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**PAY PRACTICES IN
FORTUNE 1000 CORPORATIONS**

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Pay Practices in Fortune 1000 Corporations

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Are the reward systems in major US corporations changing? As part of its triennial survey of organizational performance improvement efforts, the Center for Effective Organizations has gathered data on the pay practices of large corporations since 1987. The results of the five surveys from 1987 to 1999 show, among other things, the tendency for corporations to increase their use of pay for performance systems, and the decline in the employment security commitments of corporations (Lawler, Mohrman and Benson, 2001).

The period from 1999 to 2002 was one of considerable change in US corporations. The dot-com bust, corporate scandals, and increasing concern about stock option overhangs all occurred during this period. In order to track how much these and other events changed the pay practices of large US corporations, the Center for Effective Organizations conducted its sixth triennial survey of employee involvement and reward system practices in 2002.

Methodology

Surveys were mailed to most of the Fortune 1000 corporations in 2002. As in the previous five surveys, the mailings went to the CEO with the request that he or she either complete it or give it to somebody who is knowledgeable about their corporate practices.

The same questions about pay practices that were asked in the previous surveys were included in the 2002 survey. As in the past, definition of the practices was provided in a glossary case (Exhibit 1). For each practice, the respondents were asked to indicate the percentage of their employees who are covered by it.

Forty-eight percent of the questionnaire responses were received from somebody in the human resources organization, while 13% were received from the chief executive officer. The remainder came from a variety of other members of the organization. The response rate was approximately 16% (149 respondents), which matched closely the response rate in the last two surveys. The comparison between the characteristics of the companies responding in 2002 and those responding to earlier surveys shows that they represent comparable samples. In comparison to the overall Fortune 1000 sample, the companies responding in 2002 were slightly larger than those not responding.

Pay for Performance

Table 1 presents the results for the pay for performance reward system practices studied. The results show an overall movement toward more pay for performance in 2002. This continues the trend of most pay for performance systems gaining popularity since 1987.

The largest gain is in individual incentive plans. They cover many more individuals today than they did in 1987 and, indeed, more than they did in 1999. Obviously, organizations are doing more to tie individual performance to pay, and doing it in ways that use variable pay. This, of course, is in line with the many articles and books which suggest that variable pay is the best way to relate pay to performance (see e.g. Lawler, 2000; Zingheim and Schuster, 2000).

It is somewhat surprising that organizations have chosen to increase the use of pay for performance at the individual level given the increased adoption of teams and other practices which suggest that the use of collective incentive plans might be more appropriate. The movement toward the use of teams and other approaches to employee involvement does show up in the increased popularity of work team incentives. In 1990, only 59% of the

company had group plans while in 2002 82% had them. They have increased in popularity in every study since 1990, and they gained slightly in popularity from 1999 to 2002. However, in terms of absolute level of popularity, they are behind individual incentives.

Gainsharing plans also show a significant increase from 1987 to 2002. However, their popularity is not close to that of work group or individual incentives, and their increase in popularity since 1993 has been relatively small. This probably reflects the fact that gainsharing simply is not applicable to all organizations, and that its growth is limited by its structure and its requirements for metrics. Further, it is has been applied most frequently in manufacturing settings, and the Fortune 1000 companies have few and fewer manufacturing employees and operations.

Profit sharing shows a slight increase from 1999 to 2002, and a larger increase from 1987. It is widely adopted, with 71% of the corporations using it, a small increase from its use in 1987. When it is used, it often covers almost all employees in an organization.

Employee stock ownership plans have the highest level of coverage among the pay for performance plans. They are second only to individual incentive plans in terms of the percentage of companies that use them. Like profit sharing plans, they are in over 70% of US corporations, and when they are installed they, more than any other approach, cover all of the employees in an organization (see Rosen, Klein & Young, 1986, for more information on stock ownership).

Stock option plans are less popular than stock ownership plans (mean of 3.2 vs. 4.3), but among the financial incentive plans they are second to only individual incentive plans in terms of the percent of corporations which have them. Despite the publicity surrounding those corporations which give stock options to all employees, only nine-percent of

corporations report that they give options to all their employees. This is in noticeable contrast to stock ownership plans where 33% of the corporations report that their stock option plans cover all employees. It is also interesting to note that option plans did not gain in popularity from 1999 to 2002, perhaps because of the poor performance of the stock market and growing concerns about option overhang and option expensing (for more information on option plans, see Blasi, Kruse & Bernstein, 2003).

