HOW TO CREATE PAY STRUCTURES

PROCESS STEP NOTES

Refer to the steps on the Base Pay Project Process Overview marketing collateral piece and the Base Pay Plan Checklist.

Step 1 – Determine the appropriate pay structure: There are three different types of pay structures that can be typically developed for a client.

1. Based on discussions with the client and the results of the market benchmarking data, a decision will be made as to which structure will best serve the client's needs.
2. Overtime, experience in creating pay structures will help guide the client in deciding the best type of pay structure for their organization.
   a. The total number of jobs and employees included in the structure will be a factor in determining the type of pay structure needed.
      i. The greater the number of employees and total number of jobs to be included in the compensation program may result in the need to create a job family market-based (job by employee group nonexempt / support, exempt / professional, etc.) and/or a market-based structure(s).
      ii. The smaller number of employees and fewer jobs may result in a traditional or singular market-based pay structure.
3. Pros and cons of the three pay structures are provided below. *(Refer to Sample Pay Structures for an illustration of the design of each of the three pay structures).*

Type	Pros	Cons
Market-Based	1. Anchored to market rates. 2. Can move each pay grade as the market moves without moving entire pay structure. 3. Can see all jobs in one structure.	1. No consistent spread mid-point to mid-point. 2. Cannot clearly see career pathing.
Job Family Market-Based	1. Market driven with levels determined by number of jobs that cluster together. 2. Creates levels by job family such as nonexempt, exempt, management, etc. If organization is large, can create job families by department. 3. Creates career pathing by job family. 4. Can move each level as market moves without moving entire structure.	1. Jobs can shift in value over time as new jobs are added and level of job can shift up or down in the future.
Traditional	1. Consistent percent spread midpoint to midpoint. 2. Can see all jobs in one structure.	1. Need to move entire structure the same percentage vs. what is occurring in the external market by pay range. 2. Cannot clearly see career pathing.

Step 2– Develop Pay Grades and Pay Grade Midpoints for a <u>Base</u> Pay Job Family Market-Based and/or <u>Base</u> Pay Market-Based Structure: Once the type of structure has been decided, the steps associated in building the actual pay grade structure are essentially the same for a base pay job family market-based and/or base pay market-based structure(s). *(See Step 4 for creating a Base Pay Traditional pay structure.)* It is important to keep in mind when creating the pay structure(s), regardless of type, that multiple jobs will typically comprise a given salary range.

1. Copy the benchmarked job titles and appropriate <u>base</u> pay compensation percentile market data (i.e., base pay 50th percentile) from the consolidated benchmark title results into a new excel workbook.
   a. Use the compensation philosophy as stated on the approved market data guidelines to extract the appropriate percentile data.
      i. The percentile data may be different for the various employee groups, i.e., nonexempt / support employee groups may use base pay 50th percentile data; manager and director employee groups may use 75th base pay percentile data. Ensure the correct percentile data is copied.
      ii. Refer to Step 5 for constructing a Base Pay Structure using a total cash compensation philosophy.
   b. If a job family market-based structure is being created, copy all the roles and associated market data for a particular job family into one worksheet of the excel workbook.
      i. Each job family structure will have its' own worksheet.
      ii. The worksheet title (and excel worksheet tab) should reflect the name of the respective job family, i.e., Nonexempt, Exempt, Manager, Director, etc.
2. Look for "natural breaks and/or clusters" of jobs where the market data is reasonably close to one another.
      i. The market data is then highlighted in the chart to illustrate natural breaks and/or clustering of jobs.
      ii. Where there is a natural break and/or clustering in the data, a separate salary grade should be created.
3. Once proposed grades have been recommended, calculate a proposed midpoint for each salary grade
   a. In a job family market-based and/or market-based pay structure, the proposed midpoint will be reasonably close to the average of all the market data for a given salary grade.
4. Next, calculate the difference between the newly proposed midpoint and the market base percentile.
5. Review the jobs in the respective pay grade for reasonableness.
   a. Consider reporting and supervisory relationships, e.g., is a role reporting to the role's supervisor? Are role progressions in the same grade, e.g., Accounts Payable Technician I and Accounts Payable Technician II?

