

Chapter 9 Recognizing Employee Contributions with Pay



Chapter 9 Outline

- I. Money and Motivation
- II. Incentives for employees
- III. Organization wide Variable Pay Plans
- IV. Developing More Effective Incentive Plans

Learning Objectives

- Discuss the main incentives for operations employees
- Describe the main incentives for managers and executives
- Discuss the pros and cons of incentives for salespeople



Learning Objectives (Con't)

- Name and define the most popular organization-wide variable pay plans
- Outline the steps in developing effective incentive plans
- Establish an incentive plan

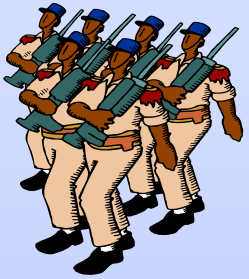


I Money and Motivation

1.1 Performance and Pay

1.2 How Does Pay Influence
Individual Employees?

1.3 overview of Incentive Plans



Money and Motivation



- Incentives motivate workers
- See “systematic soldiering” without them
- Taylor standardized a **fair day’s work**
- Which led to the **scientific management** movement
- Which in turn led to modern day HR practices



1.1 Performance and Pay

- Competition, shareholder value, and turbulence
- Businesses need an edge
 - ◆ **Question:** What do you think that edge is?
- Pay attention

1.2 How Does Pay Influence Individuals?

- Equity Theory
- Reinforcement Theory
- Expectancy Theory
- Agency Theory
 - ◆ principals as owners
 - ◆ agents as managers

Factors in the Choice of a Compensation Package

- Risk Aversion
- Outcome Uncertainty
- Job Programmability
- Measurable Job Outcome
- Ability to Pay
- Tradition



1.3 Overview of Incentive Plans



Individual Pay Programs: *Design Features*

<u>Programs</u>	<u>Payment Method</u>	<u>Frequency of Payout</u>	<u>Performance Measures</u>	<u>Coverage</u>
Merit Pay	- Change in base	- Annually	- Boss' appraisal	- All
Incentive Pay	- Bonus	- Weekly	- Output, productivity	- Direct labor
Profit Sharing	- Bonus	- Semiannual or annual	- Profit	- All
Ownership	- Equity changes	- Sale of stock	- Stock value	- All
Gainsharing	- Bonus	- Monthly / quarterly	- Production costs	- Production /service unit
Skill-based	- Change in base	- when skill is acquired	- Skill acquisition	- All

Individual Pay Programs: *Consequences*

<u>Programs</u>	<u>Performance Motivation</u>	<u>Attraction</u>	<u>Culture</u>	<u>Costs</u>
Merit Pay	- Change in base	- High performers	- Individual competition	- High maintenance
Incentive Pay	- little	- High performers	- Intra-group competition	- Good system of appraisal
Profit Sharing	- some in small units	- All	- Cooperation	- Variable
Ownership	- Little	- All	- Knowledge of business	- Ability to pay
Gainsharing	- Little	- Retain employees	- Sense of ownership	- Cost not variable
Skill-based	- Learning	- those who want to learn	- Learning	- can be high

Individual Pay Programs: *Contingencies*

<u>Programs</u>	<u>Organization Structure</u>	<u>Management Style</u>	<u>Type of Work</u>
Merit Pay	- Independent jobs	- Control	- Individual, easy to measure
Incentive Pay	- Measurable jobs / units	- Participation desirable	- Individual appraisal
Profit Sharing	- Autonomous units	- Participation	- All types
Ownership	- Any company	- Participation	- All types
Gainsharing	- Most companies	- Participation	- All types
Skill-based	- Most companies	- Participation	- Professional

Types of Incentive Plans

- Individual
- Group
- Profit sharing
- Employee group
- Variable pay



Places to Find Incentive Programs

GiftCertificates.com
 100+ certificates from over 700 of the nation's most popular stores

- SHOP FOR FRIENDS & FAMILY**
 Make your convenient gift certificate source for birthdays, anniversaries, weddings and every special occasion in your busy life.
- CORPORATE SALES**
 We've created an entire website exclusively for companies to purchase SuperCertificates and gift certificates for reward and incentive programs.
- REDEEM**
 YOUR SUPERCERTIFICATE

A SuperCert lets you then choose the merchant gift certificate they really want!