The major conclusion about stock option plans, therefore, seems to be that they are not increasing in popularity and are restricted to, in most cases, a relatively small percentage of the employees in most organizations. The most common answer to the question of percent covered is 1 – 20%. This undoubtedly reflects the fact that stock option plans tend to go to the top executive group, not to all employees.

The most popular performance based reward plans are non-monetary recognition plans. They have grown in popularity since 1990, and are in almost all corporations. Only four-percent of the corporations report that they have no non-monetary recognition rewards for performance. Despite their popularity, corporations do not necessarily cover all employees with them. Only 25% of the corporations report that they cover 100% of their employees with non-monetary rewards for performance.

Table 2 shows the concentration of pay for performance programs in corporations. It shows that since 1990 more and more organizations are adopting multiple pay for performance systems. As of 2002, only 14% had none of the pay for performance practices studied covering 40% or more of their employees; a noticeable change from 1990, when 29% had none of them covering more than 40% or more of their employees. As of 2002, 62% used two or more of the practices with more than 40% of their employees, while in 1990 only

34% used two or more of the practices. This further emphasizes the point that organizations are increasingly using multiple pay for performance practices.

Overall, the results in Table 1 and Table 2 show an increasing tendency for organizations to tie rewards to performance. There are more individuals covered by individual reward for performance plans, group and team reward plans, stock ownership plans, profit sharing plans and stock option plans than there ever have been in U.S. corporations.

There are some major important differences in the adoption patterns of the various approaches to rewarding performance. Stock ownership plans and non-monetary recognition plans tend to cover more of the employees in an organization than any other kind of reward for performance plan. Stock option plans and work group incentives, although used by a relatively high percentage of companies, tend to cover a relatively small percentage of the employees in an organization when they are adopted. Often, they cover only 1 – 20% of the employees. In the case of work teams this most likely reflects the fact that many people do not work in teams. In the case of stock option plans, it most likely reflects the fact that stock options are still predominantly a reward vehicle that is used with senior management.

Reward Practice Adoption

Table 3 shows the adoption rates of five additional reward system practices. These practices were studied because of their association with one or more organizational improvement efforts, for example, employee involvement. As with the pay for performance practices, the results here show some change in popularity since 1987.

Clearly the biggest growth is in the use of flexible or cafeteria-style benefits. The use of this type of benefit plan seems to have peaked in 1999, but they continued to be very

popular in 2002. They likely will continue to be popular because they recognize the individual differences that exist in the workforce and the value that employees place on choice. There is some increase in the popularity of all-salary pay systems, but the difference between 1987 and 2002 is not significant. There is a relative large increase from 1999 to 2002, perhaps reflecting the changing nature of work (more white collar) and management (more participative) in the United States.

The adoption of open pay information shows little change from 1993, when the survey first asked about it. Knowledge and skill-based pay shows some increase since 1987, but it has been stable since 1993.

Finally, there is a dramatic decline in the popularity of employment security commitments on the part of organizations. This decline clearly began in the late 1980's, and continues. Most of the decline occurred from 1987 to 1996. Those organizations that have any type of employment security typically cover only a relatively small percentage of their workforce. This probably reflects the tendency of organizations to think in terms of having some core employees who are particularly critical to the long-term success of the organization, and therefore deserve or command a more stable employment commitment. Finally it is interesting to note that a few companies (6 percent) still offer employment security to all their employees.

Knowledge Management

Beginning in 1999, our triennial survey included items concerned with knowledge management. Two of these items look specifically at the relationship between knowledge management and reward systems. Table 4 presents these results. It shows a noticeable increase from 1999 to 2002 in the practice of giving rewards for developing knowledge

assets, and for sharing knowledge assets. These still are not particularly common practices, but they do seem to be on the increase.

The increased use of rewards for developing and sharing knowledge may be at least partially explained by its positive impact. As is shown in Table 5, there is a significant correlation between the use of these reward practices and the effectiveness level of a knowledge management effort. When organizations reward knowledge development and knowledge sharing their knowledge management programs are more successful. Compared to other knowledge management practices, for example Internet access, using rewards to encourage better knowledge management is a relatively infrequently utilized practice despite its positive relationship with effectiveness. This suggests that organizations can significantly improve their knowledge management programs by more actively using rewards to support them.

