Describe remuneration and reward systems

Overview

How does an organisation ensure that it stays up-to-date with current remuneration and benefits practices? There are lots of ways – all of which involve a little ‘leg-work’. It could be simply a matter of making a few phone calls, or some web-based research, maybe keeping an eye on employment advertisements in the local and national papers and journals. It could mean going outside – for example, consulting with employer/employee associations, becoming part of a special interest network, or participating in a salary survey. This resource provides a good starting point, with an overview of remuneration systems and an outline of elements that may make up a package.

Key terms

**Benefit**
A cash or non-cash supplement which is regarded as adding value to the employees total pay package. Taxable as a fringe benefit in Australia.

**Cafeteria approach**
In remunerations management refers to the packaging of benefits; the offering of a limited range of benefits from which an employee may choose up to an agreed value. Often also referred to as a ‘smorgasbord approach’

**Compensation**
A term used to describe reward mechanisms; as in ‘compensation and benefits packaging’.

**ESOP**
Employee Share Ownership Plan; mechanism whereby employees buy or are granted shares in the company.
Gain share
A reward program that allows employees to share in any increase in profits over an above a pre-determined point (commonly associated with productivity agreements)

Incentives
Payments in addition to the employee’s ordinary pay granted as reward or acknowledgement for performance or service. (Such as commissions, bonuses, share options, profit share.)

Industrial awards
Also referred to as ‘awards'; historically in Australia, the main mechanism for confirming minimum terms and conditions for workers in a particular occupational group or industry

Merit pay
Any salary increase awarded to an employee based on their individual performance

Profit share
A reward program that allows employees to share in the companies profits

Remuneration
Payment for services rendered as an employee or contractor

Remuneration relativity
Equity, fairness or balance in remunerations, measured according to internal relativity (between jobs in an organisation), interpersonal relativity (between people in an organisation) and external relativity (between jobs inside and outside the organisation).

Salary packaging
A process of arranging pay, benefits, and services components to form an attractive reward package

Salary structure
A systematic approach to the arrangements of salaries for employees in an organisation. Often organised into grades with defined upper and lower ranges
The public vs private sectors

While in some respects the public sector remuneration environment may appear to be drawing closer to that of the private sector, there are still some very obvious differences. The following table illustrates some key differentiating factors.

Table 1: Private and public sector differences (2 cols)

<table>
<thead>
<tr>
<th>Private sector</th>
<th>Public sector (with exception of SES contracts)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labour market supply and demand driven</td>
<td>Large enough to be own market, not strongly influenced by external market</td>
</tr>
<tr>
<td>Highly mobile, increasingly short-term employees</td>
<td>Low mobility, long-term employees</td>
</tr>
<tr>
<td>Highly flexible pay arrangements</td>
<td>Inflexible pay arrangements</td>
</tr>
<tr>
<td>Annual performance reviews</td>
<td>Some departments have annual performance reviews</td>
</tr>
<tr>
<td>Performance assessments frequently linked to pay increases</td>
<td>Performance assessment rarely linked to pay</td>
</tr>
<tr>
<td>Large casual workforce, high use of contractors, agency personnel</td>
<td>Large full-time, part-time workforce, increasing use of contract and/or agency personnel</td>
</tr>
<tr>
<td>Highly flexible, agreement driven pay environment</td>
<td>Inflexible, large government award driven pay environment</td>
</tr>
<tr>
<td>Commissions, bonuses and incentives common</td>
<td>Bonuses rare and commissions non existent</td>
</tr>
<tr>
<td>Pay based on performance (merit)</td>
<td>Pay based on job value</td>
</tr>
<tr>
<td>Large proportion non-unionised workforce</td>
<td>Large proportion unionised workforce</td>
</tr>
<tr>
<td>Wealth building schemes (such as profit share, gainshare &amp; ESOP) common</td>
<td>Wealth building schemes non existent</td>
</tr>
<tr>
<td>Wide range of benefits available</td>
<td>Minimal range of benefits available</td>
</tr>
</tbody>
</table>

In Australia, government departments and most large private companies and institutions use remuneration structures and systems that are ‘job value’ based. This means that they use a system to determine the appropriate value of jobs to the organisation then create a structure to arrange the job values in a logical way (a series of grades, steps and ranges).

