

Human Resource Management

Chapter 12

Designing Compensation and Benefit Packages

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LEARNING OBJECTIVES

After reading this chapter you should be able to:

- Describe basic elements of a compensation package.
- Explain different features of base pay and employee benefit plans.
- Explain various types of individual incentives, including the strengths and weaknesses of each form of incentive.

LEARNING OBJECTIVES

After reading this chapter you should be able to:

- Explain various types of group and organizational incentives, including the strengths and weaknesses of each form of incentive.
- Create compensation packages that align the mix of individual, group, and organizational incentives with human resource strategy.

How Can a Strategic Compensation Package Make an Organization Effective?

- **The compensation package** represents the blend of rewards employees receive from the organization.
- Money paid as wages or salary is the largest component of most compensation packages.
- Benefits and short and long term rewards make up the rest of the package.

HOW DO COMPENSATION PACKAGES ALIGN WITH STRATEGY?

- **At-risk Compensation**
 - **At-risk pay** is compensation that can vary from pay period to pay period.
 - The money is at risk because the employee will not earn it unless performance objectives are met.

HOW DO COMPENSATION PACKAGES ALIGN WITH STRATEGY?

- Line of Sight
 - The extent to which employees can see that their actions influence the outcomes used to determine whether they receive a particular reward.

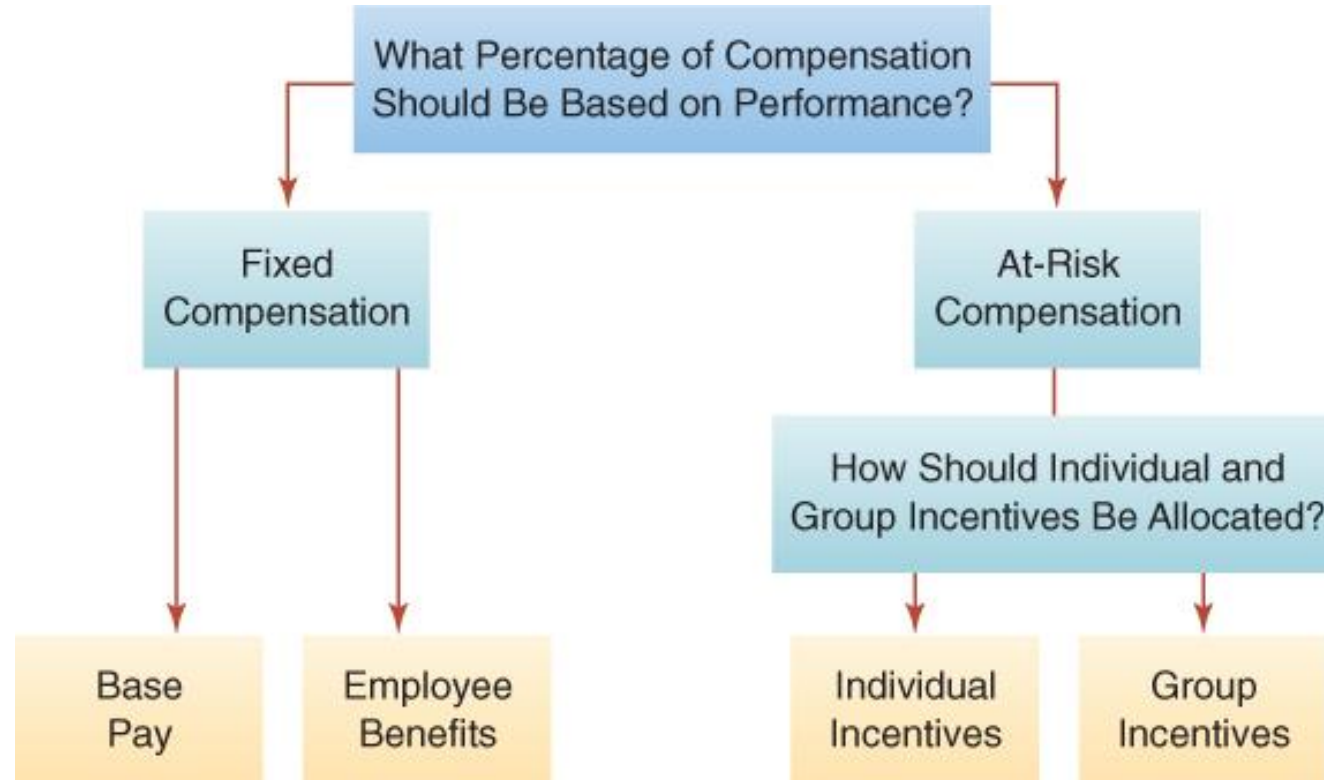
Common Elements of Compensation Packages

