

HUMAN RESOURCE MANAGEMENT – LECTURE 11

CHAPTER 11 – MOTIVATING EMPLOYEES THROUGH COMPENSATION

LESSON 11

How Can Strategic Employee Compensation Make an Organization Effective?

Employee remuneration is the practice of compensating and recognizing individuals for their contributions to an organization. Obviously, the quantity of money that employees take home on a weekly basis is a significant component of compensation, but there are also other crucial elements. Included in compensation are advantages including as insurance, retirement savings, and paid vacation time. Positive sensations associated with working at a particular location are frequently viewed as a type of compensation. In a broad sense, pay is the complete monetary and non-monetary advantages that an employee receives from a business.

A market-based pay approach that aims to create a wage structure in which people are compensated fairly relative to what they could earn performing a comparable job for another company in the same geographic area.

How Is Employee Compensation Strategic?

Strategic compensation strategies motivate employees to put out their best effort and contribute to the production of the organization's goods and services. Similar to other parts of human resource management, an organization's pay policies are most effective when they align with its entire HR strategy.

External Versus Internal Labor

Organizations with an external labor orientation commonly hire new employees who are not expected to develop a long-term commitment to the company. The lack of long-term commitment increases the importance of pay. In reality, salary is the key factor in these workers' employment selections. Current and prospective employees typically compare the salary packages of the business to those of other employers. In such work situations, the employees' view of external equity, which concerns the fairness of their compensation relative to what they may earn elsewhere, is crucial. People who perceive an absence of external equity grow unsatisfied and seek employment elsewhere. This necessitates that organizations with an external labor focus often evaluate how their compensation stacks up against that of other organizations.

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Critical are the employees' perceptions of internal equality, or their beliefs regarding the fairness of their compensation relative to that of other employees. Therefore, organizations with an internal focus devote a substantial amount of time and effort to comparing and evaluating wage disparities among their own personnel. In these firms, pay practices, such as how much each employee earns, are typically less clandestine than in organizations with an external orientation. Long-serving employees are also rewarded by firms with an internal focus with long-term incentives.

DIFFERENTIATION VERSUS COST STRATEGY

Organizations adhering to a differentiation strategy seek for people with exceptional performance who produce superior goods and services. The use of compensation to encourage risk-taking. Additionally, organizations with differentiation strategies pay some employees far more than others. Due to the fact that success is mostly dependent on the contributions of a few exceptional individuals, these companies reward high performance by paying good performers significantly more than low performers. The outcome is a considerable disparity between the salaries of high and low contributors.

ALIGNING COMPENSATION WITH HR STRATEGY

Figure 11.1 is the consequence of combining disparities in internal and external compensation with differences in cost and differentiation. The horizontal dimension represents cost and differentiation-related differences. The primary distinction in this case is the degree to which high performers are compensated differently than low performers. Variable rewards are related with a differentiation HR strategy, the purpose of which is to pay strong performers more than low performers. The objective of a cost-reduction strategy with uniform rewards is to provide consistent compensation for all employees, regardless of variances in performance. The vertical dimension of Figure 11.1 shows the desired kind and duration of the employee-organization connection. Connection commitment is a form of relationship.

Relational commitments are largely motivated by social ties as opposed to monetary incentives. In this form of relationship, employees continue to work for an organization because they experience a sense of belonging. The group employs pay to foster a sense of support and friendship. Transactional commitment is another sort of relationship. Transactional commitments are primarily motivated by monetary incentives. In this form of connection, employees are driven by immediate compensation. No one expects employees to create a long-term relationship with the firm, despite the fact that money is used to encourage individuals

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to make excellent contributions. Combining the two aspects produces four general compensation strategies: transactional uniform, relational uniform, variable relational, and transactional variable.

Uniform Transactional Compensation

Perhaps you or a close friend have worked as a grocery store bagger. The majority of people in this position do not anticipate a long-term career. There is also minimal difference in pay for baggers with high and low performance. This is an example of transactional remuneration that is commonly associated with the HR strategy of Bargain Laborer.

