

MYTHS ABOUT BONUSES

PART II

WHAT TO REPLACE BONUSES WITH?



Several examples of good practices and alternative techniques, with which bonus systems should be replaced. In the previous Knowledge for Manager article we presented arguments against using bonuses. Bonuses more often harm business than help it.

Remuneration mechanisms used in managing are acute, they cause very complex effects and are difficult to control. Therefore, they should be used very carefully. Their positive, short-term effects are small compared to the damage to business and workers they cause in the majority of systems I know. Without good preparation in terms of psychology of work, motivating and deprivation mechanisms, bonus systems should not be designed. Alas, nearly every Polish manager claims to be an expert in motivating and remunerating. The solutions I have seen in the majority of companies are horrendous. They can hardly be referred to as incentive programs. The severe damage caused by those systems grotesquely contrasts with the satisfaction of their designers and the unawareness of the managers. There are situations, however, where adaptive remuneration systems do actually work.

Bonuses work as means of communication

In this case, we may compare the role of a bonus to salt in a meal. The bonus, like salt, strengthens the message. In gastronomy, a cuisine must have its own taste - in management, the message must be clear to the recipient. A bonus can only strengthen it a little. Excessive strengthening will be detrimental to communication, since it will bring one's attention to the bonus, not to the message.

Bonuses work when managing sales, i.e. in stressing out priorities and managing product portfolios. Products more difficult to sell, but more important for the company, are rewarded so that salesmen put more effort into selling them, at the cost of other products' sales. For the bonus system to work correctly, sales plans, targets and priorities must be clearly communicated.

In managing managerial personnel, small bonuses may be applied for specific lasting achievements. The precondition is a well-functioning system of targets or project management, which will allow to accurately define tasks, goals and accomplishment indicators. Only if such system is functional, priorities may be emphasized with the use of a small bonus. It is important that the emphasis is not on the bonus. The manager should derive satisfaction from work, not from the extra earnings.

For the bonus system to work correctly as message reinforcement, the following criteria must be met:

1. First of all, an effective system of communicating priorities must be used. This may be a plans or sales targets system, managerial goal system, or project management.
2. Only selected priorities should be rewarded (selected products or goals). It must be remembered that granting bonuses for one goals is always made (and should be made) at the cost of the others.

3. Bonuses must be small (about 10% of salary).
4. Bonus terms must be clearly defined (bilaterally) with the potential recipients each time goals/targets are assigned. A written agreement should be written, in a form similar to business contracts.
5. Bonuses should be used only in cases when the company clearly needs them, i.e. during advertising campaigns or in periods of major changes. 6. Terms of granting bonuses as well as aims/targets may be changed at any moment upon consent of both parties, or unilaterally, in accordance with terms set up previously. Possibility of changing the terms should be specified in the agreement.
7. Bonuses should only be paid for a measurable and lasting added value for the company, and only if the conditions for awarding the bonus were met. Paying bonuses in other cases is demoralizing and harmful to the company.
8. Bonuses should not be treated as remuneration (in fiscal terms, bonus is deemed as worker's income and employer's cost). The benefit for the worker should be his personal success and satisfaction from work. The bonus should only emphasize this. If the worker works for the bonus, it means it is too high and fails to fulfill its purpose.
9. In terms of budgeting and productivity planning it must be assumed that bonuses do not increase the workers' engagement, but only transfer it onto higher profitability goals.

Civil code contracts

Adaptive remuneration may be effectively used in civil code contracts or work agreements of similar nature. They work well for employing board members, experts, interim managers, consultants. These are not bonuses per se, however, since their purpose is binding the interests of the manager and the owner, or transferring part of business risk on the employee. This type of solution should be reserved only to work posts having full or considerable impact on those criteria on which the remuneration is based.

In employment relationships, remuneration may be linked to work time (i.e. overtime, work time other than full time). Such remuneration should only be treated as basic remuneration, not a bonus.

There are companies that effectively use deferred remunerations - the so called Long Term Incentives. This type of remuneration (e.g. stock options, stocks) are deemed to be quite effective. It is believed that their role consists in building bonds between the worker and the company, and in awakening loyalty and responsibility. The use of these types of techniques in relation to key personnel may be justified in terms of business. This must not be confused with motivating, however.