# of Jobs	Title	Proposed Grade	Base 50th Percentile	Proposed Midpoint	Difference between Midpoint & 50th Base Percentile
1	Receptionist	1	$35,075	$35,865	$790
2	Driver/Courier	1	$35,680	$35,865	$185
3	Accounts Payable Technician I	1	$35,681	$35,865	$184
4	Maintenance, Shipping, Receiving Clerk	1	$37,025	$35,865	-$1,160
5	Accounting Technician	2	$40,913	$42,282	$1,369
6	Accounts Payable Technician II	2	$42,130	$42,282	$152
7	Communications Specialist	2	$43,804	$42,282	-$1,521
8	Graphic Designer	3	$51,712	$53,638	$1,926
9	Training Specialist	3	$55,564	$53,638	-$1,926

6. Review the dollar differences between proposed midpoint and market base pay data. Where dollars exceed $2,500 (+ or -), review the pay grade placement.
    a. Should the job be moved to a different and/or new pay grade?
    b. Is the market data an outlier? Should the role be retained in the pay grade assigned or designated to another pay grade?
    c. Is the dollar difference impacting a single incumbent or a multiple incumbent role?
        i. While all roles are important in designing a pay structure, multiple incumbent roles should take higher preference in the competitive design than single incumbent roles.
        ii. Adjust the structure as necessary ensuring all calculations are accurate.

Step 3– Develop the salary range minimums and maximums for each pay grade:
After determining the number of pay grades and proposed midpoints, the next step in the process is to develop the respective salary range minimums and maximums for each pay grade / salary grade. The salary range reflects the range of salary opportunity for the jobs assigned to a certain range.
1. The "range width" and/or "range spread" is stated as a percentage, i.e., 40%, 50% 60% etc. and is the distance between the minimum and the maximum salary range values.
    a. Most structures contain smaller range spreads for less educated and/or experienced level positions and wider range spreads for the higher-level positions. For example, a file clerk and/or courier may have a range width of 40% whereas a Systems Analyst may have a range width of 50% or 60%.
    b. The chart below illustrates typical range widths by employee group.

Job Group	Typical Range Width
Nonexempt / Support	40% - 50%
Exempt	50% - 60%
Professional	50% - 60%
Supervisory	50% - 60%
Managerial	60% - 70%
Director	60% - 70%
Executive	80%

2. Copy the proposed salary grades and midpoint data from Step 2 into an excel chart. *(The chart can be created on the same sheet as the arrayed market data or in a separate excel workbook / worksheet).*

Proposed Salary Range Structure				
Grade	Minimum	Midpoint	Maximum	Range Spread
1		$35,865		
2		$42,282		
3		$53,638		

3. Determine the desired salary range width / spread for each salary grade.
    a. All roles within a particular salary grade will have the same range width / spread.
4. Salary range minimums and maximums will be calculated from the proposed midpoints depending upon the desired range width /range. The chart below illustrates the formulas used to calculate the respective salary range minimums and maximums.

Proposed Salary Range Structure Calculations				
Range Width	Minimum	Midpoint	Maximum	Range Width
40%	=(midpoint* 0.83)	$XX,XXX	=(midpoint * 1.17)	=sum(maximum – minimum)/minimum
50%	=(midpoint* 0.80)	$XX,XXX	=(midpoint * 1.20)	=sum(maximum – minimum)/minimum
60%	=(midpoint* 0.77)	$XX,XXX	=(midpoint * 1.23)	=sum(maximum – minimum)/minimum
70%	=(midpoint* 0.74)	$XX,XXX	=(midpoint * 1.26)	=sum(maximum – minimum)/minimum
80%	=(midpoint* 0.71)	$XX,XXX	=(midpoint * 1.28)	=sum(maximum – minimum)/minimum

Step 4: Development of a Base Pay Traditional Pay Grade Structure: Traditional pay structures are designed essentially in the same manner as job family market-based and/or market-based structures except the midpoint progression from one salary grade to another salary grade is consistent between grades or gradually increases from grade to grade. Again, multiple roles will typically comprise a salary grade. A traditional pay grade structure can be a singular structure or can be created by specific employee groups, i.e., nonexempt / support, exempt /professional, supervisory, etc.

