

How to create a pay structure

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I have noticed that most people have no idea what a pay structure mean and look like. A pay structure is a series of job grades showing the minimum, midpoint and maximum salary for each grade. The pay structure allows the organisation to reward people according to the value attached to jobs of equal value. This is why there is a minimum and a maximum salary for each grade.

It is important to remember that a pay structure is a product of a [job evaluation](#) exercise in most cases. It is possible to develop a pay structure without doing a [job evaluation](#) using market pricing. In that case, jobs can be grouped based on market salary data trends.

In Table 1 below, I show a pay structure I developed based on the Castellion job grades. Let us assume this pay structure is in US dollars. Please note that all credible pay structures have salary overlaps between adjacent grades. The overlaps accommodate a situation where you need to pay good performers in a lower grade better than a poor performer or new employee in an adjacent higher grade. This is perfectly normal and standard.

Table 1- Sample Pay Structure

Grade	Minimum	Midpoint	Maximum	Range	Progression
1	18,829	26,361	33,892	80%	30%
2	14,484	20,277	26,071	80%	30%
3	11,141	15,598	20,055	80%	30%
4	8,570	11,999	15,427	80%	30%
5	6,593	9,230	11,867	80%	30%
6	5,071	7,100	9,128	80%	30%
7	3,901	5,461	7,022	80%	30%
8	3,001	4,201	5,401	80%	30%
9	2,308	3,232	4,155	80%	30%
10	1,776	2,486	3,196	80%	30%
11	1,366	1,912	2,458	80%	30%
12	1,051	1,471	1,891	80%	30%
13	808	1,131	1,455	80%	30%
14	622	870	1,119	80%	30%
15	478	670	861	80%	30%
16	368	515	662	80%	N/A

If your pay structure is not looking like the one above, it was probably developed by a person who has no understanding of pay structures or they are still learning. In the above pay structure, there are several terms I would like to explain so that as I go through this paper it makes it easy for you to understand.

I will start with the midpoint salary per grade. The midpoint is what is also referred to as a pay spine. Put differently the midpoint is the organisation's competitive market salary for each grade. Let us say your organisation is in the process of developing a pay structure, it has several options in terms of the target market position for pay. Some organisations may want to target the 25th percentile, 50th percentile {median} or the 75th percentile {upper quartile}. As to which market position to target, it is a matter of choice guided by what the organisation can afford. An organisation can decide they want to target the 75th percentile or the 50th. Here there is a need to balance between the need to attract and retain talented employee on one hand the need to have a sustainable staff cost structure. You must be careful how you pay people within the pay range. The midpoint of the pay range should be reserved for your top performers. People who have shown that they can consistently give value to the organisation. It is a waste of resources to pay poor performers competitive salaries as reflected by your grade midpoints.

The minimum salary in a grade reflects the minimum salary the organisation is willing to pay for roles in that particular grade. People paid at the minimum are new to the role, less experienced and or have not reached the right level of performance. It is advisable to pay all new employees joining your organisation close to the minimum of the grade, and only move them towards midpoint as they give more value to the organisation.

The maximum salary per grade. This salary is rarely earned by anyone if you are managing your salary structure properly. This salary is reserved for rare talent. This means that anyone being paid close to the maximum is top-notch talent. In the majority of cases, such people are ready to be promoted to a higher, new role. That will be the only way to keep them motivated.

What is a good salary range?

Salary Range – it is the difference between the maximum and minimum of a grade. {this can be expressed in absolute dollars but it is commonly expressed as a percentage}. These can range from as low as 15% to as high as 150%. The higher the range the better the options to different individuals based on performance. Common salary ranges are from 40% to 80%.

What is a good pay progression?

