

Chapter Nine – Self Notes
MANAGING COMPENSATION
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SUMMARY

OUTCOME 1 Establishing compensation programs requires both large and small organizations to consider specific goals: for example, employee retention, compensation distribution, and adherence to a budget. Compensation must reward employees for past efforts (pay for performance) while motivating employees' future performance. Internal and external equity of the pay program affect employees' concepts of fairness. Organizations must balance each of these concerns while still remaining competitive. The ability to attract qualified employees while controlling labour costs is a major factor in allowing

OUTCOME 3 Organizations use one of four basic job evaluation techniques to determine the relative worth of jobs. The job ranking system arranges jobs in numerical order on the basis of the importance of the job's duties and responsibilities to the organization. The job classification system slots jobs into preestablished grades. Higher rated grades will require more responsibilities and more important job duties. The point system of job evaluation uses a point scheme based on the compensable job factors of skill, effort, responsibility, and working conditions. The more compensable factors a job possesses, the more points are assigned to it. Jobs with higher accumulated points are considered more valuable to the organization. The work valuation system evaluates jobs based on their value relative to organizational goals—financial, customer service, and so on—and the job's contribution to organization success.

OUTCOME 4 Wage surveys determine the external equity of jobs. Data obtained from surveys will facilitate establishing the organization's wage policy while ensuring that the employer does not pay more, or less, than needed for jobs in the relevant labour market.

organizations to remain viable in domestic or international markets.

OUTCOME 2 The basis on which compensation payments are determined and the way they are administered can significantly affect employee productivity and the achievement of organizational goals. Internal influences include the employer's compensation policy, worth of the job, performance of the employee, and the employer's ability to pay. External factors influencing wage rates include labour market conditions, area wage rates, cost of living, outcomes of collective bargaining, and legal requirements.

OUTCOME 5 The wage structure is composed of the wage curve, pay grades, and rate ranges. The wage curve depicts graphically the pay rates assigned to jobs within each pay grade. Pay grades represent the grouping of similar jobs on the basis of their relative worth. Each pay grade will include a rate range. Rate ranges will have a midpoint and minimum and maximum pay rates for all jobs in the pay grade.

OUTCOME 6 The federal and provincial governments regulate compensation through the *Canada Labour Code*, employment standards acts, and employment equity/pay equity legislation.

OUTCOME 7 The concept of equal pay for work of equal value seeks to overcome the fact that jobs held by women are compensated at a lower rate than those performed by men. This happens even though both types of jobs may contribute equally to organizational productivity. Wage-rate compression largely affects managerial and senior employees as the pay given to new employees or the wage increases gained through collective agreements erode the pay differences between these groups.

OUTCOME ONE: STRATEGIC COMPENSATION

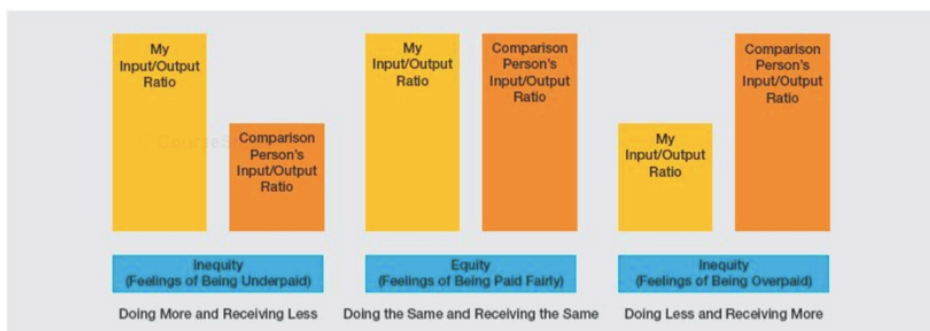
- **Total Rewards:** An integrated package of all rewards (monetary, non-monetary, extrinsic, and intrinsic).
 - To attract, retain, and engage employees.
 - Aligned to company's strategy: provide value.

