


# Handbook of Human Resource Management in Government


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CHAPTER TWENTY-NINE

# Designing and Creating an Effective Compensation Plan

Gilbert B. Siegel

Generally, the quality of a pay plan can be judged by criteria such as its internal equity, competitiveness with outside labor markets, usefulness to managers, political acceptability, and understandability. However, the emphasis on and importance of each of these criteria will vary with the objectives of a pay plan. Accordingly, this chapter begins with a consideration of compensation objectives.

Pay systems are also highly instrumental in personnel recruitment, retention, and motivation. Thus another important topic in this chapter is the relationship between compensation and performance, and several variations on individual and group merit pay systems are discussed. The latter part of this chapter is devoted to a step-by-step discussion of constructing and maintaining an effective salary structure, bringing together objectives, structural alternatives, and pay administration policies.

## OBJECTIVES: WHAT DO WE PAY FOR?

### Membership or Seniority

**Traditional Civil Service Pay System.** Objective setting is such a fundamental aspect of management that the need for it often goes without articulation. Sometimes the reason concern for objectives in compensation is obscured is that a system has been in use for so long that no one can imagine organizational life

without it. Such is the case for traditional civil service compensation systems, based as they have been on position classification, multiple-step or -rate salary ranges, and seniority pay progression. The objective in this type of system is pay for membership or seniority. The traditional model of civil service personnel administration has relied on merit competition to obtain qualified personnel. Once they are appointed, the idea is to make their employment so attractive that it is difficult for them to leave the service. This objective is supported by various forms of indirect compensation as well, such as generous retirement systems.

Realistically, however, not only have times changed but seniority-based systems can no longer be afforded by most governments. Neither the government revenue nor the political support for such largess is available. Yet costs continue to escalate as a result of the annual increases built into the public employee wage bill. Apart from growth in a public workforce for programmatic reasons, increases in costs can be attributed to the continuous pay increments required by seniority steps, cost-of-living increases and inflation adjustments, and adaptation to market rates. These upward adjustments result from inherent policies of the system and also from legislation, labor contracts, and the need to maintain competitive salaries.

**Fringe Benefits.** Like the objective of pay for membership, the objective of fringe benefits is to retain the workforce. Like the increases in pay for membership, increases in fringe benefits have driven up the cost of government labor. Public and private organizations are now attempting to retreat from generous fringe benefit entitlements. Nowhere is this better reflected than in health benefits, though retrenchment is also evident in such other entitlements as leave and pensions. Health insurance costs are being controlled through such varied containment strategies as enrolling employees in managed care, requiring employees to share or increase their share of premium costs, increasing deductibles or requiring them where they do not exist, requiring employees to share costs of treatment (coinsurance), and adding no new features to plans.

Costs of pension systems have been driven up by the demographic fact that people are living longer. Therefore the original actuarial assumptions of plans are often no longer valid. For the same reason, the past generosity of public employers toward retirees can no longer be tolerated. Thirty years ago, during the epoch of government union strength, political officials often agreed to sweetened pension benefits as a trade-off against higher salaries. Today's politicians are living with the consequences of these decisions. Accordingly, as a result of attempts to head off high future costs, it is not uncommon to see multitier systems with benefits based on date of hiring.

Another major adjustment governments are making is to switch pension funding from a defined-benefit to a defined-contribution approach. In government systems, the defined-benefit arrangement is normally financed by periodic

monetary allocations from employers and employees, in amounts sufficient to provide determined monthly payouts upon retirement. The amount of these payments is based on a formula involving, for example, an individual's years of employment and the average of his or her three highest salaries. Assuming that contributions are made in a timely fashion, pension managers are able to meet liabilities of the system through fund investments and actuarial projections. Problems have arisen when public jurisdictions fall behind in meeting their contributory obligations. Sometimes the government is so in arrears that the system is transformed from an actuarial reserve to a pay-as-you-go basis of financing in order to meet current obligations to pensioners.

In contrast, the benefit system financed by defined contributions is more like a set of individual retirement accounts (IRAs). As with defined benefits, most governments contribute to employee accounts. The level of the contributions may or may not have been reduced during a transition between systems. For example, employees under more recent federal retirement plans receive even lower government allocations than employees covered by older entitlement systems. On the positive side, however, employees can increase personal funding with pretax dollars. Without this employee enhancement of funding, estimated retirement payouts are based on assumptions about length of work life, earnings, contributions, and compounded rates of investment return, including reinvestment of interest and other returns. These benefits are usually portable or at least the vested property of the employee. Portability of a pension account is important for the person who has earned minimal entitlements in more than one system but has not remained in one long enough to maximize retirement payouts.

