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• human resource certification preparation

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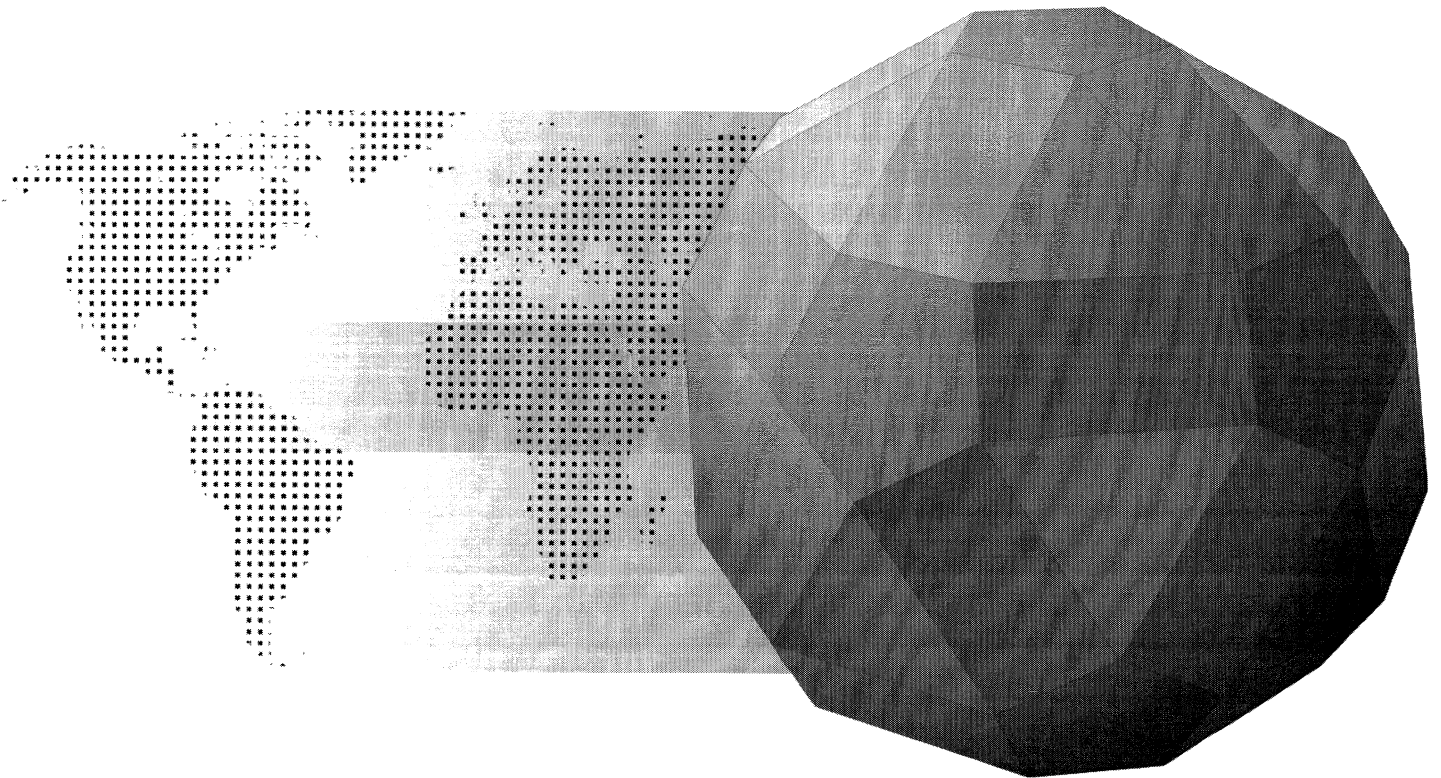
2018 Edition

UNIT 4 :: COMPENSATION AND BENEFITS

PHRi 04 Compensation, Benefits, and Work Experience

SPHRI 03 HR Service Delivery

SPHRI 04 Measurement and Analysis



HUMAN RESOURCE CERTIFICATION PREPARATION PROGRAM

Human Resource Certification Preparation Program: SPHRi™ and PHRi™ Exam Preparation
2018 Edition

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PREFACE

Our mission is to increase the standards of professionalism in the field of human resource management by helping HR managers learn the HR body of knowledge. HR managers perform a vital role in improving the quality of work life and increasing organizational effectiveness. Our desire is to have HR managers perform as true professionals by learning and applying the HR body of knowledge. We believe the human resource certification program plays a valuable role in increasing the level of professionalism. HR managers who consider themselves professionals should become certified to demonstrate their commitment to their profession.

Notice

The purpose of the *Human Resource Certification Preparation Program* is to help you prepare to take the human resource certification exam. These materials will help you learn the major concepts in the HR body of knowledge. Please be aware, however, of the following:

1. The *Human Resource Certification Preparation Program* does not teach to the test. Although these materials cover all of the major HR topics in each functional area, there is no course and no training resource available anywhere that is guaranteed to cover all of the content tested on the HR certification exam.
2. No training program, including the *Human Resource Certification Preparation Program*, is a substitute for practical experience in human resources. The HR certification exam covers “generalist” knowledge in the field of human resource management. Your success on the exam will depend in large part on your ability to apply HR concepts to practical situations.
3. Because the human resource management field is constantly changing, the HR certification exam must change as well. While we have made an effort to cover the major human resource management topics, there will likely be topics in the exam that are not covered in the *Human Resource Certification Preparation Program*. On the other hand, not all of the material covered in this program will be included in the exam. We have made every attempt to insure that the material in this program is correct and current. However, be aware that errors can occur and laws and practices may change.
4. These materials are intended for use as an aid to preparation for the HR certification exam. Studying these materials does not guarantee, however, that you will pass the exam. This program is not to be considered legal or professional advice.

International HR Certification Exams

The human resource certification exams are administered by the HR Certification Institute® (HRCI®), which is the credentialing organization for the human resource profession. HRCI has been certifying human resource professionals for more than 40 years. This set of study materials is designed to help individuals preparing for two international exams: the SPHRi and the PHRi.

SPHRi™ Exam

The SPHRi certification exam consists of 130 multiple-choice questions drawn from four functional areas. The number of questions from each area is determined by the percentage weight assigned to it. The functional areas have the following weights:

| | |
|-----------------------------------|-----|
| Business Leadership | 31% |
| Talent Development and Management | 27% |
| HR Service Delivery | 24% |
| Measurement and Analysis | 18% |

In addition to passing the certification exam, applicants for the SPHRi must demonstrate knowledge of their local HR laws. The following is a list provided by HRCI of some of the ways this requirement may be fulfilled:

- having a national or local certification (such as PHR, SPHR, GPHR, CHRP, etc.) that includes knowledge of employment laws
- having a bachelor's degree (or global equivalent) or higher in human resources
- completing a university- or college-level course in employment law
- completing a formal training class or certificate program in employment law sponsored by a university/college, HR association or other approved training provider

PHRi™ Exam

The PHRi certification exam consists of 170 multiple-choice questions drawn from six functional areas. The number of questions from each area is determined by the percentage weight assigned to it. The functional areas have the following weights:

| | |
|---|-----|
| Talent Acquisition | 19% |
| HR Administration and Shared Services | 19% |
| Management and Development | 19% |
| Compensation, Benefits, and Work Experience | 17% |
| Employee Relations and Risk Management | 16% |
| HR Information Management | 10% |

HRCI's content outlines for the SPHRi and PHRi exams are included at the end of the book.

About the Authors

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Acknowledgement

HRCP, L.C. expresses gratitude to the many individuals who have used our materials to prepare for the certification exams and to the various instructors who have adopted our materials for their review courses; many have provided invaluable feedback.

UNIT 4: COMPENSATION AND BENEFITS

| | |
|---|-----------|
| Preface | i |
| Notice | i |
| International HR Certification Exams | ii |
| SPHRI™ Exam | ii |
| PHRI™ Exam | ii |
| About the Authors | iii |
| Acknowledgement | iii |
| | |
| 4.1 Total Rewards: Financial and Non-financial | 1 |
| 4.1.1 Strategic Objectives of Compensation | 2 |
| 4.1.2 Ethical Considerations in Compensation | 3 |
| Compensation Maxim | 4 |
| Wages Versus Salaries | 4 |
| Pay Secrecy Versus Openness | 5 |
| 4.1.3 Determinants of Pay | 7 |
| 4.1.4 Three Wage Decisions | 7 |
| | |
| 4.2 The Wage-level Decision | 9 |
| 4.2.1 Establishing the Wage Level | 9 |
| 4.2.2 Factors Influencing the Wage-level Decision | 9 |
| 4.2.3 Wage Surveys | 10 |
| Government Surveys | 10 |
| Private Industry Surveys | 11 |
| Company-Sponsored Surveys | 11 |
| 4.2.4 Survey Methods | 11 |
| | |
| 4.3 Job Evaluation Methods | 13 |
| 4.3.1 Ranking Method | 14 |
| 4.3.2 Classification/Grading Method | 14 |
| 4.3.3 Point Method | 16 |
| 4.3.4 Factor Comparison Method | 20 |
| 4.3.5 Guide Chart-Profile Method (Hay method) | 22 |

| | |
|--|-----------|
| 4.4 Job Pricing and Pay Rate Administration | 25 |
| 4.4.1 Pay Grades and Pay Ranges | 25 |
| 4.4.2 Red-circle Job Rates | 27 |
| 4.4.3 Adjustments for Economic Conditions | 28 |
| Inflation | 28 |
| Economic Declines | 29 |
| 4.4.4 Individual Pay Rate Determination | 30 |
| Performance | 30 |
| Experience | 30 |
| Seniority | 30 |
| Potential | 31 |
| 4.4.5 Reflecting Geographic Influences in Pay Structures | 31 |
| 4.4.6 Establishing Administrative Controls | 31 |
| Control Through the Wage Structure | 31 |
| Controls Through Budgeting | 32 |
| | |
| 4.5 Economic Factors Affecting Compensation | 35 |
| 4.5.1 Inflation | 35 |
| 4.5.2 Interest Rates | 35 |
| 4.5.3 Industry Competition | 35 |
| 4.5.4 Foreign Competition | 36 |
| 4.5.5 Economic Growth | 36 |
| 4.5.6 Demographic Trends | 36 |
| | |
| 4.6 Incentive Compensation Systems | 37 |
| 4.6.1 Money and Motivation Theories | 37 |
| Need Theories | 37 |
| Self-determination Theory | 38 |
| Expectancy Theory | 39 |
| Equity Theory | 41 |
| Goal Setting Theory | 43 |
| Motivation and Financial Incentives | 44 |
| 4.6.2 Individual Incentives | 46 |
| Merit Pay | 46 |
| Bonuses | 47 |
| Piece-rate Incentives | 48 |
| The Standard Hour Plan | 48 |
| The Halsey Premium Plan | 49 |
| The Effectiveness of Piece-rate Incentives | 49 |

| | |
|--|-----------|
| 4.6.3 Skill and Knowledge Based Pay | 51 |
| 4.6.4 Differential Pay | 53 |
| Overtime | 53 |
| Shift Pay | 53 |
| Hazard Pay | 53 |
| On-call Pay | 53 |
| Call-back Pay | 53 |
| Weekend and Holiday Pay | 54 |
| 4.6.5 Group and Team Incentives | 54 |
| 4.6.6 Organization-wide Programs: Profit Sharing and Gainsharing | 55 |
| Profit Sharing | 55 |
| Gainsharing | 56 |
| 4.6.7 Strategic Alignment of Base Pay and Incentive Pay | 58 |
| 4.7 Executive Compensation | 63 |
| 4.7.1 Salaries | 63 |
| 4.7.2 Executive Bonus Plans | 64 |
| 4.7.3 Stock Options | 65 |
| 4.7.4 Nonfinancial Rewards | 66 |
| 4.7.5 Director Pay | 66 |
| 4.8 Employee Benefit Programs | 69 |
| 4.8.1 Pensions | 69 |
| Pension Plans | 69 |
| 4.8.2 Health and Accident Insurance | 70 |
| Medical Insurance | 70 |
| Dental Care | 70 |
| Dependent Care | 70 |
| 4.8.3 Income Replacement | 71 |
| Disability | 71 |
| Life Insurance | 72 |
| Severance Pay | 72 |
| 4.8.4 Employee Services | 72 |
| Legal Assistance | 74 |
| Auto and Property Insurance | 74 |
| Retirement Counseling | 74 |
| Transfer and Relocation Assistance | 74 |
| 4.8.5 Pay for Time Not Worked | 75 |
| Paid Holidays | 75 |

| | |
|--|------------|
| Paid Vacations | 75 |
| Paid Personal Leave | 75 |
| Union Activities | 75 |
| Reporting Time | 75 |
| Sabbatical Leaves | 76 |
| Paid Funeral Leave | 76 |
| 4.8.6 Recognition and Achievement Awards | 76 |
| Award Programs | 76 |
| Suggestion Systems | 77 |
| 4.9 Managing Employee Benefit Programs | 79 |
| 4.9.1 Employee Benefits Philosophy, Planning, and Strategy | 79 |
| 4.9.2 Employee Preference Assessment: Surveys | 79 |
| 4.9.3 Cost-Benefit Analysis and Cost Management | 80 |
| Benefit Plan Audits | 81 |
| Coordination of Benefits | 81 |
| Utilization Review | 81 |
| 4.9.4 Communicating Benefit Programs | 81 |
| Total Reward Statement | 82 |
| 4.10 Evaluating compensation | 85 |
| 4.10.1 Budgeting | 85 |
| Cost Management | 86 |
| 4.10.2 Assessment of Methods and Processes | 88 |
| 4.11 International HR Compensation Issues | 91 |
| 4.11.1 Expatriate Pay and Allowances | 91 |
| 4.11.2 Compensation and Benefits for Global Workers | 92 |
| Cost of Living Allowances | 92 |
| Exchange Rate Fluctuations | 92 |
| 4.12 Compensation Laws and Regulations | 95 |
| Key Terms | 97 |
| PHRi™ Exam Content Outline | 103 |
| SPHRi™ Exam Content Outline | 109 |
| Endnotes | 115 |
| Index | 119 |

UNIT 4: COMPENSATION AND BENEFITS

4.1 TOTAL REWARDS: FINANCIAL AND NON-FINANCIAL

People are willing to work in exchange for the inducements or rewards they receive from working. An employment exchange occurs when there is a balance between the inducements offered by the organization and the contributions made by the employees. The inducements include all of the rewards that individuals obtain from work, including both financial compensation and nonfinancial rewards, as shown in Exhibit 1. Financial compensation includes pay, financial incentives, and benefits, while nonfinancial rewards include characteristics associated with the job content and the job environment. These nonfinancial rewards are an important element in employee motivation and are often more important in motivating employees than financial incentives.

Exhibit 1: Total Rewards: Financial and Non-financial

INDUCEMENTS: REWARDS FOR WORK

Financial Compensation

Direct Pay

Wages
Salary

Direct Incentives

Merit Pay
Piece-Rate
Incentives
Bonuses
Group Incentives
Gain Sharing
Profit Sharing
Executive Incentives

Benefits

Health Care
Accident Insurance
Pay for Time Not Worked
Pensions
Employee Services

Nonfinancial Compensation

Job Content

Interesting Duties
Responsibility
Achievement
Recognition
Challenge
Advancement

Job Environment

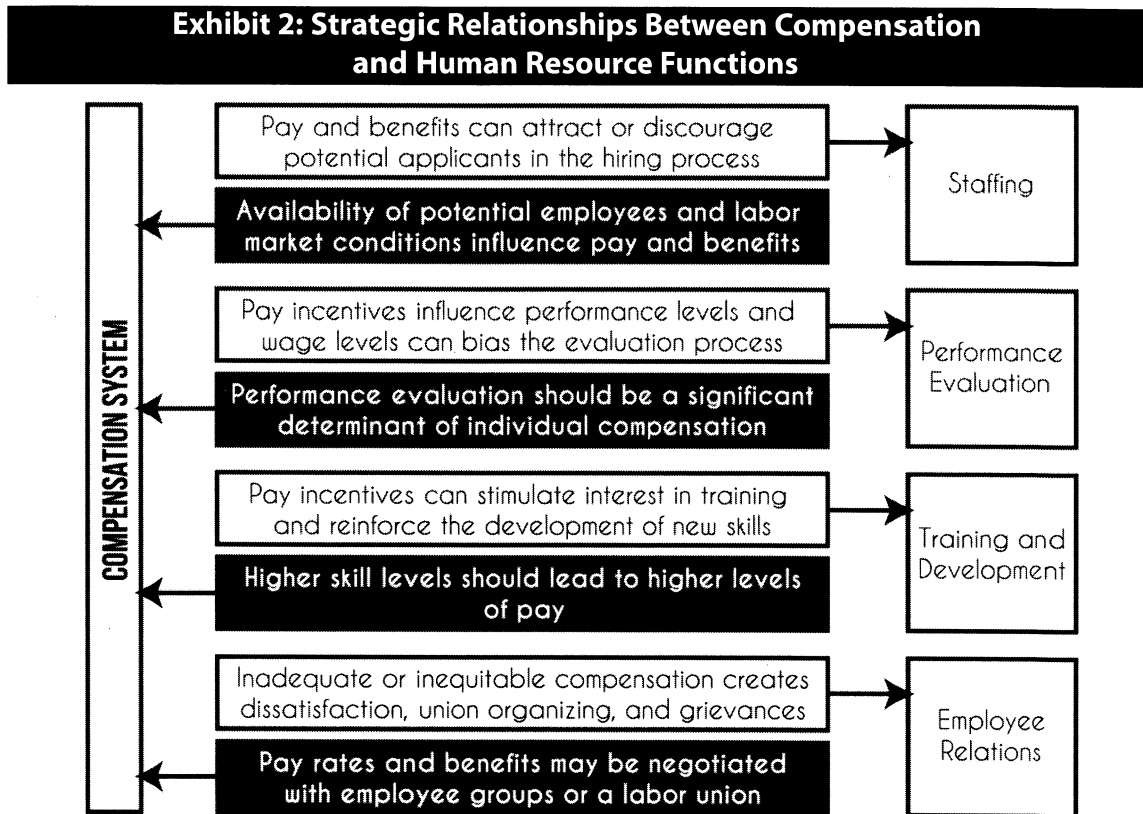
Comfortable Working Conditions
Friendly Co-Workers
Considerate Supervision
Status and Position
Fair Company Policies
Compatible Work Scheduling

Employers try to offer an attractive compensation package, consisting of base pay, incentives, and benefits, to attract employees and retain them. Employees are interested in all three components and consider each carefully when evaluating a job offer or considering a change in jobs. Employees also consider nonfinancial rewards, such as employment stability, the physical environment, commuting distance, the social environment in which the work is performed, and the nature of the work itself. For example, electricians who work for a manufacturing company may be satisfied with pay rates far below those received by

independent electrical contractors because they realize that working for a manufacturing company represents more stable employment than independent contracting.

4.1.1 Strategic Objectives of Compensation

Compensation administration is a strategic human resource function that has a significant impact on other human resource functions. Staffing, performance evaluation, training and development, and employee relations are all influenced by the compensation system and they, in turn, influence compensation. The relationship between compensation and other human resource functions is shown in Exhibit 2. The reason compensation has such a large impact on an organization's overall strategy is because it has such a strong influence on job satisfaction, productivity, labor turnover, and other organizational processes.



Total compensation consists of three major components: base pay, incentives, and benefits. In addition to practical considerations about what is legal and motivating, there are ethical considerations about what is just and fair.

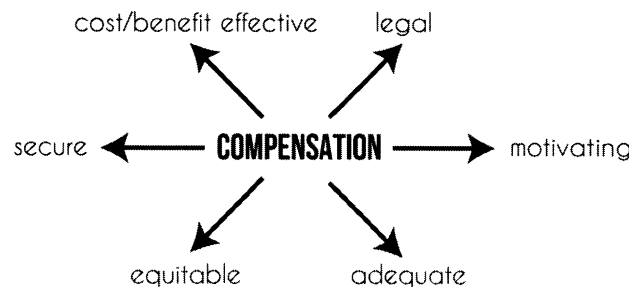
All employers have similar compensation objectives regardless of whether they are profit, nonprofit, or government agencies and regardless of size. The basic objectives are to attract qualified employees, retain them, and motivate them to perform their duties in the most effective manner. When pay decisions are made, several different objectives have to be considered simultaneously. For example, the decision to raise the pay of all mechanics might make them happy and facilitate the hiring of mechanics, but this decision also could create

several problems. It could destroy the conditions of equity with other craftworkers; it could increase the organization's labor costs and destroy its competitive position; it could inhibit motivation by destroying individual incentives; and it could be illegal if the pay increase was offered during a union election. Therefore, all pay decisions should satisfy these six objectives:

1. *Be legal:* Compensation must be consistent with numerous laws.
2. *Be adequate:* Compensation must be large enough to attract qualified employees to join the organization and stay.
3. *Be motivating:* The compensation package should provide sufficient incentives to motivate employees to perform efficiently.
4. *Be equitable:* The employees should feel that their compensation is internally equitable relative to other employees in the organization and externally equitable relative to employees doing similar work in other organizations.
5. *Provide security:* Employees like to feel that their monthly income is secure and predictable. They need to feel that their pay is somewhat insulated from changes in employment, profitability, individual performance, and personal health.
6. *Be cost-benefit effective:* The organization must administer the compensation system efficiently and have the financial resources to support it on a continuing basis.

Each of these objectives is important in developing a sound compensation system. As shown in Exhibit 3, however, these objectives require employers to balance competing objectives. For example, high wages that are adequate and able to attract qualified employees are inconsistent with the objective of being cost-benefit effective. Furthermore, as wages become more secure, they become less motivating. Security is achieved by providing a fixed monthly income, regardless of performance, while motivation is achieved by paying for performance.

Exhibit 3: Strategic Objectives of Compensation



4.1.2 Ethical Considerations in Compensation

In addition to practical considerations about what is legal and motivating there are ethical considerations about what is just and fair. Some of these ethical issues, such as the fairness of executive salaries and whether hourly employees are wage-slaves have been debated for many years. Other issues, such as the comparable worth controversy and mandatory health benefits are more recent.

Compensation Maxim

An ethical principle, called a maxim, regarding compensation is:

Employees should be compensated primarily according to the requirements of the jobs they perform and how well they perform them, and secondarily, by labor market conditions (supply and demand) and the organization's ability to pay.

Ethical issues concerning compensation are especially sensitive because money is such an important reason why people work. People expect to be treated fairly, and our concept of fairness is greatly influenced by such issues as why managers deserve more than laborers, why older workers should be paid more than younger workers, and whether people who need more should get it.

The idea of paying people according to their needs was a prevalent idea during earlier generations. People who supported large families often received higher wages to help them meet their financial needs. This practice partially explains why male-dominated jobs have historically paid more than female-dominated jobs and why many of these wage differentials still exist. In recent years, however, it is generally viewed as wrong to allow considerations of need to influence pay – pay should be based on the requirements of the job and how well it is performed. Nevertheless, how much employees need to support themselves and their families continues to influence pay for both men and women. Since welfare payments are based on need, some managers ask if it is right to ignore need as a determinant of pay.

Compensation systems ought to be rational and established according to reasonable criteria. A superficial review of what people earn seems to suggest that compensation is quite erratic. For example, grade school teachers normally make less than half the income of university professors, even though their student contact hours are three or four times greater and they play a greater role in shaping social values. These differences in income cannot be satisfactorily explained by differences in educational preparation. School teachers are underpaid for a variety of social and political reasons. The annual salaries of some public school teachers are less than the fees some management consultants charge for a single day of training. Similarly, school bus drivers typically are paid much less than city bus drivers, and yet city bus drivers often have better hours and working conditions than school bus drivers. Long-haul truck drivers make more than either school bus drivers or city bus drivers. Apparently, hauling packages and consumer goods pays more than hauling people, for reasons that are unclear.

Wages Versus Salaries

A second issue is whether employees should be paid an hourly wage or a salary. Some companies have tried to pay all of their employees on either an hourly wage or a salary basis to simplify the implementation of an electronic payroll system. Since supervisors and many non-supervisory white-collar employees receive monthly salaries, some argue that production workers should be paid similarly. However, some employers think production workers will abuse this situation: if production workers are paid monthly salaries regardless of their attendance, employers fear that they will have higher rates of absenteeism and tardiness.

Companies that pay monthly salaries instead of hourly wages generally report good results. Time clocks were retained for a time in some companies, but most were gradually eliminated. Paying salaries to everyone seems to improve employer-employee relations and to reduce class consciousness. Organizations that do not have a stable workflow, however, have difficulties paying salaries for everyone.

Changing from an hourly wage to a salary system generally does not improve productivity. Absenteeism often increases after a salary program is initiated, but peer pressure and subtle management controls usually bring it back to acceptable levels. Regardless of its long-term consequences, this issue is not a very serious concern to most employees because of the generous income-continuation and personal leave policies in their company's benefit package.

Pay Secrecy Versus Openness

A third issue is whether a company's policy regarding pay levels should be open or secret. Some pay systems are entirely open to the public; anyone who asks is told. Some public agencies and school systems even go so far as to publish complete lists of their employees and the salary each receives in local newspapers or on the internet. Some private employers also provide total wage transparency because they believe it makes recruiting new employees easier, by curtailing wage discussions, and it increases engagement.

At the other extreme is a pay-secrecy policy in which an individual's pay is known only by that person, his or her immediate supervisor, and the people in payroll. In some secret pay systems, the employee's contract clearly specifies that individual salaries are not to be revealed or discussed.

Between these two extremes are varying degrees of openness and secrecy. Although most private companies have pay systems that are moderately secret, the availability of electronic data and social media have encouraged them to be more transparent. Greater transparency can be achieved in stages. The first step is to make the wage determination process known by explaining how salary ranges are determined and what it takes to earn more. The second step is to reveal which jobs are in which labor grades and list the salary ranges for each grade. An additional step is to explain how bonuses and other rewards are determined.

Whether pay should be open or secret depends on whether the criteria is privacy, satisfaction, or productivity. If the criterion is individual privacy, then a secret pay system would be favored. If the criterion is job satisfaction, then the policy would vary from one company to another. Executives generally assume that most employees prefer a secret pay system, but the research evidence on this point is mixed. Although some studies have found that open pay systems increase job satisfaction, others have found that they decrease satisfaction.¹

If productivity is the criterion, then an open system is generally superior. Again, however, the research evidence is mixed. One study has shown that people tend to think they are equals; therefore, when pay is known those paid less than the top tend to exert less effort in their work.² Apparently, the benefit of an open pay system depends on (1) how accurately employees estimate the pay of their co-workers in the absence of confirming information, (2) how accurately performance can be measured, (3) whether the financial incentives for rewarding outstanding performance are large enough to be motivating, and (4) the

employees' need for additional income. Due to secret pay policies, many employees do not appreciate how much more they could earn if they increased their productivity or were promoted. To increase performance, an open pay system depends on sizable financial incentives and accurate performance measures.

Exhibit 4: Determinants of Pay

1. EXTERNAL FACTORS

- | | |
|--|--|
| <ul style="list-style-type: none"> A. Market factors B. Unions - settlements in other organizations C. Geographical pay differences D. Government regulations and laws E. Social expectations (customs) | <ul style="list-style-type: none"> 1. Supply and demand for labor 2. Educational and training institutions 3. Transferability of skills between industries and geographical areas 4. Changes in the composition of the work force 5. Economic conditions and unemployment |
|--|--|

2. ORGANIZATIONAL FACTORS

- | | |
|---|--|
| <ul style="list-style-type: none"> A. Industry in which the organization is located B. Union or nonunion C. Profitability and ability to pay D. Size E. Capital or labor intensive F. Philosophies of the organization G. Value of the job (contribution to the company) | <ul style="list-style-type: none"> 1. Wage leader versus wage follower 2. Mix of pay and benefits 3. Historical job relationships 4. Compensation policies, practices, and procedures 5. Part-time/full-time employment |
|---|--|

3. JOB FACTORS

- | | | | | |
|---|--|--|---|---|
| <ul style="list-style-type: none"> A. Skill B. Responsibility (for) C. Effort D. Working conditions | <ul style="list-style-type: none"> 1. Job conditions 2. Physical hazards | <ul style="list-style-type: none"> 1. Physical requirements (fatigue) 2. Mental effort 3. Attention to details 4. Pressure of work 5. Attention span required | <ul style="list-style-type: none"> 1. Money, financial rewards, commitments 2. Decision making 3. Supervision (work of others) 4. Financial results 5. Contacts with public, customers, and others 6. Dependability and accuracy (quality of work) 7. Materials, equipment, property 8. Determining company policy 9. Confidential information | <ul style="list-style-type: none"> 1. Mental requirements 2. Complexity of duties 3. Personal qualifications needed 4. Ability to make decisions, judgement 5. Managerial techniques 6. Preparation for the job (education, training, and knowledge) 7. Social skills (capacity to get along with others) 8. Ability to do detailed work 9. Ability to do routine work 10. Manual dexterity or motor skill 11. Creative ability 12. Initiative 13. Resourcefulness 14. Versatility/flexibility 15. Previous experience |
|---|--|--|---|---|

4. INDIVIDUAL FACTORS

- | | |
|---|--|
| <ul style="list-style-type: none"> A. Performance, productivity B. Experience C. Seniority, length of service D. Potential/promotability E. Personal preferences | <ul style="list-style-type: none"> 1. Desirability of the job itself 2. Status, prerequisites, title 3. Security of pay 4. Hours of work 5. Monotony 6. Out-of-town travel |
|---|--|

4.1.3 Determinants of Pay

Many factors besides the job market influence pay levels, and these factors need to be considered as a whole. For example, blue-collar workers who labor in unpleasant working conditions generally receive wages that compensate them for their discomfort. But executives who have dingy offices generally receive less than those who have lavish offices.

