COMPENSATION AND REWARDS

Definition:

The sum total of all forms of payments or rewards provided to employees for performing tasks to achieve organizational objectives.

Compensation- Nature and scope

The complex process includes decisions regarding variable pay and benefits

- It suggests an exchange relationship between the employee and the organization
- It involves design, development, implementation, communication and the evaluation of reward strategy and process of the organization

Compensation Objectives

1. To reward employees’ past performance fairly, in line with efforts, skills and competencies
2. To attract and retain competitive high performing employees
3. To motivate the high performing employees and reinforce desirable employee behaviour
4. To remain competitive in the labor market
5. To align employees’ future performance with organizational goals
6. To communicate the employees their worth to the organization
7. To provide employee social status

Compensation Policy Issues

- Pay for performance
- Pay for seniority
- Salary increases and promotions
- Overtime and shift pay
- Probationary pay
- Paid and unpaid leaves
- Paid holidays
- Salary compression (A salary inequity problem, generally caused by inflation, resulting in longer-term employees in a position earning less than workers entering the firm today)
- Geographic costs of living differences
Compensation Administration Process
Classification of rewards

Base pay
- The direct financial compensation an individual receives based on the time worked
- Two bases of calculation
  - Hourly/wage: payment for the number of hours worked
  - Salaried: receive consistent payments at the end of specific period regardless of number of hours worked
Variable Pay

- Any plan that ties pay to productivity or profitability i.e. the standard by which managers tie compensation to employee effort and performance.
- It is linked to individual, group, or organizational performance and not to time worked.

Incentive Pay Programs

- Establish a performance “threshold” to qualify for incentive payments.
- Emphasize a shared focus on organizational objectives.
- Create shared commitment in that every individual contributes to organizational performance and success.

Frederick Taylor

- Popularized scientific management and the use of financial incentives in the late 1800s.
  - Systematic soldiering: the tendency of employees to work at the slowest pace possible and to produce at the minimum acceptable level.

TYPES OF INCENTIVES

1. Individual Incentives
2. Group/team Incentives
3. Organizational Incentives

1. Individual Incentive Plans

• Piecework Plans

- The worker is paid a sum (called a piece rate) for each unit he or she produces.
  - Straight piecework:
  - A fixed sum is paid for each unit the worker produces under an established piece rate standard. An incentive may be paid for exceeding the piece rate standard.
  - Standard hour plan:
  - An incentive plan that sets pay rates based on the completion of a job in a predetermined “standard time.”
  - If employees finish the work in less than the expected time, their pay is still based on the standard time or the job multiplied by their hourly rate.
Advantage and disadvantages of piecework

- Easily understandable, equitable, and powerful incentives
- Employee resistance to changes in standards or work processes affecting output
- Quality problems caused by an overriding output focus
- Possibility of violating minimum wage standards
- Employee dissatisfaction when incentives either cannot be earned due to external factors or are withdrawn due to a lack of need for output

- Merit pay

  - A permanent cumulative salary increase the firm awards to an individual employee based on his or her individual performance.

- Bonuses

  - Bonus

    - Incentive payment that is supplemental to the base wage for cost reduction, quality improvement, or other performance criteria.

  - Spot bonus

    - Unplanned bonus given for employee effort unrelated to an established performance measure.

2. Group Incentive Plans

Team Incentive Plans

- Compensation plans where all team members receive an incentive bonus payment when production or service standards are met or exceeded.

- Establishing Team Incentive Payments

  - Set performance measures upon which incentive payments are based
  - Determine the size of the incentive bonus.
  - Create a payout formula and fully explain to employees how payouts will be distributed.

Gain sharing Plans

Programs under which both employees and the organization share the financial gains according to a predetermined formula that reflects improved productivity and profitability.

- Scanlon
- Rucker
- Improshare
The Pros and Cons of Team Incentive Plans

- Team incentives support group planning and problem solving, thereby building a team culture.
- The contributions of individual employees depend on group cooperation.
- Unlike incentive plans based solely on output, team incentives can broaden the scope of the contribution that employees are motivated to make.
- Team bonuses tend to reduce employee jealousies and complaints over “tight” or “loose” individual standards.
- Team incentives encourage cross-training and the acquiring of new interpersonal competencies.
- Individual team members may perceive that “their” efforts contribute little to team success or to the attainment of the incentive bonus.
- Intergroup social problems—pressure to limit performance (for example, team members are afraid one individual may make the others look bad) and the “free-ride” effect (one individual puts in less effort than others but shares equally in team rewards)—may arise.
- Complex payout formulas can be difficult for team members to understand.

