BARRY GERHART | JERRY M. NEWMAN

Compensation

THIRTEENTH EDITION

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Thirteenth Edition

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Preface

You can't read a news article or blog today without someone talking about compensation (wages/salaries, but also benefits like health care and retirement). Compensation is uniquely important in organizations because it typically represents the single largest operating cost, especially where employee skills or human capital are the source of competitive advantage (e.g., Google/Alphabet, Facebook; investment banking, law, accounting, and consulting firms; professional sports teams; universities). Compensation is also important because employees regularly report it as the most important factor that goes into their decision of whether to take a job or stay in a job. Compensation also plays a major role in what employees choose to do on the job: their effort level, where they direct their effort/what goals they pursue, how cooperative they are, how flexible they are, how ethical they are, and so forth. These all add up to determine how efficient, innovative, customer-oriented and (in the case of for-profit) how profitable an organization is over time. Profits, in turn, create jobs. In the absence of profits, jobs disappear. An organization that pays too much, pays too little, ties too much compensation up as fixed costs, and/or pays for the wrong things puts the company, its investors, and its employees at risk. On the other hand, designing and executing an effective compensation strategy can play a key role in great shared success.

Compensation challenges ebb and flow with changes in the economy. The Financial Crisis of 2008 and the related Great Recession brought job cuts (with the national unemployment rate rising to 10 percent, the highest since 1983), reduced hours, reduced employer contributions to 401(k) retirement plans, reduced bonus/profit-sharing payments, and some wage cuts. With revenue and profits down and with labor costs often the single largest operating cost, employers cut labor costs in these ways. The Great Recession also focused attention on executive compensation. As the government bailed out the financial industry, newspapers were reporting large bonuses going to the very executives who helped cause the financial disaster. Eventually, as company revenues picked up again, we gradually saw employers put less emphasis on cutting labor costs and more emphasis on hiring. However, job growth was initially quite modest. At the beginning of 2013, the unemployment rate was still at 8 percent. Why? Employers have become increasingly careful about adding new workers because they want to keep costs under control and they don't want to have to reduce the workforce if they guess wrong about increasing revenue growth/product demand (and the need for more workers). But competition for some types of workers has increased and wages, salaries, and benefits have likewise increased for such workers, meaning that employers must continually evaluate and benchmark their pay to be competitive. As economic growth has continued, competition for employees has increased and the U.S. unemployment rate is now under 4 percent, the lowest it has been since 1969. However, as we will see, wage gains remain modest. That is because employers are careful not only about hiring, as we have noted. They are also careful about giving wage/salary increases because once those are added to base pay, "they are there forever." Increasingly, employers seek to make labor costs variable, which means greater reliance on bonuses and/or profit-sharing, where payments to employees go up during good times, but automatically go down during bad times when profits and revenues are down.

Pay also matters around the globe. To take a (bit light) example, if you were a Russian cosmonaut, you could earn a bonus of $1,000 for every space walk you took (technically known as "extravehicular activity"), up to three per space trip. A contract listing specific tasks to be done on a space mission permits you to earn up to $30,000 above the $20,000 you earn while you are on the ground. Conclusion: *Pay matters.*

(As a small aside, in contrast to the Russian cosmonauts, wealthy Americans had the opportunity to pay many millions to the Russian Space Agency for their own personal extravehicular activity. More recently, Elon Musk's company, SpaceX, has announced planned trips not only to the moon, but also to Mars. Musk is aiming for a cost of $200,000 per person, but some of his projections in the past have not been completely accurate.)

After you have read this book, you will also better understand that *what you pay for matters.* Many years ago, when Green Giant discovered too many insect parts in the pea packs from one of its plants, it designed a bonus plan that paid people for finding insect parts. Green Giant got what it paid for: insect parts. Innovative Green Giant employees brought insect parts from home to add to the peas just before they removed them and collected the bonus.

