

Center for Quality and Productivity Improvement
UNIVERSITY OF WISCONSIN
610 Walnut Street
Madison, Wisconsin 53705
(608) 263-2520
(608) 263-1425 FAX

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**Compensation and Employment Security:
Overlooked Keys to Total Quality**

Spencer B. Graves

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Compensation and Employment Security: Overlooked Keys to Total Quality

Spencer B. Graves

Center for Quality and Productivity
Improvement and Spencer Graves
Associates

*University of Wisconsin
Madison, Wisconsin*

ABSTRACT

Research by economists supports a couple of Japanese management practices that seem to have been underemphasized in many Total Quality implementation efforts in the US – lifetime employment and linking pay to the accomplishments of the team. This paper illustrates the value of these policies with a few examples from consulting experience, then describes research by economists that suggests that the effects noted in the examples are commonplace and not isolated incidents. The focus is primarily on the link between management policies and productivity and profitability; this should make the conclusions largely independent of an understanding of the role of quality in organizational performance.

KEYWORDS: *Japanese management; Profitability; Participative management; Gain sharing; Profit sharing.*

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Research by economists supports a couple of Japanese management practices that seem to have been underemphasized in many Total Quality implementation efforts in the US – lifetime employment and linking pay to the accomplishments of the team. This paper illustrates the value of these policies with a few examples from consulting experience, then describes research by economists that suggests that the effects noted in the examples are commonplace and not isolated incidents. The focus is primarily on the link between management policies and productivity and profitability; this should make the conclusions largely independent of an understanding of the role of quality in organizational performance.

INTRODUCTION

If you are rewarded for doing it wrong, will you risk trying something that may or may not be better? If you are punished for doing it right, what are the chances you'll do it again? These apparently obvious "don'ts" for management seem to be regularly violated in common US management practices, especially regarding the impact of compensation and employment security policies on employee support for quality and productivity improvement efforts. We will consider a few examples from consulting experience and then review research by economists that suggests that the effects noted in these examples are commonplace and not isolated incidents. We focus primarily on the link to productivity and profitability to make the conclusions independent of an understanding of the role of quality in organizational performance.

EXAMPLES

EXAMPLE 1

One consultant reported that 30 people in a rework department had helped him identify and eliminate the sources of rework. These 30 people were then laid off. As this was happening the company was claiming to be implementing Total Quality. The managers of that unit were doubtless rewarded for achieving such savings. The people who actually did the work were punished.

The damage to the rate of improvement often comes more from the threat of layoffs than from the

layoffs themselves, as the next example illustrates.

EXAMPLE 2

A skilled technician, known to the author for careful commentary not given to exaggeration, described a Quality Circles effort at a previous employer. The program was highly successful with productivity improvements comparable to the work of roughly 20-30 people. Then managers began to ask the workers how many people they thought were needed to do the job. One concerned manager quietly told some employees that the management team was considering laying people off. The present author could not obtain independent validation of this story without breaching a confidence. However, in this case, perception was reality; employees believed that the management team was considering laying people off. Ultimately, a senior executive canceled the lay-off discussions. By that time, however, the enthusiasm for improving quality and productivity had disappeared. Trust had been broken. Obsolete procedures were quietly reinstated one by one. A year later, productivity was back down close to where it had been before. When people are punished for doing it right, how long are they going to do it? If people perceive that improvement for the organization will not benefit them, basic survival instincts will often direct creativity into figuring out why any change will not work. No intent to sabotage is required.

In this case, managers presumably saw a very promising Quality Circles effort evaporate. Many of those managers probably concluded that Quality Circles don't work in the US.

Quality improvement can be a threat to middle

managers as well as direct labor, as indicated by the following examples.

