

How Well Does Your Reward System Support TQM?

Linking employee performance to the organization's strategic objectives

by

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RECENTLY, QUITE A BIT OF STATISTICAL evidence has supported the positive effects of a properly implemented total quality management (TQM) program. But many organizations have tried TQM only to pronounce it a failure. Popular publications like *Fortune*, *Newsweek*, *The Wall Street Journal* and *USA Today* have proclaimed TQM to be, at best, only partially successful or, at worst, a passing fad.

Why are some organizations successful with TQM, when others fail? We decided to investigate one aspect of this important question—the impact of the reward system. Our investigation led us to conclude that many organizations are reluctant to make changes to their reward practices in support of a TQM implementation.

The reward system is typically sticky in organizations for a number of reasons. Most changes to a reward system affect people's compensation, either directly or indirectly. Managers know that any changes are likely to evoke a loud response from workers. What manager wants to take the political risk of experimenting with changes to such a controversial aspect of organizational life?

Managers who realize the importance of aligning

the reward system with TQM efforts often believe their hands are tied because many of the compensation and benefit decisions are made at a corporate, rather than local, level. Even at the corporate level, the human resource department is usually not the department charged with implementing TQM. Therefore, it is not always easy to coordinate a change in reward practices to support a TQM implementation.

The result of this reluctance, the perceived inability to change reward practices, has led many organizations to maintain reward systems that are vestiges of the past. These traditional systems typically focus on rewards tied to individual performance. They are often based solely on productivity goals, rather than on quality or customer satisfaction goals, and they do little to support the development of a corporate culture based on quality, teamwork and customer focus.

We investigated whether anyone ever took a close look at the relationship between reward practices and TQM. We found that while some have pointed out the importance of using reward practices that support TQM, and others have provided anecdotal examples, no one has yet conducted a scientific examination of this topic. We decided to >

FIGURE 1 Reward Practices Survey

Estimate the percentage of employees in your organization who are currently covered by or eligible for a pay/reward system with any of the following elements. Circle the number that represents your best estimate.

	None (0%)	Almost None (1-20%)	Some (21-40%)	About Half (41-60%)	Most (61-80%)	Almost All (81-99%)	All (100%)
1. Nonmonetary forms of recognition to acknowledge achievement of quality improvement goals—merchandise, certificates, letters, complimentary tickets.	0	1	2	3	4	5	6
2. Celebrations to acknowledge achievement of quality improvement goals—lunches, dinners and special events.	0	1	2	3	4	5	6
3. Regular expressions of appreciation by managers or leaders to employees, acknowledging the achievement of quality improvement goals—such as praise or pats on the back.	0	1	2	3	4	5	6
4. 360-degree performance appraisals—feedback from co-workers (other than the immediate supervisor), subordinates and/or customers is incorporated into performance appraisals.	0	1	2	3	4	5	6
5. Formal suggestion system, such as a suggestion box available for individuals to make quality improvement suggestions.	0	1	2	3	4	5	6
6. Development based performance appraisals—performance appraisals are used primarily for developing employees to perform better in the future rather than for evaluating their past accomplishments and failures.	0	1	2	3	4	5	6
7. Quality based promotions—wherein promotions are based primarily on the achievement of quality based goals as opposed to strictly quantity based goals.	0	1	2	3	4	5	6
8. Profit sharing—where the organization shares some portion of corporate profits with employees.	0	1	2	3	4	5	6
9. Gainsharing—portions of individual work unit gains in productivity, quality, cost effectiveness or other performance improvements are shared with employees in the form of bonuses based on a predetermined formula.	0	1	2	3	4	5	6
10. Employment security—such as having a corporate policy or union contract designed to prevent layoffs.	0	1	2	3	4	5	6
11. Compensation time—workers are given the option to be compensated for overtime hours worked in the form of additional time off rather than additional pay.	0	1	2	3	4	5	6
12. Individual based performance system—performance appraisals and pay increases are based primarily on individual achievements as opposed to team accomplishments.	0	1	2	3	4	5	6
13. Quantity based performance appraisals—performance appraisals are based primarily on achieving quantity related goals (such as number of units produced or serviced).	0	1	2	3	4	5	6

