



Strategic Compensation and Talent Management

Lessons for Managers

Written for current and aspiring managers, this textbook guides readers through the core components of compensation and puts them in the manager's chair, challenging them to apply their understanding to solve business problems such as attracting, managing, and retaining company talent. The book's central theme, supported by extensive treatment of compensating differentials, is that compensation is heavily driven by market competition. The coverage also includes analytics, negotiation and bargaining, wage theft, and non-profits and small businesses, as well as a detailed treatment of stock options. Case studies are included to demonstrate the principles in practice, and "Lessons for Managers" in each chapter provide practical advice and takeaways. A rich package of online teaching and learning materials, including teaching slides, sample syllabi, additional case studies, a test bank, and instructor notes is also provided to support teachers and students.

Jed DeVaro is the Wang Family Professor of Management and Economics, and Chair of the Department of Economics, at California State University–East Bay, where he teaches an MBA course in "Strategic Compensation and Reward Systems". He is a research fellow at Cornell University's Institute for Compensation Studies and a Senior Research Fellow at the Research Institute for the Finnish Economy. His published articles on compensation and related topics span economics, finance, strategy, organizational behavior, and human resources management.

Cambridge University Press
978-1-108-49520-2 — Strategic Compensation and Talent Management
Jed DeVaro
Frontmatter
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Lessons for Managers

Jed DeVaro

California State University–East Bay



 **CAMBRIDGE**
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University Printing House, Cambridge CB2 8BS, United Kingdom

One Liberty Plaza, 20th Floor, New York, NY 10006, USA

477 Williamstown Road, Port Melbourne, VIC 3207, Australia

314–321, 3rd Floor, Plot 3, Splendor Forum, Jasola District Centre, New Delhi – 110025, India

79 Anson Road, #06–04/06, Singapore 079906

Cambridge University Press is part of the University of Cambridge.

It furthers the University's mission by disseminating knowledge in the pursuit of education, learning, and research at the highest international levels of excellence.

www.cambridge.org

Information on this title: www.cambridge.org/9781108495202

DOI: 10.1017/9781108861458

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First published 2020

Printed in the United Kingdom by TJ International Ltd, Padstow, Cornwall, 2020

A catalogue record for this publication is available from the British Library.

ISBN 978-1-108-49520-2 Hardback

ISBN 978-1-108-81743-1 Paperback

Additional resources for this publication at www.cambridge.org/devaro

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“To those who pay, those who have been paid, and those who should have been paid.”

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Acronyms

- ARRA = American Recovery and Reinvestment Act of 2009
 ADA = Americans with Disabilities Act of 1990
 ADEA = Age Discrimination in Employment Act of 1967
 AFSCME = American Federation of State, County and Municipal Employees (a labor union)
 BART = Bay Area Rapid Transit (public transportation in San Francisco area)
 BEA = Bureau of Economic Analysis
 BFOQ = Bona fide occupational qualification
 BLS = Bureau of Labor Statistics
 BP = British Petroleum
 BSM = Black-Scholes-Merton (options pricing formula)
 BSO = Boston Symphony Orchestra
 CalPERS = The California Public Employees' Retirement System
 CBA = Collective bargaining agreement
 CBE = College of Business and Economics
 CBR = *Compensation & Benefits Review* (a practitioner journal)
 CD = certificate of deposit
 CEO = Chief Executive Officer
 CFO = Chief Financial Officer
 CFA = California Faculty Association (the faculty union in the CSU system)
 CMR = *California Management Review* (practitioner journal)
 COLA = Cost-of-living-adjustment
 COO = Chief Operating Officer
 CPI = Consumer Price Index
 CPI-U = Consumer Price Index (for all urban consumers)
 CPS = Current Population Survey
 CSU = California State University (system)
 CSUEB = California State University-East Bay
 CSUF = California State University-Fresno
 CSULA = California State University-Los Angeles
 CSULB = California State University-Long Beach
 CSUSF = California State University-San Francisco
 DB = Defined benefit (pension system)
 DC = Defined contribution (pension system)
 DOL = Department of Labor

