

# The Impact of Compensation Programs on Hourly Employee Engagement

Prepared by

Rhonda Farrington and Susan Malanowski



April 15, 2010

		Page
I.	Introduction and Overview	2
II.	Hourly Employee Engagement Strategies	8
III.	Total Rewards for the Hourly Workforce	15
IV.	Case Studies and Discussion	19
V.	Conclusions	26



## Background:

At the end of 2009, we completed an in-depth research project at the request of a client who is concerned about their hourly employees.

- They are very concerned about their employees as it related to their customers. Their hourly employees are the "face to the customer" and being challenged every day to work harder and faster as they continually make changes to improve productivity.
- They have 7,200 hourly employees who make on average \$31k or \$15 per hour and in addition receive an annual incentive payment.

Researching employee engagement is challenging because:

- The research on employee engagement tends to be focused on productivity.
- For every project examining hourly employees (60% of the US workforce), there are over 15 which examine leadership jobs.

As you consider the findings of this research and how your organization might respond, it will depend on your **philosophy** regarding the total workforce – should there be a difference between exempt and non-exempt pay and benefit programs and to what extent?



### Introductions:

Please introduce yourself :

- Name, role and organization
- What percent of your workforce is non-exempt?
- Do you refer to your workforce as exempt/non-exempt or salaried/hourly?
- Does your organization differentiate in the pay programs, benefits or other offerings?



A Framework for Performance Based Reward Systems:





## Definition of Employee Engagement:

Employee engagement is those conditions within the workplace where:

The employee is highly involved in, committed to and satisfied with the work one performs for the organization.

There are primarily two types of factors that reflect how engaged employees are in the workplace:

#### Performance (or Discretionary Effort) factors:

- 1. High levels of commitment to achieve the company's standards and/or goals.
- 2. They tend to go beyond what is normally expected in their job assignments (i.e., "Discretionary Effort")
- 3. Employees continually examine ways to improve productivity and quality by making suggestions for improvements and adopting reasonable changes provided by others.
- 4. They appear to be self-motivated and require little disciplinary or supervisory effort.

#### Retention (or Commitment) factors:

- 1. Employees remain with the company.
- 2. There is very little absenteeism or lateness to work.
- 3. They recommend the company to others (friends and family members).
- 4. They tend to have friends and strong social connections to others at work.
- 5. There is a strong commitment to the work itself, the team, one's manager, and the organization itself.



## Characteristics of a Highly Engaged Workforce:

The Gallup organization research shows that the following statements are the best predictor of employee and work group performance (referred to as the "Gallup  $Q^{12}$ "):

- 1. I know what is expected of me at work.
- 2. I have the materials and equipment I need to do my work right.
- 3. At work, I have the opportunity to do what I do best every day.
- 4. In the last seven days, I have received recognition or praise for doing good work.
- 5. My supervisor seems to care about me as a person.
- 6. There is someone at work who encourages my development.
- 7. At work, my opinions seem to count.
- 8. The mission or purpose of my company makes me feel my job is important.
- 9. My associates or fellow employees are committed to doing quality work.
- 10. I have a best friend at work.
- 11. In the last six months, someone at work has talked to my about my progress.
- 12. This last year, I have had opportunities to learn and grow.

#### A. Strongly Agree B. Agree C. Neither Agree or Disagree D. Disagree E. Strongly Disagree



## The Impact of Employee Engagement:

The Gallup organization conducted a mega-research comparing the performance of companies with different levels of employee engagement from 2001 - 2005. Those with high levels of employee engagement (4:1 ratio of employees engaged versus not) showed the following results:

- 1. Growth in earnings per share was 2.6 times greater for organizations with high levels of employee engagement versus those with limited employee engagement.
- 2. Earnings per share for top quartile organizations outpaced competitors by 18% during the study period.
- 3. This study demonstrated differences in the impact of effective employee engagement at the business unit level:
  - a. 18% higher productivity
  - b. 12% higher business unit profitability
  - c. 12% higher customer advocacy
  - d. 50% 70% lower employee turnover
  - e. 50% + lower inventory shrinkage
  - f. 38% fewer employee accidents



## The Impact of Employee Engagement (continued):

It is clear that high engagement practices have a major impact on the growth, profitability and market value of companies.

