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Exploring the Gap between Millennials' Pay Preferences and Compensation Practices

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ABSTRACT

From an organisational perspective the aim of the reward system is to attract, motivate and retain high performing employees. Pay systems that are incompatible with employee pay preferences can create direct or indirect costs for the organisation. Organizations might be able to increase their attractiveness without affecting labour costs by adapting company compensation practices to employee pay preferences. This study investigated compensation preferences of 249 students in Croatia. Research results indicate that besides high base pay, benefits were clearly identified as a preferred compensation tool by millennials'. Research results can be used by managers in developing or modifying reward plans for this generation.

Kew words: Compensation, Pay Preferences, Millennials

INTRODUCTION

Compensation is a key element of the employment relationship and, in addition to being the single greatest operating cost for many organizations, it has been advocated as a tool for enhancing organizational performance and sustained competitiveness (Milkovich & Newman, 2008). Due to high impact of compensation management on overall firm performance (Stajkovic & Luthans, 2001, Hansen, 1997, Jenkins et al. 1998), we recognized the need to research it in detail among Croatian companies.

Organisations have choices about methods of pay. Although the list of compensation dimensions is pretty exhaustive, Milkovich & Newman (2008) argue that strategic compensation dimensions include external competitiveness (e.g., pay level), internal pay structure (e.g., pay hierarchy), employee contributions (e.g., individual vs. group contribution), benefits (e.g., flexible vs. fixed), and alternatives to traditional pay systems (e.g. pay-at-risk or skill-based pay). Based on these strategic dimensions, each organisation will shape its own reward strategy that will guide employees towards fulfilment of companies' objectives. However, as argued by Kerr & Slocum (1987), reward strategy is defined purely from organisation's perspective where company interests may take precedence over those of the employees.

Compensation systems may act as signalling devices to job seekers by providing information not only about work expectations but also organization's culture: philosophy, values, and practices (Cable & Judge, 1994). Adopted reward strategy is thus a way to distinguish an organisation from other employers in the labour market (Turban & Keon, 1993, Cable & Judge, 1994).

Employees' affective reactions to both amounts of pay received and administration of pay delivery include pay satisfaction, pay justice and pay preferences (Heneman & Judge, 2000). Congruence between the implemented pay system and employee pay preferences, meaning pay system characteristics that tend to (dis)satisfy the individual, can have an effect on employee pay satisfaction. Consequentially, this can influence both broader performance indicators and employee retention, in terms of turnover intentions, absenteeism, and voluntary turnover (Heneman & Judge, 2000, Williams, McDaniel & Nguyen, 2006). For example, it has been reported that organisational loyalty is being threatened by employees' dissatisfaction with their pay and methods used to determine pay (LeBlanc & Mulvey, 1998). Employees' predispositions toward particular compensation variables may affect their reactions even in case they are dissatisfied with overall organizational compensation procedures. In addition, employees are likely to compare features of a particular preferred compensation package component with those of similar firms in the labour market rather than evaluating packages in absolute terms (Shaw & Schaubroeck, 2003)

Pay systems that are incompatible with employee pay preferences can be costly for organisations (Brown, 2001). If organizations knew the pay preferences of their ideal applicants, it might be possible to increase their attractiveness without affecting labour costs (Cable & Judge, 1994).

Despite the importance of employee pay preferences, there has been very little research on this issue (Cable & Judge, 1994, Heneman & Judge, 2000). Turban & Keon (1993) found that college students expressed a strong preference for a merit pay system as opposed to tenure based systems. Bretz and Judge (1994) found that job applicants preferred individual merit pay as compared to team based or tenure-based reward systems, as well as existing employees preferring rewards that focus on the individual rather than team or unit performance (LeBlanc & Mulvey, 1998). Cable and Judge (1994) found that individuals expressed preferences for individual versus group based pay, fixed versus contingent pay, flexible versus rigid benefits and organisations that were perceived to offer high pay levels. Brown (2001) found positive relationship between the level of perceived job security and the support for merit pay, even though good promotional possibilities are associated with lower level of merit pay support. Although some of these findings are dated, and as Scott et al. (2015) state employees may have very different pay preferences from employees even a decade ago, more recent studies mostly confirm preference for variable pay (e.g. Lee, Iijima & Reade, 2011). Most recent research by Scott et al. (2015) showed that older respondents with higher education and more dependents had a stronger preference for variable pay than respondents who were younger, less educated and had fewer dependents.

