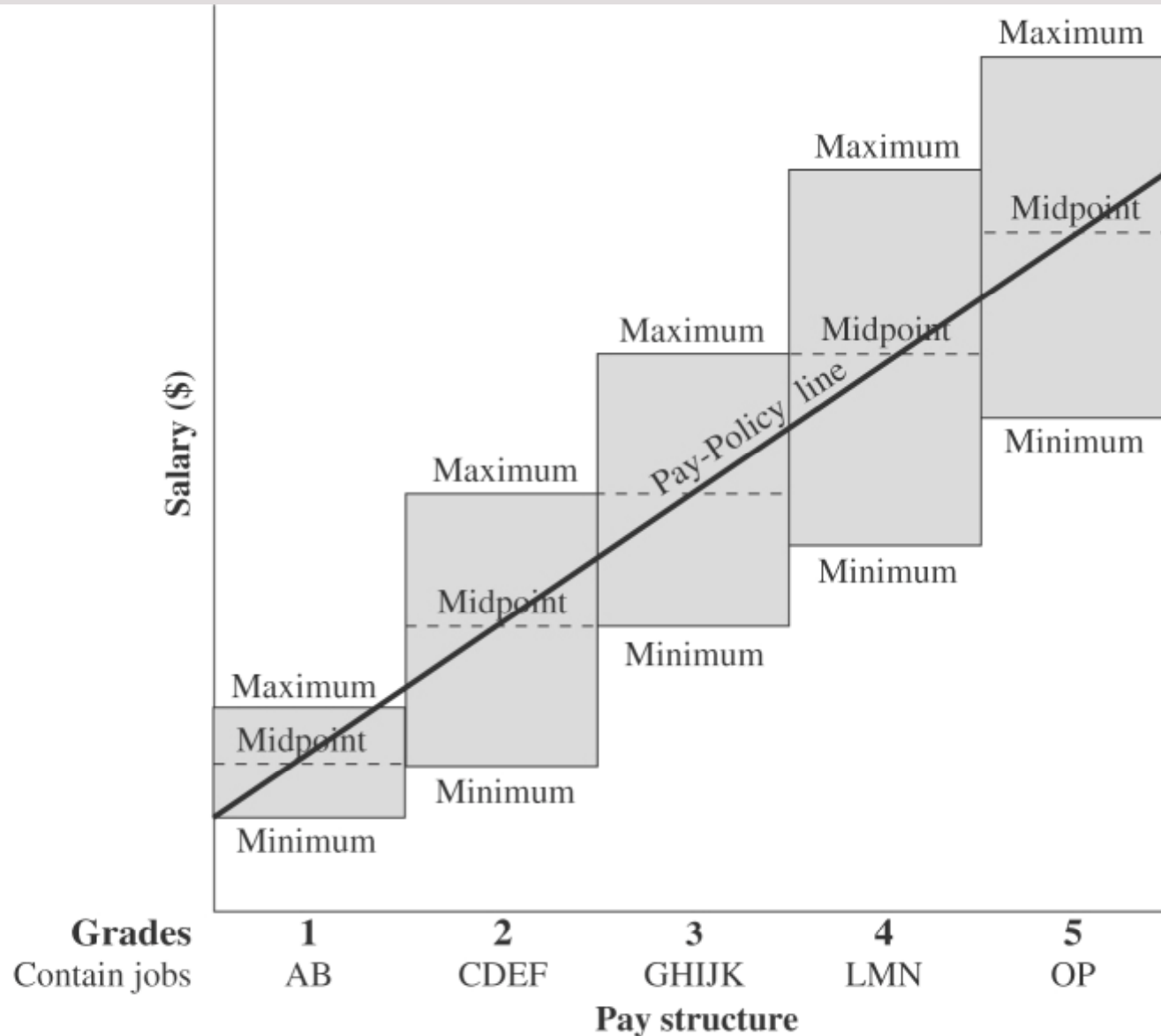
Base wage (weighted mean)
 $y = 15522.56 + 753.54x$
0.954

Combine Internal Structure and External Market Rates

- Two parts of the total pay model have merged
 - Internally aligned structure - Horizontal axis
 - External competitive data - Vertical axis
- Two aspects of pay structure
 - Pay-policy line
 - Pay ranges

