

Skill-based pay may be an advantageous option for companies that face intense competitive pressure, that are downsizing, or that encourage employee involvement.

Who Uses Skill-Based Pay, and Why

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Skill-based pay has received increased attention in management literature during the past decade. Although the concept is not new, its use appears to be growing. The purpose of this article is to examine (1) changes in the level of use of skill-based pay, (2) the types of organizations that use it, (3) its impact, and (4) whether future increases in use are likely. Information in the article is based on a study of employee-involvement practices designed by Edward E. Lawler, Gerald E. Ledford, Jr. and Susan A. Mohrman, all from the Center for Effective Organizations.

For the purposes of this study, we defined skill-based pay as an alternative to job-based pay that sets pay levels on the basis of how many skills employees have or how many jobs they can do. Data were gathered from the *Fortune* 1000 companies, which include the 500 largest manufacturing firms and an industry-stratified set of the 500 largest service companies in the United

States. A survey was mailed to the chief executive officers of these companies in 1987 and again in 1990. It was typically completed by a high-level human resources executive.

The 1987 survey was designed primarily by Lawler, Ledford, and Mohrman and was conducted by the U.S. General Accounting Office. Usable responses were returned by 476 firms. A subsample of 323 firms agreed to allow their data to be released to the research team, which permitted detailed statistical analyses. The 1990 study was conducted solely by the Center for Effective Organizations' study team. Usable responses were returned by 313 firms. The full results of the two surveys have been published in *Employee Involvement in America: A Study of Contemporary Practice* (American Productivity and Quality Center, 1989) and *Employee Involvement and Total Quality Management: Practices and Results in Fortune 1000 Companies* (Jossey-Bass, 1992). Here, we sum-

EXHIBIT 1
Percentage of Employees on Skill-Based Pay*

	None (0%)	Almost None (1-20%)	Some (21-40%)	About Half (41-60%)	Most (61-80%)	Almost All (81-99%)	All (100%)
1990	49	34	11	2	1	1	1
1987	60	25	7	2	2	2	2

*For 1987, N = 476 *Fortune* 1000 firms; for 1990, N = 313 *Fortune* 1000 firms.

marize the key findings concerning skill-based pay.

TRENDS IN SKILL-BASED PAY

The 1987 survey found that 40% of the responding companies used skill-based pay with at least some employees. On the basis of the extensive publicity given to skill-based pay since that time, we predicted that the level of use would be higher in 1990. This prediction was confirmed. The 1990 survey found that 51% used skill-based pay with at least some employees, an increase of more than 25% in just three years. In the typical company that used skill-based pay, the percentage of employees covered remained the same—less than 20%—in both 1987 and 1990 (see Exhibit 1). Overall, then, skill-based pay appears to be increasingly popular, in the sense that more companies are adopting it, but it tends to be adopted for only a minority of employees in those organizations that use it.

THE SUCCESS OF SKILL-BASED PAY

We must explore why firms are adopting skill-based pay if we wish to understand its increased use. The first explanation is rational self-interest. That is, a company may adopt skill-based pay to gain performance improvements. We asked the respondents to provide an overall rating of the success of their skill-based pay plans. Some 60% rated their plans as successful or very successful in increasing organizational performance. Only 6% rated them as

unsuccessful or very unsuccessful, and 35% were undecided. Clearly, the respondents overwhelmingly felt that skill-based pay systems were effective in achieving performance improvements.

The apparent effectiveness of skill-based pay certainly helps account for its increased popularity. But why do some firms adopt skill-based pay while others do not? To answer this question, we must look more closely at management practices and organizational characteristics that differentiate skill-based pay users from nonusers.

SKILL-BASED PAY AND EMPLOYEE INVOLVEMENT

The skill-based pay concept has received considerable attention in the literature on employee involvement in general and work redesign in particular. Skill-based pay fits well with employee-involvement practices for two reasons. First, skill-based pay reinforces employee-involvement practices. It increases employee flexibility, which broadens employees' perspective on the overall production or service-delivery system. This may lead to more insightful employee suggestions for performance improvement. Rewards for learning multiple jobs may also facilitate job rotation and cross-training, which are essential to self-managing team designs.

Second, a high level of employee involvement may be necessary for companies to realize fully the benefits of skill-based pay. Increased employee flexibility and broadened employee perspectives may be wasted if employees are not given the power to use what they learn through participation groups and job designs that create greater self-management.

For these reasons, we predicted that skill-based pay would be especially prevalent in organizations that use employee-involvement practices, such as participation groups, job enrichment, and self-managing teams. The survey results confirm this prediction. They are also consistent with the results of a recent study of 96 skill-based pay plans (*Skill-Based Pay: Practices, Payoffs, Pitfalls, and Prospects*, by G. Douglas Jenkins, Jr., Gerald Ledford, Jr., Nina Gupta, and Harold Doty, published by the American Compensation Association, 1992). In that study, respondents were at the plant level or the equivalent.

In light of our argument that skill-based pay is an important component of employee-involvement systems, we examined whether the use of skill-based pay was associated with the success of employee-involvement efforts. The respondents were asked to indicate whether their employee-involvement effort had improved organizational functioning and performance in a number of areas. Measures of organizational functioning included improved managerial decision making, movement of decision-making authority lower in the organization, and increased information flow throughout the organization. Measures of organizational performance included productivity, quality, employee satisfaction, and profitability. We found that the adoption of skill-based pay was strongly associated with employee-involvement programs that resulted in improvements in organizational functioning. It was also associated with employee-involvement efforts that produced improvements in product or service quality and in competitiveness, but not with efforts that resulted in productivity and profitability improvements.