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INCENTIVE

GoTo **incentives** atWORK.com GoTo **potentials**

Plastic Premium
access

1,000's of plastic premiums – including the ONE you need

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II Incentives for employees

- 2.1 Incentives for Operations Employees
- 2.2 Incentives for Managers and Executives
- 2.3 Incentives for Salespeople
- 2.4 Incentives for Other Professionals
and Nonmanagerial Employees

2.1 Incentives for Operations Employees

- Piecework
- Straight piecework
- Standard hour plan
- All must guarantee minimum wage
- Can create quality problems





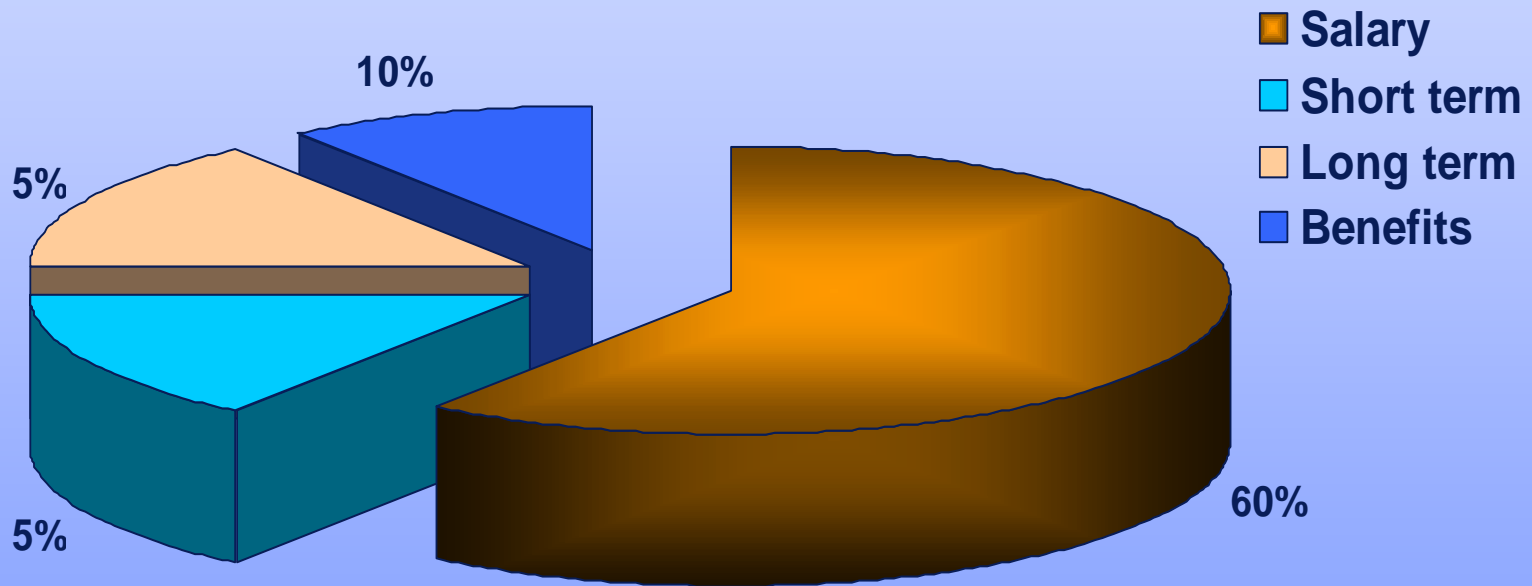
Incentives for Operations Employees

- Team or group incentive plans
 - ◆ All members receive the pay earned by the highest producer
 - ◆ Members receive pay equal to the average pay earned by the group
 - ◆ All members receive the pay earned by the lowest producer

