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**PAY FOR PERFORMANCE:
A MOTIVATIONAL ANALYSIS**

**CEO PUBLICATION
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EDWARD E. LAWLER III
Center for Effective Organizations

November 1993

Paper presented at New York University Conference on Pay for Performance, 1984.

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by

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ABSTRACT

This paper analyzes the motivational effectiveness of piece-rate incentive plans and merit salary increases. It concludes that social and organizational changes have made them ineffective. It argues that a new pay is needed which stresses employee involvement in the organization. Gainsharing, employee ownership and skill-based pay are ways to do this.

PAY FOR PERFORMANCE:
A MOTIVATIONAL ANALYSIS

By Edward E. Lawler III

The idea of pay for performance is so widely accepted that almost every organization says that it has it. A recent survey of 557 large companies found that 80% of them rate pay for performance as a very important compensation objective (Peck, 1984). Even the U.S. Government calls its system a merit pay system and under the Carter administration, legislation (the Civil Service Reform Act) was passed that calls for the system to be more dependent on merit. The major reason for the popularity of merit pay is the belief that it can motivate job performance and increase organizational effectiveness. The psychological research evidence clearly supports this view. There has been, and continues to be, considerable evidence that pay can be a particularly powerful incentive (Lawler, 1981; Locke, et al., 1980). Studies show productivity increases of between 15 and 35 percent when incentive pay systems are put into place and a Public Agenda Foundation survey (1983) reports that 73% of the workers surveyed said that the lack of incentive pay decreases job effort.

The psychological research argues that pay is an effective motivator of performance when it has two fundamental properties. First, it is important to people; second, it is tied to their performance in ways that are visible, creditable, long term, and perceived by them to be direct (see e.g., Lawler, 1971, 1973). For most people, pay is important, so typically there is no problem in using pay as a motivator. The critical issue is whether a perceived relationship exists between pay and performance.

Despite the existence of widespread support for performance-based pay, there is considerable evidence that in most organizations pay systems fail to create a perceived relationship between pay and performance. For example, the 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. As a result of this, it is likely most pay for performance systems fail to produce the positive effects which are expected of them. In addition, there are some reasons to believe that in the future, it is going to be harder to have effective merit pay programs. But before we consider what the future holds, a brief review of the reasons why pay systems often do not produce the perception that pay and performance are related will serve to highlight the problems in using pay as motivator of performance. First, we will review the experience with incentive pay plans and then we will consider plans which rely on merit salary increases.

INCENTIVE PAY

Incentive plans which pay employees bonuses based on the number of units produced are perhaps the most direct way to relate pay to performance. However, 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 employed 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.

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 develop in the organization about how productive people should be and the workers set limits on production. Anyone who goes beyond this limit is 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.

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 form it can lead to incentive people complaining about materials handling people, maintenance people, and others whom 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 do not fit their skills and interests. The reason for this is the higher pay. The higher pay of established incentive jobs may additionally cause individuals to be inflexible when asked to change jobs temporarily and it causes them to resist new technology which calls for a rate change.

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 changes in their rates (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. 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.

Organization Culture. The combined effects of dividing the work force into those who are and are not on incentive pay and the adversarial process of rate-setting can create a hostile organization culture or climate. In particular, they produce a climate of low trust, lack of information-sharing, poor support for joint problem-solving, and inflexibility because individuals want 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 analysis 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, the maintenance costs, the division of the work force, and the poor climate 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 it typically produces.

Merit Salary Systems

Merit salary increases systems are the most common form of pay for performance. There are, however, a number of problems with them. A brief review of the major problems with this approach will illustrate why they often are not effective.

Poor Performance Measures

Fundamental to an effective merit pay system are creditable comprehensive measures of performance. Without these, it is impossible to relate pay to performance in a way that is motivating. There is a great deal of evidence that in most organizations, performance appraisal is not done well and that as a result, no good measures of individual performance exist (see e.g., Meyer, Kay and French, 1965; Devries, Morrison, Shullman and Gerlach, 1981). Sometimes good measures of plant or group performance exist, but similar measures are not available for individuals. In the absence of good objective measures of individual performance, most organizations rely on the judgments of managers. These judgments are often seen by subordinates as invalid, unfair, and discriminatory. Because the performance measures are not trusted when pay is based on them, little is done to create the perception that pay is based on performance (Lawler, 1981). Indeed, in the eyes of many employees, merit pay is a fiction, a myth that managers try to perpetuate.

