

COMPENSATION MANAGEMENT

CHAPTER 1 (Study unit 1) THE PAY MODEL

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Chapter Topics

- Compensation: Definition
- Forms of Pay
- A Pay Model
- Book Plan
- Your Turn: Glamorous Internships, or House Elves?

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Learning Objectives

After studying Chapter 1, students should be able to:

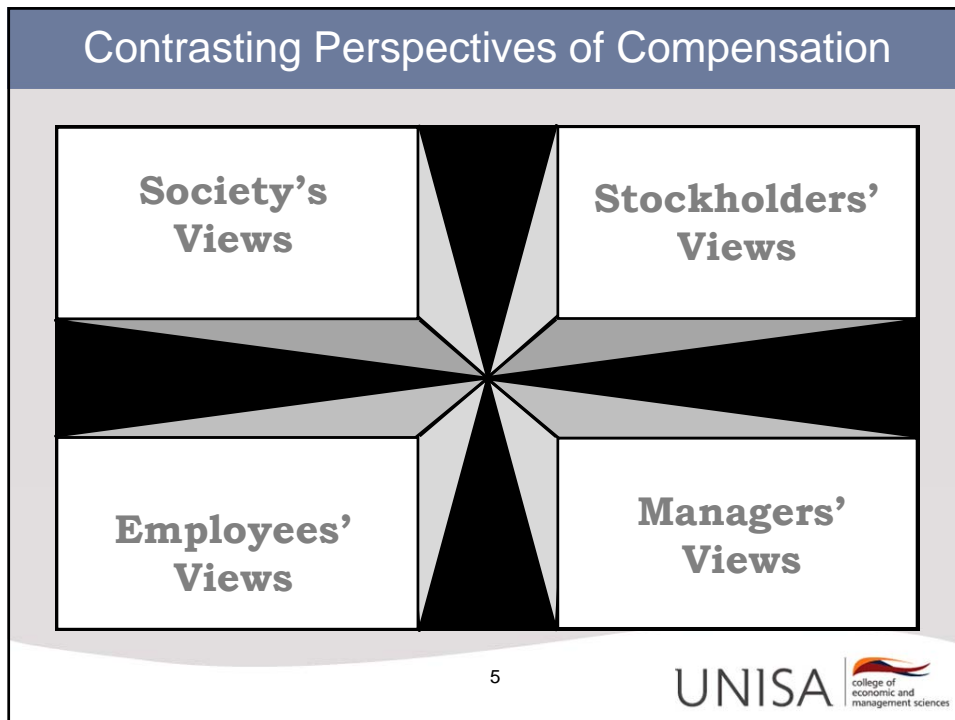
- Explain how perceptions of compensation differ among society, stockholders, managers and employees.
- Discuss the difference between cash compensation (direct compensation) and benefits (indirect compensation) and define each of the direct and indirect forms of compensation.
- Explain how the employment relationship combines both transactional and relational returns to form an implicit contract between employers and employees.
- Identify and describe the three main components of a pay model.
- Understand how the pay model integrates objectives, policies, and techniques into a compensation system.
- Distinguish empirical research from surveys and opinions.

3

Key Questions and Issues

- How differing perspectives affect our views of compensation
- Definition of compensation
 - *The meaning of compensation most appropriate from an employee's view: return, reward, or entitlement*
- Examining “network of returns” a college offers an instructor
- Four policy issues in the pay model
 - Objectives of the pay model
- Forms of pay received from work


4



Compensation: Definition

- **Society**
 - Pay as a measure of justice
 - Benefits as a reflection of justice in society
 - Job losses (or gains) attributed to differences in compensation
 - Belief that pay increases lead to price increases
- **Stockholders**
 - Using stock to pay employees creates a sense of ownership
 - Linking executive pay to company performance supposedly increases stockholders' returns
- **Managers**
 - A major expense
 - Used to influence employee behaviors and to improve the organization's performance

6

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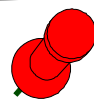
Compensation: Definition (cont.)

