Business Ownership White Paper

EMPLOYEE FRAUD

Case Studies of Typical Scams

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Why a White Paper?

A white paper is an authoritative report to educate and assist people in making decisions. I issue white papers when the subject matter is important to business owners, but it is too technical or complex to address in the length of an article or blog posting.

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EMPLOYEE MOTIVATION

A STEP BY STEP GUIDE TO EFFECTIVE INCENTIVES

ALL FOR ONE...

Most business owners approach employee incentives with mixed emotions. They want to provide some system that creates a sense of urgency and responsibility in their employees, but they don't want to give up too much of an already limited bottom line.

This isn't caused by employer greed as much as the constant memory of the early days, when the typical entrepreneur worked endless hours for a pittance. Now that some of that effort is finally bearing fruit, he or she is being asked to share a chunk of it to get the workers to do what they should be doing anyway. The most common protest that I hear is "But I am *paying* them to do the job; why should I have to pay them more if they actually do it *right*?"

Of course, if you could be sure that incentives were guaranteed to dramatically increase performance in a way that vastly grew your bottom line, you'd have no problem putting them in place for every person in the company. Why then is there such resistance to creating motivational rewards?

The answer is clear. Many and perhaps most employee incentives fail to motivate enough of the desired behavior, and too frequently wind up becoming a permanent expense with a temporary impact.

There are methods of creating and maintaining incentives that avoid becoming an entitlement, and are dynamic enough to change and adapt with current conditions. We'll talk about several approaches, beginning with an overview of he types of incentives.

WHAT'S YOUR LEVEL?

An owner once explained the incentives for his large *(1,200 employee)* business. His logic was the best I've heard. He said "We have 4 levels of incentives, depending on the level of the employee's impact on productivity."

The levels are determined like this:

1. Most employees have their performance measured by job description. There are many other workers with that same job description. Their incentive is also by position. Their job description includes productivity measures, and they re rewarded for achieving the,
2. At the next level are employees who supervise and coordinate the first level employees. They are rewarded based on how the entire group under them performs, so their incentives depend on helping as many of their direct reports as possible earn incentives.
3. Above the supervisors we have managers. These are the 50 or so people who have the authority to make decisions that will directly impact our bottom line. They are rewarded for profitability, but each one is valuable

enough to warrant a custom plan, designed around the impact of each individual performance.

4. At the topmost level we have the employees who we say "Bring the meat." They are the 5 or 6 critical people whom we never, ever want to be without. If you expect an employee to stay with you for life, then you need to offer a life-changing reward system. They have long-term benefits that accumulate. If they stay with us for their entire careers, their family will have an entirely different lifestyle than when they came to our company.

DIFFERENT STROKES FOR DIFFERENT FOLKS

People are motivated by different things. As a behavioral analyst, I know that careful observation of

"team." Now you have a tool to track which incentives you've used, and which ones work in a given the people I am dealing with will help determine the types of incentive that will work best for each of them. For some, money is a motivator. For others, recognition or helping the rest of the team *(which is a kind of recognition)* is far more powerful.

In reality, all the forms of motivation work to some degree, but different types are more or less effective depending on the time and circumstances. Begin any development of new incentives with a few preparatory steps.

Draw a two-by-two matrix. Label the left/right sides of the vertical divide "monetary" and "non-monetary." Label the top/bottom halves above and below the horizontal line "individual" and situation.

	MONETARY	**NON-MONETARY**
INDIVIDUAL	Commissions Bonuses Contests Richer opportunities *(territory, product lines)* Overtime	Trophies and Awards Trips and Tickets Clothing Publication 1st, 2nd, 3rd prizes
TEAM	Team commission Team bonuses	Social Gatherings Team clothing Team trophies Publication Team outings

Next, make a list of all the employees whose performance can affect your bottom line. *(Hint: that should be* all *of them in one way or another.)* Make two columns next to the names, one for individual/team and one for monetary, non-monetary. In the columns, write in the 2 factors for the type of incentive that you feel will work best with each type of employee. Don't worry if you have people with the same job description or in the same department whom you think will respond to different types of incentives, we will get through all types before we are done.

NAME	DEPT.	TYPE 1	TYPE 2
Jack Armstrong	Outside sales	monetary	individual
Brenda Starr	Public Relations	non-monetary	individual
Rex Morgan	Med tech	monetary	team
Dagwood Bumstead	Sales support	non-monetary	team
Charlie Brown	Kite assembly	non-monetary	team
Reed Richards	R & D	non-monetary	individual

We have four possible combinations for incentives, monetary/group, monetary/individual, non-monetary/group and non-monetary/individual. How can we determine which incentives will work best?

