Positive Management: Aligning Strategy, Performance, and Pay

Perhaps with the exception of counterfeiters, almost no business exists for the sole purpose of making money. Businesses exist because they provide some value to market and those that are better at doing so in turn make more money. As natural selection operates such that some species survive and others don't, the market selects which businesses survive and which fail. Survival begins with developing a product that the market wants. It continues by aligning organizational performance such that the product is delivered cost-effectively with a high level of service.

In this paper, we'll focus on the second aspect of survival: aligning performance to deliver the product. This is usually where the system breaks down. When a business grows beyond its original founders, considerable time and energy is spent trying to align the performance of front-line workers to meet market demands. The owners now find themselves as managers, which necessitates skillsets beyond those which made the business successful in the first place. Business owners that manage systems where performance naturally aligns with market pressures will have a distinct advantage over those that struggle with performance management. The purpose of this paper is to outline an organizational performance system that is built to go beyond survival; it is designed to have the organization thrive. We'll begin with a discussion of basic laws of behavior and how those drive individual performance. Following that, we'll look at how those laws operate in business, often to the detriment of organizational performance. We'll review a model for maximizing our knowledge of those laws to align individual and organizational performance, and finally review preliminary data from a case study of that model's implementation.

Laws of Performance

Let's begin with a discussion of why, from a behavioral perspective, people do what they do: reinforcement. From a reinforcement model, performance is always aimed at producing some result, and when the results of performance make it more likely that a person will so something similar in similar circumstances, we say that the results *reinforce* behavior. It sounds obvious, but the effects of reinforcement are not always so clear. There are different ways to reinforce behavior and we tend to only pay attention to one kind: positive reinforcement.

Positive reinforcement is what most people think of when they think of the term reinforcement. When a child does something that we like, we praise her, and say that we positively reinforced the behavior. While this may be an instance of positive reinforcement, it isn't exactly what we mean. When a behaviorist talks about positive reinforcement, it doesn't just mean praise, it means that, following a behavior, something was added to the performer's environment, and it made it more likely that the performer would do that again. In other words, the performer got something for their behavior; they had something that they wouldn't have had they not done the behavior. Our lives are full of examples of positive reinforcement. We go to work because we get money for doing so. We spend money for the things it gets us in return. We tell jokes because the people around us laugh. And when we talk of reinforcement, we are usually referring to something along these lines.

But that isn't the only type of reinforcement. While we do some thigs because it gets us things in return, we do other things because it gets rid of things that we don't want in our environment. I lie and tell someone I am busy because I don't want to talk with them any longer. When I have a headache, I take an aspirin because it gets rid of the pain. Cars are now designed so that the only way to get rid of a dinging noise is to fasten the seat belt. In each case, whether it is lying, taking medicine, or fastening a seat belt, we do them because, after we do, there is something that is no longer there. Notice that behavior is still being strengthened. In similar situations, I am more likely to do those things. It is still reinforcement. The effect, however, is to remove something from the environment, and because of this, we call it *negative.* In behavior science, we often call this type of behavior *escape.*

There is a second type of negative reinforcement, however, and that is behavior that *prevents* something else from happening. I drive close to the speed limit because it prevents a visit from police. Instead of answering the phone when I see the number of someone I don't want to talk to, I swipe an icon to send them to voicemail. I immediately clean dishes after a meal so that my love doesn't complain about the mess I've left. This is also negative reinforcement as, when I do them, it prevents the onset of something I don't want. Another way of saying this is that it avoids an outcome.

Before discussing how these operate in business, there are two things to notice about behavior that prevents things. The first is that, when someone is doing things that prevent other things, not much happens following the behavior. When you send someone to voicemail, your environment is the same way it was before the person called. When you drive the speed limit, the best thing that can happen is nothing. And, though my kitchen is left clean after I do the dishes, it does not guarantee that my loved one will interact with me positively; it is only a safeguard against an interaction that I don't want.

The second thing to attend to is that getting rid of and preventing are not very much fun. Whenever I send someone to voicemail because I simply don't want to talk, there's always a moment of annoyance before I do. I don't like paying attention to the speedometer when I'm driving and, when I glance down and see that I'm doing 85 in a 55 zone, there's a little frustration there for me as I take my foot off the gas to slow down. As I pointed to earlier, I'm never delighted to do the dishes. The same is the case for behaviors that get rid of things. Most of us wouldn't call taking aspirin, buckling a seatbelt, and lying to someone *fun*. At best, when these things happen, it's a relief. Why we call it a relief is because the situation was at least mildly stressful in the first place. If we could, we'd likely avoid those situations altogether.