EXAMPLE 3

Quality consultant, Perry Gluckman, described the management style in one of his client companies, saying, "Managers in that company get promoted on their ability to fight fires. If you are good at fire prevention, you are invisible." He had consulted in that company for a few years. One of his individual clients was a middle manager who had been enormously successful at improving quality and productivity and making things run smoothly. This manager had subsequently been repeatedly passed over for promotion. While meeting with an executive one day, the consultant Gluckman asked why this middle manager had not been promoted. "We haven't seen how he handles himself in a crisis," was the reply. Company executives had achieved their positions based on their ability to fight fires. Top management did not even have the concept of fire prevention. Result: obvious, immediate problems got attention in a way that virtually insured that the problems would recur. Gluckman said, using another metaphor, "Managers there get promoted on their ability to scavenge spilled milk. They keep an ample supply around so they can continually demonstrate their skill." The system continually generated minor crises so aspiring executives could demonstrate their crisis-management abilities; little was done to improve the system for the long term. The executives had been rewarded for doing it wrong. The middle manager? Punished for doing it right.

EXAMPLE 4

In a Fortune 500 company with a well-earned reputation for progressive management, a production manager got his people involved in a number of projects that generated some dramatic improvements. They reduced one defect rate from 2% to 20 parts per million, reduced cycle time from over a month to 1.5 days, eliminated a number of inspection and rework steps, drastically reduced the size of queues, and cut in half the labor required to build the product.

Other managers complained bitterly that this production manager was pressuring them to improve the services they provided to him. They resented the suggestion that they might be less than perfect and complained that this Total Quality business didn't make any sense to them, and they didn't see how improvement in their areas was possible. The next higher level of management ultimately responded to

the concerns of these other managers. In a re-organization, this production manager lost parts of his organization to his former peers and wound up with a much smaller job reporting one layer further down the organization to a person in his former peer group. Punished for doing it right.

GENERALIZATION

Levine and Tyson (1990, p. 197) discussed the mixed record of Quality Circles, "Most studies find that the half-life of quality circles is under three years." Babcock (1991, p. 35; see also Rice, 1982, or Parsons, 1974) noted that the famous Hawthorne experiment from the 1920s included a group that showed no increase in productivity because the work team was confident that they would not benefit from improved productivity.

Participative management programs seem to require active support from management as well as compatible employment security and team compensation policies. Young (1985), former president of Hewlett-Packard Company (HP), described the Quality Circles effort inside HP. HP has cash profit-sharing and employment security. Even with these policies, Young found that HP's Quality Circles tended to disappear unless the improvement targets selected by the Quality Circles were integrated with the business objectives of concern to the top management.

In too many organizations, honest improvement of the system is not in the best interest of either middle management or labor. Peter Scholtes, consultant with Joiner Associates, commented (personal communication), "No good work will go unpunished." Goldratt (1990) asked what will happen to a production manager who appreciably increases productivity? The company's sales may previously have been limited by production capacity. If improvements increase productive capacity beyond the demand, this will have an easily identifiable impact on profits only when the payroll in Production is reduced. The reduction in the number of production workers might then lead to a reduction in salary for the Production Manager. Alternatively, it may limit the raise he might have gotten for solving the problem by hiring more people. Punished for doing it right. Meanwhile, a Marketing manager who had not pursued quality and productivity improvements would need more people to generate demand to utilize the enhanced production capacity. Under the logic of traditional US organizations, the Marketing manager's salary may have to increase because of the

added responsibility of managing a larger staff. Rewarded for doing not pursuing improvements.

THE RULE

Thurow (1992, pp. 168-176) suggested that the negative impact of US employment security policies is substantial, not limited to a few anecdotes such as those described above,

"While real output [in the US] was growing 30 percent between 1980 and 1990, ... blue-collar productivity rose 28 percent, while white collar productivity was falling 3 percent. ... Studies of the relative cost of producing the Ford Escort in different countries show that 40 percent of the Japanese cost advantage is due to white-collar overheads that are lower in Japan than they are in the United States. When Japanese managers take over existing American enterprises, they often find that they can dramatically reduce the number of white-collar workers. ... In experiment after experiment in participatory management, the problems have not been found among workers but among middle-level managers who feel threatened. They block experiments with new, more efficient forms of

production because they fear the loss of their job or their authority. The personal dangers in the American system are not imaginary. They are real. *Personal rationality intervenes to prevent system rationality from being achieved.* [emphasis added] ... Paradoxically, the real threat of firing managers if efficiency rises, even if it is seldom done, ends up producing an American system with more managers than the European or the Japanese ... "

