Compensation and Human Resources Management

Compensation is an integral part of human resources management, which in turn is a vital component of the management of the enterprise. Compensation work in all its forms should contribute to the success of the organization and serve the direct participants of the enterprise. Compensation work must recognize that the functional areas of human resources management are interrelated and that, in combination, they support the basic strategy, goals, and values of the organization (see Exhibit 1-1).

Compensation professionals seek to provide a rational method for determining how much employees should be paid for performing their jobs. Pay is related to the maintenance of an organization's human resources; employees

Learning Objectives

By the end of this chapter, you should be able to:

• List three ways in which compensation plays a role in the management of the enterprise.
• Describe the relationship between the compensation function and other human resources functions.
• List five key issues that should be identified prior to establishing compensation policies.
• Describe why the attributes of an effective compensation program are important to the compensation professional.
• Identify the seven objectives of a compensation program and how they relate to the overall system of managing an enterprise.
must earn a living, and they may seek alternative employment if the organization's pay levels are inadequate. Therefore, the compensation function is charged with determining and maintaining pay levels that attract, retain, and motivate quality human resources.

The compensation function also affects the planning, staffing, and employee development concerns of human resources management professionals. Because compensation represents a significant organizational cost, it is a major consideration in human resources planning. For example, an organization may find it more cost-effective to maintain an employee development strategy (promote from within) than to rely on external recruiting for positions in the organization.

The Role of Compensation in Enterprise Management
Compensation work contributes to the overall success of the enterprise in several ways. To be effective, the compensation professional must appreciate the value of competitive pay, human resources, and an investment view of payroll costs.

Competitive Pay
The use of compensation to attract and retain talent is a critical management activity. As a form of motivation, pay contributes to the competitive success of the enterprise.

Human Resources
Human talent is an asset, and in an increasingly technological world, it represents the only truly unique asset of an enterprise. Compensation profession-
als must recognize that they play a critical role in the acquisition, utilization, and retention of the organization’s most critical asset.

Because human assets are essential to an efficient enterprise, the management of these resources is important. Compensation work is required to support management in achieving higher productivity by developing, adapting, and modifying programs to meet the organization’s constantly changing needs. Companies may need to change their compensation programs to support penetration into new markets, the introduction of new products, changes in competitors’ strategies, or changes in the available labor pool.

An Investment View of Payroll Costs
Compensation affects business success because pay is a major expense item. Payroll costs must be managed like any other cost. Although compensation professionals are and should be concerned with managing these costs, they must also take the view that payroll costs represent an investment in human resources that will yield a tangible, significant return to the enterprise. Compensation professionals are concerned with investing compensation dollars to gain an optimal return for the business.

Compensation Policy
Policy making is an essential management task that applies to all areas and activities of the enterprise. Policy guidelines should reflect the thinking, values, and basic strategies of the company, and they must be set consciously and thoughtfully by top management. Before setting compensation policies, management should address some basic policy questions:

• How will jobs be valued (by content, skills required, etc.)?
• How should pay compare to similar positions in relevant markets?
• What is the policy with respect to pay for performance?
• Is there a commitment to pay in relation to inflation, and if so, what is that commitment?
• Will all persons and jobs be treated in the same way regarding compensation policies, or will there be differentiation according to title, tenure, or some other criteria?
• What will be the policy regarding employee contributions to company-sponsored health and retirement benefits?
• What will be the policy on communicating the compensation program? Will the company have an "open" system?
• What federal and state laws apply to delivery of compensation and benefit programs, and how will these be implemented?

OBJECTIVES OF AN EFFECTIVE COMPENSATION PROGRAM
An effective compensation program is a key part of the human resources function and therefore an integral component of the overall system of managing
an enterprise. A sound compensation program should strive to meet the following objectives:

- Serve all stakeholders.
- Be simple.
- Identify compensation needs.
- Group employees properly.
- Include a process for developing a compensation program.
- Reflect company culture and values.
- Be skilled in the art of managing change.

**Serve All Stakeholders**

A sound compensation system is composed of programs and practices that help make pay decisions and resolve pay problems in an effective and efficient manner consistent with the interests of all stakeholders in the enterprise. Stakeholders include the enterprise's shareholders, senior managers, human resources managers, employees, and customers.

