



EMPLOYMENT RELATIONS

A CRITICAL AND
INTERNATIONAL
APPROACH

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CHAPTER 9

Pay and Reward

CHAPTER OVERVIEW

In earlier chapters we saw that the employment relationship represented an 'indeterminate exchange' whereby a readily quantifiable wage is exchanged for an inherently uncertain amount of labour power. Yet the manner in which wage rates are themselves determined is a complex business, reflecting custom, institutions, internal and external markets for labour, social relations and strategic choice. Most organisations will naturally seek to optimise their output (in terms of goods manufactured or services offered), giving greater rewards to the most productive, skilled and/or capable employees. However, too much emphasis on closely controlling the work of employees and/or the distribution of rewards in a manner that is perceived to be unfair or overly punitive will result in the most competent staff members migrating to other organisations, leaving behind discontented, less capable, and less mobile staff. The operation of reward systems may thus have effects opposite of those intended. Moreover, the close monitoring of employee performance may encourage dishonesty. Reward systems aim to control costs and increase staff morale. Many countries prohibit pay discrimination on the grounds of gender and race: the operation of a reward system has legal implications. Reward is therefore one of the key policy-making areas within the workplace.

In this chapter we review the basis under which pay is calculated, the role of incentives and rewards, individual- and collective-based pay systems, and the role of employment relations practitioners and line managers in this regard. Although the chapter includes reference to a range of countries, greater attention is drawn to OECD countries due to the possibilities for useful comparison.

LEARNING OUTCOMES

After studying this chapter you should be able to:

- understand the processes linked to pay determination
- determine a range of approaches to reaching pay awards/settlements
- explain a variety of incentives and rewards that might be offered to an employee, and critique these methods
- compare individual and collective pay systems
- critically evaluate the role of employment relations specialists and line managers in the reward process

PAY DETERMINATION

There are a number of basic ways in which firms may seek to determine wage rates. Each has implications for productivity and equity.

MINIMUM WAGES

The first is to seek to pay the bare minimum that will be necessary to secure the desired quantity and quality of labour. A limitation of this approach is that firms never possess perfect information about the state of the external labour market. This means that, at best, a decision to pay as little as possible will result in at least some guesswork in making wage offers, possibly leading to shortages of labour and/or excessively high staff turnover rates. Moreover, whereas it is easy to quantify the physical size of a workforce, it is more difficult to quantify its capabilities – low pay may attract the desperate, but it will be unlikely to attract suitably qualified or motivated individuals. In many instances, firms have chosen to respond by resorting to more vulnerable categories of labour: children and women. Interestingly, there is some evidence that single establishments employing relatively small numbers of workers tend to pay less (McNabb and Whitfield 2000).

A second possibility is to set pay rates for the lowest-ranked jobs in line with the legal minimum wage. Many countries, ranging from the United Kingdom to the United States, have minimum wage legislation in force, which may help to determine the minimum acceptable rate. Firms may choose to pay as little as is legally possible for the lowest-ranked jobs, in the expectation that many other firms will adopt a similar position, giving those with the least marketable skills little option but to accept it. A problem with this approach is that in many contexts, minimum wages are extremely low, leading to the same problems as

encountered with the first possibility: low staff morale, and low productivity. Despite this, conservative critics of national minimum wages have persistently argued that they reduce the demand for labour and encourage shirking. However, in a 2005 study, Morris *et al* (2005) found that among smaller employers it was the more effective and successful enterprises that were strongly supportive of minimum wages, on the basis that they discouraged more short-termist competitors from undercutting them through extreme labour repression.

There is a very large body of literature on national minimum wages. It is generally the case that the harshest critics of national minimum wages legislation come from the ranks of neo-liberal economists, while, on the whole, writers within the broad field of industrial and employment relations are more sympathetic (see Metcalf 1999a and 1999b; Neumark and Wascher 2001; Williams and Mills 2001; Stewart 2002). In a definitive study, Card and Krueger (1995) found that the imposition of minimum wages only had negligible effects on employment.

Within different contexts, minimum wage rates vary greatly. In Mozambique, minimum wage rates are so low, and enforcement so weak, as to have only limited effect on what firms actually do. Within the United States, certain jobs are subject to federal minimum wage law under the Fair Labor Standards Act. Others are subject to state, city or local laws. A few states, mostly located in the 'deep south' (eg Texas), have no minimum wage laws at all. In 2009 the US federal minimum wage stood at \$6.55 per hour.

In Canada, general minimum wages (rather than confined to specific jobs) are set at state level. In 2009 the lowest minimum wages were encountered in New Brunswick at 8.80 Canadian dollars per hour (US \$8.45), and the highest in Ontario at 10.25 Canadian dollars per hour.

