Chapter 11 – Pay Structure Decisions

This chapter introduces students to the concepts concerning compensation management within organizations. Students may be introduced to this through the overarching idea of how organizations must balance their overall costs against talent or employee needs (LO11-1). Table 11.1 can help illustrate the potential costs associated with compensation. As with previous chapters, these concepts may be discussed within strategic management by revisiting internal and external analysis, which may support the understanding of LO11-2 and LO11-3. LO11-4, then, may be introduced as a component of the internal managerial considerations of compensation. Students may be encouraged to discuss the potential issues identified with pay structures, and look to solve these problems with LO11-5.

LO11-6 and LO11-7 ask students to consider two specific considerations of compensation, and instructors may wish to facilitate discussions around these topics that require students to apply understanding from the previous LOs and concepts within the chapter. LO11-8 reintroduces EEO, which students should remember from previous chapters, but also includes FLSA and minimum wage.

Learning Objectives

LO 11-1: List the main decision areas and concepts in employee compensation management.

LO 11-2: Describe the major administrative tools used to manage employee compensation.

LO 11-3: Explain the importance of competitive labor market and product market forces in compensation decisions.

LO 11-4: Discuss the significance of process issues such as communication in compensation management.

LO 11-5: Describe new developments in the design of pay structures.

LO 11-6: Explain where the United States stands on pay issues from an international perspective.

LO 11-7: Explain the reasons for the controversy over executive pay.

LO 11-8: Describe the regulatory framework for employee compensation.

Society for Human Resource Management *Body of Competency & Knowledge*

This chapter contains content which may be identified within the following content areas in HR Expertise:

* Talent Acquisition
* Employee Engagement & Retention
* Total Rewards
* Structure of the HR Function
* Employee & Labor Relations
* HR in the Global Context
* Risk Management
* U.S. Employment Law & Regulations

Human Resource Certification Institute’s *A Guide to the HR Body of Knowledge*

This chapter contains content which may be identified within the following content areas:

* Business Management & Strategy
* Workforce Planning and Employment
* Compensation and Benefits
* Risk Management

Guidance to Discussion Questions and End of Chapter Sections

**Discussion Question 1:** You have been asked to evaluate whether your organization’s current pay structure makes sense in view of what competing organizations are paying. How would you identify the organizations with which to compare your organization? Why might your organization’s pay structure differ from those in competing organizations? What are the potential consequences of having a pay structure that is out of line relative to those of your competitors?

You would determine what organizations to compare an organization to by looking primarily for organizations in a similar business and located in a similar geographical region. Trade associations or employer associations can frequently help by providing information. Your organization's pay structure may differ from those in competing organizations if decisions are made to use pay as a primary reward strategy or perhaps emphasize other issues. For example, your organization might offer good training opportunities for new college graduates and therefore your pay-level decision is to pay typically below market. A consequence of having a pay structure out of line is that if you are overpaying, you will find it increasingly difficult to compete, since your labor costs are too high. If you are underpaying, it will be difficult to attract and retain employees. There are trade-offs, however, that make a considerable difference in the consequences of over- or underpaying in relationship to the market, for example, as mentioned in the text.

**Discussion Question 2:** Top management has decided that the organization is too bureaucratic and has too many layers of jobs to compete effectively. You have been asked to suggest innovative alternatives to the traditional “job-based” approach to employee compensation and to list the advantages and disadvantages of these new approaches.

The most innovative alternative discussed in the text is skill-based pay. The advantages and disadvantages discussed in the text are as follows: Advantages are that flexibility helps promote lower staffing levels and aids in situations where the manufacturing process demands adaptable, flexible responses (e.g., flexible manufacturing, just-in-time systems). Potential disadvantages are that the organization may find it difficult to use all skills effectively (i.e., work design must also change), employees may acquire skills quickly and compensation tops out, and skill-based plans may require a larger bureaucracy (related to skills definition and measurement, training, and certification). Lastly, there is almost no market information available on how to price skills.

**Discussion Question 3:** If major changes of the type mentioned in Question 2 are to be made, what types of so-called process issues need to be considered? Of what relevance is equity theory in helping to understand how employees might react to changes in the pay structure?

