

Tutorial Letter 202/1/2015

Compensation Management

HRM3705

Semester 1

Department of Human Resource Management

IMPORTANT

This tutorial letter contains guidelines for answering Assignment 02.

BAR CODE

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Dear Student

We hope you are making good progress in mastering the study material.

1 INTRODUCTION

Bearing in mind that the volume of work is fairly substantial, we strongly advise that you work through the study material and all the assignments carefully and thoroughly.

You should have received the following tutorial letters for HRM3705:

TUTORIAL LETTER	CONTENT OF TUTORIAL LETTER
HRM3705/101/3/2015	Contact details of lecturers, information about prescribed book, study material, information about examination preparation, assignments and comments on Assignment 03 (self-assessment assignment).
HRM3705/102/3/2015	Changes to the prescribed book.
HRM3705/103/1/2015	Erratum Assignment 01.
HRM3705/201/1/2015	Feedback on Assignment 01 and examination preparation.

2 GUIDELINES FOR ANSWERING ASSIGNMENT 02

We trust that you found Assignment 02 interesting and stimulating. The questions for this assignment were specifically designed to help you gain a better understanding of the study material.

The purpose of this assignment was to test your understanding and integration of the theory and to determine whether you were able to link and apply the theory to a practical situation.

LEARNING OUTCOMES

After studying these study units, you should be able to:

- discuss the role of remuneration committees in executive compensation .
- indicate how corporate governance and executive remuneration fit together.
- discuss the concept of “total reward”.
- discuss the steps in developing a total reward strategy.
- critically discuss the structure of executive pay and whether it is fair, ethical and linked to performance.

Students made the following common mistakes in answering the assignment questions:

- Some students copied information directly from the study guide and/or prescribed book without acknowledging the source(s).
- Some students could not or did not link and apply the theory (the information in sources such as the study guide and prescribed book) to the practical situation in the case study.
- No additional resources were consulted.
- Some students could not integrate the information in the prescribed book and therefore focused only on a small part of the answer and not on the “bigger picture”.

Students who consulted additional sources earned additional marks. These sources should be used in the prescribed manner (in other words, you have to acknowledge that you have used them in your work). Marks were awarded to students who could apply the theory to practice.

QUESTION 1

For this question, students were required to complete a questionnaire in Appendix F and G of Tutorial Letter 101.

The aim of this questionnaire was to show students the practical implications of remuneration and how it fits into the concept of employee retention. As you will recall from Study Unit 1, remuneration is made up of not only extrinsic rewards, but also intrinsic and even non-financial rewards, and different employees are motivated by different factors. Therefore, when remunerating and retaining employees, human resource (HR) managers or professionals need to take into account the needs of the various employees. Furthermore, this questionnaire not only gave you exposure to questions that could be asked during research on reward systems, but also an insight into factors that need to be considered when compiling HR policies. Lastly, employability fits into the concept of graduateness. The purpose of this section was to stimulate your thoughts on your own employability and to reflect on your own needs and the expectations of the labour market.

Total for Question 1: (5)

QUESTION 2

Question 2 was based on the scenario, “*Aligning your total reward strategy with your business goals*”.

2.1 The paragraph above elaborates on the importance of having reward programmes to achieve business goals. Why do you think it is crucial to have a total reward strategy in place in organisations today? (5)

Study guide

Refer to Section 12.7.1 in Study Unit 12
“Total Rewards”

The purpose of a total reward strategy is to provide the objectives, guidelines and principles necessary to design and operate the company's reward programmes consistent with its core requirements. Primarily, this means that the reward strategy should:

- **reinforce the core mission**, values and critical success factors of the company in terms that reflect the role of rewards programmes and practices.
- **define the key elements** that will create a strong competitive advantage for the company in the marketplace for talent.
- **provide sufficient clarity** and guidance to key decision-makers so they can assess the effectiveness of current programmes and practices, and determine what actions are needed to improve their effectiveness.
- **answer “why”** a particular programme is designed for functions in a particular manner.

