*A*griculture &
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*M*anagement Notes ..

Colorado State University Extension

Labor Management: Issues and Strategies for Incentive Pay Programs

Quick Notes...

Incentive based pay plans may increase employee productivity and aid in developing a positive workplace environment.

Incentive based pay plans should be customized to complement the real production, marketing, and financial objectives of the firm.

Incentives should reward the best workers while offering encouragement to average workers.

Adding incentives to your employee pay structure may result in several potential benefits for your labor management program, as well as the operation's overall profitability. In addition to lowering turnover among valued workers, you may also improve the goodwill and productivity among employees in your operation. Alternatively, for those who hire primarily seasonal workers, incentive pay may lessen concerns about choosing the best workers, and in the long run, may help to attract better workers without a high level of recruitment activities.

In this publication, several issues related to developing, implementing and evaluating incentive pay programs will be discussed.

There are some clear advantages to providing performance-based pay incentives to employees, but it is also important to understand potential complications or drawbacks.

Incentive Pay: Who Stands to Gain?

The potential benefits of paying workers based on performance are great in number, magnitude and breadth. Although there are a number of benefits to consider, the primary factors to consider when adopting a performance-based pay plan include:

- Increase productivity throughout the operation.
- Encourage better recordkeeping and analysis of production performance.
- Improve employee morale.
- Improve perceived equity between workers and management.
- Reduce employee turnover.
- Give workers a vested interest in success/profitability of operation.
- Assist in the recruitment of quality/productive workers.
- Encourage voluntary worker education and development of future managers.

The primary reason for employers to consider incentive pay plans is the expected increases in productivity. The whole idea of offering incentives is to compensate workers extra for performance “above and beyond” some set standard. This standard may relate to quantity (harvest or milking yields), quality (achieving specific grades or avoiding penalties from elevators or processors); other production related accomplishments (livestock mortality rates or irrigation efficiency) or worker activity (minimal absenteeism or no worker's compensation claims).

In all cases, the incentives offered should share the economic benefit for the worker accomplishing such an action between workers, managers and owners. This also explains why such programs tend to encourage better recordkeeping--the manager needs to see the economic benefit from such incentive programs.

The other set of benefits from incentive pay programs relates specifically to developing a positive workplace environment. Farm work is often considered an unskilled, underpaid profession. This is especially true for those workers with no vested interest in the long-run profitability of the farm. Yet, incentive pay programs allow for employees to "share" in not only the profits of the firm, but also in the pride of a job well done. Moreover, workers tend to feel their extra effort is noticed.

All of these factors will lead to lower employee turnover, easier recruitment of good workers, and possibly, lead some workers to develop their skills in hopes of higher pay in the future. But, these same factors may also lead to controversy if the pay plan is not managed correctly.

Shortcomings of Performance Pay

Although incentive pay programs have become more popular (due to the advantages discussed above), there are also some issues of concern, including:

- Overall impact on quantity and quality of work.
- Dependence on accurate, timely recordkeeping.
- Perceived equity among workers.
- Unintended effects.
- Safety concerns.
- Legal implications.
- Controversy over changes in standards.

As discussed above, incentive plans rely on measuring worker performance above some standard to determine total compensation. However, if standards are biased towards one type of effort (quantity vs. quality), the other attribute may suffer. This example is most clear in the case of piecework harvesting. Although a higher rate of harvesting per hour may occur, the quality of the harvested produce, and the eventual grade, may suffer.

Thus, it is important to consider incentive plans that either 1) compensate employees based on both criteria, or 2) monitor other outcomes of the plan and adapt the program accordingly. Once again, this assumes that production records are timely and accurate. If not, the entire incentive payment plan is likely to do little for the bottom-line of the operation.

Although outstanding workers will be encouraged by the opportunity to increase their pay, it is always important to consider the reaction of average workers. If only the most exceptional performance is compensated, morale among the other workers may actually worsen. This is why standards should be realistic, incentives should allow for a range of performance improvement, and communication should always be encouraged.

