

## HOW TO PAY MEMBERS OF SMALL, HIGH-PERFORMANCE TEAMS

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The name of the game in companies today is *performance*. Although that term has always been part of our management vocabulary, it takes on special cogency in the context of what we call "high commitment" or "high performance" work practices. Studies of these practices in various industries—automotive manufacturing, semiconductor assembly, textiles, and steel production—consistently reveal performance improvements of between 25% and 50%.<sup>1</sup> Substantial gains by anyone's measure!

Many of these high-performing companies have stated their belief that people provide their only source of sustained competitive advantage.<sup>2</sup> These organizations, therefore, are redirecting much of the time and effort once spent on strategic, nonpeople issues—such as acquisition of capital or technology or hard asset purchases—to determining how to add value from the performance of people.

Moreover, most of these of these companies claim they gain measurable advantages from organizing around small, high-performance teams. And, research evidence also documents advantages for supporting teams with team pay, i.e., basing a portion of team members' pay on team performance and a portion on acquisition and utilization of needed skills and competencies.<sup>3</sup>

Yet, most organizations—even team-based organizations—cling to pay systems that focus on traditional jobs and individual "merit," even when they are confronted with evidence that more effective pay solutions exist.<sup>4</sup>

Companies that do install team pay often encounter considerable initial resistance. Workers and managers alike have grown so accustomed to pay based on an individual's efforts that the prospect of being measured and paid by unfamiliar standards is threatening. However, studies suggest that once an organization makes the transition to teams and team pay, workers and managers prefer this alternative. The research also shows that teams having a portion of their members' pay tied to team results outperform teams whose pay is based only on individual performance.<sup>5</sup>

To gain more insight into the impact a change to team-based pay can have, Schuster-Zingheim & Associates, Inc., conducted a study of team-based pay under the sponsorship of *Compensation & Benefits Review*. We surveyed team characteristics in 20 organizations, then turned our attention to an in-depth analysis of pay practices for small teams in three companies: Honeywell Defense Avionics Systems, Solectron California Corporation, and XEL Communications, Inc. The overall positive experiences with teams and team pay reported by the survey organizations as well as by the case study participants should ease the minds of many executives uncertain about both the difficulty and value of implementing team-based pay.

Exhibit 1 lists the 20 organizations that participated in the initial survey; the sidebar [following Exhibit 1] summarizes the results.<sup>6</sup>

### Exhibit 1

#### **PARTICIPANTS IN THE INITIAL EXPLORATORY STUDY OF SMALL TEAM PAY**

American National Can Co.  
Analog Devices  
Eyewear Division, Frame Center/Bausch & Lomb  
Blue Cross Blue Shield of New Hampshire  
Clairol/Bristol-Myers Squibb Co.  
Hatch Stamping Company  
Hershey Chocolate U.S.A.  
Honeywell Defense Avionics Systems/Honeywell, Inc.  
Linvatec Corporation/Bristol-Myers Squibb Co.  
Methanex Corporation  
Multnomah Community Television  
National Rural Utilities Cooperative Finance Corporation  
Newsday/Times Mirror  
Pratt & Whitney/United Technologies  
Pet Products Group/Ralston Purina  
Textron Defense Systems  
TRW National Consumer Affairs Center/TRW, Inc.  
Consumer Products Group/The Dial Corporation  
Underwriters Laboratories Inc.  
XEL Communications, Inc.

#### **INITIAL SURVEY RESULTS**

The 20 companies participating in the initial survey had the following characteristics:

- All companies responding were organized partly or wholly around small teams.
- The total number of people working in small teams ranged from 10 to more than 1,000.
- An average of 39% of the people in these organizations worked in small teams, with the actual percentages ranging from 5% to 100%.
- Eighty-five percent of the participating organizations had both exempt and nonexempt people in small teams.
- On average, these organizations have had small teams for 3.7 years.
- All the organizations were well satisfied with small teams.
- The small teams represented a wide range of design options, including self-directed, cross-

functional (marketing, manufacturing, operations), project, functional, customer service, quality, and process improvement, and included a wide range of members, from hourly manufacturing to knowledge workers.

