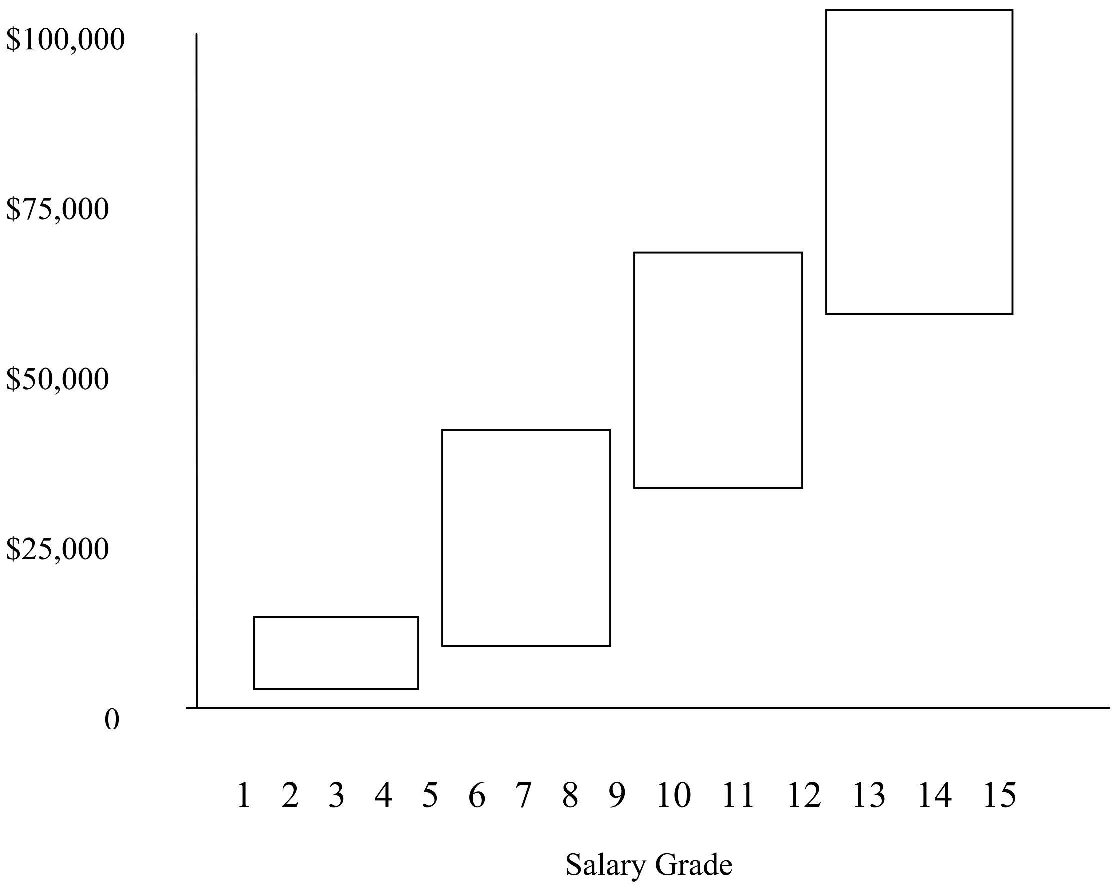
A Report by the Human Resources Management Panel

Broadband Pay Experience in the Private Sector



Report 1 of the HRM Consortium Broadband Pay Series

National Academy of Public Administration
Center for Human Resources Management

July 2003

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Broadband Pay Experience in the Private Sector

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FOREWORD

Even prior to passage of the Civil Service Reform Act of 1978, using the General Schedule (GS) to manage the salaries of professional and administrative civil service workers was a very contentious issue. Critics inside and outside government have long stated that the current system, with its 15 grades encompassing 150 pay steps, is inadequate to attract and retain the high quality workers sought by the federal government.

The 1978 Act created an opportunity for the Executive Branch to demonstrate that more flexible and less bureaucratic systems could be developed and used more effectively. In its 1980 China Lake demonstration project, the Navy implemented an approach to salary management that used broad bands encompassing several grade level ranges of the traditional system.

Although the public and private sectors were appraised of this experience, there was reluctance to move ahead broadly. It was not until 1989 that the first corporation, General Electric, shifted from a traditional model to a "broadband salary structure." From that time to the present, many companies have adopted broadbanding, as have several public agencies, like the National Institute of Standards and Technology, through agency-specific legislation. However, legislation giving all agencies the option to use broadband classification and compensation failed.

More recently, the Administration and the Congress have shown increased interest in broadbanding. Congress has passed and amended legislation permitting individual agencies to try this alternative system. The Department of Homeland Security has been given separate legislative authorization to develop broadbanding as its primary classification and pay system should it choose to do so. In addition, the Department of Defense has proposed broadband pay-for-performance as a major feature of the proposed National Security Personnel System, a broad revision of the department's civil service system.

With many of these developments in mind, the 2003 Human Resources Management Consortium of nearly 60 organizations asked the Academy's Human Resources Management Panel and Center for Human Resources Management to:

- Catalogue private and public experience in using broadband systems to identify what aspects work and do not work.
- Highlight other lessons learned from system users.
- Identify other compensation systems that the private or public sectors employ that might be appropriate for broader use in the federal sector.
- Recommend an approach for the use of broadbanding and/or other alternative systems as a replacement for the GS, or for broader use by federal agencies.

This report on private sector broadbanding experiences is the first in a series of three reports designed to achieve the objectives listed above. It will be followed by a report focused on broadbanding experiences in the public sector, primarily federal agencies. A third report will provide an analysis of the first two reports and make recommendations for how broadbanding systems may be used effectively by the federal government.

Howard M. Messner
President

EXECUTIVE SUMMARY

General Electric, the closely watched and widely respected corporation first introduced broadbanding into the private sector in 1989. That was followed by publication of *Strategic Pay* written by Dr. Edward Lawler, a highly regarded academic expert and one of the most highly respected thinkers about human resources in the United States. In the book, he severely criticized traditional pay practices. GE's new pay system and Lawler's strong criticism, combined with the poor economy at the time, prompted industry to seek to eliminate bureaucratic, time-consuming practices and to adopt more flexible and responsive management practices. In the following years, such prominent corporations as AT&T and IBM switched to banded salary structures.

Broadbanding represents a radical departure from traditional corporate salary systems, the model for which was developed in the 1930s and 1940s and used the same general format until banding was introduced. The components of the early model were almost universally used. Salaries were managed within an overlapping series of grades and ranges. Jobs were assigned to ranges based on an evaluation of the internal "value" of the job. Ranges, in turn, were aligned with salaries for similar jobs in the labor market. Individual salaries were increased each year based on an assessment of performance and contribution.

Both Lawler's criticism and the interest in broadbanding focus on the impact of traditional job evaluation/position classification practices. Corporate use of evaluation systems diminished steadily from the publication date of *Strategic Pay*. The typical corporate practice now relies on market survey data, rather than job evaluation results, to determine an appropriate salary range or broadband.

Early broadband systems were based on the simple idea that combining existing salary ranges would reduce the time and resources needed for salary management. Three ranges usually became one band. Where a traditional salary structure often had as many as 20 or 25 ranges, it would be combined into a broadband system with six to ten bands covering all white collar employees. The early broadbands were commonly 100 percent wide from the lowest to the highest salaries, which compares with the 30 percent ranges (from step 1 to step 10) in the federal General Schedule (GS) system.

The American Compensation Association (ACA), now WorldatWork, twice studied experience with broadbanding, first in 1994 and 1998. In the first study, it learned that companies switched to broadbands for a variety of reasons to include:

- Gain organizational flexibility.
- Improve operational effectiveness.
- Support a new culture/climate.
- Support delayering initiatives.
- Suggest new ways of integrating work activities.
- Promote a broad view of work and work design.

The major findings of the 1998 study include the following:

- "87% of the respondents say they feel broadbanding is either effective or very effective, essentially the same as four years ago."
- "The reasons for implementing broadbanding have changed, with more emphasis now being placed on career development and skill acquisition, and less on organizational issues."
- "Broadbanding is being extended deeper in the organization in the percentage of companies extending broadbanding to nonexempt employees."
- "Companies now rely more heavily on market data to assign jobs to bands..."
- "Companies appear to be lagging in development of formal career planning programs to support broadbanding's emphasis on career development."

Significantly, the reasons to shift to broadbanding are related to a general interest in improved company and employee performance. Broadbanding changes the way managers and employees think about their jobs and salary management. It also helps to make decision-making less bureaucratic.

Interest in broadbanding peaked and began to level off in the last decade. Recent surveys show that roughly 30 percent of larger companies in the annual *Fortune* magazine lists have banded salary programs. That percentage has remained steady for three years. Although companies often praise their banded salary programs, several subtle problems have surfaced. Perhaps the most serious one was identified in corporate interviews conducted for this report. Companies that were among the first to switch to broadbanding now realize that they have, to use a word from one conversation, a "hodge-podge" of jobs in each band. Managers and employees have trouble understanding why jobs are grouped in the same band. They also have realized that managers do not find upper and lower band limits (which typically are not referred to as maximums and minimums) useful when making salary decisions. The problems have diminished the initial enthusiasm for broadbanding and prompted companies to refine the way they design and manage banded systems.

New ideas include more focused and specific use of market survey data. Companies like IBM now provide individual managers with specific survey data, including the range of salaries, for each job. The ranges are replacing bands as the basis for salary decisions. In addition, companies are creating a series of bands using survey data, for individual job families. This facilitates and reinforces the market focus, resulting in a more homogeneous grouping of jobs in each band.

Despite early concerns that they would inflate payroll costs, broadbands have been found to be cost neutral when managed effectively. Broadbanding has changed the culture and the roles of managers in salary management. Companies increasingly delegate this responsibility to managers and provide them with the tools to make decisions.

Companies are fine-tuning their systems (e.g., reducing the width of bands) as they gain experience, but they are not reverting to the traditional program model. This is important to note. The problems identified are ones that normally can be resolved with more training, better communications, and enhanced support systems for managers.

BACKGROUND

EVOLUTION OF TRADITIONAL CORPORATE SALARY PROGRAMS

The model for corporate salary programs originated in the post-World War II era. Industry was then dominated by manufacturing organizations and factory managers relied on scientific management principles to organize work and jobs. Accompanying labor/management strife were personnel policies focused on blue-collar workers and often adopted in response to union demands or as a strategy to avoid unionization.

