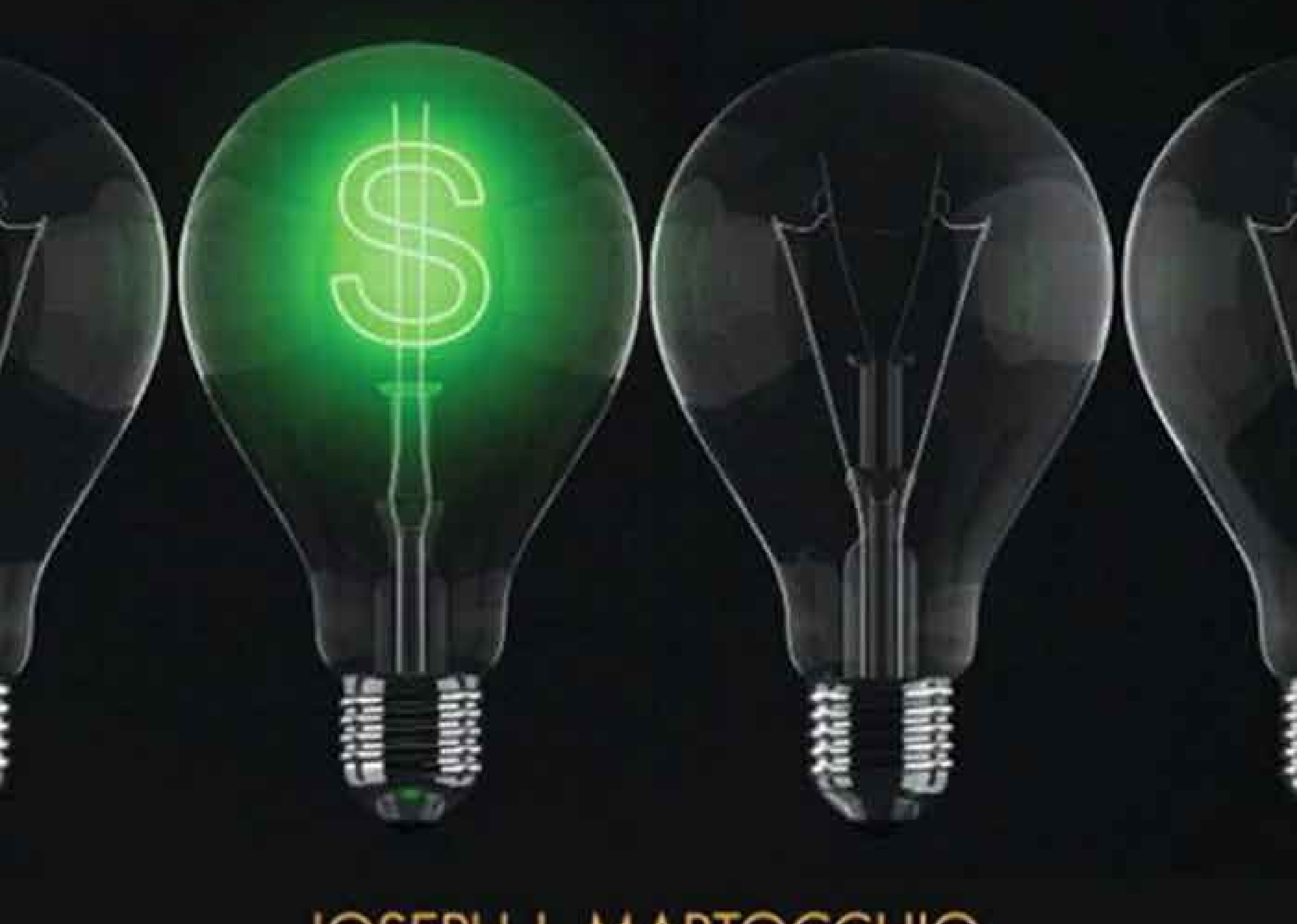
STRATEGIC COMPENSATION

A Human Resource Management Approach

EIGHTH EDITION



JOSEPH J. MARTOCCHIO

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University of Illinois at Urbana-Champaign

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Preface

The measure of a company's success is as much a function of the way it manages its employees as it is a function of its structures and financial resources. Compensating employees represents a critical human resource management practice: Without strategic compensation systems, companies cannot attract and retain the best-qualified employees. Spending more than is necessary to attract and retain top talent adds costs unnecessarily to companies in search of competitive advantage.

