SIN OF WAGES

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Chapter 1: The Evolution of the Pay Crisis

Conventional wage and salary systems are guilty of undermining organizational success in countless companies. This has led to organizations with unmotivated and uninterested employees, poor strategic alignment, and ineffective management styles.

This chapter gives a brief history of events that led to the current organizational pay and management system and an overview of the seven "sins" of the system.

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THE SIN OF WAGES

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CHAPTER **ONE**

THE EVOLUTION OF THE PAY CRISIS

A brief history of events that led us to our current organizational pay and management system, and an overview of the seven sins of this system.

Webster's defines a system as *an orderly, interconnected, complex arrangement of parts.* Our country's economy is based loosely on a free enterprise system. This system supports entrepreneurs, the self-employed and business owners, but does not extend to employees who work for others. Employees function in a different system than do their organization's ownership.

The free enterprise system rewards innovation and risk-taking. But many organizations are bureaucratic systems that discourage employee innovation and risk-taking. The free enterprise system rewards results and personal accountability. But the bureaucratic system often rewards form over function and shifts accountability from labor to management. How did this happen?

The Rise of Individual Enterprise

Before the 18th century, there was almost no expansion of wealth or income. Even the most advanced countries, such as the Netherlands, experienced at best a one percent annual increase in national wealth. The birth of Capitalism in 1776 with the publication of Adam Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations* marked a turning point in human' productivity.

Smith's economic theory was based on what he called man's *self-love*. As he wrote: "It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard for their own self interest." Smith's views spread to the extent that production and consumption in Britain increased a staggering 1,600 percent during the 19th century.(1)

Small shopkeepers, artisans and independent farmers sprung up across the country as free enterprise became a way of life. A new optimism that anyone could improve his condition replaced the thousands of years of class distinction and privilege that had repressed the working class and individual enterprise. The 19th century in the United States was a period of almost boundless optimism for the average worker. Opportunities were seemingly unlimited if one had the initiative and perseverance to capitalize on them.

As I finish this book, the Presidential campaign is in full force. There is much talk about the *American Dream*. I recall when the American Dream meant the opportunity to pursue your own goals, your own way. The politicians have perverted the dream to mean new homes and cars and a riskfree world. What happened to the real *American Dream*?

Causes of the decline of individual enterprise

- **Mass production**. During this same era a second development facilitated this prosperity, but also sowed the seeds for the death of individual enterprise for the common worker—Eli Whitney's mass production.

  > Whitney's standardized parts could be fitted by drones with no other skills...Whitney's principle of mass production through uniform molds transferred the skill from the man to the machine. His factory system entailed small teams doing only one task of an assembly routine. It was sufficiently revolutionary to be called the *Whitney System* and then, in Europe, the *American System*.(2)

- **Wages**. Henry Ford is credited with introducing hourly wages on a large scale. Since then, pay-for-time has become the standard for compensating employees in an organization. The adverse impact of this approach to pay is pervasive.

- **Information Age**. The assembly line removed workers from the fruits of their labors. This separation of the worker from his product widened again with the entrance of what John Naisbitt terms the *Information Society.*

  In 1950 only about 17 percent of us worked in information jobs. Now more than 60 percent of us work with information as programmers, teachers, clerks, secretaries, accountants, stock brokers, managers, insurance people, bureaucrats, lawyers, bankers, and technicians... Most Americans spend their time creating, processing, or distributing information...(3)

The worker has moved rapidly from a feudal system, through a free enterprise system, to today's wage and salary based mass production of information. In so doing, much of the independence and ambition found in the highly successful entrepreneurial foundations of our country were lost.

The farmer, shopkeeper and artisan of the 19th century reaped the benefits of what they sowed and conversely suffered the consequences of poor performance. Specialized *paper shuffling* often lacks any connectedness to the final product. The individual worker is so removed from the ultimate outcome of his day-to-day work, no sense of personal accomplishment or direct personal benefit is gained from good performance.

- **Bureaucratic organization**. With the assembly line, organizations grew larger and the average worker became only a cog in the machinery of the organization—what William H. Whyte, Jr., termed *The Organization Man* in 1957.

