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Pay systems are part of the very fabric of every work organization. They influence behavior in important and significant ways. Thus, as organizations focus on how they can improve the quality of their products and services, they must also focus on how they pay their employees.

In most of the United States and Europe there are strong traditions concerning how individuals are paid. Traditional pay practices usually include job evaluation systems, individual pay for performance, and the division of total compensation between cash and benefits. Many of the advocates of total quality management have been critical of traditional pay practices, pointing out that they often operate against total quality management systems that are designed to improve performance.

It is hard to argue with many of the criticisms of traditional pay systems. They were designed to support a relatively rigid, bureaucratic model of organization in which individuals were not held accountable for doing a particular job or task. In most cases, the assumption was that most individual employees would not have responsibility for quality and would not be able to play a significant role in improving it. Once different assumptions are made about the role individuals can play in improving organizational effectiveness, different pay systems need to be utilized.

Any discussion of how pay systems can support quality needs to focus on the results that pay systems can produce. My previous work has identified five major features of any organization that pay systems can influence. These are performance motivation, skill acquisition motivation, retention and attraction of employees, organizational structure, and culture. All five of these need to be properly aligned with quality in order for an organization to be effective as a quality oriented

organization.

Performance Motivation

The research on motivation has clearly established that pay can be an important motivator of behavior. For it to be a motivator, individuals have to see a clear connection between their performance and rewards that are important to them. In the case of pay, this means that the pay system must vary pay levels according to performance, and significant amounts of money must be involved. Traditionally, organizations have used merit pay in order to make pay a motivator. Merit pay systems have failed for a number of reasons, including the fact that only small changes in pay are involved and it is often difficult to accurately measure individual performance. Thus, individuals do not see a strong relationship between their performance and their pay.

Advocates of total quality management, such as Deming, have correctly pointed out that all individual pay for performance systems often end up motivating the wrong behaviors. They focus on the individual, rather than on systems, while most quality problems are caused by system problems. They also are said to "label" people and reduce self-esteem.

One solution to the problems associated with individual pay for performance is to simply abandon the whole idea of pay for performance. The problem with this is two fold. Pay is a significant cost for most organizations and, as such, not using it as a motivator involves missing a significant opportunity to get a benefit from what is a significant cost.

The second problem is the value orientation in many countries that says individuals and/or groups should be paid more when they perform better. When they are not paid more they tend to feel inequitably treated.

Advocates of employee involvement have, for a long time, recommended that gainsharing

be used instead of merit pay. There are a variety of gainsharing plans, but all of them tend to pay groups of individuals according to the improvements in performance that they produce. They are usually combined with a participative approach to management so that individuals have a chance to make suggestions, improve work approaches, and understand how their behavior impacts upon group or unit performance.

Gainsharing is potentially an excellent fit with quality oriented management. It recognizes that performance is usually the result of the collective action of individuals and the effect it has on systems. It also recognizes the importance of employee involvement in improving performance.

One area where some gainsharing plans do not fit well with a quality orientation concerns the measurement of quality. Historically, the measurement system in most gainsharing plans focused on cost and productivity numbers and did not give sufficient weight to quality. This problem, however, is usually easily correctable. Many recent gainsharing plans include customer satisfaction indicators, as well as cost of quality indicators. This means that groups of individuals are rewarded for their total performance with an appropriate focus given to quality.

Recent research that I have done on the Fortune 1000 companies in the United States indicates that gainsharing is often used in association with total quality management programs. Apparently, installers of total quality management programs recognize the important support that gainsharing plans can give to total quality management programs.

Profitsharing and employee ownership are two other forms of pay for performance which are congruent with total quality management. They also tend to be practiced more frequently in organizations that adopt total quality. The major weakness with them concerns motivation. It is hard for individuals to see a relationship between their behaviors and the performance of a total

organization. Thus, it is often wise to combine them with gainsharing plans so that individuals are recognized for the performance of their organization, and for the performance of their unit or group in the organization.

Skill Development

Just as pay systems have the ability to motivate performance, they can motivate skill development. Job based pay systems do not focus on encouraging individuals to develop particular kinds of skills. They primarily reward individuals for obtaining higher and higher levels in the organization and, thus, indirectly reward individuals for acquiring managerial skills.

In a quality organization, skill development is clearly a critical issue. Individuals need to develop skills and knowledge in a number of areas if they are to function as major contributors to quality improvement. In particular, they need to develop a greater understanding of work processes and work flows, something that is not rewarded by traditional pay systems. They also may need to develop such self-management skills, as the ability to self-inspect, to problem solve, and to improve work processes. Job-based pay, usually, does not recognize the development of these skills.

Skill based pay is a relatively new approach to determining pay that is much more compatible with quality than is job based pay. It pays individuals more as they acquire skills that are relevant to their work responsibilities. Learning can involve both obtaining greater and greater expertise in a particular function and learning new functions. At this point, about fifty percent of the Fortune 1000 companies in the United States are making limited use of skill based pay systems.

