



# COMPENSATION MANAGEMENT

## CHAPTER 1 (Study unit 1) THE PAY MODEL

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### Chapter Topics

- Compensation: Definition
- Forms of Pay
- A Pay Model
- Book Plan
- Your Turn: Glamorous Internships, or House Elves?

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## Learning Objectives

After studying Chapter 1, students should be able to:

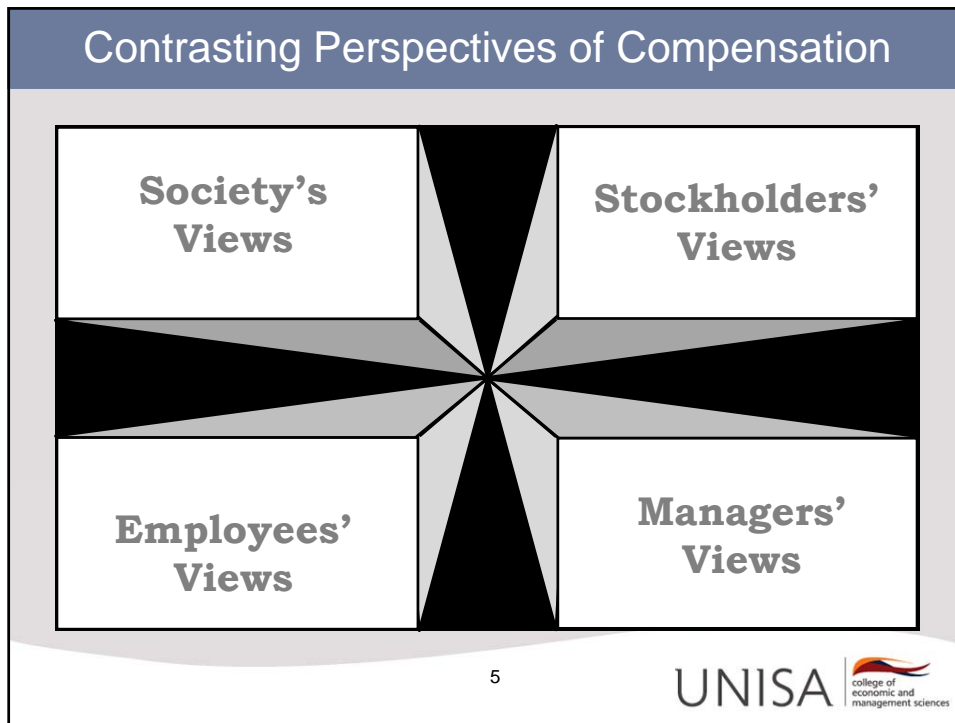
- Explain how perceptions of compensation differ among society, stockholders, managers and employees.
- Discuss the difference between cash compensation (direct compensation) and benefits (indirect compensation) and define each of the direct and indirect forms of compensation.
- Explain how the employment relationship combines both transactional and relational returns to form an implicit contract between employers and employees.
- Identify and describe the three main components of a pay model.
- Understand how the pay model integrates objectives, policies, and techniques into a compensation system.
- Distinguish empirical research from surveys and opinions.

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## Key Questions and Issues

- How differing perspectives affect our views of compensation
- Definition of compensation
  - *The meaning of compensation most appropriate from an employee's view: return, reward, or entitlement*
- Examining “network of returns” a college offers an instructor
- Four policy issues in the pay model
  - Objectives of the pay model
- Forms of pay received from work


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## Compensation: Definition

- **Society**
  - Pay as a measure of justice
  - Benefits as a reflection of justice in society
  - Job losses (or gains) attributed to differences in compensation
  - Belief that pay increases lead to price increases
- **Stockholders**
  - Using stock to pay employees creates a sense of ownership
  - Linking executive pay to company performance supposedly increases stockholders' returns
- **Managers**
  - A major expense
  - Used to influence employee behaviors and to improve the organization's performance

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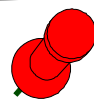
## Compensation: Definition (cont.)

- **Employees**
  - Major source of financial security
  - Return in an exchange between employer and themselves
  - Entitlement for being an employee of the company
  - Reward for a job well done
- **Global Views – *Vive la différence***
  - China: Traditional meaning of compensation providing necessities of life replaced with *dai yu*
  - Japan: Traditional word *kyuyo* replaced with *hou-syu*; very recently the phrase used is *teate*

These contrasting ideas about compensation – multiple views (i.e. societal, employee, etc) and multiple meanings (i.e. returns, reward, etc) add richness to the topic.

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## What Is Compensation/Pay?

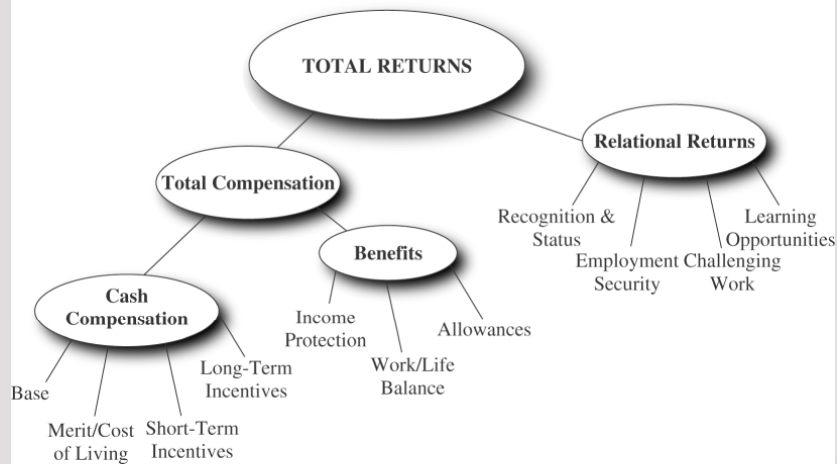


**Compensation refers to all forms of financial returns and tangible services and benefits employees receive as part of an employment relationship**

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## Exhibit 1.4: Total Returns for Work

EXHIBIT 1.4 Total Returns for Work



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## Forms Of Pay

- **Relational returns**
  - Psychological in nature, i.e. challenging work, status
- **Total compensation**
  - Cash Compensation/ transactional
    - Base wages
      - ❖ Difference between wage and salary
      - ❖ Tends to reflect the value of the work or skills and ignores differences attributed to individual employees
    - Merit pay/cost-of-living adjustments
      - ❖ Merit increases – given in recognition of past work behavior
      - ❖ Cost-of-living adjustments –same increases to everyone, regardless of performance

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## Forms Of Pay (cont.)

- Incentives/ Variable pay – tie pay increases directly to performance
  - ❖ Does not increase base wage; must be re-earned each pay period
  - ❖ Potential size generally known beforehand
  - ❖ Long-term (stock options), and short-term
  - ❖ Incentives are frequently referred to as *variable pay*

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## Forms Of Pay (cont.)

- Benefits
  - *Income protection* – some are legally required, for instance Unemployment Insurance Fund. Medical aid, retirement programmes and life insurance are common benefits
  - *Work/life balance* – programmes that help employees better integrate their work and life responsibilities include time away from work, access to services to meet specific needs (i.e. employee assistance programmes and flexible work arrangements (i.e. nonpaid time off)
  - *Allowances* – this is grown out of whatever is in short supply. For example car allowances, cell phone allowances, etc.

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## Forms Of Pay (cont.)

- **Total earnings opportunities:** Present value of a stream of earnings
  - Shifts comparison of today's initial offers to consideration of future bonuses, merit increases, and promotions
- **Relational returns from work**
  - Nonfinancial returns
- **Organization as a network of returns**
  - Created by different forms of pay, including total compensation and relational returns

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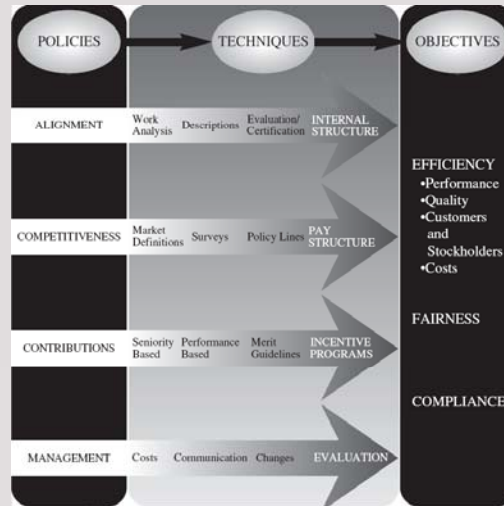
## A Pay Model

### Three basic building blocks (Refer to exhibit 1.5):

- Compensation objectives
- Policies that form the foundation of the compensation system
- Techniques that make up the compensation system

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## Exhibit 1.5: The Pay Model



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## Compensation Objectives

- **Efficiency**
  - Improving performance, increasing quality, delighting customers and stockholders
  - Controlling labor costs
- **Fairness**
  - Fundamental objective of pay systems
  - Fair treatment by recognizing both employee contributions (i.e. higher pay for greater performance), and employee needs (i.e. a fair wage as well as fair procedures)
  - *Procedural fairness* is the process used to make pay decisions and suggests that the way a pay decision is made may be as important to the employee as the results of the decisions.

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## Compensation Objectives (cont.)

- **Compliance**
  - Conformance to Federal and State compensation laws and regulations
  - If laws change, pay systems may need to change too to ensure continued compliance
- **Ethics**
  - Organizations care about how its results are achieved
  - Managing pay sometimes creates ethical dilemmas
  - Manipulating results to ensure executive bonus payouts, misusing statistics used to measure competitors' pay rates, and shaving the hours recorded in employees' time cards are all too common examples of ethical lapses

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## Compensation Objectives (cont.)

### Objectives THUS

- Guide the design of the pay system
- Serve as the standards for judging success of the pay system
- Policies and techniques are means to reach objectives

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## Four Policy Choices

- **Internal alignment**

- *Focus:* Comparisons among jobs or skill levels inside a single organization
- Jobs and people's skills are compared in terms of their relative contributions to the organization's business objectives
- Pertains to the pay rates both for employees doing equal work and for those doing dissimilar work
- Pay relationships within an organization affect employee decisions to:
  - Stay with the organization
  - Become more flexible by investing in additional training
  - Seek greater responsibility
- Fairness is affected = employees' compare their pay to the pay of others in the organisation
- Compliance is affected = basis used to make internal comparisons

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## Four Policy Choices (cont.)

- **External competitiveness**

- *Focus:* Compensation relationships external to the organization: comparison with competitors
- Pay is 'market driven'
- Effects of decisions regarding how much and what forms have a twofold effect on objectives:
  - To ensure that pay is sufficient to attract and retain employees
  - To control labor costs to ensure competitive pricing of products/services

External competitiveness directly affects both efficiency and fairness. It must do so in an ethical way that complies with relevant legislation.

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## Four Policy Choices (cont.)

- **Employee contributions**
  - *Focus:* Relation emphasis placed on employee performance as it directly affects employees' attitudes and work performance
  - Performance based pay affects fairness: employees need to understand the basis for judging performance in order to believe that their pay is fair.
- **Management**
  - *Focus:* Policies ensuring the right people get the right pay for achieving the right objectives in the right way
  - Managing compensation means answering the “So What” question. So what is the impact of this policy, this decision?

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## Pay System Techniques

- Techniques tie the four basic policies to the pay objectives
- Many variations exist
- Some techniques will be discussed through the book

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## Your turn

Answer the end of chapter 1 review questions and self-evaluation questions in the study guide

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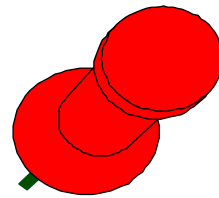
# **COMPENSATION MANAGEMENT**

## **CHAPTER 12 (Study unit 10)** **Employee Benefits**

# Chapter Topics

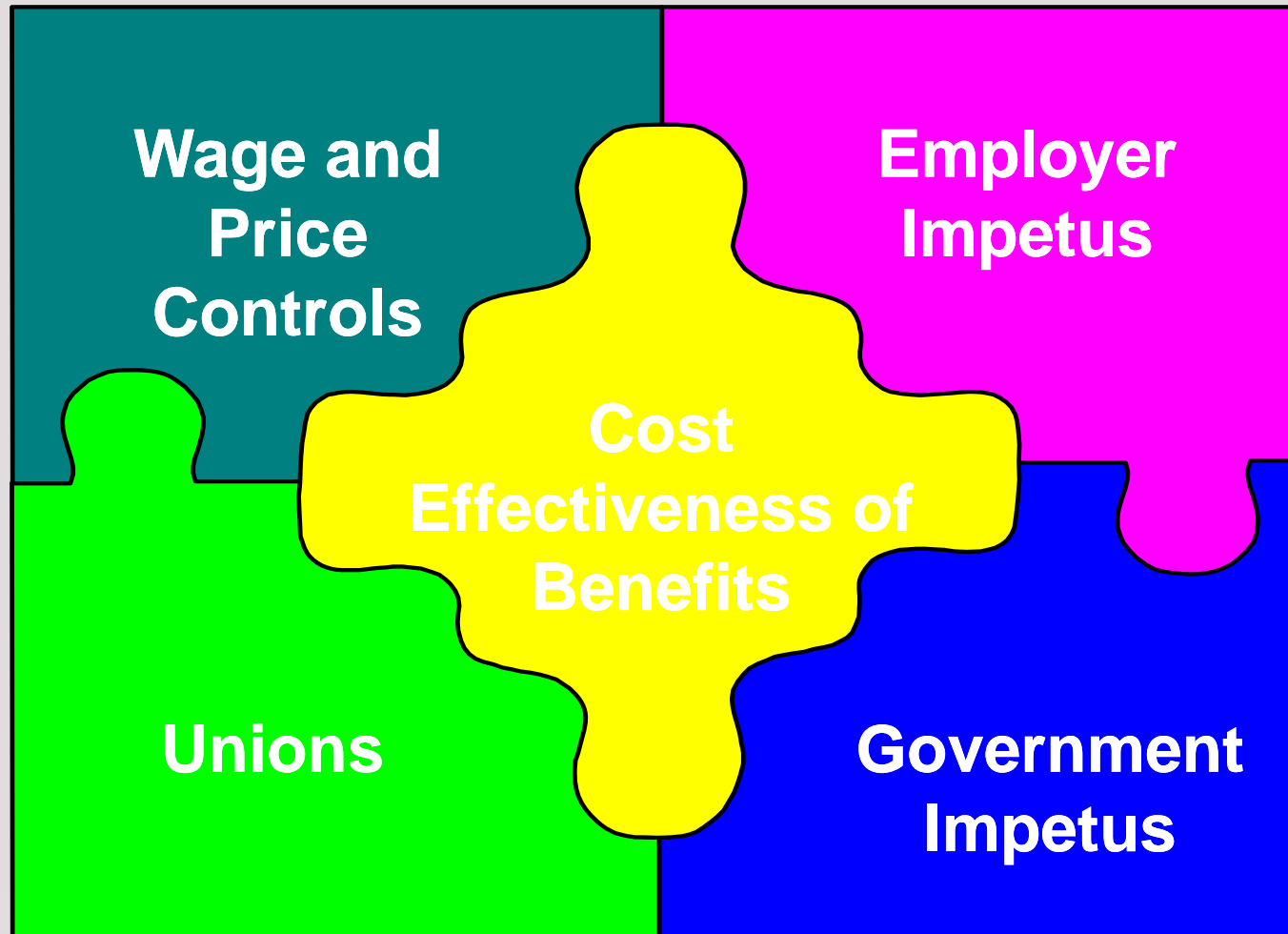
- Why the Growth in Employee Benefits?
- Value of Employee Benefits
- Key Issues in Benefit Planning, Design and Administration
- Components of a Benefits Plan
- Administering the Benefits Program

# What Are Employee Benefits?



**That part of the total compensation package, other than pay for time worked, provided to employees in whole or in part by employer payments, e.g. life insurance, pension, workers' compensation, vacation**

# Why the Growth in Employee Benefits?





# Value of Employee Benefits

- Employees:
  - Expect benefits as part of their total compensation
  - Do not understand true value of benefits
  - Often undervalue their benefits
  - Often take benefits for granted
  - Often cannot list all benefits received
  - Have preferences regarding types of benefits they want

# Key Issues in Benefit Planning, Design, and Administration

- Benefits Planning and Design Issues
  - How to attract good employees
  - How to deal with undesirable turnover
  - Integrating benefits with other compensation components
  - Strategies for ensuring external competitiveness
  - Ensuring that benefits are adequate
  - Whether employee benefits are cost justified

# Benefit Administration Issues

- Who should be protected or benefited?
  - Series of questions need to be addressed
- How much choice should employees have among an array of benefits?
  - Concerns choice (flexibility) in plan coverage
  - Standard benefit package
  - Cafeteria-style,” or flexible, benefit plans

# Benefit Administration Issues (cont.)

- How issues associated with flexibility should benefits be financed?
  - Noncontributory
  - Contributory
  - Employee financed
- Are your benefits legally defensible?

## Exhibit 12.5: Advantages of Flexible Benefits

- Employees choose packages that best satisfy their unique needs.
- Flexible benefits help firms meet the changing needs of a changing workforce.
- Increased involvement of employees and families improves understanding of benefits.
- Flexible plans make introduction of new benefits less costly.
- Cost containment: Organization sets dollar maximum; employee chooses within the constraint.

## Exhibit 12.5: Disadvantages of Flexible Benefits

- Employees make bad choices and find themselves not covered for predictable emergencies.
- Administrative burdens and expenses increase.
- Adverse selection: Employees pick only benefits they will use; the subsequent high benefit utilization increases its cost.
- Subject to non-discrimination requirements in Section 125 of the Internal Revenue Code.

# Financing Benefits Plans: Alternatives

- Non-contributory
  - Employer pays total costs
- Contributory
  - Costs shared between employer and employee
- Employee financed
  - Employee pays total costs for some benefits
  - By law the organization must bear the cost for some benefits

# Exhibit 12.6: Factors Influencing Choice of Benefit Package

## EXHIBIT 12.6 Factors Influencing Choice of Benefit Package

### Employer Factors

1. Relationship to total compensation costs
2. Costs relative to benefits
3. Competitor offerings
4. Role of benefits in:
  - Attraction
  - Retention
  - Motivation
5. Legal requirements

### Employee Factors

1. Equity: fairness historically and in relationship to what others receive
2. Personal needs as linked to:
  - Age
  - Sex
  - Marital status
  - Number of dependents



**Benefits  
Package**



# Approaches to Assess Employee Preferences

- Demographic differences
  - Age
  - Sex
  - Marital status
  - Number of dependents
  - Blue collar vs. white collar
- Employee survey via questionnaire
- Flexible benefit plan

# Administering the Benefits Program

## Three Administrative Issues

1

**Communicating about the benefits program**

2

**Claims processing**

3

**Cost containment**

# Communicating the Benefits Program

- Three elements of effective communications
  - Company must spell out its benefit objectives and ensure communications achieve the objectives
  - Match the message with the appropriate medium
    - Use of intranet – an internal organizational online Web through which all forms of communication within the organization can be streamlined
    - Streamlined call center operation
  - Content of communications package must be complete, clear, and free of complex jargon

# Communicating Employee Benefits

- Methods of communication
  - Employee handbook
  - Personalized benefit statements
  - Meetings with employees
  - Multi-media presentations
  - Intranet
  - Streamlined call center operation



# Claims Processing

- Claims processor must:
  - Determine whether the act has, in fact, occurred
  - Determine if the employee is eligible for the benefit
  - Calculate the payment level

# Cost Containment

## Prevalent Practices

**1**

**Probationary periods**

**2**

**Benefits limitations**

**3**

**Co-pay**

**4**

**Administrative cost containment**

# Exhibit 12.12: Basic Primer of Cost Containment Terminology

## EXHIBIT 12.12 Basic Primer of Cost Containment Terminology

**Deductibles:** An employee claim for insurance coverage is preceded by the requirement that the first \$x be paid by the claimant.

**Coinsurance:** A proportion of insurance premiums are paid by the employee.

**Benefit cutbacks:** Corresponding to wage concessions, some employers are negotiating with employees to eliminate employer contributions or reduce them to selected options.

**Defined contribution plans:** Employers establish the limits of their responsibility for employee benefits in terms of a dollar contribution maximum.

**Defined benefit plans:** Employers establish the limits of their responsibility for employee benefits in terms of a specific benefit and the options included. As the cost of these options rises in future years, the employer is obligated to provide the benefit as negotiated, despite its increased cost.

**Dual coverage:** In families where both spouses work there is frequently coverage of specific claims from each employer's benefit package. Employers cut costs by specifying payment limitations under such conditions.

**Benefit ceiling:** Employers establish a maximum payout for specific claims (e.g., limiting liability for extended hospital stays to \$150,000).

