

## **BEST PRACTICES FOR SMALL-TEAM PAY**

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Increasingly, companies are forming small teams in their quest for performance. Management and organization effectiveness literature emphasizes teams as a positive option for companies committed to competitive advantage through people (Lawler 1996). The question of how to pay team members eventually arises. Should traditional pay that focuses only on individual performance and the job remain dominant in team-based organizational designs? Alternatively, should some portion of team member pay be based on the performance of the small team? Should skills and competencies, rather than the job, become the "atoms" of team pay design?

This article reviews the results of an up-close study exploring the implications of team pay in a sample of three team-based companies. The study suggests how companies might design pay systems to support effective team performance, skill acquisition and application. It concludes that even less than-ideal pay systems built around team performance and necessary skills are improvements over traditional pay solutions in terms of value added to the business and employee preference. Much of the concern about the design of team pay solutions appears to result from a lack of experience with such systems, not from an understanding of how pay impacts people in teams and team success. Based on this study, the transition to team pay appears more likely to generate positive rather than negative results and is worth the effort.

### **PAY AS A COMMUNICATOR**

Pay is a powerful communicator of values and directions. It can support or reinforce change in the pursuit of performance. While some pay solutions may erode performance-based initiatives, pay based on business strategy may add real value (Schuster and Zingheim 1996). In some circumstances, companies select small teams to help execute their business strategies. When this occurs, positive results generally follow at the small-team level due to

- better team member understanding of the business process
- improved sharing of goals, values and priorities
- an understanding of what is necessary to solve problems requiring the skills and competencies of multiple team members.

The results are also positive from the business unit viewpoint because teams that have some team member pay based on team success are most likely to achieve business goals (Mohrman, Cohen and Mohrman, Jr. 1995).

Traditional pay evolved before teams were viewed as an alternative organization design, and it is more supportive of organizational units called "departments" or "divisions" than entities called "teams." Because traditional pay focuses only on the individual rather than the team as a unit of performance and emphasizes the job in its most narrow context, it is not intended for team-based organizations. It is important to change the pay system in a team-based work environment rather than have the team work around an ineffective pay system to which the organization has grown accustomed. This ineffective system may not be intended for a collaborative work environment with shared goals. It appears that teams are able to gain cohesion and attain shared goals despite pay systems that erode cohesiveness and team goal focus. However, team energies are best spent on performance matters rather than on attempting to overcome a pay system that inhibits attaining shared goals.

Reward systems should be aligned with organization design. When this does not occur, organizations send mixed messages. In one example, a major automobile company assigned people from many disciplines to one or more vehicle design teams as project assignments. However, everyone's pay was decided by discipline managers. For example, the engineering manager determined the pay of engineers while the finance manager decided the pay of financial analysts assigned to the design team. As a result, people worked to satisfy their functional manager by meeting their goals rather than by focusing on the performance of the vehicle design team. Although the vehicle team manager was "consulted" on performance issues involving people on the design team, pay was determined functionally. Functional managers were not accountable for design team performance, and input from the team manager took second priority. If some portion of team member pay were determined by whether the designs result in effective vehicles that delight customers, responsibility for design team performance would be on the "radar screen" of team members upon whom overall team performance depends.

## OVERVIEW OF TEAM PAY STUDY

While questionnaires obtain information effectively on "who does what," they capture little about the implications of practice. Without this knowledge, organizations may copy prevailing practice without understanding its impact in terms of adding business value. Case studies provide the opportunity to meet executives, managers, team members and team pay designers to ask questions that will help decide the potential value of team pay. Using case studies instead of questionnaires provides information on the advantages and pitfalls of team pay.

