



Welcome!
The presentation will begin shortly.

Pay It Forward for Results: The ROI of Skill-based Pay

Thurs, June 26 / 2:00 PM - 3:00 PM ET

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Today's Agenda



5 mins. – Introduction and Tour of Track Page



45 mins. – Our Feature Presentation



5 mins. – Wrap Up

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Today's Moderator



Joy Kosta

Senior Director of HCI Communities
Human Capital Institute

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Today's Guest



Gerry Ledford

President

Ledford Consulting Network, LLC

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Pay It Forward for Results: The ROI of Skill-Based Pay

June 26, 2008

Agenda

1. What is skill-based pay?
2. Skill-based pay design options
3. Long-term success and survival of skill-based pay
4. The ROI of Skill-based pay

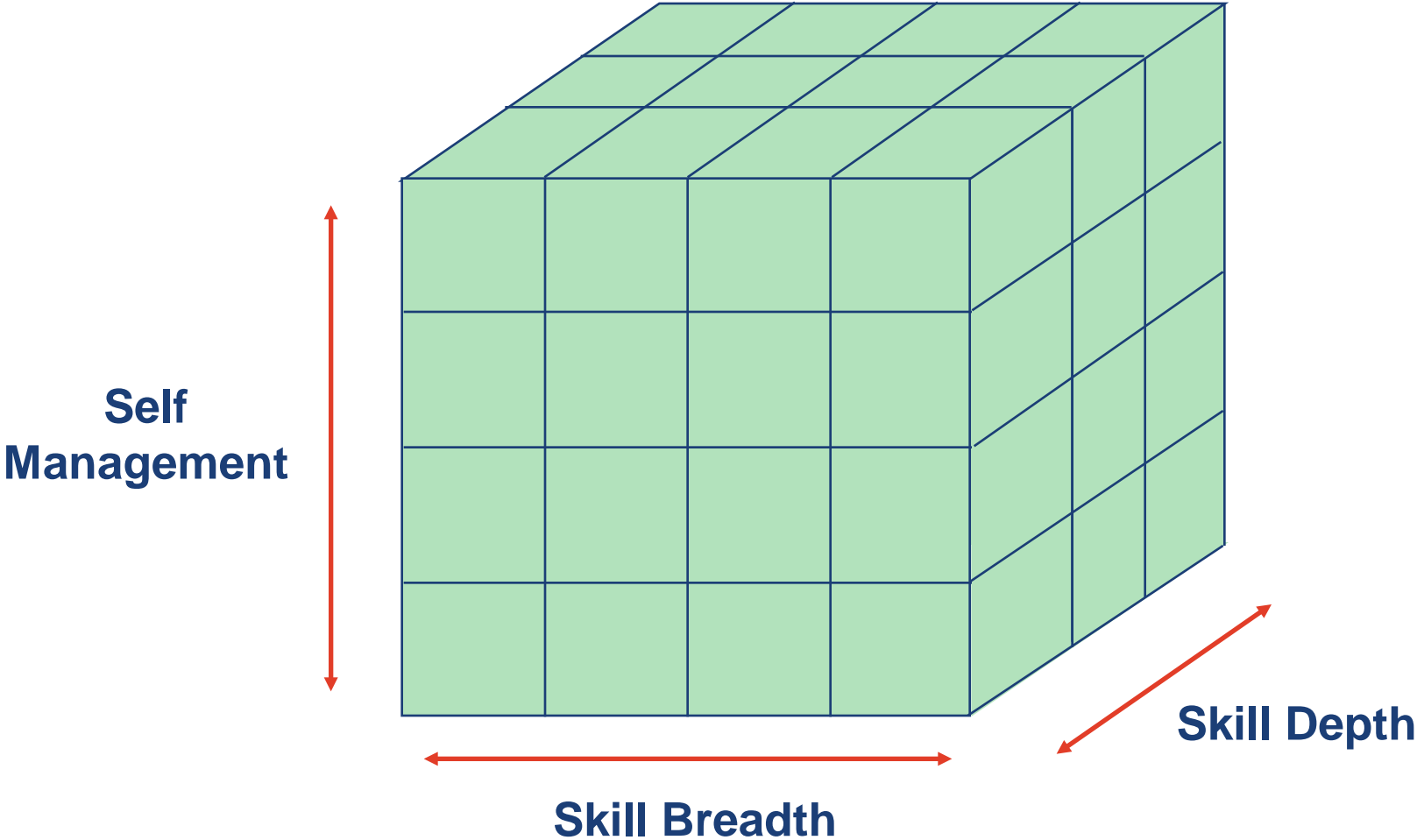
Skill-Based Pay Compared to Job-Based Pay

