Management Style—As Important as Technology For Ensuring Top Performance in Shops

By Lee Benson & Rick Watts

Advances in technology and the widespread availability of information make it difficult to hold a technological advantage over the competition for any length of time. Management style is becoming our single-most-important competitive advantage in today's market. The use of performance compensation tools, combined with "soft-skills" education and training, can dramatically improve shop performance. Presented here is a structure for effectively implementing a performance compensation system that will continually improve employee performance and promote employee motivation. During the two years this performance compensation program has been in place, the gross company revenue grew 135 percent in the first year and 66 percent in the second.

Able Engineering & Component Services is an FAA-approved repair facility specializing in the development and completion of repairs and overhauls for the aerospace industry. The company originally concentrated on rotor craft components and within the last few years has added overhaul capabilities for fixed-wing components—such as flap carriages, flap tracks, cockpit seats and hydraulic actuators. The company specializes is developing repairs that save the major operators millions of dollars a year by not having to buy replacement parts. They have in-house processing capabilities that include machining, hydraulic testing, nondestructive testing (NDT), selective plating of several materials, tank plating capabilities for chrome and cadmium, and phosphate coatings. The company has been in business for 14 years and is budgeted to do $11 million in business for 1999.

Management Styles

The traditional controlling management style of "don't think—just do as you are told" creates the lowest possible level of employee motivation. Management styles such as TQM (Total Quality Management) provide useful tools in the struggle for continuous improvement, but lack answers regarding long-term participant motivation. Having access to the latest technology, process procedures, equipment and state-of-the-art facilities can be only half of the equation when attempting to maximize shop performance. Creating an environment where employees are intrinsically motivated to get the most out of the tools and equipment they are given to work with will require a management style that promotes this type of atmosphere.

Open-Book Management

The "Open-Book" management style described by Jack Stack in *The Great Game of Business*,* was the starting point for developing the Performance Compensation program outlined in this paper. When this program was implemented in January 1997, the goals were as follows:

1. Provide a system for continuous improvement.
2. Increase employee motivation and satisfaction.
3. Keep costs under control in a fast-growing company.
4. Have non-supervisory employees work with the same scorekeeping information as management (financial statements).
5. Provide additional performance compensation dollars to all employees, substantial enough to be meaningful.
6. Promote teamwork.
7. Continually improve employee "soft-skills" performance (defined later).
8. Maximize the return on investment for shareholders.

With the Open-Book style, management will typically select TQM or other performance improvement programs to help in achieving the company goals. This approach is inefficient, because it requires two systems for measuring performance. One system is for the production employee's use, with its own common language, measurements and tools. The second system is the one management uses—the financial statements. A single system used as a basis for measuring performance throughout the company saves in implementation costs, and avoids inefficiencies caused by poor translations between multiple systems.

The basic principal of Open-Book management is that all employees have access to the financial statements. This is particularly important in the area or department within the company where employees have some control over how the money is spent. The main objective is that the employees are working from the same information that the management team is using to grade their performance.

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* *Jack Stack,* The Great Game of Business, *Currency and Doubleday, New York, NY (1992).*

Performance Compensation

For Open-Book management to be successful, there has to be an incentive for employees to achieve company goals. Performance compensation provides this incentive. Performance compensation is a way of sharing corporate profits with the people responsible for generating them. An increase in the level of performance results in an increase in the return to the participants. One source a company can use to fund the Performance Compensation program is out of pre-tax net profit dollars. Once a baseline profit number is set, for every dollar over that amount, a percentage is given back to all of the participants. Performance Compensation can be paid on an individual or team basis. The team approach will be discussed here.

Team Structure

A basic training program was designed to educate employees on interpreting the company financial statements. Departmental meetings were held monthly to go over the *detail trial balance*, which shows, by department, where every penny is spent. All departments are instructed to use a standard worksheet to prepare for this meeting. The basic questions on these worksheets are:

- How much money did our department spend for the month?
- What did we spend money on that we shouldn't have? (rework, overnight shipping, unplanned overtime etc.)
- What are we doing to prevent this type of spending in the future?
- What management, communication and work-flow systems need improvement?
- What suggestions do you have for improvement in other departments?

The monthly departmental meetings are followed by a company-wide meeting where a representative from each department answers the above questions for their department, in front of the entire company. This gives employees a better understanding of the overall workings of the company, as well as a chance to see how their work impacts other departments. Employees are encouraged to make suggestions to other departments. Any ideas for improving the overall company performance are assigned to a department, entered into a database, then followed up to ensure they are implemented.

Raises vs. Performance Compensation

One way to provide additional compensation is to give raises. The problem with raises is that this money will have to be paid, regardless of how the company or team performs. If the company continually gives out large wage increases each year, it would be difficult to carry these wages if the company went into a slump. The Performance Compensation program described here was designed so that if the team as a whole is performing well, the employees receive a portion of the profits they helped produce. Conversely, when things are not going so well, the company doesn't have to bear the burden of fixed wage increases.

