

## CRITICAL ISSUES FOR COMPENSATION AND INCENTIVES MANAGEMENT: THEORETICAL APPROACH

**Ramunė Čiarnienė, Milita Vienažindienė**

*Kaunas University of Technology, Vilnius Co-operative College*

For most people, pay is a primary reason for working. Indeed, compensation is at the core of any employment exchange, and it serves as a defining characteristic of any employment relationship. The study focuses on critical points of compensation and incentives management. The fundamentals of a good incentive program include the elements of vision, potential, communication and motivation and can be realized if incentive promises are fulfilled – by both employer and employee. The aim of the paper is to identify the most important attributes of compensation and incentives management. Research method is the analysis and synthesis of scientific literature, logical, comparative and graphic representation. On the base of analysis, authors of this paper present the model of incentive system for positive employee attitudes and behaviors.

*Keywords: compensation, employees, incentives, management.*

### **Introduction**

Compensation refers to all forms of financial returns and tangible services and benefits employees receive as part of an employment relationship. Pay may be received directly in the form of cash (e.g., wages, merit increases, incentives, cost of living adjustments) or indirectly through benefits and services (e. g., pensions, health insurance, paid time off). Programs that distribute compensation to employees can be designed in an unlimited number of ways, and a single employer typically uses more than one program (Milkovich, 2008).

Frequently, incentive programs do not go the distance because they were weak from the start. The development of an effective incentive and compensation program is rooted in a company's vision for the future and the role of key employees will play in those expectations.

**The aim** of the research is to identify the most important attributes of compensation and incentives management.

**Research methodology.** The analysis of scientific literature enabled to disclose the importance of the rewards program. Synthesis of scientific literature allowed finding out the key elements of decision making process in rewards program design and the main indicators affecting incentive system. Scientific literature was systemized and summarized by applying the logical, comparative and graphic representation. On the base of analysis, model of incentive system for positive employee attitudes and behaviors was created.

### **Decision making in compensation management**

Identifying and solidifying key compensation philosophies and priorities is at the heart of a great incentive plan. This discovery process helps achieve a unified financial vision for growing the business. It can also distinguish the relationship between company and employee wealth-building goals establish the framework for an employee and executive compensation philosophy, identify factors that will drive desired performance and create a prioritized plan of action for strategy development.

The discovery process is best described as a comprehensive set of recommendations to begin designing a total rewards program uniquely suited to support a company's short- and long-term strategic objectives. It also directly responds to the needs and desires of the individual members of the company's executive team.

The importance of a rewards program that addresses the vision of both the company and the individual employee cannot be overstated. Personalized incentive programs should be continually assessed, adjusted, analyzed and adapted to ensure top-level employees have their eyes on the same prize as the company owners (Baeten, 2010).

That prize is typically one of two scenarios—building and growing the company for the long term or bringing it to a point of success that will attract a buyer. Although employees might fully comprehend this vision and recognize the connection between the company's targets and the achievement of their own goals, the bottom line for most employees is likely drawn more with salary, benefits and job security in mind. However, a thorough discovery process may unveil other areas of incentives not considered by company owners.

Long-term incentive plans should consist of a number of components to provide executives a diversified package (see figure 1). A total rewards target represents the ideal blend of pay for different levels of employees. Although it may never actually reach the ideal, it serves as a guideline for management to consider when structuring pay arrangements for employees at different levels within the company.

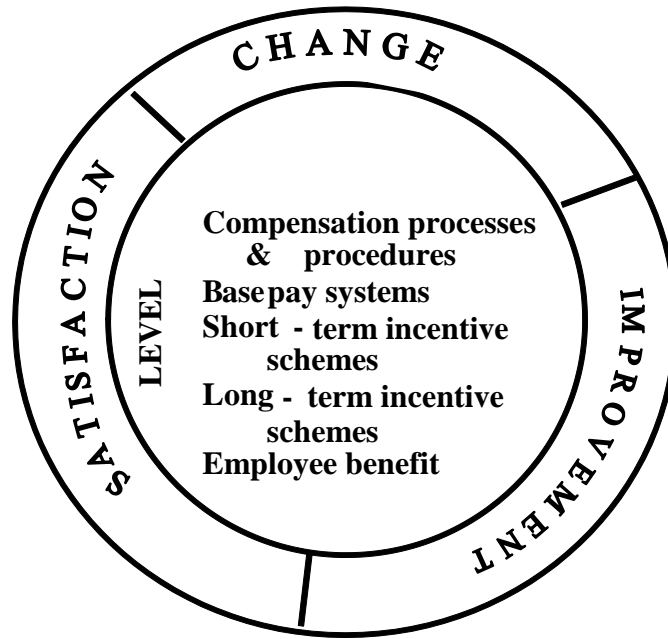


Figure 1. Decision making in compensation management

It is a good compensation practice to have a written compensation strategy in place, specifically at management levels. Looking at the level at which these compensation strategies have been developed; it is not surprising that a close link is with the employee group concerned.

