11

Establishing Strategic Pay Plans

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LEARNING OBJECTIVES

1. List the basic factors determining pay rates.
2. Define and give an example of how to conduct a job evaluation.
3. Explain in detail how to establish a market-competitive pay plan.
4. Explain how to price managerial and professional jobs.
5. Explain the difference between competency-based and traditional pay plans.
6. List and explain six important trends in compensation management.

The retail grocery business is highly competitive. Therefore, when Walmart moves into a grocery's area, the knee-jerk reaction is to cut costs, particularly wages and benefits. So as Wegman's Food Markets, Inc., adds more stores and increasingly competes with Walmart, its management needs to decide this: Should we cut pay to better compete based on cost, or pursue a different compensation policy?[1]

WHERE ARE WE NOW . . .

Once you've appraised and coached your employees, they'll expect to be paid. Of course, few firms just pay employees arbitrarily. Each employee's pay should make sense in terms of what other employees earn, and this requires a pay plan. The main purpose of this chapter is to show you how to establish a pay plan. We explain *job evaluation*—techniques for finding the relative worth of a job—and how to conduct online and offline salary surveys. We also explain how to price the jobs in your firm by developing pay grades and an overall pay plan. The next chapter focuses specifically on pay-for-performance and incentive plans.

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1 List the basic factors determining pay rates.

BASIC FACTORS IN DETERMINING PAY RATES

Employee compensation includes all forms of pay going to employees and arising from their employment. It has two main components, **direct financial payments** (wages, salaries, incentives, commissions, and bonuses) and **indirect financial payments** (financial benefits like employer-paid insurance and vacations).

In turn, there are two basic ways to make direct financial payments to employees: based on increments of time or based on performance. Time-based pay is still the foundation of most employers' pay plans. Blue-collar and clerical workers receive hourly or daily wages, for instance. Others, like managers or Web designers, tend to be salaried and paid weekly, monthly, or yearly.

The second direct payment option is to pay for performance. For example, piecework ties compensation to the amount of production (or number of "pieces") the worker turns out. Sales commissions are another performance-based (in this case, sales-based) compensation. Other employers devise pay plans that combine time-based pay plus incentives.

In this chapter, we explain how to formulate plans for paying employees a time-based wage or salary. Subsequent chapters cover performance-based financial incentives and bonuses (Chapter 12) and employee benefits (Chapter 13).

Several factors determine the design of any pay plan: company strategy and policy, equity, legal, and union.

Aligning Total Rewards with Strategy

The compensation plan should first advance the firm's strategic aims—management should produce an *aligned reward strategy.* This means creating a compensation package including wages, incentives, and benefits that produces the employee behaviors the firm needs to support and achieve its competitive strategy.[2] We will see that many employers formulate a total rewards strategy. Total rewards encompass the traditional pay, incentives, and benefits, but also things such as more challenging jobs (job design), career development, and recognition programs.

Based on Chapter 3's strategy → behaviors → HR practices process (Figure 3-7, page 81), Table 11-1 lists illustrative questions to ask.

The accompanying Strategic Context feature illustrates strategic rewards.

THE STRATEGIC CONTEXT

Wegmans Foods

Strategic compensation management means asking, "What must the company do to achieve its strategic aims?"; then asking, "What are the employee behaviors or actions needed to support this strategic effort?"; and then putting in place compensation programs to reinforce those employee behaviors.

Wegmans exemplifies strategic compensation management. It competes in the retail food sector, where profit margins are notoriously thin and where online competitors and brick-and-mortar giants like Walmart excel at driving costs and prices down. The usual reaction, from competitors like Safeway, is to cut employee benefits and costs.[3] Wegmans takes a different approach. It views its workforce as an invaluable and integral part of achieving Wegmans' strategic aims of optimizing service while controlling costs by improving systems and productivity. For example, one dairy department employee designed a new way to organize the cooler, thus improving ordering decisions and inventory control.[4]

Wegmans' compensation policies aim to elicit just this sort of employee dedication. The firm offers above-market pay rates, affordable health insurance, a full range of employee benefits, and Wegmans hasn't laid off employees in 96 years.[5] In sum, Wegmans' pay policies aim to produce exactly the sorts of employee behaviors the company needs to achieve its strategic aims.

TABLE 11-1 Do Our Compensation Policies Support Our Strategic Aims?

- What are our strategic aims?
- What employee behaviors and skills do we need to achieve our strategic aims?
- What compensation policies and practices—salary, incentive plans, and benefits—will help to produce the employee behaviors we need to achieve our strategic aims?

Equity and Its Impact on Pay Rates

In studies at Emory University, researchers investigated how capuchin monkeys reacted to inequitable pay. They trained monkeys to trade pebbles for food. Some monkeys got grapes in return for pebbles; others got cucumber slices. Those receiving the sweeter grapes willingly traded in their pebbles. But if a monkey receiving a cucumber slice saw one of its neighbors get grapes, it slammed down the pebble or refused to eat the cucumber.[6] The moral seems to be that even lower primates are programmed to demand fair treatment when it comes to pay.

EQUITY THEORY OF MOTIVATION Higher up the primate line, *the equity theory of motivation* postulates that people are strongly motivated to maintain a balance between what they perceive as their contributions and their rewards. Equity theory states that if a person perceives an inequity, a tension or drive will develop in the person's mind, and the person will be motivated to reduce or eliminate the tension and perceived inequity. Research tends to support equity theory, particularly as it applies to people who are underpaid.[7] For example, one study found that turnover of retail buyers is significantly lower when the buyers perceive fair treatment in the amount or rewards and in the methods by which employers allocate rewards.[8]

With respect to compensation, managers should address four forms of equity: *external*, *internal*, *individual*, and *procedural*.[9]

- *External equity* refers to how a job's pay rate in one company compares to the job's pay rate in other companies.
- *Internal equity* refers to how fair the job's pay rate is when compared to other jobs within the same company (for instance, is the sales manager's pay fair, when compared to what the production manager is earning?).
- *Individual equity* refers to the fairness of an individual's pay as compared with what his or her coworkers are earning for the same or very similar jobs within the company, based on each individual's performance.
- *Procedural equity* refers to the "perceived fairness of the processes and procedures used to make decisions regarding the allocation of pay."[10]

ADDRESSING EQUITY ISSUES Managers use various means to address such equity issues. For example, they use salary surveys (surveys of what other employers are paying) to monitor and maintain external equity. They use job analysis and comparisons of each job ("job evaluation") to maintain internal equity. They use performance appraisal and incentive pay to maintain individual equity. And they use communications, grievance mechanisms, and employees' participation to help ensure that employees view the pay process as procedurally fair. Some firms administer surveys to monitor employees' pay satisfaction. Questions typically include, "How satisfied are you with your pay?" and "What factors do you believe are used when your pay is determined?"[11]

employee compensation
All forms of pay or rewards going to employees and arising from their employment.

direct financial payments
Pay in the form of wages, salaries, incentives, commissions, and bonuses.

indirect financial payments
Pay in the form of financial benefits such as insurance.

When inequities do arise, conflicts ensue. To head off discussions that might prompt feelings of internal inequity, some firms maintain strict secrecy over pay rates, with mixed results.[12] But for external equity, online pay sites like Salary.com make it easy to see what one could earn elsewhere. Ironically, overpaying people relative to what they think they're worth can backfire too, perhaps "due to feelings of guilt or discomfort."[13]

Legal Considerations in Compensation

Employers do not have free reign in designing pay plans. Various laws specify things like minimum wages, overtime rates, and benefits.[14] Thus, the 1931 **Davis-Bacon Act** lets the secretary of labor set wage rates for laborers and mechanics employed by contractors working for the federal government. The 1936 **Walsh-Healey Public Contract Act** sets basic labor standards for employees working on any government contract that amounts to more than $10,000. It contains minimum wage, maximum hour, and safety and health provisions, and requires time-and-a-half pay for work over 40 hours a week. **Title VII of the 1964 Civil Rights Act** makes it unlawful for employers to discriminate against any individual with respect to hiring, compensation, terms, conditions, or privileges of employment because of race, color, religion, sex, or national origin.[15] We'll look next at other important compensation-related laws.

THE 1938 FAIR LABOR STANDARDS ACT The **Fair Labor Standards Act**, originally passed in 1938 and since amended many times, contains minimum wage, maximum hours, overtime pay, equal pay, record-keeping, and child labor provisions that are familiar to most working people.[16] It covers the majority of U.S. workers—virtually all those engaged in the production and/or sale of goods for interstate and foreign commerce. In addition, agricultural workers and those employed by certain larger retail and service companies are included. State fair labor standards laws cover most employers not covered by the Fair Labor Standards Act (FLSA).[17]

One familiar provision governs *overtime pay*. It says employers must pay overtime at a rate of at least one-and-a-half times normal pay for any hours worked over 40 in a workweek. Thus, if a worker covered by the act works 44 hours in one week, he or she must be paid for 4 of those hours at a rate equal to one-and-a-half times the hourly or weekly base rate the person would have earned for 40 hours. For example, if the person earns $12 an hour (or $480 for a 40-hour week), he or she would be paid at the rate of $18 per hour ($12 times 1.5) for each of the 4 overtime hours worked, or a total of $72 for the extra 4 hours. If the employee instead receives time off for the overtime hours, the employer must also compute the number of hours granted off at the one-and-a-half-times rate. So the person would get 6 hours off for the 4 hours of overtime, in lieu of overtime pay. Employers need to monitor when employees clock in and out, lest they become obligated for unexpected additional demands for overtime pay.[18]

Even giant firms make errors. Walmart agreed to pay up to $640 million to settle 63 wage and hour suits alleging infractions, such as failing to pay overtime and not providing required meal breaks.[19] The Chicago Police Department distributed BlackBerry smartphones to its officers in the field. One police officer subsequently sued, claiming that he wasn't paid overtime for the hours he spent using his smartphone off the clock. Vendors such as Pacific Timesheet (www.pacifictimesheet.com) provide mobile payroll time sheets. Employees who work outside the office can access and fill these in via their iPhones or similar devices. This improves attendance and payroll accuracy, and helps eliminate overpaying overtime.[20]

A great many employers today pay people as "independent contractors" rather than as employees. Strictly speaking, these people are like consultants, not covered by the FLSA. The accompanying Managing the New Workforce feature explains about paying this type of worker.

The FLSA also sets a *minimum wage*, which sets a floor for employees covered by the act (and usually bumps up wages for practically all workers when Congress raises

MANAGING THE NEW WORKFORCE

The Independent Contractor

Whether the person is an employee or an *independent contractor* is a continuing issue for employers.[21] For example, FedEx Ground is battling many lawsuits defending its right to maintain its roughly 15,000 delivery truck owner-operators as independent contractors. In December 2010, a federal district court in Indiana ruled that most of the FedEx ground package drivers were independent contractors, and that although FedEx encouraged the drivers to work fast, that didn't mean it controlled the means by which drivers achieved that result.[22]

For employers, there are advantages to claiming that someone is an independent contractor. For one thing, the FLSA's overtime and most other requirements do not apply. For another, the employer does not have to pay unemployment compensation payroll taxes, Social Security taxes, or city, state, and federal income taxes or compulsory workers' compensation for that worker. The problem is that many so-called independent contractor relationships aren't independent contractor relationships. There is no single rule or test for determining whether an individual is an independent contractor or a bona fide employee. Instead, the courts will look at the total activity or situation. The major consideration is this: The more the employer controls what the worker does and how he or she does it, the more likely it is that the courts will find the worker is actually an employee. Figure 11-1 lists some factors the courts will consider.

the minimum). The minimum wage for the majority of those covered by the act was $7.25 in 2011.[23] Many states have their own minimum wage laws. About 80 localities, including Boston and Chicago, require businesses that have contracts with the city to pay employees wages ranging from $8 to $12 an hour.[24] FLSA *child labor provisions* prohibit employing minors between 16 and 18 years old in hazardous occupations, and carefully restrict employment of those under 16.

EXEMPT/NONEXEMPT Specific categories of employees are *exempt* from the FLSA or certain provisions of the act, and particularly from the act's overtime provisions—they are "exempt employees." A person's exemption depends on his or her responsibilities, duties, and salary. Bona fide executive, administrative (like office managers), and professional employees (like architects) are generally exempt from the minimum wage and overtime requirements of the act.[25] A white-collar worker earning more than $100,000 and performing any one exempt administrative, executive, or professional duty is automatically ineligible for overtime pay. Other employees can generally earn up to $23,660 per year and still automatically get overtime pay (so most employees earning less than $455 per week are nonexempt and earn overtime).[26] Figure 11-2 lists some examples of typically exempt and nonexempt jobs.

If an employee is exempt from the FLSA's minimum wage provisions, then he or she is also exempt from its overtime pay provisions. However, certain employees are *always* exempt from overtime pay provisions. They include, among others, agricultural employees, live-in household employees, taxi drivers, and motion picture theater employees.[27]

Davis-Bacon Act (1931)
A law that sets wage rates for laborers employed by contractors working for the federal government.

Walsh-Healey Public Contract Act (1936)
A law that requires minimum wage and working conditions for employees working on any government contract amounting to more than $10,000.

Title VII of the 1964 Civil Rights Act
This act makes it unlawful for employers to discriminate against any individual with respect to hiring, compensation, terms, conditions, or privileges of employment because of race, color, religion, sex, or national origin.

Fair Labor Standards Act (1938)
This act provides for minimum wages, maximum hours, overtime pay, and child labor protection. The law, amended many times, covers most employees.