Variable Transactional Compensation

The primary source of motivation for employees in firms employing a Free Agent HR strategy is compensation. These firms utilize variable transactional compensation, which provides substantial financial incentives for top performers. A suitable illustration would be a technology consulting firm. Because they are compensated well, highly talented people choose to join and remain with a company. Because firms implementing a Free Agent HR model require exceptional workers with fairly uncommon skills, they must offer more compensation than other employers. Paying top performers within an organization more than low performers encourages more productive individuals to apply for available positions.

Variable Relational Compensation

Organizations implementing a Committed Expert HR strategy use compensation to reward top performers, while simultaneously aiming to foster long-term commitment. The aims of variable relational compensation are the following. Those who achieve these objectives are compensated more than those who do not. Thus, individuals performing the same task are frequently compensated disparately. A laboratory for medical research and development exemplifies this strategy and compensation. The necessity for long-term contributions needs remuneration practices that link workers to long-term careers.

How Does Compensation Motivate People?

Motivation can be defined as a force that causes people to engage in a particular behavior rather than other behaviors. More specifically, motivation is represented by three elements: behavioral choice, intensity, and persistence.

THEORIES OF MOTIVATION

Reinforcement theory - A psychological theory suggesting that people are motivated by antecedents (environmental cues) and consequents (rewards and punishments).

Contingency - A reinforcement principle requiring that desirable consequents only be given after the occurrence of a desirable behavior.

Pay-for-performance - Compensation practices that use differences in employee performance to determine differences in pay.

Goal-setting theory - A psychological theory suggesting that an individual's conscious choices explain motivation.

Justice theory - A psychological theory suggesting that motivation is driven by beliefs about fairness.

Equity theory - A justice perspective suggesting that people determine the fairness of their pay by comparing what they give to and receive from the organization with what others give and receive.

The theory of equity is an example of distributive justice. The objective of distributive justice is to ensure that results are equitable. Regarding remuneration, distributive justice focuses on whether or not individuals believe their salary is fair. Procedural justice is a distinct type of justice that focuses on the fairness of the methods used to assign outcomes. This article focuses on the method used to determine who receives certain incentives.

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Expectancy Theory

Expectancy theory offers a somewhat complex view of how individuals are motivated. The theory proposes that motivation comes from three beliefs: valence, instrumentality, and expectancy.

Valence

The value that an individual places on a reward being offered.

Instrumentality

The belief in the likelihood that the reward will actually be given contingent on high performance.

Expectancy

An individual's belief that he or she can do what is necessary to achieve high performance.

Agency theory

An economic theory that uses differences in the interests of principals (owners) and agents (employees) to describe reactions to compensation.

Linking Motivation with Strategy

Each motivational theory has a slightly distinct emphasis, and notions from one theory may sometimes contradict concepts from another theory. Nonetheless, numerous fundamental concepts can be derived from motivational theories. These ideas provide guidelines for establishing the most effective compensation approaches to inspire employees.

How Is Compensation Level Determined?

Pay level—the amount of overall pay that employees earn in that organization relative to what employees earn in other organizations. As with motivational strategies, the pay-level strategy an organization chooses depends largely on its competitive strategy. However, the first step in the

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process of determining pay level is to gain information to understand the compensation packages being provided by other organizations. This is done through pay surveys.

Pay survey - Gathering information to learn how much employees are being paid by other organizations.

Meet-the-market strategy - A compensation decision to pay employees an amount similar to what they can make working for other organizations.

Lag-the-market strategy - A compensation decision to pay employees an amount below what they might earn working for another organization.

Lead-the-market strategy - A compensation decision to pay employees an amount above what they might earn working for another organization.

How Is Compensation Structure Determined?

There are two primary approaches to defining compensation structure. One way, commonly referred to as job-based pay, evaluates differences in the activities and responsibilities associated with various occupations. With this system, it is anticipated that those with more challenging tasks will be compensated more. The alternative strategy focuses on directly examining differences in employees' skills and abilities and is commonly known as skill-based pay. In an organization that utilizes skill-based pay, an employee may be compensated for possessing a certain set of talents, even if the tasks the employee typically does do not need those skills.

