How to Compensate Teams

by Loren Gary

AS IN FOOTBALL, SO IN business: These days, everything is "the team, the team, the team." The power of teams is now reflexively tapped to solve just about every management problem under the sun: improving quality, integrating marketing goals into new product design, reducing the length of product development cycles, reducing absenteeism and turnover, managing costs, outsourcing payroll functions, and more.

Those lucky folk who are paid to sit around and imagine the future believe that our love affair with teams represents a key stage in the evolution of the organization. In the next century, they say, companies may consist of a series of independent mini-societies that will be cross-functional, cross-hierarchical, interdependent, and "networked." But that's tomorrow. Today, team work remains a dramatic departure from traditional approaches to getting work done. And companies have just begun to grapple with the question of how they should compensate people who work on teams.

In theory, the new team pay should tie the performance of this new work unit to a company's goals. Research suggests that "if you want people to behave as a team, you have to treat them collectively," says Edward E. Lawler III, the director of the Center for Effective Organizations at the Marshall School of Business at USC. But as compensation managers have been discovering, there is a whole different order of complexity to the design of compensation metrics for teams. That is because our existing pay systems were not made for these organisms-within-organizations that are responsible for real work. Unlike traditional work groups made up of employees reporting to the same manager, genuine teams are interdependent or mutually accountable, working together on a shared set of products, processes, and/or goals. And their members do not necessarily come from the same organizational unit.

> *Skill-based pay systems support the work of teams.*

It's also difficult for any expert to design a "one size fits all" prescription for how your company should compensate its teams because compensation systems differ widely from organization to organization. Most companies use some form of incentive pay. Steven Gross, vice president and managing director of the Hay Group in Jersey City, and author of *Compensation for Teams*, believes that, when it comes to base compensation of individuals, some systems support the work of teams more than others.

The base pay system that's most widely used is somewhat ill suited for compensating teams. Called job-based pay, it quantifies an employee's breadth of knowledge, and his or her depth of knowledge in a particular skill. The best-known job-based point system for determining salary is the Hay System, named after Ned Hay, the government worker who invented it during World War II.

The Hay System was the worldwide standard for organizational compensation until the 1980s, when downsizing, the use of technology as a competitive wedge, and global competition forced companies to invent new ways to meet their goals. But its inflexibility does not easily accommodate the fluid nature of team assignments and responsibilities. In the past decade skill-based pay has been fast replacing job-based pay as the preferred compensation system in organizations.

Roughly equivalent to knowledge-based or competency-based pay, skill-based pay determines salary according to how many skills employees have or how many jobs they can do. It encourages the employee to continuously update and acquire skills that are critical to an organization's present and future ability to compete, and is used most often by organizations in tough, competitive industries.

Some compensation experts believe that skill-based pay may be best suited to organizations that make wide use of teams because it rewards the kinds of attitudes and behaviors that make teams successful. In a 1993 article in *Compensation & Benefits*, USC's Lawler, Gerald E. Ledford, Jr., and Lei Chang wrote that skill-based pay facilitates "job rotation and cross-training, which are essential to self-managing teams."

Different kinds of pay for different kinds of teams

Complicating the problem even further is the fact that organizational exigencies have spawned different kinds of teams. And different kinds of teams, experts believe, should be compensated differently. Ed Lawler and Susan Cohen, who is an associate professor at USC's business school, identify three kinds of teams:

- **Parallel teams** exist alongside the

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regular organizational structure, often doing problem-solving or improvement-oriented tasks. (According to one study, 85% of *Fortune* 1000 corporations use parallel teams.)

- **Project teams,** such as new-product development or information-systems teams, bring together knowledge workers from across disciplines to work on projects that have a definite but relatively lengthy time frame. (The workers participate full-time, until the goals are met and the team dissolves.)
- **Work teams** are self-contained, self-managed, interdependent units that produce a product or provide a service. (These are known as process teams; their members are full-time and membership on the team is permanent.)

While traditional compensation systems match pay to a job or a person, the challenge in compensating teams is to design a system that rewards group performance and, when appropriate, also rewards individual members of the team. Effective team-based compensation strategy uses elements of existing reward systems and tailors them to particular kinds of teams.

Compensating parallel teams

Because of the adjunct nature of parallel teams, Lawler and Cohen recommend compensating team members through an add-on reward system, such as a gainsharing plan, which quantifies cost reductions or other gains and, using a predetermined formula, distributes the gain among team members. While profit-sharing plans kick in quarterly or annually, gainsharing plans can take effect more quickly. They also motivate the team to generate more such ideas. Keep in mind, though, that the motivational value of the gainsharing bonus diminishes as the time draws out between the suggestion of cost-saving ideas and the award of the bonus.

