

Human Resource Management

Eleventh Edition

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Chapter 12

Compensation Strategies and Practices

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SECTION 4
Compensating
Human Resources

Learning Objectives

- After you have read this chapter, you should be able to:
 - Identify the two general types of compensation and the components of each.
 - Discuss four issues of strategic compensation design.
 - List the basic provisions of the Fair Labor Standards Act (FLSA).
 - Describe the two means of valuing jobs.
 - Outline the process of building a base pay system.
 - Explain two ways individual pay increases are determined.

Nature of Compensation

- Types of Rewards

- Intrinsic

- ❖ Intangible, psychological and social effects of compensation

- Extrinsic

- ❖ Tangible, monetary and nonmonetary effects of compensation

- Types of Compensation

- Direct compensation

- ❖ The employer exchanges monetary rewards for work done.

- Indirect compensation

- ❖ Employer-provided benefits—like health insurance—that are provided to employees for being a member of the organization.

Components of a Compensation System

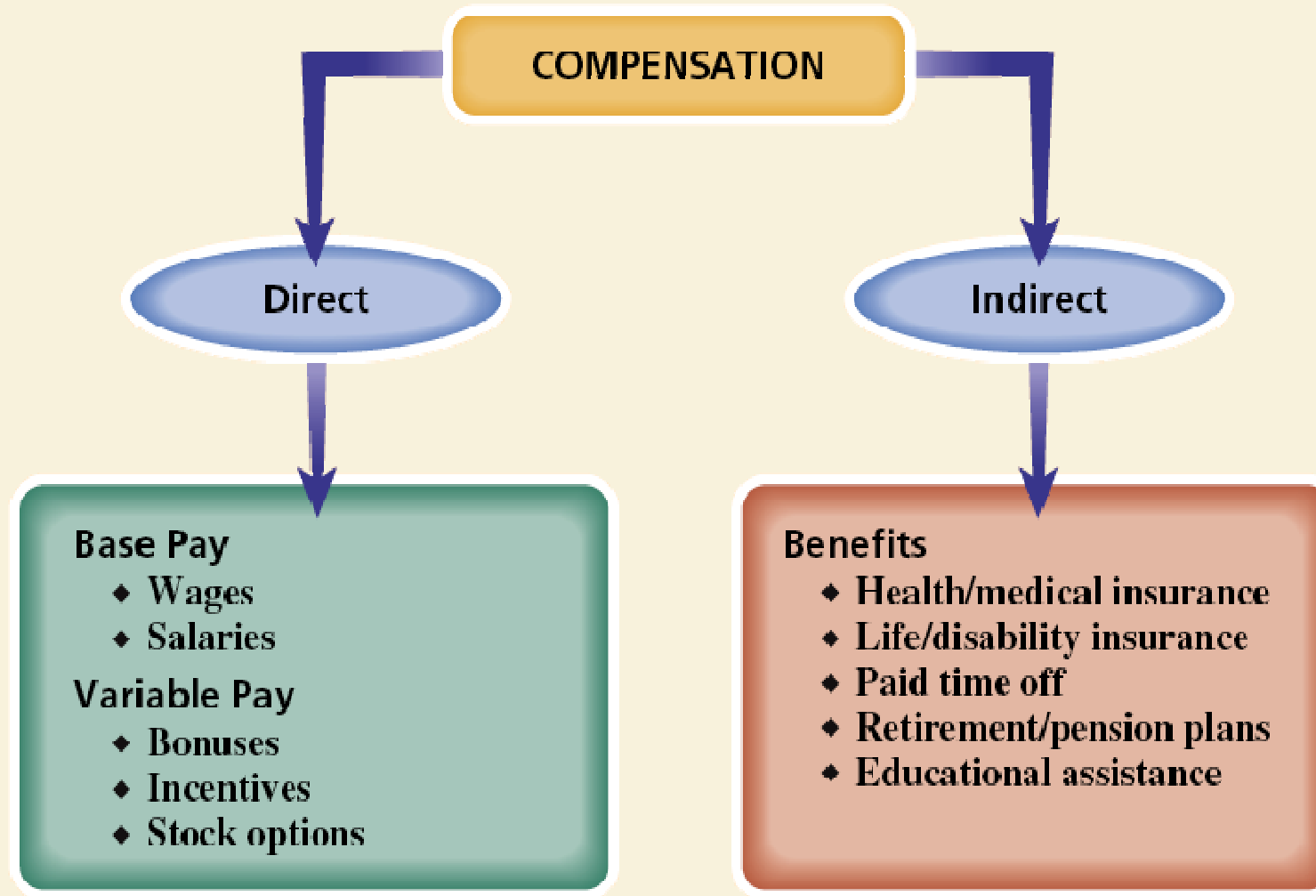


Figure 12–1

Direct Compensation

Base Pay

The basic monetary compensation that an employee receives, usually as a wage or salary.

Wages

Payments calculated on the amount of time worked.

Salary

Consistent payments made each period regardless of the number of hours worked in the period.

Variable Pay

Compensation linked to individual, team, or organizational performance.

Typical Division of HR Responsibilities: Compensation

HR Unit	Managers
<ul style="list-style-type: none">♦ Develops and administers the compensation system♦ Evaluate jobs and analyzes pay surveys♦ Develops wage/salary structures and policies	<ul style="list-style-type: none">♦ Identify job descriptions and compensation concerns♦ Recommend pay rates and increases according to HR guidelines♦ Evaluate employee performance for compensation purposes

Figure 12–2

Strategic Compensation

- Objectives of a Strategically Supportive Compensation System:
 - Legal compliance with all appropriate laws and regulations
 - Cost effectiveness for the organization
 - Internal, external, and individual equity for employees
 - Performance enhancement for the organization

Compensation Philosophies

- **Entitlement Philosophy**
 - Assumes that individuals who have worked another year are entitled to pay increases, with little regard for performance differences.
- **Pay-for-Performance Philosophy**
 - Requires that compensation changes reflect individual performance differences.