The major factors influencing pay, as presented in Exhibit 4, can be divided into four categories: external factors, organizational factors, job factors, and individual factors. Changes in labor supply and demand and in unemployment are the most important external factors influencing the amount of pay that employers must offer to attract and retain qualified employees. An external factor that is frequently overlooked is social expectations, or social customs. Certain jobs, such as nurse and secretary, have historically been viewed as “female” jobs that pay less than “male” jobs, even though these jobs are now held by both men and women.

Several organizational factors that also influence pay levels include industry standards, presence or absence of a union, and the size and profitability of the company. The organization’s philosophy concerning pay is particularly important, since some organizations try to be wage leaders, establishing high pay levels, while others prefer to be wage followers, with below-average pay levels. An organizational variable that is often overlooked is the value of a job to the company. Higher pay is generally given for a job that makes an important contribution to the company. The contribution does not necessarily have to be a financial contribution. For example, a school wanting to have a first-class athletic program generally pays its coaches more than a school that is satisfied with a mediocre athletic program.

The number of job factors that influence pay levels is almost limitless. However, the most important ones are those associated with skill, responsibility, and effort. Skill factors include both mental and physical skills, including the education, training, and preparation necessary to acquire those skills. Jobs that involve a great deal of responsibility usually receive higher pay, regardless of whether the responsibility concerns physical assets, financial assets, human resources, or company goodwill. Pay levels are also higher for jobs that require more physical or mental effort. The influence of working conditions, however, is minor unless the conditions become extremely unpleasant or hazardous. The most important individual factors are productivity and seniority.

4.1.4 Three Wage Decisions

The development of a sound wage and salary system requires three basic decisions. Each decision answers a critical question regarding an organization’s compensation program.

The **wage-level decision** concerns the overall level of an organization’s compensation. This decision answers the question, “How much money do members of one organization receive relative to people performing similar work in other organizations?”

The **wage-structure decision** concerns the pay awarded to different jobs within an organization. This decision answers the question, "How much money is paid for one job relative to other jobs within the same company?"

The **individual wage decision** concerns individual incentives and merit pay. This decision answers the question, "How much money does an employee receive relative to the money received by other employees who perform similar work?"

These three wage decisions illustrate the kinds of wage comparisons that employees make when they evaluate their wages. Accountants in Company A, for example, compare their wages with the wages of accountants in other organizations to see whether Company A has a higher or lower level of wages. The accountants also compare their wages with the pay of bookkeepers, computer programmers, and other members of Company A to learn whether the internal wage structure offers higher pay to jobs with more responsibility and greater difficulty. Finally, the accountants discuss their wages among themselves to determine whether each person's wage is the same or whether differences in wages are related to productivity, seniority, education, or something else.

Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at www.hrcp.com. Log into your account and click on My HRCP to access the practice exams.

1. Can you explain the relationship between compensation and other human resource functions (i.e. staffing, performance evaluation, training and development, employee relations)?
2. Can you describe the strategic objectives of compensation?
3. Can you list the major factors that contribute to determining pay?

4.2 THE WAGE-LEVEL DECISION

The **wage-level decision** primarily concerns the issue of pay adequacy: how much does one company pay relative to other companies with similar jobs? This is a policy decision made by top management. The organization can adopt a policy to *match* the going market rate for each job, or it can choose to *lead* the market or *lag* behind the market rate.

4.2.1 Establishing the Wage Level

Most organizations have a stated or implied wage-level policy, but they tend to communicate the policy verbally rather than in writing. The evidence indicates that a company with a policy to pay above-average wages is more likely to communicate its wage-level policy. The wage-level policies that some companies announce, however, are not necessarily the policies they follow. One study found that half the companies surveyed actually paid amounts that varied more than 5 percent from their stated policies. Since the largest variations resulted in both overpayment and underpayment, the conclusion of the study was that the errors resulted from ignorance of the going market rate rather than from a conscious effort to deceive the employees.³

A sound wage-level policy is expected to achieve three objectives: (1) to attract an adequate supply of labor, (2) to keep present employees reasonably satisfied with their compensation, and (3) to avoid costly turnover. These objectives are essential for organizational effectiveness; however, wage-level changes seem to have only a small impact on them. Attracting and keeping employees depends on many nonwage factors, especially unemployment levels in the economy. Extremely large increases in the pay level are probably required to attract a noticeably larger pool of job applicants, especially blue-collar workers.

Except for limited evidence showing that some employees will change jobs for higher pay, the consequences of wage-level changes are basically undetermined. It is probably safe to speculate that a ten or 20 percent increase in the wage level would reduce turnover and create a temporary increase in satisfaction. But across-the-board wage increases probably do not increase productivity.

4.2.2 Factors Influencing the Wage-level Decision

A company's wage level is most directly influenced by the policies and preferences of management. Top management can arbitrarily choose to pay wages and salaries that are above or below the market level. In some organizations the wage levels are extremely low to reduce labor costs and increase profits. In other organizations all employees are paid high salaries for humanitarian reasons.

Wage levels also are influenced by other factors. According to the available evidence, the most significant factors influencing wage levels are organizational size, unionization, and productivity (or ability to pay). Large organizations generally pay higher wages than small organizations. In the United States, firms with 1,000 or more employees usually pay about 30 percent more in direct wages per hour than smaller firms in the same industry and larger firms spend about twice as much on benefits. Similar wage differentials are usually found in

other European industries, while Japanese firms exhibit even greater differentials. Small Japanese firms with less than 50 employees only pay about 55 percent as much as large firms with more than 1,000 employees.⁴

The reason why larger organizations tend to pay more is not clear. Some research suggests that larger firms pay more because workers who are better educated, more stable, and less prone to quit or be fired are more likely to work for larger companies where job tenure is rewarded. Opposing studies, however, have found that wage differences in large versus small firms are unrelated to the quality of employees, unionization, working conditions, or the need for workers who require less monitoring. It may be that large firms pay more simply because managers feel less accountable for monitoring wages.⁵ Another explanation is that large organizations are able to pay higher wages because of their competitive advantage or improved ability to pay.

The wage levels of companies that bargain with unions generally tend to be higher than those of nonunion companies. Strong unions apparently are able to raise an organization's wage level through aggressive bargaining. However, if an organization is financially weak, which is the condition of many school districts, aggressive bargaining might have little effect. While union bargaining has raised the wages of organizations that were low, it also has caused the wage leaders to drop back. Collective bargaining has narrowed the wage range between different organizations within a given industry.

As productivity and the ability to pay increase, it is reasonable to expect the wage level to increase, too. However, not much research has been done on this association because of the difficulty of developing a standardized formula for defining an organization's ability to pay and because of the confidentiality of such information. Nevertheless, the pay reductions by organizations in financial difficulty clearly suggest that wage levels are influenced by profitability. Several employee groups, most notably those in the steel, auto, and rubber industries, have accepted wage cuts to avoid plant closings.

4.2.3 Wage Surveys

The major tool for making wage-level decisions is the **wage survey** (or pay survey). These surveys collect information about the compensation and benefits of other employees in similar industries or in the same geographical region. In a nonunion firm that has an average profit picture for its industry, the most compelling definition of an equitable wage is usually the going wage as determined by a wage survey. Both employees and managers are inclined to accept such a wage level as equitable.

There are three primary kinds of wage surveys: (1) surveys conducted by government agencies, (2) surveys conducted by professional organizations, and (3) surveys conducted by individual companies.

Government Surveys

Wage surveys are conducted by government agencies in many countries. These surveys typically report the occupational earnings and benefits of selected blue-and white-collar jobs in professions such as accountants, engineers, key entry operators, secretaries, machinists, mechanics, material handler laborers, and truck drivers.

Private Industry Surveys

Several professional organizations conduct wage surveys of their members. For example, the Society for Human Resource Management collects wage information from its members and publishes a report showing salary levels analyzed by position, by geographic region, by experience, and by education.

Company-Sponsored Surveys

The most frequently used surveys are those conducted by a firm or a group of cooperating firms. It is not uncommon for human resource directors of small companies to talk informally by phone or at a luncheon with other human resource directors in their area and share wage information regarding certain key jobs. In large organizations, a full-time staff person or a task force may be responsible for designing and conducting wage surveys. In metropolitan areas, numerous business associations—such as an employers' association, an industrial relations council, or a chamber of commerce—may share wage information.

For these do-it-yourself wage surveys to be useful, four conditions must be met:

1. *Reciprocity*: Organizations conducting surveys must be willing to share their wage information in exchange for the information they collect from others.
2. *Anonymity*: The information should be reported in a way that does not identify the wages of individual organizations.
3. *Low cost*: The method used to collect and analyze the data must be efficient and inexpensive.
4. *Timeliness*: The information must be current, especially in times of high inflation.

The major advantage of a do-it-yourself survey is that it can be designed to accommodate an organization's unique needs. If any organization is considering a pay increase for certain jobs, it can obtain timely information on these jobs by having the human resource department conduct a wage survey. Information from published surveys might not be available for the specific jobs in question, or, if it is, it might be two or three years old.

The major advantages of published surveys are their low cost, large sample size, and degree of sophistication. Many published wage surveys can be obtained at no cost to a company because they appear in journals and published reports. Most published wage surveys are based on sample sizes that are much larger than an individual organization could hope to survey economically. The survey procedures used by professional organizations have become sophisticated in recent years, and thus the information collected by these organizations is reliable and useful.

4.2.4 Survey Methods

Three methods are normally used to conduct a wage survey: personal interviews, mailed questionnaires, and telephone inquiries. Personal interviews are the slowest and most costly method, but they are also the most accurate. Personal interviews by trained field interviewers are able to minimize some of the serious criticisms of wage surveys. These criticisms center on the difficulty of making valid comparisons between different job descriptions, earnings, and benefits. For example, many jobs have the same title, such as "secretary," but the responsibilities and demands of the jobs with that title vary significantly. Unless the level of

each job is accurately classified, by someone such as a trained field interviewer, the wage data are meaningless.

An employee's earnings can also be difficult to interpret because of such things as overtime, incentive pay, and bonuses. The hourly or weekly rates of pay for some positions are not related to their total earnings. Finally, benefits vary dramatically from organization to organization, and such things as paid holidays, free meals, and clothing allowances are part of the total compensation.

Trained field interviewers are better able to account for unique job differences than mailed questionnaires that rely on the personal interpretation of the individual completing the form. Mailed questionnaires are the cheapest and probably the most frequently used method of conducting individual wage surveys. For mailed questionnaires to be useful, however, the jobs, earnings, and benefits must be described carefully (which adds to the length and complexity of the questionnaires and makes the respondents less willing to complete it). Telephone inquiries are often used to clarify information from mailed questionnaires or simply to obtain a quick, informal survey of local wages. Detailed information on several jobs cannot be obtained very conveniently by phone.

Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at www.hrcp.com. Log into your account and click on My HRCP to access the practice exams.

1. Can you explain the factors that most influence the wage-level decision?
2. Can you list and describe the various types of wage surveys?
3. Can you explain the conditions necessary for do-it-yourself wage surveys to be successful?

4.3 JOB EVALUATION METHODS

The systematic approach of determining the relative worth or value of each job in an organization is referred to as **job evaluation**. The basic purpose of job evaluation is to eliminate pay inequities and create a wage structure that identifies appropriate pay ranges for different jobs. The relative worth of each job is established by identifying factors that define “worth” and by comparing the requirements of each job with these factors.

Determining how much each job should be paid relative to other jobs in the organization is called the **wage-structure decision**. Here the amount of money is based on the job demands and not on how well the job holder performs (although the wage structure must allow for individual variances based on performance, experience, and seniority). All jobs in an organization are not worth the same rate of pay. Some jobs require greater skill and mental ability than others, some require greater physical effort, and some entail considerably more responsibility. The major objective of the wage-structure decision is to provide equal pay for jobs of equal worth and an acceptable set of pay differentials for jobs of unequal worth.

Some companies rely almost exclusively on wage surveys to make wage-structure decisions. However, wage surveys alone are not adequate because organizations usually have unique jobs for which there are no surveys, and wages based on wage surveys do not guarantee internal equity among jobs.

Many companies use a job evaluation committee that typically consists of five to seven individuals. An industrial engineer or a job analyst often serves as an ex officio member of the committee and is responsible for clarifying the information on the job descriptions. Sometimes managers are reluctant to allow employees to participate in developing a wage structure, but the evidence indicates that managers’ fears concerning employee involvement are largely unfounded. Trained job evaluators do not seem to be any more reliable than other employees who have been trained. Furthermore, research on the reliability of evaluator ratings indicates that a committee of three to five individuals is adequate.⁶

One study looked for evidences of sex-bias in job evaluation procedures and found that the ratings of different jobs were not biased by either the sex of the evaluator or the dominant sex of the job incumbents. These results suggest that job evaluation methods can help to eliminate sex-biased compensation systems.⁷

The job evaluation committee should have access to written job descriptions and the committee members ought to be thoroughly familiar with the jobs being evaluated. The written job descriptions should describe each job accurately, and employees should be asked to review their own job descriptions to ensure that the descriptions are correct and complete.

Many different job evaluation systems have been developed and used in various organizations. Most of these systems consist of one of these methods or a combination of them:

- Job ranking
- Classification

- Point method
- Factor comparison

Ranking and classification are considered non-quantitative methods because they do not produce a precise numerical score for each of the jobs being evaluated. Instead, these methods produce a position for each job in a job-worth hierarchy. Ranking and classification methods are also called “whole-job” evaluation methods because they determine the relative worth of jobs on the basis of an overall, or global, assessment of the content of the jobs. The factor comparison and point methods are quantitative methods that evaluate the content of jobs on a factor-by-factor basis and produce a precise numerical score for each job.

4.3.1 Ranking Method

The simplest method of developing a wage structure is to have the job-evaluation committee rank the jobs from highest to lowest in value. Although the committee could perform three or four rankings based on three or four different factors, the jobs usually are ranked only once according to their overall worth. The advantages of the **job-ranking method** are that it is the simplest of all the evaluation methods and it requires little time or paperwork.

The disadvantages of the job-ranking method are:

1. The differentials between the ranks are assumed to be equal when they usually are not (e.g., there is usually very little difference in worth between jobs in the middle of the ranking, but big differences generally exist between jobs at the top and bottom ends of the ranking).
2. Evaluating each job as a whole is not conducive to a careful analysis and cannot provide an accurate measurement of worth.
3. The ranking method is difficult to use in organizations with large numbers of jobs.

A useful technique to help evaluators rank a large list of jobs is to arrange them into clusters of related jobs, called job series, and rank each series separately. If an overall ranking is needed, it can be obtained easily by merging the job series that are already ranked.

4.3.2 Classification/Grading Method

The **classification method** (or predetermined-grading method) consists of establishing a predetermined number of grades or job classes. The classification process specifies a number of grades beforehand, and broad descriptions then are written of the types of jobs to be placed in each of the grades. Next, each job is evaluated by comparing its description with the descriptions for the grades, and it is then placed into the appropriate grade. The job grades range from high to low, and each grade has a verbal description with examples of the kinds of jobs that fit into it, as illustrated in Exhibit 5. A good classification system is difficult to develop and requires extensive knowledge about the dimensions of different jobs and the relative worth of the dimensions.

One advantage of a classification system is that it standardizes the wages for similar jobs and maintains pay differentials between jobs within an extremely large organization. For example, a new chemical engineer starting work with the federal government should receive

about the same pay regardless of the geographical region in which he or she works and regardless of which government agency is the employer. The disadvantage of using a classification system is that its stability makes it unresponsive to such factors as regional wage differences and labor-market variances. Managers have been known to manipulate job descriptions and job assignments to have a job placed in a higher or lower classification than “the rules” would indicate.

Exhibit 5: Illustration of Three Grades in a Classification System

Grade 1 includes those classes of positions the duties of which are to perform, under immediate supervision with little or no latitude of the exercise of independent judgement -

- (A) the simplest routine work in office, business, or fiscal operations; or
- (B) elementary work of a subordinate technical character in a preprofessional, scientific, or technical field.

Grade 5 includes those classes of positions the duties of which are -

- (A) to perform under general supervision difficult and responsible work in office, business, or fiscal administration or comparable subordinate technical work in a professional, scientific, or technical field requiring in either case -
 - (1) considerable training and supervisory or career experience
 - (2) broad working knowledge of a special subject matter or of office, laboratory, engineering, scientific or other procedures and practices and
 - (3) the exercise of independent judgement in a limited field.
- (B) to perform under immediate supervision and with little opportunity for the exercise of independent judgement simple and elementary work requiring professional, scientific, or technical training, or
- (C) to perform other work of equal importance, difficulty, and responsibility, and requiring comparable qualifications.

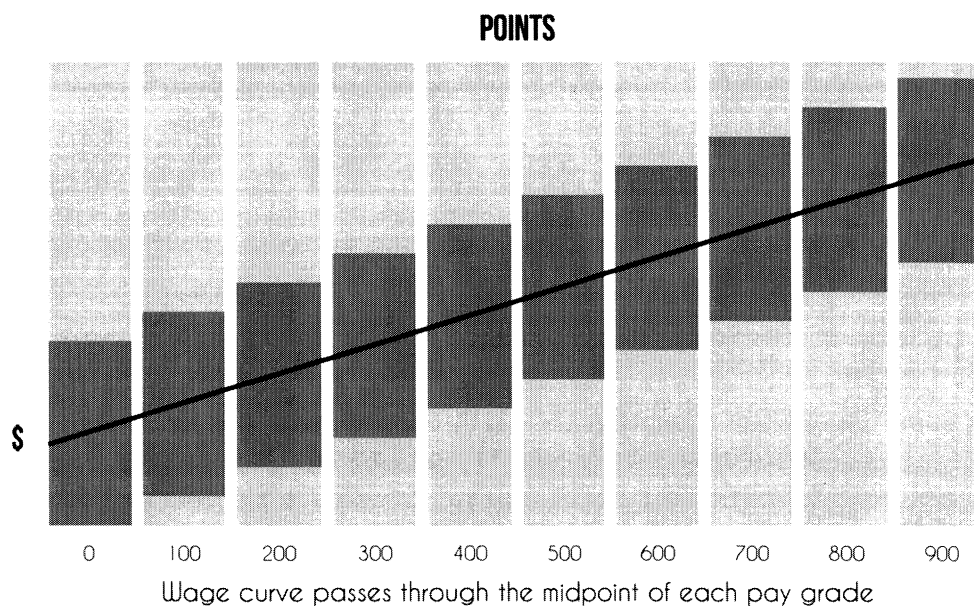
Grade 9 includes those classes of positions the duties of which are -

- (A) to perform, under general supervision, very difficult and responsible work along special technical, supervisory, or administrative lines in office, business, or fiscal administration, requiring -
 - (1) somewhat extended specialized training and considerable specialized, supervisory, or administrative experience which has demonstrated capacity for sound independent work;
 - (2) thorough and fundamental knowledge of a special and complex subject matter, or of the profession, art or science involved and
 - (3) considerable latitude for the exercise of independent judgement;
- (B) with considerable latitude for the exercise of independent judgement, to perform moderately difficult and responsible work requiring -
 - (1) professional, scientific, or technical training equivalent to that represented by graduation from a college or university of recognized standing; and
 - (2) considerable additional professional, scientific, or technical training or experience which has demonstrated capacity for sound independent work; or
- (C) to perform other work of equal importance, difficulty, and responsibility, and requiring comparable qualifications.

4.3.3 Point Method

The **point method** is the most frequently used job evaluation method because it is not very difficult to administer after it has been established and the decisions are defensible. The point method consists of analyzing the content of jobs from the written job descriptions and then allocating points for specific factors. The number of points assigned to each job determines a range of pay for that job as illustrated in Exhibit 6. The procedure for developing the point method consists of six steps:

Exhibit 6: Illustration of a Wage Curve Using the Point Method of Job Evaluation



1. *Identify key jobs:* A list of 12 to 20 key jobs needs to be identified. By definition, **key jobs** (sometimes called benchmark jobs) are jobs that are equitably paid. They are not necessarily the most important jobs in the organization, but they should be jobs that are stable and well-defined. There should be a consensus of opinion that these jobs are equitably paid because the wage structure for the entire organization will be based on these key jobs. Wage surveys help to identify key jobs.
2. *Identify job factors used to determine pay levels:* These factors are called **compensable factors** because they are the important factors for which compensation is given; they represent the critical dimensions that would justify paying one job more than another if all else were held constant. Some of the most frequently used factors include responsibility, physical demands, hazards, skill, working conditions, supervisory responsibilities, and mental requirements. Many point systems have ten or more compensable factors. However, research has consistently shown that three or four factors are highly correlated (greater than .90) with the overall results of an evaluation in which more factors are used. Studies have suggested that experience, responsibility, and skill requirements (or education/training) tend to be the most

significant factors determining pay regardless of whether they are combined into one factor or separated into two or more factors.

Even though the responsibility-education-experience factor seems to have by far the greatest impact on the wage structure in many areas, other factors also should be considered. Such factors as working conditions, hazards, and physical demands may not have much impact on the wage structure, but they do influence some jobs. Moreover, employees believe that a multifactor system is necessary to consider all the relevant aspects of a job. Six to eight factors should usually be sufficient.

3. *Weight the factors according to their contribution to the overall worth of the job:* The weights assigned to the factors will reflect the values of management and society. The most heavily weighted factors tend to be responsibility, knowledge, education, experience, complexity of duties, and supervisory responsibility. Sometimes unskilled workers are critical of the heavy weighting of education and skill, claiming that the only reason these factors are highly weighted is because the managers whose jobs require such factors are the ones who determine the weights. Although this criticism is often true, the heavy weighting of education and skill also can be defended on these grounds: (1) If education and skill are not heavily weighted, the final wage structure will be distorted and inequitable; (2) Jobs requiring high levels of skill and education usually go unfilled in the labor market and therefore need to pay well to attract qualified employees; (3) Financial incentives are considered equitable and necessary to reward individuals who have obtained additional skill and education. In Exhibit 7, skill is weighted four times as heavily as working conditions.

Exhibit 7: Point Assignments for Four Compensable Factors

| EXAMPLE: | COMPENSABLE FACTOR | DEGREE | POINTS |
|------------------|--------------------|--------|--------|
| Regrind operator | Skill | 3 | 48 |
| | Responsibility | 2 | 24 |
| | Effort | 4 | 36 |
| | Working Conditions | 4 | 18 |
| | Total Points | | 126 |

| COMPENSABLE FACTOR | WEIGHTED PERCENTAGE | DEGREES/POINTS | | | | |
|--------------------|---------------------|----------------|----|----|----|-----|
| | | 1 | 2 | 3 | 4 | 5 |
| Skill | (40%) | 20 | 32 | 48 | 72 | 100 |
| Responsibility | (30%) | 15 | 24 | 36 | 54 | 75 |
| Effort | (20%) | 10 | 16 | 24 | 36 | 50 |
| Working Conditions | (10%) | 5 | 8 | 12 | 18 | 25 |

4. *Divide each job factor into degrees that range from high to low and assign points to each degree:* An example of the degree assignments for the physical-demands factor is shown in Exhibit 8. The degrees need to be described clearly so that evaluators can reliably determine the degrees for each factor from the job descriptions. The number of points assigned to each degree should correspond with the weighting of the factor. For example, if the factor of skill is weighted 40 percent, the factor of working

conditions is weighted ten percent, and both factors have five degrees, degree two for skill should have four times as many points as degree two for working conditions.

Exhibit 8: Physical Demands Factor

This factor refers to the physical energy expended in standing, lifting, carrying, pulling, and pushing. Consider the amount of the weight that is involved and the percentage of time the worker is normally required to perform these activities. The terms "occasional" and "frequent" are defined as follows:

OCCASIONAL: observable during the normal workday routine but required less than 30 percent of the time

FREQUENT: required more than 30 percent of the time

| DEGREE | DEFINITION | EXAMPLES |
|--------|---|---|
| 1 | Very light work. Occasional lifting, up to ten pounds. May frequently lift and/or carry materials of negligible weights such as dockets, ledgers, small tools, and the like. | Audit clerk, clerk-typist, computer programmer, draftsman, payroll clerk, roller bearing inspector, sorter, timekeeper |
| 2 | Light work. Occasional lifting, up to twenty pounds. May frequently lift and/or carry objects weighing up to ten pounds. Jobs should also be rated in this category when they require continuous walking or standing even though the weight lifted is negligible, or when they require sitting most of the time but call for pushing or pulling arm and/or leg controls. | Barber, bevel saw operator, delivery clerk, die maker, drill sharpener, meter tester, loader boss, surveyor, production checker |
| 3 | Medium work. Occasional lifting, up to fifty pounds. May frequently lift and/or carry objects weighing up to twenty pounds. May be called upon to push or pull equivalent to lifting requirements. | Bricklayer, draw bench operator, machinist, tool and die maker, chipper, electrical repairperson |
| 4 | Heavy work. Occasional lifting, up to eighty pounds. May frequently lift and/or carry objects weighing up to forty pounds. May be called upon to push or pull equivalent to lifting requirements. | Blacksmith, boiler mechanic, heat treater, pipebender, steamfitter, rigger, drop-hammer operator |
| 5 | Very heavy work. Occasional lifting, more than eighty pounds. May frequently lift and/or carry objects weighing over forty pounds. May be called upon to push or pull equivalent to lifting requirements. | Feed loader, foundry laborer, hod carrier, longshoreman, miner, cross tie feeder, bending roll operator |

5. *Reach a consensus about degree assignments:* Before the committee as a whole discusses the evaluations and assigns the degrees and points to the factors for each job, each member should evaluate the jobs individually. The committee's decisions should then be reached by consensus rather than by voting or averaging. Reaching a

consensus is important even if the committee has to get more information about a job by interviewing the job holder or by observing the work performed. When evaluating jobs, the committee should follow these guidelines: (a) base the evaluation strictly on the requirements of the job, (b) consider only post-orientation entry level requirements, (c) focus primarily on what the worker does during the large majority of the time, (d) assess value relative to the total organization rather than the projected market value, and (e) avoid being influenced by the individual's performance level, education (since it may be more than is required by the job), or organizational level (since responsibility is usually a separate factor).

6. *Develop a wage curve using key jobs:* The total points for each job are calculated by summing the points assigned for each factor. The average pay for each key job can be obtained from payroll records; however, it is usually compared with wage survey data, when possible, to confirm its equity. Once the total points and the average pay of the key jobs have been determined, the data can be plotted on a graph. The **wage curve** is generally a straight line (linear curve), since the higher-level degrees are heavily weighted. The points usually are placed along the horizontal axis (the x-axis) and pay is placed along the vertical axis (the y-axis). Two methods of deriving a wage curve are (a) the freehand method of drawing a line that comes as close as possible to the key jobs; and (b) the least-squares regression line that is derived by finding the slope and y-intercept from two statistical equations.

The formula for a line is $Y = a + bX$. The following formulas are used to find the values of a and b:

$$b = \frac{(N \sum XY) - (\sum X)(\sum Y)}{(N \sum X^2) - (\sum X)^2}$$

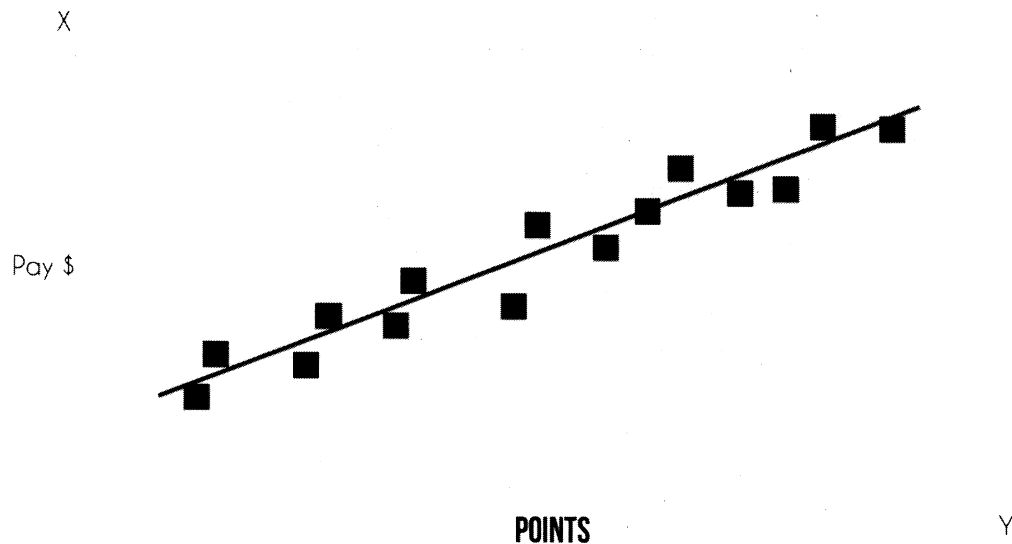
$$a = \frac{\sum Y}{N} - \left(\frac{\sum X}{N} \times b \right)$$

- N = number of jobs
- $\sum X$ = sum of the point values
- $\sum Y$ = sum of the average hourly pay rate
- $\sum XY$ = sum of the point values times the average pay rate
- $\sum X^2$ = sum of the point values squared

The regression line is clearly the most accurate method, although pay administrators are sometimes frightened by statistical equations. Fifteen key jobs plotted on a graph with a wage curve obtained from a regression line is show in Exhibit 9.⁸

After the wage curve has been drawn, the total points are usually divided into labor grades, or job classes, and a range of pay is assigned to each grade. A wage curve divided into eight labor grades is shown in Exhibits 6 and 11. All jobs in the same grade have the same pay range. The purpose of using labor grades rather than the wage curve is for ease of administration. It is easier to administer 15 or 20 labor grades than hundreds of separate points along the wage curve.

