

Establishing Strategic Pay Plans

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HRM 611

Lecture 8



Chapter

9

LEARNING OUTCOMES

1. List the basic factors determining pay rates.
2. Understand how to conduct a job evaluation.
3. Explain how to establish a market-competitive pay plan.
4. Explain how to price managerial and professional jobs.
5. Explain the difference between competency-based and traditional pay plans.
6. List and explain important trends in compensation management.

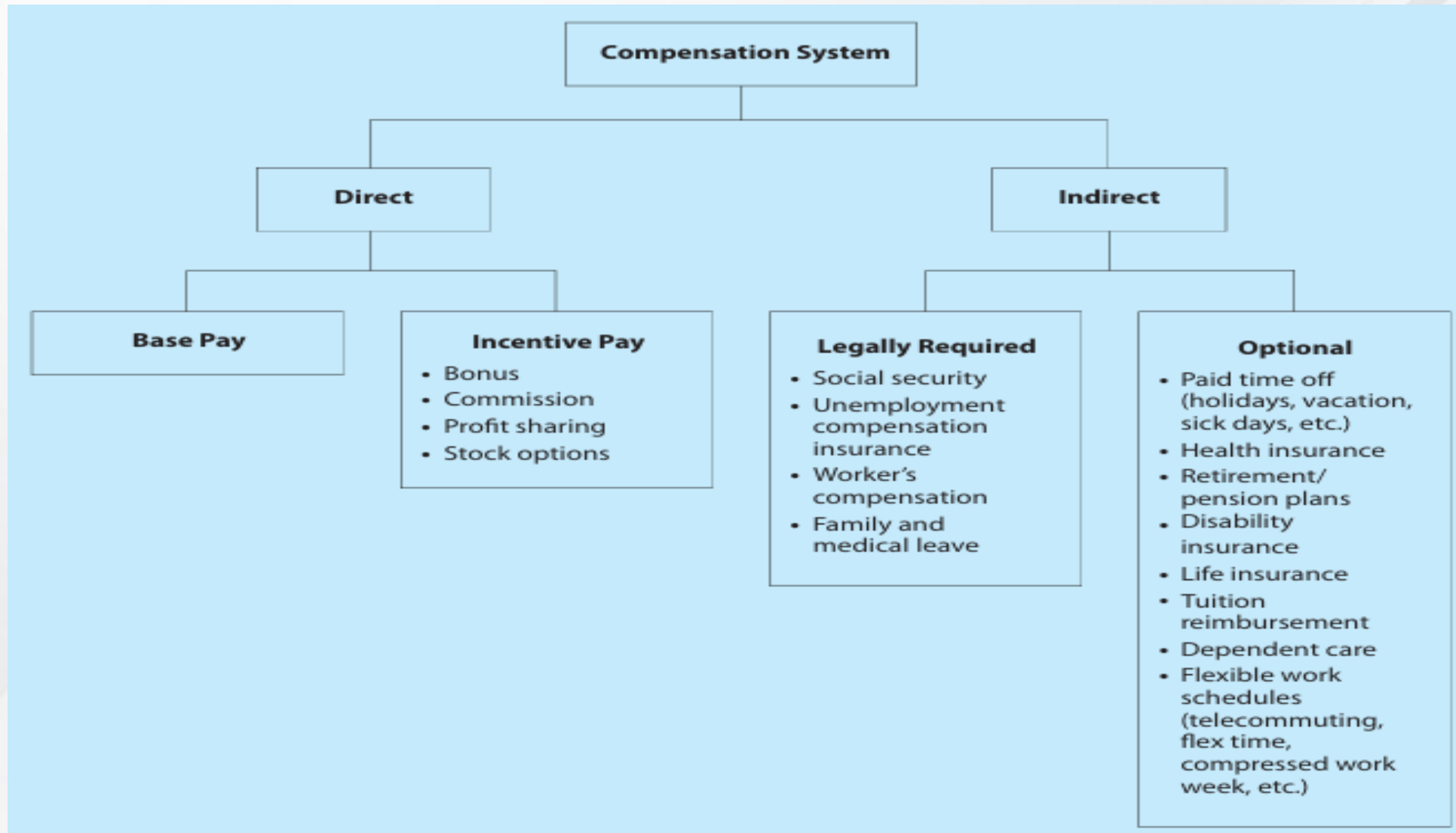
Basic Factors in Determining Pay Rates

Creating an effective compensation plan involves considering several factors, including company strategy, equity, legal requirements, and union agreements.

A crucial aspect is aligning the compensation plan with the company's overall goals. This involves developing a **total rewards strategy** that includes not only traditional pay and benefits, but also other factors like job design, career growth, and employee recognition, **that produces the employee behaviors the firm needs to support and achieve its competitive strategy.**

Essentially, the goal is to create a compensation package that are consistent with the firm's strategic aims and motivate employees to contribute to the company's success in line with its strategic objectives.

