

What are the four
policy issues in the
pay model?



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In the Pay Model, there are four policies that have been used for determining for paying the employee the organization such as internal alignment, external competitiveness, employee contributions and of the pay system but two most important pay model policies are internal alignment and external competitiveness. This is because in internal alignment look how job and skills related to importance to achieve organization objectives. In another way, we look also other method pay model, which is external competitiveness, which indicates of pay comparisons to with the competitor. Not only basic salary or wages are concerned but also what method of payment should be using the organization use for paying their employee of such as base, incentives, stock, benefits are used by these competitors use to compared to the pay mix we use to compete with other organization to stay remain competitive than competitor pay scheme.

Compensation also related directly influence key outcomes like job satisfaction, attraction, retention, performance, flexibility, cooperation, skill acquisition and so forth. However, its influence may also be indirect by facilitating or constraining the effectiveness of other human resource activities (Gerhart and Milkovich, 1991). Compensation is only one part of the policies and programs organizations use to manage employee relations. Decisions regarding employment security, development and training, career opportunities, employee assistance programs are important to decide before proceed what method and how it can be done in compensating employee (Milkovich and Broderick, 1989).

In this article not the only definition of external competitive and internal alignment are discussed but also why these elements are important to the

organization to stay competitive and retain high qualified employee with skills and knowledge need by organization to focus on to achieve goals and objective of the organization that operates around the world that has been studied by many researchers before. We also see why external competitive element plays so many roles in determining the success of the organization rather than internal alignment in the organization.

Definition of internal alignment and external competitiveness

Internal alignment or internal equity is refers to comparisons among jobs or skill levels inside a single organisations (Milkovich and Newman, 2008). Jobs and people's skills are compared in terms of their relative contributions to the organisations' business objectives. In Internal alignment also focus on why pay relationships that motivating employees to choose increased training and greater responsibility in dealing with customers, internal pay relationships indirectly affect the capabilities of the workforce and hence the efficiency of the entire organization. This also agree by report Business for Social Responsibility (BSR) Report, 2008) that defines internal alignment is the set of commitments, strategies, policies, procedures, systems and behaviours that support integrated customer decision making based on suppliers' commercial and ethical commitment and performance. This is translated into practice by the basic techniques of reward management, job analysis, job evaluation, and performance appraisal. The focus is on comparing jobs and individuals in terms of their relative contributions to the organization's objectives (Bratton and Gold, 2001).

Pay relationships within the organization affect all three compensation objectives in internal alignment. This method also affect employee decisions which to stay with the organization or leave the organization. Then the organization must motivating employees to attend training and seek greater responsibility in dealing with customers, internal pay relationships indirectly affect the capabilities of the workforce and hence the efficiency of the entire organization. Fairness is affected through employees' comparisons of their pay to the pay of others in the organization.

If the internal alignment is refers in single organization but either way external competitiveness which refers to pay comparisons with competitors. This basically involves when implementing in organization which are, to be a pay leader, to match the market rate, or to lag behind what competitive organizations are paying (Bratton and Gold, 1999). Basically when practicing external competitiveness two ways first by setting pay level that is above, below or equal to that of competitor secondly, determining of pay mix relative to those of competitors. In both of pay level and pay mix focuses in two objectives which are control cost and attract and retain employee (Milkovich and Newman, 2008). External competitiveness refers to comparisons of the organization's pay relative to the pay of competitive organizations (Bratton and Gold, 2001).

Objective of determining external competitiveness decisions in terms of both how much and what forms are (Milkovich and Newman, 2008);

To ensure that the pay is sufficient to attract and retain employees if employees do not perceive their pay as competitive in comparison to what

other organizations are offering for similar work, they may be more likely to leave

To control labour costs so that the organization's prices of products or services can remain competitive in a global economy.

Overall the internal alignment and external competitiveness are essential to compensation includes any direct or indirect payments to employees, such as wages, bonuses, stock, and benefits. So external competitiveness directly affects both efficiency and fairness and it must do so in an ethical way that complies with relevant legislation and internal alignment seek that where organizations internal drivers, include vision and mission as well as general goals, are aligned with their words and actions.