(3 Marks for any three bullets)

- The plan must be designed to support the organisation’s unique business strategy.
- A total reward strategy should also be based on hard facts and quantitative analysis.

(2 Marks for providing evidence from the scenario)

2.2 According to the article, an organisation’s reward strategy should be based on the strategic and organisational requirements envisaged for its employees and organisation. Discuss the steps to determine the right reward strategy. (10)

Study guide

Refer to Section 12.7.3 in Study Unit 12
“Determine the right reward strategy”

1. Define the organisation's philosophy.

To develop the total reward strategy, the first stage is to understand the organisation's business model, vision and strategy as well as its critical success factors. You need to know the leadership philosophy, values and desired culture, and whether or not it is written into a formal document. (2 Marks)

2. Examine the organisation's structure plus its guiding principles.

Articulate how the organisation is organised to implement the strategy and operate within the constructs of the organisation’s values and leadership philosophy. This requires more than examining the structure of the organisation. What is the culture of the organisation? The idea is to identify how much flexibility

various reward programmes will allow as well as the process for making decisions related to goal-setting, performance assessment, staffing levels and appointment agreements. (3 Marks)

3. **Determine employee groups with unique reward requirements.**

Groups of employees are defined where reward policies or programmes should be distinct or specifically tailored to unique requirements. Identify specific groups of employees and understand what they want or need as well as what the organisation needs from them. Thus, the reward strategy becomes more pragmatic and grounded in the realities of the organisation. (2 Marks)

4. **Create specific reward policies.**

Identify the specific reward policies, programmes (or systems) and practices the organisation will employ to achieve short- and long-term requirements. It is helpful to categorise reward programmes according to dimensions that reflect their inherent function and impact.

You find rewards programmes that:

- are **available** to almost everyone because they are employed by the organisation
- are **based on performance or** meeting other requirements of individuals or groups to which they belong
- are **clearly compensation based**
- **meet the personal needs** of individuals

(3 Marks)

2.3 Remuneration governance and management is an ongoing process. Why would a company benefit from establishing its own remuneration committee (RemCo) and what would you propose in terms of the ideal RemCo? (10)

Study guide

Refer to Section 10.7 in Study Unit 10
“Remuneration committees”

Such a committee addresses governance issues and aims to restore investor confidence. Why do companies need a remuneration committee? The answer is two-fold. Firstly, such a committee addresses governance issues and, secondly, it aims to restore investor confidence. Non-executive directors and remuneration committees (RemCos) are playing an increasingly important role as companies focus on issues of corporate governance. Rules and practices in remuneration and disclosure can facilitate or inhibit the effective operation of governance.

The collapse of major organisations has put certain ethical dilemmas regarding executive pay practices into the spotlight. These include such issues such as the misuse of surveys and statistics, executive benefit enhancements, the size of executive pay packages, incentives and share allocations, exorbitant retention, and severance packages. To restore investor confidence, good remuneration governance is important. And this is where the RemCo comes in. Generally speaking, high-level credible remuneration committees provide stakeholders with a measure of comfort when it comes to good remuneration governance. It is also widely believed that the combined knowledge and experience of a diverse group of RemCo members leads to better solutions too (Bussin 2011: 372).

(5 Marks for general discussion)

The ideal Remuneration Committee could cover the following topics:

Membership of the RemCo

Members of the RemCo are appointed by the board of directors, and continue to act until they resign or are removed from office. The committee comprises no fewer than three serving directors of the organisation. The majority of the members, including the chairman, are non-executive directors.

High-level duties of a RemCo

A RemCo has a many high-level duties, which include (Bussin 2011:380),

- adherence to good corporate procedural rules
- knowledge of the big picture
- decision on how much remuneration is enough
- review of programmes from the shareholders' perspectives
- review of complex plans and programmes
- review of controversial plans and programmes

Powers of the RemCo

Members of the RemCo should have full access to all financial information contained in the books and records of the organisation, including the personnel records of an employee for whom the committee will be making pay recommendations. The committee may also consult with the organisation's attorneys and its auditors where necessary. The committee is empowered to obtain the assistance of the HR executive or department in obtaining the relevant information.

