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CHAPTER 2

STRATEGIC PERSPECTIVES

LEARNING OUTCOMES

After studying Chapter 2 students should be able to:

- Explain why managers should tailor their pay systems to support the organization's strategy. Identify the four steps to develop a total compensation strategy.
- Describe the three tests used to determine whether a pay strategy is a source of competitive advantage.
- Contrast the "best fit" perspective on compensation with the "best practices" perspective.

CHAPTER SUMMARY

1. The four steps to develop a total compensation strategy are: (1) assess total compensation implications, including business strategy and competitive dynamics, HR strategy, culture/values, social and political context, employee/union preferences and fit with other HR systems; (2) map out a total compensation strategy;(3) implement the strategy; and finally, (4) assess and realign the strategy to ensure achievement of the objectives.
2. To improve organizational effectiveness, managers should align the compensation strategy to the organization's strategy.
3. The three tests used to determine whether a pay strategy is a source of competitive advantage are (1) Does it align? (2) Does it differentiate? And (3) Does it add value?
4. The "best fit" perspective on compensation suggests that compensation be aligned, or fit. With the specific business strategy adopted by the organization. given its environment, in order to maximize competitive advantage. The "best practices" perspective suggests there is one set of best pay practices that can be applied universally across situations and strategies, attracting superior employees who then create a winning strategy.

LECTURE OUTLINE

SIMILARITIES AND DIFFERENCES IN STRATEGIES

Sometimes different business units within the same corporation will have very different competitive conditions, adopt different business strategies, and thus use different compensation strategies. *As seen in Exhibit 2.1* the compensation strategies for Google, Medtronic, and Merrill Lynch are compared and contrasted to demonstrate inter-company differences along the dimensions of objectives, internal alignment, external competitiveness, employee contributions, and management. In addition to inter-company

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differences, compensation strategies are also diverse within the same industry as can be seen with Google, Microsoft, and SAS. Theycollectively compete from the same pool of candidates so it is important for each company to differentiate itself from its competitors. Finally, compensation strategies can vary within the same company pending the types of jobs and their linkage to industry compensation norms.A strategic perspective on compensation is more complex than it first appears. Taking a **strategic perspective** requires a focus on compensation decisions that help the organization gain and sustain competitive advantage.

At Nucor Steel, the emphasis is on high productivity, high quality, and low cost products. In a good year an hourly worker can make $75,000 or more per year.
Merrill Lynch has pay objectives consistent with realiance on the human capital of its employees to complete, and therefore uses competitive base pay, aggressive bonuses,and stock awards based on individuals' accomplishments.

STRATEGIC CHOICES

Compensation strategies require many critical decisions that are ongoing as opposed to static and fixed once struck. It is important to understand the relationship between strategy and competitive advantage. Ultimately an effective strategy will produce competitive strategy for the business. In determining strategy, key questions that need to be asked include:

1. What business should we be in?
2. How do we gain and sustain competitive advantage in this business?
3. How should HR help us win?
4. How should total compensation help us win?

See Exhibit 2.2 to see how these questions can be aligned with strategic choices.

Strategy refers to the fundamental business decisions that an organization has made in order to achieve its strategic objectives, such as what business to be in and how to obtain competitive advantage.

Competitive Advantage is a business practice or process that results in better performance than one's competitors.

What should the Compensation System Support?

- Support business strategy
- Support HR strategy

Support Business Strategy

The most common choice is that the compensation system should support the business strategy at the very least because the ultimate purpose of a business strategy is to gain and sustain competitive advantage. As business strategies change, compensation systems

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need to change (e.g., IBM's strategic and cultural transformation.) Some typical strategic frameworks include **Porter's model** and ***Miles and Snow.***
See Exhibit 2.3 5to review how different compensation strategies might be tailored to three general business strategies.

Support HR strategy
It is logical to assume that the business strategy is created first prior to the HR strategy. Once the HR strategy is in place, the compensation system can be generated. The processes of recruiting and selecting, retaining, rewarding, compensating and motivating employees are linked to the HR strategy. For example, SAS keeps turnover low by having generous benefits as opposed to having the highest salaries.

THE PAY MODEL GUIDES STRATEGIC PAY DECISIONS

The Pay Model from Chapter 1 can be used to assess the strategic compensation decisions along the following dimensions:

1. **Objectives:** How should compensation support the business strategy and be adaptive to the cultural and regulatory pressures in a global environment?
2. **Internal alignment:** How differently should the different types of levels of skills and work be paid within the organization?
3. **External competitiveness:** How should total compensation be positioned against competitors?
4. **Employee contributions:** Should pay increases be based on individual and/or team performance, on experience and/or continuous learning, on improved skills, on changes in cost of living, etc.?
5. **Management:** How open and transparent should the pay decisions be to all employees?

Stated versus Unstated Strategies
All organizations that pay people have a compensation strategy. Some may have written, or stated compensation strategies for all to see and understand. Others may not even realize they have a compensation strategy (unstated strategy), claiming that "We do whatever it takes."

Review Exhibit 2.4 for Key Steps in Formulating a Total Compensation Strategy

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DEVELOPING A TOTAL COMPENSATION STRATEGY: FOUR STEPS

Step 1: Assess Total Compensation Implications

Business Strategy and Competitive Dynamics
Organizations need to understand the industry in which they operate and with which they compete. Competitive dynamics can be assessed globally. Pay comparisons between countries are difficult because of different practices and different priorities.

See Exhibit 2.4 to review the key steps in formulating a total compensation strategy.

HR Strategy: Does Pay Play a Supporting Roles or a Catalyst for Change?
Compensation must fit the HR strategy so functions like performance systems support the HR strategy. A flexible compensation system can be used to activate changes to the HR strategy.

Culture/Values
Pay systems should be consistent with the overall organization's philosophy about the way it does business and the way it treats employees in the organization.

See Exhibit 2.5 9for an example of the Medtronic Mission and Values statement.

Social and Political Context
Due to legal and regulatory requirements, cultural differences andchanging work force demographics, expectations take on new meaning in a global context.

Employee Preferences
Employees are different with different preferences. Pay systems can be designed to reflect these preferences by increasing flexibility in the system.

Union Preferences
The influence by unions on pay systems remains significant in Canada. Unions are major players in Europe. The organization must consider union desires and work to design a pay system that will accomplish its goals while satisfing the union.

Step 2: Map a Total Compensation Strategy

.NETWORTH
Netflix: Freedom and Responsibility in Rewards is described in the chapter. Netflix is a global provider of streaming movies and TV series with over 75 million subscribers. Its strategy is all about innovation and its corporate culture emphasises freedom and responsibility.
Compensation strategy is formulated on the five decisions outlined in the pay model:
1) Set objectives
2) Specify four policy choices of:

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a) internal alignment
b) external competitiveness
c) employee contributions, and
d) management.

Steps 3 and 4: Implement the Strategy and Reassess the Fit
Step 3 includes implementing the strategy via the design and execution of the compensation system. This means to essentially take the plan from the strategy and make it come to life in practice.

Step 4 reassesses the fit from changing conditions and realigns the strategy to close the loop. Reassessing the fit offers the opportunity to continuously learn, adapt and improve.

SOURCE OF COMPETITIVE ADVANTAGE: THREE TESTS
There are three questions that are aligned with three tests of competitive advantage including the following:
1) Is it aligned?
2) Does it differentiate?
3) Does it add value?

Align- with the business strategy, externally with the economic and socio-political conditions and internally within the overall HR system.

Differentiate- sustained competitive advantage comes from how the pay system is different from others. One important aspect of competitive advantage is that it will strengthen if the pay system is unique and cannot be copied.

Add Value - finding ways to calculate the return on investments from incentives, benefits and base pay. This approach supports a compensation system that focuses on human capital as the recipient of investments which can be dehumanizing for some. Of all the tests, adding value is the most difficult.

"BEST FIT" VERSUS "BEST PRACTICES"

The underlying premise of designing any pay system is that if the system reflects the organization's strategy and values, and is responsive to both external considerations and internal employee needs, it is more likely to be successful in achieving its objectives.

"Best Fit"
The basic underlying premise of any strategic perspective is whether managers align pay decisions with the organization's strategy and values, and are responsive to employees and union relations, while remaining globally competitive. The organization is more likely to achieve competitive advantage. The challenge is to design the "fit" with the environment, business strategy, and pay plan; the better the fit, the greater the competitive advantage.

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"Best Practices"
Some believe that (1) a set of best practices exists, and (2) these practices can be applied universally across situations. Adopting best pay practices gives employer preferential access to superior HR talent. This talent, in turn, influences the strategy the organization adopts and be a source of competitive advantage. But many writers advocate their own view of what are "best practices."

GUIDANCE FROM THE EVIDENCE

Research supports that specific pay strategies are only relevant under certain contextual boundaries. The most important question is to ask: *"What practices pay off best under what conditions?"*

VIRTUOUS AND VISCIOUS CIRCLES

Two examples of best practices include performance-based pay and stock options grants. In a virtuous circle (*see Exhibit 2.613*), performance-based pay works best with an effective and productive organization. On the contrary, when an organization is not performing well, a vicious circle results and performance-based pay becomes ineffective.

REVIEW QUESTIONS

1. **Read again the values statements in Exhibit 2.5. Discuss how, if at all, these values might be reflected in a compensation system. Are these values consistent with "let the market decide?"**

Medtronic's statement lauds stability, so one would expect a developed internal structure. However, because the company depends on research and its development into high-quality products, it also needs enough internal flexibility so as to permit creativity and innovation. The culture of the company describes a very nurturing environment that would offer substantial relational returns from work. External competitiveness and "market" issues may be dealt with through "sharing the company's success."

2. **What are the three tests used to determine whether a pay strategy is a source of competitive advantage? Discuss whether these three tests are difficult to pass. Can compensation really be a source of competitive advantage?**

The three tests are:
1) Is it aligned?
2) Does it differentiate?

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3) Does it add Value?

A compensation system adds value if it allows the company to attract, retain and motivate the kinds of employees and behaviours that will help it achieve its goals. It must do so in a cost-effective manner, so that the company is not at a cost disadvantage in marking its goods and services.

While all companies seek to achieve this same outcome, a strategy can still be difficult to imitate if it is uniquely designed to fit with the organization's business strategy and other HR activities (recruiting, training, employee relations, etc.) and is implemented fairly.

3. Contrast the essential difference between the "best fit" (strategic business-based) and "best practice" perspectives on compensation.

A strategic, business-based approach says that compensation decisions (and all HR decisions) should be made with the unique characteristics of the company, its employees and its environment in mind, and should be based on how they can help the company achieve its business objectives.

A best practice approach says that certain practices are simply superior in all settings. These practices have been proven in certain companies and efforts should be spent on disseminating them throughout the workplace.

