Chapter 12 – Recognizing Employee Contributions with Pay

This chapter continues to build on concepts from Chapter 11, now with a focus on pay for performance. Instructors may wish to engage students in a self-reflective exercise, or facilitate a conversation on motivation to introduce the chapter (LO12-1). LO12-2 and LO12-3 may be discussed simultaneously, as they both can be used to reinforce LO12-1 as well as each other. LO12-4 may be discussed as a method for mitigating the weakness of applying only one type of pay program or performance metric. LO12-6 and LO12-7 help to reinforce the internal issues associated with pay for performance and the need for managers to anticipate and mitigate such issues. LO12-5 may arguably be one of the more interesting topics to discuss for students, and so instructors may wish to facilitate discussions at great length with this topic, which may help to reinforce learnings from chapter 12.

Learning Objectives

LO 12-1: Discuss how pay influences individual employees, and describe three theories that explain the effect of compensation on individuals.

LO 12-2: Describe the fundamental pay programs for recognizing employees’ contributions to the organization’s success.

LO 12-3: List the advantages and disadvantages of the pay programs.

LO 12-4: Describe how organizations combine incentive plans in a balanced scorecard.

LO 12-5: Discuss issues related to performance-based pay for executives.

LO 12-6: Explain the importance of process issues such as communication in compensation management.

LO 12-7: List the major factors to consider in matching the pay strategy to the organization’s strategy.

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

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

* Employee Engagement & Retention
* Total Rewards
* Workforce Management
* Employee & Labor Relations
* Risk Management
* U.S. Employment Law & Regulations

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

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

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

Guidance to Discussion Questions and End of Chapter Sections

**Discussion Question 1:** To compete more effectively, your organization is considering a profit sharing plan to increase employee effort and to encourage employees to think like owners. What are the potential advantages and disadvantages of such a plan? Would the profit sharing plan have the same impact on all types of employees? Is the size of your organization an important consideration? Why? What alternative pay programs should be considered?

The advantages are that employees will be more inclined to think like owners and will probably broaden their view about job duties and what needs to be done. Labor costs will decline in poor economic times, and layoffs may not be necessary. Disadvantages are that employees may not believe they have much power to control outcomes and will be disenchanted when there is no profit and therefore no profit- sharing. The plan would not have the same impact on all employees. Of particular concern would be high performers with high-achievement motivation. They may find the plan frustrating, since they are not rewarded for individual effort. Size of an organization should not be an important consideration because profit sharing is based more on productivity and profits of the company, not how the profits will be split up (e.g. the more employees there are, the less money each employee gets). Alternatives might be programs such as stock options or ESOPs. The company might add some component of individual and/or group incentives such as gainsharing.

**Discussion Question 2:** Gainsharing plans have often been used in manufacturing settings but can also be applied in service organizations. How could performance standards be developed for gainsharing plans in hospitals, banks, insurance companies, and so forth?

Performance standards should be developed with the help and teamwork of managers and employees. These standards must be perceived as fair, reasonable, and equitable. Costs are possible to measure in some departments, but other departments may need to rely on measures that are oriented to process, including components of quantity, quality, and timeliness of service. In service organizations, customer satisfaction with service would be extremely important.

**Discussion Question 3:** Your organization has two business units. One unit is a long-established manufacturer of a product that competes on price and has not been subject to many technological innovations. The other business unit is just being started. It has no products yet, but it is working on developing a new technology for testing the effects of drugs on people via simulation instead of through lengthy clinical trials. Would you recommend that the two business units have the same pay programs for recognizing individual contributions? Why?

No, the plan should not be the same since the business and risk are very different. Incentives for the new organization might include stock options, since salaries and benefits may need to be low in start-up. In other words, employees, to be attracted to join, may be willing to take a risk for the possibility of a large reward. There may also be a plan in place to reward individual research efforts that result in large profits, patents, and so on, by a share of the proceeds (this is labeled “intrapreneurship”).

**Discussion Question 4:** Throughout the chapter, we have seen many examples of companies making changes to how they pay for performance. Do you believe the changes at these companies make sense? What are the potential payoffs and pitfalls of their new pay strategies?

Responses may vary.

**Exercising Strategy**

Pay and Strategy Execution at Wells Fargo and “Down Under” (at ANZ): Incentives Gone Awry

1. Have you experienced cross-selling as a bank customer? What was your reaction? What would your reaction be if the bank opened a line of credit for you that you did not want (or tell you about)?

Responses will vary dependent on students' experiences.

1. How is what happened at Wells Fargo similar to what happened at Volkswagen or at Novartis? (See the Integrity in Action box, earlier in this chapter.)

