Rethinking Goals and Incentives:

What Goals/Incentives Can and Can't Do

Dr. Dan Ariely, a professor of psychology at Duke University, has conducted many studies on how human behavior is not clearly rational. Of these studies many have been on the subject of if and how incentives can influence employee behavior. One of the main things that he has discovered over the years is that once you pay someone enough to allow them to live comfortably, people, on average, don't improve performance for higher pay, but sometimes can actually lower performance. http://danariely.com/2008/11/20/what%E2%80%99s-the-value-of-a-big-bonus/

In the article cited above, Dr. Ariely ends his post, "When I recently presented these results to a group of banking executives, they assured me that their own work and that of their employees would not follow this pattern. (I pointed out that with the right research budget, and their participation, we could examine this assertion. They weren't that interested.)" Over the past 17 years, the staff at Datava has actually been collecting data from our clients to determine the answer to this question. Having worked with over 100 financial institutions during that time, we have analyzed what does and what doesn't work with regards to incentive plans and other methods of improving employee behavior.

The first thing we have learned is that there are three different types of employees.

1. The Disinterested
2. The Motivated
3. The Quality Definers

The Disinterested: This is a group of employees that fall below the standards of the institution, and after one or several interventions have taken place to improve performance, it has been determined that they are either gross detractors (they cost more than they produce for the company at the worst end), or they are net detractors (the opportunity cost of having them work for the company is worse than the possibility of their replacement.

The Motivated: This group is firstly defined by a proven track record of either meeting the standards of the institution, or showing enough improvement after one intervention as to justify their employment.

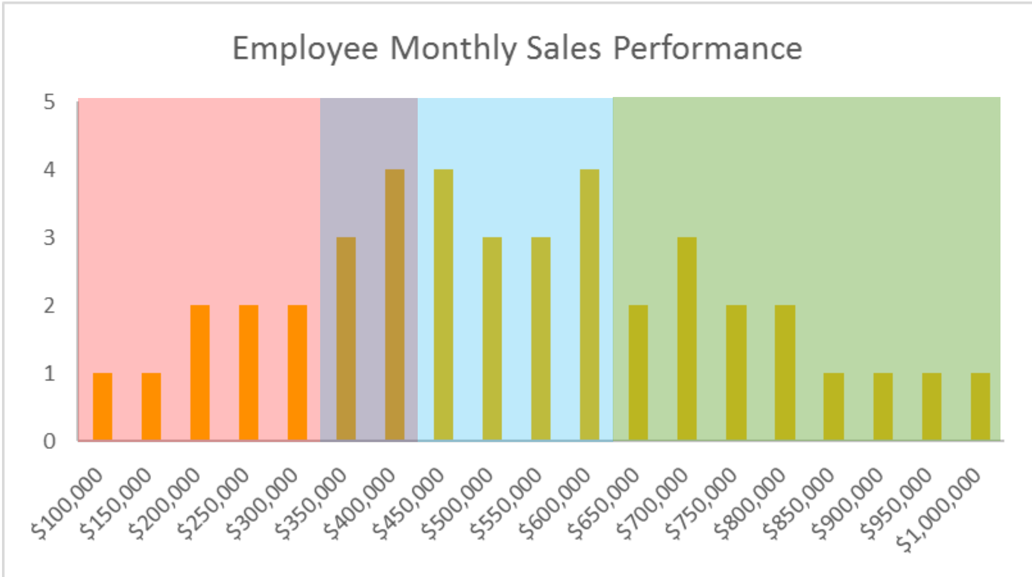
The Quality Definers: These are your employees who are self-motivated to perform. They sometimes perform better due to external incentives, but are more often impelled by their internal character to be a top-performer.

Most companies try to implement a goal/incentive program in an attempt to transform a sales team to all Quality Definers, but this is unrealistic and doesn't usually work.

and one of the most important jobs of any goal or incentive program is to classify employees within these three categories, and, when possible, move employees from the lowest to the highest, but this is unrealistic and through the research of Dr. Ariely and others has been disproven. Does this mean that incentives and goals don't work at all? No! But it must be understood what they can and can't do, and how to apply them in such a way to motivate those who can, identify those who can't, and help keep those who are your Quality Definers.

Determining Which Employees are Which

In the following example, the company has 42 sales staff who produced a total of $21.95M in sales for an average of $522,619.05 per sales person.



You can see a breakdown by number of employees who sold at each dollar amount for the month.

Quality Definers: Starting with the green shaded area, these are whom we would classify as your Quality Definers. The reason you start with these, is using this information, you can then create the rest of your categories. The first, and easiest way to define this category is to take the top 30% of your performers. In this example, after factoring in the true profits realized from a sale, any employee that sells over $650,000 in net new dollars per month is classified as a Quality Definer. One note to make, is that to true define an employee as a Quality Definer, they need to have met this performance for at least three sales periods (usually monthly or quarterly depending on the sales cycle of the product), but in this example, we'll just use this month. Now that we have defined the Quality Definers, we can now determine the other two categories.