- **The main elements of the Compensation Package consist of:**
 - **Base pay** – is compensation that is consistent, not at risk, across time periods and not directly dependent on performance.
 - **Employee benefits**, are rewards other than monetary salary and wages, typically includes such things as retirement saving and insurance.

Elements of the Compensation Package

- **Individual incentive** is a reward that is based on the personal performance of the employee. Individual incentives are linked to performance behaviors and outcomes.
- A **group incentive** is a reward based on the collective performance of a team or organization.

Figure 12.1 Combining Compensation Package Elements.



Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). *Human Resource Management Linking Strategy to Practice*. pp – 460

WHAT ARE COMMON APPROACHES TO BASE PAY?

- Two basic methods:
 - **Job Based Pay** – Each job evaluated with a point system and base pay is set at a higher level in jobs worth more points.

WHAT ARE COMMON APPROACHES TO BASE PAY?

- Two basic methods:
 - **Skill Based Pay** – Skill sets are defined in terms of the number of tasks that an employee is capable of performing. Employees who are able to perform more tasks are paid a higher base wage.

WHAT ARE COMMON EMPLOYEE BENEFIT PLANS?

Legally Required Benefits

- Social Security
- Unemployment Insurance
- Workers Compensation

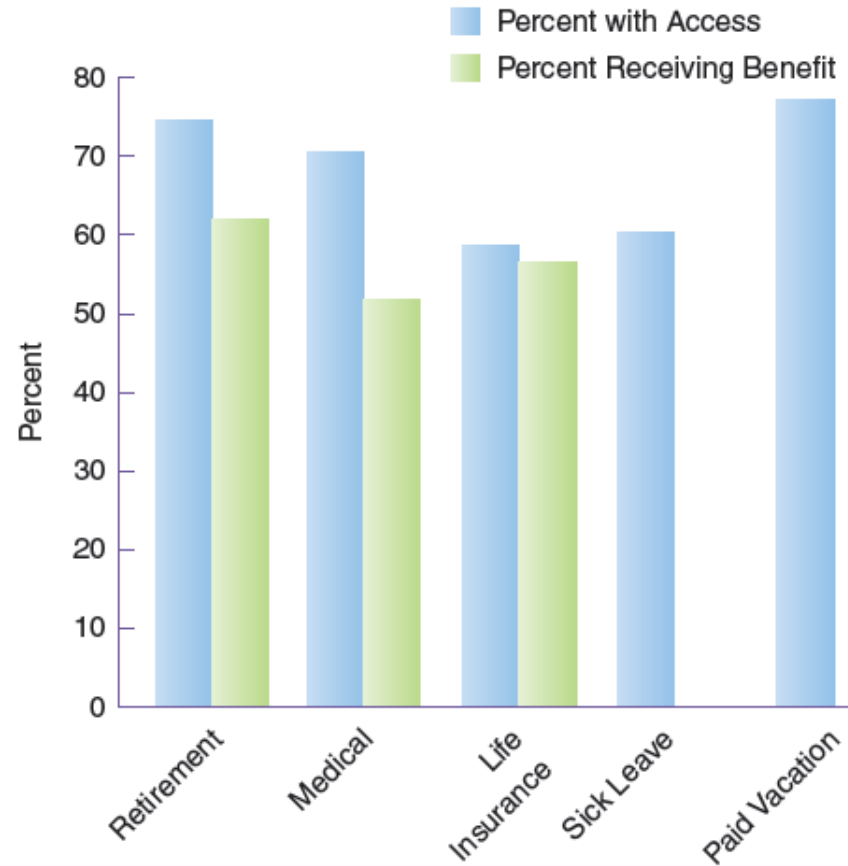
New Health Care Legislation

- In March 2010 Congress passed a Health Care Reform Bills. One provision requires:
 - Employers with more than 50 employees must provide health insurance for all employees or pay a fine.