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- DOMA = Defense of Marriage Act
 EBRI = Employee Benefits Research Institute
 ECEC = Employer Costs for Employee Compensation (index)
 ECI = Employment Cost Index
 EEOC = Equal Employment Opportunity Commission
 EPA = Equal Pay Act of 1963
 ESPP = Employee stock purchase plan (a form of equity-based compensation)
 FAA = Federal Aviation Administration
 FLSA = Fair Labor Standards Act of 1938
 FMLA = Family and Medical Leave Act of 1993
 GPA = grade point average (a measure of a student's performance in school)
 HBR = *Harvard Business Review* (practitioner journal)
 HR = Human resources
 HRS = Health and Retirement Study (longitudinal data set of older workers)
 HWHFA = Healthy Workers, Healthy Families Act of 2014
 ICS = Institute for Compensation Studies (Cornell University)
 IRA = Individual Retirement Account (either "traditional" or "Roth")
 IRS = Internal Revenue Service (the agency that collects taxes in the United States)
 IT = Information Technology
 KC = Kansas City, Kansas (and Missouri)
 ML = Merrill Lynch (an American wealth management company)
 NCS = National Compensation Survey (conducted by the BLS)
 NLRA = National Labor Relations Act
 NLRB = National Labor Relations Board
 NLS = National Longitudinal Surveys (sponsored by the BLS)
 NYPD = New York City Police Department
 OES = Occupational Employment Statistics
 OLS = Ordinary least squares (regression)
 OSHA = Occupational Safety and Health Administration
 PATCO = Professional Air Traffic Controllers Organization
 PB = Pilgrim, Baxter and Associates (an American mutual-fund company)
 PDV = Present discounted value
 PhD = Doctor of Philosophy (the highest-level academic degree in most fields)
 PHL = Philadelphia International Airport
 PSID = Panel Study of Income Dynamics (a longitudinal household data set)
 RA = Research assistant (a job title)
 RPP = Regional price parity (a regional price index produced by the US BEA)
 RSU = Restricted Stock Units (a form of equity-based compensation)
 SAS = Statistical Analysis System
 SEC = Securities Exchange Commission

SEIU 32BJ = Service Employees International Union, Local 32BJ (a labor union)
SEP = Simplified Employee Pension (a type of traditional IRA)
SF = San Francisco, California
SIPP = Survey of Income and Program Participation
SNAP = Supplemental Nutrition Assistance Program
STEM = Science, Technology, Engineering, and Mathematics
TDA = Tax-deferred annuity (more commonly called tax-sheltered annuity, or TSA)
TSA = Tax-sheltered annuity (also called tax-deferred annuity, or TDA)
VP = Vice President
WHD = Wage and Hours Division (of US Department of Labor, i.e., DOL)
WRDS = Wharton Research Data Services



Preface

Gaining and sustaining competitive advantage requires that managers understand how to use compensation strategically to attract, manage, and retain their organization's talent. This book will help you to develop and refine that understanding, equipping you to think in a sophisticated way about compensation, to recognize the implications of compensation systems for employee behavior, and to use compensation to solve problems and achieve business objectives in your current or future organization.

This book is written for managers around the world. It can also be used as a text for a one-semester compensation course with no pre-requisites that is accessible to readers with the analytical preparation and quantitative skills that are now standard in business. Instructor resources are available on the course website, including PowerPoint slides, sample course syllabi, 30 case discussions, and a multiple-choice test bank. I target three audiences, all of whom have, or aspire to have, careers in management:

- (1) MBAs and other professional masters students
- (2) advanced business undergraduates
- (3) experienced managers, including:
 - those who are enrolled in executive education programs
 - those who simply want to learn more about compensation to further their professional development.

Speaking to these audiences requires a new approach to teaching compensation. This book starts from the following concept: *Anything that fails to reach and be relevant for an audience of professional managers will also fail to reach an audience of business students.* After all, most business students will soon become professional managers, if they are not already. Business students are at their most attentive and engaged when they're treated as managers rather than as students. Moreover, most managers don't want to read anything that looks like a textbook. In addition to lacking the time and inclination to wade through stuffy and impersonal prose that's heavily laden with footnotes citing the dry academic literature, managers have little use for the usual key terms, outlines, study tips, homework questions, end-of-chapter quizzes, etc., that clutter the page, disrupt the flow of the narrative, and kill the momentum. This book omits the usual trappings of a textbook and adopts an informal, narrative, conversational style that puts the reader in the manager's chair.

It also focuses on content and themes that are highly relevant for managers but that receive little or no attention in standard compensation textbooks.