# Trends Related to Cost Containment

- **Probationary periods** – excluding new employees from benefit coverage until some term of employment is completed (e.g. three months)
- **Benefit limitations** – i.e. limiting disability income payments to some maximum percentage of income
- **Co-pay** – requiring that employees pay a fixed or percentage amount for coverage
- **Administrative cost containment** – controlling costs through policies such as seeking competitive bids for programme delivery
- Retaining strategic function internally
- Significant movement to outsourcing



# Your turn

Answer the end of chapter 12 review questions



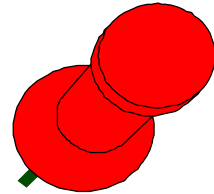
# COMPENSATION MANAGEMENT

## CHAPTER 10 (Study unit 8) Pay-for-Performance Plans

# Chapter Topics

- What Is a Pay-for-performance Plan?
- Does Variable Pay Improve Performance Results? The General Evidence
- Specific Pay-for-performance Plans: Short Term
- Team Incentive Plans: Types
- Explosive Interest in Long-term Incentives

# What Is Pay-for-Performance?



**Pay for performance plans signal  
a *movement away* from  
*entitlements***

**Pay will vary with some measure  
of individual, team, or  
organizational performance**

# Overview: Pay-for-Performance Plans

- Types of plans
  - Use of Different Variable- Pay-Plan Types
  - Base vs. Variable Pay
- Increasing interest in variable pay
  - Competition from foreign competitors
  - Fast-paced business environment

# Specific Pay-for-Performance Plans: Short Term

- Merit Pay
- Lump-Sum Bonuses
- Individual Spot Awards
- Individual Incentive Plans

# Merit Pay

- A merit pay system links increases in base pay to how highly employees are rated on a subjective performance evaluation
- An employee is evaluated at the end of the performance year
- Issues
  - Expensive
  - Doesn't achieve the desired goal: improving employee and corporate performance

# Managing Merit Pay

- Improve accuracy of performance ratings
- Allocate enough money to truly reward performance
- Make sure size of merit increase differentiates across performance levels



# Lump-Sum Bonuses

- Increasingly used substitute for merit pay
- Not built into base pay: based on employee/company performance
- Viewed as less of an entitlement than merit pay because employees need to earn it
- Less expensive than merit pay over the long run
- Employees not fond of lump-sum bonuses: by giving lump-sum bonuses for several years, a company is essentially freezing base pay

# Individual Spot Awards

- Viewed as highly or moderately effective
- Typically awarded for exceptional performance
  - Special projects
  - Exceptional performance

# Overview: Individual Incentive Plans

- Offer a promise of pay for some objective, pre-established level of performance
- **Common feature** - An established standard against which employee performance is compared to determine magnitude of incentive pay

# Exhibit 10.5: Individual Incentive Plans

## EXHIBIT 10.5 Individual Incentive Plans

		Method of Rate Determination	
		<i>Units of production per time period</i>	<i>Time period per unit of production</i>
<b>Relationship between Production Level and Pay</b>	<i>Pay constant function of production level</i>	(1) Straight piecework plan	(2) Standard hour plan
	<i>Pay varies as function of production level</i>	(3) Taylor differential piece-rate system Merrick multiple piece rate system	(4) Halsey 50-50 method Rowan plan Gantt plan

# Individual Incentive Plans: Types

- Standard is compared against individual worker performance
- Dimension on which incentive systems vary
  - Method of rate determination
  - Specified relationship between production level and wages

# Exhibit 10.7: A Straight Piece Rate Plan

## **EXHIBIT 10.7** **A Straight** **Piece Rate** **Plan**

Piece rate standard (e.g., determined from time study): 10 units/hour  
Guaranteed minimum wage (if standard is not met): \$5/hour  
Incentive rate (for each unit over 10 units): \$.50/unit

### **Worker Output**

### **Wage**

10 units or less

\$5.00/hour (as guaranteed)

20 units

$20 \times \$.50 = \$10/\text{hour}$

30 units

$30 \times \$.50 = \$15/\text{hour}$

# Advantages of Individualized Incentive Plans

- Substantial contribution to:
  - Productivity raise
  - Lower production costs
  - Workers earnings
- Reduces direct supervision to maintain reasonable output levels
- Enables labor costs to be estimated more accurately than under payment by time
  - Helps costing and budgetary control

# Disadvantages of Individualized Incentive Plans

- Conflicts may emerge between employees managers
- Introduction of new technology may be resisted by employees
- Reduced willingness of employees to suggest new production methods
- Increased complaints of poor maintenance, hindering employee efforts to earn larger incentives
- Increased turnover among new employees discouraged by the unwillingness of experienced workers to cooperate in on-the-job training
- Elevated levels of mistrust between workers and management



# Exhibit 10.10: Lincoln Electric's Compensation System

## EXHIBIT 10.10 Lincoln Electric's Compensation System

Description of culture	Reservoir of trust. Long history of employment stability even during severe economic downturns. Employees with 3+ years' seniority are guaranteed (on 1 year renewable basis) at least 75 percent full-time work for that year. In exchange, employees agree to flexible assignment across jobs.
Base wages	Market rate determined. Time study department sets piece rate so that average worker can earn market rate.
Bonus (short term)	Board of directors sets year-end bonus pool as function of company performance. Employee's share in pool is function of semiannual performance review (see below).
Incentive (long term)	Employees share in long-term company successes/failures in form of employee stock ownership plan (ESOP). Employees now own 28 percent of outstanding stock shares.
Performance review	Employees rated on four factors: (1) dependability, (2) quality, (3) output, (4) ideas and cooperation in comparison to others in department. To ensure against rating inflation, the average score in department cannot exceed 100.

# Overview of Team Incentives

- Improve organizational performance
- Use organizational measures
- Measured periodically

# Exhibit 10.11: A Sampling of Performance Measures

## EXHIBIT 10.11 A Sampling of Performance Measures

### Customer-Focused Measures

#### Time-to-Market Measures

- On-time delivery
- Cycle time
- New product introductions

#### Customer Satisfaction Measures

- Market share
- Customer satisfaction
- Customer growth and retention
- Account penetration

### Capability-Focused Measures

#### Human Resource Capabilities

- Employee satisfaction
- Turnover rates
- Total recruitment costs
- Rate of progress on developmental plans
- Promotability index
- Staffing mix/head-count ratio

#### Other Asset Capabilities

- Patents/copyrights/regulations
- Distribution systems
- Technological capabilities

### Financially Focused Measures

#### Value Creation

- Revenue growth
- Resource yields
- Profit margins
- Economic value added

#### Shareholder Return

- Return on invested capital
- Return on sales/earnings
- Earnings per share
- Growth in profitability

### Internal Process-Focused Measures

#### Resource Utilization

- Budget-to-actual expenses
- Cost-allocation ratios
- Reliability/rework
- Accuracy/error rates
- Safety rates

#### Change Effectiveness

- Program implementation
- Teamwork effectiveness
- Service/quality index

# Balanced Scorecard Approach

- Uses a *constellation* of measures
  - Pinpoints areas of success
  - Indicates areas to improve
- *Categories* of measures
  - Financial results
  - Process improvements
  - Customer service
  - Innovation
- Forces discussions about priorities among different measures
- *Outcome* – Objectives with different weights in terms of importance

# Exhibit 10.12: Types of Variable Pay Plans: Advantages and Disadvantages

## EXHIBIT 10.12 Types of Variable-Pay Plans: Advantages and Disadvantages

Source: Kenan S. Abosch, "Variable Pay: Do We Have the Basics in Place?" 30(4) 1998, pp.12-22.

Plan Type	What Is It?	Advantages	Disadvantages	Why?
Cash profit sharing	<ul style="list-style-type: none"> <li>• Award based on organizational profitability</li> <li>• Shares a percentage of profits (typically above a target level of profitability)</li> <li>• Usually an annual payout</li> <li>• Can be cash or deferred 401(k)</li> </ul>	<ul style="list-style-type: none"> <li>• Simple, easily understood</li> <li>• Low administrative costs</li> </ul>	<ul style="list-style-type: none"> <li>• Profit influenced by many factors beyond employee control</li> <li>• May be viewed as an entitlement</li> <li>• Limited motivational impact</li> </ul>	<ul style="list-style-type: none"> <li>• To educate employees about business operations</li> <li>• To foster teamwork or "one-for-all" environment</li> </ul>
Stock ownership or options	<ul style="list-style-type: none"> <li>• Award of stock shares or options</li> </ul>	<ul style="list-style-type: none"> <li>• Option awards have minimal impact on the financial statements of the company at the time they are granted</li> <li>• If properly communicated, can have powerful impact on employee behavior</li> <li>• Tax deferral to employee</li> </ul>	<ul style="list-style-type: none"> <li>• Indirect pay/performance link</li> <li>• Employees may be required to put up money to exercise grants</li> </ul>	<ul style="list-style-type: none"> <li>• To recruit top-quality employees when organization has highly uncertain future (i.e., start-ups, high-tech, or biotech industries)</li> <li>• To address employee retention concerns</li> </ul>
Balanced scorecard	<ul style="list-style-type: none"> <li>• Awards that combine financial and operating measures for organization, business unit, and/or individual performance</li> <li>• Award pool based on achieving performance targets</li> </ul>	<ul style="list-style-type: none"> <li>• Communicates organizational priorities</li> </ul>	<ul style="list-style-type: none"> <li>• Performance criteria may be met, but if financial targets are not met, there may be a reduced payout or no payout at all</li> <li>• Can be complex</li> </ul>	<ul style="list-style-type: none"> <li>• To focus employees on need to increase shareholder value</li> <li>• To focus employees on organization, division, and/or individual goals</li> <li>• To link payouts to a specific financial and/or operational target</li> </ul>

# Exhibit 10.12: Types of Variable Pay Plans: Advantages and Disadvantages-con't

Plan Type	What Is It?	Advantages	Disadvantages	Why?
Productivity/ gain sharing	<ul style="list-style-type: none"> <li>Multiple performance measures may include:                             <ol style="list-style-type: none"> <li>Nonfinancial/operating: quality improvements, productivity gains, customer service improvements</li> <li>Financial: EPS, ROE, ROA, revenues</li> </ol> </li> </ul>	<ul style="list-style-type: none"> <li>Clear performance–reward links</li> <li>Productivity and quality improvements</li> <li>Employee's knowledge of business increases</li> <li>Fosters teamwork, cooperation</li> </ul>	<ul style="list-style-type: none"> <li>Can be administratively complicated</li> <li>Unintended effects, like drop-off in quality</li> <li>Management must "open the books"</li> <li>Payouts can occur even if company's financial performance is poor</li> </ul>	<ul style="list-style-type: none"> <li>To support a major productivity/quality initiative (such as TQM or reengineering)</li> <li>To foster teamwork environment</li> <li>To reward employees for improvements in activities that they control</li> </ul>
Team/group incentives	<ul style="list-style-type: none"> <li>Awards determined based on team/group performance goals or objectives</li> <li>Payout can be more frequent than annual and can also extend beyond the life of the team</li> <li>Payout may be uniform for team/group members</li> </ul>	<ul style="list-style-type: none"> <li>Reinforces teamwork and team identity/ results</li> <li>Effective in stimulating ideas and problem-solving</li> <li>Minimizes distinctions between team members</li> <li>May better reflect how work is performed</li> </ul>	<ul style="list-style-type: none"> <li>May be difficult to isolate impact of team</li> <li>Not all employees can be placed on a team</li> <li>Can be administratively complex</li> <li>May create team competition</li> <li>Difficult to set equitable targets for all teams</li> </ul>	<ul style="list-style-type: none"> <li>To demonstrate an organizational commitment to teams</li> <li>To reinforce the need for employees to work together to achieve results</li> </ul>

# Exhibit 10.13: The Choice Between Individual and Group Plans

## EXHIBIT 10.13 The Choice between Individual and Group Plans

Characteristic	Choose an Individual Plan when . . .	Choose a Group Plan when . . .
Performance measurement	Good measures of individual performance exist. Task accomplishment not dependent on performance of others.	Output is group collaborative effort. Individual contributions to output cannot be assessed.
Organizational adaptability	Individual performance standards are stable. Production methods and labor mix relatively constant.	Performance standards for individuals change to meet environmental pressures on relatively constant organizational objectives. Production methods and labor mix must adapt to meet changing pressures.
Organizational commitment	Commitment strongest to individual's profession or superior. Supervisor viewed as unbiased and performance standards readily apparent.	High commitment to organization built upon sound communication of organizational objectives and performance standards.
Union status	Nonunion; unions promote equal treatment. Competition between individuals inhibits "fraternal" spirit.	Union or nonunion; unions less opposed to plans that foster cohesiveness of bargaining unit and which distribute rewards evenly across group.

# Team Compensation: Issues and Problems

- Many varieties of teams – difficult to argue for one consistent type of compensation plan
- “Level problem”
- Complexity
- Control
- Communication



# Gain-Sharing Plans

- Employees earn bonuses tied to unit-wide performance as measured by a predetermined, gain sharing formula
- Looks at cost components of the income ledger and identifies savings over which employees have or impact

# Key Elements in Designing a Gain-Sharing Plan

- Strength of reinforcement
- Productivity standards
- Sharing the gains
- Scope of the formula
- Perceived fairness of the formula
- Ease of administration
- Production variability

# Types of Gain-Sharing Plans

- **Rucker Plan**
  - Ratio is calculated that expresses value of production required for each dollar of total wage bill
- **Scanlon Plan**
  - Designed to lower labor costs without lowering level of a firm's activity
  - Incentives are derived as a function of ratio between labor costs and sales value of production (SVOP)
  - SVOP includes sales revenue and value of goods in inventory
- **Implementation of Scanlon/Rucker Plans**
  - Two major components are vital to implementation and success
    - Productivity norm
    - Effective worker committees

# Types of Gain-Sharing Plans (cont.)

- **Improshare** (Improved productivity through sharing)
  - Standard is developed that identifies expected hours required to produce an acceptable level of output
  - Any savings arising from production of agreed-upon output in fewer than expected hours is shared by firm and workers

# Profit-Sharing Plans

- Predetermined index of profitability
  - Employees may not feel their jobs directly impact profits
- The trend in recent variable-pay design is to combine the best of gain-sharing and profit-sharing plans
  - The plan must be self funding
  - Along with having the financial incentive, employees feel they have a measure of control

# Earnings-at-Risk Plans

- Success sharing plan
  - Employee base pay is constant
    - Variable pay increases in successful years
    - No reduction in base pay and no variable pay in poorly-performing years
- Risk sharing plan
  - Employee base pay varies
    - Base pay often reduced in poor performance years
    - Shifts part of risk of doing business from company to employee

# Exhibit 10.16: Group Incentive Plans: Advantages and Disadvantages

## EXHIBIT 10.16

### Group Incentive Plans: Advantages and Disadvantages

#### Advantages

1. Positive impact on organization and individual performance of about 5 to 10 percent per year.
2. Easier to develop performance measures than it is for individual plans.
3. Signals that cooperation, both within and across groups, is a desired behavior.
4. Teamwork meets with enthusiastic support from most employees.
5. May increase participation of employees in decision-making process.

#### Disadvantages

1. Line-of-sight may be lessened, that is employees may find it more difficult to see how their individual performance affects their incentive payouts.
2. May lead to increased turnover among top individual performers who are discouraged because they must share with lesser contributors.
3. Increases compensation risk to employees because of lower income stability. May influence some applicants to apply for jobs in firms where base pay is a larger compensation component.

# Example of Group Incentive Plan - GE Information Systems

- A team-based incentive with links to individual payouts
- Team and individual performance goals are set
- If team hits its goals, team members earn their incentive only if they also hit their individual goals
- Team incentive is 12% to 15% of monthly base pay



# Example of Group Incentive Plan - Corning Glass

- A gain-sharing program (goal sharing) where 75% of payout is based on unit objectives such as:
  - Quality measures
  - Customer satisfaction measures
  - Production targets
- Remainder is based on Corning's return on equity (ROE)

# Example of Group Incentive Plan - 3-M

- Operates with an earnings-at-risk plan
- Base pay fixed at 80% of market
- Employees have a set of objectives to meet for pay to move to 100% of market
- Additionally, there is a modest profit sharing component

# Example of Group Incentive Plan - Saturn

- Earnings-at-risk plan where base pay is 93% of market
- Employees meet individual objectives to capture at-risk component
- All team members must meet objectives for any to get at-risk money
- A profit sharing component is based on corporate profits

# Group Incentive Plans: Examples

- All incentive plans can be described by common features
  - The size of the group that participates in the plan
  - The standard against which performance is compared
  - The payout schedule

# Explosive Interest in Long-term Incentive Plans

- Long-term incentives (LTIs) focus on performance beyond the one-year time line used as the cutoff for short-term incentive plans
- Recent explosive growth in long term plans is spurred in part by a desire to motivate longer-term value creation
- Evidence suggests that stock ownership is likely to increase internal growth, rather than more rapid external diversification

# Long-Term Incentive Plans

**Employee Stock Ownership Plans  
(ESOPs)**

**Performance Plans (Performance  
Share and Performance Unit)**

**Broad-Based Option Plans (BBOPs)**

# Exhibit 10.18: Long-Term Incentives and Their Risk/Reward Tradeoffs

## EXHIBIT 10.18 Long-Term Incentives and Their Risk/Reward Tradeoffs

Source: IOMA, "PFP News Brief," *Pay for Performance Report*, June 2000, p. 8.

### Level One: Low Risk/Reward

1. *Time-based restricted stock*: An award of shares that actually are received only after the completion of a predefined service period. Employees who terminate employment before the restriction lapses must return their shares to the company.
2. *Performance-accelerated restricted stock*: Restricted stock granted only after attainment of specified performance objectives.
3. *Stock purchase plan*: Opportunity to buy shares of company stock either at prices below market price or with favorable financing.

### Level Two: Medium Risk/Reward

4. *Time-vested stock option*: This is what most stock options are—the right to purchase stock at a specified price for a fixed time period.
5. *Performance-vested restricted stock*: This is a grant of stock to employees upon attainment of defined performance objective(s).
6. *Performance-accelerated stock option*: An option with a vesting schedule that can be shortened if specific performance criteria are met.

### Level Three: High Risk/Reward

7. *Premium-priced stock option*: A stock option that has an exercise price about market value at the time of grant. This creates an incentive for employees to create value for the company, see the stock price rise, and thus be eligible to purchase the stock.
8. *Indexed stock option*: An option whose exercise price depends on what peer companies' experiences are with stock prices. If industry stock prices are generally rising, it would be difficult to attribute any similar rise in specific improvements beyond general industry improvement.
9. *Performance-vested stock option*: One that vests only upon the attainment of a predetermined performance objective.

# Your turn

Answer the end of chapter 10 review questions





# COMPENSATION MANAGEMENT

## CHAPTER 9 (Study unit 8) Pay-for-Performance

# Chapter Topics

- What Behaviors Do Employers Care About?
- What Does It Take to Get These Behaviors? What Theory and Research Say
- What Does It Take to Get These Behaviors? What Compensation People Say
- Total Reward System: Besides Money, Other Rewards Influence Behavior!
- Does Compensation Motivate Behavior? General Comments
- Does Compensation Motivate Behavior? Specific Comments
- Designing a Pay-for-Performance Plan
- Your Turn: Burger Boy

# What Behaviors Do Employers Care About?

- Employers want employees to perform in ways that lead to better organizational performance
- Organizational strategy is the guiding force that determines what kinds of employee behaviors are needed
- Behaviors that compensation needs to reinforce
  - Compensation should be sufficiently attractive to make recruiting and hiring good potential employees possible (attraction)
  - Need to make sure the good employees stay with the company (retention)
  - Need to find ways to motivate employees to perform well on their jobs—to take their knowledge and abilities and apply them in ways that contribute to organizational performance

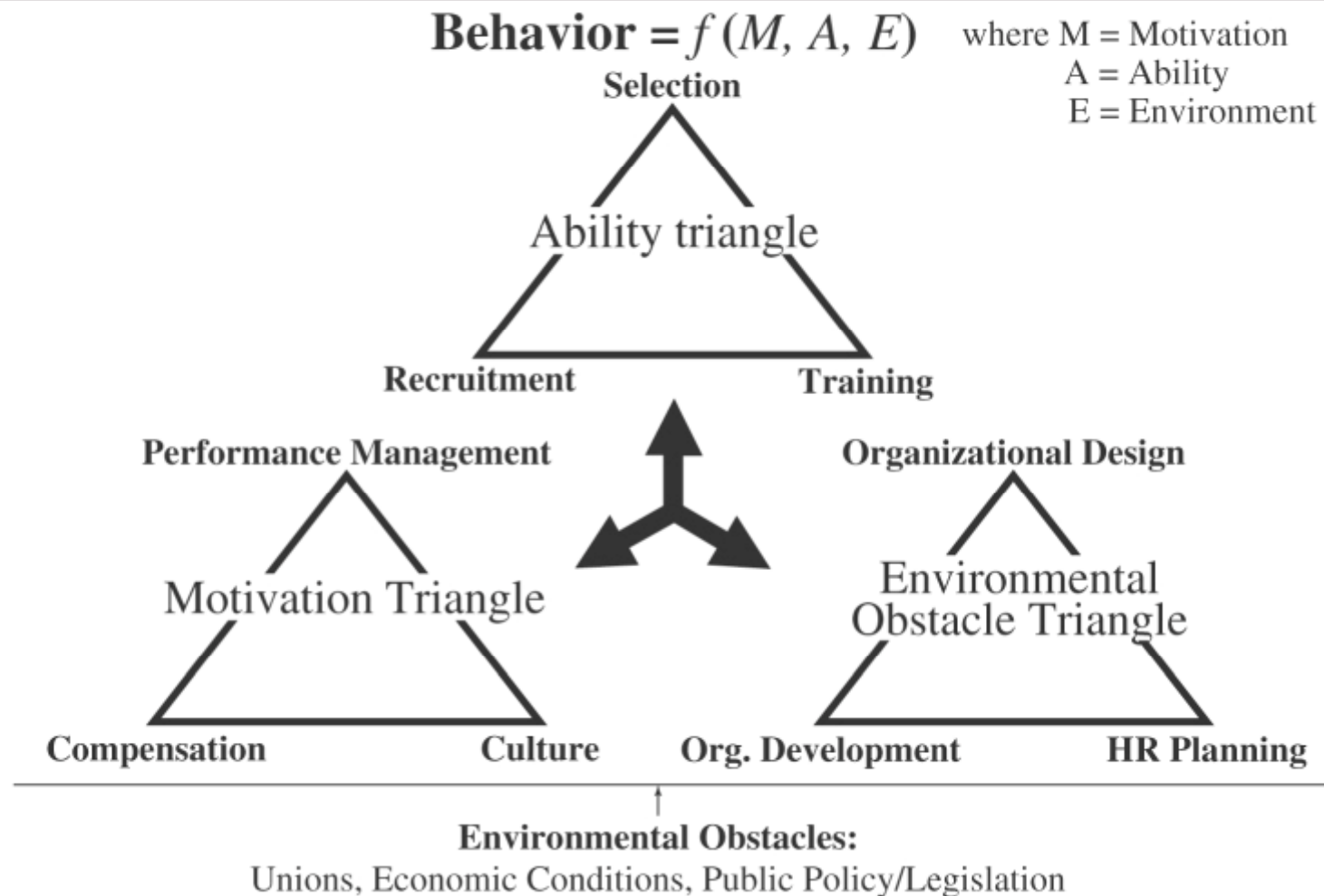
# Exhibit 9.1: The Cascading Link between Organization Strategy and Employee Behavior

**EXHIBIT 9.1** The Cascading Link between Organization Strategy and Employee Behavior



# Exhibit 9.2: The Big Picture, or Compensation Can't Do It Alone!

**EXHIBIT 9.2**  
The Big  
Picture, or  
Compensation  
Can't Do It  
Alone!



# What Behaviors Do Employers Care About? (cont.)

- Performance measurement
  - Need to accurately measure performance to tell if compensation efforts are working
- Performance management
- How do we get good employment prospects to **join** our company?
- How do we **retain** these good employees once they join?
- How do we get employees to **develop skills** for current and future jobs?
- How do we get employees to **perform well** on their current job?

# Exhibit 9.3 Performance Measurement Relates to Compensation Strategy

**EXHIBIT 9.3 Performance Measurement Relates to Compensation Strategy**

		Variability in Organizational Performance	
		Low variability: Few swings in overall corporate performance	High variability: Regular and large swings in overall corporate performance
Variability/ ease of measurement in individual performance	Unstable, unclear, and changing objectives	Cell A—provide wide range of rewards beyond just money. Include significant incentive component.	Cell B—provide wide range of rewards beyond just money. Emphasize base pay with low-incentive portion.
	Stable and easily measured	Cell C—emphasize monetary rewards with large-incentive component.	Cell D—emphasize monetary rewards: large base pay with low-incentive portion.