Variations in pay preferences have been attributed to value patterns inherent in socio-cultural groups (Hofstede 1980, Chiang & Birtch, 2006, Scott et al., 2015), individual dispositions, e.g. individual measures of motivation, competitiveness, work-related attitudes such as commitment and organizational citizenship behaviour (Clugston, Howell & Dorfman, 2000, Lee, Iijima & Reade, 2011), individual consumption behaviour (Shaw & Schaubroeck, 2003), employee demographics and characteristics (gender, age, education, work experience, position, annual pay, number of dependents; Mamman, Sulaiman & Fadel, 1996, Scott et al., 2015), organisational factors (e.g. industry/occupation, Mamman, Sulaiman & Fadel, 1996). Trade unions membership has also been found to influence pay preferences since unionists have been found to be less supportive of incentive pay schemes (Koys, Keaveny & Allen, 1989).

However, it must be emphasized that most of these research findings on pay preferences were drawn from the US settings and thus neglect the impact of national culture (e.g. Hofstede, 1980). Our research setting is on the other extreme of the individualistic American workers since Croatia is a highly collectivistic society with dominant feminine values, very high uncertainty avoidance and high power distance. Therefore, it can be expected that, compared to individualist Americans, Croatians will score low on preference for individualized performance-based pay systems. Also, emphasis on loyalty to the group could ensure that collectivists score high on preference for length of service (Mamman, Sulaiman & Fadel, 1996). Additional impact might be created through high power distance present in Croatia. This is namely because in a culture characterized by large power distance, employees accept inequalities of rewards based on 'predetermined' criteria such as age and seniority or organizational hierarchy. Mamman, Sulaiman & Fadel (1996) argue that employees from such cultural background will score high on a preference for responsibility as a criterion for pay determination, as compared to performance. Finally, it must be emphasized that in strong uncertainty avoidance societies like Croatian individuals are motivated by security and belongingness.

REWARD PRACTICES IN CROATIA

Intensely competitive environment is creating the need for organizations to develop effective compensation programs that will enable them to attract, retain and motivate employees of different profiles. Every component of the pay package is expected to trigger or direct to certain behaviour. Up to the beginning of 1990s reward systems in Croatia had limited possibilities to customize according to companies' objectives due to extensive rate of government control. Thus it is interesting to examine how Croatian enterprises adapted their reward strategies to the market economy and increased competition for workforce. Furthermore, since Croatia entered the European Union (EU) in 2013, Croatian companies constitute just a part of the larger EU market in which mobility and free movement of persons is guaranteed. In such context compensation management strategies and practices used by Croatian companies are challenged to be competitive within the larger EU context.

Previous research has shown that Croatian companies in most cases have developed reward strategy (Galetić & Načinović, 2007). This implies that they have recognized the importance of rewarding employees in a way that will be motivating for employees. The research showed that one of the most important objectives of reward strategies is improving employee performance (almost 80% of examined firms stated it as an objective for the reward system). Compensation practice usually recognizes pay for performance or variable pay as an incentive to improve individual performance. Incentive-based payments have been considered as the core element of

compensation strategies by Balkin & Gomez-Mejia (1987) thus we use it as an important indicator in our research as well.

For the purpose of describing compensation practices in Croatia and some trends in EU practices we have used Cranet (Cranfield Network on International Strategic Human Resource Management) survey on comparative human resource management practices. Cranet dataset for Croatia is based on a research performed in 2012 among Croatian firms employing more than 500 employees (Načinović, Klindžić & Marić, 2012). In our analysis we compared Croatia with EU countries that participated in global Cranet research; Austria, Belgium, Denmark, France, Germany, Sweden, the Netherlands, UK, Bulgaria, Cyprus, Estonia, Hungary, Lithuania, Slovakia and Slovenia (Cranet, 2011). The original Cranet questionnaire is divided into different sections depending upon HRM activities, including the section on compensation and benefits which is the focus of this paper. Sampled companies in Croatia in most cases belong to manufacturing, have 500 to 1000 employees and come from the private sector.