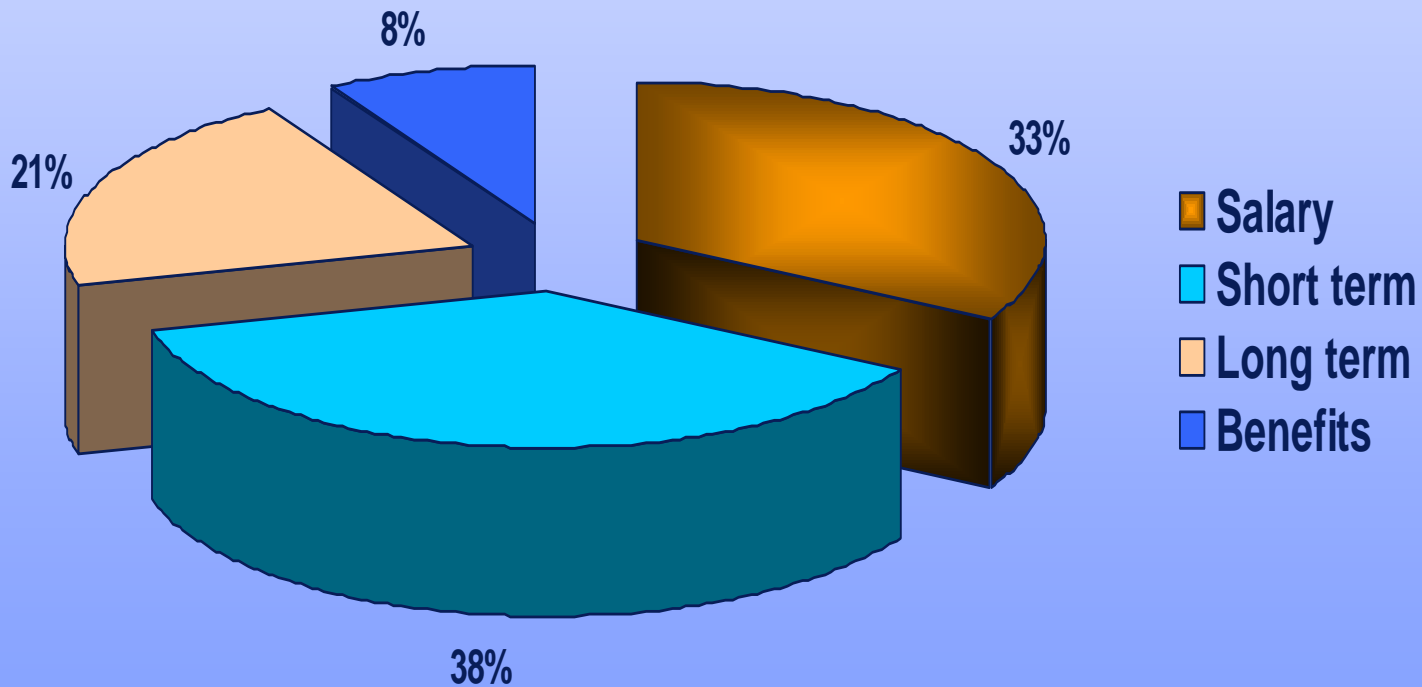


2.2 Incentives for Managers and Executives

Incentives breakdown for a mature company



Incentives breakdown for a startup company



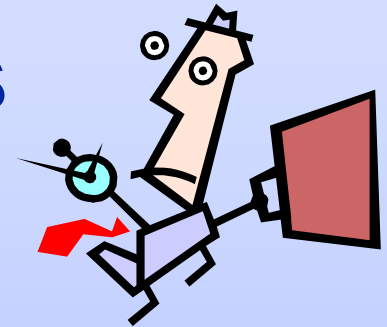


The Annual Bonus

A bonus is aimed at motivating short term performance with three issues to consider when awarding them:

- ◆ Eligibility – based on job level and salary
- ◆ Fund size – use a formula
- ◆ Individual awards – based on performance

Manager's Performance Bonus



- Bonus for managers is either individual or corporate performance based or both
- Split it with part based on individual performance rest on corporate performance
- Never give outstanding performers too little
- Never give poor performers normal or average awards

**Multiplier approach
for bonus** →

Company Performance (based on sales targets, weight .50)					
		Excellent	Good	Fair	Poor
Individual Performance (based on appraisal, weight.50)	Excellent	1.00	.90	.80	.70
	Good	.80	.70	.60	.50
	Fair	0.00	0.00	0.00	0.00
	Poor	0.00	0.00	0.00	0.00

Note: To determine the dollar amount of a manager's award, multiply the maximum possible (target) bonus by the appropriate factor in the matrix.

Long Term Incentives

- Stock options
- Different stock option plans
- Performance plans
- Cash plans
- Other plans



Long Term Incentives (Cont.)

- Other Plans
 - ◆ Stock appreciation
 - ◆ Performance achievement
 - ◆ Stock options
 - ◆ Phantom stock
- Performance Plans
- Cash Versus Stock Options

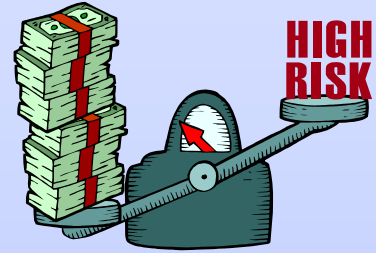
Stock Options



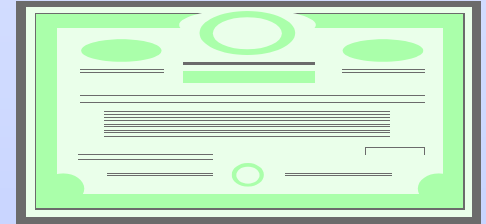
- A **stock option** is the right to purchase a stated number of shares of a company stock at a preset price at some time in the future
- A **mega-option grant** is a large, upfront stock option grant in lieu of annual grants
- Some stock plans are different for each employee
- A **restricted stock option** is an option grant which has constraints on its use



Performance Plans



- Executives do not prosper unless the company does
- Executives have some “skin in the game”
- Value is contingent on financial performance



Cash Versus Stock Options

Which do you think is a better
motivator?



