



Calculating Pay Increases

Q: What is the right way to give raises? We can't decide whether to do incremental percentage of salary, percentage increment on the midpoint of the salary range, or percentage increments on either the first, second, third, or fourth quartile of the salary range.

--- Trouble with numbers, benefits and compensation, services, Singapore.

A: In a very general sense, there is no "right way" to administer an annual-increase program for employees. Decisions around philosophy or administration depend on many cultural and environmental factors, such as your pay philosophy, degree of computerization, budget constraints, and market competitiveness.

Some companies even structure programs that don't assume annual increases. These firms provide frequent pay changes--more or less--as dictated by business needs. Typically, these types of decisions are made by a senior leadership team in light of a company's business plan.

Your specific question, of course, relates to the way your company determines the dollars an employee receives. This decision is part of the overall architecture of the program and, as such, is based on management preferences. Any of the methods you cite can be successfully applied to a system of annual increases. Most companies traditionally apply the percentage increase to actual salary, although some do apply it as a percentage of a midpoint salary range.

Here are some things to keep in mind as you evaluate the possibilities.

1. Within a specific salary range, a percentage based on salary generates relatively more dollars for employees at the top of the range. This may create pay inequities.
2. A percentage based on a salary midpoint tends to equalize the increase for all employees in that particular salary grade/range. But this also results in a reduced actual percentage for any employee above the midpoint. This approach is used to manage salaries by keeping them more closely to the midpoint.
3. A percentage based on position in range (e.g., quartile) has the same effect as percentage of actual salary: employees higher in the range receive more in actual dollars.

As an example, let's take two employees in a particular grade range with a midpoint of \$60,000. One employee is paid \$53,000 and one is paid \$65,000. Both are "at expectations" performers and thus receive an increase of 4 percent. Under the "midpoint percent" system, they both would receive \$2,400.

Under the salary system, one would receive \$2,120 and the other \$2,600. If you are comfortable that this difference is justified, then the salary percentage system may be right for you. Alternatively, if you are comfortable with telling the first employee why he received only 3.7 percent, while his colleague got 4.5 percent, then the midpoint system is the way to go.

Be sure you calculate your overall budget for raises using the method you selected for

awarding actual raises to employees. For example, if you are going to give employees raises based on a percent of their midpoint, when you calculate your overall budget, use midpoints to do the calculation.

Otherwise, your numbers will be off. I would recommend that you get your senior leadership team together and have them review the advantages and disadvantages of these methods. They can then reasonably approve the appropriate calculation method.

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