



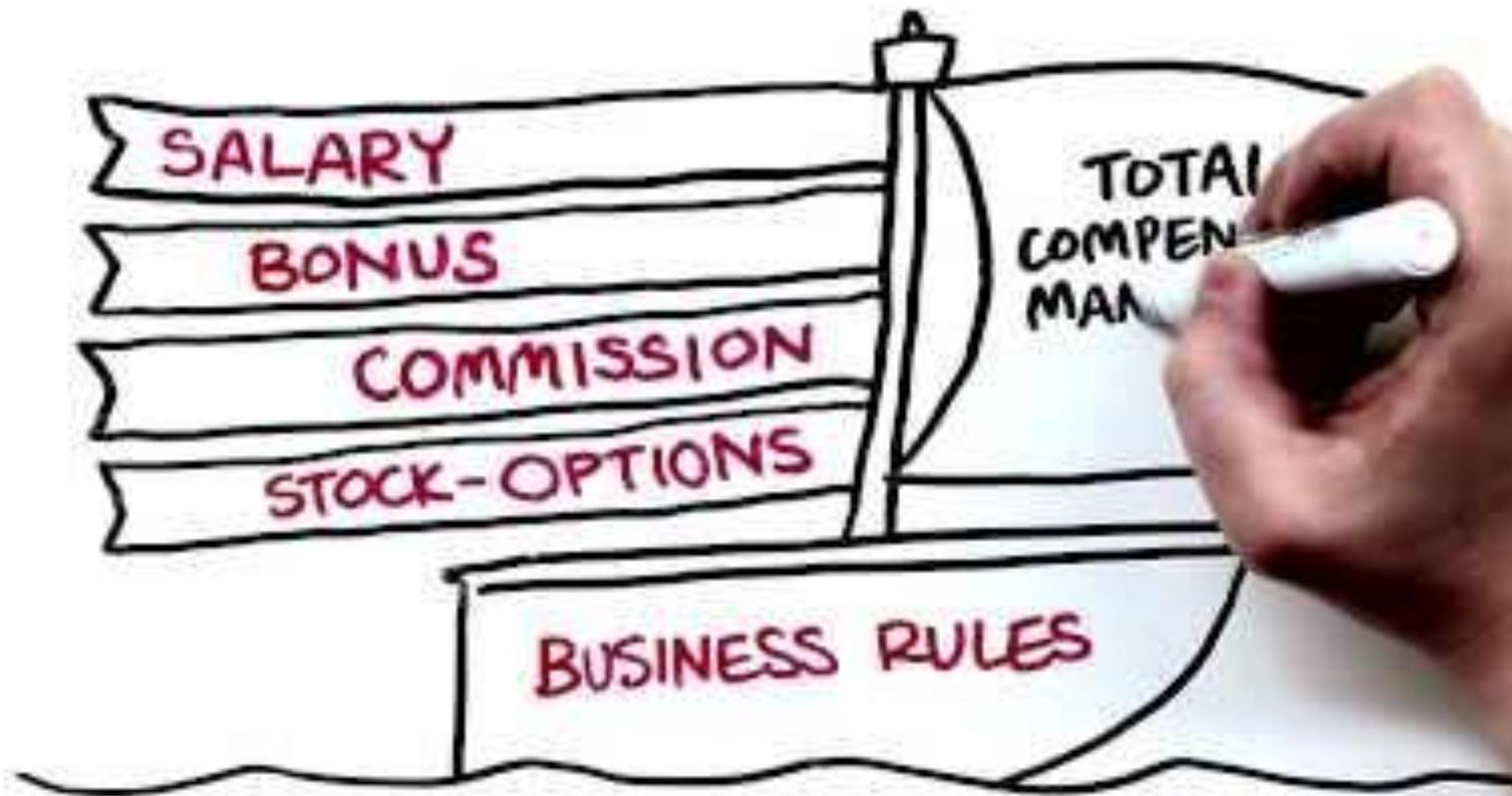
INTEGRATED INSTITUTE OF PROFESSIONAL MANAGEMENT

Our Accreditations



Our Standards





Compensation Management

Course Objectives

Introduction to Compensation Management

Economic Theories and Compensation Management

Compensation Management and Job Design

Performance-Related Compensation

Negotiation in Compensation

Attrition and Compensation Management

Executive Compensation

Sales Compensation Plans

Strategic Compensation Management

Quantitative Tools and Innovation in Compensation

International Compensation Management

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Introduction



Recently, a global pharma major noticed that its executives were leaving to join relatively lesser-known competitors. The company had always believed in stability and long-term incentives, focusing on secure post-retirement lives for all employees.

According to the company the majority of the executives leaving their jobs were in their mid-thirties. The average age of employees is 55, so the executives in their mid-thirties were future torchbearers.

Why did these people leave that company?

Let us see what happened in the next slide



An investigative study indicated that most of the employees left because of compensation issues. It was recommended that the compensation package be redesigned and the take-home pay increased, while discounting the deferred benefit for their age group.

Introduction



The term “compensation”, as a substitute word for wages and salaries, is of recent origin.

Pay or compensation represents an exchange between the employee and the organization

Compensation should be viewed as the strategic management of wages and salaries

Objectives of compensation



Equity

Compensation management strives for internal and external equity. Internal equity requires that pay be related to the relative worth of a job so that similar jobs get similar pay. External equity means paying workers what other firms in the labor market pay comparable workers.



Inefficiency

The objective of efficiency are reflected in attempts to link a part of wages to productivity or profit, group or individual performance, acquisition and application of skills and so on.



Macro-economic stability

It can be achieved through high employment levels and low inflation.



Efficient allocation of labor

It implies that employees will move to wherever they receive a net gain.

Principles of compensation formulation



External relativities

Market rates as affected by supply, demand, and general movements in pay levels



Salary

Salary relativities between jobs within the organization depending on the values attached to different jobs



Individual worth

The value of the individual's performance to the organization

Significance of employee compensation



To an employee, pay is a primary reason for working. For some individuals, it may be the only reason. For most of us, it is the means by which we provide for our own and our family's needs.



Compensation is also important to organization. It represents a large proportion of expenditure. Compensation is also significant in the operation of the economy.

Compensation decision



There are 3 core decisions, those involving pay level, pay structure, and pay system.

Supporting there are 3 other decisions, concerning pay form, pay treatment for special groups, and pay administration.

All the decisions are influenced by a number of environmental and organizational variable.

Examples of their variables are the economic, social/cultural, and legal environments; as well as the organization's structure and workforce.

Determinants of compensation decision



Compensation decisions are also affected by the dynamics of the particular organization. Employee pay must be consistent within the organization structure. Finally, compensation decisions are affected by the worldwide information highway



The social environment is changing dramatically, following the entry of women into the workforce. Valuing diversity while taking compensation decisions is very important

VIE theory and compensation



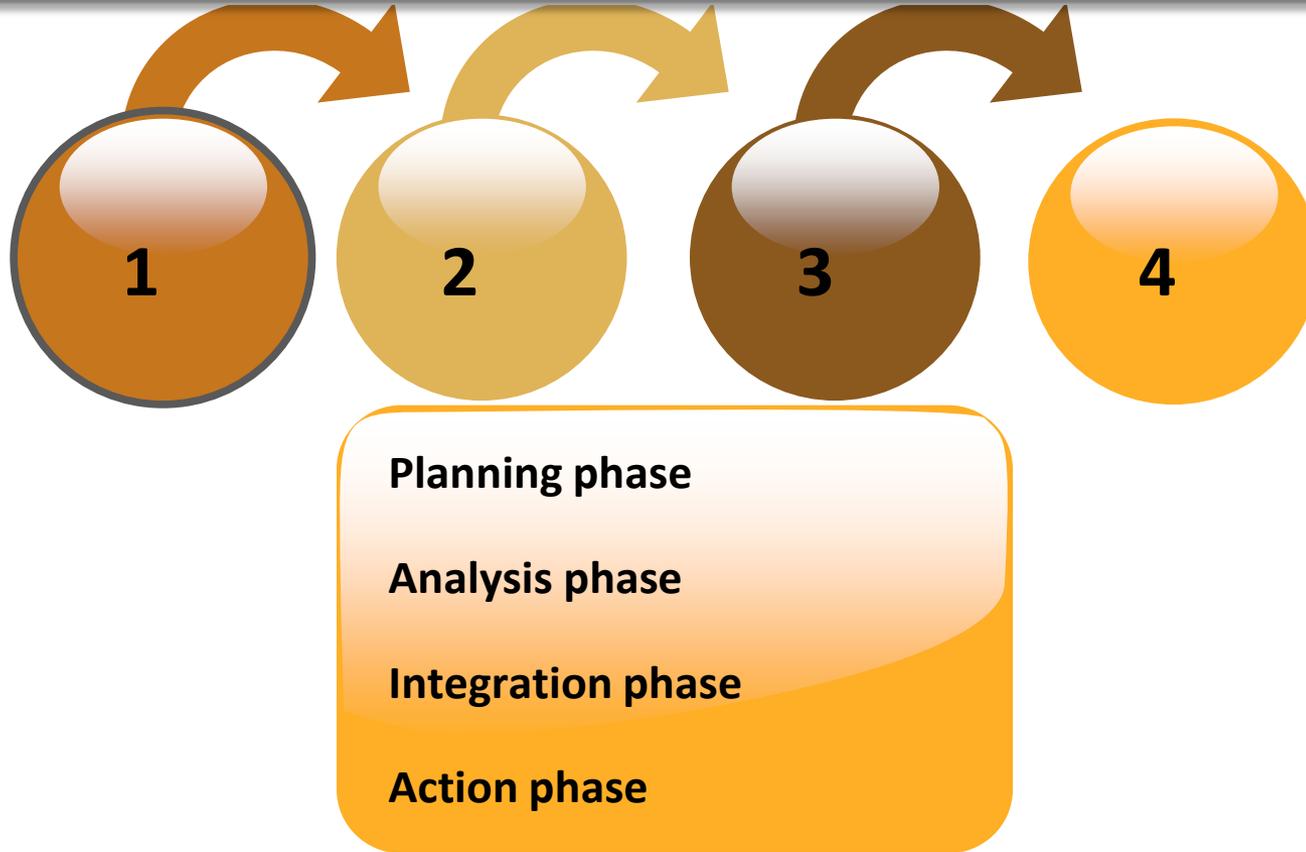
Victor Vroom formulated Valence Instrumentality Expectancy (VIE) theory. Valence stands for value, Instrumentality is the belief that if we do one thing it will lead to another, and expectancy is the probability that action or effort will lead to an outcome



An incentive or bonus scheme works only if the link between effort and reward is clear, and the value of the reward is worth the effort

Compensation benchmarking

Xerox Corporation in U.S adopted a compensation benchmarking process with 4 phases



In each of these phases, there were action items that needed to be accomplished.

Let us look at each phase in the next slides

Planning phase

Issues that were to be addressed



What will be benchmarked?

Who will be the benchmark companies?

How will the data be collected?

Analysis phase



Are the benchmarked companies better?

If so, by how much?

Why are they better?

How can we apply what we have learned to our business?

Integration phase



Have the results
been accepted by
management?



Do goals have to be
changed or modified
based on the
results?



Have these new
goals been
communicated
to all affected
parties?

Action phase

1

Have the steps required to achieve the desired goals been identified?

2

Is progress being tracked?

3

Is there a plan for recalibration of the benchmarking?

However, the Xerox experience showed that if the first two phases – the most important in the benchmarking process – are carried out effectively, then benchmarking will have a greater chance of success in the next 2 implementation phases.

Compensation plan

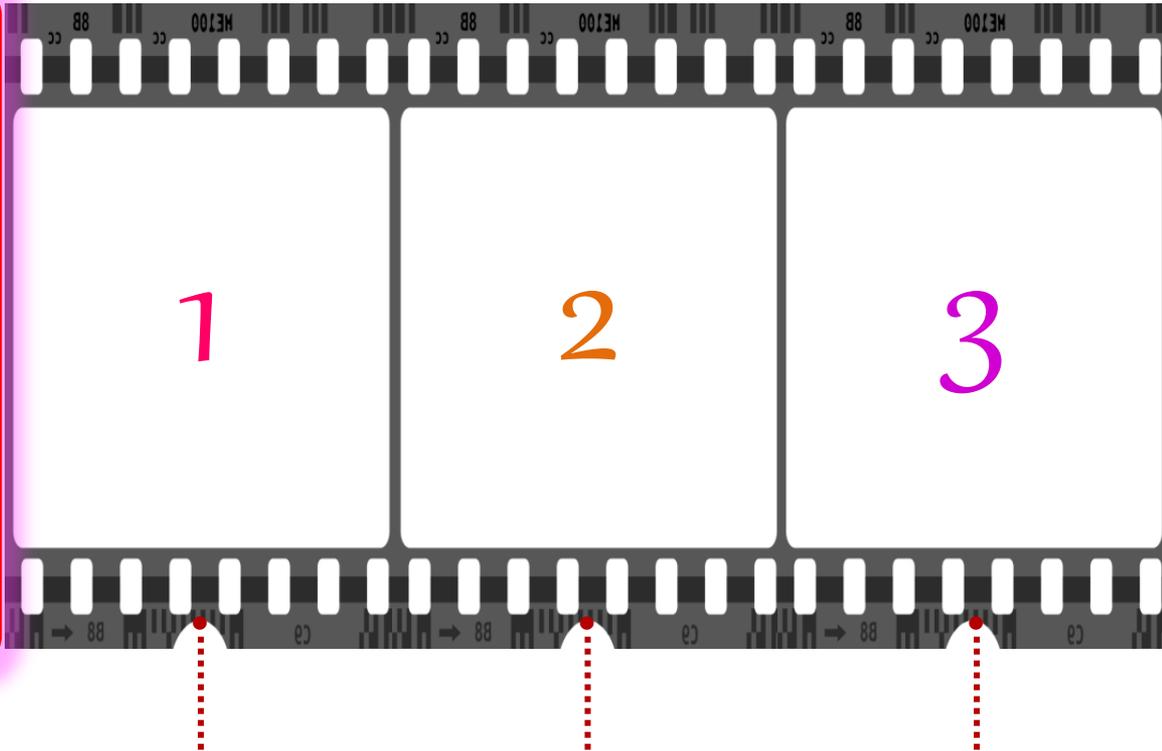
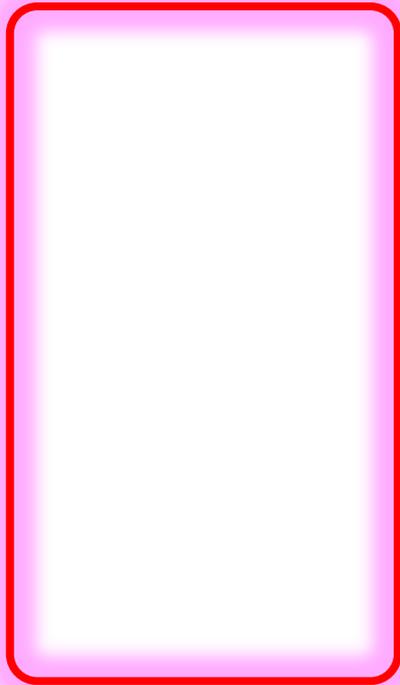


A compensation plan is defined as the components of organizational compensation

A well-designed compensation plan helps ensure equity within the organization..

A suitably designed compensation plan, mixing both strategic and statutory perspectives, optimizes the cost of compensation and simultaneously helps the organization achieve its strategic intent

Mistakes in compensation designing



First, an organizations often find it difficult to distinguish between a bonus and an incentive

The second mistake is the compensation design is the propensity of organizations to solve compensation claims on an ad hoc basis

And the third mistake occurs when organizations devise equity participation plans that are too complicated.

