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Motivating Employees for Long Term Company Success

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Motivating Employees for Long Term Company Success

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Thesis

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Abstract

Motivating Employees for Long Term Company Success

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There have been many recent examples in the news of how employees were motivated by their companies to take actions that were not best for the long term success of the company. Mortgage companies gave financial incentives to brokers for each loan approved regardless of quality, which resulted in a large number of defaults several years later. BP, the oil company, gave financial incentives to employees based on short-term profits, which motivated management to perform cheaper and less frequent maintenance on the Alaskan Pipeline. This led to increased bonuses until a pipeline failure several years later. And numerous financial institutions gave employees big performance bonuses based on short-term profits one year before their institutions failed. Many

analysts have stated that lucrative bonuses that did not take into account long-term company performance motivated many employees to take dangerous financial risks.

In addition, in my 16 years of software development consulting, I have first-hand experience with seeing how companies' motivation techniques influence people to ignore the long-term success of their company. I have seen incentives for delivering a project on time influence project managers and developers to push low quality software into production in order to meet that deadline. Similarly, I have seen incentives (for meeting budget numbers on a project) influence managers to eliminate planning and quality assurance in order to lower the cost of implementing the project. In each of those cases, the resulting low quality software caused long-term damage to the company that could have been avoided if the project were higher quality but slightly late or over budget. I have also seen that incentives, intended to encourage call center employees to take more calls per hour, ended up motivating employees to hang up on customers without solving their problems. This resulted in low customer satisfaction, which led to a long term reduction in sales. These are only a few of the many examples I have seen in my career of how the wrong motivational techniques can have unintended, negative, long-term results for a company.

Regardless of whether the motivational techniques are based on profits, revenues, productivity, stock price, or some other factor, many motivational techniques include financial incentives that are based on monthly, quarterly, or yearly results without regard for longer periods of time. Long term incentives, such as vesting in a 401(k) or increased vacation time, are typically focused solely on retaining employees rather than on long-term company performance.

This thesis explores the ways in which companies currently motivate employees. The motivation may be extrinsic, using tools such as financial incentives or it may be

intrinsic, using tools such as company culture or hiring practices. This thesis will review both academic research and practical management experience related to employee motivation with a goal of identifying practical recommendations for improving the current, common motivational practices. These improvements should encourage employees to take the best actions for the long-term success of the company.

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Chapter 1: Introduction

RESEARCH QUESTION

How can a company motivate employees to take actions that are in the best interest for the long term success of the organization? The answer to this question is elusive to many organizations, especially as new technology allows management to monitor performance metrics down to the minute and allows casual investors to monitor stock performance in real time, both of which increase pressure on employees to focus on short-term results. The goal of this thesis is to analyze existing research on this topic, compare and contrast the research against management experience in the field, and identify recommendations that can be used to motivate employees to take the best actions for the long-term success of the company.

There are many factors that may affect the choice and effectiveness of motivational techniques. The role of the employee may be a factor. Are CEOs, managers, sales-people and other employees motivated by different things? The type of company may be a factor. Are employees of large or small companies, public or private companies, young or old companies, and growth-oriented or stable companies motivated by different things?

In addition, an important aspect of such questions is whether financial incentives should play an important part in motivating employees for long-term company success or if other ways to reach that goal are more effective. The body of research overall shows that financial incentives are an effective way to get short-term results; however, I found that there is less research on how financial incentives affect long-term results. In addition, the results achieved from financial incentives are not always what are intended and can often be damaging in both the short and long term. To emphasize this point,

Mary Poppendieck, an expert in Lean Software Development, recommends that you "*treat monetary rewards like explosives, because they will have a powerful impact whether you intend it or not.*"[1]

WHY IS THIS IMPORTANT?

Many companies try to motivate employees at all levels by using financial incentives that are based on short-term results. The incentives focus on achieving some particular goal over the course of a month, quarter, or year with little or any additional incentives for company success several years in the future. Even in the cases when companies try to base incentives on long-term results, the incentives can actually motivate short-term thinking. For example, some common incentives at the CEO level cover a 3 year period, but even the results over 3 years can be manipulated by slashing the costs for maintenance, quality, customer service, modernization, research, and development to temporarily boost profits while leaving the fallout for someone else after the rewards have been reaped.

Jeffrey Pfeffer and Robert Sutton point out that there has been a large increase in the use of financial incentive plans since 2001 across a wide swath of industries and employee categories to the point that they are nearly universal.[2] The employee categories that have financial incentive plans as part of their compensation range from entry-level call center operators to CEOs. The plethora of stories in the popular business press analyzing pay-for-performance plans for various CEOs is evidence that financial incentives are common across a wide range of industries.

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[1] Poppendieck, Mary, and Tom Poppendieck. *Implementing Lean Software Development : From Concept to Cash.*

[2] Pfeffer, Jeffrey, and Robert I. Sutton, *Hard Facts, Dangerous Half-Truths, and Total Nonsense : Profiting from Evidence-Based Management.*

This growth in popularity may have led to some recent trouble for, and even failures of, some large and established companies. Short-term financial incentives appear to be the underlying motivation for financial tampering that resulted in an SEC investigation, a loss of confidence in Dell's financial reporting, and a huge financial cost to the company.[3] The New York Times specifically called out financial incentives at all levels of Countrywide for their severe financial problems in 2007.[4] Many other reports in the business press blame an overwhelming focus on the short term as the underlying cause of financially disastrous events such as the bankruptcy of General Motors and the collapse of Lehman Brothers.

Finally, despite the fact that there are a great number of studies on the effectiveness of short-term financial incentives, I found that there is much less research on the effectiveness of long-term financial incentives. I suspect that this because it is difficult and time consuming to truly study long-term effects of any given incentive. Companies rarely keep the same incentive program in place for many years, and even if they do, it is difficult to identify whether any results were truly caused by the incentive.

The popularity of short-term financial incentives, the potential cost to companies and the overall economy due to intense focus on the short term at the expense of the long-term, and the relative lack of research into the results of long-term incentives make this area of research particularly relevant now.

OVERVIEW

The remainder of this thesis is divided into four sections. First, there is a review of common extrinsic motivation techniques that are practiced today according to the research I have done. Extrinsic motivation encompasses techniques that motivate

[3] Gonsalves, Antone. *InformationWeek.*
[4] Morgenson, Gretchen. *New York Times.*

employees through external rewards, such as financial incentives or other perquisites. The review covers some of the key thinking on the topic of extrinsic employee motivation from research and trade publications as well as from interviews of managers in a variety of industries (See Table 1 for list of interviewees), including my personal experience, in order to capture both theory and practice. The next section focuses on intrinsic motivation. Intrinsic motivation encompasses techniques that motivate employees through internal rewards, such as a feeling of pride for a job well done. This section will again review research and trade publications as well as manager interviews and personal experience. It will explain in more detail the case against financial incentives as a primary motivator and explain how companies can and do encourage intrinsic motivation in employees. In the next section, I will identify several practical proposals for effectively motivating employees to achieve long-term success for a company. These proposals identify the best current practices as well as proposed improvements to those practices. These proposals will be based on the literature, case studies, and experience covered in the previous sections. Finally, there is a short conclusion section.

Table 1

Name	Experience
Jana Bertheaume	Over 20 years experience in human resources with 15 of those in management. Roles include Director of Human Resources and Director of Recruiting for various companies.
Paul Catton	Over 27 years of work experience including 17 years in management. Roles include positions as Director of IT at multiple companies and other senior management roles.
Andrew Chen	Over 12 years of technology industry experience including 6 years in management. Currently CEO of a high-tech startup.
Liam Collopy	Over 15 years of human resources experience with 14 of those in management including roles as branch manager and general manager for technology services firms.
Will Cowden	Over 12 years experience in the financial industry with 4 years of management experience including a role as the COO for a division at a major bank.
Sue Darrow	Over 22 years experience in Human Resources including roles as HR Director and VP of HR at various companies. Industries include collection call centers, food manufacturing, retail fashion, technology startups, and technology services.
Ron Froehling	Over 22 years experience in building and leading sales and IT service organizations including extensive experience in sales, sales leadership, operation management, recruiting, and team building.
Sam Goodner	Over 20 years of technology industry experience including 17 years of starting and successfully growing a technology services firm.
Aaron Leek	Over 19 years experience in the financial industry including 18 years in management. Experience includes creating and implementing sales incentives for branch and call center personnel as well as setting performance bonus and compensation plans. The last several years have been in VP roles.
Stacey Welu	Over 22 years of business experience including 16 years in management. Much of the management experience involved starting and successfully growing a company in a new market.

Chapter 2: Extrinsic Motivation

OVERVIEW

The literature about how to motivate people to do what is best for the company covers a wide variety of areas. One major division among researchers is between using extrinsic motivation such as financial incentives versus fostering intrinsic motivation using other methods. Research is highly divided as to the desirability of financial incentives, and this review explores both the pros and cons of using financial incentives as motivation tools. Commonly used financial incentives are typically divided between senior management and other employees. Because the pay packages for these two groups are currently quite different, the review is divided along these lines. Within these divisions, I first subdivide the common financial incentives between long and short term and further subdivide them among individual, team, and organization level incentives. Understanding both short and long term incentives will help generate plausible hypotheses for the best long-term motivation methods. For the purposes of this analysis, short-term incentives are those that reward people for time periods of 1 year or less while long-term incentives cover multi-year periods. The overall content of the motivation review can be summarized in Table 2.

Table 2

Technique/Group	Brief Description	Examples	Pros	Cons
Extrinsic	Motivation from external factors	Bonuses, promotions	Very effective in getting what is incented	Often get unintended results, reduced creativity, motivation lasts as long as incentive
Senior Mgt.	Generally the CEO level and the people who report to the CEO, but this can vary by company			
Short-Term	Rewards for performance over periods of a year or less	Quarterly or annual bonuses, annual salary increase	Motivates reaching short term goals	May result in long term damage by encouraging risk taking and reduced quality
Long-Term	Rewards for performance over periods of more than one year	Vested stock and stock options	Motivates executives to focus on what is important for shareholders	Executives don't have strong line of sight to share price, loses motivational effectiveness if stock prices drops too much early in the plan
Other Employees	All non-senior management			
ST Individual	Rewards for individual performance over periods of a year or less	Piecework, commission, annual merit pay salary increase	Very effective in getting what is incented	Reduces teamwork, reduces creativity, focus on short term at the expense of long term

Table 2 (Continued)

ST Team	Rewards for small team performance over periods of a year or less	Team based performance incentives	Effective in getting what is incented without sacrificing teamwork	Reduces inter-team cooperation, difficult to fairly reward all team roles, focus on short term at expense of long term
ST Organization	Rewards for company-wide performance over periods of a year or less	Goalsharing, profit sharing	Motivates all employees to focus on overall company success, can adjust key factors on a regular basis to respond to changes in the marketplace	Weak line of sight to results, especially for stock
LT Individual	Rewards for individual performance over periods of more than one year	Annuity effect of pay increases	Motivates retention of best performers, especially ones who performed well for multiple years	If performance changes, employee stays for high salary based on previous performance
LT Team	Rewards for small team performance over periods of more than one year	Knowledge and skill based pay	Motivates learning new skills that are important for the team's long term success	Most valuable for teams that will work together for a long time, which isn't always practical
LT Organization	Rewards for company-wide performance over periods of more than one year	Stock, Stock options, gainsharing	Rewards employees for long-term success of company	Low line of sight, especially at large companies
Intrinsic	Motivation that comes primarily from within the employee	Satisfaction of a job well done, enjoyment of work, autonomy	Motivates creativity, big picture and long term thinking, excellent performance	Requires a constant commitment and communication effort, may not be effective for some jobs

Common Financial Incentives

As stated earlier, financial incentives are becoming nearly ubiquitous[5]. There is a wide body of literature that discusses the effectiveness of common incentives that have been used in business for years.