Industrial engineers developed the early wage and salary programs; they were responsible for the first job descriptions to document job duties and for early job evaluation systems. Their reliance on time-and-motion studies to establish work standards reflects one of the overriding issues of the period: control of the work place. The control issue carried over to wage and salary programs, which were centralized and closely managed. Companies made internal pay comparisons a primary program goal to avoid employee relations problems. This led to the widespread use of job evaluation systems; at the time, there were no wage and salary surveys, which reinforced the importance of internal job comparisons. Companies were not willing to exchange pay information, except as requested by government.

In this pre-office automation era white-collar workers were primarily involved in "paper processing". Few employees had college degrees. The business management fields, including marketing, public relations, and personnel, were in their formative years.

The federal GS salary system was created in 1949, the same year that Edward N. Hay introduced his job evaluation system for white-collar jobs, known as the Hay System. It was developed to cover management jobs in a Philadelphia bank. The American Management Association (AMA) conducted the first national salary survey in 1950. It covered management positions.

Over the next decade the model for managing salaries evolved in minor ways but it was effectively static for the next forty years. There was very little creative thinking and no testing of new ideas. Advocates of pay equity started pushing for new policies toward the end of the 1970s but they never had much impact. Companies started relying on computers to manage salaries although even the automated systems were based on the same conceptual model.

The typical corporation commonly maintains at least three wage and salary systems. This practice derives from the requirements of the Fair Labor Standards Act (FLSA), which differentiates between exempt and non-exempt workers. The law requires that non-exempt workers be paid overtime for work beyond 40 hours a week at a rate of 150 percent, or "time and a half." One pay program covers blue-collar or production jobs, while a second covers clerical support jobs; both are non-exempt employee groups under the FLSA. The third program covers exempt employees. In many companies, the sales staff has a separate salary system, as do scientists and engineers. It is also common for executives to have a separate salary structure.

Exempt workers have been in higher demand for several decades, increasing their compensation faster than for either clerical or hourly workers. The growing need for technical knowledge requiring higher education has prompted companies to devote more time and resources to their exempt work forces. The nation's economy has moved rapidly to knowledge organizations and away from manufacturing. That trend coincides with an aging workforce as the baby boomers approach retirement, creating a very tight labor market. The phrase "War for Talent" was coined a few years ago to recognize of the importance of recruiting the best talent in a tight labor market.

Virtually all salary programs were based on essentially the same principles, the same structures, and the same core management components until the 1990s. Such practices were taught in professional workshops and outlined in textbooks. The steps for developing corporate salary structures – a series of overlapping salary grades and ranges – were relatively standard. For that reason, salary structures were based on similar parameters from company to company.

- The traditional salary range had a "range spread," or percentage difference from the minimum to a maximum of 50 percent. The typical exempt structure in a larger corporation started with a planned salary range for entry-level college graduates; thus starting salaries fell between the minimum and range midpoint.

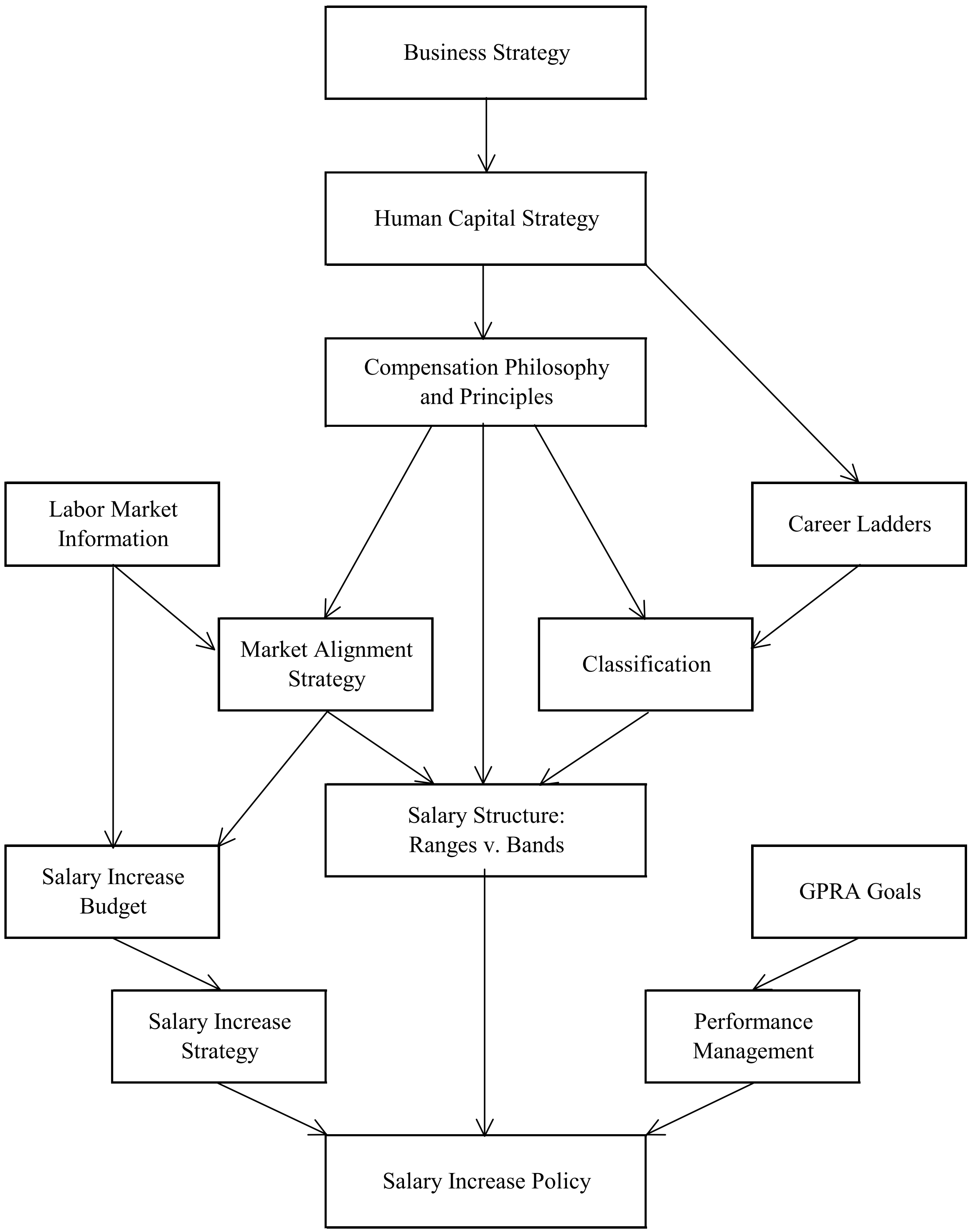
- The midpoints were the focus for managing individual salaries. Under typical corporate policy, range midpoints are aligned with market pay levels. As employees become proficient and improve their performance, their salaries should approach the midpoint of their range. When they are performing at a "fully satisfactory" level, their salary should be at midpoint, or the competitive pay level. Only better performers should progress beyond the midpoint.

- Successive salary ranges typically were 8 to 10 percent apart. In larger corporations, there were sometimes as many as 25 ranges that covered exempt employees.

The Core Program Management Components defined as separate sets of policies and practices, include the following. A complete salary program and its primary components are illustrated in Figure 1 with ties to other human resources practices.

- **Market Alignment Strategy**. A primary goal of any salary program is to enhance the employer's ability to hire and retain qualified employees. In that regard, employers analyze hiring patterns to identify the relevant labor markets and their staffing needs. Hundreds of salary surveys are conducted across the nation annually, each covering various labor markets (defined by occupation, geographic area, or industry) and reporting pay statistics for generic, "benchmark" positions. Employers use the survey information by matching their positions to the benchmark descriptions. The typical pay strategy is to align salary range midpoints with the average market rate for jobs assigned to that range.

FIGURE 1
SALARY PROGRAM COMPONENTS



- **Internal Classification/Job Evaluation**. The purpose of a job evaluation or classification system is to determine each job's relative internal "value". There are four basic methods but the most prevalent are the "point factor" systems, similar to the federal government's Factor Evaluation System (FES). A job's relative value is the basis for assigning it to a salary grade and range. Job classification/evaluation is discussed in greater depth in Appendix B.
- **Individual Salary Increase Practices**. Virtually every corporation relies on a merit-based or contribution-based pay increase policy.[1] That generally is true for white collar employees at every level, from executives to clerical support personnel. A merit increase budget is established each year based on the average increase necessary to maintain the planned alignment with market pay levels. For the past decade, merit increases have averaged roughly 4 percent of payroll. Salary increase polices are addressed in the next section of the report.

Public sector banding is associated with an interest in moving away from time-in-grade salary increases and from the rigidity of the classification system. Some of that mindset is true in the corporate world but the underlying reason for shifting to broadbanding has been the general recognition that traditional practices are too inflexible. This carries over to how employees view their jobs and their willingness to assume new duties. **The traditional salary program has, in its own way, been as inflexible in the corporate world as in government.**

Planning for salary programs starts with business and human capital strategies that are the basis for workforce planning. Pay levels are seen as key to attracting and retaining a qualified workforce.

In managing salaries day-to-day, traditional corporate programs are very different from the common public sector model. The key differences are listed in Appendix D**.**

[1] Salary increases based on an employee's performance appraisal historically were referred to as "merit" pay increases. The phrase "pay-for-performance" also is used but in the private sector this phrase has a broader definition and encompasses group and individual incentive payments. A third phrase, "contribution-based pay," is used at times to refer to annual increases linked to employee ratings. For reasons that are more relevant in government, the phrase "merit pay" has developed a negative connotation. Much of the negativism seems to come from the openness of information on the pay of individual workers.

CORPORATE SALARY INCREASE POLICIES

Corporations have very definite beliefs about how to manage salary increases. **They want to avoid fixed costs** whenever possible, especially if the costs are built into future years. They strongly prefer variable costs that are related to performance.

There is a solid belief that **employees should earn their salary and salary increases**. Corporations are not comfortable with policies that guarantee increases regardless of performance or their ability to absorb cost increases. Corporations generally agree with the need to maintain competitive salaries but they want to be certain that employee performance meets expectations. **Competitive salaries are related to the recognized need to attract and retain a qualified workforce.**

Although the high inflation of the early 1980s triggered cost-of-living increases for a few years, such policies were eliminated as soon as inflation rates fell to the modest levels that since have prevailed for almost two decades. **Corporate management is adamantly opposed to cost-of-living increases.**

Merit pay, the term that preceded **pay-for-performance, is very strongly supported.** Corporate employees begin to understand this philosophy from the day they start their careers. They quickly learn that their career and financial success depend on their performance. Rewards for good performance are prevalent in society, starting with gold stars and other awards in grade school. Society was referred to as a meritocracy early in the nation's history, and financial rewards are an accepted element of the culture.

