

Human Resource Management

Chapter 11

Motivating Employees Through Compensation

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Learning Objectives

After reading this chapter you should be able to:

- Describe how employee compensation practices strategically align with overall HR strategy.
- Use the concepts of reinforcement theory, goal setting theory, equity theory, expectancy theory, and agency theory to explain how people react to compensation practices.

Learning Objectives

After reading this chapter you should be able to:

- Describe how pay surveys are conducted and used to create compensation level strategies.
- Explain job-based pay and skill-based pay approaches to compensation structure.
- Describe the major protections provided by the Fair Labor Standards Act, as well as state and local regulations.

How Can Strategic Employee Compensation Make an Organization Effective?

- **Employee compensation** is the process of paying and rewarding people for the contributions they make to an organization.
- Compensation is a broad term which includes pay and benefits such as insurance, retirement savings, and paid time off from work.
- Compensation represents the total package of rewards—both monetary and nonmonetary.

HOW IS EMPLOYEE COMPENSATION STRATEGIC?

- Compensation practices are strategic because they encourage employees to put forth their best effort and perform in ways that help the company produce its particular goods and services.
- Organizations choosing an external labor orientation frequently hire new employees, and these employees are not expected to form a long-term attachment to the organization.

External Equity

- Employees' perception of **external equity**— which concerns the fairness of what the company is paying them compared with what they could earn elsewhere—are critical in such employment relationships.
- Organizations with an external labor orientation must assess how their compensation compares with the compensation offered by other organizations.

Internal Equity

- Employees' perceptions of **internal equity** are their beliefs concerning the fairness of what the organization is paying them compared with what it pays other employees.
- Organizations with an internal orientation spend time and effort comparing and analyzing pay differences among their own employees.

Internal Equity

- Pay practices, such as how much each person makes, are usually less secretive in these organizations than in organizations with an external orientation.
- Internally oriented organizations also use long-term incentives to reward employees who stay with them for long periods.

Figure 11.1 Strategic Framework for Employee Selection



Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). *Human Resource Management Linking Strategy to Practice*. pp - 416

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.
- Motivation is represented by three elements: behavioral choice, intensity, and persistence
 - *Behavioral choice* involves deciding whether or not to perform a particular action.
 - *Intensity* concerns deciding how much effort to put into the behavior.
 - *Persistence* involves deciding how long to keep working at the behavior.

Motivation Theory

- Motivational theory and Compensation
 - Reinforcement theory
 - Goal-setting theory
 - Justice theory
 - Expectancy theory
 - Agency theory

Reinforcement Theory

- Comes from the field of psychology, holds that behavior is caused by chains of antecedents and consequents.
 - *Antecedents* are factors in the environment that cue someone to engage in a specific behavior.
 - *Consequents* are results associated with specific behaviors.
 - Antecedents and consequents are linked together because the antecedent causes people to think about the consequent.
- When linked to compensation the theory states people will engage in the behaviors for which they are rewarded.

