

12

Incentive Plans and Executive Compensation

After you have read this chapter, you should be able to:

- Define variable pay and identify three elements of successful pay-for-performance plans.
- Discuss three types of individual incentives.
- Identify key concerns that must be addressed when designing group/team variable pay plans.
- Discuss why profit sharing and employee stock ownership are common organizational incentive plans.
- Explain three ways that sales employees are typically compensated.
- Identify the components of executive compensation and discuss criticisms of executive compensation levels.

Variable Pay at Cox Communications



Cox Communications is a well-known large firm with 20 local markets. Even though the company offers many of the same services in all of its markets, each market has differences in terms of services, customer growth, and operational factors. Cox allows local management to develop incentive plans for employees based on the different market areas, but provides a basic variable pay framework as a guide.

Although Cox has more than 400 different incentive plans, managers review the plans using four major guidelines. One guideline is used to determine the applicability of various incentives to different types of jobs. Another is to measure performance on local job tasks and unusual demands. This can identify jobs and unique aspects in each. Additionally,

the variable pay framework considers the mechanics used to make payouts, including selected performance measures and formulas used for the payouts. The final factor considers two components of timing: the periods for both the performance measures and the payouts.

The Cox incentive programs serve all types and locations of employees well. Varying incentives reflects the differences faced by service technicians, sales representatives, telephone contact workers, executives, managers, HR professionals, and other employees. However, by developing and administering the unique variable pay framework, Cox ties an effective approach to variable pay and incentives to the company's organizational success efforts.¹

Pay for performance can be a part of total rewards. As discussed in the previous chapter, more employers are moving toward systems providing base pay for performance using matrixes and other means, rather than just giving all workers a standard percentage increase in pay. If the question is whether people work harder because pay is tied to performance, the answer is yes.

Tying pay to performance holds a promise that both employers and employees find attractive. For employees, it can mean more pay; for employers, it can mean more output per employee and therefore more productivity. However, it is much more difficult to design a successful variable pay or special incentive system than to simply pay employees a set hourly wage or salary.

Variable pay programs are very popular, with more than 80% of organizations using them, according to a WorldatWork annual survey. The most widely used of these programs involve awards based on individual, unit, and organizational performance and success.² Common types of variable pay programs are based on factors such as sales, customer service, productivity, attendance, safety, and executive incentives.

VARIABLE PAY: INCENTIVES FOR PERFORMANCE

Variable pay is compensation linked to individual, group/team, and/or organizational performance. Variable pay plans attempt to provide tangible rewards, traditionally known as *incentives*, to employees for performance beyond normal expectations. The philosophical foundation of incentives rests on several basic assumptions:

- Some jobs contribute more to organizational success than others.
- Some people perform better and are more productive than others.
- Employees who perform better should receive more compensation.
- Many employees' total compensation should be tied directly to performance and results.

Pay for performance has a different philosophical base than does a more traditional compensation system, in which differences in job responsibilities are recognized through different amounts of base pay. In many organizations, length of service is a primary differentiating factor. However, giving additional rewards to some people and not others is seen as potentially divisive and as hampering employees' working together. This is why many labor unions oppose pay-for-performance programs. In contrast, high-performing workers expect extra rewards for outstanding performance that increases organizational results.

Incentives can take many forms. For example, they can include simple praise, "recognition and reward" programs that award trips and merchandise, bonuses for performance accomplishments, and rewards for successful results for the company. A variety of possibilities are discussed later in this chapter. A successful plan will include a combination of different types of incentives.

Developing Successful Pay-for-Performance Plans

Employers adopt variable pay or incentive plans for a number of reasons. Key reasons that many employers adopt these plans are as follows:

- Link strategic business goals and employee performance
- Enhance organizational results and reward employees financially for their contributions

Variable pay Compensation linked to individual, group/team, and/or organizational performance.

- Recognize different levels of employee performance through different rewards
- Achieve HR objectives, such as increasing retention, reducing turnover, recognizing training, and rewarding safety

As economic conditions have changed in industries and among employers, the use of variable pay incentives has changed as well. Under variable pay programs, employees can have a greater sharing of the gains or declines in organizational performance results. Even in organizations where the number of staff members has been reduced, such as investment firms, employers are switching from base pay to variable compensation means.³

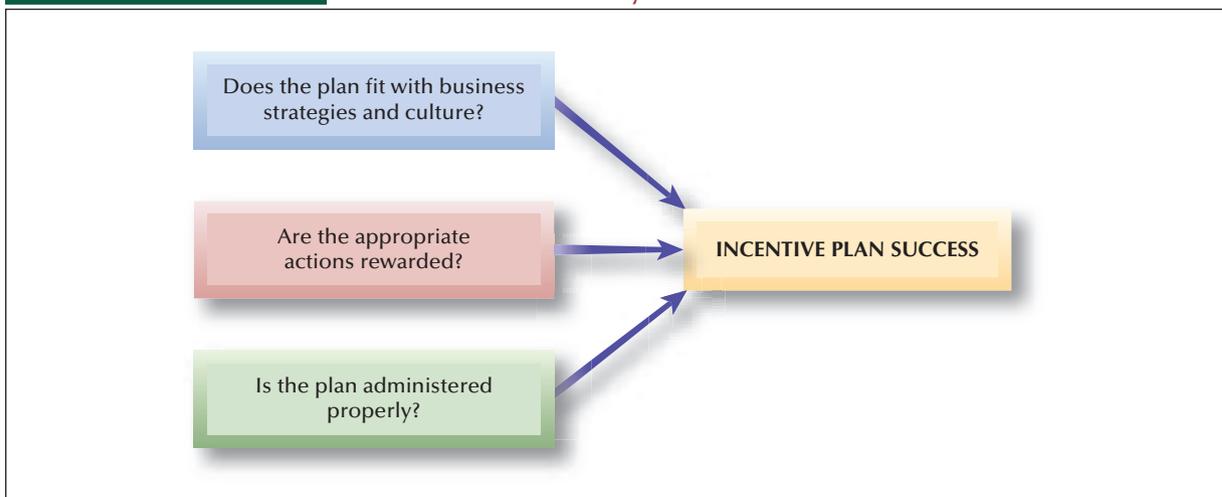
Variable pay plans can be considered successful if they meet the objectives the organization had for them when they were initiated and if they work with the organizational culture and the financial resources of the organization. Both financial and nonfinancial rewards for performance are important in pay-for-performance plans. The manner in which targets are set and measured is important.⁴ Three elements that affect the success of variable pay systems are discussed next. These are highlighted in Figure 12-1.

Does the Plan Fit the Organization? The success of any incentive pay program relies on its consistency with the culture of the organization.⁵ For example, if an organization is autocratic and adheres to traditional rules and procedures, an incentive system that rewards flexibility and teamwork is likely to fail. In such a case, the incentive plan has been “planted” in the wrong growing environment.

When it comes to variable pay-for-performance plans, one size does not fit all.⁶ A plan that has worked well for one company will not necessarily work well for another. For instance, in professional service firms, performance measures such as client progress and productivity, new business development revenues, client satisfaction, and profit contributions are typically linked to pay-for-performance programs.⁷ These measures might not work as well in a different industry. For an incentive plan to work, it must be linked to the objectives of the organization, its financial resources, and its desired performance results. However, when these criteria are met, many employers find that

FIGURE 12-1

Effective Variable Pay Plans



Awarding Points for Staff Efforts



One incentive that is widely used is award points. For taking certain actions or accomplishing designated results, the individual employees can get point-based incentive awards in addition to their pay. Examples from different industries illustrate the potential effectiveness of using this type of incentive.

One of the staffing concerns in hospitals is staffing certain work shifts. Instead of using independent contract persons to cover some shifts, some health care facilities are using award points and other incentives to encourage employees to be the extra shift workers. For example, at a Hawaiian hospital, employees who request night shifts or 8-hour days get awarded extra award points in addition to their pay. The employees can use their points for gasoline cards, tuition benefits, gift cards, and other awards. The impact of this system

for the hospital is that about 70% of the firm's unfilled shift hours are being covered by employees who get the award-point incentives. Over an extended period of time, more than 100,000 extra shift hours by workers were aligned with the awards.

Similar programs have been used in other industries. For instance, one airline used point-based awards to reward customer service personnel for getting more fees on overweight checked passenger bags. Also, the airline employees received such awards for community service, nonprofit volunteer activities, and other behaviors.

Different types of incentive systems have grown in usage in numerous other firms, industries, and organizational settings. This discussion illustrates how custom tailoring incentives can reward employees for desired actions.⁸

variable pay plans make performance results a higher priority than just how employees behave in their jobs, thus contributing to positive organizational results.

Does the Plan Reward Appropriate Actions? Variable pay systems should be tied as much as possible to desired performance. Employees must see a direct relationship between their efforts and their financial and nonfinancial rewards, as the HR Perspective illustrates.