The merit pay model is described in textbooks and professional workshops. It is based loosely on the learning curve theory, with larger increases in the early years after an employee starts a job and smaller increases when he or she has mastered it. The increase is intended to reflect the increase in an employee's value – his or her competence – from one year to the next. The salary arguably is a measure of an individual's relative value.

In a traditional salary system, range midpoints are aligned with market pay levels and the policy should provide for **salary increases so that an employee is paid at midpoint when the individual is fully competent and meets performance expectations**. At that point, his or her salary is competitive with the average worker in similar jobs. In many companies, only the salaries of "star" performers are increased above the midpoint.

The **purpose of a corporate merit pay policy is to recognize and reward star performers**. Employees learn that it is to their advantage to perform at high levels. To be sure, there are poor performers who are denied increases but they are few in number and not the focus of the policy. A merit pay policy is a positive force that benefits better performers. The increase differential for star performers is sometimes specified to ensure it is meaningful. For example, IBM has a policy that grants increases to its stars that are 2.5 times the average increase.

Most corporations establish an annual salary increase budget. All increases are paid from the budget. The budget, based on market data analyses, is an aggregate of the increases needed to raise salaries to competitive levels. In the 1990s, budgets provided for 4.0 - 4.2 percent increases on average.

Corporations understand that there are weaknesses in their merit polices, but many argue that even with the problems, these policies are preferable to automatic increase policies.

The first breaks from the traditional program model were triggered by publication of *Strategic Pay*[2], by Edward Lawler, a most respected academic expert on compensation. As background for his argument to develop new program models, Lawler devoted several pages to a criticism of traditional salary systems. His conclusions carried considerable weight and made it easier for other human resources specialists to challenge a traditional thinking.

The beginning of the 1990s was a period of economic decline with American businesses looking for ways to become more competitive and responsive to business trends. Traditional salary systems were seen as highly bureaucratic and rigid so business executives were open to change.

DR. EDWARD LAWLER'S CRITICISM OF TRADITIONAL SALARY PROGRAMS

Edward Lawler is one of the most highly regarded thinkers about human resources in the United States, focusing on compensation management in his role as Director of the Center for Effective Organizations at the University of Southern California. His opinions have been influential for several decades and his book was a turning point.

Lawler focused on traditional job evaluation/classification practices. He argued that these systems cause or contribute to the following:

- **"Game playing" to gain additional job evaluation points**. The importance of job evaluation results prompts ongoing attempts to justify additional points by claiming changes in job content. It also may trigger an interest in building an empire to justify higher pay.
- **Erosion of honesty and credibility**. The realization among supervisors and managers that job evaluation results can be "gamed" means that dishonesty is encouraged and is often rewarded with a higher salary grade. If inflated job descriptions result in higher grades, people look for excuses to rewrite descriptions.
- **Inflated pay system operating costs due to the need for additional administrative staff**. The traditional approach to job evaluation is based on close, centralized administration. If the evaluation process is managed in the textbook manner, it necessitates an enlarged staff.
- **Overemphasis on grade changes and promotions as the basis for salary increases**. If the process is not closely managed, it becomes too easy to justify a grade increase or promotion. In some organizations, supervisors rely on the reevaluation of jobs to trigger pay increases.

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[2] Edward Lawler III, *Strategic Pay: Aligning Organizational Strategies and Pay Systems* (Jossey Bass, 1990)

- **Inflated payroll costs**. Job evaluation systems serve to increase the value of some jobs relative to prevailing market pay levels. When jobs are paid more than market levels, it results in inflated payroll costs. This may, of course, be justified by strategic or political concerns.
- **Enforced and increased importance of the job hierarchy**. The evaluation points effectively lock in and formalize the job hierarchy. When arrayed from high to low, the points are essentially an index of each job's position in the hierarchy. In administering the evaluation system, the focus is on minor differences which occasionally are an impediment to people working comfortably together.
- **An impediment to organizational change and downsizing**. When job duties are reassigned, the relative value of affected job changes; some people "win" and others "lose". If some jobs are upgraded while others remain the same, people may perceive that they have "lost". Those who anticipate a reduced salary grade often resist the organizational changes.
- **Promotion and perpetuation of bureaucratic management style**. The time to write job descriptions and the process for having a job reevaluated are distinctly bureaucratic. The process is contrary to responsive and rapid decision-making.
- **Implicit limits on scope of job duties.** The focus on job duties and highly formalized written descriptions often prompts an incumbent to think, "This is what I am expected to do. That's what I'm paid to do." In some organizations, employees believe that they should not be asked to do anything that is not in their job description.

Once Lawler moved the salary management debate to the forefront, other human resources experts joined the criticism. His arguments were reinforced by reengineering which became a "hot-button" in this period. Pay systems widely were seen as overly bureaucratic and a natural target for change. The recession in early the 1990s triggered a high level of interest in reducing costs and developing more responsive and effective ways of operating.

IMPORTANCE OF A NEW WORK MANAGEMENT PARADIGM

Dr. W. Edwards Deming, the Total Quality Management (TQM) guru, started a revolution in how to organize and manage work. He realized that front line employees could play a more prominent role in quality management and in satisfying customers, and he was followed by Michael Hammer and the reengineering movement in the early 1990s. Their ideas coincided with a weak economy to trigger a broadly shared interest in finding better ways to organize and manage work, referred to as a new work management paradigm. Employers concluded that traditional salary management practices were part of the problem and incompatible with the new paradigm, contributing to a climate conducive for broadbanding.

"Paradigm" is a term that very few people understood a decade ago. It is similar to the word "weather." As weather encompasses a number of factors – temperature, wind speed, and humidity, "work paradigm" is decidedly more complex and encompasses such factors as policies and rules, formal and informal norms, equipment, work processes, and supervisory practices all of which affect the way people perform their jobs.

Discussions of the new work paradigm normally refer to the changes that started in the 1990s. Many phrases now are used to discuss the way work is organized and managed, including transformation, downsizing, empowerment, process improvement, self-managed teams, and boundaryless. Change in how people are managed has become the constant. The changes are not always dramatic, but there have been more of them in the last decade than in the prior four or five.

The work paradigm that prevailed until recently was standard in American industry. The traditional paradigm is best understood through an organization chart with its distinct hierarchical structure. The reporting relationships depicted in a chart were planned so supervisors did not have a "span-of-control" or more than six or seven direct reports employees. They were expected to exercise close, "over-the-shoulder" control. The boxes on the chart visually delimited the jobs as each employee had a limited number of fully-documented job duties. People were required to follow the chain of command, as depicted by the lines connecting the boxes. Indeed, the charts looked very similar across corporations.

The emerging work paradigm is based on a much broader span of control, flatter organizations, flexible work assignments, teams, and empowered employees. Virtually every company is moving away from the traditional work paradigm. They are, however, moving in different directions, some much more rapidly than others. Employers no longer rely on a standard work paradigm. This is a period of testing and refining of new ideas in salary management and other human resources practices. **In keeping with the lessons learned from the work system reengineering, companies no longer are adopting "textbook" or "off-the-shelf" answers. They are developing wage and salary systems that meet their unique needs and circumstances, more now than ever before.**

THE BASIC PROGRAM DESIGN QUESTION – RANGES v. BROADBANDS

For employers reconsidering their salary system, the most important issue is the choice between traditional salary ranges and "broadbands." Both are used in the same basic way: Employee salaries start at or close to the bottom of a range or band and over time are increased so that individual ones progress higher into the range or band. Traditional salary ranges essentially were the same from company to company. The logic used to develop a traditional salary structure is described and contrasted with a banded structure in Chart 1.

Banding often is described as a new management philosophy because it introduces a very different way of viewing jobs and the way employees are compensated. In a banded structure, traditionally close, centralized control of salaries is no longer possible. The concept also makes the traditional focus on minor job changes less important since it is much less likely that changes will justify a band change. Some companies have replaced the traditional "pay-the-job" with a "pay-the-person" philosophy. These two alternatives are discussed in the box on page 14.

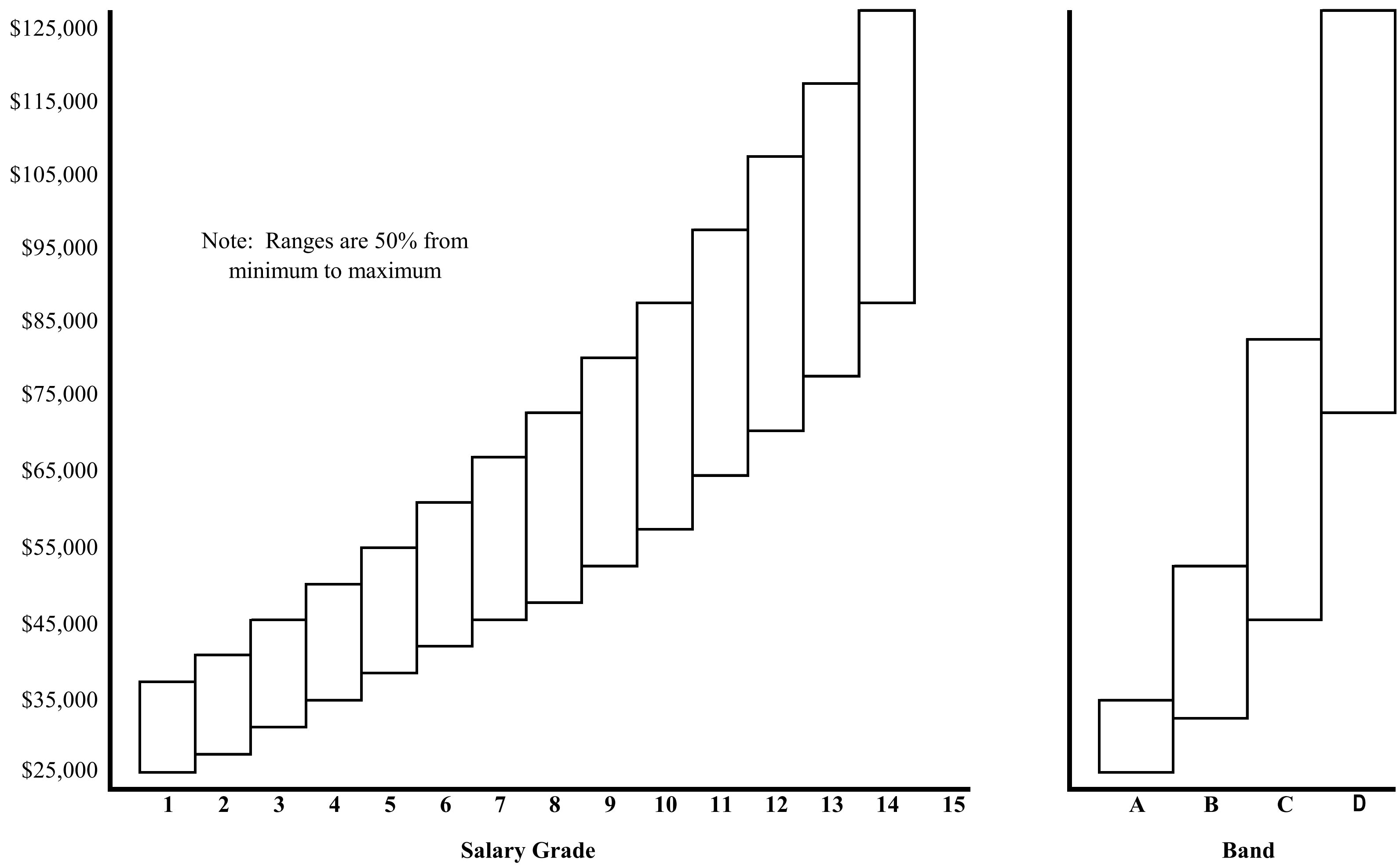
There are three basic differences between bands and ranges. First, there are fewer bands; as few as six to ten bands can cover the entire workforce of a large corporation. Second, broadbands tend to be wider than the 50 percent "range spread" in a traditional salary program. Third, and perhaps most important, there is minimal "overlap" between successive bands. With conventional salary ranges, the overlap means there are minor differences between ranges which trigger the need to evaluate each job. All of that changes with broadbanding.