Factors in internal alignment and external competitiveness

In internal alignment factors are divided into three which are External Factors, Organizational Factors and Internal and External Factors combine (Milkovich and Newman, 2008). In external factors divided into several categories which are economic pressures, government policies, laws, and regulations, external stakeholders, cultures and customs. Then in organizational factors also divided into strategy technology, human capital, HR (Human Resource) policy, employee acceptance and cost implications. All these factors can be explained in diagram 1 below;

Source: Milkovich and Newman (2008)

In external factors, there is economic pressure which has been studied before by Adam Smith and Karl Marx, which also determine marginal

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productivity that what need of an input (factor of production) the extra is output that can be produced by one using more units of the input and then supply and demand needed for paid wages and purchasing products. In government policies, laws and regulations are which every organization must follow to stay operational in certain country they business on. Finally on culture and customs according G. Hofstede (1980) is ' the mental programming for processing information that the people share in common'. This also translate into organization culture that help organizational values to develop organizational norms, guidelines, or expectations that prescribe appropriate kinds of behaviour by employees in particular situations and control the behaviour of organizational members towards one another.

Organization factors also play crucial part of the determining compensation in internal alignment. First strategy of any compensation method must alignment with organization goals and mission to make sure that any compensation that given to workers is paid back by workers fulfills goals and mission of organization they work for. Technology is the usage and knowledge of tools, techniques, crafts, systems or methods of organization in order to solve a problem. Then Human capital refers to the stock of competences, knowledge and personality attributes embodied in the ability to perform labor so as to produce economic value¹. After that HR (Human Resource) policy are the mechanisms that handling risk by staying up to date with current trends in employment standards and legislation. The policies must be stated in proper manner to ensure that companies vision & the human resource helping the company to achieve it or work towards it are at all levels benefited and at the same time not deviated from their main

objective. Then only that worker can have of 'career progress' to ensure that employee can give the best productivity towards organization. Finally when all organization factors has been determined the organization must calculate the cost to sure that is beyond the budget to stay in operation of the company. In internal structure is refers array of pay rates for different work or skills within a single organization. The number of levels, the differentials in pay between the levels, and the criteria used to determine those differences describe the structure.

In determining external competitiveness this question should be ask what level of pay base, benefits, incentive, and perquisites should be offered relative to competitors? What mix of these forms should be offered either by fix salary, flexible benefits, stock options, cash bonuses, and stock appreciation rights, etc.? What should the proportion of guaranteed compensation (base or benefits) relative to riskier returns (incentives) be? It is also determined by labour market that determine supply and demand that usually employers or organization always seek to maximize profits, then people are homogeneous and therefore interchangeable, after that pay rates reflect all costs associated with employment and finally markets faced by employers are competitive to other organizations. Product market and labor market competition may provide on the part of employers in choosing a pay level (Gerhart & Milkovich, 1990). Product market comparisons are critical, more resources need to be devoted to measuring compensation (or better, unit labor costs) paid by such organizations. In contrast, if labor market comparisons are important, it is necessary to devote resources to find out to which organizations applicants and employees are being lost (Gerhart and

Milkovich, 1991). In organization factors that will create competitiveness that influenced by pay level and pay mix either in industry, strategy, size and individual manager. Pay mix and pay level decisions focus on first controlling costs and attracting and secondly retaining employees (Milkovich and Newman, 2008). Equation of pay level is shown below;

Pay level = ((base + bonuses + benefits + value of stocks)) / (number of employees)

All factors in external competitiveness are showed in table 1 below;

- Labour Markets
- Nature of Supply
- Level of Product Demand
- Individual Manager

Similarities in internal alignment and external competitiveness

In determining internal alignment or external competitiveness or both used for designing the compensation package for an employee in an organization, there are similarities between them, which are efficiency, fairness and compliance.

First, efficiency that can help imply the future return can encourage employees to remain within the organization, increasing experience and training, cooperate with workers and seek greater responsibility for the sake of organization they work for. This will diminish shirking among workers and permit hiring best qualified employees (Milkovich and Newman, 2008).

Second, fairness also shows that organization must be fair to ensure that good employees don't retire and sustain organization productivity and trust among employees. Even though not everyone is paid equal but at least must be fair according to job, skills and knowledge a certain employee had so what happens when that is perceived as too large? Fortune (1989), for example asserts that this differential is seen by employees as unfair, resulting in a "trust gap" which suggests that such differentials are necessary to provide incentives for expending effort and taking on added responsibilities and risks to the organization which resulted in higher turnover and dissatisfaction among an employee who works for the organization.

Finally, in compliance which compensation either in internal alignment or external alignment must be complied either in terms of policy, rules, acts and regulations that have been set up by government? Other than that this to ensure that all necessary governance requirements can be met without the unnecessary organization manipulation when operating in certain countries.

Why is external competitiveness so important rather than internal alignment?