Now, let's look at how these principles operate in business. Let's start with the most obvious thing people *get* from coming to work: money. Remember, for something to be a reinforcer, whether it's something that people are *getting, getting rid of,* or *preventing*, it must happen after an instance of someone doing something, and it has to make it more likely that they will do that in the future. What behavior is money reinforcing?

If you asked any business owner what behavior money reinforces, they would probably say "doing their job." But is that really what it's reinforcing? Let's look what people actually get the money *for*. For many jobs, the amount of money a person gets isn't tied to how much work they do, but instead with how much time they put in. Let's say my job, according to the owner, is to take customers' orders, provide polite and quick service, and make sure that the workspace where I greet customers is clean and presentable. Now, let's say one week I work 40 hours in the week, I greet every customer happily, am very careful to make sure I accurately take their orders, and use my free moments to improve the physical space. At the end of the week, I am paid $600.

Now, let's look at another week. When customers come in, I sigh and roll my eyes. I am casual about taking their orders and make several mistakes. Then, I wait to clean the work area until someone makes a comment about its messiness and spend most of my free moments flipping through a magazine. At the end of the week, I am paid $600. If we ran this like an experiment, we could keep alternating weeks where I work very hard doing exactly what the owner would want me to and weeks where I did just enough to get by, and what we would likely see is that my pay would never change. If changes in the amount or quality of work I do aren't related with changes in what I am paid, then it's hard to say that pay is reinforcing my behavior of doing a good job.

This raises the question: if money is not reinforcing my behavior of doing thorough work, what is the pay reinforcing? If all I am being paid is an hourly wage, then likely what the money is reinforcing is my behavior of showing up at work, punching the clock, and then staying at work as long as the owner and I have agreed on. This leads to a further question: If the pay is only reinforcing my behavior of showing up, then why do any work at all? Remember that, from this way of looking at things, there are two other reasons why people would do something: to either get rid of something or to prevent something. If we examine our example, we can see that happening. If I only clean up when someone starts making comments about what a mess things are, then it is likely that I am cleaning up so that they'll stop making those comments.

However, there are other things that I am doing, like taking care of customers and helping them with their orders, and nothing happens when I do those things. In those cases, it is likely that I am doing those things to prevent something from happening. In the case of work, what often turns out to be the case is that I do my work to prevent things like getting reprimanded, written up, or being fired. In other words, I am not working to *get* a paycheck; I am working to *prevent* the loss of a reliable stream of money.

There are a few things to notice here. First, pay is a really good way to get people to show up for work and get them to do the things you are paying them for. If you are paying them for their time, they will likely show up to work ready to give you their time. If you are paying them for the work they complete, then they'll show up ready to do those things. Second, many business owners are not paying them for the things they think they are paying them for. Third, if there are things that we want done that employees are not being paid for, then we'll need to find some other way of reinforcing them for doing those things. Often, the form that takes in a work environment is that people end up doing things to get rid of or prevent other things. Fourth (and importantly) getting rid of things and preventing them, when that's what we're working to do, doesn't feel very good. Finally, what you'll likely see with behavior that gets rid of and prevents things is that it will rise just to the level necessary to get rid of or prevent and not much higher. If taking orders while rolling my eyes without making too many errors will keep the boss off my back, then I will likely keep rolling my eyes while taking orders and be just careful enough that I make a few, but not too many errors. Very few people drive below the speed limit.

Note that one way you could improve performance would be to increase the level of effort required to prevent getting in trouble. If I only clean my work area when the boss comments that it's getting dirty, she could likely increase that by giving me a formal reprimand instead. Another option would be to dock my pay when things get messy. If that happened, I would probably do the work to keep the area cleaner. Another solutions would be to put in some measure of customer service and do something similar when my ratings fell below some minimal standard. It would keep me motivated to keep the place clean and make sure that the customers were just happy enough.

The trouble is that, as we pointed to earlier, working to get rid of and prevent things is no fun, and when managers rely primarily on these forms of motivation, it has other consequences. First, as noted, it makes it less likely that I will do anything beyond the minimum required to stay out of trouble. Second, it's upsetting. I am more likely to complain, get angry, and do other things that will otherwise hurt the work environment. I'm more likely to steal from my employer and more likely to hurt morale through gossip. I will keep my eyes open for other job opportunities.