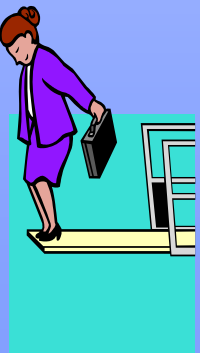
Long-Term Incentives For Overseas Executives

- Tax implications can be tricky
- May be responsible for both US and foreign taxes – may defeat the incentive
- Plans must consider various factors:
 - ◆ Tax treatment
 - ◆ Regulatory environment
 - ◆ Foreign exchange controls

Strategy and Executive Compensation



- Long-term incentives have a profound impact on strategic success
- When designing a compensation plan, 1st define strategic context
- Create package
- Ignore firm's strategy at your own peril





Steps to a Compensation Package

- Include external and internal issues
 - ◆ What are our long term goals?
 - ◆ How can compensation support them?
- What defines the work culture and how can the package be molded to it?
 - ◆ What are our competitive challenges?
 - ◆ What are our specific business objectives?



Steps to a Compensation Package (Cont.)

- Shape components into balanced plan
- Meet unique company and strategic needs
- Legal and tax effective
- Install a review and evaluation process



2.3 Incentives for Salespeople

Incentives for Salespeople - Salaries



- Sales compensation can be salaried, commission-based or hybrid
- Salaries make sense when job is primarily prospecting or servicing clients
- Useful when relocating to new territories
- Can de-motivate very productive workers

Incentives for Salespeople - Commissions

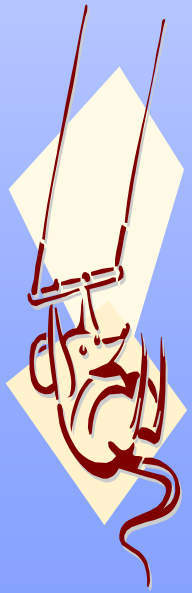


- Pay only for results
- Easy to understand and compute
- Focus only on high volume items
- May ignore non-selling aspects
- Performance is a product of ability
- May result in high turnover



Research Insight – Commissions Only

“If I go on vacation, I lose money. If I’m sick, I lose money. If I’m not willing to drop everything on a moment’s notice to close with a customer, I lose money. I can’t see how anyone could stay in this job for long. It’s like a trapeze act and I’m working without a net!”





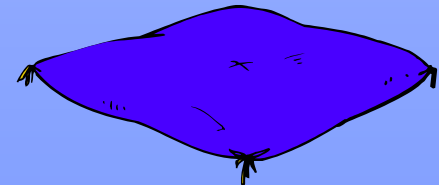
Incentives for Salespeople - Combination

80/20

70/30

60/40

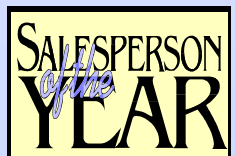
- These are the 3 most common salary/commission ratios
- All cushion downside risk while also limiting upside reward
- Next slide shows a more complicated formula





Incentives for Salespeople - Combination

- Sales:
 - ◆ Up to \$18,000 a month = base salary + 7% of gross profits + 0.5% of gross sales
 - ◆ From \$18,000 to \$25,000 a month = base salary + 9% of gross profits
 - ◆ Over \$25,000 a month = base salary + 10% of gross profits
- All three steps include an additional amount of 0.5% of gross sales



Online Award Programs

- The \$30 billion Corporate incentives programs market is growing
- Programs can be costly to administer so many companies are looking online

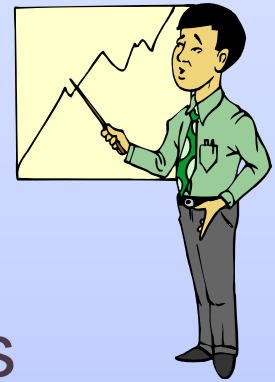
The logo for Bravanta, featuring the word 'Bravanta' in a white, serif font on a dark blue rectangular background.



A logo for 'INCENTIVE' with the word in large, blue, outlined, serif capital letters. Above it, in smaller black text, are the words 'TRAVEL • PERFORMANCE IMPROVEMENT • MERCHANDISE • RECOGNITION • PROMOS'.