Predictors of Adoption

In order to understand why organizations adopt reward practices, the tri-annual survey asks organizations about their business strategy, organizational performance improvement strategies, and their change management strategies. Although questions in these three areas show strong relationships to the adoption of many employee involvement, total quality and reengineering practices, they tend not to be strongly related to the adoption of pay for performance reward practices. This was true in the first year these questions were asked, 1996, as well as in 1999, and it is once again in 2002 (see Lawler, Mohrman & Benson, 2001, for the 1996 and 1999 results). Several significant correlations in the 2002 results are worth mentioning, however.

In the case of improvement strategies, there seems to be a consistent tendency for organizational structure changes to be related to the adoption of pay for performance practices. For example, outsourcing, using teams, adding and subtracting business units are all related to the greater use of rewards for performance. There also are several important relationships with respect to change strategies. The strongest relationship involves the degree to which organizations have a clearly stated business strategy that underlies their change efforts. Those organizations that do have a clearly stated business strategy are more likely to use pay for performance practices. In many respects this is not surprising, since having a clear business strategy provides the necessary foundation for pay for performance systems. Without a clear strategy it is difficult to know what kind of performance to reward and, therefore, what kind of pay for performance systems to build and develop.

The triennial survey, in addition to asking about rewards system practices, asks about other practices which support employee involvement and organizational effectiveness. It asks about the degree of information sharing, about the commitment of the organization to knowledge development, and about power sharing work design practices (Lawler, 1998). An analysis of these data from the 2002 survey show some significant relationships between the adoption of reward system practices and employee involvement practices having to do with information, knowledge and power. Not surprisingly, open pay information correlated significantly with the sharing of other kinds of business information, and with two organizational reward level pay for performance practices: stock ownership and profit sharing. The use of knowledge/skill-based pay correlated significantly with a commitment to knowledge development, as well as with the use of such power sharing practices as work

teams and job enrichment. Finally, power sharing correlated significantly with the adoption of profit sharing plans.

The overall picture that appears is one which shows that the adoption of numerous reward system practices in 2002 is related to management practices having to do with information sharing, knowledge development and power sharing. This supports the argument in the employee involvement literature that to have an effective employee involvement program, individuals need to have rewards, information, knowledge and power. Apparently, some organizations are committed to moving all four of these features of employee involvement to an increasing number of their employees.

Conclusion and Future Direction

Without question, the most dramatic trend since 1987 is the increased adoption by Fortune 1000 corporations of pay for performance programs. At the head of the list of programs that have increased are individual incentive plans. In 1987, only five-percent of the companies had over 60% of their employees on individual incentive plans. In 2002, 33% had over 60% of their employees on individual incentive plans. Also increasing significantly since 1987 is the use of stock option plans, employee stock ownership plans, profit sharing plans, gainsharing plans, and group and team incentives. Thus, it is fair to say that pay for all kinds of performance, individual, group, business unit and organization wide is more popular today than it was in 1987.

The most interesting question at this point in time is whether the popularity of pay for performance plans will continue to grow. There currently is room for all types of pay for performance plans to be adopted by more organizations. Only employee stock ownership plans typically cover 60% or more of the employees, and 27% of companies do not even

have one. Given the increased performance pressures that organizations are likely to face in the years ahead, greater use of pay for performance seems likely. It continues to be a potentially powerful way to affect behavior in complex organizations. The key question, of course, is how the popularity of the different types of pay for performance plans is likely to change.

Stock option plans obviously face a number of challenges. Their value is increasingly being questioned and shareholders are increasingly suggesting that they are being overused. More and more companies are expensing them, and as a result they may be resistant to granting large numbers of options. This may well lead to an increase in the use of stock ownership plans and perhaps a further growth in the use of profit sharing plans, since they are alternative ways to tie reward levels to company performance. Finally, there may well be a continued significant increase in the use of work group and team incentives. Organizations are increasingly using teams, and the best way to motivate effective team performance often is to reward them for their performance.

There is no reason to expect that the reward practices that are not related to paying for performance will show a significant increase in their use. If anything, one of them, employment security, is most likely to continue to decline in usage. It simply does not fit today's work environment and the kind of employment deal that most organizations can legitimately commit to (Lawler, 2003). There may well be an increase in knowledge and skill-based pay or, more likely, at least in competency based pay in companies that employ large numbers of knowledge workers. Competency-based pay may also be used more frequently with managers if more and more companies use competency-based leadership development approaches. Paying the person instead of the job increasingly makes sense

because of the increase in knowledge work and the importance of organizations managing the skills and competencies of individuals. This suggests there may also be an increase in the use of rewards for knowledge development and sharing knowledge. Rewarding this type of behavior fits well with the increased desire of organizations to gain competitive advantage by creating knowledge and managing it more effectively.