Basic Factors in Determining Pay Rates



Compensation Structure

Employee compensation is the total package of financial rewards and benefits given to employees in exchange for their work. It comprises two main parts:

Direct financial payments: These are monetary rewards like wages, salaries, commissions, bonuses, and incentives. They can be based on time worked (hourly or salaried) or on performance (piecework or sales commissions).

Indirect payments (Benefits): These are non-cash benefits like health insurance, paid vacations, and retirement plans.

NES Rentals Holdings, Inc. Strategic Compensation

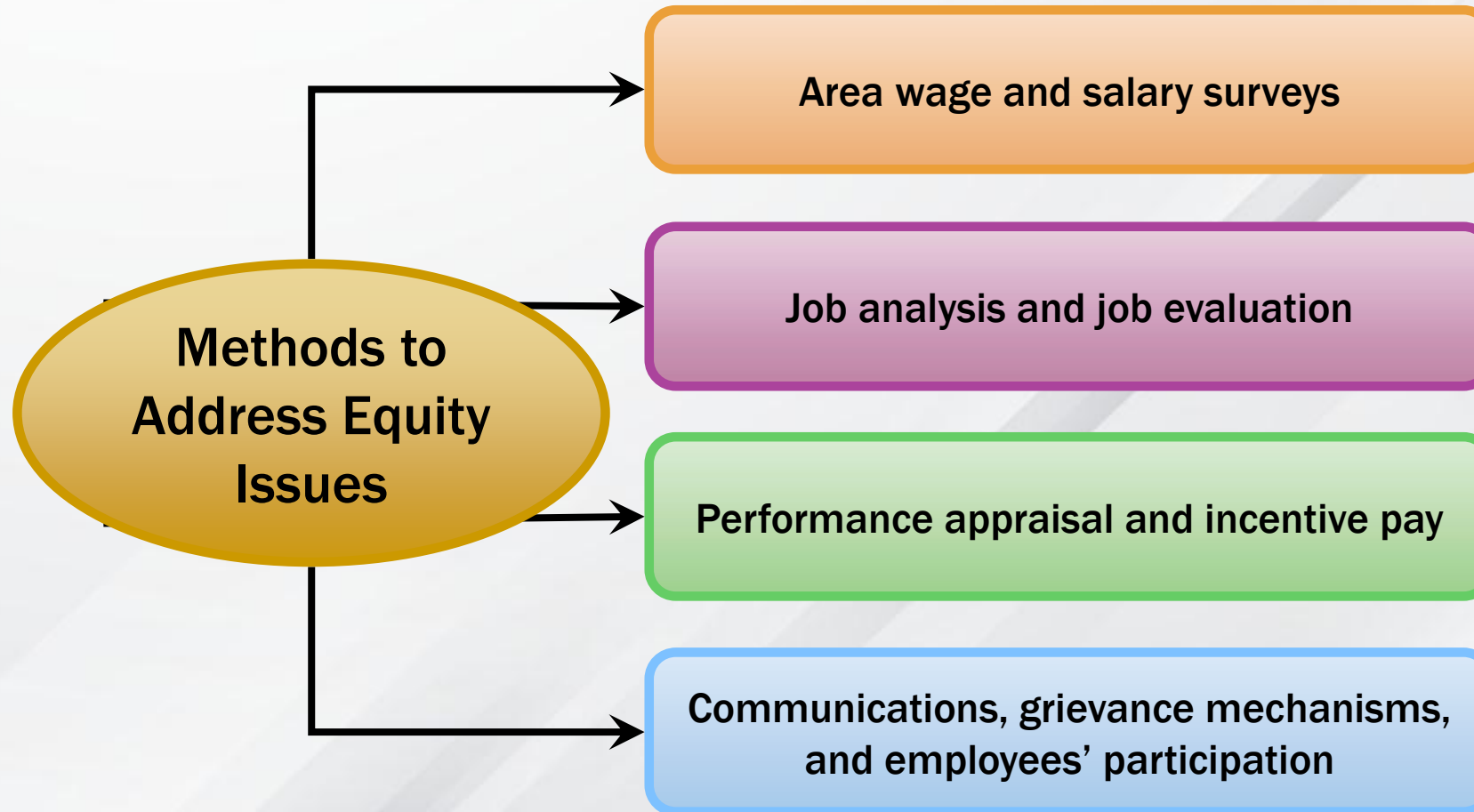
- NES's component of the employer's total rewards program, including benefits, should help produce the employee behaviors that the company needs to achieve its strategic goals.
- Seeking to cut costs while maintaining its reputation for great service, NES Rentals sent its employees home.
- Today, three-fourths of the company's Chicago office customer support, collections, finance, and other back-office workers work from home ("telecommute") at least part of the week.
- Productivity is up 20% and employee turnover is down. NES is also leasing less space.
- It estimates its total savings from its new telecommuting benefit at about \$350,000 annually. Introducing an employee benefit turned out to be a smart way to support NES's strategy.

