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EFFECTIVE REWARD SYSTEMS: STRATEGY, DIAGNOSIS, DESIGN, AND CHANGE

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Reward Systems are a critical part of any organization's design. How well they fit with the rest of the systems in an organization has an important impact on how effective the organization is and on the quality of life that people experience in the organization. Over the past decade, some new reward systems practices have become popular in order to align reward systems with the important changes that are occurring in the way organizations are designed and managed (Lawler, 1990; Schuster and Zingheim, 1992). This chapter begins by considering the role of reward systems in an organization and how reward systems in organizations can be designed. It then it focuses on the fit between reward systems and the high-involvement approaches to organization design which are becoming increasingly popular. Finally, it considers the role of pay system change in large scale organization change efforts.

The over-riding principle that will guide the discussion in this chapter is that in order to be effective organizations must have congruence among their various operating systems. Particular operating system practices are neither good nor bad in the abstract. They must be evaluated in the context of the other systems in an organization and the business strategy of the organization. The business strategy indicates what the organization is supposed to accomplish and how it is supposed to behave. It specifies the kinds of performance and performance levels the organization needs to demonstrate in order to be effective. Thus, it is a critical guide for the design of the overall organization structure as well as information systems, human resource management systems, and of course, reward systems, to mention some of the most critical systems in an organization.

Figure 1 depicts one way of thinking about reward systems in an organization. It shows that their design needs to be driven by the basic organization design and the management style of the organization which in turn, needs to be strongly influenced by the organization's strategy. Finally the figure shows that the reward system in combination with the organization's design drives the performance of the organization, since it influences critical individual and organizational behaviors.

Figure 2 makes essentially the same point as figure 1, except with a slightly different flow. It depicts the design process an organization should use in creating a reward system, and in testing its effectiveness. It shows that business strategy should be the foundation for identifying the critical behaviors that the organization needs to demonstrate. This in turn is shown as driving the design of the reward system. The challenge here is to correctly identify those features of a reward system which will produce the behavior that is needed to make the strategy come alive in terms of individual and organizational behavior.

Three critical elements of the reward systems are identified in this figure. The first is the core principles which the organization holds. These core principles may be stated or simply implicit in the way the organization operates. But, they are part of any organization and its reward system. Examples of core principles are a belief in pay for performance, a belief in secrecy about pay, and other fundamental relatively long-term commitments that organization make in the area of reward systems.

The reward system also is shown to be made up of process features and structural feature. Process design features include such things as communication policies , and decision making practices. These are critical, because they reflect not only the overall management style of the organization, but influence how well reward system practices will be accepted, understood, and how much commitment there will be to them.

Finally, reward systems include actual reward system practices and structures. These are the features of reward systems that get the most attention. They include pay delivery systems such as gain sharing plans, profit-sharing plans as well as administrative polices and a host of other specific organizational programs.

Reward systems are assumed to be effective to the degree that the core principles, processes and practices are in alignment. This is depicted in the figure by the arrows among the three elements. The fit here is critical because organizations need to be consistent in what they say and what they do. Violations of this consistency inevitability leads to misunderstanding about how the reward system works, and failure to motivate the proper or needed behavior.

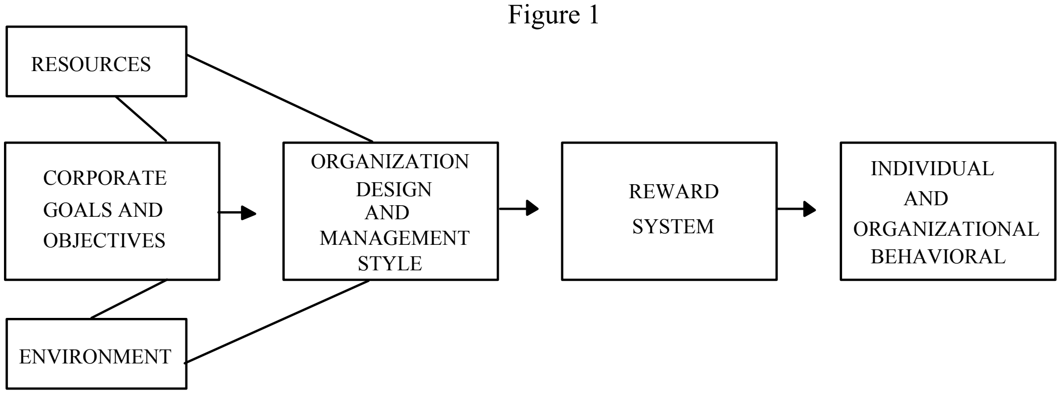
Later in the chapter we will return to the issue of the critical design decisions that need to be made concerning the core values, processes and structures. Before these are discussed consideration needs to be given to how reward systems in general, and pay systems in particular, can actually effect individual and organizational behavior. This will serve to create a foundation for the discussion of how to diagnose the current impact of a reward system, and how to design one to produce particular individual and organizational behaviors.

Objectives of the Reward System

The research on reward systems suggest that potentially they can influence six factors which in turn impact organization effectiveness.

1. *Attraction and Retention* - Research on job choice, career choice and turnover clearly shows that the kind and level of rewards an organization offers influences who is attracted to work for an organization and who will continue to work for it (see e.g. Lawler, 1973; Mobley, 1982). Overall, those organizations which give the most rewards tend to attract and retain the most people (Gerhart and Milkovich, 1992). This seems to occur because high reward levels lead to high satisfaction, which in turn leads to lower turnover. Apparently this is true because

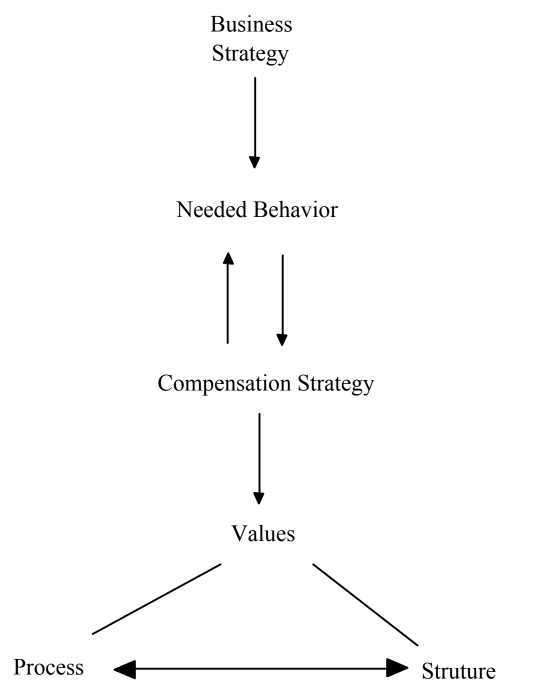
Figure 1



individuals who are presently satisfied with their jobs expect to continue to be satisfied and, as a result, want to stay with the same organization.

