Aon Hewitt
Radford

October 2016

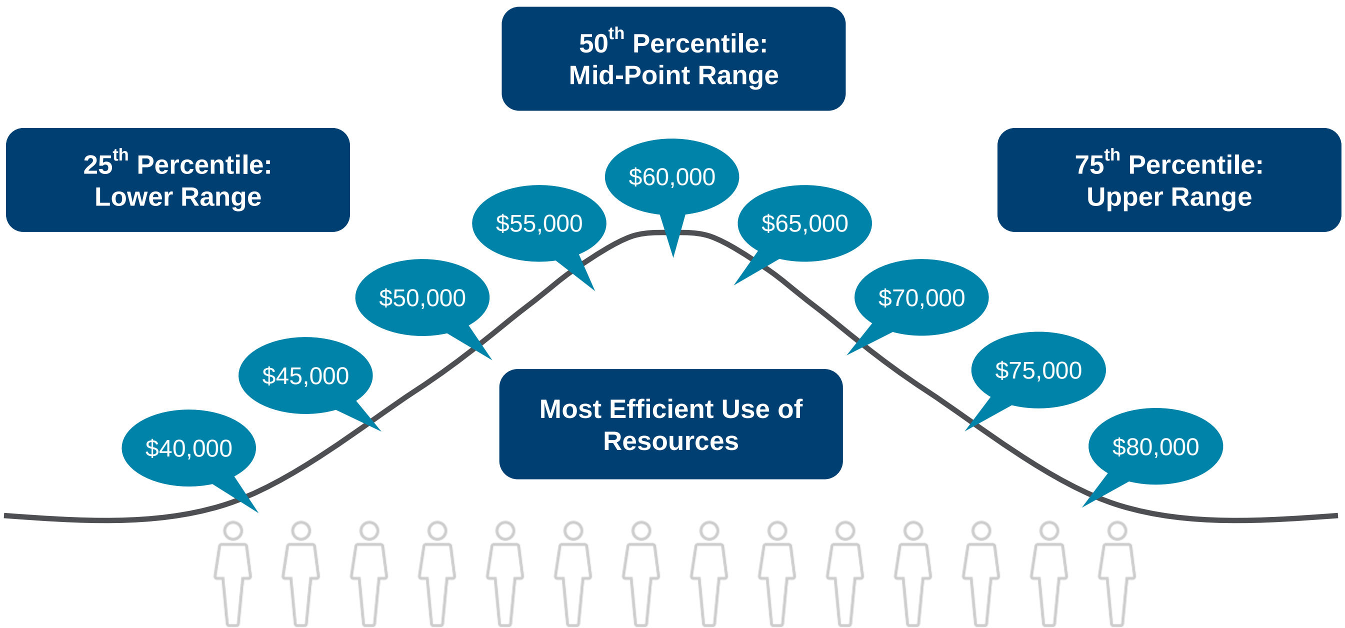
More Technology and Life Sciences Companies Are Turning to Market-Based Salary Structures

The adoption of market-based salary structures is on the rise as the competition for talent remains fierce; they balance administrative ease with the need to respond to dynamic markets

This article is the latest installment in our series on salary administration. To read earlier articles, click **here** to learn why some technology companies are turning to market-based pricing, and click **here** to learn more about Radford's unique approach to job leveling and job architecture.

Introduction

The idea of "flexible" and "structure" can sound counterintuitive to some. Structure typically connotes a system that is forced or prescribed. While compensation decisions should be anything but rigid, it is extremely beneficial to have some guardrails to predict and manage costs since base salaries account for the largest portion of a company's workforce spend. Market-based salary structures are about keeping your pulse on the market and determining the acceptable lower and upper limits for your company.