- **3 components of compensation:**
 1. **Direct Compensation**
 - Encompasses employee wages and salaries, incentives, bonuses, and commissions.
 2. **Indirect Compensation**
 - Comprise of many benefits supplied by employers.
 3. **Nonfinancial compensation**
 - Includes employee recognition programs, rewarding jobs, organizational support, work environment, and flexible work hours to accommodate personal needs.
- Strategic compensation of employees in ways that enhance motivation and growth while at the same time aligning their efforts with the objectives, philosophies, and culture of the organization.
- Strategic planning goes beyond determining what market rates to pay employees.
- Ex. Google's decision to increase base pay for all its employees was a strategic move to be more competitive with market rates, but they also offer flexible work schedules, innovative benefits, and an opportunity to work on exciting new products.
- If pay rates are high, a large applicant pool is created, and as a result, organizations may choose to raise their selection standards and hire better-qualified employees.
- **3 aspects of strategic compensation planning:**
 1. **Linking Compensation to Organizational Objectives**
 - Due to the revolution of domestic competition, globalization, increase employee skill requirements, and new technology, managers in today's dynamic business environment have had to change their pay philosophies from paying for a specific job title or position to also rewarding employees on the basis of their individual competencies or work contributions to organizational success.
 - 91% of organizations link their pay strategy with organizational performance.
 - **7 goals of a strategic compensation policy:**
 - I. To reward employees' past performance.
 - II. To remain competitive in the labour market.
 - III. To maintain salary equity among employees.
 - IV. To mesh employees' future performance with organizational goals.
 - V. To control the compensation budget.
 - VI. To attract new employees.
 - VII. To reduce unnecessary turnover.
 2. **Pay-for-Performance Standard**
 3. **Motivating Employees Through Compensation**

- Employee development is influenced by the accuracy of their knowledge and understanding of the compensation program's strategic objectives.
- **2 theories to explain the motivating effects of an organization's compensation systems:**
 - I. **Equity Theory**
 - A motivation theory that explains how people respond to situations in which they feel they have received less (or more) than they deserve.
 - It states that individuals form a ratio of their inputs (abilities, skills, experiences) in a situation to their outcomes (salary, benefits) in that situation.
 - They then compare the value of that ratio to the value or the input/output ratio for other individuals in similar class of jobs either internal or external to the organization.
 - If the value of their ratio equals the value of another's (referent others) they perceive the situation as equitable, and no tension exists.
 - If they perceive their input/output ratio as inequitable relative to others', this creates tension and motivates them to eliminate or reduce the inequity.
 - Managers must develop strategic pay practices that are both internally and externally equitable.
 - Compensation policies are internally equitable when employees believe that the wage rates for their jobs approximate the job's worth to the organization.
 - Compensation policies are externally equitable when the organization is paying wages that are relatively equal to what other employers are paying for similar types of work.

FIGURE 9.1

RELATIONSHIP BETWEEN EQUITY AND MOTIVATION



II. Expectancy Theory

- Predicts that one's level of motivation depends on the attractiveness of the rewards sought and the probability of obtaining those rewards.
- Employees exert greater effort if they have reason to expect that it will result in a reward that is valued.
- **3 conditions that must be met for a reward to be motivational:**
 1. Must have **high valence** – be valued by employees.
 2. Must have **high instrumentality** – employees must believe that the attainment of goals and objectives set by the organization must result in the promised rewards.
 3. Must have an **expectancy** that they can do the required tasks; that is, although goals can be challenging, they must be attainable.

BASES FOR COMPENSATION

- **Hourly Work:** Work paid on an hourly basis.
 - **Hourly Employees:** Employees compensated on an hourly basis.
 - Only paid for the time they work.
 - **Salaried Employees:** Employees compensated on the basis of weekly, biweekly, or monthly pay periods.
 - Paid for the same for each pay period, even though they occasionally may work more hours or fewer than the regular number of hours in a period.
 - Usually receive certain benefits not provided to hourly employees.
- **Piecework:** Work paid according to the number of units produced.
- Employment practices are a provincial jurisdiction, and each province has its own employment standards act.
 - Each act contains a provision that requires the employer to reimburse the employee at a specified rate (usually 1.5 times the employee's base hourly rate of pay) after he or she has worked the minimum required hours.

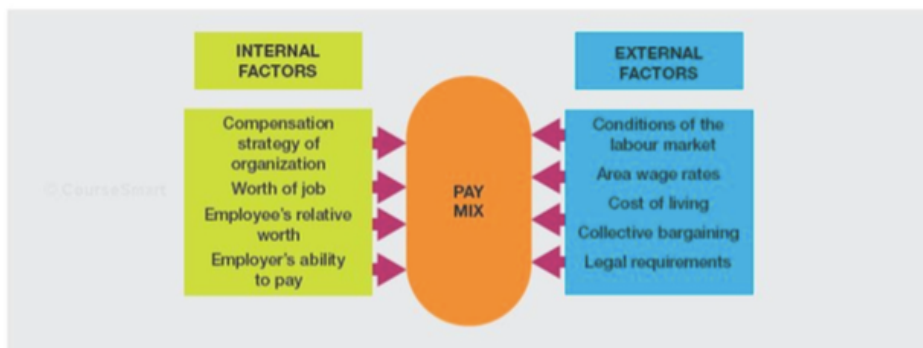
OUTCOME TWO: DETERMINING COMPENSATION – THE WAGE MIX

- A combination of internal and external factors can influence, directly or indirectly, the rates at which employees are paid.
- Through their interaction, these factors constitute the wage mix.

