IRP321 COMPENSATION MANAGEMENT

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ACADEMIC SESSION

TOPIC 1 : The Contract of Employment, Concept of Compensation, Compensation Management and Objectives of Compensation Management

Introduction

Employee compensation is critical in employment relationship and a major source of conflict in labour-management relations. The involvement of the Nigerian government in workers' compensation (wages and salaries) began at the turn of the 19th century arising from the emergence of wage labour (Fashoyin, 1992). A wage is used specifically to refer to payment to hourly-rated production and service workers and represents direct monetary compensation; whereas, salary is generally paid to administrative, professional and managerial employees. Salaries are calculated on a monthly or annual basis (Yoder & Staudohar, 1982).

TOPIC 1 : The Contract of Employment, Concept of Compensation, Compensation Management and Objectives of Compensation Management

Employment Relationship

Employment relationship entails the relationship between employers and employees, both collectively and individually, and the determination of terms and conditions of employment. The employment contract is the foundation of employment relationship as it specifies or defines the terms of an employment relationship. In order for a contract of employment to be binding it must satisfy the requirements of validity. These are: (i).Offer, (ii). Acceptance, (iii). Consideration, (iv). Intention to create legal relations, and (v). Parties who enter into a contractual relationship must be of sound mind.

The Contract of Employment

What is an Employment Contract?

According to Akpala (1982), the employment contract is a relationship well-known by an agreement between a person who agrees to render services to another, obey his orders and submit to his direction and control as a worker in consideration for wages paid by the receiver of the labour service as the employer. Compensation/pay is a contractual phenomenon, as the payment of salaries and wages is an indication of a relationship and transaction between the employees and employers. It is a consideration or quid pro quo which is extended to employees for services rendered.

Concept of Compensation

One of the methods of performance management is rewards, which comes in form of either monetary or non-monetary rewards. Compensation is the totality of financial and non-financial rewards that an employee gets in return for providing his labour services for the organisation. It is everything an organisation provides to reward the efforts or membership of the employee.

❑ Compensation/reward management

Compensation/reward management on the other hand, is the process of designing and implementing pay system that ensures that an organisation attracts, retains and motivates capable and willing employees needed to accomplish organisational goals and objectives.

Objectives of Compensation/Reward Management

Basically, compensation management has 3 major objectives which are to:

- Attract skilled manpower to the organisation
- Motivate/maintain employees to higher performance
- Retain skilled employees.

Objectives of Compensation/Reward Management

- Other minor objectives are to:
  - Reduce conflicts in the workplace
  - Control labour costs
  - Change/modify behaviour (influence)
  - Conform to government regulations.

Compensation Policies, Philosophy, and Theories

- Compensation/reward policies are based on some philosophies. Compensation philosophies are certain beliefs or values held by management which influence their compensation policies. Some managers or employers believe that employees' compensation is a cost to the organisation and as such salaries should be reduced to enable the organisation to maximise profit. This is the philosophy of cost minimisation or negative philosophy.

Compensation Philosophy

- While others hold the view that salaries paid to workers should be seen as an investment that will have a multiplier effect on productivity or the bottom line. This is the positive philosophy. The positive compensation/reward philosophy places a premium on having a reward system that is just, fair, equitable, transparent, and rewarding employees according to their efforts, performance/ contribution. These philosophies influence compensation policies.

Compensation Policies

- Compensation policies are guidelines set for the administration of compensation/pay. Some of the policies that guide compensation management are:

- Policy of salary/pay leadership or lead the market policy

- Policy of salary/ pay followership or lag the market policy.

- Policy of industry average or meet the market policy

Compensation Policies

- Policy of seniority-based pay
- Policy of performance-based pay.
- Policy of pay secrecy or openness
- Competency/skilled-based pay policy
- Policy of fairness and equity (vertical and horizontal equity)

Compensation Theories

- Compensation theories can be categorised into psychological & economic theories:

- **Psychological Theories**

1. Equity theory
2. Edward Lawler's Model of Pay Satisfaction
3. Expectancy Theory
4. Instrumentality theory

Theories of Compensation

❑Psychological Theories of Compensation

1. **Equity theory:** Equity theory is concerned with the perceptions people have about how they are treated in comparison with significant others. It is concerned with inputs and outputs comparisons of significant others. The theory states that workers should be paid wages/salaries equal to their contribution.

