A guide to successfully planning and implementing a total rewards system

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Implementing Total Rewards Strategies

SHRM Foundation's Effective Practice Guidelines Series

Implementing Total Rewards Strategies

A guide to successfully planning and implementing a total rewards system

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with assistance from Erin E. Coyne

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Foreword

As a busy HR professional, you probably find it difficult to keep up with the latest academic research in the field. Yet knowing which HR practices have been shown by research to be effective can help you in your role as an HR professional.

That's why the SHRM Foundation created the *Effective Practice Guidelines* series. These reports distill the latest research findings and expert opinion into specific advice on how to conduct effective HR practice. Written in a concise, easy-to-read style, these publications provide practical information to help you do your job better.

The *Effective Practice Guidelines* were created in 2004. The SHRM Foundation publishes new reports annually on different HR topics. Past reports, available online at www.shrm.org/foundation, include *Performance Management*, *Selection Assessment Methods* and *Employee Engagement and Commitment*.
You are now reading the fourth report in the series: *Implementing Total Rewards Strategies.*

For each report, a subject-matter expert with both research and practitioner experience is chosen to be the author. After the initial draft is written, the report is reviewed by a panel of academics and practitioners to ensure that the material is comprehensive and meets the needs of HR practitioners. An annotated bibliography is included with each report as a convenient reference tool.

This process ensures that the advice you receive in these reports is not only useful, but based on solid academic research.

Our goal with this series is to present relevant research-based knowledge in an easy-to-use format. Our vision for the SHRM Foundation is to "maximize the impact of the HR profession on organizational decision-making and performance, by promoting innovation, education, research and the use of research-based knowledge."

We are confident that the *Effective Practice Guidelines* series takes us one step closer to making that vision a reality.

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Acknowledgments

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Robert Heneman is a recognized expert in the field of total rewards strategy. His work has been reported in *The Wall Street Journal*, *USA Today*, *Money*, *Newsweek*, and the *Washington Post*.

Dr. Heneman is a professor of management and human resources in the Fisher College of Business at The Ohio State University. He has been a strategic compensation consultant for more than 60 public- and private-sector organizations throughout the world—including IBM, BancOne, Time Warner, Nationwide Insurance, Honda R&D, Whirlpool, Worthington Industries, U.S. Government Office of Personnel Management, and The Limited. He is the author of three compensation books—*Merit Pay: Linking Pay Increases to Performance Ratings*, *Business-Driven Compensation Policies: Integrating Compensation Systems with Corporate Strategies*, and *Strategic Reward Management: Design, Implementation and Evaluation*—and has published more than 80 articles in professional journals.

Prior to joining the Ohio State University, he worked as a human resource specialist for Pacific Gas and Electric Company. Dr. Heneman serves on the editorial boards of a number of journals, including *Human Resource Management Journal*, *Human Resource Management Review* and *Human Resource Planning*. He has been selected for the Outstanding Teacher Award in the Masters in Labor and Human Resources Program numerous times by Ohio State students. He was also honored as the first recipient of WorldatWork's Distinguished Total Rewards Educator Award. Dr. Heneman earned his Ph.D. in labor and industrial relations from Michigan State University, and an M.A. in labor and industrial relations from the University of Illinois at Urbana-Champaign.

The right total rewards system—a blend of monetary and nonmonetary rewards offered to employees—can generate valuable business results.

Implementing Total Rewards Strategies

Rothschild Gourmet Foods is a small, privately owned company based in the American Midwest. It manufactures gourmet food products such as jams, olive oil and sauces, and has been in operation for 13 years. As a result of a company-wide change initiative, Rothschild managed to boost sales, slash controllable costs, increase product quality, and raise employees' performance-appraisal ratings. How did they do it? The company changed the ingredients in its total rewards system (Heneman, DeSimone, Dooley & Jones, 2002). In addition to offering flexible work schedules and other nonmonetary rewards, Rothschild skillfully implemented an organization-wide incentive plan based on corporate performance.

Rothschild isn't the only company that has discovered firsthand the power of a well-designed and well-executed rewards program. Indeed, as far back as 1996, an article in *USA Today* (Neuborne, 1996) proclaimed a revolution in the rewards that organizations were offering employees. Instead of awarding employees pay increases and other incentives simply for seniority, the so-called "New Pay" linked rewards to achievement of the organization's strategic objectives. HR professionals and other managers began experimenting

with innovative types of rewards in the workplace, including skill-based pay and goal sharing. And they discovered that the right total rewards system—a blend of monetary and nonmonetary rewards offered to employees—can generate valuable business results. These results range from enhanced individual and organizational performance to improved job satisfaction, employee loyalty, and workforce morale.

Since the publication of the *USA Today* article, organizations of all stripes have continued exploring innovative reward plans—particularly with an eye toward aligning workers' interests with company goals. Today, this revolution manifests itself in two ways. First, organizations have moved beyond merely experimenting with new reward programs and have begun actually using them (Lawler, Mohrman, & Benson, 2001). Second, these plans have shown increasing variety. For example, reward systems now routinely contain both monetary and nonmonetary components—some of which (such as recognition) seldom saw use even as recently as a few years ago.

As interest in and use of total rewards systems has intensified, researchers have stepped up their examination of the ways in which

organizations put such plans into action. And they have made an interesting discovery: The specific practices companies use to implement total rewards programs— that is, to design, deliver, executive, and evaluate them—play a critical role in the programs' effectiveness. This is true not only for the older, traditional rewards plans (Heneman & Werner, 2005) but also for more recent systems (Beer, Cannon, Baron, & Dailey, 2004).

Yet implementing total rewards programs raises daunting challenges. Practitioners who ignore these challenges do so at their—and their organizations'—peril. Drawing on the findings of empirical research, this report provides guidelines for HR professionals and other senior managers seeking to revise their organizations' total rewards systems or design entirely new plans.

Challenging Questions

To implement a total rewards plan, business leaders must tackle a broad range of challenging questions—everything from who will design the plan and what types of rewards it will include to how the plan will be funded and under what business conditions the plan is intended to operate. When executives overlook one or more of these questions, they risk developing a plan that delivers mediocre results once it's implemented—as the following three stories reveal:

- **The Profitless Profit-Sharing Plan.** A large chemical manufacturer and distributor developed a new profit-sharing system for its employees. The project team took great care to use compensation principles agreed upon by compensation professionals and devoted a year to designing the program. But the team members neglected to ask a crucial question: How will the plan work during an economic downturn? With much fanfare, the company announced the plan—and employees eagerly anticipated their first profit-sharing checks. As it turned out, the organization's performance (as measured by profit) proved dismal during the plan's first measurement period. Employees received no bonus checks, and their enthusiasm gave way to resentment and skepticism. The company abandoned the plan. If it had acknowledged the possibility of an economic downturn and better communicated the ramifications of such a downturn for payouts to employees, it might have avoided the backlash.

- **The Missing Appraisal System.** A federal government agency enacted a pay-for-performance plan that pegged individual pay increases to employees' performance as assessed by a formal appraisal system. However, the agency launched the plan *before* putting an organization-wide appraisal system in place. Managers had to hastily define performance measures by which to assess their employees' contributions and thereby determine salary increases. This haphazard development of measures led to a highly subjective appraisal system that employees saw as unfair. Just one year after the plan was implemented, the agency eliminated it.

- **The No-Go Goal-Sharing Plan.** In a heavily unionized organization, top management decided to initiate a new goal-sharing plan that awarded cash bonuses to employees based on their facility's business performance. The plan was piloted at one facility, and a research team set out to track the business performance of the plant against that of a similar facility not using the plan. The team found that the performance of the facility using the goal-sharing plan exceeded that of the other facility—suggesting that the organization should roll out the new plan at its remaining facilities. But the implementation team had not consulted union leaders at these other plants on the practical implications of the goal-sharing program. And even though goal sharing had proven its mettle during the pilot, the union opposed a company-wide rollout.

Total Rewards: A Closer Look

In recent years, the phrase "compensation and benefits" has given way to "total rewards"—which encompasses not only compensation and benefits but also personal and professional growth opportunities and a motivating work environment (for example, recognition, valued job design, and work/life balance). What explains this broader view of rewards? First, stiffer competition in business has made it difficult for cost-conscious organizations to offer higher wages and more benefits each year. Employers have had to find alternative forms of rewards that cost less to implement but that still motivate employees to excel. Second, organizations have become much more strategic in their management of human resources (Barney & Wright, 1998)—including integrating their various human resource functional areas. For instance, some companies now treat compensation and training as rewards that must be managed together rather than separately by different HR teams. The "Total Rewards Strategies" chart sheds light on the wide range of strategies that can make up a total rewards program.

To implement total rewards strategies successfully, organizations must follow a disciplined process (Ledford & Mohrman, 1993), which is depicted in "Implementing

Total Rewards Strategies

Total Rewards Strategy	Definition
Compensation	
Base pay	Wages and salaries
Merit pay	Base-pay increases based on employee performance
Incentives	Cash bonuses based on employee performance
Promotions	Base-pay increases based on potential to perform new job
Pay increases	Base-pay increases based on length of service with the organization
Benefits	
Health and welfare	Payment for injuries and illness both on and off the job
Paid time off	Payment for vacation time or excused days from work
Retirement	Payment for work no longer performed based on length of employment
Personal Growth	
Training	Skill development through on- or off-the-job instruction
Career development	On-the-job coaching to develop skills
Performance management	Ongoing goal setting and feedback to develop skills

"Total rewards" encompasses not only compensation and benefits but also personal and professional growth opportunities and a motivating work environment.

a Total Rewards Program: Four Phases" (see below). The process starts with assessment. In this phase, the project team gathers data to evaluate the effectiveness of the organization's current total rewards system. The data guides the design phase, during which the team identifies and analyzes potential reward strategies. In the execution phase, total reward strategies are put into operation. Last, the team evaluates the effectiveness of the strategies that have been executed.

Clearly, implementing a new total rewards program is akin to carrying out any large-scale transformation initiative. Research on organizational change can provide some guidance. One study examined a 12-plant manufacturing division of a multibillion-dollar food-products firm (Ledford & Mohrman, 1993). The firm used a learning model to guide the change effort. First, it laid the foundation for change by educating stakeholders about the intervention, clarifying the

firm's values, and diagnosing organizational systems relative to the values of the organization. Second, the firm designed, implemented, and evaluated changes to those systems. The cycle was continually repeated, as illustrated in the diagram below. This process led to deeper learning within the organization. To evaluate the results of this learning model, the researchers collected attitudinal data at two points in time. Findings suggested that the change initiative had led to increases in job variety, supervisory participation, influence over planning and scheduling, and other positive outcomes.

The following sections take a closer look at how you and other HR professionals in your organization can take a total rewards initiative through each of the four phases in the implementation process.

Implementing a Total Rewards Program: Four Phases
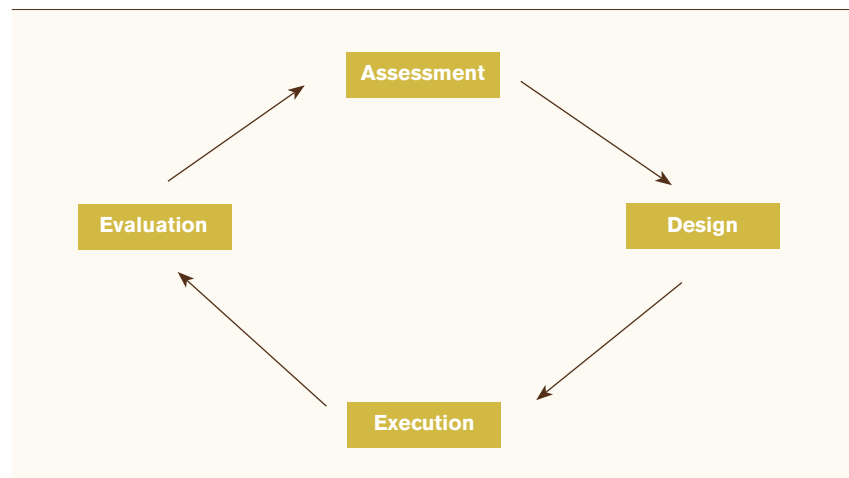
Before You Begin:
Assembling The Right Project Team

The most successful total rewards initiatives are guided by a project team from start to finish. By assembling the right team, you greatly boost your chances of success. The following guidelines can help.

NAMING THE PROJECT LEADER

As your first step in assembling the team, think about whom you'll designate as the project leader. The best leaders are senior HR professionals with project management and total rewards experience—they encourage ongoing communication between the project team and top management, and lend credibility to the project.

SELECTING ADDITIONAL MEMBERS

The team might include a consultant from outside the organization. This individual can bring technical knowledge to the project, wisdom gained from experiences with similar organizations, and project management skills. An outsider may also have a more objective view of the implementation process than an insider.

In addition, the project team should show employee representation. If your organization has unionized employees, then the team should include a union official. By involving the union in the project, you will stand a much better chance of gaining its support for proposed total rewards strategies. Likewise, be sure the project team includes one or two high-performing and well-

liked employees from the nonunion workforce. By representing the interests of nonunion employees who will be affected by the new total rewards plan, these individuals further increase your chances of gaining buy-in from the workforce. If you are concerned that the presence of a nonunion employee on the project team would create conflict between the two parts of the workforce, consider the use of an employee focus group instead.