4. Explain why performance-based pay may not always be a best practice.

In a recession or economic downturn, performance-based pay would not be a best practice because the employees would get minimal compensation if the company is performing poorly. Other methods of generating compensation for employees must be used as a best practice like putting more emphasis on non-monetary benefits.

EXPERIENTIAL EXERCISES

1. Interview a compensation specialist about his or her organization's compensation strategy, specifically the five issues – objectives, internal alignment, external competitiveness, employee contributions, and management. How does this organization compare to Google? To Whole Foods? What business strategy does it seem to fit (i.e., cost cutter, customer-centred, innovator, or something else)?

Student answers will vary depending on their ability to find compensation specialists.

2. Set up a debate over the following proposition: "Best Practices" is superior to the "Best Fit" approach when designing a compensation system.

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Although the case is made in the text for business-based approach, proponents of best practice approach can point out the limited research on strategy that supports a business-based approach as well as the narrow range of strategies. For example, almost all companies claim to pay "above the market" and to have systems that "value fairness." Proponents of best practice could make the case that what we actually have is generally accepted practice rather than strategy. The real issue, then, is to make that "generally accepted" practice the "best" practice.

3. Survey ten people about their total rewards preferences. What conclusions can you draw from the results?

Student responses will vary. Refer to chapter 1 and list the potential total rewards in a chart for easy tabulation. Note differences using demographics (age, gender, etc.), years of work experience, family responsibilities, education and other contextual information.

4. Set up a debate over the following proposition "Nonfinancial returns are more important than pay."

Student responses will vary. Consider nonfinancial returns including a great place to work, opportunities to learn, job security, and flexible work schedules. To focus solely on pay when there is high job insecurity would not be relevant. Flex-time would be more desired by parents with small children.

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CASE - Difficult to Copy? .NETWORTH
Questions to consider:

1. **Spend some time looking at the website for Netflix. What can you infer about the business strategy and the organizational culture?**
2. **What external pressures do you think Netflix faces?**
3. **Decide whether you think the compensation strategy of Netflix fits its business strategy, organizational culture, and external pressures.**
4. **How would you change compensation at Netflix?**

Discussion

Netflix created a working culture that is transparent, values its values as well as a hard working, team-oriented "no jerks allowed" employment policy. It is also a culture that fosters mutual accountability. Netflix is on track for strong revenue delivery; it has a strong twelve month stock performance and consistent revenue growth. The seven aspects of its culture are:
1) Values are what we value
2) High performance
3) Freedom and responsibility
4) Context, not control
5)Highly aligned, loosely coupled
6) Pay top of market
7) Promotions and development.

Under the Freedom and Responsibility section of its company policies, Netflix contradicts corporate tendencies because it works to increase employee freedom rather than limit it. In creating such a work environmentthe employer is able to attract creative and innovative people and reap the rewards with sustainable business results. Netflix points out that with the right people, the emphasis is less on new processes and more on the quality of talent pool. Netflix has two rules: prevent irrecoverable disaster and adhere to moral, ethical and legal issues. Netflix expects to hire the best, compensate accordingly and get results. It trusts that staff will use the same level of judgement and act in its best interest. Some highlights for Netflix include:

- The best managers figure out how to get the best from people by establishing context, not controlling the people or outcomes.
- When employees fail, managers should start by asking themselves what they could have done better to set the right context, insight and guidance.
- "Highly aligned, loosely coupled" means group interactions are focused on strategy and goals. Groups will move faster to tactical development and execution in a climate of trust (to get the work done) vs. Audit.
- Pay accordingly. Their "goal is to keep each employee at the top of market for that person".

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- It is okay for employees to test the job market and validate their worth-with the caveat that you talk to your manager about what you find so a salary discussion is transparent, honest and fact based.
- You can move from "the minors to the majors" but you have to be a superstar. Opportunity, the competing pool of superstars and timing will play a role in advancement.
- Personal develop is a personal responsibility not a corporate responsibility.

What makes Netflix unique is the practical application of its culture-starting at the top and reinforced throughout the company. It is based on reciprocity and respect for strong individual talent and results. Yes, its compensation strategy fits its business strategy, organizational culture and external pressures.Compensation would not change because Netflix pays the market rate, wants to pay the best to attract and retain an excellent talent pool. Refer to the Netflix website: https://www.netflix.com for more information on its movies/TV series rental industry and some of the external pressures/challenges it faces.

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COMPENSATION

Fifth Canadian Edition

Chapter One

The Pay Model

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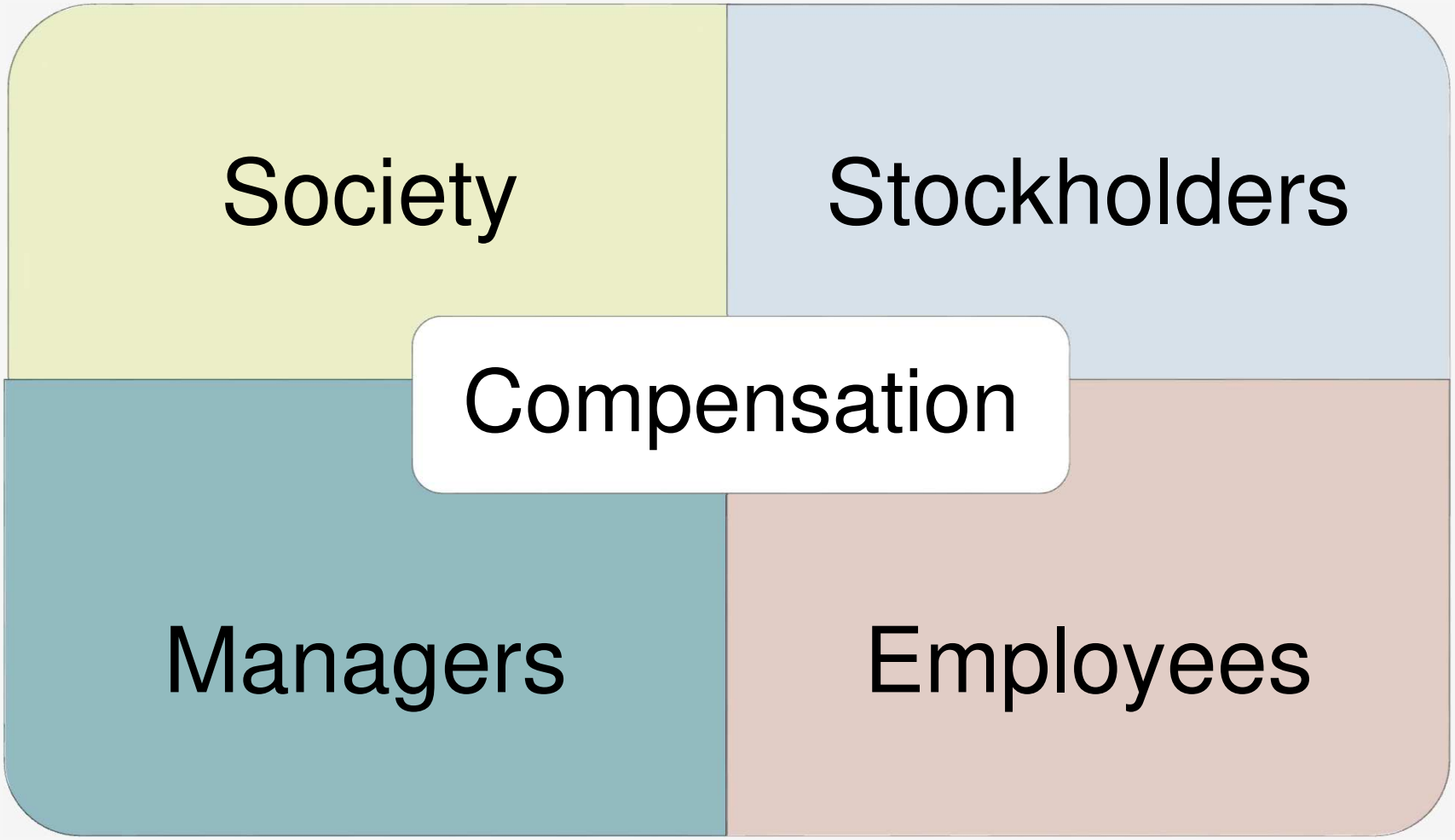
Chapter Topics

- Compensation: Definition
- Forms of Pay
- A Pay Model

What is Compensation?

Compensation refers to all forms of financial returns and tangible services and benefits employees receive as part of an employment relationship.

Different Perspectives



Society

- Some people see pay as a measure of justice.
  - Laws and regulations aim to eliminate the gap between male/female earnings differentials.
  - Benefits may also be seen as a reflection of equality or justice in society.
- Job losses (or gains) in a country is partly a function of labor costs (and productivity).

Stockholders

- Some stockholders say using stock to pay employees creates a sense of ownership.
  - Others argue it dilutes stockholder wealth.
- Stockholders have a particular interest in executive pay.
  - Linking executive pay to company performance increases stockholders' returns.

Managers

- Compensation influences manager's success in two ways.
  - First, it is a major expense that must be managed.
  - Second, it is a major determinant of employee attitudes and behaviors.

