Establishing a pay structure commerce essay

Compensation is an important factor for HR people. Indeed, it is a way to motivate employees and increase their job satisfaction. However, determine the right compensation for each individual inside the company is not an easy task: it will depend on several factors that will be discussed in this paper.

Organizations make decisions to define a job structure, or relative pay for different jobs within the organization. They establish relative pay for different functions and different levels of responsibility for each function. Organizations also must establish pay levels, or the average paid for the different jobs. These decisions are based on the organization's goals, market data, legal requirements and principles of fairness. Together, job structure and pay level establish a pay structure policy.

To be effective, the compensation must be competitive in the market, perceived as fair by employees, accurately based, motivating and easily understandable. Thus, in order to achieve it a pay structure policy can help in this process. A pay structure dresses a hierarchy of job types and grades with the associated compensation and benefits. It is a term for the array of pay rates within the organization and representing the degree of slope in its pay policy (Milkovich & Newman, 2002). Characteristics of a particular pay structure include the number of levels in the structure, the size of the pay differentials between each level in the structure, and the rate at which employees can progress through each level in the structure (Gerhart & Milkovich, 1992).

In order to realize this paper, I interviewed to HR managers that gave me their thoughts about the subject and experience.

The paper will begin with the legal requirements that a company has to respect when setting compensation in the United States, and then it will focus on the factors.

Legal Requirements

At work employees are protected by several regulations in terms of selection, health and safety, labor, etc and of course pay. When establishing a pay structure, organizations face some laws put in place by the government that may vary according to the country where the employees of the company work. There are mainly five types of constraints that companies have to take into consideration in order to avoid troubles: equal employment opportunity, minimum wages, pay for overtime and prevailing wages for federal contractors and child labor.

Equal Employment Opportunity

The Equal Employment Opportunity (EEO) gathers several laws from the Civil Rights Act, American With Disabilities Act, Age discrimination in Employment Act and Genetic Information Nondiscrimination Act. These laws protect employees from discrimination in hiring, promotion, discharge, pay, fringe benefits, job training, classification, referral and other aspects of employment according to employees’ race, color, religion, sex, origin, disability, genetics and age.

Thus, to meet the standard of EEO, employers must provide equal pay for equal work, regardless of these criteria. However it does not guarantee equal pay between men and women or young and old, etc. Indeed, differences in pay may appear but they must have good explanations relative to the business such as job responsibilities, skills, performance etc.

To summarize, two employees doing the same job cannot be paid differently because of the previous criteria mentioned otherwise it would be considered as illegal. However, if one of the employees has some particular skills, or other business related considerations, the two employees might have a different pay.

Fair Labor Standards Act

The Fair Labor Standards Act (FLSA) is administered by the Wage and Hour Division (WHD) and establishes the federal minimum wage, overtime pay and child employment standards that most of companies must comply with. It applies to most of companies operating in the US and exempts some employees such as executives, professionals and outside sales persons.

Under the FLSA, the employer must pay at least the minimum wage established by the law. Nonetheless some states and local governments have established higher minimum wages. In cases of where an employee works under state and federal minimum wage law he should be paid with the highest one. A minimum wage corresponds to the lowest compensation an employee can receive for the work s/he has performed. In 2012, the current minimum wage set by the FLSA in the United States is $7. 25. In addition, the FLSA establishes a youth minimum wage for the first 90 consecutive days of employment of people under 20 years old which represents around 85% of the minimum wage.

The FLSA also requires overtime pay for hours worked beyond 40 in each week. Thus employees should be paid at a different rate for extra hours. This rate is set at one and a half times the employee’s regular pay rate including bonuses. Overtime pay is required even if the employer did not ask the employee to work more. Moreover, there is no limit on the number of hours an employee can work during a week.

Finally, employers must meet FLSA requirements concerning child labor (children younger than 18 years old) which basically restrict the use of child labor within a company. They must be paid at the minimum wage, as adults, or youth minimum wage (for the first 90 days).

Any violation of the act may result to penalties and sanctions.

Prevailing Wages for Federal Contractors

The U. S. Department of Labor (DOL) Employment Standards Administration’s Wage and Hour Division (WHD) administers laws and regulations requiring minimum wages to be paid to workers performing construction work on federally-funded contracts or providing services to the federal government. Federal contractors must meet the requirements to pay at least the prevailing wages in the area where there employees work, that is to say the hour rate paid to the majority of workers in a specific area. It is defined by regulatory agencies.

It exists two federal laws that cover employees’ pay policy in this field:

Davis-Bacon Act for construction contractors that receive more than $2, 000 in federal money.

Walsh-Healy Public Contracts Act for all government contractors receiving $10, 000 or more in federal funds.

Economic Factors on Compensation

An organization cannot make spending decisions independent of the economy. Organizations must keep costs low enough so that they can sell their products profitably, however they must be able to attract workers in a competitive labor market. Thus, to remain competitive, employers must meet the demands of product and labor markets.

Product Markets

Product market is a market in which competing final goods and services are exchanged. Companies must be competitive in product markets so that they can generate enough profit in order to pay their employees. The more the competition, the more companies will reduce costs because they are unable to increase prices without losing money.

In addition, product markets seek to buy at the lowest price, so organizations must limit their costs as much as possible. Indeed, an organization that has high labor cost will have to raise its prices for similar products already available on the market.

In this way, product markets place an upper limit on the pay an employer can afford to offer for a specific job.