The Disinterested can be identified by any employee that meets the following two criteria:

1. Any employee that is selling less than their total employment cost. A simple calculation is 2.7 times their salary. In the example above, any employee that sells less than $350,000 fits into this category.
2. Any employee that produces less than 50% of the value that a Quality Definer produces. In the example above, we have 12 employees, who Determine the total net profits you are receiving from your Quality Definers. This is done by first diving the number of employees by the total revenue generated by them. In this case, that is roughly $10.2M/12 employees, which totals $850,000. If you then take 50% of that value, you will get $425,000.

The Motivated are defined by anyone that doesn't classify as a **Quality Definer.**

The Purple Middle Group: The Purple area is the overlap between the Disinterested and the Motivated. We can't yet determine if these employees can be motivated or if they are going to be disinterested to any motivation. This group is determined by the difference (if there is one), between the first category and the second that defines the Disinterested. In this case, the employees that are selling between $350,000 and $400,000 are possibly classified as Motivated or Disinterested.

A Word of Caution

One objection you might be feeling right now is the concern of the Wells Fargo trap, where the classifications presented up until now has the danger of creating a hyper-sales-culture, with unattainable goals and cut-throat or dishonest sales practices. It is very important for you to understand that the methods we've set out won't produce those results as will be made clearer below.

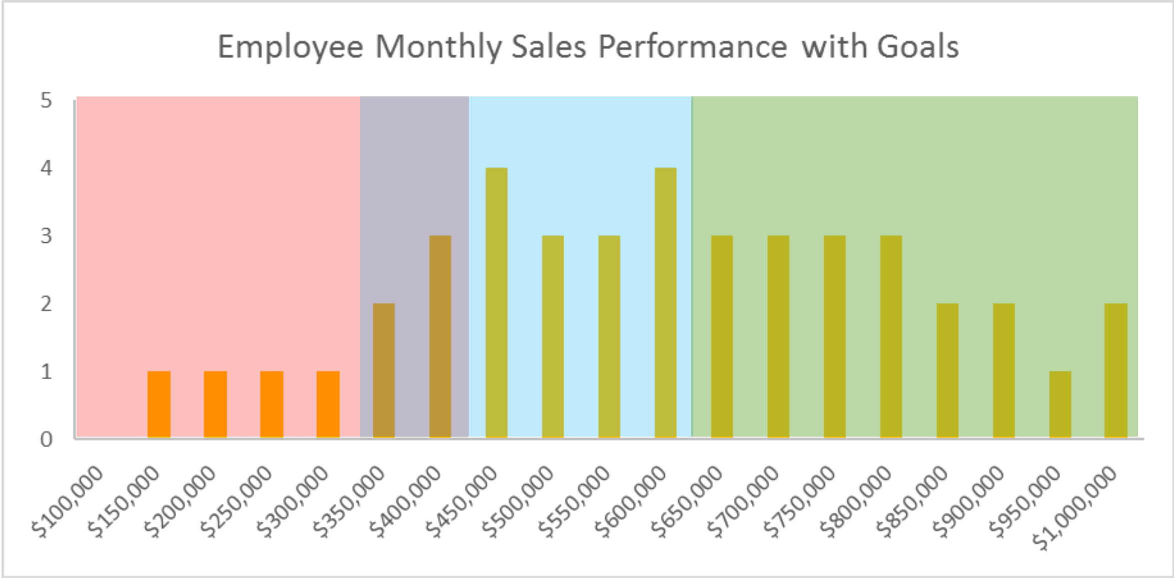
How Goals and Incentives Can Change This graph

Goals are the first thing

Goals are the most important piece to have, and we never recommend implementing incentives without some sort of floor, or minimum goals first. The goals should be set in such a way to make it clear to all employees what performance levels are outside of the requirements for employment. These should be clearly communicated through simple dashboard reports, so that employees know when they are performing and when they are not. Any employee, that continues to have more than three periods of below standard performance should be seen as a Disinterested employee and should either be transitioned to another role or should be terminated. There is strong evidence that by simply presenting these types of dashboards to employees, you will get some movement from the middle level of Disinterested and even the rare low performing Disinterested into a Motivated employee. We usually see a 10% movement of clearly Disinterested employees into Motivated.

Before you look at replacing those positions within your organization, it is important to determine what percentage of your overall employees fit into the Disinterested category. If it is less than 30%, you should be able to move forward without major internal changes of culture or management. If it is greater than 30%, we recommend re-assessing your hiring, employee onboarding, and ongoing training. If you need assistance with this, we can help you conduct those assessments.

After implementing a goal strategy (and sometimes only a goal strategy), you can expect movement of the graph to look something like this:



The first thing you should notice is that we've cut the amount of Disinterested employees in half, from 8, to 4. The next thing is with a 10% up-tick, we've moved one of those low performers into the possible motivated category. Another consequence is that with new hires, we have a 30% chance of hiring a Quality Definer, so we've added to that category as well. So, without paying any additional incentives, we now have the same number of employees now selling an additional $3.35M in the month, which is a 15% increase.