- **Job-based pay:** Pays for the job currently being performed
- **Skill-based pay:** Pays for the sets of skills or range of jobs the person is capable of performing

How Skill-Based Pay Differs

- **Skills are formally certified or evaluated in skill-based pay plans**
- **Pay increases follow skill certifications, not changes in jobs**
- **Pay is based primarily or entirely on skills, not seniority or other factors**
- **Advancement opportunities typically are much broader in skill-based systems**

Skill Dimensions



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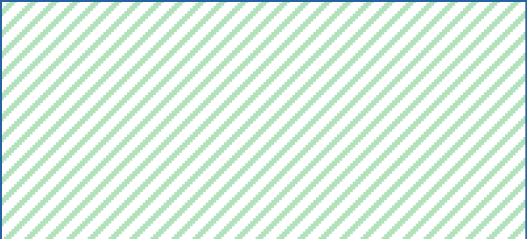
Skill-based Pay Options

- **Classic skill-based pay**
- **SBP bonuses**
- **Competency pay**

Classic High Involvement SBP: Characteristics

- Originated with Procter & Gamble in the 1960s
- By far the mostly widely seen and best known type of SBP
- Base pay (wage or salary) grows as skills grow
- Plans cover most or all non-exempt employees, although usually not exempt employees
- Mostly used in manufacturing or manufacturing-like service settings
- High start-up investment cost, then design remains semi-stable
- High employee involvement in the organization design is desirable

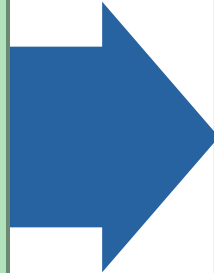
Classic Skill-Based Pay Plan: Hypothetical Example

<p>Level 4 (\$16.00/hr)</p>	<ul style="list-style-type: none"> • Proficient on fourth workstation (different team) 	<ul style="list-style-type: none"> • Performs statistical process control on at least one sub-process 	<ul style="list-style-type: none"> • Leads a process improvement team • Trains and certifies others on two operational and technical skills
<p>Level 3 (\$14.00/hr)</p>	<ul style="list-style-type: none"> • Proficient on three team workstations 	<ul style="list-style-type: none"> • Performs routine preventive maintenance on two team workstations 	<ul style="list-style-type: none"> • Participates on a process improvement team • Assume two “star” point roles (e.g., safety, training)
<p>Level 2 (\$12.00/hr)</p>	<ul style="list-style-type: none"> • Proficient on two team workstations 	<ul style="list-style-type: none"> • Performs routine preventive maintenance on one team workstation 	<ul style="list-style-type: none"> • Participates on a process improvement team • Assume one “star” point role (e.g., team safety)
<p>Level 1 (\$10.00/hr)</p>	<ul style="list-style-type: none"> • Proficient on one team workstation 		
	<p>Operational Flexibility (Skill Breadth)</p>	<p>Support Skills (Skill Depth)</p>	<p>Team Management</p>

Potential Advantages of Classic Skill-Based Pay for Companies

Causal Factors

- Employee flexibility
- Facilitation of high involvement design
- Acquisition of critical knowledge/skills
- Support for compensation strategy



Possible Outcomes

- Higher quality
- Higher productivity
- Higher output
- Lower turnover
- Lower absenteeism
- Better recruitment
- Reduced staffing
- Better labor-management relations

Potential Problems with Classic Skill-based Pay

- **Clarity and stability of the plan**
- **Costs: Wages, training, administration**
- **Evaluation: Criteria, frequency, fairness**
- **Skills paid for but not used: skill loss, obsolescence**
- **Equity issues: Pricing to market**
- **Individual differences: Ability, growth**
- **Skill versus performance**
- **Transition: Role of prior pay level and skills**
- **Topping out?**

