Incentive pay systems can be designed on an individual, group or organization wide basis. When a group of jobs are interrelated, one must consider group plans instead of individual plans. One practical problem is the linkage between an individual’s effort and results can be weakened in group plans. Each worker’s incentive payment may not match his/her effort (Dessler, 2013: 198). Moreover, about 70% of employees feel their organizations’ incentives are ineffective, so the design and execution of a plan should not be taken lightly (Dessler, 2013: 197).

Incentives plans have a strong intuitive appeal. Dating back to the Scientific Management era, many people have the idea of paying in direct connection with output appealing. The underlying assumptions seem straightforward. (1) It is assumed differences in levels of performance can be measured and are reflected in the workers' performance appraisals. (2) It is assumed all workers are economically motivated. This is sometimes referred to as the "economic men" assumption. (3) It is assumed the workers have the necessary skills and equipment to produce higher levels of output if they exert themselves. (4) It is also assumed tangible rewards in the form of praise, added monetary rewards and promotions will actually ensue.

A number of classic field studies (i.e. using observation and interviewing) were carried out, beginning in the 1920s. These revealed the aforementioned basic assumptions were not entirely accurate. The observation and interviews utilized by these researchers uncovered the following findings. In general the workers could produce thirty percent more than they were turning in to management. Why did this extensive output restriction exist? (1) Group norms prevailed with regard to what was "a fair day's work for a fair day's pay." The workers took this scientific management phrase and used it to represent a range of output that they felt was “fair.” Deviants who worked too rapidly or too slowly were labeled as either "rate busters" or "chislers." These deviants were sanctioned by the group via ostracism, insulting nicknames and binging (hitting a person in the upper arm with a knuckle or a fist). (2) The workers feared working themselves and their friends out of work (i.e. they feared added productivity would result in people being laid off). (3) They also feared the incentive standards would be raised if they produced too much (i.e. the managers would move the carrot). In the end, they thought they would be expected to produce more for much the same pay. (4) Goods were often "banked" rather than turning in the full amount produced to management. This was done in order to (a) allow for social time and (b) provide some insurance against a slow period or a bad day. The workers often worked very rapidly in the mornings, producing far more than the upper level managers realized they could. Lookouts were posted to make sure no one observed this high level of activity. (5) When the time study engineers came to study jobs, the workers normally tried to fool them by working in a slow and deliberate way. This was essentially part of a negotiation where the workers strived to get a favorable rate set, while the engineers guessed how much they were "beating it up." When the lower status workers outfoxed the engineers, they reaped social and psychological as well as monetary rewards. (6) By failing to work as fast as they could, the workers achieved a degree of power and autonomy that the engineers and managers would like to take away from them. While the workers obviously did not always get their way, neither did management. (7) Output norms also existed with regard to age and seniority. Young and relatively inexperienced workers certainly should not produce as much
as their older and more experienced counterparts. Those that exceeded their "betters" embarrassed their senior colleagues and were likely to incur their wrath.

These classic field studies discovered that only about ten percent of the population falls under the "rate buster" mind set (those who were more interested in obtaining some more money than they were about fitting into the group). Since this is a rather small minority, it was concluded we needed a more accurate socio-economic model of human behavior.

Some of the Varied Incentive Plans

Piecework simply stands for paying a fixed price per unit of output (e.g. $0.40 per unit). In other words, paying people in direct proportion to their productivity. Usually, the system is set up so the employee on the average will make more than he/she would have on straight time.

Differential Piecework was actually used by many of the early advocates of scientific management. Here, incentive rates are graduated. For example, for the first 1,000 units the rate might be $0.40 per unit, and for the next 500 the rate might be $0.50 per unit, and so forth. In short, an extra incentive is added for people who are very productive.

Sales Incentives are frequently used. Few people would accept a job that was 100% incentive. Instead, a 70% base salary and 30% incentive mix may be used to cushion the downside risk (Dessler, 2013: 199). When plans become more complicated, there is a danger of misunderstandings. There is also the danger that salespeople may neglect other tasks if they largely want to ring sales (e.g. stocking the shelves, taking care of returns, and cleaning up the dressing rooms) (Dessler 2013g: 401). One would want to monitor turnover, returns and the percentage making the targets set for the unit, to make sure the system is on track. It should also be kept in mind that frequent changes in a system can be expected to undermine motivation.

