Quality of jobs and
Innovation generated
Employment outcomes

QuInnE.eu

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Performance Pay Systems in Retail Logistics: Adjusting an Incentive Scheme to Match a Changing Workforce

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QuInnE - ***Qu****ality of jobs and* ***Inn****ovation generated* ***E****mployment outcomes* - was an interdisciplinary project investigating how job quality and innovation mutually impact each other, and the effects this has on job creation and the quality of these jobs.

Drawing on the Oslo Manual, both technological and non-technological innovation were investigated. Through quantitative analyses and qualitative organization-level case studies, the factors, as well as the mechanisms and processes by which job quality and innovation impact each other were identified.

The QuInnE project brought together a multidisciplinary team of experts from nine partner institutions across seven European countries.

QuInnE Project Member Institutions:

- *Lund University, Sweden*
- *The University of Warwick, UK*
- *Universitaet Duisberg-Essen, Germany*
- *Centre Pour La Recherche Economique Et Ses Applications (CEPREMAP), France*
- *Magyar Tudomanyos Akademia Tarsadalomtudomanyi Kutatokozpont, Hungary*
- *Universiteit van Amsterdam, The Netherlands*
- *Erasmus Universiteit Rotterdam, The Netherlands*
- *Universidad de Salamanca, Spain*
- *Malmö University, Sweden*

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More information about the project and project generated publications and material can be found at www.quinne.eu.

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The QuInnE teaching cases and teaching notes are based on the confidential field research conducted in the context of the QuInnE project. They are written to provide material for training and class discussion rather than to illustrate either effective or ineffective handling of a management situation. Personal names and identifying information from the research cases have been altered for the purpose of confidentiality. The case studies and teaching notes have been developed in cooperation with RSM Case Development Centre of Rotterdam School of Management, Erasmus University (www.rsm.nl/cdc).

Performance Pay Systems in Retail Logistics: Adjusting an Incentive Scheme to Match a Changing Workforce

On a cool November evening at the main Distribution Centre (DC) of Fast Frock Fashion Logistics, Gertrude Schwach paused for a minute in her work and rubbed her shoulder. She was getting too old for this kind of manual work, and everyday, the pain got a little worse. Her doctor had suggested that she try switching jobs for a while, but she didn't want to leave her team or the work that she knew how to do. Gertrude had her place here and she wanted to keep it. She was also working towards her pension now, and nothing, not even a little pain, would make her give that up. After years of working in the warehouse, she had managed to save up a little, but not yet enough to see her through her old age. Most of all, she didn't want to be replaced, by a temporary worker or a robot. It was important that she do her best, not just to earn her wages, but to get her performance bonus. Christmas was coming, and she had a new little grandson to spoil. So she went back to work.

Because of her performance bonus, Gertrude looked forward to the end of every month and stayed motivated in her work. The bonus wasn't much, but every little bit helped. A few years ago, the company's CEO, Martin Fischer, had made it easier for her and her long-time, older colleagues to collect the bonus. She had heard rumours that the company would soon be reviewing the performance pay system again, and she hoped that it would result in a slightly larger paycheck for her next year.

Heidi Koch, a senior warehouse employee and chairman of the main DC's works council, walked past the sorter in the dispatch area of Fast Frock's main DC. It was early, but the morning shift had already started some time ago. Koch enjoyed the sounds of the warehouse: with the holidays coming, the warehouse was at capacity, and everything was humming and buzzing at full speed. Walking towards the coffee room during her break, she was thinking about the upcoming talks between the works councils and management regarding bonus pay. While the REFA method guiding the talks had proven its usefulness over the years, she wondered whether the discussions about performance metrics might not need a fresh approach. With the increasing age of the company's diverse workforce, a 90% performance threshold for older workers to begin earning a bonus seemed a simplistic approach to employee concerns. Also, constant customer demands for higher performance levels through more stringent service level agreements (SLAs) had increased tensions during REFA meetings. Koch waved at Gertrude at the packing station. Gertrude waved back. Koch noticed that Gertrude was rubbing her left shoulder before quickly turning her attention back to the sorter.

Among logistics companies, different methods were used to monitor and enforce, or in the case of Fast Frock, to incentivise, employee performance. Performance targets were established in customer SLAs through the use of key performance indicators (KPIs). KPIs could be tracked using performance monitoring and measurement systems. The indicator with the most immediate impact on work intensity was the number of items to be processed every hour in the warehouse and the resources required to do that. Performance measurement systems transposed this overall rate into performance standards at the team or individual level, thus defining the number of items to be received, stored, picked, packed or put out per capita, either per hour or per shift. Customers imposed penalties if targets for certain indicators, such as delivery lead times, were not met.

Companies differed greatly in their methods of using performance targets. Some companies used punishment as motivation for employees to reach desired performance levels -- for example, by assigning them to the most demanding jobs in the warehouse if they did not meet targets. Others used team performance targets together with bonuses, and did not pay out bonuses unless the team as a whole reached the target, thereby using peers to pressure underperforming individuals.

Gertrude Schwach's employer, Fast Frock Fashion Logistics, used the REFA method of performance measurements and pay, which had been developed nearly a century ago in Germany by engineers working for the manufacturing industries. The company and its works councils, which represented employees, were jointly involved in REFA's application and continuous evolution. Fast Frock's employees -- several thousands, of whom 50% were aged 50 or more, and 63% of whom were women -- overwhelmingly approved of its use.

