

Raising the salary floor to \$80,000: the case of Magneto Payments, Inc.

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ABSTRACT

Employee perspectives of justice and equity in the workplace can be complex, and sometimes conflicting. This case study presents a situation where the decision to introduce an organization-wide, minimum salary of \$80,000 is instituted by the CEO. The nuances of differential impacts and outcomes on employees are presented through the eyes of a sympathetic coworker. Similarities and differences between procedural and distributive justice are defined and explained within the context of the case. Equity theory is outlined and presented as an opportunity for student reflection on the individual employee circumstances outlined in the case. Included case questions and small group activities enable students to apply critical thinking and communication skills to justice and equity theory as they apply to this particular case and beyond.

Keywords: Equity Theory, Procedural Justice, Distributive Justice, Organizational Behavior, Motivation.

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INTRODUCTION

Shana shuffled the papers on her desk and stretched, eyeing the coffee pot across the room. As she grabbed her mug and walked over, she couldn't help but reflect on the past few months. It had been nearly two years since she graduated from University, and she felt lucky to have gotten her first job here at Magneto Payments, an up and coming credit card processing company in Portland. When she had initially accepted Magneto Payments' job offer, she was excited to be hired for her first "real" job. At that time, Shana and the rest of the employees had no idea of the rollercoaster onto which they were all about to be pulled. Then, later that year, the disruptive young CEO, Bob Penny, had announced his revolutionary minimum \$80,000 pay scale.

Under this ambitious model, all employees would be paid the same minimum amount—from the clerks to managers. Magneto Payments was a private company with about 130 employees making an average salary of \$50,000. Citing research suggesting that increasing salaries to about \$75,000 could improve employee wellbeing (Kahneman & Deaton 2010), the CEO decided to raise all salaries to \$80,000 over three years. Under this plan, about 70 employees would experience salary increases, with about 30 of those doubling their salaries. Other employees already making a salary close to \$80,000 would receive much smaller raises. The increased salaries were to be funded by the CEO's own payout (down to \$80,000 from \$1,000,000) and the company would be willing to allocate 70-80% of its annual profits of about \$2,000,000 towards this change. For Shana and many others, the repercussions of this announcement were profound.

THE CONFLICT

While Shana, herself, was not in the category of employees who would dramatically benefit from the pay raise, she knew that this move had the potential to change lives. She recalled a conversation with Diane, a clerk who had been working at Magneto Payments for longer than anyone else she knew. Shana had always liked Diane. Down-to-earth and incredibly industrious, she seemed like a genuinely nice person who always met everyone with a kind word and a smile, no matter how many extra shifts she worked. Her friendly demeanor and the fact that she often brought in fresh donuts from the local diner where her husband worked helped to make her an office favorite. Diane's annual salary of \$36,000 put her in the category of employees who would now more than double their earnings. Shana vividly remembered seeing Diane actually cry while discussing the impact of this decision:

"Shana, I don't think you understand—this salary change means so much more to me than money; it is a second chance. Most people at work don't know this, but my husband, Earl, has been struggling with his health for some time, now. He has been cutting down on hours and finally had to quit his job at the diner last month. We have run the numbers over and over, and his disability pay just won't cut it. People just don't understand how expensive life can be for two seniors like us. Living isn't cheap and it just keeps costing more. Even our cats have had to feel the squeeze and switch to less expensive food! Our neighborhood keeps getting more and more expensive around us, and groceries and gas surely haven't gotten cheaper, either, not to mention the cost of healthcare in this country. I've been up so many nights, trying to search for other jobs that could pay more, but

nothing has panned out. I can't believe the CEO would give up his personal pay to help those who work for him. I've never heard of anyone doing that kind of thing before, especially not in this day and age when the rich just seem to get richer at the expense of the poor getting poorer. Maybe this will inspire others to do the same. In any case, Earl and I can't thank Mr. Penny enough, and there is no other company in the world at which I'd rather be working. This has given us more than money; it has given us hope."

Shana felt her own eyes getting misty as she thought about Diane and all of the other people who had been so excited about the initial salary announcement. Now, she looked back on this time as a whirlwind of media attention and activity. Bob's self-described goal had been to "shake things up" with this decision, and, it appears he succeeded at least in that. Interview requests had come pouring in from all of the major news outlets and talk shows. Bob's face was everywhere and Magneto Payments was the subject du jour. Detractors had predicted failure and gloom, warning that the company would become a classic example of well-intended but naïve miscalculations. Even Bob's own cousin and company co-founder had strongly opposed the move. Others, however, had heralded this as a revolutionary decision that would spawn changes across multiple industries and begin to balance the CEO-employee pay gap. At the end of the day, Shana was definitely proud to be a part of an organization that was making radical changes like this. For better or worse, they had become known as the "\$80,000" company. In Shana's mind, that was definitely a good thing.