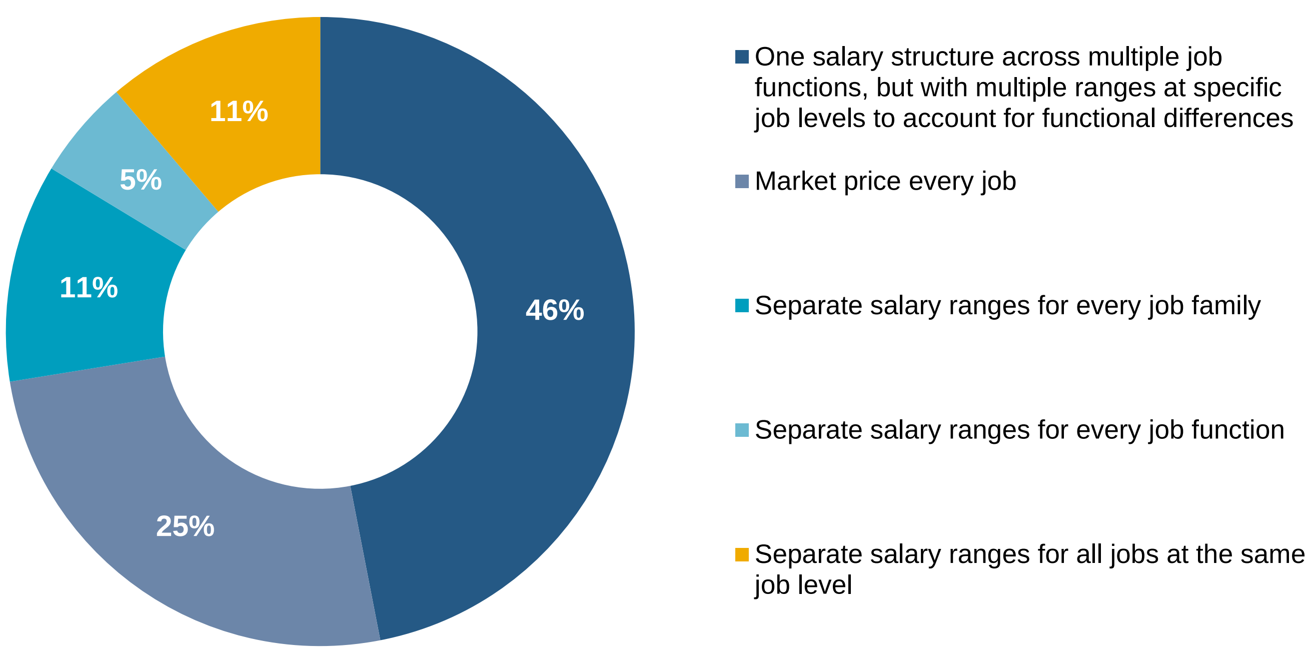
Market-based salary structures require some give-and-take: Compensation professionals should provide guidelines to managers to ensure some level of consistency for pay positioning, job levels and promotion practices. Meanwhile, managers should have the flexibility to differentiate pay based on a number of factors that may be valued by the company, such as experience, performance, potential for future contributions to the company, supply and demand for the role of skill sets required, market data and internal peer comparisons.

This flexible approach has increased the prevalence of market-based salary structures in recent years among technology and life sciences companies given the hot job market in both sectors.