Equity and Pay Rates

Equity theory posits that people strive for a balance between their inputs (effort, skills, etc.) and outputs (pay, benefits, etc.). If this balance is perceived to be unfair, it can lead to dissatisfaction and decreased motivation.

- **External equity** focuses on how a company's pay rates compare to those in the external market for similar jobs.
- **Internal equity** ensures fair pay comparisons within the company across different job roles.
- **Individual equity** relates to the fairness of pay for individual employees based on their performance and contributions.
- **Procedural equity** concerns the fairness of the processes used to determine pay, such as performance evaluation methods.

Addressing Equity Issues



Addressing Equity Issues

Managers strive to maintain fairness in pay across four areas:

External equity: Comparing pay rates within the company to those offered by similar companies for the same jobs. Salary surveys help monitor this.

Internal equity: Ensuring fair pay comparisons between different job roles within the company. Job analysis and evaluation methods are used for this.

Individual equity: Maintaining fairness in pay based on individual performance and contributions. Performance appraisals and incentive pay are relevant here.

Procedural equity: Ensuring employees perceive the pay determination process as fair. Communication, grievance mechanisms, and employee participation are crucial.

Legal Considerations in Compensation

- ❑ **Fair Labor Standards Act (FLSA):** Sets minimum wage, overtime pay (time-and-a-half for exceeding 40 hours per week), record-keeping requirements, and child labor provisions. It applies to most workers engaged in interstate commerce or for the federal government.
- ❑ **Equal Pay Act:** Prohibits gender-based pay discrimination for equal work requiring similar skills, effort, and responsibility.
- ❑ **Employee Retirement Income Security Act (ERISA):** Regulates employer-sponsored pension plans, including vesting and portability rights, and sets employer fiduciary standards.
- ❑ **Other Laws:** The Age Discrimination in Employment Act, Americans with Disabilities Act, Family and Medical Leave Act, and various state laws (e.g., workers' compensation) also impact compensation decisions

Pay Policies and Their Impact on Compensation Strategy

Key Policy Areas:

Seniority vs. Performance: This involves deciding whether to base pay increases on length of service or employee performance. While seniority offers objectivity, it can demotivate high performers.

Performance Evaluation: Determining how to differentiate between high and low performers for pay purposes is crucial.

Pay Policies and Their Impact on Compensation Strategy

Salary Increases and Promotions: Establishing guidelines for salary adjustments and promotions is essential.

Overtime, Probationary Pay, and Leaves: Policies covering these areas ensure consistent treatment of employees.

Geographic Differences: Addressing cost-of-living variations for employees in different locations, especially for those transferred or working overseas, is important.

Establishing Pay Rates

Employers use two primary methods to establish pay rates:

Market-based approach: This involves comparing job pay rates to those offered by similar companies in the same labor market. Salary surveys are commonly used to gather this data.

Job evaluation: This method assigns values to each job within a company based on factors like required skills, responsibilities, and complexity. The goal is to create a pay structure where jobs are compensated fairly relative to each other.

Key Consideration

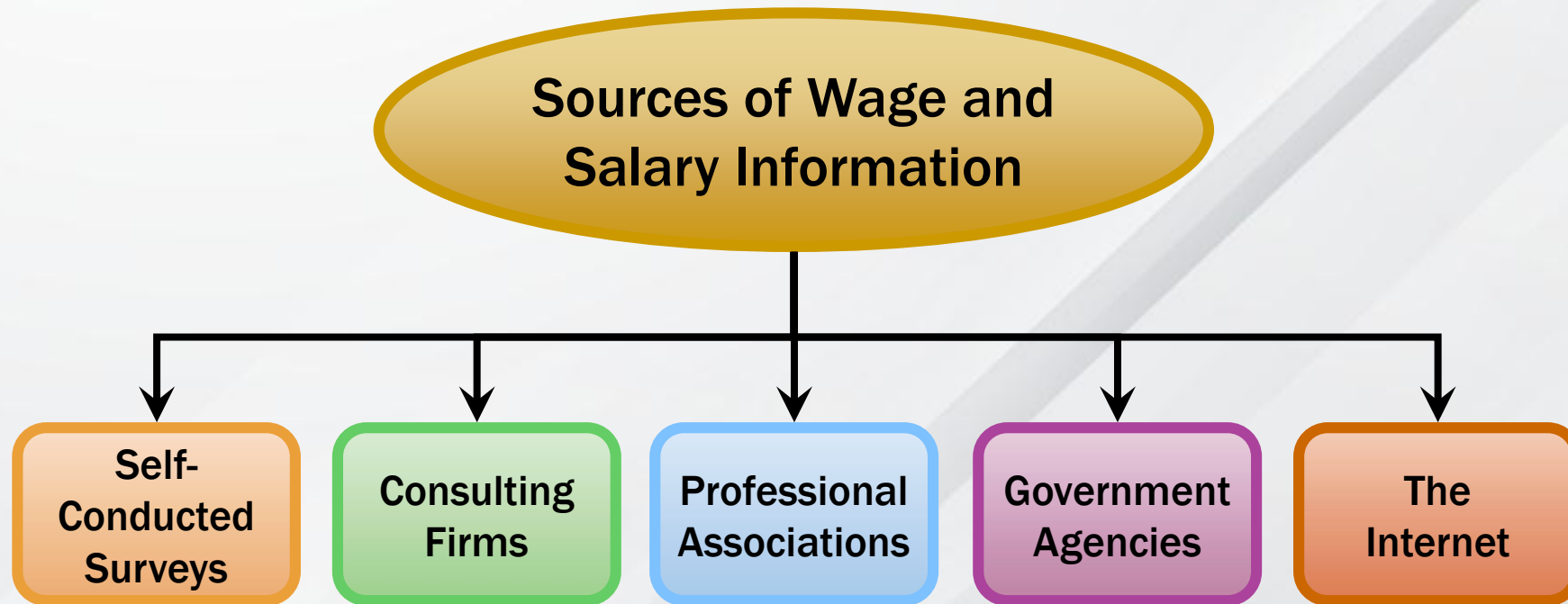
- ❑ While job evaluation establishes internal pay equity, market data is still essential to ensure external competitiveness.
- ❑ Compensable factors are carefully selected to accurately reflect the value of different jobs.
- ❑ Different job evaluation methods and compensable factors may be used depending on the company's size, industry, and specific needs.
- ❑ In essence, job evaluation provides a systematic approach to determining fair pay rates within an organization while also considering external market factors.

