

CHAPTER 1

THE PAY MODEL

LEARNING OUTCOMES

After studying Chapter 1 students should be able to:

- ❑ Describe how compensation is viewed differently by society, stakeholders, managers, and employees in Canada and around the world.
- ❑ Define the term compensation.
- ❑ Discuss major components of total returns for work.
- ❑ Identify and explain the three strategic objectives of compensation.
- ❑ Describe the four strategic policies in the pay model and the techniques associated with them.

CHAPTER SUMMARY

1. People may have different perspectives on compensation. From the societal perspective, compensation is viewed as a measure of justice as well as a cause of increased taxes and price increases. Stakeholders believe that paying employees in stock creates a sense of ownership that will improve organizational performance. Managers view compensation as a major expense and a means to influence employee behaviour. Employees view compensation as a return in exchange with their employer, or a reward. In other countries, compensation relates to being taken care of.
2. Compensation refers to all forms of financial returns and tangible services and benefits that employees receive as part of an employment relationship.
3. The two major components of total rewards are total compensation and relational returns. Total compensation is composed of cash compensation (base pay and incentives) and benefits. Relational returns include psychological aspects of work such as recognition and status, challenging work, and learning opportunities.
4. The strategic objectives of compensation are (1) efficiency in performance and quality, satisfying customers and stockholders, and controlling costs, (2) fairness, and (3) compliance with laws and regulations.
5. The four strategic policies in the pay model are internal alignment, external competitiveness, employee contributions, and management. The internal structure techniques associated with alignment are job analysis, descriptions, and evaluations/certification. The pay structure techniques associated with competitiveness are market definitions, surveys, and pay policy lines. The incentive program techniques associated with contributions are seniority-based, performance-based, and merit guidelines. The evaluation techniques associated with management are planning, budgeting, and communication.

LECTURE OUTLINE

WHY SHOULD WE CARE ABOUT COMPENSATION?

- Compensation influences the way employees behave.
- The link between behaviour and organizational effectiveness is important to consider.
- If employees also perceive compensation is not fair, then there is great potential for changes in their behaviour to undermine organizational performance.
- Compensation is a significant component of operating expenses and therefore must be controlled and monitored to ensure organizational viability.

COMPENSATION: DEFINITION

Compensation does not mean the same thing to everyone. Yet, how people view compensation affects how they behave at work. Thus, we must begin by recognizing different perspectives.

Compensation refers to all forms of financial returns and tangible services and benefits that employees receive as part of an employment relationship.

Society perceives compensation as a measure of justice (distributive). See Exhibit 1.1 on page 3 to observe the compensation gap between men and women.

Stockholders view executive pay as a special interest. In Canada, pay for executives is supposed to be tied to the financial performance of the company. Unfortunately, this does not always happen.

Managers view compensation as both an expense and an influence on employee work behaviours.

Employees view compensation as a return for the work they perform.

Global views of compensation differ around the world. For example, in China, the traditional characters are based on the signs for logs and water, provides the necessities in life. The word *dai yu* refers to how someone is being treated. In Japan, the word *kyuyo* is used for compensation, which means giving something..

FORMS OF PAY

There are numerous forms of pay that collectively create a system of total rewards. See Exhibit 1.2 on page 6.

Total rewards are all rewards received by employees, including:

1. Cash compensation
2. Benefits, and
3. Relational returns

A) Cash Compensation

1) Base Pay

- a) Wage** is the pay expressed at an hourly rate
- b) Salary** is the pay expressed at monthly or annual rate.

- 2) Merit increases** are given as an increment to the base pay in recognition of past work behaviour. **Cost-of-living adjustment** gives the same percentage increase across the board to everyone, regardless of performance, in order to maintain pay levels relative to increases in the cost of living.
- 3) Incentives/Variable Pay** is one-time payments for meeting preestablished performance objectives in a future time period.
- 4) Long-Term Incentives** are intended to focus employee efforts on multi-year results. Incentives may be short or long term.

B) Benefits

Benefits are indirect compensation which includes health insurance, dental insurance, pensions, and life insurance. They help protect employees from the financial risks inherent in daily life.

