TOPIC 9
REWARDING AND COMPENSATING HUMAN RESOURCES

9.1. Compensation: Key concepts

Financial compensation components ('compensation package')

- Package of quantifiable (financial or financially measurable) rewards an employee receives for his or her work. Includes three components:
  - **Base compensation**. Fixed pay an employee receives regularly.
  - **Pay incentives**. Variable pay programmes aimed at rewarding good performance.
  - **Benefits / Indirect compensation**. Rewards aimed at providing security and better quality of life for employees (and their families too).

Example of point-factor system: Compensable factors of the National Position Evaluation Plan (Management Association of America, MAA)

- **Knowledge**: 14
- **Experience**: 22
- **Vocational Importancy**: 16
- **Effort**: 10
- **Mental or Visual Demand**: 10
- **Responsibility**: 5
- **Equipment or Process**: 5
- **Material or Product**: 5
- **Safety of Others**: 5
- **Work of Others**: 5

**Job Conditions**

<table>
<thead>
<tr>
<th>Factor</th>
<th>1st Degree</th>
<th>2nd Degree</th>
<th>3rd Degree</th>
<th>4th Degree</th>
<th>5th Degree</th>
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<td>Knowledge</td>
<td>14</td>
<td>28</td>
<td>42</td>
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<tr>
<td>Experience</td>
<td>22</td>
<td>66</td>
<td>86</td>
<td>110</td>
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<tr>
<td>Vocational Importancy</td>
<td>14</td>
<td>20</td>
<td>42</td>
<td>56</td>
<td>70</td>
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<tr>
<td>Effort</td>
<td>10</td>
<td>20</td>
<td>40</td>
<td>50</td>
<td></td>
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<tr>
<td>Mental or Visual Demand</td>
<td>10</td>
<td>10</td>
<td>15</td>
<td>20</td>
<td>25</td>
</tr>
<tr>
<td>Responsibility</td>
<td>5</td>
<td>10</td>
<td>15</td>
<td>20</td>
<td>25</td>
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<td>Equipment or Process</td>
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<td>25</td>
<td></td>
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</tbody>
</table>

References:
- Luna-Arcasas, R. (2018). Gestión de los recursos humanos e la dirección de personas en entidades públicas. APIE. Chapter 7 ('El valor del dinero en la empresa: la compensación total').
4. Rate worth of all jobs using a predetermined system. The most common procedure is the point-factor system, which uses compensable factors: work-related criteria considered as most important in assessing the relative value of jobs (related to e.g., knowledge, skills, experience, physical demands, responsibility, physical conditions, risk hazards, etc.).

5. Create a job hierarchy. Listing of jobs in order of their importance to the organization, from highest to lowest.

6. Classify jobs by grade levels. Job categories are created.

[Other job evaluation methods: ranking system, classification system, etc.]

9.3. TOTAL COMPENSATION SYSTEM DESIGN

Total Compensation (Total Reward)

Financial Compensation

- Fixed Pay
- Variable Pay
- Indirect Pay (Benefits)

Non-financial Compensation

- Performance & Career Management
- Quality of Work Environment
- Work & Personal Life Balance

Job evaluation

Performance appraisal

Individual (esp. senior level) negotiation

Company policies

Employer/branding strategy

Extra motivational tool

Section 8.5 ‘Non-financial rewards’

Sources:

An effective compensation system should:

- Help the company achieve its strategic goals.
- Be moulded to the unique characteristics of the company.
- Carefully consider the nine key features of (financial) compensation system design.
- Carefully consider the role of non-financial rewards, so as to maximize employee engagement.
- Importance of employee involvement in compensation system design, especially regarding variable pay, indirect pay (benefits), and use of non-financial compensation.

### Nine key features of compensation system design

<table>
<thead>
<tr>
<th>Feature</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>Internal vs. external vs. individual equity</td>
<td>Equity – Perceived fairness of the pay received by an employee.</td>
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<tr>
<td>Internal equity</td>
<td>Fairness within a company (firm employees are compared)</td>
</tr>
<tr>
<td>External equity</td>
<td>Fairness between different companies (different employers’ pay for the same type of labour are compared)</td>
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<tr>
<td>Individual equity</td>
<td>Fairness of individual pay decisions (especially important in highly qualified professions)</td>
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<tr>
<td>Fixed vs. variable pay (i)</td>
<td>Job evaluation: most common source of fixed pay decisions.</td>
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<tr>
<td>Performance appraisal</td>
<td>most common source of variable pay decisions.</td>
</tr>
<tr>
<td>Variable pay is becoming increasingly popular.</td>
<td>- Variable pay is becoming increasingly popular.</td>
</tr>
<tr>
<td>In general, proportion of variable pay increases as base pay rises.</td>
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<td>Importance of employee involvement in variable pay plans design, (different layers and reward types, ethical issues, etc.)</td>
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<td>Fixed vs. variable pay (ii)</td>
<td>Variable pay – Many layers and types of rewards</td>
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<td>Layers</td>
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<tr>
<td>Types</td>
<td>- merit pay, piece rate, bonuses, awards, gainsharing, profit sharing, stock plans.</td>
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### 9.3.2. Fixed vs. variable pay (ii)