You will need team members who bring expertise in finance, employment law, and HR information and payroll systems, as well as someone to represent the middle and lower layers of management in your organization. Last, the team should include several HR professionals with extensive total rewards experience and the ability to develop policies and procedures. If your organization is small, you can designate one person to handle a number of these roles. You can also consult a legal expert during and after the design phase rather than throughout the entire implementation process.

CLARIFYING TEAM MEMBERS' ROLES

Each member of the project team should start off with a clear understanding of his or her role. "Sample Team Structure" shows how one project team organized themselves.

As this figure suggests, ultimate authority for the total rewards

project resides with senior management, while the project task force and consultants coordinate the effort. A separate subcommittee, each headed by a project team member who reports back to the larger task force, takes responsibility for each element of the company's compensation system. You can further clarify team members' roles by developing a charter that spells out who will perform which tasks during the implementation process, how the team will work together, and how members will make decisions.

Sample Team Structure

```
Senior Management ───┐            [Base Pay Subcommittee]
                     │            [Pay for Performance Subcommittee]
Project Task Force ──┤            [Overtime Pay Subcommittee]
                     │            [Geographical Differential Pay Subcommittee]
Consultants ─────────┘            [Bonus Pay Subcommittee]
                                  [Work/Life Balance Subcommittee]
```
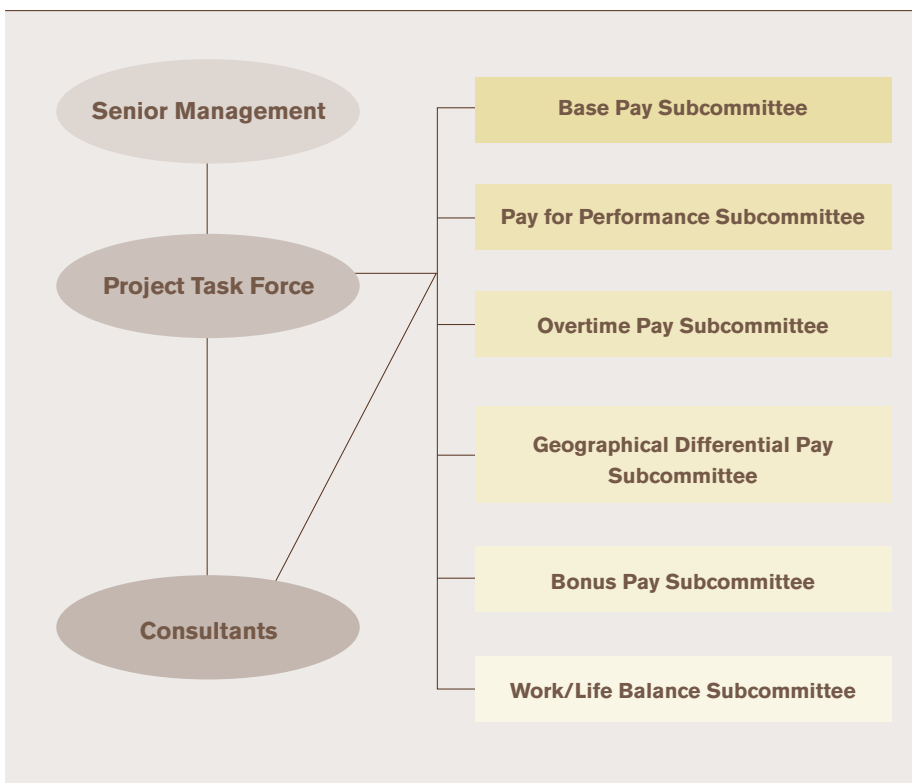
PHASE ONE: ASSESSMENT

Once you've assembled your project team, it's time to start the implementation process.

During the assessment phase, the project team evaluates the company's current total rewards system and generates ideas for improving it. To carry out this phase effectively, your project team must take responsibility for a lengthy series of tasks. These tasks include conducting focus groups and industry benchmark surveys, examining current reward strategies and employee attitudes toward them, reviewing rewards-related literature, and creating a report documenting the team's findings and recommendations.

CONDUCTING FOCUS GROUPS

The project team can use focus groups to begin gathering data on the effectiveness of the company's current total rewards system and generating ideas for ways to enhance the system. These groups can raise team members' awareness of all issues the team must address during the implementation process. To get the most useful information from focus groups, assemble one for management and one for employees. Encourage participants to voice concerns and questions about the current total rewards system. Focus groups can also help to generate survey items and test pilot surveys. Ensure that focus-group participants truly represent the employees who will be impacted by changes in the total rewards plan.

USING INDUSTRY BENCHMARK SURVEYS

As another source of data for the assessment phase, the project team can benchmark total rewards practices by successful organizations (to see whether any of these merit adoption). Many employers are willing to share this kind of data because they receive an anonymous copy of the benchmarking results. In collecting benchmark data, ensure that your project team members ask which total rewards practices the survey respondent's organization uses, as well as how effective these practices are. Appendix A contains a sample benchmark survey.

EXAMINING CURRENT POLICIES

Most organizations have an extensive set of policy documents that can provide data for the total rewards project team. These archival records can shed valuable light on an employer's stance toward total rewards issues. Strategic and operational plans may show how total rewards fit into the enterprise's larger business goals—such as lowering turnover or attracting workers with specific skills. Manuals may contain the actual policies and procedures for administering current total rewards. Previous associate surveys may show employee attitudes toward total rewards. And HR databases should contain information on employees' actual pay levels as well as market pay rates. Total rewards systems are often accompanied by various forms (for example, performance-appraisal worksheets).

The project team can use these forms to determine the type of information the organization gathers to make rewards decisions.

SURVEYING EMPLOYEE ATTITUDES TOWARD REWARDS

Surveying employees' attitudes toward total rewards can generate additional valuable information for the project team during the assessment phase. The team can conduct such surveys using a well-developed instrument called the Pay Satisfaction Questionnaire (PSQ), which measures attitudes toward base-pay levels, pay raises, rewards structures and administration, and benefits (PSQ, H. Heneman & Schwab, 1985). A lump-sum bonus satisfaction scale complements the PSQ (Sturman & Short, 2000).

The PSQ has long been used by many companies and has excellent reliability (consistency of findings) and validity (it measures what organizations intend it to measure). But because this instrument focuses on base pay, your project team will need to add supplementary questions to gauge attitudes toward matters such as pay-increase amounts, opportunities, forms and requirements.

If your project team adds questions to the standard PSQ, it will need to calculate the reliability and validity of these new dimensions. Care must also be taken in the administration of the survey. A systematic procedure should be developed to report back the aggregate survey results to respondents while protecting

Surveying employees' attitudes toward total rewards can generate additional valuable information for the project team during the assessment phase.

Employees need to know that their input was carefully considered, otherwise you may lose valuable support for the project.

confidentiality. Employees need to know that their input was carefully considered; otherwise you may lose valuable support for the project. Failure to incorporate employee feedback could jeopardize the entire implementation project as employees may come to resent the new compensation system.

REVIEWING THE LITERATURE

The total rewards project team can gain additional insight during the assessment phase by reviewing the many "how to" articles and case studies published on the subject. Good sources of such literature include edited books, technical research journals, human resource management publications, and business periodicals. Probably the best way to begin identifying relevant sources is to visit the Web sites for WorldatWork (www.waw. org) and the Society for Human Resource Management (www.shrm. org). WAW and SHRM provide objective reviews of articles and books on the subject of total rewards practices. They also publish their own materials on the subject.

WRITING THE ASSESSMENT REPORT

After collecting data from various sources, the project team writes an assessment report. First, team members should check the reliability of the data they've gathered. If the data are not consistent across the different sources, further investigation (such as conducting additional employee interviews) can help resolve discrepancies.

Second, with input from senior management, the team should consider how the current total rewards program works versus how the organization would like it to work in the future. Third, team members draft a "compensation philosophy" statement that will guide development of new total rewards strategies. This statement should address questions such as:

- Who should be eligible for rewards?

- What kind of employee behaviors and values should be rewarded?

- What types of rewards would work best?

- How will the total rewards system be funded?

- How much should employees participate in designing and implementing our new total rewards system?

- What role should the union play in designing and implementing the new system?

- What is the estimated time frame for each of the remaining phases in the implementation of the new system?

- What approvals are necessary to implement the system and at what points in the implementation process should those approvals be obtained?

PHASE TWO: DESIGN

During the design phase, the project team identifies which employee and organizational attributes to reward

and which types of rewards to offer. The team should consider the full range of reward strategies, including compensation, benefits, personal and professional development, and work environment.

COMPENSATION

Compensation comprises three major components: pay level (base wage or salary), pay increases, and incentives (cash bonuses) (Gerhart & Rynes, 2003). The sections following examine each of these components in turn.

Pay Level. Most organizations follow an elaborate process to establish pay level (R. Heneman, 2001). This process starts with job analysis—gathering information about the attributes of specific roles and the people holding them. The end product of this analysis is a *job description* (a summary of the role's duties and responsibilities) and a *job specification* (details explicating the knowledge, skills, abilities, and other attributes of the person needed to perform those duties and responsibilities).

Next, the organization determines the value of the work spelled out in the job descriptions and specifications. Value depends on how important a particular job is to the employer's competitive strategy and how similar organizations view this same role. The organization conducts job evaluations to determine the internal value of jobs relative to the company's strategy. Salary surveys are conducted to look at average salaries paid and to determine the external value of these same jobs relative to the rates paid by similar organizations. The company then combines the data from the job evaluations and salary surveys to define pay grades for each position. Pay grades specify a range of values assigned to a job. The uppermost value is called the maximum, while the lowermost

What Should You Say About Pay?

A recent narrative review of literature (Colella, Paetzold, Zardkoohi, & Wesson, 2007) shed light on the costs and benefits of withholding pay information from employees (i.e., pay secrecy).

Costs of Secrecy

- Employees question the system's fairness.
- They overestimate pay levels received by colleagues.
- Trust in the organization erodes.
- Motivation decreases.
- Lack of information creates inefficient labor markets.

Benefits of Secrecy

- Conflicts between employees or between employees and managers regarding pay occur less frequently.
- Organizations can correct pay inequities without employees' knowing.
- Competition between employees decreases.
- Employees have more privacy.
- Lack of information about other employees' pay reduces turnover.

The Middle Ground

Fortunately, there is a middle ground between complete secrecy and total openness regarding pay. Organizations can reveal some but not all pay information. For example, they can communicate minimums, midpoints, and maximums in pay grades while keeping individual salaries private. (Note that some states, such as Ohio, require state agencies to publish employees' salaries.) If your organization decides to tread this middle ground, make sure you have a well-developed compensation system. Otherwise, employees may not trust that the system is fair.

Satisfying Employees with Pay

A recent empirical study (Williams, McDaniel, & Nguyen, 2006) found that employees felt more satisfied with their pay level when they had:

- Positive perceptions of pay for performance

- Positive perceptions of their job design

- Larger base pay

- Larger pay increases

- Perceptions of pay fairness

value is the minimum. In general, the more that labor costs can be passed on to the consumer, the higher the maximum. Meanwhile, the minimum is often the lowest level that the organization can pay for the job and still attract enough employees to the organization (Milkovich & Newman, 2006).

In conducting market surveys, keep in mind that government regulation stipulates some aspects of how your team will collect and report such data (Shea, 2006). For example, be aware of relevant antitrust laws, which forbid use of salary surveys to "price fix" jobs in a certain geographic region.

In addition to defining these traditional pay ranges, an organization can use two more methods to determine pay level: skill-based pay and broadbanding. If an employer uses *skill-based pay*, it sets pay level solely on the

basis of a job's qualifications rather than the qualifications plus the job description. Skill-based pay enables a company to reward employees for performing multiple tasks in one role rather than just those indicated in a job description. In one well-designed field study (Murray & Gerhart, 1998), an organization that used skill-based pay in one facility enjoyed 55% higher productivity and 17% lower labor costs than a comparable plant that did not use skill-based pay.

If an employer uses *broadbanding*, it establishes very large pay ranges. The typical pay range usually has a maximum that is roughly 40% above the minimum. With broadbanding, the maximum can be anywhere from 100% to 300% above the minimum. Broadbanding gives organizations maximum flexibility in assigning pay levels to jobs. In one study, about 80% of the HR professionals responding to a survey saw broadbanding as effective for their organization, though the researchers did not

measure organizational outcomes such as productivity and labor costs (Abosch & Hand, 1994; 1998). Though broadbanding definitely has its advantages, it can also lead to increased labor costs (Fay, Schulz, Gross, Vande Voort, 2004). To avoid paying higher pay levels than warranted, employers must establish a rigorous performance management system. The right system can help ensure that only those contributing the most value to the organization receive the highest levels in the pay range for their job.