## Equity and Job Value

As discussed in the previous chapter, comparability of work and pay has been a sticking point with civil servants since the earliest civil service reforms in this country. In response the idea of internal organizational *equity* has been implemented as the basis for development of pay scales. Through job evaluation systems, positions are classified into jobs, jobs are given relative hierarchical value, or weighted, and this valuation is reflected in salary ranges to which similarly weighted jobs are allocated. The result is internal organizational equity. Although seemingly felicitous, this concept has some problems, as we will see.

## Market Comparisons and Ability to Pay

**Market Value.** One problem with a pay system based on job evaluation is that it can be at variance with the market value of some jobs. For example, education and experience requirements for the job of social worker might lead to a range of pay that is higher than what the market will pay. Further, markets for some jobs vary on such dimensions as geography and proximity of work to residence. Labor-management negotiation of salaries, wages, and fringe benefits

is a surrogate for the action of market forces. Presumably both sides are armed with market data preliminary to negotiations.

**Comparable Worth.** *Comparable worth* (sometimes called *gender equity*) refers to pay disparities between occupations, or job classifications, dominated by women and those dominated by men. The debate on this subject was settled by the U.S. Supreme Court in *County of Washington* v. *Gunther* (452 U.S. 161 [1981]). Advocates of comparable worth would like all jobs evaluated as having equal value to be compensated in the same range of pay. Furthermore, they would make job evaluation more uniformly inclusive, requiring a common set of factors and weights for all jobs in an organization, from janitor to highest executive, and would ignore differences in market rates of compensation for occupations otherwise seen as having equal value. However, the Court decided that unless comparable worth is legislated by a jurisdiction or agreed to under labor contract, market data can be considered in setting pay where job value is at variance with market value. This applies to jobs of equal weight that are not essentially the *same.* Under the Equal Pay Act of 1963, jobs that are basically the same must be compensated in the same pay range.

**Ability to Pay.** Governments sometimes find themselves in the position of being unable to compete for personnel. As a result, ability to pay becomes an unarticulated policy limitation on compensation. This limitation may apply only to certain occupations or be a problem in general. However, few governments have a formal ability-to-pay policy, such as to pay market or 10 percent below or above market. Such policies are more often seen in the private sector.

## Knowledge or Skill

Knowledge or skill is a relatively new compensation objective (Lawler and Ledford, 1985; Gupta, Schweizer, and Jenkins, 1987; Gerson, 1987) that can be added either in job or in team contexts. Pay is for depth (more knowledge or skill in a specialized area), breadth (knowledge or skill that extends upstream, downstream, or parallel to original job), and height (expansion of management knowledge or skill). Further, pay is for performance capabilities, not necessarily for work performed. This pay objective may be important in situations requiring a cross-trained workforce or workforce flexibility and adaptability. It can be used with a broadband pay system. A given process performed by a team might be represented by a band, or alternatively, several bands could be segments of a still larger process. For positions each band might consist of several discrete skill or knowledge blocks that would be differentially compensated. If a job's compensation needed to be compared to market rates, the block with the highest aggregation of skill and knowledge would be compared to market. This compensation objective, with or without broadbanding, appears to be an alternative

suitable for Total Quality Management/Continuous Quality Improvement (TQM/CQI) situations.

## Performance, Achievement, or Merit

*Performance, achievement,* and *merit* are synonymous in compensation systems based on outputs or outcomes. Reward is for specified objectives achieved in quantitative or qualitative terms. Two types of such systems are distinct but share the reward-for-achievement attribute: individual performance and group performance systems.

**Individual Merit Pay.** The longest government experience with individual merit pay has been in the federal government, where this form of pay was first authorized under a demonstration project of the Civil Service Reform Act of 1978. The experiment, carried out in Navy research and development laboratories, was a success but occurred as part of a more comprehensive change in personnel management practices (Naval Ocean Systems Center, 1979). Initiation of the practice throughout the federal government has proved less of a success.

The following general introduction to merit pay will be helpful before we look at actual government experience in more detail. An objective of paying for individual merit is ideally suited for a broadbanding pay system because it is less restricted than other objectives by traditional pay range limitations and its emphasis on personal rank allows greater flexibility in personnel management. As noted in the previous chapter, broadbanding systems are not for all situations because they require fundamental change in the management culture, including empowerment of managers in areas of personnel management, performance measurement, and deviation from the ethos of equal pay for equal work as it has been generally interpreted.

