

# COMPENSATION MANAGEMENT

## HRM3705

### Chapter 1

## Strategic Compensation: A Component of Human Resource Systems

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Pearson Education, Inc. Publishing as Prentice Hall

# Learning outcomes of chapter 1

Once you have completed study unit 1, you should be able to:

- define and critically discuss the context of compensation
- differentiate between tactical and strategic decisions and discuss the relevant concepts
- describe how the compensation function fits into the HR department
- critically discuss the compensation department's main objectives
- discuss the difference between cash compensation (direct compensation) and benefits (indirect compensation), and define each of the direct and indirect forms of compensation
- discuss how compensation professionals relate to various stakeholders

# What Is Compensation?

Compensation represents the rewards employees receive for performing their job. They are either:

- **Intrinsic**—intrinsic compensation represents employees' critical psychological states that result from performing their jobs.
- **Extrinsic**—extrinsic compensation includes both monetary and nonmonetary rewards.

# Five Core Job Dimensions

- **Skill variety**—the degree to which the job requires the person to perform different tasks
- **Task identity**—the degree to which a job enables a person to complete an entire job from start to finish
- **Task significance**—the degree to which the job has an impact on the lives or work of other people
- **Autonomy**—the amount of freedom, independence, and discretion the employee enjoys in determining how to perform the job
- **Feedback**—the degree to which the job or employer provides the employee with clear and direct information about job outcomes and performance

# Elements of Core Compensation

- Base pay

Hourly pay

Annual salary

- Base pay adjustments

COLAs

Skill-based pay

Merit pay

Incentive pay

Pay-for-knowledge

Seniority pay

# Core Compensation

- **COLAs**—COLAs represent periodic base pay increases that are founded on changes in prices as indexed by the consumer price index (CPI).
- **Seniority Pay**—seniority pay systems reward employees with periodic additions to base pay according to employees' length of service in performing their jobs
- **Merit Pay**—merit pay programs assume that employees' compensation over time should be determined, at least in part, by differences in job performance.
- **Incentive Pay**—incentive pay (or variable pay) rewards employees for partially or completely attaining a predetermined work objective.
- **Pay-for-Knowledge Plans**—pay-for-knowledge plans reward managerial, service, or professional workers for successfully learning specific curricula
- **Skill-based Pay**—skill-based pay is used mostly for employees who perform physical work and increases these workers' pay as they master new skills.

# Four Compensable Factors

- An employee's skill level
- An employee's effort
- An employee's level of responsibility
- The severity of the working conditions

# Discretionary Benefits

## Three Broad Categories

- **Protection programs**—provide family benefits, promote health, and guard against income loss caused by such catastrophic factors as unemployment, disability, or serious illness
- **Paid time-off**—provides employees with pay for time when they are not working
- **Services**—provides such enhancements as tuition reimbursement and day care assistance to employees and their families



# Legally-Required Benefits

## Legislation Designed to:

- Promote worker safety and health
- Maintain family income
- Assist families in crisis
- Provide assistance in case of
  - Disability
  - Unemployment, for example Unemployment Insurance Fund (UIF)

# Strategic Activities

- Strategic decisions:
  - guide the activities of companies in the market
  - are concerned with the entire environment in which the company operates, the resources and the people who form the company and the interface between the two and it supports the business objectives
- Strategic management—entails judgments that direct a company toward achieving specific goals
- Strategic planning—supports business objectives
- Tactical decisions:
  - affect the day-to-day implementation of steps required to reach the goals of a strategy, such as recruitment
  - it supports the fulfilment of strategic decisions

# Competitive Strategy

- **Competitive advantage** refers specifically to a company's ability to maintain market share and profitability over a sustained period of several years.
- Competitive strategy:
  - The planned use of company resources
    - Technology
    - Capital
    - Human Resources
  - Two or more years time span
  - Choices
    - Lowest cost strategy
    - Differentiation strategy

# Competitive Strategy Choices

- Lowest Cost: focus on being lowest cost producer/seller of goods or services
- Differentiation: focus on offering unique goods or services to the public