The Houston public school district also got what it paid for when it promised teachers bonuses of up to $6,000 if their students' test scores exceeded targets. Unfortunately, several teachers were later fired when it was discovered that they had leaked answers to their students and adjusted test scores. Teachers were motivated to raise test scores, just not to raise them in the way desired (improved student learning). Wells Fargo wanted customers to sign up for more of its products to increase its potential for revenue and profit growth. To achieve this goal, Wells Fargo incentivized its employees so they would be rewarded for achieving this goal (and/or penalized if they did not achieve it). This incentive certainly "worked," if you think this includes employees setting up fake accounts, which the customers did not sign up for, in order to achieve their targets for performance (new account sign-ups). Again, employees were motivated to achieve the outcome, but not necessarily in the appropriate way.[1]

Such problems are global. A British telephone company paid a cash bonus to operators based on how quickly they completed requests for information. Some operators discovered that the fastest way to complete a request was to give out a wrong number or—even faster—just hang up on the caller. "We're actually looking at a new bonus scheme," says an insightful company spokesperson. Conclusion: *What you pay for matters.*

After you have read this book, you will also have learned that *how you pay matters.* Motorola ended its old-fashioned pay system that employees said guaranteed a raise every six months if you were still breathing. The new system paid for learning new skills and working in teams. Sound good? It wasn't. Employees resented those team members who went off for six weeks of training at full pay while remaining team members picked up their work. Motorola was forced to get rid of its new-fashioned system, too.

[1] E. Glazer, "Wells Fargo to Roll Out New Compensation Plan to Replace Sales Goals: Bankers Say Previous Lofty Goals Pushed Them to Open Accounts without Customers' Knowledge," *Wall Street Journal,* January 6, 2017.

Wells Fargo also, not surprisingly, had to change *how* it pays and *what* it pays for.[2] Specific changes made include:

- No product sales goals.
- Performance evaluation based on customer service, usage and growth, not simply on new accounts opened.
- Incentives associated with direct customer feedback and product usage.
- A higher percentage of employee compensation comprised of base salary, rather than variable incentives.
- More employee performance metrics focused on the goals of a given bank branch, instead of on an individual worker.

To summarize, compensation is a powerful tool that has major consequences for the success or failure of an organization. Our aim is to put you in a better position to design and/or execute compensation strategies to make success more likely. That will be helpful whatever the scale and scope of your responsibility, from a unit of a few employees to an entire organization. Our book will also help you better understand how your own compensation is managed and how that can help you achieve your own career goals.

ABOUT THIS BOOK

This book focuses on the strategic choices in managing compensation. We introduce these choices, real-world issues that managers confront from New York to New Zealand and all points between, in the total compensation model in Chapter 1. This model provides an integrating framework that is used throughout the book. Major compensation issues are discussed in the context of current theory, research, and practice. The practices illustrate new developments as well as established approaches to compensation decisions.

We live in interesting times. Anywhere you look on the globe today, economic and social pressures are forcing managers to rethink how people get paid and what difference it makes. Traditional approaches to compensation are being questioned. But what is being achieved by all this experimentation and change? What is merely fad and fashion, and what, instead, is supported by the evidence? In this book, we strive to separate beliefs from facts, wishful thinking from demonstrable results, and opinions from research. Yet when all is said and done, managing compensation is part science, but also part art.

Each chapter contains at least one *e-Compensation box* to point you to some of the vast compensation information on the Internet. Real-life *Your Turn* cases ask you to apply the concepts and techniques discussed in each chapter. For example, the Your Turn in Chapter 9 draws on Professor Newman's experience when he worked undercover for 14 months in seven fast-food restaurants. The case takes you into the gritty details of the employees' behaviors (including Professor Newman's) during rush hour, as they desperately worked to fill customers' orders and meet their own performance targets set by their manager. You get to recommend which rewards will improve employees' performance (including Professor Newman's) and customers' satisfaction. We tackle major compensation issues from three sides: theory, research, and practice—no problem can survive that onslaught!

[2] Kevin McCoy, "Wells Fargo Revamps Pay Plan after Fake-Accounts Scandal," *USA Today,* January 11, 2017.

The authors also publish *Cases in Compensation,* an integrated casebook designed to provide additional practical skills that apply the material in this book. The casebook is available directly from the authors (e-mail: cases.in.compensation@gmail.com). Completing the integrated cases will help you develop skills readily transferable to future jobs and assignments. Instructors are invited to e-mail for more information on how *Cases in Compensation* can help translate compensation research and theory into practice and build competencies for on-the-job decisions.

