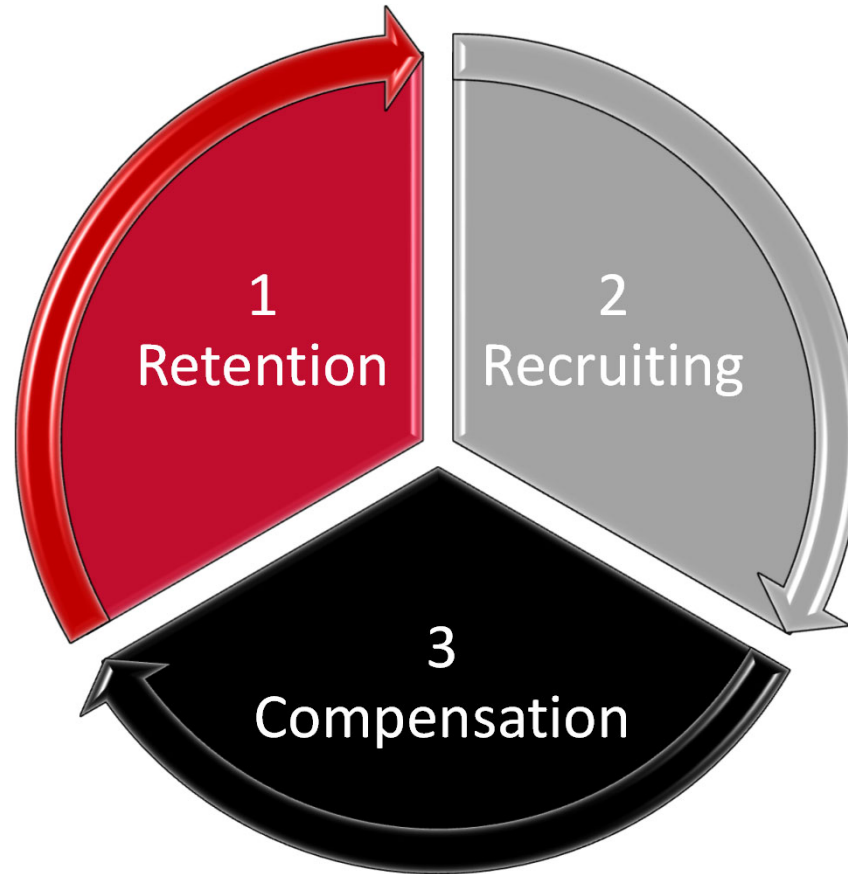


# Compensation 101

**Michael F. Maciekowich**

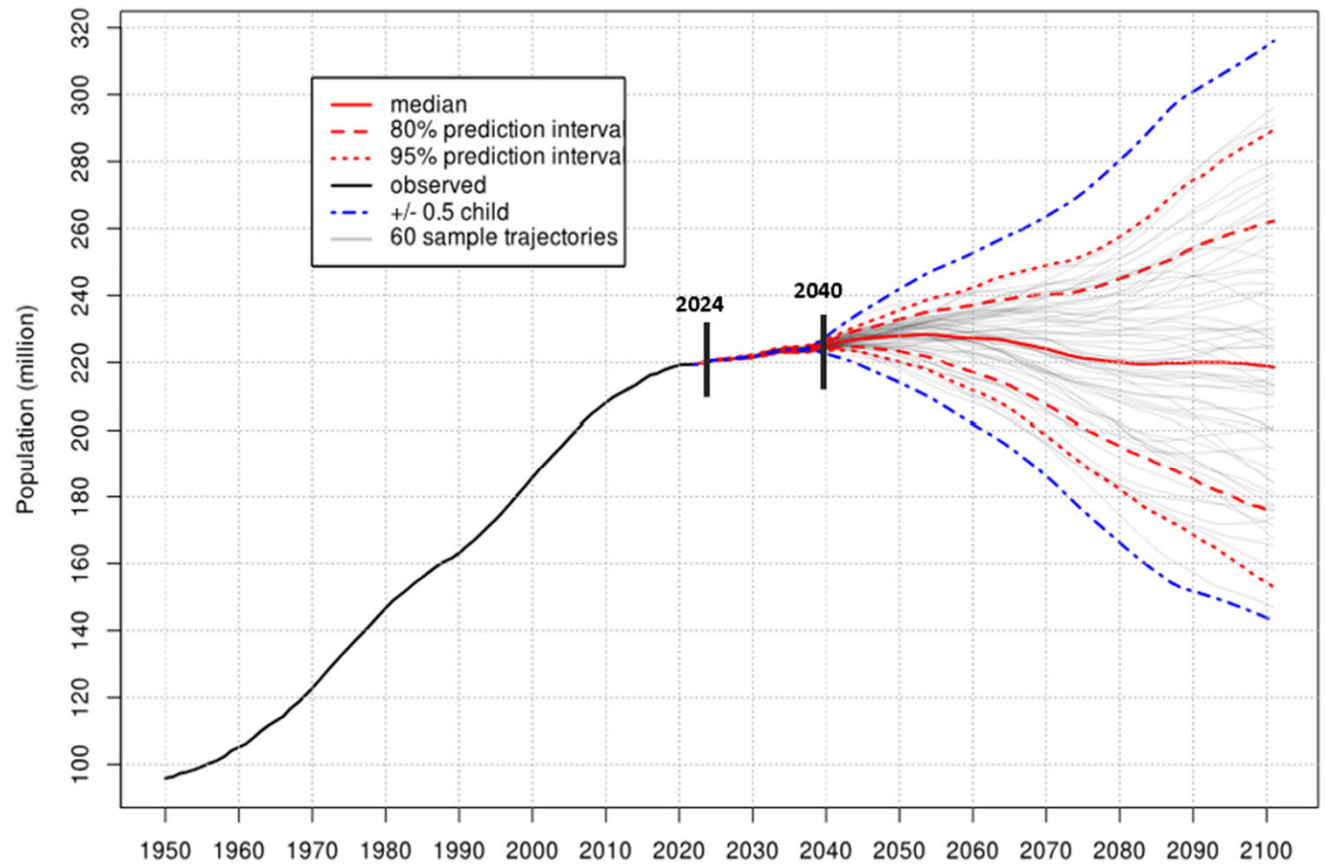
**Senior Consultant-AAIM/National Director Astron Solutions LLC**

