

Understanding the organizational compensation strategy roles



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'An organization's compensation strategy plays a critical role in motivating workers and attracting the best employees'(STRATEGIC COMPENSATION by Francesca Gino, Ian I. Larkin, 2004, pg 2). As this is supposed to lead to success-the " condition" every organization wants to achieve. One of the factors or abilities undertaken by a company which is critical to this very organizational success is designing the process of the company's work which starts by identifying outcomes and goals. And this is often referred to developing the compensation systems by considering a number of factors such as: the balance of direct and indirect rewards, the complexity and responsibility of a role and the candidate or employee filling it, as well as company's focus on internal versus external equity. Behind every organization are people with their abilities, ideas. It is said, if one wants his employees to be innovative he should reward them for new ideas, if one wants his employees to stay with him for a long period instead of training new ones every season and spending money and time, he should offer them bonuses as well as to tie their wages to their tenure, if one needs employees that show up on time, work hard and can be trusted with the most challenging of tasks-he should recruit those people, reward those people, promote those people because the future of his business depends on it as well. But bringing out the best of the employees demands an organized and efficient compensation system on each organization willing to be successful and has this kind of competitive advantage. That is why the question of compensation of employees is crucial.

But is it that good idea as a part of management to award employees with merit or non-merit issues?

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In this paper we will look at how an organization develops a motivating and rewarding incentive plan and are going to discuss compensation systems including non-monetary compensation, direct compensation, (base pay, incentive pay, stock options, annual bonuses), indirect compensation and give the answer to the question whether merit issue of rewarding employees is good or bad way of motivating people and supporting their satisfaction and give reasons for both situations.

Thus, the paper consists of introduction of the given topic, Chapter 1 representing the meaning, necessity and types of compensation systems, Chapter 2 bringing arguments for and against awarding employees with examples provided and the Conclusion with the short description of results of the discussions.

CHAPTER 1: COMPENSATION-Definition, Types , Objectives.

Compensation is the total of all payments or reward forms provided by the company to employees for tasks performed which leads to achieving organizational objectives. During the harsh economic times reality has created an atmosphere when it was difficult to balance cost efficiencies with the need to increase performance of employees by through motivation methods. Traditional merit pay systems simply did not allow for fair and sufficient differentiation of financial rewards between good and poor performance. To reward employees' past performance fairly, in line with efforts, skills and competencies. So which are the objectives of compensation?

High performing employees attraction and retaining.

High performing employees motivation and reinforcement of the behaviour of desirable ones .

Having competitive advantage in the labour market

To connect organizational goals with employee's future performance

To demonstrate the employees their worth to the organization

To provide an employee with a social status

Nowadays, almost every progressive organization is looking for new alternative pay methods to both maintain cost controls and increase employee performance which can be assessed based on individual or team contribution, on business unit results or on corporate profit or share price. It can be rewarded in different ways such as traditional wages adjustments or through variable pay techniques like one-time or recurring bonuses. HR departments are integrated into the process of proposing, designing and implementing performance pay systems in many organizations. But even where HR is not at the forefront of such efforts, it still can play a role. And as soon as the question of compensation of employees rises, most managers are busy asking " What do I have to pay to...?" And it is not that easy question to answer. A better question might be: " What do I want my compensation package to say?". So what are the objectives of compensation?

It's easy to think "pound per hour" while thinking about compensation. But successful compensation packages, however, are more about a total rewards system, containing direct, indirect and non-monetary elements with their positive and negative points which will be discussed in the examples brought below.

1. Direct Compensation Alternatives consist of payments received in the form of wages, salaries, bonuses and commissions provided at regular and consistent intervals (definition from a book)-a pay that an employee receives such as profit-sharing bonuses, Scanlon Plan, ESOP, Gain sharing and Merit plans.

Base Pay 'the cash compensation that an employer pays for the work performed' (Compensation by George T. Milkovich, Jerry M. Newman published by McGraw-Hill Education (Asia), 200, pg. 10). As paying a wage is a standard practice to get a competitive advantage an organization can only by suggesting a higher amount. One of the advantages of basic pay system is that it is really cheap and simple from administrative point of view as well as it allows labour costs to be forecasted more accurately. However this system does not provide according to its definition any direct incentives for employees to improve their productivity or performance.