Because people tend to produce what is measured and rewarded, organizations must make sure that what is being rewarded is clearly linked to what is needed. For instance, in a highly innovative firm, incentives may be very motivating for managers, given economic and other organizational performance impacts.⁹ Performance measures need to give appropriate emphasis and weights for calculating incentives in order for the programs to be effective. If incentive measures are manipulated or inappropriate, the variable pay systems may not be as effective.¹⁰

Use of multiple measures helps to ensure that important performance dimensions are not omitted. For example, assume a hotel reservation center wants to set incentives for employees to increase productivity by lowering the time they spend on each call. If that reduction is the only measure, the quality of customer service and the number of reservations made might drop as employees rush callers in order to reduce talk time. Therefore, the center should consider basing rewards on multiple measures, such as talk time, reservations booked, and the results of customer satisfaction surveys.

Linking pay to performance may not always be appropriate. For instance, if the output cannot be measured objectively, management may not be able

to correctly reward the higher performers with more pay. Managers may not even be able to accurately identify the higher performers. For example, in an office where tasks are to provide permits for building renovations, individual contributions may not be identifiable or appropriate.

Is the Plan Administered Properly? A variable pay plan may be complex or simple, but it will be successful only if employees understand what they have to do to be rewarded. The more complicated a plan is the more difficult it will be to communicate it meaningfully to employees. Experts generally recommend that a variable pay plan include several performance criteria. But having multiple areas of focus should not overly complicate the calculations necessary for employees to determine their own incentive amounts. Managers also need to be able to explain clearly what future performance targets need to be met and what the rewards will be.



Global Variable Pay

Variable pay is expanding in global firms, as well as among foreign-country employers. In Europe, Asia, and Latin America, more than 80% of management professionals and general staff are eligible for broad-based variable pay plans. Many programs are similar to those at U.S.-based companies, but global programs must accommodate cultural, legal, and economic differences.¹¹ For firms with operations in multiple countries, having widely spread incentives requires that local managers be trained to control the reward programs and that the different choices in the programs are beneficial for success.¹²

Although administering any incentive plan can be difficult, global incentive programs can be especially complex. A company may have an overarching strategy, such as growing market share or increasing the bottom line, but that strategy frequently works out to different goals in different geographical regions. Also, laws and regulations differ from one country to the next. For example, in Latin America, there are mandatory profit-sharing regulations, so variable pay must reflect that. Countries such as China and India use individual incentives more widely than do the United States and Europe. However, to attract and retain expatriates, who are persons from one country working in another one, both salaries and incentives must be considered.



Metrics for Variable Pay Plans

Firms in the United States are spending significant amounts on variable pay plans as incentives. For instance, according to one survey, incentive expenditures in one year totaled \$46 billion. Interestingly, more than \$30 billion was paid on incentive merchandise and about \$13 billion was spent on travel incentives. With such incentive expenditures increasing each year, it is crucial that the results of variable pay plans be measured to determine the success of the programs.¹³

Various metrics can be used, depending on the nature of the plan and the goals set for it. Figure 12-2 shows some examples of different metrics that can be used to evaluate variable play plans.

A common metric for incentive plans is return on investment (ROI). One firm, Leapfrog Group, has developed an ROI Estimator for its hospital pay-for-performance plan on health care activities, such as heart bypass, angioplasty, and others.¹⁴ To illustrate a general ROI example, suppose a company decides that using a program to provide rewards in the form of lottery drawing

FIGURE 12-2

Metric Options for Variable Pay Plans



chances each month for employees who were not absent during the month will reduce absenteeism. An ROI metric would look at the dollar value of the improvement minus the cost of the program divided by the total cost. So if the value of the reduction in absenteeism was \$100,000 per year, and the program cost \$85,000, calculations would be $(100,000 - 85,000) \div 85,000$, for just over a 17% return on the investment.

Other metrics also can be used to evaluate programs for management decision making. Regardless of the variable pay plan, employers should gather and evaluate data to determine if the expenditures are justified by increased organizational operating performance.¹⁵ If the measures and analyses show positive results, the nature of the plan is truly a pay-for-performance one. If not, the plan should be changed to one that is more likely to be successful.

Successes and Failures of Variable Pay Plans

Even though variable pay has grown in popularity, some attempts at incentives have succeeded while others have not. Incentives *do* work, but they are not a panacea because their success depends on multiple factors.¹⁶ The positive view that many employers have of variable pay is not shared by all workers. If individuals see incentives as desirable, they are likely to put forth the extra effort to attain the performance objectives that trigger the incentive payouts. But not all employees believe that they are rewarded when doing a good job, and not all employees are motivated by their employers' incentive plans.

Some employees prefer increases in their pay over noncash incentives, but noncash incentives do motivate some workers to perform better than cash rewards do. In addition, a research study concluded that the incentives employees say they desire may not be ones that actually lead to higher performance results.¹⁷

One factor that can lead to failure of a variable pay plan is having an incentive plan that is too complex for employees and management to understand. If the plan is too complicated to follow, the focus may not be on successful performance, employee misunderstanding and miscommunications can occur, and lower performance may be the result.¹⁸

Given these dynamics and the complexity of these plans, providing a variable pay plan that will be successful requires significant, continuing efforts.¹⁹ Some factors that contribute to the success of incentive plans are as follows:

- Develop clear, understandable plans that are continually communicated.
- Use realistic performance measures.
- Keep the plans current and linked to organizational objectives.
- Clearly link performance results to payouts that truly recognize performance differences.
- Identify variable pay incentives separately from base pay.

Three Categories of Variable Pay

The incentives offered in variable pay plans can be classified into three categories: individual, group/team, and organizational. There are advantages and disadvantages to each.

Individual incentives are given to reward the effort and performance of individuals. Some common means of providing individual variable pay are piece-rate systems, sales commissions, and individual bonuses. Others include special recognition rewards such as trips or merchandise. However, with individual incentives, employees may focus on what is best for them personally, which may inhibit the performance of other individuals with whom they are competing. For this reason, in some situations, group/team incentives may be more appropriate.

When an organization rewards an entire group/team for its performance, cooperation among the members may increase. The most common *group/team incentives* are gainsharing or goalsharing plans, in which the employees on a team that meets certain goals, as measured against performance targets, share in the gains. Often such programs focus on quality improvement, cost reduction, and other measurable results.

Organizational incentives reward people according to the performance results of the entire organization. This approach assumes that all employees working together can generate improved organizational results that lead to better financial performance. These programs often share some of the financial gains made by the firm with employees through payments calculated as a percentage of the employees' base pay. The most prevalent forms of organization-wide incentives are profit-sharing plans and employee stock plans.

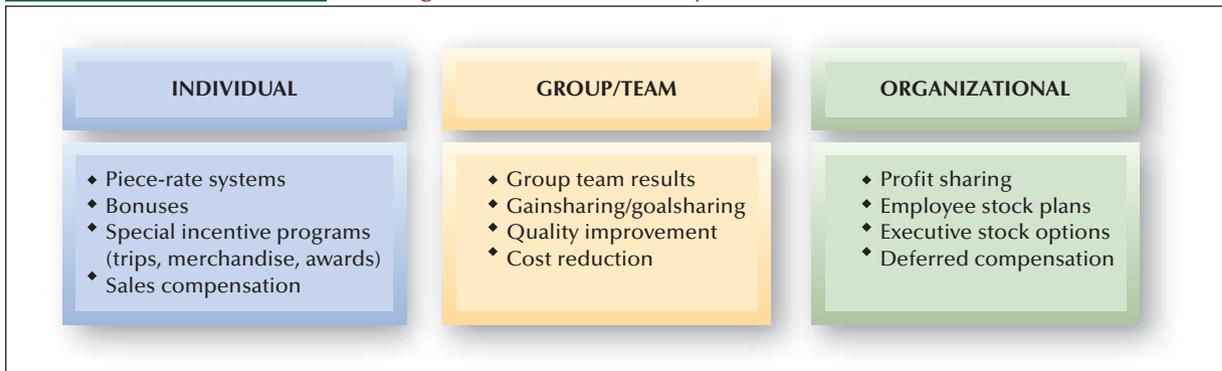
Figure 12-3 shows some of the programs that fall under each type of incentive or variable pay plan. These programs are discussed in the following sections.



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FIGURE 12-3 Categories of Variable Pay Plans



INDIVIDUAL INCENTIVES

Individual incentive systems tie personal effort to additional rewards. Conditions necessary for the use of individual incentive plans are as follows:

- *Individual performance must be identified.* The performance of each individual must be measured and identified because each employee has job responsibilities and tasks that can be separated from those of other employees.
- *Individual competitiveness must be desired.* Because individuals generally pursue the incentives for themselves, competition among employees often occurs. Therefore, independent competition in which some individuals “win” and others do not must be something the employer can tolerate.
- *Individualism must be stressed in the organizational culture.* The culture of the organization must be one that emphasizes individual growth, achievements, and rewards. If an organization emphasizes teamwork and cooperation, then individual incentives may be counterproductive.