Bonuses must be gradually eliminated

Unfortunately, we will have to say goodbye to bonuses, just like physical punishments were forgotten in the second half of XIX century - they were gradually eliminated and replaced with other, more subtle forms of external constraint. Bonuses in Poland are a very important element of business culture, however, and many people will find it difficult to manage organizations without them. Contrary to the entire Western European theory of management, and to the

experiences of Western countries, bonuses are still the foundation of the so called incentive systems in Poland. The parting will thus be long and gradual. Managers should be preparing themselves for the change already, since new generations raised after the fall of communism are now entering business. These generations will be willing to work on different terms. They will be seeking motivation, personal development and larger money themselves. They will not want to participate in outdated bonus-oriented social engineering.

What do we use instead?

In most cases, bonuses simply cannot be eliminated. An attempt to do so will cause reduction in productivity. They must be replaced with more effective solutions, which will cause smaller negative side effects. Main directions of changes are commonly known in the Western European economy, and there is no need of creating completely new solutions. It is enough that they are adapted to Polish conditions. Below I will list those that I think are the most important.

Method I. Leaving the responsibility for motivation to workers

To replace bonus systems with more effective methods, we must first of all accept the seemingly commonly known truth that motivation lies in the interest of the workers, not the employer. According to motivation theory, the main source of motivation is the work itself. The motivation comes from that the worker understands the point of what he does, thinks it is good and necessary, identifies with, or at least agrees with the goals of his work, likes the work and the conditions in which it is done. Different things will be motivating for different workers. This thing can be satisfaction or sense of success; it can be atmosphere or the team in which he works. For others, the motivation will result from aesthetic issues related to work, or from a feeling of pride, or even sense of security. Sources of motivation are different. The employer should create conditions allowing the worker to build his own motivation to work. It is not the employer who is responsible for the worker's motivation, though. Quite contrary, motivation is one of the spheres, like corporality or religious convictions, in which the employer should not intervene directly.

Accepting the principle that the employer is not responsible for the workers' motivation, and that he should not impact it directly is beneficial for business, since it pushes the managerial cadre into conceiving more effective solutions. In practice, this means implementing techniques and using such methods of employment, which permanently increase productivity, at the same time giving workers the chance to be motivated by their work. If workers want to do what they do, they understand the sense of their work, and identify with these goals, then they will prefer actions more profitable and will work more effectively. Motivation and engagement are highest when the work causes joy to workers.

Method II. Introducing workers into the management process

Adopting the above principles will automatically lead the managers into a conclusion that different forms of participation, including, above all, participative management must be introduced. It consists in that workers, especially managers, are included in the company management process. Workers should co-decide about business goals, meaning: methods of executing the assumed results, as well as their individual goals. Workers should co-decide on the selection of methods of performing tasks, on division of tasks and responsibilities, on methods of servicing clients, etc. The higher the level of participation, the higher the motivation and engagement, and the higher the pressure on optimizing processes and lowering costs coming from below. Implementing workers' participation policy is difficult for the managers, as well as for the subordinates, and requires time. To implement it effectively, many different actions must be taken. I will describe the more important ones below.

Participation should not be confused with responsibility for results. I believe that promoting responsibility for results is harmful to business. It releases the actual decision-makers from implementing solutions improving those results, transferring liability onto the executors, whose short-term impact on them (by increase of engagement or manipulating results) is harmful to the company in longer perspective.

Method III. Improving communication

Good communication with workers and other stakeholders in terms of strategy, goals, business values and market context is the basic technique of participative management. Business liability of the employer consists in creating optimum conditions for the workers to discover the sense of their work in all its aspects, and to allow them to actively engage in the process of creating commercial value together. This in practice means communicating, or even defining company strategies and goals together, and agreeing with workers on the goals of their work, as well as explaining the meaning of this work in the whole value creation chain. It is the company's interest that workers co-create their goals. For this to be possible, the employer must communicate business goals and methods of acting good enough to allow the workers to follow the same direction. This is implemented by strategic workshops, design teams, consultations, conferences, and, above all, by continued, open communication and full transparency. Concealing own strategy and operating plans is suicidal. Learning good communication requires time and practice from managers. Effects will only be visible after longer period. Good communication gradually increases workers' engagement and allows to utilize business-crucial information that they have. It definitely pays back to implement good communication techniques and habits.