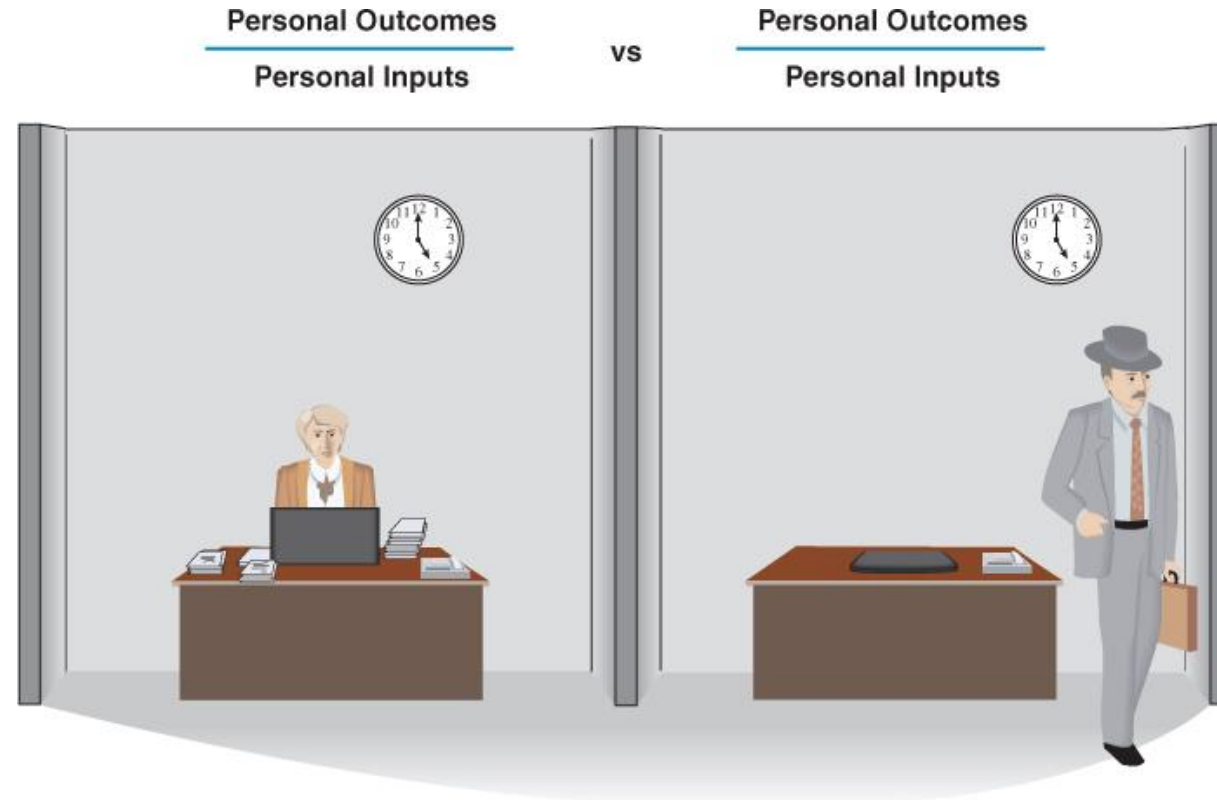
Goal-Setting Theory

- **Goal-setting theory** is grounded in cognitive psychology and holds that behavior is motivated by choices.
- Goals improve performance through four specific motivational processes:
 - Goals focus attention away from other activities toward the desired behavior.
 - Goals get people energized and excited about accomplishing something worthwhile.
 - People work on tasks longer when they have specific goals.
 - Goals encourage the discovery and use of knowledge.

Justice Theory

- This theory holds that motivation depends on beliefs about fairness.
 - Early form of this theory is equity theory. In equity theory people compare their inputs and outcomes to the inputs and outcomes of others.
- Equity theory is an example of what is known as distributive justice.
 - **Distributive justice** is concerned with the fairness of outcomes. In terms of compensation, distributive justice focuses on whether people believe the amount of pay they receive is fair.
 - A different form of justice is **Procedural justice**, which is concerned with the fairness of the procedures used to allocate outcomes. The focus here is on the process used to decide who gets which rewards.

