# COMPENSATION AND BENEFITS

Subject Code : 14MBA HR303
No. of Lecture Hours / Week : 04
Total Number of Lecture Hours : 56
Practical Component : 01 Hour / Week

IA Marks : 50
Exam Hours : 03
Exam Marks : 100

**Objectives**

• To discuss the strategic importance of compensation to the achievement of organizational goals. And the identify links between compensation objectives and business strategy.
• Discuss the role of compensation in attracting, motivating, and retaining a high-quality workforce.
• Discuss recent theoretical and practical developments in the area of compensation and benefits.
• Develop the basic competencies required for the development and management of compensation systems.
• Discuss how compensation management can become a competitive advantage.
• Discuss the role of compensation management as part of the new mandate for HR executives.

**Module 1: (6 Hours)**

**Introduction To Compensation**: Definition of Compensation, The Pay Model, Strategic Pay Policies, Strategic Perspectives of Pay, Strategic Pay Decisions, Best Practices vs. Best Fit Options

**Module 2: (6 Hours)**

**Defining Internal Alignment:** Definition of Internal Alignment, Internal Pay Structures, Strategic Choices In Internal Alignment Design, Which Internal Structure Fits Best?

**Module 3: (10 Hours)**

**Job Analysis and Evaluation:** Why Perform Job Analysis?, Job Analysis Procedures, Job Analysis Data Collection Process, Job Descriptions, Definition of Job Evaluation, Major Decisions In Job Evaluation, Job Evaluation Methods, Final Result – Pay Structure

**Module 4: (8 Hours)**

**Determining External Competitiveness and Benefits Management:** Competitiveness: Definition of Competitiveness, Pay Policy Alternatives, Wage Surveys, Interpreting Survey Results, Pay Policy Line, Pay Grades
Benefits: Benefits Determination Process, Value of Benefits, Legally Required Benefits, Retirement, Medical, & Other Benefits

**Module 5: (10 Hours)**

**Performance Based Compensation System:** Employee Contributions: Pay For Performance (PFP): Rewarding Desired Behaviors, Does
Compensation Motivate Performance?, Designing PFP Plans, Merit Pay/Variable Pay, Individual vs. Group Incentives, Long Term Incentives. Compensation of Special Groups: Who are Special Groups?, Compensation Strategies For Special Groups

**Module 6: (8 Hours)**

**Legal & Administrative Issues in Compensation:** Legal Issues, Pay Discrimination, Comparable Worth, Budgets and Administration

**Module 7: (8 Hours)**

**Global Compensation:** Recognizing Variations, Social Contract, Culture & Pay, Strategic Choices In Global Compensation, Comparing Systems, Expatriate Pay

**Practical Components**

• Students must prepare a comprehensive compensation plan to be offered to a Sales Executive, A General Manager and The CEO of an organization.
• Students to collect information from an IT organization regarding the Cost To Company of an employee.
• Students have to prepare questionnaire for conducting wage survey and carry out wage survey for any selected sector and prepare a report for the same.
**Solve various case studies.**

• Students must compare and analyze compensation practices in different countries.
• Students to calculate the bonus amount eligible to an employee working as a HR Executive for the past 10 years in a automobile manufacturing organization.

**RECOMMENDED BOOKS:**

• Compensation & Reward Management, BD Singh, 2 nd edition, Excel BOOKS, 2012, ISBN: 9350620111, 9789350620113
• Compensation, Milkovich & Newman, 6 th edition, Irwin/McGraw-Hill, ISBN: 0256259658, 9780256259650
• Compensation and Benefit Design, Bashker D. Biswas, FT Press, 2012, ISBN: 0133064859, 9780133064858
• An Introduction to Executive Compensation, Steven Balsam, Academic Press, 2002, ISBN: 0080490425, 9780080490427

**REFERENCE BOOKS:**

• Strategic Compensation, Joseph J. Martocchio, 3rd Edition, Prentice Hall, 2004, ISBN: 0131918737, 9780131918733
• Compensation Management in a Knowledge based world, Richard I. Anderson, 10th edition, Pearson Education
• Compensation Management, Er Soni Shyam Singh, Excel Books, ISBN: 8174465766,