Unfortunately, this how too many businesses operate. Managers mistakenly take it for granted that employees are being paid to act in the interest of the company, fail to positively reinforce behavior that benefits the organization, and then rely on negative reinforcement to drive results. The effect is that employees work to a minimum standard, the boss becomes a signal of danger instead of support, and morale suffers, ultimately leading to turnover and other costs. However, it doesn't have to be that way. In the sections that follow, we'll review a system for aligning employee performance with organizational strategy and a method for using that system to positively reinforce behavior that benefits the organization. Following that, we'll present case data showing the initial stages of one implementation of that system.

The Total Team System

The ideas presented here are not original. This system is largely adapted from *The Total Performance System*, which is detailed by the late Dr. Bill Abernathy in his book *Managing Without Supervising*, which is in turn adapted and pieced together from a variety of systems Dr. Abernathy experimented with in his decades as a consultant and researcher. The differences between his approach and ours is small, with most differences coming in how precisely employee performance is measured and how certain key elements of the system are calculated. For a detailed account of how to build such a system and the theory underlying it, we refer you to that book. Here we present an overview that should provide a basis for establishing some sort of performance management system that aligns employee performance with organizational interests and then positively reinforces that performance. As he outlines it, his approach contains three basic factors: balanced scorecards, performance pay, and positive leadership. Here, we will discuss the first two.

Balanced Scorecards – Managing and growing a successful business entails balancing seven key factors that drive any business. First, it is important to maintain and build revenue while, second, controlling expenses. Beyond that, businesses need to manage cash-flow and make sure the money it is generating is working in its best interests - that it is collecting on money owed and spending responsibly. The fourth factor is productivity, or output over labor costs. Customer service may be measured several ways, including product quality, timeliness, as well as customer satisfaction. Sixth, strategic projects refer to progress on new initiatives. Finally, any business must maintain integrity with respect to regulatory compliance and maintain practices such that it operates within the law.

Any successful business balances these seven factors. As such, the process begins with defining how these are measured and captured at the organizational level and giving each a percentage weight based on its importance relative to the others, which is where we find variability across organizations. For example, a company that manufactures paint cans may put very little weight into new projects but weight productivity and expense control very highly, whereas a tech company would weight strategic projects very highly. A small marketing agency might have very little concern for legal compliance beyond filing quarterly income statements, while an insurance firm has entire teams of people devoted to ensuring the organization operates within state and federal law.

These weights and measures are captured in a strategic scorecard and then each is assigned a base and goal. The base is the minimum expectation and is typically set slightly above what it takes, minimally, for the organization to get by. The goal is set more arbitrarily but is typically set slightly beyond where leadership would like to see the organization perform within the next year.

Once a strategic scorecard is established, the task becomes aligning each position's performance outcome with that strategy. Beginning with organizational leadership, and then working down through the organizational chart, a scorecard is developed for each unique position. Each scorecard has outcome measures capturing the results that position is responsible for producing and/or organizational outcomes that it impacts. Further, measures are created such that it focuses attention on all outcomes that are important to the organization and weighted accordingly. For example, while it might be important for a salesperson to focus on total sales, leadership may want its sales force focusing on sales that result in the highest margin. In this case, a measure would be created for total sales, but also for profit margin on sales. This can be further balanced by creating a customer satisfaction score, assuming the organization also wants to build customer loyalty. If individual performance outcomes are difficult to capture, team scorecards can substitute.

As with the strategic scorecard, each measure is given a percentage weight, a base, and goal. Each measure is scored monthly with the score being calculated based on percentage of goal. For example, if individual productivity is captured in a ratio of units produced over hours worked, and the base is 3.0 with a goal of 4.0, and an individual's ratio was 3.5, their score for that measure would be 50. Scores are then adjusted by multiplying by the weight to give an adjusted score. If that measure was weighted at 30%, the adjusted score would be 15 (0.3 * 50). Adjusted scores are then summed to give a score between 0 and 100.

Figure 1 gives an example of a balanced scorecard for an inside sales position. It balances overall revenue with a focus on higher margin products, developing new leads, and customer satisfaction scores as well as returns as measures of customer service. As shown, this employee scored a 44.5 for the month, indicating a score well above base and with room for growth. Ideally, goals should be difficult (though not impossible) to attain. The goal is to develop scorecards where reaching 100 is extremely challenging, as it creates a gap that the employee then works to close.

