Employee Benefits 6th edition Martocchio Solutions Manual

SKU: 9781259712289-SOLUTIONS

Part One: Introduction to Employee Benefits

Chapter Two: The Psychology and Economics of Employee Benefits[1]

I. Learning Objectives

In chapter two, you will gain an understanding of:

1. The employment relationship as an exchange relationship and the psychology behind why firms provide employee benefits
2. Employee benefits as part of the psychological contract and how some employee expectations about benefits might be formed
3. How employee perceptions of justice or fairness are important to understanding how pay and benefits practices influence employee attitudes
4. The economic rationales for why companies offer employee benefits
5. Who pays for employee benefits

The purpose of this chapter is twofold. First, it is important to learn about the *psychological* basis of employee benefits. Employers can use this knowledge to understand how employee benefits influence the attitudes and performance of their employees. Also, employers can then develop and maintain effective benefits programs aimed at promoting worker satisfaction, commitment, and productivity.

Second, it is important to understand the *economic* basis of employee benefits. Employee benefits are a costly proposition. Even though employee benefits are expensive, most employers continue to offer them. Still, it begs the question pertaining to whether companies should have workers pay for life or disability insurance. After considering the psychology of employee benefits, we will take up topics about the economics of employee benefits.

II. THE PSYCHOLOGY OF EMPLOYEE BENEFITS

This discussion is organized into three sections

First, the employment relationship as social exchange is considered

Second, psychological contracts are discussed

Third, we look at the relationship between having a benefits program and employee attitudes

A. Employment Relationship as Social Exchange

[1] The material in this chapter pertaining to the psychology of employee benefits was prepared by Professor Niti Pandey, Department of Business Administration, Eastern Connecticut State University, and edited for this edition by Joseph Martocchio. The material in this chapter pertaining to the economics of employee benefits was prepared by Professor Darren Lubotsky, Department of Economics and the Institute for Government and Public Affairs, University of Illinois at Chicago, and edited for this edition by Joseph Martocchio.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

1. In the most general terms, the employment relationship consists of clusters of human resource practices offered to a group of employees along with the resulting employee contributions to the employer
2. The basis for understanding the employment relationship lies in the concept of **social exchange** – the most basic concept of explaining social behavior
   a. All social behavior can be seen as "an exchange of activity (*work effort*), tangible (*visible performance*) or intangible (*motivation and commitment*), and more or less rewarding or costly (*pay and benefits*), between at least two persons (*employee and employer*)"
   b. Thus, social exchange in the employer-employee relationship is one in which the employer offers inducements (e.g. wages, employee benefits) in return for employee contributions (e.g. performance, commitment)

B. How Employee Benefits Constitute Social Exchange

1. For companies, employee benefits not only offer cost advantages and tax incentives, but also act as a recruitment tool for attracting and retaining desired employees
2. The employment relationship can be said to constitute both economic exchange and social exchange
   a. **Economic exchange**, as with wages and salary, is one in which the nature of the exchange has been specified at the time of employment
   b. Social exchange tends to evolve over the employment period and is not necessarily established at the time of employment
3. If an employer can provide an employee with benefits suitable to an employee's evolving needs, the employee is likely to reciprocate with increased work effort and commitment – hence, employee benefits are an especially relevant component of the social exchange between the employer and employee

C. Workforce Changes and the Employment Relationship

1. Jobs are no longer characterized by traditional job security, strong loyalty to the organization, or the patriarchal role of the organization in the life of the employee – instead, work arrangements and careers have become more flexible
2. Apart from economic and market challenges, the workforce in the U.S. and other developed economies is becoming increasingly diverse
   - Exhibit 2.1 illustrates the expected changes in workforce demographics through 2024

III. PSYCHOLOGICAL CONTRACTS

1. **Psychological contracts** are an articulation of the exchange relationship between the employer and the employee
2. A psychological contract has been defined as an employee's subjective perceptions of the relationship of mutual obligations with the employer/company
3. Employee benefits can be a part of the psychological contract that employees hold about the employer's obligations to them in exchange for their work efforts

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

4. Psychological contracts *implicitly* establish terms of employment, which stands in contrast to exchange agreements, such as wage and salary levels
5. Expectations from the employer fall on a continuum ranging from pay and promotions to career development and family welfare
6. Exhibit 2.2 shows the continuum of expectations encompassed between **transactional psychological contracts** and **relational psychological contracts**
    a. Toward the transactional end of the continuum, employees' expectations from the employer are more economic and extrinsic in nature which translates to expectations of high pay and promotions or career advancement in exchange for hard work
    b. Toward the relational end, employees' expectations might focus on either economic or non-economic factors. These expectations are emotional, subjective, and intrinsic in nature – employees' expectations of job security in exchange for loyalty to the employer represent relational types of expectations in the psychological contract
        - The main features of the continuum of expectations in psychological contracts can be summarized in Exhibit 2.3
5. Employee benefits practices could fulfill both transactional and relational expectations
    a. Legally required benefits are a part of employees' transactional expectations from the employer
    b. Employee benefits such as paid time off and accommodation and enhancement benefits examined in the previous chapter might help fulfill employees' relational expectations
    c. Some employee benefits might fulfill both transactional and relational expectations of employees, such as retirement plans, educational assistance or career development
6. Psychological contracts usually change over time – communication and education about the employee-benefits practices of the company is critical in establishing reasonable employee-expectations, discussed further in Chapter 10