# TABLE OF CONTENTS

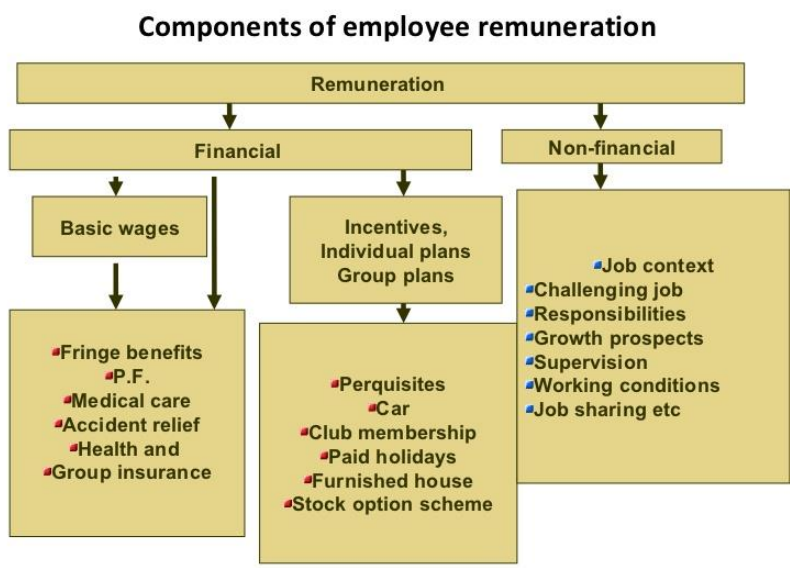
# Module 1

Introduction To Compensation: Definition of Compensation, The Pay Model, Strategic Pay Policies, Strategic Perspectives of Pay, Strategic Pay Decisions, Best Practices vs. Best Fit Options

## Defining Compensation

Compensation, or pay (the words are used interchangeably in this book), refers to all forms of financial returns and tangible services and benefits employees receive as part of an employment relationship.

Compensation (also known as Total Rewards) can be defined as all of the rewards earned by employees in return for their labour. This includes:




- ***Direct financial compensation*** consisting of pay received in the form of wages, salaries, bonuses and commissions provided at regular and consistent intervals
- ***Indirect financial compensation*** including all financial rewards that are not included in direct compensation and understood to form part of the social contract between the employer and employee such as benefits, leaves, retirement plans, education, and employee services
- ***Non-financial compensation*** referring to topics such as career development and advancement opportunities, opportunities for recognition, as well as work environment and conditions

While employees tend to focus on direct financial compensation when contemplating their rewards, according to the McKinsey Journal, for individuals who are relatively satisfied with their salary, it is the non-financial rewards that tend to be more effective in contributing to long-term employee engagement.

## Pay Model

Pay model or the compensation model varies from industry to organizations. Each and every industry has their own pay model which is generally based on three components. The basic components of pay model are:-

1. Compensation motives
2. Compensation Strategies

3. Compensation Techniques

# Compensation Motives

Compensation or pay systems are programmed and are formalized to attain organization motives and common motives according to which lead growth of company objectives. The basic objectives are:-

• Efficiency in performance

• Equity in pay system

• Compliance with laws and regulations

**Efficiency in performance objectives are:-**

Firstly it helps in improving performance, increasing quality and satisfying customers need with controlling labor costs.

**The equity objectives are:-**

Initially designing a pay system which will help in managing and recognizing employee's contribution and its need. Equity pay system is the basic pay method which portrays equal fair pay for a day work. This pay system ensures equal pay to the employees.

**The Compliance with rules and regulations objectives are:-**

Pay model should always be according to the various central and state wage legislations and regulations. As the rules and regulations of pay model changes or fluctuates so the compensation system always to be accustomed accordingly.

**PAY TECHNIQUES**

Pay Techniques are used to devise new methods in the payment structure within the organization. Technique is basically formalized and ties with the four major policies to pay objectives. Though the sequence of techniques is used to analysis various kinds of techniques with proper sequence first technique is of internal alignment which is based upon and give detail analysis about amount of work accomplished and amount of work need to be accomplished. Secondly, information about of the employee and the job profile is collected, organized and evaluated and based upon these evaluations, a work structure is designed.

With the tremendous growth and complexities in organization regarding pay structures the specific pay model devised by HR practitioner Milkovich. Reasons to follow this model are-:

1. The pay structure determines relation among job and skills and competency within an organization.

2. Pay model is based upon work's importance in achieving the organization's motives.

3. The clarity and equality in the pay model devise the employee attitude towards the organization and its rules and regulations.

4. The pay techniques in the pay model help to define the relevant labor markets in which the employer competes, and use that information with the organization's policy to derive a pay structure.

5. Another importance of the pay model is that it controls the efficiency of organization and helps to retain and motivate its workforce and labor costs.

6. Competition at external level helps in devising a pay level according to the pay structure paid by competitors for the same level of job. Various forms of pay and benefits along with annuity funds paid, apart from these funds what are the other benefits paid like contributions through seniority pay increase, stock options, performance based approaches, retention moves, attract new people and motivate the existing ones.

