

Universitat de València  
 Degree in Business Management and Administration  
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# STRATEGIC HUMAN RESOURCE MANAGEMENT

## TOPIC 9 REWARDING AND COMPENSATING HUMAN RESOURCES

Group: OR  
 Lecturer: Dr Victor Oltra

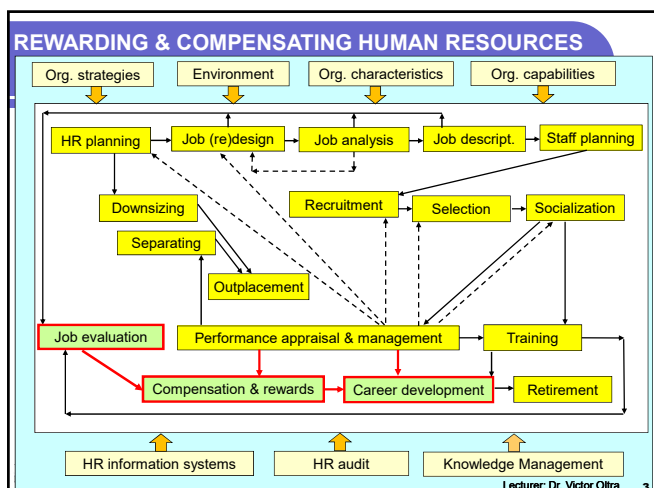
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## TOPIC 9. REWARDING AND COMPENSATING HUMAN RESOURCES

9.1. Compensation: Key concepts  
 9.2. Job evaluation  
 9.3. Total compensation system design  
 9.4. Creating a pay structure  
 9.5. Non-financial compensation

**References:**  
 Gómez-Mejía, L. Balkin, D. & Cardy, R. (2007/2012/2016). *Managing Human Resources* (5th/7th/8th International/Global Edition). Pearson. Chapters 10 ('Managing compensation') and 11 ('Rewarding performance').  
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## 9.1. COMPENSATION: KEY CONCEPTS

**Financial compensation components ('compensation package')**

Package of quantifiable (financial or financially measurable) rewards an employee receives for his or her work. Includes three components:

- **Base compensation.** Fixed pay an employee receives regularly.
- **Pay incentives.** Variable pay programmes aimed at rewarding good performance.
- **Benefits / Indirect compensation.** Rewards aimed at providing security and better quality of life for employees (and their families too).

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## 9.2. JOB EVALUATION

**Job evaluation: assessment of the relative value or contribution of different jobs** (not individual employees) to an organization. This is the **basis for calculating base compensation** (fixed pay).

Composed of six steps intended to provide a rational, orderly, and systematic judgement of how important each job is to the firm.

1. **Conduct job analysis.**
2. **Write job descriptions.**
3. **Determine job specifications.** Worker characteristics an employee must have to perform the job successfully (usually included in job descriptions).

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## 9.2. JOB EVALUATION

**Example of point-factor system: Compensable factors of the National Position Evaluation Plan (Management Association of America, MAA)**

Factor	Points Assigned To Factor Degrees				
	1st Degree	2nd Degree	3rd Degree	4th Degree	5th Degree
<b>Skill</b>					
1. Knowledge	14	28	42	56	70
2. Experience	22	44	66	88	110
3. Initiative and Ingenuity	14	28	42	56	70
<b>Effort</b>					
4. Physical Demand	10	20	30	40	50
5. Mental or Visual Demand	5	10	15	20	25
<b>Responsibility</b>					
6. Equipment or Process	5	10	15	20	25
7. Material or Product	5	10	15	20	25
8. Safety of Others	5	10	15	20	25
9. Work of Others	5	10	15	20	25
<b>Job Conditions</b>					
10. Working Conditions	10	20	30	40	50
11. Hazards	5	10	15	20	25

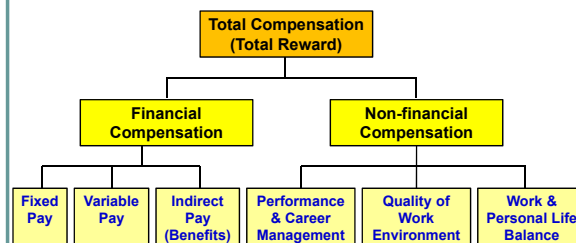
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## 9.2. JOB EVALUATION

4. **Rate worth of all jobs using a predetermined system.** The most common procedure is the point-factor system, which uses 'compensable factors': work-related criteria considered as most important in assessing the relative value of jobs (related to e.g., knowledge, skills, experience, physical demands, responsibility, physical conditions, risk hazards, etc.).
5. **Create a job hierarchy.** Listing of jobs in order of their importance to the organization, from highest to lowest.
6. **Classify jobs by grade levels.** Job categories are created.

