

## Chapter 13 Pay for Performance

### -Background and trends

- Standards of production was first identified by Frederick Taylor in the late 1800s
- He realized that workers have a tendency to work at the minimum pace and produce minimum

-During late early 1800s piece rate was in use

### -A fair day's work

- Taylor first identified this
- He realized that quotas should not be set up unscientifically

-Haphazard setting of piecework requirement and wage rate is never effective and more careful study was needed to define what is called acceptable standard of production----- this is called what a fair day's work.

### -Scientific mgmt

- Involves time and motion analysis
- Purpose was to cut slack time and unnecessary movement of body parts

### -Today's phenomenon

- More and more employers are switching towards some sort of pay for performance
- Meaning some part of their pay is dependent of performance on the job

-Types of incentive plans

-Variable pay

-Spot bonus

-Group incentive program

-Profit sharing plan

-Gain sharing program

-Incentives for advance line (Operations)

-Piecework

-Workers are paid a fixed sum for each number of productions completed successfully

-This is one of the oldest tools still in application today

-Careful piece rate plan requires systematic study of job evaluation and industrial engineering

-Job evaluation

-Industrial engineering

-Usually it is expressed as the number of units per hour or minute

-How to determine a piece rate

-Straight piece rate plan

-There is no guaranteed minimum wage here

-This could be a problem because

-Fair Labor Standard Act in USA protect a worker from this by guaranteeing a minimum wage. The minimum wage in USA now is around \$8.5 per hr

-Guaranteed piecework plan

-Advantages of piecework incentive

-Easy to calculate and easy to understand

-As it is more applied to lightly educated blue collar employees

-Equitable to principal that offers similar treatment to all

-Disadvantages of piecework

-Controversial as some supervisors deliberately rise the production standard as they see their workers are about to meet the production quota

-Workers do not become multi-skilled

-Quality can be compromised with quantity

-Standard hr plan

-Workers are paid a basic hourly rate PLUS extra percentage of his or her base rate for production exceeding standards per hr pr per day

- Team or group incentive plan
  - Members are paid based upon three ways
    - All members will receive the pay earned by the highest producer
    - All members receive the pay earned by the lowest producer
    - All members receive pay equal to the average pay earned by the group
  
- Reasons for team or group incentive
  - Reinforce group planning and group problem solving
  - Encourages a sense of cooperation and team spirit
  
- Disadvantages
  - Each worker's rewards no, longer solely based on his/her performance
  
- Incentives for the managers and Execs
  - Mostly in the form of bonus
  
- Short term incentives: Annual Bonus
  - Plans that are designed to motivate short-term performance of managers and are tied to company profitability
  - Bonus may vary with performance from yr to yr

-Determinants of bonus

-Eligibility

-Find-size

-Nondeductible formula

-Deductible formula

-Individual award

-A key question is whether the bonus will be made upon the corporate performance or individual

-Top level execs bonus are tied to corporate results

-Split award method

-Problem with split award

-It pays some incentives even to the marginal performer in the form of corporate performance

-Conclusion

-Bonus is a proven motivator and symbol of status

-There are people that the company can never afford to lose

-Long-term incentives

- Intended to motivate and reward top mgmt for the firm's long term growth and prosperity

-Stock options

- The assumption that price of the stock will go up in the future and thus they will sell them upon their retirement and seat comfortably

-Incentives for salespeople

- Heavily relied on sales commissions
- Best way to deal with it is the combination of salary plus commissions
- Incentives for salespeople is due to three reasons

-Salary plan

- Salespeople are paid a fixed salary
- Occasional bonus, sales contest are there too

-Reasons

-Advantages of salary plan

-Commission Plan

- Pay for results and only results
- Salespeople are paid only if they make sales
- Complements performance

-Advantages

-Disadvantages

- Focus is making short-term sales not long term
- Relationship selling is not encouraged

-Combination plan

- Combination of salary and commission
- Most companies use this approach

-Problems

- Salary component of the plan is not tied to performance
- Sometimes it is complicated and misunderstanding may result

-Incentives for other professionals

-Merit pay

- More applicable to white-collar workers
- More like a salary raise through annual review of the employee

-Two options of merit pay

- Usually it is granted to employees at a designated time of the yr in the form of higher base salary
- Exclusively depends on the performance of the employee

-Incentives for the professionals

- Professional employees are those who apply a learned knowledge into a solution for the employer
  - E.g. lawyers, doctors, engineers etc.

-Money is somewhat less important for them

-Organization wide incentive plan

-Profit sharing

- Effectiveness of profit sharing plan is questionable
  - Even though this may not rise productivity but it does raise workers sense of commitment and loyalty and participation

-Lincoln incentive system

- Introduced at Lincoln electric company in Ohio

-Deferred profit-sharing plan

-Gain sharing plan

- Eight steps in gain sharing plan



-Guidelines for effective incentive plans

- When units of output are difficult to measure, use straight salary or wages
- When employees are unable to control the output, pay based on time is better
- When delays in the work are frequent and beyond their control, then don't tie workers pay to their output
- If quality is the primary concern, pay based on time is better

-Suggestions

- Ensure effort and reward are directly related
- Make the plan understandable and easily calculable to the employees