
Second Edition

COMPENSATION ADMINISTRATION

**DAVID W. BELCHER
THOMAS J. ATCHISON**

SECOND EDITION

Compensation Administration

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To
Betty A.
and
the Memory of
Betty B.

Preface

Compensation administration is an organizational process that determines the total remuneration of all the organization's employees due them for their services. The aggregation of these individual amounts creates the organization's total labor costs. Since labor costs represent 40 to 90 percent of the total costs of most organizations, the judicious determination and allocation of these costs can mean the difference between success and failure for any organization. The nature and practice of compensation administration is ever-changing. Each year new techniques are being developed, new technology is being applied (computers, for instance), the behavioral sciences are contributing new knowledge, and the government and society are placing new demands on how compensation is administered. Any book hoping to cover this topic must continually change to reflect these changes. Even so, by the time this book is in print there will be changes that will affect how compensation is practiced in organizations.

It is not the sole purpose of this book to reflect and codify the practice of compensation. More than just trying to tell the student and practitioner *what things are like*, we see our purpose in this book to show *what things can be like*. This is an expressly prescriptive role. We believe that the field of compensation administration must continuously change and improve or it will become obsolete. We hope to send out students who can see a better way to do things in the

organizations that hire them. Likewise, we hope to inspire current practitioners to change and upgrade their practices.

We also attempt to integrate behavioral theory wherever we can in the discussion of compensation decisions. This is not only because we ourselves are academics but because, through the examination of theory, the effects of practice on the individual, group, and society are much more predictable. Behavioral theory has progressed greatly, and there is a body of concepts and experiments that have focused directly on compensation. We have tried to incorporate this research in this edition.

Compensation is a complex subject, partly because organizations wish it to do so many things. On the one hand, organizations and their employees want a process that creates rewards that are seen as fair and equitable. They also want a process that is competitive, so that employees are content to stay with the organization. In addition, a newer focus is on making employees more productive as well as being sure that all this is done legally. As in most circumstances where there are many goals, the actions that take place may be congruent with some goals and in conflict with others. In practice, compensation administration is at best a compromise of the various goals it seeks to serve.

Which goals are pursued actively are partly a function of organizational values. But they are also a function of the focus that society has currently placed on these goals. John Gardner in his book *Excellence: Can We Be Equal and Excellent Too?* points out the tension in our society between equality and competitive performance.¹ In a way, compensation administration is caught on the horns of this dilemma, and the approach and focus of the various editions of this book reflect something of the shift back and forth that Gardner claims is inevitable and healthy in our society. The last edition of this text was published in 1974. Through the 1960s and into the 1970s there was a deep concern with equality in our nation. Legislation such as the Equal Pay Act and the Civil Rights Act that directly affect compensation administration is a legacy of this era. The last edition of this book reflected that concern, with an outline that focused on equity.

At the end of the 1970s organizations became very concerned with keeping up with the market as inflation rates went into double digits for one of the few times in our history. Today, while preserving most of the progress made toward equality, organizations are much more concerned with productivity. This is a reaction to increased competition from foreign countries that makes us much more conscious of the high wage rates paid to American workers and the need to obtain the most from employees to counterbalance this foreign advantage. One of the areas being focused on to increase our productivity is the way employees are compensated.

Thus, this edition of *Compensation Administration* differs greatly from the previous edition. The book is organized in terms of the major decision areas that must be dealt with in compensating employees. These decisions center in the major systems developed to administer the ongoing compensation process. These systems and the decisions that activate them move from the broad system of establishing the organizational pay level, through developing the pay struc-

¹J. W. Gardner, *Excellence: Can We Be Equal and Excellent Too?* (New York: Harper & Row, Pub., 1961).

ture, to the more specific decisions of the pay system designed to determine the pay rate for the individual employee. In addition, the book explores the supporting decisions of the form that pay takes (direct or benefits), pay treatment of specific employee groups, and the planning and control of compensation. In addition, there is more of a focus on performance-motivation models, although the equity model is still appropriate. The extent of these changes made it most convenient to start almost from scratch and rewrite large portions of the book.

Part I of the book adds a chapter on the environment of compensation. It is clear that what is happening outside the organization has a dramatic effect on how compensation is administered within. The chapters on wage structure (part III) have increased the discussion of establishing a wage structure and shortened the discussion of job evaluation. The discussion of pay systems (part IV) now includes a chapter on pay for performance, and the chapter on incentive plans includes a great deal more on gain sharing. Finally, the last chapter is on discrimination in pay, which has become a major issue and one that will not go away until there are some substantive changes in compensation administration practices and, more importantly, results.

This book has gone through revisions for 32 years now (it was first entitled *Wage and Salary Administration*). To acknowledge all the people who have suggested approaches and emphasis would be impossible. We hope that the scholars and practitioners with whom we have had contact both in person and through their writings will recognize that we are trying to use their best ideas. We only hope that we have given them credit where it was due. If we did not get it right, we take full responsibility.