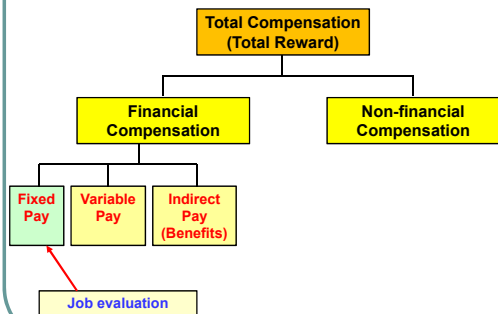
[Other job evaluation methods: ranking system, classification system, etc.]

## 9.3. TOTAL COMPENSATION SYSTEM DESIGN

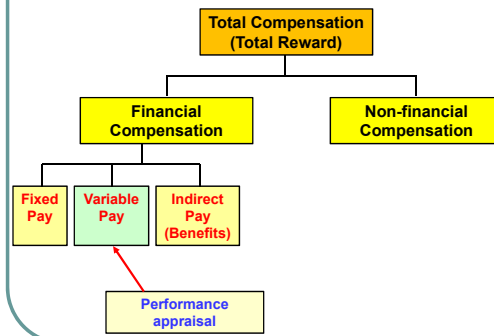


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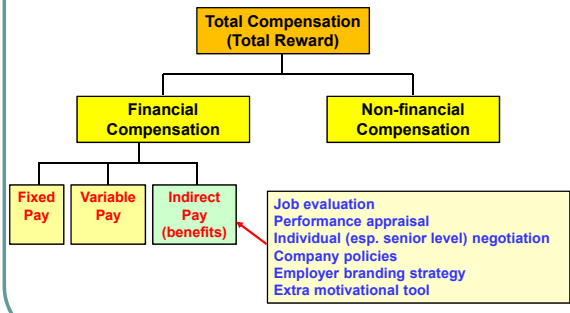
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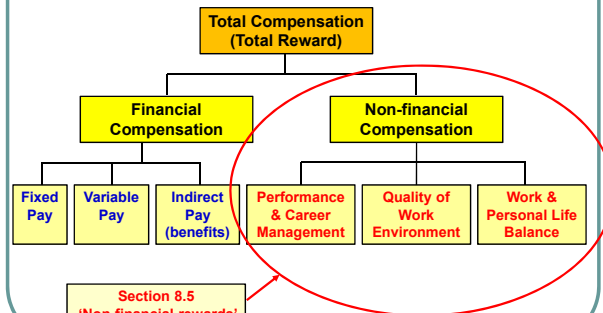
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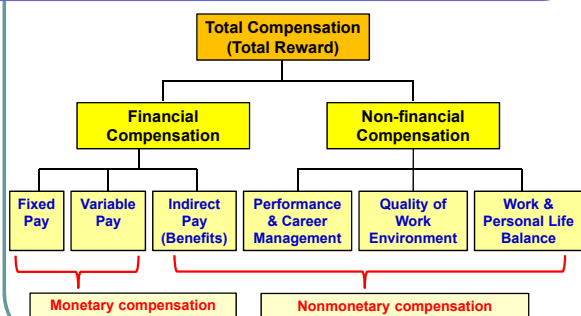
## 9.3. TOTAL COMPENSATION SYSTEM DESIGN



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### 9.3. TOTAL COMPENSATION SYSTEM DESIGN

**An effective compensation system should:**

- Help the company achieve its **strategic goals**.
- Be moulded to the **unique characteristics** of the company.
- Carefully consider the **nine key features** of (financial) **compensation system design**.
- Carefully consider the role of **non-financial rewards**, so as to maximize **employee engagement**.
- Importance of **employee involvement in compensation system design**, especially regarding variable pay, indirect pay (benefits), and use of non-financial compensation.

