

# Does That Pay Practice Really Have Any Impact?

Just because two things  
happen simultaneously  
doesn't mean one *causes*  
the other. Suppose  
someone told you she  
studied two groups  
of 100 companies.



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In the first group, not a single employee was paid with stock options. In the second group, all employees were paid base salaries that were supplemented with stock options. In the latter group, on average, profits were 5 percent higher. If this person then told you that *obviously* the stock options *caused* the higher level of profits, you would likely be skeptical. Yet this is how a great deal of evidence in compensation research (and HR research in general) is portrayed.

This column discusses a few issues regarding how to think about building credible statistical evidence of whether certain pay practices do or do not cause desired outcomes for employees and organizations.

## Why Don't More Organizations Credibly Study the Effects of Compensation Practices?

I am not entirely certain why so few organizations take the time to *credibly* study whether some pay, benefits, work-life balance or other total rewards practices have any impact on the organization's bottom line or employee outcomes like productivity or turnover. But I can think of a few possible reasons: It's too difficult (disruptive to workers) to do well, organizations don't actually want to know the answer and/or organizations don't have the know-how or time.

Let's consider the first possibility: It's too difficult (disruptive) to do well. Pharmaceutical researchers can randomly



assign a new drug to one set of test subjects and a placebo to the other. All they need to do to credibly test the efficacy of the new drug is compare the outcomes for the two groups at the end of the study. This laboratory model of test and control groups is a lot more difficult for compensation researchers and practitioners to use.

Imagine wanting to test if offering one of two different types of bonus schemes leads to higher employee productivity. To do this, we could randomly assign our employees into three groups: bonus type A, bonus type B and no bonus (type C). At the end of the year, we measure which of the three groups has the highest productivity. Compensation isn't always secret, though. Employees in any of the groups could argue that they lost out because they would have been paid more if assigned to a different group. Our organization certainly needs to weigh the cost of upsetting employees who feel they are not treated fairly with the benefit of obtaining credible evidence.

There are ways around the challenges of this kind of robust testing. We could, for example, calculate what each employee's earnings would have been if assigned to either of the other two groups. We could then actually pay every employee the highest of their three possibilities. This increases the financial cost of obtaining credible evidence but mediates employee agitation. Another workaround is found in the case study of Safelite AutoGlass (see below).

What about the second possible reason organizations may not want to study the effects of a particular compensation or HR practice — that is, not actually wanting to know the answer? If you designed a new program, convinced your leaders that it was a good idea (despite its costs) and implemented the plan, do you want to know if it *really* worked? While you may see the value of implementing only practices credibly proved to be effective, perhaps your colleagues would prefer to just declare victory and move on.

Thirdly, even if these barriers to credible testing were overcome, organizations may not have the know-how (which I doubt) or the time (which I don't doubt) to conduct these kinds of studies. Total rewards professionals have many, many things to worry about, and undertaking credible, evidence-based studies may not be high on the to-do list.

## Case Study

### Salaries vs. Piece Rates

One successfully executed, evidence-based study of a new compensation practice is Safelite AutoGlass. Stanford

Professor Edward Lazear analyzed Safelite's switch from paying hourly to paying a modified piece rate, whereby more productive windshield installers were paid more. (See "Performance Pay and Productivity," 2000, *The American Economic Review*, December, 1346-61.)

To test the relative effectiveness of the hourly-pay scheme versus the piece-rate-pay scheme, it is not enough to simply compare the productivity of all workers before and after the change. Employees who prefer hourly pay may have left Safelite in response to the switch, while new hires may have preferred it. Whether Safelite considers this "selection bias" effect on employees a good outcome, it, nonetheless, muddies the evidence on the effectiveness of the pay practice alone.

To get around this, Lazear compared the productivity change worker by worker, for only those employees present under both pay arrangements. Lazear found that not only did productivity increase after the change from hourly pay to piece rates, but so did total employee pay *and* profits. In this case, everyone was better off.

Notice Lazear's analysis did not require test groups and placebos. In this case, the new compensation practice was rolled out to the entire company. Then, after-the-fact, he analyzed employee data to measure the effect of the new practice. The key here was that Safelite's leadership sought credible, evidence-based analysis of internal processes and was willing to open up internal data to such scrutiny.

## Some Additional Ideas for Future Work

HR systems are rich with metrics, and existing practices (e.g., regular employee engagement surveys, performance reviews) that can provide data for credibly measuring outcomes. Organizations really can test if one rewards practice is more effective (as defined in many ways) than another, taking care to generate little work-flow interruption and credible results. For most academic researchers, being offered the opportunity to do this kind of study is like being offered the opportunity to go to the candy store. Except what those researchers are buying isn't calories and cavities, but more credible and robust, evidence-based pay and benefits practices. ■



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