SKILL-BASED PAY AND TOTAL QUALITY MANAGEMENT

There is a reason to expect a strong association between the use of total quality management (TQM) programs and the use of skill-based pay. TQM practices include employee work cells or manufacturing cells, just-in-time inventory systems, self-inspection, direct employee exposure to customers, and so on. These

practices often rely on and encourage greater employee flexibility and cross-training. The study results confirm that organizations that use TQM programs are significantly more likely to use skill-based pay. Indeed, this was the strongest relationship found between the use of skill-based pay and the use of any other management practice.

COMPETITIVE CONDITIONS FACING USERS OF SKILL-BASED PAY

All public corporations may be interested in gaining performance advantages through such innovations as skill-based pay, but the need for performance improvements will be felt more acutely in some firms than in others. Skill-based pay, as well as employee involvement and TQM practices, represents a substantial change in the basic assumptions and behavior of management. Thus, performance pressures must be especially strong to overcome inertia. This suggests that skill-based pay practices are especially likely to be adopted by companies that feel strong competitive pressures. Such pressures increase not only the firm's interest in increasing performance, but also its willingness to rethink basic management practices.

Foreign competition is a threat that is particularly likely to sharpen management interest in workplace innovations that lead to performance improvements. Consistent with this logic was our finding that firms facing heavy foreign competition were more likely to use skill-based pay. Because manufacturing firms are more likely than service firms to face tough foreign competition, we predicted that manufacturing firms would be significantly more likely to adopt skill-based pay than service firms. The results confirm this prediction.

SKILL-BASED PAY AND CHANGES IN ORGANIZATIONAL STRUCTURE

Skill-based pay gives employees the chance to develop their skills and increase their pay, even when promotions are not available. There-

EXHIBIT 2

Skill-Based Pay (SBP) and Other Pay Practices*

Pay Practice	Percentage of Non-SBP Companies Using This Practice	Percentage of SBP Companies Using This Practice
Gainsharing	19	59
Team incentives	49	68
Flexible benefits	51	58
All-salaried workforce	53	75
Profit sharing	54	71
Stock ownership	59	69
Individual incentives	86	92
Nonmonetary incentives	88	94

*N = 313 Fortune 1000 firms.

fore, we expected that skill-based pay would be attractive to respondents that were downsizing and delayering, both of which decrease opportunities for promotion. The results confirm that firms that have removed management layers during recent years are especially likely to adopt skill-based pay practices.

SKILL-BASED PAY AND OTHER REWARD INNOVATIONS

Finally, we found that the use of skill-based pay was associated with the use of a variety of other reward-system practices (see Exhibit 2). The strongest relationship was between skill-based pay and gainsharing: Some 59% of the companies with skill-based pay said they used gainsharing, while only 19% of those who did not use skill-based pay used gainsharing. Skill-based pay users were also more likely to use profit sharing, all-salaried pay systems, and team incentives. There was a strong tendency for users of skill-based pay to employ all other pay innovations to a greater degree than nonusers. Skill-based pay users differed from nonusers most in the adoption of pay innovations that, like skill-based pay, are associated with the use of employee involvement. This suggests global innovativeness as a partial explanation for the adoption of skill-based pay.

FUTURE USE OF SKILL-BASED PAY

We asked respondents to indicate whether they expected their corporations to increase or decrease their use of skill-based pay in the future. Overall, the respondents indicated that their organizations were much more likely to increase than to decrease use. Some 53% said that their organization planned to increase its use, while 45% predicted that use would stay about the same, and only 2% indicated that their organization planned to decrease use.

There is a significant difference between skill-based pay users and nonusers in their future plans. Among current users, 67% planned to increase their use, while 33% planned to stay the same. The percentages were reversed for nonusers: Some 34% of nonusers planned to increase their use, while 66% planned to stay the same. Overall, it was clear that the users of skill-based pay typically planned to increase their use of it. However, a significant number of nonusers also planned to increase their usage.

The data make clear that current success with skill-based pay is related to plans to use it in the future. Among the successful users, 70% planned to increase their use in the future, while 30% planned to keep their use at the same rate. Among the small number of companies that regarded their current skill-based pay plans as unsuccessful, 59% planned to increase their use, whereas 40% preferred to maintain their current rate. It is interesting and somewhat surprising that a majority of the reportedly unsuccessful users said they planned to increase their use of skill-based pay in the next two years.

The characteristics of current users of skill-based pay were strongly associated with those of companies planning increased future use. Companies that were subject to foreign competition, companies with shorter product life cycles and speed-to-market concerns, and manufacturers were particularly likely to plan increased use of skill-based pay in the future. Similarly, companies that were heavily committed to TQM programs were especially likely to plan on increasing their use of skill-based pay in the future. Finally, companies that were planning to increase their

use of such employee-involvement practices as gainsharing, quality circles, and self-managing teams were planning to increase their use of skill-based pay as well.

CONCLUSION

Overall, the data paint a rather clear and positive picture of skill-based pay. It is being used just where its advocates argue that it should be used, in association with employee-involvement management practices. Although skill-based pay is not a new idea, it seems to be on an accelerated path. It is still too early to say

whether it is going to be the dominant pay approach for organizations that have moved to TQM and employee-involvement management systems, but this clearly is a possibility.

Finally, the reported success rate of skill-based pay is impressive. The fact that only 6% of users reported skill-based pay to be unsuccessful in improving organizational performance suggests that despite the complexity and newness of the approach, it generally has a positive or, at worst, neutral impact on organizational effectiveness. As more technology and experience develop to support the use of skill-based pay, it is quite possible that this success rate will increase.



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