EIGHTH EDITION GLOBAL EDITION

STRATEGIC COMPENSATION

A Human Resource Management Approach

Joseph J. Martocchio

University of Illinois at Urbana-Champaign



Contents

Preface	14	
Part I	Set	tting the Stage for Strategic Compensation
Chapte	r 1	Strategic Compensation 20 A Component of Human Resource Systems 20 Exploring and Defining the Compensation Context 21 What Is Compensation? 21 Core Compensation 21 Employee Benefits 23 A Historical Perspective on Compensation: The Road toward Strategic Compensation 25 Strategic versus Tactical Decisions 27 Competitive Strategy Choices 29 Tactical Decisions that Support the Firm's Strategy 30 Compensation Professionals' Goals 30 How HR Professionals Fit into the Corporate Hierarchy 30 How the Compensation Function Fits into HR Departments 31 The Compensation Department's Main Goals 35 Stakeholders of the Compensation System 36 Employees 36 Line Managers 36 Executives 37 Unions 37 U.S. Government 37 COMPENSATION IN ACTION 37 Summary 38 • Key Terms 38 • Discussion Questions 38 CASE: Competitive Strategy at Sportsman Shoes 39 Endnotes 39
Chapte	r 2	Contextual Influences on Compensation Practice 41 Employment Laws that Influence Compensation Tactics 42 Income Continuity, Safety, and Work Hours 43 Pay Discrimination 47 Civil Rights Act of 1964 49 Accommodating Disabilities and Family Needs 53 Prevailing Wage Laws 54 Laws that Guide Discretionary Employee Benefits 55 Internal Revenue Code 55 Employee Retirement Income Security Act of 1974 (ERISA) 56 Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) 57 Continuation of Coverage under COBRA 58

	Pension Protection Act of 2006 58
	Patient Protection and Affordable Care Act of 2010 (PPACA) 59
	Contextual Influences on the Federal Government as an Employer 60
	Labor Unions as Contextual Influences 61
	Market Influences 63
	■ COMPENSATION IN ACTION 65
	Summary 65 • Key Terms 65 • Discussion Questions 66
	■ CASE: Exempt or Nonexempt? 66
	• Endnotes 67
Part II Base	es for Pay 69
Chapter 3	Traditional Bases for Pay 70
•	Seniority and Merit 70
	Seniority and Longevity Pay 70
	Historical Overview 71
	Who Participates? 72
	Effectiveness of Seniority Pay Systems 72
	Design of Seniority Pay and Longevity Pay Plans 72
	Advantages of Seniority Pay 74
	Fitting Seniority Pay with Competitive Strategies 74
	Merit Pay 75
	Who Participates? 75
	Exploring the Elements of Merit Pay 75
	Performance Appraisal 78
	Types of Performance Appraisal Plans 78
	Exploring the Performance Appraisal Process 83
	Strengthening the Pay-for-Performance Link 87
	Link Performance Appraisals to Business Goals 87 Analyze Jobs 87
	Analyze Jobs 87 Communicate 87
	Establish Effective Appraisals 87
	Empower Employees 87
	Differentiate among Performers 89
	Possible Limitations of Merit Pay Programs 89
	Failure to Differentiate among Performers 89
	Poor Performance Measures 89
	Supervisors' Biased Ratings of Employee Job Performance 89
	Lack of Open Communication between Management and Employees 89
	Undesirable Social Structures 89
	Factors Other than Merit 90
	Undesirable Competition 90
	Little Motivational Value 90
	COMPENSATION IN ACTION 91
	Summary 91 • Key Terms 91 • Discussion Questions 92
	■ CASE: Appraising Performance at Precision 92
	• Endnotes 93
	Lituliotes 33