Banding was conceived as a response to a recognized need for less bureaucratic, more responsive management practices. The first organization to adopt a broadband salary structure was the Naval research facility referred to as China Lake. The Civil Service Reform Act of 1978 authorized federal agencies to test new program ideas as demonstration projects. The banded structure at China Lake was conceived to reduce the bureaucracy and give the labs more flexibility to compete in a tight labor market. However, there is no evidence that corporations were aware of the new system and it was nearly a decade before broadbanding gained acceptance in the corporate world.

Banding changes salary management in only one fundamental respect that follows from Lawler's criticisms. He focused narrowly on a single practice: traditional job evaluation. His points directly or indirectly condemn the established methods. **Banded structures reduce the need for applying a "rigorous" job evaluation/classification process and experience confirms that the diminished focus on internal job comparisons will be accepted.**

However, the other core program management components remain central considerations. **Banding triggers a need to reconfigure the policies and practices that govern the way salaries are managed and the roles managers play in the process. Labor market alignment and individual performance both are basic to managing salaries. Internal salary comparisons are now handled with simplified, less bureaucratic approaches.**

CHART 1
ILLUSTRATIVE COMPARISON OF CONVENTIONAL SALARY RANGES AND BANDS



PAY-THE-JOB VS. PAY-THE-PERSON

The traditional logic of salary management posited that each job has a value that is independent of the incumbent. That is to say, the incumbent and his or her capabilities do not affect the job's value. That logic led easily to the perception that workers are interchangeable cogs in the "wheels of industry". It is consistent with the focus on job value and the importance of job evaluation systems. This philosophy has been basic to wage and salary management.

Corporations have relied on pay-for-performance policies for several decades. Until recently, this was balanced by a focus on the job and a failure to acknowledge that the individual doing the job could make a significant difference. It also has been a relatively standard practice to rely on close, centralized control. This is attributable to concerns with possible unionization and a reluctance to trust supervisors. The unionization prospect also prompted a commitment to internal equity and consistent salary adjustments. Accordingly, annual merit increases were governed by rigid policies that limited a manager's discretion.

The shift in thinking reflected in the changing work management paradigm now highlights the importance of the individual, his or her capabilities, or competencies, and the potentially significant differences in individual contribution. The shift de-emphasizes the importance of a job description with its fixed or static job duties, and moves to a more flexible logic that encourages workers "to do whatever is necessary" to "get the job done." Generic job descriptions flows from these changes. In addition, broadband salary structures de-emphasizes the claimed precision and the importance of job evaluation results.

This comes together with the growing emphasis in human resource management on individual knowledge, skills and abilities, or competencies. This new philosophy recognizes that employees are capable of developing new or enhanced competencies and that their growth enables them to tackle new tasks and increase their contribution. This philosophy is, in some respects, contrary to the idea that employees have static job duties.

Employers increasingly are introducing new human resource systems to support the new focus on individual contribution. The term "competency-based pay" refers to the new salary systems philosophy—that employees should be paid based on their knowledge, skill, and abilities, not assigned job duties. This represents an important shift in thinking.

This development is independent of the trend to move to broadbands; although, both stem from the new management thinking that started to unfold in the early 1990s. Within a broadband framework, the focus is on career ladders and the individual growth and development needed to progress to higher levels in a career ladder**.**

EXPERIENCE WITH BROADBANDING

General Electric was the first company to move to broad salary bands. It did so in 1989. The first article on banding was published two years later. A literature search shows 14 articles in human resource journals by 1994, a steady increase. Articles discussed both advantages and potential problems, and the themes in the literature shifted over time as banding became an established alternative. Two articles in 1998 publications of the American Compensation Association (ACA)[3] are illustrative of the literature five years ago: "Beyond Broadbanding" and "The Next Generation of Broadbanding."

Private sector broadbanding was studied by the ACA, now WorldatWork, in 1994 and 1998. **Different consulting firms have conducted occasional, less intensive surveys but overall the research interest has waned**. **The concept is well established and most corporate employers believe they understand the issues involved**. **Broadbanding is no longer seen as "experimental" or new, although it is still evolving.**

Corporate priorities also have shifted in the past few years. It seems that the global uncertainty following the 9/11 crisis, the sluggish economy, and the critical focus on corporate executive compensation have recently made corporations less willing to initiate major changes in their pay programs. There is evidence that the focus is on cost management, particularly benefit cost reductions.

THE 1994 ACA STUDY

The 1994 ACA study[4] looked at the experience of 116 companies that had recently introduced a broadband salary structure. At that time, few employers had more than a year or two of experience with broadbanding. The survey report is descriptive and de-emphasizes survey results. The reasons for adopting broadbanding include:

- **Improve operational effectiveness.** "By breaking down the conventional hierarchy imposed by numerous salary grades, broadbands can enable even the largest organizations to promote and take advantage of the characteristics of their smaller competitors: quickness, nimbleness, creativity, increased employee involvement, and willingness to embrace risk."

- **Support a new culture/climate**. "Bands readily support cultures that promote contemporary values…people under bands spend less time focused inside the firm simply because there is less structure upon which to focus. As a result, employees can be more effectively encouraged to engage critical external organizational dimensions such as customers."

- **Support delayering initiatives**. "When an organization dramatically reduces the number of job levels, managers typically will have increased spans of control and

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[3] The American Compensation Association changed its name a few years ago to WorldatWork.
[4] American Compensation Association, <u>Broadbanding Design, Approaches and Practices</u>, 1994.

decreased ability to provide close supervision to their expanded number of direct reports."

- **Suggest new ways of integrating work activities.** "Less structured organizations are more likely to view work as a process that can be performed better by process teams that work laterally across the organization, rather than by vertical functions."

- **Promote a broad view of work and de-emphasize an incremental view of career development.** "With less structure, broadbands help employees see a more ambiguous internal environment, with more opportunities for them to define their own roles. Getting the job done becomes secondary to identifying and tackling organizational needs."

The ACA survey respondents confirmed that a first phase of a new program should focus on assessing the "readiness" for broadbanding. The assessment should include three steps:

1. **Identify the objectives for the new program.** "To direct the assessment process, it is necessary to articulate the compensation program's philosophy and objectives." These may be stated as "a written set of guidelines that reflect a clear linkage between the organization's business vision, organizational strategy, people implications, and the compensation program's characteristics."
2. **Evaluate the effectiveness of the existing salary program.** This means identifying the strengths and weaknesses of the current program. The assessment should focus on the organization's people needs, the compensation program objectives, and the impact of the salary program in meeting those objectives.
3. **Determine the appropriateness of broadbanding.** Once the organization's leaders and human resource professionals feel they understand the implications of banding, they can decide if broadbanding will meet the compensation objectives better than the current program.

The survey responses suggested that the following organizational characteristics favor the successful switch to broadbanding.

- compelling business/operational need for change
- management/employee trust
- senior management support
- employees viewed as human capital or as an investment versus a cost
- commitment to and support for lateral movement and career development
- openness in communicating about process and work plans
- commitment to investing and growing managers' skills
- effective support systems for performance management and career planning.

THE 1998 ACA STUDY

The 1998 ACA study[5] focused on 73 companies that had lived with broadbanding for at least one year. It included 33 companies that participated in both studies. The major findings include:

- "87 percent of the respondents say they feel broadbanding is either effective or very effective, essentially the same as four years ago."
- "The reasons for implementing broadbanding have changed, with more emphasis now being placed on career development and skill acquisition."
- "Broadbanding is being extended deeper in the organization…in the percentage of companies extending broadbanding to nonexempt employees."
- "Companies now rely more heavily on market data to assign jobs to bands…"
- "Companies appear to be lagging in development of formal career planning programs to support broadbanding's emphasis on career development."

The importance of the reasons for using broadbanding has shifted. As the box below indicates, the relative importance of the reasons for using broadbanding has shifted toward competency and career development.

Reason for Broadband Use	1994	1998
Organizational flexibility	1	1
Encourage competency development	7	2
Emphasize career development	5	3
De-emphasize hierarchy	3	4
Support new culture	2	6

The width of bands has contracted slightly over time. This trend needs to be considered in light of the "standard" traditional 50 percent salary ranges and the initial 100 percent bands in the early programs. The percentages refer to the difference from the minimum to the maximum salary.

Band Width	1994	1998
No dollar range or band	14%	13%
Minimum but no "max"	0%	7%
151% to 300% bands	11%	13%
101% to 150% bands	29%	19%
50% to 100% bands	55%	48%

Broadbanding is being extended deeper in the organization, with the following coverage:

Occupational Coverage	1994	1998
Executives	56%	58%
Exempt employees	94%	97%
Nonexempt office support	56%	61%
Nonexempt hourly	22%	39%
Union employees	0%	3%

5 American Compensation Association, Life with Broad Bands, 1998

It is important to note that executives account typically for 1 percent of the workforce. These positions tend to be assigned to grades based on the tier in the organization (e.g., all VPs in same grade). Employers tend to have more bands for exempt employees, which appears to reflect the number of levels in the career ladders.

Number of Bands	Exempt	Nonexempt
1 – 2	12%	34%
3 – 4	53%	50%
5 – 6	34%	16%

Companies are changing the methods used to assign jobs to bands. Sometimes methods are used in combination or for different occupational groups.