Other economists have observed that Quality Circles and similar employee involvement/participative management efforts have tended not to last very long unless improvement was clearly in the best interest of employees, with policies like profit sharing or gain sharing and some form of employment security. In particular, Levine and Tyson (1990) reviewed 43 different studies on the productivity effects of worker participation in management conducted between 1948 and 1989. They coded 41 of them in an exhibit that is summarized in Table 1. Their conclusions were a primary source for the conclusions of the present paper: substantive employee participation in the management of their daily work lives has a generally positive effect on productivity; however, it doesn't

Table 1. Studies evaluating productivity effects of participation*.

POLICIES CONSIDERED:	NUMBER OF STUDIES BY FINDINGS				TOTAL
	Policy contributed to productivity	Policy had no impact on productivity	Policy had a negative impact on productivity	Effect of policy was contingent on other factors	
Conventional Firms					
Consultative Workplaces	2	2	1	2	7
Substantive Workplace Participation	9	2		2	13
Representative Participation	1	2	1		4
Firms with Worker Ownership					
<i>Employee Stock Ownership Plans</i>					
• Participation effects	2				2*
• Ownership effects		3			3*
<i>Worker Cooperatives</i>					
• Participation effects	6	1		1	8
• Ownership effects	7			3	10
Total	27*	10*	2	8*	41*

* Summarized from Levine and Tyson (1990, Table 1). The numbers add to more than 41 because six studies cited by Levine and Tyson had conclusions in two categories.

last very long unless policies like gain sharing or profit sharing make improvements clearly in the best interest of employees.

The literature is less clear on *how much* these policies add to profitability, but the potential appears to be substantial (Graves, 1992, 1993).

One largely overlooked aspect of the Japanese experience is worth mentioning here. This is the Japan Productivity Center (JPC, 1989) and its "three conditions of productivity growth":

1. stable employment;
2. equitable allocations and distribution of the gains of productivity growth;
3. consultation between labor and management.

These conditions were laid down in 1955 at the founding of the Japan Productivity Center (JPC). The practices that are known today as Japanese management were not commonplace at that time (Hashimoto, 1990; Arai, personal communication). Organized labor had been illegal in Japan before World War II and had been legalized by order of Gen. MacArthur, head of the occupation forces after the war. MacArthur's order was followed by a period of intense union organizing and labor strife, including a general strike that was put down by MacArthur's troops. The atmosphere of conflict between labor and management was still a major problem in 1955. Leading Japanese economists (Kosai, 1986. Minami, 1986) have stated that the legalization of labor unions was one of four major pillars upon which the modern Japanese economy has been built. The other three were the democratic constitution of modern Japan, the break up of the largest Zaibatsu or business conglomerates, and drastic land reform at the end of which the largest farm was only 5 cho, roughly 12 acres, the size of roughly a dozen football fields – a ridiculously small size by the standard of US agriculture even of the late 1940s. These four items were ordered by Gen. Douglas MacArthur, head of the occupation forces after World War II.

The founders of the Japan Productivity Center (JPC) saw that the future quality of life in Japan depended on high productivity. This could only be obtained through cooperation between labor and management. Productivity improvement could reconcile the apparent contradiction between the desires of management for low labor cost and the desires of labor for high wages and employment security. Management and labor, each recognizing that their individual futures required the cooperation of the other, could commit to protect and promote the other's interests because it was the best way to

achieve their own objectives. This is the opposite of Thurow's rule for the US, mentioned above: *personal rationality intervened to promote system rationality.*

This recognition was codified into the three conditions of productivity growth. After about five years of talking and persuading, most leaders of both management and labor in Japan recognized the value of the JPC's three conditions (Arai, 1992). *Thirty years later, a review of this issue by economists (Blinder, 1990; see also Ehrenberg, 1990), apparently without referencing the JPC, identified essentially these three conditions as summarizing the overall conclusions of economics research on the impact of compensation practices on profitability.*

Many US managers recognize the value of increasing the rate of improvement in quality and productivity. Many understand the need to involve the entire work force in improving work methods. Few understand how to make improvement clearly in the best interest of employees.