Exhibit 9: Illustration of a Wage Curve Based on 15 Key Jobs



Although most point systems have 15 to 20 labor grades, some have suggested reducing this number. This is accomplished by creating very wide labor grades and is called **broadbanding**. Broadbanding reduces the number of job classifications but increases the pay range. The advantage of broadbanding is that it allows for more jobs to fall in the same pay classification, which facilitates job rotation in work teams. If the grades are wide enough, all team members might be in the same labor grade, which encourages them to freely rotate jobs.⁹

Once the wage structure has been established using the key jobs, the appropriate level of pay can be determined for other jobs. The committee decides how many points other jobs should receive and refers to the wage curve to know how much these jobs should be paid. Unique jobs can be evaluated objectively, and logical explanations can be provided to justify their rates of pay.

4.3.4 Factor Comparison Method

The factor comparison method is conceptually similar to the point method but slightly more complex, and because of its added complexity, it is not as popular as the point method. Surveys indicate that it is used in only ten to fifteen percent of the organizations that use job-evaluation methods.¹⁰ The factor-comparison method consists of the following steps:

1. *Identify key (benchmark) jobs:* As with the point method, these are equitably paid and generally well-known jobs. The difference is that only five to eight key jobs are normally used in the factor-comparison method in contrast to the 12 to 20 key jobs used in the point method.

2. *Identify job factors:* These factors should represent the important dimensions of worth, just as in the point method. Most factor comparison methods use these five factors: mental requirements, physical requirements, skill, responsibility, and working conditions.
3. *Rank jobs:* The key jobs should be ranked with respect to each of the factors independently.
4. *Assign monetary amounts to each job on each factor:* The amount of money assigned to each job on a given factor should be consistent with how the jobs were ranked on that factor. When the dollar amounts assigned to a job are added for all five factors, their sum should equal the current rate of pay. This step is somewhat subjective, and the success of the method depends on how carefully the dollar amounts are assigned to each job on each factor.
5. *Compare unique jobs with key jobs:* This should be done, factor by factor, to determine how much each unique job should be paid.

The factor-comparison method is illustrated in Exhibit 10. In this exhibit, four student library jobs are considered equitably paid and serve as key jobs. Unique jobs, such as operating a copy machine, are compared against these key jobs to determine an equitable rate of pay. For example, the copy-center job is similar to a job at the circulation desk on three factors, but slightly lower on mental demands and higher on working conditions.

**Exhibit 10: The Factor Comparison Method
Using Student Jobs in a University Library**

| \$ Per Hour | Mental Demands | Physical Demands | Skill | Responsibility | Working Conditions |
|-------------|--------------------|---------------------|---------------------|---------------------|--------------------|
| \$4.00 | Reference (4.00) | Janitor (4.00) | Reference (4.00) | Reference (4.00) | |
| | | Sorter (3.50) | | *Circulation (3.50) | |
| \$3.00 | Circulation (3.10) | | | | Janitor (2.60) |
| \$2.00 | *Sorter (2.00) | | Sorter (2.00) | | |
| | | Reference (1.50) | *Circulation (1.50) | | |
| \$1.00 | | *Circulation (1.00) | Janitor (1.00) | Sorter (1.00) | *Sorter (1.00) |
| | Janitor (.40) | | | Janitor (.40) | Circulation (.40) |
| \$0.00 | | | | | Reference (.20) |

Reference librarian = \$4.00 + 1.50 + 4.00 + 4.00 + 0.20 = \$13.70 / hr.
 Circulation desk = \$3.10 + 1.00 + 1.50 + 3.50 + 0.40 = \$9.50 / hr.
 Sorter & Shelves = \$2.00 + 3.50 + 2.00 + 1.00 + 1.00 = \$9.50 / hr.
 Janitor = \$0.40 + 4.00 + 1.00 + 0.40 + 2.60 = \$8.40 / hr.
 *Copy center = \$2.00 + 1.00 + 1.50 + 3.50 + 1.00 = \$9.00 / hr.

4.3.5 Guide Chart-Profile Method (Hay method)

The Hay Guide Chart-Profile Method is a job evaluation system that is basically a factor comparison system, although it is also very similar to the point method since it uses points. The Hay system is used by more than 5,000 employers worldwide, including many of the largest corporations. This method uses three compensable factors:

- Know-how
- Problem solving
- Accountability

For each of these compensable factors, the Hay method uses two-dimensional matrices showing the number of points assigned to that factor. The points are determined by comparing the job description with the appropriate rows and columns for each matrix.

For the know-how factor, there are four levels of managerial know-how (limited, related, diverse, and comprehensive) and eight levels of technical know-how (ranging from primary to professional mastery). Each level of technical know-how has three degrees, and within each cell there are also subcategories that recognize three different levels of human relations skills (basic, important, and critical). An evaluator may select among at least 288 (4 x 8 x 3 x 3) different combinations of managerial, technical, and human relations know-how to evaluate a job.

Additional points come from problem solving, calculated as a percent of know-how. Problem solving has two dimensions: the thinking environment in which the problems are solved (eight levels) and the thinking challenge presented by the problem (five levels). This matrix contains 40 (5 x 8) cells, and each cell contains a percentage figure that is multiplied by the know-how factor to determine the number of points for problem solving.

Accountability is the answerability for action and for the consequences of action. This matrix contains nine levels of freedom to act and four levels of magnitude, with each level being subdivided into four degrees of impact (remote, contributory, shared, and primary).

Because the compensable factors of the Hay method are defined so broadly and generally, this system can be used for many different industries and many different jobs. After the points for each job have been determined, the job can be assigned to a labor grade with a corresponding pay range, similar to the point method.

Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at www.hrcp.com. Log into your account and click on My HRCP to access the practice exams.

1. Can you explain the purpose of job evaluation?
2. Can you describe and compare the job ranking, classification, point, factor comparison, and Hay methods of job evaluation?
3. Can you define key (or benchmark) jobs, as used in the point method?

~Notes~

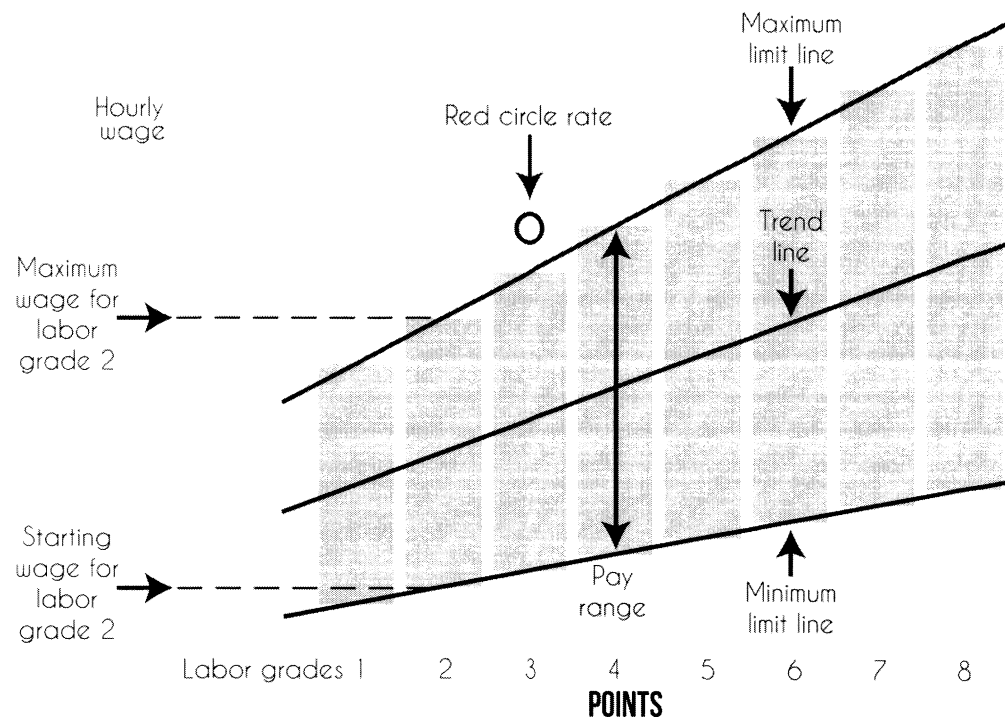
4.4 JOB PRICING AND PAY RATE ADMINISTRATION

After the jobs have been arranged in a hierarchy of job worth, specific amounts of pay need to be associated with them. The process of placing a dollar value on the worth of a job is referred to as **job pricing**. In pricing a job, most organizations assign a pay range rather than a specific fixed amount to allow for individual differences in performance. Similar jobs are grouped together into pay grades. Job pricing involves making decisions about **pay ranges** and **pay grades** in addition to developing a plan for adjusting the wage structure as necessary because of inflation. Developing the pay ranges is part of the **wage-structure decision**.

4.4.1 Pay Grades and Pay Ranges

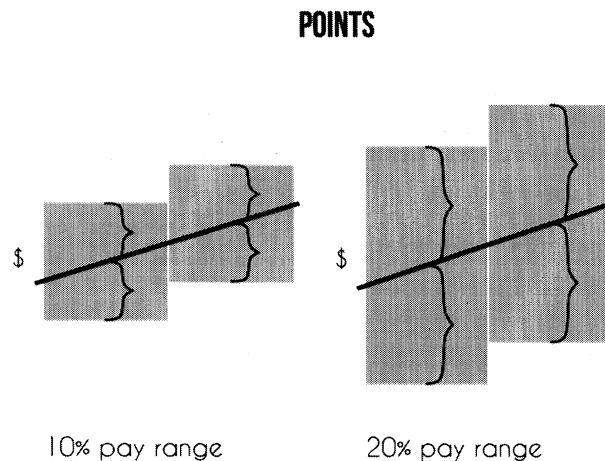
When a wage structure is developed, jobs are grouped into pay grades (also called a labor grade or job class) according to the points associated with them, and a range of pay rather than a specific wage is usually assigned to each pay grade to reward individual performance. By grouping similar jobs into a limited number of pay grades, rather than dealing with dozens of separate jobs, companies can simplify the administration of their compensation system. Pay grades are illustrated in Exhibit 11. An organization could have fewer pay grades by expanding the width of each grade. How many pay grades a company should have can be decided arbitrarily by assigning a fixed width to each labor grade; however, a better procedure is to plot each of the jobs on a chart and see if natural clusters of jobs exist.

Exhibit 11: Illustration of Pay Grades Constructed Along the Wage Curve



Most pay grades have pay ranges that are ten to 20 percent above and below the midpoint of each grade, called the range spread. The pay grades shown in Exhibit 11 have a range spread of 30 percent (15 percent above and below the midpoint of the wage line) to allow for individual incentives. A narrow pay range, such as ten percent above or below the wage curve, provides a much smaller incentive than a wide pay range, such as plus or minus 20 percent. Exhibit 12 illustrates these two pay ranges.

Exhibit 12: Illustration of Two Pay Ranges



New employees usually are paid the minimum of a pay range. Advancement within the pay range typically is based on performance and years of service. A reasonable pay policy is to allow employees to advance from the bottom of a pay range to the midpoint based upon their years of service; advancement to the top of the pay range is only permitted for those who are outstanding performers. This policy allows long-term employees who are average performers to be paid more than new employees and still have some incentive to become outstanding employees.

A useful number for analyzing how people are paid within each pay range is called a **compa-ratio**. This number is calculated by dividing a person's wage rate by the midpoint of the pay range and multiplying by 100. Someone earning \$9.00 USD per hour in a pay range with a midpoint of \$8.00 per hour would have a compa-ratio of 112.5 ($\$9 \div \8×100). A pay range of ± 20 percent would have compa-ratios between 80 and 120.

Compa-ratios can be calculated for groups and used for budgetary control purposes or to investigate discrimination. Budgetary control can be imposed by not allowing supervisors to make pay increases that exceed a specified compa-ratio. If the compa-ratio of one minority group is significantly different than the compa-ratio of another group this difference indicates the possibility of pay discrimination. This difference ought to be examined to see if pay needs to be revised or if it can be explained by differences in seniority or performance.

In some compensation systems individual pay levels are based on step increases. The step increases for one labor grade are illustrated in Exhibit 13. These step increases are based on performance and length of service. The exhibit shows a labor grade containing six step

increases and three performance levels. The starting salary for this labor grade is \$11.00, and the maximum salary is \$16.98. To reach the maximum, an employee must have a high performance level and must advance through all six steps of the labor grade. The step increases can be automatic—advancing one step each year—or variable. Variable periods of time for the step increases provide an additional means for supervisors to control pay increases. Supervisors not only evaluate performance but also decide when it is appropriate to advance each employee to a higher step within the labor grade.

Exhibit 13: Step Increases Based on Performance and Length of Service

| steps | PERFORMANCE LEVEL | | | | | | |
|--------|-------------------|-------|-------|-------|-------|-------|---------|
| | minimum | 1 | 2 | 3 | 4 | 5 | maximum |
| High | 13.30 | 13.97 | 14.67 | 15.40 | 16.17 | 16.98 | |
| Medium | 12.10 | 12.58 | 13.08 | 13.60 | 14.15 | 14.72 | |
| Low | 11.00 | 11.35 | 11.65 | 12.00 | 12.40 | 12.75 | |

Advancement within a labor grade also may be based strictly upon performance. To help supervisors make decisions regarding pay increases, the human resource department frequently provides merit increase guidelines showing the increases for each performance rating. Examples of these guidelines are presented later under Merit Pay Systems.

The purpose of following carefully developed merit pay guidelines is that it prevents having outstanding employees reach the top of their labor grade too soon. When employees reach the top of their labor grade, they are said to be “**topped out.**” Once employees are topped out, they can only receive pay increases by being promoted to higher level jobs or through cost-of-living increases that raise the entire wage curve. Merit increases represent one of the many important ways by which individual performance can be recognized.

4.4.2 Red-circle Job Rates

After all of the jobs have been evaluated, they can be plotted on a scatter diagram, as shown in Exhibit 9. Hopefully, the dot representing each job will fall within the pay range for its particular pay grade. Jobs that fall outside the pay ranges present special problems. These jobs are referred to as **red-circle rates** because they are either overpaid or underpaid.¹¹ (Sometimes underpaid jobs are called **blue circle** or **green circle rates.**)

Underpaid jobs are easy to correct since their pay rates can be raised immediately. Overpaid jobs are more difficult to correct. An illustration of an overpaid job is shown in Exhibit 11. The job is represented by a dot with a circle around it, indicating that it is a red-circle rate. The employees performing this job have been earning more than the maximum amount that this job should pay. One obvious solution to the problem is to reduce the wages for this job. However, pay cuts usually produce bad feelings unless employees understand the job-evaluation procedure and agree that their jobs are overpaid. Large pay cuts force employees to suddenly change their standard of living, something that is not easy to do.

A second approach to handling overpaid jobs is to notify the employees that their jobs are overpaid and that their pay will be systematically reduced by small increments over a period of time. If the employees understand the job-evaluation procedure and are given enough time to change their standard of living, this method will not produce as much dissatisfaction as an immediate pay cut.

A third approach is to hold the rates constant until inflation and other cost-of-living increases have increased the rest of the wage curve. These jobs are excluded from normal cost-of-living increases when pay rates are adjusted. Overpaid jobs can be brought back into line fairly quickly during times of high inflation.

A fourth approach is to redesign the job, usually by adding more responsibility. If the job is redesigned, it may no longer be overpaid. Finally, a fifth approach is to promote overpaid workers to higher-level positions. This is an ideal solution if the employees have the proper qualifications for promotion.

4.4.3 Adjustments for Economic Conditions

Inflation

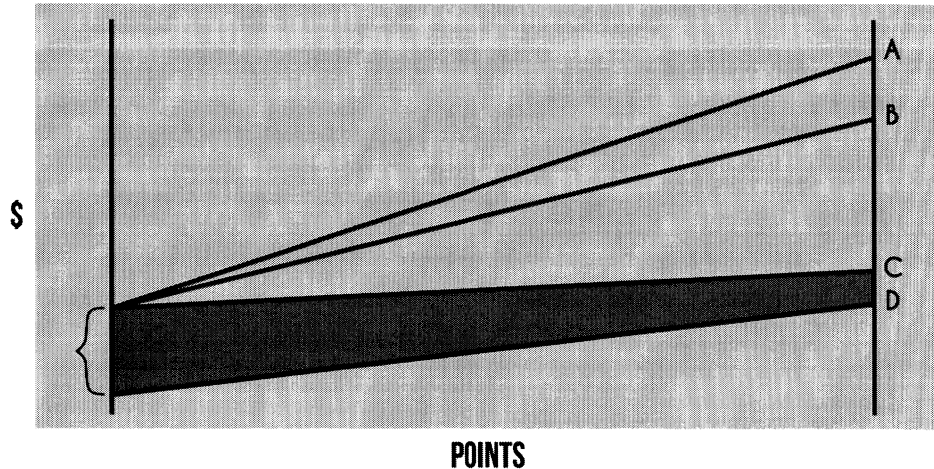
After a wage curve has been developed, it is generally easy to administer. As new jobs are created, the job-evaluation committee evaluates them and assigns an equitable pay range for them. However, some administrative problems may arise when the wage structure has to be adjusted due to inflation or internal changes within the organization, such as job redesign.

Two methods typically are used to adjust the wage curve. The first method is to provide an across-the-board increase of so many cents per hour for every job. An across-the-board increase amounts to a **fixed-rate-increase** and is illustrated in Exhibit 14 by line B. This curve shows a fixed increase of 50 cents per hour for every job. Many organizations have a fixed-rate increase tied to the **consumer price index (CPI)**, which measures the rate of inflation in the economy. Labor agreements that contain a **cost-of-living adjustment (COLA)** typically provide a fixed-rate increase triggered by changes in the CPI. One major labor agreement, for example, provides for a one-cent-per-hour increase in every job for every .1 increase in the consumer price index.

The second method of adjusting the wage curve is to use a **percentage increase** whereby the rate for each job is increased by a specified percent. Line A in Exhibit 14 illustrates a percentage increase in the wage curve. Higher-paid jobs receive a larger cents-per-hour increase than lower-paid jobs. Ten percent of ten dollars is only a one-dollar-per-hour increase, whereas ten percent of twenty dollars amounts to a two-dollar-per-hour increase.

Occasionally, organizations raise the bottom end of the wage curve faster than the top end because of special situations. Such a situation is described by line C in Exhibit 14. Here the pay increases become successively smaller with higher-level jobs. The two situations that are most likely to result in such a **decreasing-rate increase** typically are increases in minimum-wage legislation and collective-bargaining pressures that grant larger increases to lower-level jobs.

Exhibit 14: Illustration of Wage Compression Fixed-Rate versus Percentage Increase



Over an extended period of time, both decreasing-rate and fixed-rate increases result in **wage compression**. The problem caused by wage compression is that eventually organizations are unable to promote employees to high-level positions because the financial incentives for accepting more responsibility and skill are too small to attract employees. Some organizations have faced serious staffing problems because of their inability to promote lower-level employees into higher-level jobs that do not provide adequate incentives. A small amount of wage compression occurs even with percentage increases because of the tax structure in society: people who have higher incomes are subject to higher income tax rates. To maintain adequate financial incentives to reward upper-level jobs, some organizations have found it necessary to use increasing-percentage increases as they adjust their wage curves.

Economic Declines

Everyone is happy when the economy is thriving and employers can afford to raise wages; raising wages is not a problem. During economic declines, however, employers are faced with difficult choices. Their most common responses are to impose hiring freezes, defer pay increases, furlough workers, and require executives to take a week of unpaid leave.

Pay cuts are not popular. The common thinking is that pay cuts destroy morale and encourage top performers to go elsewhere. Employers can cut bonuses, eliminate raises, and even slash benefits, but base pay cuts have generally been viewed as sacrosanct and out of the question.¹²

Pay cuts, nevertheless, are a viable option during economic downturns. Some companies have learned that their employees would rather take reductions in base pay than to see some of their colleagues laid off. Highly cohesive companies where employees feel connected to each other are especially prone to recommend pay cuts as a strategy for saving jobs.

4.4.4 Individual Pay Rate Determination

The third major decision in designing a compensation system is the **individual wage decision**. This decision concerns the relative pay of individuals who perform similar jobs in the same company. If workers perform similar jobs and their performance and experience are equal, it is reasonable to pay them all the same. But if some are more productive or have more experience and training, then they should receive more money.

The individual wage decision influences feelings of job satisfaction and pay equity. Intense feelings of inequity can be created by unfavorable comparisons between co-workers regarding their pay. Higher-producing employees think they should receive higher pay than co-workers who produce less. Individuals who work together usually know how much each is paid, and they compare their performances.

Performance

Performance differences are clearly the most reasonable and well-accepted justification for paying differential amounts. Most individuals accept the principle that workers who produce more should receive higher pay. This pay-for-performance principle is particularly strong among individuals who accept the work ethic. Studies have shown that individuals who score high on the Protestant work ethic scale tend to think high performers ought to be highly rewarded to establish a condition of equity. On the other hand, individuals with low Protestant work ethic scores tend to believe that the rewards should be distributed equally to both high and low performers.¹³ Outstanding employees generally feel very demoralized when they are paid the same as less productive workers.

Experience

A common justification for giving some employees more money is that they have more experience. Years of experience are often related to productivity, and paying for experience is sometimes just another way of paying for performance. As workers accumulate more years of service, they become more productive. One study of 300 clerical workers found a rather high correlation (.60) between the efficiency ratings that the workers were given by managers and the workers' length of service. These results indicate that either length of service is related to performance, or that efficiency ratings are influenced by length of service, or both.¹⁴

A similar argument is usually made in justifying pay differentials for education. Individuals with more education are assumed to be more productive. For example, a school system usually has a wage schedule showing how much additional money should be paid to a teacher with a bachelor's, master's, or doctorate degree, or even with an additional 30 hours of graduate training. Some companies encourage their managers to return to school for additional training by offering educational incentives. The large enrollments in night MBA programs, extension courses, and educational centers on military bases indicate that these educational incentives are generally effective. Frequently, companies not only pay the cost of education but also pay higher salaries to employees who complete courses.

Seniority

Pay differentials based on seniority or length of service are found in many compensation systems. It is not uncommon for a wage decision to reflect the belief that long-term employees should be rewarded for faithful service even though their present performance

might not justify pay increases. Several organizations, such as school systems and government agencies, have salary schedules that contain step increases within each labor grade that are based on years of service or seniority. Pay differentials based on seniority often are defended as legitimate even when no relationship exists between seniority and performance.

Potential

Occasionally, organizations pay higher than average wages to individuals who demonstrate outstanding potential. Many new employees are paid higher than normal starting salaries if they have the potential for becoming supervisors or high-level managers. Since recent university graduates have not had opportunities to demonstrate potential, the decision to pay them more is generally based on grades in their university studies, leadership experiences, professional association memberships, and other academic activities. After new employees have been with an organization for a while, however, they are evaluated on what they have actually accomplished rather than on their potential for future performance.

Individual pay also can be affected by organizational politics and luck. The recommendations of influential people can create intense pressures on organizations to promote individuals and to provide pay increases. Pay levels also are influenced by being in the right place at the right time. Although being qualified and prepared are important prerequisites for being able to take advantage of opportunities, the fact that the opportunity is presented sometimes results from luck or chance. Political influence and luck should not be considered bona fide determinants of financial compensation, but overlooking them would amount to ignoring reality.

4.4.5 Reflecting Geographic Influences in Pay Structures

Wage and salary structures need to be adjusted according to the cost of living in each area and the desirability of the area for attracting employees. Companies that have operating units located in several locations may need to offer incentives to encourage employees to transfer to locations that are especially expensive or undesirable.

The cost of living is much higher in some metropolitan cities than in other smaller-sized cities and more rural areas. Companies that fail to adjust their salaries for these geographic differences will be overpaying employees in rural locations and underpaying employees in metropolitan locations.

4.4.6 Establishing Administrative Controls

Pay decisions are controlled by two basic processes: (a) the design of the wage structure and (b) the formal budgeting process.

Control Through the Wage Structure

When an organization's wage structure is designed, all of the jobs are carefully analyzed (usually with the aid of written job descriptions), labor grades are established, the jobs are assigned to specific labor grades, and each labor grade has a pay range specifying the minimum and maximum pay rates. These pay ranges help supervisors make fair and equitable pay decisions for both starting wages and pay increases. As previously stated,

wages that fall below the minimum of the range should be increased, something everyone agrees should be done immediately. Wages that are above the maximum of the range (called red-circle rates), need to be brought back into line with the wage structure.

Guidelines are usually provided to help supervisors recommend pay increases based on performance ratings and years of service. If supervisors follow these guidelines, the wage levels they recommend will stay within the appropriate pay range. Compa-ratios can be used to examine the equity and fairness of the wage structure by comparing the average compa-ratios of different ethnic and gender groups. Although differences between the average compa-ratios of various gender or ethnic groups do not necessarily indicate that supervisors are making biased pay decisions, the causes of the differences ought to be examined further.

Controls Through Budgeting

The budgeting process is the principal mechanism used to control all operating expenses in a firm. Budgeting helps to ensure that future financial expenditures are coordinated and controlled. The budget becomes a plan within which managers operate and a standard against which managers' actual expenditures are evaluated. Pay budgeting involves forecasting the compensation costs associated with employing people for the next budgeted year. Separate budget estimates should be made for pay, benefits, and pay increase amounts.

The two basic approaches to generating compensation budgets are the top-down and bottom-up methods. The top-down method involves estimating the pay increase budget for an entire organization and then allocating designated amounts to the different departments. Once supervisors know how much the wages have increased for their units, they are expected to make pay increase recommendations for each member based on relative performance and get them approved by a second level supervisor.

The bottom-up method of budgeting requires supervisors to monitor the number of people working in their units and to make careful wage increase decisions. Supervisors need to understand the budgeting process; they need to know the guidelines for making pay increases, and they need to have accurate information on the performance of their members.

Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at www.hrcp.com. Log into your account and click on My HRCP to access the practice exams.

1. Can you explain the procedure for establishing pay grades and ranges?
2. Can you describe how to calculate a compa-ratio and explain how compa-ratios are useful?
3. Can you define red-circle rates? (And blue or green?)
4. Can you describe the methods and consequences of adjusting the wage curve (i.e. for inflation)?
5. Can you explain how administrative controls can be placed on pay-rate decisions?

~Notes~

4.5 ECONOMIC FACTORS AFFECTING COMPENSATION

4.5.1 Inflation

Inflation has a substantial impact on compensation practices. At moderate rates of inflation, compensation systems must be revised annually to keep wages and salaries competitive, and the value of long-term savings and investments tends to erode. When employers revise their wage structure to adjust for moderate inflation, they have the opportunity to penalize low performers without cutting their wages by failing to raise their wages as fast as the rate of inflation.

Managing a compensation program is especially difficult during periods of high inflation. Companies in countries with high inflation rates are required to revise their salary schedules monthly or even weekly.

4.5.2 Interest Rates

Interest rates are related to inflation and closely tied to economic growth. Employment levels are influenced by interest rates because of the effects of interest on the cost of capital. When interest rates go up, the cost of capital increases, which reduces the amount of business investment. Therefore, high interest rates tend to reduce employment levels because of reduced economic activity. Employment in the construction and auto industries is especially hurt by high interest rates since consumers use loans to purchase houses and cars. As interest rates decline and employment levels improve, there are growing pressures to increase wages and benefits.

4.5.3 Industry Competition

Competition occurs in both the public and private sectors. In industry, competition occurs when firms vie for a customer's business. A clear illustration of industry competition is when two gas stations are located at the same intersection. Price pressures usually result since motorists generally buy more gas from the station with the lower prices. Similar pressures also exist among organizations such as hospitals, colleges, and government agencies where there is competition for scarce resources or clients.

Economic pressure through competition forces organizations to change their human resource strategies. As competitiveness increases, organizations offer fewer rewards to employees. In competitive industries, only the highly successful firms are able to offer high wages and benefits and favorable working conditions. Less effective firms may be severely limited in the wages and salaries they can offer, which means they may experience difficulty recruiting and hiring skilled employees. The less successful firms also may not be able to maintain positive worker attitudes, and they may experience higher absenteeism and turnover and more pressure from their employees to organize a union than the successful firms.

4.5.4 Foreign Competition

International competition results in similar job movement. Many companies have been forced to close because of their inability to compete successfully with foreign competitors, and many other companies have been struggling to survive. For example, American automakers have faced heavy competition from foreign car manufacturers, especially the Japanese. For more than a decade, American automakers experienced a loss in market share before they succeeded in designing new products to reverse the trend.

4.5.5 Economic Growth

Compensation is tied to productivity. Real increases in wages and salaries, as opposed to increases due to inflation, are directly related to increases in productivity. Productivity largely determines how effectively companies and nations compete in international markets. **Productivity** is the total goods and services produced by society divided by the total number of employee hours required to produce them.

Productivity improvements have a major impact on economic prosperity. A nation's standard of living and changes in its real compensation are closely tied to changes in its productivity. Increasing productivity is one sure way a nation can afford to raise wages while remaining competitive in an increasingly global economy.

4.5.6 Demographic Trends

Compensation practices are influenced by the supply of labor; an excess supply tends to depress wage rates, while labor shortages tend to increase wages. The labor market is primarily influenced by five demographic forces: birthrates, participation rates, immigration, education, and unemployment.

Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at www.hrcp.com. Log into your account and click on My HRCP to access the practice exams.

