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IMPLEMENTATION OF THE METHODOLOGY FOR COMPENSATION SYSTEMS EVALUATION

Summary. The purpose of this paper is to underline the importance of the evaluation process of compensation systems and demonstrate the benefits the process brings to the organization. This paper explores the main criteria and measures employers can use in the evaluation process and also provides a methodology which can be used when monitoring the compensation policies and programs in the SME sector. Further, it explains the process of implementation of this methodology in a selected medium-sized service company in malopolska region.

Keywords: compensation system, compensation systems evaluation, employee satisfaction , personnel procedures, SME sector

WDRAŻANIE METODOLOGII EWALUACJI SYSTEMU WYNAGRODZEŃ

Streszczenie. Celem artykułu jest pokazanie istotnej roli ewaluacji systemu wynagrodzeń a także wskazanie najważniejszych korzyści takiego procesu dla organizacji. Bazując na przeglądzie literatury, artykuł wskazuje możliwe kryteria oraz prezentowane dotychczas koncepcje tej oceny, które mogą być wykorzystane do monitorowania systemu wynagrodzeń w sektorze MSP. Dodatkowo zaprezentowany zostaje model kompleksowej oceny efektywności systemu wynagrodzeń oraz proces jego wdrożenia w wybranym przedsiębiorstwie z sektora MSP w województwie małopolskim.

Słowa kluczowe: system wynagrodzeń, ocena systemu wynagrodzeń, zadowolenie pracowników, procedury personalne, sektor MSP

1. Introduction

In periods of economic slowdown, most employers look for savings and improved profitability. In such times, compensation systems are crucial as effective tools for achieving desired employee behavior and engagement at work. Moreover, they can be vehicles for better performance and competitive advantage in the future. It is no wonder that many organizations are looking for ways to improve their compensation systems. This is important, especially in medium and small-sized enterprises, as pay systems in most firms in this sector are not aligned with company strategy and main goals (Juchnowicz, 2003). At the same time, this sector has become the main force driving the economy. For example, companies from this sector represent 99% of all firms in Poland (Wilmanska, 2010). Furthermore, for most of those firms, particularly from the service sector, total expenditures spent on pay and rewards represent about 60-80% of total costs. Therefore, it seems obvious that such firms must deliberately and consciously shape their compensation systems, monitor them over time, and evaluate their effectiveness.

The purpose of this paper is to underline the importance of the evaluation process of compensation systems and demonstrate the benefits the process brings to the organization. This paper explores the main criteria and measures employers can use in the evaluation process and also provides a methodology which can be used when monitoring the compensation policies and programs in the SME sector. Further, it explains the process of implementation of this methodology in a selected medium-sized service company in Poland. The case study presented in the paper will help to increase awareness among employers of the importance of evaluating compensation system and the benefits it brings to the organization.

2. Literature review

Few studies have measured the effectiveness of compensation systems and only some of these have explored the matter at all. Therefore, the issue is not well understood and many threads have yet to be examined. To clearly understand the effectiveness of compensation systems, it is important to first define the term. A compensation system consists of the reward policies and practices within a company. The main goals of this system are to attract, to motivate, to develop, and to retain the best people in the workplace and to bring forward the best of their talents and passion (Smith, 2013). A compensation system's effectiveness is understood in terms of the contribution of the remuneration system to organizational strategy (Yao Li, Weihua Liu & Hao Li, 2008, 93) and may be widely defined as meeting the

objectives of the firm, fulfillment of expectations of employees, and realization of the needs of other stakeholders (Beck-Krala & Scott, 2013, Borkowska 2012). An effective compensation system will help an organization gain a competitive advantage by attracting and retaining talented people and effectively impacting their attitudes and behavior in the company. This is why monitoring and assessing the effectiveness of compensation systems is critical for employers. The most important aims of the evaluation of the compensation system may include (Beck-Krala, Scott, 2013):

- Determining whether the compensation policies and practices are well established;
- Verifying whether the system meets its objectives as planned;
- Verifying whether the system supports the objectives of the company;
- Ensuring the different components of the compensation system return value for expenditure;
- Verifying if the system motivates employees to highly perform and creates employee engagement;
- Verifying if employees are satisfied with the system;
- Diagnosing potential problems with the system;
- Monitoring the system, looking for necessary improvements and development;
- Determining if the costs of the system are optimized and affordable.

