

Study on skill based Compensation structure with reference to Randstad

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Abstract

In skill-based pay (SBP) systems, employees are compensated for the range, depth and types of skills they possess. They are paid for the ability they can use, not for the job they are doing at a given time. This is a basic departure from traditional job-oriented pay plans, which pay employees for the jobs they hold.

Skill-based pay refers to a pay system in which pay growth is linked to the number or depth of skills the employee acquires and applies, and is a tool for developing broader and deeper skills in the workforce. Such increases are in addition to the normal wage increase that employees can receive.

Key words: Compensation, Skill, Skill based pay, job-based pay, merit pay, traditional pay.

JFL Classification: J24, J33, M52,

Introduction:

Evidence shows that companies with the best and best long-term relationships in delivering customer value have well-managed HR processes.

In skill-based pay (SBP) systems, employees are compensated for the range, depth and types of skills they possess. They are paid for the ability they can use, not for the job they are doing at a given time. This is a basic departure from traditional job-oriented pay plans, which pay employees for the jobs they hold.

Skills remuneration refers to a pay system where growth is linked to the number or depth of skills that an employee acquires and uses, and is a tool for developing broader and deeper skills for employees. Such increases increase the overall growth of the workforce that can be achieved.

Wage increases are usually associated with three types of skills:

- Horizontal Skills, which expands skills in terms of range of tasks
- Vertical skills, in which higher level skills are acquired
- Skills Depth Skills are advanced skills in specific areas related to a single job.

Skill-based wages differ from traditional wage systems in reflecting the differences in skills in the structure of wage rates for unskilled, semi-skilled and skilled workers in the following areas:

Skill-based pay is person-based and job-oriented, not systemic.

It is worth more than a job for one person. Job value is reflected in the basic wage rate for minimum skills, whereas pay progress is directly linked to skills acquisition (rather than the general wage increase applicable to all).

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It rewards (and emphasizes) a wide range of skills that make the employee multi-skilled and therefore comfortable.

It positively promotes skills development.

The skill-based pay system may not necessarily reflect how well the skill is used, as it falls into the performance segment of pay. But there is nothing to prevent performance standards from being introduced into the system. In such cases, the system has more performance than the structure that detects different pay rates for skills.

Of course the key to the success of the system is the need to strengthen the system through training opportunities. The traditional structure does not depend on such possibilities.

Reasons for Skill-Based Pay

In the history of industrial relations the generality of interests in employee skills has developed more than ever before between employers and employees. Skills provide employees with protection from unemployment, as well as opportunities for higher income. At the same time, skills provide an important way for employers to achieve competitiveness.

Today many countries are trying to move forward with more technology and skill based industries, while others have become (or are becoming) post-industrial societies in which the application of knowledge determines productivity, performance and competitiveness. Based on comparative advantage.

For example, cheap labor or raw materials have diminished the importance of competitive advantage based on the ability to add value to a particular resource or purpose. Such a comparative advantage depends in part (often mostly) on people - their literacy and education standards, work attitudes, value systems, skills and motivation. The ability to innovate and develop groups of competing firms in specialized industries is critical today.

For more industrialized nations it means some of the key industries of the coming century, such as microelectronics, biotechnology, new materials science industries, telecommunications, civil aviation, computers and software, robotics and machine tools and entertainment. When a skilled employee develops a wide range of skills, he or she will be able to learn further advanced skills, develop analytical skills, and even work in a team. Important elements of today's skills package include multiple skills, cognitive skills, interpersonal and communication skills, positive work attitudes and quality consciousness.

Training is no longer required to prepare not only for current ability, but also for the next step skills. Pay systems that promote current and future skills requirements are becoming increasingly important among employers.

The impact of rapid technological change, increasing globalization of product markets, greater customer choice and emphasis on quality requires frequent updating of skills and flexibility to respond to rapid changes in market needs. The flexible workforce, which is multi-skilled, sees to it that production is not disrupted due to the narrow skills of the workers and that the workers are responsible for the quality of the products.