## Strategic pay policies:

(1) internal alignment,

(2) external competitiveness,

(3) employee contributions, and

(4) administration of the pay system

**Internal Alignment:** Internal alignment refers to comparisons between jobs or skill levels inside a single organization. Jobs and people's skills are compared in terms of their relative contributions to the organization's objectives. How, for example, does the work of the programmer compare with the work of the systems analyst, the software engineer, and the software architect? Does one contribute to providing solutions to customers and satisfying shareholders more than another? Does one require more knowledge or experience than another? Internal alignment refers to the pay rates both for employees doing equal work and for those doing dissimilar work. In fact, deter-mining what is an appropriate difference in pay for people performing different work is one of the key challenges facing managers. Internal alignment policies affect all three compensation objectives. Pay relationships within the organization affect employee decisions to stay with the organization, to become more flexible by investing in additional training, or to seek greater responsibility. By motivating employees to choose increased training and greater responsibility in dealing with customers, pay relationships indirectly affect the capabilities of the workforce and hence the efficiency of the entire organization. Fairness is affected in employees' comparisons of their pay to the pay of others in the organization. Basic fairness is provided by Canadian human rights laws, which make paying on the basis of race, gender, age, and other grounds, illegal.

**External Competitiveness:** External competitiveness refers to compensation relationships external to the organization; i.e., comparison with competitors. How should an employer position its pay relative to what competitors are paying? How much do we wish to pay accountants in comparison to what other employers would pay them? What mix of pay forms—base, incentives, stock, benefits—will help achieve the compensation objectives? Employers have several policy options. Medtronic's policy is to pay competitively in its market based on its financial perfor-mance versus the financial performance of its competitors, while AES's policy is to expect people to be willing to take less to join the company.

Increasingly, organizations claim their pay systems are market driven, i.e., based almost exclusively on what competitors pay. However, "market driven" gets translated into practice in different ways. Some employers may set their pay levels higher than their competition, hoping to attract the best applicants. Of course, this assumes that someone is able to identify and hire the "best" from the pool of applicants.

What mix of pay forms a company uses is also part of its external competitive policy. Medtronic sets its base pay to match its competitors but ties incentives to performance. Plus it offers stock options to all its employees to promote a culture of ownership. The assumption is that owners will pay closer attention to the business. Further, Medtronic believes its benefits, particularly the emphasis on programs that balance work and life, make it a highly attractive place to work.

Medtronic believes it is how it positions its pay, and what forms it uses, that gives it an advantage over its competitors. A Medtronic competitor, say MDS, may offer lower base pay but greater opportunity to work overtime or fatter bonuses. AES believes making all employees stockholders is consistent with its emphasis on social responsibility.

**External competitiveness decisions**—both how much, and what forms—have a twofold effect on objectives: (1) 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—and (2) to control labour costs so that the organization's prices of products or services can remain competitive. Thus, external competitiveness directly affects both efficiency and fairness. And it must do so in a way that complies with relevant legislation.

**Employee Contributions:** The policy on employee contributions refers to the relative emphasis placed on performance. Should one programmer be paid differently from another if one has better performance and/or greater seniority? Or should all employees share in the organization's financial success (or failure) via incentives based on profit? Perhaps more productive teams of employees should be paid more than less productive teams.

The degree of emphasis to be placed on performance is an important policy decision, since it directly affects employees' attitudes and work behaviours. Employers with strong pay-for-performance policies are more likely to place greater emphasis on incentives and merit pay. Starbucks emphasizes stock options and sharing the success of corporate performance with the employees. General Electric emphasizes performance at the unit, division, and companywide level. Recognition of contributions also affects fairness, since employees need to understand the basis for judging performance in order to believe that their pay is fair.

**Administration:** Policy regarding administration of the pay system is the last building block in our model. Although it is possible to design a system that is based on internal alignment, external competitiveness, and employee contributions, the system will not achieve its objectives unless it is managed properly.

The greatest system design in the world is useless without competent management. Managers choose what forms of pay to include and how to position pay against competitors. They must communicate with employees and judge whether the system is achieving its objectives. They must ask, Are we able to attract skilled workers? Can we keep them? Do our employees feel our system is fair? Do they understand how their pay is determined? How do the better-performing firms, with better financial returns and a larger share of the market, pay their employees? Are the systems used by these firms different from those used by less successful firms? How do our labour costs compare to our competitors? Answers to these questions are necessary in order to tune or redesign the system, to adjust to changes, and to highlight potential areas for further investigation. At AES, there is no compensation department, nor even a human resources management department. Instead, teams of employees make all the compensation decisions. The assumption is that this approach will ensure that everyone feels they are being treated fairly.