Achieving these goals may help the organization become more effective and profitable. Despite the need to assess the effectiveness of money spent on pay and rewards, few organizations seem to justify their reward practices on a regular basis (Armstrong 2011, Brown 2008, Corby, White & Stanworth, 2005). The following are among the main reasons employers rarely conduct such analysis:

- lack of reliable measures (Corby, White & Stanworth , 2005; Brown, 2008);
- lack of conviction about the need for such analyses among managers and executives (Kearns, 1995; Corby, White & Stanworth, 2005);
- lack of resources, time, and specific information or data (Armstrong, Brown & Reilly, 2011);
- lack of knowledge and experience of the compensation professionals (Kearns 1995; Corby, White & Stanworth, 2005; Armstrong, Brown & Reilly, 2011).

According to the latest research, there is a strong awareness of the need for compensation system evaluation among US employers, as 81% of companies in the US provide a process for evaluation of their compensation programs. In the European Union, employers seem more reluctant to evaluate their compensation systems. For instance, only 39% of employers in Poland measure the effectiveness of their compensation policies and procedures (Beck-Krala, Scott, 2013). Although the situation has improved and employers have become more aware of the necessity of evaluating compensation expenditures, still the main reasons connected

with the lack of such analysis can be attributed to the lack of knowledge and reliable methodology and measures. In most cases, the only measure of the effectiveness of a compensation system is the informal opinion of managers or employees (Corby, White & Stanworth, 2005; Kearns, 1995, Armstrong, Brown & Reilly, 2011). Typically, evaluation of the effectiveness of the compensation system is done on a selective basis and is only a small part of larger studies examining the organizational climate, employee satisfaction, or commitment to the organization. While this evaluation is provided mostly in large companies (Beck-Krala, Scott, 2013), there is a need for small and medium-sized enterprises to also implement the evaluation process, as invalid and ineffective compensation procedures are present in many of these firms (Juchnowicz, 2003).

To sum up, most of the research on the evaluation of compensation effectiveness has been related to low awareness and the lack of such evaluation; for example, studies provided by Corby, White & Stanforth, 2005; then Kearns, 1995; and finally Armstrong, Brown & Reilly, 2011. Subsequent studies focused on the potential criteria and measures used for the evaluation (Armstrong, Brown & Reilly 2011; Brown 2008; Scott, McMullen & Sperling 2006; Corby, White & Stanforth, 2005). And only a small number called for a comprehensive approach to the study of that effectiveness (Scott, McMullen & Sperling, 2006, Brown 2008, Armstrong & Cummins, 2011). As proposed approaches were models and did not include cases of practical implementation of a particular methodology, there is a need for an appropriate case study that employs such a methodology.

3. A Case Study of a Selected Company

The Biprostal Company was founded in 1949 as a state-owned enterprise creating technical designs for Polish industry, and particularly for the metallurgical industry. In 1992, Biprostal was transformed into a shareholding company with the brand name Biprostal S.A. Engineering and Consulting.

Over the past 60 years, Biprostal has offered consulting services and comprehensive, multi-branch, technical documentation in all design phases for metallurgical, industrial and power-generating facilities, as well as for communal facilities, such as commercial centers, office and hotel complexes, educational and healthcare complexes, and entertainment and sport complexes. Biprostal is a medium-sized organization and currently has 90 employees. The workforce consists of 75% of employees with higher education, 17% of employees with a trade education, and 8% of employees with a high school education. The core group of employees consists of experienced engineers, possessing wide competences and rich

experience in the elaboration of complex multi-branch technical designs, using modern computer aided systems (CAD).

4. Strategy of the Company

The strategy of the Biprostal Company includes sustainable development of the company and the delivery of services at the highest level through:

- emphasis on understanding the needs of its customers and offering them more competitive solutions;
- building a strong team of talented people in order to achieve established goals;
- adhering to the principle of responsibility of each employee's quality of work;
- a systematic review of the established system of work and its continuous improvement.