Health Insurance Portability and Accountability Act of 1996 (HIPAA) 58

Chapter 4 Incentive Pay 95

Exploring Incentive Pay 95

Contrasting Incentive Pay with Traditional Pay 96

Individual Incentives 98

Defining Individual Incentives 99

Types of Individual Incentive Plans 99

Advantages of Individual Incentive Pay Programs 101

Disadvantages of Individual Incentive Pay

Programs 102

Group Incentives 102

Defining Group Incentives 103

Types of Group Incentive Plans 103

Advantages of Group Incentives 108

Disadvantages of Group Incentives 109

Companywide Incentives 109

Defining Companywide Incentives 109

Types of Companywide Incentive Plans 110

Designing Incentive Pay Programs 112

Group versus Individual Incentives 112

Level of Risk 112

Complementing or Replacing Base Pay 113

Performance Criteria 113

Time Horizon: Short Term versus Long Term 113

■ COMPENSATION IN ACTION 114

Summary 115 • Key Terms 115 • Discussion Questions 115

■ CASE: Individual or Team Reward? 116

• Endnotes 116

Chapter 5 Person-Focused Pay 118

Defining Person-Focused Pay: Competency-Based,

Pay-for-Knowledge, and Skill-Based Pay 118

What Is a "Competency"? 120

Usage of Person-Focused Pay Programs 120

Reasons to Adopt Person-Focused Pay Programs 121

Technological Innovation 121

Increased Global Competition 122

Varieties of Person-Focused Pay Programs 123

Contrasting Person-Focused Pay with

Job-Based Pay 127

Advantages of Person-Focused Pay Programs 129

Advantages to Employees 129

Advantages to Employers 130

Disadvantages of Person-Focused Pay Programs 130

■ COMPENSATION IN ACTION 131

Summary 132 • Key Terms 132 • Discussion Questions 133

■ CASE: Person-Focused Pay at Mitron Computers 133

• Endnotes 134

Part III Designing Compensation Systems 135

Chapter 6 Building Internally Consistent Compensation Systems 136

Internal Consistency 136

Job Analysis 138

Steps in the Job Analysis Process 138

Legal Considerations for Job Analysis 143

Job Analysis Techniques 145

U.S. Department of Labor's Occupational Information Network (O*NET) 145

Job Evaluation 150

Compensable Factors 150

The Job Evaluation Process 151

Job Evaluation Techniques 152

The Point Method 153

Alternative Job-Content Evaluation Approaches 156

Alternatives to Job Evaluation 157

Internally Consistent Compensation Systems and Competitive Strategy 157

■ COMPENSATION IN ACTION 158

Summary 159 • Key Terms 159 • Discussion Questions 159

■ CASE: Internal Consistency at Customers First 160

Endnotes 161

Chapter 7 Building Market-Competitive Compensation Systems 162

Market-Competitive Pay Systems: The Basic Building Blocks 162

Compensation Surveys 163

Preliminary Considerations 163

Using Published Compensation Survey Data 164

Compensation Surveys: Strategic Considerations 167

Compensation Survey Data 169

Updating the Survey Data 174

Integrating Internal Job Structures with External

Market Pay Rates 176

Compensation Policies and Strategic Mandates 179

Pay Level Policies 179

Pay Mix Policies 180

■ COMPENSATION IN ACTION 181

Summary 182 • Key Terms 182 • Discussion Questions 182

■ CASE: Nutriment's New Hires 183

• Endnotes 183

Chapter 8 Building Pay Structures that Recognize Employee Contributions 193

Constructing a Pay Structure 193

Step 1: Deciding on the Number of Pay Structures 194

Step 2: Determining a Market Pay Line 194

Step 3: Defining Pay Grades 194

```
Step 4: Calculating Pay Ranges for Each Pay Grade 196
                    Step 5: Evaluating the Results 200
                 Designing Merit Pay Systems 201
                     Merit Increase Amounts 201
                    Timing 202
                     Recurring Versus Nonrecurring Merit Pay Increases 202
                     Present Level of Base Pay 203
                     Rewarding Performance: The Merit Pay Grid 203
                    Merit Pay Increase Budgets 204
                 Designing Sales Incentive Compensation Plans 207
                     Alternative Sales Compensation Plans 207
                    Sales Compensation Plans and Competitive Strategy 209
                     Determining Fixed Pay and the Compensation Mix 209
                 Designing Person-Focused Programs 210
                     Establishing Skill Blocks 211
                     Transition Matters 212
                     Training and Certification 213
                 Pay Structure Variations 214
                     Broadbanding 214
                    Two-Tier Pay Structures 215
                     ■ COMPENSATION IN ACTION 217
                 Summary 217 • Key Terms 218 • Discussion Questions 218
                     ■ CASE: A New Sales Representative 218

