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THE NEW PAY

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by

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ABSTRACT

This paper reviews the implications of new approaches to management for pay practices. It suggests that pay needs to be administered very differently in the future. Changing skill-based pay, gainsharing plans, and egalitarian practices are suggested along with the implications of these changes.

THE NEW PAY

EDWARD E. LAWLER III

The way American corporations are managed is changing in ways that are creating the need for a new approach to pay. This change in management style reflects a number of factors including important changes in the nature of the workforce, the society, and the business scene. Because of these changes, the traditional American approach to managing and rewarding people seems suddenly outdated and in need of revision and reconceptualization. The recent popularity of books on management is testimony to the fact that the need for change is widely recognized. Books like In Search of Excellence and Theory Z point to new approaches to management that promise to improve the performance of American corporations.

It is impossible to identify a single factor which is causing the rethinking of the way U.S. corporations are managed, but there is one that probably is more important than others. The economy of the world has become more interdependent and this has changed business dramatically in the United States. U.S. companies can no longer count on controlling the U.S. market for their goods. They now have to compete with companies from all over the world, and often, overseas companies have lower labor costs, different management styles, and as a result of these and other factors, are very tough competitors. Such workforce and societal changes as the rising education level of the workforce, the increasing concern for individual rights, and the movement toward more knowledge and service work,

also have contributed to the need for changes in the way organizations are managed.

The traditional American approach to management now appears to be in need of alterations or even total replacement. But what will replace it? The answer to this question is still being developed, but some of the characteristics of the way effective American corporations will be managed in the future are becoming clear. These changes, which will be briefly reviewed next, have some important implications for the type of pay systems that organizations should use. Indeed, as will be pointed out, if pay is to be administered in a way that is consistent with the new management, a new pay is needed.

Briefly, the following are the key characteristics of the new American management style which is emerging.

1) Strategy Determines Structure - The structure of an organization exists in order to help it implement a particular strategy. Thus, there is no one correct structure, it must be a derivative of the organization's business strategy. The implications of this point are clear. First, the strategy of an organization needs to be determined and then the structure based upon it. Since businesses are likely to develop different strategies, they also are likely to develop different structures. Nevertheless, there does seem to be a general recognition that, in the United States, more organizations need to adopt structures which push decisions down, and develop decentralized, human resources oriented operating units.

2) Strategy Drives Performance - The type of performance that is desired from an individual or unit needs to be driven by business strategy as well. Increasingly, business strategies in the U.S. are emphasizing production of quality goods and services, greater desire for risk taking

and entrepreneurial behavior, and finally, a longer time orientation. Behaviors such as attention to quality, risk taking, and longer term orientation, will only be produced if the systems in an organization such as the structure of the rewards system, the selection system, the measurement system, etc., are designed to produce this type of behavior.

3) Separation of Thinking and Doing - Traditionally in organizations, management has thought, decided, and planned, while workers have done. This approach is still practical and perhaps desirable in some situations, but in many it is simply not viable. It leads to increasing layers of management bureaucracy and large staff groups. In a business that competes internationally this can be highly dysfunctional. It is simply too expensive to pay someone to be just a pair of hands. If the organization is to have reasonable labor costs, people must not only do things, they must think, plan, and control their own work.

4) Culture as Control - The recent analyses of successful U.S. corporations has clearly pointed out that control of employee behavior can be obtained through culture and the core values of the organization. This is in contrast to the traditional approach to control which emphasizes measurement, rewards, and punishments. It is also in contrast to those organizations which have tried to write extensive rules and regulations to cover every contingency. Current thinking emphasizes the desirability and importance of control through shared understandings of how the organization works, what it's goals and objectives are, and the values it stands for. This approach has the advantage in many cases of being less cumbersome and more effective.

5) Egalitarianism - Many organizations exist as multi-class societies. That is, depending upon hierarchical level, people receive

different rewards, have different privileges, and have a different work experience. This produces a number of dysfunctions; thus, the new management thinking emphasizes the desirability of having a one class society inside the organization. This leads to a much greater sense of commitment and community for people who are at lower levels.

6) Individual Rights - The increasing concern in the U.S. with individual rights and due process means that organizations must give considerable attention to programs designed to provide equal opportunities to people of all races, religions, and backgrounds. It also means that when disputes arise involving employment, pay, and job security, due process must be used in handling the dispute. Finally, it means that the variety of backgrounds that people bring to the work place must be recognized. In many cases, this may mean giving them the freedom to pursue and satisfy their particular needs.

