6. ***Identify the next step.*** The terminated employee may be disoriented and unsure what to do next. Explain where the employee should go next, upon leaving the interview.

outplacement counseling
A formal process by which a terminated person is trained and counseled in the techniques of self-appraisal and securing a new position.

OUTPLACEMENT COUNSELING With **outplacement counseling** the employer arranges for an outside firm to provide terminated employees with career planning and job search skills. *Outplacement firms* usually provide such outplacement services. Employees (usually managers or professionals) who are let go typically have office space and secretarial services they can use at local offices of such firms, plus the counseling services. The outplacement counseling is part of the terminated employee's support or severance package. Why not just give the person the outplacement fee as additional severance? In general, providing outplacement services seems to have positive effects for both the terminated employee and the employer.[114]

exit interviews
Interviews with employees who are leaving the firm, conducted for obtaining information about the job or related matters, to give the employer insight about the company.

EXIT INTERVIEW Many employers conduct **exit interviews,** just prior to the employee leaving. These aim to give employers insights into their companies' strengths and weaknesses so as to improve employee retention.[115] Questions include: What made you start looking for a new job? How would you describe our company's culture? How would you describe your supervisor's management style? What did you like most/least about the company?[116] Other questions relate to HR (such as promotion processes), the work itself (including working conditions), and to competitive benchmarks (such as salaries compared to competitors'). Try to make sure the exiting employee leaves as a supporter of the employer.[117]

The assumption is that because the employee is leaving he or she will be candid, but this is debatable.[118] One older study found that at separation, 38% of those leaving blamed salary and benefits, and 4% blamed supervision. Followed up 18 months later, 24% blamed supervision and 12% blamed salary and benefits. That apparently hasn't changed. To paraphrase one top executive, someone's not going to blame his supervisor if he wants to get that person's recommendation.[119] Questioning should therefore be incisive.

THE EXIT PROCESS The exit interview is one part of a rational exit process. The employer should have a checklist.[120] As noted earlier, ensure that the employee returns all keys and company equipment, that all computer and database password access is terminated, that proper communications are sent internally (for instance, to other employees if appropriate, and to payroll) and externally, that the employee leaves the premises in a timely fashion, and that if necessary security precautions are followed.

More employees today quit without giving notice. Sometimes that's justified. For example, those taking jobs with competitors should no longer have access to the employer's information. But more often, quitting without notice reflects unfamiliarity with the traditional 2-week notice standard, or of seeing one's colleagues summarily dismissed.[121] Similarly, about 40% of workers laid off in one study placed negative social media reviews about the employer. The point is to make the separation as civil as possible.[122]

FOR THE EMPLOYEE What should you do if you get fired or passed over for a position?[123] Most people surrender to the usual stages of shock, denial, and anger. However, the better first step is usually to think through why you lost the job. Doing so isn't easy. Actively explore what (if anything) you did to contribute to the problem. Then objectively consider what you might do differently in the future, keeping in mind that you should view the loss (difficult though this may be) as an opportunity. Then evaluate your new options and be ready to seize the right opportunity.

Layoffs and the Plant Closing Law

layoff
An employer sending employees home due to a lack of work; this is typically a temporary situation.

A **layoff,** in which the employer sends workers home for a time for lack of work, is usually not a permanent dismissal (although it may turn out to be). Rather, it is a temporary one, which the employer expects will be short term. However, some employers use the term *layoff* as a euphemism for discharge or termination. In the deep recession years of 2008 and 2009 combined, employers carried out a total of about 51,000 mass layoffs, idling over 5 million workers.[124]

A study illustrates one firm's layoff process. Senior management first met to make strategic decisions about the size and timing of the layoffs. They also debated the relative importance of the skills the firm needed going forward. Supervisors then assessed their subordinates, rating their nonunion employees either A, B, or C (union employees were covered by a union agreement making layoffs dependent on seniority). The supervisors then informed each of their subordinates about his or her A, B, or C rating, and told each that those with C grades were most likely to be laid off.[125]

LAYOFF'S EFFECTS It's not surprising that layoffs often result in "deleterious psychological and physical health outcomes" for those losing their jobs, as well as for survivors.[126]

But not just the "victims" and "survivors" suffer. In one study, researchers "found that the more managers were personally responsible for handing out WARN notices to employees . . . the more likely they were to report physical health problems, to seek treatment for these problems, and to complain of disturbed sleep."[127]

Given all this, many employers try to minimize layoffs and dismissals during downturns. Reducing everyone's work hours and mandating vacations are two options. Others reduce layoffs by offering financial bonuses for improved productivity.[128]

Ironically, when some employees most need employee assistance programs (such as counseling)—after they're laid off—they lose them. More firms are therefore extending these program benefits for a month or two to former employees. For example, Florida's Sarasota County extended employee assistance program benefits for 2 months after it laid off some employees.[129]

The Worker Adjustment and Retraining Notification Act (WARN Act, or the plant closing law) requires employers of 100 or more employees to give 60 days' notice before closing a facility or starting a layoff of 50 or more people.[130]

Adjusting to Downsizings and Mergers

downsizing
The process of reducing, usually dramatically, the number of people employed by a firm.

Downsizing means reducing, usually dramatically, the number of people employed by a firm. The basic idea is to cut costs and raise profitability. Downsizings (some call them "productivity transformation programs")[131] require careful consideration of several matters.

1. First is making sure *the right people* are let go; this requires having an effective appraisal system in place.
2. Second is *compliance with all applicable laws,* including WARN.
3. Third is executing the dismissals in a manner that is *just and fair*.
4. Fourth is *security,* for instance, retrieving keys and ensuring that those leaving don't take prohibited items with them.
5. Fifth is reducing the remaining employees' uncertainty and addressing their concerns. This typically involves a postdownsizing announcement and program, including meetings where senior managers field questions from the remaining employees.

Providing advanced notice regarding the layoff can help cushion the otherwise negative effects. So can interpersonal sensitivity (in terms of the manager's demeanor during layoffs).[132] Layoffs can be more challenging abroad due to special legal obligations, such as requirements for a year's notice in some countries.

Supportiveness and creativity are especially important in companies that rely heavily on employee engagement and teamwork.[133] Here, turnover is especially disruptive, so it may be particularly important to avoid layoffs. Options here include: implement pay freezes or cuts; introduce a hiring freeze before reducing the workforce; provide candid communications about the need for the downsizing; give employees an opportunity to express their opinions about the downsizing; and be fair and compassionate in implementing the downsizing.[134]

Chapter Review

Chapter Section Summaries

10-1. Employees are ultimately responsible for their own careers, but employers and managers also have roles in **career management.** These include establishing company-based career centers, offering career planning workshops, providing employee development budgets, and offering online career development programs. Perhaps the simplest is to make the appraisal itself career-oriented, by linking the appraisal feedback to the employee's aspirations and plans.

10-2. The employer's career planning and development process and practices (including career-oriented appraisal) help to foster **employee engagement.** Managed effectively, the employer's career development process should send the signal that the employer cares about the employee's career success.

10-3. Managing voluntary turnover requires identifying its causes and then addressing them. A comprehensive approach to **retaining employees** should be multifaceted, and include improved selection, a well-thought-out training and career development program, assistance in helping employees lay out potential career plans, providing employees with meaningful work and recognition and rewards, promoting work–life balance, acknowledging employees' achievements, and providing all this within a supportive company culture.

10-4. Employers need to address employee **life-cycle career management** issues. Most notably, promotions can provide opportunities to reward exceptional performance, and to fill open positions with tested and loyal employees. Several decisions loom large in any firm's promotion process: Is seniority or competence the rule? How should we measure competence? Is the process formal or informal? Vertical, horizontal, or other? Women and people of color still experience relatively less career progress in organizations, and bias and more subtle barriers are often the cause. In general, the employer's promotion processes must comply with all the same antidiscrimination laws as do procedures for recruiting and selecting employees or any other HR actions. Transfers and retirements are other important career life-cycle issues.

10-5. **Managing dismissals** is an important part of any supervisor's job. Among the reasons for dismissal are unsatisfactory performance, misconduct, lack of qualifications, changed job requirements, and insubordination. In dismissing one or more employees, however, remember that termination at will as a policy has been weakened by exceptions in many states. Furthermore, care should be taken to avoid wrongful discharge suits.

CHAPTER 10

Discussion Questions

10-1. Why is it advisable for an employee retention effort to be comprehensive? What activities would you say are involved in such a program?

10-2. What is the employee's role in the career development process? The manager's role? The employer's role?

10-3. What are the main decisions employers should address in reaching promotion decisions?

10-4. Discuss at least four procedural suggestions for managing dismissals effectively.

10-5. What would you as a supervisor do to avoid someone accusing you of wrongful dismissal?

Individual and Group Activities

10-6. Many rightfully offer IBM as an example of an employer that works hard to improve employee retention and engagement. Browse through the employment pages of IBM's website (such as http://www-03.ibm.com/employment/index.shtml). In this chapter, we discussed actions employers can take to improve employee retention and engagement. From the information on IBM's Web pages, what is IBM doing to support retention and engagement?

10-7. In groups of four or five students, meet with one or two administrators and faculty members in your college or university and, based on this, write a two-page paper on the topic "the faculty promotion process at our college." What do you think of the process? Based on our discussion in this chapter, could you make any suggestions for improving it?

10-8. Working individually or in groups, choose two occupations (such as management consultant, HR manager, or salesperson) and use sources such as O*NET to size up the future demand for this occupation in the next 10 years or so. Does this seem like a good occupation to pursue? Why or why not?

10-9. In groups of four or five students, interview a small business owner or an HR manager with the aim of writing a two-page paper addressing the topic "steps our company is taking to reduce voluntary employee turnover." What is this employer's turnover rate now? How would you suggest it improve its turnover rate?

10-10. Appendices A and B at the end of this book (pages 614–634) list the knowledge someone studying for the HRCI (Appendix A) or SHRM (Appendix B) certification exam needs to have in each area of human resource management (such as in Strategic Management and Workforce Planning). In groups of several students, do four things: (1) review Appendix A and/or B; (2) identify the material in this chapter that relates to the Appendix A and/or B required knowledge lists; (3) write four multiple-choice exam questions on this material that you believe would be suitable for inclusion in the HRCI exam and/or the SHRM exam; and (4) if time permits, have someone from your team post your team's questions in front of the class, so that students in all teams can answer the exam questions created by the other teams.

10-11. Several years ago, a survey of college graduates in the United Kingdom found that although many hadn't found their first jobs, most were already planning "career breaks" and to keep up their hobbies and interests outside work. As one report of the findings put it, "the next generation of workers is determined not to wind up on the hamster wheel of long hours with no play."[135] Part of the problem seems to be that many already see their friends "putting in more than 48 hours a week" at work. Career experts reviewing the results concluded that many of these recent college grads "are not looking for high-pay, high-profile jobs anymore."[136] Instead, they seem to be looking to "compartmentalize" their lives. They want to keep the number of hours they spend at work down, so they can maintain their hobbies and outside interests. If you were mentoring one of these people at work, what three bits of career advice would you give him or her? Why? What (if anything) would you suggest their employers do to accommodate these graduates' stated career wishes?

10-12. Websites such as Sporting News occasionally run a story listing what they call the greatest coaches (for example, key "greatest coaches" into Google search).[137] Look at this list, and pick out two of the names. Then research these people online to determine what behaviors they exhibited that seem to account for why they were great coaches. How do these behaviors compare with what this chapter had to say about effective coaching?

Experiential Exercise

Where Am I Going . . . and Why?

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Purpose: The purpose of this exercise is to provide you with experience in analyzing your career preferences.

Required Understanding: Students should be thoroughly familiar with the "Employee's Role in Career Management" section in this chapter, as well as using O*NET (which we discussed in Chapter 4).

How to Set Up the Exercise/Instructions: Using O*NET and the "Employee's Role in Career Management" section in this chapter, analyze your career-related inclinations (you can also take the Self-Directed Search for about $10 at www.self-directed-search.com). Based on this analysis, answer the following questions (if you wish, you may do this analysis in teams of three or four students).

10-13. What does your research suggest to you about what would be your preferable occupational options?

10-14. What are the prospects for these occupations?

10-15. Given these prospects and your own occupational inclinations, outline a brief, one-page career plan for yourself, including current occupational inclinations, career goals, and an action plan listing four or five development steps you will need to take in order to get from where you are now career-wise to where you want to be, based on your career goals.

Application Case

Uber Technologies Inc.

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The year 2017 was a tough one for Uber Technologies Inc.[138] An Uber engineer posted a blog called "Reflecting on One Very, Very Strange Year in Uber," in which she detailed, among other things, a culture of harassment at Uber. Almost at once, Uber values that symbolized its "win at any cost" way of doing things (values like "builders build, always be hustlin'," and "meritocracy and toe stepping") were called into question. So in 2017, not only was Uber's core employee turnover too high, but six top executives stepped down, including the president, finance head, senior vice president of engineering, and CEO Travis Kalanick.

Uber's Board of Directors retained former attorney general Eric Holder, Jr. to conduct an analysis of Uber's culture. Holder's recommendations provide insight into the problems Uber needed to address. The lawyers recommended, for instance, that Uber: prohibit romantic relationships among employees where one person reports to the other; institute guidelines on using alcohol and controlled substances at work; adopt a zero tolerance policy with respect to harassment, discrimination, and retaliation; broaden its recruitment practices to include sources of minority job candidates; and that the Board of Directors create a special ethics and culture committee.

Questions

10-16. Without doing any more research beyond what you learned in this chapter, what steps would you suggest Uber take to improve employee retention?

10-17. Was there any information in previous chapters of this book that would help to illustrate other steps Uber could take to improve retention?

10-18. Use other Internet sources, including Uber.com, to finalize an answer to the question: What other steps should Uber take to improve employee retention?

Continuing Case

Carter Cleaning Company

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The Career Planning Program

Career planning has always been a pretty low-priority item for Carter Cleaning, since "just getting workers to come to work and then keeping them honest is enough of a problem," as Jack likes to say. Yet Jennifer thought it might not be a bad idea to give some thought to what a career planning program might involve for Carter. Many of their employees had been with them for years in dead-end jobs, and she frankly felt a little bad for them: "Perhaps we could help them gain a better perspective on what they want to do," she thought. And she definitely believed that career support would have an effect on improving Carter's employee retention.

Questions

10-19. What would be the advantages to Carter Cleaning of setting up a career planning program?

10-20. Who should participate in the program? All employees? Selected employees?

10-21. Outline and describe the career development program you would propose for the cleaners, pressers, counter people, and managers at the Carter Cleaning Centers.

Translating Strategy into HR Policies and Practices Case*,§

**The accompanying strategy map for this chapter is in MyLab Management; overall map on the inside back cover of this text outlines the relationships involved.*

Improving Performance at the Hotel Paris

The New Career Management System

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.

Lisa Cruz knew that, as a hospitality business, the Hotel Paris was uniquely dependent upon having engaged, high-morale employees. In a factory or small retail shop, the employer might be able to rely on direct supervision to make sure that the employees were doing their jobs. But in a hotel, just about every employee is "on the front line." There is usually no one there to supervise the limousine driver when he or she picks up a guest at the airport, or when the valet takes the guest's car, or the front-desk clerk signs the guest in, or the housekeeping clerk needs to handle a guest's special request. If the hotel wanted satisfied guests, they had to have engaged employees who did their jobs as if they owned the company, even when the supervisor was nowhere in sight. But for the employees to be engaged, Lisa knew, the Hotel Paris had to make it clear that the company was also committed to its employees.

From her experience, she knew that one way to do this was to help her employees have successful and satisfying careers, and she was therefore concerned to find that the Hotel Paris had no career management process at all. Supervisors weren't trained to discuss employees' developmental needs or promotional options during the performance appraisal interviews. Promotional processes were informal. And the firm made no attempt to provide any career development services that might help its employees to develop a better understanding of what their career options were, or should be. Lisa was sure that engaged employees were key to improving the experiences of the hotel's guests, and that she couldn't boost employee engagement without doing a better job of attending to her employees' career needs. In two hotels she began encouraging supervisors to at least engage in career-oriented appraisals with their subordinates, on a pilot project basis.

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For Lisa and the CFO, their preliminary research left little doubt about the advisability of instituting a new career management system at the Hotel Paris. Based on their pilot project, employees in those Hotel Paris hotels who had been working under the new career management directive were more engaged, received more complimentary letters from guests, and received higher performance appraisal ratings than did employees who did not have career plans. The CFO therefore gave the go-ahead to design and institute a new Hotel Paris career management program.

Lisa and her team knew that they already had most of the building blocks in place, thanks to the new performance management system they had instituted just a few weeks earlier. For example, the new performance management system already required that the supervisor appraise the employee based on goals and competencies that were driven by the company's strategic needs; and the appraisal itself produced new goals for the coming year and specific development plans for the employee. These development plans had to make sense in terms of both the company's and the employee's needs and preferences.

In addition to the new performance management elements already in place, Lisa and her team created an online "Hotel Paris Career Center." With links to a choice of career assessment tools such as the Self-Directed Search (www.self-directed-search.com) and wizard-based templates for developing one's own career plan, the site went far toward providing the Hotel Paris's employees with the career assistance that they required. Also on the site, a new "International Job Openings" link made it easier for Hotel Paris employees to identify positions for which they might be qualified. The results exceeded Lisa and the CFO's expectations. Virtually every employee produced a career plan within the first 6 months. The appraisal interviews often turned into animated, career-oriented development sessions, and soon the various measures of employee commitment and guest service were trending up.

Questions

10-22. "Many hotel jobs are inherently 'dead end'; for example, maids, laundry workers, and valets either have no great aspirations to move up, or are just using these jobs temporarily, for instance, to help out with household expenses." First, do you agree with this statement? Why, or why not? Second, list three more specific career activities you would recommend Lisa implement for these employees.

10-23. Using what you learned in this chapter of Dessler *Human Resource Management*, build on the company's new system by recommending two more specific career development activities the hotel should implement.

10-24. What other specific career development activities would you recommend in light of the fact that the Hotel Paris's hotels and employees are dispersed around the world?

MyLab Management

Go to **www.pearson.com/mylab/management** for Auto-graded writing questions as well as the following Assisted-graded writing questions:

10-25. You manage a small restaurant in Columbus, Ohio and keeping good employees is one of your biggest challenges. Most waitstaff and kitchen staff last no more than 8–9 months. Explain what you would do to improve employee retention.

10-26. Explain what you as a supervisor can do to support your employees' career management needs.

10-27. MyLab Management only—comprehensive writing assignment for this chapter.

MyLab Management Try It!

How would you apply the concepts and skills you learned in this chapter? If your professor has assigned this activity, go to the Assignments section of **www.pearson.com/mylab/management** to complete the simulation.

PERSONAL INVENTORY ASSESSMENTS

P I A PERSONAL INVENTORY ASSESSMENT

Communicating plays a big role in coaching and mentoring and is important when dismissing an employee as well. Go to **www.pearson.com/mylab/management** to complete the Personal Inventory Assessment related to this chapter.

Key Terms

career, 313
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Appendix for Chapter 10

Managing Your Career and Finding a Job

The individual must be responsible for creating and managing his or her own career. And, in today's job marketplace, knowing how to find and get a job is crucial.

Making Career Choices

Many people don't put much thought into their careers. Some choose majors based on class scheduling preferences, favorite professors, or unstated psychological motives. Others stumble into jobs because "that's all that was available." If there was ever anything that demanded fact-based decisions, it is choosing your career.

The first and essential step is to learn as much as possible about your interests, aptitudes, and skills. The most direct way to do this is through experience, preferably a roster of jobs, internships, and experiences that will help you crystallize what it is you like to do and are great at. Getting experience doesn't just help career planning: In one study, the researchers sent out 9,400 fictitious resumes for "applicants" that differed in things like grade point average, major, and university. On-the-job experience—for instance, via internships—seemed to be the single most important factor in getting a job interview.[139] Beyond that, there are career tests and exercises you can use.