Table 1: Summary of CRANET report: Comparison among Croatia and EU member states

	Croatia	EU states
Proportion of companies in the private sector with ESOP	22.62%	21%
Proportion of companies in the private sector using share options	26.83%	17%
Proportion of companies in the private sector using profit-sharing	27.56%	33%
Proportion of companies with performance related pay in the private and semi-public sector	62.58%	50%
Proportion of companies with individually based bonuses in the private and semi-public sector	47.93%	61%
Proportion of companies with group based bonuses in the private and semi-public sector	43.9%	46%
Proportion of companies with flexible benefits in the private and semi-public sector	16.04%	33%

Source: Načinović, Klindžić & Marić (2012), Cranet (2011)

An overview of the use of financial participation in Croatia and EU countries in the private sector is shown in Table 1. Financial participation schemes explored were share plans, share options and profit-sharing. Among these, profit-sharing is the most used type of financial participation both in Croatia and EU countries. It is used by 27.56% of Croatian firms in the private sector, compared to 33% of companies among EU countries. Share plan in the form of ESOP is used, on average, by 22.62% of Croatian companies and 21% of companies in the EU countries. Similar pattern is found with respect to share options. Options are used by 26.83% of Croatian firms in the private sector whereas comparable average for EU countries amounts to 17%. We must emphasize that these averages are valid for firms operating in the private sector only, but there is still a high proportion of public firms in the Croatian economy thus lowering the general average for all firms.

Another aspect of compensation we compared is the use of performance related pay. Proportion of companies with performance related pay in the private and semi-public sector in Croatia is high and amounts to 62.58%. This is even higher than comparable average for EU countries (50%). Individually based bonuses in private and semi-public sector are used by 47.93% of examined Croatian companies and 61% of the examined EU companies. Although group based bonuses are also more often used among companies in the EU than among Croatian companies, a high percentage of Croatian companies uses group based bonuses (43.9%). There is a large gap in the use of flexible benefits in Croatia when compared to the EU average (used by 16.04% of Croatian companies) and 33% of sampled companies in the EU.

Presented findings are intriguing since in some aspects of compensation management Croatian companies seem to be ahead of the EU averages, whereas in others are quite behind. However, general conclusion that can be drawn from Table 1 is that large organizations do use variable pay in different forms. We must emphasize once again that such promising results are partially due to the sample characteristics (mostly large companies from the private sector) and that there are extensive variations for companies operating in the public sector.

MILLENNIALS' PAY PREFERENCES

Practitioners and consultants state that the different generations need to be managed differently (Parry & Urwin, 2011 after Guillot-Soulez & Soulez, 2014). The presence of differences between generations has been reinforced by social constructionist views (Berger & Luckmann, 1966 after Kultalahti & Viitala, 2014) stating that wars, discoveries, cultural, political, technological and economic context is fundamental to the creation of a generation (Meier & Crocker, 2010, Mannheim, 1952 after Guillot-Soulez & Soulez, 2014). Generation hence develops a unique pattern of behaviour based on these common events experienced during their upbringing (Kupperschmidt, 2000 after Guillot-Soulez & Soulez, 2014).

Being able to understand new generations as they move into the work force will be crucial in attracting, motivating and retaining them with the organisation. There is some evidence that millennials (or Generation Y, Generation Me, Generation www, Internet Generation, the Digital Generation) is different from other generations (e.g. Dries, Pepermans & De Kerpel, 2008). In this paper, similar to other authors, we define millennials as those individuals born between 1980 and 2000 (e.g. Meier & Crocker, 2010). Generation Y represents 24,05% of total population in Croatia, and is the second largest generation after Baby Boomers (Croatian Bureau of Statistics, 2014). The first millennial university graduates entered the workforce in Croatia in the summer of 2003. They will continue to do so, in large numbers, until around 2022. Thus, it is important for organisations in Croatia, as it is in any other country, to understand Generation Y and develop HRM practices and processes appropriate for them (Kultalahti & Viitala, 2015).

In order to analyse the Generation Y preferences towards different aspects of compensation, an empirical research was conducted during the months of October and November 2015.