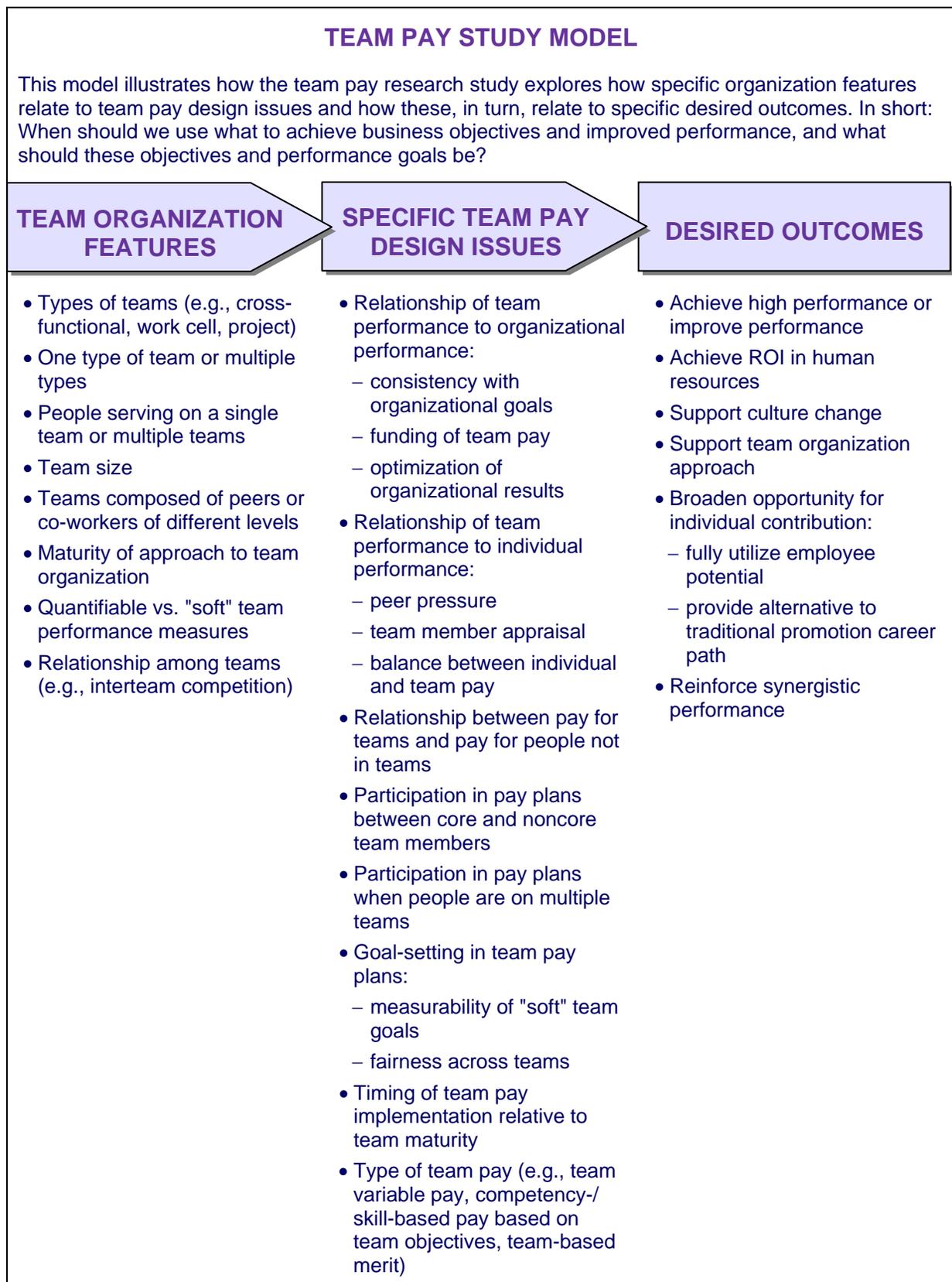
To find likely candidates for a case study, team pay in a sample of organizations that deployed teams as elements of their structure was studied with a questionnaire and teleconferences (Schuster and Zingheim 1995). The results suggested that team pay does exist. A model was developed to explore team pay in detail. (See Figure 1 below.) The model suggests that organizations will use team pay to generate some value-added outcomes.

Three companies organized around small teams were selected for site visits. They shared information on both their positive and negative experiences with team pay and admitted their solutions could be improved upon. The participants were Honeywell Defense Avionics Systems, Solecron California Corporation and XEL Communications, Inc.

Interviews with executives, managers, team members, team leaders and human resources representatives showed positive support for teams and team pay. No one said they would return to prior pay designs. While respondents said there is some distance to go to perfect team pay, they also said even a less-than-optimal team pay plan outperforms a traditional pay approach in terms of value added to the business and employee responsiveness to key goals and directions.

All participating organizations have team pay in manufacturing, and one has all employees at the location in team pay. Team designs include self-directed work teams or project teams, with two having additional parallel teams. Two organizations have team variable pay, and one has merit pay granted to individual team members based on team performance. All fund team pay at the business unit level and distribute awards based on team level measures and goals. The measures and goals of all plan designs are derived from the organization's business strategy and represent the key messages believed to generate the best results for their customers.