The purpose of this book is to provide knowledge of the art and science of compensation practice and its role in promoting companies' competitive advantage. Students will be best prepared to assume the roles of competent compensation professionals if they possess a grounded understanding of compensation practices and the environments in which business professionals plan, implement, and evaluate compensation systems. Thus, we examine the context of compensation practice, the criteria used to compensate employees, compensation system design issues, employee benefits, challenges of compensating key strategic employee groups, pay and benefits around the world, and challenges facing compensation professionals.

New to the Eighth Edition

1. Chapter 16, titled "Challenges Facing Compensation Professionals," covers more pertinent issues than included in the seventh edition. This chapter informs students that there is much more to consider besides the fundamentals of compensation design that are detailed in Chapters 1 through 15. Chapter 16 also addresses seven key issues among many that will shape the work of compensation and benefits professionals in the future:
    - Fallout from the "Great Recession"
    - Underemployment: Implications for compensation
    - Executive compensation
    - Rising wages in China
    - Challenges in health care reform
    - Workforce demographic shifts
    - Marriage between same-sex individuals and the U.S. Supreme Court ruling on the Defense of Marriage Act
2. Chapter 7 adds a section on pay policy mix, which is a key element that compensation professionals must consider when designing market competitive pay systems.
3. Chapter 2 describes the main provisions of the Patient Protection and Affordable Care Act of 2010.
4. All chapters have been thoroughly revised to describe current statistics and issues of importance for compensation professionals.
5. The *Building Strategic Compensation Systems* case is now available online in MyManagementLab and includes the CompAnalysis Software necessary to complete sections of the project. The software is compatible with Windows and Mac platforms.

About This Book

This book contains 16 chapters, lending itself well to courses offered as 10-week quarters or 15-week semesters. The chapters are organized in six parts and an epilogue (containing Chapter 16):

- Part I: Setting the Stage for Strategic Compensation
- Part II: Bases for Pay
- Part III: Designing Compensation Systems

- Part IV: Employee Benefits
- Part V: Contemporary Strategic Compensation Challenges
- Part VI: Compensation Issues around the World
- Epilogue: Challenges Facing Compensation Professionals

Course instructors on a 10-week schedule might consider spending about 2 weeks on each part. Instructors on a 15-week schedule might consider spending about 1 week on each chapter. Compressed 8-week schedules can accommodate 2 chapters per week.

This textbook is well suited to a variety of students, including undergraduate and master's degree students. In addition, the book was prepared for use by all business students, regardless of their majors. Both human resource management majors and other majors (e.g., accounting, finance, general management, international management, marketing, and organizational behavior) will benefit equally well from *Strategic Compensation*. After all, virtually every manager, regardless of functional area, will be involved in making compensation decisions. Both practitioners beginning work in compensation and current professionals will find *Strategic Compensation* a useful reference. The "Compensation in Action" feature will clarify the connections between compensation and other functions.

Available Teaching and Learning Aids

The teaching and learning accessories are designed to promote a positive experience for both instructors and students.

A feature titled "Compensation in Action" appears at the end of every chapter in the text. This feature provides clear operational points to illustrate how line managers, employees, and compensation professionals interact to put compensation concepts into practice. It was prepared by Mr. Gentz Franz, Director of Development at the University of Illinois.

Short end-of-chapter cases have been included in the text. These cases were written by Professor Lori Long of Baldwin-Wallace College about real-world compensation issues, with questions to facilitate class discussion or to be used as homework assignments. Recommended answers are available to instructors in the Instructor's Manunal, which can be accessed by logging onto the Instructor's Resource Center's website (*www.pearsonhighered.com/irc*).

MyManagementLab

MyManagementLab is an online homework, tutorial, and assessment program that truly engages students in learning. It helps students better prepare for class, quizzes, and exams—resulting in better performance in the course—and provides educators a dynamic set of tools for gauging individual and class progress. In addition to quizzes and pre- and post-tests, MyManagementLab to accompany this text includes:

Building Strategic Compensation Systems Project

This accompanying experiental case available online only in MyManagement Lab will allow students to work in small compensation consulting teams charged with the responsibility for developing a compensation plan for a company named e-sonic. The project is divided into four sections. The first section, *Strategic Analysis*, is described fully in the casebook for faculty and students who choose to complete this analysis of the business environment prior to the remaining three sections that directly address compensation system design.

