

**SOLUTIONS MANUAL**

**STRATEGIC  
COMPENSATION**  
A HUMAN RESOURCE  
MANAGEMENT APPROACH  
FOURTH EDITION



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## **CHAPTER TWO**

### **A Strategic Framework for Compensation**

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#### **Chapter Learning Objectives**

**After reading this chapter, you should be able to:**

1. Explain why the same compensation system that is a success in one firm can be a failure in another.
2. Describe an organizational system.
3. Explain how the strategic framework for compensation can be used as a tool for designing effective reward and compensation systems.
4. Describe the three main sets of elements in the strategic compensation framework, and explain how they relate to one another.
5. Describe the three main managerial strategies that organizations can adopt, and explain the implications for the most effective reward and compensation system.
6. Describe the five main determinants of managerial strategy, and explain how they can be used to select the most appropriate managerial strategy.
7. Analyze any organization to determine the most appropriate managerial strategy for that organization to adopt.
8. Discuss how conditions in North America changed during the twentieth century, and explain how this has affected today's managerial and compensation strategies.

#### **Chapter Summary**

Chapter 2 presents the first of two conceptual tools that underpin the effective design of compensation strategy. The purpose of this chapter is to follow up on the concept of strategic fit briefly introduced in Chapter 1. If fit between the compensation system and key characteristics of the firm is essential, then what exactly are these key characteristics, and how exactly do they link to compensation?

The strategic framework presented in Chapter 2 is intended to answer these questions, by providing a conceptual tool for linking compensation strategy to the managerial strategy used by the firm, as well as to the corporate strategy and other key contextual variables. The key idea for students to take away from Chapter 2 is the interdependence between the compensation system, the other structural variables, the managerial strategy, and the contextual variables. A related insight is that if any of these characteristics change, changes to other characteristics, including the compensation system, may be needed.

Key concepts covered in Chapter 2 include organizations as systems, structural and contextual variables, and the three main types of managerial strategy. Students need to understand the implications of each managerial strategy for organizational structure, including compensation structure. It is important for students to understand that none of the managerial strategies is inherently superior to the others, but that some managerial strategies

will better fit a given organization than other managerial strategies, depending on the contextual variables.

Students also need to understand that just because the contextual variables seem to call for a particular managerial strategy, this is no guarantee that the firm will have actually adopted that managerial strategy. To know which managerial strategy is actually in place, if any, they need to examine the structural variables. It may well be that a firm has no definite managerial strategy—either explicit or implicit—in place, which then makes it impossible to systematically identify the most appropriate compensation system for that firm. Ideally, before redesigning the compensation system, this organizational issue should be ironed out.

Instructors familiar with the third edition of *Strategic Compensation in Canada* will notice that, besides the updating of examples, this chapter has not undergone substantial change. The main change is a reduction in the length of the section “The Evolution of Managerial Strategies” by about five pages, in order to reduce the length of this chapter.

## Lecture Outline

### COMMENTS

#### A. Introduction/Concept of Fit

This chapter presents the first of two conceptual tools that underpin the effective design of compensation strategy.

In the opening vignette for Chapter 2, the text provides two diverse examples to illustrate the concept of fit.

If fit between the compensation system and key characteristics of the firm is essential, then what exactly are these key characteristics, and exactly how do they link to compensation? The purpose of this chapter is to present a strategic framework for answering this question.

### ACTIVITY

*Discussion Question 1 is a good lead-in for this chapter.*

Pose the question to the class: “How does the success or failure of a reward system depend on the concept of fit?”

### B. Organizations as Systems

Let's look at the essence of organizations as transformation systems. By understanding the dynamic nature of organizational processes, we can begin to understand the role that compensation plays within the organization.

Utilizing a slide of Figure 2.1, ask for examples from the class on how their organizations operate as systems.

### C. A Strategic Framework for Compensation

Now that we have some cornerstones in place with the concepts of fit and a systems paradigm for organizations, we can examine two sets of variables of crucial importance. The first of these are structural variables, which generate the behaviours needed by the organization. The second of these are contextual variables, which should determine the most appropriate managerial strategy (combination of structural variables) for an organization to adopt.

Using a slide of Figure 2.2, explain the relationships that this figure represents.

### D. Structural Variables

Let's examine the various concepts within the structural variables. Point out that the reward and compensation system is one of these variables, and it needs to mesh with the others to be effective.

Involve the class to provide explanations or definitions of each variable in this category. Record the correct information on a flip chart or board. When complete, show the the slide of Figure 2.2 to re-emphasize the interdependence of the variables.

### E. Managerial Strategy

As we have seen in Figure 2.2 there is a key linkage between all the variables, that of managerial strategy. Three main patterns of structural variables—managerial strategies—have emerged over time, and, as will be seen shortly, each managerial strategy calls for a different compensation structure.

### F. Contextual Variables

Note the importance of understanding the contextual variables, since they should determine the managerial strategy, and that changes in these contextual variables could trigger a need for change to the managerial strategy, and ultimately to the compensation system.