Figure 1



Two organizations have separate individual merit increase plans in addition to a team variable pay plan while the other distributes team-based pay increases to individual team members. Two organizations use multisource feedback for individual pay determination. The other has a supervisor decide the individual base pay of team members. Two organizations administer base pay by means of market ranking, and one has a skill-based pay plan. One organization has a quarterly profit-sharing plan, the second has a 401(k) plan and the third has an individual performance recognition plan and a defined benefit plan.

Teams and team pay are strongly championed at all organizations. High team member involvement is a feature of each organization, and strong champions for teams and team pay exist at all levels. In the manufacturing areas, all organizations either have transitioned to, or are in the process of transitioning to, some form of self-management at the small-team level.

## STUDY FINDINGS

At each organization, the implications of the team pay model in Figure 1 were investigated. These implications include team organization features, specific team pay design issues and desired outcomes from the deployment of team pay.

### Team Organization Features

The type of team used had limited impact on the success of pay designs. Team structure changed often enough that team pay had to be adaptable to business changes. The need for adaptability most affected the choice of pay tools. Because of this, clear team categorization was challenging. The definition of a team in terms of shared goals, shared fate and skill requirements influenced team pay design more than the type of team did. Following are key findings relating to team organization features:

- **Types of teams (e.g., work, project, parallel, cross-functional).** The relationship between team performance and team pay proved to be more important than the type of team used. While gainsharing may make sense at the small-team level, it does not necessarily satisfy the goal of adding value to the company or business unit unless awards are based on both business unit and team results, with quantifiable measures of business unit added value. Teams blur precise, narrow definition of jobs. To say that job-based pay solutions may be superior to skill-based pay solutions suggests that the need to emphasize skill growth is unique to one team design and not another. Instead, skill growth appears essential, regardless of the type of team.

Successful team pay was more goal-focused and acceptable to team members and management than was individual pay in any team design. Individual pay eroded team initiatives by overemphasizing the individual. Where multisource feedback was used, it had been executed too prematurely to provide feedback effectively to individuals for pay purposes. Had this solution initially been developmental rather than a pay tool, a positive transition to a pay application could likely have been made as multisource feedback matured.

- **One type or multiple types of teams.** Organizations may have multiple types of teams based upon their business needs. Because of this, team pay that "funds" at the small-team level is less effective than team pay that is funded in large part by performance at the business unit level above the small team—and that is distributed based on small-team measures of cost, productivity, quality and so on that add economic value to the business unit. If the line of sight to the goals for team members includes measures at both the business unit and small-team levels, it is possible to have many team designs in one business unit that share a focus on business goals.
- **People serving on a single team or multiple teams.** The number of teams that a single person serves on makes the team pay design more complex. However, the solution is not to limit the number of small teams a person can associate with during a performance period. Team pay designs that are clear and consistent about the basis of team pay prove to address this situation

best. A solution such as "averaging" the results of team membership or identifying a "home team" for the period was successful. However, negotiating to determine rewards on an individual basis proved corrosive to team cohesiveness because it introduced inconsistency to an issue that could have been effective and uniform.

Pay design that depends upon funding at the business unit level and partially upon a measure of small-team financial priorities (e.g., cost) makes it possible to change from membership on one team to multiple teams. Although people may be on several teams with several sets of goals at the small-team level, the longer view to the business unit will make multiple team membership more workable for pay purposes.

- **Team size.** Larger teams present more challenging communication and line of sight issues. However, team size alone is not a factor. At some point, the team becomes a more loosely organized "group," and the dynamics change for the organizational unit. Team size does not reduce the positive impact of team pay.
- **Teams composed of peers or teams composed of co-workers at different levels.** Team members accept pay differences among members of the same team based on external market worth. For example, it is acceptable to pay an engineer more than an assembler or technician on the same team. Also, differences in pay are acceptable and supported if they are based on measured skill differences within a work category. Pay differences based on tenure—unrelated to skill—are less acceptable and more likely to erode team cohesiveness.
- **Maturity of approach to team organization.** The contention that organizations should wait until small teams are mature before basing some element of team members' pay on team outcomes is not supported by the research. Simple team pay with team member involvement tended to hasten the maturation of the team process. Once a small team had become accustomed to traditional pay, it became more difficult to change to team pay as the team matured. Moving to teams and team pay within a short time span (no later than six months to a year after team formation) can help focus team members on shared goals and key team skills.
- **Quantifiable vs. "soft" team performance measures.** Team pay should be limited to three to five goals or measures to ensure a focus on key outcomes and processes. In the longer term, a balance between quantifiable goals and more "soft" goals is best suited to supporting strategic business plans. Starting with a few quantifiable goals has proven most effective.

