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**WHAT EVER HAPPENED
TO INCENTIVE PAY**

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ABSTRACT

Reviews the decline of Incentive Pay plans. Points out that many forces have caused this to happen and warns that we must not give up on pay as an incentive. Gainsharing plans are suggested as an alternative to incentive pay.

WHAT EVER HAPPENED TO INCENTIVE PAY?

by

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Historically, the popularity of incentive pay has gone hand-in-hand with the popularity of the scientific management approach to work design. The 1920s and 1930s saw a tremendous growth in the installation of piece-rate and other individual incentive plans (Lawler, 1971). For several decades, however, the popularity of incentive plans has been in a steady decline. Fewer and fewer new ones are put in and those that are in place are being eliminated. The impact of this trend has shown up in the attitudes of the American workforce. A 1983 study by the Public Agenda Foundation found that only 22% of American workers say there is a direct link between how hard they work and how much they are paid.

The movement away from incentive pay has had its costs. There has been, and continues to be, considerable evidence that pay can be a particularly powerful incentive (Lawler, 1981; Locke, 1979). Studies tend to show productivity increases of between 15 and 35 percent when incentive pay systems are put into place and the Public Agenda Foundation survey reports that 73% of the workers surveyed attributed decreased job efforts to its lack of incentive pay. Given their effectiveness, the decreasing popularity of incentive pay systems is at first glance hard to understand. We are in an era when, at least in the United States, national productivity rates are stagnant and there is a

desperate need for management approaches that will increase productivity.

There are important reasons for the decline of incentive pay that need to be considered before we turn to what can be done to make better use of pay as an incentive. This analysis will indicate that although at first it may seem that organizations have lost their way with respect to incentive pay, in fact, the abandonment of individual incentive plans is probably appropriate. However, the slowness to replace them with other kinds of pay for performance plans is be a major error.

Problems with Piece-Rate Pay

The literature on pay incentive plans is full of vivid descriptions of the counterproductive behaviors which piece-rate incentive plans produce (see e.g., Whyte, 1955). In many respects, these behaviors are caused not so much by the concept itself, but by the way it has been operationalized in most organizations. Nevertheless, it is difficult to separate the practical problems with the plan from the general idea of incentive pay. Let us briefly review the major problems with piece-rate incentive plans.

1. Beating the System. Numerous studies have shown that when piece-rate plans are put into place an adversarial relationship develops between system designers and the employees who work on them (Lawler, 1971). Employees engage in numerous behaviors in order to get rates set in such a way that they can maximize their financial gains relative to the amount of work that they have to do. They engage in such behaviors as working at slow rates in order to mislead the time study expert when he or she comes to study their job. They hide new work methods or new procedures from the time study person so the job will not be restudied.

In addition, informal norms tend to develop in the organization about how productive people should be and the workers set limits on production. Anyone who goes beyond this limit is often socially ostracized and even physically punished. Unfortunately for the organization, this limit often is set far below what people are capable of producing.

Other forms of gaming include producing at extremely low levels when the rates are set at levels that the employees consider too difficult to reach and using union grievance procedures to eliminate rates that are too difficult. Finally, it is often suggested that in order to gain leverage in negotiating piece-rates, employees will organize unions so that they can deal from a more powerful base. Often, when unions do exist in the work place, they are able to negotiate piece-rate plans which allow workers to work off standard, while being paid at a rate which represents a previous high level of performance. Thus organizations end up with the undesirable combination of high pay and low performance.

In summary then, piece-rate plans often set up an adversarial relationship between those on the plan and those designing and administering the plan. The result is that both sides often engage in practices designed to win the game or war at the cost of organizational effectiveness.

2. Divided Work Force. Since many support jobs and non-production jobs do not lend themselves to piece-rate pay, the typical organization that has incentive pay has part of the work force on it and part of the work force not on it. This often leads to a we/they split in the work force that can be counterproductive and lead to noncooperative work

relationships. This split interestingly enough is not a management-worker split, but a worker-worker split. In its most severe case it can lead to incentive people complaining about materials handling people, maintenance people, and others who they depend on for support. This split can also lead to some dysfunctions in the kind of career paths people choose. Often individuals will bid for and stay on incentive jobs even though they don't fit their skills and interests. The reason for this is the higher pay they offer. The higher pay of established incentive jobs also often causes individuals to be inflexible when asked to change jobs temporarily and it causes them to resist new technology which calls for a rate change.