The success of such systems hinges upon:

- the ability of the Job Evaluation process to value jobs correctly
- the acceptability of the rates applied to the relative values of the jobs.
Private and public sector practices are converging; however, there are still significant differences in:

- pay openness (public) versus pay secrecy (private)
- pay rigidity (public) versus pay flexibility (private)
- the application of PAYE tax rules (public) versus tax benefit and minimisations plans (private)
- the size of salary increments known (public) versus pay increases based upon performance (private)
- fixed salaries (public) versus salary plus incentives, bonus, and so on.

There are a number of major factors influencing remuneration practices in the private and public sectors. These include:

1. CPI
2. public perception
3. government agenda
4. union demands
5. economic confidence
6. company profitability
7. industry trends
8. demand for labour
9. company philosophy
10. management expertise.

Merit based remunerations systems

‘Merit-based pay’ can be differentiated from ‘pay-for performance’ by the following factors:

- Merit-based pay systems exist when the employee’s manager has the authority to recommend/authorise an increase in salary based upon performance.
- Most remuneration systems dictate a minimum and maximum remuneration level for a role or grade and then provide for a minimum or maximum annual increase based on individual or group performance.
- Usually, such increases flow on from a structured system of performance review, which may or may not be conducted quite close to salary review time.

The term ‘pay for performance’ may include merit-based systems but is more generally used to describe systems which are far more directly linked
to performance (eg on a daily, weekly or monthly basis), such as bonuses and commissions.

Also, such payments may be paid at individual, team, group or even company level (such as team performance bonuses, profit sharing and gain sharing schemes).

Performance related rewards

Bonus plans

- Bonus plans usually cover a set period of time with payments relating to performance during the period.
- Payment is somewhat discretionary and is usually based on a mix of quantitative and qualitative measurement.
- It is quite common for the criteria for payment to be unspecified until payment is made.
- Bonus plans are usually capped.

Commission plans

- Commission plans usually apply to those staff directly involved in revenue generation.
- Commission plans are paid as a percentage of the performance indicator.
- Payment frequency is usually directly after the event (weekly, monthly, quarterly).
- Commission plans may be capped or uncapped.

Employee share plans

- Employees are offered the opportunity to purchase shares at a discounted rate, usually a 10–15% discount.
- The base rate from which the discount is applied may be the average share price over a period, usually a quarter.
- Employees may be able to fund the share purchase from salary sacrifice.
- Employees may be offered low interest loans to fund share purchases.
- Options are issued to employees after a qualifying period of service.
- The issue price of the option is usually the share price at the date of issue or the share price at the date of issue discounted by up to 15%.
The number of shares issued relates to years of service, salary level, job family or hierarchy.

The options vest over time, usually 1 to 5 years.

Employers may offer low interest loans that assist employees to exercise their share options.

Share options usually expire upon termination with the company or must be exercised at termination.

Gain sharing plans

- Gain sharing plans are a refinement of profit sharing plans.
- They usually operate within a business unit and include all staff.
- Gain sharing plans reward employees for performance levels that exceed normal standards.
- Performance measures are usually quantitative (productivity ratios, lost time injury frequency rates, etc.).
- Gain sharing plans are usually uncapped.

Incentive plans

- Specific incentive targets are negotiated at the beginning of the plan year.
- Targets may be individual, team based, cover a Business Unit or a Division of the company.
- The size of the on-target incentive may vary from year to year.
- Additional payment may be made for over achievement; these plans may be uncapped.

Key contributor/star performer plans

These plans are usually limited to the top performers (either individuals or teams) who have essential skills or have made a significant contribution to the organisation.

They are usually limited to less than 5% of staff.

Profit share plans

- A pool of funds is established and, at the end of the plan period is distributed to eligible/participating employees.
• The pool of funds is generally a portion of profits or a portion of profits that exceed a specified target.

