

# COMPENSATION MANAGEMENT

## HRM3705

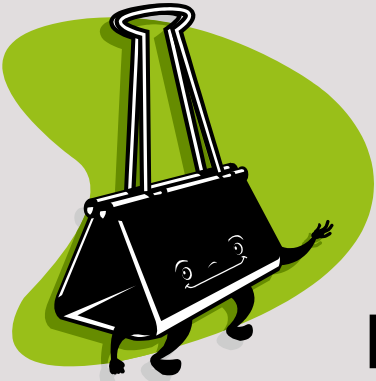
Study unit 7  
**Internally consistent pay systems**

# Learning outcomes of study unit 7

Once you have completed study unit 7, you should be able to:

- Identify and discuss the building blocks of market-competitive pay systems
- Discuss the need for conducting salary surveys
- Integrate the internal job structure with external market pay rates
- Critically discuss compensation policies and strategic mandates
- Interpret salary survey data using basic statistical analysis/terms
- Discuss and apply several of the concepts of internal alignment and external competitiveness in analysing actual pay data of specific jobs
- Identify the internal and external environmental factors that have an impact on the pay structure of an organisation
- Apply appropriate pay concepts to determine the pay for a position in a company
- Differentiate and discuss the different compensation policies

# Market-competitive pay system



Market-competitive pay systems represents a companies' compensation policies that fit the imperatives of their competitive advantage. It also plays a key role in recruitment and retention

# Excessive pay levels

- Represent undue financial burdens
- Undermine lowest-cost strategies
- Restrict investments

# Activities in a market-Competitive pay system:

Step 1

- Conducting *strategic analysis*

Step 2

- Assessing competitor's pay practices with *compensation surveys*

Step 3

- *Integrating* the internal job structure with external pay rates

Step 4

- *Determining compensation policies*

# Four Activities of Market Competitive Pay Systems

- **Strategic analysis** entails an examination of a company's external market context and internal factors.
- **Compensation surveys** involve the collection and subsequent analysis of competitors' compensation data.
- Compensation professionals integrate the internal job structure with the external market pay rates identified through compensation surveys.
- Compensation professionals recommend pay policies that fit with their companies' standing and competitive strategies.

# External/compensation competitiveness

*Compensation competitiveness* refers to how an employer pays compared with what similar or competitive companies are paying.

Parameters within which compensation choices can be made include the following:

- The labour market
- The product/service market
- The Organisation

# Compensation competitiveness (continue)

## The Labour market

- The geographical area from which an organisation recruits employees and where individuals seek employment
- A company's pay levels are based upon the market – thus the demand and supply thereof
- **Labour demand**: the employment level organisations require. An increase in salary rates will reduce the demand for labour, provided that other factors are constant
- **Labour supply**: the different number of employees available at different pay rates