Biprostal's business strategy has been developed in accordance with the specific values of its organizational culture. The most important values of the company include professionalism and continuous development of employee competences, individual reliability and responsibility, and respect and appreciation for people and care for customer satisfaction. Biprostal is a company operating in the service sector where human capital and strong professional competencies are key elements in achieving goals. The company has a strong position in the national market in Poland and has earned an excellent reputation over its long tradition of over 60 years at the marketplace.

Core competitiveness factors of Biprostal include:

- history and long tradition of the company;
- strong market position in design services;
- high employee technical competencies;
- organizational culture based on strong values and a good work atmosphere;
- excellent working conditions and use of modern technology (software) at work.

5. Evaluation Process Implementation Procedures

The first evaluation of Biprostal's compensation system began with a general analysis of the system and interviews with top management in order to understand the needs of the company and **define the main aims** of the evaluation of the system.

The second stage was concerned with **defining the aims of the evaluation**. At this stage, discussions of the consultants with top management took place. As management supported

the changes from the onset, they actively participated in this process. Among the objectives identified:

- verifying whether the system supported the objectives of the company;
- determining whether the compensation policies and practices were well established;
- indicating possible ways of improvement;
- analyzing the cost effectiveness of the system;
- verifying if employees were satisfied with the system and if the system motivated employees to highly perform.

The complex **methodology was developed** at the third stage of the implementation process. Based on the above mentioned aims of the system, the main dimensions of the evaluation process were developed, and then the specific indicators and measures used in the evaluation process at each dimension. Once the methodology was designed, there was a presentation to the management of the firm and the HR manager who discussed possible problems and difficulties connected with the methodology.

Implementation of the methodology constituted the fourth stage. At this stage, all the data and proper information was collected and a deep analysis of the system was conducted. This analysis was based on the five dimensions and the usage of the indicators proposed at the methodology meeting. The analysis was provided by consultants working together with the HR manager who will be responsible for evaluation of the system in the future.

The next stage involved **conclusions and recommendations** derived from the evaluation process. The last stage is the undertaking of appropriate action on the basis of the evaluation process. At the moment, Biprostal is working on this last stage, as the project is still being implemented. Below, the methodology for assessing the compensation system is presented as well as the main conclusions of the evaluation carried out on the system.

6. Methodology for the compensation evaluation process

When designing or remodeling a compensation system, employers must consider a broader perspective regarding total compensation. They must build a fully integrated strategy that leverages total rewards and uses incentive programs for employee engagement, as well as ensuring that all facets of compensation are optimized to motivate the workforce and help the company to thrive (Smith, 2013). It should be considered not only in terms of proper design, convergences with strategic goals, or economic rationality, but also in terms of external competitiveness, achievement of objectives of the compensation system, and benefits it brings to all stakeholders. Moreover, it must be a systematic and deep analysis that gives some suggestions for the future and helps to develop both the organization and its people

(Beck, Scott, 2013). Therefore, the methodology designed for the Biprostal Company was based on five pivotal areas that evaluate the system from various perspectives:

- philosophy of the system and its convergence with the firm's strategy;
- compliance of the system with formal regulations;
- external competitiveness of the total compensation system;
- cost effectiveness of the payroll;
- employee satisfaction with the system.

All these perspectives are shown in the following figure, no. 1.

