

COMPENSATION MANAGEMENT

HRM3705

Study unit 2

The essence of strategic compensation
This unit to be studied from the study guide!

Learning outcomes of study unit 2

Once you have completed study unit 2, you should be able to:

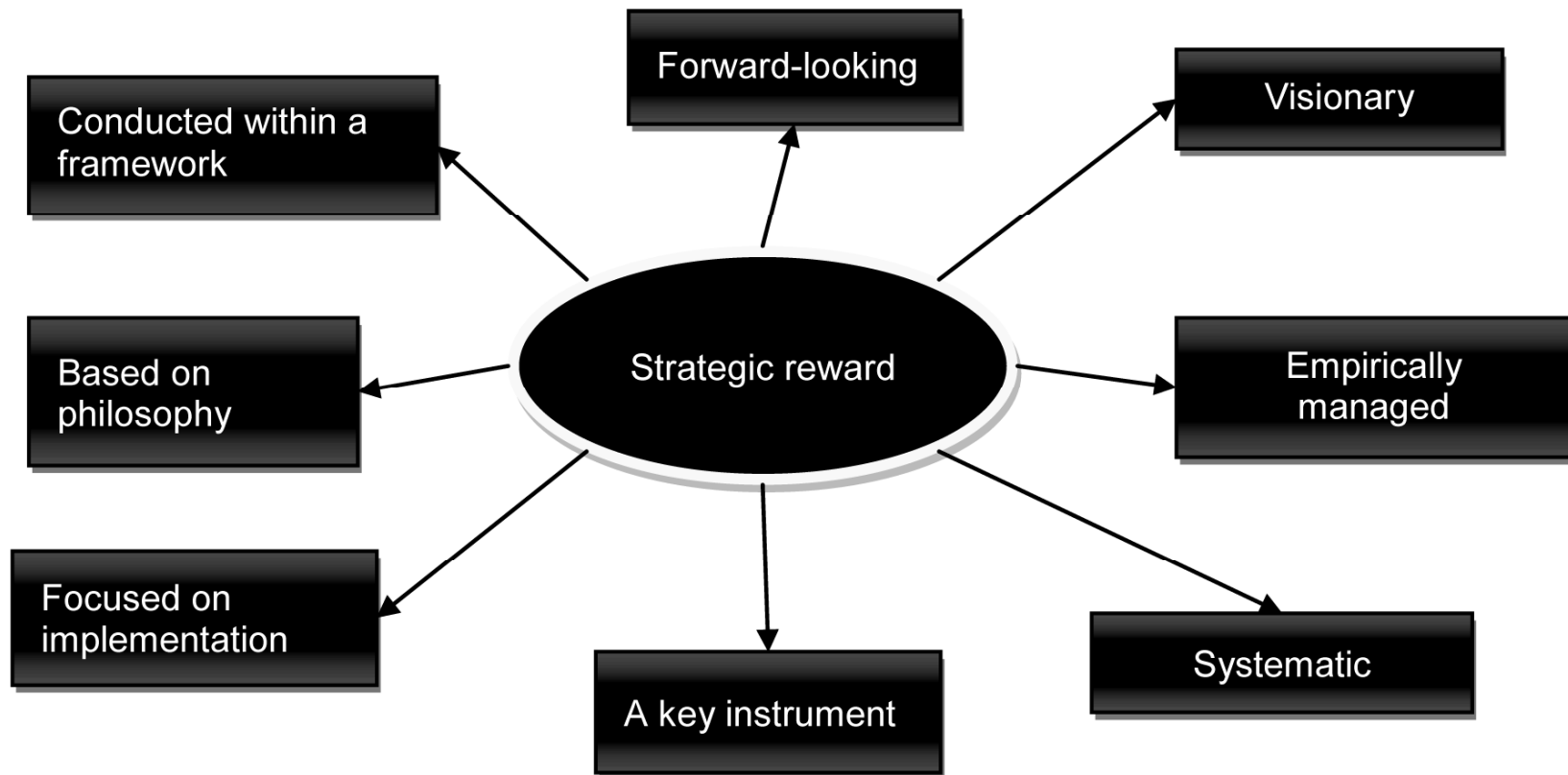
- define strategic compensation and its rationale
- discuss and contrast the different strategic choices with regard to the aims of strategic compensation
- critically discuss the purpose and content of strategic compensation
- identify the characteristics of strategic compensation
- discuss the relationship between strategic compensation and compensation management
- critique a company's compensation strategy
- develop a compensation strategy

What is strategic compensation?