Employees

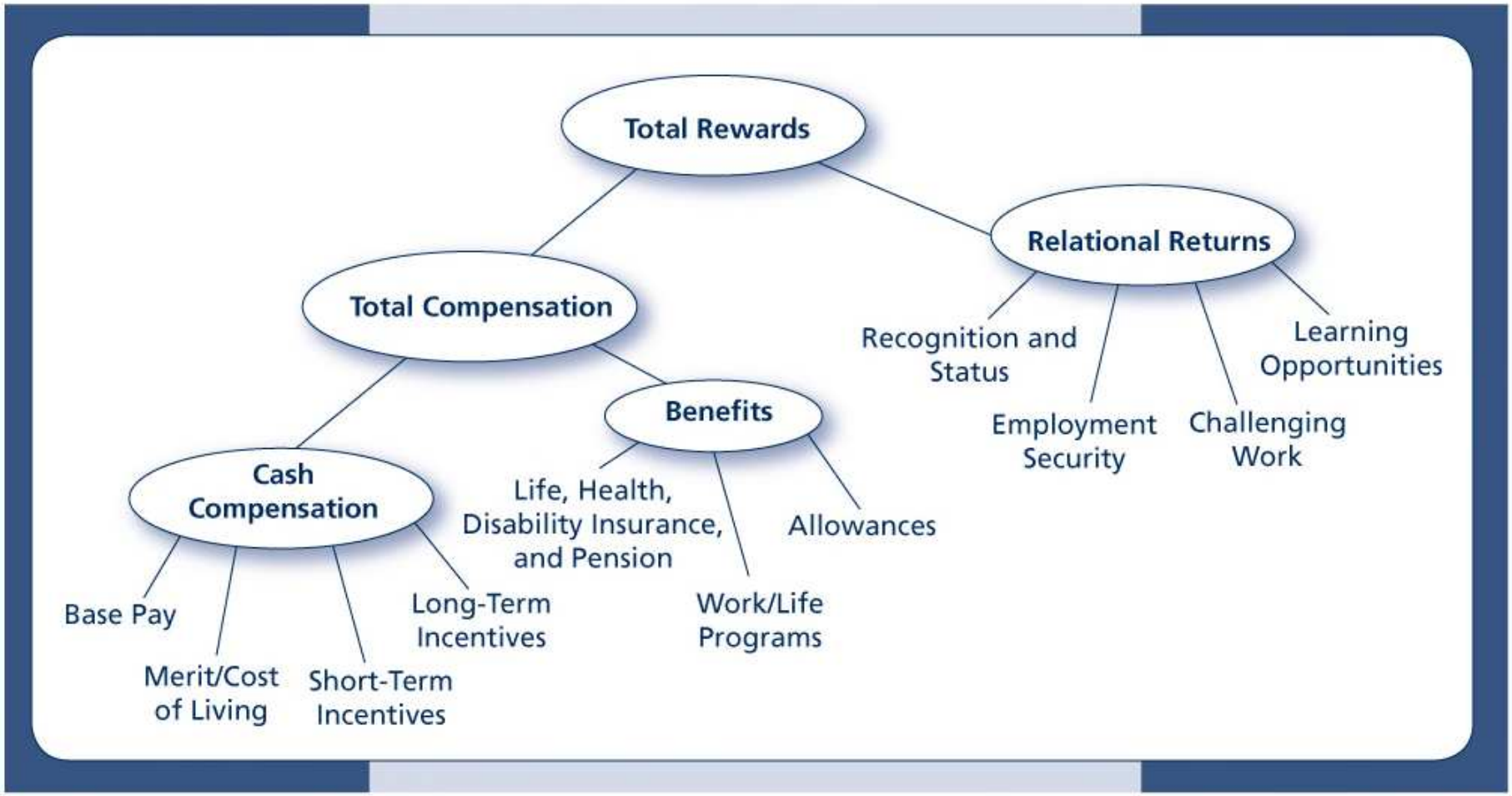
- Pay is usually a major source of financial security.
- Employees may see compensation as:
  - a return in an exchange,
  - an entitlement for being an employee of the company,
  - an incentive to take/stay in a job and invest in performing well, or
  - as a reward for having done so.

Total Rewards

- Total rewards are categorized in two ways.
  - **Total compensation:** pay received directly as cash and indirectly as benefits.
  - **Relational returns:** are psychological.

Total Rewards

EXHIBIT 1.2 Total Rewards



Cash Compensation: Base Pay, Merit/COLA & Incentives

- *Base pay:* Cash that an employer pays in return for the work performed, based on the skill or education an employee possesses
- *Merit increases* are increments to base pay based on performance.
- A *cost of living adjustment (COLA)* is made to base pay on the basis of changes in costs of living.
- *Incentives (or bonuses)* are paid in a lump sum rather than becoming a part of base pay, based on performance. *Can be long or short term.*

Benefits

- Insurance and Pension
  - Health insurance (medical/dental/vision), life and disability insurance, retirement (pension) programs.
- Work/life balance
  - Includes time away from work, access to services, and flexible work arrangements
- Allowances
  - often grow out of short supply

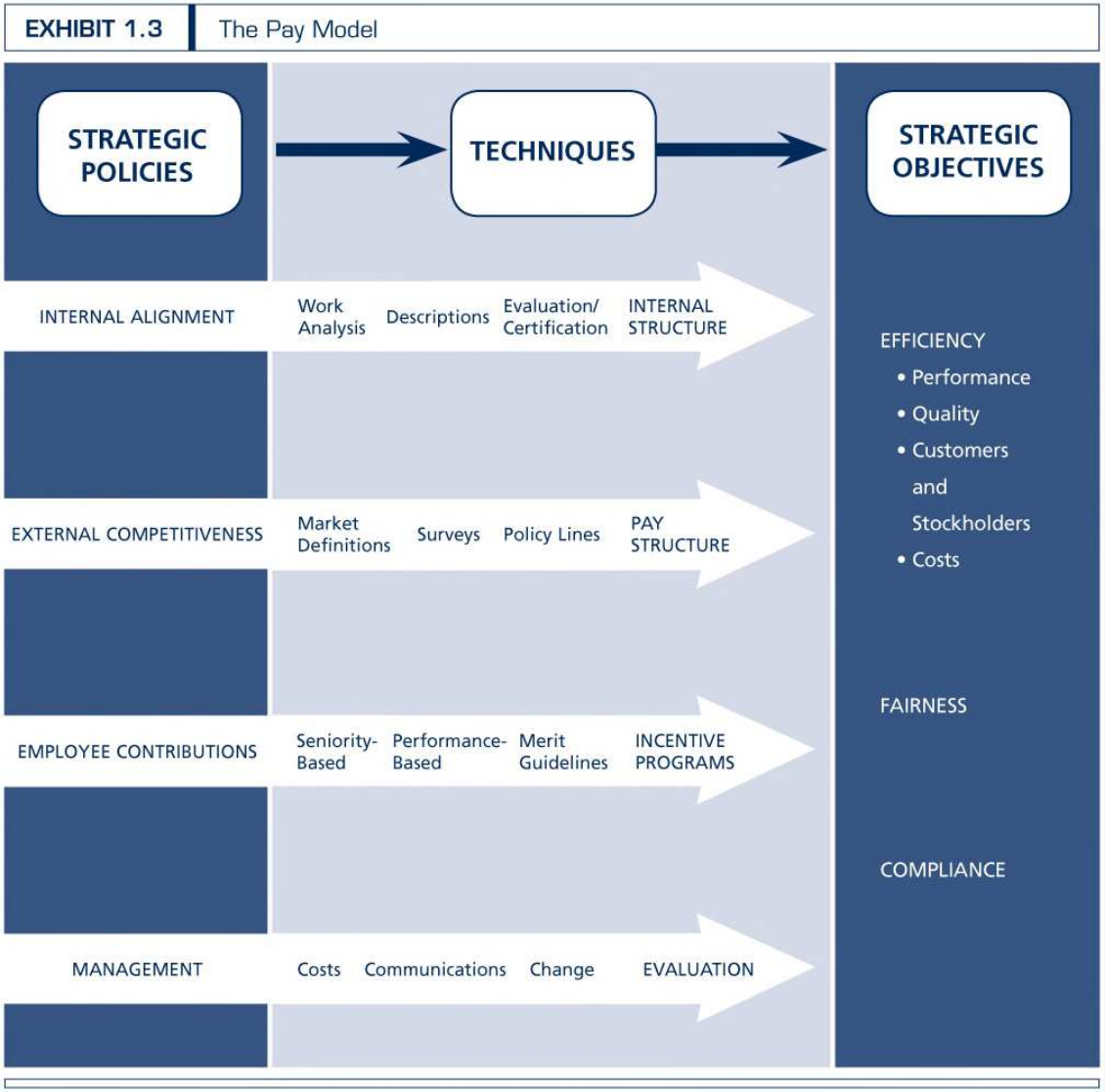
Total Earnings Opportunities

- Present value of a stream of earnings
  - Comparison of today's initial offers to consideration of future bonuses, merit increases, and promotions.
- Relational returns from work
  - Nonfinancial returns that substantially impact employee behavior.
- A network of returns
  - Created by different forms of pay; useful if bonuses, development opportunities, and promotions all work together.

A Pay Model

Three basic building blocks:

- The compensation objectives.
- The policies that form the foundation of the compensation system.
- The techniques that make up the compensation system.



Compensation Objectives

- Pay objectives guide the design of the pay system and are standards for judging success.
  - ***Efficiency*** is improving performance, increasing quality, and controlling costs.
  - ***Fairness*** (*procedural fairness)* is the process used to make pay decisions.
  - ***Compliance*** is conforming to federal, provincial and territorial laws and regulations.

Examples: Pay System Objectives

Medtronic

- Support Medtronic mission and increased complexity of business
- Minimize increases in fixed costs
- Attract and engage top talent
- Emphasize personal, team and Medtronic performance
- Recognize personal and family total well-being
- Ensure fair treatment

Whole Foods

- We are committed to increasing long-term shareholder value
- Profits are earned every day through voluntary exchange with our customers
- Profits are essential to create capital for growth, prosperity, opportunity, job satisfaction and job security
- Support team member happiness and excellence
- We share together in our collective fate

Four Policy Choices: (1) Internal Alignment

- Refers to comparisons among jobs or skill levels inside a single organization.
- Pertains to the pay rates both for employees doing equal work and for those doing dissimilar work.
- Pay relationships affect the compensation objectives of efficiency, fairness and compliance.

Four Policy Choices: (2) External Competitiveness

- Refers to pay comparisons with competitors external to the organization.
- Pay is ‘market driven’.
- Objectives:
  - To ensure that pay is sufficient to attract and retain employees.
  - To control labor costs to ensure competitive pricing of products/ services.

Four Policy Choices

(3) Employee Contributions

Understanding the basis for judging performance, helps perceive pay as fair.

(4) Management

Making sure that the right people get the right pay for achieving the right objectives in the right way.

Pay Techniques

- Techniques tie the four basic policies to the pay objectives.
- Many variations of **pay techniques** exist.

Summary

- The chapter began with the importance of compensation and provided a definition.
- It continued with a discussion on the various forms of compensation.
- The model presented in this chapter provides a structure for understanding compensation systems
- The three main components of the model include:
  - the objectives of the pay system
  - the policy decisions that provide the system's foundation
  - the techniques that link policies and objectives

COMPENSATION

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Chapter Two

Strategy: The Totality of Decisions

Chapter Topics

- Strategy and Strategic Choices
- Formulating Total Compensation Strategy
- Competitive Advantage: Three Tests
- “Best Practices” versus “Best Fit”
- Virtuous and Vicious Circles

Strategy & Strategic Choices

- Strategy: the fundamental business directions that an organization has made in order to achieve its strategic objectives.
- A strategic perspective focuses on those compensation decisions that help the organization gain and sustain competitive advantage
- The greater the alignment, or fit, between the organizational strategy and the compensation system, the more effective the organization
- Different industries may have different pay strategies, but there can be:
  - different strategies within the same industry, e.g. Google, Microsoft, and SAS, or even
  - different strategies within the same company, e.g. SK Holdings.