    Endnotes 219

Part IV Employee Benefits 221
  Chapter 9
                 Discretionary Benefits 222
                 An Overview of Discretionary Benefits
                 Components of Discretionary Benefits 224
                     Protection Programs 224
                    Paid Time Off 227
                    Services 228
                 The Benefits and Costs of Discretionary Benefits 231
                     ■ COMPENSATION IN ACTION 232
                 Summary 233 • Key Terms 233 • Discussion Questions 233
                     ■ CASE: Time Off at Superior Software Services 234

    Endnotes 235

                 Employer-Sponsored Retirement Plans
 Chapter 10
                 and Health Insurance Programs 236
                 Exploring Retirement Plans 236
                     Origins of Employer-Sponsored Retirement Benefits 237
                     Trends in Retirement Plan Coverage and Costs 237
                 Oualified Plans 238
                     Minimum Standards for Qualified Plans 238
                 Defined Benefit Plans 240
                     Minimum Funding Standards 240
                     Benefit Limits and Tax Deductions 241
```

Chapter 11

Individual Accounts 242 Investments of Contributions 242 Employee Participation in Investments 242
Minimum Funding Standards 242 Contribution Limits and Tax Deductions 242
Types of Defined Contribution Plans 242 Section 401(k) Plans 242 Profit Sharing Plans 243 Stock Bonus Plans 243
Employee Stock Ownership Plans 243 Hybrid Plans: Cash Balance Plans 244
Hybrid Plans: Cash Balance Plans 244 Defining and Exploring Health Insurance Programs 244
Origins of Health Insurance Benefits 244 Health Insurance Coverage and Costs 245
Fee-for-Service Plans 246 Features of Fee-for-Service Plans 247
Managed Care Plans 249 Health Maintenance Organizations 249 Features of Health Maintenance Organizations 249
Preferred Provider Organizations 251 Features of Preferred Provider Organizations 251 Deductibles 251 Coinsurance 251
Point-of-Service Plans 251
Specialized Insurance Benefits 251 Prescription Drug Plans 252 Mental Health and Substance Abuse 252 Features of Mental Health and Substance Abuse Plans 252
Consumer-Driven Health Care 253
■ COMPENSATION IN ACTION 254 Summary 255 • Key Terms 255 • Discussion Questions 256 ■ CASE: A Health Savings Account at Frontline PR 256
• Endnotes 257
Legally Required Benefits 258 An Overview of Legally Required Benefits 258 Components of Legally Required Benefits 259 Social Security Act of 1935 259 State Compulsory Disability Laws (Workers' Compensation) 265
Family and Medical Leave Act of 1993 269 The Benefits and Costs of Legally Required Benefits 270
Designing and Planning the Benefits Program 271 Determining Who Receives Coverage 271 Financing 272 Employee Choice 272
Cost Containment 274 Communication 274

Defined Contribution Plans 241

	■ COMPENSATION IN ACTION 277 Summary 277 • Key Terms 278 • Discussion Questions 278 ■ CASE: Benefits for Part-Time Workers 278 • Endnotes 279
	ntemporary Strategic Compensation allenges 281
Chapter 12	Compensating Executives 282 Contrasting Executive Pay with Pay for Nonexecutive Employees 283 Principles of Executive Compensation: Implications for Competitive Strategy 283 Defining Executive Status 283 Who Are Executives? 283 Key Employees 285 Highly Compensated Employees 285 Executive Compensation Packages 285 Components of Current Core Compensation 285 Short-Term Incentives 287 Components of Deferred Core Compensation 287
	Employee Benefits: Enhanced Protection Program Benefits and Perquisites 291 Principles and Processes for Setting Executive Compensation 292 The Key Players in Setting Executive Compensation 293 Theoretical Explanations for Setting Executive Compensation 294 Executive Compensation Disclosure Rules 296 Other Benefits 298
	Say on Pay 299 Executive Compensation: Are U.S. Executives Paid Too Much? 300 Comparison between Executive Compensation and Compensation for Other Worker Groups 300 Strategic Questions: Is Pay for Performance? 300 Ethical Considerations: Is Executive Compensation Fair? 300 International Competitiveness 302 COMPENSATION IN ACTION 302 Summary 303 • Key Terms 304 • Discussion Questions 304 CASE: CEO Pay in the News 304 Endnotes 305
Chapter 13	Compensating the Flexible Workforce 307 Contingent Employees and Flexible Work Schedules 307 The Contingent Workforce 308 Groups of Contingent Workers 308 Reasons for U.S. Employers' Increased Reliance on Contingent Workers 313 Pay and Employee Benefits for Contingent Workers 315 Part-Time Employees 316 Temporary Employees 317 Leased Workers 318