IDENTIFY YOUR OCCUPATIONAL ORIENTATION Career-counseling expert John Holland says that personality (including values, motives, and needs) is one career choice determinant. For example, a person with a strong social orientation on Holland's Self-Directed Search (SDS) might be attracted to careers that entail interpersonal rather than intellectual or physical activities and to occupations such as social work. Based on research with his earlier Vocational Preference Test (VPT), Holland found six basic personality types or orientations (see www.self-directed-search.com).[140]

1. ***Realistic orientation.*** These people are attracted to occupations that involve physical activities requiring skill, strength, and coordination. Examples include forestry, farming, and agriculture.
2. ***Investigative orientation.*** Investigative people are attracted to careers that involve cognitive activities (thinking, organizing, understanding) rather than affective activities (feeling, acting, or interpersonal and emotional tasks). Examples include biologist, chemist, and college professor.
3. ***Artistic orientation.*** People here are attracted to careers that involve self-expression, artistic creation, expression of emotions, and individualistic activities. Examples include artists, advertising executives, and musicians.
4. ***Social orientation.*** These people are attracted to careers that involve interpersonal rather than intellectual or physical activities. Examples include clinical psychology, foreign service, and social work.
5. ***Enterprising orientation.*** Verbal activities aimed at influencing others characterize enterprising personalities. Examples include managers, lawyers, and public relations executives.

6. ***Conventional orientation.*** A conventional orientation favors careers that involve structured, rule-regulated activities, as well as careers in which it is expected that the employee subordinate his or her personal needs to those of the organization. Examples include accountants and bankers.

Most people have more than one "RIASEC" occupational orientation (they might be social, realistic, and investigative, for example), and Holland believed that the more similar or compatible these orientations are, the less internal conflict or indecision a person will face in making a career choice. You can take Holland's SDS online for a small fee (see www.self-directed-search.com). Of course, as someone gains experience, it is possible (or likely) that his or her RIASEC scores will change over time.[141]

IDENTIFY YOUR SKILLS You may have a "conventional" orientation, but whether you have *the skills* to be an accountant, banker, or credit manager will affect which occupation you ultimately choose. Therefore, you have to identify your skills. We presented some exercises for this earlier in this chapter, on page 314.

APTITUDES AND SPECIAL TALENTS For career planning purposes, a person's aptitudes are usually measured with a test battery such as the general aptitude test battery (GATB), which most state one-stop career centers make available. This instrument measures various aptitudes including intelligence and mathematical ability. You can also use specialized tests, such as for mechanical comprehension. Holland's Self-Directed Search will also provide some insights into your aptitudes, as will O*NET.[142]

O*NET O*NET offers a free online "My Next Move" career assessment system (https://www.onetonline.org/help/onet/mynextmove).[143] It includes *O*NET Interest Profiler*, a tool that offers customized career suggestions on over 900 different careers based on a person's interests and level of education and work experience. Users obtain important information including skills, tasks, salaries, and employment outlook for occupations.[144]

IDENTIFY YOUR CAREER ANCHORS Professor Edgar Schein says that career planning is a continuing process of discovery—one in which a person slowly develops a clearer occupational self-concept in terms of what his or her talents, abilities, motives, needs, attitudes, and values are. Schein also says that as you learn more about yourself, it becomes apparent that you have a dominant *career anchor*, a concern or value that you will not give up if a [career] choice has to be made.

Career anchors, as their name implies, are the pivots around which a person's career swings; a person becomes conscious of them because of learning, through experience, about his or her talents and abilities, motives and needs, and attitudes and values. Based on his research at the Massachusetts Institute of Technology, Schein believes that career anchors are difficult to predict because they are evolutionary and a product of

As noted in the accompanying text, O*NET offers a free comprehensive online "My Next Move" occupation and career assessment system for building your future career (https://www.onetonline.org/help/onet/mynextmove).

Source: https://www.onetonline.org/help/onet/mynextmove, accessed August 6, 2018.

a process of discovery. Some people may never find out what their career anchors are until they have to make a major choice—such as whether to take the promotion to the headquarters staff or strike out on their own by starting a business. It is at this point that all the person's past work experiences, interests, aptitudes, and orientations converge into a meaningful pattern that helps show what (career anchor) is the most important factor in driving the person's career choices. Based on his study of MIT graduates, Schein identified five career anchors.[145]

TECHNICAL/FUNCTIONAL COMPETENCE People who had a strong technical/functional career anchor tended to avoid decisions that would drive them toward general management. Instead, they made decisions that would enable them to remain and grow in their chosen technical or functional fields.

MANAGERIAL COMPETENCE Other people showed a strong motivation to become managers, and their career experience enabled them to believe they had the skills and values required. A management position of high responsibility is their ultimate goal. When pressed to explain why they believed they had the skills necessary to gain such positions, many in Schein's research sample answered that they were qualified because of what they saw as their competencies in a combination of three areas: (1) *analytical competence* (ability to identify, analyze, and solve problems under conditions of incomplete information and uncertainty); (2) *interpersonal competence* (ability to influence, supervise, lead, manipulate, and control people at all levels); and (3) *emotional competence* (the capacity to be stimulated by emotional and interpersonal crises rather than exhausted or debilitated by them, and the capacity to bear high levels of responsibility without becoming paralyzed).

CREATIVITY Some of the graduates had become successful entrepreneurs. To Schein these people seemed to have a need "to build or create something that was entirely their own product—a product or process that bears their name, a company of their own, or a personal fortune that reflects their accomplishments." For example, one graduate had become a successful purchaser, restorer, and renter of townhouses in a large city; another had built a successful consulting firm.

AUTONOMY AND INDEPENDENCE Some seemed driven by the need to be on their own, free of the dependence that can arise when a person elects to work in a large organization where promotions, transfers, and salary decisions make them subordinate to others. Many of these graduates also had a strong technical/functional orientation. Instead of pursuing this orientation in an organization, they had decided to become consultants, working either alone or as part of a relatively small firm. Others had become professors of business, freelance writers, and proprietors of a small retail business.

SECURITY A few of the graduates were mostly concerned with long-run career stability and job security. They seemed willing to do what was required to maintain job security, a decent income, and a stable future in the form of a good retirement program and benefits. For those interested in *geographic security*, maintaining a stable, secure career in familiar surroundings was generally more important than pursuing superior career choices, if choosing the latter meant injecting instability or insecurity into their lives by forcing them to pull up roots and move to another city. For others, security meant *organizational security*. They might today opt for government jobs, where tenure still tends to be a way of life. They were much more willing to let their employers decide what their careers should be.

ASSESSING CAREER ANCHORS To help you identify career anchors, take a few sheets of blank paper and write out your answers to the following questions:[146]

1. What was your major area of concentration (if any) in high school? Why did you choose that area? How did you feel about it?
2. What is (or was) your major area of concentration in college? Why did you choose that area? How did you feel about it?
3. What was your first job after school? (Include military if relevant.) What were you looking for in your first job?
4. What were your ambitions or long-range goals when you started your career? Have they changed? When? Why?
5. What was your first major change of job or company? What were you looking for in your next job?
6. What was your next major change of job, company, or career? Why did you initiate or accept it? What were you looking for? (Do this for each of your major changes of job, company, or career.)
7. As you look back over your career, identify some times you have especially enjoyed. What was it about those times that you enjoyed?
8. As you look back, identify some times you have not especially enjoyed. What was it about those times you did not enjoy?
9. Have you ever refused a job move or promotion? Why?
10. Now review all your answers carefully, as well as the descriptions for the five career anchors (technical/functional competence, managerial competence, creativity and independence, autonomy, security). Based on your answers to the questions, rate, for yourself, each of the anchors from 1 to 5. 1 equals low importance, 5 equals high importance.

    Technical/functional competence ______________
    Managerial competence ______________
    Creativity and independence ______________
    Autonomy ______________
    Security ______________

What Do You Want to Do?

IDENTIFY HIGH-POTENTIAL OCCUPATIONS Learning about your skills and interests is only step one in choosing an occupation. You also have to identify those occupations that fit your occupational orientations, skills, career anchors, and occupational preferences, and that are (preferably) in high demand in the years to come.

Here, use the Internet. The U.S. Department of Labor's online *Occupational Outlook Handbook* (https://www.bls.gov/ooh/) is updated each year, and provides detailed descriptions and information on hundreds of occupations.[147] O*NET (https://www.onetonline.org/) provides occupational demand projections. Another site here is https://www.ncda.org/aws/NCDA/pt/sp/resources.

Finding the Right Job

Your next step is to find a job that you want in the company and locale where you want to work.

Before leaving a current job, make sure leaving is what you want. Many people, dissatisfied at work, assume it must be the job or the occupation. But why switch from being a lawyer to a teacher, when it's not the profession but your law firm's 80-hour weeks that are the problem?

One must use a process of elimination. For example, you may like your occupation and employer, but not how your specific job is structured. Others may find their employers' ways of doing things are the problem. Or, it may in fact be the occupation.

In any case, the solution should fit the cause. For example, if, after thinking it through, you are satisfied with your occupation and where you work, but not with your job as it's organized now, try reconfiguring it. For example, seek to delegate or eliminate job functions you least prefer; volunteer for new duties; seek out a challenging "stretch assignment"; even "decluttering" your office may help.[148] If it's the specific employer, look elsewhere.

If you're involuntarily out of work for more than a few years, perhaps take extra care. One study followed a group of workers, some of whom became and stayed unemployed. These unemployed workers' personalities changed. In before-and-after testing, the long-term unemployed showed reduced levels of agreeableness, conscientiousness, and openness. Don't hesitate to get some supportive counselling if need be.[149]

JOB SEARCH TECHNIQUES Many people send out hundreds of resumes and get few replies. As we saw in Chapters 4 (Recruiting) and 5 (Selection) modern digital tools attract huge numbers of applicants and use software to screen out almost all of them.

As a result, most people seek jobs in a manner that's almost exactly opposite to the approach most experts deem best. For example, in surveys of human resource professionals, about 70% say the best way to get a job is through referrals, but less than 10% of job seekers see referrals as their best option. Instead they rely on job boards, which HR professionals rank much lower. Use sites such as LinkedIn and Facebook to help build your network, and to publicize your availability to potential job referrers.[150]

PERSONAL CONTACTS *The best way to get job leads is usually through personal contacts (networking)*, such as friends, former colleagues, and relatives.[151] Let as many responsible people as possible know that you're looking for a job and the kind of job you want. (Beware, though, if you don't want your job search getting back to your current boss. If that's the case, then just choose two or three close friends and ask them to be discreet checking around for you.)

No matter how close your friends are to you, by the way, you do not want to impose on them—they're not an employment agency, remember. It's usually best to just ask them for the name of someone they think you should talk to. Then you do the heavy lifting.

SOCIAL MEDIA In one survey, about 90% of HR professionals surveyed said it was "very important" or "somewhat important" for job seekers to be on LinkedIn, about 83% said the same for being on the job hunter's professional or association site, and about 60% cited Facebook.[152]

Employers scour social media for recruits, so job seekers should make sure their names stand out. For example, create a Twitter presence. Those "Liking" a company on Facebook may receive early notice of job openings. Spend a few minutes each day on LinkedIn making new connections, and share links and advice with your LinkedIn network.[153] Join LinkedIn industry groups to build visibility. Make sure your résumé is in PDF format and readable on a phone screen. To bring yourself to recruiters' attention, follow up on comments they make on their blogs or on industry websites. *Social résumés* provide snapshots of who the job searcher is by combining text material, photos, and samples of a person's work in infographic résumés posted on social media such as Twitter, LinkedIn, and blogs.[154]

Finally, remember that prospective employers may Google you before extending the offer, and ask for access to your Facebook and LinkedIn pages. Be careful what's on them.

ONLINE JOB BOARDS AND EMPLOYER WEBSITES Most large job search sites such as Monster.com have local-area search capabilities. Useful open-job aggregator sites include Indeed.com and SimplyHired.com. Idealist.com is good for nonprofit jobs, and there's USAJobs for federal jobs.[155] Use *The Wall Street Journal's* career Web site (www.careerjournal.com) for career advice and insights. Most big-city newspapers also have their own (or links to) online local job listings. In addition to job boards like Monster and specialized ones (like https://www.efinancialcareers.com/), virtually all large companies, industries, and crafts have their own specialized sites. For example, the American Marketing Association (https://jobs.ama.org/) and Financial Executives International (www.fei.org) have active job sites.

ANSWERING ADVERTISEMENTS Answering ads is a low-probability way to get a job, and this is particularly so as the level of jobs increases. Furthermore, applicant tracking services crunch through thousands of résumés in seconds, making it even harder to stand out by answering ads. Nevertheless, good sources of classified ads for professionals and managers include *The New York Times*, *The Wall Street Journal*, and specialized journals in your field that list job openings. All these sources also post the positions online, of course.

For application letters or résumés, be sure to create the right impression with the materials you submit; check the style, grammar, and neatness, and adapt your résumé to the job for which you are applying. In your cover letter or email, specifically address why your background and accomplishments fit the advertised position.

Be careful in replying to blind ads. Some recruiters and employers run ads even when no position exists just to gauge the market, and there is also some risk of blundering into responding to your own firm.

EMPLOYMENT AGENCIES Agencies are especially good at placing people in jobs paying up to about $80,000, but they can be useful for higher-paying jobs as well. The employer usually pays the fees for professional and management jobs. Assuming you know the job you want, review a few back issues of your paper's Sunday classified ads and sites like LinkedIn to identify agencies that handle the positions you want. Approach three or four initially, preferably in response to specific ads, and avoid signing any contract that gives an agency the exclusive right to place you.

States' one-stop career centers can be helpful. In them, job seekers can not only apply for unemployment benefits, but also register with the state job service, talk to career counselors, use computers to write résumés and access the Internet, take tests, and use career libraries offering books and videos on various employment topics. In some centers job hunters can make use of free computers and photocopiers to facilitate job searches.

EXECUTIVE RECRUITERS Employers retain executive recruiters to seek out top talent for their clients; employers always pay any fees. Recruiters do not do career counseling, but if you know the job you want, it pays to contact a few (but they usually use contacts, and LinkedIn to find passive candidates). Send/email your résumé and a cover note summarizing your objective in precise terms, including job title and the size of company desired, work-related accomplishments, current salary, and salary requirements. (Beware, because some firms call themselves executive search or career consultants but do no searches: In return for an (often hefty) fee they help you manage your search. Remember that with a search firm you never pay a fee.)

CAREER COUNSELORS Career counselors will not help you find a job per se; rather, they specialize in aptitude testing, career counseling, and resume preparation. Search under "Career Counseling" or "Vocational Guidance." Their services usually cost $500 or so and may include some psychological testing and interviews with an experienced career counselor. Check the firm's services, prices, and history as well as the credentials of the person you will be dealing with.

EXECUTIVE SEARCH CONSULTANTS Executive marketing consultants manage your job-hunting campaign. They generally are not recruiters and do not have jobs to fill. Depending on the services you choose, your cost will range from $600 to $5,000 or more. The process may involve months of weekly meetings. Services include résumé and letter writing, interview skill building, and developing a full job-hunting campaign. Before approaching a consultant, it's advisable to do your own self-appraisal (as explained in this appendix) and read books like Richard Bolles's *What Color Is Your Parachute?*

Also do your due diligence, and remember these consultants are *not* recruiters and will not get you a job—you must do the legwork. Then check the Better Business Bureau, and decide which of these firms (if any) is for you.

WRITING YOUR RÉSUMÉ Your résumé usually still plays a big role in determining whether you get the interview. Of course, don't produce a slipshod résumé: Avoid overcrowded pages, hard-to-read copies, typographical errors, and other problems of this sort. And do not use a make-do résumé. Produce a new résumé for each job you are applying for, gearing your job objective and accomplishments to the job you want. Here are some résumé pointers, as offered by employment counselor Richard Payne and other experts.[156]

Start your résumé with your name, home and e-mail and website (if any) addresses, and home or cell phone number. Next, state your *job objective*. Gear this to the job you're applying for. It should summarize in one sentence the specific position you want, where you want to do it (type and size of company), and a special reason an employer might have for wanting you to fill the job.

For example, "Marketing manager in a medium-size e-commerce company in a situation in which strong creative skills would be valuable."

For each of your previous jobs, write a paragraph that shows job title, whom (job title) you reported to, who reported to you, how many people reported to you, the operational and human resource budgets you controlled, and what your job entailed (in one sentence).

Your accomplishments should be the heart of your résumé. These show for each of your previous jobs: (1) a concrete action you took and why you took it and (2) the specific result of your action—the "payoff." For example, "As production supervisor, I introduced a new process to replace costly hand soldering of component parts. The new process reduced assembly time per unit from 30 to 10 minutes and reduced labor costs by over 60%." Use several of these statements for each job.

Keep your résumé to two pages or less, and list education, military service (if any), and personal background (hobbies, interests, associations) on the last page. For most job applications today, it's important that the résumé is electronically readable. Applicant tracking systems scan through résumés, screening out those that don't seem to match (often based on the absence of certain key words). Therefore, present your qualifications using powerful key words appropriate to the job or jobs for which you are applying. For example, a trainer might use key words and phrases such as: *computer-based training, interactive video*, and *group facilitator*.

If you post your résumé online, experts suggest taking precautions. At a minimum, date your résumé (in case it lands on your boss's desk 2 years from now). Also insert a disclaimer forbidding unauthorized transmission by headhunters; consider posting a "confidential" resume on a job board listing your capabilities but not your name or employer—you can be reached via the job board. Scammers will use someone's online resume to pretend to be an employer, and then request bank account information "to facilitate salary direct deposits".[157]

ONLINE BIOS Employers often encourage or require their professionals and managers to post brief biographies on corporate intranets or websites. These bios let other employees know about their colleagues' expertise; they can also attract recruiters' inquiries. Tips for writing such bios include:[158]

Fill it with details. "The more information you enter, the more likely a person seeking someone with your background will find you."

Avoid touchy subjects. For example, avoid religion and politics.

Look the part. Your profile may require posting photos. If so, dress in professional attire.

Make it search friendly. Make sure your profile contains the key words you think someone searching for someone with your background and expertise would be looking for, such as *manager, supervisor*, or *engineer*.

Use abbreviations. Abbreviations are important. For example, someone searching the site might more readily punch in "MBA" than "Masters in Business Administration."

Say it with numbers. Describe specifically how your work has contributed to your current employer's and past employer's bottom lines.

Proofread. Carefully proofread your online profile, as you would your résumé.

Handling the Interview

You have done all your homework, and now you have a job interview scheduled. What must you do to excel in the interview? First review our "Interview Guide for Interviewees" on page 234. Then, here are other suggestions.

PREPARE Before the interview, learn about the employer, the job, and the people doing the recruiting. Search the Internet to find out what's happening in the industry. Know that you may have a "job tryout," in which you'll have to show how well you can do aspects of the job.[159] Many locales prohibit employers from asking applicants about their salary histories, but realistically be prepared to answer when the interviewer asks for your salary requirements.

FIRST IMPRESSIONS Interviewers usually jump to conclusions about candidates during the first few seconds of the interview. Therefore, you really do have just one chance to make a good first impression. Appropriate clothing, good grooming and posture, eye contact, a firm handshake, and energy are important.

UNCOVER THE INTERVIEWER'S NEEDS Spend as little time as possible answering your interviewer's first questions and as much time as possible getting the person to describe his or her needs—what the person is looking to get accomplished and the type of person needed. Use open-ended questions, such as "Could you tell me more about that?"

RELATE YOURSELF TO THE PERSON'S NEEDS Once you understand the person your interviewer is looking for and the sorts of problems he or she needs solved, you are in a good position to describe your own accomplishments in terms of the interviewer's needs.[160] Start by saying something like, "One of the problem areas you've indicated is important to you is similar to a problem I once faced." Then state the problem, describe your solution, and reveal the results.

MAKE A GOOD APPEARANCE AND SHOW ENTHUSIASM Appearance, a firm handshake, and visual cues such as looking the interviewer in the eyes are crucial. Remember that studies of interviews show that in almost 80% of the cases, interviewers make up their minds about the applicant during the first few moments of the interview. A good first impression may turn bad during the interview, but it is unlikely. Bad first impressions, however, are almost impossible to overcome.

NONVERBAL BEHAVIOR AND IMPRESSION MANAGEMENT Remember (Chapter 7) that your *non*verbal behavior will have a big impact on your interview rating. In one study, 23 of the 26 human resources specialists who saw the high-eye-contact, high-energy-level candidate would have invited him or her for a second interview. *None* who saw the low-eye-contact, low-energy-level candidate would have done so.