Scoring the reward practices survey

Calculate the score for your organization using the following procedure:

1. Add the numbers you circled for items 1-7.
2. Add the numbers you circled for items 8-13; then multiply this number by 2.
3. Add the two numbers you calculated in steps 1 and 2 to compute your overall score.
4. Grade your reward system based on the following scale:
 A = 100 or higher B = 90-99 C = 80-89 D = 70-79 F = 69 or lower

undertake a survey to determine which reward practices are most appropriate for organizations to use in support of their TQM programs.

The survey

We sampled 100 individuals from a wide variety of organizations. Although the research was administered in Pittsburgh, a large percentage of the respondents were located outside of western Pennsylvania. More specifically, 29% of the organizations were located in the United States (but outside of western Pennsylvania), and 39% of the organizations were located abroad.

The sample also included a wide range of different types of organizations—61% from the service sector, 23% from the manufacturing sector and 16% in the government/nonprofit sector. About 24% of the organizations were unionized. Overall, this sample was quite diverse and representative of the current business environment, helping to bolster the ability to generalize the findings.

Respondents were asked to complete a version of the reward practices survey (see Figure 1)—a survey regarding the extent to which their organizations used a wide variety of reward practices. We also asked them about the extent to which their organizations use common TQM related business practices and the outcomes they have experienced in terms of organizations' priority performance measures (such as profitability, productivity, quality and customer satisfaction).

We found that the reward practices broke down into two groups: intrinsic and extrinsic. We then statistically analyzed responses using moderated regression analysis to determine if any of the reward practices were positively related to higher levels of performance in conjunction with TQM programs.

Our results suggest TQM can be even more effective if supported by the proper type of reward practices. But which reward practices were found to be most effective? The following sections describe the specific intrinsic and extrinsic reward practices that were associated with higher levels of TQM performance.

Intrinsic reward practices

When managers think of rewards, they tend to think of compensation. But there is another class of rewards that does not deal directly with money: intrinsic rewards. Intrinsic rewards typically involve the feelings of accomplishment or self-worth an employee derives from doing a good job.

Intrinsic rewards are important motivators. While the empirical evidence was not as strong for them as for extrinsic reward practices, the use of intrinsic rewards was significantly associated with higher levels of organizational performance (at the 95% statistical confidence level). The organizations that used

these practices more extensively reported significantly higher levels of performance. These practices are represented by items 1 through 7 in the reward practices survey and summarized in Figure 2.

The results of the study suggest organizations implementing TQM should give employees nonmonetary forms of recognition such as plaques, certificates, letters of appreciation or merchandise to acknowledge quality achievement. These types of rewards can be presented at celebrations like group lunches or other special events.

Managers should also regularly give informal praise or pats on the back to employees who help the organization achieve quality goals. Praise can generate feelings of accomplishment and self-worth. These rewards cost nothing, and they can be awarded immediately after the accomplishment has taken place.

The organization should put an employee suggestion system in place for recommending quality improvements to management. Employees get a strong sense of satisfaction when their ideas are actively sought and implemented by management, and the best organizations respond to the suggestions within a few days. These companies typically have a system in which the immediate manager, rather than a centralized review board, has much of the decision making authority.

It is also important to make sure the performance management system supports TQM. A relatively new performance management practice—360-degree performance appraisals—should be considered by TQM organizations. A 360-degree performance appraisal includes feedback from co-workers, subordinates and even customers (internal or external), as well as the traditional input from the supervisor.

Such appraisals facilitate a customer satisfaction and teamwork focus as employees must also consider the needs of internal and external customers, co-workers and subordinates if they expect to receive favorable performance reviews.