Proceedings of the RemCo

The chairman is in charge of convening the RemCo and maintaining minutes, copies of all reports and data used by the committee in reaching its decisions. The chairman should take responsibility for communicating decisions made by the RemCo to the board.

Or you could also discuss, in combination with the above or alone standing, the structure of a typical RemCo.

(5 Marks for either the topics or the RemCo structure)

Total for Question 2: (25)

QUESTION 3

3.1 Executive compensation is a sensitive issue. Critically discuss the key issues in executive compensation and provide suggestions on improving a company's ethical approach towards executive compensation. (20)

Prescribed book	Refer to Chapter 10 " <i>Compensating Executives</i> "
Study guide	Refer to Section 10.4.2 in Study Unit 10 " <i>Key issues in executive pay determination</i> "

The main considerations in executive compensation are the company's ability to:

- attract and retain top executives – thus lucrative compensation for top executives are vital.
- justify the income disparity between executives and non-executive employees.
- deal with the layoff of non-executive employees – there are various reasons for these layoffs, such as global competition, mergers and acquisitions.

(3 Marks)

1. *Do executives deserve the amounts paid to them?*

There are unique competences and skills required to succeed in organisational leadership roles. This indicates that the available talent pool is limited – growing levels of competition has set the bar high for success. Certainly, in the mind of some critics, the emphasis on executives and their impact on term performance are dominated by external circumstances, while managerial actions (such as quality of strategic planning) are important for the longer term.

(3 Marks)

2. *Is pay linked to performance and is this linked to appropriate performance measures?*

It has become extremely important to make a significant proportion of executive pay contingent on performance. The majority of short-term (annual) incentive pay plans are based around performance against traditional financial indices (for example, operating income, earnings before interest, and tax, operating profit after tax). This is extremely important to help track an organisation's success. However, emphasis is placed more on aspects of performance resulting in ignoring capital invested in the organisation. This is why a growing number of organisations are using financial measures that relate to capital investment, typically return on capital employed (Bussin 2011:365).

(4 Marks)

3. *Is it ethical and are these payments fair?*

Excessive executive compensation has become a topic of immense interest because of some high-profile instances where executives receive compensation beyond the average person's comprehension. You may find that the majority of chief executive officers (CEOs) are honest and ethical and work tirelessly for the interest of their companies. Many people feel that it is not fair and just for an executive to be paid millions of rands. The gap between executives and CEOs and average workers' salaries differ tremendously. When the benefits to regular workers are reduced and real wages stagnate, this is harder to accept.

(4 Marks)

An organisation can do the following to demonstrate its willingness to act ethically about issues of executive compensation:

- **Identify the true compensation being paid to an executive.** Investigate and disclose retirement accounts and other forms of hidden pay-outs that exponentially increase an executive's pay.
- **Keep the RemCo independent.** The CEO should not serve on the nominating committee or have influence over its members.
- **Tie pay to performance.** Performance should drive compensation; if returns to shareholders are minimal or if the company consistently loses money, executive pay should be affected as well.
- **Recruit by character as well as by credentials.** Screen potential CEOs about their sense of obligation to others and stewardship to the corporation. One survey shows that executives who scored high on a personality trait called "agreeableness," which includes being cooperative, friendly,

altruistic and trusting, were more likely to advocate equitable salary distributions. Executives in this group also assigned more importance to ethical issues in general.

- **Avoid basing decisions on self-interest.** Recognise that many board members are also CEOs who may find it in their best financial interest to see executive compensation generally increase.
- **Align compensation with long-term strategic and economic goals.** A CEO whose compensation is based on short-term gains may fudge the numbers to increase the share price or hide poor numbers that hurt his or her portfolio.

(6 Marks for six bullets)

3.2 Identify and discuss the key players in setting executive compensation. What can be expected of these individuals? (10)

Prescribed book	Refer to Chapter 10 “ <i>Compensating Executives</i> ”
Study guide	Refer to Study Unit 10.2 “ <i>Executive compensation in context</i> ”

Employees: They are focused on whether the strategy provides them with the opportunity to build their wealth and career better than competing offers (Berger & Berger 2008).