But *caveat emptor!* "Congress raises the executive minimum wage to $565.15 an hour," reads the headline in the satirical newspaper *The Onion* (www.onion.com, "America's Finest News Source"). The article says that the increase will help executives meet the federal standard-of-easy-living. "Our lifestyles are expensive to maintain," complains one manager. Although the story in *The Onion* may clearly be fiction, sometimes it is more difficult to tell. One manager told us that when she searched for this textbook in her local bookstore, store personnel found the listing in their information system—under fiction!

WHAT'S NEW

All chapters have been revised, in recognition of ongoing changes at organizations and in their competitive environments around the world. Many examples are provided of the current pay strategies or practices used in specific, named companies. Some of these are well established and successful (Apple, IBM, Microsoft, Merrill Lynch, Nucor, Toyota), some face real problems (American Airlines, Best Buy, General Motors), and others are using unique practices (Google, Whole Foods). Whenever possible, we observe how the challenges faced by these companies have evolved over time. This edition continues to emphasize the importance of total compensation and its relevance for achieving sustainable competitive advantage. It reinforces our conviction that beyond *how much* people are paid, *how* they are paid really matters. Managing pay means ensuring that the right people get the right pay for achieving objectives in the right way. Greater emphasis is given to theoretical advances and evidence from research. Throughout the book we translate this evidence into guidance for improving the management of pay.

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A very special thanks goes to **George T. Milkovich**, who was the lead author on the first 11 editions of *Compensation*. George has long been our mentor, colleague, and friend. His influence on us and on *Compensation* continues.

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Part **One**

Introducing the Pay Model and Pay Strategy

Why do we work? If we are fortunate, our work brings meaning to our lives, challenges us in new and exciting ways, brings us recognition, and gives us the opportunity to interact with interesting people and create friendships. Oh yes—we also get a paycheck. Here in Part 1 of your book, we begin by talking about what we mean by "pay" and how paying people in different ways can influence them and, in turn, influence organization success. Wages and salaries, of course, are part of compensation, but so too, for some employees, are bonuses, health care benefits, stock options, and/or work/life balance programs.

Compensation is one of the most powerful tools organizations have to influence their employees. Managed well, it can play a major role in organizations successfully executing their strategies through their employees. We will see how companies like Whole Foods, Nucor, the SAS Institute, Microsoft, Google, and others use compensation to attract, motivate, and retain the right employees to execute their strategies. We will also see how companies like Apple sell premium products at attractive price points, to an important degree by using suppliers that have low labor costs. When they are managed less well—as bankruptcies at General Motors, Chrysler, Lehman Brothers, and American Airlines (which stated at the time that it needed to reduce labor costs by $1.25 billion per year to be competitive), for example, might indicate—compensation decisions can also come back to haunt you. In Part 1, we describe the compensation policies and techniques that organizations use and the multiple objectives they hope to achieve by effectively managing these compensation decisions.

Although compensation has its guiding principles, we will see that "the devil is in the details"—how a compensation program is specifically designed and implemented will help determine its success. We want you to bring a healthy skepticism when you encounter simplistic or sweeping claims about whether a particular way of managing compensation does or does not work. For example, organizations, in general, benefit from pay for performance, but there are many types of pay-for-performance programs, and it is not always easy to design and implement a program that has the intended consequences (and avoids *unintended* consequences). So, general principles are helpful, but only to a point.

Thus, in Part 1, our aim is to also help you understand how compensation strategy decisions interact with the specific context of an organization (e.g., its business and human resource strategies) to influence organization success. We emphasize that good theory and research are fundamental, not only to understanding compensation's likely effects, but also to developing that healthy skepticism we want you to have toward simplistic claims about what works and what does not.

Chapter **One**

The Pay Model

Chapter Outline

COMPENSATION: DOES IT MATTER? (OR, "SO WHAT?")