Executive-Level Financial Incentives

Because the CEO and other executive-level employees are held directly responsible for the results of a company, most companies have significantly different financial incentives for these employees than for the employees at other levels of the company. Robert Grossman pointed out in HRMagazine that one study of 417 companies with annual revenues of at least $5 billion showed that CEO compensation is divided along the lines of 18% for salary, 24% bonus, and 58% Long Term Incentives (LTI).[6]

Because personal performance at this level is so closely tied to how a larger organization performs, there is not generally a separation between organization level incentives and personal incentives. Executives may get incentive pay for their division performance, but generally, there are no incentives at this level for smaller groups than that. So, team incentives do exist but only in the larger context of a division.

Short Term

Generally, both salary and bonus fall into the category of short-term incentives. There are a lot of articles in the business press that argue that executive pay is too high, that executives' pay is not properly tied to performance, and that short-term incentives led to some of the corporate disasters of the past several years. However, Grossman

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[5] Pfeffer, Jeffrey, and Robert I. Sutton, *Hard Facts, Dangerous Half-Truths, and Total Nonsense : Profiting from Evidence-Based Management.*
[6] Grossman, Robert J.. *HRMagazine.*

points out that some of the perceived abuses regarding short-term executive pay aren't quite as widespread as conventional wisdom believes.

He says it is true that the ratio of CEO pay to typical worker pay has increased dramatically over the years to 344 and is much higher than other industrialized countries such as 20 times in Canada and 11 times in Japan.[7] However, he points out that outside of Wall Street, the non-CEO executives make significantly less than the CEO. He says that the VP of HR and the CFO typically make 1/3-1/2 of the CEO.[8] He also points out that despite high profile situations where pay seems to dramatically outstrip performance, one study showed that 72% of HR professionals think that their pay packages properly motivate executives.[9]

What results do these short-term incentives typically reward? In Forbes, Emily Lambert says, "*David Larker, who directs Stanford University's corporate governance program, says companies can measure performance one of three ways: by stock price gains (with or without dividends added), by accounting measures (like profit gains) and by nonfinancial indexes like customer satisfaction and employee turnover.*"[10] She also points out that instead of paying for performance, 86% of S&P 500 companies look at peer corporations' pay[11], which seems to contrast with the high number of HR professionals who think their pay systems properly motivate executives in the study cited by Grossman. Overall, the literature indicates that the most common short term incentives make an attempt to pay salary and bonus based on company or division financial performance.

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[7] Grossman, Robert J.. *HRMagazine.*
[8] Grossman, Robert J.. *HRMagazine.*
[9] Grossman, Robert J.. *HRMagazine.*
[10] Lambert, Emily. *Forbes.*
[11] Lambert, Emily. *Forbes.*

However, the end results have low overall correlation between pay and performance. Lambert mentions some particularly extreme cases where pay was decoupled from performance such as Angelo Mozilo of Countrywide earning $103 million the year before Contrywide failed and Rick Wagoner of General Motors was paid $39 million during a period when the stock went down 98%.[12]

Even when pay is directly related to company financial success, there can be unintended consequences if the plan is not carefully designed. During my interview with Sam Goodner, he recounted a story that illustrates what can go wrong. A senior manager who had a sales and marketing background and was highly motivated by money was promoted to president. The variable compensation portion of her pay was based on company profit, and she was brilliant at achieving that goal. In fact, the years that she was president of the company were, and still are, the most profitable years in company history. However, those profits were achieved, in part, by cutting investment in sales, marketing, and research and development. The company owners eventually realized that growth had stalled and that the long-term viability of the company was at risk, so they replaced the president.[13] The president had accomplished exactly what she was extrinsically motivated to do, but the incentive plan design rewarded short term profits at the expense of long-term growth.

Long Term

As mentioned earlier, over 50% of executive compensation is classified as LTI. This is most commonly awarded in the form of stock and stock options. These awards typically vest over time, and occasionally, the vesting schedule is tied to company performance. The prevailing idea behind stock and stock options is that when the

[12] Lambert, Emily. *Forbes.*
[13] Goodner, Sam. Interview.

executives hold a significant amount of company equity, their interests will be aligned with shareholders and they will act like owners of the company. Edward E. Lawler, a leading expert in compensation plans, points out that executives, due to their influential position, have a strong line of sight between their efforts and company performance, so stock should be an effective motivator.[14] At private companies, or when a company wants to motivate executives at a division level, phantom stock is sometimes used. Phantom stock is typically valued once a year and the value is based on financial indicators rather than the market. Kinko's and Mary Kay are two well-known examples of private companies that use phantom stock.[15] A variation on phantom stock used in publicly traded companies is tracking stock, which is a publically traded stock that is tied to just one division of a company.[16]

Some private companies motivate executives by issuing stock or stock options in the company that will only be tradable if the company goes public or is sold for a profit. Often, these shares are forfeited if the executive leaves the company before one of those events occurs. Ron Froehling described his experience with this type of incentive during our interview.[17] He said that the stock options were a huge source of extrinsic motivation for the executive team, especially in the 1990s. They saw employees at other companies such as Microsoft or Dell become instant millionaires when the companies went public, and the dream of a payoff of this size gave everyone a serious stake in the long-term success of the company.

Both stock and stock options tie executive rewards to company performance, but they do so in different ways. Options are issued with a specific strike price. The strike

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[14] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*
[15] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*
[16] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*
[17] Froehling, Ron. Interview.

price is a fixed price at which executives can buy shares in the future; however, the executives are under no obligation to buy shares in the future. This means that executives only get a reward if the stock price increases, but there is no penalty if the stock price goes down. In addition, Michael T. Jacobs, in **SHORT TERM AMERICA**, points out that since options do not pay dividends, they tend to discourage the executives from recommending dividend payments even in mature or declining companies.[18] Another issue with options is that when the trading price is well below the strike price, they lose their motivational value because there may be no realistic chance of them having any value in the future.[19] Jacobs explains that one way companies deal with this loss of motivation is by lowering the strike price of the options.[20] However, shareholders aren't typically happy with rewarding the executives who were responsible for the share price drop in this way. Ron Froehling pointed out that this can happen even in a private company. Due to an economic downturn and a lower demand for his company's services that occurred before the company went public, it became clear that the company was most likely never going to go public. At this point, the stock options were clearly worthless and lost all of their extrinsic motivational value. Ron also noted that despite the well-publicized stories of employees of private companies hitting the jackpot with stock options, the reality is that most option plans are never worth a significant amount of money. Ron stated that he believes that the CFO who was brought in to take the company public was much more familiar with the low odds of financial success and did not derive much extrinsic motivation from the stock options.[21]

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[18] Jacobs, Michael T., *Short-term America : The Causes and Cures of our Business Myopia.*
[19] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*
[20] Jacobs, Michael T., *Short-term America : The Causes and Cures of our Business Myopia.*
[21] Froehling, Ron. Interview.

Stock awards grant executives full shares of stock, which means that they get some reward regardless of whether the stock goes up or down in price, but they are penalized somewhat if the stock price goes down. Grossman points out that due to the nature of these rewards, options are typically chosen to motivate long-term performance while stock is typically chosen to motivate retention.[22]

Non-Executive Level Financial Incentives

There are a wider variety of financial incentives commonly used at the non-executive level than at the executive level. There is not a strong line of sight between most employees' jobs and the overall performance of the company, so companies tend not to base the majority of employees' compensation on the overall organization performance. Rather, the companies look for ways to motivate at the individual and team levels, in addition to the organization level. As with the executives, there are both long and short term incentives for most employees. Many of the incentives can include elements of more than one category depending on how they are set up.

Part of the reason for the wide variety of financial incentives for most employees is that there is a wide variety of jobs and roles that non-executives fill. Lawler divides the non-executives into categories of general management, production and service employees, technical and professional employees, and contingent employees.[23] In my interviews with executives, I found that it was common in practice to think of extrinsic motivation by different employee types. Sam Goodner considered Account Executives, Consultants, and all other employees to be three categories of employees who are extrinsically motivated in different ways.[24] Sue Darrow found big difference between how sales people, call center employees, factory workers, professional staff, and

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[22] Grossman, Robert J.. *HRMagazine*

[23] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*

[24] Goodner, Sam. Interview.

technical consultants each react to extrinsic motivation.[25] Ron Froehling also found that motivation differs by person although he did point out that, ultimately, everybody is motivated by money.[26] Each of these employees has a different ability to affect different company goals, and financial incentives must be tailored to be most effective.

Short Term

Short term incentives for most employees can cover very short periods, even down to the hour, all the way up to a year. These incentives are most commonly based on individual performance, but there are common incentive programs at the team and full organization levels as well.

Individual

Two of the most common short-term individual incentives are piecework and commission.[27] The literature widely agrees that these incentives are extremely effective at producing more of whatever is incented. Pfeffer and Sutton mention a study by Ed Lazear of a windshield replacement company called Safelite Glass found that piecework incentives resulted in a productivity increase of 44% with a cost increase of only 7%.[28] These results are obviously very attractive to corporations. My interviews revealed that piecework and commission were common in practice, especially for sales people and call center employees.[29][30][31]

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[25] Darrow, Sue. Interview.
[26] Froehling, Ron. Interview.
[27] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*
[28] Pfeffer, Jeffrey, and Robert I. Sutton, *Hard Facts, Dangerous Half-Truths, and Total Nonsense : Profiting from Evidence-Based Management.*
[29] Leek, Aaron. Interview.
[30] Darrow, Sue. Interview.
[31] Goodner, Sam. Interview.

The literature mentions many examples of piecework and commission incentives gone awry due to not balancing key job factors. Garbage truck drivers in Albuquerque, NM incented to finish routes early had more accidents, and New Orleans police officers incented for lower crime simply reclassified crimes to lower levels[32], just two name two of many examples in the literature. The interviews also revealed some interesting unintended consequences of commission or piecework plans. Stacey Welu worked at a call center early in her career. The call center implemented a program where the employees got credit based on the number of outbound calls made, but the program did not take into account the actual number of people talked to or sales made. In this case, many employees learned how to call those accounts that rang through to voicemail to get credit for making their calls.[33] Sue Darrow had a very similar experience at a child support collection company that gave a financial reward to the people who made the highest volume of calls, which led to employees calling cold accounts that likely had disconnected numbers rather than calling current accounts that has a higher chance of paying.[34] Aaron Leek was a manager at a call center that established a sales program that rewarded employees for selling additional financial products to people who called in for service but did not take into account customer satisfaction or call times. Besides the perhaps obvious drop in service level and call times, the management found that the employees were convincing customers to close accounts and then reopen very similar account, which defied the intention of the incentive.[35] The Safelite study showed that some of these negative unintended consequences can be mitigated by incorporating multiple performance factors into an incentive. Safelight balanced speed with quality by

[32] Pfeffer, Jeffrey, and Robert I. Sutton, *Hard Facts, Dangerous Half-Truths, and Total Nonsense : Profiting from Evidence-Based Management.*
[33] Welu, Stacey. Interview.
[34] Darrow, Sue. Interview.
[35] Leek, Aaron. Interview.

penalizing the workers for each returned windshield. Despite the potential negative effects of these types of incentives, the powerful positive potential effect for a well-designed incentive is very alluring.