Strategic compensation is an approach to the development and implementation of compensation strategies and the guiding principles that underpin it.

(Armstrong, 2010:63)

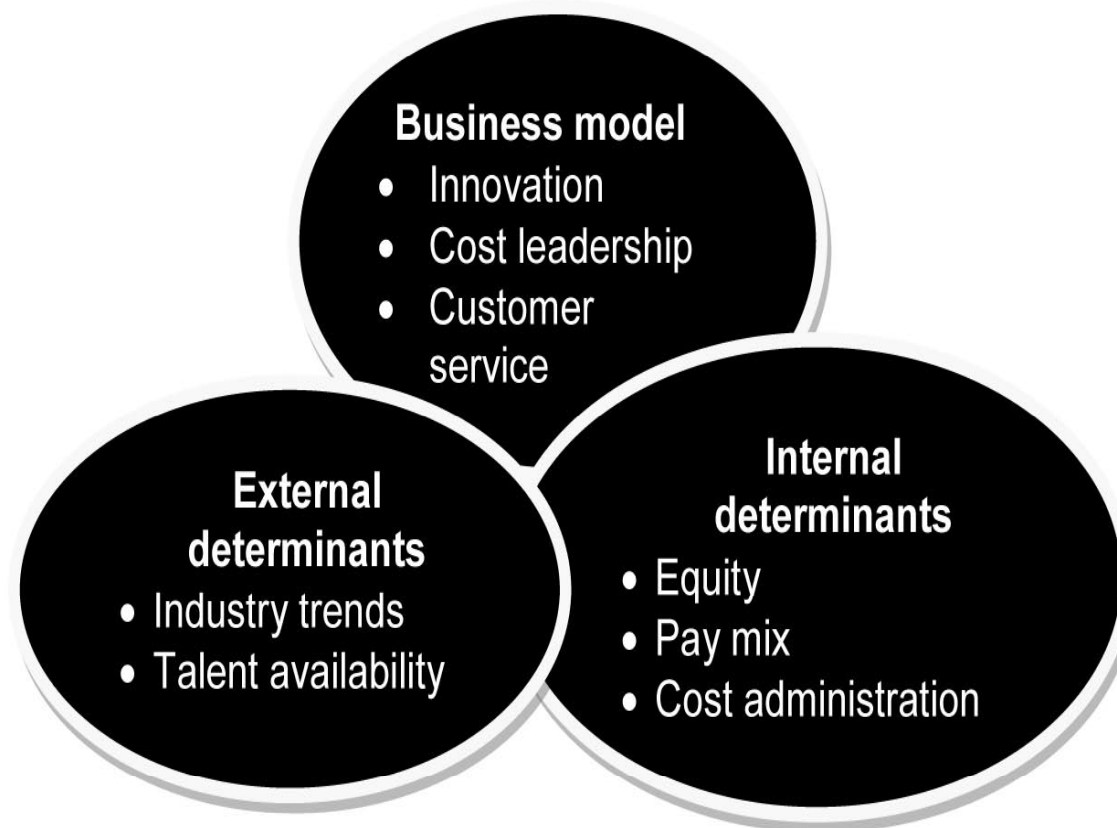
Characteristics of strategic compensation



Strategic compensation vs. compensation management

- **Strategic compensation** is about making compensation management work effectively for the organisation and its people. It aims at alleviating disconnects between business strategy and how HR supports business strategy
- **Compensation management**, deals with the formulation and implementation of strategies and policies that aim to compensate employees fairly, equitable and consistently in accordance with their value to the organisation

Strategic compensation



The practice of strategic compensation management

The following activities are involved in strategic compensation management:

- Analysing the internal and external environment
- Understanding the individual needs and preferences of employees
- Formulating a compensation philosophy
- Creating a ``total reward'' approach
- Developing the detailed components and changes required in compensation strategies
- Planning and then delivering successful implementation

Compensation philosophy and guiding principles

- A compensation philosophy is a concept designed to reward employees in alignment with the goals and values of the organisation
- The compensation philosophy of an organisation is expressed in the form of guiding principles that define the approach an organisation takes to dealing with compensation (Armstrong, 2010)

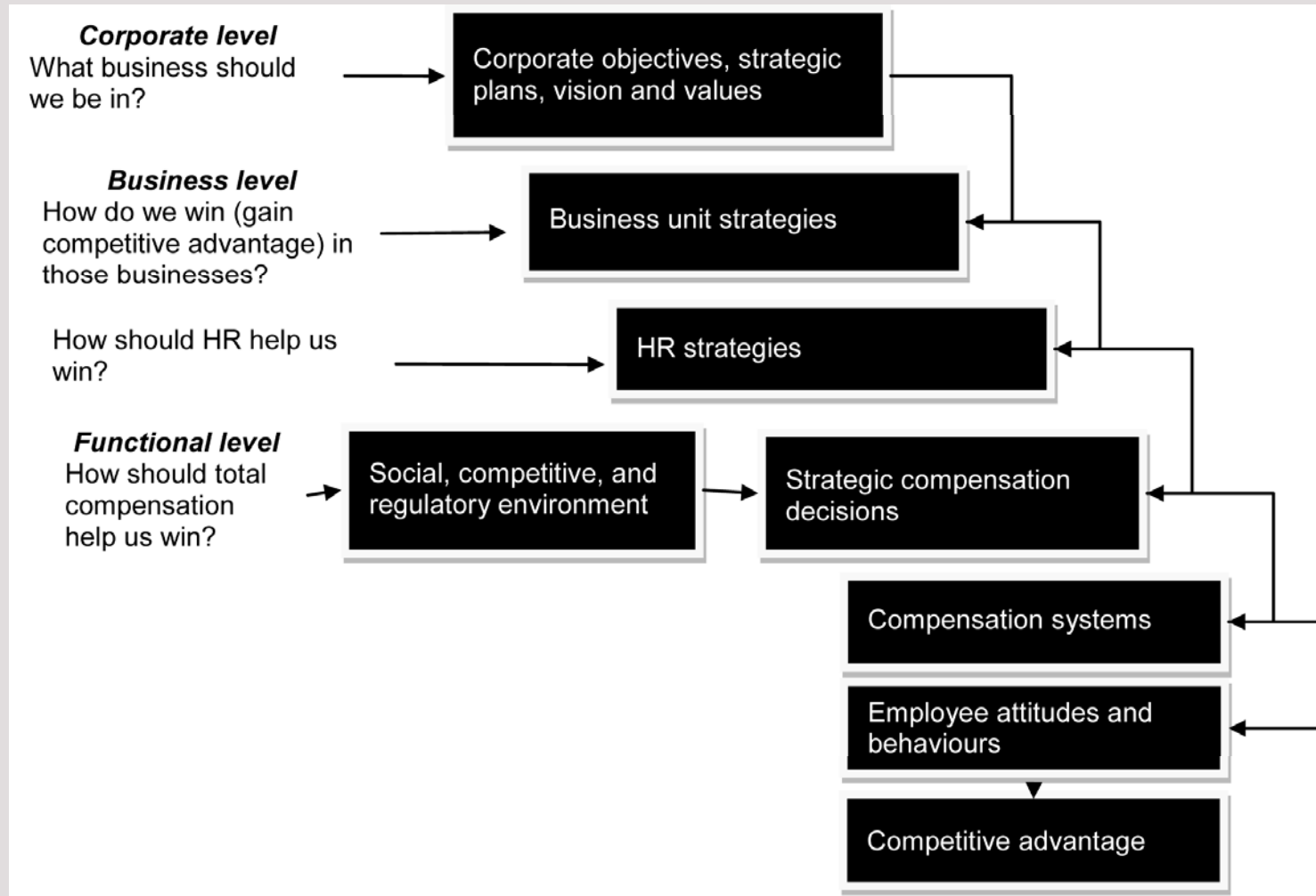
Fundamental values of guiding principles

- Consistency
- Transparency

STRATEGIC CHOICES

- Strategy refers to the fundamental directions that an organisation chooses. An organisation defines its strategy through the trade-offs it makes in choosing what to do (and what not to).
- A strategic perspective focuses on those compensation choices that help the organisation gain and sustain a competitive advantage.

