

**Chapter 1: A Road Map to Effective Compensation**

---

**TRUE/FALSE**

1. Evidence provided in the textbook appears to indicate a relationship between the level of stock options provided to executives and the risk those executives are prepared to undertake.

ANS: T                      PTS: 1                      REF: 4                      OBJ: 1

2. An effective compensation system is important to most organizations because it can mean the difference between company success and failure.

ANS: T                      PTS: 1                      REF: 7                      OBJ: 2

3. The main similarity between extrinsic rewards and intrinsic rewards is that they both satisfy so-called higher order needs such as survival and security.

ANS: F                      PTS: 1                      REF: 8                      OBJ: 3

4. A reward strategy is the plan for the mix of rewards to be provided to organization members along with the means through which they will be provided.

ANS: T                      PTS: 1                      REF: 9                      OBJ: 5

5. A compensation system must be viewed in the context of the total reward system because it is the total pattern of financial and non-financial rewards that motivates employee behaviour.

ANS: T                      PTS: 1                      REF: 9                      OBJ: 7

6. The main difference between a reward system and a compensation system is that a reward system rewards only good performance while a compensation system provides pay to all employees.

ANS: F                      PTS: 1                      REF: 8                      OBJ: 4

7. Under a total rewards philosophy, companies should first develop an appropriate compensation strategy.

ANS: F                      PTS: 1                      REF: 9                      OBJ: 6

8. Three of the key criteria for evaluating a compensation system are whether it promotes achievement of organizational goals, whether it is seen as equitable, and whether it promotes the full spectrum of task behaviour.

ANS: T                      PTS: 1                      REF: 11                      OBJ: 8

9. There is often one so-called best compensation system that applies to a broad spectrum of organizations.

ANS: F                      PTS: 1                      REF: 5                      OBJ: 8

10. According to the “Road Map to Effective Compensation,” the first step is formulating your reward and compensation strategy.

ANS: F

PTS: 1

REF: 13

OBJ: 9

### MULTIPLE CHOICE

1. Which of the following statements is supported by evidence in the textbook?
- Canadian firms spend 40 to 70 percent of their capital budgets on compensation.
  - Properly designed compensation systems usually promote unproductive behaviour.
  - Reward systems should be static and rarely reviewed.
  - Canadian firms spend 40 to 70 percent of their operating budgets on compensation.

ANS: D

PTS: 1

REF: 5

OBJ: 1

BLM: Higher Order: Understand

2. Which of the following statements most accurately describes extrinsic rewards?
- They focus on factors inherent in the work itself—the *job content*.
  - They satisfy higher-order human needs.
  - They include monetary and nonmonetary rewards and come from the *job context*.
  - They involve skill variety, task identity, task significance, autonomy, and feedback.

ANS: C

PTS: 1

REF: 8

OBJ: 3

BLM: Remember

3. Joe, a service manager, loves his job. He particularly appreciates the level of autonomy his job provides. From a rewards perspective, which kind of reward appears to be motivating Joe?
- extrinsic
  - incentives
  - intrinsic
  - compensation

ANS: C

PTS: 1

REF: 8

OBJ: 3

BLM: Higher Order: Apply

4. Which statement best describes the difference between the terms “rewards” and “incentives”?
- Rewards are given to satisfy basic human needs, while incentives are used to satisfy higher-order human needs.
  - Rewards serve to recognize valued behaviour, while incentives are intended to produce valued behaviour.
  - Rewards are *job-context* related, while incentives are *job-content* related.
  - Rewards are used to influence future performance, and incentives are given to recognize past work behaviour.

ANS: B

PTS: 1

REF: 8

OBJ: 1

BLM: Higher Order: Understand

5. As a small business owner committed to the total rewards approach to compensation, what do you need to establish before you start to develop your compensation system?
- a. a reward system
  - b. an incentive program
  - c. a compensation strategy
  - d. a reward strategy

ANS: D                      PTS: 1                      REF: 9                      OBJ: 7  
BLM: Higher Order: Apply

6. Which of the following items is considered part of a compensation system?
- a. variable pay
  - b. flexible work schedules
  - c. positive organizational culture
  - d. work/life programs

ANS: A                      PTS: 1                      REF: 9                      OBJ: 4  
BLM: Higher Order: Understand

7. Which statement best describes the term “reward strategy”?
- a. the means through which performance bonuses are paid
  - b. the mix of rewards provided to organization members
  - c. the means for recognizing outstanding achievement
  - d. the means for identifying the key contextual variables for an organization