Prevalence of Adoption

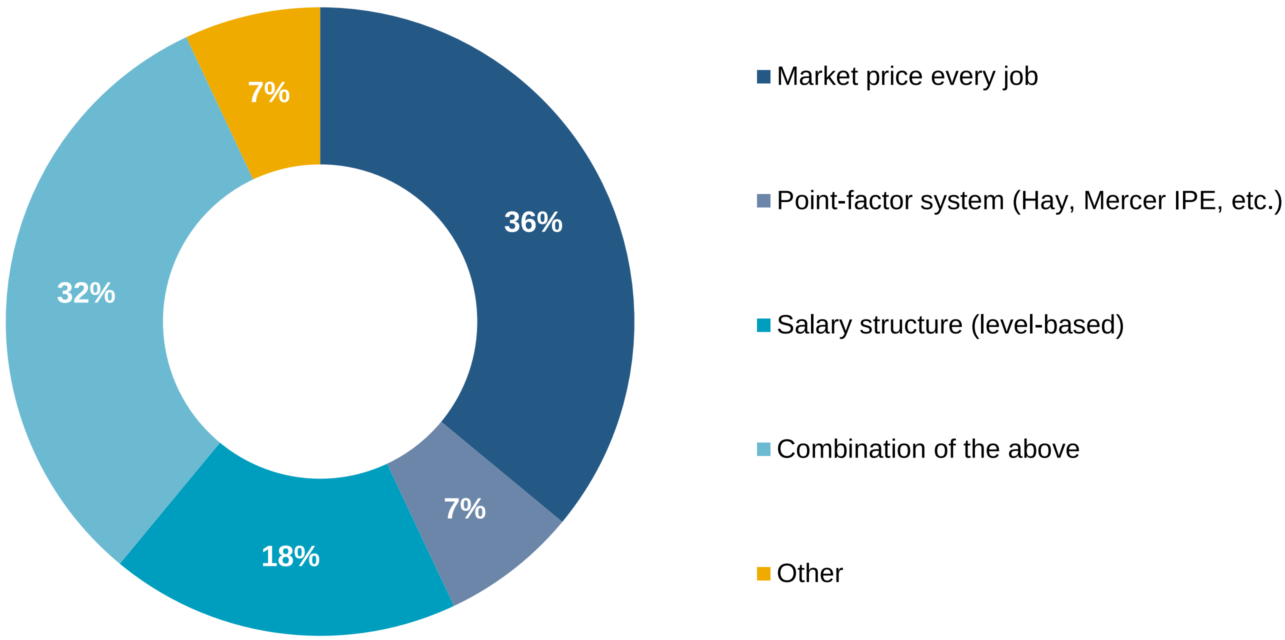
Radford polled some of our largest technology and life sciences clients in 2016 on their approach to salary administration. For the technology companies, 48% said they have one salary structure that covers most job functions, but have market-based ranges for functions that pay a premium (or a discount) in the market. Among the life sciences organizations, there was a split between those that use more rigid salary structures (tied to job leveling) and those that market price every single job, or some combination of both. Of note, we find that having any type of salary structure in place becomes much more prevalent at life sciences companies that have gone commercial or plan to shortly.

Technology Companies Prefer Salary Structures with Multiple Functional Ranges



Source: Radford Strategic Steering Committee 2016 Flash Poll of 56 large US-based technology companies

Life Sciences Companies Remain Mixed in Their Approach to Salary Structures



Source: Radford Life Sciences Executive Council 2016 Flash Poll of 30 large US-based life sciences companies

Client Case Study #1

A Small Biotech Lacks Formal Structure in their Pay Programs

A small biotech company consisting of 50 employees is starting to build out its workforce and plan for expansion ahead of anticipated completion of a Phase II Trial for a new drug to treat arthritis. The company wants to hire 50 new employees— doubling its workforce within 18 months. The new employees will fill critical positions in R&D, operations and non-technical roles in sales, marketing and finance.

Without a structure in place to set pay ranges for these new jobs, the company could run into a variety of problems. Not only are managers more likely to overpay to bring on new talent in an effort to meet aggressive hiring goals, they could alienate current employees by creating internal pay equity problems.

Leadership was resistant to implementing any structure because it felt too "corporate" and too rigid. They wanted management to have the discretion to do what's necessary to bring in the right talent.

The solution in this client situation was to show them how market-based salary structures would allow the firm to maintain the flexibility they needed to hire quickly, pulse the market for current rates for certain hot jobs or desired skill sets that are in limited supply, and still maintain a structure that could be scaled as the company grew. For example, based on the company's compensation philosophy, the salary ranges for scientific positions are based on the 75th percentile, while marketing, finance and other operations positions are based on the 50th percentile.

The Nuts and Bolts of Implementation

Unlike level-based structures where jobs are slotted into grades with other jobs at the same career level, market-based structures slot jobs into grades based on prevailing market values rather than organizational levels. In other words, current and accurate market data becomes more influential with market-based salary structures. In practice, we could see a situation where a senior manager of engineering (Management Level 4 in the **Radford Global Technology Survey**) is in the same salary grade as a director of finance (Management Level 5) because the market values those jobs equally on base salary.

Below is an example of how a market-based structure could work at a technology company. At higher salary grades there is an overlap between different job levels that come from a cross-section of job functions. In this representative sample, a Level 1 Engineer Manager pays within the same salary range as a Level 2 Operations Manager and a Level 3 Human Resources Manager.