# What Motivates Employees?

- In the simplest sense, motivation involves three elements:
  1. What is important to a person?
  2. Offering it in exchange for some
  3. Desired behavior
- Refer to Exhibit 9.4 in the prescribed book regarding the different motivation theories



# What Compensation People Say

- Employees learned what behaviors were important as part of the socialization process
- Compensation is designed to support this risk-taking behavior
  - Total Reward System
    - Compensation is but one of many rewards that influence employee behavior

# Exhibit 9.5: Components of a Total Reward System

## EXHIBIT 9.5 Components of a Total Reward System

1. Compensation	Wages, commissions, and bonuses
2. Benefits	Vacations, health insurance
3. Social interaction	Friendly workplace
4. Security	Stable, consistent position and rewards
5. Status/recognition	Respect, prominence due to work
6. Work variety	Opportunity to experience different things
7. Workload	Right amount of work (not too much, not too little)
8. Work importance	Is work valued by society
9. Authority/control/autonomy	Ability to influence others; control own destiny
10. Advancement	Chance to get ahead
11. Feedback	Receive information helping to improve performance
12. Work conditions	Hazard free
13. Development opportunity	Formal and informal training to learn new knowledge skills/abilities

# Exhibit 9.6: Wage Components

**EXHIBIT 9.6 Wage Components**

Wage Component	Definition	Level of Risk to Employee
Base pay	The guaranteed portion of an employee's wage package.	As long as employment continues, this is the secure portion of wages.
Across the board	Wage increase granted to all employees, regardless of performance. Size related to some subjective assessment of employer about ability to pay. Typically an add-on to base pay in subsequent years.	Some risk to employee since at discretion of employer. But not tied to performance differences, so risk lower in that respect.
Cost-of-living increase	Same as across-the-board increase, except magnitude based on change in cost of living (e.g., as measured by CPI).	Same as-across-the-board increases.
Merit pay	Wage increase granted to employee as function of some assessment of employee performance. Adds on to base pay in subsequent years.	Two types of risk faced by employees. Size of total merit pool at discretion of employer (risk element), and individual portion of pool depends on performance, which also is not totally predictable.
Lump-sum bonus	As with merit pay, granted for individual performance. Does not add into base pay, but is distributed as a one-time bonus.	Three types of risks faced here. Both types mentioned under merit pay, plus not added into base—requires annually "re-earning" the added pay
Individual incentive	Sometimes this variable pay is an add-on to a fixed base pay. The incentive component ties increments in compensation directly to extra individual production (e.g., commission systems, piece rate). While measures of performance are typically subjective with merit and lump-sum components, this form of variable pay differs because measures of performance are objective (e.g., sales volume).	Most risk compensation component if sole element of pay, but often combined with a base pay. No or low fixed-base pay means each year employee is dependent upon number of units of performance to determine pay.
Success-sharing plans	A generic category of pay add-on (variable pay) which is tied to some measure of group performance, not individual performance. Not added into base pay. Distinguished from risk-sharing plans, below, because employees share in any success—performance above standard—but are not penalized for performance below standard.	All success-sharing plans have risks noted in above pay components plus the risk associated with group performance measures. Now individual worker is also dependent upon the performance of others included in the group.

# Exhibit 9.6: Wage Components (con't)

<b>Wage Component</b>	<b>Definition</b>	<b>Level of Risk to Employee</b>
<ul style="list-style-type: none"><li>• Gain sharing</li></ul>	Differs from profit sharing in that goal to exceed is not financial performance of organization but some cost index (e.g., labor cost is most common, might also include scrap costs, utility costs).	Less risk to individual than profit sharing because performance measure is more controllable.
<ul style="list-style-type: none"><li>• Profit sharing</li></ul>	Add-on linked to group performance (team, division, total company) relative to exceeding some financial goal.	Profit measures are influenced by factors beyond employee control (e.g., economic climate, accounting write-offs). Less control means more risk.
Risk sharing plans	Generic category of pay add-on (variable pay) that differs from success sharing in that employee not only shares in the successes but also is penalized during poor performance years. Penalty is in form of lower total compensation in poor corporate performance years. Reward, though, is typically higher than that for success-sharing programs in high performance years.	Greater risk than success-sharing plans. Typically, employees absorb a "temporary" cut in base pay. If performance targets are met, this cut is neutralized by one component of variable pay. Risk to employee is increased, though because even base pay is no longer totally predictable.

# Does Compensation Motivate Behavior?

## Specific Comments

- Do people **join** a firm because of pay?
- Do people **stay** in a firm (or leave) because of pay?
- Do employees more readily agree to **develop job skills** because of pay?
- Do employees **perform better** on their jobs because of pay?

# Do People Join a Firm Because of Pay?

- Key factors affecting a person's decision to join a firm
  - Level of pay
  - Pay system characteristics
- Job candidates look for organizations that “fit” their personalities
- Reward systems should be designed to attract people with desired
  - Personalities
  - Values

# Do People Stay in a Firm (Or Leave) Because of Pay?

- Factors impacting turnover
  - Pay based on individual performance
  - Group incentive plans
  - Level of employee satisfaction with pay
  - Type of pay system
- Other rewards affect the decision to stay
  - Work variety and challenge
  - Development opportunity
  - Social
  - Status recognition
  - Work importance
  - Benefits

# Do Employees More Readily Agree to Develop Job Skills Because of Pay?

- Evidence is unclear
- Relevance of skill-based pay



# Do Employees Perform Better on Their Jobs Because of Pay?

- Not clear if performance of individuals can be increased by tying it to pay
- If the incentive depends on individual performance, applicants find the company more attractive
- Team-based incentives, in contrast, are less attractive
- A number of recent studies provide strong evidence that pay for performance has a direct and, at times, substantial impact on firm performance

# Exhibit 9.7: Examples of Group Incentive Plans

## EXHIBIT 9.7 Examples of Group Incentive Plans

Company	Pay Component
Corning	Competitive base pay. Group bonus based on meeting certain quality measures, customer satisfaction measures, and production targets.
Nucor	Plant manager base pay 25 percent below market. Five percent of excess over target goes to bonus. Bonus often equals base pay in amount.
PepsiCo	Competitive base pay. All employees get stock options equal to 10 percent of base pay. Employees share in corporate triumphs and failures as stock prices rise or fall.

# Designing A Pay-For-Performance Plan

- ***Efficiency***

- Strategy: does the pay-for-performance plan support corporate objectives? Does it link well with HR strategy and objectives?
- Structure: is the structure of the organisation sufficiently decentralized to allow different operating units to create flexible variations on a general pay-for-performance plan?
- Standards
  - Objectives
  - Measures
  - Eligibility
  - Funding

# Designing A Pay-For-Performance Plan (cont.)

- Equity/Fairness
  - Distributive justice: amount that is distributed to employees, does the employee view it as fair?
  - Procedural justice: Was a fair procedure used to determine the amount of rewards employees receive?
  - Communications is key in fairness
- Compliance
  - Comply with existing laws
  - Enhance and maintain firm's reputation

# Your turn

Answer the end of chapter 9 review questions



# COMPENSATION MANAGEMENT

## CHAPTER 8 (Study unit 7)

### Designing pay levels, mix and pay structures

# Chapter Topics

- Major Decisions
- Specify Competitive Pay Policy
- The Purpose of a Survey
- Select Relevant Market Competitors
- Design the Survey
- Interpret Survey Results and Construct a Market line
- From Policy to Practice: The Pay-Policy Line

## Chapter Topics (cont.)

- From Policy to Practice: Grades and Ranges
- From Policy to Practice: Broad Banding
- Balancing Internal and External Pressures: Adjusting the Pay Structure
- Market Pricing
- Review



# Exhibit 8.1 Determining Externally Competitive Pay Levels and Structures

## EXHIBIT 8.1 Determining Externally Competitive Pay Levels and Structures



### Some Major Decisions in Pay-Level Determination

- Specify pay-level policy.
- Define purpose of survey.
- Specify relevant market.
- Design and conduct survey.
- Interpret and apply result.
- Design grades and ranges or bands.

# Specify Competitive Pay Policy

- A survey is the systematic process of collecting and making judgments about the compensation paid by other employers
- Surveys provide the data for translating policy into pay levels, pay mix, and structures

# The Purpose of a Survey

An employer conducts or participates in a survey for a number of reasons:

- Adjust the pay level in response to changing rates paid by competitors
- Set the mix of pay forms relative to that paid by competitors
- Establish or price a pay structure
- Analyze pay-related problems
- Estimate the labor costs of product/service market competitors

# Select Relevant Market Competitors

- Relevant labor market includes employers who compete
  - For same occupations or skills
  - For employees in same geographic area
  - With same products and services
- Fuzzy markets

# Design the Survey

- Who should be involved?
- How many employers?
  - Publicly Available Data
  - “Word-of-mouth”
  - Where are the standards?
- Which Jobs to include?
  - Benchmark-job approach
    - Exhibit 8.6: Benchmarks
  - Low-High approach
  - Benchmark conversion approach

# Exhibit 8.6: Benchmarks

**EXHIBIT 8.6** Benchmarks

Managerial Group	Technical Group	Manufacturing Group	Administrative Group
Vice Presidents	Head/Chief Scientist	Assembler I Inspector I	Administrative Assistant
Division General Managers	Senior Associate Scientist	Packer	Principal Administrative Secretary
Managers	Associate Scientist	Material Handler Inspector II	Administrative Secretary
Project Leaders	Scientist	Assembler II	Word Processor
Supervisors	Technician	Drill Press Operator Rough Grinder	Clerk/Messenger
		Machinist I Coremaker	

# Design the Survey (cont.)

- What information to collect?
  - Organization data
  - Total compensation data

# Exhibit 8.7: Possible Survey Data Elements and Rationale

**EXHIBIT 8.7 Possible Survey Data Elements and Rationale**

Basic Elements	Examples	Rationale
<b>Nature of Organization</b>		
Identification	Company, name, address, contact person	Further contacts
Financial performance	Assets, sales, profits, cash flow	Indicates nature of product/service markets, ability to pay, size, and financials
Size	Profit centers, product lines	Importance of specific job groups
Structure	Total number of employees Organizational charts Percent of employees at each level	Impact on labor market Indicates how business is organized Indicates staffing pattern
<b>Nature of Total Compensation System</b>		
Cash forms used	Base pay, pay-increase schedules, long- and short-term incentives, bonuses, cost-of-living adjustments, overtime and shift differentials	Indicate the mix of compensation offered; used to establish a comparable base
Noncash forms used	Benefits and services, particularly coverage and contributions to medical and health insurance and pensions	
<b>Incumbent and Job</b>		
Date	Date survey data in effect	Update to current date
Job	Match generic job description	Indicates degree of similarity with survey's key jobs
Individual	Reporting levels Years since degree, education, date of hire	Scope of responsibilities Indicates training tenure
Pay	Actual rates paid to each individual, total earnings, last increase, bonuses, incentives	
<b>HR Outcomes</b>		
Productivity	Revenues/employee	Reflect organization performance and efficiency
Total labor costs	Revenues/labor costs Number of employees × (averages wages + benefits)	Major expense
Attraction	Yield ratio: Number accepting offers/Number of job offers	Reveals recruiting success, a compensation objective
Retention	Turnover rate: Number of high or low performers who leave/ Number of employees	Reveals outflow of people, which is related to a compensation objective
Employee views	Total pay satisfaction	Reveals what employees think about their pay



# Exhibit 8.8: Advantages and Disadvantages of Measures of Compensation

## EXHIBIT 8.8 Advantages and Disadvantages of Measures of Compensation

Base pay	Tells how competitors are valuing the work in similar jobs	Fails to include performance incentives and other forms, so will not give true picture if competitors offer low base but high incentives.
Total cash (base + bonus)	Tells how competitors are valuing work; also tells the cash pay for performance opportunity in the job	All employees may not receive incentives, so it may overstate the competitors' pay; plus, it does not include long-term incentives.
Total compensation (base + bonus + stock options + benefits)	Tells the total value competitors place on this work	All employees may not receive all the forms. Be careful: Don't set base equal to competitors' total compensation. Risks high fixed costs.

# Interpret Survey Results and Construct a Market Line

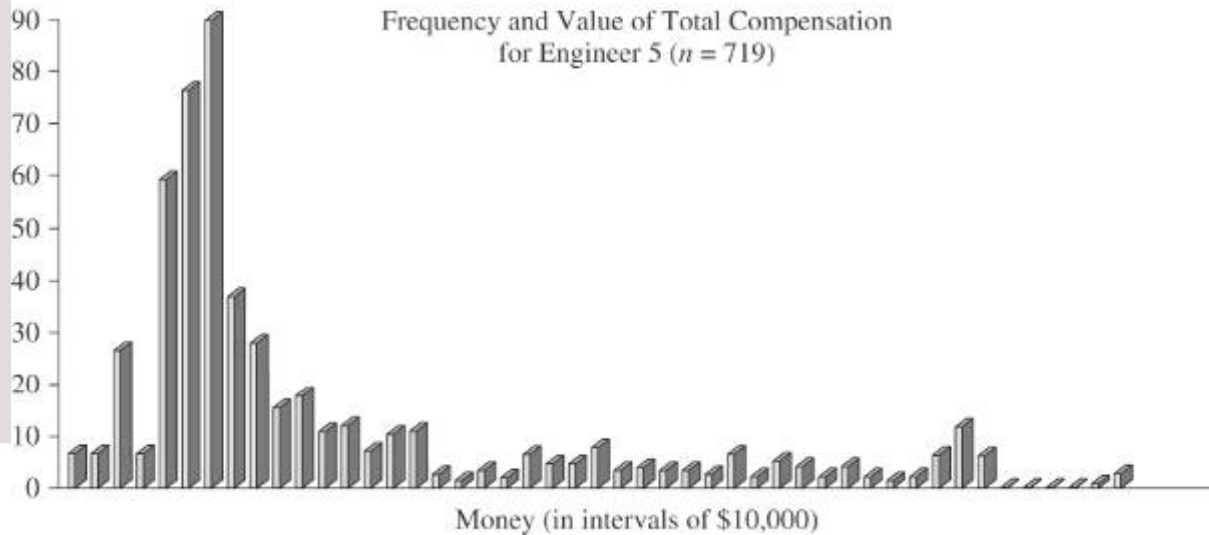
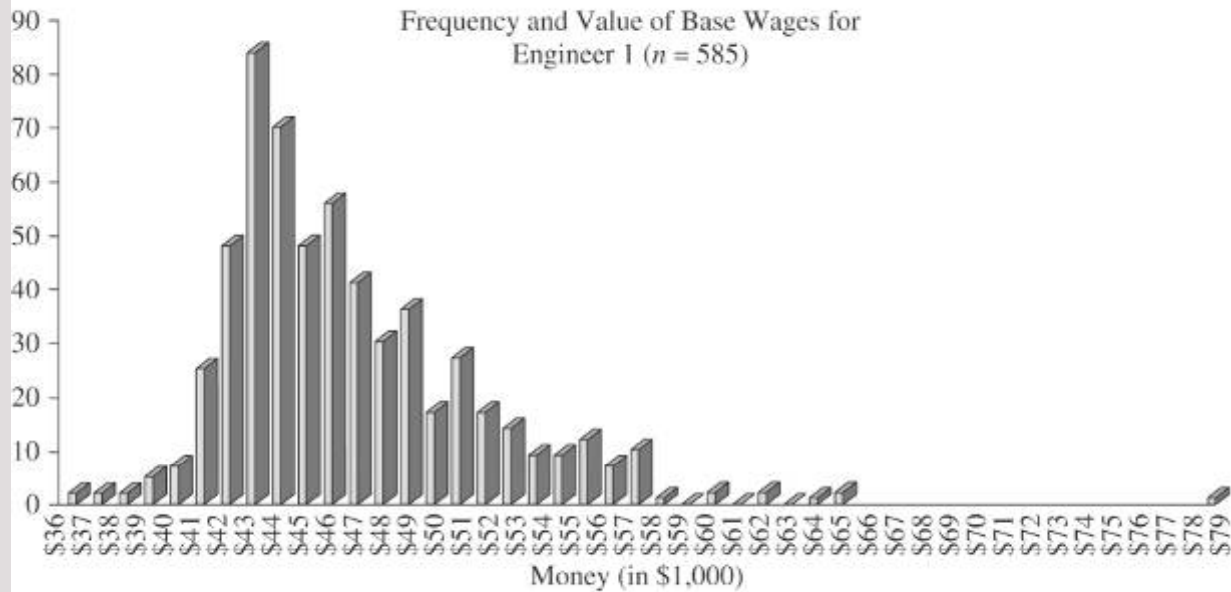
- Verify data
  - Check accuracy of job matches
    - Survey leveling
  - Check for anomalies
    - Does any *one* company dominate?
    - Do all employers show similar patterns?
    - Outliers?

# Interpret Survey Results and Construct a Market Line (cont.)

- Statistical analysis
  - Frequency distribution
  - Measures of central tendency
    - Mode
    - Mean
    - Median
    - Weighted mean
  - Measures of variation
    - Standard deviation
    - Quartiles and percentiles

# Exhibit 8.11 Frequency Distributions

**EXHIBIT 8.11** Frequency Distributions

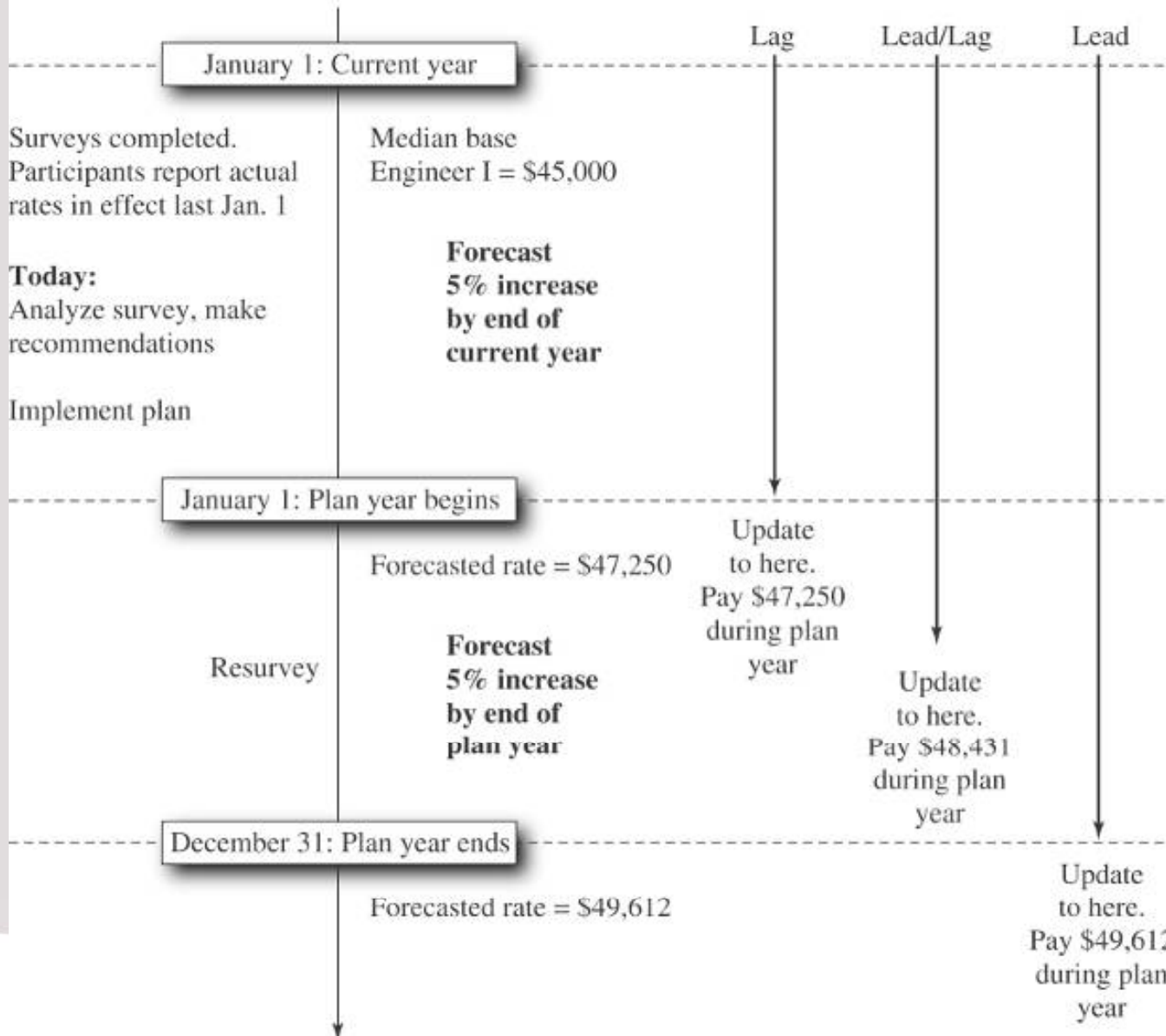


# Interpret Survey Results and Construct a Market Line (cont.)

- Update the survey data
  - Aging or trending : Pay data is updated to forecast the competitive rates for the future date when the pay decisions will be implemented

# Exhibit 8.13 Choices for Updating Survey Data Reflect Pay Policy

**EXHIBIT 8.13** Choices for Updating Survey Data Reflect Pay Policy

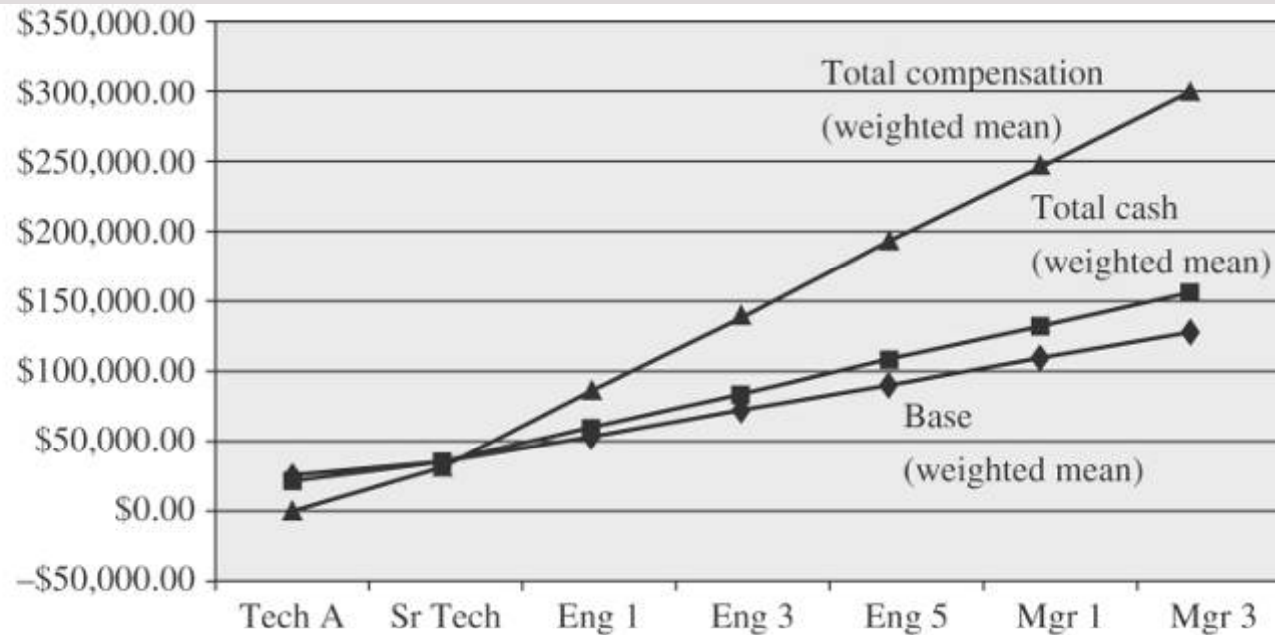


# Construct a Market Pay Line

- A market line links a company's benchmark jobs on the horizontal axis with market rates paid by competitors on the vertical axis. It summarizes the distribution of going rates paid by competitors in the market
- Approaches to constructing a market pay line
  - Free hand approach
  - Regression Analysis