Both Lawler and Pfeffer and Sutton have identified some key characteristics that increase the chance of success for individual incentives. Their lists are similar, and both emphasize that individual incentives are most effective when the work is done purely independently and have only one or two clear metrics that can be tracked and truly define performance.[36] This recommendation is consistent with feedback from the interviews. Aaron Leek found that it was important to focus on no more than three metrics[37], and Ron Froehling pointed out that overly complex incentive programs are less likely to be understood so they are less likely to motivate[38]. Tasks that are complex, not easily tracked, or require teamwork are not the best candidates for piecework or commission incentives.

Perhaps the most commonly used short-term incentive is the merit pay salary increase. This actually can be a reward for individual, team, or organizational level performance depending on how it's implemented, but it is most often used for individual performance. One issue with the merit pay increase is that the reward continues year after year regardless of future performance causing an annuity effect.[39] One common way that companies avoid the annuity affect is to offer discretionary annual bonuses to reward good performance rather than adding the reward to annual salary, which is the method recommended by Lawler.[40]

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[36] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*, Pfeffer, Jeffrey, and Robert I. Sutton, *Hard Facts, Dangerous Half-Truths, and Total Nonsense : Profiting from Evidence-Based Management.*
[37] Leek, Aaron. Interview.
[38] Froehling, Ron. Interview.
[39] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*
[40] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*

Team

Research widely agrees that purely individual incentives undermine teamwork, but most work today requires teamwork. Aaron Leek points out, “with respect to individual recognition, you run the risk of seeing a division in the team.”[41] The need for teamwork should be obvious in engineering design work, software development, and any other complex knowledge work – one individual cannot design and build an entire car alone. Even in jobs where success seems to be solely based on an individual, competition fostered by individual incentives can undermine the company’s goals: account executives may not backup others who are on vacation because of the commission structure or factory workers may not share an efficiency technique that keeps them earning higher incentives than their peers for fear that the standard will be raised for all. Clearly, it’s important for company success to incent teamwork and team performance.

One method for rewarding teamwork is to simply add a dimension for teamwork to an individual’s performance evaluation and reflect this dimension in their merit pay or annual performance bonus. However, this is not ideal because it still creates competition for reward resources that encourages teams to keep the poor performers around. In addition, people who highly value individual rewards may not have the right temperament to be an effective tem member in the first place.[42]

In order to eliminate negative competition within a team, rewards can be given equally to all team members based on the overall performance of the team. This can be done at the end of a project for project-based teams or on a regular, periodic basis for work teams. These incentives are effective at motivating all team members to work towards the same goal, but Lawler points out that this technique also can have pitfalls if

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[41] Leek, Aaron. Interview.
[42] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*

improperly designed. Motorola tried team performance based incentives, but it simply transferred the negative competition from being between individuals to being between teams. Teams fought for shared resources and were bitter when their aid to another team resulted in disparately positive rewards for the team they aided.[43] Project teams have an additional problem in that team members change throughout a project and the contributions of team members can vary widely. Should a developer and project manager get the same reward? How about the procurement officer who didn't spend much time on the project but was critical to its success?

Finally, goalsharing, and profit sharing can be applied at a team or department level to motivate teams. However, since these methods are typically used at the organization level, I will focus on them in the next section.

Organization

In order to get everyone in an organization focused on the same short-term goals, it makes sense to reward people based on organization level performance. This gives everyone a shared fate that can have a positive impact on company performance as well as company culture. The main drawback is that the line of sight between behavior and company performance can be quite weak, especially in large organizations, which reduces the motivation effect of the reward.[44] The most common short term organization-level incentives are goalsharing and profit sharing.

Goalsharing is a method of rewarding an organization for meeting specific performance goals over a limited period of time.[45] This typically rewards three to four goals that are not directly related to financial performance. One successful example of

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[43] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*
[44] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*
[45] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*

goalsharing to reach a short term goal was a program that Continental Airlines set up to improve on-time performance. They gave every employee $65 for each month that on-time performance was better than 80%. This resulted in a great improvement in the on-time performance, but it also initially resulted in more lost bags. Once baggage-handling was added as an additional part of the goalsharing, Continental Airlines reached both goals resulting in higher customer satisfaction.[46]

Profit sharing is simply sharing a part of the company-wide profit with all employees. This is similar to goalsharing, but it focuses solely on profits. Employees have less direct control over company profits than over other company goals, which makes profit sharing generally less motivational than goalsharing.[47] In the Continental Airlines example, it is much easier for employees to see how they affect on-time performance than to see how they affect profit. Managers tend to have a better line of sight to profits, but at large companies, even this connection is weak. Profit sharing is a popular option for companies despite the fact that studies show only a 1% improvement in performance in companies that have profit sharing compared to ones that don't.

Sam Goodner is a CEO who tried profit sharing for a while but found it to be ineffective even with some modifications. When he first started his company, he thought it only seemed logical that profit sharing should be an important part of everyone's compensation because it would extrinsically motivate everyone to focus on the company's ultimate goal of profits. In the initial incarnation of the program, he paid out the profit sharing on an annual basis. However, he found that the reward was so far removed from behavior that it didn't have any motivational impact. To address this, he modified the program to pay out profit sharing on a quarterly basis. The problem that he

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[46] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*

[47] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*

encountered was that in a cyclical business like technical consulting, there is generally a loss in the fourth quarter due to vacation time and holidays in November and December. So, he paid out much higher profit sharing in the first three quarters than he did under the annual plan, and he had no way to take back money in the fourth quarter. In the end, he scrapped the profit sharing program.

Long Term

There is a more limited selection of long-term financial incentives at the non-executive level that are commonly used; however, they do exist. These incentive programs cover periods of greater than a year, and they exist at the individual, team, and organization level as well.

Individual

The annuity effect of merit based pay increases is the most common individual long-term incentive. As mentioned earlier, it is a reward that lasts as long as the employee is with the company regardless of future performance. Because of this, the annuity effect has motivates employees to stay with the company, but not necessarily to continue excellent performance. Incentives to keep employees at a company can be good, but they tend to also retain the wrong people.[48] The best people find it easier to leave for the same or better compensation package, and the underperformers stick around because they cannot find anything better in the open market.

It is also common to have some types of rewards simply for employee retention. In my experience, I have seen that most companies increase the amount of vacation time an employee gets per year based on length of service. I have also seen plans where stock awards or 401(k) match money vests to the employee over time based on length of

[48] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*

service. Many companies also give gifts to employees to encourage them to stay. In fact one company I worked for gave a custom tailored leather jacket to employees on their five year anniversary and a rather expensive watch for a 10 year anniversary gift. Based on what I have seen, these common benefits have some effect on retention but I have also found that most companies hiring people in technology can offer a signing bonus that easily dwarfs the value of any of those benefits.

However, Liam Collopy described a unique retention program that was incredibly effective at reaching their retention goals. In the late 1990s, it was difficult for technical consulting firms to retain employees. The demand for technology experts outstripped the supply, and skilled people could easily leave their current jobs for one with significantly higher pay. It was common for people from my consulting firm to get offers for 20% more than their current salary at any given time, so large annual raises were common at my company just to remain competitive. Mr. Collopy's company found that it was difficult to keep technical consultants for more than 2-4 years, but his company's strategy was built in large part around hiring and retaining the best people. Because his company was willing to release underperforming employees, they were not particularly concerned that the retention rewards would retain the wrong people.

The plan rewarded employees with three days of extra vacation after three years of service, which was on par with most employers at the time. However, they gave much bigger rewards to their employees for five and seven years of service. At five years, employees received an all-expense paid trip to Hawai'i plus an additional five days off for the trip. At seven years, they received a three month paid sabbatical. Mr. Collopy said, "once people reached that 3-4 year mark, they could see on the horizon that a trip to Hawai'i was becoming a reality."[49] He also went on to say that "the three month

[49] Collopy, Liam. Interview.

sabbatical was implemented to help mitigate the proverbial '7-year itch.' Instead of looking elsewhere for a new job, people looked forward to recharging and coming back to work fresh after a three month hiatus." Mr. Collopy credits this program as the reason for a retention rate that was over 90% at a time when retaining top technical talent was extremely difficult.[50]

Unfortunately, despite the great success the program had at reaching retention goals, they found that when people started redeeming their rewards, the cost was simply much too high for the small company to absorb. The trip to Hawai'i cost over $15,000 per employee when counting lost consultant utilization. With a retention rate of over 90%, a large number of employees were taking advantage of this reward. The sabbatical was costly from a financial perspective in that the company lost at least $60,000 in revenue per consultant. In addition, because most employees who stayed with the company for seven years were considered "key players," the loss of their skills for three months cost the company more than the lost revenue in terms of ability to close sales and satisfy clients.[51]

Team

A method that Lawler recommends for long-term team improvement is knowledge and skill based pay.[52] This is best used for teams that will be together for a while. It is a way to motivate employees to learn new skills to become a more valuable employee overall rather than just filling a single role. Some of this motivation can be applied to improving skills specific to a job, but it can also be used to motivate cross-training. Although this program does reward individuals for their specific skills and

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[50] Collopy, Liam. Interview.
[51] Collopy, Liam. Interview.
[52] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*

training, the main results directly improve the team, and based on my conversations with employees throughout the years, I believe that a large percentage of employees would not choose to learn the skills of the roles that lie outside the area of their chosen profession without an extra incentive.

My experience shows that the goals of this incentive would be very valuable to improving the effectiveness of teams in the software development industry. Software development teams work better together when all members at least some background knowledge of each other's roles. Software testers who understand development are better at diagnosing the root cause of bugs, which helps the developers. Likewise, developers who understand project management are better at making tradeoffs between designing a cutting edge solution that excites them and choosing the most practical solution that delivers the necessary functionality in the required budget and schedule.

Aaron Leek also found that this type of program was valuable in the financial industry. His company had a program that rotated people who worked in branches into different departments in order to get a broader view of the company. The employees would spend some time working in the areas of sales, marketing, and business at the headquarters building. The company found that this program increased the company's "bench strength", and they were better able to work with all other areas of the company. In fact, the people who went through this training were often the ones who got faster promotions and rewards.[53]

Organization

The stock and options rewards programs used for executives are also sometimes used for non-executives to motivate long-term performance. The basic concepts are the

[53] Leek, Aaron. Interview.

same for executives and non-executives; however, non-executives have a much weaker line of sight between their work and stock price. Like profit sharing, stock ownership does have the positive effect of creating a shared fate for the company. In this case, it creates a culture of ownership as well.[54] In order for stock rewards to have the best long term effect, they should vest over time although that does result in some of the same retention problems that are caused by merit salary increases.

