

31.13: Compensation

Learning Objectives

- Summarize different forms of employee compensation



People talk about loving or hating their job, but do they ever mean that they love or hate how much compensation they receive for the job that they perform? Can someone pay you enough to take on jobs like Mike Rowe did on his television show, *Dirty Jobs*? How much an employee or manager is paid and the different ways that their compensation can be structured is an area in which HR managers find themselves competing with other employers. As the business environment become more complex, so do the forms of employee financial compensation. From a business standpoint, employee compensation can be thought of as the cost of acquiring human resources for running operations.

Salary

A salary is a form of compensation paid periodically by an employer to an employee, the amount and frequency of which may be specified in an employment contract. In general, employees paid a salary do not “punch a clock,” and they work however many hours are necessary to accomplish organizational goals and objectives. Most managers are paid a salary that is calculated in terms of annual, monthly, or weekly earnings instead of hourly pay. U.S. employment law distinguishes between exempt (salaried) and nonexempt (hourly) workers. Employers can require exempt employees to work long hours without paying overtime.

Today, the idea of a salary continues to evolve as part of a system of all the combined rewards that employers offer to employees. Salary is coming to be seen as part of a “total rewards” system, which includes bonuses, incentive pay, commissions, benefits, perks, and various other tools that help employers link rewards to an employee’s measured performance.

Something that has become increasingly common is to offer salaried employees options to purchase stock in the company. An employee stock option (ESO) is a call option on the common stock of a company, granted by the company to an employee as part of the employee’s compensation package. The objective is to give employees an incentive to behave in ways that will boost the company’s stock price. In many cases, the ESO represents an amount considerably higher than the employee’s base salary. For example, in 2015 Satya Nadella, CEO of Microsoft, was paid a salary of \$4.5 million, but his stock options earned him an additional \$79.8 million.

Wage Systems

Wage payment systems offer another means by which organizations compensate employees. Unlike salary, wage systems are based on either hours worked or some other measure of production. Some of the most common wage systems are the following:

- **Time rate:** Under this system, a worker is paid by the hour for time worked. Time worked beyond a set amount (generally 40 hours per week) is paid as “overtime” and at a higher base hourly wage, usual 1 1/2 times higher.
- **Differential time rate:** According to this method, different hourly rates are fixed for different shifts or different assignments. The most common differential time rate occurs in production facilities where workers who are assigned to a graveyard shift (e.g., 11:00 p.m.–7:00 a.m.) are paid a “shift differential” that can range from a few cents to many dollars per hour.
- **Payment by piecework:** The worker’s wages depends on his or her output and the rate of each unit of output; it is in fact independent of the time taken by the worker. In other words, for every “piece” a worker produces, he or she is paid a set amount. This type of pay has fallen out of favor with many businesses since it emphasizes quantity over quality. That said, today’s “gig economy” relies on a kind of payment by piecework. According to Uber, the company’s drivers are independent contractors, receiving payment for each trip.

Hybrid Wage Systems



Figure 31.13.1: Piecework system: A family in New York City making dolls' clothes by piecework in 1912. Each family member earns money based on how many pieces he or she produces.

Some employees' positions are structured in a way that doesn't fit with conventional salary or wage systems. In these cases, employers pay their employees by a "hybrid method." Hybrid wage systems are most common in sales positions or management positions. The most common hybrid wage systems are the following:

- **Straight Commission.** Under a straight commission system, the employee receives no compensation from their employer unless they close a sale or transaction. Real-estate agents and car sales staff are two of the best-known examples of professions in which straight commission is the standard form of compensation. One hundred percent of such employees' compensation is dependent upon selling the customer a product, good, or service. This approach to compensation has fallen out of favor in many businesses because it can lead to salespeople to make high-pressure sales—putting undue pressure on customers to buy something so the salesperson can get paid.
- **Salary plus commission.** Similar to the straight commission, salary plus commission requires an employee to make a sale or "close a deal" in order to earn compensation. However, only a portion of the employee's compensation comes from the commission. The employer pays the employee some level of wages every pay period, regardless of his or her sales level. This reduces the necessity for high-pressure sales tactics, so long as the base salary is an adequate wage. Wait staff are essentially paid salary plus commission (they receive an hourly wage plus tips), but the hourly wage for such work can be as little as \$2.10 per hour.
- **Salary plus bonus.** When an employee is paid a salary plus bonus, the bonus is not paid unless sales-volume or production goals are met or exceeded. For example, the manager of a real-estate firm may be paid a substantial salary but will earn a bonus only if the office he or she manages exceeds some pre-established sales figure for the month, quarter, or year. The advantage of a salary plus bonus is that it's tied to the performance of a department or division, thereby motivating the entire team to work together to reach organizational goals or sales targets.