FIGURE 11-1 Independent Contractor

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Independent Contractor

Managers are to use the following checklist to classify individuals as independent contractors. If more than three questions are answered "yes," the manager will confer with human resources regarding the classification. (EE = Employees, IC = Independent Contractors)

Factors which show control:

	Yes/EE	No/IC	N/A
1. Worker must comply with instructions.	☐	☐	☐
2. Worker is trained by person hired.	☐	☐	☐
3. Worker's services are integrated in business.	☐	☐	☐
4. Worker must personally render services.	☐	☐	☐
5. Worker cannot hire or fire assistants.	☐	☐	☐
6. Work relationship is continuous or indefinite.	☐	☐	☐
7. Work hours are present.	☐	☐	☐
8. Worker must devote full time to this business.	☐	☐	☐
9. Work is done on the employer's premises.	☐	☐	☐
10. Worker cannot control order or sequence.	☐	☐	☐
11. Worker submits oral or written reports.	☐	☐	☐
12. Worker is paid at specific intervals.	☐	☐	☐
13. Worker's business expenses are reimbursed.	☐	☐	☐
14. Worker is provided with tools or materials.	☐	☐	☐
15. Worker has no significant investment.	☐	☐	☐
16. Worker has no opportunity for profit/loss.	☐	☐	☐
17. Worker is not engaged by many different firms.	☐	☐	☐
18. Worker does not offer services to public.	☐	☐	☐
19. Worker may be discharged by employer.	☐	☐	☐
20. Worker can terminate without liability.	☐	☐	☐

Identifying exemptions is tricky. As noted, some jobs—for example, top managers and lawyers—are clearly exempt, while others—such as office workers earning less than $23,660 per year—are clearly nonexempt. Unfortunately, beyond the obvious categorizations, it's advisable to review the job before classifying it as exempt or nonexempt. Figure 11-3 presents a procedure for making this decision. In all but the clearest situations, carefully review the job description. Make sure, for instance, that the job currently does, in fact, require that the person perform, say, an exempt-type supervisory duty.[28]

FLSA exemption lawsuits are on the rise. For example, sales reps for a drug firm argue in one suit that the FLSA "outside salesperson" exemption doesn't cover them because they market and advise—not sell—drugs to doctors.[29] "Supervisors" are saying they don't really themselves supervise two or more employees.[30] So, again, it's not the title; it is what the employees actually do.[31]

FIGURE 11-2 Some Typical Exempt, Nonexempt Job Titles

Source: Based on www.flsa.com/coverage.html, accessed August 5, 2011.

EXEMPT	NONEXEMPT
Lawyers	Paralegals
Medical doctors	Accounting clerks
Dentists	Bookkeepers
Engineers (with degrees)	Licensed practical nurses
Teachers	Clerical employees
Scientists	Most secretaries (although some, such as the CEO's secretary, might be exempt)
Registered nurses	
General managers	Lab technicians
Pharmacists	
Administrative employees*	

* The administrative exemption is designed for relatively high-level employees whose main job is to "keep the business running." Examples of administrative functions, whose high level employees may typically be exempt, include labor relations and personnel (human resources employees), payroll and finance (including budgeting and benefits management), records maintenance, accounting and tax, marketing and advertising (as differentiated from direct sales), quality control, public relations (including shareholder or investment relations, and government relations), legal and regulatory compliance, and some computer-related jobs (such as network, internet and database administration).

1963 EQUAL PAY ACT The **Equal Pay Act**, an amendment to the Fair Labor Standards Act, states that employees of one sex may not be paid wages at a rate lower than that paid to employees of the opposite sex for doing roughly equivalent work. Specifically, if the work requires equal skills, effort, and responsibility and involves similar working conditions, employees of both sexes must receive equal pay, unless the differences in pay stem from a seniority system, a merit system, the quantity or quality of production, or "any factor other than sex."

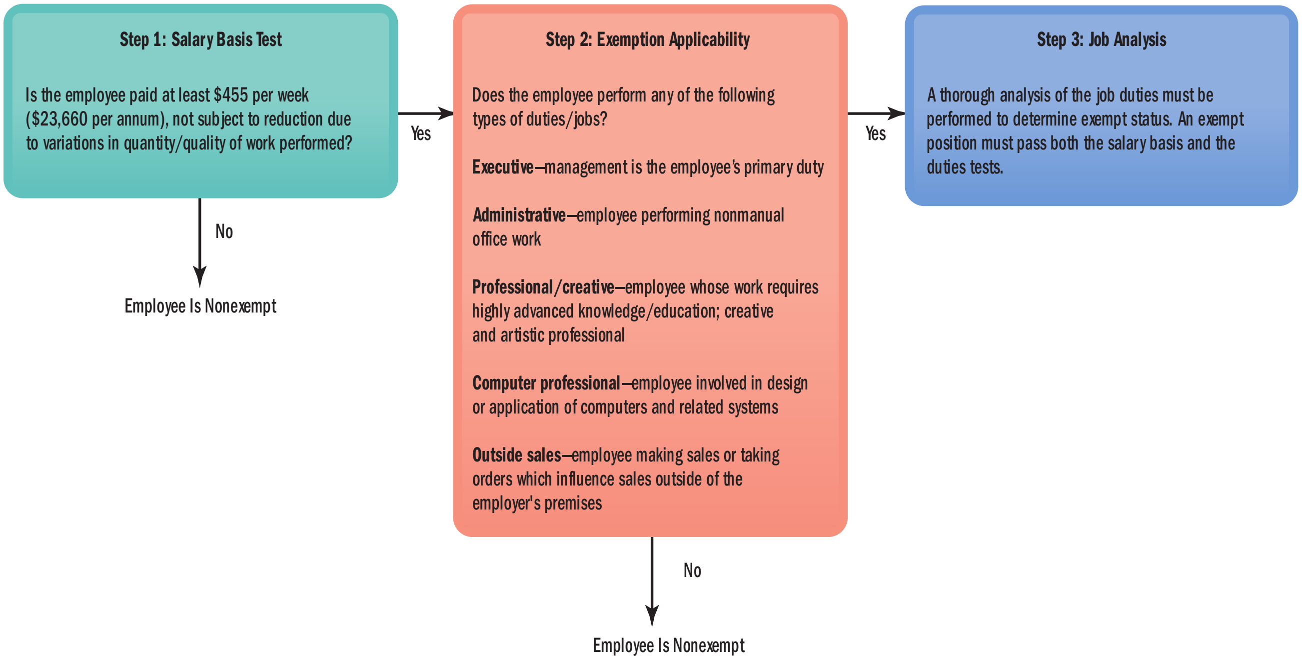


FIGURE 11-3 Who Is Exempt? Who Is Not Exempt?

Equal Pay Act (1963)
An amendment to the Fair Labor Standards Act designed to require equal pay for women doing the same work as men.


Source: Dreamstime LLC.

Two executives discuss a print layout; one happens to be in a wheelchair. Federal law mandates that the wheelchair-bound employee not suffer discrimination in compensation.

1974 EMPLOYEE RETIREMENT INCOME SECURITY ACT The **Employee Retirement Income Security Act (ERISA)** provided for the creation of government-run, employer-financed corporations to protect employees against the failure of their employers' pension plans. In addition, it sets regulations regarding vesting rights (*vesting* refers to the equity or ownership the employees build up in their pension plans should their employment terminate before retirement). ERISA also regulates *portability rights* (the transfer of an employee's vested rights from one organization to another). It also contains fiduciary standards to prevent dishonesty in pension plan funding.

OTHER LEGISLATION AFFECTING COMPENSATION Various other laws influence compensation decisions. For example, the *Age Discrimination in Employment Act* prohibits age discrimination against employees who are 40 years of age and older in all aspects of employment, including compensation.[32] The *Americans with Disabilities Act* prohibits discrimination against qualified persons with disabilities in all aspects of employment, including compensation. The *Family and Medical Leave Act* aims to entitle eligible employees, both men and women, to take up to 12 weeks of unpaid, job-protected leave for the birth of a child or for the care of a child, spouse, or parent. And various executive orders require employers that are federal government contractors or subcontractors to not discriminate, and to take affirmative action in certain employment areas, including compensation.

Each state has its own *workers' compensation laws.* Among other things, these aim to provide prompt, sure, and reasonable income to victims of work-related accidents. The *Social Security Act of 1935* (as amended) provides for unemployment compensation for workers unemployed through no fault of their own for up to 26 weeks (and recently extended), and for retirement benefits. (We'll discuss Social Security benefits in Chapter 13.) The federal wage garnishment law limits the amount of an employee's earnings that employers can withhold (garnish) per week, and protects the worker from discharge due to garnishment.

Union Influences on Compensation Decisions

Unions and labor relations laws also influence pay plan design. The National Labor Relations Act of 1935 (Wagner Act) granted employees the right to unionize, and to bargain collectively. Historically, the wage rate has been the main issue in collective bargaining. However, unions also negotiate other pay-related issues, including time off with pay, income security (for those in industries with periodic layoffs), cost-of-living adjustments, and health care benefits.

The Wagner Act created the National Labor Relations Board (NLRB) to oversee employer practices and ensure that employees receive their rights. For example, the NLRB says that employers must give the union a written explanation of the employer's "wage curves"—the graph that relates job to pay rate. The union is also entitled to know its members' salaries.[33]

Pay Policies

The employer's compensation strategy will manifest itself in *pay policies.* For example, a top hospital like Johns Hopkins might have a policy of paying nurses 20% above the prevailing market wage. Pay policies can influence the employer's performance and profitability, as the accompanying HR as a Profit Center illustrates.

Managers need to formulate pay policies covering a range of issues. One is whether to emphasize *seniority* or *performance.* For example, it takes 18 years for a U.S. federal employee to progress from step 1 to step 9 of the government's pay scale. Seniority-based pay may be advantageous to the extent that seniority is an objective standard. One disadvantage is that top performers may get the same raises as poor ones. Seniority-based pay might seem to be a relic reserved for some government agencies and unionized firms. However, one recent survey found that 60% of employees responding thought high-seniority employees got the most pay. Only about 35% said their companies paid high performers more.[34]

How to distinguish between *high and low performers* is a related policy issue. For example, for many years Payless ShoeSource was paternal in how it distributed raises—it paid everyone about the same. However, after seeing its market share drop over several years, management decided on a turnaround strategy. It necessitated revising the firm's compensation policies to differentiate more aggressively between top performers and others.[35] Other pay policies usually cover how to award salary increases and promotions, overtime pay, probationary pay, leaves for military service, jury duty, and holidays.

GEOGRAPHY How to account for geographic differences in cost of living is another big pay policy issue. For example, the average base pay for an office supervisor ranges from $47,210 in Florida to $51,120 in Texas to $57,970 in New York.[36]

Employers handle cost-of-living differentials for transferees in several ways. One is to pay a differential for ongoing costs in addition to a one-time allocation. For example, one employer pays a differential of $6,000 per year to people earning $35,000 to $45,000 whom it transfers from Atlanta to Minneapolis. Others simply raise the employee's base salary. The problem is more complicated when you're sending employees overseas. Here, for instance, the person typically gets allowances including cost-of-living, relocation, housing, education, and hardship allowances (the latter for countries with a relatively hard quality of life, such as Zambia).[37]

HR AS A PROFIT CENTER

Wegmans Foods

As we saw, Wegmans' strategic pay policies aim to produce the employee behaviors the company needs to achieve its strategic aims. It is likely that those pay policies are one reason for the firm's exceptional profitability. For example, Wegmans employee turnover (from 38% for part-timers to 6%–7% for full timers) is well below the industry's average total of about 47%.[38] Its stores (which at about 120,000 square feet are much larger than competitors') average about $950,000 a week in sales (compared to a national average of $361,564), or about $46 million in sales annually, compared with a typical Walmart store's grocery sales of $23.5 million in sales.[39] Wegmans' human resource head was quoted as saying, "Our pay and benefits are at or above our competition's . . . It helps us attract a higher caliber of employee." As she also said, good employees assure higher productivity, and that translates into better bottom-line results.[40]

JOB EVALUATION METHODS

2 Define and give an example of how to conduct a job evaluation.

Employers use two basic approaches to setting pay rates: *market-based approaches* and *job evaluation methods*. Many firms, particularly smaller ones, simply use a *market-based* approach. Doing so involves conducting formal or informal salary surveys to determine what others in the relevant labor markets are paying for particular jobs. They then use these figures to price their own jobs. *Job evaluation methods* involve assigning values to each of the company's jobs. This helps to produce a pay plan in which each job's pay

Employee Retirement Income Security Act (ERISA)
The law that provides government protection of pensions for all employees with company pension plans. It also regulates vesting rights (employees who leave before retirement may claim compensation from the pension plan).

is equitable based on its value to the employer. However, we'll see that even with the job evaluation approach, managers must adjust pay rates to fit the market.[41]

Job evaluation is a formal and systematic comparison of jobs to determine the worth of one job relative to another. Job evaluation aims to determine a job's relative worth. Job evaluation eventually results in a *wage* or *salary structure* or hierarchy (this shows the pay rate for various jobs or groups of jobs). The basic principle of job evaluation is this: Jobs that require greater qualifications, more responsibilities, and more complex job duties should receive more pay than jobs with lesser requirements.[42] The basic job evaluation procedure is to compare jobs in relation to one another—for example, in terms of required effort, job complexity, and skills. Suppose you know (based on your job evaluation) the relative worth of the key jobs in your firm. You then conduct a salary survey to see what others are paying for similar jobs. You are then well on your way to being able to price all the jobs in your organization equitably.