Advantages of Skill-Based Pay

The benefits of a skill-based salary include the following:

- It contributes to job expansion and prosperity by breaking down narrow job classifications.
- Flexibility is increased by promoting the performance of multiple tasks. This allows for job rotation and replacement of temporary vacancies. Hence it contributes to the thin workforce.
- It enhances productivity and quality by making better use of human resources.
- It facilitates technological change, which is fully resisted in the job-oriented system.
- Pay Job expansion through higher wage levels, continuous training and skills expansion will reduce staff turnover.
- Eliminating unnecessary jobs keeps the workplace narrow and the skills rather broad. It also reduces the need for monitoring.
- Employees Job satisfaction is created by employees having more control over the planning and execution of their work.
- Expanding Skills- Skills help employees develop a better perspective on the overall operations.
- Selfimprovement- It is an incentive for self-improvement.
- It provides job security through skills enhancement.
- It reduces the need to look towards promotion to a higher level (always limited) as the only way to increase earnings and it simplifies the planning of the employee's career development path.

Since the prize flows from the application of Skill and it does not reduce the chances of others to increase their skills and earnings, there is likely to be less competition among individuals.

Because wage increases due to skills are associated with measurable criteria, the critique of subjectivity often associated with performance appraisals and personal-based performance-related pay is avoided.

The Effectiveness of Skill-Based Pay Systems

Performance has long been at the core of compensation management. The desire to pay more productive employees a greater salary is, in fact, a strong business strategy, but with the multi-faceted nature of jobs today, a simple measure of performance“ is often very difficult to justify. More and more it is not just the effort put forth by the employee that makes them desirable, but also the amount of job based skills the employee possesses.

The Wide-Spread Use of Skill-Based Pay Systems

Another possibility outcomes of skill-based pay systems include a flexible workforce, lowered labor costs, and increased quality and productivity. Considering the merits of skill-based pay systems, it is obvious why about half of the Fortune 1000 companies use them (estimates are between 30 and 67 percent of the Fortune 1000).

Implementing Skill-Based Pay Systems

Skilled payment systems are based on assumptions that employees will perform proactively in obtaining new, job-related skills if they are compensated for such efforts. This is a basic principle of behavioral psychology: Actions that lead to rewards will be repeated. The underlying concept behind a skill-based pay system is relatively simple: increase an employee's compensation as he or she acquires and becomes more proficient with job-related skills. Newly implementedskill-based pay systems can be met with resistance, especially from long-tenured incumbents who have continuously received pay increases based on tenure. This can be challenging to overcome, but in most cases the tenured employees have a great deal of job-related skills, allowing them to enter into the new pay system with a high level of compensation. To use skills based on skills

pay system, it is important for the skills in the system to be job-related.

For example, a welder being rewarded for learning to use a larger, more powerful welding machine is appropriate, but the same individual should not be compensated for learning to fix a plumbing system. Another important aspect of a well thought out skill-based pay system is that the amount of compensation increase should be relevant to the difficulty of the skill: Learning to construct a basic spreadsheet in Excel is not as difficult as learning to write macros in Visual Basic, so the former should not be associated with as large of a pay increase as the latter. The final important characteristic of an effective skill-based pay system is regular testing of skill proficiency.

When incumbents initially learn skills, they should be tested for proficiency. In most cases an incumbent will not be as proficient with a newly acquired skill as with a skill they have possessed for an extended period of time. Additionally, employees who do not use a skill for a long period of time may lose proficiency. In light of both of these factors, it is important for skill proficiency to be tested at least every year. This will allow the pay system to reflect skill proficiency more accurately.

Increased Effectiveness of Skill-Based Pay Systems

Skill increases at the individual and workforce level result from the implementation of a skill-based pay system, both of which lead to a more productive workforce. However, some changes to the structure of skill-based pay systems can allow for greater effectiveness. Some of these changes include: Skills learned early in the system should be easier to learn Employees who have early success with skill-based pay plans may continue gaining new skills.

- The first reward an individual receives should be relatively large

Great rewards at the beginning of the program motivate employees to continue working hard to obtain more skills, which is the ultimate goal of skill-based pay systems. Put simply, the first skill learned, regardless of difficulty level, should be compensated at a high level, and every skill learned after that should be compensated based on the difficulty level of the skill. While this may seem contradictory to the earlier mentioned rule about making sure the size of the pay increase is related to the difficulty of the skill, the two ideas are mutually exclusive. If every employee received the same bonus after obtaining his or her first skill, it will not seem unfair that an easier skill is rewarded at a greater level.