<table>
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<tr>
<th>Unit of Analysis</th>
<th>Micro Level</th>
<th>Macro Level</th>
</tr>
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<td>Individual</td>
<td>Team</td>
<td>Business Unit/Plant</td>
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<td>Merit pay</td>
<td>Bonuses</td>
<td>Gainsharing</td>
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<td>Awards</td>
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Source: Gómez-Mejía, Balkin & Cardy (2012), p. 395
9.3. TOTAL COMPENSATION SYSTEM DESIGN

9.3.2. Fixed vs. variable pay (ii)
Variable pay – Many layers and types of rewards

- **Layers**: individual, team, business unit/plant, whole organization.
- **Types**: merit pay, piece rate, bonuses, awards, gainsharing, profit sharing.

**Unit of Analysis**

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- **Merit pay**
- **Bonuses**
- **Gainsharing**
- **Profit sharing**

Source: Gómez-Mejía, Balkin & Cardy (2012), p. 395

9.3.2. Fixed vs. variable pay (iii)
Types of pay-for-performance plans:

- **Piece-rate system**: Employees are paid per unit produced (or sold); tightest pay-performance link.
- **Merit pay**: Increase in base pay, based on periodical performance appraisal.
- **Bonus programmes**: Lump-sum payments. Financial incentive given on a one-time basis and does not raise the employee's base pay.
- **Awards**: One-time rewards usually given in the form of a tangible prize.
- **Gainsharing**: Plantwide or business unit pay-for-performance plan in which a portion of the unit’s cost savings (efficiency increase) is returned to workers, usually as a financial bonus. Includes different types of plans.
- **Profit sharing**: Corporate pay-for-performance plan that allocates a portion of declared profits to employees.
- **Employee stock ownership plans (ESOPs)**: Corporate plan that rewards employees with company stock (outright grant or below-market price sale).

9.3.3. Membership vs. performance

- **Membership-based pay systems**: Emphasis on seniority (years of service); salary progression tied to 'moving up' in the organization.
- **Performance-based pay systems**: Emphasis on performance in the current job; salary progression tied to (individual or group) contributions.

9.3.4. Job-based vs. individual-based pay (see section 8.4)

- **Job based pay**: Employees paid on the basis of current jobs.  
  - Best when:
    - Jobs and technology are stable.
    - Specific training is required to learn a given job.
    - Turnover is relatively low.
- **Individual-based pay**: Workers are paid for jobs they could do or talents/skills they have and can be applied to a variety of tasks and situations.  
  - Best when:
    - Company and environment are dynamic.
    - Workforce is relatively educated, and able and willing to learn different jobs.
    - Participation and teamwork are encouraged.
    - Opportunities to learn new skills are available.

9.3.5. Egalitarian vs. elitist pay systems

- **Egalitarian pay system**: Most employees are part of the same pay system. Reduces barriers between workers and facilitates internal mobility. More common in highly competitive environments, where risk-taking is needed, and continuous investment in new technologies and products is essential.
- **Elitist pay system**: Different compensation systems are established for employees or groups at different organizational levels. Prevalent in older firms with mature products, stable market share, and limited competition.

9.3.6. Above-market vs. below-market pay

- **Above-market pay**: Emphasis on minimizing employee turnover and maximizing motivation.
- **Below-market pay**: Emphasis on controlling labour costs.

