

ESTABLISHING STRATEGIC PAY PLANS

Week 9

BASIC FACTORS IN DETERMINING PAY RATES

- Employee compensation
 - All forms of pay going to employee and arising from their employment

 - Main components
 - Direct financial payments (wages, salaries, incentives, commissions and bonuses)
 - Time-based pay: hourly, daily, weekly, monthly or yearly
 - Pay for performance: to the amount of production
 - Indirect financial payments (employer-paid insurance and vacations)

ALIGNING TOTAL REWARDS WITH STRATEGY

- Strategic compensation management
 - What must the company do to achieve its strategic aims?
 - What are the employee behaviors or actions needed to support this strategic effort?
 - What compensation policies and practices (salary, incentive plans and benefits) will help to produce the employee behavior needed to achieve strategic aims?
- Strategy → Behaviors → HR practices process

EQUITY AND ITS IMPACT ON PAY RATES

■ Equity theory of motivation

■ People are strongly motivated to maintain a balance between

- What they perceive as their contributions and their rewards
- If a person perceives an inequity, a tension or drive will develop

■ Four forms of equity

- External equity
 - How a job's pay rate in one company compares to the job's pay rate in other companies
- Internal equity
 - How fair the job's pay rate is when compared to other jobs within the same company?
- Individual equity
 - The fairness of an individual's pay as compared with what his or her coworkers are earning for the same or very similar jobs within the company, based on each individual's performance
- Procedural equity
 - Perceived fairness of the process and procedures used to make decisions regarding the allocation of pay

ADDRESSING EQUITY ISSUES

- Means to address equity
 - External equity → salary survey, online pay sites
 - Internal equity → job evaluation
 - Individual equity → performance appraisal and incentive pay, strict secrecy policy
 - Procedural equity → communications, grievance mechanisms and employee's participation, employee's pay satisfaction surveys
- Laws
 - Minimum wages
 - Maximum hours
 - Overtime rates
 - Benefits

PAY POLICIES

- Pay policies can influence the employer's performance and profitability
- Pay policies issues
 - Seniority or performance?
 - How to distinguish high and low performers?
 - Geography ← allowance: cost-of-living, relocation, housing, education and hardship allowance

JOB EVALUATION METHODS

- **Basic approach to setting pay rates:**
 - **Market-based approaches**
 - By conducting formal or informal salary surveys to be used to price their own jobs
 - **Job evaluation methods**
 - By assigning values to each of the company's jobs to produce a pay plan
 - A formal and systematic comparison of jobs to determine the worth of one job relative to another → to determine a job's relative worth → to result in a wage or salary structure or hierarchy
 - **Basic principle**
 - job that requires greater qualifications, more responsibilities and more complex job duties should receive more pay than jobs with lesser requirements
 - **Basic procedure**
 - To compare jobs in relation to one another (e.g. effort, job complexity and skills), a salary survey, price all jobs equitably

COMPENSABLE FACTORS

- Basic approach in comparing the worth of several jobs
 - Intuitive
 - Compensable
 - Compare the jobs by focusing on certain basic factors the jobs have in common then determine the pay for each job
 - Focus on factors that establish how the jobs compare to one another
 - skills, effort, responsibility and working condition
 - know-how, problem solving and accountability
 - Compensable factors
 - Key in job evaluation
 - Depend on the job and job evaluation metho

PREPARING FOR JOB EVALUATION

- Job evaluation is a judgmental process and demand close cooperation among supervisors, HR specialists, employees and union representatives.

- Steps
 - Identifying the need for job evaluation
 - Turnover, work stoppages, arguments over pay rates
 - Getting employees to cooperate
 - Choosing a job evaluation committee
 - Employees, HR specialist, union representative
 - Identify 10 or 15 key benchmark jobs → to serve as the anchors against which the relative importance or value of all other jobs is compared
 - Select compensable factors
 - Evaluating the worth of each job

JOB EVALUATION METHODS (1)

■ Ranking Method

■ Steps:

- Obtain job information
 - Analyze job description
- Select and group jobs
 - Rank jobs by department or in clusters
- Select compensable factors
 - Choose one factor and rank jobs
- Rank jobs
 - Rank from the lowest to the highest
- Combine ratings
 - Average ratings

JOB EVALUATION METHODS (2)

■ Job Classification / Job Grading Method

- Raters categorize jobs into groups
 - Classes: similar jobs
 - Grades: different jobs but similar in difficulties

- Steps:
 - Choose compensable factors
 - e.g. difficulty and variety of work, supervision received and exercised, judgment exercise, originality required, nature and purpose of interpersonal work relationships, responsibility, experience, knowledge required
 - Write a grade definition
 - Review all job description
 - Slot each job into its appropriate grade

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JOB EVALUATION METHODS (3)

■ Point Method

- To determine the degree to which the job contain selected compensable factors
- Steps:
 - Identifying compensable factors (e.g. Responsibility and Effort)
 - Identifying degree of compensable factors (e.g. Responsibility 1-5 points, Effort 1-5 points)
 - Calculating a total point value → quantitative point rating for each job

