

***Strategic Compensation - A Human Resource
Management Approach 11th edition Martocchio
Solutions Manual***

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CHAPTER 1

Strategic Compensation: A Component of Human Resource Systems

Learning Objectives

- 1-1. Define strategic compensation.
- 1-2. Summarize the role of compensation as a strategic business partner.
- 1-3. Explain strategic compensation decisions.
- 1-4. Identify and discuss the building blocks and structural elements of strategic compensation systems.
- 1-5. Describe the fit of the compensation function in organizations.
- 1-6. Identify the stakeholders of the compensation function and summarize their stakes in the work compensation professionals perform.
- 1-7. Explore essential skills for developing your career in compensation or any other career path.

Outline

- I. Overview
- II. Defining Strategic Compensation
- III. Compensation as a Strategic Business Partner
- IV. Strategic Compensation Decisions
- V. Building Blocks and Structure of Strategic Compensation Systems
- VI. Fitting the Compensation Function in an Organization's Structure
- VII. Stakeholders of the Compensation System
- VIII. Developing Skills for your Career
- IX. Key Terms
- X. Discussion Questions and Suggested Answers
- XI. Preparing for My Career: Compensation in Action
- XII. End of Chapter Cases; Instructor Notes, and Questions and Suggested Student Responses
- XIII. Crunch the Numbers! Questions and Suggested Student Responses
- XIV. Working Together: Team Exercise with Suggested Student Responses

Lecture Outline

I. Overview

A. Manpower planning

1. Predecessor to contemporary human resource management, focus was on effective deployment of employees
2. Goal was to achieve maximum productivity per employee

B. Personnel management

1. Evolved due to government regulations concerning:
 - a. Payroll taxes
 - b. Minimum wage laws
 - c. Antidiscrimination laws
2. Competitive advantage
 - a. Since 1980's recognition that employees can contribute to competitive advantage
 - b. Competitive advantage describes a company's success when the company acquires or develops capabilities that facilitate outperforming the competition
 - c. HR becomes a strategic function

II. Defining Strategic Compensation

A. What Is Compensation?

1. Intrinsic and extrinsic compensation rewards employees receive for performing their jobs
 - a. Intrinsic compensation: Reflects employees' psychological mindsets that result from performing their jobs
 - b. Extrinsic compensation: Includes both monetary and nonmonetary rewards for:
 - i. Obtaining certain job performance levels
 - ii. Acquiring new skills and knowledge
2. Monetary compensation represents core compensation
3. Nonmonetary rewards (also known as employee benefits) include:
 - a. Protection programs (e.g., health insurance)
 - b. Paid time off (e.g., vacations)
 - c. Services (e.g., day care assistance)
4. Both monetary and nonmonetary compensation represent costs to companies

- B. What is Strategic Compensation?
 - 1. Competitive business strategy refers to the planned use of company resources
 - 2. Human resource strategies specify the use of multiple HR practices to reinforce competitive business strategy
 - 3. Strategic compensation refers to the design and implementation of compensation systems to reinforce the objectives of both HR strategies and competitive business strategies

III. Compensation as a Strategic Business Partner

- A. HR and compensation professionals today need to think like the chief executive officer (CEO) to become a strategic partner in achieving organizational plans and results
- B. Compensation professionals can give the CEO and chief financial officer (CFO) an understanding of the roles employees play in organizations to expand or shrink shareholder value
- C. How HR functions serve as strategic business partner
 - 1. Capital refers to factors that enable companies to generate income, raise stock prices, bring economic value, strong brand identity, and reputation
 - 2. Human capital refers to sets of collective skills, knowledge, and abilities that employees can apply to create value for their employers
- D. Compensation professionals can leverage the value of human capital in a variety of ways such as a well-designed merit pay program to reinforce performance

