

How Felt-Fair Pay is Key to Conscious Capitalism

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My grandson, Joshua Fowke, is a 16 year-old entrepreneur with a start up business: New Lawn Care Toronto. He defines his core purpose “to provide students with work that gives them real life skills and work experience to enhance their future”. Of course he has a business plan that runs the numbers so it will be profitable meeting that purpose. And he has disciplined logistics to be efficient, clear production standards, pricing that gives both good value and good margins. And he focuses on training his “Ambassadors” so they are empowered to go about the business of “relieving our clients of lawn care stress while providing the opportunity for students to learn and grow.”

He is my most demanding client and I have helped him put it all together. But I have got to say that the entire emphasis on values above and beyond making money is his alone. Maybe this is more typical of the millennial generation than I realize, and I got to looking into the momentum of the conscious capitalism movement.

Conscious Capitalism= Higher Purpose+Stakeholder Integration+Conscious Leadership, Culture and Management

Whole Foods CEO John Mackey, along with Raj Sisodia, have done a fine job in laying out the ideas in their new book entitled *Conscious Capitalism*¹. The first tenet is having a “higher purpose”. The second is “stakeholder integration”, which brings together customers, team members, investors, suppliers, communities, and the environment. The third and fourth tenets are “conscious leadership” and “conscious culture and management”. The interesting thing about this is that conscious capitalism leads to superior financial performance.

Raj Sisodia has data to show that what he calls “Firms of Endearment” have outperformed the S&P 500 by a ratio of 3 times to 5 times over a 15 year period. Impressive!

Beyond Whole Foods, other companies in the US who are seen to be practicing conscious capitalism include Google, Wegmans, REI, The Container Store, Southwest Airlines, Nordstrom and Starbucks. In Canada the list would include Longo Brothers, Westjet, and the Graham Group.

How employees see these companies is often an indicator of which ones are really doing it. The 100 Best Companies to Work For in the US and Canada’s 50 Best Managed Companies are a good place to look for them. Of course, not all of them are trying to implement the “four tenets” described above. Indeed many of them probably wouldn’t think of themselves as “conscious capitalists”. Some of them have the necessary culture and value set because they have been employee owned; others because they were family owned; and still others because of a style of visionary leadership by the founder. Almost certainly all of them could do some things more consciously than they do.

The enlightenment of Management and Conscious Leadership

Conscious capitalist companies have a more egalitarian feel about them. At least there is more respect of workers and front line managers than was the case 50 years ago in most industrial companies. Often in those days there was a big distinction between executives and the rest, in terms of pay, perquisites and a general sense of one’s station in life. Philosophically that has changed with a better educated popu-

lace, and more knowledge workers employed in professional and semi-professional roles in the modern company.

There has been a big change in the way managers think in that time frame as well. In the nineteen sixties there was big debate about Theory X and Theory Y, between the traditional view (X) that people were lazy and had to be coerced to work, and Douglas McGregor's emerging view (Y) that people were self motivated. In *Leadership and Motivation*, McGregor's editors, Warren Bennis and Ed Schein presented the first serious, modern book about leadership². A sophisticated tool of the era was the Blake Grid, which described managerial orientation to "task" or "people". The typical Theory X manager was 9,1 (9 points task and 1 point people) whereas the true, balanced Theory Y manager was 9, 9.

There are thousands of leadership books today. One of the more sophisticated is Richard Barrett's *The New Leadership Paradigm*³ which is built on Abraham Maslow's hierarchy of needs. Barrett's approach aligns with the focus of conscious capitalism, mapping strategies of values-based leadership bring out the best in the human side of enterprise.

Conscious Management is the Next Frontier

Sometimes with this focus on leadership there is very little emphasis on management. We may have "conscious" leadership, but not "conscious" management. John Kotter at Harvard got us going in the wrong direction in the late 1980s with his sharp dichotomy between leadership and management. He painted leadership as visionary and empowering and management as planning and controlling. The resulting dichotomy between what really are two sides of the same coin has tainted "management" with the disparaging aura of "command and control". I think this is a serious misunderstanding, and marks a major opportunity for even the most effective conscious capitalist companies. There is another way of looking at management that can make everything better for conscious capitalism, for all stakeholders, and especially owners and employees. And that leads me to "Felt-Fair Pay".