HOW TO CREATE A MARKET-COMPETITIVE PAY PLAN (1)

- **Market-competitive pay plan**
 - A job's compensation reflects both the job's value in the company as well as what other employers are paying for similar jobs in the marketplace
 - **Steps:**
 - **Choose benchmark jobs**
 - Representative of the entire range of jobs the employer needs to evaluate
 - **Select compensable factors**
 - Depends on tradition and on strategic and practical considerations
 - e.g. job complexity, effort and working condition

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HOW TO CREATE A MARKET-COMPETITIVE PAY PLAN (2)

- **Steps:**
 - **Assign weight to compensable factors**
 - e.g. job complexity 60%, effort 30% and working condition 10%
 - **Convert percentage to points for each factors**
 - Multiply the percentage with 1,00 for the maximum number of point
 - e.g. job complexity 6000 points, effort 300 points and working condition 100 points
 - **Define degree**
 - e.g. 1-5 degree for job complexity
 - **Determine point**
 - E.g. 6000 points → 1 – 5 degree : 120, 240, 360, 480, 600 points for each
 - **Review job description**
 - Focus on compensable factors and points for each degree

HOW TO CREATE A MARKET-COMPETITIVE PAY PLAN (3)

■ Steps:

■ Evaluate the jobs

- Committee determines the degree of compensable factors then add → total points
- List a hierarchy of jobs
- Pay rate → market-competitive pay system
 - Compare what the employer is currently paying (internal pay) with what the market is paying for the same or similar job (external pay)
 - Combine this information to produce a market-competitive pay system and wage curve

■ Draw the Current (Internal) Wage Curve

■ Conduct a Market Analysis: Salary Surveys

- To price benchmark jobs
- To take position against comparable firms
- To collect data on benefits
 - Informal → phone or Internet survey
 - Formal → send out surveys to other employers

HOW TO CREATE A MARKET-COMPETITIVE PAY PLAN (4)

■ Steps:

- Draw the Market (External) Wage Curve
- Compare and Adjust Current and Market Wage Rates for Jobs
- Develop Pay Grades

- Pay (or Wage) Grade
 - Jobs of approximately equal difficulty or importance as determined by job evaluation

- Establish Rate Ranges
 - Comp ratio
 - $\text{Employee's pay rate} \div \text{the pay range mid point for his or her pay grade}$

- Address Remaining Jobs
- Correct Out-of-Line Rates

PRICING MANAGERIAL AND PROFESSIONAL JOBS (1)

- **Managerial jobs**
 - Harder-to-quantify factors (e.g. judgment and problem solving)
 - Based on performance
 - “Rock Stars”
- **Four main elements:**
 - Base pay → fixed salary
 - Short-term incentives → cash or stock bonuses for achieving short-term goals
 - Long-term incentives → to encourage the executive to take actions that drive up the value of the company’s stock
 - Executive benefits and perks → supplemental executive retirement pension plans, life and health insurance

PRICING MANAGERIAL AND PROFESSIONAL JOBS (2)

- Main factors:
 - Job complexity
 - Span of control, the number of functional divisions over which the executive has direct responsibility and management level
 - The employer's ability to pay
 - Total profit and rate of return
 - The executive's human capital
 - Educational level, field of study, work experience

- Emphasis
 - Performance incentives

CONTEMPORARY TOPICS (1)

- **Competency-based pay**
 - The company pays for the employee's skills and knowledge, rather than the title he or she holds
 - Pay for knowledge / skill-based pay
 - Traditional job evaluation → job oriented
 - Competency-based pay → person oriented
 - Why?
 - To encourage employees to develop the competencies the company requires to achieve its strategic aim
 - To focus on talent management process
 - To retain high-performance work system

CONTEMPORARY TOPICS (2)

- **Competency-based pay**
 - **Main elements:**
 - A system for defining required skills
 - A process for tying the person's pay to his or her skill level
 - A training system that lets employees acquire the skills
 - A formal skills competency testing system
 - A work design that lets employees move among jobs to permit work assignment flexibility

CONTEMPORARY TOPICS (2)

- **Broadbanding**
 - How wide should the salary grades be?
 - **Broadbanding**
 - Collapsing salary grade into just a few wide levels or bands
 - Each contains a relatively wide range of jobs and pay levels
 - **Why?**
 - Greater flexibility on employee assignment

CONTEMPORARY TOPICS (3)

■ Comparable Worth

- The requirement to pay men and women equal wages for jobs that are of comparable value to the employer
 - Pay gap between women and men

■ Board Oversight of Executive Pay

- Duties and process?
- Appropriate compensation advisors?
- Compensation issues to be addressed?
- Diligence and independence?
- Shareholders?

■ Total Rewards

- To identify strategically crucial jobs and pay them at premium levels
- Encompassing traditional compensation components, as well as recognition, telecommuting programs, health and well-being programs as well as training and career development