Piece-Rate Systems

The most basic individual incentive systems are piece-rate systems. Under **straight piece-rate system**, wages are determined by multiplying the number of units produced (such as garments sewn or service calls handled) by the piece rate for one unit. Because the cost is the same for each unit, the wage for each employee is easy to figure, and labor costs can be accurately predicted.

A *differential piece-rate system* pays employees one piece-rate wage for units produced up to a standard output and a higher piece-rate wage for units produced over the standard. Managers often determine the quotas or standards by using time and motion studies. For example, assume that the standard quota for a worker is set at 300 units per day and the standard rate is 14 cents per unit. However, for all units over the standard, the employee receives 20 cents per unit. Under this system, the worker who produces 400 units in one day would get \$62 ($300 \times 14¢$) + ($100 \times 20¢$). Many possible combinations of straight and differential piece-rate systems can be used, depending on situational factors.

Despite their incentive value, piece-rate systems can be difficult to apply because determining standards is a complex and costly process for many types of jobs. In some instances, the cost of determining and maintaining the standards may be greater than the benefits derived. Also, jobs in which individuals have limited control over output or in which high standards of quality are necessary may be unsuited to piecework unless quality can be measured.

Bonuses

Individual employees may receive additional compensation in the form of a **bonus**, which is a one-time payment that does not become part of the employee’s base pay. Individual bonuses are used at all levels in some firms and are the most popular short-term incentive plan.

A bonus can recognize performance by an employee, a team, or the organization as a whole. When performance results are good, bonuses go up. When performance results are not met, bonuses go down. Most employers base part of an employee’s bonus on individual performance and part on

Straight piece-rate system

Pay system in which wages are determined by multiplying the number of units produced by the piece rate for one unit.

Bonus One-time payment that does not become part of the employee’s base pay.

company results, as appropriate. Numerous CEOs receive bonuses based on specific results.²⁰

Bonuses also can be used to reward employees for contributing new ideas, developing skills, or obtaining professional certifications. When helpful skills or certifications are acquired by an employee, a pay increase or a one-time bonus may follow. For example, a financial services firm provides the equivalent of two weeks' pay to employees who master job-relevant computer skills. Another firm gives one week of additional pay to members of the HR staff who obtain professional certifications such as Professional in Human Resources (PHR), Senior Professional in Human Resources (SPHR), or Certified Compensation Professional (CCP).

“Spot” Bonuses A unique type of bonus used is a “spot” bonus, so called because it can be awarded at any time. Spot bonuses are given for a number of reasons, perhaps for extra time worked, extra efforts, or an especially demanding project. For instance, a spot bonus may be given to an information technology employee who installed a computer software upgrade that required extensive time and effort.

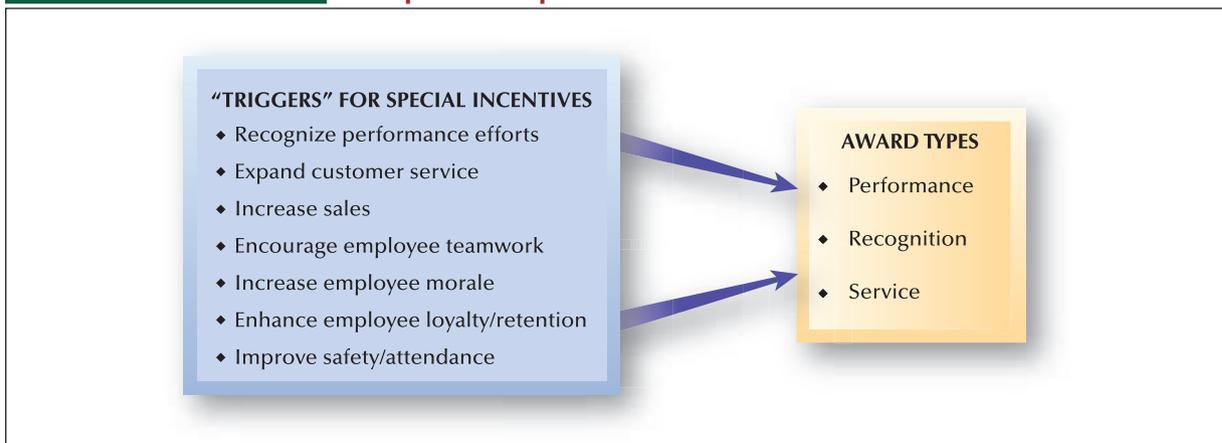
Often, spot bonuses are given in cash, although some firms provide managers with gift cards, travel vouchers, or other noncash rewards. Noncash rewards vary in types and levels, but they need to be immediately visible and useful to be seen as desirable by individuals.²¹ The keys to successful use of spot bonuses are to keep the amounts reasonable and to provide them only for exceptional performance accomplishments. The downside to their use is that they can create jealousy and resentment in other employees who feel that they deserved a spot bonus but did not get one.

Special Incentive Programs

Numerous special incentive programs can be used to reward individuals, ranging from one-time contests for meeting performance targets to awards for performance over time. For instance, safe-driving awards are given to truck drivers with no accidents or violations on their records during a year. Although special programs can be developed for groups and for entire organizations, they often focus on rewarding individuals. Special incentives are used for several purposes, as noted in Figure 12-4.

FIGURE 12-4

Purposes of Special Incentives



Performance Awards Cash, merchandise, gift certificates, and travel are the most frequently used incentive rewards for significant performance. Cash is still highly valued by many employees because they can decide how to spend it. However, noncash incentives may be stronger motivators, based on a study that considered awards such as vacation cruises, home kitchen equipment, groceries, and other noncash items.²² For instance, travel awards appeal to many U.S. employees, particularly trips to popular destinations such as Disney World, Las Vegas, Hawaii, and international locations. These examples indicate that many employees appreciate the “trophy” value of such awards as much as the actual monetary value.

Recognition Awards Another type of program recognizes individual employees for their performance. For instance, many organizations in industries such as hotels, restaurants, and retailers have established “employee of the month” and “employee of the year” awards. Hotels often use favorable guest comment cards as the basis for providing recognition awards to front desk representatives, housekeepers, and other hourly employees.

Recognition awards often work best when given to acknowledge specific efforts and activities that the organization has targeted as important. Global employers may use recognition awards that reflect cultural differences in various countries. The criteria for selecting award winners may be determined subjectively in some situations. However, formally identified criteria provide greater objectivity and are more likely to be seen as rewarding performance rather than as favoritism. When giving recognition awards, organizations should use specific examples to describe clearly how those receiving the awards were selected.

Service Awards Another type of reward given to individual employees is the service award. Although service awards often are portrayed as rewarding performance over a number of years, in reality the programs in most firms recognize length of service (e.g., 1, 3, 5, or 10 years) more than employees’ actual performance. Many of these awards increase in value as the length of service increases, and often they are made as dollar amounts rather than as gifts.

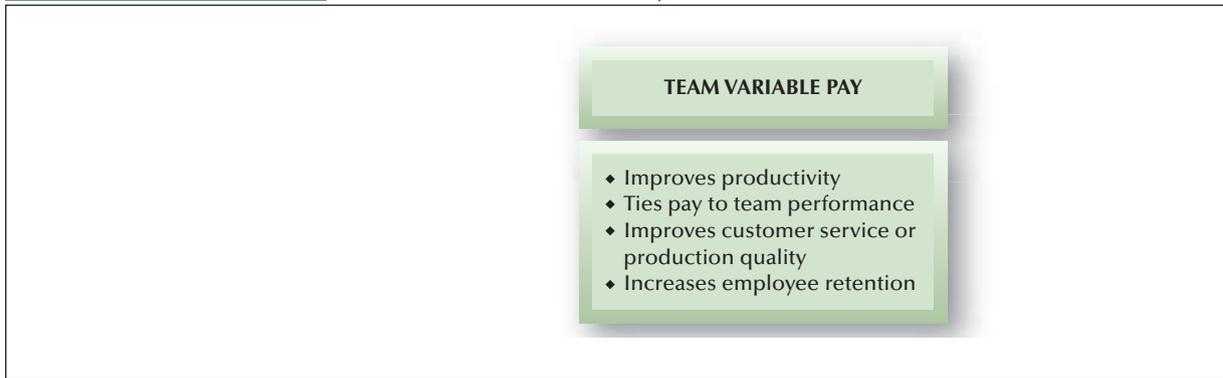
Some firms give recipients gift cards to retail or restaurant locations, while others let qualifying employees select items from a range of merchandise choices (e.g., cameras, watches, and other items). Different firms offer employees of certain lengths of service special trips to resorts or social events. The overall goal of these awards is to give appreciation to employees for service.²³

GROUP/TEAM INCENTIVES

The use of groups/teams in organizations has implications for incentive compensation. Although the use of groups/teams has increased substantially in the past few years, the question of how to compensate their members equitably remains a significant challenge. Many firms provide rewards for work groups or teams in different ways and for several reasons, as Figure 12-5 notes.