With the REFA method, employees who exceeded a determined standard performance level were rewarded with bonus pay. However, high performance levels prompted by the incentive scheme increasingly clashed with an ageing workforce. Gertrude Schwach, for example, was 54, and some employee representatives feared that older employees, in particular, might actually speed up their work pace to a degree detrimental to health and safety to receive the bonus pay. According to one employee representative: 'the risk of excessive demands is simply given by the premium system.' Gertrude did indeed experience daily pain in her left shoulder, but she was motivated by her bonus to ignore it, and simply hoped that it wouldn't eventually necessitate surgery. There were also concerns that employees would favour speed over quality and thereby increase error rates. But that didn't apply to Gertrude, only to her younger, more inexperienced co-workers. In an attempt to mitigate these issues, Fast Frock's CEO, Martin Fischer, with approval from the employee works councils, had fixed lower performance targets for employees aged 50+ which entitled them to begin receiving bonus pay when they achieved just 90% of the standard performance level. As Koch explained:

> Actually, everyone earns a bonus. After all, employees over the age of 50 receive a bonus from a rate of 90% onwards... although they still have to reach 100%. But due to their age and physical strain, they are allowed to start earning a premium as early as 90%. So maybe only 5% of employees fall below this and receive no bonus at all. When the warehouse director [CEO Fischer] launched this rule, he said: 'Now, we do not only give older people the opportunity, but also the incentive.'

In 2016, average performances had exceeded standard levels by 12% - 15%, and roughly 90% of Fast Frock's employees indeed received some amount of performance bonus. The impact of the incentive scheme had even been quantified: during those times when bonus pay had been temporarily suspended due to technical difficulties, performance levels had dropped by at least 15%. Although employees were not penalised for underperforming, the company had to pay penalties to customers when targets in the SLAs were not met; so motivating employees to reach performance targets was a key concern.

The REFA method prescribed regular updates for the time-measurement indicators used in evaluating performance, as well as updates whenever important technological or organisational changes to the work process had been introduced. An update was forthcoming. Everyone involved agreed that the indicators were due for review. Dieter Schulz, a works council chairman, voiced his concerns, explaining that REFA was modelled on '...the average worker, that is 1m75 tall, is of prime working age, is trained, and so on. But how many workers do we actually have like this? These are unrealistic values for the incentive plan.' Also, how these values were to be applied was becoming a source of contention among company and employee leadership.

The chairmen of the works councils of Fast Frock's two DCs had differing ideas on the application of the performance pay system. Schulz, the works council chairman from the returns centre -- the warehouse responsible for product returns -- sought to enforce individual rights to opt out of the system, as it was voluntary, and there were no penalties for employees if they did not meet targets. With the 'unrealistic values' of the current incentive plan, Schulz explained that he had to '... evaluate each person individually: is he capable of doing this or isn't he? That's why it makes sense that people above a certain age or with certain physical constraints opt out of this incentive plan...' He thought that supervisors sometimes exerted too much detrimental pressure on employees to exceed performance targets, and that removing the monetary incentive solved the issue. 'A few supervisors had to learn that it's a voluntary incentive scheme, and if I want an employee to achieve higher levels than he normally does, then I have to motivate him and not oppress him.' Schulz also felt strongly that profit gains from higher performance levels were '...disproportionate. The employees don't get the bonus share, the real value added of their extra efforts, but something lower than what the company gains, so benefits are not shared fairly.'

However, Heidi Koch, the chairman of the works council at the main DC, deliberately abstained from publicising the voluntary nature of the performance bonus scheme among employees; she shared management's view that without the performance pay system, the DC probably wouldn't be able to meet the service levels agreed in the SLA with its customers. According to Koch, when employees knew that they would not be receiving performance bonus pay on a particular day:

> We had a 15% loss. Because employees consciously reduce their work levels: 'I don't have to be so great today.' But if the 15% drop scratches my daily target, it costs me a lot of money. There are agreements with the customer companies, that such and such has to come out, on the same day, and such a percent has to be done, and if that does not come out, then there are service level agreements, and it costs us money.

In her view, this posed an even bigger threat to the continued existence of the DC and even the company: 'We need to make sure, on the one hand, that we continuously improve conditions for our employees and on the other hand...we also need to look to it that the company survives.'

Despite the performance pay incentive system, many employees were still opting for fewer working hours in their monthly schedules, principally, it appeared, due to job-related strain. But at already such low wage levels, monthly incomes for part-time jobs were close to poverty thresholds. Years ago, there had been a semi-retirement scheme in place, whereby older workers could work fewer hours until full retirement, with earnings partially subsidised by the company and the government. But after the government stopped subsidising these schemes in the early 2000's, most companies, including Fast Frock, stopped proposing them. According to Koch, this also had to do with the tight labour market -- the company did not want to facilitate early semi-retirements, but rather, needed to retain older employees as long as possible because it was too difficult to find new workers.

The trade-offs between trying to retain and motivate employees, while maintaining a healthy but low-cost work environment, were increasingly stark. Koch felt that between the increasing age of Fast Frock's workforce, the tight labour market, the rising client expectations and the increasing competition, the performance pay system might be reaching its limits. It was indeed time to re-examine the performance indicators, and maybe the use of the performance pay system altogether. She was looking forward to the discussion she would shortly be having with management, and to the solutions they could propose.