The objective should be to design a reward system that is very effective at retaining the most valuable employees. To do this, a reward system must distribute rewards in a way that will lead the more valuable employees to feel satisfied when they compare their rewards with those received by individuals performing similar jobs in other organizations. The emphasis here is on external comparisons because turnover means leaving an organization for a better situation elsewhere. One way to accomplish this is to reward everyone at a level that is above the reward levels in other organizations. However, this strategy has two drawbacks. In the case of some rewards, such as money, it is very costly. Also, it can cause feelings of intraorganizational inequity because the better performers are likely to feel inequitably treated when they are rewarded at the same level as poor performers in the same organization, even though they are fairly treated in terms of external comparisons (Lawler and Jenkins, 1992). Faced with this situation, the better performers may not quit, but they are likely to be dissatisfied, complain, look for internal transfers, and mistrust the organization.

Figure 2



What then is the best solution? The answer for most organizations lies in having competitive reward levels and basing rewards on performance. This should encourage the better performers to be satisfied and to stay with the organization. It also should serve to attract achievement-oriented individuals since they like environments in which their performance is rewarded. However, it is important to note that not only must the better performers receive more rewards, they must receive significantly more rewards because they feel they deserve more (Adams, 1965). Just rewarding them slightly more may do little more than make the better and poorer performers equally dissatisfied.

Research has shown that absenteeism and satisfaction are related, although the relationship is not as strong as the one between satisfaction and turnover (Mobley, 1982). When the workplace is pleasant and satisfying, individuals come to work regularly; when it isn't, they don't.

One way to reduce absenteeism is to administer pay in ways that maximize satisfaction. Several studies have also shown that absenteeism can be reduced by tying pay bonuses and other rewards to attendance (Lawler, 1981; Lawler, 1990). This approach is costly, but sometimes less costly than absenteeism. It is a particularly useful strategy in situations where both the work content and the working conditions are poor and do not lend themselves to meaningful improvements. In situations where work content or conditions can be improved, such improvements are often the most effective and cost effective way to deal with absenteeism. Reward system policies are only one of several ways to influence absenteeism, but they are potentially effective if an organization is willing to tie important rewards with coming to work. In many ways this is easier to do than tying rewards to performance, because attendance is more measurable.

2. *Motivation of Performance* - When certain specifiable conditions exist, reward systems have been demonstrated to motivate performance (Gerhart and Milkovich, 1992; Lawler, 1990; Lawler 1971; Vroom 1964). What are those condition? Important rewards must be perceived to be tied in a timely fashion to effective performance. Organizations get the kind of behavior that leads to the rewards their employees value. This occurs because people have their own needs and mental maps of what the world is like. They use these maps to choose those behaviors that lead to outcomes that satisfy their needs. Therefore they are inherently neither motivated nor unmotivated to perform effectively; performance motivation depends on the situation, how it is perceived, and the needs of people.

The approach that can best help us understand how people develop and act on their mental maps is called expectancy theory (Vroom, 1964; Lawler, 1973). Three concepts serve as the key building blocks of the theory.

A. *Performance-Outcome Expectancy.* Every behavior has associated with it, in an individual's mind, certain outcomes (rewards or punishments). In other words, individuals believe or expect that if they behave in a certain way, they will get certain things. Examples of expectancies can easily be described. Individuals may have an expectancy that if they product ten units, they will receive their normal hourly rate, while if they produce fifteen units, they will receive their hourly pay rate please a bonus. Each performance level can be seen as leading to a number of different kinds of outcomes, and outcomes can differ in their types.

B. *Attractiveness.* Each outcome has an attractiveness to a specific individual. Outcomes have different attractiveness for different individuals. This is true because outcome values result from individuals needs and perceptions, which differ because they reflect other factors in an individual's life. For example, some individuals may value an opportunity for promotion or advancement because of their needs for achievement or power, while others may not want to be promoted and leave their current work group because of needs for affiliation with others. Similarly, recognition, such as a picture in the company newspaper, may have great value to some, but little for others.

C. *Effort-Performance Expectancy.* Each behavior also has associated with it, a certain expectancy or probability of success. This expectancy represents the individual's perception of how hard it will be to achieve such behavior and the probability of his or her successful achievement of the behavior. For example, employees may have a strong expectancy (e.g., ninety-ten) that if they put forth the effort, they can produce ten units an hour, but that they only have a fifty-fifty chance of producing fifteen units an hour if they try.

Putting these concepts together, it if possible to make a basic statement about motivation. In general, an individual's motivation to behave in a certain way is greatest when:

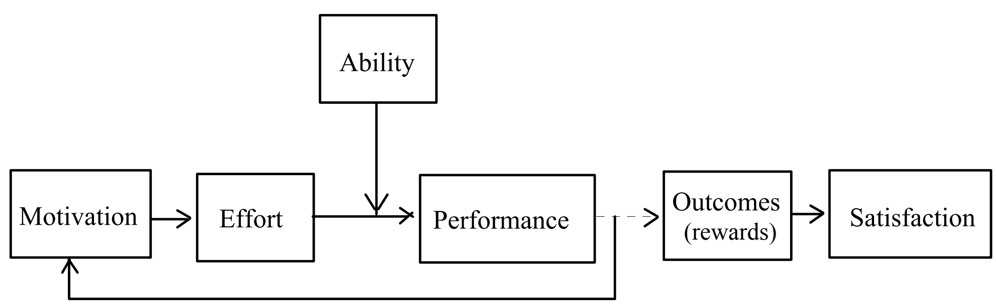
1. The individual believes that the behavior will lead to certain outcomes (performance-outcome expectancy).

2. The individual feels that these outcomes are attractive.

3. The individual believes that performance at a desired level is possible (effort-performance expectancy).

Given a number of alternative levels of behavior (ten, fifteen, or twenty units of production per hour, for example), an individual will choose the level of performance which has the greatest motivational force associated with it, as indicated by a combination of the relevant expectancies, outcomes, and values.

Figure 3
The Expectancy Theory Model



A person's motivation is a function of:

a. Effort-to-performance expectancies
b. Performance-to-outcome expectancies
c. Perveived attractiveness of outcomes

On the basis of these concepts, it is possible to construct a general model of behavior in organizational settings (see Figure 3). Working from left to right in the model, motivation is seen as the force on an individual to expend effort. Motivation leads to an observed level of effort by the individual. Effort alone, however, is not enough. Performance results from a combination of the effort that an individual puts for and the level of ability. Ability, in turn, reflects, the individual's skills, training, information, and talents. As a result of performance, the individual attains certain outcomes. The model indicates this relationship in a dotted line, reflecting the fact that sometimes people perform but do not get outcomes. As this process of performance-reward occurs, the actual events serve to provide information that influences an individual's perceptions (particularly shown in the model by the line connecting the performance outcome line with their line of sight to rewards and thus influences motivation in the future. This is shown in the model by the line connecting the performance outcome line with motivation. In many ways, the expectancy model is a deceptively simple of statement of the conditions that must exist if rewards are to motivate performance. It is deceptive in the sense that it suggests all an organization has to do is actually relate pay and other frequently valued rewards to obtainable levels of performance. Not only is this not only thing an organization has to do, it is very difficult task to accomplish.

In order for employees to believe that performance-based pay relationship exists, the connection between performance rewards must be visible, and a climate of trust and credibility must exist in the organization. The reason why visibility is necessary should be obvious; the importance of trust may be less so. The belief that performance will lead to rewards is essentially a prediction about the future. For individuals to make this kind of prediction they have to trust the system that is promising them the rewards. As will be discussed later, research suggests that a high level of openness and the use of participation can contribute to trust in the pay system.