Figure 11.2 Equity Theory

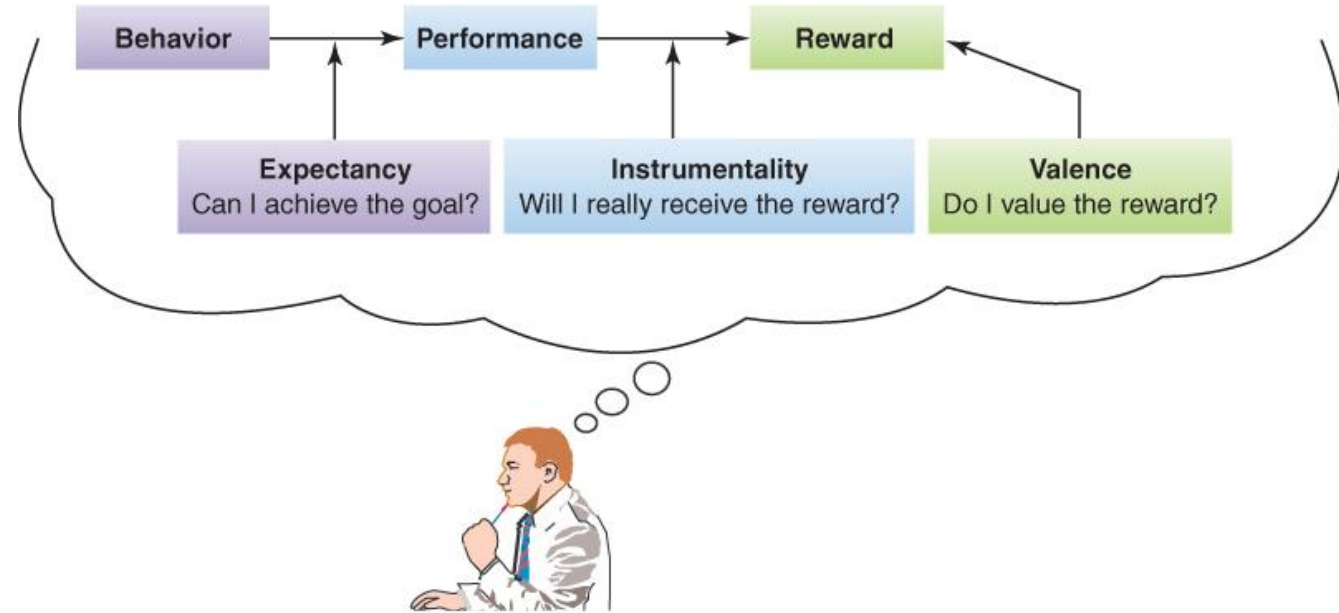


Motivation is determined by comparisons with others.

Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). *Human Resource Management Linking Strategy to Practice*. pp - 422

Figure 11.3 Expectancy Theory

This theory proposes that motivation comes from three beliefs: valence, instrumentality, and expectancy.



Motivation is a function of beliefs.

Agency Theory

- Agency theory focuses on the differences in interests between principals and agents to describe reactions to compensation.
- The conditions under which subordinate agents work with corporate managers may directly influence the behavior of the organization, such as taking risks pertaining to new ventures.
- Issues such as remuneration and risk-taking are among the major concerns of both parties in this relationship.

Linking Motivation With Strategy

- Variable Compensation and Motivation
- Uniform Compensation and Motivation

Table 11.1

Principles for Increasing Motivation through Compensation

Develop pay-for-performance plans.

Link pay with goals that encourage stretch efforts.

Understand the referent groups employees use when assessing the fairness of pay.

Follow principles of procedural fairness, including accurate assessment, lack of bias, and opportunity to have input.

Provide rewards that are large enough to matter.

Coordinate with selection and training to ensure that employees have the skills they need to meet goals.

Align the interests of employees with the interests of owners.

Give higher rewards for employees who assume risk.

HOW IS COMPENSATION LEVEL DETERMINED?

- It all begins with the pay survey.
- The pay survey provides information about how much other organizations are paying employees.
- Pay surveys are conducted by consulting firms, which obtain confidential pay information from numerous organizations and create reports that describe average pay levels in other organization.

HOW IS COMPENSATION LEVEL DETERMINED?

- Good comparison groups often include organizations that compete in the same product and service markets.
- This makes it easier to determine if the companies pay practice gives it a competitive advantage.