# The Employment Crisis



# Population Trend

## United States Population (Age 15-64)





# Compensation Strategy

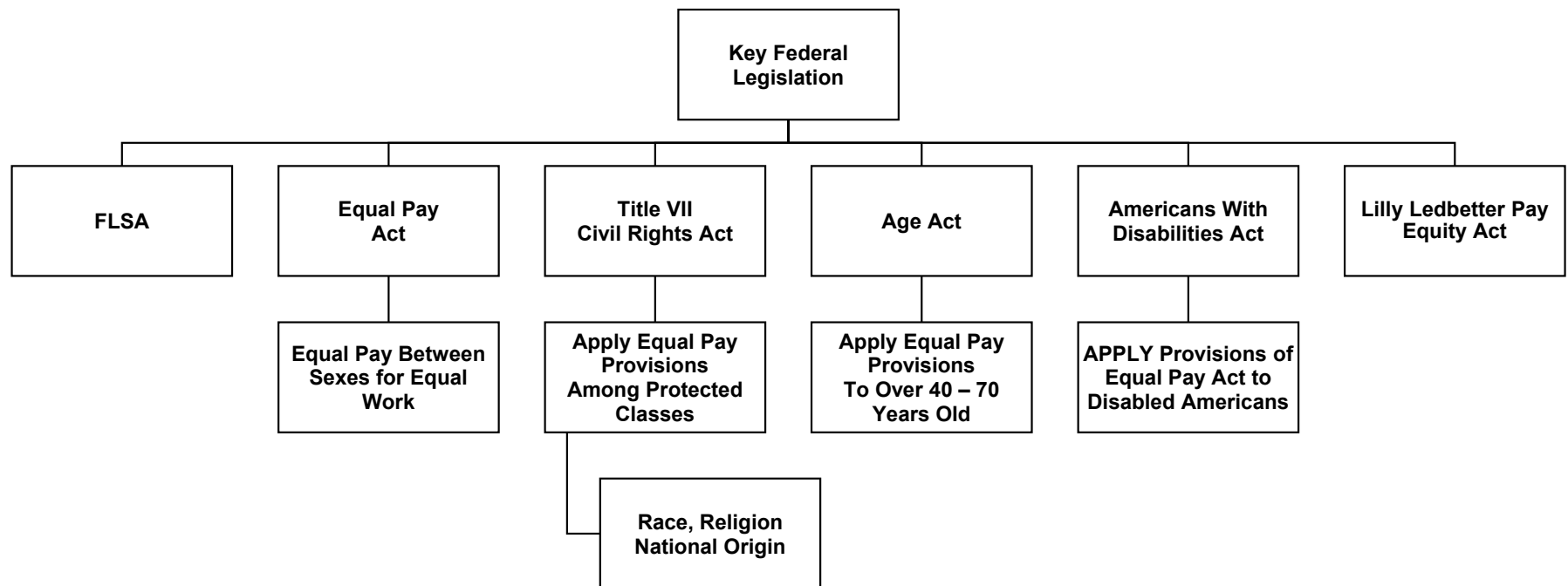
# Total Rewards “Tools”

External Position Equity	Internal Position Equity	Employee Pay and Recognition Equity	Total “Non-Cash” Compensation – Benefits/ Retirement	Ability to Fund all Aspects of the Program
<ul style="list-style-type: none"> <li>• Competitiveness in terms of Geography.</li> <li>• Competitiveness in terms of industry.</li> <li>• Level of competitiveness by organization and position.</li> <li>• Recruitment and Retention Trends.</li> </ul>	<ul style="list-style-type: none"> <li>• Determine organizational value of positions regardless of market value.</li> <li>• Determine value of positions not matched to the market.</li> <li>• Determine the differences among “families” of jobs.</li> </ul>	<ul style="list-style-type: none"> <li>• Determine internal pay levels of employees based on seniority, performance, or other methods.</li> <li>• Determine appropriate methods to recognize employee performance and contributions.</li> <li>• Understanding the impact of “Generations” in compensation decisions.</li> </ul>	<ul style="list-style-type: none"> <li>• Addressing the rising cost of insurance in plan design.</li> <li>• The need to have more employee cost sharing.</li> <li>• Understanding pressures from organized labor.</li> <li>• The need for flexibility in addressing “generational” differences in both benefit and pension design.</li> <li>• Impact of fluctuating stock market on pension design strategies.</li> </ul>	<ul style="list-style-type: none"> <li>• Funding all aspects of the program understanding the impact of current industry trends.</li> <li>• Determining the “ROI” of all programs to demonstrate the impact on effective recruitment and retention of staff required for the organization to succeed.</li> <li>• Proactively developing strategies that reduce cost impacts while remaining effective.</li> </ul>



# Compensation Regulations

# Overview of Federal Legislation Impacting Compensation



# Equal Pay Act

- **The Equal Pay Act of 1963 is an amendment to the Fair Labor Standards Act that prohibits wage discrimination based on sex. It enforces that men and women should receive equal pay for equal work rendered in the same establishment.**
- **It doesn't necessarily mean that the jobs are identical but rather substantially equal in terms of its nature and responsibilities. There is an emphasis on job content rather than job title.**
- **In order to establish that jobs are substantially equal in nature, factors such as skill, effort, responsibility, work conditions, and establishment should be considered.**
- **Skills refer to the person's education, training, and experience. The emphasis is on the skill required by the job and not necessarily the skill that the person already has.**
- **Even if one has a masters degree in chemistry but works as a call center agent, it shouldn't matter because a masters is not required skill for the job.**