Three Examples

	Google	Nucor	Merrill Lynch
Objectives	Emphasis on innovation Commitment to cost containment Recognize contributions Attract and reward the best	Focus on customer Most productive Highest quality	Focus on customer Attract, motivate, and retain the best talent Fair, understandable policies and practices
Internal Alignment	Minimize hierarchy Everyone wears several hats Emphasize collaboration	Succeed by working together No defined career paths, but many opportunities	Pay fairly internally Job sized on four factors: knowledge/skill, complexity, business impact, strategic value
Externally Competitive	Market leader in pay and benefits Unique benefits	Below market for base Market leader for total cash compensation	Market competitive in base and benefits Market competitive in incentive/bonus and stock
Employee Contributions	Recognize individual contributions Significant stock programs	Bonuses based on plant production and company profits	Financial advisors work under a strong incentive system based on client wealth management fees/ commissions and total wealth of their client base
Management	Love employees, want them to know it	Not for everyone No-layoff practice, but income fluctuates	Understandable, consistent message

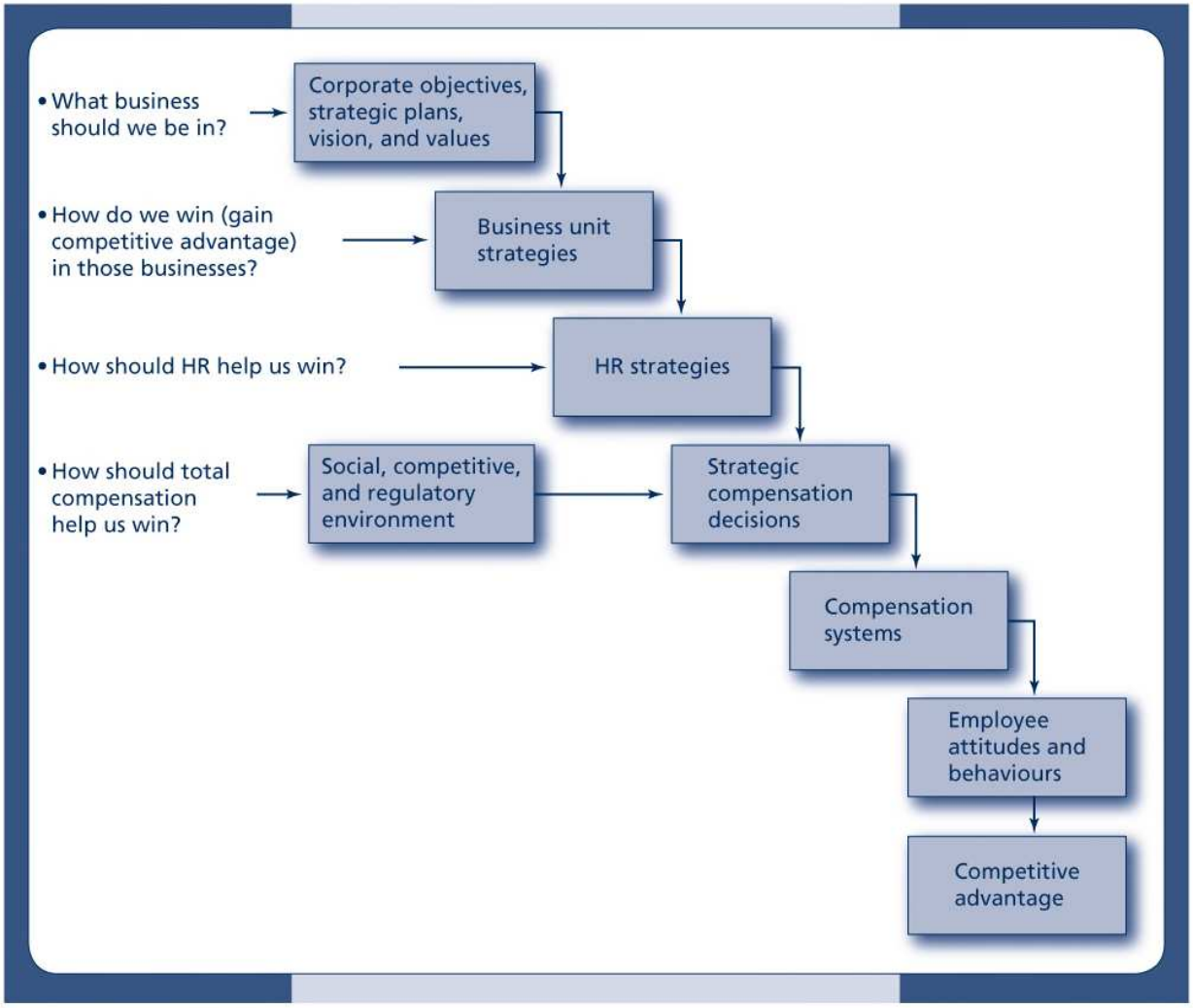
The Pay Model Guides Strategic Pay Decisions

- Five strategic compensation choices:
  - Objectives
  - Internal alignment
  - External competitiveness
  - Employee contributions
  - Management

- These decisions, taken together, form a pattern that becomes an organization's compensation strategy

Strategic Choices

EXHIBIT 2.2 Strategic Choices



Tailor the Compensation System to the Strategy

EXHIBIT 2.3 Tailor the Compensation System to the Strategy

STRATEGY	BUSINESS RESPONSE	HR PROGRAM ALIGNMENT	COMPENSATION SYSTEMS
Innovator: Increase Product Complexity and Shorten Product Life Cycle	• Product Leadership • Shift to Mass Customization • Cycle Time	• Committed to Agile, Risk-Taking, Innovative People	• Reward Innovation in Products and Processes • Market-Based Pay • Flexible—Generic Job Descriptions
Cost Cutter: Focus on Efficiency	• Operational Excellence • Pursue Cost-Effective Solutions	• Do More with Less	• Focus on Competitors' Labour Costs • Increase Variable Pay • Emphasize Productivity • Focus on System Control and Work Specifications
Customer-Focused: Increase Customer Expectations	• Deliver Solutions to Customers • Speed to Market	• Delight Customer, Exceed Expectations	• Customer Satisfaction Incentives • Value of Job and Skills Based on Customer Contact

Support Business Strategy

- Pay systems should align with the organization's business strategy
- When business strategies change, pay systems should also change

Support HR Strategy

- Pay systems should align with the organization's overall HR strategy and systems which include hiring, training and development.

- Employees possess the abilities to executing business strategy and compensation is key to attracting, retaining and motivating employees.

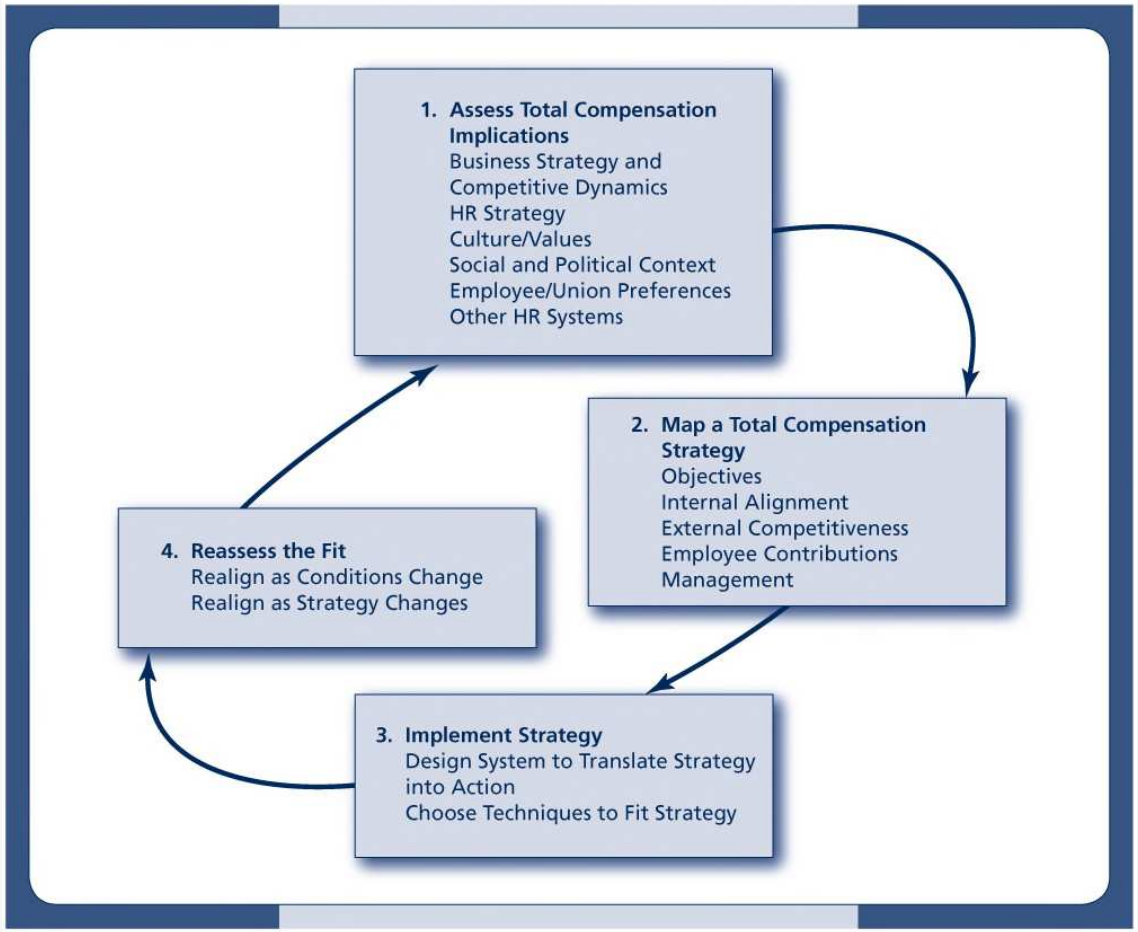
Formulating Total Compensation Strategy

Start with the pay model, and

- assess implications for the total compensation of your organization's situation;
- map out the compensation objectives and four policy choices to achieve them;
- translate policies into the workplace via the compensation system and implement it;
- reassess by comparing results against the pay objectives; and
- continue to learn, adapt, and improve.

Key Steps in Formulating a Total Compensation Strategy

EXHIBIT 2.4 Key Steps in Formulating a Total Compensation Strategy



Step 1
Assess Total Compensation Implications

- Business strategy and competitive dynamics – understand the business.
- HR strategy: pay as a supporting player or catalyst for change?
- Culture/values are reflected in the pay system.
- Social and political context is wide ranging.
- Employee preferences are also wide ranging.
- Union preferences differ by location.

Step 2
Map a Total Compensation Strategy

- Strategic maps offer a picture of a compensation strategy.
  - They provide a visual reference.
  - They are useful for analyzing a strategy as they are easily understood.
  - Strategic maps *do not* tell which strategy is "best" but provides a framework and guidance.
- Decisions in the pay model work in concert.