- Management should encourage employees to obtain new skills as much as possible

Skill-based pay systems put the responsibility of earning pay increases in the hands of the incumbents. Some employees, especially those new to skill-based pay systems, may not work as hard to obtain new skills. As such, it is important for management to be supportive in giving employees the time, encouragement, and resources necessary to obtain new skills. Skill-based pay systems, as with any compensation management strategy, can be ineffective if used incorrectly. It is important to consider the suggestion outlined in this article before implementing a skill-based pay system. Ultimately, the implementation of a skill-based pay system can lead to greater profits as employees become more skilled and more proficient, allowing for them to perform their jobs more effectively.

Objective of the study

The main aim of the study is to understand how the different skill set of an employee leads to an different level of pay for them and how does it impact their pay structure. The research aims at understanding the co-relationship between gross salary and skill category.

Skills provide employees with a certain level of unemployment protection, as well as higher pay opportunities. At the same time, skills provide employers with the most important ways to achieve competitiveness.

Hypothesis

The data is collected is of primary nature which is collected from the employers i.e. clients of the Randstad who are on the payroll of the Randstad. Sampling of data is not done as the whole chunk of data is analyzed to interpret the results. Alternate hypothesis states that there is statistical significance between two variables. So, in this study we have used alternative hypothesis to explain the relationship between gross salary and skill set that they possess. We will be using the following variables in our research.

Independent variable: Skill category

Dependent variable: Gross salary

To accomplish the research objective of the report, we state that –

H₀: Skill category of the employee and the Gross salary are independent

H_a: Skill category of the employee and the Gross salary are not independent

Research Methodology

Data used in the research is of primary nature. The data used for the research is of quantitative type and consist of data of around 524 people who get their salary on the payroll of Randstad. It consists of many factors as how their salary is calculated and at what percentages their skill influence their pay.

Various software and tools are used to analyze and interpret the data. Descriptive analysis is used to analyze the data. **Adescriptive statistic** (in the count noun sense) is a summary statistic that describes or summarizes in detail the features of a database, while descriptive statistics (in the plural sense) are the process of applying and analyzing those statistics. Descriptive statistics are separated by unlimited statistics (or diminishing statistics), in which descriptive statistics aim to summarize the sample, rather than using data to study demographic sample data is thought to represent. This generally means that descriptive statistics, unlike inferential statistics, is not developed on the basis of probability theory, and are frequently non parametric statistics.

In the business world, descriptive statistics provides a useful summary of many types of data. For example, investors and brokers may use a historical account of return behavior by performing empirical and analytical analyses on their investments in order to make better investing decisions in the future.

The tool used for analyzing data was the simple linear regression that shows the relationship between two variables out of which one is of independent nature while the other would be dependent on independent variable.

Simple linear regression

Given a dataset of variables (x_i, y_i) where x_i is the explanatory variable and y_i is the dependent variable that varies as x_i does, the simplest model that could be applied for the relation between two of them is a linear one. Simple linear regression model is as follows:

$$y_i = \alpha + \beta * x_i + \epsilon_i$$

ϵ_i is the random component of the regression handling the residue, i.e. the lag between the estimation and actual value of the dependent parameter. If Y is the estimation value of the dependent variable, it is determined by two parameters:

1. The core parameter term $\alpha + \beta * x_i$ which is not random in nature. α is known as the constant term or the intercept (also is the measure of the y-intercept value of regression line). β is the coefficient term or slope of the intercept line.
2. Above explained random component, ϵ_i .

Findings:

N denotes the total number of responses we have or the number of people whose information is being used to analyze the data.

In statistics, the **Pearson correlation coefficient** or the **bivariate correlation**, is a measure of the linear correlation between two variables X and Y , it has a value between $+1$ and -1 , where 1 is total positive linear correlation.

As per the model summary of the data the value of R Square stands to $.761$ that means 76.1% the dependent variable can be predicted by using independent variable.

The value of significance is less than 5% (0.05) that means none of our variables lies between the rejection area.

a. Dependent Variable: Gross

The standardized equation formed after regression analysis $Y = 30607.078 * X - 13460.859$.

Y = Dependent variable which is gross salary

X = Independent variable which is category.

From the above data interpretation we can say that in the given data the skills are taken as a parameter to decide on the compensation of the employees.

