

COMPENSATION MANAGEMENT

CHAPTER 3 (Study unit 3) Defining Internal Alignment

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Chapter Topics

- Compensation Strategy: Internal Alignment
- Structures Vary Among Organizations
- What Shapes Internal Structures?
- Strategic Choices in Designing Internal Structures
- Guidance from the Evidence
- Consequences of Structures

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Learning Objectives

After studying Chapter 3, students should be able to:

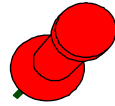
- Explain why internal alignment is an important pay policy issue and how to evaluate internal alignment.
- Discuss the three (3) key factors that define an internal pay structures.
- Identify and describe how external and organization factors shape the design of pay structures.
- Discuss the pros and cons of egalitarian and hierarchical structures and how they relate to an organization's strategy.
- Describe the key effects associated with an internally aligned pay structure.
- Discuss the impact of internal pay structures on efficiency, fairness, and compliance in the pay system.

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Compensation Strategy: Internal Alignment

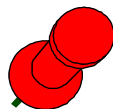
- Issues in a strategic approach to pay
 - Setting objectives
 - Internal alignment
 - Addresses relationships *inside* the organization
 - The relationships form a pay structure that should:
 - ❖ Support the organization strategy
 - ❖ Support the work flow
 - ❖ Motivate behavior toward organization objectives

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Internal alignment, often called internal equity, refers to the pay relationships among different jobs/skills/competencies within a single organization.

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Pay structure refers to the array of pay rates for different work or skills within a single organization.

The number of levels, the differentials in pay between the levels, and the criteria used to determine those differences describe the structure.

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Compensation Strategy: Internal Alignment (cont.)

- Supports organization strategy
- Supports work flow
 - Work flow: The process by which goods and services are delivered to the customer
 - The pay structure ought to support the efficient flow of that work and the design of the organisation
- Motivates behavior
 - The structure ought to make clear the relationship between each job and the organisation's objectives: *Line-of-sight*
 - Employees should be able to “see” the links between their work, the work of others, and the organisation's objectives
 - Structure must be fair to employees

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Structures Vary Among Organizations

An internal pay structure can be defined by

- Number of *levels* of work
- Pay *differentials* between the levels
- *Criteria* or *basis* used to determine those levels and differentials

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Levels

- Pay structure is hierarchical in nature, based on:
 - Number of levels
 - Reporting relationships

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Differentials

- The pay differences among levels
- Pay is determined by:
 - Knowledge/ skills involved
 - Working conditions
 - Valued addition to the company
- Intention of these differentials:
 - To motivate people to strive for promotion to a higher-paying level

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Criteria: Content and Value

- *Content* – the work performed in a job and how it gets done (tasks, behaviors, knowledge required, etc.)
 - Structure ranks jobs on – skills required, complexity of tasks, problem solving, and/or responsibility
- *Value* – the worth of the work; its relative contribution to the organization objectives
 - Structure focuses on – *relative contribution* of these skills, tasks, and responsibilities to the organization's goals
 - Can include external market value

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Use Value and Exchange Value

- *Use value* – the value of goods or services an employee produces in a job
- *Exchange value* – whatever wage the employer and employee agrees on for a job
- Difference between exchange value and use value surfaces when one firm acquires another

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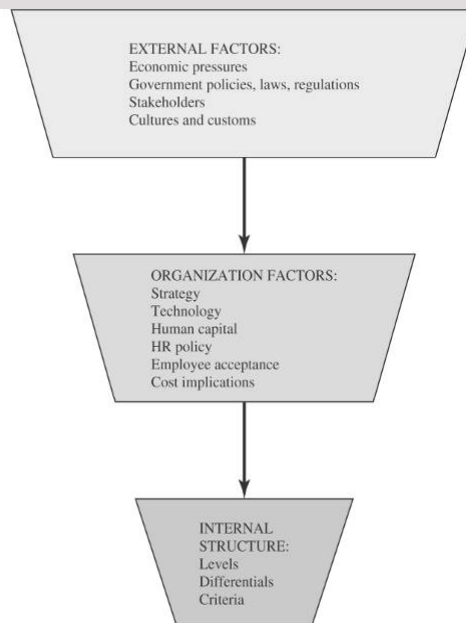
Job- and Person-Based Structures

- *Job-based* structures relies on the work content – tasks, behaviors, responsibilities
- *Person-based* structure shifts the focus to the employee
 - Skills, knowledge, or competencies the employee possesses
 - Whether or not they are used in the particular job
- In reality, both job-and-person-based structures are included

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Exhibit: 3.4: What Shapes Internal Structures?