- **4 types of internal factors:**
 1. **Compensation Strategy of the Organization**
 - Employers establish numerous compensation objectives that affect the pay employees receive.
 - **4 minimum requirements that policies should reflect:**
 - I. The internal wage relationship among jobs and skill levels.
 - II. The external competition or an employer's pay position relative to what competitors are paying.
 - III. A policy of rewarding employee performance.
 - IV. Administrative decisions concerning elements of the pay system (Ex. overtime premiums, payment periods, and short-term/long-term incentives).
 2. **Worth of Job**
 - A job's value should be based on the total value delivered to the organization.
 - Valuing work properly enables organizations to price "important" jobs effectively, provides insight into how a job relates to overall organizational success, and attracts and retains the right talent to driver organizational performance.
 3. **Employee's Relative Worth**
 - Employee performance can be recognized and rewarded through promotion and with various incentive systems.
 - This system provides a visible and credible relationship between performance and any raises received.
 4. **Employer's Ability to Pay**
 - Pay levels are limited by earned profits and other financial resources available to employers.
 - Competition and recessions can force prices down and reduce the income from which compensation payments are derived.
 - In such situations, employers have little choice but to reduce wages and/or lay off employees or, even worse, to go out of business.

FIGURE 9.2

FACTORS AFFECTING THE PAY MIX



- **4 types of external factors:**
 1. **Labour Market Conditions**
 - The forces of supply and demand for qualified labour within an area influence the wage rates required to recruit or retain competent employees.
 - The economic power of unions may prevent employers from lowering wage rates even when unemployment is high among union members.
 - Government regulations also may prevent an employer from paying at a market rate less than an established minimum set by each province.
 2. **Area Wage Rates**
 - A formal wage structure should provide rates that are in line with those being paid by other employers for comparable jobs within the area.
 - Data pertaining to area wage rates may be obtained from local wage surveys.
 - Wage surveys serve the important function of providing external wage equity between the surveying organization and other organizations competing for labour in the surrounding labour market.
 3. **Cost of Living**
 - **Consumer Price Index (CPI):** A measure of the average change in prices over time in a fixed “market basket” of goods and services.
 - Employers in a number of communities monitor changes in the CPI as a basis for compensation decisions.
 - **Escalator Clauses:** Clauses in collective agreements that provide for quarterly cost-of-living adjustments (COLAs) in wages, basing the adjustments on changes in the customer price index.
 - COLAs are favoured by unions during particularly high periods of inflation.
 4. **Collective Bargaining**
 - The primary function of a labour union is to bargain collectively over conditions of employment, this most important of which is compensation.
 - **Real Wages:** Wage increases larger than rises in the consumer price index, that is, the real earning power of wages.
 - The union’s goal in each new agreement is to achieve increases in real wages.
 - This goal includes gaining wage settlements that equal or exceed the pattern established by other unions within the area.

OUTCOME THREE: JOB EVALUTION SYSTEMS

- **Job Evaluation:** A systematic process of determining the relative worth of jobs to establish which jobs should be paid more than others within an organization.

- Job evaluation systems provide for *internal equity* and serve as the basis for wage rate determination.
- **4 job evaluation techniques:**
 1. **Job Ranking System**
 - A systematic process of determining the relative worth of jobs to establish which jobs should be paid more than others within an organization.
 - **3 disadvantages of the job ranking system:**
 - I. It does not provide a very precise measure of each job's worth.
 - II. The final ranking of jobs indicates the relative importance of the job, not the differences in the degree of importance that may exist between jobs.
 - III. It can only be used with a small number of jobs.
 2. **Job Classification System**
 - A system of job evaluation in which jobs are classified and grouped according to a series of predetermined wage grades.
 3. **Point System**
 - A quantitative job evaluation procedure that determines the relative value of a job by the total points assigned to it.
 - Allow jobs to be evaluated quantitatively on the basis of **compensable factors** that constitute the job – skills, efforts, responsibilities, and working conditions.
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 4. **Work Valuation**
 - A job evaluation system that seeks to measure a job's worth through its value to the organization.
 - Work is measured through standards that come directly from business goals.
 - The work evaluation process ends with a work hierarchy that is an array of work by value to the organization – the work hierarchy is eventually priced through wage surveys to determine individual pay rates.

