

# The Compensation Solution

## How to Develop an Employee-Driven Rewards System

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Chapter One: From Old Pay to Total Compensation

This book is about a total compensation solution, or what used to be called pay and benefits. The total compensation solution is based on a rethinking of employee compensation and investment systems into an employee-driven system I call cafeteria compensation. It is the new "new pay."

Compensation thinkers have been raising questions about the structure of existing (and often rigid) pay systems for some time. In 1971, Ed Lawler way ahead of his time introduced the then-shocking idea of linking pay and organizational development, in a book of that title.<sup>1</sup> W. Edwards Deming pointed to the random nature of the relationship between pay and performance in *Out of the Crisis* (1982).<sup>2</sup> Lawler scored again in 1990 with his classic *Strategic Pay: Aligning Organizational Strategies and Pay Systems*.<sup>3</sup> And in 1992, Jay Schuster and Patricia Zingheim introduced the concept of new pay in another book (with a foreword by-you guessed it-Ed Lawler!).<sup>4</sup>

Recently some new books have continued the contribution of these thinkers. In 2000, Lawler talked about rewards in *Rewarding Excellence*,<sup>5</sup> and Zingheim and Schuster reversed the order of their names but not their message in *Pay Them Right!*<sup>6</sup> Notice, though, that most of these books and thinkers, and many others, are still talking about pay. We Americans have pay on the brain. But is pay all there is? The answer is no. It is no because pay is often badly configured and no because other things besides pay are needed to attract, retain, and motivate employees.

I think Jerry McAdams puts it best in his terrific book, *The Reward Plan Advantage*.<sup>7</sup> He sees rewards and "the reward plan" as a way to energize the people you have and hone their skills and attention so that they are operating at close to peak performance. As any orchestra conductor or coach knows, just having the people, even talented people (or, perhaps, especially talented people) does not a good performance make. I use these examples because Jerry also speaks out in favor of team-based rewards. In our individualistic, each-tub-on-its-own-bottom society, this is courageous as well as correct. Others have talked about the importance of systems-W. Edwards Deming was one. But Jerry gives us some clues about how to approach actually doing it.

He does something else I would like to endorse, as well. He talks about best principles rather than best practices. This book is like that; it presents a set of principles to stimulate locally developed practices. Jerry comments, "There are few, if any, 'best practices.' Improving performance through people demands that you create plans unique to your organization. There is danger in cookie cutter answers."<sup>8</sup> You can say that again. And his words apply very well here. Take the cafeteria compensation idea and, with the help of your employees-the very ones who are the intended recipients of the plan-use it to build a package for your shop that makes sense for your shop. That will be something that works.

Let me add one more word about employee involvement. Throughout this book I will be

suggesting that you ask employees what they think and want. It seems so obvious. But many of the problems with the current system stem, in part, from the absence of this simple step. Remember that involvement is as American as apple pie. The Boston Tea Party was about the absence of just that-"No taxation without representation." American businesses have fallen into the same mistake the British government did, but we can learn from their mistakes.

### Cafeteria Compensation: Building in Diversity and Choice

The idea of cafeteria compensation goes beyond pay alone to propose a rewards and investment system-a group of ten variables that together encompass the variety of kinds of compensation that today's employees want from work. Pay is among them, of course (including both base pay, or salary, and one-time pay received in the form of overtime or bonuses). But in addition to monetary rewards, contemporary employees want and are increasingly demanding reward diversity and reward choice. In today's diverse, global economy one size does not fit all. Employers are finding that employees want a range of different things from the workplace. Employees will even exchange some level of base pay to get some of the other things they want, such as the psychic income derived from a job that an employee considers meaningful or, as one woman told me, a "jerk-free environment." Moreover, not only do different employees have different needs at a given time but the needs of individual employees change over time.

This roiling of the waters of need creates a pressure for choice. Choice is everywhere today, in the workplace no less than in the supermarket. Employees are increasingly looking at their paycheck the way they look at their market basket-they want some say in what goes into it. They want the chance to configure, within reasonable limits, their own rewards systems.

The model for the system proposed here is the cafeteria benefits plans that allow employees to tailor their benefits to their own needs and interests and those of their families. In a similar fashion, cafeteria compensation increases the quality and diversity of the rewards available as well as the level of employee choice. This system is one that can attract, motivate, and retain employees because, like a fine restaurant, it offers quality, variety, and choice. Because it goes beyond pay, even the "new pay" to be discussed further on, I have called it the new new pay.

Why do we need such a dramatic transformation of compensation systems? There are two basic reasons. One is that there is lots wrong with "old pay" for all workers. The second is that newer workers, in particular, need a different compensation mix from the one that suited their predecessors. This chapter examines these fundamental issues with old pay in some detail and then sketches the outline of the total compensation solution. Chapter Two presents the elements of the solution in greater detail.

### Before You Start

The remainder of this chapter deals with some of the problems with old pay, and then discusses some of the reasons those problems persist. The focus here is on the private sector. (The public and nonprofit sectors are briefly discussed in the Appendix, but the discussion in this chapter can also be applied to them fairly directly. Their picture is much the same in terms of problems, though played out in terms of smaller dollar amounts.)