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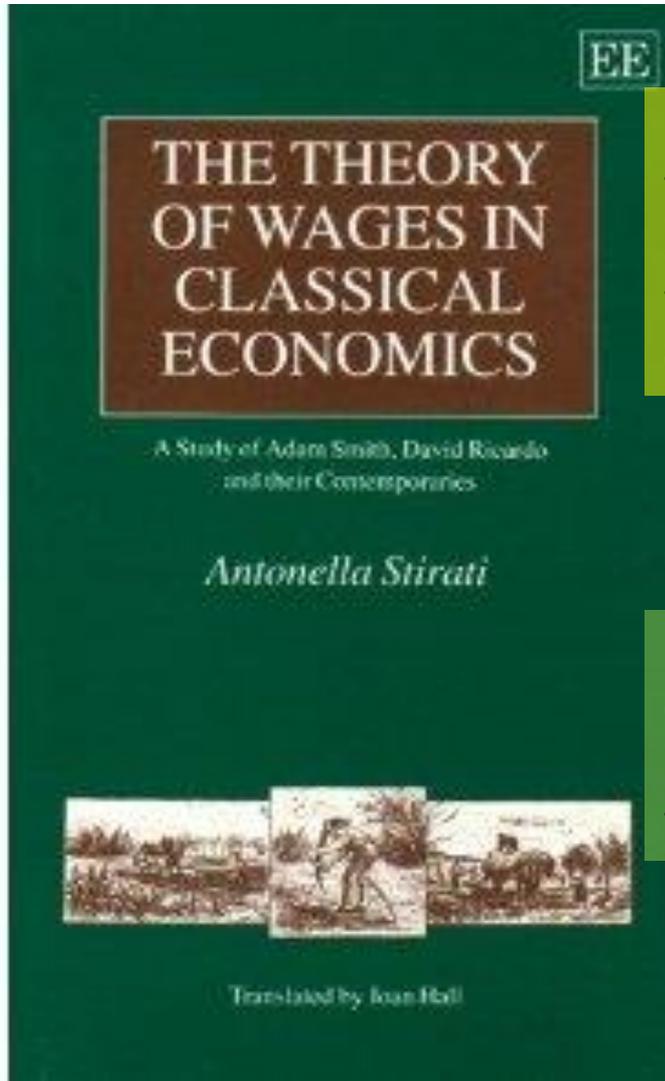
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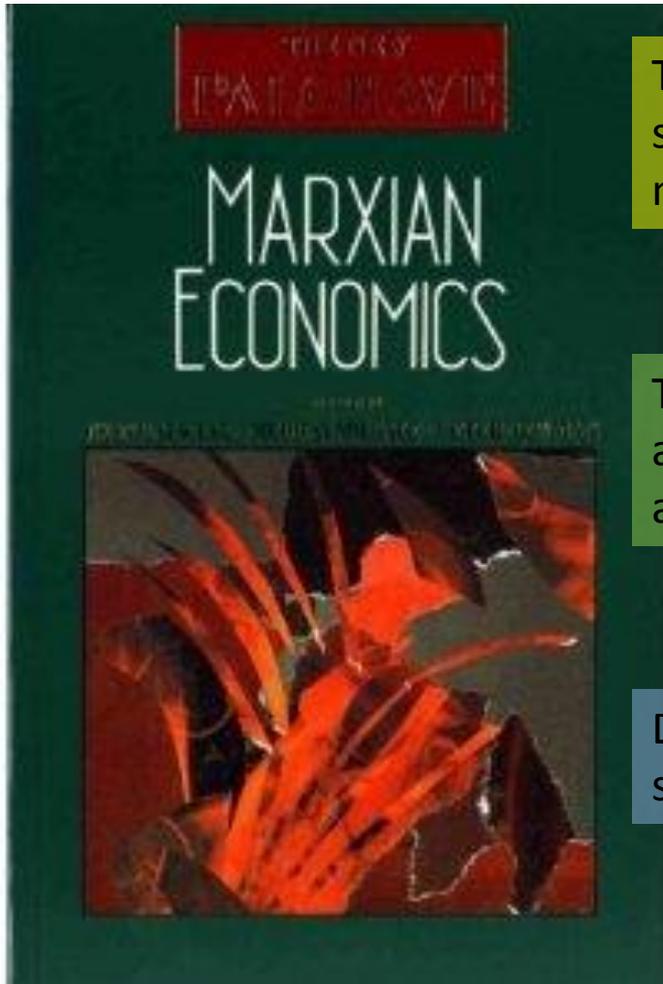
Classical school



Pioneered by Smith and Ricardo, it focuses on the concept of subsistence level of wages in the long run. Commonly termed as the natural price for labor, subsistence level is not limited to the expenses incurred for food alone

Both the pioneers agreed that in the short-run, even though there may be a temporary variation in the wage rate, in the long-run, it reduces to the subsistence level

Marxian school



This school considers labor as the basic source of all value. Labor produces more than that needed for subsistence

The excess is what in Marxian terminology is known as “surplus value”, which contributes to capital accumulation

Depriving workers from above subsistence level wages in their exploitation

Neo-classical school of thought



It considers wages as a price like any other factor of production which is determined by the market forces. Labor supply depends on the disutility; hence it needs to be overcome by wages as an incentive.

On the contrary, demand for labor depends on the marginal productivity of labor, which declines with the application of every unit of additional labor.

Marginalist school



It is an extension of neo-classical thought, which advocates the law of diminishing marginal productivity. At the equilibrium wage rate, aggregate supply of labor get fully absorbed, i.e., the stage of full employment. Hence wage rate gets adjusted implicitly to the full employment level.

Keynesian school



This school, based on Say's Law, subscribes to the view that supply creates its own demand. Hence, contrary to the belief that whatever is saved is automatically invested, the Keynesian school suggests that level of employment is dependent upon aggregate demand. At full employment, the level of income and consumptions gets adjusted with the investment.

Philips Curve

Wage rate

Philips, based on the empirical study of British economy, concluded that wage rate starts rising once the level of employment is increased. He observed a inverse relationship between the level of unemployment and the rate of increase of the wage level

Level of employment

Valuation of employee compensation

Value can be determined by answering the following questions:

Does the cost to the employer equal the value to the employee?

What if the employee had to purchase the same benefit in the market?

What if the employer wants to compare the cost of the benefits package of its employees to another employee, or an industry norm?

How does the value of benefits compute into total compensation?



Equity in employment benefits

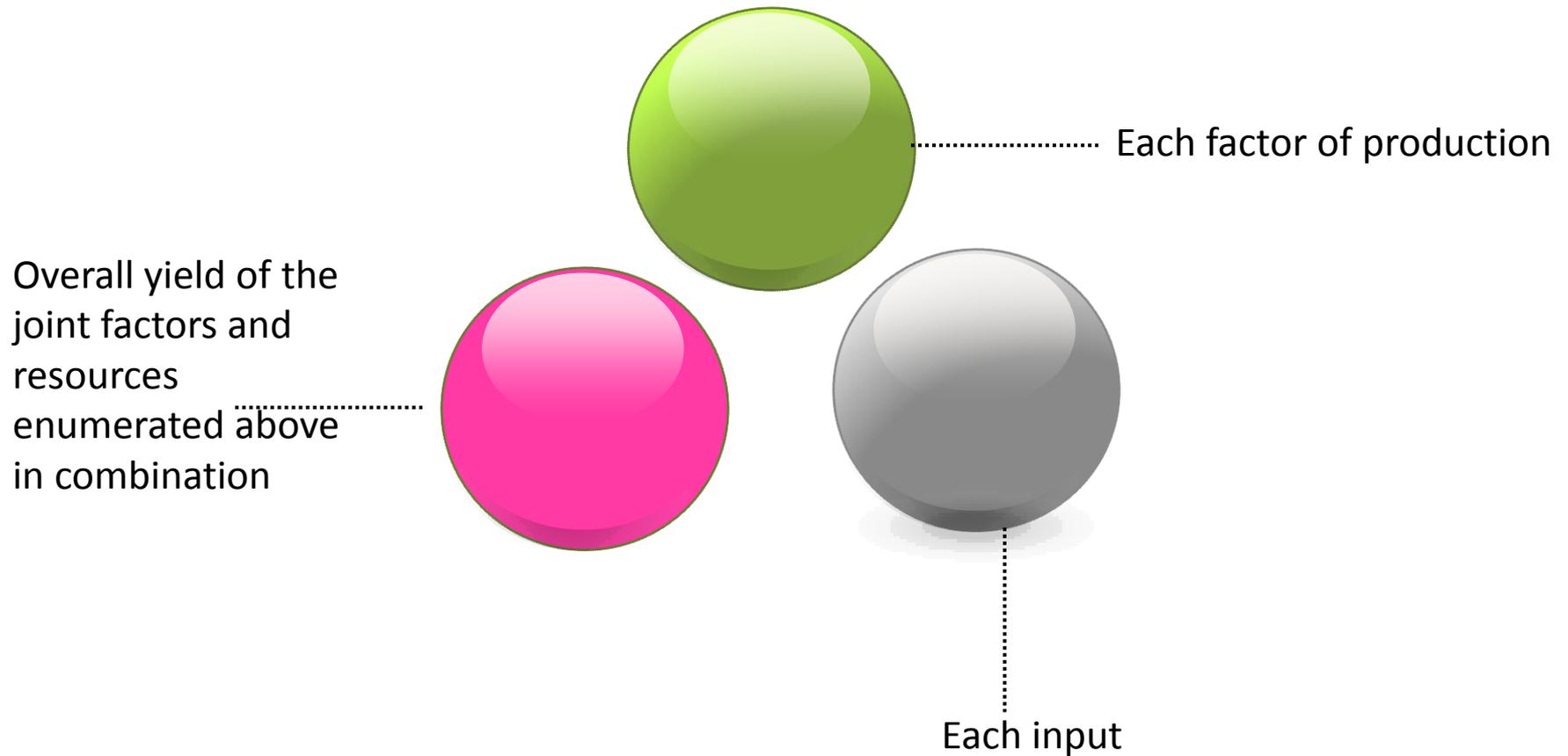


Economic theories on employee compensation and benefits frequently conflict. Neo-classical economists argue that market competition is the best premise on which to base employee compensation.

On the other hand, institutional, game theory, or Marxist approaches argue that markets may not always be competitive. To reduce the problem of inequity, there is a need to ensure fair rules of pricing with government intervention.

Productivity-linked employee benefits

Productivity – From an economic point of view, production refers to yield from

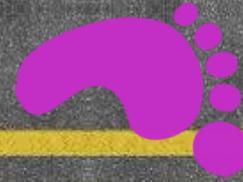
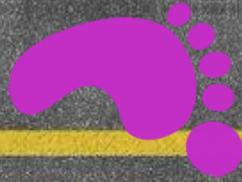


Factors to improve productivity

Nature and quality
of raw material

Plants and equipment
employed

Volume continuity
and uniformity of
production

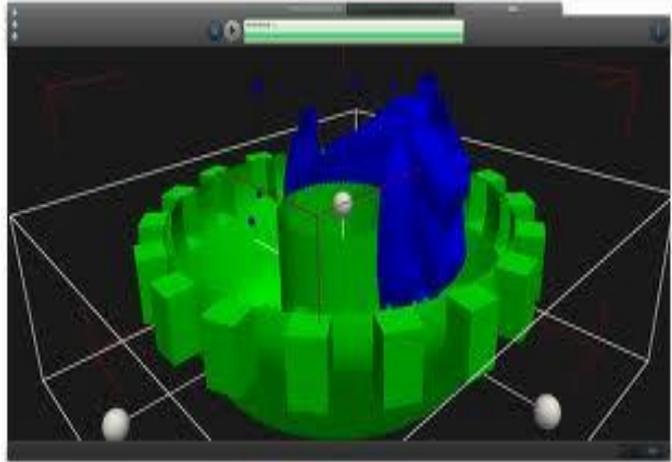


Basic nature of
process
employed

Efficiency of plant
and equipment

Utilization of
manpower

Productivity measurement



Omni factor model – this model gives a composite productivity index for all input and output costs of all products. While input costs are taken for all, output costs are determined on average marginal costs method.

Surrogate model – This model primarily considers some qualitative factors to measure productivity. Factors such as satisfaction of investors, employees, customers, and suppliers are considered in qualitative terms.

Linking wages to productivity, based on these two models, yields better results as organizations can objectively price labor, and labor can also get its legitimate share of productivity gain.

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McDonald



McDonald's recruitment process is continuous. All candidates need to fill an online application form which contains some essay type questions. After initial screening the company contacts promising applicants within 2 days and the candidates have to complete online personality questionnaire.



If the candidate is selected, they call the applicant to go through the Assessment center, which McDonald's refers to as "On Job Experience". It is an ideal opportunity for candidates to assess whether McDonald's is the right place for them to work.

▶ What happens next and how is it possible for McDonald's

McDonald



The candidate is finally invited to a final interview with an operations manager. It is more of a chat than a formal interview.



McDonald's can do this effectively because of its well-documented job design, perfect alignment of jobs to their core values, and a standard level of services and quality worldwide.

Job Design and Compensation



For compensation design and management, effective job design, information and documentation of job analysis, job descriptions, and job evaluations are important pre-requisites.



All these process help in identifying job requirement and describing the job, job-facilities, skill-sets, and skill mapping as well as developing skill inventories in the organization.

Job Design



The main purpose of job design is to increase both employee motivation and productivity. Increased productivity can manifest itself in various forms. While designing a job management must also be concerned with the practical considerations of quantity and quality of available personnel. Personal conflicts, frictions, boredom, and obsessive thinking also need to be taken care of

Characteristics of Job Design

1

Task variety

2

Task identity

3

Task significance

4

Autonomy

5

Feedback

Strategies and techniques of job design

Robertson and Smith have recommended some strategies for analyzing jobs.



Review literature and other existing data such as prevailing job description, training manuals, assessing job designs from manuals of technology providers.



Interview immediate managers to understand the responsibilities and tasks required to perform the job well.



Interview current employees, who are presently doing the job in the same line, and assess job requirements.



Observe employees while they do the job.

Components of job design



Job information: Job information is one essential input for effective job analysis. It not only facilitates job evaluations for compensation designing, but also helps in disseminating information to employees about their duties and responsibilities.



The main objective of job information is to communicate duties and responsibilities attached to a job to employees for their clear understanding. This also helps the employees to understand organizational expectations.

Job analysis

Job analysis is the process of gathering information about the job and evaluating such information in terms of what is necessary and relevant. Essentially, job analysis involves 3 questions.



What is a job?

What should be analyzed?

What methods of analysis should be used?

Methods of job analysis



Job information can be obtained in various ways either by a staff analyst or by the individual line manager. Direct observation of work performed is another important method of job analysis. Valuable job information can also be obtained from organization manuals, time-study reports, former job descriptions, and method studies.

Assessment centers

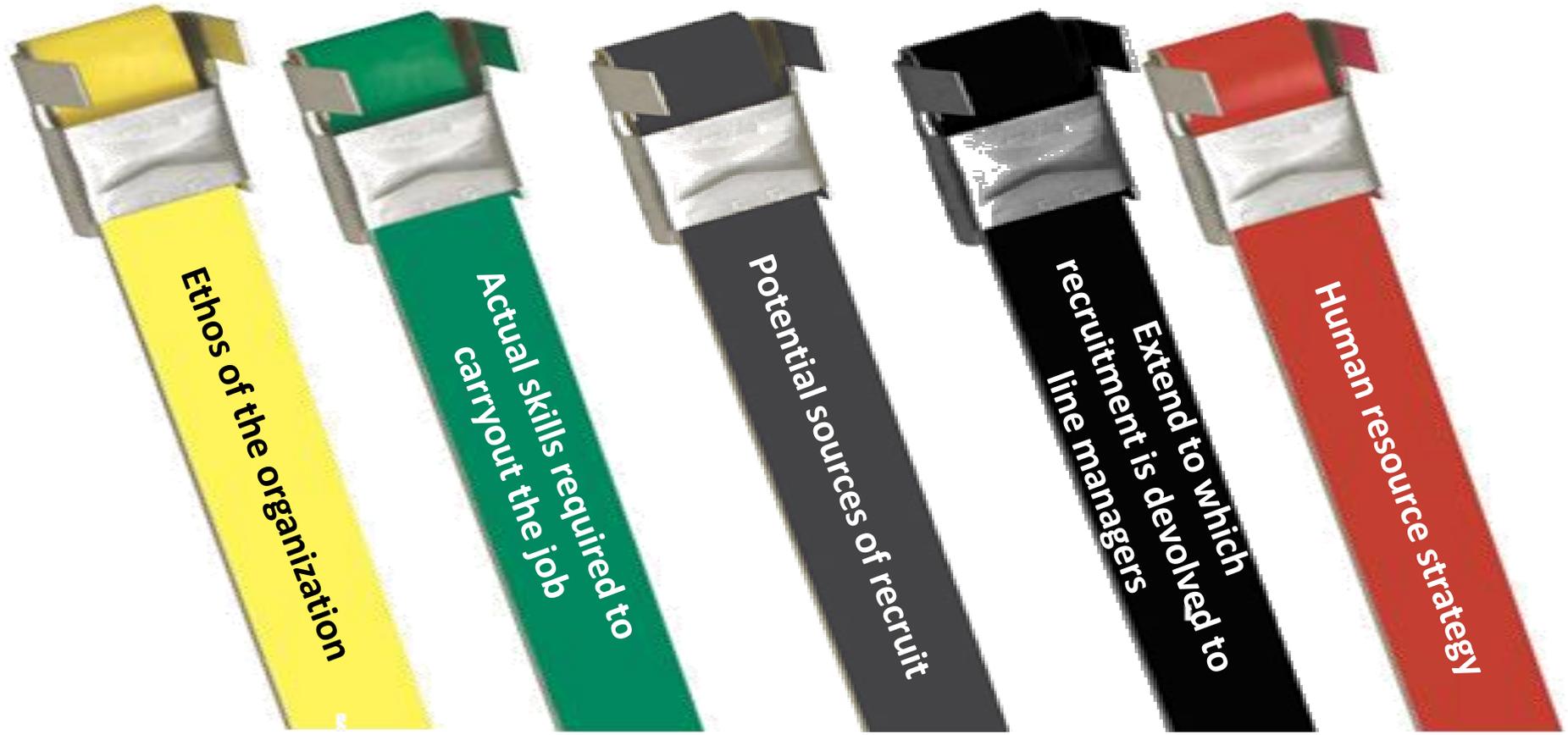


CIPD carried out a survey in 2006 and indicated that almost 50% of employers are now using the assessment center approach in selection prospective candidates for the job. An effective recruitment process is an organization follows the sequence as shown below.