Exhibit 8.16: Develop Pay Grades

EXHIBIT 8.16
Develop Pay
Grades



From Policy to Practice: The Pay Policy Line

- Approaches to translate external competitive policy into practice
 - Choice of measure
 - 50th percentile for base pay
 - 75th percentile for total compensation
 - Updating
- Policy line as percent of market line
 - Specify a percent above or below market line an employer intends to match
 - Other options
 - Pay among the leaders
 - Lead for some job families and lag for others

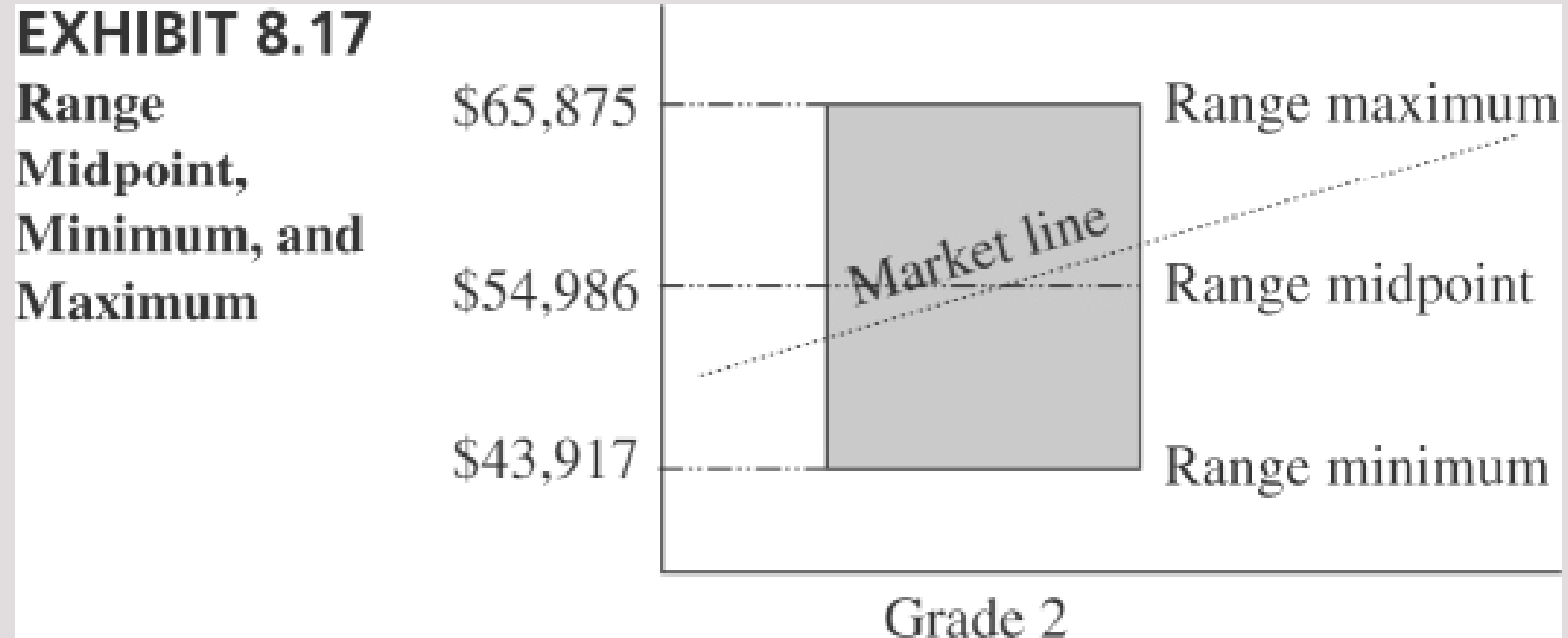
From Policy to Practice: Grades and Ranges

- Why bother with grades and ranges?
 - Offer flexibility to deal with pressures from external markets and differences among firms
 - Differences in quality among individuals applying for work
 - Differences in the productivity or value of these quality variations
 - Differences in the mix of pay forms competitors use
- A pay range exists whenever two or more rates are paid to employees in the same job
 - Recognize individual performance differences with pay
 - Meet employees' expectations that their pay will increase over time, even in the same job
 - Encourage employees to remain with the organization

From Policy to Practice: Grades and Ranges (cont.)

- Develop grades
 - Grades enhance an organization's ability to move people among jobs with no change in pay
 - Each grade will have its own pay range
 - All the jobs within a single grade will have the same pay range
- Establish range midpoints, minimums, and maximums
 - What size should the range be?
 - Size of range based on judgment about how ranges support
 - Career paths
 - Promotions
 - Other organization systems

Exhibit 8.17: Range Midpoint, Minimum, and Maximum



From Policy to Practice: Grades and Ranges (cont.)