A caveat or three: Consider offering some kind of reward to non-team members whose cooperation is needed for the team's suggestions to be accepted and implemented. And don't reward for projected savings before they are realized, unless you want to reward for effort rather than success. Finally, take care that the incentives you design for parallel team members don't create a conflict of interest between employees' regular job responsibilities and their part-time parallel team assignment. It's counterproductive, for example, to have employees cancelling important meetings they must attend to do their regular work because their parallel cost-reduction team has an incentive for having a meeting and coming up with new ideas. (Gross recommends giving team members recognition awards or merit bonuses for their regular jobs and for performance in the parallel team.)

> *Different kinds of teams require different kinds of pay.*

As for the base pay component of parallel team members' compensation, skill-based pay can be a logical choice because it rewards team members for learning new problem-solving and analytical skills. But be sure to do a cost-benefit analysis here. It may be a waste of money to pay employees to learn skills for a parallel team that meets for only a few hours a week. If it is, Lawler and Cohen recommend, use job-based pay instead.

Compensating project teams

Parallel teams can often perform optimally without any changes to the existing compensation system. Adopting the team's suggestion may be its best reward. Project teams, however, require specially designed compensation plans because they often create something new. But the value of that new product or service may not be apparent until several years down the road, when data on market share and customer satisfaction becomes available.

Traditional compensation systems evaluate and reward performance on an annual basis, but compensation for project teams should be linked to the completion of the team's tasks. (It should also be adjusted if membership on the team changes over the course of the project.) Because it's hard to judge the effectiveness of a project team in the near term, it may make sense to reward group performance with gainsharing, or with a collective pay-for-performance system that covers not just the team but also the larger organizational unit. These options make good sense when the team's work has a major impact on the overall effectiveness of the unit, or when the time span of the team's project makes it difficult to measure and reward results because they won't be apparent until later.

It's tricky to manage, but experts believe that members of certain kinds of project teams should be rewarded for their individual contributions. Some biotechnology firms, for example, have devised a "walk on water" category for high performers (about 10% of employees).

Companies can assess the individuals' contributions at the end of a project by gathering peer and customer satisfaction ratings, and then melding these ratings with the organization's assessment of the success of the overall project. Managers usually like to exercise the prerogative of modifying peer and customer ratings on a case-by-case basis, but that can be counterproductive. Too many modifications may make the compensation appear subjective to employees.

Instead, consider canvassing the members of the team. They are often in the best position to evaluate each other's performance, even when the project team is heterogeneous. If the team members are mature, they will tend to be honest about rating each member's contribution, even if one member's work is valued at ten times the contribution of others on the team. In such situations, some companies award bonuses based on a set percentage of salary rather than the same fixed-dollar bonus for every member of the team. Champion International, the paper manufacturer based in Stamford, Connecticut, has created a formal bonus system that calculates project team bonuses using the midpoint of a salary grade. The employee's performance is rated on a scale of one through five. The lowest rating (none of the goals achieved) garners no bonus. The highest rating (all goals and then some met) yields a bonus of up to 34% of the salary range midpoint. At Champion, multipliers based on overall company performance can increase the size of the bonus even further.

Compensating work teams

Specially designed team incentives are often most effective for permanent, institutionalized work teams because their members are so interdependent. In the example of a manufacturing team in a highly automated oil refinery, one individual's work can affect everyone else's, and individual contributions are difficult to identify. A work team's objectives should be clearly defined, and the feedback systems and evaluation measures should be explicitly stated by the company.

Merit pay (in the form of salary increases or bonuses) and gainsharing plans can be effective ways to reward work teams. Companies may wish to distribute different rewards to different team members. Again, it's important to monitor the system you develop so that it doesn't undermine cooperation and group effort.

Lawler and Cohen believe that gainsharing is "particularly well suited to the participative nature of work teams....It provides motivation for work teams to monitor their performance and learn about leverage points for improving performance." Starting in 1995, Champion International introduced an all-employee gainsharing award based on productivity. The results were so positive that the company expanded the program: half of all Champion's large factories now have gainsharing plans.

In some cases, however, gainsharing can be counterproductive, resulting in what Cohen refers to as "suboptimization at the group level." In one example, a geographically organized claims-processing team in an insurance company had incentives that effectively discouraged cooperation

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Incentives for Teams

When crafting compensation systems for teams, keep in mind that:

Skill-based pay alone may not get teams where you want them to go.

Literature dating back to experiments at Western Electric's Hawthorne plant in the 1920s and 1930s documents the productivity boosts that come from incentive pay.