Section 1: Chapter 6

Section 2: Chapter 7

Section 3: Chapters 2 through 5, 8 through 11

The development of a strategic analysis guides all decisions made regarding students' compensation systems throughout the project. The strategic analysis reveals firm-specific challenges, objectives, and initiatives that allow students to align the goals of a compensation system effectively with that of their company strategy.

Section 1 introduces students to the specification of internally consistent job structures. Through writing job descriptions, the development of job structures, and both the development and implementation of a point evaluation method to quantify job differences objectively, students build the framework for internal equity.

Section 2 shifts students' focus outside of their firm to understand its relationship with the external marketplace. Students will use market survey data to compare pay rates of positions inside the firm with those in the marketplace to establish the foundations of market-competitive pay. The analysis of market data also leads students to the determination of appropriate pay-policy mixes for each of their job structures. In this section, students are asked to use CompAnalysis software developed by Howard Weiss at Temple University, which is also available in MyManagementLab.

Finally, in Section 3, students will recognize the contributions of individual employees through the creation of a merit-pay system and put their plan into action by paying employees within their firm. Hypothetical pay discrepancies are introduced to each student group for resolution within the parameters of their designed compensation system. They are tasked with many of the difficult decisions that compensation professionals face on a daily basis.

The Strategic Analysis section and Sections 1 through 3 may each be completed in 2 to 3 weeks, which fits well with semester-long courses. Instructors whose courses include a variety of additional activities or span only 7 to 10 weeks may have students complete only three of the four sections in either configuration (Strategic Analysis and Sections 1 and 2 or Sections 1 through 3). The instructor may have student groups prepare written reports or oral presentations to the class. Report outlines are included in the instructor's and student's casebook versions.

Two Assisted-Graded Writing Prompts

Two assisted-graded writing prompts per chapter are provided in MyManagementLab via the Writing Space tool that allows for the online submission and grading of essay questions. The writing prompts also appear at the end of each chapter.

Supplemental Short Cases

Short cases, also written by Professor Lori Long of Baldwin-Wallace College, correspond to each chapter. Suggested answers are available to instructors under the Instructor's Manual on MyManagementLab and on Pearson's Instructor's Resource Center.

Instructor Supplements

All of the following supplements can be downloaded from our Instructor's Resource Center. Request your user name and password from your Pearson Sales Representative. *www.pearsonhighered.com/irc*

Instructor's Manual: The Instructor's Manual has been completely revised. For each chapter, the Instructor's Manual provides a comprehensive lecture outline as well as additional Teaching Resources.

Test Item File: The Test Item File consists of multiple-choice questions, true/false, and essay questions. Each question will have a difficulty rating of easy, moderate, or difficult and a classification of either application or recall to help you build a well-balanced test.

PowerPoints: The PowerPoint package is a fully revised, comprehensive package that outlines each chapter and includes figures from the text. It is designed to aid the educator and supplement in-class lectures.

TestGen Software: Containing all of the questions in the printed Test Item File, TestGen is a comprehensive suite of tools for testing and assessment.

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Joseph J. Martocchio

PART I

SETTING THE STAGE FOR STRATEGIC COMPENSATION

1 STRATEGIC COMPENSATION

A Component of Human Resource Systems

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LEARNING OBJECTIVES

When you finish studying this chapter, you should be able to:

1. Describe what compensation is and give at least three examples of core compensation practices and at least three examples of employee benefits practices.
2. Summarize at least two historical events in the evolution of compensation practice leading to the current strategic compensation era.
3. Discuss at least two differences between strategic and tactical compensation.
4. Name and summarize the goals of compensation professionals.
5. Identify the stakeholders of the compensation and summarize their stake in the work compensation professionals perform.

For most of the twentieth century, the predecessor to contemporary human resource (HR) management practices was initially referred to as manpower planning or personnel management. In the earlier part of that century, manpower planning often focused on the effective deployment of employees in factories to achieve the highest manufacturing output per employee per unit of time. For instance, management sought to increase the number of handmade garments per hour.