In a Towers Perrin study that compared companies with high versus low levels of employee engagement, they found:

- High engagement companies had a 19% increase in operating income and 28% growth in earnings per share over a three year period,
- Low engagement companies saw a drop in operating income of 33% and decline in earnings per share by 11%.
- High engagement companies had almost 4% higher operating margins and 3.5% greater net profit margins than low engagement companies.

The Corporate Leadership Council research (2004) demonstrated that highly engaged employees work **59% harder**, **perform 18% better and are 23% more likely to remain with the company** than employees with low levels of commitment.

There are no specific practices that high performers engage in that lead to success, for each organization creates and utilizes their own strategy.



## Types of Engagement Strategies:

Research by the Corporate Leadership Council shows that there are five (5) key strategies that organizations rely on to increase employee engagement and performance:

- 1. Select the right people that fit the job Hire the right people and they will perform well to improve the business.
  - > 31% of companies cite poor job fit as having the highest impact on productivity losses.
- 2. Develop the quality of managerial practices Focus on the right selection, training and development of managers to engage in those practices that enhance employee engagement.
  - Managers impact the job satisfaction and performance of hourly workers by 25% and 37% respectfully.
- **3. Support career development and training of hourly employees** Build special programs to train and improve the capabilities of hourly employees, then promote into career paths those that perform at a high level (promotional tracks).
  - > Only 40% of hourly employees indicate they are satisfied with their career development opportunities.
- 4. Engage and empower employees to achieve business goals Provide communication on business goals and performance so employees understand how their daily work drives overall business goals, and give employees the encouragement to make meaningful decisions regarding the work process.
- **5. Provide effective rewards and recognition** Create opportunities for employees to share in the performance improvements they achieve and be frequently and effectively recognized for their contributions.
  - ▶ 66% of organizations indicate that rewards and recognition encourage effective hourly employee engagement.



## Needs and Preferences of the Hourly Employees:

The Corporate Leadership Council (2002) has studied the unique characteristics of the hourly employee. The following summarizes the key findings of what is meaningful to **high performing hourly employees**:

- 1. Base pay internal equity as well as competitiveness with the market
- 2. The quality of the manager
- 3. Retirement benefits
- 4. Health benefits and work-life programs
- 5. Recognition and appreciation by one's immediate manager, peers and executive management
- 6. Work environment work tools, cleanliness, equipment, safety
- 7. Development and job-progression opportunities
- 8. Work-life balance work hours, location, vacation policies, child care, wellness programs, etc.

These identified preferences likely change with the employee's experience, age and personal circumstances.

Attributes such as work challenge, empowerment and project responsibility were more important to salaried employees but of little importance to hourly employees.



### Addressing Specific Hourly Workforce Issues – Recruitment and Hiring:

Top 20 factors that influence the attractiveness of the **job offer** (in order of importance 1 - 5 scale, average 3.85):

Base pay (and opportunity for increases)	6.67
Quality of the manager	5.14
Health benefits	4.19
External equity (offer comparison to other market rates)	4.17
Hours worked (less than 50 hours/week)	4.03
Job fit with skills/interests/values	4.03
Retirement benefits	3.93
Bonus opportunity (up to 10% of base pay)	3.92
Empowerment (frequent opportunity to make decisions)	3.91
Location (no relocation needed)	3.79
Travel	3.74
Coworker quality	3.73
Promotion opportunity	3.71
Company/product brand	3.69
Internal equity	3.68
Recognition	3.67
Quality of senior management	3.64
Vacation	3.60
Work challenge	3.58
Stock options	3.57



### Addressing Specific Hourly Workforce Issues -- Turnover:

Key factors that result from hourly employee turnover and cause employee turnover:

1. Average turnover rates are (PwC Saratoga Institute – 300 organizations in 12 industries)

	Total turnover rates:	Voluntary rates:	High performer rates:
2005	15.0%	10.5%	5.3%
2006	14.0%	10.4%	5.6%
2007	15.1%	10.4%	4.8%

2. The primary causes of voluntary hourly employee turnover are:

a.	Lack of career/job opportunities	33%
b.	Inadequate pay and benefits	23%
c.	Poor fit with the job	12%
d.	Poor quality of management	11%
e.	Incompatibility with manager or peers	9%

