

The Knowledge of Pay Study

E-mails from the FrontlineSM



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Executive Summary

The Growing Need for More Knowledge About HR Systems

In the wake of several prominent corporate bankruptcies and company stock price depreciations, new questions are being raised about employee 401(k) plan investment rules and knowledge. The spotlight now shines brightly on the need for greater employee protection from officer malfeasance, certain vesting policies and themselves.

Human resources systems changes in the last decade have resulted in more employee choice and self service. Shared service centers with toll-free phone numbers have emerged along with interactive employee intranet and Internet sites. Such self sufficiency is a popular trend, as it reduces administrative and overhead costs and can result in better-informed consumers. While many people do not think twice about filling their own soft drink cups at fast food restaurants, other types of self service – such as individual 401(k) account investing – require greater knowledge, risk and responsibility.

But when self sufficiency backfires, the public and press are quick to blame corporations and/or government. New legislation often follows highly publicized corporate failures, especially when large numbers of employees are hurt. Yet no matter how much protection is legislated, the reality is that more information sharing and education is needed inside organizations that extend more personal choice and responsibility for decision making. Indeed, self management requires knowledge.

These are contemporary issues within the employee benefits community. Yet, they are just as pertinent for compensation management. Employees and managers make choices every day about how to spend their discretionary time and effort at work. As the percentage of knowledge workers grows within companies, more people are paid to think, not just do. So what are employees thinking?

A well-functioning compensation system can make it easier for employees to think and do the right things by clarifying and aligning organizational and individual goals and priorities while maintaining external competitiveness and internal equity. When workers are troubled about their pay, how much can they think about taking care of customers? When they are unsure of the rewards for varying types and levels of performance, how can they be expected to be motivated?

The subject of employee and manager pay knowledge is embryonic. It is striking how little academic research and practitioner discussion exists on the subject. Among its many key findings, the 2002 *Knowledge of Pay Study* reveals that even less conversation is occurring inside organizations on the subject of pay than there is in academia and among practitioners. Perhaps employees are so satisfied with how much they earn and how pay decisions are made that they have little to discuss. Or, there may exist such a strong cultural norm discouraging pay talk in both the neighborhood and the office that the subject is avoided, leaving pay concerns unresolved.

Yet it is clear that low awareness and poor understanding about compensation can cause pay dissatisfaction, which can lead to low commitment or worse, dreaded turnover. How many people quit because of inadequate pay information, which results from feeling underpaid or undervalued? More importantly, how many valued employees can be retained when an organization simply is more open about pay?

Are there organizational advantages when managers and employees know more about their pay and performance systems? Or is it better for employees to be told only what they need to know at the time that they need to know it? Some public institutions, such as governments, reveal everything about pay including what all employees earn, but they pay workers below their private business counterparts. Most private companies stop well short of being as open as governments, but they distribute more money.

So which of these practices is most successful? Look no further than *The Knowledge of Pay* study for answers.

Study Highlights

This in-depth research on the knowledge of pay subject is the first of its kind. The purpose of the 2002 *Knowledge of Pay Study: E-mails from the Frontline* was to discover the amount and types of pay information that would be most helpful to both managers and employees, and to determine whether more pay and performance knowledge impacts organizational effectiveness. For the purposes of this study, organizational effectiveness is defined as engaging employees in their work, and measured by employee retention, organizational commitment, employee referrals, pay-for-performance perceptions and trust in management.

To draw conclusions, the study surveyed more than 6,000 managers and employees in 26 organizations in the United States and Canada, across multiple industries and governments. The sample included highly educated and long-service professionals and managers. To collect manager and employee perceptions on common pay and performance topics, invitations to complete an 88-item online survey were delivered via e-mail. In addition, managers and those eligible for short-term incentives and stock options received more focused survey items. An advisory board of senior-level human resources and compensation professionals was assembled to assist in the design of the questionnaire and to help interpret the data.

Overall, the data clearly say that there are advantages to sharing knowledge about pay and performance with managers and employees. In fact, the data even indicate that organizations that are perceived to pay less competitively achieve higher organizational effectiveness when they share more knowledge about pay and pay processes. Similarly, among companies that are seen to pay more competitively, greater knowledge about pay and performance systems strengthens the employee value proposition.

This study highlights eight high-level findings that provide clues to organizations about how to improve pay and performance management systems and linkages.

- Performance management processes are well understood by employees and managers.
- Pay processes are not well understood by employees and managers.
- There is more satisfaction with compensation amounts than the processes used to determine the pay levels.
- There is more satisfaction with base pay than with variable pay levels, but the reverse is true when it comes to pay process.
- Pay knowledge and performance management knowledge are positively associated with organizational effectiveness.
- Increasing pay and performance knowledge has such a strong positive impact on pay satisfaction that organizations may be able to offset modest base pay increase budgets by simply being more transparent about how pay is determined.
- Short-term incentives are not signaling necessary changes in behavior or motivating those behaviors.
- Managers are much less confident in answering employee questions about specific pay issues than performance management issues, but managers also are not receiving many questions about pay from employees.

These findings lead to the conclusion that while organizations have done an excellent job of educating managers and employees on performance management processes, better education needs to be provided to managers and employees about pay processes. Moreover, these findings indicate that organizations have opportunities for creating a better value proposition for employees that will lead to increased employee satisfaction and increased employee engagement. These specific leverage points are pay knowledge and performance knowledge.

Specific pay processes that managers and employees need to be educated about are presented in this report. Managers and employees expressed greatest concern about the lack of knowledge concerning base pay. The results clearly show that while employees understand the outcomes associated with base pay decisions (i.e., people know their grade/band/pay level), they do not understand the processes used to make these decisions or how these processes impact them. Significantly, it was found that when people report having less base pay knowledge, they also report being less satisfied with their pay. Because pay satisfaction is closely linked to various measures of organizational effectiveness such as commitment and intentions to stay, lack of base pay knowledge can explain some turnover and underperformance.

On an encouraging note, knowledge about performance management was reported to be surprisingly high among both managers and employees. Performance knowledge also is positively related to pay satisfaction and in turn, organizational effectiveness, which is contributing to higher work engagement.

Practitioner Advice

The study's results reveal the following steps that organizations should take to improve the pay knowledge of managers and employees:

- Diagnose the current manager and employee knowledge of pay in your organization.
- Be proactive in educating people.
- Train supervisors and managers to communicate directly with employees.
- Personalize the knowledge of pay for people.
- De-emphasize traditional pay information delivery vehicles (such as formal meetings, videos and handbooks).
- Invest in Web-based learning systems for certain types of messages and information.
- Provide much greater information about pay processes.
- Evaluate how improvements in the pay process and pay process information can offset increases in total pay levels.

Although this study did not calculate the economic return on investment, it is possible to say that improving pay knowledge in an organization will increase the value of human capital in two ways:

- First and most tangibly, it will increase the line-of-sight and perceived value of existing pay programs, possibly avoiding the unnecessary need to increase pay amounts.
- Second, increasing pay knowledge through process improvements and without spending additional compensation expense dollars can increase both pay satisfaction and work engagement.

Introduction

In recent years, organizations have attempted to improve performance by leveraging the work force through the use of contingent and flexible pay designs and innovative performance feedback systems. Recent examples include broadbanding, skill-based pay, competency pay, team pay, gainsharing, goal sharing, profit sharing, spot recognition and stock plans. Not only are there numerous compensation plans, but many organizations also have instituted multiple plans for the same employee population. Moreover, many new pay plans require managers to exercise greater judgment in differentiating and distributing rewards.

Manager judgments about employee performance often drive pay decisions. Consequently, new performance management systems have been introduced in attempts to better capture the full contribution, value and development needs of individuals, including multirater feedback systems, balanced scorecards and competency-based assessments.

The unanswered question is whether these new pay and performance approaches are having the desired results. *Knowledge of Pay* was conducted to determine how well these pay and performance systems are understood, and whether a fuller understanding by employees would contribute to higher results.

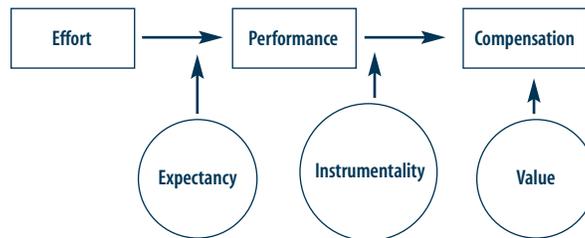
The study poses three strategic questions:

1. What do employees want to know and what do they need to know about their organization's pay and performance management systems?
2. What do managers want to know and what do they need to know to effectively manage pay and performance?
3. What impact does greater knowledge of pay and performance systems have on an organization's goals?

Ultimately, answers to these questions will show how human resources professionals can intervene in compensation and performance management systems in order to improve organizational effectiveness at low cost.

In addition, the answers to these questions are critical because they directly impact compensation plan effectiveness. One motivational theory, expectancy theory, supposes that for pay plans to motivate improved employee performance, employees need to understand the relationships between their efforts and performance levels (i.e., expectancy). Also, they need to understand the relationship between the performance levels they achieve and the compensation they receive (i.e., instrumentality). Lastly, they should place high value on compensation. These linkages are greatly improved and clarified when knowledge and information are shared openly and effectively. Figure 1 illustrates the key linkages defined in expectancy theory.

Figure 1: Expectancy Theory



Similarly, knowledge and information sharing practices also impact retention. In particular, employees are more likely to remain with an organization when the rewards and actions necessary to earn rewards are well understood. Better understanding is likely to occur with improved knowledge and information sharing about the rewards systems themselves.

For these motivational conditions to hold, employees need to have knowledge about how and why the pay plans operate and how they are connected to business results and their own performance. When this knowledge is effectively transferred, employees know precisely what is expected and what rewards they will then receive. However, providing this somewhat technical knowledge in a way that employees and managers understand is challenging, especially given the complexity, for example, of a typical incentive plan's financial measures.

The level of secrecy that surrounds pay further complicates effective knowledge building in many organizations. For example, discretionary cash bonuses often are determined and distributed based upon companywide financial performance, information that is often closely held by senior management. In the absence of full knowledge about the financial measures used and how the employee has impacted these measures, discretionary cash bonuses are not likely to be highly effective in motivating employee performance.

Another obstacle to improving pay knowledge is the increased availability of pay data to employees on Internet job boards and online surveys. Internet information can confound the building of compensation knowledge in organizations because these data are often inaccurate and do not reflect an organization's external market comparison policies or practices (Heneman and LeBlanc, in press).

This study shows that, although it is challenging to explain some compensation information to employees (especially when pay plans are frequently changed), the payback can be substantial. The power of business information sharing and literacy were well documented by Stack (1992) who applied and popularized the principles of "open-book management." Stack realized better business results by educating his work force on how his company makes money. Moreover, sharing more business information strengthens feelings of empowerment, and the sense that one has the ability to make a difference (Lawler, Mohrman & Ledford, 1998). Higher feelings of empowerment are very important because they contribute to a better understanding of the connections between employee effort and employee performance, and employee performance and rewards. In addition, many workers consider empowerment as a reward and become more strongly affiliated to the organization when they feel more empowered.

Managers also play a critical role in developing employee knowledge about compensation plans and the pay for performance relationship. This study will show what managers need to know and want to know to help them effectively motivate employees to be highly engaged in work.

It is clear that knowledge sharing can strengthen business literacy and feelings of belonging and identification. This study was conducted to understand the impact of pay and performance information sharing.

Background

Genesis of the Knowledge of Pay Study

The Rewards of Work: What Employees Value, conducted by The Sibson Consulting Group (a division of The Segal Company) and WorldatWork, examined the impact of the rewards of work on performance, retention and satisfaction (Ledford, Mulvey & LeBlanc, 2000). The study found that satisfaction with the pay process used to determine pay is more important in determining employee retention than is the satisfaction with amount of pay received.

This critical finding has two important implications for this study on the knowledge of pay. First, it is less expensive to upgrade the processes used to pay people than it is to adjust, up or down, the amount paid to people (most pay adjustments are additions to fixed costs and result in a compounding effect when benefits are added). Thus, modifying the pay process can result in substantially lower, mostly indirect costs than the direct payroll and benefits costs associated with adjusting the amount people are paid.

A second implication, however, is that it often is more involved and time consuming to fix the pay process than to fix the pay amount received by employees. While pay amounts can be adjusted fairly easily, changing a broken pay process is very difficult. It can be so complex at times that pay plans such as competency pay have been shown to take an average of 18 months to design and implement (WorldatWork, 1996). Entire books have been written on the topics of pay plan design, implementation and administration.

In addition, even after a pay system is repaired, management may not want to reveal more to managers and employees about pay because doing so may make it easier for them to assess whether the organization's pay systems are fair and equitable. It is possible that some companies do not share more information with employees about pay plan processes because of a concern of being challenged by employees. Given the judgment involved in many pay systems, the advantages of making compensation more transparent may not outweigh the inherent risks.

Thus, to better understand the real opportunities and risks of sharing more pay and performance information, it is necessary to survey both employees and managers. This was the methodology undertaken for the *Rewards of Work* studies and this *Knowledge of Pay* study. As such, this volume builds upon the previous work and attempts to determine the costs and benefits of pay and performance knowledge sharing, which is a key element of pay process. However, unlike the *Rewards of Work* studies, which collected data in the public forum by surveying workers using paper and pencil or by phone at home, *Knowledge of Pay* went directly into some of U.S. and Canada's most respected organizations to obtain access to employees and managers.

Need for a Better Understanding of Pay Knowledge

Very few empirical studies have been conducted on pay knowledge. (See Figure 2.) More importantly, it appears that the research methods used in previous studies were less than rigorous. Fournier (2000) assessed managerial knowledge of pay by asking compensation managers how much pay knowledge their managers “have” and “should have” about several dimensions of pay. Hawk and McAdams (2000) asked managers the amount of knowledge employees have about group incentive plans. In both cases, the results might be questioned because a compensation manager’s beliefs about other managers or a manager’s beliefs about employees can be poor substitutes for actual manager and employee knowledge.

Figure 2: Summary of Pay Knowledge Literature

Authors	Date	Findings
Carberry	2001	The effectiveness of stock options depends upon how much employees understand stock options.
Fournier	2000	Line managers have limited knowledge of pay systems. Pay system training for line managers is rarely conducted.
Frazer	1996	Employees have limited knowledge of pay systems.
McAdams & Hawk	2000	Compensation education is more likely to be found in effective organizations. Managers view themselves as teachers of compensation in effective organizations.
McCarty	1993	Pay knowledge is related to employee perceptions of pay fairness.
National Commission on Employee Entrepreneurship	2001	Employees don’t understand the tax implications associated with stock options. Given reduction in stock value and variable pay, employees who don’t understand pay systems may suffer because stock and variable pay are used to pay monthly bills.
Neubert & Cady	2001	Pay knowledge is likely to be linked to job satisfaction, commitment and retention.
Wellner	2001	There is a large amount of pay data available to employees on the Web and it can be dangerous to employees if they do not understand the pay systems used to derive the data.

This study asked managers and employees directly about their knowledge level. The potential bias that managers and employees are poor judges of their knowledge and/or may inflate their level of knowledge to prevent embarrassment is not likely to be a problem in this study for the following reasons:

- Research from self evaluations in the performance appraisal literature indicates that people provide credible evaluations of themselves for developmental rather than evaluation purposes (Atwater, 1998). This study’s purpose was not evaluative.
- Because this survey was confidential, the anonymity combined with the nonevaluative purpose leaves very little reason for respondents to inflate or deflate their evaluations of their knowledge.
- Employees and managers were asked only for their opinions on their own pay systems, not the pay systems of others.

Furthermore, the online survey methodology employed in this study allowed us to target questions only to respondents who were eligible for specific pay programs such as short-term incentives and stock options.