Many readers will find the list of problems familiar, and perhaps discouraging. Further, discouragement about their persistence-a feeling perhaps that we are trapped in the

current system and there is nothing we can do-may be the main thing that comes to mind. The very fact of the problems' familiarity means we need to face them squarely.

There are several points I urge you to keep in mind. First, it is important to lay the problems out as a first step to any process of improvement. Compensation is the "elephant in the living room" of most organizations-large, oppressive, and unaddressed. Attention to pay systems is often nonattention. It falls into what Harvard's Chris Argyris called "defensive routines"-they are not discussible, and their nondiscussibility is not discussible!

Second, cafeteria compensation provides a solution to some of the pressing problems of compensation. At one level it can be a solution-map. It provides a vision of where we should go, even if progress is slow. That is, it provides a systematic way of thinking about compensation issues. More concretely, it is a system that can actually be implemented. At this level, some people may balk. One can imagine the comments. "Letting individuals construct some of their own pay package? Can't do it! Could never do it! Must have been designed by a professor!" However, remember that we have already been through this kind of change when we went from one-size-fits-all defined benefits packages to cafeteria benefits. Many of the same cautionary tales were told, the same hand-wringing went on, but, voilà! Here we are today with cafeteria plans all over the place, employees picking and choosing, companies crafting overall models to the needs of their particular firm, and so on. We have already made this journey.

I see two basic approaches to change. If you take the vision approach, in which cafeteria compensation is the ultimate goal, then you can embark on transactional change-one step at a time, building on small wins toward the final, comprehensive plan. This is an evolutionary approach to change. On the other hand, you might wish to try the whole thing, whether for the entire organization or for a single unit. That would be transformational change, or revolution. Each approach has pluses and minuses, as I'll discuss in Chapter Nine. You will need to think of your own setting, energy, and support as you go forward. The point is to be open to what a new and more effective system would look like, and the advantages it would bring, whether or not you can picture getting there all at once.

#### The Many Failures of Old Pay

In the typical old pay approach, compensation can be thought of as consisting of five parts:

Base pay

Annual merit raise

Benefits

A few perks

Occasional gratuities (Christmas bonus, and so on)

This way of thinking about compensation poses a number of problems from both the organization's point of view and that of the employee. I will discuss them in more detail throughout the book, but it helps to get an overview of some of the most general and pressing problems. Here I'll mention nine of them. The first four are inherent in old pay

itself. The remaining five concerns are more generalized problems of old pay systems.

#### Inherent Problems with Old Pay

Some problems are inherent in the way old pay is conceptualized:

Pay becomes entitlement driven. In old pay, employees feel they are entitled to their pay, and to raises in pay, unconnected with any accomplishments they produce.

Increases cap out. With old pay, increases are cut off when the employee reaches the top of a job's range. Employers thus "bump" workers to higher job classifications solely to give them more pay.

Failure to motivate. Old pay does not motivate because it is mostly unlinked to the employee's production and contribution. To begin with, base pay (before "merit" adjustments) is frequently unconnected to any results or accomplishments. It is almost as if one is paid a salary just to show up.

Annuitized. With old pay, each raise goes into the base. Hence employers pay year in and year out for last year's accomplishments. This means that employee investments keep costing more without any parallel increase in productivity. It is like throwing good money after bad.

#### Problems with Old Pay Systems

Employers often realize that old pay creates entitlement, cap-out, motivational, and annuitization problems. But like runners with stones in their shoes, they can't seem to find time to stop and change the situation. However, the story does not end there. Old pay systems drive some more general problems for employers that compound the initial set. Compensation systems are supposed to attract, retain, and motivate employees. Most pay systems fail on this larger count. Many current pay systems give the wrong message. Their very structure communicates messages that are at variance with the publicly expressed wishes and commitments of executives and the corporation. The system itself fails to walk the talk. It is hard to attract and retain when the gap between pronouncement and practice is large. More specifically,

Thinking about compensation is fragmented. In most organizations many different types of people think about the various forms of compensation. Some think about pay, others think about benefits, others think about training, still others think about employee discounts. Some think about "rewards"; others think about "investments." No one thinks about the whole package.

Employee cost calculations are limited and hidden. Because the thinking about employee rewards and investments, as well as their administration, is distributed throughout the firm, the company has very limited ability to ascertain the total cost of an employee to the organization. Correlatively, it has a limited sense of what the total employee cost should be and a limited sense of the replacement cost for that employee.

Failure to leverage the system. The fact that so many people are involved in "rewards" means that firms cannot leverage the system by aligning all rewards in a single package.

Lack of employee involvement. The lack of involvement on the part of employees is a characteristic of old pay systems. In spite of the cultural history of America, which is built on participation of those involved ("No Taxation without Representation!"), many firms simply tell employees what their compensation is—they wouldn't think of asking what people want.

Failure to drive change. A failure to drive change retards change. As the old community organizers would put it, "If you are not part of the solution, you are part of the problem." Old pay tends to keep organizations from recalibrating rewards systems and aligning them to new goals and strategies. Employees work in teams, for example, but are paid as individuals. Hello!

Benefits represent another type of problem. They have become a large cost, 30 percent and up of salaries and wages. But employers get little benefit from benefits. Indeed, they are trapped in the hammerlock of "defined benefit" mind-sets, both for medical and pension elements. Having promised a certain level of medical coverage, for example, they are caught in the trap of having to provide that coverage regardless of cost. The same is true of pensions. Defined benefit plans trap the employer with high expectations and unfunded or underfunded liabilities.