Just under half (9) of the 20 organizations reported having small-team pay plans. These plans were in place for a median of 1.75 years, and the median time to implement team pay was six months after implementing small teams. In these organizations, then, team pay was implemented in close time proximity to the transition to team-based operations. This likely supported the migration to small teams.

The most common small team pay solution among these organizations was built on goal-based incentives, followed by competency and/or skill pay, gainsharing, and discretionary bonuses. One solution involved team-based merit increases.

## FOUNDATION FOR THE TEAM PAY STUDY

The initial survey, along with other contacts in the field, uncovered seven key challenges as central to the concerns organizations have about installing team pay.

1. *What is the typical experience?* Company leaders want to know what other organizations experienced during and after their transition to team pay. Positive experiences would serve to verify that team systems can add value to the business. Negative experiences, however, might suggest that individual pay is so well entrenched that even evidence of value added through team pay may not change the momentum. One study goal, then, was to determine if concerns such as these are justified.

2. *How do you pay people on multiple teams?* Organizations often require people to belong to a number of small teams at the same time—work teams, parallel teams, and project teams, for example. In such cases, how do you pay people who work on two or more small teams in the same performance period? Also, how can team pay accommodate situations in which workers move from one team to another during a performance period?

3. *How do you avoid undermining your best individual performers?* Many companies are concerned that pay systems based on collaborative organizational designs, such as small teams, will weaken the initiative and accountability of their best individual performers. So a key question is, how can organizations best pay individuals in small teams? Is it through merit pay increases? If so, should these be based on peer ratings by team members, or on some other system?

4. *How do you serve different customer goals?* Team-based pay often includes a focus on goals and measures related to customer needs. Indeed, maintaining high levels of customer satisfaction often plays an important role in a company's drive to gain strategic advantage. However, teams can have both *external* and *internal* customers, and these different constituencies may have different standards of excellence.

5. *How do you sustain the "creative juices"?* Organizations wonder whether innovation and creativity are team or individual endeavors. What impact will team pay have on the creative juices? Will it stunt individual initiative and new thinking? What team pay designs are most or least likely to encourage the juices to flow?

6. *How do you handle pay differences among team members?* People with different pay levels are likely to work on the same team. These pay differences result from competitive marketplace practice for different disciplines, length of service, prior performance, and so forth. Regardless of the pay levels, team members should focus on shared goals and identify as a team with goal achievement.

7. *How do you discourage unproductive interteam and intrateam competition?* Will small teams compete against each other because they are too closely focused on team goals? Will they also compete for resources? How can the organization focus its teams' energy on a combination of the small teams' and larger group's measures and goals in order to align them with what the company wants to accomplish?

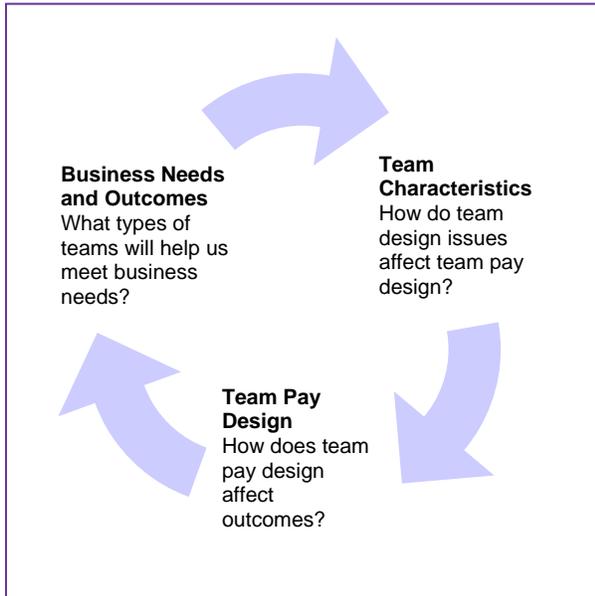
## LOOKING FOR ANSWERS

An up-close look at successful pay practices in team-based organizations is the only way to provide definitive answers to these questions. The site visits to the three companies selected for in-depth analysis looked for answers by considering three broad areas:

- Team organization characteristics
- Team pay design
- Team pay outcomes

## Exhibit 2

### THE DYNAMICS OF TEAM DESIGN, TEAM PAY, AND EXPECTED OUTCOMES



The three are interrelated. Companies move to teams in response to business needs. The way teams are designed will likely influence team pay design, which may, in turn, influence outcomes in terms of business unit performance. Exhibit 2 shows the overall relationship.