3. *Skills and Knowledge* - Just as pay systems can motivate performance they can motivate learning and development. The same motivational principles apply. Individuals are motivated to learn those changes which are rewarded. As will be discussed later, a relatively new approach to pay, skill based pay, has been developed to capitalize on just this point. It allows organizations to strategically target the learning its wants employees to engage in. This is in contrast to many job based systems which indirectly do this by tying increased pay and perquisites to obtaining higher level jobs.

4. *Culture* - Reward systems are one feature of organizations that contribute to their overall culture. Depending upon how reward systems are developed, administered, and managed, they

can cause the culture of an organization to vary quite widely. For example, they can influence the degree to which it is seen as a human resources oriented culture, an entrepreneurial culture, an innovative culture, a competence based culture, a fair culture, and a participative culture.

Reward systems have the ability to shape culture precisely because of their important influence on communication, motivation, satisfaction, and membership. The behaviors they cause to occur become the dominant patterns of behavior in the organization and lead to perceptions and beliefs about what an organization stands for, believes in, and values.

Perhaps the most obvious tie in between pay system practice and culture concerns the practice of performance-based pay. The absence/presence of this policy can have a dramatic impact on the culture of an organization because it so clearly communicates to organization members what the norms are in the organization about performance. Many other features of the reward systems also influence culture. For example, having relatively high pay levels can produce a culture in which people feel they are an elite group working for a top-flight company. Finally, having employees participate in pay decisions can produce a participative culture in which employees are generally involved in business decisions and as a result are committed to the organization and its success.

5. *Reinforce and Define Structure* - The reward system of an organization can reinforce and define the organization's structure (Lawler, 1990). Often this impact of a reward system is not fully considered in the design of reward systems. As a result, their impact on the structure of an organization is unintentional. This does not mean, however, that the impact of the reward system on structure is usually minimal. It can have a strong impact of how integrated the organization is and how differentiated it is (Lawrence and Lorsch, 1967). When people are rewarded the same way it tends to unite them, when they are treated differently it can divide them. In addition, it can help define the status hierarchy, and it can strongly influence the kind of decision structure which exists. As will be discussed later, the key features here seem to be the degree to which the reward system is hierarchical and the degree to which is allocates rewards on the basis of movements up the hierarchy.

6. *Cost* - Reward systems are often a significant cost factor. Indeed, pay alone may represent over 50% of an organizations operating costs. Thus, it is important in strategically designing the reward system to focus on how high these costs should be and how they will vary as a function of the organization's ability to pay. For example, a reasonable outcome of well-designed pay system might be an increase costs when the organization has the money to spend and a decrease costs when the organization does not have the money. An additional objective might be to have lower overall reward system costs than business competitors.

Design Options

There are many ways to design and manage reward systems. This is because there are a host of rewards that can be given, and of course, a large number of ways that they can be distributed. A useful dichotomy in thinking about options in the design of reward systems is the process/content one. As was mentioned earlier, the structural or content dimension of a reward system refers to the formal mechanisms, procedures, practices (e.g. the salary structure, the performance appraisal forms), in short, the nuts and bolts of the system. The process side refers to the communication and decision process parts of the system.

Structural Decisions

Basis for Rewards

Traditionally, important rewards are based on the type of jobs that people do. Indeed, with the exception of bonuses and merit salary increases, the standard policy in most organizations is to evaluate the job, not the person, and then to set the reward level. This approach is based on the assumption that job worth can be determined, and that the person doing the job is worth only as much to the organization as the job itself is worth. This assumption is in may respects valid since through such techniques as job evaluation programs it is possible to determine what other organizations are paying people to do the same or similar jobs. Among the advantages of this system is that it assures an organization that its compensation costs are not dramatically out of line with those of its competitors and it gives a somewhat objective basis to compensation practices.

An alternative to job based pay which has recently been tried by a number of organizations is to pay individuals for the skills that they possess (Lawler and Jenkins, 1992). In many cases this will not produce dramatically different pay rates than are produced by paying for the nature of the job (Jenkins, Ledford, Gupta and Doty, 1992). The skills people have usually match reasonably well the jobs they are doing. It can, however, produce some different results in cases these individuals are paid more than they would be paid under a job based system. In other cases individuals don't have the skills when they first enter a job and do not deserve the kind of pay that goes with the job. In these cases, individuals have to earn the right to be paid whatever it is the job related skills are worth.

Perhaps the most important changes that are introduced when skill or competence based pay is used occur in the kind of culture and motivation it produces in an organization. Instead of people being rewarded for moving up the hierarchy, people are rewarded for increasing their skills and developing themselves. This can create, a culture of concern for personal growth and development, and a highly talented work force. In the case of factories where this systems has been used, it typically means that many people in the organization can perform multiple tasks and thus, the work force is highly knowledgeable and flexible (Walton, 1980).

In most cases where skill based pay has been tried it tends to produce somewhat higher pay levels for individuals, but this is usually offset by greater work force flexibilityand high performance (Jenkins et al., 1992). Flexibility often leads to lower staffing levels, fewer problems when absenteeism or turnover occur, and indeed, it often leads to lower absenteeism and turnover itself because people like the opportunity to utilize and be paid for a wide range of skills. On the other hand, skill based pay can be challenging to administer because it is not clear how one goes to the outside marketplace and decides, for example, how much a skill is worth. Skill assessment can also often be difficult to accomplish. There are a number of well developed systems for evaluating jobs and comparing them to the marketplace, but there are none which really do this with respect to the skills an individual has.

In general, skill based pay seems to fit those organizations that want to have a flexible, relatively permanent work force that is oriented toward learning, growth, and development. It has been frequently used in new plant start-ups and in plants that are moving toward more participative management approaches (Lawler, Mohrman and Ledford, 1992). It is beginning to be used more with knowledge workers and with managers.

Performance Based

Perhaps the key strategic decision that needs to be made in the design of any reward system is whether or not it will be based on performance. Once this decision is made, a number of the features of the reward system tend to fall into place. The major alternative to basing pay on performance is to base it on seniority. Many government agencies, for example, base their pay rates and some benefits on the job the person does and on how long they have been in that job. In Japan, individual pay is also often based on seniority, although individuals often received bonuses based on corporate performance.

Most business organizations in the United States say that they reward individual performance, and they call their pay system and their promotion system merit systems (Milkovich and Wigdor, 1991). Having a true merit pay or promotion system is often easier said than done, however. Indeed, it has been observed that many organizations would be better off if they didn't try to relate pay and promotion to performance, and relied on other bases for motivating performance (Kerr, 1975). The logic for this statement stems from the difficulty of specifying what kind of performance is desired, and then determining whether, and in fact, it has been demonstrated (Heneman, 1992). There is ample evidence that a poorly designed and administered merit system can do more harm than good (see e.g. Whyte, 1955; Lawler, 1971; Schuster and Zingheim, 1992). On the other hand, there is evidence that when pay is effectively related to the desired performance, it can help to motivate, attract and retain outstanding performers (Lawler and Jenkins, 1992).