Sometimes the answer is trial and error. To start with, however, you can make a pretty good guess at the type of incentive that might work by the personalities attracted to the position.

There are many good reasons to change incentive programs regularly, not the least of which is the "Hawthorne Effect." That is the seminal behavioral study on office lighting and productivity that showed lighting levels were not nearly as important as having the employees know someone was paying attention to their productivity.

For those who aren't familiar with the study, efficiency experts wondered if the level of lighting in an office affected productivity. They increased the lighting,

and production went up. They increased it again, and production went up more. Then they reduced the lighting- and production went up even *more*. In follow-up interviews, they discovered that the employees were reacting to the *recognition* of their importance to productivity, not the lighting itself.

ALL FOR ONE…ME!

Salespeople, for example, are not usually team players. If my territory is New England, I'm not likely to get excited about a bonus that requires the salesman in Chicago to make his goal in order for me to collect. *(If you work with salespeople, you're probably smiling right now at how silly such a program would be.)*

So salespeople, for the most part, are incented by individual rewards. But that doesn't automatically mean monetary rewards. Money is the way of keeping score, but many *(if not most)* salespeople are motivated by the win, and the recognition that comes from winning. Millions are spent every year on recognition for salespeople such as contests, trophies, and trips to sales conferences. Some sales incentives come in the form of more work! How many salespeople have busted their hump for a bigger territory, or to be given a more lucrative line?

There is a behavioral study *(it might be Russell Ackoff's but I'm not sure)* that tracks a salesman's "non-compliance" factor. It goes like this:

You have a set of standards for your sales employees. They re to dress a certain way, submit call reports, get expenses in within 2 weeks or forfeit their reimbursement, be at the sales meeting every Monday at 9:00, etc. All your salespeople follow the rules, more or less.

One sales person starts to see exceptional results. He is hot, and his sales are not only number one in the system, but he's an order of magnitude better. His call reports start to go missing. *("Hey, they're buying, aren't they?")* His expense reports are late *("Do you want me doing paperwork, or selling product?")* He shows up in loud plaid sport jackets *("My customers like to be able to pick me out in a crowded trade show.")* He is late for the Monday morning sales meeting...making an entrance while talking to a big prospect on his cell phone.

Do you slap him down? Of course not, and he knows that you won't. That's why he's doing it. He may like the money, but his drive is for recognition, and if it isn't built into the system to his satisfaction, he'll find other ways to get it.

As I recall the study, the behavior is self-correcting depending on results. If the salesman cools off, the closer he falls back into the rest of the pack the more compliant he becomes. No coercion is necessary, especially if another alpha dog is rising in his place. The reaction of his peers is sufficient to tell him when he no longer merits exceptions.

Remember that all individual incentives are a form of recognition. That's why you are supposed to publicize them. Don't make the mistake of telling someone "Don't tell anyone else how large your bonus is." That's precisely the point of a bonus in the first place! Incentives are an updated version of the eons-old custom of preening

and strutting in front of the crowd. Removing that component just wastes your money, and no increase in the cash amount will make up for it.

ALL FOR ONE…ONE FOR ALL

The individual incentive, whether monetary or non-monetary, seems logical. It fits best with sales people, who are the most familiar examples when we think of collective employee incentives. What kind of people would work harder for a group incentive?

Actually, there are a number of positions in a company that attract folks who might prefer group incentives. Think about customer service representatives, technical support, back-room analysts, production teams, pick-pack teams. In fact, the terms "support" or "team" in any job description should give you a hint. Anyone who works in a group, or whose job revolves around helping others to be successful is a candidate for group incentives. This is especially true when employees share tasks, and it is difficult to measure performance individually.

If a deadline is missed because part of the production team isn't making goal, it doesn't matter much if the finishing group is running at twice their normal efficiency. From an employer's perspective, group incentives are called for when individual performance can't, by itself, produce the results.

Group incentives can be monetary, like $100 for each member of the team. More frequently, however, the non-monetary rewards work better. You particularly want to consider non-monetary incentives that let the team

celebrate together. A pizza party or company jackets are great for recognizing the whole team.

STRUCTURE

In order for incentives to be effective, they have to be understood. If an employee has to ask a manager "How are we doing on the goal?" the incentive isn't working. The objective is for the employee to relate the work being done every day to earning the reward.

If you create an incentive based on margin or profitability, you should be including some version of open-book management. Just telling employees "If we make money, you make money," isn't even *close* to sufficient. They need to be educated in how the company makes money, and what they need to do to maximize it.

Of course, any structure should support greater profitability. I had an owner say to me recently; "I am having trouble finding the money for bonuses. Most of my employees are making their individual incentive goals, but only half of my teams are achieving their department goals, and we are still losing money."