Continuum of Compensation Philosophies

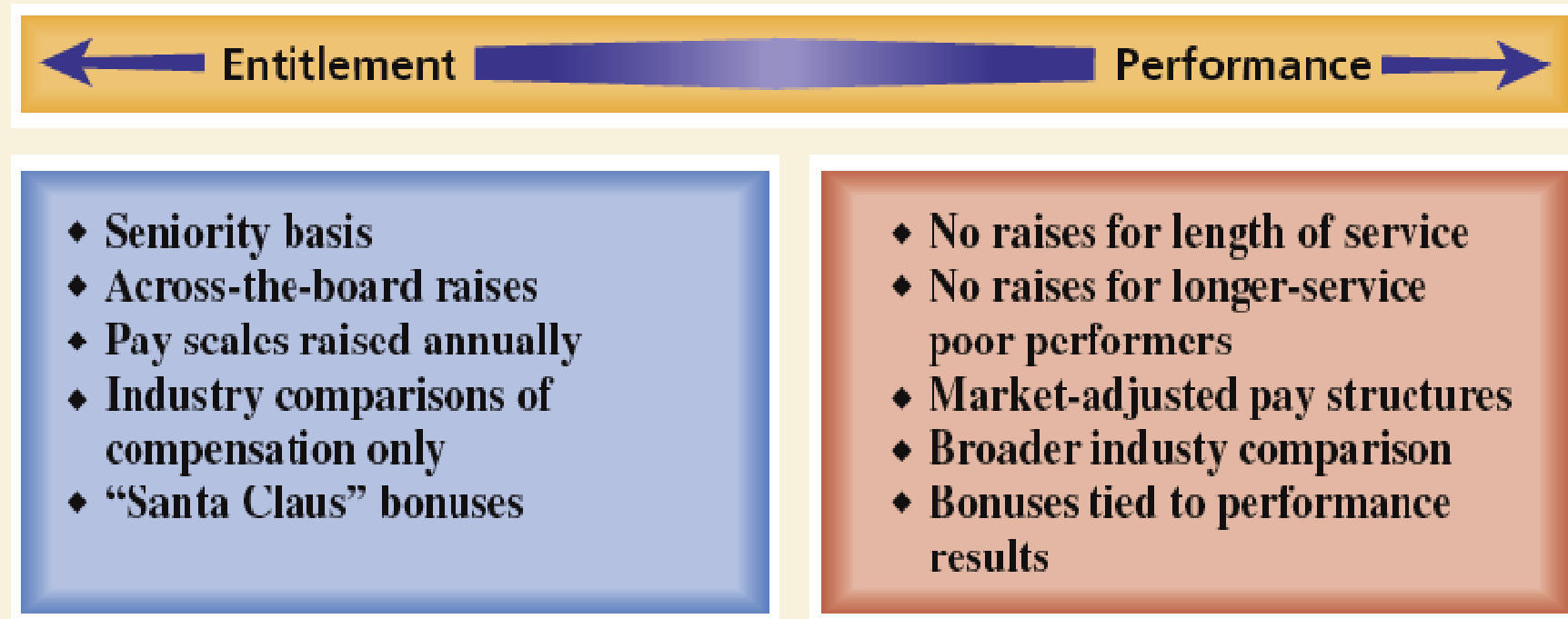


Figure 12–3

Compensation Approaches

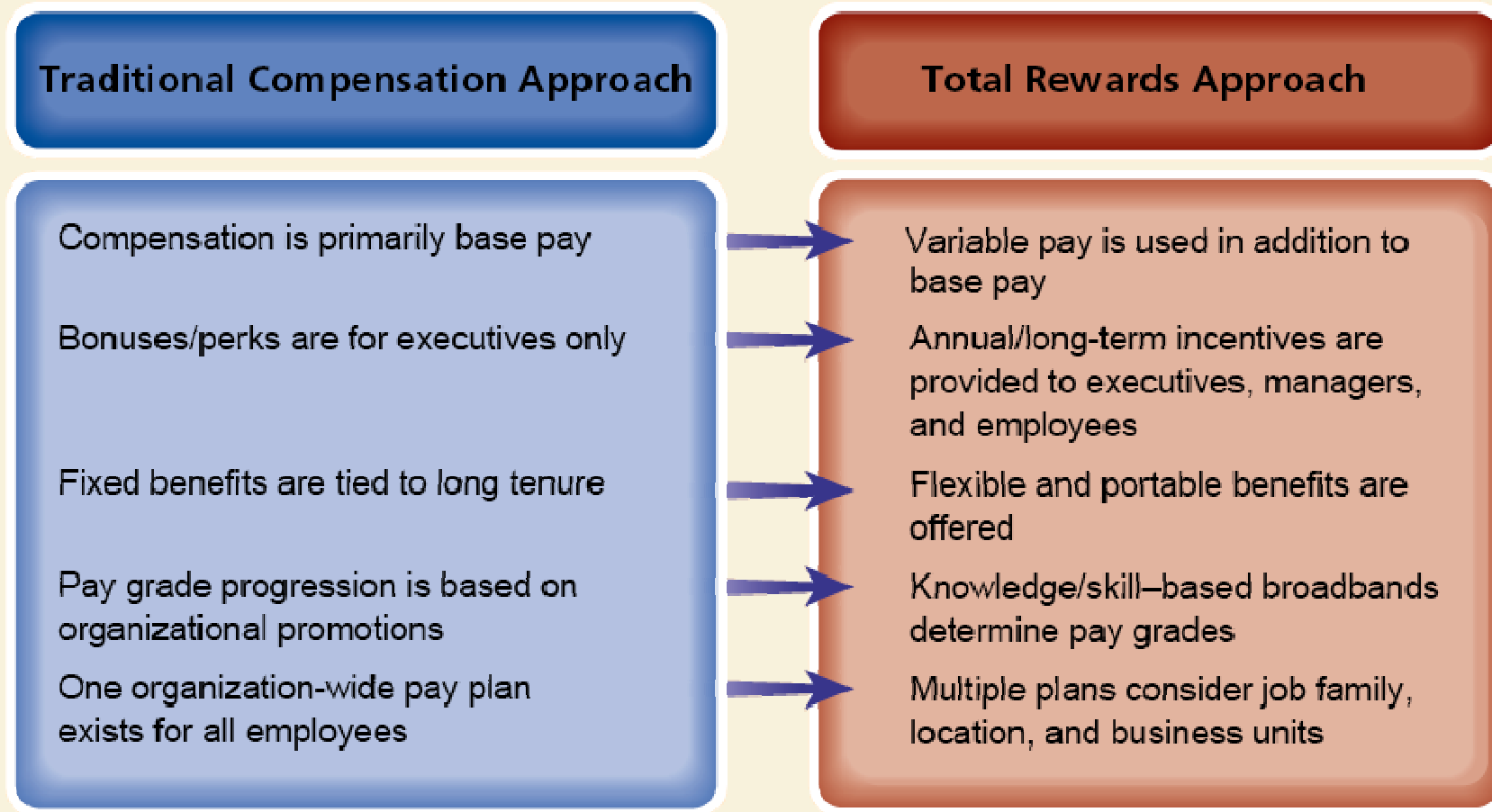


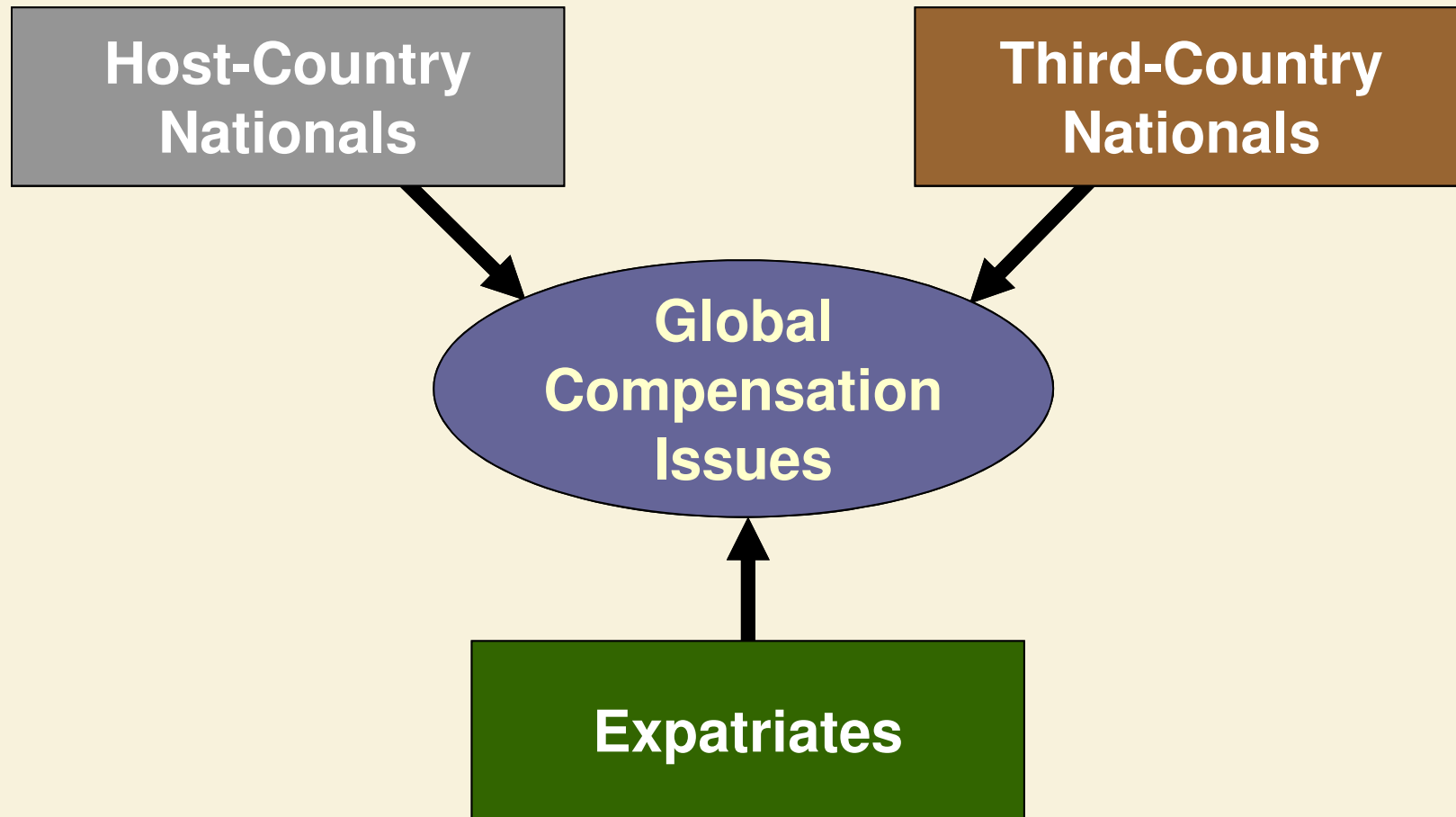
Figure 12-4

HR Metrics for Compensation

HR Performance Area	Method of Calculation
1. Pay and benefits as percentage of operating expense	Total pay and benefits expenditures
2. Human value added	$\frac{\text{Revenue} - \text{Operating expense} - \text{Pay and benefits}}{\text{Full-time-equivalent employees (FTEs)}} = \text{Adjusted profit}$
3. Return on human capital invested	$\frac{\text{Revenue} - \text{Operating expense} - \text{Pay and benefits}}{\text{Pay and benefits}} = \text{Adjusted profit}$
4. Employee cost factor	$\frac{\text{Total compensation and benefits}}{\text{Full-time-equivalent employees (FTEs)}}$

Figure 12-5

Compensation System Design Issues



Typical Components of Expatriate Compensation



Figure 12–6

Global Compensation Approaches

- **Balance Sheet Approach**
 - Compensation plan that equalizes cost differences between identical international and home-country assignments.
- **Global Market Approach**
