Chapter 29

Fostering Employee Involvement and Engagement through Compensation and Benefits

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Employee involvement and engagement are among the most widely embraced concepts in current thinking about human resource management. This chapter explores how compensation and benefits can foster employee involvement and engagement. Nearly all organizations offer compensation and benefits to their employees, and these rewards clearly play a critical, and sometimes unexpected, role in determining the level of employee involvement and engagement. The focus on compensation and benefits does not imply that these practices are the only way to promote employee involvement and engagement. Clearly, a great many other management tools play critical roles as well. However, compensation and benefits play a powerful role in determining the level of involvement and engagement, and if badly designed, these tools can undermine other approaches.

We begin by exploring the meaning, measurement, and effects of employee involvement and engagement. Next, we consider the linkage between these concepts and business outcomes. Finally, we consider how different compensation and benefits practices can foster involvement and engagement in the workforce as a whole and with different segments of the workforce.

What Is Employee Involvement?

Employee involvement is a set of management practices that extend decision-making power, business information, technical and social skills, and rewards for performance to the lowest levels of the organization (Lawler 1986). Employee involvement is thus a property of organizational systems and not individuals. Each set of practices is integral to the definition. Without the power to make decisions, employee participation is superficial. Without adequate business information, involvement is naïve and potentially harmful. Without skills, employees will not have the technical and social knowledge they need to participate effectively. Without rewards for performance, worker motivation and organizational objectives will not be aligned.

This concept of employee involvement as a set of practices distinguishes it from participation and empowerment. Participation, especially as studied in academic research, often involves a relatively trivial degree of decision-making authority. Empowerment is different from involvement because it is a feeling that results from employee involvement. It is an attitude that can be measured by an employee survey, not a set of management practices.

There are three types of employee involvement. *Suggestion involvement* entails the power to make suggestions for change, but not the power to make decisions. It typically makes use of special structures such as participation groups or quality circles that are parallel to the formal organization and are dependent on it for implementation of changes. This is the most limited and the most common form of involvement. Management can install it without making major changes to the key design elements of the normal organization.

Job involvement makes changes in the design of work so that employees have more control over day-to-day decisions relevant to their jobs. Job enrichment or work teams (also called self-managing teams, autonomous work teams, etc.) are the means for this change. This approach automatically provides the power to make decisions, but information, skills, and rewards may or may not be changed.

Finally, *high involvement* encompasses the other two types but goes further, to include employees in the management of the business. It uses a wide variety of mutually reinforcing elements, including a whole range of innovative power sharing, information sharing, skill building, rewards, and other human resource practices. The most prominent examples are high-involvement manufacturing plants pioneered by Procter & Gamble and many other companies. This type of plant has become commonplace in such industries as food processing, chemicals, paper, and metals. Procter & Gamble, General Mills, and others that have used this approach indicate that high-involvement plants have better quality and 25 percent to 35 percent higher productivity than traditional plants. In the last 20 years, this form of organization has spread to many different types of settings, including back-office operations, call centers, retail, and professional work.

A series of six surveys of Fortune 1000 firms from the late 1980s to the early 2000s by the Center for Effective Organizations (for example, Lawler, Mohrman, and Ledford 1995; Lawler, Mohrman, and Benson 2001) explored the use of employee involvement practices. The surveys found that nearly all firms used some employee involvement practices, and the use of these practices increased during the 1990s until reaching a plateau near the end of the studies. The 1995 study classified companies by their level of involvement. Some 38 percent were characterized as low in employee involvement, with less than half of employees covered by a pattern of involvement practices; 37 percent focused on suggestion involvement; 6 percent focused on job involvement; 6 percent focused on high (business) involvement; and the remainder could not be classified. In other words, the most complex and advanced forms of involvement were heavily used by fewer firms than suggestion involvement. The studies further found that users overwhelmingly (over 80 percent) reported that their employee involvement efforts were successful, and almost none reported failure. Similar percentages reported that employee involvement had positive effects on measures related to employee engagement and to a wide variety of organizational performance indicators, and very few reported negative effects.

There is a growing body of research on the positive effects of employee involvement practices on objective indicators of firm performance. The 2001 study by Lawler and colleagues, for example, found that return on sales, return on assets, return on investment, return on equity, and total return to investors were consistently higher in firms that made extensive use of employee involvement practices. Similarly, a detailed study of the steel, apparel, and medical device industries (Appelbaum, Bailey, Berg, and Kalleberg 2000) found that high-involvement systems were associated with higher engagement (higher job satisfaction, higher organizational commitment, higher trust, and less stress) and higher organizational performance (higher efficiency, quality, and productivity) on a set of measures specific to each industry.