Method IV. Contracting goals

I propose that strategies are contracted at least with managerial personnel, and that operating goals are contracted with workers. It is time-consuming and often requires negotiation, or even concessions, but participation is a much higher value. Contracting consists in setting goals and tasks using an (authentic) consensus method. Consensus, as a method of defining strategies, goals and values, is a time-consuming, but preferred management method. Even the smallest authoritarianism kills participation in the modern society, and is discouraging to workers. Contracting goals should be formal.

In task management and goal management it is important to define clearly what and for when is to be done, and how the effects will be monitored.

The majority of managers fear that, when given the possibility of negotiating or defining their goals, the subordinates will strive to minimize them. This fear is justified, but the situation may be turned to the company's advantage. Talking to, and negotiating with the workers gives the managers a clearer image of their organizational potential, and allows to plan more efficiently. Working with subordinates, building trust and inspiration gives result only after a certain time. When working personally with managers that way, I notice that they are gradually undertaking more ambitious, and at the same time more realistic goals. They must first realize themselves what they are capable of. Managers have to create a climate of promoting ambitious and engaged persons. The more often the worker takes responsibility for his projects, the higher should be his impact on business, the higher his jurisdictions and his target (basic) remuneration should be. Workers who do not engage themselves into work should be fired.

I recommend various methods of project management and improving targeting techniques in sales. These are very effective techniques. Under no circumstances should they be combined with awarding bonuses, however. Bonuses eliminate the managers' need of reaching consensus with their subordinates; they limit communication and are destructive to relationships. Bonuses are also harmful to the worker. Instead of making what they do meaningful, bonuses only make them focus on the additional remuneration, and on maximizing it by all possible means. Workers who do not care for what they do, as long as they get the bonus, are an example of complete degradation of work and motivation.

Method V. Showing respect to workers

Modern management techniques are based on openness and respect for worker. Unfortunately, there is a bad tradition of paternalistic vertical relations in Poland. Those relations are common on all organization levels: the president treats his managers disrespectfully; the managers tolerate unequal treatment, but then they treat their subordinates the same way. Paternalism in employment relations does not necessarily effect in aggression or

humiliating people directly. The most frequent forms consist in rewarding and punishing, "patting on the back", ignoring opinions of subordinates, assigning unclear or unaccepted tasks, making safety of employment-related threats, etc. Employee assessment and appreciation bonuses are techniques that usually accentuate inequality in employment relations. This inequality, resulting from formal structure, is, generally speaking, unbeneficial to business. It has a negative impact on the engagement and value introduced by workers. It is a commonly known fact that a slave is never a good worker. Economic coercion, actual or imagined, causes workers to accept the conditions that some would think to be unacceptable. In today's economy, short-time effectiveness, resulting from paramilitary obedience, doesn't work anymore (except for extreme situations). It is most often used due to managers' inability or their outdated convictions.

In the modern business, respect for subordinates, equality in vertical relationships, trust and popular participation in management should be promoted - not for ethical reasons, but because it pays off.

Inequality in employment relationships and paternalism should be eliminated by trainings, coaching, using participative management techniques, implementing company values, and by personal example of the managers. It is also necessary to use techniques allowing to locate and fire persons acting against those values. There are several IT tools on the Polish market which allow to perform these kinds of analyses at a relatively low cost.

Method VI. Assessing superiors, not subordinates

Another group of techniques that may replace bonus systems is based on the principle that it is the employer and the managers representing him that are responsible for work effectiveness - not the workers. The assumption that it is the superior who is responsible for the results of his subordinates' work forces him to improve the working process, eliminating unprofitable processes and automation. This principle is particularly business-effective. It is the superiors who are most frequently authorized to make decisions on changing work methods and prioritizing processes. The workers either have no impact on it, or do not believe that they could have any. They can only work more. Harder work is their first and natural response to the necessity of improving results. This not only fails to improve work effectiveness permanently, but also raises the costs in the long term.

The managerial personnel will naturally accept liability for improving effectiveness, provided it releases the workers from it. Implementing techniques such as Lean Manufacturing, Six Sigma or Kaizen brings real - and, most importantly - lasting increase of productivity. The improvement of effectiveness consists by lasting, usually minor improvements, and by prioritization and lasting elimination of less profitable processes. The workers - process executors - are not able to make such decisions. Instead of increasing pressure on the workers, particularly by awarding bonuses, it is better to improve processes and optimize requirements (targets), adapting them to individual possibilities of workers. In Western European plants, productivity improvement teams are often established, which develop improvements and continuously raise quotas met by the workers. Whenever the groups also consist of workers, their effectiveness is very high. The workers then understand and accept the increase in quotas and requirements resulting from process improvements.

