

# 51 Rewarding Special Groups

## Learning outcomes

On completing this chapter you should know about:

- Elements of directors' and senior executives' pay
- Types of payment for manual workers
- Payment and incentive schemes for sales staff
- Payment by results schemes

## Reward management for directors and executives

### Principles of corporate governance relating to remuneration of directors

The key principles of corporate governance as it affects the remuneration of directors, which emerged from various reviews, namely the Cadbury, Greenbury and Hampel Reports, are as follows:

- Remuneration committees should consist exclusively of non-executive directors. Their purpose is to provide an independent basis for setting the salary levels and the rules covering incentives, share options, benefit entitlements and contract provisions for executive directors. Such committees are accountable to shareholders for the decisions they take and the non-executive directors who sit on them should have no personal financial interests at stake. They should be constituted as sub-committees of company boards and boards should elect both the chairman and the members.
- Remuneration committees must provide a remuneration package sufficient to attract, retain and motivate directors, but should avoid paying more than is necessary. They should be sensitive to wider issues, eg pay and employment conditions elsewhere in the company.
- Remuneration committees should take a robust line on the payment of compensation where performance has been unsatisfactory.
- Performance-related elements should be designed to align the interests of directors and shareholders.
- Any new longer-term incentive arrangement should, preferably, replace existing executive share option plans, or at least form part of an integrated approach that should be approved by shareholders.
- The pension consequences and associated costs to the company of increases in base salary should be considered.
- Notice or service contract periods should be set at, or reduced to, a year or less. However, in some cases periods of up to two years may be acceptable.

### Elements of directors' and senior executives' pay

The main elements of directors' and senior executives' pay are basic pay, bonus or incentive schemes, share option and share ownership schemes.

## Basic pay

Decisions on the base salary of directors and senior executives are usually founded on largely subjective views about the market worth of the individuals concerned. Remuneration on joining the company is commonly settled by negotiation, often subject to the approval of a remuneration committee. Reviews of base salaries are then undertaken by reference to market movements and success as measured by company performance. Decisions on base salary are important not only in themselves but also because the level may influence decisions on the pay of both senior and middle managers. Bonuses are expressed as a percentage of base salary, share options may be allocated as a declared multiple of basic pay and, commonly, the pension will be a proportion of final salary.

## Bonus schemes

Virtually all major employers in the UK (90 per cent according to recent surveys by organizations such as Monks and Hay) provide annual incentive (bonus) schemes for senior executives. Bonus schemes provide directors and executives with cash sums based on the measures of company and, frequently, individual performance.

Typically, bonus payments are linked to achievement of profit and/or other financial targets and they are sometimes 'capped', ie a restriction is placed on the maximum amount payable. There may also be elements related to achieving specific goals and to individual performance.

## Share option schemes

Many companies have share option schemes, which give directors and executives the right to buy a block of shares on some future date at the share price ruling when the option was granted. They are a form of long-term incentive on the assumption that executives will be motivated to perform more effectively if they can anticipate a substantial capital gain when they sell their shares at a price above that prevailing when they took up the option.

## Executive restricted share schemes

Under such schemes free shares are provisionally awarded to participants. These shares do not belong to the executive until they are released or vested; hence they are 'restricted'. The number of shares actually released to the executive at the end of a defined period (usually three or, less commonly, five years) will depend on performance over that period against specific targets. Thereafter there may be a further retention period when the shares must be held, although no further performance conditions apply.

## Reward management for sales representatives

There are no hard-and-fast rules governing how sales representatives should be paid. It depends on the type of company, the products or services it offers its customers, and the nature of the sales process – how sales are organized and made. The different methods are described in Table 51.1.