A more effective long-term motivation tool for most employees is gainsharing. Gainsharing is a method of rewarding the organization for improvements to financial performance of the company or division. Typically, it is most effective for organizational units of less than 10,000 people in order to maintain line of sight and a meaningful reward. Typically, companies share any improvements to financial performance 50-50 with employees; however, plans with different breakdowns also are common.[55]

The plans work best with the gains compared to a historical set-point continue to be shared over time rather than being reset year after year although there is a risk of overpaying for improvements if competitors are able to make some of the same gains without the costs. Studies show that gainsharing plans are very effective with 80% of them having produced financial improvements lasting at least 3-5 year and some lasting decades. However, the studies also showed that the plans work better in manufacturing rather than in the service sector and work best in stable, small to medium sized business units.[56]

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[54] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*
[55] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*
[56] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*

Chapter 3: Intrinsic Motivation

OVERVIEW

Many people intuitively think that extrinsic motivation, such as financial incentives, work best to motivate desired behavior. This intuition is supported by some of the research discussed in Chapter 2 that supports the contention that extrinsic motivators are effective at driving behavior that is incented, at least for a period of time. In addition, financial incentives seem to an easier way to manage employees' behavior than trying to promote intrinsic motivation using tools such as communicating and justifying goals to each employee. This combination of intuition, supporting research, and ease of use fuels the popularity of extrinsic motivation tools.

However, there are many examples of financial incentives having negative effects to the point of destroying companies and even economies. Paul Catton's experience is that "there always seems to be good intentions when putting together incentive plans, but sometimes I think people don't think enough about the true behavior they are trying to motivate and how certain programs might be a disincentive as it relates to other behavior."[57] He goes on to say that there are "significant risks associated with a poorly managed/monitored plan."[58] Even the head of Goldman Sachs, Lloyd Blankfein, publicly said that financial incentives contributed to the current financial crisis.[59] Although many researchers dismiss the dangers as minimal with properly designed incentive plans, there is also a lot of research that shows that incentives should never be used. Claims are that incentive programs aren't effective for most work, they result in the wrong behavior, they

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[57] Catton, Paul. Interview.
[58] Catton, Paul. Interview.
[59] "Attacking the corporate gravy train." *Economist.*

result in ineffective and lazy management, and that fostering intrinsic motivation is more effective in generating company success.

Chapter 2 reviewed the pros and cons of many different types of extrinsic motivators. Given the plethora of choices and the popularity of extrinsic motivators, why should we spend time focusing on fostering intrinsic motivation? The fact is, some research and experience has found that choosing any of the extrinsic motivators can be dangerous for a company. In order to make the case for focusing resources on intrinsic motivation, it is worth spending some additional time talking about the downsides of extrinsic incentives overall.

Misconceptions Regarding Effectiveness

If incentive plans are both intuitively successful and supported by research, how can anyone consider them ineffective? Katja Rost and Margit Osterloh contend that the huge benefit relative to cost shown in the Safelite Glass experiment led people to try to apply the concepts to all types of work without truly understanding the conditions that made it successful.[60] The concept has been applied by most companies to jobs from frontline workers all the way to CEOs. Pfeffer and Sutton admit that financial incentives work, but only when key characteristics are present. They say that the task must be easily learned and done independently, that it must be easy to measure and monitor quality, that there must be a sophisticated system for monitoring work, and that the goals must be unambiguous and one dimensional.[61] These factors are all present in very few jobs, and they clearly are not present in information technology jobs, let alone in the CEO role.

In fact, Alfie Kohn states that there are at least 24 studies that show that financial rewards actually lower productivity, and that the more thinking that a task required, the

[60] Rost, Katja, and Margit Osterloh. *Schmalenbach Business Review.*
[61] Pfeffer, Jeffrey, and Robert I. Sutton, *Hard Facts, Dangerous Half-Truths, and Total Nonsense : Profiting from Evidence-Based Management.*

worse the effects were.[62] In addition, Rost and Osterloh state that "*A considerable number of empirical research papers show that there is actually no relation between the performance-related salary of a CEO and the performance of an enterprise.*"[63] One study of executives found that most ignored their incentives altogether when making decisions.[64] This isn't surprising when much of the basis of incentives is beyond the executives' direct control such as stock price or other larger economic factors such as the cost of oil or value of the dollar. Pfeffer and Sutton even cite an example of a Florida Power executive whose bonus is more affected by the weather's effect on air conditioning use than by any action he could take.[65]

If incentives aren't effective for most jobs, why do so many smart managers at so many companies intuitively think they're a good idea? Chip Heath researched this question and found that most people have what he calls an "*incentive bias.*" Basically, he found that the vast majority of people believe that others need extrinsic financial rewards in order to work hard and do their job well; however, the vast majority of people say that they are primarily motivated by intrinsic rewards. One experiment had people rank their own motivations to do good work and then rank what they thought motivated their classmates and what motivates a group of customer service representatives. The study found that 84% of people would have predicted the rankings of others better if they had simply used their own lists.[66]

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[62] Kohn, Alfie. *Harvard Business Review.*
[63] Rost, Katja, and Margit Osterloh. *Schmalenbach Business Review.*
[64] Pfeffer, Jeffrey, and Robert I. Sutton, *Hard Facts, Dangerous Half-Truths, and Total Nonsense : Profiting from Evidence-Based Management.*
[65] Pfeffer, Jeffrey, and Robert I. Sutton, *Hard Facts, Dangerous Half-Truths, and Total Nonsense : Profiting from Evidence-Based Management.*
[66] Heath, Chip. *Organizational Behavior & Human Decision Processes.*

Wrong Results

Heath's research leads into the first example of negative results that can come from even well designed financial incentives. Although most people think that extrinsic motivation is needed to get people to work well, intrinsic rewards are actually more important, especially on managerial motivation of middle management.[67] Many studies support the contention that monetary rewards for intrinsically motivated tasks lead to a decline in future intrinsic motivation.[68] Therefore, simply by offering financial incentives, a company is reducing any intrinsic motivation that their employees may have regardless of how well they're designed. Liam Collopy's practical experience agrees with the research. He says, "Money as an extrinsic motivator can only go so far. No matter how much money someone is making, at some point there needs to be something else that drives a person to do their best, to be engaged, and to make a difference. They need to contribute and feel like they are making a difference. They need to feel that they are part of something bigger than themselves and that they have a purpose. People want to matter."[69]

Deming elaborates on this in his famous book, **OUT OF THE CRISIS**. In this book, he lists 14 principles and 6 diseases that hamper businesses and are well known among quality experts. Principle 11a is "*Eliminate numerical quotas for the work force.*"[70] He states unequivocally that putting quotas in place will result in a loss of pride in workmanship. He points out that quotas make workers simply try to hit their numbers and not go any further. Often, in order to hit the stated quota, employees are forced to lower quality, as we have seen in several examples so far. Deming argues that simply

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[67] Rost, Katja, and Margit Osterloh. *Schmalenbach Business Review.*
[68] Rost, Katja, and Margit Osterloh. *Schmalenbach Business Review.*
[69] Collopy, Liam. Interview.
[70] Deming, W. Edwards. *Out of the Crisis.*

trying to add an additional dimension of quality to the incentives will not work because the goals are conflicting.[71]

One of Deming's most controversial statements is that performance evaluations are one of the business diseases and must be eliminated. He says specifically that "*Merit rating rewards people that do well in the system. It does not reward attempts to improve the system.*"[72] Deming's contention is supported by Kohn, who says that the number one casualty of rewards is creativity,[73] and Jacobs, who says that senior managers tend to look at maximizing their pay under the current system rather than improving company strategy.[74] Sam Goodner's example, discussed earlier, of the company president who maximized her pay by focusing on short-term profit at the expense of future growth illustrates this concept well.[75]

Finally, although many managers think that the most motivated people will be attracted to large incentives, the truth is that large incentives attract people who are incented by money. The influx of these people actually can drive out the intrinsically motivated employees.[76] Andrew Chen pointed out that a bonus plan for salespeople at his previous company had the effect of lowering intrinsic motivation in others at the company. The rewards were based solely on contracts closed with no regard for customer satisfaction. This resulted in salespeople who closed deals and moved on "without making sure that the actual technology integration worked effectively."[77] Mr. Chen goes on to say that this "resulted in some super highly paid people who were not

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[71] Deming, W. Edwards. *Out of the Crisis.*
[72] Deming, W. Edwards. *Out of the Crisis.*
[73] Kohn, Alfie. *Harvard Business Review.*
[74] Jacobs, Michael T., *Short-term America : The Causes and Cures of our Business Myopia.*
[75] Interview with Sam Goodner
[76] Rost, Katja, and Margit Osterloh. *Schmalenbach Business Review.*
[77] Chen, Andrew. Interview.

bringing in the types of customers we wanted, and it created conflict within the team to know that."[78]

There are other problems with attracting people who are primarily motivated by money. Pfeffer and Sutton paraphrased James Treybig, former CEO of Tandem Computers as saying, "*if people come for money, they will leave for money.*"[79] They also cite studies that show that people primarily motivated by money are more likely to cheat. The reasons why you may not want to attract employees motivated primarily by money can be summed up quite well by a hypothetical question that their colleague James Baron asks one of his classes. If you were confronting a serious illness, would you choose a doctor who went into the profession primarily to make a lot of money or who went into the profession because it was interesting and afforded an opportunity to help people?[80]

Lazy Management

Deming contends that management by numbers needs to be replaced with management by leadership in order for companies to be successful for the long term.[81] This contention is echoed by many other researchers. Pfeffer and Sutton recommend that managers don't try to solve every problem with incentives and instead try talking to everyone in the company about the strategy and priorities;[82] Rost and Osterloh state that MBAs are taught that people will not work voluntarily in the best interest of the company and need extrinsic incentives;[83] and Heath points out that due to incentive bias managers generally need to be reminded to do such simple things as communicating importance

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[78] Chen, Andrew. Interview.