Involve the class in providing explanatory definitions for each of the variables in this category, noting them on flip chart or board. When complete, show a slide of Figure 2.2 to reinforce the inter-dependence theme.

### G. Managerial Strategies and Reward Systems

“As organizations have evolved, three main patterns of management (classical, human relations, and high involvement) or managerial strategies have emerged. Each of these strategies reflects different assumptions about employees and how they should be managed.” Based on the information in the text on pages 29-39, let’s explore each of these strategies.

After explaining the three managerial strategies, use Compensation Notebook 2.1 (p. 31) to highlight the structural differences between them. Utilize the companies described in Compensation Today 2.1 (EBS) 2.2 (Kodak) and 2.3 (WestJet) to illustrate how these different strategies and structures look when in actual use.

Set students up in pairs, and ask them to use Compensation Notebook 2.1 to identify the managerial strategy of their most recent employer. Record their conclusions on the board under four headings: classical, human relations, high involvement, and “mixed.” Tell them to label a firm as “mixed” if it is not consistent on at least four of the six structural dimensions.

*Discussion Question 2 fits well here, as does Case Question 1.*

### H. Determinants of the Most Appropriate Managerial Strategy

If the most appropriate managerial strategy that a firm should adopt is determined by the contextual variables, we need to understand how, exactly, each contextual variable relates to managerial strategy.

Utilizing the slide of Compensation Notebook 2.2, (p. 46) invite participation from the class to define and discuss the five contextual variables. Using a slide of Compensation Notebook 2.2 and the two earlier examples of L-S Electro-galvanizing and Rogers Chickens, review the material covered thus far in this chapter in order to pull together the concepts of managerial strategy and contextual variables and their impact on firm performance. Also apply the framework to the EBS, Kodak, and WestJet examples.

*Use End-of-Chapter Exercises 1 and 2 here. Case Questions 2 and 3 also fit well here.*

### I. Trends in Managerial and Compensation Strategies

This part of the chapter helps us to understand how trends in managerial strategy and compensation intertwine.

*The class before, assign “Using the Internet”, and use the results to kick off the discussion. Follow up with Discussion Question 3, and summarize on the board the various trends, both longer term and shorter term, that have been taking place. Ask students if any of them have had personal experience with any of these trends.*

### Suggestions for End-of-Chapter Exercises

1. The purpose of this exercise is to give students a better understanding of the contextual variables and their purpose by applying them to organizations with which students have had personal experience, and, in so doing, reinforce their understanding of how to assess the type of managerial strategy practiced by a firm, and their understanding of the linkages between managerial strategy and reward structure.

Assign this exercise to the class to reflect on individually before breaking into small groups for further discussion. Have the groups identify the organizations they are using as their examples and list them on a flip chart or board along with their responses to each of the questions in the exercise. Depending on the size of the class, it may be necessary for each group to select just one organizational example to share with the class. Using the slide of Compensation Notebook 2.2, engage the groups in discussion of the relationships between the contextual variables and the actual managerial strategies that seem to be in use. Tie in the question of whether the reward system fits the managerial strategy.

2. The purpose of this exercise is to take Exercise 1 another step farther, by asking the students to reflect on whether the actual performance results match what theory would predict, and, if not, why not. Use the same groups as in Exercise 1. If some of the predicted linkages don't match up, discuss some of the possible reasons why this may have occurred. Possible reasons may include misclassification on the part of the students, or a misunderstanding of the actual performance level of the firm. Point out that most firms do not fall neatly into boxes, and that many factors affect firm performance, so that the theory may not necessarily "work" in every case.

### Notes for Case Questions

1. Achtymichuk Machine Works. The purpose of this case question is to help students see how the three managerial strategies can translate into specific managerial and organizational actions, to see how they can be used to generate ideas for solving problems, and to see how the implications for compensation are very different depending on the managerial strategy being pursued.

The classical consultant would see this as a problem of structure, job design, training, and compensation. First, she would study the jobs, to see how they could be broken down into smaller fragments that would make training and learning easier, as well as supervision. She would create specialist jobs, such as cleaning all washrooms, cleaning all hallways, cleaning around all of a certain type of machine. Each job would be studied to find the most efficient equipment, cleansers, and procedures. Workers would then be trained in these methods, and monitored to be sure they were using them. To provide motivation, some type of piece rate system might be implemented, where cleaners get paid for each toilet cleaned, each machine area cleaned, and the like. In order to supervise and control all this, a specialized cleaning department would be created, with all cleaners reporting to a single supervisor expert in all aspects of the necessary cleaning tasks.

The human relations consultant would see this as a job satisfaction problem. If workers received higher satisfaction from their job and workplace, then they would be more likely to stay with the firm after they had learned their jobs. He would note that worker's social needs are not being satisfied, nor related needs for esteem and recognition by peers. He would create a separate cleaning department to give the cleaners a sense of identity and create opportunities for the cleaners to socialize at breaks. Another purpose of having a separate cleaning department would be to remove the cleaners from the direct supervision of the department supervisors, who would look down on the cleaners, and not provide them with any social support. He would also change the compensation system so that pay would go up with seniority, and provide benefits, such as pension plans, to encourage retention.