1. Can you describe the impact that environmental factors such as inflation, interest rates, and competition can have on compensation?
2. Can you explain how demographic trends in the labor market can impact wages?

4.6 INCENTIVE COMPENSATION SYSTEMS

Designing an effective incentive program is an important strategic human resource issue. For organizations to compete successfully in a dynamic economy, they must have highly motivated employees who are dependable and competent. Such a commitment to excellence comes from a combination of both intrinsic and extrinsic rewards.

4.6.1 Money and Motivation Theories

Money is a significant factor in almost every theory of motivation. However, these theories predict varied, and in some cases contradictory, effects of money. Some of the major motivation theories that have implications for financial incentives include Maslow's need hierarchy, McClelland's theory of learned needs, Herzberg's hygiene-motivator theory, self-determination theory, expectancy theory, equity theory, goal-setting theory, and reinforcement theories.

Need Theories

The most popular need theory is the Hierarchy of Needs Theory proposed by Abraham Maslow. He believed everyone possessed a common set of five universal needs that were ordered in a hierarchy of importance from the lowest level basic needs through the highest order needs.

1. *Physiological needs*: needs that must be satisfied for the person to survive, including food, water, oxygen, sleep, sex, and sensory satisfaction.
2. *Safety and security needs*: a desire for security, stability, dependency, protection, freedom from fear and anxiety, and a need for structure, order, and law.
3. *Social needs*: the need for emotional love, friendship, and affectionate relationships with people in general, but especially a spouse, children, and friends.
4. *Ego and esteem*: the desire for self-respect, self-esteem, and for the esteem of others.
5. *Self-actualization*: the needs for self-realization, continuous self-development, and the process of becoming all that a person is capable of becoming.

According to Maslow these five needs are arranged in a hierarchy of importance which he called *prepotency*. Higher-level needs are not important and are not manifest until lower-level needs are satisfied. Once lower-level needs are satisfied, needs at the next highest level emerge and influence behavior.

David McClelland's Learned Needs Theory examined the needs for achievement, affiliation, and power and described how they were acquired, their behavioral characteristics, and their effects on society. The need that received the greatest research attention was the need for achievement, abbreviated nAch. High need achievers are characterized by personal responsibility, moderate risk, and a strong desire for feedback. McClelland found that the need for achievement was important for economic activity and entrepreneurial success.

McClelland concluded from his research that the need for achievement, like other personality characteristics, is apparently learned at an early age and largely influenced by child-rearing practices and other influences of parents. Children tend to have a fairly high need for

achievement if they have been raised by parents who have fairly strict expectations about right and wrong behavior, who provide clear feedback on the effectiveness of their performance, and who help their children accept a personal responsibility for their actions.¹⁵

McClelland argued that economic development and national prosperity were closely related to the need for achievement and recommended that management development programs and foreign aid programs focus on raising the need for achievement rather than on skill training or providing financial aid.

Frederick Herzberg proposed a motivator-hygiene theory which suggests that the motivator variables contributing to satisfaction and productivity are completely separate from the hygiene factors that determine levels of dissatisfaction. Motivators refer to factors that are related to the *content* of the job, such as recognition, achievement, and responsibility. Hygienes refer to factors that are related to the *context* of the job, such as salary, supervision, and company policies.

According to Herzberg, the factors that create satisfaction and dissatisfaction are qualitatively distinct. Herzberg suggested that these two factors are as separate in influencing job attitudes as vision and hearing are in perceiving the environment. Just as increasing or decreasing light will have no effect on a person's hearing, neither will increasing or decreasing the hygienes have any impact on motivation. If the hygiene factors are not present, the employees will experience job dissatisfaction. If they are present, however, there will be no dissatisfaction, but increasing them further will not lead to satisfaction. Likewise, if the motivators are present, employees will feel satisfied and motivated, but their absence will not create dissatisfaction.

Herzberg's claim that money is a hygiene factor and should not be used to motivate workers has been highly controversial. Although research has failed to support Herzberg's claim of two separate factors, his theory has been successfully applied to job redesign programs where significant job enrichment has occurred by focusing on the motivator factors.

Self-determination Theory

Self-determination theory is a motivation theory that examines the effects of extrinsic rewards, such as money and recognition awards, on intrinsic satisfaction. It was originally called intrinsic reward theory because the early research seemed to show that intrinsic satisfaction and the joy of performing an activity were destroyed by extrinsic rewards; being rewarded for doing something somehow made it less interesting.¹⁶

The label was subsequently changed to self-determination theory since the research suggested that it was the controlling nature of extrinsic rewards that destroys intrinsic satisfaction. The idea is that when people are paid to do something, they feel a loss of personal control; they are induced by bribes and they recoil at the loss of personal control.¹⁷

The early studies seemed to show that intrinsic motivation was destroyed by all external factors, such as tangible rewards and deadlines, surveillance, and performance evaluations.¹⁸ The studies were done mostly with children in a laboratory and they found that intrinsic satisfaction was diminished by all forms of extrinsic rewards, including money, gold stars, candy, and praise. Obviously, this theory has serious implications for compensation since

money is an important extrinsic reward and companies use financial incentives to motivate their employees. Employers want their employees to be engaged and derive intrinsic satisfaction from their work.

As it was originally framed, self-determination theory discouraged the use of bonuses, incentives, and employee recognition programs since all of these are extrinsic rewards and most of them involve elements of surveillance and performance evaluation. The argument is not that incentives do not work, because it is clear that well-designed incentive programs can have an immediate and substantial impact on behavior. The claim is that they work for all the wrong reasons.

Subsequent research found, however, that in some situations external rewards did not necessarily destroy intrinsic satisfaction. A meta-analysis of 128 laboratory experiments found that positive feedback enhances intrinsic motivation and the damaging effects of tangible rewards can be mitigated when the rewards are neither anticipated nor contingent on task performance.¹⁹ Therefore, to the extent that extrinsic rewards provide positive feedback on one's performance, or to the extent that they are unexpected and not part of a contingent reward system, they have the potential of increasing rather than destroying intrinsic motivation.

In an actual work setting, employees expect to be paid and they appreciate performance feedback. Therefore, managers should not worry about destroying intrinsic satisfaction by giving employees pay and other extrinsic rewards. Although incentives can be demeaning when they are used to create competition or to control behavior, they can also be used to encourage people to perform well and take pride in their work.²⁰

Expectancy Theory

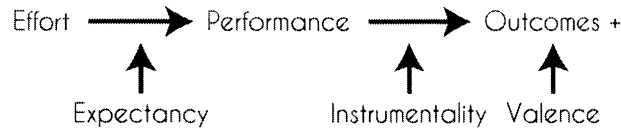
Expectancy Theory is a cognitive model of motivation based on the conscious thought processes of individuals as they evaluate the situation. It is also a decision-making theory that explains how individuals decide what to do by evaluating the outcomes and probabilities associated with them.

Expectancy Theory was derived from the research and thinking of many people including philosophers, economists, psychologists, and managers. The earliest roots of Expectancy theory stemmed from the English utilitarians of the 18th and 19th centuries, most notably Jeremy Bentham and John Stuart Mill, and the principle of hedonism. They claimed that individuals compute a hedonistic calculus which enables them to choose among possible alternatives on the basis of their assumptions about the relative amounts of pleasure and pain each option has to offer.

The first systematic and comprehensive formulation of Expectancy Theory was presented by Victor Vroom in his classic book, *Work and Motivation*.²¹ Expectancy Theory explains the relationships between effort, performance, and rewards (or outcomes).

The determinants of effort: The basic idea of Expectancy Theory is that motivation is determined by the outcomes people expect to occur as a result of their actions. The basic elements of this theory are shown in the diagram below: the amount of effort an individual is willing to exert depends on (a) the perceived relationship between effort and performance (expectancy), (b)

the perceived relationship between performance and the outcomes (instrumentality), and (c) the value of the outcomes (valence).



Expectancy refers to the probability that effort will lead to performance. “If I really try hard, can I do this job?” “If I exert enough effort, can I perform well?” This relationship is viewed as a probability, and in research on Expectancy Theory, individuals are asked to estimate the perceived probability that a certain level of effort will achieve a particular level of performance. Workers who are highly skilled and have direct control over their work normally report a high expectancy since they know they can perform well if they try. Expectancies are much lower on jobs where employees see little relationship between their effort and performance, such as sales jobs where sales depends more on the customer’s needs than the efforts of the sales representatives.

Instrumentality refers to the relationship between performance and outcomes. “If I perform well, will I be rewarded?” “What are the consequences for performing well?” Most situations produce a variety of consequences and some outcomes are more likely than others. Since several outcomes are possible, individuals subjectively calculate several instrumentalities to decide what to do—one for each outcome. Instrumentalities are typically viewed as a correlation coefficient showing the relationship between two variables. An instrumentality of +1.0 implies a direct relationship between performance and outcomes, such as piece-rate incentives. Individuals who are paid a fixed salary regardless of their performance, however, would report an instrumentality close to 0 indicating no relationship between pay and performance. Instrumentalities can also be negative. For example, leisure time would probably be negatively associated with performance since employees are forced to relinquish some of their leisure and free time to increase their performance.

Valence refers to the value of the outcomes and the extent to which they are attractive or unattractive to the individual. Some rewards are almost universally valued, such as praise, recognition, and compliments by others. Other outcomes may only appeal to certain employees, such as promotions and opportunities to work overtime. Research studies measuring Expectancy Theory typically use an arbitrary scale, such as one which ranges from +10 to -10 to measure the valence of various outcomes. Pay increases, feelings of pride in craftsmanship, and being of service to others typically have positive valences while being fired, being criticized by your supervisor, and feeling fatigue typically have negative valences.

Effort, or force, is the combination of expectancy, instrumentality, and valence. Individuals who expect to receive highly valued outcomes if they perform well, and who expect to perform well if they exert sufficient effort, should be highly motivated employees. The components of Expectancy Theory—expectancy, instrumentality, and valence—can be multiplied together to measure individual effort. The formula for combining expectancy, instrumentality, and valence, is

$$\text{effort} = \exp \sum (I \cdot V)$$

To illustrate how this formula is used, think of an activity you are contemplating and identify the possible outcomes associated with it. Measure the valence of each outcome using a scale indicating how valuable it is to you (such as a scale ranging from -5 to +5). Then measure your perceived instrumentality (a correlation ranging from -1.0 to +1.0 showing the relationship between performing the activity and the outcome). Multiply the instrumentalities and valences for each outcome, sum these products, and then multiply this sum by your perceived expectancy (a probability ranging from zero to 1.0 indicating the likelihood of being able to do the activity if you make the effort). This number can be compared with other activities you are contemplating to see which has the highest value. You would be expected to do the activity with the highest value.

Although Expectancy Theory appears rather complex, the central ideas underlying it can be simply stated in a way that is easily understood. People are motivated to exert effort if by doing so they can perform well and attain desired outcomes. It is important to remember that Expectancy Theory is based on personal perceptions. Two workers placed in an identical situation may not exert equal effort because they perceive different expectancies, instrumentalities, or valences. These perceptions are influenced by past experiences, observations of others, and future anticipations.

Some descriptions of Expectancy Theory discuss two levels of outcomes: first level outcomes and second level outcomes. First level outcomes usually refer to performance variables, such as quantity and quality of productivity and attendance, while second level outcomes usually refer to all of the consequences of performance, such as pay, promotion, fatigue, and a sense of accomplishment.²²

Equity Theory

Equity Theory is another cognitive theory of human behavior that has been used to explain motivation problems and levels of job satisfaction. Equity Theory comes from the field of social psychology and is based on a series of studies examining social comparison processes. Social comparison theories focus on the feelings and perceptions of individuals and whether they think they are treated fairly compared to others.

According to Social Comparison Theory people evaluate their social relationships in much the same way economists describe the economic comparisons in the marketplace. Social relationships are viewed as an exchange process in which individuals expect certain outcomes in return for the contributions or investments they make.

Comparison processes: According to Equity Theory individuals evaluate their inputs to the job relative to the outputs they receive.²³ However, this evaluation is based on a relative comparison rather than a comparison against a fixed standard. Employees compare what they received for their inputs relative to what they believe others received for theirs. "Did I get as much from my inputs as my co-workers received for theirs?" According to Equity Theory, therefore, attitudes toward pay are influenced by how much pay people receive, what they had to do to earn it, and whether they feel their ratio of pay to work was fair compared to the pay to work ratios of others. Those who think their ratios are unfair

experience a state of dissatisfaction that motivates them to change the situation in the direction of greater equity.

Inputs refer to all of the relevant factors individuals bring to the exchange. The typical inputs include effort, performance, education, skill, time, and opportunity costs. It is important to note that the value attached to an input is based upon the person's *perception* of its value, rather than its objective worth. Outcomes include all of the rewards individuals receive from the exchange. Although pay is the most obvious organizational outcome, many other positive and negative outcomes may also be viewed as relevant and valuable, such as working conditions, social interactions, stress, and fatigue. Again the value is determined by the person's perceptions, rather than any objective value.

$$\frac{O_p}{I_p} \stackrel{?}{=} \frac{O_o}{I_o}$$

Where O = outcomes
 I = inputs
 o = others
 p = person

The basic comparisons of Equity Theory can be illustrated by the following formula comparing the input-outcome ratios of a person relative to the input-outcome ratios of others.

In this formula O_p divided by I_p refers to the ratio of a person's outcomes to inputs while the O_o divided by I_o refers to the outcomes to inputs ratio of others. A state of equity exists when the two ratios are essentially equal. But this state of equity can be destroyed by changing any of the four values. For example, you could feel underpaid because your outcomes were decreased ("My shift differential was eliminated"), because your inputs were increased ("I have to travel further to get to the workplace"), because the outcomes of others were increased ("Sam got a production bonus"), or because the inputs of others were decreased ("Sam's new machine is easier to operate than mine.")

A state of inequity exists whenever the two ratios are unequal; this inequity can be caused by either ratio being greater than the other. In other words inequity can exist because people are either overpaid or underpaid. The available research suggests that people are more easily upset by underpayment than by overpayment. Therefore, people are more willing to accept overpayment in a social exchange than underpayment. Nevertheless, according to Equity Theory both conditions of inequity motivate individuals to establish a more equitable exchange.

Consequences of inequity: When a perceived state of equity exists individuals tend to feel satisfied and report that the conditions are fair. When a perceived condition of over reward exists, however, individuals tend to feel guilty and dissatisfied, and they are motivated to correct the imbalance. Likewise, when a perceived state of under reward exists, individuals tend to feel dissatisfied and angry, and again, they are motivated to do something about it. According to Equity Theory a perceived state of inequity creates tension within individuals and the tension is proportionate to the magnitude of the inequity.

Six methods have been proposed to explain how individuals attempt to reduce inequity.²⁴

1. People may alter their inputs. Underpaid workers could reduce their level of effort, while overpaid workers could increase theirs.
2. People may alter their outcomes. Individuals who feel over rewarded can share their rewards with others (although they usually don't), while under rewarded people will try to obtain greater rewards by increasing prices, requesting a raise, or joining a union.
3. People may cognitively distort their inputs or outcomes. Individuals who are under rewarded may cognitively distort both their inputs ("I don't really work that hard after all."), or their outcomes ("Besides, I get a lot of satisfaction living in this community."). Cognitive distortion is especially likely for over rewarded people who may distort either their inputs ("I bring with me a lot of experience and leadership from my earlier jobs."), or their outcomes ("Even though I get more money I pay more taxes.").
4. People may distort the inputs or outcomes of others. It is just as easy for individuals to distort their perceptions of others' outcomes and inputs as it is to distort their own.
5. People may change objects of comparison. Sometimes the easiest adjustment is to adopt a different comparison group. For example, if a group of executive secretaries received a substantial pay increase an easy way to rationalize it is to think of themselves more as executives and less as secretaries.
6. People may leave the field. If they can't change the actual inputs or outcomes and cognitive distortion becomes too difficult or painful, individuals may choose to leave the situation by transferring to another job or quitting.

The object of these methods is to reestablish a condition of equity and reduce the tension created by the former inequitable state. Since Equity Theory is a cognitive theory of motivation, it is frequently rather difficult to predict which method of tension reduction an individual may adopt. Over time it is likely that individuals use them all.

Goal Setting Theory

Individuals perform significantly better when they are attempting to achieve a specific goal, such as: complete a project before noon, increase productivity by five percent, work for the next hour without making a mistake, or maintain 100 percent attendance. Evidence shows that goal setting has a very powerful effect on performance.

The process of establishing goals typically occurs in one of three different ways. *Participative goals* allow employees to participate in the process of setting goals by providing information and contributing to the goal selection. *Assigned goals* are determined by management and simply assigned to the employees. *Do-your-best-goals* allow employees to control their own goals; management simply asks the employees to do their best without getting involved in approving or vetoing their goals.

Extensive research on the effects of goal setting have identified four major goal-setting attributes: goal specificity, goal difficulty, goal acceptance, and goal commitment. This research indicates that performance is greatest (a) when workers are given specific goals, rather than vague “do-your-best” goals, (b) when the goals are difficult but not unreasonable, (c) when workers accept the goals as their own and feel a sense of ownership in accomplishing them, and (d) when the workers are dedicated to reach the goals they have adopted, usually because they have participated in setting them. Goal setting is especially effective in improving performance when it is combined with feedback and incentives. All three of these factors have been found to independently contribute importantly to productivity increases. Some research has also shown that the combination of feedback, incentives, and goal setting is more powerful in improving performance than the sum of each factor’s individual contribution.²⁵

Motivation and Financial Incentives

In Maslow’s Need Hierarchy the effects of money are not clear. The needs most directly related to money are physiological and security needs since money contributes significantly to securing a comfortable and safe environment. Money is usually considered relatively unimportant for satisfying higher level needs, and the general belief is that most American workers are mainly concerned about higher level needs. Therefore, according to Maslow’s Need Hierarchy, money is not considered an effective motivator. However, this conclusion overlooks the important ways money can help people who are trying to satisfy their self-actualization needs.

In his research on the need for achievement, McClelland found that money did not have a very strong motivating effect on the performance of high-need achievers. In a laboratory study, for example, high-need achievers performed very well with or without financial incentives. Low-need achievers did not perform well without financial incentives, but when they were offered money for their work, they performed noticeably better. This study does not indicate that money is not important to high-need achievers or that it does not influence their performance. Although money may have a minimal effect on the performance of high-need achievers, it is still important as a form of feedback and recognition. When high-need achievers succeed, they look to monetary rewards as evidence of their success.²⁶

According to Herzberg, hygienes create dissatisfaction if they are absent or poorly managed, but no matter how much they are improved, they should not be expected to create satisfaction or motivation. Because pay is a hygiene factor, Herzberg advocates setting an equitable wage and then forgetting about it. Financial incentives and frequent pay adjustments only serve to keep a worker’s mind focused on money and therefore they create constant dissatisfaction. Herzberg recommends that managers avoid pay discussions and not use pay to motivate employees.

Equity Theory is useful in predicting whether employees will believe their pay is fair or unfair.²⁷ According to Equity Theory, an individual judges his or her own employment exchange and then compares it with the exchanges that others obtain. In other words, equity is based on a comparison between an individual’s inputs and rewards and the inputs and rewards of others. While examining the employment exchange, individuals look at the inputs they bring to the exchange, such as education, skill, and effort, and compare these inputs with the rewards they receive, such as money, status, and recognition. If an individual’s reward-

input ratio is equivalent to the reward-input ratios of others, then he or she believes the condition is equitable.

According to Reinforcement Theory money is a generalized secondary reinforcer.²⁸ Primary reinforcers include rewards that are innately reinforcing because of their physiological nature, such as food, water, sex, rest, and removal of pain. Secondary reinforcers are those that are learned, such as social approval, status, and friendship. Money is called a generalized secondary reinforcer because it is a secondary reinforcer that has become generalized to a wide range of conditions. Money is a positive reinforcing stimulus for almost everyone in almost every situation, even if a person has no immediate opportunity to use it.

According to Reinforcement Theory, behavior is influenced by its consequences. When an individual is offered money to perform a task, Reinforcement Theory predicts that the individual will perform the task as long as the money is considered an adequate reward. If employees are to be rewarded for producing high-quantity and high-quality work and for not being absent, Reinforcement Theory predicts that the employees will achieve high-quantity and high-quality performance and not be absent. In general, Reinforcement Theory predicts that performance will improve as financial rewards become larger, when such rewards are directly tied to performance, and when rewards are given shortly after the task is completed.

The timing of the reinforcement is also important. Continuous reinforcement schedules, in which employees are paid for each correct response, are sometimes preferred because the reinforcement is stable and predictable. However, partial reinforcement schedules that provide comparable amounts of money on a variable ratio schedule produce higher levels of performance than continuous schedules. An example of a variable ratio reinforcement schedule is the random payoffs that come from gambling, such as slot machines. Unfortunately, it is difficult to install these kinds of reinforcement schedules in industrial jobs even though studies endorse their value. In one study, college students worked under a continuous reward schedule or a variable reward schedule. The results of the study indicated that the students paid on a variable reward schedule performed better and continued working for a longer time after the rewards ceased than the students paid on a continuous reward schedule.²⁹

Expectancy Theory suggests that money can be a powerful motivator if the proper relationships between effort, performance, and rewards are perceived. Expectancy Theory is probably the most useful theory for predicting the effects of incentive pay on performance, and extensive research has generally supported the predictions of Expectancy Theory. When the three conditions are present, incentive pay usually produces a significant increase in performance.³⁰

In summary, the need theories of McClelland and Maslow suggest that money is relatively unimportant in motivating employees, and Herzberg even advises against using monetary incentives for motivation. However, both Reinforcement Theory and Expectancy Theory suggest that money can be a powerful motivator when pay is based on performance. Extensive research has confirmed that performance-based pay systems significantly increase job performance.

Incentive compensation plays a strategic role in increasing organizational effectiveness. Intense foreign competition and stagnant productivity growth have forced executives to explore ways of rejuvenating productivity. One of the most popular recommendations is to offer financial incentives that are directly tied to productivity. These incentive programs, loosely referred to as **pay-for-performance**, have significantly increased productivity in companies where they have been installed and surveys generally find that they also have a positive impact on employee morale. There are numerous methods of rewarding individual efforts. Most pay-for-performance plans are either individual, group, or company-wide incentive plans or some combination of all three.

4.6.2 Individual Incentives

Merit Pay

The most popular pay-for-performance method is the **merit pay** increase. This method consists of periodically evaluating the performance of all employees and giving commensurate pay increases. High performers receive larger merit increases than low performers. The merit pay increase is awarded in addition to cost-of-living increases or pay increases for additional education or years of service.

The merit increase can be treated as either an addition to base pay or a one-time individual bonus. Some companies have been concerned about the long term consequences of increasing the base pay of their employees with every merit pay increase and have adopted *lump-sum* merit increases. These lump-sum payments, awarded at the end of a quarter or the year, are treated as one-time rewards in recognition of outstanding performance and do not change the employee's base pay.³¹

Merit pay increases are relevant to all jobs paid a fixed wage or salary. The most important requirement for an effective merit pay incentive program is measuring performance against clearly defined objectives. But even when performance can only be evaluated subjectively, most employees still believe that pay increases should be related to performance. Although merit pay is generally intended to reward employees for their productivity, other aspects of their performance may also be recognized, such as attendance, positive work attitudes, or initiative.

Exhibit 15: Merit-Increase Guidelines: Fixed Increase or Discretionary Increase

| PERFORMANCE RATING | *EXPECTED NUMBER OF EMPLOYEES | DISCRETIONARY INCREASE or RANGE | FIXED INCREASE AMOUNT |
|---|-------------------------------------|---------------------------------------|-----------------------------|
| Outstanding: Truly exceptional performance | 1 in 10 | 12% | 10-15% |
| Excellent: Constantly exceeds standards | 2 in 10 | 8% | 7-9% |
| Good: Occasionally exceeds standards | 4 in 10 | 5% | 4-6% |
| Average: Occasionally meets standards | 2 in 10 | 3% | 2-3% |
| Fair: Marginal performance | 1 in 10 | 1% | 0-1% |

*Note to supervisors: This column shows the number of employees in a typical department who would normally be rated in each category.

Supervisors generally are responsible for evaluating performance and recommending merit pay increases with the assistance of guidelines prepared by the human resource department. A merit increase guideline showing both a fixed percentage increase and a discretionary range increase is presented in Exhibit 15.

Another method of calculating merit increase percentages is the compa-ratio approach. This approach adjusts the recommended pay increases for each person according to where that person is within the pay range: people at the top of their pay range receive smaller percentage increases than people at the bottom. This adjustment is intended to keep the wage amounts within the pay range and preserve the integrity of the pay range. Exhibit 16 provides an illustration of a compa-ratio approach to salary increases.

The following conditions must be met before an effective merit pay program can be established:

1. Individual differences in job performance must be large enough to be worth the time and effort for management to measure such differences and to relate them to pay.
2. The pay range should be sufficiently wide (15 to 20 percent above and below the midpoint of the pay range) to allow for adequate differentiation of pay based on performance.
3. Differences in individual job performance should be measurable.
4. Supervisors and managers must have the competence to evaluate employee performance and provide meaningful feedback.
5. Management must be committed, and employees must be receptive to making distinctions among employees based on performance.³²

Exhibit 16: Salary Increase Matrix using the Compa-ratio Approach

| PAY RANGE | COMPA-RATIO | | | |
|-----------------------|-------------|-------------|-------------|-------------|
| | 0.80 - 0.89 | 0.90 - 0.99 | 1.00 - 1.09 | 1.10 - 1.20 |
| OUTSTANDING | 7.0 - 8.0% | 6.0 - 7.0% | 5.0 - 6.0% | 4.0 - 5.0% |
| ABOVE AVERAGE | 5.0 - 6.0% | 4.0 - 5.0% | 3.5 - 4.5% | 3.0 - 4.0% |
| AVERAGE | 3.0 - 4.0% | 2.5 - 3.5% | 2.0 - 3.0% | 1.5 - 2.5% |
| BELOW AVERAGE | 1.0 - 2.0% | 0.8 - 1.8% | 0.6 - 1.6% | 0.4 - 1.4% |
| UNSATISFACTORY | 0% | 0% | 0% | 0% |

Bonuses

Some employers prefer using bonuses to reward performance rather than merit pay increases because bonuses do not raise base pay levels year after year; bonuses must be re-earned each year. Bonus plans also provide greater discretion than formal merit pay plans for executives to reward employees since they can wait until the end of each year to decide whether to grant bonuses and if so how much. Bonuses do not have to be tied to performance; however, most of the time they are tied to either individual performance levels, the performance of the work

group, or the success of the entire company. Variable pay as a percent of payroll is typically about 10 percent and has been increasing for the past two decades.

Although bonuses can be given at any time of the year, many employers distribute them at the end of the calendar year and refer to them as holiday bonuses. These bonuses are typically not tied to performance. While most holiday bonuses are cash, some employers give gift cards or food items.

Piece-rate Incentives

Under a **piece-rate** incentive system workers are paid a fixed amount for each item produced. Piece rates have existed for many years, and several theorists have advocated paying workers on a piece-rate basis. The most ardent advocate of this incentive system was Frederick W. Taylor, the founder of scientific management. In his 1911 book, *Principles of Scientific Management*, Taylor argued that the best way to motivate workers to higher production was to offer them additional money for producing more. Taylor showed how higher productivity meant more income for the worker and greater profits for the company.³³ As a rule of thumb, the advocates of scientific management claimed that piece rates established by time-and-motion studies increased productivity at least 25 percent over “day work.”

Over the years, Taylor’s principles of scientific management have been severely misrepresented and unjustly criticized. The misrepresentation and criticism are unfortunate because research studies have consistently demonstrated that piece-rate incentives have a greater influence on performance than any other variable.

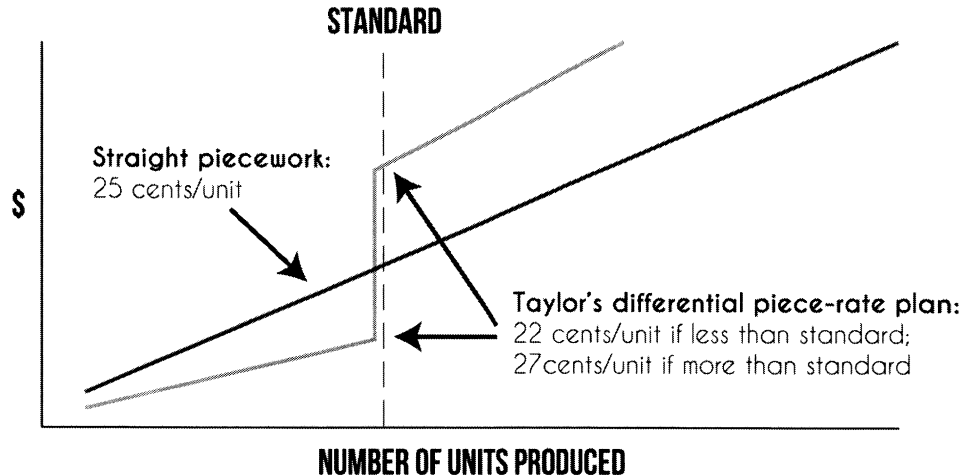
Straight piecework is the oldest and most common incentive-wage plan, and it is used in over half of all incentive-wage plans. Originally, straight piecework plans paid a fixed rate per piece regardless of how little a worker produced. Today, most straight piecework plans have a guaranteed base rate that is at least as high as the minimum-wage rate.