**Group Performance Systems.** Although several group performance and reward systems are used in the private sector, this chapter primarily considers *gainsharing* and *goalsharing* (also called *winsharing*) (Bullock and Lawler, 1984; Schuster and Zingheim, 1992) because these are the most feasible for government organizations. These are group bonus plans in which monetary savings from improved performance are shared between the organization and employees of the better performing unit.

Under gainsharing, standard hours of direct labor in each unit of output are measured and compared with historically based long-term standard performance levels. Payouts are based on the value of productivity improvement. A variation is to use baseline work measurement standards based on current performance as performance criteria. The leading experience with gainsharing in government was the Air Force's Pacer Share Project, carried out by the Directorate of Distribution of the Sacramento Air Logistics Center at McClelland Air

Force Base in California (Siegel, 1994; Schay, 1993, 1995). Pacer Share was another demonstration project under the Civil Service Reform Act. A TQM/CQI intervention, it principally involved technical improvement of work processes, reductions in force, an extended period of negotiations with unions prior to project implementation, broad bands based on consolidation of pay grades, work allocated to six process categories based on contributions to common outputs, elimination of individual performance appraisal (the idea being that quality measurement for workgroups would substitute), pay levels adjusted automatically for federal government changed rates reflecting cost-of-living increases (comparability), and extensive TQM/CQI training. Productivity bonuses were distributed for beating baseline labor distributions relative to outputs—half to the federal government and half in equal shares to each worker.

In contrast is goalsharing, which is forward looking and bases payouts on group performance compared to predetermined goals, often with a quality modifier. Current productivity against previous standards may be measured as well. Payouts may be allocated as a percentage of base salary or as the same percentage of the market rate. This system might be combined with pay for membership or to compete with market rates, or it might be the sole basis for compensation. It requires a compensation infrastructure for determining goals and payouts and accounting systems that track contributions to organizational performance. A simpler version of a goalsharing system might be applied in the public service through management-determined or collectively negotiated goals.

## MULTIPLE PAY SYSTEMS AND MULTIPLE OBJECTIVES

It is not likely that a public organization will have only one or few compensation objectives in the future. A current of environmental change is requiring governments to rethink traditional compensation systems that have rewarded mainly membership in multiple ways. Some of these important environmental changes are the reduction of government revenues; the introduction of reengineering and downsizing; and the flattening of organizations, accompanied by a recasting of vertically progressing careers to horizontally progressing careers requiring multiple roles, constant learning, and change.

This is not to argue that membership is to be avoided completely; it remains a factor in both workforce retention and the constant process of weeding out low performers. But in designing and creating a compensation plan, it is important to have in mind for what and how you are paying the workforce. Membership can be a reasonable objective because it promotes maintenance of the workforce, and perhaps fringe benefits are the best way to achieve this particular goal. Sensitivity to market changes in compensation is another way to prevent extensive turnover. What is important is not to emphasize or reward only membership.

However, if managers are to take compensation cost containment seriously, the annual-increase effects of multistep pay ranges need to be curtailed. Whether merit pay is to be applied or not, it is possible to use a system of flat rates or no more than two rates for each range (say, entry and fully competent levels); or the ranges themselves might be entry, journey, senior, and expert or supervisor. Salary adjustments other than for promotion would then be made based on performance or market rates, perhaps conditioned by the jurisdiction's ability to pay or by collective bargaining. A bonus system might be introduced for the part of compensation that is performance-based pay. Bonuses do not add to base salary and must be re-earned during each appraisal period.

In the previous sections, a series of objectives and systems have been described through which it is possible to produce and maintain a high-performing, flexible, and adaptive workforce. However, what may be a viable system for some employees may not be effective for all. Most of all, how systems are implemented is of critical importance. For these reasons, problems with performance-based systems are discussed in the next section.

## PROBLEMS OF PERFORMANCE-BASED SYSTEMS

### Individual Merit Pay

An important compound question is, Would/do government employees work harder/achieve more for higher compensation? The data are definitely mixed on these questions. The answers also evolve as contexts of government employment and economic and political environments change. On the one hand, data from the 1980s for some federal employees suggest that employees would not work harder for more money. What they feel to be important are coworkers, future pensions, and workplace comforts (Pearce and Perry, 1983). These may be the things that attracted them to federal employment in the first place. As recently as 1990, the Merit Systems Protection Board reported that 72 percent of federal supervisors felt that part of their pay should be based on performance, but only 42 percent would choose to be under a merit pay system. Only 38 percent of federal employees in general felt that pay is related to how well you perform (Schay, 1995). Rainey (1983) and Rainey, Traut, and Blunt (1986) came to the conclusion that state and local government employees have lower expectations for pay-for-performance links than do comparative private-sector groups. Rainey's study also revealed correlation of weak expectancies with the organizational constraints on pay-for-performance.