A. Psychological Contract Development

1. Most psychological contracts take shape in the pre-employment phase, when people seek information during recruitment and after receiving a job – employees might seek information about both transactional and relational expectations from their potential employer
2. Ultimately, the knowledge learned will shape expectations along this transactional-relational continuum
3. Employees can form expectations from two sources: interactions with other members of the company and their perceptions of the company's culture
4. Psychological contracts are flexible in nature, undergoing constant change based on interactions with the company and with other employees – this flexibility allows employees to adapt to changes in the company's practices
    a. If employees hold relatively stable expectations, any changes in the policies and practices will lead to the employee feeling betrayed unless changes entail offering more rather less
    b. However, flexible expectations, facilitate adjustments to any employer-initiated changes

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

B. Psychological Contract Violation

1. A violation of the psychological contract occurs when an employee perceives a discrepancy between the promises made by the employer and the actual fulfillment of the promises
2. If a company withdraws or changes certain benefits, and those practices constituted an employee's psychological expectations from the company, then the employee will feel that the contract has been violated
3. Violations of psychological contracts differ from unmet expectations
   a. The responses to the violation of psychological contracts are likely to be more intense
   b. Violation of employees' expectations can cause feelings of betrayal and the onset of mistrust
4. There may be two basic causes for violations of psychological contracts: reneging and incongruence
   a. When a company deliberately breaks a promise to employees, either willingly or because of circumstances, reneging is said to occur
   b. Incongruence occurs when the employee and the employer have different conceptualizations of the employment relationship

C. Employee Benefits as Constituting Psychological Contracts

1. If employee benefits are a part of employees' psychological contract, then it is important for employers to ensure that employee expectations about benefits are clearly articulated and flexible
2. Violations can be avoided by clear communication and education about the nature and scope of the employee benefits practices offered by the company
3. Just as employees have expectations from the employer, the employer is also likely to have expectations from the employee
4. If the organization feels that employee performance is not what is expected, it can decide to withhold certain employee benefits, especially discretionary benefits
5. Employee benefits have, over the years, become a growing source of employees' psychological contract violations
6. Expectations about employees' cost burden, needs, and benefits design will all affect employee satisfaction

IV. EMPLOYEE ATTITUDES AND EMPLOYEE BENEFITS

Congruence between employees' and the employer's expectations will lead to greater fit between the employee and the employer as well as a sense of fairness

Violations of contracts will lead to perceptions of injustice

A. Justice and Perceived Organizational Support

The concept of justice is concerned with the distribution of conditions and goods that affect individual well-being

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

In a work setting, the distribution of rewards (such as pay and benefits), information, and other resources will all lead to perceptions of justice

Perceptions of justice may be based on the rules by which distributions are made, the way rules are implemented, or the way decisions are made

There are four types of justice perceptions
1. **Distributive justice** is perceived fairness about how rewards are distributed
2. **Procedural justice** is the perceived fairness of processes
3. **Informational justice** is the fairness of the accounts given for certain procedures
4. **Interpersonal justice** is perceived fairness of the interpersonal treatment people receive from others

Job satisfaction, organizational commitment, evaluation of authority, organizational citizenship behavior, withdrawal, and performance are all affected by employees' perceptions of justice along these dimensions

Where employee benefits are concerned:

1. Distributive justice – employees will form perceptions of fairness based on the benefits they are eligible for – if employees believe the employer should provide them with certain benefits and the employer fails to do so, employees will conclude the employer is being unfair
2. Procedural justice – deals with employees' perceptions of fairness of the process by which decisions are made and includes the extent to which employees can participate in the process as well as the rules followed
   a. By establishing rules for eligibility and contributions to retirement plans, employers can ensure procedural justice perceptions
   b. Allowing employees a voice in the use of such benefits can enhance their perceptions of procedural fairness
3. Interpersonal justice – is the perception of the degree to which the employer demonstrates concern and social sensitivity toward employees
4. Informational justice – deals with perceptions about the quality of information used to explain organizational decision making – the accuracy and timeliness of information will influence employees' perceptions of informational justice

Earlier human resource practices were standardized, today there is a shift toward non-standardized, idiosyncratic work arrangements

Employee benefits can be a part of this new individualized employment relationship

Perceived organizational support is an employee's perception of the degree to which the employer values the employee's contributions and well-being
1. Certain employee benefits practices can act to signal organizational support, such as mental health benefits, wellness programs, smoking cessation programs, stress management, as well as those aimed at recognizing the employees' contributions such as recognitions and rewards

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

2. Certain rewards and job conditions are more likely to lead to perceived organizational support, such as recognition, pay, promotions, job security, autonomy, and training
3. From a social exchange perspective, employees will value the employer's discretionary efforts more highly than those that are beyond the employer's control – discretionary benefits are more likely to generate perceptions of organizational support than legally required benefits

The importance of flexible benefits practices, suited to the diverse necessities of the changing workforce, can hence be understood in terms of critical employee attitudes such as perceptions of fairness and perceived organizational support

B. Organizational Citizenship Behavior

Employees' discretionary behavior, not explicitly or directly recognized by the formal reward system of the employer, but in aggregate promoting organizational effectiveness, is termed as **organizational citizenship behavior**