Team incentives can take the form of either cash bonuses for the team or items other than money, such as merchandise or trips. But group incentive situations may place social pressure on members of the group. Everyone in the group succeeds or fails. Therefore, some argue that team incentives should be given to team members equally, although not everyone agrees.

FIGURE 12-5

Teams and Variable Pay Plan Results

Design of Group/Team Incentive Plans

In designing group/team incentive plans, organizations must consider a number of issues. The main concerns are how and when to distribute the incentives, and who will make decisions about the incentive amounts.

Distribution of Group/Team Incentives Several decisions about how to distribute and allocate group/team rewards must be made. The two primary ways for distributing those rewards are as follows:

1. *Same-size reward for each member:* All members receive the same payout, regardless of job level, current pay, seniority, or individual performance differences.
2. *Different-size reward for each member:* Employers vary individual rewards depending on such factors as contribution to group/team results, current pay, years of experience, and skill levels of jobs performed.

Generally, more organizations use the first approach. The combination of equal team member award payouts and individual pay differences rewards performance by making the group/team incentive equal while also recognizing that individual differences exist and are important to many employees. The size of the group/team incentive can be determined either by using a percentage of base pay for the individuals or the group/team as a whole, or by offering a specific dollar amount. For example, one firm pays members individual base rates that reflect years of experience and any additional training that they have. Additionally, the group/team reward is distributed to all as a flat dollar amount.

Timing of Group/Team Incentives How often group/team incentives are paid out is another important consideration. Choices seen in firms with group/team incentives are monthly, quarterly, semiannually, and annually, although the most common period used is annually. However, the shorter the time period, the greater the likelihood that employees will see a closer link between their efforts and the performance results that trigger the award payouts. For instance, employers may limit the group/team rewards to \$1,000 or less, allowing them to pay out rewards more frequently. The nature of the teamwork, measurement criteria, and organizational results must all be considered when determining the appropriate time period.

Decision Making about Group/Team Incentive Amounts To reinforce the effectiveness of working together, some group/team incentive programs allow members to make decisions about how to allocate the rewards to individuals. In some situations, members vote; in some, a group/team leader decides. In other situations, the incentive “pot” is divided equally, thus avoiding conflict and recognizing that all members contributed to the team results. However, many companies have found group/team members unwilling to make incentive decisions about coworkers.

Group/Team Incentive Challenges

The difference between rewarding team members *equally* and rewarding them *equitably* triggers many of the problems associated with group/team incentives. Rewards distributed in equal amounts to all members may be perceived as “unfair” by employees who work harder, have more capabilities, or perform more difficult jobs. This problem is compounded when an individual who is performing poorly prevents the group/team from meeting the goals needed to trigger the incentive payment. Also, employees working in groups/teams may have less satisfaction with rewards that are the same for all, versus rewards based on performance, which often are viewed as more equitable.

Generally, managers view the concept of people working in groups/teams as beneficial. But to a large extent, many employees still expect to be paid according to individual performance. Until this individualism is recognized and compensation programs that are viewed as more equitable by more “team members” are developed, caution should be used when creating and implementing group/team incentives.

Group size is another consideration in team incentives. If a group becomes too large, employees may feel that their individual efforts have little or no effect on the total performance of the group and the resulting rewards. But group/team incentive plans also may encourage cooperation in small groups where interdependence is high. Therefore, in those groups, the use of group/team performance measures is recommended. Such plans have been used in many industries. Conditions for successful team incentives are shown in Figure 12-6. If these conditions cannot be met, then either individual or organizational incentives may be more appropriate.

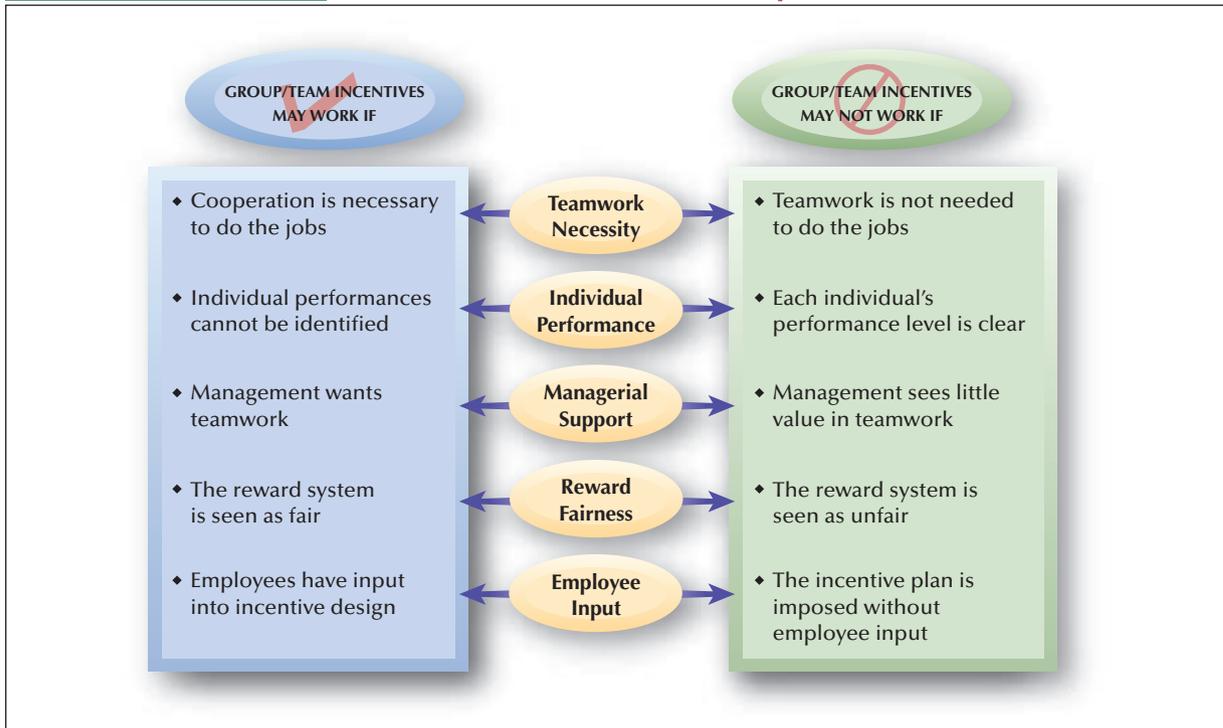
Types of Group/Team Incentives

Group/team reward systems use various ways of compensating individuals. The components include individual wages and salaries in addition to the other rewards. Most organizations that use group/team incentives continue to pay individuals based either on the jobs performed or the individuals’ competencies and capabilities. The two most common types of group/team incentives are team results and gainsharing.

Group/Team Results Pay plans for groups/teams may reward all members equally on the basis of group output, cost savings, or quality improvement. The design of most group/team incentives is based on a “self-funding” principle, which means that the money to be used as incentive rewards is obtained through improvement of organizational results. A good example is gainsharing, which can be structured as either a group or company-wide incentive.

FIGURE 12-6

Conditions for Successful Group/Team Incentives



Gainsharing The system of sharing with employees greater-than-expected gains in profits and/or productivity is **gainsharing**. Also called *teamsharing* or *goalsharing*, the focus is to increase “discretionary efforts,” which are the difference between the maximum amount of effort a person can exert and the minimum amount of effort that person needs to exert to keep from being fired.

Workers in many organizations are not paid for discretionary efforts, but are paid to meet the minimum acceptable level of effort required. When workers do demonstrate discretionary efforts, the organization can afford to pay them more than the going rate, because the extra efforts produce financial gains over and above the returns of minimal efforts. Some organizations have linked Lean Six Sigma programs together with gainsharing to emphasize the attainment of results. For example, in a global pharmaceutical plant, this kind of program was seen as contributing to improved productivity and lower direct labor costs.²⁴

To develop and implement a gainsharing or goalsharing plan, management must identify the ways in which increased productivity, quality, and financial performance can occur and decide how some of the resulting gains should be shared with employees. Measures such as labor costs, overtime hours, and quality benchmarks often are used. Both organizational measures and departmental measures may be targeted, with the weights for gainsharing split between the two categories. Plans frequently require that an individual must exhibit satisfactory performance to receive the gainsharing payments.

Two older approaches similar to gainsharing exist. One, called *Improshare*, sets group piece-rate standards and pays weekly bonuses when those standards are exceeded. The other, the *Scanlon plan*, uses employee committees and passes on savings to the employees.

Gainsharing System of sharing with employees greater-than-expected gains in profits and/or productivity.