Establishing Pay Rates

Steps in Establishing Pay Rates

- 1 → Conduct a **salary survey** of what other employers are paying for comparable jobs (to help ensure external equity).
- 2 → Determine the worth of each job in your organization through **job evaluation** (to ensure internal equity).
- 3 → Group similar jobs into **pay grades**.
- 4 → Price each pay grade by using **wave curves**.
- 5 → Fine-tune **pay rates**.

Sources for Salary Surveys



Key steps in Job Evaluation

- 1. Identify the need:** Reasons for conducting a job evaluation include inconsistencies in pay for similar jobs, employee dissatisfaction, or a desire for a more structured compensation system.
- 2. Gain cooperation:** It's crucial to secure support from management, employees, and potentially unions. Open communication about the process and its benefits is essential to address concerns and build trust.
- 3. Form a job evaluation committee:** This committee typically consists of representatives from management, HR, and employees (or union representatives). Their role is to oversee the evaluation process.

Job evaluation process: Step 4: Price Each Pay Grade

4: Build the Wage Curve

- Shows the pay rates paid for jobs in each pay grade, relative to the points or rankings assigned to each job or grade by the job evaluation.
- Shows the relationships between the value of the job as determined by one of the job evaluation methods and the current average pay rates for your grades.

Curve's Role in Rate Ranges

- The wage curve usually guides the average pay rate for each grade's range.
- Companies may then set a maximum and minimum (e.g., +/- 15%) around the average.

Job evaluation process: Step 5: Fine-Tune Pay Rates

Developing Pay Ranges

- Group similar jobs (based on point values) into pay grades.
- This simplifies pay structure management (focusing on a smaller number of pay grades instead of individual jobs).