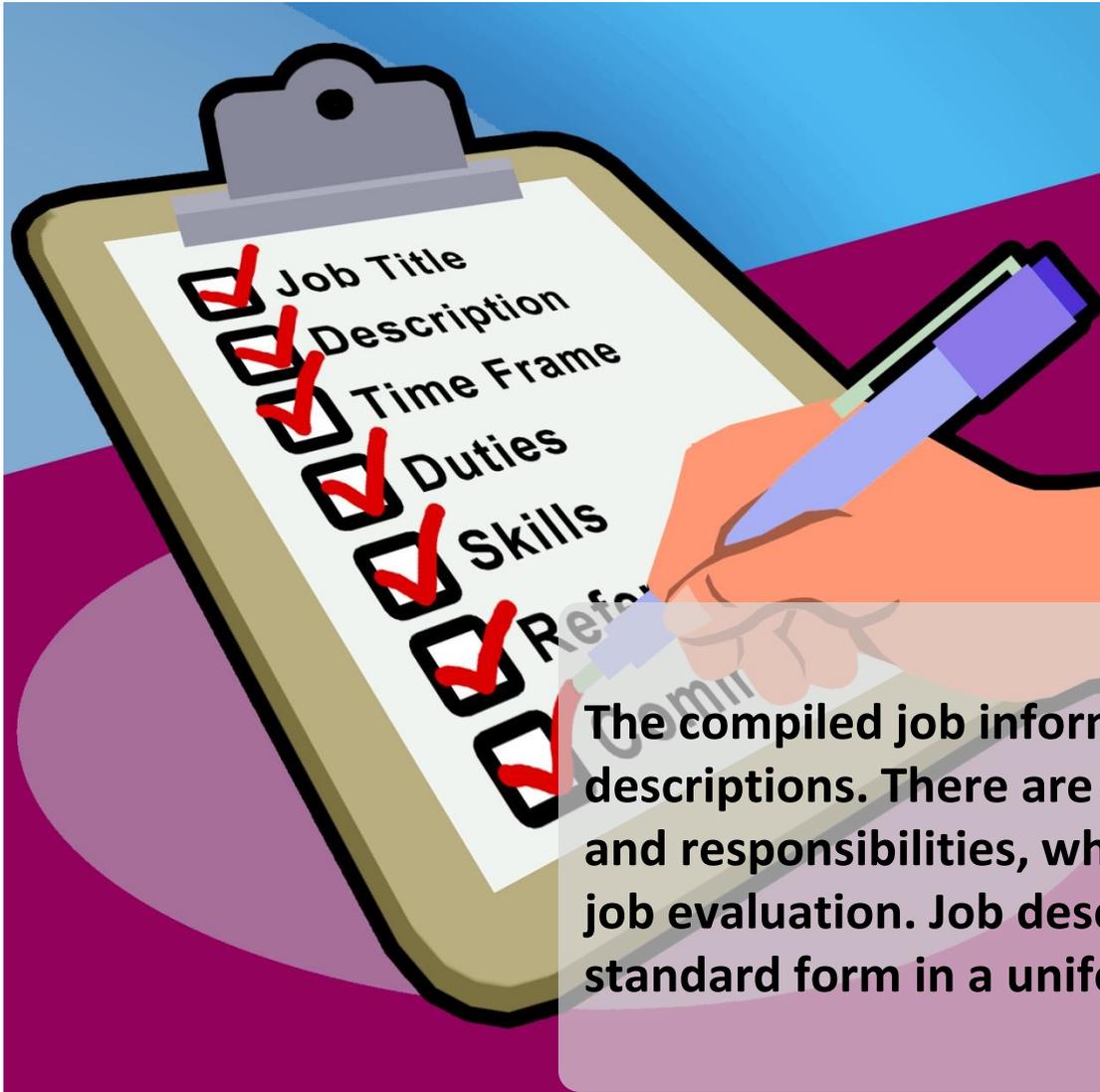


Design of assessment centers

The design should reflect



Job description



The compiled job information is translated into job descriptions. There are written records of job duties and responsibilities, which provide a factual basis for job evaluation. Job descriptions are recorded on a standard form in a uniform manner.

Job specifications



Job specifications include the education or experience required to do the job and the special knowledge and skills necessary to carry out the job.



In addition, specifications also identify soft skills, such as interpersonal skills, analytical ability, problem-solving skills, or decision-making skills, etc.

Job evaluation



Job evaluation systematically differentiates the relative worth of a job and established pay differentials. In fact, job evaluation reflects the job values, which organizations assigns to a job accordingly decide the wage rates.

A properly devised job evaluation scheme provides the management with definite systematic and reliable data for determining wage and salary scales.

Job evaluation schemes



Ranking: This is a simple system to judge each job as a whole and understand its relatively worth by ranking one whole job against another job.

Classification: In this case, the grade and wage level are pre-determined before jobs are ranked and descriptions are written defining the type of job which should fall into each group.

Points rating: under this system, to achieve a higher level of accuracy, each job is broken down into its component factors or characteristics and then evaluated separately rather than evaluating the job as a whole.

Job assessment



At this stage, information about each job is made available to the assessors. Every job, whether manual or not, is closely observed and inspected in actual operation by the assessors. If required the assessors can question the operators and their supervisors to collect further details about the job to clear any doubt

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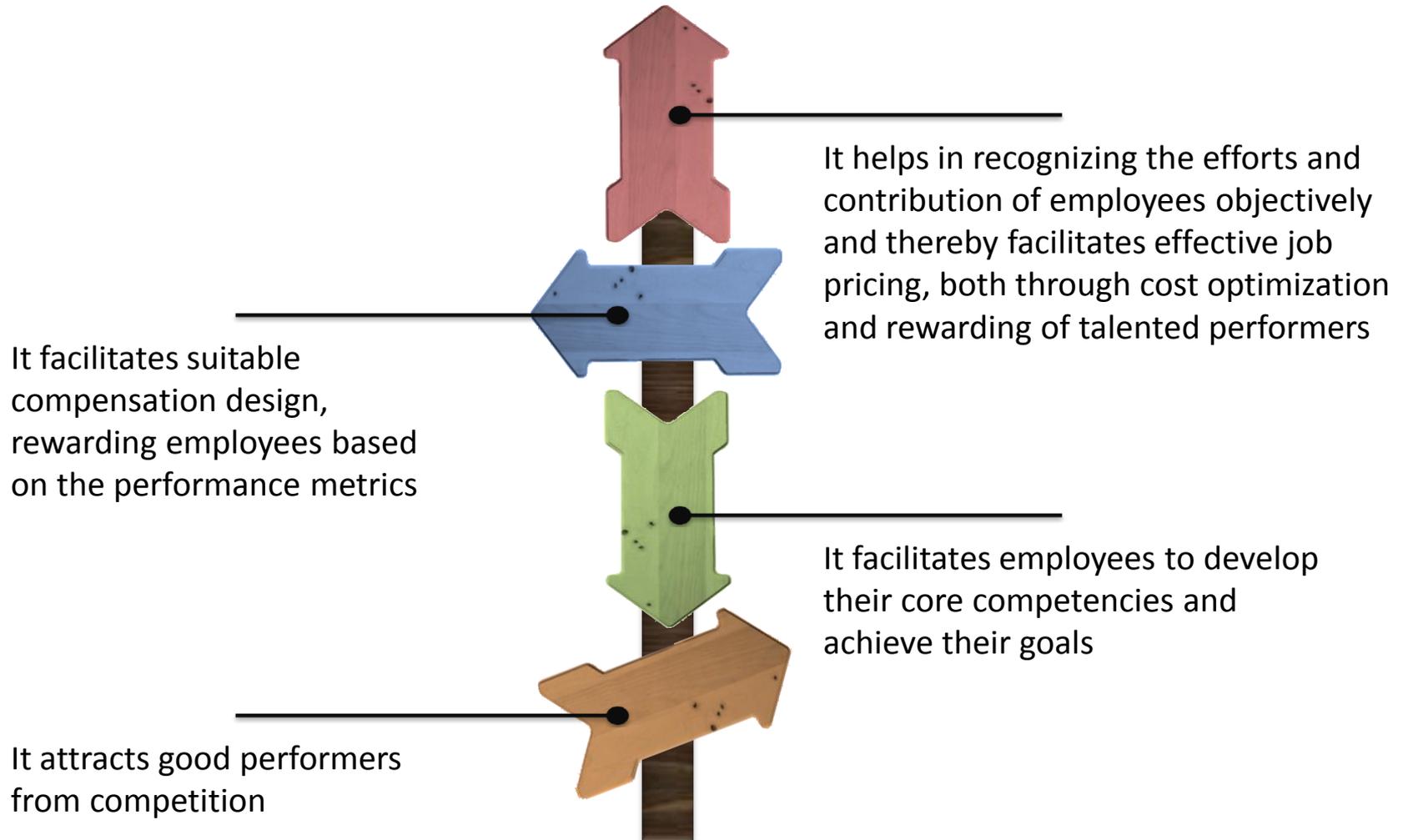
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Performance Management System (PMS)

From compensation management point of view, PMS helps in achieving the following critical goals



Performance-related pay

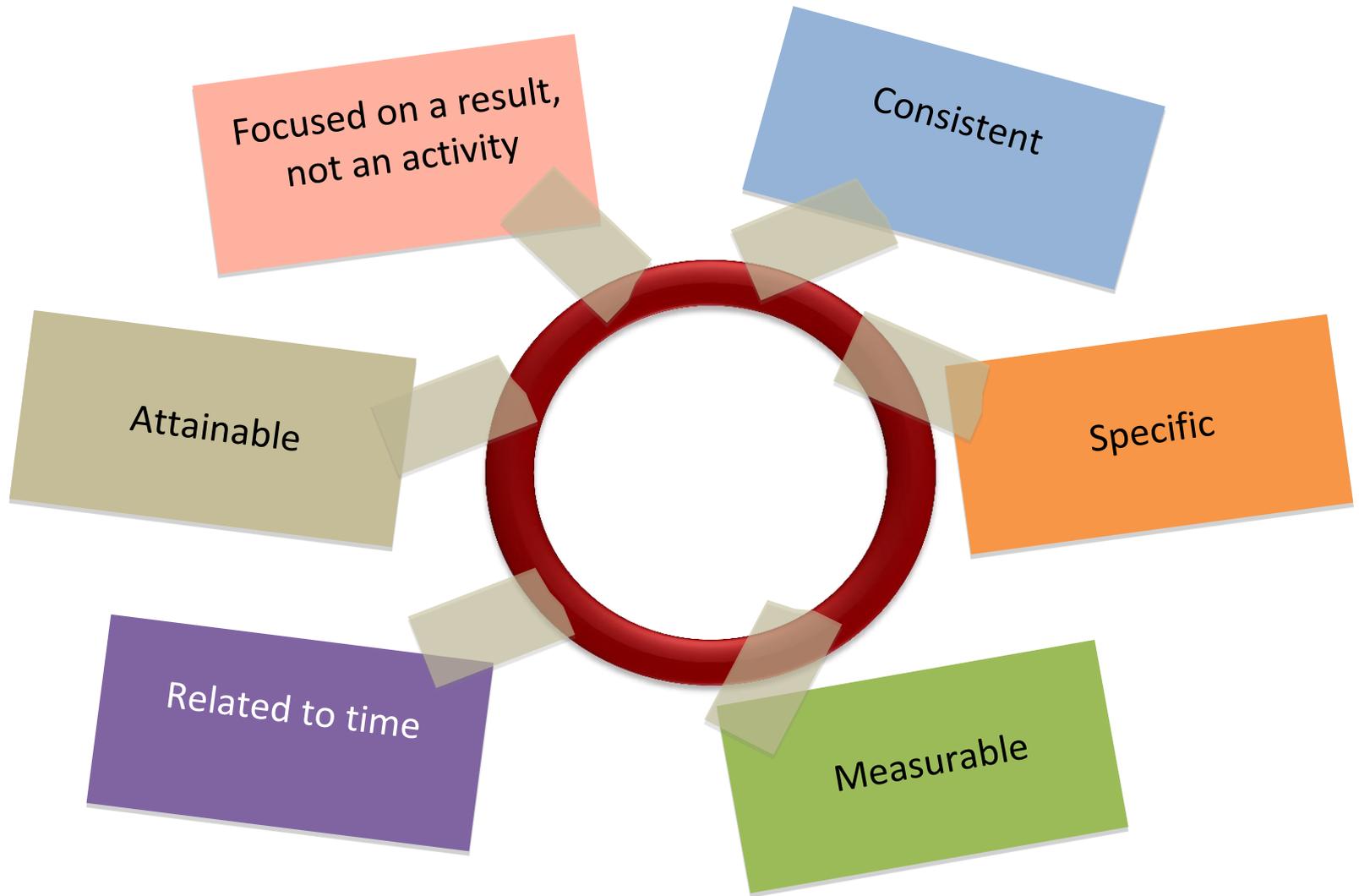
Performance-related pay schemes are designed and administered from a company's point of view

It often fails because it is not aligned closely to business strategy

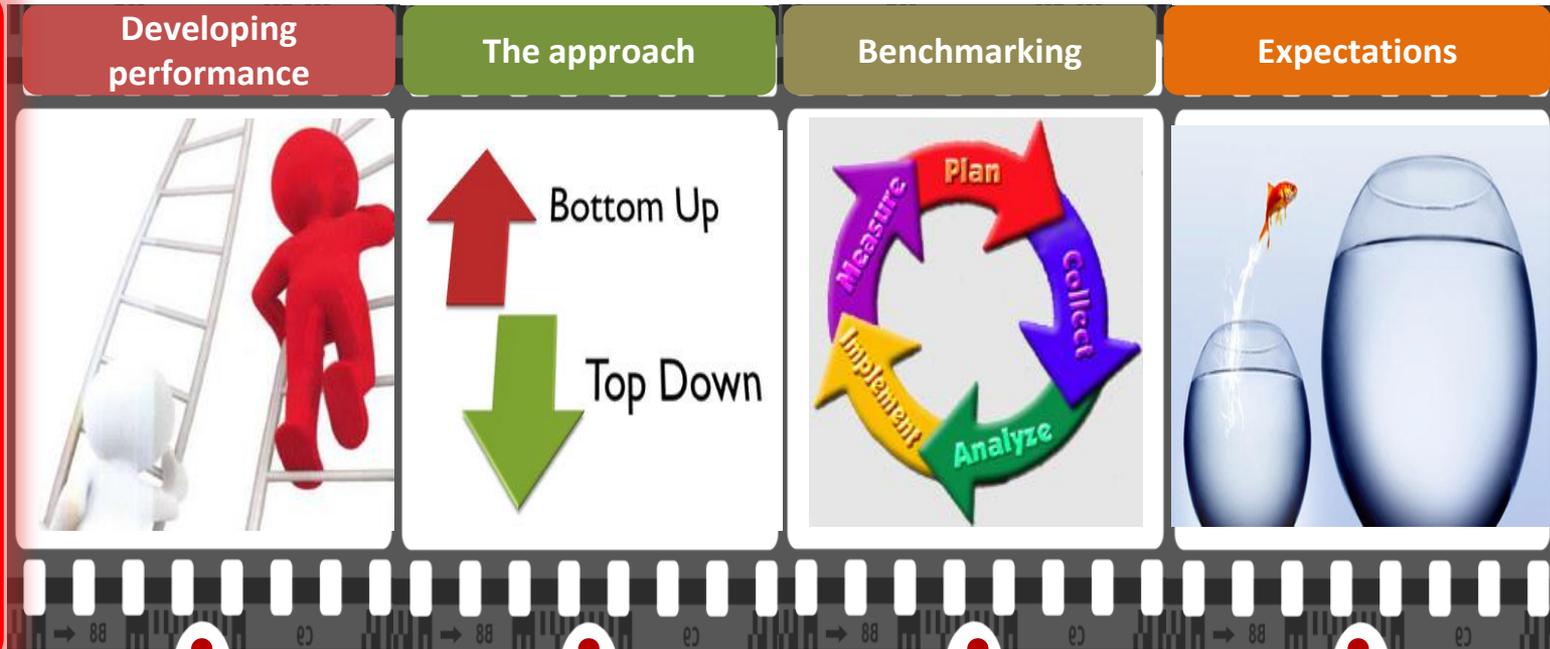


Further performance-driven compensation can support constant change and performance improvement, but can not deliver these by itself, contrary to popular belief