Grade	Salary Range			Business Functions	Operations	Engineering
	Minimum	Midpoint	Maximum			
9	$114,900	**$149,400**	$183,900	Human Resources Management Level 4	Operations Management Level 3	Senior Engineer Level 4
8	$91,900	**$119,500**	$147,700	Human Resources Management Level 3	Operations Management Level 2	Engineer Management Level 1
7	$76,500	**$95,600**	$114,700	Human Resources Representative Level 4	Manufacturing Management Level 1	Project Manager Level 2
6	$63,800	**$79,700**	$95,600	Human Resources Representative Level 3	Manufacturing Engineer Level 3	Engineer Level 1
5	$53,100	**$66,400**	$79,700		Inventory Control Analyst Level 2	
4	$44,200	**$55,300**	$66,400		Manufacturing Technician	

We typically divide salary ranges into three equal subsets. These ranges enable different target pay positioning, which can vary by the culture or financial position of each company, job type and/or employee skill-set and experience. The chart below explains the common factors that often go into defining the subset of each salary range.

Using the Entire Salary Range – A Flexible Approach		
Lower Third	**Middle Third**	**Upper Third**
▪ Employees who are not meeting the minimum performance criteria associated with the position ▪ Employees that have minimum qualifications to fulfill the position responsibilities ▪ Employees with less than the required amount of work experience for the role	▪ Employees that meet established performance criteria for the role ▪ Employees that are fully qualified for the position ▪ Employees with critical skills, yet there is no shortage of talent for the role in the market	▪ Employees that exceed established performance criteria ▪ Employees with a higher degree of qualifications than the position requires ▪ Employees that occupy key positions within the organization

Key Benefits

The advantages of a market-based salary structure can touch an entire organization. In our work with technology and life sciences companies, we have seen this type of approach:

- Take the guess work out of pay decisions. Having a market-based structure streamlines the pay-setting process, eliminating the need to gather market-based intelligence on each job
- Help managers develop an understanding of the minimum and maximum amounts an organization is willing to pay for each and every job
- Coalesce current thinking on compensation philosophy, market competitiveness and internal pay equity goals into a single, easily understood tool that can be used by company leadership
- Set company-wide standards for communicating compensation expectations
- Accurately forecast costs as an organization grows
- Create a common platform for job titles, incentive targets, and other company standards
- Provide a framework to manage pay increases and/or pay movement
- Allow recruiters and hiring managers to act with greater autonomy by offering competitive pay packages to potential new hires within an approved framework

Key Challenges

Clients that run into difficulties implementing or maintaining market-based salary structures are typically moving away from a system that supported pure market-based pricing for most, if not all, jobs. A common complaint is that market-based pay ranges may become outdated quickly and no longer reflect the market. This is very common in industries experiencing moderate to aggressive hiring, which is widespread within the technology and life sciences sectors.

Another common pain point is the difference in existing employees' base salaries and the salary demands of new-hire employees. Incumbents that have been with the company for more than three years often find themselves earning less than new-hire employees with similar job responsibilities and qualifications— referred to as salary compression. It's easy to see how pay inequality can quickly become problematic. Compensating new hires above incumbent employees could send a message that incumbents with a track record of performance aren't as valued. Taken a step further, it also sends the message that tenure within the organization is not valued. If the industry is in a period of robust hiring, you can count on dissatisfied incumbent employees to ask for a raise or to begin searching for a new job.

Outdated salary structures can also foster the misuse of promotion practices by managers. If there is a limited merit increase budget, managers will often promote high-performing employees to a new salary grade. This gives critical talent not only a pay raise but also a promotion, allowing the incumbent to be paid at current market rates without taking on the additional responsibilities required in an actual promotion. However, this practice will soon weaken the job architecture your salary structure is built upon. Not only does it create job title inflation, but the performance management process may be manipulated in order to justify a promotion to business unit leaders and HR and compensation professionals. Creating a culture of open communication on these types of issues goes a long way toward detecting cracks in the roadway before the system collapses.