Extensive government regulation involving payroll taxes, minimum wage laws, and antidiscrimination laws later gave rise to the personnel management function. Legal compliance necessitated that personnel management take on the role of an administrative, support function to maintain compliance with the myriad details of the laws (e.g., determining what equal work is and the prevailing wage in specific localities). Since the 1970s, there has been widespread recognition that managing employees or human resources can contribute to company success. Administrative efficiency of the personnel functions (e.g., recruiting, performance appraisal, and compensating employees) certainly contributes indirectly to company success through cost control.

In recent years, researchers and HR practitioners have worked steadily to quantify the impact of managing human resources on business success in terms of such outcomes as innovation, higher sales, product quality, exemplary customer service, and so forth. Some have described the HR professional's role as evolving from compliance (policing) to consultation, with a carpenter's eye toward quality HR system design. Designing HR practices with business outcomes in mind is a necessary first step, and compensation plays an important role in contributing to successful business outcomes.

EXPLORING AND DEFINING THE COMPENSATION CONTEXT

The compensation function does not operate in isolation. To the contrary, it is just one component of a company's human resource system. In addition, compensation professionals interact with members of various constituencies, including union representatives and top executives. We will explore these ideas in more detail after we have introduced some fundamental compensation concepts.

What Is Compensation?

Compensation represents both the intrinsic and extrinsic rewards employees receive for performing their jobs. Together, both intrinsic and extrinsic compensation describe a company's total compensation system. This system of practices is depicted in Figure 1-1.

Intrinsic compensation reflects employees' psychological mind-sets that result from performing their jobs. **Extrinsic compensation** includes both monetary and nonmonetary rewards. Organizational development professionals promote intrinsic compensation through effective job design. Compensation professionals are responsible for extrinsic compensation, which will be the focus of this textbook.

Extrinsic compensation includes both monetary and nonmonetary rewards. Compensation professionals establish monetary compensation programs to reward employees according to their job performance levels or for learning job-related knowledge or skills. As we will discuss shortly, monetary compensation represents **core compensation**. Nonmonetary rewards include protection programs (e.g., medical insurance), paid time off (e.g., vacations), and services (e.g., day care assistance). Most compensation professionals refer to nonmonetary rewards as **employee benefits**.

Core Compensation

There are seven types of monetary, or core, compensation (two types of which are listed as base pay). The elements of base pay adjustments are listed in Table 1-1.

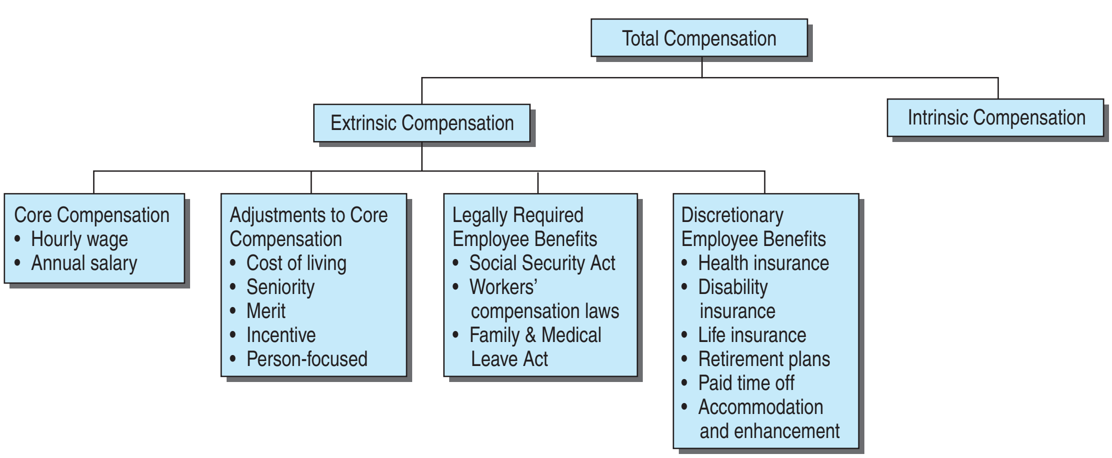

FIGURE 1-1 Total Compensation System

TABLE 1-1 Elements of Core Compensation

Base Pay

- Hourly pay
- Annual salary

How Base Pay Is Adjusted over Time

- Cost-of-living adjustments
- Seniority pay
- Merit pay
- Incentive pay
- Person-focused pay: pay-for-knowledge and skill-based pay