# Exhibit 8.14: From Regression Results to a Market Line

**EXHIBIT 8.14**  
From  
Regression  
Results to a  
Market Line



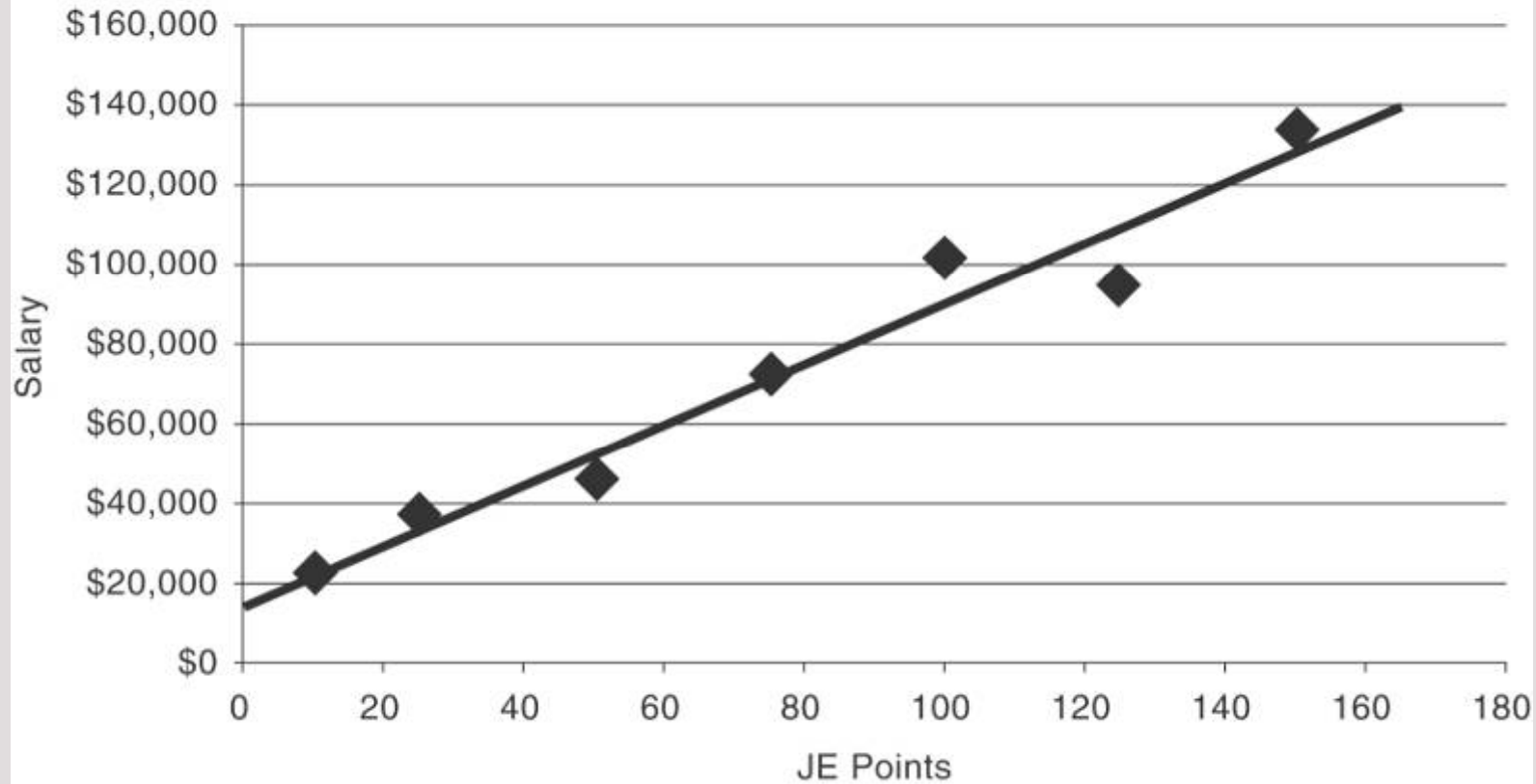
## JOB

Job	JEPTs	Predicted Base, Wtd Mean	Predicted Cash, Wtd Mean	Predicted Total Comp
Tech A	10	\$23,057.96	\$20,543.71	-\$1,330.36
Sr Tech	25	\$34,361.06	\$35,116.51	\$31,172.24
Eng 1	50	\$53,199.56	\$59,404.51	\$85,343.24
Eng 3	75	\$72,038.06	\$83,692.51	\$139,514.24
Eng 5	100	\$90,876.56	\$107,980.51	\$193,685.24
Mgr 1	125	\$109,715.06	\$132,268.51	\$247,856.24
Mgr 3	150	\$128,553.56	\$156,556.51	\$302,027.24



# Exhibit 8.15: Understanding Regression

**EXHIBIT 8.15** Understanding Regression



Tech A	Sr Tech	Eng 1	Eng 3	Eng 5	Mgr 1	Mgr 3
--------	---------	-------	-------	-------	-------	-------

Market measure  
Equation  
R-squared

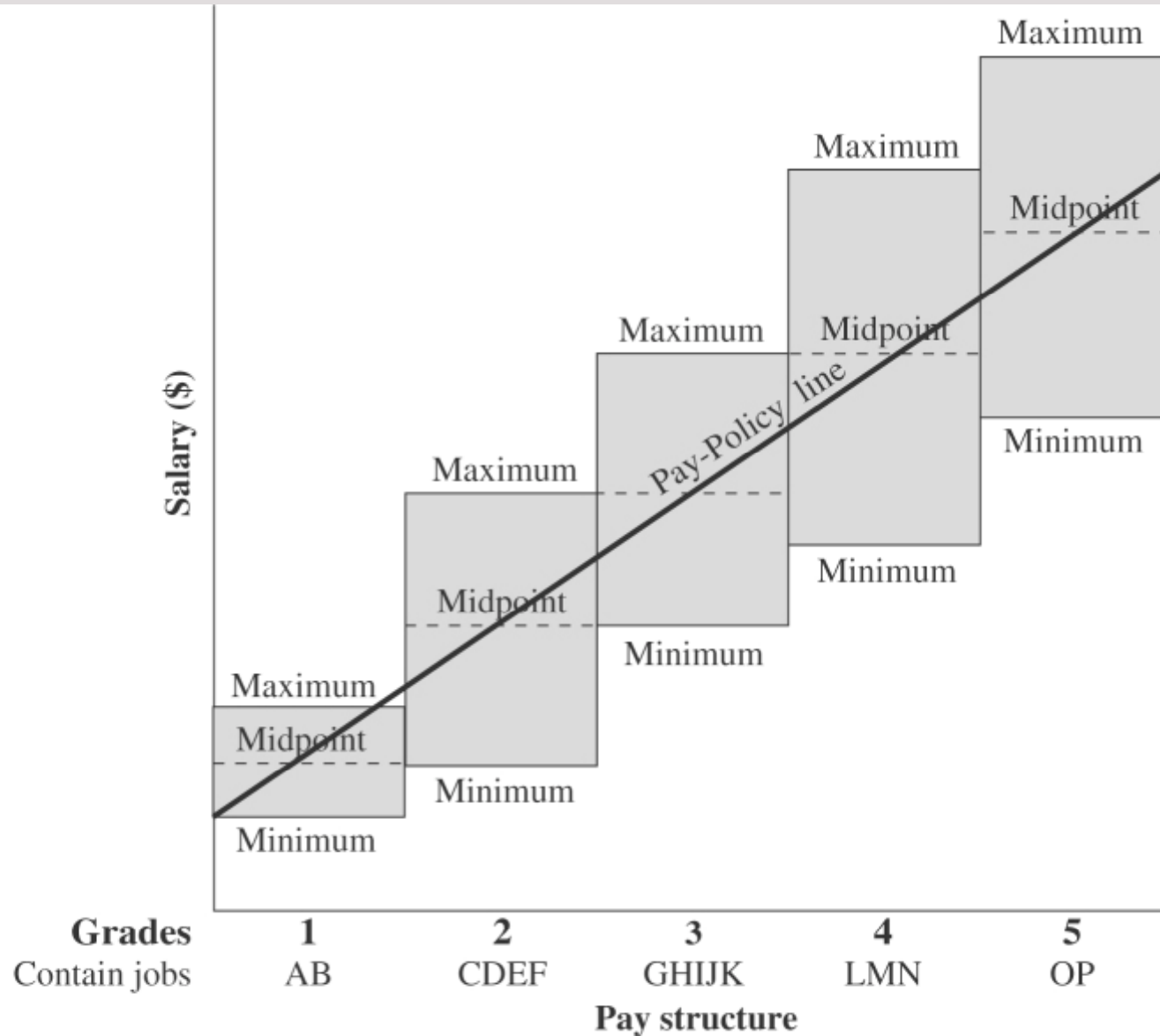
Base wage (weighted mean)  
 $y = 15522.56 + 753.54x$   
0.954

# Combine Internal Structure and External Market Rates

- Two parts of the total pay model have merged
  - Internally aligned structure - Horizontal axis
  - External competitive data - Vertical axis
- Two aspects of pay structure
  - Pay-policy line
  - Pay ranges

# Exhibit 8.16: Develop Pay Grades

**EXHIBIT 8.16**  
**Develop Pay**  
**Grades**



# From Policy to Practice: The Pay Policy Line

- Approaches to translate external competitive policy into practice
  - Choice of measure
    - 50<sup>th</sup> percentile for base pay
    - 75<sup>th</sup> percentile for total compensation
  - Updating
- Policy line as percent of market line
  - Specify a percent above or below market line an employer intends to match
  - Other options
    - Pay among the leaders
    - Lead for some job families and lag for others

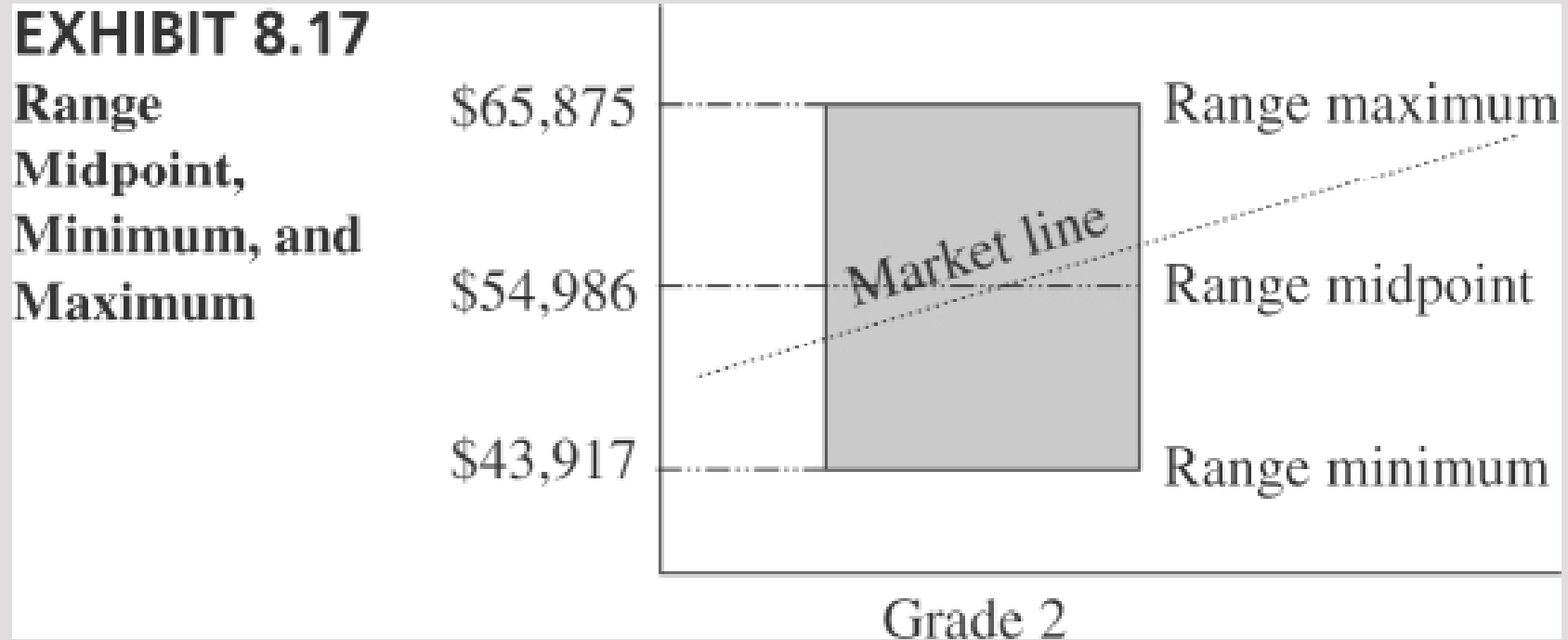
# From Policy to Practice: Grades and Ranges

- Why bother with grades and ranges?
  - Offer flexibility to deal with pressures from external markets and differences among firms
    - Differences in quality among individuals applying for work
    - Differences in the productivity or value of these quality variations
    - Differences in the mix of pay forms competitors use
- A pay range exists whenever two or more rates are paid to employees in the same job
  - Recognize individual performance differences with pay
  - Meet employees' expectations that their pay will increase over time, even in the same job
  - Encourage employees to remain with the organization

# From Policy to Practice: Grades and Ranges (cont.)

- Develop grades
  - Grades enhance an organization's ability to move people among jobs with no change in pay
  - Each grade will have its own pay range
  - All the jobs within a single grade will have the same pay range
- Establish range midpoints, minimums, and maximums
  - What size should the range be?
    - Size of range based on judgment about how ranges support
    - Career paths
    - Promotions
    - Other organization systems

## Exhibit 8.17: Range Midpoint, Minimum, and Maximum



# From Policy to Practice: Grades and Ranges (cont.)

- Typical ***range spread***

- Top-level management positions – 30 to 60% above and below midpoint
- Midlevel professional and managerial positions – 15 to 30% above and below midpoint
- Office and production positions – 5 to 15% above and below midpoint

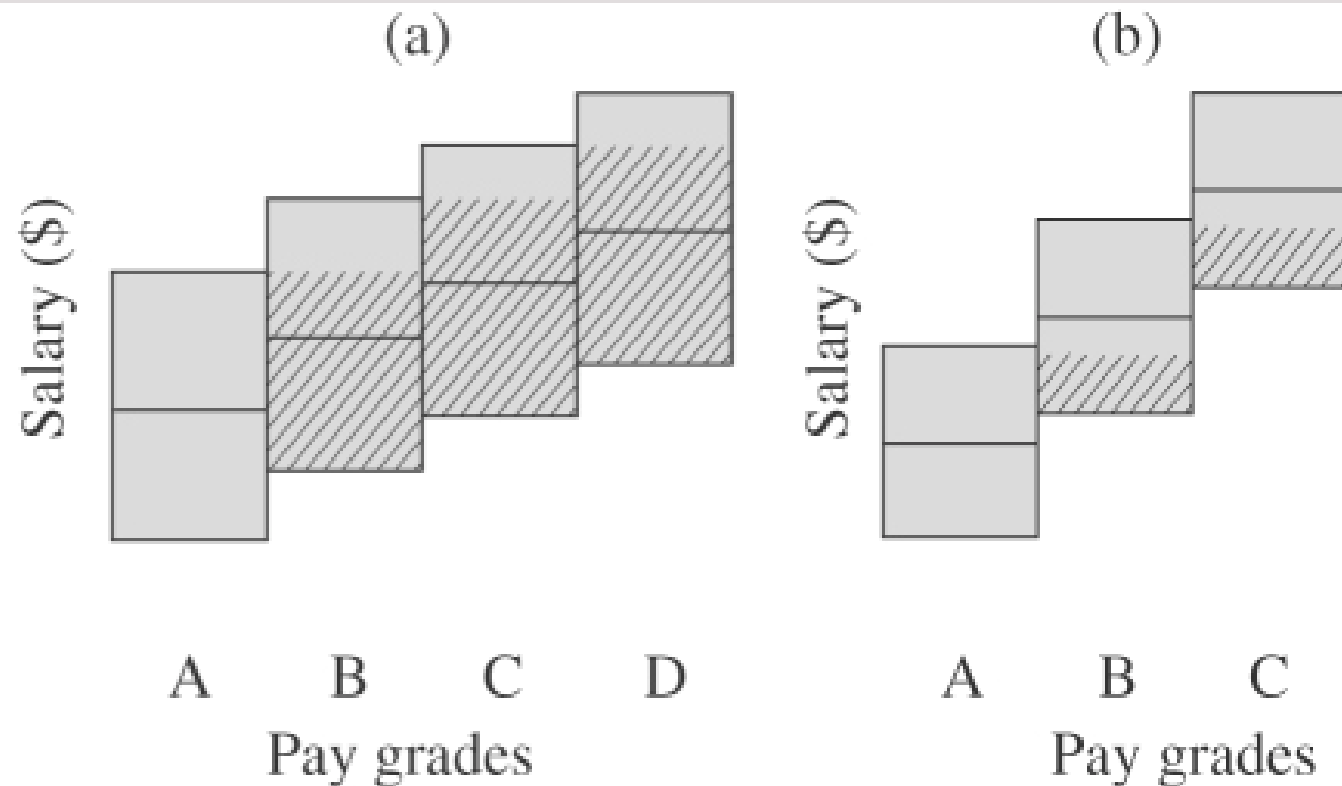


# Overlap

- Refer to Exhibit 8.18 in the next slide
- Importance of **Overlap**
- High degree of overlap and low midpoint differentials indicates small differences in the value of the jobs in the adjoining grades
- Small ranges with less overlap
- Being promoted from one grade to another may include a title change but not much change in pay
- Smaller ranges (Exhibit 8.18 (b)) create less overlap. This permits the manager to reinforce a promotion into a new grade with a larger pay increase. Downside to this – fewer opportunities for promotion

# Exhibit 8.18: Range Overlap

**EXHIBIT 8.18**  
**Range Overlap**

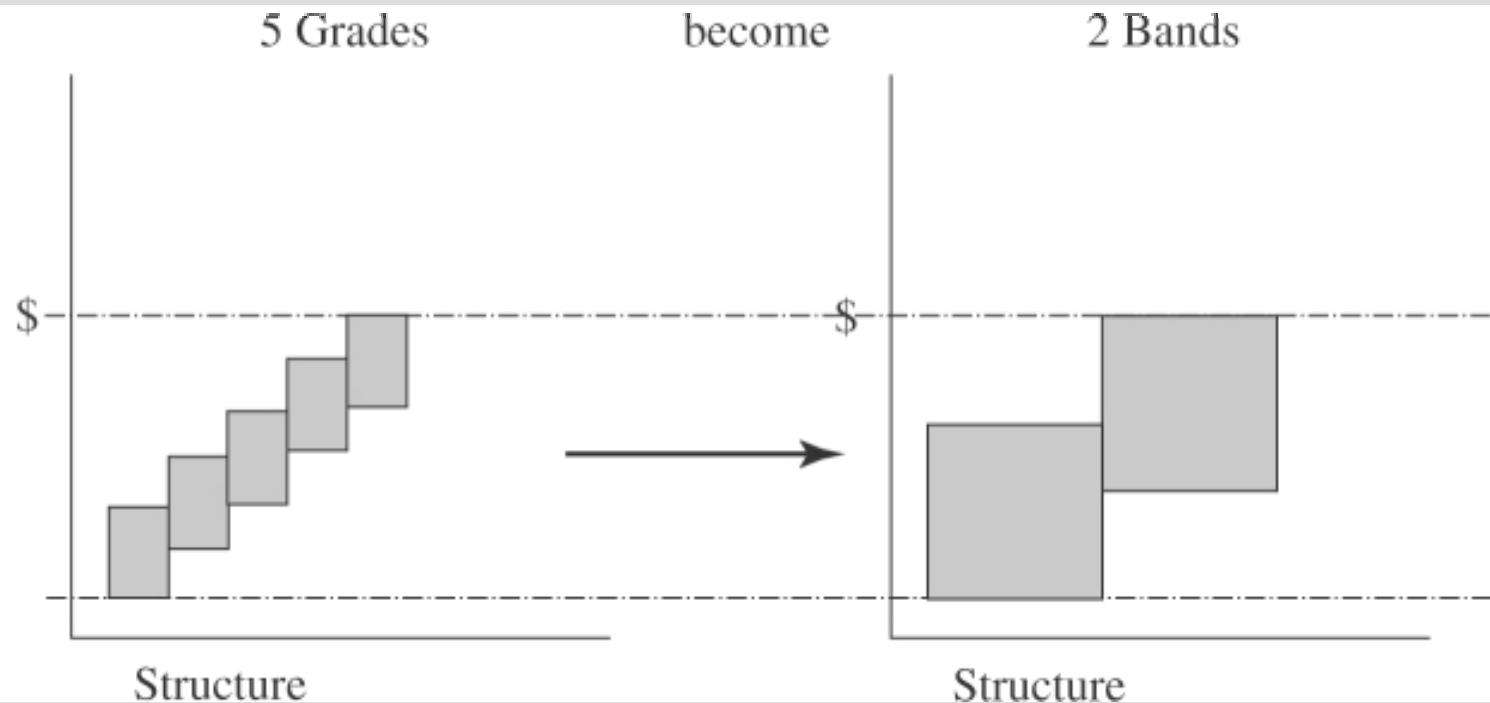


# From Policy to Practice: Broad Banding

- Involves collapsing salary grades into a few broad bands, each with a sizable range
  - One minimum and one maximum
  - Range midpoint often not used: band encompasses so many differing values
- Purposes
  - Provide flexibility to define job responsibilities more broadly
  - Foster cross-functional growth and development
  - Ease mergers and acquisitions

# Exhibit 8.19: From Grades to Bands

**EXHIBIT 8.19**  
From Grades  
to Bands



# Exhibit 8.20: Contrasts Between Ranges and Bands

## EXHIBIT 8.20

### Contrasts between Ranges and Bands

#### Ranges Support

Some flexibility within controls  
Relatively stable organization design  
Recognition via titles or career progression  
Midpoint controls, comparatives  
Controls designed into system  
Give managers "freedom with guidelines"  
To 150 percent range-spread