**Table 51.1** Summary of payment and incentive arrangements for sales staff

Method	Features	Advantages	Disadvantages	When appropriate
Salary only	Straight salary, no commission or bonus	Encourage customer service rather than high pressure selling; deal with the problem of staff who are working in a new or unproductive sales territory; protect income when sales fluctuate for reasons beyond the individual's control	No direct motivation through money; may attract under-achieving people who are subsidized by high achievers; increases fixed costs of sales because pay costs are not flexed with sales results	When representing the company is more important than direct selling; staff have little influence on sales volume (they may simply be 'order takers'); customer service is all-important
Salary plus commission	Basic salary plus cash commission calculated as a percentage of sales volume or value	Direct financial motivation is provided related to what sales staff are there to do, ie generate sales; but they are not entirely dependent on commission – they are cushioned by their base salary	Relating pay to the volume or value of sales is too crude an approach and may result in staff going for volume by concentrating on the easier to sell products, not those generating high margins; may encourage high-pressure selling as in some financial services firms in the 1980s and 1990s	When it is believed that the way to get more sales is to link extra money to results, but a base salary is still needed to attract the many people who want to be assured of a reasonable basic salary that will not fluctuate but who still aspire to increase that salary by their own efforts

Table 51.1 *continued*

Method	Features	Advantages	Disadvantages	When appropriate
Salary plus bonus	Basic salary plus cash bonus based on achieving and exceeding sales targets or quotas and meeting other selling objectives	Provide financial motivation but targets or objectives can be flexed to ensure that particular sales goals are achieved, eg high-margin sales, customer service	Do not have a clear line of sight between effort and reward; may be complex to administer; sales representative may find them hard to understand and resent the use of subjective judgments on performance other than sales	When flexibility in providing rewards is important; it is felt that sales staff need to be motivated to focus on aspects of their work other than simply maximizing sales volume
Commission only	Only commission based on a percentage of sales volume or value is paid, there is no basic salary	Provide a direct financial incentive; attract high performing sales staff; ensure that selling costs vary directly with sales; little direct supervision required	Lead to high-pressure selling; may attract the wrong sort of people who are interested only in money and not customer service; focus attention on high volume rather than profitability	When sales performance depends mainly on selling ability and can be measured by immediate sales results; staff are not involved in non-selling activities; continuing relationships with customers are relatively unimportant
Additional non-cash rewards	Incentives, prizes, cars, recognition, opportunities to grow	Utilize powerful non-financial motivators	May be difficult to administer; do not provide a direct incentive	When it is believed that other methods of payment need to be enhanced by providing additional motivators

## Paying manual workers

The pay of manual workers takes the form of time rates, also known as day rates, day work, flat rates or hourly rates. Incentive payments by means of payment-by-results schemes may be made on top of a base rate.

### Time rates

These provide workers with a predetermined rate for the actual hours they work. Time rates on their own are most commonly used when it is thought that it is impossible or undesirable to use a payment-by-results system, for example in maintenance work. From the viewpoint of employees, the advantage of time rates is that their earnings are predictable and steady and they do not have to engage in endless arguments with rate fixers and supervisors about piece rates or time allowances. The argument against them is that they do not provide a direct incentive relating the reward to the effort or the results. Two ways of modifying the basic time rate approach are to adopt high day rates, as described below, or measured day work.

Time rates may take the form of what are often called 'high day rates'. These are higher than the minimum time rate and may contain a consolidated bonus rate element. The underlying assumption is that higher base rates will encourage greater effort without the problems created when operating an incentive scheme. High day rates are usually above the local market rates, to attract and retain workers.

### Payment-by-result schemes

Payment-by-result (PBR) schemes provide incentives to workers by relating their pay or, more usually, part of their pay to the number of items they produce or the time taken to do a certain amount of work. The main types of PBR or incentive schemes for individuals are piece work, work measured schemes, measured day work and performance-related pay. Team bonus schemes are an alternative to individual PBR and plant-wide schemes can produce bonuses that are paid instead of individual or team bonuses, or in addition to them. Each of these methods is described in Table 51.2, together with an assessment of their advantages and disadvantages for employers and employees, and when they are appropriate.