BASE PAY Employees receive **base pay**, or money, for performing their jobs (Chapter 7). Base pay is recurring; that is, employees continue to receive base pay as long as they remain in their jobs. Companies disburse base pay to employees in one of two forms: **hourly pay** or **wage**, or as **salary**. Employees earn hourly pay for each hour worked. They earn salaries for performing their jobs, regardless of the actual number of hours worked. Companies measure salary on an annual basis. The Fair Labor Standards Act (Chapter 2) established criteria for determining whether employees should be paid hourly or by salary. In 2012, the average weekly rate for workers was $818.[1] On an annual basis, this figure translates to $42,536 (based on a 40-hour work week over 52 calendar weeks).

Companies typically set base pay amounts for jobs according to the level of skill, effort, and responsibility required to perform the jobs and the severity of the working conditions. Compensation professionals refer to skill, effort, responsibility, and working condition factors as **compensable factors** because they influence pay level (Chapters 2 and 6). Courts of law use these four compensable factors to determine whether jobs are equal per the Equal Pay Act of 1963. According to the Equal Pay Act, it is against the law to pay women less than men for performing equal work. Compensation professionals use these compensable factors to help meet three pressing challenges, which we will introduce later in this chapter: internal consistency (Chapter 6), market competitiveness (Chapter 7), and recognition of individual contributions (Chapter 8).

Over time, employers adjust employees' base pay to recognize increases in the cost of living, differences in employees' performance, or differences in employees' acquisition of job-related knowledge and skills. We will discuss these core compensation elements next.

COST-OF-LIVING ADJUSTMENTS (COLAS) **Cost-of-living adjustments (COLAs)** represent periodic base pay increases that are founded on changes in prices as recorded by the consumer price index (CPI). In recent years, the typical COLA equaled approximately 2–3 percent annually. COLAs enable workers to maintain their purchasing power and standard of living by adjusting base pay for inflation. COLAs are most common among workers represented by unions. Union leaders fought hard for these improvements to maintain their members' loyalty and support. Many employers use the CPI to adjust base pay levels for newly hired employees.

SENIORITY PAY **Seniority pay** systems reward employees with periodic additions to base pay according to employees' length of service in performing their jobs (Chapter 3). These pay plans assume that employees become more valuable to companies with time and that valued employees will leave if they do not have a clear idea that their wages will progress over time. This rationale comes from **human capital theory**,[2] which states that employees' knowledge and skills generate productive capital known as **human capital**. Employees can develop such knowledge and skills from formal education and training, including on-the-job experience. Over time, employees presumably refine existing skills or acquire new ones that enable them to work more productively. Seniority pay rewards employees for acquiring and refining their skills as indexed by length (years) of employment.

MERIT PAY **Merit pay** programs assume that employees' compensation over time should be determined, at least in part, by differences in job performance (Chapter 3). Employees earn permanent increases to base pay according to their performance. Merit pay rewards excellent effort or results, motivates future performance, and helps employers retain valued employees.

INCENTIVE PAY **Incentive pay** or **variable pay** rewards employees for partially or completely attaining a predetermined work objective. Incentive pay is defined as compensation (other than base wages or salaries) that fluctuates according to employees' attainment of some standard based on a preestablished formula, individual or group goals, or company earnings (Chapter 4).

PAY-FOR-KNOWLEDGE PLANS AND SKILL-BASED PAY **Pay-for-knowledge** plans reward managerial, service, or professional workers for successfully learning specific curricula (Chapter 5). **Skill-based pay**, used mostly for employees who perform physical work, increases these workers' pay as they master new skills (Chapter 5). Both skill- and knowledge-based pay programs reward employees for the range, depth, and types of skills or knowledge they are capable of applying productively to their jobs. This feature distinguishes pay-for-knowledge plans from merit pay, which rewards employees' job performance. Said another way, pay-for-knowledge programs reward employees for their potential to make meaningful contributions on the job.

