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Compensation (1): Chapter 11
Motivating Employees through Compensation

Università di Roma
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Stewart & Brown 2008: Human Resource Management: Linking Strategy to Practice,
HRM &OB module 2017/2018

Employee Compensation (1): definition

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

Employee Compensation (2): External vs Internal Equity

- Employees' perception of **external equity** - which concerns the fairness of what the company is paying them compared with what they could earn elsewhere—are critical in such employment relationships.
  - An external labor orientation requires a comparison with the compensation offered by other organizations.

- Employees' perceptions of **internal equity** - their beliefs concerning the fairness of what the organization is paying them compared with what it pays other employees.
  - An internal orientation requires a comparison among the organization employees.
  - Pay practices, such as how much each person makes, are usually less secretive in these organizations than in organizations with an external orientation.
  - Internally oriented organizations also use long-term incentives to reward employees who stay with them for long periods.

Motivation Theories (1)

- Motivational theory and Compensation
  - Reinforcement theory
  - Goal-setting theory
  - Justice (or Equity) theory
  - Expectancy theory
  - Agency theory

Motivation Theories (2): Reinforcement Theory

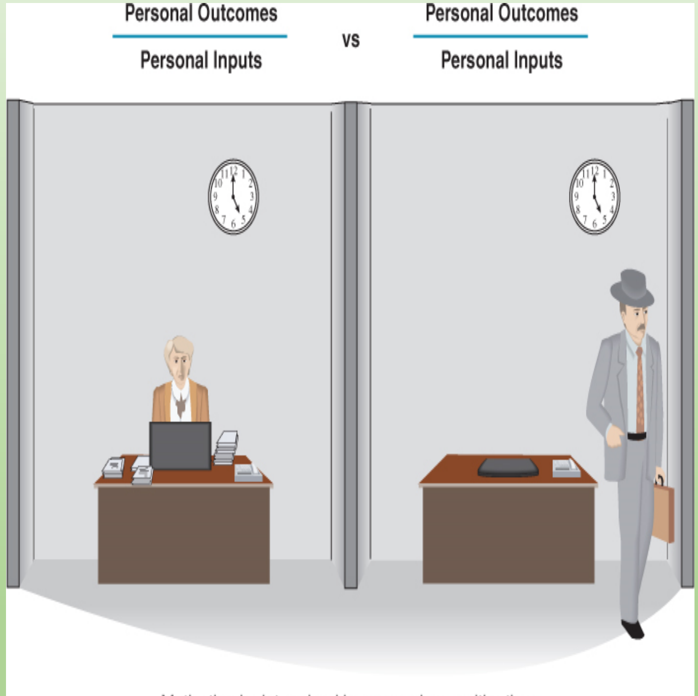
- Comes from the field of psychology, holds that behavior is caused by chains of antecedents and consequents.
  - ***Antecedents*** are factors in the environment that cue someone to engage in a specific behavior.
  - **Consequents** are results associated with specific behaviors.
  - Antecedents and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

