



Strategic Compensation and Benefits Management

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Key Learning Outcomes

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

- *Understand the multiple goals of strategic compensation and benefits*
- *Describe the dominant approaches to strategic compensation and benefits*
- *Analyse the relationship between of strategic compensation and benefits and performance*
- *Identify the theoretical bases for determining strategic compensation and benefits*

Introduction

This chapter focuses on the role of compensation and benefits for strategically managing the contribution employees make to an organisation. While compensation and benefits are critical aspects of keeping employees motivated and committed in their jobs, often the strategies implemented do not achieve the intended results. In some cases the ‘M’ factor in the AMO framework gets compromised by the ‘O’ or the opportunity that exists in the wider environment. Motivating employees is a core task of managers often through HR policy choices they exercise. The options range from meeting intrinsic to extrinsic motivational needs of employees. Different groups of employees desire different motivational bases and for some, a hybrid approach can indeed be very effective for motivating them and realizing their discretionary performance effort. Therefore, implementation matters a lot as does

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communication and managing the expectations of employees when it comes to distributing discretionary aspects of compensation and benefits. HR practitioners must, in the first instance be mindful of the wider strategic context, a firm's business model and the ability of the firm to afford the disbursement of a given set of compensation and benefits. Typically, problems that occur during implementation often relate to feelings and perceptions of inequity and unfairness. This chapter briefly reviews popular functional approaches to compensation and benefits and then proposes some guidelines for its design and implementation for ensuring that strategic fit and employee expectations are met. The issue of 'appropriation' of value captured and realized through a firm's business model and the extent to which certain constituencies in an organisation perceive problems in the distributive and procedural justice aspects of rewards are vital aspects to attend to in a successful compensation and benefits program.

Strategic Compensation and Benefits Approaches

Martocchio (2006) suggests that strategic decisions must include activities in a functional area that allows a firm to differentiate itself from the marketplace. Armstrong (2007) highlights that the terrain of rewards and incentives should cover both internal and external factors such as business strategy, culture, technology, people, global trends, national demographic trends, local and industry norm, industrial relations, legislation and institutional factors. Based on a firm's strategic positioning in the market in terms of compensation and benefits, the next step focuses on tactical decisions such as determining the bases of pay (for example, HR managers can choose from a seniority versus merit-based approach; and incentive versus person-focused pay, which includes pay for skills and knowledge-based pay systems). Most individual-focused pay options include aspects such as piecework plans, behavioural rewards, referrals and so on. Differences in performance may also necessitate the design and implementation of group or team-based approaches such as those evident in gain-sharing plans, the Scanlon Plan, Lean Six Sigma, company-wide profit sharing, employee stock option and ownership plans (Martocchio 2006).

The second set of strategic and tactical decisions focus on deciding the guiding principles for determining the compensation and benefit systems. In this latter set of decisions, Stewart and Brown (2009) argue that rewards can take a transactional or a relational form and can be further provided in monetary and non-monetary reward forms. Transactional elements typically include direct and indirect forms of monetary and non-monetary rewards. Relational rewards on the other hand focus on intangibles such as provision of learning opportunities, employee and peer recognition, offering employment security, providing challenging learning tasks and work opportunities and so on. This latter aspect of design focuses on factors that appeal certain individuals intrinsically.

Objectives of Strategic Compensation and Benefits Program

Martocchio (2006) noted that from a strategic perspective, irrespective of the chosen bases for pay, firms must attempt to build (1) internally consistent compensation and market systems; (2) achieve strategic and internal /horizontal fit with other HR systems; (3) ensure that such pay systems are competitive in the market to prevent loss of talent; and (4) be able to continuously attract high quality talent. We know from the research on performance management and rewards is that typically there exists a distribution of performers ranging from outstanding and high performers to poor and average performers. An organisation must be able to offer some differentiation for these groups of employees to recognise high performing individual contributors. High performers may be offered market and performance loadings or some form of merit-based pay.