In one study of three pilot projects in the U.S. federal government, wages did increase in agencies that paid through broadbanding, as compared with wages for a control agency without broadbanding (Shay, 1997). But this cost was offset by low intention to leave the organization, improved attitudes toward pay, and higher performance overall by the pilot agencies.

The question of how to determine pay levels brings up another concern:

How Big a Pay Increase?

About 11 studies have explored the question of how big a pay increase must be to improve employee attitudes and behaviors. The findings range from 4% to 12% of base salary. Yet most pay increases fall below this range. In addition to providing these figures, one group of researchers (Mitra, Gupta, and Jenkins, 1997) noted several methodological flaws with the studies they reviewed. To minimize these flaws, the authors used an experimental simulation to assess the magnitude of the raise in base pay required to positively influence employee attitudes and behaviors. The results showed that an increase in base pay of at least 7% was needed. This study's sample consisted of students; however, they were hired and paid as actual employees in the study.

What Do Employees Want?

Some business leaders have argued that employees want new forms of pay (such as team-based pay) more than traditional forms (for example, base salary or merit pay). A study of college students suggested that this is not the case (Cable & Judge, 1994). Another study of the general population of working employees generated similar findings (LeBlanc & Mulvey, 1998). According to these two studies, employees actually prefer:

- **Flexible benefits rather than a standard benefits package**

- **A small ratio of variable pay to base pay**

- **Individual rewards (such as merit pay) rather than group rewards**

How much should employees know about one another's pay? "What Should You Say About Pay?" (p. 9) explores the pros and cons of sharing information about pay levels with the workforce. "Satisfying Employees with Pay" offers additional guidelines.

Pay Increases. Organizations can provide pay increases through two means: merit pay and promotion pay. With *merit pay*, the employer correlates the pay increase with performance ratings: The higher the performance rating, the higher the pay increase. To minimize the cost of merit pay, companies can link merit raises to the employee's position in the pay grade: The higher the pay level of the employee in the range, the smaller the merit increase.

Merit-pay plans have generated mixed results. Empirical research has consistently shown a connection between these plans and employee attitudes (R. Heneman & Werner, 2006). In particular, there is a positive correlation between merit pay and pay satisfaction. In turn, pay satisfaction leads to better attendance, retention and union vote (H. Heneman & Judge, 2000). But merit pay's impact on productivity is mixed. Some studies have found a positive correlation; others, a negative one. Clearly, more research is needed to further illuminate this relationship.

With *promotion pay*, a company considers criteria such as an employee's previous performance, anticipated performance, difficulty of the job, and position in the pay range. Every organization seems to make promotion-pay decisions differently, so it's difficult to draw lessons from their practices. Moreover, there are no empirical studies in this area showing which factors most employers use to determine the size of a promotion increase, the reasons for the increase, and the outcomes associated with such increases. "How Big a Pay Increase" and "What Do Employees Want?" provide additional insight into this subject.

Incentives. Incentives take the form of a cash bonus or stock. To award incentives, organizations use more objective measures of performance, such as an employee's productivity, rather than performance ratings (R. Heneman & Werner, 2006). Because incentives are not linked to base salary, they do not compound over time. Therefore, they are less costly for employers than merit pay and promotion pay. Companies can award incentives based on individual, group, or organizational performance. "An Overview of Incentives" compares the advantages and disadvantages of these criteria.

Individual incentives provide a cash or stock payment for performance measured at the level of the individual employee. Classic examples of individual incentive plans would be sales commissions and piece-rate pay systems. With this approach, the greater the person's job performance, the greater the cash bonus he or she receives. Individual incentives exert the most powerful impact on productivity of all total rewards practices, usually increasing productivity by about 30% (Jenkins, Mitra, Gupta, Shaw, 1998; Gupta & Mitra, 1998). However, they do not ensure a commensurate increase in product quality. Also, they don't promote teamwork, because they emphasize individual rather than team performance. Lastly, many jobs do not have readily available metrics for assessing individual performance. Thus an employee's contribution may be difficult to measure.

Group incentives provide a cash or stock payout for performance measured at the group or work-team level. Classic examples of group incentives would be gain sharing

An Overview of Incentives

Criteria	Incentives	Advantages	Disadvantages
Individual performance	Sales commissions Piece-rate pay	Exert most powerful impact on productivity (30% increase)	Do not promote teamwork or ensure a commensurate increase in product quality May be difficult to measure
Group performance	Gain-sharing, goal-sharing, and team-based incentive plans	Encourage teamwork	Yield a moderate impact (13%) on productivity
Organizational performance	Profit sharing and stock sharing, including broad-based stock options, stock-purchase programs, and employee stock- ownership plans	Increase shareholder returns and company profits	Generate a small increase (6%) in productivity

(incentives provided to reduce costs, popular in the health care industry); goal sharing; and team-based incentive plans. Group incentives have a more moderate impact on productivity than individual incentives do, yielding increases of about 13% (Welbourne & Gomez-Mejia, 1995). But they reinforce the importance of teamwork.

Organizational incentives provide cash or stock to employees based on the overall performance of the organization or business unit (sector, division, department, or plant). Classic examples of these incentive plans are profit sharing and stock sharing, which may include broad-based stock options, stock-purchase programs, and employee stock-ownership plans. A review of the available research reveals that profit-sharing plans generate a relatively small increase in productivity: about 6% (Blinder, 1990). Why the meager impact? Most employees probably see organizational performance as outside their control, so they are less motivated to perform. On the other hand, some research indicates that stock sharing results in positive shareholder returns (Gerhart & Rynes, 2003). Indeed, one study found that organizations with stock-ownership plans were about 5% more profitable than organizations without these plans (Blasi, Conti, & Kruse, 1996).

"Introducing Incentive Pay at SimCom International" reveals the kinds of results organizations can generate through savvy implementation of incentive pay.

BENEFITS

Owing to their hefty price tag, benefits such as health care and insurance constitute an increasingly large proportion of total rewards costs. As a result, employers want to ensure an acceptable return on their investment in the form of employee performance. In designing a benefits package, organizations must consider two important issues: how they will communicate the details of the package to employees, and how much choice employees will have in selecting benefits that interest them.

Communication. Research has clearly shown that employees in many organizations are unaware of or do not understand the benefits offered by their employer (Dreher, Ash, & Bretz, 1988). When employees lack this understanding, they tend to be dissatisfied with the benefits. And dissatisfied employees are less likely to attend work, more likely to leave the company, and more likely to vote for a union (H. Heneman & Judge, 2000). Acknowledging this problem, organizations have begun providing employees with individual benefit statements so they can periodically see the cash value of their benefits.

Choice. Studies also suggest that flexible benefits plans can increase employees' satisfaction with the system. With these types of benefits, employees can select from a menu

Introducing Incentive Pay at SimCom International

A small, privately held company with locations in Orlando and Phoenix, SimCom International builds flight simulators for training pilots on twin-engine propeller planes as well as small jets. The company has about 80 employees organized into teams based on functions: production, marketing, sales, training, computer services, and clerical. SimCom has enjoyed rapid growth. In 1990, it trained 54 pilots. In 1997, that number had risen to about 2,650, and SimCom was recognized with a "Best of the Best" award from Flying magazine.

In 1992, during its start-up days, SimCom's senior management considered introducing an incentive-pay plan. At that time, its current pay system was based on market rates, with pay increases linked to seniority. The company's new president expected associates to act like owners and to focus on providing excellent customer service. The president and owner thought that incentive pay might help boost performance on these criteria.

The company defined a three-phase project for introducing incentive pay. In Phase One, the project team developed a survey to assess possible desirable outcomes that might come from basing individual incentive pay on the company's profitability and individual performance ratings. In Phase Two, the team designed and implemented the new pay system. In Phase Three, management assessed the effectiveness of the new system by comparing business outcomes before the system was in place with outcomes after implementation.

The surveys gauged employees' attitudes toward:

• **Job satisfaction**

• **Pay satisfaction**

• **Performance ratings**

• **Pay for performance**

According to the findings, job satisfaction, pay satisfaction, and pay for performance perceptions significantly increased after the new system was put in place, but performance ratings declined. However, executives attributed this decline to managers' increased commitment to an accurate rating process–which caused them to be less lenient in their ratings than before.

Source: Heneman, Eskew & Fox (1998)

the benefits they receive based on what they value most at different life stages. For example, retirement benefits and health care are less important to workers in their 20s, but become increasingly important as employees age. One study at a financial services firm showed that employee satisfaction with benefits significantly increased following the implementation of a flexible plan (Barber, Dunham, & Formisano, 1992). This increase, the authors note, may have stemmed in part from the extensive communication and training that accompanied the introduction of the flexible plan.

PERSONAL AND PROFESSIONAL DEVELOPMENT

Personal and professional development opportunities—such as training, career development, and performance management—can constitute valuable rewards for employees. But the value of these rewards for an organization is less clear. From the employer's perspective, personal and professional development is good only if it enables workers to acquire specific skills that add value to the enterprise. Valuable skills are those that give an organization unique capabilities that rivals can't copy—and thus afford the employer a sharp competitive edge (Barney & Wright, 1998). Clearly, development opportunities that give workers general skills that can be easily transported to other organizations do not provide strategic value.

For these reasons, companies must walk a fine line in including

Provide development experiences valued by employees that also serve the organization's strategic needs.

personal and professional growth opportunities in their total rewards systems. The goal? Provide development experiences valued by employees that also serve the organization's strategic needs.

WORK ENVIRONMENT

A positive work environment can be an important component in an organization's total rewards strategy. Work environment includes job design, recognition, and work/life balance. The sections below consider each of these in turn.

Job Design. Most people think of job design in terms of the physical characteristics of a work setting, such as office size. But job design also includes psychological characteristics—in the form of employees' *perceptions* of their work. These characteristics include perceptions of whether the work is meaningful or challenging, whether the job affords autonomy, and whether the person identifies with the role. According to the job characteristics model (Hackman & Lawler, 1971), positive perceptions of work lead to higher employee motivation and, in turn, better on-the-job performance. A review of all the studies conducted to test this theory showed a modest correlation between perceptions of psychological characteristics of a job and employee motivation, and a weak correlation between these perceptions and employee performance (Fried & Ferris, 1987). Research also suggests that job design is most effective when other total rewards strategies are poorly developed. If other reward strategies are operating

effectively, then job design simply becomes redundant (Morgeson, Johnson, Campion, Medsker & Mumford, 2006).

Recognition. Most employee recognition systems provide rewards that are relatively inexpensive compared to compensation, benefits, and personal and professional growth. Given heightened world competition and the need to minimize labor costs, employers today are placing as much emphasis on recognition as financial incentives—sometimes even more (Nelson, 1994; Barton, 2006). Interestingly, according to some studies, many employees prefer nonfinancial rewards over financial ones (Amabile, Hill, Hennessey, & Tighe, 1994). Note, however, that these studies ask individuals to self-report their preferences. Though people *say* that nonfinancial rewards are more important to them, evidence about what people actually *do* shows that pay is equally if not more important to most employees (Rynes, Gerhart, & Minette, 2004).

Still, studies also show that recognition can exert a powerful impact on employee performance (Stajkovic & Luthans, 1997; 2001) and that it may influence organizational effectiveness as much as financial incentives do. Indeed, one study of fast-food franchises found that, over time, nonfinancial incentives had just as large an impact on profitability and customer service as financial incentives (Peterson & Luthans, 2006). In addition, financial and nonfinancial rewards apparently become more effective when used together rather than separately (Stajkovic & Luthans, 2003).

Work/Life Balance. Although work/life balance programs take a number of different forms, most of the research to date has focused on flexible work schedules and compressed work weeks. One extensive review of empirical studies on these forms (Baltes, Briggs, Huff, Wright, and Newman, 1999) showed that such rewards had a mixed impact on certain organizational priorities. For example, the largest demonstrated impact was on absenteeism followed by productivity. Flextime had a bigger impact on employees than on managers. The more flexible a company's work schedules, the greater the positive impact on organizational priorities.

Turning to compressed workweeks, the researchers again saw a moderately positive impact. Compressed workweeks had the largest positive effect on job satisfaction and the next-largest effect on supervisory performance ratings. However, they had almost no impact on absenteeism or productivity.

In short, it seems that flexible work schedules exert a more positive impact on performance than on employee attitudes, while compressed work schedules improve attitudes more than performance.

SYNERGIES THROUGH TOTAL REWARDS DESIGN

How do you decide which of the many available reward strategies to incorporate in your total rewards system design? Start by weighing each component's strengths and weaknesses. Also consider whether you can generate any synergies by mixing and matching certain strategies. One empirical study (Stajkovic and Luthans, 2003) found that combinations of different total rewards strategies led to higher employee performance than did any single strategy.

In thinking about ways to generate synergies, consider the interactive effects of various strategies *as well as* the interactive effects of strategies and other HR practices. A recent study showed that aligning compensation with training, selection, flexible work arrangements and employee involvement practices had a larger positive impact on employee performance than did compensation alone (Combs, Liu, Hall, & Ketchen, 2006). "Synergistic Design at Dale Carnegie" illustrates the power of combining strategies in your total rewards design.

PHASE THREE: EXECUTION

Once the project team has designed a total rewards system, it moves to the execution phase of the implementation process—putting the new system in place in the organization. During this phase, the team must consider numerous issues, each examined below.