#### Bands Support

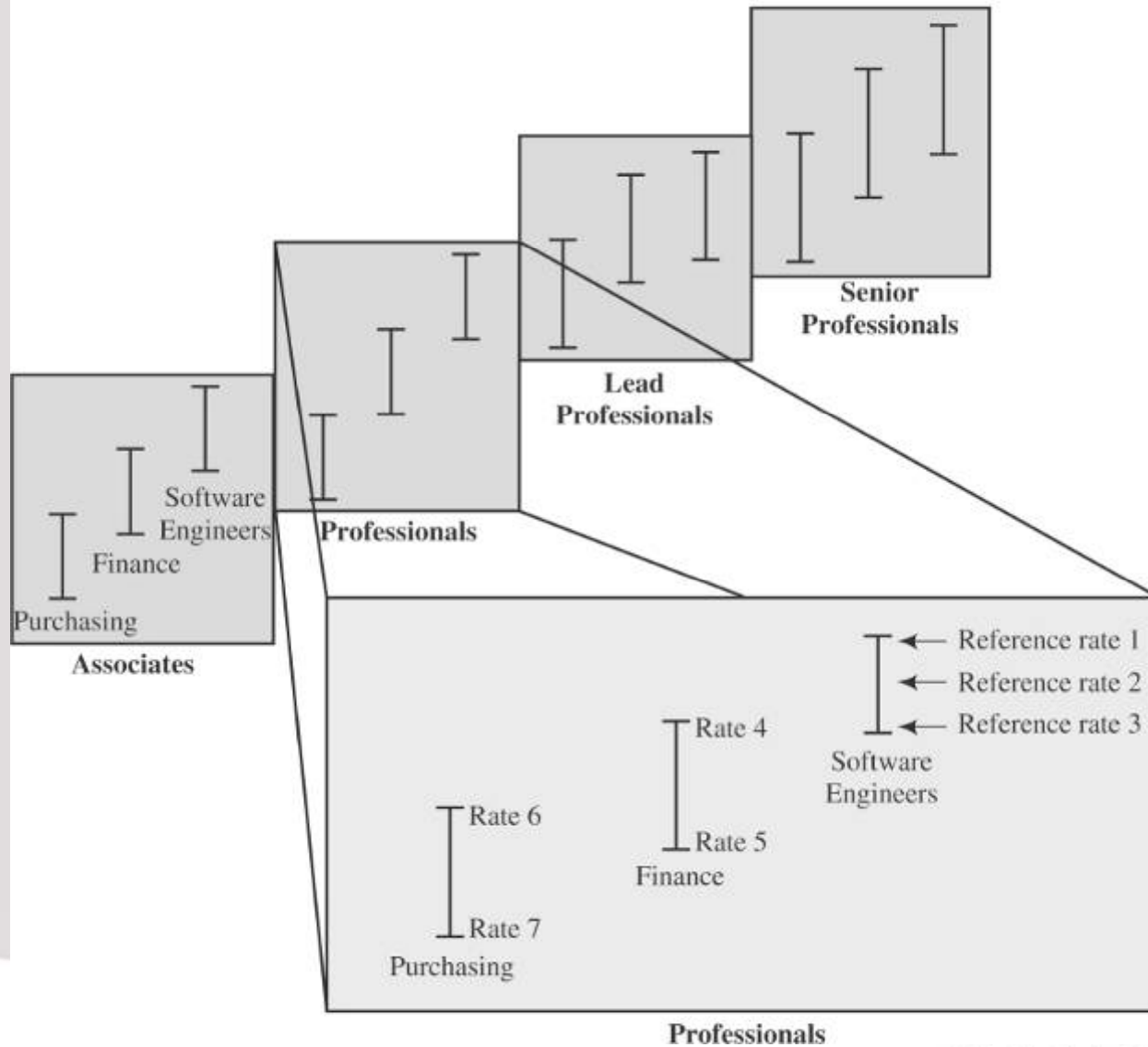
Emphasis on flexibility within guidelines  
Global organizations  
Cross-functional experience and lateral progression  
Reference market rates, shadow ranges  
Controls in budget, few in system  
Give managers "freedom to manage" pay  
100–400 percent spread

# Steps Involved in Broad Banding

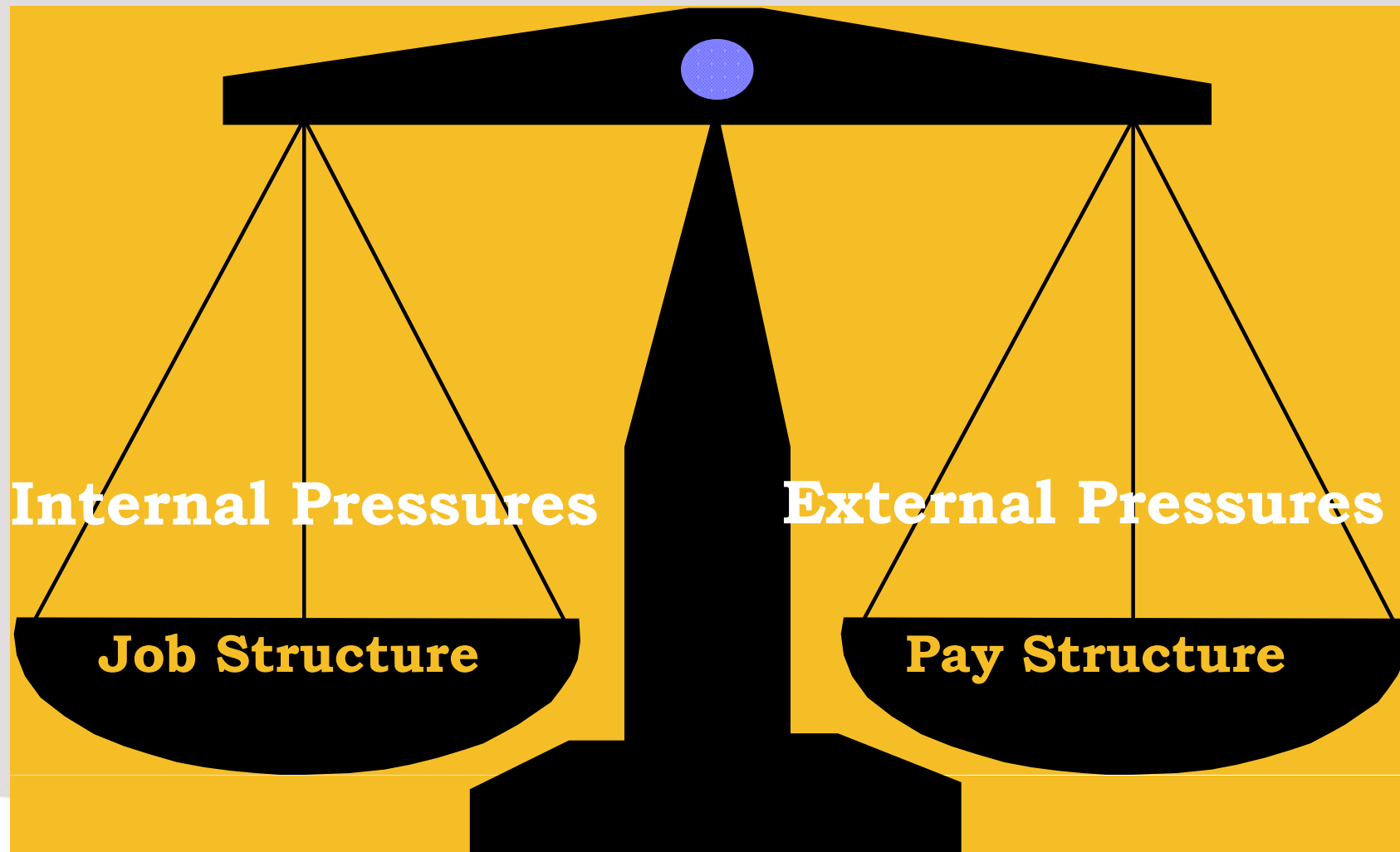
- Set the number of bands
- Price the bands: Reference market rates
  - Reference rates
- Flexibility-Control

# Exhibit 8.21: Reference Rates Within Bands

EXHIBIT 8.21 Reference Rates within Bands



# Balancing Internal and External Pressures: Adjusting the Pay Structure





# Market Pricing

- Issues
  - Validity of market data
  - Use of competitors' pay decisions as primary determinant of pay structure
  - Lack of value added via internal alignment
  - Difficult-to-imitate aspects of pay structure are deemphasized
  - Fairness
- Market pricing: pay strategies that emphasize external competitiveness and deemphasize internal alignment
  - Sets pay structures almost exclusively on external market rates
- Objective
  - Is to base most of the internal pay structure on external rates, breaking down the boundaries between the internal organization and the external market forces

# Your turn

Answer the end of chapter 8 review questions

# COMPENSATION MANAGEMENT

## CHAPTER 7 (Study unit 6) Defining Competitiveness

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### Chapter Topics

- Compensation Strategy: External Competitiveness
- What Shapes External Competitiveness?
- Labor Market Factors
- Modifications to the Demand Side
- Modifications to the Supply Side
- Product Market Factors and Ability to Pay

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## Learning objectives

After studying Chapter 7, students should be able to:

- Explain the importance of external competitiveness to the pay model.
- Discuss the factors that influence external competitiveness.
- Discuss the differences among labor market, product market, and organizational factors in determining external competitiveness.
- Explain the different pay policy positions and the consequences of using each.

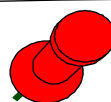
## Chapter Topics (cont.)

- Organization Factors
- Relevant Markets
- Competitive Pay Policy Alternatives
- Consequences of Pay-Level and Mix Decisions: Guidance from the Research
- Your Turn: Sled Dog Software
- Still Your Turn: Fit the Pay Mix Policy to the Compensation Strategy

## Compensation Strategy: External Competitiveness

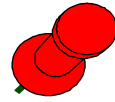
- External competitiveness is expressed in practice by:
  - Setting a pay level that is above, below, or equal to that of competitors
  - Determining mix of pay forms relative to those of competitors
- Pay level and pay mix decisions focus on:
  - Controlling costs
  - Attracting and retaining employees

## What Is External Competitiveness?



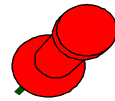
***External competitiveness***  
**refers to pay relationships**  
**among organizations - an**  
**organization's pay relative to**  
**its competitors.**

## What is Pay Level?



***Pay level* refers to the average of the array of rates paid by an employer: (base + bonuses + benefits + value of stocks) / number of employees.**

## What are Pay Forms?



***Pay forms* are the various types of payments, or pay mix, that make up total compensation.**

## Pay Level and Pay Mix: Two Objectives

**Control Costs**

**Attract and Retain  
Employees**

## Pay Level Decisions Impact Labor Cost

**Labor Costs**

=

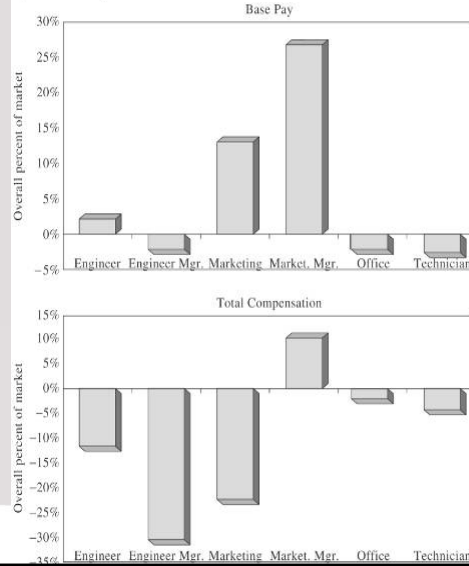
**Pay Level**

×

**Number of  
Employees**

## Exhibit 7.1: Single Company's Market Position May Differ Depending on Whether Comparing Base Pay or Total Compensation

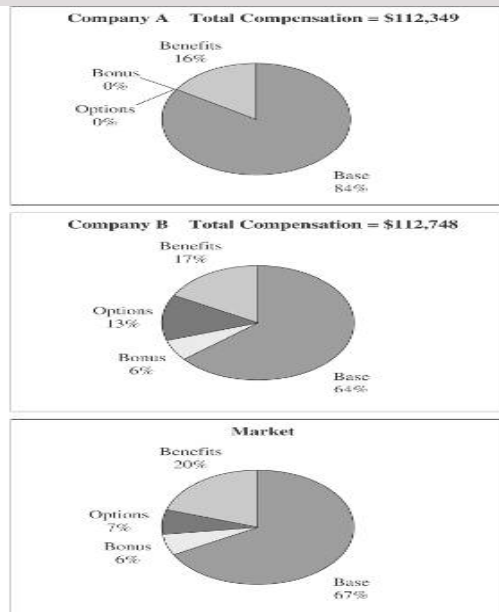
EXHIBIT 7.1 A Single Company's Market Position May Differ Depending on Whether Comparing Base Pay or Total Compensation



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## Exhibit 7.2: Two Companies: Same Total Compensation, Different Mixes

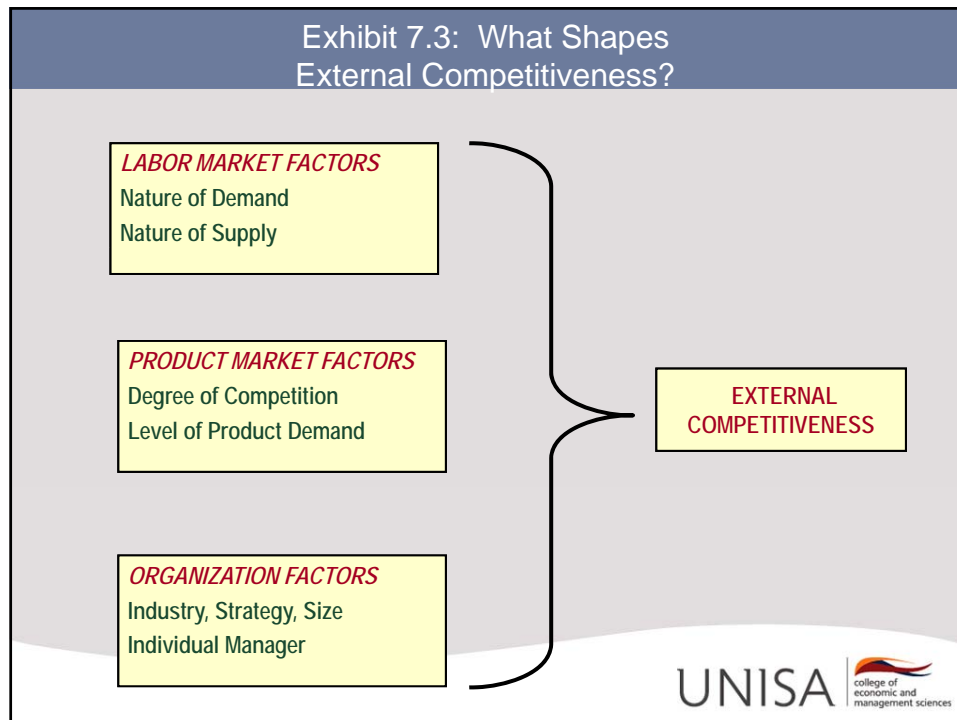
EXHIBIT 7.2 Two Companies: Same Total Compensation, Different Mixes



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## Exhibit 7.3: What Shapes External Competitiveness?



## How Labor Markets Work

- Theories of labor markets begin with four assumptions
  - Employers always seek to maximize profits
  - People are homogeneous and therefore interchangeable
  - Pay rates reflect all costs associated with employment
  - Markets faced by employers are competitive
- Understanding how the market works requires an analysis of the demand and supply of labor
- Demand: focuses on the actions of the employers: How many new hires they seek and what they are willing and able to pay new employees
- Supply: looks at potential employees – their qualifications and the pay they are willing to accept in exchange for their services

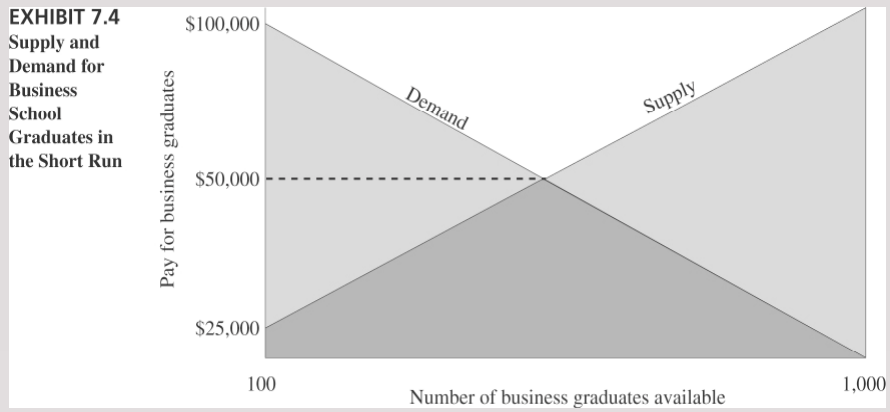
## Labor Demand

- Analysis of *labor demand* indicates how many employees will be hired by an employer
- In the short run, an employer cannot change any factor of production except human resources
  - An employer's level of production can change only if it changes the level of human resources
  - An employer's demand labor coincides with the marginal product of labor

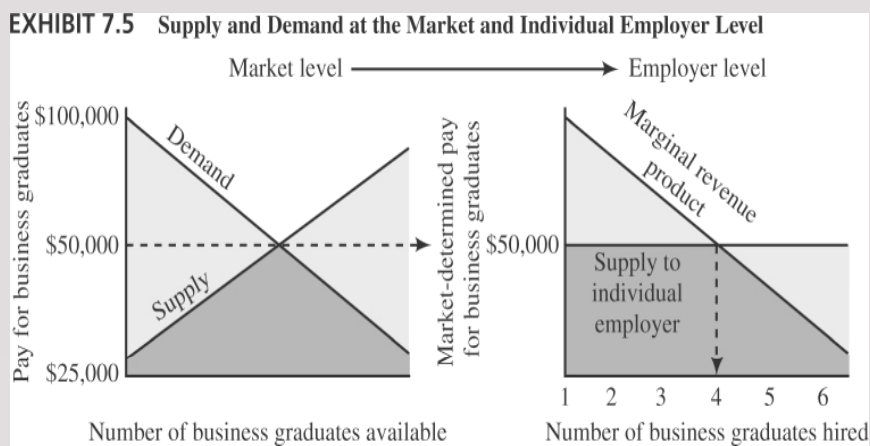
## Labor Demand (cont.)

- **Marginal product of labor**
  - Additional output associated with employment of one additional human resources unit, with other production factors held constant
- **Marginal revenue of labor**
  - Additional revenue generated when firm employs one additional unit of human resources, with other production factors held constant
  - A manager using the marginal revenue product model must:
    - Determine pay level set by market forces
    - Determine marginal revenue generated by each new hire

## Exhibit 7.4: Supply and Demand for Business School Graduates in the Short Run



## Exhibit 7.5: Supply and Demand at the Market and Individual Employer Level



## Labor Supply

- Assumptions on behavior of potential employees
  - Several job seekers
  - Possess accurate information about all job openings
  - No barriers exist to mobility among jobs
- Upward sloping supply curve:
  - More people willing to take a job as pay increases
- If unemployment rates are low, offers of higher pay may not increase supply = everyone who wants to work is already working. If competitors quickly match a higher offer, the employer may face a higher pay level but no increase in supply

## Modifications to the Demand Side

- Economic theories must frequently be revised to account for reality
  - When focus changes from *all* the employers in an economy to a *particular* employer, models must be modified to help understand what actually occurs
- Issue for economists:
  - Why would an employer pay more than what theory states is the market-determined rate?

## Exhibit 7.6: Labor Demand Theories and Implications

EXHIBIT 7.6 Labor Demand Theories and Implications	Theory	Prediction	So What?
	Compensating differentials	Work with negative characteristics requires higher pay to attract workers.	Job evaluation and compensable factors must capture these negative characteristics.
	Efficiency wage	Above-market wages will improve efficiency by attracting workers who will perform better and be less willing to leave.	Staffing programs must have the capability of selecting the best employees; work must be structured to take advantage of employees' greater efforts.
	Signaling	Pay policies signal the kinds of behavior the employer seeks.	Pay practices must recognize desired behaviors with more pay, larger bonuses, and other forms of compensation.

## Compensating Differentials

- According to Adam Smith, "If a job has negative characteristics then employers must offer higher wages to compensate for these negative features"
- For instance, if:
  - Necessary training is very expensive
  - Job security is tenuous
  - Working conditions are disagreeable
  - Chances of success are low

## Efficiency Wage

- According to efficiency-wage theory, high wages may increase efficiency and actually lower labor costs if they:
  - Attract higher-quality applicants
  - Lower turnover
  - Increase worker effort
  - Reduce “shirking”
  - Reduce the need to supervise employees
- Efficiency increases by hiring better employees or motivating present employees to work smarter and harder
- Underlying assumption = pay level determines effort

## Efficiency Wage (cont.)

- Research evidence states:
  - Higher wages associated with lower shirking (measured as number of disciplinary layoffs)
    - Inconclusive evidence on if it was cut enough to offset higher wage bill
  - Higher wages do attract more qualified applicants
    - Also attract more unqualified applicants
- Above-market wage allows organizations to operate with fewer supervisors

## Signaling

- Employers deliberately design pay levels and mix as part of a strategy that signals to both prospective and current employees kinds of behaviors sought
  - Policy of paying below the market for base pay yet offering generous bonuses or training opportunities
- On the supply side of the model:
  - Suppliers of labor signal to potential employers
  - Characteristics of applicants, and organization decisions about pay level and mix act as signals that help communicate

## Exhibit 7.7: Supply Side Theories and Implications

EXHIBIT 7.7 Supply Side Theories and Implications	Theory	Prediction	So What?
	Reservation wage	Job seekers will not accept jobs whose pay is below a certain wage, no matter how attractive other job aspects.	Pay level will affect ability to recruit.
	Human capital	The value of an individual's skills and abilities is a function of the time and expense required to acquire them.	Higher pay is required to induce people to train for more difficult jobs.