Most available studies have a shortcoming: The direction of causality cannot be determined definitively. If employee involvement and organizational performance are correlated, is that because employee involvement increases performance or because high-performing companies are more likely to adopt employee involvement practices? Considerable research indicates that better-performing companies are more likely to adopt human resource innovations of all kinds, including employee involvement practices.

What Is Employee Engagement?

One might expect that the mountain of publications about employee engagement would have generated clarity about the term. This is not the case. Macey and Schneider (2008) note the commonalities in typical definitions of engagement: Engagement is a desirable condition, has an organizational purpose, and connotes involvement, commitment, passion, enthusiasm, focused effort, and energy. This focus implies an emotional connection between employee and employer that is far stronger than simply satisfaction. The strong emotional bond implied by engagement is the basis for claims that it is something new, different, and important.

Practitioners might be surprised to learn that the definitions and survey measures of employee engagement overlap heavily with three very old concepts in the research literature: job satisfaction, organizational commitment, and job involvement. The concept of "job satisfaction" has been assessed in survey research for almost 60 years. Job satisfaction implies satiation, a cerebral evaluation of one's feelings about the job, and a focus on the employee's connection to the job rather than to the organization as a whole. "Organizational commitment" was proposed over 30 years ago. It implies attachment to the organization as a whole, including feelings of loyalty and pride as well as shared values. "Job involvement" dates to the mid–1960s and indicates an intensity of feelings, with a focus on the job rather than the organization.

There is a great deal of conceptual and measurement overlap between each of these terms and engagement (see Figure 29-1). Survey respondents do not make fine distinctions between these concepts. They are highly correlated and are best thought of as different reflections of a more general concept—something like employee morale, to use the oldest term of all (Harter and Schmidt 2008; Harrison, Newman, and Roth 2006). Despite the claims that engagement is something new and different, it is old and familiar.

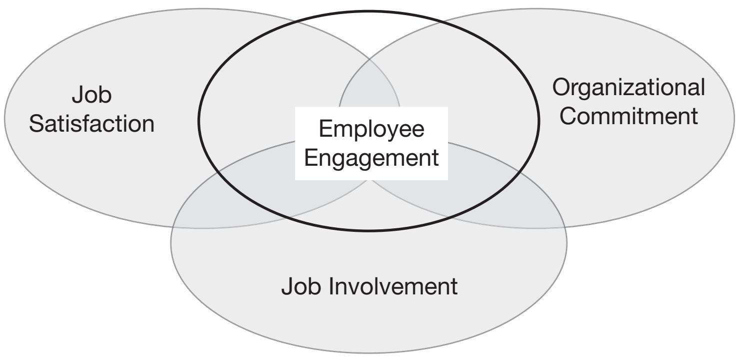

Figure 29-1 Concepts Related to Employee Engagement

The measurement discussion raises a very important practical issue for managers: What exactly do we want employees to be engaged *to*? Their jobs, their work groups, their local work units, or the organization as a whole? This is a basic decision with no obvious answer. The answer may also be different for different segments of the workforce. Certainly, we want senior executives to feel attachment to the entire corporation, not only a part of it. For front-line employees, however, building engagement to a large organization may be a much tougher and more complex task than building engagement to a job, team, or work unit. Focusing on the organization as a whole requires practices including rewards that lift employee attention to the entire company. Rewards such as profit sharing and broad-based stock options might make sense if engagement with the company is the goal; these have too long a line of sight to be effective if the goal is to improve the performance of the local work unit.

A final issue is whether more engagement is always a good thing. At what point does the organization ask for too much engagement? Several studies link high levels of job involvement to neuroticism and burnout. In practice, this is not as serious a problem as it might appear. The usual emphasis is on increasing the engagement of those who are low on the measure, not asking ever more from those who are already high.

Relationship between Employee Involvement and Employee Engagement

The evidence very strongly indicates that high employee involvement leads to high employee engagement. Indeed, the relationship between employee involvement and employee engagement is probably stronger and more certain than the relationship between employee involvement and organizational performance. Many factors can cause employee involvement or engagement to be disconnected to performance, but employees so widely embrace employee involvement that it almost always is associated with improved attitudes.