Example 1: "Toyota's financial benefits are rated as exceptional. To keep salaries competitive the company participates in outside salary surveys every 12 months. Individual salaries are reviewed every 12 months" (<http://www.eluta.ca/top-employer-toyota-canada>).

Incentive Pay: 'A bonus paid when specified performance objectives are met' (<http://www.cnr.berkeley.edu/ucce50/ag-labor/7article/article33.htm>).

A good incentive pay scheme can motivate employees to work better for your business. A badly thought-out scheme, on the other hand, can be divisive and demoralizing. But it is not always having its positive effect. According to the article published by Allen Z. Gilbert ("Incentive Pay Might Gets Results, But Not Always The Ones You Want" *Vending Times Inc.*, Issue Date: Vol. 50, No. 2, February 2010, Posted On: 2/14/2010). In his work Schwartz concluded, "Despite our abiding faith in incentives as a way to influence behavior in a positive way, they consistently do the reverse." Which will prove following examples.

Example 2: A company agrees to pay its chief executive a bonus which will be connected to the increased value of the company's stock. "The compensation committee would agree with this incentive contract believing that the share prices would be increased due to profit improvement. And it was assumed that the CEO would increase sales. Reduce costs, develop new products by implementing new programs. But they didn't think of other ways which can influence the share prices such as using the company's hard-earned cash for share buybacks. It does not increase profits, but it raises the price of a share by reducing the number of shares outstanding or committing the company to a course of action that sounds exotic, costs a lot of money and increases the price per share, but that will result in no real, continuing benefit to the bottom line - and he might know that. So the CEO doesn't actually care about continuing profits. He just wants to maximize his bonus based upon share price" (www.jstor.org/stable/764957) <https://assignbuster.com/understanding-the-organizational-compensation-strategy-roles-essay-samples/>

Or let us take another example:

Example 3: The case happened on Wall Street. " Traders loaded their companies' balance sheets up with toxic assets that produced immediate profits based upon accounting standards approved by the Financial Accounting Standards Board. They did so because their incentive compensation was tied directly to the value of profits they brought into the firm. The fact that the ownership of those assets posed a real and continuing threat to the operations of their employer didn't even enter their thoughts. They could not have cared less about the risks to, or even the survival of the company that employed them. They were only concerned with the millions they would make in bonus pay"(<https://www.vendingtimes.com>).

But anyway most of the companies do use incentive- pay systems, such as BOEING, COCA COLA, BMI.

Everything depends on the specific differences of the business all of these systems are being implement for. As we can see in the following example, incentive pay system might be the best one to use and improve productivity.

Example 4: In a sales environment an employer may wish to suggest extra pay or benefits when targets are achieved by employees.

Stock Options: is about the right given to employee to buy a piece of the business to reward his/her excellent service. As it is thought the one who ones even a small part of the company he operates in will be more likely to stay with this very company longer and try to do a better job so as to increase the value of his "piece"

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Example 5: If employees option gives him/her the right to purchase the stock at \$10 per share while the stock is trading at \$12, the option has an intrinsic value of \$2 per share.

Example 6: " In Google corporation employees are given base salaries that are on the lower end of normal for the markets they operate in. But at the same time they are supplemented by stock options which challenge work and benefits as a result"([http://jobsearchtech. about. com/od/companyprofiles/a/google. htm](http://jobsearchtech.about.com/od/companyprofiles/a/google.htm))

But there can occur disadvantages as well because decline in the value of the options due to daily market fluctuations may cause less motivation at the owner of this option.

Bonuses: " are gifts given to reward exceptional performance or on special occasions demonstrating the appreciation of the work done by employees by employer. They are given for creating incentives to reduce costs; to pay people for doing a good job; or to encourage employees to think like shareholders" . ([http://www. adelaide. edu. au/hr/strategic/reward_recog_gldns. pdf](http://www.adelaide.edu.au/hr/strategic/reward_recog_gldns.pdf)).

One of the advantages is that bonus packages allow the company to be focused on those areas which can maximize performance and profit as a result. However, not all jobs that can show the clear connection between employee performance and improvement in financial results of the company.