Taylor advocated a **differential piece-rate plan**. This plan pays a lower rate to workers who produce less than the standard amount and a higher rate to workers who exceed the standard. This plan significantly rewards productive workers since they are not only paid for producing more pieces but their rate of pay is higher for each piece (normally 20 percent higher than the lower rate). Taylor intended this system to encourage slower workers to quit and find more suitable employment. A comparison of straight piece rates and Taylor’s differential piece-rate plan is shown in Exhibit 17.

The Standard Hour Plan

The **standard hour plan** is another form of incentive piece rates. This plan, which is sometimes called a 100 percent premium plan, usually requires the establishment of performance standards through time-and-motion studies. On a standard hour plan, workers are paid an hourly wage, but the hour is measured in units produced rather than in minutes. If workers perform the standard amount each hour, they receive the hourly wage, but if they produce above standard, they receive proportionately more money. Standard performance is usually set at 60 units of work per hour, with a unit of work equaling what a worker should produce in one minute. Therefore, if a worker consistently produces 90 units of work per hour, the worker receives one-and-one-half hour’s pay for each hour worked.

Exhibit 17: A Comparison of Straight Piecework and F. W. Taylor's Differential Piece-Rate Plan



The Halsey Premium Plan

An incentive plan similar to the standard hour plan is the *Halsey premium plan*, developed in the 1880s by an engineer, Fredrick A. Halsey. With this plan the workers receive a guaranteed hourly wage plus a percentage (33 percent was recommended) of the wage for any time saved. The actual production standards are determined by past performance rather than by time-and-motion studies. For example, if a worker is paid \$12.00 USD per hour and the task usually requires eight hours, the worker receives an additional \$4.00 per hour for each hour saved under eight hours. A worker who completes an eight-hour task in seven hours receives a \$4.00 premium.

The Effectiveness of Piece-rate Incentives

The effectiveness of piece-rate incentives has been studied extensively, and the evidence shows that piecework incentive systems generally have a stronger influence on increasing productivity than any other single factor.³⁴ Increased productivity has been attributed to three factors associated with piece-rate plans:

1. The motivational impact of financial incentives.
2. Changes in the design of the work.
3. Higher performance goals and performance feedback.

When a piecework plan is installed, a careful analysis of the job is conducted to ensure that it is being performed efficiently. This job analysis helps to identify more efficient methods of performing the task, if they are needed. Moreover, when the job is being timed to establish pay rates, a goal-setting process occurs, and this is followed by performance feedback. Some researchers have questioned whether the processes of goal setting, measurement, and job redesign might not be more responsible than pay incentives for increasing productivity. Studies generally show that each factor alone has a positive influence on productivity but that the impact is greater when all three factors are present. Thus, individual and group incentive systems contribute to productivity increases due to (1) improved methods and better

organization of work, (2) higher performance goals with specific performance feedback, and (3) monetary incentives that induce greater effort.³⁵

When pay incentives are eliminated, productivity typically falls, even when no changes have been made in job design or in performance goals. For example, a midwestern paper mill dropped an incentive pay plan that provided semiannual bonuses to hourly workers. The bonuses were based on monthly evaluations of individual performance that were conducted by supervisors. The union objected to the subjective nature of the supervisors' evaluations and succeeded in pressuring the company to discontinue the incentive pay plan. Following the plan's termination, productivity dropped 20 percent, and the turnover rate of top performers doubled. Poor performers liked their jobs better without the incentive pay plan, but the satisfaction of top performers plummeted. Supervisors attempted to boost sagging productivity by using reprimands and threats of layoff, but these only served to create greater dissatisfaction.³⁶ Finally, the company decided to reinstate the incentive system.

The popularity of piece-rate incentives has declined, to some extent, not because they have lost their motivating potential, but because of new technology. Piece-rate incentives are ideal when employees work independently and their productivity can be easily measured. However, new technology often forces employees to work together and their work is machine-paced. Furthermore, some jobs change so quickly that it is not practical to establish a piece-rate standard for them. Consequently, some industries that have utilized piece-rates for many years, such as the machine tool and canning industries, are having to develop different pay systems. Piecework systems are being replaced with team-related and company-wide bonuses.³⁷

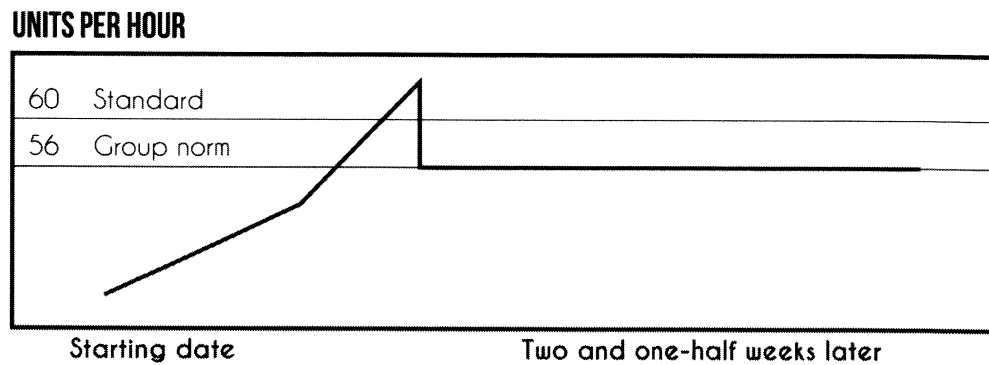
Restriction of Output: Although many studies have shown that incentive-pay systems significantly increase productivity, numerous examples have also been reported of incentive-pay systems that restrict output to arbitrarily low levels. This **restriction of output** problem is at least as old as scientific management. Taylor referred to the problem as **soldiering** and described several examples of work groups that had established arbitrarily low levels of productivity and pressured their members not to exceed these group norms.³⁸ Evidence of group norms restricting productivity is sometimes quite obvious when new employees join a work group. The influence of group norms on the productivity of a new employee is illustrated in Exhibit 18. Within two-and-one-half weeks, the new employee's productivity increased from 32 units of work per hour to 74 units of work per hour. Then suddenly the employee's productivity fell to 56, the same as every other member of the work group.

Group norms restricting productivity are very troublesome to managers, and they are particularly perplexing because they seem to be irrational. Why should a group of workers collectively decide to hold down their level of production when they are paid only for what they produce? The problem centers around timing the job and establishing performance standards. Workers know that performance standards are somewhat arbitrary. They believe that if they consistently produce more than the standard, the industrial engineer will return and retime the job. Then they will be expected to produce more work for the same amount of pay.³⁹

Management has been guilty of retiming jobs often enough in some organizations to justify the workers' fears. Several interesting studies have closely examined the games that are

played by workers and industrial engineers in setting performance standards. Since industrial engineers know that workers intentionally work slowly, they arbitrarily tighten the standards above the measured times. But the workers realize that the industrial engineers suspect them of working slowly so they add unnecessary and inefficient movements to look busy (which the industrial engineers expect and try to disregard).

**Exhibit 18: Illustration of Group Norms
Restricting Productivity: Individual Productivity of a New Employee**



One of Taylor’s solutions to the rate-restriction problem was to have workers work alone. Group norms cannot restrict output if a worker is not in a work group. Another solution relies on better selection – only hire workers who will accept the performance standards and work as fast as possible. In recent years various organizational development techniques, such as group discussion and team-building sessions, have been proposed to change group norms.

4.6.3 Skill and Knowledge Based Pay

A valuable strategy for increasing organizational flexibility and rewarding team efforts is through skill-based pay or a pay-for-knowledge program. These programs reward employees for their ability to perform an array of related tasks or skills rather than for the actual work performed. Rewarding employees for their ability rather than for their productivity is an important difference between these incentives and pay-for-performance incentives.⁴⁰

In a skill-based pay program, jobs are grouped into job families according to the kinds of related skills required to perform them. In pay-for-knowledge programs, the job families are grouped according to knowledge requirements. Employees are paid according to the skills or knowledge they have demonstrated. New employees are paid the entry level wage rate, and they receive pay increases as they acquire additional skills or knowledge. Employees who have mastered additional skills or knowledge receive added pay for this mastery even when they are not currently using them.

Skill-based pay and pay-for-knowledge programs significantly improve work-force flexibility and the capacity to respond to changing demands and schedules. These programs are especially valuable for work teams that perform complex operations requiring a variety of skills or knowledge. When employees are cross trained and capable of performing a

variety of skills, they can be moved more freely from job to job in a work group to do what needs to be done. Multi-skilled teams contribute to innovation and new product development. This flexibility is especially important in a union setting where restrictive work rules often prevent shifting employees to different jobs. Employees are also motivated to learn new skills and apply them. Employees accept responsibility for their own training, which makes training more effective.⁴¹

Skill-based pay and pay-for-knowledge programs must be designed to fit the requirements of the job and the company's overall compensation program. Different models have been used in the design of these programs:⁴²

1. The *stair-step model* assumes that the requisite knowledge and skills can be arranged hierarchically, such that more complex skills or knowledge builds on earlier skills or knowledge. Employees begin on the first step and receive higher pay rates as they advance sequentially to higher steps.
2. The *building blocks model* assumes that the various skills and knowledge are discrete and can be acquired in any order. Employees usually begin in an entry-level block of jobs and their mastery of other blocks might be determined by the needs of the organization or their own interests.
3. The *job-point accrual model* is similar to the building blocks model. It is typically used when there are many different skills or ideas employees may acquire and they are not equally valuable. Point values are assigned to each skill or knowledge area and employees accumulate points as they master them. As with other models, employees cannot receive partial credit for partial skill or knowledge. Either they have it and can demonstrate it competently, or they need more training time.

The first step in creating a skill-based pay program is to identify the skills that deserve premium pay. The organization then needs to develop assessment procedures to measure each of the skill levels. Finally, training opportunities that focus on relevant job requirements and company objectives need to be provided to facilitate the learning process.

Skill-based pay and pay-for-knowledge programs also can be tied to performance, as shown in Exhibit 19. Rather than having just one column of pay rates based on skill level, there are multiple columns, one for each level of performance. This skill x performance pay matrix communicates to employees that both skill and dependable performance are vitally important to the company. It also illustrates how an employee could advance to a higher skill level, but receive a lower rate of pay due to poor performance.

About half of the Fortune 1000 companies offer some form of skill-based pay and these programs are considered quite successful. In a survey of 97 companies with skill-based pay programs, 75 percent thought they had higher productivity and better quality than organizations with traditional compensation systems. Most of the companies (69 percent) also thought skill-based pay reduced their overall compensation costs.⁴³

Exhibit 19: Skill x Performance Pay Matrix—Hourly Rates of Pay

| skill level | PERFORMANCE LEVEL | | | |
|-------------|-------------------|------------|----------------|-------------|
| | marginal | acceptable | above standard | exceptional |
| 1 | \$11.00 | 11.50 | 12.00 | 12.50 |
| 2 | \$12.00 | 12.60 | 13.20 | 13.80 |
| 3 | \$13.00 | 13.70 | 14.40 | 15.10 |
| 4 | \$14.00 | 14.80 | 15.60 | 16.40 |

4.6.4 Differential Pay

In addition to their base pay, employees often receive additional compensation for factors that make work more difficult or unpleasant. These wage differentials are considered an important and essential part of making compensation fair.

Overtime

Some countries have laws that require employers to pay overtime pay for hours worked in excess of a set amount, such as 40 hours per week. Some employers provide additional overtime payments, such as paying overtime for more than eight hours a day and paying double time for more than ten hours a day or 50 hours a week.

Shift Pay

Since night shifts and swing shifts are less desirable and more disruptive to an employee's life, companies often pay a shift differential, such as an additional 50 cents per hour.

Hazard Pay

Employers who have jobs that are especially hazardous typically provide a hazardous pay differential to compensate employees for the added risk of performing them and also to remind employees of the need for greater caution.

On-call Pay

Employees who are on-call receive their normal hourly wage if they are restricted in their ability to move about and not free to plan their own activities. If they are free, however, employers often pay on-call employees a premium anyway.

Call-back Pay

Employees who are called back to work because of emergencies often receive an additional premium to compensate them for the inconvenience and disruption this creates.

Geographic Differentials

Employees who live in or are transferred to locations with a high cost of living may receive a geographic differential to offset the high cost of living.

Weekend and Holiday Pay

Employees who are required to work on weekends or holidays may receive a higher rate of pay, especially if they do not receive overtime for it. For example, Saturday work may be paid time and one half, while Sunday and holiday work is paid double time.

4.6.5 Group and Team Incentives

With the growth of self-directed work teams, group and team incentives have become increasingly popular. Flexible organizations that strive to compete in dynamic environments often rely on self-directed work teams to design new products and respond to customer needs. An essential component of a successful team is an incentive plan that rewards cooperation and builds teamwork. When people work together, it seems reasonable that they be rewarded together.

Team incentives can be patterned after individual incentives: anything that can be paid as an individual incentive can be paid as a group incentive and distributed equally or according to skill or job demands. Piecework plans can be paid on either an individual or a group basis. Straight piece rates can be based on group production figures, with all members of the group sharing in the incentive pay earned by the group. Standard hour plans also can be applied to group productivity through the establishment of a group performance standard. If a group produces 80 units of work each hour when the standard is 60 units per hour, all members of the group will receive one and one-third times the hourly rate.

Group incentive plans are often essential for smoothly functioning teams, and they have some important advantages over individual incentive plans. Group incentives create greater cooperation among coworkers than individual incentives. This climate of cooperation usually reduces the need for direct supervision and control since workers are supervised more by their coworkers than by their supervisor. In such a climate, slow workers are pressured by their coworkers to increase their productivity. Moreover, the flow of work and flexibility in job assignments are greatly facilitated by group incentives. When the normal work routine is disrupted by unique problems, such as illness or broken machines, individuals paid on a group incentive plan are more likely to adapt to the problem and solve it themselves.⁴⁴

Group incentives also have certain disadvantages. When the jobs of members of a group are independent, the members only feel responsible for their own jobs and think they should be paid only for their own work. In such a situation, group incentives provide limited motivation to produce more. Extra efforts by one worker will only result in a small increase in that worker's weekly pay. As the group gets larger, this problem becomes more severe. Thus, group incentives are most useful when jobs are interdependent, when the output of a group can be counted, and when a group is small.

Group incentives occasionally are paid to indirect labor departments. These incentives are called secondary, or indirect, labor incentives. They are relevant for those departments that do not produce a direct product but instead support other departments, such as safety and maintenance departments. For example, rewarding a maintenance department that breaks machines just to create work for themselves would be senseless. Instead, the department should be rewarded for fixing the machines so they will not break. Usually the incentives paid to indirect labor departments are determined by the performance of the direct

departments they assist. When the direct departments produce more than the standard, the indirect departments receive incentives.

4.6.6 Organization-wide Programs: Profit Sharing and Gainsharing

In addition to paying people according to their individual or group performance, pay also can be based on the performance of the entire plant, division, or organization. The most common large-scale incentive systems include profit sharing plans, gainsharing plans, and stock ownership plans.

Profit Sharing

In **profit-sharing** plans, employees receive a share of the company's profits in addition to their regular pay. The major types of profit-sharing plans are cash plans, deferred plans, or some combination of cash and deferred plans. Under a cash plan, payments are made to employees at the end of each period (usually quarterly or annually). Small companies generally prefer cash plans. Under a deferred plan, an employee's share is held until a later period, usually retirement, although workers who become unemployed or disabled may receive payments earlier than retirement under some deferred plans. Deferred plans not only motivate good performance but also contribute to the financial security of their participants. The money in deferred plans is normally invested, and as a result, some plans provide sizable sums of money to their participants.

Profit-sharing plans are increasing in popularity, particularly among small companies. Comparisons between companies that have profit-sharing plans and those that do not indicate that improved efficiency, reduced costs, and lower turnover are evident in profit-sharing companies. Many different kinds of profit-sharing plans exist. Some plans have a *constant proportion* of profits that are contributed by the company, usually 20 to 25 percent. Other plans have a *discretionary* arrangement whereby the company's contribution is decided each year by its board of directors. Other plans have *ascending* or *descending scale formulas* where the percentage of profits designated for a profit-sharing plan increases or decreases as a company's profits increase or decrease.

The **allocation formula** determines how the money in a profit-sharing fund is divided among the individual participants. Allocation formulas usually are based on level of responsibility, merit, base pay, and/or years of service. In one company, for example, the allocation is based on units: 1 unit is given for each \$500 USD of annual compensation up to 200 units, plus 2 units for each year of continuous service. Many companies allocate profit-sharing money according to base pay only since they assume that base pay is related to level of responsibility, merit, and years of service.

Profit-sharing plans have been successful in reducing conflict between managers and production workers. Many companies claim that their plans have succeeded in creating a sense of partnership between employees and management and in increasing employee interest in the company. In turn, many profit-sharing plans have contributed to the financial security of employees.

Profit-sharing plans also have certain limitations. Because each worker's share of the profit is not directly tied to individual productivity, a profit-sharing plan does not effectively

motivate some employees. Immediate rewards that are directly tied to specific individual behaviors are more effective than profit-sharing plans for motivating employees who have short attention spans and cannot delay gratification. Furthermore, an effective profit-sharing program must have profits to share. Occasionally, profits are eliminated by economic forces that neither managers nor production workers can control.

Profit-sharing plans do not provide much motivation during an economic recession. However, some employers argue that employees should carry part of the burden in years when losses are incurred since they also share in the profits during good years. Another reason why a profit-sharing plan may not be very motivating is due to an organization's size. As an organization grows, workers may feel that their influence on the overall profit level is insignificant. Deferred plans are especially poor for providing employees with immediate incentives to work hard. Even small companies that produce large profit-sharing funds can fail to motivate young workers who do not expect to receive any of the benefits for another 40 years.⁴⁵

Gainsharing

Gainsharing is similar to profit-sharing, but the bonuses are based on improved productivity rather than a percent of the profit. Gainsharing plans normally reward employees on a monthly or quarterly basis, depending on how productivity is measured, whereas profit-sharing is usually paid annually. The most popular gainsharing plans are Scanlon Plans, Rucker Plans, and Improshare.

Scanlon Plan: A **Scanlon Plan** is a combination of a gainsharing plan and an employee suggestion system. While a Scanlon Plan usually increases efficiency and productivity, it also is advocated as a means of reducing union-management conflict. A Scanlon Plan has come to represent a philosophy of industrial relations whereby management and employees work cooperatively to increase the efficiency of the company and then share in the rewards. Although a Scanlon Plan was originally intended only as an instrument for a unionized company, the presence of a union is *not* necessary.

The Scanlon Plan was developed by Joseph Scanlon in 1937 to help reduce costs in a steel mill. Scanlon, who had been trained as a cost accountant, was acting as a union representative at the time. He formulated a plan based on the idea that the company should pay a fixed labor cost per ton of steel. If the employees produced more steel with fewer hours of labor, they then would share in the labor cost savings.⁴⁶ The results of installing the plan in the steel mill were very favorable, and as a result, Scanlon became employed by the national headquarters of the steel workers' union and helped to install other plans. Later, he joined the Massachusetts Institute of Technology, where he promoted his plan through writing and research.

A Scanlon Plan is installed by establishing a standard ratio of labor costs as a percentage of revenue; that is, the labor costs are divided by total sales or by the dollar value of the units produced. This standard is based on historical data for a company, such as the company's average ratio for the past five years. Once union and management have agreed on a normal cost of labor, the standard is not altered unless significant changes affect the production process or the products. After the ratio is established, all employees share in any labor-cost savings or productivity increases. For example, when the standard labor-cost ratio is 45

percent and \$200,000 USD in sales are produced, then \$90,000 is the expected labor cost. But when actual labor costs are only \$75,000, then the \$15,000 savings goes into a bonus fund. Most of this fund, usually 60 to 75 percent, is paid directly to the employees, part is held in a reserve for possible deficits (usually 25 percent), and some may be paid to the company. The bonus fund increases when creative ideas help to either increase revenues or reduce labor costs.

The suggestion system is a central factor in the Scanlon Plan. Normally a system of departmental committees is established in addition to a central committee that screens suggestions and evaluates them. Individuals generally are not paid directly for submitting suggestions but share with everyone else in any cost savings produced by the suggestions. The departmental committees meet periodically to eliminate problem situations that are reducing efficiency. These meetings are useful not only for improving efficiency but also for providing communication links between union and management.

Several studies have evaluated the effectiveness of Scanlon Plans. While the results have not been universally positive, most have indicated productivity increases of 20 to 25 percent after a plan has been established for one or two years. Case studies of firms using the Scanlon Plan indicate that it generally produces improvements in efficiency and in labor-management relations, favorable employee attitudes toward efficiency, and less resistance to change. Like other profit-sharing plans, however, Scanlon Plans probably work best in smaller companies.⁴⁷

Rucker Plans: Allen Rucker developed an incentive plan during the 1970s called a **Rucker Share-of-Production Plan** that is similar to a Scanlon Plan but based on a more sophisticated accounting analysis of "value added." Here the ratio is calculated by dividing the labor costs by the "value added" rather than by total revenues as recommended by Scanlon. Under a Rucker plan, a historical relationship is established between total employee earnings (i.e., total labor costs) and the value added by the employees through the production process. The value added by the firm is simply the sales value of output less the cost of materials used. A standard productivity ratio is calculated, which expresses the production value required for each dollar of compensation. As productivity increases, compensation increases and is shared between labor and management. The ratios are revamped if major changes in products or production processes occur.

Improshare: Improshare plans are similar to Scanlon and Rucker plans, but improshare plans are tied directly to measures of productivity rather than to the dollar value of the product. The basic idea is that a firm sets a base level of performance, tracks improvements in performance, and then pays bonuses proportionate to the amount of time saved either to all workers or just to those in the group being measured. Improvements in productivity are shared with the employees, which explains why they are called improshare plans (*improved productivity through sharing*).

One advantage of improshare plans over Scanlon and Rucker plans is that improshare plans can be used in a broader variety of situations where a physical product is not produced. For example, the employees of a hotel could have bonuses tied to the occupancy rate, and employees in a training institute could receive bonuses tied to the number of people trained. Oil refineries could tie bonuses to reductions in accident rates and environmental accidents.

Retail companies could tie bonuses to reductions in inventory shrinkage, which is mostly caused by employee theft and shoplifting.

Gainsharing plans became very popular starting in the 1980s because they contributed significantly to productivity improvements that were estimated to be as high as 35 percent in some companies.⁴⁸ Like profit-sharing plans, gainsharing creates greater motivation in small companies and requires careful record keeping and a cooperative attitude within the company.

4.6.7 Strategic Alignment of Base Pay and Incentive Pay

In designing a compensation system, companies need to make a strategic decision regarding the best balance between base pay and incentive pay – what percentage of an employee’s pay should be base pay and what percentage should be incentive pay? This issue concerns the proper balance between two compensation objectives: security and motivation.

How this issue is resolved is usually the most important consideration in aligning human resource programs with the strategic direction of the organization. A stable, bureaucratic company needs a much different compensation program than a flexible, innovative company that is trying to survive in a highly competitive growth industry. Stable, bureaucratic companies tend to rely on fixed salaries with small incentives in the form of merit pay; flexible, innovative companies tend to use a variety of financial incentives and stock options to motivate employees.

Three compensation objectives are *security*, *equity*, and *motivation*. Although straight wages and salaries provide a feeling of security, they are not very motivating or equitable. To provide equity and motivation, compensation systems must have financial incentives where pay is based at least partially on performance. However, financial incentive systems do not always function smoothly. Some of the difficulties include:

1. Incentive pay requires better record keeping and complicates the processing of weekly payrolls.
2. Incentive pay requires that performance be carefully evaluated and recorded; this becomes increasingly difficult as performance evaluations become more subjective.
3. Greater managerial control is required to create and monitor incentive pay rates.
4. Employees may experience excessive anxiety and concern when incentives represent a large percentage of their total compensation, especially if they have limited control over their performance.
5. Some employees complain that their bonuses are inadequate regardless of the amounts.
6. Incentive pay systems require greater explanation and justification and are more frequently challenged, especially by poor performers.
7. Extrinsic rewards, such as pay, have been criticized for destroying the intrinsic satisfaction associated with performing a task.⁴⁹ Even if they do not destroy the intrinsic satisfaction, they divert attention from the meaning of work and the internalization of the work ethic.

Because of the problems financial incentives create, some companies refuse to tie pay to performance and prefer to pay straight base pay, either hourly wages or an annual salary. The disadvantage of base pay is that it does not motivate employees. When employees receive the same income regardless of their productivity, they have no incentive to work harder.

To satisfy the objectives of a sound compensation system, managers must fine-tune the compensation system by balancing the base pay and incentive pay components. If the base pay is too large, inadequate motivation will result. If the incentives are too large, problems of inequity will develop, including increased turnover because of inadequate security, dissatisfaction caused by inaccurate performance evaluations, and dysfunctional competition between coworkers. Achieving a proper balance is especially important for sales jobs where motivation is essential. A sizable portion of variable pay can be highly motivating; however, it is recommended that at least 50 percent of the pay of sales representatives be in base pay to reduce the pressures to manipulate or game the incentive structure.⁵⁰

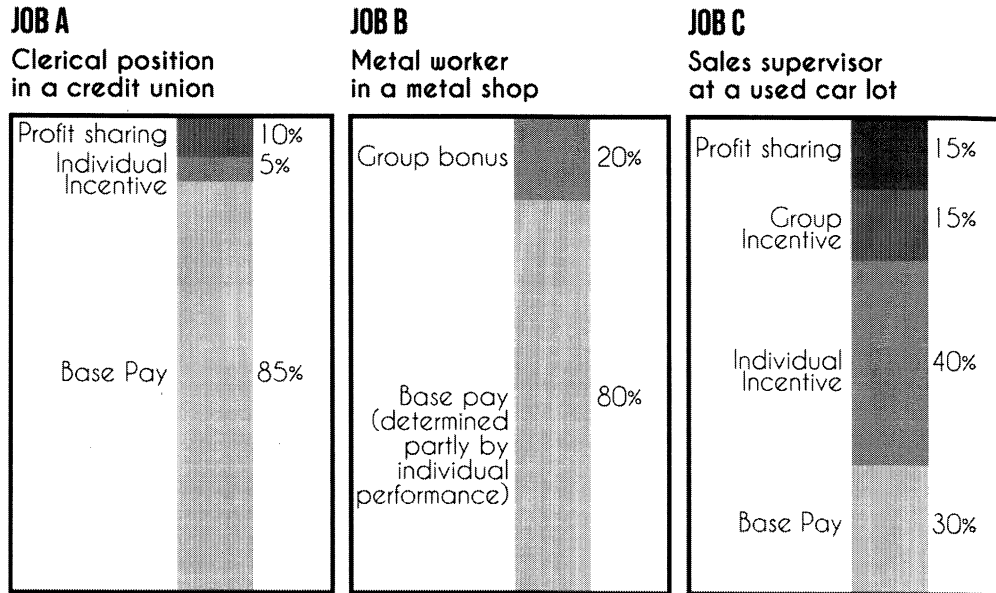
In fine-tuning a compensation system, several issues need to be considered:

1. The ability to *measure individual performance* accurately, objectively, and conveniently—as a larger portion of the total compensation is based on individual incentives, the measurement of individual performance must become more precise. Occupations that are difficult to measure precisely, such as engineer, lawyer, and college professor, should not have as large of an individual incentive component determining their compensation as occupations that are easier to measure, such as sewing machine operator.
2. The extent to which workers can *control the rate of production*—individual incentives are not very useful if workers have little control over the quantity or quality of their performance. Assembly-line workers and security guards, for example, have very little control over the quantity of work that they produce.
3. The degree of *interdependence and cooperation required* within the work group—when individuals work together to produce a group product, their pay should be based on the group's performance rather than individual performance.
4. The *size of the work group* and the organization—as work groups and organizations become larger, the measurable influence of a single worker shrinks. In large work groups and large organizations, group incentives and profit-sharing plans lose some of their motivating influence.
5. The organization's *ability to produce a profit* and obtain accurate and timely measures of performance—a profit-sharing plan not only requires profits to share (which largely excludes most nonprofit organizations) it also requires an acceptable procedure for measuring the profits and a formula for dividing them.

The fine-tuning process consists of adjusting base pay, individual incentives, group incentives, and profit sharing to provide a feeling of security, equity, and motivation. Security is provided by base pay while equity and motivation are provided through incentive plans.⁵¹ Some organizations pay small base salaries and give large bonuses to their executives, while others pay large base salaries and give small bonuses. The appropriate combination of base pay and incentive pay needs to be selected to maximize the pay

objectives. The fine-tuning process can be illustrated by considering three jobs, as shown in Exhibit 20.

Exhibit 20: Fine-Tuning of Base Pay and Incentive Pay for Three Jobs



All three jobs offer both incentive pay and base pay, but the proportions are quite different. Job A is a clerical job in a credit union with 260 employees. The base pay is determined by a job classification schedule. New employees start at the bottom of their classification. Pay increases, which can be granted twice a year, are based on performance evaluations by a supervisor. The supervisor also can recommend a 50-dollar monthly bonus for outstanding performance. The credit union has a form of profit sharing in which 20 percent of the undivided earnings at the end of each quarter are given to the employees according to their relative base-pay rates. The compensation plan is designed so that the average employee receives approximately 85 percent of total compensation in base pay, 5 percent from individual incentives, and 10 percent from profit sharing.

Job B is a job in a metal shop that consists of 16 employees who make table and chair frames. Because most workers rotate from job to job throughout the day, maintaining accurate records of individual productivity is impossible. However, daily production records are kept for the group. The base pay of the metal workers is determined by their placement in one of five skill categories: learner, apprentice, intermediate, craftworker, and skilled craftworker. The company pays a monthly group bonus that is allocated according to skill category. Approximately 80 percent of each worker's income is derived from base pay and 20 percent from the group bonus. Individual performance is rewarded only in the sense that it determines the base-pay category to which each worker is assigned.