Figure 11.4 Sample BLS Pay Survey Results

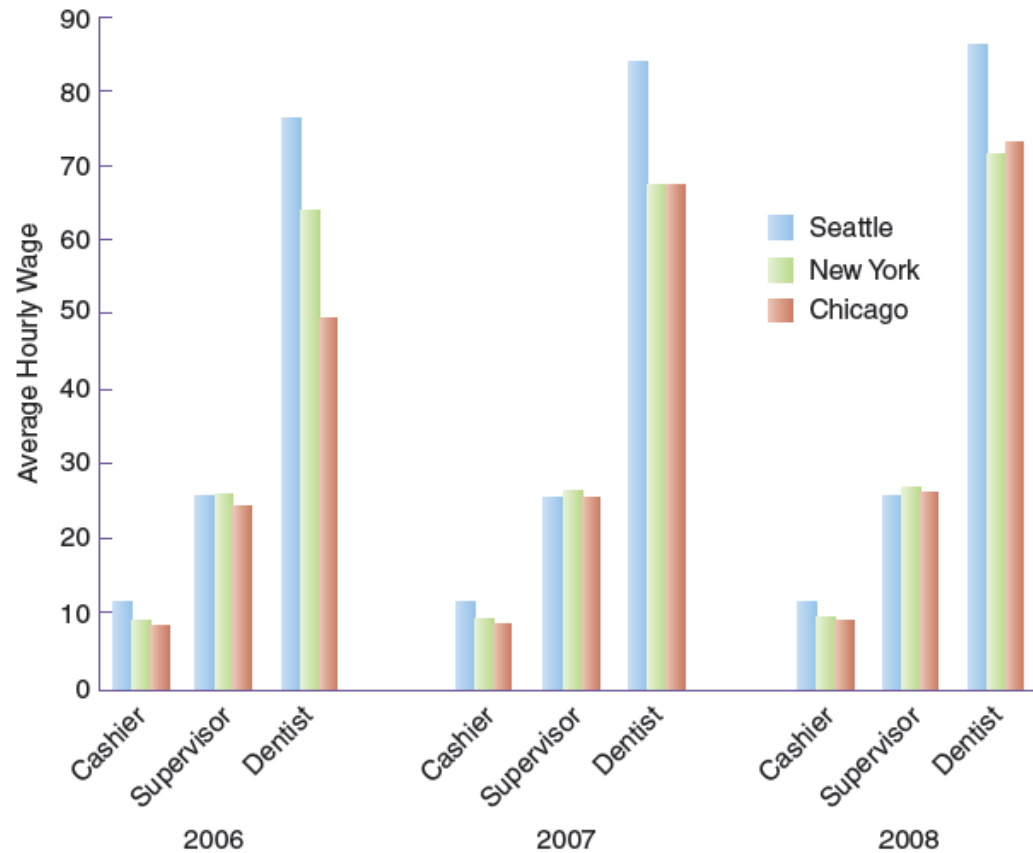


Figure 11.4 Sample BLS Pay Survey Results. *Source* : Information from Bureau of Labor Statistics (<http://www.bls.gov/home.htm>).

Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). Human Resource Management Linking Strategy to Practice. pp – 429

