

## **HUMAN RESOURCE MANAGEMENT – LECTURE 12**

### **CHAPTER 12 – DESIGNING COMPENSATION AND BENEFITS PACKAGES**

#### **LESSON 12**

##### **How Can a Strategic Compensation Package Make an Organization Effective?**

A pay package is the assortment of benefits that employees receive from a firm. The greatest portion of most compensation packages is the pay or salary paid. Some employees are paid a predetermined sum for each period, while others are compensated based on their performance. In these circumstances, establishing the percentage of pay that will be performance-based is a crucial compensation decision. When compensation is tied to performance, it is crucial to determine whether the amount given will depend on individual performance, group performance, or the performance of the entire business. The remainder of the compensation package consists of employee benefits like as health insurance and retirement savings. Organizations must determine what proportion of employee compensation will take the form of employee benefits. The key to success in making all of these crucial compensation decisions, as well as decisions about other human resource practices, is to ensure that the decisions correspond with organizational strategy.

##### **How Do Compensation Packages Align with Strategy?**

###### **At-Risk Compensation**

The degree of pay to risk is an element of strategic design. At-risk pay is compensation that can fluctuate from one pay period to the next. The employee will not earn the money unless performance objectives are reached.

In actuality, the majority of compensation packages incorporate both risk-based and guaranteed compensation. The key to aligning compensation with strategy is determining the proportion of remuneration to place at risk. On the one hand, firms adopting a differentiation strategy aim to hire and retain exceptional individuals. These organizations are successful because they encourage

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employees to exceed minimum requirements. This can be accomplished in part by providing employees with strong incentives that place a considerable portion of their salary at risk.

**Line of Sight**

Another aspect of strategic pay package is employees' views of their influence over significant outcomes. It is essential that employees believe their activities have a genuine impact on the outcomes used to determine whether they will earn a particular incentive. In other words, employee motivation increases when they are paid for visible accomplishments.

**Common Elements of Compensation Packages**

Compensation packages are most effective when tailored to the specific needs of a given firm. However, fundamental features of pay are consistent across enterprises. One factor is base wage. Base pay is a non-risky form of compensation that can take the shape of an hourly wage or an annual salary.

The employee benefit package is typically another component of remuneration packages that is not at risk. As we've seen, employee benefits are rewards other than monetary income and compensation. Statutes and tax regulations oblige organizations to provide comparable benefits to all employees. Thus, benefits provide a risk-free component of pay.

Group incentives are a typical form of risk-based remuneration seen in compensation packages. A group incentive is a reward based on the team or organization's collective performance. Because individual incentives can hinder cooperative effort, many firms use group incentives to encourage employees to contribute to the group's common objectives.

**What Are Common Approaches to Base Pay?**

The opportunity to plan and budget personal resources afforded by base pay provides employees with stability. Certain individuals prefer to avoid taking risks and are consequently drawn to organizations that guarantee a set income. From the organization's perspective,

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calculating basic pay is straightforward. Most firms mix base pay with additional incentives. Base pay provides employees with a safety net, whereas individual and group incentives reward exceptional achievement.

The total compensation comprises both base pay and bonuses. The primary question is therefore what portion of total compensation will be base pay and what portion will be incentive pay. In general, firms that prioritize innovation and increased individual performance place a greater proportion of total remuneration at risk. In firms employing the Bargain Laborer and Loyal Soldier human resource strategies, base pay accounts for a greater proportion of total compensation. Nonetheless, the "Building Strength Through HR" article illustrates how Netflix deviates from the norm by using a high rate of base pay as a powerful incentive for outstanding performance. Even though their entire HR strategy is closer to the Free Agent strategy, they prioritize base pay.

### **What Are Common Employee Benefit Plans?**

The majority of the growth in employee benefits is due to favorable tax laws. Employees are generally not required to pay taxes on the benefits they receive. However, they must pay taxes on their wages and salaries. This means that firms can deliver greater value to employees through benefits.

Perks are a key tool for attracting and retaining outstanding employees. However, many companies fail to maximize the value of their employee benefits. The majority of employees grossly misunderstand how much their employers spend on benefits. In order to maximize the benefits package's contribution to the overall pay strategy, it is crucial to effectively communicate the monetary value of employee perks. The benefits offered to employees fall into two basic groups. One category includes statutorily mandated benefits. The other group comprises of advantages that employers grant employees willingly.

### **Legally Required Benefits**

Government regulations mandate benefits that are necessary by law. The restrictions are intended to shield individuals from the hardships associated with inability to work and make a living.