Strategic choices



Strategic choices (continue)

- The most common methods in developing a remuneration strategy are based on the industrial growth rate and the pay continuum – these should be use in conjunction with each other
- Industry or product growth has an important impact on the remuneration strategy that a company adopts

The link between the industry growth rate and remuneration strategy

Industry maturity			
Embryonic	Growth	Mature	Aging
<ul style="list-style-type: none"> •Start up •Common strategies •New product development 	<ul style="list-style-type: none"> •Acquire market share •Find new markets 	<ul style="list-style-type: none"> •Consolidate position •Find and protect market niches •Become low-cost producer 	<ul style="list-style-type: none"> •Cost reduction •Withdraw from unprofitable market segments
Common approaches to remuneration			
<ul style="list-style-type: none"> •Less emphasis on salary, benefits and perks •Attention to share options and long-term incentives •Stress on non-financial rewards 	<ul style="list-style-type: none"> •Continued emphasis on long-term incentives with increasing attention to ways to promote short-term results •Catch up with salary and benefits (excitement of the new venture) 	<ul style="list-style-type: none"> •Most attention focused on keeping salary and perks competitive •Reduced concern for long-term incentives •Bonuses oriented to productivity improvement 	<ul style="list-style-type: none"> •Benefits and salary are king •Very little attention given to long-term growth-oriented incentives

Source: Bussin (2011: 10)

Support business strategy

- Managers need to tailor their pay systems in such a way that they are aligned with the organisation's business strategy.
- Thus, differences in a company's business strategy should be supported by corresponding differences in its HR strategy, including compensation.
- Compensation systems can be tailored to generic strategy frameworks (discussed in study unit 1) as well as three general business strategies, namely:
 - Innovator
 - Cost cutter
 - Customer-focused

General business strategies

- The innovator strategy stresses new products and short response time to market trends. The objective of this strategy is to develop unique products or services.
- The cost cutter strategy is an efficiency-focused strategy which stresses doing more with less by minimising costs, encouraging productivity increases.
- The customer-focused business strategy stresses delighting customers and bases employee pay on how well they do this.