Building on the notion of workforce flexibility, firms must also differentiate different groups of workforce in its compensation and benefits approaches. An egalitarian and one size fits all approach may not be the best way forward as it may create different emotions amongst other groups of employees who are on permanent full-time employment versus non-standard forms of employment. Additionally, consideration should be given to accommodate 'employee flexibility' in the design of both compensation and benefits. For example, this might include allowing benefits in terms of flexible scheduling and options such as working from home, a co-working place or a smart work hub (Malik et al. 2016). Similarly, an organisation must offer rewards and recognise their top talent from the rest of the staff to avoid losing them to competition.

Although there are a number of well-developed industry HR approaches for managing compensation and benefits, the Hayes method of job evaluation, for determining the relative worth of a job is well established. Annual wage and salary surveys also inform strategic choices in the design and implementation of compensation and benefits. Classical economics theories, for example, argue for the idea of *exchange* and *use value* as a sound basis for compensating employees in exchange of the services offered. Marginal productivity theory notes that employees are recompensed based on the 'use' value of their services expended. Similarly, as noted earlier, human capital theories have attempted to link pay with the associated increases in human capital and productivity. As a proxy for the quality of human capital, firms often rely on the level of education and the length of experience in determining the appropriate levels of compensation. Theories from the literature on organisational behaviour, such as motivation theories of equity theory, reinforcement theory, expectancy theory and agency theory are highly relevant in designing and implementing compensation and benefits. Equity theory provides guidance on the extent to which employees make assessments of whether the efforts they have expended at their workplace and the rewards they receive for their contribution is fair. Often these assessments are undertaken in relation to internal and external market relativities of occupations. Equity theory is also linked to the idea of procedural and distributive justice where, in instances of perceived inequity in rewards for the expended efforts, a sense of distributive injustice and unfair treatment sets in (Baron

and Kreps 1999). Alternatively, the process through which rewards are offered for some employees relative to others can be cause for procedural unfairness (Baron and Kreps 1999).

As noted above, a firm must pay special attention to the principles of natural and distributive justice and we mustn't forget a firm's ability to pay. Ability to pay has been noted as a make or break point in a number of industries that are struggling under competitive pressures or operating in industries that have very inefficient resourcing models. Sometimes extremely generous reward schemes bargained by trade unions or indeed very high levels of executive compensation distributed by senior executives and top management teams can lead to the financial collapse of a business. Agency theory provides some discussion that is relevant in maintaining the balance between employee, shareholder and senior manager interests. According to agency theory (Jensen and Meckling 1976), the owners of an organisation (principals) recruit managers and leaders (agents) for carrying out the productive operations of an enterprise. As agents, they have an obligation to provide financial returns to the principal (and the shareholders) on the invested capital. The agents however also keep in mind ways in which they can maximise their returns. While the principal views the agents as costs and aims to minimise such costs, there is tension here as agents often look for ways to increase their income. In a bid to deal with this dilemma, the principal engages in profit sharing schemes, bonuses and pay for performance plans to manage the expectations of agents and at the same time ensuring a fair return for the principals. One can argue that there is a significant misalignment between the goals of the agency and principals that led, albeit partially, to the global financial crises of 2008–2009, as the incentives offered in the pay for performance to agents were disproportionate to the risks involved in the safe running of banks on a sustainable basis. As Boxall and Purcell (2011) caution that managing the problem of (politics) and (mis) appropriation is critical in maintaining the solvency of firms. In times of a slowdown or boom, there are plenty of examples where senior executives have come under direct media scrutiny for rewarding themselves in a selfish and often unjustified manner. Designing your own golden handshake, a practice that has been implemented by senior executives and noted in media reports, raises ethical issues. Therefore, not only is it critical, but it is also necessary to maintain transparency in design and implementation of executive compensation schemes. There are ethical dilemmas at work and several commercial-in-confidence issues that have brought disrepute to organisations due to the nature of their compensation and benefit schemes.

In relation to benefits, these can be broadly classified into: *legally mandated* – through legislation such as medical and work cover insurance, unemployment insurance, health and safety awards, and disability benefits; and *discretionary benefits* – for example, varying rates of superannuation contribution, union membership benefits, paid time-off, and purchase of car and computer and other goods lease plans.