**Table 51.2** Comparison of shop floor payment-by-results schemes

Scheme	Main features	For employers		For employees		When appropriate
		Advantages	Disadvantages	Advantages	Disadvantages	
Piece work	Bonus directly related to output	Direct motivation; simple, easy to operate	Lose control over output; quality problems	Predict and control earnings in the short term; regulate pace of work themselves	More difficult to predict and control earnings in the longer term; work may be stressful and produce RSI	Fairly limited application to work involving unit production controlled by the person eg agriculture, garment manufacture
Work-measured schemes	Work measurement used to determine standard output levels over a period or standard times for job/tasks; bonus based by reference to performance ratings compared with actual performance or time saved	Provides what appears to be a 'scientific' method of relating reward to performance; can produce significant increases in productivity, at least in the short term	Schemes are expensive, time-consuming and difficult to run and can too easily degenerate and cause wage drift because of loose rates	Appear to provide a more objective method of relating pay to performance; employees can be involved in the rating process to ensure fairness	Ratings are still prone to subjective judgement and earnings can fluctuate because of changes in work requirements outside the control of employees	For short-cycle repetitive work where changes in the work mix or design changes are infrequent, down time is restricted, and management and supervision are capable of managing and maintaining the scheme

Table 51.2 *continued*

Scheme	Main features	For employers		For employees		When appropriate
		Advantages	Disadvantages	Advantages	Disadvantages	
Measured day work	Pay fixed at a high rate on the understanding that a high level of performance against work-measured standards will be maintained	Employees are under an obligation to work at the specified level of performance	Performance targets can become easily attained norms and may be difficult to change	High predictable earnings are provided	No opportunities for individuals to be rewarded in line with their own efforts	Everyone must be totally committed to making it work; high standards of work measurement are essential; good control systems to identify shortfalls on targets
Performance-related pay	Payments on top of base rate are made related to individual assessments of performance	Reward individual contribution without resource to work measurement; relevant in high technology manufacturing	Measuring performance can be difficult; no direct incentive provided	Opportunity to be rewarded for own efforts without having to submit to a pressured PBR system	Assessment informing performance pay decisions may be biased, inconsistent or unsupported by evidence	As part of a reward harmonization (shop floor and staff) programme; as an alternative to work measured schemes or an enhancement of a high day rate system

**Table 51.2** *continued*

Scheme	Main features	For employers		For employees		When appropriate
		Advantages	Disadvantages	Advantages	Disadvantages	
Group or team basis	Groups or teams are paid bonuses on the basis of their performance as indicated by work measurement ratings or the achievement of targets	Encourage team co-operation and effort; not too individualized	Direct incentive may be limited; depends on good work measurement or the availability of clear group output or productivity targets	Bonuses can be related clearly to the joint efforts of the group; fluctuations in earnings minimized	Depend on effective work measurement, which is not always available; individual effort and contribution not recognized	When team working is important and team efforts can be accurately measured and assessed; as an alternative to individual PBR if this is not effective
Factory wide bonuses	Bonuses related to plant performance – added value or productivity	Increase commitment by sharing success	No direct motivation	Earnings increased without individual pressure	Bonuses often small and unpredictable	As an addition to other forms of incentive when increasing commitment is important

## Rewarding special groups – key learning points

### **Elements of directors' and senior executives' pay**

Basic pay, bonus schemes, share options, executive restricted share schemes.

### **Payment and incentive schemes for sales staff**

Summarized in Table 51.1.

### **Types of payment for manual workers**

The pay of manual workers takes the form of time rates, also known as day rates, day work, flat rates or hourly rates. Incentive

payments by means of payment-by-results schemes may be made on top of a base rate.

### **Payment-by-results schemes**

Payment-by-result (PBR) schemes provide incentives to workers by relating their pay or, more usually, part of their pay to the number of items they produce or the time taken to do a certain amount of work. The main types of PBR or incentive schemes for individuals are piece work, work measured schemes, measured day work and performance-related pay.

## Questions

1. What is the function of a remuneration committee?
2. What are the advantages and disadvantages for employers and employees of work-measured payment by result schemes?
3. What are the main methods of rewarding sales staff?