In the United Kingdom, minimum wages are linked to age. In 2009 the rates were GB£5.80 per hour for the main body of workers, which included those of 22 years of age or older. Meanwhile, workers aged between 18 and 21 must be paid at least GB£4.83 per hour, and those aged 16 to 17 GB£3.57 per hour (Direct Government UK 2010).

In contrast, a number of continental European countries – most notably Germany and Denmark – have no national minimum wages. Instead, minimum wages for entire occupations and industries are set through national collective bargaining, which are then compulsory for particular sectors. In practice, this means that pay rates for the lowest-ranked jobs are higher than in countries where there is little or no centralised bargaining, but where national minimum wages are in force. Does this mean that employers in such countries are less likely to hire labour? Although the job creation record of Germany may indeed appear superficially worse than that of the United States, a closer scrutiny reveals the converse. Large numbers of the employed in the United States are in part-time contingent jobs owing to a lack of alternatives (some 7 to 8 million people); there are some 2.3 million people in prison (by far the highest national proportion of prisoners per capita – and in terms of sheer numbers – in the world) and around 1.5 million people in the armed forces. If these numbers are taken into account,

the USA has the worst job creation record in the developed world, despite – or perhaps because of – weak labour market regulation. Table 9.1 compares national minimum wage rates across the OECD in those contexts where minimum wages are in force; it will be seen that there is considerable variation from context to context, but rates are generally low.

Table 9.1 National minimum wages in national currency units per year

Country	National currency unit	2005	2006	2007	2008	2009	2010 GB£*
Australia	Australian dollar	24820	25309	26757	27432	28277	17,466
Belgium	Euro	15224	15451	15933	16732	17288	15,128
Canada	Canadian dollar	15184	15808	16182	17305	18429	11,455
Chile	Chilean peso	1485000	1575000	1674000	1818000	1944000	2,545
Czech Rep	Czech koruna	86220	93150	96000	96000	96000	3,479
France	Euro	14232	14833	15206	15664	15952	13,959
Hungary	Forint	684000	750000	786000	828000	858000	2,777
Ireland	Euro	12168	12521	13873	14164	14164	12,602
Korea	Won	7937120	8407200	9437760	10224240	10848000	615
Lithuania	Litas	6300	6900	7800	9600	9600	2,474
Luxembourg	Euro	17711	18078	18843	19235	20045	17,835
Mexico	Mexican peso	11762	12233	12709	13218	13829	715
Netherlands	Euro	16392	16570	16964	17442	18013	16,026
Portugal	Euro	5245.8	5402.6	5642	5964	6300	5,605
Slovak Rep	Euro	2629	2818	3077	3226	3546	3,155
Spain	Euro	7181	7573	7988	8400	8736	7,772
Turkey	Turkish lira	5864	6372	6885	7483	8154	3,649
Utd Kingdom	Pound sterling	8606	8944	9334	9656	9953	9,953
United States	US dollar	10712	10712	11350	12806	14262	9,094

Data from Minimum Wages at Current Prices in NCU under Earnings under Labour from OECD.Stat Extracts, <http://stats.oecd.org> [accessed on 31 October 2010].

*The pound sterling equivalent (2010) facilitates a rough comparison of amounts. However, this does not take account of the costs of living in each country.

In some cases, organisations have paid the required minimum wage rates to their core employees but have neglected to enforce appropriate wage rates for suppliers. The case study below illustrates this situation.



WAGE RATES – A SWEATSHOP SCANDAL IN INDIA

An investigation carried out by the *Observer* newspaper (2010) revealed that the suppliers of three large retail companies – Marks & Spencers, Next and Gap – were consistently paying low wages to workers and employing them under 'sweatshop' conditions. In some cases, factories in India used middlemen to employ workers who were then paid as little as 25p an hour, and required to work up to eight hours a day in overtime, while some worked seven days a week. In one case, it was reported that those who objected to working overtime had been beaten. The corporations were seeking to address the situation through

ordering suppliers to pay workers any amounts that were owed to them, and to reduce working hours to legal limits.

Questions

Do you think that large corporations have any responsibility for the industrial relations policies (and wage rates) of their subcontractors? Give reasons for your answer.

What are the consequences of the use of cheap outsourced labour in India for wage rates within advanced economies such as Britain and the United States?

NEGOTIATING WAGES THROUGH COLLECTIVE BARGAINING

A third possibility is to set wage rates through a negotiated agreement with one or more representative trade unions via the collective bargaining process. An advantage of this mechanism is that wage rates enjoy legitimacy; it is the union's responsibility to sell any deal to its members. Moreover, in between annual rounds of collective bargaining, it is administratively easy – all the firm has to do is pay what has been agreed upon. Also, although collective bargaining may result in higher wages than would otherwise be the case, the determination of wages through collective bargaining encourages firms to take labour and the concerns of labour more seriously (which, in turn, is good for productivity). More generally, higher average wages boost consumer demand across an economy. However, although the agreement is a collective one (in other words, it covers a pre-agreed component – generally, the bulk – of a workforce), not all workers covered by the agreement will be paid the same. Rather, pay within particular job bands is typically linked to seniority, but within the parameters of agreed pay rates. More detail is given on collective bargaining in Chapter 7. Within non-union firms, this entire dimension of pay-setting is absent; pay is therefore set through one of the other mechanisms outlined in this chapter.