- Typical ***range spread***

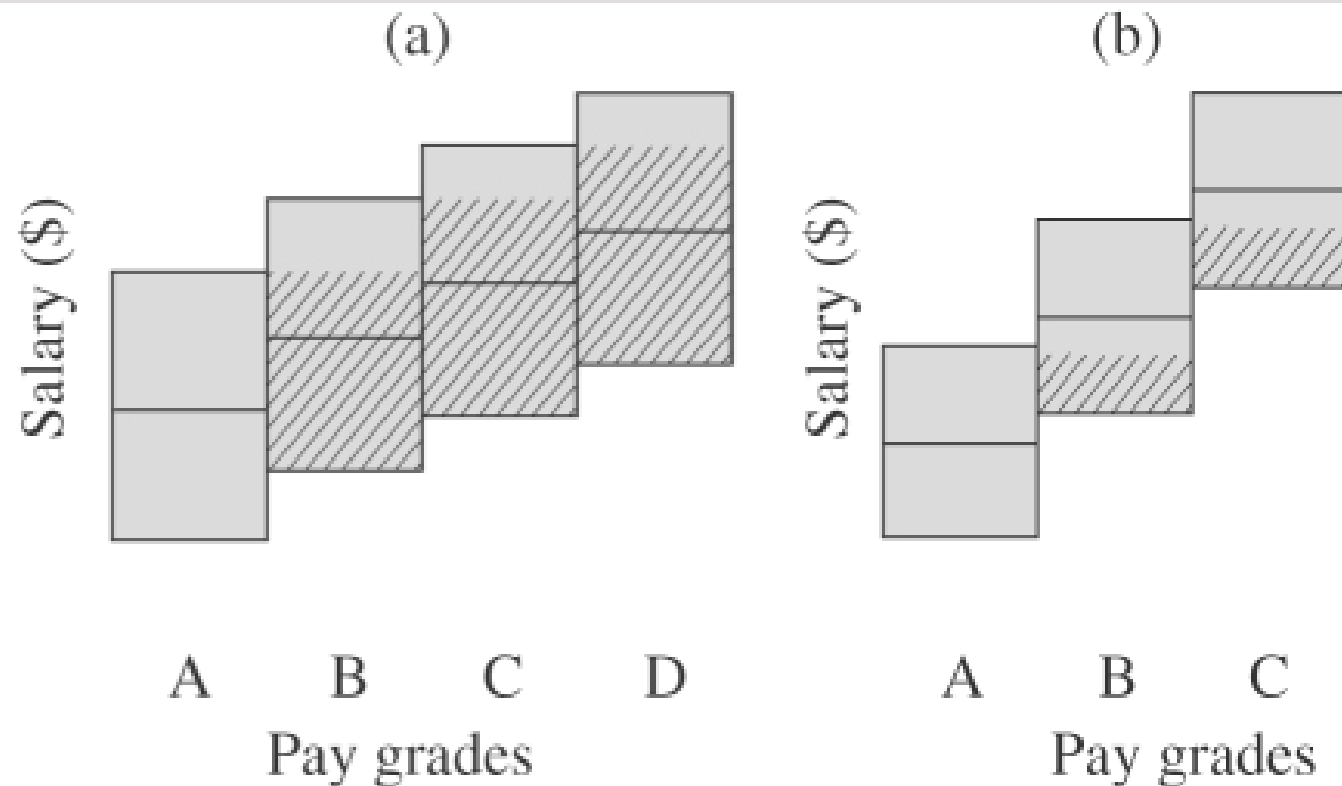
- Top-level management positions – 30 to 60% above and below midpoint
- Midlevel professional and managerial positions – 15 to 30% above and below midpoint
- Office and production positions – 5 to 15% above and below midpoint

Overlap

- Refer to Exhibit 8.18 in the next slide
- Importance of **Overlap**
- High degree of overlap and low midpoint differentials indicates small differences in the value of the jobs in the adjoining grades
- Small ranges with less overlap
- Being promoted from one grade to another may include a title change but not much change in pay
- Smaller ranges (Exhibit 8.18 (b)) create less overlap. This permits the manager to reinforce a promotion into a new grade with a larger pay increase. Downside to this – fewer opportunities for promotion