 - Compensation plan that attempts to be more comprehensive in providing base pay, incentives, benefits, and relocation expenses regardless of the country to which the employee is assigned.
- **Tax Equalization Plan**
 - Compensation plan used to protect expatriates from negative tax consequences.

Compensation Quartile Strategies

Third Quartile: Above-Market Strategy

(Employer positions pay scales so that 25% of other firms pay above and 75% pay below)

Second Quartile: Middle-Market Strategy

(Employer positions pay scales so that 50% of other firms pay above and 50% pay below)

First Quartile: Below-Market Strategy

(Employer positions pay scales so that 75% of other firms pay above and 25% pay below)

Figure 12–7

Market Competitiveness and Compensation

Meet the Market

Attempting to balance employer costs and the need to attract and retain employees.

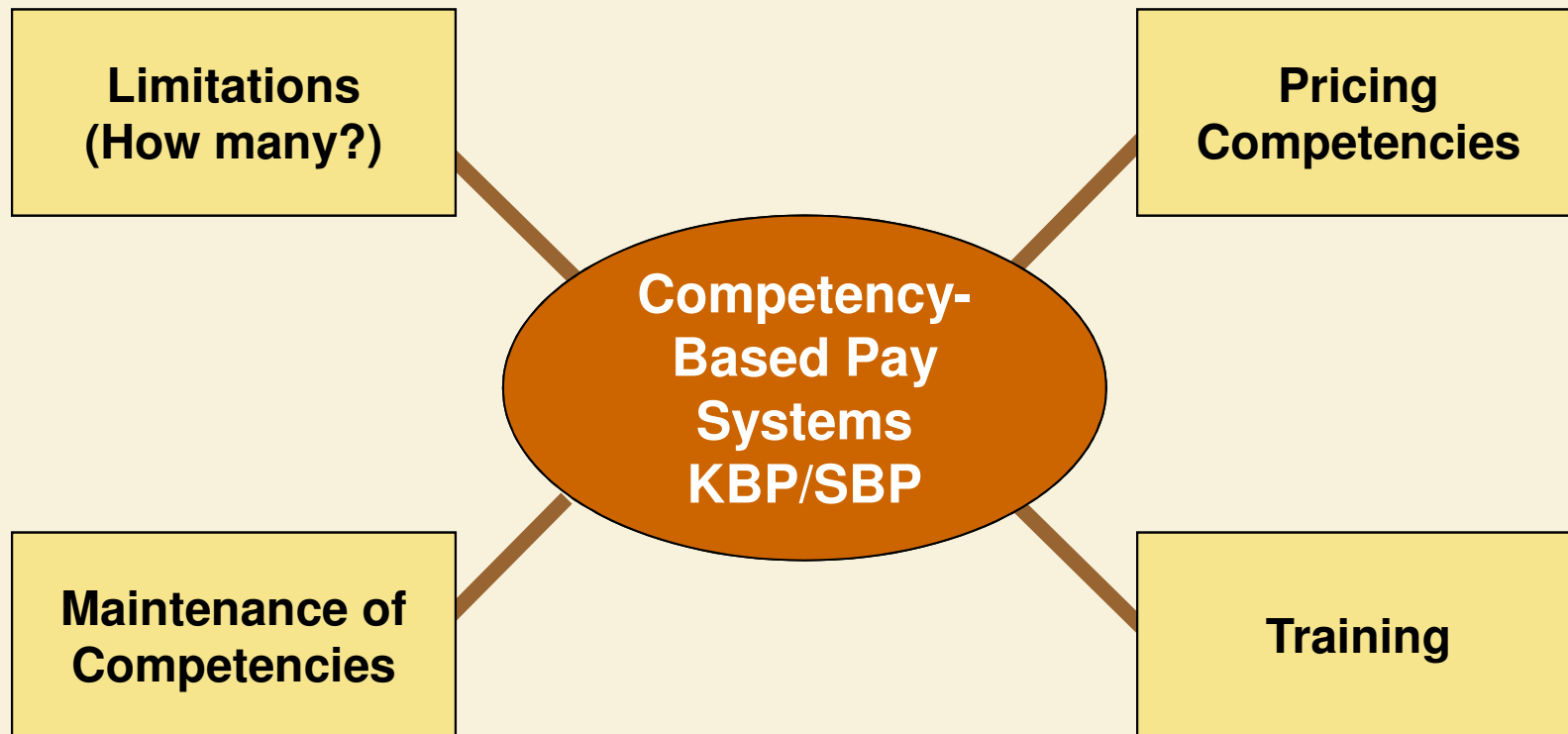
Lag the Market

Paying all that the firm can afford. Taking advantage of the abundant supply of potential employees in a loose labor market.

Lead the Market

Paying for higher qualified, more productive workers.