For nearly 20 years I have taught different versions of this material at the undergraduate through PhD levels, at Cornell, California State University–East Bay (CSUEB), and the University of Cologne. In CSUEB’s business school, I use the book to teach an MBA elective in the Management Department called “Strategic Compensation and Reward Systems” and its undergraduate counterpart. I have also presented this material to groups of business executives.

Employers who engage with compensation-related issues are of two types: the general managers who run the organization, and the professionals who administer compensation systems in the human resources (HR) and payroll offices. This book speaks to both groups but particularly to the first. For that reason, and in contrast to most compensation textbooks, I focus more on general concepts, theory, and ideas than on facts and details of compensation systems. This approach also makes the book more relevant for an international readership than most compensation books. Although most of the labor law and institutional context focuses on the United States, all of the insights and ideas are easily transportable to other countries, because my focus is less on the specifics of regulations and institutions than on how to think about them. Other unique features that distinguish this compensation text from others are:

- ***Conversational writing style.*** Compensation can be pretty dry material. Textbook discussions easily become encyclopedic, verbose, and tedious to read. I’ve tried to avoid that by writing in a conversational style. I rely heavily on first and second person and usually avoid third person. “I” (first person) am speaking directly to “you” (second person) informally, just as we would in an in-person chat. Moreover, “you” are assumed to be seated in the manager’s chair throughout the book, because that’s where you’re likely to ultimately end up, if you’re not already there. This approach, though unconventional for a textbook, has the advantage of disciplining my writing. By speaking to you directly as a manager, I am forced to keep the discussion sharply focused on exactly what is relevant for business managers. To further that end, every chapter ends with a “lessons for managers” section that gives you (the manager) the key takeaways.
- ***Case discussions.*** Actively and collaboratively engaging with the material is the best way to learn about compensation. To facilitate such learning, I have created 30 mini cases that are designed to stimulate group discussion. One case appears at the end of each chapter, and the entire set of 30 is available online on the course website. Many of the cases are relevant to several chapters, and they span a variety of industries, occupations, and sectors. They are designed to be completed in class, spontaneously, in about an hour. Students break off into groups for 30 or so minutes to discuss the case and prepare answers, and the

remainder of the hour is devoted to class discussion. That format works well in my MBA class. Alternatively, cases can be assigned for homework, with students bringing written answers to class for discussion. Many of the cases have more discussion questions than can reasonably be completed in an hour, to give instructors choice.

- **Emphasis on market competition.** The central theme that pervades this book is that compensation is heavily driven by market competition. To develop that theme, I draw on economic concepts to an unusual extent, though striving to do so in a way that will resonate with those who have had no prior exposure to economics or whose prior exposure has been unpleasant. My multidisciplinary background positions me well to pull this off. In the business school at CSUEB, I hold a joint appointment in the Departments of Management and Economics. My home department is Management, and my compensation courses are offered in the Human Resources and Organizational Behavior (HR/OB) subdivision of that department, but I am also the chair of the Economics Department. Multidisciplinary perspective is crucial in the area of compensation, and my academic research on compensation spans economics, finance, human resources management, organizational behavior, and strategy.
- **Content.** The book contains material that is important for managers in practice but that is typically absent from compensation texts. Some examples are:
 - **Compensation analytics.** Chapters 6 and 7 on compensation analytics reflect the increasingly central role of business analytics in modern managerial decision-making. Recent technological advances in hardware and software, along with expanded availability of “big data” human resources records in electronic form, facilitate the development of innovative, analytically deep, data-driven solutions to business problems. Many companies are already doing this, and creating and sustaining a competitive advantage now requires it. Readers of this book who will become consultants need to understand how to leverage a client’s internal compensation data, and those who will become general managers or run their own organizations need to know how to leverage their own company’s internal data and draw on external benchmarks. The two chapters are designed to quickly equip readers to conduct and evaluate competent, impactful analysis of compensation data, and they are unique in offering lots of practical advice (e.g., on organizing and cleaning the data prior to analysis) that is critical for data analysis.
 - **Negotiation and bargaining** with current and prospective employees over compensation is one of the most important challenges that managers face. I cover the subject in Chapter 14.
 - **Compensating differentials**, which can derive from any characteristic of a job (good or bad), form the core analytical support structure for the book’s

central theme, namely the role of market competition in shaping compensation. A real appreciation for how other companies' compensation practices affect those of your own requires a thorough understanding of compensating differentials. Chapter 3 develops that material in depth, and it is consistently reinforced throughout the book.