LINKING PAY TO PERFORMANCE

As Heery (1996: 57) notes, criticisms of the above three possibilities centre on the fact that they reward job categories, not the productivity or actual operational capabilities of a particular worker. Central to the rise of human resource management in the 1980s was the argument that pay should be linked to actual performance – in other words, that the risks borne by the firm are shared by the workers, with pay and upward movement on pay scales being closely linked

to performance (Heery 1996). There was thus a renewed emphasis not only on bonuses but on the linking of base pay to the quality and quantity of labour power delivered (*ibid*). This philosophy is often referred to in the literature as 'New pay', a fourth possibility.

In practice, in common with many 'new-style' HRM policies, New pay represented 'old wine in new bottles' (Guest 1987) rather than genuine innovation. During the Industrial Revolution – and, indeed, before it – many employers adopted piecework-based pay systems, simply paying a worker according to how much he or she produced. Although the physical amount produced is easy to quantify, quality is often rather harder. Those employed under this basis are often remarkably adept at concealing low-quality goods and waste in order to maximise their pay. In turn, employers that profess to practise piecework are often more arbitrary than systematic in quantifying real value generated by employees.

There are a number of reasons why the piecework system was gradually replaced by standardised pay systems. Firstly, not all types of output are readily quantifiable and it is significantly easier to measure quantity of output than quality. Secondly, as we saw in Chapter 2, the rise of trade unions was characterised by struggles for procedures and equity. In response, employers increasingly chose to adopt standardised systems based on a fixed rate for a job within parameters set by experience and the length of tenure (Brown 1996). However, the decline of unions in many industrialised societies has made output-based pay more attractive again (see Brown 1996). New pay is not, however, simply a product of union weakness; its proponents argue that it also allows for a closer integration between the different functional areas of HRM and a more strategic perspective (see Richbell and Wood 2009). New pay is inherently flexible, in that pay can be adjusted according to output – indeed, through subtly 'moving the goalposts', firms may, in fact, cut real wages in a manner that is not immediately visible. As Twomey and Quazi (1994) note, in order to function properly, pay must genuinely be adjusted upward and downward according to the circumstances the firm finds itself in and how well employees perform. Keeping the fixed component of pay low means that, should an individual employee under-achieve, he or she will bear some of the indirect costs borne by the firm (Twomey and Quazi 1994: 567).

New pay is based on the assumption that remuneration should reflect not just external labour markets but also the real contribution of the individual employee to the firm. The operation of more flexible pay systems forces staff to take more responsibility for their work. Those who excel can do extremely well, potentially resulting in a win/win situation for both the firm and the employee. In practice, many firms have been reluctant to abandon more traditional systems owing to fears of employee resistance and because of the administrative complexities associated with quantifying and duly rewarding the output of every single employee. New pay-type reward systems are more commonly encountered within more senior jobs bands than those at the base of the organisation. However, within all job categories, a further problem that can be encountered is in terms of employment equity legislation. For very good reason it may be difficult for

an organisation to prove that imbalances in perceived performance and pay on gender, age and/or ethnicity are wholly coincidental. Given this, it may be attractive to reduce the risk through the use of more standardised reward systems (Richbell and Wood 2009). A further limitation of New pay systems is that the adoption of a reward system linked to performance assumes that pay is the primary motivator – most psychological theories of motivation assume that a range of other factors are at work.



APPLYING THEORY TO PRACTICE

Performance-related pay in China

Research conducted by Baruch *et al* (2004) focused on payment systems in China. Since China is often identified as a collectivist country, it could be considered that performance-related pay (PRP) is not appropriate for Chinese organisations. However, the modernisation process in China has involved a range of changes, including the introduction of new HR practices such as performance-related pay. A key argument for introducing this type of reward system is that it acts as a motivator by providing incentives and recognising achievements. It might therefore be appropriate for industries such as professional sports, where both individual and team-based achievements can be measured in an objective manner. In China, performance-related pay has been used in sports organisations such as the Shanghai Sports Technical Institute (SSTI) since 1985 following Chinese participation in the Los Angeles Olympic Games (*ibid*).

Surveys conducted by the same authors (Baruch *et al* 2004) showed that team sports players regarded the PRP system to be more effective for improving performance than did individual sports players. In addition, they also found that females who played individual sports viewed PRP more favourably than males. This was because they viewed the payment system as being more likely to provide them with rewards that matched their abilities (*ibid*: 257). However, women did not view PRP as favourably when used for team sports.