There are numerous ways to relate pay to performance, and one of the most important strategic decision that organizations make is how they do this (Blinder, 1990). The options open to organizations are enormous. The kind of pay reward that is given can vary widely and include such things as stock and cash. In addition, the frequency with which rewards are given can vary tremendously from time periods of a few minutes to many years. Performance can be measured at the individual level so that each individual gets a reward based on his or her performance. Rewards also can be given based on the performance of groups, and the total organization. Finally, there are many different kinds of performance which can be rewarded. For example, managers can be rewarded for sales increases, productivity volumes, their ability to develop their subordinates, their cost reduction ideas, and so on.

Rewarding some behaviors and not others has clear implications for performance, and thus, decisions about what is to be rewarded need to be made carefully and with attention to the overall strategic plan of the business (see e.g., Galbraith and Nathanson, 1978; Salscheider, 1981). Consideration needs to be given to such issues as short vs. long term performance, risk taking vs. risk aversion, division performance vs. total corporate performance, ROI maximization vs. sales growth, and so on. Once the strategic plan has been developed to the point where key performance objectives have been defined, then the reward system needs to be designed to motivate the appropriate performance. Decisions about such issues as whether to use stock options (a long term incentive), for example, should be made only after careful consideration of whether they are supportive of the kind of behavior that is desired.

It is beyond the scope of this chapter to go into any great detail about the pros and cons of the many approaches to relating pay to performance. A few general points do need to be made however. Bonus plans are generally better motivatiors than pay raise and salary increase plans. This is due to the fact that with bonus plans it is possible to substantially vary an individual's pay from time period to time period. With salary increase plans, this is very difficult since past raises become an annuity (Heneman, 1992). Approaches that use objective measures of performance are better motivators than those that use subjective measures. In general, objective measures enjoy higher credibility; that is, employees will often accept the validity of an objective measure, such as sales volume or units produced, when they will not accept a superior's rating. When pay is ties to objective measures, therefore, it is usually clearer to employees that pay is determined by performance. Objective measures are also often publicly measurable. When pay is tied to them, the relationship between performance and pay can be much more visible than when it is tied to a subjective, non verifiable measure, such as a supervisor's rating.

Group and organizational bonus plans are generally best at producing integration and team work. Under group and organizational plans, it is generally to everyone's advantage that an individual work effectively, because all share in the financial results of higher performance. As a result, good performance is likely to be supported and encouraged by others when group and organizational plans are used. If people feel they can benefit from another's good performance, they are likely to encourage and help other workers to perform well. This is not true under individual plans. They tend to produce differentiation and competition.

Many organizations choose to put individuals on multiple or combination reward systems. For example, they may put individuals on a salary increase system which rewards them for their individual performance, while at the same time giving everybody in the division or plant a bonus based on divisional performance. Some plans measure group or company performance and then divide up the bonus pool generated by the performance of a larger group among individuals based on individual performance. This has the effect of causing individuals to be rewarded for both individual and group performance in the hope that this will cause individuals to perform all needed behaviors.

A common error in the design of many pay for performance systems is the tendency to focus on measurable short term operating results because they are quantifiable and regularly obtained anyway. Many organizations reward their top level managers in particular, on the basis of annual profitability. This can have the obvious dysfunctional consequence of causing managers to be very short-sighted in their behavior and to ignore strategic objectives which are important to the long-term profitability of the organization. A similarly grievous error can be the tendency to depend on completely subjective performance appraisals for the allocation of pay rewards. Considerable evidence exists to show that these performance appraisals are often biased and invalid, and instead of contributing to positive motivation and good work climate that improves superior subordinate relationships, they lead to just the opposite (see e.g. Devries, Morrison Shellman and Gerlach, 1981; Latham and Wexley, 1981; Mohrman, Resnick-West, Lawler, 1987). These are just two of the most common errors that can develop in the administration of performance based reward systems. Other common errors include the giving of too small rewards, failure to clearly explain systems, and poor administrative practices.

In conclusion, the decision of whether or not to relate pay to performance is a crucial one. The error of automatically assuming that they should be related can be a serious one. Admittedly, the advantages of doing it effectively are significant. What is often overlooked is that doing t poorly can have more negative consequences than positive ones.

Market Position

The reward structure of an organization influences behavior partially as a function of how the amount of rewards given compare to what other organizations give. Organizations frequently have well developed policies about how their pay levels should compare with the pay levels in other companies. For example, some companies feel it is important to be a leading payer, and they consciously set their pay rates at a higher level. Other companies are much less concerned about being in the leadership position with respect to pay, and as a result, are content to target their pay levels at or below the market for the people they hire. This structural issue in the design of pay systems is a critical one, because it can strongly influence the kind of people that are attracted and retained by an organization. It also influences the turnover rate and the selection ratio.

If many of the jobs in the organizations are low-skilled and people are readily available in the labor market to do them, then a strategy of high pay may not be appropriate. It can increase labor costs and produce a minimum number of benefits. Of course, organizations don't have to be high payers for all the jobs. Indeed, some organizations identify certain key skills they need, and adopt the stance of being a high payer for them, and an average or below average payer for other skills. This has some obvious business advantages in terms of allowing organizations to attract the critical skills that it needs to succeed, and at the same time to control costs.

The kind of market position that a company adopts with respect to its reward systems can also have a noticeable impact on organization culture. For example, a policy which calls for above market pay can contribute to the feeling in the organization that it is elite, that people must be competent to be there, and that they are indeed fortunate to be there. A policy which puts certain skill groups into a high pay position and leaves the rest of the organization at a lower pay level, can on the other hand, contribute to a spirit of elite groups within the organization and cause devisive social tensions.

Finally, it is interesting to note that some organizations try to be above average in non-cash compensation as a way of competing for the talent they need. They stress hygiene factors as well as interesting and challenging work. This stance potentially can be a very effective one, because is puts organizations in the position of attracting people who value these things, and could give them a competitive edge at least with these people.

Internal-External Comparison Oriented

Organizations differ in the degree to which they strive toward internal equity in their pay and reward systems. Those organizations that are highly internal equity oriented work very hard to see that individuals doing similar work will be paid the same even though they are in different locations, and/or in different businesses. Some corporations set a national pay structure for their organization based on the highest pay that a job receives anywhere in the country. Those organizations that do not stress internal equity typically focus on the labor market as the key determinant of what somebody should be paid, and although this does not necessarily produce different pay for people doing the same job, it may. For example, the same job in different industries, electronics and auto, may be paid quite differently.

There are a number of advantages and disadvantages associated with focusing on internal pay comparisons and paying all people in similar jobs the same. It can make the transfer of people from one location to another easier since there won't be any pay differences with which to contend . In addition, it can produce an organizational culture of homogeneity and the feeling that everyone working for the same company is treated well or fairly. It also can reduce or eliminate the tendency of people to want to move to a higher paying division or location, and the tendency for rivalry and dissatisfaction to develop within the organization because of "unfair" internal pay comparisons.

On the other hand, a focus on internal equity can be very expensive, particularly if the organization is diversified, and as usually happens, pay rates across the corporation are set at the highest level that the market demands anywhere in the corporation (Salscheider, 1981). The disadvantage of this is obvious. It causes organizations to pay a lot more money than is necessary in order to attract and retain good people. Indeed, in some situations it can get so severe that organizations become non-competitive in certain businesses, and find they have to limit themselves to those businesses where their pay structures make labor costs competitive.