Similarly, **self-promotion** (**promoting one's own skills and competence**) is strongly related to the interviewer's perceptions of candidate–job fit. Some interviewees use "ingratiation" to persuade interviewers to like them: For instance, they praised the interviewers or agreed with their opinions, thus signaling they shared similar beliefs.

Some candidates check with recruiters to determine their status, which can be a turnoff. Something more subtle, like sending a link to an article touching on something you discussed with the recruiter, is usually better.[161]

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11 Establishing Strategic Pay Plans

LEARNING OBJECTIVES

When you finish studying this chapter, you should be able to:

11-1 **List** the basic factors determining pay rates.

11-2 **Define and give** an example of how to conduct a job evaluation.

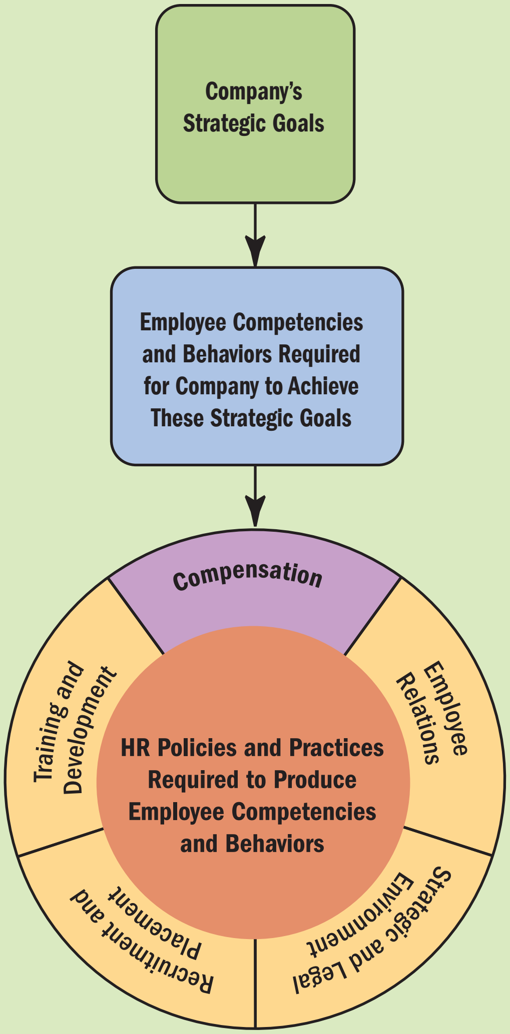
11-3 **Explain** in detail how to establish a market-competitive pay plan.

11-4 **Explain** how to price managerial and professional jobs.

11-5 **Explain** the difference between competency-based and traditional pay plans.

11-6 **Describe** the importance of total rewards for improving employee engagement.

In the grocery business, when Walmart opens a store, the nearby stores' usual reaction is to cut costs, particularly wages and benefits. So as Wegmans 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 strategy?[1] We'll see how Wegmans boosted profits by raising pay.



WHERE ARE WE NOW . . .

Once you've appraised and coached your employees, they of course expect to be paid. Prudent employers don't set pay rates 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. The main topics we cover are **Basic Factors in Determining Pay Rates**, **Job Evaluation Methods**, **How to Create a Market-Competitive Pay Plan**, **Pricing Managerial and Professional Jobs**, **Contemporary Topics in Compensation**, and **Total Rewards for Employee Engagement**. The next chapter focuses specifically on pay-for-performance and incentive plans.

LEARNING OBJECTIVE 11-1

List the basic factors determining pay rates.

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.

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, employers can make direct financial payments to employees based on increments of time or based on performance. Time-based pay still predominates. 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 tie pay to sales. Many employers' pay plans combine time-based pay and 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 should influence any pay plan's design. These include strategic policy considerations, as well as equity, legal, and union considerations.

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 that produces the employee behaviors the firm needs to achieve its competitive strategy.[2] Put another way, there should be a clear "line of sight" between each reward and specific business goals.

We will see that many employers formulate a total rewards strategy to support their strategic aims. *Total rewards* encompass traditional pay, incentives, and benefits, but also "rewards" such as more challenging jobs (job design), career development, and recognition.

Table 11-1 lists illustrative questions to ask when crafting a strategy-oriented pay policy.

HR in Action at the Hotel Paris Even a casual review by Lisa Cruz and the CFO made it clear that the Hotel Paris's compensation plan wasn't designed to support the firm's new strategic goals. To see how they handled this, see the case on page 384 of this chapter.

Equity and Its Impact on Pay Rates

In studies at Emory University, researchers investigated how capuchin monkeys reacted to inequitable pay. Some monkeys got sweet grapes in return for trading pebbles; others got cucumber slices. If a monkey receiving a cucumber slice saw a neighbor get grapes, it slammed down the pebble or refused to eat.[3] It seems even lower primates may demand fair treatment in pay.

Among humans, too, *the equity theory of motivation* postulates that people are 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 that motivates him or her to reduce the tension and perceived inequity. Research tends to support equity theory, particularly as it applies to those underpaid.[4] For example, in one study turnover of retail buyers was significantly lower when the buyers perceived fair treatment in rewards and in how employers allocated

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?

rewards.[5] Overpaying can sometimes backfire, too, perhaps "due to feelings of guilt or discomfort."[6]

In compensation, one can address *external, internal, individual*, and *procedural* equity.[7]

- ***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 earns?).
- ***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 person's performance.
- ***Procedural equity*** refers to the "perceived fairness of the processes and procedures used to make decisions regarding the allocation of pay."[8]

Managers address equity issues in various ways. 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 attitude surveys to monitor employees' pay satisfaction. Questions typically include, "How satisfied are you with your pay?" and "What factors do you believe we used to determine your pay?"[9]

"Open pay" policies—listing what everyone earns—may help reduce inequities (such as the gender pay gap), but can obviously cause other disagreements.[10] Some firms therefore maintain pay rate secrecy.[11] The research concerning pay secrecy is inconclusive, and most employers don't have open pay policies.[12] However, the federal government mandated pay transparency for all businesses having contracts with it.[13] And of course for external equity, online pay sites like Salary.com preclude secrecy. Short of "open pay," some experts advise at least explaining how the company computes compensation.[14]

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

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

KNOWLEDGE BASE

Legal Considerations in Compensation

Employers do not have free rein in designing pay plans. Various laws specify things like minimum wages, overtime rates, and benefits.[15] For example, 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.[16] We'll look next at other important compensation-related laws.

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 1938 act provides for minimum wages, maximum hours, overtime pay, and child labor protection. The law, amended many times, covers most employees.

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.[17] It covers virtually all U.S. workers 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).[18]

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.[19] 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 $72 ($18 times 4) for the extra 4 hours. If the employee instead receives time off for the overtime hours, the employer must compute the number of hours granted off at the one-and-a-half-times rate (6 hours off for the 4 hours of overtime in our case), in lieu of overtime pay. The FLSA mandates special damages against employers who pressure workers to work extra hours unpaid.[20]

KNOW YOUR EMPLOYMENT LAW

The Workday

Employers should be vigilant for employees who arrive early or leave late, lest the extra time spent on the property obligate it to compensate the employee for that time. For example, a diligent employee may get dropped off at work early and spend, say, 20 minutes before his or her day actually starts doing work-related chores, like compiling a list of clients to call that day. Tyson Foods recently paid over $12 million to resolve suits by workers who said they should have been paid for time spent putting on and removing their protective work gear.[21] While there is no hard and fast rule, some courts follow the rule that employees who arrive 15 or more minutes early are presumed to be working unless the employer can prove otherwise.[22] If using time clocks, employers should instruct employees not to clock in more than 5–10 minutes early (or out 5–10 minutes late).

Smart phones give employers further reason to meticulously record workers' hours. A Department of Labor app lets employees track their work hours.[23] The Chicago Police Department distributed smart phones to its officers. One officer subsequently sued, claiming he wasn't paid overtime for the hours he spent using his smart phone off the clock. Vendors such as Pacific Timesheet (www.pacifictimesheet.com) provide mobile payroll time sheets.[24] Outside the office, employees can fill these in via their iPhones or similar devices.[25] New time clocks reduce "buddy punching" with instant photos and biometric sensors.[26] ■

The FLSA also sets a *minimum wage*. This sets a floor for employees covered by the act (and usually bumps up wages for practically all workers when Congress raises the minimum). The minimum wage was $7.25 in 2018. Many states have their own minimum wage. For example, the minimum wage as of 2018 was $10.50 in California and $11.00 Massachusetts.[27] New York State is debating raising its minimum wage to $15 per hour. Various cities have set their own (higher) minimum wages.[28] Under new federal rules, workers on federal contracts earn a minimum of $10.10 per hour.[29]

FLSA *child labor provisions* prohibit employing minors between 16 and 18 years old in hazardous occupations, and carefully restrict employment of those under 16.

A great many employers today pay people as "independent contractors" rather than as employees. The Know Your Employment Law feature (page 354) explains about paying this type of worker.

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.[30] 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).[31] Figure 11-1 lists some examples of typically exempt and nonexempt jobs.

FIGURE 11-1 Some Typical Exempt, Nonexempt Job Titles

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	Lab technicians
General managers	
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).

In 2016, the Obama administration mandated new overtime rule exemptions.[32] Instead of the salary threshold of $23,660 per year (below which basically any person working was eligible for overtime pay) the new threshold was $47,476; basically *anyone* earning under $47,476 had to be paid overtime.

A federal judge blocked the new overtime rule, and for now the change is on hold. It appears that the current secretary of labor may agree that $23,660 is too low, but that jumping to more than $47,476 is excessive, so any increase may be less.[33] But to some extent the debate is moot. Many employers, including Walmart, seem to have accepted the new rule. Walmart, for instance, raised managers' salary to over the $47,476 threshold.[34]

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.[35]

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 (as of 2018) per year—are clearly nonexempt. But beyond that, one should review the job before classifying it as exempt or nonexempt. Figure 11-2 presents a procedure for making this decision. Make sure, for instance, that the job currently does in fact require, say, an exempt-type supervisory duty.[36]

FLSA exemption lawsuits are on the rise. "Supervisors" are saying they're not exempt because they don't really supervise two or more employees.[37] And the U.S. Supreme Court held that drug company sales reps that call on doctors are FLSA-exempt outside salespersons.[38]

INEQUITY AND THE MINIMUM WAGE[39] Jamie Dimon, Chairman and CEO of JP Morgan Chase & Company wrote an article for *The New York Times*; he argued that years of wage stagnation had led to income inequality, with some people earning vastly more than others. Several 2016 presidential candidates made similar arguments.[40]

Many municipalities and employers are in fact moving to raise the local minimum wage. The San José, California, City Council voted to raise the local minimum to $15.

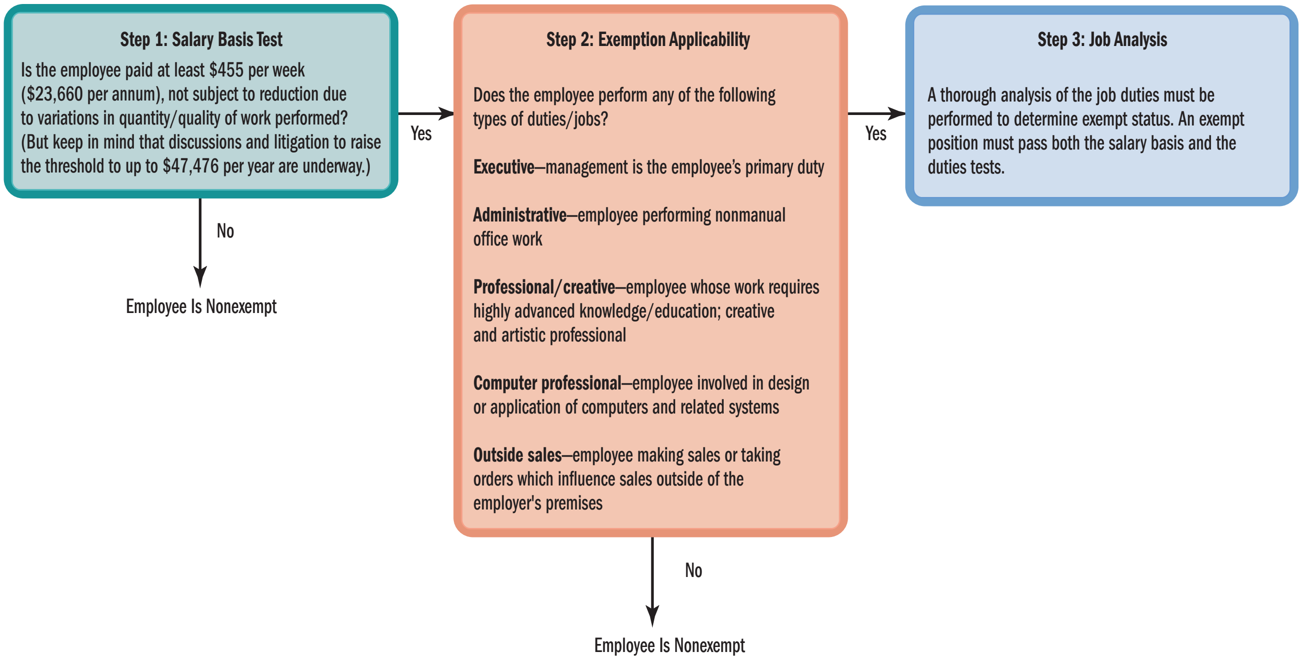


FIGURE 11-2 Who Is Exempt?; Who Is Not Exempt?

Source: Based on www.flsa.com/coverage.html, accessed August 5, 2011; https://webapps.dol.gov/elaws/whd/flsa/screen75.asp; www.dol.gov/whd/overtime/fs17a_overview.pdf, both accessed August 9, 2018.

Walmart said it would unilaterally pay all its U.S. hourly workers at least $10 per hour. McDonald's said it would raise its minimum wage to at least one dollar more than the local municipalities' minimum wage in all company-owned stores. MetLife recently set a $15 minimum wage for its employees.[41]

Some economists argue that higher minimum wages reduce the chances that traditionally low-wage workers (like younger people) will get hired. But an increasing number of employers —including Walmart—seem to agree that income inequality needs to be addressed.

KNOW YOUR EMPLOYMENT LAW

The Independent Contractor

Whether someone is an employee or an *independent contractor* is a continuing concern for employers.[42] For example, a federal court ruled that most of FedEx's roughly 15,000 owner–operator delivery people were independent contractors, not employees.[43]

Why claim that someone is an independent contractor? Because the FLSA's overtime and most other requirements do not apply, and the employer need not 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. In general, an individual is an independent contractor if the payer has the right to control or direct only the result of the work and not what will be done and how it will be done.[44] However, there is no single rule or test. Instead, courts look at the total 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 to be an employee. Figure 11-3 lists some factors courts will consider. The IRS lists rules at its Web site.[45] Uber faces lawsuits that its drivers are employees, not independent contractors.

FIGURE 11-3 Independent Contractor or Employee Checklist

Source: Adapted from information in IRS, Employer's Supplemental Tax Guide, https://www.irs.gov/pub/irspdf/p15a.pdf accessed June 6, 2017.

The main question is, how much control does the employer exert over the person at work? Facts that provide evidence of the degree of control/independence fall into three categories: behavioral control, financial control, and relationship of the parties. Affirmative answers below generally suggest "independent contractor."

Behavioral control: Does the business direct and control how the worker does the task, such as:	**Independent Contractor**	**Employee**
1. When and where to do the work.		
2. What tools or equipment to use.		
3. What workers to hire or to assist with the work.		
4. Where to purchase supplies and services.		
5. Whether the business has retained the right to control the details of a worker's performance or instead has given up that right.		
Financial control: Does the business control the business/financial aspects of the worker's job, such as:		
6. The extent to which the worker has unreimbursed business expenses.		
7. The extent of the worker's investment.		
8. The extent to which the worker makes his or her services available to other businesses in the relevant market.		
9. Whether the worker is not generally guaranteed a regular wage amount for an hourly, weekly, or other period of time.		
10. The extent to which the worker can realize a profit or loss.		
Questions regarding the parties' relationship include:		
11. Whether the business does not provide the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.		
12. Whether there's no expectation that the relationship will continue indefinitely, rather than for a specific project or period.		

To minimize the risks of independent contractor misclassification, employers should execute written agreements with all independent contractors; you'll find samples online.[46] Furthermore, employers should not impose work rules on or attempt to prohibit independent contractors from working for others. They should require independent contractors to provide their own tools and to be separately incorporated business entities.[47]

Because the Affordable Care Act covers employers with 50 or more employees, government agencies have been looking more closely at employers' independent contractors. To minimize problems, some employers are having staffing companies supply more of their workforce, thus staying below the 50-employee limit.[48] ■

HR AND THE GIG ECONOMY: *ARE GIG WORKERS EMPLOYEES OR INDEPENDENT CONTRACTORS?*

A few years ago, Uber and Lyft drivers filed suit in California, demanding to be treated as employees rather than independent contractors. The companies contend they're independent contractors who can work (or not) as much as they want, start and stop when they want, and use their own cars.

Yet the answer is not clear-cut. Although it's true that there's a lot "independent" about what the drivers do, the drivers' lawyers say that Lyft and Uber control what the drivers do at work. For example, algorithms and systems control what rides the drivers can accept or decline, the routes they take, how much they can earn, and even how they're evaluated (below an average rating of about 4.5 stars, a driver was in danger of deactivation.) The cases settled out of court. Uber agreed to pay about $100 million to drivers in certain states and to let them solicit tips; however, the settlement left the drivers as independent contractors.

Similar litigation continues.[49] Two federal appellate courts recently held that some FedEx drivers were employees, not independent contractors. In another case, an arbitrator ruled Uber drivers were independent contractors. A recent California decision may make it easier for drivers to press for employee status.[50]

Even in traditional workplaces there was some ambiguity about how to distinguish between independent contractors and employees. Today, gig workers are often free to come and go as they please and to quit any time, but at work computer algorithms tightly control their efforts. It's therefore even more difficult to distinguish between employees and independent contractors. Congress seems less inclined to curtail independent contractor use.[51] It is considering new gig economy laws but recently had not taken action.[52] Expect more lawsuits.

MyLab Management Talk About It 1

If your professor assigned this, go to the Assignments section of **www.pearson.com/mylab/management** to complete this discussion question. How would you itemize the arguments for and arguments against making Lyft and Uber drivers independent contractors?

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

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."

Employee Retirement Income Security Act (ERISA)
The 1974 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).

1974 EMPLOYEE RETIREMENT INCOME SECURITY ACT Aimed at protecting employees' pensions, the **Employee Retirement Income Security Act (ERISA)** provides for the creation of government-run, employer-financed corporations to protect employees against the failure of their employers' pension plans. It also 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.[53] The *Americans with Disabilities Act* prohibits discrimination against qualified persons with disabilities in all aspects of employment. 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 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 for retirement benefits. (We'll discuss Social Security benefits in a later chapter.) 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. To do this, employers must furnish the union with "information that is relevant and necessary" to the union performing its duties.[54] This would include giving 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 members' salaries.

Pay Policies

The employer's compensation strategy will manifest itself in *pay policies.* For example, it might be the policy of a top hospital like Johns Hopkins to pay nurses 20% above the market wage.

Four managers discuss a print layout; one happens to be in a wheelchair. Federal law prohibits discrimination against qualified persons with disabilities in all aspects of employment, including compensation.

auremar/123RF

Employers need policies on a variety of compensation-related matters. These would include, for instance, how to set base salary (below, at, or above market rates); what employees (if any) can get stock options; how to award salary increases; how to handle leaves for military service, jury duty, and holidays; and whether to emphasize seniority or performance through annual raises (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). The accompanying Wegmans Food Markets feature illustrates how pay policies impact a company's performance.

IMPROVING PERFORMANCE: *THE STRATEGIC CONTEXT*

Wegmans Food Markets

Strategic compensation management means formulating a total rewards package that produces the employee skills and behaviors that the company needs to achieve its strategic goals.