1. Behaviors such as helping other employees, looking out for the employer's interests, going beyond job requirements to help achieve company goals, are all examples of organizational citizenship behavior
2. Satisfied employees engage in good citizenship behavior – a company's employee benefits practices can influence employees' satisfaction
3. Organizational citizenship behavior is discretionary, it is not enforceable but rather a matter of personal choice
4. Employees' perceptions of both distributive and procedural justice are likely to affect citizenship behavior
5. There are two reasons why job satisfaction would lead to organizational citizenship behaviors
   a. It could be because people tend to reciprocate those who benefit them
   b. Also, employees who are satisfied and experience positive mood states tend to engage in good citizenship behaviors
6. The concept of organizational citizenship behavior is based in social exchange – employee benefits are an important part of the social exchange process and can be an important component of employees' psychological contract with the employer

Based on how companies design, communicate, and implement employee benefits they can lead to varying perceptions of fairness and organizational support

Thus, employees will engage in related organizational outcomes such as job performance, commitment, and citizenship behavior

The role of employee benefits in eliciting organizational effectiveness is undeniable

V. THE ECONOMICS OF EMPLOYEE BENEFITS: WHY DO EMPLOYERS OFFER BENEFITS?

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

Most employers compensate employees with some combination of cash and benefits, representing the extrinsic component of total compensation

What advantages are there to employers and employees having benefits

An employer might choose to include benefits in its compensation package for three primary reasons:
1. A cost advantage to the employer
2. Recruitment of certain types of workers
3. Tax incentives

A. Cost Advantage

1. Benefits, like health insurance are cheaper for the employer to purchase for a group than employees can purchase individually
2. EXAMPLE: *Health insurance costs $1000 per employee, if purchased by employer that employs 500 – individually, the same policy would cost each employee $2500 Employees are better off if pay is reduced less that $2500 – the employer benefits if they deduct more than $1000 to provide insurance*
3. Reasons why group insurance rates decrease as group size increases
   a. As the group gets larger, insurance becomes less risky to provide
   b. The fear of high-risk policyholders driving out the low-risk ones is reduced
   c. The fixed administrative cost per employee is reduced, referred to as *economies of scale*
4. As the size of the insured group gets larger, it becomes easier for the insurance company to predict the total medical expenses for the group – that means it is less risky to provide insurance to a larger group than to a smaller group
   a. In very large groups, total medical expenses are likely to be close to those predicted by the age, gender, and past medical history of the group
   b. The number of people with larger-than-expected medical expenses will likely offset those with smaller-than-expected medical expenses
   c. Because the insurance company bears less risk, they are willing to provide coverage at a lower cost to larger groups
   d. Individual policyholders and small groups of policyholders may have to undergo *medical underwriting*, a process by which employees provide information on their past medical history in a questionnaire or physical exam
5. The larger the group the less likelihood of *adverse selection*
   a. The condition where the insurance pool attracts only high-risk individuals
   b. Adverse selection in insurance markets stems from the fact that individuals know more about their own health status than does the insurance company
   c. One solution is for the company to gather as much information as possible about each participant's risk profile and then offer the insurance at a lower price to healthier people and at a higher price to less-healthy people – this is referred to as **experience rating**
   d. Avoiding adverse selection is one justification for government-provided insurance programs, like
      i. Social Security

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

ii. Medicare
iii. Workers' Compensation

6. Finally, administering an insurance policy involves a good deal of paperwork, claims processing, and other administrative functions
   a. Many of these functions are not much more time-consuming and expensive to perform for a large group than for a smaller group, a process referred to as **economies of scale**
   b. As the group gets larger, the average cost per insured person is reduced

B. Recruiting Certain Types of Workers

1. Recent undergraduates might be attracted to a tuition reimbursement benefit
2. Women 20-40 might be interested in company-paid health insurance
3. Older workers might be attracted to stronger retirement plans
4. Tailoring packages might have unintended consequences, like
   a. Offering strong mental health or substance abuse benefits might attract substance abusers
   b. (not in book) Attracting older workers with strong retirement benefits, might increase health insurance costs
   c. (not in book) Attracting younger women might increase the need for replacement workers due to maternity leaves and FMLA time off

C. Tax Incentives

1. The Internal Revenue Code (IRC) provides financial incentives to offer benefits
2. Many benefits are not taxed as income to employees
3. EXAMPLE: *Employee at 25% tax rate. If company raises the employee's salary by $1000, the IRC would get $250 of it. If company gives the employee a health insurance plan that costs $1000, employee receives total benefit without being taxed. To buy a $1000 policy, employee would have to earn $1333.33 pretax to pay for it.*
4. Retirement plans are driven by generous tax treatments

All three of the preceding motivations presuppose that employees value a particular benefit and are willing to give up something to receive it – there are two important consequences of this

1. First, employers need to figure out the cash value that employees place on a particular benefit and which types of employees value the benefit more than others
2. Second, if employees are willing to give up something to receive a particular benefit, then the cash component of wages and the types and amounts of benefits an employer offers will be inexorably linked

VII. WHO PAYS FOR BENEFITS?

One of the biggest misconceptions about employee benefits is that employers give them as "free add-ons" in compensation packages and the employees do not give up anything to receive these benefits

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

1. Employees pay for all of their benefits in the form of lower cash wages or salaries then they would otherwise receive
2. When the cost of a benefit increases, it is employees who pay for the increase; employers' profits are generally not affected

The degree to which an increase in benefits costs is passed along to employees depends on four factors:

1. The cash value that employees place on the benefit
   a. EXAMPLE: *Employees have 2 options; a $90,000 salary with no health insurance or $75,000 and a comprehensive educational assistance plan. Those who want to earn a graduate-level degree will place a relatively higher value on educational assistance programs and willing to forgo the extra $15,000 in salary. People with a graduate degree are more likely to choose the extra salary in lieu of the educational assistance.*
2. The degree to which employers will increase/decrease their hiring when the market compensation level decreases/increases; and the degree to which employees will change their desire to work when the market compensation package changes
   a. EXAMPLE: *If an employer wants to add a $10,000 (per employee per year) benefit to employee's salary of $100,000. Employers could assume the cost, which would reduce profits of $10,000 per employee per year, or reduce pay by $10,000. Could the company assume the cut in profits and still afford to keep their employees or hire new ones? Would the $90,000 salary attract the right workforce? That depends on the value the employee places on the benefit.*
3. Whether the benefit cost increases for all employers in the market, or for a specific employer
   a. EXAMPLE: *When benefits costs rise for a single employer, that employer will likely not be able to pass along the benefits costs to workers if the workers' valuation hasn't changed or has increased. If a company offered a total compensation package worth $100,000 ($80,000 in salary and benefits valued at $20,000). If benefits costs increase, this is not balanced by an increase in valuation from employees. The employer must pay the increase in costs.*
4. Whether the hiring decisions of a particular employer affect the market compensation level
   a. EXAMPLE: *What if all employers could agree to pass along the higher benefits cost to employees? Workers in this scenario have the option of leaving the workforce altogether. The smaller workforce would force employers to raise their wage offers to fill their staffing needs. Employers will tend to pay for benefits cost increases.*

Exhibit 2.4 summarizes whether employers or employees will tend to pay for a benefits cost increase in various scenarios

Most workers with employer-sponsored health insurance pay a token monthly contribution towards their insurance premium

According to data from the 2015 National Compensation Survey

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

a. Most employees were required to make a contribution toward their health insurance cost
b. The typical monthly contribution was ranged between $28.00 to $300.00 for single coverage
c. The typical monthly contribution ranged between $86.00 to $1279.00 for family coverage

It may seem peculiar that employers charge employees these monthly contributions but there are advantages

a. They easily allow employers to charge different prices to people with different family sizes, or to people who choose different plans
b. Employers can more easily raise these contributions when benefits costs increase

Instead of lowering income employers may also

a. Scale back a scheduled bonus
b. Reduce the yearly income increase
c. Hire new workers at a lower income level

VIII. Summary

This chapter discusses the psychological basis of employee-benefits practices from the point of view of employees, as well as the economics of employee benefits from the perspective of employers. Taken together, these topics illuminate the importance of offering employee benefits. Psychologically, employee-benefits practices can fulfill employees' transactional and relational expectations of the employer and the employment exchange relationship. If employees view their employer's benefits program as fair and meeting their expectations, then those employees will be satisfied and productive. When employees are satisfied and happy with the way the employer is treating them, they will be committed to the employer and even engage in good citizenship behaviors. Hence, it is important for employers to understand employee perceptions and attitudes about employee benefits. This will allow employers to design and communicate benefits programs that can attract and retain productive and committed employees. The economics of employee benefits explore why employers offer a mixture of cash and benefits and whether workers tend to pay for benefits cost increases in the form of lower cash wages. The primary reasons why employers offer benefits are that they can purchase the benefits at a lower cost than could employees on their own, employers use benefits to attract particular types of employees, and the government gives employers a tax incentive to provide some benefits. Whether workers or employers pay for benefits costs increases depends crucially on why costs increase, whether costs increase for all employers in the market, and how willing employees and employers are able to adjust their labor supply and demand when compensation costs change.

IX. Discussion Questions

1. Discuss the concept of social exchange as it relates to the employment relationship. How does this concept apply to employee-benefits practices?

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

Main Points

- Employment relationship consists of clusters of human resource practices offered to a group of employees along with the resulting employee contributions to the employer
- Social exchange in the employer-employee relationship is one where the employer offers inducements (e.g., employee benefits) in return for employee contributions (e.g., performance)
- If an employer can provide an employee with benefits suitable to the employee's evolving needs, the employee is likely to reciprocate with increased work effort and commitment
- Therefore, employee benefits are an especially relevant component of the social exchange between the employer and employee

2. What are psychological contracts? Discuss the main features of psychological contracts and how they develop. How do employee benefits form a part of employees' psychological contracts?

Main Points

- A psychological contract has been defined as an employee's subjective perception of the relationship of mutual obligations with the employer and company
- Psychological contracts result in employees holding a range or continuum of expectations from the employer, ranging from pay and promotions to career development and family welfare
- The continuum of expectations have two ends: transactional psychological contracts and relational psychological contracts
- Toward the transactional end, employees' expectations are more economic and extrinsic in nature
- On the other hand, toward the relational end, employees' expectations might be either economic or non-economic, but are also emotional, subjective, and intrinsic in nature
- Most psychological contracts take shape in the pre-employment phase, when people seek information during recruitment and selection
- Employees can form expectations that comprise their psychological contracts from two sources: their interactions with other members and their perceptions of the company's culture
- Psychological contracts are flexible, undergoing constant change based on the interactions
- Employee benefits can be a part of the psychological contract employees hold about the employer's obligations to them in exchange for their efforts
- Employee benefit practices can be seen to fulfill both transactional and relational expectations
- Employees might expect to receive legally required benefits in addition to wages (more transactional)

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

- Employee benefits such as paid time-off and accommodation and enhancement benefits might help fulfill the relational expectations
- Educational assistance and retirement could fulfill both transactional and relational expectations

3. Discuss how employees' psychological contracts might be violated and the consequences of these violations for employers.