# Civil Rights Act of 1964

- **Title VII of the Civil Rights Act of 1964, 42 USC 2000e, makes it unlawful for an employer to hire or discharge any individual, or otherwise to discriminate against any individual with respect to his/her compensation, terms, conditions or privileges of employment, because of an individual's race, color, religion, sex or national origin.**
- **This covers hiring, firing, promotions and all workplace conduct. An employer can't decide whether or not to promote a worker, or fire one, based on the employee's color, race, religion, sex or national origin. He or she can't use this information when classifying or assigning workers.**
- **An employer can't use an employee's race, color, religion, sex or national origin to determine his or her pay, fringe benefits, retirement plans or disability leave.**
- **An employer can't harass you because of your race, color, religion, sex or national origin.**

# Age Act

- **Age discrimination involves treating someone (an applicant or employee) less favorably because of his or her age.**
- **The Age Discrimination in Employment Act (ADEA) only forbids age discrimination against people who are age 40 or older. It does not protect workers under the age of 40, although some states do have laws that protect younger workers from age discrimination.**
- **It is not illegal for an employer or other covered entity to favor an older worker over a younger one, even if both workers are age 40 or older.**
- **Discrimination can occur when the victim and the person who inflicted the discrimination are both over 40.**

# Americans With Disabilities Act

- **The ADA recognizes and protects the civil rights of people with disabilities and is modeled after earlier landmark laws prohibiting discrimination on the basis of race and gender.**
- **The ADA covers a wide range of disability, from physical conditions affecting mobility, stamina, sight, hearing, and speech to conditions such as emotional illness and learning disorders.**
- **Essential functions are the fundamental, crucial job duties performed in a position. They do not include marginal functions, which are extra or incidental duties.**
- **Essential functions must be identified for each position, not job class, and they must be based on the work performed, rather than the capabilities of an individual.**

## Lilly Ledbetter

- **The Act restores the pre- *Ledbetter* position of the EEOC that each paycheck that delivers discriminatory compensation is a wrong actionable under the federal EEO statutes, regardless of when the discrimination began. As noted in the Act, it recognizes the “reality of wage discrimination” and restores “bedrock principles of American law.”**
- **Charge-triggering events. Under the Act, an individual subjected to compensation discrimination under Title VII of the Civil Rights Act of 1964, the Age Discrimination in Employment Act of 1967, or the Americans with Disabilities Act of 1990 may file a charge within 180 (or 300) days of any of the following:**
  - **when a discriminatory compensation decision or other discriminatory practice affecting compensation is adopted;**
  - **when the individual becomes subject to a discriminatory compensation decision or other discriminatory practice affecting compensation; or**
  - **when the individual’s compensation is affected by the application of a discriminatory compensation decision or other discriminatory practice, including each time the individual receives compensation that is based in whole or part on such compensation decision or other practice.**



# Job Descriptions

# Importance of Job Descriptions

## **#1 – Helps Attract the Right Employee**

**The purpose of a job description is to ensure the job will meet the needs of the organization and to recruit the appropriate talent for the position. When you clearly specify the qualifications for a specific role, it will be less likely that employees who don't fit the criteria apply. This will, in turn, help you save valuable recruitment time by limiting the number of applications that come through the door, thereby improving the quality of the applications that come in.**

## **#2 – Helps Guide Training**

**Figuring out the type and depth of training a new employee requires can be a difficult task. However, a complete job description helps make it a bit easier. If your job description is thorough, it will be easier to know where a new employee falls short in terms of knowledge, skills, or qualifications and where he/she might require additional training.**

**Using the skills gaps as a guide, you can put together a customized training plan that will help get the employee into an actionable position faster.**

## **#3 – Offer Protection After Terminations**

**While job descriptions help bring in qualified employees, a bad hire might still find their way in. In such a scenario, a good job description will serve as back-up documentation for poor performance. If you had outlined the expectations right from the beginning, it would be easier to pinpoint and document exactly where the employee's performance doesn't meet the standards. This information will supplement any other documentation of performance issues such as performance reviews, one-to-one meeting notes, and other discussion notes.**

# Importance of Job Descriptions

## #4 – Assist with Retention and Satisfaction

When you look at it from an employee candidate's perspective, a job description is a sample snapshot of what a candidate's life with the company will look like. If you fail to put forward an accurate job description, the employee will feel that your company has been deceitful. He/she will also be more likely to quit.

On the other hand, if a job description is accurate, the chances are that the employee will enjoy their job and have a sense of purpose and loyalty towards the company.

## #5 – Helps Gauge Performance

After hiring an employee, an in-depth job description serves as a tool to gauge performance. The job competencies, duties, tasks, and responsibilities that are outlined in the description will act as expectation guidelines. Once the probationary period ends, or when it is time for employee reviews, a job description is an excellent tool to measure performance shortcomings or areas where the employee exceeds expectations.



# Job Evaluation

# Introduction

## What is Job Evaluation?

**Job evaluation is a systematic process for defining the relative worth or size of jobs or roles within an organization in order to establish internal relativities and provide the basis for designing an equitable grade structure, grading jobs in the structure and managing relativities.**

**There are two basic types of job evaluation schemes, known as "non-analytical" and "analytical".**

## Non-analytical Schemes

**The defining feature of non-analytical evaluation schemes is that whole jobs are compared with each other without any attempt to break down and analyze jobs under their various demands or components. These types of job evaluation schemes are particularly prone to sex discrimination because where whole jobs are being compared (rather than scores on components of jobs) judgments made by the evaluators can have little objective basis other than the traditional value of the job.**

## Analytical Schemes

**Analytical evaluation schemes are schemes where jobs are broken down into components (known as factors) and scores for each component of the job are awarded with a final total giving an overall rank order.**

