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WHY THEY USE IT**

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Skill-based pay has received increasing attention in the management literature during the past decade. Although the concept is not new, its use appears to be increasing. We examined data from a broader longitudinal study of employee involvement practices (Lawler, Mohrman, and Ledford, 1992) to investigate changes in the level of use of skill-based pay, the types of organizations that use it, its impact, and whether future increases in use are likely.

For purposes of this study, we defined skill-based pay as an alternative to job-based pay that sets pay levels on the basis of how many skill employees have or how many jobs they can do. Data were gathered from the *Fortune* 1000 companies. These companies include the 500 largest manufacturing firms in the U.S. and an industry-stratified set of the 500 largest service companies in the U.S. A survey was mailed to the chief executive officers of these companies in 1987 and again in 1990, and typically was completed by a high-level human resource executive. The first survey was designed primarily by Lawler, Ledford, and Mohrman of the Center for Effective Organizations, and the survey was conducted by the U.S. General Accounting Office. Usable responses were returned by 476 firms. A subsample of 323 firms agreed to allow the release of their data to the research team, permitting detailed statistical analyses. The second study was conducted solely by the Center for Effective Organizations study team. Usable responses were returned by 313 firms. The full results of the two surveys have been published elsewhere (Lawler, Ledford, & Mohrman, 1989; Lawler, Mohrman, & Ledford, 1992). Here, we summarize the key findings concerning skill-based pay.

Trends in Skill-Based Pay Use

The 1987 survey found that 40 percent of the companies used skill-based pay with at least some employees. On the basis of the extensive publicity given to skill-based pay since 1987, we predicted that the level of use would be higher in 1990. This prediction was

confirmed. The 1990 survey found that 51 percent used skill-based pay with at least some employees, an increase of over 25 percent in the number of companies using skill-based pay in just three years. The percentage of employees covered by the typical company using skill-based pay remained the same in 1987 and 1990. The typical user covered less than 20 percent of their employees with skill-based pay (see Table 1). Overall, skill-based pay appears to be increasingly popular in the sense that more companies are adopting it, but it tends to be adopted only for a minority of employees in the organization.

Success of Skill-Based Pay

We must explore the reasons that firms are adopting skill-based pay if we wish to understand its increased use. The first explanation to explore is rational self-interest. That is, a company adopts skill-based pay to gain performance improvements. We asked the respondents to provide an overall rating of the success of their skill-based pay plans. Sixty percent of the respondents rate their skill-based pay plans as successful or very successful in increasing organizational performance. Only six percent rate them as unsuccessful or very unsuccessful, while 35 percent are undecided. Clearly, the overwhelming feeling of the respondents is that skill-based pay systems are effective in achieving performance improvements.

The apparent effectiveness of skill-based pay certainly helps account for its increased popularity. But why do some firms adopt skill-based pay while others do not? To answer this question, we must look more closely at management practices and organizational characteristics that may differentiate skill-based pay users and non-users.

Skill-Based Pay and Employee Involvement

The skill-based pay concept has received considerable attention in the literature on employee involvement in general and work redesign in particular (Lawler, 1990, 1992). Skill-based pay fits well with employee involvement practices, for two reasons. First, skill-based pay reinforces employee involvement practices. It increases employee flexibility, which broadens their perspective on the overall production or service delivery system. This

may lead to more insightful employee suggestions for performance improvement. Rewards for learning multiple jobs may also facilitate job rotation and cross-training, which are essential to self-managing team designs. Second, a high level of employee involvement may be necessary to fully realize the benefits of skill-based pay. Increased flexibility and greater employee perspective may be wasted if employees are not given the power to use what they learn through participation groups and job designs that create greater self-management. For these reasons, we predict that skill-based pay will be especially prevalent in organizations that are using employee involvement practices such as participation groups, job enrichment, and self-managing teams. The survey results confirm this prediction. This result is consistent with the results of a recent study of skill-based pay of 96 skill-based pay plans, in which the respondents were at the plant level or the equivalent (Jenkins, Ledford, Gupta, & Doty, 1992).

In light of our argument that skill-based pay is an important component of employee involvement systems, we examined whether the use of skill-based pay is associated with the success of employee involvement efforts. The respondents were asked to indicate whether their employee involvement effort improved organizational functioning and organizational performance in a number of areas. Measures of organizational functioning included improved managerial decision-making, movement of decision-making authority lower in the organization, and increased information flow throughout the organization. Measures of organizational performance included productivity, quality, employee satisfaction, and profitability. We found that the adoption of skill-based pay was strongly associated with employee involvement programs that resulted in improvements in organizational functioning. It was also associated with the degree to which employee involvement efforts produced improvements in the quality of products or services and in competitiveness, but not productivity and profitability improvements.

Skill-Based Pay and Total Quality Management

There is a reason to expect a strong association between the use of total quality management programs and the use of skill-based pay. TQM practices include organizing employees into work cells or manufacturing cells, just-in-time inventory systems, self-inspection, direct exposure to customers, and so on. These practices often rely on and encourage greater employee flexibility and cross-training. The study results confirm that organizations that use total quality management programs are significantly more likely to use skill-based pay. Indeed, this was the strongest relationship found between the use of skill-based pay and other management practices.