Overall, the reward practices in organizations are more likely to evolve than they are to radically change. Change in reward systems is difficult and a traumatic experience for most organizations, so it is unrealistic to expect rapid and radical change. Indeed as our comparison of the 1987 practices with 2002 practices shows change in comprehensible and explainable ways does occur, but it takes time.

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TABLE 1. PERCENTAGE OF EMPLOYEES COVERED BY PERFORMANCE-BASED REWARD PRACTICES

		MEAN	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	2.4	13	49	27	6	2	1	2
	1990	2.8	10	46	24	8	5	3	5
	1993	2.9	10	40	30	8	3	4	5
	1996	3.2	9	34	27	9	7	6	8
	1999	3.4	7	26	31	11	11	5	9
	2002	3.7	8	20	27	12	13	10	10
Work-Group or Team Incentives	1990	2.1	41	38	10	6	1	2	3
	1993	2.4	30	40	14	6	3	3	5
	1996	2.8	13	45	21	8	2	4	6
	1999	3.0	20	31	19	9	5	5	10
	2002	3.0	19	33	18	11	6	7	7
Gainsharing	1987	1.5	74	19	4	1	0	1	1
	1990	1.6	61	28	8	1	1	1	0
	1993	1.8	58	26	7	2	3	2	2
	1996	1.9	55	26	9	3	1	2	4
	1999	2.1	47	30	9	4	3	4	4
	2002	2.2	49	24	10	4	6	5	3
Profit Sharing	1987	3.1	35	20	11	4	5	10	15
	1990	3.2	37	19	7	4	6	10	17
	1993	3.3	34	23	7	4	3	11	19
	1996	3.6	31	18	7	3	9	13	20
	1999	3.4	30	16	18	2	6	10	19
	2002	3.7	28	18	7	5	9	13	20
Employee Stock Ownership Plan	1987	3.8	39	8	4	4	6	10	28
	1990	3.8	36	9	6	3	5	13	29
	1993	4.1	29	9	9	4	6	14	30
	1996	4.1	32	9	4	3	5	15	32
	1999	4.2	29	8	9	3	5	13	33
	2002	4.4	26	8	5	6	6	15	34
Stock Option Plan	1993	2.6	15	56	15	2	1	2	10
	1996	2.9	13	46	21	2	3	5	10
	1999	3.3	9	42	18	7	3	6	15
	2002	3.1	16	36	18	8	6	8	10
Non-Monetary Recognition Awards for Performance	1990	4.0	9	23	18	10	13	10	17
	1993	4.3	6	22	17	7	10	17	22
	1996	4.5	4	17	17	10	16	12	25
	1999	5.0	4	14	12	10	10	19	32
	2002	4.7	4	12	16	12	16	16	24

Note: Not all questions were asked in 1987 and 1990.

Mean based on 1 = None to 7 = All

Table 2. PERCENTAGE OF COMPANIES USING PERFORMANCE-BASED REWARD PRACTICES WITH MORE THAN 40 PERCENT OF EMPLOYEES

Number of Kinds of Rewards Provided	1990 (N = 313)	1993 (N = 279)	1996 (N = 212)	1999 (N = 143)	2002 (N=149)
0	29	24	18	21	14
1	38	41	30	28	24
2	24	21	32	26	27
3	8	8	16	17	21
4	2	5	3	6	12
5	0	1	1	2	1

Five possible kinds: individual incentives, profit sharing, gainsharing, employee stock ownership, work group or team incentives.

