

# 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:

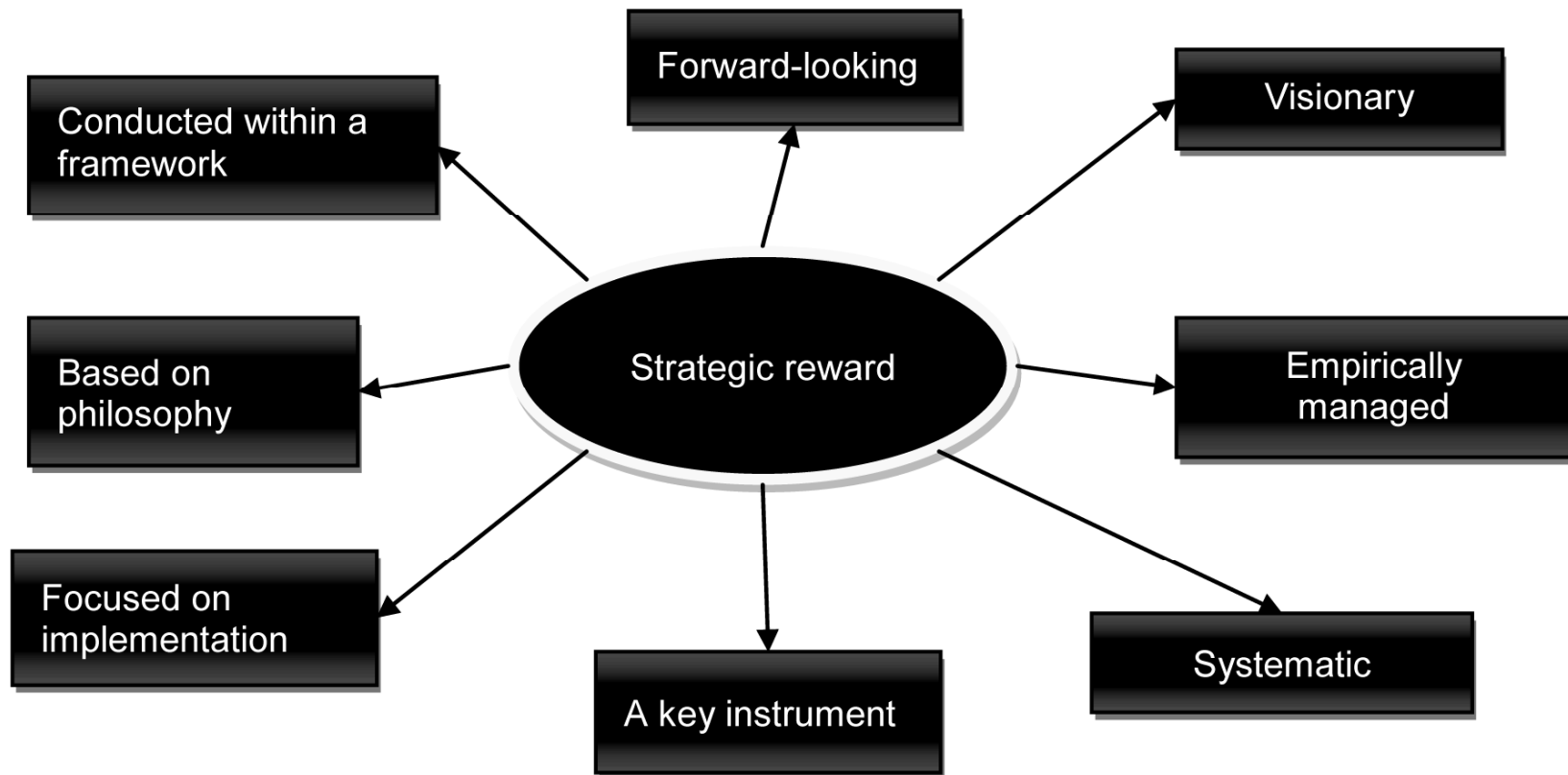
- define strategic compensation and its rationale
- discuss and contrast the different strategic choices with regard to the aims of strategic compensation
- critically discuss the purpose and content of strategic compensation
- identify the characteristics of strategic compensation
- discuss the relationship 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)