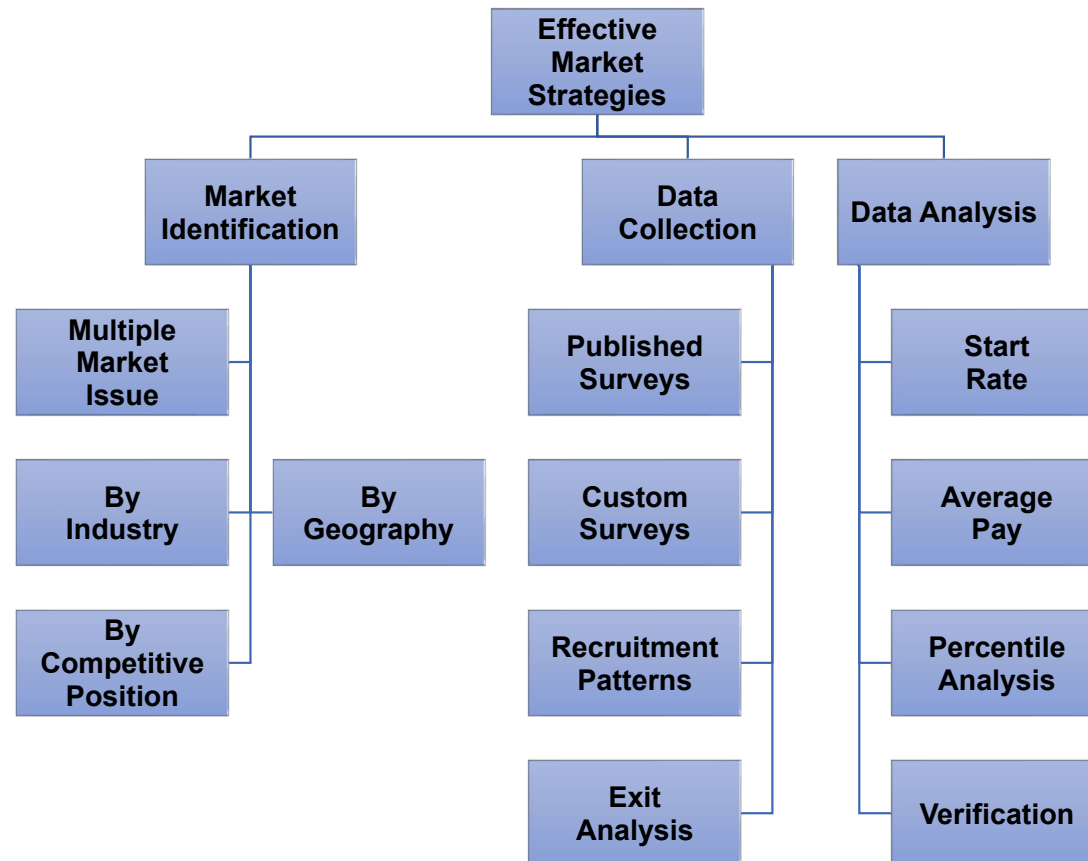


# Market Pricing

# Characteristics of a “Competitive” Compensation Program

- **Depends on the organization’s definition of competitive in the market.**
- **Typically, market competitive reflects 50<sup>th</sup> percentile (P50) rates of pay.**
- **Requires market studies to determine the competitive nature of current pay and benefits practices.**

# The World of Compensation Market Analysis



# Aging of Data

- Salaries in the market, as well as your own organization, are constantly moving due to merit and promotional increases, newly hired employees, and termination of employees.
- In order to determine how your organization's rates of pay compare to the market, it is necessary to look at both sets of data at a specific point in time.
- This "snapshot" approach is accomplished by aging the survey data to the point in time of the market review.
- Survey data can be aged to the current date to compare it to your organization's current rates of pay.
- Survey data can be aged to a point of time in the future to estimate pay levels for the coming year.

# Analyzing and Presenting Data – Basic Survey Statistics

- **Mean:** Simple average based on the sum of all data points.
- **Weighted Mean:** Each respondent's data are weighted by the number of incumbents in the job.
- **Median:** The value in the very middle of a range of data. Also known as the 50<sup>th</sup> percentile.
- **Percentiles:** Represents the value that x percent of the data are less than. For example, the 75<sup>th</sup> percentile is that point at which 75% of the data fall under when individual data points are ranked from high to low.
- **Quartile:** Cuts a data array into subsets at the 75<sup>th</sup> and 25<sup>th</sup> percentile points to represent the middle 50% of the data.
- **Regression Analysis:** Tests the correlation between two or more variables and allows a prediction of the dependent variable (compensation) by knowing the value of the independent variable (sales, evaluation points, etc.).
  - The coefficient of correlation should be above 0.70.
  - 1.0 is perfect correlation.