Theories of Compensation

Equity theory of Compensation

When O(S)/I(S) compare with O(A)/I(A)

Where	I	=	input {educational qualification, experience, effort}
	O	=	output {pay, recognition, promotion}
	S	=	Sola
	A	=	Ade

Case I) O(S)/I(S) = O(A)/I(A) i.e., Equity (No problem)

Case II) O(S)/I(S) > O(A)/I(A) i.e., Inequity (dissatisfaction -Ade is cheated)

Case III) O(S)/I(S) < O(A)/I(A) i.e., Inequity (dissatisfaction-Sola is cheated)

Theories of Compensation

2. **Edward Lawler's Model of Pay Satisfaction:** Lawler asserts that the cause of pay satisfaction is a function of two variables namely: Actual Pay and Expected Pay:

- Expected Pay = Actual Pay → Satisfaction
- Expected Pay > Actual Pay → Dissatisfaction
- Expected Pay < Actual Pay → Satisfaction/Dissatisfaction

Theories of Compensation

3. Expectancy Theory: When workers believe that increased pay is tied to increased job performance, this will have a motivating effect on workers to put in more efforts to increase their pay. The valence or value they place on the reward or the attractiveness of the reward will also increase their efforts and productivity. This theory is also referred to as performance-expectation theory.

4.Instrumentality theory: It assumes that a person will be motivated to work if rewards (carrots) and punishments (penalties or sticks) are tied directly to his or his/her performance. Compensation provides the means to achieve ends.

Theories of Compensation

- Economic Theories of Compensation

1. The classical economic theory: If supply of labour exceeds the demand for labour, pay levels go down, but if the demand for labour exceeds the supply of labour, pay goes up.

Theories of Compensation

2. Efficiency wage theory: This theory is also known as the "economy of high wages

3. Human capital theory

4. Agency (principal – agent) theory

5. The effort bargain

Topic 3: The Role of Job Analysis and Job Evaluation in Compensation Mgt.

- **Job Analysis:** Job evaluation is based on job analysis which involves an investigation of a job in order to identify its essential characteristics upon which job description and specification are based.

- **Job Evaluation:** Job evaluation is a systematic process for defining the relative worth of jobs within an organisation in order to establish internal relativities and to provide the basis for designing an equitable salary structure. According to Fajana (2002), job evaluation is the comparison of jobs by the use of formal and systematic procedures to determine their relative worth within the organisation. Job values may be determined by negotiation or fixed on the basis of market rates and internal relativities.

Topic 3: The Role of Job Analysis and Job Evaluation in Compensation Mgt.

- **Concept of Compensable Factors**

Through job analysis compensable factors are identified. Compensable factors are the factors in a job that the employer/organisation is paying for. For example: skills/ competencies, experience, education/qualification, risk/hazards, responsibility, physical efforts, commitment, initiative, dedication, mental efforts, and loyalty to name a few are compensable factors.

Topic 3: The Role of Job Analysis and Job Evaluation in Compensation Mgt.

Internal and External Relativities

Pay relativity or equity issues in compensation management is the process of ensuring that fair pay is extended to employees for their labour services. There are internal and external relativities. Job analysis and job evaluation will establish internal relativities /equities while market survey can be used to ensure external relativities in pay. Thus, external relativity is achieved when the organisation pays attention to market rates so that the organisation can attract and retain good quality staff from the external labour market.

Topic 3: The Role of Job Analysis and Job Evaluation in Compensation Mgt.

- **Methods of Job Evaluation**

Job evaluation methods can be group into two categories or typologies. These are the qualitative (non-analytical) and quantitative (analytical) methods. The qualitative method consists of ranking and job classification (grading system) and the quantitative method comprises point rating and factor comparison.

Topic 3: The Role of Job Analysis and Job Evaluation in Compensation Mgt.

- **Ranking**

Ranking is the simplest method of valuing jobs. It involves comparing one job description with another and arranging jobs in order of importance to the organisation. Ranking entails arranging jobs from the highest to the lowest, in order of their values to the organisation. The job at the top of the list has the highest value and the job at the bottom of the list has the lowest value. There is the danger of doing the ranking subjectively, that is based on impression as against facts.

Topic 3: The Role of Job Analysis and Job Evaluation in Compensation Mgt.

RANK	JOBS	Amount (₦)
1	Accountant	240, 000
2	Purchasing officer	150,000
3	Receptionist	I20, 000
4	Computer Operator	100, 000
5	Office Assistant	85,000

Job Classification (Grading System)

This method of job evaluation begins with a-paragraph verbal descriptions of a number of grades or job levels. The job descriptions are then examined and jobs are classified into grades or levels that seem most appropriate based on job responsibility and skill requirements. Job evaluation is less subjective when compared to the ranking method. This method is well adopted in government establishments in the public sector. The 17 grade salary structure in the civil service in Nigeria typifies the grading system.

Job Classification (Grading System)

S/N	Grades	Experience/Qualification
1	Grade I	Semi-skilled workers
2	Grade II	Skilled workers
3	Grade III	Executives

Points Rating

In points rating method, several compensable factors common to the jobs to be evaluated are examined and then each job is rated along a scale of each factor. The scales are divided into point distances. Point values are assigned to the compensable factors and added to arrive at a total score. These total scores are ranked and the job with the highest score has the highest value or worth to the organisation. From the table below, the Secretary should earn the highest and used as the bench mark for other jobs.