Employees, including middle managers, who feel threatened often find ways to show why improvement ideas won't work. On the other hand, if they feel they will benefit from improvement, that same creativity may go into making successes out of marginal ideas.

STABLE EMPLOYMENT

Fortunately, this attitude does not require an ironclad guarantee of lifetime employment. Hewlett-Packard Company (HP) has no written promise of lifetime employment. However, the management culture makes it clear that employees should not be punished because the managers lost a market. Managers work to find other jobs for employees if business disappears in a certain area. More than once when the corporation as a whole was suffering they instituted a "nine-day fortnight" under which everyone including the President and Chief Executive Officer (originally Bill Hewlett and David Packard) took every other Friday off without pay in order to cut payroll 10 percent. A few months later, business improved and everyone came back to their normal work schedule. HP's commitment to employment security is not a written policy. It works for them because it is a living tradition.

Kikkoman Foods of Walworth, WI, has a written policy to this effect (Graves, 1993). Senior executives in many organizations have the power to promulgate a similar written policy. Such a policy might say that the need for a 10 or 20 percent cut in payroll, for example, will be handled with equal percentage reductions in pay and working hours beginning with top management, and that if deeper cuts become

necessary, some priority for retention will be given to employees who have shown the greatest skill in developing and adapting to improvements in quality and productivity. A written policy of this nature may reduce the likelihood of a need for reducing payroll.

Van Buskirk and Adams (1989) reported that employment security has a major impact on the competitive position of Japanese construction firms in two ways: First, when business is slow, these Japanese firms will bid projects at slightly below their anticipated costs in order to keep their people busy, occupied and growing. Their people, being aware of the tight budget, are often amazingly creative in figuring out how to complete such projects within the budget. Second, their employees, knowing that their future is tied to the future of the organization, often work near miracles to ensure that projects meet deadlines. In contrast, employees of their American competitors often find ways to stretch projects out, blowing deadlines and budgets, because they know or believe that they will have to hunt for a job after the project is finished. As mentioned above, no intent to sabotage is required. Basic survival instincts may mask themselves as a sincere belief that the deadlines and budgets are unattainable.

There have been press reports recently that the lifetime employment tradition in Japan may be changing. For example, Mroczkowski and Hanaoka (1989) note that lifetime employment and other aspects of "traditional" [post-1955] Japanese management practices are being threatened by recent changes in international markets resulting in slower growth in the Japanese economy. In fact, the renowned Japanese management never was perfect and never was universal. And there have been previous reports of its impending demise (e.g. Woronoff, 1981). In particular, employment security never did extend to all employees, even among the leading Japanese companies. On the other hand, some Japanese managers have indicated that they feel a commitment to provide stable employment even to "temporary" employees, though their commitment is not as strong as for their official "regular" employees. In a competitive environment, one doesn't have to be perfect, only better. And change anywhere in management practices as profound as employment security will generally come slowly and after much discussion.

On the other hand, middle managers don't always have to wait for executives to take the lead on employment security. Any middle manager can draft a written policy on employment security for his / her department that includes appropriate recognition of the limitations on his / her power. A draft can be

shared with the next higher-level manager in the hopes of getting support for local implementation. If the next level manager is not impressed, the idea can be shelved, in many cases without risk to the relationship. If accepted, it may contribute to the future success of the department and the organization – and the prestige of the manager who proposed the policy.

Example: Certain aspects of a "time-based competitiveness" program in a US company were described to the author. The program was enormously successful from many perspectives: productivity was increasing; profits were increasing; top managers and shareholders were thrilled; and people here and there were being declared "excess" and were being "redeployed" one by one as productivity went up and managers decided who was no longer needed. All "redeployees" were officially offered six months to find another job inside the company, but not everyone seemed aware of that option or seemed to appreciate it. One individual called it "profits without a future." He predicted that it would not be too long before many other employees became aware that this program would not benefit them. At that point, they would become creative at delaying or sabotaging proposed improvements, in many cases without an overt intention to do so, and the rate of improvement would likely drop to zero. One portion of this organization was managed by a leader in a local professional organization devoted to Total Quality. That portion of the company was generating comparable productivity increases but without the quiet lay-offs that were occurring in other parts of the organization. That manager was somehow able to manage her part of the company without the forced reductions that were quietly occurring in other parts of the company; she acknowledged to the author that quality and productivity improvement and ethical management were not easy in an organization where top executives seemed not to appreciate the value of policies like employment security. The point of this story is that middle managers are often capable of influencing policies like employment security even though they don't have the control they would like, and even when the environment does not support it.