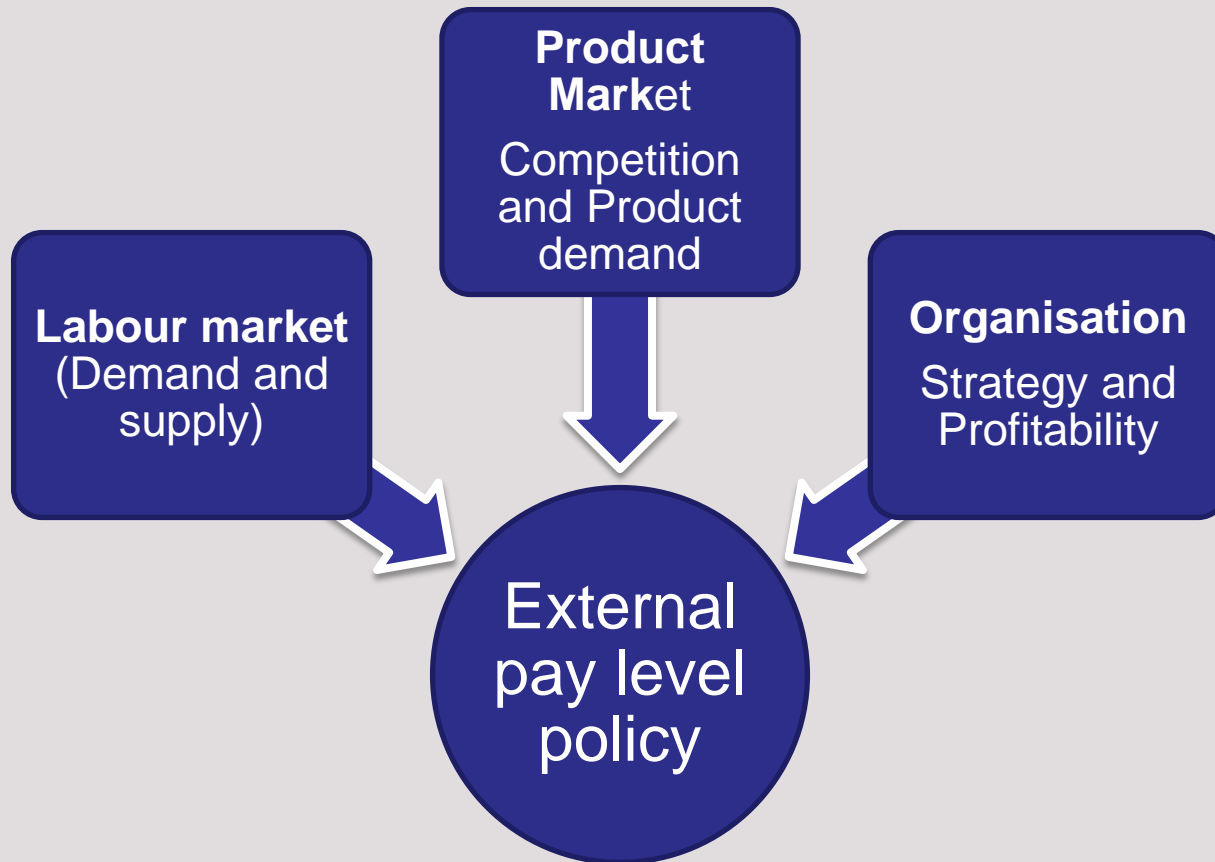
# Compensation competitiveness (continue)

## The Product market

- National and international pressures are major factors affecting pay levels
- An employer's ability to pay is constrained by the ability to compete
- The nature of the product market affects external competitiveness and the pay level that the organisation sets
- The product market factors set the limits within which the pay level can be established

## The Organisation

- Conditions in the labour and product market set the upper limit within which the pay level can be established
- The conditions of both the labour and product markets offers managers a choice – the pay level can be set within a range of possibilities
- Strategic choice emphasises the role of managerial choice in determining the pay level to be established
- A general model of the factors influencing the determination of external competitiveness and pay level can be depicted as follows:



# External market factors

- With *external market factors*, the following needs to be considered: Industry profile, information on competition and long-term growth prospects
- Considering *competitor's pay practices*, consider: base pay, incentive awards structure and mix and level of discretionary benefits

# Compensation surveys



Compensation survey is a gathering and summarising of compensation information paid by employers for various jobs in the labour market

# Considerations for using compensation surveys

The two important *preliminary considerations* are:

- What companies hope to gain from compensation surveys
- Custom developed surveys vs. use of an existing compensation survey
- *Two essential strategic considerations* are:
  - Defining the relevant labor market
  - Choosing benchmark jobs

# Defining Labour Market

## Qualified organizations' based on:

- Occupational classification
- Geography
- Market competitors

# Benchmark Jobs

- Used for
  - Job evaluations
  - Compensation surveys
- Established, well-known, stable
- Common across employers
- Entire range of jobs
- Accepted for setting pay rates



# Compensation surveys (continue)

## Data from salary surveys help organisations to:

- Set entry rates or new graduate starting salaries
- Verify salary structures or make appropriate changes
- Identify positions that need to be paid differently for the rate for the grade, for example Financial Accountant
- Assess typical salary increases required for the salary structure as a whole, or by grade or by position
- Keep informed of benefits and extras being offered
- Review all the components of the remuneration mix, i.e. guaranteed pay, variable pay (e.g. incentives, shares) and performance related pay
- Assess the slope, pay ranges and overlap of the salary structure

# Custom developed surveys

- Can be custom tailored
- Quality can be monitored by employer
- Usually not done in-house
- External data not readily accessible
- Can be expensive

