

The Compensation Space : An Approach Towards the Compensation Conundrum

* *Sunaina Kuknor*

Abstract

It is said that compensation is not about how much is paid to an employee, but how much they are valued – with the tangibles (money, perks) only being a surrogate for the intangible. This lifts the whole understanding from mundane money to valued humans. For organizations, it is important to design what the compensation package says in terms of valuing the employee, before arriving at the tangible components of the compensation package. Naturally, the organization also spells out what the return value is for the compensation, which can cover performance, retention, innovation, and so on. Mass customized/ individualized compensation can be aspirational for an organization. This paper conceptualized a matrix which may help organizations on the path to dealing with the compensation conundrum. Using five catchy labels – need, greed, seed, deed, and freed – it provides a framework to design compensation in line with the strategic intent of the organization. It suggests how the components of the package can be designed in line with the strategic intent, and pinpoints what value is being emphasized in the design of the package. It also suggests that customized compensation can be worked out. Being conceptual, it is naturally open to debate and empirical validation.

Keywords : compensation, strategy, matrix, compensation space, need, greed, seed model

JEL Classification: J32, J33, M12, M52

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An organization is formed of a conglomerate of individuals, who then function as a team. This transition occurs when there is a commonality of purpose and processes. The commonality of purpose translates to the value offered by the organization to the customer. In return the organization develops a compensation system that rewards the individuals and the team for their effort in the processes leading to the value offering (Gomez-Mejia & Tosi, 1987; Gwalani, 2006). Compensation system can help an organization achieve and sustain competitive advantage. To develop a competitive advantage in a global economy the compensation program of the organization must support totally the strategic plans and actions of the organization (Henderson, 2009). Most employers believe that how people are paid affects people's behaviors at work, which affect an organization's chances of success.

However compensation system does not apply only to roles that contribute to customer offerings, but also to other roles as assigned by the organization. The role assigned to each individual is driven by what is the strategic intent in assigning the role. Bowles and Babcock (2013) state that while the primary strategic intent would be to

* *Assistant Professor*, Symbiosis Institute of Business Management (SIBM), Symbiosis Knowledge Village, Lavale, Pune, Maharashtra. E-mail: sunainakuknor@sibmpune.edu.in

[1] The ballast effect is a term coined by the authors for employees retained in a role that is deemed necessary, but does not primarily contribute to the value generation. A loose analogy is the hygiene factor in Herzberg's two-factor theory of motivation.

contribute to the organizational purpose of the customer, there may be other needs like the *ballast effect* [1], and the investment for future potential and returns. The strategic intent is realized through performance in the assigned role. The compensation system to reward performance is the choice of suitable compensation components, and structuring the components in a package. This paper conceptualizes a 'compensation matrix' which links performance and compensation to strategic intent. The matrix can also open up the possibility for an organization to customize the structure.

A Brief Note on Compensation^[2]

Compensation package is the return value by an organization for the performance value of the employee. It is the equivalent not only of 'how' or 'how much' they are paid, but also a reflection of 'how they are valued'. Successful compensation packages are more like a total reward system, containing direct or indirect, extrinsic or intrinsic, monetary or nonmonetary, statutory or discretionary, current or deferred elements (Ahlers & Pfirsch, 2001; Milkovich, Newman & Gerhart, 2010). By combining many compensation alternatives, progressive managers can create compensation packages that are as individual as the employees who receive them (Giovani, Snider, & Balakrishnan, 2013).

A brief understanding of each element is essayed below. It must be noted that there could be overlaps in some definitions almost having the feel of synonyms.

(i) Direct is what is offered to an employee for them to exercise the choice of use (Basic, DA). Indirect is what comes with conditions attached (LTA, Medical).

(ii) Blackwell, Dudney, and Farrell (2007) highlights extrinsic component address the tangible needs of the employee and includes both monetary and non monetary rewards (Wages, salaries, allowances, recognition that are all crucial for extrinsic motivation). Intrinsic is based on the intrinsic motivation (Working environment, training and development, professional growth, supervision, communication pattern, participation in decision making, responsibility and accountability). It is normally believed that it reflects the employee's mindset, and the employee gets these rewards from just doing the job.