On the other hand, Navy and National Institute of Standards and Technology (NIST) experiments have shown positive attitudinal findings, such as employee perceptions that raises were linked to performance, that high performers stayed and low performers left the organization, and that individuals were sat-

isfied with pay (Schay, 1995). Both of the experimental units involved are science and engineering organizations that were granted authority to significantly alter their personnel systems to support high-performance environments. Further, they did not commit many of the merit pay system implementation and administration errors that plagued first efforts at merit pay for GS 13 to 15 managers and supervisors and super-grade managers in the federal government: abrupt changes in agreed-upon levels of rewards (Silverman, 1982); lack of training in performance appraisal (U.S. General Accounting Office, 1984); lack of follow-through when planned performance objectives were no longer viable (Perry, Petrakis, and Miller, 1989); pursuit of planned objectives resulting in neglect of other duties (Pagano, 1985); use of a pay pool system of competing for rewards that did not work well (Pagano, 1985; U.S. General Accounting Office, 1983); insignificant amounts of money available for rewards (Harron, 1981; Pagano, 1985; Silverman, 1982); creation of individual performance contracts, resulting in divisiveness when coordination and interaction were required (Pagano, 1985); use of evaluation based on nonplanned objectives (U.S. General Accounting Office, 1984; Sauter, 1981); and general perception of favoritism in reward allocation (U.S. General Accounting Office, 1983).

In general, it can be concluded that individual merit pay can work well where certain conditions are met; conversely, their absence can result in failure. Desired achievements to be rewarded must be within the ability of the individual to carry out. Tasks or functions of positions so compensated should be ones for which the individual controls the pace of work and its achievement rather than being highly dependent upon others. Superiors and subordinates must be trained in the process of setting performance objectives (unless studied performance measurement systems already in place can be the basis of assessment). Performance objectives should be meaningful; they should be within the state of the art of the particular function involved. Undesired behaviors prompted by the setting and rewarding of specific objectives must be anticipated and circumscribed (for example, a concentration on rewarded objectives to the neglect of objectives that are not objects of special reward). The reward must be valued by the person who is to perform. The person must be able and willing to perform. Performance should be monitored and compared with plans; in other words, there must be feedback and evaluation. At this point questions may arise from the previous steps. Were any of the conditions changed in the process? Were either rewards or outcomes imprecisely or insufficiently identified? Finally, is the entire process worth it in cost-effectiveness or cost-benefit terms for the individual? for the organization? (Siegel, 1989). The requirements of individual merit pay are onerous if carried out continually by superiors and subordinates. As discussed, considerable investment in infrastructure such as training is needed, and a commitment to large amounts of time for goal setting, reviewing, evaluating, and rewarding is needed.

Skill-based pay is a special case of individual merit pay for which the research evidence is different. As of 1992, Schuster and Zingheim could find no evidence that organizations get direct financial gain from skill-based pay. However, other positive effects were discovered in a 1986 U.S. Department of Labor survey (pp. 143–144). Most organizations with skill-based pay improved workforce flexibility; improved employee satisfaction, commitment, and motivation; and increased output per hour worked. About half reduced labor costs and layoffs. Somewhat fewer reduced absenteeism and voluntary turnover. However, there were also disadvantages: costs increased as employees learned more skills, training and administrative costs increased, complex record keeping on individual certification and pay was required, and continual skill proficiency assessment presented problems.

## Group Merit Pay

Growing numbers of private-sector organizations are embracing forms of team-based pay ("What's the Best Incentive for Employees?" 1992; "Companies Shift (Slowly) to Team-Based Pay," 1995). Bullock and Lawler (1984), in a study of thirty-three gainsharing programs, concluded that most resulted in improvements in such areas as productivity, quality, customer service, and reduced costs, accompanied by improvements in morale, attitudes, and quality of work life. However, they cautioned that relatively unchanging organizations are needed for such success, with no new technology introduced, flat learning curves (so managers can set standards from historical data), little capital investment planned, little use of overtime, high levels of trust, a largely nonunion workforce, a highly participative management style, and stable product lines.

