Chapter 1

The Pay Model
Learning Objectives

After studying Chapter 1, students should be able to:

1. Explain how perceptions of compensation differ among society, employees, and managers.
2. Discuss the difference between direct and indirect compensation and define each of the direct and indirect forms of compensation defined.
3. Explain the three main objectives of a pay model.
4. Understand the notion of competitive advantage and how it relates to compensation.
5. Be able to distinguish empirical research from surveys and opinions.
6. Understand how the pay model integrates objectives, techniques, and strategy.
Compensation refers to all forms of financial returns and tangible services and benefits employees receive as part of an employment relationship.
Contrasting Perspectives of Compensation

- Society Views
- Stockholders’ Views
- Employees’ Views
- Managers’ Views
Total Returns for Work

Total Returns

Total Compensation

Cash Compensation
- Base
- Merit/Cost of Living
- Short-term Incentives
- Long-term Incentives

Benefits
- Income Protection
- Allowances
- Work/Life Focus

Relational Returns
- Recognition & Status
- Employment Security
- Challenging Work
- Learning Opportunities
**Forms of Pay**

- Cash Compensation: Base
- Cash Compensation: Merit Pay / Cost-of-Living Adjustments
- Cash Compensation: Incentives
- Long-Term Incentives

- Benefits: Income Protection
- Benefits: Work/Life Focus
- Benefits: Allowances
### Pay Objectives at Medtronic and AES

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<th>Medtronic</th>
<th>AES</th>
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<tr>
<td>◆ Support objectives and increased complexity of business</td>
<td>Our guiding principles are to act with integrity, treat people fairly, have fun, and be involved in projects that provide social benefits. This means we will</td>
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<td>◆ Minimize increases in fixed costs</td>
<td>◆ Help AES attract self-motivated, dependable people who want to keep learning new things</td>
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<td>◆ Emphasize performance through variable pay and stock</td>
<td>◆ Hire people who really like the place and believe in the AES system</td>
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<td>◆ Competitiveness aligned with financial performance: 50th percentile performance paid at 50th percentile of market</td>
<td>◆ Pay what others are paid both inside and outside AES, but willing to take less to join AES</td>
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<td>◆ Use teams of employees and managers to manage the compensation system</td>
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<td>◆ Make all employees stockholders</td>
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Caveat Emptor - Be An Informed Consumer

- Does the research measure anything useful?
- Does the study separate correlation from causation?
- Are there alternative explanations?
Summary

ุด The model presented in this chapter provides a structure for understanding compensation systems.

ุด The three main components of the model include:

ุด The objectives of the pay system
ุด The policy decisions that provide the system’s foundation
ุด The techniques that link policies and objectives

ุด Two key questions should constantly be asked:

ุด First, Why do it this way? There is rarely one correct way to design a system or pay an individual.
ุด Second, So what? What does this technique do for us? How does it help achieve our organization goals?
Review Questions

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

2. What is your definition of compensation? Which meaning of compensation seems most appropriate from an employee’s view, return, reward, or entitlement?

3. How does the pay model help organize one’s thinking about compensation?

4. What can a pay system do for an organization? For an employee?