

Performance Management and Reward Systems

Block

4

COMPENSATION AND REWARD MANAGEMENT

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BLOCK 4: COMPENSATION AND REWARD MANAGEMENT

The fourth block on the course on Performance Management and Reward System (PMRS) examines the concept of rewards, their management, as well as their use in recognizing the contributions made by employees. The block contains five units.

Compensation management is one of the most important and strategic aspects of Performance Management. Both employers and employees are concerned about the same. Employers want to design a compensation package and reward their employees in a manner that is cost effective and at the same time attractive, and motivating to the employees to retain them in the organizations. Employees, on the other hand, always look for a compensation that awards rewards on a regular basis so as to reach higher positions. For them compensation and rewards are related to their career growth and should be in line with their performance,

Unit ten, *Rewards and Recognition*, delves into the various facets of rewards and incentives. How to get the bases for determining incentives is examined next. The unit closes with a section on the factors that determine pay.

Unit eleven, *Reward Management*, looks at the concept of rewards management and its relation to HRM. This is followed by a thorough analysis of the rewards management process. The unit discusses the various reward strategies and how they should be devised. The unit closes with a discussion on how to evaluate the rewards system in an organization.

Unit twelve, *Performance Management and Compensation*, deals with the components and objectives of compensation management. It emphasizes that compensation should be fair, equitable and cost-effective to attract and retain talented employees. It deals with various implications of compensation system on the performance of employees, with a special emphasis on executive compensation.

Unit thirteen, *Job Evaluation and Pay Structure*, goes into an in-depth discussion on the concept of Job Evaluation. The unit begins with bringing out the needs and objectives of Job evaluation. This is followed by a discussion on the various methods of job evaluation. The unit closes with a comprehensive discussion on the concept of pay and its related components, such as pay structure and broad branding.

Unit fourteen, *Performance Competence and Skill-based Pay*, deals with an examination of the concepts of pay, performance, competence and skill. It looks at the various incentive schemes that are being increasingly used in organizations. The unit closes with a discussion on team-based pay.

Unit 10

Rewards and Recognition

Structure

- 10.1 Introduction
- 10.2 Objectives
- 10.3 Meaning and Definition of Rewards
- 10.4 Purpose of Rewards
- 10.5 Incentives versus Rewards
- 10.6 Types of Incentives
- 10.7 Bases for Determining Incentives
- 10.8 Factors that Affect Levels of Pay
- 10.9 Summary
- 10.10 Glossary
- 10.11 Self-Assessment Test
- 10.12 Suggested Readings/Reference Material
- 10.13 Answers to Check Your Progress Questions

"Recognition is not a scarce resource. You can't use it up or run out of it."

- Susan M. Heathfield

10.1 Introduction

As has been propounded by Susan Heathfield, it may not be possible for an organization to provide monetary rewards each time they want to appreciate and recognize contributions of the employees. Recognition doesn't cost much to the manager but goes a long way in elevating the motivation and morale of the employees. Mere saying thank you for a job well done, would have a profound impact on employee performance especially if it was being done at all in the past. In the previous unit, we discussed important organization measures and models.

In the organizational context, the extent of motivation of an individual is linked to the rewards and the recognition provided by the organization. Each and every individual differs from the other in their needs and expectations. The rewards have to match up with the particular needs and expectations of the person concerned. This means that the performance management system has to deliver the rewards that match the expectations of individuals: organizations must ensure that the rewards are timely, creative, and authentic.

This unit would focus on rewards and types of incentives. Further it would examine the bases for determining incentives and the factors that affect the levels of pay.

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10.2 Objectives

After studying this unit, you should be able to:

- Explain the concept of rewards
- Describe the purpose served by rewards
- Differentiate between incentives and rewards
- Enumerate the various types of incentives
- Identify the bases used to determine incentives
- Appraise the factors that determine pay

10.3 Meaning and Definition of Rewards

Rewards are benefits given to employees for doing well at tasks that contribute to the organizational goals. According to Bob Nelson, a reward is ‘benefit resulting from some event or action, appreciation for a service rendered.’ Reward management is concerned with the formulation and implementation of strategies to reward on the basis of their contribution to the organization without any bias. Reward management has increasingly adopted a ‘Total reward’ approach aims to maximize the impact of initiatives on employee motivation. Total rewards would combine the traditional quantifiable elements like salary, variable pay, and benefits, with intangible non-cash elements such as scope to achieve and exercise responsibility, career opportunity, and learning.

Example

Amidst the fight with Covid-19 with the onset of second wave in 2021, Indian Inc. like Tata Steel, Mi India, Swiggy to name a few are fast enough to respond by chalking out plans for fast-track inoculations for their employees and families in line with the approvals for the same. This serves as an illustration for employee benefits.

For more details, check out <https://economictimes.indiatimes.com/news/company/corporate-trends/amid-covid-second-> (accessed on 20/4/2022)

10.4 Purpose of Rewards

Rewards act as a catalyst to increase organizational performance. They deliver the following benefits:

10.4.1 Act as a Retention Strategy

A well-designed rewards strategy acts as a tool for talent retention by meeting the various needs and aspirations of its employees. Moreover, an effective rewards management strategy can stimulate performance, which in turn can lead to retention of talent.

For an effective rewards strategy, three things must be ensured:

- First, there should be desired recognition and compensation of individual achievements with pay hikes, bonuses to name a few
- Second, group performance should ensure achievement of the desired objectives.
- Third, the organization's performance as a whole should be measured to ensure profits and value addition.

It is held that the increased performance should result in greater profits that would lead to an increase in share price over a period of time. Further, Employee Stock Options (ESOPs) contribute to a great extent in retaining talented employees.

10.4.2 Efficiency Scaling

Organizations are becoming increasingly diverse in nature resulting in variation in the level of performance throughout the organization. However, the performance management system keeps a tab on the various activities taking place and enables measurement or scaling of performance. Hence, the rewards system systematically documents the efficiencies of individuals and teams and helps to create a systematic procedure of performance and rewards throughout the organization.

10.4.3 Act as a Morale Booster

Rewards of various kinds motivate employees to take an interest in the job as well as the organization. For instance, rewards can be used to foster innovation or encourage cost cutting: for a company that looks for innovation, the employees will be motivated to cultivate a creative mindset. In the same way, cost reduction can also be a goal to be achieved through rewards.

10.4.4 The 'Feel Good' Factor

An organization's growth is related to the extent to which employees feel satisfied while in the organization. It is closely related to employee psychology. Lack of feel good factor may result in increase in attrition and job hopping. Thus, it is essential that employees should be made to feel good about working with the company. The 'feel-good' factor would depend on the amount of recognition that an employee gets in various ways – through perks, facilities, or even a simple thank you!

10.4.5 Promoting a Competitive Spirit

The competitive spirit refers to the predisposition among employees to put in their best efforts at their job. It should be noted that workers put in efforts for contributing small parts to realizing organizational goals. The contribution of people with the right skills for the particular job helps in promoting competitive spirit. They form into teams complementing each other, and sometimes even going in for 'stretch' targets, where an employee would have to put in an extra amount of effort to achieve the organizational goal.

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Example

Zappos Grant-a-Wish program allows its employees to submit and grant wishes and is a great way to build a team and family spirit in the company (e.g. learning how to play guitar, ride a motorcycle to name a few). In addition to employees granting wishes, Zappos, as a company, grants wishes. One of the most inspiring wishes granted was for an employee who wanted to become an American citizen, but was unable to afford the citizenship program. Zappos granted his wish and he went on to become a US citizen.

For more details, check out <https://www.zappos.com/about> (accessed on 20/2/2022)

Check Your Progress - 1

1. The concept of efficiency scaling deals with which of the following elements of reward strategy?
 - a. Employee Stock Options
 - b. Tracking the efficiency of employees
 - c. Recruitment of employees
 - d. Ensuring a valid pay to the employees
 - e. Training of employees

10.5 Incentives versus Rewards

An incentive is described as a factor (financial or non-financial) leading a person to opt for a particular choice as a motivator to perform a job, wherein the performer selects a particular choice from among the available alternatives. In effect, it says, 'do this and you will be able to get that'. Thus, an incentive works as a direct motivator. On the other hand, a reward gives a tangible recognition for the accomplishment of a task. They act as an indirect motivator as people expect further achievement to lead to rewards. It is observed that:

- Financial incentives motivate people to achieve objectives, improve performance levels and enhance competence or skills. It is done through a focus on specific targets and priorities.
- Financial rewards give recognition to people for their achievements. These achievements may be got through attaining the prescribed targets or by exceeding the given targets.
- Incentives give direct motivation. Rewards act as indirect motivators through giving a tangible form of recognition. For example, while a shop floor incentive which is given to an employee is an example of a financial incentive, team-based lump sum payments would be a financial reward.

Example

Google's outdoor sports facilities, free food and more are quite popular among people, but there's another perk that is quite lucrative about Google. If a U.S. employee passes away while working for the tech giant, the employee's spouse or domestic partner receives 50% of the deceased's salary, no matter how long or short his tenure, every year for the next decade.

For more details, check out <https://about.google/> (accessed on 20/4/2022)

10.5.1 Incentives

According to E.H. Burack, an incentive scheme is a plan or program to motivate individuals or group performance. An incentive program is most frequently built on incentive pay or bonus. But it may include a variety of non-monetary rewards or prizes.

According to Dale Yoder, 'Incentive wages relate earnings to productivity and may use premiums, bonuses, or a variety of rates to compensate for superior performance'.

According to Wendell French, the incentive system has a limited meaning that excludes many kinds of inducements offered to people to perform at work or to work up to or beyond acceptable standards.

It does not include:

- i. Wage and salary payments and merit pay.
- ii. Over-time payments, pay for holiday work, or differential according to shifts, i.e., all payments which could be considered incentives to perform work at undesirable times.
- iii. Premium pay for performing dangerous tasks. The incentive system is related to the way in which payment plans tie wages directly or indirectly to standards of productivity or to the profitability of the organization or to both criteria.

A common rationale underlying all compensation systems is that there is a change in the individual's pay in terms of productivity, profit, or the level of sales achieved by the employee.

10.5.2 Advantages of Incentives

Incentives elevate the motivation and morale of the people. Both employers and employees perceive several advantages of incentives which are given below:

- Good incentives motivate the employee to perform better in order to enhance productivity. Employees become more innovative, bringing new ideas into the organization. Moreover, they bring various wasteful practices and problems to the notice of the management.
- Incentives are based on the standpoint of the equity theory: Individuals always compare their incentives with that of others in relation to their inputs.

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- A spirit of mutual cooperation is created: as the activities of the workers become interdependent, any obstruction created by even a single worker affects output.
- Incentive systems are based on the philosophy of behavior modification. For instance, the system provides a desirable outcome (pay) which tends to reinforce appropriate behavior positively.
- The morale of the workers increases when they are offered incentives for good performance.
- Relations between employees and management improve if employees are rewarded fairly for their contribution with increased productivity.
- Incentives work on objective ratings rather than subjective ratings by superiors.

10.5.3 Disadvantages of Incentives

Despite its advantages, administering incentives may have many disadvantages as well:

- In the absence of a ceiling on incentive earnings, some workers may work overtime and spoil their health.
- Incentives motivate people to produce more. This may sometimes come at the cost of quality of the products.
- The incentives lead to an increase in the costs to an organization, along with the increase in productivity
- The introduction and administration of incentive plans requires additional staff.
- Sometimes the production flow may get hampered due to the faults of the management. In that case, workers may insist on compensation.
- Peer conflicts may arise if some workers earn more than others. In order to produce more, workers may disregard safety concerns.

Activity 10.1

Macko Manufacturing

At Macko Manufacturing, which supplies custom built steel structures for sky-scrapers, the incentive and compensation structure has created a culture of haves-vs. have-nots. At the top end, the designers get the largest pay packets and stock options; at the bottom, are the welding and polishing staff who are left to fend themselves for daily survival. The company has devised new pay schemes that make this gulf even wider, by giving a much higher pay to the structure designers who work at more prestigious projects such as the Khalifa in Dubai.

You have been appointed as the new HR manager at Macko. How would you ensure a fair disbursement of incentives to all employees and reduce the gap between haves and have nots?

Answer:

Check Your Progress - 2

2. Which of the following is included under incentives?
- Wages
 - Pay for doing dangerous tasks
 - Payments to work at undesirable times
 - Bonus
 - Overtime pay
-

10.6 Types of Incentives

Incentives are classified in various ways. According to one view, they can be classified as positive and negative. Another way of looking at incentives is to classify them as financial and non-financial incentives.

Positive and negative incentives are:

- While positive incentives are agreeable factors, negative incentives are disagreeable factors in a work situation to avoid when an individual strives to accomplish the standards required on his/her part.
- Positive incentives include employee stock options, profit sharing plans, paid time off, bonuses expected promotions, continuity of employment, approval of superior to name a few whereas the negative incentives may include the fear of lay-off, being discharged from work, reduction in wages, and disapproval of the employer.

Essentials of financial and non-financial incentives are as given below:

- Financial incentives include employee stock options, profit sharing plans, paid time off, bonuses and cash awards. The non-financial incentives are based on the philosophy that work is natural for people who tend to perform an additional amount of it due to a force other than money. The various types of the non-financial incentives include: flexible work hours, training

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opportunities and, continuity of employment, approval of superior, etc., relationships with superior, advancement on the job, job security, good quality of supervision, job satisfaction and enrichment, praise and recognition, knowledge of results, experience of progress.

- Financial incentives are payments for improved productivity, attendance, and general improvement in employee performance. Financial incentive schemes are direct and indirect in nature.
- In direct financial incentive schemes, the payments are based on the employee's own performance or contribution to the job such as: production incentive schemes, attendance bonus, profit sharing bonus to name a few.
- In case of indirect financial incentives, the payments are not directly related to the employee's contribution but the schemes are subsidized. Examples are gratuity schemes and leave travel concession.
- The non-financial incentives aim at giving psychological benefits to workers. There may be monetary rewards, but only indirectly. Financial incentives can also serve as 'attention getters' and 'encouragers' of action'. The non-financial incentives give psychological satisfaction more than the financial incentives.
- The non-financial incentives are usually seen as the outcome of an enlightened management: The provision for better working conditions, encouragement and appreciation of good work, and a general atmosphere of willingness and cooperation in dealing with common problems, all contribute to excellence in all areas of work and higher productivity.

The various non-financial incentives are discussed here:

10.6.1 Supervisory Relationship

Though many factors affect how well an employee performs on the job, the most decisive factor is the supervisory relationship. A supervisor's attitude can affect employee performance. Industrial psychologists consider supervisory relationship as a drive conducive to active performance.

Supervisors should aim at building more satisfying relationships with the workers as employees largely depend upon the skills of the supervisor to manage and get the work done. Employees would produce more if they are guided properly by an able supervisor. Most importantly, there should be a spirit of a team work in the organization, in order to achieve good results.

10.6.2 Advancement and Security

As employees gain experience at work, they consider promotions, growth and job security more important than salary. However, in general, workers attach more importance to money than to any other single factor.

10.6.3 Job Enrichment

This is a way to motivate employees by giving them increased responsibility and variety in their jobs. Job enrichment allows employees to have more control over planning their work and how to accomplish it. Greater control ensures that a better job gets done. Thus, job enrichment taps into the need for employees to do a good job and be appreciated for their work.

10.6.4 Praise and Blame

As a means of ego satisfaction, praise acts as a more powerful incentive than blame. However, praise has a better impact if it is felt as being received as recognition - and not as a means to control recipient behaviour. Disapproval or blame in public damages the ego and lowers the prestige of the individuals, while it is beneficial if it is expressed in private.

10.6.5 Knowledge of Result and Experience of Progress

Knowledge of prior work performance motivates the individual to produce more. It also affects team performance by facilitating communication and problem-solving. This is especially relevant where teammates are required to coordinate their efforts.

10.6.6 Cooperation and Competition

Cooperation and competition are part and parcel of any working system but performance of the employees in the organization is higher when competition is on health grounds.

10.6.7 Level of Aspiration and Nature of Goal

A high level of aspiration of people operates as a determinant of success while a low level of aspiration hampers their motivation to go ahead. However, there must be an optimal balance between ability and level of aspiration. Similarly, the goal-oriented behavior forms an effective non-financial incentive. There is a need to integrate individuals and organizational goals to accomplish effective performance.

10.6.8 Experience of Achievement

An experience of achievement through tasks completion provides job satisfaction to the individual. Job involvement of the employees can be created by assigning tasks with definite completion points.

Exhibit 10.1 illustrates the reward and incentives provided by Accenture.

Exhibit 10.1: Rewards and Incentives Programs at Accenture

Accenture has a mix of financial rewards to recognize the unique skills of the employees and facilitate career progression. The personal blend of base pay, bonus and equity is tailored to the market where the employees live and work.

Contd....

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Added to it, Accenture offers a comprehensive suite of programs to make it easier to stay physically, emotionally and financially healthy. As a part of it, the company provides medical coverage, dental and vision coverage and wellness programs.

- The families at Accenture are supported by a robust offering of benefits including fertility benefits, support for adoption and surrogacy and caregiver concierge services.
- Parental leave of 16 weeks paid maternity leave, 8 weeks paid time off for primary care givers and 2 weeks for secondary caregivers.
- Subsidized back-up dependent care, as well as a concierge service, is available for children, spouses or elderly family members.
- Primary caregivers, both men and women, may work locally for one year following their return from the birth or adoption of a child.
- Flexible work arrangements help employees achieve work/life balance while also meeting Accenture's business needs.
- Paid time off and holidays encompasses traditional vacation time along with paid sick leave with days varying based on level and tenure.
- For ensuring financial security, Accenture provides opportunity to take advantage of saving plans, employee share purchase plans, life insurance, spending accounts for eligible health and dependent day care expenses.
- Disability coverage at Accenture amounts to up to 180 days along with disability insurance.

Accenture offers additional benefits and programs including free annual flu shots, a legal services plan, personal excess liability insurance, identity theft insurance, pet insurance, gym membership discounts, and an online mall providing discounts on various retail offerings.

Source: <https://www.accenture.com/us-en/careers/local/total-rewards> (accessed on 20/4/2022)

Activity 10.2

Is this a Good Incentive System?

Razorhead Chemicals is a leading bulk chemicals producer in the United States. It is known for a distinctively egalitarian organizational culture. For instance, the junior and middle level employees that work and supervise its plants are divided into work-groups of 30 people. A bonus is given to each group only when the desired production levels and attendance is reached. The rules can be strict, sometimes, if an employee is even late by 10 minutes, the entire group loses its bonus for the week. Employees also have to ensure that the chemical manufacturing plant does not have unnecessary shut-downs, if it happens, the bonus is lost. This has made employees take care of equipment and instilled a sense of ownership in them, which, in turn, has led to high productivity.

The senior level employees have only one compensation plan. There is the marked absence of hefty pay cheques. In fact, the senior level executives have the lowest basic pay in the entire organization. The senior level employees can achieve returns on share-holder's equity in case the company performs extremely well.

Razor head gives an extraordinary bonus to all its employees. However, senior level officers are not entitled to extra-ordinary bonus.

The entire organization is highly egalitarian – there are no plush corporate jets or chauffeur driven cars for senior employees. There are no marks of status such as executive dining rooms or executive parking places. All employees have the same holidays and insurance program. Razorhead Chemicals attributes its solid profits to this egalitarian and performance-based philosophy.

What do you think is the role played by the incentive system in this organization? Mention the disadvantages of the incentive system also.

Answer:

Check Your Progress - 3

3. Which of the following does not come under financial incentive plans?
 - a. Profit sharing plan
 - b. Price rate
 - c. Differential price rate
 - d. Gratuity schemes
 - e. Appreciation for good work
4. Factors such as attitude, advancement, security, quality of supervision, job satisfaction and enrichment, praise, and recognition come under:
 - a. Positive incentives
 - b. Financial incentives
 - c. Non-financial incentives
 - d. Other incentives
 - e. Negative incentives

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5. Non-financial incentives aim at giving which type of reward to the workers?
 - a. Physiological
 - b. Psychological
 - c. Sociological
 - d. Chronological
 - e. Financial
6. Non-financial incentives are the outcome of which type of management?
 - a. Dominating
 - b. Enlightened
 - c. Exploitative
 - d. Cost-conscious
 - e. Hierarchical
7. What type of incentive is job enrichment?
 - a. Non-financial
 - b. Financial
 - c. Satisfying
 - d. Wanting
 - e. Negative
8. Competition improves performance only when it is free from which of the following elements?
 - a. Unhealthy rivalry
 - b. Achievement
 - c. Target setting
 - d. An urge to move ahead
 - e. Rivalry

10.7 Bases for Determining Incentives

The incentive plan is framed on the basis of two variables. They are the individual and the work situation.

10.7.1 The Individual

Different people value things differently. Enlightened managers realize that all people do not attach the same value to monetary incentives, bonuses, prizes, or trips.

Different things will motivate different people as ‘one man’s food is other man’s poison’. Individuals are unique and all individuals cannot be motivated by a single incentive plan. For some individuals, the monetary reward may be the motivating factor and for some it may be the non-monetary incentives that are more important.

10.7.2 The Work Situation

The work situation is made up of four important elements. They are: technology, satisfying job assignments, feedback, and equity.

- a. **Technology:** Based on the technology and the machine a person is operating the range of an incentive may vary.
- b. **Satisfying job assignments:** A worker’s job may incorporate a number of activities that he/she finds satisfying. Incentives may take the form of earned time off, greater flexibility in hours worked, extended vacation time, and other privileges that an individual values.
- c. **Feedback:** Workers need to be able to see the connection between their work and rewards. These responses provide important reinforcement.
- d. **Equity:** Workers consider fairness or reasonableness in exchange for their work.

Example

The currency of Zappos employees is called “Zollars”. They have to earn their Zollars and are used as a way to recognize employees for times when a co-worker or manager feels they’ve gone above and beyond. Employees can spend their Zollars on Zappos branded merchandise such as sweatshirts, glasses, and sun shades or they can buy movie tickets, donate them for a charitable purpose or enter them into a raffle for bigger prizes.