• Allocation of the pool to participants is generally based on:
  - individual performance
  - management level
  - team performance
  - base remuneration
  - total fixed remuneration
  - nominal base salary.

These plans may be capped or uncapped depending on the method chosen to establish the pool of funds

Special contribution plans

A cash or non-cash award recognising a one-off significant contribution of an individual or a team. Payment is after the event.

Suggestion schemes

Cash or cash equivalent awards for suggestions that are implemented and increase the profitability of the organisation.

Contemporary benefits

Table 2: Benefits and services by class (2 cols)

<table>
<thead>
<tr>
<th>Class of Benefit</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pay for time not worked</td>
<td>▪ Annual and public holidays</td>
</tr>
<tr>
<td></td>
<td>▪ Sick leave</td>
</tr>
<tr>
<td></td>
<td>▪ Parental and maternity leave</td>
</tr>
<tr>
<td></td>
<td>▪ Bereavement leave</td>
</tr>
<tr>
<td></td>
<td>▪ Jury service</td>
</tr>
<tr>
<td></td>
<td>▪ Defence force leave</td>
</tr>
<tr>
<td></td>
<td>▪ Termination/redundancy payments</td>
</tr>
<tr>
<td>Insurance benefits</td>
<td>▪ Worker’s compensation</td>
</tr>
<tr>
<td></td>
<td>▪ Life insurance</td>
</tr>
<tr>
<td></td>
<td>▪ Health insurance</td>
</tr>
<tr>
<td></td>
<td>▪ Salary continuance insurance</td>
</tr>
</tbody>
</table>
Benefits of long-term reward plans

Long-term benefits such as topping up superannuation or employee share ownership plans (ESOPs) are not designed to be part of the employee’s weekly wage or salary. In the short term, the reward value of such schemes may appear to be minimal, and this is not their purpose. Such programs are designed to be attractive to, and reward, longer-serving employees and the real benefits may not be felt until resignation or retirement time.

There are some key characteristics about such programs that help to differentiate them.

• **Gain-sharing programs** are usually linked to organisational (or ‘group’) performance and are a reward for increased productivity and/or profit over and above previous (or ‘normal’) company performance. Employees may share equally in the ‘gain’.

• **Profit sharing** is different in that it does not always require an increase in profitability and/or profit above the norm. Employees may share in a percentage of the profits, once a predetermined point (e.g., break even after taxes) is reached. (It may appear similar to the distribution of profits by a cooperative, but it is not the same because not all of the profit is distributed.)

• **Employee share ownership plans (ESOPs)** are designed to provide employees with the opportunity to own part of the business by being shareholders of real or ‘replicator’ shares. Different systems exist, ranging from share options where the employee is granted the shares for a nominal fee and exercises the option to pay the remainder at a later date, to fully-paid shares where the employee allocates fully-paid shares to the employee. The risk to the employee varies with the type of scheme.

Think

**What are the benefits of gain-sharing, profit sharing and employee share ownership plans?**
Here are some more things to think about:

- How is subjectivity kept out of pay-linked performance appraisals?
- Should commissions be paid on a fixed or sliding scale?
- Can shared commissions and bonuses, such as ‘team performance’ bonuses, work?
- Non-cash incentives – when do they work or not work?
- Can benefits be taken for granted by staff?
- When is a benefit not a benefit?
- Can an employer justify uncompetitive pay rates by offering attractive benefits?
- Is ‘prestige’ a benefit?

Determining appropriate remuneration

When determining appropriate remuneration the organisation must define its attitude towards the labour market. You may already be familiar with these three market postures:

Lag the market

This means paying below market rates. Wage structure is updated to current market rates. No provision is made for market changes throughout the year, so that at the end of the year the company will be behind the market rates.

Match the market

Also called lead-lag, this means paying the market average. The organisation takes account of estimated market changes for the year but wishes to be on average with the market. Provided the market rate increases steadily over the year the organisation will be ahead of the market for the first half of the year and behind for the second half of the year.

Lead the market

This means paying above the market. Companies with jobs that require out-of-hours work, a lot of time away from home or a heavy travel schedule often fall into this category.