ELIGIBILITY

In the past, only executives and sales personnel were eligible for incentives. Today, thanks to research showing the connection between rewards and productivity, all employees—from the highest to the lowest level, and from the front line to the support functions—are eligible for most total rewards strategies. With support staff, organizational leaders recognize that these employees enable line personnel to perform. Employers who do not include support staff in their total rewards programs risk eroding these workers' motivation. Moreover, because many women and minorities fill support jobs,

Synergistic Design at Dale Carnegie

The Ohio and Indiana Tyson/Eppley franchise of Dale Carnegie carefully blends total rewards strategies to support a key strategic objective: developing junior talent in the organization. To meet this objective, the organization brings in entry-level professional employees just out of college and has them work at a call center to learn the business from the bottom up. Though it pays below-market salaries, the firm offers extensive training in the skills needed for these new hires to advance to higher levels in the organization. Additional nonmonetary incentives are provided, including well-defined career paths and a friendly work environment featuring pool tables, video games, comfortable furniture, and refreshments. The results of this strategy are still being evaluated; however, evidence suggests that the approach is helping to attract junior talent to the firm.

Source: Robert Heneman's consulting work.

excluding these employees may put your company at risk for a discrimination law suit.

TOP MANAGEMENT SUPPORT

As noted earlier, implementing total rewards is a large-scale organizational intervention. To ensure buy-in, top managers must show visible support for the intervention. And in showing support, action speaks louder than words. Executives must not only verbally advocate the plan, they must also be covered by it. Consider the well-known apparel retailer Limited Brands (R. Heneman & Thomas, 1997), which established an HR management system that linked its total rewards system to competencies. To that end, the top 200 managers identified competencies for themselves, which the company then used to determine these managers' merit pay and stock. Only then was the total rewards system extended to lower levels in the organization. A review of 30 studies of performance appraisal interventions showed that productivity from interventions that received management support was 51 percentage points higher than those which did not (Rodgers & Hunter, 1992).

MEASUREMENT

In deciding which rewards to offer to which employees, organizations must determine whether employees have met the criteria defined for receiving each reward. Those criteria may include aspects of performance such as individual productivity,

customer service, and group or company profitability. To determine whether employees have met these criteria—and therefore deserve a particular reward—employers must measure (gather data on) these aspects of performance.

But measurement is useful only if the resulting data are reliable and valid. *Reliability* refers to the consistency of interpretations of data. In other words, the results should be consistent over repeated measurements. To accurately link rewards- such as pay increases- to employees' on-the-job contributions, the organization must confirm that the data gathered is reliable.

Validity refers to whether the project team has really measured what it intended to measure. For example, in appraising an employee's productivity, the team must be certain that it is evaluating actual productivity rather than some other closely related criterion, such as engagement.

PROJECT MANAGEMENT

Successfully executing a total rewards plan requires strong project management skills. As with any complex project, your project team will need to consider a wide range of issues. The sections below examine each of these challenges.

When will the new plan be operational? There are two schools of thought on the subject of when you might make your new total rewards system fully operational. You can think of these two schools as "lead" versus "lag" (Ledford &

R. Heneman, 2000; R. Heneman, DeSimone, Dooley, & Jones, 2002). If you view total rewards as a *lead system*—that is, you believe that putting the right rewards in place will encourage your workforce to accomplish key strategic goals—you would make the plan operational *before* launching a new business strategy. That way, you would show that the organization is committed to change and is willing to invest up front to secure employees' commitment to the new strategic plan. This approach can help attract and retain workers. However, it is also costly, because the company must allocate money for total rewards before achieving its business goals.

If you view total rewards as a *lag system*, you would make the new plan operational *after* employees had helped carry out your company's new business strategy. With this approach, rewards reinforce the successful execution of a business plan rather than lay the groundwork for that execution. This approach may be less costly than a lead approach, because the investment is linked to the successful accomplishment of business goals. However, it does not demonstrate a commitment by the organization to invest in human capital before the workforce can generate measurable results.

Properly designed and implemented, a total rewards system can serve both lead *and* lag purposes. For example, in one case study (R. Heneman, DeSimone, Dooley, & Jones, 2000), empirical data

showed how a new total rewards plan comprised of group and individual incentives walked this middle road. Involving employees in the design and implementation of the plan increased their awareness and understanding of the organization's strategy (a lead effect). And payouts from the incentive plan after key business goals were met encouraged employees to accomplish additional objectives related to the firm's strategy (a lag effect).

How will you explain the new total rewards program to your workforce? A recent survey explored this question with an eye toward determining how communication affects employees' attitudes toward total rewards (R. Heneman, Mulvey, & LeBlanc, 2002). The researchers conducted the survey in 13 organizations, gathering input from more than 13,000 employees. The findings?

The more employees knew about their company's rewards system, the more satisfied they were with it. And with greater satisfaction came greater commitment and engagement at work. Unfortunately, the study also showed that most employees had very little knowledge of how their organization's rewards system worked. To improve employee knowledge of pay and other rewards, the researchers recommended the following communication practices:

Educating and Involving Employees at Rothschild Gourmet Foods

Rothschild Gourmet Foods is a small, privately owned manufacturer of gourmet food products. The company consists of a kitchen, assembly line, and warehouse for distribution. A small corporate support staff and internal and external sales staff complete the labor force. The business is very seasonal, registering the bulk of its sales from September through January.

The company prides itself on quality and financial success. It uses only premium ingredients and high-quality containers, such as glass imported from Italy. Employees are viewed as an important asset since the company depends on a skilled workforce to maintain high quality standards and generate new product ideas. Rothschild uses a market-based pay system and offers a combination of incentives to reward its workforce. It sets pay at the fiftieth percentile for small employers and compensates for the differential by emphasizing variable pay and offering a generous benefits package. It also boasts a friendly workplace, flexible work schedules, and other nonmonetary rewards.

Rothschild decided to augment its existing total rewards program with an organization-wide plan linking incentives to corporate performance as measured by changes in return on assets. The amount made available for cash bonuses from the funding pool was determined by the company's performance on the following criteria: product and service quality, "controllable" cost savings, and sales. Actual payouts from each of these three sources were determined by individual performance and tenure at the organization.

The project team took several steps to win employees' buy-in. First, it measured only those elements of performance that lay within employees' control. For example, large capital expenditures made by senior managers were not counted as "controllable" costs. Second, the team established a participative governance system whereby employees suggested and implemented ideas for improving performance on the organizational measures. Third, employees received training on what these measures meant and how they would be evaluated.

The team collected several rounds of data on the measures before introducing the new incentive plan and several rounds afterward. The results proved impressive: Sales increased, controllable costs decreased, quality improved, and performance appraisal ratings increased after the incentive plan was put in place.

Source: Heneman, DeSimone, Dooley & Jones (2002)

- Make more information about the total rewards system available to employees, especially details about how the system operates.

- Personalize total rewards by creating a statement for each employee detailing the rewards he or she has received.

- Minimize the use of traditional communication vehicles, such as policy statements, to announce or explain rewards.

- Encourage one-on-one conversations between supervisors and employees about total rewards.

- Provide more interactive communication through your company Web site or intranet.

How will you train people in the new system? By training members of the project team and approval parties (such as senior management) on the basics of the new total rewards system, you give them the knowledge they need to make informed decisions throughout the execution phase. Also train managers on how best to use elements of the total rewards system (including job evaluation, performance measures, and pay-survey data) to accomplish business goals. Finally, educate employees on how the new system operates, including showing them how their rewards will grow as they contribute more to the organization. "Educating and Involving Employees at Rothschild Gourmet Foods" (p. 17) shows how one company used training (among other practices) to win employees' buy-in for a new incentive program.

How will you handle employees' concerns about the system? A large body of research shows that employee attitudes and behavior are influenced both by how much they are paid and also how their pay is determined (Folger & Konovsky, 1989). This research suggests that employees need a safe way to express any concerns about their rewards. To that end, consider establishing a committee of senior managers and employees who can listen to and address such concerns.

Will your new system adhere to employment laws? At least three areas of laws and regulations govern total rewards decisions: employment laws (such as the Civil Rights Act of 1991); compensation laws (for example, the Fair Labor Standards

EXECUTION CHECKLIST

As you prepare to implement your new total rewards system, use the following checklist to ensure that you are addressing all the major issues:

☐ Determine who will be eligible for each type of reward.

☐ Ensure that the new system has the support of top management.

☐ Establish the reliability and the validity of the performance data you will gather to determine reward levels.

Develop a solid plan for managing the project—including:

☐ When will the new system be operational?

☐ How will you communicate the new system to the workforce?

☐ How will you train people to use the system?

☐ How will you handle employee concerns?

☐ Does the system adhere to all employment laws?

☐ How will you fund the new system?

☐ When will you evaluate the system's effectiveness?

☐ Under what conditions would the plan need to be put on hold?

☐ If unionized, how will you involve union leaders?

☐ How will you handle cross-border cultural differences?

☐ Which technology is the best match to design and run the new system?

☐ How will you handle the unique execution challenges that arise for small- and medium-size organizations?

☐ Will you outsource execution to a third-party vendor?

Act); and labor laws (including the National Labor Relations Act). During the execution phase, your project team will need to ensure that the revised or new total rewards system adheres to all employment laws. As a valuable step, the team could periodically audit or review compensation decisions' impact on employees in various categories such as age, race, sex, color, religion, and national origin. If this review reveals differences within each category that cannot be explained by job-related decisions (for example, job evaluation), the team should investigate immediately and rectify the situation.

How will you fund the new system?

One of the biggest issues to be resolved during the execution phase is how the total rewards plan will be funded. The direct costs associated with a new or revised total rewards system can reach immense proportions. Increasingly, organizations are trying to ensure that the new system costs no more than the old one. To generate the savings needed to fund the plan, a company can take steps such as reducing overtime, seniority, and merit pay, as well as decreasing headcount through attrition.

What will the system's duration be?

To give the new total rewards plan the best chances of succeeding, the project team should stipulate when the program will be reevaluated and modified if necessary. Members should also ensure that the organization sets aside enough money to continue funding the plan even if the enterprise experiences financial problems.

In addition, the team should explain to employees early on that the plan may be temporarily stopped under certain conditions outside the organization's control such as a drastic economic downturn or a spike in fuel prices.

How will you involve the union?

In the United States, the National Labor Relations Act requires that organizations with unions negotiate wages, hours and working conditions with union workers. Total rewards strategies come under this banner as well. But negotiating total rewards with union leaders can be difficult, as unions historically have favored rewards based on seniority rather than performance. To implement total rewards strategies in a unionized environment, employers must involve the union in the execution phase at a minimum (R. Heneman, von Hippel, & Eskew, 1997), and in the assessment and design phases if possible. Involving the union means soliciting, listening to, and acting on union leaders' opinions on proposed rewards without having to resort to the formal collective bargaining process. The more your project team can involve the union, the greater the likelihood that union leaders will see that they and management share similar goals when it comes to using total rewards. Unions that have had input into the design and execution of rewards are also more likely to vote in favor of new total rewards strategies during the collective bargaining process. Why? People who have been consulted about an impending change tend to feel committed to that change.

How will you handle cross-border cultural differences?

Many leading U.S. companies use similar total rewards strategies in the different countries in which they operate (R. Heneman, Fay, & Wang, 2001). Clearly, it is easier to implement and administer one total rewards plan than to offer different plans for different locations. However, a one-size-fits-all approach carries some risks. First, owing to cultural differences, employees in one country might view a particular reward as fair while those in another country may consider the same practice unfair. Second, rewards already in use in a country may be embedded in the culture and therefore may be difficult to overcome. For example, Chinese and U.S. reward practices differ markedly (R. Heneman, Wang, Tansky, & Wang, 2002). Third, laws and regulations vary dramatically across countries. To illustrate, a form of gain sharing is heavily governed by law in many French organizations (Roussel & R. Heneman, 1997).

To ensure that your organization's total rewards system works as intended at an international level, the project team must take cross-cultural differences into account (R. Heneman, Fay, & Wang, 2001).

Will you use technology?

Modern technology is both a blessing and a curse to the implementation of total rewards systems. On the positive side, technology enables organizations to automate complex decisions about rewards strategies. Consider the digital expert system that can help employers implement compensation plans (R. Heneman

& Dixon, 2001). Decision makers simply input the strategy, structure and culture of their organization into the expert system. Based on this input, the system provides a detailed summary of the most appropriate compensation system based on the available research (R. Heneman, Ledford, & Gresham, 2000).

On the negative side, modern technology may be *too* easy to use. There are hundreds of "plug and play" total rewards systems that companies can easily install and begin using. Unfortunately, many of these systems do not meet different employers' specific needs. Instead, these products' manufacturers have made them as homogeneous as possible to sell to a wide range of customers. Thus these generic systems cannot provide users with competitive advantage (Combs, Liu, Hall, & Ketchen, 2006). This situation suggests that organizations can get the most from their total rewards technology by building a customized system. One downside of such systems is that they are difficult to upgrade.