# Published Surveys Sources

- Professional associations
- Industry associations
- Consulting firms

# Survey Data Characteristics

- They contain a lot of data
- Outdated data due to lag time
- Statistical analysis needed to integrate internal job structures with external market

# Statistical analysis

## Two Descriptive Properties:

- *Central tendency:* Represents the fact that a set of data center around a central point
- *Variation:* Represents the amount of spread or dispersion in a data set

# Central tendency

## Two Types of Measures:

- Arithmetic mean (mean, average)
  - Sum of salaries/number of salaries
  - Represents typical market salaries
  - Weighted mean gives equal weight to each individual employee's salary. Refer to the example on page 174 of the study guide
- Median (midpoint)
  - Middle value of sequential numerical data

# Mean

- Outliers can distort values
- Understated means occur with extremely small outliers
  - May set salaries to low
- Overstated means occur with extremely large outliers
  - May set salaries too high

# Calculating the mean

- Take for example the following salaries: R150 000; R130 000; R120 000; R110 000; R100 000
- Add all the salaries above together
- It adds up to R610 000
- Divide the total by 5 (the number of individual figures)
- Thus, the mean is

R122 000



# Median

- The median is the middle number of a particular salary range
- Calculating the mean:
  - Take the salary range provided at the mean
  - Arrange the salary from highest to lowest: R150 000; R130 000; R120 000; R110 000; R100 000
  - There is *uneven numbers*: Thus, the median is the middle value, thus R120 000
  - If there is *even numbers*: R150 000; R130 000; R120 000; R110 000
  - Calculate the mean for the middle values:  $R130\ 000 + R120\ 000 = R250\ 000$
  - Divide by 2 = R125 000

# Mode

This is the most popular salary – thus, the salary that is received by most in the sample

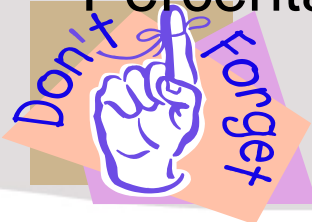
For example:

If 20 staff members received R110 000, five received R100 000 and 10 received R120 000, the mode would be R110 000.

Sometimes, rather than produce a single salary, surveys identify a “model range”, for example, R100 000 to R150 000, which contains the largest concentration of salaries

# Variation

- *Standard deviation*
  - Refer to the mean distance of each figure from the mean
  - The most common statistical measure of variation
  - The use in use of salary surveys are uncommon
- *Quartile*
  - Percentage of figures below a point
  - Based on four groupings
- *Percentile*
  - Percentage of figures below a point
  - The data point at the 50<sup>th</sup> percentile is also the median