Discretionary Benefits

- Common discretionary benefits include:
 - health-care plans
 - supplemental insurance
 - retirement savings
 - pay without work
 - lifestyle benefits

Figure 12.2 Percentage of Workers Receiving Benefits

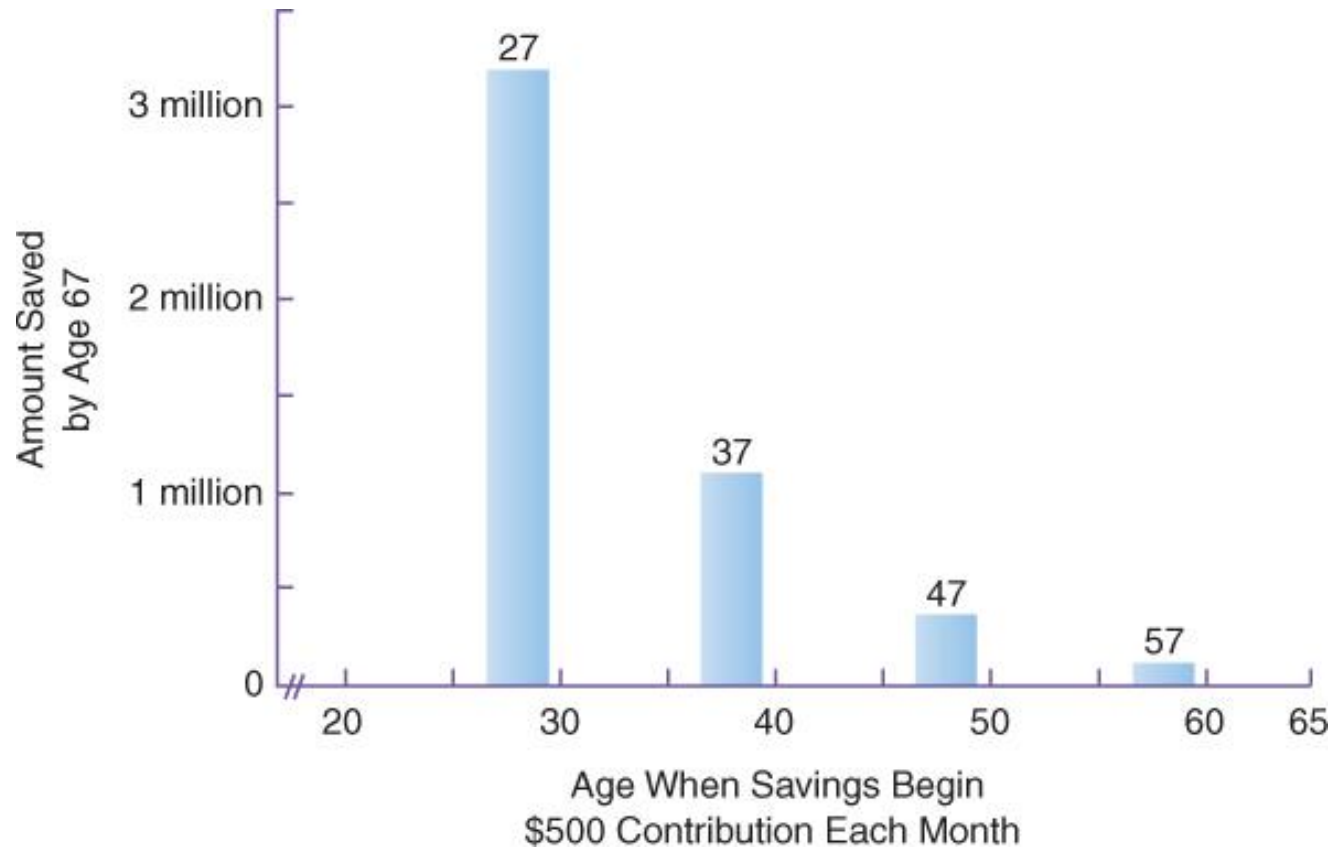


Note: The percentage of workers receiving benefits is smaller than the percentage with access, as some workers may not need benefits because they are covered through a spouse's policy. In other cases, workers may not elect to receive benefits because they are unwilling or unable to pay their portion of the cost.