Steps 3 and 4
Implement and Reassess

- Step 3 involves implementing the strategy through the design and execution of the compensation system.

- Step 4 recognizes that the strategy must change to fit changing conditions, and involves periodic reassessment.

Competitive Advantage: Three Tests

- Is it aligned?
  - Is the compensation strategy aligned with the business strategy, economic and sociopolitical conditions, and the overall HR system?
- Does it differentiate?
  - Is the compensation strategy different and difficult to imitate?
- Does it add value?
  - Does the compensation strategy add value by providing a return on investment?

“Best Fit” versus “Best Practices”

- “**Best fit**” approach suggests that a company is more likely to achieve competitive advantage if pay practices are aligned with business and overall HR strategies. reflects the company’s strategies and values.

- “**Best practices**” approach suggests that there exists a set of best-pay practices, which can be applied universally across all situations, results in better performance with almost any business strategy.

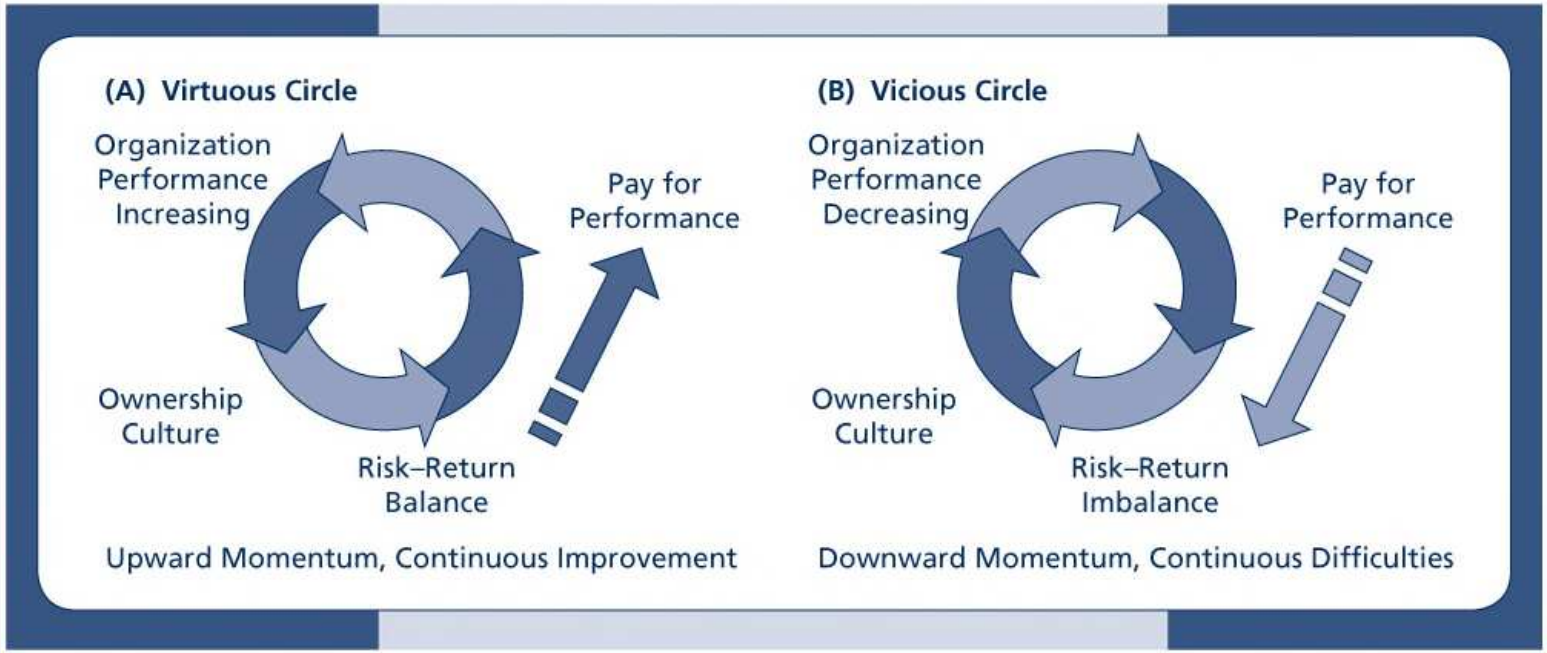
Guidance from the Evidence

- Internal alignment: Pay differences among internal jobs can affect results.
- External competitiveness: Paying higher than the average paid by competitors can affect results.
- Employee contributions: Performance-based pay can affect results.
- Managing compensation: All dimensions of the pay strategy need to be considered.
- Compensation strategy: Embedding compensation strategy within the broader HR strategy affects results. Need to identify what practices pay off best under what conditions.

Virtuous and Vicious Circles

Performance-based pay improves performance when combined with high-performance practices, and can be a best practice under right circumstances.

EXHIBIT 2.6 Virtuous and Vicious Circles



Summary

- Strategy and strategic choices that support business strategy and HR strategy was discussed
- The four-step process to develop a compensation strategy is:
  - assess environmental conditions
  - decide on the best strategic choices
  - implement the strategy, and
  - reassess the fit
- Compensation strategy must be aligned with overall business and HR strategies
- The three tests for whether pay strategy provides competitive advantage are: (1) does it align?; (2) does it differentiate?; and (3) does it add value?
- Emerging evidence suggests that a focus on “What practices pay off best under what conditions?” will be most effective.

COMPENSATION

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Part One

Internal Alignment

Part Two

External Competitiveness

Part Three

Employee Contributions

Part Four

Managing the System

Chapter Three

Defining Internal Alignment

Chapter Topics

- Defining internal alignment and pay structure.
- Factors that shape internal structures and the strategic choices to consider when designing internal structures.
- Guidance from research on internal alignment and the positive consequences of internal alignment.

Internal Alignment

- Often referred to as *internal equity*
- refers to the relationships among different jobs/skills/competencies within a single organization → job structure
- Structure needs to:
  - Supports organization strategy.
  - Supports work flow.
    - **Work flow** is the process by which good and services are delivered to the customer.
  - Motivates behavior.
    - **“line-of-sight”.**
    - Structure must be fair to employees.

Internal Pay Structure

- Refers to the array of pay rates for different work or skills within a single organization.
- An internal pay structure can be defined by:
  - the number of *levels* of work,
  - the pay *differentials* between the levels, and
  - the *criteria or bases* used to determine those levels and differentials.

Job Structure at an Engineering Company

EXHIBIT 3.1 Job Structure at an Engineering Company

Entry Level

Engineer

Limited use of basic principles and concepts. Develops solutions to limited problems. Closely supervised.

Senior Engineer

Full use of standard principles and concepts. Provides solutions to a variety of problems. Under general supervision.

Systems Engineer

Wide applications of principles and concepts, plus working knowledge of other related disciplines. Provides solutions to a wide variety of difficult problems. Solutions are imaginative, thorough, and practicable. Works under only very general direction.

Lead Engineer

Applies extensive expertise as a generalist or specialist. Develops solutions to complex problems that require the regular use of ingenuity and creativity. Work is performed without appreciable direction. Exercises considerable latitude in determining technical objectives of assignment.

Advisor Engineer

Applies advanced principles, theories, and concepts. Contributes to the development of new principles and concepts. Works on unusually complex problems and provides solutions that are highly innovative and ingenious. Works under consultative direction toward predetermined long-range goals. Assignments are often self-initiated.

Consultant Engineer

Exhibits an exceptional degree of ingenuity, creativity, and resourcefulness. Applies and/or develops highly advanced technologies, scientific principles, theories, and concepts. Develops information that extends the existing boundaries of knowledge in a given field. Often acts independently to uncover and resolve problems associated with the development and implementation of operational programs.

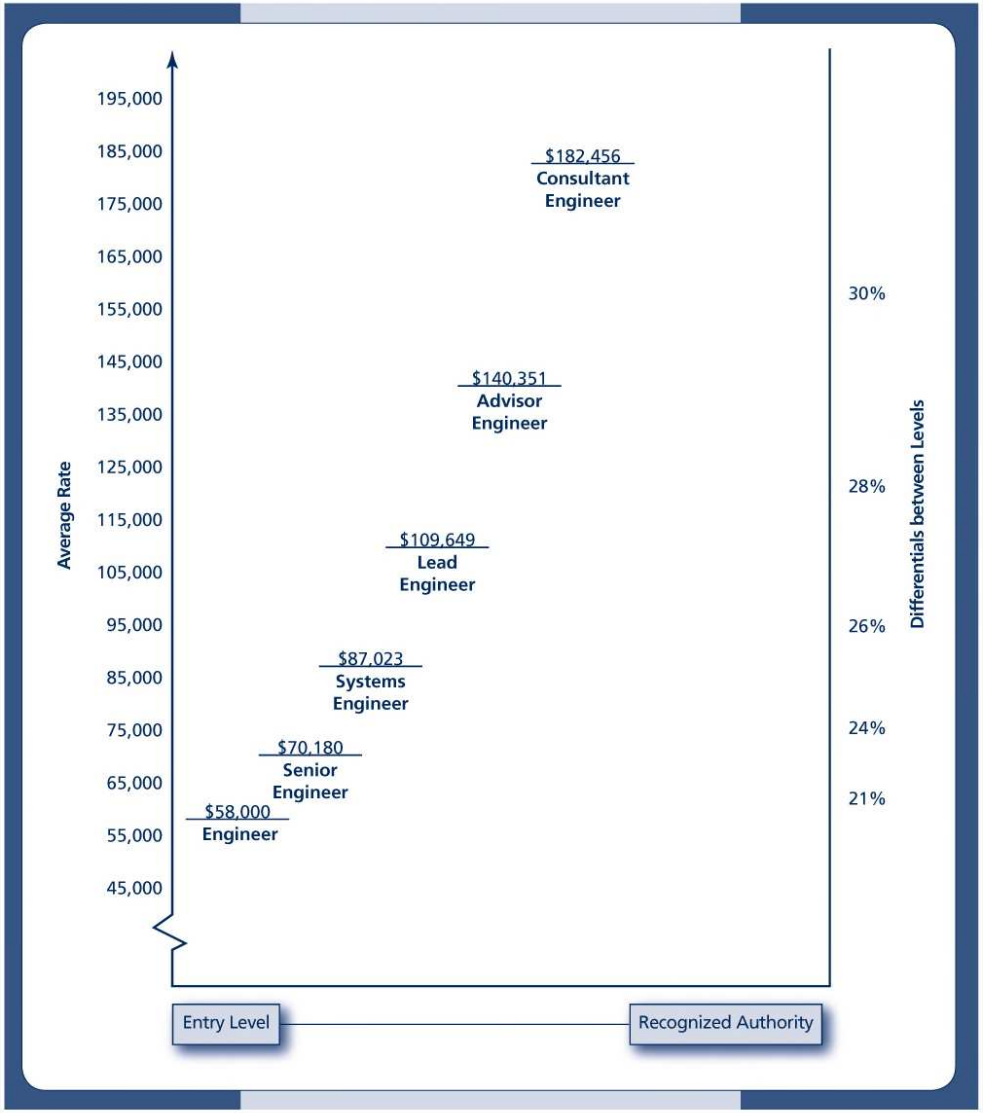
Recognized Authority

Differentials

- The pay differences among levels are **differentials**.
- Higher pay is usually due to work:
  - requiring more skill/knowledge,
  - performed in unpleasant work conditions, or
  - work that adds more value to the company.