Felt-Fair Pay: Compensating the Weight of Responsibility

Many companies practicing conscious capitalism have shied away from the very extreme pay differentials that are so common today in major corporations, where CEOs earn 300 – 500 times as much as front line employees. Ironically, these extreme pay differentials have arisen in the last 20 years, essentially the same time period that has seen the emergence of the conscious capitalist movement. Whole Foods has a policy that no one can be paid more than 19 times as much as the average of all employees. This is recognition that there is something profoundly unfair about the expanding differentials.

Elliott Jaques, writing in his *Social Power and the CEO: Leadership and Trust in a Sustainable Free Enterprise System*⁴, makes a strong plea for business to get away from the dehumanizing practice of treating its employees as a "labor commodity". He argues instead for a "fair, just, and trust inducing" system of compensation which he terms "Felt-Fair Pay". This system is based on stable patterns of differential pay for different weight of responsibility born by levels of management. The differential weight of responsibility has a precise meaning in Jaques' work, which is the complexity inherent in the managerial role. A good working proxy for this complexity is the length of time for completion of the longest task in the role, called time span of discretion. These patterns of relativity have a sound scientific basis in peoples' perception of fairness. Roy Richardson of the University of Minnesota showed, in a study for Honeywell, that the correlation between time-span of the role and felt-fair pay explained 75% of the variation in comparison to 29 other variables. The next highest factor was market value, which accounted for only 1% of the variance⁵.

The Structure of Felt-Fair Pay

Table I illustrates what a felt fair pay structure looks like for a North American company in 2013. The table needs to be calibrated to the pay structure of the community in which it operates. But the relative differentials apply world-wide, in every culture and have proven stable for more than

half a century.

There is more to a felt-fair pay system than just the averages in Table I. Each of the Levels contains a Low, Medium and High band, and each band a six step progression, as suggested in Table II.

North American users of the Felt-Fair

compensation plan distinguish between basic salary and incentive pay within the basic total compensation structure. While Jaques eschewed incentive pay, companies like to distinguish between basic fixed pay, which is salary, and variable pay, which is available when the company does well. For Levels IV, V and VI, the variable pay may also be subdivided between STIP (short term incentive) and LTIP (long term

TABLE I: FELT-FAIR PAY STRUCTURE

<u>Role</u>	<u>Level</u>	<u>Average Compensation</u>	<u>Time Span of descretion</u>	<u>Complexity</u>
CEO International Company	VI	\$1,276,489	10 - 20 years	4th Order Information; Cumulative Processing; Meta-Field Coverage Work
Business Unit President	V	\$638,244	5 - 10 years	4th Order Information; Declarative Processing; Field Coverage Work
General Manager	IV	\$319,122	2 - 5 years	3rd Order Information; Parallel Processing; Comprehensive Provision Work
Middle Manager	III	\$159,561	1 to 2 years	3rd Order Information; Serial Processing; Systematic Provision Work
First Line Manager	II	\$82,345	3 months to 1 year	Information; Cumulative Processing; Situational Response ("Results") Work
Front Line Worker	I	\$45,150	< 3 months	3rd Order Information; Declarative Processing; Direct Action Work

TABLE II: BAND AND STEP STRUCTURE FOR LEVEL III

III	High	\$173,221	\$180,021	\$187,089	\$194,434	\$202,067	\$210,000
	Med	\$137,485	\$142,883	\$148,492	\$154,322	\$160,381	\$166,677
	Low	\$109,122	\$113,406	\$117,859	\$122,486	\$127,294	\$132,292

incentive), as suggested in Table III, so that senior management with time span beyond two years have their variable income pegged to things that can be measured in a longer time frame.

