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## **Case Analysis**

# **Skill-Based Pay**



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**Global Human Resource Management-GSM 5126**

**June 24, 2002**

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## Introduction

Skill-based pay (SBP) is one of the fastest-growing compensation approaches in the United States today. Its attractiveness for private sector companies is in part due to a strong emphasis on reorganizing and reengineering business processes and strategically aligning business with human resources management systems. The SBP approach begins with an analysis of the organizational context including business objectives, viewpoint, needs, technology and workflow, management practices, and employee characteristics. Without such an analysis, meaningful decisions about skill-based pay specifics are impossible (Barkman, 2002).

The motivation behind the use of skill-based pay is because many businesses are seeking to advance to more technology and skill-based industries in which the application of knowledge or skill determines productivity, performance and competitiveness. Creating an ability for companies to innovate and develop clusters of competitive enterprises in particular industries. For the Imaginative Design Center (IDC), this means capturing some of the key sectors that will lead them into the development of a greater market segment in the future. An employee with skills is most flexible and productive when he or she develops a broad range of skills, the ability to learn the next higher skill, develop analytical skills and is also able to work in a team.

Important aspects of today's skills package include multi-skills, cognitive skills, interpersonal and communication skills, positive work attitudes and quality consciousness. Training is no longer only for current competence, but is also to prepare for the next stage of skills. Thus, pay systems, which promote current and future skills needs, are increasing in importance for Bea N. Bee, owner of (IDC). This study will further discuss the key elements behind skill-based pay as well as the advantages and disadvantages under this compensation methodology. Lastly, this analysis will provide

specific illustrations of McDonnell Douglas and JLG Industries, Inc. experiences using skill-based pay.

### Discussion/Analysis

The Society for Human Resource Management defines skill-based pay (SBP), as a pay delivery system designed to reward employees with an increase in pay rate as they demonstrate they have attained additional skills. This is in contrast with more traditional systems which are designed to pay employees based primarily on the job they hold or are assigned (Dantico, 2002). The concept is attractive to many employees since there is a direct link between their compensation and the work-related skills they may learn and use.

From the employer's perspective, SBP offers an alternative means for managing individual performance, advancing the competency of employees and enhancing the flexibility with which personnel can be used within and between one or more units of the organization (Dantico, 2002). Moreover, properly designed SBP plans can provide key support for the team, employee involvement, empowerment, flattened hierarchy, total quality, continuous improvement and other related organizational initiatives. These unique qualities demonstrate the effectiveness of skill based pay implementation. For that reason, and more to be discussed, SBP is a benefit to the organization.

In the article What is SBP? (2002), the author articulates that the adoption of skill-based pay may be done for a variety of reasons. The system stands the greatest chance for success if it is founded on solid business needs. SBP should be designed and measured to demonstrate that it reduces total organizational costs. If it does not do this, then it will eventually be replaced by a system that is perceived to do so. However, skill-based pay may likely result in individual pay rates that are higher than pay for similar positions in

other firms not using SBP. The cost of labor is a function of the wages paid, the level of staffing, and the productivity of the workforce.

SBP can more than offset higher wage rates by higher productivity. It has not been researched that overall staffing levels are always significantly changed (either up or down) by using SBP. David F. Barkman, author of What is SBP?, research contends that it has been difficult to document productivity and staffing improvements because finding comparable SBP and non-SBP operations is difficult. Some organizations have measured reductions in staffing of 10% due to removal of backup utility workers. Others have measured 30% productivity gains and 30% cost reductions in work systems using SBP as a component (Barkman, 2002).

The key relationship lies between SBP systems and total cost per unit, not just labor costs. Greater efficiencies, quicker problem solving, and less wasted time and material can create significant gains in other cost categories to offset higher labor rates. This is one intent of SBP; however, not a guarantee. The intent of SBP is to provide an incentive for employees to learn and apply new skills to increase organizational productivity and profitability while fostering high commitment to organizational goals. With a good system, everybody succeeds (Barkman, 2002).