For more details, check out <https://www.zappos.com/about/> (accessed on 20/4/2022)

10.8 Factors that Affect Levels of Pay

Reward management policies and practices need to be developed on the basis of an understanding of the internal and external influences on the pay.

The internal influences on pay include organizational influences and the external influences include extra organizational influences.

10.8.1 Internal Influences

Internal Value of Job

Pay is related to the relative contribution or internal value of the jobs that the employee performs.

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External Value of Job

This depends on the market rates, in accordance with the policy of the organization on how it wants its own rates to relate to market levels. It also depends on the amount of money required to retain its talented workforce. . The business will decide whether it is a high payer, prepared to pay above market rates, or low payer, having to accept, probably for financial reasons, that it must pay less than the market rate.

Employee's Value

If the employees' value is high in the market, they may be paid higher than the market price. It is then perceived that they make a significant contribution, that they excel in their job, or that they have a higher level of skill or competence than other employees.

Organizational Affordability

The pay also depends upon the organizational affordability to pay employees and also the ability of trade unions to bargain more for the employees.

If the trade unions are powerful, the organization would have to pay according to their demands. The bargaining capacity of the trade unions decide the pay structure of the employees.

10.8.2 External Influences

The economic determinant of pay is supply and demand. The pay levels are further explained by the economic wage, human capital, and agency theories.

Supply and Demand of Human Resources

Several theories explain the supply and demand of human resources. Supply and demand also influence the pay. According to the Classical Economic Competitive Theory, the pay levels in the labour markets are determined by supply and demand considerations. Other factors remaining constant, if the supply of labour exceeds the demand, the pay level goes down; if the demand for labour exceeds the supply, the pay level increases.

The significance of this theory is that it focuses its attention on external pressure. The classical theory is used as a justification for concentrating on external competitiveness at the expense of internal equity, in the belief that 'a job is worth what the market says it is worth'.

The Economic Wage Theory

This theory says that the firm pays more than market rates by motivating superior performance, attracting better candidates, and reducing labour turnover and persuading workers that they are being treated fairly.

The Human Capital Theory

This sees the workers as embodying a set of skills which can be 'rented out' to employers. The knowledge, skills and experience the employees possess,

generate a certain stock of productive capital. From a pay point of view it is believed that human resources are an asset to organization and they add value to the firm. Individuals expect a return on their own investment, and the firms recognize that the increased value of the employees should be rewarded.

The Agency Theory

In its purest form, this theory recognizes that in most firms there is a separation between the owners (the principals) and the agents (the managers). However, the principal may not have complete control over their agents. The Agency Theory also indicates that it is desirable to operate a system of incentives to motivate its employees. This process of 'incentives distribution consists of paying for measurable results that are deemed to be in the best interests of the owners. This process helps in measuring performance, such as: earning per share rather than being concerned with the behaviour that led up to them.

Example

The pay packages of the executive directors at HSBC Holdings were linked to the need to expurgate the carbon emissions of the bank and assist their clients for achieving the same, failing which there would be a reduction in their pay packages through 2023 (Courtesy Bloomberg Survey). This is an instance of external influence on pay.

For more details, check out <https://www.businesstimes.com.sg/banking-finance/banker-bonuses-tied-to-esg-metrics-are-> (accessed on 20/4/2022)

Check Your Progress - 4

9. Which of the following is not an element of a work situation?
 - a. Technology
 - b. Satisfying job assignments
 - c. Feedback
 - d. Equity
 - e. Primary relationships
 10. Which of the following options best describe the concept of the Agency Theory?
 - a. Separation between the interests of the owners (the principals, the agents and the managers)
 - b. Separation between the interests of the senior management and the junior management
 - c. Separation between the interests of the owner and the advertising agency
 - d. Separation between the interests of the owners and the trade union leaders
 - e. Separation between the owners and employees
-

Block 4: Compensation and Reward Management

10.9 Summary

- Rewards act as a catalyst on the human mindset, leading to an increase in the reality of performance of employees, provided they are managed within a framework of scientific objective parameters.
- It has been proved that effective management of rewards could act as a stimulant for human performance, thereby raising the scope of talent retention.
- The reward package can be molded as a retention strategy only when it is done in three steps. They are: (i) Recognizing and compensating, (ii) Group performance towards objectives, and (iii) Organization's performance and business profit.
- An incentive is described as a factor that leads a person to prefer a particular choice to the other available alternatives. Incentives can be of two types: financial and non-financial incentives.
- Financial incentives are payments for improved productivity, attendance, and general improvement in employee performance. Non-financial incentives are the outcomes of an enlightened management.
- Incentive plans are formulated based on the three variables: individual work, work situation, and types of incentive.
- Factors affecting incentives are classified into two categories: internal factors and external factors.
- Incentives are classified financial and non-financial incentives. The incentive plan is framed on the basis of two variables. They are the individual and the work situation.
- Pay in organizations can be influenced by internal or external influences. The internal influences look into the internal and external value of the job, employee's value, organizational affordability and trade unions
- The external influences would look into the supply and demand of human resources, economic wage theory, human capital theory and agency theory.

10.10 Glossary

Classical economic competitive theory: According to this theory, the pay levels in labour markets are determined by supply and demand considerations. Other factors remaining constant, if the supply of labour exceeds the demand, the pay level goes down; if the demand for labour exceeds supply, the pay level increases. The theory focuses its attention on external pressure and the perceived need for 'competitive pay' that is, pay that matches or exceeds market rates.

External Value of Job: This depends on the market rates, in accordance with the policy of the organization on how it wants its own rates to relate to market levels. It also depends on the amount of money required to retain its talented workforce.

Feel-good factor: Employees when feel good about working with the company, it is referred to as feel-good factor

Incentive: is a factor (financial or non-financial) that leads a person to prefer a particular choice to the other available alternatives.

Internal Value of Job: Pay is related to the relative contribution or internal value of the jobs that the employee performs.

Reward: is a benefit resulting from some event or action, an appreciation for a service rendered.

The agency theory: In its purest form, this theory recognizes that in most firms there is a separation between the owners (the principals) and the agents (the managers). However, the principals may not have complete control over their agents. The Agency Theory also indicates that it is desirable to operate a system of incentives to motivate and reward acceptable behaviour.

The economic wage theory: This theory says that the firm pays more than market rates because it believes that high pay levels will contribute to an increase in productivity by motivating superior performance, attracting better candidates, reducing labour turnover, and persuading workers that they are being treated fairly.

The human capital theory: Ehrenberg and Smith (1994) conceptualized workers as embodying a set of skills which can be 'rented out' to employers. The knowledge and skills a worker has, which comes from education and training, including the training that experience brings generate a certain stock of productive capital. From a pay point of view, the implication for Human Capital Theory is that investment in people adds value to the firm. Individuals expect a return on their own investment, and the firms recognize that the increased value of the employees should be rewarded.

10.11 Self-Assessment Test

1. Rewards are being increasingly used by organizations. What are rewards? What are the benefits that are expected to accrue from rewards?
2. An incentive is described as a factor (financial or non-financial) that leads a person to prefer a particular choice to the other available alternatives. What types of incentives are available? What are the advantages of having incentives?
3. How are incentives plans designed on the basis of the individual and the work situation?
4. The reward management policies and practices need to be developed on the basis of an understanding of the internal and external influence on the pay. What are the internal and external influences on pay? Describe in detail.

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10.12 Suggested Readings/Reference Material

1. John Shields, Jim Rooney, Michelle Brown, Sarah Kaine; Managing Employee Performance and Reward: Systems, Practices and Prospects, 3rd Edition, Cambridge University Press, 2020
2. Susan L. Verhulst, David A. DeCenzo, Rama Shankar Yadav; Human Resource Management, 13th Edition, Wiley, 2021
3. Durai Pillai, Total Reward Strategy: Retain Your Best Talent, 1st Edition, Notion Press, 2020
4. Stephen J Perkins, Sarah Jones, Reward Management: Alternatives, Consequences and Contexts, 4th Edition, Kogan Page, 2020
5. Kevin R. Murphy, Jeanette N. Cleveland, Madision E. Hanscom, Performance Appraisal and Management, Sage Publications, 2020

10.13 Answers to Check Your Progress Questions

1. (b) Tracking the efficiency of the employees

The concept of efficiency scaling tracks the efficiency of the employees.

2. (d) Bonus

Bonus is paid as an incentive to employees. Incentives do not include: wages, pay for doing dangerous tasks, payment to work at undesirable times and overtime pay.

3. (e) Appreciation for good work

Appreciation for good work is a non-financial incentive and does not come under financial incentives.

4. (c) Non-financial incentives

Factors such as attitude, advancement, security, quality of supervision, job satisfaction and enrichment, praise and recognition come under non-financial incentives.

5. (b) Psychological

Non-financial incentives act as a psychological reward to the workers.

6. (b) Enlightened

Non-financial incentives are the outcome of an enlightened management.

7. (a) Non-financial

Job enrichment is a vertical expansion of the job which provides a challenge to the individuals. It thus forms a significant non-financial incentive.

8. (a) Unhealthy rivalry

People work well as a group under conditions of cooperation than under conditions of competition. Competition improves performance where it is free from unhealthy rivalry.

9. (e) Primary relationships

The work situation is made up of four important elements -technology, satisfying job assignments, feedback, and equity. Primary relationships is not an element of work situation.

10. (a) Separation between the interests of the owners (the principals, the agents and the managers)

The basic concept of the Agency Theory is a separation between the interests of the owners (the principals) and the agents (the managers).

Unit 11

Reward Management

Structure

- 11.1 Introduction
- 11.2 Objectives
- 11.3 Meaning of Rewards Management
- 11.4 The Reward System
- 11.5 Reward Management and Human Resource Management
- 11.6 Reward Strategy
- 11.7 Reward Policy
- 11.8 Reward Management Process
- 11.9 Evaluating the Reward System
- 11.10 Innovations in Reward Management
- 11.11 Reward Systems and Legal Issues
- 11.12 Summary
- 11.13 Glossary
- 11.14 Self-Assessment Test
- 11.15 Suggested Readings/Reference Material
- 11.16 Answers to Check Your Progress Questions

“If you don’t create a great rewarding place for people to work, they won’t do great work.”

- Ari Weinzweig

11.1 Introduction

As has been popularized by Ari Weinzweig, administering reward is the best way to help the employees understand that they are valued and helps in fostering a culture of engagement, commitment and performance. In the previous unit, various facets of rewards and incentives were discussed along with the bases for determining incentives and pay.

There needs to be a comprehensive system of reward management in the organization. This would help in retaining the existing employees and attracting right kind of talent into the organization, not to forget the contributions to organization productivity. The focus of this unit would be on the concept of reward management and its process and relationship with HRM. Further this unit would focus on the legal issues in reward management.

11.2 Objectives

After studying this unit, you should be able to:

- Examine the reward system
- Analyze the relationship between reward management and HRM
- Describe the rewards management process
- Formulate a rewards strategy
- Explain the evaluation of reward system

11.3 Meaning of Reward Management

Reward management implies employees must receive rewards in proportion to their contribution. The philosophy of rewards management holds that employees are to be rewarded fairly and equitably, on a continuous basis. Their value or contribution to the organization should be taken into account. To achieve this outcome, reward management formulates and implements desirable policies in every organization.

Reward management deals with the formulation, implementation, and evaluation of a reward process in an organization. Reward management policies are to be communicated to all its stakeholders.

Reward management takes a 'total reward' perspective. It recognizes that there are numerous ways of rewarding people. The preferences of individuals have to be taken into account and integrated in order to maximize the effectiveness of reward policies and practices.

The aims of reward management are:

- Creating a performance orientation by rewarding employees according to the value created by them.
- Promoting right behavior by rewarding the right things.
- Attracting, retaining, and developing talented workforce.
- Ensuring consistently high levels of motivation among employees.

The aims of reward management are achieved through alignment between various rewards practices: There should be an alignment of reward practices – both with employee values and the business goals. The same can be achieved by implementing the following:

- Ensuring equal pay for equal work
- Emphasis should be on fair treatment where the employees feel that they are fairly treated
- Ensuring greater transparency in the reward management practice in an organization.

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Example

Infosys believes in high-performance work ethics and rewards employees through a range of monetary and non-monetary rewards. One such initiative is InfyGold, a unique multi-partner employee discount programme where employees are awarded redeemable InfyGold plus points for excellence in their projects. They can use them across 2000 plus brands that are curated for them. This provides employees the freedom of choice and takes customization of rewards to the next level.

For more details, check out <https://www.infosys.com/newsroom/> (accessed on 21/4/2022)

11.4 The Reward System

According to Armstrong, the reward system has interrelated processes as well as activities which ensure maximum returns.

The reward system comprises the overall reward strategy of the organization, the reward policy being currently followed, the approach toward total rewards represents transparency and equity. It also balances the importance given to ensure external competitiveness versus internal equity.

We look at each of these aspects here:

- The reward strategy sets out the aims of the reward policies of the organization in the longer term.
- Another important aspect of the reward policy is that a comparison is always made between the internal rates of pay and the market rate to assess total reward and the use of contingent rewards. Total reward aims to achieve a greater impact on the motivation and commitment of employees as they include both financial and non-financial rewards.
- Contingent rewards are additional financial rewards which are related to performance, and abilities of employees. Contingent pay can be for an individual, teams, or the entire organization.
- External competitiveness is ensured by identifying rates of pay for comparable jobs within the organization.

Example

Netflix follows the incentive compensation model that is highly entrepreneurial and rewards tangible successes, inciting producers and directors to make sure that their work performs well. It is qualitative in terms of its bonuses for awards won, but also quantitative as well because it rewards success in terms of numbers of views for “mainstream” films.

For more details, check out <https://about.netflix.com/> (accessed on 22/4/2022)

11.5 Reward Management and Human Resource Management

Reward management has always been an integral part of human resource management due to the following reasons:

- Rewards management supports the accomplishment of business strategy. It deals with the long-term issues of how people should be valued for their performance.
- The 'total reward' approach adopted by organizations recognizes the various ways of rewarding people, which can be financial or non-financial. The aim should be that the reward policies have the maximum effect.

Example

Employees can earn Zollars or "Zappos dollars" for their performance and the same can be used to redeem Zappos branded merchandise, such as a gym bag, desk fan, or water bottle, which are sold through the company's internal Zollar Store. They can also donate them to other employees. The Zapponian who awards the Zollar to another employee has to fill out the recipient's name along with the reason of why they are giving the Zollar, which makes the recognition meaningful. It gives employees a warm, fuzzy feeling that every time they spend Zollars it can help others out which, in turn, makes the employee happy for being part of something bigger than themselves.

For more details, checkout <https://www.zapposinsights.com> (accessed on 22/4/2022)

Check Your Progress - 1

1. How does reward management attempt to achieve its goals?
 - a. By ensuring greater transparency and consistency
 - b. By not aligning various practices
 - c. By emphasizing unfair treatment
 - d. By not ensuring greater level of equity
 - e. By rewarding employees as per their needs

11.6 Reward Strategy

The reward strategy sets out the reward policies in order to accomplish business objectives. Thus, it is concerned with how the organization will go about giving rewards for the coming two or three years. Armstrong feels, "Reward strategy provides specific directions on how the organization will develop and design programs that will ensure that it rewards the behavior and performance outcomes that support the achievement of its business goals."

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Through the use of a rewards strategy, the organization ensures that rewards turn into a mechanism for integrating the efforts of its various units towards achieving its strategic objectives.

However, while setting and implementing the strategy, the costs should not be more than the perceived benefits. Effective good rewards strategy must ensure three things:

1. There should be clearly defined goals and a well-defined link between the reward strategy and the business objectives.
2. The rewards program should be able to meet the needs of the organization.
3. There have to be supportive HR and reward processes in place in the organization.

We now examine various aspects of reward strategies:

11.6.1 Alignment with Organizational Needs

The fundamental criterion behind an effective rewards strategy is supporting the overall corporate strategy wherein reward policies and processes should be in alignment with organizational needs. It should give a sense of purpose and direction to the organization.

Following are the features of effective reward strategies:

- An effective rewards strategy visualizes organizational goals. An effective rewards strategy links reward plans with corporate goals. An effective rewards strategy has flexibility in achieving goals.
- An effective rewards strategy reinforces organizational values.
- An effective rewards strategy is formulated only after considering the resources available.
- An effective rewards strategy ensures that the organizational objectives are achieved to a significant extent.
- An effective rewards strategy examines the extent to which it can drive culture change.
- An effective rewards strategy aligns individual or team competence with organizational core competencies.
- An effective rewards strategy ensures that rewards give the right messages about the organizational priorities.
- An effective rewards strategy has the required flexibility, given the competitive and turbulent environment.
- An effective rewards strategy ensures that the reward processes fit into employees' individual needs and expectations.
- Lastly, effective reward strategies have a backup plan in case it fails to achieve the desired objectives.

11.6.2 Developing a Reward Strategy

Theoretically, the formulation of a reward strategy can be conceived as a linear process. Beginning with the conception of the business strategy that seeks to satisfy stake-holder expectations as well as achieve value addition, the required human resources strategy is conceived.

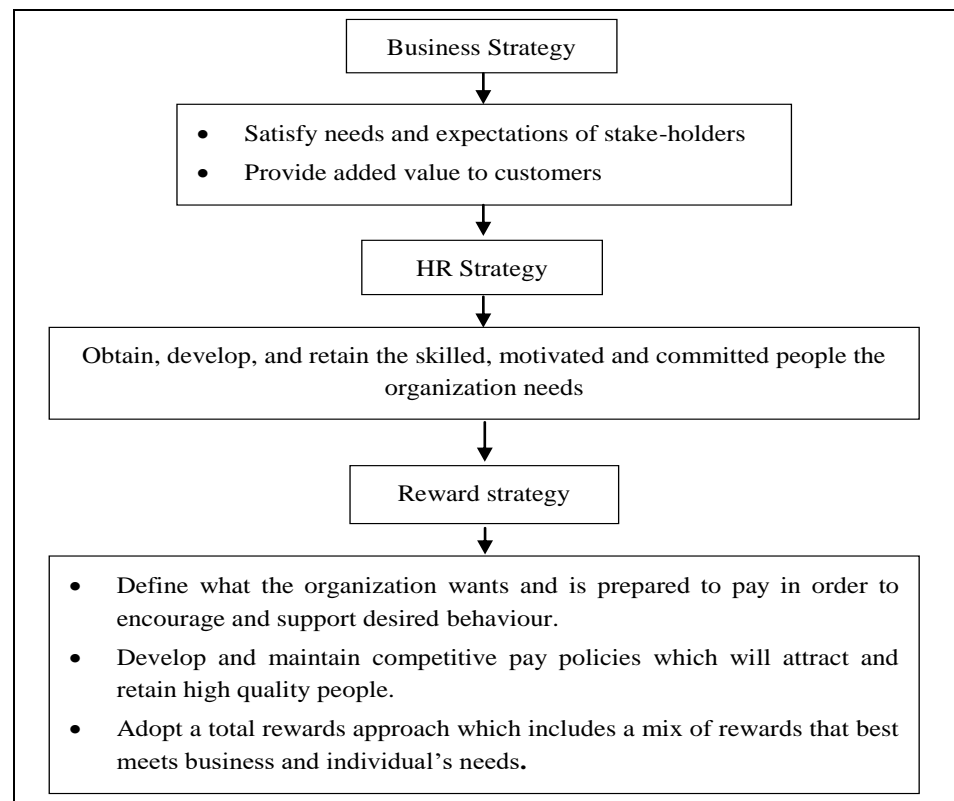
Human resource strategies aim to recruit, develop, and retain talented, skilled and motivated talented people the organization needs in order to achieve its aims.

The reward strategy clarifies what the organization wants and is prepared to pay in order to encourage and support desired behavior. It develops and maintains competitive pay policies that attract and retain quality people.

However, in practice, the formulation of strategy is seldom rational or linear. For practitioners, strategic planning is often reduced to analyzing events in light of the organization's expectations.

This should not mean that organizations should simply 'react' to events and never plan. It is essential that there be a defined and clearly understood sense of purpose and direction existing in the organization. The development of reward strategy is shown in Figure 11.1.

Figure 11.1: The Development of Reward Strategy



Source: Michael Armstrong, 2004, *A Hand Book of Human Resource Management Practice*, New Delhi, Pearson Education Pvt. Ltd.

https://www.academia.edu/32280546/ARMSTRONGS_HANDBOOK_OF_HUMAN_RESOURCE_MANAGEMENT_PRACTICE_i (accessed on 22/4/2022)

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Exhibit 11.1 illustrates the reward system at Zappos.

Exhibit 11.1: Reward System at Zappos

In the Zappos Family, peer-to-peer employee rewards programs help build a positive team spirit. Zapponians get an opportunity to appreciate the good work done by their organizational members. This speaks about the culture at Zappos. A Zapponian can be acknowledged for his efforts, if he goes that extra mile to help out another team member or WOWing a customer. A system of employees rewarding their peers talks about the culture at Zappos. Some of the employee reward programs that are affordable and scalable are:

Master of WOW Parking

In Vegas, it is a treat to get a covered parking spot close to the entrance of one of the four buildings of the Zappos for a week.

The same can be facilitated by nominating an employee by submitting a brief story to the ZCON Team (Zappos' concierge) on how they were WOW'd by a fellow colleague. WOW parking is chosen once a week (usually Friday) for a one-week period. Any Zappos employee can award the parking spot to a lucky employee. It can be given to a teammate, team lead, someone who opened a door for them, someone who always smiles, or maybe to the person who magically cleans the restrooms or the break room.

Co-worker Bonus Program

Employees can reward each other with a \$50 co-worker bonus. Zapponians can show their fellow co-workers how much they appreciate them with moola. Each Zapponian can give one bonus per calendar month, but they can receive more than one as long as they are from different employees. Having employees give bonuses allows both the giver and the receiver to spread happiness.

Hero Award

The Zappos Hero award works in combination with the co-worker bonus program. Zappos HERO is an employee who embraces their core values to the fullest and lives to deliver WOW to their fellow Zapponians. They are chosen by the leadership team which is made up of all the heads of departments along with the CEO, CFO, and "no title."

