

White Paper

Team-Based Pay

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Traditionally, U.S. organizations have depended on individual achievement encouraged by largely hierarchical work-force structures and top-down distribution of information, knowledge, power and rewards. Back in the mid-'90s, some businesses went away from the traditional structure and moved toward a more team-oriented environment. Today, many U.S. companies are making use of teams in one form or another, a striking increase from the late 1980s when less than 30 percent of organizations used teams.

The transition from an organizational structure that emphasizes the individual to one that emphasizes teams is rarely painless, largely because it represents such a significant departure from past experience. A common explanation for difficulties that arise while forming teams is that Americans are accustomed to valuing individual achievement above the challenges of working with others, and this attitude is reinforced during the earliest stages of grade school when teachers hand out gold stars and special privileges to students who perform the best.

Americans also are taught from an early age the importance of getting along with others and that people who work together can achieve more than any single person can alone. But if the concept of helping others and working on teams is within the grasp of most Americans, why is the transition to teams so painful for many organizations? The answer lies not in the supposed strangeness of teamwork but in the failure of most organizations to consider the strategic need for teams, the structure that best supports teams and reward systems that reinforce desired employee skills, competencies and behaviors. If teams are to be successful, they need to operate in environments where information, knowledge, power and rewards are distributed appropriately, and this distribution is rarely hierarchical in the traditional sense. Once the strategies and types of teams are established, decisions can be made on how to reward performance in the new organizational environment.

There are many possible strategic reasons for why organizations turn to teams; some common reasons are to improve customer satisfaction, product/service quality and productivity. While many organizations may maintain, validly, that teams are not necessary for them to achieve success given their specific circumstances, the overall trend appears to be toward a future where most organizations make significant use of teams. The strategic reasons for this trend

are clear and have been elaborated throughout related literature as well as at countless organizations:

- Increased global competition
- Ever-growing pressure to reduce costs
- Organizationwide initiatives to reengineer work processes so they may be as efficient as possible
- A tendency among increasing numbers of organizations to view themselves through the lenses of core "competencies" or "capabilities" that can be converted into competitive advantage.

These factors clearly are interrelated, and they all point to the need to do more with less. Once organizations have drawn the somewhat intuitive conclusion that a work force where people work together is likely to be more productive in most instances than when people work in isolation, the question remains of what type or types of teams make the most sense.

The Pay Question

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?

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.

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. 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. 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.

There are several team organization features that need to be considered before designing a team-based pay system. These include the following:

Types of teams (e.g., work, project, parallel, cross-functional). The relationship between team performance and team pay can be more important than the type of team used. Successful team pay is more goal-focused and acceptable to team members and management than individual pay in any team design. Individual pay erodes team initiatives by overemphasizing the individual.

One type or multiple types of teams. Organizations may have multiple types of teams based upon their business needs. 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. Team pay designs that are clear and consistent about the basis of team pay prove to address this situation best. 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.

Team size. Larger teams present more challenging communication and line of sight issues. 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. Also, differences in pay are acceptable and supported if they are based on measured skill differences within a work category.

Maturity of approach to team organization. Simple team pay with team member involvement tends to hasten the maturation of the team process. 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. 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.

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 team goals, even when goals are specific to each team. While measurability is important, strategic alignment is essential to inter-team cohesion. 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. Best practice is to proceed initially with pay based on team outcomes. 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.

Relationship between pay for people on teams and pay for people not on teams. 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.

Timing of team pay implementation relative to team maturity. Traditional individual merit erodes team pay. 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 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.

Desired Outcomes

Achieve high performance or improve performance. 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. 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 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.

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.

Several features should be included in team pay design to achieve the best results, including 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.
- 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.
- Clearly communicate up-front how pay adjustments/increases are administered and that forms of team-based pay may supplement, adjust, or even entirely replace merit pay for affected individuals.
- 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. Complete the transition and plan development in a reasonable period. Celebrating is important, and the transition should be "fun." Simple solutions that are not "overengineered" are viewed as best.

Types of Teams

Generally speaking, there are three types of teams: parallel, project and work. The members of parallel teams, project teams and work teams are interdependent and work on a common task, although they may or may not be from the same organizational unit.