Do you think that PRP is more appropriate for measuring individual than for measuring team-based performance? Give reasons for your answer.

Would you anticipate that PRP for individual performance would be viewed more favourably by females than males in countries other than China? Again, give reasons for your answer,

A HYBRID APPROACH

Given the problems identified in the previous sections, a fifth possibility for payment systems emerges – that firms adopt a mixed or hybrid approach. Indeed, in the real world, this is often the chosen path. Firstly, if New pay is indeed about the alignment of HR with general organisational strategic objectives, then the relative contingency of actual pay rates may vary greatly according to the overall goals of the organisation. An organisation may, for example, seek to simplify administration as part of a general desire to cut costs to the bare minimum, or seek to engender the long-term commitment of the workforce through equity. Mixed or hybrid approaches may involve the use of New pay only within certain job categories and/or the retention of a basic pay rate for a job that is only marginally supplemented through performance bonuses. As Heery (1996) notes, employees generally desire an income that is stable and secure, and may

feel extremely unhappy that the organisation has the capacity to cut pay at will. Moreover, any form of linking pay with performance may have unexpected consequences – employees may, for example, avoid or defer more difficult tasks in order to be rewarded for performing a large number of simple ones, or conceal quality defects in order to be rewarded for a high output (Cacciope 1999). Thus, as Twomey and Quazi (1994) note, pay systems must link the needs of the firm and the individual with the social and technological context. More highly paid professionals may be more sensitive to non-pay factors, whereas those working for low wages are likely to be more immediately concerned with securing a basic income for subsistence (*ibid*). Meanwhile, in industries where the external and technological environments change rapidly, firms are more likely to adopt highly flexible systems – but even then may be left behind by events.

TEAM-BASED PAY SYSTEMS

A sixth possibility is to set pay according to the performance of a group of employees or a team. The increased popularity of teamwork in many countries in the 1980s led to an increased use of team-based pay. However, here again, finding objective measures of group performance may be difficult, meaning that organisations may often opt for superficial gestures rather than properly linking performance with pay (Cacciope 1999). In addition, team-based pay systems may undermine individual pay rather than being complementary (*ibid*). In practice, Kerrin and Oliver (2002: 323) argue that teamwork is often incompatible with individual pay systems – the former may encourage free-riding whereas the latter may discourage information-sharing and undermine team efforts (Kerrin and Oliver 2002: 323). As Cacciope (1999) notes, there are always difficulties in reconciling team solidarities and in effectively measuring actual performance. Finally, the relationship between individual effort and group-based rewards may seem tenuous in practice (*ibid*). At the same time, team-based pay may represent a viable alternative in those cases where the individual performance or contribution of employees is hard to measure, and where technology more readily lends itself to group work (Ichniowski and Shaw 2003). Examples of team-based pay systems include rewards according to the physical output generated by a team. Not all group-based pay needs to be team-based. For example, profit-sharing represents a form of group incentive that transcends the efforts of a single grouping performing a set range of tasks. However, profit-sharing may be associated with even more pronounced problems of free-riding, the links between what an individual does and firm-level outcomes often appearing tenuous (*ibid*). Training and the promotion of specific value sets may mitigate this, with performance being promoted via peer pressure (*ibid*). However, where objective circumstances are poor, no amount of training or indoctrination is likely to work.

PAY AND INEQUALITY

The uncertainties inherent in any contingent pay system, and the inevitable discretion given to supervisors and managers, means that existing inequalities may be perpetuated – for example, women may be paid less than men (Heery

1996). As noted earlier, this may open the organisation to legal challenges in those circumstances where employment equity legislation is in force. In addition, because contingent performance-based pay is predicated on the absence or complicity of a union, it means that employees may lack genuine representation, which, again, may mean that the system is lacking in legitimacy (*ibid*).

There are also issues regarding distributive justice. Such models transfer risks on to the shoulders of employees and away from managers – it is employees who share the costs of poor overall organisational performance. Chronic failings in corporate governance mean that senior managers are often relatively free to set their own pay, meaning that they are insulated from the costs of organisational failure (*ibid*). The 2008 financial crisis underscored the extent to which senior managers are often able to continue to reap exceptional rewards even when their incompetence is clearly visible.

A further point worth observing is that within liberal market economies such as Britain and the United States (see Chapter 5) the gaps between top- and lower-ranked jobs have grown wider since the 1970s. There is, however, little objective evidence that senior managers have become progressively better at their jobs – indeed, some of the best-rewarded managers often seem to be among the most incompetent. Moreover, as Baron and Cooke (1992) comment, there is significant evidence that smaller gaps between the senior managers and ordinary workers are associated with higher product quality. The reasons for this are simple: greater equity promotes trust and commitment, and therefore a greater willingness of employees to excel. It is worth noting that in some of the most unequal mature economies – such as the United States and the United Kingdom – rising social inequality has been associated with declining competitiveness in manufacturing and, indeed, a host of social ills. There is little doubt that there is a contradiction between increased inequality within both firms and society at large, and rhetoric about teamwork, gain-sharing and partnership (Baron and Cooke 1992: 193). Employees are unlikely to be deceived by rhetoric about commitment in the absence of material evidence.