[79] Pfeffer, Jeffrey, and Robert I. Sutton, *Hard Facts, Dangerous Half-Truths, and Total Nonsense : Profiting from Evidence-Based Management.*

[80] Pfeffer, Jeffrey, and Robert I. Sutton, *Hard Facts, Dangerous Half-Truths, and Total Nonsense : Profiting from Evidence-Based Management.*

[81] Deming, W. Edwards. *Out of the Crisis.*

[82] Pfeffer, Jeffrey, and Robert I. Sutton, *Hard Facts, Dangerous Half-Truths, and Total Nonsense : Profiting from Evidence-Based Management.*

[83] Rost, Katja, and Margit Osterloh. *Schmalenbach Business Review.*

and relevance of company mission, giving feedback on performance, and making jobs more interesting or meaningful.[84] Paul Catton points out that a closed management style is extremely ineffective at motivating employees. He says that a closed management style "is not typically a policy/procedure, but often the senior management does not make communicating a priority and as a result, people don't know what is going on. This always leads to speculation and eventually assuming the worst."[85] Even proponents of incentives such as Lawler agree that leadership including good communication and education of goals as well as including employees in decisions related to compensation is critical to the success of incentive plans.[86]

PROMOTING INTRINSIC MOTIVATION

Even if the critics of incentives are correct in their claims that they are ineffective and dangerous, what alternatives do they recommend? Most managers would agree that employees need some type of motivation to take actions in the best interest of the company. As Gerald Cusack points out, "*No business organization can be assured of long-term strategic vitality without the continuing willingness of employees to act in the interest of the organization's goals and wellbeing.*"[87]

Cusack refers to the views of economist Albert O. Hirschman in pointing out that employees who don't have an internal willingness will tend to exit a company, either actually or in spirit. He says that the key to this willingness is to build loyalty and commitment through giving voice, the ability to express a problem and believe that it will be taken seriously, to employees.[88]

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[84] Heath, Chip. *Organizational Behavior & Human Decision Processes.*
[85] Catton, Paul. Interview.
[86] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*
[87] Cusack, Gerald P.. *Review of Business.*
[88] Cusack, Gerald P.. *Review of Business.*

Stone, Deci, and Ryan look to the psychological self-determination theory (SDT) as a way of creating long-term motivation in employees. This theory states that motivation comes from the self, not from money and that employees should be empowered, participated in decision-making, and have some autonomy in order to be motivated.[89] SDT claims that when the meaning and value of a task is understood, humans will be motivated to fully commit to even tedious tasks. Studies on SDT show that meeting three core psychological needs of competence, relatedness, and autonomy leads directly to employee productivity, creativity, and happiness. Going further, the studies show that these effects transcend culture, economic system, and company size. Conversely, studies show that in controlling workplaces, the sense of being controlled leads to apathy, poor performance, and low creativity among other problems.[90]

Both of these views, one economic and one psychological, support the research that condemns financial incentives altogether. Common themes are that management needs to inform employees about company goals, why the goals are sensible and important, listen to employees, create a culture of loyalty and trust, and give employees some autonomy. Studies show that these concepts actually lead to the best long term results for a company, but it can be difficult for managers to act in these ways.

The success of implementing these concepts is more than theoretical. Stone et. al refer to applying SDT at the Kansas City, KS school district with fantastic results.[91] Cusack points out that CEOs John Chambers at CISCO and Jim Sengal at Costco follow these principles and have had long term success.[92] In addition, Pfeffer and Sutton cite

[89] Stone, Dan N., Edward L. Deci, and Richard M. Ryan. *Journal of General Management.*
[90] Stone, Dan N., Edward L. Deci, and Richard M. Ryan. *Journal of General Management.*
[91] Stone, Dan N., Edward L. Deci, and Richard M. Ryan. *Journal of General Management.*
[92] Cusack, Gerald P.. *Review of Business.*

several case studies of companies that follow these principles and have achieved long term success, including SAS Institute and Men's Wearhouse.[93]

The people I interviewed also found that sharing information, listening, an atmosphere of trust, and employee autonomy are successful motivation techniques in practice in a variety of industries and jobs. Will Cowden has had success in motivating employees in the financial industry by providing "a consistent flow of objective data and one-on-one feedback sessions to everyone." He went on to say, "You cannot improve if you do not know where you stand. Information empowers employees to manage their work, particularly when the data includes areas where they have influence and control."[94] Sue Darrow has found that autonomy is a much bigger motivator than money for technology consultants.[95] Sam Goodner noted that one of his clients has the most motivated call center employees that he has seen, even after some tough times and layoffs. He credits the continued intrinsic motivation and low turnover rate partially to open lines of communication, honesty, and treating employees well. He said that the employees understood the reasons for the layoffs and saw that the departing employees were treated well.[96] Paul Catton confirms the importance of open communication in tough times when he says, "The highly respected organizations are the ones that continue to communicate and listen during the hard times."[97]

Stacey Welu shared two stories from her startup company that dramatically illustrate the effect that open communication has on intrinsic motivation. In one case, a

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[93] Pfeffer, Jeffrey, and Robert I. Sutton, *Hard Facts, Dangerous Half-Truths, and Total Nonsense : Profiting from Evidence-Based Management.*
[94] Cowden, Will. Interview.
[95] Darrow, Sue. Interview.
[96] Goodner, Sam. Interview.
[97] Catton, Paul. Interview.

lack of openness with employees about some hard times lowered productivity for over a year.[98] Ms. Welu shared:

"One summer we were running short on cash and projects were not meeting timelines. We were afraid that if we didn't complete a couple of large engagements and get paid that we would need to cut jobs. Since we didn't have funds to hire contractors to finish the projects, we thought we could implement a short-term practice of starting the workday at 7 AM instead of 8 AM. We thought that if all the developers put in an extra hour that it would be the equivalent of hiring a couple of contractors and we would also eliminate the need to cut jobs. The idea was for everyone to pitch in to save jobs. However, we didn't do a good job of explaining the situation since we didn't want to scare the employees. Although the focus was on the development teams to get their projects complete, we thought it was unfair to single them out, so we made the policy company-wide. That also brought on a lot of negative feelings since other departments couldn't see that their extra effort would directly impact the projects we needed to finish. Since employees didn't understand it was for 'the greater good' and maybe even to save their own job, they saw it as a negative impulse decision from executive management. Most people did indeed show up at the new time, but productivity actually went down as did morale. We had the plan in place a little over a month before we needed to remove it because reaction was so poor. It took us over a year as a company before morale returned to its original level."[99]

Fortunately, most of the communication at Ms. Welu's company was open, and the employees usually understood the importance of their work to the company. The employees found this very motivational. As Ms. Welu puts it:

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[98] Welu, Stacey. Interview.
[99] Welu, Stacey. Interview.

"As a small startup, employees realized that they were critical to new product development and support. They understood what their role was and that without them the product would not be built or implemented. They also knew that they would personally get full credit for their hard work and good ideas. The small-team concept with visible accountability worked extremely well. People worked long hours when necessary, but they were happy and always thinking about how to solve problems. They felt part of something new and exciting. There are still products that we refer to as being built by a particular small set of employees and customers that know their…employees by name. The more that employees understand how what they do matters, whether it is to the customer or to another employee, the more that they will work hard to ensure that they do a good job. It is even more powerful if their output is attached to them directly – i.e. when customers knew that it was Jane that fixer their problem as opposed to just 'The Help Desk'."[100]

There are definitely downsides to focusing too heavily on promoting intrinsic motivation. Management has to spend additional time and effort understanding what drives each employee, which costs money and is not a skill that every manager has. In addition, there are many times that a company has to reach goals regardless of whether employees are intrinsically motivated or now. Still, it is clear that meeting the employees' psychological needs of competence, relatedness, and autonomy, which is promoted by the self determination theory, truly can lead to employee productivity, creativity, and happiness. The practical experiences of the senior executives who I interviewed demonstrate that these methods have more than just theoretical merit and need to be considered when looking for ways to motivate long term success.

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[100] Welu, Stacey. Interview.

Chapter 4: Proposed Improvements to Motivation Techniques

OVERVIEW

All of the motivation techniques have strengths and weaknesses. The weaknesses can be quite dangerous to the long term survival of companies. Extrinsic motivation techniques may focus employees so intently on a small number of short term success factors that they ignore or actively damage the long-term interests of the company. Intrinsic motivation techniques can be resource intensive, potentially costly, and may not motivate people in all types of jobs. However, both the proven and intuitive effectiveness of the extrinsic and intrinsic techniques makes dismissing them altogether difficult for a company. There is a common refrain in both the literature and the interviews that the problems caused by extrinsic motivation programs are not inherent to them but rather due to poor design and implementation of those incentives; likewise, the problems with intrinsic motivation techniques are commonly dismissed as simple laziness or incompetence on the part of management.

There are a number of ways that the literature and interviews suggest to improve the common implementations of the motivation techniques. Since the goal of this thesis is to identify practical improvements that contribute to motivating employees for the long-term success of a company, I will focus on five categories of improvements that are commonly cited as areas of long-term weakness in extrinsic motivation techniques: accounting for risk, quality, teamwork, financial performance for periods of 5 years or more, and understanding and communicating goals. I will then focus on how intrinsic motivation can be achieved with reasonable cost and effort.

Extrinsic Motivation – Accounting for Risk

A common problem with extrinsic financial incentives is that they reward employees for taking specific actions without penalizing them for any risk that their actions introduce to the company. We can clearly see in the example of Countrywide that employees were rewarded for issuing loans regardless of the risk that the company was taking on for those loans.[101] As pointed out earlier, stock options reward employs for increasing stock prices but do not expose employees to any downside risk. In fact, the option price is often reset after a steep decline so they'll keep their motivational factor.[102] The downside of ignoring risk in incentive compensation can be truly stunning. In fact, Claudia Poster and Richard Furniss recently stated in *Corporate Governance Advisor* that "*Many believe that compensation programs played a major role in causing the current global financial crisis through incentives that encouraged excessive risk taking.*"[103]

Examples of reward without accounting for risk abound. The financial Services Authority of the UK recently identified some incentive practices related to risk that may have led to the financial crash: payments based on revenues with no concern for risk, not deferring parts of bonuses, permitting the front office to influence back office controls, and not aligning incentive practices with a company's stated risk tolerance.[104]

Poster and Furniss point out that companies must first have a risk management system in order to effectively incorporate risk standards into the incentive plans.[105] Having clear risk management policies will help set the right metrics for balancing the rewards.

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[101] Morgenson, Gretchen. *New York Times.*
[102] Jacobs, Michael T., *Short-term America : The Causes and Cures of our Business Myopia*.
[103] Poster, Claudia Zeitz, and Richard A. Furniss. *Corporate Governance Advisor.*
[104] Stern, Melanie. *Accountancy Age.*
[105] Poster, Claudia Zeitz, and Richard A. Furniss. *Corporate Governance Advisor.*

Of course, companies do not want to eliminate risk-taking altogether, they just want to ensure that the risks taken are appropriate and shared. One recommendation is to determine if return on capital is appropriate relative to risk exposure. Another recommendation is to incorporate thorough analysis of methods used to achieve results as well as the sustainability of the results.[106]

Finally, many people are recommending clawbacks and deferrals as a way to force employees to take on some of the risk. Clawbacks were allowed by the Sarbanes-Oxley act to recover bonuses that were paid in the past based on misstated financials and used in one case to recover $448 million from CEO William McGuire of United Health Group.[107] More companies are implementing this provision as part of their standard incentive program to make employees take on the risk of financial restatements. Deferrals are a similar idea except that the companies hold on to part or all of the bonus for several years to ensure that they can adjust for any financial restatements as well as any unexpected negative results of risks that were taken. It is easier to recover any improper bonus money if it is still held by the company than if it was already paid out.

Stern cites one example of a bonus plan that takes into account some of the recommendations for incorporating risk. UBS recently changed their executive bonus plan to pay up to 1/3 of the performance bonus in cash at the end of the year and put the rest into an escrow account. The larger portion of the bonus will be held for 3 years – longer for top executives – and reduced if there were any violations of law, unacceptable risks, or if individual performance targets are not met. Due to lessons learned in the financial collapse, these types of changes to incentive plans should become more common.