Source: <https://www.zapposinsights.com/> (accessed on 22/4/2022)

11.6.3 Evaluating the Effectiveness of Reward Strategy

Duncan Brown¹ has suggested that reward strategy delivery should be evaluated by rating it against various objectives. This is given in Table 11.1.

¹ <https://www.employment-studies.co.uk/resource/measuring-effectiveness-pay-and-reward-practices> (accessed on 22/4/2022)

Table 11.1: Evaluating the Effectiveness of Reward Strategy

Objectives	Rating Scale = 10 Incredible Scale = 5 OK Scale = 1 Appalling
Reinforces the realization of business goals	
Reinforces organizational values	
Recruits and trains staff of required calibre	
Strong relationship between pay and contribution	
Motivating the employees	
Cost effective	
Well communicated, understood, and supported by employees	
Managed effectively in practice by line managers	
Simple and efficient to operate and maintain	
Flexible enough to react to change	
Reinforces the achievement of business goals	
Reinforces organizational values	
Recruits and trains staff of required calibre	
Positive relationship between pay and contribution	
Employee motivation	
Cost effective	
Well communicated, understood, and supported by employees	
Managed effectively in practice by line managers	
Simple and efficient to operate and maintain work	
Flexible enough to react to change	

Activity 11.1

Based on the above given format for evaluating the effectiveness of Reward Strategy, assign some imaginary scores about the reward strategy being followed in an organization and analyze how effective the reward strategy is.

Answer:

11.6.4 Recent Developments in Reward Strategy

According to Armstrong and Brown, there has been a shift in the strategic concept of reward. Of late, there has been a shift away from the traditional concept of the reward system as a complex, inflexible, and mechanistic system to a reward process which is organic and much simpler.

Moreover, the strategy is now much more inclusive: instead of the emphasis being on an entirely business-driven focus, there has been a marked shift for achieving

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greater alignment with the laid out strategies of the organization, while keeping in mind the employee needs and environmental requirements.

The new approach towards rewards is much more practical as it gives importance to achieving the best fit with the organization, instead of going after the conventional best practices approach. In the process, there is a greater degree of communication and involvement throughout the organization, than the earlier top-down approach.

Most importantly, the reward process believes in evolutionary change, rather than achieving sudden drastic changes. Reward as a driver of cultural change in an organization has changed. They are being used more like a system to limit short-run damage as many a time incentives work best to meet specified performance goals and to motivate people to perform better. This implies a much reduced role of planning in the reward system and a greater shift towards practicing reward management as more of a short-run process. This shift towards thinking of the reward system and strategy from a short-run perspective is much more pronounced in the UK than in the US.

Check Your Progress - 2

2. Which of the following ensures that the rewards policy supports the achievement of an organization's business goals?
 - a. Radical strategy
 - b. Reward strategy
 - c. Cyclical strategy
 - d. Bonus strategy
 - e. Business strategy
3. Which of the following is the term for referring to the perception about the process of reward policy?
 - a. Circular
 - b. Never ending
 - c. Linear
 - d. Diagonal
 - e. Vertical
4. Which of the following is not considered in the recent shifts in the reward strategy of an organization?
 - a. Employee needs
 - b. Environmental needs
 - c. Business needs
 - d. Organizational needs
 - e. Trade union needs

5. Which of these characterizes the new approach toward the rewards strategy?
- a. Achieving the best fit
 - b. Following the best practices approach
 - c. Leaving the policy to adjust to the circumstances
 - d. Going after the conventional best practices approach
 - e. Not having greater degree of communication and involvement
-

11.7 Reward Policy

Reward policies give the guidelines for the implementation of the reward strategy through the design and management of the reward system. The reward philosophy plays a very important role in setting and setting reward policies in every organization. Armstrong has highlighted the following factors as concerning reward policies:

11.7.1 Level of Pay or Remuneration

The structure of the company influences the pay levels as well as the differentials and the number of steps or grades that should exist in the pay hierarchy.

11.7.2 Market Rate and Equity

There is often a conflict between the need to match market rates and the desire to maintain an internal equitable pay structure. The market sometimes determines the pay of the employees. Companies in order to attract and retain talented employees who have high market rates may, to a degree, have to sacrifice its ideals of internal equity to the realism of the market-place.

11.7.3 Differential Rewards

The policy will need to maintain whether or not the organization wants to pay for performance, competence or contribution, and if so, how much and under what circumstances. The policy may also indicate the approach to be used in relating pay to individual, team, or organizational performance.

11.7.4 Flexibility

Reward policies should also take in to account the extent to which the reward processes are in line with the fast changing external conditions along with the changes or variations in the needs of the company or its employees.

11.7.5 Involving Employees in Reward Policy

In order to make the reward policy more effective, the employee's involvement should be added to it. This will help management to understand the type of rewards the employees would prefer.

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11.7.6 Communicating to Employees

The reward policy should be communicated to the individuals, teams, and representative bodies. The communication should ensure that the various aspects of the reward processes are brought out. Along with this, how the reward processes would be used and how they would affect the employees should be communicated. Lastly, the role the individuals and teams would be expected to play should also be highlighted.

11.7.7 Transparency

If there is transparency in pay policies there will be corresponding boost in the morale of the employees. Only then employees will feel that the reward management processes of an organization are fair if they know how they are rated and evaluated for their pay and rewards. Lack of understanding only breeds suspicion and hostility. Transparency can be achieved through the involvement and communication of the employees in the reward setting process.

11.7.8 Relating Rewards to Business Performance

The reward policy refers to the link between business performance and pay. It will cover the extent to which pay varies based on results. It is essential to ensure that the reward strategy spurs employee performance in order to achieve better results. The reward policy should have a component of recognizing the contribution made by employees.

Example

Accenture awards leadership equity grants to recognize exceptional performance or achievement of a significant career milestone.

For more details, check out <https://www.accenture.com/us-en/careers/local/total-rewards> (accessed on 22/4/2022)

Activity: 11.2

Wonnacott and Wonnacott

Wonnacott and Wonnacott is a leading financial services firm in the United States. During the financial downturn, it received substantial funding from the government to prevent it from collapse. However, during the same period, the firm gave away billions of dollars as bonus payments to its executives. This created substantial resentment among the general public, who accused the firm of promoting a culture of 'greed'. However, the firm said it was helpless on this count as the bonus payments were legally binding on it and had been negotiated at a time when the economy was booming. The firm's bonus contracts are set to expire in a month's time. This gives it a good opportunity

to put in place a rewards system that is in tune with the expectations of the tax paying public that wants to slash the pay of the ‘fat cats’. You are the director of Human Resources at Wonnacott and Wonnacott.

Based on the meetings you have had with the CEO, it is clear that the firm must continue to get business at a fast pace, if it has to survive. This means that the firm will require the very top performing executives, whom the public has begun to increasingly dislike. However, your experience in the financial services industry tells you that top performing executives do not come cheap – they would have to be given substantial rewards to stay at the firm. In this situation, what is the rewards policy that you would devise for Wonnacott and Wonnacott?

Answer:

Check Your Progress - 3

6. Tension can prevail in the reward system due to the conflicting requirement of which of these?
 - a. Market rate and internal equity of pay in the organization.
 - b. The internal equity of remuneration.
 - c. The market determined rate of interest
 - d. Flexibility
 - e. Transparency in reward system
7. Transparency in the rewards process is created through which of the following elements?
 - a. Communication and involvement.
 - b. Abstract process
 - c. Collective bargaining.
 - d. External competitiveness.
 - e. Internal equity

11.8 Reward Management Process

The reward management process covers both financial and non-financial rewards. The process of reward management is led by business needs. The philosophy of the reward management must be to satisfy the needs of the employees and identify them as the shareholders of the organization.

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11.8.1 Financial Reward Process

The processes of financial rewards are related to the basic and variable pay and with the provision of benefits and pensions. There are various dimensions of the financial rewards process such as base pay, pay survey and job evaluation, pay structures, contingent pay, employee benefit, and pensions and total remuneration.

Base Pay

The base or basic pay is the price for the job as determined by the internal and external employment markets. If performance pay and rewards for competence or skill or service increments are combined with an employee's base rate, then it becomes the level of pay for that employee.

The size of cash bonuses is usually set in relation to base pay, as are the level of pension contributions and the size and nature of other benefits. Levels of pay are influenced by external and internal relativities. External relativities are the levels of pay for similar jobs in the external labor market – market rates. Internal relativities reflect the relative value of jobs and people within the organization's internal labor market.

Pay Surveys and Job Evaluation

Pay surveys and research establish external relativities that analyze and compare market rates in order to achieve external competitiveness.

The internal relativities are judged by job evaluation. The relative values or size of jobs within an organization are considered as a basis for achieving internal equity structures.

Benefits of pay surveys and job evaluation are:

- Pay surveys and job evaluation provide the necessary data to design and manage pay structures.
- They provide frameworks within which levels of pay for jobs and the differentials are described or defined in the form of grades, bands, scales, or spot rates (individual job rates).
- Pay structures also define the limits within which the pay of employees can progress within their grades or bands. This can vary with assessments of performance, competence, or skill. Progression may be up a fixed incremental scale or spine which explains the predetermined pay increases that can be received by employees' year by year on the basis of their time in the job.
- Different structures may exist for different job families. Job families are those groups of jobs where the nature of work is similar, or market groups. Structures may consist of an extended hierarchy of relatively narrow grades or a fairly small number of broad bands.

Pay structures are designed from job evaluation, competence analysis, and analysis of market practice by external benchmarking (pay surveys). The design is not a scientific one and depends upon judgement.

Contingent Pay

Contingent or differential pay is pay which is influenced by the level of performance of individuals, teams, or the organization and/or individual levels of competence or skill. When it takes the form of performance or competence-related pay, it may be consolidated into base pay. Contingent pay is not consolidated into the base rate and is typically not pensionable. In this case, it is often referred to as 'variable pay' and, because it is related to potentially variable factors and has to be re-earned at the next pay review, it is sometimes called pay-at-risk.

Employee Benefits and Pensions

Employee benefits are many such as pensions, death in service benefits, sick pay, company cars, or permanent health insurance which are provided in addition to the routine cash pay. They can also include benefits such as annual holidays, child-care provisions, and subsidized meals.

Total Remuneration

The sum of base pay, variable pay, and the value of employee benefits and pension constitute total remuneration. This represents the complete worth of financial rewards to individuals.

11.8.2 Non-financial Reward Process

The non-financial rewards usually involve a nominal cost but lead to substantial goodwill. However, before giving out non-financial rewards, it is essential to know what the employees would want. For instance, it may happen that more mature employees would like recognition and praise, while the younger ones would like extra time off to enjoy themselves. The extent of non-financial rewards is limited by the creativity one can have.

Companies offer benefits ranging from movie tickets to visits to the dentists, holiday destinations, or a meal at a restaurant of their choice with their friends. There can be summer events for all the employees and their families that include things like a friendly cricket match to a hiking expedition.

It should be ensured that financial and non-financial components should be judiciously included in reward management. Non-financial rewards focus on people's need for recognition, achievement, responsibility, and personal growth, and therefore they contribute to increases in motivation, commitment, and improved performance. They can make a deeper and longer-lasting impact on motivation and commitment.

11.8.3 Performance Management Process

Performance management includes personal development plans, management, and coaching. There are periodic reviews of achievements performance in relation to those plans.

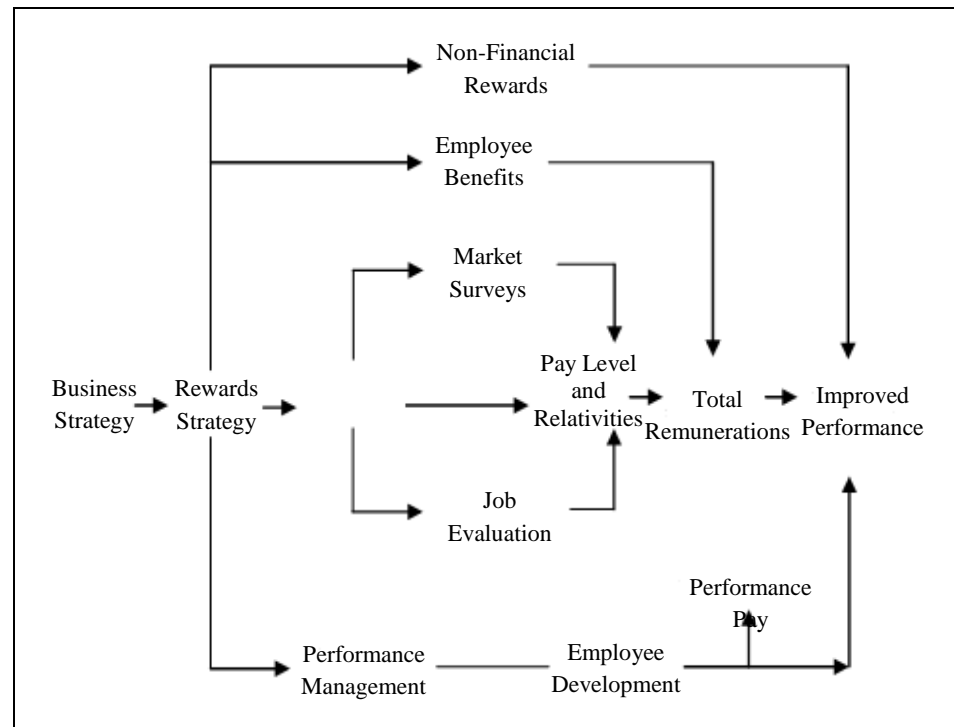
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The purpose of performance management is to develop competence and skill and improve performance. Though performance management has been traditionally concerned with appraisals, it has become increasingly holistic and been extended to the assessment of inputs – knowledge, skill, and competence as well. A distinction is sometimes made between knowledge and skills as inputs to performance, and competency i.e., the behavior that generates excellent performance, in the conversion of inputs to outputs.

The measurement and management of performance at organization, team, and individual level can be done by the Balanced Scorecard approach which was devised by Kaplan and Norton. This approach involves looking at the business from four related perspectives: customer, internal processes, innovativeness and learning, and finance. This process can be extended to teams and towards a longer-term perspective.

These performance management reviews may generate ratings which influence variable pay decisions. They also provide non-financial motivation through feedback which recognizes achievement. In this process, 360-degree feedbacks that give remarks from various sources – from managers to peer groups and direct reports by the manager – can be used. Performance agreements and reviews identify performance gaps and analyze training needs. Through this, they enable personal development of the individual which in turn lead to improved performance. (Refer Figure 11.2 for reward management process).

Figure 11.2: Reward Management Process



Source: Michael Armstrong, 2004, *Hand Book of Reward Management- Remuneration strategy and Practice*, New Delhi, Kogan Page India Pvt. Ltd.

Pay is an important component for both performance management and reward management.

Example

HRS MART solution of Capgemini provides better tracking and management of human capital and efficient workforce and performance management, critical to the overall functioning of the organization. Its big data capability improves the processing of unstructured data, including social media sentiment and history and enables predictive analysis of likely attrition.

For more details, check out <https://www.capgemini.com/service/digital-services> (accessed on 22/4/2022)

11.9 Evaluating the Reward System

The reward system should be audited regularly to assess its effectiveness, and its relevance to the present and future needs of the organization. The audit should include an assessment of opinions about the reward system by its key users and those who are affected by it. This would lead to a diagnosis of the strengths and weaknesses of the reward system and an assessment of what needs to be done and why.

The personnel department continuously monitors the operation of the reward system through audits by using compa-ratios and attrition analysis. The internal and external relativities need to be monitored thoroughly to check the performance of the reward system.

The internal relativities are monitored by carrying out periodic studies of the differentials that exist vertically within departments or between categories of employees. The external relativities are monitored by tracking movements in market rates by studying published data and conducting pay surveys.

No reward innovations should take place unless a cost - benefit analysis has forecast that they will add value. The audit and monitoring process should establish the extent to which the predicted benefits have been obtained and check on the cost on the forecast.

A compa-ratio measures the relationship in a graded pay structure between actual and policy rates of pay as a percentage. The policy value is the midpoint or reference point in a pay range which represents the 'target rate' for a fully competent individual in any job in the grade. Compa-ratios are used to define where an individual is placed in a pay range. The analysis of compa-ratios indicates the actions that might have to be taken if compa-ratios are too high or too low compared with the policy level. This process is sometimes called 'midpoint management'.

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Compa-ratios are calculated as follows:

$$\frac{\text{Actual Rate of Pay}}{\text{Mid Reference Point of Range}} \times 100$$

A compa-ratio of 100 per cent means that actual and policy pay are the same. Compa-ratios which are higher and lower than 100 per cent mean that pay is above or below respectively, of the policy target rate.

Compa-ratios establish the difference between policy and practice and the reasons for such differences need to be established.

Example

Google conducted employee survey and found that cash prizes are evaluated on a cognitive level, and seen through practical eyes, whereas a non-cash prize invokes emotional response. This led Google to discontinue its big cash awards up to \$1 million -- for its top performers as it discovered that the program fostered jealousy and resentment -- not the positive response that they had in mind. So Google phased out the cash rewards program and rolled out a new rewards program that offered experiences -- everything from dinners out to new tech gadgets to trips to Hawaii. Employees said they found the new program more fun, more memorable, and more thoughtful than the cash awards.

Source: ICFAI Research Center

11.10 Innovations in Reward Management

Organizations devise unique and innovative ways of rewarding employees to motivate them for excellent performance.

Armstrong et al, propound that reward management is not just a soft art but requires scientific and evidence-based methodologies. Many companies though use balanced score card and benchmarking, yet do not have concrete evidence to justify their reward practices.

Evidence-Based Reward Management (EBRM), researched by Armstrong et al, is based on facts rather than opinion, on understanding rather than assumption, on grounded theory rather than dogma. EBRM model illustrates what can be done to increase the effectiveness of reward systems, which follows the following steps:

- Setting objectives and success criteria
- Conducting reward reviews
- Measuring the impact of reward
- Evaluating the impact
- Developing, implementing and applying reward policies and practices on the basis of evidence

It has been propounded that there cannot be one best method for reward management and only the needs and circumstances of organizations determine the best reward policy. The following Table 11.2 illustrates the fact.

Table 11.2: Successful Reward policies

Organization	Reward policy that brought success
DSG International	Re-design of executive incentive plan to enhance the line-of-sight between individual performance, group performance and reward
Kent country Council	Success due to strong and united political direction from top with a high involvement and adapting to local circumstances
KPMG	Focus on rewarding performance and meeting the needs of a large and young diverse workforce
McDonalds	Regularly reviewing and changing reward policies and adopting processes of consultation and change management for reward effectiveness
Standard Chartered Bank	Linking achievement of business goals with a human capital scorecard which gathers, organizes and reports key trends
The NSPCC	Aligning culture and values of organization with values of the people in the organization
A Technology Company	Understanding of culture and change processes and making reward development as an evolutionary process

Sources: Michael Armstrong, Duncan Brown and Peter Reilly, *Increasing the effectiveness of reward management- An evidence-based approach*, Institute for employment Studies, UK, 2009

<https://www.employment-studies.co.uk/system/files/resources/files/hrp6.pdf> (accessed on 21/4/2022)

The innovative EBRM framework comprised 10Cs as given below:

- Competitive externally to recruit and retain
- Convergent with business strategies
- Contribution and performance rewarded
- Customized to needs of different employees
- Communicated well and understood and valued by employees
- Commits-engages and motivates employees
- Cost effective and affordable
- Changes in response to different needs
- Controlled-efficient to manage and administer
- Compliant legally, internally, equitable, fair

Block 4: Compensation and Reward Management

The EBRM approach emphasizes evidence based methodology for reward management. It further establishes that each organization is unique and reward policy should be based on their needs and circumstances.

Many companies feel that rewards reflect organization's culture and creativity and compete with each other in offering innovative rewards to employees such as flexi-time, tele-commuting, personal appreciation, membership cards, gift vouchers, parties with families, picnics, conducting competitions and awarding prizes etc.

Example

Reward Gateway, an employee engagement platform, provides employees with millions of choices for their reward redemption via simple, seamless integration with Amazon. Real-time access to the breadth of Amazon's products means employees will always find just what they want – and receive it quickly via Amazon's world-class delivery – for a truly rewarding experience.

For more details, check out <https://www.rewardgateway.com/integrations> (accessed on 21/4/2022)

11.11 Reward Systems and Legal Issues

In designing and implementing performance management systems, care needs to be taken that the system is fair and acceptable to employees and above all is legal.

Important Legal Principles Affecting Performance Management

While awarding rewards, organizations should bear in mind the principles and legal issues related to performance management:

- **Employment at will** - This means that the employer can end the relationship with the company subject to his contract period and public policy issues.
- **Negligence** - Legal problems arise if employees or employers do not adhere to the statements given in the employee manuals, contracts or other materials.
- **Defamation** - Defamation is disclosure of false information. It becomes a legal issue if the employer defames or damages the reputation of the employee negligently or intentionally with false statements and discloses them to a third party, who may be a potential future employer to the employee.
- **Misrepresentation** - If employers give false information about favorable performance of the employee, knowing that it is not so, causing damage to others. Misrepresenting information which is not true becomes a legal issue.
- **Adverse Impact** - If an unintentional discrimination takes place on a particular section of employees on their performance and evaluation,

it becomes a legal issue. For instance, if women are evaluated on networking for managerial jobs, probably, they will be ranked low.

- **Illegal discrimination** - If evaluators evaluate performance on non-related performance factors, it is an illegal discrimination.

This emphasizes the fact that employees should participate in the design and implementation of performance management system.

Example

In 2021, over 1,000 Microsoft employees shared their salaries in a leaked spreadsheet in a push for pay transparency. Dozens of women in technical roles at Microsoft started an email thread sharing stories about disparities in compensation and promotions at the company and then compiled a pay spreadsheet to document the inequities.

