Employee Compensation Factors

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Compensation and Benefits

December 01, 2013

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**Introduction**

One of the biggest concerns for any company is deciding an employee compensation package. Employee compensation has a huge impact of the overall success of a company. It has an effect on the ability of the company to hire quality employees. It also affects the retention of good employees. Compensation is a great motivator for most employees. A company must pay salaries that their employees perceive as fair. This will help them feel satisfied and more motivated. With employee compensation being so important, how do we determine employee compensation? What factors play a role in determining employee compensation? There are four main factors that deal with employee compensation. The four factors that help to determine employee compensation are Internal Alignment, external competitiveness, employee contributions and management of pay (Milkovich, Newman, & Gerhart, 2014). In this paper I will discuss each factor and employee compensation.

**Internal Alignment**

Internal Alignment, often called internal equity, refers to the pay relationships among different jobs/skills/competencies within a single organization (Milkovich, Newman, & Gerhart, 2014). Internal alignment is affected by many things these include economic pressures, government policies, laws, and regulations, external stakeholders, cultures and customs, organization strategy, organization human capital, organization work design and overall HR policies.

Economic pressures have an effect on shaping internal alignment in the fact that employers can only pay employees an amount equivalent to how much they get for a product. An example would be if a furniture company hired an employee for $10 an hr. If they made rocking chairs and sold four a week for $100 then they would make $400 a week. If that employee worked 40 hours a week then they would make $400 a week. The company could not afford to pay the employee and other bills. The only way they could afford the costs is if they had an increase in demand. If the economy is struggling, then people may not spend money due to unknown risks at the time.

Government policies, laws, and regulations require the company to establish a pay system that does not discriminate on the basis of race, gender, religion or national origin (Milkovich, Newman, & Gerhart, 2014). A company can pay someone differently based upon job scope, skills or other factors. An organization cannot determine pay based on gender, race, religion or national origin. The government also plays a role in pay structures in the fact that they establish minimum wage.

External stakeholders play a role in internal alignment in the fact they determine pay structures. Unions, stockholders, and even political groups have a stake in how internal pay structures are determined (Milkovich, Newman, & Gerhart, 2014). Stakeholders are individuals or organizations with an interest in the success or failure of a project or entity. External stakeholders in a company may include customers, clients, distributors, wholesalers, retailers, suppliers, partners, creditors, stockholders (shareholders), communities, government courts and departments (city, state, federal, and international), banks, media, institutional investors and fund managers, labor unions, insurers and re-insurers, trade associations, competitors, the general public, and the environment (local, regional, and global). Different stakeholders can exercise different types of power, including voting, legal, economic, and political, and can form coalitions with others (Boundless).Stakeholders are individuals or organizations with an interest in the success or failure of a project or entity. External stakeholders in a company may include customers, clients, distributors, wholesalers, retailers, suppliers, partners, creditors, stockholders (shareholders), communities, government courts and departments (city, state, federal, and international), banks, media, institutional investors and fund managers, labor unions, insurers and re-insurers, trade associations, competitors, the general public, and the environment (local, regional, and global). Different stakeholders can exercise different types of [power](https://www.boundless.com/management/definition/power/), including voting, legal, economic, and political, and can form coalitions with others

Cultures and customs play a role because depending on where you are they may determine that one factor plays the biggest role in pay structure over others. Many traditional Japanese employers place heavy emphasis on experience in their internal pay structures (Milkovich, Newman, & Gerhart, 2014)

A company should ensure that its pay scale is aligned with its organization strategy. An example is if a company is an IT consultant. If the strategy was to become the largest IT consultant then they would take on as many jobs as possible. They would then in return high lots of IT members most likely at minimum pay. IF the company’s strategy was to have the best IT support then they may pay more for the most qualified IT techs.

Human capital is the education, experience, knowledge, abilities, and skills required to perform the work (Milkovich, Newman, & Gerhart, 2014). A company is going to pay more for an employee that has more education in the career field. As I recruiter I tell applicants when you graduate school and apply for a job the company usually wants people with experience. Who would make more a jet mechanic that got a degree or one that actually worked on planes for four years? Experience and other qualities tend to save the company money due to the fact they don’t have to pay for training.

Organizational design is a step-by-step methodology which identifies dysfunctional aspects of work flow, procedures, structures and systems, realigns them to fit current business realities/goals and then develops plans to implement the new changes (Allen). This involves the overall decision to use certain technologies to lessen the work. An example is if a company brought in a human resource information system to track employee information. They may pay the HR employees less due to the fact the human resource information system alleviates some of the work or stress that the department may have.

Overall HR policies are another factor in internal alignment. This is the process of a company offering various promotion opportunities. Offering an employee to increase in position level may lessen the amount of pay raises it gives out throughout the year.