Assign Jobs to Bands	1994	1998
Based on market data	30%	55%
Based on existing classification	53%	30%
Based on "whole job slotting"	40%	39%
Based on competencies/skills	23%	33%
Based on reporting relationships	17%	15%
Other	13%	6%

During this period, employers also were dealing with tight labor markets, rising salaries, and organizational changes. In the early 1990s, the traditional focus on internal equity was prominent in policies, but the focus then shifted to competing in tight markets.

One of the triggers for the interest in broadbanding was criticism of the job evaluation and its impact on people management. Over time, separate surveys have confirmed the diminished use of traditional job evaluation systems.

Salaries are managed within the bands. Private sector employers rely almost exclusively on merit pay, or pay-for-contribution policies for all exempt and many nonexempt employees. With a traditional salary program, the salary ranges and range midpoints are used to control or limit manager and supervisor discretion for merit pay decisions. Broadbands, however, reduce the possible controls with more discretion delegated to managers. This means the human resource function loses some of its traditional program control.

Managers and supervisors were accustomed to making salary increase decisions prior to adopting broadbands. Yet companies still require managers to participate in training sessions. The time spent in training is as follows:

Manager Training Length	At Introduction	Ongoing
Attendance at 1–2 hour session	65%	32%
Attendance at ½ day session	16%	9%
Attendance at full day session	5%	3%
Attendance at multi-day session	3%	6%

Despite the training, 55 percent of the respondents felt companies should have required more training to strengthen program management understanding and skills.

The increased emphasis on market pay information is reflected in the information provided to managers. This information is to be used by supervisors in managing individual salaries. With the advances in electronic decision tools, many companies today would make this information available electronically. The information includes:

Market values (average, median, etc.)	55%
Survey job matches and market values	47%
Market ranges (market low and high)	47%
Furnish data on request only	42%
Job-specific market data points	24%
Broad survey data	19%

It is increasingly common for companies to expect supervisors to manage individual salaries relative to market pay levels, taking into account individual experience and performance.

Communication has proved to be a critical planning consideration. Only 41 percent of the survey respondents felt that time and resources invested in employee communication was "about right." The majority felt they spent too little, particularly after the new program was adopted. The following methods were used to communicate new programs.

Communication Method	Used for Introduction	Ongoing Communication	Rated as Most Effective
Printed brochures & booklets	64%	30%	27%
Departmental meetings	63%	37%	56%
Meeting with supervisor	51%	57%	46%
Companywide meetings	42%	11%	20%
Newsletter	33%	28%	15%
Video	16%	7%	5%
E-mail	16%	15%	27%

These data must be considered in light of the specific changes introduced by the shift to broadbanding. **The use of market data and merit pay was not new policy. Broadbanding changed the way these concepts were used and redefined the role of managers and supervisors, but these were not significant policy changes for the private sector.**

Broadbanding proved to be cost neutral. Of the surveyed companies, roughly one-third did not track costs. However, 83 percent of those that did reported the new program as cost neutral. Of the rest, 9 percent realized a cost saving and 9 percent saw cost increases.

Consulting firms conducted the most recent surveys, which tended to focus on one or two "usage" questions in broader surveys. In 2001, Mercer Human Resource Consulting reported steady increases in the number of broadband salary programs. Starting with 1 percent in 1991, the percentages increased each year to 25 percent in 2000.[6] The survey did not report on program coverage or design characteristics. A 2001 survey conducted by Buck Consultants of Fortune 1000 companies showed that 26.3 percent had broadband programs, 2.1 percent were implementing a new broadband program, and 8.8 percent were studying the change.[7] The percentages were similar to the prior year's survey.

THE BENEFITS AND THE POTENTIAL PROBLEMS OF BROADBANDING

Books and articles have reported numerous benefits and potential problems to broadbanding. A slide presentation on the Mercer survey summarizes many of the points made in the literature. The benefits include:

Flexibility

- Promotes increased job flexibility through de-emphasis on titles, grades and position hierarchies
- Introduces flexibility in setting salaries for recruiting purposes and for career management
- Enables flexibility and adaptability in managing pay during times of major organizational change
- Facilitates reorganization and job mobility

Career Progression

- Allows for lateral growth in position duties without requiring unnecessary promotions or title changes
- Facilitates management of expectations around promotion opportunities, particularly when limited promotion opportunities exist
- Facilitates cross-functional career progression
- Provides framework for managing salary growth linked to performance and career development

Teamwork/Collaboration

- Promotes collaboration across business units and geographies due to less rigid focus on position titles and grades
- Eliminates status distinction that arise when team members come from different pay grades

Manager Involvement

- Encourages managers to assume broader responsibility for managing their people

6 The survey includes responses from a broad cross-section of employers, including government.
7 Buck Consultants, 2001/2002 Compensation Budget and Planning Survey of Fortune 1000 Companies.

Potential Problems

The slide presentation also lists a series of potential problems:

- De-emphasis on job hierarchy may be perceived as reduced promotional opportunities and may conflict with other human capital practices.
- Collapsing current grade structure may translate to an unbalanced organization over time.
- "Career earnings" will be negatively impacted unless promotional increases are replaced by new policies and opportunities to increase base pay.
- May create misalignment with other reward practices, existing human capital needs and the business strategy.
- Change in career framework introduces ambiguity and uncertainty about careers.
- The new program will not solve all salary management issues.
- Broadbanding triggers a need for more extensive market survey data.
- Program development may require a significant investment and diversion of resources.
- Program maintenance will require human resource and line managers to develop new competencies.
- Managers may be uncomfortable with increased flexibility and responsibility for managing employee salaries.
- Increased emphasis on individual value, in contrast to the traditional focus on job value, may be misunderstood and trigger concerns about fairness and discrimination.
- Miscommunication can lead to employees assuming higher pay opportunities than under the current salary system.
- Potentially can lead to higher payroll costs if necessary management systems and controls are not in place.

Experience indicates that these potential problems can be avoided with effective planning and roll-out strategies.

RELATED CHANGES IN THE MANAGEMENT OF FINANCIAL REWARDS

Too often, the perception is that the switch to broadbanding was the only change in the management of employee compensation during the past decade. The framework for corporate salary management has changed but other, in some respects more significant, changes also occurred. Broadbanding may not have been as prominent in the minds of private sector employees and managers as other changes and certainly did not receive the same attention that it did in government.

In contrast to the public sector, the focus on market pricing and pay-for-performance certainly is not new for private organizations. They were widely emphasized before broadbanding and continue to be important. These practices are now more prominent but the changes were not very obvious to the typical employee.

Monetary rewards as an incentive is a solidly entrenched U.S. business practice. Over the decade, the increased use of stock options perhaps was the most prominent trend. Stock options make it possible for plan participants to purchase shares of company stock at current prices for up to ten years into the future. In periods of rapid price escalation, options can generate significant income for plan participants. This was highlighted by Enron and Worldcom and other recent events. With the hot stock market through most of the 1990s, companies relied on company stock as a key element of compensation. It now is common for companies to extend option plan participation well below the executive level.

In addition, group incentive plans, under such names as gain sharing, goal sharing, and success sharing, were introduced. They now cover many non-managerial employees. Profit sharing also continues to be important in smaller companies. They tend to be much more effective incentives for improved performance than merit salary increases.

At executive and management levels, virtually every corporation has an incentive plan that is linked to company and individual performance. These plans originated as profit sharing and many still have formulas that determine aggregate payouts as a percentage of profits. The company-based performance measures are balanced by individual measures, usually in the form of performance goals. The balanced scorecard concept often is the basis for the payouts. These are best understood as team incentives as company success drives the level of payouts.

For lower level, "junior" employees, a successful company opens growth opportunities for individuals judged as key contributors. Promotions are the avenue to rapid salary increases. The "pot of gold" is an important incentive for many. The high tech companies that flourished in the 1990s provide an excellent example of how the promise of financial rewards in the form of rapid stick appreciation can affect employee job choice and their drive for success.

These financial rewards are directly or indirectly related to company performance and success. Corporate employees learn early that performance is almost an obsession and their rewards always flow from the company's financial performance and ability to pay. Executives and managers seem eternally optimistic and their financial fortunes ride on their ability to make the company successful. That, for many, is a powerful motivator.

In this environment, a pay-for-performance policy is understood and accepted. Research in corporations has shown that corporate employees are interested in participating in their employer's success. Everyone, from senior executives to the lowest level employees, is affected by the commitment to good performance. It is a common element of the corporate culture. The environment diminishes the focus on annual merit increases and on the basis for managing salaries. It makes a switch to broadbanding considerably less significant than in government.

CURRENT CORPORATE SALARY MANAGEMENT PRACTICES

The following case studies of companies, based on interviews with compensation managers in each, illustrate some of the concepts used by private sector leaders.

- **American Express**. American Express now operates in several related business lines. The best-known are the credit card and business travel services, and the others focus on financial services. The global work force is between 90,000 and 100,000, with 60,000 in the United States.

The company's compensation program was revised in 1997. It went from 26 grades (below the vice president level) to 9 bands that are defined by tiers in the organizations (e.g., all director level positions are assigned to a single band). The system is managed on the same basis throughout the world. Meanwhile, the pay system is "owned" by line managers who are expected to handle salary management. Human Resources is available to assist as a consultant.

Salaries are managed within the bands based on market survey data. More than 40 surveys are used to determine market rates, and the survey data help to specify market reference points within the bands. That means a high demand occupation might be paid higher in one band than others. The focus is on job families with individual salaries managed relative to others in the family. American Express has a dual career ladder for technology jobs. It is a leader in the use of information technology and employs world caliber experts.

The company strategy is to pay employees in total cash – base salary plus cash incentives – at the 50^{th} percentile of the relevant labor markets. All salary increases are based on the results of an annual performance appraisal. Employees are rated on two sets of criteria: results or performance relative to goals, and a list of leadership competencies. There are five generic competencies (e.g., Thought Leadership) with a listing of more specific behavioral anchors for each.

- **American Telephone & Telegraph (AT&T).** AT&T had one of the early broadband salary systems. Its initial bands were 200 percent from the bottom to the top of a band. Yet the company concluded that there was a hodge-podge of jobs in a band, making the bands less meaningful for any specific job and complicating the salary management process. It also provided managers with too much discretion.

  The corporation recently shifted to a slightly different concept that focuses on job families. For each job family (e.g., research, finance, human resources), AT&T defines four levels of management and six levels of individual contributors. Each level is market priced to determine the 10^{th} and the 90^{th} percentiles of pay levels in the labor market. These values define the "band" for jobs or roles at that level. This means the range of salaries (i.e., high to low) for a job family and level. [survey data as the basis for] market data are compiled by a contractor and provided for managers use. Salary increases are based on an assessment of individual results or contribution.