ANS: B                      PTS: 1                      REF: 9                      OBJ: 5  
BLM: Remember

8. An owner of an enterprise asks you to describe the major components of a compensation system. Which of the following would you exclude in your description?
- a. base salary
  - b. performance pay linked to some organizational objectives
  - c. employee benefits, which may include: disability insurance, medical, and dental plans
  - d. flexible work schedules and some element of job autonomy

ANS: D                      PTS: 1                      REF: 14                      OBJ: 6  
BLM: Higher Order: Apply

9. Which of the following best explains intrinsic rewards?
- a. Intrinsic rewards focus on increasing an employee’s financial position.
  - b. Intrinsic rewards are provided by job content.
  - c. Intrinsic rewards provide security and employee services.
  - d. Intrinsic rewards relate to bonuses based on performance.

ANS: B                      PTS: 1                      REF: 8                      OBJ: 3  
BLM: Higher Order: Understand

10. The compensation system typically refers to which aspect of the reward system?
- the mix of intrinsic and extrinsic rewards
  - the economic or monetary part
  - the entire spectrum of rewards
  - incentives

ANS: B                      PTS: 1                      REF: 9                      OBJ: 6  
BLM: Remember

11. You have offered to your sales associate an all-expenses-paid trip for two to Australia if she doubles her annual sales volume from last year. What concept are you applying?
- intrinsic rewards
  - extrinsic rewards
  - incentives
  - job enrichment

ANS: C                      PTS: 1                      REF: 8                      OBJ: 1  
BLM: Higher Order: Apply

12. Which of the following would be an example of an extrinsic reward?
- interesting and meaningful work
  - pay for performance based on the number of units produced per hour
  - being able to see the company's product being used by a satisfied customer
  - work that allows for enhanced personal development

ANS: B                      PTS: 1                      REF: 8                      OBJ: 3  
BLM: Higher Order: Apply

13. What philosophy is the total rewards approach to compensation based on?
- Proper incentives can change employee behaviour.
  - Intrinsic rewards are more important to people than other rewards.
  - There are many awards associated with the work environment that have value.
  - Pay is still what matters most.

ANS: C                      PTS: 1                      REF: 9                      OBJ: 7  
BLM: Higher Order: Understand

14. Your company is experiencing high turnover and poor work quality. Exit interviews indicate that a large percentage of employees indicate boredom as the primary cause for quitting your company. Almost 100 percent were satisfied with their compensation packages. Which of the following actions may reduce your high turnover rate?
- providing a pension option and offering a retirement planning service
  - introducing pay-for-performance plans
  - trying to enrich the jobs to make them more interesting
  - offering dental and medical coverage

ANS: C                      PTS: 1                      REF: 11                      OBJ: 3  
BLM: Higher Order: Apply

15. What does a firm's compensation strategy identify?
- a. all of the financial and nonfinancial rewards of work
  - b. the total amount of cash compensation employees will receive
  - c. the mix of intrinsic rewards
  - d. the mix and total amount of base, performance, and indirect pay

ANS: D                      PTS: 1                      REF: 14                      OBJ: 6  
BLM: Remember

16. Which of the following statements is most accurate regarding the reward strategy?
- a. The reward system is the blueprint for creating the reward strategy.
  - b. Intrinsic awards alone will not motivate the needed behaviour.
  - c. Determining the mix of rewards to be provided is an easy process.
  - d. Various combinations of intrinsic and extrinsic rewards need to be considered for developing the optimal reward strategy.

ANS: D                      PTS: 1                      REF: 10                      OBJ: 5  
BLM: Higher Order: Analyze

17. Which of the following items is a component of the compensation strategy?
- a. employee benefits
  - b. employment security
  - c. promotion criteria
  - d. compensation plan

ANS: A                      PTS: 1                      REF: 9                      OBJ: 6  
BLM: Understand

18. A group of unionized employees negotiating a new contract is holding out for a better indirect pay plan. What should management offer the group in order to reach an agreement?
- a. better services and benefits
  - b. better training and development opportunities
  - c. pay for performance
  - d. a more competitive base pay

ANS: A                      PTS: 1                      REF: 9                      OBJ: 6  
BLM: Higher Order: Apply

19. As head of the human resources department for a new company, you have been asked to formulate a compensation strategy. What do you need to determine first?
- a. the role that compensation will play in the reward system
  - b. the correct mix of performance and base pay
  - c. the total amount of compensation to be provided
  - d. the role the reward system will play in the compensation strategy

ANS: A                      PTS: 1                      REF: 14                      OBJ: 7  
BLM: Higher Order: Apply

20. You are a newly hired director of human resources for a new software company. Your CEO has asked you to provide the board of directors with recommendations relating to the company's yet-to-be-established reward system. What should you tell the board?
- The various combinations of intrinsic and extrinsic rewards need to be considered.
  - The optimal strategy is the least expensive.
  - Like most companies in Canada, we should adopt a total compensation approach.
  - The plan for creating the compensation system is the most important aspect of the strategy.