3. Employers indicated that it costs \$3,000 to replace each hourly employee.



### Addressing Specific Hourly Workforce Issues -- Productivity:

Hourly workforce productivity is largely a function of four different types of employee behavior:

- 1. Job Performance: Employees' effectiveness carrying out tasks and objectives associated with their job.
- 2. Counter-productivity: Employees engaging in activities that negatively impact organizational productivity (e.g., theft, substance abuse, accidents).
- **3.** Attendance: Employees showing up to work on time as scheduled and staying at work throughout their entire scheduled shift.
- 4. **Retention:** Employees remaining with the same employer over time.

These four aspects of workforce productivity are fairly independent from one another. Therefore a variety of human resource strategies are needed to fully address them.



## Hourly Rewards and Pay Systems: The Philosophy Regarding the Hourly Workforce

Jobs are classified as non-exempt and exempt based on the Fair Labor Standards Act of 1938 .

- Some organizations have held onto these differences in their compensation and benefit programs and others feel that the differences are no longer valid .
- In General Electric's 1990 annual report Jack Welch had a vision to erase barriers that divided employees from one another. He wanted to eliminate the labels such as management, salaried and hourly and get people working together. there have been many instances where reinforcing differences between these two sets of workers has been viewed as an obsolete boundary and barrier to contemporary management practices.
- Within the large group of jobs that make up non-exempt workers (nurse versus dishwasher) with different needs and preferences.



## Hourly Rewards and Pay Systems: Findings from Landmark Research Studies

#### 1. Does incentive pay impact performance? – Yes, under certain circumstances

In two studies, one laboratory and one with truck drivers, performance was examined in conditions where individuals received clear tasks and goals; and one group received incentive pay and the other did not. The results were conclusive that the groups receiving variable pay performed significantly higher than the groups receiving just base pay. In one of these studies, *performance increased 31.7% with the introduction of performance based pay and in another the performance increased by 26%.* 

#### 2. Does the amount of money matter? -- *No*

In five studies, performance was examined at different levels of payouts. In one laboratory study, the group receiving only 3% additional pay achieved performance that was significantly higher than the group who received no payouts. When *the payout was increased to 10% and up to 50%, performance did not increase measurably.* In the study involving two groups of truck drivers, the higher payouts did not result in higher performance, *but the performance was sustained over a long-term period* (3% incentive sustained performance for approximately 20 weeks, 6% sustained performance for 39 weeks, and 9% sustained performance for 107 weeks).

### 3. Which system of pay works better, flat (linear) or accelerated rate? -- Little difference

Two studies examined the relationship between performance and payouts – if one produces more do they earn more in relation to their previous performance? Both studies found that *individuals did produce more when they received variable pay, but their performance tasks did not increase when they received higher rates of pay for higher levels of performance.* It appears that variable pay serves to increase performance up to a limit defined by the tasks, physical abilities or system capabilities, and the performance – payout ratio does not increase with higher levels of pay opportunity.



### Hourly Rewards and Pay Systems: Findings from Landmark Research Studies (continued)

**4.** Which type of pay system works better – individual or group? – *Individual plans for high performers* There have been over 10 studies comparing individual versus group based incentive pay plans. The researchers concluded that *performance increased by 45% in team based plans while it increased by 27% in individual plans.* These team based plans included an average of 10 people, and the range was usually between 2 and 12 individuals. Further, it was found that these group based plans often resulted in higher levels of turnover. This reflected the "social consequences" of these work settings where the high performers "drove out" the lower performers. In contrast to these results, several studies indicated that *high performers preferred individual to group based incentive plans, and their performance dropped between 12% and 16% when they moved from individual to group based incentive plans.* Lower performers preferred group based plans over individual plans in several studies where preference was measured.