   Main Point

   - A violation of the psychological contract occurs when the employee perceives a discrepancy between the promises made by the employer and the actual fulfillment of the promises
   - Two basic causes for violations: 1) reneging, and 2) incongruence
   - Reneging occurs when a company deliberately breaks a promise to employees
   - Incongruence occurs when the employee and the employer have different conceptualizations of the employment relationship
   - Violations of employees' expectations by the employer can cause feelings of betrayal and loss of trust

4. One reason employers offer benefits is that the benefits may be cheaper for the employers to provide than it would be for the employees to purchase on their own. Even if a particular benefit is cheaper for an employer to provide, would that employer always want to provide it? Why or why not?

   Main Points
   - Student answers will vary
   - Even if a particular benefit is cheaper for an employer to provide, employers would not always want to provide it as part of a compensation package for variety or reasons
   - For instance, offering mental health services or substance abuse treatment might be cheaper for the employer to purchase similar to health insurance plans
   - However, the employer might also find that the types of employees who are most likely to accept a position, or most likely to stay at the employer, are those suffering from these conditions
   - Employers would like to attract and retain certain types of employees and therefore, they would want to design their benefit packages based the needs and preferences of their current and potential employees
   - It does not make sense for the employer to provide benefits just because they can purchase it cheaper

5. A major theme of this chapter is that employers need to know the dollar value that employees place on benefits. Explain concisely why this type of information is important for employers to have. What methods do employers actually use to gauge their employees' valuation of benefit packages?

   Main Points

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

- The greater value employees place on a benefit, the larger reduction in cash wages they will accept if the benefit is introduced into a compensation package
- For instance, an employer can understand their employees' valuation of benefit packages by offering two choices for a newly hired employee
- In the first choice, let's say the employer provides $75,000 annual salary plus a comprehensive health care plan, and as a second choice the employer offers a $90,000 annual salary without a health care plan
- Those who tend to use health services more frequently and more risk averse will tend to place a relatively higher value on the health insurance plan, and are therefore, more likely to forgo the extra $15,000 in salary
- On the other hand, healthier people and those willing to bear more financial risk are more likely to choose the extra salary
- Similarly, if the choice was between a $75,000 salary plus the health plan vs $100,000 salary and no health plan some employees who would have opted for the health insurance in the first situation would now choose the higher salary instead
- Here, employees prefer $25,000 in cash to health insurance provided by the employer
- This type of decisions of employees helps employers to understand their employees' valuation of benefit packages

X. Cases

Understanding Your Employee Benefits: Forgoing a Benefits Package

1. Why would a company offer salary with no benefits?
2. Do you think the offer without benefits is worth pursuing?

Instructor Notes

Employers offer benefits to employees for many reasons. An employer is able to offer benefits such as health insurance at a lower cost than if the employee would purchase the benefit on his or her own, and thus the benefit becomes of more value in the compensation package. Employee benefits can also attract certain kinds of workers and offers tax incentives for employers. As most employers now offer benefits such as a retirement savings plan, an employer will also consider competitor offerings when establishing a benefit plan. For these reasons, benefits can offer a different value in the total compensation offered to an employee.

Student Responses

1. Why would a company offer salary with no benefits?

   Few companies offer no benefits such as in this case, but there may be a variety of reasons why a company does not offer benefits. Often start-up companies can't afford to offer certain benefits or may have an uncertain future. If you consider that a

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

company may use benefits to recruit certain kinds of workers, it may be a concern that the company does not offer any benefits. What kind of worker does not want health insurance or retirement benefits? That is concerning. Perhaps the company is looking for short-term employees for some reason. It is important to fully understand the company and the job you are looking at as you consider the compensation offered.

2. Do you think the offer without benefits is worth pursuing?

   It may be risky to take a position without benefits. While you could seek an independent health insurance option, you don't have the same buying power as an organization with a lot of employees. Further, while you can have good intentions to set aside money for retirement, often it is easy to slip behind. If you have cash coming in your pay instead, you may decide to spend the money on a current need as opposed to saving for retirement which is a far off need.

Managing Employee Benefits: Cutting Benefits at Generals Construction

1. Does Jane have a valid concern?
2. What kind of changes could the company make to benefits to address Jane's concerns?

Instructor Notes

When designing benefit plans, organizations are challenged to balance economic needs with the expectations of employees. In this case, based on the psychological contract that the employees have with the company, these cuts could make the employees feel that their expectations were violated. Such cuts are particularly challenging when the company is doing well financially. It will be difficult for workers to understand the need of such cuts. Newer companies often make decisions about benefit offerings without taking a long-term outlook. Creating a generous benefit package can attract needed workers, but employers should be cautious and only offer benefits they can sustain.