The Harrods logo, featuring the word 'Harrods' in a yellow, cursive font above the words 'KNIGHTSBRIDGE' in a smaller, yellow, sans-serif font, all on a black background.

Setting Sales Quotas



- Setting effective quotas is an art
- Make sure commissions match expenses
- Ask these questions:

Have we communicated quotas to the sales force within one month of the start of the period?

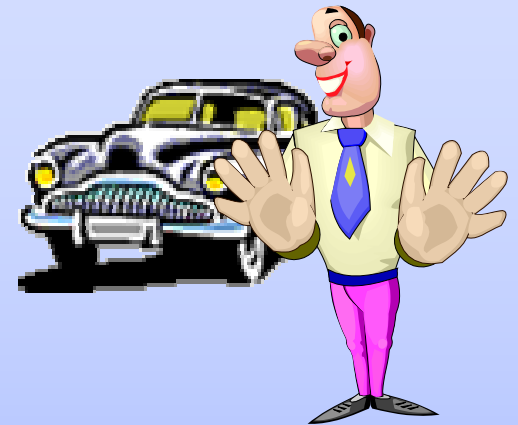
Does the sales force know exactly how its quotas are set?

Do you combine bottom-up information with top-down requirements?

Does 60% to 70% of the sales force generally hit their quota?


Are quotas stable through the performance period?

Auto Dealer Commissions



Insight into why auto salespersons behave the way they do:

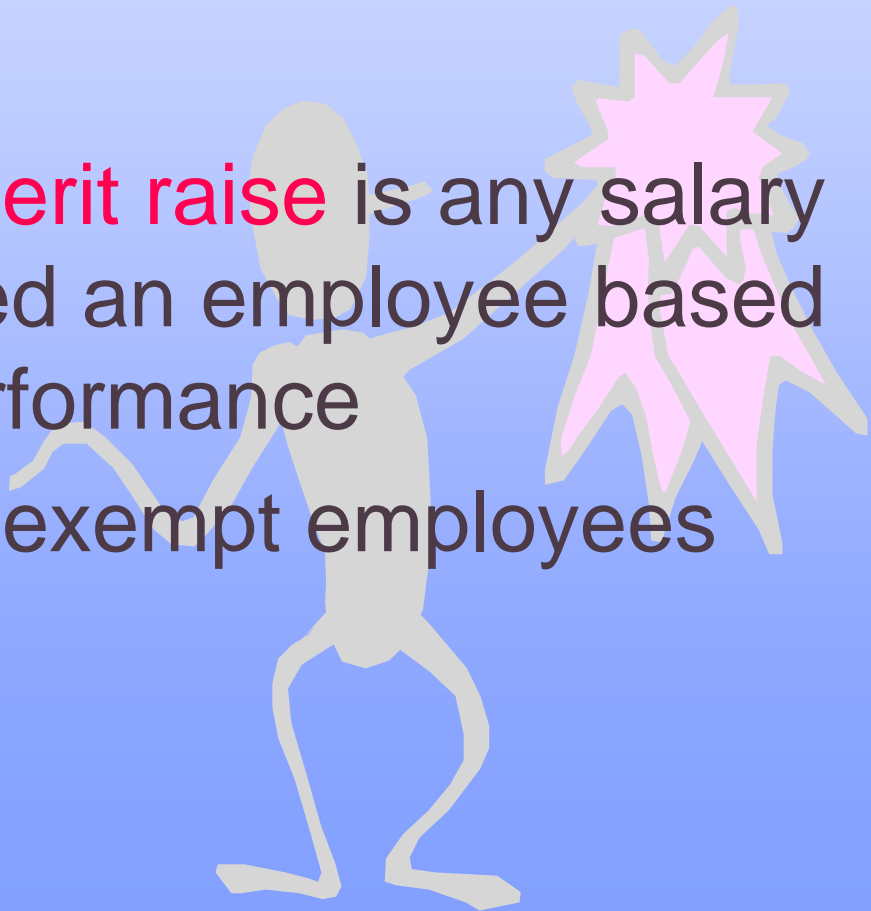
- ◆ Some are 100% commission based
- ◆ Others get commissions and small base salary
- ◆ Net profit of car
- ◆ Slow movers may get “spiff”



2.4 Incentives for Other Professionals and Nonmanagerial Employees

Professional and Non-managerial Incentives

- **Merit pay** or a **merit raise** is any salary increase awarded an employee based on individual performance
- Usually granted exempt employees





