Incentive Awards Programs

OVERVIEW

Incentive pay programs have proven to be a popular option for improving warehouse productivity by as much as 15-30 percent, even after implementation of engineered standards. Here, you will learn about general incentive program philosophies, three types of rewards, and several "Keys to Success" for implementing an incentive awards program.

We will also discuss a case study where enVista implemented a simple 2-step incentive pay program that delivered a 15-30 percent labor savings to the client and an estimated average of $45.00 of incentive pay per week per employee, resulting in a "Win-Win" scenario for the employees and the company.

Introduction

Incentive pay programs have proven to be a popular option for improving warehouse productivity by as much as 15-30 percent, even after the implementation of engineered labor standards. Other incentive program benefits include increased job satisfaction and improved employee morale. These benefits lead to reduced employee turnover, which is a key metric that is often overlooked in the distribution industry. Depending upon factors such as required background checks, medical screening, internal reviews and indoctrination training, human resource departments estimate the onboarding and hiring costs of a new employee to be in the range of $2,500-$5,000 or more. Companies experiencing high turnover rates of 50 percent or more, may want to consider implementing an incentive program as a way to help retain employees.

Philosophy

There are literally no boundaries that define how to design an incentive award program. However, when implementing an incentive award program, the program must be easily explainable to the employees. Programs that are difficult to document often result in lack of confidence on behalf of the employees and supervisors. This will most likely lead to failure at some point within the lifetime of the program.

Individual incentives have been found to be the most effective type of award in a distribution environment, as the employees control their own levels of performance and their potential reward. Team and reflective incentives should be considered when individual performance cannot be measured. Reflective incentives reward one group for their contributions toward the performance of another group.

Other factors that should be understood prior to implementing an incentive award program are:

- **Wage rate** – Are you paying comparable in-markets rates compared to other companies in the immediate area?

- **Experience of workforce** – A highly tenured workforce with in-market wages may not respond as favorably to an incentive plan compared to a younger workforce and those in a low-end market wage scale.

- **Level of engineered standards in place** – Multi-variable or discrete-based labor standards will provide the necessary foundation for properly aligning employee performance (against engineered standard) to the incentive award. Single variable labor standards, expressed as Units per Hour (UPH), or

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Reasonable Expectations (RE's), can lead to runaway incentive awards, or no award at all, due to the fluctuations in employee performance based on inbound and outbound volumes.

• **Labor environment –** Historically, labor unions have been slower to respond to incentive programs than non-labor shops. The business agent should be approached to gauge the interest of the local union, prior to implementing an incentive program. Team approaches may be a good fit in a union environment.

Incentive Rewards

Incentive program rewards fall into three categories:

• **Monetary incentives** tend to be the most impactful. Additional take-home pay is always a powerful motivator for long-term, successful programs.

• **Time-off** can be successful, but it often leads to managerial challenges, such as seniority issues in the workforce, potential overtime issues, and customer constraints.

• **Awards** such as gift cards, event tickets, or discount coupons, can have a positive, short-term impact, but generally lose their appeal after 3-6 months. Starting with awards and moving to a monetary incentive is a great combination that is easy to implement and allows for the company to determine the long-term costs and benefits before committing to a monetary-based incentive.

10 Keys to Success

When building an incentive program, the following guidelines are recommended to ensure a successful company incentive rewards program:

• Easily defined programs ensure supervisor and employee buy-in and participation.

• Get input from employees on what they would like to see included in an incentive program.

• Accurately defined Preferred Methods and Engineered Labor Standards are a must.

    - Yearly reviews of all engineered labor standards that are included in the incentive program are recommended.

• Communication with the workforce during the standards auditing process.

    - Employees must feel the labor standards are accurate to ensure their buy-in.

    - Standards that are unobtainable will not provide the motivation required for employees to work toward achieving incentives.

• Individual incentive pay should only be awarded for direct labor activities, such as picking, replenishment, etc.

• Incentive rewards should be granted in a timely manner, such as weekly, bi-weekly or monthly.

• Include the entire workforce in the incentive program by combining individual, team and reflective incentives.

• Incorporate safety, attendance and quality into the program as incentive qualifiers and gates.

• Minimize the amount of administrative effort required to operate the incentive program.

• Any reward earned should not replace verbal praise from management to the employees.

Summary

Companies that are able to offer incentive-based rewards to high-performing employees and teams are quickly differentiating themselves from other companies in terms of attracting, hiring and retaining employees. "Companies that offer some type of incentive compensation program, will be more apt to retain their existing workforce than those that don't," notes Peter Schnorbach, Senior Director of Transportation and Labor Management at Manhattan Associates.

Organizations that are contemplating incentives as part of their overall employee compensation package should ensure their current organizational structure supports the basic incentive philosophies described above. Proper alignment of high-performance work teams with timely awarding of incentives will provide improved operating performance, reduced supply chain costs, and highly motivated employees for years to come.

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CASE STUDY

Several leading supply chain execution software companies offer configurable incentive-based pay functionality as a part of their base Labor Management System (LMS) applications. These applications offer a variety of options including individual and team-based incentives, along with various payout methods such as linear or step-based pay.