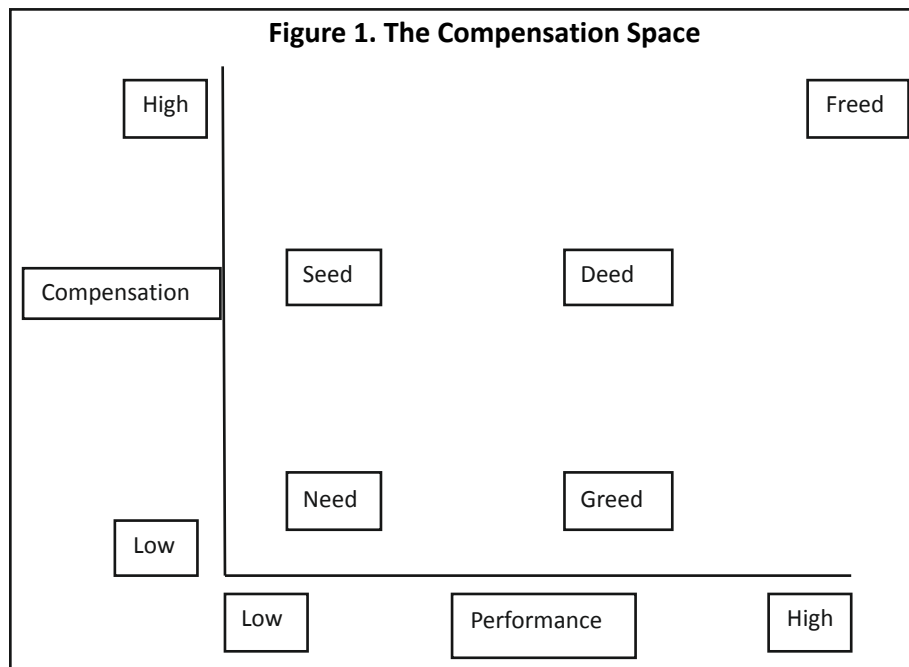
(iii) Monetary is the cash component (Basic, DA). Nonmonetary is more in kind which must be availed as offered and not transferable to Monetary part (Medical, Club Membership).

(iv) Statutory is what is required by law (PF, Gratuity, Paid Leave +). Discretionary is left to the organization (Stock Options, Bonus, Moving expense).

(v) Current is what is offered on hand to the employee (Basic, DA). Deferred is realized in the future, subject to time and other considerations (Gratuity, Superannuation, PF).

While the above are given broad classification of compensation elements or components, the number of components are myriad and limited only by creativity. A listing of these components can be garnered from standard research papers and texts on compensation (Anderson, Banker & Ravindran, 2001 ; Hoque, Mosa, Zohora & Mishra, 2013 ; Rao, 2003).The inputs from these sources have been used to conceptualize the

[2] This section is not a comprehensive review of compensation concepts and practices, but just a basic understanding (the tip of the iceberg) which is relevant for the compensation models conceptualized in this paper.



compensation matrix and framework in the paper. This paper goes beyond listing the components to help structure a compensation package. To structure the compensation components in a package, certain other considerations have to be taken into account. These are developed in the succeeding sections

Conceptualizing the ‘Compensation Space’

The Compensation Space is a two-axis framework with Performance on the x-axis and Compensation System on the y-axis. A scale of low to high is used for both axes. In this space, 5 distinct sub-spaces can be identified that reflect the strategic intent. These 5 sub-spaces are designated (by admittedly catchy titles) as: need, seed, greed, deed and freed (See Figure 1). The strategic intent that characterizes each sub-space is explained below :

Brief Explanation of Each Strategic Intent:

(i) Need : This was introduced above as the '*ballast effect*'. The contribution to organisation's customer offering is not the primary purpose. Rather, the purpose could be to meet some obligations e.g. the position in organizations given to sports persons who represent the country. In this state both employee's performance (towards customer purpose) as well as the compensation received by employees are low. In this state, only the bare minimum requirements of the employee is met.

(ii) Greed : This is an '*exploitative*' state where the compensation is low but performance expectations are high. The difference between the Need and Greed state is that the latter is linked to customer purpose of the organization. This state is highly prevalent at entry level into industry of fresh graduates. The ethical dimension of exploitation is not the consideration but what is the bare minimum compensation one can get away with. Normally employee engagement is characterized by a sense of 'helplessness'. This is actually a problem state in the long run and is open to high attrition.