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Group/Team Incentives and Information Sharing

Team incentives such as gainsharing programs provide money to be used as a cash bonus for employees based on cost savings from implementing employee ideas. The increased usage of employee-based knowledge in a gainsharing program may enhance organizational results, reduce production costs, and make other useful changes. For example, at one time, bonuses at IBM were based primarily on individual performance. The result was a number of “fiefdoms” that paralyzed information exchange. People would not share valuable information because “knowledge is power,” so executive management changed compensation to a team-based model. The result was better information flow, which aided the growth of IBM in the decade that followed.²⁵

ORGANIZATIONAL INCENTIVES

An organizational incentive system compensates all employees according to how well the organization as a whole performs during the year. The basic concept behind organizational incentive plans is that overall results may depend on organization-wide efforts and cooperation. The purpose of these plans is to produce better results by rewarding cooperation throughout the organization. For example, conflict between marketing and production can be overcome if management uses an incentive system that emphasizes organization-wide profit and productivity. To be effective, an organizational incentive program should include everyone from nonexempt employees to managers and executives. Two common organizational incentive systems are profit sharing and employee stock plans.

Profit Sharing

As the name implies, **profit sharing** distributes some portion of organizational profits to employees. One research study found that profit-sharing plans in small firms can help to enhance employee commitment and increase job-related performances of individuals.²⁶ The primary objectives of profit-sharing plans can include the following:

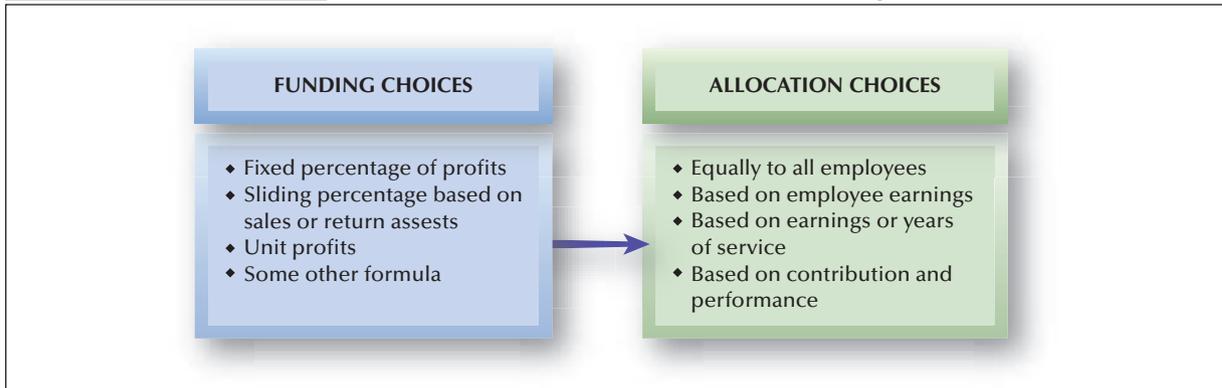
- Increase productivity and organizational performance
- Attract or retain employees
- Improve product/service quality
- Enhance employee morale

Typically, the percentage of the profits distributed to employees is set by the end of the year before distribution, although both timing and payment levels are considerations. In some profit-sharing plans, employees receive portions of the profits at the end of the year; in others, the profits are deferred, placed in a fund, and made available to employees on retirement or on their departure from the organization.²⁷ Figure 12-7 shows how profit-sharing plans can be funded and allocated. Often the level of profits is influenced by factors not under the employees’ control, such as accounting decisions, marketing efforts, competition, and elements of executive compensation. In recent years, some labor unions have supported profit-sharing plans that tie employees’ pay increases to improvements against broader organizational performance measures, not just the “bottom-line” numbers.

Profit sharing System to distribute a portion of the profits of an organization to employees.

FIGURE 12-7

Framework Choices for a Profit-Sharing Plan



Drawbacks of Profit-Sharing Plans When used throughout an organization, including with lower-level workers, profit-sharing plans can have some drawbacks. First, employees must trust that management will disclose accurate financial and profit information. As businesspeople know, both the definition and level of profit can depend on the accounting system used and on decisions made. To be credible, management must be willing to disclose sufficient financial and profit information to alleviate the skepticism of employees, particularly if profit-sharing levels fall from those of previous years. If profit-sharing communication is done well, employee pay satisfaction and commitment can be improved.²⁸ Second, profits may vary a great deal from year to year, resulting in windfalls or losses beyond the employees' control. Third, payoffs are generally far removed by time from employees' efforts; therefore, higher rewards may not be obviously linked to better performance.

Employee Stock Plans

Two types of organizational incentive plans use stock ownership in the organization to reward employees. The goal of these plans is to get employees to think and act like “owners.”

A **stock option plan** gives employees the right to purchase a fixed number of shares of company stock at a specified exercise price for a limited period of time. If the market price of the stock exceeds the exercise price, employees can then exercise the option and buy the stock. The number of firms giving stock options to nonexecutives has declined in recent years, primarily due to changing laws and accounting regulations.

Stock option plan Plan that gives employees the right to purchase a fixed number of shares of company stock at a specified price for a limited period of time.

Employee stock ownership plan (ESOP) Plan designed to give employees significant stock ownership in their employers.

Employee Stock Ownership Plans Firms in many industries have an **employee stock ownership plan (ESOP)**, which is designed to give employees significant stock ownership in their employers. According to the National Center for Employee Ownership, an estimated 11,000 firms in the United States offer broad employee-ownership programs covering about 13 million workers.²⁹ Firms in many industries have ESOPs. For example, a clothing designer in New York, Eileen Fisher, has an ESOP for about 600 employees. The account was established when Fisher transferred about 30% of her total shares to the ESOP. Doing this gave her employees more incentive to enhance the performance of the firm, which hopefully would raise its stock value.³⁰

Globally, employees stock purchase plans (ESPPs) are expanding in companies operating outside the United States. However, in some countries, such as Hong Kong, Austria, and the European Union, regulations are more limiting.³¹

Establishing an ESOP creates several advantages. The major one is that the firm can receive favorable tax treatment on the earnings earmarked for use in the ESOP. Another is that an ESOP gives employees a “piece of the action” so that they can share in the growth and profitability of their firm. Employee ownership may motivate employees to be more productive and focused on organizational performance.³²

Many people approve of the concept of employee ownership as a kind of “people’s capitalism.” However, the sharing also can be a disadvantage for employees because it makes their wages/salaries and retirement benefits dependent on the performance of their employers. This concentration poses even greater risk for retirees because the value of pension fund assets is also dependent on how well the company does or does not perform.³³ The financial

downturns, bankruptcies, and other travails of some firms in tough economic conditions have illustrated that an ESOP does not necessarily guarantee success for the employees who become investors.

Salespeople and executives are unique in many ways from other employees and their pay is different as well. Both of these types of employees are typically tied to variable pay incentives more than other employees. Therefore, a consideration of sales and executive pay follows.



LOGGING ON

myStockOptions.com

For tools to communicate with, educate, and train employees about stock options, visit this website at www.mystockoptions.com.

SALES COMPENSATION

The compensation paid to employees involved with sales and marketing is partly or entirely tied to individual sales performance. Salespeople who sell more products and services receive more total compensation than those who sell less. Sales incentives are perhaps the most widely used individual incentives. The intent is to stimulate more effort from salespeople so they earn more money.

Jobs in sales in many organizations have changed greatly in the last 20 years. Certainly the sales department is still responsible for bringing in revenue for a company, but today’s customers have more choices and more information, and so the distribution of power has changed. Because of the pressure to make sales and the international environment in which competition is taking place, ethical issues have arisen in the sales area, as discussed in the HR Perspective.

Types of Sales Compensation Plans

Sales compensation plans can be of several general types, depending on the degree to which total compensation includes some variable pay tied to sales performance. A look at three general types of sales compensation and some challenges to sales compensation follows.

Salary Only Some companies pay salespeople only a salary. The *salary-only approach* is useful when an organization emphasizes serving and retaining

Ethical Concerns and Sales Compensation



Sales commission programs can effectively drive the behavior of sales representatives, especially if the sales performance measures are based wholly or mostly on sales volume and revenues. However, some sales incentives programs may encourage unethical behavior, particularly when compensation of sales representatives is based solely on commissions. For instance, there have been consistent reports that individuals in other countries buying major industrial equipment have received bribes or kickbacks from sales representatives. The bribes are paid from the incentives received by the sales representatives. This criticism may apply especially with major transactions that generate large revenues, such as aircraft contracts or large insurance coverage products.

One way of addressing sales compensation ethical issues uses a mixture of guaranteed base salary and lowered commission rates. Other approaches use other sales-related dimensions, such as customer service, repeat business, and customer satisfaction.

A key consideration for management is to have ongoing communications with sales professionals, so that the salespeople themselves can identify what is unfair or inappropriate in sales incentive plans. Also, it is important for salespeople to view a sales incentive plan as fair when they compare it to what other sales representatives are paid in relation to their own pay. Thus, numerous activities can influence ethical issues when developing and managing sales incentive plans.³⁴

existing accounts over generating new sales and accounts. This approach is frequently used to protect the income of new sales representatives for a period of time while they are building up their clientele. Generally, the employer extends the salary-only approach for new sales representatives to no more than six months, at which point it implements one of the other systems discussed later in this section. Salespeople who want additional rewards often function less effectively in salary-only plans because they are less motivated to sell without additional performance-related compensation.