Exhibit 8.18: Range Overlap

EXHIBIT 8.18
Range Overlap



From Policy to Practice: Broad Banding

- Involves collapsing salary grades into a few broad bands, each with a sizable range
 - One minimum and one maximum
 - Range midpoint often not used: band encompasses so many differing values
- Purposes
 - Provide flexibility to define job responsibilities more broadly
 - Foster cross-functional growth and development
 - Ease mergers and acquisitions

Exhibit 8.19: From Grades to Bands

EXHIBIT 8.19
From Grades
to Bands

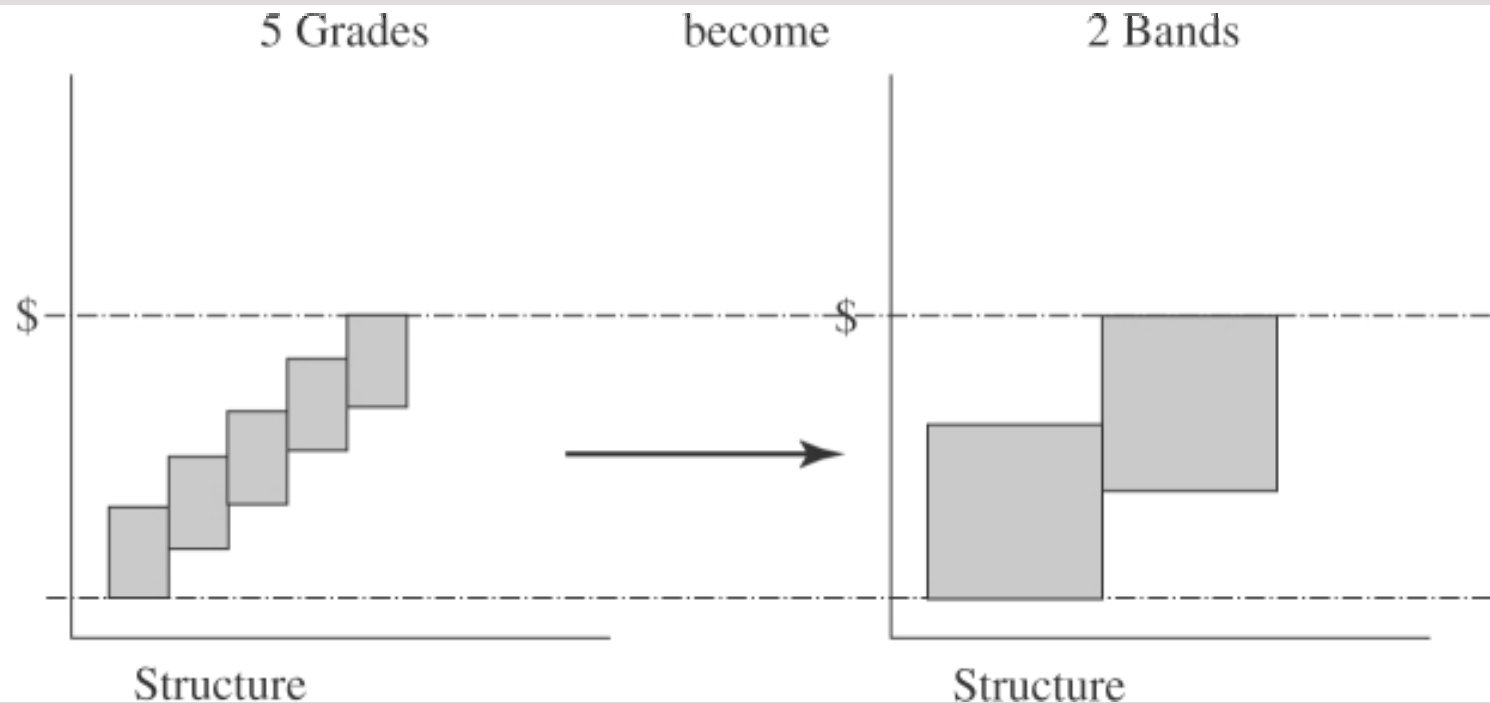


Exhibit 8.20: Contrasts Between Ranges and Bands

EXHIBIT 8.20 Contrasts between Ranges and Bands

Ranges Support

Some flexibility within controls
Relatively 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