Research methods and sampling

The first step in designing our research was to select participants for the empirical research. As this empirical research is part of a larger project that aims at covering entire period ascribed to Generation Y individuals (namely, individuals born from 1980 till 2000), as well as comparing Generation Y pay preferences to their predecessors (generation X), the first step of data collection included gathering data from the second year students that attended a course “Organization” at University of Zagreb – Faculty of Economics and Business Zagreb at the undergraduate level of Bachelor of Business program in autumn semester. Furthermore, as some assign pay preferences to national culture setting and value patterns (e.g. Chiang & Birtch, 2007) this research reveals reward preferences among Croatian students who share specific cultural characteristics.

A questionnaire designed for the purpose of data collection consisted of several closed-ended questions about different pay modalities (e.g., base pay, variable pay, perks and benefits etc.) for which respondents were asked to assign preference using Likert 5-point scale (1 = not important at all, 5 = most important). Other questions included different background questions that were used to describe independent characteristics of respondents and were either closed-ended (e.g., gender, students status, previous knowledge on motivation management, etc.) or open ended (e.g. year of birth, years of working experience, etc.). Before the questionnaires were distributed to students they were tested by several student assistants that were asked to read the draft of the questionnaire and give their suggestions to make the final version more understandable to second year students. The estimated time for fulfilling the questionnaire was approximately 5 to 10 minutes.

As for the following phase of empirical research, students were asked to voluntarily fulfil the questionnaire in written form as a part of the topic that was discussed during the lectures. Questionnaires were distributed to students in 10 out of 20 groups of seminars at the second year of Bachelor of Business program. At the end of the collection phase a total of 249 students fulfilled the questionnaires, which makes a proportion of 31,80% of all second year students. As the data collection phase was concluded a statistical analysis of the primary data with SPSS 18.0 followed. The independent characteristics of the respondents are given in a summary table below.

Table 2. Independent characteristics of respondents

Independent characteristics	Distribution
Gender	M – 41.10%; F – 59.90%
Age	1993 or older – 5.5%; 1994 – 8.5%; 1995 – 65.20%; 1996 – 20.60%
Student status	With permanent, temporary or occasional employment – 27.10% Without permanent, temporary or occasional employment – 72.90%
Approximate number of years of working experience	Zero or less than one year – 74.40%; One year – 13.20%; Two years – 7.30%; Three or more years – 4.9%
Approximate number of different employers	Zero employers – 54.10%; One employer – 18.90%; Two employers – 12.8%; Three employers – 8.6%; Four or more employers – 5.6%
Type of education in motivation management	Knowledge gained at university in a course or as a special topic in the course – 18.90%; Knowledge gained outside university or via self-initiated learning – 18.10%; No formal education gained on the topic at hand – 63.00%

As it can be seen from the table, 60% of the sample is comprised of female students which corresponds to the general structure of student population at University of Zagreb – Faculty of Economics and Business. The majority of respondents were born in either 1995 (65.20%) or 1996 (20.60%) which is in line with the general rule of Croatian population that enters university level education at the age of 18 or 19. As for the student status regarding work experience, only 27.10% of respondents stated that they had permanent, temporary or occasional jobs. As for the number of years working, 3/4 of respondents had either zero or less than a year of working experience which is line with the previously examined characteristic. Additionally, students reported working for one employer in 18.90% of cases, while additional 27.00% reported working for more than two employers. Finally, we were interested in exploring source of knowledge on the topic at hand, if any, where the results revealed that 37% of students had some sort of knowledge on motivation management (gained either at university or outside university and by self-initiated learning), while the majority of them (63%) had no previous knowledge on motivation management.

After analysing students' independent characteristics we were interested in exploring their preference of different pay structure elements. Additionally, we aimed at investigating differences in assigning importance to aforementioned motivation strategies with regard to respondents' independent characteristics, such as gender, student status and previous knowledge on motivation management. The results are shown in the next section.

Research results

Expectancy theory suggests that, in general, job seekers will prefer individual-based pay plans because the attractiveness of an alternative is expected to increase as the links between personal efforts, results, and outcomes become more direct.