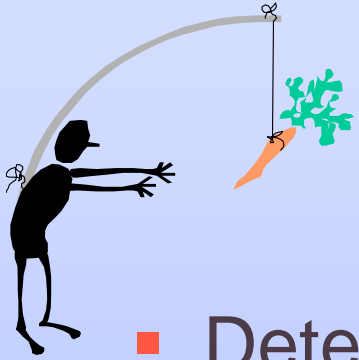
Merit Pay Options

- Lump sum raises are not cumulative; traditional raise is
- Lump sum can be a bigger motivator

Lump sum award matrix based on individual and organization performance



The Employee's Performance (Weight = 0.50)	The Organization's Performance (Weight = 0.50)				
	Outstanding (1.00)	Excellent (0.80)	Commendable (0.60)	Marginal or Acceptable (0.40)	Unacceptable (0)
Outstanding (1.00)	1.00	0.90	0.80	0.70	0.00
Excellent (0.80)	0.90	0.80	0.70	0.60	0.00
Commendable (0.60)	0.80	0.70	0.60	0.50	0.00
Acceptable (0.00)	—	—	—	—	—
Unacceptable (0.00)	—	—	—	—	—



Incentives for Professionals

- Determining this type of incentive is challenging
- Professionals are well-paid and driven
- Keep highly motivated professionals by using:
 - Stock options and profit sharing
 - Better vacations
 - Home offices
 - Improved pension plans



III. Organizationwide Variable Pay Plans

3.1 Profit-Sharing Plans

3.2 Employee Stock Ownership Plan (ESOP)

3.3 Scanlon Plan

3.4 Gainsharing Plan

3.5 At-Risk Variable Pay Plans

Organization Wide Variable Pay Plans

- Variable pay plans include:
 - ◆ Profit sharing
 - ◆ Employee Stock Ownership Program (ESOP)
 - ◆ Scanlon or gain-sharing plans
 - ◆ At risk plans





3.1 Profit Sharing

- Employees share in some part of profits
- In cash plans
- Lincoln incentive plan
- Deferred plans



3.2 ESOP



- Builds a sense of commitment and ownership in company
- Positive tax advantages for company and employee
- ERISA allows firm to borrow against stock held in trust

ESOP – Research Insight

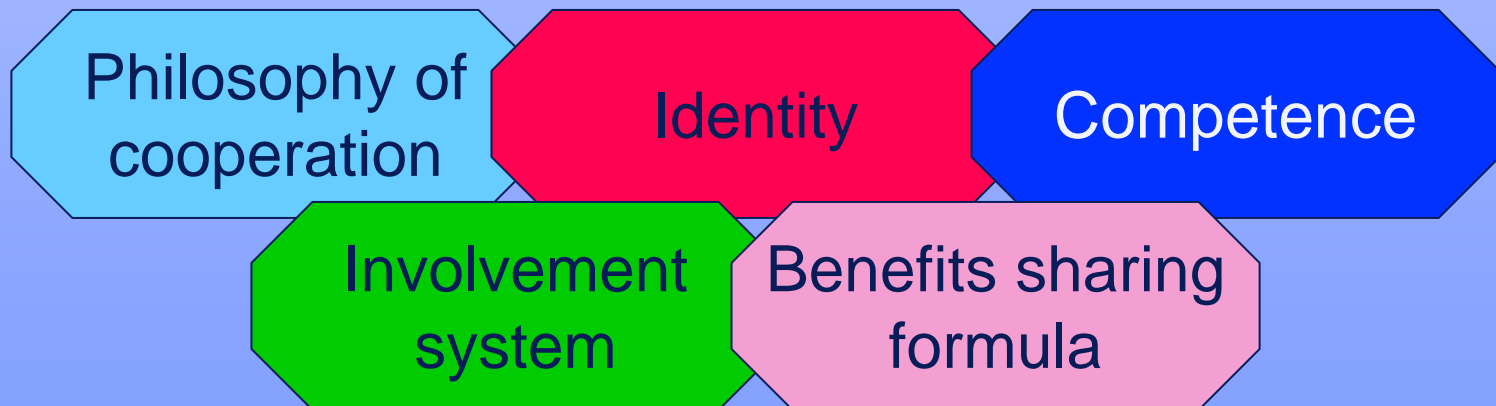
- Thermacore transformed itself
- Attributes success to its employees and rewards them with annual bonus and ESOP program
- All employees get identical bonus
- ESOP is purchased by allotment of private stock