All stakeholders have a tangible interest in the enterprise and are affected by its compensation programs and policies. The compensation program has a direct impact on the standard of living and self-esteem of owners, managers, and employees. A good program should facilitate the execution of their responsibilities. Shareholders and customers are also served by a sound compensation program, although less directly.

**Be Simple**

The best compensation plan is not necessarily the most elaborate nor the most complicated. It is the plan that best meets the needs of a particular enterprise. A complicated program may lack the flexibility needed to adapt to changing business needs and practices. The compensation program should be useful to the enterprise, facilitate the achievement of reasonable employee goals, be helpful to managers, balance the interests of all the stakeholders in the enterprise, and, at the same time, be as simple as possible.

In recent years, a great deal of technology in the field of compensation has been developed. It has encouraged elaborate, complicated, and institutionalized programs. The challenge for the compensation professional is to apply available information and technology in the most practical, useful, and efficient way to meet the needs of the organization.

Three basic criteria can be used to evaluate the appropriateness of any program or practice. First, a clear and compelling internal business or market need must be present. Second, the proposal to deal with the need should address the problem directly. Third, the value of the new program or practice must be greater than the cost, including the time costs of employees and the costs of disruption.

**Identify Compensation Needs**

A practical business approach to compensation administration starts by identifying the organization's needs. Identifying needs leads compensation man-
agers to ask the right questions, find out what the issues are, and seek the best solutions.

Some compensation needs and opportunities are caused by broad economic, political, and social trends and therefore affect all companies to some degree. Other needs and opportunities vary by industry and from company to company, based on company operations and management actions. Within a given company, needs will also vary among divisions and business units. Compensation needs should be considered in the context of overall human resources priorities.

**Group Employees Properly**

The proper development of compensation programs involves the proper grouping of employees for purposes of human resources management generally and compensation administration specifically. Different types of jobs may require different types of pay programs and practices. How employees are grouped and how programs are tailored to the different needs of groups are basic issues in compensation.

For management purposes, jobs must be grouped so that work elements and characteristics are similar in each group and the types of training and recruiting methods required to fill the jobs are appropriate. Many human resources practices, such as recruiting, communications, training, and compensation, can be developed to meet the needs of the jobs and the people who fill the jobs in each group.

At least five groups of employees should be considered. Not all companies will have all of these groups:

- Production/operations employees
- Sales employees
- Administrative, technical, and supervisory employees
- Professional employees
- Management employees

Frequently, subgroups can be found within these groups. For example, large companies sometimes distinguish between the management group and executives.

At the top of the company hierarchy are executive and management employees. This is a small group of high-level managers who make decisions and judgments that affect business results and the long-term success of the company.

Professional employees are those who apply formal knowledge to the solution of company problems. Included in this group are physicians, lawyers, engineers, and others who apply recognized academic disciplines. Also included are business disciplines such as human resources and finance.

Sales employees include those who sell the company’s products or services. Production and operations workers may include both factory and office staff, including those who operate equipment, process materials, and perform clerical tasks.
Exhibit 1-2
Recommended Process for Developing a Compensation Program

1. Identify needs, problems or opportunities, focusing on such methods as:
   - Data analysis
   - Reported issues
   - Discussions with managers
   - Discussions with employees
   - Personnel audits

2. Develop objectives:
   - Set specific goals
   - Consider impact on other human resources management programs
   - Schedule
   - Consider resources available

3. Conceptualize the answer early in the work and at first as a broad sketch, considering:
   - Company characteristics
   - Competitive practices
   - Company culture
   - Employee reactions

4. Testing and specific program design, which may involve:
   - Legal, tax, and accounting considerations
   - "What-if "gaming and modeling
   - Comparative analysis with alternative answers
   - Evaluation against company plans and forecasts

5. Implementation
6. Evaluating the effectiveness of the program
7. Review

Source: Reprinted, with permission of the publisher, from COMPENSATION, FIFTH EDITION by Robert E. Sibson, C 1990 AMA-COM, a division of the American Management Association. All rights reserved.

Include a Process for Developing a Compensation Program
Exhibit 1-2 shows a traditional approach to problem solving in business and is applicable to the development of a solid compensation program.

Reflect Company Culture and Values
Business circumstances and operating characteristics influence the proper design and management of a compensation program. Issues to be considered include the organization's inclination to innovate, its management style, and its inclination to depend on bureaucracy.