Table 3. Transactional compensation preferences of generation Y

Transactional element	N	Min	Max	Mean	Median	Mode	Std. Dev.
Retirement and security benefits	248	2.00	5.00	4.42	5.00	5.00	.73
Health benefits	249	2.00	5.00	4.28	4.00	5.00	.81
High base pay	249	2.00	5.00	4.26	4.00	4.00	.70
Off-the-job training	249	1.00	5.00	4.07	4.00	5.00	.96
Variable individual pay	249	1.00	5.00	3.90	4.00	4.00	.89
Perks and benefits in terms of different services to employees	249	2.00	5.00	3.57	4.00	4.00	.94
Profit-sharing	248	1.00	5.00	3.56	4.00	4.00	1.00
Child care	249	1.00	5.00	3.41	3.00	3.00	1.22
Variable group pay	248	1.00	5.00	3.34	3.00	4.00	.94

The analysis of the primary data collected among students revealed that out of different pay elements explored, respondents assign most importance to retirement and security benefits ($\bar{x} = 4.42$, $\sigma = 0.73$), followed by health benefits ($\bar{x} = 4.28$, $\sigma = 0.81$) and high base pay ($\bar{x} = 4.26$, $\sigma = 0.70$). Interestingly, these preferred benefits are already available to all employees since they are employment-based and form part of Croatian labour and social security policies. Additionally, these benefits are usually attractive to older employees and our respondents were millennials born around 1995. On the other hand, voluntary benefits in terms of perks and other different services to employees are less attractive to respondents ($\bar{x} = 3.57$, $\sigma = 0.94$). Even training possibilities that are usually very attractive in early career stages were not rated as extremely attractive ($\bar{x} = 4.07$, $\sigma = 0.96$).

Although authors argue that Millennials have already become used to the idea that short-term contracts and job insecurity are the new norm, especially in the early career stages, permanent job and job security have been found to be important motivators in French setting as well (Guillot-Soulez, Soulez, 2014).

We consider that benefits were given such a high rating due to country-specific situation in Croatia. Namely, Croatia is a country with very-high uncertainty avoidance index (Hofstede, 1980) which results with (1) a very high preference for avoiding uncertainty and (2) security as an important element in individual motivation. High uncertainty avoidance accompanied with Croatian poor economic conditions that limit the possibilities for further salaries' and pension growth result with growing attractiveness of those benefits that increase employee security.

Another finding from Table 3 fully supports the claim that people from strong uncertainty avoidance cultures tend to avoid any pay system that has some elements of 'risk' (e.g. a performance-based pay system). As seen from the table, high base pay (that is a form of fixed compensation) is still much more attractive to Croatians ($\bar{x} = 4.26$, $\sigma = 0.70$) when compared to variable pay. With respect to variable pay, we must emphasize that although Croatia is attributed as a collectivistic society, individual variable pay ($\bar{x} = 3.90$, $\sigma = 0.89$) is more preferred than group based variable pay ($\bar{x} = 3.34$, $\sigma = 0.94$). However, both individual and group based variable pay are less preferred than benefits.

General conclusion that can be drawn from Table 3 is that Croatian employers do not need to insist on contingent forms of rewards such as variable pay or profit-sharing. People from cultures with very high uncertainty avoidance like Croatia are comfortable with structured situations. This is perhaps the reason why they will be more comfortable with fixed-based 'structured' pay systems (e.g. systems based on authority and responsibility, seniority, educational attainment, skill, length of service) than pay systems based on individual performance, innovation/entrepreneurship or profit sharing (e.g. Mamman, Sulaiman & Fadel (1996).

The elements of the pay structure that were assigned least importance (although with greater variability in data) were variable group pay ($\bar{x} = 3.34$, $\sigma = 0.94$) and child care ($\bar{x} = 3.41$, $\sigma = 1.22$). Due to respondents' age and childless status such finding on the lack of attractiveness of company supported child care was to be expected.

Since variations in pay preferences can be assigned to individual characteristics, we were interested in exploring differences in preferences towards different pay elements with regard to respondents' characteristics. The summary table of various statistical analyses is shown in table 4.

