Henry ford's efficiency wages essay

Economics of Management Strategy| January 1 2011 | On 5th January 1914 the Ford Motor company announced that it would more than double the wages of its workers. Briefly describe the history of this decision and relate to the theory of incentives and efficiency wages. | Assignment 1| Table of Contents Introduction

One of the major variables that can determine the rate of profit maximization for firms is the efficiency and productivity levels of employees. Ultimately, firms seek to minimize total costs to induce lower expenses and as labour is a vital component in the factor of production, wages are one of the most fundamental expenses incurred by firms. The efficiency wage hypothesis states that " the productivity of workers is affected by the wage rate that they receive" (Sloman 2006, G: 5). Essentially the introduction of Henry Ford's " 5 dollar-a-day" employee wage structure evidently proved this theorem correct, with empirical evidence.

The idea behind Ford's supracompetitive (Raff and Summers 1987, s 58) wages must be critically evaluated and analyzed. This essay will briefly describe the history behind the decision making process leading to the 5 dollar-a-day wage rates as well as an analysis on its effects on absenteeism, shirking and employee morale. The scope of this essay will highlight the degree to which efficiency wages were of importance to Ford Motor Company and evaluate the importance of the doubling of wages with theoretical and empirical support.

Brief History: Human Capital Crises at Ford, 1913-1914 The necessity for high skilled workers was never a concern for Ford but the degree to which employees valued their jobs was (Raff and Summers 1987, s 65). Workers in the assembly line revealed the monotonous and low skill level required for the production of the T Models (Chandler 1964, p 28). Boyd Fisher (1917) accounts that there were high turnovers as a result of a under par working conditions, “ inequities in pay and the monotony of the work. A Company survey revealed that 7, 300 workers left in Match 1913 of which a staggering 71% were accounted for workers who left for 5 days and did not return (Raff and Summers 1987, s 63). Even though employee replacement was easy as a result of no shortages of labour the fact was that costs would be incurred in training new employees. The implication that the general population of workers undervalued their positions disabled Ford to utilize the maximum productivity of the assembly line. Thus the assembly line consisted of low morale employees who practiced shirking (Raff and Summers 1987, s 67).

Additionally the dissatisfaction in the workplace was aided by the unpleasant management of men by foremen and superintendents (Meyer 1981, p 100-101). On 5th January 1914 the Ford Motor Company announced that it would more than double the wages of its workers. The 5 Dollar-a-Day Wage Rate: Theoretical and Empirical Impact A Diminution in Absenteeism and Shirking Efficiency wage theorist’s state that when firms increase their wages above the market clearing point, then the relative productivity and efficiency of employees will increase as a result (Shapiro and Stiglitz 1984, p 433).

Henry Ford’s increasing of wages from $2. 34 to $5 was, in his eyes a profit-sharing plan rather than wage increases (Raff and Summers 1987, s 68). The increase in wages gave an increased incentive for people to not only want a place on the assembly line but to ensure that they kept it. The increase in wages did attract the labour market to Ford Motor Company yet given the low skilled level required to operate at Ford there was a significance benefit that Ford would yield.

The Shapiro-Stiglitz Equilibrium Unemployment model demonstrates that when a firm offers wages above the market clearing point then there is a sharp disincentive for workers to shirk (a moral hazard) as they are exposed to involuntary unemployment (Shapiro and Stiglitz 1984, p 439). Ford's doubling of wages initiated efficiency in that there were sharp risks involved for any workers shirking. Inefficient workers were now in a place where they faced discharged and lose out on the ' profit sharing' scheme should they prove to be counter-productive.

As the number of plant supervisors increased, there was an increase in the cost of shirking (Raff and Summers 1987, s 82). Morale Increase, Turnover Decrease The atmosphere and mentality of the workplace and employees changed as a result of the increase in wages. Ford had intertwined the wage increases with a unambiguous concern for the employees' pride (Raff and Summers 1987, s 82). Nevins (1954, pg 549) exemplifies that employees mentality soon changed and a moral boost was evident in that employees wore their ID badges to a variety of social events.

This heightened sense of dignity and value in their jobs ultimately induced higher levels of productivity, which binds with the equality of Akerlof's (1982) theory. Quantitative evidence presents an 87% fall in quit rates between

March 1913 and March 1914 (Abell 1915 p 37) as well as a staggering turnover rate drop from 400% to 23% (Fisher 1917, p 15). The productivity of workers increased in order to ensure that they fit the portfolio to keep a job at Ford as long as they could.

This meant that employees had to honour the thinking process of Ford Motor Company which was their doubling of wages meant doubling of efficiency and productivity. The results of the experimental 5 dollar a day plan that was announced on January 5th 1914, Ford initiated a ‘ substantial productivity increment of between 40% and 70% in a year’(Raff and Summers 1987, s 77). Conclusion Theory suggests that the implementation of efficiency wages can be as a result of the high cost of replacing workers and reduce those costs whilst promoting an increased incentive for productivity. Evidence shows that Ford as able to dramatically reduce turnover costs and improve efficiency to see higher profit margins as a result of doubling wages. The 5 Dollar a Day wages enabled Ford to answer all his labour problem questions which were in the form of high absenteeism, shirking and the air of low morale at the plant. Ford was able to drive incentives for employees to become more resourceful even though they were doing menial work they were discontent with (Harold Slausen 1914 page 263,) In doubling the wages, he was able to reduce his total costs and increase revenue in turn seeing a large level of profitability.

Henry Ford (1992) quoted that the 5 dollar a day scheme was the ’finest cost cutting move we ever made’. Bibliography Abell, O. J. “ The Ford’s Plan For Employees’ Betterment. ” Iron Age (January 8, 1914), p 307-8 Akerlof, G. A . “ Labour Contracts as partial Gift Exchange. ’’, Quarterly Journal of

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