3.3 Scanlon Plan

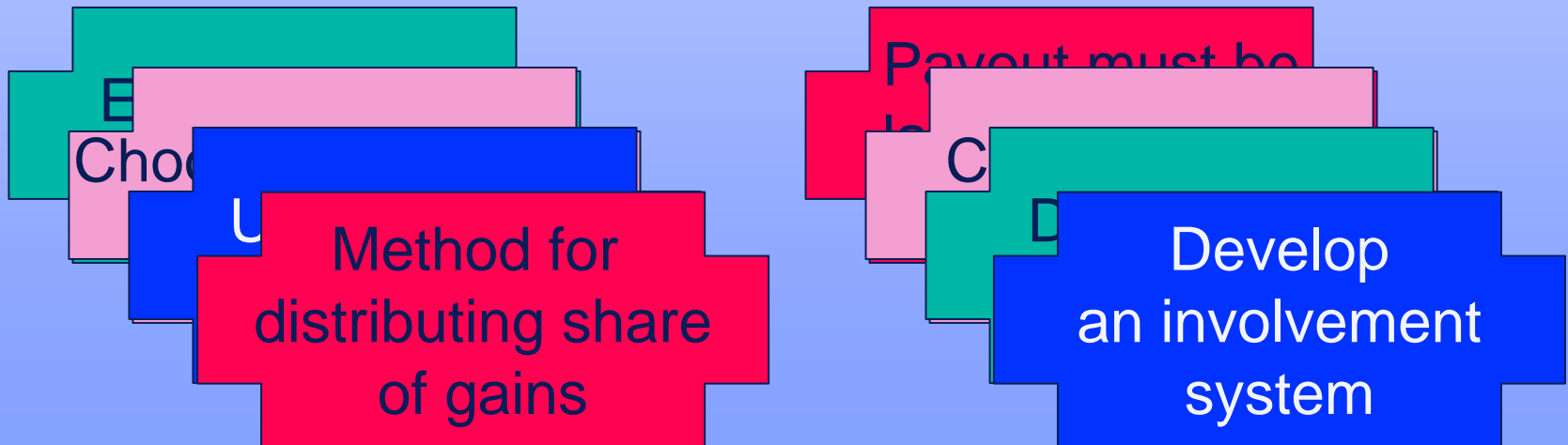
- An incentive plan developed in 1937 by Joseph Scanlon and designed to encourage cooperation, involvement, and sharing of benefits



3.4 Gain sharing



- A modern Scanlon type plan where cost savings are shared
- Eight basic steps:



Making Gainsharing Work

- Use multiple measures
 - ◆ Productivity cost performance, product damage, customer complaints, shipping errors, safety, and attendance
- Committed managers
- Straightforward formula
- Employee involvement



3.5 At Risk Plans

- Some portion of weekly pay at risk
- Exceed goals and get extra pay
- Miss goals and lose some pay
- Employees become committed partners
- Relies on trust, respect, communication and opportunities for advancement

Ameristeel's Incentive Plan



- Having a tough time, Ameristeel made all employees partners in the business
- All employees took immediate cut in pay
 - ◆ All other pay became part of pay at risk plan
 - ◆ Pay was tied to steel production
- Plan worked with profits up 40%

IV. Developing More Effective Incentive Plans



Why Incentive Plans Can Fail

- Performance pay can't replace good management
- You get what you pay for
- Pay is not a motivator
- Rewards punish
- Rewards rupture relationships



Why Incentive Plans Can Fail

- Rewards can unduly restrict performance
- Rewards may undermine responsiveness
- Rewards undermine intrinsic motivation
- People work for more than money



Implementing Incentive Plans

- Use common sense
- Incentive linked to strategy
- Effort linked to reward
- Easily understood
- Set effective standards
- Standard is a contract
- Get support
- Use accurate measurement
- Long and short view
- Consider corporate culture
- Comprehensive commitment oriented approach

Incentive Plans in a Small Business

- In small company, life cycles are short and broad-based, profit sharing is preferred to individual incentives or gainsharing
- Incentive payments should be included in overtime and computation can be complex

Alison worked
45 hours @
\$6.00/hr

+ \$18 bonus

Totals \$288.00

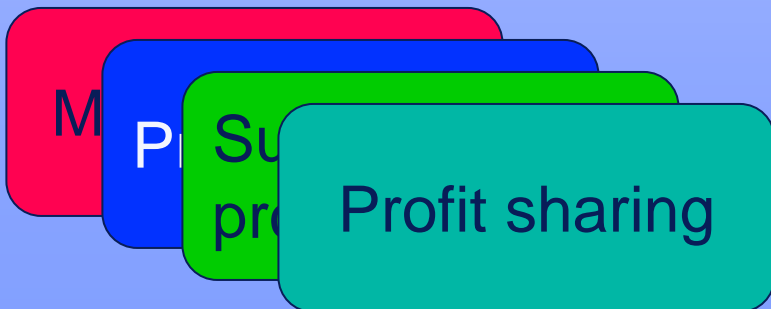
Which is correct?