Tailoring the compensation system to the generic business strategy

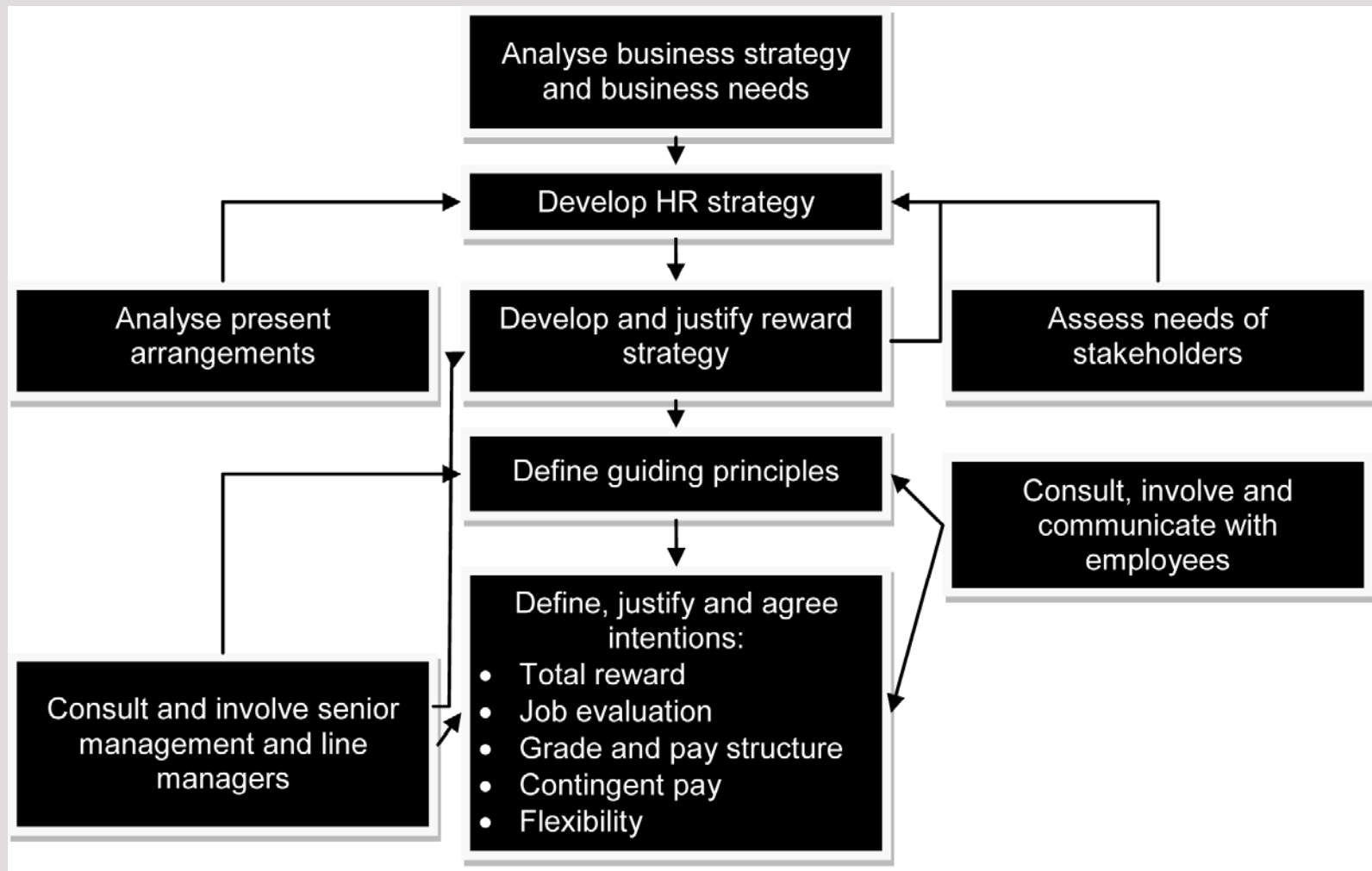
Strategy	Business response	HR programme alignment	Compensation systems
Innovator	<ul style="list-style-type: none"> •Product leadership •Sift t mass customization •Cycle time 	<ul style="list-style-type: none"> •Committed to agile, risk-taking innovative people 	<ul style="list-style-type: none"> •Reward innovation •Market-based pay •Flexible-generic job descriptions •Indirect compensation packages must be generous •Cafeteria-style benefits to be offered
Customer focused	<ul style="list-style-type: none"> •Deliver solutions to customers •Speed to market 	<ul style="list-style-type: none"> •Delight customer, exceed expectations 	<ul style="list-style-type: none"> •Customer satisfaction incentives •Value of job and skills based on customer contact
Cost cutter	<ul style="list-style-type: none"> •Operational excellence •Purse cost-effective solutions 	<ul style="list-style-type: none"> •Do more with less 	<ul style="list-style-type: none"> •Short-term compensation mix •Increase variable pay •Focus on competitor's labour costs

Compensation Strategy

Compensation strategy:

- is a declaration of intent
- provides a sense of purpose and direction
- is a pathway that links the needs of the business and its people with the compensation policies and practices of the organisation
- is underpinned by a compensation philosophy

Steps in developing a compensation strategy



Source: Armstrong & Stephens (2005:35)

Prepared by Magda Bezuidenhout,

When is a compensation strategy a source of competitive advantage?

Three tests determine whether a pay structure is a source of advantage:

- Is it aligned?
- Does it differentiate
- Does it add value?

END OF STUDY UNIT 2