The implications for your organization? Carefully weigh the pros and cons of the various technology options before deciding which may be best for your total rewards plan.

What if you work in a small- or medium-size organization? If you are in a smaller organization, you may encounter unique challenges when implementing a total rewards system. Perhaps the largest challenge is funding. Many small and medium enterprises (or "SMEs") must

finance technological and capital improvements in order to grow. As a result, their budgets are relatively small on a per-capita basis. With less funding available, you may want to de-emphasize cash in your total rewards programs and lean more toward recognition. As discussed earlier in this report, recognition systems can be just as effective as financial incentives.

Also consider stock. If your enterprise is not publicly traded, this type of stock will not be available as a reward. However, your SME can still distribute what's called phantom stock—which is based on the enterprise's book value rather than its market value (R. Heneman, DeSimone, Dooley, & Jones, 2002). Phantom stock helps to motivate employee performance because the employee has a monetary stake in the effectiveness of the organization. Employees receive cash bonuses if the organization performs well.

Will you outsource some aspects of execution? Organizations can now outsource execution of their total rewards systems to vendors, which can save time and hassle. However, the resulting rewards systems may not be customized enough to meet your enterprise's needs. Also, you have no guarantee that the consultants who perform the work are well trained in total rewards or human resource practices. To ensure that your total rewards program gives your company a strategic advantage, use great care in selecting a vendor. In particular, look for vendors who can offer solutions tailored to your needs and who have staff well trained in total rewards

strategies and human resource management.

PHASE FOUR: EVALUATION

Probably the most often overlooked phase of total rewards implementation is evaluation. In this phase, the project team compares the actual results of the executed total rewards strategies against the desired results. The hope is that by conducting this evaluation, you can show top management that the company's investment in its total rewards system has paid off. Of course, conducting an evaluation can be unnerving if you fear that the selected reward strategies are in fact not delivering as anticipated (Corby, White, & Stanworth, 2005). To get the most from the evaluation phase, encourage your project team to measure the outcomes of the executed total rewards system and to interpret the findings correctly.

MEASURING THE OUTCOMES

To decide which outcomes of your total rewards system to measure, revisit the system's objectives and then consider which data sources will provide the information you need to evaluate those outcomes. For example, if the new rewards program was intended to improve employee satisfaction, the project team can measure this outcome through workforce surveys. "Outcomes and Data Sources" shows examples of the kinds of outcomes you may want to measure and the sources that might generate the data you need.

INTERPRETING YOUR FINDINGS

In an ideal world, your project team would pilot-test each reward strategy in the proposed total rewards system (and each combination of strategies within the system) before implementing it. Moreover, the team would randomly assign some employees to groups receiving changes in total rewards and other employees to a control group that is not receiving any changes. Of course, this kind of testing raises several challenges. First, senior managers will want more immediate results than those most teams can produce with pilot studies. Moreover, randomly assigning employees to different groups may not be practical in your organization. Finally, few employees will take kindly to being assigned to a group that receives no rewards for the purpose of experimentation.

For these reasons, your project team may need to evaluate the results of total rewards changes "in the field" rather than in an organizational "laboratory." And field evaluation is as much art as it is science. Team members will need to use judgment in estimating the effectiveness of particular total rewards strategies. And they will never know for certain whether an observed result is due to the new plan or to some other variable that they did not study. For example, a rise in productivity may stem more from the fact that employees had input into job design than from the actual job designs themselves or the types of rewards offered.

How might your project team conduct the most effective evaluation possible, given the constraints at hand? The following practices can help:

- Compare measurements of important criteria taken before execution of the new rewards system against measurements of the same criteria after execution.

- Consider whether any other variables not studied may have influenced the outcomes you're seeing.

- Search the management literature to see how effective the total rewards strategies you selected have proved in other organizations operating under similar circumstances.

- Measure outcomes over time— in the months or years before execution of the new rewards and in several time periods after execution. This helps you see whether any outside forces have affected those outcomes. For example, if employee productivity changed dramatically in the months leading up to execution of the new rewards system, whatever caused that change may have also influenced productivity during and after execution. Your team will need to identify such influences in order to accurately evaluate the impact of the new rewards.

Outcomes and Data Sources

To measure this outcome:	Use this data source:
Productivity	Operational reports
Job satisfaction	Workforce surveys
Revenue	Income statements
Costs	Income statements
Profits	Income statements
Fit with the organization's strategic plan	Senior management
Customer or employee complaints	Human resource information system (HRIS)
Recruitment and retention	Human resource information system (HRIS)

Conclusion

Successfully implementing a revised or entirely new total rewards program will always be challenging. To boost your chances of success, you and your pilot team must carefully shepherd the project through the four phases of implementation: assessment, design, execution, and evaluation. Each of these phases requires careful thought, patience, and a willingness to solicit input from a wide range of individuals in your organization.

But the effort is worthwhile. A well-thought-out and skillfully implemented rewards program can give your organization a competitive edge. In particular, it can help you generate the business outcomes that matter most to your strategy—whether those outcomes take the form of employee retention, productivity, job satisfaction, or service quality. In an age of stiffening competition and increasing pressure to do more with less, no organization can afford to ignore the strategic value that a well-designed total rewards system can provide.

Appendix A:
Industry Benchmark Phone Survey

BASE PAY

Do you have job descriptions?   Y_____   N_____

Do you conduct job evaluation?   Y_____   N_____

Do you offer skill-based pay?   Y_____   N_____

Do you offer competency pay?   Y_____   N_____

Do you have an overtime pay policy? Y_____   N_____

How many pay grades are in your current structure?   _____ Grades

What is the average width of pay grades? _____% (minimum to maximum)

Promotion Pay Criteria (check all that apply):

_____ Formula

_____ Internal equity

_____ Performance

_____ Potential

_____ Seniority

_____ Other (please list) _____

INCENTIVES

Types of incentive plans (including merit pay): _____

_____

_____

FOR EACH PLAN, FIND OUT THE FOLLOWING:

Plan objectives (list): _____

_____

_____

Type of employees covered by plan (list): _____

_____

_____

TYPE OF PERFORMANCE MEASURES
(check all that apply):

_____ Financial

_____ Productivity

_____ Quality

_____ Safety

_____ Output/Volume

_____ Cost Reduction

_____ Attendance

_____ Project Milestones

_____ Other (list) _____

OVERALL EFFECTIVENESS OF INCENTIVE PAY PLAN
(circle one number only):

  1   2   3   4   5   N/A

1 =   Not effective   4 =   Very effective

2 =   Neutral   5 =   Highly effective

3 =   Somewhat effective   N/A Not known

Benefits

List Work/Life Programs: _____

_____

_____

A well-thought-out and skillfully implemented rewards program can give your organization a competitive edge. In particular, it can help you generate the business outcomes that matter most to your strategy.

Sources and Suggested Readings

Abosch, K.S., & Hand, J.S. (1994). *Broadbanding design, approaches, and practices.* **Scottsdale, AZ: American Compensation Association.**

The objectives of this study were to provide organizations with information on broadbanding, to identify the processes and practices that will help make broadbanding a success, and to evaluate the effectiveness of broadbanding. Four hundred and twenty four HR professionals, top executives, employees, and organizations that did not implement broadbanding were surveyed and interviewed to gain information about broadbanding. Results suggested that the primary reasons for implementing broadbanding include creating more organizational flexibility, supporting new culture and climate, de-emphasizing traditional structures, fostering a flatter organization, and emphasizing career development. Methods used to place positions into bands include transitioning jobs from current grades, job slotting using band descriptions, market value slotting, pre-existing job evaluations, and skill requirements. Broadbanding significantly consolidated job titles for 42% of people that participated in this study. Seventy-eight percent of the companies surveyed found broadbanding to be effective.

Abosch, K.S., & Hand, J.S. (1998). *Life with broadbands.* **Scottsdale, AZ: American Compensation Association.**

This study looks at 73 companies using broadbanding for at least one year, and analyzes longitudinal data from 33 organizations to evaluate the effectiveness of broadbanding over time. First, a review of research on broadbanding is presented to explain what is known about broadbanding now and what is still left to learn. Next, the research methodology for this particular study is shared. After that, the design and implementation of broadbanding over the years is explored. Finally, the impact of broadbanding on organizations is discussed. Reasons for implementing broadbanding include career development, skill acquisition, and organizational issues. Overall, results from the study indicated that 87% of respondents think broadbanding is quite effective, and is received positively by management, human resources, and employees.

Amabile, T.M., Hill, K.G., Hennessey, B.A., & Tighe, E.M. (1994). The work preference inventory: Assessing intrinsic and extrinsic motivational orientations. *Journal of Personality and Social Psychology,* **66:5, 950-967.**

Individual differences in intrinsic and extrinsic motivational orientations are assessed in this study of a common scale used to measure these characteristics. This scale is called the Work Preference Inventory (WPI) and is used to capture elements of intrinsic motivation such as evaluation, recognition, money,

and other tangible incentives. Data was collected from both college students and working adults over an eight year time span. The analysis of the WPI scale indicated that the instrument did assess stable motivational orientations in individuals, and has adequate fact structures, internal consistency, and reliability. The WPI measure also related to personality characteristics, attitudes and behaviors that are important in an organizational setting.

Baltes, B.B., Briggs, T.E., Huff, J.W., Wright, J.A., & Neuman, G.A. (1999). Flexible and compressed workweek schedules: A meta-analysis of the effects on work-related criteria. *Journal of Applied Psychology,* **84:4, 496-513.**

The effects of flexible and compressed workweek schedules on work-related criteria such as productivity, job satisfaction, absenteeism and work schedule satisfaction are explored in this study. The work adjustment model (Dawis, England, & Lofquist, 1968) and the job characteristics theory (Hackman & Oldham, 1976) are used as theoretical frameworks suggesting the impact alternative work schedules can have on psychological states that influence attitudes and behavior. A meta-analysis was conducted using 29 published studies on alternative work arrangements. Flexible work schedules were found to have generally positive effects on all work-related criteria. However, some moderators were found to

impact these results. Specifically, positive effects were not found for managers/professionals and for organizations with too much flexibility. Compressed workweeks also had positive effects on all work-related criteria except absenteeism.

Barber, A.E., Dunham, R.B., & Formisano, R.A. (1992). The impact of employee benefits on employee satisfaction: A field study. *Personnel Psychology,* **45, 55-75.**

Employee satisfaction with benefits was found to significantly increase following the implementation of a flexible benefits plan. Overall satisfaction was also found to be somewhat higher. Empirical support was demonstrated through a study of 110 employee attitudes before and after a flexible benefits plan was introduced at a financial services company. Demographic profiles and satisfaction with benefits were not found to be related. The authors suggest that the high level of satisfaction with the flexible benefit plan may have been related to the extensive communication and training that went along with the implementation of the new plan.

Barney, J.B., & Wright, P.M. (1998). On becoming a strategic partner: The role of human resources in gaining competitive advantage. *Human Resource Management,* **37(1), 31.**

This ground-breaking article establishes the significance of

human resources in helping an organization gain (and maintain) a strategic and competitive advantage. The authors present the value, rareness, imitability and organization (VRIO) framework in describing how the human resource (HR) function can be a source of sustained competitive advantage due to its impacts on important resources such as human capital skills, employee commitment, culture and teamwork. The framework suggests that HR activities that are valuable, rare, difficult to imitate, and supported by the organization (such as firm-specific skill training, for example) will help lead to a sustained competitive advantage and above-normal performance for the firm. Other HR activities such as selection, general training, and compensation must still be performed efficiently to maintain competitive parity or a temporary competitive advantage. Without these HR activities in an organization, a firm could be at a competitive disadvantage. This article provides support for the role of the HR executive as a strategic partner in an organization.

Beer, M., Cannon, M.D., Baron, J.N., & Dailey, P.R. (2004). Promise and peril in implementing pay-for-performance. *Human Resource Management,* **43, 3-20.**

This article explores the decision-making process that managers at Hewlett-Packard went through when deciding to abandon the pay-for-performance programs they previously used. These managers

found that the costs of these programs seemed to be greater than the benefits. Employees in this high-commitment culture felt pay-for-performance was like a bribe, and often caused bitter feelings and hurt relationships. Other managerial practices were found to be more beneficial, including effective leadership, clear objectives, coaching and training. When implementing a pay-for-performance program, managers must clearly state expectations and communicate the purpose of the program—while giving employees a chance to ask questions.

Blasi, J., Conti, M., & Kruse, D. (1996). Employee stock ownership and corporate performance among public companies. *Industrial and Labor Relations Review*, **50, 60-79.**

The association between employee stock ownership and economic performance has been a source of debate for several years. Some believe the group compensation schemes result in employee free-rider problems, while others think employee stock ownership can result in increased information sharing, identification with the company, and monitoring of co-workers, which can lead to improved company performance. The corporate performance of two groups of companies (one group had more than 5% of company stocked owned by employees while the others had less than 5%) was compared to determine the impact of employee stock ownership on

profitability, productivity and compensation. Results indicated that companies with employee stock ownership of more than 5% were more profitable than those with less than 5%, particularly for corporations smaller in size. No significant differences were found for productivity and compensation levels among companies that had more than or less than 5% employee stock ownership. Therefore, employee stock ownership *will* likely increase or not change company performance, but it will *not* negatively impact performance in an organization.