Centralized/Decentralized Reward Strategy

Closely related to the issue of internal versus external equity is the issue of a centralized versus decentralized reward system strategy. Those organizations that adopt a centralized strategy typically assign to corporate staff groups the responsibility for seeing that pay practices are similar throughout the organization. They typically develop standard pay grades and ranges, standardized job evaluation systems, and perhaps, standardized promotion systems. In decentralized organizations design and administration in the same areas of pay, promotion, and other important rewards, are left to local option. Sometimes the corporations have broad guidelines or principles they wish to stand for, but the day to day administration and design of the system is left up to the local entity.

The advantages of a centralized structure rest primarily in the pay administration expertise that can be developed at the central level and the degree of homogeneity which is produced in the organization. This homogeneity can lead to a clear image of the corporate culture, feelings of internal equity, and the belief that the organization stands for something. It also eases the job of communicating and understanding what is going on in different parts of the organization. The decentralized strategy allows for local innovation and practices which fit particular businesses.

Just as is true with many other of the critical choices, there is no right choice between a centralized and decentralized approach to reward systems design. Overall, a decentralized system tends to make the most sense when the organization is involved in businesses that face different markets, and perhaps, are at different points in their maturity (Greiner, 1972; Galbraith and Nathanson, 1978). It allows those unique practices to surface which can give a competitive advantage to one part of the business but may prove to be a real hindrance or handicap to another. For example, such perquisites as cars are often standard operating procedure in one business while they are not in another. Similarly, extensive bonuses may be needed to attract one group of people, but make little sense with others.

Degree of Hierarchy

Closely related to the issue of job-based versus competence based pay, is the strategic decision concerning the hierarchical nature of the reward systems. Often, no formal decision is ever made to have a hierarchical or an egalitarian approach to rewards in an organization. A hierarchical approach simply happens because it is so consistent with the general way organizations are run. Hierarchical systems usually pay people greater amounts of money as they move higher up in the organization and give greater perquisites and symbols of office. The effect of this approach is to strongly reinforce the traditional hierarchical power relationships in the organization and to create a climate of different status and power levels. In steeply hierarchical reward systems, the reward system usually has more levels in it than the formal organization chart and as a result, creates additional status differences.

The alternative to a hierarchical system is one in which differences in rewards and perquisites that are based only on hierarchical level are dramatically downplayed. For example, in those large corporations (e.g. Digital Equipment Corporation) that adopt an egalitarian stance such things as private parking spaces, executive restrooms, and special entrances are eliminated. People from all levels in the organization eat together, work together, and travel together. This less hierarchical approach tends to encourage decision making by expertise rather than by hierarchical position, and draws fewer status differences.

As with all reward system strategic choices, there is no right or wrong answer as to how hierarchical a system should be. In general, a steeply hierarchical system makes the most sense when an organization needs relatively rigid bureaucratic behavior, strong top down authority, and a strong motivation for people to move up the organizational hierarchy. A more egalitarian approach fits with a more participative management style, and the desire to retain technical specialists and experts in non-management or lower level management roles. It is not surprising, therefore, that many of the organizations which emphasize egalitarian perquisites are in high technology and knowledge based industries.

Reward Mix

The kind of rewards that organizations give to individuals can vary widely. For example, the money that is given can come in many forms varying all the way from stock to medical insurance. Organizations can choose to reward people almost exclusively with cash, downplaying fringe benefits, perquisites, and status symbols. The reward mix can determine the type of people who work for an organization. Highly variable cash compensation programs will attract different employees than will stable levels of cash compensation. Similarly, high levels of benefits will attract different employees than will cash compensation programs.

One major advantage of cash is that the value of cash in the eyes of the recipient is universally high. When the cash is translated into fringe benefits, perquisites, and other trapping of office, it may lose its value for some people and as a result, be a poor investment (see e.g., Nealey, 1963; Lawler, 1971). Certain benefits can best be obtained through mass purchase and therefore, individuals may be valued by some individuals beyond their actual dollar cost to the organization and thus, represent good buys. Finally, as was mentioned earlier, there often are some cultural and organizational structure reasons for paying people in the form of perquisites and status symbols.

Flexible or cafeteria style benefit program (see e.g. Lawler, 1981) allow individuals to make up their own reward package to fit their needs and desires. They have become increasingly popular in part because organizations get the best value for their money by giving people only those things they desire (Lawler, Mohrman and Ledford, 1992). It also has the advantage of treating individuals as mature adults rather than as dependent people who need their welfare looked after in a structured way.

Process Issues and Reward Administration

Process issues come up frequently because organizations are constantly having to make reward system management, implementation and communication decisions. Rather than discussing specific process issues here, the focus will be on broad process themes that can be used to characterize the way reward systems are designed and administered.

Communication Policy

Organizations differ widely in how much information they communicate about their reward systems. Some organizations are extremely secretive, particularly in the area of pay. They forbid employees from talking about their pay, give minimal information to individuals about how rewards are decided upon and allocated, and have no publicly disseminated policies about such things as market position, the approach to gathering market data, and potential increases and rewards. At the other extreme, some organizations are so open that everyone's pay is a matter of public record, as is the overall organization pay philosophy (many new high involvement plants operate this way, see e.g., Lawler, 1992; Walton, 1980). In addition, all promotions are subject to open job postings, and in some instances peer groups discuss the eligibility of people for promotion.

The difference between an open and a closed communication policy in the area of rewards is enormous. Like all the other choices that must be made in structuring a reward system, there is no clear right or wrong approach. Rather, it is a matter of picking a position on the continuum from open to secret that is supportive of the overall culture and types of behavior needed for organizational effectiveness. An open system tends to encourage people to ask questions, share data, and ultimately be involved in decisions. On the other hand, a secret system tends to put people in a more dependent positions to keep power concentrated at the top, and to allow an organization to keep its options open. Some negative side effects of secret systems are the existence of considerable distortion about the actual rewards that people get and creation of a low trust environment in which people have trouble understanding the relationship between pay and performance (see e.g. Lawler, 1971). Thus, a structurally sound pay system may end up being rather ineffective because it is misperceived if strong secrecy policies are in place.

Open systems put considerable pressure on organizations to do an effective job in administering rewards. Thus, if such difficult to defend policies as merit pay are to be implemented, considerable time and effort needs to be invested in pay administration. If they are done poorly, strong pressures usually develop to eliminate the policies and pay everyone the same (see e.g., Burroughs, 1982). Ironically, therefore, if an organization wants to spend little time administrating rewards, but still wants to base pay on merit, secrecy may be the best policy, although secrecy in turn may limit the effectiveness of the merit pay plan.

Decision Making Practices

Closely related to the issue of communication is the issue of decision making. Open communication makes possible the involvement of a wide range of people in the pay decision-making process. Further, if individuals are to be actively involved in decisions concerning reward systems, they need to have information about policy and actual practice.

In discussing the type of decision-making processes that are used in organizations with respect to reward systems, it is important to distinguish between decisions concerning the design of reward systems and decisions concerning the ongoing administration of reward systems. It is possible to have different decision-making styles with respect to these two types of decisions.