Compensable Factors

You can use two basic approaches to compare the worth of several jobs. First, you can take an intuitive approach. You might decide that one job is more important than another is, and not dig any deeper. As an alternative, you could compare the jobs by focusing on certain basic factors the jobs have in common. Compensation management specialists call these **compensable factors**. They are the factors that establish how the jobs compare to one another, and that determine the pay for each job.

Some employers develop their own compensable factors. However, most use factors popularized by packaged job evaluation systems or by federal legislation. For example, the Equal Pay Act uses four compensable factors—skills, effort, responsibility, and working conditions. The method popularized by the Hay consulting firm emphasizes three factors: know-how, problem solving, and accountability. Walmart uses knowledge, problem-solving skills, and accountability requirements.

Identifying compensable factors plays a central role in job evaluation. You usually compare each job with all comparable jobs using the same compensable factors. However, the compensable factors you use depend on the job and the job evaluation method. For example, "decision making" might make sense for a manager's job, but not for a cleaner's job.[43]

Preparing for the Job Evaluation

Job evaluation is a judgmental process and demands close cooperation among supervisors, HR specialists, and employees and union representatives. The main steps include identifying the need for the program, getting cooperation, and then choosing an evaluation committee. The committee then performs the actual evaluation.

Identifying the need for job evaluation should not be difficult. For example, dissatisfaction reflected in high turnover, work stoppages, or arguments may result from paying employees different rates for similar jobs. Managers may express uneasiness with an informal way of assigning pay rates.

Employees may fear that a systematic evaluation of their jobs may reduce their pay rates, so *getting employees to cooperate* in the evaluation is important. For example, you can tell employees that because of the impending job evaluation program, pay rate decisions will no longer be made just by management whim, and that no current employee's rate will be adversely affected because of the job evaluation.

Third, *choose a job evaluation committee.* The committee usually consists of about five members, most of whom are employees. Management has the right to serve on such committees, but employees may view this with suspicion. However, a human resource specialist can usually be justified to provide expert assistance. Union representation is possible. In most cases, though, the union's position is that it is accepting the results of the job evaluation only as an initial decision and is reserving the right to appeal actual job pricing decisions through grievance or bargaining channels.[44] Once appointed, each committee member should receive a manual explaining the job evaluation process, and how to conduct the job evaluation.


Source: Shutterstock.

The job evaluation committee typically includes at least several employees, and has the important task of evaluating the worth of each job using compensable factors.

The evaluation committee performs three main functions. First, it usually identifies 10 or 15 key **benchmark jobs**. These will be the first jobs they'll evaluate and will serve as the anchors or benchmarks against which the relative importance or value of all other jobs is compared. Next, the committee may select *compensable factors* (although the human resources department will usually choose these). Finally, the committee performs its most important function—actually *evaluating the worth of each job*. For this, the committee will probably use one of the following methods: ranking, job classification, or point method.

Job Evaluation Methods: Ranking

The simplest job evaluation method ranks each job relative to all other jobs, usually based on some overall factor like "job difficulty." There are several steps in the job **ranking method**.

1. **Obtain job information.** Job analysis is the first step. Here job descriptions for each job are prepared, and the information they contain about the job's duties is usually the basis for ranking jobs. (Sometimes job specifications are also prepared. However, the ranking method usually ranks jobs based on the whole job, rather than on several compensable factors. Therefore, job specifications, which tend to list job demands in terms of compensable factors such as problem solving, decision making, and skills, are not as important with this method as they are for other job evaluation methods.)
2. **Select and group jobs.** It is usually not practical to make a single ranking for all jobs in an organization. The usual procedure is to rank jobs by department or in clusters (such as factory workers or clerical workers). This eliminates the need for direct comparison of, say, factory jobs and clerical jobs.
3. **Select compensable factors.** In the ranking method, it is common to use just one factor (such as job difficulty) and to rank jobs based on the whole job. Regardless of the number of factors you choose, it's advisable to explain the definition of the factor(s) to the evaluators carefully so that they all evaluate the jobs consistently.
4. **Rank jobs.** For example, give each rater a set of index cards, each of which contains a brief description of a job. Then they rank these cards from lowest to highest. Some managers use an "alternation ranking method" for making the procedure more accurate. Here you take the cards, first choosing the highest and the lowest, then the next highest and next lowest, and so forth, until you've ranked all the cards. Table 11-2 illustrates a job ranking. Jobs in this small health facility rank from orderly up to office manager. The corresponding pay scales are on the right. After ranking, it is possible to slot additional jobs between those already ranked and to assign an appropriate wage rate. Online programs, as at www.hr-guide.com/data/G909.htm, can help you rank (and check the rankings of) your positions.
5. **Combine ratings.** Usually, several raters rank the jobs independently. Then the rating committee (or the employer) can simply average the raters' rankings.

This is the simplest job evaluation method, as well as the easiest to explain. And it usually takes less time than other methods.

job evaluation
A systematic comparison done in order to determine the worth of one job relative to another.

compensable factor
A fundamental, compensable element of a job, such as skills, effort, responsibility, and working conditions.

benchmark job
A job that is used to anchor the employer's pay scale and around which other jobs are arranged in order of relative worth.

ranking method
The simplest method of job evaluation that involves ranking each job relative to all other jobs, usually based on overall difficulty.

TABLE 11-2 Job Ranking at Jackson Hospital

Ranking Order	Annual Pay Scale
1. Office manager	$43,000
2. Chief nurse	42,500
3. Bookkeeper	34,000
4. Nurse	32,500
5. Cook	31,000
6. Nurse's aide	28,500
7. Orderly	25,500

Note: After ranking, it becomes possible to slot additional jobs (based on overall job difficulty, for instance) between those already ranked and to assign each an appropriate wage rate.

Some of its drawbacks derive more from how it's used than from the method itself. For example, there's a tendency to rely too heavily on "guesstimates" (of things like overall difficulty), since ranking usually does not use compensable factors. Similarly, ranking provides no yardstick for quantifying the value of one job relative to another. For example, job number 4 may in fact be five times "more valuable" than job number 5, but with the ranking method all you know is that one job ranks higher than the other. Ranking is usually more appropriate for small employers that can't afford the time or expense of developing a more elaborate system.

The *factor comparison method*—a considerably more complicated method of ranking jobs according to various skill and difficulty factors, then adding up these rankings to arrive at an overall numerical rating for each job—is seldom used today.

Job Evaluation Methods: Job Classification

Job classification (or **job grading**) is a simple, widely used job evaluation method in which raters categorize jobs into groups; all the jobs in each group are of roughly the same value for pay purposes. We call the groups **classes** if they contain similar jobs or **grades** if they contain jobs that are similar in difficulty but otherwise different. Thus, in the federal government's pay grade system, a "press secretary" and a "fire chief" might both be graded "GS-10" (GS stands for "General Schedule"). On the other hand, in its job class system, the state of Florida might classify all "secretary IIs" in one class, all "maintenance engineers" in another, and so forth.

In practice, there are several ways to categorize jobs. One is to write class or grade descriptions (similar to job descriptions) and place jobs into classes or grades based on how well they fit these descriptions. A second is to write a set of compensable factor-based rules for each class (for instance, how much independent judgment, skill, and physical effort does the class of jobs require?). Then categorize the jobs according to these rules.

The latter is the most popular procedure—choose compensable factors, and then develop class or grade descriptions for each class or grade based on the amount or level of the compensable factor(s) in those jobs. For example, the U.S. government's classification system uses the following compensable factors: (1) difficulty and variety of work, (2) supervision received and exercised, (3) judgment exercised, (4) originality required, (5) nature and purpose of interpersonal work relationships, (6) responsibility, (7) experience, and (8) knowledge required. Based on these compensable factors, raters write a **grade definition** like that in Figure 11-4. This one shows one grade description (GS-7) for the federal government's pay grade system. Then the evaluation committee reviews all job descriptions and slots each job into its appropriate grade, by comparing each job description to the rules in each grade description. For instance, the federal government system classifies the positions automotive mechanic, welder, electrician, and machinist in grade GS-10.

FIGURE 11-4 Example of a Grade Level Definition

Source: www.opm.gov/fedclass/gscler.pdf, accessed May 18, 2007.

Grade	Nature of Assignment	Level of Responsibility
GS-7	Performs specialized duties in a defined functional or program area involving a wide variety of problems or situations; develops information, identifies interrelationships, and takes actions consistent with objectives of the function or program served.	Work is assigned in terms of objectives, priorities, and deadlines; the employee works independently in resolving most conflicts; completed work is evaluated for conformance to policy; guidelines, such as regulations, precedent cases, and policy statements require considerable interpretation and adaptation.

The classification method has several advantages. The main one is that most employers usually end up grouping jobs into classes or grades anyway, regardless of the evaluation method they use. They do this to avoid having to price separately dozens or hundreds of jobs. Of course, the job classification automatically groups the employer's jobs into classes. The disadvantages are that it is difficult to write the class or grade descriptions, and considerable judgment is required to apply them. Yet many employers use this method with success.

Job Evaluation Methods: Point Method

The **point method**'s overall aim is to determine the degree to which the jobs you're evaluating contain selected compensable factors. It involves identifying several compensable factors for the jobs, as well as the degree to which each factor is present in each job. Assume there are five degrees of the compensable factor "responsibility" a job could contain. Further, assume you assign a different number of points to each degree of each compensable factor. Once the evaluation committee determines the degree to which each compensable factor (like "responsibility" and "effort") is present in a job, it can calculate a total point value for the job by adding up the corresponding degree points for each factor. The result is a quantitative point rating for each job. The point method of job evaluation is the most popular job evaluation method today.[45]

"PACKAGED" POINT PLANS A number of groups (such as the Hay Group, the National Electrical Manufacturer's Association, and the National Trade Association) have developed standardized point plans. Many thousands of employers use these systems. They contain ready-made factor and degree definitions and point assessments for a wide range of jobs. Employers can often use them with little or no modification.

Computerized Job Evaluations

Using quantitative job evaluation methods such as the point method can be time-consuming. Accumulating the information about "how much" of each compensable factor the job contains is a tedious process. The evaluation committees must debate the level of each compensable factor in each job. They then write down their consensus judgments and compute each job's point values or rankings.

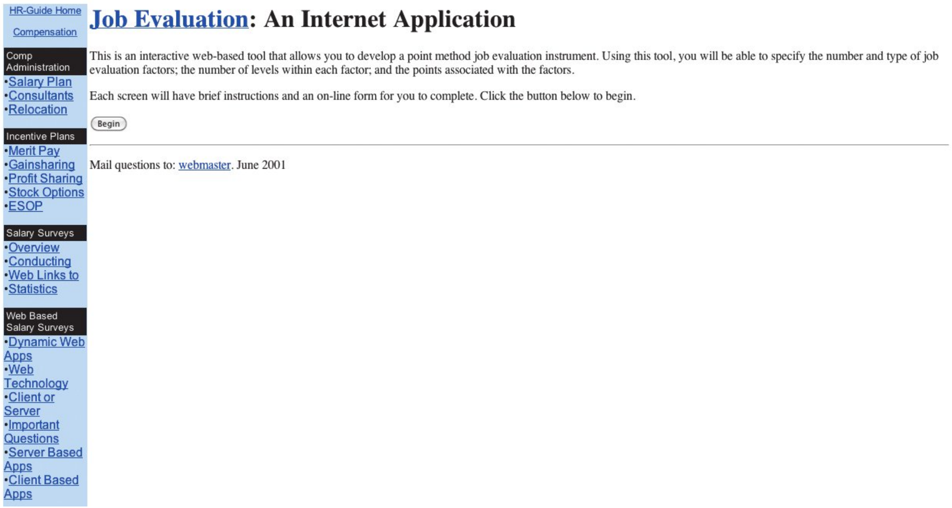
job classification (or grading) method
A method for categorizing jobs into groups.

classes
Grouping jobs based on a set of rules for each group or class, such as amount of independent judgment, skill, physical effort, and so forth, required. Classes usually contain similar jobs.

grades
A job classification system like the class system, although grades often contain dissimilar jobs, such as secretaries, mechanics, and firefighters. Grade descriptions are written based on compensable factors listed in classification systems.

grade definition
Written descriptions of the level of, say, responsibility and knowledge required by jobs in each grade. Similar jobs can then be combined into grades or classes.

point method
The job evaluation method in which a number of compensable factors are identified and then the degree to which each of these factors is present on the job is determined.



Source: www.hr-software.net/cgi/JobEvaluation.cgi.

Computer-aided job evaluation streamlines this process. The accompanying screen grab illustrates one. Most of these computerized systems have two main components. There is, first, a structured questionnaire. This contains items such as "enter total number of employees who report to this position." Second, all such systems use statistical models. These allow the computer program to price jobs more or less automatically, by assigning points.

3 Explain in detail how to establish a market-competitive pay plan.

HOW TO CREATE A MARKET-COMPETITIVE PAY PLAN

As we said, many firms simply price their jobs based on what other employers are paying—they use a market-based approach. However, most employers also base their pay plans on job evaluations. These evaluations assign values (such as point values) to each job. This helps to produce a pay plan in which each job's pay is internally equitable, based, as it is, on the job's value to the employer (as measured, for instance, by how many points it warrants). However, even with the job evaluation approach, managers must adjust pay rates to fit the market.[46] After all, you want employees' pay to be equitable internally—relative to what their colleagues in the firm earning—but also competitive to what other employers are paying. In a *market-competitive pay plan* a job's compensation reflects both the job's value in the company, as well as what other employers are paying for similar jobs in the marketplace. Because the point method (or "point-factor method") is so popular, we'll use it as the centerpiece of our step-by-step example for creating a market-competitive pay plan.[47] The 16 steps in creating a market-competitive pay plan begin with choosing benchmark jobs.