Knowledge of Pay Model

The Knowledge of Pay model was developed by the authors to define and test the relationship between the key components of pay and work engagement. (See Figure 3, on page 12.) The model illustrates that total pay amount (how much total income is distributed) and the total pay process (how base pay and variable pay systems are managed) influence both pay satisfaction and work engagement. The idea is that the more satisfied an employee is with his/her pay amount and the process used to set that amount, the more he/she will be engaged at work.

The *Knowledge of Pay* (KOP) study was conducted primarily to understand how much total pay knowledge might affect both total pay satisfaction and work engagement. Our hypothesis was that higher knowledge of pay would contribute to higher pay satisfaction and higher work engagement, though it is accepted that even employees who are uninformed about their pay systems can be satisfied with their pay and be engaged at work. Understanding the impact that pay knowledge has on pay satisfaction and work engagement will help practitioners project the payback from an increased investment in knowledge and information sharing. Each component of the KOP model and its relationship to other model components are described below.

Total pay knowledge refers to all specific knowledge areas in compensation that contribute to a fuller understanding about the ways people inside the organization are paid including:

- Base pay knowledge
- Short-term incentive knowledge
- Stock option knowledge
- External market pay knowledge.

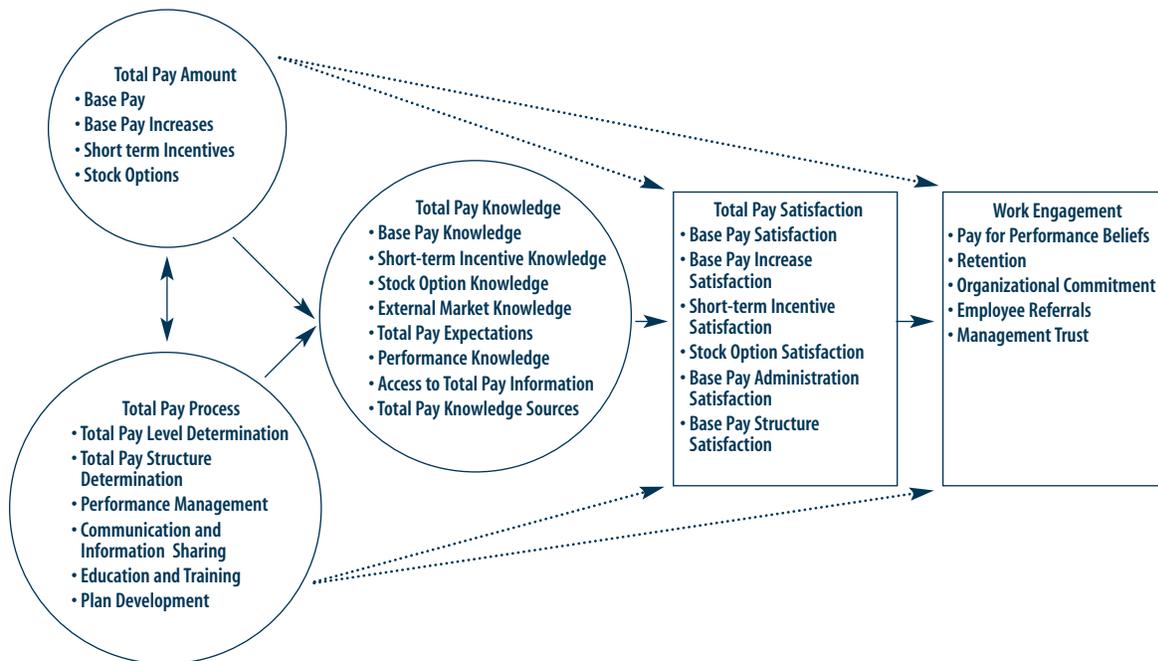
Total pay knowledge is also supplemented by:

- Total pay expectations
- Performance knowledge
- Knowledge about information access
- Knowledge about information sources.

Other determinants of pay satisfaction beyond knowledge of pay are the processes used to determine pay (total pay level determination, total pay structure determination, performance measurement, communication and information sharing, plan development, and education and training) and the total pay amount (base salary level, base pay increases, short-term incentive awards and stock options). Total pay satisfaction is measured separately by examining satisfaction levels with base pay, base pay increases, short-term incentives, stock options, base pay administration and base pay structure. Work engagement refers to the attitudes held by employees toward the company (pay for performance beliefs, management trust, organizational commitment) and the behaviors (retention, employee referrals) figured toward the organization.

The arrows in Figure 3 illustrate the relationship between these various components. This study tested the relationships among pay knowledge, pay satisfaction and work engagement. It also measured the influence of pay amount and pay processes on these relationships.

Figure 3: Knowledge of Pay (KOP) Model



Survey Methodology and Respondent Demographics

The online survey questions were arranged in the following sections with multiple items used in each section:

- Your pay plans
- Access to information about your pay
- Knowledge about your performance, pay and pay processes
- Satisfaction with your base pay
- Attitudes about your job and organization
- Background information about the respondent
- Manager items
- Short-term incentive recipient
- Stock option recipient.

To ensure the scientific accuracy of the results, the research team took several steps in developing survey items.

1. Existing measures with known reliability and validity properties were used when possible.
2. A literature review was conducted as previously described and used to formulate items.
3. The practitioner advisory board carefully reviewed each of the items and made suggestions for new, revised or deleted items.
4. Actual respondents in several organizations pretested the items.

The survey items were designed to tap into attitudes concerning employee and manager rewards received, their sources of information about their pay, their knowledge of pay issues and work engagement issues (e.g., pay satisfaction, commitment to the organization and turnover intentions). In addition, new measures were developed to investigate manager knowledge of the pay process, short-term incentives and stock options.

Importantly, the flexibility of online, software-driven surveying enabled the selection of questions by respondents to focus only on those pay programs in which the respondents participate. This step prevented respondents from guessing on certain items and getting upset about not being eligible for other pay programs (e.g., stock options and short-term incentives). Also, the survey technology allowed for certain questions for managers only (i.e., those who “manage the pay and performance of others”).

When interpreting the data in this report, the reader should bear in mind three important methodological considerations.

First, the data are correlational in nature for definitions of the statistical terms used in the *Knowledge of Pay* study (See Figure 4-A, page 14.) As a result, causality cannot be assessed from these data. Instead, inferences are made based on the relationship between variables in the study.

Second, the correlations reported in the study show the magnitude of the relationships between variables. In general, a correlation of .00 to .20 is small, a correlation of .21 to .40 is moderate and a correlation of .41+ is large relative to correlations reported in human resources management research. Bear in mind, however, that in an absolute sense, even a relatively large correlation of .60 means that the amount of variation shared in common by the two variables in the correlation is only 36 percent. To assess the amount of such variance shared between two variables in the study, the correlation (r) value reported should be squared.

Third, in order to know the level of reliability for variables, it always is desirable to measure each variable with multiple items. Whenever possible, this was done. However, to keep time demands to a manageable level for respondents, the survey length was kept to 88 items for most respondents. As a result, in some cases (e.g., stock option satisfaction), multiple items for all measures were not used.

Figure 4-A: Description of Statistics Included in the Knowledge of Pay Study

Statistical Term	Definition
Percent Responding	Is the value that ranges from 1-100% that represents the portion of the total number of responses that falls into a certain scale category
Mean	Is the average value for a certain item or question. It is calculated by summing all the values collected from all employees answering the question, then dividing that summed number by the number of employees answering the question.
Median	Is also an average value for a certain item or question. The median is determined by finding the response that lays exactly in the middle of all the responses. That is, a certain response will be the median if half of the responses in the sample are higher than that response and half of the responses are lower.
Correlation	Is a measure of the strength of the relationship between two items or scales (e.g. total pay knowledge and total pay satisfaction). Correlation values range from -1 to 1. The closer the value is to 1 or -1, the stronger the relationship is between the two items or scales.

Each participating organization used a stratified random sample method to generate a representative sample of the occupations and demographics in each organization. Organizations invited managers and employees to participate in the survey by e-mail. Invitations briefly explained the study's purpose, guaranteed anonymity and confidentiality, and included a hypertext link or universal resource locator (URL) to the survey. Four organizations sent invitations in late December and the remainder sent invitations in January. Respondents were given approximately a two-week timeframe to participate. Each survey took approximately 20 minutes to complete.

The total number of employees responding to the survey was 6,286 out of 15,467 invited across all 26 organizations, for a response rate of 41 percent. Respondent demographics of this sample are shown in Figure 4-B on page 15. Data in this report are weighted to take into account the differences in the number of employees responding from each organization. The research team surveyed a mix of U.S. and Canadian employees to generalize findings across multiple industries, organization sizes and sectors (private and public).

Figure 4-B: Respondent Demographics

Survey Item	Participant Response
Percent of respondents who experienced a significant change to their compensation system in last year	41.3%
Percent of respondents who are managers	33.9%
Percent of managers who supervise the following number of direct reports	1-5 reports53.7% 6-10 reports27.4% 11-15 reports10.6% 16-20 reports3.9% 21 or more4.4%
Percent of managers who supervise the following number of indirect reports (employees who report through an intermediate level of management)	1-5 reports49.8% 6-20 reports20.4% 21-100 reports21.6% 101 or more reports8.2%
Average age of respondents	40.9 years
Average number of years respondents worked for the organization	9.3 years
Percent of respondents who work in the United States	72.0%
Percent of respondents who work for an organization with more than 10,000 employees	75.5%
Percent of respondents who work for a for-profit organization	93.0%
Others	7.0%
Percent of respondents based on their highest level of education	High school diploma4.9% Some college or technical school20.9% 2-year college degree (AA, AS)9.9% 4-year college degree (BA, BS, etc.)41.7% Master's degree19.1% Law degree or medical doctor1.5% Ph.D.1.9%
Percent of respondents based on their type of occupation	Senior Management or Executive7.2% Manager/Supervisor ¹35.1% Technical/Scientific23.1% Professional18.6% Customer service6.0% Sales3.1% Faculty0.2% Administrative support6.7%
Annual median base pay	United States\$64,962 CanadaC\$56,000
Annual median short-term incentives	United States\$5,000 CanadaC\$5,000
Percent of respondents reporting pay plan participation in last 12 months	Merit pay 61.4% Pay decrease1.8% Promotion increase20.0% Market-based pay adjustment9.4% Equity adjustment4.6% Cost-of-living increase17.2% Seniority pay1.9% Skill-, knowledge- or competency-based pay 6.8% Individual incentive31.1% Group incentive13.1% Divisional incentive13.7% Organizationwide incentive45.0% Stock option or stock grant eligibility36.9%

¹ The percent of managers is not the same as reported in item #2 as some managers and supervisors do not manage the pay and performance of others.

Findings and Discussion

Overall Findings

"The results of this study help set the context for executives to implement pay plans."

*Anne C. Ruddy
Executive Director
WorldatWork*

The purpose of this study was to assess the level of pay and performance knowledge by managers and employees, and define the relationship that this knowledge has with organizational effectiveness. The answer to these issues, at a very high level, comes from expectancy theory and the results of the survey conducted for this study. (See Figure 2 on page 10.) Expectancy theory indicates that for employees to be motivated, they must value the rewards their employer provides and clearly see two relationships: 1) between their effort and their performance and 2) between their performance and rewards. To establish these links, employees must understand both the performance management process and the pay process.

The results of this study show that both employees and managers clearly understand the performance management process. Recent efforts by employers to improve their performance management processes appear to have been quite successful. On the other hand, managers and employees report a lower level of knowledge about pay processes. While employers have changed and added many pay plans in recent years, they do not appear to be well understood by those who are being rewarded, according to the study's data.

Many organizations may now be in a situation in which the performance management process is well understood, but the pay process is not. In situations where this is indeed the case, the link between pay and performance is likely not strong, and therefore, motivation may not be as strong as it could be. Consequently, many organizations may be experiencing a low return on their compensation investment. To improve both employee motivation and the return on compensation investment, this study indicates that employers need to educate people more about pay processes, as they have done for performance management processes.

“Knowledge of pay (KOP) provides a new element to engaging people at work. KOP is a cornerstone of being an employer of choice.”

*Ranjit Nair
Director, Compensation, Benefits, and Human Resource Technology
Honeywell*

Knowledge of Pay shows that when managers and employees understand pay processes, organizational effectiveness measures go higher. In particular, greater pay knowledge is associated with higher levels of pay satisfaction. In turn, higher levels of pay satisfaction are positively associated with some measures of organizational effectiveness, including high levels of retention, organizational commitment, employee referrals, management trust and pay for performance perceptions. From these observations, the utility of improving pay knowledge for organizations is clear.

This study’s results will be encouraging for many organizations because they suggest that organizations are likely to improve their performance by increasing pay knowledge. Additional increases to actual pay are not necessarily needed to improve pay satisfaction and organizational effectiveness. While it is indeed true that both more pay knowledge *and* more actual pay (versus pay knowledge alone) are associated with higher levels of organizational effectiveness, improved pay knowledge was found to be related to higher levels than just additional pay. As a result, the cost of improving organizational effectiveness with pay may be lower than anticipated because indirect costs are needed to improve pay knowledge, and indirect costs usually are less than direct costs.

In recent years, compensation professionals have worked hard at developing and implementing new pay systems consistent with business objectives. A critical administrative component of these new pay plans is often ensuring that the parties affected by these new pay plans have knowledge about them. This report first will illustrate specific types of pay knowledge (i.e., base pay, short-term incentives and stock options) that employees and managers need to understand. Next, the report will review the findings concerning measures of pay satisfaction. Those specific findings will lead to recommendations about low-cost, high-impact pay knowledge “leverage points” associated with improved pay satisfaction and organizational effectiveness. The last part of the report reviews the results of survey questions targeted to managers. Specific attention is paid to the direct and indirect reports for whom they manage pay and performance.

“The lack of transparency in pay policies is a big issue for traditional companies. It probably extends to benefit communications as well.”

*Jeff McCutcheon
Vice President, Human Resources
CSX*

Key Points: Overall Findings

1. Performance management processes are well understood by managers and employees.
2. Pay processes are not well understood by managers and employees.
3. Pay knowledge is associated with organizational effectiveness.

Pay and Performance Knowledge

This section addresses employees' knowledge of pay and performance management plans in their organizations. Respondents answered questions concerning their knowledge of performance, base pay; external market, short-term incentives; and stock options and grants. Additional survey items assessed total pay expectations, access to pay information and pay knowledge sources. If employees reported being eligible for short-term incentives or stock options or grants, they then were asked questions addressing these specific rewards.

"Efforts to improve the understanding about performance management really seem to have paid off, although actually giving and receiving feedback could be improved."