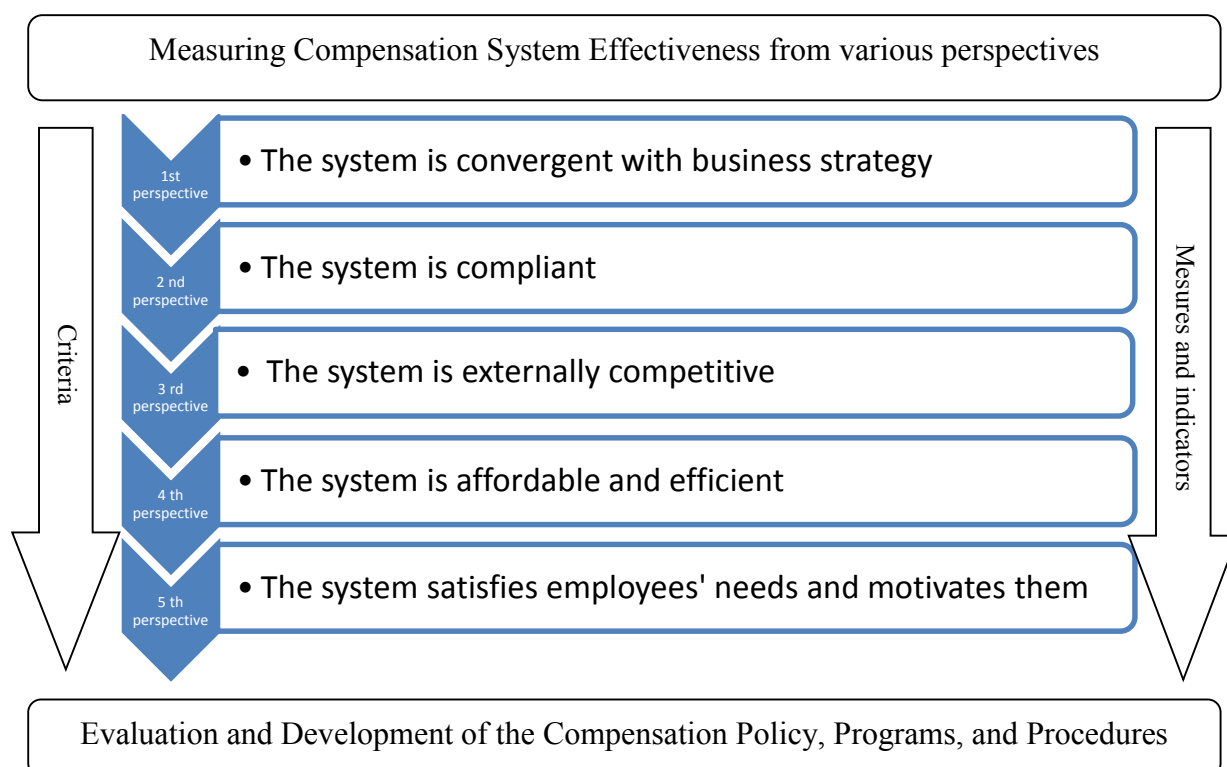


Fig. 1. The methodology for compensation systems evaluation

Rys. 1. Model ewaluacji systemu wynagrodzeń

Source: Own study.

Based on the main goals of the evaluation process, the dimensions of the evaluation methodology were established. After the dimensions of the methodology had been identified, the work on indicators and proper measures began. As Biprostal is a medium-sized company, the methodology had to be simple and easy to monitor. This is why there are mostly three or four important indicators HR personnel can use and easily monitor. All the indicators and measures provided with the appropriate dimension are shown in Table 1.

Table 1

Dimensions and indicators of evaluation for Biprostal Company

Dimension	Methods of evaluation	Measures/Indicators
1. The system is convergent (with business strategy and values)	Evaluation against organizational goals and success criteria	<ul style="list-style-type: none"> - The firm has a clear and formal compensation strategy - Alignment of business strategies or goals with reward programs - Goals are evident in incentive and performance assessment criteria - Employees know and understand the compensation system.
2. The system is compliant (legally, internally, fair)	Evaluation of equity and fairness of the system, compliancy with law regulations, and motivational rules	<ul style="list-style-type: none"> - Analysis of average pay level for different demographic groups of employees in different positions - Analysis of procedures and documentation on equal treatment and law regulations - Opinion of employees on equality in pay system and distribution of rewards - Transparency of the system.
3. The system is externally competitive	Evaluation of pay levels and attractiveness of the total reward package against external market	<ul style="list-style-type: none"> - Use of external survey - Actual market position of the pay level - Indicator of staff turnover - Employee opinions on competitiveness of the total reward (range of benefits, pay levels, incentive programs)
4. The system is cost effective and affordable	Evaluation and monitoring of payroll costs	<ul style="list-style-type: none"> - Productivity Indicators - the ratio of incomes compared to payroll costs monitored over time - Average cost of employee compensation package compared overtime and with the market - Monitoring of HC ROI
5. The system satisfies employee needs and motivates employees	Are employees satisfied with the system? Are managers satisfied with the system?	<ul style="list-style-type: none"> - Manager and Employee opinions on the compensation system - Cafeteria plan – flexible benefits - Absence indicator