1. Choose Benchmark Jobs

Particularly when an employer has dozens or hundreds of different jobs, it's impractical and unnecessary to evaluate each of them separately. Therefore, the first step in the point method is to select benchmark jobs. Benchmark jobs are representative of the entire range of jobs the employer needs to evaluate. Like "accounting clerk" they should be common among employers (thus making it easier to survey what competitors are paying for similar jobs).[48]

2. Select Compensable Factors

The choice of compensable factors depends on tradition (as noted, the Equal Pay Act of 1963 uses four compensable factors: skill, effort, responsibility, and working conditions), and on strategic and practical considerations. For example, if your firm's competitive advantage is quality, you might substitute "responsibility for quality" for working conditions, or simply add it as a fifth factor.[49] Similarly, using "working conditions" makes little practical sense for evaluating executive jobs.

FIGURE 11-5 Illustrative Point Values and Degree Definitions for the Factor Job Complexity

Factor Definition: What Is Job Complexity? Job complexity generally refers to an amount of judgment, initiative, ingenuity, and complex data analysis that doing the job requires. To what extent does the person doing this job confront unfamiliar problems, deal with complex decisions, and have to exercise discretion?

Degree	Points	Job Complexity Degree Definitions: What to Look for in the Job
First	120	Here the job is routine and consists of repetitive operations requiring little or no choice of action and the automatic application of easily understood rules and procedures. For example, a filing clerk.
Second	240	Here the employee follows detailed instructions but may have to make limited decisions based on previously prescribed instructions which lay our prescribed alternatives. For example, a billing clerk or a receptionist.
Third	360	Here the employee again follows detailed instructions but because the number of matters to consider is more varied the employee needs to exhibit initiative and independent judgment, under direct supervision. For example, a nurse's aide.
Fourth	480	Here the employee can generally follow standard practices but the presence of nonroutine problems requires that the employee be able to use initiative and judgment to analyze and evaluate situations, possibly modifying the standard procedures to adjust to the new situations. For example, a nurse.
Fifth	600	On this job, the employee needs to use independent judgment and plan and perform complex work under only general supervision, often working independently toward achieving overall results. For example, medical intern.

The employer should carefully define each factor. This is to ensure that the evaluation committee members will each apply the factors with consistency. Figure 11-5 shows (on top) one such definition, in this case for the factor job complexity. The human resource specialist often draws up the definitions.

3. Assign Weights to Compensable Factors

Having selected compensable factors, the next step is to determine the relative importance (or weighting) of each factor (for instance, how much more important is "skill" then "effort"?). This is important because for each cluster of jobs some factors are bound to be more important than others are. Thus, for executive jobs the "mental requirements" factor would carry far more weight than would "physical requirements." To assign weights, we assume we have a total 100 percentage points to allocate for each job. Then (as an illustration), assign percentage weights of 60% for the factor job complexity, 30% for effort, and 10% for working conditions.[50]

4. Convert Percentages to Points for Each Factor

Next, we want to convert the percentage weights assigned to each compensable factor into point values for each factor (this is, after all, the point method). It is traditional to assume we are working with a total number of l,000 points (although one could use some other figure). To convert percentages to points for each compensable factor, *multiply the percentage weight for each compensable factor (from the previous step) by 1,000.*[51] This will tell you the *maximum number of points* for each compensable factor. The example above would translate into 1,000 × 0.60 = 600 possible points for job complexity, 1,000 × 0.30 = 300 points for effort, and 1,000 × 0.10 = 100 points for working conditions.

5. Define Each Factor's Degrees

Next, split each factor into degrees, and define each degree so that raters may judge the amount or degree of a factor existing in a job. Thus, for a factor such as "job complexity" you might choose to have five degrees, ranging from "here the job is routine" to "uses independent judgment." (Definitions for each degree are shown in Figure 11-5 under "Degree definitions: What to look for in each job"). The number of degrees usually does not exceed five or six, and the actual number depends mostly on judgment. Thus, if all employees work either in a quiet, air-conditioned office or in a noisy, hot factory, then two degrees would probably suffice for the factor "working conditions." You need not have the same number of degrees for each factor, and you should limit degrees to the number necessary to distinguish among jobs.

6. Determine for Each Factor Its Factor Degrees' Points

The evaluation committee must be able to determine the number of points each job is worth. To do this, the committee must be able to examine each job and (from each factor's degree definitions) determine what degree of each compensable factor that job has. For them to do this, we must first assign points to *each degree of each compensable factor*. For example, in our illustration, we have five possible degrees of job complexity, and the job complexity compensable factor is worth up to 600 points total. In our case, we decide that the first degree level of job complexity is worth 120 (or one-fifth of 600) points, the second degree level is worth 240 points, the third degree level is worth 360 points, the fourth degree level is worth 480 points, and the fifth degree is worth the full 600 points.[52] Do this for each factor (as in Table 11-3).

7. Review Job Descriptions and Job Specifications

The heart of job *evaluation* involves determining the amount or degree to which the job contains the selected compensable factors such as effort, job complexity, and working conditions. The team conducting the job evaluation will frequently do so by reviewing each job's job description and job specification. As we explained in Chapter 4 (Job Analysis), it is through the job analysis that the manager identifies the job's duties and responsibilities and writes the job description and job specification. Ideally, the job analysis should therefore include an explicit attempt to gather information about the compensable factors (such as job complexity) around which the employer plans to build its compensation plan.[53]

TABLE 11-3 Points Assigned to Factors and to Their Degrees (revised)

Factors	First-Degree Points	Second-Degree Points	Third-Degree Points	Fourth-Degree Points	Fifth-Degree Points
Job complexity (Total maximum points equal 600)	120	240	360	480	600
Effort (Total maximum points equal 300)	60	120	180	240	300
Working conditions (Total maximum points equal 100 points)	20	40	60	80	100

8. Evaluate the Jobs

The preceding steps provide us with the information on points and degrees we need to evaluate the jobs. Therefore, the committee now gathers job descriptions and job specifications for the benchmark jobs they want to focus on. Then for each of these jobs, the committee reviews the job description and job specification.

From this, the committee *determines the degree to which each compensable factor is present in each job*. Thus for, say, a job of master mechanic, the team might conclude (after studying the job description and job specification) that the master mechanic's job deserves the third degree level of job complexity points, the first degree level of effort, and the first-degree level of *working conditions*.

Knowing the job complexity, effort, and working conditions degrees for each job, *and knowing the number of points we previously assigned to each degree* of each compensable factor, we can now determine how many job complexity, effort, and working conditions points each benchmark job should contain. (We know the degree level for each factor for each job, so we merely check the corresponding points (see Table 11-3) that we previously assigned to each of these degrees.)

Finally, we add up these degree points for each job to determine each job's total number of points.[54] We thereby get a total point value for each benchmark job. This in turn enables us to list a hierarchy of jobs, based upon each job's points. We can then turn to assigning wage rates to each job (step nine). But first, we should define market-competitive pay plan, and **wage curve**.

WHAT IS A MARKET-COMPETITIVE PAY PLAN? What should the pay rate be for each job? Of course, jobs with more points should command higher pay. The question is what pay rate to use. Our company's current, "internal" pay rates? Or pay rates based on what the "external" market is paying?[55]

With a **market-competitive pay system**, the employer's actual pay rates are competitive with those in the relevant labor, as well as equitable internally.[56] Put simply, the basic approach is to compare what the employer is *currently* paying for each job ("internal pay") with what the market is paying for the same or similar job ("external pay"), and then to combine this information to produce a market-competitive pay system.

WHAT ARE WAGE CURVES? Wage curves play a central role in assigning wage rates to jobs. The wage curve typically shows the pay rates paid for jobs, relative to the points or rankings assigned to each job by the job evaluation. Figure 11-6 presents an example. Note that it shows pay rates for jobs on the vertical axis, and point values for these jobs along the horizontal axis. The purpose of the wage curve is to show the relationships between (1) the value of the job (expressed in points) as determined by one of the job evaluation methods and (2) the pay rates for the job. (We'll see that many employers may combine jobs into classes or grades. Here the wage curve shows the relationship between average pay rates for each grade, and each grade's average point value.) The pay rates on the wage curve are traditionally those now paid by the employer. However, if there is reason to believe the current pay rates are out of step with the market rates for these jobs, the employer will have to adjust them. One way to do this is to compare a wage curve that shows the jobs' *current* wage rates relative to the jobs' points, with a second curve that shows *market* wage rates relative to points. We do this as follows.

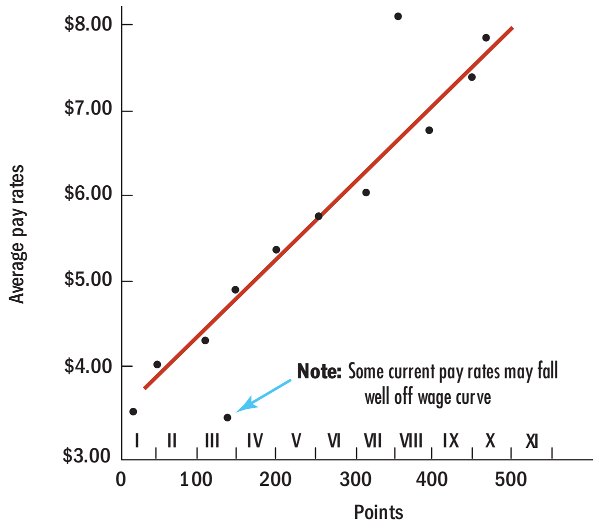
9. Draw the Current (Internal) Wage Curve

First, to study how each job's points relates to its current pay rate, we start by drawing an *internal wage curve.* Plotting each job's points and the wage rate the

wage curve
Shows the relationship between the value of the job and the average wage paid for this job.

market-competitive pay system
A pay system in which the employer's actual pay rates are competitive with those in the relevant labor market.

FIGURE 11-6 Plotting a Wage Curve



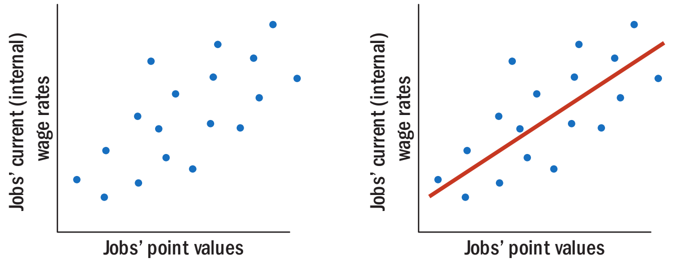
employer is now paying for each job (or wage rates, if there are several for each job) produces a scatter plot as in Figure 11-7 (left). We now draw a wage curve (on the right) through these plots that shows how point values relate to current wage rates. We can draw this wage line by just estimating a line that best fits the plotted points (by minimizing the distances between the plots and the curve). Or we can use regression, a statistical technique. Using the latter will produce a current/internal wage curve that best fits the plotted points. In any case, we show the results in Figure 11-7 (right).[57]

10. Conduct a Market Analysis: Salary Surveys

Next, we must compile the information needed to draw an *external wage curve* for our jobs, based on what other employers are paying for similar jobs. **Salary surveys**—surveys of what others are paying—play a big role in pricing jobs.[58] Employers use salary surveys in three ways. First, they use survey data to price benchmark jobs. Benchmark jobs are the anchor jobs around which they slot their other jobs, based on each job's relative worth to the firm. Second, employers typically price 20% or more of their positions directly in the marketplace (rather than relative to the firm's benchmark jobs), based on a survey of what comparable firms are paying for comparable jobs. (Google might do this for jobs like systems engineer, whose salaries fluctuate widely and often.) Third, surveys also collect data on benefits like insurance, sick leave, and vacations for decisions regarding employee benefits.

Salary surveys can be formal or informal. *Informal* phone or Internet surveys are good for checking specific issues, such as when a bank wants to confirm the salary at which to advertise a newly open teller's job, or whether some banks are really paying tellers an incentive. Some large employers can afford to send out their own *formal* surveys to collect compensation information from other employers. These ask about things like number of employees, overtime policies, starting salaries, and paid vacations.

FIGURE 11-7 The Current/Internal Wage Curve



COMMERCIAL, PROFESSIONAL, AND GOVERNMENT SALARY SURVEYS

Many employers use surveys published by consulting firms, professional associations, or government agencies. For example, the U.S. Department of Labor's Bureau of Labor Statistics' (BLS) *National Compensation Survey (NCS)* provides comprehensive reports of occupational earnings, compensation cost trends, and benefits (www.bls.gov/bls/wages.htm).

Detailed occupational earnings are available from the national compensation survey for over 800 occupations in the United States, regions, states, and many metropolitan areas (http://stats.bls.gov/oes/current/oes_nat.htm). The Current Employment Statistics survey is a monthly survey of the payroll records of business establishments that provides data on earnings of production and nonsupervisory workers at the national level. This provides information about earnings as well as production bonuses, commissions, and cost-of-living increases. The National Compensation Survey—Benefits provides information on the share of workers who participate in specified benefits, such as health care, retirement plans, and paid vacations. These data also show the details of those benefits, such as amounts of paid leave. Internationally, the BLS reports comparative hourly compensation costs in local currencies and U.S. dollars for production workers and all employees in manufacturing in its international labor comparisons tables.

Private consulting and/or executive recruiting companies like Hay Associates, Heidrick and Struggles, Watson Wyatt Data Services, and Hewitt Associates publish data covering compensation for top and middle management and members of boards of directors. Professional organizations like the Society for Human Resource Management and the Financial Executives Institute publish surveys of compensation practices among members of their associations.[59]

USING THE INTERNET TO DO COMPENSATION SURVEYS A rapidly expanding array of Internet-based options makes it easy for anyone to access published compensation survey information. Table 11-4 shows some popular salary survey Web sites.