Determining the Number of Pay Grades

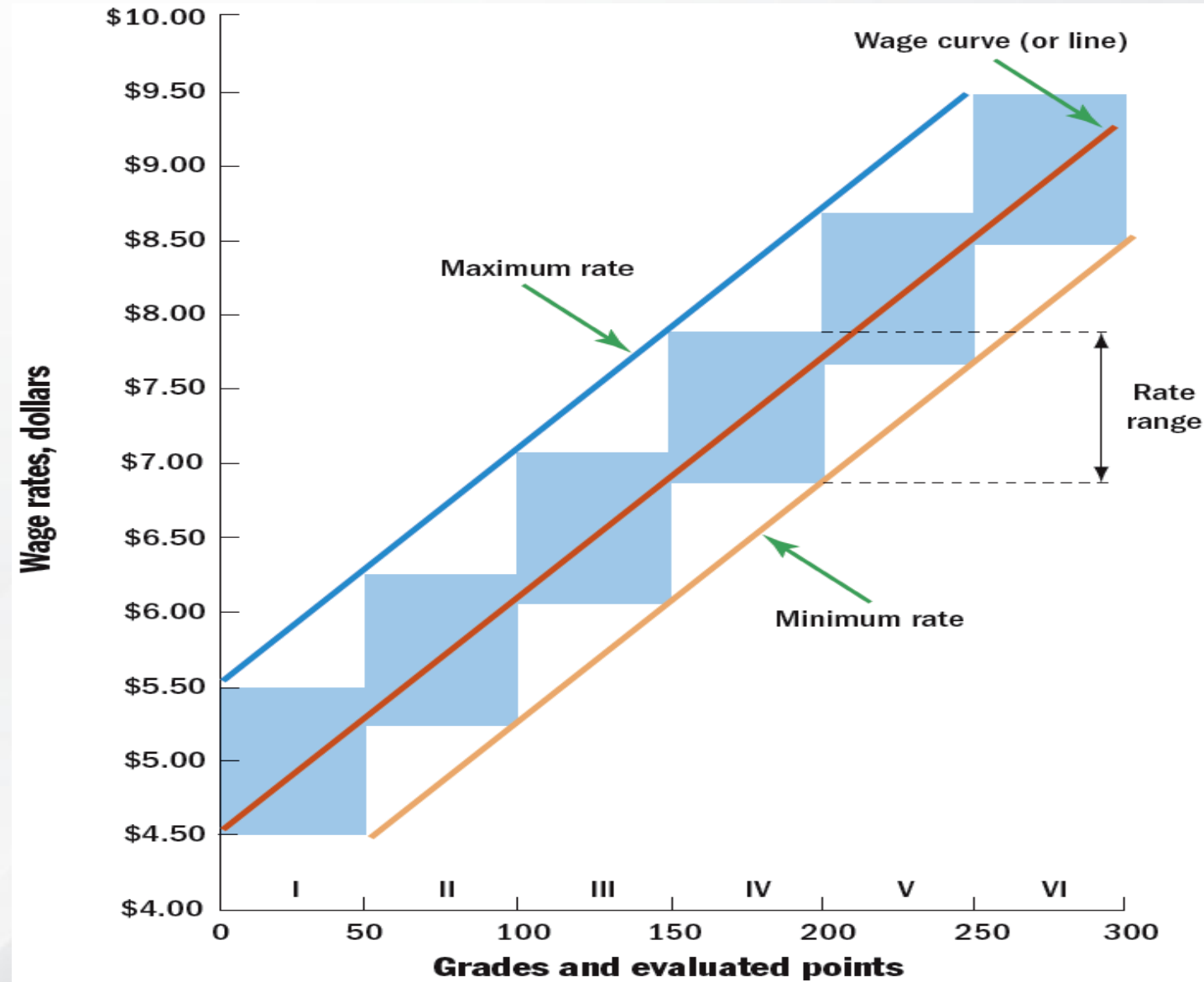
- No ideal number exists, but commonly used ranges are 10-16 grades per job cluster.
- More grades are needed for larger numbers of jobs to be classified.

Job evaluation process: Step 5: Fine-Tune Pay Rates

Establishing Rate Ranges

- Most employers don't offer a single rate within a pay grade.
- Pay ranges are established with a minimum, midpoint, and maximum salary for each grade
- **5- Adjust pay range**
 - Raising underpaid jobs to the minimum of the rate range for their pay grade
 - Freezing rates or cutting pay rates for overpaid (“red circle”) jobs to maximum in the pay range for their pay grade

Wage Structure



Considerations for Rate Ranges

Key Considerations

- Wider pay ranges are used for higher grades to reflect greater complexity of jobs.
- Overlapping ranges ensure salaries in one grade can be higher than entry-level salaries in the next grade (based on experience or seniority).

Benefits of Pay Ranges

- Employers gain flexibility in attracting experienced employees.
- Allows for performance-based pay adjustments within a grade.

Job Evaluation Committee's responsibilities:

- ❑ **Identify benchmark jobs:** These are key positions that represent a range of job levels within the organization and serve as reference points for evaluating other jobs.
- ❑ **Select compensable factors:** These are the criteria used to compare jobs, such as skills, effort, responsibility, and working conditions.
- ❑ **Evaluate jobs:** The committee applies the chosen job evaluation method (ranking, classification, or point factor) to assess the relative worth of each job based on the compensable factors.