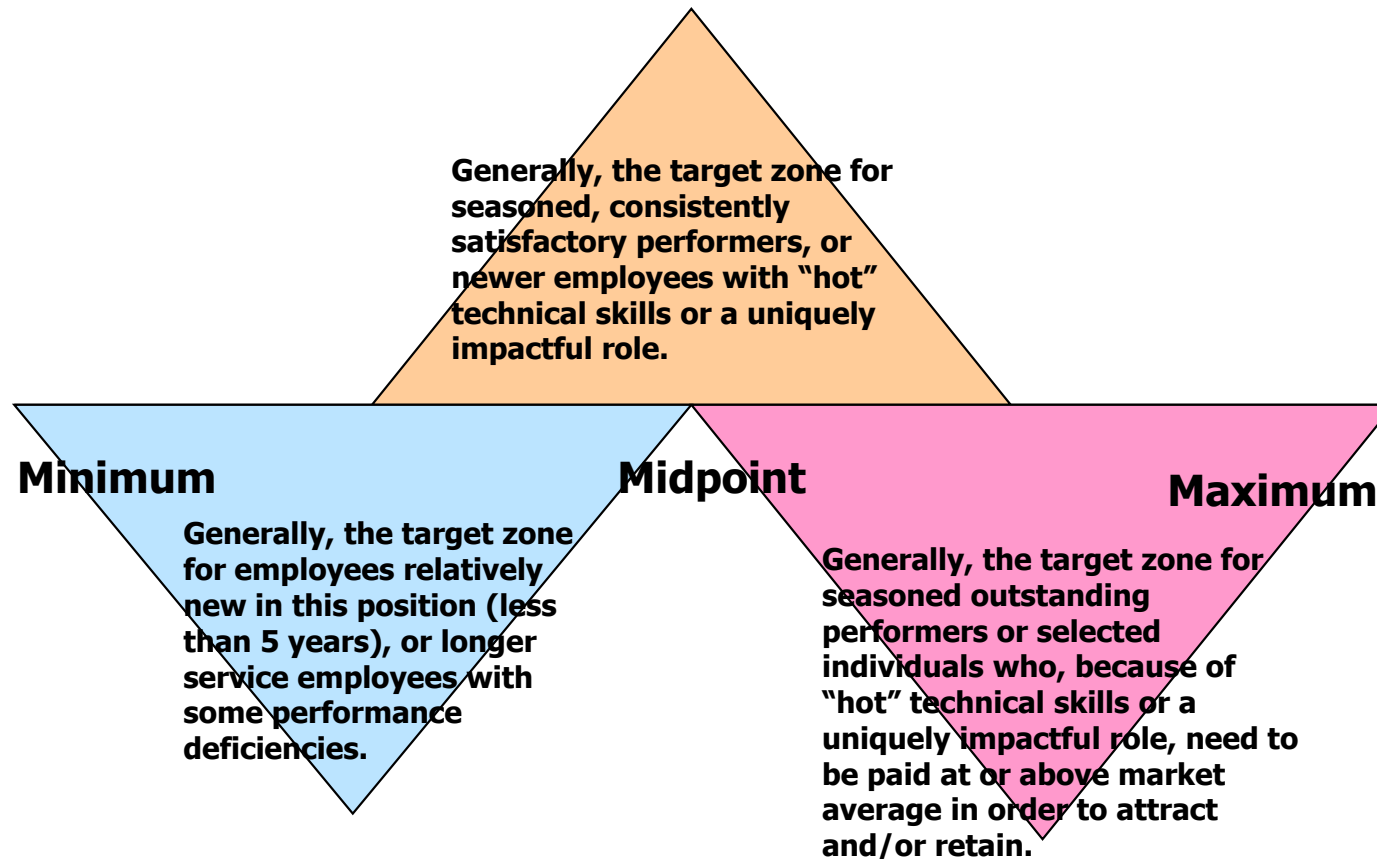
# Pay Ranges

# Steps in Designing Effective Pay Structures

## • Market Focus

- Determine Appropriate Market Data Sources
- Determine Benchmark Jobs to be Analyzed
- Determine Market Position (Percentile / Level in Market)
- Match Benchmark Jobs to Market Data
- Factor Data for Geographic and Chronological Differences
- Rank Order Jobs from High to Low Based on Results
- Group Benchmarks into Market Families and Grades
  - Market family based on similar skills and responsibilities such as IT, Clerical, Engineering, Financial, etc.
  - Grades based on grouping jobs by common market value (+-10%)
- Develop Market Minimums or Midpoints and Salary Ranges
- Slot Remaining Jobs Based on “Whole Job” Ranking Method
- Audit Results

# General Anatomy of a Salary Range





# Pay Movement

# Base Range Penetration Methodologies

- **Pay for Time/Seniority**
  - Seniority Step Systems
  - Breathing Pay Syndrome
  - Cost Implications
  - Employee Morale Implications
- **Pay for Performance**
  - Linkage to Performance System
  - Pure Point Systems
  - Performance Level/Position in Range System
  - Base Pay/Bonus Combination Systems
- **Pay For Competency**
  - Set job levels with job family
  - Primary competency levels defined

# Base Range Penetration Methodologies

- **Linking Pay to Performance**
  - **Determining what to reward**
    - **Organization values**
    - **employee contributions to be rewarded**
    - **organization's ability to pay**
    - **organization's ability and willingness to communicate the plan**
    - **organization's ability to administer the plan**
  - **Documenting Performance Standards**
    - **Quality**
    - **Quantity**
    - **Communications**
    - **Creativity and Innovation**
    - **Teamwork**
    - **Planning and Organizing**
    - **Problem Analysis**

# Base Range Penetration Methodologies

- **Linking Pay to Performance**
  - **Establishing a Merit Budget**
    - Anticipated and actual organization financial performance
    - inflation factor
    - industry trends
    - retention and recruiting issues
    - competitive position of the organization
    - Performance needs of the organization
  - **Setting a Merit Policy**
    - Size of available rewards
    - Timing of increase
    - Base or Lump Sum Increase
    - Performance and Position in Range
    - Performance and Position in Range and Variable Timing

# Pay for Performance Issues

## For Most Organizations:

- **Traditional merit programs not workable due to limited budgets.**
- **Pay for performance linked directly to the results of the performance appraisal in terms of timing difficult to administer.**
- **Trend is to separate performance review and related compensation decisions.**
- **Trend is to tie base compensation to market, performance compensation to one time bonus payments.**



# **Support Policy Development and Employee Communication Strategies**

# Communication and Implementation

- **Defining Objectives**
  - **Ensure employees fully understand all the components of the new pay system.**
  - **Change employee perceptions of how their pay is determined.**
  - **Motivate employees to perform their jobs to the best of their abilities.**
- **Key Questions**
  - **What is the current understanding regarding the current compensation program?**
  - **Do managers and employees have accurate information?**
  - **How well do managers and employees communicate with each other?**
  - **Are consistent messages being communicated by top management?**
  - **Do managers have the necessary people skills?**
  - **Do employees believe there is a connection between pay and their performance?**
  - **With what method of communication are employees and managers most comfortable with.**

# Communication and Implementation

- **Compensation Components Communicated to All Audiences**
  - **Job Descriptions; Job Evaluation; Market Data Collection and Analysis; Pay Structure Development; Incentive Plan Design; Performance Appraisal System; Compensation Policies and Procedures; Benefit Plans**
  - **Detail for Executives**
    - Components explained in a general way
    - Emphasis on strategic implications
    - Executive compensation explained in confidential one to one meetings
  - **Detail For Management**
    - Components thoroughly explained and reviewed in formal sessions
    - Emphasis on development and motivation of employees using salary management, performance appraisal and incentive plan
  - **Detail for Employees**
    - Fairly detailed explanation of components
    - Emphasis on both process and policy information
    - Attention paid to the workings of the pay for performance and/or incentive process.



