CHAPTER 2

Contextual Influences on Compensation Practice

Learning Objectives

2-1. Discuss the reasons for interindustry wage differentials.
2-2. Explain the factors that contribute to pay differentials based on occupational characteristics.
2-3. Summarize the reasons for the occurrence of geographic pay differentials.
2-4. Discuss the role of labor unions in setting compensation.
2-5. Identify and discuss key employment laws pertinent to compensation practice.

Outline

I. Overview
II. Interindustry Wage Differentials
III. Pay Differentials Based on Occupational Characteristics
IV. Geographic Pay Differentials
V. Labor Unions
VI. Employment Laws That Influence Compensation Tactics
VII. Key Terms
VIII. Discussion Questions and Suggested Answers
IX. End of Chapter Case; Instructor Notes, and Questions and Suggested Student Responses
X. Crunch the Numbers! Questions and Suggested Student Responses
XI. Assisted-Graded Questions
XII. Additional Case from the MyManagementLab Website; Instructor Notes and Questions and Suggested Student Responses

Lecture Outline

I. Overview

A. Contextual influences on pay
   1. Compensation professionals must understand patterns of pay differentials to make informed decisions about pay
   2. Must also make decisions within scope of employment and labor laws
   3. Global context also influences compensation

II. Interindustry Wage Differentials

A. The differences in wages and benefits across industries
   1. Attributed to:
      a. The industry's product market
      b. The degree of capital intensity
      c. The profitability of the industry
      d. Unionization

B. Companies in Product Markets with Little Competition
   1. Generally pay higher wages
   2. Exhibit substantial profits
   3. Exhibit limited new competition because of:
      a. Higher barriers to entry
      b. Insignificant influence of foreign competition
   4. Government regulations and extremely expensive equipment represent entry barriers

C. Capital Intensity
   1. Defined as the extent to which companies' operations are based on the use of large-scale equipment
   2. The amount of average pay varies with the degree of capital intensity
      a. Generally manufacturing jobs are capital intensive, service jobs are not

C. Profitability
   1. Generally, the more profitable the industry, the higher the compensation

D. Unionization
   1. Unionized industries tend to pay higher
   2. Power of collectively negotiating leads to higher wages than individually negotiating

III. Pay Differentials Based on Occupational Characteristics

A. Occupation
   1. Group of jobs, found at one or more company, in which a common set of tasks are performed or are related in terms of similar objectives methodologies, materials, products, worker actions, or worker characteristics
   2. Pay variations can occur within occupations, based on the complexity of the jobs

B. Knowledge, skills and abilities
   1. Role of job analysis
   2. Jobs that require formal education or early experience are paid more

C. Supply and demand
   1. Companies demand for individuals relative to supply influences compensation

IV. Geographic Pay Differentials

A. Relative pay differentials
   1. Occur between geographic areas

B. Pay rate differentials
   1. Expressed in dollars as hourly or annual pay
   2. For occupations based on particular geographic regions
   3. Cost of living differences

V. Labor Unions

A. National Labor Relations Act of 1935 (NLRA)
   1. Designed to remove barriers to free commerce and to restore equality of bargaining power between employees and employers
   2. Collective bargaining agreement is a written document that describes the terms of employment approved by management and employees during negotiations

B. Compensation Issues in Collective Bargaining
   1. Union and management negotiations usually center on pay raises and employee benefits
   2. Cost-of-living-adjustments (COLAs)
      a. Automatic pay increases based on changes in prices, as indexed by the consumer price index (CPI)
      b. Enables workers to maintain their standards of living by adjusting wages for inflation
   3. Union influence has declined because:
      a. Legislation outlawed unions' use of intimidation
      b. Anti-discrimination laws provided protections for women and minorities
      c. Globalization increasing competition
      d. Right-to-work laws that prohibit management and unions from entering into agreements requiring union membership as a condition of employment
      e. Higher rates of unionization in the public or government sector

VI. Employment Laws That Influence Compensation Tactics

A. Legislative Actions
   1. Four Amendments to the U.S. Constitution
      a. Article 1, Section 8 ("The Congress shall have the power…to regulate Commerce with foreign nations, and among the several States, and with the Indian Tribes…")
      b. First Amendment ("Congress shall make no laws respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the

people peaceably to assemble, and to petition the Government for a redress of grievances.")

c. Fifth Amendment ("No person shall...be deprived of life, liberty, or property without due process of law…")

d. Fourteenth Amendment, Section 1 ("No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States, nor shall any State deprive any person of life, liberty, or property without due process of law; nor deny any person within its jurisdiction the equal protection of the law.")