Parallel Teams

Parallel teams supplement the regular organizational structure and perform problem-solving and improvement-oriented tasks. Parallel teams usually contribute useful ideas about how to improve quality and productivity. Examples of parallel teams include problem-solving teams, quality circles, quality-improvement teams and employee-participation teams. These improvement-oriented teams are called parallel teams because participating employees are taken out of their regular organizations and placed in separate team structures with different operating procedures and objectives. Parallel teams usually meet regularly (each week or two) and follow a defined problem-solving or quality-improvement process. Employees are trained in the use of these processes. They make recommendations that are considered by the management hierarchy. Typically, no change results unless management approves the recommendations.

Project Teams

Project teams involve a diverse group of knowledge workers, such as design engineers, process engineers, programmers and marketing managers. They are brought together to conduct projects for a defined but typically extended period of time. These knowledge workers apply their disparate specialties to develop innovations and fulfill customer requirements. Examples of project teams include new-product development teams, information-systems teams and new-factory

design teams. Project teams are assigned unique, uncertain tasks and are expected to innovate. Their products usually are identifiable, but measurement may be difficult because the value of the unique output may not be known for a long time after the work is completed. Project teams usually have broad mandates and considerable authority. They are assigned the responsibility to make key decisions within broad strategic parameters. Project teams need to respond to the requirements of their sponsors and customers for their work. Therefore, they balance the need for independent thinking with responsiveness to key stakeholders and make sure that appropriate external communication occurs. Finally, project teams are structures that disband once projects are completed.

Work Teams

Work teams are responsible for producing a product or providing a service and are self-contained, identifiable work units that control the processes involved in transforming inputs into measurable outputs. They are performing units in which members report through the team and are responsible for the group's performance. Work teams are found most frequently in manufacturing settings, but this design is applicable to any situation in which people are interdependent and can be collectively responsible for a product or service. Examples include production teams, assembly teams, administrative-support teams, insurance-processing teams, customer sales and service teams, and management teams. For work team members to take responsibility for the team's performance, they must feel in control of the work processes and make key decisions about how the work is done. The degree of management responsibility placed in the group varies significantly. Typically, work teams control how the task is performed, but not what is performed. Management sets performance and quality standards.

Parallel Teams and Pay

Because parallel teams are an extra, they have the fewest implications for the reward system in an organization. They are an add-on and, as such, potentially can be supported by add-on reward systems. Rewards can and should be used to motivate effective problem solving. Membership is not usually an issue because individuals are already members of the organization and are released from their regular, often less-interesting work, to participate in problem-solving activities.

A relatively wide variety of approaches can be used to reward parallel teams for the effectiveness of their problem-solving work. Gainsharing works particularly well when it is combined with problem-solving groups, open financial-information systems and participative decision-making. A major motivational weakness with gainsharing plans is that the line of sight between a suggestion and the size of a bonus is weak.

Project Teams and Pay

The use of project teams presents a particularly interesting challenge for reward

systems. They often require a reward system that is specifically designed to support them. The obvious first choice for motivating a group is a reward system that establishes metrics for successful group performance and sets rewards that are tied to the accomplishments of the group. It also is desirable to have the rewards distributed at the time the group completes its project. One alternative to rewarding group performance at the end of each project is to rely on a gainsharing plan or a collective pay-for-performance system that covers a total organizational unit. This may be the preferred alternative to rewarding individual teams when, in fact, the teams' activities have a major impact on the effectiveness of the unit, and it is difficult to measure the effectiveness of the team. It also may be a preferred alternative if project teams are in existence for short periods of time.

Sometimes, it is necessary and desirable to focus on individual performance in a project-team environment. The best approach is to measure the contributions of individuals to the team's effectiveness and to measure each individual's performance at the completion of each project. Individual ratings can be modified by the success of the overall project. In many cases, peer ratings, as well as customer satisfaction ratings, need to be used. Peer ratings are particularly critical because, in most project teams, peers are in the best position to assess the contribution of team members.

In many respects, skill-based pay fits a project-based organization better than does job-based pay. In a true project-based organization, often it is not clear what an individual's job is. What needs to be clear are the skills the individual has. Often, the critical organizational effectiveness issue is developing the right skill mix so projects can be staffed with individuals who are competent to execute them.

Skill-based pay can help create the right mix of skills in two ways. First, it can provide incentives for individuals to learn skills that are needed so the organization will have a configuration of skills to match its project needs. Second, it also can help through attracting and retaining individuals who have the right skill mix for the organization.

Work Teams and Pay

The use of work teams requires a fundamental shift in reward practices. Traditional reward practices are designed to support individual job performance through individual pay-for-performance systems and job-based compensation. Both of these practices do not fit the requirements of work teams.