(2 Marks)

Executive compensation consultants: They propose general recommendations for alternate pay packages and are often employed by large consulting companies that specialise in executive compensation.

(2 Marks)

Board of directors: They represent shareholder interests. According to the King III report, a board should not have less than two executive directors and three non-executive directors so that the non-executives constitute the majority of board members. The aim of the board is to keep executives, shareholders and regulators satisfied.

(3 Marks)

Compensation committee: In South Africa, this committee is called the remuneration committee (RemCo). Within this context, the RemCo must develop an executive compensation strategy to meet the company's needs. Its aim is to minimise conflict of interest. The RemCo reviews consultants' alternate recommendations for compensation packages. This is accompanied by a discussion about the advantages and disadvantages of the recommendations. The legislation regulating compensation needs to be taken into consideration. The RemCo needs to deliberate extensively to identify the best proposal and to submit it to the board of directors for consideration.

(3 Marks)

3.3 Provide a theoretical explanation for setting executive compensation and discuss the important role the theory plays in setting executive compensation. (15)

Prescribed book	Refer to Chapter 10 “ <i>Compensating Executives</i> ”
Study guide	Refer to Section 10.5.1 in Study Unit 10 “ <i>Theoretical explanations for setting executive compensation</i> ”

The answer to each theory requires two elements: firstly, you are required to identify the theory and explain the theory; secondly you are required to provide the importance/role the theory serves.

Agency theory: A part of the executive's pay is placed at risk to motivate the executive (agent) to act in the best interests of the shareholders rather than in the executive's own self-interests (Milkovich *et al.*, 2011:650). In terms of the agency theory, the compensation package is important because it is used to provide the proper incentives to executives, and hence, mitigate the conflict between owners and executives.

Tournament theory: This theory emphasises that a person's job and changes in the job are key drivers of executive pay, rather than their competencies, experience and knowledge (in other words, their “human capital” to use the language of labour economics once again). Pay growth over time is not smooth, but has kinks due to the effect of pay rises occurring on promotion.

Social comparison theory: According to this theory, compensation is compared to others. Board members use their own pay as a reference point when setting the pay of executives (WorldatWork, 2007:290).

Efficiency wage theory: This theory suggests that executives are paid a premium to provide them with the incentive to exert enough effort to avoid being fired. By being fired, they would in effect have to accept another position at a lower salary. In theory, this effort increases executive productivity and reduces turnover (WorldatWork, 2007:290).

Marginal productivity theory: According to this theory, the executive should receive as compensation his/her value to the organisation (WorldatWork, 2007). Work is thus compensated in proportion to its contribution to the organisation's production objectives (Milkovich *et al.*, 2011:659).

Human capital theory: According to this theory, the value of the executive and his/her compensation is based on the executive's accumulated knowledge and skills. Milkovich *et al.*, (2011:657) explains the theory as follows, “An economic theory proposing that the investment one is willing to make to enter an occupation is related to the returns one expects to earn over time in the form of compensation”.

(15 marks for general discussion)

Total for Question 3: (45)
TOTAL FOR ASSIGNMENT 02: [75]

3 RUBRIC FOR ASSIGNMENT/MARKING SCHEDULE

Together with the guidelines on how to approach this assignment, we gave you the assessment criteria for the assignment. Many students were unsure of what the assessment criteria mean.

The assessment criteria are the guidelines that the markers use to assess your answers for an assignment. It gives you an indication of why your work is rated as excellent, average or poor. You are therefore able to determine the difference between these categories. In other words, you can use the assessment criteria as your own guidelines on what you need to do for your work to be rated as excellent, average or poor. After you have completed an assignment, you can check whether you have covered everything in accordance with the assessment criteria.

