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Editor

Linking Strategy, Performance, and Pay / *R. Henry Migliore*

The appraisal portion of the strategic plan has long been a problem. How do you reward the achievement and performance of individuals as they operate the organization's strategic plan? How do you use the performance appraisal area to motivate the management team to achieve the objective in the strategic plan? How do you provide incentive for your people to stay with your organization? How do you develop a commonsense approach to salary and bonus rewards?

The keys to performance appraisal and salary administration within the strategic plan are profit and performance. This discussion focuses on two factors: (1) appraisal and reward for individual performance and (2) group bonus reward systems.

Exhibit 1 represents the various possible reward alternatives each individual faces. In the lower left-hand Section A, the low performer in an organization whose objectives were not achieved would receive low pay and a low bonus. At the other extreme, in Section C where the individual had achieved his objectives and the organization had achieved its objectives, then the individual would receive high pay and a high bonus. Sections B and D represent other situations. In Section B, the individual achieves his objectives yet the organization has modest success. Then he could receive high pay and a medium bonus. Section D is in a situation where a person didn't do as well on achieving his individual objectives but the organization did well, and he would receive medium pay and a high bonus. The rest of this column will discuss specific programs that contribute to individual rewards along with the group bonus reward.

Individual Reward

Ideally, the organization meets its broad overall purpose and reason for being. Specific measurable objectives in key result areas are largely met on a constant, sustaining basis. This success is based on a management team that has the motivation, ability, and insight to manage the organization's resources. The individual manager meets or excels his specific, measurable, key result objectives.

The successful organization rewards its contributors: stockholders, owners, managers, and employees. As a spin-off, it now contributes to society in its roles as taxpayer, employer, etc. It en-

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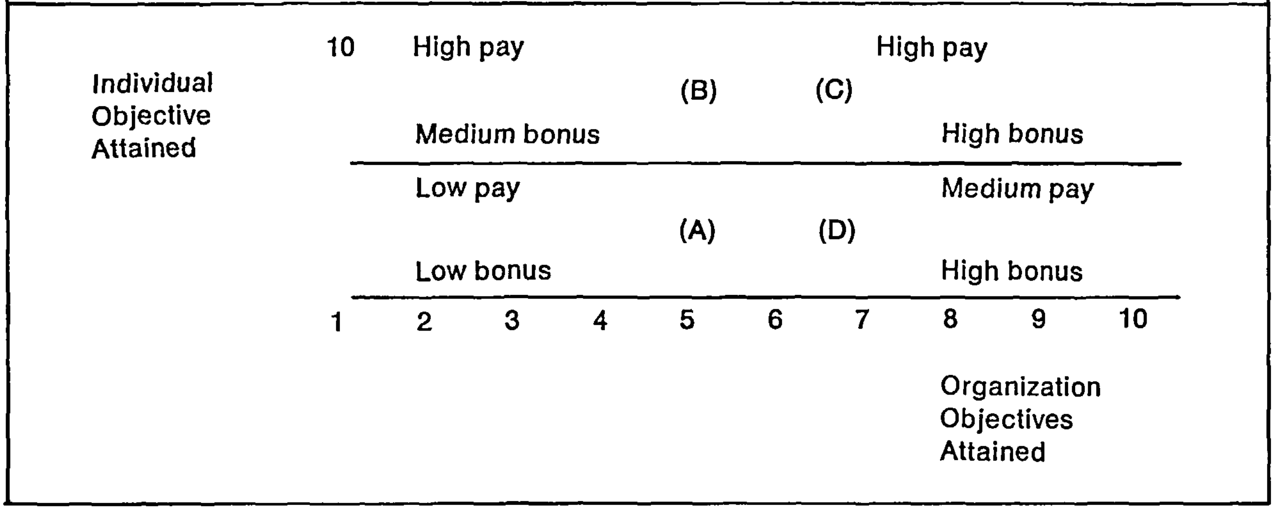
EXHIBIT 1
Reward Alternatives



courages its suppliers to make long-term plans to meet its needs. The ripple effect of success works its way down.

The successful organization now must devote attention to rewarding its own managers and employees for their contributions. The organization's needs are met. Now how does the organization meet the extrinsic and intrinsic needs of its people?

