

**Compensation: Creating A Strategic Advantage - by Anne Howard**  
(Part 2 of a 3 part Series on Compensation)

Last quarter I began a discussion on the essential elements required for developing a compensation and rewards structure that provides a strategic advantage for organizations (See [Winter, 2005](#)). This time I want to discuss the importance of understanding the organizational factors affecting the development of compensation and rewards structures.

Organizations are open systems in which a number of factors both internal and external interact continuously creating and re-creating the organization. The internal factors include the structure of the company, how information is shared and control exercised, the way the product/service provided is created, the human resource management policies and procedures, and the culture. External factors include the industry in which the organization operates; labor markets; economic environments; supplier industries; laws and regulations; technological, scientific and other discoveries and innovations and the socio-cultural environment, among others.

Just as the organization must define itself and chart its path in the external environment, so must it establish the internal processes that support what it is and what it wants to achieve. The challenge for any organization is in determining what about it is fundamental and enduring and what is not. Once that choice is made the design of various interdependent processes that support and facilitate the desired organization can occur.

**For example:**

If an organization determines that it is going to be an innovator and industry leader, the human resource management processes including compensation and rewards structures will be different than they will be in an organization that decides it will focus on efficient production of existing products/services.

When those two different organizations are operating in an external environment of rapid change in many areas – technological, labor markets, regulatory, economic and socio-cultural the internal factors for both will also be affected by change. The design of the compensation and reward structures for the two must take similar changes into consideration but will still be very different because of the fundamental difference between them.

Add a desire by the organizations to encourage team-work and another dimension is added to compensating and rewarding people.

What frequently occurs particularly in knowledge service environments is that both of the operating types identified co-exist in a single organization. This further complicates the design of the compensation and reward structure because there is a need to support two substantially different environments simultaneously.

When considering the much greater complexity of the interaction between all of the internal and external factors it is easy to see why designing an effective compensation and reward structure is challenging.

Some of the people related issues involved in developing effective compensation and reward structures will be addressed in the next newsletter.