  AT&T uses a simple classification process to assign jobs to levels. The classification system looks at factors such as the complexity of work and job scope. Human resources specialists handle job classification.

- **Daimler Chrysler.** Chrysler adopted a broadband salary structure in 1991. There are 10 bands covering all non-bargaining unit employees in the United States, Mexico, and Canada, totaling 15,000 people, including some clerical employees. The corporation defines ranges within the bands based on market data; the ranges actually control pay levels for each job. Managers manage pay within the ranges. The Chrysler pay program is typical of the early broadband systems.

The salary increase budget is based on salary increase trends in the market and the company's ability to pay. In contrast to the banded program, bargaining unit employees are granted automatic increases to the "top of their job progression" or career ladder. Any increases above that level are based on merit.

- **Consumers Energy Corp**. Consumers is a regional utility in Michigan. It relies on a banded program for its regulated utility business and uses a traditional salary structure for its non-regulated businesses. Roughly 5,000 employees are paid within the bands. Consumers has 10 bands, five for exempt employees and five for nonexempt.

- **Harley Davidson**. The motorcycle manufacturer converted to a broadband salary program in the late 1990s. The program now covers all 2,500 white-collar employees, including office support personnel. Harley wants to maintain a "we're all in this together" culture so everyone is paid on the same basis.

  The corporation has eight salary bands starting with a 200 percent band for executives and tapering off to a 150 percent band for office support staff. The bands are redefined each year based on survey data. Managers are provided with market data for the people they supervise, along with a market rate and a range (calculated as ±20 percent). The human resources staff assembles the data.

  The bands are purposely broad and cover jobs at different tiers in the organization. There are three bands for nonexempt personnel, three for non-management exempt, and two for executives. All salary increases are based on merit.

- **IBM.** IBM is a global business machines and information technology services company with 320,000 employees located in more than 160 countries. It employs 260,000 professionals with 3,000 executives.

  It is important to be aware of the financial crisis that IBM experienced in the early 1990s. The company was close to bankruptcy in 1993, when a new Chief Executive Officer, Lewis Gerstner, was hired. Gerstner proceeded to transform the organization from a slow moving, bureaucratic company that suffered from some of the same entitlement thinking common in government. He relied on a radically changed compensation system as a critical lever to improve performance. The IBM compensation strategy is to pay the best performers like the best in the information technology marketplace.

  IBM uses the same salary management polices worldwide. Salaries are managed within 10 bands for all non-management employees. The first five bands, used for clerical support and plant operations personnel, are based on local salary surveys. The next five bands are reserved for professional employees. In addition, there are four bands for top management. Jobs are classified to a band based on a Position Reference Guide that defines the characteristics of the jobs assigned to each band based on three criteria: skills and competencies, contribution leadership, and scope of responsibility. These decisions are made by managers.

All jobs have a “market reference point,” or the going market rate based on survey data. Managers are then responsible for managing staff salaries relative to the market reference points, taking into account the individual’s competence, performance or contribution, retention impact and job complexity and scope. Retention impact is the supervisor’s assessment of how costly it would be if the individual resigned.

IBM participates in salary surveys conducted by third-party firms and limited to larger IT corporations. The “market pricing” philosophy is central to IBM’s compensation strategy. The company has a dual career ladder with the highest level reserved for IBM Senior Fellows, a prestigious honor within the company. These are high-level technical experts.

All jobs are managed within 24 job families that are, in turn, grouped in broad job categories. For example, Human Resources is in a group with other business management jobs (such as accounting and public relations).

IBM relies on a 3-level performance rating scale. Guidance is provided at the corporate level, and business units have the flexibility to manage around it. Internal guidelines suggest no more than 15 percent of employees should be rated as outstanding. The policy is that employees rated at the third level should have an individual development plan to address weaknesses. By policy, the salary increases for the best performers - the “1’s” - are to be 2.5 larger (in percentage terms) than the lowest performers. Differentiation is very important and related to the goal of retaining people with critical skills.

- **Johnson & Johnson.** Johnson & Johnson (J&J) has roughly 100,000 employees, with 40 percent in professional and managerial positions. Half of its work force is based outside of the United States. It operates in three main businesses: medical and diagnostic equipment, pharmaceuticals, and consumer products. It works through 190 subsidiary companies so its business units and operations are highly decentralized.

  Significantly, J&J has determined that its salary program is not meeting its needs, and has undertaken a comprehensive review. Currently, all U.S. jobs are grouped into 10 career bands for salary management. Market data are developed for each job and used to manage individual pay. The market focus is central to J&J compensation strategy. Outside the United States, the program is based on more traditional program concepts. J&J plans to develop a new program that pays everyone around the world on the same basis.

  Pharmaceutical companies are known to pay exceptionally high salaries, which facilitates recruiting and retention. J&J enjoys a high level of loyalty and unusually low turnover.

  The performance management system is seen as a basic problem. Rewards are based primarily on tenure and incentives are focused on encouraging people to stay. There is a sense of entitlement. Performance management is highly decentralized. J&J has adopted a set of competencies, “Standards for Leadership,” but the concept has not become an integral element of the appraisal process.

- **Marriott Hotels.** Marriott operates hotels in hundreds of cities and towns across the United States and in other countries. It is one of the few corporations that may have as many work sites as the federal government. The corporation also operates several different hotel chains with compensation programs geared to specific hotel markets.

  In general, Marriott pay levels are higher in the higher quality hotels (or “properties”) to help it attract and retain better employees. The career ladders encourage the more competent, better performers to move over time to jobs in prestigious properties. Since some hotel jobs are non-exempt, with people hired from local labor markets, it is essential for them to track locality pay differentials. Marriott participates in a hotel industry salary survey that enables it to generate job-specific data at the zip code level.

  The corporation has defined four bands covering all hotel positions. The bands, however, primarily are used for career planning and management. Similar jobs with similar competency requirements are grouped together. There are no dollar or salary ranges linked to the bands. Managers in each hotel can use the database of market information to determine the competitive range of salaries for a job in the local labor market. The manager is expected to manage the individual’s salary based on an assessment of performance and competence.

  Marriott has an innovative policy to recognize promotions and job changes. It no longer uses the word “promotion.” It rewards every job change with a pay increase. The corporation believes that the new experience will enable the employee to grow and enhance his/her value, thus justifying the pay increase. Moves to a new job within a career band are recognized with a small increase. Those that involve moving to a higher band – the traditional promotion – are recognized with larger increases. In the most recent fiscal year, the increases were 4 percent and 8 percent, respectively.

- **Metropolitan Life Group**. The Metropolitan Life insurance business unit adopted a broadband system in 1997, covering roughly 15,000 employees. Almost all of them work in the United States. Significantly, the Metropolitan Auto & Home business, a subsidiary, has a traditional salary system, although it plans to move to broadbanding.

  Metropolitan has six salary bands covering all employees from mid-management to office support. The bands are defined with market data for the jobs assigned to the band. That means the width varies, with the bands [somewhat wider] for higher professional and managerial levels.

  The human resources staff determines market pay rates and makes the information available to managers who are expected to base salary increase decisions on comparisons across their people, taking performance, experience and qualifications into account. Internal equity is an element of the ‘Met’ pay philosophy.

- **Nortel Networks**. Formerly Northern Telecom, Nortel was one of the early companies with a broadband system. It shifted to a somewhat different concept in 1998.

  The Nortel salary system now is planned to pay employees within job families. The corporation recognizes six job or career levels (below the executives) for each job family. The third level is the "full performance" level. People move into a management position at the fourth level, which also has "experts" in a dual career ladder concept. At each career level, Nortel uses market data to determine the 25th, 50th, 75th and 90th percentile pay levels.

  Managers are instructed to manage employee salaries relative to their experience and performance. Generally, the corporation wants people paid at the 50th percentile. It does not want people paid below the 25th percentile or above the 90th percentile. The salary increase budget is determined by analyses of amounts needed to raise salaries to the 50th percentile balanced by the company's ability to pay. All salary increases are based on individual performance.

- **Xerox**. Xerox adopted a broadband salary system for executives and managers in 1994. There are two bands: one for senior executives that covers 225 individuals and a second for mid-managers that covers 3,300 individuals. These individuals all participate in the incentive plan.

  Xerox market prices the jobs in the two bands. The range of salaries has grown progressively wider over time. It is concerned that the second band is too wide – over 150 percent - and has lost its meaning. It is close to rethinking the way it manages salaries.

  Xerox continues to rely on a traditional salary structure below the management level which includes three salary ranges. All salary increases are based on performance. The company has experienced serious competition and product market problems, making human resources systems less of a high priority.

EMERGING PRACTICES

The sample of companies profiled in this report is small, but they are prominent organizations. Their salary systems suggest two new practices are emerging.

First, market data for specific jobs are commonly made available to managers. The data are compiled and analyzed now by human resources specialists and then entered into a database for use by managers in making pay decisions. The phrase "market reference point" has been adopted by several companies to refer to the data. IBM, one of the leaders, makes these data available to managers across its global operations. As another variation on this practice, Marriott does not actually have dollars associated with its bands, which primarily are used for career management. Managers in each hotel have access to locality-specific job data to make salary decisions.

This practice means market data, not the broadbands, are the focus of salary management. Managers make their decisions relative to the market data within broadband groupings, a significant change in the concept. Many companies changed their compensation philosophy in the 1990s as tight labor markets forced them to respond to rapidly rising market rates. Most now downplay or ignore internal equity considerations. The phrase “market based” is now used to describe their pay strategy.

It also is common among major corporations to define their labor market narrowly to compete with other corporations in their industry. IBM for example participates in a private survey of other leading information technology companies and bases its salary planning on that survey. Similar surveys are conducted in several other industries. Elite corporations recognize that they are competing with each other, and pay is a major driver.

A second emerging practice is the use of market data to define separate bands at each career stage or level. Several companies define the bands based on the 10^{th} and 90^{th} percentile values at each career stage or level. The mean or median (50^{th} percentile) is used in the same way as a range midpoint in a traditional salary system. These companies also are defining a separate series of bands for defined occupational groups (e.g., information technology specialists) based on market data.

