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REWARD INNOVATIONS IN FORTUNE 1000 COMPANIES

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Benchmarking has long been central to the practice of compensation. Compensation practitioners regularly compare the pay practices and pay levels in their organization to those of other organizations. Recently they have shown tremendous interest in the degree to which major companies use reward innovations. How many firms are using the types of innovations discussed in this volume, and to what extent are firms using them?

This paper summarizes data on reward innovations from a unique study of the employee involvement (EI) and total quality management (TQM) practices of large U.S. companies. We researched practices of the "Fortune 1000," the listing of the 500 largest manufacturers and the 500 largest service firms that Fortune published annually until this year. We report the data in our new book, Creating High Performance Organizations: Practices and Results in the Fortune 1000.[1]

Surveys of the EI practices and TQM practices of Fortune 1000 companies were conducted in 1987, 1990, and 1993. The U.S. General Accounting Office (GAO) conducted the first survey, using a questionnaire that we developed with Michael Dulworth of GAO. We conducted the subsequent surveys at the Center for Effective Organizations, University of Southern California with financial support from the Association for Quality and Participation. Responses were obtained from 476 firms in 1987 (response rate of 51 percent), 313 firms in 1990 (32 percent), and 279 firms in 1993 for a response rate of (28 percent). Surveys were sent to fewer than 1000 firms in each year because mergers, acquisitions, and consolidations removed some firms from the Fortune list. Analyses indicate that our samples were representative of the full Fortune 1000 on a wide range of variables, including measures of productivity, profitability, and stock market return. Firms in the sample are, however, larger than the Fortune 1000 average.

The study has limitations. It represents a view only from the top, since senior managers completed most of the surveys. The study addresses the practices of only the largest U.S. companies. However, Fortune 1000 firms are a key segment of the economy. They employ about

24 million, or about one in five U.S. workers, and their annual sales exceed $4 trillion. Also, the use of innovations by large firms is a lead indicator of their adoption throughout the economy.

Despite its limitations, our study is the most comprehensive available on the use of practices relevant to employee involvement and TQM. It documents many important changes in management practice that are of keen interest to the human resource function in general and the compensation community in particular.

Rewards for Performance

Compensation consultants and researchers increasingly argue for basing rewards partly on organizational performance as a way to assure that employees are involved in and care about their organization. Employee stock ownership plans, profit sharing, stock options, and gainsharing are examples of plans that can link employees to the success of the business and reward them for it. Work group or team incentives may be helpful where employees work in teams. Non-monetary recognition programs are often advocated by proponents of total quality management programs.

Table 1 shows the popularity of these approaches to paying for performance. The most widely used rewards for performance are non-monetary recognition awards, used by over 90 percent of firms in 1993; employee stock ownership (ESOP) plans (71 percent); and profit sharing (66 percent). Stock options (85 percent); work group or team incentives (70 percent); and gainsharing (42 percent) are used less widely or cover fewer employees in the corporations that use them. For comparison, we report on the use of individual incentive plans. These conventional incentives focus on individual performance, not business success, and can interfere with teamwork and problem solving. Nearly all firms (90 percent) still use such incentives to some degree.

Although most firms use most of these approaches with at least some employees, they typically do not cover most of the work force with the plans. Non-monetary rewards are the most widely used, covering on average about half of the work force. ESOP plans tend to cover all employees or none. Profit sharing plans cover, on average, between 21 and 40 percent of the work force. Work group or team incentives, stock options, and gainsharing plans cover, on average, less than 21 percent of employees.

Table 1 indicates that the use of gainsharing plans grew rapidly between 1987 and 1990 but then plateaued. There was growth in the use of work group or team incentives and non-monetary recognition awards between 1990 and 1993. Finally, there was little growth in the use of profit sharing, ESOPs, or individual incentives from 1987 to 1993.

Rewards Supportive of Employee Involvement

Some reward innovations are important in part because they support employee involvement efforts. All-salaried pay reduces the distinctions between the exempt and non-exempt classifications, consistent with an egalitarian culture. Pay for knowledge and skill rewards individuals for their capability and flexibility, encourages cross-training, and promotes broad business understanding. Flexible benefits provide employees with some control over how the benefit portion of their compensation package is distributed. Employee security reduces disincentives for employees to contribute ideas for increased productivity through EI and TQM efforts. Finally, open pay information helps employees understand how they are paid, a precondition to their participation in decisions about pay.

Table 2 reports data on the use of these practices. The most common were all-salaried systems, used by 73 percent of Fortune 1000 firms in 1993; flexible benefits (68 percent); open pay information (67 percent); and knowledge or skill-based pay systems (60 percent). On the other hand, only 37 percent of firms in 1993 made promises of employment security.

The depth of use these practices varies considerably. Flexible benefit plans cover, on average, about half of employees, and 30 percent of firms cover all employees with such plans. Open pay and all-salaried systems cover an average of 21 to 40 percent of employees. However, open pay tends to apply to all employees or none. Skill-based pay plans and employment security cover an average of only 1 to 20 percent of employees in Fortune 1000 firms.