TABLE 11-4 Some Pay Data Web Sites

Sponsor	Internet Address	What It Provides	Downside
Salary.com	Salary.com	Salary by job and zip code, plus job and description, for hundreds of jobs	Adapts national averages by applying local cost-of-living differences
U.S. Office of Personnel Management	www.opm.gov/oca/09Tables/index.asp	Salaries and wages for U.S. government jobs, by location	Limited to U.S. government jobs
Job Star	http://jobstar.org/tools/salary/sal-prof.php	Profession-specific salary surveys	Necessary to review numerous salary surveys for each profession
cnnmoney.com	cnnmoney.com	Input your current salary and city, and this gives you comparable salary in destination city	Based on national averages adapted to cost-of-living differences

salary survey
A survey aimed at determining prevailing wage rates. A good salary survey provides specific wage rates for specific jobs. Formal written questionnaire surveys are the most comprehensive, but telephone surveys and newspaper ads are also sources of information.

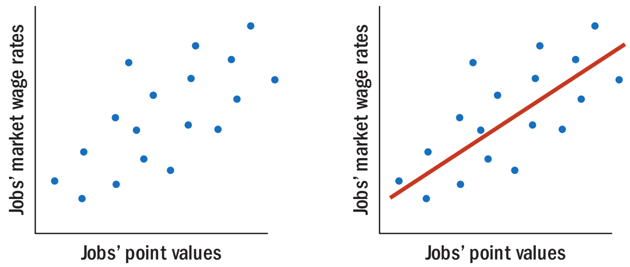


FIGURE 11-8 The Market/External Wage Curve

Many of these sites, such as Salary.com, provide national salary levels for jobs that the site then arithmetically adjusts to each locale based on cost-of-living formulas. To get a real-time picture of what employers in your area are actually paying for, say, accounting clerks, it's useful to access the online Internet sites of one or two of your local newspapers. For example, the *South Florida Sun-Sentinel* (and many papers) uses a site called careerbuilder.com. It lists career opportunities—in other words, just about all the jobs listed in the newspaper by category and, in many instances, their wage rates (www.sun-sentinel.com/classified/jobs).

11. Draw the Market (External) Wage Curve

The current/internal wage curve from step 9 is helpful. For example, showing, as it does, how a job's current pay rate compares with its points helps the employer identify jobs for which pay rates are currently too high or too low, relative to others in the company. (For example, if a job's current wage rate is well above the internal wage curve, it suggests that the present wage rate for that job is inequitably high, given the number of points we've assigned to that job.)

What the current (internal) wage curve does *not* reveal is whether our pay rates are too high, too low, or just right relative to what other firms are paying. For this, we need to draw a *market* or *external wage* curve.

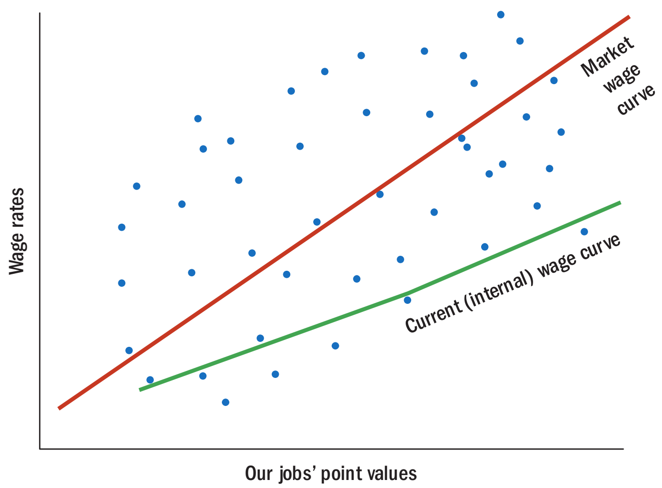
To draw the market/external wage curve, we produce a scatter plot and wage curve as in Figure 11-8 (left and right). However, instead of using our firm's current wage rates, we use market wage rates (obtained from salary surveys). The market/external wage curve compares our jobs' points with market pay rates for our jobs.

12. Compare and Adjust Current and Market Wage Rates for Jobs

How different are the market rates others are paying for our jobs and the current rates we are now paying for our jobs? To determine this, we can draw both the current/internal and market/external wage curves on one graph, as in Figure 11-9. The market wage curve might be higher than our current wage curve (suggesting that our current pay rates may be too low), or below our current wage curve (suggesting that our current wage rates might be too high). Or perhaps market wage rates are higher for some of our jobs, and lower for others.[60]

Based on comparing the current/internal wage curve and market/external wage curve in Figure 11-9, we must decide whether to adjust the current pay rates for our jobs, and if so how. This calls for a policy decision by management. Strategic considerations influence this decision. Do our strategic aspirations suggest we should pay more, the same, or less than competitors? For example, we might decide to move our current internal wage curve up (and thereby give everyone a raise), or down (and thereby perhaps withhold pay increases for some time), or adjust the slope of the internal wage curve to increase what we pay for some jobs and decrease what we pay for others. In any case, the wage curve we end up (the green line in Figure 11-10, on page 372) should now be equitable internally (in terms of the point value of each job) and equitable externally (in terms of what other firms are paying).[61]

FIGURE 11-9 Plotting Both the Market and Internal Wage Curves



13. Develop Pay Grades

Employers typically group similar jobs (in terms of points) into grades for pay purposes. Then, instead of having to deal with hundreds of job rates, you might only have to focus on, say, pay rates for 10 or 12 pay grades. For example, Serco, a services firm which operates a London, England light railway system, set up pay grades after ranking jobs using a point system based on knowledge, management complexity, and the job's magnitude and impact on the organization.[62]

A **pay (or wage) grade** is comprised of jobs of approximately equal difficulty or importance as determined by job evaluation. If you used the point method of job evaluation, the pay grade consists of jobs falling within a range of points. If the ranking method was used, the grade consists of a specific number of ranks. If you use the classification system, then your jobs are already categorized into classes (or grades).

DETERMINING THE NUMBER OF PAY GRADES It is standard to establish grades of equal point spread. (In other words, each grade might include all those jobs falling between 50 and 100 points, 100 and 150 points, 150 and 200 points, etc.) Since each grade is the same width, the main issue involves determining how many grades to have. There doesn't seem to be any optimal number, although 10 to 16 grades for a given job cluster (shop jobs, clerical jobs, etc.) seems to be common. You need more pay grades if there are, say, 1,000 jobs to be graded than if there are only 100.

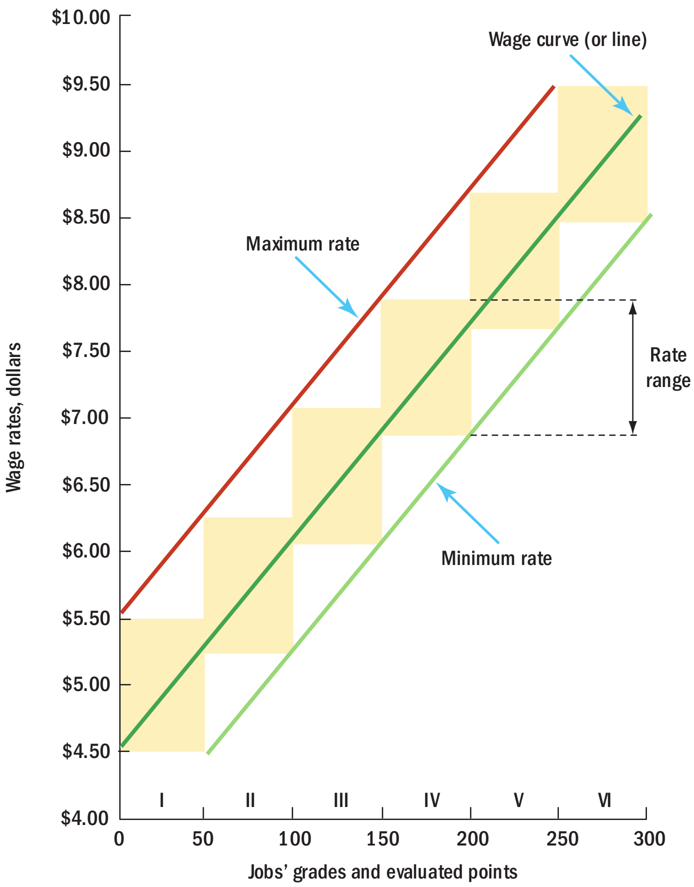
14. Establish Rate Ranges

Most employers do not pay just one rate for all jobs in a particular pay grade. For example, GE Medical won't want to pay all its accounting clerks, from beginners to long tenure, at the same rate, even though they may all be in the same pay grade. Instead, employers develop vertical pay (or "rate") ranges for each of the horizontal pay grades (or pay classes). These **pay (or rate) ranges** often appear as vertical boxes within each grade, showing minimum, maximum, and midpoint pay rates for that grade, as in Figure 11-10. (Specialists call this graph a *wage structure.* Figure 11-10 graphically depicts the range of pay rates—in this case, per hour—paid for each pay grade.) Alternatively, you may depict the pay range for each class or grade as steps in a table, such as Table 11-5, on page 373. Here you will have specific corresponding

pay (or wage) grade
A pay grade is comprised of jobs of approximately equal difficulty.

pay (or rate) ranges
A series of steps or levels within a pay grade, usually based upon years of service.

FIGURE 11-10
Wage Structure



pay rates for each step within each grade in tabular form. Thus Table 11-5 shows the pay rates and steps for some federal government grades. As of the time of this pay schedule, for instance, employees in positions classified in grade GS-10 could be paid annual salaries between $45,771 and $59,505, depending on the level or step at which they were hired into the grade, the amount of time they were in the grade, and any merit increases they've received.

DEVELOPING RATE RANGES The wage curve usually anchors the average pay rate for each vertical pay range. The firm might then arbitrarily decide on a maximum and minimum rate for each grade, such as 15% above and below the wage curve. As an alternative, some employers allow the pay range for each grade to become wider (they include more pay rates) for the higher pay ranges, reflecting the greater demands and performance variability inherent in more complex jobs. As in Figure 11-10, most employers structure their rate ranges to overlap a bit, so an employee in one grade who has more experience or seniority may earn more than would someone in an entry-level position in the next higher pay grade.[63]

There are several reasons to use pay ranges for each pay grade. First, it lets the employer take a more flexible stance in the labor market. For example, it makes it easier to attract experienced, higher-paid employees into a pay grade at the top of the range, since the starting salary for the pay grade's lowest step may be too low to attract them. Pay ranges also let companies provide for performance differences between employees within the same grade or between those with different seniorities.

Compensation experts sometimes use *compa ratios*. The **compa ratio** equals an employee's pay rate divided by the pay range midpoint for his or her pay grade. A compa ratio of 1 means the employee is being paid exactly at the pay range midpoint. If the compa ratio is above 1 then the person's pay rate exceeds the midpoint pay for the job. If it is below then the pay rate is less than the midpoint.

TABLE 11-5 Federal Government Salary Table[65]

SALARY TABLE 2009-GS

INCORPORATING THE 2.90% GENERAL SCHEDULE INCREASE EFFECTIVE JANUARY 2011

Annual Salary Rates by Grade and Step

Grade	Step 1	Step 2	Step 3	Step 4	Step 5	Step 6	Step 7	Step 8	Step 9	Step 10
1	17,803	18,398	18,990	19,579	20,171	20,519	21,104	21,694	21,717	22,269
2	20,017	20,493	21,155	21,717	21,961	22,607	23,253	23,899	24,545	25,191
3	21,840	22,568	23,296	24,024	24,752	25,480	26,208	26,936	27,664	28,392
4	24,518	25,335	26,152	26,969	27,786	28,603	29,420	30,237	31,054	31,871
5	27,431	28,345	29,259	30,173	31,087	32,001	32,915	33,829	34,743	35,657
6	30,577	31,596	32,615	33,634	34,653	35,672	36,691	37,710	38,729	39,748
7	33,979	35,112	36,245	37,378	38,511	39,644	40,777	41,910	43,043	44,176
8	37,631	38,885	40,139	41,393	42,647	43,901	45,155	46,409	47,663	48,917
9	41,563	42,948	44,333	45,718	47,103	48,488	49,873	51,258	52,643	54,028
10	45,771	47,297	48,823	50,349	51,875	53,401	54,927	56,453	57,979	59,505
11	50,287	51,963	53,639	55,315	56,991	58,667	60,343	62,019	63,695	65,371
12	60,274	62,283	64,292	66,301	68,310	70,319	72,328	74,337	76,346	78,355
13	71,674	74,063	76,452	78,841	81,230	83,619	86,008	88,397	90,786	93,175
14	84,697	87,520	90,343	93,166	95,989	98,812	101,635	104,458	107,281	110,104
15	99,628	102,949	106,270	109,591	112,912	116,233	119,554	122,875	126,196	129,517

The compa ratio can help reveal how many jobs in each pay grade are paid above and below competitive market pay rates.[64]

15. Address Remaining Jobs

To this point, we have focused our job evaluation on a limited number of benchmark jobs, as is traditional. We now want to add our remaining jobs to the wage structure. We can do this in two ways. We can evaluate each of the remaining jobs using the same process we just went through. Or we can simply slot the remaining jobs into the wage structure where we feel they belong, without formally evaluating and assigning points to these jobs. Jobs similar to our benchmark jobs we can easily slot into the wage structure. Jobs we're not sure about should undergo the same job evaluation process; we assign points to them and precisely slot them into the wage structure.[66]

16. Correct Out-of-Line Rates

Finally, the wage rate the firm is now paying for a particular job may fall well off the wage curve or well outside the rate range for its grade, as illustrated in Figure 11-6 (page 368). This means that the average pay for that job is currently too high or too low, relative to other jobs in the firm. For underpaid jobs, the solution is clear: Raise the wages of underpaid employees to the minimum of the rate range for their pay grade.

compa ratio
Equals an employee's pay rate divided by the pay range midpoint for his or her pay grade.