By looking at team and business unit dynamics in this way, an organization can establish a team design, pick the pay design characteristics that are most critical, and convert these into team outcomes required to justify team pay.

The seven questions and the relationships shown in Exhibit 2 provided a foundation for the on-site investigations. The sidebar [below] presents some commonalities and differences among the organizations, and the following section provides a closeup on each company.

#### COMMONALTIES AND DIFFERENCES IN THE THREE CASE STUDY ORGANIZATIONS

Team designs and pay systems at Honeywell Defense Avionics Systems, Solectron California Corporation, and XEL Communications, inc. shared some characteristics but differed in other ways, as follows:

- All three organizations have team pay in manufacturing. One has all employees at one location in team pay.
- Team designs include self-directed work teams and project teams, with additional parallel teams.
- Two organizations have team variable pay and one has merit pay, which it grants to individual team members based on team performance.
- All three organizations fund team pay at the business unit level and distribute awards based on team-level measures and goals.
- The measures and goals of all their pay plan designs are derived from the business strategy and represent the key messages they believe will generate the best results for their customers.
- Two organizations have separate, individual merit increase plans in addition to a team variable pay plan, and the other company distributes team-based pay increases to individual team members.
- Two organizations use multisource feedback for individual pay determination. The other has the supervisor determine 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 company has a quarterly profit-sharing plan; the second, a 401(k) plan; and the third, an individual performance recognition plan and a defined benefit plan.
- High involvement among team members is a feature of all three organizations, and strong champions for teams and team pay exist at all levels of these organizations.
- In the manufacturing areas, all three organizations have either made a transition to "self-management" at the small team level or are in the process of doing so.

## HONEYWELL DEFENSE AVIONICS SYSTEMS

Honeywell Defense Avionics Systems, a high-performance business unit of Honeywell, Inc., develops and builds military aircraft cockpit display and flight management systems. It is one of the first Honeywell business units to move to a team-based organizational design.

The business unit, which began its transition to teams in 1992, has 1,200 employees in project and project support teams. Honeywell Defense Avionics sees the entire business unit as a team, and this larger team encompasses a number of small, high-performance teams. Team members include unit leaders and engineering, technical, manufacturing, and support personnel.

### TEAM PAY DESIGN

The Defense Avionics business unit is organized around jobs and uses a market-based, job-valuing system to determine job values. The business unit offers employees a defined benefit pension plan as part of total compensation. Three pay elements are in place:

1. *"Team-based" variable pay (since 1994)*. The unit funds its variable pay program at the business unit level and distributes pay at the manufacturing team level. All nonmanagement employees have some portion of their variable pay award tied to the performance of manufacturing.

Funding is based on business unit annual contribution margin (revenues minus project-controlled costs). Two gates control payout: profit and contribution margin.

Project teams negotiate goals in multiple areas, such as customer satisfaction, working capital, inventory control, and unit product cost. Forty percent of the pay pool, which is funded by contribution margin dollars in excess of goal, is shared if the business unit meets gate requirements and if the project teams make their goals. Support teams must collectively make their cost budget to participate in the pool. They share a percentage average of the project teams' share. Rewards are shared as percentage of base pay.

2. *Merit-based pay using a multisource assessment tool*. Honeywell's Avionics unit has an individual merit pay plan based on a market-ranking, job-valuing system in addition to the team-based variable pay plan.

To help determine merit pay increases, the business unit uses a multisource annual individual performance appraisal system in which a combination of five internal customers, team members, and other peers evaluate performance. Nonsupervisors are responsible for integration of the multisource feedback results, which are used for a combination of development purposes and pay determination. Supervisors are involved in the process only as participants providing feedback.

3. *Individual employee recognition*. The unit uses a peer recognition system to acknowledge outstanding individual behavior. There are two categories. The first includes oral or written acknowledgment and preferred parking. The second includes awards at four levels (gold, silver, bronze, and platinum), based on the breadth of impact of an individual's contribution. Awards include gifts as well as checks up to \$250.