**5. Does feedback impact performance more than money?** *Money is more effective, both is most effective* Feedback did improve performance better than when individuals received only task instructions and no/little feedback. After establishing a baseline of performance with fixed pay, another study introduced both feedback and variable pay to assess the impact. *Performance did increase moderately with the introduction of feedback on performance and increased similarly with just a monetary incentive was introduced.* When both feedback and monetary incentives were introduced, *the performance increased dramatically and sustained at high levels even when the amount of feedback was reduced.* 

#### 6. Which has a higher impact on performance – money or social consequences? Both in tandem work best

Type of reward:	Improvements in performance over time:
Fixed, standard pay	11%
Performance feedback	20%
Social recognition	24%
Monetary incentives	32%



## Hourly Rewards and Pay Systems: Highly Successful Performance Based Reward Programs

- 1. The unit for the reward program is as small as feasible and effective the individual, team or group.
- 2. The measures (quantitative and qualitative) are clearly defined, understood (people can translate the results into desired actions or behaviors) and within the ability of the performers to influence.
- **3.** The performance goals are challenging and achievable; they are based on a well defined reference point or established baseline of performance.
- 4. Actual feedback on results is provided as frequently as possible, which is at least 3 to 5 times over the course of the performance cycle.
- 5. Individuals receive frequent feedback and social recognition for their progress and contributions; issues are viewed as learning opportunities or challenges to correct systems that are creating barriers to high performance.
- 6. The payouts are meaningful and range between 3% and 10% of one's base pay; the payouts are viewed as an "opportunity" and not money that is "at risk."
- 7. People clearly understand how the plan works, how their actions and results are translated into positive rewards.
- 8. If a team or group approach is used, the high performers are clearly identified and rewarded in a meaningful fashion.
- 9. The program is seen as an on-going process within the organization, and it receives periodic attention and improvements.
- **10. The people and the work** that they do are viewed as vitally important to the organization. This is communicated and reinforced to these individuals frequently.



## Hourly Rewards and Pay Systems: Our Experience and Best Practices

### **Base Pay:**

- Pay is extremely competitive for employed unskilled to semi-skilled workers
- There is pay compression with the skilled hourly workers
- Long seniority, general increases ("cost of living"), the economy and low demand and high supply have contributed to the pay issue
- There is a need to motivate hourly employees to "step up"

#### **Performance Management:**

- Language barriers between supervisors and employees
- Hourly employees claim "favoritism" and want supervisors assigning ratings to "prove it"

### Linking Pay to Performance:

- What alternatives are available if we want to keep hourly rates down
- Recognition and formal incentive programs



### **Base Pay Programs – Food Processing Case Study**

Grade Level Structure								
	Grade							
	1	2	3	4	5	6	7	8
Expereience	Up to six months prior related experience	Six months to one year prior experience in a related field	1 to 2 years prior experience in a related field	Up to three years prior experience in a related field	3 to 5 years prior experience in a related field	Five plus years prior experience in a related field	5 to 8 years prior experience in a related field.	Eight plus years prior experience in a related field.
Scope/Knowledge	Work is repetitive and involves predictable situations	Work is repetitive and involves variable situations	Work is specific and routine; selects from several recognizable courses of action	Work is specific and routine but occasionally varied or non-routine; selects from many recognizable courses of action	Work reflects variety, complexity, and detailed knowledge of functional/departmental procedures	Work reflects substantial variety, complexity, and detailed knowledge of functional/departmental procedures; selects and adapts procedures, tools and techniques and materials	Work is highly variable; modifies methods and procedures to meet broader outcomes and requirements	Relies on extensive experience and judgment to plan and accomplish goals; performs a variety of complicated tasks; a wide degree of creativity and latitude is expected
Skill Level I	General Laborer I	General Laborer II						
Skill Level II			Group/Team Lead I Machine Operator Packaging Machine Operator	Group/Team Lead II Packaging Machine Operator II Processing Machine Operator	Packaging Machine Operator III			
Skill Level III				Material Handler	Building Maintenance Worker Group/Team Lead III Research Technician	Mechanic Technician I Truck Driver	Mechanic Technician II HVAC Technician I	HVAC Technician II

Market Driven :	Created new, broadly-defined jobs in alignment with the market and ensured that skilled hourly jobs are competitive.				
Pay Administration Focus:	Classified jobs into eight grades in order to: - Facilitate employees performing multiple tasks/jobs as needed without the need for temporary rate differentials - Provide a 10% promotion opportunity between eight grades				
Skill Group Design:	Defined three skill groups for purpose of consistent pay administration within groups and flexibility between groups.				
son					