Levels

EXHIBIT 3.3 Engineering Pay Structure



Criteria

Content

Work performed in a job and how it gets done

A structure based on content ranks jobs based on skills required, complexity of tasks, problem solving, and/or responsibility.

Value

The worth of the work.

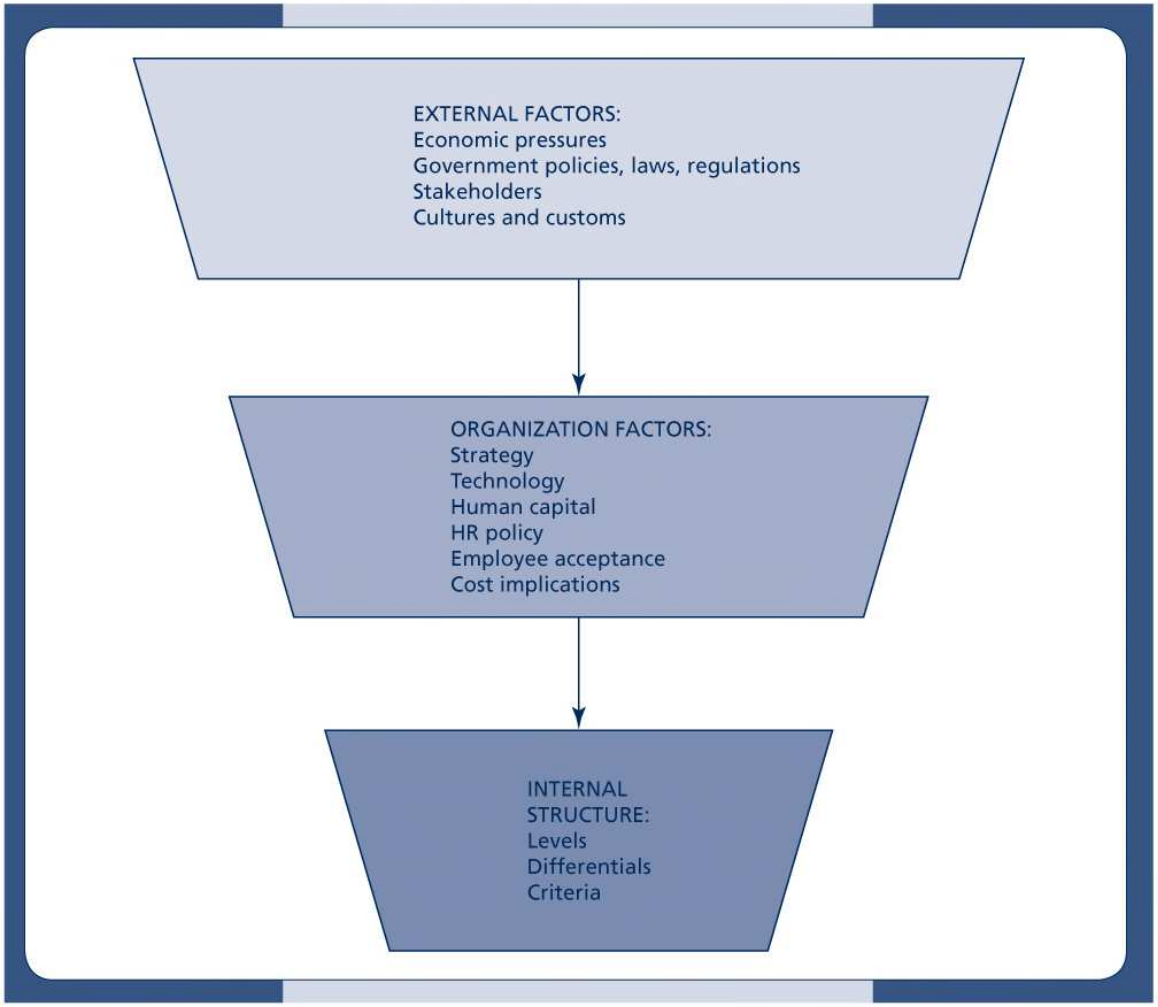
A structure based on value focuses on the *relative contribution* of the skills, tasks, and responsibilities.

Job- and Person-Based Structures

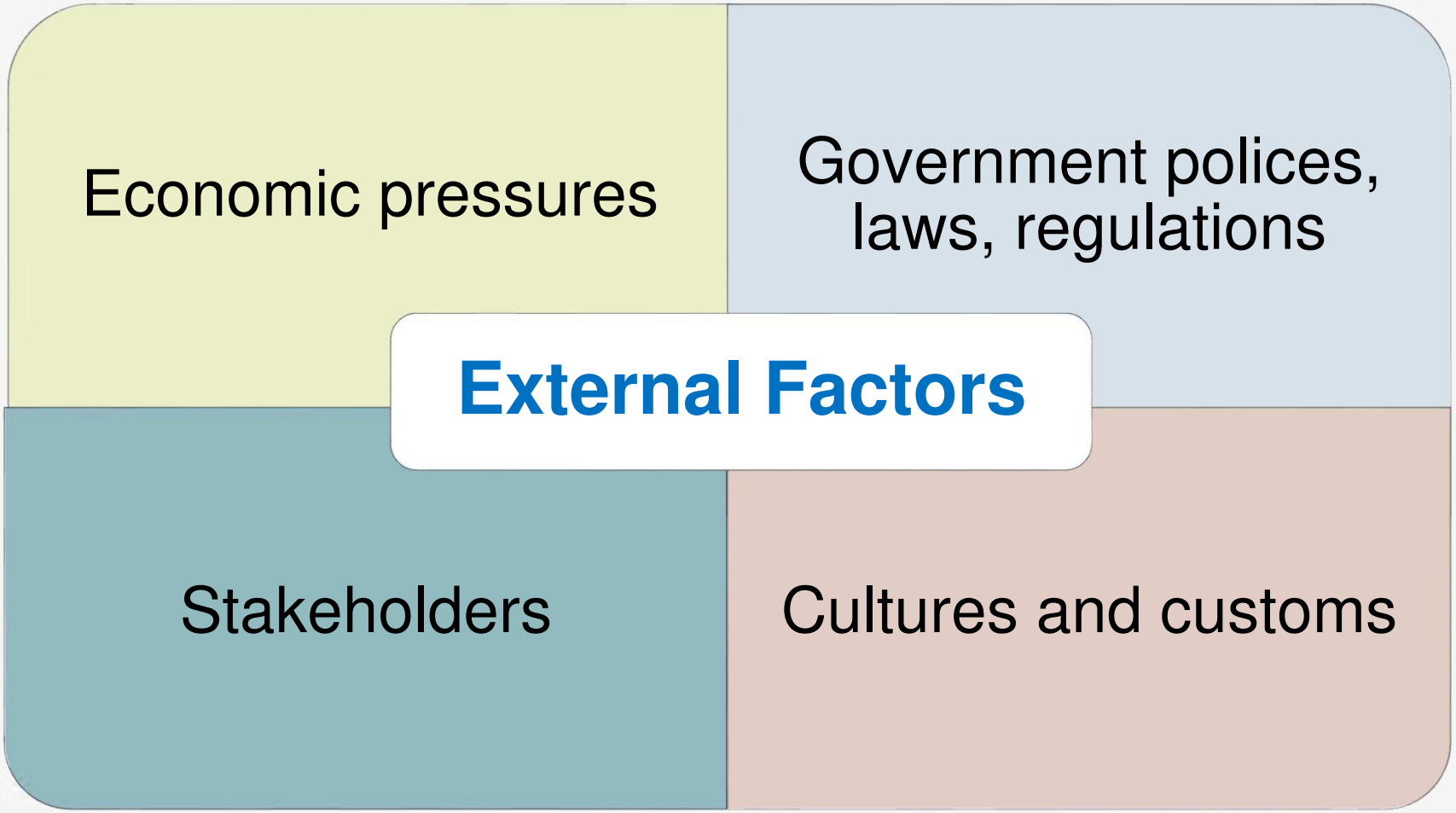
- A **job-based structure** relies on the work content – tasks, behaviors, responsibilities.
- A **person-based structure** shifts the focus to the employee.
  - The *skills, knowledge, or competencies* the employee possesses and if they are used in the job.

What Shapes Internal Structures?

EXHIBIT 3.4 What Shapes Internal Structures?



What Shapes Internal Structures?

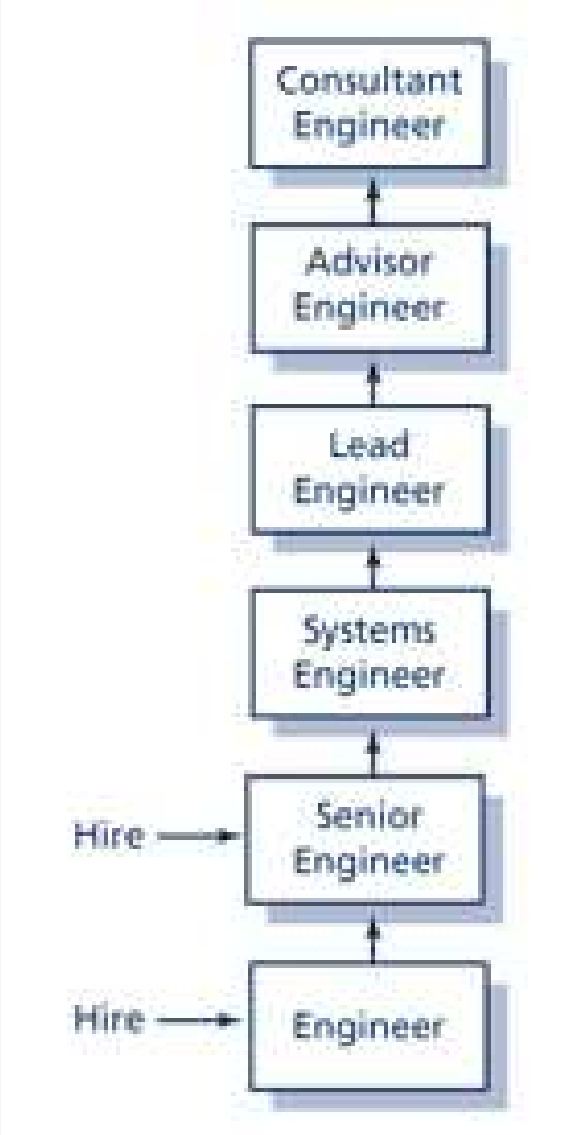


What Shapes Internal Structures?