7. The Analysis of HRM and Compensation system with the methodology

When analyzing the HRM function, it must be said that Biprostal was founded during the Socialist period in Poland. As Festing and Sahakiantz noted, the Socialist past in CEE (Central and Eastern European countries) accounts for important specificities in the remuneration systems (Festing & Sahakiantz, 2010). When analyzing Biprostal's system, it was obvious that although the system had been affected by the practices from the Socialist era in Poland, it had undergone some changes since that time. The Human Resources Management in the company used to play a minor role and focus mainly on administrative work. However, as the firm has undergone many organizational changes, there is a need for a more supportive role of the Human Resources Department and close cooperation with line and project managers. The current compensation policy must still undergo modifications as there have been some problems with employee engagement at work.

Before modifying the system, analysis of the HR function and the compensation system took place according to the designed methodology. The analysis was based on the documentation analysis, analysis of the HRM procedures, and some chosen financial indicators as indicated in Table 1. The employee satisfaction survey on the compensation system was also conducted. During that survey, interviews were conducted with all line and project managers, as well as with selected employees. Respondents were surveyed with a structured interview constructed by consultants. There were two different schemes of interviews – the first one for managers, consisting of 25 questions, and the second for subordinates, consisting of 20 questions. The questions included in the interview were closely connected with the objectives of the evaluation process and with the measures indicated in the methodology. All interviews were conducted by consultants in a special training room within the company's building. The rate of interviewed employees was 27% (7 managers, 15 employees from production, and 3 employees from administration).

8. Convergence of the compensation system

The compensation strategy is in written form, and employees know and understand it. However, the strategy only partially supports the objectives of the organization. Employees are motivated to seek professional development and are supported financially and mentally in this area. However, employees are not sufficiently engaged in their at work, as there is no evidence the performance assessment system and the incentive system in the company focuses on the main goals connected with engagement and high performance. Furthermore, the incentive plan does not work properly as there are no consequences for the results of the performance assessment, and the assessment relies only on the subjective opinion of the supervisor.

9. Compliancy of the system

The system is transparent and employees have sufficient information about the system and the pay range in different grades. Analysis of the average pay for different demographic groups and in various positions has shown there is no discrimination in this area. The compensation procedures are compliant with the regulations. Unfortunately, analysis of the incentive plan and discussions with employees revealed design flaws and confirmed excessive discretion of the system.

10. External competitiveness

The company used external salary surveys, although the benchmark of the pay levels indicated that high-level professionals and managers are paid slightly below the market average. Positions of other groups of employees were above or at the level of the market median.

Recruitment and retention of talented people is important and this is why the turnover indicator was selected as one of the measures in the methodology. The employee turnover rate for Biprostal ranks among the average value for service companies. The turnover rate for the year 2012 $Wte = 8,1$ and for the 2013 year was a bit higher $Wte = 8,4$. This level for a company with high stability and good relationships seems very high. Additionally, mostly young professionals – designers with the technical and construction certificates – have left the firm. Further analysis with the external benchmark included the attractiveness of the total reward package.

At the same time, employees were asked about both their expectations and satisfaction with the total reward package. Employees noted that the package is simplified. Unfortunately, the incentive pay is ineffective. In addition, some employees indicated the benefits to be poor and the package to be inflexible.

11. Efficiency of the system

To analyze the cost effectiveness of the system, the payroll cost must be controlled and monitored over time, as the overall expenditure on compensation are around 70% of total costs for the company.