As for perks, except at the executive level, they are being phased out (except for discounts on company products) because they have become taxable and require lots of record keeping. Also, employees frequently are unclear about who is entitled to what. Finally, the occasional gratuities that firms throw to employees have little motivational value, as they are neither prewards (rewards in anticipation of accomplishment) nor postwards (rewards that follow accomplishment); connectivity and line of sight are lost.

These and other problems of old pay create an organizational subsystem that is always lagging behind the other parts of the organization. No wonder Steve Kerr talks about the "folly of rewarding A while hoping for B."<sup>9</sup>

Problems from the employer's side of course have impacts on employees as well, though the employee perspective is usually different. Employees are mostly satisfied with their pay, but very dissatisfied with the pay system. The "capping out" problem traps them in some rank; the raises are usually small (because they are across the board). Money comes, or does not, independent of accomplishments, and this apparent randomness is a huge demotivator. Oddly, the system we think should attract and retain often dissuades and dismisses.

#### One Professional's View of the Problems with Old Pay

I'm not alone in pointing out the deficiencies of the standard pay system; other practicing consultants concur. When I talked with Don Lowman (a principal of Towers Perrin) about compensation-related issues, he stressed the following five issues with old pay:

1. Structurally behind the times. Organizations have changed their structures a lot in recent years. They have become flatter—with fewer layers—and they have revised career paths. Job responsibilities are more flexible and more ambiguous. And there have been fundamental shifts in workforce profile and expectations. Meanwhile, new sources of competition are continually emerging.

Despite these changes, many organizations persist in using outmoded elements of pay programs: narrow and confining salary ranges (although this feature diminished greatly

in the late 1990s); salary programs that continue to reward heavily for traditional values (for example, scope of responsibility and number of direct reports) rather than current needs (competencies and hot skills); job-based criteria for determining pay opportunities; use of market pay data from traditional competitors; overreliance on cash for retention and motivation; and merit pay processes that provide little opportunity to recognize differences in individual contributions.

2. Culturally behind the times. Current pay systems are based on an implicit contract with employees that expired without being renewed. The old contract said, "If you work hard, the firm will take care of you." Taking care of you meant, largely, that you would keep your job, almost no matter what you did (or, more likely, did not do), and that all employees were entitled to some market adjustment to stay "whole." Pay, in the old contract, involved the following elements:

Cost of living increase. This increase came every year.

Increases attached to base. That is, raises were added to the employee's base pay.

Increases largely based on seniority. Raises were greater for those who had been with the organization longer, sometimes because length of service was directly figured in, and sometimes because, using a percentage increase model, those who had been there longer made more money and hence received a bigger dollar increase.

Grade-based promotion. Promotion to higher salary grades (based on seniority) carried employees to higher pay potential, both in salary and bonus. (Bonuses were typically calibrated as a percent of salary so in this model the more you made the more you got.)

Trophies. At various anniversary dates of employment (five years, ten years, and so on) employees were given mementos of their association with the company: the hat, the pen and pencil set, the watch. Usually the watch was given (as it was to my grandfather) on retirement, just when the employee didn't need it. Trophies would, of course, have been more meaningful if they had been given in relationship to some actual accomplishment rather than just for hanging around.

Holiday gifts. At holiday times, especially Christmas, the company gave employees a gift—a turkey, a ham, a basket of fruit.

Bonuses. Periodically, but often unconnected or connected only hazily to anything the employee could figure out, a bonus was provided.

This old contract was based on old rules, which in turn were driven by the old organization. It has run smack into a new culture, fueled in part by new organizations, new generations of workers (Gen X), by new consciousness in workers who are fed up with being treated as second-class citizens (older workers and women of all ages), and by traditional workers who are sick of being evaluated on the basis of facetime (time in the plant). As many firms are beginning to realize, this new culture calls for a new work contract.

The new contract says, "If we outperform the market, you will share the rewards." This approach is more of a "contingent contract." It sets goals of production and invites employees, units, and divisions to share in them. Perhaps the most famous statement of

this kind of approach was articulated by General Electric's Jack Welch. Each division at GE was to be number one or number two in its market. Otherwise one of three things would happen: "fix, close, or sell." If a division maintained its desired position, however, workers in that division were entitled to share in the profits.

The new contract has several elements that are quite different from the old one:

Employees have to earn the right to competitive pay. No more entitlement. No one is guaranteed anything, necessarily. Personal pay is driven primarily by performance, which takes into account not only individual contributions but also group and company performance.

Self-funded at the unit level. As in the GE approach, the profit is shared by profit centers within the organization. Employees may have several sources of pay, and what they get depends on the performance of the various units.

Variable pay. At the individual level, pay (or salary) becomes somewhat variable. Employees are not entitled to their entire pay unless they meet certain benchmarks; however, if they exceed the benchmarks, they can make more than their agreed-upon base.

Line of sight. Most organizations have tried to adopt approaches with a stronger line of sight between the pay individuals receive and the performance results they most directly influence. As a result, many variable-pay arrangements are tied to business-unit results.