EXHIBIT 3.4
What Shapes
Internal
Structures?



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What Shapes Internal Structures? *External Factors*

- *Economic pressures*
 - Early advocates: Adam Smith, Karl Marx
 - Marginal productivity: Employers do in fact pay use value:
 - ❖ Unless an employee can produce a value equal to the value received in wages/salary, it will not be worthwhile to hire the employee
 - ❖ One job is paid more or less than another due to differences in relative productivity of the job and/or differences in how much a customer values the output
 - ❖ Thus: Differences in productivity provide a rationale for the internal pay structure
 - Supply and demand for labor and products affect internal structures

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What Shapes Internal Structures? *External Factors (cont.)*

- *Government policies, laws, and regulations*
 - Employment Equity Act and Affirmative Action requires “equal pay for equal work”
 - Living wage
- *External stakeholders*
 - Have a stake in how internal pay structures are determined
 - Internal alignment focuses on pay differentials within an organization
- *Cultures and customs*
 - Culture – the mental programming for processing information that people share in common
 - Global competition and an aging workforce has made age-based pay an expensive affair

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What Shapes Internal Structures? *Organizational Factors*

- *Organization strategy*
 - Aligned, yet adaptable pay structures may be required
- *Organization's human capital*
 - Education
 - Experience
 - Knowledge
 - Abilities
 - Skills required to perform the work

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What Shapes Internal Structures? *Organizational Factors (cont.)*

- *Organization work design*
 - Technology used in producing goods and services influences
 - Organizational design
 - Work to be performed
 - Skills/Knowledge required to perform work
 - Temporary work supplier
 - Outsourcing specialists
 - Pay for employees under both practices based on internal structure of home employer
 - Delayering
 - Cuts unnecessary, non-contributing work
 - Adds work to other jobs, enlarges them, changes the job's value and structure

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What Shapes Internal Structures? Organizational Factors (cont.)

- Overall HR policies
 - Feeling of 'career progress'

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What Shapes Internal Structures? Combining External and Organization Factors

- Internal labor markets
 - Rules and procedures that
 - Determine pay for different jobs within a single organization
 - Allocate employees among those different jobs
- Employee acceptance
 - Employees make comparisons to assess the fairness of an internal pay structure
 - They compare both with other jobs in the same internal structure and with the pay for their job in the external market
 - Sources of fairness: Procedural, and distributive justice
 - Procedural: process by which a decision is reached
 - Distributive: the fairness of the decision

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What Shapes Internal Structures? Combining External and Organization Factors (cont)

- Employee acceptance (cont)
 - Applied to internal structure, *procedural justice* addresses how design and administration decisions are made and whether procedures are applied in a consistent manner. *Distributive justice* addresses whether the actual pay differences among employees are acceptable
- Pay structures change
 - ‘Change-and-congeal” process

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Guidance from the Evidence

- Equity theory: Fairness
 - Research suggests that employees judge fairness by multiple comparisons
 - Comparing to jobs similar to their own
 - Comparing their job to others at the same employer
 - Comparing their jobs’ pay against external pay levels

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Guidance from the Evidence (cont.)

- Tournament theory: Motivation and performance
 - All players will play better in the first tournament, where the prize differentials are larger
 - Greater difference between an employee's salary and the boss's, harder he/she will work
 - Several studies have given rise to "winner-takes-all"
 - Does not directly address turnover
- Institutional Model: Copy Others
 - Very few "first movers"

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Exhibit 3.8: Some Consequences of an Internally Aligned Structure

EXHIBIT 3.8
Some
Consequences
of an Internally
Aligned
Structure



(More) Guidance from the Evidence

- Impact of internal structures depends on context in which they operate
- More hierarchical structures are related to greater performance when the work flow depends on individual contributors
- High performers quit less under more hierarchical systems when:
 - Pay is based on performance rather than seniority
 - When people have knowledge of the structure
- When close collaboration and sharing of knowledge are required, more egalitarian structures are related to greater performance
- Impact of any internal structure on organization performance is affected by other dimensions of the pay model
 - Pay levels (competitiveness)
 - Employee performance (contributions)
 - Employee knowledge of the pay structure (management)

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Consequences of Structures

- Importance of internal alignment
- *Efficiency*
 - Pay structures imply future returns
 - *Fairness*
 - For fair (sizable) differentials
 - Against fair (sizable) differentials
 - *Compliance*
 - Comply with regulation of the country

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Your turn

Answer the end of chapter 3 review questions