Blinder, A.S. (Ed.) (1990). *Paying for productivity: A look at the evidence.* **Washington, D.C.: Brookings Institution.**

One potential mechanism for increasing productivity growth in the future is tying worker compensation to performance. The major finding of this book is that meaningful worker participation enhances productivity no matter what compensation plan is used. This book reviews alternative pay systems and takes a closer look at compensation issues such as profit sharing, employee ownership plans, employee participation, and the employment system in Japan. The answer to the question regarding whether productivity can be increased by changing the way employees are paid seems to be that changing the way employees work is more beneficial than changing the way they are paid. However, combining alternative pay systems

with work participation may be the ultimate solution to boosting productivity.

Cable, D.M., & Judge, T.A. (1994). Pay preference and job search decisions: A person-organization fit perspective. *Personnel Psychology*, **47, 317-348.**

This article provides empirical support for the theory that job seekers find organizations perceived to offer high pay levels, flexible benefits, individual-based pay, and fixed-pay policies more attractive. Greater fit between personality of the job seeker and characteristics of the compensation system resulted in even greater attractiveness. One hundred and seventy-one college students from a large northeastern university participated in the study. A policy-capturing approach was used in which participants reviewed positions based on compensation system attributes and then indicated their attractiveness to those positions. Survey data was collected on job-pursuit intentions, materialism, individualism, self-efficacy, locus of control, risk aversion, and other demographic characteristics. The findings suggest that job attractiveness is influenced by not only high pay level, but also flexible benefits, individual-based pay, fixed pay, and job-based pay.

Colella, A., Paetzold, R.L, Zardkoohi, A., & Wesson, M.J. (2007). Exposing pay secrecy. *Academy of Management Review,* **32, 55-71.**

Pay secrecy can be thought of as a restriction of the amount of information employees are provided about what others are paid. It can become complex in organizations when considering who and what pay information is restricted. The costs of pay secrecy can include sacrifices in employee judgments about fairness and trust, decreases in employee motivation, and (potentially) a less efficient labor market. In addition, pay secrecy can have benefits such as organizational control, protection of privacy, and decreased labor mobility. Several contextual factors are related to when costs and benefits can occur. These factors include—but are not limited to—the nature of human capital, the criteria for pay allocation, and the gauging of relative pay status. Several questions remain related to pay privacy and its implications in organizations and society.

Combs, J., Liu, Y., Hall, A., & Ketchen, D. (2006). How much do high-performance work practices matter? A meta-analysis of their effects on organizational performance. *Personnel Psychology,* **59, 501-528.**

A meta-analysis was performed to find the relations between high-performance work practices (HPWP) and organizational performance. HPWPs are performance-enhancing practices such as incentive compensation, training, employee participation, selectivity, and flexible work arrangements. Ninety-two studies were used in this analysis. Results indicated that organizations can increase their performance by .20 of a standardized unit for each unit increase in HPWP. The effect sizes demonstrated greater effects for HPWP systems over individual practices and for manufacturing organizations over service organizations. Future research could explore why HPWPs didn't work as well in service organizations.

Corby, S., White, G., & Stanworth, C. (2005). No news is good news? Evaluating new pay systems. *Human Resource Management Journal,* **15: 4-24.**

The focus of this article is on HR managers who have introduced new pay systems in their organizations in England between 2000 and 2002. The evaluations HR managers make to assess the effectiveness of changes in pay and grading systems is explored through interviews and case studies with 15 organizations. Results suggest that new pay systems can impact labor turnover, recruitment, retention, staff attitudes, and working practices. However, even given these impacts, the study indicates that HR managers usually only conduct limited evaluations that are based on employee self-report. Given the complexities of evaluation and the limited time of managers, the authors suggest that practitioners focus on evaluating the costs of the system and report their findings to all employees.

Dreher, G.F., Ash, R.A., & Bretz, R.D. (1988). Benefit coverage and employee cost: Critical factors in explaining compensation satisfaction. *Personnel Psychology,* **41, 237-254.**

Employers invest in employee benefits under the assumption that providing these benefits will increase employee satisfaction, commitment, and loyalty to the organization. This article empirically explored this assumption by looking at the relationship between benefit program characteristics and compensation satisfaction. An extensive compensation survey was administered to employees in eight state agency organizations. Results indicated that increased benefit coverage and decreased employee costs were related to greater satisfaction with benefits and compensation. Changes in the cost of health insurance were particularly influential in altering employee satisfaction levels. The study also demonstrated that employees who possessed more accurate information about actual benefit costs and coverage were more satisfied with compensation and benefits programs.

Fay, C., Schulz, E., Gross, S.E., & van de Voort, D.V. (2004). Broadbanding, pay ranges, and labor costs. *WorldatWork Journal,* **13:2, 8-24.**

This study investigated whether base salaries and total cash compensation would be higher in firms using broadband pay administration policies than in firms using

traditional pay ranges. Broadbands collapse multiple pay ranges into a large band with a minimum and a maximum. It may consist of several jobs and does not contain a midpoint. Survey data from 5,593 IT job incumbents in 2000 and 10,906 IT job incumbents in 2001 was collected to test the hypotheses. Results indicated that both base salaries and total cash compensation were higher in firms using broadbanding when controlling for organizational, occupational, and individual characteristics known to be associated with salary differentials.

Folger, R., & Konovsky, M.A. (1989). Effects of procedural and distributive justice on reactions to pay raise decisions. *The Academy of Management Journal*, **32, 115-130.**

The impact of distributive and procedural justices on reactions to pay raise decisions was examined in this study. Two hundred and seventeen first-line employees of a privately owned manufacturing plant completed a survey on the practices supervisors used to determine their most recent salary increase. Procedural justice was found to influence levels of employee commitment to an organization and trust in management. Distributive justice, however, was related to higher levels in satisfaction with pay. These results suggest that the manner in which pay raises are distributed, as well as the distribution itself, are important to the satisfaction levels of employees with pay raise decisions.

Fried, Y., & Ferris, G.R. (1987). The validity of the job characteristics model: A review and meta-analysis. *Personnel Psychology*, **40:2, 287-322.**

Approximately 200 relevant studies on Hackman and Oldham's Job Characteristics Model were reviewed in this meta-analysis. The results of the meta-analysis supported parts of the model such as the multidimensionality of job characteristics, but the exact number and definition of dimensions was more debatable. Relationships between job characteristics and psychological and behavioral outcomes were also demonstrated in the results. Job complexity indices like the MPS seem to be less predictive of work outcomes than a simple additive index. Therefore, the main findings of this article indicate that although the Job Characteristics Model has some usefulness in predicting work outcomes, several modifications and improvements need to be made to enhance the validity and accuracy of the model.

Gerhart, B., & Rynes, S.L. (2003). *Compensation: Theory, Evidence, and Strategic Implications.* **Thousand Oaks, CA: Sage.**

Pay level, pay structures and pay delivery systems are the three main compensation decisions explored in this book. It reviews the determinants and effects of compensation. Theory and empirical evidence are integrated to demonstrate practical significance of compensation research. First, differences in pay level are examined

in an attempt to explain why some companies pay more than others, and why pay levels for particular jobs differ. Next, the effects of pay level for employers are studied to find the importance of pay to individuals and what employers get in return for higher pay. Pay structure is also discussed to provide information about job evaluations and work-life incentives. Psychological versus economic perspectives of motivation and compensation are offered as well. Then the book summarizes research on pay-for-performance programs and pay strategies. Finally, future research and methodological recommendations are made to guide research on compensation.

Gupta, N., & Mitra, A. (1998). The value of financial incentives: Myths and empirical realities. *ACA Journal*, **Autumn, 58-66.**

Years of research on the relationship between financial incentives and employee performance is reviewed in this article on the myths and realities related to the value of financial incentives. The myths (found as a result of this study) are that financial incentives do not motivate, people do not value money, financial incentives are punishing, financial incentives undermine intrinsic motivation, and financial incentives erode performance quality. The empirical realities of the value of financial incentives are that financial incentives consistently improve performance quantity, money makes a difference in people's behavior, financial incentives are rewarding, financial incentives complement

intrinsic motivation, and financial incentives are, at worst, unrelated to performance quality. The main conclusion from this article is that although money is not the only thing that matters, it does matter, and the challenge is to design effective incentive systems.

Hackman, J. R. (1971). Employee reactions to job characteristics. *Journal of Applied Psychology,* **55(3), 259-276.**

This article suggests that jobs high on variety, autonomy, task identity and feedback tend to result in higher motivation, higher job satisfaction, fewer absences from work, and high quality work as rated by supervisors. Data was collected from employees in 13 different jobs in plant and traffic departments of an eastern telephone company. Employees were surveyed, observed and interviewed about the characteristics of their job. The results suggest that the motivational potential of jobs can only be reached when the personal goals and needs of employees match up with the psychological demands and aspects of their jobs.

Heneman, H., & Judge, T. A. (2000). Compensation attitudes. *Compensation in organizations: Current research and practice.* **San Francisco: Jossey-Bass, 61-103.**

The attitudinal issues of pay satisfaction, pay justice and pay preferences are explored in this chapter on employees' affective reactions to the amount of pay they

receive and pay delivery systems. Antecedents of pay satisfaction may include pay program characteristics such as pay- for-performance, merit, incentive, bonus, stock and benefits. Outcomes of pay satisfaction or lack thereof could include changes in input such as performance, commitment and trust, or steps toward change: job interviewing, searching, and union voting. Pay satisfaction outcomes could also result in withdraw, with employees that have turnover intentions, lateness, or job transfers. Pay preferences have been found that suggest employees prefer individual rather than group pay, performance rather than seniority based pay, fixed salaries, and a choice of benefits.

Heneman, H. G., & Schwab, D. P. (1985). Pay satisfaction: It's multidimensional nature and measurement. *International Journal of Psychology, 20(2), 129-141.*

This study suggests the multidimensional nature of pay and proposes the Pay Satisfaction Questionnaire (PSQ) as a tool for measuring the multiple dimensions of satisfaction with pay. The proposed dimensions include satisfaction with levels, benefits, raises, structure and administration. The research was conducted by first constructing the questionnaire, then testing it on a sample of white-collar employees. A modified version then emerged, and was tested using a new sample of employees. Reliability and consistency were found for all of the scales. The results provide support for the multidimensionality of pay

satisfaction. Future research to confirm these results and test other dimensions would be beneficial.

Heneman, R.L. (2001). *Business-Driven Compensation Policies: Integrating Compensation Systems with Corporate Business Strategies.* **New York: AMACOM.**

This book provides practitioners with step-by-step information on how to make strategic decisions on compensation. Corporate business strategies should be used to guide compensation strategies that impact base pay systems, rewards systems, and ultimately pay system administration. Part one presents a model of strategic pay systems and part two explores work analysis, work evaluation, market surveys, and pay structures of base pay systems. Individual, team, and organizational rewards are examined The author also looks at pay system administration and offers suggestions on strategic pay design, pay implementation, and pay evaluation. Part five recommends general do's and don'ts for compensation-related decisions.

Heneman, R.L., DeSimone, B., Dooley, A.E., & Jones, D. (2002). Taking a middle stance: Goalsharing as a lead and lag system for business performance improvement. *WorldatWork Journal,* **11:2, 65-70.**

Some researchers argue that goal-sharing should be used as a lead system to improve organizational

performance while others believe goal-sharing should be used after the strategic plan has been formulated. This article uses longitudinal data from a privately held manufacturing company to support a combination of these positions, arguing that goal-sharing can play a role in both the formulation and implementation of business strategy. Employee awareness, understanding and commitment to strategic business plans can be increased by involving them in the design and implementation of a gain-sharing pay plan and clearly communicating any changes that may take place.

Heneman, R.L, & Dixon, K. (2001). Reward and organization systems alignment: An expert system. *Compensation and Benefits Review*, **November/December, 17-28.**

Aligning the design and implementation of a reward system with the business strategy, structure and culture is essential to creating a unique system that will steer company performance in the right direction. Eight reward systems are recommended to help align and integrate a company's strategy, structure and culture with the reward system. Strategies explored include defender strategies in stable markets with a narrow range of products versus prospector strategies in changing markets with a wide variety of products that compete using innovations. Organizational structures looked at were mechanistic, or highly formalized, centralized and standardized

with a narrow span or control; or organic, with low formalization, centralization and standardization. Cultures investigated included traditional-style with a clear division of labor and vertical communications or involvement-style with shared decision making and risk taking. Reward form, unit of analysis, value comparisons, reward measures and levels, administrative processes, timing and communications were used as components of the reward system. The eight expert systems described offer ideal combinations that can be used to align reward and organization systems.