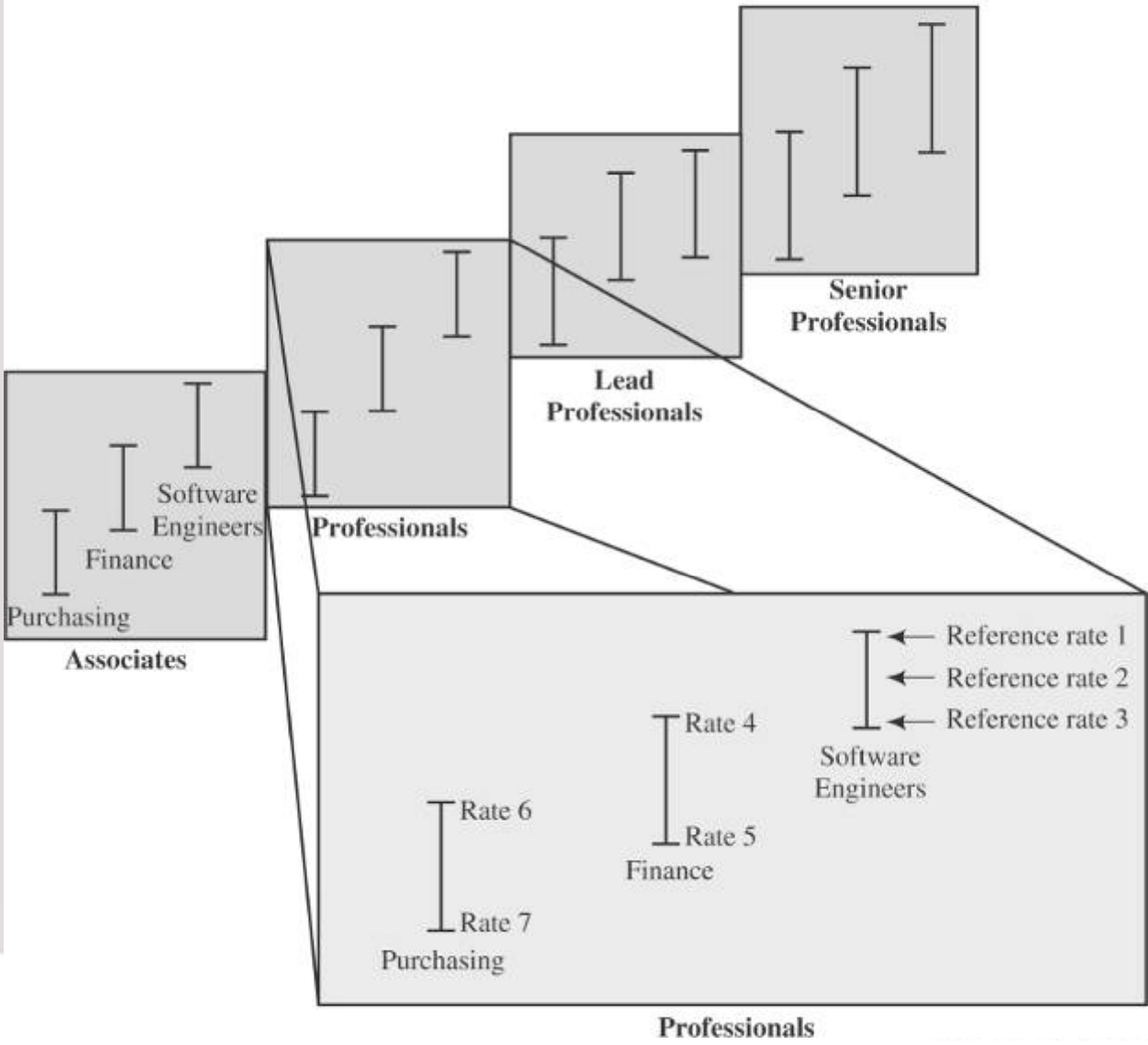
Emphasis on flexibility within guidelines
Global organizations
Cross-functional experience and lateral progression
Reference market rates, shadow ranges
Controls in budget, few in system
Give managers "freedom to manage" pay
100–400 percent spread