Competency-Based Pay



Individual vs. Team Rewards

Using Team-Based Reward Systems

- Use skill-based pay for the base.
- Make system simple and understandable.
- Use variable pay based on business entity performance
- Distribute variable rewards at the team level
- Maintain a high degree of employee involvement

Perceptions of Pay Fairness

Equity	The perceived fairness between what a person does (inputs) and what the person receives (outcomes).
External Equity	Employee compensation viewed as equitable in relation to the compensation of employees performing similar jobs in other organizations.
Internal Equity	Employees receive compensation in relation to the knowledge, skills, and abilities they use in their jobs as well as their responsibilities and accomplishments.
Procedural Justice	Perceived fairness of the process and procedures used to make decisions about employees.
Distributive Justice	Perceived fairness in the distribution of outcomes.
Pay Openness/ Secrecy	The degree of openness or secrecy that an organization allows regarding its pay system.

Equity Considerations in Compensation

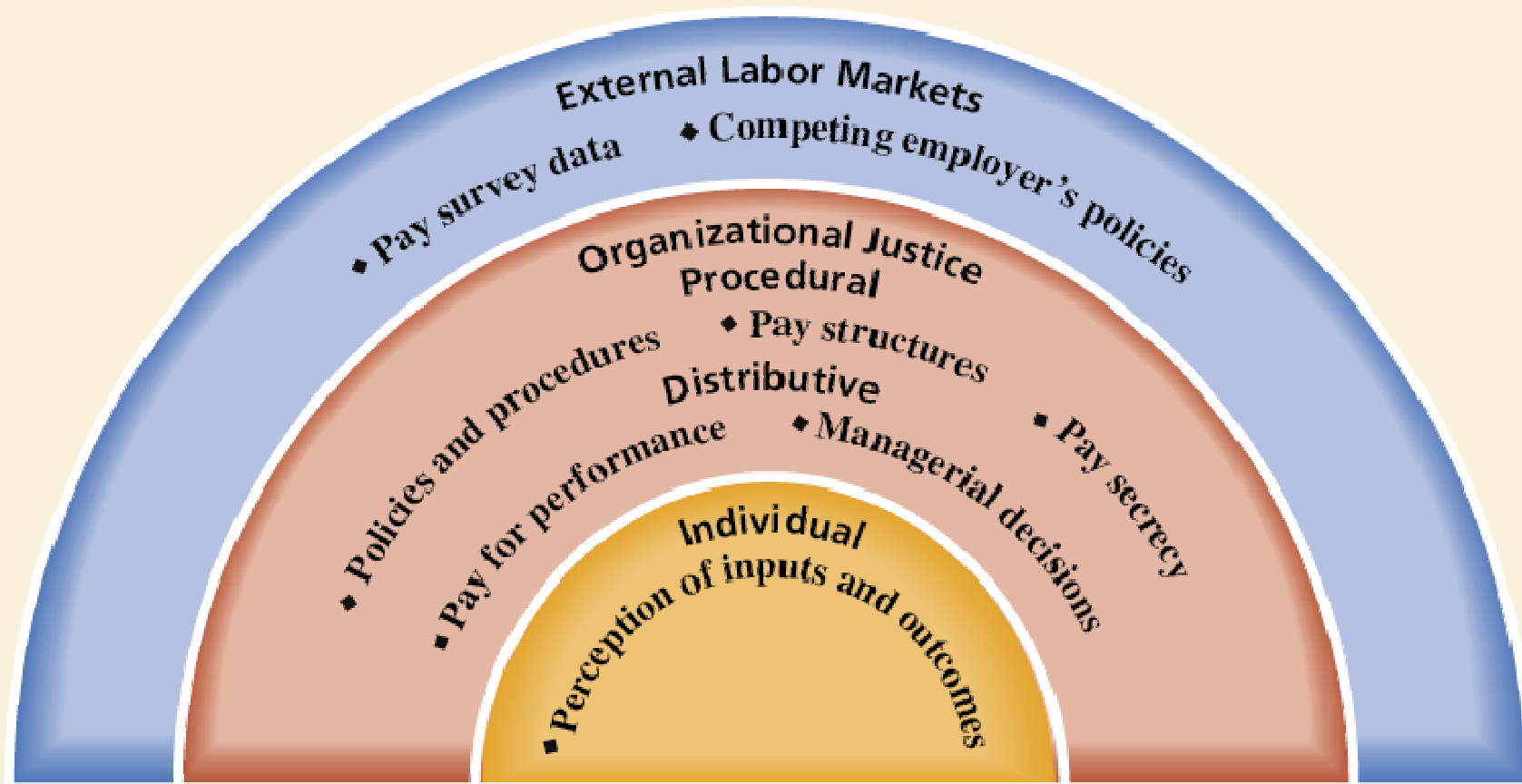
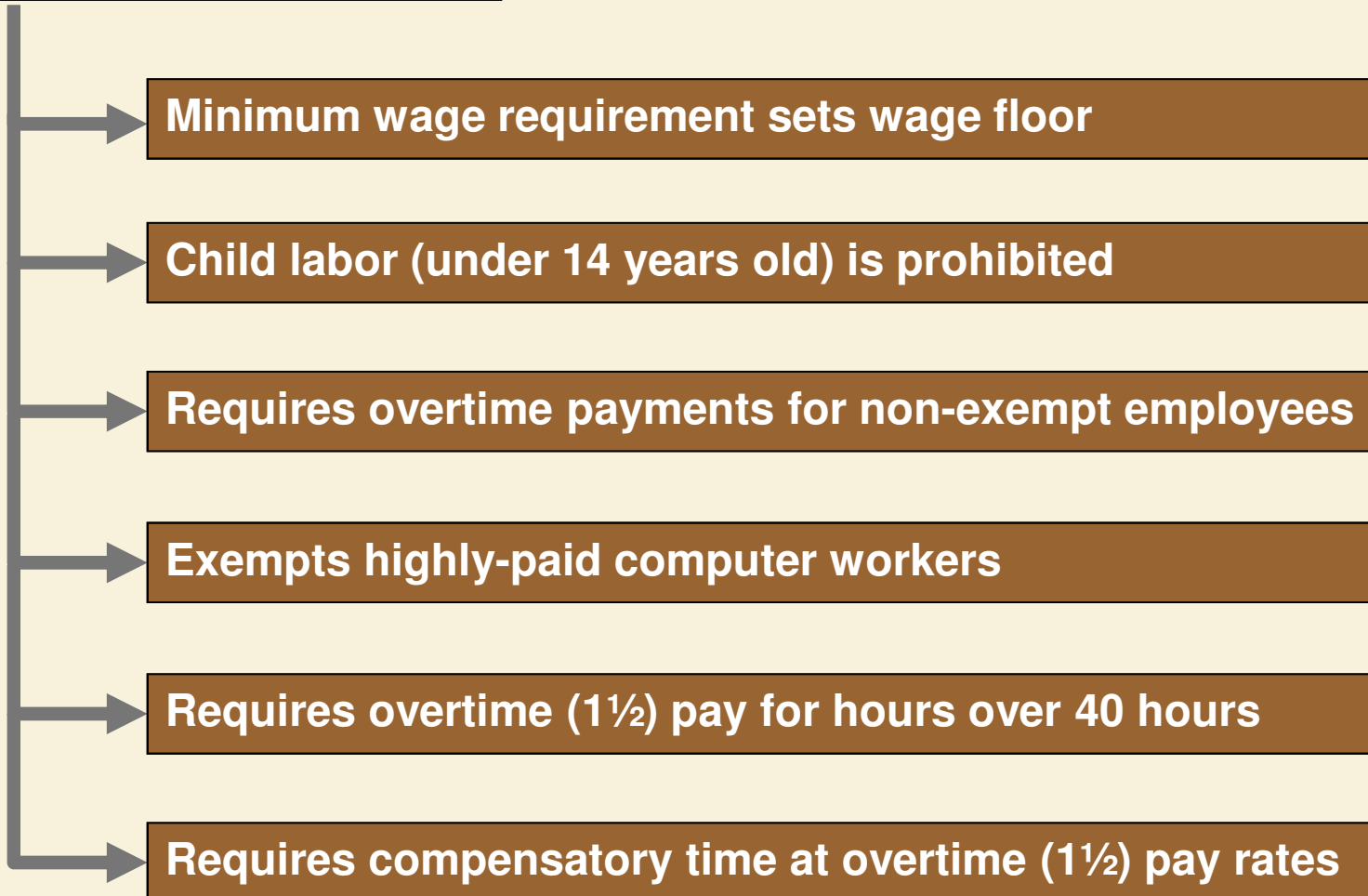


Figure 12-8

Fair Labor Standards Act (FSLA) of 1938

Provisions of the Act



FLSA Employee Classifications

- Exempt Employees

- Employees to whom employers are not required to pay overtime under the Fair Labor Standards Act.