For more details, check out <https://www.businessinsider.in/tech/enterprise/news/> (accessed on 21/4/2022)

Check Your Progress - 4

8. Which of these are components of non-financial incentives?
 - a. Contingent pay
 - b. Employee benefits
 - c. Base pay
 - d. Variable pay
 - e. Praise and recognition
 9. Which of these best describes 'frameworks within which levels of pay for jobs and the differentials are described'?
 - a. Pay structures
 - b. Pay survey
 - c. Job evaluation
 - d. Job specification
 - e. Job description
 10. What do compa-ratios measure?
 - a. The relationship between the actual and policy rates of pay as a percentage
 - b. The 'mid-point' pay range
 - c. Target rate for a competent employee
 - d. Actual rate of pay
 - e. Policy rate of pay
-

Block 4: Compensation and Reward Management

11.12 Summary

- Reward management is the development, implementation, maintenance, communication, and evaluation of the reward process.
- The basic purpose of the reward strategy is to support the corporate strategy and align reward policies and processes with organizational needs.
- The factors with which the reward policies need to be considered are levels of pay, market rate and equity, differential rewards, flexibility, involving employees, communicating to employees, and transparency.
- The process of reward management covers financial and non -financial rewards which are led by business needs.
- The reward system has to be audited regularly to assess its effectiveness. The operation of the reward system is monitored continuously by the HR Department through audits using compa-ratio analysis
- EBRM model illustrates what can be done to increase the effectiveness of reward systems.
- In designing and implementing performance management systems, care needs to be taken that those systems are fair and acceptable to employees and they are also legally sound. For this standardized procedures are to be adopted

11.13 Glossary

Base pay: The base or basic pay is the price for the job as determined by the internal and external employment markets.

Compa-ratio: A compa-ratio measures the relationship in a graded pay structure between actual and policy rates of pay as a percentage

Contingent pay: Contingent or differential pay is pay which is influenced by the level of performance of individuals, teams, or the organization and/or individual levels of competence or skill.

Job evaluation: Job evaluation considers the relative values or size of jobs and sometimes generic roles within an organization as a basis for achieving internal equity.

Pay structures: Pay structures define the frameworks within which levels of pay for jobs and the differentials are described or defined in the form of grades, bands, scales, or spot rates.

Pay surveys: Pay surveys and research analyze and compare market rates in order to achieve external competitiveness.

Reward management: Reward management is the development, implementation, maintenance, communication, and evaluation of a reward process.

Reward strategy: Reward strategy defines the purpose of the organization on how the reward policies and processes of the organization should be developed to meet business needs.

Total remuneration: The sum of base pay, variable pay, and the value of employee benefits and pension constitute total remuneration.

11.14 Self-Assessment Test

1. Reward management has become an integral part of HRM. What are the ways in which rewards management is linked with HRM?
2. How would you conceptualize a rewards strategy?
3. What is the purpose of a rewards strategy? What would be the characteristics of an effective rewards strategy?
4. The philosophy of rewards management is to satisfy the needs of the employees and identify them as the shareholders of the organization. What would be the components of such a rewards management process?

11.15 Suggested Readings/Reference Material

1. John Shields, Jim Rooney, Michelle Brown, Sarah Kaine; Managing Employee Performance and Reward: Systems, Practices and Prospects, 3rd Edition, Cambridge University Press, 2020
2. Susan L. Verhulst, David A. DeCenzo, Rama Shankar Yadav; Human Resource Management, 13th Edition, Wiley, 2021
3. Durai Pillai, Total Reward Strategy: Retain Your Best Talent, 1st Edition, Notion Press, 2020
4. Stephen J Perkins, Sarah Jones, Reward Management: Alternatives, Consequences and Contexts, 4th Edition, Kogan Page, 2020
5. Kevin R. Murphy, Jeanette N. Cleveland, Madision E. Hanscom, Performance Appraisal and Management, Sage Publications, 2020

11.16 Answers to Check Your Progress Questions

1. (d) By ensuring greater transparency and consistency

By ensuring greater transparency and consistency, reward management attempts to achieve its goals.

2. (b) Reward strategy

The rewards strategy sets out the rewards policies and processes of the organization in the context of accomplishing its business objectives. Thus, it is concerned with how the organization would go about giving rewards over the next two or three years. According to Armstrong, “Reward strategy provides specific directions on how the organization

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will develop and design programs that will ensure that it rewards the behavior and performance outcomes that support the achievement of its business goals”.

3. (c) Linear

Theoretically, the formation of a reward strategy can be conceived as a linear process.

4. (e) Trade union needs

Trade union needs are not considered in the recent shifts in the reward strategy of an organization.

5. (a) Achieving the best fit

The new approach toward reward strategy is much more practical. It gives greater importance to achieving the best fit with the organization, instead of going after a conventional best practices approach.

6. (a) Market rate and internal equity of pay in the organization

There is often a conflict between the need to match market rates and the desire to maintain an internally equitable pay structure. The market sometimes determines the pay of the individuals. Any company that has to attract and retain valuable employees that have high market rates may, to a degree, have to sacrifice its ideals of internal equity to the realism of the marketplace.

7. (a) Communication and involvement

Transparency can be achieved through involvement and communication of the employees in the reward setting process.

8. (e) Praise and recognition

Praise and recognition are non-financial incentives.

9. (a) Pay structures

Pay structures provide the frameworks within which levels of pay for jobs and the differentials can be described.

10. (a) The relationship between the actual and policy rates of pay as a percentage

Compa-ratios measure the relationship between the actual and policy rates of pay as a percentage.

Unit 12

Performance Management and Compensation

Structure

- 12.1. Introduction
- 12.2. Objectives
- 12.3. Components and Objective of Compensation Management
- 12.4. Role of Work analysis- Work Evaluation in Deciding Compensation
- 12.5. Components of CTC
- 12.6. Diagnosing the Current Situation
- 12.7. Market Comparisons
- 12.8. Preparing Compensation Revision Plans
- 12.9. Tax Considerations
- 12.10. Pension Plans
- 12.11. Executive Compensation
- 12.12. Different Types of Compensation
- 12.13. Summary
- 12.14. Glossary
- 12.15. Self-Assessment Test
- 12.16. Suggested Readings/Reference Material
- 12.17. Answers to Check Your Progress Questions

“The best compensation for doing things is the ability to do more.”

- Napoleon Hill

12.1 Introduction

As has been popularized by Napoleon Hill, productivity in relation to the compensation starts with employees feeling valued which in turn elevates employee motivation. In the previous unit, the focus was on the concept of reward management and its process and relationship with HRM. Further, the legal issues in reward management were also discussed.

Compensation refers to the returns employees receive for their contributions to the company and can be both financial and non-financial. These returns are of different types and may be both financial and non-financial. Compensation management is also known as wage and salary administration, reward management and remuneration management.

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The basic aim of compensation management is to establish and implement sound policies with regard to employee compensation. The objectives of performance management are closely related to reward systems. The important objectives of performance management are to provide valid information regarding employees, to take managerial decisions with respect to employees' salary adjustments, promotions, retention or termination, recognition of excellent performance, identification of poor performers, layoffs and giving merit incentives.

In this unit we would discuss about the objectives and components of compensation and the essentials of preparing compensation revision plans. Further the unit would focus on different types of compensation.

12.2 Objectives

After studying this unit, you should be able to:

- Describe the basics of compensation management
- Explain work analysis
- Analyze the impact of cost to company
- Appraise the preparation and communication of compensation revision plan
- Examine the intricacies of executive compensation plans

12.3 Components and Objectives of Compensation Management

Different people view pay in different ways. For some pay is a measure of justice, for some employers it is an expense and for employees it is a return for the services rendered. Some consider it as a reward for the job done

Compensation is what employees receive for their contribution to the organization. The generally accepted meaning of compensation is all forms of financial returns, tangible services and benefits employees receive as a part of an employment relationship.

These returns are two types - *total compensation*, which includes cash compensation and benefits; the second one is *relational returns* that include recognition, security, challenging work and learning opportunity

12.3.1 The objectives of Compensation Management

The objectives of compensation management are:

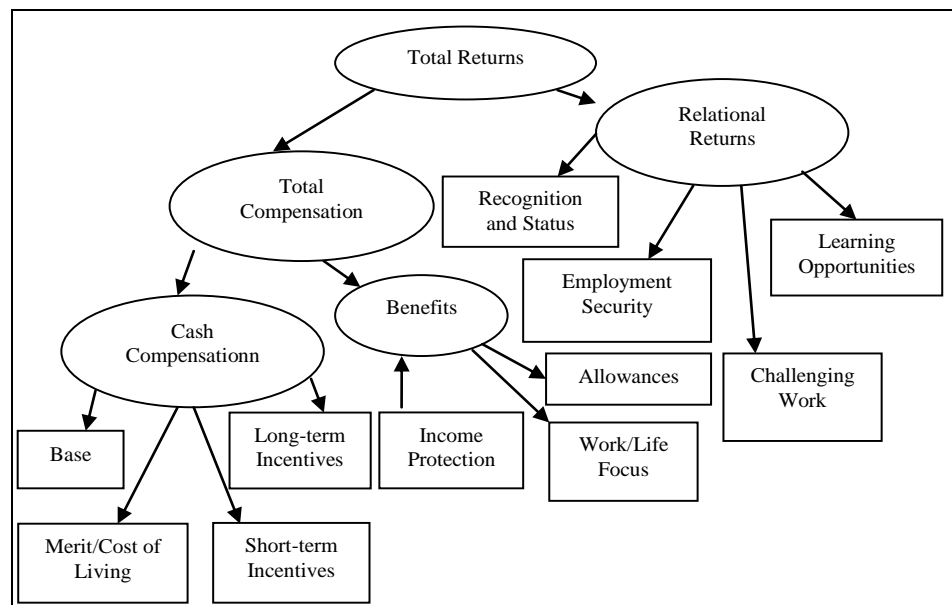
- Compensation should be equitable and each person should be paid fairly and fair treatment is to be given for all employees, taking in to consideration their efforts, abilities and training.
- Compensation should be such that it attracts and retains talented employees.
- Balanced-pay benefits and other rewards should provide a justifiable reward package. It should strike a balance between the needs of the employees and the capabilities of the organization.

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- Compensation should be cost effective. The pay should be such that it is within the affordability range of the company. It should be optimum with a linkage to performance and affordability.
- Compensation should be able to meet the basic needs of the employee and secure enough to lead a dignified life.
- Compensation should be such that it enhances performance and efficiency of the employee and increases quality of the products and services.
- Compensation should be in compliance with government laws and regulations, and if global, compliance with all laws of other countries.
- Compensation should motivate employees for superior performance and productive work.
- Compensation should be consistent and acceptable to the employees and should take into consideration the internal factors like the criticality of the job and performance of the employee and externally it should be at par with industry. The employee should feel that the compensation is reasonable and worthy.

Figure 12.1 shows total returns for work.

Figure 12.1: Total Returns for Work



Source: George Milkovich, Jerry Newman, Carolyn Milkovich: *Compensation*, McGraw-Hill Education, 9th Edition, 2008

12.3.2 Components of Compensation

The components of compensation are:

- *Wage and salary*: This is the fixed pay.
- *Incentives*: This refers to the additional payments to employee besides wages and salary often linked with productivity and performance.

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- *Fringe benefits:* The fringe benefits include provident fund, gratuity and pension, medical benefits, accident relief, health, life insurance, job uniforms, canteen facility and the like.
- *Perquisites:* Perquisites or perks include company car, residential accommodation, paid holiday trips, stock options, club membership and the like.

Example

Over and above the easy and flexible working hours, employees at Microsoft are provided with medical, vision and dental care, physical well-being programs, disability support employee stock purchase plan, loan refinancing program, group legal plan and family support care to name a few.

For more details, check out <https://careers.microsoft.com/us/en/usbenefits> (accessed on 23/4/2022)

12.4 Role of Work Analysis - Work Evaluation in Deciding Compensation

Work analysis also known as job analysis, plays a vital role in compensation management and performance management. Work analysis is the systematic process of collecting information that identifies similarities and differences in the work.

Work Analysis is useful in providing:

- Information relating to the different aspects of the jobs and
- Information regarding what activities to perform in a particular job,
- Indication how to perform them,
- The skills and responsibilities to assume in order to perform them well
- Its impact in achieving the individual and organizational performance expectations

Features of work analysis or job analysis are:

- It tries to identify the content of a job in terms of activities involved and attributes or job requirements needed to perform the activities
- It provides information to organizations which helps to determine which employees are best fitted for specific jobs.
- It helps to understand what the important tasks of the job are, how they are carried out
- It enumerates the necessary human qualities needed to complete the job successfully
- Job analysis involves the analyst describing the duties of the incumbent
- Job analysis deals with the nature and conditions of work

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- Job analysis is crucial for first, helping individuals develop their careers, and also for helping organizations develop their employees in order to maximize talent.
- The outcomes of job analysis are key influences in designing learning, developing performance interventions, and improving processes.
- It helps to develop programs to recruit, select, train, and appraise people for the job as it will exist in the future.

In simple terms, the deliverables of job analysis are job specification and job description which provide the following details:

- The purpose of the job
- The physical and mental activities the worker undertakes
- The nature of the job - The tasks and activities to be performed by the job holder
- The qualifications required by the job holder to perform the job

All this helps in fixing compensation for each job.

The three Ps of Compensation Management are:

1. *Compensation for Position* - Takes into account the qualifications, education and training one possesses to offer a particular position
2. *Compensation for Person* - To determine the pay structure that is both equitable and competitive. The competencies of the person are important here.
3. *Compensation for Performance* - The basis for fixing a pay is the performance of the person-how well he/she performed or reached the targets.

Work Evaluation in Deciding Compensation

Different wages/salaries are paid to different worth of jobs. The relative worth of a job means relative value produced. Depending upon different responsibilities, skills, efforts, and working conditions, compensation is decided.

Job is evaluated on the basis of the following factors:

- Know-how - Includes technical, human and managerial know-how
- Problem-solving and Accountability - How much accountability rests with the job
- Education - How much knowledge is required
- Experience - How much experience is required to handle the job
- Complexity of the job - How much time is taken for learning and adapting to the work and how complex the job is to handle
- Scope of job - The length and breadth of the job
- Supervision received - How much guidance is required
- Authority exercised - How much authority is vested with the job

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All these factors are required to determine and evaluate a job for which appropriate techniques are to be used.

Job Evaluation Techniques

There are three ways in which jobs are generally evaluated.

1. *The Point Method* - In point method each factor is defined and assigned certain points based on the value the factor carries to the company. The relative importance of each factor is weighted to know the worth of the job.
2. *Simple Ranking Plans* - In this method each component is ranked from lowest to highest to know the worth of the job.
3. *Paired Comparisons* - Two jobs are paired and compared and if there are many jobs, a comparison will be made for every two jobs and valued. Jobs with higher scores/points are considered more valuable than jobs with lesser scores/points.

Example

Alphabet Inc's Google had a plan to discontinue its Engineering Residency Program that was designed for entry-level engineers from underrepresented backgrounds. But the participants complained of "systemic pay inequities" (Courtesy: Reuters). Then Google carried out extensive job evaluation to address the same.

For more details, check out: <https://www.reuters.com/technology/exclusive-google-drops-engineering-residency-after-protests-over-inequities-2021-06-22/> (accessed on 23/4/2022)

12.5 Components of CTC

It is a known fact that compensation is closely associated with performance of employees. Organizations analyze how much they have to spend on an employee for getting the required performance. This type of analysis continues till the employee retires because cost to company (CTC) and performance of an employee are positively correlated.

Cost to Company- CTC is the amount that costs the company or the amount the company spends – *directly or indirectly* – because of employing the person.

Thus, CTC is the money given to employee plus the money spent by the company because of employing the person, which is inclusive of salary paid to the employee plus deductions. To understand clearly, let us explain the terms associated with CTC:

- *Gross Salary* - Amount of salary paid after adding all benefits and allowances before deducting tax.
- *Net salary* - It is generally the take home salary after deductions made by the employer.

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- *CTC* - The cost incurred by the employer, in other words, all the costs associated with an employment contract. CTC includes compulsory deductions or contributions made by the company like Provident Fund, Medical Insurance and expenses incurred for hiring, maintaining and retaining the employee.

Let us look at the components of CTC:

- *Basic Pay* - Fixed compensation paid as basic salary
- *Dearness Allowance (DA)* - refers to allowances paid to employees in order to face the increasing dearness of essential commodities
- *Allowances* - include Incentives or bonuses, Conveyance allowance, House Rent Allowance (HRA), Medical allowance, Leave Travel Allowance or Concession (LTA/LTC), Vehicle Allowance, Telephone / Mobile Phone Allowance and Special Allowances All the above are a part in-hand salary, and therefore, are a part of CTC pay as well.
- *Deductions* - Include deductions like Provident Fund, Medical Insurance. Generally, an employee has to contribute 12% of basic salary towards provident fund (PF). Employer makes an equal contribution (12% of the basic). PF is an expense that a company incurs on the employee every month. PF rules vary from company to company as also according to the rules stipulated by the government.
- *Performance-Linked Pay* - Many companies pay their employees, generally annually, on the basis of productivity and performance of the employee.
- *Taxes* – Deductions are made and credited to the Income Tax department

The Ministry of Labour and Employment, Government of India has, with effect from 1 September 2014, brought into force several important amendments to the following existing schemes:

These amendments have enhanced the applicability, scope and benefits provided to employees under the EPF Act. It has also increased the liability of the employers who would now be responsible to enroll additional eligible employees and to contribute on the increased statutory wage ceiling.

Example

In 2021, McDonald's Corp announced its performance-linked pay for its managers. It tied its executive bonuses to diversity and inclusion goals.

For details, check out <https://economictimes.indiatimes.com> (accessed on 23/04/2022)

12.6 Diagnosing the Current Situation

It is essential to diagnose the current situation for taking up decisions with regard to performance and enhancing the compensation of employees.

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For taking critical decisions and taking up action plans for future development, organizations conduct current situational analysis. In the context of compensation management, current situational analysis refers to the analysis of current compensation system so as to develop a compensation strategy for future development. Preparing a comprehensive and impartial compensation structure is key to attracting and retaining talent. For this, the current situation needs to be analyzed. It comprises the following steps:

1. Assessing the existing internal environment- getting up-to-date information on important aspects of job in line with:
 - a. Job positions
 - b. Job description for each position
 - c. Job rating of each position
 - d. Employee's current pay
2. Analysing employee data in terms of:
 - a. Number of vacant positions
 - b. Number of requirements position wise
 - c. Present salaries paid
 - d. SWOT analysis of the employees
3. Market comparison to identify:
 - a. Current rate paid to similar positions in other organizations in the same industry.
 - b. Skill shortage
 - c. Compare present rate with market rate
 - d. Find average pay rate through statistical analysis-regression line
4. Actionable to examine:
 - a. The gaps
 - b. Action-orientation to bridge the gaps
 - c. Pay equity and framing rational pay policies
 - d. Adapting internally equitable and externally competitive philosophy and practice for paying employees

Example

As per the reports of moneycontrol, Cognizant attrition rate touched record high of 31%; and the company made 100,000 lateral hires in 2021. Jan Siegmund, CFO of Cognizant said that these costs weighed on its results for the next several quarters as management focuses on comprehensive initiatives like job promotions, job rotations and many more. This serves as an illustration for pay revisions.

Source: ICFAI Research Center

12.7 Market Comparisons

Organizations keep a constant watch on prevailing market rates for specific jobs. In other words, organizations analyze how much is to be paid for different jobs requiring different types of efforts and performance. Prevailing market rates are taken in to consideration before fixing compensation for different jobs.

Enterprises are driven by market forces. Each job hence has a market rate and it is common for every job holder and also every job provider to compare compensation with the market rate. Companies determine compensation of employees in relation to market price, depending upon their internal factors. Accordingly, they are classified in three ways:

- *Market Lead*- where employees are compensated higher than market rate
- *Market Lag*- where employees are compensated lesser than the market rate
- *Market Match*-where employees are compensated at par with market rate

Generally, companies rely on standard company surveys and keep them as a benchmark for fixing compensation of employees. Company surveys provide information about competing companies and company practices. Companies try to integrate internal job structure with external market pay rates.

Market comparisons help the organizations in:

- Hiring and retaining competent employees
- Promoting worker productivity
- Developing an adequate and acceptable pay structure
- Recognizing market trends in the market place
- Defending pay practices in a court of law

Example

In the annual “Googlegeist” survey 2022, Google workers gave their employer particularly poor marks on compensation compared to pay for similar jobs at other companies. Employees also said that they face growing bureaucracy that slows them down, survey results showed.

For details, check out <https://www.cnbc.com/2022/03/14/> (accessed on 23/4/2022)

Check Your Progress - 1

1. Which of the following comes under relation returns of compensation management?
 - a. Bonus
 - b. Increment
 - c. Challenging work
 - d. Incentive
 - e. Salary

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2. Ramesh, MD of company X was provided with the facility of company car to and fro from his home. To which category of compensation this facility belongs to?
 - a. Wages
 - b. Incentives
 - c. Fringe benefits
 - d. Perquisites
 - e. Bonus
3. Ram before joining an MNC was briefed by his boss on what is to be done and how it is to be done in his job. What was the boss trying to explain to Ram?
 - a. Job description
 - b. Job specification
 - c. Job analysis
 - d. Job evaluation
 - e. Job briefing
4. Which of the following is referred to the amount of salary paid after adding all benefits and allowances before deducting tax?
 - a. Net salary
 - b. CTC
 - c. Gross Salary
 - d. Compensation
 - e. Total salary
5. Zarina Begum, B. Pham with three years' experience in Ranbaxy is being paid a compensation of INR 80000 per month. She tried to analyze her compensation and found that in a pharmaceutical company a person with similar qualification and experience is being paid INR. 65000. Which of the following is the compensation plan in Ranbaxy?
 - a. Market lead
 - b. Market lag
 - c. Market match
 - d. Market ego
 - e. Market trend

12.8 Preparing Compensation Revision Plans

After making market comparisons, compensation revision plans are to be prepared. Comparisons tell the gaps in compensation components. One has to identify not only the financial aspects but also the existing gaps in skills, knowledge and competencies. These gaps negatively affect the performance of organizations. After assessing the existing gaps, revision plans are to be prepared.