Wegmans exemplifies this. It competes in the retail food sector, where profit margins are thin and where online competitors and giants like Walmart drive costs and prices down. The usual competitor's reaction is to cut employee benefits and costs.[55] Wegmans takes a different approach. Number 2 on Fortune's 100 Best Companies to Work For,[56] Wegmans views its workforce as an integral part of achieving Wegmans's 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 and inventory control.[57] The firm offers above-market pay rates, affordable health insurance, and a full range of employee benefits.[58] Wegmans's pay policies thus aim to produce exactly the sorts of high-productivity employee behaviors the company needs to achieve its strategic aims.

It's likely that its pay policies are one reason for Wegmans's exceptional profitability. For example, its employee turnover (about 6% for full-timers) is well below the industry's overall average of about 47%.[59] 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 $49 million in sales annually, compared with a typical Walmart store's grocery sales of $23.5 million in sales.[60] As Wegmans's human resource head has said, good employees assure higher productivity, and that translates into better bottom-line results.[61]

MyLab Management Talk About It 2

If your professor has assigned this, go to the Assignments section of **www.pearson.com/mylab/management** to complete this discussion question. If Wegmans does so well with a high-pay policy, why don't more employers do this as well?

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 about $49,980 in Florida to $60,980 in New York.[62]

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 accompanying feature on compensating expatriate employees expands on this.

IMPROVING PERFORMANCE: *HR PRACTICES AROUND THE GLOBE*

Compensating Expatriate Employees

The question of cost-of-living differentials has particular significance to multinational firms, where costs range widely from, say, France to Zambia. The challenge is in maintaining the expatriate's standard of living abroad.[63]

How should multinationals compensate expatriate employees—those it sends overseas? Two basic international compensation policies are popular: *the balance sheet or home-based* plan, and the *host-based plan*.[64]

With a *home-based salary plan*, an international transferee's base salary reflects his or her home country's salary. The employer then adds allowances for cost-of-living differences—housing and schooling costs, for instance, to "make the employee whole." Among other advantages, this approach avoids having to change the employee's home-based salary.

In the *host-based plan*, the firm ties the international transferee's base salary to the host country's salary structure. In other words, the manager from New York who is sent to France would have his or her base salary changed to the prevailing base salary for that position in France, rather than keep the New York base salary. The firm often tacks on cost-of-living, housing, schooling, and other allowances here as well.

Most multinational enterprises set expatriates' salaries according to the *home-based salary plan*. (Thus, a French manager assigned to Kiev by a U.S. multinational will generally have a base salary that reflects the salary structure in the manager's home country, in this case France.) In addition, the person typically gets allowances including cost-of-living, relocation, housing, education, and hardship allowances (for more challenging countries). The employer also usually pays any extra tax burdens resulting from taxes the manager is liable for over and above those he or she would have to pay in the home country.

MyLab Management Talk About It 3

If your professor has assigned this, go to the Assignments section of **www.pearson.com/mylab/management** to complete this discussion question. Why do you think most employers opt for the home-based salary plan?

LEARNING OBJECTIVE 11-2

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

Job Evaluation Methods

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 process helps produce a pay plan in which each job's pay is equitable based on what other employers are paying for these jobs *and* based on each job's value to the employer.[65]

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

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.[66] 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. By combining the information from the job evaluation and from the salary survey, you are on your way to being able to create a **market-competitive pay plan**—one where your pay rates are equitable both internally (based on each job's relative value) and externally (in other words, when compared with what other employers are paying).

market-competitive pay plan
Pay plan where pay rates are equitable both internally (based on each job's relative value) and externally (in other words when compared with what other employers are paying).

Compensable Factors

You can use two basic approaches to compare the worth of several jobs. First, 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.

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

Some employers develop their own compensable factors. However, most use factors popularized by packaged job evaluation systems or by federal legislation. For

Ryan Lees/Agefotostock

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.

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.

Choosing compensable factors plays a big 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.[67]

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 initial 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 shouldn't 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.

Finally, *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.[68] Once appointed, each committee member should receive a manual explaining both the job evaluation process and how to conduct the job evaluation.

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.

The evaluation committee then 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

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

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 ranking 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 removes 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. However, regardless of the number of factors you choose, explain the definition of the factor(s) to the evaluators carefully so that they all evaluate the jobs consistently.
4. ***Rank jobs.*** For example, each rater gets a set of index cards, each of which contains a brief description of a job. Then they arrange these cards from lowest to highest. Some managers use an "alternation ranking method" to make this 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 such a job ranking. Jobs in this small health facility rank from orderly up to office manager. The corresponding current pay scales are shown in the column following the job titles. (After ranking, it is possible to slot additional jobs based on their difficulty between those already ranked and to assign each an appropriate wage rate.) The ranked listing of jobs enables us to compare each job's rank with its current pay, and decide if what we are currently paying is internally equitable; we may adjust a job's pay up or down, based on this. Online programs (for example, go to www.hr-guide.com, click under "Job Evaluation, Ranking," and then click "Interactive Ranking Program") can help you rank (and check the rankings of) your positions.[69]
5. ***Combine ratings.*** Usually, several raters rank the jobs independently. Then the rating committee (or the employer) can simply average the raters' rankings.
6. ***Compare current pay with what others are paying based on salary survey.*** Next, we show on the same table (in the middle column) what others in the community are paying for similar jobs, based on a salary survey that we conduct. This helps us ensure that our pay will be *externally* equitable.
7. ***Assign a new pay scale.*** Finally, we compare what we are currently paying for each job with what others are paying, and decide (in this case) to adjust our pay scale by raising what we pay for each job. The last column therefore shows our new pay scale.

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

TABLE 11-2 Job Ranking at Jackson Hospital

Ranking Order	Our Current Annual Pay Scale	What Others Pay: Salary Survey Pay	Our Final Assigned Pay
1. Office manager	$43,000	$45,000	$44,000
2. Chief nurse	42,500	43,000	42,750
3. Bookkeeper	34,000	36,000	35,000
4. Nurse	32,500	33,000	32,750
5. Cook	31,000	32,000	31,500
6. Nurse's aide	28,500	30,500	29,500
7. Orderly	25,500	27,000	27,000

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.

Drawbacks derive more from how managers use ranking 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 a more elaborate method.

The *factor comparison method* is a special ranking method. It requires ranking each of a job's "factors" (such as education required, experience, and complexity), and then adding up the points representing the number of "degrees" of each factor each job has. Employers seldom use it today.

Job Evaluation Methods: Job Classification

job classification (or job grading)
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.

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 these 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 summaries or descriptions (similar to job descriptions); you then place jobs into the classes or grades based on how well they fit these descriptions. Another 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 each job according to these rules.

The usual procedure blends these two: the analysts choose compensable factors and then develop short class or grade descriptions that describe each class (or grade) in terms of the amount or level of the factors in those jobs. For example, the U.S. government's classification system uses eight 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 (for grade 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. Thus, the federal government system classifies the positions *automotive mechanic, welder, electrician*, and *machinist* in grade GS-10.

FIGURE 11-4 Example of a Grade Definition

Source: From "Grade Level Guide for Clerical and Assistance Work" from www.opm.gov/policy-data-oversight/classification-qualifications/classifying-general-schedule-positions/functional-guides/gscler.pdf, accessed September 12, 2018.

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 isn't easy 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

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.

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.[70]

"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

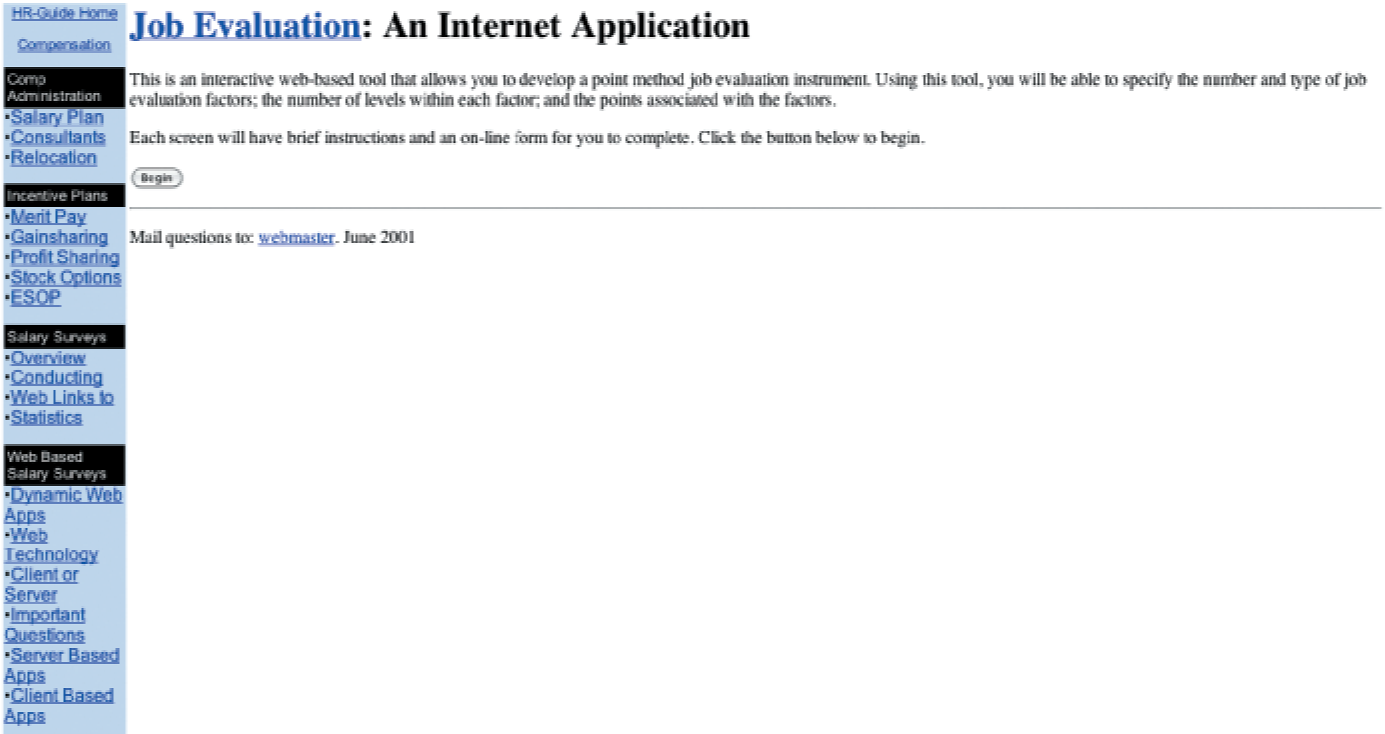
Using job evaluation methods such as the point method can be time-consuming. Accumulating the information about "how much" of each compensable factor the job contains is a tedious process. The evaluation committees must debate the level of each compensable factor in each job. They then write down their consensus judgments and compute each job's point values or rankings. Many employers therefore turn to computerized systems (see example on page 364.)

Most such computerized systems have two main components.[71] There is, first, a structured questionnaire. This contains items such as "enter total number of employees who report to this position." Second, such systems may use statistical models. These allow the computer program to price jobs more or less automatically, by assigning points based on the questionnaire responses.

LEARNING OBJECTIVE 11-3
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 just use a market-based approach. However, most employers also base their pay plans on job evaluation methods like those just described. These evaluations assign



Computer-aided job evaluation can streamline the job evaluation process

Source: Reprinted by permission from Computer-aided job evaluation can streamline the job evaluation process, in Screen capture: www.hrsoftware.netcgi/JobEvaluation.cgi.

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.[72] After all, you want employees' pay to be equitable internally—relative to what their colleagues in the firm are earning—but also competitive externally—relative to what *other employers* are paying. In a *market-competitive pay plan* a job's compensation reflects 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.[73] 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 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).[74]

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.[75] Similarly, using "working conditions" makes little practical sense for evaluating executive jobs.

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

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

Source: Copyright Gary Dessler, PhD.

Factor Definition: What Is Job Complexity? Job complexity generally refers to the 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.

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" than "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.[76]

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 of 1,000 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*.[77] This will tell you the *maximum number of points* for each compensable factor. Doing so in this case would translate into $1{,}000 \times 0.60 = 600$ possible points for job complexity, $1{,}000 \times 0.30 = 300$ points for effort, and $1{,}000 \times 0.10 = 100$ points for working conditions.

5. Define Each Factor's Degrees

Next, split each factor into degrees, and define (write degree definitions for) each degree so that raters may judge the amount or degree of a factor existing in a job.

Thus, for a compensable factor such as "job complexity" you might choose to have five degrees, ranging from "here the job is routine" to "uses independent judgment." (Our definitions for each degree are shown in Figure 11-5 under "Job Complexity Degree Definitions: What to Look for in the 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 maximum. In our case, we simply 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 maximum 600 points (see Figure 11-5).[78] 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 first 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, therefore, the job analyst included, in the job description and specification, information about the compensable factors (such as job complexity) around which the employer plans to build its compensation plan.[79]

8. Evaluate the Jobs

Steps 1–7 provide us with the information (for instance, on points and degrees) based on which we can evaluate the jobs. The committee has also gathered the job descriptions and job specifications for the benchmark jobs they will focus on.

Then, from their review of each job description and job specification, 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

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

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.[80] The master mechanic job gets 360 + 60 + 20 = 440 points from Table 11-3. This enables us to list a hierarchy of jobs, based upon each job's points. We can soon turn to assigning wage rates to each job (step 9). But first, we should define market-competitive pay plan and wage curve.

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?[81]

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

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

With a **market-competitive pay system,** the employer's actual pay rates are competitive with those in the relevant labor market, as well as equitable internally.[82] 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.

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 would show 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 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

FIGURE 11-6 Plotting a Wage Curve

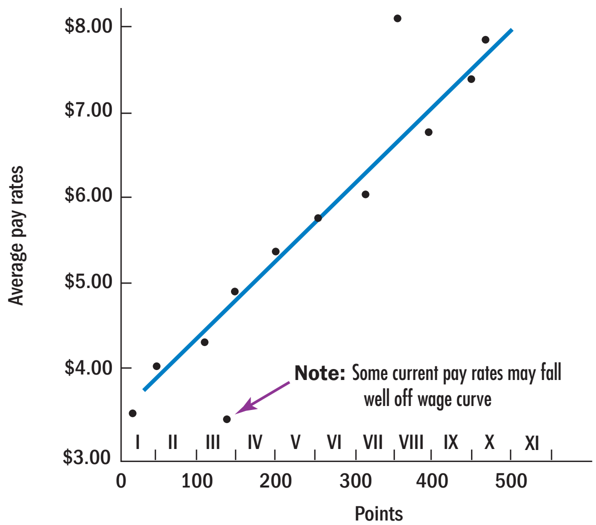
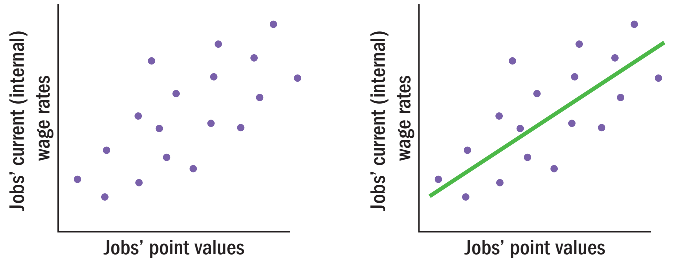


FIGURE 11-7 The Current/Internal Wage Curve



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).[83]

10. Conduct a Market Analysis: Salary Surveys

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.

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.[84] 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.

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). A consultant might charge $12,000 for its salary survey—a lot of money, but a tiny fraction of the millions a client with 5,000 or so employees pays in compensation.[85]

Detailed occupational earnings are available from the *National Compensation Survey* for over 800 occupations in the United States, calculated with data from employers in all industry sectors in every state and the District of Columbia (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 Group, Towers Watson Global Data Services, and Aon/Hewitt (www.aon.com) 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

TABLE 11-4 Some Pay Data Web Sites

Sponsor	Internet Address	What It Provides	Downside
Salary.com	www.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
CNN Money	http://money.cnn.com	Input your current salary and city; for comparable salary in destination city	Based on national averages adapted to cost-of-living differences

the Financial Executives Institute publish surveys of compensation practices among members of their associations.[86]

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

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 just about all the job opportunities listed in the newspaper by category and, in many instances, their wage rates (www.careerbuilder.com).

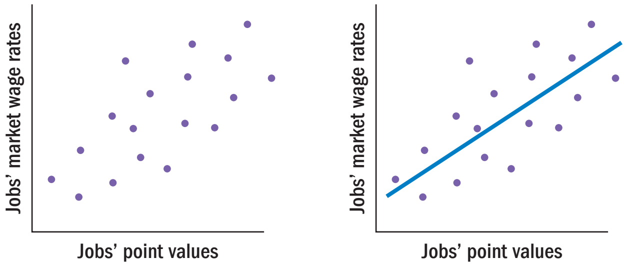
11. Draw the Market (External) Wage Curve

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 other jobs 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 thereby compares our jobs' points with market pay rates for our jobs.

FIGURE 11-8 The Market/External Wage Curve



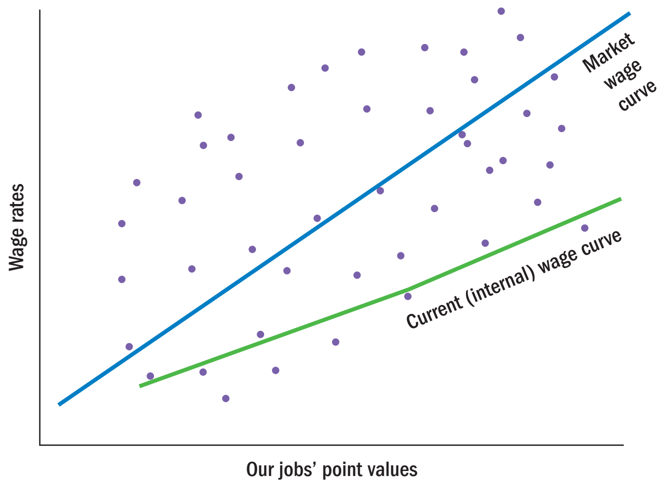


FIGURE 11-9 Plotting Both the Market and Internal Wage Curves

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

How different are the market rates other employers are paying for our jobs and the current rates we are now paying for our jobs? To determine this, we combine 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.[87]

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 with (the orange line in Figure 11-10) 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).[88]

13. Develop Pay Grades

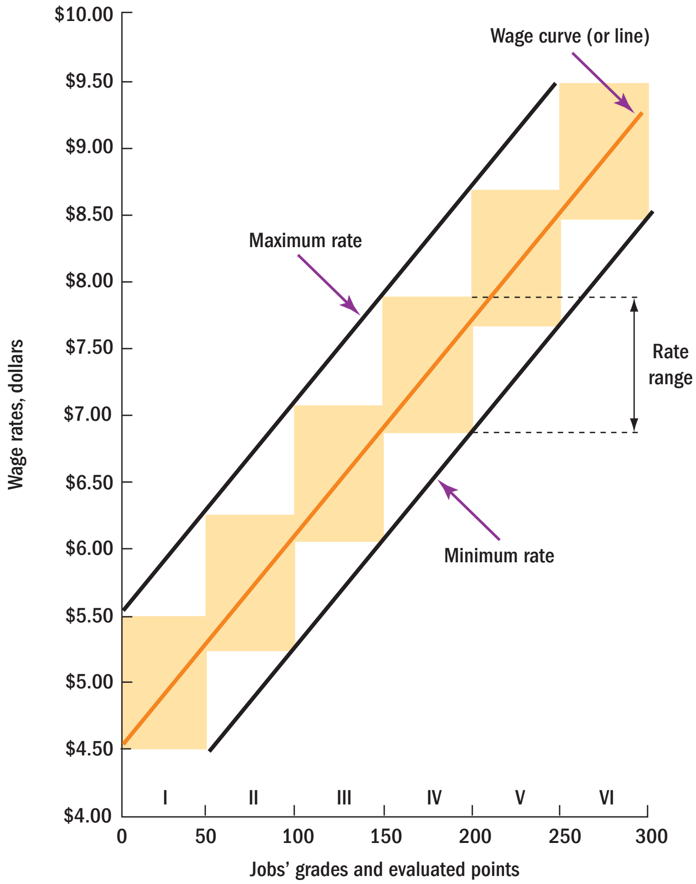
Employers typically group similar jobs (in terms of points) into grades for pay purposes. Then, instead of having to deal with hundreds of job rates, you might only have to focus on, say, pay rates for 10 or 12 pay grades. For example, Serco, a services firm that operates a London, England, light railway system, set up pay grades after ranking jobs using a system based on knowledge, management complexity, and the job's magnitude and impact on the organization.[89]

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

A **pay (or wage) grade** is composed 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

FIGURE 11-10 Wage Structure



(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, as in Table 11-5. Here you will have specific corresponding pay rates for each step within each grade in tabular form. Thus, Table 11-5 shows the pay rates and steps for most 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 $47,630 and $61,922, 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.