Employee Benefits

Earlier, we noted that employee benefits represent nonmonetary rewards. Employee benefits include any variety of programs that provide paid time off, employee services, and protection programs. Companies offer many benefits on a discretionary basis. We refer to these as **discretionary benefits** (Chapters 9 and 10). In addition, the U.S. government requires most employers to provide particular sets of benefits to employees. We refer to these as **legally required benefits** (Chapter 11). Different forces led to the rise of legally required and discretionary employee benefits, which we discuss shortly.

DISCRETIONARY BENEFITS The first signs of contemporary discretionary employee benefits were evident in the late 1800s when large companies such as American Express offered pension plans to employees. Most of the development in employee benefits practice for the next few decades resulted from government legislation, as previously noted. Discretionary benefits offerings became more prominent in the 1940s and 1950s due in large part to federal government restrictions placed on increasing wage levels. Employee benefits were not subject to those restrictions.

Discretionary benefits fall into three broad categories: protection programs, paid time off, and services (Chapter 10). Protection programs provide family benefits, promote health, and guard against income loss caused by such catastrophic factors as unemployment, disability, or serious illness. Not surprisingly, **paid time off** provides employees with pay for time when they are not working (e.g., vacation). **Services** provide such enhancements as tuition reimbursement and day care assistance to employees and their families.

LEGALLY REQUIRED BENEFITS Legally required benefits historically provided a form of social insurance. Prompted largely by the rapid growth of industrialization in the United States during the late nineteenth and early twentieth centuries as well as the Great Depression of the 1930s, initial social insurance programs were designed to minimize the possibility of destitution for individuals who were unemployed or became severely injured while working. In addition, social insurance programs aimed to stabilize the well-being of dependent family members of injured or unemployed individuals. Further, early social insurance programs were designed to enable retirees to maintain subsistence income levels. These intents of legally

TABLE 1-2 Employer Costs per Hour Worked for Employee Compensation, Civilian Workers[a]

	Total Compensation	Wages and Salaries	All Benefits	Paid Leave	Supplemental Pay	Insurance	Retirement and Savings	Legally Required Benefits
	Cost per hour worked (in dollars)							
Civilian Workers	30.84	21.35	9.49	2.15	0.74	2.76	1.44	2.40
Occupational Group								
Management, professional, and related	51.03	35.46	15.56	4.10	1.22	4.16	2.74	3.35
Sales and office	23.11	16.24	6.88	1.48	0.47	2.30	0.79	1.83
Natural resources, construction, and maintenance	32.36	21.68	10.68	1.85	0.90	2.96	1.88	3.08
Production, transportation, and material moving	24.97	16.54	8.43	1.48	0.86	2.74	0.94	2.41
Industry Group								
Goods-producing	34.18	22.84	11.34	2.25	1.34	3.23	1.54	2.98
Service	30.28	21.10	9.17	2.13	0.64	2.68	1.42	2.30

[a] Includes workers in the private nonfarm economy excluding households and the public sector excluding the federal government.

Source: U.S. Department of Labor (March 12, 2013). Employer costs for employee compensation, December 2012 (USDL: 13-0421). Available: *www.bls.gov/ect/htm*, accessed March 31, 2013.

required benefits remain intact today. The U.S. government has established programs to protect individuals from such catastrophic events as disability and unemployment. Legally required benefits are **protection programs** that attempt to promote worker safety and health, maintain the influx of family income, and assist families in crisis. The key legally required benefits are mandated by the Social Security Act of 1935, various state workers' compensation laws, and the Family and Medical Leave Act of 1993. All provide protection programs to employees and their dependents (Chapter 11).

Employers typically spend substantial amounts to pay employees and provide benefits. Table 1-2 lists the major legally required and discretionary benefits and the typical expenses incurred by employers to offer these benefits as of December 2012.[3] This table also includes the cost of wages and salaries based on a sample of occupations and industry types. The costs are expressed on an hourly basis per employee. For example, in December 2012, employers characteristically spent $30.84 per employee per hour worked, incuding wages and salaries as well as benefits. Of this figure, $21.35 was spent on wages and salaries and $9.49 was spent on benefits ($2.40 for legally required benefits and $7.09 for discretionary benefits).