Benefits

Compensation includes more than just salary, and benefits are a key legal, motivational, and organizational consideration when it comes to employee relations. Standard benefits address a range of employee needs, and they can be a key reason for employees to seek out employers who offer them. Human resource professionals must familiarize themselves with the various benefit options that are out there. The following lists the most common types of benefits:

- **Relocation assistance:** Often enough, hiring someone means moving the new employee to a different location. The talent an employer needs may come from another city or country, and attracting the right person may entail providing assistance with visas, housing, flights, and a range of other moving costs.
- **Medical, prescription, vision, and dental plans:** Particularly in countries with poor social benefits (such as the U.S.), medical insurance is a necessity for employers hiring full-time workers (sometimes it's even legally required). In countries with strong social welfare systems (such as Canada), these benefits are provided by the government.
- **Dependent care:** Many employees obtain health insurance coverage through their employer not only for themselves but for their spouse and/or children, too.
- **Retirement benefit plans (pension, 401(k), 403(b)):** Larger employers usually offer employees various retirement-related benefits such as long-term investments, pensions, and other savings for retirement. The primary draw for most of these benefits is the tax benefit (the ability to set aside pretax income for retirement savings).
- **Group term life and long-term care insurance plans:** Life insurance and long-term care are benefits paid by employers to insure individuals against various types of risks and disasters. Employees with life insurance or long-term care insurance will see their dependents (and themselves, in the case of long-term care) financially supported if a serious ailment or tragedy occurs.

- **Legal assistance plans:** Not quite as standard as the rest of the benefits above, legal assistance plans can be established for jobs in which personal liability is high. Legal assistance is expensive, and such plans draw on organizational resources to cover the employee under circumstances when legal aid is needed.
- **Child care benefits:** Supporting employees' families is absolutely critical to retaining great talent. Especially in families with two working parents, employer-covered child care is a key benefit that provides cost savings to the employee while enabling the employee to focus on work (which benefits the employer).
- **Transportation benefits:** Another common benefit is paid transportation. Particularly in countries/regions where public transportation is the norm, it's quite common for the employer to pay for all work-related transportation.
- **Paid time off (PTO) in the form of vacation and sick pay:** All organizations must provide paid time off, vacation, and sick pay under certain circumstances. Many countries have stringent legislation governing minimum requirements for paid time off and vacation leave to ensure that employees have a healthy work-life balance.

While there are other, less common benefits that employers can offer, the list above describes the standard benefits that employees can expect to encounter.

Fringe Benefits



Figure 31.13.2: One of the perks this lifeguard enjoys is the use of a company car.

The term *fringe benefits* was coined by the War Labor Board during World War II to describe the various indirect benefits that industry had devised to attract and retain labor when direct wage increases were prohibited. The term perks (from “perquisites”) is often used colloquially to refer to those benefits of a more discretionary nature.

Perks are often given to employees who are doing notably well or have seniority or particularly high-value skills. Common perks are hotel stays, free refreshments, leisure activities on work time, stationery, allowances for lunch, and use of a company vehicle. When numerous options are available, select employees may also be given first choice on such things as job assignments and vacation scheduling. They may also be given first chance at job promotions when vacancies exist.

Benefits may also include formal or informal employee discount programs that grant workers access to specialized offerings from local and regional vendors (e.g., movies and theme-park tickets, wellness programs, discounted shopping, hotels and resorts, and so on). Companies that offer these types of work-life perks seek to increase employee satisfaction, boost loyalty and minimize turnover by providing valued benefits that go beyond a base salary. Fringe benefits are thought of as the costs of keeping employees (besides, of course, salary).

? Practice Question

<https://assessments.lumenlearning.com/assessments/14522>

Contributors and Attributions

CC licensed content, Original

- Revision and adaptation. **Authored by:** Linda Williams and Lumen Learning. **License:** [CC BY-SA: Attribution-ShareAlike](#)
- Practice Question. **Authored by:** Nina Burokas. **Provided by:** Lumen Learning. **License:** [CC BY: Attribution](#)

CC licensed content, Shared previously

- Compensation. **Authored by:** Boundless Business. **Provided by:** Boundless. **Located at:** <https://courses.lumenlearning.com/boundless-business>. **License:** [CC BY-SA: Attribution-ShareAlike](#)

- The Bait. **Authored by:** nist6dh. **Located at:** <https://www.flickr.com/photos/53801255@N07/7995656412/>. **License:** *CC BY-SA: Attribution-ShareAlike*

31.13: Compensation is shared under a [not declared](#) license and was authored, remixed, and/or curated by LibreTexts.