Figure 11.5 Pay Survey Results for Training Professionals

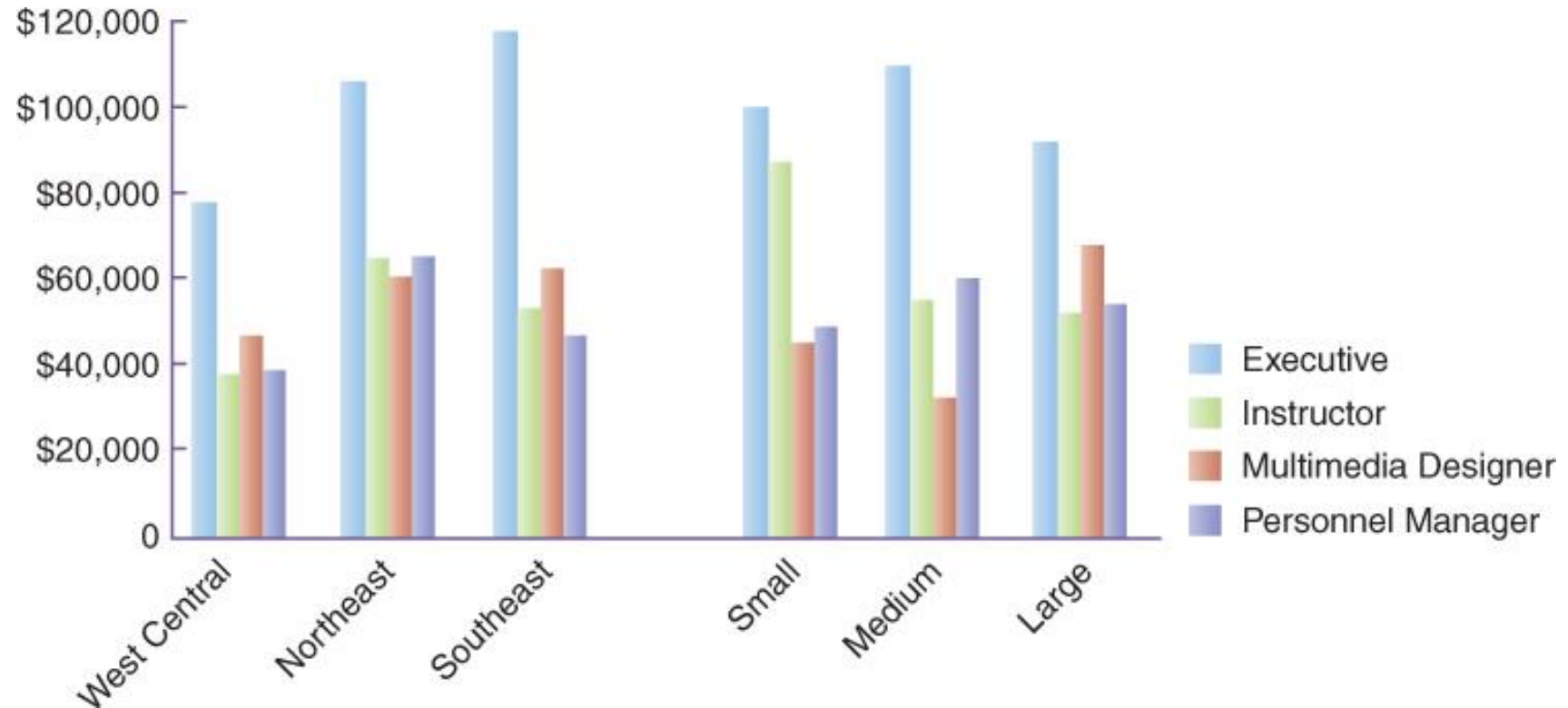


Figure 11.5 Pay Survey Results for Training Professionals. *Source* : Information from Holly Dolezalek, "The 2005 Annual Salary Survey," *Training* 42, no. 10 (2005): 12–23.

Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). Human Resource Management Linking Strategy to Practice. pp – 431

Pay-Level Strategies

- There are three market strategies
 1. **meet-the-market** which establishes pay that is in the middle of the pay range for the selected group of organizations.
 2. **lag-the-market** where an organization establishes a pay level that is lower than the average in the comparison group.
 3. **lead-the-market** where the average pay level is higher than the average in the comparison group.

HOW IS COMPENSATION STRUCTURE DETERMINED?

- The **pay structure** focuses on how compensation differs for people working in the same organization.
- **Job-based pay**—focuses on evaluating different tasks and duties associated with various jobs in the organization.
- **Skill-based pay** focuses on the difference in skill and ability required to perform the job.

Figure 11.6 Job-Based Pay for Management Accountants.

