Designing Strategic Salary Structures

Salary structures provide guidelines for making pay-related decisions within an organisation, bridging the gap between where you are today and where you want to be tomorrow (target pay positioning). **CEDRIC NG MONG SHEN** shows, in six simplified steps, how to design such strategic salary structures.

Your CEO has just returned from a management retreat with a new strategic business plan that will revitalise the company and lead it into lucrative new markets. As the Director of Compensation and Benefits, you are charged with translating the strategic business plan into a pay strategy that supports the company's vision and business strategy. But do you know what to do?

To design the salary structures that drive business results and performance, you need to know which positions are 'hot skills', which positions are difficult-to-hire, which positions have high attrition rate, which employees are talents, which employees are under-performers and which functions are strategic functions. Each of these has implications for designing a salary structure that drives business results and performance.

ESTABLISH YOUR PAY POSITIONING

Your salary structure should reflect the pay positioning of your organisation. Is your pay positioning at the 40th, 50th, 60th or 75th percentile of the market? If you have different pay positioning for different grades, your salary structure should reflect that. Many companies like to follow the herd by positioning their pay at the 50th percentile for all positions. Companies that blindly copy competitor's pay positioning ignore the significance of an organisation's benefits and employer brand. As an example, some companies differentiate by positioning their benefits at the 75th percentile and positioning their compensation at the 40th percentile. Establish your pay positioning by considering your unique company's circumstances such as affordability, difficult-to-hire positions, difficult-to-retain positions, competitor practices and business strategy/stage.

DETERMINE JOB-WORTH HIERARCHY

After establishing your pay positioning, you need to establish the job-worth hierarchy by evaluating the relative value of each job's contribution. Job evaluation is a systematic process for measuring the relative worth of jobs. It does not mean determining a job's pay rate; and inequities of job evaluation are not the same as inequities of pay. Some organisations decide to align more with market pay rates (external equity) than with internal equity, so they skip job evaluation. The market pay levels for all benchmark jobs are arranged from highest to lowest to assess the relative value of each job. The job-worth hierarchy forms the basis for grouping jobs of similar value into grades.

CULTIVATE JOB GRADES

After establishing your job worth hierarchy, you need to group jobs into grades. The number of grades that your firm has should distinguish between the different difficulty levels of the jobs, and the number of levels in your organisation structure. Less job grades suits a development culture, whereas more job grades provides clear career progression path and suits a promotion culture. However, too many grades make the distinction between the pay grades insignificant. More than 30 pay grades may be difficult to administer and fewer than five will create very broad bands.

DEVELOP PAY RANGE

Market pay is then added for each benchmark job. If your target pay positioning is the 50th percentile for all grades, use the 50th percentile of the market pay for your benchmark jobs. Derive the midpoint for each grade by computing the average of the benchmark job's pay in each grade.

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CALCULATE STRUCTURAL PARAMETERS

Once you have your grade midpoint, you need to decide on your pay range (also called range spread) and calculate the minimum and maximum pay for each grade. Pay range describes the distance between the minimum and maximum salary range values, and is expressed as a percentage. For example, 50 per cent pay range means that the maximum (say S$1,500) is 50 per cent higher than the minimum (S$1,000).

- The formula for pay range = [(maximum – minimum) / minimum] x 100%.
- The formula for minimum = midpoint / [1 + (Pay range / 2)]. Thus, if your midpoint is S$5,900 and you want your pay range to be 50%, then your minimum is S$4,720.
- The formula for maximum = minimum x (1 + Pay range). Thus, if your minimum is S$4,720 and you want your pay range to be 50%, then your maximum is S$7,080.

In determining your pay range, you should ensure that there is reasonable amount of overlap in your pay range and consider the cost of impact of implementing the new salary structure. You should consider having wider ranges for higher level positions, if you job rotate your employees to different countries, and if you want to provide more opportunity for employees to move up in salary.

Salary ranges are typically narrower for junior levels, and wider for managerial levels as their contributions can vary substantially among individuals. Typical pay range is 75–150 per cent for top management grades, 60–75 per cent for middle-management grades, 50–60 per cent for professional/supervisory grades, and 30–40 per cent for entry level grades. If you decide to have a pay range of 50 per cent for all positions, your salary structure will look this:

'SLOT' YOUR EMPLOYEES AND TWEAK YOUR SALARY STRUCTURE

After you have developed your draft salary structure, 'slot' all your employees into the grades. Some employee's salary might be above the maximum or below the minimum pay of the grade. Salaries that fall above the maximum of a grade are called 'red-circle' employees. Actions for resolving red-circle employees include freezing the employee's pay until the salary falls inside the pay range, reducing the employee's pay and paying the excess via bonus, or promoting the employee into a higher salary grade. In contrast to red-circle rates, 'green-circle' rates are where the employee's salary falls below the grade minimum pay. Actions for resolving green-circle employees include raising the employee's salary to the grade minimum pay immediately or during next salary review date.

Finally, review your salary structure and tweak it to align to your business plan and drive performance. This step is the art, not science, of compensation. If you have many red-circle employees, you can increase the maximum of your pay range. If you have many green-circle employees, you can lower the minimum of your pay range.

For 'hot skills' positions, difficult-to-hire positions, high attrition positions, talented employees, and strategic functions, you can either create a separate salary structure or increase the maximum of your pay range. However, if you have under-performing employees, don't adjust your pay range to fit them in. Either freeze the pay of under-performing employees or manage them out of the company.

Designing a salary structure is not a one-off exercise. You need to adjust it if there are changes in your business strategy, when there are new jobs added or removed, and when there are significant market pay movements.

Benchmark job title	Job Evaluation points	Market pay	Job grade	Pay range	Grade minimum	Grade mid-point	Grade maximum
HR Mgr	530	S$6,000	4	50%	S$4,720 [S$5,900 (1+{0.5/2})]	S$5,900 [(S$6,000+S$5,800)/2]	S$7,080 [S$4,720x(1+0.5)]
Finance Mgr	530	S$5,800					
Senior Accountant	450	S$4,500	3	50%	S$3,400 [S$4,250/(1+{0.5/2})]	S$4,250 [(S$4,500+S$4,000)/2]	S$5,100 [S$3,400 x(1+0.5)]
Senior HR Exec	440	S$4,000					
Buyer	410	S$3,500	2	50%	S$2,800 [S$3,500/(1+{0.5/2})]	S$3,500 [(S$3,500+S$3,500)/2]	S$4,200 [S$2,800x(1+0.5)]
HR Exec	350	S$3,500					
Accounts Clerk	220	S$1,500	1	50%	S$1,160 [S$1,450(1+{0.5/2})]	S$1,450 [(S$1,500+S$1,400)/2]	S$1,740 [S$1,160x(1+0.5)]
Receptionist	180	S$1,400					

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