The performance objective must be



Developing performance standards



For effective compensation design, developing performance standards is another important task

The approach an organization should adopt should be a top-down or a bottom-up collaborative approach

As Simply benchmarking performance standard with competing organizations may not always be the right approach

Exceeding expectations in setting performance standards and thereby requiring employees to overstretch is a common organizational syndrome, particularly for new start-ups, which aim to grow disproportionately

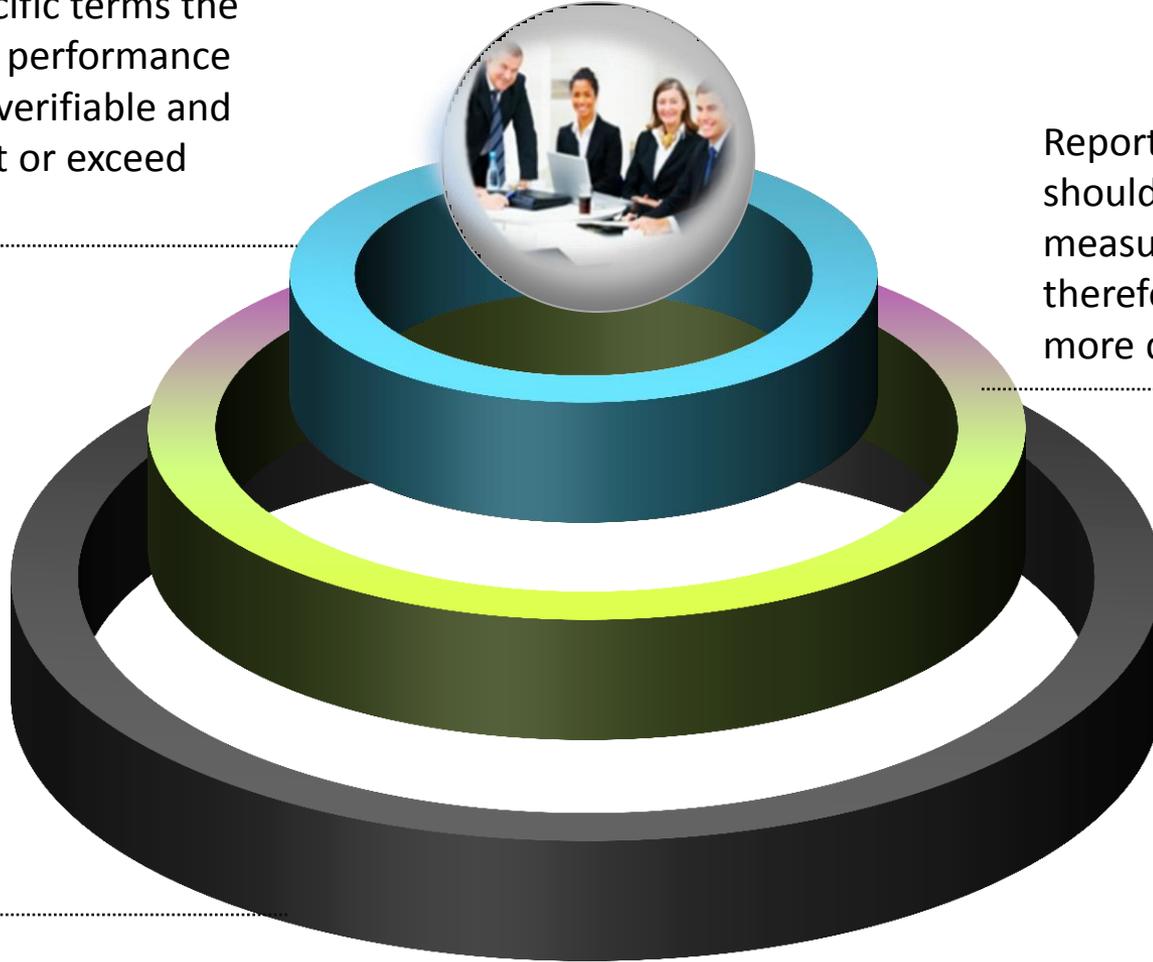
Guidelines

Quantifiable measures may not apply to all functions. Describe in clear and specific terms the characteristic of performance quality that are verifiable and that would meet or exceed expectations.



Reporting systems should be adequate to measure and, therefore should have more quantitative data

Performance standard should be related to the employee's assigned work and job requirements



Checklist



Are the standards realistic?



Are the standards specific?



Are the standards based on measurable data?



Are the standards consistent with organizational goals?



Are the standards challenging?



Are the standards clean and understandable?

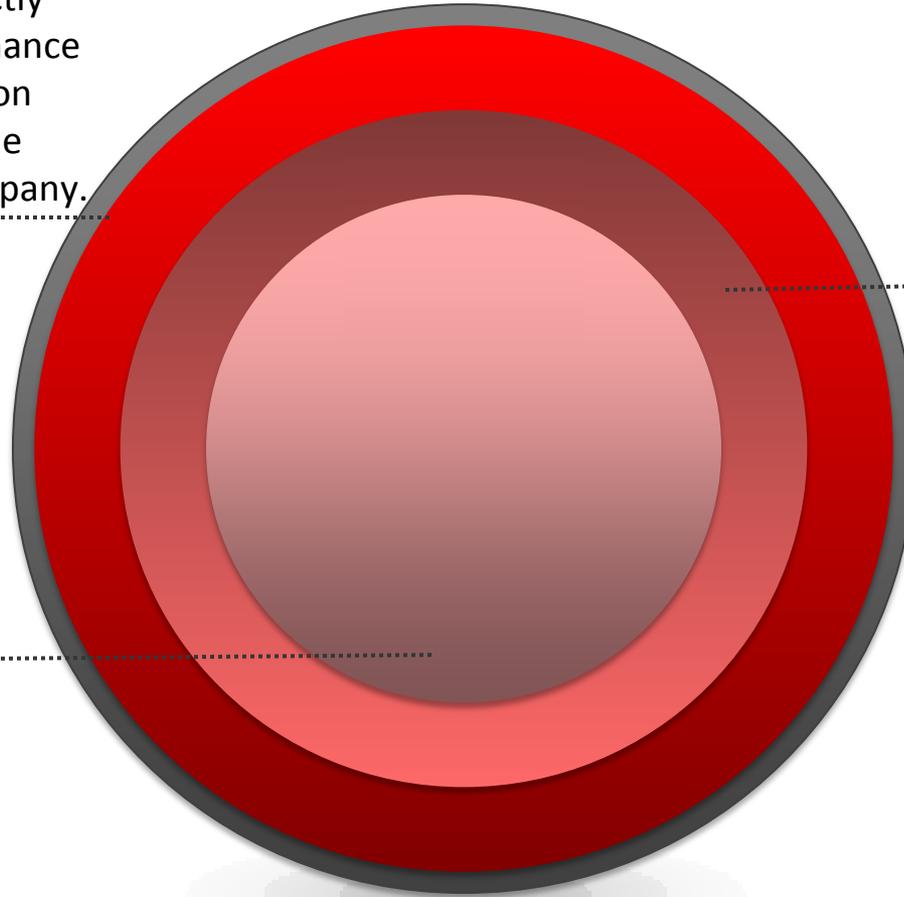


Are the standards dynamic?



Effective performance modeling

If an employee performs well, such performance is directly linked to process performance and to department/division performance as well as the ultimate goals of the company.



For a performance model to work, employee performance appraisal criteria must be aligned with the performance metrics.

An effective performance modeling enables the management to be specific that the end results are not arbitrary, but a summation of all different activities and processes, given an attainable standard of performance.

Features of Performance Management System (PMS)



**Objective
stating**



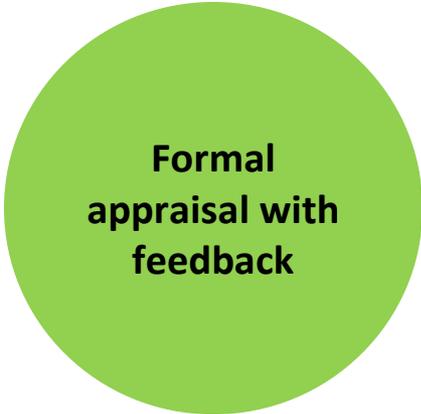
**Review of
objectives**



**Personal
improvement
plans**



**Alignment
with training
and
development**



**Formal
appraisal with
feedback**



Pay review



**Competence-
based
organizational
capability**

Various dimensions of performance

Output/result dimension

Input dimensions

Time dimensions

Focus dimensions

Quality dimensions

Cost dimensions

Results and output

Compensation broad banding using PMS result



- Compensation broad banding is a type of salary program that replaces multiple grades and ranges with a limited number of wide ranges
- Employee move through salary ranges without traditional promotions or job delineation, based on individual skill attainment and expansion of duties, rather than on any prescribed time pattern.
- Broad banding reduces trade levels and job titles, combining multiple jobs levels into a single range

Compensation design through skill-based programme



It rewards employees for attainment of additional skills and knowledge. A skill-based pay system enables employees to enjoy additional payment of compensation for new learning, which correspondingly enhances their level of performance. To introduce skill-based compensation programme, organizations at the outset break the jobs or group of jobs into different components. Organization then encourage such employees to acquire additional skills.

Problems

Major obstacles to introduce the skill-based pay can be listed as follows

Defining of skill set

Skill obsolescence

Pricing skill sets

High cost of training

Validation of skills

Increased payroll costs

Skill recertification test

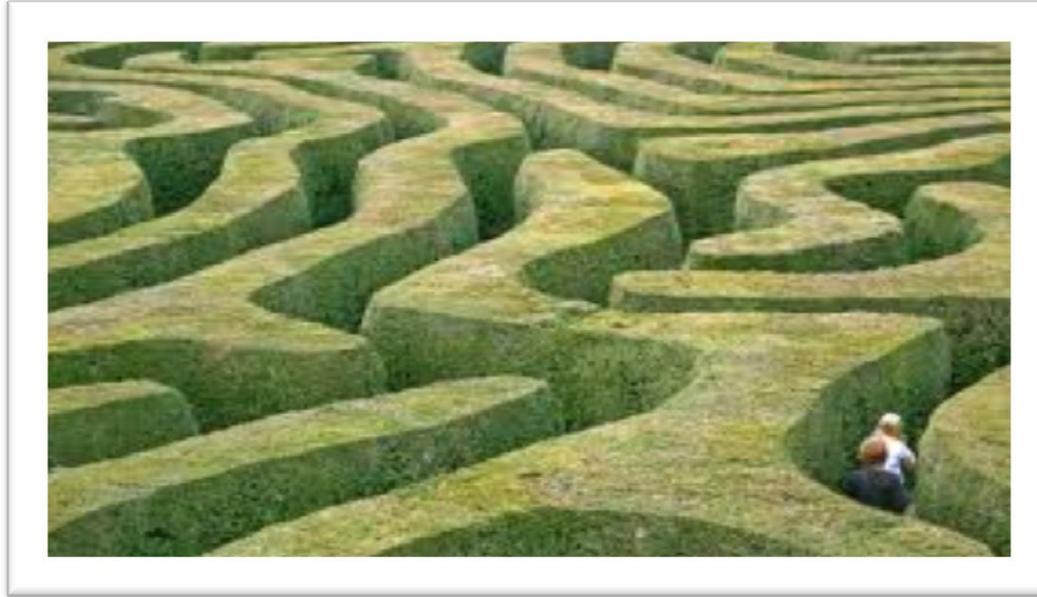
Regulatory bottlenecks

Competency-based pay



Competency is more holistic, as it aggregates knowledge, skill, and abilities of employees, integrated with the behavioral requirements. Instead of compensating for the position and the job-title, competency-based pay emphasizes on the job accomplishments, much wider than job efficiency.

Obstacles



It is important to remember that performance-linked pay or compensation is not the absolute criterion for compensation design, and is one among the various criteria.

Relating compensation directly to performance is not so easy. In fact, in some type of organizations, it may not be even desirable. Both the management and the employees need to agree to relate compensation to performance.

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Negotiation



To talk about compensation management without referring to the process of negotiation and bargaining that is an integral part of compensation management is impossible

As anybody who has worked in the formal or even the informal sector knows, the process of negotiating one's salary and perks is fundamental to the process of hiring and selection.

Plan in place



Employer

The first element of negotiation is to plan for the process by deciding on how much more you want and how much you think the employer is willing to give

The fine art of knowing how much you should ask for and at what point should you strike the deal is something that experienced professionals know and rookies should learn

Without having a clear idea of the target level of compensation that you are aiming for, the negotiation process would turn out to be an exercise in futility

Communicating your needs



HR Manager

- Once you have arrived at a figure that you think you deserve, the next step is to communicate the same to the prospective employer without delay.
- The important point to note here is that the way in which you articulate your needs is as important as the need to drive a bargain.
- For instance, without expressing yourself clearly to the HR manager of the prospective employer, there is little chance that he or she would understand your needs and respond appropriately.
- Hence, once you have sorted out the target compensation that you want, you should also have a strategy to communicate it to the employer.

Time is everything



You need to remember that there is something called being too early when you negotiate and too late as well. Hence, the timing of your articulation forms the basis for a successful negotiation.

For instance, if you start your demands early on in the hiring process, the prospective employer might stall the process or even put a stop to your hiring.

On the other hand, if you put forward your demands as you are about to join the firm, there is precious little anyone can do about your demands.

Hence, you should have a keen eye for when you should communicate your demands.

Time is everything



The three aspects of having a plan, communicating the need and then timing it in such a way as to derive maximum advantage are essential to the negotiation process

Of course, there are many firms that do not entertain any sort of negotiation and there are firms that put up pretence of negotiation when in reality, they do not budge at all

In these cases, it is better to adopt a wait and watch policy and make your move once they get into the details of your compensation

Time is everything



In conclusion, a successful negotiation hinges on the willingness of both the parties to hear each other and an ability to arrive at a common denominator in a spirit of accommodation

Hence, do not be overtly rigid and at the same time do not give in to the employer totally

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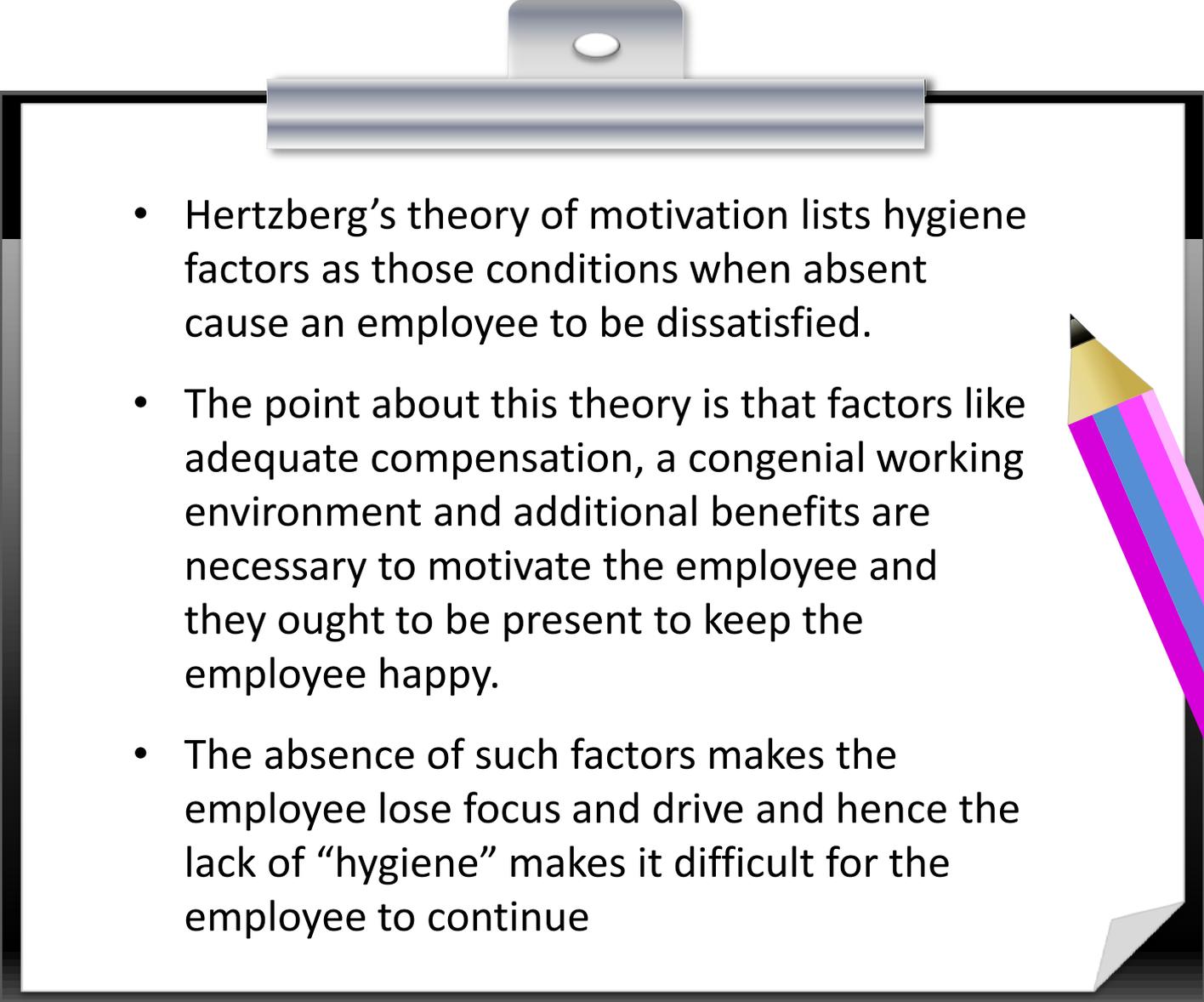
Low compensation and attrition



The exit interviews conducted by the HR professionals to ascertain the reasons behind an employee's exit usually reveal that low compensation is a major factor behind the employee's decision to quit the company

Research into the phenomenon of attrition has found that many employees (particularly at the entry and the middle management levels) leave companies because they have been offered better compensation at another company. On the other hand, the senior management personnel quit to take up challenging roles that pay well as well as provide self actualizing drives to them.