The over-arching requirement of any incentive plan is that first, the company has to make money. The only exception to that rule is in sales. If a salesperson sold the right amount of product at the right price, he or she can't be held responsible if the processes that followed failed to make money.

This is how a properly structured bonus system would work in the case above.

- If the company is profitable, there will be a bonus pool for division among the departments
- The pool will be divided among the departments who made department goals, thus contributing to the bonus pool. If any department did not perform to goal *(presumably reducing the pool)* they will not be included in the bonus allocation, nor will any employee in hat department be eligible for individual bonus.
- Department allocation, when earned, will be divided among those who achieved their individual goals within the department.

This top-down structure keeps not only motivation, but also peer pressure at every level. Individual employees watch others to make sure that their department achieves eligibility. Department heads communicate how they are doing, with awareness that a single poorly performing department could cost everyone their bonus.

TIMING

The last variable to consider is timing. In order to be effective, an incentive plan has to be close to the actions that earned it. It also has to be frequent enough to continually reinforce behavior, but not so frequent as to considered a part of "normal" compensation.

That is the issue with weekly or monthly incentives. If they are going to motivate behavior, the employees should be earning them regularly. If they earn them too regularly, then they start to expect them all the time. That makes it very hard to change incentives, even by raising the bar.

At the other extreme are annual incentives. Many companies pay holiday bonuses based on annual profitability. That both distances the reward from the action, and mixes the message about why the bonus is being paid. Holiday gifts are gifts. Bonuses are incentives. Don't mix the two. Annual bonuses should be limited to the level three and four employees discussed above; they are high enough in the organization to understand the longer-term impact of their actions.

I find that quarterly incentives often nicely span the gap between action and reward. The first month of the quarter includes distribution for the previous quarter's bonus, which is clearly motivational. The second month defines what is needed to make the next goal. The third month is the push for the goal. Then the cycle repeats.

When creating incentives, be careful of allowing a deficit. If there are quarterly incentives based on profitability, what happens if you miss goal in the first quarter? The natural tendency is to say that the first quarter has to be recovered *and* the second quarter must reach goal for bonuses. If the hole is too deep, however, you could lose a motivational tool for the rest of the year. Sometimes building in "forgiveness" at some point is wise.

Another defense against dips is to hold back some bonus money against the end of the year. So a first quarter bonus may be 30% distributed and 70% held against future performance. At the second quarter, 50% of the entire accumulated amount would be distributed and 70% at the end of the third. The full amount is paid out a year-end. This gives employees "skin in the game" to maintain results after one good quarter.

INCENTIVES AREN'T EFFECTIVE FOREVER

All incentive plans go stale. Employees learn to game them. Worst of all, too many managers allow an incentive to remain in place long after the goals are being exceeded with ease, and the bonus has slipped into an entitlement.

There is one critical point to emphasize in any incentive program. *Nothing motivates forever*. Every bonus scheme has a lifetime. Any plan should be introduced with the caveat "This inventive is intended to motivate specific behavior and results. Management reserves the right to modify or cancel it at any time."

Change incentive plans regularly. Swap a long-term individual monetary plan for a short-term non-monetary team goal just to loosen things up. Give team members the ability to excel individually from time to time. One incentive can be a contest, with only a single winner, or first, second and third place but no rewards for fourth on down. Top three performers, top two performers, qualify to be in the group with a drawing for the best prize, or multiple entries in a drawing scaled to your performance. Spend some time thinking of how many ways you can vary rewards, and save them for future use.

When you finally come up with a program that works, avoid the temptation to dust off your hands and walk away. It merely means you've bought some time until the next incentive plan is due.

AUTHOR'S BIO

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John F. Dini is widely recognized as one of the nation's leading experts on small business ownership. He is a consultant and coach to hundreds of business owners, CEOs and Presidents of companies. John is an outlier in coaching business owners, having achieved the rare feat of delivering over 10,000 hours of face-to-face, personal advice to entrepreneurs.

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John founded and operates the most successful peer group franchise in North America, overseeing 15 monthly meetings of business owners' groups under the auspices of The Alternative Board®. He holds a Bachelor of Science in Accounting from Rutgers University, a Master of Business Administration from Pepperdine University, is a Certified MBA, and holds six additional certifications in exit planning, business brokerage, behavioral analysis, medical practice management, facilitation and coaching.

Mr. Dini writes numerous articles on business topics for newspapers and magazines, in addition to his weekly column on business ownership on this website Awake at 2 o'clock in the morning? and his opinion blog at Awake at 3 o'clock. He speaks frequently to business groups and national associations, and is a 10-year member of Jim Blasingame's "Braintrust" appearing regularly on "The Small Business Advocate" nationally syndicated radio program as an expert in the issues of business ownership.

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