Steps Involved in Broad Banding

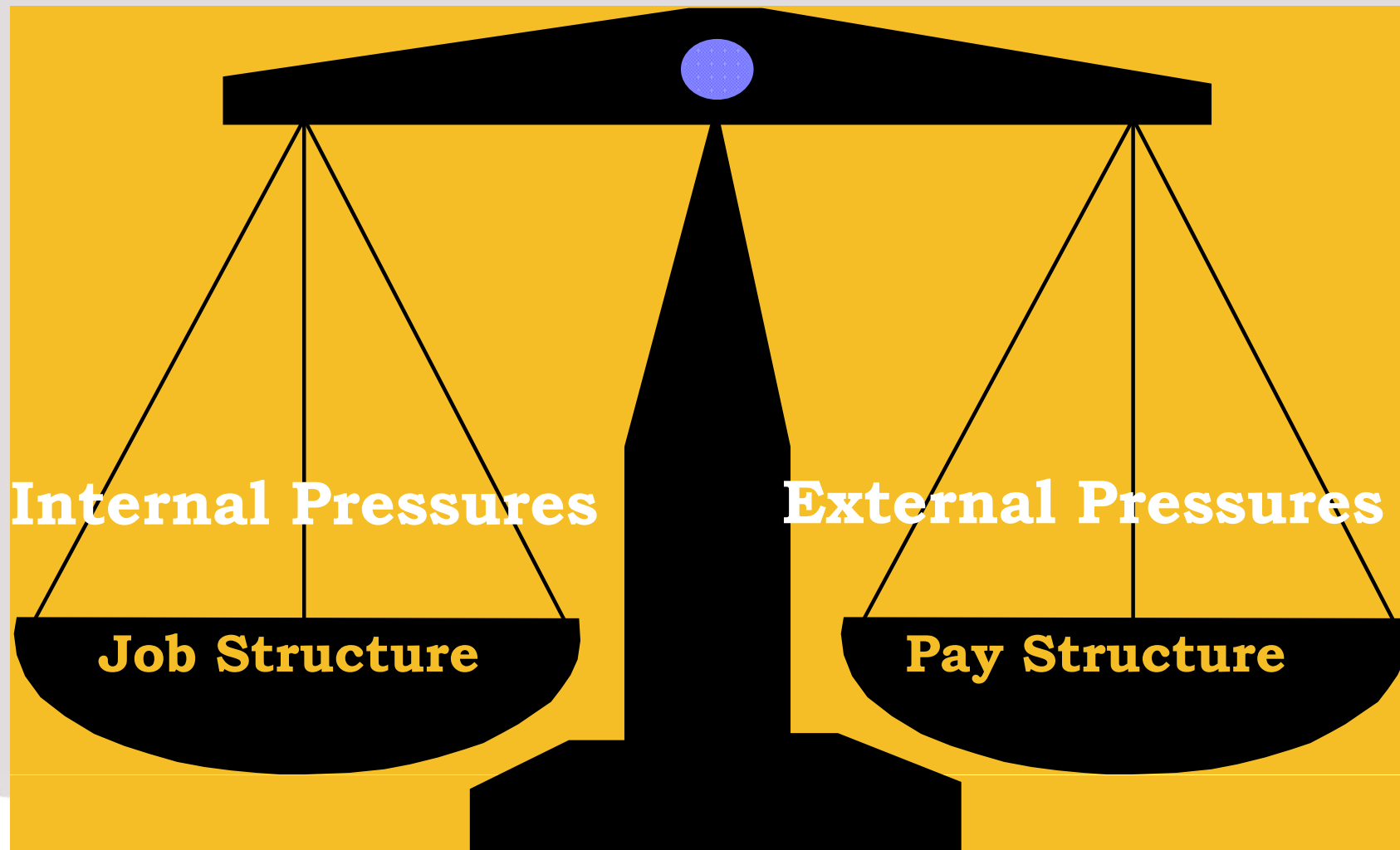
- Set the number of bands
- Price the bands: Reference market rates
 - Reference rates
- Flexibility-Control

Exhibit 8.21: Reference Rates Within Bands

EXHIBIT 8.21 Reference Rates within Bands



Balancing Internal and External Pressures: Adjusting the Pay Structure



Market Pricing

- Issues
 - Validity of market data
 - Use of competitors' pay decisions as primary determinant of pay structure
 - Lack of value added via internal alignment
 - Difficult-to-imitate aspects of pay structure are deemphasized
 - Fairness
- Market pricing: pay strategies that emphasize external competitiveness and deemphasize internal alignment
 - Sets pay structures almost exclusively on external market rates
- Objective
 - Is to base most of the internal pay structure on external rates, breaking down the boundaries between the internal organization and the external market forces

Your turn

Answer the end of chapter 8 review questions