Communication and participation would both be critical if skill-based pay was implemented. Communication would undoubtedly be complicated since, as mentioned in the last question, employees must understand what skills are, how they are defined, what has to be learned to be certified as acquiring a new skill, and so forth. Participation is also important since skill-based pay is logically connected with the need for participation (e.g., technology that is advanced and complex). It also makes sense to ensure participation is built into the process so that skill-based pay will be cost-efficient. That is, given the existence of skills, there should be a system that ensures the skills are employed.

**Discussion Question 4:** Are executive pay levels unreasonable? Why or why not?

There is evidence that may be presented on both sides for this question. The text discusses that pay levels may not be unreasonable, since executives are critical in determining the success of an organization. Data are also presented that suggest that on average most executives are not paid much differently from several other professionals. In addition, only salaries themselves tend to be compared without benefits factored into the equation. This presents a different picture in comparing executive compensation across countries. On the other hand, there are some executives who tend to be very highly compensated (often on the basis of stock options). This presents some problems relative to social comparisons of workers.

**Discussion Question 5:** Your company plans to build a new manufacturing plant but is undecided where to locate it. What factors would you consider in choosing in which country (or state) to build the plant?

For most organizations, the cost of labor is the highest operating expense; therefore labor with the appropriate skills must be available. Also, the area should be assessed to determine prevailing wage and benefit rates. Some other issues to consider would be the availability of an appropriate infrastructure to ensure your raw materials can arrive and that you can ship your product with few problems, cost of building and running a plant, supportiveness of local government, and tax structure.

**Discussion Question 6:** You have been asked to evaluate whether a company’s pay structure is fair to women and minorities. How would you go about answering this question?

First, you would have to examine whether any policies exist that are unfair to women and minorities. For example, although it is likely that seniority plays a strong role in rewarding employees, this is considered a legitimate factor. If there are, however, separate seniority systems across your organization and women and minorities are located in lower-paying departments, this is not legal. Next, you would want to examine possible clusters of minorities and women, what their jobs and skills are, and their average pay in comparison to white males in similar jobs and with similar skills. A statistical method such as multiple regression, might be useful in determining what predicts pay in the organization. For example, one would expect that experience, education, certification of skills, and other job-related factors would predict pay while race or sex should not be predictive.

**Exercising Strategy**

The Wealth Management Industry and the Drive to Lower Costs (and Increase Revenues)

1. Describe the nature of the innovation in investing introduced by John Bogle and Vanguard. If need be, search for more information on the Web using terms like active investing and passive investing.

Vanguard uses passive management for its investments by tracking a benchmark index like the S&P 500, which saves investors money by charging lower fees.

1. What happened to Vanguard’s revenues in response to Vanguard driving its costs down?

Vanguard became the second largest mutual fund firm.

1. Was John Bogle seen as an innovator when his idea was first introduced? What about now?

He was seen as an innovator. Now, likely less so, although many brokers still charge much higher fees.

1. How is the change that has taken place in the wealth management industry currently playing out at Merrill Lynch?

Merrill Lynch reduced broker pay to reduce its costs, which has resulted in the need for more cross-selling to obtain growth.

**Managing People**

Reporting the Ratio of Executive Pay to Worker Pay: Is It Worth the Trouble?

1. Do you believe it is an undue burden on companies to compute and report the ratio of chief executive compensation to employee compensation? Why or why not?

Responses will vary, but may discuss the politics versus the utility of improving worker pay.

1. Do you believe reporting this ratio will result in changes that benefit companies, employees, or society? Explain.

Responses will vary.

**HR in Small Business**

Changing the Pay Level at Eight Crossings

1. How did the change in pay level at Eight Crossings affect its ability to attract and retain a high-quality workforce?

Students should identify how the change did not seem to not impact retention, as employees expressed understanding of the decision. However, it may impact future employees, including the ability to attract new employees.

1. Do you think the company’s pay structure was better suited to its objectives before or after the reduction in pay level? Why?

It seems that the new pay structure is more in line with the company’s objectives since it is more efficient and simply utilizes boilerplate to enhance productivity and efficiency with no impact on the quality of service.

