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CHAPTER 1

THE PAY MODEL

LEARNING OUTCOMES

After studying Chapter 1 students should be able to:

- Define the term compensation.
- Describe how compensation is viewed differently by society, stakeholders, managers, and employees in Canada and around the world.
- Discuss major components of total rewards.
- Identify and explain the three strategic objectives of compensation.
- Describe the four strategic policies in the pay model and the techniques associated with them.

CHAPTER SUMMARY

1. Compensation refers to all forms of financial returns and tangible services and benefits that employee receive as part of an employment relationship.

2. People may have different perspectives on compensation. From the societal perspective, compensation is viewed as a measure of justice and a cause of increased taxes and price increases. Stakeholders believe that paying employees in stock creates a sense of ownership that will improve organizational performance. Managers view compensation as a major expense and a means to influence employee behaviour. Employees view compensation as a return in exchange with their employer, or a reward. In other countries, compensation relates to being taken care of.

3. The two major components of total rewards are total compensation and relational returns. Total compensation is composed of cash compensation (base pay and incentives) and benefits. Relational returns include psychological aspects of work such as recognition and status, challenging work, and learning opportunities.

4. The strategic objectives of compensation are (1) efficiency in performance and quality, satisfying customers and stockholders, and controlling costs, (2) fairness, and (3) compliance with laws and regulations.

5. The four strategic policies in the pay model are internal alignment, external competitiveness, employee contributions, and management. The internal structure techniques associated with alignment are job analysis, descriptions, and evaluations/certification. The pay structure techniques associated with

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competitiveness are market definitions, surveys, and pay policy lines. The incentive program techniques associated with contributions are seniority-based, performance-based, and merit guidelines. The evaluation techniques associated with management are planning, budgeting, and communication.

LECTURE OUTLINE

COMPENSATION: DEFINITION

- Compensation refers to all forms of financial returns and tangible services and benefits that employee receive as part of an employment relationship.

WHY SHOULD WE CARE ABOUT COMPENSATION?

- Compensation influences the way employees behave.
- The link between behaviour and organizational effectiveness is important to consider.
- If employees believe that compensation is not fair, there is potential for behaviour that undermines organizational performance.
- Compensation is a significant component of operating expenses and therefore must be controlled and monitored to ensure organizational viability.

COMPENSATION: DIFFERING PERSPECTIVES

Compensation does not mean the same thing to everyone. Yet, how people view compensation affects how they behave at work. It is important to recognize different perspectives.

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

Society perceives compensation as a measure of justice (distributive).

See Exhibit 1.1 – Overviews the gender wage gap in median earnings of full-time employees

Stockholders view executive pay as a special interest. In Canada, pay for executives is supposed to be tied to the financial performance of the company. Unfortunately, this does not always happen.

Managers view compensation as both an expense and an influence on employee work behaviour.

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Employees view compensation as a return for the work they perform.

Global views of compensation differ around the world. For example, in China, the traditional characters are based on the signs for logs and water, provides the necessities in life. The word ***dai yu*** refers to how someone is being treated. In Japan, the word ***kyuyo*** is used for compensation, which means giving something.

See Exhibit 1.2 – Overviews hourly compensation costs for production workers in manufacturing and economy-wide productivity (GDP) per employed person), in U.S. dollars.

FORMS OF PAY

There are numerous forms of pay that collectively create a system of total rewards.

See Exhibit 1.3 – Overviews forms of pay

Total rewards are all rewards received by employees, including:

1. cash compensation,
2. benefits and
3. relational returns: psychological returns employees believe they receive in the workplace.

A) Cash Compensation

1) **Base Pay**
   - **a) Wage** is the pay expressed at an hourly rate.
   - **b) Salary** is the pay expressed at a monthly or annual rate.
2) **Merit increases** are given as an increment to the base pay in order to recognize past work success. **Cost-of-living adjustment** gives the same percentage increase across the board to everyone, regardless of performance, in order to maintain pay levels relative to increases in the cost of living.
3) **Incentives/Variable Pay** means one-time payments for meeting pre-established performance objectives in a future time period.
4) **Long-Term Incentives** are intended to focus employee efforts on multi-year results. Incentives may be short or long term.

B) Benefits

Benefits are indirect compensation which includes health insurance, dental insurance, pensions, and life insurance. These help protect employees from the financial risks inherent in daily life.

1) **Insurance and Pensions** include those legislated by law (CPP/QPP, EI and Workers' Compensation) and those provided by the employer (company pension, health insurance, and life insurance).
2) **Work/Life Programs** help employees better integrate their work and life responsibilities including time away from work (vacations, jury duty, drug counselling, financial planning, referrals for child and elder care, flexible work arrangements).