# **“Balanced Scorecard” Compensation Strategic Planning**

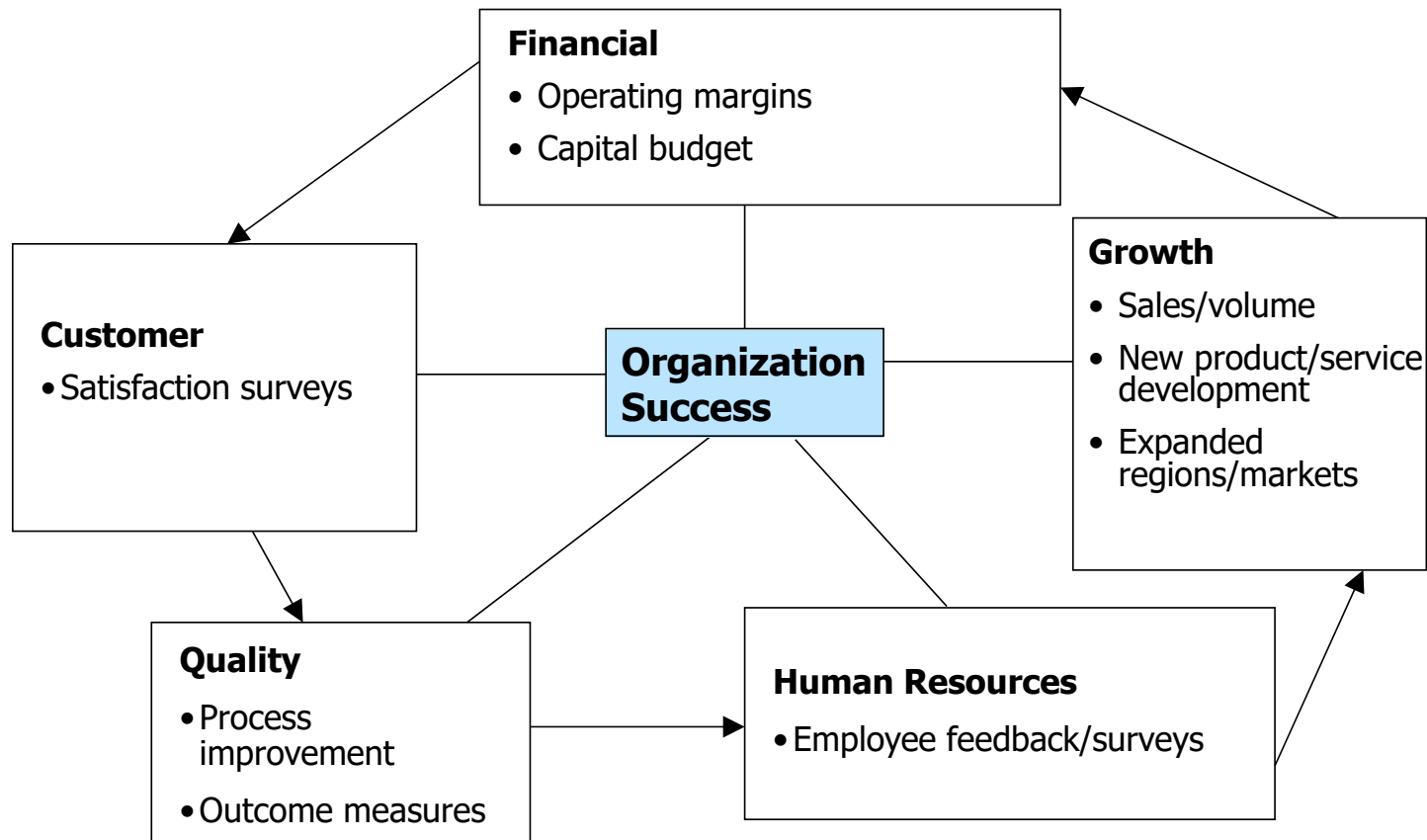
# The Balanced Scorecard

## Translating Strategy Into Action

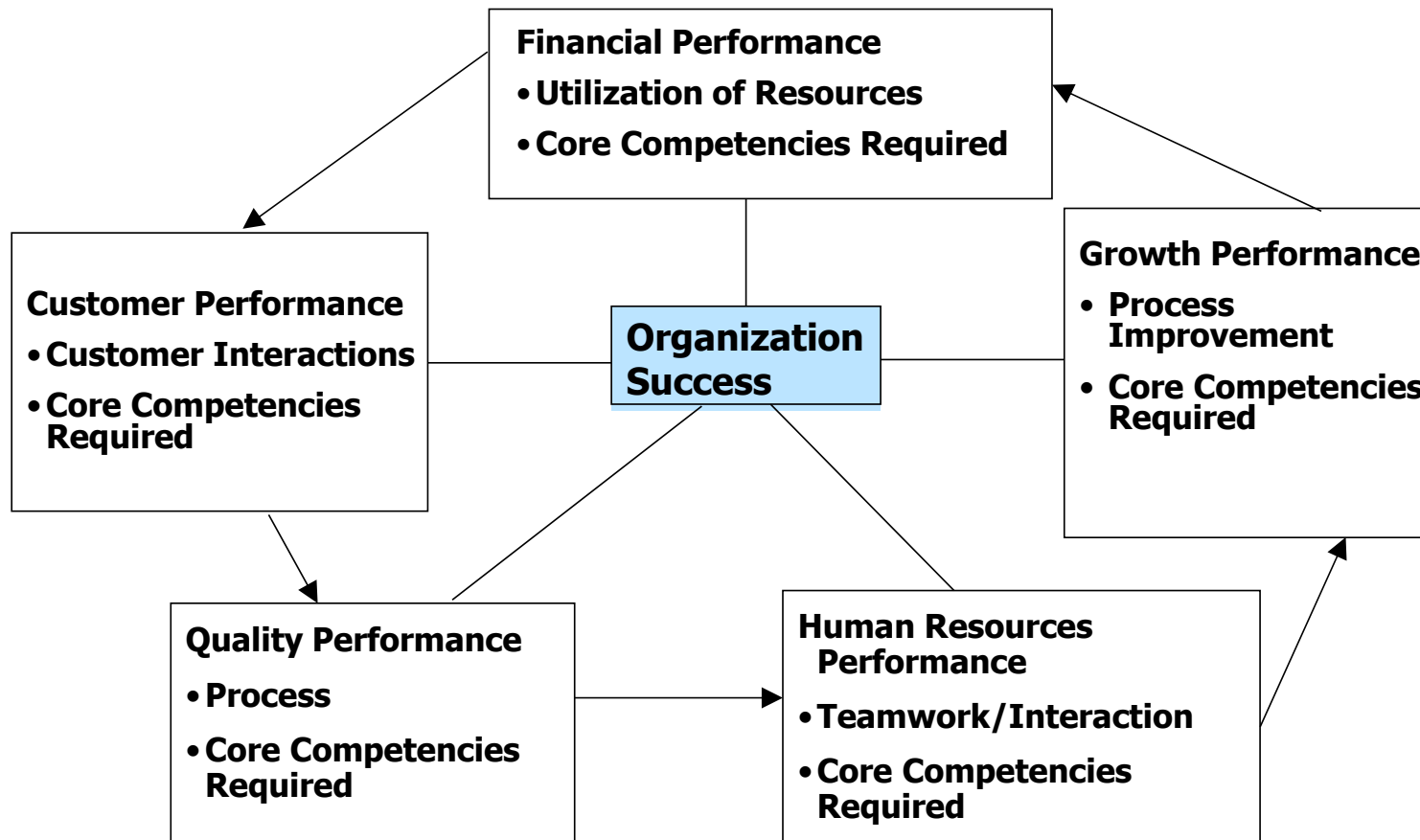


# The Balanced Scorecard

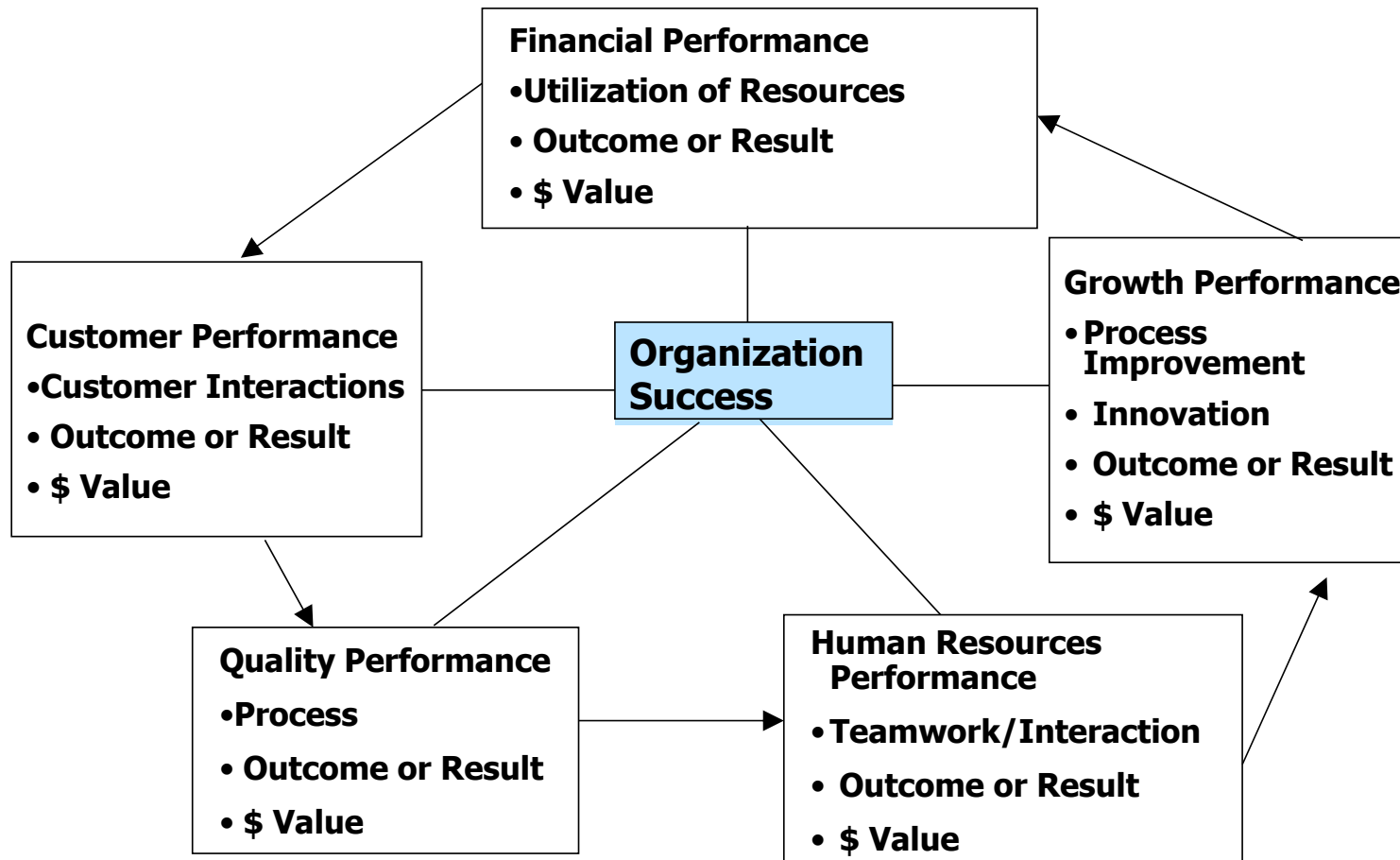
## Setting Targets/Measuring Performance



# The Balanced Scorecard Competency Based Performance Management Model



# The Balanced Scorecard Individual Incentive Model





# Speaking the Language of the CFO

# Economics of Compensation Programs

- **Business Literacy and Value Creation**
  - **Primary business functions:**
    - **Production/Services**
    - **Sales**
  - **Primary Support Functions**
    - **Materials**
    - **Finances**
    - **Human Resources**
- **Compensations Influence on Value Creation**
  - **Harmonization of Business Functions**
  - **Control of Costs**
  - **Support Company's Position in the Market**
  - **Equitable Distribution of Wealth**

