More on Compensation

- Compensation based on inputs or outputs
  - Pay by the hour or
  - Pay by the job

Inputs or Outputs

- Pay by Inputs
  - You get paid by the hour or month
- Pay by Outputs
  - You get paid by output.

Piecework

- Piecework seems the way to go where it is easy to measure productivity.
- There are situations where monitoring is quite difficult.
  - Suppose you pay a lettuce picker by the pounds of lettuce picked.
  - Workers will not look at the quality of heads and will overlook smaller heads.
Piecework

• Output is stochastic.
  – A salesman’s success depends in part on skills and motivation (which argues for piecework) and in part on factors beyond his control
  – A risk averse salesman will prefer not to be paid on output.

Piecework

• An aside
  • Any waiter or waitress would prefer to work weekends: the tips are better.
  • A sensible restaurant requires that all wait staff work weekdays as well

Piecework

• Work is often a team effort.
  – Workers paid strictly on piecework may not maximize total output.
  • In sum, the choice of how to pay workers is not straightforward.

Piecework

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Using Wage Policy as an Incentive Mechanism

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Using Wage Policy as an Incentive Mechanism

- Suppose I have employees whose performance is difficult to monitor.
- Pay a premium, where they lose the premium if they are caught mis-performing.
  - Police officers
  - McDonald’s Franchises
  - Bank Tellers

An Example

- John Smith and Bill Wilson are both product managers for Baker Electronics.

An Example

- They know that when a senior product manager’s slot opens, it will be filled by “promotion from within”.

An Example

- That way they are best motivated to do their job.
  - Smith and Wilson can be paid the same salary, even though Smith is a better worker.
  - There will be a little griping about salary, but Smith will get his reward through a promotion.

An Example

- Now suppose that it appears that Smith is the better worker, but it may take a year or two before that is clear.
  - Smith has brought in all sorts of profitable clients for the firm. He deserves a reward of (say) $25,000 for that.
  - It may turn out however that the clients will turn out to be unprofitable, perhaps because Smith made promises that can be kept only at high cost.
An Example

• Why not give Smith a promotion and a $5,000 a year increase in pay? If it turns out a year from now that Smith screwed up, he can be fired.

An Example

• There is a drawback. Smith and Wilson may need to work together, and the opportunities for “back-stabbing” seem to grow when they are competing for the same job.

Summary

• We have only scratched the surface.
• Compensation policy would be easy if we could monitor performance at no cost.
• We cannot, so it becomes more complicated.

End