A HISTORICAL PERSPECTIVE ON COMPENSATION: THE ROAD TOWARD STRATEGIC COMPENSATION

Agriculture and small family craft businesses were the bases for the U.S. economy before the 1900s. The turn of the twentieth century marked the beginning of the Industrial Revolution in the United States. During the Industrial Revolution, the economy's transition from agrarian and craft businesses to large-scale manufacturing began. Individuals were increasingly becoming employees of large factories instead of self-employed farmers or small-business owners. This shift from the agricultural sector to the industrial sector promoted the beginnings of the field of human resource management.[4]

The factory system gave rise to divisions of labor based on differences in worker skill, effort, and responsibilities. The growth in the size of the workplace necessitated practices to guide such activities as hiring, training, setting wages, handling grievances, and terminating employment. At the time, practitioners referred to these activities as personnel administration, which is the predecessor of modern human resource management.

The early personnel (and compensation) function emphasized labor cost control and management control over labor. Many employers instituted so-called **scientific management practices** to control labor costs, as well as welfare practices to maintain control over labor. Scientific management practices gave rise to individual incentive pay systems. Welfare practices represent the forerunner of modern discretionary employee benefits practices.

Scientific management practices promoted labor cost control by replacing inefficient production methods with efficient ones. Factory owners used time-and-motion studies and job analysis to meet that objective. **Time-and-motion studies** analyzed the time it took employees to complete their jobs. These studies literally focused on employees' movements and the identification of the most efficient steps to complete jobs in the least amount of time.[5] Job analysis is a systematic process for gathering, documenting, and analyzing information in order to describe jobs. At the time, employers used job analysis to classify the most efficient ways to perform jobs.

How did scientific management methods influence compensation practices? Scientific management methods gave rise to the use of piecework plans (Chapter 4). Under piecework plans, an employee's compensation depends on the number of units she or he produces over a given period. Specifically, these plans reward employees on the basis of their individual hourly production against an objective output standard, determined by the pace at which manufacturing equipment operates. For each hour, workers receive piecework incentives for every item produced over the designated production standard.

There were also developments in the area of employee benefits during World War II. **Welfare practices** were generous endeavors undertaken by some employers, motivated in part to minimize employees' desire for union representation, to promote good management, and to enhance worker productivity. Welfare practices were "anything for the comfort and improvement, intellectual or social, of the employees, over and above wages paid, which is not a necessity of the industry nor required by law."[6] Companies' welfare practices varied. For example, some employers offered such facilities as libraries and recreational areas; others offered financial assistance for education, home purchases, and home improvements. In addition, employer sponsorship of medical insurance coverage became common. The use of welfare practices created the need to administer them. Welfare secretaries served as an intermediary between the company and its employees, and they were essentially predecessors of human resource professionals.[7]

In the 1960s, the U.S. government instituted major legislation aimed at protecting individual rights to fair treatment in the workplace. Most often, fair treatment means making employment-related decisions according to job performance—for example, awarding higher merit pay increases to better performers.

Federal laws led to the bureaucratization of compensation practice. Personnel and compensation administrators took the lead in developing and implementing employment practices that upheld the myriad federal employment laws. These professionals also maintained records, creating documentation in the event of legal challenges to employment practices. In short, compensation professionals were largely administrators who reacted to government regulation.

Personnel administration was transformed from a purely administrative function to a competitive resource in many companies during the 1980s as technology transformed the workplace and pressures from global competitors intensified. Since the early 1980s, compensation professionals have designed and implemented compensation programs that contribute to companies' competitive advantage by motivating employees to excel, learn new knowledge and skills, and take on a sense of ownership in the company.[8]

Competitive advantage describes a company's success. **Competitive advantage** refers specifically to a company's ability to maintain market share and profitability over a sustained period of several years. Employers began to recognize that employees are key resources necessary for a company's success, particularly in changing business environments characterized by rapid technological change and intense business competition from foreign countries. Employers' recognition that employees represent an important resource led to the view of employees as human resources. In line with this view, companies design human resource management practices to promote competitive advantage.