APPROACHES TO REACHING PAY AWARDS/SETTLEMENTS

This leads us on to the practical approaches for determining pay. Where collective bargaining is in force (see Chapter 7), a collective agreement results in staff being placed on specific pay scales that, in turn, are subject to renegotiation, typically on an annual basis. What an individual is paid is thus subject to the specific job and where he or she finds himself or herself on the pay scale. Although an individual's position on the scale is generally related to seniority, there may be some room for upward adjustment on the scale in the case of exceptional performance (within the broad parameters of the collective agreement), whereas new employees with previous work experience or some or other desirable attribute may be able to negotiate a favourable point of entry. Such approaches are founded on attempts to quantify what a specific job is worth, rather than to measure the performance of individuals or groups. This may be problematic

in that there are considerable variations in the performance of individuals and groups, but it does leave considerably less room for personal prejudices and for the possibilities of discrimination.

MARKET TRENDS

Pay may reflect market trends. For example, in 2010 a commitment by the UK government to freezing pay in the public sector led to employers in other areas seeking to follow suit, and, indeed, to moves to withdraw previously tabled pay offers. Moreover, more generally, the exponential increase in senior managerial pay in the early 2000s led to mutually supporting rounds of leapfrogging. Proponents of very high managerial pay argued that this was necessary to retain high talent in the face of increased competition for much-needed skills. However, as noted above, there often appears to be little connection between high managerial pay and real and sustainable performance.

It is also worth noting that downturns strengthen the relative power of employers, and so mean downward pressures on pay. In liberal market economies (see Chapter 5), wages have stagnated for those in the lower job bands for many years, contributing to a chronic crisis of consumer demand only resolved through excessive borrowing. Calls for pay restraint or cuts during a recession may make things worse, and exacerbate existing systemic distortions. For example, within the United States, as much as 17% of the population may be considered to be objectively poor (US Census Bureau 2009) and lack the capacity to meaningfully consume goods and services. Increasing poverty means that fewer people can consume, leading to reduced demand for goods and services, leading to further wage squeezes and business failures, resulting in turn in worsening poverty – a vicious cycle that is difficult to overcome. So although cutting wages might mean that a firm can, in the short term, make more money, if all or most firms do it, then all lose – and stagnant wages for most workers make it difficult to sustain growth.

PAY AS A MECHANISM FOR DISCIPLINE OR GAIN-SHARING

The determination of pay in practice may also reflect how a firm understands the operation of reward systems: as a mechanism for disciplining the workforce, as genuinely sharing in any gains, or, as something to be grudgingly dispensed to workers, with as little being paid out – as noted earlier – as the external labour market and/or the law will tolerate. In a particularly influential paper, Kochan and Osterman (2000) argued that if firms wish to actively promote their competitiveness in terms of quality, flexibility and innovation, they need to be willing to share gains with employees. This includes equitable reward systems, the employees being given a fair share of any new profits generated through employee endeavour, resulting in a self-reinforcing virtuous circle. However, firms can, and do compete through paying very low wages – which makes it difficult to promote fairness in pay on profitability grounds.

Despite the rhetoric of gains-sharing, therefore, it has been argued that HRM is concerned with control and discipline and promoting individual self-interest,

rather than collective identity (Storey 1995). Indeed, there has been an increased move away from secure employment contracts characterised by wage stability, to greater contingency and flexibility, with increasing risks downloaded on to employees, even if there is, at least, in theory, the possibility of greater rewards accruing to exceptional achievement (Kato and Morishima 2002: 488). However, employment relations cannot operate where trust is completely absent. The employment relationship is one that is based on reciprocity, framed by norms and unwritten expectations (Akerlof 1982). Management may seek to enhance notions of fairness via financial participation, linking reward to overall organisational outcomes – in effect sharing in gains (MacInnes *et al* 1985). In other words, rather than piecework – which primarily aims to discipline workers – financial participation may be seen as a positive incentive ... although in reality it may not always be seen as such by workers.



REFLECTION ON PRACTICE

Financial participation – a positive incentive?

Have you worked in an organisation where employees were given shares in the firm?

Do you think that being given shares, and consequently benefiting from the firm's profits, will motivate workers to increase productivity? Give reasons for your answer.