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3) **Allowances** are compensation to provide for items that are in short supply.

C) Relational Returns

Relational returns are the psychological returns employees believe they receive in the workplace, like the following:

1) Recognition and Status
2) Employment Security
3) Challenging Work
4) Learning Opportunities

Total Earnings

Compensation decisions offer temporary motivation. The present value means there is a low initial offer in consideration of future income.

Relational Returns

Non-financial returns affect employees such as recognition, status, employment security etc.

The Organization as a Network of Returns

It is useful to think of an organization as a network of returns created by all of these different forms of pay.

A PAY MODEL

The Pay Model contains three basic building blocks:

1) Strategic Policies
2) Techniques
3) Strategic Objectives

See Exhibit 1.4 – Overviews the Pay Model

STRATEGIC COMPENSATION OBJECTIVES

1) Strategic Compensation Objectives shape the pay system and serve as the standard for evaluating the pay system.

1. ***Efficiency*** improves performance, quality, delighting customers and stockholders and controlling labour costs.
2. ***Fairness*** attempts to ensure fair pay treatment for all employees by recognizing employee contributions and employee needs. ***Procedural fairness*** is the fairness of the process used to make a decision.
3. ***Compliance*** *as a pay objective involves conforming to various federal, provincial and territorial compensation laws and regulations.*

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See Exhibit 1.5 which compares pay system objectives at Medtronic and Whole Foods

Ethics means organizations care about how their results are achieved. There have been many ethical dilemmas over the last decade including manipulated results to ensure executive bonus payouts, misused statistics, and re-pricing or backdating of stock options to increase their value.

See Exhibit 1.6 which describes the Amazon.com Code of Business Conduct and Ethics

FOUR POLICY CHOICES

1. ***Internal Alignment*** refers to pay comparisons between jobs or skill levels inside a single organization. Jobs and employees' skills are compared in terms of their relative contributions to the organization's objectives.
2. ***External Competitiveness*** refers to compensation relationships external to the organization; i.e., comparison with competitors. Since employees will make comparisons with others doing similar jobs, or with similar skills or competencies outside the organization, pay must be high enough to attract and retain a motivated work force. On the other hand, pay cannot be too high because the employer must control labour costs to remain competitive.
3. ***Employee Contributions*** refers to relative emphasis placed on performance. The degree of emphasis placed on performance is an important policy decision, since it directly affects employees' attitudes and work behaviours. Employers with strong pay-for-performance policies are more likely to place greater emphasis on incentives and merit pay.
4. ***Management*** refers to the fact that the system will not achieve its objectives unless it is managed properly. Managers need to be competent and choose what forms of pay to include and how to position pay against competitors. They must communicate with employees and judge whether the system is achieving its objectives.

Pay Techniques

Pay techniques are the procedures used to implement policy decisions. They are the mechanisms used to link the policy decisions to overall compensation objectives. Job analysis and job evaluation are techniques used to establish a pay structure in order to achieve *internal consistency* in the pay system. Pay surveys are one technique used to establish *external competitiveness*. Incentive plans or performance based pay increases are techniques used to distinguish *employee contributions*.

The Structure of the Remainder of this Book includes:

Chapter 2 discusses how to formulate and implement a compensation strategy.

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Chapters 3, 4, 5, 6 (internal alignment) examine pay relationships within a single organization.

Chapters 7, 8 examine external competitiveness-the pay relationships among competing organizations and analyzes the influence of market-driven forces. **Chapter** 9 considers employee services and benefits.

Chapters 10, 11 examine issues such as the amount of pay for each employee, how much and how often should pay be increased, on what basis, and how organizational successes and failures should be shared with employees.

Chapter 12 examines the role of the government and unions in compensation.

Chapter 13 includes management of the compensation system through planning, budgeting, evaluating and communication. More detail on global compensation systems is provided in the **Appendix.**

REVIEW QUESTIONS

1. How do differing perspectives affect our views of compensation?

From a societal perspective, compensation may be viewed as:

- A measure of the inherent equity and justice in a society (examine the wages of similarly situated men versus women, minorities, physically and mentally challenged workers, etc.)
- A cause of tax increases (public employee wages) or costs influence inflation (increased wages cause higher production costs, which may be passed on as price increases for goods and services.)
- A reason for Canadian difficulties competing in international market

From an employee perspective, compensation may be:

- a return for services rendered
- a reward for good performance
- an indicator of the worth of an individual's skills or training
- a major determinant of economic and social well being

From an employer perspective, compensation may be:

- a major expense to be managed,
- a means to influence employee work attitudes and behaviour, which affects productivity.