2. Government has three levels in U.S.

   a. Federal government oversees the entire U.S. and territories

   b. State governments enact laws that pertain exclusively to respective regions

   c. Local governments enact laws that are pertinent to smaller geographic regions

B. Income Continuity, Safety, and Work Hours Laws

1. Three main factors

   a. Great Depression

      i. Passage of the Social Security Act of 1935 (Title IX)

      ii. Passage of workers' compensation programs

   b. Family businesses to large factories

   c. Division of labor

2. Fair Labor Standards Act of 1938 (FLSA)

   1. Addresses three main issues of minimum wage, overtime pay, and child labor provisions

      a. Enforced by the U.S. Department of Labor

   2. Minimum wage

      a. Designed to ensure wages for a minimally acceptable standard of living

      b. Originally set at $0.25 per hour

      c. Federal law supersedes state minimum wage law where the federal minimum wage is greater than the state

   3. Overtime pay provisions

      a. Defined in FLSA

      b. Most employers must pay time and one-half for over 40 hours work in a period of 7 consecutive days

      c. Executive, administrative, learned professional, creative professional, computer workers, and outside sales employees are generally exempt from the FLSA

      d. Nonexempt employees are those subject to the FLSA overtime pay provision

e. Aaron v. City of Wichita Kansas provided some guidance in determining what employees are exempt

d. Fair Pay Rules in 2004 added additional complexity in determining what employees are exempt

e. Portal-to-Portal Act of 1947 defines the term hours worked to include these compensable work activities:

i. Waiting time

ii. On-Call time

iii. Rest and meal periods

iv. Sleeping time and certain other activities

v. Lectures, meetings, and training programs

vi. Travel time

f. Equal Pay Act of 1963, which prohibits sex discrimination in pay for employees performing equal work

4. Child labor provisions

a. Intended to protect children from being overworked, working in potentially hazardous settings, and having their education jeopardized due to excessive work hours

b. Children younger than age 14 usually cannot be employed

c. Children ages 14 and 15 may work in safe occupations outside school hours with some limitations

d. Children ages 16 and 17 do not have hourly restrictions but annot work in hazardous jobs (e.g., running heavy industrial equipment, working around harmful substances)

C. Pay Discrimination Legislation

1. Came out of the Civil Rights Movement of the 1960s

2. Equal Pay Act of 1963

a. Enforced by the Equal Employment Opportunity Commission (EEOC)

b. Applies to jobs of equal worth according to the Department of Labor's definition of compensable factors, such as:

i. Levels of skill

ii. Effort

iii. Responsibility

. iv. Working conditions

c. Jobs must have "similar", not necessarily the "same" working conditions

d. Pay differentials are not always illegal; are legal where such payments are made pursuant to:

i. A seniority system

ii. A merit system

iii. A system which measures earnings by the quantity or quality of production

iv. A differential based on any factor other than gender

D. Civil Rights Act of 1964

1. Legislators designed Title VII of this Act to promote equal employment opportunities for underrepresented minorities
2. Disparate treatment discrimination
   a. Represents intentional discrimination, occurring whenever employers intentionally treat some workers less favorably than others because of: race, color, religion, sex, or national origin
3. Disparate impact discrimination
   a. Represents unintentional discrimination that occurs whenever an employer applies employment practices to all employees
   b. The practice leads to unequal treatment of protected employee groups
4. Title VII applies to:
   a. Companies with 15 or more employees
   b. Employment agencies
   c. Labor unions
   d. Labor management committees controlling apprenticeship and training
5. Lilly Ledbetter Fair Pay Act overturned the Ledbetter v. Goodyear Tire & Rubber Co. case removing allowing women to file a pay discrimination charge within 180 days of a discriminatory paycheck
6. The Paycheck Fairness act strengthens the remedies available to put sex-based pay discrimination on par with race-based pay discrimination
7. Bennett Amendment (to Title VII)
   a. Allows female employees to charge employers with Title VII violations regarding pay only when the employer has violated the Equal Pay Act of 1963
8. Age Discrimination in Employment Act of 1967 (ADEA)
   a. Designed to protect workers age 40 and older (“baby boomers”) from age discrimination
   b. Older Workers Benefit Protection Act (OWBPA) places additional restrictions on employers’ benefits practices
      i. Employer may require older employees to pay more for health insurance or life insurance coverage if the cost is significantly greater than the cost for younger workers because these costs generally rise with age
      .ii. Equal benefit or equal cost principle which specifies that employers do not have to provide equal benefits to older workers if it costs them more to do so
9. Civil Rights Act of 1991
   a. Designed to overturn several Supreme Court rulings