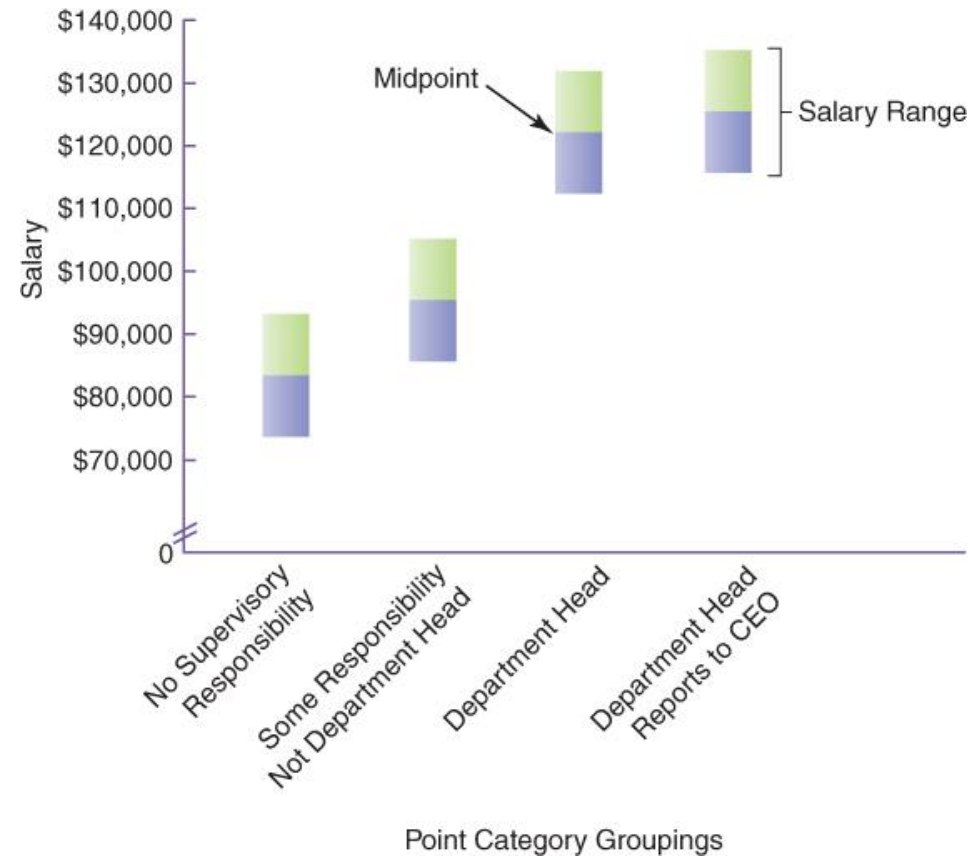
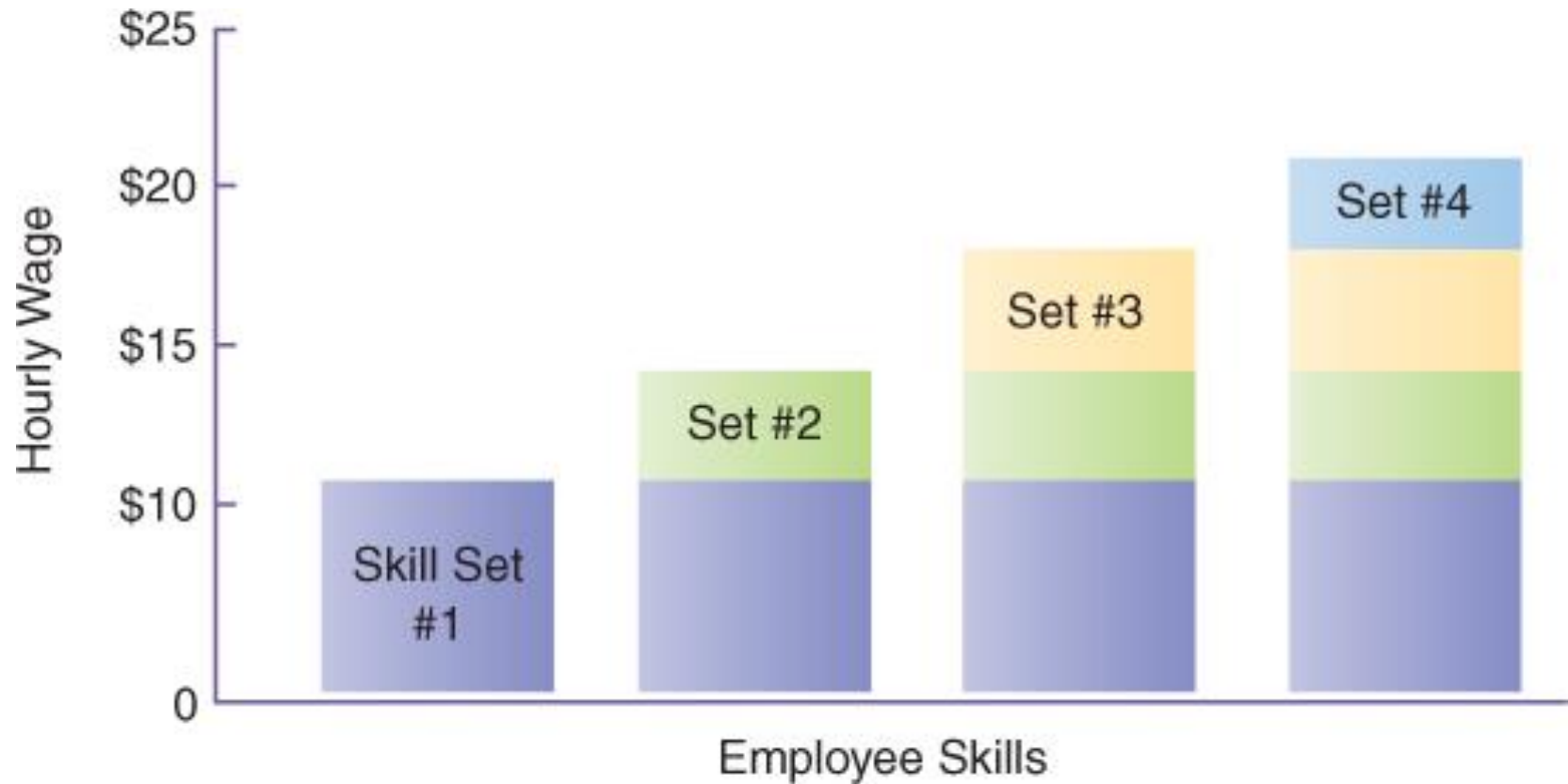


