

The Basics of Salary Grades

One of the required Affirmative Action Plan reports, the Workforce Analysis, requests that you sort the jobs in each department by wage or salary. Most organizations, particularly small organizations, usually prefer not to show the actual annual compensation. Salary or pay grade is an appropriate substitute for actual compensation. The grade can be shown on the report without revealing confidential information.

Salary grades are used by many organizations to help managers manage the compensation of new employees and establish appropriate pay increases for existing employees while maintaining equity among the jobs in the company. Salary grades provide a structure for fairly compensating employees and managing the payroll.

If your organization has never used salary grades in the past, you may find the following article helpful. As you will see, it's nothing magical. It's simply a measuring tool that sorts out compensation. Your structure need not be complex, particularly if your organization has less than several hundred employees.

The article appears on www.hr.com.

Basics of Grade Structures

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Grade structures are the basic underlying element of most compensation schemes. They are simple, easy to understand and use, and effective.

Sample Grade Structure

A simple grade structure might look like this:

Grade	Salary Minimum	Salary Midpoint	Salary Maximum
1	\$7,500	10,000	12,500
2	9,500	12,000	14,500
3	11,500	14,000	16,500
4	14,000	17,000	20,000

I've used round numbers here. See the [accompanying spreadsheet](#) to see an example using a specific formula.

Points to note:

- The salary range is typically +/- 15 to 25% percent of the midpoint.
- The salary midpoint of a grade is typically 20-30% higher than the preceding grades salary midpoint.
- The maximum of a grade may be higher than the minimum of the next higher grade (but doesn't need to be).

Not a Lot of Rules

There are not a lot of rules one has to follow in setting up a grade structure. It doesn't have to be mathematically pure. For example the mid-point of grade 9 may be 20% lower than the midpoint of grade 10, whereas the midpoint of grade 10 may only be 15% lower than the midpoint of grade 11.

Often specific pay issues will cause specific changes in the grade structure. For example, there may be a wish to distinguish between a truck driver and a senior truck driver, even though the jobs are almost the same size and would normally be in the same grade. In this case one might split a grade into two smaller grades so that the senior driver could be in a higher grade.

The salary range from the top to the bottom of a grade is often narrower for smaller jobs than it is for big jobs. The rationale being that there is more latitude in big jobs. However, again this is not a rule and one can manage well (or poorly) without it.

Assigning Jobs to Grades

Informal

For many purposes, once a grade structure is in place, it is relatively easy to slot jobs into grades. HR or a committee of managers is typically empowered to decide what grade a given job is in.

Formal Job Evaluation

Many organizations use formal job evaluation processes to assign jobs to grades. In many cases there are good legal reasons for doing this. However, even without the legal issues, job evaluation can help organizations assign jobs to grades in a more systematic manner.

Most job evaluation systems assign a number of points for a job. It is then simply a matter of constructing a table to assign point ranges to grades. For example:

Job Evaluation Points	Grade
100-132	1
133-175	2
176-230	3
231-304	4

Again, there are not a lot of rules one must follow. One simply creates a reasonable progression.

Alternatives to Grade Structures

Pay for Points

As discussed above most job evaluation systems generate a specific point total for each job. Hence, it is possible to build a pay range for the specific point rather than using grades.

For example, in a grade based system a 140 point and 142 point job would likely be in the same grade with the same salary midpoint. However it is possible to pay for points with a formula like:

$$\text{Salary Midpoint} = \text{points} \times 100 + 2000$$

In this example the 140 point job would have midpoint of \$16,000 while the 142 point job would have a midpoint of \$16,200.

Many companies have successfully used pay for points for years. In general, grades are preferred because they are a little simpler. However, both methods work well and there is no profound reason why you should choose one over the other-it won't make a significance difference. What will make a difference is how you manage the system on an on-going basis.

Broad Banding

Broad banding isn't really an alternative to grades, rather it simply suggests using very wide grades (e.g. salary ranges +/- 30 to 60% of the salary midpoint). This is meant to be a more flexible system.

So a company replacing a traditional grade system with broadbanding would do something along the lines of combining grades 1 and 2 into band A, grades 3 and 4 to band B and so on.

In practice, wide bands have their own problems. For example, a job at the top of band A is very clearly bigger than a job at the bottom of band A. To solve this problem companies will create subbands, so for example band A is split into A1 and A2.

This leaves us with the following comparison:

Old fashioned inflexible grade structure	Modern flexible broad bands
1	A1
2	A2
3	B1
4	B2
5	C1
6	C2

different from a traditional pay system, what really matters is how you manage the problems with grades.

Individual/Market Pay

In some cases it is possible, practical and desirable to set pay levels for jobs or individuals on a case-by-case basis reflecting the specific market value of that job or individual.

Problems with Grades

Since pay is an emotional subject and since assigning jobs to grades is invariably an exercise in judgement, **there will always be disputes.**

The mistake companies make is to think that the problem is with the grade structure itself. They then waste time and money tinkering with the grade structure and accomplish nothing.

The key to avoiding and resolving conflict is to have a good management process. This means:

- Being thoughtful when you assign jobs to grades
- Following the same process for everyone
- Making the process as open and transparent as is practical
- Having respected people assign jobs to grades
- Having some kind of appeal process (this can be informal)
- When there is a dispute look for the underlying business issue (i.e. this key employee is going to quit) rather than focusing on the mechanics of the system (i.e. they are at the pay maximum of the grade)

Legal Issues

Many jurisdictions have rules to ensure that pay is equitable. Normally, this doesn't impact the grade structure per se, only how jobs are assigned to grades. However, if management attempts to design a grade structure that somehow manages to discriminate against some group, then it could lead to legal trouble. For example, if there was one grade structure for jobs that are traditionally female and a different grade structure for jobs at a similar level that were traditionally male, then in many jurisdictions you would be asking for trouble.