1. How would you evaluate the company’s method of communicating the change in pay level? What improvements to that process can you suggest?

Students should discuss the apparent transparency and conversations the CEO undertook. Improvements should be aligned with chapter content.

Guidance to Chapter Cases

**A Look Back**

Pay Levels, Labor Costs, and Pay Strategy

1. What types of changes have the companies discussed in this chapter made to their pay levels and pay structures to support execution of their business strategies?

Students should be able to discuss the pay strategies of several companies, including Costco, Walmart, and Amazon.

2) Would other companies seeking to better align their pay structures with their business strategies benefit from imitating the changes made at these companies?

Responses should reflect an understanding of the need to align compensation with strategy. Thus, while organizations may imitate compensation practices, it is better for organizations to first understand their strategy, identify the best compensation strategy, and then implement. Organizations may benchmark and imitate only when it will help achieve their strategy.

**Competing through Technology**

Automation, Technology and the Demand for Employees

1. What factors make it more likely that employers will substitute technology for employees?

Responses should identify such factors as the labor costs versus the technology costs, and labor that is easily replaced or results in lower costs may be those considered for automation.

1. Does technology inevitably result in a lower demand for employees? Can you think of examples where demand for employees was not reduced or was even increased? (Hint: How did people get around before the automobile? Or, how did computations get done before computers? Or, how did people shop before there was Amazon? How did these technology changes affect employment, both at particular companies and in the economy overall?)

Responses will vary, but should identify how employment may shift from one job to another, or from one industry to another.

1. What about from the point of view of the consumer? Can you provide examples of technology that has made your life better (or worse)? How do you feel about shopping via Amazon?

Responses will vary.

1. Is automation good or bad for employees? In thinking about this, think about the relationships between efficiency and revenue growth and between revenue growth and employment growth.

Responses will vary.

**Competing through Environmental, Social, and Governance Practices**

Reducing Employee Financial Precarity

1. How common is financial precarity? What effects, especially over time, can financial precarity have on an individual?

Financial precarity is very common in the U.S. Besides affecting an employee's performance in the workplace, it can also put stress on employees' families and relationships. When a family does not have the money to pay medical bills or buy nutritional food, it can affect their health. Many families are one crisis away from bankruptcy.

1. If you have experienced financial precarity and if you are willing to share your experience, describe the effects you experienced.

Responses will vary.

3) From the point of view of an organization, why take steps to reduce employee financial precarity?

Keeping employees happy and less stressed will help them perform better at work by having a better quality of life. It will also make them more loyal to the company, reducing turnover.

**Competing through Globalization**

Where to Manufacture? Labor Costs and the Automobile Industry (including Tesla)

1. How important do labor costs appear to be in determining where companies manufacture automobiles?

Responses will vary, but students should indicate that yes, the costs have led some companies to relocate. Students should also recognize that location is a function of both cost and business needs.

1. What factors other than labor costs do firms consider when making production location decisions. Are there differences across companies? If so, what factors explain these differences? For example, do General Motors and Tesla make these decisions the same or differently?

Responses will vary, but students should identify the location, supply chain, consumer needs and other business critical factors.

1. Under what circumstances is a firm most likely to emphasize low labor costs versus other factors in locating production? Is one factor the nature of the product? Do firms have some products that are more mass market and some that are more customized?

Responses will vary, but students should link the strategy (low-cost; customized product) with the location.

Other Classroom Materials: CONNECT

There are CONNECT exercises available through McGraw-Hill, which can greatly assist student preparation for class and understanding of chapter concepts. Instructors may wish to structure the class, where students must complete the CONNECT exercises prior to class, thus, further reinforcing material and allowing instructors to expand and challenge student understanding during class time. CONNECT exercises may be set-up to be time-based, requiring students to practice chapter materials for a specific timeframe. It is the instructors’ discretion how they desire to include this into the course grade, but a low-stakes grading system based on completion is suggested to help encourage student usage, while minimizing penalties for mistakes during completion.