IV. Strategic Compensation Decisions

- A. Environmental scanning
 - 1. Used for strategy formulation
 - 2. Main focus is discerning threats and opportunities
- B. Competitive Business Strategy Choices
 - 1. Lowest-cost strategy or cost leadership strategy focuses on gaining competitive advantage by being the lowest-cost producer of a product or service within the marketplace
 - 2. Differentiation strategies develop products or services that are unique from those of their competitors
- C. Compensation Decisions That Support the Firm's Strategy
 - 1. Compensation professionals use two broad elements to support strategic initiatives
 - a. Basic building blocks
 - b. Structural design elements

2. Employee roles associated with competitive strategies
 - a. Compensation professionals must design and implement compensation practices that elicit strategy-consistent employee roles

V. Building Blocks and Structure of Strategic Compensation Systems

A. Building Blocks: Core Compensation and Employee Benefits

1. Core compensation
 - a. Base pay includes hourly pay or wage or salary
 - b. Is governed by Fair Labor Standards Act
 - c. Is set according to compensable factors such as level of skill, effort, and responsibility required to perform the job and the severity of the working conditions
 - i. Compensable factors are used to determine if jobs are equal under the Equal Pay Act of 1963
 - d. Is adjusted periodically for cost-of-living increases, differences in an employee's job performance, and increases in an employee's skill level or job knowledge
 - i. Cost-of-living adjustments (COLA's) represent periodic base pay increases that are founded on changes in prices as recorded by the Consumer Price Index (CPI)
 - e. Seniority pay systems reward employees with periodic additions to base pay according to employees' length of service in performing their jobs
 - i. Designed according to the human capital theory: Employees will become more productive as they refine existing skills and acquire new skills and knowledge through length of service
 - f. Merit pay is permanent base pay increases granted because of job performance
 - g. Incentive pay or variable pay rewards employees for partially or completely attaining a predetermined work objective
 - h. Person-focused pay or competency-based pay rewards employee for specifically learning new curricula
 - i. Pay-for-knowledge plans reward managerial, service, or professional workers for successfully learning specific curricula
 - ii. Skill-based pay is used mostly for employees who perform physical work and increases as workers master new skills
2. Employee benefits
 - a. Represent nonmonetary rewards
 - b. Discretionary benefits include three broad categories
 - i. Protection programs that provide family benefits, promote health, and guard against income loss caused by factors such as unemployment, disability, or serious illness

- ii. Paid time off such as vacation
 - iii. Services provide such enhancements as tuition reimbursement and day care assistance
 - c. Legally-required benefits are protection programs that attempt to promote worker safety and health and maintain family income streams
 - i. Social Security Act of 1935
 - ii. Family and Medical Leave Act of 1993
 - iii. Patient Protection and Affordable Care Act of 2010
- B. Fundamental Compensation System Design Elements
1. Internal consistency
 - a. Internally consistent compensation systems clearly define the relative value of each job among all the jobs within a company
 - b. Is based on the principle that employees working at jobs that require greater qualifications, more responsibilities, and/or more complex job duties should be paid more
 - c. Is achieved using job analysis and job evaluation
 - i. Job analysis is a systematic process for gathering, documenting, and analyzing information in order to describe jobs
 - ii. Job evaluation is used to systematically recognize differences in the relative worth among a set of jobs
 2. Market competitiveness
 - a. Market-competitive pay systems are based on results of compensation surveys
 - b. Compensation surveys collect and then analyze competitors' compensation data
 3. Recognizing employee contributions
 - a. Pay structures recognize differences in employee contributions, such as credentials, job knowledge, and job performance
 - b. Pay grades group jobs for pay policy application
 - c. Pay ranges include minimum, maximum, and midpoint pay rates
- C. Alternative Pay Structure Configurations
1. Merit pay plans
 2. Sales compensation plans
 3. Broadband structures
 4. Two-tier wage structures
 5. Executive compensation
 6. Contingent worker compensation
 7. Expatriate compensation
 8. Compensation structures in countries other than the United States

VI. Fitting the Compensation Function in an Organization's Structure

A. How HR Professionals Fit into the Corporate Hierarchy

1. Line employees are workers who are directly involved in producing a company's goods or services
2. Staff employees are workers whose job it is to support the line functions
human resource professionals are staff employees
3. HR practices include:
 - a. Recruitment
 - b. Selection
 - c. Performance appraisal
 - d. Training
 - e. Career development
 - f. Labor-management relations
 - g. Employment termination
 - h. Managing HR within the context of legislation