Internal Labour Markets

Refer to the rules and procedures that:

- determine the pay for the different jobs within a single organization, and
- allocate employees among those different jobs.



Strategic Choices in Designing Internal Structures

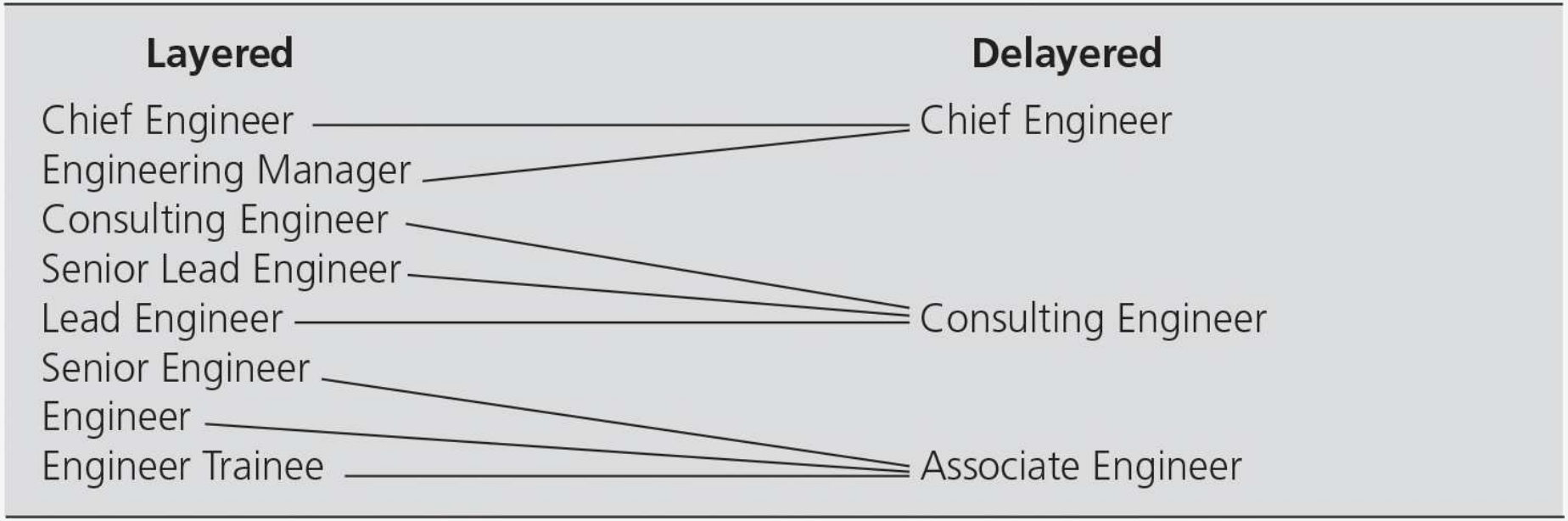
Tailored

- Adapted by organizations with a low-cost, customer-
- focused strategy.
- Has well-defined jobs with detailed steps or tasks.
- Very small pay differentials among jobs.

Loosely Coupled

- Requires constant innovation.
- Jobs are flexible, adaptable and changing
- Pay structures are more loosely linked to the organization to provide flexibility.

Structures Vary in Number of Levels



Strategic Choices in Designing Internal Structures

Egalitarian

- All employees are valued equally.
- Advantages:
  - Fewer levels and smaller differentials.
- Disadvantages:
  - Equal treatment can mean more knowledgeable employees feel underpaid.

Hierarchical

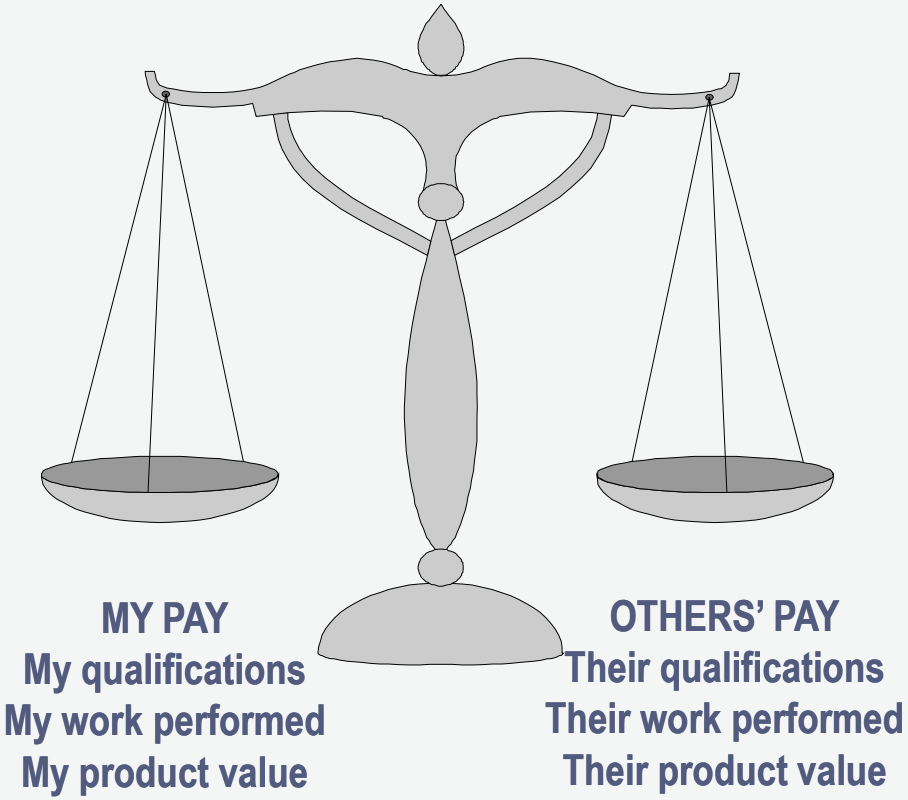
- Values the differences in work content, skills, and contribution.
- Many levels with large differentials
- Includes detailed descriptions of work done at each level.

Hierarchical vs Egalitarian Structures

	Hierarchical ←	→ Egalitarian
Levels	Many	Fewer
Differentials	Large	Small
Criteria	Person or job	Person or job
Supports:	Close fit	Loose fit
Work Organization	Individual performers	Teams
Fairness	Performance	Equal treatment
Behaviors	Opportunities for promotion	Cooperation

Guidance from the Evidence Equity Theory: Fairness

- People compare the ratio of their own outcomes to inputs with that of others.
- Employees judge fairness by comparing:
  - to jobs similar to their own,
  - their job to others at the same employer, or
  - their pay against external pay levels.



Guidance from the Evidence Tournament Theory

Relationship between motivation & performance.

- Example: players perform better where prize differentials are sizeable
- Works best in situations where individual performance matters most
- Does not directly address turnover.

Guidance from the Evidence Institutional Model

Copy others and conform

- Organizations use “best practices”.
- What aligns with the strategy of one organization may not align with that of another.

Consequences of an Internally-Aligned Pay Structure

- Efficiency
  - Aligned structures lead to better performance.
- Fairness
  - Proponents say fair differentials motivate.
  - Others say only small differentials incite cooperation.
- Compliance
  - Comply with regulations of the country.

Potential Outcomes of an Internally-Aligned Pay Structure:

- Undertake training
- Increase experience
- Reduce turnover
- Facilitate career progression
- Facilitate performance
- Reduce pay-related grievances
- Reduce pay-related work stoppages

Summary

- Internal alignment refers to the relationships among jobs/skill/competencies within a single organization.
- Pay structures refer to the array of pay rates for different jobs within an organization and are defined by number of levels, amount of differentials, and the criteria used for determining these.
- Both economic and organization factors shape internal structures and strategic choices to consider when designing internal structures were discussed.
- The goals of the entire compensation system must be kept in mind when designing internal pay structures. The chapter ends with a look at research on internal alignment and the positive consequences of internal alignment.