Why should you care about compensation? Do you find that life goes more smoothly when there is at least as much money coming in as going out? (Refer, for example, to the lyrics for the Beatles' song "Money."[1] To exaggerate a bit, they say something like: Money doesn't buy everything, but if money can't buy it, I can't use it.) Of course, it is the same for companies. It really does help to have as much money coming in (actually, more is better) as going out. Until recently, production workers at Chrysler received total compensation (i.e., wages plus benefits) of about $76 per hour. U.S. workers doing the same jobs at Toyota received $48 per hour, and the average total compensation per hour in U.S. manufacturing was $25 (and $16 in Korea, $3 in Mexico). It is one thing to pay more than your competitors if you get something more (e.g., higher productivity and/or quality) in return. But Chrysler was not. So its "strategy" was not sustainable. Chrysler ended up going through bankruptcy, being bought out by Fiat, and then reducing worker compensation costs as part of its strategy for a return to competitiveness. Specifically, Chrysler took steps (as part of its bankruptcy plan) to bring its hourly labor costs down to about $49.[2]

General Motors (GM), like Chrysler, has for decades paid its workers well—too well, perhaps, for what it received in return. So what? Well, in 1970, GM had 150 U.S. plants and 395,000 hourly workers. In sharp contrast, GM now has 35 U.S. manufacturing plants and 57,000 U.S. hourly workers.[3] In June 2009, GM, like Chrysler, had to file for bankruptcy (avoiding it for a while thanks to loans from the U.S. government—i.e., you, the taxpayer). Not all of GM's problems were compensation related. Building too many vehicles that consumers did not want was also a problem. But having labor costs higher than the competition's, without corresponding advantages in efficiency, quality, and customer service, does not seem to have served GM or its stakeholders well. Its stock price peaked at $93.62/share in April 2000. Its market value was about $60 billion in 2000. That shareholder wealth was wiped out in bankruptcy. Think also of the billions of dollars the U.S. taxpayer had to put into GM. Think of all the jobs that have been lost over the years and the effects on communities that have lost those jobs.

On the other hand, Nucor Steel pays its workers very well, relative to what other companies inside and outside of the steel industry pay. But Nucor also has much higher productivity than is typical in the steel industry. The result: Both the company and its workers do well. Apple Computer is able to reduce the prices for its iPads and iPhones by outsourcing manufacturing to China in facilities owned by the Hon Hai Precision Industry Co., Ltd. (Foxconn), a Taiwanese company. (See Chapter 7.) As we will see later, doing so generates billions (yes, billions with a "b") of dollars in cost savings per year. Google and Facebook are companies that are known for paying very well. So far that seems to have worked, in that their high pay allows them to be very selective in who they hire and who they keep, and they would say that their talent-rich strategy has helped them to foster growth and innovation.

Wall Street financial services firms and banks used **incentive** plans that rewarded people for developing "innovative" new financial investment vehicles and for taking risks to earn a lot of money for themselves and their firms.[4] But several years ago, the markets discovered that many such risks had gone bad. Blue chip firms such as Lehman Brothers slid quickly into bankruptcy, whereas others, like Bear Stearns and Merrill Lynch, survived to varying degrees by finding other firms (J.P. Morgan and Bank of America, respectively) to buy them. The issue has not gone away. U.S. Federal Reserve officials have "made it clear that they believe bad behavior at banks goes deeper than a few bad apples and are advising firms to track warning signs of excessive risk taking and other cultural breakdowns." In the words of one Fed official, "Risk takers are drawn to finance like they are to Formula One racing." An important driver of risk taking among traders and others is the incentive system that encourages them to be "confident and aggressive" and that often results in those who thrive under this incentive rising to top leadership positions at the banks.[5]

Does greater expertise in the design and execution of compensation plans help control excessive risk taking and other problematic behaviors and encourage a more positive culture? Congress and the president seemed to think so, because in hopes of avoiding a similar financial crisis in the future they put into place legislation—the Troubled Asset Relief Program (TARP)—that included restrictions on executive pay that were designed to discourage executives from taking "unnecessary and excessive risks." One commentator agreed. In an opinion piece in *The Wall Street Journal,* entitled "How Business Schools Have Failed Business," the former director of corporate finance policy at the United States Treasury argued that misaligned incentives were a major cause of the global financial crisis (see above) and wondered how many of the business schools that educated top executives and directors included a course on how to design compensation systems. His answer: not many.[6] Our book, we hope, can play a role in helping to better educate you, the reader, about the design of compensation systems, both for managers and for workers.