Source: www.bls.gov

Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). *Human Resource Management Linking Strategy to Practice*. pp – 446

Figure 12.3 Accrual of Retirement Benefits.



Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). *Human Resource Management Linking Strategy to Practice*. pp – 470

WHAT ARE COMMON INDIVIDUAL INCENTIVES?

- **Piece-rate incentive**, where employees are paid a fixed amount for each piece of output they produce.

WHAT ARE COMMON INDIVIDUAL INCENTIVES?

- **Commissions** represent a special form of piece-rate compensation that is most often associated with sales. For each sale obtained, a **commission**, or percentage of the total amount received, is paid to the salesperson.

WHAT ARE COMMON INDIVIDUAL INCENTIVES?

- **Merit pay increases** represent an increase in base salary or hourly rate that is linked to performance

COMMON INDIVIDUAL INCENTIVES

- **Merit bonus** is a sum of money given to an employee in addition to normal wages on a fixed schedule, such as at the end of the year.
- Sometimes bonuses are unplanned and given when high performance is observed.

WHAT ARE COMMON GROUP AND ORGANIZATIONAL INCENTIVES?

- **Goal-based team reward** – provides a payment when a team reaches a specific goal.

WHAT ARE COMMON GROUP AND ORGANIZATIONAL INCENTIVES?

- **Discretionary team bonus** – provides payment when high performance is observed. With discretionary rewards, no goal is set to achieve a specific outcome.
- Team Awards are usually
 - Divided equally among the team or
 - Higher-performing members receive a greater reward than other team members.

Group and Organizational Incentives

- **Gainsharing** occurs when groups of workers receive a portion of the financial return from reducing costs and improving productivity.
- **Profit sharing** occurs when employees receive incentive payments based on overall organizational profits.

Group and Organizational Incentives

- **Stock plans** transfer corporate stock to individual employees. Two popular programs are:
 - **stock options**, which represent the right to buy company stock at a given price on a future date and could be tied to performance or pay grade.
 - **employee stock ownership plans (ESOPs)**, in which the organization contributes stock shares to a tax-exempt trust that holds and manages the stock for employees

Issues that increase the likelihood of success for gainsharing programs

Table 12.1	<i>Rules for Gainsharing Success</i>
Rule	Explanation
1. Make sure the payout formula is understood by employees.	Motivation is increased when the rules by which the bonus is calculated are understood.
2. Ensure a high level of employee involvement.	Involvement increases employee commitment and trust.
3. Provide monetary rewards as close to the time of performance as possible.	Motivation is increased when rewards are clearly associated with actions and outcomes.
4. Involve gainsharing specialists who provide valuable recommendations.	Each organizational setting is somewhat different, and expert advice helps tailor the plan to the specific organization.