1. To create a traditional base pay salary structure, copy the benchmarked job titles and appropriate <u>base</u> pay compensation pay percentile data (i.e., base pay 50th percentile) from the consolidated benchmark title results into a new excel workbook.
2. Again, array the market data from low to high.
3. The number of grades in a traditional structure will depend upon the upon the breath of the market data.
    a. As an example, does the market data span (when arrayed from low to high) from $30,000 to $125,000 and above?
    b. The greater the span of data and the clustering of market data will result in the need for more salary grades.
    c. Upon review of the market data being arrayed, a natural grouping / clustering of jobs/market data again will typically appear.
4. As indicated earlier, a traditional pay structure has a smooth or graduated midpoint progression from salary grade to salary grade.
5. Begin by creating the pay grade midpoint of the first pay grade.
    a. Use the market data average of Pay Grade 1 as the proposed midpoint. *(The figure can be rounded to the nearest $5, $10, $50 $100, $1,000 etc. if desired).*

# of Jobs	Title	Proposed Grade	Base 50th Percentile	Proposed Midpoint
1	Receptionist	1	$35,075	$36,000
2	Driver/Courier	1	$35,680	$36,000
3	Accounts Payable Technician I	1	$35,681	$36,000
4	Maintenance, Shipping, Receiving Clerk	1	$37,025	$36,000
5	Accounting Technician		$40,913	
6	Accounts Payable Technician II			
7	Communications Specialist			
8	Graphic Designer			
9	Training Specialist			

Average Market Data of Proposed Pay Grade 1 is $35,865. Proposed midpoint has been rounded to nearest $1,000.

6. Next, create an excel table on the same spreadsheet with the arrayed market data.
    a. Determining the range-to-range percent for the most part is "trial and error". There is no magic, but rather designing the structure is an "art".
    b. Generally, the pay structure will have more pay grades using a lower range-to-range percent e.g., 5%, 6%, 8% etc. than a higher percent, e.g., 10%, 12%, etc.

c. Consider the following.
- i. How many potential grades would the structure have if the structure were market-based?
- ii. What is the dollar span from the lowest market data figure to the highest market data figure? If a flat 8% were used to create the structure, how many pay grades would be created to encompass the highest market data point? In other words, if the lowest market data figure were $35,075 and the highest market data point was $124,750, using a flat 8% would result in 17 pay grades. Using the same example, if 10% was used, the structure would only have 14 pay grades.
- iii. The number of pay grades could be reduced further if the structure(s) were created using varying percentages, e.g., 10% for grades 1 and 2, 12% for grade 3, 4, and 5, 14% for grades 6, 7, 8, etc. In this example *(using the same market data figures as above)*, the pay grades would be reduced to 14 if pay grades 1 through 3 had a midpoint growth of 10%, pay grades 4 through 9 has a 12% midpoint growth and pay grades 10 and 11 had 14% growth, the structure would have 12 pay grades in total.

A	B	C	D	E	F	G
1	Proposed Pay Grade Structure					
2	Pay Grade	Minimum	Midpoint	Maximum	Salary Range Spread	Range-to-Range
3	1	=(D3*.80)	$36,000	=(D3*1.20)	50%	10%
4	2	=(D4*.80)	=(D3*1.10)	=(D4*1.20)	50%	10%
5	3	=(D5*.77)	=(D4*1.10)	=(D5*1.23)	60%	12%
6	4	=(D6*.77)	=(D5*1.12)	=(D6*1.23)	60%	12%
7	5	=(D7*.77)	=(D6*1.12)	=(D7*1.23)	60%	

Upon completion, the pay grade structure will resemble the chart below.

A	B	C	D	E	F	G
1	Proposed Pay Grade Structure					
2	Pay Grade	Minimum	Midpoint	Maximum	Salary Range Spread	Range to Range
3	1	$28,800	$36,000	$43,200	50%	10%
4	2	$31,680	$39,600	$47,520	50%	10%
5	3	$33,541	$43,560	$53,579	60%	12%

| 6 | 4 | $37,566 | $48,787 | $60,008 | 60% | 12% |
| 7 | 5 | $42,074 | $54,642 | $67,209 | 60% | |