Rather than exclusively referring to past failures, performance appraisals should have a strong developmental component, helping individuals obtain the training and skills necessary to be successful in the future. TQM and the development of a learning organization go hand in hand. Performance appraisals in a TQM environment need to foster continuous learning and skill development.

Finally, promotions should be based on the achievement of quality related goals, as employees reaching such goals are more likely to make TQM a priority in their new positions. Promoting people who are role models sends a signal to employees that quality is important.

Extrinsic reward practices

Extrinsic rewards are typically directly related to

pay or compensation issues. These practices are represented by items 8 through 13 of the reward practices survey and are summarized in Figure 3.

The use of extrinsic reward practices was shown to increase the effectiveness of TQM programs (at the 95% statistical confidence level). In other words, organizations that made more extensive use of extrinsic reward practices in conjunction with TQM reported significantly higher levels of performance than organizations using lower levels of these practices.

Because our research suggests that the extrinsic reward practices have a stronger effect on organizational performance than intrinsic practices, we decided to give them double weighting when calculating the overall score in the reward practices survey.

Since the power of the pocketbook (extrinsic rewards) seems to have an even stronger motivational impact than the power of praise (intrinsic rewards), it is critical that managers involved with TQM implementation align their extrinsic reward system to support TQM. More specifically, managers should implement programs that link organizational, work group and individual performance to the accomplishment of strategic quality objectives.

At the organizational level, this includes utilizing practices such as profit sharing. Profit sharing helps ensure that all employees benefit when the organization does well, instilling a pro-company attitude in employees.

A related practice, gainsharing, rewards specific work groups with monetary bonuses for improvements they make in quality, productivity or cost reduction. Gainsharing is focused more at the immediate work group level as opposed to the company-wide orientation of profit sharing. Gainsharing can be an effective motivator because employees often perceive themselves as having more control over their own work group performance than over the company's performance.

Because effective TQM programs tend to increase productivity, properly implemented improvement suggestions will generally reduce cycle time for a specific work process. This time reduction translates into labor hour savings and, consequently, a lower overall demand for workers.

So why would workers suggest improvements or participate in TQM projects if they know that such endeavors could ultimately cost them their jobs? It is for this reason that TQM programs need to be backed by employment security practices. Employees must

FIGURE 2 Effective Intrinsic Reward Practices

Nonmonetary forms of recognition to acknowledge achievement of quality improvement goals.
Celebrations to acknowledge achievement of quality improvement goals.
Regular expressions of appreciation by managers or leaders to employees to acknowledge achievement of quality improvement goals.
360-degree performance appraisals—feedback from co-workers (other than the immediate supervisor), subordinates or customers is incorporated into performance appraisals.
Formal suggestion system available for individuals to make quality improvement suggestions.
Developmental based performance appraisals.
Quality based promotions.

FIGURE 3 Effective Extrinsic Reward Practices

Profit sharing
Gainsharing
Employment security
Compensation time
Individual based performance systems
Quantity based performance appraisals

not fear losing their jobs as a result of making their work processes more efficient. Job security practices can take the form of a "no-layoffs as a result of TQM improvements" corporate policy or a stipulation in union contracts. The organization can still reap the benefits of increased productivity by moving displaced workers to other jobs, reducing the need for overtime or slowing the increase in hiring new employees.

In fact, the prolonged economic expansion in the United States has created a lot of overtime in organizations. It appears that time off has become an important form of compensation for today's employees. Organizations should seriously consider the use of compensation time, which gives employees the option of receiving overtime reimbursement in the form of additional time off rather than overtime pay.

A recent survey indicated that 75% of the public favors having a choice between receiving compensation time and overtime pay for extra time worked.¹ Currently this option is legally available only to government workers and exempt employees, but pending legislation may soon make it available to all non-exempt employees.