Responses will vary, but should identify the link with incentives (or disciplinary action) and employee actions.

1. What caused the problems at Wells Fargo, and how can they be fixed? How helpful will the new compensation plan be in fixing things? Why?

Students should link the incentive plan with the employee actions within the response, as well as how the new plan may encourage ethical actions.

1. Consider the same questions for ANZ. How would you react as a customer if your adviser did not act in your best interest? If you currently have a financial adviser, how do you know that person is acting in your best interest? Will the changes to ANZ’s compensation be effective?

Since ANZ had a history of advisers giving advice that was not in the best interest of their clients, the decision to eliminate sales-based bonuses was a good one. Evaluating advisers based on customer satisfaction, consistency with the bank's values, and minimization of risk will improve customer satisfaction.

**Managing People**

ESOPs: Who Benefits?

1. Is an ESOP good for employees? Why or why not?

Some students will believe they are very beneficial, while others will likely side with those who feel they are encouraging employees to gamble with their retirement.

1. Does an ESOP motivate employees “better”? Explain the reasons for your answer.

Responses should apply the concepts in the chapter to support their responses.

1. What happens to employees’ retirement income if they are at an ESOP company that runs into financial problems? What happens to the same employees, if instead, they work at a non-ESOP company that runs into financial problems?

As with any investment or business, there is risk involved in these plans—it is the risk-return tradeoff. If these employees worked for non-ESOP firms, their retirement would be more structured.

**HR in Small Business**

Employees Own Bob’s Red Mill

1. Which types of incentive pay are described in this case? Are these based on individual, group, or company performance?

The case indicates the company has an ESOP and profit sharing plan. The ESOP plan by nature is a company performance based plan. The profit sharing plan is also based on firm performance.

1. Would you expect the motivational impact of stock ownership or profit sharing to be different at a small company like Bob’s Red Mill than in a large corporation? Explain.

Responses may indicate that at a smaller company like Bob’s Red Mill, more line of sight for employees to see direct effects of their contributions to bottom-line performance of the firm, which translates into cash for the employee.

1. Suppose Bob’s Red Mill brought you in as a consultant to review the company’s total compensation. Explain why you would or would not recommend that the company add other forms of incentive pay, and identify any additional forms of compensation you would recommend for the company’s employees.

Responses will vary. At present, the company appears to only have firm performance-based incentive plans. Advice should take into consideration what the company’s management wants to give incentive to do. To bolster individual performance, individual performance-based plans should be considered.

Guidance to Chapter Cases

**A Look Back**

Pay for Performance: Balancing Objectives (and Risks)

1. Does money motivate? Use the theories and examples discussed in this chapter to address this question.

Responses will vary, but should be supported by the chapter concepts. Instructors should look to challenge student responses to ensure both understanding and deeper reflection on question.

1. Think of a job that you have held. Design an incentive plan. What would be the potential advantages and disadvantages of your plan? If your money was invested in the company, would you adopt the plan?

Responses should reflect an understanding of the need to align compensation with strategy and the need to motivate employees.

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

Carbon-Emissions Targets (and Incentives) at Royal Dutch Shell

1. Why did Royal Dutch Shell decide to incentivize achievement of carbon-emissions target? Because they care about the environment, because it is good for business, and/or because of stakeholder pressure? (Is it necessary to pick one?)

Responses will vary. The most likely answer is both.

1. Do you think other companies will make similar decisions? Which companies and why? Would you recommend they use incentives in a way similar to how Royal Dutch Shell is using them? Do you have other suggestions for how to encourage these behaviors?

Responses will vary. Most incentives, in the end, are financial.

**Competing through Technology**

Financial Services Firms Turn to Social Media and Automation

1. How does social media offer the opportunity for a firm to capitalize on the performance of its star employees in this case? Also, what are its implications for pricing of services for customers?

Social media and mobile platforms turn its top performing asset managers into stars who are visible and easily accessible to investors, including small investors. Technology will serve not only to advertise the opportunity to invest with such stars, but will also make it more efficient and profitable than in the past to take on clients with less money to invest. Technology can also allow a firm to reduce its workforce, saving it money.

1. How does the move over recent decades to low-cost, passive investing help explain the growth of automation in these financial services firms?

Passive investments can be managed by software, lessening the need for human financial managers.

**Integrity in Action**

Novartis Changes the Way It Pays: Now, Not Just Whether, but also How, You Achieve Your Objectives Matters

1. What caused the Novartis scandals? What can you infer about the nature of its former pay strategy and the role it may have played?

The scandals involved bribery in China, South Korea, and the U.S. to increase sales, including $1.2 million to Michael Cohen for influence. Bonuses were previously compensated just for sales, which encouraged unethical practices.

