Base Salary

The base salary program is the foundation of all other pay programs in the organization. A good base pay program starts with a philosophy and a set of objectives that the company is trying to achieve by setting up the program.

A typical philosophy statement might go something like this:

> ***In order to support our ability to recruit, develop and retain a diverse group of employees with the right skills for the right position, we have established an objective to maintain our base compensation program at or above average market rates.***

Objectives define what your organization expects to achieve with the base compensation plan. Objectives align employees' compensation with the strategic goals and performance of the Company.

Here are three compensation objectives that are quite often found in compensation programs.
- Align interests of employees with those of shareholders, customers, and the Company.
- Create a sense of fairness and equity.
- Attract, motivate and retain high caliber employees with the skills and competencies required to achieve business objectives in the global marketplace.

Once the philosophy and objectives of the program it is time to start developing the base compensation plan. There are at least five components that make up a good base pay program. They are discusses below:

1. Competitive and Equitable Base Salaries and Pay Structures

In order to put a company's base salary program in perspective, it might be worthwhile to review the results of a recent survey. In a summary of findings from this recent study sponsored by the WorldatWork, the majority of companies reported that they:
- Pay at the middle of the labor market (i.e., 40^{th} to 60^{th} percentile). (81% of companies reported this)
- Have salary ranges that are between 30% and 70% wide;
- Adjust salary ranges annually;
- Formally assess individual performance and assign performance ratings on a scale with three to five ratings;
- Base salary increases on assessment of individual performance; and
- Pay increases that are primarily determined by a combination of individual performance compared to job standards (68%), performance compared to objectives (50%), or the market value of the position (50%)

It is interesting to note the first bullet where 81% of the reporting organizations reported having a base salary target between the 40th and 60th percentile. According to statistical rules only 20% are actually between the 40th and 60th percentile.

This information gives a company a great starting point as they design their compensation program.

Why is a Base Pay Structure Needed

Every supervisor and manager is challenged to make decisions that provide fair and equitable compensation for employees. In the absence of a rational frame of reference, these decisions may reflect only rates negotiated at the time of hire, the perceived importance of an individual's traits, or the supervisor's personal estimates of compensation trends. This may lead to a pattern of pay rates that is difficult to defend or evaluate. A properly designed base pay structure can provide an invaluable and creditable basis for making pay decisions and establish a sound foundation for analyzing and comparing other forms of direct and indirect compensation.

A base pay structure is essentially an administrative construct that incorporates the internal value or rank of jobs and external competitive rates of pay into a basic scheme of approved limits and target of base pay. The structure design process requires express consideration of market rates as reported in various salary surveys, the company's pay philosophy, cost/budget constraints, and performance management systems.

- The salary range is designed with the midpoint of the range being set at the market rate for the specific position.
- The minimum rate is set at a value that is typically 80% of the midpoint and should be used for employees who are new to the job.
- The maximum is set at a value that is typically 120% of the midpoint or market average.

Normally on an annual basis the salary range midpoint is compared to the labor market as represented by a number of compensation surveys. Based on market data the salary range midpoints are adjusted to maintain their position relative to the market.

Market Decisions

Before one develops a pay structure, one should answer the following question. How do we want to pay in relation to the market? The market is typically defined as the area from which applicants are recruited for a particular job or set of jobs. The market rate is the average rate of pay for a particular job or set of jobs.

How should we pay in relation to the market? The answer to this questions is, it depends. It depends upon the compensation philosophy. It depends upon the financial condition of the company. It depends upon labor market conditions such as the unemployment rate. It depends upon the availability in the market of the key skills needed. For example, if there is high unemployment, the market position might not be as critical as if there is low unemployment. If there is a tight labor market, a company may wish to pay higher than the market.

A few years ago a friend of mine worked in a company that had a philosophy of paying at the 25^{th} percentile of the market. That means that they were willing to pay less than 75 percent of their competitors for labor. They were willing to do that because there was a ready supply of the type of labor they needed and the training period on most of their jobs was very short.

The old economy tradition of having one pay structure has become obsolete. Firms now establish multiple pay structures. Typically one finds, at a minimum one for exempt and one for non-exempt jobs. Additionally some companies have a separate structure for sales positions a separate one for managerial positions, a separate one for executive positions, and a separate one plant jobs.

2. Merit Increase Program

As there are various levels of performance among the employees in the same salary grade, there should also be various salary levels within the salary range. Those who are top performers should, over a period of time, be paid in the upper part of the salary range.

Most companies will indicate that they have a pay for performance program and that the base pay is determined by the performance of the individual employee. However it is infrequent that we find a company that really pays for performance. The annual merit increase has become to be expected and considered an entitlement unless the performance is so bad that the employee is about to be terminated.

Also a number of other factors should be considered when making a salary increase, such as

- position requirements (responsibility);
- the individual's time and experience in their present position;
- the individual's pay history, i.e., time since last increase, salary position in the salary range;
- pay relationship to other employees with similar experience and responsibility;
- the amount of money available for salary increases within the applicable merit budget; and
- the market rate as depicted by the salary range for the position.

3. Promotional Increases

When the pay program is developed one should define a promotion and a lateral move. A promotion is one where the job one moves to is at least one grade above the job one left. Another definition might be one where the new job has a midpoint or market rate that is at least ten percent above the job one is leaving. A lateral move is where the new job is in the same grade as the old one or the difference in midpoints is less than ten (10) percent.

4. Equity Increases

An equity increase is one that is necessary to correct a pay inequity between two employees, the employee and the market, or the employee and his or her supervisor.

5. Pay Administration

A good Compensation Policy and Administration Manual is essential to assists management with job definitions as well as wage and salary administration. It should also provide an overall understanding of the Company's policy and administrative guidelines with respect to the following:

- Salary Grades and Ranges: How they are set, when are they reviewed, which surveys are used, etc.?
- Merit review: When are they done, what is the process, is there a salary increase guide?
- Lump Sum Merits: When are they used, for what purpose, how is the amount determined?
- Promotions: Define when a move is a promotion and define the range of increases that are appropriate at the time of a promotion.
- Equity Adjustments: What do we mean by equity, equity with whom, who has to approve an equity increase, etc.?
- Cost of Living, General Increase: Any across the board increases that might be given outside of the above should also be defined.

Each of these items should be defined and communicated to all employees covered by the program.

Pay Plan Effectiveness

Once the pay plan has been developed there are a number of questions one must answer satisfactorily to determine if the pay program is effective. Those questions are:

- Does it support the organization's mission and strategy?
- Is it compatible with the organization's culture and the needs reflected by workforce demographics?
- Is it cost-effective and externally competitive?
- Does it share the success with the employees who help the organization succeed? Does the workforce perceive it as fair and equitable?
- Is it integrated with other HR functions, such as, employment, benefits, et al? Do they support each other?
- Is it simple to communicate and relatively easy to administer?

Summary

Current trends in total compensation reveal a lower base pay, greater emphasis on performance-based variable pay, long-term incentive compensation and non-cash reward and recognition practices such as benefits, perks and non-cash rewards and intrinsic rewards.

According to an October 2000 study by the Corporate Leadership Council, salaried employees receive total compensation comprised of base pay, incentive pay, and gain sharing while non-exempt employees receive base pay, overtime pay and intrinsic rewards.

In the next issue, I will take a look at incentive pay and how it fits into the total rewards picture.