- ❖ Executives, administrators, professional (learned or creative) employees, computer employees, outside sales persons

- Non-exempt Employees

- Employees who must be paid overtime under the Fair Labor Standards Act.

- ❖ Hourly

- ❖ Salaried non-exempt

FLSA Wage Provisions

- Overtime

- Non-exempt employees must be paid overtime pay (one and one-half the regular pay rate) for all hours worked over 40 regular hours in a workweek (168 hours—7days x 24 hours).

- Compensatory Time Off (*Comp Time*)

- Hours off regular work time given to an employee in lieu of payment for extra time worked.
 - ❖ Compensatory hours off must be awarded at rate of one and one-half times hours worked over 40 hours.

IRS Test for Employees and Independent Contractors

An Employee	An Independent Contractor
<ul style="list-style-type: none">◆ Must comply with instructions about when, where, and how to work◆ Renders services personally◆ Has a continuing relationship with the employer◆ Usually works on the premises of the employer◆ Normally is furnished tools, materials, and other equipment by the employer◆ Can be fired by the employer◆ Can quit at any time without incurring liability	<ul style="list-style-type: none">◆ Can hire, supervise, and pay assistants◆ Generally can set own hours◆ Usually is paid by the job or on straight commission◆ Has made a significant investment in facilities or equipment◆ Can make a profit or suffer a loss◆ May provide services to two or more unrelated persons or firms at the same time◆ Makes services available to the public

Source: U.S. Internal Revenue Service, www.irs.gov.

<http://www.deden08m.com>

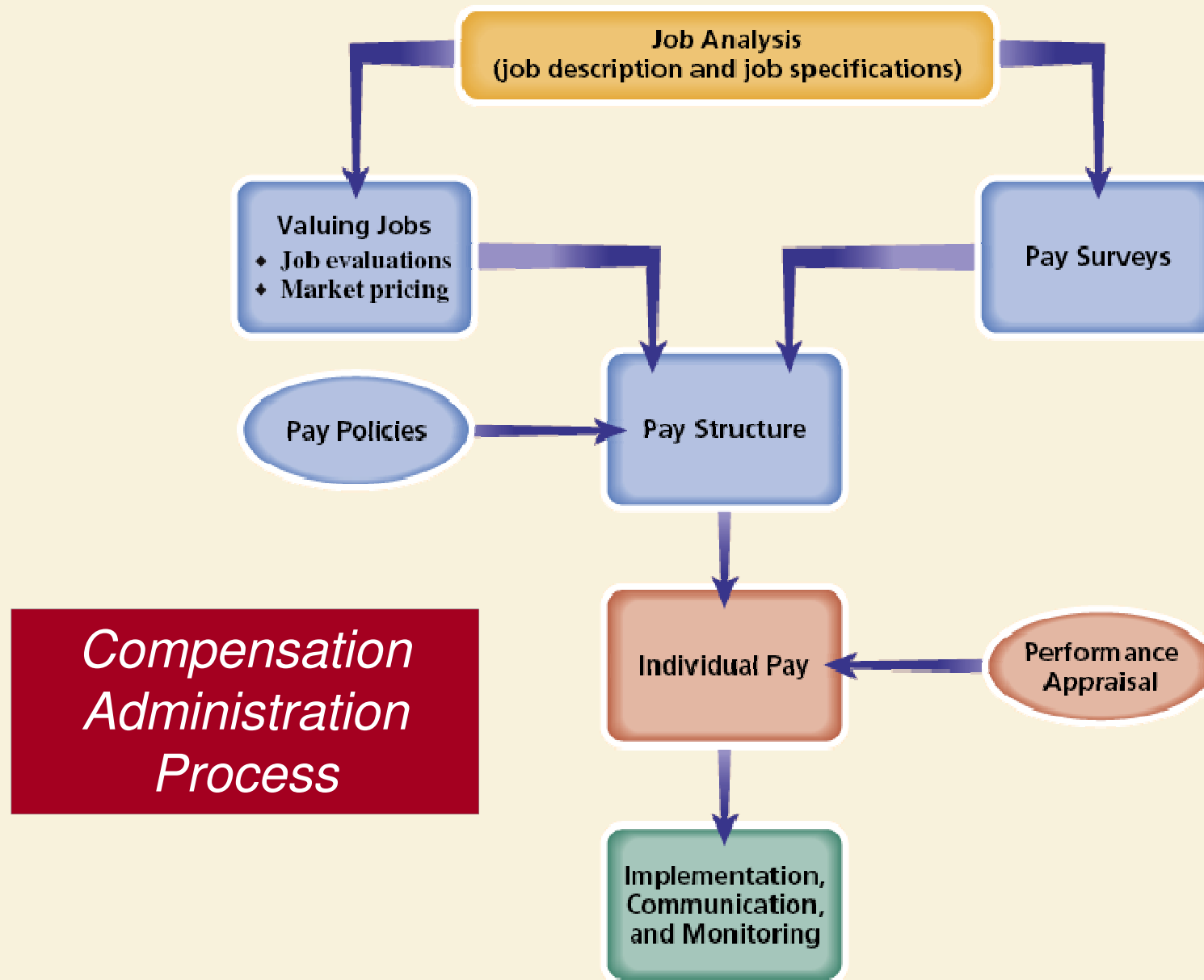
Figure 12-9

Other Laws Affecting Compensation

- Davis-Bacon Act of 1931
 - Required payment of “prevailing wage” by firms engaged in federal construction projects.
- Walsh-Healy Public Contracts Act and the McNamara-O’Hara Service Contract Act
 - Extended the payment of “prevailing wage” to service contracts
 - Required overtime payment for any employee hours worked over eight hours in one day; applies only to federal contracts, not the private sector.

Legislation on Equal Pay and Pay Equity

- **Equal Pay Act of 1963**
 - Requires that men and women be paid the same for performing substantially similar jobs with limited non-gender exceptions (e.g., merit and seniority).
- **Pay Equity (or Comparable Worth)**
 - Similarity in pay for all jobs requiring comparable level of knowledge, skills, and abilities, even if actual duties and market rates differ significantly.
- **Garnishment**
 - A court action in which a portion of an employee's wages is set aside to pay a debt owed a creditor.



*Compensation
Administration
Process*

Figure 12–10

Development of a Base Pay System

- **Job Evaluation**

- Formal, systematic means to identify the relative worth of jobs within an organization.
- Evaluating every job in the organization on:
 - ❖ Knowledge, skills, and abilities required
 - ❖ Nature of job tasks, duties, responsibilities, and competencies
 - ❖ Difficulty of the job, including the physical and mental demands

- **Compensable factor**

- Factor that identifies a job value commonly present throughout a group of jobs.