*Daniel P. Purusbotbam, Ph.D., CCP
Vice President, Compensation and Performance Management
The Hartford Financial Services Group*

Performance Knowledge

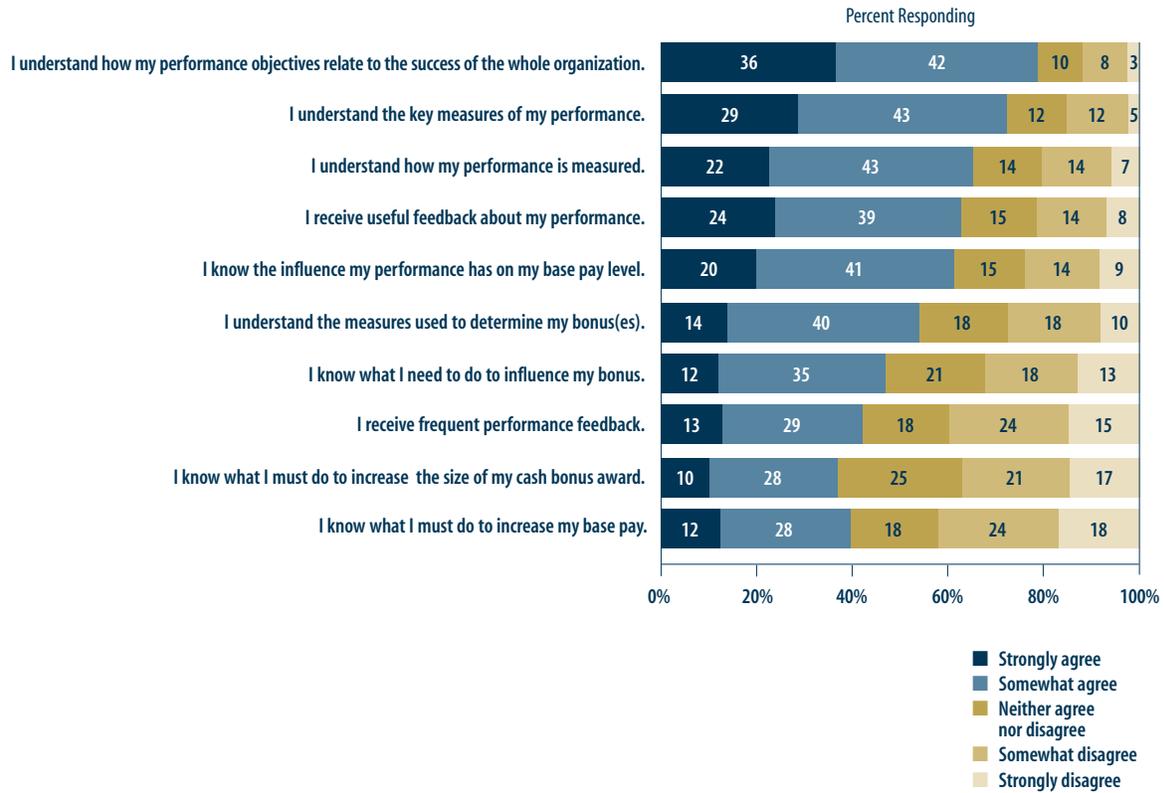
As shown in Figure 5 on page 20, most employees feel well versed in the performance management process. More than three out of four (78 percent) respondents either strongly or somewhat agree that they understand how their performance objectives relate to the organization's success, and 72 percent report understanding how their performance is measured.

Although 63 percent said they strongly or somewhat agree they receive useful feedback about their performance, only 42 percent note receiving frequent performance feedback. Furthermore, only about four out of 10 report they know how to increase base pay and the size of their cash bonus plan.

Although respondents noted that the performance management process is effective with regard to setting goals, understanding performance measures and receiving performance feedback, the performance-to-reward link and subsequently the link to future behavior is weak. These findings suggest that the motivational impact of compensation systems may be suboptimized because a large segment of the respondents report not knowing how their performance affects their compensation.

Figure 5: Performance Knowledge*

Please indicate the extent to which you agree or disagree with each of the following statements:



Key Points: Performance Knowledge

Employees and managers...

1. Understand their performance objectives.
2. Understand the relationship between their objectives and organizational goals.
3. Understand how their performance is measured.
4. Do not understand how pay and performance are related.

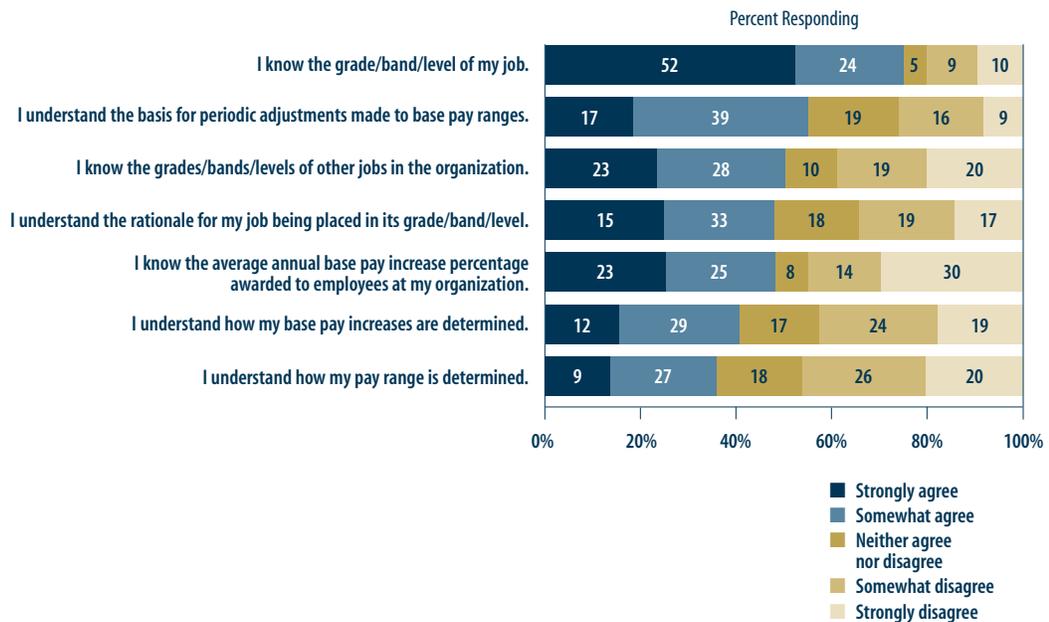
*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

Base Pay Knowledge

Two key findings are apparent from the base pay items in Figure 6. Employees seem to understand the outcomes of base pay decisions. For example, 76 percent of respondents strongly or somewhat agreed that they know their grade/band/pay level. However, it is not nearly as clear to employees how decisions are made about their individual base pay. Only 41 percent, in fact, indicated that they understand how their base pay increase is decided and even fewer (36 percent) report understanding how their pay range is determined. Overall, the data make clear that processes for base pay and base pay increases are not well understood by many employees.

Figure 6: Base Pay Knowledge*

Please indicate the extent to which you agree or disagree with each of the following statements:



Key Points: Base Pay Knowledge:

Respondents...

1. Understand the grade/band/pay level for their job.
2. Are not clear about how their pay ranges and base pay increases are determined.

*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

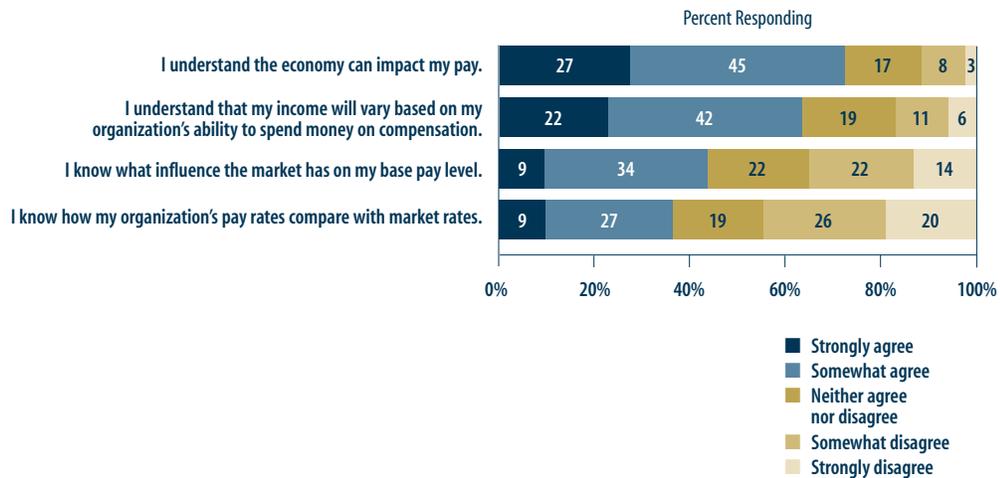
External Market Knowledge

As illustrated in Figure 7, respondents only have a general understanding of the role that the external market plays on pay. Seventy-two percent strongly or somewhat agree that they understand the economy can impact their pay. Further, 64 percent strongly or somewhat agree that their income will vary based on the organization's ability to spend money on compensation. These responses may be a function of the period during which the data were collected, which was typified by a slowdown in pay increases due to a slowing economy.

However, people are not familiar with the techniques used by HR to associate their pay to the external market. For example, only 43 percent indicated they know what influence the market has on their base pay level and 36 percent agreed that they know how their organization's pay rates compare to the market.

Figure 7: External Market Knowledge *

Please indicate the extent to which you agree or disagree with each of the following statements:



Key Points: External Market Knowledge

Employees and managers...

1. Know the general economy will affect their company's ability to pay.
2. Do not know how the external market influences their base pay.

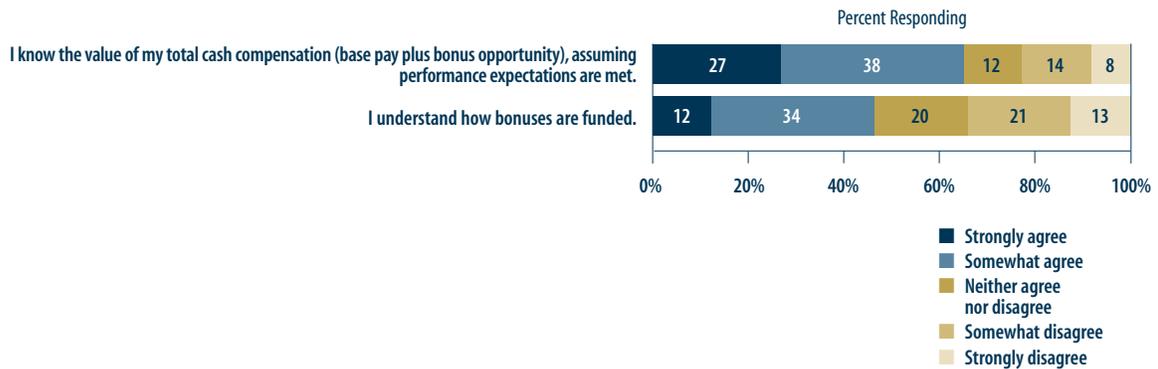
*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

Short-term Incentive Knowledge

Figure 8 shows that, again, as with other aspects of pay, employees understand what it is they receive, but are not as sure of the process used to make this determination. In particular, 65 percent somewhat or strongly agreed that they know the value of their incentives, but only 56 percent understand how these incentives are funded. Recall from Figure 4-B that there are more respondents reporting participation in organizationwide incentive plans than individual, group or divisional incentive plans. In general, the further away the reward is from the employee, the more distant are the performance objectives, and the more challenging it is to connect performance to an individual award.

Figure 8: Short-term Incentive Knowledge*

Please indicate the extent to which you agree or disagree with each of the following statements:



Key Points: Short-term Incentive Knowledge

Respondents...

1. Understand the value of their short-term incentives.
2. Are not clear how their short-term incentives are calculated.

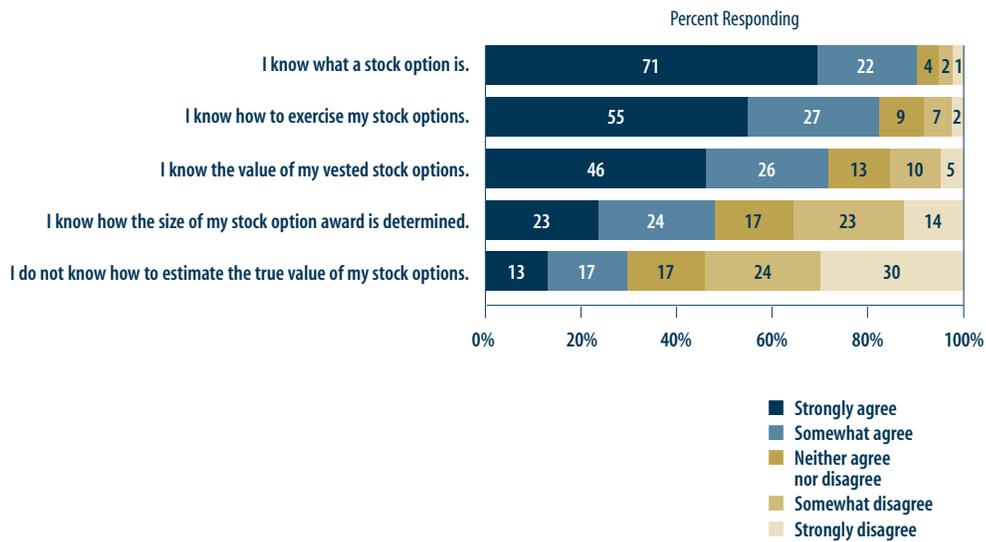
*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

Stock Option Knowledge

Many participants (almost 40 percent) in the KOP study indicated eligibility for stock options or stock grants. (See Figure 4-B on page 15.) The data in Figure 9 illustrate that the stock option- or grant-eligible employees have knowledge about some stock option basics. In particular, an overwhelming majority of eligible employees (93 percent) are aware of what stock options are and how to exercise them (82 percent). On the other hand, the related processes are reported to be less clear. Only slightly more employees (47 percent) report that they know how the size of their stock option award is determined than those who reported that they did not (37 percent).

Figure 9: Stock Option Knowledge*

Please indicate the extent to which you agree or disagree with each of the following statements:



Key Points: Stock Option Knowledge

Employees and managers...

1. Are knowledgeable about their stock options and how to exercise them.
2. Are less clear about the processes to determine stock option awards.

"Employees can intellectualize the pay system, but cannot personalize it to their own situation."

*Susan Zelinski-Davis, CCP
Manager, Employee Performance and Rewards
Nationwide Insurance*

*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

“Don’t underestimate the intelligence of the work force. They want to know about their pay systems.”

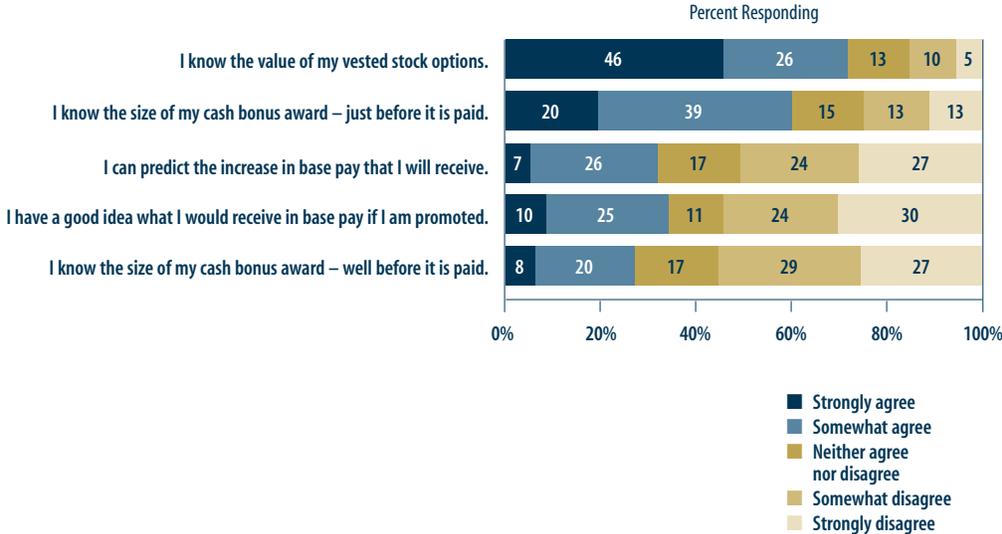
*Ranjit Nair
Director, Compensation, Benefits, and Human Resource Technology
Honeywell*

Total Pay Expectations

It is clear from the total pay expectation data in Figure 10 that employees have a difficult time assessing how their own performance will impact their pay. Employees are not aware of how a new job, promotion or performance increase will be reflected in their pay. For example, only about one of three respondents strongly or somewhat agrees with the statement that he/she knows the amount of base pay or promotional increase he/she will receive. Although 60 percent of respondents knew their cash bonus, only 28 percent knew it well before it was paid.

Figure 10: Total Pay Expectations*

Please indicate the extent to which you agree or disagree with each of the following statements:



Key Points: Total Pay Expectations
 Respondents...

1. Do not understand how an internal promotion will impact their pay.
2. Are not aware until the very end of the performance period how their performance will influence the amount of their cash bonuses.