Unit gainsharing. The bonus pool is figured on the gain the unit makes above market averages, minus costs and scrap.

Firm gainsharing. This portion of the bonus comes from the overall firm performance, again, looking at the amount above market.

Market adjustment to base. Base pay is adjusted, overall and for individuals, depending on market forces, not seemingly random acts of the Human Resources Department.

New-contract thinking is part of—indeed the basis of and driver for—the total compensation solution explored in this book.

3. Strategically out of whack. A third problem identified by Lowman is that traditional pay systems are misaligned (or unaligned) with fundamental business strategies. For example, the firm states that part of its strategy is to be a top performer. Yet the same company targets median competitive pay levels and rewards only senior executives for financial performance. What the strategy calls for is increasing target pay opportunities, creating incentive leverage, and rewarding everyone for contributions to financial performance.

Here's another example. The company states a strategic goal of increasing long-term value for shareholders, yet it ties bonuses exclusively to short-term financial performance. What it needs to do is to identify performance measures linked to shareholder value creation and incorporate these into incentive programs.

Or consider an announced strategy of achieving competitive advantage through people.

The same company may manage pay programs to minimize cost, equate employees with cost, and cling to the belief that employees should not be paid too much (the sticker shock hypothesis). Aligning pay systems with the strategic goal requires managing pay programs to maximize returns. It means treating employees as the ratio of output and cost, and rethinking sticker shock by paying less attention to whether pay exceeds some competitive norm and more attention to whether the firm is getting its money's worth through performance accomplishments.

4. Significant say/do gaps. Old pay systems frequently are in conflict with the values espoused publicly by management. For example, managers may proclaim values like these:

Link executive and shareholder interests.

Develop a highly skilled workforce.

Encourage employee involvement.

Promote teamwork.

Recognize outstanding contributions.

Focus on quality and customer satisfaction.

Meanwhile, the pay system

Allows frequent churning of stock options.

Uses traditional job-evaluation approaches.

Ignores or discounts employees' views in developing pay programs.

Uses restrictive merit-pay approaches as a primary reward device.

Ties bonuses to accounting measures of performance.

5. Top management double standard. In many organizations, there are only weak links between pay and performance at the very top, at the same time that management insists on stronger links elsewhere. Thus firms pay their top people large bonuses in the face of languishing performance, make "mega" options grants with multimillion-dollar paybacks in the face of below-average returns, and generally eliminate pay risk for top executives. What messages do such practices communicate to the rest of the organization?

"We are exempt from the pay-for-performance doctrine we claim for you."

"We should have less financial risk than our shareholders."

"We should make money from company stock even if the owners lose."

"Entitlement is out-except for us."

Combining my recital of issues with old pay with Don Lowman's observations (and the similar problems in the public sector mentioned in the Appendix), I am reminded of the gallows joke-"Other than that, Mrs. Lincoln, how did you enjoy the play?" Yet even though many compensation specialists, human resource officers, CEOs, and employees would agree with these problems-and indeed could add to the list-somehow the band plays on. Why should that be the case?

### Structural Lag and Means Ritualism

Social scientists call this kind of situation structural lag. Structural lag occurs when a culture and its values have progressed and the organizational structure has not caught up. It is, in other terms, what the sociologist Robert Merton called "means ritualism."<sup>10</sup> New ends have come into play, but we are still stuck using the old methods and cannot seem to get out of them.

Structural lag and means ritualism emerge from two broad groups of processes. One group involves the lack of a change strategy; that is, we keep on doing things the same way because we cannot think of anything new, or we do not have ways to implement the new thing, or we do not have the energy to implement the new thing.

The second group results from an organization's muscle memory. When organizations (or people) do something one way for a while, it becomes a default style-action taken without thought. Default styles are tougher to change than more surface behaviors, a fact that makes the lack of a change strategy even more important. Worse, default styles emerge most powerfully under stressful conditions-that is, when organizations (and persons) fall back on the "tried and true." The tried and true, of course, are the very things that got the organization into the stressful condition in the first place, so their employment is usually 100 percent contraindicated.

### False Theories About Employees

Default styles continue to pop up despite the repeated failure of the tried and true solutions to address new conditions, however. They are sustained in part by false theories about employees, which form an important element in resistance to change:

- Misunderstanding of the motivational components of performance

- Misunderstanding of the importance of Theory Y

- Misunderstanding of job structure and the order of satisfaction with work and the completion of good work

- Misunderstanding of job satisfiers and job dissatisfiers

- Misunderstanding of the motivational structure of the employee

- Misunderstanding of the cultural conflict between achievement and equality in the workplace

- Misunderstanding of the motivational hierarchy of needs

It's useful to consider the ramifications of these seven misunderstandings.

1. Components of performance. Employers typically undervalue their own responsibility for employee performance. Performance results from a complex interaction of ability multiplied by motivation. (I provide a more detailed discussion of performance in Chapter Eight.) Employees with lesser ability can compensate with higher motivation; those with great ability do not have to work as hard as others do to achieve even better results.

The manager's job is not only to recruit for ability and motivation but to develop them on the job. Organizations are only now beginning to understand that it is almost impossible to "recruit" to greatness. Recruitment is only a beginning.