Examples of Compensable Factors for Different Job Families

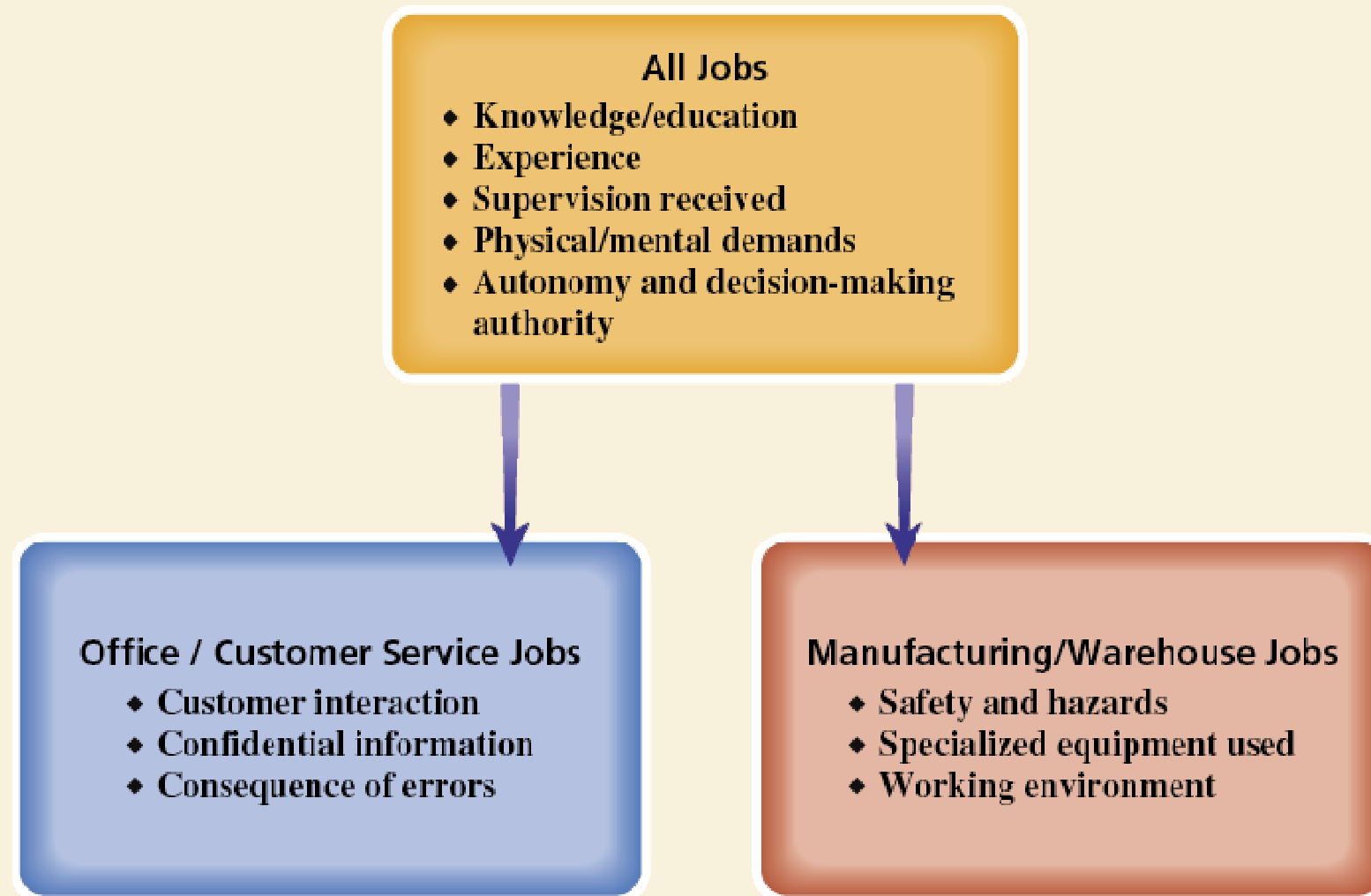
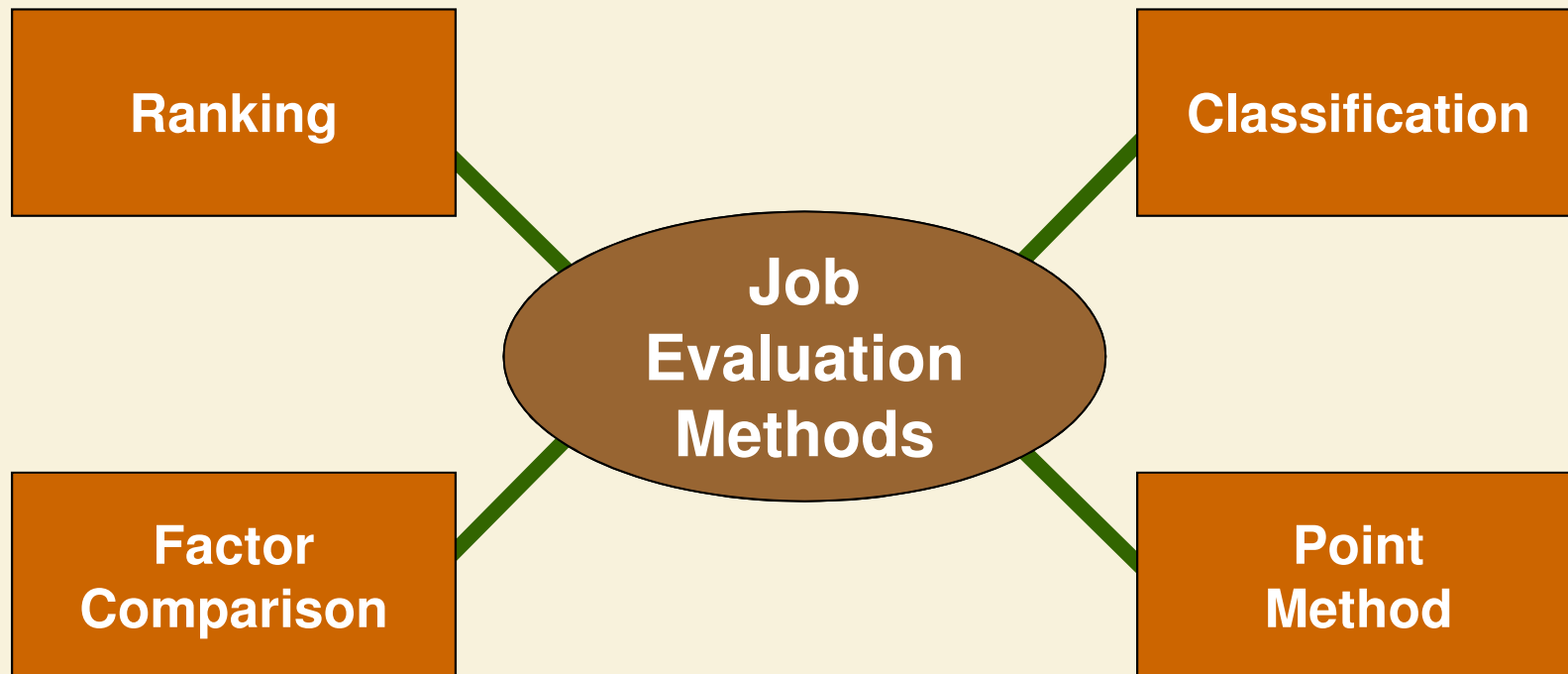


Figure 12–11

Job Evaluation



Legal Issues and Job Evaluation

Americans with Disabilities Act

Job evaluations may not identify job functions related to physical demands as essential

Job Evaluation

Gender Issues

Traditional job evaluations place less weight on knowledge, skills, and working conditions for female-dominated jobs

Valuing Jobs Using Market Pricing

- **Market Pricing**

- Use of pay survey data to identify the relative value of jobs based on what other employers pay for similar jobs.