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

DEVELOPING RATE RANGES As in Figure 11-10, 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 taller (they include more pay rates) for the higher pay ranges, reflecting the greater demands

TABLE 11-5 U.S. Government Annual 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	Within Grade Amounts
1	$ 18,526	$ 19,146	$ 19,762	$ 20,375	$ 20,991	$ 21,351	$ 21,960	$ 22,575	$ 22,599	$ 23,171	VARIES
2	20,829	21,325	22,015	22,599	22,853	23,525	24,197	24,869	25,541	26,213	VARIES
3	22,727	23,485	23,243	25,001	25,759	26,517	27,275	28,033	28,791	29,549	758
4	25,514	26,364	27,214	28,064	28,914	29,764	30,614	31,464	32,314	33,164	850
5	28,545	29,497	30,449	31,401	32,353	33,305	34,257	34,209	36,161	37,113	952
6	31,819	32,880	33,941	35,002	36,063	37,124	38,185	39,246	40,307	41,368	1,061
7	35,359	36,538	37,717	38,896	40,075	41,254	42,433	43,612	44,791	45,970	1,179
8	39,159	40,464	41,769	43,074	44,379	45,684	46,989	48,294	49,599	50,904	1,305
9	43,251	44,693	46,135	47,577	49,019	50,461	51,903	53,345	54,787	56,229	1,442
10	47,630	49,218	50,806	52,394	53,982	55,570	57,158	58,746	60,334	61,922	1,588
11	52,329	54,073	55,817	57,561	59,305	61,049	62,793	64,537	66,281	68,025	1,744
12	62,722	64,813	66,904	68,995	71,086	73,177	75,268	77,359	79,450	81,541	2,091
13	74,584	77,070	79,556	82,042	84,528	87,014	89,500	91,986	94,472	96,958	2,486
14	88,136	91,074	94,012	96,950	99,888	102,826	105,764	108,702	111,640	114,578	2,938
15	103,672	107,128	110,584	114,040	117,496	120,952	124,408	127,864	131,320	134,776	3,456

Source: From salary table 2015-gs incorporating the 1% general schedule increase effective January 2015, from https://www.opm.gov/policy-data-oversight/pay-leave/salaries-wages/salary-tables/pdf/2017/GS.pdf.

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.[90]

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.

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

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. The compa ratio can help reveal how many jobs in each pay grade are paid above and below competitive market pay rates.[91]

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 enough 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.[92]

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 367). 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.

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. The accompanying HR Tools discussion explains a streamlined pay plan procedure for small businesses.

IMPROVING PERFORMANCE: *HR TOOLS FOR LINE MANAGERS AND SMALL BUSINESSES*

Developing a Workable Pay Plan

Pay plans are as important for small firms as large ones. Pay that is too high wastes money; too low triggers turnover; and internally inequitable causes endless demands for raises. The owner who wants to concentrate on major issues like sales needs a rational pay plan.

Surveying market rates come first. Sites like LinkedIn and Salary.com will show localized average pay rates for jobs in your geographic area. The Sunday newspaper classified ads (online and offline) will contain information on wages offered for jobs similar to those you're trying to price. Local job service "one-stop" offices can provide a wealth of information, as they compile extensive information on pay ranges and averages for many jobs. Employment agencies, always anxious to form ties with employers, will provide good data. Local college and university career centers will reveal prevailing pay rates for many jobs. Professional associations (such as the careers link for civil engineers at www.asce.org) are good sources of professionals' pay rates.

Smaller firms are making use of the Internet in other ways. StockHouse Media Corp (www.stockhouse.com) uses the Web for determining salaries for all the firm's personnel. For example, the HR manager surfs the Web to monitor rates and trends by periodically checking job boards, company Web sites, LinkedIn, and industry associations.[93]

If you employ more than 20 employees or so, conduct at least a rudimentary job evaluation (probably using the ranking method we covered on pages 361–362). For this you will need job descriptions (from, for example, O*NET and jobdescription.com), since these will be the source of data regarding the nature and worth of each job.

You may find it easier to split your employees into three clusters—say, managerial/professional, office/clerical, and plant personnel. For each of the three groups, choose one or more compensable factors. Then rank (or assign points to) each job in that cluster based on, say, a ranking job evaluation. For each job you will then want to create a pay range. In general, you might choose as the midpoint of that range the average market salary for that job, or an average of the market rate and what you are currently paying. Then produce a total range of about 30% around this average, broken into five steps. (Thus, assemblers, one of the plant personnel jobs, might earn from $8.00 to $12.60 per hour, in five steps.)

Required compensation policies will include amount of holiday and vacation pay (as we explain in Chapter 13), overtime pay policy, method of pay (weekly, biweekly, monthly), garnishments, and time card or sign-in sheet procedures. Many pay policy examples are available online.[94] ■

MyLab Management Talk About It 4

If your professor has assigned this, go to the Assignments section of **www.pearson.com/mylab/management** to complete these discussion questions. What type of job evaluation method would you use in a company with 15 employees? Why?

LEARNING OBJECTIVE 11-4

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 a marketplace for executives who often have rock star pay. So, job evaluation, although still important for management jobs, usually plays a secondary role to issues like bonuses, incentives, market rates, and benefits.

What Determines Executive Pay?

Because average CEO pay has leaped relative to the average worker's, executive pay has become a contentious topic today.

Whatever it is that accounts for CEO pay, it's apparently not always company performance. In one survey, the best-performing CEOs received the lowest average compensation, while those in low-performing companies were paid relatively well.[95] Conversely, one expert says CEOs with the highest 20% of compensation produced stock returns 60% greater than those of other firms in their industries.[96] Another 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.[97]

In practice, external equity plays a big role in setting a top manager's compensation plan. The board of director's compensation committee may retain a compensation consultant, and together they will choose and analyze top executives' pay in what they consider to be "peer companies"—companies that may (or may not) be in the same industry as theirs. Critics argue that this process creates upward pressures on CEO compensation, because the peer companies often are ones with higher-paid CEOs.[98] Alternatively, companies such as Berkshire Hathaway and Amazon tend to pay their founder/CEOs (Warren Buffet, Jeff Bezos) far less than do comparably sized firms; however, the CEOs have of course become very wealthy (as have many stockholders) through their stockholdings.[99]

Below the CEO, many employers do use job evaluation for pricing managerial jobs (at least, below the top jobs). The basic approach is to classify executive and management positions into 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, then group into classes those of similar value. However, firms also use the job classification and point methods, with compensable factors like position scope, complexity, and difficulty. As with any jobs, job analysis, salary surveys, and fine-tuning salary levels around wage curves play roles.

Shareholder activism and government oversight have tightened the restrictions on what companies pay top executives. For example, Walt Disney shareholders recently rejected (in a nonbinding vote) a plan to pay Disney CEO Robert Iger a total of almost $300 million over four years.[100]

Compensating Executives

Compensation for a company's top executives usually consist of several main elements.[101] *Base pay* includes the person's fixed salary. *Bonuses* are single payments generally to reward the manager for achieving a specific goal such as "total company profit over $18 million." *Short-term incentives* are usually cash or stock bonuses for achieving progress toward strategic goals, such as "reducing reliance on domestic sales from 80% to 50%." *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. Finally, *executive benefits and perks* include things such as supplemental executive retirement pension plans. As an example, one CEO's total compensation was about $24 million in one year. Long-term stock awards and stock options of about $15 million were the largest component. About $1.5 million was base salary. About $3.5 million was annual incentive plan, just over $4 million was increased pensions and deferred compensation, and most of the rest went to "all other compensation."[102]

Salary is traditionally the cornerstone of executive compensation. On it, employers layer benefits, incentives, and perquisites. Top executive compensation packages can be whoppers. The CEOs of Charter Communications and of CBS recently earned a total of about $98 million and $68 million, respectively.[103]

Executive compensation emphasizes performance (discussed in Chapter 12) more than do other employees' pay plans, since organizational results reflect executives' contributions more than those of lower-echelon employees. 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 measures. Typical short-term measures include revenue growth and operating profit margin. Long-term measures include rate of return above some predetermined base. With so many complicated elements, employers must also be alert to the tax and securities law implications of their executive compensation decisions.

Compensating Professional Employees

In compensating professionals, employers should first ensure that the person 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."[104]

However, calling someone a professional doesn't make them one. 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."[105] 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.[106]

Beyond that, compensating professionals such as engineers and attorneys presents unique challenges.[107] Analytical jobs like these emphasize compensable factors such as creativity and problem solving that are not easily measured. Furthermore, how to measure performance? For example, the success of an engineer's idea depends on how the firm develops and markets it. And such jobs can be highly sensitive to market conditions and industry demand. For example, Facebook, Google (Alphabet), and Amazon reportedly hire about 30% of American computer science graduates, which creates highly competitive pricing conditions.[108] Wages for other jobs—such as for engineers in the heating and air conditioning industry—face less pressure.[109]

Employers can and do 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 (as noted) are hard to measure, and nonpay issues often influence professionals' job decisions. Tech firms in particular also take dramatic steps to keep their best engineers from leaving. A few years ago Google 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.[110] Many of them, well paid by most standards, still felt underpaid. Tech firms like Facebook also award far more stock options (or stock shares) than do most other industries, and many give large signing bonuses that they can claw back if someone leaves the company prematurely.[111]

Most employers therefore emphasize a market-pricing approach for these jobs. 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 (such as engineer) 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.[112] That way, even outside Silicon Valley, engineers' pay stays competitive: In one (non-high-tech) study a few years ago, the engineers earned a base salary of $89,000, and a bonus of about $9,000 based on personal performance, product profitability, and safety metrics.[113]

IMPROVING PERFORMANCE: *THROUGH HRIS*

KNOWLEDGE BASE

Payroll Administration

Payroll administration is one of the first functions most employers computerize or outsource, and for good reason. Administering the payroll system—keeping track of each employee's FLSA worker status, wage rate, dependents, benefits, overtime, tax status, and so on; computing each paycheck; and then directing the actual printing of checks or direct deposits is a time-consuming task, one complicated by the need to comply with many federal, state, and local wage, hour, and other laws.

Many employers do perform this function in-house, usually with a payroll processing software package. Intuit's *Basic Payroll* lets the employer "enter hours worked and get instant paycheck calculations, including earnings, payroll taxes, and deductions. Then print paychecks yourself. *Basic Payroll* calculates federal and state payroll taxes for you, so you can easily e-pay federal taxes and write a check for state taxes."[114] Kronos's *Workforce Payroll* automates the payroll process, and offers self-service features. For example (see www.kronos.com/products/payroll), *Workforce Payroll* will "let your employees see pay stubs and earning histories, make changes to direct deposit and W-4 forms, print W-2s, and even check out how changes to their deductions will affect their paychecks."

On the other hand, many employers do outsource payroll administration to vendors such as ADP. In deciding which vendor to use, the employer should consider its goals and the potential economic benefits, as well as factors such as the vendor's reputation. SHRM recommends evaluating the initial list of prospective vendors based on the employer's goals for the relationship. Don't just consider the relative economic benefits of outsourcing the function (rather than doing it in-house), but also the desirability of integrating the employer's internal systems with the vendor's, streamlining tax compliance and filings, and increasing employee self-service.[115] ■

LEARNING OBJECTIVE 11-5
Explain the difference between competency-based and traditional pay plans.

Contemporary Topics in Compensation

In this section, we'll look at five important contemporary compensation topics: competency-based pay, broadbanding, comparable worth, board oversight of executive pay, and total rewards.

Competency-Based Pay

Some managers question whether job evaluations that slot jobs into narrow cubbyholes ("Machinist I," "Machinist II," and so on) might not actually be counterproductive. For example, high-performance work systems depend on flexible multiskilled job assignments and on teamwork, and there's no place here for employees to say, "That's not my job."

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.

Competency-based pay aims to avoid that problem.[116] With competency (generally skill or knowledge-based) pay, you pay the employee for the skills and knowledge he or she is capable of using rather than for the responsibilities or title of the job

Many employers pay certain workers based on attained skill levels.

Monty Rakusen/Cultura/Getty Images

currently held.[117] 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. *Competencies* are demonstrable personal characteristics such as knowledge, skills, and personal behaviors such as leadership. Why pay employees based on the skill levels they achieve, rather than based on the jobs they're assigned to? Because, for example, a company that organizes a facility around teams may want to encourage employees to get and to use the skills required to rotate among jobs.

As an example, review Chapter 4's Figure 4-11 on page 124. For this job, BP lists the minimum level of each skill (Technical Expertise, Problem Solving, and so on) someone holding this job must attain. As an employee achieves and is tested on each level of each skill, he or she would receive a bump in pay.

Broadbanding

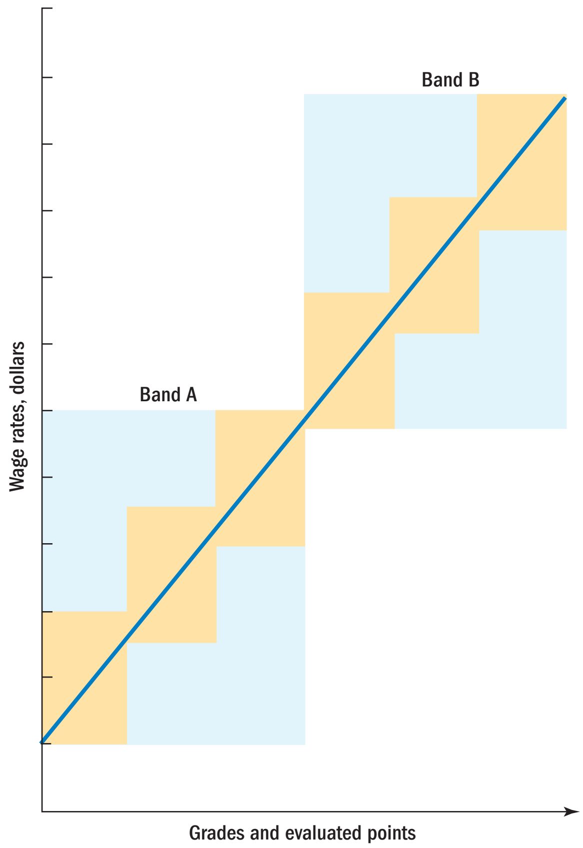
Most firms end up with pay plans that slot jobs into classes or grades, each with its own vertical pay rate range. For example, the U.S. government's pay plan consists of 15 main grades (GS-1 to GS-15), each with its own pay range. For an employee whose job falls into one of these grades, the pay range 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, should the U.S. government collapse its 15 salary grades into 5 or 6 broader bands?) There is a downside to having (say, 15) 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 first want a corresponding raise to grade 3 pay. Traditional grade pay plans could thus breed inflexibility.

That is why some firms broadband their pay plans.[118] **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. Here,

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.

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



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 (vertical) 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. (Again, see Figure 11-11). 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 easily, without worrying about the employee's moving outside the (relatively) narrow rate range associated with a traditional narrow pay grade. This can make it easier to train someone on a higher level job, or to have them fill in for a time on a lower level job without worrying about pay levels.

Comparable Worth

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.

Comparable worth refers to the requirement to pay men and women equal wages for jobs that are dissimilar but of comparable value (for instance measured in points) to the employer. This may mean comparing dissimilar jobs, such as nurses to mechanics. 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?

County of Washington v. Gunther (1981) was a pivotal case. It involved Washington County, Oregon, prison matrons, who claimed sex discrimination. The county had evaluated roughly comparable (but different) 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.[119] Why should there be such a pay discrepancy for roughly comparable jobs? After moving 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.

Comparable worth has implications for job evaluation. Virtually every comparable worth case that reached court involved 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 plans? Perhaps the wisest approach is for employers to price their jobs as they see fit (with or without point plans), but to also ensure that women have equal access to all jobs. In other words, eliminate sex-segregated jobs.

Diversity Counts: The Pay Gap

All this notwithstanding, women in the United States earn only about 81% as much as men.[120] This seems true even among the most highly trained. For example, new female medical doctors earn about $17,000 per year less than their male counterparts.[121] Reasons put forward for the gap include what one writer calls a "Motherhood Penalty" (women take more time off to care for the family, and are penalized career-wise for this), employer discrimination, the outdated notion that employers view women as having less leverage, 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.[122] In any case, it's a problem employers have to recognize and address. Some, like Alphabet are already doing so. Pressures from investor groups, some states, and the national #MeToo movement are forcing others to do so.[123] ■

MyLab Management Apply It!

How do companies actually adjust salaries and raises? If your professor has assigned this activity, go to the Assignments section of **www.pearson.com/mylab/management** to complete the video exercise.

Board Oversight of Executive Pay

The company's board of directors is responsible for setting and approving top executives' pay, and boards today are scrutinizing that pay for two reasons: governmental regulation/legal, and shareholder activism/inequity.

First, legislation gives various governmental agencies oversight over executive pay. To ensure adequate disclosure, the Securities and Exchange Commission (SEC) requires detailed compensation-related information for the CEO, chief financial officer, and next three highest paid executives. The company usually summarizes this in a Summary Compensation Table in the company's annual proxy statement filed with the SEC.[124] The Dodd–Frank Law of 2010 requires that American companies give shareholders a (nonbinding) "say on pay." The Sarbanes–Oxley Act makes executives personally liable, under certain conditions, for corporate financial oversight lapses. Similarly, tax treatment and disclosure are overseen by the Departments of the Treasury and of Labor, and the Internal Revenue Service.[125]

Second, CEO pay compared with an average worker's pay has mushroomed in the past 20 or so years—the gap is about six times larger than it was then.[126] Boards therefore face shareholder activism on executive pay. Law firms file class-action suits demanding information from companies about their senior executive pay decisions.[127] As of 2018, public corporations in the United States must compute the ratio of CEO to median company employee pay.[128] The net result is that lawyers specializing in executive pay suggest that boards of directors ask themselves these questions:[129]

- Has our compensation committee identified its duties and processes?
- Is our compensation committee using the appropriate compensation advisors?
- Are there particular executive compensation issues that our committee should address?

- Do our procedures demonstrate diligence and independence (including careful deliberations and records)?
- Is our committee appropriately communicating its decisions? How will shareholders react?[130]

LEARNING OBJECTIVE 11-6

Describe the importance of total rewards for improving employee engagement.

Employee Engagement Guide for Managers

Total Rewards Programs

Total rewards is an important concept in compensation management. People bring to their jobs many needs—for challenging work and for respect and appreciation, for instance—not all of which are satisfied by pay or bonuses. "'Total rewards' encompass not only compensation and benefits but also personal and professional growth opportunities and a motivating work environment."[131] It includes not just traditional financial rewards (wages and incentives plus benefits and perks), but also nonfinancial and intangible rewards such as recognition, the nature of the job/quality of work, career development opportunities,[132] good relationships with colleagues, organizational justice, trust in employees, feeling of being valued and involved, opportunities for promotion,[133] and a great work climate.[134] Specific total rewards also include recognition programs and redesigned jobs (discussed in Chapter 4), telecommuting programs, health and well-being programs, and training and career development.

