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Emerging Model
for Salary Management

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Survey after survey shows that managers in the public sector are dissatisfied with existing wage and salary programs. The problems are not always the same, but the level of frustration is pretty consistent. The programs are seen as too paper-intensive and time-consuming, too inflexible, and too costly. In fact, it is probably safe to say that the traditional program model has no supporters outside of the personnel function.

Perhaps surprisingly, managers in the private sector voice many of the same complaints about the programs in their organizations. The more-or-less standard program model has become a dinosaur. Critics have been diverse: women arguing for pay equity, quality management advocates repeating the points made by W. Edwards Deming, reengineering specialists working to improve administrative processes, and accountants worried about rising payroll costs. Now, management experts contend that the model is an impediment to change because it was designed to support a traditional, hierarchical organization. For a time, personnel specialists defended their programs, but that battle seems to be over. The traditional model is rapidly being replaced by newer concepts.

Interest in moving away from the traditional model runs high in every sector. Compensation problems are essentially the same, and the basic program goals also are similar in every organization. While many management systems look the same in both public and private organizations, when it comes to compensation the underlying philosophies and values are in fact different. This article looks at the trends in compensation management and at the implications of these trends for government.

Storming the Personnel Ramparts

One of the most significant trends is the gradual tearing-down of the walls surrounding the personnel/human resource function. Textbooks may refer to wage and salary programs as management systems, but anyone who has tried to make a change related to base pay learns quickly that personnel dominates the decision process. The personnel "police" commonly have to approve any changes. In the corporate world, even CEOs sometimes have to obtain personnel's approval to initiate a change. The personnel department's attempts to control pay decisions sometimes appear to be heavy-handed, but they defend their approach as warranted to maintain system integrity.

That situation is changing rapidly. One reason is that managers are increasingly being held accountable for the performance of their units, and this development logically involves increased discretion and autonomy for personnel actions. There is a recognition that managers know the situation best and that their input is rightly more important than that of a personnel analyst.

Another reason is that the staff and budget reductions in personnel mean, quite often, that that department simply does not have enough staff to monitor and control the program at the traditional level. Personnel functions also are responding to their new "customers" and working to understand and meet their needs.

Perhaps the most significant trend is the reliance on cross-functional reengineering teams for process improvement. These teams are composed of people who have been critical of the way in which salaries are administered, who owe no allegiance to the traditional policies and practices, and who have a mandate to develop better answers. After these teams have finished with other administrative systems, it's not unusual for them to fix their sights on the wage and salary program, and in many organizations it is difficult for the personnel executive to argue against this frontal assault.

When the need for program change is addressed by a cross-functional team, there are no sacred cows. Reengineering team members' experiences with the existing program mean they cannot start with a truly clean slate, but they have a high level of interest, and they understand how important and sensitive the changes will be to the organization. The involvement of people from other functions represents an important new direction in the design of compensation programs.

The New Compensation Model

The new model is an attempt to address the problems in existing programs. Salary programs bring together several basic concepts, with the new model as a whole representing a radical departure from the static programs of the past. Taken separately, the components of the new model are based on the following ideas.

Greater delegation of decision making. In contrast to the close, centralized control exerted by personnel specialists, the new model is much more of a management system, with greater delegation of day-to-day decision making to managers and first-line supervisors. Personnel is moving toward more of a consulting and less of a policy-policing role.

Limited number of salary bands. In contrast to the traditional salary structure, with as many as 20 or 30 overlapping salary ranges, the new model is based on a limited number of broad salary bands. In contrast to traditional salary ranges, which are typically based on a difference from the range minimum to the maximum of 30 to 50 percent, the bands are much wider. The bands adopted by Charlotte, North Carolina (see box on page 13), illustrate this. The salary bands are 100 percent in width except for the lowest band. Charlotte uses labor market data as a guide in managing salaries within the bands. This responsibility has been largely delegated to managers and supervisors. Broad bands make close program control impossible and nullify the established logic of automatic step increases.

Broad bands are believed to be more compatible with the flattening of organizations and with a deemphasis on the traditional hierarchy. They also fit a team environment in which differences in salary grades are detrimental to working relationships.