Table 4. Differences in transactional pay elements preferences with regard to selected respondents' independent characteristics

Independent characteristic	Statistically significant differences	Statistical test
Gender	Profit-sharing	Mann-Whitney test
Student status	Off-the-job training Variable team pay	Mann-Whitney test
Knowledge on motivation management	Off-the job training	Kruskal-Wallis test

The results of the non-parametric tests revealed only a small number of statistically significant differences in assigning importance to various transactional rewards. More specifically, it was shown that "gender" does not imply greater differences in perceiving various elements of pay as more or less preferred, where only profit-sharing was found to be statistically significantly more important to men than women ($p = 0.003$). On the other hand, "student status" generated two differences that were statistically significant – namely, off-the-job training ($p = 0.008$) and variable team pay ($p = 0.015$) where in both cases students with permanent, temporary or occasional job assigned more importance to it than the other group. Finally, whether students had "previous knowledge" on the topic at hand, made a difference in the case of off-the-job training ($p = 0.000$) where students that gained knowledge outside university or by self-initiated learning assigned more importance to it than those who gained knowledge at university and especially compared to those that had no knowledge on the topic. Altogether, we cannot confirm that gender has an important role when examining pay preferences.

CONCLUSION

Much research has focused on finding the appropriate mix of compensation variables in the pay package. Mostly, compensation literature advocates for pay policies that match corporate and business strategy and are internally consistent (e.g., Milkovich & Newman, 2008). However, overall effectiveness of pay policy is severely influenced by understanding employee pay expectations. Namely, this is because pay system characteristics may either satisfy or dissatisfy the individual, and having an effect on employee pay satisfaction impact employee performance. Therefore, learning about the relative importance of different aspects of pay is an imperative if companies are to learn how to use pay more effectively (Heneman & Judge, 2000).

With respect to the status of compensation strategy, our secondary data sources show a common trend in practices used by both Croatian companies and EU practices. For example, as a key indicator of employed compensation strategy, we used the information on variable compensation. Secondary data indicate a similar rate of use for variable pay in Croatia as in the EU average. We do however question the methods of implementation of variable compensation in Croatia; we would like to confirm that variable compensation in Croatia is based on objective criteria, in order to be able to serve as an incentive for performance.

Individuals may prefer organizations that better fit their pay preferences and may be more or less attracted to organizations based on the match between their pay preferences and organizations' pay systems (e.g. Cable & Judge, 1994). For organizations, it is important to know that reward plans attract people with certain preferences in terms of individual motivation or individual consumption behaviour (Clugston, Howell & Dorfman, 2000, Shaw & Schaubroeck, 2003).

An empirical research was conducted in order to analyse preferences towards different aspects of compensation among millennials'. This generation is just entering the workforce and is expected that very soon this generation will form the largest proportion of the total workforce. Our respondents, members of the millennial generation, prefer security and stability over variability in pay. Variability in pay created through incentive programs, either at the individual, group or organisational level (mean scores 3.34 to 3.9) was not as appreciated as health and security benefits (mean scores 4.28 to 4.42). Besides benefits, Croatsians were most interested in attaining high base pay (mean score 4.26). All this implies that although variable pay has been advocated as a very popular compensation tool that should be implemented by all companies, it is not something that will be highly appreciated by the young workforce. In case variable pay plans are implemented, millennial generation will appreciate more variable pay linked to individual performance than variable pay linked to group or company performance. Current practice is aligned with these preferences, since variable pay linked to individual performance is more often used than group based variable pay. Developing and managing a reward system should take into consideration all these findings in order to use the personnel budgets in the most efficient way.

Research results on pay preferences may be severely impacted by personality dimension, since for example more materialistic job seekers would be expected to place greater importance on level of pay than would those low in materialism (Cable & Judge, 1994). As a part of our research, we did not find any differences in preferences to different pay elements with respect to respondents' independent characteristics (work experience, number of employers). Some minor differences in pay preferences were found only with respect to gender (Profit-sharing preferred more by men) and student status (off-the-job training and variable team pay preferred more by students with permanent, temporary or occasional job). Additionally, there is some empirical evidence in the existing literature that preference for financial rewards grow steadily with the age (Bonsdorff, 2011) so we might expect that as our respondents will be ageing their pay preferences might change as well. However, overall impact of pay satisfaction on individual and organisational performance is a strong argument to further analyse pay preferences.

This study has a number of limitations that should be acknowledged. First, data were reported by respondents, so self-report bias may have influenced the results. We did not control for effects of other variables such as personality traits, family background or family income. This is an exploratory study; further studies need to address the pointed limitations. We are aware that we should expand our research by including members of the millennial generation who are already employed and thus have some experience with compensation systems. Furthermore, as a part of the further studies on the topic of pay preferences we should investigate the impact of some controlled variables, e.g. employees' abilities, current performance, salary level or nature of contract of employment.

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