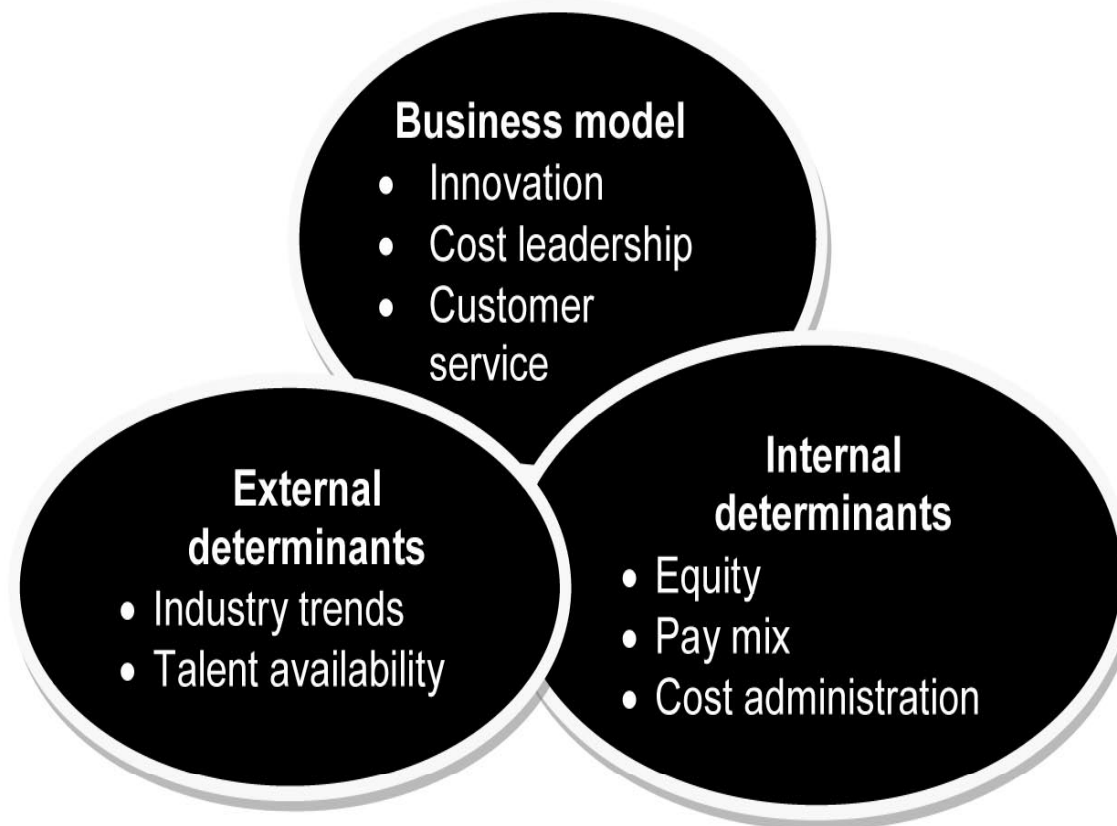
# Characteristics of strategic compensation



# 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)



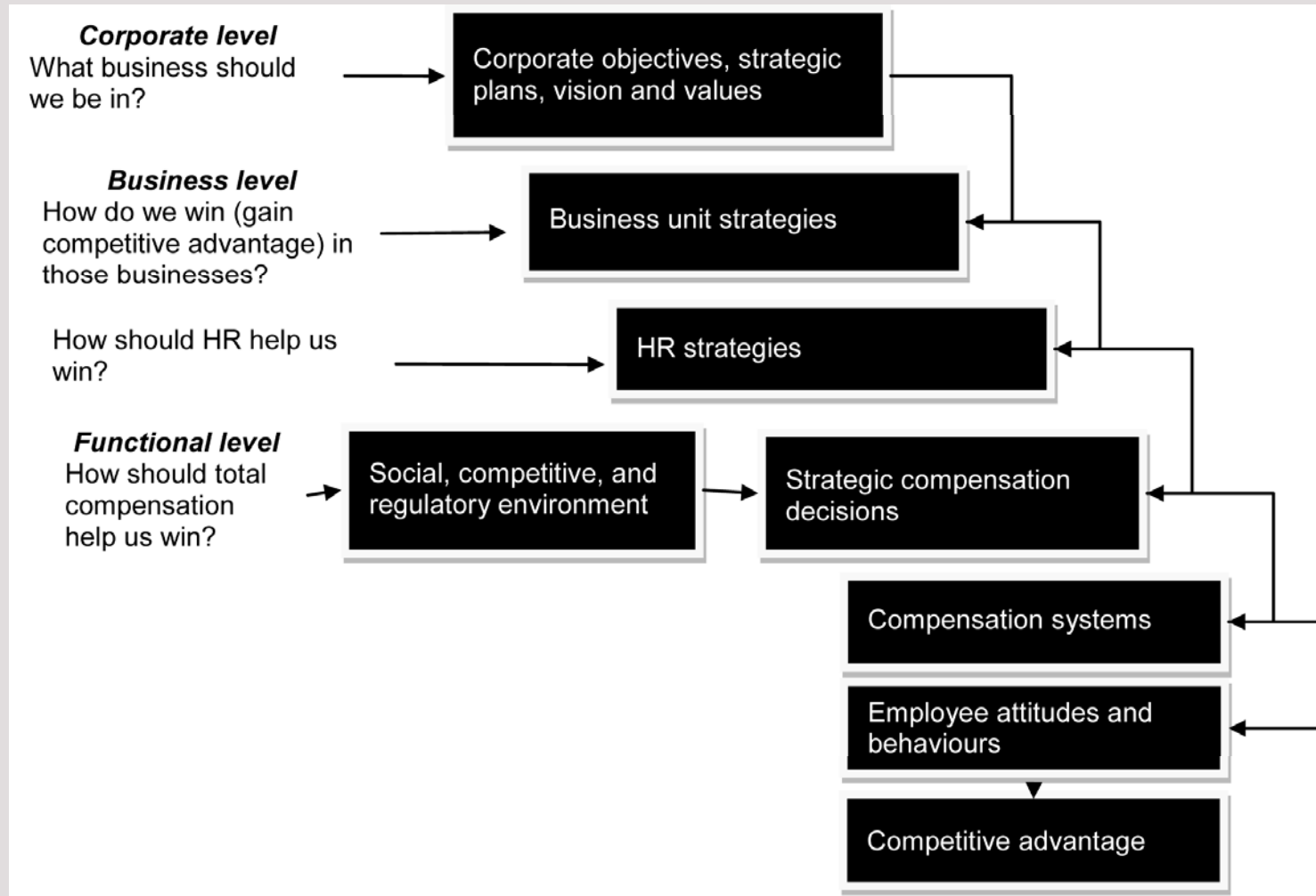
# Fundamental values of guiding principles