Employee Engagement and Business Outcomes

The relationship between employee engagement and organizational outcomes is more complex and varied. Figure 29-2 suggests that three types of outcomes that matter to employers: increased job performance, increased citizenship behavior, and decreased withdrawal behavior (absenteeism and turnover). Each of these is potentially valuable to the organization. Clearly, job performance matters because organizational performance is largely the sum of the performance of individual employees. Organizational citizenship behavior represents things that an employee does that are necessary but not formally a part of the job. All firms depend on employees who take initiative, are proactive, go above and beyond their formal role, and conscientiously do what needs to be done. Withdrawal behavior (absenteeism and especially turnover) is far more expensive than is commonly realized. An incident of turnover typically costs one 0.5 to 2 times annual salary, depending on employee skills.

Organizations always want greater job performance and greater citizenship behavior, but they do not always want less turnover. Turnover rates vary inversely with

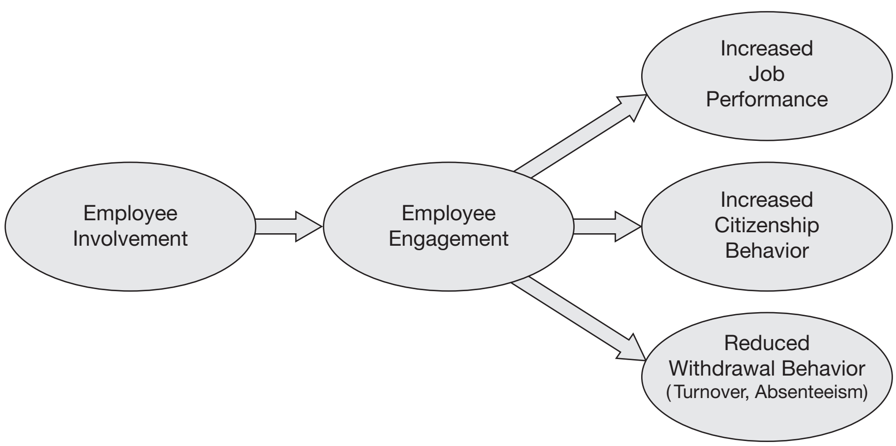

Figure 29-2 Employee Involvement, Employee Commitment, and Organizational Effectiveness

unemployment rates; when employees have few job opportunities, they stay put. At such times, organizations do not need to reduce voluntary turnover and they may welcome it when they need to reduce staffing.

How strong is the relationship between engagement and business outcomes? The contemporary practitioner literature is filled with claims that employee engagement is a key to business results. A sampler of such reports:

- Gallup Consulting (2008) claims that disengaged employees cost the U.S. economy over $300 billion in lost productivity and that the difference between organizations in the top quartile of engagement on its 12-item survey measure show 18 percent greater productivity, 12 percent greater profitability, 27 percent less absenteeism, 51 percent less turnover, and 62 percent fewer safety incidents than organizations in the bottom quartile on engagement.
- A Corporate Leadership Council study (Buchanan 2004) surveyed over 50,000 employees in 39 companies worldwide and concluded that increased engagement can lead to a 57 percent improvement in discretionary effort, a 20 percent individual performance improvement, and an 87 percent reduction in turnover intentions.

The findings from academic research, spanning decades and thousands of studies, are not so consistent or dramatic as in the popular literature. Early reviews found small, almost inconsequential correlations between morale and performance. More sophisticated recent meta-analytic reviews indicate that morale accounts for between 9 percent and 14 percent of the variance in employee performance (Judge et al. 2001; Harrison et al. 2006)—enough for a significant competitive advantage. A limitation of the available research is that there are not enough direct tests of the hypothesis that performance improvement follows increases in employee engagement. High organizational performance may cause high engagement rather than the other way around. Successful organizations offer more pay, more career opportunities, more security, more good feelings that come with working for a winner, and more feelings of personal success. On the other hand, there is strong evidence showing that reducing engagement leads to turnover.

Overall, there is strong evidence that employee involvement practices foster employee engagement, relatively good evidence that employee engagement promotes job performance, and strong evidence that employee engagement decreases withdrawal and increases citizenship.