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Workers who are wounded, laid off, or beyond the age at which they could reasonably be expected to work receive protection. In the majority of instances, legally mandated benefits must be provided to all employees in prescribed quantities. This makes it difficult for a company to leverage legally mandated benefits to create a more appealing workplace than its competitors.

**Social Security**

In the early days of the United States, the majority of people lived in large farming families. Families collaborated to assist those whose age or health stopped them from working. As more people moved to cities, this dependence on family diminished, necessitating the need for new kinds of assistance for the old and disabled. The Social Security Act established a social security system in which workers contribute to a fund and then draw from it in retirement.

**Unemployment Insurance**

The Social Security Act of 1935 also established incentives for governments to offer unemployment insurance to workers. The measure imposed a 3 percent payroll tax on businesses with eight or more employees. However, the measure permitted payments to state unemployment funds to offset the tax. This led in a system in which each state has an unemployment insurance program that protects workers who lose their jobs due to no fault of their own.

**Workers' Compensation**

All states have worker's compensation schemes, which compensate employees for injuries sustained on the job. Due to the fact that worker's compensation is no-fault insurance, individuals receive payments even if their own negligence caused the injury.

The cost of worker's compensation insurance varies according on the nature of the sector and the employer's accident record. Organizations that participate in dangerous employment and have a high accident rate pay more than those that provide a workplace with a low risk of injury or accident. This offers an incentive for firms to preserve the safety of their employees, which is another way for organizations to strategically benefit from legally mandated benefits.

### **Discretionary Benefits**

The majority of companies provide employees with a comprehensive benefits package that exceeds the minimum legal requirements. Offering benefits in excess of what is legally necessary allows employers to use perks as a strategy for recruiting and retaining employees. Common discretionary benefits include healthcare plans, additional insurance, retirement savings, and non-work-related compensation.

### **What Are Common Individual Incentives?**

The majority of businesses offer at least a few incentives to recognize strong performers. These incentives may be offered to individuals or groups. In this part, we evaluate individual worker motivations.

Individual incentives are something that everyone encounters very early on. If you clean your room, you can play outside. If you consume your carrots, you can have a cookie. You can purchase a new toy if you enter the store without haste. These are frequent incentives used by many parents to motivate their children's conduct. In many ways, rewards in organizations are comparable. On completion of the project on time, you will receive a bonus. Cooperating with coworkers will result in a salary increase. Close the deal and you'll receive a substantial commission. Each of these incentives is contingent on individual success. Those that complete the necessary steps or achieve the expected goals are rewarded.

### **Piece-Rate Incentives**

Suppose you are paid to install automobile stereos. A standard compensation plan may pay an hourly wage. The hourly rate would be paid regardless of the number of stereos installed. None of your compensation is at danger. Alternatively, you could be paid a certain fee for each radio you install. If no stereos are installed, you earn nothing. Your entire salary is at jeopardy. This is an example of a piece-rate incentive, in which workers are paid a defined sum for each unit of product they create.

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The base wage is the intended compensation for the position, and it is competitive with equivalent positions in other firms in the same geographic region. It is determined through time studies how many units an average worker in each occupation can create each hour. The standard rate refers to the average number of units generated each hour. Employees are compensated for each unit they generate; therefore, a worker who produces the standard rate of units earns the equivalent of the minimum wage. A worker whose output exceeds the standard rate is compensated with a higher hourly wage. A worker that produces fewer units is compensated with a reduced hourly salary. Thus, compensation is based on the quantity of units generated.

## **COMMISSIONS**

Commissions are a sort of piece-rate pay that are typically related with sales. A commission, or a percentage of the total cash received, is paid to the salesman for each transaction made. For items such as novelty items, commission fees can reach up to 50 percent of total sales, compared to 3 percent for real estate. In a system based solely on commission, sales personnel are compensated only when they generate sales. Sales agents may also receive a base pay plus commissions.

## **Merit Pay Increases**

Numerous employees, especially university professors, anticipate yearly salary increases. One of the purposes of the annual raise is to ensure that a person's compensation keeps pace with inflation. In most years, the cost of living rises, necessitating a salary raise so that employees may maintain their quality of life. In the majority of firms, however, employees do not receive comparable raises. Some employees are paid more than others. The majority of yearly increases include a merit pay rise, which is an increase in base income or hourly rate that is performance-based. Increases in merit pay compensate employees for their continued contributions. Research indicates that firms that offer merit-based pay increases are truly more productive.