## Selected HR strategies that fit two major types of Business Strategies

Business Strategy	Common Organisational Strategy	HR Strategies
Overall Cost Leadership	<ul style="list-style-type: none"> <li>• Sustained capital investment and access to capital</li> <li>• Intense supervision of labour</li> <li>• Tight cost control requiring frequent, detailed control reports</li> <li>• Low-cost distribution system</li> <li>• Structured organisation and responsibilities</li> <li>• Products designed for ease in manufacture</li> </ul>	<ul style="list-style-type: none"> <li>• Explicit job descriptions</li> <li>• Detailed work planning</li> <li>• Emphasis on technical qualifications and skills</li> <li>• Emphasis on job-specific training</li> <li>• Emphasis on job-based pay</li> <li>• Use of performance appraisal as a control device</li> </ul>
Differentiation	<ul style="list-style-type: none"> <li>• Strong marketing abilities</li> <li>• Product engineering</li> <li>• Strong capability in basic research</li> <li>• Corporate reputation for quality or technological leadership</li> <li>• Amenities to attract highly skilled labour, scientists, or creative people</li> </ul>	<ul style="list-style-type: none"> <li>• Broad job classes</li> <li>• Loose work planning</li> <li>• Emphasis on individual-based pay</li> <li>• Use of performance appraisal as development tool</li> </ul>

**Source:** Porter (1980) as cited in Gómez-Mejía, Balkin and Cardy (2007: 29)

# Lowest-Cost Strategy

## Effective when Jobs:

- Include predictable behaviors
- Have a short-term focus
- Require autonomous activity
- Focus on quantity of output

# Differentiation Strategy

## Effective when Jobs:

- Require highly creative behaviors
- Have a long-term focus
- Demand cooperation and independence
- Involve risk-taking

# HR's Role

- A quotation from Jay Hannah of BancFirst Corporation:

“The HR department is the source and keeper of critical information, which is key in today’s workplace. With the information they provide, we in turn can build and design strategies to hire and retain the best workforce possible. And this may sound cliché, but it’s very true—the real competitive advantage is our company’s human resources.”



# Human Resources Responsibilities

- **Recruitment**

- **Selection**

- **Performance appraisal**

- **Training**

- **Career development**

- **Labor–management relations**

- **Employment termination**

- **Insuring legal compliance**

# Main characteristics of the HR, remuneration and finance functions

Human Resources	Remuneration	Finance
<ul style="list-style-type: none"> <li>• People-oriented</li> <li>• Deals mainly with soft issues</li> <li>• Operates within a flexible environment</li> <li>• Gains co-operation through consultation</li> </ul>	<ul style="list-style-type: none"> <li>• People- and finance-oriented</li> <li>• Balances soft issues with principles and procedures</li> <li>• Remains flexible within a controlled environment</li> <li>• Formulates instructions though consultation</li> </ul>	<ul style="list-style-type: none"> <li>• Finance-oriented</li> <li>• Strictly adheres to predetermined principles and procedures</li> <li>• Operates within a tight and controlled environment</li> <li>• Forces adherence through instruction</li> </ul>