Figure 11.6 Job-Based Pay for Management Accountants. *Source* : Some of the data for these ranges are from Karl E. Reichardt and David L. Schroeder, "2005 Salary Survey," *Strategic Finance* 87, no. 12 (2006): 34–50.

Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). Human Resource Management Linking Strategy to Practice. pp – 435

Figure 11.7 Skill-based Pay.



Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). *Human Resource Management Linking Strategy to Practice*. pp – 437

HOW DO GOVERNMENT REGULATIONS INFLUENCE COMPENSATION?

- **Fair Labor Standards Act (FLSA)** is a federal law that governs many compensation practices. The FLSA, which was passed in 1938, is designed to protect employees.
- The law establishes a national minimum wage, regulates overtime, requires equal pay for men and women, and establishes guidelines for employing children.

Summary of the Four Major Exceptions

Table 11.2	<i>Common Exemptions to the Fair Labor Standards Act</i>
<p>Executive Exemption Primarily manages a business or department Supervises two or more employees; hires and fires Exercises discretion</p>	<p>Professional Exemption Performs tasks that require specialized knowledge Produces original and creative work Exercises discretion</p>
<p>Administrative Exemption Performs office or nonmanual work Performs technical work Assists executives</p>	<p>Outside Sales Regularly works away from place of business Spends at least 80% of time selling</p>

Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). *Human Resource Management Linking Strategy to Practice*. pp – 440

Exempt and Nonexempt Employee

- The FLSA creates two broad categories of workers: exempt and nonexempt.
 - **Exempt employees** are not covered by FLSA regulations. This group does not receive overtime for work over 40 hours in a week.

Exempt and Nonexempt Employee

- The FLSA creates two broad categories of workers: exempt and nonexempt.
 - **Nonexempt employees**, are covered by FLSA and receive overtime for time worked over 40 hours in a week.

Thank You