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[106] Poster, Claudia Zeitz, and Richard A. Furniss. *Corporate Governance Advisor.*
[107] Lambert, Emily. *Forbes.*

Extrinsic Motivation – Accounting for Quality

Studies show that there is a lagged relationship between changes in quality and its effect on financial performance.[108] This lag can lead to plans where employees get rewarded for short-term improvements to financials that have long term negative consequences. Lawler cites an example where information operators were rewarded for giving out more phone numbers, and the end result was achieved by giving out more wrong numbers.[109] Dell customer service, which had a great reputation early in the company's history, went downhill when the phone representatives were rewarded for keeping calls short. The result was short calls with many customer problems left unresolved. The resulting poor reputation for customer service was likely a factor in their subsequent drop in sales.

The manufacturing world seems to be more acutely tuned to quality even though they sometimes ignore it to lower costs. My experience in software quality assurance has shown that many companies do not see the value in ensuring quality in software or in other areas outside of manufacturing. Many people concerned about quality look to W. Edwards Deming as the father of quality and interpret his principles to mean that financial incentives shouldn't be used at all.[110] Despite this, there are some ways to improve financial incentives to reward quality.

Adam Magia and Fred Jacobs published a study in *Behavioral Research in Accounting* that examined the relationship between some factors of management control systems (MCS) and quality improvement, customer satisfaction, and financial performance.[111] They specifically studied 3 components of MCS: presence of quality

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[108] Maiga, Adam S., and Fred A. Jacobs. *Behavioral Research in Accounting.*
[109] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*
[110] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*
[111] Maiga, Adam S., and Fred A. Jacobs. *Behavioral Research in Accounting.*

goals, provision of quality feedback, and presence of quality based incentives. They found that there is a strong link between these 3 factors and quality performance. In turn, they found a strong link between quality performance and both customer satisfaction and company financial performance. Although they focused on manufacturing business units, I believe that their findings may be useful for all types of business.

Quality based incentives can easily be added as a factor in a goalsharing situation and can be added as a factor in many other types of incentives. The more difficult part of implementation may be finding the right metrics to use. In software quality assurance, I have found that many managers instinctively want to measure developer performance strictly by number of bugs found. I need to point out that there are several major problems with that measure: one bug that prevents running the program is worse than 20 minor bugs that the end user can work around; the best programmers are generally assigned the most complex code, which has a higher likelihood for bugs; and when developers are measured on number of bugs, they generally find ways to reject or reclassify the bugs and put pressure on the testers to not report them. However, by identifying the correct measures of quality and adding them to financial incentive programs, areas other than manufacturing may achieve the same results that Magia and Jacobs found in manufacturing.

Aaron Leek discussed a situation where call center employees were incented for selling new products, but the incentive resulted in poor customer service. Mr. Leek was able to correct the problem by adding minimum quality measures that employees must meet in order to get any bonus. Mr. Leek referred to these as “toll gates”. In this case, he set standards for average call time and customer satisfaction that needed to be met in

order to get any bonus for new business. He found that these adjustments gave the desired results.[112]

Extrinsic Motivation – Accounting for Teamwork

Motivating employees to focus on team and larger organizational goals is critical in nearly any work. Whether building a house or building software, workers need to coordinate their activities to best produce the final product. Earlier, we discussed some of the common practices that are used to incent teamwork. Companies could improve their team performance just by using those techniques more often. However, there are some additional recommendations to improve teamwork.

Magia and Jacobs cite research that shows that it is not enough to simply reward teams, but the reward for team effort needs to be larger than the reward for individual effort.[113] This is especially important because employees already have a weaker line of sight to team performance than they do to individual performance. As Will Cowden points out, "Team goals often make sense as part of the equation because they foster collaboration and teaching; however, sometimes managers lose track of the metrics lower level employees can actually influence".[114] Therefore, the reward for team performance needs to be high enough to still motivate with the weaker line of sight and it needs to focus on areas that can be influenced by the team members. This is consistent with Lawler's recommendations that production, service, technical, and professional employees all receive a mix of individual and team rewards that appropriately reflect the importance of each for their position.[115]

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[112] Leek, Aaron. Interview.
[113] Maiga, Adam S., and Fred A. Jacobs. *Behavioral Research in Accounting.*
[114] Cowden, Will. Interview.
[115] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*

Poppendieck has an additional perspective on rewarding teams that is often overlooked. She emphasizes that team rewards should be based on the individual's span of influence rather than their span of control.[116] A good way to illustrate this concept is with a basic software team. Typically, a project manager's span of control is budget and schedule, a developer's span of control is producing code, a business analyst's span of control is usability and functionality, and a tester's span of control is finding bugs.

When each employee is evaluated on their span of control, obvious conflicts arise. The project manager is willing to ignore quality in order to be on-time and on-budget. The developer is not as concerned with schedule, budget, or quality as long as they complete code quickly. They often don't take time to do basic unit testing because it slows down their efforts towards producing a high volume of code, and, for the same reason, they do not want to spend time suggesting or implementing basic usability improvements. Business analysts will refuse to compromise on functionality to keep a product on budget and schedule, and testers will refuse to sign off on a go-live document because there is always the opportunity to do additional testing when schedule and budget are ignored.

However, all of these roles have a span of influence to create useful, usable, quality software while making sensible tradeoffs necessary to meet schedule and budget. Rewarding teams for hitting these goals helps ensure the best outcome for the business. Poppendieck goes even further and suggests that teams are rewarded for the actual business success of the software rather than simply the technical success of the project.[117] Based on my experience, this would be useful in getting teams to focus on the best use of software development resources and make smarter business decisions about which

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[116] Poppendieck, Mary, and Tom Poppendieck. *Implementing Lean Software Development : From Concept to Cash.*
[117] Poppendieck, Mary, and Tom Poppendieck. *Implementing Lean Software Development : From Concept to Cash.*

projects to continue and which ones to scrap rather than focusing on completing a project simply for the project's sake.

Extrinsic Motivation – Accounting for Long Term Performance

Most of the common long term incentives only focus on periods of up to three years. Three years may be a longer period than most incentives cover, but for companies to truly thrive over decades, employees need to think strategically beyond even three years. Incentives that focus on incorporating risk and encouraging quality and teamwork should help improve the long-term success of a company. However, there are some additional improvements that can be made to long-term incentive programs to extend them beyond three years.

Most of the suggestions for improvement focus on changes to stock and stock option plans. Jacobs suggests that one way to improve the motivation factor of options is to increase the strike price each year by the interest rate on long term government securities.[118] This would mean that the holders of the options would only be rewarded for beating the return on the safest investment. This is consistent with one of Lawler's recommendations that issued options cannot be exercised for at least three years and should be issued at a strike price higher than the current price.[119]

One big problem with stock as a long-term motivational tool is that the market can have wild gyrations that reward or punish stockholders regardless of actual company performance. During 2008-2009, even the worst oil company executives had huge gains in their stock price and the best auto executives had huge drops in stock price. One solution is to use phantom stock even for publically traded companies.[120] This phantom

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[118] Jacobs, Michael T., *Short-term America : The Causes and Cures of our Business Myopia.*
[119] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*
[120] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy*

stock is valued based on measures of company value other than what the open market is willing to pay.

In order to eliminate the effects of the vagaries of the market, some suggest that stock isn't even the right way to measure long term success. Jude Rich and John Larson argue that successful long term incentive plans need to focus on economic measurements of value other than earnings per share. They found that companies that measured return on equity and growth and that used a systematic approach to setting and communicating plan targets actually produced better stock returns than companies focused on earnings per share. They recommend that companies focus on improving the spread between return on equity and cost of equity over time as a key element of long term rewards.[121] However, even these numbers can be manipulated. Grossman quotes Doug Cariberg, the CEO of M2Global, as saying, "The CEO can get the financial numbers by stripping out the R&D or outsourcing stuff to make return on capital numbers look better."[122]

Ellig agrees with this sentiment saying that focusing on factors other than stock price actually helps the stock price more. He says that no company can exist without employees, customers, and community support. By focusing rewards on those three factors, stock price will generally increase while focusing on the stock price will generally have a negative effect.[123]

Ellig further suggests that plans need to be set up to make manipulation difficult. He suggests that there are multiple measures of success, longer periods of measurement, overlapping periods of measurement, and measurement based on performance relative to external companies rather than purely internal goals.[124]

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[121] Rich, Jude T., and John A. Larson. *Incentives, Cooperation, and Risk Sharing :Economic and Psychological Perspectives on Employment Contracts.*
[122] Grossman, Robert J.. *HRMagazine*
[123] Ellig, Bruce R.. *Corporate Board.*
[124] Ellig, Bruce R.. *Corporate Board.*

Sam Goodner described another factor to consider when using extrinsic motivation for long-term results. Earlier, we discussed the situation where an incentive based primarily on profit put the company's long term viability at risk. The company learned from this error and added a component to the compensation plan that rewarded company growth.[125] By combining both profit and growth into the bonus structure, the new president was incented to balance short and long-term goals without sacrificing one over the other. The company reached the goals that the CEO desired while this plan was in place.

Extrinsic Motivation – Understanding and Communicating Goals

Earlier I explained that open communication was a common technique for improving intrinsic motivation. However, based on my interviews with senior management, there was wide consensus that open communication of goals was critical at enhancing the effectiveness of extrinsic motivation tools as well. This is consistent with Lawler's research that found that good communication and employee education of how the extrinsic incentives are tied to the company goals increases employee line of sight to the goals and increases the effectiveness of extrinsic motivators.[126] If a company sets up extrinsic incentives for the long-term success of the company, they need to communicate the goals well in order to maximize the effectiveness of the incentives.

Of course, if management plans to clearly communicate how the extrinsic incentives are tied to company goals, they must understand the connection themselves. It may seem obvious that the incentives should be tied to company goals, but my interviews showed that this connection was often overlooked. Paul Catton found that the least effective extrinsic incentives focused on objectives that did not align with the corporate

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[125] Goodner, Sam. Interview.
[126] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*

objectives. He said that these plans "rewarded activity and not results."[127] Stacey Welu said, "The least effective incentives are those that are ties to metrics that don't necessarily correlate to the ultimate corporate objective."[128] Aaron Leek corroborated these observations when he said, "Regarding least effective plans; the big 'ah-ha' is not tying it back to some corporate objective."[129] When managers plan to communicate how extrinsic incentives tie in to corporate goals, they are forced to think more deeply about that connection and avoid a seemingly common problem of misalignment between incentives and company objectives. They also should be less likely to have unintended results similar to the many examples that we've reviewed.