### SITE VISIT FINDINGS

The team pay system has clearly created a number of value-added benefits. These include a sharper employee focus on customers, cost, and delivery; support for the unit's transition to a team-based organization; and clearer communication of the unit's key goals and priorities.

Champions for team pay can be found at all levels of the organization. "Team variable pay links everyone to the success of the project teams—people understand what they can do to help—everything is positive," according to Linda McKee, director of human resources for the site and a key facilitator of the transition to team pay.

Both company leaders and team members believe continuous improvement will occur because of the team-based organization design and team pay plan. They are unwilling to return to a more traditional pay solution. The company's approach works with an important sense of inclusion: all site employees participate in the team pay system, and this supports the teams' alignment with business objectives. Moreover, funding at the business unit level extends the teams' and support staff's line-of-sight to business unit success.

In addition, line-of-sight goals developed at the team level help teams determine what is important, create cohesion around goal achievement, and support high performance. Finally, the presence of champions for team pay along with periodic celebration of business results are positive elements. This sponsorship and support mean that the plan does not need to be continually resold.

Although the business unit strongly supports team pay, our interviews suggested that the system could be improved. For example, the individual merit pay system may not add value to the team pay initiative. During performance periods when the team variable pay system may not grant awards, the merit system can still grant base pay increases. As McKee commented, "The 'merit increase' process erodes a focus on team outcomes and collaboration and should eventually be deleted."

Another challenge is that the division may have prematurely deployed multisource feedback for pay purposes. Some of the feedback system's processes are questionable, and several problems have cropped up with its use for determining pay. For one, the system uses people not responsible for team performance to integrate the feedback inputs and to determine compensation outcomes.

The division also found that people skewed the feedback because they knew it would affect their co-workers' pay. McKee noted that "multisource feedback led to inflated performance ratings because people did not want to negatively impact coworker pay. Multisource feedback should not be linked to pay until team members have experience with this feedback process and are ready to translate it into pay decisions."

## **CRITICAL SUCCESS FACTORS**

The key design advantage in the Honeywell Defense Avionics team pay system is that it includes all people in the business unit and funds the pay plan out of business unit performance. The system has produced solid payouts—and it has missed payouts. Yet support for the system remains strong.

## **CONCLUSIONS AND IMPLICATIONS**

Everyone approached during the site visit expressed the belief that the business unit has strong support for the team pay solution because it adds value to performance. "We wanted to create a norm of recognizing the contributions of everyone," said Tim Osking of Honeywell Human Resources. "This program does this effectively."

Some recommendations to further strengthen the system might include the following:

- The formula for funding at the site level is complex and difficult to use and explain. A simpler formula would be easier to interpret and communicate.
- The merit system is principally a response to Honeywell, Inc.'s view of traditional pay system design. Budgeted merit funds could eventually erode the business unit's team pay system. A better approach may be to remove multisource feedback as a pay contributor while evolving it more completely as a developmental tool and to exclude "uninvolved" people from providing coordination of the feedback. Then, at a later date, the business unit could reintroduce multisource feedback as a tool to help team members allocate variable pay.
- The division might do well to grant base pay increases only as needed in response to changes in competitive practice. It could make variable pay the only performance pay tool at the team level.

- The corporation might replace the defined benefit plan with a profit sharing plan that provides better portability. The defined benefit plan communicates that a one-company career is still possible and desirable, when it may be neither.
- The division could change its concept of the structure for work from jobs to a structure valuing skills and competencies. It could implement a simple skill pay system at the team level and replace market-based job-valuing with a person-based pay system.

## SOLECTRON CALIFORNIA CORPORATION

Solectron California Corporation is a contract manufacturing company whose performance has earned it the Malcolm Baldrige National Quality Award and the California Quality Award. The company has team-based variable pay in manufacturing for 4,500 team members in 240 self-directed work teams. Self-directed work teams have been operational since 1993.

### TEAM PAY DESIGN

The elements of Solectron California's pay system include:

1. *Team-based variable pay.* A variable pay plan, in place since 1985, became team-based beginning in 1995. The transition to team pay replaced a retrospective, discretionary bonus plan. Funded by site profit and return on assets, the variable pay plan provides a quarterly payout based on quality (defects measured in parts per million) and productivity (percent standard time) at the team level. Team members share payout dollars equally.