FINANCIAL PARTICIPATION

Financial participation policies may be adopted by the firm for a wide range of reasons, from a genuine commitment to fairness through to coercing workers to act in a particular way. It is fair to say that in the 1990s and 2000s, the latter has become more prominent than the former. As Poutsma and de Nijs (2003) note, financial participation may be broadly based on the entire workforce, or narrowly focused on a specific component. The most prominent example of the latter constitutes financial participation schemes aimed at managers, with the specific aim of more closely aligning them to the interests of shareholders, and on distributing returns to those who own the firm. However, this practice may have perverse effects. It may weaken the ties that exist between the manager in the firm in a way that is not necessarily good for shareholders. It may, for example, encourage excessively instrumental views towards the firm – that it is an immediate source of personal enrichment rather than something to be nurtured or sustained. In other words, it may encourage excessive managerial 'irresponsibility' (Boyer 2010). Secondly, not all shareholders have an interest in prioritising short-term returns. Although short-term gains may be in the interests of fund managers (whose pay is often linked to short-term performance), many shareholders are concerned with long-term stability in earnings. The 2008 financial crisis highlighted the limitations of excessive short-termism. However, the dominance of neo-liberal ideologies and powerful vested interests has meant that narrowly based financial participation remains popular in liberal market economies.

Why do firms adopt financial participation schemes aimed at non-managerial employees? There are three reasons for it (Croucher *et al* 2010). Firstly, there is the legitimating role that such schemes can play (*ibid*). The managerial agenda may be a lot more acceptable to workers if they have a material interest in its success. Secondly, it may be argued that increasing workers' involvement in the financial affairs of the enterprise may incentivise workers to maximise their potential and to share their 'insider' knowledge with managers (Croucher *et al* 2010). It may therefore be part of a broader commitment to involvement and participation with a view to maximising productivity and co-operation. Thirdly – albeit increasingly less common – there may be a commitment towards fairer working (Croucher *et al* 2010). Co-operatives and employee-owned enterprises share profits among their members/employees. Although this may incentivise employees to work harder, it also reflects a commitment to a fairer and more democratic working life.

Clearly, there are a number of different rationales for financial participation. It may be part of a general 'hard' or instrumental HR strategy, aimed at maximising value to shareholders and avoiding unnecessary waste or 'excessive' diversion of resources towards rank-and-file employees (Croucher *et al* 2010). Alternatively, it may transcend 'soft' or co-operative HRM, as part of a broader framework of workplace democracy. As noted earlier, a single pure HR strategy is rarely encountered, firms often mixing and matching policies and strategies. Financial participation may indeed reflect a combination of motives, especially given that different schemes may be directed at different categories of employee – for example, managers versus non-managers.

WAGE RATES AND INFLATION

Before we conclude this section it is necessary to consider two further issues pertinent to pay rates. Firstly, wages rates may vary according to inflation. Although inflation has been generally low in advanced societies for many years, it should be noted that this has not always been the case. Official indices of inflation may mask differential increases within the notional baskets of goods that are used to calculate official inflation rates. For example, in recent years, food prices have increased significantly more than the cost of manufactured goods. Those on very low incomes will necessarily spend a far higher proportion of their income on the former, so those on low incomes may immediately feel increases in the cost of living even if increases in the overall inflation rate are slight. Firms are, of course, under no obligation to increase wages in line with inflation, but inflation is likely to have effects on overall wage rates.

WAGE RATES AND INEQUALITY

Secondly, we noted a tendency towards rising inequality in liberal market economies. Table 9.2 compares increases in inequality rates within the OECD economies since the mid-1970s (the higher the figure, the more inequality). Liberal market economies such as the United Kingdom and the United States are more unequal, and inequality has worsened over the past 30 years.

Table 9.2 Inequality in the OECD – general trends

Age	Working age population: 18–65					
Period Country	mid- 1970s	mid- 1980s	around 1990	mid- 1990s	around 2000	mid- 2000s
Australia	..	..	..	0.30	0.29	0.31
Austria	..	0.23	..	0.23	0.25	0.27
Belgium	..	..	..	0.28	0.28	0.27
Canada	0.28	0.29	..	0.29	0.31	0.32
Czech Republic	..	..	0.23	0.25	0.26	0.27
Denmark	..	0.21	0.21	0.21	0.22	0.23
Finland	0.23	0.20	..	0.23	0.26	0.27
France	..	0.31	0.30	0.28	0.29	0.28
Germany	..	0.25	0.25	0.27	0.27	0.30
Greece	0.41	0.33	..	0.32	0.34	0.31
Hungary	..	..	0.27	0.30	0.30	0.30
Ireland	..	0.34	..	0.32	0.29	0.32
Italy	..	0.31	0.29	0.35	0.34	0.35
Japan	..	0.30	..	0.32	0.33	0.31
Luxembourg	..	0.24	..	0.26	0.26	0.26
Mexico	..	0.45	..	0.52	0.50	0.47
Netherlands	0.25	0.26	0.28	0.28	0.28	0.27
New Zealand	..	0.26	0.31	0.33	0.33	0.33
Norway	..	0.22	..	0.25	0.26	0.28
Poland	..	..	..	..	0.32	0.38
Portugal	..	..	0.32	0.34	0.35	0.38
Slovak Republic	..	..	..	..	..	0.27
Spain	..	0.30	0.27	0.28	0.27	0.31
Sweden	0.20	0.20	0.20	0.22	0.24	0.24
Switzerland	..	..	..	..	0.28	0.27
Turkey	..	0.43	..	0.51	..	0.42
United Kingdom	0.28	0.32	0.36	0.35	0.37	0.34
United States	0.30	0.33	0.34	0.35	0.35	0.37
OECD Total	..	..	..	..	..	0.31