There were some interesting changes in the use of these practices between 1987 and 1993. There was a stunning increase in the adoption of two practices. The percentage of companies using flexible benefits almost doubled, from 35 percent to 68 percent, largely as a result of the cost control advantages of these plans. The percentage using knowledge or skill-based pay increased by half, from 40 percent to 60 percent of firms. The use of all-salaried systems was flat. Employment security guarantees dropped sharply, from 54 percent to 37 percent of firms, as the tough competitive environment in many industries made such promises increasingly suspect.

Success of Reward Innovations

Companies using reward innovations tend to view them as successful. No reward practice was reported to be "unsuccessful" or "very unsuccessful" by more than 11 percent of firms using it. A clear majority of firms reported each practice to be "successful" or "very successful." Three-fourths or more of the firms using profit sharing, stock options, recognition awards, all-salaried systems, and flexible benefits reported success. However, many firms reported that they were undecided about the effectiveness of each innovation (20 percent or more in most cases). The greatest uncertainty surrounded skill-based pay, team incentives, gainsharing, and open pay information. These tended to have been adopted more recently than other practices.

Reward Innovations and High Involvement

The larger study found that adoption of reward innovations in Fortune 1000 firms tends to lag the use of other EI and TQM practices, such as participation groups, sharing of business information, and employee training. Nevertheless, firms that adopt EI and TQM practices tend also to adopt reward innovations. This is especially true of practices that represent the greatest change in management philosophy and organizational decision making structure.

Table 3 illustrates this pattern. It shows the relationship between several reward innovations and the use of two important power sharing practices: self-managing work teams and mini-business units. Mini-business units are self-contained units that produce products or services and operate as relatively autonomous small businesses. The use of skill-based pay, gainsharing, and work group or team incentives is dramatically higher in firms that use self-managing work teams and mini-business units than in nonusers of these practices. Profit sharing covers slightly more employees in firms using of these practices. Individual incentives, which often are thought to be inconsistent with EI practices, are applied widely by user and non-user firms alike.

Conclusion

The data indicate that reward practices relevant to EI and TQM are used by a high percentage of firms. The use of such reward practices has increased notably in less than a decade. However, firms tend to cover a minority of the workforce with them. The apparent success of these innovative reward practices is likely to encourage further adoption, especially in in firms that are implementing employee involvement and total quality management efforts.

REFERENCE

Lawler, E. E. III., Mohrman, S.A., & Ledford, G.E. Jr. (1995). Creating High Performance Organizations: Practices and Results in the Fortune 1000. San Francisco: Jossey-Bass.

Table 1:

Percent of Fortune 1000 Firms Covering Employees

with Performance - Based Reward Practices

		None 0%	Almost None (1-20%)	Some (21-40%)	About Half (41-60%)	Most (61-80%)	Almost All (81-99%)	All (100%)
Individual Incentives	1987	13	49	27	6	2	1	2
	1990	10	46	24	8	5	3	5
	1993	10	40	30	8	3	4	5
Work Group or Team Incentives	1990	41	38	10	6	1	2	3
	1993	30	40	14	6	3	3	5
Profit Sharing	1987	35	20	11	4	5	10	15
	1990	37	19	7	4	6	10	17
	1993	34	23	7	4	3	11	19
Gainsharing	1987	74	19	4	1	0	1	1
	1990	61	28	8	1	1	1	0
	1993	58	26	7	2	3	2	2
Employee Stock Ownership Plan	1987	39	8	4	4	6	10	28
	1990	36	9	6	3	5	13	29
	1993	29	9	9	4	6	14	30
Stock Option Plan	1993	15	56	15	2	1	2	10
Non-Monetary Recognition Awards for Performance	1990	9	23	18	10	13	10	17
	1993	6	22	17	7	10	17	22

Source: Lawler, Mohrman, and Ledford, 1995.

Table 2:

Percent of Fortune 1000 Firms Covering Employees

with EI Support Reward Practices

		None 0%	Almost None (1-20%)	Some (21-40%)	About Half (41-60%)	Most (61-80%)	Almost All (81-99%)	All (100%)
All-Salaried Pay Systems	1987	29	15	13	10	12	11	10
	1990	36	18	14	10	7	9	7
	1993	27	18	11	13	11	11	9
Knowledge/ Skill-Based Pay	1987	60	25	7	2	2	2	2
	1990	49	34	11	2	1	1	1
	1993	40	37	12	4	2	2	3
Flexible, Cafeteria Style Benefits	1987	66	7	4	3	2	6	13
	1990	46	12	5	4	5	9	20
	1993	32	9	7	4	7	12	30
Employee Security	1987	47	14	6	2	6	8	18
	1990	47	20	6	4	6	9	8
	1993	63	13	5	2	3	5	9
Open Pay Information	1993	34	17	8	7	6	9	20

Source: Lawler, Mohrman, and Ledford, 1995.

Table 3:

Percentage of Employees Covered by Reward Innovations in 1993:

Users versus Nonusers of High Involvement Practices

	Uses Skill-Based Pay	Uses Gain-sharing	Uses Profit Sharing	Uses Individual Incentives	Uses Work Group or Team Incentives
Uses Self-Managing Work Teams	71	54	69	90	76
Does Not Use Self-Managing Work Teams	36	16	59	91	57
Uses Mini-Business Units	73	55	72	95	82
Does Not Use Mini-Business Units	49	32	61	87	60

Source: Additional analysis of data from study by Lawler, Mohrman, and Ledford, 1995.