Using the Right Carrots: Creating incentive programs that work

Sarah L. Fogleman

Kansas State University

Send the Right Message

When it comes to employee compensation, most managers are busy asking: "What do I have to pay to ….?" That is not an easy question to answer. A better question might be: "What do I want my compensation package to say?" Whether you realize it or not, it is already saying a lot. The benefits, bonuses, and incentives your business offers speak volumes as far as your employees are concerned.

Child care and health benefits say that you value family.

Longevity bonuses for employees on the anniversary of their employment with you says that you value employees who stay with the business.

Throwing a party at the end of your business's busy season lets the employees and their families know that you appreciate it when your people go the extra mile.

Bonuses, profit sharing plans, and other incentives are amazing managerial tools, but they can also become a slippery slope if you aren't careful. Before dangling any carrots in front of your employees, make sure they lead your business down the right path.

First, some definitions

According to Schuler, "Total compensation involves the assessment of employee contributions in order to distribute fairly and equitably both direct and indirect organizational rewards in exchange for these contributions." In other words, compensation has evolved beyond just an hourly wage. It's no longer a matter of answering the question, "how much do I have to pay?" Today, successful employers utilize both direct and indirect elements to meet the needs of their employees.

Compensation takes two basic forms:

--*Direct compensation* includes an employee's base salary which can be an annual salary or hourly wage and any performance-based pay that an employee receives, such as profit-sharing bonuses.

--*Indirect compensation* is far more varied, including everything from legally required public protection programs such as Social Security to health insurance, retirement programs, paid leave, and life cycle benefits, for example child care or moving expenses (Schuler).

Employee incentives can take both indirect and direct forms. An eBoth of these types of compensation are important in developing a competitive compensation package.

Goal-Setting Theory

This theory focuses on motivating workers to contribute their inputs by meeting goals set to improve the overall performance of the organization. Ed Locke and Gary Latham, the leading researchers on this theory, suggest that the goals that employees strive to obtain are prime determinants of their motivation and subsequent performance. Goal-setting theory suggests that to stimulate high motivation and performance, goals must be both *specific* (generally quantitative and measurable) and *difficult* (hard but not impossible to obtain).

A survey of 1,010 people, conducted in March of 1999 by Wirthlin Worldwide, examined how respondents spent their most recent cash rewards, cash incentives or cash bonuses. The results of the study highlighted the limited impact of cash incentives. Of those responding, the answers given to how the cash award was spent were as follows:

Bills	29%
Do not remember	18%
Never received cash reward/bonus	15%
Gifts for family	11%
Household items	11%
Savings	11%
Special personal treat	9%
Vacation	5%
Something else	2%

This study appears to confirm that tangible rewards tend to stimulate the performance of employees and their co-workers for much longer than does "slippery" cash.

3. American Express Incentive Services (AEIS)

In a survey conducted by AEIS, 17% of the American employees polled said they had received a year-end cash bonus. A full 32% of these respondents admitted that the cash bonus did not improve their work performance.

4. WorldatWork

WorldatWork (formerly the American Compensation Association) found than noncash reward programs achieved three times the return on investment, compared with cash-based programs. A recent Incentive Federation survey found that, on average, 79% of respondents found noncash reward programs to be fairly to extremely effective in motivating participants to achieve sales and marketing goals.

Top Reasons for Formal Employee Recognition by Employer

Length of service	87%
Above-and-beyond performance	85%
Sales	43%
Suggestions/ideas	36%
Employee of the month	29%
Safety	28%
Attendance	20%

Note: Totals add to more than 100% because respondents were asked to indicate all that applied.

Source: *2003 Employee Recognition Survey* (WorldatWork and NAER, 2003).

The first thing employers should consider when developing compensation packages is fairness. It is crucial that businesses maintain internal and external equity. *Internal equity* refers to fairness between employees in the same business while *external equity* refers to relative wage fairness compared to wages with other farms or businesses. No matter the compensation level, if either internal or external equity is violated, a business will most likely experience employee dissatisfaction and employees will begin to balance their performance through a variety of ways ranging from decreased productivity to absenteeism and eventually to leaving the business (Billikopf).

Tips for an effective incentive plan

The Program

The Idea	The		
Safety Bonus	Employees receive cash and/or noncash rewards when the “team” meets a set of pre-established safety goals.	Days without an accident; OSHA review grades;	People may not report minor injuries; people may not support program if management and key leaders aren’t behind it.