Poor Communication

The salaries of many individuals in organizations have traditionally been kept secret. In addition, some organizations keep many of their pay practices secret. For example, it is common for organizations to keep secret such things as how much was given out in

salary increases or bonuses and what the highest and lowest raises were. Thus, the typical employee is often in the position of being asked to accept, as an article of faith, that pay and performance are related. Given secrecy, it is simply impossible to determine if they are.

In situations of high trust, employees may accept the organization's statement that merit pay exists. However, trust depends on the open exchange of information; thus, with secrecy, it is not surprising that many individuals are skeptical. In a significant number of organizations, the communication situation is worsened because the organizations either don't spend the time and energy needed to explain their system, or they communicate in ways that lead people to doubt the system. For example, organizations often state that all pay increases are based on merit, even though virtually everyone gets an increase because of inflation and changes in the labor market. It is hardly surprising that individuals often question how much merit had to do with their "merit increase."

Poor Delivery Systems

The actual policies and procedures which make up a merit pay system often lead to actions which do little to relate pay to performance. In addition, the policies and procedures often are so complex that they do more to obfuscate than to clarify the relationship between pay and performance. The typical merit salary increase is particularly poor at actually relating pay and performance, because it allows only small changes in total pay to occur in one year. All too often only a few percentage points separates the raises given the good performers and those given the poor performers. Thus, the differences are often both unimportant and invisible. Salary increase systems further compound the

problem by making past "merit payments" part of the individual's base salary. This means that an individual can be a poor performer for several years, after having been a good performer, and still be highly paid. Bonus plans typically are better at relating pay to performance, but they are sometimes flawed by policies which fund them at such low levels as to be insignificant and by procedures which lead everyone to get the same bonus.

Poor Managerial Behavior

Managers do a number of things that adversely affect the perceived connection between pay and performance. Perhaps the most serious is the failure to recommend widely different pay increases or bonuses for their subordinates when large performance differences exist. Some managers are unwilling to recommend very large and very small pay actions, even when they are warranted. One reason for this seems to be the unpleasant task of explaining why someone got a low raise or bonus.

The difficulty of explaining low raises or bonuses often leads to a second destructive behavior on the part of managers: disowning the pay decision. Despite the fact that they may have recommended a small raise and believe it was appropriately given, supervisors sometimes deny or discount their role in determining their subordinates' pay. They may, for example, say that they fought hard for the subordinate to get a good raise but lost out. This clearly communicates to the subordinate that pay increases are beyond their control, and thus not based on performance.

Conclusion

The existence in most corporations of any one of the common problems which plague the administration of merit pay programs is

usually enough to destroy the belief that pay is related to performance in the eyes of most employees. In reality, the merit pay systems of most organizations typically suffer from all or most of these problems. As a result, at best the policy of merit pay fails to achieve its intended objectives, at worst it becomes an embarrassment which undermines management's credibility.

The New Scene

The United States has changed dramatically since the first installations of incentive and merit 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 the ways that pay for performance can be effectively delivered.

Nature of the Work. In the early 1900s, many of the jobs in the United States were in manufacturing and agriculture and 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 simple repetitive jobs in manufacturing 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 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 traditional incentive pay. 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 initial costs.

Finally, even in those situations where there are simple, repetitive, stable jobs that lend themselves to piece-rate pay, 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 (Hackman and Oldham, 1980). 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, has become less and less amenable to individual pay for performance.

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; 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 its 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).

Nature of the Society. The rate of social 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 and merit salary increase plans subject to grievances and to the kind of challenges which make them difficult and expensive to maintain.

