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Imagine a company that set the pay level of each of its employees and then gave the employees nearly complete choice over the mix.

Suppose the company set the level of pay and then let employees choose the fractions they wanted as guaranteed salary, stock options and at-risk bonus. The fraction in at-risk bonus was capped at 20 percent of total pay and the payout was between 0 and 2.5 times the amount put at-risk and was a function of individual and group performance.

This is not a theoretical example; it's real! And, it is interesting for a variety of reasons, including that it is so extreme and because the organization invited some researchers inside to study the fascinating choices made by employees.

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The Company and the System

The organization that employed this pay system was a company in a technical sector with fewer than 1,000 employees. The company was young, and the average age of employees (35) was about five years under the national average. The company also aggressively recruited and had very high average levels of compensation. So it is not necessarily typical, but offers interesting learning nonetheless.

The company originally had the idea for this pay plan because the senior leaders reasoned that certain employees may value certain forms of compensation more than others. So, they figured, why not let the employees choose? Of course, offering employees some choice over their compensation is not particularly new and has been discussed in practical and academic outlets (see, for example, John E. Tropman's "The Compensation Solution," 2001, Jossey-Bass).

Cafeteria and related pay plans have enjoyed varying levels of interest in the past decades. Such plans can be beneficial because organizations can get more for their money if employees value differently different forms of pay. On the other hand, some have argued against such plans for a variety of reasons, including that they are more difficult to administer.

Did Employees Make Different Choices?

I was incredibly enthusiastic about this organization's plan. They were essentially running an experiment by externally changing the system, and letting me and one of my colleagues do some evidence-based analysis of what followed. Craig Olson and I have a working paper on the topic ("Employees' Choice of Method of Pay"). In the paper, we document that certain kinds of workers made quite different choices compared with their peers, and consider some potential reasons why.

We found that there is substantial variation in the choice of contingent pay with some workers choosing almost all base pay and others choosing almost entirely stock options. I can only touch on some of the highlights here, but one interesting feature is that men and women made substantially different choices over their method of pay. The bottom line is that women were much less likely to choose at-risk pay than men. For example, on average, women chose to have 91 percent of their pay in salary, 8 percent in stock options and only about 1 percent in at-risk bonus. On the other hand, on average, men chose 81 percent salary, 17 percent as stock options and about 2 percent in at-risk bonus. The findings based on gender are consistent with some work in psychology and behavioral economics relative to attitudes toward risk by gender.

We also found some evidence based on other sorts of demographic characteristics of the employees. For example, we found some evidence that younger employees, more experienced employees and higher-paid employees are more likely to allocate a larger fraction of their total compensation to at-risk alternatives.

Of course, many of these characteristics could be interrelated. For example, it turns out that during the time of our study, men at that company were, on average, paid more and had been at the company longer, making gender correlated with level of pay and experience. But, controlling for several things at once, and doing some statistical analysis, one result stands out among all others — in this firm at the time of the study women chose less risky forms of compensation than men.

But what does this mean? Should more companies try this sort of thing? Will the employees be better off? Will the firms be better off? Does this type of compensation plan put the company at any kind of risk?

An Extreme Reversal

The organization ultimately decided to switch completely away from the complete choice model to one in which there are was no choice at all — everyone was compensated, pretty much, only in cash. The company removed essentially all benefits, but left health insurance intact, then took all of the resources saved and redistributed them to the employees in terms of higher salaries. There were a variety of possible reasons for this change, including that some employees may have been earning less than the minimum wage in cash and the fact that those who chose to be paid heavily in options may not have been perfectly educated on this type of pay — both potential liabilities to the organization. Another reason may have been the administrative burden of a plan based on employee choice.

But, I believe the biggest reason for the switch to (almost) all cash pay was the chief human resources officer's (CHRO) belief that employees know what they value most and should be in the best position to decide. To this executive, cash compensation seemed the most efficient mechanism for letting employees have total choice. If an employee wanted child care or a gym membership or equity assets, he/she could buy it on his/her own. For the organization at that time, the CHRO believed that its employees valued certain things so differently that they would be better off with the cash, making their own choices. The company's leadership team, however, decided to keep one benefit in addition to health-care insurance because they found the employees valued it much more than it cost the company (a benefit that I was even able to enjoy when I visited): free food. ws

got a question?

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