Client Case Study #2

A Mid-Sized Technology Company Seeks to Update their Broad-Band Salary Structure

In our second case study, we have a technology company that has grown from 50 to 500 employees in four years through organic growth and one acquisition. They have what we refer to as broad-band salary ranges, which are extremely wide salary bands and are much more encompassing than traditional salary structures. A typical salary band has a 40% to 50% difference in pay between its minimum and maximum; broad-bands have a 100% or greater difference. Although they aren't as common as they once were, companies typically use broad-bands to consolidate the number of levels or job grades. This allows for much more flexibility with hiring and puts less of an administrative burden on grade change requests.

However, one of the disadvantages of broad-bands is that they do not have a midpoint that is based on the market rate. This makes it very challenging to ensure market competitiveness. In this company's case, they did not have a good sense of how competitive their compensation levels were.

The solution for this company was to create market reference points (MRPs) within their broad-bands. These were based on the current market value so managers knew where within the range to target pay for each job. This allowed their current structure to continue to be flexible but still tied to the market.

Looking Ahead: Maintaining a Salary Structure

Updating a market-based salary structure on a regular basis will help avoid the key challenges described above. The frequency with which you update your pay and job ranges will depend on the unique situation of your company and industry. We typically recommend spot checking a representative sample of jobs in each salary grade annually to ensure midpoints are still aligned with market-based pay and that jobs still fit within the assigned range (some high-demand jobs may have moved target percentiles in the past year). Every other year, we recommend reviewing your salary structures as a whole. This can include a) comprehensive competitive benchmarking, b) making any necessary adjustments to grade midpoints, range spreads and the number of grades in the structure, and c) assessing individual pay levels compared to adjusted salary ranges.

When considering whether a market-based salary structure is right for your organization, there are four guiding principles that we use at Radford:

- **Strategic**: Does the salary structure support the company's compensation strategy, particularly with respect to compensation philosophy and growth projections?
- **Internal Equity**: Will the salary structure be perceived as fair by employees, especially when used to communicate compensation decisions and career path development?
- **External Competitiveness**: Will the salary structure allow for competitive compensation levels when attracting and retaining key talent?
- **Efficiency**: Will it be easy to use, will it streamline decisions, and can we easily communicate it to managers (and employees, if desired)?

Thinking through each of these principles is a good exercise when reviewing changes to your pay-setting process. While market-based salary structures are becoming popular among technology and life sciences companies, that may not mean they are the right fit for your company right now. As we noted earlier, salary structures are typically a late-stage development for biopharma companies in particular. Pre-commercial or startup companies with a smaller workforce may not have the need or depth of job levels to support a salary structure. Each company's approach to establishing pay levels should be a fluid decision and one that is revisited during a company's different stages of growth.

To speak with a member of our compensation consulting group about implementing a salary structure or reviewing your current pay-setting process, please write to consulting@radford.com.

Author Contact Information

Aria Glasgow
Associate Partner, Radford
Aon Hewitt | Talent, Rewards & Performance
+1.781.906.2304
aria.glasgow@radford.com

Brooke Green
Partner, Radford
Aon Hewitt | Talent, Rewards & Performance
+1.415.486.6911
brooke.green@radford.com

About Radford

Radford delivers compensation data and advice to technology and life sciences companies. We empower the world's most innovative organizations, at every stage of development, to hire, engage and retain the top talent they need to do amazing things. Today, our surveys provide in-depth compensation insights in more than 80 countries to 3,000 participating organizations and our consultants work with hundreds of firms annually to design rewards programs for boards of directors, executives, employees and sales professionals. Radford is part of Aon Hewitt, a business unit of Aon plc (NYSE: AON). For more information on Radford, please visit radford.com.

About Aon Hewitt

Aon Hewitt empowers organizations and individuals to secure a better future through innovative human capital solutions. We advise, design and execute a wide range of solutions that enable our clients' success. Our teams of experts help clients achieve sustainable performance through an engaged and productive workforce; navigate the risks and opportunities to optimize financial security; redefine health solutions for greater choice, affordability and wellbeing; and help their people make smart decisions on managing work and life events. Aon Hewitt is the global leader in human resource solutions, with nearly 34,000 professionals in 90 countries serving more than 20,000 clients worldwide across 100+ solutions. For more information on Aon Hewitt, please visit aonhewitt.com.