3. Maintenance Costs. Because incentive plans by themselves are relatively complicated and need to be constantly updated, a significant investment needs to be made in people whose job it is to maintain them. The problem of maintaining the incentive systems is further complicated by the adversarial relationship that develops between the employees and the management. Since employees try to hide new work methods and avoid having changes in their rates made, unless of course, it is to their advantage, management needs to be extremely vigilant in determining when new rates are needed. In addition, every time a technological change is made or a new product is introduced, new rates need to be set.

Finally, there is the ongoing cost of computing peoples' wages relative to the amount of work and kind of work they have done during a particular performance period. All this takes engineers, accountants, and payroll clerks. Added together, the support costs of an incentive system are significantly greater than those associated with a straight hourly pay or a traditional pay for performance salary increase plan.

4. Organization Culture. The combined effects of dividing the work force into those who are and are not of incentive pay and the adversarial process of rate setting can create a very negative organization culture or climate. In particular, it produces a climate of low trust, lack of information sharing, poor support for joint problem solving and inflexibility due to individuals wanting to protect their rates. Overall, incentive pay works against creating a climate of openness, trust, joint problem solving and commitment to organizational objectives.

In summary, the above list should make it clear that the installation of incentive pay is, at best, a mixed blessing. Although it may improve work performance, the counterproductive behaviors that it leads to, maintenance costs, the splitting of the work force and the poor climate that it leads to may make it a poor investment. Many organizations have dropped it or decided not to put it in simply because they have decided that the negative effects and maintenance costs outweigh the potential advantages that come from the increases in performance that it typically produces. The decreasing popularity of incentive pay, however, probably cannot be understood solely from this perspective. Some important societal changes have taken place since Frederick Winslow Taylor first wrote about scientific management. These changes have in many ways led to the declining popularity of piece-rate pay.

Societal Changes

The United States has changed dramatically since the first installations of incentive pay. The society, the work force, and nature of the work have all changed. Let us look at how each of these has changed and then see how they relate to incentive pay.

1. Nature of the Work. In the early 1900s, many of the jobs in the United States were in the manufacturing and agricultural parts of the economy and they involved the production of relatively simple, high volume products. Today, the United States is moving rapidly toward work which is service sector based, knowledge based, information processing based, and/or high technology based. Many of the simple repetitive jobs in the manufacturing sectors have left the United States for less developed countries or they have been automated. Instead of simple stand-alone jobs that an individual could do by him or herself, many jobs involve the operation of complex machines, continuous process plants, or delivering services which require the integrated work of many individuals.

The type of work that exists in the United States today, therefore, is less amenable to individual measurement and to the specification of a normal level of individual production. Instead, performance can only be measured reliably and validly when a group of workers or even an entire plant of workers is viewed. In many knowledge-based jobs, it is even difficult to specify what the desired product is until it has been produced. Work of this nature simply does not lend itself to incentive pay. Where knowledge work is unsalaried and where high technology is unvalued, the nature of jobs and technology is often subject to rapid change. Rapid change conflicts directly with incentive pay because it requires stability to set rates and to justify the start up costs.

Finally, even in those situations where there are simple repetitive, stable jobs that lend themselves to piece-rate pay, the work on individual job enrichment has led organizations to try to make those jobs more complex and to create conditions under which employees will be

intrinsically motivated to perform them well. For example, in some cases self managing teams have been given responsibility for whole pieces of work. In many cases, the process of enriching them has made them less likely candidates for incentive pay, first, because a different kind of motivation is present and, secondly, because the enrichment process has made the simple, measurable, repetitive, individual nature of the jobs disappear. In summary then, the nature of work at least in the United States, is less and less amenable to individual incentive pay.

2. Nature of the Work force. When incentive pay was introduced in the United States, the work force was primarily composed of poorly educated immigrant workers who were for the first time entering factories and manufacturing environments. Today, the work force is much more highly educated and there is evidence to indicate that it has different values and different orientations toward work. For example, today over 20 percent of the work force has a college education and this, combined with a number of other changes, has produced a different work force. It is interested in influencing work place decisions, desires challenging and interesting work, and hopes to develop their skills and abilities. Incentive pay plans because of their top-down nature and the kind of work they are typically associated with do not fit this type of work force. Indeed, it is this change in the nature of the work force that is often used to support the call for more enriched jobs and for the elimination of standardized, specialized, highly repetitive work (Hackman and Oldham, 1980).

3. Nature of the Society. The rate of societal change in the United States has been accelerating during the last decades.