Some reasons why not to use skill-based pay is that “everyone is doing it” gives it a marginal chance for survival. Since pay is an outlay of money by the company, this rationale will not support a system once competitive cost pressures arise. SBP adopted because it is “good for the employees” or will cause “higher morale” is well intended. However, this logic will not maintain a system that does not reveal its business value. In addition, applying SBP to some groups and not others causes resentment by those not included (Barkman, 2002). The following section will demonstrate the advantages and disadvantages of SBP. In addition, the below section will further allude to the benefits of implementing SBP system in Imaginative Design Center’s.

**Advantages**

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In the article What is Skill Based Pay? The author argues that SBP is adopted because it provides advantages over other types of pay systems. He also contends that the reverse is true, that SBP implementation and training techniques create specific advantages.

Anticipated advantages are related both to business performance and employee morale.

The specific advantages stated by Donald F. Barkman, include the following:

- 1) increased ability to focus personnel on problem areas and avoid idle time waiting for problems to be fixed by others;
- 2) flexibility in position coverage enabling work teams to cover for absent members for short periods of time;
- 3) faster adaptation to changes in technology and product mix due to greater skill base;
- 4) improved participation in problem solving and other participatory activities because of wider perspective on total workflow;
- 5) lower overall staffing levels caused by incorporation of specialized functions (e.g., maintenance, quality, supervision) into team skill requirements;
- 6) higher commitment to organizational goals due to broader perspective;
- 7) increased self-esteem from development of personal talents;
- 8) improved self-managing abilities;
- 9) higher minimum hiring qualifications since employees are required to progress through a multi-skilled job; and
- 10) overall increases in total productivity.

Currently, organizations using skill-based pay report gains in flexibility and versatility along with enhanced employee motivation and team effectiveness. Accompanying this is an increased use of technology and increased output per hour (Barkman, 2002).

Furthermore, David F. Barkman states that systems which succeed have good local management support and often originate in the local operation as opposed to being mandated by the corporation. They place emphasis on employee growth and development and honor a commitment to thorough training. The following section illustrates the disadvantages of SBP for some organizations.

### **Disadvantages**

Skill-based pay also brings with it other requirements sometimes perceived as disadvantages (Barkman, 2002).

- 1) higher individual pay rates: higher skill levels may command higher marketplace wages, and certainly do in the minds of employees; these can be offset by lower total unit costs due to reduced staffing and/or higher total productivity;
- 2) training investment in both time and money by learners, instructors, program design, materials, administration, foregone production, errors due to multiple learning curves;
- 3) skill assessment difficulties including time to conduct assessments, training and knowledge of assessors, poor assessment methods, inadequate peer input, speed of evaluation;
- 4) difficulty in identifying comparable jobs and wage rates with other employers;
- 5) administrative complexity and time requirements to track training and evaluation dates and completions;
- 6) managing rotations within work groups to provide cross training and to keep skills refreshed;
- 7) training investment required in the form of overtime or additional employees to provide time for training and learning;
- 8) acquiring learning to increase pay without concern for true competency;
- 9) personal reluctance to learn;
- 10) replacing outdated skills with new ones once original learning progression has been fulfilled and pay earned;
- 11) “topping out” at the highest pay rate with no more increases;

- 12) employees' desire for sharing in rewards of high organizational performance created (in part) by increased employee skills.

These advantages and disadvantages excerpts are directly taken from David F. Barkman's book entitled, Skill-Based Pay: Design and Implementation. The following section further provides evidence of the benefits of SBP by focussing on two specific experiences of two companies that have used skill-based pay.

### Company Experiences

The first example can be found in McDonnell Douglas Corporation's compensation philosophy. Their thinking is to effectively utilize pay to attract and retain highly qualified individuals and motivate employees to achieve short-term and long-term business objectives. McDonnell Douglas Helicopter Systems (MDHS) compensation philosophy is aligned with that of the Corporation. Its intent is to provide a program which will enhance the component's ability to balance external competitiveness with internal equity, strategically manage pay to reinforce desired behavior, reward outstanding performance, and provide employees with an understanding of the process used to determine pay (MDHS, 2002).

In keeping with these philosophies, MDHS website states how they gradually replaced their automatic pay progression for hourly workers to a skill-based pay program. All 40-job families have created their own SBP program and assembled their own SBP Review Team to verify and document individual employee attainment of skills. A pay increase of 35 cents every 26 weeks is granted only after the employee has demonstrated he/she has learned all the skills in a skill block.

