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Item Type	event;event
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Download date	2025-04-18 07:52:14
Link to Item	<a href="https://hdl.handle.net/20.500.14394/29971">https://hdl.handle.net/20.500.14394/29971</a>

## **Choosing a compensation strategy in the hotel industry: An exploratory study**

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### **Abstract**

One of the key human resource decisions made by any organization is the design of its compensation strategy. When choosing a compensation strategy, hospitality executives must make a variety of complex decisions that will ultimately impact a company's recruitment and retention efforts, as well as the attainment of organizational goals. This exploratory study looks at the decision making patterns of hospitality executives as it comes to compensation.

Keywords: Hotel compensation, Compensation strategies, pay structures, Human Resources

### **Review of Literature**

When managing an organization, executives need to make a variety of short and long-term decisions that will impact the future of the organization. One key decision is the development of a compensation strategy. The development of a compensation strategy is highly critical, as it could potentially impact employee recruitment, retention, motivation, and performance. Some studies in have attempted to contrast hospitality compensation against that of other industry. According Sturman (2001), hourly earnings are lower among hospitality workers, as compared to similar jobs elsewhere. Using the dictionary of occupational titles, Struman's (2001) research sought to compare job titles and group them in three categories: high, low and moderate complexity based on the characteristics of the job. Despite the existence of an earnings differential between industries at the lower skilled levels, this disparity is more pronounced at middle and upper levels of the organization. According to Sturman (2001) the industry on that particular year, paid the same for low-complexity jobs, but only 85% of other industry's pay for moderate complexity and 75% of other's industry's pay for high complexity occupations.

Every organization has to compensate their workers, however, not every organization uses compensation strategically. "Salary and benefits policies are not being used strategically, within the organization to improve morale, reduce turnover, and achieve targets within an establishment" (Davies, Taylor, & Savery, 2001). Furthermore, research by Moncraz, Zhao and Kay (2009) concluded that compensation was not one of the top factors influencing non-management turnover. However, compensation was in fact a critical factor in reducing managerial turnover and increasing commitment (Moncraz, Zhao, and Kay, 2009).

Although many authors have stressed the importance of using compensation strategically, debate can arise, as to how to develop an optimal pay policy for an organization. Sturman and McCabe (2008) sought to develop a strategy for external competitiveness that would maximize benefits and reduce costs for a newly opened restaurant. According to their research, leading the market by 5% had the highest utility (that is, it produced the most benefit for the organization) and lagging the market by 15% the lowest.

Milkovich and Newman (2008), suggest that the developers of a compensation strategy must consider four policy choices: internal alignment, external competitiveness, employee contributions, and the management of the pay system. Internal alignment deals with the pay relationships within the organization. External competitiveness is concerned with the pay relationships with competitor firms. Employee contributions considers how employees contribute to the organization and how this is tied to the compensation system. Finally, management of the pay system is concerned with the implementation of strategy. In developing a strategy for external

competitiveness, a company must decide how much it will pay as compared to its competitors. This would seem like a relatively easy decision. However, the challenge is quite often is to decide: who is the competitor? Therefore, the organization must decide on benchmark jobs and benchmark companies as part of the development of their compensation strategy (Milkovich and Newman, 2008).

In light of its strategic importance, the purpose of this study was to better understand the process and philosophies that guide the choices and implementation of a compensation strategy within lodging organizations. Specific objectives include:

1. What philosophies guides the development of compensation strategies within the hospitality industry?
2. Are hospitality organizations using their compensation strategically (that is, tying compensation to organizational goals)?
3. What types of comparisons do hospitality executives utilize when developing a pay structure?
4. What are the benefits perceived to be most important by hospitality organizations?

### ***Methodology***

This research was an exploratory study that sought to obtain information through the use of use a quasi-experimental research design. Such design allowed the researchers to study the general philosophies, strategies and decisions made by the executive within the hotel industry who decide on compensation strategies. A questionnaire was built around a fictitious company. Executives were asked to make decisions that will build the compensation strategy for this company. The purpose of using a fictitious example is to uncover their likely choices on compensation strategy within real companies. The main purpose of this research was to provide a descriptive study for the compensation strategy choices and orientations of executives.

The survey was sent to the Vice President of Human Resources as well as the CEO within the corporate headquarters of the major hotel management companies. In order to find the companies, a directory from the American Hotel and Lodging Association (produced by Smith Travel Research) was utilized. From this list, the top 90 property management companies were selected based on the total number of rooms. A total of 180 surveys were mailed with half (90 surveys going to the CEO and 90 going to the Vice-Presidents of Human Resources).

### **Results:**

A total of thirteen hotel industry executives responded to the survey. Among these were 10 Vice-Presidents of Human Resources, 2 Vice-Presidents of Compensation and 1 Chief Executive Officer. Executives were asked for the optimal combination of base pay, variable pay and benefits for three employment categories: non-exempt (hourly) employees, exempt-level professionals and managers, and senior level management and executives. When it comes to non-exempt employees, executives chose to pay 73.3% base pay, 3.8% in variable pay and 23.5% in benefits. Executives were also asked to indicate their preferences for exempt professionals and mid managers. On average, executives would pay 65% of total compensation in base pay, 11.5% in variable pay and 23.4% in benefits. When it comes to senior management and executives, they would be compensated with 58.7% base pay, 20.7% variable pay and 22.5% benefits.

As part of the survey, executives were asked as to their preference of strategy for external competitiveness for the same employment categories. When it comes to non-exempt (hourly) employees, executives indicated a preference towards a matching the labor market (85% of

respondents). Executives were split when it came to a strategy for external competitiveness in managerial positions (with 53% expressing a preference towards a match strategy and 47% preferring a lead strategy). When it comes to executives and senior-level managers, most respondents preferred a match strategy (62% match, 38% lead). In all three categories, no executive thought a lag strategy would be ideal for a company.