Variable pay distribution is based on meeting two team-level goals, which the teams develop and negotiate. The variable pay system was developed using a high-involvement design process and is strongly communicated and sponsored at both the site and team levels.

2. *Merit increase plan.* The unit also provides a merit increase budget based on a review of competitive practice. Under the plan, supervisors review individual performance as the basis for base pay increases. The system is administered by supervisors without feedback from team members.

Compensation includes a 401(k) plan, in place for ten years, with matching contributions from the company. Employee participation is strong.

### SITE VISIT FINDINGS

Team members, management, and all stakeholders at Solectron California believe their variable pay solution is a major improvement over the prior bonus system because it:

- significantly improved team performance in terms of quality and productivity,
- improved perceived fairness of variable pay compared with the retrospective bonus plan,
- extended line-of-sight to help team members understand site financial issues, and
- unified self-directed work teams on the importance of goal performance.

"The basic advantage of team pay based on reaching customer-oriented goals," according to Richard Seaman, former director of strategic development for Solectron California, "is that it shifts the focus of team members from trying to make the boss happy to trying to make the customer happy. There is frequently a world of difference between the two." Seaman led the transition to self-directed work teams and team pay.

Members of self-directed work teams indicate that they focus not only on improving team performance but also on site performance because a portion of their pay is linked to a combination of site and team performance. At the same time, team members view base pay increases as unrelated to either team or individual performance. To change this perception and tie base pay increases firmly to performance, Solectron California is considering a skill pay system that would offer a combination of lump-sum payments and base pay increases when skills are actually applied. In addition, since variable

pay has proved so successful, the company is interested in applying team principles to professional, technical, and managerial people.

## CRITICAL SUCCESS FACTORS

Solectron California's transition to team pay has made major contributions toward improving the effectiveness and goal performance of small teams, and the company now has a high-performance, hourly workplace. Whereas the prior bonus plan added no value, the current solution has greatly increased the likelihood that teams will meet or exceed goals. The plan's funding at the site level extends the line-of-sight so that awards are self-funded and related to effectiveness improvements.

## CONCLUSIONS AND IMPLICATIONS

Moving to skill-based pay from job-based pay is a priority because Solectron California views jobs as being too narrow a work structure for a team-based organization. The company has enough information now to generate a simple skill pay system.

Solectron California is well positioned to continue extending its variable pay initiative. Funding variable pay at the site level and granting awards at the team level are major facilitators in improving performance and strengthening the team initiative. Team goal-setting creates ownership of goals and a problem-solving approach when goals are missed. Whether teams meet or miss their goals, they clearly own responsibility for goal performance.

In addition, Solectron California's 401(k) retirement plan tends to complement its team pay system by placing emphasis on employees' sharing the responsibility for saving for their retirement and managing their own assets.

Nevertheless, the company still has some work ahead on improving its team pay solution. For example, it needs an alternative to merit increases and market pay at the job level—namely a simple skill pay system. And because the team pay solution is so powerful, it should include more people at the site. Also, goal-setting can continue to improve, consistent with continuous improvement.

This company's solution to paying teams displayed an inherent understanding of senior management's role in making team pay effective. As Seaman noted, "The biggest problem with implementing team pay is the ingrained behavior of executives. A careless comment or a misaligned decision from senior executives can instantly undermine even the most effective communication and involvement campaign. Executives need to realize that they are being watched closely by team members. Any inconsistencies between what executives say and what they do will be pounced upon by skeptical team members as proof that the 'change' isn't real."

## XEL COMMUNICATIONS, INC.

XEL Communications, a spin-off from GTE, manufactures voice/data transmission equipment. The company, which moved to self-directed work teams in 1987, now has 300 manufacturing people in 16 teams. XEL Communications' team pay initiative relies on three pay elements:

1. *Profit sharing.* Started in 1985, the profit sharing plan distributes quarterly cash awards based on W2 earnings. Payouts average \$500 per quarter.

2. *Skill pay.* This system, launched in 1988, pays people on the manufacturing teams for core skills as acquired. The plan allows for four job categories— assembler, stockroom, technician, and operator—and the company pays for on-the-job training. The company allocates training based on company needs by making it more available as the business requires added skills. The system requires that people certify and recertify for each skill. Wage increases for skills acquired range from \$.25 to \$1.50 per hour.