COMPENSATION

Fifth Canadian Edition

Part One

Internal Alignment

Part Two

External Competitiveness

Part Three

Employee Contributions

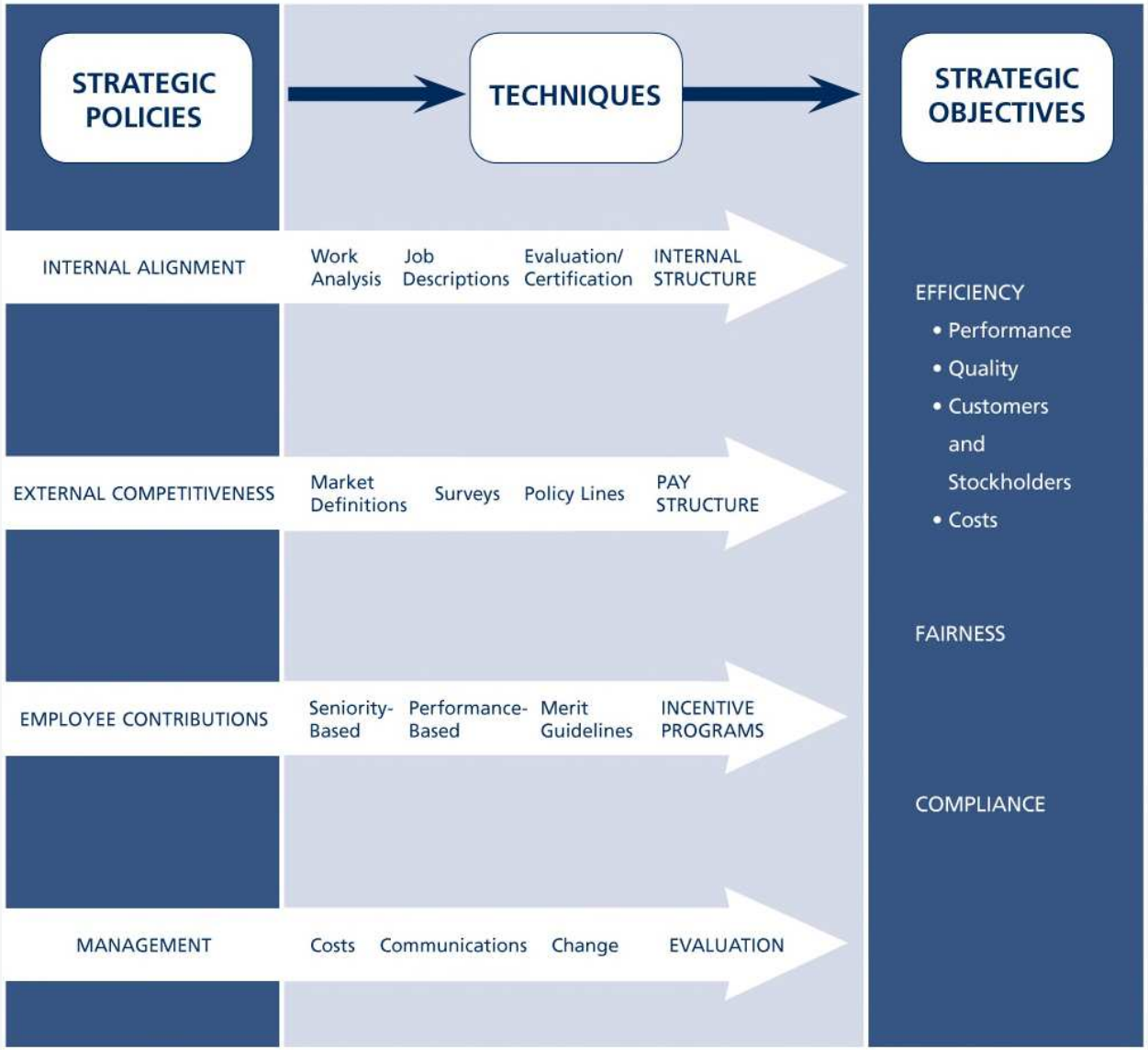
Part Four

Managing the System

Chapter Four

Job Analysis

EXHIBIT I.1 The Pay Model



Some information from L. Myers, "Cornell Alumni Make *CSI* Television's Most Watched Show," *Cornell University Chronicle Online*, November 2, 2005, www.news.cornell.edu/stories/Nov05/Alum.focus.CSI.lm.html, www.news.cornell.edu (accessed July 28, 2012).

Compensation (Canadian) 5th edition Milkovich Solutions Manual

Chapter Topics

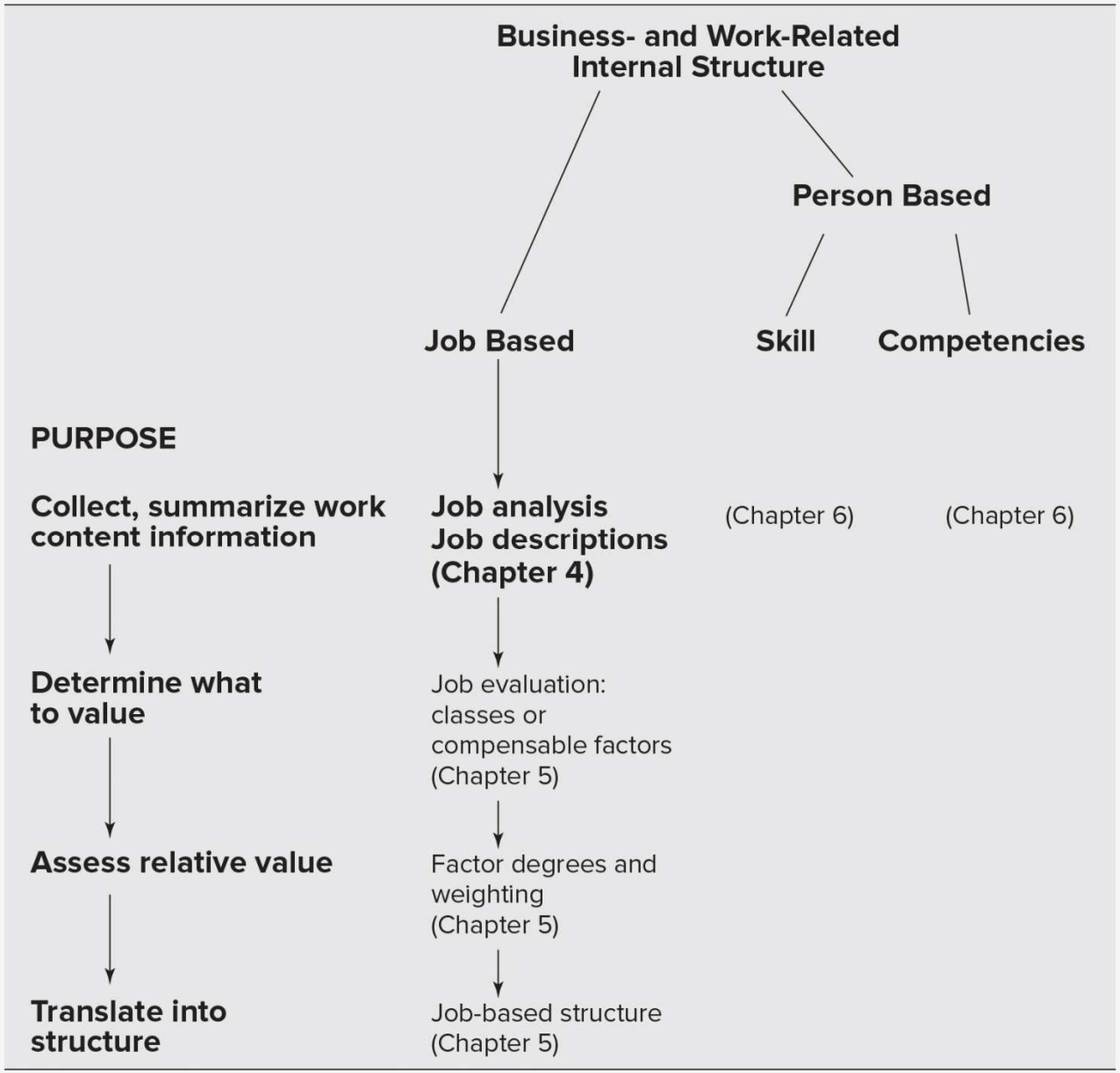
- Criteria for pay structures
- Importance of job analysis
- Job analysis procedures
- Job analysis and globalization
- Judging job analysis

Structures Based on Jobs, People, or Both

- Job-based structures:
  - look at what people are doing and the expected outcomes
- Skill- and competency-based structures:
  - look at the person

EXHIBIT 4.1

Many Ways to Create Internal Structure



Job Analysis

- the systematic process of collecting information about the nature of specific jobs.
- Involves the identification and description of what is happening on the job
  - required tasks, duties and responsibilities
  - required knowledge and skills
  - working conditions
- results are used for describing and valuing work.

EXHIBIT 4.3

Determining the Internal Job Structure

Internal work relationships within the organization →

Job analysis → The systematic process of collecting information that identifies similarities and differences in the work

Job descriptions → Summary reports that identify, define, and describe the job as it is actually performed

Job evaluation → Comparison of jobs within an organization

Job structure An ordering of jobs based on their content or relative value

Some Major Decisions in Job Analysis

- Why perform job analysis?
- What information is needed?
- How to collect information?
- Who to involve?
- How useful are the results?

Why Perform Job Analysis?

- Job analysis potentially aids every HR function.
- In compensation, job analysis has two critical uses:
  - it establishes similarities and differences in the work contents of the jobs, and
  - it helps establish an internally fair and aligned job structure.

EXHIBIT 4.4

Job Analysis Terminology

JOB FAMILY

Grouping of related jobs with broadly similar content; e.g., marketing, engineering, office support, technical.

JOB

Group of tasks performed by one person that make up the total work assignment of that person; e.g., customer support representative.

TASK

Smallest unit of analysis, a specific statement of what a person does; e.g., answers the telephone.
Similar tasks can be grouped into a task dimension; e.g., responsible for ensuring that accurate information is provided to the customer.

Information To Be Collected

- Related to the job:
  - Job Identification – includes job titles, departments, and the number of people who hold the job
  - Job content – elemental tasks or units of work, with emphasis on the purpose of each task

- Related to the Incumbent
  - Employee characteristics
  - Internal relationships
  - External relationships

Methods for Collecting Information

- Interviews
- Focus Groups
- Questionnaires
- Observation
- Journals and Diaries

Who Collects and Who Provides?

Who Collects?

- Human resource generalists and supervisors.
- Someone thoroughly familiar with the organization and its job.

Who Provides?

- Jobholders and supervisors.
- Subordinates and employees in other jobs that interface with the job under study.
- Number of incumbents from which to collect data varies with the stability of the job and ease of collecting the information.

What About Discrepancies?

- Collect more data and discuss discrepancies, asking for sign off on revised results.
- Disagreements can:
  - clarify expectations, learn a better way to do a job, and document how the job is performed.
- Support of top management, and union officials, is critical.

Outcomes of Job Analysis

Job Description

A written record of the tasks, duties, and responsibilities that make up a job.

Identifies and describes the job title, job summary, relationships to other jobs.

Job Specification

Specifies the knowledge, skills, and abilities necessary to perform the job.

More on Job Descriptions

- Use generic job descriptions to avoid starting from scratch or to cross-check externally.
- Descriptions of managerial/professional jobs are often more detailed.
- Verify the description with jobholders and supervisors to make sure it is accurate and complete, note needed clarifications.

A Judgment Call

- Work-related information is needed to determine pay
- differences in work determine pay differences.
- The real issue should be: How much detail is needed to make these pay decisions?
  - enough to set pay levels, encourage continuous learning, increase the experience / skill of the work force, and minimize the risk of pay-related grievances.

Job Analysis: Bedrock or Bureaucracy?

- Employers are reducing jobs, cross-training employees, and using generic job descriptions, improving flexibility.
- Traditional job analysis makes distinctions among levels of jobs, increases rigidity.
- Job analysis in a globalized economy:
  - job analysis maintains consistency in job content.
  - One potential challenge is that perceptions of what is part of the job may vary by country.

Job Analysis and Globalization

Offshoring

Refers to the movement of jobs to locations beyond a country's borders.

Susceptibility to Offshoring

- Historically only blue collar jobs were susceptible to offshoring, now white collar jobs are susceptible too.
- Managerial jobs and positions where local knowledge is essential are not as susceptible.

Judging Job Analysis

Reliability

A measure of the consistency of results among various analysts/methods/ sources of data, or over time.

Validity

Examines the convergence of results among sources of data and methods.

Note: Reliability is a necessary, but not sufficient condition for **validity**.

Acceptability

Data and process must be acceptable to job holders and managers.

Currency

The job information must be current.

Usefulness

Refers to the practicality of the information collected, e.g. Can it be used for multiple purposes?

Summary

- Job analysis is the systematic process of collecting information about the nature of specific jobs
- job analysis establishes similarities and differences in the work contents of the jobs, and helps facilitate the establishment of an internally fair and aligned job structure.
- The following decisions have to be made:
  - What information should be collected?
  - How can the information be collected?
- Job analysis (both the process and the outcomes) has to be reliable, valid, acceptable, current and useful.