Competitive Conditions Facing Skill-Based Pay Users

All public corporations may be interested in gaining performance advantages through innovations such as skill-based pay, but the need for performance improvements will be felt more acutely in some firms than in others. Skill-based pay, as well as employee involvement and total quality management practices, represent a substantial change in the basic assumptions and behavior of management. Thus, performance pressures must be especially strong to overcome the inertia of conventional practice. This suggests that skill-based pay practices are especially likely to be adopted by companies that feel strong competitive pressures. Such pressures not only increase the firm's interest in increasing performance, but also increase its willingness to rethink basic management practices. Foreign competition is a competitive threat that is particularly likely to sharpen management interest in workplace innovations that lead to performance improvements. Consistent with this logic is our finding that firms facing heavy foreign competition are more likely to use skill-based pay. Because manufacturing firms are more likely to face tough foreign competition than service firms, we predicted that manufacturing firms would be significantly more likely to adopt skill-based pay than service firms. The results confirm this prediction.

Skill-Based Pay and Changes in Organizational Structure

Skill-based pay allows individuals a chance to develop their skills and increase their pay, even when promotions are not available. Therefore, we expected that skill-based pay

would be attractive to organizations that are downsizing and delayering, both of which decrease opportunities for promotion. The results confirm that firms that have removed management layers during recent years are especially likely to adopt skill-based pay practices.

Skill-Based Pay and Use of Other Reward Innovations

Finally, we found that the use of skill-based pay is associated with the use of a variety of other reward system practices (see Table 2). The strongest relationship is with the use of gainsharing. Fifty-nine percent of the companies with skill-based pay use gainsharing, while only 19 percent of those who do not use skill-based pay use gainsharing. Skill-based pay users also are more likely to use profit sharing, all-salaried pay systems, and team incentives. There is a strong tendency for users of skill-based pay to use all other pay innovations to a greater degree than non-users of skill-based pay. Skill-based pay users differ from non-users most in the adoption of pay innovations that, like skill-based pay, are associated with the use of skill-based pay. This suggests global innovativeness as a partial explanation for the adoption of skill-based pay.

Future Use of Skill-Based Pay

We asked respondents to indicate whether they expected their corporation to increase or decrease its use of skill-based pay in the future. Overall, the respondents indicate that their organizations are much more likely to increase than to decrease their use of skill-based pay. Some 53 percent say that their organization plans to increase its use; 45 predict that use will stay about the same; and only two percent indicate that their organization plans to decrease use of skill-based pay.

There is a significant difference between skill-based pay users and non-users in their future plans with respect to skill-based pay. Among current users, 67 percent plan to increase their use while 33 percent plan to stay the same. The percentages are reversed for non-users. Some 34 percent of non-users plan to increase their use, while 66 percent plan to stay the same. Overall, it is clear that the users of skill-based pay typically plan to increase their use of it. However, a significant number of non-users do plan to increase their usage.

The data make clear that current success of skill-based pay is related to plans to use it in the future. Among the successful users, 70 percent plan to increase its future use while 30 percent plan to keep their current use at the same rate. Among the small number of companies who regarded their current skill-based pay plans as unsuccessful, 59 percent still plan to increase future use, whereas 40 percent prefer maintaining their current rate of use. It is interesting and somewhat surprising that a majority of the reportedly unsuccessful users plan to increase the use of skill-based pay in the next two years.

The characteristics that are associated with the current use of skill-based pay are strongly associated with its planned future use. Companies that are subject to foreign competition, shorter product life cycles and speed to market concerns, and manufacturers are particularly likely to plan increased use of skill-based pay in the future. Similarly, companies that are heavily committed to total quality management programs are especially likely to plan on increasing use of skill-based pay in the future. Finally, companies that are planning to increase their use of such employee involvement-oriented practices as gainsharing, quality circles, and self-managing teams are planning to increase their use of skill-based pay as well.

Conclusion

Overall, the data paint a rather clear and positive picture of skill-based pay. It is being used just where its advocates argue that it should be used, in association with employee involvement-oriented management practices. Although skill-based pay is not a new idea, its growth seems to be on an accelerated path. It is still too early to say whether it is going to be the dominant pay approach where organizations have moved to total quality management and employee involvement-oriented management systems but this clearly is a possibility.

Finally, the reported success rate of skill-based pay is impressive. The fact that only six percent of adopters report skill-based pay to be unsuccessful in improving organizational performance suggests that despite the complexity and newness of the approach, it generally has a positive or at worst a neutral impact on organizational effectiveness. As more

technology and experience develops to support the use of skill-based pay, it is quite possible that this success rate will increase.

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Table 1

Percentage of Employees on Skill-Based Pay

	None 0%	Almost None 1-20%	Some 21-40%	About Half 41-60%	Most 61-80%	Almost All 81-99%	All 100%
1990	49	34	11	2	1	1	1
1987	60	25	7	2	2	2	2

Notes:

1987 N=476 *Fortune 1000* firms

1990 N=313 *Fortune 1000* firms

Table 2

Pay Practices Related to Use of Skill-Based Pay

Pay Practice	Percentage of Companies Without Skill-Based Pay Using Practice	Percentage of Companies With Skill-Based Pay
Gainsharing	19	59
Team Incentives	49	68
Flexible Benefits	51	58
All-Salaried Work Force	53	75
Profit Sharing	54	71
Stock Ownership	59	69
Individual Incentives	86	92
Nonmonetary Incentives	88	94

N=313 *Fortune 1000* Firms