(iii) Seed : This is an '*investment*' state. In some instances, the organization may nurture an employee with

potential in the hope of superior performance in the future. Krieger and Ang (2013) highlighted employees in elite programs (like the Tata Administrative Service or TAS), or employees whose further qualification overseas are funded, fall in this state. The compensation needs to be high, else the potential leaves the organization. And like any investment, this carries the risk of being a poor investment.

(iv) Deed : This is the '*ROI*' state. Murphy (1998) emphasizes that a high level of compensation is linked to a high level of performance towards customer offerings. This is a win-win situation for both the stakeholders. Every company aims for a majority of roles in this state.

(v) Freed : This is the state of an '*alternate paradigm*' beyond the current parameters of KRA/ KPI. This will reward innovation, creativity, new thinking, etc. that will lead to new opportunities for the organization. While this may be a standalone state, it may surface while any of the other roles are being carried out.

The Compensation Matrix

In order to navigate the Compensation Space, a Compensation Matrix has been drawn up (See Figure 2). This matrix attempts to tie-in 4 aspects :

- (i)** What is the weighted mix of strategic intent expected from the role (role profile).
- (ii)** What is the performance expectation (KRA/ KPI) in this role profile.
- (iii)** What is desired to be said through compensation i.e what is valued in the employee.
- (iv)** What are the relevant compensation components in line with (i) to (iii) above.

In Figure 2, these 4 aspect are laid out and indicated by their numbers (i) to (iv).

(1) How to Construct the Compensation Matrix

- ↪ For any given role, identify the profile of the strategic intent with weighted score (I) e.g. For a particular role the profile could be Need = 20%, Greed 40%, Seed 0%, Deed 40% and Freed 0%.
- ↪ List down the performance indicators (KRA and KPI) for each strategic intent in line with the weighted score (ii) e.g. Under Deed, one could have say sales target, market share, etc.
- ↪ List down the menu of Compensation Components from which the Final Compensation is to be built (iv) e.g. in order to enforce the Deed KRAs and KPIs, one may choose Basic, DA, Incentive, Creche, Cell phone and laptop, in addition to all the statutory components.
- ↪ Populate each cell with what you would like each compensation component to say (iv). This will permit putting together a package in a customized way for the role incumbent. It can have the flexibility to change the components for an alternate incumbent. E.g. Creche is included in the package to value the family for one incumbent, but another incumbent may see no value in it.

Once the Matrix is constructed, one can move on to implementation.

(2) How to Implement the Compensation Matrix

- ↪ For each role establish the maximum monetary benefits the organization can offer. This can be both Total

Figure 2. The Compensation Matrix

NOTE: In the Matrix, What the does the **Compensation say (iii)** should be populated in each cell. Some indicative examples are shown

		(i) The Weighted Strategic Intent				
		(ii) Performance (KRA/ KPI)				
		Need (Ballast) Weight	Greed (Exploit) Weight	Seed (Invest) Weight	Deed (ROI) Weight	Freed (Paradigm Shift) Weight
		KRA/KPI	KRA/KPI	KRA/KPI	KRA/KPI	KRA/KPI
(iv) Compensation Component (only indicative).						
a1) MONETARY	Basic	Hygiene	Hygiene	Hygiene	Hygiene	Hygiene
Extrinsic, Direct,	DA	Protect inflation			Protect Inflation	
	HRA	Family			Hygiene	
	Bonus	Time Ethic			Reward, Business Objective	
	LTA				Family	
	Profit Sharing				Reward	
	Incentive				Reward	Motivation
	Separate Contract				Business Objective	Motivation
a2) MONETARY	Health Insurance	Statutory	Statutory	Statutory	Statutory	Statutory
Extrinsic, Indirect,	Retirement - PF, Gratuity	Statutory	Statutory	Statutory	Statutory	Statutory
Statutory	Paid Leave (sick/holiday/personal days)	Statutory	Statutory	Statutory	Statutory	Statutory
a3) MONETARY	company parties			Social	Social	Social
Extrinsic,	tickets to events (ball games, concerts)			Social	Social	Social
Indirect,	Cell phones, laptop			Hygiene	Hygiene	Hygiene
Discretionary	Crèche/ elder care			Family	Family	
	Stock Options				Reward	Motivation
	moving expenses			Hygiene		
	Retirement- pension superannuation				Security	
	Magazine, clothing, boots				Incentive	
b1) NON-	Flexi Hours			Motivation	Motivation	Motivation
MONETARY	Work from home			Family	Family	Family
Extrinsic	Recognition			Motivation	Motivation	Motivation
	Job Security				Retention	
b2) NON-	working environment					
MONETARY	T & D					
Intrinsic	Professional Growth					
	Supervision					
	Communication Pattern					
	Participate in decision					
	Responsibility					
	Accountability					
	Autonomy					

Guaranteed Cash Component as well as Maximum Earning Potential (these concepts are different from the standard CTC. Visit the IPRS site for definitions [3]).