It is important that the performance incentives do not have unintended effects which may increase the overall liability of the firm. For example, it will not help the operation's bottom line if, in an effort to harvest more quickly, more workers are injured and file worker's compensation claims.

Employers should always make sure that all labor law standards are met to avoid legal liability (as some incentive plans may leave room for under-minimum wage payment if quite inferior performance is measured).

Strategies for Colorado Employers

Each employer needs to design an incentive pay program independently, based on the specific characteristics, objectives and workforce of their operation. However, there are some general strategies which can provide a starting point to developing, implementing, and evaluating your own plan.

What are the firm's objectives? The firm's manager should customize the incentive pay to complement the real production, marketing and financial objectives of the firm. For example, a producer who aspires to grow in size to capture more economies of scale should choose to give quantity (hours worked) incentives whereas a value-added, small producer may be more likely to encourage quality (based on grading and standards-based measures) incentives.

When outlining your objectives, think of the ways that you internally measure how well your operation performed over the past year. Do you focus mostly on production-based measures such as yields, daily rate of gain and mortality rates?? Or, do you focus on purely marketing measures such as price received, input prices paid, and price premiums for superior products? Or, are you mostly concerned with financial measures such as outstanding debt, net income and taxes paid? The answers to these questions should alter the type of incentive plan you put into place (and are good to consider in any type of farm planning).

It is a good idea to ask longer-term workers for suggestions as they have often considered ways to improve the firm's performance. Although some objectives may seem irrelevant to most workers (i.e., using minimal debt), realize that labor can be a substitute for many farm inputs, including capital improvements.

How and when to implement your program? You should consider your recent employment history as you determine the approach and timing of implementing an incentive based pay program. If you have mostly long-term employees, the program should be implemented after you have developed fair standards (based on historical records), solicited suggestions from long-term workers and communicated your goals and standards to all workers. If you hire mostly seasonal workers (recruited from year-to-year for particular seasons), implement the program early in the season so that incentives are established before hiring any short-term workers (it may even assist in the recruitment of such workers).

It may be wise to discuss your program with a variety of other professionals including your accountant, lawyer, crop consultants and extension agents. It is likely they have worked with other growers who have tried similar strategies, or may be able to think of unintended effects before they actually occur in your operation. Finally, stick to the plan once it is implemented. Workers are not likely to be friendly to a performance-based pay plan that is canceled mid-year.

Implement a joint recordkeeping and analysis program. In addition to communicating often with workers about standards and incentive levels, it will be important to give them accurate, timely feedback. Although many agricultural producers are knowledgeable of production levels, all production records (yields, grades, and prices received) may need to be monitored on a weekly, if not daily, basis. Workers paid on an incentive basis will only be motivated if they immediately see or know how their efforts affect their take-home pay. Such records may also signal whether standards were set at a realistic level.

For your own benefit, timely and accurate records will show how the incentive program is benefitting the bottom-line of the operation (since there is generally some resistance in writing larger payroll checks). It may also alert you to workers who may need better training or monitoring to meet the incentive standards you have set.

Monitor the plan. Plan to have a mid-year evaluation of the performance pay plan, with feedback from the workers. Although the plan should be kept in place for at least a year once it has been implemented, workers will be accepting of changes in standards or pay rates that are substantiated by solid production records. Also, it may improve worker morale even further if you can show them how they have benefitted the operation's bottom line in addition to their own paychecks.

Conclusions

Incentive pay plans have been used for almost a century throughout the world economy. There are numerous advantages to implementing such a plan, but it requires careful consideration and planning. Using the guidelines discussed above, feedback from workers and professional advisors, and your own intuition about what type of rewards you can offer workers, it is feasible to implement an effective performance-pay plan.

There are three simple rules-of-thumb to remember:

1. Offer incentives that would be attractive to you as a worker

2. Reward your best workers while offering encouragement to the average worker.

3. Monitor how this labor management tool affects your production, marketing and financial success as a firm, and communicate that to your workers.

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