B. The Compensation Profession

1. An executive is a top-level manager who reports directly to the corporation's CEO or to the head of a major division
2. A generalist, who may be an executive, performs tasks in a variety of HR-related areas
3. A specialist may be an HR executive, manager, or non-manager who is typically concerned with only one of the areas of compensation practice
4. Opportunities for employment for compensation and benefits managers are projected to grow

C. How the Compensation Function Fits into HR Departments

1. Compensation, recruitment, and selection
 - a. Companies can spark interest by communicating the positive features of the core compensation and employee benefits programs
 - b. Companies may offer inducements such as signing bonuses
2. Compensation and performance appraisal
 - a. Performance appraisals are key to effective merit pay programs
 - b. Employees must perceive a strong relationship between attaining performance standards and receiving pay increases
3. Compensation and training
 - a. Successful pay-for-knowledge plans depend upon a company's ability to develop and implement systematic training programs
 - b. Companies implementing pay-for-knowledge plans typically increase the amount of classroom and on-the-job training
4. Compensation and career development

- a. Employees make lateral moves across a company's hierarchy or vertical moves up the hierarchy
 - b. Employee's compensation changes reflect career development
- 5. Compensation and labor-management relations
 - a. Collective bargaining agreements describe terms of employment
 - b. Companies may provide COLAs
 - b. Companies establish base pay on seniority pay
- 6. Compensation and employment termination
 - a. Employment terminations are either involuntary or voluntary
 - b. Some companies offer severance pay for involuntary terminations
 - c. Companies sponsor pension programs in the case of retirement
 - d. Companies sometimes use early retirement programs to reduce workforce size
- 7. Compensation and legislation
 - a. Laws were enacted to establish acceptable employment practices and protect employees' rights
 - b. Are grouped on four main themes
 - i. Income continuity, safety, and work hours
 - ii. Pay discrimination
 - iii. Medical care and accommodation of disabilities and family needs
 - iv. Prevailing wage laws
 - c. Relevant laws include:
 - i. Fair Labor Standards Act of 1938
 - ii. Equal Pay Act of 1963
 - iii. Civil Rights Act of 1964
 - iv. Patient Protection and Affordable Care Act of 2010
 - v. Pregnancy Discrimination Act of 1978
 - vi. Americans with Disabilities Act of 1990
 - vii. Family and Medical Leave Act of 1993
 - viii. Davis–Bacon Act of 1931

VII. Stakeholders of the Compensation System

- A. The success of HR departments depends on how they will serve various stakeholders including:
 - 1. Employees
 - 2. Line managers
 - 3. Executives
 - 4. Unions
 - 5. U.S. Government
- B. Employees
 - 1. Must educate employees on training options and connections between training and their pay
 - 2. Must determine which objectives of discretionary benefits are most important to their particular workforce
- C. Line managers
 - 1. Use their knowledge of relevant laws to help them make sound compensation judgments
 - 2. Advise them on establishing pay rates
- E. Executives
 - 1. Develop and manage sound compensation systems
- F. Unions
 - 1. Abide by their collective bargaining agreements
- G. U.S. Government
 - 1. Keep updated and comply with all employment legislation
 - 2. Demonstrate that alleged discriminatory pay practices are not discriminatory

VIII. Developing Skills for Your Career

- A. This course and this text will give you the opportunity to develop and practice seven important skills:
 - 1. Communication
 - a. The effective use of oral, written, and nonverbal skills for multiple purposes
 - 2. Critical Thinking
 - a. Purposeful and goal-directed thinking used to define and solve problems
 - 3. Collaboration
 - a. Individuals actively work together on a task, constructing meaning and knowledge as a group