Conclusions & Recommendations

Our research has introduced us to the literature of various fields as we try to piece together evidence that separates the best scientific understanding of the adequacy of skills as a basis for decision-making by employees regarding their compensation and the effectiveness of pay-based skill to improve performance. Investigating the consequences of linking compensation and capabilities took us from the question of individual performance to organizational performance and required an examination of two relevant and different payment systems.

From the above data interpretation we can say that the accurate salary compensation structure will only be possible if the skill is given proper weightage to analyze and decide upon the salary of the employees.

Skill-based pay (SBP) systems are like snowflakes -- they share some common characteristics, but each one is unique. We will explore the foundations which underlie skill-based pay and many of the options which are available.

Designing skills-based payments is not something which can be done by copying someone else's system. Every company has its own unique products, people and work processes. What works in one organization may or may not work in another. Much can be learned by studying what has succeeded or failed with other companies, but a sound understanding of the many variables and principles involved in SBP is essential to an SBP design.

Skill-based pay has a purpose -- to promote learning. It is not the only way to compensate employees and it is not a system for all situations nor one which lasts forever. It is very useful in promoting new learning. This accounts for its popularity in start-up organizations and its association with organization redesigns. SBP systems mature as the majority of participants either reach the limits of the system or coast to a stop somewhere along its path. Paying for learning may eventually give way to requests to pay for performance based upon team or total organization results. If higher skills create higher performance, this is a foreseeable development.

Developing a skill-based pay system is not a linear process. The system requires that many items be balanced. Very often what looks promising as a way to handle one part of the system becomes impractical when meshed with other pieces. Original ideas need to be reworked again and again. Designers of SBP can expect to travel the same territory several times before a system takes final shape.

The best systems are deceptively simple. That simplicity is usually the result of untangling a great many hidden complexities. Like snowflakes, a good SBP system is a wonder to behold, but it's hard to tell what went into creating it. This book can help melt away some of that mystery.

Most skill-based pay systems have been instituted in manufacturing and processing plants. SBP is commonly found with team systems or other participative settings. More is known about these types of installations. For that reason, those environments will be the primary focus of examples and discussion in this guide. Many of the ideas and cautions for those systems can be extended into other work environments.

Employees should expect to learn as part of living. Administered incorrectly, SBP can encourage people to expect all learning will be compensated -- "You want me to learn it, pay me for it." There is a delicate balance between encouraging and recognizing learning with pay and creating a tit-for-tat mentality in an organization. Keeping learning broad and expectations high can help avoid the problem. Trying to assess minute skills and provide pay in small increments may contribute to the problem.

ADVANTAGES

SBP is adopted because it provides advantages over other types of pay systems. Intended advantages are related both to business performance and employee morale.

Intended advantages include:

- a) increased ability to focus personnel on problem areas and avoid idle time waiting for problems to be fixed by others;
- b) flexibility in position coverage enabling work teams to cover for absent members for short periods of time;
- c) faster adaptation to changes in technology and product mix due to greater skill base;
- d) improved participation in problem solving and other participatory activities because of wider perspective on total workflow;
- e) lower overall staffing levels caused by incorporation of specialized functions (e.g., maintenance, quality, supervision) into team skill requirements;
- f) higher commitment to organizational goals due to broader perspective;
- g) increased self-esteem from development of personal talents;
- h) improved self-managing abilities;
- i) higher minimum hiring qualifications since employees are required to progress through a multi skilled job;
- j) overall increases in total productivity.

Organizations using skill-based pay report gains in flexibility and versatility along with enhanced employee motivation and team effectiveness. Accompanying this is an increased use of technology and increased output per hour. About two-thirds of firms in the ACA study reported moderate success in reducing overall compensation costs.

Systems which succeed have good local management support and often originate in the local operation as opposed to being mandated by the corporation. They place emphasis on employee growth and development and honor a commitment to thorough training.

WHY DO IT? WHY NOT?

Adoption of skill-based pay may be done for a variety of reasons. The system stands the greatest chance for success if it is founded on solid business needs. SBP should be designed and measured to demonstrate that it reduces total organizational costs. If it does not do this, then it will eventually be replaced by a system that is perceived to do so.

A caution is in order. Skill-based pay may likely result in individual pay rates that are higher than pay for similar positions in other firms not using SBP. Organizations using SBP have reported the following rates:

- a) starting rates at the 63rd percentile compared to local rates,
- b) average rates at the 75th percentile compared to local rates and at the 65th percentile for their industries,
- c) top rates at the 90th percentile compared to local rates and at the 80th relative to their industries.