TABLE 3. PERCENTAGE OF EMPLOYEES COVERED BY REWARD PRACTICES

		MEAN	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	3.5	29	15	13	10	12	11	10
	1990	2.9	36	18	14	10	7	9	7
	1993	3.3	27	18	11	13	11	11	9
	1996	3.1	30	14	18	13	12	8	6
	1999	3.2	31	12	18	14	10	7	10
	2002	3.7	24	8	17	18	8	12	13
Knowledge/Skill- Based Pay	1987	1.7	60	25	7	2	2	2	2
	1990	1.8	49	34	11	2	1	1	1
	1993	2.1	40	37	12	4	2	2	3
	1996	2.1	38	40	13	2	4	1	2
	1999	2.0	38	36	20	2	2	1	1
	2002	2.1	44	30	12	6	2	2	3
Flexible, Cafeteria-Style Benefits	1987	2.4	66	7	4	3	2	6	13
	1990	3.2	46	12	5	4	5	9	20
	1993	4.0	32	9	7	4	7	12	30
	1996	4.1	32	7	6	5	5	11	33
	1999	4.5	25	9	7	3	6	11	40
	2002	4.3	26	9	5	5	12	12	31
Employment Security	1987	3.0	47	14	6	2	6	8	18
	1990	2.6	47	20	6	4	6	9	8
	1993	2.2	63	13	5	2	3	5	9
	1996	2.0	65	15	4	3	5	3	6
	1999	1.9	66	16	5	3	2	4	5
	2002	1.9	70	9	6	4	3	4	6
Open Pay Information	1993	3.4	34	17	8	7	6	9	20
	1996	3.6	30	18	6	7	8	10	21
	1999	3.7	31	14	7	5	12	10	22
	2002	3.5	27	17	11	11	6	11	16

Mean based on 1 = None to 7 = All

TABLE 4. PERCENTAGE OF COMPANIES USING KNOWLEDGE MANAGEMENT REWARD PRACTICES

		MEAN	Little or No	Some	Moderate	Great	Very Great
Rewards for Developing Knowledge Assets	1999	1.8	45	36	15	3	1
	2002	2.1	35	34	22	8	1
Rewards for Sharing Knowledge	1999	1.8	47	36	14	3	1
	2002	2.1	38	33	17	11	1

Mean is based on 1= Little or No to 5 = Very Great

TABLE 5. RELATIONSHIP BETWEEN EXTENT OF ADOPTION OF REWARD PRACTICES AND KNOWLEDGE MANAGEMENT OUTCOMES

	KNOWLEDGE MANAGEMENT OUTCOMES	
	Experience with Knowledge Management Overall	
	1999	2002
Rewards for Developing Knowledge Assets	.32***	.33***
Rewards for Sharing Knowledge	.28***	.25**

Correlation Coefficients

Key: ** = moderate relationship ($p \leq .01$)

*** = strong relationship ($p \leq .001$)

Exhibit 1

Pay/Reward Systems

1. **All-salaried pay systems**: A system in which all employees are salaried, thus eliminating the distinction between hourly and salaried employees.
2. **Knowledge/skill-based pay**: An alternative to traditional job-based pay that sets pay levels based on how many skills employees have or how many jobs they potentially can do, not on the job they are currently holding. Also called pay for skills, pay for knowledge, and competency-based pay.
3. **Profit sharing**: A bonus plan that shares some portion of corporation profits with employees. It does not include dividend sharing.
4. **Gainsharing**: Gainsharing plans are based on a formula that shares some portion of gains in productivity, quality, cost effectiveness, or other performance indicators. The gains are shared in the form of bonuses with all employees in an organization (such as a plant). It typically includes a system of employee suggestion committees. It differs from profit sharing and an ESOP in that the basis of the formula is some set of local performance measures, not corporation profits. Examples include the Scanlon Plan, the Improshare Plan, the Rucker Plan, and various custom-designed plants.
5. **Individual Incentives**: Bonuses or other financial compensation tied to short-term or long-term individual performance.
6. **Work group or team incentives**: Bonuses or other financial compensation tied to short-term or long-term work group, permanent team, or temporary team performance.
7. **Non-monetary recognition awards for performance**: Any non-monetary reward (including gifts, publicity, dinners, etc.) for individual or group performance.
8. **Employee stock ownership plan**: A credit mechanism that enables employees to buy their employer's stock, thus giving them an ownership stake in the corporation; the stock is held in trust until employees quit or retire.
9. **Flexible, cafeteria-style benefits**: A plan that gives employees choices in the types and amounts of various fringe benefits they receive.
10. **Employment security**: Corporation policy designed to prevent layoffs.
11. **Open pay information**: A communication program that gives employees information about pay policies, ranges, increase amounts, bonus amounts and job or skill evaluation systems. May or may not include information about what specific individuals are paid.

12. **Stock option plan:** A plan that gives employees the opportunity to purchase company stock at a previously established price.