Straight Commission A widely used individual incentive system in sales jobs is the **commission**, which is compensation computed as a percentage of sales in units or dollars. Commissions are integrated into the pay given to sales workers in three common ways: straight commission, salary-plus-commission, and bonuses.

In the *straight commission system*, a sales representative receives a percentage of the value of the sales the person has made. Consider a sales representative working for a consumer products company who receives no compensation if that person makes no sales, but who receives a percentage of the total amount of all sales revenues that person has generated. The advantage of this system is that it requires the sales representative to sell in order to earn. The disadvantage is that it offers no security for the sales staff.

To offset this insecurity, some employers use a **draw** system, in which sales representatives can draw advance payments against future commissions. The amounts drawn are then deducted from future commission checks. Arrangements must be made for repayment of drawn amounts if individuals leave the organization before earning their draws in commissions.

Commission Compensation computed as a percentage of sales in units or dollars.

Draw Amount advanced against, and repaid from, future commissions earned by the employee.



LOGGING ON

Capterra

This website is an online software marketplace for commission-based incentive plans. Visit the site at www.capterra.com/commission-solutions.

Salary-Plus-Commission or Bonuses The form of sales compensation used most frequently is the *salary-plus-commission*, which combines the stability of a salary with the performance aspect of a commission. A common split is 80–20% or 70–30% salary to commission, although the split varies by industry and can be based on numerous other factors.³⁵ Some organizations also pay salespeople salaries and then offer bonuses that are a percentage of the base pay, tied to how well each employee meets various sales targets or other criteria. A related method is using *lump-sum bonuses*, which may lead to salespeople working more intensively to get more sales results than the package approach.³⁶

Sales Compensation Challenges

Sales incentives work well, especially when they are tied to the broad strategic initiatives of the organization and its specific marketing and sales strategies. However, as economic and competitive changes have become more complex and shifted in nature, employers in many industries have faced challenges in their sales. Therefore, firms need to analyze more thoroughly their sales compensation costs, assess how the sales pay is increasing or decreasing performance efforts by employees, and then evaluate the extent to which the sales and profit goals are being met.³⁷ HR must be actively involved in meeting these challenges.

Technology and Sales Compensation Programs The last few years have seen the growth of sales compensation plans with different design features. Many of them are multitiered and can be rather complex. Selling over the Internet brings challenges to incentive compensation as well. Some sales organizations combine individual and group sales bonus programs. In these programs, a portion of sales incentive is linked to the attainment of group sales goals.

Internet-based software has helped employers administer programs and post results daily, weekly, or monthly. Salespeople can use this information to track their results. Administering incentives globally is difficult, but HR technology has helped as incentive management software has become widespread. These systems are advantageous because they can track the performance of numerous employees worldwide who may be covered by different incentive plans. Consider a company that has different product lines, geographic locations, and company subsidiaries, and imagine tracking the performance of hundreds or thousands of sales representatives for a sales incentive program. Or imagine manually tracking attendance, safety, and training incentives for firms with employees worldwide. The development of software systems to measure and record such things has been important in helping executives and managers support and manage their global sales forces more effectively.



MEASURE

Sales Performance Metrics Successfully using variable sales compensation requires establishing clear performance criteria and measures. Figure 12-8 shows some of the possible sales metrics. Generally, no more than three sales performance measures should be used in a sales compensation plan. Otherwise, sales commission plans can become too complex to motivate sales representatives.³⁸ On the other hand, some plans may be too simple, focusing only on the salesperson's pay, and not on wider organizational objectives. Many companies measure performance primarily by comparing

FIGURE 12-8

Sales Metric Possibilities



an individual's sales revenue against established quotas. These plans would be better if the organizations used a variety of criteria, including total revenue, obtaining new revenue, and selling specific and new products or services.³⁹

Effectiveness of Sales Incentive Plans So many organizations have sales incentive plans that it would be logical to think those plans are effective. However, many sales compensation plans are not seen as effective by either salespeople or managers and executives. One problem that can occur is constantly making too many changes in sales incentives, resulting in confusion by many people. Frequent changes reduce the effectiveness of plans and create problems with the sales representatives and managers. HR professionals may be involved in designing, revising, and communicating sales incentive plans, as well as responding to the complaints and concerns of sales representatives.

Effective sales incentives ideally should provide extra compensation for making sales, but sales managers warn that incentive systems will fail when an "entitlement culture" takes hold in the sales force. An entitlement culture is the idea that bonuses are *deferred salary* rather than extra pay for extra sales performance. When sales incentives designed to be extra pay for top performers become reliable paychecks on which everyone can count, entitlement has taken root and motivation drops.⁴⁰

Failure to deal with incentive programs that no longer motivate salespeople causes variable costs (pay for performance) to actually become fixed costs (salary) from the perspective of the employer. Pay without performance, poor quota setting, and little difference in pay between top and bottom performers cause problems. Therefore, significant efforts are needed to establish and maintain effective sales incentive plans.

EXECUTIVE COMPENSATION

Most organizations administer compensation for executives somewhat differently than compensation for other employees. An executive typically is someone in the top two levels of an organization, such as Chief Executive Officer

(CEO), President, Senior Vice President, Chief Operating Officer, Executive Vice President, Chief Financial Officer, or Senior HR Executive. As HR has become more strategic and important, top HR executives also may be covered by executive compensation.

At the heart of most executive compensation plans is the idea that executives should be rewarded if the organization grows in profitability and value over a period of years. Therefore, variable pay distributed through different types of incentives is a significant part of executive compensation components in both U.S. and global organizations.

Changing worldwide economic conditions have influenced executive compensation throughout many jobs. In some firms, executive compensation has been frozen or reduced due to declining performance in the United States and globally. For example, a survey of U.S. companies identified that more than 60% were not planning to restore the executive pay levels, and about 40% were putting more emphasis on performance incentives.⁴¹ In addition, criticisms of executive pay in U.S. firms have increased as plants have been closed, firms have gone bankrupt, and unemployment rates have increased. Undoubtedly, the major elements of executive compensation will continue to be part of how employers and HR address these concerns.

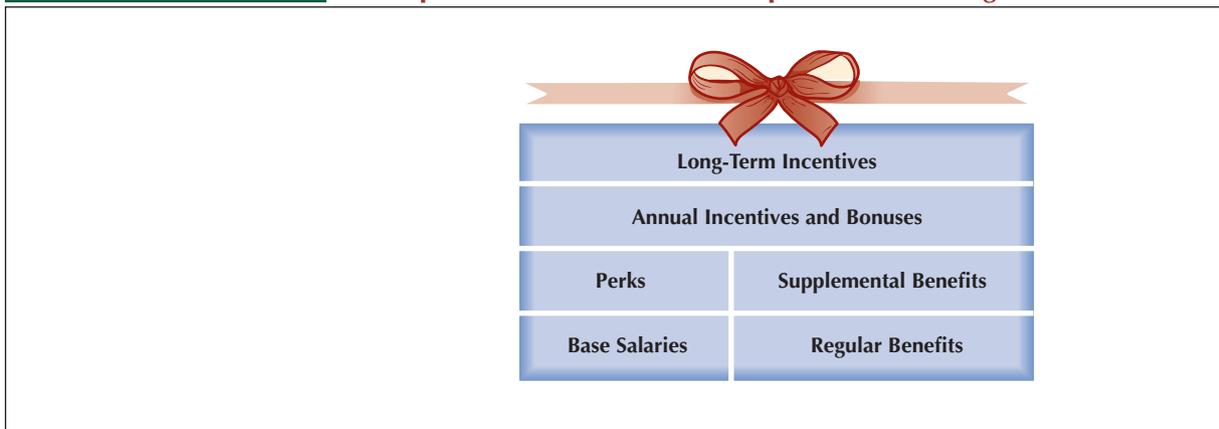
Elements of Executive Compensation

Because many executives are in high tax brackets, their compensation often is provided in ways that offer significant tax savings, which means that their total compensation packages may be more significant than just their base pay. Thus, executives often are interested in current compensation and the mix of items in the total package. Figure 12-9 illustrates the components of executive compensation packages.

Executive Salaries Salaries of executives vary by the type of job, size of organization, the industry, and other factors. In some organizations, particularly nonprofits, salaries often make up 90% or more of total compensation. In contrast, in large corporations, salaries may constitute less than half of the total package. Survey data on executive salaries are often reviewed by boards of directors to ensure that their organizations are competitive.

FIGURE 12-9

Components of Executive Compensation Packages



Executive Benefits Many executives are covered by *regular benefits plans* that are also available to nonexecutive employees, including traditional retirement, health insurance, and vacation plans. In addition, executives may receive *supplemental benefits* that other employees do not receive. For example, corporate-owned insurance on the life of the executive is popular; this insurance pays both the executive's estate and the company in the event of death. One supplemental benefit that has grown in popularity is company-paid financial planning for executives. Also, trusts of various kinds may be designed by the company to help executives deal with estate-planning and tax issues. *Deferred compensation* is another way of helping executives with tax liabilities caused by incentive compensation plans.