*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

Access to Pay Information

The amount of access that employees feel they have to pay information within their organization is shown in Figure 11. Clearly, pay secrecy still is an important fact of life in many organizations. Many respondents indicated that, “At our organization, our pay programs are not to be discussed.” In fact, only about one in five respondents either somewhat or strongly disagreed with that statement. Moreover, most respondents are dissatisfied with their inability to access pay information from their organization. On the two survey items that assess employees’ satisfaction with access to pay information, only about three in 10 reported being very or somewhat satisfied.

Although many employees and managers describe their organization’s pay information sharing practices as closed, it is interesting to note that many employees also feel that they know where to go in the organization to get pay information (73 percent somewhat or strongly agree) and slightly less agree that they get the information they need. The source and the accuracy of the information they receive are not known, however. At a minimum, one might worry that employees may not receive complete information given the perceived unwillingness of the organization to present pay information.

Figure 11: Access to Pay Information*

Please indicate the extent to which you agree or disagree with each of the following statements:

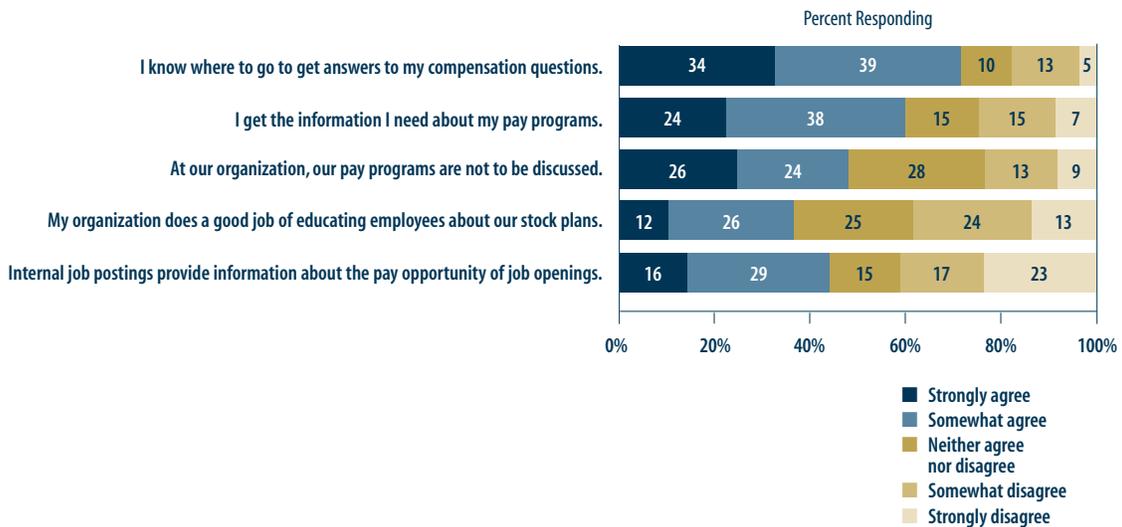
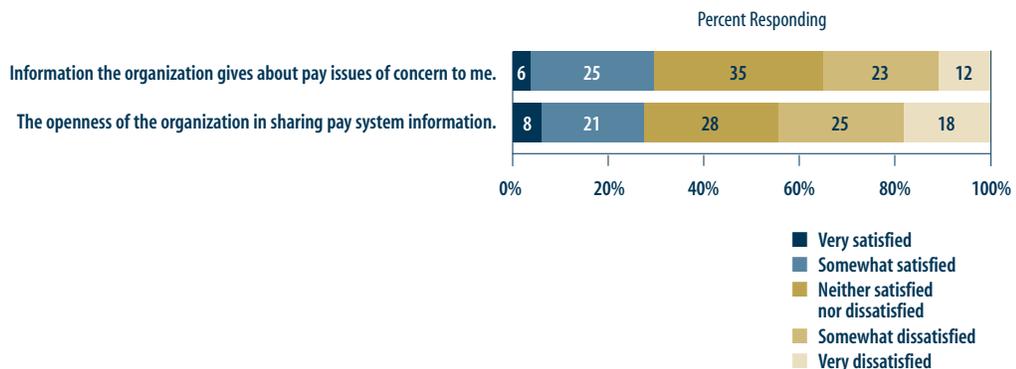


Figure 11A: Access to Pay Information*

Please indicate the extent to which you are satisfied or dissatisfied with each of the following statements:



*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

“We need to demystify for employees what is going on with compensation in the organization.”

*John G. Anderson, CCP
Director, Compensation and Benefits
Chicago Mercantile Exchange*

Key Points: Access to Pay Information

Respondents...

1. See organizations as secretive about their pay systems.
2. Want more information about the pay system, especially as it relates to their personal situation.
3. Know where to go to get pay information.

Figure 12: Advantages and Disadvantages of Making More Pay Process Information Available to Employees

Advantages
<ol style="list-style-type: none"> 1. Employees are more likely to be satisfied with their pay. 2. Employees are more likely to see pay decisions as fair. 3. Employees are more likely to be motivated when they see the link between their behavior and pay.
Disadvantages
<ol style="list-style-type: none"> 1. Management is fearful that it will lose flexibility and discretion in making pay decisions. 2. Employees may become aware of problems with the pay system.

“Human contact seems more important than nonhuman contact. Is there an over reliance on technology? Technology gives us efficiency, but not effectiveness. Technology helps build speed but not relationships.”

*Dan Purusbotbam, Ph.D., CCP
Vice President, Compensation and Performance Management
The Hartford Financial Services Group*

Pay Knowledge Sources

Regarding the effectiveness of sources of pay knowledge used by employees to obtain pay information, three findings stand out from the data in Figure 13 on page 29. First, employees and managers do not believe that the traditional sources of pay knowledge (i.e., orientation, policy manual, handbooks, videos, classroom training) are effective. Within the group of traditional methods, respondents rated written communications as most effective, with 49 percent indicating it is either very or somewhat effective (although only 10 percent of respondents indicated it is very effective). Video communication is the least used, with only 54 percent reporting receiving pay information by this method. It is also seen as the least effective pay information sharing method.

"Typical education about compensation programs emphasizes concepts and technical information, but may fail to show employees how it impacts their personal situation."

*Lisa Turner
Director of Compensation
Wendy's*

A second important finding is that employees see face-to-face communication with supervisors, managers and HR representatives as most effective. Managers and supervisors are viewed as the most effective source, with 63 percent of respondents noting they are very or somewhat effective, probably because they speak the same language as employees and have a closer working relationship with the employees. It is important to note that the human resources department representative was a close second to the supervisor or manager, with 58 percent of respondents noting they are either very or somewhat effective. Despite their relative effectiveness, both sources have substantial room for improvement in transferring pay information.

A third major finding is that intranets and organizational Web sites have a moderate level of effectiveness relative to the highly rated face-to-face communications and the lower-rated traditional sources, with 47 percent noting it as an effective source. Given the relatively recent introduction of corporate intranet sites it is possible that this source will become more effective for many organizations in the near future. Increasing the effectiveness of the intranet or organization's Web site is more likely when it utilizes technology that personalizes the compensation information for each employee (Mulvey & Makoid, in press). Although this source will never be a perfect substitute for the face-to-face interactions with a supervisor, manager or HR representative, it is likely a relatively low-cost complement to those sources.

The bottom line is that more personal and easily accessed sources seem to be most effective. Fortunately, as shown in Figure 14 on page 29, more organizations report that they use more effective than ineffective pay knowledge sources. For example, the most effective source (supervisors or managers) also is the most widely used, whereas the least effective source (video communications) also is the least used.

While this study's results are positive in terms of the sources of pay knowledge, it should be remembered that the actual knowledge held by respondents is low. An important implication here is that both managers and human resource professionals need to be knowledgeable about pay processes, especially base pay, as they are being relied on to share critical pay-related information.

"If technology is to be used to communicate pay, it should be used for transactional issues. When it comes to transformational information, personal contact should be used."

*Tim Reynolds
Director of Human Resources
Whirlpool Corporation*

Figure 13: Pay Knowledge Sources*

Rate the effectiveness of each source for learning about your pay plans:

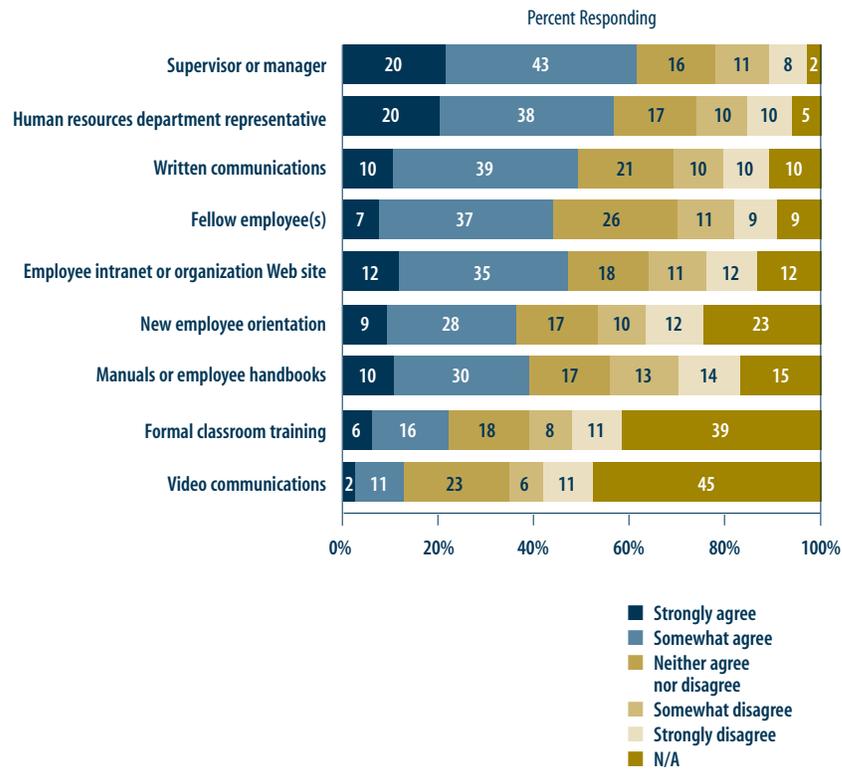
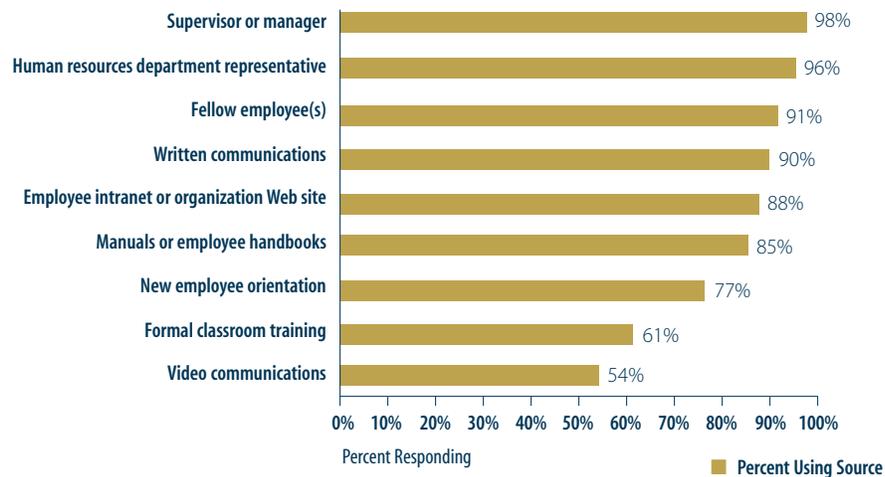


Figure 14: Ranking of Pay Knowledge Sources by Frequency of Use



*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

Key Points: Pay Knowledge Sources

1. Traditional methods to educate employees (orientation, policy manual, handbook, video, classroom training) are least effective.
2. Supervisors, managers and HR representatives are the most effective sources for pay information.
3. Web sites and intranet sites are efficient, but still not the most effective information source.
4. Most organizations use effective information-sharing sources.

"Although sometimes perceived as a negative, informal communications can be advantageous. Fellow employees can help generate excitement about compensation programs. For example, word travels fast when the stock price climbs."

*Lisa Turner
Director of Compensation
Wendy's*

Total Pay Knowledge

Total pay knowledge refers to the total level of knowledge regarding: Base pay, external markets, short-term incentives and stock options. Figure 15 on page 31 reports the means for total pay knowledge and all pay and performance knowledge scales. The means range from a low of "1" anchored with "strongly disagree" to a high of "5" anchored with "strongly agree" for all of the scales. One exception is for pay knowledge sources that range from a low of "1" anchored with "very ineffective" to a high of "5" anchored with "very effective."

Figure 15 illustrates that employees are most knowledgeable about their stock options (mean = 3.89) and performance (mean = 3.40) and least knowledgeable about their base pay (mean = 3.18). Also, respondents are relatively unclear about what to expect in total pay (mean = 2.70). One possible explanation concerning these findings is that the level of employee participation in the process likely affects pay knowledge. For example, in contrast to typical employee participation in base pay decisions, employees' active participation in exercising their stock options likely increases their stock option knowledge. Additional evidence for this explanation is found with responses to the item "My organization does a good job of educating employees about our stock plans" – only 38 percent of respondents either strongly or somewhat agreed with this statement. This suggests that employee knowledge about stock options or stock grants is not solely a derivative of organizational education or training programs, as employees are learning about their stock options when they exercise them.

A review of specific items in Figures 5, 6, 9 and 10 also helps explain why respondents are more knowledgeable about their stock options and performance compared to their base pay and total pay expectations. As displayed in Figure 9, stock option-or grant-eligible employees report they strongly or somewhat agree with knowing what a stock option is (93 percent), how to exercise them (82 percent) and the value of their vested stock options (76 percent). In Figure 5, respondents also report strong or some agreement with knowing how their performance objectives relate to organizational success (78 percent), key measures of their performance (72 percent) and how their performance is measured (65 percent).

In contrast, data from Figures 6 and 10 demonstrate less agreement concerning knowledge of base

pay and total pay expectations. Specifically, items from Figure 6 demonstrate that there was less agreement for knowing the average annual base pay increase percentage awarded (48 percent), how base pay increases are determined (41 percent) and how their pay range is determined (36 percent). Also, items from Figure 10 reveal that although employees agree that they know the value of their vested stock options (72 percent), they agree that they are less knowledgeable about the increase in base pay they will receive (33 percent) and the increase in base pay they will receive if they are promoted (35 percent).

Another key finding in reviewing the data from total pay knowledge is that respondents know much more about the value of their base pay, short-term incentives and stock options than they do about how these rewards are determined. Scanning the items in Figures 5 (Performance Knowledge) through 9 (Stock Option Knowledge) reveals that the items with the lowest scores are ones that assess “how” a particular reward is determined. That is, knowledge of the pay process is generally lower than knowledge of the pay outcomes.

To illustrate this point a few of these findings are listed below. Few respondents somewhat or strongly agree that they understand:

- *How* their pay range is determined - 36 percent (Figure 6)
- *How* their organization’s pay rates compare to the market - 36 percent (Figure 7)
- *How* bonuses are funded - 46 percent (Figure 8)
- *How* the size of their stock option award is determined - 47 percent (Figure 9).

Figure 15: Total Pay Knowledge



“People understand that their pay is structured, but they don’t understand how the structure was determined or how it impacts them personally.”

*Lisa Turner
Director of Compensation
Wendy’s*

Key Points: Total Pay Knowledge

Employees and managers ...

1. Are most knowledgeable about their stock options and performance.
2. Are least knowledgeable about their base pay.
3. Are unsure what to expect in total pay.
4. Know their grade/band/pay level.
5. Understand that the market will influence base pay.
6. Know the value of their short-term incentives.
7. Are not clear about how their base pay increases are determined.
8. Are not clear about how the external market influences their base pay.
9. Do not know how their short-term incentives are calculated.

“Unfortunately, the things that a compensation department prides itself on are not well understood by people. Taking aggregate compensation data and applying it to an individual employee is an inherent weakness in compensation systems.”