Figure 2
PREVAILING SALARIES IN WASHINGTON-BALTIMORE CORRIDOR, 2002

Career Stage	*%*	*Salary Range*	*Career Stage*	*%*	*Salary Range*	*Career Stage*	*%*	*Salary Range*
Accountant I	10th	$32,000	Network Analyst I	10th	$38,100	Mechanical Engineer I	10th	$42,800
	Mean	$39,800		Mean	$47,000		Mean	$51,600
	90th	$47,400		90th	$57,700		90th	$58,000
Accountant II	10th	$37,100	Network Analyst II	10th	$45,300	Mechanical Engineer II	10th	$51,800
	Mean	$45,600		Mean	$58,000		Mean	$61,700
	90th	$54,600		90th	$73,000		90th	$70,300
Accountant III	10th	$44,000	Network Analyst III	10th	$55,200	Mechanical Engineer III	10th	$57,200
	Mean	$55,300		Mean	$67,600		Mean	$72,600
	90th	$69,000		90th	$82,500		90th	$88,800
Source: Human Resource Association of the National Capital Area, 2002 Compensation Survey Report								

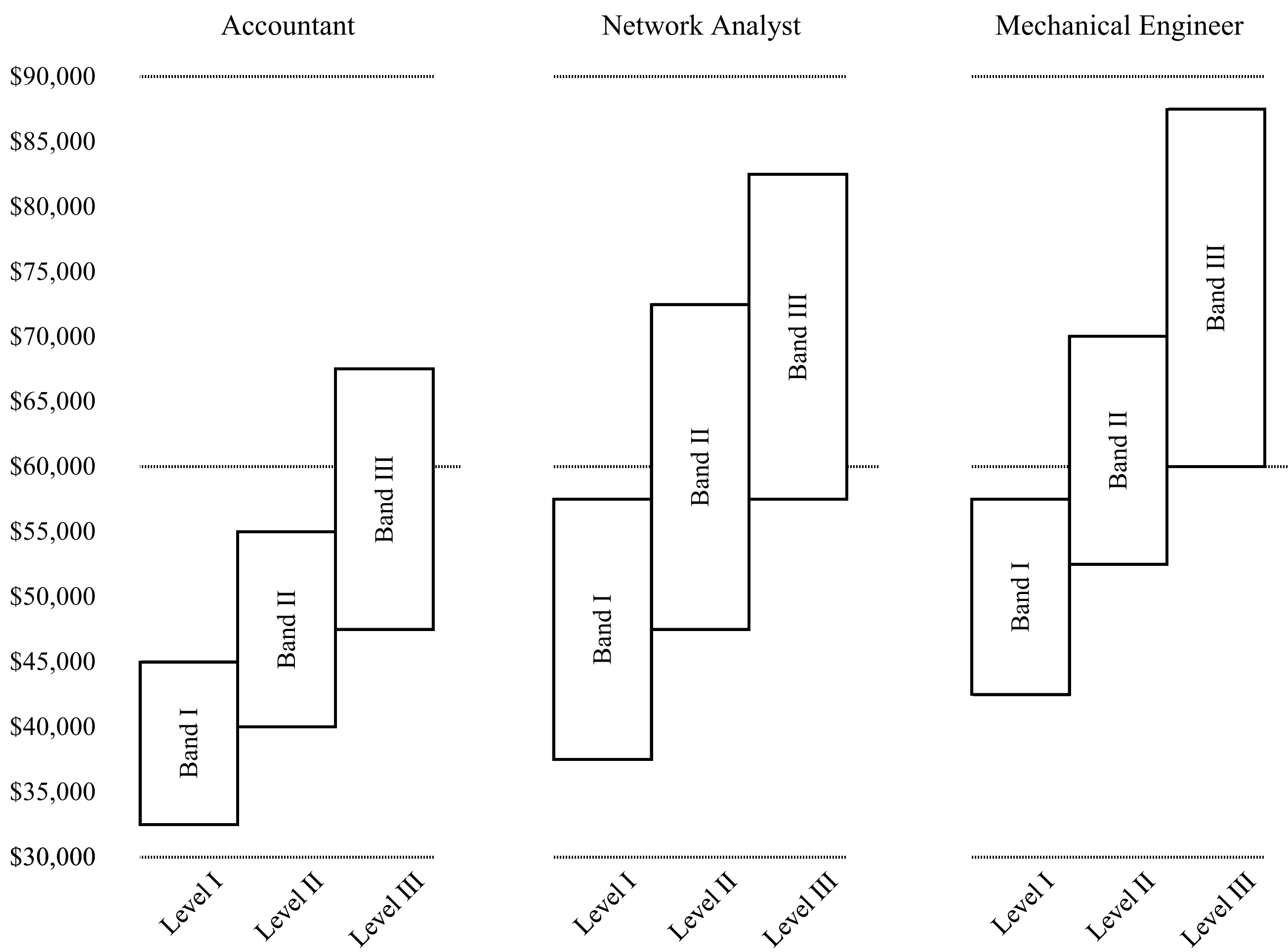
To illustrate the concept, Figure 2 shows data for three job families in the Washington Baltimore corridor for 2002. Salary bands would be based on these data. Possible bands are illustrated in Figure 3. The first band for Accountants starts at $32,000 and tops out at $47,400 or 48 percent width. The second band then starts at $37,100 and extend to $54,600.

The bands are very different from the “broadband” concept as it was originally conceived. The percentage difference from low to high is smaller and varies from 35 percent (for Mechanical Engineer I) to 61 percent (for Network Analyst II). The differences tend to be similar to the 50 percent “range spread” that is common in traditional corporate salary ranges. It also is apparent that a single 150 percent band would nearly cover all three job families and levels but would have little direct relevance to any single job.

For the first career stage, Level I, a single band from $36,000 to $54,000, a 50 percent band, basically covers the range of salaries paid in the DC area. However, graduating mechanical engineers very differently from new accountants. Mechanical engineers are paid roughly $10,000 more than accountants at the entry level. A single band also could be defined for each of the two higher levels but they each would be affected by the same problem: They do not represent equal reward opportunities.

The use of market-based career bands addresses several concerns with the broadbanding model adopted in the early 1990s. It facilitates a manager's decision making since the limits of the band are directly relevant to the decisions. The policy would be to pay employees at the market mean when they demonstrate their ability to perform at "full performance". At that salary, they would be paid "competitively". Consistent with the policy, only high performers would be paid above the mean. This approach also provides a transparent and easy to understand picture of how an employee's salary compares with market levels.

Figure 3
Illustrative Career Salary Bands



Each year, new survey data enables companies to adjust their bands to maintain planned alignment with market data. The bands could be defined for broader job groups and occupations (e.g., research jobs, information technology jobs) which would perpetuate internal comparisons within occupational groups and support traditional internal equity philosophy. If the occupational groupings are too broad, however, the system would revert more to the broadband concept since bands would be broader. A series of bands for all information technology jobs, for example, would require the use of job-specific data to manage salaries within the bands. The market indicates very different salaries for COBOL programmers than for the network analysts.

It is apparent that a new standardized program model has not gained wide acceptance. In contrast to the traditional salary program model, with virtually identical salary structures and practices, current trends suggest it is important for each company to develop its own variation. Many companies are still "fine-tuning" their programs to make them more effective.

OVERVIEW OF CURRENT PRACTICE

The economic slowdown has shifted corporate priorities to cost control, particularly in human resources. Benefit costs now are a focus. There also has been a concern with executive compensation programs as a result of corporate bankruptcies. Very few companies have addressed base salary problems.

It is important to keep in mind that the practices highlighted here are not new to the private sector. Pay-for-performance and other practices long have been important to corporate salary management. Market alignment or market pricing is not new either but is a higher priority for organizations that have adopted a banded structure and even those that have not. The market focus has largely replaced the internal focus that was common in the past.

The expanded role for managers is evolutionary. Corporate managers have been the locus of salary management for several decades. The evolving definition of their role is made possible by new information systems that make pay-related information more easily available to managers to make decisions and human resources specialists to monitor pay decisions. Managers have access to specific market data and information relevant to the salaries of other employees in similar positions. The expectation that they will use the information in their planning can be an indirect control on their decision making.

Perhaps one of the key differences between the public and private sectors is the fact that private sector managers grow up within an environment where compensation is broadly used as a tool to influence performance. They know that their pay and career success depend on their units performance. Their pay includes cash incentives and often stock ownership opportunities, which makes the annual salary increase almost insignificant except as an indicator of how they are seen by their superiors. In this context, they take performance management seriously and know it is to their benefit to avoid some of the practices that make federal employees skeptical and suspicious of pay-for-performance. Of course, their decisions related to staff pay increases are confidential.

Along with the evolving role of managers is a reduction in the human resource staff resources committed to monitoring and maintaining pay systems. Companies no longer are willing to live with high administrative costs. The reductions in staff have forced the human resources function to back away from close program control. In major corporations, it is not uncommon to find only a handful of "compensation specialists" at corporate headquarters and several human resources generalists working in advisory or consulting roles with line managers.

Salary management in corporations, even in the most traditional programs, is carried out within ranges that are wider than the 30 percent (from step 1 to step 10) found in the federal GS schedule. Moreover, corporations rely on open ranges and avoid automatic increase practices. There always has been greater flexibility for granting pay increases in the private sector than in the federal pay system. Within this environment, it is possible to shift from the traditional internal focus to a market focus without changing the salary structure.

There is evidence that companies are reluctant to adopt the broadband concept as it emerged a decade ago, although this has not been confirmed in the literature. At the same time, there is no evidence that they are reverting to the traditional salary management model. The model for banded salary structures is evolving as companies gain experience. Recent changes are intended to give managers the tools they need to make sound pay decisions.

The evidence now suggests that companies are developing pay strategies and new systems to meet their operating needs and culture. New pay systems are commonly developed internally and do not follow an established model. The new systems represent a break from the past but do not provide a clear picture of the future, other than the continued reliance on pay-for-performance and the increased importance of market alignment.

LESSONS LEARNED

Based on the two ACA research studies and emerging practices highlighted by the company profiles, it is possible to identify are several program design concepts associated with effective salary management. It is important to appreciate that these "lessons learned" are based on private sector experience and would require some modification for public employers.

An important starting point is articulating the compensation program's philosophy and objectives. This provides a basis for assessing the program in the future and refining it. The objectives help managers and employees understand what they can expect.

Communication is essential, first when the new program is announced and then on an ongoing basis. Employees must understand how the new program is going to affect them and what they need to do to be successful. Employee communications experts note that messages need to be repeated multiple times and in different media. Supervisors represent a focal point for communication and must be prepared to respond to questions.

The management of salaries sends important messages to employees that help them manage their careers. There is a need for consistency so employees can plan and make personal decisions. That includes annual adjustments to the salary system and criteria used for employee appraisals.

Responsibility for salary management can be successfully delegated to line managers. For years, it was more appropriate to refer to salary administration. Human resources maintained close control and policies allowed minimal discretion. That has changed over time. Human resource's role in a growing number of companies is limited to monitoring, consulting and planning annual changes to respond to labor market trends.