She adjusted her glasses and turned to take stock of the room. The company was filled mostly with young, hopeful people, much like herself. Many of the new faces were hires resulting from the thousands of resumes submitted from around the world in the first week after Bob Penny's announcement. The room almost hummed with a sense of energy and unity. Many of these people, like Shana, were highly talented and motivated with good credentials. They could have gotten jobs anywhere, but were attracted to the atmosphere and at Magneto Payments. Surely they could sense that something special was happening here, and they all wanted to be a part of it.

Well, almost everyone. As she continued her survey of the room, she frowned. Her gaze fell onto a new face. Quickly, she smiled, but couldn't help feeling a twinge of sadness as she thought about Steve, the former occupant of that corner desk. She and Steve had started working at Magneto Payments during the same week, so they had shared many of the exciting and sometimes challenging aspects of starting a new job. Both easygoing, science fiction fans from the same small, midwestern town, the two had naturally gravitated towards one another. This camaraderie was part of the reason Steve's reaction to the salary announcement had so surprised her.

"It just isn't fair", he had bluntly retorted to her befuddlement at his lack of excitement. Shana couldn't understand. Steve was the same age, from virtually the same background, and made exactly the same salary as her. How could he have this so wrong? Why couldn't he see that this was a great idea; an essential step towards balancing the inequity in employee pay? She knew Steve was a strong advocate for giving employees a livable wage and empowering workers' rights. What was his problem?

"I have several problems: first and foremost, I have a heap of college debts to pay off. I depend on being compensated for that investment of time and money by working for a company that could pay me a commensurate salary. Speaking of salary, I don't want

everyone to know what I make. Susie and I have another baby on the way and need more space. How is this going to affect prospective buyers' perceptions of us when we try to sell our house? Additionally, you and I both know that there are a handful of people who do the majority of the work in this office. A company that is going to reward lazy employees as much as the hardest workers is headed down a bad road. I'm still young and need the opportunity to work somewhere I can make regular raises. I have to worry about putting my kids through college and eventually taking care of my parents. Lastly, I'm really worried that this decision just isn't sustainable. Not only will the company have to make major changes to absorb this cost (which, no doubt, will increase customer fees), but I don't trust that it will change anything long-term. I'm all for giving everyone the opportunity to make a livable wage, and there are plenty of good people who deserve to make a lot more money. But, in my opinion, this feels like an expensive and incredibly risky media stunt by the CEO. Besides, suddenly giving all of our employees more money only raises expectations and hurts other small businesses who are already struggling to make ends meet. Until the whole system changes, *this* change just doesn't make sense for people like me, and I surely don't want to be the one to suffer for it."

Steve did have some good points. He left the company not too long after that conversation and took a job in California. Still, Shana just couldn't understand.

JUSTICE & EQUITY THEORY

It was now a year later, and Magneto Payments at least appeared to be on track. Several key employees and customers had left during the initial turmoil, but the company was now being inundated with applications and a number of new customers, all precisely because of the salary decision. True, the cost of salaries had dramatically increased and would continue to do so as the increase plan was rolled out. And, there were rumors that the CEO had reportedly sold off personal assets to make ends meet. But, profits had nearly doubled and turnover rates had plummeted. There was a lot of information to consider.

After work, Shana went to dinner with her friend, Jan, and her mind wandered again to both Diane and Steve's stories. Shana shook her head to try to dispel the doubt from her mind. She firmly believed in the overall good of Magneto Payments' current trajectory. Still, how could this one decision be a lifesaver for some and a breaking point for others? She just couldn't shake her feelings of inner conflict over the way things had turned out. As their food and drinks arrived, Shana decided to get Jan's take on things. Jan had recently gotten her MBA and been promoted to a management position at a similar company; maybe she would have some valuable insight.

"From an outside perspective, the differing reactions to these salary adjustments are understandable" Jan began. "For instance, if we think about justice theory, it makes sense that this increase in salary should be perceived positively by many employees and negatively by many others.

Justice theory, traditionally, can be thought of in terms of distributive and procedural justice. Distributive justice deals with what you would expect—the way in which the organization hands out, or distributes, rewards (Cook & Hegtveldt 1983). Naturally, many employees at Magneto Payments probably believe they, and others,

deserve to be rewarded for their work—for showing up, following the rules, and doing the best work they can. They see that it's the job of the company to fairly distribute these rewards in the form of salary. For some of these employees, distributing an equal reward or salary to all employees would probably seem to be the ultimate act of distributive justice by compensating everyone in the same, equitable way. At the same time, others may feel that this same action, instead, violates their sense of distributive justice. They may believe that some employees deserve to be rewarded differently than others if they work harder, have higher qualifications, or have invested more time into the company. These people would find the company's equal salary rule to violate their personal sense of distributive justice."

"Still with me", Jan asked? Shana nodded. This was making sense, even if it didn't point to a clear answer.

