

April 2011 - Leadership Letter (58)



PAYING FOR PERFORMANCE

We're enjoying a beautiful spring ... grass is greening, Crocuses have popped, trees are budding and the daylight hours are lengthening! Time to clean the fireplace and uncover the deck furniture.

This month's letter will be on an old favorite ... **PAYING FOR PERFORMANCE**. I began learning about this in the 60's as a manager in P&G's central engineering division. In the 70's, Woodward-Clyde Consultants asked me to help tune up their bonus system.

Many firms who provide consulting services have struggled to find a fair and effective way to provide performance-based pay, incentive pay, or bonuses. Few have been really satisfied.

The major difficulty is this: It's hard to connect project outcomes or department or office results to one individual. It's usually a **team** effort ... and sometimes ... several teams' efforts.

In the attached letter, I comment a bit more on the difficulties. And then, outline the three methods in most common use to provide "performance-based pay" for consulting and service professionals and leaders.

REMINDER: If you need to reach me quickly, please do not email. Please call or text me on my cell at **513/919-7672. I have my phone with me while consulting, traveling, planting trees, biking or canoeing!**

With best wishes,

Mel

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"PAYING FOR PERFORMANCE"

The experts and the research on this topic have shared these views and outcomes ...

- "Paying for Performance" is usually another term for incentive compensation (or bonus) in addition to salary, to motivate employees to their **full potential performance**.
- Paying for Performance can be **very** motivating **if** it is ... (1) well structured, (2) honestly and fairly administered, (3) for **easily measured performance**. Lincoln Electric is a well known example, over many years.
- It's also been successfully used for firms or practices as diverse as accounting, programming, dentistry, and construction, among others. The key to "success" here is the third criteria ... **easily measured performance**.
- It's often suggested that incentive compensation should be primarily for those who **lead the business** or otherwise make a big difference to it, such as business developers or recognized experts.
- Whether for leaders only or for all employees, it works best for those with **clear and measurable** goals, objectives or targets.

What else is there that could be useful to know about this?

- **Paying for Performance** has been tried and/or used in all types and sizes of firms that do architecture and engineering, environmental science, management consulting, etc.

In those businesses, it's most effectively applied to management and business development work that's somewhat measurable. Unit **profitability** and **revenue** won are two frequent measures.

It can be done less effectively for project managers, depending on the size, length and complexity of projects, factoring in claims and losses, etc.

- **Balanced Scorecard:** Some firms have tried to incorporate value or credit for less measurable, but important management work, including ...
 - Client Development
 - Leadership Development
 - Market Leadership
 - Technical Innovation ... etc.

While such work is **extremely** important, it is very difficult to place **specific** value on it, relative to "paying for performance."

- The **primary complaint** and fault of most "performance-based" compensation systems in actual use is this ...

Most people in the firm see little connection between their bonus pay and their performance, in spite of management's policies and explanations!

- Employees perceive little difference in reward for really outstanding vs. ordinary performance.
- Poor performers are given small bonuses (vs. none), so management won't have to be honest about poor performance.
- Allowances are often made for tenure, illness, loyalty or family situations, etc.
- With all the tweaking and averaging, resulting bonuses may be small as a % of salaries.

The net result is that bonuses are often seen as entitlements rather than motivators, by the people receiving them.

Methods of Performance-based Pay for Professionals:

Performance-based pay for professionals, such as engineers, scientists, architects, specialists (such as IT, HR, accounting, safety), and administrators ... whose work is hard to measure ... is difficult. We see three methods in common use:

- A. **Firm-based:** Many firms fall back on providing **good competitive salaries** for the professional person's experience level, reputation and difficulty of replacement ... plus good benefits, including retirement plan contributions.

Bonuses are often provided, but they are based on ...

- firm profitability,
- team or unit profitability,
- significant achievements in the past year.

- B. **Roles and Goals:** Some firms try to create **clear and measurable goals or targets** for their people:

Each person has a clear job description consisting of his/her **current roles and goals**.

- Example **role**: Provide electrical design for assigned projects.
- Example **goal**: Help achieve a minimum of 12% operating profit on assigned projects.

Then annually, prior to bonus determination, the professional's leader reviews his/her performance on those roles and goals, using performance levels like these ...

1. **Outstanding:** Far exceeds expectations, needs no attention, excellent example and help for colleagues and clients.
2. **Excellent:** Exceeds expectations, needs little attention, strong team player, well regarded by colleagues and clients.
3. **Competent:** Meets most expectations, uses coaching and feedback to improve, team player.

4. **Apprentice:** Meets some expectations, requires coaching, feedback and review, learning teamwork and procedures.
5. **Marginal:** Meets few expectations, likely a problem for colleagues, requires review and possibly reassignment.

Bonuses are then based on ...

- **firm** profitability.
- **unit** profitability.
- **individual responsibility** (usually defined by salary level).
- **individual performance** level (1 through 5, as above).

C. **Contribution Ranking:** Some accounting and legal and management consulting firms use an approach that is quite subjective, non-numeric, hard to explain but easy to use and pretty much "pay for performance."

In small to medium size firms, or the regions or divisions of a larger firm, the appropriate leaders gather in a room to discuss the contributions of **all their people**.

Using a whiteboard, Post-it notes or a computer and projector (best), they then rank employees by contribution during the past year.

Technical people, administrative people, business developers, PM's, etc. (all those **not** in the room) are discussed and ranked by the leader group. No ties.

Graduated bonuses are then provided from the top ranked individual say through perhaps the third quartile.

- Fair ... yes.
- Simple ... yes.
- Subjective ... yes.
- Performance-based ... yes.
- Better than alternatives ... probably.

See the following page for an example.

This approach has three other important advantages over most others because it ...

- uses the perspectives of **several** managers.
- eliminates a lot of tedious paperwork by managers.
- disconnects "performance reviews" from incentive compensation decisions.

Performance reviews should be discussions focused on roles and goals, accomplishments, growth and development, new goals, etc.



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CONTRIBUTION RANKING & BONUS SCHEMATIC