Executive Perquisites (Perks) In addition to the regular benefits received by all employees, perquisites often are received by executives. **Perquisites (Perks)** are special benefits—usually noncash items—for executives. Many executives value the status enhancement of these visible symbols, which allow the executives to be seen as “very important people” both inside and outside their organizations. Perks also can offer substantial tax savings because some of them are not taxed as income. Some commonly used executive perks are company cars, health club and country club memberships, first-class air travel, use of private jets, stress counseling, and chauffeur services.

Annual Executive Incentives and Bonuses Annual incentives and bonuses for senior managers and executives can be determined in several ways. One way is to use a discretionary system whereby the CEO and the board of directors decide bonuses; the absence of formal, measurable targets detracts significantly from this approach. Another way is to tie bonuses to specific measures, such as return on investment, earnings per share, and net profits before taxes. More complex systems create bonus pools and thresholds above which bonuses are computed. Whatever method is used, it is important to describe it so that executives attempting to earn additional compensation understand the plan; otherwise, the incentive effect will be diminished.

Long-Term Executive Performance Incentives Executive performance-based incentives tie executive compensation to the long-term growth and success of the organization. However, whether these incentives really emphasize the long term or merely represent a series of short-term rewards is controversial. Short-term rewards based on quarterly or annual performance may not result in the kind of long-run-oriented decisions necessary for the company to perform well over many years. As would be expected, the total amount of pay-for-performance incentives varies by management level, with CEOs receiving significantly more than subsidiary or other senior managers.

A *stock option* gives individuals the right to buy stock in a company, usually at an advantageous price. Various types of stock option plans are the most widely used executive incentive. A survey by Watson Wyatt identified that about two-thirds of companies granted stock equity awards to employees who were paid \$100,000 to \$125,000, and those who were paid higher amounts were given such participation opportunities also. Several types of stock option plans are used for executives, with *restricted stock options* becoming more prevalent. A *restricted stock option* indicates that company stock shares will be paid as a grant of shares to individuals, usually linked to achieving specific performance criteria.⁴² Other types of stock options include *phantom stock*, *performance shares*, and other specialized technical forms that are beyond the scope of this discussion.

Perquisites (Perks) Special benefits—usually noncash items—for executives.

Despite the prevalence of such plans, research has found little relationship between providing CEOs with stock options and subsequent firm performance. The two items may not be closely linked in some firms. Because of the numerous corporate scandals involving executives at Enron, WorldCom, Tyco, and elsewhere who received outrageously high compensation due to stock options and the backdating of those options, the use of stock options has been changing. Also, the recent economic difficulties in the automobile, banking, financial, investment, manufacturing, and other industries have led to more governmental and regulatory oversight of these plans. One outcome of the

corporate abuses by executives has been the passage of the Sarbanes–Oxley Act. This act has numerous provisions that have affected the accounting and financial reporting requirements of different types of executive compensation. Also, the Financial Accounting Standards Board (FASB) has adopted rules regarding the expensing of stock options and related types of executive compensation.



LOGGING ON

Graef Crystal: The Crystal Report

The Crystal Report evaluates executive compensation levels and issues. Visit the website at www.crystalreport.com.



Global Executive Compensation

The expansion of global business by firms based in both the United States and other countries has raised executive compensation issues. Numerous executives have responsibilities for operations throughout the world, and they are compensated for those expanded responsibilities. However, senior executives in the United States continue to earn higher salaries than similar executives in other countries.

In the United States, critics of executive pay levels point out that many U.S. corporate CEOs have a ratio value of more than 350 times that of the average workers in their firms, while in Britain the ratio is 22, in Canada it is 20, and in Japan it is 11.⁴³ Even though executives in other countries often have lower base pay, they also may have valuable incentives at percentage rates similar to those of U.S. executives. However, in some global firms, long-term incentives may be reduced for foreign executives to be more similar to U.S. practices in their countries.⁴⁴ This example illustrates that global compensation programs for executives can be complex and extensive.

“Reasonableness” of Executive Compensation

The notion of providing monetary incentives that are tied to improved performance results makes sense to most people. However, in the United States, there is an ongoing debate about whether executive compensation, especially that of CEOs, is truly linked to performance. Given the astronomical amounts of some executive compensation packages, this concern is justified, as highlighted in the HR Perspective.

The reasonableness of executive compensation is often justified by comparison to compensation market surveys, but these surveys usually provide a range of compensation data that requires interpretation. One study found that a 60% increase in the U.S. CEO compensation over two decades could be linked to the market capital in large companies in that same period.⁴⁵ Despite this methodological analysis, there is continued concern about the overall levels of executive compensation. Some useful questions that have been suggested for determining whether executive pay is “reasonable” include the following:

- Would another company hire this person as an executive?
- How does the executive’s compensation compare with that for executives in similar companies in the industry?

CEO Executives Overpaid?



The staggeringly large amounts of some annual compensation packages for executives have raised ethical questions. A primary question is whether any single CEO is really deserving of annual compensation totaling more than \$20 million plus stock option profits, retirement bonuses, and other payments.

With the recent economic problems in the financial, banking, and related industries, many people have been angered to learn that a Goldman Corporation CEO received more than \$50 million in pay, bonuses, and stock incentives, and that a former Merrill Lynch CEO received a \$15 million signing bonus plus a pay package for several years valued at \$50 to \$120 million. In some nonfinancial firms, CEOs have received compensation totals ranging from \$30 to \$322 million per year!

Such compensation packages for executives have led many to question the ethical implications. A significant issue for both board members and governmental investigators is whether any single CEO is really deserving of compensation totaling more than

\$50 million when a range of executives are included in an organization.

As large as they are, these compensation packages provide little meaning unless they are put into context. If the company is doing well and performing better than competitors and above expectations, such packages *might* be justifiable to stockholders. But these large numbers have created increased emphases by legislators and regulators to change federal compensation rules regarding banks and some other industries.

Excluding the most highly paid executives from a survey of smaller companies, median total executive compensation has been found to be about \$2.5 million.⁴⁶ Even at this level, the question that still must be addressed by boards of directors, stockholders, and executives is this: How realistic is it to provide an amount to one person, when other managers and executives contribute to organizational performance and do not receive such payouts? Is company performance really dependent on one person's performance? What do you think?

- Is the executive's pay consistent with pay for other employees within the company?
- What would an investor pay for the level of performance of the executive?

Link between Executive Compensation and Corporate Performance

Of all the executive compensation issues that have been raised, the one that is discussed most frequently is whether executive compensation levels, especially for CEOs, are sufficiently linked to organizational performance. Board members of some organizations have viewed CEO compensation as not being as closely linked to performance as needed, resulting in CEO total compensation being seen as too high.⁴⁷

The most important reason for giving pay as incentives is that it is thought to be effective in motivating employees and increasing corporate performance and stock values. Another common reason for using variable compensation is related to the ability to attract and keep employees. These reasons apply to executives as well as to other employees. But in order for compensation based on these reasons to be effective, executive compensation packages must be linked to performance.

One key aspect in evaluating this topic is the performance measures used. In many settings, financial measures such as return on equity, return to shareholders, earnings per share, and net income before taxes are used to measure performance. However, a number of firms also incorporate nonfinancial organizational

measures of performance when determining executive bonuses and incentives. Customer satisfaction, employee satisfaction, market share, productivity, and quality are other areas measured for executive performance rewards.

Measurement of executive performance varies from one employer to another. Some executive compensation packages use a short-term focus of one year, which may lead to large rewards for executive performance in a given year even though corporate performance over a multiyear period is mediocre, especially if the yearly measures are not carefully chosen. Executives may manipulate earnings per share due to stock-based incentives by selling assets, liquidating inventories, or reducing research and development expenditures.⁴⁸ All of these actions may make organizational performance look better in the short run but impair the long-term growth of the organization.

A number of other executive compensation issues and concerns exist. Figure 12-10 highlights some of the criticisms and counterarguments in regard to executive compensation.

One of the more controversial issues is that some executives seem to get large awards for negative actions. It seems contradictory to some to reward executives who improve corporate results by cutting staff, laying off employees, changing pension plans, or increasing the deductible on the health insurance, although sometimes cost-cutting measures are necessary to keep a company afloat. However, a sense of reasonableness must be maintained. If rank-and-file employees suffer, giving bonuses and large payouts to executives appears counterproductive and even hypocritical.