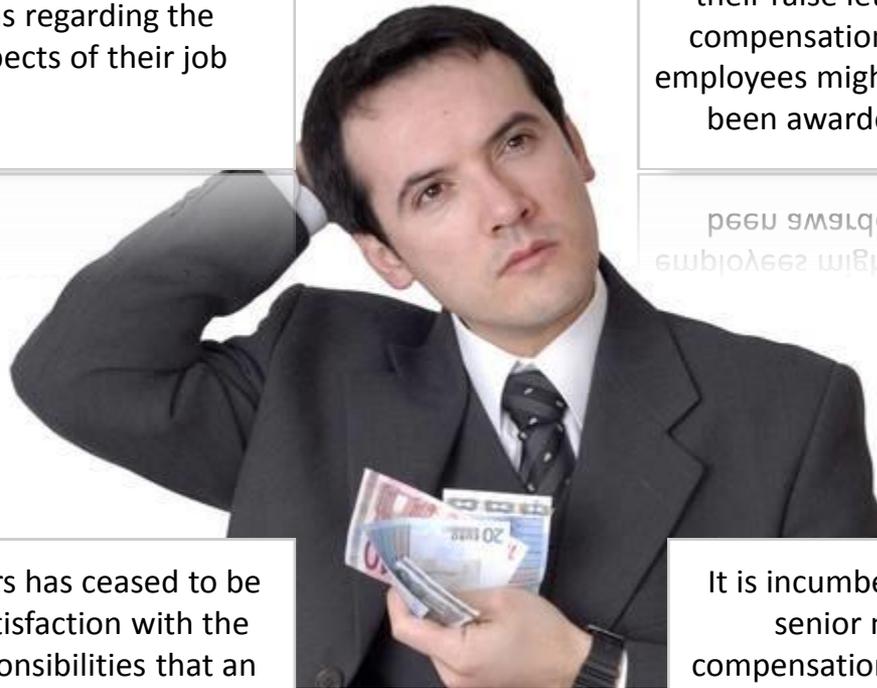
Compensation as hygiene factor

- 
- Herzberg's theory of motivation lists hygiene factors as those conditions when absent cause an employee to be dissatisfied.
 - The point about this theory is that factors like adequate compensation, a congenial working environment and additional benefits are necessary to motivate the employee and they ought to be present to keep the employee happy.
 - The absence of such factors makes the employee lose focus and drive and hence the lack of "hygiene" makes it difficult for the employee to continue

Managing compensation expectation

The appraisal time or the time of the year when employees are graded on their performance is usually the time when employees put forth their aspirations and expectations regarding the compensation and other aspects of their job

The line managers and the HR managers must make it a point to “manage” the expectations of the employees during this period. The attrition is usually the highest when employees are handed their raise letters that specify how much their compensation is increased. This is because the employees might expect more than what they have been awarded which leads to dissatisfaction



Compensation in recent years has ceased to be the “be all” of employee satisfaction with the nature of work and the responsibilities that an employee has becoming more important in determining job satisfaction, it still is one of the most important factors behind an employee’s decision to quit a company

It is incumbent upon HR professionals and the senior management that they devise compensation plans keeping in mind the various factors that drive an employee’s psyche. Only when an employee is satisfied with his or her condition in a company can they perform at the desired levels

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Components of executive compensation

Base salary

Annual incentives

**Long-term capital
accumulation**

**Deferred compensation
arrangement**

**Supplemental benefit
and perquisites**

**Special severance and
retirement arrangement**

Emerging trends in executive compensation



Increase in the number of corporate collapses is now dragging executive pay and corporate governance into the public domain



Business condition are putting pressures on existing pay levels and structure



Corporate restraint and accountability in tough economic times make executive compensation a major issue to control



Executive compensation movements at the median of the market are getting subdued over the years

Executive compensation design

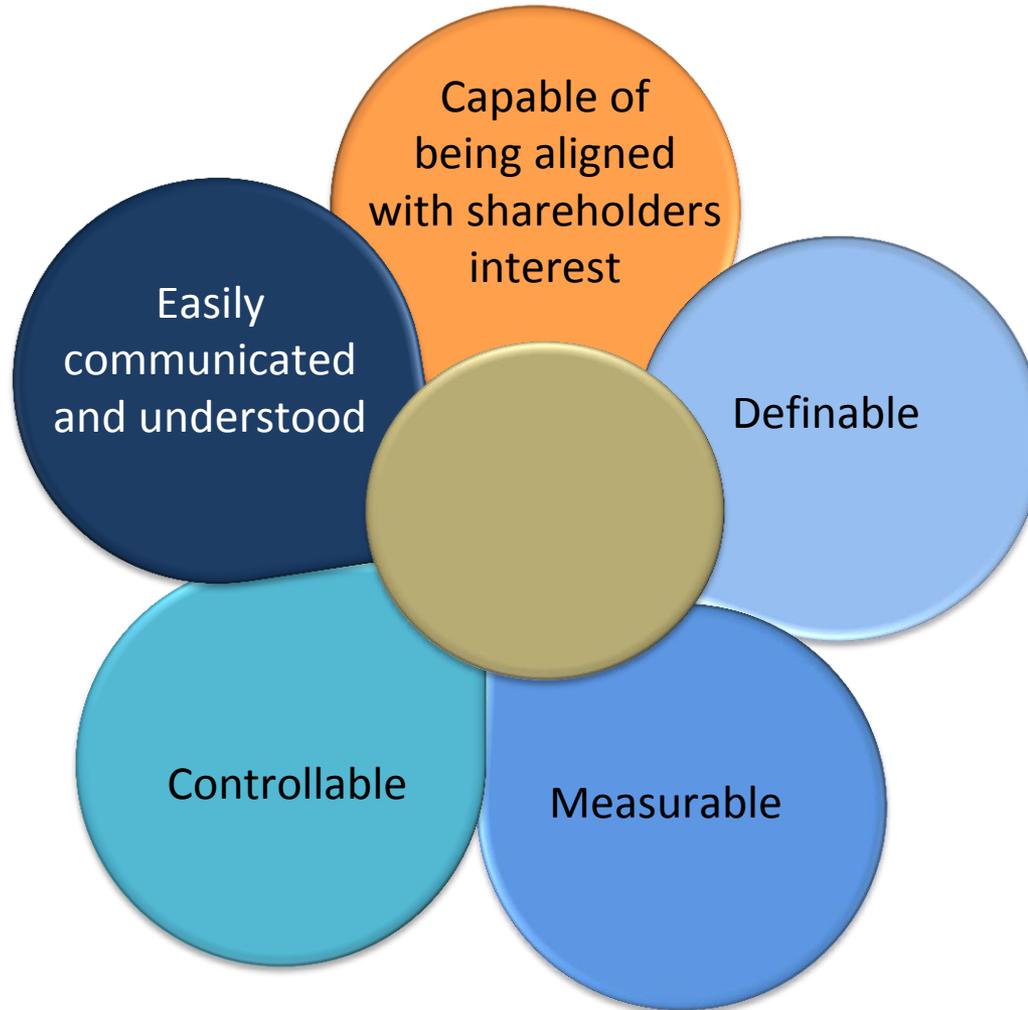


Executive compensation design process links compensation criteria, such as organizational performance or size, to compensation consequences, such as pay at risk. Such process is categorized into 2 forms – the process that centers on contract and the process that involves direct monitoring of the executive.

Organizations that follow the contract process make it a time-bound employment offer, which becomes a legal arrangement. Direct monitoring is a behavioral approach to monitor the performance of the executive. It is a subjective evaluation.

Performance measurement in executive incentive programmes

There are certain criteria that incentive performance measures should ideally meet. They should be:



Different criteria of executive compensation

- ① Strategy criterion
- ② Role/position criterion
- ③ Individual characteristics criterion
- ④ Performance criterion
- ⑤ Behavior criterion
- ⑥ Size criterion
- ⑦ Market criterion
- ⑧ Peer compensation criterion

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Understanding the sales function

Before designing a sales compensation plan, managers need to understand the sales function.



The financial performance of an organization depends on the sales executive's performance; hence sales compensation also needs to be different, as it is largely incentive based.

For managers, an understanding of the sales function involves the study of the various activities involved in sales, from the beginning.

Sales compensation issues



Sales are lifeline of the organization. Sales directly help in achieving the organizational goals and objectives.

Hence when organization need to achieve an accelerated pace of growth, a strategic design of sales compensation, without altering the overall compensation structure, can help achieve the objective

Sales compensation plan



Sales compensation plan varies from one organization to another, depending on their practices

Salary is considered as right option. A commission of sale is also considered as the other alternative model of sales compensation

A straight salary plan is simple to administer and it also provides security to the sales executives, as their pay is not at risk

Sales compensation design and administration

Although no model on sales compensation programme, which applies uniformly across the organizations, exists, some common steps are adopted for a sales compensation design. Such steps are:

Identification of realistic and challenging sales goals



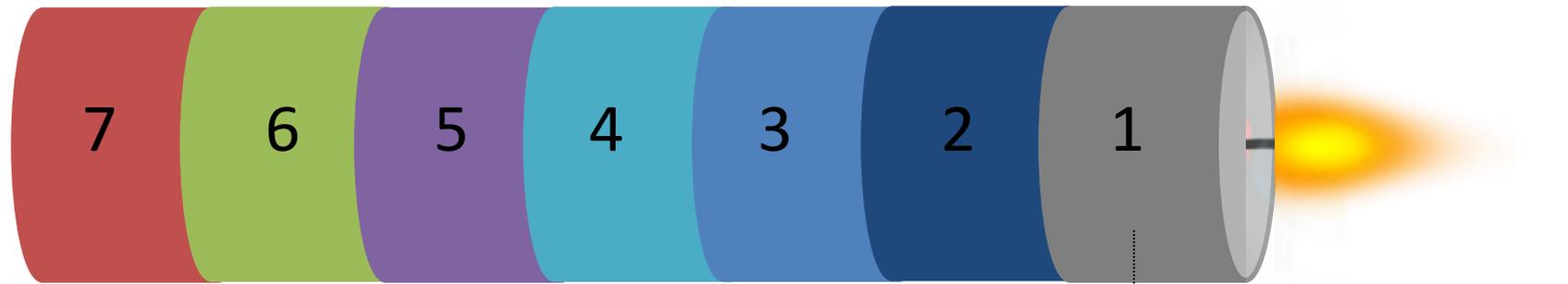
Translating sales goals into measurable objectives



Finally, designing sales compensation, which is competitive and motivational for the employees



Designing an effective Sales compensation plan



Basic understanding of the sales job description:

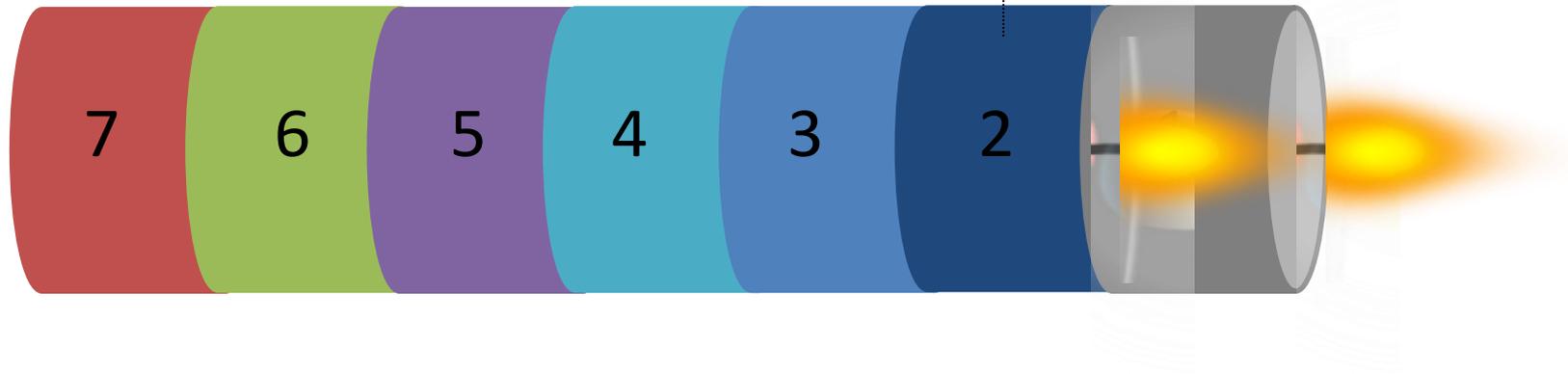
This is very important as the nature of the sales job cannot be uniform for all types of products and services. Effectively describing the role of a sales executive and then developing a suitable compensation structure requires organizations to first decide about the job description for sales executives.



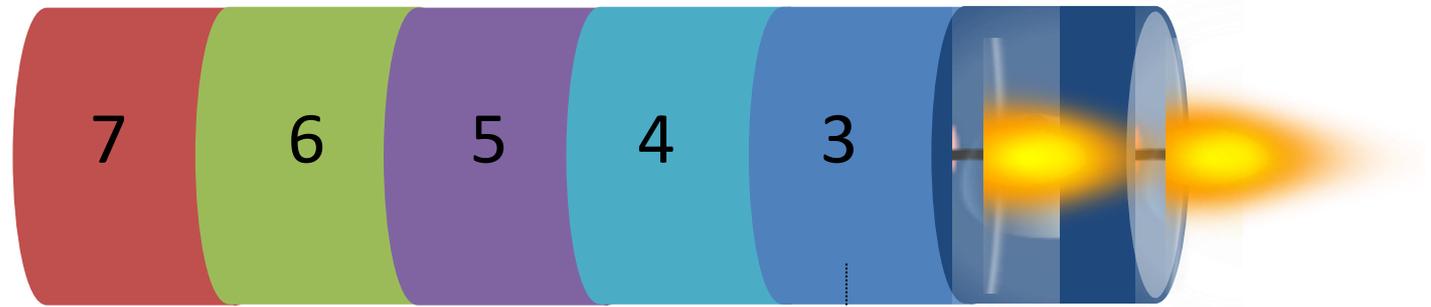
Designing an effective Sales compensation plan

Understanding the objective:

For the sales function, the overall objectives of the organization based on MBO approach may cascade to key result areas (KRA), key performance areas (KPA) and key sales objectives (KSO). These could be identified for individual sales executive or for a sales team.



