Salary Structures

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Abstract
Organizations develop and implement salary structures to provide a framework for administering their employee compensation programs. The authors present an overview of traditional and broadband structures then discuss why organizations adopt one versus the other. Further discussion pertains to key issues to consider before implementing a salary structure for compensation administration purposes.

Effective administration of a compensation program requires a balance between the pay levels for employees inside the company (internal equity) and the pay levels those employees could command in the company’s recruiting markets (external equity). The primary external factors to consider are:

- The compensation practices of competitors.
- The availability of talented employees in relevant recruiting markets.

The primary internal factors to consider are:

- The diversity of jobs employed by the organization.
- The performance expectations of the company for its employees.
- The employer’s human capital investment strategy.
- The culture of the organization.

Corporate compensation professionals develop salary structures to provide a framework for managing this balance. Salary structures are used to classify a company’s jobs by compensation value. Jobs of similar value are assigned to the same classification within the salary structure. Jobs of dissimilar value are assigned to different classifications within the structure.

How to Develop a Salary Structure
Most companies determine their employee pay levels by evaluating market pay levels for the majority of their jobs. Compensation professionals call these benchmark jobs. In contrast to benchmark jobs, nonbenchmark jobs are not evaluated for the purpose of determining market pay levels, usually because market data is unavailable. The market pay levels for all benchmark jobs can be arranged from highest to lowest to assess the relative value of each job. The company’s nonbenchmark jobs are then “slotted” in between comparable benchmark jobs to create a job worth hierarchy that incorporates both the external value and the company’s internal value for all jobs in relationship to each other. The job worth hierarchy forms the basis for grouping jobs of similar value and to establish the classifications that compose the company’s salary structure.

Figure 1 illustrates the process of evaluating company jobs to create a job worth hierarchy. The challenge illustrated in Figure 1 is to assess the value of all company jobs based on external and internal factors as a means of arranging the jobs from highest to lowest value.

A company can construct its salary structure once the job worth hierarchy has been completed. Building the salary structure is a process of identifying groups of jobs that cluster together by virtue of having similar values. Figure 2 illustrates this process as means of creating salary ranges that compose the structure. Salary ranges are created with minimum and maximum values that represent the range of pay in the marketplace that the company has targeted in its competitive pay policy.
Business Considerations for Pay Structure Design

Business considerations for pay structure design include strategic issues, competitive practices, the organizational culture, and the affordability of pay. The key strategic issues to consider are the objectives of the company and the extent to which salary will be used to attract and retain employees capable of achieving business success. Also consider the salary practices of competitors by studying compensation surveys that report data regarding how they structure their salary administration programs. Organizations with a dynamic culture tend to place less emphasis on base pay in favor of variable pay, which has greater impact on employee behavior for achieving business objectives. By contrast, organizations with static cultures place emphasis on base pay because they can reasonably predict business performance and employee behaviors. Finally, consider the organization’s financial resources with regard to its ability to pay employees in the form of salaries, which are fixed costs.

Technical Considerations for Pay Structure Design

Technical considerations for pay structure design include the number of range levels, width of the ranges from minimum to maximum values (i.e., range spreads), the distance between adjacent range midpoint values (i.e., midpoint differentials), and the degree of overlap between adjacent ranges.

The number of ranges in a salary structure is a characteristic that describes the number of hierarchical levels needed to distinguish the value of jobs in the organization. The number of ranges required to compose a complete structure is determined by the following considerations:

- The number of skill and/or responsibility distinctions evident in the organization’s job worth hierarchy.
- The number of supervisor-subordinate relationships in the company’s organizational structure.
- The degree of emphasis on career development and progression.
- The resources available to administer the pay program. Generally, the more range levels, the more administration required.

The “range spread” is a characteristic of salary structures that describes the distance between the minimum and the maximum salary range values. The degree of range spread is dependent on a balance between the internal value a company places on the job and the range of salaries paid to comparable jobs in the relevant recruiting markets. Essentially, spread reflects the range of salary opportunity for the jobs that are assigned to the range, from a minimum to maximum salary values.

Figure 3 illustrates a salary range with a 50% spread. To calculate range spread, divide the difference between the maximum and minimum values by the minimum value. A salary range with a spread of 100% would be twice as wide as the one shown in Figure 3. In general, wider ranges apply to jobs that are determined to have larger salary values (e.g., executive jobs), whereas narrower ranges apply to jobs with smaller salary values (e.g., clerical jobs).

Midpoint differential is a characteristic of salary structure design that describes the percentage difference between the midpoint values of adjacent salary ranges. In general, if the company’s job evaluation approach doesn’t discriminate finely between levels, the result will be fewer salary range levels. Another factor to consider in concluding midpoint differentials is the company’s policy with regard to the cost of promoting employees into jobs at higher salary range levels. For example, a policy that limits promotional salary increases to 8%, but with a midpoint differential of 15%, may result in salaries for the promoted employees to fall below the new grade minimum salary value.

The degree to which ranges overlap each other’s salary values is a function of midpoint differentials and range spreads. Analyze range overlap after decisions have been made about midpoint differentials and range spreads to ensure that there is a reasonable progression between the range levels that compose the salary structure; and adjust if necessary.

Figure 4 illustrates a completed salary structure for the staff of a hypothetical human resources department. Study the salary structure to identify characteristics discussed in this section.