  > In current retrospect the turn of the century seems a golden age of individualism; yet by the 1880s the corporation had already shown the eventual bureaucratic direction it was going to take. As institutions grew in size and became more stratified, they made all too apparent inconsistencies which formerly could be ignored.
  >
  > One of the key assumptions of the Protestant ethic had been that success was due neither to luck nor to the environment but only to one's natural qualities if men grew rich, it was because they deserved to. But the big organization

> became a standing taunt to this dream of individual success. Quite obviously to anyone who worked in a big organization, those who survived best were not necessarily the fittest but, in more cases than not, those who by birth and personal connectedness had the breaks.[4]

Whyte argued that the Protestant ethic of self-reliance and improvement was essentially a myth in corporate America. There is little in his argument that has changed since then. Much of the formal groundwork for the modem corporate bureaucracy is found in the writings of Max Weber at the turn of the century. Weber described six characteristics of the large organization:

1. specific activities and duties (division of labor) are defined and the extent of authority delimited by rules.
2. a chain of command exists to promote informational and decision flow within the organization.
3. ownership is separated from management.
4. management is distinct from other types of activities.
5. management is a full-time activity.
6. managers follow specific rules which are applied uniformly and unemotionally in order to fairly regulate each case.[5]

- **A loss of connectedness in the workplace**. It is com mon for people to confuse the benefits the workplace offers with the satisfaction derived from the work itself. A good example of this confusion is the debate over merit pay for teachers. The union's position is that the salary is inadequate and should be increased to retain excellent teachers rather than pay on teacher merit. This view misses the point. The absolute amount of pay is a separate issue from how the pay is earned. What is important, and overlooked, is establishing a connection between performance and organizational rewards. The behavioral psychologist B.F. Skinner eloquently described this relationship:

> But satisfaction is a limited objective; we are not necessarily happy because we have everything we want. The word *sated* is related to the word sad. Simple abundance, whether in an affluent society, a benevolent climate, or a welfare state, is not enough. When people are supplied according to their needs, regardless of what they are doing, they remain inactive.[6]

The effects of mass production, the wage and salary system, the information age, the bureaucratic organization, and the loss of connectedness between performance and pay has eroded worker initiative and job satisfaction.

The Pay Crisis

Our work force is in the beginnings of a real crisis. Job security has declined and layoffs are commonplace. Wage gains have moved from stagnant to real declines in buying power. Pay reductions were once unheard of and now are grimly accepted. The Fortune 500 companies employed sixteen million workers in 1974 but only twelve million in 1994.

Many reasons are cited including increased healthcare costs and government mandates; the entrance of global competition; and Third World low-paid, highly motivated workers.

However, one of the most overlooked problems facing business and labor is our outmoded pay system.

The conventional pay system is characterized by:

- guaranteed wages and salaries.
- annual *merit evaluations* and merit pay increases.
- annual cost-of-living pay increases.
- market-based pay set by a market survey.

This system came into its current form after World War II when there was a labor shortage and high worldwide demand for products. Conventional pay has become so ingrained in our thinking, it is now difficult to imagine any other way of paying people. However, before the industrial revolution, some 75 percent of Americans were farmers or artisans and not paid a wage or salary. Today over ten percent of the work force is self-employed and a significant number of sales positions are highly commissioned. The concept of paying for time rather than results is, then, relatively new and only one of several options.

It is interesting to speculate what would happen if beings from another planet visited here. If they observed our personnel departments, they would hear about paid hours, time sheet hours, vacation time, sick time, holiday time, overtime, undertime, lost time, compensatory time, time-in-grade and so on. They might conclude that our companies are in the business of manufacturing time.

On their planet, workers are paid directly for the products and services they produce. Imagine a meeting where we tried to persuade these beings to adopt our approach to pay. *You should stop paying your workers for what they produce and start paying them for the time they spend producing it.*

The Seven Sins of Conventional Entitlement Pay

The following is an overview of the concepts presented in chapters two through eight. These chapters will describe the seven sins of conventional compensation and provide examples from several types of organizations. Chapter 9 will outline problems with conventional alternative pay plans. The remaining five chapters discuss the theory and design of the Total Performance System as an alternative to conventional entitlement pay.

1. *Fixed-Cost Pay.* Pay has come to be viewed as an entitlement by employees. Employees believe they are not only entitled to their current pay, but pay increases each year. This view makes the payroll effectively a fixed cost to the organization that grows at a compound rate over time. When revenues stabilize or decline, profits decrease and layoffs are the only recourse. Employees are risking long-term job insecurity for short-term pay guarantees.

   Entitlement pay also reduces the number of people employed and the level of pay. Because pay is essentially guaranteed for life, employers are reluctant to add employees or increase pay when the business is successful for fear of the high fixed expense when revenues stabilize or decline. This entitlement view of pay also necessarily makes labor and management adversaries. Management is tied to profit while the work force is artificially removed from it.