The following activities are available in Connect for this chapter:

**Developing a Pay Structure**

*Case Analysis*

This activity asks students how pay structure should fit in with the organization’s overall business strategy, taking into account the various jobs and their importance in day-to-day operations.

LO: 11-03 Explain the importance of competitive labor market and product market forces in compensation decisions.

Difficulty: 2 Medium

Blooms: Understand; Analyze

AACSB: Analytical Thinking

Topic: Factors Related to Pay Structure Decisions

**I’m with the Band**

*Case Analysis*

This activity reviews the concept of "banding," or making wider groups of jobs with similar pay.

LO: 11-05 Describe new developments in the design of pay structures.

Difficulty: 2 Medium

Blooms: Understand; Apply

AACSB: Analytical Thinking; Knowledge Application

Topic: Factors Related to Pay Structure Decisions; Approaches to Performance Management

**Communicating Executive Pay**

*Video Case*

This activity reviews the issues associated with executive pay.

LO: 11-01 List the main decision areas and concepts in employee compensation management.

11-04 Discuss the significance of process issues such as communication in compensation management.

11-07 Explain the reasons for the controversy over executive pay.

Difficulty: 2 Medium; 3 Hard

Blooms: Remember; Understand; Apply

AACSB: Analytical Thinking; Knowledge Application; Reflective Thinking

Topic: Factors Related to Pay Structure Decisions; How to Establish Pay Rates; Issues Related to Executive Pay

**Legal Requirements for Pay**

*Click & Drag*

This activity asks students to match the specific legal requirements to the associated pay policy: nonexempt, exempt, or minimum wage.

LO: 11-08 Describe the regulatory framework for employee compensation.

Difficulty: 2 Medium

Blooms: Apply

AACSB: Knowledge Application

Topic: Legislation Governing Employee Compensations

**Factors Affecting a Company Pay Structure**

*Click & Drag*

This activity asks students to classify various decisions based on the factors used to establish a pay structure: legal requirements, organizational goals, or market forces.

LO: 11-01 List the main decision areas and concepts in employee compensation management.

11-08 Describe the regulatory framework for employee compensation.

Difficulty: 2 Medium

Blooms: Understand

AACSB: Analytical Thinking

Topic: Factors Related to Pay Structure Decisions; Legislation Governing Employee Compensations

**Setting Up a Pay Structure**

*Case Analysis*

This activity reviews the aspects to consider when designing a pay structure.

LO: 11-01 List the main decision areas and concepts in employee compensation management.

11-02 Describe the major administrative tools used to manage employee compensation.

11-03 Explain the importance of competitive labor market and product market forces in compensation decisions.

Difficulty: 1 Easy; 2 Medium

Blooms: Remember; Understand

AACSB: Analytical Thinking; Knowledge Application

Topic: Factors Related to Pay Structure Decisions; Market Forces Affecting Compensation Decisions

**Manager's Hot Seat: Negotiations**

*Video Case*

This activity reviews the process of negotiating with a union representative.

LO: 11-01 List the main decision areas and concepts in employee compensation management.

11-07 Explain the reasons for the controversy over executive pay.

Difficulty: 1 Easy; 2 Medium; 3 Hard

Blooms: Understand; Apply

AACSB: Analytical Thinking; Knowledge Application

Topic: Factors Related to Pay Structure Decisions

**Where Should We Go?**

*Case Analysis*

This activity reviews the factors to consider when deciding where to manufacture a firm's product.

LO: 11-06 Explain where the United States stands on pay issues from an international perspective.

Difficulty: 2 Medium; 3 Hard

Blooms: Apply

AACSB: Knowledge Application

Topic: Job Outsourcing

**CHRO Conversations: Jerrold Williams, Daymon Worldwide**

*Video Case*

This activity has students watch a video interview with the CHRO of Daymon Worldwide and answer questions about the factors impacting employees’ perceptions of equity and fairness.

LO: 11-01 List the main decision areas and concepts in employee compensation management

Difficulty: 2 Medium; 3 Hard

Blooms: Apply; Analyze; Evaluate

AACSB: Knowledge Application; Analytical Thinking

Topic: Factors Related to Pay Structure Decisions