Efforts should be made to attract talented people by offering competitive compensation and retain the existing talented pool by revising their compensation. Compensation revision plans should contain best in class compensation which is fair and equitable. The word of caution is revision plans should not only match with the goals and objectives of the company but also company's financial capabilities.

12.8.1 Communicating and Implementing Compensation Revision Plans

After revising the plans, all revision plans should be communicated to all stakeholders. Communication should go through varied channels so that it reaches the potential candidates.

The following steps need to be taken before communicating the revision plans to its stakeholders:

- *Preparation* - A thorough preparation is required for communicating the revision plans to the stakeholders. They should work on the points to be communicated and be prepared to face questions from stakeholders. They must be prepared with justifying the revision plans worked on and must be thorough with the implications of plans. They should make sure about the affordability of these measures to the company.
- *Conducting meetings for communication* - Meetings are to be conducted with the stakeholders in an amicable and conducive environment. All their queries should be clarified. The meetings should end with a positive note for implementation.
- It is not always possible to communicate face to face to stakeholders. Care should be taken to communicate to all stakeholders through different channels.
- A consensus for implementation should be arrived at.

The following steps need to be taken for implementing compensation revision plans:

- Serious efforts should be put for implementation of revision plans
- The revision plans should come into force in earliest possible time.

As such communicating and implementing compensation revision plans remain as an important aspect of compensation management

Example

Tata Consultancy Services (TCS), India's largest information technology (IT) firm, rolled out salary hikes for all of its over 469,000 employees from April 2021 – the second raise in six months. TCS was the first IT services player to announce salary hikes for FY22.

Source: ICFAI Research Center

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12.9 Tax Considerations

As discussed earlier, not all the compensation reaches the employee. Many deductions take place. From the CTC, PF and taxes are important deductions that organizations make, the former for the security during old age and the latter is what the employee needs to pay to the Government. But while paying taxes to the government, several considerations are given to employees.

Tax considerations are those allowances which are exempted from paying taxes. They are known as tax exemptions or applicable deductions or tax benefits. Pay packets are restructured in such a way that they are exempted from paying taxes. For instance, expenses like house rent, medical, transport, education, house loans, insurances are various examples which warrant tax concessions.

The purpose of providing tax considerations is to enable employees to have maximum value for the given compensation package. Government stipulates rules and regulations from time to time either to add or delete provisions for tax payment.

Taxes are major revenue for any government. Individuals, corporate, estates, trusts are required to pay income taxes. Taxable income is the difference between the gross income and deductions. From time to time, the calculations of income tax are changing. The Finance Minister while presenting annual budget underlines the tax exemptions, which are applicable for that financial year, which starts from 1st of April.

Tax exemption calculations vary depending on gender, marital status and number of dependents. Likewise, nature of capital gains and also nature of business/work undertaken also impact tax deductions.

Exhibit 12.1 illustrates the income tax slabs for FY 2022-23.

Exhibit 12.1: Income Tax Slabs for FY 2022-23

The finance minister, Nirmala Sitharaman, did not announce any change in the tax slabs or rates in Budget 2022.

Income Tax slabs and rates for resident individuals are as follows:

- For income upto Rs. 2.5 lakh – Nil
- From Rs. 2,50,001 to Rs. 5,00,000 - 5%
- From Rs. 5,00,001 to Rs. 7.5 lakh - 10%
- From Rs. 7,50,001 to Rs. 10 lakh -15%
- From Rs. 10,00,001 to Rs. 12.5 lakh - 20%
- From Rs. 12,50,001 to Rs. 15 lakh - 25%
- From Rs. 15,00,001 and above - 30%

Contd....

Tax rebate of up to Rs. 12,500 is available to an individual taxpayer under section 87A of the Income-tax Act, 1961. This would effectively mean that individuals having net taxable income of up to Rs. 5 lakh would not pay any income tax.

A cess at the rate of 4 percent is added on the income tax amount. Further surcharge is levied at different income tax rates if the total income exceeds Rs. 50 lakh in a financial year.

Under the old income tax regime, basic tax exemption limit for an individual taxpayer depends on their age and residential status. However, in the new tax regime, the basic exemption limit is Rs. 2.5 lakh in a financial year.

Source: <https://economictimes.indiatimes.com/> (accessed on 24/04/2022)

12.10 Pension Plans

A retirement plan is a financial arrangement designed to replace employment income upon retirement. These plans may be set up by employers, insurance companies, trade unions, the government, or other institutions.

Retirement Plans in USA

The Employee Retirement Income Security Act of 1974, or ERISA, is a federal law that sets minimum standards for pension plans in private industry.

The benefits of ERISA are enumerated below:

- It protects the assets of millions of Americans so that funds placed in retirement plans during their working lives will be there when they retire.
- It sets minimum standards for participation and the law specifies minimum number of years of service to become eligible for participation.
- It gives participants the right to sue for benefits and breaches if violated. It guarantees payment of certain benefits if a defined plan is terminated.

There are three kinds of retirement plans.

1. Pension Plans

Pension plans are deferred arrangements. They are in existence for a long time in civil service and government organizations. They provide payments over a prescribed schedule. The actual amount of the pension depends on the employee's base pay and length of service. Pension plans are two types - defined benefits plan and defined contribution plan.

- *Defined benefits plan* – Under this plan an employee's pension is calculated on average earnings in the highest 3 years of employment multiplied with 2% times the total years of service. It is not unusual for an employee with around 30 years of service to receive 50 to 60% of his salary as pension under this plan.

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- *Defined contribution plan* – Under this plan, an employee's pension depends on the actual amount contributed and the increased earnings of the invested funds. For example, if an employee contributed 5% of his salary with around 30 years of service, he will receive 15% of his salary as pension.

Retirement Plans in India

Pension plans in India are intended to provide financial security during old age when people will not have a regular source of income. Retirement plan ensures that people will be able to maintain a decent standard of living during post retirement life. Pension plans help employees to get lump sum amount as regular income through annuity plan on retirement by saving certain amount during their working period.

National Pension System

NPS (National Pension System) is launched by Government of India in 2004 with a view to provide old age income and old age security to its employees. Initially in 2004, it was applicable to new entrants of Central Government services except the Armed Forces. Later State Governments also followed the suit. The scheme was made available to all citizens with effect from 1st May 2009 on voluntary basis. Since December 2011, NPS was provided to the employees of corporate sector also.

A unique Permanent Retirement Account Number (PRAN) is allotted to each employee upon joining NPS. NPS accumulates savings into subscribers' accounts during the tenure of the subscriber and the accumulated amount is used at retirement as a pension for the rest of his life.

The Government of India added in NPS a new scheme named Atal Pension Yojana (APY) for the welfare of all citizens working in the unorganized sector during 2015. The minimum age of joining APY is 18 years and maximum age is 40 years.

Funding of APY-Government would provide:

- (i) Fixed pension guarantee for the subscribers
- (ii) Co-contribute 50% of the total contribution or Rs. 1000 per annum, whichever is lower, to eligible subscribers
- (iii) Would also reimburse the promotional and development activities including incentive to the contribution collection agencies to encourage people to join the APY.

Basic Issues Considered in Pension Plans are:

- *Standard Retirement Age* - Generally the standard retirement age ranges between 60-65, depending on the type of organization.
- *Size of benefits* - The amount of benefits employees receive are increasing from year to year as organizations take in to consideration cost of living index and inflation rates.

- *Discrimination in plan design* - There was discrimination earlier against women in fixing pension rate. Many legal suits were taken up to end this practice.
- *Early Retirement* - Reduced pensions are provided to people who retire early, but with stipulated years of service.

2. Profit-sharing

It is a plan that gives employees a share in the profits of the company and under the plan each employee receives a percentage of the profits earned by the company. It provides a sense of ownership in the company to the employees. For exceeding financial goals, profits are distributed equally among all employees in proportion to their incomes. Profit sharing plans can be a powerful tool in promoting financial security to employees after retirement.

3. Stock-bonus Plans

In a qualified stock bonus plan, employer contributes stock to the plan, similar to that of a defined contribution plan. Many pension plans permit an employee to receive pension to the spouse after his death as reduced pension.

Employee Stock Ownership Plan (ESOP)

An employee stock ownership plan (ESOP) is an employee-owner method that provides ownership to employees with an interest in the company in an ESOP. It is a contributory retirement plan, where employees participate in corporate ownership. Companies provide their employees with stock ownership, often at no up-front cost to the employees. ESOP shares, however, are part of employees' remuneration for work performed. Shares are allocated to employees and may be held in an ESOP trust until the employee retires or leaves the company. Under ESOP, employer contributes stock to an employee stock bonus trust (ESOT).

ESOPs are two types -

Stock bonus ESOP: In a stock bonus ESOP, employee contributes company stock to the ESOT.

Leveraged or leverageable ESOP: In a leveraged ESOP, the employer uses the special privileges granted to an ESOT to obtain funding for various purposes. The stock becomes part of an employee profit-sharing or retirement program. Employees receive the stock upon retirement along with special tax credits for the value of the stock the company bought for the employees.

Savings or Thrift Plan

Many organizations have developed savings or thrift plans for their employees. Under these plans, employees set aside certain amounts of earnings in order to have a secure and happy retirement. The organization contributes 50-100% amount saved by the employee. These amounts are eligible for tax exemptions. There will be a ceiling on savings, which should not exceed 25% of the salary of the employees.

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Individual Retirement Account (IRA)

Individuals who do not participate in any retirement plans are eligible for IRA. The employee can contribute up to \$3000 under this plan and the amount increases year by year. The contributions under IRA are tax deductible. The IRA owner has the freedom to select his own investment plan.

Simplified Employee Pension Plans (SEP)

SEP permits employers to establish a qualified IRA program for employees of 25 years age. These plans are similar to qualified plans

Savings Incentive Match Plan for Employees (SIMPLE)

SIMPLE is meant for employees with less than \$5000 income per month and in a company with less than 100 employees. Employee using SIMPLE plan should not contribute to any other qualified plan. Both employee and employer contribute to the saving with lot of flexibility.

Keogh (HR-10) Plan

This is meant for self-employed persons such as partners or sole proprietors for themselves or their employees. There are three types in this plan:

- Profit-sharing plan
- Money-purchase plan
- Paired-plan

Roth and Education IRAs

All incomes under this plan are tax free and there is no age limit to contribution. The money is to be used only for education purposes.

College Savings Plan

This plan also provides enhanced options for education savings and earnings on these plans are tax free. There are no income restrictions to participation.

Example

In July, 2021, the Chief Executive Officer of Flipkart Group, Kalyan Krishnamurthy announced a buyback of 5% of the past three years' vested options leading to a spending of about 600 crores thereby enabling the employees to liquidate up to 10% of their vested shares given by the management in the earlier years depending upon their individual holding pattern.

For more information, check out <https://economictimes.indiatimes.com/tech/> (accessed on 23/4/2022)

12.11 Executive Compensation

Executives play a vital role in organization development; hence, their compensation should also match their position. Executives belong to the highest

decision-making group such as CEOs, full-time Directors, Senior Managers etc. In India and all other countries, executive compensation is a point of discussion-how much it should be, what their components are and how it is to be fixed.

Factors affecting executive compensation are:

- Complexity of the job they hold - This complexity entails them for higher compensation.
- Competencies required - Executives have to handle crucial situations and are responsible for the overall development of the organization, requiring superior competencies.
- Capacity to pay - Higher executive pay is directly related to the affordability of the company.
- Organizational philosophy - Executive compensation depicts the image and philosophy of the company.
- International impact - Many of the international companies look at executive compensation for a tie-up with the organizations.
- Legal implications - Several legal implications are involved with executive compensation.

Example

The 2021, Executive Rewards Survey in India by Aon, states that the median CEO compensation in India ranges from Rs. 15 crores for owner promoters to Rs. 3.63 crores to the Indian private companies, barring the long-term incentives.

For details, check out <https://www.business-standard.com/article/management/aon-survey-projects-6-salary-hike-in-2021-for-senior-executives-in-india-> (accessed on 23/04/2022)

12.12 Different Types of Compensation

Compensation may be of different types. The same have been enumerated below:

- *Seniority pay:* It is a traditional practice to fix employee's pay on the basis of seniority or length of service. This is the essence of human capital theory which states that employee's knowledge and skills generate productive capital known as human capital.
- *Merit Pay:* Wage increase granted to employees on the basis of performance. It is based on subjective appraisal of employee performance. Only when performance appraisals are conducted efficiently, merit pay has certain value. This helps in retaining company's valued employees.
- *Lump-sum bonus:* Granted for performance as one-time payment
- *Incentive pay:* Incentive pay or variable pay rewards employees for partially or completely attaining a pre-determined work objective. There are three types of incentive pays:

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- *Individual incentive*: It is variable pay for individual performance
- *Group incentive plans*: It is paid to groups for a particular achievement
- *Company-wide plans*: It is paid to employees for company's performance over a period of time
- *Pay for performance*: These are generally rewarded to employees for acquiring job related competencies, knowledge or skills rather than for demonstrating successful job performance. There are two types in it- pay for knowledge and skill based pay. Both skill and knowledge based pay programs reward employees when they apply their knowledge and skills productively in their jobs.
- *Gain sharing*: Gains made by companies (as depicted by increased productivity, increased customer satisfaction or better safety records) are distributed to departments that contributed to the gains. Gain sharing is given to the employees, usually as a lump sum bonus. There are three major types of gain sharing:
 - *Scanlon plan*: This is paid on the basis of labor costs.
 - *Rucker plan*: This is paid on the basis of labour costs, raw materials and monthly service costs.
 - *Improshare*: This is paid for completing the work at or sooner than production standard.

Different types of pay discussed above show that there are large number of types and organizations, as per their norms, stipulations and rules follow any one or few of them.

Example

In 2021, Accenture announced a week's base salary to be paid to the employees below the managing director and thus indicating that the IT service sector is back on the growth path despite the ongoing Covid-19 pandemic. This serves as an illustration for bonus.

Source: ICFAI Research Center

Check Your Progress - 2

6. Sushmita, aged 45, working for an Insurance company is paid 30000 per month. What could be her tax deductions, considering that all her income is taxable?
 - a. No tax
 - b. 10%
 - c. 20%
 - d. 30%
 - e. 35%

7. Which of the following refers to the federal law that sets minimum standards for pension plans in private industry?
 - a. COLA
 - b. IRA
 - c. SIMPLE
 - d. CODA
 - e. ERISA
8. What is the plan that provides ownership to employees with stock ownership?
 - a. COLA
 - b. ERISA
 - c. ESOP
 - d. CODA
 - e. IRA
9. Which of the following is the most important factor for calculating pension of an employee?
 - a. Location
 - b. Size of the company
 - c. Large income
 - d. Length of service
 - e. Personality
10. Individuals who do not participate in any retirement plans are eligible for which type of plan?
 - a. COLA
 - b. ERISA
 - c. ESOP
 - d. CODA
 - e. IRA

12.13 Summary

- Compensation management is an important component of performance management. Compensation should be fair and equitable so that employees lead a dignified life.
- It should be cost effective and attract and retain talented people.
- Compensation is of two types- monetary and relational.
- Compensation includes wage/salary, incentives, fringe benefits and perquisites.

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- In addition to salaries companies offer several benefits to employees while at work and also at retirement. -
- As executives are responsible for the major growth of the organizations, special emphasis is given to their compensation.
- The whole unit is concentrated on the various implications of compensation system.

12.14 Glossary

Cost to Company - CTC is the money given to employee plus the money spent by the company *because of employing the person*.

Employee Retirement Income Security Act or ERISA - It is a federal law that sets minimum standards for pension plans in private industry

Employee Stock Ownership Plan (ESOP) - An employee stock ownership plan (ESOP) is a contributory retirement plan, where employees participate in corporate ownership

Gain sharing - Gains made by companies as depicted by increased productivity, increased customer satisfaction or better safety records; are distributed to departments that contributed to the gains.

Job Analysis - Process of studying and collecting information relating to the operations and responsibilities of a specific job.

Job Description - It tells what is to be done, how it is to be done and why. It is an organized statement of the duties and responsibilities of a specific job.

Job Evaluation - It is a systematic and orderly process of determining the worth of a job in relation to other jobs.

Job Specification - It specifies the minimum qualities required for acceptable performance.

Profit-sharing - It is a plan that gives employees a share in the profits of the company and under the plan each employee receives a percentage of the profits earned by the company

12.15 Self-Assessment Test

1. Explain the components and objectives of compensation management
2. Discuss the importance of work analysis and work evaluation in compensation management
3. What are the components of cost to company? Explain the same with an example, not given in the unit
4. Discuss various pension plans
5. Critically evaluate executive compensation

12.16 Suggested Readings/Reference Material

1. John Shields, Jim Rooney, Michelle Brown, Sarah Kaine; Managing Employee Performance and Reward: Systems, Practices and Prospects, 3rd Edition, Cambridge University Press, 2020
2. Susan L. Verhulst, David A. DeCenzo, Rama Shankar Yadav; Human Resource Management, 13th Edition, Wiley, 2021
3. Durai Pillai, Total Reward Strategy: Retain Your Best Talent, 1st Edition, Notion Press, 2020
4. Stephen J Perkins, Sarah Jones, Reward Management: Alternatives, Consequences and Contexts, 4th Edition, Kogan Page, 2020
5. Kevin R. Murphy, Jeanette N. Cleveland, Madision E. Hanscom, Performance Appraisal and Management, Sage Publications, 2020

12.16 Answers to Check Your Progress Questions

1. (c) Challenging work

Some of the relational returns of work are challenging work, employment security, learning opportunity, recognition and status.

2. (d) Perquisites (Perks)

Perks include company car, residential accommodation, paid holiday trips, stock options, club membership and the like.

3. (a) Job description

It tells what is to be done, how it is to be done and why. It is an organized statement of the duties and responsibilities of a specific job.

4. (c) Gross Salary

Amount of salary paid after adding all benefits and allowances before deducting tax.

5. (a) Market Lead

where employees are compensated higher than market rate.

6. (b) 10%

Females earning between 2.5-5 lakhs are taxed at the rate of 10%.

7. (e) ERISA

Federal law sets minimum standards for pension plans in the private industry through ERISA

8. (c) ESOP

An employee stock ownership plan (ESOP) is a contributory retirement plan, where employees participate in corporate ownership

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9. (d) Length of service

Income last drawn and length of service are important factors for calculating pension.

10. (e) IRA

Individuals who do not participate in any retirement plans are eligible for IRA.

Unit 13

Job Evaluation and Pay Structure

Structure

- 13.1 Introduction
- 13.2 Objectives
- 13.3 Concept and Definition of Job Evaluation
- 13.4 The Need for Job Evaluation
- 13.5 Methods of Job Evaluation
- 13.6 Importance and Objectives of Pay
- 13.7 Pay Structure
- 13.8 Broad Banding
- 13.9 Summary
- 13.10 Glossary
- 13.11 Self-Assessment Test
- 13.12 Suggested Readings/Reference Material
- 13.13 Answers to Check Your Progress Questions

“It is difficult to get a man to understand something when his salary depends upon his not understanding it”

- Upton Sinclair

13.1 Introduction

As has been popularized by Upton Sinclair, deciding the worth of the job relative to other jobs in the organization would help formulating appropriate pay structure in the organization and elevate the motivation and morale of the employees. In the previous unit, we have examined compensation management as an important component of performance management.

Job evaluation is the formal process of deciding the relative worth of the job. Subsequently, the pay structure gives the framework for implementing the pay policies through the organization.

This unit will focus on the concept of job evaluation followed by discussion on the various methods of job evaluation. The unit closes with a comprehensive look at the concept of pay and its related components, such as pay structure and broad banding.

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13.2 Objectives

After studying this unit, you should be able to:

- State and explain the concept of job evaluation
- Examine the need for job evaluation
- Enumerate the objectives of job evaluation
- Explain the methods of job evaluation
- Justify the importance of pay
- Describe the concept of broad banding

13.3 Concept and Definition of Job Evaluation

Job analysis describes the duties of a job, authority relationships, skills required, conditions of work, and additional relevant information. Job evaluation, on the other hand, uses the information derived through job analysis to evaluate each job – each component is valued and the relative job worth ascertained

Job evaluation is a process of determining the relative worth of the various jobs within the organization, so that differential wages may be paid to jobs of different worth.

Process of job evaluation is explained below:

- It rates jobs in order to determine their position in the job hierarchy. This evaluation may be achieved through a formal assignment of points to different jobs or through evaluating skills, experience, and responsibility of the person concerned.
- During the process of job evaluation, various positions are analyzed and described. These are then grouped in order to determine their relative value through a comparison of the duties of different positions in terms of their different responsibilities and other requirements. In other words, it can be said that job evaluation involves the quantitative measurement of the relative job worth for the purpose of establishing consistent wage rate differentials through objective means.

It should be emphasized that job evaluation does not consider the performance of an individual on the job. It does not look at how well the individual performs the job. This also means that job evaluation is an attempt to determine and compare demands which the normal performance of a particular job makes on normal workers – without taking into account the individual abilities or performance of the workers concerned.

Example

Virgin Media Inc is a UK-based company that provides broadband internet services to fixed/mobile telephone and television for consumers and businesses as well.

Contd....

Virgin Media was successful in expanding to different markets as its works adapt to changes quickly keeping organization ahead of their competitors. For designing competitive pay structures, Virgin Media continuously assesses the skills of its workforce. It measures the number of workers who underwent training, lists their qualifications, skills, competencies and experiences for future plans with respect to recruitment, training to name a few.

Source: ICFAI Research Center

Activity 13.1

Job Analysis

You have been appointed as recruitment specialist in Synchrony Financial, a financial software and business analytics company. You were asked to analyse the job of a Data Scientist for the organization. Please describe it.