This can be deceptive. The cost of labor is a function of the wages paid, the level of staffing, and the productivity of the workforce. SBP can more than offset higher wage rates by higher productivity.

It has not been clearly demonstrated that overall staffing levels are always significantly changed (either up or down) by using SBP. It has been difficult to document productivity and staffing improvements because finding comparable SBP and non-SBP operations is difficult. Some organizations have measured reductions in staffing of 10% due to removal of backup "utility" workers. Others have measured 30% productivity gains and 30% cost reductions in work systems using SBP as a component.

The key relationship lies between SBP systems and total cost per unit, not just labor costs. Greater efficiencies, quicker problem solving, and less wasted time and material can create significant gains in other cost categories to offset higher labor rates. This is one intent of SBP, not a guarantee.

The intent of SBP is to provide an incentive for employees to learn and apply new skills to increase organizational productivity and profitability while fostering high commitment to organizational goals. With a good system, everybody wins!

Recommendation

Other factors such as pay for performance, merit pay and the pay as per the numbers of years a person had given to the firm should also be considered.

Skill-based pay adopted because "everyone is doing it" has a marginal chance for survival. Since pay is an outlay of money by the company, this rationale will not support a system once competitive cost pressures arise.

SBP adopted because it is "good for the employees" or will cause "higher morale" is well intended. However, this logic will not sustain a system that does not demonstrate its business value. In addition, applying SBP to some groups and not others causes resentment by those not included.

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Appendix

Regression

Coding is done so as to analyze the data.

Category	Gross Salary	Frequency
1	0-350000	501
2	35000-70000	19
3	70000-105000	3
4	105000-140000	0
5	140000-175000	1

Category 1 signifies unskilled employees

Category 2 signifies semi-skilled I employees

Category 3 signifies semi-skilled II employees

Category 4 signifies skilled employees

Category 5 signifies highly skilled employees

Descriptive Statistics

	Mean	Std. Deviation	N
Gross	18840.12	10336.694	524
Category	1.06	.295	524

From the above table it can be concluded that the N denotes the total number of responses we have or the number of people whose information is being used to analyze the data.

Correlations

	Gross	Category
Gross	1.000	.872
Pearson Correlation		
Category	.872	1.000
Gross	.	.000
Sig. (1-tailed)		
Category	.000	.
Gross	524	524
N		
Category	524	524

In statistics, the **Pearson correlation coefficient** or the **bivariate correlation**, is a measure of the linear correlation between two variables X and Y, it has a value between +1 and -1, where 1 is total positive linear correlation.

Variables Entered/Removed^a

Model	Variables Entered	Variables Removed	Method
1	Category ^b	.	Enter

- Dependent Variable: Gross
- All requested variable sentered.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.872 ^a	.761	.761	5058.157	.761	1662.139	1	522	.000

a. Predictors: (Constant), Category

b. Dependent Variable: Gross

As per the model summary of the data the value of R Square stands to .761 that means 76.1% the dependent variable can be predicted by using independent variable.

ANOVA^a

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	4252576316 5.581	1	4252576316 5.581	1662.139	.000 ^b
1 Residual	1335534753 8.602	522	25584956.97 1		
Total	5588111070 4.183	523			

a. Dependent Variable: Gross

b. Predictors: (Constant), Category

The value of significance is less than 5% (0.05) that means none of our variables lies between the rejection area.

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	-13460.859	822.523		-16.365	.000		
1 Category	30607.078	750.738	.872	40.769	.000	1.000	1.000

c. Dependent Variable: Gross

VIF Factor = 1, which should be varied between 1 to 4, data is correct.

Collinearity Diagnostics^a

Model	Dimension	Eigenvalue	Condition Index	Variance Proportions	
				(Constant)	Category
1	1	1.963	1.000	.02	.02
	2	.037	7.308	.98	.98

a. Dependent Variable: Gross

Residuals Statistics^a

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	17146.22	139574.53	18840.12	9017.273	524
Residual	-12753.297	17776.781	.000	5053.319	524
Std. Predicted Value	-.188	13.389	.000	1.000	524
Std. Residual	-2.521	3.514	.000	.999	524

a. Dependent Variable: Gross

The below chart shows that the tools used was linear regression which can be easily depicted through it.