Now for Incentives

The first thing you should keep in mind is that money isn't everything, but it is something. When we talk about incentives, we will first be speaking about financial compensation, but we will also later speak about the effects of accolades, prizes and other intangibles. But it must also be understood that, as we said from the beginning, incentives often have no effect on your employee's performance, but there have historically been two areas where we have seen this not to be true:

1. Incentives can move performance of low performers by approximately 20%.
2. Incentives can increase loyalty of employees, improving the likelihood you will keep Quality Definers.

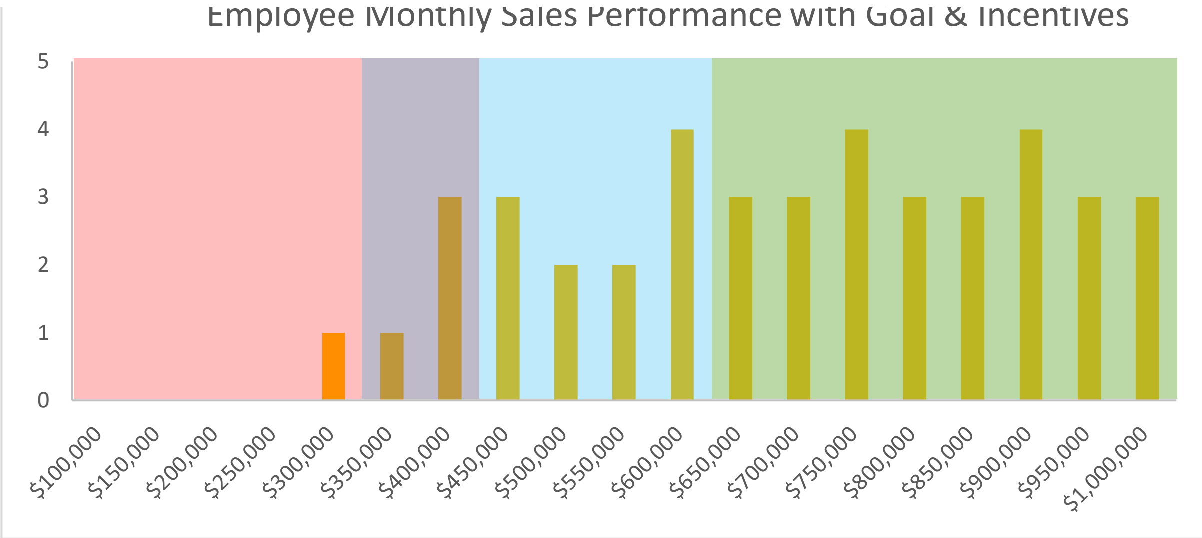
The easiest and most effective way we've determined to clearly improve performance of low performers is to create a simple, small incentive attached to behaviors that directly tie to revenue for your business. These incentives will usually have the potential to total 2-10% of their salary, and should be a broad enough set of goals that it discourages dishonesty within the system.

The other, and often more valuable, thing that incentives do for you, is it allows you to recognize and retain Quality Definers. Often employees are given raises due to seniority, and it is often a difficult thing for a business to determine whom should be getting paid what. It is a strong temptation for companies to view paying high performers the same salaries as lower performers as a means of getting a deal and helping to justify the overall department spend, but this rarely works in the long run, as Quality Definers will often realize the lack of recognition and will move on to a different company. Incentives are a very useful way to easily and dynamically identify top performers and make it very difficult for them to leave, and their total compensation becomes such that when looking for jobs elsewhere, it becomes unlikely they can be guaranteed pay to what they are realizing with your company.

Beyond Financial Incentives

To look beyond simple incentives, there is a large body of evidence that giving awards and other means of recognition are of great value to employees, especially for the satisfaction and loyalty of your Quality Definers. We recommend that along with incentives, to produce plaques, give gift cards, have ceremonies, and recognize individuals in company-wide meetings. These have all been proven to have huge payoffs in the long-run, and to improve employee performance.

Based on our company's experience, if you implement a robust goal and incentive structure, you can expect performance metrics like the following:



What these results will mean is an increase of $7.2M in sales, or a 33% increase in performance over a program with no goals or incentives. Almost all Disinterested employees have been transitioned higher up or transitioned out of their roles, Motivated employees have improved performance, and Quality Definers are retained.

If you would like help structuring or implementing a goal or incentive program, Datava can help.

Post Script: One thing to be sure you are doing is to ensure that you compare employees that are at the same location, selling the same type of product, and that all employees have been trained using similar programs. We also recommend having your employees go through a certification program, to ensure they all are qualified to be selling. Different markets, different products all need to be factored into the classification program discussed below. Economic conditions and job markets should also inform you as you look to hire employees.