Ability and motivation in turn have components. Aptitude, of course, is a factor in ability. But most of us tend to overrate aptitude and diminish the importance of training and resources. These components need to be provided by management, in cooperation with employee input.

Motivation also has components: desire and commitment. Here again, employees have their part to play; the firm, though, has to create followers who want to come to their work and are committed to the importance of it.

The misunderstanding, then, is an almost total reliance on the employee to "produce" performance. It is one of the important elements of cluelessness about the firm's role in becoming a high-performing organization.

2. Theory Y. One of the most famous distinctions in management is that between Theory X and Theory Y.<sup>11</sup> Theory X refers to a belief that workers do not want to work and that an employer therefore needs a reward and punishment system (very much like that used in animal training) to assure that workers show up and shape up. Part of Theory X is the notion of "span of control," the idea that the number of workers a supervisor can supervise is about five. Each worker has to be closely watched. And the watchers have to be watched. You can see how this produces a tall pyramid with a narrow base and many levels. Part of the organizational structure that is now passing was driven "by the numbers."

Theory Y argues that that workers want to work and get satisfaction out of doing a good job. The job of the organization is not to control the worker but to provide resources so the worker can get the job done. Theory Y is the one needed for today's flatter, more self-directed organizations. This theory replaces span of control ( $n = 5$ ) with "span of communication." Managers do not check on workers; workers check in with managers when there is a problem.

The problem is that we continue to have a Theory X mind-set in a Theory Y environment. Old compensation systems are still, in many ways, driven by Theory X thinking. No wonder they hold back change and diminish the organization's productivity.

3. Structure of the job. Many employers believe that satisfied employees produce good work. Hence they try to "improve morale" in the hope of improving quality. The trouble is, they have the causality backwards. What employers should do is improve the structure of the job first. Good jobs lead to satisfied workers, and satisfied workers lead to higher quality and productivity. Employees like jobs that have significance (meaningful work), wholeness (you get to do a complete package, making the whole salad instead of being

"lettuce man"), variety (using different skills and having different assignments), autonomy (being able to work "on your own" in a Theory Y way), and responsibility (being accountable). Employers would be better off if they started by modifying the job rather than the worker. Besides, changing the job is a lot easier.

4. Satisfiers and dissatisfiers. One of the casualties of Theory X is that employers fail to see three important things about their employees' relationship to the workplace. First, employees have a wide range of satisfactions from work that begin with the work itself and extend into the social elements of the workplace. Second, there are some surprising things about work that workers do not like and that employers leave largely unattended. Third, the "satisfiers" and the "dissatisfiers" are not the same things, meaning that employers have two tasks: create satisfaction and remove dissatisfaction.

Table 1.1 depicts how the combination of satisfiers and dissatisfiers characterizes the desirability of the workplace. Optimally, the employer would like to be the workplace of choice—a place so good to work that people struggle to get there. At the other end of the continuum is the workplace from hell. Scott Adams—through his "Dilbert" series—tells us much about that.<sup>12</sup>

Table 1.1. Effects of Satisfiers and Dissatisfiers

on the Desirability of the Workplace

		Dissatisfiers	
Satisfiers	Few	Many	
Many	Employer of choice		A great place to work, but it costs you.
Few	Comme çï, comme çã		The job from hell.

With this picture in mind, consider the following list, which spells out some of the things employees like and dislike. It would be good to study this list. Employees like to be able to achieve—in levels or in tasks. The work itself and the feeling of responsibility have just been mentioned. Attachment, the social dimension of the workplace, is important as well. Each of these things—and money is not among them—are things the employer has to manage, create, and assist over and above money in order to draw and retain employees.

Top Satisfiers	Top Dissatisfiers
Achievement	Company policy and management
Recognition	Supervision
Work itself	Relationship with supervisor
Responsibility	Work conditions
Attachment	Relationships with peers

Growth Relationships with subordinates

Notice that the dissatisfaction list is heavily relationship-based. One thing employees find problematic about their workplace is the other people in it! As a practical matter, this means-based on the employees I have interviewed-that managers really are not doing their job. People are problems because management does not take appropriate action to provide discipline and structure.

5. Motivational structure: employees' dual nature. Most employers think of the employee as a single person. So do most employees. As is so often the case, however, reality is more complex. Some years ago Harvard economist Thomas Schelling came up with a two-self model in an article he titled "Egonomics."<sup>13</sup> Schelling pointed out that the two "selves" embody two different preference schedules: money now (cash in hand) and money later (cash put aside for retirement). There is the good-for-me-now self and the good-for-me-later self. These selves conflict along a range of issues. In a way, employers pay both of these selves, via the monthly check for the here-and-now self and the retirement contribution for the then-and-there self.

A little bit later, Richard Thaler and H. M. Shiffrin developed the "planner/doer" model (they referred to it as the farsighted planner and the myopic doer).<sup>14</sup> Here's a summary of these views of the dual self:

Here-and-Now Self	Then-and-There Self
Fun for me	Good for me
Doer	Planner
Money now	Money later

What this insight means for employers is that there are really two compensation targets: the employees' present and future selves. Philosophers can debate how much compensation should be current and how much deferred. As a practical matter, though, giving employees some choice among forms of current income (salary versus bonus versus opportunity for growth, for example), some choice among forms of deferred income (more retirement versus lump sum at year's end versus deferred payment into future years versus more medical benefits), and some choice between money now and money later makes a lot of sense and gives employees options-something over and above the compensation itself. This kind of choice is what the new new pay provides.