How people are paid affects their behaviors at work, which affect an organization's success.[7] For most employers, compensation is a major part of total cost, and often it is the single largest part of operating cost. These two facts together mean that well-designed compensation systems can help an organization achieve and sustain competitive advantage. On the other hand, as we have recently seen, poorly designed compensation systems can likewise play a major role in undermining organization success.

COMPENSATION: DEFINITION, PLEASE

How people view compensation affects how they behave. It does not mean the same thing to everyone. Your view will probably differ depending on whether you look at compensation from the perspective of a member of society, a stockholder, a manager, or an employee. Thus, we begin by recognizing different perspectives.

Society

Some people see pay as a measure of justice. For example, a comparison of earnings between men and women highlights what many consider inequities in pay decisions. In 2016, U.S. Bureau of Labor Statistics data indicated that, among full-time workers in the United States, women earned 82 percent of what men earned, up from 62 percent in 1979.[8] If women had the same education, experience, and union coverage as men and also worked in the same industries and occupations, the ratio would increase, but most evidence suggests that no more than one-half of the gap would disappear. Thus, even under such a best-case scenario the ratio of women's earnings to men's would be about 90 percent, still leaving a sizable gap.[9] Society has taken an interest in such earnings differentials. One indicator of this interest is the introduction of laws and regulations aimed at eliminating the discrimination that causes them.[10] (See Chapter 17.)

Benefits given as part of a total compensation package may also be seen as a reflection of equity or justice in society. Civilian employers spend about 46 cents for benefits on top of every dollar paid for **wages** and **salaries.** (State and local government employers pay even more: 60 cents in benefits on top of every wage dollar.)[11] Individuals and businesses in the United States spend $3.5 trillion per year, or about 18 percent of U.S. economic output (gross domestic product) on health care.[12] Nevertheless, 27.6 million people in the United States (over 8 percent of the population) have no health insurance.[13] (Prior to implementation of The Affordable Care Act of 2010, 44 million were uninsured.)[14] A major reason is that the great majority of people who are under the age of 65 and not below the poverty line obtain health insurance through their employers, but small employers, which account for a substantial share of employment, are much less likely than larger employers to offer health insurance to their employees. As a result, the great majority of uninsured in the United States are from working families. (Of the uninsured, 85 percent have a full-time worker in the family and another 11 percent have a part-time worker in the family.)[15] Given that those who do have insurance typically have it through an employer, it also follows that whenever the unemployment rate increases, health care coverage declines further. (Some users of online dating services provide information on their employer-provided health care insurance. Dating service "shoppers" say they view health insurance coverage as a sign of how well a prospect is doing in a career.)

Job losses (or gains) within a country over time are partly a function of relative labor costs (and productivity) across countries. People in the United States worry about losing manufacturing jobs to Mexico, China, and other nations. (Increasingly, white-collar work in areas like finance, computer programming, and legal services is also being sent overseas.) Exhibit 1.1 reveals that hourly compensation (wages plus benefits) for Mexican manufacturing work ($3.91) is about 10 percent of the compensation paid in the United States ($36.34). China's estimated $5.45 per hour is about 14 percent of the U.S. rate. However, the value of what is produced also needs to be considered. Productivity in China is 24 percent of that of U.S. workers, whereas Mexican worker productivity is 34 percent of the U.S. level. Finally, if low wages are the goal, there always seems to be somewhere that pays less. Some companies (e.g., Coach) are now moving work out of China because its hourly wage, especially after recent increases, is not as low as in countries like Vietnam, India, and the Philippines. However, for other companies—such as Foxconn, which builds iPhones and iPads for Apple—even with rapid increases in wages in China, labor costs remain very low in China compared to those in the United States and other advanced economies. Foxconn appears to be poised to continue having a larger presence in China.[16] (More recently, Foxconn has also announced it will build a major new presence in southeast Wisconsin. Reasons include proximity to the U.S. market, as well as major incentives provided by the State of Wisconsin. We return to the topic of international comparisons in Chapter 7 and Chapter 16.)