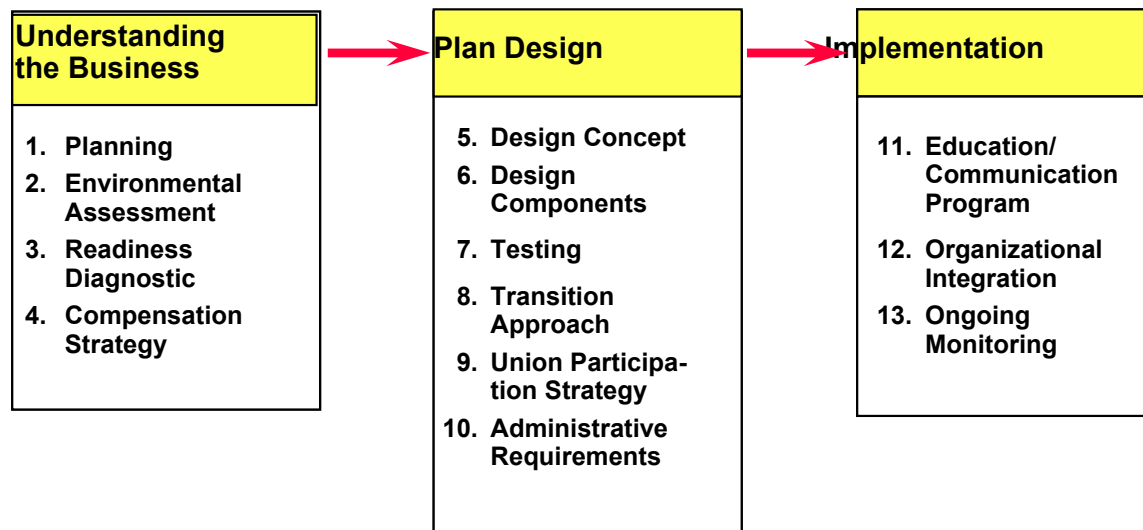
# Economics of Compensation Programs

- **Three Basic Financial Statements**
  - **Cash Flow Report-Cash Inflows and Outflows**
    - Demonstrates a company's ability to generate cash
    - Shows the company's ability to meet financial obligations and pay dividends
    - Identify potential needs for additional financing
    - Assess the effects of cash and noncash and financial transactions
  - **Income Statement-Revenues, Expenses and Resulting Net Income or Loss over a period of time**
    - $\text{Sales} = \text{Revenues}$
    - $\text{Net Sales} = \text{Gross Sales} - \text{Sales Returns and Allowance}$
    - $\text{Gross Margin} = \text{Net Sales} - \text{Cost of Goods Sold}$
    - $\text{Operating Income (Loss)} = \text{Gross Margin} - \text{Operating Expenses}$
    - $\text{Income Before Taxes} = \text{Operating Income (Loss)} \pm \text{Other Income (Expenses)}$
    - $\text{Net Income} = \text{Income Before Tax} - \text{Provision for Tax}$



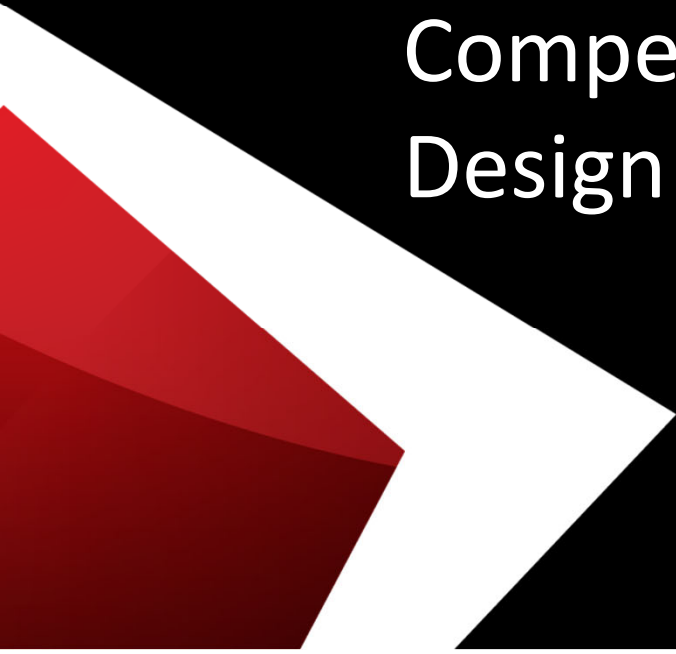
# Incentive Design Considerations

# Overview of Design Process



# Readiness Assessment Checklist

Readiness Dimension	Question	Answer
Competitive Position/Financial Health	Do we have a business opportunity to improve? How do we fund the program?	
Leadership/Strategy	Do we have a well articulated business plan? Do we know how to measure success?	
Culture	Are we capable of employee involvement? What is the current level of trust between employees and management?	
Employee Readiness	Is there sufficient line of sight or can it be established? Are employees willing to participate?	
Technology/Measures	Do we have the systems to measure performance? What do we measure well now?	



# Competency & Career Progression Design Considerations

# Challenges for Competency Pay Design

- **Selecting and defining competencies.**
- **Defining role-model behaviors for each competency.**
- **Determine how competencies will be attained and assessed.**
- **Develop effective measurements of competencies.**
- **Determine if pay will be based on competency, acquisition, utilization or value added contributions.**

# Uses for career ladders

**Employee Retention** - Career ladders provide an incentive for employees to stay with an organization when they see opportunities to advance. Employers save on costly turnover, recruitment, and training expenses.

**Performance Incentive** - The opportunity for advancement motivates employees to produce and perform well on the job and to acquire new knowledge and skills.

**Succession Planning** - Career ladders enable organizations to plan for and develop the skills, knowledge, and abilities they need now and in their future workforce.

**Boost to Small Firms** - Regional industry-based career ladder strategies spread the expenses of developing and maintaining career ladders and training among participants. This makes career ladder programs affordable for small and medium-sized employers rather than just large employers.