The most effective way to motivate team performance is to establish objectives and metrics for successful team performance, and link rewards to team success. There are three ways of rewarding performance at the team level. First, rewards can be tied to team performance through the use of a merit-pay system based on team performance appraisals. Second, special awards can be provided to teams

to recognize outstanding performance. Third, rewards can be provided to teams using gainsharing plans.

Merit pay in the form of salary increases or bonuses can be distributed to a team based upon the results of a team performance appraisal. For performance appraisal to work for teams, there must be clear and explicit objectives, accepted measures and feedback about team performance. Team performance appraisals provide opportunities for teams to conduct self-appraisals and obtain customer evaluations. This data can be used to assist managers in the determination of team ratings.

If team members are not highly interdependent, then it may make sense to combine team and individual merit pay. A bonus pool can be created based on team performance, with the amounts divided among members based on individual performance. For this not to be divisive, it is critical that the manager solicit input from team members about the relative contributions of individual members. It is more effective if team members assess team performance before individual performance, because team performance sets the framework for individual performance. Individuals will perform better if team members support one another, understand all the components of the team task and have the opportunity to develop multiple skills.

The second way of linking pay to team performance is through the use of special award or recognition programs. They reward exceptional performance after it has occurred. Special awards should be used only to recognize special team achievements. Because work teams perform ongoing and repeated work to produce products or services, performance that meets the requirements of customers should happen regularly, but extraordinary performance will be rare.

Gainsharing is the third major approach that can be used to provide rewards for team performance. Gainsharing requires the work unit covered to be relatively autonomous, responsible for a measurable output and comprised of members who are interdependent with one another. Gainsharing is particularly well suited to the participative nature of work teams. It provides motivation for work teams to monitor their performance and learn about leverage points for improving performance. Gainsharing can help work teams identify ways to continuously improve their performance.

In general, an organization composed of work teams needs to make sure its pay-for-performance systems motivate team performance. This can be done through the design of the right mix of team-level and organizational-level pay-for-performance systems. The more that work teams stand alone as performing units, the more rewards should be focused at the team-level. The greater the interdependencies between work teams and functional groups, and among different work teams, the more that pay-for-performance systems should operate at the organizational level.

Skill-based pay is well suited to work teams and is used most commonly in team environments. Skill-based pay should be designed to motivate team members to be cross-trained and become multi-skilled. Skill-based pay also should be used to encourage team members to learn vertical skills that are applicable to work normally performed by managers. This learning is critical if a team is to operate in a self-managing manner and not just as a traditional work group.

Challenges and Opportunities of Team-Based Pay System Design

Team-based organizations require different pay systems than do individual job-based organizations with traditional work groups. Skill-based pay is most appropriate for work teams and project teams, with job-based pay a better fit for parallel teams. These teams vary as to the recommended mix of individual, team and unit rewards. Organizations that use parallel teams still may need to rely on individual merit-pay systems for job performance, supplemented by possible recognition or gainsharing systems at team and unit-level rewards. In contrast, organizations that use project or work teams should emphasize team and unit-level rewards, with the appropriate balance being determined by the degree of interdependence of the project or work team with other contributors and teams. The less a team can be self-contained, the more that unit-level rewards should be used.

Although these are important differences, all three approaches to teaming call for the use of participation, open communication and rewards that consider team or unit performance. In addition, many organizations use multiple approaches to teams and may need to design reward practices that can encompass these different types. This calls for establishing generic pay principles that can be applied across the three types of teams, permitting local design and variation.

Teams represent a single technique that helps create integrated, learning-oriented organizations where employees are rewarded for supporting each other and developing themselves laterally by enhancing their skills and competencies.

The key to supporting teams in any form is moving knowledge, information, power and rewards downward in the organization, essentially dismantling a hierarchical structure that generally does not support team operation. As this transition occurs, people at all levels of the organization likely will find they can add more value, which in turn gives the organization a new source of competitive advantage through its work force. Teams support lateral processes and overall organization flatness, and research has shown that these factors, in turn, help bridge quality, productivity and general performance problems that arise in more hierarchical work structures.

Whether an organization embraces the pursuit of high performing teams or simply encourages a culture where teamwork is the norm, compensation professionals will find increasing challenges in the future to develop reward systems that support appropriate behaviors. Before making dramatic changes in

pay strategy, it will be important to understand the types of teams in place within the organization and their varied, often changing, roles in supporting business objectives.

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