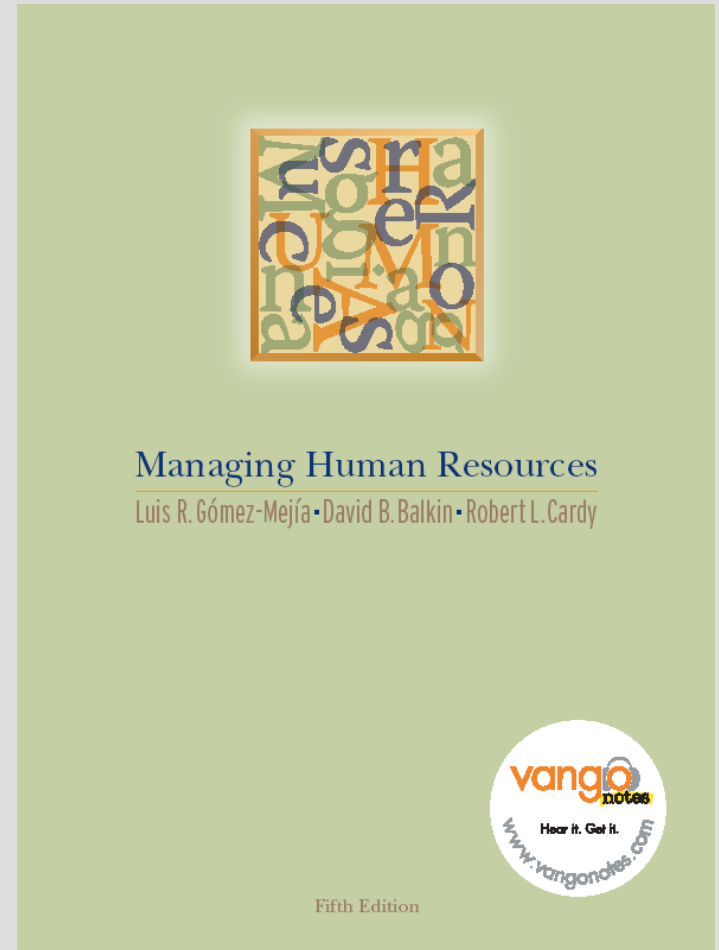


Chapter 11

Rewarding Performance



Chapter 11 Overview

- Recognize individual and group contributions to the firm by rewarding high performers
- Develop pay-for-performance plans that are appropriate for different levels in an organization
- Identify the potential benefits and drawbacks of different pay-for-performance systems and choose the plan that is most appropriate for a particular firm

Chapter 11 Overview (cont'd)

- Design an executive compensation package that motivates executives to make decisions that are in the firm's best interests
- Weigh the pros and cons of different compensation methods for sales personnel and create an incentive plan that is consistent with the firm's marketing strategy
- Design an incentive system to reward excellence in customer service

Pay-for-performance: The Challenges

- Pay-for-performance or Incentive Systems
- The “*do only what you get paid for*” syndrome



Pay-for-performance: The Challenges

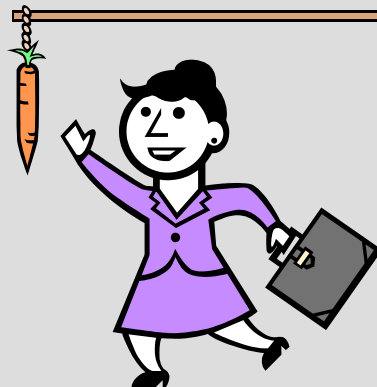
- Negative effects on the spirit of cooperation
- Lack of control
- Difficulties in measuring performance
- Psychological contracts
- The credibility gap
- Job dissatisfaction and stress
- Potential reduction of intrinsic drives

Meeting the Challenges of Pay-for-performance Systems

- Link pay and performance appropriately
 - Piece-rate system – *A compensation system in which employees are paid per unit produced.*
- Use pay-for-performance as part of a broader HRM system
- Build employee trust

Meeting the Challenges of Pay-for-performance Systems

- Promote the belief that performance makes a difference
- Use multiple layers of rewards
- Increase employee involvement
- Use motivation and nonfinancial incentives



Types of Pay-for-performance Plans

Figure 11.1

Unit of Analysis			
<i>Micro Level</i>		<i>Macro Level</i>	
Individual	Team	Business Unit/Plant	Organization
Merit pay	Bonuses	Gainsharing	Profit sharing
Bonuses	Awards	Bonuses	Stock plans
Awards		Awards	
Piece rate			