- ↳ Nonmonetary benefit options may also be identified in order a basket of different values to the employee. This may be more personalized.
- ↳ Spread the benefits across the matrix, maybe in consultation with the employee (the organisation may decide at which roles and levels it would wish to customize the compensation and at which roles and levels it can design a standard package. Even in the standard package it can be bold enough to offer choices but from a pre-determined 'menu').
- ↳ Finalize the offer with the employee.
- ↳ Establish review milestones and Sign off.

Managerial Implications

The study puts forth five strategic intents which form a part of the organizational compensation structure and design. These five intents namely need, seed, greed, deed and freed are designed to facilitate compensation professionals to design the structure giving a widespread benefits to employees across the matrix (Ref. Fig 2). The matrix takes into consideration both extrinsic and intrinsic monetary and non-monetary rewards which may be a part of compensation design. KPI's for each intent can help being clearer of what is expected under each strategic intent. For e.g.: Seed intent being the "investment" stage should spell out KPI's in terms of how an individual needs to develop himself for nurturing both self and company. Each intent in the matrix states how it impacts any individual employee be it to protect inflation, family support, business objective, hygiene factor so on. In an organization, levels need to be identified and the five strategic intents needs to be fitted with each level. Entry level fall under the greed intent, whereas freed intent is only for those who outdo performance expectation and go beyond. This design of the compensation may be time consuming at an initial phase because of its numerous options in the matrix but at the same time will link various components of compensation & reward plan to employee performance.

Conclusion

Organizations today need to adopt an approach towards building a comprehensive employee value proposition for the employee. Compensation strategy should be looked at in a tandem with the overall HR strategy for the organization. There are various research studies which show positive relation between compensation structures and a firm's performance (Mehran, 1995 ; Michaud & Gai, 1995). Much of it depends on what constitutes a compensation. This is a dilemma faced by compensation professionals at all levels including the blue to white collar employees or be it the executive compensation which tends to be more equity based. The need today is to design an integrated approach towards the total rewards flexible enough to cater to market demands and closely linked to other processes and systems (Dulebohn & Werling, 2007; Rao, 2003). Depending on an organization's strategic intent, compensation philosophy and stage of market growth, increasingly organizations are linking their variable pay plans to individual, team and organization performance.

An ideal compensation system is one of the enduring conundrums in HR. It has to satisfy many needs - organization's strategic needs, organization's motivational needs, organization's performance needs, employee's

[3] Indian Placement Reporting Standards : <http://www.iimahd.ernet.in/iprs/>

extrinsic and intrinsic needs, and many more which may not be listed here. The building blocks to construct an ideal compensation have to be around these needs. A majority of these needs (building blocks) have been well understood and reported in literature. But when it comes to integrating the building blocks, the compensation conundrum poses the same problem that describing an elephant poses to myopic men! Maybe HR intellectuals are not myopic and maybe it is the *Vishwaroopam* nature of the conundrum that requires a sixth sense beyond what we are endowed with.

Limitations of the Study and Scope for Further Research

Compensation has always been a critical and sensitive function in organizations. While the study would have enriched by empirical evidence, the framework and matrix were designed using a conceptual approach. The conceptual approach adopted in the paper needs to be anchored in with further empirical validation showing how the strategic intents can be implemented in real time compensation design. Secondly this study focuses more on the structure rather than the level of compensation. Future study can be undertaken on how the components vary at different levels in an organization.

True there are some models which integrate a few of these elements as stated in the research paper by Henderson (2009) for linking compensation dimensions and compensation components). However as there is no model which is holistically comprehensive, there is scope for one more integrative model, no matter how limited. The paper has forwarded one such model which links some of the needs. Thirdly the next level of study can be to test this model for executive compensation as a function with compensation professionals and look at its practical application in today's contemporary organizational setting.

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