Student Responses

1. Does Jane have a valid concern?

   Yes, Jane does have a valid concern. Generals Construction has a psychological contract with its employees regarding their benefits. During the hiring process, and over the first ten years, the employer offered a generous benefit package to attract and retain employees. In turn, the employees expected those benefits to be a continuing part of the employment relationship. A violation of the psychological contract occurs when there is a discrepancy between what was promised and the actual fulfillment of those expectations. While the employer likely did not have a written contract promising the continuation of the benefits, the fact that they were offered for ten years suggests to the employees that they will continue. This is particularly true as the company is continuing to succeed and grow. Now that the

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

company is stable, the employees will react negatively to such a cut in benefits. They are likely to feel betrayed and distrustful. They might be willing to accept the changes if the company was in a downturn. Further, cutting the benefits of the construction workers and not the others is likely to have an even more problematic effect on company morale.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

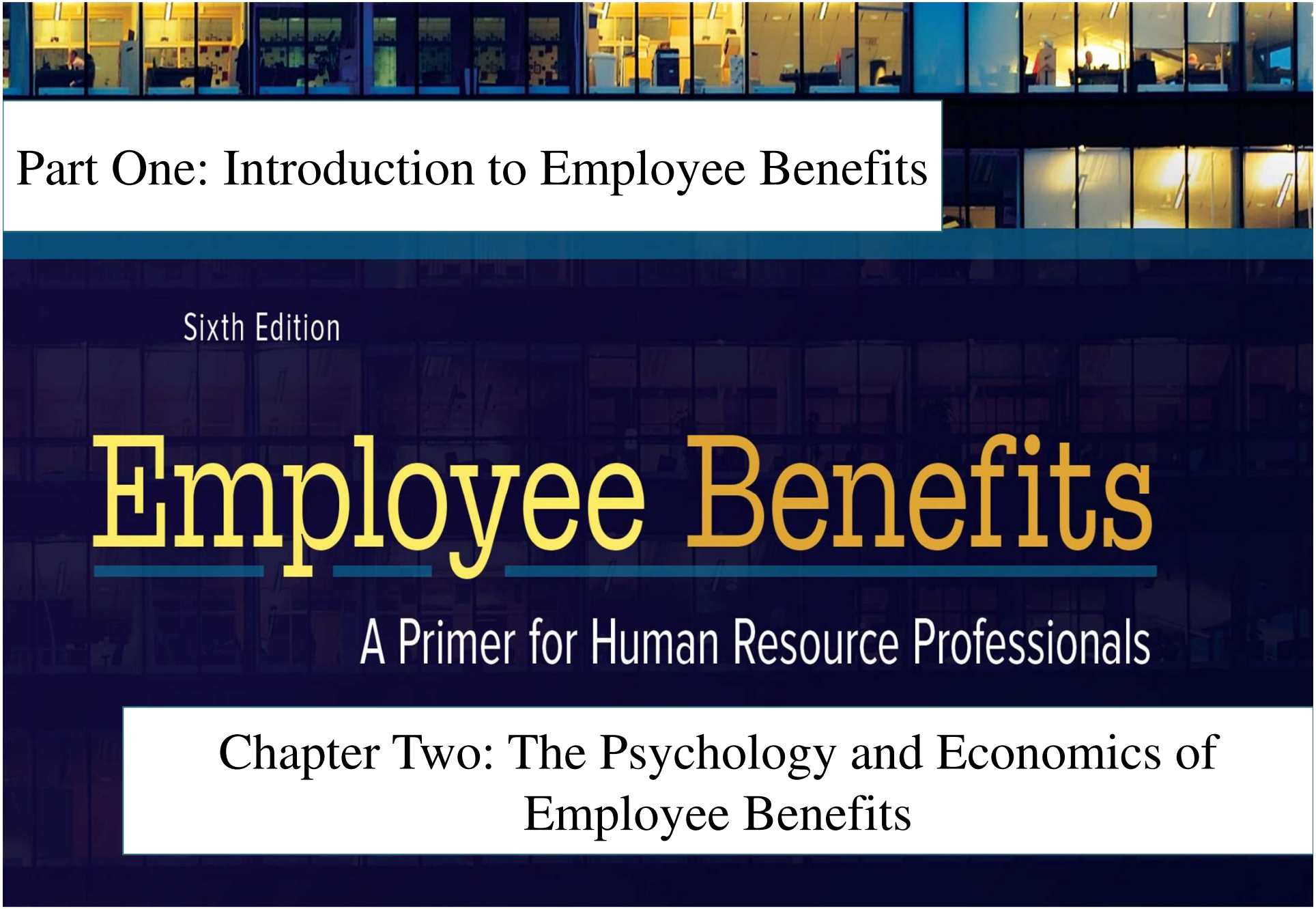
Employee Benefits 6th edition Martocchio Solutions Manual

2. What kind of changes could the company make to benefits to address Jane's concerns?

   The employees in this case may have an unrealistic expectation of what the company should provide them, but that expectation was established based on the company providing them the benefits consistently over an extended period of time. If the company wants to shift employee expectations, it needs to do so gradually as well. Shifting some of the burden of the cost of health care insurance to employees would not be entirely unacceptable. However, those changes should be more gradually. It would be wise to begin with giving a smaller portion of the premium to the employees. While they might charge a little more for employees who have coverage for their full family, they should not cut their support entirely. Further, cutting a vacation benefit that the employees have grown accustom to having is not something that the employees will accept readily. The company could change the new hire vacation allowance, however, the negative impact of cutting only the construction worker vacation would likely result in the loss of workers. Jane should take some time to review all benefits offered by the company to understand utilization rates. For example, if the company offers vision insurance and only a few employees use it, they could consider cutting the vision insurance. They could also examine expenses in other areas of employee management that they could cut.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual



Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

Learning Objectives

- In this chapter you will gain an understanding of:
  - the employment relationship as an exchange relationship and the psychology behind why firms provide employee benefits.
  - employee benefits as part of the psychological contract and how some employee expectations about benefits might be formed.
  - how employee perceptions of justice or fairness are important to understanding how pay and benefits practices influence employee attitudes.
  - the economic rationales for why companies offer employee benefits.
  - who pays for employee benefits.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

Overview

- We first learn about the psychological basis of employee benefits.
  - Employers can understand how employee benefits influence employee attitudes and performance.
- It is also important to understand the economic basis of employee benefits.
  - Even though benefits are expensive, most employers continue to offer them.
- And finally, who pays for benefits?