SBP Bonuses: Characteristics

- **One-time payments for demonstrating specific knowledge and skills (e.g., meeting “learning contracts”)**
- **Can be much more targeted than classic SBP to:**
 - Specific business needs
 - Specific types of skills
- **Design process requires relatively low investment, is easily changed**
- **Good fit when wages are already high versus the market**
- **Biggest user: U.S. military; experiments at defense contractors**



Potential Problems with SBP Bonuses

- Incentive power may be limited
- May raise equity issues
- Can invite too much sloppiness
- May be hard to sustain over time

Despite potential problems, this form of SBP is seriously underused

Competency-Based Pay: Definition

■ Characteristics of competency-based pay systems

- Competencies are demonstrable characteristics of the person that enable performance, including knowledge, skills, and behaviors
- Analysis determines which competencies are compensable
- Typically these are base pay systems, but they can be bonus-based as well
- Most often used for managers and professionals

Competency-based Pay: Varieties

■ Pay for differentiating competencies

- Competency pay usually focuses on characteristics that are presumed to differentiate superior performers from average performers
- Considerable validity research on individual behavior and performance associated with competencies
- Relatively little research on organizational effects of competency pay

■ Pay for strategic competencies

- Pays for competencies that the organization will need in the future – and does not yet have
- Top down process is required
- Limited research on organizational effects is encouraging

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Research on Long-Term Success and Survival: A Large-Sample Study

Shaw et al. (2005) was a large-scale, longitudinal study

- 61% of organizations using SBP in 1991 ACA study had continued using SBP
- On average, the plans had survived 12 years at the time of the study
- **Success factors:**
 - Use in manufacturing rather than service organizations
 - Employee involvement in design and administration
 - Supervisor support for the plan
 - Skill breadth orientation
 - More learning opportunity (more skill blocks)

Research on Long-Term Success and Survival: Intensive Small Sample Study

Ledford (2008) study of 9 well-established SBP plans

- **Plans were in high involvement, capital intensive manufacturing plants**
 - These are ideal conditions for SBP
 - Mix of greenfield startups and conversions, union and non-union
 - Data:
 - Compensation / organizational survey in all plants
 - Site visits to four plants
 - Participation in a follow-up conference by five sites

Findings from Ledford (2008) study

- 1. Many organizations have with SBP show impressive results**
 - 3 were among the best plants in their company
 - Paper products plant: The work design saved \$15 million
 - Chemicals plant: 50% higher efficiency, 35% more production, 50% cut in managers in previous five years
- 2. SBP plans are highly customized – every plan is unique**
- 3. SBP support systems are critical but require maintenance**
- 4. Skill recertification is important and often overlooked**
- 5. Leadership is essential**
- 6. Competitive wage assessment is becoming more important**

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Observations about SBP

Return on Investment (ROI)

- **It may be impossible to separate SBP effects from effects of the broader work system**
 - Separating the effects of each piece of a complex work system is difficult or impossible, unless each piece is implemented separately in time
 - That is not necessarily a problem if SBP is integral to the work system; for example, SBP may be the “what’s in it for me” that makes the system possible
 - Calculate total system effects if necessary
- **Keep the analysis focused on total labor cost, not wage differentials**
 - Focusing only on wage differentials is a loser because the goal is fewer, better paid employees; SBP typically pays employees a ~10-15% premium
 - Calculate the number of direct labor, support, supervisors, and managers needed with and without SBP
 - Sum of wages of employees with and without SBP
 - Account for additional training and certification costs of SBP

Observations about SBP

Return on Investment (Cont'd)

- **Consider all savings from higher performance generated by the plan**
 - Productivity, quality, costs other than labor
 - Flexibility in meeting customer demands, adaptability to change
 - Lower absenteeism and turnover
 - Better labor-management relations
- **Organization-specific benefits and cost**
 - Example: New plant start-up with slow ramp-up in costs
 - Example: Preparing new workers to take over as a wave of retirements begins
 - Example: Creating a new organizational culture that, by design, cannot be compared directly to the industry