OUTCOME FOUR: THE COMPENSATION STRUCTURE

- The evaluated worth of each job in terms of its rank, class, points, or monetary worth must be covered into an hourly, daily, weekly, or monthly wage rate.
- **Wage and Salary Survey:** A survey of the wages paid to employees of other employers in the surveying organization's relevant labour market – local, regional, or national, depending on the job.
 - When job evaluation and wage survey data are used jointly, they link the likelihood of both internal and external equity.

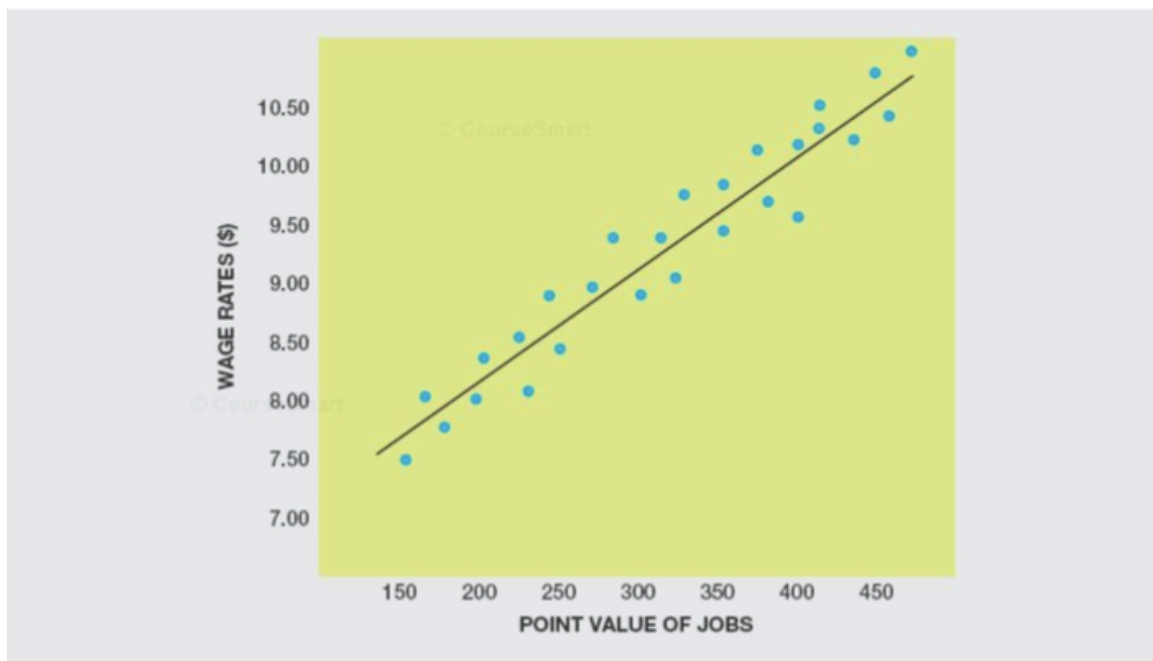
- Can also collect information on employee benefits or organizational pay practices (such as overtime rates or shift differentials).

OUTCOME FIVE: THE WAGE CURVE

- **Wage Curve:** A curve in a scattergram representing the relationship between the relative worth of jobs and wage rates.
- This curve indicates the rates currently paid for jobs within an organization, new rates resulting from job evaluation, or rates for similar jobs currently being paid by other organizations within the labour market.
- The wage curve can be used to determine the relationship between the value of a job and its wage rate at any given point in time.

FIGURE 9.3

FREEHAND WAGE CURVE



OUTCOME SIX: GOVERNMENT REGULATION OF COMPENSATION

- **3 legal requirements for compensation:**
 1. **Employment Standards Act**
 - Each province/territory establish minimum standards with a view to protecting both employees and employers in certain employment situations.
 - Includes minimum wage, overtime pay, maximum work hours, and workplace health and safety.

2. **Human Rights Legislation – Employment Equity**
 - Employment equity is under federal jurisdiction for all federally regulated companies, as well as for provincially regulated companies that are suppliers to the federal government.
 - The treatment of employed individuals in a fair and nonbiased manner.
3. **Pay Equity**
 - Equal pay for work of equal value.
 - Pay equity is covered provincially where applicable.

OUTCOME SEVEN: SIGNIFICANT COMPENSATION ISSUES