Designing an effective Sales compensation plan



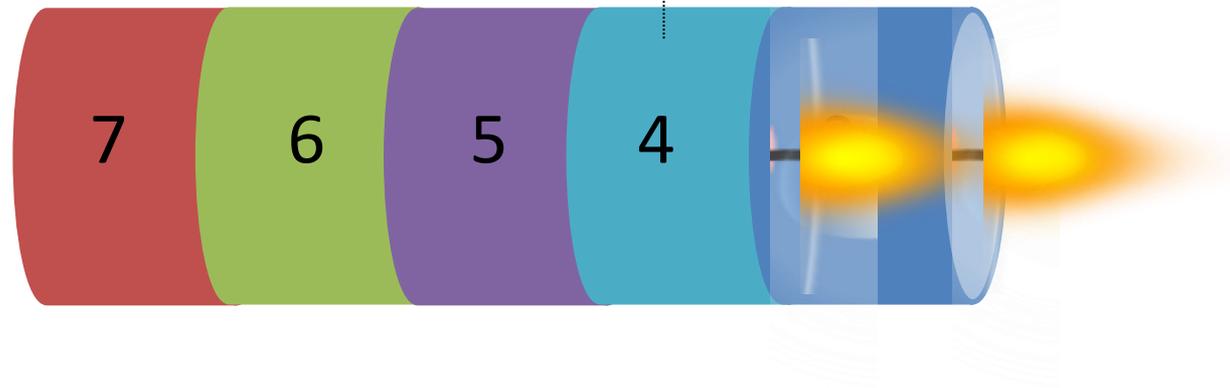
Understanding of controllable and measurable elements of the sales function:

Sales compensation plans are largely linked to performance. To understand the performance and its possible bottleneck, and degree of performance achievement, emphasis should be placed on the controllable and measurable elements of the sales function.

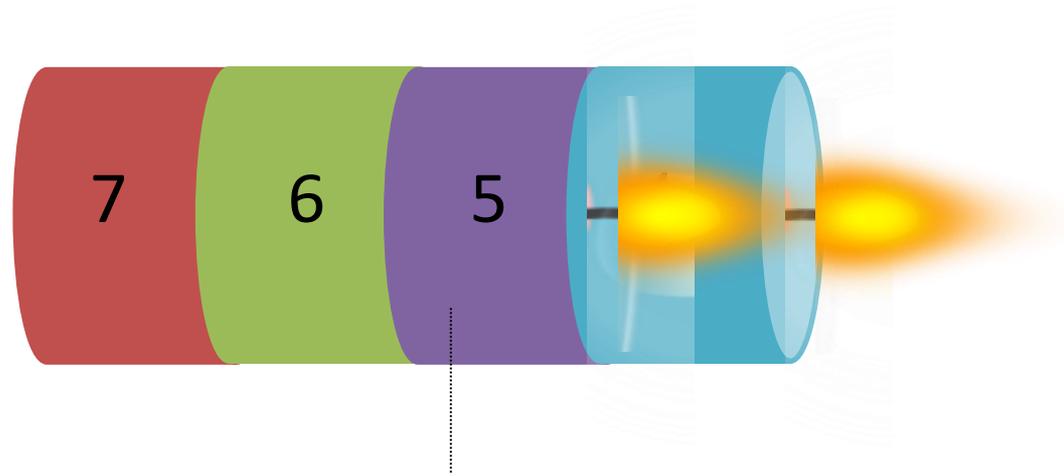
Designing an effective Sales compensation plan

Determine the level of compensation:

At this stage, the organization designs a compensation matrix with respect to the job role on one axis and salary, incentives, and total compensation on the other axis. Along with this the organization also needs to understand industry's average compensation, fixed-variable mix for the salary, salary-incentive mix, and other determinants of compensation level.



Designing an effective Sales compensation plan



Understanding the compensation method:

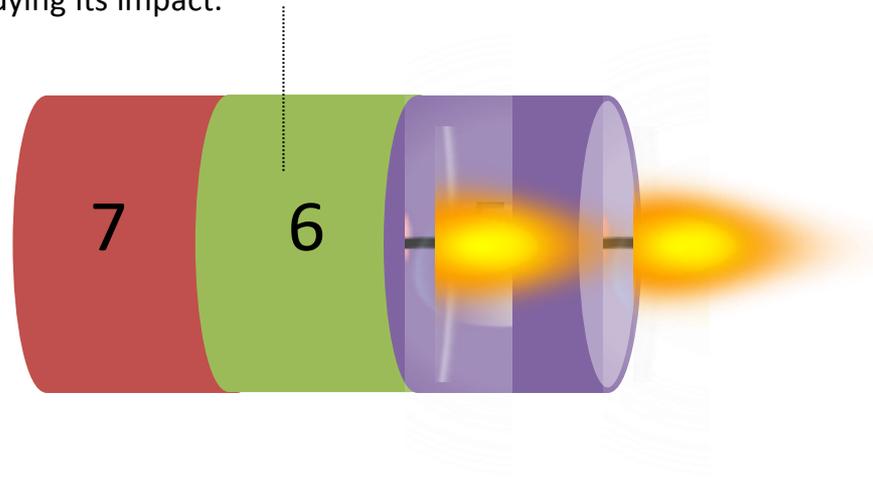
Straight salary, straight commission, and the combination of both are considered while designing sales compensation.

Absolute straight salary or absolute straight commissions are not suitable models of sales compensation. The organization is required to adopt a combination approach, identifying a suitable mix of salary, incentives, benefits and expenses.

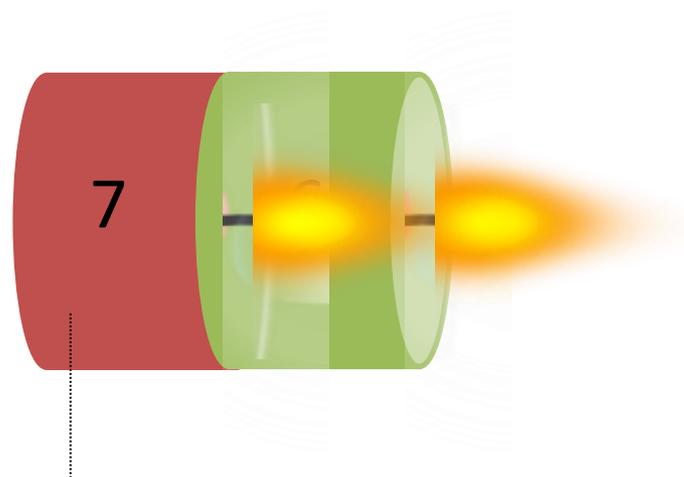
Designing an effective Sales compensation plan

Pilot testing of designed method:

A newly designed sales compensation method should be tested for administrative feasibility, sales compensation expense optimization and enhancement of motivation of the sales force. A better understanding of all these factors would be possible by fitting the organization's immediate past year's sales performance data into new model and studying its impact.



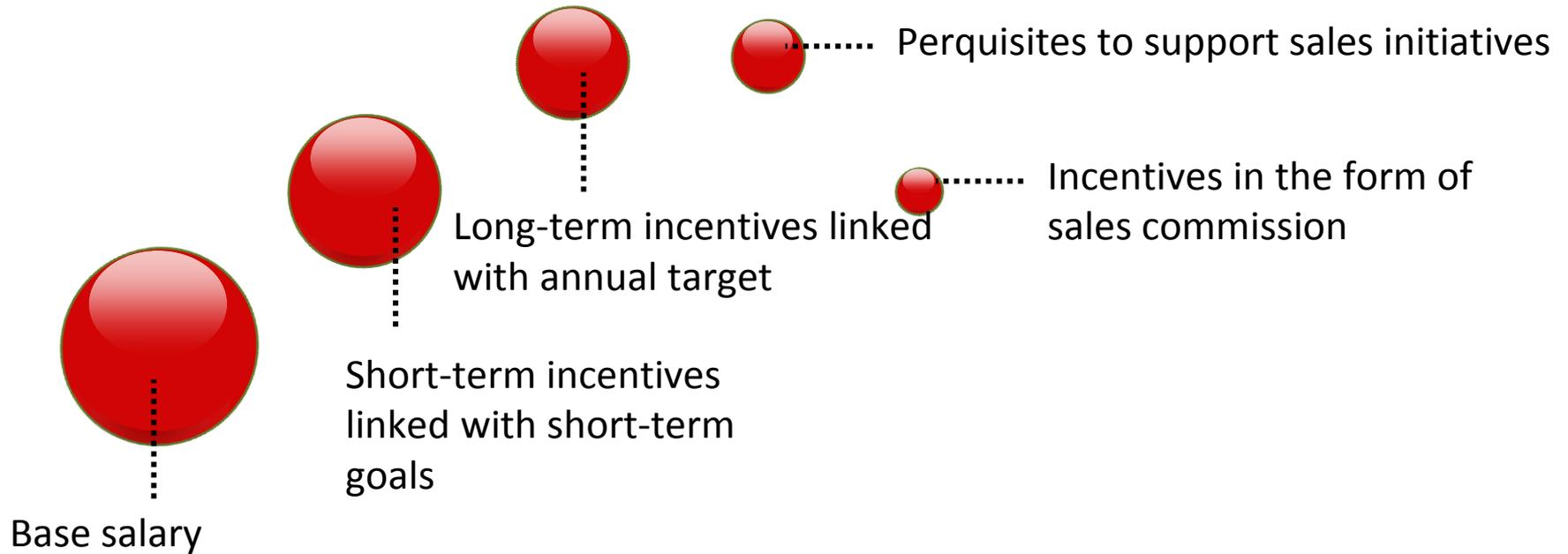
Designing an effective Sales compensation plan



Rollout of the plan:

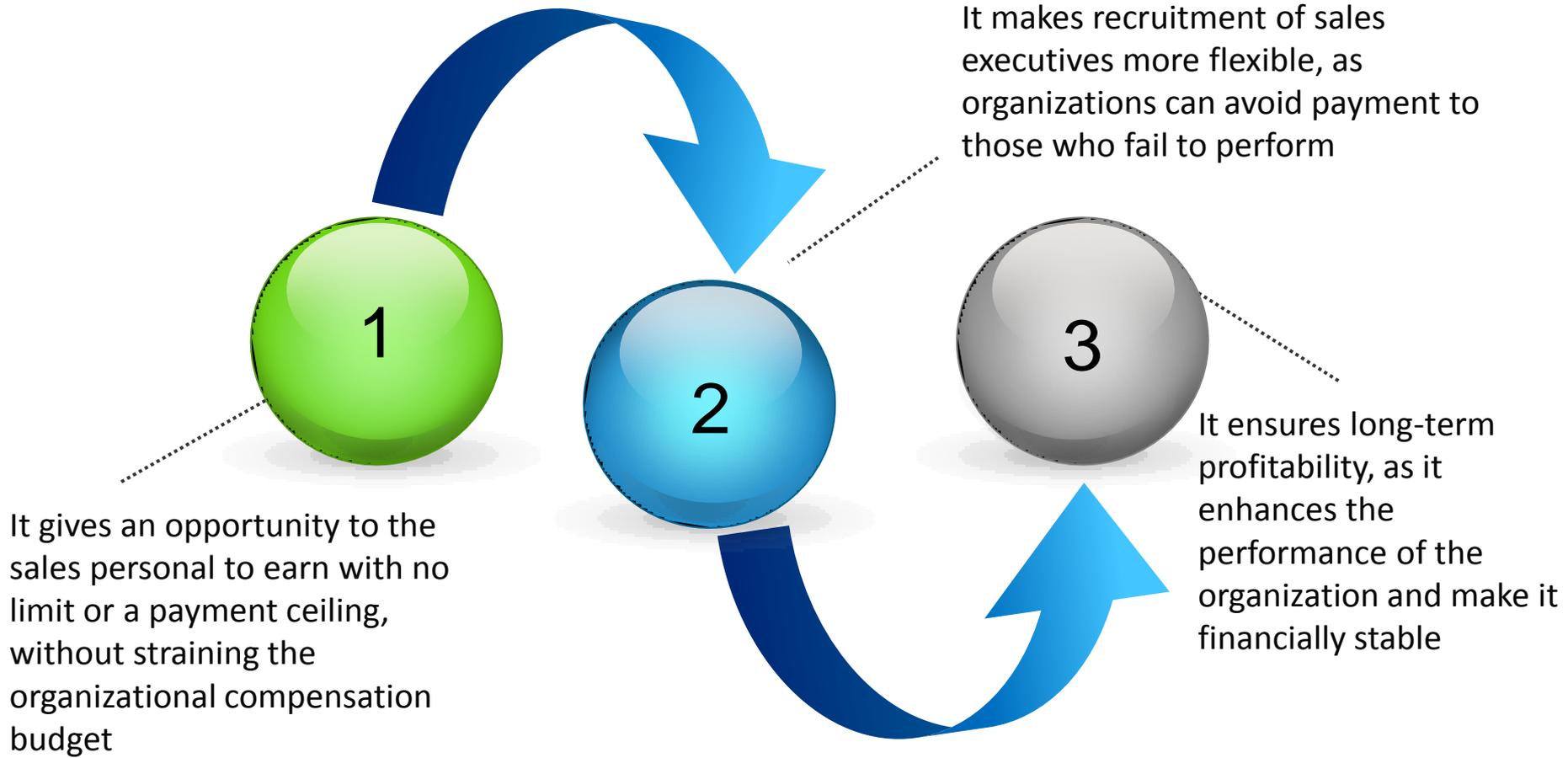
Finally, the newly designed plan is rolled out in the organization. Organization, as an ongoing process, should study the motivation level of sales force, keep a track on the performance changes, and incorporate possible changes, if needed.

Components of sales compensation



Contribution-based sales compensation

A contribution-based sales compensation benefits the organization in following ways:



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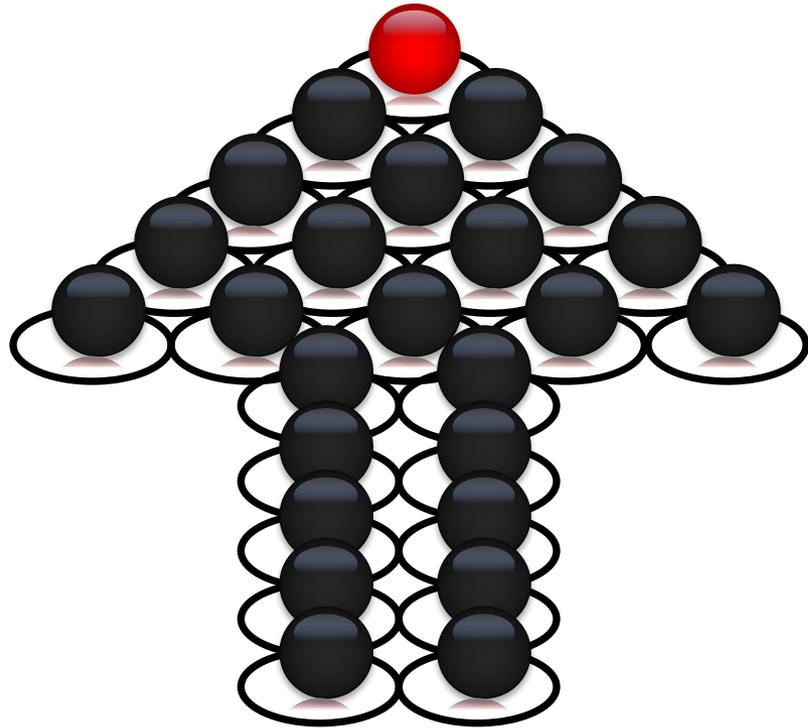
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Strategy



Strategy is a pattern of decisions concerning policies and practices associated with an organizational system. Understanding organizational system helps in formulating strategies. Strategies need to be formulated in each functional area of an organization and also at each level of an organization.



Mintzberg et al. identifies 10 schools of strategy – broadly classified under Prescriptive schools and Descriptive schools.

Schools

Prescriptive school

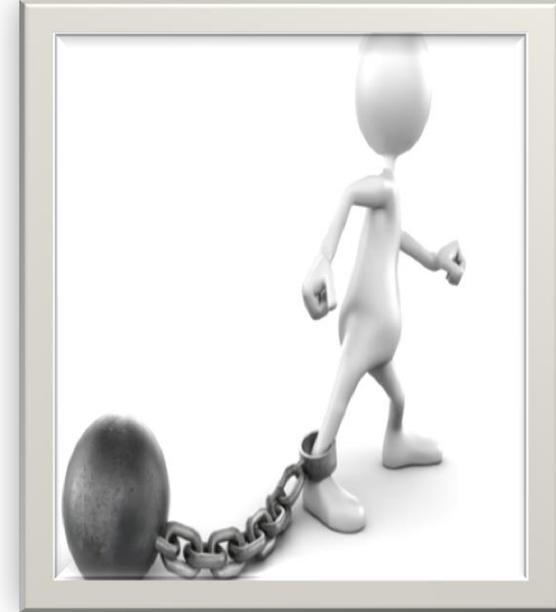
- Design school
- Planning school
- Positioning school

School

Descriptive school

- Entrepreneurial school
- Cognitive school
- Learning school
- Power school
- Cultural school
- Environmental school
- Configuration school

Design school



When it comes to making major mistakes, it's not your weaknesses that will get you in trouble, it's your strengths. Most successful people are aware of their weaknesses. Any strengths which is overextended becomes weakness. For example, listening is a strength for some people. But if a person listens a lot but does not speak enough, it becomes his/her weakness.