Heneman, R.L., Eskew, D., & Fox, J. (1998). Using employee attitudes to evaluate a new incentive program. *Compensation and Benefits Review*, **28:1, 40-44.**

This study suggests that employee attitudes towards pay can be used to determine the effectiveness of a pay system. Employees at a small flight-simulator company in Orlando and Phoenix were surveyed to assess the need for incentive pay. Then, an incentive pay system was developed and implemented, and employees once again completed the survey. The survey measured employee attitudes on job satisfaction, pay satisfaction, performance ratings, and pay-for-performance. Results suggest that employees had greater job satisfaction, extrinsic satisfaction, intrinsic satisfaction, pay satisfaction, benefits, structure, and pay-for-performance after incentive pay was implemented. Performance declined, however, but this was explained by

a large amount of turnover among employees over the five year period.

Heneman, R.L., Fay, C.H., & Wang, Z.M. (2001). Compensation systems in the global context. In D. Ones & C. Viswesvaran *Global handbook of Industrial, Work and Organizational Psychology*, **(pp. 77-92). London, England: Sage.**

This chapter provides a summary of global research on compensation including base pay, variable pay, individual incentives, ownership and benefits. The chapter begins by exploring the history of compensation, continues with the current state of compensation affairs, and ends with a discussion of future research and practice. Global compensation issues such as the impact of culture, legal systems, and other local conditions on compensation strategies are also considered. The impact of pay systems on organizational effectiveness has been shown to be positive, yet one must recognize that some pay plans are more effective than others, and the implementation of pay strategies is just as important as the plan itself.

Heneman, R.L., Mulvey, P.M., & LeBlanc, P.V. (2002). Improving base pay ROI with employee base pay knowledge. *WorldatWork Journal*, **11:4, 21-27.**

This study suggests that return on investment for base pay is likely to be improved by simply

increasing employee knowledge of base pay systems. Results suggested that knowledge of base pay is the strongest predictor of pay satisfaction, which is greatly associated with work engagement. Participants in the study reported knowing much more about their base pay structure and outcomes than about how their base pay system operates. Another important finding in this study is that knowledge of base pay is a more significant predictor of pay satisfaction than amount of pay itself. Employee-base-pay knowledge can be improved by first collecting data, then proactively sharing information, training managers to talk about base pay, personalizing concepts by individually communicating to each employee, de-emphasizing traditional knowledge techniques like manuals and classes, and openly presenting information on compensation systems, philosophies and processes.

Heneman, R.L., Ledford, G.E., & Gresham, M. (2000). The changing nature of work and its effects on compensation design and delivery. In S. Rynes & B. Gerhart *Compensation in Organizations: Current Research and Practice* **(Society for Industrial and Organizational Psychology Frontiers of Industrial and Organizational Psychology Series). pp. 195-240. San Francisco: Jossey-Bass.**
Fundamental changes in the nature of work have been taking place in the areas of the employment

relationship, technology, business strategy, organizational structure, and job design. These changes at work have led to changes in pay systems such as broadbanding, skill-based pay, benefits, variable pay, and ownership. Four types of employment relationships are explored: quasi-spot contracts, mutual investment contracts, underinvestment contracts, and overinvestment contracts. Change in technology that has impacted the nature of work is electronic performance monitoring. Business strategy has changed from a traditional approach emphasizing attraction, retention and motivation to a strategic perspective focused on improving organizational performance. Virtual organizations have changed organizational structures into five types: functional, divisional, matrix, network, and cellular. Finally, the nature of job design is changing in the number, types and relationships between jobs.

Heneman, R.L., Tansky, J.W., Wang, S., Wang, Z.M. (2002). Compensation practices in small entrepreneurial and high growth companies in the United States and China. *Compensation and Benefits Review*, **34:4, 13-22.**

Compensation in small, high-growth companies such as Internet start-ups, networking companies, and software companies is an important facet of human resource practices in China. When making reward decisions, Chinese managers focus more on relationships whereas U.S. managers place a greater emphasis

on performance. This article compares pay practices in the U.S. to those in China, and whether China could benefit from using U.S. pay practices. Job analyses in China were found to be quite detailed and strict as compared to looser, less comprehensive descriptions in small- and high-growth companies in the U.S. Performance appraisals in small Chinese companies focus on objective improvement rather than the subjective behavioral appraisals used for development in the U.S. While pay practices in the two countries are found to be similar, Chinese companies are more likely to offer gain sharing, profit sharing, and stock options. Small Chinese companies also use internal rates instead of external market rates to determine pay rates.

Heneman, R.L. & Thomas, A.L. (1997). The Limited Inc.: Using strategic performance management to drive brand leadership. *Compensation and Benefits Review*, **27:6, 33-40.**

The Limited Inc. created a strategic competitive advantage by developing organizational leaders who can build brand leadership. A performance management system was implemented across the company that provided a common yardstick to assess performance across business units, alignment in individual and business unit objectives, improved feedback quality, and an integration of human resource processes. In order to develop the system, The Limited had to create performance standards, establish leadership

competencies, test the new tool, and finally implement and train the new process for performance management. This system gave managers a new appreciation for how things are done. It also helped direct managers through the changing nature of managerial work by providing a tool with competencies and standards they could use to guide their work.

Heneman, R.L., von Hippel, C., Eskew, D., & Greenberger, D. (1997). Alternative rewards in unionized environments. *American Compensation Association Journal*, **Summer, 42-55.**

Alternative reward plans can include lump sum merit pay, piece-rate pay, skill-based pay, gainsharing, goal-sharing, profit sharing, and stock sharing. Deciding which of these to use in a unionized environment can be difficult, and so this article offers some suggestions on a framework under which various alternative reward strategies are likely to succeed in unionized environments. Data provided by 150 unionized firms and 350 nonunionized firms indicated that unionized organizations are more likely to use skill-based pay, gainsharing, goal-sharing, and stock sharing than non-unionized environments. Unionized organizations are also more likely to use objective, group-based performance measures, base performance standards on historical standards, and provide payouts to employees in equal pay amounts.

Heneman, R.L. & Werner, J.M. (2006). *Merit Pay: Linking Pay to Performance in a Changing World.* **Greenwich, CT: Information Age Publishing.**

This book answers several questions related to merit pay, including why it is based on performance; how salary increases are impacted by organization, job and situation; what constitutes performance under merit pay; why certain amounts are given; what kind of policies are related in merit pay; and what can be expected after receiving an increase in merit pay. In addition to answering these questions, the authors of this book offer a comprehensive overview of the history of merit pay, a description of pay-for-performance, administering merit pay, and evaluating merit pay outcomes. The differences among merit pay plans are also explored according to the performance criteria that are evaluated, the form that merit pay takes, the method used to calculate the increase, and the permanence of the increase.

HR Focus. **(2006). Retention, morale, and productivity result from work/life programs. 83:10, S1-S3.**

Work/life practices such as flexible scheduling, telecommuting and job sharing are used by many organizations in today's society. However, the 'best practices' and the costs and benefits of these programs are still being developed. This article suggests the main benefits from these practices include

higher retention, morale and productivity. One of the biggest challenges of these programs is inconsistency in implementation at various levels or in different departments of an organization. Advice for implementing these programs in an organization includes communication, planning and support. Involve employees in work/life practice decisions, and make policies clear about when and how flextime can be used.

Jenkins, G.D., Jr., Ledford, G.E., Gupta, N., & Doty, D.H. (1992). *Skill-Based Pay: Practices, Payoffs, Pitfalls, and Prescriptions.* **Scottsdale, AZ: American Compensation Association.**

This study examines 97 different skill-based pay plans. Typically, skill-based pay plans have 10 skill units that can be acquired in three years. These plans can help promote flexibility, productivity and employee growth. Some of the difficulties associated with skill-based pay plans are that they are not implemented correctly, are poorly communicated, and involve inadequate training. Skill-based pay plans are most often used in manufacturing organizations, flat structures with few layers, and companies using continuous process technologies. This study found skill-based pay to be beneficial in unionized organizations as well, and it did not make companies susceptible to litigation. The success of skill-based pay plans is enhanced with employee and manager involvement, participation and commitment.

Jenkins, G.D., Jr., Mitra, A., Gupta, N., & Shaw, J.D. (1998). Are financial incentives related to performance? A meta-analysis review of empirical research. *Journal of Applied Psychology*, 83, 777-787.

This meta-analysis explores the relationship between financial incentives and the quality and quantity of performance. Thirty-nine studies were analyzed which contained 47 relationships between these variables. Results of the study conclude that financial incentives are significantly related to performance quantity, but not performance quality. The effect size of the incentive-quantity relationship is estimated to be .34. Theoretical framework moderated the strength of the relationship, as did the setting (laboratory, field, experimental simulation), but task type did not affect the relationships investigated in this study. Future research suggested included looking at the impact of interdependencies among employees on performance, as well as the relationship between financial incentives and perceptions of organizational justice.

Lawler, E.E. III, Mohrman, S.A., Benson, G. (2006). *Organizing for High Performance: Employee Involvement, TQM, Reengineering, and Knowledge Management in the Fortune 1000.* San Francisco, CA: Jossey-Bass.

This book presents the results of a fifth study in a continuous research program that looks at how management practices in *Fortune 1000* companies are changing. The adoption and effectiveness of employee involvement practices, total quality management, reengineering, and knowledge management practices are explored. The book also focuses on organizational changes occurring, such as the type of employment relationships, new performance-improvement approaches, and change-management strategies. Finally, the last portion of the book looks at predictors of practice adoption including organizational size, downsizing, competitive environments, de-layering, and working towards high performance. Data is presented about organizational practices and management activities that support corporate change initiatives and suggest approaches to improvement efforts in large corporations.

LeBlanc, P.V., & Mulvey, P.W. (1998). How American workers see the rewards of work. *Compensation and Benefits Review*, 30, 24-28.

A survey conducted on the rewards of work addressed pay system preferences regarding benefits, work content, affiliation, career, and pay itself. Results demonstrated that employees are concerned not only with how much money they make, but also how they are paid. It's important that the system for administering pay to employees is effective, fair and inclusive. Pay systems should take employee preferences, concerns, commitment and performance into account. Employees in the United States want individual, not team or company rewards, and fixed increases in pay such as bonuses and incentives in the form of one-time payments. Most workers were satisfied with benefits, job security and opportunities for personal growth and development.

Ledford, G.E., & Heneman, R.L. (2000). Compensation: A troublesome lead system in organizational change. In M. Beer & N. Noria (Eds.) *Breaking the Code of Change* (pp. 307-322). Cambridge, MA: Harvard Business School Press.

Some people argue that compensation is ineffective in changing employee behavior and therefore should not be used as a system to lead organizational change. These authors contend that empirical research supports the effectiveness of compensation systems, but they may be better as a lag rather than a lead in organizational change. Compensation is a highly emotional topic that may initiate resistance to change and emotional turmoil. Also, using compensation as a lag in organizational change allows it to better match the business strategy, structure and culture of the organization after the change. Therefore, compensation can be influential in changing employee behavior, but compensation systems should be designed as a lag rather than a lead when organizational change takes place.

Ledford Jr., G. E. & Mohrman, S.A. (1993). Self-design for high involvement: A large-scale organizational change. *Human Relations,* **46(2), 143-173.**

This case study examines a five-year action research project in a 12-place manufacturing division of a food-products firm that is trying to change its culture. The change efforts consider high-involvement management practices, large-scale organizational change, and self-design for managers and employees. Surveys were completed by 2,152 employees and assessed high involvement practices, organization functioning, employee quality of work life, and employee perception of team and plant effectiveness. The data suggests high involvement systems have particularly positive effects for start-up divisions. Survey, interview and performance results indicate change occurred and improved satisfaction and performance for both employees and the company as a whole.

McAdams, J.L., & Hawk, E.J. (1995). *Organizational performance and rewards.* **Scottsdale, AZ: American Compensation Association.**

This report is about performance-reward plans that can be successful for both the employee and the organization. The study identifies 663 variable pay plans from 372 companies in the manufacturing and service industries to explore strengths and weaknesses and offer suggestions at what type of performance-reward plan works best. The four areas of objectives for this study include business performance, improving teamwork, improving the performance-reward link, and improving the quality of the workforce. Organizational information such as communications, employee involvement, business performance, and plan development are also provided. The report lays out design features for performance-reward plans such as types of payout measures, output, cost reduction, gains, and management involvement. Financial, satisfaction, and non-financial results are reported, and suggestions are made for plan administration, reassessment and termination.

Milkovich, G. T., & Newman, J. M. (2005). *Compensation.* **Irwin Homewood, IL.**

This textbook examines the strategic choices in managing total compensation. A model of total compensation is introduced in the first chapter and serves as a framework for the remainder of the book. The authors discuss how to determine the structure, pay levels, individual pay and benefits in an organization. Internal alignment with strategic goals is reviewed through job analysis, job evaluation and person-based structures. External competitiveness is explored by examining pay levels and mixes in comparison with market values. Employee contributions are also identified through pay-for-performance plans and performance appraisals. Finally, the compensation of special groups, the role of the union in wage and salary administration, international pay systems, and legal issues in compensation are also discussed.