A great deal of this book is the result of a friendship between the authors that has extended over 20 years and countless luncheons at which the book and more broadly the topic of compensation has been discussed in depth. Betty Ann Belcher was of great help in typing, editing, and transforming Dave's scribbling on yellow pads into finished manuscript for as long as she was able. Betty Atchison was critic, goad, and supporter when needed. But her major contribution was to obtain an IBM personal computer for Tom for Christmas some years ago. That gift has changed Tom's world.

The previous editions of this book were well received and used in a variety of courses in different college departments.

Professors who are examining this book for adoption in their course may note that this book does not contain many of the pedagogical features of numerous textbooks. This has been purposeful, since this book is used considerably as a reference by professionals. However, an instructor's manual is available, and it contains discussion and examination questions (essay and multiple choice) as well as exercises, cases, and term projects. It was also in evidence in the offices of many compensation practitioners throughout the country. We sincerely hope that this edition is as useful as past editions appear to have been.

David W. Belcher
Thomas J. Atchison

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PART



**THE THEORY
AND ENVIRONMENT
OF COMPENSATION
ADMINISTRATION**



"What do we need to think about if we are going to set up a new pay plan for this division?"

"Does the low unemployment rate mean that we should raise wages to keep our employees from changing companies?"

"I don't see why we have to offer so much to these new college graduates; they ought to be thankful to have a job!"

"I think it's unfair that Jim makes more money than I do!"

"How do we get more production out of our employees?"

"You can't pay women less than men for the same job!"

These questions and comments reflect the types of decisions organizations have to make each day regarding how people are paid. In particular, they reflect the environment in which these decisions are made and the theory underlying them. These topics are the subject of part I (chapters 1–4) of this book. These first four chapters set a framework for the discussion in later parts of the way in which organizations make the wide variety of decisions concerning what would seem to be a rather simple thing—paying employees.

Chapter 1 develops a model of compensation administration that illustrates how these various decisions relate to each other. Chapter 2 describes the environments that compensation decision makers must consider, as opportunities or constraints. Chapters 3 and 4 deal with the applicable theories, economic and behavioral, of why compensation decisions can be expected to produce certain results.

1

A Model of Compensation Administration

Almost every worker receives a paycheck at some regular interval. The amounts of these paychecks vary enormously, from the minimum wage to the salary of the chief executive of a major corporation. Why the particular amount of each paycheck? If we asked the recipients, we might get answers like these:

“I worked all week.”

“My job is very important.”

“I did a good job on that project.”

“I’m paid what I’m worth!”

“This is the market rate for my job.”

“This job is boring and the work conditions are terrible!”

These answers are almost as diverse as the amount on the paycheck. People are paid for the work they do. They are also paid for their performance, their skills, their seniority, and a host of other factors. Their pay is influenced by the market value of labor, by unions, by social attitudes, and by other factors. The way the organization they work for sets pay rates also influences the size of the paycheck.

In other words, compensating people is a complex task requiring many

decisions. This book is about this daily multitude of decisions and the influences on them both inside and outside the organization.

PAY AND WORK

In short, this book is about pay—how it is determined and managed. But pay, like a coin, has two sides: it represents income to employees, cost to the employer. What the employer provides the employee is called a *wage* or a *salary*. Often, the term *compensation* is used to indicate the various forms of pay—money, benefits, nonfinancial rewards.

What the employee provides the employer is labor service, usually called *work*. This labor service consists of many different kinds of employee behavior, for example: showing up regularly and on time, carrying out tasks dependably, cooperating with others, making useful suggestions.

So pay or compensation represents an exchange between employee and organization. Each gives something in return for something else.

Significance of Compensation

To an employee, pay is a primary reason for working. For some people, it may be the only reason. For most of us, it is the means by which we provide for our own and our family's needs. Few people refuse to accept pay for their work. Perhaps fewer would continue to work if they were told they would not be paid. Pay can represent status or recognition for accomplishment to an employee.

Compensation is also important to organizations. It represents a large proportion of expenditures. In manufacturing firms it is seldom as low as 20 percent; in service enterprises it is often as high as 80 percent. Even more important, organizations try to accomplish many goals with compensation—attracting and retaining people and motivating them to perform more effectively, for example.

Compensation is also significant in the operation of the economy. Salaries and wages account for about 60 percent of the gross national product. Compensation is the largest type of income.

COMPENSATION DOMAINS

So far we have established that compensation (1) represents an employment contract, and (2) is important to employees, organizations, and the economy. But what class of variable does it represent? In what scholarly discipline does it belong? What kind of theory is applicable to it?

An Economic Concept

Compensation is a price for a factor of production. As such it serves to allocate scarce human resources to productive uses. To the employer, compensation is the price paid for labor services. As an economic concept, compensation is governed by the same logic as any other purchase by a firm—to get the