6. Workplace culture in conflict: the achievers versus the egalitarians. It is one thing to look at the employee as having two selves-two selves whose needs must be balanced in a compensation system. These two selves ramify into a cultural conflict within the firm. To this cultural conflict we can add other firm-level conflicts that revolve around an achievement orientation versus egalitarianism (see Table 1.2).

One manifestation of this conflict is the clash between the individual-worker view and the team-player view. Do we pay persons or teams? Another has to do with the rules for rewards. Is fair play appropriate, or is fair share a better way to go? Should firms pay top dollar to optimize employee recruitment and retention, or should they pay the going market rate? Do they give rewards to those who deserve it or those who need it? Do they promote based on merit or on seniority?

At the extremes, an organization could have an "achievement" culture made up of the orientations in that column in Table 1.2, or it could have an "equality" culture made up of the elements in that column. In reality, of course, all organizational cultures are a blend of achievement and equality. It's the tension between winner-take-all and everyone-gets-rewarded, between "each tub on its own bottom" and "a rising tide lifts all boats." A compensation system that permits some employee customization seems to be a pretty good solution to the problem of how to balance these competing orientations.

Table 1.2. Achievement Versus Egalitarian Cultures

	Achievement Culture	Egalitarian Culture
Firm culture	Market base	Clan base
Self	Here and now	Then and there
Employee/worker	Solo worker	Ensemble or team worker
Rules for reward	Fair play	Fair share
Goals for rewards	Optimizing	Satisficing
Bases of reward	Worthy	Needy
Bases of promotion	Merit	Seniority

Source: Adapted from John E. Tropicman, *The Catholic Ethic in American Society* (San Francisco: Jossey-Bass, 1996).

7. The hierarchy of needs. Not only are employee needs stretched, they are also stacked, as depicted in Abraham Maslow's famous hierarchy of needs (Figure 1.1). As Gareth Morgan says, Maslow's hierarchy is something of a pile of elastic bags, one atop the other.<sup>15</sup> There are two key elements to Maslow's work that affect us here. One is that the needs are a hierarchy-it is hard to address higher-level needs when lower-level ones remain unfulfilled. The second is that the hierarchy gives employers a checklist that can be used to review the total compensation package.

Overall, these seven misunderstandings tend to mean that employers have a rigid, overadministered, and undermanaged compensation system. Things need to change-especially given the composition, needs, and expectations of today's workforce.

### The New Workforce

The old pay workforce was essentially one of white male breadwinners. Of course, there were working women as well as members of minorities, but they were often relegated to a secondary labor market and certainly paid secondary wages. Their interests did not drive the pay system. The new workforce is far more diverse. Today, women's interests and needs are becoming a serious force in the workplace; it is in part because of unresponsive workplaces that so many women are becoming entrepreneurs. At the same time, individuals from previously minority cultures are achieving dominant numbers in the workplace.

Other aspects of demographics are changing as well. Couples are working. This means, for one thing, that such matters as child care and flextime-quality of life issues-are achieving heightened importance. Then too, families have elders to be concerned about. Firms are offering long-term-care insurance for the parents of workers, as well as health coverage for their children.

Other aspects of family work become key. Workers increasingly think in terms of family income, as opposed to the income of one. Hence employers seeking to attract a worker need to think of what the worker's partner makes as well. A signing bonus of \$25,000, for example, an amount most employers would think of as handsome, means little to me if accepting the offer means that my partner loses a \$75,000 job. This problem is exacerbated (or as one HR manager put it to me, in a quaintly apt misphrasing, "exasperated") at the upper end because high-income, highly educated men tend to marry high-income, highly educated women. One of the reasons that pay in the traditional sense becomes less important is that any individual's fraction of family income is now reduced.

Further, the idea of what a family is, and what its needs are, becomes more complicated daily. Gay couples, lesbian couples, couples who want to adopt children, and so on each have special needs. All expect to meet some of these needs through the compensation provided by the workplace.

These changes place extraordinary demands on the workplace in general and on the compensation system in particular. American society teaches us that through work-and hence through the workplace-many of our most important needs will be met. Hence the work itself needs to be rewarding-that is, one kind of compensation. We get many of our friends through work; hence, a "jerk-full," toxic organization is unacceptable. Education has also become the province of the firm. As Stan Davis and Jim Botkin discuss in *The Monster Under the Bed*,<sup>16</sup> educational "dominance" has moved from the state to the firm. Employees expect to be educated at the workplace.