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

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

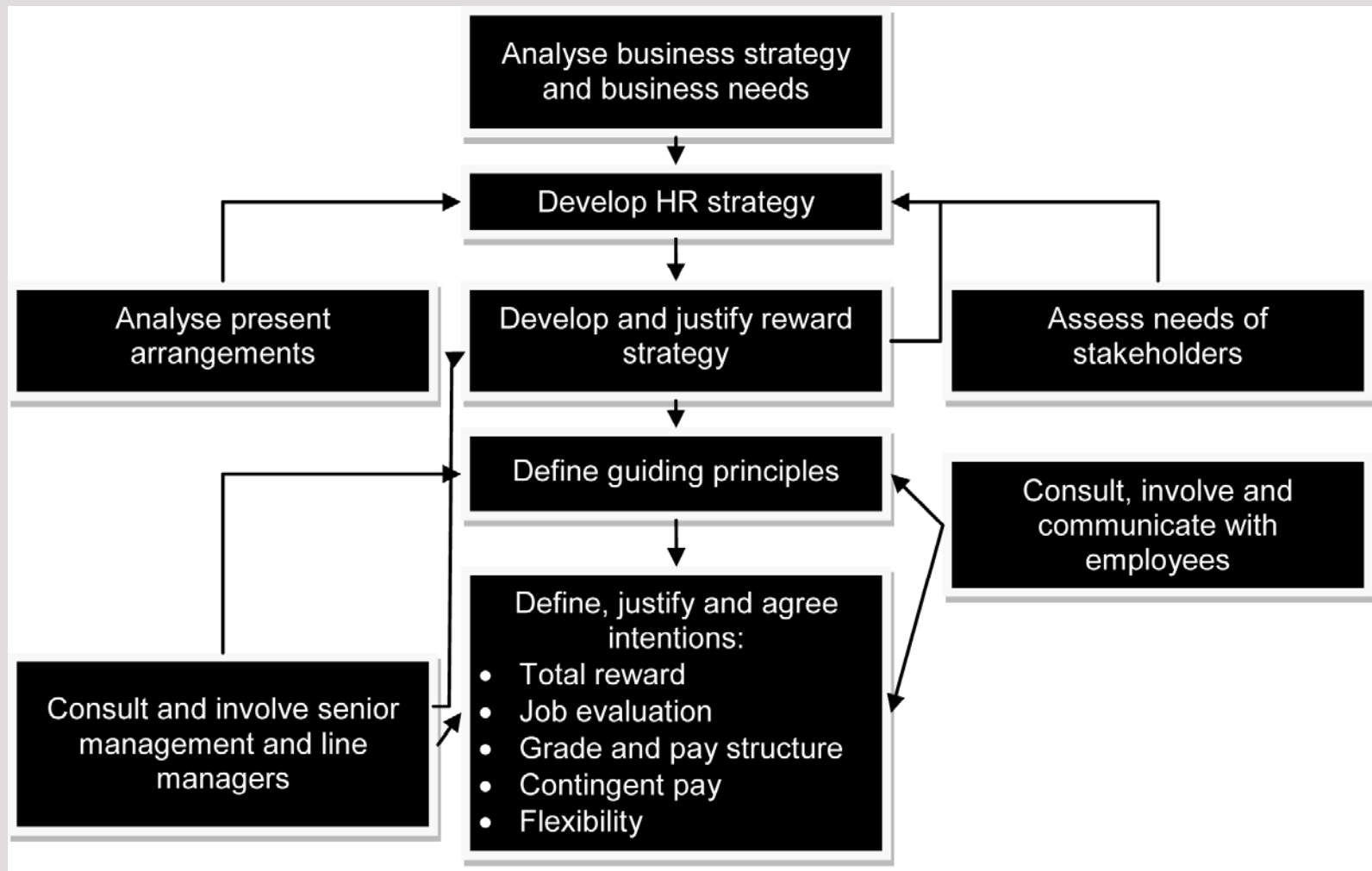


# Compensation Strategy

## 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