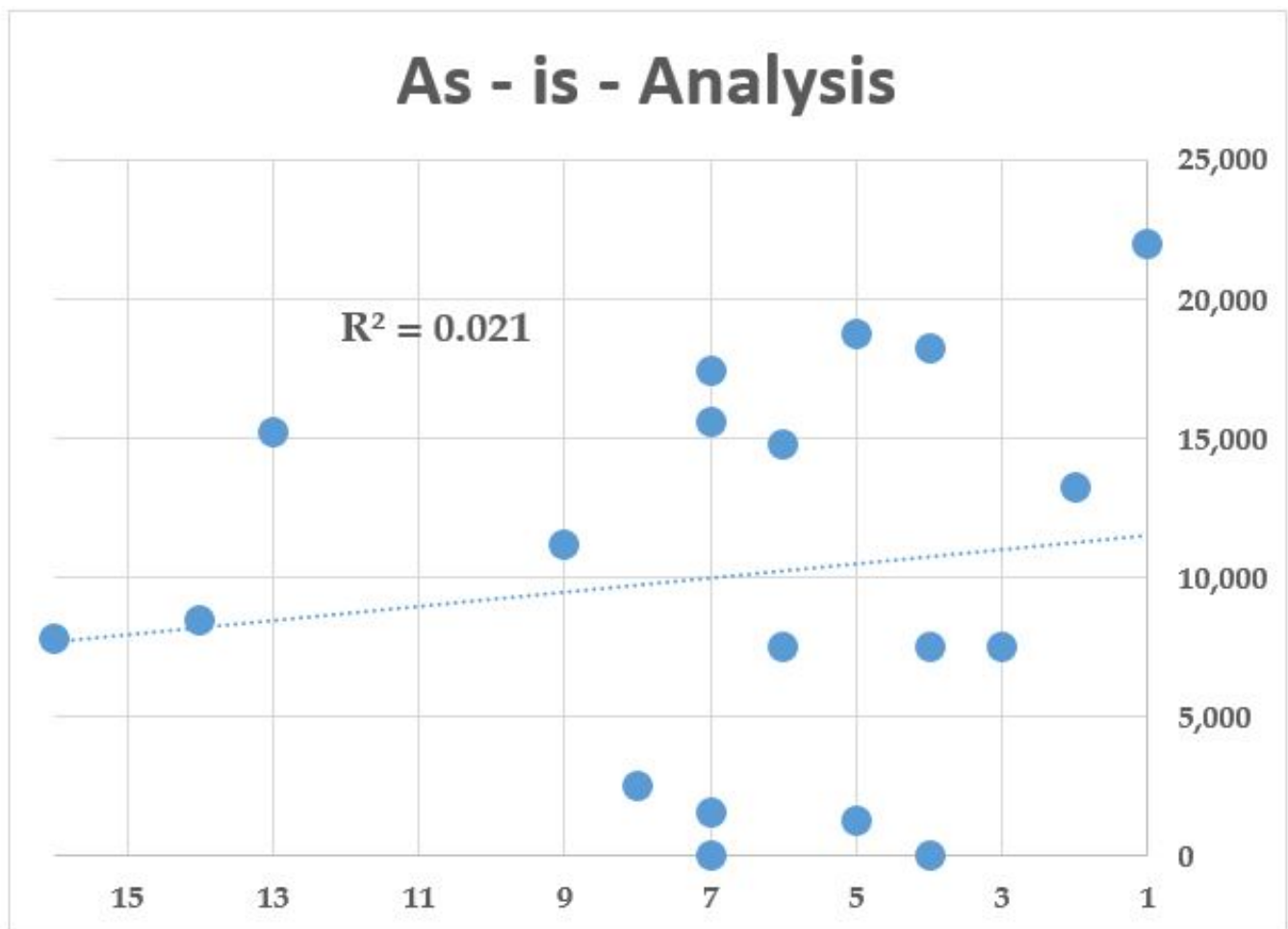
Progression- This is the percentage difference in salaries between the midpoints of adjacent pay grades in a pay structure. It can range from as low as 10% to as high be 60% or even 80%.

It is common practice to maintain the same range and progression across all grades. Others, however, do vary their range across grades with smaller range applied to lower grades and higher range to managerial grades. The same applies to progression.

What determines the range and progression for your pay structure is your strategy around pay.