Current pay rates falling above the rate range are a different story. These are "red circle," "flagged," or "overrates." There are several ways to cope with this problem. One is to freeze the rate paid to these employees until general salary increases bring the other jobs into line. A second option is to transfer or promote the employees involved to jobs for which you can legitimately pay them their current pay rates. The third option is to freeze the rate for 6 months, during which time you try to transfer or promote the overpaid employees. If you cannot, then cut the rate you pay these employees to the maximum in the pay range for their pay grade.

4 Explain how to price managerial and professional jobs.

PRICING MANAGERIAL AND PROFESSIONAL JOBS

Developing compensation plans for managers or professionals is similar in many respects to developing plans for any employee. The basic aim is the same: to attract, motivate, and retain good employees. And job evaluation is about as applicable to managerial and professional jobs (below the top executive levels) as to production and clerical ones.

There are some big differences, though. Managerial jobs tend to stress harder-to-quantify factors like judgment and problem solving more than do production and clerical jobs. There is also more emphasis on paying managers and professionals based on their performance or on what they can do, rather than on static job demands like working conditions. And one must compete in the marketplace for executives who sometimes have the pay of rock stars. So, job evaluation, although still important, usually plays a secondary role to issues like bonuses, incentives, market rates, and benefits.

Compensating Executives and Managers

Compensation for a company's top executives usually consists of four main elements.[67] *Base pay* includes the person's fixed salary as well as, often, guaranteed bonuses such as "10% of pay at the end of the fourth fiscal quarter, regardless of whether or not the company makes a profit." *Short-term incentives* are usually cash or stock bonuses for achieving short-term goals, such as year-to-year increases in sales revenue. *Long-term incentives* aim to encourage the executive to take actions that drive up the value of the company's stock and include things like stock options; these generally give the executive the right to purchase stock at a specific price for a specific period. Finally, *executive benefits and perks* include things such as supplemental executive retirement pension plans, supplemental life insurance, and health insurance without a deductible or coinsurance. With so many complicated elements, employers must also be alert to the tax and securities law implications of their executive compensation decisions.[68]

What Determines Executive Pay?

For top executive jobs (especially the CEO), job evaluation typically has little relevance. The traditional wisdom is that company size and performance significantly affect top managers' salaries. Yet studies from the early 2000s showed that size and performance explained only about 30% of CEO pay: "In reality, CEO pay is set by the board taking into account a variety of factors such as the business strategy, corporate trends, and most importantly where they want to be in a short and long term."[69] One recent study concluded that three main factors, *job complexity* (span of control, the number of functional divisions over which the executive has direct responsibility, and management level), the employer's *ability to pay* (total profit and rate of return), and the executive's *human capital* (educational level, field of study, work experience) accounted for about two-thirds of executive compensation variance.[70] In practice, CEOs may have considerable influence over the boards of directors who theoretically set their pay. So, their pay sometimes doesn't reflect strictly arms-length negotiations.[71]

Shareholder activism and government oversight have tightened the restrictions on what companies pay top executives. For example, the banking giant HSBC recently shelved plans to raise its CEO's pay by over a third after shareholders rejected the proposals.[72]

ELEMENTS OF EXECUTIVE PAY Salary is traditionally the cornerstone of executive compensation. On it, employers layer benefits, incentives, and perquisites—all normally conferred in proportion to base pay. Executive compensation emphasizes performance incentives more than do other employees' pay plans, since organizational results are likely to reflect executives' contributions more directly than those of lower-echelon employees.[73] Indeed, boards are boosting the emphasis on performance-based pay (in part due to shareholder activism). The big issue here is identifying the appropriate performance standards and then determining how to link these to pay. Typical short-term measures of shareholder value include revenue growth and operating profit margin. Long-term shareholder value measures include rate of return above some predetermined base, and what compensation experts call *economic value added.* We'll discuss such short and long-term incentives in Chapter 12.

Performance-based pay can focus a manager's attention. In 2010, Microsoft's board cut CEO Steve Ballmer's bonus in half, when (among other things) Microsoft failed to move fast enough to introduce a tablet to compete with the iPad.

MANAGERIAL JOB EVALUATION Many employers use job evaluation for pricing managerial jobs (at least, below the top jobs) in most large firms. The basic approach is to classify all executive and management positions into a series of grades, each with a salary range.

As with nonmanagerial jobs, one alternative is to rank the executive and management positions in relation to each other, grouping those of equal value. However, firms also use the job classification and point evaluation methods, with compensable factors like position scope, complexity, and difficulty. Job analysis, salary surveys, and the fine-tuning of salary levels around wage curves also play roles.

Compensating Professional Employees

In compensating professionals, employers should first ensure that each employee is actually a "professional" under the law. The Fair Labor Standards Act "provides an exemption from both minimum wage and overtime pay for employees employed as bona fide executive, administrative, professional and outside sales employees."[74] However, calling someone a professional doesn't make him or her so. In addition to earning at least $455 per week, the person's main duty must "be the performance of work requiring advanced knowledge," and "the advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction."[75] One company hired a high school graduate as an exempt "Product design specialist II," earning $62,000 per year. The job required 12 years of relevant experience, but no particular education. The court ruled the job was non-exempt.[76]

Beyond that, compensating professional employees like engineers and scientists presents unique problems.[77] Analytical jobs emphasize compensable factors such as creativity and problem solving, compensable factors not easily compared or measured. Furthermore, how do you measure performance? For example, the success of an engineer's invention depends on how well the firm develops and markets it. Employers can use job evaluation for professional jobs. Compensable factors here tend to focus on problem solving, creativity, job scope, and technical knowledge and expertise. Firms use the point method and job classification.

Yet in practice, firms rarely rely on just job evaluation for pricing professional jobs. Factors like creativity are hard to measure, and other issues often influence professionals' job decisions. Competing for engineers in Silicon Valley illustrates the problem. Google recently raised its employees' salaries by 10% in the face of defections by even their highest paid professionals, such as the head of its Chrome OS team, to Facebook.[78] Many of these Google professionals, although well paid by national standards, still felt underpaid. Some undoubtedly moved to jobs they hoped would have more challenges. Many also probably felt that the best way to hit it big in terms of pay was to join a younger faster-growing firm and capitalize on new stock options.

Most employers therefore use a market-pricing approach. They price professional jobs in the marketplace as best they can, to establish the values for benchmark jobs. Then they slot these benchmark jobs and their other professional jobs into a salary structure. Each professional discipline usually ends up having four to six grade levels, each with a broad salary range. This helps employers remain competitive when bidding for professionals who literally have global employment possibilities.[79]

CONTEMPORARY TOPICS IN COMPENSATION

How employers pay employees has been evolving. In this final section, we'll look at six important contemporary compensation topics, competency-based pay, broadbanding, talent management, comparable worth, board oversight of executive pay, and total rewards. Chapter 12 then addresses performance-based pay.

5 Explain the difference between competency-based and traditional pay plans.

Competency-Based Pay

Employers traditionally base a job's pay rate on the relative worth of the job. The job evaluation committee compares jobs using compensable factors such as effort and responsibility. This allows them (1) to compare jobs to one another (as in, "based on its duties, this job seems to require about twice the effort of that one"), and (2) to assign internally equitable pay rates for each job. Therefore, the pay rate for the job principally depends on the job itself, not on who is doing it.

For reasons we'll explain shortly, some compensation experts and employers are moving away from assigning pay rates to jobs based on the jobs' numerically rated, intrinsic duties. Instead, they advocate basing the job's pay rate on the level of "competencies" the job demands of those who fill it.[80] "Title and tenure have been replaced with performance and competencies" is how one expert puts it.[81] Compensation specialists call this second approach *competency-based pay.*

WHAT IS COMPETENCY-BASED PAY? In Chapter 4 (Job Analysis), we defined *competencies* as observable and measurable behaviors of the person that make performance possible. To determine what a job's required competencies are, ask, "In order to perform this job competently, the employee should be able to . . . ?" Competencies are most typically skills. Examples of competencies include "program in HTML," "produce a lesson plan," and "engineer the struts for a bridge."

In brief, **competency-based pay** means the company pays for the employee's skills and knowledge, rather than for the title he or she holds.[82] Experts variously call this competence-, knowledge-, or skill-based pay. With competency-based pay, an employee in a class I job who could (but may not have to at the moment) do class II work gets paid as a class II worker, not a class I.

In practice, competency-based pay usually comes down to *pay for knowledge* or *skill-based pay.*[83] Pay-for-knowledge pay plans reward employees for learning organizationally relevant knowledge—for instance, Microsoft pays new programmers more as they learn the intricacies of Windows. Skill-based pay tends to be used more for workers with manual jobs—thus, carpenters earn more as they become more proficient at finishing cabinets.

In sum, the biggest difference between traditional and competency-based pay is this:

- Traditional job evaluation ties the worker's pay to the worth of the job based on the job description and duties. Pay is *job oriented.*
- Competency-based pay ties the worker's pay to his or her competencies—pay is *person oriented.* Employees are paid based on what they know or can do—even if (at the moment), they don't have to do it.

WHY USE COMPETENCY-BASED PAY? Why pay employees based on the skill, knowledge, or competency level they achieve, rather than based on the duties of the jobs to which they're assigned? For example, why pay an Accounting Clerk III who has achieved a exceptional mastery of accounting techniques the same (or more than) someone who is an Accounting Clerk IV?

There are three reasons. First, paying for competencies *enables the company to encourage employees* to develop the competencies the company requires to achieve its strategic aims. For example, Canon Corp. needs competencies in miniaturization and precision manufacturing to design and produce its cameras and copiers. It thus makes sense for Canon to pay employees based on the skills and knowledge they develop in these two strategically crucial areas.

Second, paying for measurable competencies provides a focus for the employer's *talent management process*. Thus at Canon, hiring, training, appraising, and rewards all focus on the competencies of miniaturization and precision manufacturing competencies.

Third, traditional pay plans can backfire if a *high-performance work system* is your goal. The whole thrust of these systems is to encourage employees to work in a self-motivated way. Employers do this by organizing the work around teams, by encouraging team members to rotate freely among jobs (each with its own skill set), and by pushing more responsibility for things like day-to-day supervision down to the workers. In such systems, the manager wants employees to be enthusiastic about learning and moving among jobs. Pigeonholing workers by classifying them too narrowly into jobs based on the job's points may actually discourage such enthusiasm and flexibility.

COMPETENCY-BASED PAY IN PRACTICE In practice, a skill- (or competency- or knowledge-) based pay program generally has five main elements:

1. A system for defining required skills
2. A process for tying the person's pay to his or her skill level
3. A training system that lets employees acquire the skills
4. A formal skills competency testing system
5. A work design that lets employees move among jobs to permit work assignment flexibility[84]

GENERAL MILLS EXAMPLE A General Mills manufacturing plant pays workers based on skill levels.[85] Plant management created four job clusters, corresponding to the plant's four production areas: mixing, filling, packaging, and materials. Within each cluster, workers could attain three levels of skill. Level 1 indicates limited ability, such as the ability to perform simple tasks.[86] Level 2 means the employee attained partial proficiency. Attaining Level 3 means the employee is fully competent. Each of the four job clusters had a different average wage rate. There were therefore 12 pay levels in the plant (four job clusters with three pay levels each).

General Mills set the wages for each job cluster's three levels by making the pay for the lowest of the three pay levels in each job cluster equal to the average entry-level pay rate for similar jobs in the community. A new employee could start in any job cluster, but always at Level 1. If after several weeks he or she was certified at the next higher skill level, General Mills raised his or her salary. Employees freely rotated from job cluster to cluster, as long as they could achieve Level 2 performance within their current cluster.

competency-based pay
Where the company pays for the employee's range, depth, and types of skills and knowledge, rather than for the job title he or she holds.

Many employers, such as General Mills, pay certain workers based on attained skill levels.

Source: Mark Richards/ PhotoEdit Inc.

THE BOTTOM LINE ON COMPETENCY-BASED PAY Some note that competency-based pay "ignores the cost implications of paying [employees] for knowledge, skills and behaviors even if they are not used."[87] There may also be simpler alternatives. For example, overlapping rate ranges allow workers to move from grade to grade, within limits. An article in *Compensation & Benefits Review* recently summed up the bottom line. It argued that, "after two decades of innovation in pay rate determination, it appears that old-fashioned job evaluation is back in vogue, if indeed it was ever gone."[88] In challenging times, perhaps the efficiencies of job evaluation sometimes outweigh the flexibility that comes with competency-based pay.