i. Atonio v. Ward Cove Packing Company, shifted the burden of proof from the employee to the employer

ii. Lorance v. AT&T Technologies - allows employees to file a discrimination claim when the system is implemented or whenever the system negatively affects them

iii. Boureslan v. Aramco- allows expatriates to file discrimination lawsuits

E. Accommodating Disabilities and Family Needs

1. Pregnancy Discrimination Act of 1978 (PDA)

   a. An amendment to Title VII of the Civil Rights Act of 1964 that prohibits disparate impact discrimination against pregnant women for all employment practices

   b. Employers must not treat pregnancy less favorably than other medical conditions covered under employee benefits plans

2. Americans with Disabilities Act of 1990 (ADA)

   a. Prohibits discrimination against individuals with mental or physical disabilities within and outside employment settings

   b. Applies to employers with 15 or more employees

   c. Title I requires reasonable accommodations may include such efforts as making existing facilities readily accessible, restructuring jobs, and modifying work schedules

3. Family and Medical Leave Act of 1993 (FMLA)

   a. FMLA was designed to provide employees with job protection in cases of family or medical emergency

   b. Guarantees unpaid leave and the right to return to either the same position or a similar position with the same pay, conditions, and benefits

F. Prevailing Wage Laws

1. Davis–Bacon Act of 1931

   a. Established employment standards for construction contractors holding federal government contracts valued at more than $2,000, including:

2. Walsh–Healey Contracts Act of 1936

   a. Applies to contractors and manufacturers who sell supplies, material, and equipment to the federal government with contracts worth at least $10,000

   b. Requires contractors to meet guidelines relating to wages and hours, child labor, convict labor, and hazardous working conditions

   c. Prohibits contractors from exposing workers to conditions that violate the Occupational Safety and Health Act of 1970

End of the Chapter

VII. Key Terms

Interindustry wage differentials: Represent the pattern of pay and benefits associated with characteristics of industries
Occupation: A group of jobs, found at more than one company, in which a common set of tasks are performed or are related in terms of similar objectives, methodologies, materials, products, worker actions, or worker characteristics
National Labor Relations Act of 1935 (NLRA): The purpose of this act was to remove barriers to free commerce and to restore equality of bargaining power between employees and employers
Collective bargaining agreement: A written document that describes the terms of employment approved by management and employees during negotiations
Spillover effect: Occurs when management of nonunion firms generally offered somewhat higher wages and benefits to reduce the chance that employees would seek union representation
Right-to-work-laws: Prohibit management and unions from entering into agreements requiring union membership as a condition of employment
Concessionary bargaining: Unions departed from concessionary bargaining by vowing to negotiate for wage increases
Federal constitution: Forms the basis for employment laws
Federal government: Oversees the entire United States and its territories
State governments: Enact and enforce laws that pertain exclusively to their respective regions
Local governments: Enact and enforce laws that are most pertinent to smaller geographic regions
Great Depression: Triggered legislation designed to stabilize the income of an individual who became unemployed because of poor business conditions or workplace injuries
Social Security Act of 1935 (Title IX): Provided temporary income to workers who became unemployed through no fault of their own
Workers' compensation: Granted income to workers who were unable to work because of injuries sustained on the job
Fair Labor Standards Act of 1938 (FLSA): Establishes minimum wage, overtime pay, recordkeeping, and youth employment standards affecting employees in the private sector and in Federal, State, and local governments
Exempt: Employees not covered by the FLSA including generally executive, administrative, learned professional, creative professional, computer workers, and outside sales employees
Nonexempt: Jobs that are subject to the FLSA overtime pay provision
Aaron v. City of Wichita, Kansas: Case that illustrates that classifying jobs as either exempt or nonexempt is not always clear-cut