Answer:

Check Your Progress - 1

1. Job evaluation achieves a number of objectives. Which of these would be true?
 - i. Ranking of jobs in the hierarchy.
 - ii. Determining the worth of various jobs in the organization.
 - iii. Grouping of jobs.
 - iv. Determining and comparing the demands which the normal performance of a job makes on normal workers.
 - a. i
 - b. iii
 - c. iv
 - d. i, ii, iii, and iv
 - e. ii
2. Which of the following is the best way to define a job?
 - a. Performing an activity.
 - b. Getting paid for performing an activity.
 - c. Similar activities that are related to each other
 - d. Evaluating the job
 - e. Performing the job

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13.4 The Need for Job Evaluation

There are several reasons for the growing interest in job evaluation in recent times and these are discussed here:

- Job evaluation is a valuable technique to evolve a more rational and consistent wage and salary structure.
- Job evaluation brings about harmonious relations between labour and management through elimination of wage inequalities.
- Given the mechanization and automation in industry, it has become unrealistic to pay workers primarily on the basis of their output. Job evaluation is of use in fixing realistic wages.
- Job differentials should not be based on skill differences alone; various factors such as risks and working conditions should also determine the worth of jobs.
- Job evaluation keeps down the cost of recruitment and selection of workers. Selection can be made objective by matching the qualifications of the candidate with job requirements.
- The process of determining the wage differentials for different jobs becomes standardized through job evaluation.
- An increasingly dynamic economy requires continuous job evaluation.

Example

Gravity Payments, a credit card payment processing company located in Seattle, US believes that income of a person directly influences his emotional health, and generally employees who earn less would be happy if a little extra money was given and improves the motivation and morale of the employees. It pays competitive salaries to its customer service representative, salesmen and clerks despite the fact that it put a toll on the company's profits.

Source: ICFAI Research Center

Check Your Progress - 2

3. Job evaluation is done to set wages and salary on the basis of the relative work or jobs in the organization. In this context, what do you think job evaluation facilitates?
 - a. Working conditions of employees
 - b. Standardizing the work capacities of employees
 - c. Standardizing effort
 - d. Standardizing the development of employees
 - e. Standardizing the performance of an individual
-

13.5 Methods of Job Evaluation

Whenever possible, pooled or combined evaluation is the best way of setting the rates of wages within a firm. A decision must be made concerning what groups of jobs are to be covered by a single evaluation system.

Essentials of job evaluation are:

- A clear and accurate job description and specification must be available to provide data concerning the factors to be measured.
- It must be noted that during evaluation, it is the job that has to be rated and not the employee.
- In deciding how much money a particular job is worth, there is always a temptation to be influenced in one's judgment by the qualifications and caliber of the individual who is present while doing the job.

Example

At McDonald's, the job responsibilities of crew members include attending to individual needs and delivering services fast and compassionately. Crew members are given training on cleanliness and hygiene requirements to maintain high standards in the restaurant. Before direct entry into service section, they are also trained on how to use utensils and cleaning products (chemical) and taking correct and necessary precautions while using equipment.

Source: ICFAI Research Center

The job evaluation method can be classified into two main types depending on the comparison method used:

- *Non-analytical method* in which whole jobs are examined and compared without being analyzed into their constituent parts or elements.
- *Analytical method* in which jobs are analyzed by reference to one or more criteria, factors, or elements.

In both these means of comparison, there are two bases on which comparisons are made:

- *Job-job* where judgments are based on a direct comparison between one job and another, and
- *Job-scale* where the judgments are made by comparing each job with a set scale.

Job evaluation methods are classified as non-quantitative methods and quantitative methods. Let us discuss the same in detail.

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13.5.1 Non-quantitative Methods

The non-quantitative methods of job evaluation along with their relative merits and demerits are discussed below:

Ranking or Job Comparison

This is perhaps the simplest method of job evaluation.

Process of ranking or job comparison is as given below:

- Here, the total or whole job is ranked against other jobs on the basis of difficulty level.
- No measurable points or score values are assigned.
- It is simply arranging the job in a hierarchy. Since the job as a whole is taken into consideration, no attempts are made to break each job into its composite segments.
- First, ranking is done by functional areas, and then they are combined for developing an organization level system.

This method is useful in small organizations with a relatively flat structure.

The most obvious limitation of the ordering method is the sheer inability to manage it as there are a large number of jobs in an organization. It is virtually impossible to do the ranking correctly. Other drawbacks are the subjectivity of the method – there are no definite or consistent standards by which to justify the ranking and employees have no knowledge of the distance between the ranks.

Internal Benchmarking

Internal benchmarking is done intuitively, in order to decide on the value of jobs. The method is used more in smaller organizations that have few formal personnel policies. Usually in this method, a job which is believed to be properly graded and paid is taken as a benchmark and all other jobs which are to be reviewed are compared with it. The comparison is made on a whole job basis without analyzing the job factor by factor. This is referred to as job slotting. This method can lead to equal pay problems.

Advantages of internal benchmarking system are:

- It is realistic in nature.
- Is simple to implement
- It recognizes that this is a natural way of valuing jobs.
- It can produce reasonable results as long as it is based on the comparison of accurate job or role descriptions and is done by people who are familiar with the work involved and its relative complexities.

Disadvantages of internal benchmarking system:

- It relies on judgments which may be entirely subjective, may confirm implicit prejudices, and could be hard to justify if tested analytically.
- It is dependent on the identification of suitable benchmarks that are properly graded and paid, and such comparisons may only perpetuate existing inequities and discrimination.
- It would not be acceptable in cases of equal value.

Job Classification Method

This method consists of first identifying classes, categories, or grades.

Following explains the process of job classification:

- Once the classes or grades are identified, their level of difficulty is identified by defining their specifications and then the individual jobs are classified in those categories/grades.
- The individual jobs may come from various functional areas with common responsibilities and work.
- The classification is sometimes also created by identifying such common denominator-skills, knowledge, and responsibilities, the desired goal being the creation of a number of distinct classes or grades of jobs.
- Once the classification has been established, the categories are ranked in an overall order of importance according to the criteria chosen, and each job is placed in its appropriate classification.
- Compensation levels for each grade/category are allocated and employees working in various departments and sections may end up with the same compensation level as long as they belong to same grade/category.

Though the classification method has proven successful and viable in classifying millions of kinds and levels of jobs in the civil service, it suffers from disadvantages of writing classification, description, judging which job goes where and dealing with jobs that appear to fall into more than one classification.

13.5.2 Quantitative Methods

The quantitative methods are discussed below:

Point Rating Method

Administration of point rating method is elaborated below:

- This method of job evaluation consists of first developing key compensable factors based on which each job must be evaluated.

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- The collection of these key factors is called a manual or yardstick. These manuals can be developed on the basis of the organization's own experience or on those developed through industry-wide effort by various organizations.
- Each of these key compensable factors has a scale value which defines the degree to which the factor is present in the job.
- Each job is rated on these key factors and a value assigned.
- At the end of this exercise, the values of each factor are added to get a total score which is then converted into a compensation level.

Factor Comparison Method

This method is complicated and expensive. It requires consultation with experts and specialists for the comparison and appraisal of jobs to assign weights on key factors.

Process of factor comparison is given below:

- The current rate of pay is used to derive weights for each element of compensable factors in the key jobs.
- After all the key jobs have been analyzed, weights are assigned to the elements by taking an average on the key jobs.
- Thus the money value of one factor in one job is compared to the money value of the same factor in another job. This is what makes this method more acceptable because it is based on the established compensation structure. It is not as arbitrary as the point system

Thus, we see that methods of job evaluation are based on the judgments of those that evaluate the jobs. This sometimes leads to disagreement about the quality and nature of the evaluation being carried out. However, given the absence of more scientific techniques, they are the best approaches available. In fact, with sophisticated software, the methodology can be fine-tuned to give more objective results.

Check Your Progress - 3

4. Of the following, which is the simplest method of job evaluation: Internal benchmarking, job comparison, job classification, job segmentation?
 - a. Job classification.
 - b. Job comparison
 - c. Job segmentation
 - d. Internal benchmarking
 - e. Job evaluation

5. Which of the following can turn into a disadvantage for the Internal Benchmarking system?
 - a. The handling of cases where jobs have a different value
 - b. The absence of factors in grading
 - c. Use of suitable benchmarks that are properly graded
 - d. Internal benchmarking being an intuitive process
 - e. Objective judgements
 6. Which of the following methods involves the development of key compensable factors that are called a manual or yardstick?
 - a. Internal benchmarking
 - b. Job classification
 - c. Point rating
 - d. Factor comparison
 - e. Job evaluation
-

13.6 Importance and Objectives of Pay

Pay is among the most important yet contentious elements in the employment relationship. Given its unique role, it has always been of substantial interest to both the employer and the employees. The Government also monitors the pay levels in various organizations.

The following points enumerate the importance of pay:

- Pay is important for an employer because it forms a significant part of the costs of running the organization. This has implications for the performance of the firm as well as its competitiveness. It also affects an organization's ability to recruit and retain a labor force.
- Pay is important to the employee as it represents the value of his/her performance to the organization and is a measure of the value of his services or performance.
- Pay is important for the government as well as it has implications for the overall level of purchasing power and prosperity of the workforce of the country.

Pay determination can have one or more objectives, which may often be in conflict with each other. The objectives of pay determination can be classified under five broad headings:

- *Establishing Equity:* Pay helps establish equity in the organization, which may translate into raising the wages of the lowest paid employees and the concept of equal pay for work of equal value.

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- *Establishing Efficiency:* Pay helps to establish efficiency which links a part of the wages to productivity, profit, or group or individual performance. Arrangements to achieve efficiency are related to equity as the firm should reward performance.
- *Existence of motivated workforce:* Pay is an important hygiene factor in Herzberg's theory of motivation. This means that an appropriate level of pay should exist in order to prevent dissatisfaction among the employees.
- *Act as a Mechanism to Control the Growth of Pay:* This will ensure that a substantial amount of costs (ie, pay) of the organization, is kept under check.
- *A Matter of Prestige:* Pay is a matter of prestige for the company. A good pay system is a hallmark of a well-functioning organization that helps it to attract and retain talent.

Example

The onset of Covid-19 and the resultant reverse migration of unskilled and semi-skilled labour, have increased the daily wage rates from INR 250 to INR 350-400 as of April, 2021. The minimum wage in India comes under the purview of The Minimum Wages Act, 1948 with amendments as per Code on Wages Act, 2019 that determines the irreducible amount that is necessary for the bare sustenance of the worker and his family along with the preservation of his efficiency at work. This illustrates the importance of establishing equity.

For details, check out <https://www.india-briefing.com/news/guide-minimum-wage-india-2021-19406.html/> (accessed on 25/4/2022)

13.7 Pay Structure

The pay structure provides a framework within which an organization defines the different levels of pay for jobs or groups of jobs. The pay structure is based on the assessment of the relative internal valuation and external valuation of the job.

13.7.1 Objectives of the Pay Structure

The pay structure has the following objectives:

- i. It should establish an appropriate framework for the implementation of fair, equitable, and consistent reward policies.
- ii. The pay structure should facilitate determination of the appropriate levels of pay for both jobs and people.
- iii. The pay structure should act as a basis for monitoring and controlling the implementation of pay practices.
- iv. Last, it should enable organizations to communicate to the employees the pay opportunities that are available.

13.7.2 Characteristics of the Pay Structure

The characteristic features of pay structure are enumerated below:

- i. The pay structures contain pay ranges for jobs which are grouped into various grades, individual jobs, or job families.
- ii. Pay structures point to the existing rates of pay for different jobs.
- iii. They enable pay progression which is in accordance with the performance and competence of the employee.

13.7.3 Types of Pay Structures

There are various types of pay structures. Each structure has a different way of operating. The main types are:

a) *Graded Structures*

These are conventional pay structures. These consist of a sequence of job grades in which jobs of broadly equivalent value are placed. The same has been explained below:

- Each grade has a pay range.
- The maximum range is between 20 percent and 50 percent above the minimum pay.
- The pay range gives the scope for pay progression. Typical pay structures consist of between 6 and 15 grades
- The grades are defined through job evaluation which is in terms of points. The jobs can also be put into grades through the differentials between the pay ranges.

b) *Broad Banded Pay Structures:*

The broad banded pay structure has a range of pay which is higher than in a conventional graded structure. The same has been explained below:

- The band width is quite large and sometimes exceeds 100 percent.
- Band boundaries are defined by job evaluation. A combination of both job evaluation and market rate analysis can be done.
- The bands are given by their generic roles and not hierarchy.
- A broad banded structure gives room for horizontal room in the band, on the basis of activities, contribution, and competence.
- In this structure, pay progression and career development do not always come from being promoted to higher grade.

Example

Toyota had a unique system of job classification where hierarchy of pay grades or salary ranges were compressed into small number of wide bands. Each band thus consisted of a wide range of jobs and salary levels.

Contd....

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There were only 3 plant job classifications such as Division I – all production members, Division II – all general maintenance team members and Division III – all tie and dye members. This serves as an illustration for broad banding.

Source: ICFAI Research Center

c) *Job Family Structures*

A job family consists of related jobs that deal with a similar type of work. The same has been explained below:

- They also require similar knowledge, skills, and abilities. For instance, a ‘Financial’ job family can consist of a number of related jobs such as investment analyst and accountant.
- Each job family will have its own structure which is graded in terms of responsibility, skill, or competence.

d) *Spot Rate Structures*

This is the individual job rate which allocates a specific rate for a particular job. These rates can be set through job evaluation or through market rates. The same has been explained below:

- There is no scope for the basic rate for the job to progress through a defined pay range.
- Job holders can receive a bonus or other forms of incentive payment on top of the base rate.

e) *Pay Spines*

These consist of incremental pay points extending from the lowest to the highest-paid jobs in the structure. The same has been explained below:

- Each spine has a minimum and maximum, with progression based on service.
- The increments may be standardized. For instance, there may be an increment at a standard rate of three percent all through the spine. On the other hand, the increments can be such that they are wider at higher levels.
- Pay scales for different job grades can also be superimposed on the spine. Pay spines are usually found in the public sector undertakings.

f) *Pay Structure for Manual Workers*

This pay structure is used for workers that perform manual tasks. For instance, this rate would be paid for employees who do distribution and transportation. The same has been explained below:

- This pay structure can be arrived at by national, local, or plant negotiations with the existing trade unions. In case the firm is not unionized, the contract the individual makes determines the pay structure.
- It may include numerous spot rates, i.e., fixed base rates for each job that has similar skill or merit
- The pay structure can also be based on the day rate or flat rate. In this arrangement, the workers are paid a predetermined rate for the time period worked.

g) *Integrated Pay Structures*

The integrated pay structure covers groups of employees that are paid under separate arrangements. The same has been explained below:

- It may include numerous spot rates, i.e., fixed base rates for each job that has similar skill or merit.
- Job evaluation is used to arrive at an integrated pay structure.
- Under an integrated pay structure, the old system is abolished and the one that has consolidated pay is used.

13.8 Broad Banding

Broad banding combines salary grades into a few wide bands. Each band consists of a wide range of jobs and salary levels. Broad banding is useful since it avoids the difficulty of making ranges for a very large number of jobs.

Broad banding is the compression of a hierarchy of pay grades or salary ranges into a small number of wide bands. Each of these bands therefore spans the pay opportunities previously covered by pay ranges.

Variations in broad banding structures are:

- Some broad banding structures have zones or sub-bands within bands in order to provide guidance on the pay range for different roles that may come within the band.
- Pay levels in broad banding can be market driven. In other cases, there may be scrutiny in relation to market trends. Thus, the thrust can vary from internal equity to being externally competitive.
- The decisions on pay increases depend on internal equity considerations. There would be comparison between the pay of people with similar roles in job cluster or job families.

Steps to achieve a broad banded pay structure are as given below:

- At the outset, there should be an agreement among the parties concerned that broad banding is the most appropriate pay structure for progression.

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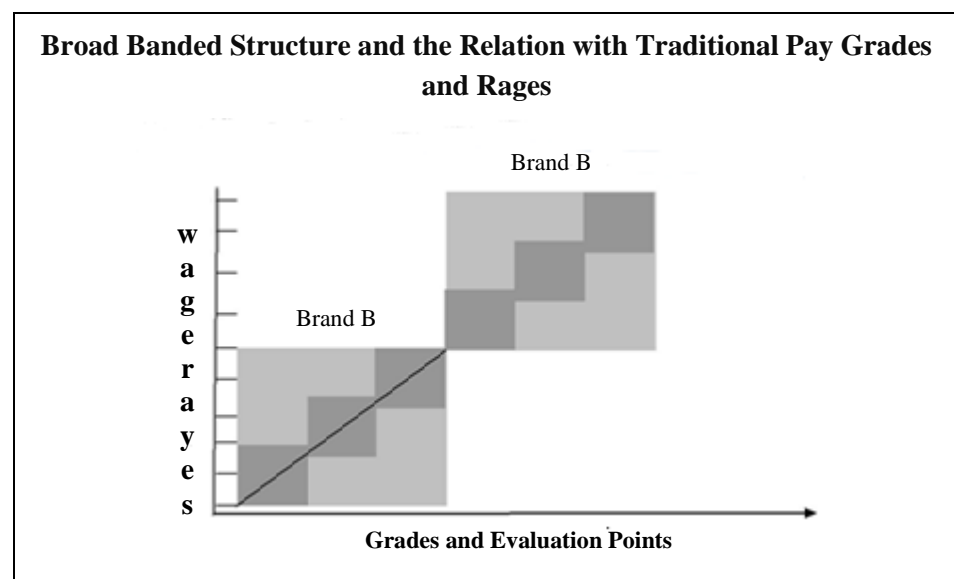
- The number of bands desired should be estimated. This can be done by examining the organizational structure and roles at each level. Subsequently, the size or width of the band should be determined.
- Job evaluation should be carried out to define the band boundaries and devise the appropriate band structures.
- An external pay survey should be done to determine the market rates of pay.
- The roles in the bands would have to be positioned on the basis of the results of job evaluation and market rates. A decision would have to be made on the weight to be given to internal and external relativities. Subsequently, one has to decide the basis for progressing pay within zones and for adjusting pay levels following a change in role.

The existing rates of pay for employees would have to be examined. It would have to be done to identify any increases or establish cases where pay protection may be necessary.

- There is a need to draw up procedures for managing the structure in areas of allocation of roles to bands, use of job evaluation, conduct of pay reviews, etc.
- The managers have to be trained on the new structure for managing pay.
- Last, the details of the new structure and how it will affect the staff need to be communicated.

Figure 13.1 gives a typical broad banded structure showing the relation with traditional pay grades and ranges.

Figure 13.1: Broad Banded Structure



Source: Gary Dessler, *Human Resource Management*, Pearson, 16th Edition, 2020

Activity 13.2**Broad Banding**

Be Healthy is a pharmaceutical company that follows a spot rate structure for fixing pay for its employees. But to provide a greater flexibility for the organization in making and administering pay decisions, it has decided to adopt broad -banding. List out the steps involved in fixing the broad-band pay structure.

Answer:

Advantages of broad banding are:

- It provides greater flexibility for organizations to make and administer pay decisions.
- It creates greater scope for lateral career development since broad bands create a flatter organizational structure.
- It acts as a mechanism that can enable an organization to change from a traditional hierarchical approach to one that is flatter and multi-skilled.
- An organization that operates with a small number of bands can address communication issues more effectively since it places far more employees within the same category.
- By linking Broad Banding with performance, there can be alignment of pay progression with the corporate goals of the organization.
- With more employees falling under the same band, there is a reduction in the status consciousness observed in a narrow banded pay structure.
- When aligned to a competence based method of reward, it can encourage employee development and therefore, multi-skilling.

Disadvantages of broad banding are:

- Status conscious employees feel resentment at the elimination of a narrow banded grading structure and the status it confers.
- Broad banding needs to be monitored. There is a danger of band drift since the number of spinal column points between the lowest and the highest points of a band are considerably greater than in a narrow banded pay structure.
- Market rates of pay will have to be continuously monitored to address recruitment problems due to external competition. This can be a very costly and time consuming process.

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- A broad banded pay structure may not suit the culture of every organization. If it is imposed without the commitment of the majority of the workforce, it can cause significant workforce problems.
- In case employees believe that the decision of their line manager on their pay progression has been subjective, the whole process can be undermined.
- If broad banding is not introduced with a full and clear explanation of how it will affect individual employees, it is highly likely to be rejected since it is too difficult to understand.
- Sometimes if a broad banded structure is linked to a competency based reward system, the scope for employees to acquire new skills may be controlled to avoid costs increasing too rapidly.

Example

Atla Bates Summit Medical Center in the USA, follows clear and concise broadband structure. The pay bands are based on competitive pay and relate to the general staff, the chief executive and other senior type roles. For instance, a resident doctor working under the Spine Specialist and Surgeon falls in the junior salary band and upon acquiring the skill set by dint of his tenure and experience, would achieve an upward movement in the salary band.

Source: ICFAI Research Center

Check Your Progress - 4

7. Which of the following pay structures are found in public sector units?
 - a. It usually comprises pay spines.
 - b. There is a fixed increment
 - c. There is fixed pay for higher level jobs in the organization.
 - d. Other pay scales cannot be superimposed on the pay spine.
 - e. Uniform pay scales for different jobs
8. Broad banding is fast gaining popularity in organizations. Which of the following are true in the context of broad banding?
 - i. It combines salary ranges into wider bands.
 - ii. It evolved as organizations wanted to retain their hierarchies.
 - iii. It allows career growth but at the cost of formal promotions.
 - iv. It is easy to administer.
 - a. i and iii
 - b. ii
 - c. ii and iv
 - d. iii
 - e. ii and iii

9. In an organization that has a few wide bands, the type of pay structure being followed is:
 - a. Broad banding
 - b. Integrated pay structure
 - c. Pay spine
 - d. Graded structure
 - e. Spot rate structures
 10. Broad banding, if not carried out properly, can have numerous disadvantages. Which of the following are the disadvantages of broad banding?
 - i. It creates a flatter organizational structure.
 - ii. It cannot be linked with performance or corporate goals due to the existence of wide salary bands.
 - iii. It can lead to an increase in costs due to higher pay.
 - iv. It causes resentment among status conscious employees.
 - a. i, ii, and iii
 - b. ii
 - c. iii and iv
 - d. iv
 - e. ii and iv
-

13.9 Summary

- Job evaluation is the evaluation or rating of jobs to determine the position of the job in the job hierarchy.
- Job evaluation may be achieved through the assignment of points or the use of some systematic methods for essential job requirements, such as skills, experiences, and responsibilities.
- Job evaluation methods are classified as quantitative methods, which include the point rating method and factor comparison method and non-quantitative methods include ranking or job comparison, internal benchmarking, and job grading or classification.
- Pay represents the most important element in the employment relationship. The objectives of pay can be classified as: equity, efficiency, financial stability and the efficient allocation of labour.
- The pay structure gives a framework within which an organization defines the different levels of pay for jobs or groups of jobs. The pay structure is based on the assessment of the relative internal valuation and external valuation of the job.