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2. **Refer to the image that opens this chapter and categorize the various items based on what the following stakeholder groups may refer to as compensation: employee, employer, society, and stockholders.**

All of the items in the image might well be relevant to all three groups. However, it is likely that employees will focus more than the other groups on items such as defined benefit plans, pay, wages, profit sharing plans, RSUs, tuition assistance, short term disability, gain sharing plans, spot awards, employee discount, workers compensation, extended healthcare, RRSP, sales compensation, pay raises, EI, dental, holidays, vacation, bonuses, promotion, pension, CPP, salary, defined contribution plans, long term disability,incentives, stock options, benefits, allowances, recognition, merit increase, commission, paid time off, and bonuses. Productivity and market share will be relevant to employees when such items are tied to their compensation. Employees might be loyal but will unlikely view loyalty as a form of compensation, although for some it might result in greater job security, a relational return.

The employer and stockholders, as providers of much of the above, will also refer to those items, but will also likely focus on higher productivity, increased market share, retention. In short, they will see everything in the image as compensation related. However, loyalty might well be seen as a return from employees.

Society is generally likely to also see the entire set of items in the image as compensation, although are likely to focus more on pay, wages, benefits, medical, dental, pensions, and stock options.

3. **Discuss five different forms of pay that one might expect to receive from work.**

One might expect to receive various cash compensation such as base pay and cost-of-living increases as well as benefits such as life insurance, disability insurance, and pension – all various forms of pay.

4. **What are the four policy issues in the pay model? And what are the strategic objectives of a pay system**

The four pay policy issues in the pay model are internal alignment, external competitiveness, employee contributions, and management.

The strategic objectives of a pay system are efficiency, fairness, and compliance.

EXPERIENTIAL EXERCISES

1. **What is your definition of compensation? Which meaning of compensation seems most appropriate from an employee's view- return, reward, or**

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entitlement? Compare your ideas with someone who has more experience, with someone from another country, with someone from another field of study.

Students may focus on direct compensation only, since many of them have part-time, summer or contract jobs. The students can share their experiences. Point out that people's perspectives vary depending on their experiences in their country.

2. **List all the forms of pay you receive from work. Compare yours to someone else's list. Explain any differences.**

Different pay forms would include pay received directly as cash such as: base, merit, incentives, and cost-of-living adjustments. Pay received indirectly includes: pensions, medical insurance, and programs to help balance work and life demands.

Someone else's differences could include financial incentives, such as piece rate production or salary and commission base pay for employees. Other forms of pay can be straight commission, especially for a sales position or any number of indirect pay benefits. These benefits include health insurance, life insurance, dental, optical and prescription drug plans. Mandatory fringe benefits required by employers are employment insurance and workers compensation.
Compensation differences occur depending on the size of the company, type of company and the financial status of the company.

3. **What is your ideal total compensation package upon your completion of the program at your current institution? Do you think these are achievable? What are some of the things you can offer your employer?**

Students' responses will vary depending on their occupational/professional goals. However, quick surveys of student answers will help to promote themes that emerge, for example, what are some key items? Are there some things that students express a greater need or want for, or are there things that they do not generally mention.

4. **Go to the website of a company that you want to work in. Find out what kind of benefits it offers their employees.**

Students' responses will vary depending on the websites visited. Stimulate a discussion on the findings of the student findings. For example, how do what firms offer fit with what they want or need by way of benefits?

CASE: The Role of Labour Costs

Summary of Case

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The case provides a brief history of the electronics retailer, Best Buy and its takeover a Canadian retailer, Future Shop. The differences in compensation between the two are firms are highlighted. The case describes various cost-saving measures taken by Best Buy in response to slowing sales and increased competition from Amazon and Walmart, among others. Savings were achieved through store closures, job cuts and reductions in compensation for Best Buy employees. The corporate culture of Best Buy is characterized. Stock prices for 11 years, 2009-2019 for Best Buy, Amazon, and Walmart are presented.

Questions

1. **Is replacement of highly-paid workers with lower-paid workers a good idea to ensure a company's success?**

Company success can be defined from many perspectives including quantitative and qualitative; objective and subjective; financial and non-financial, among others. Further, success is affected by many factors such as having sufficient capital, creating appropriate market plans, having well trained employees, and developing effective responses to increasing competition.

It is quite unlikely that one factor such as compensation will solely result in company success. The compensation plan should fit the broader human resource strategy, which in turn should fit the broader company strategy.