Types of Pay-for-performance Plans



- Individual-based plans
 - Merit pay
 - Bonus programs
 - Lump-sum payments
- Advantages and disadvantages of individual-based pay-for-performance plans

Types of Pay-for-performance Plans

Conditions under which individual-based plans are most likely to succeed-

- When the contributions of individual employees can be accurately isolated
- When the job demands autonomy
- When cooperation is less critical to successful performance or when competition is to be encouraged

Team-based Plans

- **Advantages and disadvantages to team-based pay-for-performance plans**



Team-based Plans

Conditions under which team-based plans are most likely to succeed-

- *When work tasks are so intertwined it is difficult to single out who did what*
- *When the firm's organization facilitates the implementation of team-based incentives*
- *When the objective is to foster entrepreneurship in self-managed work groups*

Advantages and Disadvantages

Figure 11.3

	Individual-Based Plans	Team-Based Plans
Advantages	<ul style="list-style-type: none">■ Rewarded performance is likely to be repeated■ Financial incentives can shape a person's goals■ Can help the firm attain individual equity■ Fit an individualistic culture	<ul style="list-style-type: none">■ Fosters group cohesiveness■ Aids performance measurement
Disadvantages	<ul style="list-style-type: none">■ Can promote single-mindedness■ Disbelief that pay and performance are linked■ May work against achieving quality goals■ May promote inflexibility	<ul style="list-style-type: none">■ Possible lack of fit with individualistic culture■ May lead to free-riding effect■ Group may pressure members to limit performance■ Hard to define a team■ Intergroup competition

Plantwide Plans

- **Gainsharing**
- **Conditions favoring plantwide plans**
 - **Firm size**
 - **Technology**
 - **Historical performance**
 - **Corporate culture**
 - **Stability of the product market**



Corporatwide Plans

- Profit sharing
- Employee Stock Ownership Plan (ESOP)
- Advantages and disadvantages of corporatwide pay-for-performance plans



Corporatwide Plans

Conditions favoring corporatwide plans

- *Firm size*
- *Interdependence of different parts of the business*
 - *Market conditions*
- *The presence of other incentives*

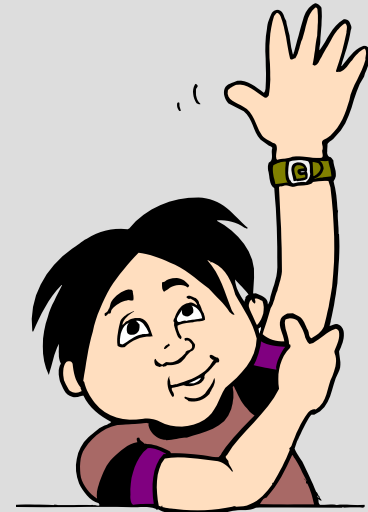
Designing Pay-for-performance Plans

For Executives and Salespeople

- *Salary and short-term incentives*
 - *Long-term incentives*
 - *Perks*
- *Directors and shareholders as equity partners*
 - *Salespeople*

A Question of Ethics -

- Do you think it is ethical for a company to give its CEO and its other top executives multimillion-dollar pay packages that are not closely tied to the company's performance?*



Key Strategic Pay Questions

Figure 11.6

1. How long should the time horizon be for dispensing rewards?
2. Should length of service be considered in determining the amount of the award?
3. Should the executive be asked to share part of the costs and, therefore, increase his or her personal risk?
4. What criteria should be used to trigger the award?
5. Should there be a limit on how much executives can earn or a formula to prevent large unexpected gains?
6. How often should the awards be provided?
7. How easy should it be for the executive to convert the award into cash?

Sources: Makri, M., and Gómez-Mejía, L. R. (2007). Executive compensation: Something old, something new. In Wemer, S. (ed.) *Current Issues in Human Resource Management*. London: Routledge. Grabke-Rundell, A., and Gómez-Mejía, L. R. (2002). Power as a determinant of executive compensation. *Human Resource Management Review*, 12, 3-23; and Deya-Tortella, B., Gómez-Mejía, L. R., De Castro, J., and Wiseman, R. (2005). Incentive alignment or perverse incentives? *Management Research*, 3(2), 109-120.

Rewarding Excellence in Customer Service

- *Customer service rewards may be individual-, team-, or plant-based*



Summary and Conclusions

- Pay-for-performance: The Challenges
- Meeting the challenges of pay-for-performance systems
- Types of pay-for-performance
- Designing pay-for-performance plans for executives and salespeople