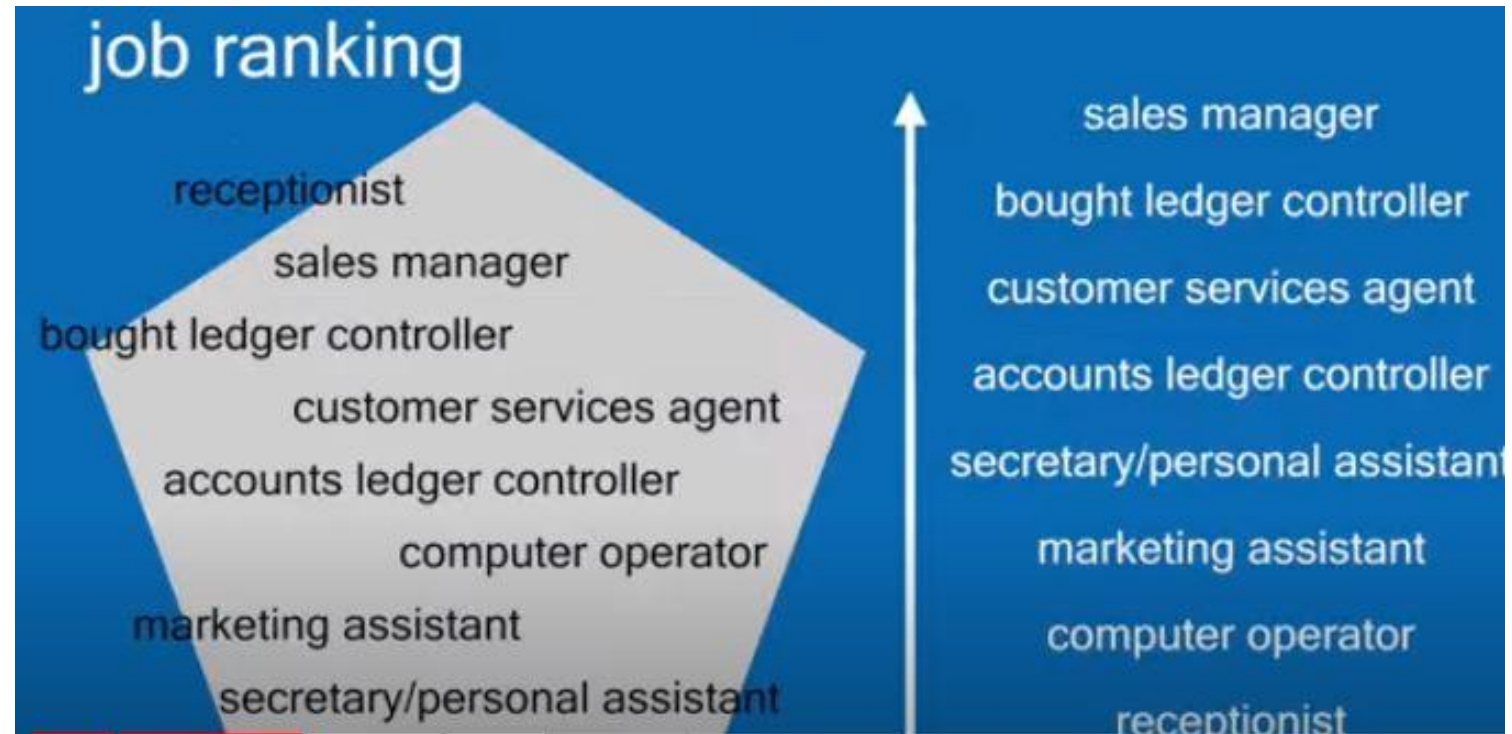
Job Evaluation Methods

	Job as a whole (Non-analytical)	Job parts or factors (Analytical)
Job vs. job	Job Ranking System	Factor Comparison System
Job vs. scale	Job Classification System	Point System

Job Evaluation Methods- Job Ranking

1- Job Ranking:

A simple method where jobs are ranked based on overall difficulty, suitable for - small organizations.



Job Evaluation Methods- Job Ranking

Advantages:

Simple to understand and implement
Less time-consuming compared to other methods

Disadvantages:

Relies on subjective judgments ("guesstimates")
Lacks quantification of job value differences (e.g., how much "more valuable" is one job compared to another)

Suitability:

This method is best suited for small organizations that lack the resources for more complex systems.

Job Evaluation Methods- Job Classification

2-Job Classification:

Groups similar jobs into classes or grades, offering a more structured approach than ranking.

Grade Level	Grade Description	Jobs Included in Grade
GS 1	Includes those classes of positions the duties of which are to perform, under immediate supervision, with little or no latitude for the exercise of independent judgment: • The simplest routine work in office, business, or fiscal operations; or • elementary work of a subordinate technical character in a professional, scientific, or technical field.	Typist, Messenger
GS 2	Includes those classes of positions the duties of which are: • to perform, under immediate supervision, with limited latitude for the exercise of independent judgment, routine work in office, business, or fiscal operations, or comparable subordinate technical work of limited scope in a professional, scientific, or technical field, requiring some training or experience; or • to perform other work of equal importance, difficulty, and responsibility, and requiring comparable qualifications.	Engineering aide
GS 5	Includes those classes of positions the duties of which are: • to perform, under general supervision, difficult and responsible work in office, business, or fiscal administration, or comparable subordinate technical work in a professional, scientific, or technical field, requiring in either case— • considerable training and supervisory or other experience; • broad working knowledge of a special subject matter or of office, laboratory, engineering, scientific, or other procedure	Chemist, Accountant, Engineer (civil), Statistical clerk

Job Evaluation Methods- Job Classification

Advantages:

- ☐ Simple to understand and implement
- ☐ Reduces the number of pay rates to manage

Disadvantages:

- ☐ Can be subjective and inconsistent
- ☐ Less precise in determining pay differentials between jobs

Job Evaluation Methods- Factor Comparison

3. Factor Comparison:

Compares jobs based on factors like responsibility, skills, and effort to determine relative pay.