Reward systems typically are designed by top management with the aid of staff support, and administered by strict reliance on the chain of command. The assumption is that this provides the proper checks and balances in the system, and in addition locates decision-making where the expertise rests. In many cases this is a valid assumption and certainly fits well with an organizational management style that emphasizes hierarchy, bureaucracy, and control through the use of extrinsic rewards. It does not fit, however, with an organization that believes in more open communication, higher levels of involvement on the part of people, and control through individual commitment to policies (Lawler, 1992). It also doesn't fit when expertise is broadly spread throughout the organization.

There have been a number of reports of organizations experimenting with having employees involved in the design of pay systems (Lawler, 1981; Lawler, 1990). For example employees have been involved in designing their own bonus system and the results have been generally favorable. When employees are involved, it leads them to raise important issues and to provide expertise which is not normally available to the designers of pay systems. Perhaps more importantly, once the system is designed the acceptance level of it and the understanding of it tends to be very high. This often leads to a rapid start-up of the system and to a commitment to see it survive. In other cases, systems have been designed by line managers rather than by staff support people. This can lead to greater effectiveness because the managers see the need to support it, maintain it, and be committed to it.

There also has been some experimentation with having peer groups and lower level supervisory people handle the day-to-day decision making about who should receive pay increases and how jobs should be evaluated and placed in pay structures. The most visible examples of this are in the new participative plants which use skill based pay (see e.g., Lawler, 1992; Walton, 1980). In these, typically, the work group reviews the performance of the individual and decides whether he or she has acquired the new skills. Interestingly, what evidence there is suggests that this has gone very well (Jenkins, et al., 1992). In many respects this is not surprising since peers often have the best information about performance, and thus, are in a good position to make a performance assessment. The problem in traditional organizations is that they lack the motivation to give valid feedback and to respond responsibly, thus, their expertise is of no use. In more participative open systems, this motivational problem seems to be less severe, and as a result, involvement in decision-making seems to be more effective.

There have been isolated instances of executives assessing each other. There is evidence that this can work effectively when combined with a history of open and effective communication. Deciding on rewards is clearly not an easy task for groups and thus should be done only when there is comfort with the confrontation skills of the group, and trust in their ability to talk openly and directly about each other's performance.

Assessing Organizational Reward Systems

Now that consideration has been given to both what a reward system can do and to the key design dimensions that influence what it will actually do, it is appropriate to consider how these ideas can be used to design an organizations reward system. Within limits, it is true that if an organization can specify what it wants a reward system to do an appropriate reward system can be designed. The problem in many organizational diagnosis and design situations is that the organization cannot specify the behaviors that it wants the reward system to produce. There are a variety of reasons for this, ranging all the way from an unclear organizational strategy to a failure on the part of the organization to understand the potential array of organization design elements that can influence behavior.

Often a good reward system design consultant spends as much or more time clarifying the intent of the reward system as she does working with the organization to design the reward system. This identification must go beyond such simple statements as to attract and retain the best employees or to motivate effective performance. The strategy needs to identify the kind of people to be attracted and retained, how long they need to be retained, what kind of skills the people should have, and so forth. Similarly, in the area of performance, it needs to be very clear what kind of performance is to be motivated, how much emphasis is to be placed on group and team performance. Attention also needs to be placed on the issue of organizational structure and the desired degree of integration and differentiation.

The task of developing a reasonable outcome model for reward a system is complicated by the fact that other systems in the organization may influence the same behaviors. Thus, it is critical to identify which individual and organizational behaviors are going to be primarily driven by the reward system and which are going to be driven by other factors such as organization structure, or the information systems. In some cases, the best design may be to have multiple systems driving the same behavior so that consistency exists. On the other hand, in some cases it may be important to use the reward system to balance the effects of other systems, so that the organization gets the mixture of behavior it needs.

A good example of balance is the competing focuses of individual and organization performance. The organization may decide that it needs individuals to focus on increasing individual performance regardless of its impact on others, but to demonstrate cooperative behavior with other people at critical times. In this situation the reward system might be used to reward both individual and organizational performance or it may be used to emphasize only one of these while work design or some other feature is focused on the other. For example teams can be created and their performance can be measured. This should clearly lead to individuals emphasizing team performance (Lawler and Cohen, 1992). If the right mix of organizational behavior calls for some emphasis on individual performance excellence, it may make sense to focus at least some of the reward system on recognizing outstanding individual performance. In this respect, the reward system would end up contributing to a carefully designed balance in the organization between motivating team behavior and individual behavior.

Once the decision has been made about the behaviors that the reward system is supposed to support, and how it fits with the other operating systems in the organization, it is possible to assess the current reward system. There are two elements of any reward system that need to be focused on in an organizational assessment. The first is how the system actually operates, and the second concerns the impact of the system on the six areas that were identified earlier.

Assessing how the reward system actually operates is basically a matter of reviewing the organizational policies, practices, statements and records, in order to see not only what the organization says its reward systems are, but how they operate in practice. In doing organizational assessment with respect to reward systems, the focus should be on the major design dimensions and critical choices that were mentioned earlier. At the end of this diagnostic stage, it should be possible to describe the organizations reward system in terms of how well it pays in the market, the degree to which is pays for performance, how much it focuses on individual versus organizational performance, and so on. In short, an entire organizational profile should be developed to focus on how the organization actually operates, and how effective it is in implementing its various programs and policies.

Often there is a difference between what the organization says it does and the behavior that it demonstrates. For example, organizations often say that they pay for performance, but an analysis of the raises that are given frequently shows that they are not related to performance (Heneman, 1992). Similarly, organizations often say that they appraise peoples performance on a regular basis, but a check of the records shows that there are no written performance appraisals in the files of individual employees--or they are poorly and incompletely done. Perhaps the hardest feature of doing a diagnosis concerns identifying how well an organization executes its programs. To continue with the example of performance appraisals, there are really two issues here. First, do appraisals get done, and secondly, are they done in a way that is effective in producing the behavior that the organization desires?

The final step in organizational diagnosis is determining the actual impact of the organizations policies and practices. Some impact data can be obtained from looking at company records and analyzing individual behavior. For example, organizational performance can be analyzed as can hiring, turnover, and other personnel data. In assessing the impact of the current reward system it is also desirable to gather perceptual and attitudinal data from employees. These data can be gathered either by carefully structured interviews or by written attitude surveys. Both of these methods have distinct advantages and often the best approach is a combination of the two. Interviews typically give a richness about why the individual sees or doesn't see a relationship between pay and performance and how specific practices create this and other perceptions. Surveys on the other hand, allow much better relative assessments of how satisfied employees are with their pay, the degree to which they see pay based on performance, how well they understand the pay system, and so on down the list of behaviors and attitudes that pay systems are supposed to influence.

The final step in an organizational assessment is to compare the actual impact of the reward system with the desired impact. It is this step which combines the strategy driven specification of what the reward system should do with the assessment of existing practices and attitude data. It typically shows significant gaps between what the reward system needs to do, and what it actually does. For example, a typical finding is that the reward system tends to motivate bureaucratic empire building behavior, while the greatest need in the organization is for individuals to learn new skills, to be increasingly flexible in their job behavior, and contribute to down sizing their particular work area.

