Compensation philosophy and critical components of a compensation strategy

Business

Compensation Philosophy and Critical Components of A Compensation Strategy Defining Compensation Compensation can be defined as the total paymentthat includes monetary as well as non-monetary part made to an employee in lieu of the work performed according to the need of an employer. Overview of Compensation Philosophy Compensation policies have been the most controversial topic in human resource management. Greene (2011) argues that compensation policies are framed in such a way that employees display higher commitment and performance, stay longer in the organization, exhibit stronger attendance and lesser absenteeism. Certain compensation policies can achieve these goals; most of the experts agree that above the scale and piece rate payments can reduce the absenteeism. Incentive schemes can also reduce the absenteeism to a large extent. Similarly, pension scheme or similar fringe benefits can enhance the employee tenure. Many experts have found that certain fringe benefits such as pension plan can reduce the employee turnover by as much as 20 percent. At the same time, fringe benefits other than health and ESOP do not produce any appreciable impact on employee turnover. Critical Components of a Compensation Strategy Greene (2011) argues that before formulating a compensation strategy it is necessary to identify all its components. It can be bifurcated in direct and indirect components of the compensation. Direct compensation is usually the largest component of the total rewards that organization pays to the employee. Also, the direct pay component is the most visible component of the compensation to employees. It can be further sub-divided as per the following. Basic Pay The basic pay is devised to cover minimum standard of living and it also takes into account the existing market levels within the same industry group. Short-term Variable Pay This provides an opportunity to the employee to earn additional direct compensation. The objective is to encourage team work to achieve organizational goals. This has linkages with the results hence it can be called a variable component of the total direct costs. Long-term variable Pay The component provides employees with a stake so as to reap long term fruits as the organization progresses. This also helps organization to retain key employees with them. Employee Benefits This component of compensation covers retirement needs, protecting employee income against illness or disability or pre-retirement death. Indirect Compensation Component Though direct compensation is the largest cost to the organization but currently, indirect compensation has also become quite significant part of the total cost. Currently, companies spend a lot on employee entertainment, on nice office, furniture, canteen, on group trips and many more. Though nothing goes in the pocket of an employee yet the company needs to spend a lot on all these activities. In smaller organizations, indirect spending does not help much as employee wants direct benefits in one way or the other; however fortune 500 companies are found to be spending a lot on indirect component such as on training and improving employee skills (Greene, 2012). Example of an Effective Compensation Practice/Policy Williams (2012) argues about the compensation that is most effective for every member of the company – from sales to administration; from marketing to research and development; from customer support to finance. The compensation that he describes about is made of base salary and commission. Commission is not paid at the end of year but every month so its visibility increases among its employees.

Employee motivation is at its highest to achieve organizational objectives. Salient features of the compensation philosophy can be described in the ensuing paragraph. Company's cost rises in direct proportion to the incoming cash and falls when reverse happens. Thus, company and their employees both are secured during difficult times and employees can see their rewards instantaneously as company’s performance improves. This is ideal for smaller companies where it is not possible to devise stock option scheme. Since all the employees get commission, everyone gets motivated to work toward betterment of the company and its set goals. Since focus is on revenue and profits, no gaps are seen between departments. This kind of compensation structure brings transparency and team building. Monthly budget is set in advance and working report is made available to all on daily basis. Beyond the target, profits are distributed in the ratio of one-third and two-third between the company and employees respectively. This kind of structure keeps everyone engaged and results are stupendous. The advantage is that highly motivated people prefer to join such companies. Employees continue to bring novelty at their work places in product design and services. Deploying above compensation policy, Williams (2012) establishes that the company called Fishbowl could achieve growth of 70% per year beginning from 2007 until date with a staff turnover of less than 10 percent per year. Such growth pattern is astonishing because the economy of the world and the US in particular is in doldrums since 2008. References

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