TRENDS SHAPING HR: *DIGITAL AND SOCIAL MEDIA*

Noncash recognition/appreciation rewards such as gift cards, merchandise, and recognition are parts of such total compensation.[135]

New digital and social media tools enable employees to recognize and reward each other. For example, a West Virginia DuPont plant installed an online system that enabled employees to give each other recognition; 95% were soon using it.[136] International Fitness Holdings lets employees use a Facebook-type app to recognize peers by posting messages and sending private e-mails.[137] Employers contract with sites like Globoforce.com to provide online recognition systems. ■

Total Rewards and Employee Engagement

When it comes to employee engagement, both material and nonmaterial rewards—total rewards—seem essential.[138] For example, one study found that base pay and benefits alone were weakly related to engagement.[139] However, intangible rewards (such as the nature of the job/quality of work and career development opportunities) had high or very high impacts on engagement and performance, when combined with base salary and short-term incentives or bonuses.[140]

It's therefore not surprising that many high-engagement employers emphasize total rewards. For example, the values laid out in Toyota's famous "The Toyota Way" include mutual trust and respect, stable employment, helping employees to develop their technical skills, and providing extensive benefits such as childcare. Disney emphasizes providing employees with a total rewards package that includes pay plus various benefits and career development opportunities.[141] Similarly, many "Best Companies to Work For" emphasize intangible rewards. For example, one top executive at NetApp takes an opportunity to call and thank several employees each day for their efforts; Whole Foods emphasizes employee involvement, for instance letting employees vote on new hires and see what all Whole Foods employees earn.[142] At SAS there is stimulating work, an empowering management philosophy, flexible work, and an emphasis on being happy at work.[143]

In addition to offering such rewards, the employer should issue total reward statements periodically. List all the rewards—financial and nonfinancial—the company offers, and note their importance to the employees' overall well-being.[144] This increases their impact.

Chapter Review

Chapter Section Summaries

11-1. 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.

11-2. 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. 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 is equitable based on its value to the employer. Popular job evaluation methods include ranking, job classification, and the point method.

11-3. We said the process of **creating a market-competitive pay plan** while ensuring external, internal, and procedural equity consists of 16 steps as follows: (1) Choose benchmark jobs; (2) Select compensable factors; (3) Assign weights to compensable factors; (4) Convert percentages to points for each factor; (5) Define each factor's degrees; (6) Determine for each factor its factor degrees' points; (7) Review job descriptions and job specifications; (8) Evaluate the jobs; (9) Draw the current (internal) wage curve; (10) Conduct a market analysis: Salary surveys; (11) Draw the market (external) wage curve; (12) Compare and adjust current and market wage rates for jobs; (13) Develop pay grades; (14) Establish rate ranges; (15) Address remaining jobs; and (16) Correct out-of-line rates.

11-4. **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.

11-5. We addressed five important **special topics in compensation.** More employers are moving from paying jobs based on their intrinsic duties toward paying jobs based on the competencies the job requires. 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. 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 advisors and exercise diligence and independence in formulating executive pay plans.

11-6. Research shows that if **employee engagement** is the aim, it makes sense to emphasize total rewards, not just financial rewards. For example, one study found that base pay and benefits alone had a weak relationship with employee engagement. However, total rewards including intangible rewards such as the nature of the job/quality of work, and career development opportunities had a high or very high impact on engagement and performance, when combined with base salary and short-term incentives or bonuses.

Discussion Questions

11-1. What is the difference between exempt and nonexempt jobs?

11-2. Should the job evaluation depend on an appraisal of the jobholder's performance? Why? Why not?

11-3. What is the relationship between compensable factors and job specifications?

11-4. Define and give an example of how to conduct a job evaluation.

11-5. The average pay for most university presidents is around $300,000 per year, but many earn much more. For example, the president of NYU received about $1 million in 1 year. Discuss why you would (or would not) pay university presidents as much as or more than many corporate CEOs.

11-6. Do small companies need to develop a pay plan? Why or why not?

11-7. After Walmart raised its minimum starting pay to $10 an hour, some longer-term employees (like one earning $12 per hour) complained that the strictly entry-level increase was unfair to them. And when the head of a company called Gravity Payments decided to pay all his employees at least $70,000 a year, some longer-tenure employees complained that it was unfair to raise new peoples' salaries and not theirs.[145] How should Walmart and Gravity address these complaints?

Individual and Group Activities

11-8. 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?

11-9. 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.

11-10. 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?

11-11. Appendices A and B at the end of this book (pages 614–634) list the knowledge someone studying for the HRCI (Appendix A) or SHRM (Appendix B) certification exam needs to have in each area of human resource management (such as in Strategic Management and Workforce Planning). In groups of several students, do four things: (1) review Appendix A and/or B; (2) identify the material in this chapter that relates to the Appendix A and/or B required knowledge lists; (3) write four multiple-choice exam questions on this material that you believe would be suitable for inclusion in the HRCI exam and/or the SHRM exam; and (4) if time permits, have someone from your team post your team's questions in front of the class, so that students in all teams can answer the exam questions created by the other teams.

11-12. Working individually or in groups, use the point system described in steps 1 to 16 in this chapter. Do so for a job description that you find online—a list like that at http://hiring.monster.com/hr/hr-best-practices/recruiting-hiring-advice/job-descriptions/sample-job-descriptions.aspx is useful. To simplify things, assume there is only one compensable factor you have to use, and that it is job complexity, so that you can use Figure 11-5.

11-13. How do you think politicians in the United States should address the problem of income inequality?

Experiential Exercise

Ranking the College's Administrators

Written and copyrighted by Gary Dessler, PhD.

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.

Perform a job evaluation by ranking the jobs. You may use one or more compensable factors.

11-14. 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 AstraZeneca

Written and copyrighted by Gary Dessler, PhD.

More than 50 years after passage of the Equal Pay Act, women in America still earn about 80 cents for every dollar earned by a man. That adds up to a loss for the average female worker of about $380,000 over a lifetime.

The U.S. Department of Labor's Office of Federal Contract Compliance Programs (OFCCP) entered into an agreement with AstraZeneca, a large international pharmaceuticals firm, for the company to pay some of its female sales associates a total of $250,000.[146] AstraZeneca had a contract valued at over $2 billion with the U.S. Department of Veterans Affairs to provide drugs to hospitals around the country. That made it subject to Executive Order 11246, which aims to ensure that employees of U.S. contractors and subcontractors with federal contracts pay their employees fairly without regard to sex, race, color, religion, and national origin.

After conducting a compliance review, the OFCCP concluded that AstraZeneca violated Executive Order 11246 by failing to ensure certain women employees were paid fairly. According to the OFCCP lawsuit, an AstraZeneca Business Center had routinely paid some of its female "primary care" and "specialty care" level III pharmaceutical sales specialists an average of $1,700 less than men with the same positions. Because of the company's pay secrecy policies, many of the women didn't know they were being paid less. In addition to the financial settlement, AstraZeneca and OFCCP will review records of the firm's female employees in 14 states. If they find additional statistical evidence of wage discrimination, the company must remedy it.

Questions

AstraZeneca has brought you in as a compensation consultant. Here are the questions they would like you to answer for them:

11-15. Although the case with OFCCP is closed, we wonder if there are any less-discriminatory explanations possible for why our women sales reps on average earned less than men. If so, what are they?

11-16. Our own company now uses a point method to evaluate jobs for pay purposes, and each resulting job class also has a rate range associated with it. Sales associates are now paid a salary that is not based on incentive pay. List three specific things we can do to ensure that a similar problem (inequitable pay based on gender) does not arise again, assuming they continue using the point plan.

11-17. What sort of compensation plan would you recommend for us, and why?

Continuing Case

Carter Cleaning Company

Written and copyrighted by Gary Dessler, PhD.

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

11-18. Is the company at the point where it should be setting up a formal salary structure based on a complete job evaluation? Why?

11-19. Is Jack Carter's policy of paying 10% more than the prevailing rates a sound one, and how could that be determined?

11-20. Similarly, is Carter's male–female differential wise? If not, why not?

11-21. Specifically, what would you suggest Jennifer do now with respect to her company's pay plan?

Translating Strategy into HR Policies and Practices Case*,§

** The accompanying strategy map for this chapter is in MyLab Management; the overall map on the inside back cover of this text outlines the relationships involved.*

Improving Performance at the Hotel Paris

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 its 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 the most 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 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 getting paid about the same as employees who performed better and worse than they did. So, the firm's compensation plan actually created a disconnect between pay and performance: 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 engagement, 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.

Lisa and her team (which included a consulting compensation expert) set numerous new measurable compensation policies for the Hotel Paris, and these new policies formed the heart of the new compensation plan. A new job evaluation study provided a more rational and fair basis upon which the company could assign pay rates. A formal compensation survey by the consultant established, for the first time at the Hotel Paris, a clear picture of what competitive hotels and similar businesses were paying in each geographic area, and enabled the Hotel Paris team to more accurately set targets for what each position at the hotel should be paying. Rather than just paying at the industry average, or slightly below, the new policy called for the Hotel Paris to move all its salaries into the 75th percentile over the next 3 years.

As they instituted the new compensation policies, Lisa and the CFO were pleased to learn from feedback from the hotel managers that they were already noting several positive changes. The number of applicants for each position had increased by over 50% on average, turnover dropped by 80%, and surveys of morale and commitment were producing higher results. Lisa and her team now began to consider how to inject more of a "pay for performance" element into the company's compensation plan, perhaps by instituting new bonuses and incentives.We will see what she did in Chapter 12.

Questions

11-22. Lisa knew little about setting up a new compensation plan. Based on what you learned here in Dessler *Human Resource Management*, what would you tell her if she asked, "How do I set up a new compensation plan for the Hotel Paris?"

11-23. Would you suggest that Hotel Paris implement a competency-based pay plan for its nonmanagerial staff? Why or why not? Outline what they need to do for one.

11-24. 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.

MyLab Management

Go to **www.pearson.com/mylab/management** for Auto-graded writing questions as well as the following Assisted-graded writing questions:

11-25. You want to hire a new salesperson for the small dress shop you own in Columbus, Ohio, but first need to decide what sort of pay package to offer whomever you eventually hire. How would you conduct a salary survey to determine what the pay should be?

11-26. Compare and contrast the following methods of job evaluation: ranking, classification, factor comparison, and point method.

11-27. MyLab Management only—comprehensive writing assignment for this chapter.

MyLab Management Try It!

How would you use pay or other components of a total rewards program to solve a "motivation problem" in a company? If your professor has assigned this activity, go to the Assignments section of **www.pearson.com/mylab/management** to complete the simulation.

Key Terms

employee compensation, 350
direct financial payments, 350
indirect financial payments, 350
Davis-Bacon Act (1931), 351
Walsh-Healey Public Contract Act (1936), 351
Title VII of the 1964 Civil Rights Act, 351
Fair Labor Standards Act (1938), 351
Equal Pay Act, 356
Employee Retirement Income Security Act (ERISA), 356
job evaluation, 359
market-competitive pay plan, 359
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benchmark job, 361
ranking method, 361
job classification (or job grading), 362
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grade definition, 362
point method, 363
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wage curve, 367
salary survey, 368
pay (or wage) grade, 370
pay (or rate) ranges, 371
compa ratio, 372
competency-based pay, 376
broadbanding, 377
comparable worth, 378

Endnotes

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12 Pay for Performance and Financial Incentives

LEARNING OBJECTIVES

When you finish studying this chapter, you should be able to:

12-1 **Explain** how you would apply four motivation theories in formulating an incentive plan.

12-2 **Discuss** the main incentives for individual employees.

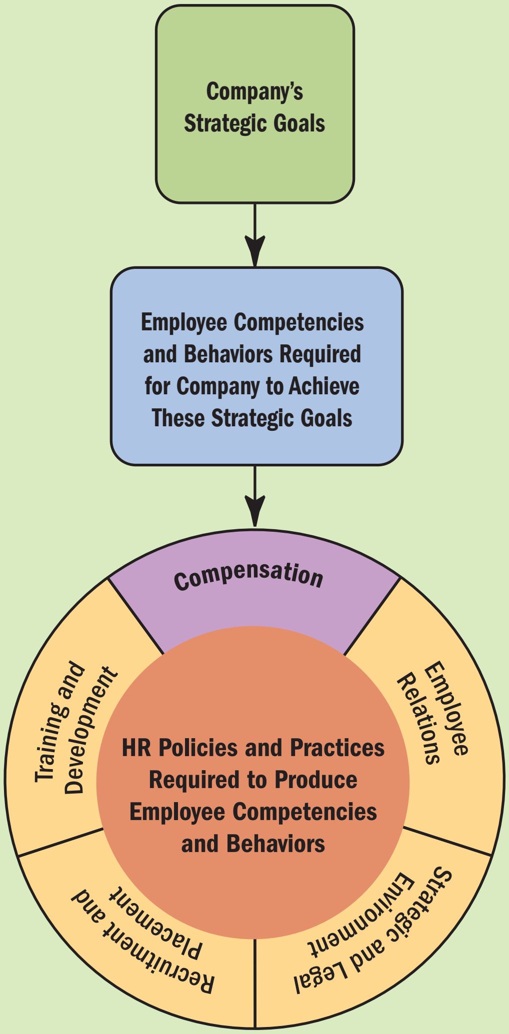
12-3 **Discuss** the pros and cons of commissions versus straight pay for salespeople.

12-4 **Describe** the main incentives for managers and executives.

12-5 **Name and describe** the most popular organization-wide incentive plans.

12-6 **Explain** how to use incentives to improve employee engagement.

The owners of a 21-store fast-food franchise in the Midwest knew that their stores' performance and profits depended on their employees' performance. They hoped a new employee incentive program could boost their employees' and their stores' performance. We'll see what they did.



WHERE ARE WE NOW . . .

Chapter 11 focused on developing pay plans and on salaries and wages. Incentives are important in any pay plan. The main purpose of this chapter is to explain how managers use incentives to motivate employees. The main topics we'll discuss are **Money's Role in Motivation**, **Individual Employee Incentive and Recognition Programs**, **Incentives for Salespeople**, **Incentives for Managers and Executives**, **Team and Organization-Wide Incentive Plans**, and **Incentives and Employee Engagement**. In Chapter 13, we'll turn to the financial and nonfinancial benefits that comprise the third component of employee compensation packages.

LEARNING OBJECTIVE 12-1

Explain how you would apply four motivation theories in formulating an incentive plan.

Money's Role in Motivation

Frederick Taylor popularized using **financial incentives**—financial rewards paid to workers whose production exceeds some predetermined standard—in the late 1800s. As a supervisor at the Midvale Steel Company, Taylor was concerned with what he called "systematic soldiering"—the tendency of employees to produce at the minimum acceptable level. Some workers had the energy to run home and work on their houses after a 12-hour day. Taylor knew that if he could harness this energy at work, Midvale could achieve huge productivity gains. **Productivity** "is the ratio of outputs (goods and services) divided by the inputs (resources such as labor and capital)."[1]

In pursuing his aim, Taylor turned to financial incentives. At the time, primitive incentive plans were in use, but were generally ineffective (because employers arbitrarily changed incentive rates).

Taylor made three contributions. He saw the need for formulating a **"fair day's work,"** namely precise output standards for each job. He spearheaded the **scientific management movement,** which emphasized improving work through observation and analysis. And he popularized using incentive pay to reward employees who produced over standard.

financial incentives
Financial rewards paid to workers whose production exceeds some predetemined standard.

productivity
The ratio of outputs (goods and services) divided by the inputs (resources such as labor and capital).

fair day's work
Output standards devised based on careful, scientific analysis.

scientific management movement
Management approach based on improving work methods through observation and analysis.

pay-for-performance
Any plan that ties pay to some measure of performance, such as productivity or profitability.

variable pay
Any plan that ties pay to productivity or profitability, usually as one-time lump payments.

Incentive Pay Terminology

Managers often use two terms synonymously with incentive plans.[2] All incentive plans are **pay-for-performance** plans. They all tie employees' pay to the employees' performance. Some limit the term **variable pay** to group or team incentive plans,[3] but most use *variable pay* to include any performance-based incentive plan.

Linking Strategy, Performance, and Incentive Pay

Incentive pay—tying worker pay to performance—is popular.[4] The problem is that doing so is easier said than done. United Airlines tried replacing its quarterly bonus with a lottery. Instead of getting quarterly bonuses when United attained its performance goals, qualified employees would instead be eligible to win, say, $100,000 prizes. Employees revolted, and United returned to its bonus plan.[5] Another incentive plan, at Levi Strauss, is widely assumed to have been the last nail in the coffin of Levi's U.S.-based production.

Research on incentive plans is sketchy, but one older study found that just 28% of 2,600 U.S. workers said their companies' incentive plans motivated them. "Employees don't see a strong connection between pay and performance, and their performance is not particularly influenced by the company's incentive plan," said one expert.[6]

One problem is that many incentive plans incentivize the wrong behavior. For example, a Wells Fargo Bank incentive plan pushed bank employees to hit high sales goals, such as selling eight bank products per customer.[7] Bank employees opened accounts for thousands of customers without the customer's permission.[8] At ethics workshops, managers told employees not to create fake bank accounts. But employees knew they had to meet their sales goals, so they opened fake accounts.[9] Fines, lawsuits, and the CEO's exit came next.

Another big reason for incentive plans' often-dismal results is that incentives that may motivate some people won't motivate others. We'll review some motivation background next, and then go on to explain various incentive plans.

Motivation and Incentives

Several motivation theories have particular relevance to designing incentive plans.

MOTIVATORS AND FREDERICK HERZBERG Frederick Herzberg said the best way to motivate someone is to organize the job so that doing it provides the challenge and recognition we all need to help satisfy "higher-level" needs for things like accomplishment and recognition. These needs are relatively insatiable, says Herzberg, so challenging work provides a sort of built-in motivation generator. Doing things to satisfy a worker's "lower-level" needs for things like better pay and working conditions just keeps the person from becoming dissatisfied.

Herzberg says the factors ("hygienes") that satisfy lower-level needs are different from those ("motivators") that satisfy or partially satisfy higher-level needs. If *hygiene* factors (factors outside the job itself, such as working conditions, salary, and incentive pay) are inadequate, employees become dissatisfied. However, adding more of these hygienes (like incentives) to the job (supplying what Herzberg calls "extrinsic motivation") is an inferior way to try to motivate someone, because lower-level needs are quickly satisfied. Inevitably the person says, in effect, "I want another raise."

Instead of relying on hygienes, says Herzberg, managers interested in creating a self-motivated workforce should emphasize "job content" or *motivator* factors. Managers do this by enriching workers' jobs so that the jobs are more challenging, and by providing feedback and recognition—by making doing the job intrinsically motivating, in other words. In organizational psychology, **intrinsic motivation** is motivation that derives from the pleasure someone gets from doing the job or task. It comes from "within" the person, rather than from externally, such as from a financial incentive plan. Intrinsic motivation means that just doing the task provides the motivation. Herzberg makes the point that relying exclusively on financial incentives is risky. The employer should also provide the recognition and challenging work that most people crave.

intrinsic motivation
Motivation that derives from the pleasure someone gets from doing the job or task.

DEMOTIVATORS AND EDWARD DECI Psychologist Edward Deci's work highlights another potential downside to relying too heavily on extrinsic rewards: They may backfire. Deci found that extrinsic rewards could at times actually detract from the person's intrinsic motivation.[10] The point may be stated thusly: Be cautious in devising incentive pay for highly motivated employees, lest you inadvertently demean and detract from the desire they have to do the job out of a sense of responsibility.

EXPECTANCY THEORY AND VICTOR VROOM In general, people won't pursue rewards they find unattractive, or where the odds of success are very low. Psychologist Victor Vroom's expectancy motivation theory echoes these commonsense observations. He says a person's motivation to exert some level of effort depends on three things: the person's **expectancy** (in terms of probability) that his or her effort will lead to performance;[11] **instrumentality**, or the perceived connection (if any) between successful performance and actually obtaining the rewards; and **valence,** which represents the perceived value the person attaches to the reward.[12] In Vroom's theory:

expectancy
A person's expectation that his or her effort will lead to performance.

instrumentality
The perceived relationship between successful performance and obtaining the reward.

valence
The perceived value a person attaches to the reward.

$$\text{Motivation} = (E \times I \times V),$$

where E represents expectancy, I instrumentality, and V valence. If E or I or V is zero or inconsequential, there will be no motivation.

Vroom's theory has three implications for how managers design incentive plans.

- First, if employees don't *expect* that effort will produce performance, no motivation will occur. So, managers must ensure that their employees have the skills to do the job, and believe they can do the job. Thus, training, job descriptions, and confidence building and support are important in using incentives.
- Second, Vroom's theory suggests that employees must see the *instrumentality* of their efforts—they must believe that successful performance will in fact lead to getting the reward. Managers can accomplish this, for instance, by creating easy-to-understand incentive plans.
- Third, the reward itself must be of *value* to the employee. The manager should take into account individual employee preferences.