FairPay Rules: Revised FLSA guidelines by the Department of Labor
Portal-to-Portal Act of 1947: Defines the term hours worked that appears in the FLSA
Integrity Staffing Solutions, Inc. v. Busk et al.: Case that helped determine compensable time
Equal Pay Act of 1963: Prohibits sex discrimination in pay for employees performing equal work
Civil Rights Act of 1964: Key legislation designed to protect designated classes of employees and to uphold their rights individually against discriminatory employment decisions
Compensable factors: Skill, effort, responsibility, and working conditions
EEOC v. Madison Community Unit School District No. 12 39 Title VII: Case that sheds light on whether jobs are equal
Disparate treatment: Represents intentional discrimination, occurring whenever employers intentionally treat some workers less favorably than others because of their race, color, sex, national origin, or religion
Disparate impact: Represents unintentional discrimination
Ledbetter v. Goodyear Tire & Rubber Co.: U.S. Supreme Court case that rendered a very strict interpretation as to when the statute of limitations period begins for women to sue their employers for discrimination in pay
Lilly Ledbetter Fair Pay Act: Restores prior law providing that a pay discrimination charge must simply be filed within 180 days of a discriminatory paycheck
Paycheck Fairness Act: Strengthens the Equal Pay Act of 1963 by strengthening the remedies available to put sex-based pay discrimination on par with race-based pay discrimination
Bennett Amendment: Allows female employees to charge employers with Title VII violations regarding pay only when the employer has violated the Equal Pay Act of 1963
Age Discrimination in Employment Act of 1967 (ADEA): Protects workers age 40 and older from illegal discrimination
Baby boom generation: Generation born roughly between 1946 and 1964 and represented a swell in the American population
Older Workers Benefit Protection Act (OWBPA) The 1990 amendment to the ADEA—placed additional restrictions on employer benefits practices
Civil Rights Act of 1991: Overturned several Supreme Court rulings
Atonio v. Wards Cove Packing Co.: Supreme Court case overturned by the Civil Rights Act of 1991 resulting in the shifting of the burden of proof from employees to employers
Lorance v. AT&T Technologies: Supreme Court case overturned by the Civil Rights Act of 1991 resulting in employees being able to challenge the use of seniority systems either when the system is implemented or whenever the system negatively affects them
Boureslan v. Aramco: Supreme Court case overturned by the Civil Rights Act of 1991 that now allows U.S. citizens working overseas to file suit against U.S. businesses for discriminatory employment practices
Pregnancy Discrimination Act of 1978 (PDA): Prohibits disparate impact discrimination against pregnant women for all employment practices
Americans with Disabilities Act of 1990 (ADA): Prohibits disparate impact discrimination against pregnant women for all employment practices.

Title I: Of the ADA requires that employers provide reasonable accommodation
Family and Medical Leave Act of 1993 (FMLA): Provides guaranteed leave and the right of the employee to return to either the position he or she left when the leave began or to an equivalent position with the same benefits, pay, and other terms and conditions of employment
Davis–Bacon Act of 1931: Establishes employment standards for construction contractors holding federal government contracts valued at more than $2,000
Walsh–Healey Public Contracts Act of 1936: Mandates that contractors with federal contracts meet guidelines regarding wages and hours, child labor, convict labor, and hazardous working conditions
Occupational Safety and Health Act of 1970: Ensures safe and healthful working conditions for working men and women by authorizing enforcement of the standards under the act

VIII. Discussion Questions and Suggested Answers

2-1. Identify the contextual influence that you believe will pose the greatest challenge to companies' competitiveness and identify the contextual influence that will pose the least challenge to companies' competitiveness. Explain your answer.

This is a very subjective question and answers can include things ranging from discussions of laws, politics, economics, or other contextual influences.

Learning Objective: Could support any chapter objective depending on the student's response.
AACSB: Analytical thinking

2-2. Should the government raise the minimum wage? Explain your answer.

Answers can be pro or con. 'Yes' answers should discuss living or competitive wages among other things. 'No' answers should include impact on business and employment levels.