Traditional Structures

Many salary ranges that have narrow range spreads, small midpoint differentials, and broad overlap between adjacent ranges characterize traditional structures. Traditional structures tend to place greater emphasis on internal equity, as opposed to external equity. Traditional structures focus on job content evaluation to arrange a job worth hierarchy.

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With a focus of internal factors to create traditional structures, evaluation of market salary levels is limited to having a secondary influence on the arrangement of the job worth hierarchy. As a consequence, the company is likely to make many more distinctions between company jobs than may actually exist in relevant recruiting markets.

Traditional structures are best suited to companies that recognize and reward employee performance with promotions to jobs assigned to higher salary ranges, as opposed to moving an employee’s salary deeper within the range over time.

Broadband Structures

By definition, **broadbanding** is a salary structure that consolidates the relatively large number of ranges found in a traditional structure into fewer ranges. Because there are fewer ranges, a broadband salary structure has characteristics that distinguish it from a traditional structure. Fewer salary ranges that have wider range spreads, larger midpoint differentials, and a lesser degree of overlap characterize broadband structures. Broadband structures tend to place greater emphasis on career development opportunities that employees would otherwise seek in the company’s recruiting markets.

Broadbanding has been a recognized practice of corporate compensation professionals since roughly 1990. Organizations that implemented broadband structures sought to improve the administration of the salary program subsequent to downsizing initiatives that created flatter organizations. In flat hierarchies, greater emphasis tends to be placed on career development as opposed to job promotion. Today, broadbanding still refers to collapsing a company’s job worth hierarchy into fewer, wider salary ranges. This is done to manage pay delivery in a manner that recognizes career growth in light of fewer promotional opportunities, and company pay practices that are closely tied to competitive levels.

Broadbanding usually appeals to organizations that want to be more nimble in response to persistent changes in business conditions or recruiting markets. Such organizations would likely implement broadband salary structures in attempt to achieve the following human capital management objectives:

- Broader workforce skills
- Career development among employees
- Improvement in the way job evaluation, salary structures, and performance rewards are administered and maintained

Broadbanding is a compensation management response to changing business conditions. In broadband salary structures, employers reward employees who demonstrate substantial capability improvements with a salary progression that penetrates more deeply into the banded range over time, in lieu of promotions. Whereas the design characteristics of traditional structures emphasize internal equity and focus the employee’s attention on the world inside the firm, broadbanding focuses employees on the changing needs of the organization and helps them experience an internal culture that more closely reflects the external business environment and the competitive recruiting market.

**Figure 5** illustrates the changes in design characteristics when moving from a traditional to a broadband salary structure.

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**Administrative Issues**

Occasionally, employee salaries may fall outside the company’s defined salary range for the job. The employee salary will either be above the maximum value or below the minimum value. Salaries that fall above the maximum are referred to as **red-circle** rates. Red-circle rates may be caused by demotion, an exceptional salary paid to retain a high-potential employee, reorganization or acquisition, or the structure falling behind competitive circumstances. Actions compensation professionals suggest for resolving red-circle rates include freezing the employee’s pay until the salary falls back inside the updated range, reducing the employee’s pay and paying the excess in the form of a bonus, or reviewing the employee for promotion into a higher salary range.

In contrast to red-circle rates, **green-circle** rates are where the employee’s salary falls below the range minimum. Green-circle rates may be caused by adjustments to the salary structure subsequent to a recent promotion or new hire, reevaluation of the job’s value causing reassignment to a lower range in the structure, or reorganization or acquisition. Compensation professionals recommend that employees not be paid salaries below the company’s prescribed minimum value. The employee’s salary should be raised to the range minimum value immediately, or at some scheduled event in the salary administration process such as annual salary review.

**Pay compression** can occur when the pay rates of several employees, despite clear differences in capability, are in a cluster. This means highly capable employees are paid similarly to employees with less skill and experience. This eventually creates morale problems, particularly for the more capable employees.

Eligibility for company compensation programs is often tied to the salary range assignment for an employee’s job.
example, companies often use the salary range assignment for jobs to determine employee eligibility for participation in incentive plans and certain benefit plans. Therefore, an organization may have to reexamine the eligibility criteria for other compensation programs when traditional structures are updated or broadband structures are implemented.

Notes

1. Internal equity is a fairness criterion that implies an employer’s pay practices correspond to each job’s relative value in the organization.

2. External equity is a measure of an employer’s compensation levels compared to those employers within its recruiting market. As a fairness criterion, external equity implies that the employer compensates at levels that correspond to prevailing, external market rates, as determined by the job’s market range. External equity must be balanced with internal equity.

3. Job evaluation is a formal process used to create a job worth hierarchy within an organization. The two basic approaches are the market data approach and the job content approach. Most job evaluation processes use a combination of these two basic approaches.

4. Competitive pay policy establishes the strategic and philosophical principles that guide design, implementation, and administration of an employer’s compensation programs that attract and retain talented employees. Compensation strategy supports an organization’s business objectives and specifies what programs will be used and how they will be administered. Compensation philosophy ensures that compensation programs support business needs and organizational culture. Refer to Salary.com, Inc.’s white paper devoted to this topic.

5. Job content evaluation methods focus on the responsibilities and qualifications for the job as defined by the employer in developing a job worth hierarchy. With these methods, market pay levels are typically a secondary influence on the job worth hierarchy. Point factor job evaluation is the most common form of job content evaluation methods.