Strategic Compensation Aligns Focus

There are several compensation policy decisions that need to be taken within the context of the felt-fair structure. These are strategic levers in any company. Pay is not a motivator: but it can be a de-motivator. People pay

TABLE III: COMPONENTS OF TOTAL DIRECT COMPENSATION

Role	Level	Total Average Salary	Average Short Term Incentive	Average Long Term Incentive
CEO International Company	VI	\$638,244	\$127,649	\$510,596
Business Unit President	V	\$319,122	\$95,737	\$223,386
General Manager	IV	\$175,517	\$57,442	\$86,163
Middle Manager	III	\$127,649	\$31,912	
First Line Manager	II	\$65,876	\$16,469	
Front Line Worker	I	\$41,087	\$4,064	

attention to how they are remunerated, and conversations between managers and subordinates around progression through the salary system and the awarding of bonus payments commands attention. Incentive pay is more about focus than it is about inducing greater effort. So compensation conversations provide an opportunity to align the focus of personal efforts with strategic objectives and with operational targets.

proportion varies from 91% for the Front Line Worker to 50% for the CEO. Then the split between short term and long term variable pay needs to be decided. In the example only Level IV and up are in the long-term plan, and the proportion varies from 60% at the General Manager level to 80% for the CEO. But these proportions could be different. Some companies have broadly based employee ownership, maybe including front line workers, and these might have the long-term incentive in fact extended from top to bottom.

For example, one of the first policy decisions in a Felt-Fair pay system is the proportion of total compensation that is to be paid as salary and the proportion to be paid as variable pay. In the example of Table III, the salary

TABLE IV: SALARY ADMINISTRATION FOR LEVEL III

III	High	\$138,577	\$144,017	\$149,671	\$155,547	\$161,654	\$168,000
	Med	\$109,988	\$114,306	\$118,794	\$123,458	\$128,305	\$133,342
	Low	\$87,298	\$90,725	\$94,287	\$97,988	\$101,835	\$105,833

Salary Administration

Within the band and step structure for the salary portion of pay, there are salary administration policy decisions to be made.

Table IV shows three distinct levels of Middle Management, reflecting the relative complexity of specific roles at Low, Medium and High III. A Director of Purchasing might be classified as a Low III role, with a salary range of \$78,984 to \$95,754, while a Controller might be defined as a High III role, with a salary range of \$125,379 to \$152,000. Movement through the ranges may be more or less automatic in some situations, or other companies may define the first three steps in a range as developmental, requiring achievement of certain mastery to move to the next step, and the last three steps as fully satisfactory with more or less automatic progression.

The point of all of this is that the strategic pay questions and the administrative pay questions are all taken within the context of a relative pay structure that is perceived by people within it as being fair and equitable, given the different weight of responsibility carried by different roles.

I'm Not Responsible for My Performance: My Manager is!

Having the relative pay structure feel equitable is only the first step. The devil is in the details of its administration, or what is commonly called "performance management" today.

The first, and maybe most important point, is that an employee or a manager is not responsible for his or her own performance. One's manager is responsible for one's performance. One is accountable only for one's effectiveness, and for the performance of direct reports. This idea runs counter to how most companies think about performance management. Yet getting it right is liberating and empowering for everybody. It puts accountability where it belongs: where the person has the ability to manage it. This idea is the essence of conscious management.

A first line manager is not accountable for his own performance. He is accountable for the performance of the front line workers who report to him. This is because he is accountable for maintaining and developing a team of subordinates capable of producing the required outputs, is to recom-

mend and have authority to veto their appointment, and to decide task-type assignments. He is also the one who must make certain that the required resources are available to the team, and if they are not, can vary the assignments to fit the resources. He also has the authority to decide the personal effectiveness appraisal of members of his team and their merit review. Note that the front line worker is not accountable for her own performance, but instead for her effectiveness in performing the assigned tasks. She looks to the first line manager to be coached on context of her work, to be assigned appropriate tasks in terms of the quantity and quality of output expected of her, in the allotted time frame and within the resources provided, and to be coached by the first line manager on how to improve her effectiveness.