- 1) Insurance and Pensions** include those legislated by law (CPP/QPP, EI and Workers' Compensation) and those provided by the employer (company pension, health insurance, and life insurance)
- 2) Work/Life Programs** help employees better integrate their work and life responsibilities include time away from work (vacations, jury duty, drug counselling, financial planning, referrals for child and elder care, flexible work arrangements)
- 3) Allowances** are compensation to provide for items that are in short supply.

C) Relational Returns

Relational returns are the psychological returns employees believe they receive in the workplace, like the following

- 1) Recognition and Status**
- 2) Employment Security**
- 3) Challenging Work**
- 4) Learning Opportunities**

What Do Employees Want?

In the 2010 Global Workforce Study with 20 000 employees in 22 markets, the following were the primary wants of employees:

- Job security
- Job stability
- Managerial support
- Freedom and flexibility
- Personalized work experience
- Relational returns

A PAY MODEL

Pay Model in Exhibit 1.3 on page 10, contains three basic building blocks:

- 1) the strategic compensation objectives,
- 2) the strategic policies that form the foundation of the compensation system, and
- 3) the techniques of compensation.

1) Strategic Compensation Objectives shape the pay system and serve as standard for evaluating the pay system.

1. **Efficiency** improves performance, quality, delighting customers and stockholders and controlling labour costs.
2. **Fairness** attempts to ensure fair pay treatment for all employees by recognizing employee contributions and employee needs. **Procedural fairness** is the fairness of the process used to make a decision.
3. **Compliance** as a pay objective involves conforming to various federal, provincial and territorial compensation laws and regulations.

2) Four Strategic Policies

1. **Internal Alignment** refers to pay 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.
2. **External Competitiveness** refers to compensation relationships external to the organization; i.e., comparison with competitors. Since employees will make comparisons with others doing similar jobs, or with similar skills or competencies outside the organization, pay must be high enough to attract and retain a motivated work force. On the other hand, pay cannot be too high because the employer must control labour costs in order to remain competitive.
3. **Employee Contributions** refers to relative emphasis placed on performance. 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.
4. **Management** refers to the fact that the system will not achieve its objectives unless it is managed properly. Managers need to be competent and 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.

3) Pay Techniques

Pay techniques are the procedures used to operationalize policy decisions. They are the mechanisms used to link the policy decisions to the overall compensation objectives. Job analysis and job evaluation are techniques used to establish a pay structure in order to achieve *internal consistency* in the pay system. Pay surveys are one technique used to establish *external competitiveness*. Incentive plans or performance based pay increases are techniques to distinguish *employee contributions*.

BOOK PLAN

Chapter 2 discusses how to formulate and implement a compensation strategy.

Chapters 3, 4, 5, 6 (internal alignment) examines pay relationships within a single organization.

Chapters 7, 8 examines external competitiveness- the pay relationships among competing organizations and analyzes the influence of market-driven forces.

Chapters 9, 10 examines the amount of pay for each employee, how much and how often should pay be increased and on what basis.

Chapter 11 discusses employee services and benefits.

Chapter 12 examines the role of the government and unions in compensation.

Chapter 13 includes planning, budgeting, evaluating and communication. More detail on global compensation systems is provided in the **Appendix**.

REVIEW QUESTIONS

1. How do differing perspectives affect our views of compensation?

From a societal perspective, compensation may be viewed as:

- A measure of the inherent equity and justice in a society (examine the wages of similarly situated men versus women, minorities, physically and mentally challenged, etc)
- A cause of tax increases (public employee wages) or cost push inflation (increased wages cause higher production costs, which may be passed on a price increases for goods and services.)
- A reason for Canadian difficulties in competing in international markets

From an employee perspective, compensation may be:

- A return for services rendered
- A reward for good performance
- An indicator of the worth of an individual's skills or training
- A major determinant of economic and social well being

From an employer perspective, compensation may be:

- A major expense to be managed

- A means to influence employee work attitudes and behaviour, which affects productivity

2. How does the pay model help organize one's thinking about compensation?

The pay model provides a framework for learning that helps integrate numerous topics (e.g. job analysis, surveys, performance evaluation), and directs us toward the issues of usefulness and appropriateness of each technique. The model should help students understand the role of compensation in the organization, so that as employees or managers, they can make the system work positively for them.