- **Employees**
 - Major source of financial security
 - Return in an exchange between employer and themselves
 - Entitlement for being an employee of the company
 - Reward for a job well done
- **Global Views – *Vive la différence***
 - China: Traditional meaning of compensation providing necessities of life replaced with *dai yu*
 - Japan: Traditional word *kyuyo* replaced with *hou-syu*; very recently the phrase used is *teate*

These contrasting ideas about compensation – multiple views (i.e. societal, employee, etc) and multiple meanings (i.e. returns, reward, etc) add richness to the topic.

7

What Is Compensation/Pay?

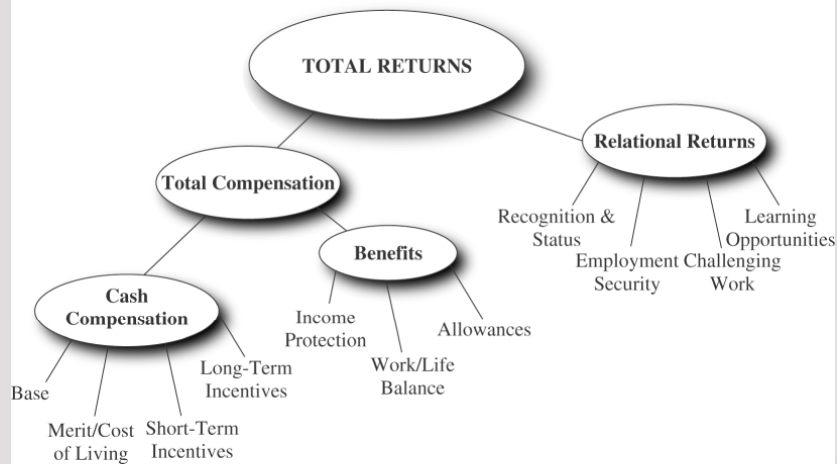


Compensation refers to all forms of financial returns and tangible services and benefits employees receive as part of an employment relationship

8

Exhibit 1.4: Total Returns for Work

EXHIBIT 1.4 Total Returns for Work



9

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Forms Of Pay

- **Relational returns**
 - Psychological in nature, i.e. challenging work, status
- **Total compensation**
 - Cash Compensation/ transactional
 - Base wages
 - ❖ Difference between wage and salary
 - ❖ Tends to reflect the value of the work or skills and ignores differences attributed to individual employees
 - Merit pay/cost-of-living adjustments
 - ❖ Merit increases – given in recognition of past work behavior
 - ❖ Cost-of-living adjustments –same increases to everyone, regardless of performance

1
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Forms Of Pay (cont.)

- Incentives/ Variable pay – tie pay increases directly to performance
 - ❖ Does not increase base wage; must be re-earned each pay period
 - ❖ Potential size generally known beforehand
 - ❖ Long-term (stock options), and short-term
 - ❖ Incentives are frequently referred to as *variable pay*

11

Forms Of Pay (cont.)

- Benefits
 - *Income protection* – some are legally required, for instance Unemployment Insurance Fund. Medical aid, retirement programmes and life insurance are common benefits
 - *Work/life balance* – programmes that help employees better integrate their work and life responsibilities include time away from work, access to services to meet specific needs (i.e. employee assistance programmes and flexible work arrangements (i.e. nonpaid time off)
 - *Allowances* – this is grown out of whatever is in short supply. For example car allowances, cell phone allowances, etc.

12

Forms Of Pay (cont.)