### 9.3. TOTAL COMPENSATION SYSTEM DESIGN

**Nine key features of compensation system design**

- 9.3.1. Internal vs. external vs. individual equity
- 9.3.2. Fixed vs. variable pay
- 9.3.3. Membership vs. performance
- 9.3.4. Job-based vs. individual-based pay
- 9.3.5. Egalitarian vs. elitist pay systems
- 9.3.6. Above vs. below market pay
- 9.3.7. Monetary vs. nonmonetary rewards
- 9.3.8. Open vs. secret pay
- 9.3.9. Centralized vs. decentralized pay decisions

### 9.3. TOTAL COMPENSATION SYSTEM DESIGN

**9.3.1. Internal vs. external vs. individual equity**

**Equity – Perceived fairness of the pay received by an employee.**

- **Internal equity.** Fairness within a company (firm employees are compared)
- **External equity.** Fairness between different companies (different employers' pay for the same type of labour are compared)
- **Individual equity.** Fairness of individual pay decisions (especially important in highly qualified professions)

**9.3.2. Fixed vs. variable pay (i)**

- **Job evaluation:** most common source of **fixed pay** decisions.
- **Performance appraisal:** most common source of **variable pay** decisions.
  - Variable pay is becoming increasingly popular.
  - In general, proportion of variable pay increases as base pay rises.
  - Importance of **employee involvement in variable pay plans design**, (different layers and reward types, ethical issues, etc.).

### 9.3. TOTAL COMPENSATION SYSTEM DESIGN

**9.3.2. Fixed vs. variable pay (ii)**

**Variable pay – Many layers and types of rewards**

- **Layers:** individual, team, business unit/plant, whole organization.
- **Types:** merit pay, piece rate, bonuses, awards, gainsharing, profit sharing, stock plans.

Unit of Analysis			
Micro Level		Macro Level	
Individual	Team	Business Unit/Plant	Organization
Merit pay	Bonuses	Gainsharing	Profit sharing
Bonuses	Awards	Bonuses	Stock plans
Awards		Awards	
Piece rate			

### 9.3. TOTAL COMPENSATION SYSTEM DESIGN

**9.3.2. Fixed vs. variable pay (ii)**

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Merit pay	Bonuses	Gainsharing	Profit sharing
Bonuses	Awards	Bonuses	Stock plans
Awards		Awards	
Piece rate			

### 9.3. TOTAL COMPENSATION SYSTEM DESIGN

#### 9.3.2. Fixed vs. variable pay (ii)

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Unit of Analysis			
Micro Level		Macro Level	
Individual	Team	Business Unit/Plant	Organization
Merit pay	Bonuses	Gainsharing	Profit sharing
Bonuses	Awards	Bonuses	Stock plans
Awards		Awards	
Piece rate			

Source: Gómez-Mejía, Balkin & Cardy (2012), p. 395

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### 9.3. TOTAL COMPENSATION SYSTEM DESIGN

#### 9.3.2. Fixed vs. variable pay (iii)

##### Types of pay-for-performance plans:

- **Piece-rate system.** Employees are paid per unit produced (or sold); tightest pay-performance link.
- **Merit pay.** Increase in base pay, based on periodical performance appraisal.
- **Bonus programmes** (lump-sum payments). Financial incentive given on a one-time basis and does not raise the employee's base pay.
- **Awards.** One-time rewards usually given in the form of a tangible prize.
- **Gainsharing.** Plantwide or business unit pay-for-performance plan in which a portion of the unit's cost savings (efficiency increase) is returned to workers, usually as a financial bonus. Includes different types of plans.
- **Profit sharing.** Corporate pay-for-performance plan that allocates a portion of declared profits to employees.
- **Employee stock ownership plans (ESOPs).** Corporate plan that rewards employees with company stock (outright grant or below-market price sale).

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### 9.3. TOTAL COMPENSATION SYSTEM DESIGN

#### 9.3.3. Membership vs. performance

##### Membership-based pay systems

Emphasis on **seniority** (years of service); salary progression tied to 'moving up' in the organization.

##### Performance-based pay systems

Emphasis on performance in the current job; salary progression tied to (individual or group) **contributions**.

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### 9.3. TOTAL COMPENSATION SYSTEM DESIGN

#### 9.3.4. Job-based vs. individual-based pay [see section 8.4]

- **Job based pay.** Employees paid on the basis of current jobs.

Best when:

- Jobs and technology are stable.
- Specific training is required to learn a given job.
- Turnover is relatively low.

- **Individual-based pay.** Workers are paid for jobs they could do or talents/skills they have and can be applied to a variety of tasks and situations. Best when:

- Company and environment are dynamic.
- Workforce is relatively educated, and able and willing to learn different jobs.
- Participation and teamworking are encouraged.
- Opportunities to learn new skills are available.

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### 9.3. TOTAL COMPENSATION SYSTEM DESIGN

#### 9.3.5. Egalitarian vs. elitist pay systems

- **Egalitarian pay system.** Most employees are part of the same pay system. Reduces barriers between workers and facilitates internal mobility. More common in highly competitive environments, where risk-taking is needed, and continuous investment in new technologies and products is essential.

- **Elitist pay system.** Different compensation systems are established for employees or groups at different organizational levels. Prevalent in older firms with mature products, stable market share, and limited competition.