"The same is true when we think about procedural justice. Again, this refers to exactly what you would think- the organization's procedures of handing out rewards (Greenberg & Tyler 1987). And, again, most employees at Magneto Payments probably believe that they, and others, deserve to have a just process governing how they are rewarded for their work. They believe that the company's job is to have a fair procedure for determining these rewards in the form of salary and other compensation. For some of them, the process of equally distributing salaries to all employees fulfills the requirements of procedural justice; it is, quite literally, the same process applied to everyone, equally. For others, this same action is the exact opposite of procedural justice. To them, a process that determines rewards without regard for merit, investment, or efforts is, by nature, incredibly unjust."

To Shana, this also made sense, even if it hadn't offered any resolutions. She sighed and picked at her food. Jan smiled sympathetically at her friend. She knew there were no easy answers; "real world" application of management principles was rarely simple, and often created more questions than answers. After paying the bill, Jan used the server's pen to quickly draw a diagram on the back of her napkin. She slid the drawing over to Shana as she peeled herself out of her side of the leather booth:

As indicated in Table 1 (appendix)

"Here- I'll leave you with this. At the end of the day, a lot of your conundrum comes down to equity theory (Pritchard 1969). In an organizational setting, this is based on the comparison that individuals make to determine how much they want to "put into" a job based on what they "get out" of a job, compared with what others "put into" and "get out" of the same job. Simply put, it's a comparison of inputs and outputs. Inputs can include anything from qualifications such as ability, skill, education, or experience, to more temporal things like hours, effort, or even loyalty."

A few minutes later, Shana held onto the napkin as she walked to her car. What "inputs" and "outputs" had Diane considered when she cried over the hope her higher salary had provided? Which comparisons had played a role as Steve left the company and moved his young

family to another state? She sighed as she looked down the darkened road ahead of her, the streetlights flickering on to illuminate the evening, one by one. Right now, Shana knew she had some thinking to do when she got home—she had to decide which factors she would consider as she came to terms with her own internal conflict.

CASE DISCUSSION QUESTIONS

Case Question 1: Distributive Justice and Procedural Justice are both used by organizations when determining employee compensation and rewards. Describe each type of justice and give an example of each from this case.

Case Question 2: Equity theory can be used to explain employee attitudes across many organizational situations. Describe the three situations of equity and inequity outlined in the Equity Theory Equation by using examples from this case.

Case Question 3: Using the principles of Equity Theory, explain how Steve may have come to feel it was best for him to leave the organization.

Case Question 4: Using the principles of Equity Theory, describe which feeling you think someone in Diane's situation may have come to experience both before and after the pay raise: anger, satisfaction, or guilt? Give reasons for your answer.

Reflection Question 1: Imagine yourself in an organization that is about to give employees raises. Which type of justice is more important to you in relation to compensation and raises: distributive justice or procedural justice? Explain your reasoning.

Reflection Question 2: It came to light a few years after the big salary adjustment announcement that the CEO Bob Penny had been taking as much as two-thirds of the entire company's profits as his salary in the years leading up to his public salary adjustment announcement. This is much higher, proportionally, than the average pay for CEOs at companies of a similar size and stage in development. In fact, many analysts reported that such a high salary at a company of this size was unheard of, and at least 500% more than would be expected. How does this information influence your thoughts on the CEO? Do you think if employees knew this, they would have different perceptions of Bob Penny? Do you think they would have different perceptions of the pay raise? If so, how?

TEACHING ACTIVITY: SMALL GROUP DISCUSSION

After students read the case, have the students first write their name on a piece of paper and choose "yes" or "no" to whether they believe CEO Bob Penny's salary floor adjustment was a good idea. Collect the responses. Then, break into several small teams of 2-3. Assign each group one of 7 role-playing cards. Roles include Chief Financial Officer, Chief Marketing Officer, office administrative assistant, software developer, marketer, call center representative, and investor. Each group will be given a short bio for their assigned role. Groups will then be asked to imagine themselves in a meeting with CEO Bob Penny a month before the decision to raise salaries. Bob tells each employee of his idea to raise salaries. In this theoretical scenario,

however, these seven employees have a vote on whether the company should implement the following policy:

All employees making below 74,500 will automatically be given a raise to 80,000. All employees making above 74,000 will receive a 6.5% raise.

Each group is to assume the role of their assigned employee to determine whether or not that employee would be in favor of the change and why.

After groups are given ample time to discuss and write notes (typically 10-20 minutes), a representative from each group will explain their choice and reasoning for it. The vote will be tallied and the “decision” will be implemented. Ask students to then (either in class or as an assignment) report 1). What their original choice was before class 2). Whether the activity changed their opinion and 3). Whether they think this sort of adjustment would be good for other companies? Why or why not?



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APPENDIX – Table 1

$\frac{\text{Individual's outcome}}{\text{Individual's input}} < \frac{\text{other's outcome}}{\text{other's input}} = \text{Inequity (anger)}$

$\frac{\text{Individual's outcome}}{\text{Individual's input}} = \frac{\text{other's outcome}}{\text{other's input}} = \text{Equity (satisfied)}$

$\frac{\text{Individual's outcome}}{\text{Individual's input}} > \frac{\text{other's outcome}}{\text{other's input}} = \text{Inequity (guilt)}$