Once a clear connection is made between the incentives and corporate objectives, the connection must be openly communicated. Mr. Leek experience taught him that "the vision, mission, and objective must be completely spelled out. Communication of the 'whys' to those impacted is critical."[130] He recommends that the communication plan include both formal and informal leaders throughout the company. He says that effective communication of the goals should include inviting team leaders to a kick-off meeting and giving those leaders a written plan to take back to their respective teams. In addition, he says, "a best practice is to engage some of your 'informal' leaders. If you can get them on-board, they will become your cheerleader and driver for the rest of the team."[131] Open communication extends to sharing the results as well. Mr. Leek recommends that "Results must be posted visibly and communicated often."[132] Will Cowden found that it's important to communicate the trend of the results in addition to the results. He says,

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[127] Catton, Paul. Interview.
[128] Welu, Stacey. Interview.
[129] Leek, Aaron. Interview.
[130] Leek, Aaron. Interview.
[131] Leek, Aaron. Interview.
[132] Leek. Aaron. Interview.

"trend data is often very motivational when the message is 'let's get the trend moving in the right direction' rather than 'why are we not at goal X yet?'"[133]

Of course, open communication needs to go in both directions in order to be truly considered "open". Lawler recommends involving employees in the process of determining incentives. His research shows that this increases commitment of the employees towards reaching the goals and helps set realistic, beneficial goals because the employees have relevant information that is not known by higher level executives.[134] Although some executives may worry that involving employees in setting objectives may result in setting much lower goals, Mr. Leek found quite the opposite in practice. He found that the managers who reported to him actually set higher goals for themselves than he would have set for them.[135] He found that getting employees' feedback was critical to setting realistic, beneficial goals and also increased their commitment to reaching those goals, which matches Lawler's findings.

Intrinsic Motivation – Practical Implementation

Assuming that creativity, productivity, and employee enthusiasm are important to the long term success of a company, intrinsic motivation is critical to company success.[136] Chapter 3 discussed the importance of intrinsic motivation and covered some concepts that can be applied to increase intrinsic motivation; however, Stone, Deci, and Ryan found that many managers have difficulty implementing these techniques because they question organizational assumptions, may require tough and unpopular choices, and require an element of risk taking.[137] This section will present some practical

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[133] Cowden, Will. Interview.
[134] Lawler, Edward E.. *Rewarding Excellence : Pay Strategies for the New Economy.*
[135] Leek, Aaron. Interview.
[136] Stone, Dan N., Edward L. Deci, and Richard M. Ryan. *Journal of General Management.*
[137] Stone, Dan N., Edward L. Deci, and Richard M. Ryan. *Journal of General Management.*

recommendations and attempt to assuage some fears that managers may have regarding implementation.

Autonomy

As we have discussed, the academic research and my management interviews found that autonomy is a critical factor in improving intrinsic motivation. Some managers may be concerned that too much autonomy is a bad thing because someone needs to set company direction. If everyone can just do whatever they like, how can the company possibly meet its goals? Stone, Deci, and Ryan address this concern by pointing out that autonomy and independence are different concepts.[138] Employees with increased autonomy use that autonomy within a structure that promotes reaching the company's goals. Liam Collopy illustrated one such structure that is effective at his company. He said, "We expect our employees to make critical business decisions without having to ask for management approval. The employee just needs to ask themselves: 1. Is it right for the customer?, 2. Is it right for [our company]?, 3. Is it ethical?, 4. Is it in line with [our company's] Core Values?, 5. Are you willing to be held personally accountable for your decision? If the answer to all five questions is "yes," don't ask, just do it."[139]

Through their research, Stone, Deci, and Ryan identified 6 effective path towards autonomous motivation: "Asking open questions including inviting participation in solving important problems," "actively listen and acknowledge employee perspectives," "offer choices within structure including the clarification of responsibilities," "provide sincere, positive feedback that acknowledges initiative and factual, non-judgmental feedback about problems," "minimize coercive controls such as rewards and comparisons

[138] Stone, Dan N., Edward L. Deci, and Richard M. Ryan. *Journal of General Management.*
[139] Collopy, Liam. Interview.

with others," and "develop talent and share knowledge to enhance competence and autonomy."[140]

The managers who I interviewed were able to effectively implement many of these suggestions without much trouble. There is an investment in time, but the managers who invested the time found that the rewards were easily worth the investment. Paul Catton said that it was important to have "one-on-one manager meetings where an employee has an identity within the organization and a mechanism to communicate directly what is on their mind."[141] In order to achieve this, he implemented an open door policy where he "personally met with each member of the IT team on a quarterly basis."[142] He found the results to be well worth the time saying, "The feedback I got was amazing."[143] Of course, it's important that any feedback is listened to with sincerity. Will Cowden cautions, "managers should not ask for employee feedback unless they are prepared to take it seriously and address relevant pieces of the feedback promptly."[144]

The feedback from employees doesn't always have to be between manager and employee and it doesn't always have to be one-on-one. Jana Bertheaume recommended a program that allows feedback to flow in any direction. Her company has a program that gives consultants "up to $50 a month to recognize their peers for doing something great."[145] Andrew Chen has taken the concept of inviting employee participation to the extreme. At his startup company, he "give[s] all the employees votes on almost everything that the company does, in particular with product planning design, and execution."[146] He says that this "emphasizes the level of equality that people on the team

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[140] Stone, Dan N., Edward L. Deci, and Richard M. Ryan. *Journal of General Management.*
[141] Catton, Paul. Interview.
[142] Catton, Paul. Interview.
[143] Catton, Paul. Interview.
[144] Cowden, Will. Interview.
[145] Bertheaume, Jana. Interview.
[146] Chen, Andrew. Interview.

have" and that even the CEO "can be routinely overruled on decisions."[147] He found that although this does slow some aspects of development, the end result is that employees have a "greater feeling of ownership" and everyone is focused on the same goals.[148]

Relatedness

Another aspect of SDT is relatedness. Stone, Deci, and Ryan describe relatedness as having satisfying and supporting social relationships.[149] Sam Goodner has seen that relatedness can motivate employees even when they have jobs that are not necessarily exciting in of themselves. He describes one of his clients where most of the employees work in a call center. He observed that the people in the call center are truly motivated to be there, but he stated that he believes that their motivation primarily comes from relatedness rather than the work itself. Mr. Goodner noted that the company has created this sense of relatedness with free food, parades in the office, open, friendly communication, and fostering a sense of community.[150]

Jana Bertheaume found that promoting a sense of relatedness is particularly important in a consulting company. She says, "We also do a lot of activities to pull our consultants together. …in consulting it is difficult because everyone is spread out all over. We do things monthly to bring people together. Some are social, some are educational, some are in the office, and some are over the web."[151] I have worked for several consulting firms, and I have also seen that group events are especially important when employees are typically spread out among many client locations. My current company has a mix of events with some being for employees only, some being for employees and one adult guest, and some being for employees, an adult guest, and

[147] Chen, Andrew. Interview.
[148] Chen, Andrew. Interview.
[149] Stone, Dan N., Edward L. Deci, and Richard M. Ryan. *Journal of General Management.*
[150] Goodner, Sam. Interview.
[151] Bertheaume, Jana. Interview.

children of the employees. Based on what I have seen, having a mix of these three types of events is excellent at fostering relatedness because employees get to socialize on a number of different levels. By including the employees' families in some of the events, the level of relatedness is increased.

Hiring

The goal of increasing the intrinsic motivation of employees is a lot easier if a company starts with employees who are intrinsically motivated to do their job before they start working for a company. Sam Goodner has found that a key to intrinsic motivation at is company is hiring people who are compatible with the company's mission as opposed to people who just want a paycheck. He admits that this is very difficult to do, though.[152]

Mr. Goodner puts a lot of effort into hiring people with the right motivation. His hiring process includes at least six interviews including a final "Topgrading" interview. The interview process attempts to look beyond technical skills and into job fit. For consulting work, Mr. Goodner looks for a high tolerance for change. For sales, he looks for people who are highly motivated by money.[153] Other hiring managers have also found that it's critical to look beyond the technical skills of a candidate to find the right fit. Jana Bertheaume will only hire people who have the right culture fit for her company even if that means it takes "a long time to find those individuals who are of like mind to embrace and grow the culture."[154] Stacey Welu has found that finding the right fit includes finding the right fit for the pace and environment that the job candidate is used to. In one case, she hired someone with great managerial qualifications "from a

[152] Goodner, Sam. Interview.
[153] Goodner, Sam. Interview.
[154] Bertheaume, Jana. Interview.

government job into a fast paces start-up environment."[155] Stacey said that the manager "lasted three days before walking out the door in tears."[156]

Hiring managers need to be careful not to mistake an energetic personality with intrinsic motivation. Ms. Welu warns that "being enthusiastic and bubbly is not necessarily an indicator of motivation. Several of the most hardworking, motivated, and dedicated tech people that I've hired over the years have been very laid-back and low-key from a personality standpoint."[157] Will Cowden has experienced the same difficulty, and he stated that he believes that the problem is compounded because he hires many employees who are early in their career path. He says, "During the interviewing process, job candidates often display the enthusiasm, confidence, and people skills that you want to see regardless of whether that is part of their true work ethic. I have had more difficulty determining the employee's potential in cases where they are still in the first five years of their career. Just as they may be less certain regarding how the job fits their future aspirations, so too it is more difficult for the manager to read the clues."[158] Mr. Cowden recommends using situational questions for determining the candidate's thought process and finding clues to their true motivation level. He also recommends that the people who will work with the new employee should be involved in the interview process once the pool of candidates has been narrowed down because "the candidate's colleagues are the people who will be spending the majority of time collaborating with the individual, not the manager themselves."[159] Note that by involving the candidate's colleagues in the decision making process, Mr. Cowden gets the extra benefit of increasing the current employees' intrinsic motivation through increased autonomy.

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[155] Welu, Stacey. Interview.
[156] Welu, Stacey. Interview.
[157] Welu, Stacey. Interview.
[158] Cowden, Will. Interview.
[159] Cowden, Will. Interview.

Chapter 5: Recommendations and Conclusion

OVERVIEW

I have reviewed a lot of information about employee motivation. In order to better illustrate how this information could be applied, I will describe a hypothetical case study that is an amalgam of experiences of people I've spoken to, experiences I've read about, and experiences that I've had in my career. Based on my research, I will then make specific recommendations as to how to improve the situation described in the case study.

CASE STUDY

CTP Industries is a large, multi-national, publicly-traded company that has had many years of fast growth and success in the past. However, for the past 5 years, the company has seen their market share, profits, and stock price erode significantly. The board of directors is not sure why the company has been having problems. However, they believe that some of the problem is due to a low return on investment (ROI) on their internal information technology (IT) projects. They expressed that they think that the low ROI is partially due to poor employee motivation and they have hired me as a consultant to review the situation.

Company Policies

The CIO of CTP Industries takes great pride in the company's hiring practices and motivation techniques. He said that the company only hires the "best and brightest" employees. CTP's base pay and benefits package is in the 95th percentile of the industry for every position, and there are ample opportunities to earn bonuses. The cash bonuses are based on a combination of company, department, and individual performance. In

addition, the top performing employees earn stock and stock option rewards that vest over the course of several years.

CTP's CIO proudly stated that employee performance at CTP is based on objective measurements. At the beginning of the year, managers set the measurements based on company goals. These measurements vary by employee role, but all employees are at least partially evaluated based on whether or not projects go live on time. On-time performance is the primary metric used to evaluate project managers. Software developers and software testers are additionally evaluated based on the number of valid defects found in the code. Of course, the developers are rewarded for having a lower number of bugs while the testers are rewarded for finding a high number of bugs. In addition, every employee in the company must demonstrate leadership and be able to provide specific examples of their leadership. The CIO stated that anyone who could be considered the "best and brightest" should be a natural leader.