The use of a compensation plan in which pay is based on an individual's achieving quantifiable goals was associated with the more effective TQM programs. This seems to run counter to the advice of W. Edwards Deming who believed these types of pay for

performance programs would reduce teamwork. Deming also felt it was unfair to compensate people based on their individual accomplishments because most work processes are cross functional in nature and typically not under the direct control of the individual.

But the research on goal setting performed over the last few decades indicates it is an effective method for increasing worker performance. Many organizations attempting to implement TQM have traditional pay for performance plans based on quantifiable, individual based goals. It appears that such plans can be compatible with TQM. Organizations utilizing such plans should broaden their focus to include quantifiable customer satisfaction and quality improvement based goals to supplement their productivity related goals.

Make rewards a priority

Our research validates the importance of aligning the reward system in support of TQM and sheds light on how management can use the reward system to ensure that TQM is as effective as possible. The increased use of appropriate intrinsic and extrinsic reward practices should be seriously considered to guarantee that TQM business practices have an even greater effect on the company's performance.

Managers should implement policies and programs that link performance to the accomplishment of strategic quality objectives at the organizational, group and individual levels. (See the sidebar below, "Evaluating Your Organization," for a summary of extrinsic and intrinsic reward practices.)

Evaluating Your Organization

Are the reward practices used at your organization properly aligned to support the investment of total quality management (TQM)? Take the reward practices survey (Figure 1) and find out.

If your organization scored 100 points or higher, it's doing an outstanding job of using reward practices to support TQM efforts. But if your organization didn't score so well, consider the following ways to increase the percentage of employees who are covered by reward practices.

Extrinsic reward practices:

- Profit sharing: links organizational performance with individual rewards.
- Gainsharing: rewards work groups with bonuses for improvements they make in quality.
- Pay for performance plans: pays employees for achievement of quantifiable goals that are linked to the organization's quality strategy.
- Compensation time: gives employees the option of receiving overtime pay or bonus compensation in the form of additional time off.
- Employment security: averts fear that employees will lose their jobs as a result of making their work processes more efficient. Commonly achieved through a policy or union contract designed to prevent layoffs.

Intrinsic reward practices:

- Improvement suggestion policy: a system inviting employees to make quality improvement suggestions to management.
- Informal praise: communication to employees who help the organization achieve quality goals.
- Celebrations: group lunches, dinners or other special events that acknowledge quality achievements among staff.
- Nonmonetary forms of recognition: plaques, certificates, letters of appreciation, complimentary tickets, merchandise and others that acknowledge quality achievements.

Another key intrinsic reward practice is linking the performance management system to quality. For example, 360-degree performance appraisals should be considered because they incorporate feedback from co-workers and customers, encouraging a customer satisfaction and teamwork focus.

Performance appraisals should have a strong developmental component focused on helping individuals obtain the training and skills necessary to be successful in achieving quality goals. Promotions should also be based on the achievement of quality related goals.

Complete the survey in Figure 1 and see how your organization scores. What is your company doing right? Is it time to consider a new way of recognizing TQM accomplishments? If your experience is like that of many other organizations, changes in your reward practices will help you achieve the most from your TQM implementation. After all, when it comes to TQM, you can't afford to forget about rewards.

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
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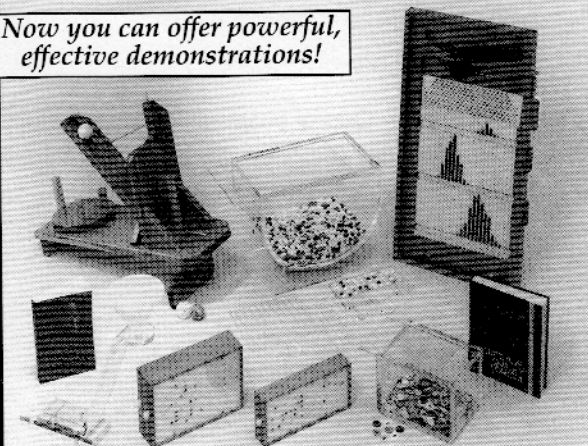
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