The skill pay plan has contributed to a close focus on effectiveness and productivity. This focus is reinforced by XEL's profit sharing plan.

3. Team-based merit pay. The company's self-directed work teams have a unique, team-based base-pay increase system. Teams recommend their own quarterly goals to manufacturing management in categories that include assembly defects, on-time delivery, rework, productivity, cycle time, and cost per component. Management allocates the merit budget based on how effectively teams meet their goals. The average-performing team receives the budgeted amount, the best team receives the largest base pay increase budget, and those that do not meet team goals receive little or no base pay increase budget (zero to 7% is the normal range of team increase budgets).

The company also relies on a multisource feedback system in which team members provide direct input on team member pay awards. Every six months, each employee receives five peer reviews, which use five levels to give feedback on quality, productivity, knowledge, skill use, skill acquisition, initiative, communication, teamwork, attitude, and accountability. The peer/self-rating system is visible to the supervisor, who then determines each employee's annual merit award. Individual annual awards are based on contribution to the team and individual base pay increases range from zero to 12%.

## **SITE VISIT FINDINGS**

The company's leadership team as well as work team members give the pay system credit for both sustained team performance and a major culture change. Previously, XEL was a small unit of a large company with an entrenched entitlement-driven pay system. Changing the pay system has led to major improvements in financial results and workforce flexibility and has been a major element in making the organization a success.

Julie Rich, former vice president of human resources and a key champion of teams and team pay, says, "Strategic alignment is absolutely critical to success of any pay system. This is especially critical in the design of team pay. If the pay systems are not aligned with the company strategic goals, the pay system will undermine the company goals. In designing a pay system, it is important to tie in the business unit goals and to include as many people as possible in the team pay design."

This approach also communicates to employees that the company has developed a performance/skill culture; has improved all elements of performance at company, team, and individual levels; and has made the self-directed work team concept a success.

Our interviews uncovered concern with the complexity of its skill pay system, which is now mature, and with the fact that the system pays for the acquisition of skills rather than the application of skills. This design would have inflated base pay costs and reduced flexibility in new skill acquisition if XEL had not closely managed pay against external competitive practice. The skill pay system process is also excessively detailed, and the company has selected a high-involvement employee task force to revise it. Rich comments: "Communication is critical and the transition to team pay should be done as quickly as possible. Even when XEL used a team-member task force to review skill pay, the process took too long. It needs to be developed and updated in a timely manner."

The company has set a goal of extending the team pay solution and skill pay beyond manufacturing teams. The system has proved successful and XEL is ready to expand the concept.

## **CRITICAL SUCCESS FACTORS**

Management and employees alike believe the team pay system has given the company enough workforce flexibility to change from an entitlement-focused company that could not make it without its parent organization's support to an independent, enterprising company. Skill pay and a team-based merit system successfully communicated to employees the company's major goals and objectives. In fact, the pay system works so effectively that it has become a national benchmark for many manufacturing organizations. The company is proud of its pay system and freely shares information.

## CONCLUSIONS AND IMPLICATIONS

The company's course of action is solid. Skill pay has supported the transition to skills from jobs—a transition that continues and has created a very flexible workforce. Team pay has focused teams on important company goals, including sustaining team performance.

To improve its approach, XEL should simplify its skill pay plan, make it pay for the application, not the acquisition, of needed skills, and pay lump-sum awards to emphasize new skills when new products and processes are necessary. It can also change the team merit system to a variable pay plan funded at the company level and distributed based on team goals.

## STUDY FINDINGS

Each site visit provided opportunity for focus groups and interviews with team members, managers, executives, professionals, and human resources professionals. As noted previously, this exploration focused on how elements of team organization influence pay design, and how pay design influences team outcomes.

### TEAM ORGANIZATION-TEAM PAY RELATIONSHIPS

Team-based organizations are designed to accommodate and support company business needs and objectives. This means the pay system must be designed to match the business reasons teams are being used. Because team designs change in response to business needs, the pay system must also be flexible.

