# CHAPTER 1

# A Road Map to Effective Compensation

**ESSENTIAL OUTCOMES**

**If nothing else, my students should learn:**

1. That developing an effective compensation system can be the difference between company success and failure.
2. That there is no “one best” compensation system, and that the same compensation system that is a success at one firm may be a complete failure at another.

# LEARNING OUTCOMES

**After completing this chapter, students should be able to:**

* Describe the purpose of a compensation system.
* Explain why an effective compensation system is so important to most organizations.
* Distinguish between extrinsic and intrinsic rewards.
* Distinguish between a reward system and a compensation system.
* Describe the key aspects of a compensation strategy.
* Explain why a compensation system must be viewed in the context of the total reward system, and the broader environment of the organization.
* Identify and explain the key criteria for evaluating the success of a compensation system.
* Describe the steps along the road to effective compensation, and explain how this book will facilitate that journey.

**KEY CONCEPTS**

Key concepts introduced in Chapter 1 include the purpose of a compensation system, intrinsic vs. extrinsic rewards, rewards vs. incentives, reward vs. compensation strategy, the three main components of compensation strategy (base, performance, and indirect pay), and the criteria for assessing the success of a compensation system. Students are also introduced to the concept of “fit”—the fundamental notion that there is no one best compensation system, and that the key is to find the compensation system that best fits with a given organization’s characteristics and circumstances. The chapter concludes by providing some perspective on the role of the compensation professional within the human resources function of an organization.

A crucial distinction exists between a compensation *strategy* and a compensation *system*. In order to reinforce this distinction, the first six chapters of the text are devoted to compensation strategy, while the technical details required to convert the compensation strategy into a compensation system are deferred to the second half of the text.

This chapter connects to the world of practice of Human Resources (HR) professionals in several ways. First, compensation is an integral part of the HR function, and virtually every organization must deal with this aspect of Human Resources Management. Second, compensation has become much more complicated in recent years, and HR professionals must spend more and more of their time dealing with compensation issues. Third, as compensation increasingly becomes recognized as a strategic variable, integral to the success of the organization’s business strategy, the importance of compensation specialists and the HR function as a whole has been rising in many organizations in recent years.

**STUDENT MOTIVATION**

Why should students care about the material in this chapter?

* Virtually all students will be subject to compensation systems during their working lives, and it is in their interest to understand how they work.
* An understanding of compensation will help students unravel the mystery of why some employees (and co-workers) behave as they do.
* Young HR graduates will find it much easier to compete successfully in their hunt for an appropriate HR position if they can demonstrate that they have an understanding of, and ability to apply, compensation knowledge on the job.
* To be effective in developing and advancing their HR careers, HR specialists need to understand the role that compensation can play in company success.
* To eventually become a part of top management, it is important for HR specialists to be able to convey and demonstrate to senior management how compensation strategy can support the business strategy of the organization.

**BARRIERS TO LEARNING**

* Some students may see compensation as irrelevant to them. Pedagogical devices that highlight the five points above may help overcome this.
* Students may think compensation is a very technical specialty and thus boring. Building on the real-life experiences of the class, and showing how the understanding of compensation may help to solve behavioural “mysteries” in organizations, may help to bring the subject matter to life.
* Students may think that compensation works in isolation and without recognizing the inter-connectedness to other HR processes. It is important for instructors to ensure students are reminded how processes like Performance Management and Succession planning to name a few can impact changes to compensation as an overall organizational strategy.
* Many terms (e.g., “rewards”) may seem familiar to students and they may assume they know what they mean. However, their colloquial “understanding” of these terms may prevent them from developing the precise compensation vocabulary that is an essential tool for understanding the concepts to come. It is important for instructors to be careful in their use of terminology, so as to demonstrate proper usage, and to highlight how important this is for future understanding.

**ENGAGEMENT STRATEGIES**

To introduce the subject of compensation, first discover who within this class has a compensation system that works well, and who has encountered some of the compensation problems discussed in this opening chapter, by using end of chapter *Exercise Question 1*. After allowing time within groups, have each group share their best compensation system or their worst with the class, indicating why it was so good or so bad.

Ask “Is there a ‘one-size fits all’ compensation system that will work well for all organizations?” “How is it that the same compensation system can be either an asset or a liability?” Discuss with reference to the examples from *Compensation Today 1.1* (Introduction).