Motivation Theories (3): Goal-Setting Theory

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

Motivation Theories (4): Justice (or Equity) Theory

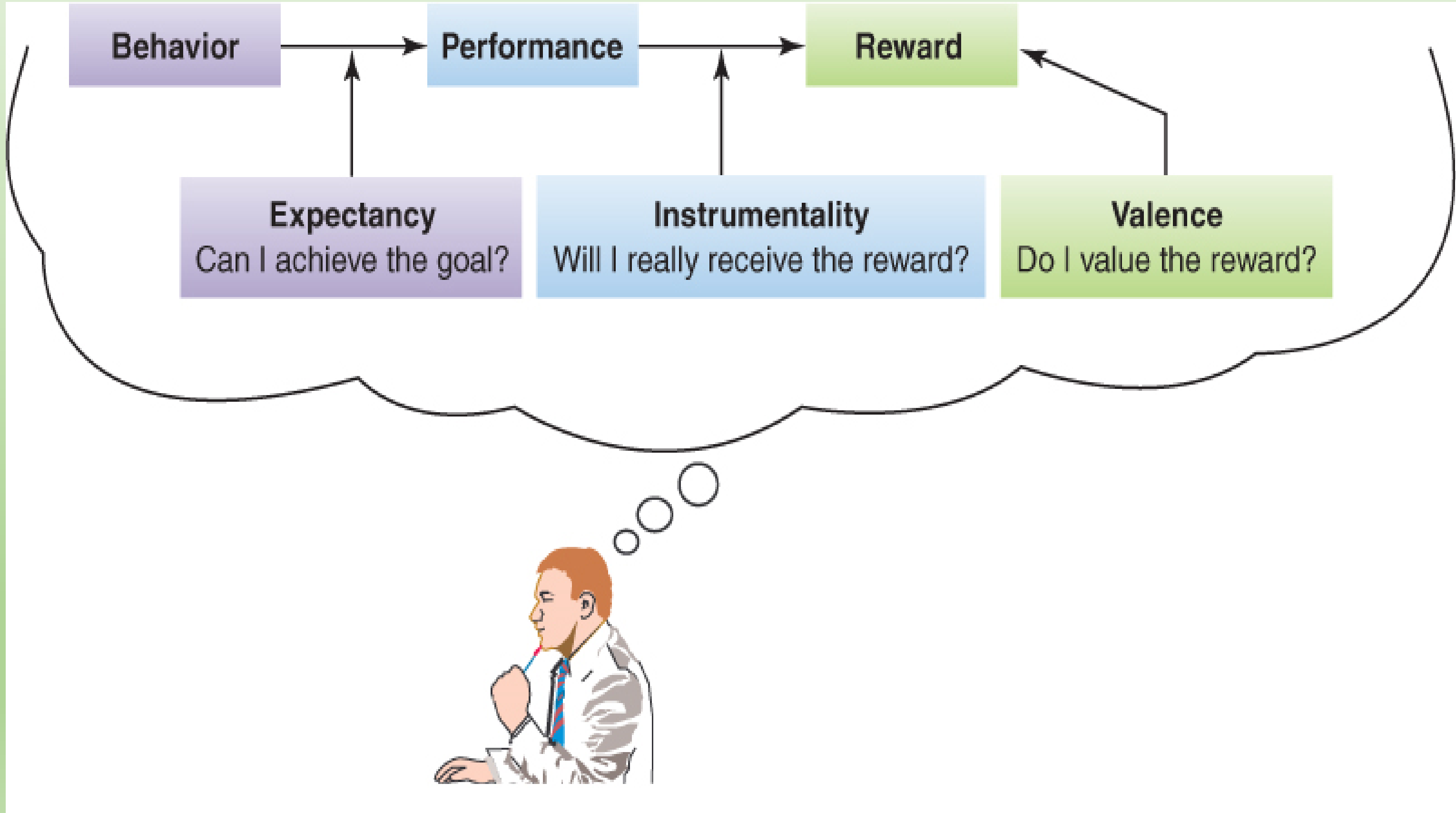
- Motivation depends on beliefs about fairness.
  - People compare their inputs and outcomes to the inputs and outcomes of others.
- Equity theory is an example of what is known as distributive justice.
  - **Distributive justice** is concerned with the fairness of outcomes. In terms of compensation,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



Motivation is determined by comparisons with others.

Motivation Theories (5): Expectancy Theory

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



Motivation is a function of beliefs.

Motivation Theories (5): Agency Theory

- Agency theory, developed in the 1970s, focuses on the way management of a firm manages its relations and enters into **contractual arrangements** with its managers or employees.
- The conditions under which subordinate agents work with corporate managers may directly influence the behavior of the organization, such as taking risks related with new ventures.
- Issues such as remuneration, accounting techniques or risk-taking are among the major concerns of both parties in this relationship.

Motivation Theories (6):Linking motivation with strategy

Table 11.1	*Principles for Increasing Motivation through Compensation*
Develop pay-for-performance plans.	
Link pay with goals that encourage stretch efforts.	
Understand the referent groups employees use when assessing the fairness of pay.	
Follow principles of procedural fairness, including accurate assessment, lack of bias, and opportunity to have input.	
Provide rewards that are large enough to matter.	
Coordinate with selection and training to ensure that employees have the skills they need to meet goals.	
Align the interests of employees with the interests of owners.	
Give higher rewards for employees who assume risk.	