Results from the Air Force's Pacer Share Project are mixed and raise more questions than they answer (Schay, 1993, 1995; Siegel, 1994). Although there were fewer grievances and the work climate improved, productivity did not increase relative to baseline data and in comparison with control groups. There was dissatisfaction with the connection between job performance and compensation and with opportunities for advancement. Quality measurement did not satisfactorily substitute for individual performance appraisal. Schay's interpretation (1993) was that "elimination of performance appraisal resulted in weakening of the pay-performance link" (p. 663), that line of sight that should exist between the individual's work, achievement, and ultimately, reward.

Some type of group bonus system is needed for TQM/CQI to work. It is possible to attain flexible, self-controlled workgroups where employees work harder and smarter. However, the organizational climate must support cooperation and employee empowerment. Workgroups do not function in highly competitive, individualistic cultures. As mentioned, a line-of-sight problem between work and reward may be unavoidable in any case. Some innovation, such as 360-degree performance evaluation (in which superiors, subordinates, and peers all evaluate each other), may alleviate this problem.

# HOW TO CONSTRUCT AND MAINTAIN AN EFFECTIVE SALARY STRUCTURE

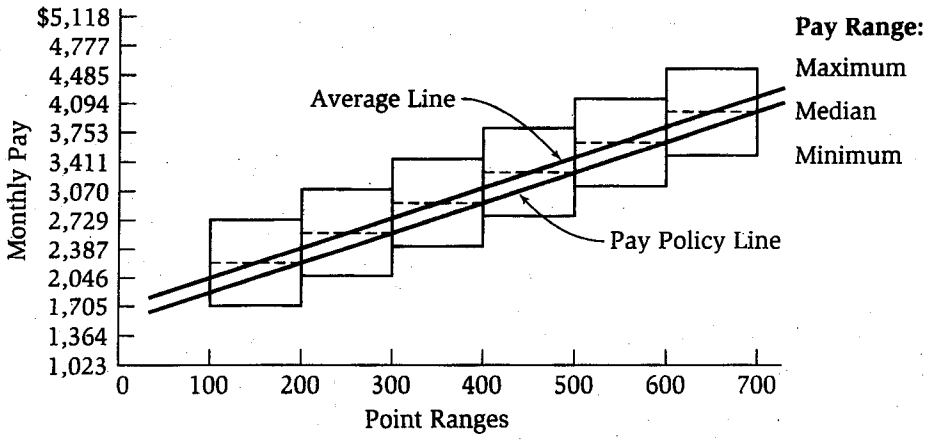
We now turn to a step-by-step approach to constructing and maintaining salary standardization, along with a discussion of design alternatives. The basic issues are (1) design structure and policies and (2) administration of pay. Both relate to the compensation objectives previously discussed.

## Step 1. Design Pay Ranges

We learned in the previous chapter that point values for benchmark positions derived from job evaluation (as are found in a factor-point system) must be correlated with the pay rates for these positions. It is a good idea to go to the marketplace for these pay rates rather than to use internal organizational rates. In addition, the correlation should produce a tight cluster of values around the average line. Values that significantly vary should probably be removed from the analysis because they distort the average. (Market surveying of benchmarks is discussed later in this chapter.)

Figure 29.1 illustrates one model of pay range design. Focusing for the moment on the two diagonal lines, it can be seen that one represents averages derived from correlating pay medians with job evaluation point values for benchmark positions. The other represents the pay policy line, which in this case is below market. (Remember from the discussion on ability to pay earlier in this chapter that the organization may set a policy on what it will pay relative to market.)

**Figure 29.1. Constructing Pay Ranges.**




*Pay range:* Job A is worth 200 job evaluation points. It is allocated to range 2, which is 200 to 300 points. Range 2 is $2,046 to $3,070 per month.

Once the average line is available, a worksheet can be provided for trying out different pay range designs. Various point ranges on the *x* axis can be tested against ranges of pay on the *y* axis for pay periods of the jobs in the system. Most managerial, professional, clerical, and technical support jobs are compensated on a monthly basis (the pay period used in Figure 29.1), and blue-collar jobs are often paid hourly rates. It can be seen that the ranges in Figure 29.1 (indicated by the boxes) are linear. They also have a constant overlap of about one-third as they increase in points and dollars.

Once the pattern of ranges is designed, the pay ranges of the *y* axis are converted to tabular form, and the compensation levels available in each range are indicated based on the organization's policy on how employees will progress in the range: for example, step rates might be used (administration of pay within ranges is addressed further later). The point ranges on the *x* axis then become the guide for allocating positions (which have been previously job evaluated) to pay ranges, as the pay range example in Figure 29.1 illustrates.

