

More on Compensation



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- 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

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 - 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.
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Using Wage Policy as an Incentive Mechanism

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 - Police officers
 - McDonald's Franchises
 - Bank Tellers

An Example

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- 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

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An Example

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- 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

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