## **Merit Bonuses**

A merit bonus is an additional sum of money given to an employee on top of their regular earnings. In contrast to a merit bonus, a merit pay raise is incorporated into the employee's base salary for the next year. In many instances, merit incentives are distributed on a regular basis, such as at the end of the year.

## **What Are Common Group and Organizational Incentives?**

Team bonuses and profit-sharing schemes are typical group-based incentives. The majority of companies also use organizational incentives to encourage employees to establish a sense of ownership within the corporation. Profit-sharing and stock programs are two common corporate incentives.

## **Team Bonuses and Incentives**

Individual incentives and team rewards are comparable in numerous ways. Individual incentives are tied to an individual's success, whereas team incentives are tied to the collective performance of the group. When the group as a whole exhibit's exceptional achievement, rewards are awarded. When the group being measured is relatively small, when collective performance can be effectively measured, and when management support for the program is strong, team incentives are most effective. The goal-based team reward is a sort of group incentive that gives a payout when a team achieves a particular objective. Thus, goal-based team rewards are a type of contract in which the organization commits to offer a reward if the team achieves a particular performance goal. Another type of team incentive is the discretionary team bonus, which gives compensation for exceptional achievement. With discretionary rewards, no predetermined outcome is intended.

## **Gainsharing**

Gainsharing is when groups of employees receive a piece of the cash return from cost reduction and productivity improvement. Essentially, gainsharing aligns the interests of employees with those of business owners.

### **Profit Sharing**

Profit sharing happens when employees get incentives depending on the overall profitability of the firm. Seventy percent or more of Fortune 1000 organizations engage in some sort of profit sharing. In the majority of profit-sharing arrangements, employees receive a portion of the company's publicly stated earnings. Others defer payment so that employees only earn a portion of the profit after a number of years of employment.

### **Stock Plans**

Employee ownership is one strategy to align the interests of employees and owners. This is possible in corporations through stock ownership. Stock plans distribute shares of the company to employees. In some instances, direct stock grants are made to employees. However, the majority of companies provide stock options, which reflect the right to purchase company stock at a certain price at a future period. The majority of stock options are granted at the market price. This implies that the stock option has no value unless the stock price rises, as anyone can purchase the shares at its current price.

### **How Do Strategic Decisions Influence a Compensation Package?**

The broad human resource strategy is then driven by the competitive strategy. After determining the human resource strategy, a number of compensation decisions are made to match the incentive system's components with the strategy. These decisions include creating a salary and a pay structure. The amount of at-risk compensation to include in the package is a crucial issue. After determining the percentage of at-risk pay, compensation must be allocated between base pay, benefits, individual incentives, and group incentives.

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**True or False**

1. By providing perks including as insurance and retirement plans, organizations boost the overall value of compensation.
2. If all members of a team are paid the same amount, some members will work less diligently.
3. An annual raise is a critical motivator for the majority of employees.
4. Giving employees business stock is an ineffective method of motivating.
5. The majority of recent college graduates are willing to work long hours in monotonous jobs if they are compensated well.
6. Workers that place an excessive emphasis on achieving great individual performance frequently detract from the group's overall performance.
7. When employees are rewarded for outcomes that are within their line of sight, their motivation increases.
8. Base pay is a non-risky form of compensation that can take the shape of an hourly wage or an annual salary.
9. Benefits are a sort of short-term pay that strengthens employee loyalty and ties them to a firm.
10. Paying employees by the hour as opposed to a wage has also been found to increase their awareness of the worth of their time, which can lower their motivation.

**Answer Key**

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

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**Identification**

1. A company-wide incentive scheme that distributes a portion of organizational revenues to employees.
2. A program that allows employees to select the desired perks from a list of available benefits.
3. Compensated time off, like as for holidays.
4. Employees who are unable to work due to illness are compensated.
5. A type of insurance that pays death benefits to the insured's family or other dependents.
6. A type of insurance that gives compensation to persons who become unable to work due to mental or physical illness.
7. A benefit plan that complies with federal requirements in order to provide employees with nontaxable perks.
8. A health insurance plan that provides medical services to employees.
9. Other than income and pay, benefits often include retirement savings and insurance.
10. A reward that is contingent on the performance of the employee.

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**Answer Key**

1. Profit Sharing
2. Flexible benefit programs or cafeteria benefits
3. Pay without work
4. Sick Leave
5. Life Insurance
6. Disability Insurance
7. Qualified Benefit Plan
8. Healthcare Plan
9. Employee Benefits
10. Individual Incentive