4. Knowledge Application and Analysis
 - a. The ability to learn a concept and then appropriately apply that knowledge in another setting
5. Business Ethics and Social Responsibility
 - a. Business ethics are sets of guiding principles that influence the way individuals and organizations behave
 - b. Social responsibility is the implied, enforced, or felt obligation of managers to protect the interests of others
 - c. Corporate sustainability focuses on the possible future impact of an organization on society
6. Information Technology Application and Computing Skills
 - a. The ability to select and use appropriate technology to accomplish a given task
7. Data Literacy
 - a. Ability to access, assess, interpret, manipulate, summarize, and communicate data

End of the Chapter

IX. Key Terms

Competitive advantage: Describes a company's success when the company acquires or develops capabilities that facilitate outperforming the competition

Compensation: Represents both the intrinsic and extrinsic rewards employees receive for performing their jobs and for their membership as employees

Intrinsic compensation: Reflects employees' psychological mind-sets that result from performing their jobs

Extrinsic compensation: Includes both monetary and nonmonetary rewards

Core compensation: Monetary compensation

Employee benefits: Non-monetary compensation

Competitive business strategy: The planned use of company resources—financial capital, equipment capital, and human capital—to promote and sustain competitive advantage

Human resources strategies: Specify the use of multiple HR practices to reinforce competitive business strategy

Strategic compensation: Refers to the design and implementation of compensation systems to reinforce the objectives of both HR strategies and competitive business strategies

Capital: Refers to the factors that enable companies to generate income, higher company stock prices, economic value, strong positive brand identity, and reputation

Human capital: Refers to sets of collective skills, knowledge, and abilities that employees can apply to create value for their employers

Cost leadership or lowest-cost strategy: Focuses on gaining competitive advantage by being the lowest-cost producer of a product or service within the marketplace, while selling the product or service at a price advantage relative to the industry average

Differentiation strategies: Companies adopt this strategy when they develop products or services that are unique from those of their competitors

Base pay: Recurring money employees receive for doing their jobs

Hourly pay or wage: Base pay received for each hour worked

Annual salary: Base pay received for performing a job, regardless of the actual number of hours worked

Compensable factors: Skill, effort, responsibility, and working condition factors

Cost-of-living adjustments (COLAs): Represent periodic base pay increases that are founded on changes in prices as recorded by the Consumer Price Index (CPI)

Seniority pay: A system to reward employees with periodic additions to base pay according to employees' length of service in performing their jobs

Human capital theory: Employees' knowledge and skills (human capital) add value

Merit pay: Program that assumes that employees' compensation over time should be determined, at least in part, by differences in job performance as judged by supervisors or managers

Incentive pay: Compensation (other than base wages or salaries) that fluctuates according to employees' attainment of some standard based on a preestablished formula, individual or group goals, or company earnings

Variable pay: Compensation (other than base wages or salaries) that fluctuates according to employees' attainment of some standard based on a preestablished formula, individual or group goals, or company earnings

Person-focused pay plans: Programs that reward employees for specifically learning new curricula

Competency-based pay: Programs that reward employees for specifically learning new curricula

Pay-for-knowledge: Programs that reward managerial, service, or professional workers for successfully learning specific curricula

Skill-based pay: Programs that increase workers' pay as they master new skills

Discretionary benefits: Any variety of programs that provide paid time off, employee services, and protection programs that are offered on a discretionary basis

Legally required benefits: Particular sets of benefits the U.S. government requires employers to offer to employees

Protection programs: Legally required benefits that attempt to promote worker safety and health, maintain the influx of family income, and assist families in crisis

Paid time off: Provides employees with pay for time when they are not working (e.g., vacation)

Services: Provide such enhancements as tuition reimbursement and day care assistance to employees and their families

Internally consistent compensation systems: Clearly define the relative value of each job among all jobs within a company

Job analysis: A systematic process for gathering, documenting, and analyzing information in order to describe jobs

Job evaluation: A process to recognize differences in the relative worth among a set of jobs and to establish pay differentials accordingly

Market-competitive pay systems: Compensation professionals build market-competitive compensation systems based on the results of compensation surveys