Many pay range designs are possible, each with potential implications for pay policy or administration. For example, ranges may touch only at corner points as they ascend. This emphasizes a structure of flat rates without overlap in points or dollars. Overlap in pay ranges gives management the flexibility to reassign personnel to jobs allocated to neighboring ranges without having to increase or decrease pay. A corner point design might be the result of negotiated flat rates, particularly for craft jobs, where pay rates are considered to be separate for each craft.

Another design arrays the ranges on a positively inflected curve rather than a straight line. This, with no changes in the rest of the design features, means that higher compensated jobs begin at the point of upward inflection of the curve. The widths of the point ranges, however, remain constant, as do the widths of pay ranges. This outcome might occur when too broad a spectrum of jobs is encompassed by the job evaluation and pay plans, as when pay standardization covers all organizational jobs rather than separate subsystems.

Yet another design is positively curvilinear but with diminishing job evaluation points and higher levels of pay as the curve ascends. Here management wants to be less bound by job evaluation criteria and to be free to award increased pay for the higher-level jobs.

What would a broadband design look like? Assume that the graph is for jobs in a career progression, such as office clerical and technical personnel. Each box on the graph then represents career progression for a job, with possibility of movement to other boxes on the plot for designated jobs. However, pay range widths would be exaggerated, usually in excess of 100 percent (that is, maximum pay minus minimum pay, the result expressed as a percentage of the minimum). This design allows the personal rank concept to be applied to individual positions.

## Step 2. Conduct a Pay Survey

Even though job evaluations represent the organization's value system for its jobs, the organization still must consider market rates in order to compete in recruiting, to adjust its pay policy relative to market rates, and to adjust its pay standardization to market averages. The latter purpose is also important for adjusting pay levels to reflect inflation in the general economy. Several U.S. Department of Labor indexes might be used to determine increases in cost of living, but they are based on selected purchases and subject to statistical artifacts, such as variations in the significance of the cost changes of the purchases and variations in the importance of the purchases as indicators. Better is to use average market rates for benchmark jobs, because these rates reflect both market adjustment to inflation and occupational supply and demand effects.

Survey data from other organizations might be relied upon solely or for comparative purposes. Various professional organizations do national surveys of their occupational specialties as do consulting companies, the U.S. Bureau of Labor Statistics, and several state agencies. Of course, comparability of benchmarks must be considered. Fundamental for an organization conducting its own survey are accurate job descriptions, particularly for benchmark jobs. As discussed under job evaluation, if the organization does not have a quantitatively based job evaluation system, it must develop one if it is to survey the market and design salary standardizations.

The geographic area to be surveyed will vary from job to job, depending upon the occupational specialty and the community of recruitment. For example, a small or medium-size city in a metropolitan area may survey only similar cities and local businesses for data on common clerical jobs. This is because many of these jobs are filled by secondary wage earners who prefer to work close to home. Many blue-collar jobs are filled locally as well. Even some professionals are attracted to a limited commuting distance and may be willing to trade off some salary for it. However, markets for most managers and professionals are at least regional, usually national, and even international in some cases. Because of the extensive spread and size of its workforce, the federal government has developed area rate adjustments for various metropolitan areas to supplement its General Schedule system. Whatever the geographic extent of the survey, mainly public and private employers from comparable size organizations should be surveyed. Other nonprofit organizations should be included where there are relevant specializations, such as social and health services jobs.

Optimally, data should be gathered by questionnaires that are followed up with visits or at least telephone conversations. For every job reported by an employer, the following minimum pay data should be gathered: the number of employees with the job title, their average rate of pay, and the number of hours in their work week. Compensation should be summarized by job surveyed to show the following

(in separate lines for each employer and listed in columns): the date of the survey, number of employees in the class or job, number of hours in work weeks, and average pay of employees (converted to the same period for all employees). For each job or class, the surveyor should then compute the totals for employers, employees, and hours in the work week; the average work week per employer; and weighted average pay (employees × average pay/total number of employees).

## Step 3. Gather Fringe Benefit Data

If possible, data on fringe benefits and perquisites should be gathered in the salary survey, and these rewards should be subtracted from salary and wage data. *Perquisites* differ from *fringes*, theoretically, in that they are allocated to particular jobs, services, or organizational levels as a requirement for proper functioning rather than as a form of compensation.