1. Consider Novartis’s revised pay strategy. How well do you think it will succeed going forward? Do you have suggestions for other changes? Explain.

The new pay strategy caps bonuses at 35% of pay, intended to discourage unethical sales practices. Responses will vary on suggestions for other changes.

**Competing through Globalization**

Japanese Companies Shift Emphasis from Seniority to Performance: Some Japanese Now Even Switch Companies

1. What is wrong with paying for seniority instead of performance?

Responses should identify how paying for seniority may only encourage tenure, while performance suffers.

1. Why is the prime minister of Japan interested in how companies pay?

Responses will vary, but should apply their rationale in question 1 and how Japanese companies may need to improve their ability to compete.

1. If you were choosing between a company that paid for seniority and a company that paid for performance, which would you choose? What about 20 years from now? What if you were a native of Japan, working in Japan? Would you make the same choice? Explain.

Responses will vary.

Other Classroom Materials: CONNECT

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

The following activities are available in Connect for this chapter:

**Executive Pay: Make the Link**

*Case Analysis*

This activity reviews the various forms of executive pay.

LO: 12-04 Describe how organizations combine incentive plans in a balanced scorecard.

12-05 Discuss issues related to performance-based pay for executives.

Difficulty: 2 Medium

Blooms: Remember; Understand

AACSB: Analytical Thinking

Topic: Issues Related to Executive Pay

**A Meritorious Plan?**

*Case Analysis*

This activity reviews the various forms of individual pay.

LO: 12-02 Describe the fundamental pay programs for recognizing employees’ contributions to the organization’s success.

12-03 List the advantages and disadvantages of the pay programs.

Difficulty: 2 Medium

Blooms: Understand; Analyze

AACSB: Analytical Thinking; Knowledge Application

Topic: Types of Individual Incentives; Pay-for-Performance Systems; Stock Options and Profit Sharing as Incentives

**The Ownership Society**

*Case Analysis*

This activity reviews profit sharing and ownership plans.

LO: 12-01 Discuss how pay influences individual employees, and describe three theories that explain the effect of compensation on individuals.

12-03 List the advantages and disadvantages of the pay programs.

Difficulty: 2 Medium; 3 Hard

Blooms: Analyze

AACSB: Analytical Thinking; Knowledge Application

Topic: Stock Options and Profit Sharing as Incentives

**Theories of Influence**

*Click & Drag*

This activity asks students to determine which theory of motivation (reinforcement, expectancy, or agency) best relates to various statements.

LO: 12-01 Discuss how pay influences individual employees, and describe three theories that explain the effect of compensation on individuals.

Difficulty: 2 Medium

Blooms: Apply

AACSB: Analytical Thinking

Topic: Types of Individual Incentives

**Show Me the Money**

*Case Analysis*

This activity reviews compensation plans.

LO: 12-01 Discuss how pay influences individual employees, and describe three theories that explain the effect of compensation on individuals.

Difficulty: 2 Medium; 3 Hard

Blooms: Understand; Apply

AACSB: Analytical Thinking; Knowledge Application

Topic: Types of Individual Incentives

**Manager's Hot Seat: Cyberloafing**

*Video Case*

This activity discusses issues managers may face when employees do not feel they are receiving appropriate pay.

LO: 12-01 Discuss how pay influences individual employees, and describe three theories that explain the effect of compensation on individuals.

12-03 List the advantages and disadvantages of the pay programs.

Difficulty: 1 Easy; 2 Medium; 3 Hard

Blooms: Understand; Apply

AACSB: Analytical Thinking; Knowledge Application

Topic: Types of Individual Incentives; Employee Motivation

**Which Type of Strategy?**

*Case Analysis*

This activity reviews the various programs for recognizing employees’ contributions to the organization’s success.

LO: 12-02 Describe the fundamental pay programs for recognizing employees’ contributions to the organization’s success.

12-03 List the advantages and disadvantages of the pay programs.

Difficulty: 2 Medium; 3 Hard

Blooms: Apply

AACSB: Knowledge Application

Topic: Advantages and Disadvantages of Various Pay Programs; Pay-for-Performance Systems

**CHRO Conversations: SVP of HR Tim Richmond, AbbVie**

*Video Case*

This activity has students watch a video interview with the Senior Vice President of HR at AbbVie and answer questions about the HR activities that reward and recognize employees who produce at high levels and how they can support the strategic goals of a company.

LO: 12-01 Discuss how pay influences individual employees, and describe three theories that explain the effect of compensation on individuals.

Difficulty: 1 Easy; 2 Medium

Blooms: Remember; Analyze

AACSB: Reflective Thinking; Knowledge Application

Topic: Comparable Worth Theory