### **Performance Management – Manufacturing Firm Durable Goods**

### **Anchored Rating Scale Approach**

- 1. Fewer performance items (standards)
- 2. Performance "anchors" how would you know it if you saw it? for each standard
- 3. Define and apply "stepping up"
- 4. Only three ratings below, meets and exceeds expectations



## **Performance Management – Manufacturing Firm Durable Goods**

### **Anchored rating scales**

Category	Definition	Needs Improvement	Meets Expectations	Exceeds Expectations
Quality of work produced	Work meets high standards of accuracy, timeliness and completeness; quality issues are identified and resolved	Regularly has quality issues with work output and repeats errors after instruction.	Occasionally produces work with quality issues but corrects and does not pass on defective work; does not repeat the same errors.	Rarely produces work that fails with quality issues; identifies ways to prevent errors and assists others in improving quality.
Quantity of work produced	Produces work at standard levels based on available work; shows initiative and self-motivation	Must be reminded to use available time efficiently and does not meet quantity standards	Consistently uses company time efficiently minimizing non-productive activities; shows efforts and interest in accomplishing required output	Seeks to increase productivity and upgrade standards; redirects and/or expands own work efforts to be more productive and contribute to overall performance
Attendance and reliability	Is someone others can count on; dependable and takes responsibility for own work	Repeatedly does not follow attendance standards and doesn't come in when expected.	Can be counted on to come in when expected; starts and ends work on time	Highly dependable; sets an example for others
Application of job skill and knowledge	Has and utilizes skills and experience to perform assignments; follows established standards	Requires frequent instructions on how to perform the job and is unable to reliably produce output to standards.	Requires little or no guidance to perform job tasks. Shares job information with others. Occasionally identifies work and process improvements.	Knows own job completely and its impact on other jobs; consistently acts as a resource to others; regularly seeks ways to improve work and processes.
Flexible and cooperative team player	Works effectively and communicates with others; adjusts own work to meet team requirements	Avoids shifting to other tasks when required. Creates tensions and conflict with others. Causes problems or extra work for others.	Approachable and cooperative in dealing with others; understands team requirements and adjusts own work as required	Identifies need for coordination; adjusts own behavior to accommodate others; contributes to development of others
Safety	Works to avoid and prevent injury and is careful to follow standards that apply.	Selectively complies with applicable standards; Receives disciplinary action for at fault accident or safety policy violation.	Complies with all applicable safety standards and procedures; no disciplinary action for at fault accident or safety policy violation; identifies hazardous conditions and situations and brings them to the attention of the supervisor.	Follows all applicable safety standards and procedures and assists others to comply; Makes safety recommendations that are implemented to prevent property damage or injury; takes initiative to correct unsafe conditions; volunteers and participates in safety initiatives; safety habits are a model for other employees to follow.



## Linking Pay to Performance – Manufacturing Firm Durable Goods

AWARD TYPE	FREQUENCY	SENIORITY	PERFORMANCE
1. Base Pay Modified Step Increase	Annually up to a maximum # of years	Effective on the employee's anniversary date Reach market/midpoint at 4 years Reach maximum at 8 years	A performance review is required for a step increase No increase if performance is below expectations
2. Performance Bonus between 1% and 6% of hourly rate	TBD - 6 months to 1 year	Not Applicable	A performance review is required for the bonus and the amount varies based on Focal effective date, not anniversary based Bonus opportunity can be enhanced based on team performance
3. Pay Structure Adjustment Increase	Every other year, amount based on the competitiveness of the pay ranges	the subscription is a second	No increase if performance is below expectations Focal "review" date, not anniversary based



### Incentive Program – Corning

#### Context

- <u>Corning</u> has 20,600 employees and revenues of \$3 billion.
- Goalsharing began in the early 1990s to connect compensation to both individual and organization goals using a combination of stock and incentive for both exempt and non-exempt employees.
- Employees help develop the system, which is reviewed and adjusted annually at the business unit level by committees that include workers, managers, and union representatives.

#### Program

- Each U.S.-based Corning employee can receive an annual bonus of up to 10 percent of salary.
- Three-fourths of bonus depends on how well employees meet job performance goals established for their business unit over the year.
- One-fourth of the bonus is based on earnings per share of company stock for the preceding year.