The work productivity ratio for the company was calculated for the year 2012 and found to be at the level of $Wp = 2,74$. For the year 2013 the ratio was at $Wp = 2,36$. Unfortunately, the value of the ratio is at a very low level and, what is worse, is decreasing. This ratio should range at least at the same level and, preferably, should increase.

The total value of the average compensation package per employee was below the market.

The human capital return on investment was measured and the value was at 1.018 in 2012 and at 1.05 in 2013. The HC ROI value is unimpressive; however, it seems to be increasing. The system must be aligned with employee talent and the return on investment in human capital must be measured long-term. Therefore, the HC ROI was measured.

12. Employee satisfaction

The last dimension in the methodology was employee satisfaction with the compensation system.

The survey showed that most employees like working for Biprostal and enjoy a good work atmosphere and relationships, as well as challenging projects and the possibility of professional development. Moreover, most of those surveyed understand the pay system and know the procedures. Unfortunately, some of the well-qualified professionals are dissatisfied with the pay level. Furthermore, most employees underline that the incentive program and the performance evaluation process are ineffective. Some employees also indicated that there is a poor range of benefits offered by the company.

The level of employee absenteeism is one of the indicators that can be used to measure employee engagement. In Poland, the absenteeism ratio is one of the highest in Europe – the average value was 4.9 in 2008 (EU average was 3.9) but it is steadily decreasing (Saratoga, 2009). The absenteeism rate for the analyzed firm was 8.01 for 2012 and 4.25 for 2013, which, based on Polish reality, seems to be at a good level.

13. Conclusions from the Evaluation Process

The compensation system at the Biprostal Company is consistent with the law and equal opportunities policies, and it is affordable. The system is also simplified which helps employees to know the rules and understand the procedures. Unfortunately, it does not support the organization's objectives and contains some errors in its construction. The system was characterized with transparency, pay equalization (there was very small pay vertical dispersion between jobs within the hierarchy of the firm), and high subjectivity involved in assessment and appreciation. The analysis of the system has shown that the compensation practices are rather ineffective, as there was dissatisfaction in some managerial positions with the pay level and significant turnover of well-qualified employees. The current economic crisis has forced the management to analyze and change the system and its further monitoring. Such action will help the company to operate more efficiently and achieve the desired employee attitude. Analytical results have revealed that the company is struggling with employee engagement and that the performance assessment system does not work properly, as it has no further consequences for employees. Additionally, the incentive systems rely too much on subjective managerial opinion rather than on specific criteria.

14. Future Directions

One objective was to propose a methodology for the implementation of necessary modifications and directions for further development of the system. The analysis allowed an exploration of key areas where proper action needed to be undertaken. Modifications should be made in the following areas:

- clarification of the goals and objectives of the remuneration system that would support the objectives of the company and its strategy;
- raising the pay level of selected groups of employees (managers and highly qualified specialists) ;
- improvement of the incentive plan and introduction of appropriate criteria for the evaluation of incentive pay for employees;
- development of precise procedures for performance assessment and their integration with other HR procedures which will result in higher performance;
- systematic and continuous monitoring of the effectiveness of the compensation system in accordance with the prepared methodology.

Companies of all kinds and sizes are focusing on how well their employees engage in the workplace and how to bring forward the best of their talents and passion (Smith, 2013). That was the rationale for choosing this medium-sized company, where evaluation revealed some problems with employee behaviors and undesired attitudes at work. These resulted from some errors and inconsistencies in the system design. The evaluation helped to detect those errors and outlined the necessary changes and possible means for improvement and development of the system. What is more, the employee survey was conducted in the company for the first time and it has made a significant impact on employee morale.

Compensation effectiveness is a complex area that must be understood and measured from various perspectives, even in small and medium-sized companies. Since the important feature of this approach is its continuity, a systematic analysis is necessary to help develop the organization and its people.

15. Research limitations

The designed model was implemented at the Biprostal Company just a few months ago; therefore, it would be necessary to monitor how the methodology works over a longer time perspective. Moreover, the implementation of similar methodology in other organizations would be important.

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