Job C is a supervisor at a used-car lot who monitors the performance of six other salespeople. The sales supervisor is paid a base salary that has been negotiated with the owner of the lot, a commission on the cars that she sells, a commission on the sales of her subordinates, and

one percent of the monthly profit of the dealership. These amounts are intended to represent 30 percent of her monthly income in base salary, 40 percent from personal commission sales, 15 percent from group commission sales, and 15 percent from profit sharing.

Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at www.hrcp.com. Log into your account and click on My HRCP to access the practice exams.

1. Can you explain how money is viewed in the various theories of motivation?
2. Can you describe the various methods for providing individual pay incentives to employees?
3. Can you explain skill-based pay and pay-for-knowledge programs?
4. Can you explain profit sharing and gainsharing?
5. Can you describe the factors that should be considered in balancing base pay and incentive pay?

~Notes~

4.7 EXECUTIVE COMPENSATION

The compensation of executives is much larger than that of other employees. It also tends to be determined by a different set of factors and includes both monetary and nonmonetary rewards. Some nonmonetary rewards—such as a company car, reserved parking, and first-class air tickets—are available only to executives.

4.7.1 Salaries

The compensation of executives is influenced by many factors, such as revenue, responsibility, and the fact that executives have a large role in setting their own salaries. Sales are clearly the best predictor of a chief executive officer's salary. Apparently, individuals who determine the pay for CEOs believe that the larger a company's revenues, the heavier the load on the chief executive, and therefore, the greater should be the CEO's pay and bonus. The median remuneration of CEOs in companies with more than \$5 billion USD in revenue is almost triple the income of CEOs in companies with under \$500 million USD revenue.⁵²

The evidence suggests that CEO salaries are closely related to revenue but not to profitability. One study of executive salaries in middle-sized manufacturing and distribution companies found that such salaries were almost directly related to revenue. The only information needed to predict the salary of chief executives was a formula based strictly on revenue. This study also found that the compensation of lower-level managers was a fairly predictable ratio of the CEO's salary and that the compensation of these managers was unrelated to company profits (in dollars) or profitability (ratio of profits to sales). Other studies also have shown that corporate performance is not related to either salaries or salaries plus bonuses, even though most executives claim that their pay is based on their performance.⁵³

Below the level of chief executive, most studies have found relatively consistent percentages representing the pay of the second- and third-highest executives. The second-highest executive is usually paid about 71 percent of the CEO's salary, except in retail trade where the second executive receives 84 percent. The third-highest executive normally receives 55 to 60 percent of the CEO's salary, and the next level down the pyramid receives 68 percent of that. These percentages reveal wide variations between the levels. Some question whether the responsibilities and demands of the CEO position justify such wide variations. The typical justification for such large pay differentials is based on the concept of a **just noticeable difference (JND)**, taken from the psychological literature on sensation and perception. A JND is the amount (weight, size, color) that is required to make a meaningful difference. At higher income levels a much larger dollar amount is required to make a noticeable difference between two income levels.

The pay of middle managers and supervisors is primarily influenced by their levels in the organizational hierarchy. A statistical analysis of the salaries of 150 managers found that a move from a first-level to a second-level managerial position resulted in a 12 percent pay increase. An additional 7 percent increase was obtained if such a move required the manager to report to a higher level in the structure. Education and age also were found to be related to pay. A master's degree in business administration was worth an additional 8 percent, and 50-year-old managers received 12 percent more than 40-year-old managers. Although a

manager's pay is assumed to be closely related to sales and profits, this assumption was not sustained by the results of the analysis. A 15 percent increase in sales only produced a 4 percent increase in pay, and a 15 percent increase in profits produced a one percent decrease in base pay and only a four percent increase in salary plus bonus. Apparently all managers receive pay increases, but high performers receive larger bonuses than low performers who, instead, tend to get larger increases in base salary.⁵⁴

4.7.2 Executive Bonus Plans

Most incentive plans for upper- and middle-level managers include bonuses. The basic philosophy behind bonuses is to reward managers for good performance. Bonuses are expected to stimulate managers to higher levels of effort and dedication. When bonuses are tied to the overall performance of a company, they are expected to create cooperation between managers and to increase flexibility and creativity.

The size of executive bonuses is typically larger for upper-level managers than for middle-level managers, even when expressed as a percentage of salary. Bonuses for CEOs are typically about 120 to 160 percent of their base pay. Bonuses for other upper level managers might be 50 to 80 percent of salary. At lower levels, supervisors and managers typically receive bonuses that are only 14 to 40 percent of their salaries, if they receive bonuses at all.⁵⁵ Top corporate officers receive larger bonuses than lower-level managers, both in dollar amounts and as a percentage of salary.

Participation in bonus plans is typically determined by salary level, salary grade, or organizational level. A difficulty with all three of these methods is that the bonuses are determined by arbitrary formulas rather than by performance levels. Again, the basic idea behind bonuses is to reward outstanding performance and to provide an incentive for diligence in the future. When bonuses are based on salary level, salary grade, or organizational level, rather than on individual performance, the bonuses lose their incentive properties.

Some companies strive to tie executive bonuses to company performance. To prevent managers from sacrificing long-term growth for short-term success, some executive bonuses are based on the company's performance over three to five years. These plans are growing in popularity because they create a better balance in motivated effort by rewarding both long-term growth and short-term profitability.

Although bonuses are intended to improve performance, the research evidence does not entirely support their effectiveness. Several case studies have reported positive benefits from carefully designed and administered bonus plans in individual companies. One study compared the economic performance over a ten-year period of 100 bonus-paying companies with 100 companies that did not pay bonuses. The companies were matched according to size and industry. The results indicated that the paying of bonuses was associated with higher economic performance.⁵⁶

In many companies, however, the bonus plans are not carefully designed and administered. In these companies, bonuses are not tied to operating goals or to company profits. A survey of 571 major companies over a two-year period found that bonus-paying companies were not

necessarily more profitable than companies that did not pay bonuses. In this survey, bonus-paying companies and companies that did not pay bonuses were compared within 16 industries. The bonus-paying companies, as compared to those not paying bonuses, had a higher return on investment in nine industries and a lower return on investment in six industries; there was no difference in the remaining industry.⁵⁷

Therefore, even though little research evidence supports the effectiveness of executive bonuses, they are widely used despite their high costs. Some have concluded that executive bonuses are an example of management's ability to pay itself what it wants, regardless of performance, and to pass the cost on to the consumers.

Perhaps one of the most lavish executive bonuses is the money they receive when they leave office. Executives typically receive large bonuses whether they are outstanding leaders who generate supernormal returns or whether they fail and are forced to resign. These bonuses, called **golden parachutes** or change-in-control benefits, are generally part of the negotiation at the time of hiring. In recent years, the average golden parachute provided to CEOs at large U.S. companies has been more than \$30 million.⁵⁸

4.7.3 Stock Options

In its simplest form, a **stock option** is the right to buy a company's stock at a certain price over a certain period of time, usually ten years. Stock options are viewed as an inexpensive benefit because they don't cost a business any cash or cause any charge to earnings. However, they may dilute a company's stock if enough options are exercised.

Although numerous kinds of stock-option plans exist, the basic premise of most is that executives are given the option of buying a specified number of shares at a fixed price. The option can be exercised over a period of time, which allows executives to wait and see if the value of the stock appreciates before buying it. For example, if someone is granted a stock option when the stock is trading at \$10 USD and it appreciates to \$15, the holder can cash out at the \$10 exercise price, also called a "strike price," and gain a \$5 profit on each option. Options usually don't "vest," or become exercisable, for at least a year after they are granted. During periods of rising stock prices, income from stock options can be sizable. For high-salaried executives, income from stock options can easily double their income from bonuses and salaries.

Stock options are also attractive to companies since they can often deduct the value of the options gains for tax purposes. Furthermore, until recently, stock options were not a current cost to the company because accounting rules didn't require companies to recognize them as an expense until they were exercised.

An employee stock ownership plan is advocated as an effective means of creating a sense of ownership or proprietorship in a company. However, an inherent conflict exists between the income purposes and the ownership purposes of stock options. To obtain money from a stock option plan, an employee must buy the stock and then resell it. Therefore, the feeling of ownership supposedly derived from holding the stock is not very great if the employee's intent is to immediately resell it.

4.7.4 Nonfinancial Rewards

In addition to many lucrative financial rewards, executives also receive numerous nonfinancial rewards. These nonfinancial rewards, known as perquisites (perks), vary greatly from company to company. Top-level executives generally receive more perks than middle-level executives.

Some of the most popular perks include a large and elaborately furnished office, a choice location for one's office, a company car for personal use, reserved parking, and first-class air tickets. Other perks, as shown in Exhibit 21, are memberships in private clubs, health spas, or athletic clubs; use of a company recreation center, such as a cabin; use of recreational equipment, such as a fishing boat; use of a special cafeteria; expense accounts; cell phones; and other electronic devices.

Exhibit 21: Common Executive Perks

| | |
|------------------------------|---------------------------|
| physical exam | chauffer service |
| company car | first-class air travel |
| financial counseling | reserved parking |
| company plane | executive dining room |
| income tax preparation | home security system |
| airline VIP clubs | communications equipment |
| country club | health club |
| luncheon club | financial seminars |
| estate planning | free long-distance phone |
| personal liability insurance | loans |
| spouse travel | flexible perquisite plans |
| home computer | |

Workers who have to pay for their own cars, food, and phone calls from a much smaller base salary are understandably quite critical of executive perks. The most significant criticism of executive perks, however, involves the ineffective way in which they are distributed—as membership rewards rather than as performance rewards. When all executives at the same level receive the same executive perks regardless of performance, companies overlook a potentially powerful motivating tool. For example, parking positions could be changed each month among division heads to reflect division sales. Use of the company cabin could be reserved for only those managers who are the top performers. The awarding of perks according to performance could have a stronger motivating effect on executives than large financial bonuses.

4.7.5 Director Pay

Many executives receive additional compensation for serving on a board of directors for their own corporation or for an outside corporation. Most outside directors receive an annual retainer fee, plus a separate fee for each board meeting or committee meeting they attend. Other benefits in addition to pay also are provided to some outside directors. Liability insurance coverage customarily protects board members from legal suits that may be brought against the board. Some board members' benefits include life insurance, travel insurance, and

even group health and dental insurance. Stock purchase plans also are available for some board members.

Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at www.hrcp.com. Log into your account and click on My HRCP to access the practice exams.

1. Can you explain the rules governing the use of stock options?
2. Can you describe the monetary and non-monetary compensation that might be offered to executives?

~Notes~

4.8 EMPLOYEE BENEFIT PROGRAMS

Employee benefits, also called benefits-in-kind, fringe benefits, perquisites, or perks, include various types of compensation provided to employees in addition to their normal pay. Employee benefits may be considered taxable income in many countries. Employee benefits are often provided as a way to increase the economic security of employees and improve employee retention. Some employee benefits are required by law, and others are subject to legal regulations if a company chooses to provide them.

4.8.1 Pensions

Pension Plans

A **pension** is the income individuals receive during retirement as a deferred payment for past services rendered. It is a fund made up of contributions paid by either the employer, the employee, or both, plus (or minus) the yield of the investments. Most countries have laws that regulate pension funds, and many pensions are administered by the government. HR managers must understand the laws in their country that regulate pensions.

A **defined benefit (DB) pension plan** is the traditional company-provided benefit plan. This plan uses a formula that combines salary and years of service to determine the benefits that employees receive. The formula usually involves an earnings base (the average earnings during the final working years) times the years of service, times a stipulated percentage (generally between one and three percent). This formula typically provides a monthly pension that is about 50 to 70 percent of a person's previous salary. Employers set aside annual contributions, based upon actuarial computations, that will provide sufficient funds to pay the vested retirement benefits after employees retire. Separate accounts are not maintained for each participant.

A **defined contribution (DC) pension plan** requires a separate account for each participant and the money that is put into these accounts typically comes from both employers and employees. Retirement savings are placed in separate accounts for each employee during working years, and the employees are free to decide how this money should be invested. Retirement benefits are then determined by the amount contributed to the account plus the interest income it earns.

A hybrid plan that combines aspects of both defined benefit and defined contribution plans is a **cash balance plan**. These plans are similar to defined contribution plans since they involve individual accounts that belong to the employees and they are portable when employees want to change jobs. But, they are also a form of a defined benefit plan since they are employer-funded. In a typical cash balance plan, a participant's account is credited each year with pay and interest credits. These plans have important advantages: they allow employers to decide how the funds will be invested, the amounts can grow substantially if they are invested well and the stock market is flourishing, and they are more portable when employees want to move from company to company.

In a cash balance plan, participant accounts grow through a combination of employer contributions and the annual interest credit rate set by the employer.

4.8.2 Health and Accident Insurance

In some countries, health and accident insurance are optional benefits that employers can decide whether they want to offer. In other countries, health insurance is a required benefit.

Medical Insurance

Major medical and hospitalization coverage is included in many benefits plans. Medical insurance usually covers the following services:

- physician services, including office visits, adult physical exams, and well-childcare
- eye exams
- radiology and laboratory tests
- prescription drugs
- hospital services
- maternity services
- mental health therapy
- surgery
- physical therapy
- chiropractic therapy
- medical equipment
- emergency room services
- telemedicine services

Dental Care

Dental and orthodontic coverage are included in some benefit plans. Plans may cover expenses for the extraction or replacement of natural teeth when necessitated by an accident. Reimbursement is also provided for a percentage of most other dental services, such as exams, crowns, x-rays, fluoride treatment, and cleaning. A percentage of orthodontic treatment is also sometimes covered.

Dependent Care

Childcare and elder care are important benefits for some families. Many employers have discovered that dependent care is more than a humanitarian issue, it is also an economic issue since caring for a dependent tends to reduce attendance, increase stress, and decrease productivity.⁵⁹

Employers have experimented with a variety of successful childcare programs. Probably the greatest deterrent to more extensive childcare programs is a philosophical belief that child-rearing is a responsibility best performed by parents rather than by companies or day-care centers. Although research in moral development abundantly demonstrates the vital role parents play in teaching moral values, some parents choose to work and others are required to work by economic necessity.

Finding a dependable and affordable source of childcare is a high priority for many working parents. These are the four most popular forms of childcare benefits:

1. *On-site childcare facility:* The companies that have an on-site childcare facility number in the hundreds; they tend to be large companies, and many of them are hospitals. Some neighboring companies form cooperatives to provide on-site facilities. The major advantage of an on-site facility is that parents can visit their children during their breaks and lunch periods. The major disadvantages are legal liability for accidents and the cost of creating and maintaining the facility. In spite of the costs of on-site facilities, some companies believe they are cost effective due to improved attendance, productivity, and retention.⁶⁰ Another disadvantage shared by on-site child-care facilities is the spread of illness which causes parents to stay home with sick children. One study found that parents who were able to arrange care for their children in their homes only lost .19 day per month because of sick children while those whose children were in a day-care center missed an average of .52 day per month.
2. *Childcare allowances :* Since on-site day-care centers are not very feasible for small and medium-sized companies, some of these companies try to help employees by subsidizing their expenses in off-site centers or in their homes.
3. *Day-care information:* Some employers have provided excellent help for their employees by simply providing a resource and referral system. This information often includes names of day-care centers, rest homes, clinics, and baby-sitters.
4. *Flexible scheduling:* Being able to adjust work hours is occasionally very important to employees who are caring for others and who cannot always control their schedule. Some of the most helpful schedule changes include flextime, permanent part-time jobs, and job sharing.

4.8.3 Income Replacement

Benefit plans can create a valuable feeling of security by providing life insurance and various forms of income continuation. Accidents and illnesses that result in death are the most serious personal losses, but a permanent disability can also create a serious financial strain. If disabled employees cannot support themselves and their families, or if they require extensive medical assistance, their financial burdens could become very great indeed. Life insurance and income-continuation plans help to alleviate such difficulties by sharing both the risks and the cost of accidents and illnesses.

Disability

Long-term disability (LTD) insurance is a method of providing disabled employees with long-term security. If an employee is unable to work because of an incapacitating accident or illness, LTD provides a continuing source of income until the employee returns to work or reaches retirement age.

Sick leave provides employees with the continuation of their regular pay when they are unable to work because of illness. Many organizations allow a specific number of days of sick leave each year that may or may not be accumulated.

The abuse of sick-leave benefits is a general problem in many organizations because employees call in sick when they want to miss work. Most organizations do not require evidence of illness unless strong evidence exists that sick-leave policies are being abused. To discourage employees from abusing sick leave, some organizations allow employees to accumulate sick leave from year to year. Accumulated sick leave can then be used for an extended illness or applied toward early retirement. Another approach is to give each employee a specified number of days off for **personal time** in addition to those allowed for sick leave. These personal days can be used for illness, or they can be added to an employee's annual vacation, or accumulated for early retirement.

Long-term-care (LTC) insurance provides assistance to people who are unable to care for themselves due to old age or disability. While LTC coverage does not include health care expenses, it covers other professional services when they are needed, such as feeding, bathing, dressing, and taking medications. Care may be provided in the person's home by a home-health nurse or in a nursing home, in an assisted living facility, or in a hospice. LTC coverage for the employee and sometimes for family members also is offered by some employers; however, only about one in ten workers in private industry is covered by it. Employees are often required to pay the premiums for LTC, which are generally reduced through group plans. A growing percentage of large companies offer long-term-care insurance to their retired employees.⁶¹

Life Insurance

The two major forms of insurance covering the death of an employee are life insurance and accidental death and dismemberment.

1. **Group term life insurance** provides financial assistance to an employee's beneficiary if the employee dies. The costs of life insurance are normally lower under a group plan than under an individual plan. The amount of life insurance on each employee is usually some multiple of the employee's annual salary, such as one or two times the annual base salary.
2. **Accidental death and dismemberment** is a special form of insurance coverage for accidents that result in death or the loss of limbs or eyesight.

Severance Pay

Severance pay is designed to provide financial security when employees are terminated and have to look for new jobs. In the United States, severance pay averages 1.4 weeks of pay for each year of service. This is considerably below some other countries, such as Netherlands (4.1 weeks), Japan, (3.7 weeks), Germany (3.3 weeks), Brazil (3.1 weeks), England (2.7 weeks), Canada (2.4 weeks), and France (2.1 weeks).⁶²

4.8.4 Employee Services

Employee services, also called voluntary benefits, include a broad range of benefits that are provided for a variety of reasons. Employees are able to purchase most of these benefits based on discounted group rates negotiated by the employer. The costs to the employer are typically limited to administrative costs, such as those for payroll deduction. Stock purchase plans, credit unions, and matched payroll-deduction savings plans may be provided to encourage employees to save money and develop their own financial estates. Legal services

and emergency loans may be provided to help employees keep their jobs or to stay out of jail. Charter flights, group tours, and other social and recreational facilities may be provided to create good morale and to satisfy the social needs of employees. Counseling services and alcohol and drug rehabilitation programs may be provided for humanitarian reasons to assist employees who need help. The major employee services are listed in Exhibit 22.

Exhibit 22: Employee Services

1. Stock purchase plans
2. Credit unions
3. Matched payroll-deduction savings plans
4. Emergency loans
5. Matching gifts to charitable organizations or schools
6. Tuition for the employee and family members
7. Clothing and uniforms
8. Service awards
9. Christmas bonuses
10. Food services and cafeteria
11. Transportation and parking
12. Company car
13. Auto and homeowners insurance
14. Liability coverage
15. Child care and day-care center
16. Child adoption
17. Moving and transfer allowances
18. Personal counseling
19. Legal assistance
20. Alcohol and drug rehabilitation
21. Gymnasium and physical training center
22. Recreation center
23. Group tours and charter flights
24. Discount privileges on purchases from the company
25. College savings plans
26. Pet insurance
27. Cancer and critical care insurance
28. Long-term care
29. Game room with TV
30. Place to bring pets to work
31. Free massages
32. Dry cleaning services
33. Tax preparation services
34. Sports team competitions
35. Wellness seminars
36. Retirement planning

Many organizations have established **employee assistance programs** that provide professional help for employees with personal problems. The most frequent problems include alcoholism and drug use, financial indebtedness, emotional stress, and marriage and family problems. Alcoholism is the most frequent and most serious problem that is dealt with in employee assistance programs.

Legal Assistance

Some employees, usually only top level executives, receive free legal assistance as a benefit. This assistance is usually in the form of preparing a will, creating a personal trust, or assisting with a divorce or adoption, and the assistance comes from the corporation's own legal department.

Auto and Property Insurance

Some companies provide auto and property insurance either free to the employees or at a group rate that is much lower than the employees could obtain it on the open market.

Retirement Counseling

To help employees prepare for retirement, many organizations sponsor informal discussion groups in which workers can discuss their future plans. Some of the important topics that are covered include financial planning, wills and inheritance provisions, earning money after retirement, recreation and hobbies, health problems of older persons, and organizations for retirees. Some employers provide tuition aid, educational assistance, and publications describing activities for retired persons to encourage employees to prepare both financially and psychologically for the change. To help employees ease into a new style of life gradually, some companies even have "tapering off" programs that allow employees to reduce their work hours as they approach retirement.⁶³

Transfer and Relocation Assistance

When employees are transferred to new locations, they often receive **transfer assistance** in the form of allowances and other personal assistance. Most organizations have a policy of reimbursing reasonable moving expenses, and major corporations typically pay more than 90 percent of all direct out-of-pocket moving expenses.

An alternative to reimbursing actual expenses is a lump-sum payment that gives employees a fixed amount to move. Employees can use the money to pay a moving company to move them or move themselves and keep the remainder. Lump-sum payments are typically based on family size and the distance of the move. Lump-sum payments provide greater flexibility for employees to manage their own relocations and respond to special circumstances, such as pets.

Since both husband and wife may be employed, transferring one creates problems for both. Therefore, some companies now attempt to arrange a new position for the spouse of a transferred employee, even if the new position is with another organization. If the cost of living is higher in the new location, some companies offer a cost-of-living allowance that is usually a percentage add-on to the transferee's base salary. To facilitate the change in residence, some companies agree to buy the employee's old home (which they resell) at a fair market value and to arrange a low-interest loan to buy a new home. All of these benefits are in addition to the salary increase that typically is awarded with a promotion to a new position or given as an incentive to move.⁶⁴

4.8.5 Pay for Time Not Worked

Paid vacations and paid holidays create the impression that employees are being paid for not working and that the company is generously providing wonderful benefits. Consequently, vacations, holidays, personal excused absences, and other opportunities for not working are regarded as part of the benefit package.

Paid Holidays

Holidays are days of special religious, cultural, or patriotic significance on which work and business ordinarily ceases. Some countries require a certain number of paid holidays each year. Workers usually receive time-off from work, at full or partial pay, for a specified number of holidays each year. Some employers also include “personal holidays,” such as an employee’s birthday or “floating holidays” that vary from year-to-year as determined by the employer or employee. When a holiday falls on a scheduled day off, such as a weekend, another day off is often substituted.

Paid Vacations

Paid vacations consist of continuing the employees’ regular wages during vacation periods. The length of the vacation period is generally tied to an employee’s length of service.

Vacation plans with a carryover provision allow employees to move a certain number of unused vacation days into the next leave year. Any unused vacation days above the carryover limit are lost. Cash-in provisions allow employees covered by such plans to receive their normal daily earnings or some other amount for each unused vacation day up to a certain number of vacation days per year. Like carryover provisions, any unused vacation days above the cash-in limit are lost.

A recent study shows that only 25 percent of employees with paid vacations use all of their available leave. Fifty-one percent use less than half their leave, and 15 percent don’t use any leave at all. In addition, 61 percent of those who do take leave say they do some work during their vacation.⁶⁵

Paid Personal Leave

Personal leave allows employees to be paid while absent from work for a variety of reasons not covered by other specific leave plans. Employees granted personal leave are usually eligible for one to five days per year, and a few employees are provided as much personal leave as needed.

Union Activities

Union activities often require union officers to be excused from work. The nature of the activities and the time allowed for them is specified in most labor contracts. For example, most unionized companies permit time off with pay to employees who are involved in a grievance procedure.

Reporting Time

Reporting time guarantees that employees who report for work will receive a minimum amount of pay even if they do not work. In construction and manufacturing, for example,

employees normally get paid for so many hours of work just for reporting to work even if there is nothing to do.

Sabbatical Leaves

Sabbatical leaves have been popular for college professors for many years. A few businesses have started to permit certain professionals and executives to have up to one year of sabbatical leave when they perform work that has value to society or that enhances their professional competence. For example, some executives are asked by their companies to become involved in urban development projects and other full-time civic activities.

Paid Funeral Leave

Funeral leave provides time off from work due to a death in the family. Eligible employees usually receive a set number of days per occurrence and the number of days off may vary depending on the employee's relationship to the deceased. For example, a plan may provide three days off for the death of a spouse, parent, or child, but only one day off for the death of other relatives. Employees who do not have a formal funeral leave plan may be allowed to use other types of paid leave such as a paid sick leave days to attend the funeral.

4.8.6 Recognition and Achievement Awards

Companies also use a variety of nonfinancial incentives to motivate and reward their employees. These programs, which include various award programs and suggestion systems, often have a greater impact on motivation and company loyalty than financial incentives.

Award Programs

Recognition awards can be highly motivating if they are part of an overall recognition program that includes a history of meaningful presentations. For example, a 25-year service pin can be an extremely motivating reward, not because of its financial worth but because of the symbolic meaning associated with the way it is presented in an annual awards ceremony where recipients are individually recognized. Employees who observe this ritual year after year come to appreciate the ceremony and see the pin as a highly valued reward. The best awards are functional jewelry or office/home accessories made of precious materials (such as gold and diamonds) that contain some form of symbolism, such as the company logo or colors. Meaningful presentations make employees feel genuinely appreciated and increase their job satisfaction and company commitment. The awards should be presented in the presence of coworkers by a higher-level manager who can describe the employee's contribution to the company. Careless and casual award presentations can make employees feel demeaned and unappreciated.⁶⁶

Organizations use a variety of recognition programs to influence the attitudes and behaviors of employees. Some programs are designed to achieve specific results by rewarding specific behaviors while other programs are intended to have a broad impact on employee attitudes and behaviors. Length of service programs are the most popular form of employee recognition. A survey by Recognition Professionals International (RPI) indicated that 89 percent of the 614 companies surveyed have programs that recognize employees for their years of service. Length of service awards are generally given to employees on their anniversary date of hire at the end of the first year, the fifth year, and succeeding five-year

increments. Since the awards are based on length of service, it would appear that they simply reward employees for “sitting in a chair.” Companies that use them effectively, however, claim that service awards do much more than reward employees for “hanging around;” they can significantly increase productivity and improve job attitudes. Other recognition programs identified in the RPI survey, and the percent of companies offering them, include above-and-beyond performance awards (87%), sales awards (51%), retirement awards (51%), awards for suggestions or creative ideas (42%), employee of the year or month awards (36%), safety awards (33%), and attendance awards (22%).⁶⁷ Another survey by the Worldatwork of 544 companies reported that the average cost of recognition programs was 2.7 percent of payroll.⁶⁸

The kinds of rewards companies use to recognize good behavior include cash awards, savings bonds, shares of company stock, jewelry, clothing, theater tickets, dinner for two, luncheons with top managers, refreshments with co-workers during break times, time-off from work, extra vacation days, travel for two or travel with a company tour, cruise trips, plaques, and pictures displayed on prominent walls. Virtually any consumer product can be used as an award. Some employees select their own awards from gift catalogues.

Suggestion Systems

Most organizations have formal suggestion systems that encourage employees to submit ideas for improving efficiency or profitability. Some organizations even provide attractive monetary rewards for good ideas. The reward usually is based on the estimated cost savings of the idea, although an upper limit usually restricts how much a person may receive for an acceptable suggestion. For example, one company pays \$25 USD for every idea that is used and 10 percent of the estimated cost savings during the first year up to \$1,000.

In some companies, suggestion systems have generated many valuable ideas that have produced considerable savings. At Nippondenso Manufacturing USA, a \$45,000 USD investment in a suggestion system produced a savings of nearly \$1.7 million, a 38-to-1 return on investment. American Airlines created an employee suggestion program, called American Airlines’ IdeAAs, that rewarded employees a percent of the cost savings of their suggestions. This program was credited with over \$500 million in cost reductions over 13 years. However, it was also extremely labor intensive, since it required a staff of about 100 cost accountants, business analysts, etc. to calculate the savings. It was replaced with a recognition only program called “Ideas in Flight”. Interestingly they achieved double the rate of cost savings in the first year—without any financial compensation—and they were able to handle the huge volume of suggestions with a team of just six people.⁶⁹

Companies that have active suggestion systems almost universally report positive results: employees submit constructive ideas that increase product reliability, reduce production costs, improve the firm’s competitiveness, and contribute to better communications.

Suggestion systems work especially well in small companies because employees are likely to get quick feedback and feel that their ideas receive serious consideration. Suggestions normally must be submitted in writing. A committee then evaluates them and prepares a written evaluation of each to show that it has been seriously considered. Some employees are highly motivated by suggestion plans and submit numerous creative ideas.

Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at www.hrcp.com. Log into your account and click on My HRCP to access the practice exams.

1. Can you list and explain the types of employee benefits that are required by law?
2. Can you explain the difference between a defined benefit pension plan and a defined contribution pension plan?
3. Can you describe the various deferred compensation plans?
4. Can you explain income replacement benefits?
5. Can you describe the employee services that may be offered by an organization?
6. Can you list and describe the various types of paid leave?
7. Can you explain recognition awards and suggestions systems?