Within the bands, there is much more emphasis on "market pricing." That is to say, salary surveys are used to determine the prevailing wage or salary, and starting salaries within a band are set to enable the employer to recruit adequately qualified candidates. Over time, salary increase trends in relevant labor markets are key considerations in salary budgeting. It is unlikely that anyone will begin at the bottom of a band.

The market focus translates into less emphasis on internal salary relationships. Employers continue to need a simplified job evaluation system because many jobs cannot be priced with survey data. One of the continuing duties of personnel analysts is to monitor salaries for possible pay discrimination.

Increased stress on merit pay. Despite the strong criticism of W. Edwards Deming and, more recently, Alfie Kohn, merit pay and other pay-for-performance systems are more important today than they were a decade ago. Other critics of traditional pay practices have focused on the entitlement mindset that frequently prevails. In an era of tightened budgets, it is difficult to justify automatic increases. It is, however, easy to promulgate a merit pay policy in an environment in which improved performance is important.

Focus shifts to the value of the person. The latest development in the new model involves a shift in focus from "paying for the value of the job" to "paying for the value of the person." In scientific management thinking, workers were effectively cogs in a wheel and expected to perform assigned tasks. With the new work management paradigm, there is work to be done, and anyone who is qualified is expected to pitch in as needed. Assigned job duties are expected to change frequently in the new paradigm—a frequency that would be impossible to support with burdensome job evaluation methods. Because pay is not tied to job duties, management has much more flexibility to use people as needed.

The phrases "pay for knowledge," "skill-based-pay," and "competency-based pay" refer to concepts that fit this new environment. When employees are paid for what they know or what they can do, each individual has an incentive to expand or enhance his or her capabilities. This is consistent with the learning organization philosophy that emphasizes continued individual development and skill enhancement.

Group and team incentive plans, with cash payments. The final component of the new model is the mushrooming interest in introducing group and team incentive plans, with cash payouts tied to savings or other performance measures. The rush to teams and to collaborative work efforts has prompted considerable experimentation with new plan concepts. The phrase associated with the earliest of these plans, "gainsharing," often still is used, but the new plans are different from the original concept. Payouts usually are not high, and it is common to see awards that are only 4 to 8 percent of salary.

It is important to keep in mind that because these payouts are dependent on improved performance, the cost is not significant. Recent research shows that with the typical group incentive plan, the organization can expect to gain $2 for every $1 paid to employees.

For anyone who has worked in compensation management, one of the striking differences in the new model is the emphasis on process rather than on technical considerations. Wage and salary management was previously a "techie" field, with considerable energy being devoted to in-depth analyses and complex "black-box" solutions. Much of the work was done behind the proverbial closed doors, and there was a shared attitude that only trained specialists could deal with many of the issues. That environment is changing rapidly, as neophyte reengineering teams get involved and as concerns with customer satisfaction become a priority.

The new program concepts have emerged largely in the private sector. There, the demand for improved performance is of paramount concern, and there is little support for any practice that is seen as ineffective or inconsistent with a performance-based culture. On the other hand, the first organization to test broad banding was a naval research lab in the San Diego area. There is no inherent reason to assume that any of the ideas is inappropriate in government.