Each SBP Review Team consists of the SBP Administrator, who monitors and regulates the process; the supervisor, who approves goals and coordinates training; and peers, who witness and verify skills. In the article Best Practices in Payment Systems (2002), the review criteria for each individual requires that the skill be appropriate (has not previously been used, meets plan requirements, and is current), that any required certification or training is completed and current, and that the task meet quality and time standards. The skill must be witnessed by at least one SBP Review Team Member. Upon verification of a skill block, a SBP Review Team member signs the SBP Input Document, recording the skills acquired. The manager of the group then reviews and signs off the increase and forwards it to HR Systems and Records to initiate the pay increase.

Moreover, the article Best Practice in Payment Systems, states that of the employees' involvement in the creation and implementation of the pay system, the company made a smooth transition from an automatic wage increase system to a skill-based pay system. In addition, by using the creativity and input of the employees, the company saved in development and implementation costs. Roughly all of the management team has expressed support of and comfort with the new system. MDHS' workforce is more productive and better skilled. The company successfully piloted an automated job evaluation program for their parent, McDonnell Douglas, who is currently implementing it throughout the corporation.

Another example can be traced to the JLG Industries. In the article Information: Skill-Based Pay Program, the author institutes that JLG instituted a skill-based pay program in 1994 to reward employees for the number of basic skills they can perform rather than for the jobs to which they are assigned. Prior to initiating this system, pay increases were based on a merit system. The merit system is still in effect; however, the SBP program focuses emphasis on continued acquisition of new skills. It also helps JLG maintain competitive pay rates with the current wage market.

The SBP program is integrated into the existing payroll system and is supported by a computerized tracking and reporting system. As an employee acquires and masters a new skill, pay is increased on a scheduled basis. Pay increases are directly proportional to employee “value” through skill acquisition. This method focuses on the individual and is a departure from the traditional concept of set pay rates for specific jobs.

Additionally, the article Information: Skill-Based Pay Program further contends that SBP assessment is an ongoing process. Formal evaluation begins at the completion of the six-month pilot period at which time the employee is tested for mastery of the minimum skills required for the Job Family; a 100% mastery rate is required for successful completion of the probationary period. After this period, the employee’s progress is analyzed and training objectives are established twice a year. Careful consideration is given to the employee’s interest, capabilities, limitations, and cross training requirements. Overall responsibility for skills acquisition and career development rests with the employee. The employee determines his/her level of participation in acquiring new or additional skills. Supervisors assist the process by helping the employee identify and plan for new skills to be acquired, creating opportunities for cross training, and certifying the skills training.

In place only since 1994, the program is already producing benefits. It allows supervisors and employees more flexibility in accomplishing work and managing careers. In the Information: Skill-Based Pay Program article, the author describes how the greater skill base permits faster adaptation to changes in technology and product mix. Workers are better able to focus on problem areas and avoid idle time waiting for problems to be fixed or for work done by others. Employees can participate more actively in problem-solving and improvement activities because of a wider perspective on total workflow. The program permits lower overall staffing levels by incorporating specialized functions into team skill requirements. The analysis describes that workers are experiencing higher self

esteem from development of personal talents and improved self-managing abilities. The company has also been able to raise minimum hiring qualifications. Overall, in these specific examples the implementation of SBP has lead to increases in productivity which have enabled expansion of capacity.

### Summary

The role of a skill-based pay system can directly lead to increases in employee's skill development, morale, and translate into profits for the organization. Given the size and level of training behind IDC operations, implementing a SBP system would be beneficial for a variety of reasons. Many of the companies incorporating SBP have experienced increased job satisfaction, flexibility, and commitment to employees. These are among the many advantages in executing a SBP system for IDC. However, SBP is not without some disadvantages. The program can be difficult to install and maintain, requiring considerable time, and money. The SBP system emphasizes the attainment of skills and knowledge, and is not necessarily results orientated. Despite the drawbacks the companies examined showed increased productivity and capacity. Overall, the development of SBP technique positively effected the companies operations. Given the unique attributes of the SBP system and the needs of IDC this analysis recommends implementing a SBP structure for IDC.

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