It is likely that variable pay is the best initial tactic. Subsequently, skill-based pay should be considered. Skill-based pay should be simple and flexible to emphasize a few core skills that are key to the business. It should be delivered in the form of base pay and lump sum awards, which would be granted when employees apply skills that are valuable to the business.

- **Relationships among teams (inter-team competition).** Team pay did not create competition among teams as long as it was not funded only at the small-team level. Funding at the business unit level primarily and at the small-team level secondarily creates inter-team collaboration. Business unit funding for team pay supports the idea that teams can be customers to other teams as much as external customers can. Team pay is most effective when it is designed to communicate to team members how the small team fits in the business process. Funding should be decided at a level to ensure inter-team cooperation. This means funding should be above the small-team level unless teams are autonomous and not interdependent.

## Team Pay Design

The team pay design is very important. However, much "conventional wisdom" about how team pay is to be designed is not sustained upon close inspection:

- **Relationship of team performance to organizational performance.** Business unit strategic goals should be used as the basis for setting small-team goals, even when goals are specific to each small team. While measurability is important, strategic alignment is essential to interteam cohesion.

Leadership will not provide sustained support for team pay merely because it generates awards and is popular with team members. It is critical to fund team pay at the business unit level and extend the line of sight of team members to the business unit. It should be possible to attribute team awards to the success of the business unit. It is critical to avoid sacrificing business unit performance for team performance. Designs that optimize results at both the business unit and team levels are critical.

- **Relationship of team performance to individual performance.** There is much anecdotal support for attempting to pay individuals based on their contribution to team outcomes. This belief is driven by a strong ethic that emphasizes "rugged individualism."

Much of the support for individual pay is generated from studying employee preferences. Employees commonly are asked whether they would rather be paid based on their own individual performance or based on the results of the team to which they belong. Because these employees have had no experience with team pay, they prefer an individual pay system, with which they are familiar.

Peer pressure from team members is a powerful factor in dealing with performance outliers in a small-team situation. In the case studies, this proved to be the best individual performance solution. Best practice is to proceed initially with pay based on team outcomes. This is because, in the view of experienced team pay designers, it is more difficult to develop an individual pay system in a team environment that does not erode the team initiative by creating competition for individual pay among team members. Some teams are ready to add individual pay to a team pay environment sooner than others. Team readiness is the determining factor.

The idea of multisource feedback will become increasingly important in team environments. It provides feedback from a wide range of sources who have knowledge of individual team member behavior and performance. Moving to multisource feedback too soon is a potential problem. Team members often need considerable practice and training in getting and giving feedback. Linking pay to multisource feedback too soon could provide negative experiences that hurt this potentially powerful communication tool (Zingheim and Schuster 1995).

- **Relationship between pay for people on teams and pay for people not on teams.** This issue is driven by a belief that people who are not in teams need "fair" treatment rather than by team pay design. It is important that everyone—people on teams and people not on teams—support the success of teams. Practice supports including people who are not officially on teams in a team pay plan by paying them an award based on a composite of the performance of the teams they support.
- **Participation in pay plans between core and noncore team members.** Extending line of sight by funding at both the business unit and team levels broadens the concept of team membership to include a wide range of potential contributors to team results. Defining membership broadly and avoiding the challenge of having members who are "more important" to team results than others is a positive strategy.
- **Goal setting in team pay plans.** It is essential to involve team members in understanding business unit goals, selecting team pay goals that are derived from business unit goals, reviewing periodically performance progress against goals, addressing goal achievement problems during the performance period and seeking goal improvement. Differences in the toughness of goals are an important issue among teams. Sticking at first with quantitative goals proved a wise choice.

- **Timing of team pay implementation relative to team maturity.** Traditional individual merit erodes team pay. Team members in the case studies consistently said they liked merit pay because, "We don't need to do anything to get it! It is automatic." In the same sentence, they said, "... team pay is a different matter. We need to make sure the team generates outcomes and solves its performance problems. This is real work!"