These companies also tend to be the same ones that are making greater use of total quality management programs. This is not accidental; there is a natural fit between pay for skills and the

focus of total quality management on individuals becoming more capable so they can take more responsibility for quality. By itself, skill-based pay is not sufficient to improve quality because all it does is encourage individuals to learn new skills. However, when combined with a management system that capitalizes on the new skills that employees learn and a culture which supports them making additional contributions to the organization, skill-based pay can make a very positive contribution.

Attraction and Retention

Pay is one of the major determinants of whether individuals are attracted to work for a particular organization and whether they remain employed once they join the organization. The major determinant of how effective pay is in attracting and retaining individuals is the amount of pay. Not surprisingly, higher paying organizations attract more individuals and have less turnover.

The implication of this for quality oriented organizations is obvious. If they want to attract competent individuals and retain them, they need to pay at least as highly as other organizations and perhaps slightly higher. This is where skill based pay can help. The research on skill based pay shows that it leads to slightly higher pay levels, but it does not necessarily lead to higher costs.

Because pay is only raised when individuals are more skilled, the extra costs are offset by having a more talented and competent work force. Gainsharing can also help with attraction and retention. It increases an individual's pay when the organization performs well. Thus, the potential exists for individuals to make more if performance is high.

In addition to pay level, how pay is administered can influence who is attracted to and retained by an organization. Some individuals like security in their pay and are not as oriented to learn and develop. Thus, they choose organizations with more stable and bureaucratic pay

practices. Other individuals like risk and the chance to control their pay through adding skills. Hence, they like organizations with skill based pay and performance based bonuses.

Since total quality management programs are based on individuals getting involved in the business and adding to their skills, a combination of performance-based pay and skill-based pay may help attract and retain the right kinds of individuals. Individuals who do not want to add to their skills and earn more pay probably should not be in a quality oriented organization. Thus, there is a good fit between skill-based pay and the kinds of individuals that need to be attracted and retained in order to have an effective, quality oriented organization.

Organization Structure

When pay systems are thought of, organizational structure is typically ignored. This is a mistake, however. Pay systems tend to reinforce a number of features of an organization's structure. Recent attention has focused on the organizational hierarchy and how it is reinforced by pay systems that pay senior managers much more than other employees. This feature can work against quality if it leads to ideas and changes being ignored because they do not come from the correct place in the hierarchy.

Job-based pay systems also tend to divide organizations into units, sub-units and, ultimately, to isolate individuals. Because traditional job based pay holds individuals accountable only for how well they perform their own duties, pay systems often work against integration and cooperation. Quality programs, on the other hand, depend upon cooperative work among departments and functions. Individuals need to focus on how well the process they are part of functions and how well customers they serve are treated by the overall organization.

Several of the pay approaches, which have already been discussed, can help improve the

alignment between organizational structure and a quality orientation. Gainsharing, profitsharing, and other employee ownership programs can help do this because they focus on total organizational performance. Skill based pay is another approach that can motivate individuals to relate to processes, products, and customers in a whole and meaningful way. This, of course, is just what needs to happen if organizations are to be more horizontal and less specialized.

Organizational Culture

The culture of an organization is based upon the sum of its characteristics and, in particular, its human resource management policies and practices. Pay systems are a critical element of an organization's systems and have a strong impact on culture. Over the years, research has shown that the focus on pay for individual jobs and individual pay for performance creates a particular kind of organizational culture. In it, individuals see themselves needing to optimize their particular job performance and, in many cases, to increase the size and scope of their jobs so that they will be paid more. It also tends to create a culture in which promotion is the most valued reward.

In order for organizations to be effective in the area of quality, a very different culture is needed. Individuals need to be responsible for serving customers and for the effectiveness of a particular process. They also need to be willing to continuously learn, develop and improve processes, products, and customer service levels.

The pay system practices already mentioned as valid, desirable alternatives to traditional job based pay can help to create the right kind of culture for a quality organization. Gainsharing, for example, reinforces the importance of collective action and shared responsibility for results. It also can reward quality in a way that makes it an important part of the culture. Similarly, skill

based pay reinforces the culture of continuous growth and continuous improvement in capability.

Ultimately, in order to get a more egalitarian organization and a greater sense of shared responsibility for results, organizations may need to flatten their hierarchy with respect to pay. This means having smaller differences between the highest and lowest paid individuals in the organization and having common pay practices.

The New Pay

Pay systems are slow to change, but there is increasing evidence that they are changing. A major impetus for change is the desire of organizations to improve their performance. It is increasingly clear that unless organizations change their pay systems they will never realize the potential rewards of becoming a quality organization. Becoming a quality organization calls for new management practices in virtually every area. Pay systems are not exempt from this. Organizations need to reinvent pay so that, in many respects, they create a new pay that is a dramatic departure from the old bureaucratic job-based pay systems that were invented for use in entirely different types of organizations.

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