PAY IN ORGANIZATIONS

Reward systems are an important part of the very fabric of organizations. As such, they must fit with the overall design of an organization and must reinforce and support the kind of behavior and culture that is desired. Thus, changes in the way an organization is managed demand a change in the reward system. Indeed, one of things that has been so fascinating and interesting about the exploration of alternative management styles is the discovery that they typically do include different reward system practices. For example, the Japanese have an emphasis on lifetime employment and large bonuses for everyone in the organization. This is in noticeable contrast to traditional American management practices which have emphasized low job security and, for people at the lower levels of an

organization, hourly pay with no bonuses. Although we can learn from the practices of other countries, it is unlikely that their pay practices can simply be adopted. Rather, what is needed is the development of a new pay that fits the new approaches to management that are being developed. With this in mind, let us turn to a consideration of the major features of pay systems.

Features of Pay Systems

Reward systems in organizations are made up of core values, structures, and processes. Often in organizations the emphasis is on the structures. They are tangible and often easy to manipulate. They include such things as the merit pay delivery system, the job evaluation systems, the pay ranges, and so forth. In short, these structures or mechanics are the nuts and bolts of the reward system.

Associated with the various forms and procedures are a number of process issues that concern communication and decision making. In the area of communication, organizations vary from being highly secret to quite open. As far as decision making is concerned, they can use a participative strategy which allows a number of people to be involved in decision making or they can use a top-down strategy.

Finally, organizations have core values with respect to their pay systems. These may be explicitly stated as they are in some corporations, or they may simply develop over time and be generally shared as part of the culture. Core values usually concern key process issues (e.g. communication) and key structural issues (e.g. pay for performance). They guide what is done in these areas.

In reviewing the characteristics of the new pay, consideration will be given to how it affects the core values, the structures, and finally the

process. As will be seen, the new pay means changes in all three of the ares.

CORE VALUES

The realization that values are something that can be consciously planned has important implications for compensation. Specifically, it means the new pay needs to be driven by a clearly articulated, well accepted set of core values. These core values should not be simply a passing emphasis in the organization, rather they should be fundamental beliefs which will be unchanged for decades. Just as there is no right organization structure in the new management, there is no right set of core values for the new compensation. What is right is placing strong emphasis upon them, matching them to the desired culture of the organization, adhering to them, and being sure that people are aware of them.

There are a set of important core issues that the values ought to address. These include:

- 1) Job security
- 2) How pay levels will compare to those of other organizations.
- 3) The major determinants of an individual's pay, that is, whether it is performance pay, seniority based, etc.
- 4) What the individual's rights are concerning access to information and involvement.
- 5) The relationship of pay levels to the business success.
- 6) The degree to which the system will be egalitarian.
- 7) The degree of support for learning, personal growth, and involvement.

Although there are no right values, it is possible to make some statements about the general orientation which is congruent with some of the major principles associated with the new management. In particular, the core values in the new pay need to emphasize the relationship of pay to success of the business, individual rights, due process, egalitarian approaches, pay rates that are competitive with similar businesses, and greater emphasis on rewarding individual growth and skill development. These core values are supportive of a management style in which the organization depends upon people to both think and do, and which stresses broad scale business involvement on the part of all employees.

PROCESS ISSUES

The new approaches to management suggest some very important changes on the process side of pay administration. In particular, they suggest greater openness of communication about pay practices and broader involvement on the part of all organizational members in the development of pay and reward system practices. Greater openness, of course, is a prerequisite for broader involvement and participation in the development and administration of pay practices. Openness and participation are congruent with the emphasis on egalitarian reward structures, individual rights, and having individuals involved in both the thinking and doing sides of the business. They acknowledge that for a reward system to be effective it has to be both understood and designed in ways that individuals accept it. Participation in the design and administration process helps assure this as well as that the system will fit the situation because it allows the people who will be affected by the system to influence its designs.

With openness and participation, widespread ownership of the reward system develops so that it is not simply the responsibility of the compensation or personnel department. Instead, it becomes the responsibility of everyone in the organization to see that it operates effectively and fairly. This is a particularly important point, since in traditional management structures all too often the reward system becomes the property of the personnel department, and as a result, it ends up being ineffectively and poorly supported by line management. It almost goes without saying that in the absence of broad support in the organization, the reward system cannot support particular business objectives and strategies.

PAY SYSTEM STRUCTURE

The structure of the new pay must flow directly from the core values and the management style. There are some structural mechanisms which are fit particularly well with the way management thinking is changing. Many of them represent important changes in the way pay is currently administered in organizations.

In particular, the following structural approaches to rewards are particularly appropriate for organizations practicing the new management.