## Strategic perspectives of pay:

A strategic perspective focuses on those focuses on those competitive choices that competitive choices that help the organization gain help the organization gain and sustain competitive and sustain competitive advantage.

## Pay System Objectives

- Attract and retain employees
- Motivate performance
- Promote skills and knowledge development
- Shape corporate culture
- Reinforce and define structure
- Determine pay costs

Example: The Strategic ompensation Decisions Facing Starbucks

## Objectives:

How should compensation support business strategy and be adaptive to the cultural and regulatory environment?

Starbucks objectives:

- Grow by making employees feel valued.
- Recognize that every dollar earned passes through
- employees' hands.
- Use pay, benefits, and opportunities for personal development to help gain employee loyalty and become difficult to imitate.

**Alignment:**

How differently should the various types and levels of skills be paid within the organization?

Starbucks:

- De-emphasize differences.
- Use egalitarian pay structures, cross-train employees to handle many jobs, and call employees partners

**Competitiveness:**

How should total compensation be positioned against our competitors? What forms of compensation should we use?

Starbucks:

- Pay just slightly above other fast-food employers.
- Provide health insurance and stock options for all
- employees (including part-timers).
- Give everyone a free pound of coffee every week.

**Contributions:**
Should pay increases be based on individual and/or team performance, on experience and/or continuous learning, on improved skills, on changes in cost of living, on personal needs, and/or on each business unit's performance?
Starbucks:

- Emphasize team performance and shareholder
- returns.
- For new managers in Beijing and Prague, provide
- training opportunities in the U.S.

**Administration:**
How open and transparent should pay decisions be to all employees? Who should be involved in designing and managing the system?
Starbucks:

- As members of the Starbuck's "family," our employees realize what is best for them.
- Partners can and do get involved

## Strategic Pay Decisions:

Pay decisions refer to the methods used by human resources and payroll professionals to choose the pay scales of employees. Techniques that assist payroll professionals in making their pay decisions include:

- External measures such as benchmarking (salary surveys) and ongoing reporting that constitute a market survey approach.
- Internal measures such as projections, simulations, and predictive modeling or the use of pay grades use an organization's needs to assess the relative value of tasks within it.
- Variable systems like pay-for-performance create a policy line that connects job pay and job evaluation points.

# Benchmarking

Benchmarking is when an organization compares its own pay practices and job functions against those of its competitors. Obvious cautionary points in the use of these kinds of salary surveys include the inclusion of only appropriately similar peers in the comparison, the inclusion of only appropriately similar jobs in the comparison, and accurately weigh and combining rates of pay when multiple surveys are used.

There are two types of salary surveys that can be used in benchmarking: **labor market comparisons** and **product market comparisons.** Labor market comparisons are best when employee recruitment and retention is a major concern for the employer and when recruiting costs are a significant expense. Product market comparisons are more salient when labor expenses make up a major share of the employer's total expenses, when product demand is very fluid, when the labor supply is relatively steady, and/or when employee skills are specific to the product market in question.

Within the benchmarking process, the job category and range of pay rates within it are important to the payroll professional. Certain key jobs are very common to organizations in a given field and have a relatively stable set of duties. As a result, key jobs are useful in benchmarking since they allow for more accurate comparison across many organizations. Non-key jobs are unique to their organizations and are therefore not useful in benchmarking. Job content is far more important than job title in this context, although it is easy to confuse content for title. Range of pay rates refers to the variety in pay rates that workers in one job area might receive.

## Salary Surveys

The use of salary surveys demands credible survey sources with multiple participating organizations. Organizations responding to a given survey must be similar to the organization using that survey. Close attention to job function is also crucial; it is inappropriate to match and compare salaries based on job title alone.

## Internal Measures

Benchmarking uses external measures to make internal pay decisions. Internal measures are also available in most cases, and include the use of analytic techniques such as projections, simulations, and predictive modeling in the pay decision-making process. External and internal measures have very different focuses. External measures ask the market what any given individual should be paid. Internal measures correlate pay decisions to potential organizational benefits.

## Pay Grade System

A pay grade system is simply tiered levels of pay based on position, experience, and seniority. Using a pay grade system has its own risks that should be backed by strongly predictive internal measures because 0nce pay grades are in place, the cost of changing and updating them is significant. This can lead to stagnation in an organization's pay scale system.

Connected to this problem is the fact that an existing pay scale can reward skill sets that were highly useful to the organization in the past more than skill sets that are currently needed. Projections, simulations, and predictive modeling assist in counteracting these issues, as they make use of an organization's own internal data to ensure that assessments of value and need are accurate.

## Pay for Performance Systems