7. After creating the pay structure, use the chart above to assign a pay grade and midpoint to each of the benchmarked roles. *(See Chart as illustrated in Step 4, point #5).*
   a. The proposed midpoint will serve as a guide to assigning a pay grade number to the benchmarked role(s).
   b. Because the percent increase between midpoints is constant and/or gradually increases, there may be pay grades with no current roles assigned.
      i. Vacant pay grades are acceptable and enable the organization to use the pay grade(s) in the future.
      ii. Caution is urged, however, in having too many vacant pay grades.
      iii. If this occurs, it is recommended the pay structure be modified and/or "tweaked".
8. Review the jobs in the respective pay grade(s) for reasonableness.
   a. Consider reporting and supervisory relationships, e.g., is a role reporting to the role's supervisor? Are role progressions in the same grade, e.g., Accounts Payable Technician I and Accounts Payable Technician II?
9. Calculate and review the dollar differences between proposed midpoint and market base pay data.
   a. Do the dollars exceed $2,500 (+ or -)?
   b. If there are significant roles that exceed + or - $2,500, the structure may need to be modified.
10. It may take several attempts to create a traditional salary structure before feeling comfortable with the design.
    a. Often the client is provided with two traditional salary structure design options
11. An example is provided below.

# of Jobs	Title	Proposed Grade	Base 50th Percentile	Proposed Midpoint	Difference between Midpoint & 50th Base Percentile
1	Receptionist	1	$35,075	$36,000	$926
2	Driver/Courier	1	$35,680	$36,000	$321
3	Accounts Payable Technician I	1	$35,681	$36,000	$319
4	Maintenance, Shipping, Receiving Clerk	1	$37,025	$36,000	-$1,025
	No roles assigned to Pay Grade 2	2	N/A	$39,600	N/A
5	Accounting Technician	3	$40,913	$43,560	$2,647

6	Accounts Payable Technician II	3	$42,130	$43,560	$1,430
7	Communications Specialist	3	$43,804	$43,560	-$244
	No roles assigned to Pay Grade 4	4	**N/A**	$48,787	**N/A**
8	Graphic Designer	5	$51,712	$54,642	$2,930
9	Training Specialist	5	$55,564	$54,642	-$922

Step 5: Development of a Base Pay Structure based on a Total Cash Compensation Philosophy: Organizations that compensate their employees with bonuses and/or incentive compensation may desire to develop their compensation structure based on total cash compensation percentile rather than base pay compensation percentile. It is not uncommon for a salary structure to be built based on total cash compensation for incentivized sales employees and/or employee groups with highly leveraged bonuses such as directors, vice presidents, and executives

1. A base pay total cash compensation structure(s) can be created using a job family, market-based and/or traditional salary structure approach.
    a. First, decide upon the type of structure will best serve the client's needs.
    b. This determination will typically be made when the market data guidelines are being discussed, finalized, and ultimately approved. *It is acceptable to defer this decision until the benchmarking has been conducted and the results shared with the client, however, it is preferred to have the decision made at the time the market data guidelines are approved.*
    c. While the process is essentially the same for creating the actual compensation structure, there are some differences / steps which need to be taken before the actual structure can be created
2. It will be necessary to obtain the bonus and/or incentive target(s) for each employee group prior to creating the base pay structure. The bonus / incentive target is defined as the annual dollar amount or percentage an employee will achieve assuming his/her goals and objectives are met.
    a. All employees in the same job title should have the same bonus / incentive target.
    b. The bonus / incentive target is not the **actual** payout but is the anticipated amount / percent at 100% of goal attainment.
    c. If the target amount / percentage is not defined or available, an average bonus / incentive paid out over the past 2-3 years can be used. *(This is not ideal but can serve as an alternative approach for obtaining a relevant bonus / incentive target information.)*
    d. Once the bonus / incentive targets have been obtained; copy the benchmarked job titles and appropriate compensation pay percentile market data (i.e., 50th percentile total cash compensation data) from the consolidated benchmark title results into a new excel workbook.

i. The percentile data may be different for the various employee groups, i.e., sales and director level roles may use the 50th total cash compensation pay percentile data; executives may use 75th total cash pay percentile data. Ensure the correct percentile data is copied into the spreadsheet.