4.9 MANAGING EMPLOYEE BENEFIT PROGRAMS

Workers today are seeking more, and different, benefits from their employers. Their desire for the traditional benefits, like medical, dental, and life insurance, remains strong. But increasingly they also want new benefits such as childcare assistance, flexible work hours, and parental leave.

Employee benefits are not free, however, even if workers are not charged for them. Employee benefits are a substantial cost to employers; the costs of benefits have grown faster in most companies than any other cost factor.

4.9.1 Employee Benefits Philosophy, Planning, and Strategy

Benefit programs are based primarily on three philosophies:

1. Sharing the risks of accidents and illness
2. Forced savings for retirement or bad times
3. Sharing the costs of special services

In essence, benefit programs provide a dignified way for employees to receive a relatively secure and constant level of income regardless of illness, accident, or time away from work. Benefit programs require employees to adopt an attitude of sharing and giving. Although wanting to get back as much as you put in is a natural attitude, most people must receive far less than their fair share to fund those who encounter serious misfortune. People need to remember that insurance companies can only pay out what they receive in premiums (plus returns on investments), and a significant portion of the premiums must be used to pay salaries and other overhead expenses.

Benefit programs also force people to provide for themselves by requiring them to save for retirement. History has demonstrated that most people fail to provide adequately for their retirement years; therefore, society requires people to plan ahead. Rather than viewing this requirement as an unreasonable encroachment on individual liberties, it is typically viewed as a reasonable inducement to save for the future.

Should all employees have equal access to employee benefits? Executives usually receive more benefits, and an ethical analysis reveals that most benefit plans discriminate in favor of highly compensated executives.

4.9.2 Employee Preference Assessment: Surveys

As the cost of employee benefits continues to rise, employers want to know whether benefits contribute to employee satisfaction, and if so, which benefits are the most important. Most surveys find that benefits and pay are the most highly ranked factors influencing employee satisfaction, regardless of age. When asked which benefits are the most important, healthcare and medical benefits usually are at the top of the list, followed by flexible work hours, retirement benefits, and paid time off – depending on age.⁷⁰

Because of differences in age and family circumstances, employees have dramatically different benefits needs. While older workers are very interested in retirement benefits, workers with young children may be much more interested in orthodontic coverage. A few studies have examined the benefits preferences of employees and have found that the kinds of benefits employees want are significantly influenced by their age, marital status, and number of dependents. The results of one study found these differences:

- Older workers were more interested in pension plans than younger workers.
- Younger workers were more interested in dental plans and four-day weeks than were older workers.
- People who were married were more interested in both pension increases and dental plans than single workers.
- People with fewer dependents were more interested in shorter work days than people with more dependents.
- People with more dependents were more interested in dental plans than people with fewer dependents.

This same study also found that some benefits were much more important to all employees, regardless of age, marital status, and number of dependents. For example, all employees were highly interested in more vacation time, but they were not very interested in a shorter workday. In general, dental plans were also more important than pension plans; however, both dental and pension plans are considered important benefits.

4.9.3 Cost-Benefit Analysis and Cost Management

Since employee benefits represent a major cost item for most companies, efforts to analyze and control benefit costs have become increasingly important. Four methods have been developed for analyzing the costs of employee benefit plans. The **annual cost method** simply reports the total annual cost figure for each benefit. Although some benefits may seem difficult to measure, careful cost accounting methods can be used to measure the cost of each benefit as well as the total cost for the entire benefit package.

The **cost per employee per year** is computed by dividing the total cost of each benefit by the number of employees receiving the benefit. Such an analysis might show that some very expensive benefits, such as legal counseling and alcohol and drug rehabilitation, are only used by a few employees. In addition to determining the average cost of each benefit, the company also may wish to aggregate the costs for all benefits. This figure, showing the total cost per employee, is especially meaningful when communicating with employees. Most employees do not appreciate how much employers spend on benefits for each employee.

The **percent of payroll** shows the costs of benefits relative to the amounts spent for wages and salaries. This figure is particularly useful in making comparisons between the benefits costs of different companies. It is calculated by dividing the total annual cost of benefits by the total annual payroll cost. This produces a simple percentage figure that normally ranges between 20 and 60 percent for most companies. However, a company could feasibly spend more on benefits than payroll, and, as a result, the percent of payroll figure could exceed 100 percent.

The **cents-per-hour** figure shows the costs of benefits per employee per hour. This figure is frequently used in expressing the costs of benefits, especially in union companies. It also is cited frequently in contract negotiations between unions and employers. Improvements in benefit plans are translated into cents per hour figures that become very important in the bargaining process.

Benefit Plan Audits

Because employee benefits are so costly, and because poorly administered benefit plans have such a negative impact on employee attitudes, companies should audit their plans regularly, including both eligibility and claims audits. Since many employers essentially delegate to a third party administrator the responsibility of providing and administering their health care benefits, employers need to occasionally review the procedures they are following and monitor the expenses they are paying.

Eligibility audits ensure that those who are enrolled in benefit plans satisfy the requirements for being active employees or legitimate dependents who are entitled to participate. Employers should not continue to pay monthly fees for employees who have terminated employment or died. Divorced spouses and adult children who are no longer eligible to participate should be purged from the list. Continuing to pay for people who are not actually in the plan is an unnecessary expense.

Coordination of Benefits

The most difficult coordination problems occur when both husband and wife are covered by separate benefit plans that provide overlapping coverage, or when coverage must be coordinated with government-sponsored benefits.

Some companies have a spousal surcharge program that requires employees to pay an additional cost to cover their working partners when these partners could be covered under their own employer's plan. This surcharge is intended to reduce benefits costs and create an incentive for spouses to enroll in their own plans. If the spouse is not working or does not have access to a benefit plan, the spousal surcharge is typically deleted.

Utilization Review

A utilization review consists of examining how often each benefit is used by employees and the costs of providing each benefit program. Benefit administrators need to know how much each benefit costs and what percent of the workforce is using it. Benefit programs that are extremely expensive and used by only a small percent of the employees are identified in a utilization review.

4.9.4 Communicating Benefit Programs

Employers can use a variety of communication strategies, including employee handbooks, online benefits portals, agent enrollment sessions, employee newsletters, lunch-and-learn sessions, customized benefits booklets, and frequently-asked-questions materials. Many companies focus their benefits communications to the time just prior to the open enrollment period; however, evidence suggests that employees are less likely to leave their jobs when companies provide more frequent benefits communications.⁷¹

Most organizations communicate information regarding employee benefits via a website or a printed employee handbook. Benefits websites should be mobile-optimized and available to employees and their family members twenty-four hours a day, seven days a week. Employees can be referred to the information via email, text messages, bulletin boards, printed materials, and meetings. Benefits websites and handbooks should have sections describing health and medical benefits, vacations and time off, employee services, and pensions. These sections need to describe the levels of coverage, eligibility requirements, costs to the employees, and options the employees may choose. When employees reject benefits options, especially with cafeteria plans, employers should document that the employees have been informed of their choices and have refused to make an election. This should be done by having the employee sign an acknowledgment.

The benefits' descriptions need to be written in language the employees can understand. Too many handbooks are written in a complex language that the average employee cannot understand.

Explaining employee benefits is an important part of new employee orientations. New employees need written descriptions of their benefits in addition to verbal explanations to answer their questions. Individual counseling sessions with benefits specialists are often needed to help employees make difficult choices in their benefits options.

If a company ever decides to change its benefits offerings, it is essential for the company to communicate these changes to employees. These changes need to be announced in company bulletins, through direct correspondence to the employees' homes, and in training and counseling sessions. Some companies have developed electronic communications that allow employees to learn about their benefits through e-mail systems, interactive computer training programs, and networked websites.

Total Reward Statement

A **total reward statement** is a personalized summary of an organization's financial commitment for each of its employees. Also known as "employee benefit statements" and "total compensation statements," these documents summarize the various ways in which an organization compensates its employees. Seeing a description of the comprehensive benefits of employment can help employees appreciate the investment their employer makes in them. A total reward statement can raise employee awareness of the benefits available to them, and it can help attract, motivate, and retain employees.

The following items may be included in a total reward statement:

- *Compensation:* Include base salary or hourly pay, overtime, bonuses, commissions, and incentives.
- *Health care benefits:* Explain medical, dental, mental health, and vision care, along with information about flexible spending accounts and cafeteria benefits plans.
- *Insurance:* List plans, including life insurance, short- and long-term disability, accidental death and dismemberment, and travel insurance.

- *Vacation and leave:* Describe the organization's leave benefits, including paid holidays, personal leave, vacations, sick leave, jury duty, and bereavement.
- *Retirement:* Explain the benefits provided for retirement, such as pensions and health care benefits.
- *Costs of employment:* List the government-required expenses for hiring the employee.
- *Additional benefits:* Include wellness programs, childcare, elder care, awards programs, legal assistance, tuition reimbursements, uniforms, food services, transportation assistance, employee assistance program, fitness centers, adoption services, etc.

Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at www.hrcp.com. Log into your account and click on My HRCP to access the practice exams.

1. Can you describe the methods for measuring and analyzing the costs of employee benefit plans?
2. Can you describe a total reward statement?

~Notes~

4.10 EVALUATING COMPENSATION

4.10.1 Budgeting

The formal budgeting process is a vital part of the pay system. It is through budgeting that compensation cost-benefit objectives are achieved. Budgeting helps to ensure that future financial expenditures are coordinated and controlled. Budgets also provide a valuable forecasting tool for managers since the budget becomes a plan that guides managerial decisions and a standard against which managers' actual expenditures are evaluated. Pay budgeting involves forecasting the compensation costs associated with employing human resources for the next budget year.

As noted earlier, there are two basic approaches to generating compensation budgets: (a) a "bottom-up" approach, in which individual pay rates for the next plan year are forecasted and summed to create the total budget, and (b) a "top-down" approach, in which a total pay budget for a unit is centrally determined and then allocated to each unit and individual.

Bottom-up budgeting: Bottom-up budgeting requires supervisors to forecast the pay increases they will recommend for each of their subordinates during the coming plan year. Although this method relies heavily on lower-level supervisors, it also requires considerable assistance from the human resource department and approval from top managers. An eleven-step process has been developed:⁷²

1. Instruct supervisors in compensation policies and techniques so they understand the basics of a sound pay-for-performance policy and how to use pay increase guidelines, salary ranges, and market data.
2. Help supervisors understand the pay-increase guidelines and how to use them.
3. Distribute forecasting instructions and worksheets.
4. Provide consultation to supervisors as needed.
5. Collect the forecasted increases and ensure that they are consistent with the pay guidelines.
6. Compile statistical data summarizing the forecasts and prepare feedback reports.
7. Analyze forecasts and identify inequities among the supervisors.
8. Review the forecasts and budgets with the supervisors and revise them as needed.
9. Submit a final budget for approval to top management.
10. Conduct feedback with supervisors showing statistical summaries of the forecasted data by department.
11. Monitor budgeted versus actual increases by tracking the results and reporting periodically to supervisors.

This approach to budgeting places the responsibility for pay management on the supervisors and managers who are responsible for managing the work group. Compensation professionals serve as advisers to the supervisors and managers.

This approach to budgeting is consistent with a method called "**zero-based budgeting**" that assumes all expenses for the next period must be justified. Zero-based budgeting requires that a program be justified from the ground up each fiscal year. Rather than assuming that

next year's budgets will be similar to this year's budget with minor adjustments, zero-based budgeting starts from zero and requires managers to identify every activity and justify every expense.

Top-down budgeting: Top-down budgeting involves estimating the pay increase budget for an entire organization and then allocating an amount to each manager or supervisor. The managers and supervisors are then responsible for distributing the budgeted increases among the members of their groups. These pay increase distributions are typically based on performance and must be approved by a second-level manager. The human resource office generally provides guidelines, sometimes called **merit increase grids**, showing the appropriate pay increase for different performance levels.

A typical top-down budgeting strategy, called a **planned pay-level rise**, involves centralized decision making by top managers, who determine the overall percentage increase in average pay for the plan year. This decision is primarily based on these factors:

- The current year's increase in compensation costs—the budgeted costs for the next year may be reduced if significant increases have already occurred in the past year.
- The increase in the cost of living—wage changes should generally correspond with changes in the labor market wages, as determined by wage surveys and changes in the consumer price index.
- The firm's ability to pay—financially healthy firms typically try to retain their market position by continuing to pay above average wages, while financially troubled firms may be forced to limit their wage increases.
- Competitive market forces—the wages paid by competing firms provide a benchmark for recommending pay increases.
- Turnover effects—the loss of highly trained employees and their replacement by newer inexperienced employees generally results in a reduction in labor costs. Senior employees are usually paid substantially more than new employees, and this differential needs to be factored into the planned pay-level rise.

Cost Management

Three variables combine to determine a firm's labor costs: (a) the number of employees, (b) the average cash compensation, and (c) the average benefit cost. Managing labor costs effectively requires a careful review of all three variables. The formula for combining these variables is:

$$\text{labor costs} = \text{employment} \times (\text{average cash compensation} + \text{average benefit cost})$$

Controlling employment: The most obvious and perhaps the most common approach to managing labor costs is to control the "head count." Reducing the size of a firm's workforce is a strategy that has been used frequently to reduce costs, especially during adverse economic times. This strategy entails both positive and negative consequences.

On the positive side, reducing the size of a company's workforce creates an immediate reduction in labor costs, which may be necessary for survival. Furthermore, some evidence indicates that layoffs, or even the announcement of a layoff, will increase a company's stock price and produce favorable reactions from stock analysts.

On the negative side, reductions in the workforce through layoffs, early retirements, and attrition generally result in the loss of trained and talented employees and create a serious reduction in employee morale among those who stay. The employees most likely to accept voluntary separation agreements are usually the best employees, who have the greatest confidence in finding new employment. Employees who survive a layoff generally complain that they are required to do the work of those who left in addition to their own jobs, and they live in fear that they will be the next to go. Consequently, employers need to think carefully about both the positive and negative consequences of downsizing and balance the cost savings against the opportunity costs.

Controlling cash compensation: A strategy for controlling labor costs that has grown in popularity is for companies to use more contingent workers, rather than core workers. Core workers refer to a company's regular full-time employees. **Contingent workers** refer to a heterogeneous collection of workers who do not have an ongoing expectation of full-time employment, such as regular part-time workers, supplemental employees, independent contractors, temporaries, consultants, "life-of-the-project" workers, gig workers, leased employees, and subcontractors. Many women who have dropped out of the labor force to raise their children and older workers who have retired are interested in working on special projects and welcome opportunities to work part time.

Another strategy for controlling average cash compensation that has grown in popularity is to decrease the percentage of fixed pay and increase the percent of pay that is tied to performance, which is called variable pay. **Variable pay** refers to performance-based pay and includes individual performance bonuses, executive bonuses, gainsharing, group incentives, profit sharing, and other incentives tied to productivity. By reducing their fixed base pay amounts and shifting to more variable pay, companies hope to pay employees only for what they do and, at the same time, not pay them for what they don't do.

Controlling benefits costs: As described earlier, companies have attempted to control the dramatic increase in benefits costs through a variety of strategies that include:

- Moving from a fee for service health-care insurance to managed-care.
- Increasing the co-pay for health insurance.
- Requiring employees to pay a larger percent of the covered expenses.
- Adopting a flexible benefit plan.
- Using flexible spending accounts and medical spending accounts.
- Using self-funding rather than insurance companies.
- Provide greater transparency in health-care costs so employees will make better decisions and reduce unnecessary expenses.

4.10.2 Assessment of Methods and Processes

The assessment of a total compensation system involves comparing the outcomes of the firm against the six criteria described earlier for a compensation system: legal, adequate, motivating, equitable, secure, and cost-benefit effective. This assessment, sometimes called a *compensation impact analysis*, examines how well each of these strategic objectives is being achieved.

Whether a pay system is adequate, motivating, equitable, and secure is based largely on subjective factors. Obtaining measures for these criteria requires developing an information system that generates such indexes as turnover rates of high performers (retention), job acceptance to job offer ratios (attraction), promotion offers to promotion acceptances, unit productivity, unit labor costs, support staff salaries to total sales ratios, and total labor costs as a percent of revenue. Similarly, it could also involve comparing such indexes as a unit's compa-ratio to the turnover rates of employees rated above average and the rate of change in salaries relative to the rate of change in earnings or return on investments.

Exhibit 23: Questionnaire Measuring Attitudes Towards an Incentive Commission Program

Here are some statements about the commission incentive program. You may agree with some and disagree with others. Please circle the number that comes closest to indicating your true feelings.

| | no opinion | strongly disagree | disagree | neutral | agree | strongly agree |
|--|------------|-------------------|----------|---------|-------|----------------|
| 1. My pay is too low, considering the work I do. | X | 1 | 2 | 3 | 4 | 5 |
| 2. I have always been treated fairly by the company. | X | 1 | 2 | 3 | 4 | 5 |
| 3. The incentive commission program is unfair because some get higher commissions than others. | X | 1 | 2 | 3 | 4 | 5 |
| 4. The customers get much better service because of the incentive commission program. | X | 1 | 2 | 3 | 4 | 5 |
| 5. The incentive commission program should be eliminated and replaced with straight hourly wages. | X | 1 | 2 | 3 | 4 | 5 |
| 6. Because of the incentive commission program, my income fluctuates wildly, and I'd like it to be a little more stable. | X | 1 | 2 | 3 | 4 | 5 |
| 7. The incentive commission program is an excellent program for motivating and rewarding employees. | X | 1 | 2 | 3 | 4 | 5 |
| 8. There is a crucial need to change the incentive commission program so that it is more fair. | X | 1 | 2 | 3 | 4 | 5 |
| 9. What changes are needed to make conditions in this organization more fair and equitable? _____ | | | | | | |

Employee attitudes are another important source of evaluative information regarding a company's compensation system. Feelings of equity and fairness and an acceptance of the compensation system among employees are vital for pay effectiveness. Many companies have a regular practice of surveying employee attitudes, and most surveys include items assessing attitudes toward pay adequacy and pay equity. An illustration of a questionnaire measuring attitudes toward an incentive commission program is shown in Exhibit 23.

Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at www.hrcp.com. Log into your account and click on My HRCP to access the practice exams.

1. Can you describe the difference between bottom-up and top-down budgeting?
2. Can you define "zero-based budgeting"?
3. Can you describe the three variables that combine to determine an organization's labor costs and explain how each can be controlled?

~Notes~

4.11 INTERNATIONAL HR COMPENSATION ISSUES

4.11.1 Expatriate Pay and Allowances

It is expensive to station an executive in another country. When managers of multinational companies receive international assignments, they normally draw additional compensation in the form of special **expatriate allowances**. These allowances are often as much as three or four times the executive's base salary, and they become quite complicated because of tax considerations.

A typical compensation package includes base salary, premiums for foreign service and hardship, and allowances for cost of living, housing, storage, and taxes. Most companies pay at least an extra \$10,000 USD a year for accepting the foreign post, plus another \$10,000 if the assignment is considered hazardous or a hardship. Because living quarters in other countries may be more expensive, most companies pay housing differentials.

These amounts illustrate how costly international assignments are for multinational organizations. The foreign-service premium and the area, or hardship, allowance are amounts that the employee is paid to accept the foreign assignment. All other allowances are intended to equalize the financial costs so that the costs of living abroad are comparable to the costs of remaining at home. The tax allowance is extremely costly because it involves a tax on a tax, that is, it is the amount paid to the expatriate to cover the high tax burden due to his or her overseas assignment, an amount which is itself taxable.

Other elements of an expatriate benefit package may also be quite different because they are either provided by or mandated by the government. Some countries, for example, provide health care, retirement benefits, and possibly life and disability insurance. Other foreign governments require government-mandated benefits, such as vacations, holidays, maternity and paternity leave, and medical leave. There may also be special requirements regarding severance-related benefits, such as protections against layoffs and severance payments for terminated employees.

Increasingly, companies are adopting the compensation practice of *localizing* employees who are working on assignments in other countries. Localizing refers to converting an international employee's remuneration package to one that is essentially identical to normal full-time employees at that location, which encompasses base compensation, incentive payments, equity plan participation, perquisites, and retirement benefits. The impetus for deciding to localize an international assignee may stem from both business and personal considerations. The most common business considerations are a need for the employee on assignment to remain in a particular position indefinitely, and a recognition of the potential cost savings to the company by placing the assignee on a local program. The most common personal considerations are that the assignment is in a desirable location where the assignee wants to live, the assignee may not have any particular ties to the "home" location, or the assignee marries a local individual and wishes to remain. Localizing typically occurs gradually as the assignee adjusts to living in the local economy without expatriate allowances.

4.11.2 Compensation and Benefits for Global Workers

International compensation systems are more similar than they are different. Wage surveys and job evaluation systems are used extensively throughout the world to create a wage structure with a hierarchy of labor grades. For the most part, every culture uses similar factors to assign jobs to labor grades: skill, effort, and responsibility.

Wage levels and benefits differ dramatically from country to country, but individual wage decisions are almost universally determined by performance and seniority.

The proportion of executive pay that is tied to performance, called variable pay, differs greatly country by country. In countries that have a very competitive culture, executives are expected to achieve specific performance objectives and they are highly rewarded for their accomplishments. In less competitive cultures, a much lower percentage of an executive's total compensation comes from variable pay. This applies to both line and staff managers, including human resource managers.

Cost of Living Allowances

Compensation plans for expatriates are usually complex and expensive because of the taxes, allowances, and premiums. A cost-of-living allowance is often given to employees who are assigned to live abroad to equalize the costs of living in both the host and home countries. Compensation specialists must assess the cost of a comparable living standard in the host country relative to some comparison country, which is usually the employee's country of origin. If the host country costs more than the home country, a cost-of-living adjustment is made. However, if the cost-of-living in the host country is less than the home country, very few companies will make a negative adjustment.

In many countries, housing allowances have become the single most expensive item in expatriate compensation packages. Many firms provide some form of assistance when there are extreme disparities in housing costs between the home and host country. Some firms simply add a fixed housing cost to an expatriate's monthly income and let the executive pocket the money if less expensive housing can be found. Other firms calculate the exact difference in home and host country housing costs and compensate employees for that amount. Occasionally, firms will provide rent-free housing in the host country for expatriates.

Exchange Rate Fluctuations

Cost-of-living adjustments must be frequently reviewed because of exchange rate fluctuations and inflation. These adjustments may need to be reviewed quarterly, if not monthly, when there are significant changes in exchange rates or inflation.

Official exchange rates are not always equivalent to unofficial or real exchange rates. Especially in developing countries, where the national currency is not freely traded on world exchange-rate markets, governments have a tendency to overvalue their currencies. Compensation specialists need to focus more on the unofficial or real exchange rates than on the official rates to make fair compensation.

Test Your Knowledge

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1. Can you explain the considerations that must be given in compensating expatriate managers?

~Notes~

4.12 COMPENSATION LAWS AND REGULATIONS

Most countries have laws that regulate the compensation and benefits of employees. Human resource managers must ensure that their companies comply with these regulations. The following is a list of aspects of employee compensation that are often regulated:

- *Minimum wage.* Most countries have laws that set a minimum wage, the lowest amount of pay an employee may receive, based on an hourly, daily or monthly standard.
- *Overtime.* Some countries have laws that require employers to pay overtime premiums, such as one and a half times or twice the hourly rate, for hours worked in excess of a set amount, such as 40 hours per week or for more than a certain number of hours in a day.
- *Equal pay for equal work.* Some countries have a law mandating equal pay for equal work. This concept is typically used to prevent future or rectify past sexual discrimination. The concept of pay equality is also covered in international labor law.
- *Paid leave.* Many national governments have laws guaranteeing paid leave to their employees for a variety of reasons, including holidays, vacations, maternity leave, paternity leave, and sick leave. Most countries require between two and four weeks of paid leave per year.
- *Workers' compensation.* Workers' compensation insurance provides medical benefits and income replacement to employees injured on the job. In exchange for this coverage, employees agree to relinquish their right to sue the employer for negligence. Survivor benefits are provided to family members of employees killed in workplace accidents. Many countries have workers' compensation laws.
- *Unemployment compensation.* Unemployment is a type of insurance that provides compensation to unemployed people. In some countries unemployment benefits are provided through a government system, and in others the benefits are provided by trade and labor unions. Generally, unemployment benefits are provided only to those who register for unemployment benefits and can document that they are currently seeking work.
- *Pensions.* A pension is the income individuals receive during retirement as a deferred payment for past services rendered. Most countries have laws that regulate pension funds, and many pensions are administered by the government.
- *Benefits.* Employee benefits include various types of non-wage compensation provided to employees in addition to their normal pay. Employee benefits may be considered taxable income in many countries.

- *Taxation.* Most employees around the world are required to pay income taxes. The involvement of the employer varies by country, and human resource managers need to understand the employer's role in taxation. Most tax laws are extremely complex.
-

Test Your Knowledge

The following test-your-knowledge questions are open-ended items designed to help you assess your understanding of the concepts discussed in the preceding section. A vital part of your preparation for the human resource certification exam is taking the online multiple-choice practice exams provided as a part of this program at www.hrcp.com. Log into your account and click on My HRCP to access the practice exams.

1. Can you describe the types of laws and regulations that impact compensation and benefits?

KEY TERMS

Accidental death and dismemberment: A special form of insurance coverage for accidents that result in death or the loss of limbs or eyesight.

Allocation formula: The formula used in profit-sharing plans that determines how the profit is allocated to individuals; it is normally based on seniority and performance.

Annual-cost method: A method of computing the costs of benefits by calculating the total annual cost of each benefit.

Bonus: The incentive pay that individuals may receive for outstanding performance; it is not part of their base pay.

Broadbanding: Creating wide labor grades so that there are fewer labor grades with more jobs in each one.

Cafeteria benefit plans: Employees choose the benefits they desire, subject to certain limitations and total cost constraints.

Carryover provision: Allows employees to move a certain number of unused vacation days into the next leave year. Any unused vacation days above the carryover limit are lost.

Cash balance plans: Individual retirement plans that replace a defined benefit pension plan. These plans allow employees to decide how their funds will be invested, and they are more portable when employees want to move from company to company.

Cash-in provisions: Allow employees covered by such plans to receive their normal daily earnings, or some other amount, for each unused vacation day up to a certain number of vacation days per year. Any unused vacation days above the cash-in limit are lost.

Cash profit-sharing plan: A profit-sharing plan in which payments are made to employees at the end of each period.

Cents per hour: A method of calculating the cost of employee benefits by dividing the total annual cost per employee by the number of hours worked per year.

Classification method: A procedure used to develop a wage structure in which the job descriptions for each job are compared with a classification scheme that ranks the jobs in a hierarchy of job worth.

Commission sales: A form of incentive pay offered to sales representatives whereby they receive a fixed percentage of the sales proceeds from merchandise they sell.

Compa-ratio: A number that compares a person's pay rate with the midpoint of the pay range.

Compensable factors: The factors associated with the different jobs that justify paying one job more than another. Responsibility, education, and skill are usually considered the most important compensable factors.

Consumer Price Index (CPI): A well-accepted measure of the rate of inflation.

Contingent workers: Workers who do not have an ongoing expectation of full-time employment, such as part-time workers, independent contractors, temporaries, consultants, "life-of-the-project" workers, leased employees, and subcontractors.

Cost-of-living adjustment (COLA): A procedure that provides for automatic increases in the level of pay based on the rate of inflation—usually indexed to the consumer price index.

Cost per employee per year: A benefit costing method that is computed by dividing the total annual cost of each benefit by the number of employees receiving the benefit.

Decreasing-rate increase: A procedure for adjusting the wage curve in which higher-level jobs are increased by successively smaller amounts.

Deferred profit-sharing plan: A profit-sharing plan in which an employee's share is held until a later period, usually retirement.

Defined benefit plan: A pension plan that provides a retirement income to retirees based on a formula that usually combines the retiree's years of service and average annual income for the last five years.

Defined contribution plan: An individual pension fund created for each employee into which the company invests a specified amount of money each year until the individual retires.

Differential piece-rate plan: A piece-rate incentive plan that provides a low piece rate for individuals who produce less than the standard and a high piece rate for individuals who meet or exceed the standard.

Employee assistance program: A benefit program that provides counseling to employees with such problems as marital conflict, indebtedness, alcoholism, and drug abuse.

Equity theory: A theory of job satisfaction suggesting that people compare their inputs and outputs with the inputs and outputs of others.

Expatriate allowances: The additional income and benefits provided for employees who are transferred to a foreign country.

Expectancy: A component of expectancy theory. The probability that effort will lead to performance.

Expectancy theory: A process theory of motivation in which people decide what to do by subjectively estimating the probability of being able to perform an activity and whether that activity will be rewarding. The three components of expectancy theory include expectancy, instrumentality, and valence.

Factor comparison: A method for developing a wage structure in which benchmark jobs are compared with other jobs, factor by factor, to determine how much money should be paid for each factor.

Fine-tuning compensation: Adjusting a compensation package to achieve a balance between security and motivation.

Fixed-rate increase: A procedure for adjusting the wage curve in which a fixed sum of money is added to every job in the hierarchy.

Gainsharing: A pay-for-performance plan such as a Scanlon plan, a Rucker plan, or an improshare plan. Most gainsharing plans involve greater employee participation in their design.

Golden parachute: An agreement between a company and an executive employee specifying that the executive will receive certain significant benefits if employment is terminated due to events such as a merger or takeover.

Group term life insurance: Provides financial assistance to an employee's beneficiary if the employee dies. The costs of life insurance are normally lower under a group plan than under an individual plan.

Halsey Premium Plan: An incentive plan where the workers receive a guaranteed hourly wage plus a percentage of the wage for any time saved.