BEHAVIOR MODIFICATION/REINFORCEMENT AND B. F. SKINNER Using incentives also assumes the manager understands how consequences affect behavior.[13] Psychologist B.F. Skinner's findings are useful here. Managers apply Skinner's principles by using *behavior modification*. **Behavior modification** means changing behavior through rewards or punishments that are contingent on performance. For managers, behavior modification boils down to two main principles. First, that behavior that appears to lead to a positive consequence (reward) tends to be repeated, whereas behavior that

behavior modification
Using contingent rewards or punishment to change behavior.

appears to lead to a negative consequence (punishment) tends not to be repeated; and second, that managers can therefore get someone to change his or her behavior by providing the properly scheduled rewards (or punishment).

To arrange our discussion, we will organize the following sections around individual employee incentive and recognition programs, sales compensation programs, management and executive incentive compensation programs, and team- and organization-wide incentive programs. First, however, we look at some legal aspects of incentive plan design.

KNOW YOUR EMPLOYMENT LAW

Employee Incentives and the Law

Various laws affect incentive pay. Under the Fair Labor Standards Act, if the incentive the worker receives is in the form of a prize or cash award, the employer generally must *include the value of that award* when calculating the worker's overtime pay for that pay period.[14] So, unless you structure the incentive bonuses properly, the bonus itself becomes part of the week's wages. For example, suppose someone who earns $10 per hour for a 40-hour week also earns, in one week, performance incentive pay (a performance bonus) of $80 for the week, or $480 total pay for the week. Further, assume she *also* works 2 hours overtime that week. The overtime rate for each of the 2 hours she works overtime is not simply 1.5 times her regular $10-per-hour pay. Instead, it is 1.5 times $12 per hour. Why? Because with her performance bonus she earned $480 for the 40-hour week, and $480 divided by 40 hours is $12 per hour. Therefore, she will actually earn in total that week $480 plus the overtime pay of $12 per hour for the two extra hours, or $480 + $24 = $504 total for the week.

Certain bonuses are excludable from overtime pay calculations. For example, Christmas and gift bonuses that are not based on hours worked, or are so substantial that employees don't consider them a part of their wages, do not have to be included in overtime pay calculations. Similarly, purely discretionary bonuses in which the employer retains discretion over how much if anything to pay are excludable.

However, other types of incentive pay *must* be included. Under the Fair Labor Standards Act (FLSA), bonuses to include in overtime pay computations include those promised to newly hired employees; those provided for in union contracts or other agreements; and those announced to induce employees to work more productively or efficiently or to induce them to remain with the company. Such bonuses would include many of those we turn to next, such as individual and group production bonuses. ■

KNOWLEDGE BASE

Individual Employee Incentive and Recognition Programs

LEARNING OBJECTIVE 12-2

Discuss the main incentives for individual employees.

Several incentive plans are particularly suited for use with individual employees.

Piecework

piecework
A system of pay based on the number of items processed by each individual worker in a unit of time, such as items per hour or items per day.

Piecework is the oldest incentive plan and still the most commonly used. Earnings are tied directly to what the worker produces. The person is paid a piece rate for each unit he or she produces. Thus, if Tom Smith gets $0.40 apiece for stamping out doorjambs, then he would get, say, $80 for stamping out 200.

Developing a workable piece rate plan requires job evaluation and (ideally) industrial engineering. Job evaluation enables you to assign an hourly wage rate to the job in question. But the crucial issue is the production standard, and this is often developed by industrial engineers. The engineers state production standards in terms of a standard number of minutes per unit or a standard number of units per hour. In Tom Smith's case, the job evaluation indicated that his doorjamb stamping job was worth $8.00 an hour. The industrial engineer determined that 20 jambs per hour was the standard production rate. Therefore, the engineered piece rate (for each doorjamb) was $8.00 divided by 20, which equals $0.40 per doorjamb.

straight piecework
An incentive plan in which a person is paid a sum for each item he or she makes or sells, with a strict proportionality between results and rewards.

With a **straight piecework** plan, Tom Smith would be paid based on the number of doorjambs he produced; there would be no guaranteed minimum wage. However, today most employers must guarantee their workers a minimum wage. With a guaranteed piecework plan, Tom Smith would be paid $7.25 per hour (the 2018 minimum wage) whether or not he stamped out 18 doorjambs per hour (at $0.40 each). But he would also get $0.40 for each unit over 18.

Piecework generally implies "straight piecework," a strict proportionality between results and rewards regardless of level of output. Thus, in Smith's case, he continues to get $0.40 apiece for stamping out doorjambs, even if he stamps out more than the planned, say, 500 per day. However, some piecework plans share productivity gains between worker and employer. For example, the employee might only get $0.35 per piece over 400 units per day, instead of $0.40. Other plans *boost* the employee's share once a threshold is met—such as paying Tom $0.45 each once he reached 400 units per day.

standard hour plan
A plan by which a worker is paid a basic hourly rate but is paid an extra percentage of his or her rate for production exceeding the standard per hour or per day. Similar to piecework payment but based on a percent premium.

The **standard hour plan** is like the piecework plan, with one difference. Instead of getting a rate per piece, the worker gets a pay premium equal to the percent by which his or her performance exceeds the standard. So if Tom's standard is 160 doorjambs per day ($64 per eight hour day), and he actually makes 200 jambs, he'd get an extra 25% (40/160), or $80. Using this approach may reduce workers' tendency to link their production standard (18 jambs per hour) to pay. This makes it easier to change the standard.

ADVANTAGES AND DISADVANTAGES Piecework incentive plans have several advantages. They are simple to calculate and easily understood by employees. Piecework plans appear equitable in principle, and their incentive value can be powerful since they tie pay directly to performance.

Piecework also has disadvantages. One is an unsavory reputation, based on employers' habit of arbitrarily raising production standards whenever workers earned "excessive" wages. A more subtle drawback is that because piece rates are quoted on a per piece basis, in worker's minds the production standard (in pieces per hour) becomes tied inseparably to what they earn. Piecework plans can thus engender rigidity. When the employer tries to raise production standards, resistance ensues. Employees may similarly focus less on quality, and may resist switching jobs (since doing so could reduce productivity). Even equipment maintenance may suffer as employees push to hit quotas.

Merit Pay as an Incentive

merit pay (merit raise)
Any salary increase awarded to an employee based on his or her individual performance.

Merit pay or a **merit raise** is a salary increase the firm awards to an individual employee based on individual performance. It is different from a bonus in that it usually becomes part of the employee's base salary, whereas bonuses are generally one-time payments. Although the term *merit pay* can apply to the incentive raises given to any employee, the term is more often used for professional, office, and clerical employees.

Merit pay has pros and cons. Advocates say granting pay raises across the board (*without* regard to merit) reduces performance by rewarding employees regardless of how they perform. Detractors argue, most notably, that since most appraisals are unfair, so too are the merit decisions based on them.

The evidence is mixed. For example, one study in a nuclear waste facility found a "very modest relationship between merit pay increase and performance rating."[15] Studies of merit pay for teachers found that merit pay was more linked to research productivity than to teaching effectiveness.[16] A recent survey found that only 20% of employers in North America said merit pay drives higher levels of performance.[17] (This survey also concluded that awarding raises for demonstrating job-critical knowledge and skills was the better option.)[18]

If a merit pay plan isn't working, one sensible reaction is to improve it. This starts with establishing effective appraisal procedures, to ensure that managers actually do tie merit awards to performance. Similarly, merit plan effectiveness requires really differentiating among employees. In one survey, the highest-paid office clerical employees got short-term incentive payouts of about 13%, the lowest-rated got 3%, and mid-rated employees got 8%.[19]

HR in Action at the Hotel Paris Based on their analysis, Lisa Cruz and the CFO concluded that, by any measure, their company's incentive plan was inadequate. The percentage of the workforce whose merit increase was tied to performance was effectively zero, because managers awarded merit pay across the board. To see how they handled this, see the case on pages 414–415.

MERIT PAY OPTIONS Two merit pay adaptations are popular. One awards merit raises in a lump sum once a year (making them, in effect, short-term bonuses for lower-level workers). Traditional merit increases become part of the employee's salary, but these *lump-sum merit raises* do not. This has two benefits. First, the merit raise is not baked into the employee's salary, so you need not pay it year after year. Lump-sum merit increases are also more dramatic. For example, a 5% lump-sum merit payment to a $30,000 employee is $1,500 cash, as opposed to a weekly merit payout of about $29.

The other adaptation ties merit awards to both individual and organizational performance. Table 12-1 shows an example. In this example, you measure company performance by profits. Here, company performance and the employee's performance (using his or her performance appraisal) receive equal weight in computing merit pay. In Table 12-1 an outstanding performer would receive 70% of his or her maximum lump-sum award even when the company's performance is marginal. However, employees with marginal or unacceptable performance get no lump-sum awards even when the firm's performance was outstanding. Alternatively, you might decide to award, say, 60% of someone's bonus based on the supervisor's appraisal, 30% based on department performance, and 10% based on company performance.

Incentives for Professional Employees

Professional employees are those whose work involves the application of learned knowledge to the solution of the employer's problems, such as lawyers and engineers.

Making incentive pay decisions for professional employees is challenging. For one thing, firms usually pay professionals well anyway. For another, they're already driven by the desire to produce high-caliber work.

However, it is unrealistic to assume that people like Google engineers work only for professional gratification. Few firms, therefore, work harder than Google to maintain competitive incentives for professionals. For example, Google reportedly pays higher incentives to engineers working on important projects. Those who choose the intrinsic motivation of working on more theoretical long-term projects are rewarded if their research pays off.[20] As at most Silicon Valley firms, Google's professionals also bask in the light of potentially millionaire-making stock option grants.

Dual-career ladders are another way to manage professionals' pay. At many employers, higher pay requires rerouting from, say, engineering into management.

TABLE 12-1 Merit Award Determination Matrix (an Example)

The Employee's Performance Rating (Weight = 0.50)	*The Company's Performance (Weight = 0.50)*				
	Outstanding	Excellent	Good	Marginal	Unacceptable
Outstanding	1.00	0.90	0.80	0.70	0.00
Excellent	0.90	0.80	0.70	0.60	0.00
Good	0.80	0.70	0.60	0.50	0.00
Marginal	—	—	—	—	—
Unacceptable	—	—	—	—	—

Note: To determine the dollar value of each employee's award: (1) multiply the employee's annual, straight-time wage or salary as of June 30 times his or her maximum incentive award (as determined by management or the board—such as, "10% of each employee's pay") and (2) multiply the resultant product by the appropriate percentage figure from this table. For example, if an employee had an annual salary of $40,000 on June 30 and a maximum incentive award of 7% and if her performance and the organization's performance were both "excellent," the employee's award would be $2,240: ($40,000 × 0.07 × 0.80 = $2,240).

However, not all professionals want management. Therefore, many employers institute one career path for managers, and another for technical experts, allowing the latter to earn higher pay without switching to management.[21]

KNOWLEDGE BASE

Nonfinancial and Recognition-Based Awards

Employers often supplement financial incentives with various nonfinancial and recognition-based awards. The term *recognition program* usually refers to formal programs, such as employee-of-the-month programs. *Social recognition program* generally refers to informal manager–employee exchanges such as praise, approval, or expressions of appreciation for a job well done. *Performance feedback* means providing quantitative or qualitative information on task performance so as to change or maintain performance; showing workers a graph of how their performance is trending is an example.[22]

TRENDS SHAPING HR: *DIGITAL AND SOCIAL MEDIA*[23]

Employers are bulking up their recognition programs with digital support. For example, Baudville offers a workplace recognition e-card service called ePraise. Employers use this to tell employees they're appreciated. Intuit shifted its employee recognition, years of service, patent awards, and wellness awards programs to Globoforce.com, an online awards vendor. This "allowed us to build efficiencies and improved effectiveness" into the programs, says Intuit.[24]

Various new apps let employees showcase their awards, contributions, and praise from coworkers, and enable employees to praise each other.[25] For example, one lets employees "give recognition by picking out a badge and typing in a quick note to thank the people who matter most. . . ." Others let users post the positive feedback they receive to their LinkedIn profiles.

Mobile technology is also changing how employers incentivize front-line service people. For example, pay for a $5.00 espresso in many coffeehouses with a credit card and the iPad screen will ask how big a tip you want to leave—from $1.00 to $3.00.[26] ■

Most employers offer both financial and nonfinancial awards. At one company, customer service reps who exceed standards receive a plaque, a $500 check, their photo and story on the firm's intranet, and a dinner for themselves and their teams.[27] One survey of 235 managers found the most-used financial and nonfinancial rewards (from most used to least) were:[28] employee recognition, gift certificates, special events, cash rewards, merchandise incentives, e-mail/print communications, training programs, work/life benefits, variable pay, group travel, individual travel, and sweepstakes. The HR Tools feature elaborates.

IMPROVING PERFORMANCE: *HR TOOLS FOR LINE MANAGERS AND SMALL BUSINESSES*

The supervisor should not rely only on the employer's financial incentive plans for motivating subordinates. There are simply too many opportunities to motivate employees every day to let those opportunities pass. What to do?

First, the best option for motivating an employee is also the simplest—*make sure the employee has a doable goal* and that he or she agrees with it. It makes little sense to try to motivate employees with incentives if they don't know their goals or don't agree with them. Psychologist Edwin Locke and his colleagues have consistently found that specific, challenging goals lead to higher task performance than do specific unchallenging goals; vague goals ("do your best"); or no goals.

Second, *recognizing an employee's contribution* is a powerful motivation tool. Studies show that recognition has a positive impact on performance, either alone or combined with financial rewards. For example, in one study, combining financial rewards with recognition produced a 30% performance improvement in service firms, almost twice the effect of using each reward alone. Figure 12-1 presents a list.

FIGURE 12-1 Social Recognition and Related Positive Reinforcement Managers Can Use

Source: Based on Bob Nelson, *1001 Ways to Reward Employees* (New York: Workman Publishing, 1994), p. 19; Sunny C. L. Fong and Margaret A. Shaffer, "The Dimensionality and Determinants of Pay Satisfaction: A Cross-Cultural Investigation of a Group Incentive Plan," *International Journal of Human Resource Management* 14, no. 4 (June 2003), p. 559 (22).

- Challenging work assignments
- Freedom to choose own work activity
- Having fun built into work
- More of preferred task
- Role as boss's stand-in when he or she is away
- Role in presentations to top management
- Job rotation
- Encouragement of learning and continuous improvement
- Being provided with ample encouragement
- Being allowed to set own goals
- Compliments
- Expression of appreciation in front of others
- Note of thanks
- Employee-of-the-month award
- Special commendation
- Bigger desk
- Bigger office or cubicle

Third, use *social recognition* apps for positive reinforcement. As noted earlier, online tools such as Globoforce (www.globoforce.com/how-it-works/superior-innovation/social-recognition/) enable employees to recognize each other's contributions in real time, and encourage them to emulate outstanding behaviors.[29] One pitfall to avoid: awarding points for recognizing colleagues can lead to excessive compliments.[30] ■

MyLab Management Talk About It 1

If your professor has assigned this, go to the Assignments section of **www.pearson.com/mylab/management** to complete this discussion question.You have decided to verify that recognition does in fact improve performance. To that end, you will use an honest observation to praise someone's performance today. What was the effect of your experiment?

HR AND THE GIG ECONOMY: *RECOGNITION, NONFINANCIAL REWARDS, AND GIG WORKERS*

Some assume that pay is all that matters to gig workers, but that's not the case. One study found that gig workers will exhibit intrinsic motivation (motivation that comes from "inside" the person, driving him or her to do a good job), if the workers identify with the organization.[31] How to accomplish that? According to Mercer, a human resource management consultant, employers can do at least three things.[32]

Provide Meaning and Structure

Everyone wants to feel they're contributing in a meaningful way.Use company communications to provide gig workers with a context within which to understand how they're contributing to the company's success.

Create a Sense of Belonging and Connection

At work most people want to feel that they're part of a community. Take steps to make gig workers feel they're part of something, such as through online communities where they share stories and ideas.

Value and Respect Your Workforce

Treat your gig workers (and all workers) respectfully, and consider rewarding their progress with things like badges based on customer ratings.

Job Design

Although not usually considered an "incentive," job design (discussed in Chapter 4) can affect employee motivation. A study by Harvard Business School researchers concluded that job design is a primary driver of employee engagement. Another by Sibson Consulting concluded that job responsibility and feedback were the fifth- and seventh-most important drivers of employee engagement. Another study concluded that challenging work ranked as the seventh-most important driver for attracting employees.[33] Job design can thus be a useful part of a total rewards program.

The Strategic Context feature illustrates how employers combine incentives to boost profits.

IMPROVING PERFORMANCE: *THE STRATEGIC CONTEXT*

The Fast-Food Chain

The heart of just about any fast-food chain's strategy is to control performance: One asked, "Can financial and nonfinancial incentives boost performance in our fast-food chain?"

Two researchers studied the impact of financial and nonfinancial incentives on business performance in 21 stores of a Midwest fast-food franchise.[34] The researchers compared performance over time in stores that did and did not use financial and nonfinancial incentives. Each store had about 25 workers and two managers. The researchers trained the managers to identify measurable employee behaviors that were currently deficient but that could influence store performance. Example behaviors included "keeping both hands moving at the drive-through window" and "repeating the customer's order back to him or her."[35] Then the researchers instituted financial and nonfinancial incentive plans. They measured store performance in terms of gross profitability (revenue minus expenses), drive-through time, and employee turnover.

Financial Incentives

Some employees in some of the stores received financial incentives for exhibiting the desired behaviors. The financial incentives consisted of lump-sum bonuses in the workers' paychecks. For example, if the manager observed a work team exhibiting up to 50 behaviors (such as "working during idle time") during the observation period, he or she added $25 to the paychecks of all store employees that period; 50 to 100 behaviors added $50 per paycheck, and more than 100 behaviors added $75 per paycheck. Payouts eventually rose over time as the employees learned to enact the behaviors they were to exhibit.

Nonfinancial Incentives

The researchers trained the managers in some stores to use nonfinancial incentives such as feedback and recognition. For example, for *performance feedback* managers maintained charts showing the drive-through times at the end of each day. They placed the charts by the time clocks. Thus, these store employees could keep track of their store's performance on measures like drive-through times. The researchers also trained managers to administer *recognition* to employees. For instance, "I noticed that today the drive-through times were really good."[36]

Results

Both the financial and nonfinancial incentives improved employee and store performance.[37] For example, store profits rose 30% for those units where managers used financial rewards. Store profits rose 36% for those units where managers used nonfinancial rewards. During the same 9-month period, drive-through times decreased 19% for the financial incentives group, and 25% for the nonfinancial incentives groups. Turnover improved 13% for the financial incentives group, and 10% for the nonfinancial incentives group.

Implications for Managers

Here is what these findings mean for managers designing incentive plans:[38]

1. Link the incentive to behavior that is crucial for achieving strategic goals.[39] For example, this chain wanted to boost store performance and profits. Incentivizing employees to work faster and smarter accomplished that.
2. The point of an incentive is to motivate the person to work better. Therefore, it makes more sense to use an incentive plan when (1) motivation (not ability) is the problem; (2) when the employee's effort and results are directly related; and (3) when the employee can actually control the results you plan to incentivize. Put another way, make sure there is a clear link between the person's *effort and performance* and between the *performance and reward*, that the incentive is *attractive* to the employee, and that the employee *has the skills* to do the job.

3. Don't just rely on material rewards. Support the incentive plan with performance feedback (like the performance graphs) and with recognition.[40]
4. Set complete standards. For example, don't just pay for "repeating the customer's order" if speed is important too.
5. Be scientific. As in this study, *gather evidence*, and analyze the effects of the incentive plan over time.[41]

MyLab Management Talk About It 2

If your professor has assigned this, go to the Assignments section of **www.pearson.com/mylab/management** to complete this discussion question. The dean has asked you to design an incentive plan for your professor. How would you apply what you learned in this feature to do so?

LEARNING OBJECTIVE 12-3

Discuss the pros and cons of commissions versus straight pay for salespeople.