## Product Market Factors and Ability to Pay

- Two key product market factors affect ability of a firm to change price of its products or services
  - *Product Demand* – Puts a lid on maximum pay level an employer can set. If the employer pays above the maximum, it must either pass on to consumers the higher pay level through price increases or hold prices fixed and allocate a greater share of total revenues to cover labour costs
  - *Degree of competition* – In highly competitive markets, employers are less able to raise prices without loss of revenues
- Dose of reality: What managers say
  - Provides insight into how all the economic factors translate into actual pay decisions

## More Reality: Segmented Supplies of Labor

- **People flow to the work**
  - Some firms (Example: St. Luke's Hospital) face a *segmented labor supply* that involves
    - Multiple sources of employees
    - From multiple locations
    - With multiple employment relationships
  - This implies a company uses multiple sources of employees, from multiple locations, with multiple employment relationships
  - The level and mix of cash and benefits paid to each employee depends on the source
  - The segmented supply results in employees working the same jobs side by side but earning significantly different pay



## Segmented Supplies of Labor (cont.)

- Work flows to the people
  - On-site
  - Off-site
  - Offshore

## Conclusions from Discussion

- Reality is complex; theory abstracts
- Segmented sources of labor means that determining pay levels and mix requires understanding market conditions in different locations
- Managers need to know:
  - Jobs required to do the work
  - Tasks to be performed
  - Knowledge and behaviors required to perform them

## Organization Factors

- **Industry and Technology** in which an organisation competes influences the technologies used. Labour-intensive industries tend to pay lower than technology-intensive industries
- **Employer size**: large organizations tend to pay more than smaller organizations. This is consistent with the economic theory
- **People's preferences**: organizations need to establish what pay forms (health insurance, bonuses, pensions, etc.) employees value
- **Organization strategy**: Different organizations have different pay strategies depending on their circumstances

## Relevant Markets

- Managers need to determine the relevant labour markets that are relevant for pay purposes and establish appropriate competitive positions in these markets
- Three factors determine relevant labor markets
  - Occupation: skills/knowledge required
  - Geography: willingness to relocate, commute or become virtual employees
  - Competitors: other employers in the same product/service and labour markets

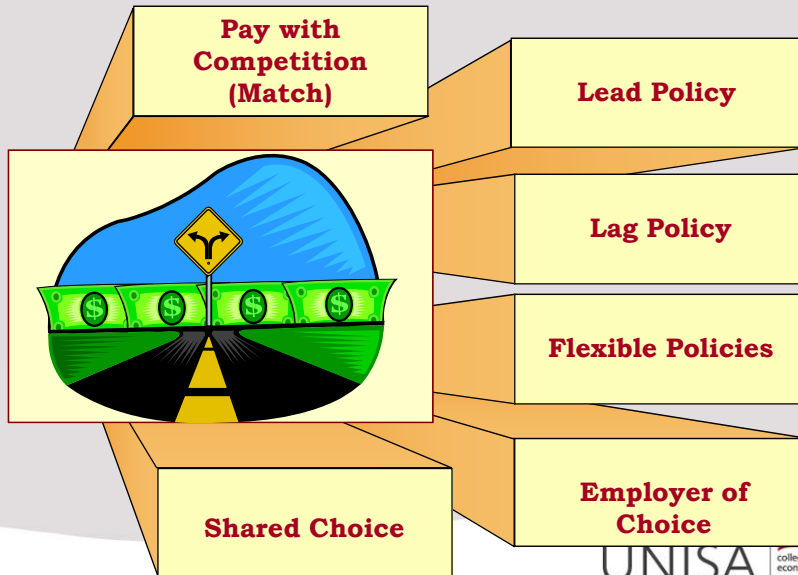
## Relevant Markets (cont.)

- Employers choose their relevant markets based on
  - Competitors – Products, location, and size
  - Jobs – Skills and knowledge required and their importance to organizational success
- Data from product market competitors likely to receive greater weight when:
  - Employee skills are specific to the product market
  - Labor costs are a large share of total costs
  - Product demand is responsive to price changes
  - Supply of labor is not responsive to changes in pay

## Competitive Pay Policy Alternatives

- Three conventional pay-level policies:
  - To lead
  - To meet
  - To follow competition
- Newer policies emphasize flexibility among:
  - Policies for different employee groups
  - Pay forms for individual employees
  - Elements of the employee relationship that company wishes to emphasize in its external competitiveness policy

## Competitive Pay Policy Alternatives



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## Exhibit 7.8: Probable Relationships Between External Pay Policies and Objectives

EXHIBIT 7.8 Probable Relationships between External Pay Policies and Objectives

Policy	Compensation Objectives				
	Ability to Attract	Ability to Retain	Contain Labor Costs	Reduce Pay Dissatisfaction	Increase Productivity
Pay above market (lead)	+	+	?	+	?
Pay with market (match)	=	=	=	=	?
Pay below market (lag)	-	?	+	-	?
Hybrid policy	?	?	+	?	+
Employer of choice	+	+	+	-	?

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## Pay with Competition (Match)

- Attempts to ensure an organization's
  - Wage costs are approximately equal to those of its product competitors
  - Ability to attract potential employees will be approximately equal to its labor market competitors
- Avoids placing an employer at a disadvantage in pricing products or in maintaining a qualified work force

## Lead Policy

- Maximizes the ability to attract and retain quality employees and minimizes employee dissatisfaction with pay
- May also offset less attractive features of work
- If used only to hire new employees, may lead to dissatisfaction of current employees
- May mask negative job attributes that contribute to high turnover later (e.g. boring assignments or hostile colleagues)

## Lag Policy

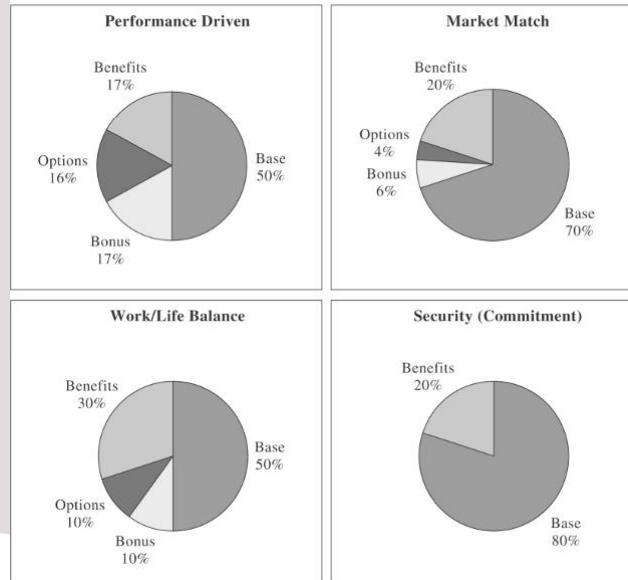
- A policy of paying below-market rates
- May hinder a firm's ability to attract potential employees
- If pay level is lagged in return for promise of higher future returns
  - May increase employee commitment
  - Foster teamwork
  - May possibly increase productivity

## Flexible Policies

- Employers have more than one pay policy
- Policy may vary for different occupational families
- Alternative policies include
  - Performance driven
  - Market match: mimicking the pay mix competitors are paying
  - Work/life balance
  - Security

## Exhibit 7.9: Pay-Mix Policy Alternatives

EXHIBIT 7.9 Pay-Mix Policy Alternatives



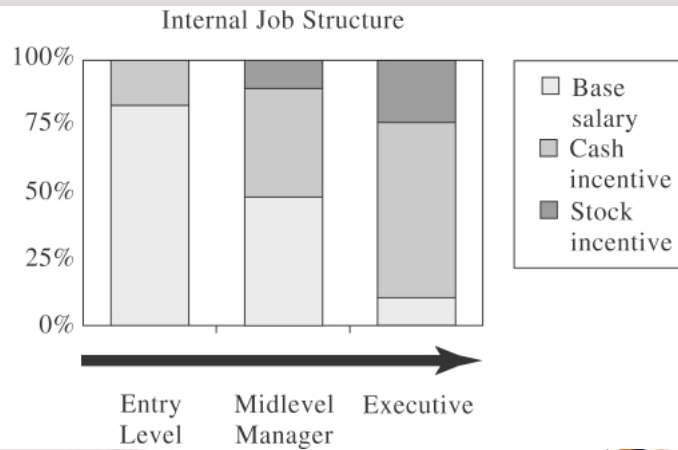
## Employer of Choice/ Shared Choice

- Companies compete based on their overall reputation as a place to work
- *Shared choice* begins with traditional options of lead, meet, or lag
  - Adds a second part – *offers employees choices* (within limits) in the pay mix
- Similar to employer of choice in recognizing importance of both pay level and mix
- Employees have more say in forms of pay received



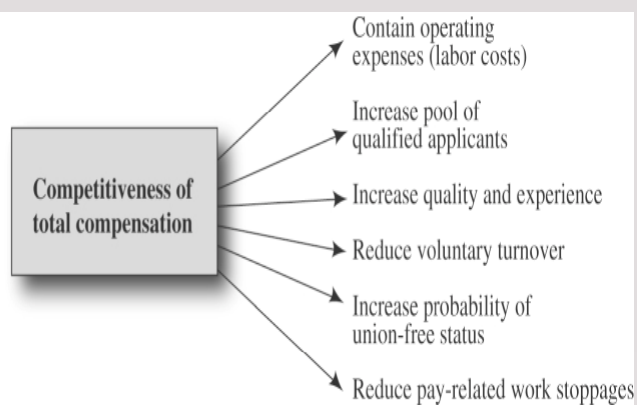
## Exhibit 7.12: Pay Mix Varies Within the Structure

**EXHIBIT 7.12**  
Merrill Lynch's  
Pay Mix Varies  
within the  
Structure



## Exhibit 7.13: Some Consequences of Pay Levels

**EXHIBIT 7.13**  
Some  
Consequences  
of Pay Levels





## Consequences of Pay-Level and Mix Decisions

- Efficiency
- Fairness
- Compliance



## Which Pay Policy Achieves Competitive Advantage?

- Involves assessing consequences of different pay policy options
- Evidence:
  - Pay level affects costs
  - Effects on productivity
  - Effects on ability to attract and retain employees
- Possibility of achieving competitive advantage
  - Message that pay level and mix signal to people

## Your turn

Answer the end of chapter 7 review questions

# COMPENSATION MANAGEMENT

## CHAPTER 5 (Study unit 5) Evaluating Work: Job Evaluation

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### Chapter Topics

- Job-Based Structures: Job Evaluation
- Defining Job Evaluation: Content, Value, and External Market Links
- “How-to”: Major Decisions

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## Learning objectives

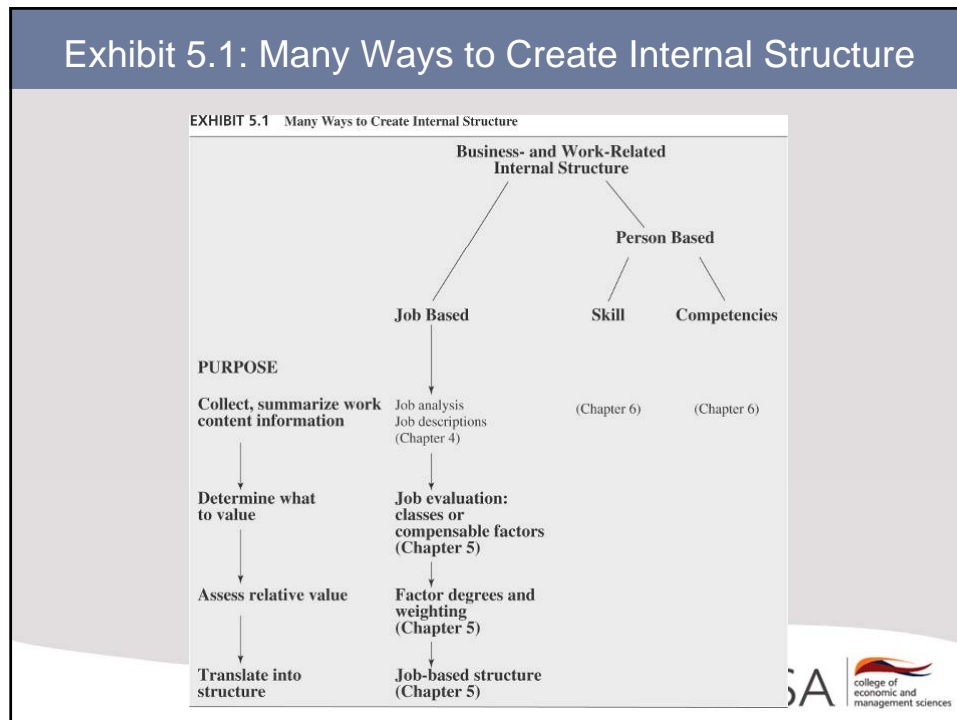
After studying Chapter 5, students should be able to:

- Discuss the relationship between internal alignment, job analysis, job evaluation, and job structure.
- Identify the major decisions involved in job evaluation.
- Compare the advantages and disadvantages of the most common job evaluation methods.

## Job-Based Structures: Job Evaluation

- *Job evaluation* – process of systematically determining the relative worth of jobs to create a job structure for the organization
- The evaluation is based on a combination of:
  - Job content
  - Skills required
  - Value to the organization
  - Organizational culture
  - External market

## Exhibit 5.1: Many Ways to Create Internal Structure



## Defining Job Evaluation: Content, Value, and External Market Links

- Content and value
  - Exchange value
  - Content: the work that is performed and how it gets done
- Linking content with the external market
  - Value of job content is based on what it can command in the external market
- “Measure for measure” vs. “Much ado about nothing”. Exhibit 5.2 summarizes the assumptions that underlie the perspectives on job evaluation

## Exhibit 5.2: Assumptions Underlying Different Views of Job Evaluation

EXHIBIT 5.2 Assumptions Underlying Different Views of Job Evaluation	Aspect of Job Evaluation	Assumption
	Assessment of job content	Content has intrinsic value outside external market.
	Assessment of relative value	Stakeholders can reach consensus on value.
	External market link	Value cannot be determined without external market.
	Measurement	Honing instruments will provide objective measures.
	Negotiation	Negotiating brings rationality to a social/political process; establishes rules of the game and invites participation.

## Defining Job Evaluation: Content, Value, and External Market Links (cont.)

“How-To”: Major decisions (Refer to Exhibit 5.3)

- Establish the purpose: Job evaluation is part of the process of establishing an internally aligned pay structure
  - ❖ *Supports organization strategy:* Job evaluation aligns with the organisation’s strategy by including what it is about work that *adds value* – that contributes to pursuing the organisation’s strategy and achieving its objectives
  - ❖ *Supports work flow:* Job evaluation supports work flow in two ways: (a) it integrates each job’s pay with its relative contributions to the organization, and it helps set pay for new, unique, or changing jobs

## Defining Job Evaluation: Content, Value, and External Market Links (cont.)

“How-To”: Major Decisions (cont)

- ❖ *Is fair to employees*: Job evaluation can reduce disputes and grievances over pay differences among jobs by establishing a workable, agreed-upon structure that reduces the role of favoritism and bias in setting pay
- ❖ *Motivates behavior toward organization objectives*: Job evaluation calls out to employees what it is about their work that the organisation values, what supports the organisation’s strategy and its success. Job evaluation thus helps create the network of rewards (promotions, challenging work) that motivates employees

## Exhibit 5.3: Determining an Internally Aligned Job Structure

### EXHIBIT 5.3 Determining an Internally Aligned Job Structure

Internal alignment:

Work relationships

within the

organization

→ Job analysis → Job description → Job evaluation → Job structure

#### Some Major Decisions in Job Evaluation

- Establish purpose of evaluation.
- Decide whether to use single or multiple plans.
- Choose among alternative approaches.
- Obtain involvement of relevant stakeholders.
- Evaluate plan’s usefulness.

## Defining Job Evaluation: Content, Value, and External Market Links (cont.)

“How-To”: Major decisions (cont.)

- Single versus multiple plans
  - ❖ Characteristics of a benchmark job:
    - Contents are well-known and relatively stable over time
    - Job not unique to one employee
    - A reasonable number of employees are involved in the job
  - ❖ Depth and breadth of job
  - ❖ Refer Exhibit 5.4
- Choose among methods

## Who Should be Involved?

- Managers and employees with a stake in the results should be involved
  - Can include representatives from key operating functions, including non-managerial employees
- Organizations with unions find including union representatives helps gain acceptance
  - Extent of union participation varies
- Design process matters
  - Attending to fairness of design process and approach chosen likely to achieve employee and management commitment, trust, and acceptance of results



## Who Should be Involved? (cont.)

- Appeals/review procedures
  - Inevitable that some jobs are incorrectly evaluated
  - Requires review procedures for handling such cases and helping to ensure procedural fairness
- “I know I speak for all of us when I say I speak for all of us”
  - Procedures should be judged for their susceptibility to political influences

## Your turn

Answer the end of chapter 5 review questions

# COMPENSATION MANAGEMENT

## CHAPTER 4 (Study unit 4) Job Analysis

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### Chapter Topics

- Structures Based on Jobs, People, or Both
- Job-based Approach: Most Common
- Job Analysis Procedures
- What Information Should Be Collected?
- How Can the Information Be Collected?
- Job Descriptions Summarize the Data
- Job Analysis: Bedrock or Bureaucracy?
- Judging Job Analysis
- Your Turn: The Customer-Service Agent

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## Learning objectives

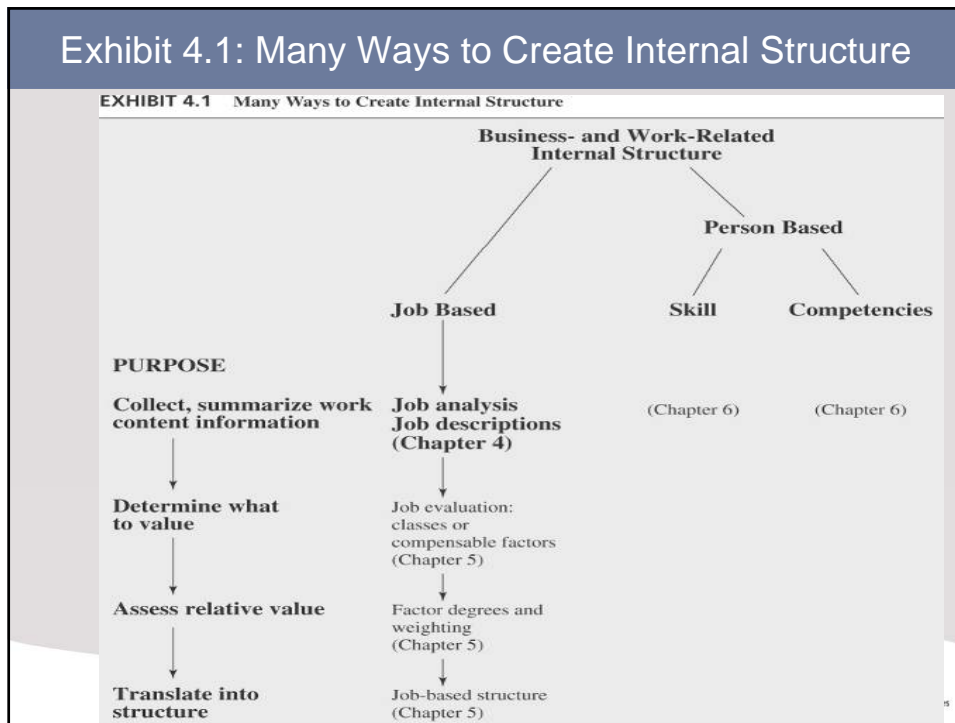
After studying Chapter 3, students should be able to:

- Explain the importance of job analysis, the uses of job analysis, and the relationship of job analysis to internal alignment.
- Discuss the key difference(s) between job-based, skill-based and competency-based pay structures.
- Identify and describe the key components of the job-based approach to the job analysis process.
- Discuss the difference(s) between the quantitative and conventional methods to collect job analysis information.
- Describe the key criteria to judge job analysis.

## Structures Based On Jobs, People, Or Both

- Job-based structures look at what people are doing and the expected outcomes
- Skill- and competency based structures look at the person

## Exhibit 4.1: Many Ways to Create Internal Structure

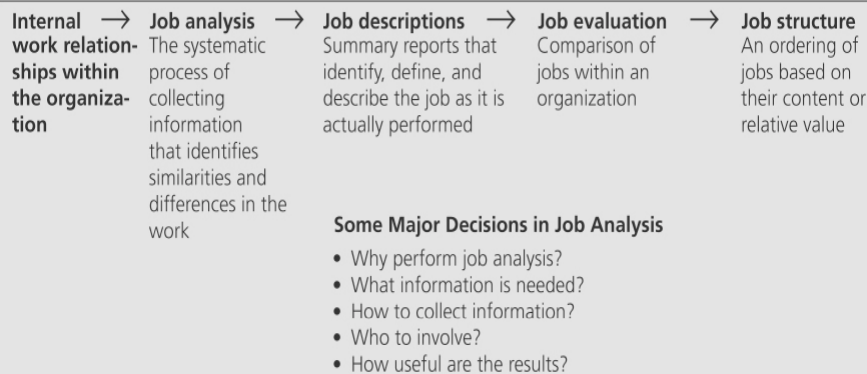


## Job Analysis

**The systematic process of collecting information that identifies similarities and differences in the work.**

## Exhibit 4.3: Determining the Internal Job Structure

### EXHIBIT 4.3 Determining the Internal Job Structure



## Job-Based Approach: Most Common

- **Why Perform Job Analysis?**
  - Potential uses for job analysis have been suggested for every major personnel function
    - Type of job analysis data needed differs by function
  - Internal structure based on job-related information provides a work-related rationale for pay differences to both managers and employees
  - In compensation, job analysis has two critical uses:
    - Establishes similarities and differences in the work contents of the jobs
    - Helps establish an internally fair and aligned job structure
- Key issue for compensation decision makers:
  - Ensuring that data collected are useful and acceptable to employees and managers involved

## Job Analysis Procedures

- Job analysis usually collects information about specific tasks or behaviors
  - *Position* – a group of tasks performed by one person
  - *Job* – made up from identical positions
  - *Job family* – broadly similar jobs
- Traditional, stable structures are shrinking, but persist in many large organizations

## Exhibit 4.4: Job Analysis Terminology

### EXHIBIT 4.4 Job Analysis Terminology

#### **JOB FAMILY**

Grouping of related jobs with broadly similar content; e.g., marketing, engineering, office support, technical.

#### **JOB**

Group of tasks performed by one person that make up the total work assignment of that person; e.g., customer support representative.

#### **TASK**

Smallest unit of analysis, a specific statement of what a person does; e.g., answers the telephone.  
Similar tasks can be grouped into a task dimension; e.g., responsible for ensuring that accurate information is provided to customer.