6 List and explain six important trends in compensation management.

Broadbanding

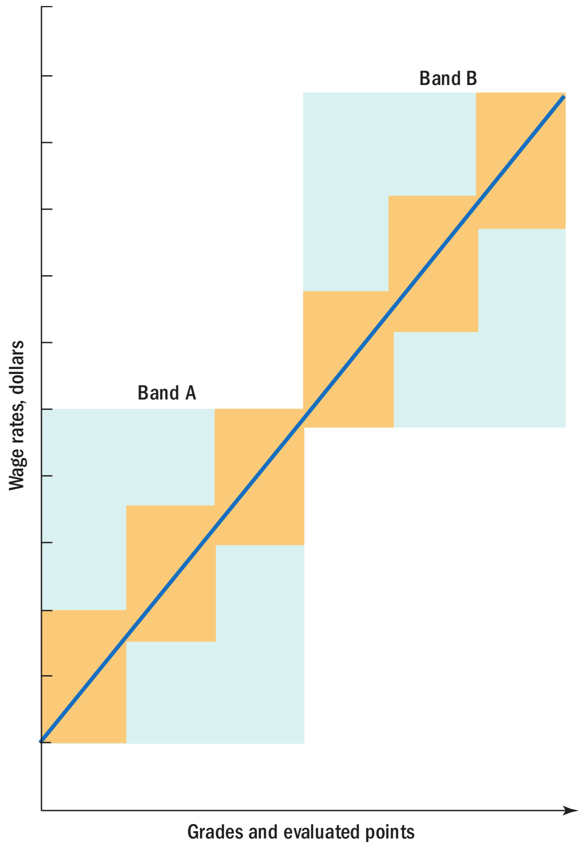
Most firms end up with pay plans that slot jobs into classes or grades, each with its own vertical pay rate range. For example, the U.S. government's pay plan consists of 18 main grades (GS-1 to GS-18), each with its own pay range. For an employee whose job falls in one of these grades, the pay range for that grade dictates his or her minimum and maximum salary.

The question is, "How wide should the salary grades be, in terms of the number of job evaluation points they include?" (For example, might the U.S. government want to collapse its 18 salary grades into 6 or 7 broader bands?) There is a downside to having (say, 18) narrow grades. For instance, if you want someone whose job is in grade 2 to fill in for a time in a job that happens to be in grade 1, it's difficult to reassign that person without lowering his or her salary. Similarly, if you want the person to learn about a job that happens to be in grade 3, the employee might object to the reassignment without a corresponding raise to grade 3 pay. Traditional grade pay plans thus may tend to encourage inflexibility.

That is why some firms are broadbanding their pay plans. **Broadbanding** means collapsing salary grades into just a few wide levels or bands, each of which contains a relatively wide range of jobs and pay levels. Figure 11-11 illustrates this. In this case, the company's previous six pay grades are consolidated into two broad grades or "broadbands."

A company may create broadbands for all its jobs, or for specific groups such as managers or professionals. The pay rate range of each broadband is relatively large, since it ranges from the minimum pay of the lowest grade the firm merged into the broadband up to the maximum pay of the highest merged grade. Thus, for example, instead of having 10 salary grades, each of which contains a salary range of $15,000, the firm might collapse the 10 grades into three broadbands, each with a set of jobs such that the difference between the lowest- and highest-paid jobs might be $40,000 or more. For the jobs that fall in this broadband, there is therefore a much wider range of pay rates. You can move an employee from job to job within the broadband more

FIGURE 11-11 Broadbanded Structure and How It Relates to Traditional Pay Grades and Ranges



easily, without worrying about the employee's moving outside the relatively narrow rate range associated with a traditional narrow pay grade. Broadbanding therefore facilitates flexibility.

PROS AND CONS Companies create broadbands for several reasons. The basic advantage is that it injects greater flexibility into employee assignments.[89] It is especially sensible where firms organize into self-managing teams. The new, broad salary bands can include both supervisors and subordinates and also facilitate moving employees slightly up or down along the pay scale, without bumping the person into a new salary range. For example, "the employee who needs to spend time in a lower-level job to develop a certain skill set can receive higher-than-usual pay for the work, a circumstance considered impossible under traditional pay systems."[90] Similarly, one expert argues that, say, point plans, may actually encourage inadaptability.[91] He says that jobs narrowly defined by compensable factors such as "effort" are unlikely to encourage job incumbents to be flexible. Instead, the tendency may be for workers to take a "that's not my job" attitude and to concentrate on their usual assigned duties.

On the other hand, broadbanding can be unsettling, particularly for new employees. For example, The Home Depot has used broadbanding for more than 10 years, and "when employees want to learn something new, they play to the level [on that project] that they're capable of," says the firm's head of information systems. Moving among jobs is motivating once you get used to it. However, it can make a new employee feel adrift: "There's a sense of permanence in the set of job responsibilities often attached to job titles," he says. That sense of permanence isn't nearly as clear when employees move frequently from project to project and job to job.[92]

broadbanding
Consolidating salary grades and ranges into just a few wide levels or "bands," each of which contains a relatively wide range of jobs and salary levels.

Actively Managing Compensation Allocations, and Talent Management

As we saw in previous chapters, employers are increasingly segmenting their employees and actively assigning more resources to those they deem "mission-critical" in terms of the firm's strategy. Recall, for instance, that Accenture uses a 4×4 matrix to plot employees by Performance (exceptional, high, medium, low) and Value to the Organization (mission-critical, core, necessary, nonessential). It then allocates pay and other resources based on where the employee places in the matrix.[93] The decisions on whether to allocate pay on such a basis, and if so how to do so, are therefore important policy matters for employers.

Many employers are taking this more active, segmentation approach. For example, we saw that one telecommunications firm previously spread development money and compensation evenly over its 8,000 employees. When the recession came, it segmented its talent into business impact, high performers, high potentials, and critical skills. Then they shifted their dollars away from low performers and those not making an impact to high performers and high potentials.[94]

As another example, the human resources consulting company Hewitt says that,

> "In the next generation of talent management, organizations will use consumer-marketing technologies to customize total rewards packages. Through personalized Web portals, organizations will offer rewards menus and associated dollar credits that are tailored to groups of workers and even individual workers. Dollar amounts will be tied to role and performance as opposed to age or seniority. Options offered will go beyond the traditional flexible benefits fare to include choice in work assignments and location, time and money for training, and working time flexibility. For example, AstraZeneca PLC offers workers customized rewards menus, allowing them to design the specifics of their rewards packages."[95]

Comparable Worth

Comparable worth refers to the requirement to pay men and women equal wages for jobs that are of *comparable* (rather than strictly *equal*) value to the employer. Thus, comparable worth may mean comparing quite dissimilar jobs, such as nurses to truck mechanics or secretaries to technicians. The question "comparable worth" seeks to address is this: Should you pay women who are performing jobs *equal* to men's or just *comparable* to men's the same as men? If it's only for equal jobs, then the tendency may be to limit women's pay to that of the other, lower-paid jobs in which women tend to predominate.

County of Washington v. Gunther (1981) was a pivotal case for comparable worth. It involved Washington County, Oregon, prison matrons who claimed sex discrimination. The county had evaluated roughly comparable but non-equal men's jobs as having 5% more "job content" (based on a point evaluation system) than the women's jobs, but paid the men 35% more.[96] Why should there be such a pay discrepancy for roughly comparable jobs? After seesawing through the courts to the U.S. Supreme Court, Washington County finally agreed to pay 35,000 employees in female-dominated jobs almost $500 million in pay raises over 7 years to settle the suit.

Comparable worth has implications for job evaluation. Virtually every comparable worth case that reached a court involved the use of the point method of job evaluation. By assigning points to dissimilar jobs, point plans facilitate comparability ratings among different jobs. Should employers still use point-type plans? Perhaps the wisest approach is for employers to price their jobs as they see fit (with or without point plans), but to ensure that women have equal access to all jobs. In other words, eliminate the wage discrimination issue by eliminating sex-segregated jobs.

THE PAY GAP All this notwithstanding, women in the United States earn only about 77% as much as men.[97] In general, education may reduce the wage gap somewhat. For example, studies suggest that schooling's impact on earnings is greater for females than for males, other things equal.[98] But gaps remain, even among the most highly trained. For example, new female medical doctors recently earned about

$17,000 per year less than their male counterparts did, and that gap has been widening for years.[99] Reasons put forward for the male-female gap range from the outdated notion that employers view women as having less leverage, to the fact that professional men change jobs more often (gaining more raises in the process) and that women tend to end up in departments that pay less.[100] In any case, it's a problem employers need recognize and to address.

Board Oversight of Executive Pay

Several years ago, the antivirus company McAfee apparently pushed out its president and saw its CEO leave after "a stock options investigation found accounting problems that will require financial restatements."[101]

There are various reasons why boards are clamping down on executive pay. As of 2005, the Financial Accounting Standards Board required that most public companies recognize as an expense the fair value of the stock options they grant.[102] The Sarbanes-Oxley Act makes executives personally liable, under certain conditions, for corporate financial oversight lapses. Writing in the *Harvard Business Review*, the chief justice of Delaware's Supreme Court said that governance issues, shareholder activism, and other changes have "created a new set of expectations for directors."[103] As of 2007, the Securities and Exchange Commission (SEC) required filing more compensation-related information, including a detailed listing of all individual "perks" or benefits if they total more than $100,000.[104] The economic downturn that began around 2008 exposed the enormous disconnect between what many executives were earning and their performance. The U.S. government's "pay czar" was soon overseeing certain pay awards in firms that had U.S. treasury loans. Yet none of these SEC or legislative actions seem (in retrospect) to have prevented some employers from dramatically overpaying their executives. The net result is that lawyers specializing in executive pay suggest that boards of directors (board compensation committees usually make executive pay decisions in large firms)[105] ask themselves these questions:

- Has our compensation committee thoroughly identified its duties and processes?
- Is our compensation committee using the appropriate compensation advisors? (Government regulators and commentators strongly encourage this.)
- Are there particular executive compensation issues that our committee should address?[106]
- Do our procedures demonstrate diligence and independence? (This demands careful deliberations and records.)
- Is our committee appropriately communicating its decisions? How will shareholders react?[107]

Total Rewards and Tomorrow's Pay Programs

Companies face severe economic and competitive challenges.[108] There will be what consultants McKinsey & Co. calls a "war for talent" as companies vie to hire and retain top employees. With reduced Social Security and company pensions, employees will have to build their own wealth for retirement. And younger "millennial" applicants will enter the workforce with greater expectations for recognition and feedback than did their predecessors.

Tomorrow's pay programs will therefore probably exhibit several features. Every company has jobs that are strategically crucial to their futures, and others, which while important, are supportive. Talent management–oriented employers will have to identify the strategically crucial jobs and pay them at premium levels. To engage the millennial

comparable worth
The concept by which women who are usually paid less than men can claim that men in comparable rather than in strictly equal jobs are paid more.

employees, it's essential that they know what's expected of them, and that they get continuing constructive feedback about their performance. Incentives will be a component of every compensation package. Employers will have to be creative about providing rewards like stock ownership options to provide young talent with the opportunity to create retirement wealth through their employment. And nonfinancial rewards including personal recognition will grow in importance as supplements to financial rewards.

That last point highlights the trend toward viewing rewards not just in terms of pay, incentives, and benefits, but as *total rewards*. As noted earlier, *total rewards* encompass the traditional compensation components, but also things such as recognition and redesigned more challenging jobs (as we discussed in this chapter), telecommuting programs, health and well being programs, and training and career development (discussed in Chapters 8 and 10). Some employers distribute annual total rewards statements to employees, to help them appreciate the full range of rewards that they are receiving.[109]

Improving Productivity through HRIS

Automating Strategic Compensation Administration

Traditionally, employers used spreadsheets to administer annual pay raise decisions, and many still do. The human resource department creates individual spreadsheets for each manager. The managers then record salary increase recommendations for their subordinates on these spreadsheets. The human resource team then compiles the spreadsheets by unit, department, division, and, finally, company-wide to add up who was spending what. This is a labor-intensive and costly process.

Today, companies more often use server-based intranet compensation planning programs to keep track of who is spending what.[110] This Web-based method has many advantages. The employer can quickly update its compensation programs (such as how much is available, and how much each manager can allocate) without having to modify the software on individual managers' computers. Automating the system reduces costs by eliminating manual processes. For example, one company estimated that it cost about $35 to complete a single manual compensation transaction (such as combining the raise budgets for two departments), but about $16 if it automated this process. Using a centralized application saves money in other ways. For example, employers often assign pay raise budgets to all their managers, only to find that (once the various department budgets all come together) the total accumulated raises are excessive. This generally doesn't happen with automated systems.

REVIEW

MyManagementLab Now that you have finished this chapter, go back to **www.mymanagementlab.com** to continue practicing and applying the concepts you've learned.

CHAPTER SECTION SUMMARIES

1. In establishing strategic pay plans, managers first need to understand some **basic factors in determining pay rates**. Employee compensation includes both direct financial payments and indirect financial statements. The factors determining the design of any pay plan include legal, union, company strategy/policy, and equity. Legal considerations include, most importantly, the Fair Labor Standards Act, which governs matters such as minimum wages and overtime pay. Specific categories of employees are exempt from the act or certain provisions of the act, particularly its overtime provisions. The Equal Pay Act of 1963 and the Employee Retirement Income Security Act are other important laws.
2. The process of **establishing pay rates** while ensuring external, internal, and procedural equity consists of five steps: conducting a salary survey, determining the worth of

each job, doing a job evaluation, grouping jobs comprised of approximately equal difficulty and pricing each pay grade with wage curves, and fine-tuning pay rates.

- Salary surveys may be informal phone or Internet surveys, or formal surveys conducted by the employer or utilizing commercial, professional, and/or government salary surveys.
- Job evaluation is a systematic comparison done in order to determine the worth of one job relative to another based on compensable factors.
- Compensable factors refer to compensable elements of a job such as skills and efforts.
- Popular job evaluation methods include ranking, job classification, the point method, and factor comparison. With ranking, for instance, you conduct a job analysis, group jobs by department, and have raters rank jobs.
- Once the committee uses job evaluation to determine the relative worth of each job, it can turn to the task of assigning pay rates to each job; it would usually first want to group jobs into pay grades to streamline the process.
- The team can then use wage curves to price each grade and then fine-tune pay rates.