2. *Pay for Time.* "When you pay for time, you get time.

When you pay for results, you get results." Hourly pay is particularly detrimental to employee productivity. Parkinson's law tells us *work expands to fill the time available.* When you are paid by the hour it is not in your financial interest to work more efficiently since this will simply result in more tasks being assigned or, worse, a cutback in your hours. Employees living on overtime pay aggravate the problem. I find it amazing that management really expects employees to form teams to develop more efficient processes that will simply result in their having to learn additional jobs for the same pay, or even lose their current jobs.

4. *Corporate Socialism.* Entitlement pay is unfair to good performers. It pays everyone in the same job or pay grade about the same regardless of their personal contribution. The result is that high performance goes unrewarded and performance drifts toward mediocrity. Entitlement thinking has failed as economic policy and doesn't work any better inside our businesses.

4. *Performance-Based Promotions.* Conventional pay prevents supervisors and managers from directly and immediately paying a subordinate for a job well done. Tight pay bands reduce even the ability to reward performance through annual pay increases. The consequence is that many supervisors and managers must promote top performers to reward them. This creates competition among employees and forces the best performers out of their jobs and into management. Often, top performers prefer to work independently and do not work well through others. The result is the company loses a good performer

and creates a dissatisfied and ineffective manager.

The Peter Principle states *employees rise to the level of their incompetence*. I would simply add that the driving force behind this principle is the conventional pay system. We reward employees by promoting them until their performance no longer justifies additional promotions.

6. *Management by Perception.* Conventional wage and salary systems encourage and support *lazy management* practices that undermine employee effectiveness. Time-oriented pay does not require the ongoing measurement of employee performance results. Because employee performance results are not measured, managers must rely on subjective perceptions to determine who is performing and who is not.

7. *Management by Exception.* Without an objective performance measurement system, managers have no accurate means for recognizing or rewarding improvement and must therefore manage exceptions. In practice, acceptable performance is largely ignored but failures to perform are "managed." In this system, employees don't work to earn their pay, they work to avoid losing it.

8. *Entitlement Thinking.* Fifty years of guaranteed pay have created an "entitlement culture" in which employees believe they are owed their pay regardless of personal or company performance. The technical term for pay, compensation, is revealing. We are compensated for going to work rather than working to earn a living. Entitlement thinking has created a nation of risk-averse employees who

refuse accountability and are unwilling to accept the cold fact that without a successful business, there can be no pay.

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About the Author

Dr. William Abernathy is an Associate Professor of Psychology at Southeastern Louisiana University and former Vice President of Performance Measurement Systems at Aubrey Daniels International (ADI). Throughout his consulting career, Bill worked with over 170 clients to successfully implement Profit-Indexed Performance Pay and scorecards. Bill has also delivered hundreds of workshops in performance measurement, performance pay, and performance analysis and improvement.

Bill began his career as a professor of psychology at Ohio University. He then joined Edward J. Feeney & Associates, a firm that specialized in the application of behavioral principles in the workplace. In 1981, Bill left to pursue his interests in a behavior systems approach to employee performance improvement and founded Abernathy & Associates. In 2005, Bill's company was acquired by ADI.

With more than thirty years of consulting experience in the design of performance measurement and performance pay systems, as well as performance analysis and improvement, Bill is considered an expert in this field. A sample of Bill's specific work experiences and consulting engagements include:

- Designed the Performance System Database and Data Viewer performance reporting systems
- Author of three books: *The Sin of Wages, Pay for Profit* and *Human Performance Diagnostics*
- Associate Editor of the Journal of Organizational Behavior Management
- Adjunct professor in the graduate applied behavior analysis programs of the University of Nevada-Reno and the Florida Institute of Technology
- Has had twenty nine publications in academic, professional and trade journals
- Has consulting with over 170 client organizations representing businesses and industries such as banking, manufacturing, distribution, oil and gas, and transportation, among others
- Currently Coordinator of the Industrial/Organizational Psychology graduate program at Southeastern Louisiana University. Bill teaches courses in performance measurement, performance pay, performance improvement, I/O Psychology, and Organizational Development.

Bill earned his Ph.D. in Industrial/Organizational Psychology from The Ohio State University; his M.S. from Vanderbilt, and his B.A. from Florida State University. He was a recipient of the International Association for Applied Behavior Analysis' 'Outstanding Contributor Award'. Bill lives in Covington, Louisiana.

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