External competitiveness is established by reference to job advertisements in the press, or by more systematic labour market surveys. This information is then used to construct a pay structure within the organization rather than internal alignment which more in structure of pay is based only on knowledge, skills and ability that certain individuals had to offer within a single organization. So that why in determining pay structure and compensation

method must have external competitiveness to focus and to maintain competitive to another organization. There are several reasons why external competitiveness important rather than internal alignment like following below;

- Reduce negative perception of employee towards organization.
- Pay only what be supposed to the organization should be paid towards workers.
- Get better view what the other organization does to compensate the workers to make workers motivate and minimized turnover among them.
- Internal alignment is very completed process and hard to implement in organization.
- External competitiveness is more strategic rather than internal alignment.
- Reduce negative perception of employee towards organization.

While employees' negative feelings concerning internal pay equity might be removed by an effective job evaluation scheme, employees will still compare their pay with those in other organizations and industries (Bratton and Gold, 2001). It so is better having combined internal and external to the same to fulfil employee needs and reduce turnover at the same time. These as well agreed by (Milkovich and Broderick, 1989) which choices about the competitive position besides communicating to both prospective and incumbent employees. Savvy employees, for example, can discern the organization's ability and willingness to recognize their needs based on the flexibility and tax protection offered in benefit plans or the opportunity to

share in the organization success through stock- and performance-based plans.

Even that not all internal alignment structure can be a success one like in General Electric Co.'s in 1980's plastics division adopted an exempt pay structure with only four levels: executive, director, leadership, and technical and professional. Managers believe that it provides greater flexibility to move employees without requiring pay changes. It also communicates to employees a relatively egalitarian philosophy about the value (base pay) of different skill groups. However, to be successful, the increased flexibility must be managed effectively. Inconsistencies within levels can result in anarchy and quickly will lead to employee dissatisfaction and distrust (Milkovich and Broderick, 1989).

According to Spence (1973) which has studied case of sales jobs, if there is not a large incentive component in which individual effort is important, and one or more of the following three consequences is likely to happen:

- The right people will not be attracted,
- They are attracted, but leave when they discover that their efforts are under rewarded,
- The right people are attracted and retained, but because they are not rewarded for high performance, their performance declines.

Rynes (1987) also supported of Spence (1973) idea that " compensation systems are capable of attracting (or repelling) the right kinds of people because they communicate so much about an organization's philosophy, values, and practices". Milkovich & Bloom (1998) also finds that

compensation systems must support organizational goals, foster corporate culture, and help motivate employees to contribute their efforts to further organizational success.

Pay only what the organization should be paid towards workers.

The fact that value to the employee may differ from cost to an employer suggests that, in some cases, fewer costly total compensation packages may actually provide total inducements that are of greater value to employees than those associated with more expensive packages if internal alignment is used for determining pay and compensation for an employee who works for the organization. In many cases, costly benefit options might be the most expensive; their value to employees might fall short of the value attached to a compensation package of benefits that is better tailored to employee needs or values. In another study, in which 2000 manufacturing firms were classified into growth, mature, or declining stages, Anderson and Zeithaml (1984) reported that the firms' competitiveness (pay level relative to competitors) was greater in each progressive stage. They also reported that the higher relative pay in mature firms adversely affected their return on investment. However, growth firms with higher pay levels relative to competitors' reported increased market share of these companies.

Therefore, measurement of own and competitors' pay levels would ideally include the value to employees of different elements of total compensation. Like the study of Gerhart and Milkovich (1991) in Bank of America, which eliminated retiree health care coverage for all new hires, suggests that organizations

believe that different groups of employees (for this, new hires) may differ in the value attached to particular aspects of compensation.

Get better view what the other organization does to compensate the workers to make workers motivate and minimized turnover among them.

In world of the organization which has paid the works to work not only related in external market without seeing what actually other organization are doing to survive and maintain efficiency of current in the organization. Many organization today organizations do not compete solely in the product market but more refer to market for labour. The classical economics literature suggests that product market and labour market competition may provide relatively little discretion on the part of employers in choosing a pay level (Gerhart & Milkovich, 1990).

Ford, for example, competes for engineers, lawyers, and human resource managers not only with other automotive companies, but also with companies in the computer, aerospace, electronics, and other industries. Fay (1989) also recognizes that organizations are attempted to gather information about pay practices of competitors through the use of pay surveys. As Rynes and Milkovich (1986) found out, administrative decisions are required about a range of issues including when compensate workers:

- Which employers are included?
- Which jobs are included?
- Which jobs are considered similar enough to use in benchmarking?