1) Decentralized - In a large corporation a centralized compensation approach is incongruent with the idea of business involvement and with targeting structure and reward system practices to the business strategy. By their very nature, most large corporations are engaged in multiple businesses which have quite different needs and which compete with organizations that pay differently. Having a single approach to pay which emphasizes a corporate-wide approach to market position, to merit pay,

performance measurement and so forth, makes it impossible for particular business units to structure their rewards system effectively. Business units end up being forced to adopt a corporate structure which often is not congruent with what is needed to compete in the particular environment that they operate in. Smaller organizations tend not to have this problem because they often face a single external environment. Some large organizations that are in a single business may not need to decentralize since they also face a single external market. In most cases, however, organizations which have multiple businesses need to decentralize compensation practice.

Decentralized pay argues for a dramatically different role for corporate compensation staff. In a centralized system, they are the designers and controllers of the corporate driven system. In effect, they administer, in a centralized manner, a single compensation system which is monolithic within the corporation. Decentralized pay requires locally driven and designed plans, and needs a central compensation function which is capable of taking on a support and consulting role to the different business units. Carrying this out effectively requires a knowledge of the business strategy, the determinants of business effectiveness, and knowledge of alternative pay system approaches. This is a radically different role than most compensation departments currently serve. Overall, though, it offers the chance to be involved in a business in a way that they never have before and to do design work which is both challenging and rewarding.

2) Business Based Rewards for Performance - If people are to be concerned about the success of a business, then their rewards must be driven by the success of the business. This is not to say that individual

pay for performance systems should be eliminated. It is to say that organizations need more systems which reward organization performance. Indeed, organizations need to be riddled with reward systems so that individuals' pay is driven by such things as their own performance, the performance of their business, and total corporate performance. For example, at the plant level, gain sharing plans as well as corporate wide stock purchase and profit sharing plans, should affect an individual's rewards.

The emphasis on individual pay for performance may decrease somewhat, but it will be replaced by multiple business and corporate wide pay for performance systems. Already, some organizations have this emphasis. Among the better publicized ones are: Lincoln Electric, with its individual and company-wide bonus systems, Hewlett-Packard, which has a well developed corporate-wide profit sharing plan, Motorola, with its profit sharing and small group bonus plans, and finally, Dana Corporation, with its multiple Scanlon Plan and other pay for performance systems.

At the management level the new pay needs to place emphasis upon long term performance. Particularly in the case of executive compensation, this suggests the importance of replacing or supplementing many of the current short term profit driven incentive plans with five to ten year incentive plans. It also argues for paying managers based on the performance units they have managed in the past as well as on the performance of their current units. This can help to assure that when managers leave a position, they cannot simply walk away from their past performance.

In summary, the new pay places much greater emphasis on rewarding performance than has existed in the past. It also changes the emphasis to a degree from individual performance-based rewards to business-based

rewards and from short term rewards to longer term rewards for performance. Overall, it calls for organizations riddled with pay for performance systems.

3) Choice Oriented - Traditional compensation provides the individual with a fixed package of benefits, cash, and perquisites. This approach is inconsistent with the substantial individual differences which exist in the workforce and with the idea that individuals can and should be able to make decisions concerning their own lives. Thus, the new pay needs to emphasize individual choice.

Some organizations are already giving individuals greater choice. Initially, this was evident in the popularity of flexible working hours, and more recently, is evident in the growing popularity of flexible benefit systems. In flexible benefits systems individuals are allowed to choose the mixture of benefits they wish. Individual choice, however, does not need to be limited simply to fringe benefits and hours of work.

Ultimately, the new pay could allow individuals to have tremendous flexibility in determining their own reward package. It could extend, for example, to the kind of perquisites and benefits they receive, and to the mixture of cash, stock, and bonuses that they receive. This has the potential of benefiting both the individual and organization because it will help individuals to get the rewards they value and assure the organization that the money they are spending on pay is being spent in ways that produce the maximum impact on individuals.

4) Skill Based - Traditional pay emphasizes paying people for the jobs they do rather than the skills they have. The new pay suggests paying individuals for the skills they have. This has already been done in a number of high participation manufacturing settings. In these settings

individuals are put into self managing work teams and are cross-trained so they can perform all the functions within the team's area of responsibility. In this situation it is particularly useful to have individuals who understand the whole manufacturing operation, and thus, paying individuals more to learn additional jobs fits with the general management style and business strategy.

Paying for skills in manufacturing situations also reinforces psychological participation. It creates a situation where individuals are able to understand the total operating situation and feel responsible for the overall performance of the organization.