Method VII. Individualization

Individualization of relations with workers and of requirements is crucial for managerial effectiveness. It consists in using quite simple, but time-consuming techniques, such as: individual meetings and approaching subordinates individually. The respect for subordinates expressed by individualization of relations effects in higher engagement and loyalty to the predefined goals. Individualization is especially important for planning, monitoring and assessing. Naturally, very detailed monitoring is not always possible, but an optimum situation is when each worker has his own quotas which correspond to his optimum level of aspiration. Workers should define the level of their professional ambitions themselves, and the employer should evaluate them in terms of the benefits brought to the company, and pay for them adequately.

Method VIII. Promoting self-control

An ideal control is self-control. This was admitted by Peter Drucker as early as 50 years ago. Self-control is the cheapest form of control, but requires business awareness of workers, good managerial information system, and

the most difficult thing - trust. Trust, in turn, allows to eliminate huge costs of control and securities. It also puts weight off the managers, allowing them to focus on strategic planning.

Self-control can be successfully implemented in Poland. For instance, many project management systems use self-control techniques. I always recommend using those techniques in operational management. One of the most effective self-control techniques is the three indicators technique, implemented by me, and described in the book *Market of targets. Return from investment in HR*. The technique may be used in advanced MBO systems. It allows the managers to self-assess in terms of the added value introduced into their company.

Certain forms of results visualization are very effective techniques of self-control. Computerization today gives huge possibilities of applying visualization and self-control. It should be implemented in place of the bonus systems eliminated.

Method IX. Stimulating personnel rotation

Many readers, having read those management methods, may ask: fine, but what if my workers still do not want to work after applying all those methods? The question is justified. Having ten-odd years of managing people professionally on my back, and several years of experience in the advisory branch, I am sure that those methods are effective... but there always will be difficult cases in any team. Thus the last of my proposed techniques for management:

techniques of adjusting personnel rotation. Rotation is necessary in any organization. Employers, in the interest of their organization, as well as the workers, should maintain rotation on an optimum level for the given branch, department and position. In most cases in Poland, this means forcing, not lowering rotation. Failure to manage rotation by the employer means that the company loses control over it, resulting in losing efficient personnel, and leaving ineffective people. No rotation, or failure to control it automatically causes failure of the other techniques too. Keeping workers who provide relatively small added value and use the work of others is especially discouraging and harmful to the engaged workers.

In companies with too high rotation index, techniques of rotation limitation should be used, such as: worker satisfaction and opinion survey, evaluating occupational preferences and suitability for posts, talking to workers, engaging key workers into projects, revisions of basic remuneration, or - in extreme cases - raising basic remunerations. The spectrum of techniques for adjusting rotation is very large.

Companies with too small rotation must force it by using appropriate techniques. The most often used ones consist in differentiating employment conditions, implementing substitutability systems, functional analysis, analysis of added value of posts, results ranking, or active outplacement, if necessary. Forcing correct rotation always requires applying several techniques simultaneously.

Will productivity drop if I eliminate bonuses?

In all the cases that I have seen, the removal of bonuses system caused increase in productivity. Of course, the increase resulted not merely from removing bonuses, but from applying appropriate mitigation and equivalents for bonuses.

In White Cap factory, in which we had removed the work-piece bonus some long time ago, thus reducing actual remuneration of operators by 20-40%, work efficiency raised in the first three months by 3%. In subsequent years, productivity kept rising.

In another company I know, in which the bonus was implemented into basic remuneration in two thirds of its value, productivity raised by 30%. By implementing a change to the system of remunerations, we have increased production targets and control of results. The success exceeded our expectations.

Bonuses, in certain specific situations, can be effective, but these are very dangerous tools. To use them well, the urge to overuse them must be suppressed, and the mechanisms of remuneration expectations, deprivations, depreciation of work through pay must be understood well. The discouraging character of remuneration must be understood. Only if those mechanisms are well learned, one may proceed with designing adaptive remunerations. Today, remuneration policy is not a field for talented and ambitious architects, but rather for professional sappers.

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