Mitra, A., Gupta, N., & Jenkins, G.D. (1997). A drop in the bucket: When is a pay raise a pay raise? *Journal of Organizational Behavior,* **18, 117-137.**

In this study, 192 student employees participated in a data-transferring task to determine how large a pay raise had to be before employees actually considered it a pay raise. Results indicated that minuscule pay raises were not viewed as raises and were often disappointing. The threshold at which an employee seems to consider a pay raise an actual raise appears to occur at about 7% of base pay. Anything less than that may not elicit any positive cognitive or behavioral reactions, and may not be effective in motivating employees. Future research on the cognitive reactions to pay decisions should be considered.

Morgeson, F., & Humphrey, S. (2006). The Work Design Questionnaire (WDQ): developing and validating a comprehensive measure for assessing job design and the nature of work. *Journal of Applied Psychology, 91(6), 1321-39.*

This study was used to develop the Work Design Questionnaire (WDQ) as a new tool to measure

satisfaction and learn more about work and job design. First, 107 work-characteristic terms were identified and sorted into three major categories: motivational, social and contextual. The motivational work characteristics included autonomy, task significance, task identity, feedback, job complexity, information processing, and problem solving. Social characteristics identified included social support, interdependence, interaction outside the organization, and feedback from others. Ergonomics, physical demands, work conditions, and equipment use were identified as contextual characteristics. The sample consisted of 540 job incumbents who held 243 distinct jobs. Results demonstrated excellent reliability as well as convergent and divergent validity.

Murray, B., & Gerhart, B. (1998). An empirical analysis of a skill-based pay program and plant performance outcomes. *Academy of Management Journal*, **41, 68-78.**

Outcomes related to productivity and labor costs were examined in this study to determine how they are impacted by the use of skill-based pay programs in organizations. Skill-based pay was found to have positive effects on organizational outcomes. Specifically, organizations using skill- based pay reported greater productivity (58%), lower labor cost per part (16%), and favorable quality outcomes. Researchers suggest that skill-based pay fits best in high-involvement environments such as those in a start-up or growth phase,

those that have participative cultures, and those that offered other incentive programs to complement skill-based pay. Although skill-based pay is related to positive outcomes, it's important to remember that successful use of skill-based pay includes challenges such as increased training, designing certification tests, recordkeeping, keeping track of employees, and many more administrative tasks.

Nelson, B. (1994). *1,000 ways to reward employees.* **New York: Workman Publishing.**

Rewards and recognition are some of the most motivating factors to improving performance in a company. This book offers a number of ways to reward employees in a variety of situations. The first part discusses informal rewards such as communications, time off, gift certificates, and celebrations. Next, awards for specific achievements were reviewed: employee suggestion awards, productivity awards, customer service awards, sales goal awards, attendance awards, and team awards, among others The final part of the book offers suggestions for formal rewards such as contests, educational rewards, special events, travel, stock ownership, benefits, and anniversaries. The book also features where to get reward items, companies with unusual rewards, and motivational companies and associations.

Neuborne, E. (1996, October 15). Meeting goals just got more rewarding. *USA Today,* **Retrieved Jan. 12, 2007, from www. usatoday.com.**

In this newspaper article, Eileen Neuborne explores the revolution happening at work in the 1990s in relation to a management theory called New Pay. New Pay links compensation to achieving the company strategy, and thus changes rewards at work. In the past, pay systems were based on seniority and cost of living increases, but New Pay compensation programs are offering profit sharing and bonus plans as incentives. Innovation and experimentation with new types of rewards are being investigated to improve pay plans at organizations across the country. Employees are being given a greater role in determining their own compensation by working hard and meeting strategic goals.

Peterson, S.J., & Luthans, F. (2006). The impact of financial and nonfinancial incentives on business-unit outcomes over time. *Journal of Applied Psychology*, **91:1, 156-165.**

This study demonstrated that both financial and non-financial incentives significantly improved business unit outcomes such as profitability, customer service, and employee turnover. In addition, this improvement in performance was found to continue over time. A quasi-experimental design used 21 fast food franchises split into

a financial group, a non-financial group, and a control group. Results show that the financial incentive had greater initial impact initially, but the discrepancy between this and non-financial incentives disappeared for profitability and customer service over time. Manager training and the use of a behavioral performance management incentive system were critical components to increasing employees' key performance behaviors.

Rodgers, R. and Hunter, J. E. (1991). Impact of management by objectives on organizational productivity. [Monograph]. Journal of Applied Psychology, 76, 322-336.

Management by objectives (MBO) includes participating in decision making, goal setting, and objective feedback. This study uses a meta-analytic technique to explore the effectiveness of MBO in the public and private sectors. Seventy studies that look at management by objectives were used in the meta-analysis. MBO programs were found to result in large gains in productivity when commitment from top management is high. MBO was not as successful in the government sector, usually due to a lack of management commitment. However, MBO was demonstrated to be successful in all public-sector agencies studied.

Roussel, P. & Heneman, R.L. (July-August, 1997). The emergence of individual reward systems in France. American Compensation Association News, 18-20.

Individual reward systems are beginning to replace general pay increases based on the cost of living and seniority in the French labor force. Higher costs of living, a decline in general funds for increases, and moves towards more efficiently designed organizations are some of the factors that led to this change. French employers feel that individual reward systems will allow employees to be held accountable for results-based performance objectives, and will not be based on the assessment of personality traits. Profit sharing and gainsharing are regulated by law in France, and team-based pay is only used by a few firms.

Rynes, S.L., Gerhart, B., & Minette, S. (2004). The importance of pay in employee motivation: Discrepancies between what people say and what they do. _Human Resource Management_, 43: 381-394.

Several practitioners underestimate the importance of pay in motivating employees. In many company surveys, employees respond that pay is not that important to them since they do not want to appear greedy or materialistic. In reality, however, academic research demonstrates that pay is a necessary but not sufficient condition in motivating employees. The authors suggest that

HR practitioners take complaints about pay seriously, don't fall very far below market pay levels, realize that most of the best employees want strong pay-performance relationships, and examine whether executive pay is moving in the same direction and at roughly proportionate rates to employee increases. These tips will help a pay system remain effective and will maintain the premise of pay as a motivator to employees.

Schay, B.W. (1997). Paying for performance: Lessons learned in fifteen years of federal demonstration projects. In _New Strategies for Public Pay: Rethinking government compensation programs._ San Francisco, CA: Jossey-Bass Publishers.

This book chapter is a review of federal demonstration project experiences in the area of pay for performance and their results. Conditions suggested for successful pay-for-performance systems include communication to employees about how rewards are given, supervisors explaining and supporting reward systems in discussion with their subordinates, varying rewards based on performance, objective and inclusive measures of performance, and high levels of trust between supervisors and subordinates. Several lessons were learned from these three projects. The first lesson suggested that mistrust of merit pay can be overcome by experiencing a system that works. Next was that money does not have to drive

performance ratings. Furthermore, labeling employees with adjectival performance ratings should be avoided. Finally, supervisor training in managing pay for performance is essential for successful implementation.

Shea, M.B. (2006). Anti-Trust implications in the Salary Survey Process. In *The Survey Handbook and Directory: A Guide to Pay and Benefits Solutions.* **Scottsdale, AZ: WorldatWork.**

Benchmarking through informal and formal surveys can potentially be violating antitrust regulations. In order to avoid these regulations, benchmark surveys should be managed by independent third parties, the information provided by survey respondents should be based on data more than three months old, reluctant participants should not be pressured into responding, and there should be significant number of participants that no one can be identified. When reporting results, the article suggests not identifying individual company data, displaying aggregate and historic data, and being cautious if the industry only has a few companies or high-profile companies.

Shaw, J.D., Gupta, N., Mitra, A., & Ledford, G.E. Jr. (2005). Success and Survival of Skill-Based Pay Plans. *Journal of Management,* **31:1, 28-49.**

Human Resource managers at 97 facilities of 73 companies answered

a questionnaire regarding design features and preferences related to skill-based pay. The success and survival of skill-based pay programs is based mostly on contextual factors like supervisor and co-worker support in addition to environmental characteristics such as the facility. Skill-based pay systems are less likely to survive in organizations following a technically innovative strategy. Design characteristics such as a focus on skill breadth, the total number of skills in the pan, and topped out percentages were less likely to predict the success of a skill-based pay system in an organization.

Stajkovic, A.D., & Luthans, F. (1997). A meta-analysis of the effects of organizational behavior modification on task performance, 1975-1995. *Academy of Management Journal,* **40, 1122-1149.**

The O.B. Mod approach was established in the 1950s and is based on reinforcement theory. The model developed from the behavior-modification approach is a five-step framework for measuring and evaluating employees' task-related behaviors intended to impact performance improvement. This study offers a meta-analysis of the research findings related to the O.B. Mod approach. It looks at the effect on task performance and characteristics that may moderate the relationship between the O.B. Mod approach and task performance. Results indicated a significant main effect for the O.B. Mod. approach on task performance of .51. Practical

implications of this study are that the O.B. Mod. approach produces stronger effects in manufacturing than in service organizations; that in service organizations, financial reinforcers result in stronger effects than non-financial interventions; and that the natures of different behavioral interventions should be examined to help increase employee effectiveness.

Stajkovic, A.D., & Luthans, F. (2001). The differential effects of incentive motivators on work performance. *Academy of Management Journal,* **44, 580-590.**

The nature, impact and mechanisms underlying the relationship between incentive motivators and performance are explored in this study. One hundred and eighty-two employees in the operations division of a large company were split into four groups representing various financial incentives. These intervention groups included one that received routine pay for performance, one that received monetary incentives, one that received social recognition, and one that received performance feedback. Financial incentives (money) were found to have high instrumental value that translated into increased performance. Social recognition was seen as a sign of future benefits and therefore also improved work performance. The feedback slightly improved performance as well, since employees felt they were communicated to in a positive manner.

Stajkovic, A.D., & Luthans, F. (2003). Behavioral management and task performance in organizations: Conceptual background, meta-analysis, and test of alternative models. *Personnel Psychology*, **56, 155-194.**

A meta-analysis of behavioral management studies in organizational settings was performed to examine reinforcement effects on task performance. The types of reinforcement effects looked at included additive, which are the sum of individual effects; redundant, which are when combined effects are less than additive effects; and synergistic, which are when combined effects are greater than the sum of the individual effects. The overall effect size was 0.47, with 16% improvement in performance and 63% probability of success when using behavioral management in an organization. The use of all three reinforcement effects together produced the strongest effect on task performance.

Sturman, M.C., & Short, J.C. (2000). Lump-sum bonus satisfaction: Testing the construct validity of a new pay satisfaction dimension. *Personnel Psychology*, **53: 673-700.**

This article focuses on satisfaction with lump-sum bonuses and finds a relationship with attitudinal variables beyond those provided by typical pay level variables and the pay satisfaction questionnaire. Lump-sum bonuses are cash payments to employees that are not added to employees' base wages. The study demonstrates the need to measure lump-sum bonus satisfaction, how the construct fits into the nomological network of the pay satisfaction questionnaire, and reliability and convergent validity of the instrument used to measure lump-sum bonus satisfaction. Results indicate that lump-sum bonuses are a separate and distinct component of pay. Future research should explore behavioral outcomes and the determinants of lump-sum bonus satisfaction.

Welbourne, T., & Gomez-Mejia, L.R. (1995). Gainsharing: A critical review and a future research agenda. *Journal of Management*, **21, 559-609.**

Gainsharing is growing rapidly in organizations for many reasons. The authors include the fact that many firms moved toward team-based work designs; many people are dissatisfied with other pay-for-performance systems; gainsharing is a relatively simple program to sell to top management, has a long history, and offers considerable flexibility to determine payoffs and the distribution of gains. This article offers a theoretical framework for studying gainsharing, as well as a conceptual review of past research and recommendations for future research. Some of these future research ideas include linking aggregate, team, and individual rewards; using gainsharing as a control mechanism, an instrument of change, and a strategic tool; understanding failures, risks and responses to gainsharing; and using multidimensional reward criteria.

Williams, M.L., McDaniel, M.A., & Nguyen, N.T. (2006). A meta-analysis of the antecedents and consequences of pay level satisfaction. *Journal of Applied Psychology*, **91:2, 392-413.**

This meta-analysis summarizes the past 40 years of pay level satisfaction research by looking at the relationships between determinants, antecedents, correlates and consequences. Two hundred and forty samples from 203 studies were analyzed to test a current model of pay level satisfaction. Results suggest that antecedents of pay level satisfaction include perceptions of pay policies, perceived job characteristics, perceived inputs and outputs of relevant others, and actual pay and pay raises received. Consequences include turnover intentions and population performance. Correlates such as perceived distributive justice were also important. Future research is recommended, such as testing the impact of personality and pay satisfaction, and further examination of other correlates such as performance reward contingency.
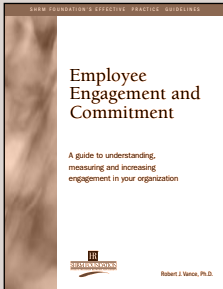
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by Robert J. Vance, Ph.D.

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by Elaine Pulakos, Ph.D.

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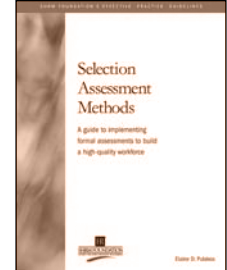
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by Elaine Pulakos, Ph.D.

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