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# A Story About STEPS



## How to Avoid the Pitfalls of Midpoints

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Performance-based step (PBS) salary administration helps increase morale and retention by moving employees through their salary range based on performance and tenure.

Jane Doe was dissatisfied with her salary increases at Company X since she'd joined the organization five years before. The original employment offer was attractive and represented a promotion with new opportunities and a salary increase to boot. During the interview process, she was pleased to learn that she would be coming in toward the low end of the salary range for the job. That certainly meant a lot of room for upward movement if she performed well.

Or, did it?

Five years later, Jane had five solid, "at-expectation" performance evaluations under her belt. Yet, though the salary structure (i.e., range minimums, midpoints and maximums) had been increased each year, Jane's salary remained at the low end of the range. She, like most employees, had received annual salary increases ranging from 3 percent to 4 percent. Meanwhile, since Jane joined the company, three employees were hired into the same position title as she. Jane learned that one of the new hires was making $1,000 more per year than she was, even though this individual had less job-related experience.

It wasn't fair, and Jane faced making some key decisions. She liked the company and wanted to stay. However, it appeared that the only way to reach her income goals would be to leave. If she chose to stay, she would have to face the reality that salary progression would continue at a glacial pace, and she may never attain the midpoint (i.e., competitive market rate for experienced professionals) associated with her salary range. This scenario would have a negative effect on Jane's morale and overall motivation.

**QUICK LOOK**

- The vast majority of good, solid performers receive a flat 3 to 4 percent increase each year.
- Few, if any, employees attain the midpoint of their salary range, resulting in high turnover and low morale in the organization.
- PBS is a new approach that moves employees through salary ranges in a systematic manner.
- In a PBS salary structure, employees who meet or surpass expectations will eventually progress to the range midpoint within a defined period of time.

## The Same Old Story

Unfortunately, Jane's experience is very typical within many organizations, especially those that lack an effective performance management system with strong ties to compensation. A few superstars and other "favored" employees may receive significant salary adjustments. But the vast majority of good, solid performers receive the same flat 3 percent to 4 percent increase each year. Few, if any, employees attain even the midpoint of their salary range. The result is that these organizations frequently experience high turnover. There also may emerge a culture of mediocrity because many employees believe that going the extra mile will make a minimal difference in their paycheck.

## Rewriting the Rules

How can these conditions be addressed? Certainly, part of the solution could lie in enhancing the performance assessment process. However, independent of such a process, several organizations are using a new approach to salary administration that is showing promise in moving employees expeditiously and systematically through salary ranges based primarily on performance, while considering long-term employee contributions and budgetary constraints. It is perhaps best labeled the "performance-based step" (PBS) approach.

Many executives and HR professionals cringe upon hearing the word "step" – it frequently is associated with the public sector, an industry in which employees progress from step to step each year based exclusively on tenure. There are many examples of mediocre schoolteachers who are at the highest step in the salary range due to tenure. But, on the flip side, this approach has the advantage of progressing employees through salary ranges in a systematic manner.

The PBS approach builds on the positive, but moves the focus to performance instead of tenure alone. A PBS plan includes:

- **Position assignment.** The assignment of positions to classification levels and establishment of salary range parameters (e.g., minimums, midpoints and maximums).
- **Step identification.** The identification of five to 10 steps between each salary range minimum and midpoint. Employees currently compensated below midpoint will progress at least one step each year if their performance is assessed to be at least "at expectation." If performance is exemplary and the budget permits, employees can progress at a faster pace (e.g., two steps instead of one each year). If performance is below expectation, employees will stay at the same step until performance improves. Figure 1 illustrates this step concept.
- **Increment selection.** Steps can represent equal dollar increments or equal percentage increments. A key advantage of equal dollar increments is that the percentage increase from step to step is the largest at the bottom of the salary range. Employees at or close to the bottom are theoretically the farthest away from the competitive market rate (midpoint) and should be advanced at a faster clip than other employees.
- **Awareness of implications.** Organizations should be mindful of budgetary and motivational implications in determining the number of steps to use. Assuming an equivalent spread in the salary range from minimum to maximum, the percentage increase from step to step is necessarily higher under a five-step approach than it is under a seven- or 10-step approach. An organization that chooses to use five or fewer steps might find that funding step increases leaves very little for salary increases to those currently compensated above midpoint. Conversely, using 10 or more steps may serve to defeat the underlying purpose of the PBS approach – expeditiously moving