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- The main types of pay structures are: graded structures, broad-banded structures, job family structures, spot rate structures, pay spines, pay structure for manual workers, and integrated pay structures.
- Broad banding is a concept of combining salary grades and ranges into just a few wide levels, each of which contains a relatively wide range of jobs and salary levels.
- Job evaluation techniques, pay structures, and broad banding are the different means in which the values of job can be assessed.
- Job classification consists of identifying classes, categories, or grades. Subsequently, the level of difficulty is identified by defining the specification.

13.10 Glossary

Broad banded pay structures: This structure has the range of pay in a band, which is significantly higher than the conventional graded structure.

Broad banding: This means combining salary grades and ranges into just few wide level or brands each of which contains a relatively wide range of jobs and salary levels.

Factor comparison method: This method involves a comparison of all key jobs and appraisal of jobs. The money value of one factor in one job is compared to the money value of the same factor in other job.

Graded pay structure: A conventional graded pay structure is that of a sequence of jobs into which jobs of broadly equivalent value are slotted.

Integrated pay structures: Integrated pay structures cover groups of employees who have traditionally been paid under separate arrangements.

Job analysis: Job analysis describes the duties of a job, authority relationships, skills required, conditions of work, and additional relevant information.

Job comparison: In this method, the whole job is ranked against other jobs on the basis of difficulty level. The jobs are arranged in a hierarchy, without any measureable points or values being assigned.

Job evaluation: Job evaluation uses information from job analysis to evaluate each job. It evaluates its components and ascertaining relative job worth. It involves a formal and systematic comparison of jobs in order to determine the worth of one job relative to another.

Job family structures: This type of structure consists of a collection of separate pay structures for job families.

Job slotting: This is also called internal benchmarking. It is an intuitive method where a properly graded and paid job is taken as a benchmark and all the other jobs are compared with it. The comparison is made on the whole job without analyzing the job factor by factor.

Job: A job is a group of positions that are similar to the kind and level of work.

Pay spines: This is a pay structure that consists of a series of incremental pay points extending from the lowest to the highest-paid jobs covered by the structure.

Pay structures: These indicate the rate of pay for different jobs and provide scope for pay progression in accordance with performance, competence, contribution, skill, or service.

Point raking method: This method involves the development of key compensable factors for the evaluation of each job. These manuals are developed on the basis of the organization's own experience or on the basis of industry-wide organization. Each of these key factors has a scale value which defines the degree to which that factor is present. Each job is rated on these key factors and a value is assigned. At the end of this exercise, the values of each factor are added to get a total score that is converted to get the compensation level.

Spot rate structures: The spot rate structure allocates a specific rate for a job.

13.11 Self-Assessment- Test

1. Job evaluation is a process by which jobs in an organization are evaluated. What are the factors that lead an organization to undertake job evaluation?
2. Explain the various benefits that an organization derives from performing job evaluation.
3. Give an overview of quantitative and non-quantitative categories of job evaluation.
4. Pay represents an important but contentious element in the employment relationship. In this context, explain why pay is important to the employer, employee, and the government.
5. What are pay structures? Explain in detail about each pay structure.

13.12 Suggested Readings/Reference Material

1. John Shields, Jim Rooney, Michelle Brown, Sarah Kaine; Managing Employee Performance and Reward: Systems, Practices and Prospects, 3rd Edition, Cambridge University Press, 2020
2. Susan L. Verhulst, David A. DeCenzo, Rama Shankar Yadav; Human Resource Management, 13th Edition, Wiley, 2021
3. Durai Pillai, Total Reward Strategy: Retain Your Best Talent, 1st Edition, Notion Press, 2020
4. Stephen J Perkins, Sarah Jones, Reward Management: Alternatives, Consequences and Contexts, 4th Edition, Kogan Page, 2020
5. Kevin R. Murphy, Jeanette N. Cleveland, Madision E. Hanscom, Performance Appraisal and Management, Sage Publications, 2020

13.13 Answers to Check Your Progress Questions

1. (d) i, ii, iii, and iv

Job evaluation touches the grouping of jobs, ranking of the jobs, determining the worth of various jobs in the organization as well as determining the demands which the normal performance of a job makes on a normal worker.

2. (c) Similar activities that are related to each other

A job can be considered to be a group of positions or activities that are similar to the kind and level of work.

3. (a) Working conditions of employees

Job evaluation is done to set wages and salary on the basis of the relative work or jobs in the organization. In this context, it facilitates standardization of the working conditions of employees

4. (b) Job comparison

Job comparison is among the simplest methods of job evaluation. It consists of ranking the whole job against another on the basis of difficulty level of the job.

5. (b) The absence of factors in grading

The internal benchmarking system is dependent on the identification of suitable benchmarks that are properly graded and paid. As a consequence, the comparisons may only perpetuate existing inequities and discrimination.

6. (c) Point rating

Point rating is a method of job evaluation which consists of first developing key compensable factors based on which each job must be evaluated. The collection of these key factors is called manual or yardstick. These manuals can be developed on the basis of the organization's own experience or those developed by industry wide organization.

7. (a) It usually comprises pay spines

Only the first statement is true, since it is the public sector units who prefer to use the pay spines.

8. (a) i and iii

The broad banding exercise allows the combining of salary ranges into wider bands.

9. (a) Broad banding

The type of pay structure being followed in this case is broad banding. This type of salary structure combines salary grades into a few wide bands. Each band thus consists of a wide range of jobs and salary levels.

10. (c) iii and iv

In the context of broad banding, it should be noted that status conscious employees may resent the elimination of a narrow banded grading structure and the status it confers. Further, if a broad banded structure is linked to a competency based reward system the scope for employees to acquire new skills will need to be tightly controlled to avoid costs increasing too rapidly.

Unit 14

Performance, Competence and Skill Based Pay

Structure

- 14.1 Introduction
- 14.2 Objectives
- 14.3 Performance-based Pay
- 14.4 Competence-related Pay
- 14.5 Skill-based Pay
- 14.6 Incentive-based Schemes
- 14.7 Team-based Pay
- 14.8 Summary
- 14.9 Glossary
- 14.10 Self-Assessment Test
- 14.11 Suggested Readings/Reference Material
- 14.12 Answers to Check Your Progress Questions

“Learn to hide your need and show your skill.”

- Jim Rohn

14.1 Introduction

As has been advocated by Jim Rohn, the key to successful work life is to become skillful enough to be able to do rewarding things. The previous unit dealt with the concept of job evaluation that looked at the need for such evaluation, its objectives, and methods. This was followed by a comprehensive discussion on the concept of pay with its related components.

However, there are other aspects of pay such as performance, competence, and skill-based pay, which are becoming increasingly more important. The reward systems of organizations have an impact on the organizations, which in turn, use these systems in a way that best serves their objectives.

It should be noted that in this age of global competition, organizations use their compensation systems to attract, motivate, and retain good talent. The traditional concepts of the pay system such as status, seniority, and responsibility level have given way to a performance-based culture. Organizations are witnessing a rise of performance and skill-based pay systems.

This unit deals with an examination of the concepts of pay, performance, competence, and skill. The unit closes with a discussion on team-based pay.

14.2 Objectives

After studying this unit, you should be able to:

- Explain the concept of performance-based pay
- Appraise competence related pay
- Describe skill-based pay
- Examine incentive-based schemes
- Analyze team-based pay

14.3 Performance-based Pay

A salary is deemed to be adequate and fair only to the extent that it matches the individual's ability and performance to achieve an adequate level of rewards. Moreover, the employees would also equate this salary with their own preconceived notion of the 'correct' salary.

Components of the financial reward processes are:

- The basic pay is the rate for the job as affected by the internal and external employment markets; it is a fixed compensation paid to employees for performing a specific job. This is typically pensionable.
- The contingent or differential pay is the pay which is influenced by the level of performance, competence, and skills of individuals or teams. It may be consolidated into base pay and is typically not pensionable. It is often referred to as 'variable pay' since it is related to potentially variable factors and has to be re-earned at every review of performance.
- The other factors that also influence pay are profitability of the company, job evaluation, seniority of an employee, cost of living, the manpower availability and the strength of the parties in negotiating.

However, in response to the newly emerging global challenge of increased competition, organizations are beginning to increasingly emphasize performance-based pay.

Challenges faced by the organization in terms of reward management are:

- If employees realize that their pay is not based on merit, it would lead to a decrease in their commitment to the organization.
- This may lead to a decrease in the level of effort and productivity may be adversely affected.
- Some employees may even go for jobs elsewhere. Hence there would be an increase in rate of attrition.

Hence, in order to motivate people, organizations link pay with performance in line with the organizational culture to avoid misfit.

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14.3.1 Assumptions of the Performance-based Pay System

The pay-for performance system rewards an employee's performance on the basis of three assumptions:

- b. There is a difference in the level of contribution between the contribution made by an employee as an individual and a team.
- c. The overall performance of an organization is dependent on the performance level of individuals and groups.
- c. In order to attract, retain, and motivate high performers and to be fair to all employees, the company must reward employees on the basis of their performance. The good performers always expect, and indeed require, to be paid more in order to continue with their good performance. They must be paid more than poor performers.

14.3.2 Types of Performance-based Pay

A single pay plan would not be able to meet the expectations of the employees or deliver what the management would want from the employees. Thus, there are different types of pay plans for employees who work at different levels in an organization, since a single plan will not be compatible with all levels. Thus, many organizations, particularly large ones, have more than one performance-based pay plan.

Performance-based pay can be categorized into the following types:

- *Piecework*: A price is paid for each unit of output. This is the oldest form of performance pay.
- *Payment by Results*: These are bonus earnings that depend on measured qualities or values of output for individuals or groups. These are usually based on time and work studies. They cover a range of bonus schemes and are the main method of performance pay for manual workers.
- *Organization-wide Incentives*: In organization-wide incentives employees are encouraged to subordinate personal goals for that of the organization or the department. The payments are usually based on sharing the overall profits achieved through the collective efforts of all the employees or by sharing the money which is saved through an organization-wide effort at cost cutting.
- *Merit Pay*: Bonus is based on a general assessment of an employee's contributions to performance; this is an earlier, less structured form of
- *Individual Performance Related Pay (IPRP)*: This is based on the notion that employees will be motivated if they believe that they will be rewarded for improving their contribution to the success of the enterprise. The pay will be in the nature of bonus earnings which are based on the assessment or appraisal of an employee's or team's performance against previously set objectives. It usually falls under the performance management system.

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- *Profit-related Pay*: This refers to a bonus or share options based on the organization's profits. It is widespread in the private sector, where share options are often important for senior managers.
- *Commission*: This refers to percentage payments on sales or turnover, paid on an individual or group basis; generally seen in sales, retailing to name a few

Example

Google provides its employees with performance bonus which is based on three variables: the employee's job position, their performance or results obtained and a multiplier rate that can be 15% or more of the fixed payroll.

Source: ICFAI Research Center

14.3.3. Fixed and Variable Pay

Firms are increasingly paying its employees which have elements of both base pay and variable pay.

However, there remains a great deal of variation in the way firms look at the fixed versus variable pay criteria. Let us understand the same in detail:

- Variable compensation can be in the form of individual bonus, team bonus, profit sharing, and employee stock options programs.
- It should be noted that a higher proportion of variable pay would mean that there would be more risk sharing between the employee and the firm.
- In effect, there is a trade-off between income security and potential higher earnings.

Fixed pay has become popular in a majority of organizations since it reduces the risk to both employer and employee. Moreover, it can be used advantageously in smaller companies, especially with firms with products that are not well established.

Variable pay is the payment given to individuals in the form of performance pay or bonuses on the basis of their own performance or that of their team or organization.

Essentials of variable pay are:

- Variable pay is used in situations where organizations have varying revenue, shortage of funds or with a younger labor force that is willing to delay gratification.
- It focuses on the quality and quantity of performance and rewards for individuals or groups.
- Variable pay has to be re-earned at each performance period. It is 'pay at risk' which is awarded for specific achievements. The employee's risks are not paid for unless the same or a higher level of performance is achieved.

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- While designing the variable pay, performance measures should be focused on the basis on which the employees and teams are receiving their reward. The performance measures are customer satisfaction, cost savings, accuracy, and timeliness.
- Once these measures have been established, they must be clearly and frequently communicated to employees. Establishing benchmarks and performance targets is a must to have an effective variable pay system.
- Variable pay focuses on the quality or quantity of performance and rewards teams or individuals. It includes incentives, bonuses, gain sharing, and goal plans.
- Variable pay is not consolidated into base pay, as often happens with performance-related payment systems.

The argument against variable pay is it assumes past performance will continue in future at the same level and should therefore be rewarded with a permanent increase in pay.

Variable pay has always been the rule in executive pay, pay for sales representatives and remuneration and payment – by-results schemes for manual workers. It has been less common in performance – related pay schemes, although organizations with such schemes are increasingly turning toward the use of achievement or sustained high performance bonuses, often in the form of spot payments for a particular achievement.

Check Your Progress - 1

1. Performance-based pay rests on certain fundamental assumptions. In this context, identify which of the following are true.
 - i. Employees and firms differ in the capacity to do a particular task
 - ii. All employees have an equal capacity to work
 - iii. Employees differ in the types of tasks they can perform
 - iv. Organizations should have the capacity to attract and reward good performers
 - a. i, iii
 - b. i, iii, and iv
 - c. i and iv
 - d. iv
 - e. i and ii

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2. There are various systems of performance-based pay. In this context, which of the following statements are applicable?
 - i. The merit pay system gives bonus earnings that are based on a general assessment of an employee's contributions to performance
 - ii. Profit plans are based on percentage of turnover, which is paid on an individual or group basis
 - iii. Individual performance related pay works on the assumption that employees will be motivated if they believe that they will be rewarded for improving their contribution to the success of the enterprise
 - iv. Commissions are paid on the basis of percentage payments on sales or turnover, which are paid on an individual or group basis
 - a. i, ii
 - b. i, iii, and iv
 - c. ii and iv
 - d. i, ii, iii, and iv
 - e. i and iii
 3. Of the following, which plan subordinate's personal goals to that of the organization or the department?
 - a. Payment by Results
 - b. Performance related pay
 - c. Organization-wide Incentives
 - d. Profit-Related Pay
 - e. Gain sharing
 4. Which performance-based pay system works on the assumption that employees are motivated if they believe that they will be rewarded for improving their contribution to the success of the enterprise?
 - a. Merit pay
 - b. Individual performance related pay
 - c. Performance-related pay
 - d. Commission
 - e. Seniority
 5. Variable pay has become an increasingly important component of modern reward system. In this context, which of the following is not incorporated into variable pay plans?
 - a. Incentives
 - b. Bonus
 - c. Goal plans
 - d. Gain sharing
 - e. Fixed pay
-

14.4 Competence-related Pay

Competence is an inherent characteristic of an individual related to effective or superior performance. Competence-related pay refers to the ability of a person to perform a job or task competently. It looks into how people ought to behave in order to carry out a role with competence. It also refers to areas of work in which the person is competent or the dimensions of behavior lying behind competent performance.

The concept of competence is made even more complex by the contention of some people that competence embraces behavior, knowledge, and skills while others claim that competence is about the effective use of knowledge and skills by themselves.

Competence-related pay provides for pay progression to be linked to assessments of the levels of performance that people have achieved. Competence-based pay reflects an intention by the organization to reward the use or development of job-related competencies.

The following points illustrate the differences between performance and competence-related pay:

- Competence pay may be concerned with *how* work is done (behavior) while performance pay is concerned with *what* work is done.
- Competence pay decisions are made by assessing behavior and the outcomes of that behavior against competence profiles, which have usually been prepared by a joint analysis process. Performance pay decisions are usually made by comparing results against individual or team objectives.
- Competence-related pay is not based on the achievement of specific results expressed in the form of targets or projects to be completed, although it can be said that it is concerned with the attainment on a continuing basis of agreed standards of performance.
- Competence-related pay is forward looking which means that when people have reached a certain level of competence, they will be able to go on using it effectively into the future; conversely, performance related pay looks backward – this is what the employees have achieved and rewarding their achievement.
- Competence pay helps to integrate core, generic, and individual competencies, whereas performance pay helps to integrate corporate, individual, or team objectives.

14.4.1 Designing Competency-based Pay

Competency-based pay focuses on paying for the person's capability rather than paying the person for his/her job. It is intended to motivate employee to do his best.

Unit 14: Performance, Competence and Skill Based Pay

There are five steps in designing such a compensation system:

- Conduct a job analysis and establish a clear link between a job's content, a person's qualifications, and optimal performance of that job.
- Based on the job analysis, identify the competencies needed to perform the work.
- Develop assessments to measure the staff member's performance of these competencies.
- Value the competencies by analyzing compensation survey data.
- Establish a salary for each staff member based on the set of competencies he or she uses on the job.

Activity 14.1

Competency-based Pay

Ankit is working as Sales Manager for a branch in an automobile company. His pay structure included a CTC of Rs.10,00,000 per annum (Basic: Rs.6,00,000, DA Rs.200,000, HRA:1,00,000 and other allowances Rs.1,00,000). In addition to this, he was assured to receive 5% of his branch sales amount as incentives, a commission of 1% on sale of each vehicle and a gain sharing of 1% from his branch's profit, if sales are improved by 40% over the previous year.

From the above example, specify fixed pay and variable pay.

Answer:

14.4.2 Advantages of Competence Related Pay

Listed below are the advantages of competence based pay:

- Competence-based pay develops a broader perspective for staff. It encourages and rewards on the basis of the skills that the staff possesses (rather than their 'positions').
- It reinforces a culture of improvement.
- It facilitates self-management and enables leaner staffing. Since this model rewards staff members for developing new skills, it prepares them to be more productive, take on greater responsibility, and work more collaboratively with other staff.

Block 4: Compensation and Reward Management

- It facilitates staff retention, because staff members develop their skills continuously, have more control over their pay, and are unlikely to find comparable jobs elsewhere – since a majority of organizations still use the traditional model.
- It builds acceptance for a culture of change.
- It focuses attention on the need for high levels of competence. It encourages competence development.

The cited advantages of competence related pay, which rewards employees based on how well they perform in the workplace, show that competence at work is essential for better performance.

14.4.3 Disadvantages of Competence Related Pay

The disadvantages of competence related pay are listed below:

- The assessment and documentation of competence levels can be time consuming and expensive.
- It requires a large investment in training. Since peers train each other, there are chances that productivity will decline initially. But in the later stages, productivity is bound to go up.
- Market comparisons can be more difficult because most of the data relate to the traditional pay model; staff salary comparison may not actually be a simple task.
- The process makes considerable demands on the commitment and skills of line managers.
- Administrative involvement can increase keeping track of each person's competency assessments, competency mix, and pay rates though it requires time and effort.
- It is recognized that competence related pay will require the mobilization of extensive management resources and will take time to implement and manage.

The disadvantages of competence related pay show that competence rather than hierarchy of position or years of experience in a job is more important.

Example

The Volkswagen Group (UK) Ltd discontinued its performance management system that rated most of the employees as average with very small differentiation in pay rewards as normal distribution was followed. Consequently, it introduced a new pay scheme where ten critical competencies needed for every job family were described and employees were assessed against the well-articulated three/four levels of achievements. This enabled the company to create a completely transparent system that rewarded capabilities of employees.

Source: ICFAI Research Center

14.5 Skill-based Pay

Skill-based pay refers to pay increases in relation to the increase in the number of skills acquired by an employee. It is a means of developing broader and deeper skills among the workforce. Skill-based pay links pay to the level of skills used on the job, and sometimes the acquisition and application of additional skills by the person carrying out the job.

In skill-based pay, the employees are slotted into grades informally based on their training, qualification, and experience. The three grades into which employees are graded are unskilled, semiskilled, and skilled. The pay increases are usually tied to these three types of skills.

- *Horizontal skills* which involve a broadening of skills in terms of the range of tasks.
- *Vertical skills* which refer to the skills of a higher level.
- *Depth skills* which refer to a high level of skills in specialized areas relating to the same job.

Skill-based pay differs in various ways from traditional pay systems. The traditional pay system could only reflect skill differences in a structure consisting of rates of pay for unskilled, semiskilled, and skilled workers. These differences are:

- Skill-based pay is a person-based and not a job-based system. It rewards a person for what he/she possesses, rather than the job's worth. Job worth is related to basic rate of pay given for minimum skills, but pay progression is connected to skills acquisition.
- It rewards a broad range of skills which makes the employee multi-skilled and therefore flexible.
- It positively encourages skill development.
- A skill-based pay system may not necessarily reflect how well the skill is used as this falls within the performance component of pay. But performance based criterion may be included in this.
- In such cases, the system will be performance-oriented rather than a structure. The system needs to be supported or justified by opportunities for training which is critical to its success. The traditional structure is not dependent on such opportunities.

14.5.1 Purposes of Skill-based Pay

Skills serve a dual purpose: They protect against unemployment and promote better earnings while giving the employers a chance to compete with better quality products or achieve cost reductions.