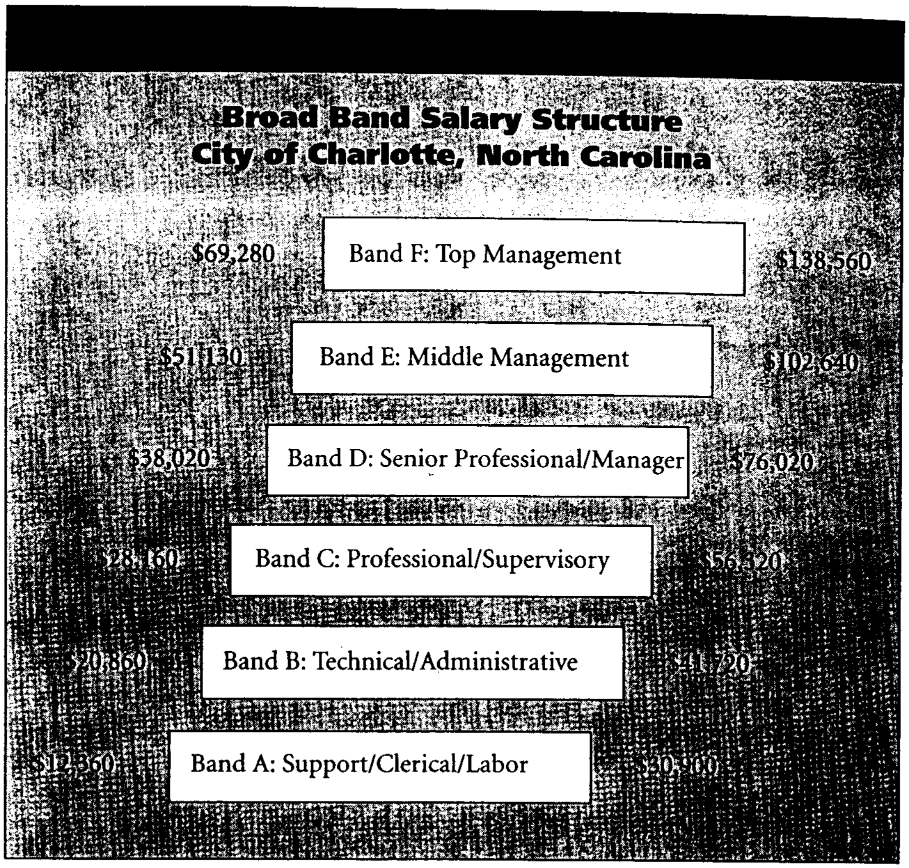
In fact, all of the concepts have been used successfully in government organizations. At the local level, the compensation program adopted by the city of Charlotte, North Carolina, is the closest to the full model described above. Ken Wallace, the city's compensation manager, has been deeply involved in developing each aspect of the program and is quick to tell people that it is working well. It is a simple program that is managed largely by managers, with Ken's input; it definitely is not just "another personnel program."

The Big Question: Will Merit Pay Work?

The biggest difference between private and public pay programs is the emphasis on paying for performance. In the private sector, performance measurement and performance improvement are focal issues—even survival issues—and every employee understands why. Perhaps the most striking difference between the two sectors is the avalanche of performance data in the private sector; there are daily indicators of how well companies are performing. The importance of remaining successful and profitable makes the data a high priority, which justifies and confirms the importance of individual, team, and group performance.

In the private sector, merit pay is virtually universal, at least for white-collar occupations. The typical company's practices are not necessarily effective, but the philosophy is deeply entrenched and integral to American values. In the current climate, each corporation is driving for improved performance, and policies that link employee rewards to company performance have become a hot-button item. It is possible that by the end of the decade the overwhelming majority of people working in the private sector will have a portion of their compensation tied to the financial performance of their employer.

This environment carries over to public employers. The importance of improved performance permeates initiatives for reinventing government. The public's concern with the performance of government workers has been an issue for decades. This has carried over to the perceived entitlement culture and the belief that government workers are not as productive as they should be. And these beliefs have been reinforced repeatedly in recent years by elected officials who bash government workers.



After all, the validity of this viewpoint is not up for debate; at this point, the public would like to see changes in government practices.

The drive for performance improvement also has triggered new ideas for measuring and assessing performance. The interest in customer satisfaction exemplifies this trend. In the performance appraisal arena, there also has been developmental work to overcome the criticism of Dr. Deming. Corporations definitely have not stopped appraising employee performance.

One important new approach is to look to customers (virtually every employee works to satisfy the needs of some external or internal customer) and also to coworkers for feedback on individual performance. Employers need this information for personnel management purposes. And research actually shows that employees too want performance feedback and they would prefer to be rewarded for their performance, but they are reluctant to trust their supervisors when assessment is linked to a pay increase.

Employers are modifying their merit practices. One simple change is to move to a performance rating scale on three levels—superstars, turkeys, and the 80 percent who perform adequately. That simple three-level practice is a response to Deming's argument regarding the validity of performance ratings. Employers need to identify their outstanding people and their problem workers. There are special rewards for the outstanding workers.