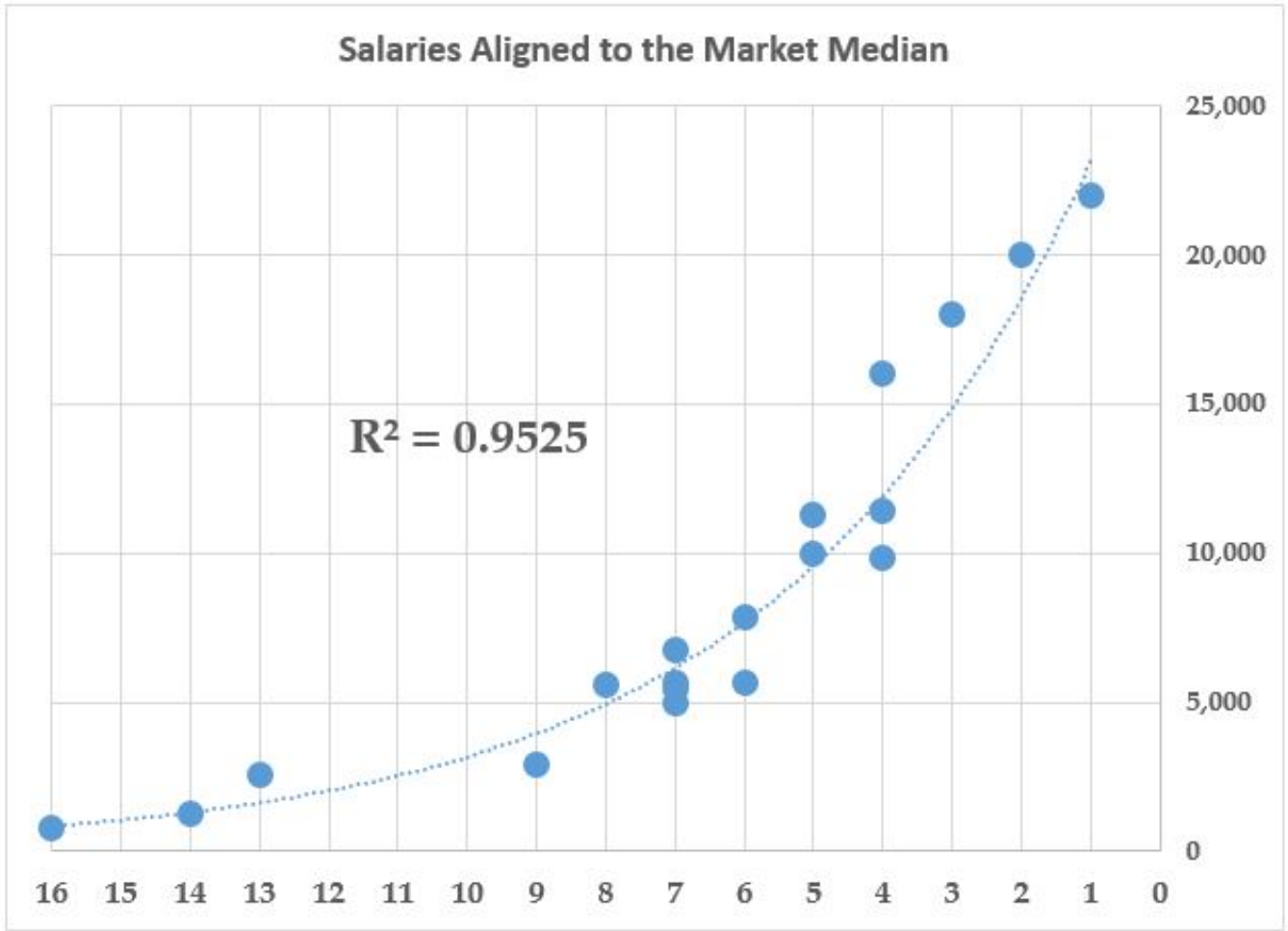
What is a salary structure and how it is designed?

In the sections above, I gave a typical example of a pay structure. When structuring your pay you must start by having a credible grading structure showing the relative worth of each job within your organisation. Once the results of the grading are out and approved, do an “As is analysis” of your salary distribution by grade.



As you can see above, the distribution of salaries is not in line with the new grades. This means that people were being paid using other factors other than job hierarchy and that brought lots of complaints within the organisation. As you can see from the coefficient of determination $R^2 = 0.0066$. This means that grade explains less than 1% of the variation in salaries.

In the graph below, I show the distribution of salaries based on the target market median. As you can see the relationship between grade and salary is much better now as at $R^2 = 0.9525$. Using this data and graph, you can now proceed to develop a pay structure anchored on this target median.



Maintaining the Pay Structure

Once the pay structure has been developed, most people struggle to maintain it. Consultants often hired to develop pay structures rarely empower the client with the capacity to keep the pay structure current.

Table 2- Pay Structure adjusted by 22% {due to market movements and cost of living}

Grade	Minimum	Midpoint	Maximum	Range	Progression
1	22,971	32,160	41,349	80%	30%
2	17,670	24,739	31,807	80%	30%
3	13,593	19,030	24,467	80%	30%
4	10,456	14,638	18,821	80%	30%
5	8,043	11,260	14,477	80%	30%
6	6,187	8,662	11,136	80%	30%
7	4,759	6,663	8,566	80%	30%
8	3,661	5,125	6,590	80%	30%

9	2,816	3,942	5,069	80%	30%
10	2,166	3,033	3,899	80%	30%
11	1,666	2,333	2,999	80%	30%
12	1,282	1,794	2,307	80%	30%
13	986	1,380	1,775	80%	30%
14	758	1,062	1,365	80%	30%
15	583	817	1,050	80%	30%
16	449	628	808	80%	N/A

Let's say it now a year after the pay structure was developed and there have been changes in the market due to various factors including changes in the cost of living. What you do is, you go to the midpoint of the lowest grade and apply a percentage increase. Because the whole pay structure has inbuilt formulas, if you are doing it in excel the whole pay structure will move by the same percentage. In the above example, the pay structure bottom grade midpoint was moved by 22%. This is done every time you give an across the board increase or there are significant pay changes in the market.

