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The changing landscape of employee rewards: Observations and prescriptions

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Employee rewards have changed dramatically since the Center for Effective Organizations (CEO) was created 35 years ago. This article examines these changes and considers why they have been so pervasive. It concludes with the author's prescriptions for future directions, which involve extending some changes and abandoning others.

The focus is on rewards for employees in the U.S. CEO's research mostly has examined rewards for employees in general, and therefore this article mostly avoids discussions of rewards for subsets of employees, such as executives, that are complex topics in their own right. The focus is on the U.S. because practices vary across countries, making generalizations difficult. However, countries that are part of a global economy have experienced many of the same pressures that have shaped rewards changes in the U.S., and practices probably are more similar across the globe today than they were 35 years ago. Many conclusions of this paper therefore apply to other countries as well.

During the past 15 years, the rewards profession has rebranded "Compensation" or "Compensation and Benefits" to "Rewards" or "Total Rewards." This article uses the newer terminology. The updated terms emphasize all types of extrinsic rewards (salaries, incentives, recognition, benefits) and sometimes, intrinsic rewards (job design, careers). To keep the discussion bounded, this paper focuses on extrinsic rewards, although a more complete view requires attention to both types of rewards.

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HOW HAVE EMPLOYEE REWARDS CHANGED IN THE PAST 35 YEARS?

Since the founding of CEO, changes in rewards for U.S. employees have been remarkable. Ten changes stand out.

1. *Rewards design becomes market facing*. Perhaps the most profound change in employee rewards in recent decades is the shift in orientation from the internal to the external labor market. Value in the internal market is based on the rewards of one position compared with others in the organization. An internal orientation sends the message to employees that, "What matters in setting your rewards is how you compare to others in the organization." Value in the external market is based on what other companies pay in the relevant labor market for a position. An external orientation communicates that, "What matters is your external value; if you want more money, develop the skills and take the positions that the labor market values." Rewards professionals have always balanced internal and external market positioning, but the shift in emphasis toward the external market has been dramatic, and the consequences have been far-reaching.

One indicator was a change in the method of determining wages and salaries. In 1979, rewards professionals devoted much effort to job analysis techniques such as point-factor plans that emphasized relative internal value. Simpler plans maintained internal equity by uncomplicated rubrics, usually seniority. Today, most organizations rely primarily on "whole job" market pricing that matches job descriptions to those in rewards surveys. A WorldatWork study of 941 organizations found in 2012 that:

> Market pricing far exceeds all other job evaluation methods in prevalence. 88 percent of organizations use market

pricing to some degree; 50 percent use market pricing exclusively. The point-factor approach, once the most common method a few decades ago, is far behind at 20 percent.

One reason that the orientation shifted was because it could. External market data from large-sample compensation surveys became readily available by the 1980s. Salary survey data had been collected for decades, but the data were usually expensive, unsystematic, and of poor quality. Compensation managers often did their own surveys of a few peer companies. This changed beginning in 1982, when a Boston survey group was found guilty of violating the Sherman Anti-Trust Act for using salary surveys to fix wages. Because third-party surveys collected anonymously and in large samples remained legal, anti-trust cases provided a huge boost to compensation firms selling surveys. The electronic compilation, collection, and distribution of survey data greatly decreased costs and increased survey quality. Surveys revolutionized salary administration. Today, the survey database for WorldatWork, the primary association of rewards professionals, lists almost 1000 surveys, covering virtually every type of employee and organization.

Business needs also reoriented rewards toward the market. As competitive pressures escalated in the 1980s, companies began to rethink business models and cost structures. As the single largest expense for most companies and the greatest variable cost by far, rewards received intense scrutiny. Salary survey data enabled companies to better manage labor market position. Also impactful was the decision by large, diversified corporations to manage business units separately. Business units with different competitors and markets began to adopt different designs. Business units facing low cost, low margin competitors could lower reward costs to meet the competition, while high margin units competing fiercely for talent could increase or change pay as needed.

Finally, the tremendous rise of the rewards consulting industry and professional associations (primarily WorldatWork) helped to foster the external perspective. These organizations provided benchmark data, disseminated stories of what worked, and packaged "hot" offerings. This reduced the insularity of rewards professionals.

2. *Strategic rewards design ebbs and flows.* Rewards managers have always found safety in copying prevailing practices—the opposite of strategic design. Common practices and the innovations of prestigious companies are often labeled "best practices" in the absence of evidence that such practices are best or that they best fit an organization's unique business needs. Market-oriented wage setting probably encourages copying by rewards professionals. However, a firm gains no competitive advantage from imitating its labor market and business competitors.

This pattern was broken during the period from the mid-1980s until the early 2000s. This was the "Golden Age" for reward system design, in which there was intensive experimentation with new rewards practices. The trigger was the demand by corporate leaders that reward systems better meet business needs, coupled with the belief that new approaches offered potential competitive advantage. Business leaders challenged the instinct to look like everyone else, asked hard questions about pay levels, and looked at how reward systems might be leveraged to increase organizational performance.

There were two signals that compensation had become more strategic. First, new goals began to supplement traditional reward system goals. Cost control is the traditional goal of rewards—often foremost for business leaders. Other conventional goals are attracting, retaining, and motivating employees. Few would challenge the importance of rewards in attracting and retaining employees. Motivating performance is more controversial, partly because two best-selling authors, Alfie Kohn and Daniel Pink, have argued that extrinsic rewards do not motivate performance. However, every major academic review of rewards research in the past 35 years has shown that monetary incentives motivate employee performance, often strongly.

Traditional goals were supplemented by new goals: supporting the business strategy, reinforcing organizational structure, and enhancing the desired culture. For example, a company with an entrepreneurial business strategy wants a highly leveraged reward system that encourages risk-taking. A business strategy that encourages operational excellence can be supported by incentives for cost cutting, quality, and on-time delivery. The most important organizational structures can be signaled by the reward system. For example, one forest products firm is comprised of small business units, each made up of several interdependent plants. Business units (BU) are more important to company success than plant performance, and at times, plants sacrifice their own performance for the benefit of the BU. The management incentive system encourages the right behaviors by paying out 50 percent on plant performance and 50 percent on BU performance. Finally, a reward system sends strong messages about the culture desired by leadership, as employees see what is rewarded and as reward practices lead to self-selection in employment. For example, companies that strongly tie pay to performance communicate the importance of high performance, and they attract employees who want performance-driven rewards.

The second sign of strategic change was the emergence of new congruence models of rewards effectiveness. The new models indicated that the most effective reward systems were those that supported the business strategy, structure, and desired culture of a unique organization, and were reinforced by other human resource processes. Fig. 1 depicts one such model—the current version of the congruence model that CEO has used for 30 years. The starting point is not benchmarking others' rewards practices; it is the business needs of the organization. That opens the door to developing innovative pay systems that are not commonplace and that offer potential competitive advantage.

This Golden Age of rewards design (the mid-1980s to about 2002) was an era in which "alternative rewards" were prominent, including changes in both base pay and incentives that are discussed below. Not all innovations survived, but the rewards field was never more exciting than during this era. Rewards professionals have looked ever since for the "next big thing" that would reinvigorate the field.

As this era ended over a decade ago, companies returned to the traditional design model of imitation. A key reason for this was the unrelenting management emphasis on cost control during a difficult decade that included two recessions. The risks of innovating were clearer than the