This survey also asked respondents indirectly what would the best benchmark companies be for the case study given. Overall executives preferred comparisons of similar hotels within the local market, as opposed to a national comparison. When it comes to choosing benchmark jobs, executives demonstrated a preference to do comprehensive comparisons and look to related industries when comparing their choices (85%).

The researchers wanted to get a sense of which benefits executives deemed most important. For the purposes of this comparison, all employees were divided into non-exempt and exempt. Each benefit was rated on a four point likert scale that went from Very Important (4) to Not important (1). For non-exempt employees, respondents indicated that health insurance, paid time off and retirement benefits were the most important. For exempt employees (including managers), health insurance also topped the list, followed by paid time off and performance bonus. Other benefits were ranked lower. Compensable factors are of critical importance when deciding a strategy for internal alignment. The researchers gave executives a series of compensable factors and asked them to rate their importance on a four point likert scale. Most executives rated all compensable factors as important or very important. The average scores were as follows: experience required for position- 3.77, interpersonal skills-3.77, financial accountability-3.46, supervisory responsibilities- 3.46, link to customer service goals – 3.46, , problem solving skills- 3.23, link to quality assurance goals – 3.08, technical skills – 2.92, and educational requirements – 2.85.

Executives were given a choice of goals to be attained from the compensation strategy and asked to order them from most important to least important. Achieving financial goals, was the most important goal to be attained through compensation, followed by attaining customer satisfaction goals. Employee retention was third followed by talent acquisition. Achieving work-life balance was last on the list. Another finding, relates to the use of compensation as a motivational tool. In this regard, 62% of executives thought that compensation was a motivational factor, whereas 37% thought it was a hygiene factor (a term extracted from Herzberg's two factor theory). Finally, executives were asked to choose an organizational structure that will best benefit a hotel organization; 55% thought an organization will best benefit from an egalitarian structure, whereas 45% of all executives believe that a hierarchal organization is best.

## **Discussion, Conclusions and Implications**

The choice of compensation strategy and the design of a compensation system is of critical importance for hospitality firms. When compensation is used strategically, it can help attain financial goals, customer satisfaction goals, and human resource goals including talent acquisition and retention. When choosing a strategy, executives face multiple choices. The researchers would suggest that the executive's philosophies, regarding compensation, human resources and management in general will guide their choices when it comes to making compensation strategy decisions.

The executive's allocation of total compensation dollars (see table 1) indicates that the higher level in the organization, the greater percentage of total compensation that comes from variable pay. Given current trends in compensation outside of the hospitality industry, the researchers noted the variable pay suggested by respondents for hourly (non-exempt) employees was very low (3.5%).

The hospitality industry could potentially benefit from more performance bonus and incentive programs for employees. This will ensure a more strategic use of compensation, as long as the programs are properly designed to meet organizational objectives.

This research also revealed that executives are more likely to engage in local comparisons when benchmarking companies. Nevertheless, respondents are also more likely to look at related industries when benchmarking specific jobs. The benchmark process can be complex and deciding on which companies and jobs to benchmark can be difficult choices. However, the authors would suggest using national comparisons (as opposed to regional) for middle and upper management, whereas for non-exempt positions, a local comparison will suffice.

Health insurance was the most important benefit for both the exempt and non-exempt employment categories. This likely reflects the importance of healthcare to prospective and current employees. Many of the top benefits could be categorized as “security” benefits or “wealth protection” benefits. These benefits (i.e. health, life, disability insurance) are meant to assist employees protect their assets. The use of performance bonus was ranked third on the list for exempt employees and ninth for non-exempt. It is normal for a manager’s pay to be more variable than that of an hourly employees. However, the researchers fear that hospitality executives are missing opportunities to promote the behaviors that would help accomplish organizational objectives among its hourly workers. More variable compensation, if properly structured could help the organization attain its financial goals.

Compensable factors are of critical importance, as they help in the design of pay structure and represent an important tool in attaining internal alignment. They also reflect what executives value and the relative importance placed on certain skills as compared to others. Overall executives placed greatest importance in experience and inter-personal skills and least emphasis on education and technical skills. While this ensures rewards for extensive experience, it may also hinder the retention of highly educated individuals, who may bring new ideas and specialized knowledge to the organization.

Executives were also asked to rank the importance of various compensation goals. Attaining financial goals was most important. This may seem like a contradiction, as variable pay for attaining financial goals is relatively low, as compared to other industries. The researchers will also suggest that a greater emphasis on work-life balance (currently ranked last among the goals) will help reduce the high employee turnover the industry is known to have.

One of the most important findings, is that many executives regard compensation as a motivational factor. This is in sharp contrast to Herzberg’s two-factor theory that suggest that pay is a “hygiene” factor (in other words, it prevents dissatisfaction, but it is not motivational). Some academics, also suggest otherwise, indicating that compensation can be motivational (Meudell and Rodlham, 1998). An egalitarian structure was the preferred organizational design among hospitality executives. However, the industry is characterized by hierarchal structures. Changing such a structure can prove challenging.

More research is needed in the field of hospitality compensation. This study adds to the field of knowledge, albeit its limitations. Namely, the exploratory nature of the study, as well as the small response rate. As such, making generalizations about the industry is not possible. However, this study does reveal the philosophies and likely choices of hospitality executives who are in charge of making compensation decisions. Choosing a compensation strategy implies many difficult decisions; building a compensation system and pay structure implies many hours of detailed analysis and a requires a certain level of expertise. Despite the increasing complexity and multiple choices behind, the industry could benefit

from taking a close look at its compensation strategies and the choices that guide those strategies. Only that way, can we ensure that compensation strategy matches business strategy, and thus compensation used strategically.

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