ANS: A                      PTS: 1                      REF: 10                      OBJ: 4

BLM: Higher Order: Analyze

21. Which of the following would be the best choice for a compensation system?
- A competitive base pay and incentives are offered.
  - Employees share in the organization's profits.
  - Compensation is linked to knowledge.
  - The system is cost effective and achieves company goals.

ANS: D                      PTS: 1                      REF: 11                      OBJ: 8

BLM: Higher Order: Understand

22. Which of the following statements most accurately describes the optimal reward system?
- It adds the most value to the organization after considering all its costs.
  - It maximizes opportunities for learning and development.
  - It identifies best practices.
  - It provides whatever will satisfy the employee's needs.

ANS: A                      PTS: 1                      REF: 11                      OBJ: 8

BLM: Higher Order: Evaluate

23. Which of the following is considered a goal of an effective reward and compensation system?
- distributing rewards in an equal manner across the organization
  - reducing turnover to the lowest possible level
  - supporting the corporate strategy
  - decreasing overall salary levels

ANS: C                      PTS: 1                      REF: 11                      OBJ: 9

BLM: Higher Order: Apply

24. You have been given the responsibility to develop an effective compensation system for your company. Which of the following should serve as your first focus?
- understanding your organization and your people
  - formulating and determining budgets
  - designing your performance pay and indirect pay plans
  - implementing, managing, evaluating, and adapting the system

ANS: A                      PTS: 1                      REF: 12                      OBJ: 9

BLM: Remember

25. Which statement best describes current compensation practices and expectations related to the key criteria for evaluating the success of a compensation system?
- a. It is realistic to expect that a reward system will achieve all eight of the effectiveness criteria.
  - b. Continuing evaluation of the effectiveness of the reward and compensation system is crucial for most organizations.
  - c. Successful organizations all have equitable reward systems.
  - d. Most firms have found the right answers to the compensation puzzle.

ANS: B                      PTS: 1                      REF: 15                      OBJ: 8  
BLM: Higher Order: Analyze

26. What is the last step to effective compensation according to the “Road Map to Effective Compensation”?
- a. developing new job descriptions and performance evaluation criteria
  - b. implementing, managing, and evaluating the compensation system as circumstances change
  - c. securing senior management approval and implementing the compensation system
  - d. determining the compensation mix to be used in the compensation system

ANS: B                      PTS: 1                      REF: 15                      OBJ: 9  
BLM: Remember

27. According to the textbook, what is the primary reason for the increased usage of compensation consultants by organizations?
- a. Corporations are contracting out most human resource functions.
  - b. Given greater standardization associated with compensation systems, it makes sense to use dedicated outside consultants.
  - c. The level of complexity of compensation systems has increased.
  - d. It is often cheaper to use to use consultants.

ANS: C                      PTS: 1                      REF: 16                      OBJ: 10  
BLM: Remember

28. Which of the following statements best describes the context of compensation management within a firm?
- a. All organizations need a human resources department to deal with compensation issues.
  - b. The larger the firm, the greater the need for compensation specialists.
  - c. In smaller organizations, compensation consulting firms are responsible for compensation strategy.
  - d. Within a large firm, all managers require extensive knowledge of compensation.