Learning Objective: 2-5 Identify and discuss key employment laws pertinent to compensation practice.
AACSB: Analytical thinking

2-3. Do unions make it difficult for companies to attain competitive advantage? Explain your answer.

Answer to this question can be found in the MyLab

2-4. Explain the pros and cons of adjusting pay based on cost-of-living differences from a company's perspective and an employee's perspective.

Answer to this question can be found in the MyLab

2-5. Some people argue that there is too much government intervention, whereas others say there is not enough. Based on the presentation of laws in this chapter, do you think there is too little or too much government intervention? Explain your answer.

One could argue that the government doesn't do enough to intervene based on the fact that although many laws, acts, and decrees protect employees and employers alike, it is difficult to focus attention on some matters. Increases in wages, for example, may be something that the government ought to look into more closely and with more severity. Wages are a great source of struggle and anguish for many people. If the government increases wages in line living costs, then all would be well, but this is not always the case. However, one could also argue that the government gets involved in such issues too readily, and that sometimes it's best for the employees and employers to work out their differences on their own.

Learning Objective: 2-5 Identify and discuss key employment laws pertinent to compensation practice.
AACSB: Analytical thinking

VIII. End of Chapter Case; Instructor Notes, and Questions and Suggested Student Responses

Case Name: Exempt or Nonexempt?

Instructor Notes

The Fair Labor Standards Act (FLSA) addresses the issues of minimum wage, overtime pay and child labor. The FLSA requires employers to properly classify employees as Non-exempt (covered by the Act) or Exempt (not covered by the Act). Many companies want to classify workers as Exempt to avoid the requirement to pay overtime. While the company has the responsibility to properly classify employees, the decision needs to be made based on the responsibilities of the job. The Department of Labor (DOL) has interpreted Exemptions from the Fair Labor Standards Act (FLSA) narrowly. Students can find more details on the exemptions on the DOL's website at http://www.dol.gov . Many companies wrongly assume that all supervisors or managers in an organization are Exempt from the FLSA. ***Aaron v. City of Wichita*** provides some guidance on classifying supervisors:

- Relative importance of management as opposed to other duties
- Frequency with which they exercised discretionary powers

- Relative freedom from supervision
- Relationship between their salaries and wages paid to other employees offer similar nonexempt workers

In examining all of these factors, it is clear that Jane Swift and the other Shift Leaders should be classified as Non-exempt.

Suggested Student Responses:

2-6. Why did Amy classify the Shift Leaders are Exempt? Are there any advantages to Jones Department Store to having the Shift Leaders classified as Exempt?

Amy most likely assumed that the Shift Leaders met the Executive exemption under the FLSA. Classifying the Shift Leaders as Exempt was advantageous to the store management, as they did not have to pay the Shift Leaders overtime pay. Further, management saved some extra administrative work because they did not need to track the hours of the Shift Leaders.

Learning Objective: 2-5 Identify and discuss key employment laws pertinent to compensation practice.
AACSB: Analytical thinking

2-7. Do you think that the shift leaders are properly classified as exempt? Why or why not?

Answer to this question can be found in the MyLab

2-8. What are some factors that Amy should consider when determining if Shift Leaders are Exempt or Non-exempt?

Amy should consider the fact that the Shift leaders spend a majority of their time working as Associates and their pay rate is closer to the Associates than the Assistant Managers. While they are involved in employment related decisions, their decision-making ability is limited.

Learning Objective: 2-5 Identify and discuss key employment laws pertinent to compensation practice.
AACSB: Application of knowledge

IX. Crunch the Numbers! Questions and Suggested Student Responses

Whether to Work Overtime or Hire Additional Employees

Questions:

2-9. Is it more cost effective to have current manufacturing employees work on an overtime basis during the life of the contract or to hire new employees?