Merit pay in the perceived entitlement culture is a problem for government that defies simple answers. It probably also defies quick fixes. It needs to be seen as a process, not an annual event. The starting point has to be senior management's commitment. There also is a compelling need to invest in training and effective communication. In light of trends in the private sector, this need is not going to go away.

Any decision on this policy issue is important because it will affect the culture and the employees' performance orientation. The old adage "You get what you pay for (or reward)" is relevant to salary management. With the widely used step-increase or general-increase policy, the message to employees is: Everyone who stays out of trouble and meets at least minimal performance expectations will get an increase. Merit pay, while not by itself an effective incentive, does in fact reinforce the importance of performance. When increases are essentially automatic, the best performers will be the least satisfied.

Getting Ready for Change

The underlying philosophy behind the management of salaries in the public sector has not changed much in this century. The traditional model was developed at a time when the principles of scientific management were the driving force in organization planning and in work management. The need for new pay programs is only one element in a more pervasive change in the way work and people are organized and managed. Any changes in the program need to be considered in this context.

Moving to a new model, of course, means moving away from the old model, and even when people agree that something is not working, they find it difficult to accept change. That makes the strategy for developing a sufficient consensus to move forward the single most important element in making the change.

The thinking that goes into the traditional model is deeply entrenched. Unfortunately, the personnel community in the public sector has been somewhat isolated, with little experience or interaction with its counterparts in the private sector. For this reason, few people in government understand the thinking that prevails in the private sector. It is not that private sector programs are better. But the isolation of public personnel staff means that there is an inadequate knowledge of alternatives. This applies to managers as well because many managers only know the existing program.

A lack of knowledge also undermines the possible effectiveness of existing programs. Individual salaries may be in the public record, but more than a few public employers have not communicated the program mechanics well enough so that managers and employees can understand how their salaries are determined. This situation often leads employees to conclude that their employers "must be trying to cover something up."

When this suspicion is combined with the absence of recent changes in the wage and salary program, the prospect of a new program can quickly generate a real fear of the unknown. Managers, of course, know this, and the anticipated employee reactions make them reluctant to go forward with changes.

The answers are education and communication. There is a need for open discussion of the existing program, as well as of the possible goals for a new program. Generally, the work involved in designing a new program is best handled by a cross-functional task force, and individuals below management level should serve in the group. This selection of individuals is a key step in the change strategy. They need to be both credible and, to some degree, representative of important factions. Technical expertise is not a prerequisite.

The strategy also must encompass the spokespersons for competing points of view and the groups who will be affected by any changes. Changing a government pay program is a political decision and needs the support or at least the acquiescence of key leaders. This side of the strategy can only be developed locally.

Criteria for a New Program

Among the biggest surprises—and the first hurdles—is the realization that there are no universal answers. But there may be a shared recognition that an existing program is not working, and over time, support may grow for considering alternatives. In contrast to the thinking of only a few years ago, however, the new salary programs that are being implemented are based largely on locally developed answers. There are no widely used answers like the one the Hay job evaluation system offered for almost four decades.

The salary management problem is universal. Every employer has to develop a systematic answer to this organizational need. The need to manage payroll costs is universal. In the private sector, keeping those costs in line with levels in competing organizations is a common goal. In the public sector, employee pay levels represent a major component of an agency's budget so there is a similar reason to manage payroll. Employee recruiting and retention also are common goals, which means that market sensitivity is a common criterion. Internal equity is, however, in the eyes of the beholder; there always is some level of dissatisfaction and no completely valid methods to establish defensible pay relationships. Policies and practices that link pay to performance also involve judgment and may become a source of friction.

These are conflicting organizational needs so the first step in developing a new base pay program is to develop a consensus on the underlying philosophy and program goals. That should start with senior administrators and ideally, elected officials. The conversations also may involve key representatives of employee groups.

The issue of perception is central to the acceptance of a new pay program. Employees would always like to be paid more. At the same time, they are adults and certainly understand the factors that limit the public sector. In most communities, government workers are paid roughly the same as their counterparts in the private sector. Data confirming that wage and salary levels are competitive with local companies will go a long way toward convincing employees to support planned changes. Those data also should help sell a new program to the public. PM

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