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

The Psychology of Employee Benefits

Organized into three sections.

The employment relationship as social exchange

Psychological contracts

The relationship between a benefits program and employee attitudes

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

Employment Relationship as Social Exchange

- The employment relationship consists of HR practices offered to a group of employees
  - and the resulting employee contributions.
- **Social exchange** is an activity exchange, tangible or intangible, between two or more.
  - At work, the employer offers inducements (wages, benefits)
  - in return for employee contributions (performance, commitment).

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

How Employee Benefits Constitute Social Exchange

- The employment relationship constitutes both economic exchange and social exchange.
  - **Economic exchange** is wages and salary specified at the time of employment.
  - Social exchange evolves over time.
- If employers provide benefits meeting employee's evolving needs,
  - they reciprocate with increased work effort and commitment.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Workforce Changes and the Employment Relationship

- Jobs are no longer traditional as in
  - job security,
  - strong loyalty to the organization, or
  - the patriarchal role of the organization.
- Work and careers are more flexible.
- The workforce is becoming increasingly diverse.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

Psychological Contracts

Employee benefits can be a part of the psychological contract.

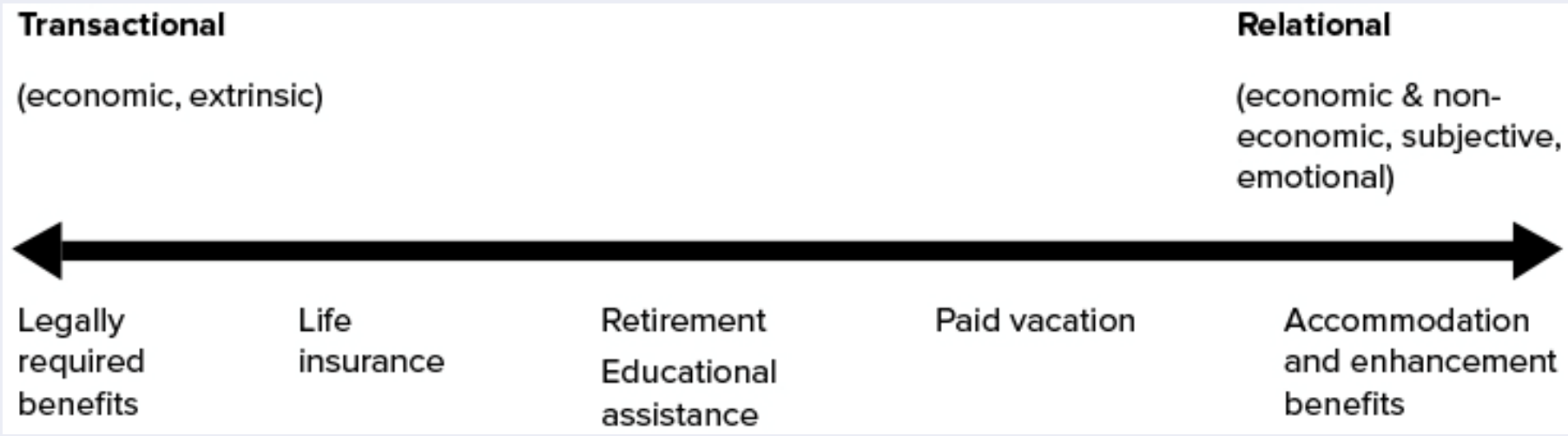
A **psychological contract**

is an employee's subjective perceptions of the relationship of mutual obligations with the employer

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

EXHIBIT 2.2

Transactional – Relational Continuum of Employee Expectations



Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Psychological Contracts

- Employee benefits practices could fulfill both transactional and relational expectations.
  - Legally required benefits fulfill transactional expectations.
  - Benefits such as paid time off might fulfill relational expectations.
  - Some benefits might fulfill both, such as retirement plans or educational assistance.
- Psychological contracts change over time.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Psychological Contract Development

- Most psychological contracts start in the pre-employment phase.
- Employee expectations form in two ways:
  - interactions with other members of the company,
  - and their perceptions of the company's culture.
- Psychological contracts undergo constant change, allowing employees to adapt.
  - Stable expectations resist changes while flexible expectations more easily accept changes.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

Psychological Contract Violation

- A violation occurs when an employee perceives a discrepancy between employer promises and fulfillment of those promises.
  - Differs from unmet expectations.
- Two basic causes for contract violations:
  - Reneging – when a company deliberately breaks a promise, willingly or due to circumstances.
  - Incongruence – when the employee and employer have different conceptualizations of the employment relationship.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

Employee Benefits as Constituting Psychological Contracts

- Avoid contract violations by using clear communication and education about benefits.
- Employer's have expectations too.
  - If employee performance is not what is expected, the company may withhold benefits.
- Benefits have become a growing source of psychological contract violations.
  - Expectations about cost, needs, and benefits design affect employee satisfaction.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Attitudes and Employee Benefits

Congruence between employees' and the employer's expectations will lead to a greater fit between the employee and the employer as well as a sense of fairness.