For Further Reading

- Ledford, G., Heneman, R.L., & Salimäki, Aimo. (2008). Skill, knowledge, and competency pay. In Lance A. Berger and Dorothy R. Berger (Eds.), *The Compensation Handbook* (5th ed.). New York: McGraw-Hill (pp.143-158).
 - *Thought piece that explores different types of SBP; reports on usage of SBP; and reviews data on plan effectiveness*

- Ledford, G. (2008). Factors Affecting the Long-term Success of Skill-based Pay. *WorldatWork Journal*, 17(1), 6-17.
 - *Based on benchmarking case studies of established pay for skills plans*

- Shaw, J.D., Gupta, N., Mitra, A., & Ledford, G.E. Jr. (2005). Success and survival of skill-based pay plans. *Journal of Management*, 31(10), 1-22.
 - *Academic article based on a large-sample, longitudinal study of SBP plans*

About the Ledford Consulting Network, LLC

- The Ledford Consulting Network, founded in January 2004, focuses on thorny business problems in which people issues are central. These problems require that we see people issues in their business context. We are not just business consultants or just human resource consultants.
- We provide the greatest value when we work on problems in which the business need is compelling but the problem is murky, the likely solutions are complex, change management is difficult, and/or organizational politics are blocking solutions. We do not look for opportunities to implement canned solutions that we have used many times before. We seek client partnerships that jointly develop innovative, creative solutions.
- We combine practical and theoretical knowledge in our work. Both are important in understanding and solving thorny problems. Neither academic studies and reports of other companies' "best practices" provide the whole answer. However, greater knowledge gives us better ways of understanding underlying problems, enriches our solution set, and helps us avoid other companies' mistakes.
- LCN uses a virtual organization model. Gerry Ledford is the President and primary consultant for the firm, and he performs the project work himself. If a particular project requires additional assistance, he draws on his wide circle of consulting colleagues from a myriad of specialties to assist with the project.

Gerald E. Ledford, Jr., Ph.D. – Biographical Statement

Expertise

Gerry Ledford is a nationally recognized authority on human capital issues, including compensation, talent management, organization design, change management, and management of the Human Resource function. He has devoted over 25 years to consulting and research on these topics. Gerry has consulted to dozens of Fortune 500 companies. He has done extensive work in many industries, including high technology, insurance, health care, telecommunications, paper and forest products, food manufacturing, and consumer goods.

He has deep experience with employee compensation. He has consulted extensively on compensation systems that reward employee knowledge, skills, and competencies. He has helped a number of major companies to develop an overall corporate rewards strategy that reflects business needs. He also has worked with many companies to develop employee incentives that reinforce unit performance.

Gerry has helped many organizations to develop comprehensive approaches for improving performance and changing organizational culture. For example, in a large insurance firm, he led a project that developed a package of nine changes including employee incentives, business literacy, better performance management, a recognition system, and work redesign. He has extensive experience in developing high performance work systems, especially in new plants.

Professional Background

From 1998 to 2003, Gerry was a leader at Sibson Consulting. He was Senior Vice President and National Practice Leader, Employee

Effectiveness, the largest Sibson practice. Previously, he was Research Professor at the Center for Effective Organizations, Marshall School of Business, University of Southern California, where he was a key contributor from 1982 - 1998.

Education

Dr. Ledford received his Ph.D. and M.A. in Psychology from the University of Michigan. He received a B.A. in Psychology (with Distinction) from the George Washington University.

Professional Affiliations, Awards, and Intellectual Contributions

Gerry is active in such professional societies as WorldatWork, the Human Resource Planning Society, the Society for Industrial and Organizational Psychology, and the Academy of Management. He is past chair of the Organizational Development and Change Division of the Academy of Management. His awards include the Society for Human Resource Management's Yoder-Heneman Personnel Research Award.

Gerry has published extensively in academic and practitioner-oriented outlets. He is the author of over 90 articles and is the author of ten books and monographs, most recently [The Rewards of Work: The Employment Deal in a Changing Economy](#) (2003). He is a frequent speaker for such groups as WorldatWork, the Human Resource Planning Society, and SHRM. His research and opinions have been cited in many print and broadcast media outlets, including the [Wall Street Journal](#), [Business Week](#), [Fortune](#), the [Los Angeles Times](#), the [Washington Post](#), and PBS.



Questions & Answers



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Thank You!

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