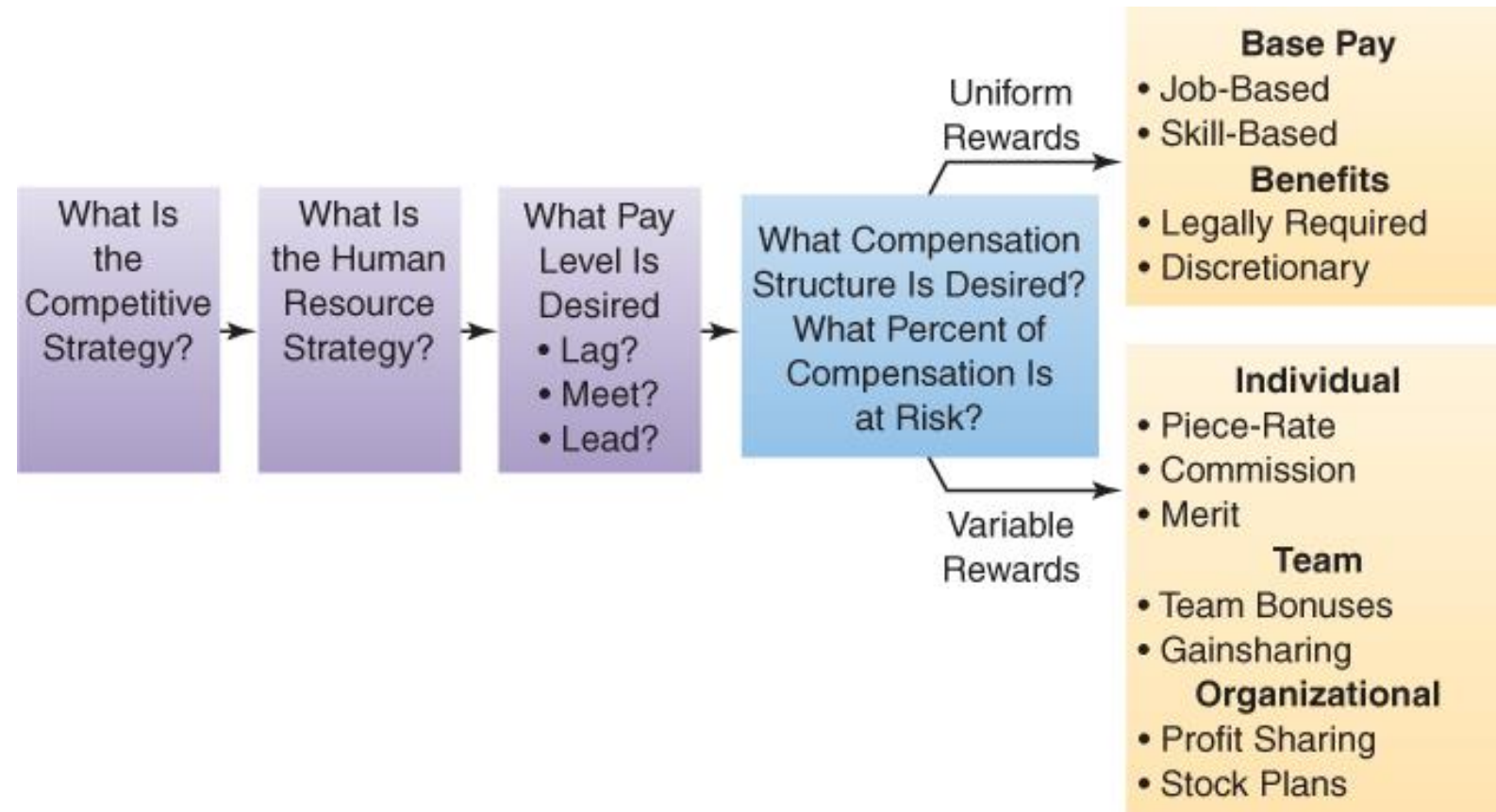
See page 480. Source: Information from Matthew H. Roy and Sanjiv S. Dugal, "Using Employee Gainsharing Plans to Improve Organizational Effectiveness," *Benchmarking* 12 (2005): 250-259.

Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). *Human Resource Management Linking Strategy to Practice*. pp – 480

HOW DO STRATEGIC DECISIONS INFLUENCE A COMPENSATION PACKAGE?

- The organization must decide how much compensation to allocate to base pay, benefits, individual incentives, and group incentives in order to align pay to the organization's broad HR strategy.

Figure 12.4 Strategic Compensation Process.



Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). *Human Resource Management Linking Strategy to Practice*. pp – 483

Figure 12.5 Typical Compensation Elements



Source: Stewart, G.L., & Brown K.G., 2nd Edition (2015). *Human Resource Management Linking Strategy to Practice*. pp – 484

Figure 12.5 summarizes links between specific incentive elements and human resource strategies.

- Organizations with a competitive strategy of differentiation seek innovation and recognition of top performers. Placing a high percentage of compensation at risk is thus common in organizations pursuing Free Agent or Committed Expert HR strategies
- In contrast, organizations with a cost-reduction strategy prefer to pay employees lower overall wages, which is at odds with the need to pay employees more when they assume the risk of receiving less compensation if performance is poor. Organizations with Bargain Laborer and Loyal Soldier HR strategies are therefore likely to have less at-risk compensation.

Figure 12.5 summarizes links between specific incentive elements and human resource strategies.

- Organizations with Bargain Laborer HR strategies tend to compensate their employees mostly in the form of base pay.
- Organizations with Loyal Soldier HR strategies also offer base pay as a high percentage of overall compensation.
- The Committed Expert HR strategy fits with higher levels of at-risk compensation.
- At-risk pay is often highest in organizations with Free Agent HR strategies.

Thank You