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Compensation (2): Chapter 12
Designing Compensation and Benefit Packages

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Compensation package (1)

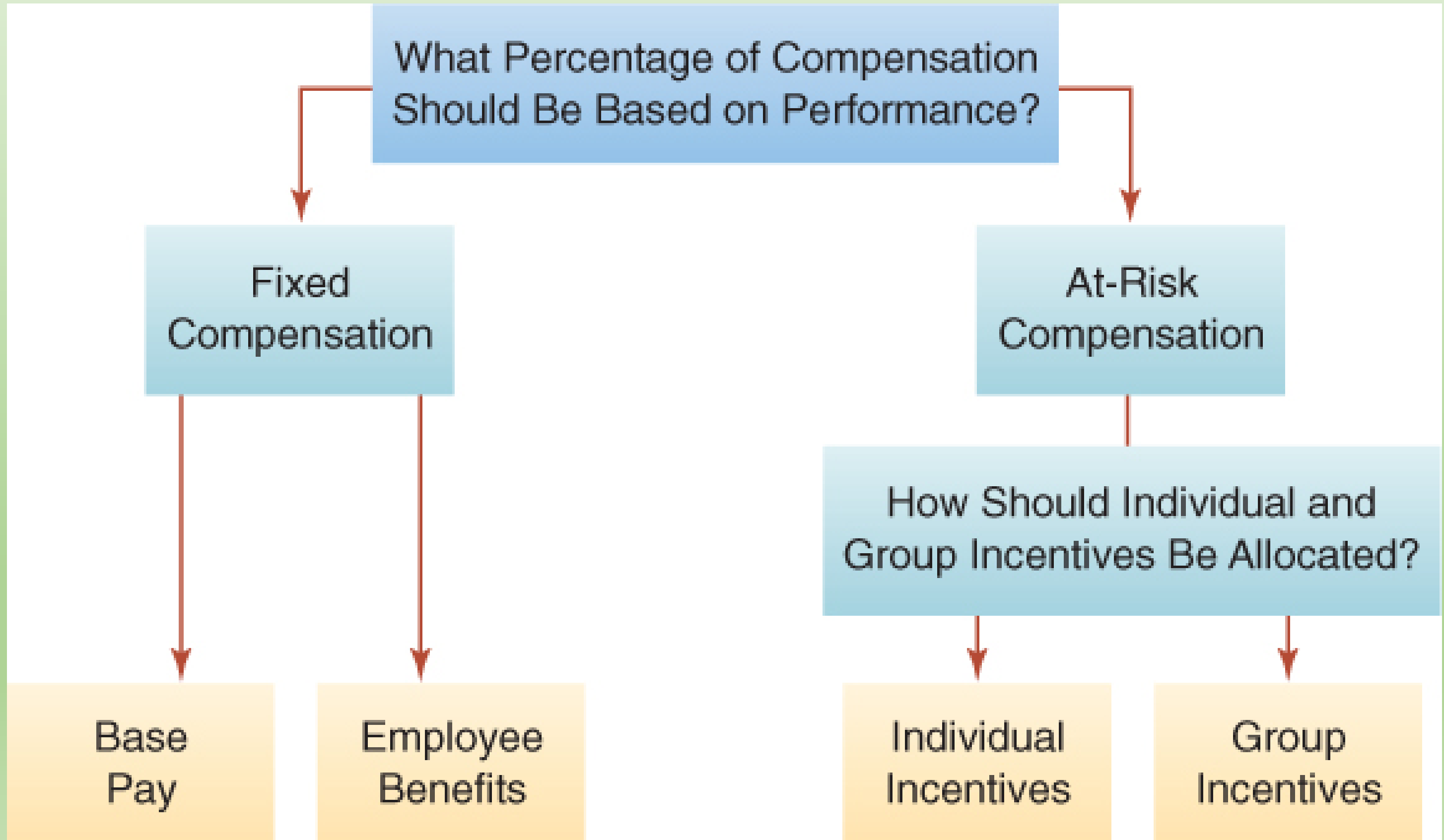
- **Compensation packages** are the blend of rewards.
  - Money paid as wages or salary is the largest component of most compensation packages.
  - Benefits and (short and long term) rewards make up the rest of the package.
- Two issues:
  - **At-risk Compensation** is a compensation that can vary from period to period. The money is at risk because the employee will not earn it unless performance objectives are met.
  - **The Line of Sight** is the extent to which employees can see that their actions influence the outcomes. It is used to determine whether they receive a particular reward.
- Main elements of Compensation Packages, **FIXED (NOT AT RISK)**:
  - **Base pay** is a form of compensation not at risk (hourly wage or an annual salary).
  - **Employee benefits**, are rewards other than monetary salary and wages. Organizations are required by laws and tax regulations to provide similar benefits to all employees.