Pay Structure Administration

To keep the pay structure competitive, you would need to understand the terms and mechanism for managing a pay structure. Remember the whole purpose of developing a pay structure is to ensure your organisation operate an equitable remuneration structure.

Name	Job Title	Grade	Current Salary	Grade Min	Grade Mid	Grade Max	Compa-Ratio	Range Penetration
John	Marketing Manager	4	11,452	10,456	14,638	18,821	78%	12%
Sam	HR Manager	4	16,000	10,456	14,638	18,821	109%	66%
Edna	Sales Executive	4	9,875	10,456	14,638	18,821	67%	-7%
Marko	Engineer	5	10,000	8,043	11,260	14,477	89%	30%
Magwe mbi	Mine Manager	5	11,260	8,043	11,260	14,477	100%	50%
Nhamo	Front Office Manager	7	6,742	4,759	6,663	8,566	101%	52%
Musumo	Corporate Affairs Officer	7	5,689	4,759	6,663	8,566	85%	24%
Obert	HR Officer	7	5,460	4,759	6,663	8,566	82%	18%
Matemai	Accountant	6	7,845	6,187	8,662	11,136	91%	34%
Vitalis	IT Administrator	7	4,987	4,759	6,663	8,566	75%	6%
Costa	Internal Auditor	6	5,640	6,187	8,662	11,136	65%	-11%
Morgan	Secretary	8	5,620	3,661	5,125	6,590	110%	67%
Nyasha	Procurement Officer	9	2,896	2,816	3,942	5,069	73%	4%
Sharon	Machine Operator	13	2,563	986	1,380	1,775	186%	200%
Diana	Driver	14	1,245	758	1,062	1,365	117%	80%

Dhama	Cleaner	16	785	449	628	808	125%	94%
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The first control mechanism is to review the compa- ratio. The compa- ratio is the position of an individual’s salary relative to the midpoint of that grade. Ideal compa-ratio must be between 80% and 120%. Anything outside this range must be investigated and justified where necessary. The more you have people outside this range the more complains you are likely to get from employees about pay equity. There could be valid reasons why some people are outside this range. As an example, you may get people who are paid outside this range because their jobs which used to be in higher grades were downgraded after a [job evaluation exercise](#) {Person to holder roles}. These can be managed and be brought within the range gradually with time. For that to happen there must be a conscious decision to target such roles as you manage the pay structure over time. One way is to give them less salary increase every time you do salary adjustment.

Range penetration looks at the movement of an individual’s salary within the pay range. Flag those over 100% and those in negative and investigate why they are in that situation. Where possible make an effort to bring them within the right range.

Avoid pay compression – There are various forms of pay compression. This can be a situation where there is very little difference in salaries for people in the same grade. This could be because the company does not use pay to recognise differences in performance, length of service, qualification etc. As a result, you may find people who join the organisation today earn the same salary as someone who has been with the organisation for 10 years. This could also be a result of narrow pay ranges that do not recognise the variation of salaries on the market for jobs of equal value to the organisation. Another form of pay compression is grade creep, where people in a lower grade end up earning close or above the midpoint of the adjacent higher grade. This may be due to salary adjustments that target to give more salary adjustments to lower grade employees compared to managerial grades. You can use the following formula to check for pay compression; Pay compression factor =average salary higher grade/average salary of lower grade. Or use Standard deviation and covert to Coefficient of Variation. A smaller CV could indicate pay compression or no differentiation based on performance.

What to do when you are giving salary adjustments?

Compa Ratio	80%	85%	90%	95%	100%	105%	110%	115%	120%
Salary adjustment	50%	45%	40%	35%	30%	25%	20%	15%	10%

Whenever you are doing salary adjustments, make sure you take into consideration the individual’s position within the pay range using the compa- ratio. People with lower compa-ratio will get more than people with higher compa-ratios. The reasoning here is that people on higher compa-ratio are already being rewarded adequately given that this is a permanent adjustment. By using compa-ratios to do salary adjustments you ensure you maintain equity within your pay structure.

Merit Increase Table

Compa- Ratio									
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	80%								
5	50%								
4	40%								
3	35%								
2	0%								
1	0%								

If you are giving merit increase, you use a table similar to the one above.