Organizations typically evolve through four phases from foundation to maturity. Each phase requires a substantially different compensation program and a different emphasis in the mix of pay for some groups. The first phase involves the early formation of the company and its beginning opera-
tions. The second involves a rapid growth phase and heavy investment in the business. The third phase represents high levels of profitability and slowing growth. The fourth phase involves a period of stability and maturity.

A sound compensation program must reflect the culture of the organization. A company's culture is based on its fundamental values and beliefs and in simple terms is "the way we do things around here."

The issues of company culture are human resources management issues. Company culture relates to how a company manages people, its human resources management policies, its executive management attitudes toward the management of people, how people work together, how people are paid, and how decisions are made. Understanding a company's culture is particularly valuable in the development and implementation of management and executive pay programs. Company cultures also may reflect the dominant culture within a particular industry. (See Chapter 2 for more on company culture.)

Be Skilled in the Art of Managing Change

Compensation professionals must learn to work in an environment of change. Often this involves changing or adapting compensation programs on very short notice. It is much easier to change a program than it is to manage people's reactions and resistance to the change in the program.

Many changes that must be managed are unique to a business and initiated by the management of the business. Other changes, however, are caused by social, economic, technological, and political developments and are sometimes more difficult to predict. Compensation managers, like their counterparts in other functions, need to develop the skills necessary to anticipate and manage change.

SUMMARY

This chapter defines the role of the compensation professional within an organization and within the human resources function and emphasizes the importance of that role to the organization's success. Compensation is an integral part of human resources management, which in turn is a vital component of the management of the enterprise. Compensation professionals are responsible for determining and maintaining pay levels that attract, retain, and motivate employees, who, as a company's most important asset, will determine the success of the organization.

Creating and refining the company's compensation policies are essential responsibilities of top management and compensation professionals. Policies should reflect the company's values and culture and should address such issues as competitiveness, pay for performance, communications, and fairness.

The compensation program is an important and integral component of the overall system of managing an enterprise. Basic objectives in creating a compensation program are suggested and described in this chapter.
Review Questions

1. The compensation function:
   (a) is responsible for determining and maintaining pay levels for an enterprise's employees.
   (b) is an integral part of the human resources function.
   (c) affects the planning, staffing, and employee development concerns of human resources management professionals.
   (d) is characterized by all of the above.

2. Which of the following statements is false?
   (a) Compensation plays a key role in attracting, retaining, and motivating an enterprise's human resources.
   (b) Compensation is important not only in the acquisition of human talent but in the utilization of these resources.
   (c) Compensation levels should be allowed to rise and fall in response to market forces without regard to cost controls.
   (d) Effective compensation policy can help provide the competitive edge for the enterprise.

3. ________ as a group include the enterprise's owners, senior managers, employees, and customers.
   (a) Human resources managers
   (b) Stakeholders
   (c) Shareholders
   (d) Company investors
4. Some important compensation policy issues that apply to most enterprises include:
   (a) the relative competitiveness of the enterprise's pay levels compared to those in the marketplace.
   (b) pay for performance.
   (c) equity in employee treatment.
   (d) all of the above.

5. A practical business approach to compensation administration should start by:
   (a) interviewing employees.
   (b) conducting a senior management survey.
   (c) identifying organizational needs.
   (d) ranking the human resources department's priorities.

6. Which of the following categories is used when grouping employees for purposes of compensation administration?
   (a) Production/operations employees
   (b) Part-time employees
   (c) Contract employees
   (d) All of the above

7. A recommended process for developing compensation programs does not include:
   (a) developing objectives.
   (b) developing a hiring strategy.
   (c) considering company culture.
   (d) evaluating the effectiveness of the program.

8. ______ is one of the four phases that companies typically go through as they grow from foundation to maturity.
   (a) The period around the development of a new business plan
   (b) Raising capital from a variety of sources
   (c) A period of rapid growth and heavy investment in the business
   (d) The sale of the business to the highest bidder

9. In which of the following is company culture not reflected?
   (a) How a company manages people
   (b) A company's human resources management policies
   (c) Where the company is located
   (d) How decisions are made
10. All compensation professionals must:
   (a) learn to manage in an environment of change.
   (b) understand all the details of the company's collective bargain-
       ing agreements.
   (c) establish a formal compensation program to meet the com-
       pany's objectives.
   (d) conduct annual market surveys of competitive practices.