Base wage increases should be given to ensure employees are paid competitively when compared to positions in similar companies. Beyond that, if employees want to make more money—short of assuming additional responsibilities or advancing within the company—it has to come from net profit.

For the Performance Compensation program to work, it has to provide an opportunity for all employees to receive additional money each month that is linked to the company financials, and substantial enough to be important to them. As a baseline, it was determined that five-percent pre-tax net (PTN) profit was the minimum the company needed to retain in order to meet its objectives. Keeping this in mind, the Performance Compensation plan was set up so that 16 percent of the PTN profit would be paid out to participating employees, as long as the company PTN did not fall below six percent (subtract 16% from 6% and the company still retains its minimum 5% PTN profit). If the company makes $100,000 in PTN profit, for example, and this amount is equal to or greater than six percent of gross sales, then $16,000 will be paid out in performance compensation.

The Performance Compensation program was implemented on a trial basis in September of 1996. The intention was to educate the employees and develop the ground work so that when the program started with full payout the following January, there would be a better understanding of how it worked.

In order to promote consistent employee performance throughout the year, 25 percent of the performance compensation was paid out monthly, with the final balance held for end-of-year accumulation. This was done for two reasons:

- If the company had a poor month or two and profit levels fell below the minimums, there would be a pool of money from which to draw.
- This rule also promoted employee retention.

All employees begin participating in the program as of the date they are hired (no vesting period). The only restriction is that employees must still be employed by the company on December 31 in order to receive their end-of-the-year accumulation.

"Hard Skills" vs. "Soft Skills"

"Hard" skills are those associated with performing the job. An example of hard skills would be electroplating nickel on a bearing journal or machining a diameter on a shaft. It is very important when translating skills into job descriptions that they are end-result orientated and not activity orientated. Going through the motions (activity orientated) would be of little value if the desired end result is not accomplished. Making job descriptions end-result orientated would eliminate the common problem of confusing efforts with results.

"Soft" skills describe how employees (at all levels) interact with each other and promote company culture. At first, it was very difficult to effectively grade performance in this area because of its subjective nature. This has been a major problem with other typical employee evaluation processes. Although some aspects of employee performance are objectively measurable in typical employee evaluations, invariably, both sides spend a fair amount of time discussing how they *"feel"* the other side is doing. This subjective process is usually uncomfortable for both sides, especially when the employee is unsure of management's expectations for the evaluation.

Combining Hard & Soft Skills In Performance Evaluations

One of the best ways to improve employee motivation is to take the guesswork out of how they can earn more money. It should be very clear what is expected of the employee on an individual, as well as a team basis, for that employee to make more money. It is important to stress that pay increases cannot depend only on individual performance. For example, an employee may be the best at a particular job with respect to low rework and learning new skills, but if the company overall is losing money, all raises may be put on hold as a result. Stressing this point gives employees an incentive to help other team members be more successful.

Taking the guesswork out of soft-skills assessment meant taking the subjectivity out of this area of the evaluation as well. To do this, the soft skills that the team decided were important were broken down into a list of observable behaviors. Rather than saying a particular employee is or is not a good team player and leaving it at that, the assessment is now based on what can be observed about that employee's behavior that demonstrates compliance in this area.

There are approximately 50 desired observable behaviors by which all employees are graded by their supervisors (including managers). The grading system is as follows:

0—low, needs lots of help in these areas
1—making progress
2—already exhibits these traits on a continual basis

These behaviors are divided into three major categories: Attitudes and Behaviors, Work Ethics, and Performance Compensation Program Management Philosophy. Examples of some of the observable behavior traits are as follows:

Interpersonal skills: Able to resolve conflicts with others. Approachable—good listener.
Positive attitude: Able to maintain good attitude regardless of production level. Willing to take on any task, regardless of desirability.
Time management: Initiates time saving ideas. Attempts to consolidate tasks for increased efficiency.

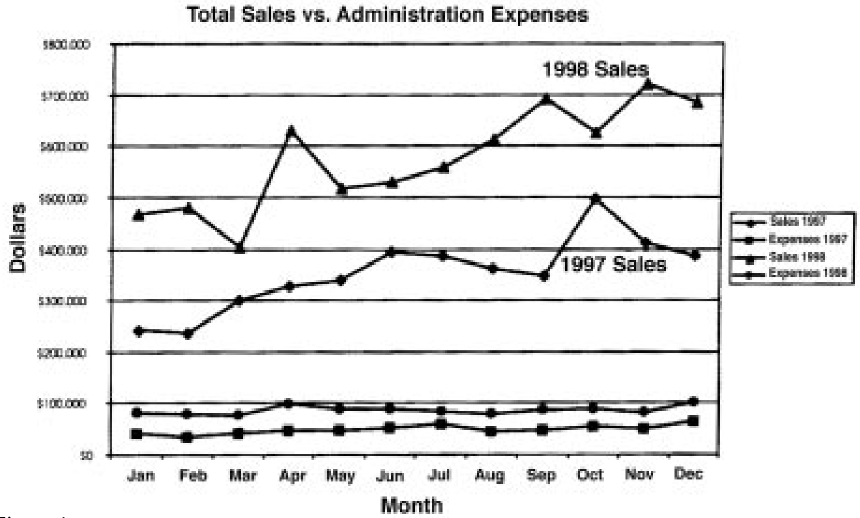

Figure 1.