*Jeff McCutcheon
Vice President, Human Resources
CSX*

Pay Satisfaction

This section addresses employees' reactions to their pay plans. Respondents answered questions concerning their satisfaction with base pay, base pay increases, short-term incentives, stock options and stock grants, base pay administration, and base pay structure. Only employees who noted that they were eligible for short-term incentives and stock options or grants were asked these survey questions.

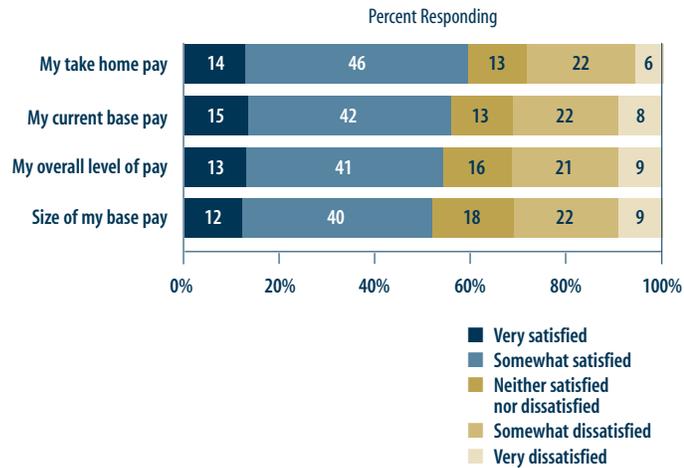
Base Pay Satisfaction

The results for base pay satisfaction in Figure 16 might be encouraging for employers. Contrary to popular wisdom that employees never are satisfied with their base pay, the majority of respondents are either very or somewhat satisfied with their level of base pay, ranging from 52 percent with "size of my base pay" to 60 percent with "my take home pay." Only an extremely small segment of respondents (between 6 percent and 9 percent) are very dissatisfied, and approximately one in five employees is somewhat dissatisfied with his/her base pay.

These relatively high scores may be explained by strong productivity and low unemployment during the 1990s resulting in compensation increases that rose faster than at any time since the 1950s. It is also a fact that everyone benefited in this "real" wage growth, from CEOs down to nonexempt personnel. These long trends, combined with recent layoffs and the softening economy, may cause employees and managers to be more focused on job security than pay level.

Figure 16: Base Pay Satisfaction*

Please indicate the extent to which you are satisfied or dissatisfied with each of the following:



Key Point: Base Pay Satisfaction

Most respondents generally are satisfied with their base pay level.

*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

Base Pay Increase Satisfaction

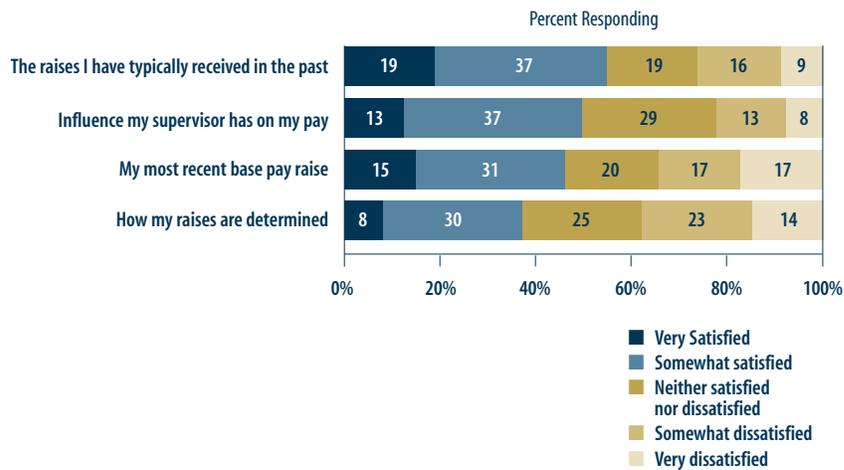
As with base pay, Figure 17 indicates that respondents are, for the most part, either neutral or satisfied with increases to their base pay. Fifty-six percent of respondents indicated they are either very or somewhat satisfied with “the raises I have typically received in the past.” This is higher than the percentage that indicated they were very or somewhat satisfied with “my most recent base pay raise” (46 percent). The difference in these two related base pay increase questions may reflect the weak economy which prevailed during the period when the data was collected, as many employees’ most recent base pay increases may not have been as large as they had been in the past.

In addition, fewer respondents were satisfied with base pay increase processes than with base pay increase amounts. One item that assesses the base pay increase process (“how my raises are determined”) reveals that only 38 percent are either very or somewhat satisfied. The response to this process item revealed lower satisfaction than the item that assessed base pay increase amounts, where 56 percent indicated they are either very or somewhat satisfied with “the raises I have typically received in the past.”

This finding is consistent with a key point regarding base pay knowledge. Recall that respondents report that they do not know much about how their base pay increases are determined. It is logical that if they are not knowledgeable about the base pay increase process, they will be less satisfied with it.

Figure 17: Base Pay Increase Satisfaction *

Please indicate the extent to which you are satisfied or dissatisfied with each of the following:



Key Points: Base Pay Increase Satisfaction

Respondents...

1. Are satisfied or neutral regarding their base pay increases.
2. Are not satisfied with how their base pay increases are determined.

*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

“(Organizations) should only fund incentive plans if the line-of-sight is clear.”

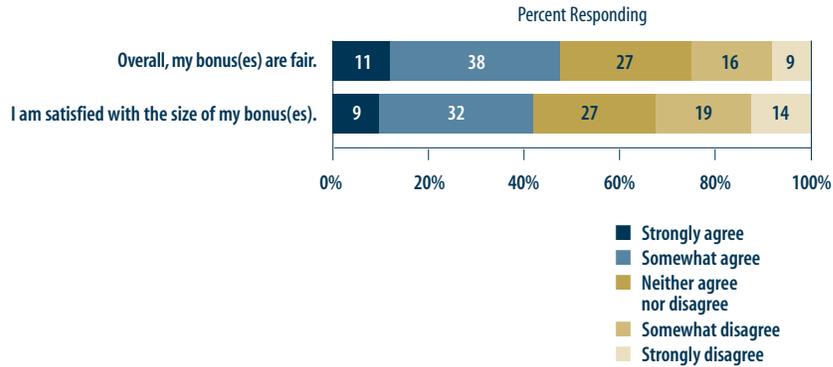
*Susan Zelinski-Davis, CCP
 Manager, Employee Performance and Rewards
 Nationwide Insurance*

Short-term Incentive Satisfaction

Actual pay received by employees, this time in the form of short-term incentives, again is viewed positively by respondents, as shown in Figure 18. The majority of respondents either are neutral or positive about short-term cash incentive awards. In fact, only one-third of the respondents indicated that they either somewhat or strongly disagree with the statement: “I am satisfied with the size of my bonus(es).” Almost half (49 percent) either strongly or somewhat agreed that their bonuses are fair.

Figure 18: Short-term Incentives Satisfaction *

Please indicate the extent to which you agree or disagree with each of the following statements regarding cash bonuses (cash bonuses are any incentives including individual, group, divisional or organizationwide):



Key Point: Short-term Incentive Satisfaction
 Most respondents believe their bonuses are fair.

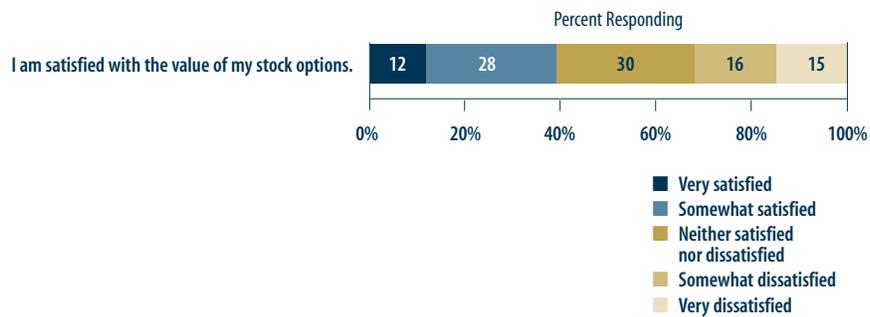
*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

Stock Option Satisfaction

Figure 19 shows that more respondents are satisfied than dissatisfied with the value of their stock options. Specifically, 40 percent of stock option-eligible employees either are very or somewhat satisfied with the value of their stock options, compared to 31 percent who either are very or somewhat dissatisfied. Stock option satisfaction is primarily related to the amount of access that people have to stock option information and the amount of knowledge that people have about stock options. Perhaps these scores would be stronger if organizations did a better job explaining how stock options are granted and how they are valued. Recall that both of these shortcomings to stock option knowledge were shown in Figure 8 on page 23.

Figure 19: Stock Option Satisfaction*

Please indicate the extent to which you are satisfied or dissatisfied with each of the following:



Key Point: Stock Option Satisfaction

Respondents are generally neutral about their stock options.

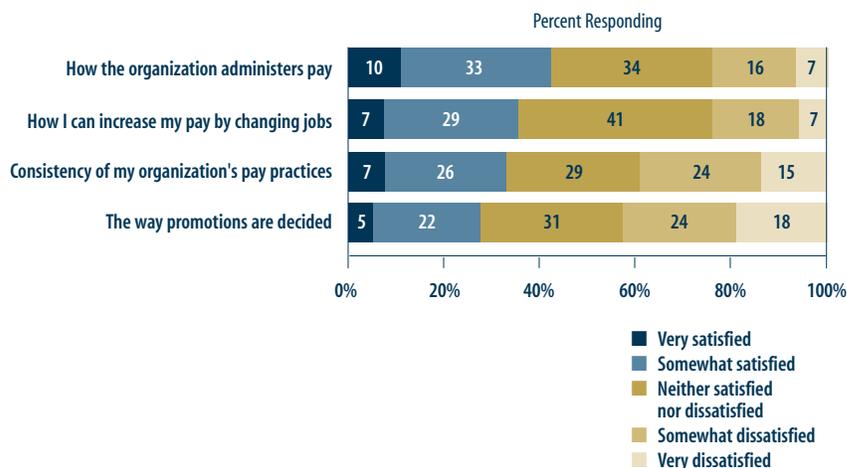
*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

Base Pay Administration Satisfaction

In terms of the administration of their pay, the majority of respondents generally are not satisfied, as illustrated in Figure 20. Forty-three percent indicated they were either very or somewhat satisfied with “how the organization administers pay.” Approximately one of three employees is either very or somewhat satisfied with the “consistency of my organization’s pay practices.” More concern is expressed, however, about the way that promotions are decided, as only 27 percent reported being very or somewhat satisfied. Compared to satisfaction with base pay, which ranged from 52 percent to 60 percent in Figure 16, satisfaction with base pay administration clearly is much lower, ranging from 27 percent to 43 percent. Although concerning, this difference in satisfaction levels between base pay and base pay administration is not surprising, as the two earlier *Rewards of Work* studies found similar results in 1998 and 2000.

Figure 20: Base Pay Administration Satisfaction*

Please indicate the extent to which you are satisfied or dissatisfied with each of the following:



Key Point: Base Pay Administration Satisfaction

Employees and managers...

1. Are not satisfied with how promotions are decided.
2. Believe their organization’s pay practices could be more consistent.

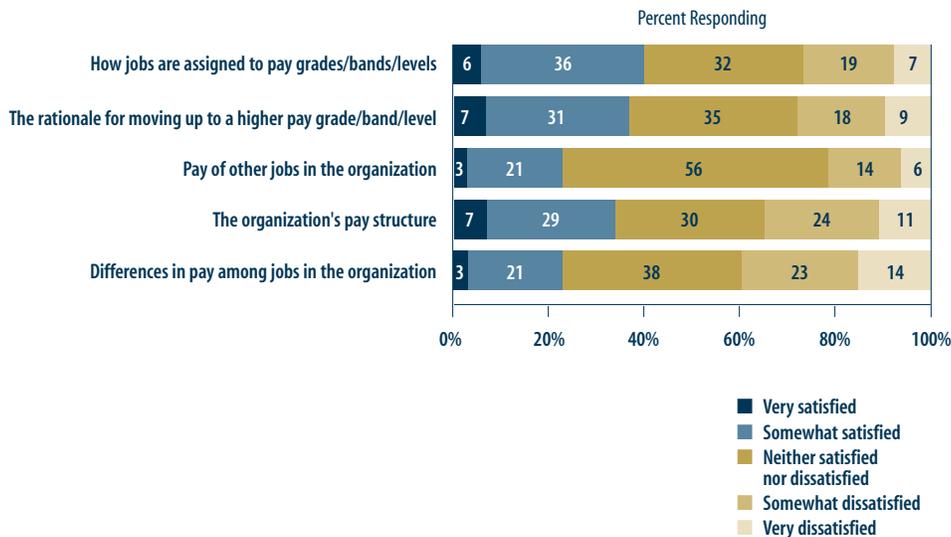
*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

Base Pay Structure Satisfaction

Consistency of base pay practices is a concern for many, as shown in Figure 21. In particular, concern is expressed about the overall base pay structure and the placement of other employees' jobs in the base pay structure. Thirty-six percent report satisfaction with "the organization's pay structure" and only 24 percent are satisfied with "pay of other jobs in the organization" and "differences in pay among jobs in the organization." It is noteworthy that respondents are more satisfied with "how jobs are assigned to pay grades/bands/levels," with 42 percent either being very or somewhat satisfied. Overall, respondents are not as pleased with their base pay structure, as satisfaction ranged from 24 percent to 42 percent for these survey items. This finding is in sharp contrast to their relative satisfaction with their base pay level, which ranged from 52 percent to 60 percent.

Figure 21: Base Pay Structure Satisfaction*

Please indicate the extent to which you are satisfied or dissatisfied with each of the following statements:



Key Point: Base Pay Structure Satisfaction

Respondents are not satisfied with their organization's pay structure.

*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

“Evolving compensation practices, such as broadbanding, have blurred the traditional definitions of promotion.”

*Lisa Turner
Director of Compensation
Wendy’s*

Total Pay Satisfaction

The average score for each category of total pay satisfaction is shown in Figure 22. Possible scores range from 1 “very dissatisfied” to 5 “very satisfied.” As illustrated, people are more satisfied with the amount of pay that is received represented by “base pay satisfaction” (mean = 3.32) and “base pay increase satisfaction” (mean = 3.20) than with the processes used by the organization to determine the amount of pay received represented by “base pay structure” (mean = 3.00) and “base pay administration” (mean = 2.98).

Figure 22: Summary of Pay Satisfaction Scales



Most employees seem to be neutral or positive about the amount of base pay that they receive. This result is impressive, given that the data to support this conclusion were collected during a softening labor market, when base pay increase budgets were under downward pressure. Alternatively, employees may feel better about having a job as more layoffs and business closures are announced. During insecure economic periods, the focus may well shift from pay to job security.

Also, respondents’ concerns about pay processes should be of concern to compensation and human resources professionals. It is clear from the data that employees want more information about pay processes. To provide more data requires employers to be more open about the organization’s pay system. It also is clear that employees want better information. The need for better information is especially true for judgments made about the value of jobs to the organization. The concern appears to be more about internal equity rather than external equity issues.

While dissatisfaction with pay processes is not necessarily good news for employers, there is a bright side to this dilemma. Fixing a dysfunctional base pay process is typically less expensive than trying to fix pay amount issues, which could require higher salaries and bonuses. Pay process problems may be more complex, but typically do not require as much money to solve.

Key Points: Total Pay Satisfaction

Employees and managers...

1. Are neutral or satisfied with the amount of base pay that they receive.
2. Are concerned about the pay processes used to determine the amount of base pay that they receive.
3. Are most concerned with promotion decisions, the placement of other people in the pay structure, jobs in the pay structure and the inconsistency in organizational base pay practices.

"Position in range, particularly with reference to the midpoint, is a very emotional issue to employees. This emotionality needs to be addressed with much positive communication. At the same time, internal equity should not be overlooked."