Labor Markets

In order to define labor market, we need to define its demand and supply. The demand side focus on the employer’s actions, that is to say how much he is willing to pay and how much employees he is looking for. The supply side consists of workers who want to earn as much as possible. To attract and keep workers, employers must pay at least the going rate in their labor markets. That is to say, to remain competitive in the labor market, organizations in a similar area have to pay this minimum amount to hire the most qualified employees.

In this way, labor markets place a lower limit on the pay an employer must be willing to offer for a specific job.

Pay Policy Identification

Organizations make decisions about whether to pay at, above or below the pay rate set by these market forces. Paying above the market rate may make the organization less competitive in product markets but give it an advantage in labor markets. The organization benefits only if it can attract the best candidates and provide the system that motivate and enable them to do their best work. Furthermore, the efficiency wage theory (A. Marshall, 1920) explains that paying employees above the market rate increase productivity and efficiency for firms. Indeed, thanks to that they would be able to avoid shirk, reduce employees' turnover, attract the best people, provide motivation for employees and allow them to eat so that they are less willing to be sick.

Organizations that pay below the market rate need creative practices for recruiting and training workers so that they can find and keep enough qualified people. It is the less recommended strategy. If an organization choose it, it is probably because it has not enough financial resources to pay its employees, however in order to keep employees or even attract them the company must provide other non-financial advantages. Companies that are using this strategy experience high rates of employees' dissatisfaction, high turnover and low productivity.

The most use strategy is to match the market by paying the same pay for same jobs. Indeed by setting the same pay level, companies are able to remain competitive while managing their labor costs.

Benchmarking

In order to define the going rate in the market, companies use benchmarking. It consists for them to compare their own practices in terms of pay with the ones practiced by their competitors. Benchmarking is done through pay surveys to the right competitors, for the right jobs, and through the right methods (phone interviews, personal interviews, questionnaire, etc.). This is usually done by some agencies, especially the US bureau of labor statistics, with National Compensation Survey; rather than by the company itself.

While developing a pay survey, companies must take into the two previous factors mentioned in pay level decisions (product market and labor market). Indeed, according to the goal of the company, it will focus more on product markets or labor markets comparisons.

Pay structure related to jobs

Along economic forces, organizations must consider the relative contribution each job should make to the organization's overall performance. Creation of a pay structure requires that the organization develop an internal structure showing the relative contribution of its various jobs, called job structure. One way to do it is through job evaluation.

Job evaluation

Job evaluation has several objectives, it can help to:

Define what positions and job responsibilities are similar

Decide right pay grades and other compensation issues

Develop job classifications

Help employees along their career path

Organizations typically begin with a job evaluation to measure the relative worth of their jobs. A job evaluation committee identifies each job's compensable factors and rates each factor. These compensable factors are the specificities that each job requires and that the company decided to value most and pay for its employees, such as education, skills, effort, job complexity, responsibilities, working conditions, experiences of the employee, etc. Then, for each factor the organizations define several degrees (usually no more than five) in order to judge the degree of a factor existing in a job. Once it is done, the committee assigns points for each factors and degrees. In order to simplify this process the committee may write down a job evaluation manual and use it to evaluate each job according to their significance into the organization.

Pay Structure Creation

The committee can research market pay levels for key jobs, then identify appropriate rates of pay for other jobs, based on their number of points relative to the key jobs. The organization can do this with a pay policy line, which plots a salary for each job. The pay policy line is a graph that shows the relationships between job evaluation and pay rate. It is then used to define the compensation for non-key jobs, for which the company has no data.

The organization can combine jobs into several groups, called pay grades. For each pay grade or job, the organization typically establishes a pay range that will determine a minimum, midpoint and maximum of pay for a specific job or job within a specific pay grade, using the market rate or pay policy line as a midpoint. Thus, the salary of an employee may change according to some factors such as performance, seniority, etc. However, for some reasons, it is possible that an employee’s pay fall outside the pay range that the organization established. For instance, when an employee pay rate fall below the pay range for the job, it is called “ green-circle rate”. It can happen when the employee has been promoted to a new position that is under a new pay grade. Conversely, when the employee pay rate fall above the pay range for the job, it is called “ red-circle rate”. It can happen when the employee is demoted and keeps his/her current compensation. When these kinds of situation happen it is important for the company to solve the problem, nonetheless it is still rare.

Differences in working conditions or labor markets sometimes call for the use of pay differentials to adjust pay levels. For instance, some companies pay a differential for night work to compensate them.

Alternatives to Job-Based Pay

To obtain more flexibility, organizations may reduce the levels in the organization's job structure. This process of delayering creates broad bands of jobs with a pay range for each. Other organizations reward employees according to their knowledge and skills. They establish skill-based pay systems, or structures that set pay according to the employees' level of knowledge and what they are capable of doing. This encourages employees to be more flexible and adapt to changing technology. However, if the organization does not also provide systems in which employees can apply new skills, it may be paying them for skills they do not actually use.

Monitoring Compensation Costs

The Human Resource Department should routinely compare actual pay with the pay structure to see that policies and practices match. A common way to do this is to measure a compa-ratio for each job or pay grade. The compa-ratio is the ratio of average pay to midpoint of the pay range. Assuming the pay structure supports the organization's goals, the compa-ratio should be close to 1. When compa-ratios are more or less than 1, the HR department should work with managers to identify whether to adjust the pay structure or the organization's pay practices.

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