2. **Why are Walmart and Amazon doing better than Best Buy? Do they have higher pay?**

Amazon and Walmart are doing better than Best Buy, generally speaking, based on one criterion, stock price. It is unclear how the three firms are doing in terms of other criteria.

The case provides insufficient detail in order to answer the higher pay question. However, given the nature of the work in Amazon and Walmart one might predict that front-line employees receive relatively low pay, although managers might be well compensated. Further, the Chapter indicates the high level of turnover among Walmart employees, often indicative of high levels of dissatisfaction with work-related factors such as compensation.

Students might have greater insights into the pay situations of the three firms based on their own working lives or those of their families and friends.

3. **Are there larger problems in the competitive landscape for Best Buy that cannot be solved by compensation strategy changes (e.g., lowering labour costs) alone? When customers look to buy electronics, what options do they have other than Best Buy, and why would they choose these other options**

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over Best Buy? Where do customers "test drive" the product and where do they buy it? Can compensation changes address these challenges? Explain.

Yes, there are likely numerous problems in the competitive landscape that cannot be solved by compensation strategies alone. For example, technology changes very quickly these days, so for example, new products must get to the market, marketing strategies must be developed to best promote products, and employees must be constantly trained and updated as things change.

This is a good question for students, who are likely young and highly tech savvy. There are some small independents who cater to audiophiles not the mass market and operate as differentiators, not on cost leadership, which appears to be a Best Buy tactic.

My suspicion is that people test drive the products in store – which is what I did recently in purchasing an electronics item from Best Buy for a present. Again, this is a general discussion type of question to bring in students to share their experiences, which will help generate some themes.

Compensation can play a part in responding to the above challenges. For example, employees could be paid for more developing increased product knowledge and developing sales skills that help customers to test drive products. However, the compensation strategy should fit with the human resource management strategy, which should fit the broader company strategy (as above) – compensation is not an island.

4. **The stock price for Best Buy went down to $11.81 in 2013, but it has been doing better since then. Are you surprised by their performance since 2013?**

Students' answers might vary here based on their own knowledge and experiences with the firms in question.

It is possible that the actions that management has taken might well have increased consumer and investor confidence and thus the stock price has increased.

5. **What do you think about the CEO's message to the shareholders about the beliefs that Best Buy's culture is built on?**

Students' answers might vary here based on their own knowledge and experiences with Best Buy and the notion of organizational culture.

In many respects the CEO's stated beliefs seem quite broad-brush in nature. They do focus on relational types of returns for employees, for example, having opportunities to learn and to have autonomy. However, some of the company's actions regarding closings, cutbacks, and pay decreases seem a bit at odds with the statements on the

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company not being a “soul-less body” and a business is “more than for profit” – so, part of the question and answer might be trying to establish a balance among conflicting organizational goals and within that balance finding a role for compensation.

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Manager's Hot Seat Teaching Notes
Bullying in the Workplace

Introduction

This scenario explores the complexities of bullying in the workplace. Bullying is a serious form of workplace violence, though workplace bullies typically use words and actions on their victims. This case shows one example of bullying, while adding a second dimension of nepotism since the one bullying is the boss's sister.

Learning Objectives

1) To analyze approaches for handling a bully.
2) To recognize effective ways to deal with bullying.
3) To understand why threats are ineffective when trying to persuade.

Scenario Description

Overview

Susan Sheppard, Creative Design Manager at Word-of-Mouth Marketing Group, is consistently bullied by her colleague, Alexandra Woodward, the boss's sister. Alexandra has been working at the firm a little over a month, after quitting her job as a Rare Artifacts Curator at the Museum of Indigenous Culture. During her short time at Word-of-Mouth, she has shown a propensity for "self-governance" and defiance. Extra work has been heaped on Sheppard, and she has had to face sarcasm and a constant barrage of inappropriate comments from her newly appointed subordinate.

Profile

- **Susan Sheppard**, Creative Design Manager, Word-of-Mouth. Sheppard has been at Word-of-Mouth for four and a half years and was appointed manager of the Creative Design Department seven months ago.

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- **Alexandra Woodward**, Creative Design, Word-of-Mouth. Woodward is the boss's sister and is the newest and least qualified recruit.

Backstory

The Word-of-Mouth Marketing Department is eight people strong, including Sheppard and her new colleague Woodward, the newest and least qualified recruit.

Woodward shares the boss's family name, and presumably feels she shares the boss's default authority, too. She came to the company six months after leaving her job as a museum curator. Only one month into her new career, she is already dictating her own workload and that of others; she dumps work onto Sheppard and is bullying and inappropriate.

In the last two weeks, Sheppard's desk has been littered with unfinished work originally assigned to Woodward, including design layouts, annual report figures, copyright disputes, and print schedules.