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### 9.3. TOTAL COMPENSATION SYSTEM DESIGN

#### 9.3.6. Above-market vs. below-market pay

- **Above-market pay.** Emphasis on minimizing employee turnover and maximizing motivation.
- **Below-market pay.** Emphasis on controlling labour costs.

#### 9.3.7. Monetary vs. nonmonetary rewards

- **Monetary rewards** (tangible). Direct financial compensation (money or money-convertible), e.g., base pay and most pay-for-performance plans. Emphasis on achievement & extrinsic motivation.
- **Nonmonetary rewards** (intangible). With financial value (e.g., company car, fitness centre, childcare) or non-financial (e.g., interesting work, good work atmosphere, work/personal life balance). Emphasis on organizational commitment, intrinsic motivation & engagement.

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### 9.3. TOTAL COMPENSATION SYSTEM DESIGN

#### 9.3.8. Open vs. secret pay

- **Open pay.** Forces managers to be fair and effective in administering compensation (bad decisions cannot be hidden and good decisions motivate the best workers). However, it may be impossible to satisfy everyone. Appropriate for fostering employee involvement, trust and commitment, especially in egalitarian cultures.
- **Secret pay.** It usually fosters dissatisfaction with pay. However, it may be appropriate for highly competitive climates.

#### 9.3.9. Centralized vs. decentralized pay decisions

- **Centralized pay system.** Pay decisions are tightly controlled from the HR department or corporate HQs. Emphasis on internal equity.
- **Decentralized pay system.** Pay decisions are delegated deep down, usually to unit managers. Emphasis on external equity. Better for large, diverse organizations.

### 9.4. CREATING A PAY STRUCTURE

#### 9.4.1. Job-based vs. skill-based compensation plans

#### 9.4.2. Job-based compensation plans

#### 9.4.3. Skill-based compensation plans

### 9.4. CREATING A PAY STRUCTURE

#### 9.4.1. Job-based vs. skill-based compensation plans

##### Job-based compensation plans

- **Most traditional and widely used** types of compensation programmes. Key assumption: work is done by people who are **paid to perform well-defined jobs**.

##### Skill-based compensation plans

- **Far less common.** Key assumption: workers should be paid not according to the job they hold, but rather by **how flexible and/or capable they are at performing multiple tasks**.

[Also called individual-based, knowledge-based, competency-based, etc.]

### 9.4. CREATING A PAY STRUCTURE

#### Example of the pay structure of a large restaurant: job-based vs. skill-based approaches

Jobs	Number of Positions	Pay	Skill Block	Skills	Pay
GRADE 6 Chef	2	\$23.50-\$34.00hr	5	• Create new items for menu • Find different uses for leftovers (e.g., hot dishes, buffets)	\$26.00/hr
GRADE 5 Manager	1	\$14.50-\$24.00hr	4	• Coordinate and control work of all employees upon manager's absence	\$20.00/hr
Sous-Chef	1			• Cook existing menu items following recipe	
GRADE 4 Assistant Manager	2	\$10.50-\$15.00hr		• Supervise kitchen help	
Lead Cook	2		3	• Ensure quality of food and adherence to standards	\$13.50/hr
Office Manager	1			• Schedule servers and assign workstations	
GRADE 3 General Cook	5	\$9.50-\$11.00hr		• Conduct inventory	
Short-Order Cook	2		2	• Organize work flow on restaurant floor	\$10.50/hr
Assistant to Lead Cook	2			• Greet customers and organize tables	
Clerk	1			• Take orders from customers	
GRADE 2 Server	45	\$9.00-\$10.00hr	1	• Bring food to tables	\$9.00/hr
Hostess	4			• Assist in kitchen with food preparations	
Cashier	4			• Perform security checks	
GRADE 1 Kitchen Helper	2	\$8.50-\$9.25hr		• Help with delivery	
Dishwasher	3			• Use dishwashing equipment	
Janitor	2			• Use chemicals/disinfectants to clean premises	
Busser	6			• Use vacuum cleaner, mop, waxer, and other cleaning equipment	
Security Guard	2			• Clean and set up tables	
				• Perform routine kitchen chores (e.g., making coffee)	

Source: Gómez-Mejía, Balkin & Cardy (2012), pp. 352-353.

### 9.4. CREATING A PAY STRUCTURE

#### 9.4.2. Job-based compensation plans (i)

##### Achieving internal equity: Job evaluation

**Assessment of the relative value or contribution of different jobs** (not individual employees) to an organization. This is the **basis for calculating base compensation** (fixed pay). (See details in section 9.2).