Similarly, the first line manager looks to the middle manager for coaching on the context of his work, for clarity of the tasks assigned him in terms of the quantity and quality of the work expected, the time deadlines for their completion and the provision of adequate resources to complete them. He is accountable for his effectiveness in this context. It is the middle manager who is accountable for the performance of the front line manager. She in turn has the accountability and authority for developing and maintaining a team of first line managers, to recommend and have the authority to veto their appointment, to decide task-type assignments and to decide the first line managers' effectiveness appraisal and merit review.

This is a very different view of the management function than "command and control". Management's job at each level is to enable the team supporting him or her because their performance is what he or she is accountable for. Their performance is her effectiveness. Said another way, a manager's job is to make the supporting team succeed. Set up this way, the chain of managerial accountability creates a trusting and supporting environment.

Note that it is important that the front line worker at Level I be accountable to a first line manager at Level II. If the first line manager is also capable at Level I, he is not able to provide the context to guide the Level I work. Similarly, if the middle manager is not capable of handling the complexity at Level III, she will not have the ability to set the context for the Level II work, nor the ability to coach the front line management team.

In other words, if the levels are not determined correctly and if they are not staffed with managers

the way through the general management and executive roles at Levels IV, V and VI.

Conscious Management is Requisite

If the structure outlined here looks like *Requisite Organization*⁶, it is. Elliott Jaques articulated this approach to management over a period of 50 years, starting with Glacier Metals in England in the 1950's, evolving with the mining industry in Australia and with the US Army in the 1980's, and articulated in a broad swath of industries in the 1990's and since by many practitioners skilled in the methods. The Global Organization Design Society's web site (www.globalro.org) displays the breadth and depth of this work. Because of RO's success in many industrial age companies, in mining, manufacturing and electric power, for example, it is sometimes thought to be a managerial technology applicable only to the industrial era. It is important to take RO out of the industrial context within which it was developed, and see how its fundamental human truths apply in a 21st century of empowered employees, managers and executives.

The test of conscious culture and management is

1. John Mackey and Raj Sisodia, *Conscious Capitalism: Liberating the Heroic Spirit of Business*, Harvard Business School Press, Boston, 2013.
2. Douglas McGregor, *Leadership and Motivation*, The M.I.T. Press, Cambridge, 1966.
3. Richard Barrett, *The New Leadership Paradigm*, <http://valuescentre.com>, 2010.
4. Elliott Jaques, *Social Power and the CEO: Leadership and Trust in a Sustainable Free Enterprise System*, Quorum Books, Westport CT, 2002.
5. Roy Richardson, *Fair Pay and Work*, Cason Hall, Gloucester MA, 1971.
6. Elliott Jaques, *Requisite Organization: A Total System for Effective Managerial Organization and Managerial Leadership for the 21st Century*, Cason Hall, Arlington VA, 1998 (revised second edition).
7. Elliott Jaques, *Social Power and the CEO*, *op. cit.*

whether the environment evidences trust. The test that Elliott Jaques applied to all of his work was whether its implementation would create trust. He expressed his hope in his message to the CEO written late in life that our society would escape the economic concept of labor as a commodity, and its reward as a market price, replacing it with the structure of Felt-Fair Pay. This way, dignity and trust could be assured in the future world of work.

If the thrust of conscious capitalism is pointing to the future of enterprise in the post industrial world, as I think it is, Jaques may be able to rest assured that Felt-Fair pay is part of it. It certainly holds a key to conscious management.

And where does all of this leave Joshua and his partner with their New Lawn Care Toronto? Their business is a Level II business, even though I see evidence of Level III thinking in the entrepreneurial intuition apparent in its creation. Implementing Felt-Pay for their Ambassadors is probably a long way down the road. But I do see attention to the conscious management ideas in things like clear accountability in an emerging enterprise that is clearly in the mainstream of conscious capitalism.



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