Twice, Sheppard was left with design layouts to complete within three hours of their deadline. On one of those occasions, Woodward had done barely more than sketch text boxes, leaving Sheppard with more than a day's work to accomplish within an hour and twenty minutes.

When asked to obtain the copyright to publish a particular photograph (featuring a celebrity's home), Woodward skipped over the details (not even filing the request), almost trashing a print-run of 70,000 brochure covers as well as leaving Word-of-Mouth open to possible legal action. Luckily, Sheppard picked up on Woodward's oversight and gained permission from the relevant parties before any damage was done.

Woodward point-blank refused to write the annual report figures, saying that as an "Artistic Consultant" it was insulting to ask her to file facts and figures. In fact, Woodward doesn't have a job title, which is something Sheppard cannot address.

The print schedules, which Woodward was supposed to deliver a week before the commencement of the Approval Stage, arrived on Sheppard's desk with one day to spare, and, as with the design layouts, were so incomplete, they required Sheppard to put aside her own work and concentrate on getting the schedules out in time.

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During a recent meeting with a photographer, Woodward undermined Sheppard continually either by contradicting her suggestions or through disrespectful gestures and sighs.

Whenever Sheppard approaches Woodward's desk, Woodward initially completely ignores her and then does little to engage in conversation, deliberately avoiding eye contact.

Just four days ago, when Sheppard issued instructions to another member of the team, Woodward took it upon herself to approach the team member and, on "Sheppard's behalf", retract the instructions.

When Sheppard initially asked Woodward into her office for a discussion, Woodward created such a scene of angry complaints and accusations of bullying, that Sheppard had to back out of her intention to diffuse the situation.

At every opportunity, Woodward has been bad-mouthing Sheppard to other members of the Creative Design Department.

Scene Setup

Sheppard has scheduled a meeting with Woodward to discuss the completion of one of their big projects—the creation of a new brochure for the home furnishings giant, Soft Landings. More importantly, she hopes to confront Woodward about her bullying behavior.

Scene Location

Sheppard's office.

The Meeting—Summary

Throughout the meeting, Woodward continues her bullying of Sheppard by making verbal threats and complaining she is a bad superior. In addition to the bullying behavior, she also is rude to Sheppard by answering her cellphone and her overall tone of voice. Sheppard tries to level with Woodward to outline what she sees as her position with Word-of-Mouth. However, Woodward refuses to give a direct answer and constantly plays the "my brother is your boss" card. She continues to skirt around taking any responsibility and suggests she is "above" the work that has been assigned to her. The meeting concludes with Sheppard notifying Woodward that she will be notifying human resources and will be talking with the boss.

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Afterthoughts—Summary

Sheppard believes the meeting went poorly. She had a framework in place and Woodward derailed the entire plan. Sheppard is worried about the nepotism issue and notes that she wishes she had recorded the meeting. She concludes by noting that if nothing changes in the firm, she will possibly leave and seek legal action.

Discussion Questions

Leaning Objective #1 To analyze approaches for handling a bully.

How effective was Sheppard in handling the meeting with Woodward?

Sheppard made the right choice to host a meeting with Woodward before talking to the boss. She conducted herself professionally most of the time and did not sink to Woodward's level. Bullies usually look for situations to become escalated, such as yelling or threatening, and they thrive on this type of environment. Sheppard was assertive, yet remained as calm as possible throughout the confrontation. She also refrained from showing weakness and tried to outline how Woodward's behavior was impacting the work environment.

Leaning Objective #2 To recognize effective ways to deal with bullying.

Sheppard called a meeting with Woodward to discuss a current project and her bullying. What are others ways Sheppard might handle the bully situation?

Calling the meeting with Woodward to confront her as a bully is a good first step. Other effective ways that Sheppard can deal with the bully situation would be to:

- Keep notes of the bullying behavior.
- Document all of the bully's actions (or in this case, inactions).
- Ask co-workers to observe and/or document the bullying situations.
- Check company policies related to employee conduct.
- Seek advice from someone in human resources.
- Tell the boss (though this situation is tricky given the relationship).

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Leaning Objective #3 To understand why threats are ineffective when trying to persuade.

Throughout the meeting, Woodward constantly threatens Sheppard. Why are threats ineffective?

Threats are statements—either implicit or explicit—that suggest someone will be punished for doing (or not doing) something. In general, threats are ineffective for many reasons: 1) they don't produce permanent change, 2) they won't necessarily produce the desire action, 3) they make people abandon action, 4) they produce tension, 5) they provoke counter-aggression, and 6) people dislike and avoid anyone who threatens them.

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