Consulting organizations, like enVista, can define incentive pay plans without the usage of actual incentive-based tracking software. In a recent engagement, enVista worked with a food manufacturer/distributor to define an incentive program by establishing the incentive pay framework and extracting individual labor performance from their host LMS to the host time and attendance system, which was already integrated to the company's payroll application.

Incentive Program Details: Case Study

The warehouse incentive program implemented by enVista for the food manufacturer/distributor consisted of two, easily identifiable components.

First, employee performance was measured against engineered labor standards. This was capped at 125 percent performance to ensure safety and quality compliance.

Secondly, three incentive program qualifiers were defined: attendance, quality and safety.

In order for the incentive to be earned, the employees must have performed at or above 105 percent performance level against the engineered labor standard and met all three of the incentive qualifiers. If any one qualifier was not achieved, the incentive pay would be forfeited for that pay period. The program qualifiers were:

- No OSHA recordable safety incidents within the pay period in question.

- No unexcused absences within the pay period in question.

- Met the established company picking accuracy rate of 98.8 percent or higher.

The incentive payout framework for this plan was designed as a step-based pay program, with the following performance and payout parameters:

MINIMUM % PERFORMANCE	MAXIMUM % PERFORMANCE	INCENTIVE PAYOUT
	< 104%	No earned incentive payout
105%	115%	50% of base pay for the earned incentive hours
116%	125%	75% of base pay for earned incentive hours
>125%		Same as above due to program cap due to safety concerns of performance > 125%

Incentive Pay Work Flow & Readiness Plan

The following 7-step process defined the weekly incentive pay program that was implemented:

- The warehouse supervisors verify the weekly employee productivity data and edit as necessary.

- A weekly export of the productivity data from the host WMS/LMS to the time and attendance application is run as a scheduled task by IT after the production data verification has occurred.

- The warehouse manager records the incentive qualifiers for each employee.

- The warehouse manager provides the weekly qualifying information via email to the payroll clerk.

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- The payroll clerk edits each employee's pay record and enters a 0 (qualified) or 1 (not qualified) for the incentive qualifiers as a separate entry into the weekly time and attendance record.

  - For this site, there were only 8 warehouse workers, so the amount of time required by the payroll clerk to manually enter the qualifying information was insignificant.

- After the qualifying data was entered for all the employees, the payroll clerks conduct the weekly export of the time and attendance and incentive data to the host payroll application.

- The host payroll application computes the weekly pay, including earned incentive pay.

After defining the incentive payout parameters and the incentive pay workflow, the company documented the following readiness steps prior to implementation of the incentive plan:

- Introduce the incentive program to other affected departments including:

  - Senior Management
  - Legal and Human Resources
  - Payroll
  - Information Technology (IT)

- Create the employee communication plan with Human Resources and Legal input including formal presentation, official company announcement, and communication board flyers.

- Communicate the reasons for the incentive plan, along with the goals, expectations, and expected rollout dates to the entire company.

- Define the IT department requirements for all data exports

  - WMS/LMS system to time and attendance system
  - Time and attendance system to the payroll system

- Training for the payroll clerk on incentive data entry.

- Create the testing plan for incentive pay calculation.

  - Four weeks of incentives to be verified prior to actual payout to occur

- Final go-live assessment

Company Incentive Program Savings

Based on a 40-hour work week and an average performance of 115 percent for all employees with 35 direct labor hours per employee per week, the company experienced the following savings from the incentive program:

Total labor cost before the incentive plan:

- 8 employees
- Average wage rate of $26.00/hour (includes benefits & overtime)
- Total labor cost:

  8 employees * 2080 hours/year
    * 26.00/hour

  = $432,640 per year

  = *$54,080 per employee per year*

  = $1,040 per employee per week

New labor cost after the incentive plan:

- Average of 115 percent performance with a 50 percent payout
- Average of 35 direct hours per week per employee
- Results in 3.5 incentive hours per week per employee
- New weekly pay calculation:

  = $1,040 + (3.5 hours * $26.00/hour * 50%)

  = $1,040 + $45.50

  = $1,085.50 per employee per week

  = *$56,446 per employee per year*

- Represents an increase in pay of $2,366 per year per employee
- Equivalent to a 4.375 percent wage increase

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Incentive Program Savings Calculation:

- At 115 percent average performance, the new employees required to produce the same amount of work at the food manufacturer/distributor were reduced from 8 to 7.

- Total labor cost of 7 employees

  = 7 employees * $56,446 per employee per year

  = $395,122 per year

- Program Savings:

  = $432,640/yr (cost of 8 employees) - $395,122/yr (cost of 7 employees with incentives)

  = *$37,518 labor savings per year!*

Summary

When implementing incentive awards programs in distribution environments, simple has been proven to be most effective, time and time again.

As illustrated above, a simple 2-step incentive program was implemented without the usage of complicated incentive calculation-based software. This program resulted in a win for both the company and the employees. The company benefited from a reduction in total employee payroll cost, while the employees enjoyed a $2,400 increase in annual compensation.

The results shown above are very typical for most incentive plans and were implemented by enVista in a period of approximately three calendar months. The total implementation time was less than six months, which included the company readiness plan requirements.

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