Compensation surveys: Collect and then analyze competitors' compensation data

Pay structures: Represent pay rate differences for jobs of unequal worth and the framework for recognizing differences in employee contributions

Pay grades: Group jobs for pay policy application

Pay ranges: Include minimum, maximum, and midpoint pay rates

Line employees: Employees that are directly involved in producing companies' goods or delivering their services

Staff employees: Employees that support the line functions

Generalist: A human resource professional that may be an executive that performs tasks in a variety of HR-related areas

Specialist: An HR executive, manager, or non-manager who is typically concerned with only one of the areas of compensation practice

Severance pay: Companies may choose to award an amount, usually the equivalent of several months' pay following involuntary termination

Pension programs: Provide income to individuals throughout their retirement

Early retirement programs: Contain incentives designed to encourage highly paid employees with substantial seniority to retire earlier than they had planned

X. Discussion Questions and Suggested Answers

1-1. What are the main building blocks of compensation systems? Briefly describe each one.

The main building blocks of a strategic compensation system are core compensation, which includes base pay and adjustments to base pay over time; and employee benefits which includes discretionary benefits and legally required benefits.

Learning Objective: 1-4. Identify and discuss the building blocks and structural elements of strategic compensation systems.

AACSB: Application of knowledge

1-2. How can compensation professionals serve as strategic business partners?

To serve as strategic business partners, compensation professionals need to think like the chief executive officer (CEO). They can give the CEO and chief financial officer (CFO) an understanding of the role that employees play in the organization and the way it combines with business processes to expand or shrink shareholder value.

Learning Objective: 1-2. Summarize the role of compensation as a strategic business partner.

AACSB: Analytical thinking

1-3. Are the three main elements of compensation systems—internal consistency, market competitiveness, and recognizing employee contributions—equally important, or do you believe that they differ in importance? Explain.

Student answers will vary. Importance of each element may vary based on the company, the industry, and other factors in the internal and external environments.

Learning Objective: 1-4. Identify and discuss the building blocks and structural elements of strategic compensation systems.

AACSB: Analytical thinking

1-4. The compensation profession is expected grow at a healthy pace through the year 2026. Based on your understanding of how the chapter material blends together, what might be some reasons for this anticipated growth? Explain.

Student responses may vary. Some reasons may include future government regulations, more competitive environments, and changing employee demographics or societal motivators. All of these factors may influence the need for compensation professionals as they work to meet the needs of the multiple stakeholders in organizations.

Learning Objective: 1-6. Identify the stakeholders of the compensation function and summarize their stakes in the work compensation functions perform.

AACSB: Analytical thinking

1-5. Stakeholder expectations pose challenges for compensation professionals. At times, there may be conflict among the expectations of different stakeholders. For two stakeholders, how do compensation professionals meet their expectations?

Employees: Educate about compensation programs and benefits.

Line Managers: Provide advice about pay for different jobs.

Executives: Developing and managing sound compensation systems.

Unions: Administering the pay and benefits policies specified in collective bargaining agreements.

U.S. Government: Comply with employment legislation.

Learning Objective: 1-6. Identify the stakeholders of the compensation function and summarize their stakes in the work compensation functions perform.

AACSB: Application of knowledge

1-6. How are the seven employability skills relevant regardless of your career aspirations?

The skills you will develop and practice in this text are those that employers have identified as critical to success in the workplace. Therefore, you will benefit even if you do not pursue a career as a compensation professional.

Learning Objective: 1-7. Explore essential skills for developing your career in compensation or any other career path.

AACSB: Analytical thinking

XI. Preparing for My Career: Compensation in Action

Instructor Notes:

This section outlines the role human resources professionals and line managers take in aligning compensation with strategy. This section can help students understand the importance of understanding compensation practices whether they pursue a career as a human resources professional or a line manager.