Particularly in the last ten years, the United States has seen an expansion in employee rights, employee entitlements, and the kind of legal avenues that are open to employees when they feel unfairly treated in the work place. This has made incentive pay plans subject to grievances and to the kind of challenges which make them difficult and expensive to maintain.

In addition, the society has seen increased international competition and the loss of jobs to other countries. The net effect of these and other changes seems to have been to push the society toward pay practices that are more egalitarian and which have less money at risk. Today we have high fringe benefits and high base wages. In many respects, this does not fit with the increasing national awareness that the U.S. needs to be more productive, but it does fit with the idea of increased entitlements and the elimination of incentive pay plans. Interestingly, the fear of job loss also can lead to production restriction on incentive jobs. Individuals reduce production because they are afraid that if they produce too much they will work themselves or their co-workers out of a job. The macro issue of international competitiveness gets overlooked because of the short term need for a job.

Overall, the United States has become a society in which the profits of companies are at risk as a function of performance, but the pay of individuals is affected only at the extremes of performance. That is, an employee only loses when the company is in such poor shape that it has to lay the individual off and the employee only gains when growth is such that the employee has the opportunity to be promoted. The society seems to have evolved to a state where individuals consider

that they are entitled to a fair wage and extensive fringe benefits simply because they are employed by the organization. This kind of thinking is represented in the union contracts that have eliminated piece-rate pay and in companies that in order to stay nonunion have simply given high base wages to all employees.

Future Developments

Looking to the future, there are no indications that changes in the United States are occurring which are likely to tip the scales in favor of incentive pay. Indeed, if anything, the trends which have led to the abandonment of incentive pay seem to be continuing such that if anything, the next ten years will probably see a continuing decline in the use of incentive pay plans. There is, however, one important trend which seems to call for the increased use of pay as a motivator--the lack of growth in national productivity and the strong international competitive situation with respect to productivity and economic growth.

Given the competitive situation, it seems foolish for any organization to abandon such a potentially powerful incentive for performance as pay. Just this point was made by the 1983 White House Conference on productivity; it recommended the increased use of pay as a motivator. The Public Agenda Foundation study also supports pay for performance; it found that 61% of its workers surveyed want pay tied to performance. On the other hand, the analysis so far has suggested that at least piece-rate and incentive pay plans are not a good answer. The typical merit increase plan also has many drawbacks and usually is not an adequate motivator (Lawler, 1981). Simply stated it fails to effectively tie significant amounts of pay to performance. What then is the answer?

There probably is no one answer, but for some, one good alternative is the use of some combination of profit sharing, gainsharing and stock ownership. As a combination, they can shoot an organization through with pay for performance plans and dramatically increase the business involvement of everyone in the organization. Not surprisingly, the use of these plans is showing a dramatic increase in the United States and every indication is that they will continue to grow in popularity. Let us therefore turn to a brief discussion of them and a consideration of why they seem to be an appropriate method at this point in time.

Gainsharing Plans. The Scanlon Plan is perhaps the oldest and best known gainsharing plan (Moore and Ross, 1978). More recently, a number of companies have adopted the Improshare plan while many others have developed their own plans. The idea in all of these plans is to define a business unit, typically a plant, or major department and to relate pay to the overall performance of that business unit. Bonuses are paid out to all employees in that unit on a monthly basis. A formula is used to decide the size of the bonus. Typically, bonuses are paid when the formula indicates a decrease in such costs as labor, materials, and supplies.

The Scanlon Plan has been around in the United States for decades. It was first formulated by Joe Scanlon, a union leader in the 1930s and has been in place in some companies for over 30 years. Until recently, it was used primarily in small family-owned manufacturing organizations. During the 1970s, however, an interesting and important trend developed. Such large companies as General Electric, TRW, Dana, and Owens-Illinois began installing gainsharing plans in some of their manufacturing plants. This tendency of large corporations to define organizational

units which have their own bonus plans seems to be spreading. The reasons for this are many and relate directly to the kinds of changes which have been going on in the work force in the society in general. In many respects, the work situation in the United States today is more in tune with the idea of plantwide or organizationwide bonuses such as those that are typically generated by gainsharing plans than they are in tune with the idea of piece-rate pay. Let us briefly review why gainsharing plans seem to fit better in the current situation than piece-rate plans.

First, gainsharing plans do not rely on individual performance measurement. This is important in several respects. First, it fits many work places because performance in them can only be measured in an objective manner at the group or plantwide level. The technology in them does not lend itself to the identification of individual output.

Gainsharing plans are also typically participatively developed and administered. That is employees have a say in the design of the plan and are able to participate in the ongoing maintenance and administration of the plan. This tends to significantly decrease the adversarial relationship between employees and management and to fit better with a society in which people want influence on work place discussions and want to be involved in business decisions.