Overtime option:
1000 employees will have to work an extra 4 hours per week, for 4,000 extra hours each week.
There are 52 weeks in a year and the contract spans 5 years, so there are a total of 260 weeks.
260 weeks multiplied by 4,000 hours = 1,040,000 additional hours.
Per the scenario, the hourly rate for these overtime hours is $30 per hour.
1,040,000 hours x $30 per hour = $31,200,000

Hire additional employees option:
Base pay for the additional workers at $20 hour x 2080 hours a year (52 weeks x 40 hours each week) = $41,600 x 100 workers =$4,160,000 x 5 years =$20,800,000
Benefit costs = $10,000 x 5 years x 100 workers = $5,000,000
One-time costs per worker include $5,000 (recruitment) plus $3,000 (training), plus $12,000 (termination) = $20,000 x 100 workers =$2,000,000
Total cost of workers $20,800,000 +$5,000,000 +$2,000,000 = $27,800,000

Hiring additional employees is more cost efficient.

Learning Objective: 2-5 Identify and discuss key employment laws pertinent to compensation practice.
AACSB: Analytical thinking

2-10. Let's assume that the unemployment rate in the area is low, which is making it difficult to attract new manufacturing employees. ACME is finding that it is able to overcome this problem by paying new employees at a higher hourly rate of $25 per hour. Under this scenario, is it more cost effective to have current manufacturing employees work on an overtime basis or to hire new employees?

Hiring additional employees at $25 per hour would result in a higher total base pay.

Base pay for the additional workers at $25 hour x 2080 hours a year (52 weeks x 40 hours each week) = $52,000 x 100 workers =$5,200,000 x 5 years =$26,000,000
The total pay for these workers = 26,000,000+$5,000,000 +$2,000,000 =$33,000,000

This amount is higher than the cost of overtime at $31,200,000.

Thus, under this scenario of needing to pay $25 per hour to new employees, it is more cost efficient to pay current employees overtime.

Learning Objective: 2-5 Identify and discuss key employment laws pertinent to compensation practice.
AACSB: Analytical thinking

2-11. Would it be more cost effective to hire 50 new employees as well as having half of current manufacturing employees work overtime?

To find the cost of this scenario, you must total half of the projected overtime cost and half of the cost to hire 100 employees.

Overtime: half of $31,200,000 = $15,600,000

Hiring additional workers: half of $27,800,000 = $13,900,000

The total of these two amounts = $29,500,000

This option would be more cost effective than paying overtime to all 1000 workers. However, it would cost more than hiring 100 workers. Thus hiring 100 workers is the most cost efficient option.

Learning Objective: 2-5 Identify and discuss key employment laws pertinent to compensation practice.
AACSB: Analytical thinking

XI. Assisted-Graded Questions

2-12. How would the compensation system change if the minimum wage provision of the Fair Labor Standards Act of 1938 were repealed?

Answer to this question can be found in the MyLab

2-13. Suggest ways that companies in low-paying industries can increase their ability to attract and retain highly qualified individuals.

Answer to this question can be found in the MyLab

2-14. MyManagementLab Only – comprehensive writing assignment for this chapter.

XII. Additional Case from the MyManagementLab Website; Instructor Notes, and Questions and Suggested Student Responses

Case Name: Preparing for Growth at Waxman Candles

Instructor Notes

In determining a company's compensation strategy, a company must analyze both external and internal factors that may impact the strategy. Such an analysis can help support a company's compensation tactics and ensure effective practices are in place to attract and retain the right talent. This is especially important for companies that are in the growth stage as they can ensure that compensation decisions are made deliberately and the company is positioned well for future growth.

Suggested Student Responses:

2-15. What are some competitive forces that human resource management consultant will consider in conducting a strategic analysis to determine compensation practices?

The consultant should examine the external market environment. In searching for some experienced staff, such as marketing professionals, it is important to understand how to position the company to compete for talent. The consultant should also make an assessment of the labor market. As many of the positions require little skill, understanding the available labor pool and typical earnings ranges will help determine the compensation strategy. Internally, the consultant should examine the necessary capabilities for the different functional areas. For example, because the customization of the product is what differentiates the product from competitors, the customer service function is crucial to business success. Further, the financial condition of the company will help set the parameters of the compensation strategy.

AACSB: Analytical thinking

2-16. How will being in the growth stage impact the company's compensation practices?

Even though the company appears to be financial stable, as a company in the growth stage they must still be aware of cash flow concerns as they determine compensation tactics. Further, they will likely limit discretionary benefits as they have a high cost. The company may choose to emphasize incentive pay, which ties pay to the company's profitability as they grow.

AACSB: Analytical thinking