### Results

- The average bonus in 2002 was 8.00%, 3.98% in 2003 and 6.11% in 2004.
- Employees have the ability to most impact the business unit results on which the majority of their variable pay is based.
- In addition, the company fosters a common company vision and motivates employees towards an overall objective of increasing total company profit and shareholder value by using stock price to calculate a portion of variable pay.



## **Recognition – Allied Trucking Co.**

#### Context

- Company transports cars from railroad depots to dealer showrooms.
- A key measure of performance costs and customer satisfaction is for the cars to arrive without dents and scratches.
- Executives decided to develop a recognition program that emphasizes minimal errors in product delivery.
- Historically about 10% of the drivers could achieve 99% error free deliver for 12 months or more.
- The challenge was to bring 90% of the drivers to the same level as the other 10%

#### Program

- The program was entitled the "Top Gun" club.
- When a driver achieves a 99% error free delivery in a given month, he or she becomes a member of the Top Gun Club. They receive a hat with Top Gun printed (and the company logo); at the initial award ceremony, the station manager welcomes the new comers into the club with the hat award.
- When the drivers continue this record for additional months, quarters and years, they receive special pins, patches, license plates. Additional ceremonies follow these awards as well.
- The program had initially tried tangible awards like video/DVD machines and radios, but they had little impact and could not be sustained.
- Members of the Club are frequently asked to train and assist others, and executives often solicit their opinions and ideas about new initiatives.
- The program encourages collaboration and training, with little ineffective competition. Drivers receive immediate feedback on the delivery and can track their performance on a daily basis.

#### Results

- Over a 3 year period, the number of drivers that became members of the Club grew from 10% to 60%.
- The standard increased from 99% to 99.7%.
- Over three years the company realized a savings of millions from the reduction in defect costs and growth in customer loyalty.



# V. Conclusions

- 1. Many organizations fail to understand the value and contribution made by their hourly workforce. They are often viewed as the "invisible" employee. High performance and high engagement companies have programs that address the specific concerns of hourly workers and they are consistent with the firm's overall strategy and the work structure.
- 2. Hourly employees often have **different interests and expectations** than professional or managerial employees. High performance companies understand what their employees want and tailor programs to address these needs. Hourly employees tend to seek to be:
  - Secure in their job and with their current and future income (i.e. retirement),
  - > Trained and developed that enable them to better meet the needs of the organization,
  - > Involved in and asked for advice on making process improvements (but not have to assume the responsibility for it),
  - > Know what is expected of them and receive frequent and meaningful feedback on their progress,
  - > Recognized (i.e., appreciated) and rewarded for their own work and that of their immediate team.
- 3. Engagement is more than a single approach to addressing the needs of the workforce. While companies employ many different strategies, a combination of a few key drivers, developed based on **sound, well-established principles of success that are implemented effectively** and achieve results organizations seek.
- 4. The reward programs reflect the mission and goals of the business, utilize meaningful measures, provides timely awards and rewards contingent on performance. These reward programs translate the firm's strategy into action that encourage desired hourly workers' performance and create a share in the success that they help achieve.



### **Our mission:**

"We develop with our clients customized solutions that increase the retention and motivation of people, so that the organization becomes more competitive and successful.

### What we offer:

- Total Rewards Strategies
- Executives Compensation
- Performance/Competency Pay Programs
- Team Incentives/GoalSharing
- Sales Incentives
- Retention Strategies and Programs
- Performance Recognition
- Performance Management Process

### What makes us unique:

- We listen and understand strategies and priorities
- Our expertise, creativity and resourcefulness
- We collaborate with our clients and each other

- to focus time and resources to drive strategy implementation to be competitive and distinctive to drive key success factors to strengthen market leadership to retain the best and develop the rest to make special recognition special to link people with measures and priorities
  - We are highly responsive to changes
  - Our commitment to client satisfaction
  - We are flexible with high integrity

### Visit our Home Page at:

### http://www.wilsongroup.com

### **Contact us at:**

978-371-0476 801 Main Street, Suite 2 Concord, MA 01742 rfarrington@wilsongroup.com & smalanowski@wilsongroup.com