Also, the idea of the job as the atom of the organization works poorly in a team environment where people have to work beyond what is "in their job description." Clearly, it is best to move to team pay as early as possible so team members can move quickly to supporting team results and acquiring and applying the skills that teams need.

- **Type of team pay.** Simple variable pay, funded at the business unit level and distributed based on measures/goals at the small-team level, was the preferred "first move." Team sharing as equal shares rather than as a percentage of base pay was often most acceptable to participants.

The next team pay move should be to a simple skill-/competency-based pay solution that pays a lump sum award when needed skills are used, not when skills are acquired.

Variable pay that shares awards among team members, funds at the business unit level and is distributed based on team outcomes is the most workable design. Possibly, and only when the team is ready, the team could allocate pay to team members based on individual contributions. This may or may not evolve. Merit systems erode team cohesiveness.

## Desired Outcomes

Given what the case study companies learned about small-team pay, what are the desired outcomes in terms of value-added to the business they expect to enjoy? How do they design team pay to achieve this type of outcome? The outcomes include the following:

- **Achieve high performance or improve performance.** Case study companies clearly benefited in all measured areas even with less-than-excellent team pay design. Even flawed team pay is better than traditional pay in a team situation, no matter how much effort is expended on making traditional pay as contemporary as possible. The best practice is clearly to set up a team pay system and enjoy the positive impact or "honeymoon" period for 18 months to two years before any deficiencies become exaggerated because of experience with the system. At that time, the solution can be modified as necessary to achieve the next level of added value to the business.
- **Achieve return on investment in human resources.** If team-based variable pay is funded at the business unit and distributed based on small-team goals, the investment is justified in terms of management goals. The key is the selection of goals and measures that make sense to the organization. If skill-based pay is simple and straightforward, added value results in terms of team member flexibility.
- **Support culture change.** Study participants said, "If you haven't changed pay, you haven't changed anything." Best practice suggests organizations should stop the erosion of their team initiative by moving to pay that rewards team results. The core issue is getting everyone to help make the organization move in the desired direction.
- **Broaden opportunity for individual contribution.** Companies that organize around small teams believe the best way for individuals to contribute effectively is by being a team member. Individuals are rewarded by sharing the fate of the team by achieving results they cannot attain alone. Study participants believe that people have more impact as team performers, and team pay supports this belief.

- **Reinforce synergistic performance.** Team pay demonstrates the importance of a shared-fate focus and holds team members responsible for team outcomes. Team pay creates an environment where team success counts and where people should put the team first to gain rewards.

## TEAM PAY STUDY CONCLUSIONS

The study suggests that organizations that move to small-team pay get added value from the transition. Several features should be included in team pay design to achieve the best results. Although the case study companies would be the first to say they have room to improve, they would recommend the following:

- **Use variable pay funded at the business unit level and distributed at team level based on team measures and goals that add business value.** Funding at the business unit level helps address challenges such as team switching, multiple team membership, team size, interteam issues and so on.
- **Use a skill-based pay system that is simple and pays lump sum awards based on applying needed skills rather than on learning these skills.** If job-based pay is to be used, employ a simple market-based system that avoids narrow, detailed job documentation.
- **Keep the reward systems simple, and refresh them often.** Realize that the "best" pay system for teams activated now will be improved upon as experience is gained.
- **Avoid using merit pay increases.** Review base pay competitiveness periodically and adjust it when necessary. Do not disguise competitive pay with merit pay.
- **Resist the temptation to use multisource feedback systems for pay purposes early in the team pay process.** Team members will communicate their readiness for multisource feedback.

Doing the obvious remains important. This means keeping the business strategy in mind to ensure that the pay system adds value. Study participants found that traditional pay was time-consuming and failed to add value. This mistake should be avoided in team pay design. Study participants believe communication and championing are critical, and they suggested this is an area where they could have done more.

Complete the transition and plan development in a reasonable period—six months or less was commonly mentioned by respondents. Celebrating is important, and the transition should be "fun." Simple solutions that are not "overengineered" are viewed as best.