Hay Method: A widely-used job evaluation method that uses three compensable factors—know-how, problem solving, and accountability, to determine how many points should be assigned to different jobs.

Improshare: A pay-for-performance plan whose name comes from improved productivity through sharing.

Individual wage decision: One of the major decisions that must be considered in the development of a compensation system. This decision considers the issue of whether individuals performing the same job should all receive the same rate of pay or whether individuals who have more seniority, experience, or higher productivity should receive higher pay.

Instrumentality: A component of expectancy theory: the relationship between performance and outcomes.

JND (Just noticeable difference): The amount of money required to make a significant difference in the perception of an incentive. For an individual at a low pay level, a small amount of money would constitute a just noticeable difference, but for a highly paid executive, only a large sum of money would be perceived as a significant incentive.

Job evaluation: A procedure for developing a wage structure that is based on an evaluation of the job. The four job-evaluation methods are the job-ranking method, the classification method, the point method, and the factor-comparison method.

Job pricing: The process of deciding how much each job should be paid by determining which labor grade the job falls within and the pay range for that labor grade.

Job-ranking method: A procedure for developing a wage structure that involves ranking the various jobs in a hierarchy of job worth and then assigning monetary values to them.

Key jobs: Jobs that are considered equitably paid and are used in the point method to develop a wage structure. The pay levels for other jobs are determined from the wage curve that was developed using the key jobs.

LTD (Long-term disability): Insurance that provides disabled employees with long-term security.

Maslow's need hierarchy: A theory of motivation based on a hierarchy of five needs: physiological, safety, social, esteem, and self-actualization.

McClelland's achievement need: A theory of motivation built around the need for achievement and its influence on behavior.

Merit increase grids: Guidelines provided by the HR department recommending appropriate pay increases for different performance levels.

Merit pay: Increases in an employee's basic wage level based upon performance levels.

Pay-for-knowledge programs: A program under which employees are paid according to the skills or knowledge they have demonstrated.

Pay for performance: A pay system that ties pay to performance levels.

Pay grade: A cluster of jobs along the hierarchy of job worth that are all paid the same rate of pay.

Pay range: The range of pay associated with each pay grade, which indicates how much individual incentive is associated with the job.

Pay secrecy: A policy that restricts employees from discussing their pay and limits the amount of information about pay that can be made public.

Pension: The income that an employee receives from his or her employer after retirement.

Percent of payroll: A method of calculating the costs of employee benefits by expressing the cost as a percentage of the total payroll costs.

Percentage increase: A procedure used for adjusting the pay levels in which the pay for every job is increased by a fixed percentage amount.

Perquisites (perks): Nonfinancial rewards or benefits.

Personal time: Paid leave that can be used for illness, vacation, or accumulated for early retirement.

Piece rates: The amount of money that an employee receives for performing a particular unit of work.

Planned pay-level rise: A top-down budgeting strategy that involves centralized decision making by top managers who determine the overall percentage increase in average pay for the plan year.

Point method: The most popular job-evaluation method for developing a wage curve. The compensable factors of key jobs are used to develop the wage curve. Points are assigned to each factor, and the total points are associated with a specific pay level.

Productivity: The total goods and services produced by society divided by the total number of employee hours required to produce them.

Profit sharing: A program that allows employees to share in the profits of a company based upon the profitability of the company and an allocation formula determining each employee's share.

Red-circle jobs: Jobs that are either overpaid or underpaid relative to the amount the wage curve indicates ought to be paid for them.

Reinforcement theory (operant conditioning): A theory of motivation that says behavior is determined by the types of rewards or punishments associated with the behavior.

Restriction of output (soldiering): The practice of producing less than is possible. This restriction occurs when peer-group norms establish an arbitrarily low standard of performance.

Rucker Share-of-Production Plan: A company-wide incentive plan in which compensation is based on a ratio of income to value added by the employees in the production process.

Scanlon Plan: A company-wide incentive plan that combines profit sharing with a suggestion system.

Severance pay: Provides financial security when employees are terminated and have to look for new jobs.

Sick leave: A program that provides employees with the continuation of their regular pay when they are unable to work because of illness.

Skill based pay: A pay system in which an employee's pay is partially determined by the employee's skills, used as a means of motivating employees to acquire greater skills.

Soldiering: The practice of producing less than is possible. This restriction occurs when peer-group norms establish an arbitrarily low standard of performance.

Standard hour plan: An individual or group incentive plan that pays a fixed rate per hour where the hour is measured by an hour's worth of work rather than by a standard 60 minutes.

Step increases: Pay increases that are based on performance and length of service.

Stock option: A part of the executive compensation program that allows employees to buy shares of the company's stock, usually at a reduced price.

Straight piecework: An individual incentive plan that provides a fixed rate of incentive pay for each item produced.

Total reward statement: A personalized summary of an organization's financial commitment to each employee, including compensation and all benefits programs.

Topped out: When employees receive pay increases to the point that their salaries are at the top of their pay ranges, they are said to be topped out. They are no longer eligible for pay increases based on performance and receive higher salaries only as the entire wage curve is increased.

Transfer assistance: The special assistance provided to an employee who is transferred to a new location. Examples include a transfer bonus, moving allowance, assistance in buying and selling a home, and help in finding employment for the employee's spouse.

Unemployment compensation: Money provided by the unemployment compensation funds to temporarily assist employees who are laid off through no fault of their own.

Valence: A component of expectancy theory. The value of the outcomes and the extent to which they are attractive or unattractive to the individual.

Variable pay: Performance-based pay that includes individual performance bonuses, executive bonuses, gainsharing, group incentives, profit sharing, and other incentives tied to productivity (as opposed to fixed base pay).

Wage compression: A reduction in the relative wage differentials between high- and low-paying jobs. Upper-level jobs do not provide sufficient incentives to justify the higher levels of responsibility and skill required to perform them.

Wage curve: The line on a wage structure graph that shows higher levels of pay associated with higher-level jobs. Most wage curves using the point method are straight lines (linear curve) which are constructed by drawing a freehand line or by using regression equations.

Wage-level decision: One of the major decisions involved in designing a compensation system, compares the wages paid in one organization with the pay in other organizations for employees performing similar work.

Wage-structure decision: A major decision in the design of a compensation system that examines how much money is paid for different jobs within the same organization.

Wage survey: A survey of the wages, salaries, and benefits offered by different organizations. The wage survey is the major tool used in making the wage-level decision. Many organizations conduct their own wage surveys, but often the most sophisticated wage surveys are conducted by the government.

Zero-based budgeting: A budgeting method that requires each program to be justified from the ground up each fiscal year. The alternative is to use the prior funding level for that program as the basis for further adjustments.

PHRi™ Exam Content Outline

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PHRi Exam Weighting by Functional Area:

Functional Area 01 | Talent Acquisition (19%)

Functional Area 02 | HR Administration and Shared Services (19%)

Functional Area 03 | Talent Management and Development (19%)

Functional Area 04 | Compensation, Benefits, and Work Experience (17%)

Functional Area 05 | Employee Relations and Risk Management (16%)

Functional Area 06 | HR Information Management (10%)

Functional Area 01 | Talent Acquisition (19%)

Actions needed to make sure an organization has employees with the right skills in the right positions at the right time.

Responsibilities:

- 01 Create job description in partnership with hiring manager to ensure that requirements are accurate and up-to-date
- 02 Recommend and implement most efficient and cost effective sourcing strategies for hiring managers (e.g., agencies, job boards, internal postings, social media, job fairs, college recruitment)
- 03 Work with hiring managers to facilitate interviews by evaluating all sourced and submitted applications
- 04 Partner with hiring manager to determine preferred candidate(s), communicate job offer, and ensure acceptance

Knowledge of:

- 01 The job analysis process and organization needs
- 02 Job evaluation and job descriptions
- 03 Existing best recruitment practices, platforms, sourcing channels, and labor market
- 04 Existing best recruitment practices and trends (utilizing different platforms or channels to source talent)
- 05 Current market situation and talent pool availability (internal and external)
- 06 Interview and assessment methods
- 07 Job requirements

- 08 How to measuring recruiting effectiveness (e.g., time-to-fill, cost-per-hire)
- 09 Applicant tracking systems and/or methods
- 10 General compensation and benefits administration methods (e.g., market reference ranges/pay tiers, compa-ratio, fringe benefits)
- 11 Verbal and written offer/contract techniques

Functional Area 02 | HR Administration and Shared Services (19%)

Activities that support employees and managers by responding to requests for information and gathering and storing information in a manner that ensures integrity and accurate retrieval.

Responsibilities:

- 01 Respond to employee inquires and requests as first point of contact in order to provide positive employee experience
- 02 Maintain personnel files and records to ensure accuracy and data integrity
- 03 Administer leave management programs for all employees by tracking time off requests and hours worked in order to maintain compliance and ensure alignment with appropriate pay policies
- 04 Process employee status changes and life events, such as payroll changes, terminations, transfers, promotions, birth of a child
- 05 Coordinate new hire activities by working with various teams and hiring managers to ensure successful employee integration
- 06 Initiate employee offboarding process by completing tasks to effectively separate the employee
- 07 Support organization-wide communication initiatives which provide updates and results in order to keep employees engaged
- 08 Maintain organizational charts to match organization requirements

Knowledge of:

- 01 Organization policies, procedures, ongoing programs, and other engagement activities
- 02 Record keeping requirements
- 03 Regulations related to handling sensitive personal data
- 04 Leave management policies and processes
- 05 Statutory leave of absence requirements (e.g., holidays, paid leave, maternity)
- 06 Benefits tracking systems
- 07 Organization benefits and compensation policies and processes
- 08 Statutory requirements related to benefits
- 09 HR Information Systems (HRIS) platforms

- 10 Onboarding process and logistical arrangements
- 11 Employment lifecycle
- 12 Legal requirements to onboard new employees
- 13 Organization values, history, organizational structure
- 14 Offboarding process and logistical arrangements
- 15 Legal requirements to separate employees
- 16 Upcoming updates, changes, organization news
- 17 Employee demographics in order to effectively communicate with all employees
- 18 Various organizational structures

Functional Area 03 | Talent Management and Development (19%)

Processes that support effective talent management, employee engagement and development.

Responsibilities:

- 01 Administer measurement tools to determine success of organizational development programs
- 02 Maintain a process for creating new, and revising existing, job profiles and competencies
- 03 Support succession planning program to identify and develop high potential employees for key and leadership positions
- 04 Administer organization supported activities to enhance employee participation and engagement
- 05 Execute organization's performance management strategy by completing appropriate steps in order to achieve organizational goals and objectives
- 06 Support employee development by administering learning and development programs to achieve desired outcomes by the organization

Knowledge of:

- 01 Best practice survey methods
- 02 Job analysis
- 03 Principles of employment
- 04 Market trends
- 05 Learning and development tools and methodologies
- 06 Coaching and mentoring methods
- 07 Organizational structure
- 08 Qualitative/quantitative survey and reporting methods
- 09 Corporate culture and policies

- 10 Emerging HR trends and the impact on the workplace
- 11 Organization's performance management strategies and methodologies
- 12 Adult learning theories and best practices
- 13 Organization's development strategy

Functional Area 04 | Compensation, Benefits, and Work Experience (17%)

Total reward systems that support recruitment, retention, and recognition of employees and improve organizational results.

Responsibilities:

- 01 Provide total rewards/compensation statements by organizing data to deliver to employees
- 02 Prepare compensation analysis for recommendation in order to acquire and retain talent
- 03 Manage organization recognition and/or rewards program(s) to foster employee engagement and enhance employee experience
- 04 Ensure employees are aware of benefits and compensation for internal comprehension and appreciation
- 05 Recommend and support strategic initiatives to enhance Employee Value Proposition (EVP), culture, and brand
- 06 Ensure equality in total rewards by using job evaluations and salary structure in compliance with organization requirements

Knowledge of:

- 01 Benefits and compensation strategy and the connection to human capital strategy
- 02 Methods to align and benchmark compensation
- 03 Employee engagement principles and theories to enhance employee experience
- 04 Benefits and compensation programs in extensive detail
- 05 Employee Value Proposition and its effect on employee engagement, talent acquisition, and retention
- 06 Current market data obtained through market studies and salary surveys
- 07 Pay structure techniques

Functional Area 05 | Employee Relations and Risk Management (16%)

Policies and practices that ensure workplace safety, legal compliance and employee satisfaction.

Responsibilities:

- 01 Develop and communicate safety incident investigation to ensure compliance with safety guidelines

-
- 02 Advise managers and supervisors on proper corrective practices in order to ensure fair and consistent administration of corrective actions
 - 03 Administer and educate business units on employee handbook and organization policies in order to ensure internal comprehension
 - 04 Support internal and external HR compliance audit process to ensure organization readiness
 - 05 Coordinate workplace security protocols and disaster recovery communication plans to ensure workplace safety and business continuity
 - 06 Maintain and execute employee grievance procedures by ensuring that each case is properly handled for the purposes of a healthy working environment

Knowledge of:

- 01 Regional safety laws and guidelines
- 02 Process management
- 03 Specific employment laws and guidelines
- 04 Corrective action methods
- 05 Organization policies
- 06 Legal best practices
- 07 Internal and external audit procedures
- 08 Proper documentation methods and systems
- 09 Recordkeeping best practices
- 10 Business continuity plan development
- 11 Process mapping and workflow development
- 12 Local labor compliance and regulations
- 13 Investigation practices

Functional Area 06 | HR Information Management (10%)

Processes that help the organization access and use human resource technology.

Responsibilities:

- 01 Identify processes to be automated in HRIS by mapping and validating with users to be sure they are properly implemented
- 02 Obtain user requirements to design various processes and ensure alignment with organizational standard operating procedures
- 03 Generate reports and determine metrics as required by users to support business initiatives
- 04 Provide support for systems change management efforts by facilitating change to ensure user acceptance

- 05 Design training materials and user manuals to ensure users comprehend and utilize systems capabilities
- 06 Maintain security by monitoring user access rights to ensure compliance and data integrity
- 07 Execute regular review and audit of HRIS data to ensure accuracy and appropriate integration with other organization systems in order to achieve effective reporting, compliance, and personnel data output
- 08 Provide support for problems reported by users in collaboration with technical support team to ensure that HRIS operates smoothly and satisfies requirements
- 09 Propose improvements to the system by identifying gaps in current automation to ensure effective and efficient operation of the organization

Knowledge of:

- 01 Existing business processes within areas of expertise
- 02 Organizational policies and procedures
- 03 Gap analysis
- 04 Effective data reporting
- 05 Existing HRIS, reporting tools, and other systems
- 06 Change management tools and techniques
- 07 Different communication techniques
- 08 Knowledge management techniques and practices
- 09 Organization structure and responsibilities
- 10 Job profiles to ensure proper access to users
- 11 Ongoing processes the system performs
- 12 Organization HRIS/tools/procedures
- 13 Trends and root causes of problems
- 14 Existing processes in the organization
- 15 User and customer requirements
- 16 Business

SPHRi™ Exam Content Outline

The following information is provided by HR Certification Institute from their SPHRi™ Exam Content Outline. ©2017 HR Certification Institute.

SPHRi Exam Weighting by Functional Area:

Functional Area 01 | Business Leadership (31%)

Functional Area 02 | Talent Development and Management (27%)

Functional Area 03 | HR Service Delivery (24%)

Functional Area 04 | Measurement and Analysis (18%)

Functional Area 01 | Business Leadership (31%)

Leading the HR function, providing strategic HR consultation to senior management, and developing partnerships with all areas in the organization. Contributing to the overall strategy of the organization through activities such as evaluating organizations considered for mergers and acquisitions, conducting human capital analyses, and understanding global HR issues.

Responsibilities:

- 01 Contribute to the development of the organization's strategy
- 02 Determine how the organization's strategy guides workforce requirements (for example, decide how human capital strategy will support the business)
- 03 Assess future business opportunities from an HR perspective (for example, building new operations, global expansion, mergers and acquisitions)
- 04 Conduct due diligence before acquiring another company (for example, evaluate important information about the potential acquisition)
- 05 Manage the integration of people, systems and cultures during organizational transitions
- 06 Design and lead an HR function by establishing major HR roles and responsibilities
- 07 Co-lead in establishing the organization's values and ethics that support its strategy
- 08 Promote the organization's corporate social responsibility initiatives
- 09 Advise business leaders and others on HR matters
- 10 Align the human capital strategy with the organization's business strategy
- 11 Align local HR strategy with global HR strategy
- 12 Lead the executive management team in HR discussions and decisions
- 13 Conduct a human capital risk analysis, (for example, workforce needs)
- 14 Promote the organization's employer brand
- 15 Promote and support the organizational culture

16 Promote a culture that welcomes new ideas and innovation

17 Develop and manage the HR budget

Knowledge of:

- 01 Business elements of an organization (for example, products, competition, customers, technology, demographics, culture, processes, safety and security)
- 02 Financial knowledge (for example, evaluating financial statements, budgets, accounting terms, and cost management)
- 03 Vision, mission and values of an organization
- 04 Strategic planning process
- 05 Global and local economic and geopolitical trends that affect the business
- 06 Methods of gathering data for strategic planning purposes (for example, using methods such as a SWOT analysis [Strengths, Weaknesses, Opportunities, Threats] and a PEST analysis [Political, Economical, Socio-Political and Technological])
- 07 Legal and regulatory requirements
- 08 Merger and acquisition processes
- 09 Expectations of HR from the internal and external stakeholders
- 10 Cultural and social sensitivity (for example, awareness of and appreciation for cultural differences in the workplace)
- 11 Corporate social responsibility (for example, environmental practices, sustainability and protection of resources)
- 12 Management functions (such as planning, directing, assessing, implementing, delegating, coaching, etc.)
- 13 Decision making processes in the organization (problem solving, consensus building, rational, etc.)
- 14 Drivers and impact of organizational culture
- 15 Labor legislation and compliance (for example, labor categories, health care, retirement and cross-border legislation)
- 16 Effective communication skills locally and globally (for example, interpersonal skills, listening, speaking, and cross-cultural communication)
- 17 Human relations concepts and applications (for example: relationship building, emotional intelligence, interpersonal communication)
- 18 Dealing with situations that are uncertain, unclear or chaotic
- 19 Corporate governance procedures and compliance (for example, Board of Directors)

Functional Area 02 | Talent Development and Management (27%)

Identifying and developing relevant individual and organizational competencies; developing and using a talent management strategy to sustain long-term, effective alignment with organizational strategies to achieve human capital objectives; establishing a learning environment in which continuous professional development includes staying current in HR practices. Using a set of systematic and planned activities designed by the organization to help people develop the necessary skills to meet current and future organizational needs and objectives. Creating an organizational environment that encourages and retains the employees.

Responsibilities:

- 01 Design and implement programs or processes in order to develop and engage the workforce (for example training and development programs, knowledge management)
- 02 Analyze labor market trends that influence workforce availability
- 03 Train and coach managers on performance management systems and processes
- 04 Facilitate change in the organization
- 05 Develop programs and processes that promote diversity and inclusion
- 06 Establish programs to identify and develop high potential employees
- 07 Create succession and career development plans
- 08 Engage in continuous professional development
- 09 Provide mentorship to the HR team and overall organization

Knowledge of:

- 01 Organizational development methods and problem-solving techniques
- 02 Change management processes and techniques
- 03 Leadership theories and applications
- 04 Adult learning principles and methods
- 05 Training design and development
- 06 Techniques for integrating employees into the organization after a merger, acquisition or restructure
- 07 Methods to motivate employees
- 08 Employee collaboration methods (for example team building)
- 09 Cross cultural and multigenerational awareness (for example dynamics of global teams)
- 10 Retention strategies
- 11 Benchmarking
- 12 Performance management theories and approaches
- 13 Talent management practices (selecting, assessing and developing employees)

- 14 Organizational demographics (for example the generations of employees, their ages, cultures, and genders)
- 15 Conflict management (recognizing and resolving difficult issues and problems)
- 16 Coaching and mentoring techniques (helping others develop, providing guidance and feedback, executive coaching)
- 17 Facilitation (for example, managing teams, leading meetings and focus groups)
- 18 Succession planning frameworks
- 19 Techniques to encourage creativity and innovation
- 20 Career development paths (structuring promotional and developmental opportunities within an organization)
- 21 Compensation and benefits philosophy

Functional Area 03 | HR Service Delivery (24%)

Using effective HR Service Delivery methods to deliver accurate and consistent programs that support sustainable organizational growth. Creating an environment where all employees can find answers to HR questions; using effective communication plans, HR technology and tools; identifying HR service delivery methods used by a group that may be applicable across the organization; defining and implementing compensation and benefit programs and managing employee arrivals and departures from the organization as appropriate.

Responsibilities:

- 01 Develop and implement effective recruiting and hiring processes
- 02 Establish programs that support flexible work practices
- 03 Analyze internal and external labor market conditions (for example, skills available locally, salary expectations)
- 04 Optimize technology and tools to deliver HR services (for example, payroll, employee self-service, social networking, and Human Resource Information Systems [HRIS])
- 05 Plan and implement employee benefits programs
- 06 Develop and implement total rewards programs (for example, salary, bonus and other forms of employee recognition, expatriate and foreign national compensation programs)
- 07 Establish on-boarding processes and employee integration plans
- 08 Develop and manage programs to balance the organizational and employee needs (for example, expatriates, disability challenges, dependent care, employee health and safety)
- 09 Manage the return of employees to the organization (for example, people returning from maternity leave, expatriates returning to home country, people ending sabbaticals, or employees returning from layoffs)
- 10 Manage employee's exit from the organization (both voluntary and involuntary)

Knowledge of:

- 01 Industry trends in HR (for example, population statistics, economics, sources of talent)
- 02 Industry benchmarks for compensation (for example, salary surveys, benefit packages)
- 03 Local labor conditions, including laws, legislation and international practices
- 04 Organizational needs and practices
- 05 Employee relocation, domestic and international
- 06 Forecasting techniques (for example, determining staffing needs for the future)
- 07 Assessment methodology (survey, observer ratings, gap analysis, etc.)
- 08 Recruitment practices and sources in target markets
- 09 Employer marketing and branding techniques
- 10 Techniques and methods for organizational design (for example outsourcing, shared services, organizational structures [matrix, hierarchy])
- 11 Evaluation of HR information systems (HRIS) and technology (for example, their use for payroll, talent development, and employee data)
- 12 Social media and web applications
- 13 Project management (for example, goals, timetables, deliverables, and procedures)
- 14 Negotiation techniques (including influencing others)
- 15 Interviewing techniques
- 16 Investigation techniques
- 17 Parameters around giving advice to employees
- 18 Supporting ideas and concepts to the appropriate audience (advocacy)
- 19 Compensation and benefits administration (including non-cash rewards, stock programs)
- 20 Termination processes
- 21 Data security and privacy
- 22 Organizational documentation and electronic record retention and storage requirements
- 23 Workplace security (including disaster preparedness, recovery, business continuity)
- 24 Workplace health, wellness and safety practices
- 25 Service standards for HR service delivery

Functional Area 04 | Measurement and Analysis (18%)

Developing and utilizing key HR and business metrics such as those related to individual and organizational performance. Interpreting data to improve employee performance and increase the value of the organization.

Responsibilities:

- 01 Monitor the effectiveness of an employee performance management system
- 02 Establish and analyze HR metrics as they relate to the organization's goals (for example, employment statistics, return on investment [ROI] of HR activities, training evaluation, employee satisfaction surveys, productivity data, organizational analysis)
- 03 Integrate individual and team performance results with organizational measures of success
- 04 Develop and utilize key HR and relevant business metrics to measure achievement of the organization's strategic goals and objectives

Knowledge of:

- 01 Quantitative metrics
- 02 Qualitative measures
- 03 Performance management data interpretation
- 04 Financial metrics (for example, ROI, cost per hire, gross profit, cost-benefit analysis)
- 05 Operational metrics (for example, measures of production, service measures, customer satisfaction)
- 06 HR measures (established measures, benchmarks and scorecards)
- 07 Data appropriate to different audiences (customized reports for appropriate audiences)
- 08 Methods of reporting organizational metrics (for example dashboard indicators)
- 09 Technology available to evaluate and present metrics (for example, Enterprise Resource Planning system [ERP], desktop software, HRIS)
- 10 HR audit and evaluation (for example payroll reconciliation, head count)
- 11 Techniques to assess training program effectiveness (for example: participant surveys, pre- and post-testing)
- 12 Basic research principle

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INDEX

- accidental death and dismemberment72
- achievement awards76
- allocation formula55
- annual cost method80
- auto and property insurance74
- award programs76
- base pay46, 58
- benchmark jobs16
- blue circle rates27
- bonuses47
- bottom-up budgeting85
- broadbanding20
- budgeting32, 85
- carryover provisions75
- cash balance plan69
- cash plans55
- cents per hour28
- cents-per-hour81
- childcare70
- classification method14
- COLA28
- compa-ratio26, 47
- compa-ratio approach to salary increases47
- company-sponsored surveys11
- compensable factors16
- compensation maxim4
- compensation objectives2
- competition35
- consumer price index28
- coordination of benefits81
- cost management86
- cost of living86
- cost of living allowances92
- cost per employee per year80
- cost-of-living adjustment28
- CPI28
- day-care71
- decreasing-rate increase28
- deferred plans55
- defined benefit pension plan69
- defined contribution pension plan69
- determinants of pay7
- differential pay53
- call-back pay53
- geographic differentials53
- hazard pay53
- on-call pay53
- shift pay53
- director pay66
- economic growth35, 36
- employee assistance programs73
- employee benefit programs69, 79
- cost management80
- employee services72
- equity theory41, 44
- exchange rate fluctuations92
- executive bonus64
- executives5
- expatriate allowances91
- expectancy39, 40
- expectancy theory39, 45
- experience30
- factor comparison method20
- financial incentives1
- fine-tuning a compensation59
- fixed-rate-increase28
- flexible scheduling71
- foreign competition36, 46
- gainsharing55, 56, 58
- geographic influences31
- goal setting theory43
- golden parachutes65
- government surveys10
- grading method14
- green circle rates27
- group incentive plans54
- group norms50
- group term life insurance72
- guide chart-profile method22
- Halsey Premium Plan49
- hedonism39
- Herzberg38, 44
- Hierarchy of Needs Theory37
- improshare56, 57
- incentive pay58
- incentives5
- Incentives48
- income replacement71
- individual wage decision8, 30
- inducements1
- industry competition35
- inflation28, 35
- instrumentality40
- insurance70
- auto and property74
- dental care70
- dependent care70
- disability71
- health and accident70
- life72
- long-term disability71
- medical70
- interest rates35
- international competition36
- JND63
- job evaluation13
- job pricing25
- just noticeable difference63

| | | | |
|-----------------------------------|----------------|---------------------------------------|-----------|
| key jobs | 16, 19, 20, 21 | reinforcement theory | 45 |
| legal assistance | 74 | relocation assistance | 74 |
| Life Insurance | 72 | restriction of output | 50 |
| long-term-care insurance | 72 | retirement counseling | 74 |
| LTC | 72 | Rucker Share-of-Production Plan | 57 |
| LTD | 71 | Rucker, Allen | 57 |
| lump-sum merit increases | 46 | salaries | 63 |
| Maslow | 37 | salary | 5 |
| McClelland | 37 | Scanlon plan | 57 |
| McClelland's Learned Needs Theory | 37 | Scanlon Plan | 56 |
| medical insurance | 70 | Scanlon, Joseph | 56 |
| merit increase grids | 86 | self-determination theory | 38 |
| merit pay | 46 | self-directed work teams | 54 |
| Mill, John Stuart | 39 | seniority | 30 |
| motivation theories | 37 | severance pay | 72 |
| motivator-hygiene theory | 38 | sick leave | 71 |
| need hierarchy | 44 | skill-based pay | 51 |
| need theories | 45 | social comparison theory | 41 |
| nonfinancial rewards | 1, 66 | Society for Human Resource Management | 11 |
| overtime | 53 | soldiering | 50 |
| pay for time not worked | 75 | standard hour plan | 48 |
| funeral leave | 76 | step increases | 27, 31 |
| paid holidays | 75 | stock option | 65 |
| paid vacations | 75 | stock ownership plans | 55 |
| personal leave | 75 | strategic alignment | 58 |
| reporting time | 75 | suggestion systems | 76, 77 |
| sabbatical leaves | 76 | top-down budgeting | 86 |
| union activities | 75 | topped out | 27 |
| pay grades | 25 | total reward statement | 82 |
| pay levels | 7 | transfer assistance | 74 |
| pay ranges | 25 | turnover effects | 86 |
| pay secrecy | 5 | union | 7 |
| pay-for-knowledge | 52 | utilization review | 81 |
| pay-for-performance | 30, 46 | valence | 40 |
| pay-secrecy policy | 5 | variable pay | 87 |
| pensions | 69 | Vroom, Victor | 39 |
| percent of payroll | 80 | wage compression | 29 |
| percentage increase | 28, 86 | wage curve | 19 |
| percentage increases | 47 | wage survey | 10 |
| performance | 30 | wage-level decision | 7, 9 |
| perks | 66 | wage-structure decision | 8, 13, 25 |
| perquisites | 66 | wages versus salaries | 4 |
| personal time | 72 | zero-based budgeting | 85 |
| piece-rate incentives | 40, 48, 49, 50 | | |
| differential piece-rate plan | 48 | | |
| straight piecework | 48 | | |
| planned pay-level rise | 86 | | |
| point method | 16 | | |
| potential | 31 | | |
| prepotency | 37 | | |
| privacy | 5 | | |
| productivity | 5, 36, 49 | | |
| ranking method | 14 | | |
| real compensation | 36 | | |
| recognition awards | 76 | | |
| red-circle job rates | 27 | | |