##### Achieving external equity: Market surveys

Purpose of market surveys: determine pay ranges for each grade level. Conducted by companies, or (mostly) purchased from specialized consultancies.

1. **Identify benchmark or key jobs.** Jobs that are similar or comparable in content across firms.
2. **Establish a pay policy.** How the firm chooses to establish itself in the pay market. Three options: **lead** pay market, **lag** behind, or pay **market rate**.

### 9.4. CREATING A PAY STRUCTURE

#### Example of job hierarchy and grade levels: Hierarchy of clerical jobs, pay grades, and weekly pay range for a hypothetical office

	1 Points	2 Grade	3 Weekly Pay Range
Customer Service Representative	300	5	\$600-\$750
Executive Secretary/ Administrative Assistant	298		
Senior Secretary	290	4	\$550-\$650
Secretary	230		
Senior General Clerk	225		
Credit and Collection Clerk	220	3	\$525-\$575
Accounting Clerk	175		
General Clerk	170		
Legal Secretary/Assistant	165	2	\$490-\$530
Senior Word Processing Operator	160		
Word Processing Operator	125		
Purchasing Clerk	120	1	\$450-\$500
Payroll Clerk	120		
Clerk-Typist	115		
File Clerk	95		
Mail Clerk	80		
Personnel Clerk	80		
Receptionist	60		

Source: Gómez-Mejía, Balkin & Cardy (2012), p. 358.

## 9.4. CREATING A PAY STRUCTURE

### 9.4.2. Job-based compensation plans (ii)

#### Achieving individual equity: Within pay-range positioning criteria

After the firm has finalized its pay structure by determining pay ranges for each job, it must perform one final task: assign each employee a pay rate within the range established for his/her job. Most common criteria include:

- Previous **experience**
- **Seniority** (years of service)
- **Performance appraisal** ratings

#### Advantages and disadvantages of job-based compensation plans

- **Advantages:** rational, objective and systematic; easy to administer.
- **Disadvantages:** neglect of specific nature of business; job descriptions are often too general; mechanistic and inflexible.

## 9.4. CREATING A PAY STRUCTURE

### 9.4.3. Skill-based compensation plans

Skills (in a broad sense, i.e., competencies) are the basis of pay, not jobs.

**Pros:** more flexible workforce, fewer supervisors needed, more employee control over compensation.

**Cons:** higher training costs, obsolescence of skills.

Three types of skills:

- **Depth skills:** learning more in a specialized area; i.e., becoming an expert.
- **Breadth/horizontal skills:** learning more jobs or tasks within the firm.
- **Vertical skills:** 'self-management' abilities (e.g., scheduling, coordinating, supervising, leadership, training, etc.).

## 9.5. NON-FINANCIAL COMPENSATION

**Non-financial compensation** is increasingly important for optimizing employee (mainly intrinsic) motivation, organizational (mainly affective) commitment and, especially, **engagement**.

#### • Three key broad components:

1. Performance & career management.
2. Quality of work environment.
3. Work and personal life balance.

#### 1. Performance & career management

- Using performance appraisal as **developmental tool**.
- Providing regular **feedback**, counselling and support to employees.
- Identifying 'talent pools' and designing **career paths**.

## 9.5. NON-FINANCIAL COMPENSATION

### 2. Quality of work environment

- Includes diverse powerful, potentially (de)motivating aspects:

- **Physical circumstances:** physical safety, risks and hazards, schedules, deadline pressure, stress, anxiety, etc.
- **Psychological circumstances:** management and leadership styles, self-perception of own value, task richness, task recognition, perception of personal and professional growth opportunities, personal relationships among co-workers, mobbing, etc.

- Importance of **employee participation** as a tool to improve employee (intrinsic) motivation, organizational (affective) commitment, and engagement.

- Different types of **participation approaches and programmes:** employee consultation, suggestion programmes, quality circles, improvement groups, employee **empowerment**, etc.

## 9.5. NON-FINANCIAL COMPENSATION

### 2. Quality of work environment (continued)

- Importance of regularly **conducting work atmosphere and employee satisfaction surveys**, as tools to assess work atmosphere, employee motivation, etc. They can be part of **HR audit** programmes.

### 3. Work and personal life balance - importance of:

- Developing a **systematic work-life balance strategy**.
- Including work-life balance evaluation as part of **HR audit**.
- Integrating the work-life balance strategy with **flexible work arrangements**, **family-friendly policies**, **diversity management**, **work discrimination** concerns, **gender issues** at work, etc.
- Integrating the work-life balance strategy with the **employer branding strategy**.