**FIGURE 1: THE STEP CONCEPT**

| | | | | | | | Midpoint | |
|---|---|---|---|---|---|---|---|---|
| Minimum | Step 1 | Step 2 | Step 3 | Step 4 | Step 5 | Step 6 | Step 7 | Maximum |
| \$18,018 | \$18,662 | \$19,305 | \$19,949 | \$20,592 | \$21,236 | \$21,879 | \$22,523 | \$27,027 |

employees through the salary range. Employees will be discouraged to learn that it might take them 10 years to reach the midpoint.

- **Finalizing compensation guidelines.** Several companies use one or two control points beyond salary range midpoint. The spot between the midpoint and control point 1 usually is reserved for solid, at-expectation performers. Between control point 1 and control point 2 is reserved for long-term employees who recently have demonstrated above-expectation performance. Between control point 2 and the maximum is reserved for employees with a long history of above-expectation performance. (See Figure 2.)
- **Finalizing allocation guidelines.** Most companies establish an overall budget for salary increases on an annual or other periodic basis. In recent years, this has ranged from 3.5 percent to 4.5 percent. A typical allocation of this budget under the PBS approach would include:

– **Priority 1:** A pool of money to address significant internal and external inequities. Typically, there will be few such instances in any given year. One recent example in many organizations is the need to significantly increase salaries of information technology and other "hot skill" positions due to the competitive market.

– **Priority 2:** A pool of money to cover a general structure adjustment. Many companies increase their salary structure (i.e., minimums, steps, midpoints, control points and maximums) by a flat percentage amount each year. This typically has ranged between 2 percent and 3 percent in recent years. It is important that all employees performing at least "at expectation" receive a salary increase equal to the structure adjustment to maintain their relative position within the salary range.

**FIGURE 2: CONTROL POINT FEATURE**

| Minimum | Midpoint | Control Point 1 | Control Point 2 | Maximum |
|---|---|---|---|---|
| $18,018 | $22,523 | $24,024 | $25,526 | $27,027 |

– **Priority 3:** A pool of money to assure that all minimum step increases are funded. Depending on the number of steps used, the breadth of the salary ranges and the percentage of employees below midpoint, the effect of this priority on the overall budget can easily range between 0.5 percent to 1.5 percent.

– **Priority 4:** The remainder, if any, will fund additional performance-based increases to employees – those both below and above the salary range midpoint.

## Case Study: Council for Jewish Elderly's Experience

Council for Jewish Elderly (CJE), a not-for-profit organization that provides a wide range of services to elderly citizens in the Chicago area, provides a PBS case study. Before starting PBS, CJE lacked a formal salary administration plan. At the end of each year, the executive team met to review each staff person's current salary and negotiate the salary for the coming year. There was no systematic method to progress employees' salaries based on the competitive market, their performance and experience with the organization.

CJE started a PBS plan that included seven steps. Employees currently compensated below their assigned salary range midpoint were initially placed on a step (always rounding up to the next highest step). Since the plan was implemented, CJE has successfully administered one round of salary increases and is in the midst of a second round. The salary structure was adjusted and most employees have progressed to higher steps in the range. The PBS plan has added a welcome amount of structure to salary administration, said Ann Thomas, director of human resources.

"Like many organizations, we had long-term, high-performing employees who were making less than new, untested employees who were performing the same job. There were morale and retention problems, and concerns regarding the overall equity and competitiveness of compensation," Thomas said. "Each year, the executive team dreaded the time-consuming salary negotiation process and all the time it took away from other key activities.

"The PBS approach has minimized these concerns and appears to be viewed favorably by staff, supervisors, and those who manage the salary administration plan."

### PBS in Practice: Back to Jane's Story

Going back to our fictitious employee, consider how Jane would fare under a PBS salary administration plan. Figure 3 depicts her salary range upon employment. Because she is new to the job, with no prior experience, Jane would be brought in at the salary range minimum ($18,750). Had she been in a similar position elsewhere, she could have been brought in at Step 1, Step 2 or higher.