If multiple surveys are used (fairly typical), how are the multiple rates of pay weighted and combined? Practice in these areas seems to vary across (and probably within) employers.

If not following what Rynes and Milkovich (1986) has been done which make the organization make pay level that is too low relative to these competitors could lead to difficulties in attracting and retaining sufficient numbers of quality employees. As such, labour market competition can be seen as placing a lower bound or floor on pay level (Milkovich & Newman, 1990). As the importance of a particular comparison increases, so too should the resources devoted to information and measurement. For example, if product market comparisons are critical, more resources need to be devoted to measuring compensation (or better, unit labor costs) paid by such organizations. In contrast, if labor market comparisons are important, it is necessary to devote resources to find out to which organizations applicants and employees are being lost (Gerhart and Milkovich, 1991).

Internal alignment is very completed process and hard to implement in organization.

Internal alignment is very completed process and hard to implement in the organization even though validity of conclusions reached through the survey process may depend critically on how the competition is defined, for example, what organizations are chosen for inclusion, little evidence exists on how such choices are made or their implications. Rather, most attention has been focused on potential problems in the job evaluation process, especially in the context of pay equity or comparable worth discussions.

Nevertheless, as Schwab (1980) has pointed out, job evaluation is usually “validated” against some measure of the market rate, meaning that the

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measure of the pay system is critical. In this manner, many organizations today focus on external competitiveness which is more reliable than internal alignment for determining the compensation scheme for an employee. This has agreed by Lawler (1986) has argued that organizations need to focus greater attention on external competitiveness He believes that an internal focus encourages employees to compare themselves with others within the organization, rather than focusing on the really competition-other organizations. He also suggests that an internal focus result in employees focusing on promotions rather than on performing well on their current job. Moreover, there is some belief that conflicts between external and internal equity may be resolved by increasing the pay of all jobs, not just those were competing in the labour market requires higher pay. Whether true or not, such as organizations would seem to be at a serious labour cost disadvantage in the product market.

External competitiveness is more strategic rather than internal alignment.

The strategic portfolio model suggests that the notion of compensation system ' fit' may be a messy construct to be done. Generally, strategy refers to the overarching, long-term directions of an organization that are critical to its survival and success. Strategies take advantage of the opportunities and manage the threats in the external environment by marshalling internal resources in some coherent, consistent direction (Dyer, 1985). In from a strategic perspective, organizations and markets are more appropriate units of analysis for understanding changes in international compensation and rewards. The strategic thinking from differences between countries to differences within countries so using internal alignment as medium are

unrealistic. Compensation and reward systems are designed to help create and motivate a workforce with the values and capabilities necessary to achieve an organization's unique goals and objectives rather than being designed to meet the national values exhibited by a work force (Bloom, Matt and Milkovich, 1998). Morishima's (1995) study of Japanese companies' HR strategies reports differences in compensation approaches associated with organization profitability, size, degree of unionization, capital-labour ratio, and exposure to global competitive forces. For example, Japanese companies operating in protected domestic markets are more likely to use the more traditional *nenko* system² than those competing in global and less protected market which reported using more performance and ability-based schemes (Morishima, 1992, 1995; Sano, 1993). Other study related to strategic conditions by Lee, Scarpello, and Rockman (1995) found that factors such as labour market conditions, customer and supplier relations, economic conditions and technology accounted for differences in compensation strategies among Korean chaebols. Pearce, Branyiczki, & Bakacsi's (1994) study of compensation systems in Hungarian and US companies suggests that political, economic, and institutional forces, rather than national cultures, explain differences in compensation practices. Effective international compensation systems might be those that match internal contingencies for example fit the organization's goals and culture first and then respond to external forces within the constraints of strategic alignment (Bloom, Matt and Milkovich, 1998).

Yeung and Wong (1990) assert that organizational goals, political forces, labor market conditions, and demographic factors explain differences in pay

and other HRM systems in Japan and the People's Republic of China. Recent surveys in Central European countries such as Slovenia and Slovakia also report differences in the use of variable performance based pay schemes, allowances and services, and even in the ratios of top managing directors' salaries to the average workforce (Bajzikova, 1996; Zupan, 1995). Although the recent evidence does not suggest national boundaries (national pay systems) can be ignored or overlooked, it does suggest that sufficient discretion for individual organizations exists within these national systems to allow organizations to adopt compensation and reward systems to align them with the organization's business strategies. We believe that