3. If the client has bonus /incentive targets that are a <u>percent</u>, create a spreadsheet as illustrated below to determine the new base pay market value which will be used to create the midpoint of the new salary structure.
    a. Using the formula below, convert the client's bonus target percentages to a dollar amount. Once calculated, place the results in column F of the spreadsheet.
        =Total Cash Market Percentile (column E) * Client Bonus Target Percentage (column D)
    b. Once the dollar amount has been calculated, subtract the dollar amount (column F) from the Total Cash Market Percentile (column E). Place the derived figure in Column G of the spreadsheet

A	B	C	D	E	F	G
1	# of Jobs	Title	Client Bonus Target Percent	Total Cash Market 50th Percentile	Client Target Bonus / Incentive Pay Percent as a Dollar Amount	Based Pay Market Data to be Used for Developing Salary Range
2	1	Sales Representative I	17%	$65,789	$11,184	$54,605
3	2	Sales Representative II	20%	$75,822	$12,890	$62,932
4	3	Sales Representative III	25%	$95,069	$19,014	$76,055
5	4	Director Information Technology	25%	$176,465	$44,116	$132,349
6	5	Chief Financial Officer	30%	$299,643	$89,893	$209,750
7	6	Chief Executive Officer	40%	$345,890	$138,356	$207,534

4. If the client has bonus /incentive targets that are <u>dollar amounts</u>, create a spreadsheet as illustrated below to determine the new base pay market value which will be used to create the midpoint for the new salary structure(s).
    a. Using the formula below, subtract the client's bonus dollar amount(s) from the market total cash market data. Once calculated, place the derived figure in column F of the spreadsheet.
        = Total Cash Market Percentile (column E) - Client Bonus Target Dollar (column D).

A	B	C	D	E	F
1	# of Jobs	Title	Client Bonus Target Dollar	Total Cash Market 50th Percentile	Based Pay Market Data to be Used for Developing Salary Range
2	1	Sales Representative I	$10,000	$65,789	$55,789
3	2	Sales Representative II	$12,000	$75,822	$63,822
4	3	Sales Representative III	$15,000	$95,069	$80,069
5	4	Director Information Technology	$18,000	$176,465	$44,116
6	5	Chief Financial Officer	$25,000	$299,643	$89,893
7	6	Chief Executive Officer	$50,000	$345,890	$138,356

5. Once the new market values have been calculated, follow the steps outlined in "Step 2– Develop Pay Grades and Pay Grade Midpoints for a Base Pay Job Family Market-Based and/or Base Pay Market-Based Structure", "Step 3– Develop the salary range minimums and maximums for each pay grade" and "Step 4: Development of a Base Pay Traditional Pay Grade Structure for developing the actual pay structure midpoints and salary ranges".

Step 6: Create Pay Grade Sheet(s): Once the structure(s) has been developed, create the pay grade sheet(s).
1. The pay grade sheet(s) will contain the titles of all benchmarked roles, proposed salary grades, salary range minimums, midpoints, and maximums and salary range width for each grade.
    a. If job families have been created, create a separate pay grade sheet for each job family, i.e., nonexempt / support, exempt / professional, supervisor / manager, etc.
        i. Each job family pay grade sheet should be created in a separate excel worksheet but in the same workbook.
        ii. The pay grade / salary grade numbering system should be different for each job family.

Job Family	Pay Grade / Salary Grade Numbering
Nonexempt / Support	NE1, NE2, NE3 etc. or S1, S2, S3 etc.
Exempt / Professional	E1, E2, E3 etc. or P1, P2, P3 etc.
Supervisor / Manager	M1, M2, M3, etc.
Director	D1, D2, D3, etc.
Executive	EX1, EX2, e3, etc.

        iii. Upon completing the pay grade sheet(s), create a copy for the client to review. Before sending, remove all formulas and password protect the document. *(Refer to "Sample Pay Grade Sheet templates").*

b. The client should review the placement of the roles within each pay grade for internal equity reasons to determine if any jobs should move up or down a pay grade.

c. Advise the client there should only be a few job changes / pay grade changes.

2. After the client has reviewed the Pay Grade Sheet(s), have a discussion with the client about any jobs that need to move for internal equity reasons and/or any jobs that need to be "slotted". Upon discussion, make any changes to the Pay Grade Sheet(s) as necessary.

   a. Slotted roles can be discussed with the client after review of the pay grade sheets or a pay grade can be recommended based on the average salary of the current incumbent(s) obtained from the employee census report *(see Step 13)*.

   b. A comparison of the job titles in the employee census against the job titles on the "Consolidated Market Data Summary" will illustrate any roles that need to be "slotted".

3. Upon gaining alignment on the structure and job placement, send email #4 "Salary Structure Completed".