Figure 2.

Dependability: On time consistently. Is not abusive about taking personal time off.

By breaking down general traits into very distinct behaviors, a much more accurate assessment of an employee's performance is possible.

At the standard time(s) of the year when employee reviews are given, each employee has a list of hard skills they have been acquiring since the last base wage review. These objectives are clearly described so employees know exactly what is expected of them in order to make more money. By acquiring these additional hard skills, employees know where they stand and how much of a base wage increase they qualify for. Once the amount of base wage increase an employee qualifies for is established, based on the hard-skills assessment, that amount is then multiplied by the score from the soft-skills assessment to determine how much the employee will actually get. If an employee qualifies for a two dollar-an-hour raise based on acquired hard skills, for example, but only scored 50 percent on the soft-skills assessment, then the amount of base wage increase given would be one dollar an hour.

At review time, to ensure employees are not surprised by their soft-skills score, they are encouraged to score themselves on a quarterly basis and submit the results to their supervisors. If the supervisor does not agree with the employee's assessment on some of the behaviors, this allows them both to put a plan in place to work on those issues. It is not always easy for some employees to see themselves as others do. In cases where the supervisor and employee cannot agree on a soft-skills observable behavior assessment, the issue is then brought up at the next departmental performance compensation meeting to get peer input on the behavior in question.

Once an understanding was developed with the employees that improvements in the soft-skills area translated into more money in their pockets as a direct result of improved company-wide performance, there was little-to-no resistance in dealing with these issues.

A "Win-Win-Win" Solution

Since the implementation two years ago, all eight of the goals listed at the onset of this program have been achieved. The two goals pertaining to systems orientation were accomplished at the program's inception. They were providing a system for continuous improvement and using the financial statements as a basis for keeping score throughout the company. The remaining six goals were measured on a regular basis to ensure compliance.

An increase in employee satisfaction and motivation were measured through employee turnover. Out of approximately 85 employees in 1998, there were only four employees who left the company on their own. Within the same year, they all returned to the company in positions similar to those they had left.

Keeping expenses under control was measured within each department. Figure 1 is an example of administrative and overhead costs, compared to total sales. The slight increase in administrative costs in 1998 over 1997 was the result of moving into a new facility that was three times the size of the one occupied in 1997. The company's gross sales increased 135 percent in 1997, with an additional 66-percent increase in 1998. This increase, along with a substantial facilities move, demonstrates that the company was able to keep costs under control.

Another example of keeping expenses under control was tracked by using total rework dollars or lost profit. Figure 2 shows a comparison of lost profit to total sales over the two-year period. Although the total sales have substantially increased, the "lost profit" has remained about the same in dollars and decreased as a percentage of total sales. Typically, "lost profit" would increase in dollars as total sales increased.

The Performance Compensation program's average payout to all participating employees was just over seven percent each year, for the first two years. In other words, whatever the employees made in base compensation for the year, they each received an additional seven percent in performance compensation. This does not factor in cost-of-living increases, which are calculated at the local rate of inflation.

By having employees know where they stand in the soft-skills area and actively working on these characteristics, teamwork and group projects become much more easy to manage and progress more efficiently, because everyone works toward common solutions. It is not just a matter of "putting on a happy face" for your manager. It becomes a matter of the employees' progress having a definite impact on their financial rewards. Additionally, employees have a desire to help each other with "soft" and "hard" skill development, because it effects the good of the entire group—as well as the company.

In the past two years, some unexpected challenges arose out of a perception of a disparity in fairness. With an Open-Book management style, all of the employees see the amount of money their coworkers are earning and employees immediately compare themselves with what others earn. The performance compensation payout described here distributes the money proportionate to employee wages. Any base-pay differences between employees performing the same job will make the performance compensation distribution seem unfair and will generate employee morale problems. To eliminate this problem, base-pay salaries and job descriptions were fine-tuned. The job descriptions are extremely important because, even if the amount of money an employee makes may be more than justified, if the job description does not clearly show that to the other team members, there can be a problem.

For best results, all employees (including management) need to be on the same bonus program to prevent a destructive *"them and us"* attitude. With the exception of commission-only sales people, there should be no other bonus program in the company. When the employees see that all of the team members participate in the same performance compensation program, any perception of unfairness goes away.

The overall benefit of the Performance Compensation program is a "win-win-win" solution—for employees, customers and managers.

The employees have an opportunity to participate in the direction of the company, with direct financial rewards for themselves. The customers are rewarded by people that are genuinely concerned in doing a good job and optimizing processes to potentially lower or at least maintain prices. The managers are rewarded by a highly motivated work force that doesn't require a lot of "baby-sitting."

Although this program is relatively young and was designed as a monetary reward program, individual personal growth of several employees has been noticed as an additional bonus. P&SF

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