Independent Contractors, Freelancers, and Consultants 318

	Flexible Work Schedules: Flextime, Compressed Workweeks, and Telecommuting 319 Flextime Schedules 321 Compressed Workweek Schedules 321 Telecommuting 321
	Flexible Work Schedules: Balancing the Demands of Work Life and Home Life 322
	Pay and Employee Benefits for Flexible Employees 322 Pay 323
	Employee Benefits 323
	Unions' Reactions to Contingent Workers and Flexible Work Schedules 324
	Strategic Issues and Choices in Using Contingent and Flexible Workers 325
	■ COMPENSATION IN ACTION 326
	Summary 327 • Key Terms 327 • Discussion Questions 327
	CASE: Telecommuting at MedEx 328
	• Endnotes 328
Part VI Coi	mpensation Issues around the World 331
Chapter 14	Competitive Advantage and How International Activities
	Fit In 333 Lowest-Cost Producers' Relocations to Cheaper Production Areas 333
	Differentiation and the Search for New Global Markets 333
	How Globalization Is Affecting HR Departments 333
	Complexity of International Compensation Programs 334
	Preliminary Considerations 334
	Host Country Nationals, Third Country Nationals, and Expatriates: Definitions and Relevance for Compensation Issues 334
	Term of International Assignment 335
	Staff Mobility 335
	Equity: Pay Referent Groups 335 Components of International Compensation Programs 336
	Setting Base Pay for U.S. Expatriates 336
	Methods for Setting Base Pay 336 Purchasing Power 337
	Incentive Compensation for U.S. Expatriates 338
	Foreign Service Premiums 338
	Hardship Allowances 338
	Mobility Premiums 339 Establishing Employee Reposits for U.S. Expatriates 339
	Establishing Employee Benefits for U.S. Expatriates 339 Standard Benefits for U.S. Expatriates 340
	Enhanced Benefits for U.S. Expatriates 341
	Balance Sheet Approach for U.S. Expatriates' Compensation
	Packages 342
	Housing and Utilities 343
	Goods and Services 344

```
Tax Considerations 344
                Repatriation Pay Issues 345
                   ■ COMPENSATION IN ACTION 346
                Summary 347 • Key Terms 347 • Discussion Questions 347
                   ■ CASE: Jenkins Goes Abroad 348
                • Endnotes 349
                Pay and Benefits outside the United States 350
 Chapter 15
                North America 351
                   Canada 351
                   Mexico 354
                South America 355
                   Brazil 355
                Europe 356
                   Germany 357
                Asia 358
                  India 358
                  People's Republic of China 360
                   ■ COMPENSATION IN ACTION 362
                Summary 362 • Discussion Questions 363
                   ■ CASE: North American Expansion for Threads Apparel 363

    Endnotes 364

Epilogue 367
Chapter 16
                Challenges Facing Compensation Professionals 368
                Fallout from the "Great Recession"
                   What Is an Economic Recession? 369
                Underemployment: Implications for Compensation 370
                   The Compensation–Productivity Gap 372
                Executive Compensation 374
                Rising Wages in China 374
                Challenges in Health Care Reform 375
                Workforce Demographic Shifts 376
                   Labor Force Diversity 376
                   Relevance for Employee Benefits 376
                   Considerations for Employee Motivation 377
                Marriage between Same-Sex Individuals and the U.S. Supreme
                Court Ruling on the Defense of Marriage Act 377
                Summary 379 • Key Terms 379 • Discussion Questions 380
                • Endnotes 380
 Glossary 381
 Author Index 399
 Subject Index 401
```

Discretionary Income 344