XII. End of Chapter Cases; Instructor Notes, and Questions and Suggested Student Responses

Case 1: Competitive Strategy at Sporting Shoes

Instructor Notes:

The human resource planning process follows the company's strategic planning process. In this case, the company is shifting from a low-cost strategy to a differentiation strategy. Under the low-cost strategy, human resource practices focused on controlling costs and working to hire and retain workers focused on efficiency and productivity. The differentiation strategy will require some employees with a different skill set. Certain functions will need high levels of creativity and innovation. Human resource practices must shift to support these needs by attracting the right talent, and motivating the right behaviors to produce shoes for the new niche markets.

Questions and Suggested Student Responses:

1-7. Following Sporting's shift in competitive strategy, what are some considerations for the company's human resource management practices?

Sporting's shift in competitive strategy will require the company to examine all of its' human resources practices including recruiting, selection, performance appraisal, compensation, and training.

Learning Objective: 1-3. Explain strategic compensation decisions.

AACSB: Analytical thinking

1-8. What kind of challenges will Sporting face specifically in the area of compensation?

The new hires the company will need to make will create some compensation challenges. The company will need to make compensation competitive in the market place to make sure that they are able to attract the new talent needed. However, they must also keep compensation internally consistent at the same time. The company will need to examine its entire compensation strategy (including benefits and incentive pay) to make sure it is aligned with the company's new goals.

Learning Objective: 1-3. Explain strategic compensation decisions.

AACSB: Analytical thinking

Case 2: Ethics Dilemma: Profits at Any Cost

Instructor Notes:

Wells Fargo's incentive pay plan that paid sales commissions based on opening new accounts led to more than 5,000 employees opening 2 million bank accounts for customers who did not request them. Many current and past employees claimed that the unethical behavior was the result of unrealistic sales goals made by the company.

Questions and Suggested Student Responses:

1-9. As a compensation professional, what would you do?

Students may have a variety of responses based on when the compensational professional learned about the concern. When designing the program, the compensation professional should take steps to assure the sales goals were reasonable. After some of the fraudulent activities were identified, it is important for the compensation professional to investigate the problem to assure the design of the incentive system did not encourage unethical behavior.

Learning Objective: 1-6. Identify the stakeholders of the compensation function and summarize their stakes in the work compensation professionals perform.

AACSB: Ethical understanding and reasoning

1-10. What factor(s) in this ethical dilemma might influence a person to make a less-than-ethical decision?

There are several factors that may have influenced the employees' unethical behaviors. The high-pressure environment that was created and the threat of losing one's job or sales commission likely influenced the employees the most.

Learning Objective: 1-6. Identify the stakeholders of the compensation function and summarize their stakes in the work compensation professionals perform.

AACSB: Ethical understanding and reasoning

XIII. Crunch the Numbers! Questions and Suggested Student Responses

Calculating the Costs of Increasing the Total Compensation Budget at Butcher Enterprises

1-11. On an average hourly basis, how much does Butcher Enterprises spend on wages and benefits, respectively, in dollars?

Butcher Enterprises spends an average of \$19 per hour on wages and benefits. 70% of this amount or \$13.30 is allocated for wages and 30% or \$5.70 for benefits.

Learning Objective: 1-4. Identify and discuss the building blocks and structural elements of strategic compensation systems.

AACSB: Analytical thinking

1-12. How much does the company spend on wages and benefits over the course of one year for 100 office workers? Assume that each worker provides 2,080 hours of service each year.

The number of hours for 100 workers = $100 \times 2080 = 208,000$. The average hourly wage of \$19 $\times 208,000$ hours = \$3,952,000 is how much the company spends on wages and benefits over the course of one year.

Learning Objective: 1-4. Identify and discuss the building blocks and structural elements of strategic compensation systems.

AACSB: Analytical thinking

1-13. How much additional money does the company need to match the market rates for this group of 100 employees?

You must first calculate the total for wages and benefits for market rate which is $\$23 \times 208,000 \text{ hours} = \$4,784,000$. The difference between $\$4,784,000$ and $\$3,952,000 = \$832,000$. Therefore, Butcher Enterprises would need to spend an additional $\$832,000$ per year to match the market rate for this group of employees.

Learning Objective: 1-4. Identify and discuss the building blocks and structural elements of strategic compensation systems.

AACSB: Analytical thinking