Finally, there is the generational perspective. Old pay existed in the era of old values. Those were what Yankelovich called the "giving/getting compact."<sup>17</sup> The giving/getting compact was developed out of the trauma of the Depression of the 1930s and the security of armed forces employment during World War II. It said to employees, you give us loyalty and stay with us, and you'll get security and regular wage increases. You'll also get the security of good fringe benefits (also a product of World War II, when wage and price controls meant that wage increases could not be given). That was the era of Big Blue, U.S. Steel, General Motors, General Electric, and General Mills (an awful lot of "Generals"), when the man in the gray flannel suit (immortalized in the title of Sloan Wilson's popular 1955 book) replaced the man in the army uniform. Old pay is linked to old values systems and subcultures.<sup>18</sup>

Today we have the Boomers, Gen X, and beyond, cohorts with quite different preferences and expectations. Although categorizing people in terms of generations is somewhat hazardous, the following breakdown seems to have some agreement: Veterans, born 1922-1943; Boomers, born 1943-1960; Gen Xers, born 1960-1980; and Nexters, born 1980 to the present. Each generation has a somewhat different schedule of preferences. But as Veterans move out and others move in, proportions change and the workforce changes. Overall, the preference schedule shown in Table 1.3 seems to apply to Gen X and beyond.<sup>19</sup>

It seems clear from the list in Table 1.3 that choice, personal ability to customize work site activities and rewards, authenticity, and independence are among the kinds of compensation that workers from this generation seek from their workplace. To become

the employer of choice, firms need to totally rethink their compensation system. Old pay simply will not work.

Table 1.3. Turn-Offs and Turn-Ons for Gen X

Turn-Offs

High stress work situations

Incentive programs that are "here today and gone tomorrow"

Micromanagement

A company which does not believe in long-term investment in Generation Xers

General and insincere feedback and rewards

Turn-Ons

Marketable learning opportunities

Flexible schedules accommodating personal needs

Management who appreciate and provide accurate feedback

A cafeteria-style benefits package that values individual needs

Regular staff meetings

Feeling as if you make a difference

A productive work atmosphere

Source: Vivian Yang, personal communication, Spring 1999

As early as 1993, the National Study of the Changing Workforce came to this

conclusion: "Taken together, the responses of all workers and young workers suggest there is sentiment in favor of more balanced lives, requiring at least a modest shift from work to self and family. Employers might also expect young workers to want a different balance in their lives than older workers have chosen."<sup>20</sup> Assessing your workforce on these dimensions of preference would be an excellent way to get some sense of what your employees are thinking. One way to do that is to use the Index of Difference instrument introduced in Chapter Two.

### The Total Compensation Solution, or the New New Pay

There are many changes on the horizon. Phrases like variable pay, flattening base, cafeteria benefits, opportunities for growth, and psychic income are common. Pay programs go by various names such as nontraditional rewards, alternative reward strategies, and contemporary pay.

Jay Schuster and Patricia Zingheim's 1992 book, *The New Pay*,<sup>21</sup> clearly recognized that old pay was not working. To quote the flyleaf of this important book: "Traditional pay, although professing to reward performance, is actually based on tenure, entitlement and internal equity. In contrast, the new pay practices . . . help form a positive partnership linking employee and organizational performance and providing employees with rewards that correspond to their own success and that of the organization. Viewing pay from the total compensation perspective, new pay ensures the most effective use of each component-base pay, variable pay (incentives) and indirect pay (benefits)."

Ed Lawler wrote the introduction to this book. He gave these initiatives the name "new pay," because the name "suggests that it will replace what now exists, rather than be a peculiarity that will pass with time. New pay is more than just business plan gainsharing, skill-based pay and employee involvement. The new pay view provides that organizations use all the elements of pay-direct cash (compensation) and indirect pay (benefits)-to help form a partnership between the organization and the employee. . . . New pay helps link the financial success of both the organization and its employees."<sup>22</sup>

Lawler had opened the door with his earlier work; Schuster and Zingheim walked through it. It was a pathbreaking stroll. They got three of the ten important variables in the total compensation solution. But as you can see from the Gen X chart in the preceding section, none of the things discussed in *The New Pay* were actually mentioned by this important group. Pay and benefits are necessary but not sufficient conditions for a compensation system.

The new new pay expands the idea of "total compensation" considerably, going beyond new pay in three important ways. The new new pay includes more variables than have been typically included in thinking about compensation. It also changes the basic assumption that compensation is an employer-driven element, positioning it as employee driven. The employee moves from being a recipient of pay to a customer of compensation. Customers, however, have to make choices. This is the third element of difference. There are trade-offs. If you sit down with a buddy over a beer and talk about the things you want from a workplace and the trade-offs you are willing to make for them, many, if not all, of these items will figure in that discussion. But you will not value all of them equally; you may want more base pay and less risk pay, or the reverse, or whatever. Cafeteria compensation allows for some of this trading to be done explicitly.

### The Total Compensation Equation

The concept of the new new pay can be expressed in terms of an equation with ten

variables. The equation is based on my research at the University of Michigan Business School-asking dozens of MBAs what they want from their workplace-as well as countless discussions with corporate executives and HR professionals. These ten variables represent the compensation package that is already implicitly present in most of our thinking. The problem is that it has not been organized in one place and presented as a unit, so it has been impossible to work with it effectively.

$$TC = (BP + AP + IP) + (WP + PP) + (OA + OG) + (PI + QL) + X$$

where

TC = total compensation

BP = base pay, or salary

AP = augmented pay, that is, any one-time payment, even if received at regular intervals (such as overtime)

IP = indirect pay (benefits)

WP = works-pay, that is, employer-subsidized equipment, uniforms, and so on

PP = perks-pay, that is, special benefits-anything from accessories to employee discounts on company products

OA = opportunity for advancement and increased responsibility

OG = opportunity for growth, both through on-the-job training and through off-site training and degree attainment

PI = psychic income, the emotional enhancements provided by the job itself and the setting (the people)

QL = quality of life, that is, opportunity to express other important aspects of life (location close to home, flextime, on-site child care, ski to work, or whatever)

X = any unique element that an employee wants that the workplace can facilitate ("Can I bring my dog to work?")