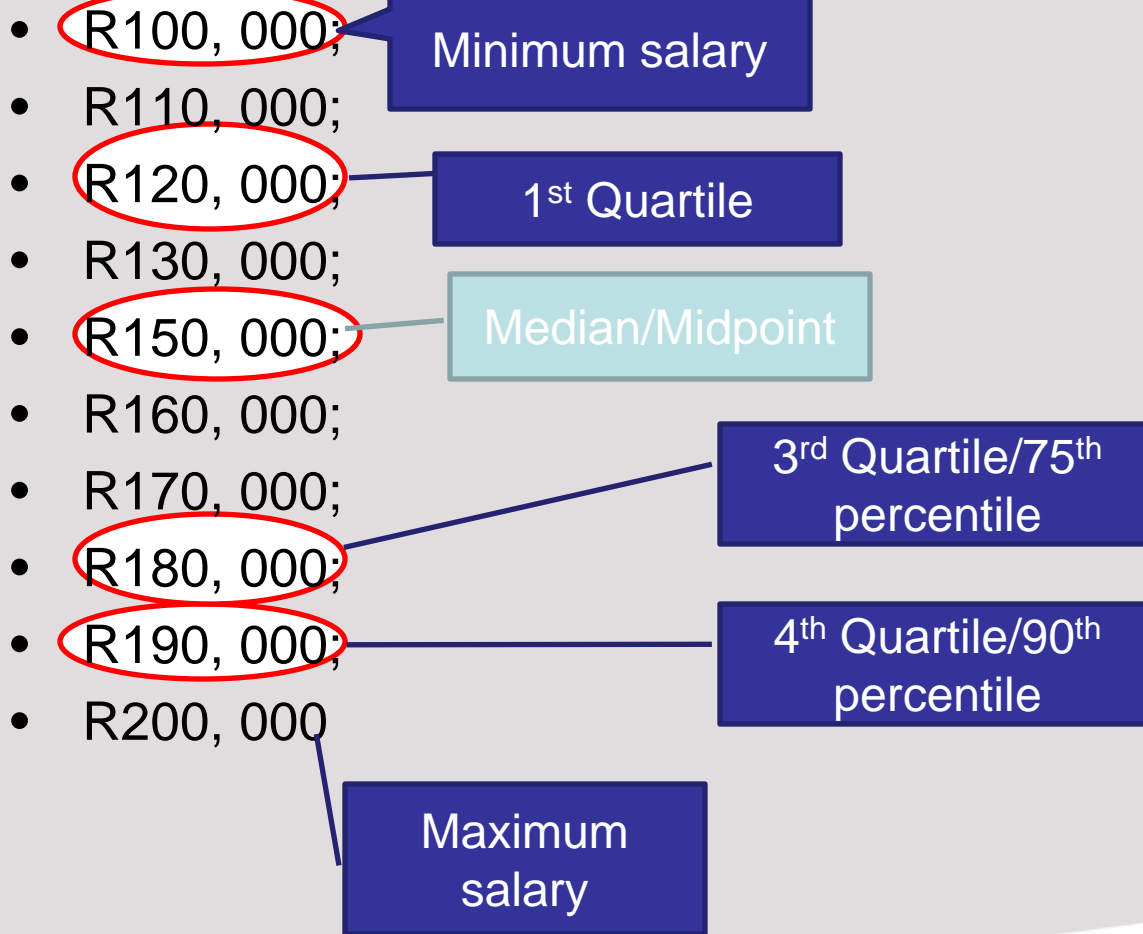
# Quartile

Dispersion by % below a set value

- Quartile 1 = 25%
- Quartile 2 = 50%
- Quartile 3 = 75%
- Quartile 4 = 100%

# Quartiles and Percentiles

If we take the following as our salary survey data:



# Integrating internal job structures with external market pay lines



Here you only need to know what regression analysis and market pay line is

- *Regression analysis*: describes the linear relationship between two variables (i.e. Simple regression) or between the linear composite of multiple variables and one other variable (i.e. Multiple regression)
- Regression analysis finds the best-fitting line between two variables. Compensation professionals use job evaluation points assigned to benchmark jobs and the salary survey data for the benchmark jobs. The best-fitting lines are referred to as the ***market pay line***

# Regression analysis

- When conducting regression analysis in compensation, you are trying to establish the correlation between two variables.
- A regression analysis is used to:
  - determine internal equity of the company i.e. the bigger the job, the higher the salary;
  - determine the salary spread of jobs within the same job points / grade;
  - identify outliers i.e. jobs falling outside the two controlling lines (maximum and minimum); and
  - identify gaps in grade structure.

# Pay level policies

- Market lead
  - Levels above market pay lines
  - Best for differentiation strategies
  - Maximises a company's ability to attract and retain quality employees
  - Minimise employee dissatisfaction with pay
  - Disadvantages:
    - May force employer to increase wages of current employees too to avoid internal misalignment and murmuring
    - Marks negative job attributes that contribute to high turnover later on



# Pay level policies (continue)

- **Market lag**
  - Levels below market pay lines
  - Best for lowest-cost strategies
  - Can hinder a company's ability to attract and retain potential employees
- **Market match (pay with competition)**
  - Pay according to market pay line
  - Appropriate with differentiation strategy
  - A company's ability to attract and retain employees will be approximately equal to its labour competitors

# Pay Level policies (continues)

- **Flexible policy**
  - Combination of the afore-mentioned policies
  - Purpose is to focus an employee's attention on the organisation's financial performance and his/her own productivity
  - Includes all forms of rewards
- **Employer of choice policy**
  - Where companies compete based on their overall reputation as a place to work, beyond pay level and mix

END OF STUDY UNIT 7