- **Advantages of Market Pricing**

- Ties organizational pay levels to what is actually occurring in the market, without being distorted by “internal” job evaluation.
- Communicates to employees that the compensation system is “market linked,” rather than distorted by internal issues.

Valuing Jobs Using Market Pricing (cont'd)

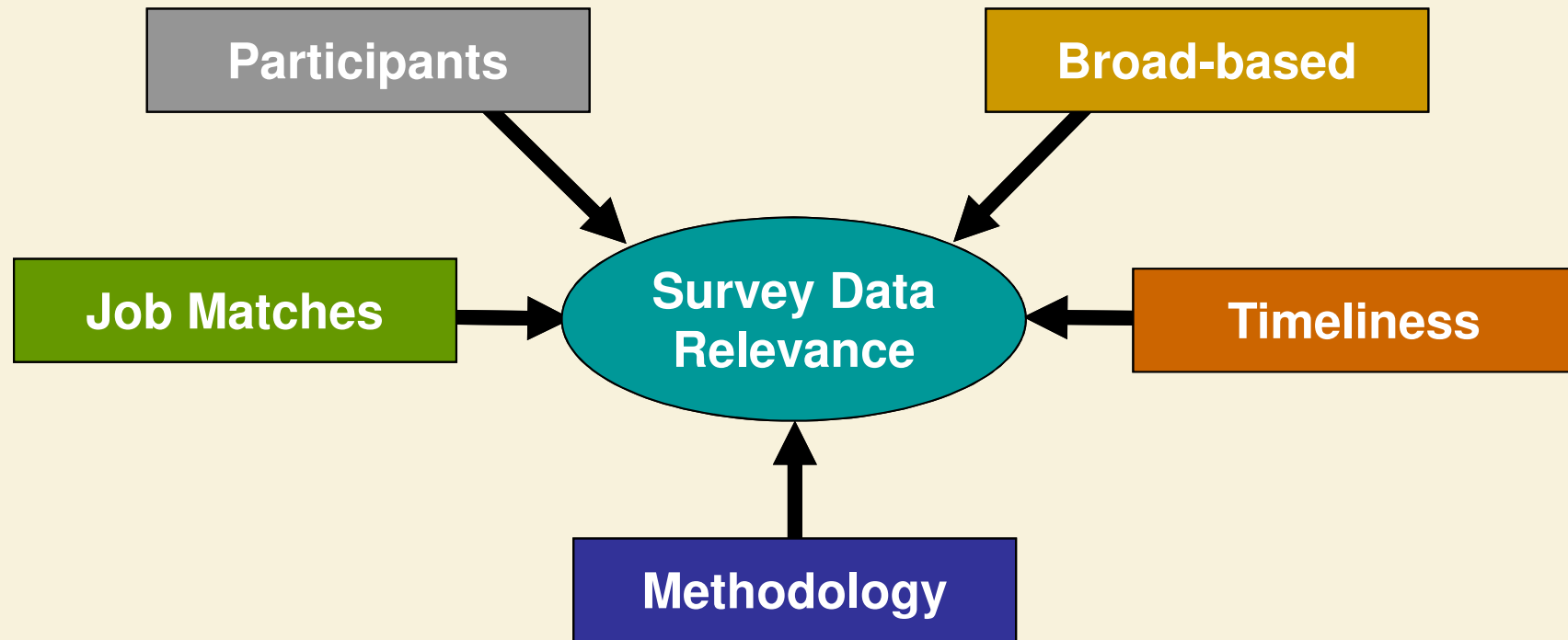
- **Disadvantages of Market Pricing**

- It relies on market survey data that is limited or may have been gathered in methodologically sound ways.
- The responsibilities of a specific job in a company may be somewhat different from those of the “matching” job identified in the survey.
- The market data’s scope (range of sources) is another concern.
- Tying pay levels to market data can lead to wide fluctuations based on market conditions.

Pay Surveys

- **Pay Survey**
 - Collection of data on compensation rates for workers performing similar jobs in other organizations.
- **Benchmark Jobs**
 - Jobs found in many organizations.
- **Internet-Based Pay Surveys**
 - Pay survey questionnaires are distributed electronically rather than as printed copies.

Using Pay Surveys



Developing Pay Surveys

Select Employers with Comparable Jobs



Determine Jobs to be Surveyed



Decide What Information Is Needed



Conduct Survey

Pay Structures

- **Job Family**
 - A group of jobs having common organizational characteristics.
- **Common Pay Structures**
 - Hourly and salaried
 - Office, plant, technical, professional, managerial
 - Clerical, information technology, professional, supervisory, management, and executive
- **Pay Grades**
 - Groupings of individual jobs having approximately the same job worth.



Establishing Pay Structures

Figure 12–12

Market-Banded Pay Grades for Community Bank

Grade	Job	Pay Survey Summary	Pay Grade		
			Minimum	Midpoint*	Maximum
1	Bookkeeper	\$22,913	\$17,966	\$22,458	\$26,950
	Loan Clerk	\$22,705			
	Customer Service Representative	\$22,337			
	Data Entry / Computer Operator	\$22,309			
	Head Teller	\$22,305			
	Special Teller	\$22,179			
2	Mail Clerk / Messenger	\$19,167	\$14,962	\$18,703	\$22,444
	Proof Machine Operator	\$18,970			
	General Office Clerk	\$18,594			
	Receptionist	\$18,184			

*Computed by averaging the pay survey summary data for the jobs in each pay grade.

Figure 12-13

Pay Structures (cont'd)

- Market Banding

- Grouping jobs into pay grades based on similar market survey amounts.

- Market Line

- Graph line that shows the relationship between job value as determined by job evaluation points and job value as determined by pay survey rates.
- Shows the distribution of pay for the surveyed jobs, allowing a linear trend line to be developed by the *least-squares regression method*.