Because benefits often vary with the characteristics of employees (for instance, with age, salary, seniority, or marital status), it is important to be able to categorize data according to both the number of employees to whom the benefit applies and the differences in rates or amounts. Typical fringes and perquisites for which pay year costs should be gathered include

- Paid holidays (number)
- Severance pay per employee
- Paid vacation (number of days)
- Paid sick leave (number of days)
- Bonuses per employee
- Other leave (number of days)
- Profit sharing per employee
- Social Security benefits per employee
- Special allowances (food, clothing) per employee
- Pension cost per employee
- Life insurance per employee
- Health insurance per employee
- Automobile allowance or use of vehicles per employee
- Unemployment benefits per employee
- On-the-clock nonproductive time per employee (for example, transit time to and from the job)

It can be argued that this list of fringes is too detailed and perhaps not all items are worth the survey effort. Items that might be questioned are severance

pay, bonuses, profit sharing, special allowances, and transit time. The answer to this argument is that it depends on how comparable a database is desired. These items are typical hidden forms of compensation, and *total compensation* implies all forms of monetary equivalents. The feasibility of surveying them must be decided by the comparing organization.

One approach to summarizing fringes is to develop a standardized cost under which costs for each benefit are computed, based on prototypical groups of the organization's employees. These groups are assembled to reflect combinations of variables, such as seniority and marital status, that represent the statistical variance in the employee population.

Finally, it is important for actors such as labor-management negotiators, compensation staff, and policymakers to be informed on total compensation—fringes plus direct pay—inasmuch as controversial public and private-sector comparisons are frequently made. Informed deliberation on pay policy should stem from total compensation data.

## Step 4. Compute a Pay Line

Community job average rates must be regressed (points × dollars) to determine an average line of best fit. The shape of this line is usually curvilinear, rising more steeply at the upper end. Several regression formulas may have to be tried for best fit.

Given an existing pay plan, the current median of each range is adjusted for the new average line for all benchmarks. Thus the midpoint of each salary range will correspond to the intersection of median job evaluation points of the range and average data at that point from surveyed benchmarks. The new median ranges are then extrapolated to the extremes of each range. If there are steps or rates in the ranges, the structure of the standardization governs adjustments between bottom and top values of each range. The new medians of each range are, accordingly, the overall averages from the market survey. It is here that a policy to pay above or below the market may be applied. For example, if the policy is to pay 10 percent below market, the midpoint and extremes of each range are adjusted downward by 10 percent.

## Step 5. Administrate Pay Within Ranges

This is the area where grade range design and compensation objectives come together. Exhibit 29.1 describes a few examples of ranges, which will be related to objectives.

**Variables.** Aside from the issues of the total size of the salary standardization and whether it is for subsystems or the entire organization, there are several variables that characterize salary schedule alternatives: the number of steps in ranges, the nature of difference between steps and between ranges (percentage

**Exhibit 29.1. Examples of Salary Range Alternatives.**

Example 1. Integrated Six-Step, Monthly Salaries

| Grade | 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|---|
| 14 | 1915 | 2011 | 2112 | 2218 | 2329 | 2445 |
| 15 | 2011 | 2112 | 2218 | 2329 | 2445 | 2567 |
| 16 | 2112 | 2218 | 2329 | 2445 | 2567 | 2695 |

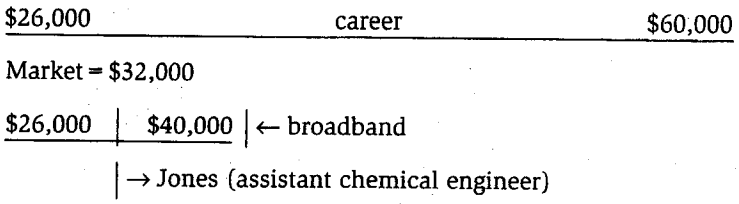
Example 2. Flat Rate, Nonintegrated Nine Steps, Monthly Salaries

| Grade | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | Increment |
|---|---|---|---|---|---|---|---|---|---|---|
| 14 | 1937 | 2029 | 2121 | 2213 | 2305 | 2397 | 2489 | 2581 | 2673 | 92 |
| 15 | 2050 | 2147 | 2244 | 2341 | 2438 | 2535 | 2632 | 2729 | 2826 | 97 |
| 16 | 2163 | 2266 | 2369 | 2472 | 2575 | 2678 | 2781 | 2884 | 2987 | 103 |

Example 3. Two-Step Flat Rate, Annual Salaries

| Grade | Entrance Step | Competent Step |
|---|---|---|
| 14 | 58140 | 61200 |
| 15 | 61560 | 64800 |
| 16 | 64980 | 68400 |

Example 4. Broadband, Annual Salaries




Example 5. Pay for Knowledge or Skill, Monthly Salaries

| Entry Min K/S | 25 percent of Team K/S | 66 percent of Team K/S | 100 percent of Team K/S |
|---|---|---|---|
| 2000 | 2500 | 3320 | 4000 |

difference, constant percentage difference, constant dollar amount difference, whether ranges overlap or are flat rates, and width of ranges), and the compensation objective.