EXHIBIT 1.1 Hourly Compensation Costs for Production Workers in Manufacturing and Economy-Wide Productivity (Gross Domestic Product [GDP] per Employed Person), in U.S. Dollars

	Hourly Compensation Cost	Productivity (GDP per employee)
China	5.45	27,196
Mexico	3.91	38,306
Czech Republic	10.71	65,467
United States	39.03	113,922
Germany	43.18	89,309

Source: "Hourly Compensation Cost: The Conference Board. International Comparisons of Hourly Compensation Costs in Manufacturing, 2016," February 16, 2018. Productivity (projected for 2017): The World Bank, http://data.worldbank.org/indicator/SL.GDP.PCAP.EM.KD, retrieved March 15, 2018.

Notes: Compensation includes wages and benefits. The most recent Conference Board compensation cost was $4.11 (in 2013) for China. The 2016 estimate for China was obtained by inflating the Conference Board estimates based on data on annual average wage growth in urban units from the China Statistical Yearbook, Table 4-12, National Bureau of Statistics of China. Productivity is gross domestic product (GDP), in constant 2011 PPP $, divided by total employment in the economy. Purchasing power parity (PPP) GDP is GDP converted to 2011 constant international dollars using PPP rates. (As such, these GDP per employee numbers are higher than past estimates using 1990 constant international dollars using PPP rates.) An international dollar has the same purchasing power over GDP that a U.S. dollar has in the United States.

Some consumers know that pay increases often lead to price increases. They do not believe that higher labor costs benefit them. But other consumers lobby for higher wages. While partying revelers were collecting plastic beads at New Orleans' Mardi Gras, filmmakers were showing video clips of the Chinese factory that makes the beads. In the video, the plant manager describes the punishment (5 percent reduction in already low pay) that he metes out to the young workers for workplace infractions. After viewing the video, one reveler complained, "It kinda takes the fun out of it."[17]

Stockholders

Stockholders are also interested in how employees are paid. Some believe that using stock to pay employees creates a sense of ownership that will improve performance, which in turn will increase stockholder wealth. But others argue that granting employees too much ownership dilutes stockholder wealth. Google's stock plan cost the company $600 million in its first year of operation. So people who buy Google stock (stockholders) are betting that this $600 million will motivate employees to generate more than $600 million in extra stockholder wealth.

Stockholders (also called shareholders) have a particular interest in executive pay.[18] (Executive pay will be discussed further in Chapter 14.)[19] To the degree that the interests of executives are aligned with those of shareholders (e.g., by paying executives on the basis of company performance measures such as shareholder return), the hope is that company performance will be higher. There is debate, however, about whether executive pay and company performance are strongly linked in the typical U.S. company.[20] In the absence of such a linkage, concerns arise that executives can somehow use their influence to obtain high pay without necessarily performing well. Exhibit 1.2 provides descriptive data on chief executive officer (CEO) compensation. Note the large numbers (total annual compensation of $11.5 million) and also that the bulk of compensation (stock-related) is connected to shareholder return or other (primarily short-term, or one year or less) performance measures (bonus). As such, one would expect changes in CEO wealth and shareholder wealth to generally be aligned. We will return to this topic in more depth in Chapter 14.

EXHIBIT 1.2 **Annual Compensation of Chief Executive Officers, U.S. (S&P 500) Public Companies**

	Median
Compensation Component	
Salary	$ 1,200,000
Bonus	$ 2,100,000
Perquisites	$ 171,000
Stock Awards	$ 5,800,000
Stock Option Awards	$ 666,000
Total Annual Compensation	$11,700,000

Source: The Associated Press. How AP and Equilar Calculated CEO Pay. AP News, May 26, 2018. https://apnews.com/a3d216dc488347b8b9b23651b5f08e31

Notes: *N* = 339 chief executive officers in that role for at least two years at an S & P 500 company. Because medians are used, compensation components do not add up to equal total annual compensation.