Intrinsic needs are met through a properly functioning long-range planning/MBO philosophy. Organization members meet their higher-level needs of self-esteem, autonomy, recognition, and self-worth with this particular style of MBO.

The extrinsic needs have always been more difficult to deal with. Few salary and bonus systems do well over the long run. The big question mark among MBO scholars, students, consultants, and executives is: "How do you combine MBO with salary administration?"

In its simplest form, the person must be evaluated on how he performed against key objectives that were negotiated, thoughtfully considered, and obtainable. They usually number from five to ten.

The managers should also be evaluated. Then each year's pay increase should be based on performance of the five-to-ten key performance objectives and the ten criteria listed.

1. Use of long-range planning/MBO.
2. Developing people.
3. Contribution to morale.
4. Communication.
5. Creativity.
6. Emotional stability.
7. Job knowledge.
8. What kind of leader.
9. Problem solver.
10. Public image/social responsibility.

One method the author has devised would take already existing sets of objectives and turn them into appraisal forms as suggested in Exhibit 2. The individual's regular performance objectives are listed at the top of the sheet and their final outcome is given a rating of 5 for excellent through 1 for poor performance. The ten items listed above are then rated according to the same system.

These ten items are nonmeasurable, but should be considered. The main criteria should be the results of how the managers performed as compared to what they negotiated as their performance objectives. Each objective at year-end would have performance rated excellent through poor. Exhibit 3 might be followed in determining the specific pay increases. You would average the objectives and give them a 75 percent weight. The ten nonmeasurable areas would get a 25 percent weight.

If the person fared well against these expectations and the organization has done well, he should receive a salary boost commensurate with the performance. In today's climate, this would be a 12 to 20 percent + pay increase.

Next, let's consider another circumstance: the organization doesn't do as well, but the individual performer posted a good record in all areas over which he has control. He should be paid by the same criteria. The organization has too much at stake to risk losing its high performers. Usually

EXHIBIT 2
MBO Performance Appraisal Form

	Excellent 5	Above Average 4	Average 3	Below Average 2	Poor 1	Discussion Notes
1. Operate within budget of $146,032 and cost per credit hour of $130	5					
2. Graduate 25 MBAs in May 1980	5					
3. Maintain enrollment of 100 FTE MBA students		4				
4. Publish in top ⅓ of the nation	5					
5. Average 35 aerobic points per week and reduce weight to 205			3			
	15	4	3			22 = Total
1. Use of LRP/MBO	5					
2. Developing people	5					
3. Contribution to morale	5					
4. Communication			3			
5. Creativity	5					
6. Emotional stability	5					
7. Job knowledge		4				
8. What kind of leader	5					
9. Problem solver			3			
10. Public image	5					
	35	4	6			45 = Total

Average of objectives = 22 ÷ 5 = 4.4
Average of other items = 45 ÷ 10 = 4.5
Weighted average = (4.4 × 75%) + (4.5 × 25%) = 4.425

20 percent of the people contribute 80 percent of the *key* results. Don't be niggardly with the 20 percent. The same rule of thumb, 12 to 20 percent pay increase, holds if the organization does poorly. The other 80 percent receive pay in the third 10 percent range.

In the third possible circumstance, the organization does poorly but the individual does very well. In this case, the high-performance individual is not in a position to expect the kind of organizational rewards listed in the first two circumstances. A mature management system should realize this. My best suggestion is that the same five performance levels above be recognized but that the pay scales be exactly half of what they normally would have been.

In the circumstance where the individual does poorly, it doesn't make any difference what the organization did. The individual did not make the right kind of contribution and should not be rewarded. Rewarding for a poor performance is a guarantee to continue the same.

One complicating factor in this era of high inflation is what do you call a pay increase and what do you call an adjustment for inflation? I know of no organization that has completely solved that problem. In reality, even with Exhibit 3 above, this past year with inflation at 15 percent, if a top performer received 20 percent, in effect he is receiving only a net 5 percent reward for his performance. This author believes the recommended pay percentages should be tied into the inflation rate. Theoretically,

EXHIBIT 3
Pay Increase Determinants

Performance Level	Recommended Pay
1. Performance less than satisfactory (has not met all minimum acceptable performance standards and objectives for the position). Point average below 1.5.	Zero % increase.
2. Performance meets minimum standards and objectives but not up to average. Point average 1.5 to 2.5.	Not more than 5% increase (0-5).
3. Performance meets at least average standards and objectives and may excel in some areas. Point average 2.5 to 3.5.	Not more than 10% increase (5-10).
4. Performance is better than average overall and excels in a majority of standards and objectives for the position. Point average 3.5 to 4.5.	Not more than 15% increase (11-14).
5. Performance is outstanding because it excels in all of the objectives and conditions previously listed. Point average 4.5 to 5.0.	Not more than 20% increase (15-20).

every organization should automatically modify its pay ranges based on the inflation level and then add the pay increase on top of inflation.