It’s not about money….It’s about meeting the needs of your employees

It’s easy to think “dollars per hour” when thinking about compensation. But an employer who develops a truly creative and successful compensation package understands that it’s not about money. It’s about meeting the employee’s needs.

Most agricultural businesses are small, and most agricultural business managers think that limits their ability to create competitive compensation packages. True, a business with three employees might have a more difficult time setting up a 401(k) or health insurance package, but small businesses have the opportunity to know their employees much better, therefore better understanding their needs.

The success of compensation packages is not measured by the dollar cost to the employer. The success of a compensation package is measured in how difficult it would be to duplicate those same benefits from a competing employer. This refers not just to cash wages but also to direct and indirect benefits, including such items as flexibility in scheduling or working conditions.

One of the biggest mistakes an employer can make is to make a large investment of time or money to initiate compensation elements that his/her employees do not need or want. Successful compensation packages are really total rewards systems, containing non-monetary, direct, and indirect elements all based on the objectives of the employer and the needs of the employees.

Employers have a wide variety of compensation elements from which to choose. By combining many of these compensation alternatives, progressive managers can create compensation packages that are as individual as the employees who receive them.

Some indirect compensation elements are required by law: social security, unemployment and disability payments. Other indirect elements are up to the employer and can offer excellent ways to provide benefits to the employees and the employer as well. For example, a working mother may take a lower-paying job with flexible hours that will allow her to be home when her children get home from school. A recent graduate may be looking for stable work and also an affordable place to live. Both of these individuals have different needs and, therefore, would appreciate different compensation elements.

In a tight labor market, indirect compensation becomes increasingly important. Businesses that cannot compete with high cash wages can offer very individualized alternatives that meet the needs of the people you want to employ. Such creative compensation alternatives are the small business's competitive advantage.

Indirect Compensation Alternatives	
Flexible Working Schedules	Elder Care
Retirement Programs	Moving Expenses
Insurance (Health, Dental, Eye)	Subsidized Housing
Paid Leave (Sick/ Holiday/ Personal Days)	Subsidized Utilities
Tickets to Events (ball games, concerts)	Magazine Subscriptions
Boots and Clothing	Laundry Service
Company Parties	Use of Farm Trucks, Machinery
Farm Produce / Foods/ Meals	Cellular Phones/ Pagers
Child Care	Use of Farm Pastures and Gardens

While money isn't everything when constructing a compensation package, it is a large portion of what the package may eventually contain and it may be the only element a potential or current employee may think about when considering other employment options. So, what constitutes a fair wage? One approach to determining a fair wage is a market survey. These are typically fast and easy ways to establish compensation guidelines for many businesses. A few phone calls to other employers in similar businesses can determine the "market" value for a specific job (Schuler). Unfortunately, this technique is not necessarily well suited for agricultural producers (Fogleman et al). An agricultural manager can do informal surveys of other agricultural producers to determine the “going rate” for labor or modify existing studies of non-agricultural businesses to compare employees not by job title but by skill sets. For example, operating a forklift in a factory and driving a tractor may require similar skills and, therefore, can be compensated similarly.

Compensation Package Values in Kansas

To help producers make more informed decisions in regards to employee compensation, the Kansas Farm Management Association conducted a survey of its membership during the fall of 2001. In this survey, participating operations provided detailed information about employee characteristics and compensation, including cash wages and complete benefit information.

Cash compensation, whether through hourly wages or annual salaries, are certainly the backbone of most compensation packages. But as seen in the following tables, benefits are very prevalent, particularly with full-time employees who receive, on average $5,537 in non-cash compensation per year. The most common benefit was farm products, followed by health insurance and bonuses. While housing was not the most common benefit, it was, on average the most costly, valued typically at just over $4,000 per year. Profit sharing was the least common benefit, received by 2% of all employees and 4% of full-time employees.

Table 1.

Full-Time Employees (>1800 hours/year)						
	All	Employee Competency Level				
		1	2	3	4	5