Rewards are not the most important element of a performance-management system.

It's more important to define the team's objectives and establish mechanisms for reviewing and modifying behavior. These are the key drivers of team effectiveness. As USC's Cohen says, "Rewards should be a lag system rather than a lead system."

Make sure that your compensation system gives first priority to the collective goals.

Within this framework, don't feel bad about naming and rewarding a "most valuable player," as long as the method of evaluation is clear.

The amount of incentive pay must be meaningful.

It takes incentive pay of at least a month's worth of salary—and a minimum of $1,000—to get a line worker's attention. At Champion International, says Mark Childers, senior vice president for human resources, "It's not unusual for management teams to have incentive pay make up 40% of total compensation, with these bonuses dependent on the achievement of team goals."

Match the incentive to the value of the task.

If a successfully completed task has permanent value to the company, use a salary increase. If the task has only one-time value, reward it through a one-time bonus.

To optimize the team's efforts, express incentives in terms of unit or organizational goals.

This discourages teams from winning incentives at the expense of the overall unit or the company.

with work teams from other parts of the country, thereby impairing the company's overall performance. "In such instances," says Lawler, "the real issue is not whether to reward teams, but whether to reward individual teams or collections of teams." To prevent such suboptimization, Lawler recommends tying incentives to overall organizational goals so that various work teams will be motivated to collaborate.

The team—and the swamp

Crafting team-based performance metrics is complicated, fuzzy, highly nuanced work. If you are charged with doing it, the best advice is this: Override the urge to stick slavishly to guidelines, and focus instead on the particular needs of particular teams. Otherwise, instead of cheering "the team, the team, the team," you may be found wandering the halls of the organization muttering "the swamp, the swamp, the swamp." Your creativity will benefit your company and its teams. So might a pair of hip waders, and the exhortation "Go, team, go!" ■

If you want to learn more . . .

Compensation for Teams: How to Design and Implement Team-Based Rewards by Steven Gross (1995, AMACOM, $65.00, 272 pp., Tel. 800-262-9699 or 518-891-1500)

Strategic Pay: Aligning Organizational Strategies and Pay Systems by Edward E. Lawler III (1990, Jossey-Bass, $26.95, 328 pp., Tel. 800-956-7739 or 415-433-1767)

"Designing Pay Systems for Teams" by Edward E. Lawler III and Susan G. Cohen (*American Compensation Association Journal,* Autumn 1992, pp. 6–18, Tel. 602-951-9191)

"How the Right Measures Help Teams Excel" by C. Meyer (*Harvard Business Review,* May–June 1994, pp. 95–103, Tel. 800-988-0886 or 617-496-1449)

"Who Uses Skill-Based Pay, and Why" by Edward E. Lawler III, Gerald E. Ledford, Jr., and Lei Chang (*Compensation & Benefits Review,* 1993, pp. 22–26, Tel. 800-262-9699 or 518-891-1500)

web sites for managers

Focus on Process Management

The following sites on process management and its components—business process reengineering, business process redesign, workflow management, etc.—are recommended by electronic products specialist Ken Liss.

Process Management and Improvement

http://www.dtic.dla.mil/c3i/bprcd/3003s2.htm

The value of a process management model for modern organizations is laid out in considerable detail in this section of a Department of Defense (DoD) paper on process improvement. While the paper was written with an eye toward DoD processes, it is nevertheless broad in scope, outlining ways for all managers to meet the diverse interests of customers, suppliers, resource providers, and other "process stakeholders." The paper helps explain the differences between various components of process management, such as business process reengineering and business process redesign. Links are provided to the full paper and to other material from the government's extensive Electronic College of Process Innovation.

WARIA Web Sites

http://www.waria.com/@5sites.html

This site, from the Workflow and Reengineering International Association, provides links to publications, associations, research organizations, and government bodies concerned with workflow and related topics. It also offers information about Internet mailing lists that are available for those interested in process management.

Business Process Reengineering & Innovation

http://www.brint.com/BPR.htm

Business Process Reengineering (BPR) is the focus of a section of @BRINT (A Business Researcher's Interests), which is a wide-ranging guide to business information available on the Web. The Business Processing Reengineering section of @BRINT includes links to BPR articles and papers, books, periodicals, bibliographies, and tools, as well as other resources and related topics.

Process Management Glossary

http://www.carras.com/glossary.html

Useful for anyone seeking an understanding of basic terms and concepts used in process management. Jim Carras, a Texas-based business process management consultant, has put together a glossary that defines Activity-Based Costing, Integrated Definition Language (IDEF), Cause and Effect Diagrams, Knowledge-Based Processes, and more.