Incentives for Salespeople

As one survey said, "the performance metrics given to the sales team must drive behaviors that will help the company's . . . strategy to be successful."[42] Unfortunately, that survey also found that "30% of respondents believe their sales compensation program rewarded the right behaviors 'not well' or 'very poorly.'"[43] Employers are therefore moving to align how they measure and reward their salespeople, with their firms' strategic goals.[44]

Salary Plan

Sales compensation plans focus on salary, commissions, or some combination of the two.[45] Some firms pay salespeople fixed salaries (perhaps with occasional incentives such as bonuses, sales contest prizes, and the like).[46] Straight salary makes sense when the main aim is prospecting (finding new clients) or account servicing. Recruiting is another reason. Faced with difficulty attracting good salespeople, a car dealership in Lincolnton, North Carolina, offers straight salary as an option to salespeople who sell an average of at least eight vehicles a month (plus a small "retention bonus" per car sold).[47] Straight salary also makes it easier to switch salespersons' territories. The main disadvantage, of course, is that straight salary lacks commissions' motivation potential.

Commission Plan

Straight commission plans pay salespeople only for results. Commission plans tend to attract high-performing salespeople because they see that effort produces rewards. Sales costs are proportionate to sales rather than fixed, and the company's fixed sales costs are thus lower. Such plans are easy to understand and compute. Commission plan alternatives include straight commissions, quota bonuses (for meeting particular quotas), management by objectives programs (pay is based on specific metrics), and ranking programs (which reward high achievers but pay little or no bonuses to the lowest-performing salespeople).[48] About half of companies surveyed use "top-line" measures like revenue, while the others use bottom-line criteria like profits; some also use nonsales measures.[49]

However, in poorly designed plans, salespeople may focus on making the sale, and neglect nonselling duties such as servicing small accounts and pushing hard-to-sell items. Wide variations in pay can make some feel the plan is inequitable. Misjudging sales potential can lead to excessive commissions and to having to cut commission rates. Salespersons' pay may be excessive in boom times and low in recessions. Furthermore, sales performance—like any performance—reflects not just motivation, but also ability. If the person can't sell, commissions won't help.[50]

Combination Plan

Most companies pay salespeople a combination of salary and commissions. The combination varies by industry and by what the company hopes to achieve, but a split of about 60%–70% base salary and 40%–30% incentive seems typical.[51]

Combination plans have pros and cons.[52] They give salespeople a floor to their earnings, let the company specify what services the salary component is for (such as servicing current accounts), and still provide a performance incentive. But the salary isn't tied to performance, so the employer trades away some incentive value.

Combination plans also tend to be complicated, so misunderstandings can ensue. This isn't a problem with a simple salary-plus-commission plan, but most plans aren't so simple. For example, in a "commission-plus-drawing-account" plan, the salesperson is paid based on commissions. However, he or she can draw on future earnings during low sales periods. In the "commission-plus-bonus" plan, the firm pays its salespeople mostly based on commissions. However, they also get a small bonus for directed activities like selling slow-moving items.

Maximizing Sales Results

In setting sales quotas and commission rates, one wants to motivate sales activity but avoid excessive commissions. Unfortunately, the tendency to set commission rates informally often reduces such plans' effectiveness.[53]

Setting effective quotas is an art. Questions to ask include: Are quotas communicated to the sales force within 1 month of the start of the period? Does the sales force know how their quotas are set? Do you combine bottom-up information (like account forecasts) with top-down requirements (like the company business goals)? Are returns and de-bookings reasonably low?[54]

One expert suggests this rule as to whether the sales incentive plan is effective: 75% or more of the sales force achieving quota or better, 10% of the sales force achieving higher performance level (than previously), and 5% to 10% of the sales force achieving below-quota performance and receiving coaching.[55] Also consider the effect of sales carryover: In most firms, a significant portion of the sales in one year reflects a "carryover" (sales that would repeat even without any efforts by the sales force) of sales from the prior year. Paying the sales force a commission on all the current year's sales means the employer pays a commission on last year's carryover sales, which the salesperson had little or no role in bringing in this year.[56]

A survey of sales effectiveness reveals that salespeople at high-performing companies:

- Receive 38% of their total cash compensation in the form of *sales incentive pay* (compared with 27% for salespeople at low-performing companies)
- Are twice as likely to receive stock, *stock options*, or other equity pay as their counterparts at low-performing companies (36% versus 18%)
- Spend 264 more hours per year on *high-value sales activities* (e.g., prospecting, making sales presentations, and closing) than salespeople at low-performing companies
- Spend 40% more time each year with their *best potential customers*—qualified leads and prospects they know—than salespeople at low-performing companies
- Spend nearly 25% *less time on administration*, allowing them to allocate more time to core sales activities, such as prospecting leads and closing sales[57]

Distinguishing among performers is also important. For example, some companies distinguish among stars, laggards, and core sales performers. Companies that limit commission earnings can perversely encourage stars to stop selling when they reach their quotas. Laggards do better with more frequent, quarterly bonuses and social pressure to improve. Core performers—the midrange of the sales force—need multitier targets. The first tier target is what sales agents historically attain. The second tier is what a small percentage of the sales force attains. The third tier target is usually only attained by the company's star salespeople.[58] One expert advocates "acceleration": here the commission rate rises for those who meet their sales targets.[59] Finally, track cost of sales—for instance, a salesperson's *salary* plus *commissions* (assuming 100% of quota) plus *bonus* opportunities—divided by that person's sales revenues.[60]

ENTERPRISE INCENTIVE MANAGEMENT Many employers use Enterprise Incentive Management (EIM) software to track and control sales commissions.[61] For example, Oracle Sales Cloud enables management to easily create scorecard metrics such as number of prospecting calls and sales contracts, and to monitor these in real time on the system's dashboards.[62] It also helps users gamify the sales incentive process, by awarding points or badges based on each salesperson's performance.

Sales Incentives in Action

Traditionally, a car salesperson's commission is based on a percentage of the difference between the dealer's invoice cost and the amount the car is sold for, minus an amount to cover the "pack" or dealer overhead (the pack being perhaps $300 for a new car to $800 for a used car, and rising for pricier cars).[63]

This approach encourages the salesperson to hold firm on the retail price, and to push "after-sale products" like floor mats and side moldings. There may also be extra incentives to sell packages such as rustproofing. For selling slow-moving vehicles, the salesperson may get a "spiff"—an extra incentive bonus over commission. And there are bonuses, such as Salesperson of the Month (perhaps $300 for most cars sold).[64]

KNOWLEDGE BASE

LEARNING OBJECTIVE 12-4

Describe the main incentives for managers and executives.

Incentives for Managers and Executives

Managers play a crucial role in divisional and company-wide profitability, and most employers therefore think through how to reward them. Most managers get short-term and long-term incentives in addition to salary. Short-term incentives might include, for instance, annual incentive plans (which reward achieving preset results and are usually paid in cash), discretionary bonuses (based on performance), retention bonuses, and the manager's share of any profit-sharing plan.[65] To link shareholders' and managers' interests, long-term incentives are often paid in stock or stock options.

Strategy and the Executive's Long-Term and Total Rewards Package

Whether consolidating operations or pursuing growth, firms can't fully implement most strategies in just 1 or 2 years. Therefore, the long-term signals you send managers via long-term incentives can determine whether the firm's strategy succeeds.

The executives' reward components—base salary, short-and long-term incentives, and benefits—must align with each other and with the company's strategic aims. Compensation experts suggest first specifying the strategic aims—"What is our strategy, and what are our strategic goals?"—and then deciding what long-term behaviors (boosting sales, cutting costs, and so on) are important for achieving these strategic aims. Next shape each component of the executive total compensation package (base salary, short-and long-term incentives, and benefits) to encourage these required behaviors; then combine the components into a plan. The point is this: Each pay component should help focus the manager's attention on the behaviors required to achieve the company's strategic goals.[66]

Using multiple, strategy-based performance criteria for incentivizing executives is best. Criteria include financial performance, number of strategic goals met, employee productivity measures, customer satisfaction surveys, and employee morale surveys.[67]

One expert estimates that the typical CEO's salary accounts for about one-fifth of his or her pay. A bonus based on explicit short-term performance standards accounts for another fifth, and long-term incentive awards such as stock options and long-term performance plans account for the remaining three-fifths.[68] Ideally, the performance standards should include a combination of market benchmarks (such as performance against competitors) as well as business performance standards (such as earnings per share growth).

KNOWLEDGE BASE

SARBANES–OXLEY The Sarbanes–Oxley Act of 2002 affects how employers formulate their executive incentive programs. Congress passed Sarbanes–Oxley to inject a higher level of responsibility into executives' and board members' decisions. It makes them personally liable for violating their fiduciary responsibilities to their shareholders. The act also requires CEOs and CFOs of a public company to repay any bonuses, incentives, or equity-based compensation received from the company during the 12-month period following the issuance of a financial statement that the company must restate due to material noncompliance with a financial reporting requirement stemming from misconduct.[69]

Short-Term Incentives and the Annual Bonus

annual bonus
Plans that are designed to motivate short-term performance of managers and that are tied to company profitability.

For better or worse, employers are shifting away from long-term incentives to put more emphasis on short-term performance and incentives.[70] Most firms have **annual bonus** plans for motivating managers' short-term performance. Such short-term incentives can easily produce plus-or-minus adjustments of 25% or more to total pay. Three factors influence one's bonus: eligibility, fund size, and individual performance.

ELIGIBILITY Employers first decide eligibility. Traditionally, most based annual bonus eligibility on job level/title, base salary, and/or officer status. Some simply based eligibility on job level or job title, or salary.[71] Recently, more employers were offering a broader range of employee annual incentive plans ". . . in which both executives and other employees participate."[72]

The trend is evident from surveys of what determines bonus plan eligibility. Rather than job title or officer status, s*alary grade or band* was the most common eligibility determinant, reported by 42% of employers in one survey. This was followed by *title/reporting relationship* (24%), *officer status* (13%), *compensation committee approval* (11%), *discretionary* (6%), and *base salary* (2%).[73]

The percentage size of any bonus is typically greater for top executives. Thus, an executive earning $250,000 in salary may be able to earn another 80% of his or her salary as a bonus, while a manager in the same firm earning $100,000 can earn only another 30%. In one year, Microsoft's CEO was eligible for an annual bonus of up to 100% of his salary (but collected only half). A typical bonus percentage might be executives, 45% of base salary; managers, 25%; and supervisory personnel, 12%.

FUND SIZE Second, one must determine how big the annual bonus fund should be. Most employers (33% in one survey) use the sum of targets approach.[74] This means they estimate the likely bonus for each eligible ("target") employee, and total these to arrive at the bonus pool's size.

However, more employers are funding the short-term bonus based on financial results. Here there are no fixed rules about how much of the profits to pay out. One alternative is to reserve a minimal amount of the profits, say, 10%, for safeguarding stockholders' investments. Then establish a fund for bonuses equal to, say, 20% of the operating profit (profit from the company's core business) before taxes in excess of this safeguard amount. Suppose the operating profits were $200,000 (after putting away 10% to safeguard stockholders). Then the management bonus fund might be 20% of $200,000, or $40,000.

Most employers use more than one financial measure on which to base the bonus fund; sales, earnings per share, and cash flow are the most popular.[75] Other illustrative formulas include:

- Twelve percent of net earnings after deducting 6% of net capital
- Ten percent of the amount by which net income exceeds 5% of stockholders' equity

Employers also use formulas to set their bonus pools based on other measures they wish to emphasize. For example, Transocean Ltd., the firm that managed the Deepwater Horizon Gulf oil rig that sank in 2010, uses a formula that includes "safety" as 25% of the formula. After the Gulf explosion, senior Transocean executives donated safety bonuses to the victims' families.[76] Other firms decide bonuses on a discretionary basis.

THE INDIVIDUAL AWARDS Finally, one must decide the actual individual awards. Typically, the employer sets a target bonus (as well as maximum bonus, perhaps double the target bonus) for each eligible position. The actual bonus then reflects the manager's performance. For example, having previously decided which financial performance

Even in retail stores, it's not unusual to compensate managers partly based on short-term sales and profits.

Monkey Business Images/Shutterstock

measures (return on assets, revenue growth, and so on) to use to measure each manager's performance, the employer computes preliminary total company bonus estimates, and compares the total amount of money required with the bonus fund available.[77] If necessary, it then adjusts the individual bonus estimates. In any case, outstanding managers should receive at least their target bonuses, and marginal ones should receive at best below-average awards. Use what you save on the marginal employees to supplement the outstanding employees. A study of CEOs of Standard & Poor's 1500 companies for one 3-year period found that 57% of the CEOs received pay increases, although company performance (in terms of total shareholder return) did not improve.[78]

One question is whether to give managers bonuses based on individual performance, corporate performance, or both. Firms usually tie top-level executive bonuses mostly to overall corporate results (or divisional results if the executive heads a major division). But as one moves farther down, corporate profits become a less-accurate gauge of a manager's contribution. For supervisors or the heads of functional departments, it often makes more sense to base the bonus more on individual performance.

Many firms end up tying short-term bonuses to both organizational and individual performance. Perhaps the simplest method is the *split-award plan*. This makes the manager eligible for two bonuses, one based on his or her individual effort and one based on the organization's overall performance. Thus, a manager might be eligible for an individual performance bonus of up to $10,000, but receive only $2,000 at the end of the year, based on his or her individual performance evaluation. But the person might also receive a second bonus of $3,000, based on the firm's profits for the year.

One drawback to this approach is that it may give marginal performers too much—for instance, someone could get a company-based bonus, even if his or her own performance is mediocre. One way to avoid this is to use the *multiplier method*. As Table 12-2 illustrates, multiply the person's target bonus by 1.00, 0.80, or zero (if the firm's performance is excellent, and the person's performance is excellent, good, fair, or poor). A manager whose own performance is poor does not even receive the company-based bonus.

LONG TERM INCENTIVES Employers use *long-term incentives* to inject a long-term perspective into their executives' decisions. With only short-term (generally one year) criteria to shoot for, a manager could conceivably boost profitability by reducing plant maintenance, for instance; this tactic might catch up with the company 3 or 4 years

TABLE 12-2 Multiplier Approach to Determining Annual Bonus

Individual Performance (Based on Appraisal, Weight = 0.50)	*Company Performance (Based on Sales Targets, Weight = 0.50)*			
	Excellent	Good	Fair	Poor
Excellent	1.00	0.90	0.80	0.70
Good	0.80	0.70	0.60	0.50
Fair	0.00	0.00	0.00	0.00
Poor	0.00	0.00	0.00	0.00

Note: To determine the dollar amount of a manager's award, multiply the maximum possible (target) bonus by the appropriate factor in the matrix.

later. Popular long-term incentives include cash, stock options, stock, stock appreciation rights, and phantom stock.[79] PepsiCo's CEO was paid $26.4 million for one year, including a base salary of $1.6 million, stock awards of $6.25 million and a performance-based cash bonus of $13.9 million, a $4.26 million adjustment to her pension, plus perks such as air travel.[80]

Long-term incentives such as stock options, if well-designed, should only pay off if the firm achieves its strategic goals (such as "double our rate of return"), because the owners and investors should also benefit from the executives' efforts. Long-term incentives may also be "golden handcuffs," motivating executives to stay by letting them accumulate capital (usually options to buy company stock) that they can cash in only after a certain period. Again, popular long-term incentives include cash, stock, stock options, stock appreciation rights, and phantom stock.[81] We'll look at each.

stock option
The right to purchase a stated number of shares of a company stock at today's price at some time in the future.

STOCK OPTIONS A **stock option** is the right to purchase a specific number of shares of company stock at a specific price during a specific period. The executive thus hopes to profit by exercising his or her option to buy the shares in the future but at today's price. This assumes the stock will go up. Unfortunately, this depends partly on considerations outside the manager's control.[82] When stock markets dropped a while ago, many employers including Intel and Google adjusted their option plans to boost the likely payout.[83] The HR Practices Around the Globe feature addresses one aspect of this.

IMPROVING PERFORMANCE: *HR PRACTICES AROUND THE GLOBE*

Until January 2006, China basically prohibited publicly listed companies from offering stock incentive plans to their managers.[84] At that point better economic conditions and an evolving political philosophy led to new regulations. Soon 42 Chinese-listed companies were permitting such plans.

A study focused on those 42 companies. It sought to determine how the new incentive plans affected company performance. To understand the findings it's important to know that managing in China still has unique characteristics. For example, prior to becoming publicly listed firms, the big firms were usually owned by the government. Furthermore, the government may well continue to retain certain ownership control rights even after the firms go on the stock market. In such cases, the goals of the owners and the management may diverge. For example, government owners might want to maximize employment, rather than profitability. The question is, given such cultural and political realities, do management stock option plans in China translate into improved company performance, as they often do in the United States?

The researchers compared the performance of the 42 Chinese companies that did adopt management stock option plans with a control group of firms without such plans. One thing they found was that the stock option plans did improve firm performance in companies controlled by private shareholders, but not in companies controlled by the government. In the latter, goals such as maximizing employment may have outweighed boosting profits, thus limiting managers' profit-boosting efforts.

The findings highlight why managing globally is challenging. In this case, a stock option plan that might improve financial performance in the United States might fail in China, where the government owners' goals may well differ from the desire of managers to boost profits.

MyLab Management Talk About It 3

If your professor has assigned this, go to the Assignments section of **www.pearson.com/mylab/management** to complete these discussion questions.Given these findings, would it make sense for managers in government-controlled companies to receive stock options tied to something other than profitability, such as "no employees lose their jobs in this company"? Why?

The chronic problem with stock option plans is that many reward even managers who have lackluster performance, but there are also other problems. Several years ago some executives allegedly lied about the dates they received their options to boost their returns. Options may also encourage executives to take perilous risks in pursuit of higher profits.[85] One alternative may be to force recipients to convert their options into stock sooner. One paper argues that it's probably cheaper just to pay cash awards than stock options.[86]

OTHER STOCK PLANS Beyond that, the trend is toward tying rewards more explicitly to performance goals. Instead of stock options, more firms are granting various types of performance-based shares. With *performance-contingent restricted stock* the executive receives his or her shares only if he or she meets the preset performance targets.[87] With (time-based) *restricted stock plans*, the firm usually awards rights to the shares without cost to the executive but the employee is restricted from acquiring (and selling) the shares for, say, five years, and the award may be subject to forfeiture if the recipient ceases to be employed by the company for a set period. Unlike options, the recipient usually pays nothing for the stock. The employer's aim is to retain the employee's services during that time.[88] With *indexed options*, the option's exercise price fluctuates with the performance of, say, a market index. If the company's stock does no better than the index, the manager's options are worthless. With *premium priced options*, the exercise price is higher than the stock's closing price on the date of the grant, so the executive can't profit from them until the stock makes significant gains;[89] IBM has used these for years.[90]

Stock appreciation rights (SARs) let the recipient exercise the stock option (by buying the stock) or to take any appreciation in the stock price in cash, stock, or some combination of these. Under *phantom stock plans*, executives receive not shares but "units" that are similar to shares of company stock. Then at some future time, they receive value (usually in cash) equal to the appreciation of the "phantom" stock they own. Both SARs and phantom stock essentially "are bonus plans that grant not stock but rather the right to receive an award based on the value of the company's stock."[91] A *performance achievement plan* awards shares of stock for the achievement of predetermined financial targets, such as profit or growth in earnings per share. Most employees seem to prefer cash bonuses to either stock options or restricted stocks. Due to differences in employee preferences, when possible, enable each employee to choose whether to receive stock options or restricted stock.[92]

POTENTIAL PROBLEMS Two problems plague executive incentives: short termism, and lack of range. Many plans encourage short-term thinking. For example, the manager boosts earnings per share (and his or her short-term bonus) by cutting R&D, which in turn hurts earnings three or four years down the road. Relatedly, tying the incentive to one metric rather than to several can encourage counterproductive behavior. For example, incentivize the manager just for earnings, and he or she could boost earnings by cutting advertising and other costs, which in turn cause future revenues (unmeasured by the bonus plan) to fall.[93]

Three experts suggest several solutions. First, use *multiple metrics*, for instance earnings, and revenue growth, and R&D spending.[94]

Second, reward performance *relative to competitors*. For example, increasing a company's earnings when its industry grew 10%, isn't as impressive as increasing them 2% when industry sales and earnings fell. Rewarding performance relative to