Planning school



Restructuring the strategy formation into some distinctive and identifiable steps, this school makes strategy formation more a formal process, rather a cerebral one. This school, therefore, emphasizes on making managerial decisions more formal and documented by norms such as a standard operating procedure to ensure consistency in a series of actions.

Positioning school



It views strategy formation as an analytical process placing the business within the context of the industry that the organization is in, and evaluating how the organization can improve its competitive positioning within the industry.

Descriptive school – Entrepreneurial school



Like the design school, the entrepreneurial school centers around the strategy formation process at the chief executive level, relying on intuition and gut feeling

Cognitive school



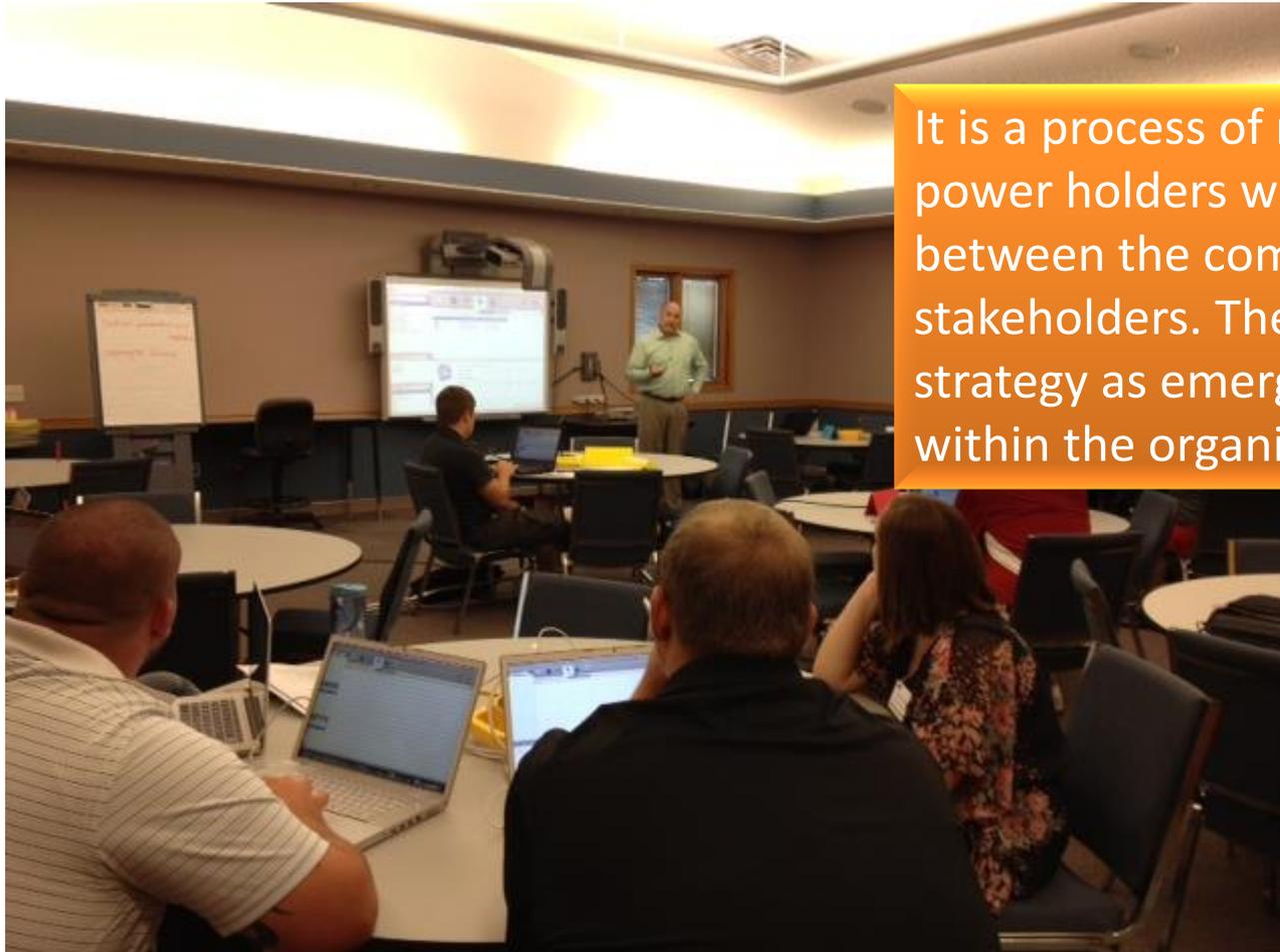
It considers strategy formation as a mental process and analyses how people perceive patterns and process of information. The cognitive school looks inwards into the minds of strategists. This school subscribes to the view that strategies are developed in people's mind as frames, models, or maps.

Learning school



It regards strategy formation as an emergent process, where the management of an organization pays close attention to what works and does not work over time, and incorporate these “lessons learned” into their overall plan of action

Power school



It is a process of negotiation between power holders within the company, and/or between the company, and the external stakeholders. The power school views strategy as emerging out of power games within the organization and outside it.

Cultural school



The cultural school views strategy formulation as a process rooted in the social force of culture. As opposite to the power school that focuses on self-interest and fragmentation, the cultural school focuses on common interest and integration. Strategy formulation is viewed as a social process rooted in organizational school

Environmental school



The environmental school believes that an organization's strategy depends on events in the environment and the organization's reaction to them. The environmental school deserves attention for the light it throws on the demands of the environment. It sees strategy formation as a reactive process – a response to the challenges imposed by the external environment.

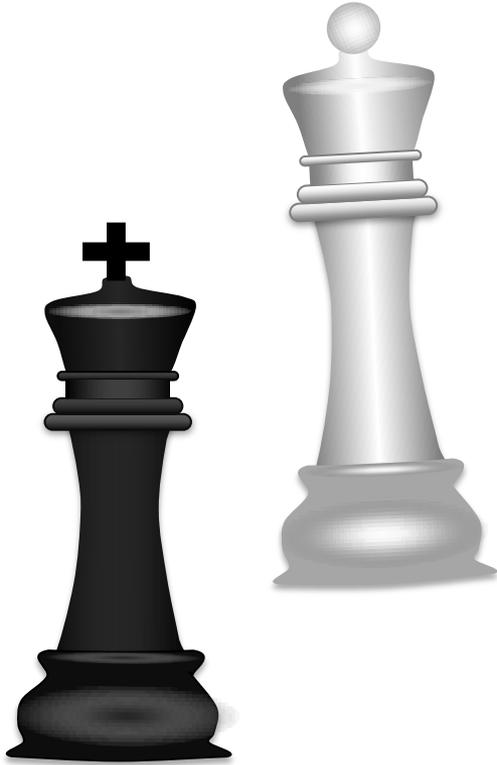
Configuration



It finally mandates strategy formation as a process of transforming the organization from one type of decision-making structure into another.

The configuration school, which views strategy as a process of transforming the organization, describes the relative stability of strategy, interrupted by occasional and dramatic leaps to new ones. This school enjoys the most extensive and integrative literature and practice at present.

Compensation design and strategy

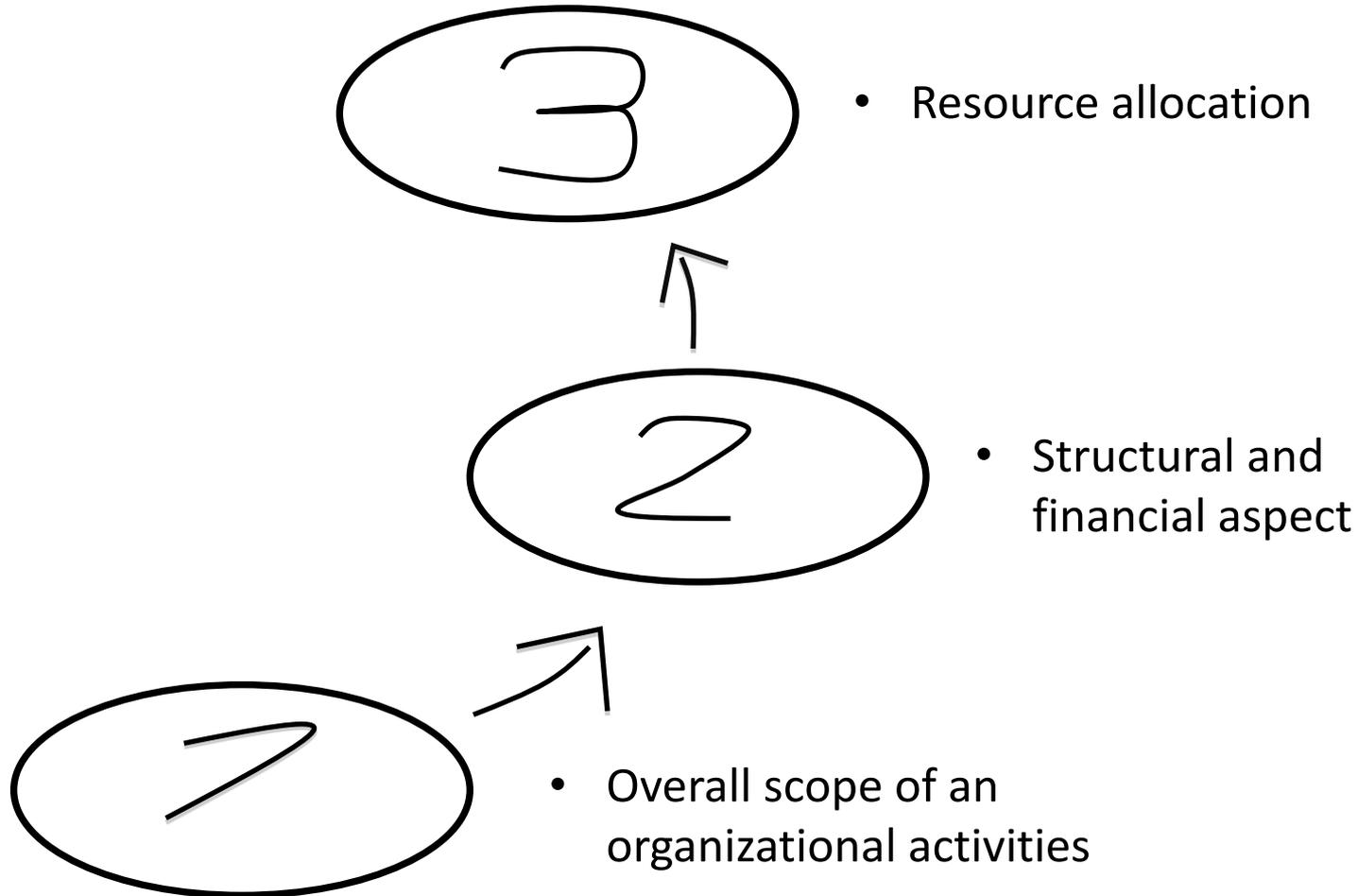


Organizational practices in strategically designing the compensation structure vary widely. In fact, compensation is designed with the influence of more than one school of thought

While framing compensation strategies, the organization should align its policies and practices with its strategy. This will ensure fulfillment of role expectations for employees within the organization

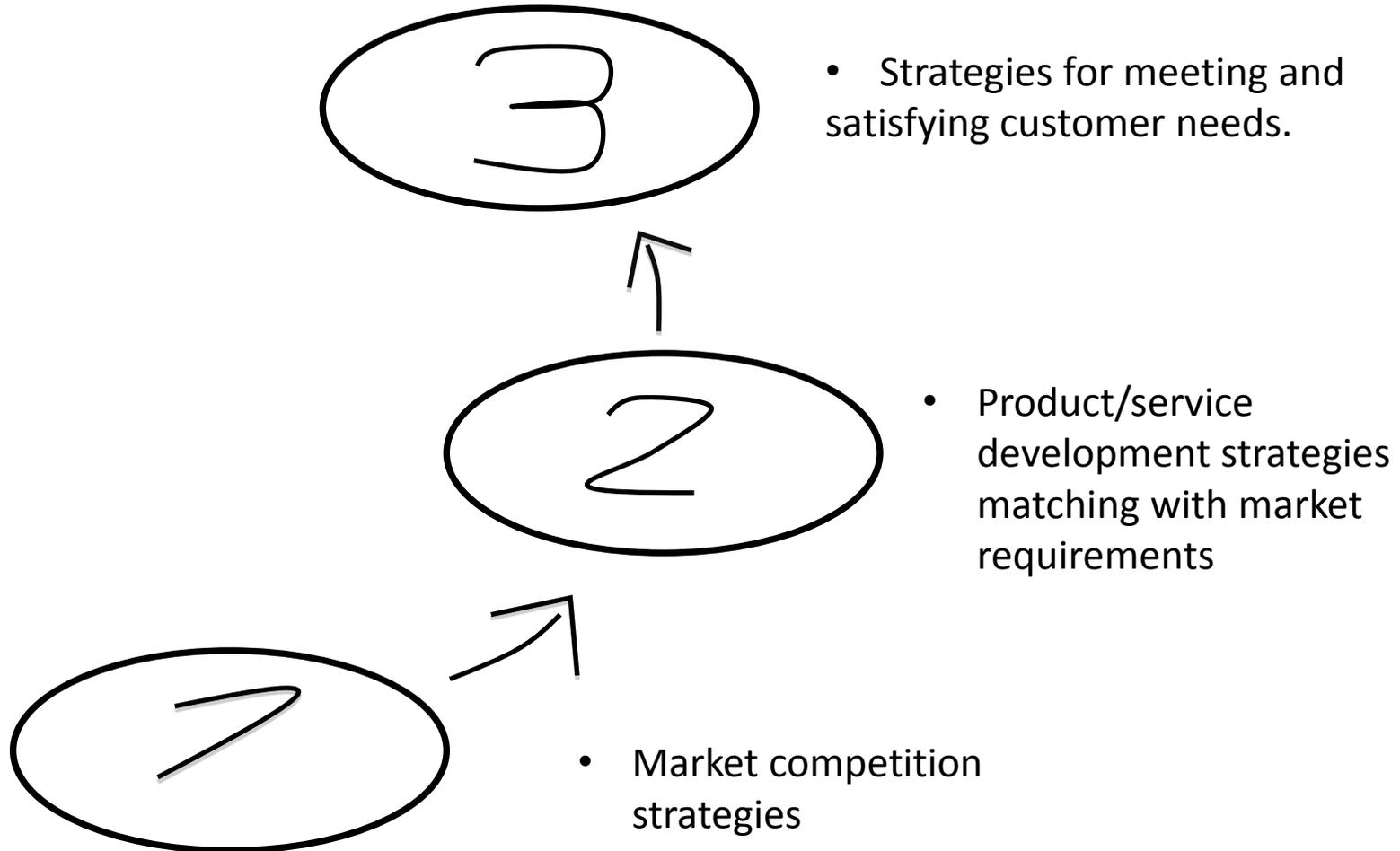
Strategy across levels

Corporate level strategy focus on



Strategy across levels

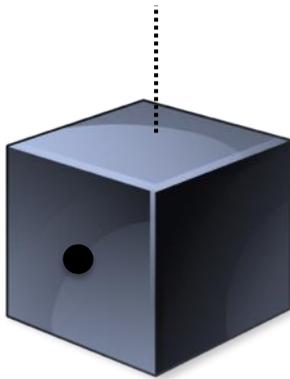
Strategies framed at middle level deal with



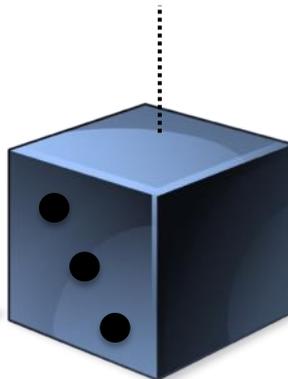
Strategy compensation design

Organization design compensation in a flexible, competitive, and performance-oriented way, by adopting the following processes

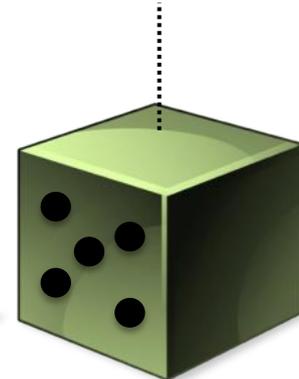
Looking into the history of the organizations to understand the principles and norms



Focusing on performance management, structure setting and adjustment



Implementing the new strategically designed compensation plan



Using various workgroups to understand the issues

Matching with the legislative regulatory norm

Strategy compensation policies



To achieve and maintain consistency, equity, and fairness in evaluating and compensating employees

To reward employees based on their experience and performance

To reward employees based on their support of organization-specific mission, strategies, and operating plan

To allow attraction and retention of high-quality professional employee

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Variable compensation



Variable pay is employee compensation that changes as compared to salary which is paid in equal proportions throughout the year. Variable pay is used generally to recognize and reward employee contribution toward company productivity, profitability, team work, safety, quality, or some other metric deemed important.