Bonus System

Working hand in hand with salary rewards based on individual achievement is the bonus system. This is nothing new of itself. But how does it work with MBO? If the organization meets certain understood, agreed-upon objectives and criteria, every organization member shares in the harvest. Objectives such as sales, profit, manufacturing efficiency, quality, and safety could be the bases. Criteria could be set for those deemed to be of importance based on the individual organization. The bonus system must be simple, straightforward, and understood.

The most important objective is profit. Good, solid, long-term-oriented profit is the golden word of capitalism. It's simple: no profit, no bonus. Other objectives can be a factor but only after profit objective is met.

The criterion for profit might be 15 percent before-tax profit on sales. A pool is set up with 20 percent of all profit above the minimum criterion of 15 percent going into the pool. For example, a $40 million sales company with $6 million profit would have no bonuses. One company provides a nice working vacation at a popular resort area if the minimum criteria are met. Another idea would be to give some percentage (e.g., one percent of all profits) if the minimum criteria are met. However, a $7 million profit would put $200,000 into a pool. If there were 500 employees, this would be a bonus of $400 per person. All employees share equally in this pool. The bonus is a nonbudgeted item.

Another way the pool can be distributed is to give divisional managers shares of the pool to distribute as they see fit within their units. This method is of doubtful value because of the bias problem. This is one instance in which the author advocates treating everyone on the team the same. The bonus is the team reward. If the team wins the league championship, it goes to the Superbowl and everyone shares equally in the reward. If you don't win the league championship (in this case 15 percent profit before taxes), you stay home and everyone gets the same thing . . . nothing.

Under this system, a person has an opportunity to get ahead on his own and is also rewarded for being a team player.

This author still believes the most effective way to handle a bonus is to include everyone, including the management team, by setting up a bonus fund. The fund is not budgeted, but comes out of after-tax corporate profits based on an audited financial statement. Another alternative is that funds should be available for bonus distribution unless the corporate performance exceeds all of the following: (1) 10 percent return on sales before taxes; (2) 5 percent return on sales after taxes; (3) manufacturing efficiency 80 percent; and (4) sales growth 40 percent increase. The total fund available for distribution each year is not to exceed 10 percent of corporate after-tax net profit or one percent of sales. This sets some standards, is reasonably simple, and lets everyone in on the bonus if things go well. Another criterion is 20 percent of after-tax profit in excess of 8 percent gross revenue.

Again, pay particular attention to the 20/80 rules. Those 20 percent who contribute the 80 percent need to be rewarded. A rigid reward system that holds them back just encourages them to go elsewhere. The other 80 percent are not going anywhere anyway so don't spend as much time worrying about them.

Some guidelines to keep in mind are:

- The key is accountability, not activity.
- Use job objectives instead of job descriptions as the focal point.
- People who are committed to your organization are worth more than people who are not committed to it.
- People who feel they are underpaid will act like it.
- Don't give any kind of merit increase to someone not meeting his job responsibilities and objectives.
- Bonuses should be paid only for beating an indicator.
- Paying people below equitable market rates will assure you of marginal performance and high turnover.
- Fair pay does not motivate, but unfair pay demotivates.
- The higher the person is in the organization, the more you pay for strategies and creative thinking.
- Performance appraisal and salary administration are part of the strategic planning process.

Conclusion

The performance appraisal approach outlined in this article is now being used in four organizations. Each adapted parts of it to fit particular needs in the organization. It has been in use for six months to two years. At this stage, this approach seems to be very positive. The management team in all four agree that this approach is superior to the one previously used. They now have a way of rewarding performance fairly, emphasizing the strategic plan, and providing a real incentive for people to see that they have a long-range future in the organization.