

# Performance Pay is Not the Problem, It's the Solution

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By Marc Emmer

**Is incentive pay the problem or the solution? Pay for Performance should be linked to a framework such as the Balanced Scorecard where high performing employees are rewarded for meeting meaningful company metrics. A company where employees are measured, recognized, and compensated for productivity, efficiency, and quality will create a win-win for both parties.**

The public is mad as hell at AIG (and other recipients of Federal bailouts) who have handed out lucrative retention bonuses. One might wonder, are incentives appropriate in such difficult times?

It is not incentives that are on trial; it is distribution of bonuses when a company is performing poorly that is so infuriating. At a time where companies are facing a harsh business climate, industry leaders such as GE and WalMart are keeping score on their vendor's performance on price, quality, cycle time, etc. Those vendors have become more vigilant about scoring their suppliers and employees to insure that specific deliverables are met. In this economic mayhem, there is momentum towards more rigorous accountability and transparency.

Thus incentive laced compensation systems (often known as pay for performance) are all the rage, as they reward the best performing employees for doing good work. In AIG's case, the design of their system was terribly flawed because it triggered massive payouts, even at a time when the company was crumbling.

Every year, Bain and Company does a study of all the management initiatives (those fancy ideas consultants throw at you such as Six Sigma, customer satisfaction, time motion studies, etc.) and they found that pay for performance is the one proven to yield the greatest financial return. At a time when companies must do more with less, frameworks such as The Balanced Scorecard (also ranked high in the Bain study) help organizations to develop metrics that allow them to manage their strategic priorities and track individual contributions.

The difference between the metrics used in a scorecard and those more typically found in financial statements are that they are more apt to include predictive indicators that are communicated to employees in public view. Using such numbers can provide a foundation on which individual performance measurements can be established. Tying employee compensation to predictive indicators is a powerful method for ensuring that employee behavior is consistent with the mission and goals of the organization. In a well designed compensation plan, an employee's pay is balanced between company performance and individual contributions, and poor corporate results typically trigger very modest incentives; or none at all.

One of the more important lessons learned for some in this downturn is that companies must be vigilant in calibrating labor costs with demand. For years, employers have faced the prospects of labor costs increasing faster than profits, a zero sum game that can eat away profitability. Escalating employment costs such as health care inflation directly hit the bottom line. Over the long term, a shift to a higher

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proportion of incentives and lower salaries (which represent a more rigid cost structure) is both advantageous to the employer, and potentially to the best employees.

Incentive pay has been somewhat controversial in H.R. circles, as organizations have pondered if it is inherently fair to treat people the same, or to reward those who accomplish the most. Organizations which are slashing costs are conflicted with the prospect of cutting or freezing the pay of some workers, so that they can afford to keep the most productive employees. Clearly, sharing the burden of variability in profitability is better than eliminating jobs, or cutting base pay.

Certainly, there is a movement in leadership philosophy towards softer, trendier management techniques that enable innovation and employee growth, but that shift has to occur within the context of profit. A framework that includes scorecards and pay for performance can be used as a carrot (in lieu of being a stick) in a way that enhances the employee experience. For example, posting a handful of strategically significant numbers, and celebrating accomplishments after hitting specific targets is a great way to boost morale and enable results.

A couple of years ago, Best Buy offered their 5000 corporate employees the opportunity to take part in a "results oriented work environment" test. Participating workers were provided the opportunity to work virtually, with no fixed schedule and had the option to work from home. Employees were told that they would only be judged based on quantitative business results. After achieving a staggering double digit increase in productivity, Best Buy is testing the program at the store level. Within our firm, we employ a similar model with our staff. If members of our team have to take their kids to soccer practice or the dentist, we just don't care, as long as we provide the best possible service, every day.

As a business culture, we need to move away from measuring activity (such as how many hours a person works) and towards measuring their output. Paying people based on their specific results is simply a natural extension of the needs of organizations to be more productive, more efficient and more profitable. When structured properly, incentives can be a win-win for both employer and employee.

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