Critical Reflections

Perceived inequity and unfair treatment are core issues that the practice of compensation and benefits is grappling with. There are numerous instances where a well-designed compensation and benefit system is not applied consistently due to either lack of understanding of how to administer rewards on part of the managers or by engaging in political behavior and deliberate and unethical conduct on part of senior managers. The problem is that often such deals are made in private and are generally brought to public knowledge when either the beneficiary or the person responsible for the decision have moved on. The issue of developing moral intensity is central here. This was covered earlier in chapter “[SHRM & ER: Professionalism and Ethics](#)” using the example of sexual harassment where a number of factors contribute to people not seeing a moral issue in an activity and hence engaging in immoral and unethical conduct. The likely consequences of such poor implementation is loss of key talent, expensive lawsuits and a damage of organizational reputation. In some extreme cases of misappropriation of value capture, this could lead to the demise of the entire organisation or even a wider industrial, national or indeed global contagion, as was noted in the recent global financial crisis.

Illustrations and Skills Sandpit

Using the concepts from agency theory, design a system of incentives for lawyers in a large law firm who are specializing in medical compensation claims. Ensure you define who the agent and the principal is. What type of incentive system might be most appropriate here?

Concept Integration with Cases and Learning Activities

The case study by De Simone et al. entitled *Stressed and demotivated public servants...Looking for a motivational miracle at Paywell agency* provides a novel context of the public sector organisation where people seek membership of such an organisation driven primarily by a public service motivation (PSM) ethos. However, in an era of new public management, the concept of PSM gets challenged significantly with the ongoing change and demands posed on public servants leading to adverse employee outcomes. The case study by Bardoeel titled *Work-life balance in an MNE* can also be explored for viewing work-life balance as a non-monetary benefit for employees.

Conclusion

To summarize, strategic rewards management must assess the impact of change (cultural, value, and external influences), fit design with business strategy and other HR systems for effective implementation and monitoring against pre-established measures and benchmarks. Further, managers need to make strategic choices about the nature and the degree to which strategic alignment with competitive strategies is necessary. Whether they want a market positioning stance to be seen as *leading* the market, remain as an organization offering compensation and benefits in the *median* range or be looked at as a *laggard* are critical choices. Implementation in terms of transparent communication, developing internally consistent policies, putting in place appeal and evaluation procedures and regularly reforecasting budgets is vital in a dynamic and fast changing environment. Irrespective of the choices and techniques followed, there are some desirable outcomes for all strategic rewards management systems. These include: equity, efficiency, quality, high performance, statutory compliance and customer focus (internal and external).

Glossary

Agent in relation to agency theory covered here typically refers to senior leaders of the executive team whom the principals have hired for day-to-day decisions of an organisation.

Principals are those who own and have invested a major equity stake in an organisation. Though this has now been widely interpreted and used to include other shareholders of an organisation.

Public service motivation can be defined as a set of values and attitudes that motivates individuals involved in undertaking public service jobs that serve and benefit the wider society.

Work engagement refers to employees demonstrating high levels of involvement, dedication and energy in carrying out their work tasks. Often highly engaged employees tend to involve them so much in work that they are sometimes unable to balance their work-life balance but are still holding high levels of job satisfaction.

Work-related stress is a psychological state of mind that is caused by stressors at work such as the nature of job, excessive volume of work demands, little or no control over one's workflow, minimal levels of social support, lack of role clarity, high degree of work-related conflict, feelings of job insecurity, and harassment and violence at the workplace.

Key Questions and Learning Activities

Question. 1 What are the key sources of inequity and unfairness caused by compensation and benefits in an organisation?

Question. 2 Provide an overview of the dominant theories of motivation that can be directly linked to the design and implementation of compensation and benefits in an organisation.

Question. 3 What are the common consequences of a poorly designed compensation and benefits program?

Learning Activity: Analysing Your Personal Motivations at Work

Thinking of your key motivators at work, what would these be? Are these motivators available to you through your employing organisation's current rewards and benefits program? If yes, what aspects of the program would you like to change? If they are not offered, does your organisation offer other motivators? Are there voice mechanisms available to you? If so, how and who would you approach in the first instance for having a meaningful say in relation to your terms and conditions of employment and why?

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