Compensation package (2)

- **Individual incentives** are rewards based on personal performances of employees. Individual incentives are linked to performance behaviors and outcomes.

- **Group incentives** are rewards based on the collective performances of teams or of an organization.

Compensation package (3)

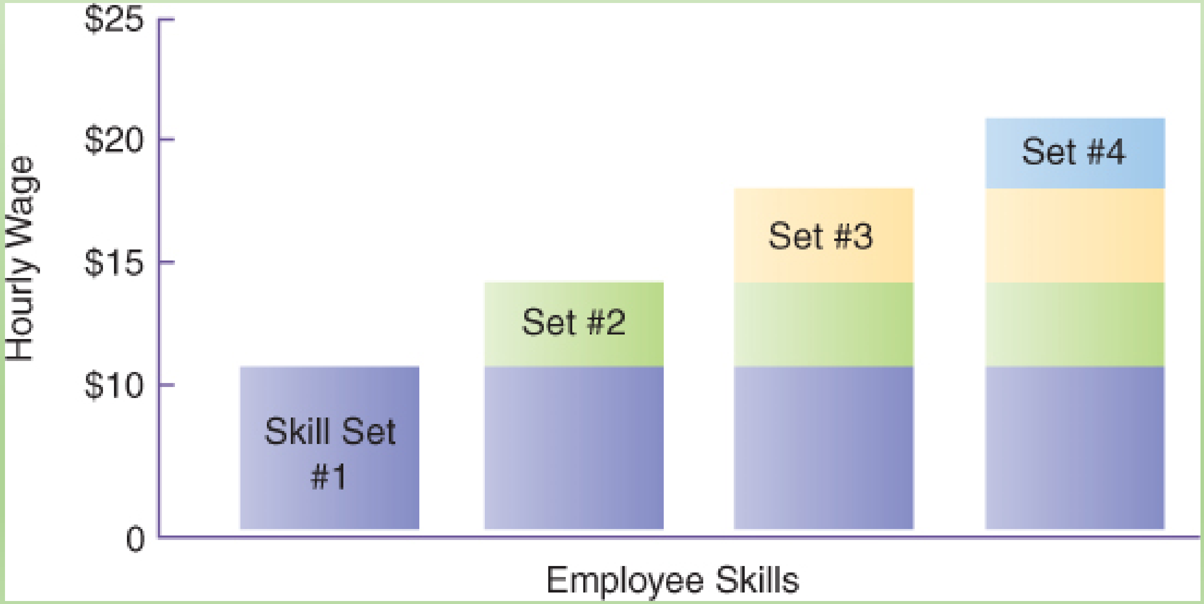


Fixed compensation (1)

- Two basic methods:
  1. **Point Systems**: each job is evaluated within a range of marks, and base pay is set at a higher level in jobs with more points.

  2. **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.

Fixed compensation (2): Example



Incentives (1): Individual level

- **Piece-rate incentive**, where employees are paid a fixed amount for each piece of output they produce.
  - **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.
- **Merit pay increase** represents an increase in base salary or hourly rate that is linked to performance
- **Merit bonus** is a sum of money given to an employee in addition to normal wages. It is given on a fixed schedule, usually the end of the year.
  - Sometimes bonuses are unplanned and given when high performance is observed.