Finally, the high-involvement consultant would see this mainly as a problem of insufficient intrinsic rewards, and attempt to redesign jobs to make them more interesting. Workers would be given some say over the cleaning products and methods to be used. Cleaners might be organized in self-managing work teams, in which they would make decisions about which cleaners would clean what. To give them some sense of being on a team, and to give them more independence, a cleaning department would be created, headed by a supervisor with a participative leadership style. Cleaners would be put on salary, and also some type of group-based pay plan to tie their goals to those of the firm, and probably organizational performance pay as well, depending on whether this is offered to other employees in the firm.

Which solution is the best? It depends on the managerial strategy being practiced by the firm. If classical is being practiced, the classical method may work best; if human relations is being practiced, then the human relations suggestions will work best; and if high-involvement is being practiced then the high involvement ideas would be most suitable. One thing that I point out to the students is that any of the three would likely be an improvement over what is being done now. I also point out that there are some commonalities in the suggestions of the three consultants—the creation of a cleaning department with its own supervisor—although the reasons for this suggestion are very different in each case.

2. The Fit Stop. The purpose of this case question is to give students a better understanding of the contextual variables and their purpose by giving them an opportunity to apply the template for selecting the most appropriate managerial strategy (Compensation Notebook 2.2). (Note: This is a recurring case, and students can be given the opportunity to do further work with this case later in the book. See Chapter 4, Case Question 1; Chapter 5, Case Question 3; Chapter 6, Case Question 1; Chapter 11, Case Question 2; Chapter 12, Case Question 1; and Chapter 13, Case Question 1.)



Some points that may inform this case discussion are as follows:

- To determine the most appropriate managerial strategy for The Fit Stop, we need to examine the contextual variables. The environment is quite unstable, given the competitors and the changing state of knowledge in physical fitness. The corporate strategy would be most similar to the prospector, as the firm wants to be the first to make new fitness products and solutions available to its customers. Under Porter, it would be a focused differentiator.
  - The technology is intended to be intensive, where every customer is given a custom-made solution to their fitness problems. The overall organization will be quite large, but the size of each store will be relatively small. Susan needs dedicated employees who will be willing to learn and develop, and to have a high concern for customers and the company. She is going to need high membership behaviour, high task behaviour, and high citizenship behaviour from her employees. All of this suggests a high involvement managerial strategy.
  - Susan would likely be favourably disposed towards high involvement, because she recognizes the importance of teamwork and employee commitment to the success of her business. She has already decided to hire only full-time employees, in recognition of the need to have a stable and highly trained work force, which fits in very well with a high involvement organization. Moreover, her background in sports will likely have taught her the value of teamwork in achieving success.
3. Multi-Products Corporation. The purpose of this case question is also to give students a better understanding of the contextual variables and their purpose by giving them an opportunity to apply the template for selecting the most appropriate managerial strategy (Compensation Notebook 2.2). In contrast to the Fit Stop above, this case calls for a classical managerial strategy, although an argument could be made for a human relations strategy. (Note: This is a recurring case, and students can be given the opportunity to do further work with this case later in the book. See Chapter 4, Case Question 2; and Chapter 6, Case Question 2.)

Some of the points that may inform this case discussion are:

- The first step is to examine the contextual variables:
  - Relatively stable environment, because of the patents, guaranteed source of funding, stable technology, non-militant labour unions, etc.
  - Relatively simple environment, because firm will basically make one product
  - Golf club production technology unchanged and straightforward, long linked, routine, and mass
  - Defender strategy whereby the division will focus on excelling and dominating in a limited domain, focused differentiator under Porter.
  - The size of the division is small to medium
  - The skills needed by employees are only moderate, although consistency of performance is important.

- Overall, the organization probably does not need high membership, task, or citizenship behaviour.
- Given all this, the strategic template clearly calls for a classical managerial strategy.
- However, a human relations strategy has some appeal because the firm wants a high quality product, and the human relations strategy is more likely to produce committed workers. Moreover, because of the monopoly position the firm holds in regard to the product, and the fact that demand is price inelastic, the company could afford the higher costs of a human relations strategy. Use of the classical strategy will make it more likely that the employees will become unionized. If the firm does become unionized, use of a classical strategy could end up producing disgruntled workers who are difficult to fire. On the other hand, the union in this industry has not been very militant, so unionization may not be a huge problem for the firm, and if pay and benefits are kept at market levels, employees may not have a strong incentive to unionize in any case.
- If a classical strategy is adopted, a fairly simple system including hourly wages and a limited set of employee benefits would fit best. Piece rates would fit this philosophy, but may detract from the product quality needed.
- If a human relations strategy is selected, a salary approach, with seniority increases and liberal benefits increasing with time, would be the best bet, along with opportunities for social interaction among organization members.