They also affect everyone in the work force: managers, production employees, and support people so they encourage cooperation and teamwork and thus tend to produce an increase in organizational performance. This is in contrast to incentive plans which affect only a limited number of employees and motivate competition within organizations.

Finally, to a degree, gainsharing plans meet the needs of organizations for increased productivity. There is considerable evidence that indeed they do produce performance improvements (Lawler, 1981). On the other hand, it is important to note that they may not produce as great an increase in the performance of individual production workers as will piece-rate plans. They produce a much less direct connection between individual performance and reward and, therefore, are a less powerful motivator than are individual piece-rate incentives. Clearly then there is a loss here in comparison to piece-rate incentive plans but the expectation is that the loss will be made up in a number of respects.

First, extra cooperation should lead to better performance particularly in work places where cooperation is key to performance (e.g., process production technologies). Second, the ability to include everyone in a plan can be an important advantage in most work places since it means that the performance of many can be increased, not just the performance of a few. Third, gainsharing plans do not seem to produce as many negative side effects because rather than leading to an adversarial relationship, they typically lead to a cooperative problem-solving relationship between management and the workers. After all, managers and employees are on the same incentive plan and the plans are installed jointly in a cooperative mode. Fourth, most plans include a problem-solving group process which is intended to develop and implement individuals' ideas about how the work process can be improved. Fifth, gainsharing pays off on organizational performance and this produces a good fit between how well an organization does and the payout to the individual. Situations are unlikely to develop where a bonus is

paid and the organization performs poorly. Finally, gainsharing plans often take less administrative support than individual piece-rate plans. While they still require administrative support, they do not require the setting of individual standards for each job nor the calculation of pay for each individual based upon their performance.

So far, the installation of gainsharing plans has largely been limited to manufacturing situations. Recently some service organizations such as banks and hospitals have begun to experiment with gainsharing plans. A good guess is that over the next five to ten years there will be increased use of gainsharing plans in nonmanufacturing situations. Although a great deal remains to be learned about how they should be installed in nonmanufacturing environments, they are one approach for linking pay to performance that fits the conditions which exist in today's work places.

Profit Sharing and Stock Ownership. Profit sharing and employee stock ownership are better known, older, and more widely practiced than is gainsharing. By themselves they typically are less effective motivators, however. This is particularly true in large organizations where the line of sight from individual performance to corporate performance is poor and the connection between individual performance and stock price is virtually nonexistent. Thus, particularly in large organizations, these approaches are desirable primarily because of their symbolic value. They effectively point out to everyone that they are part of one organization and that joint effort is needed. Stock ownership in particular can serve to emphasize the importance of long term organizational performance. In very small organizations they may make gain sharing plans unnecessary because they have the same effect.

In most organizations however, they should be thought of as supplements to gainsharing which are not as important but which are important symbolically and as balancers. The one exception here is top management. For them, profit sharing and stock ownership plans should be thought of as the major motivators of performance.

Conclusion

The strategy of installing multiple pay systems that reward organizational performance represents a potentially effective approach to improving organizational performance through using pay as an incentive. The alternative of essentially abandoning pay as a motivator of performance is always there but it represents the abandonment of a very important potential incentive, something that most organizations cannot afford to do. If anything, it is surprising how slow most organizations have been to move to the use of multiple bonus plans. Particularly in large organizations, it has been noted for decades that people have lost a sense of the business and a sense of involvement in the ongoing operation of the organization. As a result, they have in many cases become bureaucrats routinely carrying out tasks with little appreciation or concern for how their performance relates to the overall success of the business. Indeed, it has often been suggested that it is this type of relationship between individuals and organizations that has led to stagnation in national productivity growth in the United States and in many cases the production of poor quality products.

Gainsharing, profitsharing, and stock ownership when combined with a number of other organization design features are a way of getting people involved in the organizations they work for (Lawler, 1982). Approaches such as quality circles, self-managing work teams and

individual job enrichment can also do this, but in the absence of any relationship between the success of organization and the pay of individuals, an important part of the business experience is missing for the individual. Everything that is known about motivation clearly points out that motivation is going to be greatest when people have both a psychological stake in the organizations' success and a financial stake in its success. Shooting the organization through with bonus plans represents a way to produce this for a significant number of employees. Those organizations that fail to take advantage of this kind of opportunity are missing an important way of increasing organizational performance. Indeed they may be missing out on the next management wave.

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