Example 7: It will be really difficult to clarify what was the input of some employees working in research & development department of a company or field .

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Example 8: " Toyota also provides signing bonuses for some employees; year-end bonuses for all employees; year-end bonuses (to \$18, 000); defined benefit pension with employer contribution (up to 8. 9% of salary); life & disability insurance; retirement planning assistance; phased-in retirement program; discounts (to \$1, 000 off dealer cost) of new Toyota vehicles for employees (and \$800 for family members); lottery for discounted purchase of manager-driven vehicles; the use of a white Lexus RX350 on an employee's (or the children of employees) wedding day"(([http://www. eluta. ca/top-employer-toyota-canada](http://www.eluta.ca/top-employer-toyota-canada)).

Example 9: This practice is implemented by NIKE company " which has an annual bonus plan that rewards employees based on Nike's performance (to reward team success) and individual performance (to reward employees contributions to that success)"

[http://www. new-academy. ac.](http://www.new-academy.ac)

[uk/publications/keypublications/documents/nikereport. pdf](http://www.new-academy.ac.uk/publications/keypublications/documents/nikereport.pdf)).

But this system has also some disadvantages. Lets turn to the following example:

Example 10: " Dr. Bennett's company is seeing a tremendous growth during recent two years which was probably caused by several new industries that had moved into the area. She has a loyal, dedicated staff. So the doctor decides to start a bonus plan based on achievement of few goals-number of new patients, exceeding 98 % of production etc. So what happened? At first employees got excited about the opportunity to earn extra money. However

this bonus plan appeared to be un-motivating because the bonus was
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payable only if all the goals were met which was actually impossible. Thus every incentive should be achievable to be a motivator and the goals should be evaluated and adjusted".(http://www.dentalofficemag.com/display_article/222735/76/none/none/Depts/What-about-BONUS-incentives)

ESOP- " Employee stock ownership plan, is a qualified retirement program through which employees receive shares of the corporation's stock"(www. Investopedia. com). To one of the advantages one can refer financial ones regarding conventional loan repaid by a company when the interest payments are deductible while the principle ones are not in comparison with the situation when a corporation borrows money to buy a stock for ESOP both the principal payments and the interest are which reduces significantly after tax costs of the corporation.

One of the disadvantages is the Equity Dilution which means that when adopting an ESOP it reduces the percentage ownership of present shareholders. To demonstrate another disadvantage of this system lets have a look at following example.

Example 11: "... an employee has been working for an ESOP company for 15 years, and decides to retire at 55, in December 1997. There is generally a " year break in service rule" meaning that, assuming that the employee has not returned to work, the value of the benefits to be paid out will be set by the stock value at year-end 1998. This company has done very well and the employee has seen his per share stock value rise from \$20 a share in 1982 to \$80 a share on his retirement date in 1997. Unfortunately, this was a bad

year for the company and two clients with 50% of the company's revenue left to do business with competitors. By the time the year break in service is over, the stock has now been valued at \$40 a share, and the employee has lost half of

what he had expected to be able to retire on".

So annual valuations is another disadvantage of ESOP compensation plan.

Profit sharing: These are monetary benefits apart from salary and bonuses suggested to employees by the employer. The profit can be shared in the form of bonds, stocks or cash, which can be given at the time of retirement. One of the advantages to be mentioned are that it can bring all the employees together to work towards a common goal, motivation level will be high and they will be focused on profitability.

Example 12: " IBM has introduced in 2006 its worldwide Growth Driven Profit-sharing program, which replaced the Performance Bonus program immediately. This new plan was designed to return a portion of revenue and profit growth right back to the employees who help drive that growth. For starters, all eligible employees participate in a single, worldwide " One IBM" profit-sharing pool, reinforcing our commitment to cross-enterprise collaboration and integration. We will no longer base results on separate unit-specific pools. Further, results will be driven by how well IBM grows revenue and profit, year-over-year, rather than the more complex measures we have been using in recent years"([http://www. endicottalliance. org/ibmannouncementonnewcompensationplan. htm](http://www.endicottalliance.org/ibmannouncementonnewcompensationplan.htm))

Example 13: " Each year Nike's Board of Directors determines the contribution amount to Profit Sharing Retirement Plan based on Nike's annual financial performance. It is fully funded and invested by Nike. Generally, employees are eligible after one fiscal year of employment" (<http://www.new-academy.ac.uk/publications/keypublications/documents/nikereport.pdf>).