- **Total earnings opportunities:** Present value of a stream of earnings
 - Shifts comparison of today's initial offers to consideration of future bonuses, merit increases, and promotions
- **Relational returns from work**
 - Nonfinancial returns
- **Organization as a network of returns**
 - Created by different forms of pay, including total compensation and relational returns

13

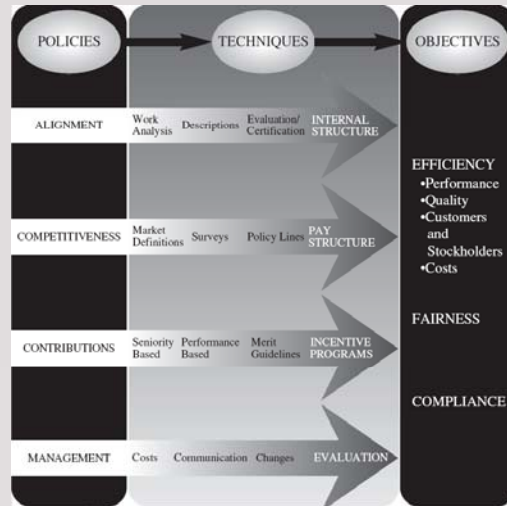
A Pay Model

Three basic building blocks (Refer to exhibit 1.5):

- Compensation objectives
- Policies that form the foundation of the compensation system
- Techniques that make up the compensation system

14

Exhibit 1.5: The Pay Model



15

Compensation Objectives

- **Efficiency**
 - Improving performance, increasing quality, delighting customers and stockholders
 - Controlling labor costs
- **Fairness**
 - Fundamental objective of pay systems
 - Fair treatment by recognizing both employee contributions (i.e. higher pay for greater performance), and employee needs (i.e. a fair wage as well as fair procedures)
 - *Procedural fairness* is the process used to make pay decisions and suggests that the way a pay decision is made may be as important to the employee as the results of the decisions.

16

Compensation Objectives (cont.)

- **Compliance**
 - Conformance to Federal and State compensation laws and regulations
 - If laws change, pay systems may need to change too to ensure continued compliance
- **Ethics**
 - Organizations care about how its results are achieved
 - Managing pay sometimes creates ethical dilemmas
 - Manipulating results to ensure executive bonus payouts, misusing statistics used to measure competitors' pay rates, and shaving the hours recorded in employees' time cards are all too common examples of ethical lapses

17

Compensation Objectives (cont.)

Objectives THUS

- Guide the design of the pay system
- Serve as the standards for judging success of the pay system
- Policies and techniques are means to reach objectives

18

Four Policy Choices

- **Internal alignment**

- *Focus:* Comparisons among jobs or skill levels inside a single organization
- Jobs and people's skills are compared in terms of their relative contributions to the organization's business objectives
- Pertains to the pay rates both for employees doing equal work and for those doing dissimilar work
- Pay relationships within an organization affect employee decisions to:
 - Stay with the organization
 - Become more flexible by investing in additional training
 - Seek greater responsibility
- Fairness is affected = employees' compare their pay to the pay of others in the organisation
- Compliance is affected = basis used to make internal comparisons

19

Four Policy Choices (cont.)

- **External competitiveness**

- *Focus:* Compensation relationships external to the organization: comparison with competitors
- Pay is 'market driven'
- Effects of decisions regarding how much and what forms have a twofold effect on objectives:
 - To ensure that pay is sufficient to attract and retain employees
 - To control labor costs to ensure competitive pricing of products/services

External competitiveness directly affects both efficiency and fairness. It must do so in an ethical way that complies with relevant legislation.

20

Four Policy Choices (cont.)

- **Employee contributions**
 - *Focus*: Relation emphasis placed on employee performance as it directly affects employees' attitudes and work performance
 - Performance based pay affects fairness: employees need to understand the basis for judging performance in order to believe that their pay is fair.
- **Management**
 - *Focus*: Policies ensuring the right people get the right pay for achieving the right objectives in the right way
 - Managing compensation means answering the “So What” question. So what is the impact of this policy, this decision?

21

Pay System Techniques

- Techniques tie the four basic policies to the pay objectives
- Many variations exist
- Some techniques will be discussed through the book

22

Your turn

Answer the end of chapter 1 review questions and self-evaluation questions in the study guide

23

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