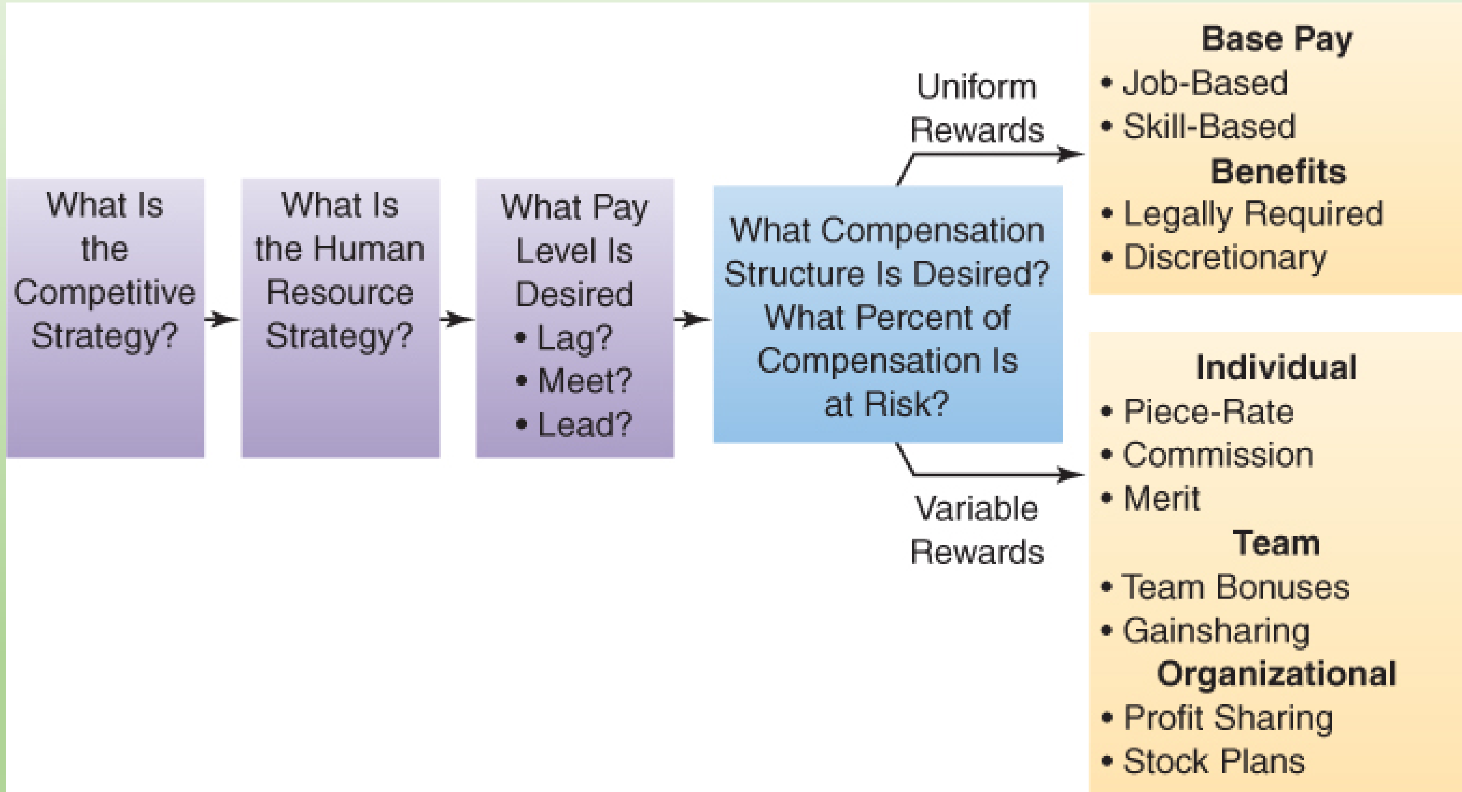
Incentives (2): Group level

- **Goal-based team reward**, provides a payment when a team reaches a specific goal.
- **Discretionary team bonus**, which 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.

Incentives (3): Group and organizational level

- **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.
- **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

Strategic Compensation Process (1)



Strategic Compensation Process (2)