9.3.7. Monetary vs. nonmonetary rewards

- **Monetary rewards**: Direct financial compensation (money or money-convertible), e.g., base pay and most pay-for-performance plans. Emphasis on achievement & extrinsic motivation.
- **Nonmonetary rewards**: Indirect financial compensation (non-financial, e.g., interesting work, good work atmosphere, work/personal life balance). Emphasis on organizational commitment, intrinsic motivation & engagement.
9.3. TOTAL COMPENSATION SYSTEM DESIGN

9.3.8. Open vs. secret pay
- **Open pay.** Forces managers to be fair and effective in administering compensation (bad decisions cannot be hidden and good decisions motivate the best workers). However, it may be impossible to satisfy everyone. Appropriate for fostering employee involvement, trust and commitment, especially in egalitarian cultures.
- **Secret pay.** It usually fosters dissatisfaction with pay. However, it may be appropriate for highly competitive climates.

9.3.9. Centralized vs. decentralized pay decisions
- **Centralized pay system.** Pay decisions are tightly controlled from the HR department or corporate HQs. Emphasis on internal equity.
- **Decentralized pay system.** Pay decisions are delegated deep down, usually to unit managers. Emphasis on external equity. Better for large, diverse organizations.

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9.4. CREATING A PAY STRUCTURE

9.4.1. Job-based vs. skill-based compensation plans

**Job-based compensation plans**
- Most traditional and widely used types of compensation programmes. Key assumption: work is done by people who are paid to perform well-defined jobs.

**Skill-based compensation plans**
- Far less common. Key assumption: workers should be paid not according to the job they hold, but rather by how flexible and/or capable they are at performing multiple tasks.

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9.4.2. Job-based compensation plans (i)

**Achieving internal equity: Job evaluation**
Assessment of the relative value or contribution of different jobs (not individual employees) to an organization. This is the basis for calculating base compensation (fixed pay). (See details in section 9.2).

**Achieving external equity: Market surveys**
Purpose of market surveys: determine pay ranges for each grade level. Conducted by companies, or (mostly) purchased from specialized consultancies.
- Identify benchmark or key jobs. Jobs that are similar or comparable in content across firms.
- Establish a pay policy. How the firm chooses to establish itself in the pay market. Three options: lead pay market, lag behind, or pay market rate.
9.4. CREATING A PAY STRUCTURE

9.4.2. Job-based compensation plans (ii)

Achieving individual equity: Within pay-range positioning criteria

After the firm has finalized its pay structure by determining pay ranges for each job, it must perform one final task: assign each employee a pay rate within the range established for his/her job. Most common criteria include:

- Previous experience
- Seniority (years of service)
- Performance appraisal ratings

Advantages and disadvantages of job-based compensation plans

- Advantages: rational, objective and systematic; easy to administer.
- Disadvantages: neglect of specific nature of business; job descriptions are often too general; mechanistic and inflexible.

9.4.3. Skill-based compensation plans

Skills (in a broad sense, i.e., competencies) are the basis of pay, not jobs.

Pros: more flexible workforce, fewer supervisors needed, more employee control over compensation.

Cons: higher training costs, obsolescence of skills.

Three types of skills:

- **Depth skills**: learning more in a specialized area; i.e., becoming an expert.
- **Breadth/horizontal skills**: learning more jobs or tasks within the firm.
- **Vertical skills**: 'self-management' abilities (e.g., scheduling, coordinating, supervising, leadership, training, etc.).

9.5. NON-FINANCIAL COMPENSATION

Non-financial compensation is increasingly important for optimizing employee (mainly intrinsic) motivation, organizational (mainly affective) commitment and, especially, engagement.

- **Three key broad components:**
  1. Performance & career management.
  2. Quality of work environment.

1. **Performance & career management**

   - Using performance appraisal as developmental tool.
   - Providing regular feedback, counselling and support to employees.
   - Identifying 'talent pools' and designing career paths.

2. **Quality of work environment**

   - Includes diverse powerful, potentially (de)motivating aspects:
     - **Physical circumstances**: physical safety, risks and hazards, schedules, deadline pressure, stress, anxiety, etc.
     - **Psychological circumstances**: management and leadership styles, self-perception of own value, task richness, task recognition, perception of personal and professional growth opportunities, personal relationships among co-workers, mobbing, etc.
   - Importance of employee participation as a tool to improve employee (intrinsic) motivation, organizational (affective) commitment, and engagement.
   - Different types of participation approaches and programmes: employee consultation, suggestion programmes, quality circles, improvement groups, employee empowerment, etc.

3. **Work and personal life balance - importance of:**

   - Developing a systematic work-life balance strategy.
   - Including work-life balance evaluation as part of HR audit.
   - Integrating the work-life balance strategy with flexible work arrangements, family-friendly policies, diversity management, work discrimination concerns, gender issues at work, etc.
   - Integrating the work-life balance strategy with the employer branding strategy.