After the first year, the entire salary range is moved up by 3 percent. Figure 4 shows the new salary range. Jane's base salary would be adjusted to at least $20,600 (i.e., the structure increase plus the increase to step 1 if her performance is at least at-expectation). If her performance is exemplary and the budget allows, her base salary could be increased to Step 2, Step 3 or somewhere in between.

After five years, again assuming at least at-expectation performance, Jane, at least, would reach the midpoint of the salary range. At that point, she would be compensated at or above the competitive market level for her job. Chances are slim that new hires with less or comparable experience would be brought in at a higher base salary level.

### PBS Approach in Action

The PBS approach is not the answer to every organization's needs. Figure 5 depicts two nearly polar opposite profiles of organizations/situations. Most organizations will fall between these two extremes. At minimum, such organiza-

**FIGURE 3: JANE'S SALARY RANGE UPON EMPLOYMENT**

| | | | | | Midpoint | | |
|---|---|---|---|---|---|---|---|
| Minimum | Step 1 | Step 2 | Step 3 | Step 4 | Step 5 | Control Point | Maximum |
| $18,750 | $20,000 | $21,250 | $22,500 | $23,750 | $25,000 | $28,125 | $31,250 |

**FIGURE 4: JANE'S NEW SALARY RANGE**

| | | | | | Midpoint | | |
|---|---|---|---|---|---|---|---|
| Minimum | Step 1 | Step 2 | Step 3 | Step 4 | Step 5 | Control Point | Maximum |
| $19,313 | $20,600 | $21,888 | $23,175 | $24,463 | $25,750 | $28,969 | $32,188 |

**FIGURE 5: DECIDING IF PBS IS FOR YOU**

**Ideal Candidate for PBS**

- An organization that lacks an effective performance management system and/or supervisors willing to make appropriate distinctions in performance appraisals and compensation adjustments. Some organizations, such as those embracing the Deming approach to management, actually discourage making distinctions.
- An organization, even one with supervisors willing to make performance distinctions, that desires a consistent, systematic methodology to advance employees through salary ranges.
- Conducive to cultures placing a relatively high value on internal equity. Such organizations believe controls and policies are needed to assure that a given employee's compensation is "reasonable" vis-à-vis the compensation of other, similarly performing employees.

**Poor Candidate for PBS**

- An organization that has a highly effective performance management system and supervisors with a demonstrated track record of making appropriate distinctions in performance appraisals and compensation adjustments.
- An organization that desires the maximum possible flexibility in its salary administration practices.
- Organizational cultures that place a relatively low value on internal equity. Compensation packages are viewed more on an individual basis.

tions should consider PBS as an alternative in enhancing their salary administration plan. Organizations that have implemented PBS emphasize the following advantages, which tie directly to the "ideal" profile.

- A PBS plan strategically uses the salary increase budget, blending considerations of the external market, performance and tenure.
- It assures that employees move through the salary structure and don't become mired in the lower end of their assigned salary range. All at-expectation or above-expectation employees will eventually progress to the range midpoint within a defined period of time.
- It offers a systematic approach, under which supervisors can simply follow the guidelines of progressing employees from step to step. The plan is flexible enough to give supervisors discretion. For example, if employees perform above expectation, supervisors can award more than a one-step increase – if the budget allows.
- A PBS plan typically is perceived as fair from an internal perspective. Employees quickly grasp the concept that both their performance and tenure will affect salary adjustments. There should be few – if any – situations in which a new employee makes more than a long-term employee in the same position, assuming equivalent levels of performance.

In making a decision regarding any salary administration approach, an organization needs to consider both the culture and values it wants to reinforce, and the need to attract and retain employees that will enable the company to succeed. Retention, in particular, is a struggle that most organizations face in today's nearly full employment environment. Employees become unhappy in their career and with their current employer for many reasons. Compensation administration policies typically are a big factor in decisions to pursue other opportunities. Depending on the operating environment and the nature of the work force, a PBS plan may well be part of the answer to increasing employee satisfaction and reducing an organization's vulnerability to competitive threats for their human capital.

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