Exhibit 3 shows what we learned in this area. The first column lists various issues of team design, and the second column suggests a best practice in dealing with each issue, based on successful practices observed at the three companies. A number of these lessons are worth highlighting:

- The sooner team pay is implemented, the better. It is best not to handicap teams with the added challenge of needing to "overpower" a pay system that was not intended to support team results.
- In the initial phases of team pay, quantitative measures build trust and provide the best support for variable pay. Later, "softer" measures (teamwork, leadership, and other nonquantitative measures) can be used, provided that these relate to observable differences in behavior.
- Defining team membership as broadly as possible provides a community of support for team goals. Every unit will have people who are not formally part of a team, yet impact team outcomes. These people must be included in the pay design.
- Variable pay focused on quantifiable goals is the best initial team pay application. Goal-focused variable pay supports collaboration. At the same time, individual "merit" systems are to be avoided, even though there may be cases in which special individual recognition awards may be used. Simple skill pay is the next move; this focuses teams on skills and competencies rather than narrowly defined jobs.
- Team members can tolerate differences in pay as long as these differences are the result of skill and competitive pay, based on market value.

Admittedly, some of these findings counter prevailing wisdom, especially in such areas as retention of individual merit systems, timing of team pay implementation, and use of "soft" measures for team effectiveness. The problem, perhaps, is that much of what passes as "prevailing wisdom" stems from flawed research. Much of the information supporting individual pay, for example, is generated by studying employee preferences, i.e., asking employees whether they would rather be paid as individuals or as part of a team. Because they have no experience with team pay, they voice preference for the familiar.

### Exhibit 3

#### HOW ARE TEAM PAY DESIGN ISSUES ADDRESSED?

Key Design Issues	Answers from Team Pay Study
Membership on a single team or multiple teams	"Funding" variable pay at the business unit level rather than the small team level makes multiple team membership possible.
Team size	Larger teams create coordination issues, but large teams add no unique design challenges compared to smaller teams.
People from different levels on the same team	Team members accept pay differences resulting from applied skills and competitive practice; they are less likely to accept differences resulting from tenure.
Maturity of teams as indicator of readiness for team pay	Team pay implemented early (within six months of team formation) helps teams mature.
Types of team measures used	Quantifiable measures should be used initially to build trust. Ultimately, "soft" measures can be considered.
Relationship between teams	To avoid unproductive interteam competition, fund variable pay at the business unit level.
Relationship between team and broader organizational performance	Company leaders require return from team pay in terms of measurable value added. Design team pay with funding at wider business unit and distribution at team level.
Paying people not specifically in teams; dealing with core/noncore members	Include those that contribute to team success even when they are not specifically team members. Seek reasons for inclusion in team performance.
Change in team participation during a performance period	Use "averaging" of team outcomes or "home" teams as basis. Avoid situational negotiation and inconsistency.
Type of team pay	Use variable pay initially to focus on shared goals and solidify the team. Avoid individual merit pay that erodes team cohesiveness. Special individual contribution awards may be used. Next, implement simple skill pay to focus on team skills rather than "jobs."

#### TEAM PAY AND ORGANIZATIONAL OUTCOMES

There is only one reason to change a pay system—namely, to generate value added to both the company and team members. Exhibit 4 reflects the study findings relative to team pay outcomes. Again, several points deserve special note:

- Even "less than ideal" team pay outperforms traditional pay in terms of return on investment. Variable pay based on team and organizational goals and skill pay focused on essential skills are better business investments than job-based pay.

- Team pay systems generate measurable advantages over traditional pay systems in terms of supporting a move to a collaborative culture; this culture, in turn, supports the company's goal of achieving a differential strategic advantage through people.
- Individual performance should be defined in terms of adding value to the team by extending the line of sight to organizational measures of cost, financial success, quality, customer satisfaction, and the like. Traditional merit systems and job evaluation systems are not consistent with new company designs.

Clearly, team pay outperforms traditional pay if the goal is to help the business thrive. It requires shedding some comfortable beliefs that no longer apply, but the change will result in a more successful company.