3. What can a pay system do for an organization? For an employee? Are these mutually exclusive?

For an organization, the pay system can:

- Facilitate organizational performance, e.g. motivate workers by recognizing performance with merit pay, attract job applicants in sufficient numbers and quality for optimal productivity
- Control labour costs in relation to production
- Influence employee work behaviours by attracting competent job applicants, inducing people to accept job offers and promotions, or undertake training, retain valued employees and motivate employees to perform effectively
- Comply with pay legislation designating illegal pay discrimination

For an individual, the pay system can:

- Foster pay satisfaction
- Influence their decision to join and stay with an organization
- Motivate the employee to come to work and do a good job
- Undertake training or education programs
- Accept a promotion or work effectively

Both the organization and the employee mutually work together to achieve the goals and objectives of the organization.

EXPERIENTIAL EXERCISES

- 1. What is your definition of compensation? Which meaning of compensation seems most appropriate from an employee's view- return, reward, or entitlement? Compare your ideas with someone who has more experience, with someone from another country, with someone from another field of study.**

Students may focus on direct compensation only, since many of them have part-time, summer or contract jobs. The students can share their experiences. Point out that people's perspectives vary depending on their experiences in their country.

2. List all the forms of pay you receive from work. Compare to someone else's list. Explain any differences.

Different pay forms would include pay received directly as cash such as: base, merit, incentives, and cost-of-living adjustments. Pay received indirectly would include: pensions, medical insurance, and programs to help balance work and life demands.

Someone else's differences could include financial incentives, such as piece rate production or salary and commission base pay for employees. Other forms of pay could be straight commission, especially for a sales position or any number of indirect pay benefits. These benefits could include health insurance, life insurance, dental, optical and prescription drug plans. Mandatory fringe benefits required by employers are employment insurance and workers compensation.

Differences will occur depending on the size of the company, type of company and the financial status of the company.

3. What is the "network of returns" upon completion of the program at your current institution? Do you think these are achievable? What are some of the things you can offer your employer?

Typically the whole organization is involved in a network of returns which includes all forms of compensation (cash and benefits) and relational returns (recognition and status, employment security, challenging work and learning opportunities)..Not all the network of returns is available to a student – no cash, some benefits, challenging work and learning opportunities. New graduates can offer knowledge, skills, motivation etc.

4. Answer the two questions in the chapter's Conclusion, above (Why do it this way? So what?) for any study or business article that tells you how to pay people. Such articles can be found in the *WorldatWork Journal* or *Compensation and Benefits Review*.

Students' responses will vary depending on their articles. Stimulate a discussion on these articles to generate diversity and breadth for these questions.

CASE: Inside Internships

Summary of Case

Many students work as unpaid interns as they begin their careers. The internship was provided through Career Edge, a private organization that arranges youth internships. Rebecca Fraser completed a one-year internship at TD Waterhouse. When her internship was coming to an end, her manager recommended her for a short-term contract position

in another department. That position led to a full-time permanent job with TD Waterhouse. Rebecca was very happy with this opportunity.

Questions

- 1. What do employers receive from summer interns? What returns do students get from the opportunities?**

Employers receive an opportunity to judge the capabilities of the intern before hiring them. Summer interns are usually talented in their fields. Students get the opportunity to develop their knowledge and skills and therefore make them more marketable in their professional field. Internships also provide a useful network of contacts.

- 2. Should summer interns be paid? If so, how much? How would you recommend an employer decide the answers to both these questions?**

Student responses will vary. Analyze why the employer would offer a non-paying internship. To what pressures is an employer responding? Non-paying internships with government look good on your resume, demonstrate seriousness of purpose and willingness to work hard for goals to which you are committed. On the other hand, internships should be paid to give credibility to the program and motivate the employee. Suggestion of pay could be approximately \$15,000/yr.

- 3. What added information would you like to have before you make your recommendations? How would you use this information?**

Students responses will vary. Added information would be: does the employer have an internship program that is offered to community college and university students. There are many benefits to an internship program. The employer must weigh and analyze these benefits. A human resource plan should reflect this internship program and whether the employer can finance the internship through the payment of wages to students enrolled or a part of the internship.