Example 14: " Chrysler Corporation developed a profit-sharing plan for its employees during the economic recession of 1988. The plan was incorporated into the union contract in exchange for wage concessions made by its workers. Although harsh economic times made contributions small, by 1994 (when the economy had recovered) Chrysler was paying an average bonus of \$4, 300 per person to 81, 000 employees, for a total of about \$348 million"(<http://www.referenceforbusiness.com/encyclopedia/Per-Pro/Profit-Sharing.html>).

The main disadvantage of this system is that the focus of employee can be on quantity not quality as for the employees there is no guarantee for future benefits.

ANOTHER EXAMPLES OF ORGANIZATIONS USING PROFIT-SHARING SYSTEM ARE PROCTER & GAMBLE , INTEL AND OTHERS.

Gain sharing: through this system the organisation looks for higher performance levels due to involvement and participation of its employees. As performance improves the staff shares its gains. To the main advantage we can draw that it helps the company to achieve sustained improvement in key

performance. As for the disadvantage it is paid taking into consideration group improvement not individual.

Example 15: Lets pretend there is a company producing rigid and steering differential axles for tractors. From its records, the company determined that every \$1, 000, 000 of good product output demanded 10, 000 worker hours. Under gain sharing, the next \$1, 000, 000 of axle output and shipment was produced with only 9, 000 hours. If the average wage rate is \$10 an hour, the 1, 000 hours saved are worth \$10, 000. That is a gain to be shared equally between the workforce and company.

Now lets have a look how gainsharing systems work in different organizations (Government, School, Military) (Example 15).

Example 16:

Government

The Indianapolis Department of Public Works (DPW) agreement with AFSCME Council 62 and Locals 725, 1887, 1831, 3131, and 3766 defines gain as the difference between bid operating costs and actual annual operating costs. Service improvement, defined as a reduction in the total number of annual calls, is also considered in computing gains.

The City of Loveland, Colorado's gainsharing program, which has been in effect since 1982, set three distinct criteria in defining gain: city revenues had to exceed actual expenses; actual expenses had to be less than or equal to the prior year's expenses on a per capita basis; and there had to be an

acceptable level of satisfaction with city services as determined by a citizen satisfaction survey performed each year.

School

The Monona Grove, Wisconsin, School District agreement with AFSCME Council 40 and Local 60 defines gain as the excess of food service revenues over food service costs for a single school year. Language proposed in other localities defines gain as the difference between " allowed," or budgeted, costs and actual incurred costs.

Military

An agreement between the Sacramento Air Logistics Center at McClellan Air Force Base, California, and the American Federation of Government Employees (AFGE), involving a program that ran from 1988 to 1993, defined gain as expected costs minus actual costs, adjusted for inflation, technology changes, and workload changes.

Scanlon Plan " is a type of gain sharing plan paid as a bonus to employees for incremental improvements" (www. bnet. com). The main advantage of this plan is that the company has to go through an analysis of profit and loss in order to decide the ratio, hence encouraging a focus on financial results. While the disadvantage is that the actual work and contribution performed by all the employees may not be reflected by equal bonus, because education and skills may have a major effect on what savings were the most cost effective. Let us have a look at the example of Scanlon Plan calculation.

Example 17:

Merit Plans- " Merit increases are given as increments to the base pay in recognition of past work behaviour" (Compensation by George T. Milkovich, Jjerry M. Newman published by McGraw-Hill Education(Asia), 2008, pg. 10). It is one of the most frequently used methods of rewarding employees based on compensation upon performance. Usually it is used in educational organizations.