Totals \$304.00



Incentive Plans in Practice - Insight

- FedEx's pay plan illustrates how firms use innovative incentive plans to boost quality and productivity
- Uses quarterly pay reviews
- Has a strong emphasis on pay for performance



Chapter 9 Summary

- Use of financial incentives can be traced back to Frederick Taylor
- Piecework, straight piecework, and guaranteed piecework all based on production
- Other plans include standard hour plan and group incentive plans



Chapter 9 Summary

- Most sales personnel are paid on commission
- Profit sharing and the Scanlon plan are examples of organization-wide incentive plans
- Gainsharing and merit plans are two other popular plans



Chapter 9 Summary


- Incentive plans work best when
 - ◆ Units of output are easily measured
 - ◆ Employees can control output
 - ◆ The effort/reward relationship is clear
 - ◆ Work delays are under employees' control
 - ◆ Quality is not paramount
 - ◆ The organization must know precise labor costs anyway (to stay competitive)




End of Chapter Case




Wells Fargo Employee Recognition Program. Wells Fargo Bank had a year of record-breaking profits in 1988. Throughout the company, bottom-line oriented managers and their staffs were steeped in the importance of “return to the shareholder.” A renewed focus on the customer was evident in ambitious new customer service standards. Extra effort and constant change became the norm. A decision was made to implement an all-employee reward program for the final quarter of 1988. The objectives of this program included the following:

- 
- To recognize contributions made by employees as a group.
 - To recognize individuals who had made exceptional contributions.
 - To reinforce the qualities most valued in Wells Fargo employees.
 - To have fun.
 - To retain an awareness and an appreciation for the program over an extended period of time.

Wells Fargo developed a program with several elements phased in over about eight months. The program involved three phases: all-employees cash awards, peer recognition through cash bonuses, and corporate recognition of those receiving the most peer recognition. The theme of the program, “In Good Company,” was chosen because it was upbeat and positive and recognized the importance of the team effort as well as the effort of individuals.




To recognize all employees as a group, the program design included a \$550 pretax cash award to be given to every salaried employee (16,000 employees) below the senior vice-president level with at least one year of service. An award of \$50 (pretax) was given to 3,000 hourly employees with a year of service. The cash awards were announced and given to employees by managers in staff meetings. Managers had no prior knowledge of the event. Each employee also received the first issue of the “In Good Company” newsletter with the check. The newsletter explained the \$500 and announced the peer recognition phase of the program. Most of the newsletter focused on the qualities most valued




in a Wells Fargo employee. To answer employee questions about the awards, an “In Good Company” hot-line took calls throughout the duration of the program.

The peer recognition part of the program involved giving a coupon worth \$35 to each employee with a year of service. With the coupon were instructions for awarding \$35 to a co-worker. The rules provided were that an employee could not award the coupon to themselves, no coupons could be given to employees who were senior vice-presidents or above, and coupons could not be awarded to contract workers or temporaries. Any other employee could be given a coupon, even those who did not have a year of service and



had not qualified for any other part of the program. On each coupon, employees were asked to mark the valued quality that the awardee had demonstrated (e.g., “this coupon is a way of saying thanks for inspiring me to excel”). Employees were given three weeks from the date of distribution to return the coupons to payroll for payment. Coupons received after that date were paid, but were not counted for the corporate recognition part of the program. Coupon recipients were tracked by Social Security number to calculate the number of coupons each received and to determine qualifications for corporate recognition.

Employees who received the most coupons were singled out for additional recognition.



Most of those who qualified were from the administrative/clerical ranks of the company. Employees who received the most coupons qualified to select a gift from “101 Awards.” The awards list was constructed to appeal to a wide variety of tastes, lifestyles, and priorities. Examples of the awards included a week off with pay, payment of an individual’s mortgage for a month, grooming for a pet for a year, and four movie tickets a month for a year. The “101 Award” winners were recognized at a cocktail party and dinner hosted by the CEO, president, vice-chairman, and group heads in each winner’s reporting structure.



End of Chapter Case



Questions

1. What are the strengths and weaknesses of the Wells Fargo recognition program? What improvements would you suggest?
2. What part of the program has the strongest link to employee motivation? Why?
3. Assume Wells Fargo has now experienced a year of losses. Cash is not available for the recognition program. How could the program be modified or changed to continue to meet the program objectives?