Relatively little use has been made of skill based pay in non-manufacturing situations, and even in manufacturing situations it has been limited to the lower level employees. There is reason to believe, however, that skill based pay should be extended. Many of the organizations that are emphasizing the new management recognize that skills are the key to effectiveness. Knowledge based work requires a broad spread of skills throughout the organization. Similar self management and business involvements requires a skilled work force. Skill based pay can motivate skill acquisition and reinforce it so organizations can build the kind of skill base they need to be effective.

The changing demographics of the society also suggest that skill based pay should be increasingly popular. The "baby boom" group of individuals is rapidly approaching the age when they can be expected to end up in middle management. At the same time, the new management calls for flatter organizational structures and leaner staff groups. This means that the number of positions in middle management will be limited, and there will be less upward mobility opportunities for the large group of individuals in

the age group which typically staffs middle management. In traditional management this would simply mean individuals staying in a plateau or dead end position for a long period of time. If skill based pay were put into place, they could be rewarded for making lateral moves, and as a result, continue to learn and develop. They also might become more valuable to the organizations since they would have a better overall understanding of the business, and not be subject to the negative impact of topping out in pay.

In summary, a number of forces suggest the increasing use of skill based pay. It fits the new management, the changing nature of the workforce, and the type of work that's being done in the United States. If widely accepted it will represent a truly revolutionary change in the nature of compensation practice. To mention just a few of the potential changes, it might mean that an individual who is promoted would not receive a pay raise for being promoted. First, he or she would have to demonstrate the skills associated with a new job. Once demonstrated, however, a pay increase would be awarded. It also means that individuals at lower levels of the organizational hierarchy could be paid more than people at higher levels. With an emphasis on skills, it is quite possible that a highly skilled production worker or a highly skilled specialist might make considerably more than a middle level manager. In this sense pay would become unhinged from the hierarchical nature of the organization and be used to reinforce skills rather than hierarchy.

5) Egalitarian - There are several respects in which the pay system can be made more egalitarian in order to match this emphasis in the new management. A number of organizations already call all their employees salaried employees and treat them the same. Treating them the same primarily means eliminating time clocks and putting all individuals on the

same benefit package. It can be, and often is, extended to include many of the perquisites which are allocated according to management level (e.g., parking spaces, office size). An egalitarian approach can be combined with flexible benefits such that, although individuals have differing total compensation levels, they have access to all benefits in the organization if they are willing to pay the price.

Also consistent with the idea of a more egalitarian pay treatment, is to change the level at which such things as stock option plans and profit sharing plans operate in organizations. Traditionally, incentive pay plans have been concentrated only at the top level of management. This is inconsistent with the new management. It suggests pay for organization performance plans be pushed much further down in the organization. The one thing that probably should vary as these plans move further down the organization, is the amount of an individual's compensation which is dependent upon them. At the lower levels, individuals should participate only to a small degree in profit sharing and stock option plans which are based on corporate performance, while at the top level, compensation should be heavily dependent upon these plans. As was mentioned earlier, long-term incentive plans may be the one type of plan which should be targeted at top management.

6) CONGRUENCE AND STRATEGY - Rather than being something that always has existed, pay systems should be designed and structured to fit the particular needs of the business. Thus, such structural features as the market position, the type of incentive pay, and the percentage of compensation based on performance, all need to be designed to fit the type of culture, climate, and behavior that supports the business. If, for example, the business needs to be a technology leader in its field, strong

emphasis is placed on such things as skill based pay, relatively high market position for technical people, and innovation in compensation system practice to reinforce a culture of innovation. If, on the other hand, the major focus and strategy is to be a low cost producer, a quite different set of compensation structures is needed, for example, a lower market position and bonuses driven by productivity measures.

SUMMARIZING THE NEW PAY

The new management practices and strategies which are evolving in the U.S. require new pay practices. Because compensation is the fabric of any organization, it must be congruent with the overall management style and strategy of the business. The current movement in American management practice and strategy suggests some important new directions for pay. It suggests new core values, new administrative processes, and finally, some exciting new pay structures.

As shown in Table 1, pay needs to be characterized by egalitarianism, local control of decision making, individual choice, and most importantly a strong performance based system which ties into business itself. Taken as a package, these new pay practices not only represent a new pay, they are congruent with the new approaches to management that promise to change the way work is done in the United States.

TABLE 1
THE NEW PAY

	<u>FROM</u>	<u>TO</u>
Communication:	Secret	Open
Decision Making:	Top Down	Wide Involvement
Structure:	Centralized	Decentralized
Pay for Performance:	Merit Pay	Business Success Based
Reward Mix:	Standardized	Individual Choice
Base Pay:	Job Based	Skill Based
Degree of Hierarchy:	Steep Level Effect	Egalitarian
Design Strategy:	Tradition Driven	Congruence, Strategy Driven