#### Exhibit 4

<b>WHAT OUTCOMES CAN COMPANIES EXPECT FROM TEAM PAY?</b>	
<b>Targeted Team Pay Outcomes</b>	<b>Conclusions from Team Pay Study</b>
High or improved team performance	Even with imperfect team pay, all measures improved. To continue this advantage, measures should be revisited in 1-1/2 to 2 years.
Return on investment (ROI) in team human resources	Line of sight measures define ROI and context of value added. All companies were able to do more with less.
Support for culture change	All individuals interviewed said that team pay helped remarkably in the change to a team-based, high performance workplace.
Broaden individual opportunities	Individuals have more opportunities to contribute to and make an impact on the business.

#### SIX PRINCIPLES OF TEAM PAY

The research supports six principles that compensation professionals may find useful in building team pay designs. The unifying theme in these principles is that the pay system should support business strategy by creating value for both the business unit and the teams.

##### **Principle #1: Make Team Pay "Win-Win"**

Create a positive, natural experience. Team pay is often not within the experience of most employees. Thus, companies must take care to communicate the business reasons for change and advantages of team pay. Involvement in team pay design by the people on the team is essential to their understanding and acceptance of the plan.

##### **Principle #2: Base Pay on Business Unit and Team Success**

Extend people's line of sight. It is not enough for team members to see how their work affects the results of their team; they must also understand how team results add value to the business. Consequently, team pay must fund at the business unit level.

##### **Principle #3: Reward Individuals for Team Success**

Identify individual success with team success. This requires a shift in focus, which can be communicated through variable pay based on business unit and team results. Individual contributions to the team may be recognized with lump-sum awards. When the team is ready for multisource feedback, it should be used to help individuals improve their performance as part of a team.

#### **Principle #4: Stay Agile to Reflect Changing Business Needs**

Adopt business value-added customer goals and create a chain of customers. Internal and external customers make a variety of demands on teams. So, it is important to be flexible enough to adjust to these changing demands by reviewing and changing goals and measures as business needs dictate.

#### **Principle #5: Emphasize Needed Skills/Competencies More Than Jobs**

Build a skill/competency logic through skill/competency pay. The structure and goals of teams change too rapidly to permit rigid and inflexible job documentation, so companies must move to a skill/competency foundation. This encourages application of capabilities needed to make the team a success.

#### **Principle #6: Both Skills/Competencies and Performance Are Needed for Team Success**

Require a pay system based on both skills/competencies and performance to add value. Skill/competency pay in the form of variable pay should be focused on using the capabilities to generate needed outcomes.

These principles reflect the study findings and the views of study participants. It seems clear that the bulk of the opposition to real team pay comes from those with no direct experience with team pay. Those who have made the journey agree there is more to learn but none would step back to the pay systems they abandoned.

### **PARTING COMMENTS**

Doing the obvious remains important. This means keeping the business strategy in focus so the pay system adds value. This takes some relearning, but it is clearly within reach, as experiences at the three companies studied indicate. Celebrating is also important and the transition should be "fun." Simple but adequate solutions are the best. However, it is important to realize that the KISS principle can also mean "Keep it silly, stupid." This is what happens when simplicity overrides business objectives.

The subject of team pay needs more research in the form of up-close exploration. This is especially true for knowledge-based teams in such areas as sales and marketing, research and development, engineering, information systems, and related areas that are critical to business success. We simply do not need additional research that reports on the prevalence of specific practices without providing insight on what works and why. The case study rather than the questionnaire is what practical business people need—and what they want to listen to.

### **ENDNOTES**

1. For a summary of the various research efforts, see Jeffrey Pfeffer, "When It Comes to Best Practices—Why Do Smart Organizations Occasionally Do Dumb Things?"; *Organizational Dynamics*, Volume 25, No. 1, pp. 33-44.
2. Lawler, Edward E. III. *Strategic Pay*. San Francisco: Jossey-Bass, 1990.
3. Lawler, Edward E. III. *From the Ground Up: Six Principles for Building the New Logic Corporation*. San Francisco: Jossey-Bass, 1996
4. Schuster, Jay R. and Patricia K. Zingheim. *The New Pay: Linking Employee and Organizational Performance*. San Francisco: Jossey-Bass, 1992 and 1996.
5. Mohrman, Susan A., Susan G. Cohen, and Allan M. Mohrman, Jr. *Designing Team-Based Organizations*. San Francisco: Jossey-Bass, 1995.
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