Why Rewards Matter to Employee Involvement and Engagement

Decades of research on employee motivation confirm that well-designed reward systems are critical to linking employee involvement, employee engagement, and organizational performance. The reward system specifies the behaviors and performance that the organization values, and reinforces them through compensation and benefits. Without good reward systems, employee engagement and involvement will lack focus and may not improve performance.

This is not the popular view. The popular belief is that "a happy worker is a productive worker," and if management just showers employees with the things that make them happier, performance will follow. Considerable evidence demonstrates that this is not the case. Both happy and unhappy workers can be either productive or unproductive. Ensuring that employees see a linkage between rewards and performance creates the condition in which employee involvement and engagement generate organizational as well as individual returns.

Impact of Rewards on Involvement, Engagement, and Organizational Outcomes

We next consider the most important types of compensation—base pay, short-term incentives, and long-term incentives—and benefits. Earlier, we defined performance-based rewards as an element of employee involvement. Here we consider how other elements of employee involvement are reinforced or undermined by rewards, and how they affect employee engagement and organizational outcomes.

Base Pay

Base pay, the largest component of compensation, usually is determined by the market value of the employee's job. Research has long established that pay level has a great deal to do with employee withdrawal behaviors. A more recent finding (Mulvey et al. 2002) is that pay process, which includes systems for determining pay levels and communicating how those are set, is a major problem for employee engagement. Knowledge of pay process and satisfaction with pay process on average is actually worse than satisfaction with pay level. Moreover, pay process has strong effects on employee engagement and retention. This suggests that management has a great deal of work to do in helping employees understand the pay system.

The most important base pay innovation for increasing employee commitment and performance is skill-based pay (also called pay for skills and competency pay). Skill-based pay plans can take many forms, including bonuses, but the most common form is a base pay system that rewards skills, knowledge, or competencies. Skills are acquired and observable expertise in performing tasks, knowledge is the acquired information that is applied to task performance, and competencies are generic skills and traits. Skill-based pay systems are used extensively for manufacturing workers, teachers, scientists and engineers, and military personnel.

There is considerable evidence that skill-based pay increases both employee engagement and organizational performance (Ledford, Heneman, and Salimäki 2008). Skill-based pay can increase employee engagement in several ways. First, employees tend to prefer the logic of earning more by learning more, and they typically can earn a premium of 10 percent to 15 percent of wages in return for learning more skills. Second, cross-skilling helps employees gain a better understanding of how their job fits into the whole, increasing their focus from the job to the organization as a whole. Finally, skill-based pay reinforces other employee involvement practices including power sharing, training, and communication of business information. For this reason, skill-based pay has long been considered a standard part of high-involvement manufacturing plant designs. A variety of survey and case studies also indicate that skill-based pay tends to produce a smaller, more capable, more highly paid workforce, with increases in productivity and decreases in staffing and turnover offsetting higher average costs.

There are many potentially difficult issues in the design and administration of skill-based pay systems. Poorly designed plans can increase costs without generating off-setting benefits. Certain types of employees (senior employee near retirement or those with low needs for personal growth) may reject these pay systems. Overall, however, the track record for pay for skills plans appears to be a good one.

Short-Term Incentives

Short-term incentives pay out at least annually, usually as cash bonuses. The use of performance-based bonuses has increased markedly in the past two decades, especially for rank-and-file employees. For most of the U.S. workforce, individual incentives are difficult to design and in fact would be counterproductive to work unit performance. That has led to increased use over time of group incentives. The basic choice in rewarding unit performance typically is between approaches that reward unit performance (gain sharing and goal sharing plans) and plans that reward corporate performance (profit sharing). Ultimately, the choice between these approaches depends partly on whether management wishes to have employees who are engaged in the entire corporation, business unit, or their work unit. There is reasonably good evidence that corporate profit sharing can increase employee engagement, decrease turnover, and possibly increase citizenship behavior by increasing compensation and by giving employees a stake in the performance of the entire corporation. Such plans have the additional advantage of varying wages with the firm's ability to pay. However, employees lack line of sight to the profitability of the corporation in a firm of any size, so these plans probably have little effect on corporate performance. Gain sharing and goal sharing focus on productivity, quality, cost, and customer service metrics that offer greater line of sight, in work units that are not too large for the employee to understand and influence. There is considerable evidence that these plans have the advantages of profit sharing but a much stronger effect on unit performance.