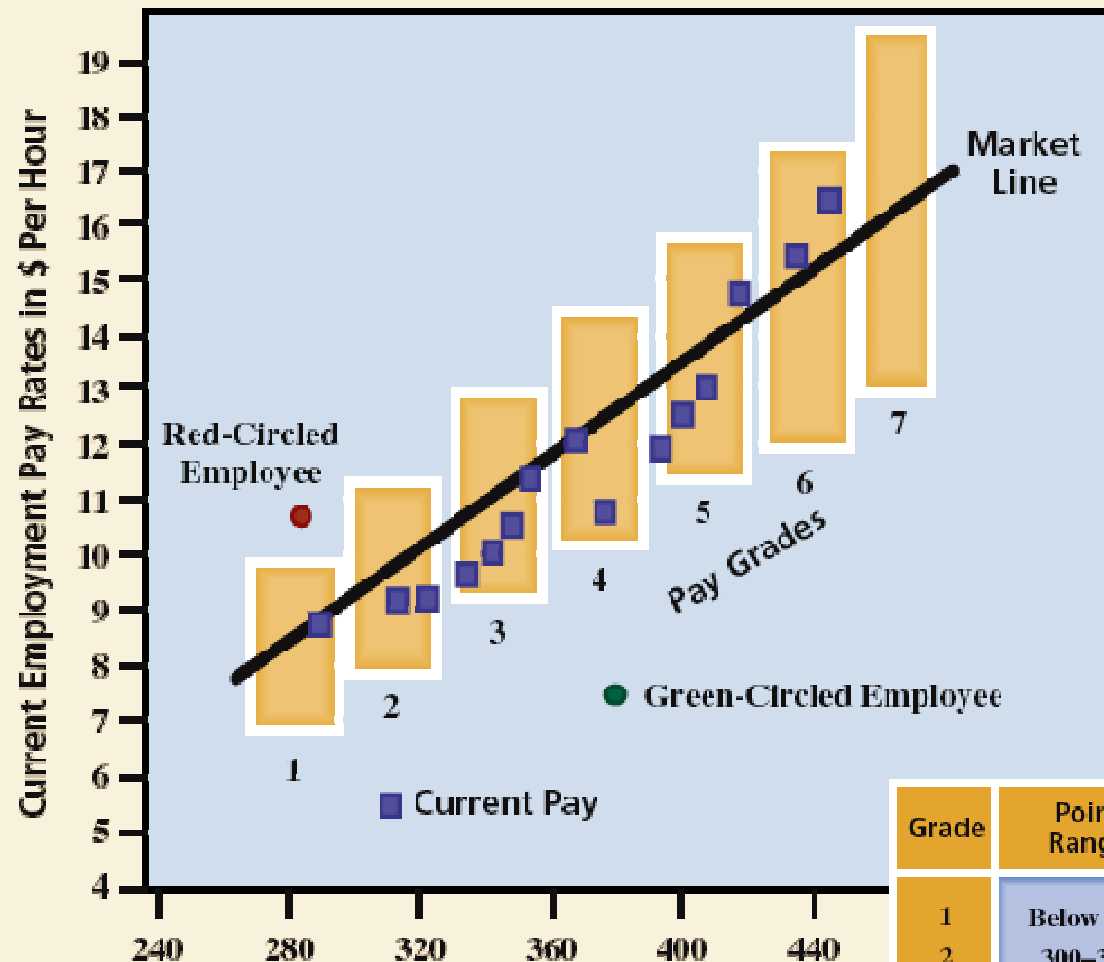
Pay Ranges

- Broadbanding

- The practice of using fewer pay grades having broader pay ranges than in traditional systems.

- Benefits

- ❖ Encourages horizontal movement of employees
 - ❖ Is consistent with trend towards flatter organizations
 - ❖ Creates a more flexible organization
 - ❖ Encourages competency development
 - ❖ Emphasizes career development



*Example of
Pay Grades
and Pay
Ranges*

Job Evaluation Points

Grade	Point Range	Minimum Pay	Midpoint Pay	Maximum Pay
1	Below 300	6.94	8.50	10.06
2	300-329	7.96	9.75	11.54
3	330-359	8.98	11.00	13.02
4	360-389	10.00	12.25	14.50
5	390-419	11.01	13.49	15.97
6	420-449	11.79	14.74	17.69
7	Over 450	12.79	15.99	19.18

Figure 12-14

Individual Pay

- Rates Out of Range
 - Red-Circled Employees
 - ❖ An incumbent (current jobholder) who is paid above the range set for the job.
 - Green-Circled Employees
 - ❖ An incumbent who is paid below the range set for the job.
- Pay Compression
 - A situation in which pay differences among individuals with different levels of experience and performance in the organization becomes small.

Pay Adjustment Matrix

- Compa-ratio

➤ The pay level divided by the midpoint of the pay range.

$$\text{Employee } \mathbf{R} = \frac{\$16.50 \text{ (current pay)}}{15.00 \text{ (midpoint)}} \times 100 = 110 \text{ (Compa - ratio)}$$

$$\text{Employee } \mathbf{J} = \frac{\$13.05 \text{ (current pay)}}{15.00 \text{ (midpoint)}} \times 100 = 87 \text{ (Compa - ratio)}$$

Pay Adjustment Matrix

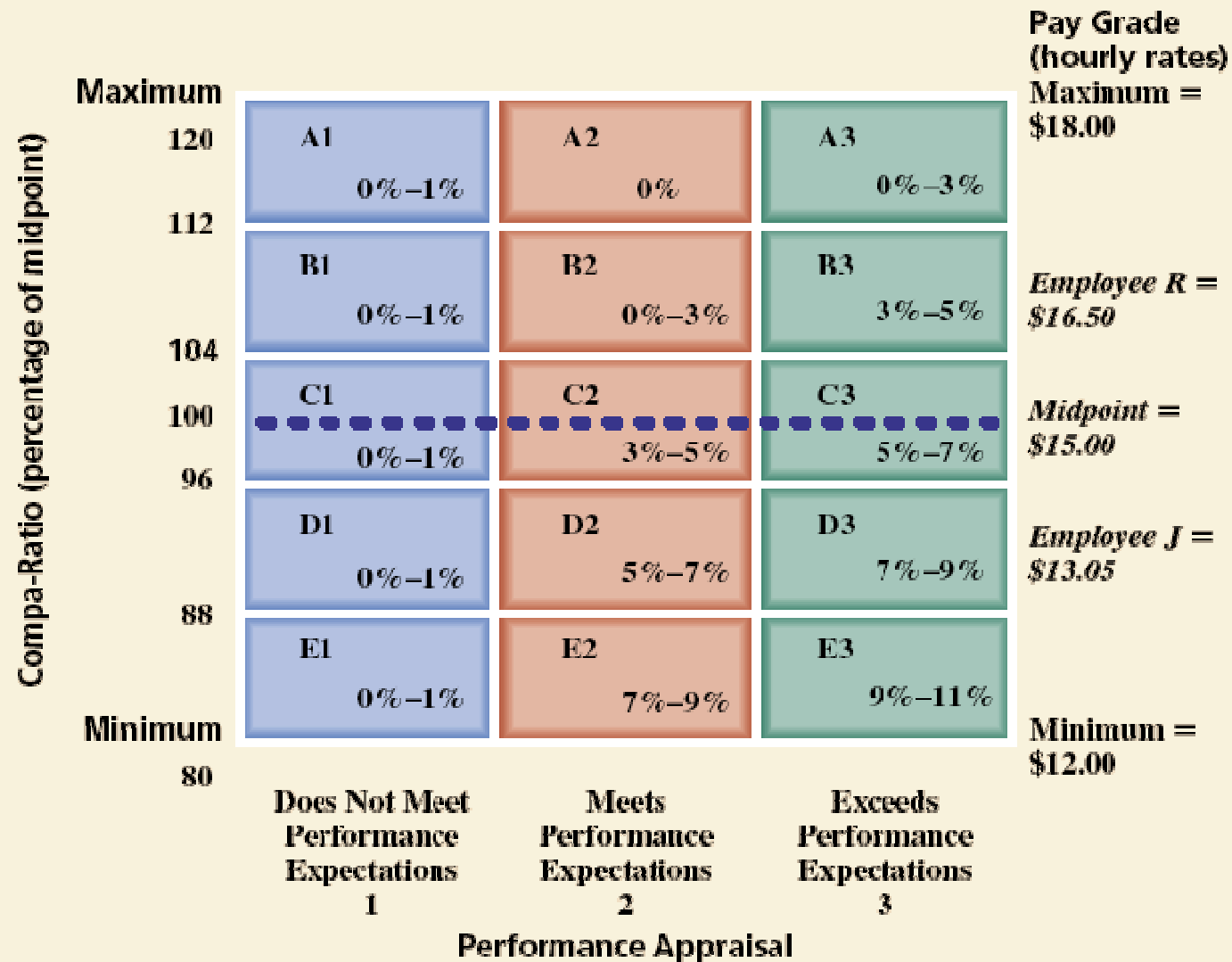


Figure 12–15

Determining Pay Increases

- **Seniority**
 - Time spent in an organization or on a particular job that is used to determine eligibility for organizational rewards and benefits.
- **Cost-of-Living Adjustments (COLA)**
 - A percentage increase in wages to maintain real wages in a period of economic inflation.
 - Adjustments are tied to changes in an economic measure (e.g., the Consumer Price Index).
- **Lump-Sum Increases (LSI)**
 - A one-time payment of all or part of a yearly pay increase that does not increase base wages.