SHARING THE GAINS OF PRODUCTIVITY GROWTH

Hewlett-Packard and a few other leading companies have cash profit sharing. The Pacer Share program at McClellan Air Force Base near Sacramento, California, seemed to make progress with gain sharing, under which employees got cash bonuses

depending on the level of improvements achieved in some measure of the effectiveness of their organizations (Moen, 1989).

The principle is simple. During the initial phases of an employee participation program such as Quality Circles or Quality of Work Life, there is often a lot of excitement: people believe that they have more control than they have ever had over their daily work lives. As time passes and improvements accumulate, many see those improvements benefiting their management and stock holders and not themselves. They begin to lose interest in racking their brains to make someone else rich.

Any commercial organization can institute profit sharing. Other organizations can institute gain sharing. Profit sharing or gain sharing by themselves appear to have little impact on organizational effectiveness – especially if it is deferred profit sharing that employees won't see until they retire. If an organization wants to maintain a traditional, top-down management culture, the available studies suggest that profit or gain sharing will not likely provide any benefits. These policies are primarily of value when coupled with efforts to improve quality and productivity built, in part, on employee involvement.

EMPLOYEE STOCK OWNERSHIP

Stable employment and profit or gain sharing blend very naturally with various kinds of employee ownership. If employees own a sizable portion of the company, the organization will be less susceptible to being taken over by corporate raiders and the executives can more easily make the decision to forgo dividends in favor of investments and stable employment (see Rosen and Young, 1991 or Craig and Pencavel, 1992).

Bill Gates, chairman of Microsoft Corporation, rocketed from nowhere to become the richest man in the US in a dozen years – and made millionaires of close to 20% of his employee-owners (San José Mercury News, 1992). In any one case such as this, the impact of a single policy is unknown and unknowable. However, Microsoft's generous employee-ownership plan may have contributed to their success. Microsoft clearly has been enormously successful in a market with explosive opportunities and colossal failures. No one can say for sure whether this success is because of or in spite of their team-oriented compensation system, presumably coupled with a very open management style. This kind of question can only be resolved by reference to theory, supported or refuted by reference to empirical studies

such as those contained in Blinder (1990) and Ehrenberg (1990).

EMPLOYEE PARTICIPATION

Forty Years, Twenty Million Ideas: The Toyota Suggestion System (Yasuda, 1991) is the title of a very interesting book. Toyota Motors averages roughly one suggestion per employee per week – *implemented*. Most of these changes are small; however, they add up to an impressive rate of improvement. They also condition the work force to expect and support continual improvement.

SUMMARY

Prior to around 1970, employment security and profit or gain sharing were not competitive issues for the vast majority of US organizations: Few organizations used them effectively. This is no longer the case. The success of virtually all leading Japanese companies and a small but growing number of non-Japanese companies is apparently built in part on a culture of continuous improvement supported by policies of this nature.

Many organizations now understand the need for continual improvement, supported by meaningful employee participation in the management of their daily work lives. Many organizations have been frustrated by the apparent short lifetimes of programs like Quality Circles and Quality of Work Life. The available evidence suggests that the vitality of employee participation can be sustained by making improvements genuinely in the best interest of employees and middle managers. Two policies to support this are a reasonable (not ironclad) commitment to employment security and equitable allocation and distribution of the gains of productivity growth. These two policies have been shown to be effective in countering some of the dysfunctions that exist in real organizations, though they do not respond to all the problems associated with the examples given above. Still, without such policies, people are too often "rewarded for doing it wrong and punished for doing it right."

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