Table 3 – Moving Employees within the Pay Range

Grade	Minimum	Midpoint	Maximum	Range	Progression
	New/Poor Performers	Top Performers	Exceptional Performers		
1	22,971	32,160	41,349	80%	30%
2	17,670	24,739	31,807	80%	30%
3	13,593	19,030	24,467	80%	30%
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Start new and less competent individuals at the minimum or close to the minimum, top performers around the midpoint and exceptional and consistent performers around the maximum. The exceptional performers are often very few per grade. Once you have too many of these in each grade, it could be an indication of a fault performance assessment system.

Job Grading revaluations

Once you have an approved grading structure avoid to ever entertain speculative submissions for job re-evaluations. These are submissions not based on significant changes in job content. Once you accept such a trend, your grading systems will lose credibility. Thereafter you will find that you may need to change the grading system because people have lost trust in the grading system.

Arbitrary Grade Changes

One of the biggest challenges to maintaining an equitable pay system is when senior management has the power to arbitrary move people into higher or lower. This will normally be based on the personal circumstances of the individual. This is a sure way to bring inequity in the pay system. One area to guard against is; never move an individual into a higher grade, holding the same job title unless the job has significantly changed in job content such that it is re-evaluated and thrust into a higher grade.

What is a salary notch?

A salary notch depicts a subdivision of a pay range into equal percentage steps. These predetermined steps are used to manage pay progression within a grade. As an example, you may find that on an anniversary date each year an individual is awarded a certain predetermined number of notches. While administratively, it looks easy to administer, it is associated with managing pay in the civil service where performance is rarely a factor in salary progression. The trend nowadays is to do away with notches and use merit tables when adjusting salaries. This takes into consideration the individual's performance within a particular period.

Transparency

While most organisations believe that they gain from hiding their pay structure, the opposite is true. There is nothing wrong with sharing your full pay structure with your employees through the correct internal channels. If your culture is not tuned to that, at least share with each employee the minimum, midpoint and maximum salary for their grade. Let them know what they need to do to progress within the pay range e.g. You may want to let them know that every year or quarter their performance will be factored in all salary adjustments.

What to do when you are hiring and the new employee is demanding a salary higher than the grade maximum?

Grade	Minimum	Midpoint	Maximum	Range	Progression
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Let's say you are hiring a Procurement Manager, who happens to be in grade 3. For the new manager to join your organisation they are demanding a salary of 23 000 USD. This is a big challenge. If you are experiencing frequently problems of this nature, it could mean that your pay structure is not competitive. You may have failed to adjust your whole pay structure to align with market movements. If you are lagging behind too much it may now even be more costly to adjust the pay structure. The best way forward while you are trying to fix the lagging pay structure will be for you to pay them a basic pay of 15 598 USD, plus a variable 7 402 USD. Put tight conditions on the variable component. With time if they are worth their demand you should be able to accommodate them within their grade structure.

Benefits Structure

Once your pay structure is in place you need to come up with a benefit structure. Here, you list all grades from grade 1 to 16 in the first column, then horizontally you put all the benefits you offer e.g. company vehicles, school fees, medical aid etc. All these tend to vary with grade. Employees need to know upfront which benefits apply to their grade.

Total Cost to Employer

Most employers are now moving towards the total cost to the employer concept. The basic principle here is that every earning is converted to cash and the employee chooses how they want to utilize their money. It is a less paternalistic approach. It allows the employer to know staff costs with certainty upfront. This allows for better costing of products and services.

Pay is both a cost and an investment

In organisations where employees are paid for not giving value, certainly, pay becomes a huge cost to the business. Why is that so? Every dollar spent on staff costs reduces profit and ultimately shareholder value. Pay can also be viewed as an investment, where for every dollar invested in staff costs the business gets, for example, \$3 in return. For most businesses, there is no direct link between what they pay staff and the profitability or even revenue. If there is more return in the dollars invested in staff costs, why would you hesitate to increase salaries and benefits?

Factors to consider as you design your pay structures

As you design your pay structure always look at your ability to pay and how sustainable the pay is. Take into consideration factors such as; economic factors, labour supply, market salary trends, socio-political environment, legal environment and Short term vs long term orientation of your business.

What is your philosophy concerning pay mix



My view is that those organisations that have proportionally high fixed and guaranteed pay tend to get less value from what they are paying employees. In such organisations, employees know whether they perform or not their earnings are guaranteed. A 98% fixed and guaranteed pay is not good for any business. Such organisations would need to restructure the pay system so that the system supports how the business generates value for shareholders.

Why is pay structure important?

A pay structure is a very useful and valuable tool used by organisations to create and maintain internal pay equity within the organisation. Done properly, it reduces complains related to job grades and salaries.

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