*Dan Purushotham, Ph.D., CCP
Vice President, Compensation and Performance Management
The Hartford Financial Services Group*

Leverage Points for Improving Pay and Performance System Returns

The purpose of this study was not just to identify knowledge gaps about pay, but to also understand whether organizations benefit in some way from a work force that knows more about pay and performance. As described in the Knowledge of Pay model (Figure 3), this study set out to determine whether a positive association exists between pay knowledge and the outcome factors of pay satisfaction and work engagement. That is, as employees become more knowledgeable, does their satisfaction with pay and engagement with work increase?

To answer this, we ran a series of correlations. A correlation is a statistic that measures the strength of the relationship between two factors or scales. In this case, the factors consist of those listed in the Knowledge of Pay model in Figure 3 on page 12. Correlations can range from -1 to 1, although all the correlations between factors reported in this study are positive. A positive correlation between two factors (e.g., base pay knowledge and base pay satisfaction) denotes that as values for one scale increase, so will values for the second scale. The closer the correlation is to 1, the stronger the relationship between the two scales. (See the survey methodology section for more information on statistics in this study.)

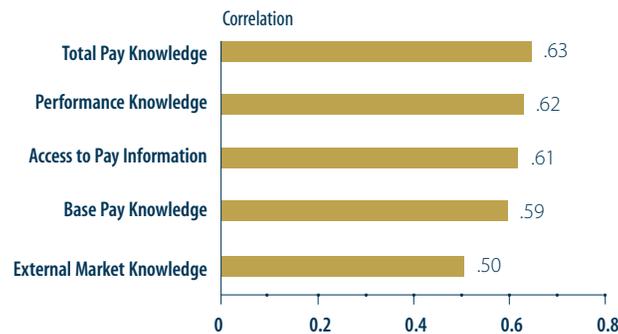
In this section, the results of the correlation analysis are reported, as well as the key leverage points associated with measures of pay satisfaction and work engagement. Leverage points are key factors (e.g., performance knowledge) that have a positive influence on pay satisfaction (e.g., base pay knowledge) or work engagement (e.g., retention).

As illustrated in the Knowledge of Pay model, work engagement variables include: Pay for performance, retention, organizational commitment, employee referrals and management trust. It is important to note that we only report the five highest correlates for each factor. We do not report all the correlations with the factors of pay satisfaction and work engagement, such as the amount of base pay and short-term incentives, as they show weaker relationships than the reported measures. However, these factors are listed in the Knowledge of Pay model in Figure 3 under the headings of Total Pay Amount and Total Pay Process. For example, the correlation between base pay amount (i.e., an employee's annual base salary) and total pay satisfaction is .17. Although positive and statistically significant, this correlation is much lower than the associations detailed in subsequent figures, and therefore, is not reported.

Leverage Points Associated with Pay Satisfaction

The results of the correlation analyses are displayed in Figures 23 through 29. In this section, only the scales or factors that are most strongly related to pay satisfaction are shown and are presented in order of the size of the correlation. For example, in Figure 23 the factor most strongly associated with total pay satisfaction is total pay knowledge (.63) and the next factor most strongly associated is performance knowledge (.62). For each scale, we report the top five factors correlated with that scale. The figures are arranged by category of pay satisfaction: total pay satisfaction, base pay satisfaction, base pay increase satisfaction, short-term incentives satisfaction, base pay administration satisfaction, pay structure satisfaction and stock option satisfaction. Each is discussed below.

Figure 23: Leverage Points Associated with Total Pay Satisfaction



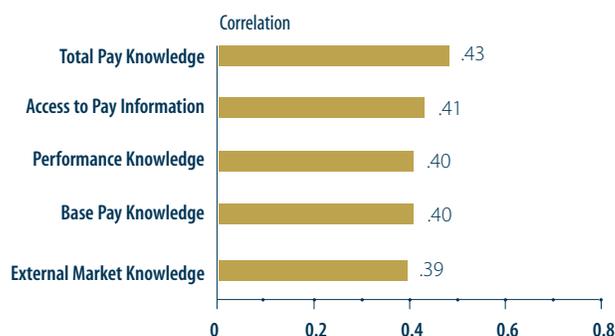
The leverage points in Figure 23 that demonstrated the strongest relationships with total pay satisfaction had correlations ranging from .63 for total pay knowledge to .50 for external market knowledge. All five correlations with total pay satisfaction were similar in size except for external market knowledge, at .50. However, as noted in the survey methodology section of the monograph, all five correlations are considered large relative to those typically found in human resource management research.

On average, the higher an employee's total pay knowledge, the higher his or her total pay satisfaction. This relationship also was true for performance knowledge, access to pay information, base pay knowledge and external market knowledge. Recall that total pay satisfaction includes base pay satisfaction, base pay increase satisfaction, short-term incentive satisfaction, stock option satisfaction, base-pay administration satisfaction and base-pay structure satisfaction.

In Figure 24, all the leverage points associated with base pay satisfaction were strong, ranging from .39 to .43, but not as strong as with total pay satisfaction, ranging from .50 to .63. (See Figure 23.) Base pay satisfaction includes items such as satisfaction with overall level of pay. Thus, total pay knowledge positively influences base pay satisfaction.

The major implication of the findings in Figures 23 and 24 is that organizations that increase total pay knowledge likely will see increases in total pay and base pay satisfaction. Within the framework of total pay knowledge, increasing access to pay information and also increasing performance, base pay and external market knowledge would be particularly helpful.

Figure 24: Leverage Points Associated with Base Pay Satisfaction



Figures 25 through 27 on page 43 refer to knowledge leverage points with base pay increase satisfaction, short-term incentive satisfaction and base pay administration satisfaction, respectively. To review, base pay increase satisfaction refers to satisfaction with how raises are determined and raises received most recently and those in the past. Short-term incentive satisfaction consists of the fairness and size of their bonuses. Base pay administration satisfaction was assessed by satisfaction with the administration and consistency of pay procedures.

The three figures display remarkably similar findings with one exception – short-term incentive knowledge. Understandably, short-term incentive knowledge is highly correlated with short-term incentive satisfaction, but is not as highly correlated with base pay increase satisfaction or base pay administration satisfaction. The most prominent similarity is that performance knowledge is the measure with the highest correlation with each measure of pay satisfaction. This finding is quite understandable as base pay increases, short-term incentives and base pay administration are largely affected by the performance management system in most organizations. The correlations in these three figures are all large, ranging from .40 to .61.

Figure 25: Leverage Points Associated with Base Pay Increase Satisfaction

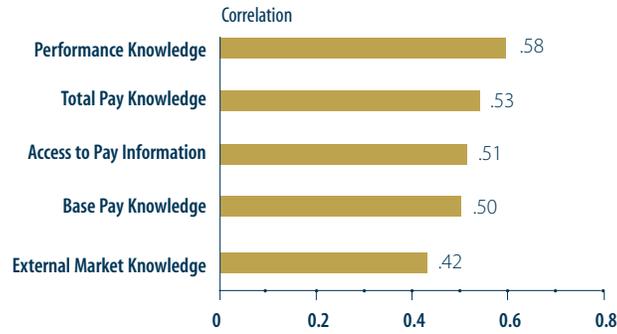


Figure 26: Leverage Points Associated with Short-term Incentives Satisfaction

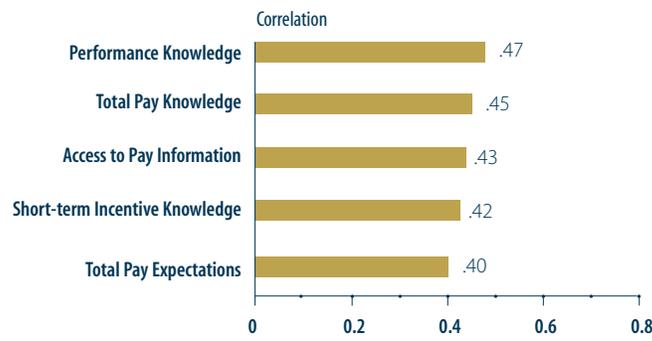
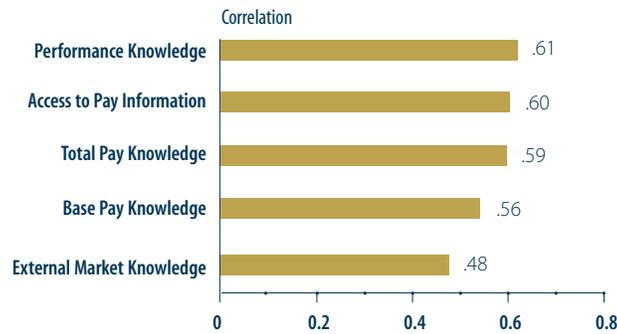
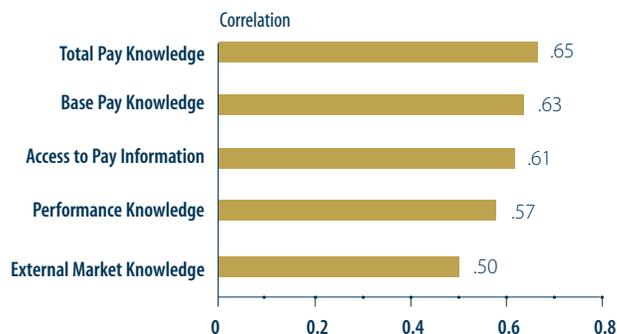


Figure 27: Leverage Points Associated with Base Pay Administration Satisfaction



Leverage points associated with base pay structure satisfaction are displayed in Figure 28. Base pay structure satisfaction consists of satisfaction with the pay grade/band/level system, the grades/band/level of your own and other jobs, and pay ranges. The correlations with pay structure satisfaction are large, and range from .50 to .65, with total pay knowledge as the highest leverage point. The difference between these correlations and the correlations in the three previous figures is that total pay (.65) and base pay (.63) knowledge, rather than performance knowledge (.57), have the highest correlations with pay structure satisfaction. This is quite understandable as individual performance and performance knowledge have less impact on an organization's base pay structure.

Figure 28: Leverage Points Associated with Base Pay Structure Satisfaction

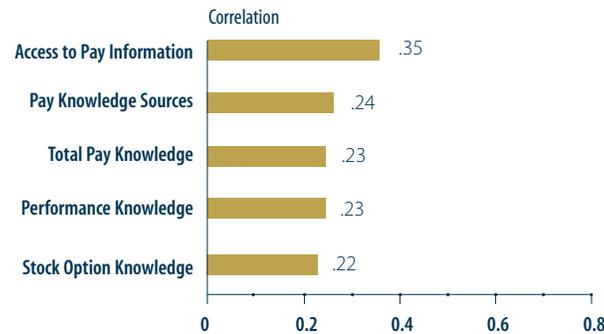


Of all the measures of pay satisfaction, stock option satisfaction had the lowest correlations with measures of pay and performance knowledge as illustrated in Figure 29 (see page 45). Stock option satisfaction consisted of one item, “I am satisfied with the value of my stock options.” The highest correlations with stock option satisfaction ranged from .22 with stock option knowledge to .35 with access to pay information. Interestingly, access to pay information and pay knowledge sources emerged as important correlates of stock option satisfaction. Not surprisingly, having effective sources for and access to timely information is useful when stock option recipients want to exercise their stock options.

Overall, the correlations in Figure 29 on page 45 are considered moderate in size. Note that correlations in Figures 23 to 28 are higher, ranging from .39 to .65. The implication of the lower correlations among various measures of pay knowledge with stock option satisfaction compared to other measures of pay satisfaction is that compensation and human resource managers may find it more challenging to influence stock option satisfaction. In other words, increasing knowledge will have less influence on stock option satisfaction than increasing knowledge for other measures of pay satisfaction, specifically satisfaction with base pay, base pay increases, short-term incentives, base pay administration and base pay structure.

In general, this is understandable because stock option satisfaction is greatly affected by external and largely uncontrollable factors such as stock price appreciation compared to strike price. It is important to note, however, that stock option knowledge emerged as an important leverage point with stock option satisfaction.

Figure 29: Leverage Points Associated with Stock Option Satisfaction



“(Companies) don’t need to throw money at the problem to increase pay satisfaction, (they) need to communicate the process better.”

*Susan Zelinski-Davis, CCP
Manager, Employee Performance and Rewards
Nationwide Insurance*

Overall, the findings in Figures 23 to 29 should be of great interest to compensation and human resources professionals because they state clearly that pay knowledge and performance knowledge are highly related to pay satisfaction. In addition, they are significantly more related than factors such as total pay amount and total pay process or any of the demographic measures, such as age, tenure and occupation. (See Figure 3 on page 12.)

The good news for managers and compensation and human resources professionals is the incredible consistency of the top factors across these correlations. For example, total pay knowledge, performance knowledge, access to pay information, base pay knowledge and external market knowledge are consistently related to the measures of pay satisfaction. Moreover, these knowledge measures are more strongly related to pay satisfaction than other measures of pay satisfaction, such as pay fairness, that have been shown in previous research to be strongly related. The three most strongly related scales to all categories of pay satisfaction are total pay knowledge, performance knowledge and access to pay information. Base pay knowledge, market pay knowledge, short-term incentive knowledge and stock option knowledge define total pay knowledge. Within the total pay knowledge set, base pay knowledge is most important. Knowledge of base pay includes an understanding of the pay grade/band/level system, the grades/band/level of your own and other jobs, and pay ranges.

Knowledge about performance also is strongly related to many categories of pay satisfaction. That is, pay satisfaction is likely to be increased when people understand:

- How their performance objectives relate to the organization’s success
- The key measures of their performance
- How their performance is measured
- The influence of performance on their base pay adjustments and bonuses.

The good news revealed by the *Knowledge of Pay* study is that both employees and managers

report knowing a lot about these performance management issues.

Open access to pay process information is another critical scale related to multiple categories of pay satisfaction. Satisfaction is likely to be higher if employers simply would share more and better pay process information with employees. Because of the consistency of these findings across the various measures of pay satisfaction, compensation and HR professionals will find it more manageable to address the knowledge gaps in their organizations.

Key Points: Leverage with Pay Satisfaction

1. Relative to all the scales in the survey, pay satisfaction is most strongly associated with total pay knowledge, performance knowledge and access to pay information.
2. Satisfaction with pay is more likely when base pay process information is shared with employees rather than kept secret.

“The ROI on process ‘fixes’ will be greater than the ROI for increased pay amounts.”

*Dan Purusbotham, Ph.D, CCP
Vice President, Compensation and Performance Management
The Hartford Financial Services Group*

Leverage Points Associated with Work Engagement

For the purposes of this study, work engagement is defined by several categories of employee attitudes and behaviors: Employee retention, organizational commitment, employee referrals, pay-for-performance perceptions and trust in management.

- Employee retention was assessed by items focusing on the respondents’ intentions to stay with their current employer and their job search behavior.
- Organizational commitment refers to the respondents’ willingness to perform well and put forth effort on the employer’s behalf.
- Employee referrals assessed whether the respondent would refer friends and family for employment at their organization.
- Pay-for-performance perceptions were measured by asking respondents to assess how pay programs in their organization rewarded their performance and aligned their goals with their organization’s goals.
- Trust in management refers to whether respondents believed management statements were valid, particularly those concerning pay issues.

The five scales having the largest correlations with each work engagement scale are shown in Figures 30 to 34. Compared to all the questions asked in this survey, these questions (scales) are most strongly related to the work engagement.

The leverage points in Figure 30 that demonstrated the strongest relationships with employee retention had correlations ranging from .40 for total pay satisfaction to .34 for performance knowledge. All five correlations with employee retention are considered moderate relative to those typically found in human resource management research.

As employees' total pay satisfaction increases, so do their intentions to remain with the organization. This relationship with employee retention also applies to base pay increase satisfaction, base pay satisfaction, base pay administration satisfaction and performance knowledge.

The major implication of the findings in Figure 30 is that organizations that increase total pay satisfaction likely will see increases in employee retention. Within the framework of total pay satisfaction, employers should focus on increasing base pay increase satisfaction, base pay satisfaction and base pay administration satisfaction.

