



Examination: Human Resource Management –Final Exam (WT 2005/06)

Examiner: Prof. Dr. B. Wolff; Course No.: 1524/5076

Please note that in the Final Exam at hand, you will have **2 hours** to solve the problems worth a maximum of **70 points**. Please consider the following general advice:

1. Use the theoretical tools and terminology you have learned in class and from the textbook.
2. Make sure there is a clear structure in your argument. (Use some time to sort your ideas before you start writing the version you want to submit, esp. if you answer B).
3. Use the time you have! If you are ready much earlier than we planned you should ask yourself whether you forgot something.
4. Remember: people have to be able to decipher what you write.
5. Leave a margin for our comments, so we can give you a more detailed feedback than just the number of points.
6. Each main question has sub-questions. Answer each one explicitly.

Examination Questions:

Please solve **either** problem(s) **A** or **B** (maximum 70 points):

You are welcome to use a non-programmable calculator.

A) Please answer only 7 out of the following 9 questions:

1. Employee turnover (max. 10 points)

Widgets Inc. is undergoing a severe market decline. Susan, the general manager is pondering ways to reduce costs. She noticed that since the seniority wage structure is implemented, the older workers are being paid much higher than their productivity. You are the personnel manager, and asked to design a buyout plan.

- 1) What will happen if the same buyout plan is offered to all employees?
- 2) Susan considers it important to keep some of the senior workers because of complementarities between the workers. Explain what complementarity means and why there is complementarity between the junior and the senior workers.
- 3) Will buyout plans be feasible for the employee groups described in the following table?

Age	Present value of decreased productivity	Present value of wages	Present value of alternatives
61	48,000	48,800	47,500
62	46,000	47,400	46,200
63	44,000	46,400	44,500

2. Hierarchical or Flat Structure (max. 10 points)

While facing the decision whether to accept or reject a project, an organization can make mistakes. Explain what α -errors and β -errors are. How will the likelihood of α -errors and β -errors be affected by

- 1) A hierarchical structure,
- 2) A flat structure,
- 3) Better information?

In addition, explain why, given the following data of an airline, it is more profitable to implement a hierarchical decision-making structure for deciding on flight routes. Support your argument by your calculation.

Flight Routes	Probability of crash	Costs of crash	Fuel costs of trip
Go through storm	0.00001	\$ 1 billion	\$ 17,000
Go around storm	0.000000001	\$ 1 billion	\$ 20,000

3. Team Incentive (max. 10 points)

- 1) Monetary incentives in teams can take two forms: explicit rewards and implicit rewards. What are the differences between these two forms? You are welcome to use examples for the explanation.
- 2) Why can free-rider effects arise in teamwork? How does team size affect the free-rider effect?
- 3) How can we use variables of stock option plans (only consider call options) to control managerial investment decisions?

4. Reengineering and Empowerment (max. 10 points)

- 1) Describe the idea of reengineering as a specific form of change management. Elaborate on why the implementation of plans promising improvements of the firm's performance nonetheless frequently fails in practice.
- 2) Explain the idea of open book management. What are the costs and benefits of open book management for the firm?

5. On-the-job training (max. 10 points)

Explain the difference between General on-the-job training and Firm-specific on-the-job training, and comment on the following case. James is an employee at Best Plumbers GmbH. The manager is considering whether to send James to a one-year language training program. The manager estimates that James will work for another three years in the company after the training. The training costs are € 1000, afterwards James will be better at communicating with the customers, raising his productivity by € 400 per year over the next years. Suppose the market interest rate is 3%. Is it worthwhile for the firm to send James to the training? Which contractual risk does the firm face when making this investment? What could the firm do to limit the potential loss?

6. Commission (max. 10 points)

Top Truck's salespeople get their compensation based on their sales revenue, while paying the company a fixed amount each month (like a franchise fee). The variable cost for a truck is € 2400. The price is set at € 6000. The following data is available:

Number of trucks sold per month	Salespeople's marginal costs of effort	Total required compensation
10	3000	16500
11	3300	19800
12	3600	23400
13	3900	27300

- 1) What compensation scheme should Top Truck implement to maximize the firm's profit?
- 2) If the commission rate rises by 5 per cent point, what will the salespeople do and what is the consequence for the profit of Top Truck?

7. Evaluation (max. 10 points)

In CSS Public Accounting firm, the newly recruited staff are usually evaluated after one year working in the firm. The evaluation costs are € 500 per employee. Past experience shows that 80% of the newly recruited staff prove to have gained valuable experience and will be more productive in the following year. The rest however will turn out to be less productive in the second year.

Probability	Salary in the first and the second year	Productivity in the second year
Value at current firm	€ 25,000	€ 40,000
Value elsewhere	€ 25,000	€ 30,000

Assume that effort is totally unresponsive to compensation and that the evaluation is perfectly effective.

- 1) Should the evaluation be carried out if dismissal is possible?
 - 2) Should the evaluation be carried out if dismissal is not possible?
- Explain your answers and support your argument by your calculation.

8. Trust in Work Relations (max. 10 points)

Explain the notion of trust according to David Kreps' "trust game". Why do economists tend to think of trust as an implicit contract which can be superior to explicit contracting under certain conditions?

9. International Human Resource Management (max. 10 points)

Explain the principle of cost-utility-arbitrage. What effects does the institutional framework have on employee incentive design for a multinational firm?

B) Essay (max. 70 points)

Following are excerpts from various laws and regulations:

German Co-determination Act

- § 1 Enterprises which
1. are operated in the legal form of a stock corporation, a limited partnership with shares, a company with limited liability, or a cooperative or industrial society and
 2. regularly employ more than 2000 employees,
- must grant the employees the co-determination right in accordance with conditions of this law.
- [...]

German Stock Corporation Act

[...]
§ 161 Declaration to the German Corporate Governance Code
Executive committee and supervisory board of the listed companies must declare annually, that the recommendations in the German Corporate Governance Code, released by the Federal Ministry of Law in the official part of the electronic legal index, have been and will be complied with or, which recommendations have not been or will not be complied with. The declaration must be permanently accessible for the shareholders.

[...]

German Corporate Governance Code

[...]
3.2 The Management Board coordinates the enterprise's strategic approach with the Supervisory Board and discusses the current state of strategy implementation with the Supervisory Board in regular intervals.

[...]

5.1.1 The task of the Supervisory Board is to advise regularly and supervise the Management Board in the management of the enterprise. It must be involved in decisions of fundamental importance to the enterprise.

5.1.2 The Supervisory Board appoints and dismisses the members of the Management Board. Together with the Management Board it shall ensure that there is a long-term succession planning. The Supervisory Board can delegate preparations for the appointment of members of the Management Board to a committee, which also determines the conditions of the employment contracts including compensation.

[...]

Your task:

Interpret the notion of co-determination in terms of the allocation of property rights. Under which conditions can co-determination help to increase the overall efficiency of the firm? The Co-determination Act came into being due to the government effort to improve worker's situation by law forcing firms to empower workers. Why is this approach not necessarily efficient?