## Exhibit 4.5: Conventional Job Analysis Procedures

EXHIBIT 4.5 Conventional Job Analysis Procedures	
Step	Things to Remember or Do
1. Develop preliminary job information	<ul style="list-style-type: none"> <li>a. Review existing documents in order to develop an initial "big-picture" familiarity with the job: its main mission, its major duties or functions, work flow patterns.</li> <li>b. Prepare a preliminary list of duties that will serve as a framework for conducting the interviews.</li> <li>c. Make a note of major items that are unclear or ambiguous or that need to be clarified during the data-gathering process.</li> </ul>
2. Conduct initial tour of work site	<ul style="list-style-type: none"> <li>a. The initial tour is designed to familiarize the job analyst with the work layout, the tools and equipment that are used, the general conditions of the workplace, and the mechanics associated with the end-to-end performance of major duties.</li> <li>b. The initial tour is particularly helpful in those jobs where a firsthand view of a complicated or unfamiliar piece of equipment saves the interviewee the thousand words required to describe the unfamiliar or technical.</li> <li>c. For continuity, it is recommended that the first-level supervisor-interviewee be designated the guide for the job-site observations.</li> </ul>
3. Conduct interviews	<ul style="list-style-type: none"> <li>a. It is recommended that the first interview be conducted with the first-level supervisor, who is considered to be in a better position than the jobholders to provide an overview of the job and how the major duties fit together.</li> <li>b. For scheduling purposes, it is recommended that no more than two interviews be conducted per day, each interview lasting no more than three hours.</li> <li>c. The interviewees are considered subject-matter experts by virtue of the fact that they perform the job (in the case of job incumbents) or are responsible for getting the job done (in the case of first-level supervisors).</li> <li>d. The job incumbent to be interviewed should represent the typical employee who is knowledgeable about the job (not the trainee who is just learning the ropes or the outstanding member of the work unit).</li> <li>e. Whenever feasible, the interviewees should be selected with a view toward obtaining an appropriate race/sex mix.</li> </ul>
Notes on selection of interviewees	<ul style="list-style-type: none"> <li>a. The second tour of the work site is designed to clarify, confirm, and otherwise refine the information developed in the interviews.</li> <li>b. As in the initial tour, it is recommended that the same first-level supervisor-interviewee conduct the second walk-through.</li> </ul>
4. Conduct second tour of work site	<ul style="list-style-type: none"> <li>a. The consolidation phase of the job study involves piecing together into one coherent and comprehensive job description the data obtained from several sources: supervisor, jobholders, on-site tours, and written materials about the job.</li> <li>b. Past experience indicates that one minute of consolidation is required for every minute of interviewing. For planning purposes, at least five hours should be set aside for the consolidation phase.</li> <li>c. A subject-matter expert should be accessible as a resource person to the job analyst during the consolidation phase. The supervisor-interviewee fills this role.</li> <li>d. The job analyst should check the initial preliminary list of duties and questions—all must be answered or confirmed.</li> </ul>
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6. Verify job description	

## What Information Should Be Collected?

- **Job data: Identification**
  - Job titles, departments, the number of people who hold the job etc.
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- **"Essential elements" and the Employment Equity Act**
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  - *Essential functions* – the fundamental job duties of the employment position the individual with a disability holds or desires

## What Information Should Be Collected? (cont.)

- *Level of analysis*
  - Level at which an analysis begins influences whether work is similar or dissimilar
    - Microscopic approach
    - Broad, generic descriptions
  - Countervailing view
    - Promotion to a new job title is part of the organization's network of returns
    - Reducing title may reduce opportunities to reinforce positive employee behavior

## How Can the Information Be Collected?

- *Conventional methods*
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    - Advantages: involvement increases understanding of process
    - Disadvantage: open to bias and favoritism
    - Potential subjectivity and huge amount of time the process takes this method has given way to more quantitative (and systematic) data collection
- *Quantitative methods*
  - Web sites where questionnaires are completed online
    - Advantages: practical and cost-effective
    - Disadvantages:
      - Important aspects of a job may be omitted
      - Resulting job descriptions can be faulty



## How Can the Information Be Collected? (cont.)

- Who collects the information?
- Who provides the information?
- What about discrepancies?
- Top management (and union) support is critical



## Job Descriptions Summarize The Data

- *Job description* – information collected is summarized and documented in a way that will be useful for HR decisions, including job evaluations
  - *Job specifications* – knowledge, skills, and abilities required to adequately perform the tasks
- Describing managerial/professional jobs – more-detailed information on the nature of the job, its scope, and accountability
- Verify the description

## Job Analysis: Bedrock or Bureaucracy

- Reducing number of different jobs and cross-training employees makes work content more fluid and employees more flexible
- Generic job descriptions provide flexibility in moving people among tasks without adjusting pay
- Traditional job analysis making fine distinctions among levels of jobs could reinforce rigidity
- Analyzing work content is now conducted as part of work flow and supply chain analysis

## Judging Job Analysis

- Reliability
  - Measure of consistency of results among various analysts, various methods, various sources of data, or over time
- Validity
  - Examines the convergence of results among sources of data and methods
- Acceptability
- Usefulness
  - Practicality of information collected

## A Judgment Call

- Work-related information is needed to determine pay, and differences in work determine pay differences – no satisfactory substitute
- Real issue should be:
  - “How much detail is needed to make these pay decisions?”

## Your turn

Answer the end of chapter 4 review questions

# COMPENSATION MANAGEMENT

## CHAPTER 4 (Study unit 4) Job Analysis

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management sciences

### Chapter Topics

- Structures Based on Jobs, People, or Both
- Job-based Approach: Most Common
- Job Analysis Procedures
- What Information Should Be Collected?
- How Can the Information Be Collected?
- Job Descriptions Summarize the Data
- Job Analysis: Bedrock or Bureaucracy?
- Judging Job Analysis
- Your Turn: The Customer-Service Agent

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management sciences

## Learning objectives

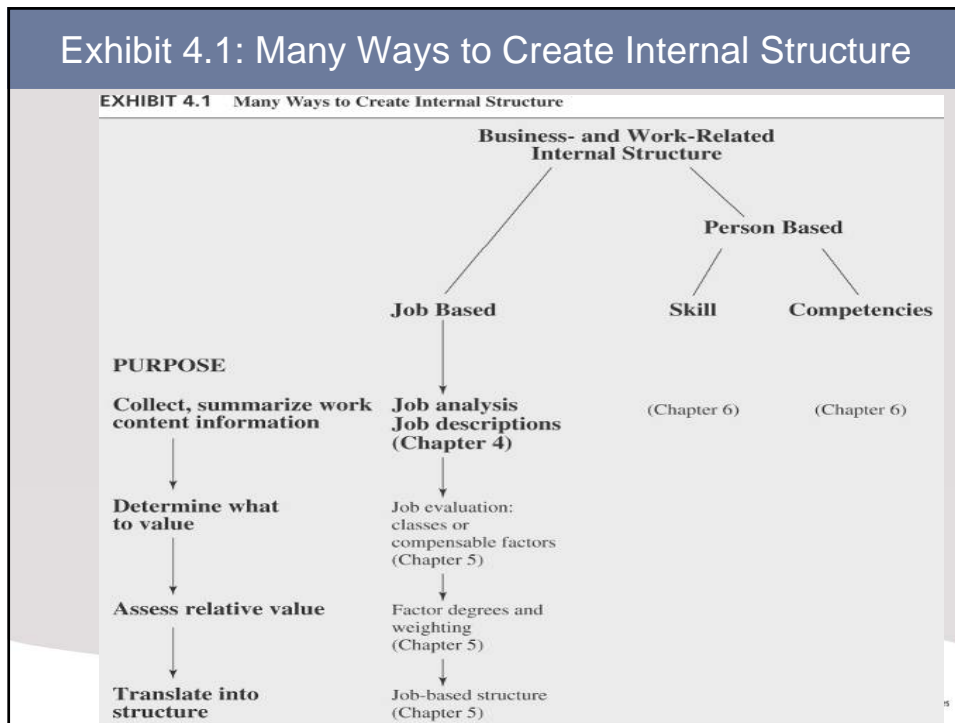
After studying Chapter 3, students should be able to:

- Explain the importance of job analysis, the uses of job analysis, and the relationship of job analysis to internal alignment.
- Discuss the key difference(s) between job-based, skill-based and competency-based pay structures.
- Identify and describe the key components of the job-based approach to the job analysis process.
- Discuss the difference(s) between the quantitative and conventional methods to collect job analysis information.
- Describe the key criteria to judge job analysis.

## Structures Based On Jobs, People, Or Both

- Job-based structures look at what people are doing and the expected outcomes
- Skill- and competency based structures look at the person

## Exhibit 4.1: Many Ways to Create Internal Structure



## Job Analysis

**The systematic process of collecting information that identifies similarities and differences in the work.**

## Exhibit 4.3: Determining the Internal Job Structure

### EXHIBIT 4.3 Determining the Internal Job Structure

<p><b>Internal work relationships within the organization</b></p>	<p>→</p> <p><b>Job analysis</b></p> <p>The systematic process of collecting information that identifies similarities and differences in the work</p>	<p>→</p> <p><b>Job descriptions</b></p> <p>Summary reports that identify, define, and describe the job as it is actually performed</p>	<p>→</p> <p><b>Job evaluation</b></p> <p>Comparison of jobs within an organization</p>	<p>→</p> <p><b>Job structure</b></p> <p>An ordering of jobs based on their content or relative value</p>
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#### Some Major Decisions in Job Analysis

- Why perform job analysis?
- What information is needed?
- How to collect information?
- Who to involve?
- How useful are the results?

## Job-Based Approach: Most Common

- **Why Perform Job Analysis?**
  - Potential uses for job analysis have been suggested for every major personnel function
    - Type of job analysis data needed differs by function
  - Internal structure based on job-related information provides a work-related rationale for pay differences to both managers and employees
  - In compensation, job analysis has two critical uses:
    - Establishes similarities and differences in the work contents of the jobs
    - Helps establish an internally fair and aligned job structure
- Key issue for compensation decision makers:
  - Ensuring that data collected are useful and acceptable to employees and managers involved

## Job Analysis Procedures

- Job analysis usually collects information about specific tasks or behaviors
  - *Position* – a group of tasks performed by one person
  - *Job* – made up from identical positions
  - *Job family* – broadly similar jobs
- Traditional, stable structures are shrinking, but persist in many large organizations

## Exhibit 4.4: Job Analysis Terminology

### EXHIBIT 4.4 Job Analysis Terminology

#### **JOB FAMILY**

Grouping of related jobs with broadly similar content; e.g., marketing, engineering, office support, technical.

#### **JOB**

Group of tasks performed by one person that make up the total work assignment of that person; e.g., customer support representative.

#### **TASK**

Smallest unit of analysis, a specific statement of what a person does; e.g., answers the telephone.  
Similar tasks can be grouped into a task dimension; e.g., responsible for ensuring that accurate information is provided to customer.



## Exhibit 4.5: Conventional Job Analysis Procedures

EXHIBIT 4.5 Conventional Job Analysis Procedures	
Step	Things to Remember or Do
1. Develop preliminary job information	<ul style="list-style-type: none"> <li>a. Review existing documents in order to develop an initial "big-picture" familiarity with the job: its main mission, its major duties or functions, work flow patterns.</li> <li>b. Prepare a preliminary list of duties that will serve as a framework for conducting the interviews.</li> <li>c. Make a note of major items that are unclear or ambiguous or that need to be clarified during the data-gathering process.</li> </ul>
2. Conduct initial tour of work site	<ul style="list-style-type: none"> <li>a. The initial tour is designed to familiarize the job analyst with the work layout, the tools and equipment that are used, the general conditions of the workplace, and the mechanics associated with the end-to-end performance of major duties.</li> <li>b. The initial tour is particularly helpful in those jobs where a firsthand view of a complicated or unfamiliar piece of equipment saves the interviewee the thousand words required to describe the unfamiliar or technical.</li> <li>c. For continuity, it is recommended that the first-level supervisor-interviewee be designated the guide for the job-site observations.</li> </ul>
3. Conduct interviews	<ul style="list-style-type: none"> <li>a. It is recommended that the first interview be conducted with the first-level supervisor, who is considered to be in a better position than the jobholders to provide an overview of the job and how the major duties fit together.</li> <li>b. For scheduling purposes, it is recommended that no more than two interviews be conducted per day, each interview lasting no more than three hours.</li> <li>c. The interviewees are considered subject-matter experts by virtue of the fact that they perform the job (in the case of job incumbents) or are responsible for getting the job done (in the case of first-level supervisors).</li> <li>d. The job incumbent to be interviewed should represent the typical employee who is knowledgeable about the job (not the trainee who is just learning the ropes or the outstanding member of the work unit).</li> <li>e. Whenever feasible, the interviewees should be selected with a view toward obtaining an appropriate race/sex mix.</li> </ul>
Notes on selection of interviewees	<ul style="list-style-type: none"> <li>a. The second tour of the work site is designed to clarify, confirm, and otherwise refine the information developed in the interviews.</li> <li>b. As in the initial tour, it is recommended that the same first-level supervisor-interviewee conduct the second walk-through.</li> </ul>
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Answer the end of chapter 4 review questions

# COMPENSATION MANAGEMENT

## CHAPTER 3 (Study unit 3) Defining Internal Alignment

1

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### Chapter Topics

- Compensation Strategy: Internal Alignment
- Structures Vary Among Organizations
- What Shapes Internal Structures?
- Strategic Choices in Designing Internal Structures
- Guidance from the Evidence
- Consequences of Structures

2

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## Learning Objectives

After studying Chapter 3, students should be able to:

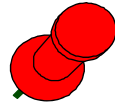
- Explain why internal alignment is an important pay policy issue and how to evaluate internal alignment.
- Discuss the three (3) key factors that define an internal pay structures.
- Identify and describe how external and organization factors shape the design of pay structures.
- Discuss the pros and cons of egalitarian and hierarchical structures and how they relate to an organization's strategy.
- Describe the key effects associated with an internally aligned pay structure.
- Discuss the impact of internal pay structures on efficiency, fairness, and compliance in the pay system.

3

## Compensation Strategy: Internal Alignment

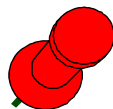
- Issues in a strategic approach to pay
  - Setting objectives
  - Internal alignment
    - Addresses relationships *inside* the organization
    - The relationships form a pay structure that should:
      - ❖ Support the organization strategy
      - ❖ Support the work flow
      - ❖ Motivate behavior toward organization objectives

4



**Internal alignment, often called internal equity, refers to the pay relationships among different jobs/skills/competencies within a single organization.**

5



**Pay structure refers to the array of pay rates for different work or skills within a single organization.**

***The number of levels, the differentials in pay between the levels, and the criteria used to determine those differences describe the structure.***

6



## Compensation Strategy: Internal Alignment (cont.)

- Supports organization strategy
- Supports work flow
  - Work flow: The process by which goods and services are delivered to the customer
  - The pay structure ought to support the efficient flow of that work and the design of the organisation
- Motivates behavior
  - The structure ought to make clear the relationship between each job and the organisation's objectives: *Line-of-sight*
  - Employees should be able to “see” the links between their work, the work of others, and the organisation's objectives
  - Structure must be fair to employees

7

## Structures Vary Among Organizations

An internal pay structure can be defined by

- Number of *levels* of work
- Pay *differentials* between the levels
- *Criteria* or *basis* used to determine those levels and differentials

8

## Levels

- Pay structure is hierarchical in nature, based on:
  - Number of levels
  - Reporting relationships

9

## Differentials

- The pay differences among levels
- Pay is determined by:
  - Knowledge/ skills involved
  - Working conditions
  - Valued addition to the company
- Intention of these differentials:
  - To motivate people to strive for promotion to a higher-paying level

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## Criteria: Content and Value

- *Content* – the work performed in a job and how it gets done (tasks, behaviors, knowledge required, etc.)
  - Structure ranks jobs on – skills required, complexity of tasks, problem solving, and/or responsibility
- *Value* – the worth of the work; its relative contribution to the organization objectives
  - Structure focuses on – *relative contribution* of these skills, tasks, and responsibilities to the organization's goals
  - Can include external market value

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## Use Value and Exchange Value

- *Use value* – the value of goods or services an employee produces in a job
- *Exchange value* – whatever wage the employer and employee agrees on for a job
- Difference between exchange value and use value surfaces when one firm acquires another

12

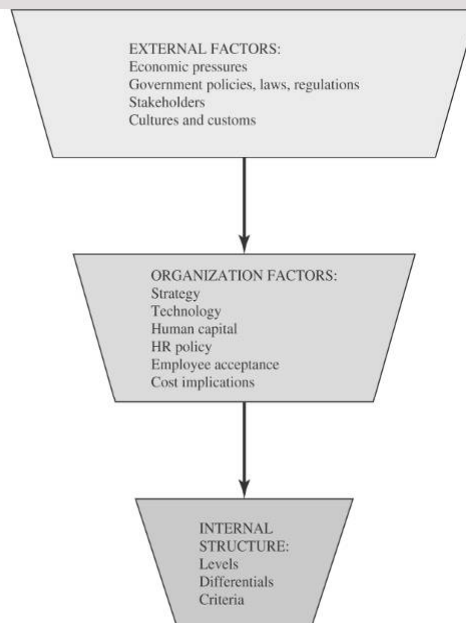
## Job- and Person-Based Structures

- *Job-based* structures relies on the work content – tasks, behaviors, responsibilities
- *Person-based* structure shifts the focus to the employee
  - Skills, knowledge, or competencies the employee possesses
  - Whether or not they are used in the particular job
- In reality, both job-and-person-based structures are included

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## Exhibit: 3.4: What Shapes Internal Structures?

EXHIBIT 3.4  
What Shapes  
Internal  
Structures?



14

## What Shapes Internal Structures? *External Factors*

- *Economic pressures*
  - Early advocates: Adam Smith, Karl Marx
  - Marginal productivity: Employers do in fact pay use value:
    - ❖ Unless an employee can produce a value equal to the value received in wages/salary, it will not be worthwhile to hire the employee
    - ❖ One job is paid more or less than another due to differences in relative productivity of the job and/or differences in how much a customer values the output
    - ❖ Thus: Differences in productivity provide a rationale for the internal pay structure
  - Supply and demand for labor and products affect internal structures

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## What Shapes Internal Structures? *External Factors (cont.)*

- *Government policies, laws, and regulations*
  - Employment Equity Act and Affirmative Action requires “equal pay for equal work”
  - Living wage
- *External stakeholders*
  - Have a stake in how internal pay structures are determined
  - Internal alignment focuses on pay differentials within an organization
- *Cultures and customs*
  - Culture – the mental programming for processing information that people share in common
  - Global competition and an aging workforce has made age-based pay an expensive affair

16

## What Shapes Internal Structures? *Organizational Factors*

- *Organization strategy*
  - Aligned, yet adaptable pay structures may be required
- *Organization's human capital*
  - Education
  - Experience
  - Knowledge
  - Abilities
  - Skills required to perform the work

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## What Shapes Internal Structures? *Organizational Factors (cont.)*

- *Organization work design*
  - Technology used in producing goods and services influences
    - Organizational design
    - Work to be performed
    - Skills/Knowledge required to perform work
  - Temporary work supplier
  - Outsourcing specialists
    - Pay for employees under both practices based on internal structure of home employer
  - Delayering
    - Cuts unnecessary, non-contributing work
    - Adds work to other jobs, enlarges them, changes the job's value and structure

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## What Shapes Internal Structures? Organizational Factors (cont.)

- Overall HR policies
  - Feeling of 'career progress'

19

## What Shapes Internal Structures? Combining External and Organization Factors

- Internal labor markets
  - Rules and procedures that
    - Determine pay for different jobs within a single organization
    - Allocate employees among those different jobs
- Employee acceptance
  - Employees make comparisons to assess the fairness of an internal pay structure
  - They compare both with other jobs in the same internal structure and with the pay for their job in the external market
  - Sources of fairness: Procedural, and distributive justice
  - Procedural: process by which a decision is reached
  - Distributive: the fairness of the decision

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## What Shapes Internal Structures? Combining External and Organization Factors (cont)

- Employee acceptance (cont)
  - Applied to internal structure, *procedural justice* addresses how design and administration decisions are made and whether procedures are applied in a consistent manner. *Distributive justice* addresses whether the actual pay differences among employees are acceptable
- Pay structures change
  - ‘Change-and-congeal” process

21

## Guidance from the Evidence

- Equity theory: Fairness
  - Research suggests that employees judge fairness by multiple comparisons
    - Comparing to jobs similar to their own
    - Comparing their job to others at the same employer
    - Comparing their jobs’ pay against external pay levels

22



## Guidance from the Evidence (cont.)

- Tournament theory: Motivation and performance
  - All players will play better in the first tournament, where the prize differentials are larger
  - Greater difference between an employee's salary and the boss's, harder he/she will work
  - Several studies have given rise to "winner-takes-all"
  - Does not directly address turnover
- Institutional Model: Copy Others
  - Very few "first movers"

23

## Exhibit 3.8: Some Consequences of an Internally Aligned Structure

**EXHIBIT 3.8**  
Some  
Consequences  
of an Internally  
Aligned  
Structure



## (More) Guidance from the Evidence

- Impact of internal structures depends on context in which they operate
- More hierarchical structures are related to greater performance when the work flow depends on individual contributors
- High performers quit less under more hierarchical systems when:
  - Pay is based on performance rather than seniority
  - When people have knowledge of the structure
- When close collaboration and sharing of knowledge are required, more egalitarian structures are related to greater performance
- Impact of any internal structure on organization performance is affected by other dimensions of the pay model
  - Pay levels (competitiveness)
  - Employee performance (contributions)
  - Employee knowledge of the pay structure (management)

25

## Consequences of Structures

- Importance of internal alignment
- *Efficiency*
    - Pay structures imply future returns
  - *Fairness*
    - For fair (sizable) differentials
    - Against fair (sizable) differentials
  - *Compliance*
    - Comply with regulation of the country

26

## Your turn

Answer the end of chapter 3 review questions



# COMPENSATION MANAGEMENT

## CHAPTER 2 (Study unit 2) Strategy: The Totality of Decisions

1

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### Chapter Topics

- Similarities and Differences in Strategies
- Strategic Choices
- Support Business Strategy
- The Pay Model Guides Strategic Pay Decisions
- Developing a Total Compensation Strategy: Four Steps

2

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## Chapter Topics (cont.)

- Source of Competitive Advantage: Three Tests
- “Best Practices” versus “Best Fit”
- Guidance from the Evidence
- Virtuous and Vicious Circles
- Your Turn: Mapping Compensation Strategies
- Still Your Turn: Pay Matters (Productivity Does, Too)

3

## Exhibit 2.1: Three Compensation Strategies

EXHIBIT 2.1 Three Compensation Strategies

	Google	Medtronic	Merrill Lynch
<b>Objectives</b>	Emphasis on innovation Commitment to cost containment Recognize contributions Attract and reward the best	Focus on customers Fully present at work and in personal lives Recognize personal accomplishment and share success Attract and engage top talent Control costs	Focus on customer Attract, motivate, and retain the best talent Fair, understandable policies and practices
<b>Internal Alignment</b>	Minimize hierarchy Everyone wears several hats Emphasize collaboration	Reflect job responsibilities Support promotional growth opportunities Foster team culture	Pay fairly within ML Job sized on four factors: knowledge/skill, complexity, business impact, strategic value
<b>Externally Competitive</b>	Explore novel ideas in benefits and compensation Generous, unique benefits	Market value of jobs establishes overall pay parameters Choices in benefits	Market competitive in base and benefits Market leader in bonus and stock
<b>Employee Contributions</b>	Recognize individual contributions Unrivaled stock programs	Incentives directly tied to business goals Opportunity to earn above-market pay Recognition of individual and team performance	Bonus based on individual, unit, and company success Differentiate on bonuses and stock In high-profit years, top bonuses significantly larger In less-profitable years, top performers' bonuses decrease much less than poorer performers
<b>Management</b>	Love employees, want them to know it Technology support	Clearly understood; open Technology support Employee choice	Understandable, consistent message Intranet support both individuals and managers

4

## Learning Objectives

After studying Chapter 2, students should be able to:

- Explain the idea of a strategic perspective to compensation.
- Identify the five dimensions of a compensation strategy and how a compensation strategy can support an organization's strategy.
- Discuss how the pay model guides strategic pay decisions.
- Understand the four steps involved in developing a total compensation strategy.
- Discuss how three tests can be used to determine if a pay strategy can be a source of competitive advantage.
- Describe the key arguments related to the two approaches – best-fit vs. best-practices – in developing a compensation strategy and system.