S/N	Compensable Factors	Drive	Job clerk	Secretary	Receptions	Typist
1	Experience	4	2	5	3	3
2	Skill	4	2	4	3	3
3	Physical efforts	4	2	3	3	3
4	Mental efforts	2	3	5	3	2
5	Education	2	3	4	3	3
	TOTAL	16	12	21	15	14
	RANK	2	5	1	3	4

NOTE: The Likert 5-point scale was used

Factor Comparison

Factor comparison is similar to points rating method. However, the factor comparison assigns monetary values to compensable factors. This method tends to produce internal equity but external equity may suffer. See illustration:

	S/N	Compensable Factors	Weight in ₦	Driver	Clerk	Secretary	Receptions	Typist
	1	Experience	100	4 (400)	2 (200)	5(500)	3 (300)	3 (300)
	2	Skill	150	4 (600)	2 (300)	4 (600)	3 (450)	3 (450)
	3	Physical efforts	90	4 (360)	2 (180)	3 (270)	3 (270)	3 (270)
	4	Mental efforts	50	2 (100)	3 (150)	5 (250)	3 (150)	2 (100)
	5	Education	200	2 (400)	3 (600)	4 (800)	3 (600)	3 (600)
		TOTAL		₦1,860	₦1, 430	₦2,420	₦1, 770	₦1,720
		RANK		2	5	1	3	4

NOTE: The Likert 5-point scale was used

TOPIC 4: MANAGING EXPATRIATES' COMPENSATION

- Multinational companies make sure that international assignees or expatriates are well remunerated (compensated). Category of staff in multinational companies consists of parent or home country nationals or expatriates, host-country nationals or local nationals and third country nationals.

Managing Expatriates' Compensation

Expatriate Compensation

Rewarding expatriates is also known as international compensation (Reynolds, 1997). Owing to differences in tax and cost of living, pay and benefits of expatriates living abroad involves some complexities.

Managing Expatriates’ Compensation

- In the policy documents of global or multinational companies, an expression often found reads thus, “the aim of expatriates or international assignees’ remuneration policy is to ensure that expatriates are neither better nor worse-off as a consequence of their overseas assignments or tour of duty” (Armstrong & Murlis, 2004).

Models/ Methods of Expatriates' Compensation

Compensation and reward management in Multinationals is based on the following approaches/models:

- **Home-base or Headquarters'-based model:** Expatriates are paid according to the home or headquarters' compensation structure. This is called the balance sheet approach.

- **Host-country-based model /local market model:** Expatriates are paid according to the host-country compensation structure. This is also known as localisation approach.

Models/ Methods of Expatriates' Compensation

- **Global market approach:** Salary is based on international benchmarking. This entails comparing salary levels and benefits across countries or industries and aligning expatriates' salaries with global standards in similar industries or roles. That is global best practices. This can be done via international salary surveys or through obtaining salary data from global HR consulting firms.

Models/ Methods of Expatriates' Compensation

- **Hybrid model:** This is a combination of home-based and host-based pay systems (Armstrong & Murlis, 2004). The choice of the most appropriate remuneration method depends on the following:

Models/ Methods of Expatriates' Compensation

- Nationality of expatriates and the countries to which they are posted (developed or developing)

- Duration or length of the assignment (short-term, long-term or permanent)

- Reason or nature of the assignment (developmental, management function or skill transfer)

Models/ Methods of Expatriates' Compensation

- Need for equity between certain groups of employees. For example, other expatriates and local peer groups (Armstrong & Murlis, 2004).

Models/ Methods of Expatriates' Compensation

- By far, the most widely used compensation model is the home-country approach also called the balance sheet approach. The balance sheet approach enables the expatriate to have enough money to purchase exactly the same basket of goods in the host country that he or she could buy in the home country (Fisher, Schoenfeldt & Shaw, 2007).

Models/ Methods of Expatriates' Compensation

- According to Rao (2005), the balance sheet approach tries to equalise purchasing power across countries. This approach requires estimating expenses for income tax, housing, goods and services, school fees for children and payment of supplements or additional allowances so as to maintain the same standard of living the expatriate would have had at home office or parent company.

Models/ Methods of Expatriates' Compensation

- Thus, expatriates pay should at least be equivalent to what he or she would have been entitled to at the home country. Briscoe et al., (2009) argue that for multinational companies to achieve their objectives, their compensation and reward management must be designed to achieve the following:

Models/ Methods of Expatriates' Compensation

- Attraction and retention of the best qualified talent to staff the multinational companies;
- Attraction and retention of employees who are qualified for international assignments;
- Establishment and maintenance of a consistent and reasonable relationship between the compensation of employees both at corporate headquarters and subsidiary; and
- Maintenance of compensation that is reasonable in relation to the practices of competitors

END

INTERACTIVE SESSION