It is the result of the comparison between what reward systems should do, and what it does that should form the basis for redesigning the reward system. At this point, the organization needs to go back to the basic design dimensions of the reward system and look at what can be done to close the gap between what the reward system needs to do and what it actually does.

There are at least two obvious possibilities here. One is that the organization is simply positioned wrong on the reward system dimension to get the behavior that it wants. For example, it talks about wanting team behavior, but in fact, the reward system is focused on primarily rewarding individual behavior. If this type of discrepancy appears then of course the reward system needs to be redesigned to produce the type of behavior that is needed. A second alternative is that the reward system is positioned correctly, but that the reward systems are either poorly designed or poorly implemented. In this case, the critical corrective action may be to get a group of employees involved in redesigning the way the reward system is managed and implemented so that the policies and practices will be better understood, employees will be committed to them and they will be more likely to produce the kinds of behavior that is needed.

Finally, it is important to note that reward system assessment and change should not stop with simply one diagnosis, a set of changes, and the implementation of those changes. Organizations are dynamic as are the impacts of reward systems. Thus, it is important to continue to assess the impact of the reward system and test its effectiveness relative to the business strategy and the behavioral objectives of the organization (Mohrman and Cummings, 1987). Typically, either renewal or significant redesign of the reward system is needed when ongoing assessments are made. Often no changes in core principles are needed, nor are changes in the basic policies and practices, but improvement is needed in the way these policies are implemented and carried out. Frequently new employees have joined the organization and they have not been trained in the policies and as a result, they are not aware of how the rewards system operates. Another common problem is that attention has not been focused on how well the policies are implemented and the organization has become careless and wasteful.

Employee Involvement and Pay System Design

The most prevalent approach to designing work organizations calls for such features as hierarchical decision making, simple repetitive jobs at the lowest level, and rewards based on carefully measured individual jobs and job performance. This "control approach", appears to be losing favor (Lawler, Ledford and Mohrman, 1989; Lawler, Mohrman and Ledford, 1992). Numerous articles and books have recently argued that organizations need to move toward a more involvement or commitment oriented approach to management. The advantages of the involvement approach are said to include higher quality products and services, less absenteeism, less turnover, better decision making, better problem solving, and lower overhead costs; in short, greater organizational effectiveness (Denison, 1990; Lawler, 1992).

Employee involvement approaches to organization design generally argue that three features of an organization are critical. Briefly the features are:

1. *Information* about the performance of the organization and the ability to bring information about needed organizational changes to the attention of key decision makers.
2. *Knowledge* that enables employees to understand and contribute to organizational performance.
3. *Power* to make decisions that influence organizational direction and performance.

How information, knowledge, and power are positioned in an organization determines the core management style of the organization. When they are concentrated at the top, traditional control-oriented management exists; when they are moved downward some form of participative management is being practiced.

In reviewing how a pay system can be aligned with an employee involvement approach to management, consideration will be given to how it should affect core values, process, and structures. As might be expected, employee involvement calls for approaches in all three areas, approaches which are different from those that are used in command and control organizations.

Core Values

To support employee involvement pay needs to be driven by a clearly articulated, well accepted set of core values. These core values should not be a temporary commitment of the organization, rather they should be fundamental beliefs which will be unchanged for decades.

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, seniority, 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.

There are no "right" core values, indeed a part of the employee involvement process may be developing them. However, it is possible to make some statements about the general orientation which is congruent with the major principles of the employee involvement approach to management. In particular, the core values need to emphasize the relationship of pay to the success of the business, individual rights, due process, open communication, egalitarian approaches, pay rates that are competitive with similar businesses, and an 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

Employee involvement suggests some specific process approaches to pay administration. In particular, it suggests greater openness of communication about pay practices and broader involvement on the part of all organizational members in the development and administration of pay and reward system practices. Openness and participation are congruent with the emphasis on moving power downward, and having individuals involved in both the thinking and doing sides of the business. For a reward system to be effective, it has to be both understood and designed in ways that lead to individuals accepting it. Participation in the design and administration process helps assure this as well as assuring that the system will fit the situation, because it allows the people who will be affected by the system to influence its design.

With openness and participation, widespread ownership of the reward system should develop so that it is not only 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 Human Resources 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.

System Structure

There are some structural mechanisms which fit particularly well with employee involvement. Many of them represent important changes in the way pay is currently administered in most organizations (Schuster and Zingheim, 1992; O'Dell, 1987). In particular, the following structural approaches to rewards are appropriate for organizations practicing employee involvement.

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 reward 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 their particular environment. 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.
2. *Rewards for Business Performance* - If employees are to be concerned about the success of a business, then their rewards must be driven by the success of the business (Lawler, 1990). This is not to say that individual pay for performance systems should be eliminated since they may still be appropriate if performance can be measured at the individual level (Mohrman, Resnick-West, and Lawler, 1989). It is to say that organizations need systems which reward organization and business unit performance. Indeed, organizations need to be riddled with performance based reward systems so that the pay of individuals is driven by their 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 ownership and profit sharing plans, could cover every employee. This combination can help push both power and information downward because it gives rewards for business performance to lower level employees, legitimizes their getting information and power (Frost, Wakeley, and Ruh, 1974). It also can influence motivation and create a team culture.

At the management level emphasis needs to be placed upon long term performance. Particularly in the case of executive compensation, this suggests 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 of the organizational units they 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 do not walk away from their past decisions.

3. *Choice Oriented* - A fixed package of benefits, cash, and perquisites 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, it is evident in the growing popularity of flexible benefit systems (Lawler, Mohrman and Ledford, 1992).

   Individual choice does not need to be limited to fringe benefits and hours of work. Ultimately, organizations taking the employee involvement approach could allow individuals to have tremendous flexibility in determining their own total reward package. Flexibility could extend, for example, to the kind of perquisites and benefits offered, and to the mixture of cash, stock, and bonuses. This has the potential of benefiting both the individual and the organization, because it will help individuals to get the rewards they value and assure the organization that the money it is spending is being spent in ways that produce the maximum impact.

4. *Skill Based* - Employee involvement suggests paying individuals for the skills they have. Skill based pay represents a major change in the nature of compensation practice. To mention just a few of the consequences, 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, particularly if the specialist and production worker are encouraged to learn managerial skills in order to become more self-managing. In this sense, pay would become unhinged from the hierarchical nature of the organization and be used to reinforce skills rather then hierarchy.

Relatively little use has been make 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 the use of skill based pay should be expanded. Skills are the key to effectiveness in the growing number of organizations that are emphasizing employee involvement. In addition, knowledge based work organizations require that skills be spread throughout the organization. Skill based pay can motivate skill acquisition and reinforce it so knowledge work and high involvement organizations can build the kind of skill base they need to be effective.

The changing demographics of the society also suggests that skill based pay will 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, employee involvement 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 on a plateau or in a dead-end position for a long period of time. If skill based pay is put into place, they can 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.

5. *Egalitarian* - There are several respects in which the pay system can be made more egalitarian in order to match the emphasis in employee involvement on moving information, knowledge, and power downward. 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, offices). 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 lowering the level at which such things as stock option plans and profit sharing plans operate in organizations. 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 only at top management.