In Chapter 14 we will suggest that, on average, CEO interests and shareholder interests appear to be significantly aligned, but there are important exceptions and it is certainly an ongoing challenge to ensure that executives act in the best interest of shareholders. For example, during the meltdown in the financial services industry, top executives at Bear Stearns and Lehman Brothers regularly exercised stock options and sold stock during the period 2000–2008 prior to the meltdown. One estimate is that these stock-related gains plus bonus payments generated $1.4 billion for the top five executives at Bear Stearns and $1 billion for those at Lehman Brothers during the 2000–2008 period. "Thus, while the long-term shareholders in their firms were largely decimated, the executives' performance-based compensation kept them in positive territory." The problem here is that shareholders paid a huge penalty for what appears to have been overly aggressive risk-taking by executives, but the executives, in contrast, did quite well because of "their ability to claim large amounts of compensation based on short-term results."[21]

Shareholders can influence executive compensation decisions in a variety of ways (e.g., through shareholder proposals and election of directors in proxy votes). In addition, the Dodd–Frank Wall Street Reform and Consumer Protection Act (see Chapter 14) was signed into law in 2010. Among its provisions is "say on pay," which requires public companies to submit their executive compensation plan to a vote by shareholders. The vote is not binding. However, companies seem to be intent on designing compensation plans that do not result in negative votes. In addition, clawback provisions (designed to allow companies to reclaim compensation from executives in some situations) are available under Dodd-Frank and have also been adopted in stronger form by some companies.[22]

Managers

For managers, compensation influences their success in two ways. First, it is a major expense that must be managed. Second, it is a major determinant of employee attitudes and behaviors (and thus, organization performance). We begin with the cost issue. Competitive pressures, both global and local, force managers to consider the affordability of their compensation decisions. Labor costs can account for more than 50 percent of total costs. In some industries, such as financial or professional services and in education and government, this figure is even higher. However, even within an industry, labor costs as a percentage of total costs vary among individual firms. For example, small neighborhood grocery stores, with labor costs between 15 percent and 18 percent, have been driven out of business by supermarkets that delivered the same products at a lower cost of labor (9 percent to 12 percent). Supermarkets today are losing market share to the warehouse club stores such as Sam's Club and Costco, which enjoy an even lower cost of labor (4 percent to 6 percent), even though Costco pays wages that are above average for the industry. And, now Amazon has entered the grocery business by purchasing Whole Foods, which is expected to cause further cost reductions and disruption.

Exhibit 1.3 compares the hourly pay rate for retail workers at Costco to that at Walmart and Sam's Club (which is owned by Walmart). Each store tries to provide a unique shopping experience. Walmart and Sam's Club compete on low prices,

EXHIBIT 1.3 **Pay Rates at Retail Stores, Customer Satisfaction, Employee Turnover, and Sales/Square Ft.**

	Average Pharmacy Tech Annual Wage	Average Stocker Hourly Wage	Average Cashier Hourly Wage	Customer Satisfaction (100 = highest)	Employee Annual Turnover	On Best Employer List?	Stores	Revenues	Store Size Average (Sq. ft.)	Number of Employees	Revenue per (Sq. ft.)	Revenues per Employee
Costco	$ 45,239	$13.00	$14.00	83	lower	Yes[b]	741	$126 billion	144,804	239,000	$1,176	$528,033
Sam's Club		$11.00[a]	$10.00	80			660	$ 57 billion	133,333	—	$ 652	—
Walmart	$ 29,352	$10.00	$9.00	71	higher	No	11,035	$424 billion	97,508	—	$ 394	—
Walmart + Sam's Club							11,695	$481 billion	99,530	2,300,000	$ 414	$209,268

Sources: Customer Satisfaction data from American Customer Satisfaction Index TM, http://www.theacsi.org/, retrieved March 27, 2017; Annual Turnover after 4 Years from Liza Featherstone, "Wage against the Machine," *Slate*, June 27, 2008; Number of Stores, Revenues, Store Size, Number of Employees from Wal-Mart 2017 10-K (Annual Report) and Costco 2017 10-K (Annual Report); Average Wage from www.glassdoor.com, retrieved March 27, 2017.

[a]Estimated.
[b]#1 on Forbes list.