Job	Hourly rate	Skill	Effort	Responsibility	Working Conditions
Admin Assistant	£9.00	£4.50	£2.00	£2.00	£0.50
Secretary	£11.00	£5.50	£2.50	£2.50	£0.50
Supervisor	£15.00	£6.00	£3.50	£4.00	£1.50
Manager	£21.00	£9.00	£3.50	£7.00	£1.50

Job Evaluation Methods- Job Classification

Advantages:

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Disadvantages:

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Job Evaluation Methods- Point Method

4. Point Method:

A quantitative method assigning points to job factors like skills, responsibilities, and working conditions to determine pay. The **Hay Plan** is a popular point system.

			Levels				
Factors	Points	Weights	1st	2nd	3rd	4th	5th
Skill							
•Education	250	50%	15	30	45	60	75
•Experience			20	40	60	80	100
•Knowledge			15	30	45	60	75
Effort							
•Physical Demand	75	15%	10	20	30	40	50
•Mental Demand			5	10	15	20	25
Responsibility							
•Equipment or process	100	20%	5	10	15	20	25
•Material or product			5	10	15	20	25
•Safety of others			5	10	15	20	25
•Administrative			5	10	15	20	25
Job Conditions							
•Work Condition	75	15%	10	20	30	40	50
•Hazards			5	10	15	20	25
Total Points		500					

Job Evaluation Methods- Point Method

Advantages:

- ☐ More precise in determining pay differences between jobs
- ☐ Provides a quantitative basis for pay decisions

Disadvantages:

- ☐ Can be time-consuming and complex to develop and implement
- ☐ Requires careful job analysis and evaluation

Packaged Point Plans: Many organizations use pre-developed point plans, such as those offered by the Hay Group, which provide standardized compensable factors, degree definitions, and point values.

Pricing Managerial Jobs

What Determines Executive Pay?

- CEO pay is set by the board of directors taking into account factors such as the business strategy, corporate trends, and where they want to be in the short and long term.
- CEOs can have considerable influence over the boards that determine their pay.
- Firms pay CEOs based on the complexity of the jobs they fill.
- Shareholder activism and government oversight have tightened the restrictions on what companies pay top executives.
- Boards are reducing the relative importance of base salary while boosting the emphasis on performance-based pay.

Pricing Managerial Jobs

Executive compensation packages typically comprise four main elements:

Base Pay: Includes fixed salary and guaranteed bonuses.

Short-Term Incentives: Cash or stock bonuses for achieving short-term goals.

Long-Term Incentives: Stock options that incentivize executives to increase stock value over time.

Benefits and Perks: Executive retirement plans, supplemental life insurance, and comprehensive health insurance.

Contemporary Compensation Topics

- **Competencies**

- Demonstrable characteristics of a person, including knowledge, skills, and behaviors, that enable performance.

- **What is Competency-Based Pay?**

- Paying for the employee's range, depth, and types of skills and knowledge, rather than for the job title he or she holds.

Competency-Based Pay in Practice

Key elements of competency-based pay:

- Defining required skills
- Linking pay to skill levels
- Providing training opportunities
- Implementing competency testing
- Designing flexible job roles
- While this approach offers flexibility, it can be challenging to implement and may not be suitable for all organizations.