Use end-of-chapter *Discussion Question 1*. Review key points in regard to the impact of the compensation system on company performance. Follow up by asking “How can a compensation system be turned from a liability into an asset?” (Learning how to do so is what this course is all about!)

Pose the question “How do you get organization members to do what the organization wants and needs them to do?” Ask how this question relates to a course on compensation. Emphasize that there are many ways of motivating employee behaviour, and that compensation is normally one important way. Add that the behaviour you want is not always the behaviour you get, referencing the examples of reward problems in the Introduction. Ask students why they work. What do they get out of working? Are the only rewards money? Be sure students are clear that “anything provided by the organization that satisfies one or more of an employee’s needs can be considered a reward.” Many students think that a “reward” is something special that is given only for some accomplishment. Make sure that they understand that rewards can be extrinsic and/or intrinsic, and arise from their connection with the organization. Many “rewards” may have little or nothing to do with what management specifically grants.

Ask if “rewards” and “incentives” are the same thing. Make sure students understand that they are very different concepts, although over time consistently granted rewards may come to be seen as incentives. Follow up with *Discussion Question 2* to set the stage for a discussion of the “total rewards” concept, and then to differentiate between a “reward” and a “compensation” strategy. Make sure students are clear on the two main aspects of a compensation strategy (*How* should compensation be paid? *How much* compensation should be paid?).

Ask students, “If you were developing a compensation system for your organization, what would your goals be?” Record the responses. Then show a slide of *Compensation Today 1.1* (Introduction) and compare. Segue intothe *Henderson Printing Case* and relate to *Compensation Notebook 1.1*. (Criteria for Success: Goals for The Compensation System)

At this point, you are ready to introduce the process for developing an effective compensation system. Show a slide of Figure 1.1 (A Road Map to Effective Compensation) and discuss each of the five steps along the road to effective compensation.

The purpose of the final section of the chapter (“The Context of Compensation Management’) is to place compensation management within the context of the Human Resources function in an organization and within HR as a profession. Ask students what kinds of opportunities they think knowledge of compensation can bring, and relate this discussion to material in *Compensation Today 1.3* (The Context of Compensation Management). *Using the Internet Question 2* can be used here to both reinforce the monetary value placed on compensation-related jobs and engage students more actively in compensation issues outside the class context. Announce this assignment in a previous class so it can be discussed in class.

**ASSESSMENT TOOLS**

To assess student learning against the chapter learning outcomes, before the end of the lecture, students may be asked to write short answers to questions such as the following:

* What was the most important thing you learned during this class?
* What important unanswered questions do you have?

Students can compare their questions and answers with a classmate or you can invite questions/responses from the large group.

**REFLECTIONS ON TEACHING**

The key to providing the best possible learning experience for students is continually assessing the extent to which students are mastering the course material, and reflecting on ways to promote the learning experience. This can be aided by instructors asking themselves the following questions after each chapter:

* Which learning exercises/pedagogical activities really worked?
* Which didn’t work as well as I had hoped?
* Were students engaged with the material?
* Were students focused on key concepts, or were they distracted by tangents?
* Did my assessments suggest that students understood the concepts?
* Were my students able to relate and apply the concepts effectively?
* What should I do differently next time?
* How can I best gather student feedback?

# ADDITIONAL RESOURCES

# Chapter Summary

Chapter 1 sets the stage for the study of compensation and the rest of the text by explaining the importance of effective compensation systems to firm success, by defining key reward and compensation concepts, and by providing students with a map to guide them along the road to development of an effective compensation system. This “road map” is used as the organizing framework for everything that is to come, and links specific text chapters to each step along the road to effective compensation. Although many students tend to gloss over the introductory chapters in most text books, an understanding of the key concepts underpinning compensation design, and an understanding of the process for design of effective compensation systems, will make it much easier for students to put the following chapters in context, and will facilitate their comprehension and understanding.