The Standard Hour calls for an average hour's work to be calculated. The employees are paid according to their actual output relative to this standard hourly rate. This system eliminates the need to recomputed piece rates when hourly wage rates change (Dessler, 2013g: 396). Auto repair schedules are normally constructed along these lines. Consider the following example that deals with sets of electrical components. The standard rate was 60 sets per hour. The standard hourly rate was $7.50. The actual output in a 40 hour week was 3,000 sets. 3,000/60 = 50 standard hours. $7.50 X 50 = $375. This is somewhat above the expected $300 ($7.50 X 40).

Scanlon Plans are group incentives. One normally uses a group incentive when it is difficult to measure individual levels of performance. Joseph Scanlon (1899-1956) was a steelworker, cost accountant and a local union president at various points in his life. In the later stages of his life, he served as a consultant and taught at MIT. He would only introduce his gain sharing plan into environments he deemed promising. He sought out managers and workers that were concerned about the future viability of the operation (i.e. they might go under soon if things did not change). People would thus be willing to pull together, be open to new ideas and be interested in sharing the gains. A Scanlon ratio is utilized which consists of the average monthly costs for a project divided by the average monthly sales value of production for the previous year. Essentially, the gain sharing bonus will consist of how much is saved in terms of (1) productivity, (2) quality (scrap), and (3)
shop supplies. Using the prior year as an anchor should alleviate the workers' fears that the carrot will be pulled away. For example, on one project, the expected cost was $80,000. The project was actually completed for $60,000. Thus, $20,000 was saved. Of this savings, 25% ($5,000) would be committed to improvements in the operation's productive capacity (investment in new machinery, etc.). The remaining 75% ($15,000) would be split up as follows. 20% ($3,000) was placed in a reserve account to offset potential future deficits on other projects. If money remained in this reserve account at the end of the year, it would be paid out in bonuses. The final 80% ($12,000) would be immediately distributed to the workers.

While Scanlon plans are highly thought of, there are some concerns to consider. It is far more difficult for the workers to gauge how they are doing compared to piecework or the standard hour. If too much accounting jargon is used in reports, or there is a delay in paying the bonuses, the workers may become suspicious. Peer pressure is likely to be exerted on the slowpokes. Those who do not carry their fair share of the load are often called "social loafers." Although one normally thinks about this plan as being cooperative, internal group conflict certainly can surface.

**Profit Sharing Plans** Most if not all employees may be given a share of the annual profits. A typical plan would provide 15-20% of the profits at regular intervals. One study found evidence this did indeed boost productivity, but it had an insignificant impact on profits once the costs were factored in (Dessler, 2013: 200).

**Executive Incentive Plans** This category includes short-term incentives (one time bonuses and merit pay), and long term incentives. A CEO survey published in 2007 found the average salary was 16% of total compensation, bonus 22%, and long term incentives 62% (Dessler, 2013g: 403).

One survey found 69% of companies provide short-term bonuses and one-third of those respondents did not feel short-term incentives boosted performance (Dessler, 2006: 227).

Stock options allow a person to purchase up to a specified number of shares for a specified period into the future. Such plans are meant to link the future of the executive with that of the organization and the shareholders. The chronic problem with stock options has been even poor performance has been rewarded (Dessler, 2013: 198). Is it economic cycles or effort that drives these outcomes? A survey revealed over half the executives saw little or no relationship between their performance and the value of their stock options (Dessler, 2003: 340).

Until recently, most companies did not treat stock options as an expense (Dessler, 2013: 201, 214). Since the actual expense was not stated, this encouraged the use of stock options. Some people also have criticized stock options for giving managers an incentive to take greater risks. The Sarbanes-Oxley Act of 2002 dealt with executive incentive programs. Executives and Board members can be personally liable for violating their fiduciary responsibilities. CEOs and CFOs of a public company are also required to repay any bonuses, incentives or equity based compensation for the year, if financial statements must be restated due to material noncompliance (Dessler, 2013: 199).

One can link managers’ rewards to how the company is performing relative to competitors and/or a market average. The question remains whether the shareholders press for this technique, and if compensation committees are independent enough to enact such reforms.