3. Organizational Incentive Plans

- Profit Sharing
  - Any procedure by which an employer pays, or makes available to all regular employees, in addition to their base pay, current or deferred sums based upon the profits of the enterprise.
  - Paid once in a year or deferred sums until retirement

Challenges:

- Agreement over division of profits between company and employees.
- Possibility of no payout due to financial condition of company.
Stock Options
– Granting employees the right to purchase a specific number of shares of the company’s stock at a
guaranteed price (the option price) during a designated time period.
– The value of an option is subject to stock market conditions at the time that option is exercised.

WHY INCENTIVE PLANS FAIL

- Performance pay can’t replace good management.
- You get what you pay for.
- “Pay is not a motivator.”
- Rewards punish.
- Rewards rupture relationships.
- Rewards can have unintended consequences.
- Rewards may undermine responsiveness.
- Rewards undermine intrinsic motivation.

Indirect Financial Compensation – Benefits

Are most effective as motivators when the award is combined with a meaningful employee recognition program.

- Intrinsic motivators are worthwhile as financial package
- Organization reward high performing employees
- Psychological rewards that employees receive in recognition of their skills and contributions

Types of Awards

– Often used to recognize productivity gains, special contributions or achievements, and service to the organization.
– Employees feel appreciated when employers tie awards to performance and deliver awards in a timely, sincere and specific way.

- Recognition awards
  – Recognition has a positive impact on performance, either alone or in conjunction with financial rewards.
  – Combining financial rewards with nonfinancial ones produced performance improvement in service firms almost twice the effect of using each reward alone.
  – Day-to-day recognition from supervisors, peers, and team members is important.
- Service awards
  - Award for the length of service and exactly not on performance
Needs and Motivation

• Abraham Maslow’s Hierarchy of Needs

– Five increasingly higher-level needs:

1. physiological (food, water, sex)
2. security (a safe environment)
3. social (relationships with others)
4. self-esteem (a sense of personal worth)
5. self-actualization (becoming the desired self)

– Lower level needs must be satisfied before higher level needs can be addressed or become of interest to the individual.

• Herzberg’s Hygiene–Motivator theory

– Hygienes (extrinsic job factors)

• Inadequate working conditions, salary, and incentive pay can cause dissatisfaction and prevent satisfaction.

– Motivators (intrinsic job factors)

• Job enrichment (challenging job, feedback and recognition) addresses higher-level (achievement, self-actualization) needs.

– The best way to motivate someone is to organize the job so that doing it helps satisfy the person’s higher-level needs.

Equity and motivation of employees

• Pay Equity (also Distributive Fairness)

– An employee’s perception that compensation received is equal to the value of the work performed.

– A motivation theory that explains how people respond to situations in which they feel they have received less (or more) than they deserve.

• Individuals form a ratio of their inputs to outcomes in their job and then compare the value of that ratio with the value of the ratio for other individuals in similar jobs.
The greater the perceived disparity between my input/output ratio and the comparison person’s input/output ratio, the greater the motivation to reduce the inequity.

- **Vroom’s Expectancy Theory**
  - A person’s motivation to exert some level of effort is a function of three things:
    - **Expectancy**: that effort will lead to performance.
    - **Instrumentality**: the connection between performance and the appropriate reward.
    - **Valence**: the value the person places on the reward.

    \[
    \text{Motivation} = E \times I \times V
    \]

  - If any factor (E, I, or V) is zero, then there is no motivation to work toward the reward.
  - Employee confidence building and training, accurate appraisals, and knowledge of workers’ desired rewards can increase employee motivation.
Determinants of compensation

INTERNAL DETERMINANTS

- Employer’s Compensation Strategy
  - Setting organization compensation policy to lead, lag, or match competitors’ pay.
- Worth of a Job
  - Establishing the internal wage relationship among jobs and skill levels.
- Employee’s Relative Worth
  - Rewarding individual employee performance
- Employer’s Ability-to-Pay
  - Having the resources and profits to pay employees.

EXTERNAL DETERMINANTS

- Labor Market Conditions
  - Availability and quality of potential employees is affected by economic conditions, government regulations and policies, and the presence of unions.
- Area Wage Rates
  - A firm’s formal wage structure of rates is influenced by those being paid by other area employers for comparable jobs.
• Cost of Living

– Local housing and environmental conditions can cause wide variations in the cost of living for employees.

– Inflation can require that compensation rates be adjusted upward periodically to help employees maintain their purchasing power.

• Collective Bargaining

The term extends to all negotiations that take place between an employer, group of employers or one or more employers’ organizations on the one hand, and one or more workers’ organizations on the other to

(a) Determine the working conditions and terms of employment and/or

(b) Regulate relations between employer and employee/workers and/or

(c) Regulate relations between employer organization or employee/workers organization