Violations of contracts will lead to perceptions of injustice.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Justice and Perceived Organizational Support

- In a work setting, the distribution of:
  - rewards (such as pay and benefits),
  - information, and
  - other resources,
  - will all lead to perceptions of justice.
- Perceptions may be based on:
  - the rules by which distributions are made,
  - the way rules are implemented,
  - or the way decisions are made.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Justice and Perceived Organizational Support

There are four types of justice perceptions.

Distributive justice	• is the perceived fairness about how rewards are distributed
Procedural justice	• is the perceived fairness of processes
Informational justice	• is the perceived fairness of the accounts given for certain procedures
Interpersonal justice	• is perceived fairness of the interpersonal treatment people receive from others

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Justice and Perceived Organizational Support

Where employee benefits are concerned:

Distributive justice	• employees form perceptions of fairness based on the benefits they are eligible for
Procedural justice	• perceptions of the fairness of decisions and the extent of employee involvement
Informational justice	• perceptions about the quality of information used to explain decision making
Interpersonal justice	• perception of the degree to which the employer demonstrates concern

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Justice and Perceived Organizational Support

- **Perceived organizational support** is an employee's perception of the degree to which the employer values the employee's contributions and well-being.
  - Certain benefits signal organizational support.
    - Wellness programs or recognition and rewards.
  - Discretionary benefits generate perceptions of organizational support more than legally required benefits.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Organizational Citizenship Behavior

Employees' discretionary behavior, not explicitly or directly recognized by the formal reward system, but in aggregate promoting organizational effectiveness, is termed as **organizational citizenship behavior**.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

Organizational Citizenship Behavior

- Satisfied employees engage in good citizenship behavior.
  - Employee benefits practices influence satisfaction.
- Discretionary and not enforceable.
- Distributive and procedural justice affect citizenship behavior.
- Based in social exchange.
  - Employee benefits are also part of social exchange.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

The Economics of Employee Benefits: Why Do Employers Offer Benefits?

Three primary reasons:

- A cost advantage to the employer
- Recruitment of certain types of workers
- Tax incentives

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Cost Advantage

- Some benefits are cheaper for the employer to purchase for a group rather than individuals.
- Group rates decrease as group size increases.
  - Insurance becomes less risky to provide.
  - Reduced fear of high-risk policyholders driving out the low-risk ones.
  - Fixed administrative cost per employee is reduced.
    - Referred to as *economies of scale*.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

Cost Advantage

- The insurance company can more easily predict total expenses for a larger group.
  - Medical expenses will likely be close to predictions for age, gender, and medical history.
  - Those with more expenses will offset those with less expenses.
  - Due to less risk, they get lower costs for coverage.
  - Individuals and small groups may undergo *medical underwriting*, and provide a medical history.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Cost Advantage

- The larger the group, the less likelihood of *adverse selection*.
  - A condition where the insurance pool attracts only high-risk individuals.
  - One solution is **experience rating** where healthier people get insurance at lower costs.
  - Reason behind government-provided insurance.
- Due to **economies of scale**, as the group gets larger the average cost per person is reduced.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Recruiting Certain Types of Workers

- Recent undergrads might be attracted to a tuition reimbursement benefit.
- Women 20-40 might want health insurance.
- Older workers may want a retirement plan.
- Tailoring packages may have unintended consequences.
  - A strong mental health program may attract those with mental health issues.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Tax Incentives

- The Internal Revenue Code provides financial incentives to offer benefits.
- Many benefits are not taxed as income to employees.
- Retirement plans are driven by generous tax treatments.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

The Economics of Employee Benefits: Why Do Employers Offer Benefits?

- Consequences to presupposing that employees value a benefit and are willing to give up something to receive it.
  - Employers need to define the cash value employees place on a benefit.
    - And which types they value more.
  - If employees willingly give up something to receive a benefit, then the cash component and the benefits are inexorably linked.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Who Pays For Benefits?

One of the biggest misconceptions is that benefits are "free add-ons."

Employees pay for all benefits in the form of lower cash wages

When the cost of benefits increase, employees pay the increase; employers' profits are generally not affected

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Who Pays For Benefits?

- When benefit costs increase, the degree that cost is passed on to employees depend on:
  - The cash value that employees place on the benefit.
  - The degree to which employers will change their hiring practices and the degree to which employees will change their desire to work.
  - Whether the benefit cost increases for all employers in the market, or for a specific employer.
  - Whether the hiring decisions of a particular employer affect the market compensation level.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Employee Benefits 6th edition Martocchio Solutions Manual

Who Pays For Benefits?

- Most employees are required to contribute toward their health insurance costs.
- There are advantages to this.
  - This allows employers to charge different prices according to family sizes, or plan type.
  - Employers can more easily raise these contributions when benefit costs increase.

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.

Summary

- We first learned about the psychological basis of employee benefits.
  - Employers must understand how employee benefits influence employee attitudes and performance.
- We now understand the economic basis of employee benefits.
  - Even though benefits are expensive, most employers continue to offer them.
- And finally, we answered who pays for benefits?

Copyright © 2018 McGraw-Hill Education. All rights reserved. No reproduction or distribution without the prior written consent of McGraw-Hill Education.