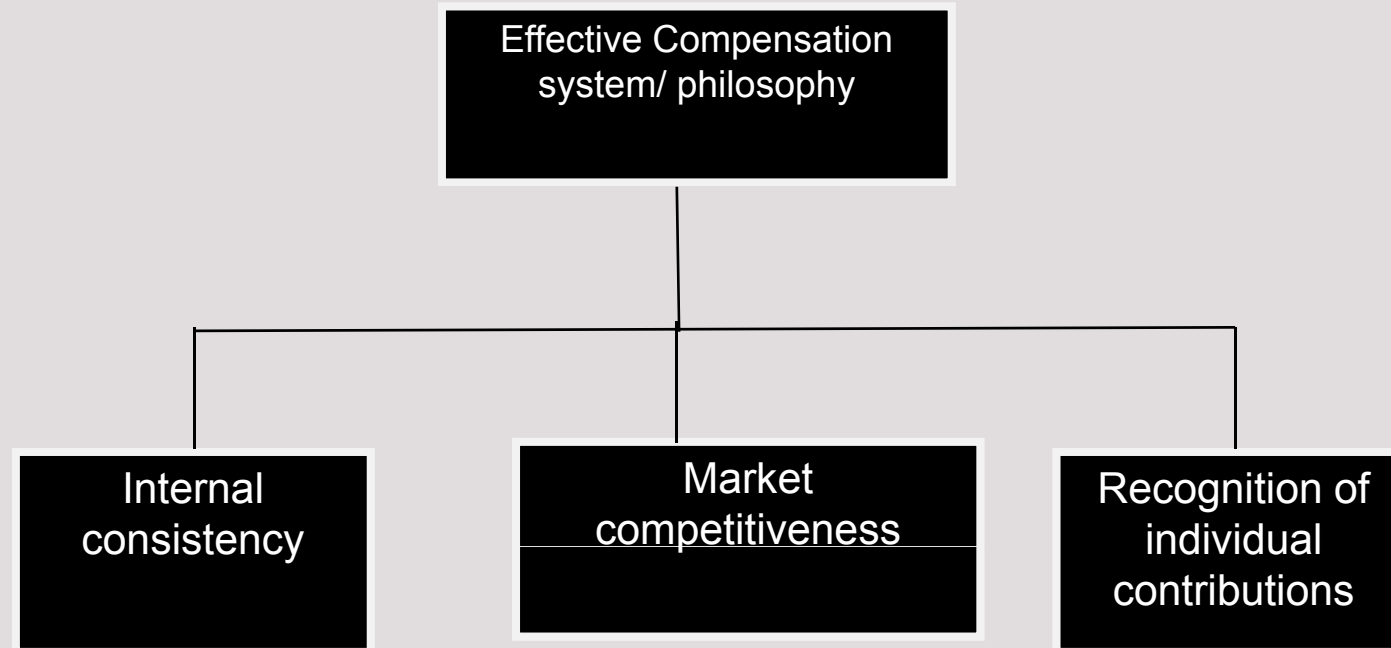
Bussin (2011: 131)

# Compensation Department's Main Goals

- Compensation professionals promote effective compensation systems by meeting three important goals:
  - **internal consistency**
  - **market competitiveness**
  - **recognition of individual contributions**

# Compensation Department's Main Goals (continue)

Main goals can be depicted as follows:



# Compensation Department's Main Goals/Objectives and how they link with different pay techniques

Philosophy (policy issues)	Techniques	Objectives
Market Competitiveness (External Competitiveness)	Market surveys Market competitive pay systems Pay levels	Efficiency
Internal consistency	Job analysis Job evaluation	Legal Compliance
Recognising individual contributions	Seniority Performance increase guidelines Incentives Pay structure	Equity

# Equity/Fairness

- **External equity** (also called external competitiveness) involves the comparisons of rewards across similar jobs in the labour market.
- **Internal equity** (also called internal alignment) deals with comparisons of rewards across different jobs within the same organisation. Internal equity pertains to the pay rates both for employees doing equal work and for those
- **Procedural fairness** is concerned with the extent to which an employee's remuneration is reflective of his or her contribution and the fairness with which pay changes such as increases are made.
- **Distributive fairness:** The distributive justice model of pay equity holds that employees exchange their contributions or input to a company (skills, effort, time and so on) for a set of outcomes.

# Compliance with legal requirements

Labour legislation such as the Employment Equity Act, No 55 of 1998 and the Basic Conditions of Employment Act, No. 75 of 1997 has a direct impact on remuneration design and collectively for the remuneration manager

# Efficiency

- Efficiency relates to:
  - (1) improving performance, increasing quality, delighting customers and shareholders, and
  - (2) controlling labour costs.

Regardless of the philosophy (goals) adopted by an organisation, the overall objectives of any compensation system should be the same namely: efficiency, equity and legal compliance.



# Internal Consistency

Achieved when the value of each job is clearly defined

- Represents:
  - Job structure
  - Hierarchy
- Achieved using:
  - Job analysis
  - Job evaluation

# Market Competitiveness

- Definition: The pay relationship among organisations and focuses attention on the competitive positions reflected in these relationships
- Also known as external competitiveness
- Compensation policies that fit with business objectives
- Vital in attracting and retaining employees
- Are based on:
  - Strategic analyses
  - Compensation surveys

# Individual Contributions

- Pay Structures: pay is determined by employee's credentials, job knowledge, and job performance
- Pay Grades: based on compensable factors and value
- Pay Ranges: builds on grades, uses midpoints, minimums, and maximums

# Stakeholders

Individuals or entities directly affected by compensation practices, like:

- Employees
- Line managers
- Executives
- Unions
- South Africa Government

END OF STUDY UNIT 1