- *Compensation contract failure and wage theft* is a neglected subject that I cover early. Compensation is about *contracts* (or agreements involving an exchange of labor for pay) between employers and employees. A great way to learn how something works is to study it when it's broken, and wage theft is the consequence of a broken (i.e., breached) contract. Chapter 2 sets the stage for the core chapter on compensating differentials that immediately follows it, because employees view the threat of wage theft as a negative job characteristic, and any negative job characteristic can create a compensating differential.

Selected recommendations for further reading appear at the end of each chapter. I do not attempt to provide an exhaustive list, though I do strive for breadth in disciplinary perspectives. Practitioner outlets are included as well as academic journals.

The limited amount of quantitative material in this book is not daunting and involves only basic mathematics. Chapters 6 and 7, on compensation analytics, cover the basics of regression analysis, and Chapters 8 (on training) and 12 (on turnover management and talent retention) cover present value analysis, which is needed for discussing streams of compensation over time. Compensation is inherently quantitative, as a glance at your last W-2 form reveals! As a current or prospective manager, you will benefit from enhancing your quantitative skills, because quantitative problems arise increasingly often in business, particularly in compensation.

The book is best read cover to cover, like a novel. The presentation is cumulative, and as the discussion progresses I highlight the interconnectedness of the topics. A modular design of any compensation textbook, that attempts to treat the chapters as self-contained, would encourage the tunnel vision that can lead to catastrophic mistakes in organizations. Compensation systems offer powerful tools for solving business problems and fueling organizational success, but they also create fields of landmines . . . an understanding not only of the individual components of compensation systems but of how they interact in the entire system, and with other human resource management practices, is the surest way that a manager can avert the landmines.

I intentionally draw many examples from my own employment experiences, particularly from the California State University (CSU) system where I currently work. One reason for this is simply convenience, because all of the anecdotes are at

my fingertips from personal experience. But a more important reason is to illustrate that most chapters of this book have relevance for *any given organization*. I have connected many of the chapters to examples from the CSU system, and, as you read, you should be able to connect many of the chapters to your own organization.

My principal intellectual debts are to the scholars whose work forms the foundation of this book and who shaped my understanding of compensation, including my former teachers and mentors at Stanford (Ed Lazear, Tom MaCurdy, John Pencavel, and Luigi Pistaferri). I am also indebted to Stanley Wang (President, Pantronix Corporation) and his family for endowing the chair I've held since joining CSUEB in 2008, and to Terri Swartz for creating the joint appointment in the Management and Economics Departments that equipped me uniquely to write this book. I'm also thankful for the support of friends, family members, and my present and former colleagues from CSUEB and Cornell. Particularly detailed and helpful feedback was provided by Jagdish Agrawal, Alan Benson, Alex Bryson, Anil Comelo, Eve DeVaro, Scott Fung, John Heywood, Antti Kauhanen, Jack Kilgour, Mee Sook Kim, Jason Perry, the anonymous reviewers at Cambridge and elsewhere, and my former MBA students who provided research assistance (Tim Gugenhan, Kilby Hammond, and Vasana Ly). Valerie Appleby has been a superb and enthusiastic editor at every stage of the publication process. Finally, I am grateful to my students, whose needs, interests, aspirations, and questions inspired this project.

The following pages are intended to be the first step in an ongoing enterprise. I welcome emails or other communications offering suggested improvements, criticisms, ideas for new case discussions, sample course syllabi, instructor notes, and any other commentary.

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Case Discussions

Each chapter is followed by a related case discussion. Those 15 cases appear in boldface in the table below, and the entire set of 30 is available on the course website. The cases are designed to be prepared and discussed in class. Most require about an hour, though some require more time. The lists of questions are intentionally kept rather extensive to allow instructors to be selective. Students break off to work in groups, preparing answers for the first half of the allotted time, and the remaining time is spent on class discussion. In the following table, open circles indicate chapters that are relevant to the case, and closed circles indicate a particularly strong connection.

Case Discussions	Chapter															Page
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	
1. Buffer, Inc.	●				○	○	○									20
2. Flying Pig		●		○												online
3. The Deadliest Catch			●						○							51
4. Uber				●												online
5. Philadelphia Airport Workers				○	●									●		online
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Cambridge University Press
978-1-108-49520-2 — Strategic Compensation and Talent Management
Jed DeVaro
Frontmatter
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