In addition, our 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

There are no indications that changes are occurring which are likely to tip the scales in favor of traditional incentive pay or merit salary increase plans. Indeed, if anything, the trends which have led to the abandonment of incentive pay seem to be continuing so that if anything, the next ten years will probably see a continuing decline in the use of incentive pay plans. In the case of merit increases the approach itself is so flawed that it is hard to imagine a set of conditions which would make it effective. 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 1984 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 the workers it surveyed want pay tied to performance. On the other hand, the analysis so far has suggested that incentive pay plans and merit increase plans are not a good answer. Simply stated, they fail to create the perception that significant amounts of pay are tied to performance and thus, they fail to motivate performance. What then is the answer? To the degree there is an answer, it rests not in a new form of pay for performance, but in a new pay which fits the new approaches to management which are emerging in the United States.

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 the things that is 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 emphasize lifetime employment and large bonuses for everyone in the organization. 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 tried in the United States. These approaches stress such things as greater employee involvement in the business, leaner, flatter organizations, and developing cultures which support business strategies.

Reward systems in organizations are made up of core values, structures, and processes. Often in organizations the emphasis is on the structures, which are tangible and easy to manipulate. They include such things as merit pay systems, job evaluation systems, pay ranges, and so forth. In short, these structures or mechanics are the nuts and bolts of the reward system. Associated with the various structures are a number of process issues that concern communication and decision-making. At the heart of the reward system though, are the core values, thus this discussion of new approaches will begin by considering them.

Core Values

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.

The realization that values are something that can be consciously planned has important implications for compensation. Specifically, it means that 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 remain unchanged for decades. There is no right set of core values. What is right is placing a 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 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 changes in American management. In particular, the core values in the new pay need to emphasize the relationship of pay to the 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 support a management style in which the organization depends upon people both to 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. 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 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 pay must flow directly from the core values and the management style. There are some structural mechanisms which 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 employee involvement oriented management.

1. Pay for Performance. A widely applicable approach to paying for performance is the use of a combination of profit-sharing, gainsharing, and stock ownership. As a combination, they can riddle an organization with pay for performance plans and dramatically increase the business involvement of everyone in the organization. At the same time, they avoid many of the problems associated with individual pay for performance plans. 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 according 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. The 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 or merit pay. Let us briefly review why gainsharing plans seem to fit better in the current situation.

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 decrease significantly 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, 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, Bullock and Lawler, 1984). 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.

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 workers. After all, managers and employees are on the same incentive plan. 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 where a bonus is paid and the organization performs poorly are unlikely to develop. Finally, gainsharing plans often take less administrative support than do 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 such plans should be installed in nonmanufacturing environments, gainsharing is 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 gainsharing. By themselves they are typically 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 gainsharing plans unnecessary because they have the same effect. In most organizations, however, they should be thought of as supplements to gainsharing 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.

At the management level, 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, today more emphasis needs to be placed on rewarding performance. The emphasis needs to change from individual performance-based rewards to business-based rewards and from short-term

rewards to longer-term rewards for performance. Overall, organizations need to be riddled with pay for performance systems.

Decentralized. In a large corporation a centralized compensation approach is incongruent with the ideas of business involvement, and targeting organization 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, to 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.

Choice Oriented. Traditional compensation provides the individual with a fixed package of benefits, cash, and prerequisites. 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.

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 benefit 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, individuals could 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 benefitting both the individual and the 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.

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 (see e.g., Lawler, 1982). 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; thus, paying individuals more to learn additional jobs fits with the general management style and business strategy. Paying for skills in manufacturing situations 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.

The changing demographics of 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 for the larger 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 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 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.

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 so that, although individuals have different total compensation levels, they have access to all benefits in the organization if they are willing to pay the price.

SUMMARIZING PAY CHANGES

The new management practices and strategies which are evolving in the U.S. require new pay practices. 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 the business itself. The strategy of installing multiple pay systems that reward organizational performance represents a potentially effective approach to improving organizational performance by using pay as an incentive. The alternative of essentially abandoning pay as a motivator 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 often lose a sense of the business and a sense of involvement in the ongoing operation of the organization. As a result, they 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, to 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 as well, but in the absence of any relationship between the success of the 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. Riddling the organization with pay for performance plans represents a way to produce this for a significant number of employees.

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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