Special Topics in Compensation

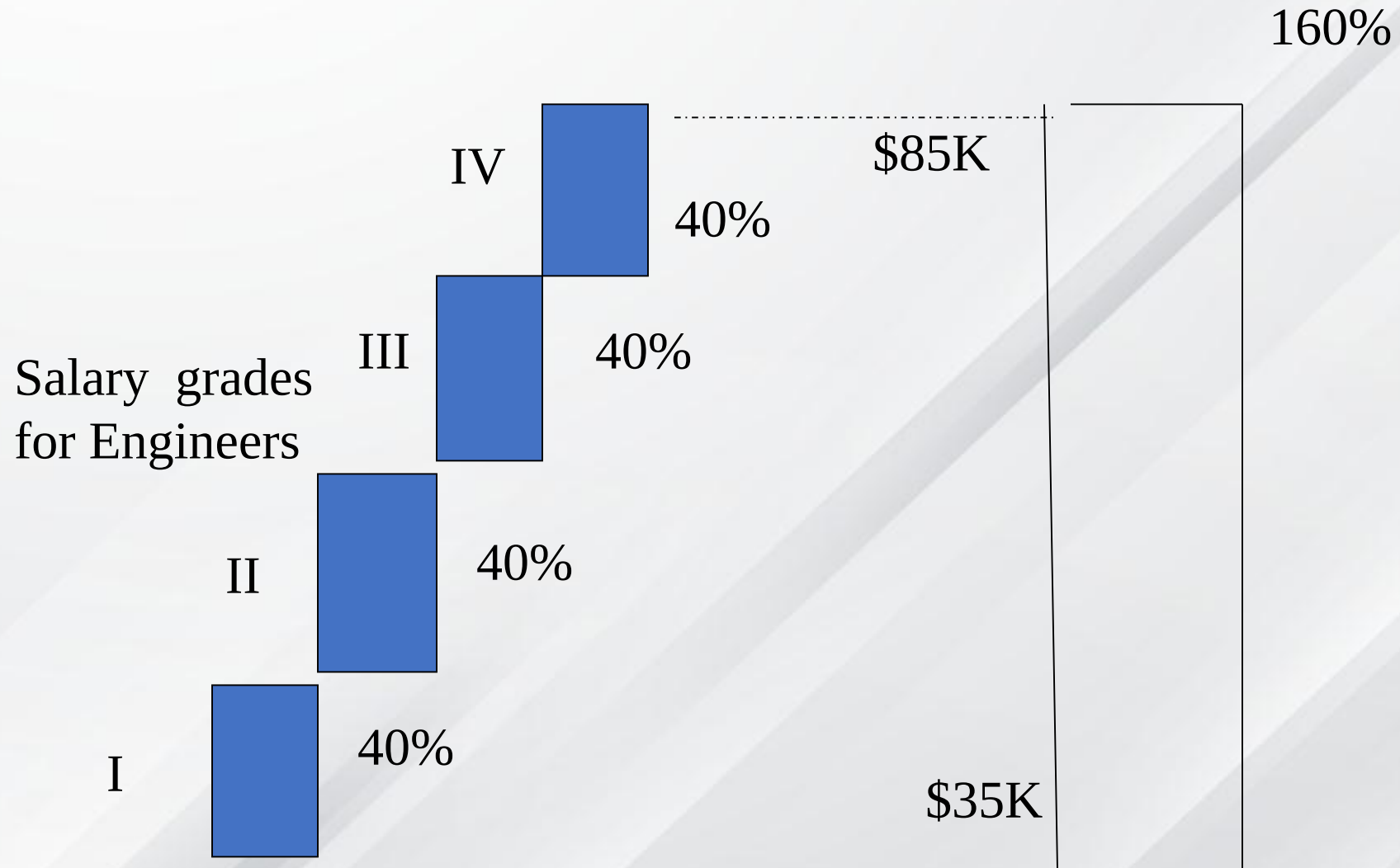
- **Broadbanding**

- Consolidating salary grades and ranges into a few wide levels or “bands,” each of which contains a relatively wide range of jobs and salary levels.

- **Pros and Cons**

- More flexibility in assigning workers to different job grades
- Provides support for flatter hierarchies and teams
- Promotes skills learning and mobility
- Lack of permanence in job responsibilities can be unsettling to new employees.

Broad banding Example



Comparable Worth

- **Concept:**

- Employers should be required to pay men and women equal wages for dissimilar jobs that are of comparable (rather than strictly equal) value to the employer.

- **Basis:**

- Seeks to address the issue that women have jobs that are dissimilar to those of men and those jobs are often consistently valued less than men's jobs.

- **Question at Hand:**

- Who will get to make final decisions on the comparability of jobs?
 - Employers
 - Courts

CHAPTER SUMMARY

Compensation management is a strategic process involving the design, implementation, and administration of pay structures to attract, motivate, and retain employees.

Several factors influence pay rates, including:

Job-related factors: Job complexity, responsibility, required skills, working conditions, and performance levels.

Employee-related factors: Education, experience, certifications, and performance.

Organizational factors: Company size, industry, profitability, and compensation philosophy.

Market factors: Labor supply and demand, cost of living, and competitor pay rates.

Legal and regulatory factors: Minimum wage laws, overtime regulations, and equal pay legislation.

CHAPTER SUMMARY

Job evaluation is a systematic process of determining the relative worth of different jobs within an organization. It involves comparing jobs based on factors like skills, effort, responsibility, and working conditions. Methods include job ranking, job classification, and the point factor method.

Establishing a Market-Competitive Pay Plan

Conduct a Job Evaluation: Determine the relative worth of jobs within the organization.

Conduct a Salary Survey: Gather data on market rates for similar jobs.

Develop Pay Grades and Ranges: Group similar jobs into pay grades and establish pay ranges for each grade.

Create a Wage Curve: Plot the relationship between job evaluation points and pay rates to visualize pay distribution.

Adjust Pay Rates: Compare internal pay rates to market rates and make necessary adjustments.

CHAPTER SUMMARY

Pricing Managerial and Professional Jobs

Managerial and professional jobs often require specialized compensation approaches due to their unique characteristics. Factors such as education, experience, certifications, and performance play a more significant role in determining pay for these positions. Market-based pricing and incentive compensation are often used.

Competency-Based vs. Traditional Pay Plans

Traditional pay plans focus on job titles and responsibilities, with pay rates based on job grades.

Competency-based pay rewards employees for the skills and knowledge they possess, regardless of their job title. This approach encourages skill development and flexibility.

CHAPTER SUMMARY

Contemporary Compensation Trends

Broadbanding: Consolidating pay grades into wider bands to increase flexibility.

Talent Management: Focusing on high-potential employees and allocating resources accordingly.

Comparable Worth: Ensuring equal pay for jobs of comparable value, regardless of gender or job title.

Pay for Performance: Linking compensation to individual or team performance.



Thank You