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The rapid pace of change in the economies and the shift to a knowledge-based economic system means that employees will have to continuously improve and add on their skill-set. Moreover, the modern workplace is increasingly taking on a skill-based color, where even doing a simple task requires the operation of highly sophisticated machines. Skill-based pay serves the following purposes:

- It enables organizations to adapt to change and emphasizes on learning new skills. The emphasis on total quality and customer service has also led to the demand for learning new skills.
- It helps employees to be flexible and adapt to the technological changes and competitive challenges in a world of fast changing technologies and competitive pressure. Skilled employees will be more flexible and respond quickly to the new demands and peak workloads.
- Skill-based pay systems promote commitment among employees and help to enhance their skills, develop their careers within the organization, and increase their employability.
- It enables the production of quality products, which can be done better only through skilled workers. Multi-skilled workers ensure that the production will not be disturbed even to meet new demands.

14.5.2 Introducing Skill-based Pay

The introduction of a skill-based pay system is a complex process. It requires several steps to be taken and several issues to be addressed. These are given here:

- The skill requirements of the company needs to be analyzed. The availability of resources for training should be ascertained. The jobs to be covered by the scheme should be identified.
- The individual's jobs have to be grouped into 'job families' on the basis that in each 'family' the skill needs are similar. The skills within each job family and the tasks needed to perform the job should be analyzed.
- The steps just seen will lead to an identification of the skill blocks or levels. The skill level is the pay grade relating to the competence to use particular skills, and the skill block is the training input which has to be completed to the satisfaction of the certifying authority in order to gain entitlement to the extra pay.
- Training modules have to be formulated.
- The way in which certification is obtained that the skill has been acquired should be agreed upon.
- The base rates for 'job families' have to be fixed, as also the payments that will be made in future when an employee moves upward through the skills route.

- The criterion for extra payments should not be acquisition of the skill but its application.
- The period during which the skill should be applied before a new one is acquired should normally be decided on, as the skill should benefit the employer who should receive a return on the investment made.

14.5.3 Advantages of Skill-based Pay

The system of skill-based pay provides the following advantages:

- It contributes to job enlargement and job enrichment as it narrows down job classifications.
- There is lot of flexibility as the performance of multiple tasks is encouraged. It enables job rotation and the filling of temporary vacancies.
- It enhances productivity and quality through the better use of human resources.
- It facilitates technological change. Pay increases, continuous training, and job enrichment and job enlargement through the broadening of skills, tend to reduce staff turnover.
- Elimination of unnecessary jobs reduces the need for supervision.
- Job satisfaction is engendered through employees having greater control over the planning and execution of jobs.
- Broadening of skills develop a better perspective of operations as a whole.
- It acts as an incentive for self-development.
- Skill enhancement provides employment security. Promotion to higher levels are easy because of skill upgradation, leading to employee's career development path.
- Competition is restricted as the reward flows from the application of a skill and does not reduce opportunities for others since the pay increases on account of skills which are linked to a measurable standard, subjectivity in performance appraisals and individual-based performance-related pay is avoided.

14.5.4 Problems with Skill-based Pay

The problems associated with the introduction of skill-based pay are enumerated below:

- There may be substantial training costs.
- It may happen that some skills would be paid for but would be used infrequently.
- There is a strong possibility that unusable skills may be acquired unless the system is properly administered.

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- Identifying the type of training to be given to the employees is difficult since employers cannot always anticipate what skills would be required in the future.
- The administration of the skill-based system is a complex task, with regard to skill acquisition, certification, and its payment. Hence, unless the system is administered properly, the costs would outweigh the gains.

Example

At Wipro, the compensation of the employees is based upon the value of a person's earnings from technology and businesses using a different skill set. The criteria speak about skills in analytics, open source and big data. This serves as an illustration for skill-based pay.

Source: ICFAI Research Center

Check Your Progress - 2

6. Which of the following statements is true with regard to competence related pay?
 - a. Competence related pay does not require considerable resources to implement and manage
 - b. Competence related pay makes considerable demands on the abilities of line managers
 - c. Competence related pay leads to a cultural change
 - d. Competence related pay creates change for its own sake
 - e. Competence related pay is negatively associated with productivity.
7. Which of the following is not an advantage of skill-based pay?
 - a. It contributes to job enlargement and job enrichment as it narrows down job classifications
 - b. It enhances productivity and quality through the better use of human resources
 - c. It facilitates technological change
 - d. Broadening of skills develop a better perspective of operations as a whole
 - e. It increases attrition rate
8. With the rapid pace of change in technology, skill-based pay is becoming increasingly popular. What purpose does skill-based pay serve?
 - i. Adapting to change
 - ii. Being flexible

- iii. Making better quality products
- iv. Enabling increased commitment of employees
- a. i and ii
- b. ii
- c. iii and iv
- d. i, ii, iii, and iv
- e. i, ii and iii

14.6 Incentive-based Schemes

To bring out incentive-based schemes, organizations consider payment by results as well as sales for incentive schemes.

14.6.1 Payment by Results

Payment by results is done when the employee is paid for the results achieved. It is assumed that this relationship would lead the individual to continue or increase his or her level of performance in order to receive more financial rewards, and, by implication, to increase his/her efforts.

Payment by result schemes relate either the whole or part of an employee's total pay package to the output produced by the individual or group to which he or she belongs.

These schemes can vary on several dimensions:

- The level of financial reward for each incremental level of output.
- The level of basic pay
- The inter-relationship between incremental pay and incremental output
- The threshold of output for receiving payment by results

Types of incentive or payment-by-result schemes are given below:

Individual piecework: Under individual or straight piecework, a uniform price is paid per unit of production. Operators are therefore rewarded according to the number of pieces they produce or process, so pay is directly proportional to results. Most piecework schemes provide a fallback rate or minimum earning level.

Work-measured schemes: In a work-measured scheme, the job or its component task is timed and the incentive payment is related to performance above the standard time.

The process of work measurement is explained below:

- Work measurement involves working out standard values or times for a complete task, which can, however, be broken down into components to each of which standard minute values can be allocated.

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- The difference between the actual time taken to perform the task and the standard time allowed is the amount of incentive pay received. If a task is done in less than the standard time, then there is a time saving, which means that the operator's output will increase.

Measured day work schemes: These schemes relate pay to the achievement and sustenance of a specified level of performance. The arrangement depends on work measurement to define the required level of performance and to monitor the actual level.

The same is explained in the points below:

- The fundamental principle of measured day work is that there is an incentive level of performance and that the incentive payment is guaranteed in advance, thereby putting the employee under an obligation to perform at the effort level required.
- In contrast, a conventional work-measured incentive scheme allows employees discretion on their effort level but relates their pay directly to the results they achieve.
- Between these two extremes there are a variety of alternatives, including banded incentives, stepped schemes, and various forms of high day rate.

Example

Mediocrity has no place at Netflix. In fact, adequate performance gets a generous severance package. If an employee does not pass the Keeper Test which is applied as a judgement of someone's overall expected contribution, they are offered a generous severance package, and respectfully asked to move on to their next opportunity.

Source: ICFAI Research Center

14.6.2 Sales Force Incentive Schemes

Sales are where the revenues are generated for an organization – hence it is necessary that sales compensation itself be well designed. Sales personnel tend to have different roles that vary from giving cold-calls to promoting the firm's products. They have to resort to various approaches from hard selling to relationship building. The design of a sales force pay plan becomes a sensitive issue as the motivation of the sales force generally has immediate and strong impact on the business results.

However, developing performance standards for sales employees is a difficult task, as their performance is often affected by external factors beyond their control. The sales volume alone, therefore, may not be an accurate indicator of the effort sales people have expended.

Reasons for designing effective sales force incentive program are:

- To motivate the direct sales force of the company
- To get people to focus on the products over the competitors. To build team spirit internally or externally
- To capitalize on the competitive nature of the sales team
- To reward the best sales teams and build a strong customer relationship

14.7 Team-based Pay

Team-based pay provides rewards to teams or groups of employees carrying out similar and related work which is linked to the performance of the team. Performance may be measured in terms of outputs and/or the achievement of service delivery standards. The quality of the output and the opinion of customers are also often taken into consideration.

Team pay is usually paid in the form of a bonus which is shared amongst team members in proportion to their base rate of pay (much less frequently, it is shared equally). The individual team members may be eligible for competence related pay or skill-based pay but not for performance-related pay.

There are various advantages to team-based pay:

- It encourages effective team working and cooperative behavior.
- It clarifies team goals and priorities.
- It enhances flexible working conditions within team.
- It encourages multi-skilling.
- It provides an incentive for the team collectively to improve performance.
- It encourages less effective team members to improve and meet the standards.

There are some disadvantages to team-based pay as well:

- It only works in cohesive and mature teams.
- Individuals dislike the fact that their own efforts are not rewarded specifically.
- Peer pressure, may compel the employees to conform to group notions and this can sometimes have undesirable effects.

In this section, we will discuss various team-based pay systems that are being used in organizations:

- *Profit sharing* which distributes a portion of corporate profits among designated employees.
- *Gain sharing* which divides a portion of cost reductions or productivity increases between groups covered by the plan
- *Employee stock ownership plan* that distributes stocks and stock options to employees based on corporate performance measures such as return on equity.

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All the three types are designed to establish a link between the pay and performance, but performance is measured at the group, unit, or company level.

14.7.1 Profit Sharing

Profit sharing is regarded as a stepping stone to industrial democracy. It is a plan under which an employee receives an additional remuneration to their regular pay a special sum in the form of cash or shares in the company related to the profit of the business. The amount shared is determined either by an established formula, or is at the discretion of management.

The theory behind profit sharing is that employees will fulfill their responsibilities with renewed vigor if they find that their efforts will yield higher profits through profit sharing.

Profit sharing serves the following objectives:

- It facilitates enhanced awareness and interest in the performance of the organization, and possibly creating an impression of ownership of the business.
- It encourages long-term commitment and loyalty to the company.
- Profit sharing ensures that employees benefit from company profitability and share in the wealth they helped to create.
- It ensures that labor costs are responsive to the performance, and hence profits, of the company.
- It helps in retaining existing employees and attracting talent.
- It promotes harmonious industrial relations.
- It facilitates employees and employers to take advantage of tax breaks.
- It follows the principle of equity to reward good performance.

Advantages of Profit Sharing

The advantages of profit sharing are enumerated below:

- Many firms use profit sharing as a tool to control employee turnover because the idea of sharing the profits inspires the management and the workers to be sincere, devoted, and loyal to the firm.
- It brings groups of employees to work together towards a common goal (the success/benefit of the company).
- The costs of implementing the plan rise and fall with the company's revenues, which mean that profit sharing does not become a burden on the firm.
- It helps in supplementing the remuneration of workers and enables them to lead a richer life.
- Workers become self-motivated and do not require close supervision. It attracts talented people to join the ranks of the firm with a view to sharing the profits.

Profit sharing has been criticized as being remote and perceptually unrelated to individual performance. Following are the disadvantages of profit sharing:

- The profit sharing schemes are like a fair-weather plan. Workers may not get anything in case the business does not do well and does not generate profit. Employees would dislike their base pay getting affected negatively by the profit sharing provision.
- Profit sharing sometimes hurts solidarity towards the trade unions, as the workers develop a greater sense of belonging with the enterprise.
- Fixing the share in the profit of the firm is sometimes a very difficult task as it may happen that the management may want to give away a smaller share than the workers are willing to accept.
- The overall focus of the firm turns out to be that of profit, which comes at the costs of other goals such as quality of production. In case of small business units, there is a high likelihood of a fluctuation in earnings of firms causing drastic shifts in the earnings of employees.
- The pay for each employee moves up or down together, depending on the overall performance of the firm, at the cost of individual difference in merit.

14.7.2 Gain Sharing

Gain sharing can be conceived as an incentive plan that engages many or all employees in a common effort for achieving the productivity objectives of the organization. It can also be perceived as a factory-wide bonus plan that provides for employees to share the gains made by a company with its improved performance. Gain-sharing plans are tailored to the company's requirements.

Advantages of Gain Sharing

- There is a greater involvement of employees in the functioning of the organization.
- Employees share the benefits of improved functioning. There is improvement of various measures of company performance such as teamwork, product quality, etc.
- It stresses greater promotion of communication about issues concerning work and productivity.
- There is an increased attention of the employees on key issues that affect organizational performance. Through gain sharing, the entire organization has, increases in productivity.
- There is an enhanced commitment to organizational goals.

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Disadvantages of Gain Sharing

- Compliance with legal formalities may require the calculation of a regular rate of pay of the employees. As a consequence, the employers may not go in for this type of compensation.
- The gain sharing formulation would require a more team-oriented leadership style.

14.7.3 Employee Stock Ownership Plan (ESOP)

ESOP enables employees to turn into owners of the company. The plan is based on payment of equity.

Features of ESOP are:

- Generally, full-time employees of the company participate in the plan.
- The allocations of shares are usually made on the basis of relative pay or some other formula.
- Over time, as the employees accumulate seniority, they have an increasing right over shares in their account.
- Further, it should be noted that ESOPs are also used as savings plan where the company contributes on par with the employee contribution with stock from ESOP instead of cash.

Refer to Exhibit 14.1 that illustrates ESOP at SAP Inc.

Exhibit 14.1: Employee Stock Ownership Plan (ESOP) of SAP

SAP offers an award-winning employee share purchase plan, enabling employees to own a part of SAP and build long term value. Employees become shareholders, are entitled to voting right at the Annual Shareholders Meetings and receive dividends.

SAP has a long tradition in sharing company success with its employees. In this spirit, SAP announced to dedicate an additional budget of €400 million to launch a new equity program “Grow SAP” from 2020–2023. Besides acknowledging everyone’s commitment to past achievements, the focus of Grow SAP is to unite all employees behind achieving SAP’s 2023 ambitions.

As SAP CEO Christian Klein has put it “SAP wouldn’t be the company it is without the commitment and passion each colleague brings to work every day”. The Executive Board is committed to the investment in its employees even more so in the Covid-19 crisis! This program will support employees to stand together to sustain and grow their success.

Contd....

Grow SAP is offered on top of the already existing equity plans “Own SAP”, an award-winning share purchase plan that enables all employees to become shareholders at preferred conditions, and “Move SAP”, a Restricted Stock Unit plan offered to employees who have a significant sustained impact on business success.

Source: <https://sap.com/2020/06/16/sap-launches-additional-equity-plan-to-deepen-employees-participation-in-company-performance/> (accessed on 25/4/2022)

Activity 14.2

Upgrading skills at the former electronics marvel

Makhailovich Electronics has been making consumer electronics ever since private capital came into Russia after the fall of the USSR. Although they have factories all over Russia, the plant in Moscow is the crowning glory. It has the best engineers from the former Soviet Union who made cathode ray tube based TVs. There was a good demand for their television sets all over Russia.

However, the plant has not seen major innovations even though the Makhailovich group as a whole has gone in for major improvements and the launch of new LCD viewing systems. Much of these innovations have come from other plants. Today, the Moscow-based plant stands at the bottom of the ladder in its contribution to the profits of the Makhailovich Group. Sadly, no one wants a cathode ray based TV anymore!

The senior management of the group has been thinking of closing down the plant and laying off the workers. However, they realize that the fault lies with the senior management, since no one was interested in giving proper direction to the Moscow plant; it was conceived as a cash cow. The management also knows that the workers at the plant are among the most qualified, honest, and dedicated.

The senior management wants to give the Moscow plant one fair chance. It has sent Ivan Vitaly, the new Human Resources director, in his additional role as the chief manager of the plant.

What problems do you foresee for Ivan at this plant? How can Ivan help the plant regain its former glory?

Answer:

Check Your Progress - 3

9. What are the three major types of group-based incentives?
 - i. Profit sharing plans
 - ii. Employee gain sharing plans
 - iii. Employee stock option plans
 - iv. Employee pay
 - a. i, iii, and iv
 - b. i, ii, and iii
 - c. i and ii
 - d. i and iii
 - e. ii, iii and iv
 10. Under profit sharing, a special sum is kept in the form of cash or shares in the company related to the profit of the business. Which of the following are the objectives of profit sharing?
 - i. To increase the responsiveness of the labor force to the profit and hence performance of the company.
 - ii. To attract and retain employees.
 - iii. To reduce the role of trade unions.
 - iv. To increase long-term loyalty toward the company.
 - a. i and iv
 - b. iii and iv
 - c. ii and iii
 - d. i, ii, iii, and iv
 - e. i and ii
-

14.8 Summary

- A salary is deemed to be adequate and fair only to the extent that it matches the individual's ability and performance to achieve an adequate level of rewards.
- Financial reward processes use base pay and variable pay, plus the provision of employee's benefits and pensions.
- The performance-based pay can be categorized into piecework, payment by results, organization wide incentives, merit pay, individual performance related pay, profit related pay, and commission.

- Firms are increasingly going in for a system that has elements of both base pay and variable pay. Certain companies prefer going in for fixed pay. However, there is an increasing proportion of total compensation that goes in the form of variable pay that fluctuates according to some pre-established criteria.
- Competence-related pay provides for pay progression to be linked to assessments of the levels of performance that people have achieved.
- Skill-based pay refers to a pay system in which pay increases are linked to the number or depth of skills an employee acquires and applies.
- Team-based pay provides rewards to teams or groups of employees carrying out similar and related work which is linked to the performance of the team. Performance may be measured in terms of outputs and/or the achievement of service delivery standards.
- Team pay is usually paid in the form of a bonus which is shared amongst team members in proportion to their base rate of pay. The individual team members may be eligible for competence related pay or skill-based pay but not for performance related pay.

14.9 Glossary

Commission: This refers to percentage payments on sales or turnover.

Competence related pay: This pay system provides for pay progression to be linked to assessments of the levels of performance that people have achieved.

Employees stock ownership plan: An ESOP is an employee benefit plan which enables employees to turn into owners of stock in the company in which they work.

Gain sharing: Gain sharing is an incentive plan that engages many or all employees in a common effort to achieve a company's productivity objectives, with any resulting cost-savings gains being shared among employees and the company.

Individual Performance Related Pay (IPRP): This is based on the notion that employees will be motivated if they believe that they will be rewarded for improving their contribution to the success of the enterprise.

Individual piece work: In individual or straight piecework, a uniform price is paid per unit of production.

Measured day work schemes: Measured day work schemes provide for the pay of employees to be fixed on the understanding that they will maintain a specified level of performance. However, the pay does not fluctuate in the short-term with their performance.

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Merit pay: Merit pay is usually based on the general assessment of an employee's contributions to performance

Payment by Results: These are bonus earnings which depend on measured qualities or values of output for individuals or groups.

Performance-based pay: A salary can be deemed to be adequate and fair only to the extent it matches an individual's ability and performance with adequate rewards.

Piecework: A price is paid for each unit of output.

Profit related pay: This is bonus or share options based on the organization's profit.

Profit sharing: Profit sharing holds that workers will fulfil their responsibilities more diligently if they realize that their efforts may result in higher profits which will be returned to the workers.

Shop-floor incentives: Shop-floor incentive schemes relate to the pay or part of the pay received by employees to the number of items they produce or process, the time they take to do a certain amount of work, and/or some other aspect of their performance.

Skill based pay: Skill-based pay refers to a pay system in which pay increases are linked to the number or depth of skills an employee acquires and applies.

Team based pay: Team-based pay provides rewards to teams or groups of employees carrying out similar and related work which is linked to the performance of the team.

Work-measured schemes: In a work-measured scheme, the job or its component task is timed and the incentive payment is related to performance above the standard time allowed for the job.

14.10 Self-Assessment Test

1. How would you differentiate between performance and competence-based pay?
2. Skill-based pay practices are becoming increasingly common. What are the pros and cons of a skill-based pay system for an organization?
3. Describe in detail the various types of incentive or pay or payment-by-result schemes.
4. What is gain sharing? What are the advantages that flow from gain sharing?
5. Organizations are going to be increasingly under pressure to have good pay packages in order to retain star employees. Do you agree or disagree with this statement. Give reasons.

14.11 Suggested Readings/Reference Material

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14.12 Answers to Check Your Progress Questions

1. (b) i, iii and iv

There are three crucial assumptions that are the basis of performance-based pay. First, it is held that employees and work teams differ in how much they contribute to the firm not only in what they do, but also in how well they do it. Second, the overall performance of the organization depends largely on the performance of individuals and groups. Third, in order to attract, retain, and motivate high performers, it is essential to reward employees on the basis of their relative performance. This happens as the good performers would both expect and require more pay in order to retain their good performance.

2. (b) i, iii and iv

Bonus earnings or pay levels are usually based on the general assessment of an employee's contributions to performance. Further, individual performance related pay works on the assumption that employees will be motivated if they believe that they will be rewarded for improving their contribution to the success of the enterprise. Last, a commission is paid on the basis of percentage payments on sales or turnover, which are paid on an individual or group basis.

3. (c) Organization-wide incentives

Organization-wide incentives are plans that encourage employees to subordinate personal goals for that of the organization or the department.

4. (b) Individual performance related pay

Individual performance related pay is based on the notion that employees will be motivated if they believe that they will be rewarded for improving their contribution to the success of the enterprise.

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The pay would be in the nature of bonus earnings which are based on the assessment or appraisal of an employee's or team's performance against previously set objectives. It usually falls under the performance management system.

5. (d) Fixed pay

Fixed pay is not incorporated into variable pay plans. Instead incentives, bonuses, goal plans, and gain sharing are components of the variable pay plans.

6. (b) Competence related pay makes considerable demands on the abilities of line managers

The competency related pay makes considerable demands on the commitment and skills of line managers.

7. (e) It increases attrition rate

Skill-based pay helps in reducing attrition. So option 'e' is not an advantage of skill-based pay.

8. (d) i, ii, iii and iv

Among other things, skill-based pay enables organizations to adapt to change and become more flexible. It also enables organizations to have a quest for commitment and produce better quality products.

9. (b) i, ii and iii

The three major types of group payment schemes are profit sharing, gain sharing and Employee Stock Ownership Plans (ESOPs).

10. (d) i, ii, iii, and iv

Profit sharing enables an increase in the responsiveness of the labour force to the profit and hence performance of the company. It enables the organization to attract and retain employees. It reduces the role of trade unions and also increases long-term loyalty towards the company.

Performance Management and Reward Systems

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