An additional issue in short-term incentives is the increasing use of unit engagement scores as a criterion for management bonuses. Zingheim and Schuster (2007) found that fully 50 percent of a sample of fast-growing technology companies did this. Such incentives pose a serious threat to the validity and value of surveys. Managers can encourage, cajole, or threaten employees to give high scores without doing anything that really increases engagement.

Long-term Incentives

Long-term incentives include stock grants and options, restricted stock, and "phantom stock" arrangements that mirror equity value in organizations that are not publicly traded. Clearly these incentives pay out based on the performance of the organization.

As such, they appropriately are a critical component of compensation for senior executives. In the last 20 years, they have become increasingly important in executive compensation.

Programs to provide broad-based stock options to all employees surged during the 1990s. As changes in tax laws made these plans more expensive, their use has receded sharply in recent years. Certainly there is merit to the argument that individual rank-and-file employees cannot affect organization performance and therefore stock price directly. The motivational arguments are the same as for corporate profit sharing. However, some research indicates that equity programs are highly valued by employees and that providing a modest level of stock options to all employees can increase engagement, possibly influencing citizenship behavior and withdrawal behavior. The Sibson Rewards of Work Study (Ledford and Lucy 2003), based on a random sample of the U.S. workforce, found that stock grants were more powerful at inducing employees to quit their job for a similar position with another employer than time off, bonus opportunities, salary increases, career opportunities, or extra retirement benefits. Fully 50 percent of the U.S. workforce would quit their current position for a similar job that offered 100 shares of a $10 stock (total value of $1,000) that they would not be able to sell for four years. The same 50 percent would quit for a salary increase of $7,500 (an average of 24 percent increase for this sample) or a one-time retirement plan contribution of $20,000.

Benefits

Benefits are a large slice of the rewards pie, currently representing over 40 percent of wages on average in private-sector firms. The most expensive benefits are health care, paid leave (vacation and holidays), and retirement. Typically, all or most employees receive benefits by virtue of employment, not their performance. As a result, benefits play an important role in attracting and retaining employees, but there are few ways to link benefits and performance.

Paid leave is among the most highly valued rewards by U.S. employees. The Sibson study (Ledford and Lucy 2003) found that fully half of a random sample of the workforce would leave their current position for another employer if they were offered an additional two weeks of paid vacation per year. Given the average wage of the sample, this would have cost an employer $1,400 per employee. By contrast, retirement benefits tend to have low value for most employees. Retirement plans have the most value to older employees, who are more likely to see retirement approaching. On average, it would take a $20,000 one-time contribution per employee to the company retirement plans to achieve the same effect. In other words, time off is 14 times as powerful as retirement benefits in retaining the average U.S. employee.

There have been just a few transitory experiments with basing some retirement benefits—for example, the level of 401(k) match—with individual performance. Perhaps more common in the future will be varying retirement benefits based on firm rather than individual performance.

One of the most prominent developments in the benefits arena has been the widespread attention to "work/life benefits." Given that these programs are typically aimed at creating balance between work and non-work lives, it is ironic that such programs are often advocated as an employee engagement tonic. Because the wide range of work/life benefits are almost never tied to performance, they have little motivational value, and in the view of this author, there is little convincing evidence that such programs affect job performance or citizenship. They can reduce withdrawal behavior, but the corporate emphasis on such programs tends to ebb and flow with the economy and the need to attract and retain employees.

Rewards for the Contingent Workforce

Current estimates are that a staggering one-fourth of the U.S. workforce is part-time, an independent contractor, or a temporary employee. This poses a tremendous challenge for involvement, engagement, and rewards. Clearly the contingent workforce helps companies avoid the costs of full-time employment. Contingent employees usually receive less compensation than full-time regular employees, and no performance bonuses or benefits. Employers are often unconcerned about high turnover in this workforce segment. As this segment grows, there will be an increasing need to develop rewards that focus the effort and talents of contingent workers, and we expect to see more experimentation with rewards for such employees. A key design issue is the level of engagement desired. The company typically does not want contingent employees to be highly engaged with the firm; the emphasis is on engagement with a job or work unit, or in many cases only with a project. However, it is possible to create incentives that support unit-level engagement.

Conclusion

Employee involvement and engagement remain core ideas in contemporary human resource practice, and there is much excitement about their promise. Our argument has been that the benefits of increased involvement and engagement depend on well-designed reward systems that create motivation for employees to meet organizational as well as personal goals. A wide variety of compensation and benefits tools can be used for this purpose.

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