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Question	Poor performance (0–39%)	Average performance (40–59%)	Good performance (60–74%)	Excellent performance (75–100%)	Mark
2.1	Understanding of the importance or need for a total reward strategy is doubtful.	Some understanding of the importance or need for a total reward strategy.	Good understanding of the importance or need for a total reward strategy.	In-depth understanding of the importance or need for a total reward strategy.	
	No sources acknowledged or some sources used but not acknowledged.		Consulted one or two of the recommended or other sources.	Consulted a variety of sources.	
	0 - 2	3	4	5	
2.2	Unable to identify and discuss the “right” strategy for organisations.	Provided some content regarding the “right” strategy for organisations.	A good understanding of the “right” strategy for organisations is present.	An in-depth discussion and understanding regarding the “right” strategy for organisations is present.	
	No sources acknowledged or some sources used and not acknowledged.	Consulted only the study guide or a single source.	Consulted one or two other sources.	Consulted a variety of sources.	
	0 – 3	4 - 5	6 - 7	8 - 10	
2.3	No/poor understanding of the benefits for forming a RemCo and a RemCo’s structure.	Some understanding of the benefits for forming a RemCo and a RemCo’s structure.	Good understanding of the benefits for forming a RemCo and a RemCo’s structure.	In-depth understanding of the benefits for forming a RemCo and a RemCo’s structure.	
	No sources acknowledged or some sources used but not acknowledged	Consulted only the study guide or a single source	Consulted one or two of the recommended or other sources	Consulted a variety of sources	
	0 – 3	4 – 5	6 – 7	8 – 10	

Question	Poor performance (0–39%)	Average performance (40–59%)	Good performance (60–74%)	Excellent performance (75–100%)	Mark
3.1	Poor understanding of the key issues in executive compensation.	Limited understanding of the key issues in executive compensation.	Good understanding of the key issues in executive compensation.	In-depth understanding of the key issues in executive compensation.	
	Limited suggestions provided for improving companies' ethical approach toward executive compensation	Some suggestions provided for improving companies' ethical approach toward executive compensation	Provided suggestions for improving companies' ethical approach toward executive compensation	Provided concrete suggestions for improving companies' ethical approach toward executive compensation	
	No sources acknowledged or some sources used but not acknowledged.	Consulted only the study guide or a single source.	Consulted one or two of the recommended or other sources.	Consulted a variety of sources.	
	0 – 5	6 - 10	11 - 15	16 - 20	
3.2	Provided no/poor discussion on the key players in setting executive compensation.		Provided a discussion on the key players in setting executive compensation.	Provided a detailed discussion on the key players in setting executive compensation.	
	No/poor discussion on expectations.	Limited discussion on expectations.	Provided a discussion on the expectations.	Expectations discussed in depth.	
	No sources acknowledged or some sources used and not acknowledged.	Consulted only the study guide or a single source.	Consulted one or two of the recommended or other sources.	Consulted a variety of sources.	
	0 – 2	3 – 5	4 – 6	7 – 10	
3.3	No discussion on the theoretical framework for setting executive compensation.	Limited discussion on the theoretical framework for setting executive compensation.	Detailed discussion on the theoretical framework for setting executive compensation.	In-depth discussion on the theoretical framework for setting executive compensation.	
	No discussion on the importance the theory plays in setting executive compensation.	Limited discussion on the importance the theory plays in setting executive compensation.	Detailed discussion on the importance the theory plays in setting executive compensation.	In-depth discussion on the importance the theory plays in setting executive compensation.	
	No sources acknowledged or some sources used but not acknowledged.	Consulted only the study guide or a single source.	Consulted one or two of the recommended or other sources.	Consulted a variety of sources.	
	0 – 5	6 – 8	9 – 11	12 – 15	

Technical presentation and layout	Correct referencing technique used	2	No/incorrect referencing technique	0	/9
	Additional resources used	2	No additional resources used	0	
	Completed question 1 (personal information and questions)	5	Did not complete Question 1 (personal information and questions)	0	
TOTAL MARK FOR ASSIGNMENT 02:					%

4 CONCLUSION

We trust that you have found these explanations helpful.

Please contact us any time, in writing or personally, to discuss any problems you may encounter in your studies or in your preparation for the examination.

Wishing you every success in your studies!

Kind regards

Ms. J. Lee

LECTURER: HRM3705

Department of Human Resource Management

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