Count[1]	245	22	60	64	42	54
Employees paid an annual salary, #	130	4[3]	22	35	28	40
Employees paid an hourly wage, #	114	18	38	29	13	14
Compensation and Wages						
Total compensation, $	28,188	20,871	25,008	29,016	33,060	30,139
Hourly compensation, $	10.13	8.07	9.10	10.77	11.73	10.21
Total cash wage (hourly & salaried)	22,651	18,415	20,462	23,527	27,155	22,351
Annual cash wage (salaried)	23,126		18,963	23,176	27,229	22,710
Hourly wage ($paid/hour)	8.36	7.01	7.94	8.88	10.63	7.94
Hourly wage equivalent (salaried)	8.08		6.78	8.65	9.27	7.52
Benefits[2]						
Health insurance, $	3,676		3,118	3,382	3,987	4,281
Receive health insurance, %	38	18	25	41	45	54
Housing, $	4,036	4,300	3,914	3,552	5,520	4,060
Receive housing, %	35	27	45	42	24	26
Utilities, $	1,828		1,724	2,047	1,925	1,770
Receive utilities, %	37	18	38	38	38	43
Farm products, $	934	392	472	832	1,569	1,266
Receive farm products, %	56	55	60	48	67	52
Personal use of vehicles, $	1,160		1,132	1,113	1,171	1,275
Receive use of vehicles, %	21	14	25	23	17	22
Use of equipment, $	2,011		357	1,692	3,400	3,714
Receive use of equipment, %	16	0	20	19	14	17
Retirement program contribution, $	1,538		675	972	1,900	2,935
Receive retirement contribution, %	11	1	8	14	12	11
Profit sharing, $	3,767					
Receive profit sharing, %	4	0	5	3	0	7
Bonuses, $	730	360	968	681	1,014	481

Receive bonuses, %	38	55	45	45	26	24
Average hours worked per week	53	49	52	52	54	57

[1] Competency information was not provided for three of the full-time employees included in the study.

[2] Benefit values are included in the average only when an employee receives that benefit.

[3] Due to confidentiality concerns, results are not reported when responses<5.

Use the Right Carrots

While the second principle applies to meeting the needs of the employees, the third principle applies to meeting the needs of the business.

A compensation package is one of the most concrete ways in which an employer can communicate the mission, vision, and values of the business. The benefits and incentives set in place by the compensation package will invoke certain responses from the employees. An employer has to be certain that those responses match the objectives of the business. In other words, the employer has to be careful to "use the right carrots."

For example, consider a farrow to finish swine operation where the farrowing unit has seen an increase in pre-weaning mortality. To help solve this problem, the owner instigates a bonus system based on live pigs out the door. The result: nursery mortality starts to rise as sick and weak pigs who normally would have stayed in the farrowing unit are shipped off to the nursery and, eventually, die.

Are the employees of that farrowing unit to blame for the sudden rise in nursery mortality? No. If you're surprised by that answer, think again. Based on their compensation package, those employees were only doing what their managers wanted them to do—they were following the carrots. As Johanna Slan said in Using Stories and Humor, "Sometimes we try to fix people when it's the system that stinks."

So, is it worth the risk? Should an employer instigate some type of performance incentive when there is a possibility that it will only create problems in other areas of the business? The answer is, yes, it is worth the risk. The general consensus of recent studies is that pay should be tied to performance to be effective. The key is in finding carrots that don't send the wrong message and making employees understand how their actions impact the entire business.

Successful managers must search for things the employees influence and base performance objectives on these areas. Your operation may benefit from the following: tenure bonuses for long-time employees, equipment repair incentives to encourage good equipment maintenance, or bonuses for arriving to work on time. The more production information data your business has, the easier this is to accomplish. Measures such as feed conversion rates, somatic cell count, or mortality can offer great sources for performance incentives. But, as always, be certain that those incentives send the message that you want your employees to receive. It may take a few tries to find the system that meets your objectives and your employees' needs, but with good communication and an open mind, you can achieve great rewards.

Conclusions

Successful agricultural producers rely heavily on common sense when it comes to management decisions. The area of employee compensation should be no different. If you want your employees to be innovative—reward them for new ideas. If you want your employees to stay with you for a long time instead of training new employees every season—offer bonuses or tie their wages to their tenure. If you need employees that show up on time, work hard, and can be trusted with the most challenging of tasks—recruit those people; reward those people; promote those people. The future of your business could depend on it.

References

Billikopf, Gregory. Labor Management in Ag: Cultivating Personnel Productivity. Agricultural Extension: University of California.

Doane's Agricultural Report. Risk Management Education Summit. Volume 60, Number 39-6. September 1997.

Fogleman et. al. Employee Compensation and Job Satisfaction on Dairy Farms in the Northeast. April 1999. Cornell University, RB99-02.

Kansas Department of Human Resources. Kansas Wage Survey: 1996 Edition. April 1998.

Rosenberg, Howard. "Labor Management Decisions". University of California APMP Research Papers, Volume 8, Number 1, Winter-Spring 1999.

Schuler, R. (1998). Managing Human Resources. Cincinnati, Ohio: South-Western College Publishing.