3. **Pricing managerial and professional jobs** involves some special issues. Managerial pay typically consists of base pay, short-term incentives, long-term incentives, and executive benefits and, particularly at the top levels, doesn't lend itself to job evaluation but rather to understanding the job's complexity, the employer's ability to pay, and the need to be competitive in attracting top talent.
4. More employers are moving from paying jobs based on their intrinsic duties toward **paying jobs based on the competencies** the job requires. The main reason for doing so is to encourage employees to develop the competencies they need to move seamlessly from job to job. At General Mills, for instance, certain plant personnel are paid based on the skill levels they attain.
5. We addressed several important **special topics in compensation**. Broadbanding means consolidating several rates and ranges into a few wide levels or "bands," each of which contains a relatively wide range of jobs in salary levels. Broadbanding encourages employees to move freely from job to job and facilitates implementing team-based high-performance management systems. Comparable worth refers to the requirement to pay men and women equal pay for jobs that are of comparable rather than strictly equal value to the employee. With many stockholders concerned with excessive executive remuneration, board oversight of executive pay has become an important issue, and boards of directors should use qualified advisers and exercise diligence and independence in formulating executive pay plans. Total rewards encompass the traditional compensation components, but also things such as recognition and redesigned more challenging jobs.

DISCUSSION QUESTIONS

1. What is the difference between exempt and nonexempt jobs?
2. Should the job evaluation depend on an appraisal of the jobholder's performance? Why? Why not?
3. What is the relationship between compensable factors and job specifications?
4. Compare and contrast the following methods of job evaluation: ranking, classification, factor comparison, and point method.
5. What are the pros and cons of broadbanding, and would you recommend your current employer (or some other firm you're familiar with) use it? Why or why not?
6. It was recently reported in the news that the average pay for most university presidents was around $250,000 per year, but that a few earned much more. For example, the new president of Vanderbilt received $852,000 in one year. Discuss why you would (or would not) pay university presidents as much or more than many corporate CEOs.
7. Do small companies need to develop a pay plan? Why or why not?

INDIVIDUAL AND GROUP ACTIVITIES

1. Working individually or in groups, conduct salary surveys for the following positions: entry-level accountant and entry-level chemical engineer. What sources did you use, and what conclusions did you reach? If you were the HR manager for a local engineering firm, what would you recommend that you pay for each job?
2. Working individually or in groups, develop compensation policies for the teller position at a local bank. Assume that there are four tellers: two were hired in May and the other two were hired in December. The compensation policies should address the following: appraisals, raises, holidays, vacation pay, overtime pay, method of pay, garnishments, and time cards.
3. Working individually or in groups, access relevant Web sites to determine what equitable pay ranges are for these jobs: chemical engineer, marketing manager, and HR manager, all with a bachelor's degree and 5 years' experience. Do so for the following cities: New York, New York; San Francisco, California; Houston, Texas; Denver, Colorado; Miami, Florida; Atlanta, Georgia; Chicago, Illinois; Birmingham, Alabama; Detroit, Michigan; and Washington, D.C. For each position in each city, what are the pay ranges and the average pay? Does geographical location impact the salaries of the different positions? If so, how?
4. The "HRCI Test Specifications Appendix" (pages 633–640) lists the knowledge someone studying for the

HRCI certification exam needs to have in each area of human resource management (such as in Strategic Management, Workforce Planning, and Human Resource Development). In groups of four to five students, do four things: (1) review that appendix now; (2) identify the material in this chapter that relates to the required knowledge the appendix lists; (3) write four multiple-choice exam questions on this material that you believe would be suitable for inclusion in the HRCI exam; and (4) if time permits, have someone from your team post your team's questions in front of the class, so the students in other teams can take each others' exam questions.

5. Some of America's executives have come under fire recently because their pay seemed to some to be excessive, given their firms' performances. To choose just two of many: one Citigroup division head was due a $97 million bonus in 2009, and Merrill Lynch paid tens of millions in bonuses soon after Bank of America rescued it. However, big institutional investors are no longer sitting back and not complaining. For example, TV's *Nightly Business Line* says that pension manager TIAA-CREF is talking to 50 companies about executive pay. And the U.S. government's "pay czar" is looking to roll back some such payouts. Do you think they are right to make a fuss? Why?

EXPERIENTIAL EXERCISE

Ranking the College's Administrators

Purpose: The purpose of this exercise is to give you experience in performing a job evaluation using the ranking method.

Required Understanding: You should be thoroughly familiar with the ranking method of job evaluation and obtain job descriptions for your college's dean, department chairperson, director of admissions, library director, registrar, and your professor.

How to Set Up the Exercise/Instructions:

Divide the class into groups of four or five students. The groups will perform a job evaluation of the positions of dean, department chairperson, and professor using the ranking method.

1. Perform a job evaluation by ranking the jobs. You may use one or more compensable factors.
2. If time permits, a spokesperson from each group can put his or her group's rankings on the board. Did the groups end up with about the same results? How did they differ? Why do you think they differed?

APPLICATION CASE

SALARY INEQUITIES AT ACME MANUFACTURING

Joe Black was trying to figure out what to do about a problem salary situation he had in his plant. Black recently took over as president of Acme Manufacturing. The founder and former president, Bill George, had been president for 35 years. The company was family owned and located in a small eastern Arkansas town. It had approximately 250 employees and was the largest employer in the community. Black was a member of the family that owned Acme, but he had never worked for the company prior to becoming president. He had an MBA and a law degree, plus 5 years of management experience with a large manufacturing organization, where he was senior vice president for human resources before making his move to Acme.

A short time after joining Acme, Black started to notice that there was considerable inequity in the pay structure for salaried employees. A discussion with the human resources director led him to believe that salaried employees' pay was very much a matter of individual bargaining with the past president. Hourly paid factory employees were not part of the problem because they were unionized and their wages were set by collective bargaining. An examination of the salaried payroll showed that there were 25 employees, ranging in pay from that of the president to that of the receptionist. A closer examination showed that 14 of the salaried employees were female. Three of these were front-line factory supervisors and one was the human resources director. The other 10 were nonmanagement.

This examination also showed that the human resources director appeared underpaid, and that the three female supervisors earned somewhat less than any male supervisor did. However, there were no similar supervisory jobs with both male and female job incumbents. When asked, the HR director said she thought the female supervisors may have been paid at a lower rate mainly because they were women, and perhaps George, the former president, did not think that women needed as much money because they had working husbands. However, she added she personally thought that they were paid less because they supervised less-skilled employees than did the male supervisors. Black was not sure that this was true.

The company from which Black had moved had a good job evaluation system. Although he was thoroughly familiar with and capable in this compensation tool, Black did not have time to make a job evaluation study at Acme. Therefore, he decided to hire a compensation consultant from a nearby university to help him. Together, they decided that all 25 salaried jobs should be in the same job evaluation cluster; that a modified ranking method of job evaluation should be used; and that the job descriptions recently completed by the HR director were current, accurate, and usable in the study.

The job evaluation showed that the HR director and the three female supervisors were being underpaid relative to comparable male salaried employees.

Black was not sure what to do. He knew that if the underpaid female supervisors took the case to the local EEOC office, the company could be found guilty of sex discrimination and then have to pay considerable back wages. He was afraid that if he gave these women an immediate salary increase large enough to bring them up to where they should be, the male supervisors would be upset and the female supervisors might comprehend the total situation and want back pay. The HR director told Black that the female supervisors had never complained about pay differences.

The HR director agreed to take a sizable salary increase with no back pay, so this part of the problem was solved. Black believed he had four choices relative to the female supervisors:

1. To do nothing
2. To gradually increase the female supervisors' salaries
3. To increase their salaries immediately
4. To call the three supervisors into his office, discuss the situation with them, and jointly decide what to do

Questions

1. What would you do if you were Black?
2. How do you think the company got into a situation like this in the first place?
3. Why would you suggest Black pursue the alternative you suggested?

Source: This case was prepared by Professor James C. Hodgetts of the Fogelman College of Business and Economics of the University of Memphis. All names are disguised. Used by permission.

CONTINUING CASE

CARTER CLEANING COMPANY

The New Pay Plan

Carter Cleaning Centers does not have a formal wage structure nor does it have rate ranges or use compensable factors. Wage rates are based mostly on those prevailing in the surrounding community and are tempered with an attempt on the part of Jack Carter to maintain some semblance of equity between what workers with different responsibilities in the stores are paid.

Carter does not make any formal surveys when determining what his company should pay. He peruses the want ads almost every day and conducts informal surveys among his friends in the local chapter of the laundry and cleaners trade association. While Jack has taken a "seat-of-the-pants" approach to paying employees, his salary schedule has been guided by several basic pay policies. Although many of his colleagues adhere to a policy of paying minimum rates, Jack has always followed a policy of paying his employees about 10% above what he feels are the prevailing rates, a policy that he believes reduces turnover while fostering employee loyalty. Of somewhat more concern to Jennifer is her father's informal policy of paying men about 20% more than women for the same job. Her father's explanation is, "They're stronger and can work harder for longer hours, and besides they all have families to support."

Questions

1. Is the company at the point where it should be setting up a formal salary structure based on a complete job evaluation? Why?
2. Is Jack Carter's policy of paying 10% more than the prevailing rates a sound one, and how could that be determined?
3. Similarly, is Carter's male–female differential wise? If not, why not?
4. Specifically, what would you suggest Jennifer do now with respect to her company's pay plan?

TRANSLATING STRATEGY INTO HR POLICIES & PRACTICES CASE

THE HOTEL PARIS CASE

The New Compensation Plan

The Hotel Paris's competitive strategy is "To use superior guest service to differentiate the Hotel Paris properties, and to thereby increase the length of stay and return rate of guests, and thus boost revenues and profitability." HR manager Lisa Cruz must now formulate functional policies and activities that support this competitive strategy by eliciting the required employee behaviors and competencies.

Like several other HR systems at the Hotel Paris, the compensation program was unplanned and unsophisticated. The company has a narrow target range for what it will pay employees in each job category (front-desk clerk, security guard, and so forth). Each hotel manager decides where to start a new employee within that narrow pay range. The company has given little thought to tying general pay levels or individual employees' pay to the company's strategic goals.

For example, the firm's policy is simply to pay its employees a "competitive salary," by which it means about average for what other hotels in the city are paying for similar jobs. Lisa knows that pay policies like these may actually run counter to what the company wants to achieve strategically, in terms of creating an extraordinarily service-oriented workforce. How can you hire and retain a top workforce, and channel their behaviors toward high-quality guest services, if you don't somehow link performance and pay? She and her team therefore turn to the task of assessing and redesigning the company's compensation plan.

Even a casual review by Lisa Cruz and the CFO made it clear that the company's compensation plan wasn't designed to support the firm's new strategic goals. For one thing, they knew that they should pay somewhat more, on average, than did their competitors if they expected employees to consistently exceed expectations when it came to serving guests. Yet their review of a variety of metrics (including the Hotel Paris's salary/competitive salary ratios, the total compensation expense per employee, and the target percentile for total compensation) suggested that in virtually all job categories the Hotel Paris paid no more than average, and, occasionally, paid somewhat less.

The current compensation policies had also bred what one hotel manager called an "I don't care" attitude on the part of most employees. What she meant was that most Hotel Paris employees quickly learned that regardless of what their performance was, they always ended up being paid about the same as employees who performed better and worse than they did. So, the firm's compensation plan actually was dysfunctional: It was not channeling employees' behaviors toward those required to achieve the company's goals. In some ways, it was doing the opposite.

Lisa and the CFO knew they had to institute a new, strategic compensation plan. They wanted a plan that improved employee morale, contributed to employee commitment, reduced employee turnover, and rewarded (and thus encouraged) the sorts of service-oriented behaviors that boosted guest satisfaction. After meeting with the company's CEO and the board, the CFO gave Lisa the go-ahead to redesign the company's compensation plan, with the overall aim of creating a new plan that would support the company's strategic aims.

Questions

1. Draw a diagram showing with arrows how compensation at Hotel Paris should influence employee performance, which should in turn influence Hotel Paris performance. Include at each level examples of relevant compensation policies, employee behavior, and Hotel Paris outcomes.
2. Would you suggest that Hotel Paris implement a competency-based pay plan for its nonmanagerial staff? Why or why not?
3. Devise a ranking job evaluation system for the Hotel Paris's nonmanagerial employees (housekeepers, valets, front-desk clerks, phone operators, waitstaff, groundskeepers, and security guards) and use it to show the worth of these jobs relative to one another.

KEY TERMS

employee compensation, *352*
direct financial payments, *352*
indirect financial payments, *352*
Davis-Bacon Act (1931), *354*
Walsh-Healey Public Contract Act (1936), *354*
Title VII of the 1964 Civil Rights Act, *354*
Fair Labor Standards Act (1938), *354*
Equal Pay Act (1963), *357*
Employee Retirement Income Security Act (ERISA), *358*
job evaluation, *360*
compensable factor, *360*
benchmark job, *361*
ranking method, *361*
job classification (or grading) method, *362*
classes, *362*
grades, *362*
grade definition, *362*
point method, *363*
wage curve, *367*
market-competitive pay system, *367*
salary survey, *368*
pay (or wage) grade, *371*
pay (or rate) ranges, *371*
compa ratio, *372*
competency-based pay, *376*
broadbanding, *378*
comparable worth, *380*

ENDNOTES

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