As technology leads to the automation of more tasks, employers combine jobs and confer broader responsibilities on workers. For example, the technology of advanced automated manufacturing, such as that used in the automobile industry, began doing the jobs of people, including the laborer, the materials handler, the operator-assembler, and the maintenance person. A single employee now performs all of these tasks in a position called "manufacturing technician." The expanding range of tasks and responsibilities in this job demands higher levels of reading, writing, and computation skills than did the jobs that it replaced, which required strong eye–hand coordination. Most employees must possess higher levels of reading skills than before because they must be able to read the operating and troubleshooting manuals (when problems arise) of automated manufacturing equipment that is based on computer technology. Manufacturing equipment previously had a relatively simple design, based on such easily understood mechanical principles as pulleys, and it was easy to operate.

Increased global competition has forced companies in the United States to become more productive. More than ever, companies must now provide their employees with leading-edge skills and encourage them to apply their skills proficiently to sustain a competitive advantage. Evidence suggests that workers in other countries are more skilled and able to work more productively than U.S. employees.[9] In addition, companies, particularly in Japan, adopted lean manufacturing and process development techniques that enabled workers to contribute to products of outstanding quality.

Compensation practices contribute to competitive advantage by developing more productive and highly skilled workforces. Well-designed merit pay programs reinforce excellent performance by awarding pay raises commensurate with performance attainments. The use of incentive pay practices is instrumental in changing the prevalent entitlement mentality U.S. workers have toward pay and in containing compensation costs by awarding one-time increases to base pay once work objectives have been attained. Pay-for-knowledge and skill-based pay programs are key to giving employees the necessary knowledge and skills to use new workplace technology effectively. Management can use discretionary benefit offerings to promote particular employee behaviors that have strategic value. For example, employees who take advantage of tuition reimbursement programs are more likely to contribute to the strategic imperatives of product or service differentiation and cost-reduction objectives.

Moving to the realm of executive compensation (Chapter 12) becomes quite interesting because the rules for establishing compensation and benefits for employees are cast aside for a set of unique rules that creates tremendous wealth for executives. In addition, the pay-for-performance ethic that we stress for nonexecutive employees is debated among shareholders of companies, employees, labor unions, and the government.

Compensation professionals face additional challenges, as defining who is an employee becomes complex and, as a result, who is responsible for compensating and providing benefits for nonemployees. These nonemployees are members of the growing contingent workforce in the United States. As we will learn in Chapter 13, there are multiple types of contingent workers, and the compensation and benefits issues vary with these various contingent worker classifications.

It is not surprising that the globalization of business often requires that employees be sent from their home countries (e.g., a U.S. citizen working for Microsoft) as expatriates to manage business activities throughout the world. As we will see in Chapter 14, compensation professionals must learn about the techniques for compensating expatriate employees. In addition, as U.S. companies expand their operations to the far reaches of the world, it is essential that they become familiar with the laws and norms that define compensation and benefits practices in those countries. We will review the compensation and benefits issues around the globe in Chapter 15.

STRATEGIC VERSUS TACTICAL DECISIONS

Business professionals make two kinds of decisions—strategic decisions and tactical decisions. **Strategic decisions** guide the activities of companies in the market; **tactical decisions** support the fulfillment of strategic decisions. Business professionals apply these decisions to companies' functions, including manufacturing, engineering, research and development, management information systems, HR, and marketing. For example, HR professionals make strategic compensation decisions and tactical compensation decisions. Figure 1-2 shows the relationship between strategic decisions and tactical decisions.

Strategic management entails a series of judgments, under uncertainty, that companies direct toward achieving specific goals.[10] Companies base strategy formulation on environmental scanning activities (as described later in this chapter). Discerning threats and opportunities is the main focus of environmental scanning. Strategic management is an inexact process because companies distinguish between threats and opportunities based on interpretation. A threat suggests a negative situation in which loss is likely and over which an individual has relatively little control. An opportunity implies a positive situation in which gain is likely and over which an individual has a fair amount of control.[11]

For instance, Mercedes-Benz, a manufacturer of luxury automobiles, stepped outside its typical product offerings by introducing the C230, a well-equipped hatchback model in the $25,000–$30,000 price range. Most new well-equipped Mercedes vehicles retail well above the $50,000 level and are bought by affluent individuals who are into their forties and beyond. Mercedes's offering was geared toward extending its market base to car buyers in their twenties and thirties who typically cannot afford the Mercedes price tag. Given so many fine car