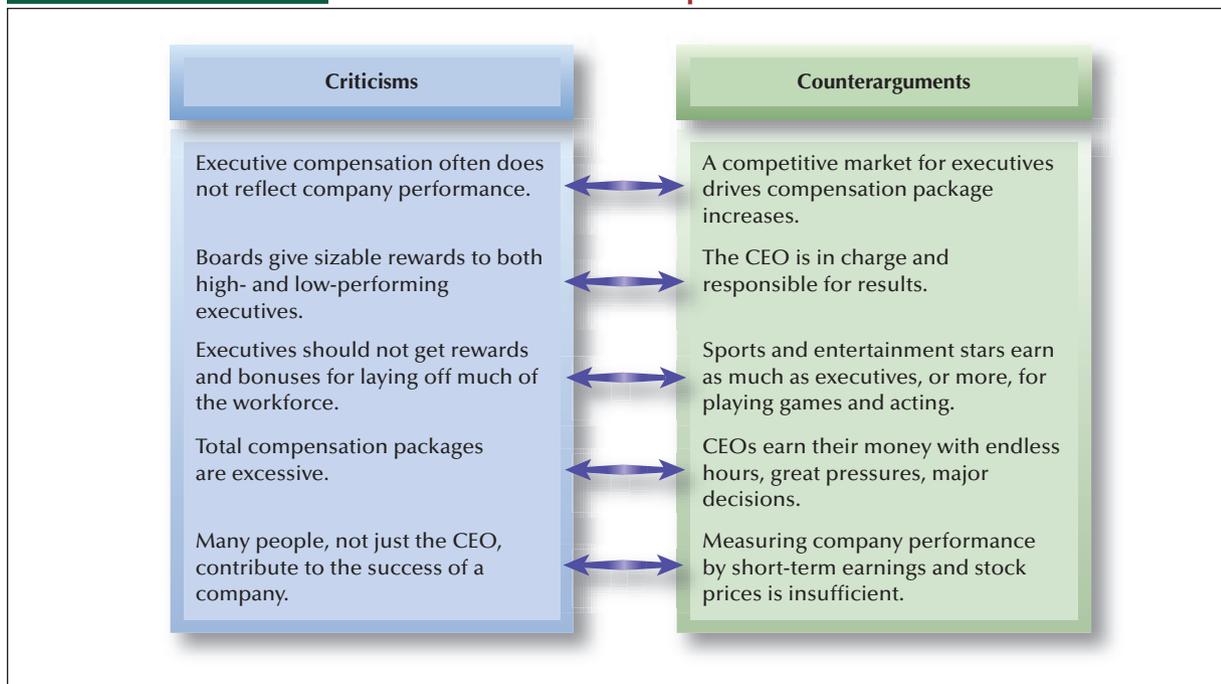
Compensation committee

Subgroup of the board of directors that is composed of directors who are not officers of the firm.

Executive Compensation and Boards of Directors In most organizations, the board of directors is the major policy-setting entity and must approve executive compensation packages. Corporate directors receive compensation for board and committee meetings and other activities.⁴⁹ The **compensation committee**

FIGURE 12-10

Common Executive Compensation Criticisms



usually is a subgroup of the board of directors that is composed of directors who are not officers of the firm. A compensation committee generally makes recommendations to the board of directors on overall pay policies, salaries for top officers, supplemental compensation such as stock options and bonuses, and additional perquisites for executives.

One major concern voiced by many critics is that the base pay and bonuses of CEOs are often set by the members of board compensation committees, many of whom are CEOs or executives of other companies with similar compensation packages. Also, the compensation advisors and consultants to the CEOs often collect large fees, and critics charge that those fees distort the objectivity of the advice given.

To counter criticism, some corporations have changed the composition of the compensation committees by taking actions such as prohibiting “insider” company officers from serving on them. Also, some firms have empowered the compensation committees to hire and pay compensation consultants without involving executive management. Finally, better disclosure can provide the board with a fuller picture of a chief’s entire compensation package.

S U M M A R Y

- Variable pay, also called incentives, is compensation that can be linked to individual, group/team, and/or organizational performance.
- Effective variable pay plans fit both business strategies and organizational cultures, appropriately award actions, and are administered properly.
- Metrics for measuring the success of variable pay plans are crucial.
- Piece-rate and bonus plans are the most commonly used individual incentives.
- The design of group/team variable pay plans must consider how the incentives are to be distributed, the timing of the incentive payments, and who will make decisions about the variable payout.
- Organization-wide rewards include profit sharing and stock ownership plans.
- Sales employees may have their compensation tied to performance on a number of criteria. Sales compensation can be provided as salary only, commission only, or salary-plus-commission or bonuses.
- Measuring the effectiveness of sales incentive plans is a challenge that may require the plans to be adjusted based on success metrics.
- Executive compensation must be viewed as a total package composed of salaries, bonuses, benefits, perquisites (perks), and both short- and long-term performance-based incentives.
- Performance-based incentives often represent a significant portion of an executive’s compensation package.
- A compensation committee, which is a subgroup of the board of directors, generally has authority over executive compensation plans.

C R I T I C A L T H I N K I N G A C T I V I T I E S

1. Discuss why variable pay-for-performance plans have become popular and what elements are needed to make them successful.
2. Give examples of individual incentives used by an organization in which you were employed, and then describe why those plans were or were not successful.
3. Describe the nature and components of, and the issues currently facing, executive compensation in various U.S. industries.
4. Suppose you have been asked to lead a taskforce to develop a sales incentive plan at your firm. The taskforce is to generate a list of strategies and issues to be evaluated by upper management. Using details from www.salescompensation.org and other related websites, identify and develop preliminary materials for the taskforce.

HR EXPERIENTIAL PROBLEM SOLVING

Your insurance company needs to update the sales incentive program for its sales/marketing representatives. Due to growth in the volume and diversity of the products being sold, the existing system of having one incentive program for all sales marketers no longer meets the needs of the company. To maximize sales in each of the product lines, the system needs to provide an incentive and reward system to encourage employees to focus on their specific product lines while also cross-marketing the

company's portfolio of other products. To identify the key facets of a sales commission program, visit websites including www.8020salesperformance.com/sales_compensation.html.

1. Would a compensation program that offered only commission work for your company? Why or why not?
2. What other incentives would assist the company in motivating the sales staff?

CASE

Sodexo Incentives

Many employers offer incentives to employees working in different jobs. Often, the incentives are to reward employee performance, both in the short and the long term. But some company incentive plans are viewed negatively by employees, while others are seen as highly positive by employees at all levels.

One firm that has a well-regarded, broad-based incentive plan is Sodexo, a large food and facilities service firm with more than 350,000 employees in 80 countries. Being such a large firm, Sodexo has a variety of clients, including many corporate and governmental entities, hospitals, manufacturing firms, and universities. Thus, the firm's client services are varied, with many of them being basic ones such as cleaning offices, maintenance of all types of facilities, doing landscaping, and managing other basic and professional activities. In North America, including the United States, Sodexo has almost 125,000 staff members. More than 40,000 of the North American staff members work in health care, including clinics, offices, and hospital sites.

Being such a large firm with employees doing many different types of jobs, a key part of Sodexo's organizational and HR cultures involves engaging its employees in many ways. One aspect is having a widely based employee rewards program containing recognition and incentives. The company's "Spirit of Sodexo" program focuses on three general-award facets: service, teamwork, and progress. To operate this program, the company has required executives, including the top HR officer, to develop processes for the nomina-

tion of employees who make significant contributions, locally and regionally, as well as in business and corporate divisions of the firm.

Some of the recognitions and awards provided to employees are interesting. Because the biggest division of workers is in health care locations, a special incentive program called Sodexo CARES has been used for several years for employees who accomplish especially unique results. At one hospital, a small group of dieticians developed a new system for ordering medication and devices online, something that is not done in most hospitals. These dieticians received recognition and incentive awards for their job-related accomplishments.

Another incentive reward for exceptional efforts went to a female employee who worked as a food caterer and prepared special meals for a young foreign hospital patient who had difficulty eating typical U.S. foods. The employee home-cooked various items for that patient when the patient had surgery. Her efforts were increasingly recognized throughout Sodexo, and she received a national incentive award. Both she and her husband attended a national meeting in a different city where she was recognized and became the subject of a short video. She also received a \$500 gift card and a lot of publicity.

Numerous other examples exist showing how Sodexo uses employee incentives as part of its culture in many different industry jobs. To learn more about Sodexo and its organizational and HR culture, go to www.sodexo.com. The overall picture of such widely focused incentive recognition efforts

illustrates how incentives can significantly influence the motivation and performance of employees.⁵⁰

QUESTIONS

1. Based on the Sodexo example, discuss the importance of widespread incentives in improving

both the culture and employee retention efforts in a firm.

2. How might having employees receive recognition and incentives at a national level impact the performance of their coworkers and colleagues?

S U P P L E M E N T A L C A S E S

Cash Is Good, Card Is Bad

Both the positive and negative issues associated with the use of an incentive plan are discussed in this case. (For the case, go to www.cengage.com/management/mathis.)

Incentive Plans for Fun and Travel

This case discusses incentive plans that stimulate employee interest and motivate them to perform well. (For the case, go to www.cengage.com/management/mathis.)

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