To borrow a phrase used conventionally with reference to external customers, this expanded view of compensation amounts to a "whatever it takes" approach to attracting, motivating, and retaining employees. Although increasingly comfortable with that approach with outside customers, employers have not applied this kind of thinking to internal customers, their employees. This larger view of what employees might want or need and the ways in which the employers can help will become a cornerstone of the compensation systems of the future. As Peter Capelli comments in Harvard Business Review, "Traditional strategies for employee retention are unsuited to a world where talent runs free. It's time for some fresh thinking."<sup>23</sup> For one thing, compensation strategy needs to have a threefold goal with respect to the workforce: encourage retention of the best (the top 20 percent), balance inflow and outflow of the middle mass (the middle 60 percent), and encourage departure of the rest (bottom 20 percent). Golden handcuffs will not hold the people you want to keep, because they are negated by golden

hellos. Emphasis needs to be put on job design, job customization, good business location, and the encouragement of social ties. Capelli points out that people who will leave a company in a New York minute will hesitate to walk out on teammates. And Sue Shellenbarger, writing in the Wall Street Journal, titled one of her columns "An Overlooked Toll of Job Upheavals: Valuable Friendships."<sup>24</sup> Each of these items, and others, are addressed in the total compensation equation.

Capelli actually talks about Prudential's work on such an idea, and his observations are worth sharing: "In addition to tailoring jobs to particular categories of employees, companies can also tailor them to the needs of individuals. Prudential is experimenting with such a program. It provides workers with a variety of tools to help them assess their own interests, values and skills, and encourages managers to tailor rewards, benefits and assignments to individual requirements. A part-time arrangement might satisfy an employee's desire to pursue outside interests or meet a parenting need, while tuition reimbursement might be the key to keeping another employee happy."<sup>25</sup>

Prudential's program draws on an array of employment options, most of which are available to all workers. It's easy to imagine, however, programs that would go even further in customizing jobs. Key employees might undertake a formal self-assessment of their work and nonwork goals, and of how those goals could best be achieved in the context of the company's operations. The assessments would form the basis for individual employment agreements, which might be created using cafeteria-style programs similar to those used in allocating employee benefits. Each employee would be able to allocate a set amount of money toward options in such areas as career development and balancing work and personal life. The amount available to allocate would depend on the importance of the employee to the company. However, with this expanded list another important element comes into play. It is one thing to have different needs. It is another thing to have a system that allows you be able to make choices among them. That is where customization comes in.

#### Customization and Trade-Offs

Choice and customization are the watchwords of the 2000s. Everyone-Americans in particular-likes choice. We have choices among toothpastes, dog foods, dates, you name it. Choice itself has become a value. Hence the one-size-fits-all pay system of most companies is in need of upgrading.

Cafeteria benefits are perhaps the best example of this approach in today's workplace. Workers have an array of options from which to select-both within offerings (low-end to high-end medical coverage, for example) and among them (choosing, for example, between higher-end medical and long-term care insurance). A cafeteria benefits plan allows employees to build their own fringe benefits package, within limits.

Similarly, cafeteria compensation allows employees to build their own compensation package, and to change it at intervals (say, once a year) as their needs and interests change. The choice piece, however, also communicates to employees that there are trade-offs among kinds of compensation. Employers are asked to put the full package on the table, as they do in cafeteria benefits. The fact that employees need to pick and choose (as part of the customization process) among elements of the package educates them about the package and encourages them, rather than the employer, to make choices important to them.

The next chapter presents a more detailed view of these options and of the total compensation equation. For now, the bottom line is that over and above an expanded list

of compensation dimensions, the new new pay allows employers to provide the gift of choice. And at least in America, that is a very valuable leverage.

#### CHAPTER SUMMARY

Cafeteria compensation-the new new pay-is a response to the need for diversity and choice in compensation programs. It is also a response to the intractable problems of old pay.

From the employer's perspective, old pay has several inherent problems that are compounded by the problems in old pay systems. Employees, too-particularly newer ones-may be satisfied with the money they receive and yet very dissatisfied with the pay system and the way pay information is communicated. Further, employees increasingly expect many other kinds of rewards besides dollars. The net result is that old pay no longer does the job of attracting, retaining, and motivating top-notch employees.

Even though employers may recognize many of these issues, there are several impediments to change. Among them are structural lag, means ritualism, and fundamental misunderstandings about employees. These issues become all the more serious in light of the changing nature of the workforce and the new demands and expectations of a diverse population of employees.

The total compensation equation addresses these issues by bringing all compensation elements together in a coherent package and introducing a degree of customization and choice into compensation. The model is cafeteria benefits-a once-radical solution that has achieved wide acceptance. Cafeteria compensation is responsive both to the changing workforce and to the failures of old pay from the employer's perspective. It is the direction in which compensation is moving and needs to move-whether all at once, or in incremental steps.

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