Data from Income Distribution – Inequality under Social Protection under Social and Welfare Statistics from OECD.Stat Extracts, <http://stats.oecd.org> [accessed on 31 October 2010].

What does this mean in terms of employment relations? Firstly, in highly unequal societies, psychological well-being is generally speaking worse; there is a higher incidence of mental and stress-related illnesses. Secondly, the gap between senior managers and the rank and file is much greater. This means that managers have a diminishing understanding of the material conditions of employees, which is likely to weaken internal solidarity and cohesion within the organisation. For similar reasons, the worldview of employees is likely to be completely different from that of senior managers, reducing the common ground on which consensus may be reached. Highly opaque managerial pay systems, from which senior managers visibly live a lifestyle that is totally unreachable for employees, is further likely to diminish the latter's trust in, and commitment to, the firm. Thirdly, although firms can seize short-term competitiveness by reducing or freezing wages, if all firms do so, the capacity for consumption across a society will decline. In turn, firms will be under greater pressure to cut costs, resulting in a vicious downward circle that is extremely difficult to break out of. Equity thus matters, not only in terms of fairness and morals but also potentially in terms of competitiveness and in ensuring overall economic growth. However, in exercising pay restraint on themselves, and in ensuring decent pay for employees, costs are incurred for managers up front, without necessarily reaping immediately recognisable benefits.



CRITICAL DEBATE

Pay and Inequality

Are you aware of inequality of income in the country that you are most familiar with (either Britain or another country)? If you are, how have you been made aware of it?

Some people would argue that inequality of income is not a problem as long as there are 'trickle-down' effects from the rich to the poor. If the rich invest their money in business, it will help those who are poorer in the long run. Others argue that it is not morally right for there to be a great deal of inequality of income in society. What is your opinion on this issue?

INCENTIVES AND REWARD

What forms can incentive-related reward systems take? The simplest – as we saw when we were linking pay and performance, above – is piecework, where employees are paid according to how much output they generate. A variation of this is commission-based pay. For example, estate agents receive an income that directly relates to the number of properties they can sell. Profit-related pay involves cash handouts to employees according to annual returns. On some occasions this may be deferred in order to encourage employees to take a somewhat longer-term view. In the case of share ownership schemes, employees have the option of purchasing shares at a preferential rate via pay deductions.

Alternatively, employees may receive shares as part of their overall pay (Poutsma and de Nijs 2003: 866). In theory, because employees own shares, they have

a say in the overall governance of the firm (Cin *et al* 2002: 922), although in practice it may be the case that employee shares are held in a trust. This may preclude employees from immediately selling on their shares and/or limit their voting power at shareholders' meetings. Within the UK, employee share ownership schemes were used as a means of making privatisations more palatable to workers. A further issue is that specific managerial agendas – for example, encouraging employee buy-in without necessarily increasing the say that employees enjoy in the running of the firm – may mean that such schemes are extremely complex, and so are incomprehensible to the average worker and, more specifically, those in the lower job bands (Morris *et al* 2005). Moreover, as Poutsma and de Nijs (2003) note, share ownership schemes rarely form part of the contract of employment, which in turn limits the rights employees enjoy in that regard. This is sometimes due to the difficulties in incorporating share ownership schemes into collective agreements (*ibid*), but may also be due to a desire to impart a greater flexibility and contingency into pay. Studies by Jones (1997) and Kato and Morishima (2002) have found that financial participation works best when there are effective forums for employee participation in other areas. In this event employees can obtain a clearer picture of managerial intentions, facilitating legitimacy. The *Applying theory to practice* box below gives an example of where employees might have doubted the legitimacy of payment systems.



APPLYING THEORY TO PRACTICE

Executive pay in the United States

A number of banks in the United States have been bailed out by the US government – some more than once. In effect, the government has sometimes become a major shareholder. However, at the same time there have been various news reports of chief executives and senior managers receiving huge payments, either in salaries or through bonuses.

What is the relationship between the problems experienced by large US banks and the operation of the reward system enjoyed by senior managers?

What should be done about this situation, and by whom?

Can the financial crisis, in any respect, be considered caused by the failures of HR practitioners?

Is the case of the USA unique, or is the situation similar in other countries?