The compensation strategy usually focuses on senior management and is developed at a headquarters level. In the case of middle management, corporate headquarters still plays the most important role, but in some cases it is done by local entities.

Regional and business unit levels also play a role with respect to compensation strategies for middle management. Finally, local entities play the most important role regarding operational employees' compensation strategy. In any case, it is advisable for corporate levels to stimulate local entities more to develop these compensation strategies for operational employees.

**Decision Making on Compensation Procedures.**

X. Baeten (2010) focuses about the level at which decisions on compensation procedures and systems are taken. For each of the employee categories and for the most relevant procedures, table 1 gives an overview of the degree of (de)centralization. The compensation procedures that were studied include (a) external benchmarking, (b) the performance management system, (c) compensation communication, (d) IT tools and systems used in compensation and (e) employee satisfaction surveys.

Table 1. Decision Making on Compensation Procedures

Level	External benchmarking	Performance management system	Compensation communication	IT tools and systems used in	Employee satisfaction surveys
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				compensation	
Senior Management	Centralized	Centralized	Centralized	Centralized	Centralized, but local entities also play a role
Middle Management	Mostly centralized for methodology; predominantly decentralized for number of providers	Centralized	Mostly decentralized, but headquarters and regional level also play a role	Mostly centralized	Centralized, but local entities also play a role
Operational employees	Decentralized	Mostly decentralized, but headquarters also plays a role	Decentralized	Decentralized	Mostly centralized, but local entities also play a role

### Decision Making on Compensation Systems

Table 2 gives an overview of the levels at which decisions are taken for the underlying items. First and foremost, it should be mentioned that, in general, at the level of middle management and operational employees, it is very difficult to say whether decision making on compensation systems is centralized or decentralized. There seem to be significant differences depending on the concrete underlying compensation issue.

Table 2. Decision Making on Compensation Systems

Level	Base pay	Short-term incentives	Long-term incentives	Employee benefits
Senior Management	Centralized	Centralized	Centralized	From centralized for some issues to decentralized for other issues
Middle Management	From centralized for some issues to predominantly decentralized for other issues	From centralized for some issues to predominantly decentralized for other issues	Centralized	From centralized for some issues to predominantly decentralized for other issues
Operational employees	From predominantly decentralized for some issues to	From role for headquarters as well as local entities for some	Not applicable	From role for headquarters as well as local entities for some

	decentralized for other issues	issues to decentralized for other issues		issues to decentralized for other issues
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Satisfaction with decision making shows on how satisfied (Bloom, 2003) the respondents are with decision making on each of the dimensions of compensation and benefits.

### **Indicators affecting incentive system**

Seasoned corporate professionals recognize that the fundamentals of a good incentive plan include the elements of vision, potential, communication and motivation. A sound incentive program projects the potential that can be realized if incentive promises are fulfilled – by both employer and employee. However, in the absence of well-defined indicators and a “best practices” framework for the long term, even the most comprehensive program can fall short (Moniz, 2010; Core, 2003).

Indicators, which are sometimes referred to as measures and metrics in a company’s reward strategy, are pivotal to a comprehensive incentive program. The role of indicators is straightforward. They seek to improve performance, influence behavior and create focus. These far-reaching elements can only be accomplished through communication and consistent reinforcement that promotes a company-wide mindset of employee ownership. Without a base of thoroughly defined indicators, employee motivation can collapse, creating a domino effect that can negatively affect a company’s structure and culture.

To create a culture where employees think like owners, a “best practices” framework that addresses a number of issues should be in place. Key among those issues is how company growth is defined; the baseline on which contributions to the profit pool will be based; payment threshold; percentage to be shared; an allocation formula; and a definition of the expected individual’s performance.

Companies must match incentive programs to their culture, business model and goals. Great companies generate great results by focusing employees on achieving great goals. But to realize that end result, rewards programs must be reviewed regularly to determine whether what worked yesterday still works today.