Figure 30: Leverage Points Associated with Employee Retention



Leverage points associated with organizational commitment, employee referrals, pay for performance and management trust are displayed in Figures 31 through 34 on pages 48 and 49, respectively. The correlations with these four scales are large, and range from .42 to .63, with total pay satisfaction as the highest leverage point for three of the four work engagement variables. Upon scanning the data in these four figures it should be noted that the five factors that are most highly correlated with each work engagement variable are exactly the same.

Although there is a great deal of consistency between Figures 31 to 34 and Figure 30, two key differences exist. First, the difference between the correlations with scales in Figures 31 to 34 and the correlations with employee retention is that the highest five correlations with employee retention are all smaller than with the other work engagement factors (i.e., organizational commitment, employee referrals, pay for performance perceptions and management trust). The second difference is that base pay structure satisfaction appears in Figures 31 to 34 as more important than base pay satisfaction. Thus, focusing on increasing satisfaction with base pay processes (base pay administration satisfaction and base pay structure satisfaction) and base pay increases will likely have a positive influence on employees' commitment to the organization, the extent of that they refer others to the organization for employment, their pay for performance perceptions and their management trust.

Figure 31: Leverage Points Associated with Organizational Commitment



Figure 32: Leverage Points Associated with Employee Referrals



Figure 33: Leverage Points Associated with Pay for Performance

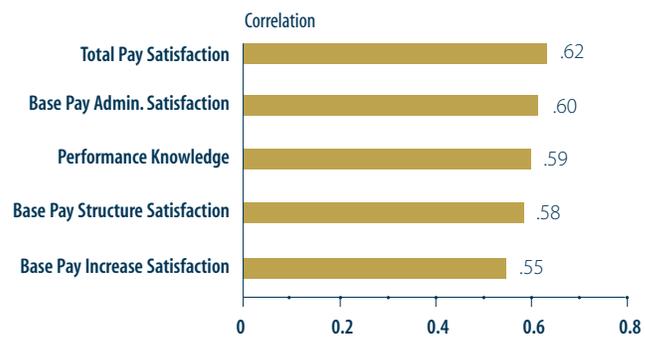


Figure 34: Leverage Points Associated with Management Trust

In sum, two critical points stand out when one reviews Figures 30 to 34. First, total pay satisfaction is most strongly related to the work engagement variables. This finding means that all of the categories of total pay satisfaction (base pay level, base pay increase, short-term incentives, stock options, base pay administration and base pay structure) can be used to influence work engagement. This finding indicates that a “total pay” perspective should be taken in order to influence the level of employee work engagement.

A second critical point about the influence of pay satisfaction on work engagement is that while all components are important, some are more important than others. In particular, base pay administration, base pay structure and base pay increase are the pay satisfaction categories most strongly related to work engagement. Organizations with low work engagement scores need to look no further than the base pay system as a possible leverage point for improvement.

Unfortunately, if current issues of human resources and compensation journals and magazines are any indication, not nearly enough attention has been paid to base pay issues in recent years. It seems as though variable pay has gathered most of the attention. Base pay may be a traditional concept, but it is one highly valued by the work force and one that has the strongest influence on pay satisfaction and work engagement.

Key Points: Work Engagement Leverage Points

1. Relative to all the scales in the survey, total pay satisfaction is most strongly associated with work engagement variables (retention, commitment, referrals, pay-for-performance perceptions, management trust).
2. The most important aspects of total pay satisfaction related to work engagement variables are base pay administration, base pay structure and base pay increase satisfaction.

"It's scary how many managers do not understand compensation laws and regulations."

*John G. Anderson, CCP
Director, Compensation and Benefits
Chicago Mercantile Exchange*

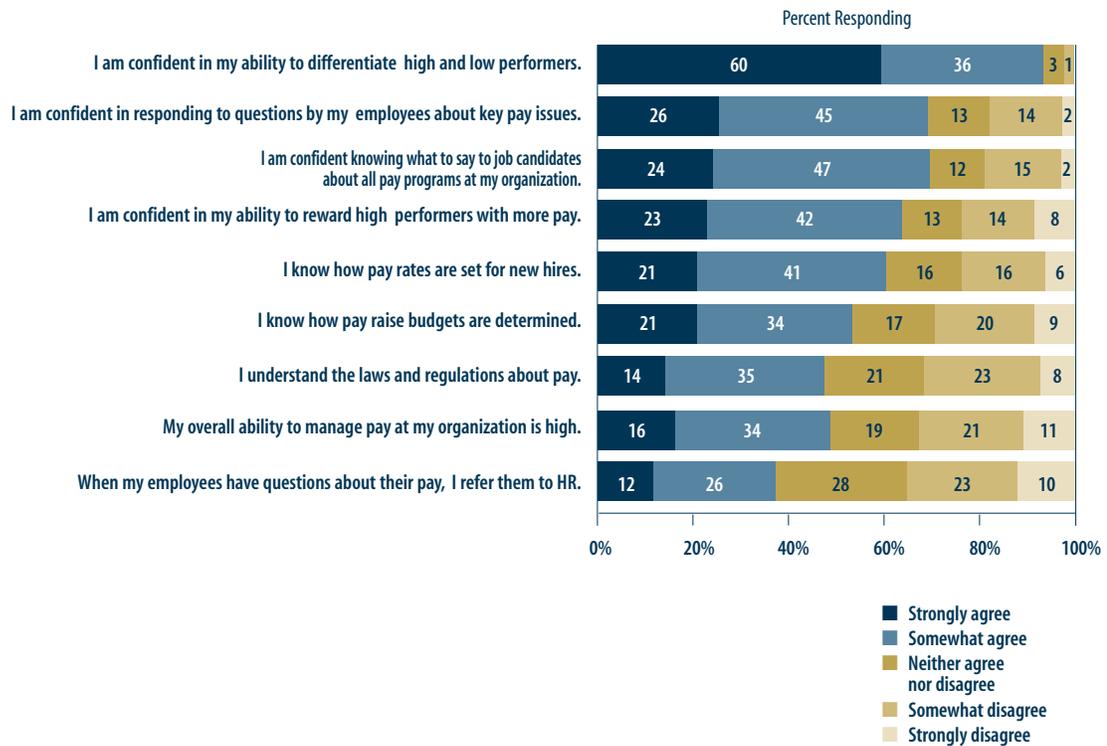
Management Viewpoint

Another purpose of the *KOP* study was to understand managers' views about their level of pay knowledge and their ability to use that knowledge with their direct and indirect reports.

Those who identified themselves as managing the pay and performance of others in their organization were asked to answer questions about their overall knowledge and confidence in making and communicating performance and pay decisions, the frequency their employees asked pay and performance questions, and finally, their confidence in answering those questions. Managers' viewpoints concerning performance and pay knowledge is summarized in Figure 35.

Figure 35: Management Viewpoint*

Please indicate the extent to which you agree or disagree with each of the following statements:



*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

A striking finding in Figure 35 on page 50 is the degree of confidence that managers have in their ability to differentiate between high-and low-performing employees. Ninety-six percent of managers reported that they have the ability to differentiate between performance levels. This finding is encouraging in that it indicates that the work put into improving performance management systems may be paying off. On the other hand, it may be an inflated self assessment by managers of their ability, although this explanation is less than likely, given that self-evaluation ratings for developmental reasons rather than evaluative reasons are usually accurate (Atwater, 1998). Self ratings in this study were for developmental, not evaluative, reasons.

It is surprising that more managers are not well versed in legal knowledge concerning compensation. Almost half of responding managers either strongly or somewhat agreed with the item “I understand the laws and regulations about pay.” Clearly, managers need to be better trained by HR professionals to understand compensation laws and regulations. Having managers unaware or not knowledgeable about laws and regulations poses a considerable risk to organizations.

Data in Figure 35 also illustrate that managers are more confident in things under their control versus things that they do not have control over. They have control over differentiating between employee performance levels (96 percent strongly or somewhat agree) and responding to employee questions (71 percent), but they have less control over pay levels for new hires (62 percent), budgets (55 percent), and laws and regulations (49 percent). These results show that while they have high personal confidence regarding pay issues, they have less confidence in the organization regarding pay issues.

This personal confidence may also be represented in the managers’ response item “When employees have questions about their pay, I refer them to HR.” Only 38 percent of managers either strongly or somewhat agreed with the statement.

Key Points: Management View

1. Managers are very confident in differentiating between employee performance levels.
2. Many managers say they do not understand compensation laws and regulations.
3. Managers have more confidence in their own pay practices than in the organizations’ pay practices.

“Many managers tend to ‘spread the dollars like peanut butter’ rather than allocating more dollars to higher-performing individuals and having to face the challenges of communicating less than the average budgeted amount to those employees who are either higher in their range or of average performance or both.”

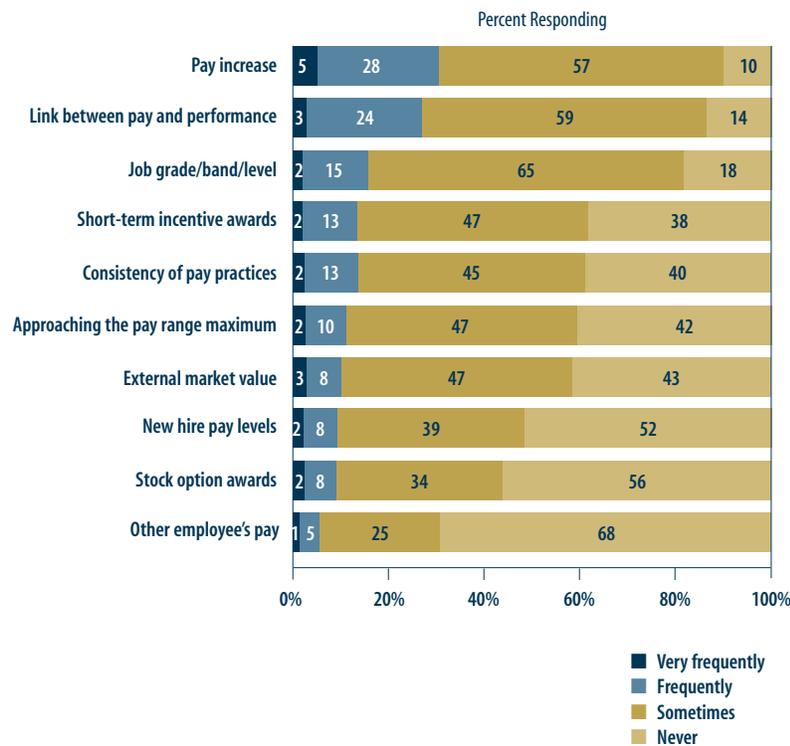
*Susan Zelinski-Davis, CCP
Manager, Employee Performance and Rewards
Nationwide Insurance*

Employee Questions Referred to Managers

Figures 36 and 37 on pages 52 and 53 display the frequency of particular questions that employees pose to managers regarding performance and pay issues. As illustrated, managers report not receiving a high frequency of pay or performance questions. However, the data indicate that they receive more questions from employees about performance than pay.

In Figure 36, 17 percent of managers report receiving job grade questions from employees either very frequently or frequently. Questions about short-term incentive awards (15 percent), consistency of pay practices (15 percent), external market value (11 percent) and stock option awards (10 percent) are received even less frequently. In contrast, questions about performance feedback (40 percent), performance objectives (40 percent), and organizational objectives (35 percent) are received more frequently. This result is not surprising given that previously discussed findings indicate that employees are satisfied with performance management in organizations and that pay information is viewed by employees as “secret” in organizations. Figure 38 on page 53 offers possible reasons why employees fail to ask about pay.

Figure 36: How frequently do your employees ask you about each of the following pay issues?*



*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

Figure 37: How frequently do your employees ask you about each of the following performance issues?*

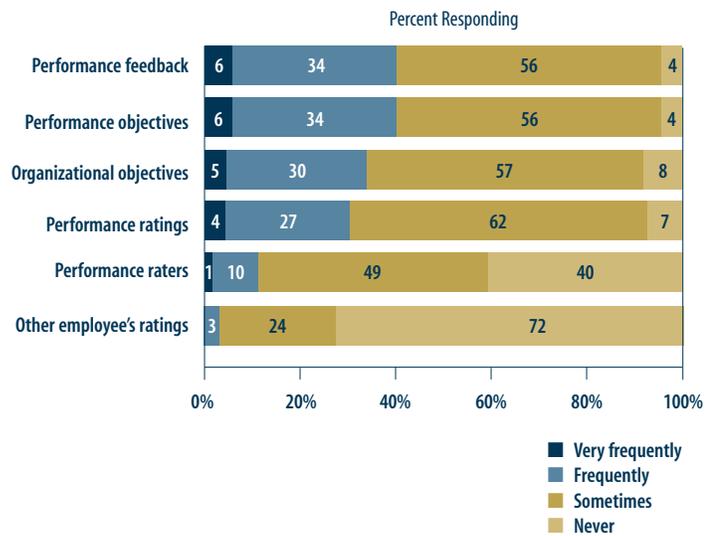


Figure 38: Possible Reasons Why Employees Fail to Ask Questions About Pay

The organization discourages it.
Society discourages it.
Employees...
Are so confused that they do not know what to ask.
Don't want to be seen as a malcontent.
Are fearful of retribution by management.
Don't expect actions to be taken to remedy their concerns.
Already know the answers to the most salient issues.
Trust management to do the right thing.

“Why do employees ask questions about the pay level of other employees? Not to berate others, but to see if the organization loves them by their relative standing.”

*John G. Anderson, CCP
Director, Compensation and Benefits
Chicago Mercantile Exchange*

*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

“(Employers) need to make pay plans less complex and more understandable to both employees and managers.”

*Susan Zelinski-Davis, CCP
Manager, Employee Performance and Rewards
Nationwide Insurance*

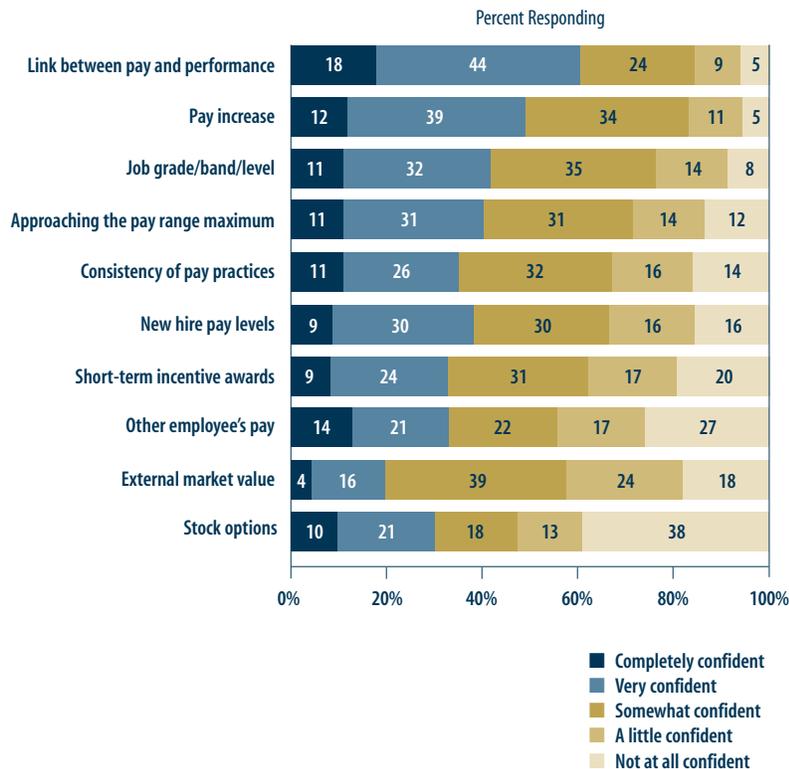
Managers’ Confidence in Answering Questions

Managers’ confidence in answering specific performance and pay issues is shown in Figures 39 and 40 on pages 54 and 55. Along with the previous figures, these data can serve loosely as a training needs analysis for managers.