INDIVIDUAL AND COLLECTIVE PAY SYSTEMS

A review of the nature of collective- versus individual-based reward systems is provided above. However, there is a further issue worth considering. The decline of trade unions in liberal market economies, and the general weakening of the position of ordinary employees, have led to increasing pay dispersion within firms. As collective-based pay systems have become less common, increasing organisational resources have been directed away from ordinary employees, and managers have benefited from this process. Agency theory suggests

that as agents of owners, managers should be reined in from unnecessary extravagance or empire-building (Pendleton 2006: 754). In attempting to solve this problem, managerial pay has increasingly become incentive-based, linked to the performance of the firm on the stock market. Yet even prior to the 2008 economic crisis there were growing concerns over whether these changes had really led to more competent or effective management (see, for example, Bebchuck and Fried 2006). Significantly, Core *et al* (2008) found that executive pay appeared to be immune to negative press coverage. The financial crisis appears, to date, to have done little to dent this excess. Indeed, as noted earlier, Boyer (2010) argues that share price-linked executive reward systems contributed directly to the financial crisis.

THE CRITICAL ROLE OF EMPLOYMENT RELATIONS SPECIALISTS AND LINE MANAGERS

In devising and running reward systems, employment relations practitioners not only have to fall into line with overall organisational strategy and policy (even if they may be in a position to lobby for specific sets of practices) but also have to ensure that they abide by current legislation. This includes ensuring that pay is in line with the legal minimum, the firm's contractual commitments are maintained, and workers within particular job categories are treated equitably. Meanwhile, line managers also face the challenge of ensuring that employees are treated fairly and equitably. In practice, in the case of individual performance-based pay, it may be very difficult to be totally objective. Operationalising accurate measures of value generated by workers remains an open-ended challenge for line management. This can lead to tensions in the workplace that may be resolved through union involvement where there are co-operative relations.

As noted elsewhere, gender, age and ethnicity often coincide with pay inequalities. Although there may be structural reasons for this across society at large, it is likely that they will be mirrored in the actions of managers. For example, if society expects men to be the principal breadwinners, lower pay for women can be justified – in other words, women can 'afford' to have lower pay because men will be the main source of household income. However illogical this may be (especially in the light of the large numbers of woman-headed single-parent households), such attitudes are widespread. Social inequality can often thus be reconstituted through the day-to-day decisions of managers and supervisors.



REFLECTION ON PRACTICE

Gender gaps in pay

Are you aware of any gender gaps in pay in the organisation where you are currently working, or where you have worked before?

In Britain, the Equality Act 2010 established that all workers should have the right to see the pay of other workers – so that both women and men can compare pay rates. What effect, if any, do you think that this will have on equal pay claims in Britain over the next five years?

Are you aware of similar legislation in other countries?

SUMMARY

This chapter has examined the determination of pay systems, and included coverage of both individual and collective pay. Complementing other chapters that have drawn attention to fairness and equity issues, this chapter has addressed the issue of minimum pay, and pay and equity.

Pay and reward represent one side of the operationalisation of the employment contract, the other being the physical delivery of labour power. The amount of pay and rewards and the manner in which they are delivered are thus central to understanding employment relationships. The amounts given to employees will depend on the relative power of each party (determined by relationships within the organisation and external labour market conditions) and the role of external regulating bodies. They will also reflect the relative commitment of the employer to fairness and equity, and the ability of employees to promote this. Within liberal market economies there has been increasing inequality in earnings since the 1970s between those in the highest-paying jobs and the majority of the workforce. In many cases, the latter have had to contend with wages that are stagnant or have declined. Although this may have helped to boost the profit rates of individual firms, it has also contributed to a chronic crisis of consumer demand, leading to growth being fuelled by debt, and attempts to rekindle demand via cost-cutting (which again places downward pressures on wages, worsening the cycle). In short, whereas it may be good for an organisation's short-term profits to constrain the amount that it spends on its workforce, if all organisations operate in the same way, it can create structural economic problems. Moreover, there is no evidence that the emergence of a highly paid managerial super-elite has made organisations any more effective – rather, it appears in many cases to have contributed to a climate of excessive short-termism and irresponsibility (Boyer 2010).



EXPLORE FURTHER

Reading

- Gerhart, B. and Trevor, C. O. (2008) 'Merit pay', in A. Verma, P. S. Budhwar and A. DeNisi (eds) *Performance Management Systems: A global perspective*. London: Routledge
- Kato, T. and Morishima, M. (2002) 'The productivity effects of participatory employment practices', *Industrial Relations Journal*, Vol.41, No.4: 487–520
- McNabb, R. and Whitfield, K. (2007) 'The impact of varying types of performance-related pay and employee participation on earnings', *International Journal of Human Resource Management*, Vol.18, No.6: 1004–25

Website

- Chartered Institute of Personnel and Development www.cipd.co.uk