The employee who is awarded variable compensation has gone above and beyond his or her job description to contribute to organization success.

Incentives



Incentives are the additional payment to employees besides the payment of wages and salaries. Often these are linked with productivity, either in terms of higher production or cost saving or both. These incentives may be given on individual basis or group basis.

Fringe benefits



Fringe benefits include such benefits which are provided to the employees either having long-term impact like provident fund, gratuity, pension; or occurrence of certain events like medical benefits, accident relief, health and life insurance; or facilitation in performance of job like uniforms, canteens, recreation, etc

Perquisites



These are normally provided to managerial personnel either to facilitate their job performance or to retain them in the organization. Such perquisites include company car, club membership, free residential accommodation, paid holiday trips, stock options, etc.

Need for rationale wage policy

Formulation of rational wage policy continues to be one of the most important and significant social demands.

Earlier, it formed the basic responsibility of the employer but with the industrial progress, wage bargain has become a matter of concern for the employer, employee, and the state.

Any rational wage policy has hence to be woven into the socio-economic texture reflecting the objectives and aspirations of the people of a particular country.

It cannot be dealt with, on purely economic considerations in isolation from the social policy and political culture of that particular community.

Economic objectives of wage policy



An important objective of any society is the achievement of maximum economic welfare.

This requires the national income to be maximized. The national income should be divided equally among all the members of the economy and finally, there should be a fair amount of stability in the national income.

Economic welfare gets maximized if the highest and most stable standard of living possible for each section of the community is attained. In order to secure this, it is necessary to achieve:

Economic objectives of wage policy

Full employment and optimum allocation of all resources.

The highest degree of economic stability consistent with an optimum rate of economic progress.

Maximum income security- for all sections of the community.

Remuneration administration

1. It should be developed keeping in view the interests of the employer, the employees, the consumers and the community.
2. Wage policy should be stated clearly in writing to ensure uniform and consistent application.
3. Remuneration plans should be consistent with the overall plans of the company. Compensation planning should be an integral part of financial planning.
4. Remuneration plans should be sufficiently flexible or responsive to changes in internal and external conditions of the organization.
5. Management should ensure that employees know and understand the wage policy of the company.
6. All remuneration decisions should be checked against the standards set in advance in the wage policy.

Steps involved in designing a remuneration plan



Appraisals/new joiners/pay increases



Creating a pay structure is not the final step in the creation of a compensation plan. An organization must also decide how to administer this compensation plan.

This means deciding how to pay new employees, how and when to give employees increases, including how to move existing employees from the minimum to the maximum of their assigned pay grades, how to determine the pay increase for an employee being promoted from one job to another and what influence, if any, cost of labor increases will have on the determination of pay increases for employees.

Fixed vs. variable pay



Variable pay programs are widely followed throughout many organizations and for all levels of employees.

Widespread use of various incentive plans, team bonuses, profit-sharing programs have been implemented with a view to link growth in compensation to results.

Of course, while using variable pay systems, management must look into two issues carefully;

- Should performance be measured and rewarded based on individual, group or organizational performance?
- Should the length of time for measuring performance be short term or long term?



Payroll Management



Payroll is a compensation record of each employee, which shows gross pay, deductions, and net pay. It also provides the details of cost to the company, associated with employment.

Payroll management involves accounting and administration of payroll. Payroll accounting, using payroll software, can be automated and payroll reports can be prepared with speed and accuracy.

Quantitative analysis

Quantitative Analysis

In compensation designing and management, intuition is often used rather than mathematical systems. Certain norms are following in mathematical system. For example, the observation must be dependent, i.e., one measurement should not bias the other. The measurement must be from a normally distributed population, the traditional “bell-shaped” curve.

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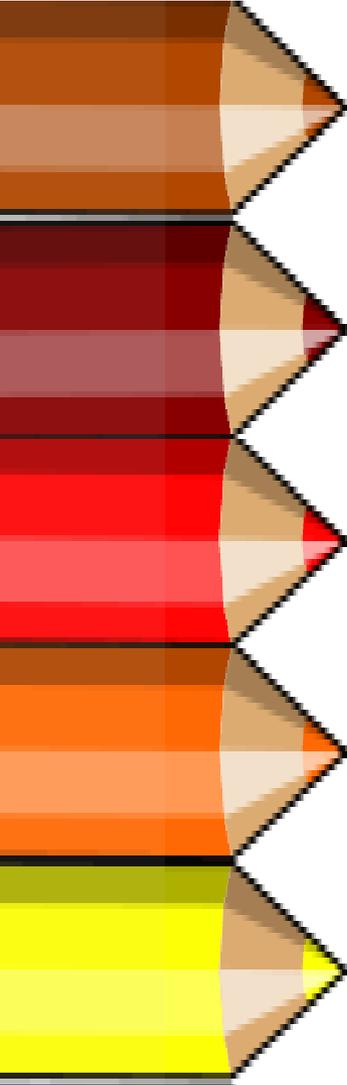
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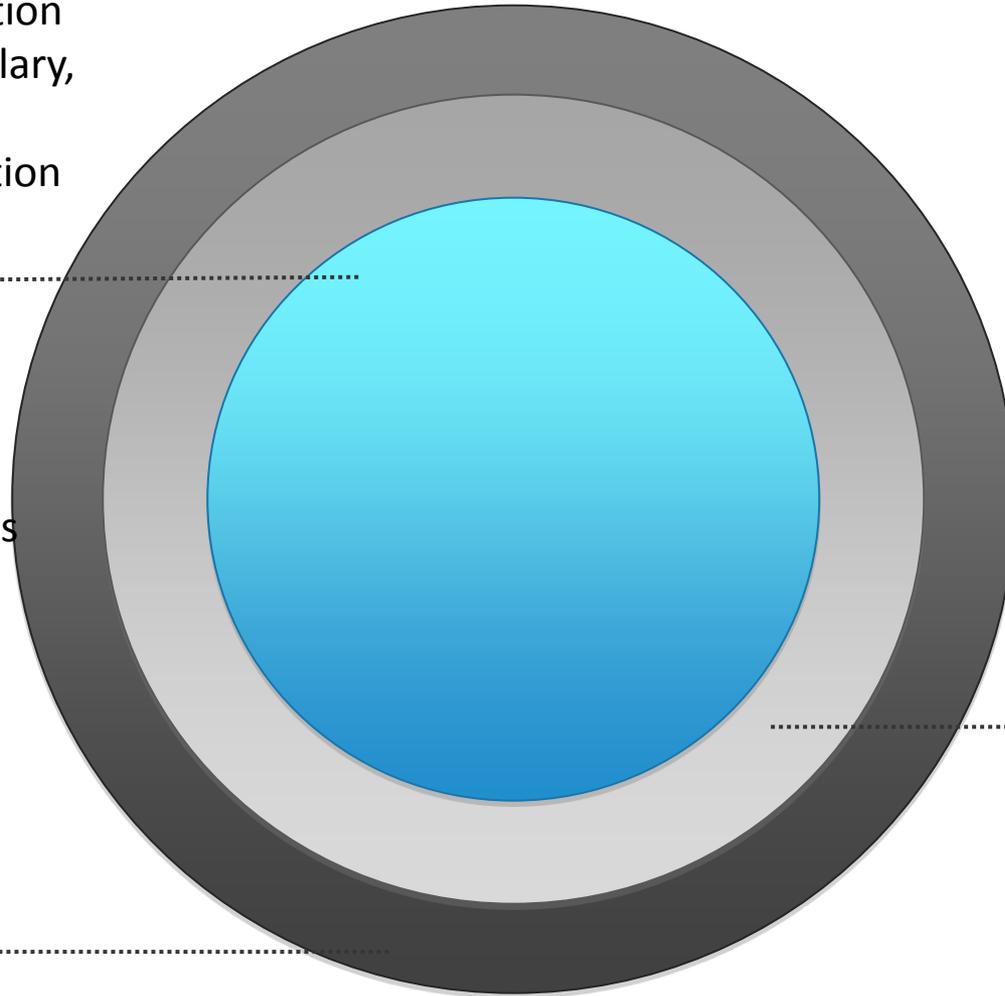
International Compensation

- 
- Globalization is now a reality for organizations.
 - Globalization has enhanced the level of awareness of free flow of information across nations, influencing the market and the people.
 - As a natural consequence, it has bearings on compensation management.
 - International compensation management is a complex area because of cross-cultural issues, difference in organizational practices, labor, costs etc.
 - For an multinational organization, it is now important to understand international compensation practices.

Components of International Compensation

Some of the common international compensation components are base salary, indirect monetary compensation, equalization benefits, and incentives.

Equalization in benefits is practiced in international compensation as a transitional support to expatriates, as a part of social adjustment assistance.



In international compensation, design of incentives for expatriates is also a crucial issue. Various cash bonuses, stock options, and performance-related payments are used as incentives.

International compensation design



This requires a global mindset.

With a global mindset, organizations can become flexible in designing compensation for the expatriates.

For example, in China local labor costs for the state-owned enterprises and for the private and foreign organizations are different.

To successfully compete in a global market, it is essential for organizations to design their inter-national compensation with a global mindset, to understand the economic, social, and political changes in the countries they operate.

Approaches to international compensation



Going-rate approach

The basic characteristics of this approach are linking the compensation of the expatriates as per the compensation structure in the host country. For this purpose, organizations need to first decide the basis of benchmarking their compensation structure. Some of the advantages of the going-rate approach are equality, simple administration, and simple for the expatriates to understand, and the overall sense of identity to the expatriates, as they can relate them with the host country.

Approaches to international compensation



This type of approach provides for extra financial benefits to adjust the home country's living standard. Thus home-country pay and benefits are the basis of their approach. Financial benefits are provided in alignment with the living standard. An Italian expatriate, working for an Italian company in India, will certainly not feel comfortable with the India level of compensation. His/her base salary would be of Italian standard. The basic purpose of this approach is to equalize the purchasing power of expatriates in the home country.

Critical thinking questions

A particular organization, engaged in the business of pharma drugs, offers the best salaries in the industry to its employees. Due to the increase in inter-industry job mobility, the company has started losing talented employees. Initially, the company did not pay any attention to this issue, as it gets skilled manpower from its relatively small competitors, because of its competitive compensation package.

However, its talent flight has now become so acute that the company has decided to opt for an industry benchmark of their compensation packages.

As a team leader of this project, chalk out your action plans, detailing the types of industries that you may like to benchmark.

Prepare a wage policy for payment of wages to industrial workers



Critical thinking questions

Rupee appreciating in recent times has made Indian IT and ITES organizations prune compensation. While one way for the company is to attribute such reduction in variables to performance, the other way is to consider this as economic phenomenon. Examine the effect on the compensation design of manufacturing organizations in the era of rupee depreciation.



Critical thinking questions

A company engaged in the manufacturer of life style drugs and cosmetics gives 80% weightage to the competencies of marketing managers. You have been entrusted to help the company design a competency-based job description for marketing managers. Prepare the report and explain your reasons.



Case Study – Salary inequities



TONY, MBA and Law Graduate

Tony was trying to figure out what to do about a problem salary situation he had in his plant. Tony recently took over as president of Best Group Manufacturing. The founder and former president, Robert, had been president for 35 years. The company was family owned and located in a small eastern Arkansas town. It had approximately 250 employees and was the largest employer in the community. Tony was the member of the family that owned Best Group, but he had never worked for the company prior to becoming the president. He had an MBA and a law degree, plus five years of management experience with a large manufacturing organization, where he was senior vice president for human resources before making his move to Best Group.

Salary inequities

A short time after joining Best Group, Tony started to notice that there was considerable inequity in the pay structure for salaried employees. A discussion with the human resources director led him to believe that salaried employees pay was very much a matter of individual bargaining with the past president. Hourly paid factory employees were not part of this problem because they were unionized and their wages were set by collective bargaining. An examination of the salaried payroll showed that there were 25 employees, ranging in pay from that of the president to that of the receptionist. A closer examination showed that 14 of the salaried employees were female. Three of these were front-line factory supervisors and one was the human resources director. The other 10 were non management.



Salary inequities

This examination also showed that the human resources director appeared to be underpaid, and that the three female supervisors were paid somewhat less than any of the male supervisors. However, there were no similar supervisory jobs in which there were both male and female job incumbents. When asked, the HR director said she thought the female supervisors may have been paid at a lower rate mainly because they were women, and perhaps Robert, the former President, did not think that women needed as much money because they had working husbands. However, she added she personally thought that they were paid less because they supervised less-skilled employees than did the male supervisors. Tony was not sure that this was true.

Salary inequities



TONY, MBA and Law Graduate



Compensation consultant

The company from which Tony had moved had a good job evaluation system. Although he was thoroughly familiar with and capable in this compensation tool, Tony did not have time to make a job evaluation study at Best Group. Therefore, he decided to hire a compensation consultant from a nearby university to help him. Together, they decided that all 25 salaried jobs should be in the same job evaluation cluster, that a modified ranking method of job evaluation should be used, and that the job descriptions recently completed by the HR director were current, accurate, and usable in the study.

Salary inequities



The job evaluation showed that the HR director and the three female supervisors were being underpaid relative to comparable male salaried employees.

Tony was not sure what to do. He knew that if the underpaid female supervisors took the case to the local EEOC office, the company could be found guilty of sex discrimination and then have to pay considerable back wages.

He was afraid that if he gave these women an immediate salary increase large enough to bring them up to where they should be, the male supervisors would be upset and the female supervisors might comprehend the total situation and want back pay. The HR director told Tony that the female supervisors had never complained about pay differences.

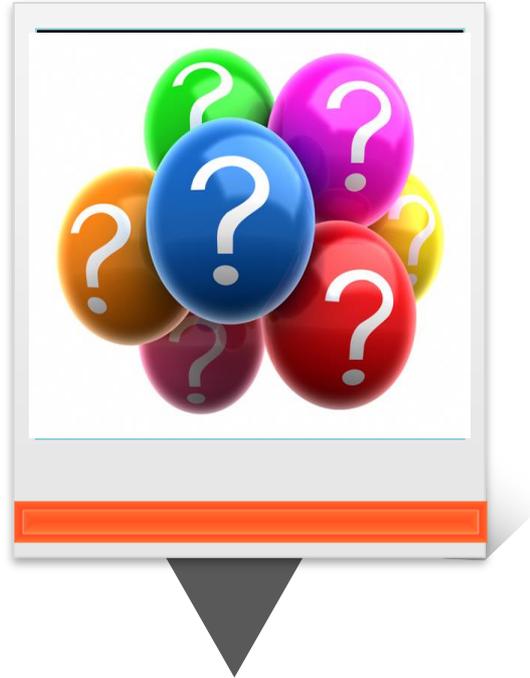
Salary inequities

The HR director agreed to take a sizable salary increase with no back pay, so this part of the problem was solved. Tony believed he had four choices relative to the female supervisors:

- To do nothing.
- To gradually increase the female supervisors salaries.
- To increase their salaries immediately.
- To call the three supervisors into his office, discuss the situation with them, and jointly decide what to do.



Questions



1. What would you do if you were Tony?
2. How do you think the company got into a situation like this in the first place?
3. Why would you suggest Tony pursue the alternative you suggested?

Summary

Compensation Management: Key learnings from this module

- Pay or compensation represents an exchange between the employee and the organization.
- Compensation should be viewed as the strategic management of wages and salaries.
- Compensation management strives for internal and external equity. Internal equity requires that pay be related to the relative worth of a job so that similar jobs get similar pay.
- External equity means paying workers what other firms in the labor market pay comparable workers.
- A well-designed compensation plan helps ensure equity within the organization.
- A suitably designed compensation plan, mixing both strategic and statutory perspectives, optimizes the cost of compensation and simultaneously helps the organization achieve its strategic intent.
- For compensation design and management, effective job design, information and documentation of job analysis, job descriptions, and job evaluations are important prerequisites.
- While framing compensation strategies, the organization should align its policies and practices with its strategy. This will ensure fulfillment of role expectations for employees within the organization.