Let us have a look at Barak Obama's-the president of the US, merit plans justifications :

Example 18: According to the President`s speech, the increase of funding for teachers salaries through implementing wiser merit pay system is a really good idea because it assures them of getting what they pay for. The problem with education is how lazy so many teachers are. " They sit at their desks all day sipping their expensive coffee and not paying any attention to what their students are doing. What about the lazy cops who hang out in the doughnut shop or the lazy firemen who don't want to run into a burning building though? Let's face it teachers aren't the only lazy government workers on easy street".

Thus concluding from our example, we can withdraw the advantage for this system which is it allows the employer to differentiate pay given to high performers and also make conclusions about at least one of the disadvantage - the pay is too subjective which already means that is not fair enough to implement though it is still popular especially among educational institutions.

But it is not all about direct compensations only. In a tight labor market, indirect compensation becomes increasingly important. Companies which cannot compete with high cash wages can gain competitive advantage by offering very individualized alternatives that meet the needs of the people they want to employ. Hence indirect alternatives of compensation can be following.

2. Indirect Compensation Alternatives " financial rewards that are not included in direct compensation and can be understood to form part of the social contract between the employer and employee such as benefits, leaves, retirement plans, education, and employee services"
(<http://hrcouncil.ca/hr-toolkit/compensation-systems.cfm>)

flexible working schedules

elder care

retirement programs

moving expenses

insurance (health, dental, eye)

subsidized housing

paid leave (sick/holiday/personal days)

subsidized utilities

tickets to events (ball games, concerts)

magazine subscriptions

boots and clothing

laundry service

company parties

use of farm trucks, machinery

farm produce/foods/meals

cellular phones/pagers

child care

use of farm pastures and gardens

Further the examples of organizations are brought practicing different types of indirect compensation modes.

Example 19: " Wal-Mart Stores, Inc offers following indirect alternatives:

Discounts on child care, travel & other services, educational reimbursements, professional counselling services, leaves of absence, scholarships for higher educational long-term benefits" (http://www.jobbankusa.com/employment_jobs_career/walmart.html).

Example 20: " Google Corporation provides its employees with the following cutting-edge benefits:

Health care for you and your family, plus on-site physician and dental care at our headquarters in Mountain View, California and our engineering center in Seattle, Washington

Vacation days and holidays, and flexible work hours

Maternity and parental leave, plus new moms and dads are able to expense up to \$500 for take-out meals during the first four weeks that they are home with their new baby

Adoption assistance

Google Child Care Centre, just five minutes from Google headquarters in Mountain View

Back-up child care helps California parents when their regularly scheduled child care falls through

Free shuttle service to several San Francisco, East Bay, and South Bay locations

Fuel Efficiency Vehicle Incentive Program

Employee discounts

Onsite dry cleaning, plus a coin-free laundry room in the Mountain View office"([http://jobsearchtech. about. com/od/companyprofiles/a/google. htm](http://jobsearchtech.about.com/od/companyprofiles/a/google.htm))

Example 21: " Ford Motor Company provides employees with a flexible and extensive benefit package that includes generous vacation and

comprehensive insurance. The insurance benefit alone includes health care, medical, dental, prescriptions, disability and life. Paid time off varies year to year, but can be up to 15 holidays a year and as much as 25 days vacation after 20 years with the company. Salaried employees are automatically enrolled in the employee retirement plan on date of hire, but options are personal and employees make their own investment choices. The company also has programs for vehicle purchases, tuition assistance and a dependent scholarship program, among others"

(http://www.jobbankusa.com/employment_jobs_career/ford_motor.html).

3. Non-financial compensation referring to issues such as career development and advancement opportunities, opportunities for recognition, as well as work environment and conditions which means proper job description as well so that employees could avoid the inconveniences regarding the scope of their work needed to be done.

Example 22: Wall Mart Inc suggests following career Benefits: Classroom training, internships, in-store & on-the-job training, computer-based training, mentoring and various other opportunities for employees to gain the skills they need for promotions and a successful career, praise and recognition, task enjoyment and friendships.

Example 23: IBM invests over \$750 million annually to ensure that their workforce has ongoing development opportunities and well-honed skills.

People development provides the employees with the guidance, resources & tools needed to widen their knowledge base and allow for career

progression. Some of the foundational competencies that establish a <https://assignbuster.com/understanding-the-organizational-compensation-strategy-roles-essay-samples/>

common standard of excellence are adaptability, communication, creative problem solving and trustworthiness.