ANS: B                      PTS: 1                      REF: 16                      OBJ: 10  
BLM: Higher Order: Understand

29. In large organizations, who is typically responsible for approving strategic changes to compensation strategy?
- the head of human resources
  - the board of directors
  - the manager of compensation
  - compensation consultants

ANS: B                      PTS: 1                      REF: 16                      OBJ: 10  
BLM: Higher Order: Understand

30. After graduation, you have been offered a position as a job analyst with a local bank. Which of the following would best describe your new job?
- designing and implementing compensation policies
  - formulating compensation strategy and ensuring congruency with corporate objectives
  - evaluating market data from organizations of similar size and scope
  - developing job descriptions and conducting job evaluations

ANS: D                      PTS: 1                      REF: 16                      OBJ: 10  
BLM: Higher Order: Understand

### SHORT ANSWER

1. Explain the difference between “extrinsic” and “intrinsic” rewards. Provide examples for each type of reward.

ANS:

Extrinsic rewards satisfy our basic needs for survival, security, social requirements, and recognition. They are derived from the context of the job in the workplace. They include the financial returns, tangible services, and benefits employees receive as part of the employment relationship. Intrinsic rewards satisfy higher-level needs for self-esteem, achievement, and growth. They are derived from job content rather than job context. They focus on job design and building more opportunities for challenge and achievement into jobs through job enrichment. Intrinsic rewards provide skill variety, task identity, task significance, autonomy, and feedback.

PTS: 1                      REF: 8                      OBJ: 3

2. Explain the difference between a “reward strategy” and a “compensation strategy.”

ANS:

A reward strategy is the plan for the mix of all of the financial and nonfinancial rewards of work (i.e., the mix of extrinsic and intrinsic rewards) the organization plans to provide to its employees, along with the means through which they will be provided. Used to create the reward system, this design plan needs to be determined before the compensation strategy. The compensation strategy is one part of the reward strategy and is used to create the compensation system (which is the economic or monetary part of the reward system). The compensation strategy is the plan for mix and total amount of financial returns, tangible services, and benefits employees receive as part of the employment relationship.

PTS: 1                      REF: 8                      OBJ: 4



3. Explain the ways in which “direct” and “indirect” pay are similar *and* different to each other.

ANS:

Combined, both are tangible financial extrinsic rewards that make up the compensation system—the economic or monetary part of the reward system used to help create a willingness among qualified persons to join the organization and to perform the tasks needed by the organization. Direct pay (sometimes known as “cash compensation”) represents monetary rewards. Types of cash compensation include the following: base pay or money—the foundation pay for most employees based on hourly pay or wage or as salary; performance pay—cash recognition based on individual, group or organizational performance; and cost of living adjustments (COLA). Indirect pay (sometimes known as “employee benefits”) represents nonmonetary rewards. It consists of the noncash items or services that put money in employees’ pockets—things that would have required the expenditure of money had they not been provided by the employer. Used in lieu of money, goods and services are made available and paid totally, or by percentage, by the employer. These items satisfy a variety of specific employee needs such as pay for time not worked, protection programs, and employee services.

PTS: 1

REF: 9

OBJ: 6

4. What is the goal of an organization’s reward and compensation system?

ANS:

All organizations have a compensation plan, written or unwritten, formal or informal. For some organizations, the purpose of the plan may be merely to meet compliance requirements. For other organizations, the goal of the compensation plan may be to attract qualified employees, to retain those employees, and to motivate employees to direct their efforts towards achieving the goals of the organization.

The goals of reward and compensation system are to:

- 1) Promote achievement of organizational goals. (The plan must be strongly tied to the objectives of the organization.)
- 2) Fit with and support the organization’s strategy and structure. (If the business strategy or plans are not considered, then it would be very easy to pay for activities that do not actually help the organization be more successful.)
- 3) Attract and retain qualified employees.
- 4) Promote desired task behaviour. (Links rewards directly to performance through a strong performance management system.)
- 5) Be seen as being equitable and communicating openly. (Transparency encourages honesty and straightforward discussions of how the program works. Employees tend to overestimate others’ income level, so be as open as possible with summary data that will not breach individual confidentiality.)
- 6) Comply with the law.
- 7) Be within the financial means of the organization.
- 8) Achieve all of the above goals in the most cost effective manner.

PTS: 1

REF: 11

OBJ: 8

5. Identify the steps in developing an effective compensation strategy.

ANS:

Now that we have some basic ideas on compensation, rewards, employee needs, and goals of an effective compensation system, we need to look at the process for creating an effective compensation system. These steps are:

- 1) Understand your organization and your people.
- 2) Formulate your reward and compensation strategy.
- 3) Determine your compensation values.
- 4) Design your performance pay and indirect pay plans.
- 5) Implement, manage, evaluate, and adapt the compensation system.

PTS: 1

REF: 13

OBJ: 9

6. Why would a large organization require approval by senior management and/or the board of directors for initiating strategic changes to an organization's compensation strategy?

ANS:

Answers will vary from student to student. That said, students should identify identical variables as question 4 above.

PTS: 1

REF: 16

OBJ: 8