

“Confusion Between Pay Structures and Employee Pay Adjustments”

Blair Johanson, Principal Partner – DBSquared & Johanson Group

As a teenager, my twin brother and I learned how to construct houses. We worked on a local construction crew a couple of summers and then built two homes for our parents during our high school and early college years. What a gift our Father gave to us and at the same time, he was able to use cheap labor on his homes. With home construction, you have a foundation, a frame and a roof. This structural part of construction goes relatively fast compared to the internal finish work that can take months to complete. Another way to express this structural part of construction is the beginning, middle and top.

We have found through our compensation consulting work that it is not unusual for our clients to confuse compensation pay structures with annual employee pay policy adjustments. Most pay structures (like our home structures) have a beginning, middle and top and are commonly known as the pay minimum, midpoint and maximum. For each particular pay grade or broad-band, there is a pay minimum to maximum spread. The common range spread is 50% or 80% of midpoint (minimum) to 120% of midpoint (maximum). Typically, the range spread tightens for hourly positions and widens for salaried professional and management positions.

The confusion occurs when people hear the question, “How much did you adjust employee pay last year and how much did you adjust the pay structure? For example, let’s say our sample organization is 3% behind the market and the market employee pay inflation/increase will average 2.7% for 2011. We have heard a combination of comments as a result of this type of market pay statement such as, “Does that mean that our employees should receive a 5.7% pay increase?”; “Should we adjust the employees pay by 3.0%?”; or “Since the local cost of living is only 1.5%, should we increase our employees’ pay by 1.5% to remain competitive in the market?”

Often times, pay structure and employee pay adjustments are seen as one in the same. Pay structures and employee pay adjustments come close to being the same when an organization utilizes a step and grade pay schedule matrix. The pay structure includes pay steps with predetermined pay adjustments that are normally tied to each additional year of service.

Outside of the step and grade pay structures, the most common compensation management process utilizes a pay structure with the minimum, midpoint and maximum pay range by grade level. The pay range structure and internal employee averages are compared with market pay means, medians and pay range midpoints to determine its competitiveness in the relevant market recruitment area. This pay structure (frame) is separate from an organization’s decision to budget X% for employee pay increases associated with merit, performance, tenure, cost of living and other related factors.

It is best to see pay structure and budgeted employee pay adjustments as two separate compensation management policy decisions. So given the above market pay scenario and the company’s desire to remain competitive with its pay policy, the organization will

increase its pay structure by 3%. This pay structure adjustment doesn't increase the employee compensation costs for the organization unless an employee's current pay is below the new pay grade range minimum. The additional direct dollar expenses will occur when the organization increases the overall employee pay budget by 2.7% to remain competitive with employee pay inflation for 2011. The dollars are expensed when the employees receive the actual pay adjustment either on a set date for all employees or a specific anniversary date for each employee.