

1.9: Types of Compensation

Learning Outcomes

- Discuss types of compensation
- Discuss factors affecting compensation

Compensation is generally broken down into two primary types: direct and indirect. Direct compensation consists of monetary payments based on time worked or results achieved, including both base and incentive pay. Indirect compensation includes costs incurred for benefits, including vacations, health insurance, retirement plans, federally required protections (e.g., disability and unemployment insurance), and other employee benefits.

A third type of compensation is intangible. Intangible compensation includes non-financial rewards such as mentoring, awards or badging, recognition, and factors that impact quality of work or work/life balance such as greater autonomy, a flexible work schedule, or the ability to work remotely.

Common Examples of the Types of Compensation^[1]

Direct Compensation	Indirect Compensation	Intangible Compensation
Base salary/ hourly wage	Retirement Plan	Quality of work/life balance
Cash bonuses	Health Insurance	Company values/inspiration
Annual incentives	Cars	Future growth opportunity

? Practice Question

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Compensation is determined by the interplay of internal and external market and regulatory factors, as summarized below.

Worker Productivity

Theoretically, wages should increase when worker productivity increases. This is an economic calculation based on the market structure, costs of production, and market price and quantity.

Supply and Demand for Labor

Theoretically, wages should increase when the demand for labor exceeds supply or, as is the case currently, unemployment is at a historical low. There may also be geographic variances in wages based on the local/regional availability of and competition for labor.

Legislation

As discussed in Fair Labor Standards Act, laws such as the FSLA—including state and local variations—set a minimum standard for compensation.

Labor Unions

Wages are one of a union's mandatory collective bargaining issues. As we'll discuss in Module 13: Union–Management Relations, employers who are subject to collective bargaining agreements tend to have higher wage and benefit costs than similar employers without union representation.

Cost of Living

An increase in inflation results in a corresponding loss of purchasing power. Theoretically, wages should increase when the cost of living increases so workers are able to maintain their standard of living. There is also a geographic element to this factor. We see this in the variation in minimum wages set in cities and localities where the cost of living is relatively high.

Industry Ability to Pay

There is a significant gap in what a technology company like Facebook can pay and what a non-profit, small business or start-up can afford to pay. The compensation differential may be offset by the sense of purpose or the opportunity to build a small business.

Compensation Policy

An employer's position relative to the competition or market will affect the wages it offers. Generally, employers will take one of three positions: lead, lag or match. If an employer's policy is to lead the market, they will pay relatively higher wages than the competition. The rationale is that they will be able to attract a higher caliber of employees and see an offset in increased productivity and reduced training and turnover costs. Similarly, the face value employee cost savings of a "lag" practice may be offset by higher recruiting, training and turnover costs. A match policy is simply to set compensation at the market rate.

? PPractice Question

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1. "[Managing Reward: Why Line Managers are the Vital Link.](#)" go2HR. Accessed August 22, 2019. ↵

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