## Similarities and Differences in Strategies

- Different strategies within the same industry
- Different strategies within the same company
- “Let the market decide our compensation” philosophy is untenable in the real world, especially in global environments

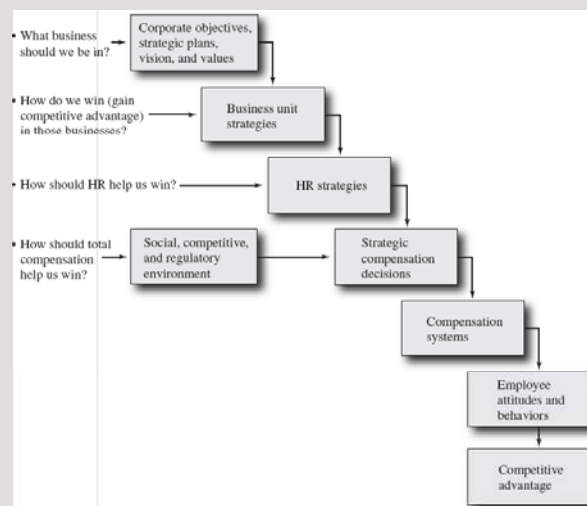
THUS:                    A strategic perspective on compensation is more complex  
                                  than it first appears

## Strategic Choices

- *Strategy* refers to the fundamental directions that an organization chooses
  - Corporate level: “What business should we be in?”
  - Business unit level: “How to gain and sustain competitive advantage?”
  - Functional level: “How should total compensation help gain and sustain competitive advantage?”
  - A *strategic perspective* focuses on those compensation choices that help the organization gain and sustain competitive advantage

7

## Exhibit 2.2: Strategic Choices



8

## Support Business Strategy

- Pay systems should align with the organization's business strategy
  - Based on *contingency notions*: Differences in a company's business strategy should be supported by corresponding differences in its human resource strategy, including compensation
  - *Underlying premise*: the greater the alignment (fit) between the organisation and the compensation system, the more effective the organisation

## Support Business Strategy (cont)


- Compensation systems can be tailored to:
  - *Innovator* business strategy: stresses new products and short response time to markets
  - *Cost cutter* business strategy : efficiency focused strategy and stresses doing more with less by minimizing costs, encouraging productivity increases and specifying in greater detail exactly how jobs should be performed
  - *Customer-focused* business strategy: stresses delighting customers and bases employee pay on how well they do this

(Refer to Exhibit 2.3)



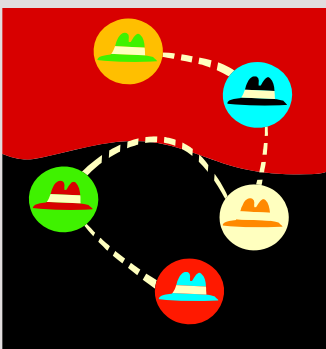
### Exhibit 2.3: Tailor the Compensation System to the Strategy


Strategy	Business Response	HR Program Alignment	Compensation Systems
<b>Innovator: Increase Product Complexity and Shorten Product Life Cycle</b>	<ul style="list-style-type: none"> <li>Product Leadership</li> <li>Shift to Mass Customization</li> <li>Cycle Time</li> </ul>	<ul style="list-style-type: none"> <li>Committed to Agile, Risk-Taking, Innovative People</li> </ul>	<ul style="list-style-type: none"> <li>Reward Innovation in Products and Processes</li> <li>Market-Based Pay</li> <li>Flexible—Generic Job Descriptions</li> </ul>
<b>Cost Cutter: Focus on Efficiency</b>	<ul style="list-style-type: none"> <li>Operational Excellence</li> <li>Pursue Cost-Effective Solutions</li> </ul>	<ul style="list-style-type: none"> <li>Do More with Less</li> </ul>	<ul style="list-style-type: none"> <li>Focus on Competitors' Labor Costs</li> <li>Increase Variable Pay</li> <li>Emphasize Productivity</li> <li>Focus on System Control and Work Specifications</li> </ul>
<b>Customer Focused: Increase Customer Expectations</b>	<ul style="list-style-type: none"> <li>Deliver Solutions to Customers</li> <li>Speed to Market</li> </ul>	<ul style="list-style-type: none"> <li>Delight Customer, Exceed Expectations</li> </ul>	<ul style="list-style-type: none"> <li>Customer Satisfaction Incentives</li> <li>Value of Job and Skills Based on Customer Contact</li> </ul>

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### Five Strategic Guidelines for Compensation Choices

- Objectives – how should compensation support the business strategy and be adaptive to the cultural and regulatory pressures in a global environment?
- Internal Alignment – How differently should the different types and levels of skills and work be paid within the organisation?
- External Competitiveness – how should total compensation be positioned against competitors?
- Employee Contributions: should pay increases be based on individual and/or team performance or experience and/or each business unit's performance?
- Management: How open and transparent should the pay decisions be to all employees?



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## The Pay Model Guides Strategic Pay Decisions

- Decisions based on the five strategic compensation choices of the pay model, taken together, form a pattern that becomes an organization's compensation strategy
  - Stated versus Unstated Strategies

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## Example: The Strategic Compensation Decisions Facing Whole Foods

- **Objectives:** How should compensation support business strategy and be adaptive to the cultural and regulatory global environment?

### Whole Foods' Objectives

- Increase shareholder value through profits and growth
- Go to extraordinary lengths to satisfy and delight customers
- Seek and engage employees who are going to help the company make money

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## Example: The Strategic Compensation Decisions Facing Whole Foods (cont.)

- **Internal Alignment:** How differently should the various types and levels of skills and work be paid within the organization?

### Whole Foods' Approach

- Store operations are organized around eight to ten self-managed teams
- Egalitarian, shared-fate philosophy – executive salaries do not exceed 14 times the average pay of full-time employees
- All full-time employees qualify for stock options, and 94 percent of the company's options go to non-executive employees

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## Example: The Strategic Compensation Decisions Facing Whole Foods (cont.)

- **External competitiveness:** How should total compensation be positioned against our competitors? What forms of compensation should we use?

### Whole Foods' Approach

- Offer a unique deal compared to competitors
- Provide health insurance for all full-time employees
- 20 hours of paid time a year to do volunteer work

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## Example: The Strategic Compensation Decisions Facing Whole Foods (cont.)

- *Employee contributions*: Should pay increases be based on individual and/or team performance, on experience and/or continuous learning, on improved skills, on changes in cost of living, on personal needs, and/or on each business unit's performance?

### Whole Foods' Approach

- A shared fate – every four weeks, assess the performance of each team
- Top teams get an extra R1.50 to R2.00 an hour in the next pay period

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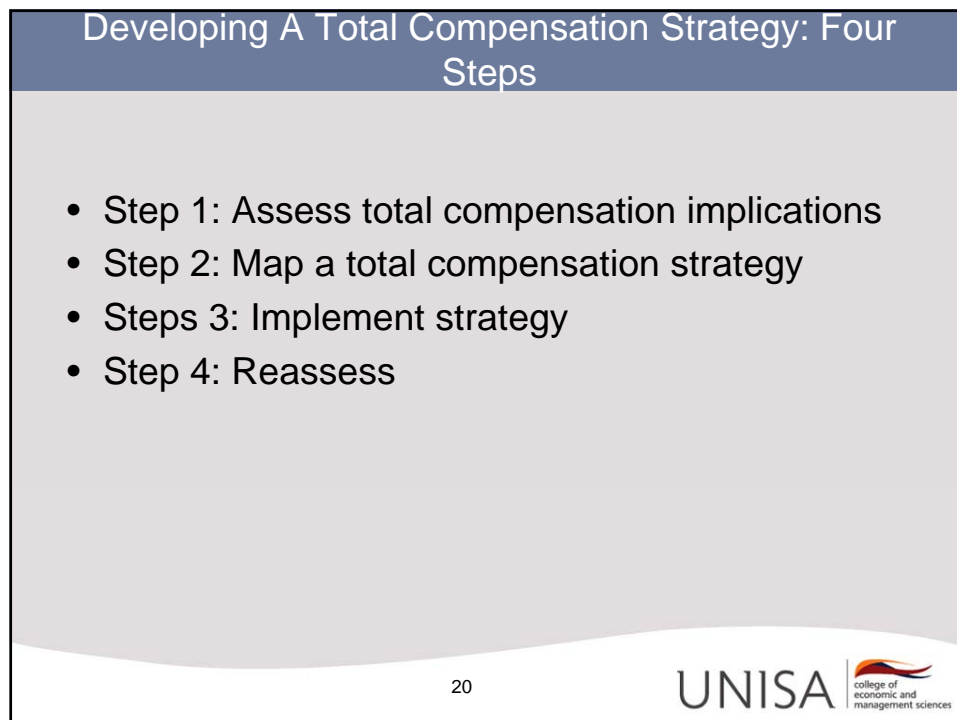
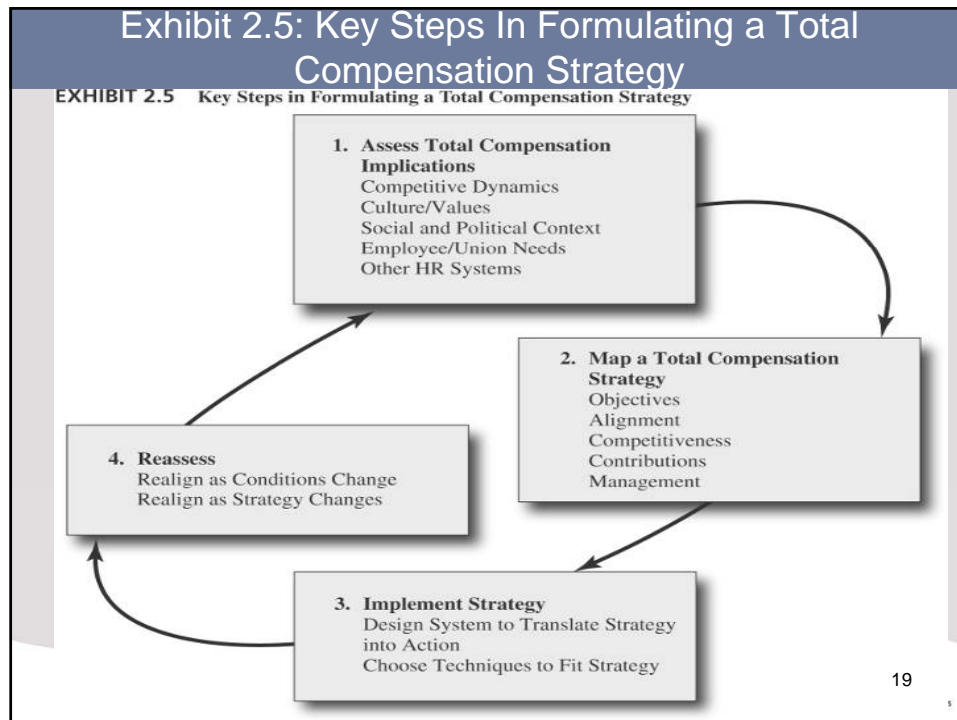
## Example: The Strategic Compensation Decisions Facing Whole Foods (cont.)

- *Management*: How open and transparent should pay decisions be to all employees? Who should be involved in designing and managing the system?

### Whole Foods' Approach

- “No-secrets” management; every store has a book listing the previous year's pay for every employee including executives
- “You Decide” – employees recently voted to pick their health insurance rather than having one imposed by leadership

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## Step 1: Assess Total Compensation Implications

- **Competitive Dynamics** – Understand the Business
  - To cope with turbulent competitive dynamics, focus on what factors are important in the business environment:
    - Changing customer needs
    - Competitors' actions
    - Changing labor market conditions
    - Changing Laws
    - Globalization
  - Competitive dynamics can be assessed globally
- **Culture/values**
  - A pay system reflects the values that guide an employer's behavior and underlie its treatment of employees
  - The pay system mirrors the company's image and reputation

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## Step 1: Assess Total Compensation Implications (cont.)

- **Social and political context**
  - *Context* refers to legal and regulatory requirements, cultural differences, changing workforce, demographics, expectations etc.
  - Affects compensation choices
  - Governments are major stakeholders in determining compensation: Lobbying to influence laws and regulations is also part of compensation strategies
  - From a strategic perspective: Managers of compensation may try to shape the sociopolitical environment as well as be shaped by it
- **Employee preferences**
  - How to better satisfy individual needs and preferences
  - Offering more choice is one approach

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## Step 1: Assess Total Compensation Implications (cont.)

- **Union preferences**
  - Pay strategies need to be adapted to the nature of the union-management relationship
  - Unions' interests can differ (i.e. protected retirement and health care plans)
  - Compensation deals with unions can be costly to change
- **Prominence of pay in overall HR strategy: Supporting player or catalyst for change**
  - Pay strategy is influenced by how it fits with other HR systems
  - High-performance systems
    - High skill/knowledge requirements
    - Work designed so that employee teams enjoy discretion in making decisions and continue to learn
    - Pay systems based on performance
  - Pay can be a supporting player or a catalyst for change

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## Step 2: Map a Total Compensation Strategy

- Mapping is used in marketing to clarify and communicate a product's identity
- Offers picture of a company's compensation strategy based on the five choices in the pay model
- Clarifies the message the company is trying to establish with its compensation system
- Maps do *not* tell which strategy is the "best", providing rather framework and guidance

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## Steps 3 and 4: Implement and Reassess

- Step 3
  - Involves implementing strategy through the design and execution of compensation system
- Step 4
  - Reassess and realign, closes the loop and recognizes that the strategy must be changing to fit changing conditions
  - Involves periodic reassessment

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## Sources of Competitive Advantage: Three Tests

- Three tests determine if a pay strategy is a source of advantage
  - Is it aligned?
  - Does it differentiate?
  - Does it add value?
    - Calculate the return on investment (ROI)



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## Best Practices” Versus “Best Fit”?

### **Best Practices**

- Assumptions
  - A set of best-pay practices exists
  - Practices can be applied universally across all situations
  - Results in better performance with almost any business strategy

### **Best Fit**

- If design of pay system
  - Reflects company's strategy and values
  - Is responsive to employees' and unions' needs
  - Is globally competitive
    - ❖ Company is more likely to achieve competitive advantage

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## Guidance from the Evidence

Consistent research evidence that the following practices do matter to the organization's objectives

- *Internal alignment*
  - ❖ Pay differences among internal jobs can affect results
- *External competitiveness*
  - ❖ Paying higher than average paid by competitors can affect results
- *Employee contributions*
  - ❖ Performance-based pay can affect results

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## Guidance from the Evidence (cont.)

- *Managing compensation*
  - ❖ Need to consider all dimensions of pay strategy
  - ❖ Therefore not focusing only on pay for performance or internal pay differences
- *Compensation strategy*
  - ❖ Embedding compensation strategy within the broader HR strategy affects results

“What practices pay off best under what conditions” is an important question to be answered

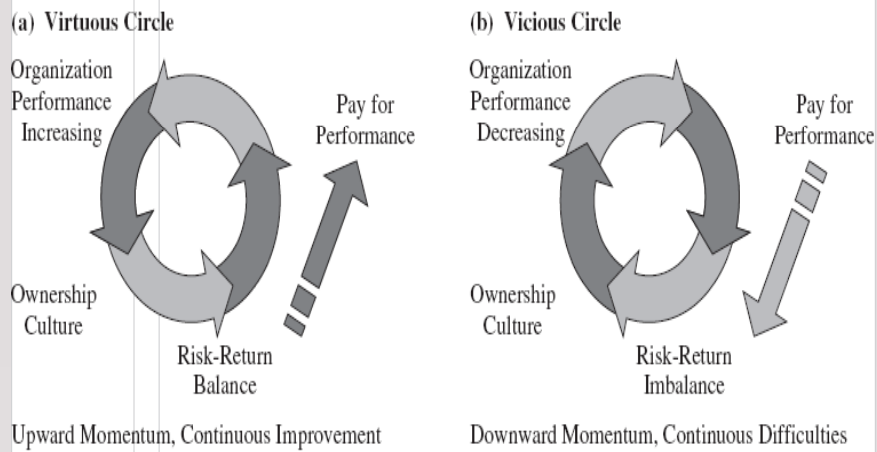
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## Virtuous and Vicious Circles

- One study concluded that *how* you pay also matters as much as *how much* you pay
- Studies conclude that performance-based pay that shares success with employees improves employee attitudes, behaviors, performance – especially when combined with high-performance practices
- Performance-based pay can be the best practice under right circumstances
- Think of pay as part of a circle (Refer to Exhibit 2.9 below)

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## Exhibit 2.9: Virtuous and Vicious Circles (cont.)



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## Virtuous and Vicious Circles (cont.)

- Exhibit 2.9 (a) suggest that performance-based pay work best when there is success to share
- An organisation whose profits or market share is increasing is able to pay larger bonuses and stock awards
- Paying these bonuses fairly improves employee attitudes and work behaviours, which in turn improves their performance
- The circle gains upward momentum. Employees receive returns that compensate for the risks they take.
- Employees behave like owners, since they are sharing in the organisation's success

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## Virtuous and Vicious Circles (cont.)

- Exhibit 2.9 (b) suggest that when organisation performance declines, performance-based pay plans do not pay off (there are no bonuses, and the value of their stock declines – with potentially negative effects on organisation performance)
- Declining organisation performance increases the risks facing employees – risk of still smaller bonuses, demotions, and even layoffs
- Unless the increased risks are offset by larger returns, the risk-return imbalance will reinforce declining employee attitudes and speed the downward spiral

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## Your turn

Answer the end of chapter 2 review questions

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# COMPENSATION MANAGEMENT

## CHAPTER 15 (Study unit 11) The role of trade unions

# Chapter Topics

- The Impact of Unions in Wage Determination
- Unions and Alternative Reward Systems

# Impact of Unions in Wage Determination

- Impact on general wage and benefit levels
- Impact on structure of wages
- Impact on non-union firms, spillover effect
- Impact on wage and salary policies and practices in unionized firms

# Union Impact on General Wage Levels

- Unions do make a difference in wages
  - Union workers earn between 8.9% and 12.4% more than nonunion workers
- Size of gap varies from year to year
  - During periods of higher unemployment, impact of unions is larger
  - During strong economies, union-nonunion gap is smaller
- Union-nonunion wage differentials in public sector
  - Union employees earn about 22% more than their nonunion counterparts



# Structure of Wage Packages

Three dimensions related to wage structure

- Division between direct wages and employee benefits: In unionized companies, voluntary benefits amount to 36.9% of the total compensation package and 27.8% for nonunion employees
- Evolution of two-tier pay plans: two-tier wage structures differentiate pay based upon hiring date. From management's perspective, wage tiers represent a viable alternative compensation strategy
- Relationship between worker wages and pay of managers in union and nonunion environments: the gap between workers and their managers is 23% smaller in unionized companies

# Wage Structure: Division Between Direct Wages and Employee Benefits

- Presence of unions adds 20-30% to employee benefits
- Greater percentage of total wage bill allocated to employee benefits
  - Union workers: 36.9% of total compensation package
  - Nonunion workers: 27.8%
  - Higher costs due to – higher pension expenditures, and higher insurance benefits

# Wage Structure: Two-Tier Pay Plans

- Two-tier pay structures are a phenomenon of union sector
  - Contract differentiates pay based upon hire date
  - Employees hired after a target date will receive lower wages than their higher-seniority peers in similar jobs
- From management's view, wage tiers are a viable alternative pay strategy
  - Cost control strategy to allow expansion or investment
  - Cost-cutting device to allow economic survival

# Wage Structure: Two-Tier Pay Plans (cont.)

- From a union's perspective, wage tiers are viewed as less painful than
  - Wage freezes
  - Staff cuts among existing employees
- However, tradeoff bargained away equivalent wage treatment for future employees

# Wage Structure: Wages of Workers vs. Pay of Managers

- Evidence indicates gap between workers and their managers is 23% smaller in unionized firms
- Managers in union firms receive higher wages than nonunion managers
- Narrowing of gap arises because worker wages increase faster than managerial wages in unionized firms

# Union Impact: The Spillover Effect

- Employers seek to avoid unionization by offering workers wages, benefits, and working conditions won in rival unionized firms
- Outcomes
  - Nonunion management continues to enjoy freedom from union “interference” in decision making
  - Workers receive “spillover” of rewards obtained by unionized counterparts

# Role of Unions in Wage and Salary Policies and Practices

- Role of unions in administering compensation is outlined in contract
- Basis of pay
  - Regular pay
  - Overtime pay
  - Pay for nonstandard shifts
  - Incentive pay
- Occupation-wage differentials
- Experience/merit differentials
  - Automatic progression based on seniority
  - Merit
  - Combination of automatic and merit progression

# Role of Unions in Wage and Salary Policies and Practices (cont.)

- Other differentials
  - Pay to unionized employees employed by firm in different geographic areas
  - Part-time and temporary employees
- Vacations and holidays
- Wage adjustment provisions
  - Deferred wage increases
  - Re-opener clauses
  - Cost-of-living adjustments (COLAs) or escalator clauses



# Unions and Alternative Reward Systems

- When employers face extreme competitive pressures, unions are receptive to alternative reward systems linking pay to performance
- Union stipulations
  - Equity issue involves use of group-based measures with equal payouts
  - Minimize bias
    - Use of objective performance measures in unionized firms
    - Use of measures based on past performance
- 20 percent of all U.S. collective bargaining agreements permit some alternative reward system

# Types of Alternative Reward Systems

- Lump-sum awards
  - Given in lieu of merit increases
- Employee stock ownership plans (ESOPs)
  - Give employees part ownership in company
- Pay-for-knowledge plans
  - Pay employees more for learning a variety of different jobs or skills
- Gain-sharing plans
  - Align workers and management in efforts to streamline operations and cut costs
- Profit sharing plans
  - Allows union members to share wealth with more profitable firms

# Exhibit 15.2: Union Perceptions of Gain Sharing

## EXHIBIT 15.2 Union Perceptions of Gain Sharing

Source: <http://www.bovino-consulting.com/unions.htm>, Retrieved on June 7, 2006

### The top nine reasons for unions favoring gain sharing were:

1. Increased recognition
2. Better job security
3. Increased involvement with job activities
4. More money
5. Increased feeling of achievement or contributing to the organization
6. Increased influence of union
7. Greater contributions to the nation's productivity
8. Compatibility with union goals
9. Fewer grievances

### The top nine reasons for unions opposing gainsharing were:

1. Management may try to substitute it for wages
2. Management cannot be trusted
3. Peer pressure to perform may increase
4. Bonus calculations are not understood or trusted
5. Union influence is undermined
6. Increased productivity may reduce need for jobs
7. Grievances may go unprocessed
8. Gain sharing is incompatible with union goals
9. Employees really do not want more involvement

# Your turn

Answer the end of chapter 15 review questions  
and self-evaluation questions in the study guide