## BUILDING A TEMPLATE FOR SMALL-TEAM PAY

It is possible to develop a "template" for further testing and exploration. This is presented in Figure 2 and includes all the principles that have proven most effective:

- High involvement, strong communication and sponsorship are essential.
- Variable pay is the primary performance recognition element funded at the business unit level and distributed at the small-team level based on small-team goals.
- Simple skill-based pay decides base pay; a simple market-based solution is used if the business unit is job-based. Lump sum awards allow changes in skills and competencies.
- Addressing individual pay based on contributions to the small team is deferred and only started based on team readiness. It is possible to use multisource feedback to determine individual sharing in some future generation design.

Figure 2

<b>PAY SYSTEMS FOR SMALL TEAMS</b>	
<b>Individual Performance</b>	Avoid in initial iteration. Can erode team focus. Defer to later generation based on team readiness. Possible future multisource feedback application. No merit pay. Skill-based pay in simple form implemented after variable pay will link individual development to critical team/organization skills.
<b>Small-Team Performance</b>	Performance pay is variable pay funded at the business unit level and distributed based on small-team measures. Few measures/goals. Simple business-focused message.
<b>Business Unit Performance</b>	Variable pay with short line of sight at team level funded at the business unit level to ensure value is added to the business. Justify connection for business reasons between team and business unit.
<b>Participation</b>	Broadly defined and inclusive based on equal shares to receive variable pay. Manage team boundaries to ensure interteam cohesiveness.
<b>Involvement and Communication</b>	Team members involved in design. Open communication on measures. The more involvement and understanding, the more lasting the effect.

This template is not consistent with conventional wisdom, but it is based on the experience of organizations using small teams and having team pay systems designed to support this organizational design.

In the situations studied, it is clear that design matters. Variable pay and skill pay can add value to team and organizational performance. "Key Elements of Team Pay Design" (below) suggests how the relationship among variables may serve to generate desired outcomes.

Team pay is better in small-team situations. Much of the concern about team pay comes from those who have no experience with team pay. More case studies are needed, especially in the area of team pay in knowledge-based teams.

## KEY ELEMENTS OF TEAM PAY DESIGN

Which solution should be used to achieve the desired business goals and when? Starting with the desired outcomes, team pay designs can add value.

### Desired Outcomes

The study suggests it is reasonable to expect team pay to generate the following outcomes:

- high or improved performance
- achievement of return on investment (ROI) in human resources
- support for culture change
- broadened opportunity for individual contribution by fully using employee potential and providing alternatives to promotional career path
- reinforcement for synergistic performance.

### Team Organization Features

To get the business results required, organizations need to be able to design teams in a variety of ways. Some of these create design challenges. They include the following:

- type of teams
- one type of team or multiple types
- people on single or multiple teams
- team size
- teams composed of co-workers of different levels
- maturing of approach to team organization
- quantifiable vs. "soft" team performance measures
- relationship among teams (e.g., interteam competition).

### Specific Team Pay Designs

Based on the companies studied, small-team pay should be designed as follows:

- **Organization vs. team performance.** A combination of measures at the business unit and small-team level can optimize organizational results.
- **Team vs. individual performance.** An initial focus is on the team rather than the individual

to ensure a move to a shared-fate focus. Depending on team member readiness, the system may later measure individual performance in a small team based on ability to measure performance. Use of multisource feedback is possible in a later-stage transition.

- **People on vs. not on teams.** It is important to include all who influence the success of small teams in small-team pay. Possibilities include sharing rewards based on the average of small-team outcomes, linking rewards to specific teams that people support or linking rewards to business unit measures shared in small-team designs.
- **Participation among core vs. noncore team members.** The key is defining the team to include all team members whether they are in the core business of the team or in support roles. Inclusion is critical to small-team pay success.
- **People on multiple teams.** Business needs dictate flexibility and membership on one or more teams. Funding at the business unit level extends line of sight. Shorter line of sight can be reinforced by allocating rewards based on time in each small team, the importance of small-team goals or other judgments.
- **Goal-setting fairness.** The difficulty of goal achievement related to internal and external customers should be reconciled to ensure a fair opportunity to earn rewards.
- **Team maturation/team pay implementation.** Moving to team pay early negates the corrosive impact of traditional pay in a team environment. Later moves may be more difficult because teams may adapt to pay systems that do not support team pay.
- **Type of team pay.** Variable pay based on business unit and small-team goals is a clear first move. Skill-based pay in simple form is an equally important next move. Pay based entirely or mostly on individual performance is corrosive and needs to be replaced.

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