Individual salaries encapsulate numerous factors, including historic and incumbent-specific factors. As such, competitive pay data should be used as a guide for establishing acceptable ranges (Pfeffer, 2006). Other factors to consider when determining appropriate pay ranges include forgone compensation, individual contribution, roles and responsibilities, knowledge, qualifications, profitability, other elements of compensation and internal equity (Glassman, 2010; Hansen, 2009; Terpstra, 2005).

Establishing tiers is vital to a comprehensive incentive program because not everyone has an equal part in creating increased value. A business needs to define tier levels and assign participating employees. By establishing various levels, the

company can assign greater potential value to those who will have the greatest impact. Weighting – or determining how much of a reward should be assigned to the achievement of various categories of expectations—is part of the tier concept (Moniz, 2010).

The present economic climate offers an opportunity to evaluate the compensation structure and make necessary adjustments to accommodate various challenges, whether recessionary or otherwise. When business is on an upward trend, salaries are at or may even be slightly above market; short-term incentives are equal to a percent of salary; and long-term awards are based on market guidelines. Conversely, when business is trending down, salaries are at or slightly below market; short-term incentives are minimal; and long-term awards are higher than market levels. Businesses that adopt these compensation philosophies have the capability of interjecting practical solutions when the economic flow is downward.

Recessionary periods often engender reactionary response, such as layoffs or the euphemistic “reduction in force.” But a company with a thoughtful compensation philosophy may consider other cost-cutting measures that in the long run could assist in retaining top talent. Employees who have embraced an ownership mentality will comprehend that shifting financial circumstances may redefine their compensation and short-term rewards. And if dealt with honestly and fairly, they will maintain their focus to achieve company goals with the knowledge that better times will eventually return.

Even the most well-intentioned incentive programs can fast approach the edge of failure in the face of specific obstacles. An unclear definition of the company’s future is a major impediment to the success of an incentive program. When plans for the future are not effectively communicated, employees often don’t see a role for themselves beyond the short term, leading to feelings of being “kept out of the loop” and a sense of insecurity.

Other barriers are created when the company has not established a consensus about how to use rewards programs to accelerate company growth. And in some cases, a rewards philosophy has been developed, but not properly communicated to employees. And then there are those incentive plans that are incomplete or simply inadequate. While these barriers can make or break an incentive plan, other indicators that a rewards strategy is not working are even less subtle.

The framework of an incentive program becomes compromised when the company does not view compensation as an investment, but rather as an expense. The fundamental focus of an incentive plan becomes blurred when the full potential value of the total rewards package is not regularly and powerfully communicated and when some but not all of the elements are built to generate “line of sight”. Failure can also lurk when company tradition is to build rewards plans separately for individual employees and not on an integrated team basis. And the absence of clear standards and methods to set and reset values that are consistent with employee expectations may prompt key talent to leave.