Some objectives work best with some designs and not well with others. For instance, examples 1 and 2 in Exhibit 29.1 are not good designs under a pay-for-individual-performance policy. Award of step increments could be made contingent upon performance, but how can individuals at the top step of the range be rewarded? More important, the performance obtained may not be worth the size of the step increment that would have to be awarded.

**Traditional Pay System.** Examples 1 and 2 of Exhibit 29.1 are the traditional systems that reward membership in the organization. The employee marches through the steps in each range, mainly based on time. Step 1 is usually the entry level, followed by a second step after the employee completes the probationary period. Other steps generally are time phased for different periods. If the standardization is not adjusted for changes in market and inflation, the individual does not achieve compensation above the extent of range values. Usually, without such adjustment, pay will be limited to the top step of the range unless the person is promoted or the job is reclassified.

Example 1 is known as an *integrated system* because of its constant percentage differences between maximum and minimum rates in ranges (width of near 28 percent), between steps in ranges (5 percent), and between ranges (about 5 percent). Thus, constant percentages provide the basis for integration as does a repetition of rates. Look diagonally up or down rates in ranges for repetition. Rate repetition provides an extension of the range overlap previously discussed. The design illustrated by example 1 has traditionally been used in small governments.

Example 2 has typically been used in large governments, where the great variety of occupations makes rate integration difficult. It is characterized by a flat rate system with constant dollar amounts (not percentages) between steps in a range and increasing dollar amounts between ranges. These types of systems sometimes use grade allocation criteria that are separate from those of the job evaluation plan for various levels of difficulty and responsibility.

**Merit Pay.** Example 3 eliminates multiple-step rates in ranges, except for a probationary step. Traditionally, this type of standardization has been associated with negotiated blue-collar rates. However, it can have great utility for compensating other employees in view of the trend toward government cost conservation. Its virtue is that it eliminates the annual-increase effects of multiple steps, exacerbated by cost-of-living and market adjustments.

Example 3 also provides the greatest potential for managerial flexibility with individual pay-for-performance. The ultimate in cost conservation and individual

merit pay is this flat rate system, with rates increased only by market change and ability to pay and with performance rewarded through a bonus system. The jurisdiction that really wants to squeeze its workforce for performance might also make market change adjustments contingent upon performance. Because bonuses do not increase base salary and must be re-earned, bonus systems also make sense in pay-for-group-performance systems as well (such as goalsharing and gainsharing).

**Sizing Merit Increments.** A system of individual merit pay requires criteria for bridging performance appraisal to reward increments. The Navy demonstration project uses five performance appraisal thresholds for merit pay awards—two levels above and two below the level of *fully successful* (recall that the Navy and emerging federal government systems have collapsed multiple GS pay grade levels into pay bands). Fully successful performance is awarded *comparability.* Comparability is essentially the federal government's estimate of a national cost-of-living change, adjusted for political reality. Performance above fully successful is rewarded with comparability plus multiples of the salary increment for each pay level. One level below fully successful, comparability is halved, and two levels below it, zero is awarded.

Example 4, a broadbanding example, shows Jones, an assistant chemical engineer, placed at the market rate of $32,000, the center or median of a broad band. This band covers a career and spans a range of 131 percent. Private-sector applications use market rates as the basis for increasing or decreasing compensation for performance or competency growth (Hofrichter, 1993). This action suggests that pay for knowledge or skill, as well as for individual performance, can be accommodated with a broadbanding system. Market rate at the time the individual is appointed is the median of the band around which high and low percentiles are set. Pay is increased or decreased for performance or competency growth in percentile levels, just as the Navy system uses compressed GS grades. Individuals with exceptional qualifications might be initially appointed above the median.

Example 5 is a variation on broad bands in a pay for knowledge or skill system that rewards acquisition of team competencies.

## CONCLUSION

From this chapter the reader should have learned that management needs to decide on compensation objectives and that objectives, in turn, can be translated to action through pay system structure and administration policies. Also, it should be clear that these various combinations have advantages and disadvantages. Further, the need for a job evaluation system and market survey data should be ap

parent. Finally, an understanding of the concept of total compensation (direct pay *and* fringe benefits) is fundamental. Although pay standardization and policies establish the direct pay, the fringe benefits must also be understood as important parts of any plan, albeit possibly for different objectives.

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