Managers and supervisors must develop the understanding and skills to handle any change in their role. Corporate managers and supervisors are accustomed to making pay decisions but even their companies believe they should have required more training when a new pay system was introduced. They will benefit from refresher sessions over the first year.

Performance must become a priority at all levels. This is essential for pay-for-performance to be accepted. Executives and managers should be rewarded for their performance and for their management of subordinate performance. That will help them focus on their new role.

Banding simplifies salary management. There is a need for a logical and systematic process for classifying jobs to bands. Companies have developed simplified classification systems for this purpose which describe the types of jobs in each band. Managers can assume responsibility for making decisions in a banded system, and they can do it effectively.

Employees must understand the logic governing the assignment of their jobs to their band. The decisions have to be credible. It is highly advantageous to group jobs in bands that are at the same career stage and affected by similar market forces. Employees must be able to identify with other jobs and employees in the same band. That also facilitates the management of the employees for other human resources purposes.

Bands no longer are as wide as the original broadband systems. Increasingly, career stages and market pay levels define bands. That is simple and understandable. It also reinforces the importance of career progress and supports the introduction of competency models. The new bands also reduce problems associated with inflated expectations.

Managers need user-friendly tools to make pay decisions. Perhaps the most important are the new information systems that make relevant information available to managers and enable human resources to monitor pay decisions. They need guidance on market pay levels and comparative internal salaries. The information indirectly limits the manager's discretion.

It is apparent that broadbanding is no longer experimental. Companies are not testing the concept; it is well established. It is important to appreciate, however, that broadbanding is not a single model. Perhaps the most important lesson is that employers must develop salary systems that meet their needs and support their operating plans.

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APPENDIX B
ALTERNATIVE METHODS FOR JOB CLASSIFICATION/EVALUATION

The phrase "job classification" refers to decisions made to determine the appropriate job family or series, and the appropriate salary grade and range. It is interesting to note that corporations rarely use the word, "classification". They do not spend much time on assigning jobs to a job family because those decisions are generally routine. Rather, they typically limit their focus to "job evaluation," which narrowly refers to the grade decisions.

Compensation management textbooks refer to four basic approaches to job evaluation. Two are based on quantitative techniques and two on non-quantitative techniques. Quantitative in this context refers to methods that assign a numerical value interpreted as a measure of internal job value. There is a fifth alternative, market pricing, which often is used in combination with one of the other methods; increasingly, it is used as the solitary basis for grade decisions.

Non-Quantitative Methods

- **Whole Job Slotting**. This approach is based on a subjective comparison of a job with other jobs, with "equal" jobs assigned to the same salary grade. It is the simplest method.
- **Classification**. This is the traditional approach used by public employers prior to the introduction of quantitative methods in the early 1970s. Jobs are assigned to grades based on a comparison with a description of the jobs at the grade level. The grade descriptions include statements related to a series of factors or job characteristics.

Quantitative Methods

- **Point Factor**. The employer identifies a series of "compensable factors," the job characteristics or criteria that affect a job's relative value. Skill, effort, responsibility, and working conditions are the generic factors recognized in law and in practice. For each factor, there is a measurement scale defined with levels, to which points are assigned. These design decisions essentially are arbitrary and not based on theory. Each job is "evaluated" factor by factor by comparing it with the definitions at each level, which establishes a point value for the factor. The job's "value" is determined by adding the points across the factors. The Factor Evaluation System is a point factor system.
- **Factor Comparison**. The fourth method is based on compensable factors and is similar to the point factor approach. It is rarely used.

Prior to broadbanding most corporate employers relied on one of the job evaluation methods to assign jobs to ranges. Point factor plans were the most common for exempt positions; they were not as common for office support positions or for hourly pay systems.

However, many corporations now rely on market pricing in lieu of job evaluation. They assign jobs to the grade where the range midpoint approximates the market average. For example, if a survey reports the average salary for a job is $47,500 and the midpoint of a range is $49,000, it is likely the job would be assigned to that range. This approach ignores internal job value but assures that jobs are paid competitively.

There effectively are no legal requirements governing job evaluation in the private sector. The courts have decided that companies must be consistent and avoid discrimination. Attempts to gain acceptance for the "comparable worth" or "pay equity" arguments never gained support and more or less have been forgotten.

The job evaluation methods were conceived in the 1920s and the 1930s, an era of scientific management, and pseudo-scientific approaches to decision making. There were virtually no developments until the pressure for pay equity in the mid 1970s prompted efforts to develop better approaches. New methods, based on statistical models introduced in the early 1980s, certainly were faster and more reliable but the decision logic was essentially unchanged from the older systems. Jobs were compared against "measurement" scales and a summary "job value" used to assign jobs to salary grades.

None of these methods actually determines a job's value. Years ago, the U.S. Office of Personnel Management turned to a contractor to assess social science methods to determine value. The conclusion was that job value cannot be measured except by reference to salaries dictated by the labor market. Point values are an index of where each job is ranked within the hierarchy of jobs, but they cannot be interpreted as a measure of value.

The switch to a broadband structure, where a career ladder may have only three or four bands, reduces the importance of the claimed precision of quantitative methods. Over the past decade, job evaluation systems have diminished, while market pricing and simplified classification systems have grown.

APPENDIX C
SALARY RANGES v. BANDS: DIFFERENT DESIGN ALTERNATIVES

The process to design a traditional salary structure began in the first half of the last century. The first step concerns the early job evaluation systems and the point totals for each job. To make wage and salary programs more systematic and rational, employers used the simple idea of plotting each job on an X-Y graph, where evaluation points were on the X-axis and current pay rates on the Y-axis. The graphs led to the use of linear regression to develop a line-of-best-fit, the basis for defining salary range midpoints and is referred to as a "policy line." This would enable an employer to decide how much to pay any job once it is evaluated. This is a simple and seemingly logical way to provide an easy to understand structure.

The next steps created the problems with traditional salary systems. With any regression analysis, the actual data points are above and below the line. That is to say, some jobs are paid more than the amount indicated by the regression analysis and some less. To accommodate the variance, employers defined salary ranges with minimums below the policy line and maximums above. That has been a standard practice. Yet, there is unfortunately no obvious way to decide how many ranges are necessary. The point is to focus on a percentage difference between range midpoints.

To illustrate the logic, assume new hires for exempt jobs start at a low of $25,000 and the highest paid, non-supervisory professionals receive $125,000. The task is to define a series of salary ranges for employees. The minimum for the lowest range would be $25,000 and the maximum, following established practice, would be $37,500 ($25,000 x 1.5). The range midpoint would be $31,250 ($25,000 x 1.25).

The highest range would have a maximum of or above $125,000 to encompass the highest paid employee. In practice, the range calculations are based on a geometric progression starting with the lowest midpoint: $31,250. Successive midpoints are inflated by the planned percentage between ranges.

For example, when the difference between midpoints is 5 percent, it generates 28 ranges. The second range has a midpoint of $26,250 ($25,000 x 1.05) and so on. When the difference is 10 percent, there are 14 ranges. The highest range has a minimum of $86,300 and a maximum of $129,500. Specialists interested in the technical side of salary management sometimes debate the "right" percentage to use for these calculations.

Jobs are assigned to grades and ranges based on job evaluation points. For example, jobs with 100 to 125 points might be slotted in grade 1, those with 126 to 150 points in grade 2, etc. The problems arise for job jobs evaluated, for example, in the 120 to 130 range where a couple of points can mean a difference in grade. The argument over those points can be contentious.

Broadbands are based on a completely different logic framework. The phrase "career bands" often is used in industry to refer to the logic used to define bands. The focus shifts to career ladders and the stages or levels in the ladders. To illustrate how bands might be defined, assume the career ladders have four levels: trainee, independent contributor, senior specialist, and expert.

This suggests only four bands are needed. Jobs are classified to a level based on duties and competencies.

The bands can be defined as equal in width, or according to the salaries at each career stage. Typically employees spend less time in the first and second career stages, prior to promotion. Many will spend most of their careers in the third stage. Only a few will qualify for the expert stage. The goal is to define a series of bands covering the planned salaries at each level.

The actual bands would be based on a review of salaries. To illustrate the logic, the lowest band might be defined as $25,000 to $35,000, a 40 percent “spread”, with the expectation that people would be promoted in a year or two. The second might be $32,000 to $52,000, or 60 percent. The third could be $46,000 to $82,000, or 80 percent. The highest band then might be $72,000 to $130,000, or 80 percent. (All values are roughly consistent with the 2003 GS and rounded for simplicity.) Employees move to higher bands when they demonstrate competence to qualify for promotion.

APPENDIX D
PRIMARY DIFFERENCES BETWEEN TRADITIONAL PRIVATE AND PUBLIC PAY PROGRAMS

- There are separate salary systems for "exempt" and "nonexempt" employees. The programs are managed separately. The reliance on separate pay systems is related to the Fair Labor Standards Act (FLSA) and legal requirements. This practice is deeply entrenched.
- The range of salaries in the larger companies is much greater. Non-supervisory "exempt" employees often are paid in excess of $100,000. Managers and executives often are paid much more, in some cases over $1 million.
- The difference in salary level between the tiers in the organization increases at higher levels, to as much as 30 percent or more. The differentials are one of the reasons for broadbands.
- In a traditional salary structure, there often are 25 or more grades for exempt employees. Again, this is related to the range of salaries.
- The typical range "spread" or difference between the minimum and maximum is 50 percent for exempt, non-management employees.
- Jobs are assigned to grades and ranges based on a balancing of internal and external considerations. Over the past decade, companies have moved aggressively to more of a market-based strategy.
- There are hundreds of salary surveys conducted every year. There virtually are no legal issues in using survey data so employers have a variety of practices and strategies.
- The typical salary structure is "aligned" with market data based on mean or median pay levels for specified labor markets.
- The internal job hierarchy also is important and reflected in the job evaluation system. Point factor job evaluation systems are prevalent.
- Salary range midpoints are commonly the linkage to market pay levels. When an employee is paid at midpoint, his or her salary is "competitive."
- Starting salaries for new hires are flexible and generally reflect individual credentials. The typical policy permits a starting salary between the range minimum and midpoint.
- Salary increases within a range are based almost universally on "merit." The use of general, across-the-board, or cost-of-living increases ended a decade or so ago.
- Some companies limit increases by policy above the midpoint to the "high performers." That means every employee can reach the market average or midpoint after a few years but only the best performers are paid above average salaries.
- Salary increase budgets are prepared annually based on the projected increases to maintain the planned alignment with market pay levels.
- Managers are expected to determine an appropriate increase for each subordinate based on a "corporate" policy and the salary increase budget. Their recommendations typically require one level of management approval.
- Individual salary information is typically treated as confidential, which makes it easier for a manager to differentiate among his or her people. Salaries never are public information.