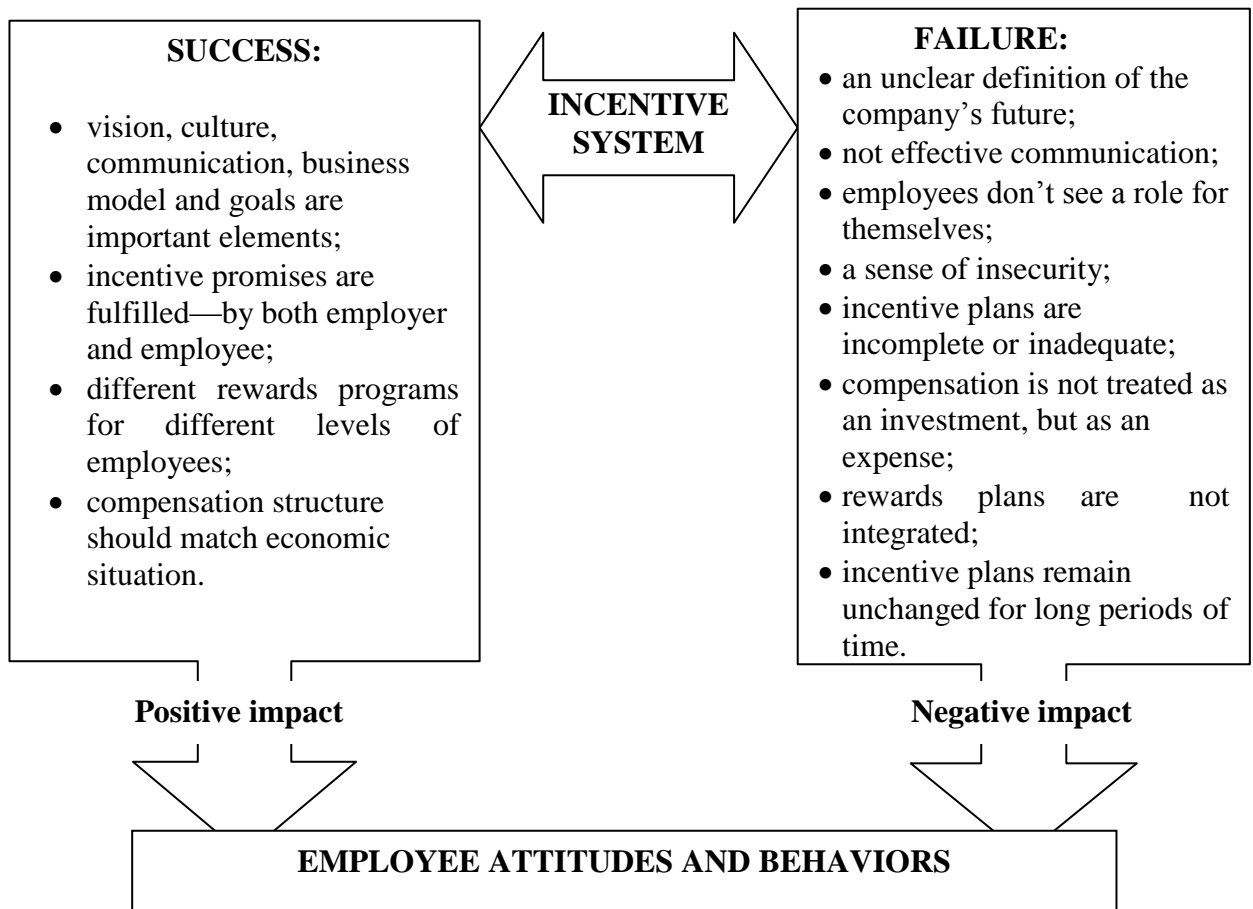


Figure 2. Model of incentive system

Summarizing, authors of the paper present model of incentive system for positive employee attitudes and behaviors (see figure 2).

Incentive plans—even the most successful ones—must be reviewed and reevaluated periodically to ensure relevancy. Those that remain unchanged for long periods of time may weaken their goal to motivate and/or assume entitlement status. Incentive plans that become stagnant can engender a company culture where employees configure their performance to meet the minimal needs of the plan, rather than fulfilling the company’s maximum business needs.

### Conclusions

1. Compensation is at the core of any employment exchange, and it serves as a defining characteristic of any employment relationship.
2. Decision making process in rewards program design involves decision on compensation procedures and compensation systems.
3. Important elements of incentive system’s success are the following: vision, mission, business model and goals, culture of organization and communication process. Incentive promises should be fulfilled—by both employer and employee;

different rewards programs should be applied for different levels of employees; and compensation structure should match economic situation.

4. Over the course of time, incentive programs should be reevaluated and refined in accordance with shifting organizational goals.

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## PAGRINDINĖS DARBO APMOKĖJIMO IR PASKATŲ VALDYMO PROBLEMOS: TEORINIAI ASPEKTAI

**Ramunė Čiarnienė, Milita Vienažindienė**

*Kauno technologijos universitetas, Vilniaus kooperacijos kolegija*

### Santrauka

Pagrindinė darbo apmokėjimo paskirtis yra padėti įgyvendinti organizacijos strateginius siekius ir trumpalaikius uždavinius, ugdant kvalifikuotus, kompetentingus ir motyvuotus darbuotojus.

Straipsnio tikslas – identifikuoti pagrindinius darbo apmokėjimo ir paskatų valdymo aspektus. Tikslui pasiekti taikyti šie tyrimo metodai: mokslinės literatūros loginė ir palyginamoji analizė, sintezė ir grafinis pateikimas. Tyrime akcentuojami šie klausimai: priimamų sprendimų įvairiuose valdymo lygiuose pobūdis; pagrindiniai reikalavimai skatinimo sistemai; kliūtys,



sąlygojančios neigiamą darbuotojų požiūrį ir elgseną. Straipsnio autoriai pateikia originalų paskatų sistemos, siekiant jos rezultatyvumo bei teigiamo darbuotojų požiūrio ir elgsenos, modelį.

*Raktiniai žodžiai: darbo apmokėjimas, paskatos, valdymas, darbuotojai.*