The importance of a strategic perspective on compensation rests on three fundamental tenets. The first is that compensation policies and practices differ widely across organizations and across employee groups within organizations. To some students of organizations this may be self evident. But to others, such as economists using human capital models to examine compensation differentials, differences in organizations' compensation policies and practices are treated as random noise with little relevance. Anecdotal evidence and sporadic surveys of specific policies or practices report that differences do exist (The Conference Board, 1984; American Productivity Center, 1987). For example, some organizations claim to position their base pay to meet the market, while others follow it; some design incentive schemes to emphasize long-term performance, others short term. Some firms employ individual based incentives while others emphasize group or team based gain-sharing schemes. Some decentralize the administration of compensation, others do not. Some disclose very specific

information about pay to employees, such as ranges and merit guide charts, while others communicate only the broad policies, such as fairness and competitiveness. So a strategy may be intended and formally articulated in some plan or document, or it may emerge through the patterns of decisions shown by the organization's behaviors. Thus, strategies are both plans for the future and patterns from the past to make survival of the organization itself (Mintzberg, 1987). External competitiveness strategies are often expressed as leading, lagging, or matching the market (Milkovich & Newman, 2007). In practice, many organizations pursue more than one external competitiveness strategy (Mark, 2008). These organizations may vary their external competitiveness strategies for different groups of jobs. For instance, some organizations may lead for positions deemed critical, whereas for less significant positions they may match or lag the market (Milkovich & Newman, 2007).

What can conclude about this topic?

External competitiveness is but one part of an organization's overall compensation strategy. In addition to external competitiveness considerations, issues of internal salary alignment, the design of pay for performance plans, and the administration of the overall pay system are also important. Of these areas, internal salary alignment seems a particularly pertinent area of consideration for those interested in further expanding their knowledge of compensation topics beyond external competitiveness.

Internal alignment considers pay relationships between employees inside an organization versus the external relationships considered by external competitiveness. Whereas external competitiveness considers salary

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comparisons across organizations for employees performing similar work, internal alignment considers salary comparisons inside organizations for employees doing different types of work. Moreover, just as external competitiveness has significant implications for individual and organizational performance, internal alignment has equally important implications.

Recommendations

The policy on external competitiveness is important if the organization is going to attract, retain, and motivate its employees while achieving the other objectives of controlling labour costs and complying with pay legislation around must be consider due of lack of study about this. To the individual employee, compensation decisions also have important consequences. Salaries and wages represent the main sources of income for most people, and may also be taken as key indicators of a person's social standing or success in life. Benefits, such as health care and pensions, are also important determinants of well being and financial security among employees and their dependents. Not surprisingly then, employees have sought to influence such decisions in a variety of ways, including through unions, supporting government regulation of compensation decisions, and through the courts.

Then we must also study more element of strategic involved in determine whatever to attract and retain people in jobs having more unfavourable non-compensation attributes, a compensating differential (for example, higher pay or same pay) is required. Therefore, it is important to understand how individuals are affected by (and react to) different compensation decisions (Gerhart and Milkovich, 1991). Such as what determines variations in <https://assignbuster.com/what-are-the-four-policy-issues-in-the-pay-model/>

patterns of compensation decisions their effects. On the other hand, issues too generally drawn are too time consuming, too ambiguous, too expensive, and often poorly specified. Perhaps a place to begin is to identify compensation decisions that have strategic properties must be included in next study to elaborate more why people attracted to better compensation at organization their work for?

Dyer and Theriault's (1976) also mention that in early indication of the potential importance of procedural justice, in addition to distributive justice, in compensation but many researchers has less mention about this manner. Although this particular increment was not large, procedural justice perceptions also explained variance in organizational commitment and trust in supervisor, suggesting that its influence on broader organization attitudes may be greater.

Beyond descriptive research, more work is needed to understand both what determines variations in patterns of compensation decisions their effects. A major challenge is to formulate manageable research issues. Issues too narrowly defined suffer from ignoring the multi- dimensionality of compensation and the context in which compensation decisions occur. On the other hand, issues too broadly drawn are too time consuming, too ambiguous, too expensive, and often poorly specified. Perhaps a place to begin is to identify compensation decisions that have strategic properties. For example, do firms within the same industry establish different competitive positions in labour markets? Conventional wisdom is that they do. How do they accomplish this-by different average levels of base pay, by varying the risk-return tradeoffs or the ratio of incentives to total

compensation? Do characteristics of organizations vary with their competitive position? These might include some of the determinants discussed in this paper such as organization strategies, organization characteristics, and external factors. Finally does a firm's competitive position have any discernable effect on the size and quality of the applicant pool, on its ability to hire those people it se