Thus, non-monetary or non-financial compensation includes any benefit an employee receives from an employer or job does not involve tangible value.

So as we have seen employers have a wide range of compensation elements from which to choose. By combining many of these compensation alternatives, progressive managers can create compensation packages that are as individual as the employees who receive them because while determining effective awards, the uniqueness of each employee must also be considered. Because different people have different needs and reasons for working process. Thus the most relevant compensation will meet these individual needs. To a large degree, adequate or fair compensation is in the mind of the employee. The one that corresponds to these demand can be a strategy which will contain a balance between internal equity and external competitiveness. Lets not forget that compensation should be beneficial for both sides: happiness and satisfaction of employees as well as effective realization of company's . Thus It is to company's advantage to guarantee that its employees are creatively compensated and knowledgeable of their benefits. All above mentioned we can assume in the table (Table 1.)

DIRECT

Equitable Wages and Salaries;

Market Adjustments or Cost of Living Increases;

Merit Increases or Performance bonuses;

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Fair Commissions.

NON-FINANCIAL

FINANCIAL

(Table 1)

THE JOB DESCRIPTION

Interesting Duties and Responsibilities;

Challenges;

Authority;

Autonomy;

Opportunity for recognition;

Feeling of achievement;

Advancement Opportunity.

WORK ENVIRONMENT

Fair and Consistent Practices and Policies;

Competent Supervision;

Fun and effective co-workers;

Comfortable and Safe Working Environment;

Flexible Scheduling;

Alternative Working Arrangements;

Modified Retirement.

INDIRECT

Insurance Plans:

Life, Supplementary Health, Dental, Vision, Disability Coverage

Social Security Benefits;

Retirement plans;

Employment Insurance;

Workers Compensation;

Educational Services;

Employee Services;

Paid absences;

Vacations;

Holidays;

Sick Leave;

Educational Leave;

Compassionate Leave.

As it has been already mentioned equity or fairness is a key factor in creating a successful compensation system. It can be defined in the following three ways:

Workplace equity which is about the perception that all employees in the company are being treated fairly.

External pay equity when employees in the company perceive that they are being rewarded fairly in comparison with those who perform similar jobs in other organizations.

Example 24: A number of non profit organizations have tried to address quality of life concerns by only requiring full-time employees to work a 35-hour week, while many other organizations require their employees to work 37.5 or even 40 hours per week.

Internal pay equity when employees in the company perceive that they are being rewarded fairly according to the relative value of their jobs within an organization

Example 25: An agency may employ a number of social workers to work with similar client groups. By reviewing the salary of each employee and comparing it with others in the same role, you will be able to determine if internal equity exists. This does not mean that all employees are paid the same; it means that they are paid fairly in relation to other staff in the same role. Differences in salary may be based on education, experience, years of service, or responsibility level.

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CHAPTER 2: Compensation: Good or Bad?

We have discussed the compensation types and mentioned their advantages and disadvantages. But the question here is are these rewarding systems a good idea? Are they that beneficial and necessary for both the employers or employees. Let us try to analyze by taking into consideration the scientific researches and examples

Compensation is considered to be a primary motivator for employees. And it sounds really fair. Because people are searching for those jobs that will suit not only their skills and talents but will compensate them both in terms of salary or benefits. Compensation is also one of the fastest changing fields in Human Resources, as companies continue to investigate various ways of rewarding employees for performance. Due to compensation the company can achieve several purposes assisting in recruitment, job performance as well as job satisfaction. Rewarding workers who performed well or excellent is the best way of increasing productivity and ensuring the dominance in its potential market because the payments will fulfill a promise to employees that better performance results in better compensation. Some can argue that compensation alternative is just wasting money and time for developing the one appropriate for the certain company while the others support the idea that even in down economy paying for performance is more productive than during economic boom by bringing the such reasons as The reason is that companies typically have a smaller amount of funds to be allocated for compensation during these times. As it already says a lot in order to not to loose employees. Child care and health benefits say that the company management values family. Giving longevity bonuses for employees on the

anniversaries of their employment with the company says that management
val