The annual performance review process starts in September each year. Each first level manager ranks all of the employees reporting to them based on performance. Performance rankings are based on a combination of objective measurements and the subjective judgment of the manager. Every manager is expected to have the performance of their team fit a bell curve with a small number of excellent performers, a small number of poor performers, and a large number of average performers. The 2nd level managers then take the rankings from the first level managers and rank all of the employees against each other including the first level managers. This methodology continues through 6 levels of management until the CIO ends up with a single list ranking every employee in IT from best to worst. CTP typically laid off the bottom 10% of people on this list each year. The company did this under the theory is that they can hire people better than the bottom 10% of their current employees. In addition, the CIO said that this policy creates

healthy competition that motivates people to do their best work. In the past, when the company had fast growth, the company would hire many more people than they laid off each year. However, due to the company's decreased market share, there was a hiring freeze. Any layoffs reduced the number of employees in the company.

The CIO stated that because they only hire and retain the best employees, they make a strong effort to empower their employees, especially their managers. When the IT department plans the projects for the year, all the managers meet over the course of several months in order to determine the projects with the best ROI. A project schedule is created with specific project names and dates, and the IT department is held accountable for meeting the schedule that they agreed to. In order to ensure that managers can be held accountable for these medium-term commitments, the company asks each manager who takes on a new assignment to agree to spend a minimum of 18 months in their new role.

The CIO also pointed out that employee empowerment goes all the way to the front-line employees. Every 6 months, there is a companywide employee survey called "Talk Back". This survey is a chance for employees to give feedback about how the company is run. CTP takes real actions based on this feedback. They have fired managers who get poor feedback, and they form task-forces to fix the top problems that were identified in the survey. Consistent with CTP's culture of measuring results, the company holds the task forces accountable by expecting to see improvement in the next employee survey.

Issues

Based just on feedback from the CIO, the company seems to be doing a lot of things right. CTP uses a mix of extrinsic and intrinsic motivation techniques. They even offer stock and stock options with a vesting schedule which should offer some long-term

extrinsic motivation. However, because there is often a disconnect between what executives intend and what is actually happening, I looked deeper into the actual implementation and outcomes of CTP's policies.

I found that the high pay did seem to truly attract and retain very bright, very hard-working employees. The stock also served as a good retention tool. However, CTP had a very demanding work environment, and I found that many employees who were burnt out and no longer passionate about their jobs were staying with the company simply because they couldn't find similar pay elsewhere.

Although these burnt out employees should theoretically fall into the bottom 10% of the companywide ranking based on their performance, it turned out that performance measurements tended to be less objective than the CIO was led to believe. An employee's past reputation and friendships played a big role in where employees were ranked despite the official policy that only current year performance should be considered. In addition, true objective performance measurements were nearly impossible. Despite the official company policy that managers should stay in one position for 18-24 months, it was rare for a manger to manage the same people for more than 6 months. Departments were regularly reorganized, managers and front-line employees were regularly moved, and company objectives were regularly changed. The objectives set for each employee were generally obsolete within 6 months. This is probably just as well since the performance review needs to be completed in the 9th month of the year, which ignores 25% of an employee's annual performance anyhow. Also, because the objectives for each role were quite different, each employee's place in the overall ranking was determined more by the influence of those advocating for her than by any objective measurement.

The conflicting goals of the measurable objectives also seem to cause problems. Each time a tester reports a bug, the developer's first reaction is to state that the bug is invalid. They may try to say that the requirements were wrong, the test case was wrong, or that the tester made an error. Although these situations are sometimes the case, the developers spend more time trying to get a reported defect marked as invalid than trying to fix the defect because they believe that the number of valid defects against their code will directly lower their ranking. Meanwhile, the testers try to increase the reported bug count by dividing problems into multiple bugs even when there is one core problem. For example, if the font on every screen of a new application is wrong, the tester may report a bug for each screen with the wrong font rather than one, all-encompassing bug for all screens. Project managers, who are rewarded primarily based on meeting deadlines, are known to do anything to meet a deadline including putting code into production in "blackout mode". "Blackout mode" means that the code is in production but cannot be used because it's not really complete. However, the project manager reports that the project went live on-time and that all additional time spent is considered "production support" due to the poor quality of code. The fact that people are competing directly against their co-workers in order to not be laid off means that many employees spend much of their considerable talents on identifying who to blame for problems rather than on finding solutions to those problems.

Managers also expressed frustration with the often conflicting company policies of evaluating employees based on objective measurements while forcing employees into a bell curve. One manager had five high-performing employees reporting to her and was told that at least one had to be rated "underperforming". She had a team of 8 in the past and was forced to lay off the lowest performer each year with no replacements due to a hiring freeze. Although all her direct reports exceeded the objective metrics that were set

early in the year, she was left with the awful task of trying to explain to one employee why he was graded as "underperforming."

Managers felt further disempowered by the way the project schedule was changed throughout the year. Experienced, competent managers spend a lot of time coming up with the schedule based on the ROI of each project; however, throughout the year, senior executives seem to change the schedule on a whim. The managers who set the original schedule know that there needs to be flexibility over the course of a year, but they report that the senior executives make the changes without any consultation with the managers who set the schedule. The managers report that they're often forced to drop high ROI projects for projects that seem to have no ROI.

Non-management employees reported that the "Talk Back" program did not make them feel empowered. In fact, it only highlighted the hopelessness of fixing any problems that they identified. Approximately two months after the survey is taken, the results are presented to the employees. Then, the non-management employees are told to form task-forces to fix the top issues before the next survey is taken. The employees on the task force are not allowed to take time away from their regular, full-time duties to participate; the task force is not given a budget; and the task force has no people in management positions. Given these constraints and a 4-month timeline, it's not surprising that the task forces are rarely able to change the survey results. When the survey results do not improve, management blames the task forces for being ineffective.

Recommendations

There are a number of improvements that the CIO could implement to improve both extrinsic and intrinsic motivation of employees in ways that would help the company achieve their long-term goals.

One big improvement that could be made to the extrinsic motivation program is to measure performance based on the company's true goals. The CIO stated that the biggest problem is that the IT projects are not achieving a high enough ROI. Therefore, employees' performance should be measured based on the ROI of projects. This has a number of benefits. First of all, it extrinsically motivates all employees to focus on the actual goals of the department and company rather than ancillary goals that may not have real benefit. Even more importantly, it focuses all employees on the same goal. Focusing on the ROI also empowers employees to make sensible decisions about quality and go-live dates. An added benefit is that the ROI measurement can be done over several years, which will transform a formerly short-term incentive into a long-term motivator. The major risk with using ROI as a performance measure is that the calculation may be complicated and unclear to the employees. The CIO will need to work closely with the finance department to clearly define how ROI is measured so employees understand how they can influence it.

The current project schedule is set based on anticipated ROI, so the method for setting the schedule can remain the same. However, the CIO should change the policy regarding schedule changes throughout the year. Any schedule changes should be discussed with the team that set the original schedule and ROI should be a major factor in any changes. Not only would this change in policy improve the ROI of the project portfolio, it would increase the managers' feelings of competence, relatedness, and autonomy, which should improve their intrinsic motivation and lead to higher productivity.

In order for the long-term ROI to be more of a motivation, the CIO also should aim to implement the current company policy of keeping managers in the same position for a minimum of 18 months. The current situation, where managers typically move

every 6 months, gives managers very little motivation, extrinsically or intrinsically, to think long-term. Seeing a project through from the beginning to the point where ROI is measurable can easily take 18 months. Still, given that it will take time to change the current culture, it is important that the ROI calculation will reward employees for projects that they worked on as they move from department to department.

The "Talk Back" program has the potential to improve employees' intrinsic motivation and their commitment to the long term success of the company. However, the execution of it is quite poor. Under the current execution, there is no chance of any of the feedback from the program actually leading to changes in the company. This eliminates the employees' feelings of competence, relatedness, and autonomy. In order to improve the program, the task forces should include managers and the members of the task forces should be given time to analyze the problems and make suggestions. The suggestions should be seriously considered by management with budget authority and the best proposals should be given the proper financial and human resources to be implemented. At one of my previous companies, there was a similar program that led to real changes in company policy. Although the employees knew that not every proposal would be implemented, they knew that several of the best proposals would be implemented each year. The result was both a better run company and a greater sense of ownership among the employees. That sense of ownership led to intrinsic motivation to take actions that were in the best long-term interest for the company.

My final suggestion to the CIO was to eliminate the companywide ranking systems and accompanying mandatory layoffs. Based on what I saw, the intense competition led people to spend time identifying causes of rather than solutions to problems. Identifying the root cause of a problem would necessarily be a bad thing if it weren't for the related layoffs. At CTP, the cause of the problem was often the person

laid off, so people had a strong disincentive to identify the true cause if they were involved. More time was wasted because of the intense complexity of the companywide ranking system. Every manager in the company spent weeks per year in the ranking meetings. This time could be much better used for other tasks. Finally, the disconnect between the concepts of objective rankings and a forced bell curve made employees and managers feel no sense of relatedness. Employees did not understand how they could be rated as "underperforming" when they exceeded every goal and managers didn't understand why they were forced to rank valuable employees so low.

The CIO liked most of the suggestions and plans to implement many of them. However, he said that the companywide ranking system was ingrained in CTP's DNA and would never change under any circumstance.

CONCLUSION

So, what is the answer to the research question of "how can a company motivate employees to take actions that are in the best interest for the long term success of the organization?"

I have found that body of literature regarding employee motivation is quite comprehensive. It clearly supports the idea that financial incentives effectively motivate some behavior for some period of time. Well designed incentives clearly are effective in at least certain situations. There are a number of types of incentives, and most compensation experts recommend a mix of incentives to motivate employees to achieve long term, short term, individual, team, and organization goals.

There is also a body of work that shows that incentives, even if effective at motivating something, often do not motivate the right things. This research contends that incentives are dangerous and should not be used at all. These proponents argue that leadership should replace incentives in order to achieve long term success. Interestingly,

even many proponents of incentives admit that they are ineffective without implementing many on the leadership traits recommended by the critics.

I did not find much convincing research or practice supporting the effectiveness of long-term financial incentives. However, both the research and interviews revealed that techniques for intrinsic motivation are effective for long-term company success. In addition, these techniques have been shown to be important for improving the effectiveness of extrinsic incentives. Given this dual benefit, there does not appear to be a good reason for companies to avoid the intrinsic motivation techniques. In fact, Sam Goodner stated that he believes that it's not the things that cost money that are the most motivating. He has found that being open and honest in communicating with his company, and doing it consistently, is not only the most effective choice, it is the easiest choice.[160]

Extrinsic motivation techniques are effective for achieving very specific goals when used carefully and in moderation, but both research and experience shows that they are not the best tool to be the centerpiece of a company's long term success strategy. Ultimately, intrinsic motivation is much more effective at motivating employees to take actions that lead to a company's long-term success.

[160] Goodner, Sam. Interview.

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Vita

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