JOB-BASED PAY

There are two primary techniques to establishing the structure of compensation. One method, known as job-based pay, examines differences in the activities and responsibilities associated with different employment. It is envisaged that people with more difficult responsibilities will be reimbursed more under this approach. The alternative technique is usually

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known as skill-based pay and focuses on explicitly examining disparities in employees' skills and talents. In a company that uses skill-based pay, an employee may be compensated for possessing a given set of talents, even if the jobs they regularly perform do not require them.

How Do Government Regulations Influence Compensation?

Fair Labor Standards Act (FLSA) - Federal legislation that governs compensation practices and helps ensure fair treatment of employees.

Exempt employees - Workers, such as executives, administrators, professionals, and sales representatives, who are not covered by the FLSA.

Nonexempt employees - All employees who are not explicitly exempt from the FLSA, sometimes referred to as hourly workers.

Minimum wage - A compensation rule requiring organizations to pay employees at least a certain amount for each hour they work.

Overtime - A compensation rule requiring organizations to pay a higher hourly rate for each hour that a nonexempt employee works beyond 40 hours in a one-week period.

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True or False

1. When individuals believe they are not being paid appropriately, they frequently steal from their employer.
2. Increasing employee salary has no effect on motivation unless workers perceive that they have the necessary skills and abilities to improve their performance.
3. Those who are well compensated care little about what others are paid.
4. When organizations pay their employees no more than their competitors, they are more profitable.
5. Paying certain workers far more than their peers can reduce teamwork and cooperation.
6. Typically, a point system that assigns a numerical value to each work position is employed by a skill-based compensation system.
7. In a company with a market-leading strategy, the average pay level is higher than the market average.
8. Pay surveys are frequently undertaken by consulting firms, which collect confidential data from a variety of corporations and generate reports describing average pay levels without revealing specific company names.
9. The purpose of standard procedures is to foster a culture of equity and collaboration.
10. According to agency theory, we can obtain insight into motivation by considering these differences.

Answer Key

1. True
2. True
3. False
4. False
5. True
6. False
7. True
8. True
9. True
10. True

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Essay Questions

1. How is employee compensation strategic?
2. How does compensation motivate people?
3. How is compensation level determined?
4. How is compensation structure determined?

Answer Key

1. The compensation varies in two dimensions. The varied or uniform nature of compensation is one dimension. The goal of uniform compensation is to foster a sense of togetherness by compensating people similarly, regardless of their degree of performance. Variable compensation tries to compensate top performers generously greater than subpar performers. Another aspect of compensation is the distinction between relational and transactional commitment. Transactional obligations emphasize immediate compensation and bonuses. Relational commitments emphasize organizational long-term rewards and psychological support.

2. People are motivated at work when they choose to engage in activities that enhance organizational success and when they pursue such actions with vigor and persistence. According to the principle of reinforcement, individuals engage in behavior when they obtain favorable outcomes. Nonetheless, only contingent consequences inspire activity. In the context of remuneration, this implies that increased pay should only be awarded when performance is exceptional.

3. Utilizing pay surveys to ascertain compensation rates in a set of comparable firms. Some information for salary surveys can be collected from public sources, such as the Bureau of Labor Statistics, but private consulting firms perform the majority of surveys. Quality pay surveys ensure that the comparison group is comprised of companies with the appropriate geographic and strategic

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features. Additionally, care must be made to verify that the tasks being evaluated in the comparison group are comparable to those in the organization of interest.

4. Pay structure refers to the relative compensation of employees within a business. With job-based compensation, each job is granted a point value based on numerous employment qualities, and those who work in positions with a higher point value are compensated more. The benefits of job-based pay include objectivity, simplicity of comparing jobs, and transparent means of administering compensation. The disparities in employee skills are the basis for deciding pay in skill-based compensation. Employees have the option to earn more as their abilities improve. The benefits of skill-based compensation include enhanced flexibility, a higher emphasis on participation, and a more skilled labor force.