   The employee involvement approach also brings into question the wisdom of pay plans which pay senior executive much more than is paid to lower level employees. Large differences can be justified under a tradition management system since the executives are expected to exercise considerable power and to control information. However, under the employee involvement approach, power, information and knowledge are pushed downward so it follows that so should rewards like pay.

Summarizing Employee Involvement and Pay

The management practices and strategies which are consistent with employee involvement 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. It suggests new core values, new administrative processes, and finally, some 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 to the business itself. Taken as a package, these new pay practices are congruent with employee involvement and promise to change the way work is done.

Table 1
Pay & Management Style

	Traditional Management	Employee Involvement
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

Reward Systems and Organizational Change

In many major organizational changes it is difficult to change all the systems in an organization simultaneously. Typically, one or one set of changes leads to another set of changes. Reward systems change may either be a lead change or a lag change in the overall change process.

Reward as a Lead

There are a number of examples of pay being a lead change. Perhaps the most frequently discussed of these is the use of the Scanlon plan or some other forms of gain sharing to improve plant productivity (Moore and Ross, 1978; Lawler, 1981). In these situations, the initial change effort is focused on the development and installation of a gain sharing plan that pays bonuses based on improvements in productivity (Graham-Moore and Ross, 1983). In the case of the Scanlon Plan emphasis is also placed on building participative problem solving groups into the organization but the clear emphasis is on the gain sharing formula and the financial benefits of improved productivity. The participate management structure is put in for the purpose of supporting and making possible productivity improvement which in turn will result in gains to be shared. Not surprisingly, once gain sharing starts and inhibitors to productivity are identified, the result is other changes. Typical of these are improvements in the organizations structure, the design of jobs and work, and training programs. Often these are dealt with rather swiftly and effectively because the gain sharing plan itself provides a strong motivation to deal with them.

There are other reward system changes that also can key broader organizational change efforts. For example, the introduction of skill based pay can potentially key a broad movement to participation because among other things, it provides people with the sills and knowledge they need to participate. In somewhat different vein a dramatic change in the pay for performance system can be very effective in altering the kind of strategic directions that an organization takes. For example, installing bonus systems which pay off on previously unmeasured or unfocused upon performance indicators can dramatically shift the direction of an organization. Similarly, installing a long term bonus plan for executives can cause them to change their time horizons and their decision making practices in important ways.

Reward as a Lag

In the majority of major organization change efforts pay ends up as a lag factor. This certainly is true in most change efforts that involve movement toward participative management.

The initial thrust often is on team building, job redesign, quality circles, or some other area. It is only after these other practices have been put in place for a while that the organization tends to deal with the reward system changes which are needed to support these new practices. Often, there is surprise that these other important changes lead to a need for revision in the reward system. The connectedness nature of organizations makes it almost inevitable that when major changes are made in an organization's strategic direction or management style and practices, changes will also have to be made in the reward system.

New participative plants represents an interesting example of where participative reward systems changes are put in at the same time as are other participative practices (Lawler, 1981, 1992). Indeed, one reason for their success probably is their ability to start with all their systems operating in a participative manner.

Rewards as a Motivator of Change

Finally, it is important to consider the use of rewards systems in producing organizational change. Major organizational changes are often difficult to accomplish. The forces of equilibrium tend to work to cancel out many changes. To the extent that changing one component of an organizational system reduces its congruence with other components, energy will develop to limit, encapsulate, or reverse the change. In addition, to the extent that management needs to give time and attention to directing a change, it may become diverted from other ongoing management tasks.

Management is therefore faced with two key tasks if change is to be brought about. The first task is *motivating change*, or overcoming the natural resistance to change that emerges and getting individuals motivated to behave in ways that are consistent with the immediate change goals and still consistent with long-range corporate strategy. The second major task is *managing change*. We can think of many organizational changes in terms of transitions (Beckhard and Harris, 1977). The organizational exists in a current state (C). An image has been developed of a future state of the organization (B). The period between A & B can be thought of as the transition period (T). The question is how to manage the transition.

The transition state frequently is overlooked. People become fixated with the future state and assume that all that is needed is to design the best possible future. They think of change as simply a mechanical or procedural detail. The problems created by the lack of concern for the transition state are compounded by the inherent uniqueness of it. In most situations, the management systems and structures developed to manage either C or B are simply not appropriate or adequate for the management of T. They are steady state management systems, designed to run organizations already in place rather than transition management systems. This suggests the need for temporary reward systems that are designed to operate during the transition period. One reason many change efforts are resisted by individuals is that they are often perceived to be a threat to their pay level. Particularly when the present system is highly job based and tie to objective measures, such as the number of subordinates, the vagaries of a reorganization or other type of change may lead people to resist the change because of its unclear and potentially negative impact on their pay rate. There is no magical formula for overcoming this resistance, but two approaches can help.

1. Until the change period is complete, a floor can be put under individual pay rates. That is, no one should have to fear losing pay during the change process. This point is critical where major reorganizations are planned because, in order for the change to go well, some people might have to give up some subordinates and responsibilities. As a result, if their job were reevaluated, it might be evaluated lower. If this problem is likely to be severe, the organization may want to assure individuals that their pay will not be cut, even after the change is in place.
2. Assign a group of key individuals the responsibility for the development of an approach to compensation that will fit the new organization. The group should do to the type of strategic assessment that was discussed earlier.

The reward system can be used to encourage and support successful implementation of the reorganization. In most reorganizations, financial rewards are not used to motivate a speedy and successful implementation process. This is an unfortunate oversight. If careful thought is given to rewards and the process of change, often pay can be used to help assure that changes which are keyed to other systems are implemented effectively. Specifically, the following points are relevant:

1. In many change efforts, the key question is how to get people to act in ways that are consistent with an effective transition. The organization needs to make it clear that the jobs and associated rewards given to managers after the transition will be dependent upon their contribution to an effective transition process.
2. At some organizational levels, the transition situation may call for the use of one-time bonuses and payments. In most cases, it makes sense for these to be paid on a group basis rather than on an individual basis. There may be a few instances where individuals have particular goals to accomplish that are individual in nature, but in most cases, one-time financial payments should be based at the group level and tied to transition periods.
3. It is important that transition goals be set with respect to both the rate at which change is introduced, and the process that is used to introduce it. Both should be as explicit and quantitatively precise as possible. They are a critical ingredient in the effective motivation of change and should be tied directly to the reception of the one-time payments just mentioned. The goals should include specific dates, what should be accomplished by these dates, and measures of the process that was used to implement change. These process measures are harder to define than are implementation events, such as having a new unit operating or having people relocated, but they should be measured. Typical of measures that can be used here are people's understanding of the new system, the degree to which it was explained to them, the level of turnover among people that the organization wished to retain, signs of stress among people involved in the transition, and the willingness of managers to give up people to other parts of the organization where they can make a greater contribution.

The best way to summarize this discussion is to say that the transition process can be managed and that rewards, goals, and performance measures are critical tools in managing this process. They can be used to assure that a rapid implementation of the change strategy takes place, and that it does so in a way that minimizes the dysfunctional consequences for both the organization an the people who work within it.

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