It appears that managers need little additional training on performance management, but they need additional training on pay processes. Confidence percentages for the categories completely and very confident range from 42 percent to 86 percent for performance issues compared to 20 percent to 62 percent for pay issues. In particular, managers are not confident answering employee questions about new hire pay levels (39 percent completely or very confident), consistency of pay practices (37 percent), short-term incentives (33 percent), other people’s pay (35 percent), stock options (31 percent) and external market value (20 percent). Although a sizeable percentage of managers are somewhat confident in these areas, these responses do indicate some need for additional education in these pay areas.

Figure 39: Managers’ Confidence in Answering Questions *

How confident are you about answering employee questions about each of the following pay issues:



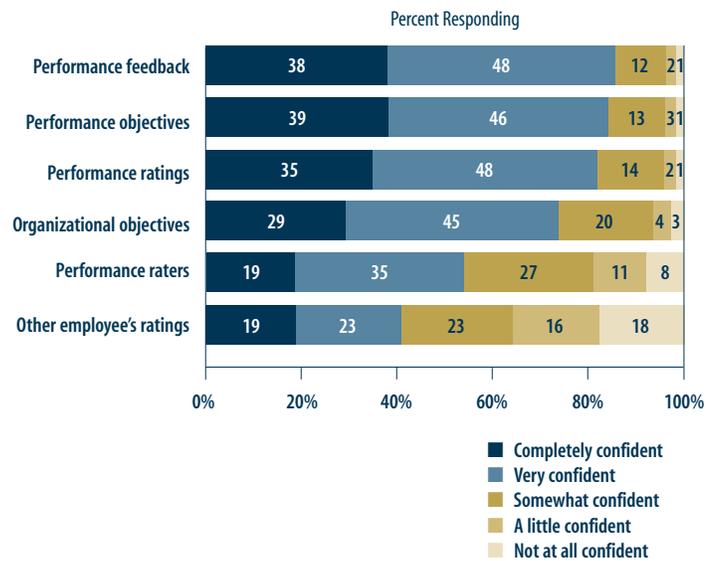
*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

"Managers want employees to know about the pay structure, but they do not personalize it for employees when they explain it so that they retain flexibility in pay decisions."

*John G. Anderson, CCP
Director, Compensation and Benefits
Chicago Mercantile Exchange*

Figure 40: Managers' Confidence in Answering Questions*

How confident are you about answering employee questions about each of the following performance issues



Key Points: Employee Questions and Management Answers

Managers...

1. Are asked more questions about performance than pay.
2. Are more confident answering questions about performance than pay.
3. Need to be trained about new hire pay, consistency of pay practices, short-term incentives, internal and external equity, and stock options.

"Managers should be able to explain their pay decisions to employees. However, it takes courage to take a stand."

*Susan Zelinski-Davis, CCP
Manager, Employee Performance and Rewards
Nationwide Insurance*

*Note: The sum of values for "Percent Responding" may not equal 100 due to rounding.

"A critical issue for organizations to consider is whether your employees ask enough questions about their pay. Organizations usually consider questions about pay as a negative event, but it may actually be a very positive event."

*Susan Zelinski-Davis, CCP
Manager, Employee Performance and Rewards
Nationwide Insurance*

Testing for Alternative Explanations

It is possible that the study findings could vary with the demographic profile of the respondents, the types of pay plans the respondents participated in, the amount of pay or short-term incentives received, or if the respondents experienced a new pay plan in the last year. That is to say: Are alternative explanations for our findings possible?

For example, one alternative explanation is that if compensation plans changed in the last year, workers experiencing those changes would become more (or less) knowledgeable about their pay. To check for these alternative explanations for the findings in this study, we conducted a series of analyses on the data that are reported below.

Demographics

All major variables in this study were correlated with the following demographic variables of the respondents: Age, education, seniority, tenure, occupation and organization size (i.e., more than or less than 10,000 employees). Although many of these correlations were statistically significant ($p < .05$), they were so small in size ($r < .10$) as to not be practically significant. Hence, we do not report them.

The most significant implication from this finding is that the results presented in this report hold true regardless of demographic groups. Yet, significant differences in responses by demographic variable may well exist within an individual organization that gets washed out when the data is aggregated as it has been here.

Pay Plan Participation

All major variables in this study also were correlated with the following types of pay plans: cash incentives, stock options, merit pay, market adjustments, skill/knowledge/competency pay and stock options. Although many of the correlations were again statistically significant ($p < .05$), they were so small in size ($r < .10$) as to not be practically significant. This finding indicates that this study's results do not change depending upon the type of pay plan(s) used by the organization.

Regression Analysis Results

Two possible variables may alter the information presented in this report: Amount of pay received by respondents and whether the respondents were part of a significant change in the pay system in the past six months. The amount of pay variable may mean that the amount people are paid is more strongly related to pay satisfaction than is their knowledge of pay. The significant change in the pay system variable may indicate that the novelty of the situation (i.e., Hawthorne effect) is more strongly related to pay satisfaction than knowledge of pay.

To guard against these possible contaminants in the study's findings, a regression analysis was performed. The relationship between pay satisfaction (dependent variable) and knowledge of pay (independent variable) was assessed, while holding constant the relationships between pay satisfaction and amount of pay and between pay satisfaction and significant change in the pay system.

The results indicate that the knowledge of pay level more strongly related to total pay satisfaction than the amount of pay received. In addition, the regression results showed that a change in the pay system in the last six months was not related to total pay satisfaction. From these findings, we are very confident that the strong relationships with pay knowledge reported are actual ones and not simply due to the amount of money paid to people or due to the Hawthorne effect.

Key Points: Alternative Explanations

The results of this study are not...

1. Altered by demographic variables.
2. Altered by types of pay plans used.
3. Due to amount of pay received.
4. Due to the Hawthorne effect.

Implications for Compensation Management

Organizations should take the following steps to improve employee knowledge of pay.

Diagnose Level of Knowledge of Pay in Your Organization

The data presented in this report pertain to practices across multiple types of organizations in multiple industries, spanning two countries. Obtaining a true picture of the level of knowledge of pay for a given individual organization can only be obtained through data collection specific to that organization.

To assess an individual organization after data have been collected, several steps should be taken. First, the data for the organization can be compared with the benchmark data presented in this monograph. Second, knowledge of pay data should be collected at multiple points in time to measure improvement over time. Finally, the average knowledge of pay level for the organization should be calculated to assess the knowledge of pay levels for various business units and functions versus the entire organization or versus the most effective business units and/or functions.

Be Proactive

The education of people in organizations regarding pay can be thought of along a continuum ranging from “inactive” to “proactive” with “reactive” in between. The traditional approach in organizations is to be inactive or reactive. With an inactive approach, pay information is kept secret and employees are instructed not to talk about pay. With a reactive approach, employees are only informed about pay information on a “need to know” basis. For example, upon promotion to management one might be informed that they are eligible for stock options. With a proactive approach, information is openly shared with employees by the organization even if the employees do not ask for it.

This does *not necessarily* mean that peoples’ individual pay amounts should be shared with other people. It does, however, mean that the processes used to make pay decisions are made known as is the structure of pay that results from these decisions.

Take merit pay, for example. Being proactive does not mean that employees are to be informed of the merit increases received by others. They however might be provided with the relevant information used to make merit decisions (e.g., merit budget, merit matrix) and the resulting merit decision parameters (e.g., highest, lowest and average merit increase values). Finally, going back to the stock option example, employees and managers are more aware if stock options are provided when promoted, as well as the range of the stock option share award.

Train and Involve Supervisors and Managers to Talk Pay

The data in this report have identified the manager as the most effective source for obtaining pay-related information. Yet, managers report having more confidence addressing performance rather than pay-related questions from employees. To increase manager confidence and capability, they should be provided with assistance and tools to have more and more effective pay conversations. Doing so should open the book on this subject, which would be an improvement in many organizations, since employees were found to be raising very few pay questions.

Preparing managers to handle conversations about pay with their people will require that the more technical and complicated aspects of pay administration be conveyed in layperson language, which may be a challenge due to the well-established and unique human resources lexicon.

Personalize the Knowledge of Pay

The data in this study show that it is not enough for employees to simply understand pay concepts. Instead, pay knowledge should be personalized so that people can apply the concepts to their own situation. This probably will require one-on-one communication. Although personal approaches are time consuming, they are more effective than general responses. Also, there is precedence of organizations using personal pay communications. Human resources professionals for years have counseled employees on benefits and have provided personal benefits statements.

De-emphasize Traditional Delivery Vehicles

To have an impact on the knowledge of pay gained by employees, personal communication is needed. The results of this study show that people gauge the effectiveness of policy manuals, handbooks, in-class training and videos as minimal. Instead, people believe that conversations with supervisors and managers, along with interactive training on Web sites and the intranet, are most effective. This result suggests that HR professionals need to be creative in getting supervisors and managers involved in the pay education process.

Open Up the Pay System

With the exception of reporting pay amounts for individual employees, this study indicates that organizations should err on the side of presenting too much pay knowledge to employees rather than too little. Although senior management, especially private owners, may be reluctant to share pertinent pay information (e.g., pay budget), both anecdotal (Stack, 1992) and survey data (Lawler et al, 1998) indicate that openness with business information is likely to be associated with improved organizational effectiveness. Web-based technologies and intranets can be used to provide meaningful pay information at the desktop for both managers and employees.

Final Discussion

Should your organization share more compensation information? The results of the *Knowledge of Pay* study indicate that companies could significantly benefit from pulling back the curtain and revealing how the compensation system works. After all, if pay for performance is the goal, it would appear that half the job is already done.

KOP respondents report that they are very knowledgeable about how their performance relates to higher-level organizational goals, how their performance is measured and where they stand relative to their performance objectives. Knowledge of performance is one of the critical elements needed to motivate performance in the organization. Moreover, as shown in this study, performance knowledge is associated with pay satisfaction and, in turn, pay satisfaction is associated with organizational effectiveness.

Yet, a close pay for performance link requires that employees possess similar information about pay. Such information helps workers to understand the value and fairness of their reward and to compare it to their contribution. KOP discovered that employees are much more satisfied with their level of pay than the related pay process. This finding causes us to think that organizations can improve their return on compensation by first explaining more about how the pay system works and how pay decisions are made. Among the pay subjects that people need to learn about are:

- *The type and level of performance that will increase base pay and short-term incentives.* Employees are uncertain which behaviors will lead to increases in base pay and bonuses.
- *How base pay decisions concerning pay structures and pay ranges are made.* Compensation professionals have used relatively sophisticated processes to create pay structures, but these processes are not well understood by employees.
- *How the external market can impact employee base pay.* Although employees have a general understanding that the health of the economy can impact on pay, they are unsure how external markets affect their base pay level. This gap would seem crucial at companies that rely heavily on market pay methods.
- *How short-term incentives are calculated and bonus programs are funded.* Too often short-term incentives require complicated financial return calculations and employees are at a loss when they attempt to estimate the size of their potential incentive awards.
- *How to estimate the value of stock options.* Despite a reported high level of knowledge of stock options and how to exercise them, many stock option recipients are unaware how their stock option award is determined and how to estimate the value of their stock options.

Perhaps one of the more powerful findings of this study was the small number of respondents who say their behavior has changed as a result of participation in their short-term incentive plan. Given the intent of short-term incentives, it is pretty clear that many of these plans are not achieving their purpose.

Moreover, variable pay has been management's modern solution for better linking pay and performance on a cost-effective basis, meaning that awards are distributed as payments, not increases, to fixed payroll costs. The KOP study raises the question how different might these participants have responded if they knew more about their short-term incentive pay process – for example, how the payout schedule relates to the various performance plateaus? Because many of these plans involve a funding schedule that is based on financial performance of the enterprise, the other opportunity might be to share more knowledge about financial measurements.

Sharing more information about pay and its link to performance would also address the perception that pay is not to be spoken of in organizations. KOP respondents feel that pay information is kept secret in organizations. More relevant information is needed because while people report that they understand the general principles of compensation, they do not understand how compensation decisions are reached and how these compensation decisions directly impact them. Perhaps the most puzzling barrier is that in spite of their knowledge gaps, employees are not asking enough questions about pay.

It is possible of course that management realizes the benefits of sharing more information but chooses not to for good reason. They may not want to say more about a compensation system or process that is not well designed, as it would be difficult to explain or defend. The compensation system may also be functioning on broad management discretion, the judgments about which change based on the situation, also making it challenging to explain. Nevertheless, given the attendant benefits of information sharing, it might be worth tuning up the process and system so that its rationale can be more easily and confidently explained by members of first- and second-level management.

People think that face-to-face explanations with supervisors, managers and HR professionals are the most effective information delivery vehicles. People rated other sources of information such as classroom training, policy manuals, handbooks and videos as least effective. Web sites and the intranet were evaluated at a moderate level of effectiveness, though younger workers found them to be more helpful. These results have profound implications for HR professionals as to how to best deliver pay knowledge to the organization. It is more costly to rely on interpersonal communications only, so what might HR use that is more efficient but does not result in a big drop-off in effectiveness? One such opportunity is e-learning, or online learning, which leverages technology to provide an interactive learning experience. This option might also make it easier for employees to obtain information that they are reluctant to request from their manager or HR. Additionally, many online learning systems can be personalized to the employee and offer powerful interactivity.

The 2002 KOP study reveals the benefits of information sharing on a subject that is not much discussed. While the data provide solid evidence to back organizations' efforts to improve pay knowledge, the data must be interpreted in the context of some limitations to this study. In particular, the data were collected during a period of slow economic growth and the sample consists mostly of highly educated people in professional and managerial positions. It remains to be seen with future research whether the results will transfer to more prosperous economic times and with less-educated people in hourly positions.

It should be noted, however, that due to increased competition, cost control is likely to continue to be a fact of life. Also, macroeconomic trends indicate movement toward a knowledge worker market for professional, managerial *and* hourly employees. Hence, we have confidence that these results will have ongoing implications for organizations in more positive, growing economies and for hourly knowledge workers.

As organizations face increasing pressures to attract and retain talented employees in a cost-constrained environment, human resources professionals will be expected to leverage the existing investment in human capital. The 2002 *Knowledge of Pay Study: E-mails from the Frontline* has identified several opportunities for improving the employee value proposition and, in turn, important organizational effectiveness outcomes without increasing direct payroll cost. These gains can be realized by increasing the knowledge of pay.

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Participating Organizations

More than 10,000 Employees:

Amkor Technology

<http://www.amkor.com/>

Aliant Inc. and Aliant Telecom

<http://www.aliant.com/>

Cisco Systems

<http://www.cisco.com/>

CSX

<http://www.csx.com/>

Honeywell International Specialty Materials

(a business segment of Honeywell)

<http://www.honeywell.com/>

NexInnovations

<http://www.NexInnovations.com/>

The Hartford Financial Services Group

<http://www.thehartford.com/>

The State of Ohio

<http://www.state.oh.us/>

Praxair

<http://www.praxair.com/>

Wendy's International

<http://www.wendys.com/>

Whirlpool

<http://www.whirlpool.com/>

Fewer than 10,000 employees

Allied Insurance

<http://www.alliedinsurance.com/>

Chicago Mercantile Exchange

<http://www.cme.com/>

Cognos

<http://www.cognos.com/>

Datex-Ohmeda

<http://www.datex-ohmeda.com/>

Farmland Mutual Insurance Company

<http://www.farmlandins.com/>

Gates-McDonald

<http://www.gatesmcdonald.com/>

Johns Hopkins University – Applied Physics Laboratory

<http://sd-www.jhuapl.edu/>

Innovatia

<http://www.innovatia.net/>

Millennium Chemicals

<http://www.millenniumchem.com/>

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Scottsdale Insurance Company

<http://www.scottsdaleins.com/>

Tim Hortons

<http://www.timhortons.com/>

About the Advisory Board

Organizations participating in the *Knowledge of Pay* study formed an advisory board, composed of senior human resources and compensation practitioners from multiple industries. The board reviewed and improved survey questions, commented on the overall survey findings and reviewed an early draft of the monograph.

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