**External Competitiveness**

External compensation refers to the pay relationships among organizations-the organization’s pay relative to its competitors (Milkovich, Newman, & Gerhart, 2014). A firm achieves external competitiveness when employees perceive that their pay is fair in relation to what their counterparts in other organizations earn. To become externally competitive, organizations must first learn what other employers are paying and then make a decision regarding just how competitive they want to be (Refence for business). External competitiveness plays a huge role in determining which company gets the most qualified individuals. The factors that affect pay levels include: competition in the labor market for people with various skills, competition in the product and service markets, which affects the financial condition of the organization; and characteristics unique to the organization and its employees, such as its business strategy, technology, and the productivity and experience of its workforce (Milkovich, Newman, & Gerhart, 2014).

Labor Market factors include nature of demand and the nature of supply. The demand side focuses on the actions of the employers; how many new hires they seek and what they are willing and able to pay new employees (Milkovich, Newman, & Gerhart, 2014). The supply side looks at potential employees: their qualifications and the pay they are willing to accept in exchange for their services (Milkovich, Newman, & Gerhart, 2014). Demand and supply in employees is the mediation point between what employers are willing to pay and what employees are willing to work for.

The product factors include degree of competition and the level of product demand. The employer can only pay employees based off what they can afford based on the market. Product demand establishes a maximum pay level an employer can pay. If an employer pays above the maximum, it must determine wether pass on to consumers the higher pay level through price increases of hold process fixed and allocate a greater share of total revenues to cover labor costs (Milkovich, Newman, & Gerhart, 2014). Degree of competition consists of adjusting the prices of goods to be equal or competitive with other companies that offer the same products or services. If a company is too high then they may lose business to others that offer the same product at a lower price.

Organization factors include things like the industry, strategy, size and the individual manager. The industry is influenced by the technology the company uses. Depending on the technology and what the cost is to have certain technology that keeps the company running has an affect on pay. There is consistent evidence that large organizations tend to pay more than small ones (Milkovich, Newman, & Gerhart, 2014).

The organizational strategy can have an effect on pay. The strategy can be anything from being known as the company that has the lowest price. Having the lowest price will most like appease to customers, but may limit employee pay if the demand is not high. The company may have a strategy may involve offering low pay but multiple benefits such as health care, gyms and other non-pay compensation. The company may decide to be high pay with limited benefits. These factors will help determine employee pay scale.

**Employee Contributions**

“Pay for contribution” is a practice organizations use to reward employees who have contributed value to the organization beyond their performance objectives. For example, an organization might reward an employee who landed a big account, implemented a cost-saving measure, prevented a potential loss of business or developed intellectual property (Bersin). The U. S. Postal Service (USPS) and the U.S. General Accounting Office (GAO) have both adopted programs that compensate their employees based on performance (OPM.GOV).

A company may decide to provide low wages but offer certain incentives to motivate employees. A company may also decide the pay scale depending on how important they see a certain position. They determine the importance by job analysis, job evaluations and job pricing. Some companies may use lump-sum bonuses to pay employees based on employee or company performance.

In a survey of 783 employees across diverse companies, 20 percent of executives said they are seeing productivity rewards, and 27 percent of management-level employees said they get similar bonuses. Roughly 29 percent of exempt/professional employees said they receive productivity pay. This compares to the 36 percent of hourly workers who said they receive similar pay bonuses. The survey was published in 2000 by the Society for Human Resource Management and Arthur Andersen Consulting (Salary for business).

**Management of pay**

Management means ensuring that the right people get the right pay for achieving the right objectives in the right way (Milkovich, Newman, & Gerhart, 2014). This involves management deciding what the pay scale should be to attract qualified people to apply for positions within a company. If they do not offer the right pay then applicants may venture to other organizations. They must also ensure they pay the right people they have the right pay. If they do not ensure they have a good pay scale then they may lose employees. It goes beyond simply managing pay as an expense to better understanding and analyzing the impact of pay decisions on people’s behaviors and organizations success (Milkovich, Newman, & Gerhart, 2014).

**Conclusion**

When a company is looking at employee pay they must ensure they do the proper research. If the proper research is not done they may lose out on good employees. Looking into factors like internal alignment, external competiveness, employee contributions and management of pay can help a company not only in the recruiting department but also in retention. For a company to be successful they must have a good team. Compensation plays a huge factor when building a team. Compensation explains to employees and applicants what the company has to offer them based upon the work they will be required to do. Compensation is one of the main variables that are looked at when someone is applying for a job. Compensation affects productivity and the company’s success. Putting the time in to establish a good pay scale can help a company get quality employees and keep them motivated so that they stay with a company.

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