**Answers to Discussion Questions**

1. Effective compensation systems are important to most organizations because they have a direct and influential impact on behaviour. Organizations today are requiring higher levels of performance and a desire to have more achieved with less resources. Also, no organization is alike, and so it can become challenging for students to realize there is no perfect definitive answer. What should be focused on is the required level of performance, the make-up and structure of employees and the complexity of employee behaviours are critical to ensure organizations have the right mix of employees with the better chance or retaining and keeping their talent.
2. A compensation system alone does not what drive, motivate, and inspire all employees. Compensation, critical rewards, and incentives need to be balanced and structured in a way whereby employees perceive them as satisfying and supporting their personal needs. Not all employees are alike, but an organization must ensure it can also achieve its desired level of performance requirements and behaviour expectations in order to manage total rewards. Organizations are affected by the economy and look for creative and less-costly options to reward employees. Using a total reward approach can give employers the motivation to engage in more creative ways to reward employees given the often complex make up and staffing today.
3. Refer to Figure 1.1 in the textbook. Ensure that students can identify at least one fact from each of these steps before moving on. Their answers should include an implication if a step is not performed correctly.

# Notes for Exercises

1. This exercise provides the opportunity for students to relate the class content to their own personal experiences, as well as providing excellent material for class discussion. It also sets the tone that student input is both expected and valued, and that student interaction with the material will be a norm for this class.

Depending on the size of the class, organize the participants in groups of four to six. Provide each person with a pre-printed worksheet with the questions posed in the exercise and a space for the responses. Instruct each group to elect a facilitator/ spokesperson. Each person should answer each question for her or his own work situation, followed by group discussion. Consensus should be reached in each group on the best system. Instructor collects input from each group highlighting reasons for their choice.

1. This exercise, based on internships, provides the opportunity for students to think about what makes a compensation system effective and what amount of pay is needed to discuss how organizations best attract and retain the appropriate workforce and how this varies with the other rewards that the organization can offer (See *Compensation Today 1.2).*

Divide the class into groups of four to six participants, and ask each group to address the questions posed in the exercise. Give them a specific period of time to do so, and tell them that their answers will be discussed in the class as a whole. This exercise always generates a lot of discussion, with some students outraged by the concept of working for free, believing that this exploits workers who are already disadvantaged, while others contend that workers are agreeing to this arrangement of their own free will, and therefore shouldn’t complain about it. The benefits to the organization should be included in the conversation that eventually leads to the benefits to the employee.

Some points that may inform this discussion are as follows:

* Any organization’s goals are to minimize or eliminate payroll costs in an effort to seek profitability from acquired distressed businesses.
* Apprenticeships appeal to those employees who are motivated to know about the long-term benefits of their future profession, knowing there may be some stability of their income.
* The key discussion point should focus on “educational purposes.” If the internship is for this specifically, pay is not required. Where it becomes an issue is where this is extended into situations where a person want to earn experience (working hours) towards a certification. For example, an auto mechanic requires work experience after achieving all educational requirements.
* One discussion item that can service is the benefit to the employer to offer salary and provide strong learning support. This provides significant opportunity from a requirement standpoint. The organization knows what they are getting in an employee’s work habits and skills and hopefully has worked to engage a committed employee.

# Notes for Case Question

Henderson Printing. This case question provides the opportunity for students to understand what an inadequate compensation system looks like within a real-life context. (Note: This is a recurring case, and students can do further work with this case later in the book. See Chapter 3, Case Question 1, and Chapter 10, Case Questions 1 and 2.)

The “Henderson Printing” case is a great example of a small business that has enjoyed some success and growth, but is now being severely hampered by a failure to apply some basic managerial and organizational principles. The compensation system is a perfect example of this; it is haphazard and inequitable, and, far from supporting organizational effectiveness, is actually working against it. Students will find that virtually none of the criteria for an effective compensation system discussed in *Compensation Notebook 1.1* (Criteria for Success: Goals for the Compensation System) are being met.

**Possible Sources of Lecture Enrichment**

The following web links can be used as a source of materials for lecture enrichment:

* For examples of trends in labour incomes in Canada, go to Statistics Canada’s website at <http://www.statcan.gc.ca>.
* For examples of the concept of “total rewards,” go to the *WorldatWork* website at <http://www.worldatwork.org/waw/pub/workspan_trarticle.pdf>.
* For examples of employers with leading edge compensation practices, go to *Maclean’s* magazine’s Canada’s Top 100 Employers website at <http://www.CanadasTop100.com>.
* For examples of pay levels for various jobs in Canada, go to <http://monsterca.salary.com>.