Inside Salesperson						
Measure	Base	Goal	Weight	Score	Percent of Goal	Adjusted Score
Net Profit on Sales	20,000	30,000	30%	26,000	40%	12
Profit Margin on Sales	20	25	15%	22.5	50%	7.5
New Prospects	10	20	20%	17	30%	6
Customer Satisfaction	3.5	4.5	20%	3.8	70%	14
Return Percentage	8	5	15%	6	33%	5
					TOTAL	44.5

Scorecards are then used as a performance management tool. Managers meet monthly with their reports to review results and develop plans for improvement. Additionally, scorecards can be used as a diagnostic. When an employee fails to improve while her peers are excelling, it may indicate the need for training. Conversely, if numerous employees fail to improve on the same measure, it may indicate that the workplace needs reorganization or other systemic problems with workflow.

Implementing this system alone should demonstrate performance improvement. Numerous controlled studies show that regular performance feedback leads to performance improvement. One powerful reinforcer is to simply see the difference our behavior makes, and regular feedback is a powerful way to presence that difference. However, feedback alone still leaves the problem of behavior controlled largely through the threat of reprimand or dismissal and all of the unintended consequences discussed above. Thus far, all we have done is align the expectations of the employee with the outcomes that are beneficial to the organization. To maximize results, what works is to also align the *interests* of the employee with those of the organization. To do that, we now turn to performance pay.

Performance Pay – There are several ways to structure performance pay, but the method used in this system is "Profit-Indexed Performance Pay." Essentially, what that means is that performance pay is based on the profitability of the organization and, as profitability increases the opportunity to earn performance pay increases. This does two things. First, it ensures that the performance pay system is affordable to the organization. Bonuses aren't paid unless it works for the organization to do so. Second, it focuses the employee's attention on the health of the organization and gives them incentive to do things that promote that health. If a predictable employee perspective is that, "the organization is trying to get everything it can from me," such a system alters that view by rewarding the employee when he or she performs in ways that makes a difference for organizational outcomes.

Creating such a pay system is relatively simple and it begins with creating an incentive multiplier scale. To do this, the first step is to determine all expenses that will be considered before money is allocated toward the incentive pool. This should include things like fixed expenses, minimum shareholder return on investment, and savings. These should be fixed numbers and remain stable month to month. If you are a business owner and take part of your salary on a draw, set what you will take as a draw ahead of time and do not add to it (don't worry, you'll have the opportunity to make more money). It is important for employee trust in the system that these numbers be predictable. Otherwise, it will occur to them that they system is being manipulated against their advantage. On a monthly basis, every dollar above this number will be reported as net.

The next step is to determine how much of an employee's base earnings will be available for incentive pay. Typically, companies make available either 5 or 10 percent of base pay. The number is arbitrary, but do note that the higher the percentage, the more difficult it will be for the organization to hit the threshold at which bonuses will be granted, and therefore the less likely that the employees will experience the benefit of the system.

The third step is to determine the amount of money that the organization will owe if everyone makes 100% of bonus. For example, if monthly payroll is $100,000, and the bonus opportunity is set at 10%, then the minimum that the organization will have to net will be $10,000. We'll call this the base threshold. However, as the owner always assumes a greater risk than employees in such a system, not every dollar netted will be made available to the incentive pool. To accommodate this, ownership sets a share percentage, which is the percentage of each dollar netted that ownership is willing to share with employees. To determine the bonus threshold, the base threshold is divided by the share percentage. So, in our previous example, if the base threshold is $10,000 and the share is set at 30%, 10,000 divided by .3 is $30,000. As such, the organization must earn $30,000 beyond all expenses before bonuses are paid.

If the system stopped there, we would have a powerful system in which employees came to work knowing what results were expected of them and with a strong incentive to ensure that the company was profitable month to month. However, there would be no incentive to grow profitability. Because of this, we create an incentive multiplier, shown in Figure 2.

Multiplier Scale	Net Profit
1	30,000
1.5	45,000
2	60,000
2.5	75,000
3	90,000

When this sample organization hits $30,000 in profit, each employee is eligible to receive 10% of their base pay in incentive pay. However, as profitability increases, the incentive opportunity increases with it. When the organization nets $45,000, the base opportunity is multiplied by 1.5. In that scenario, and employee that earned $3,000 in a month would see their opportunity rise from $300 to $450. Thus, it pays the employees to look for ways to increase the profitability of the organization.

Finally, in the above example the employee's opportunity, when the organization nets $45,000 is $450. The actual incentive payout, however, is based on their scorecard performance. Going back to our inside salesperson, if that person's opportunity was $450 and their scorecard performance was 44.5, they would take home just over $200 in incentive pay, and the remainder of the money reverts to the organization.

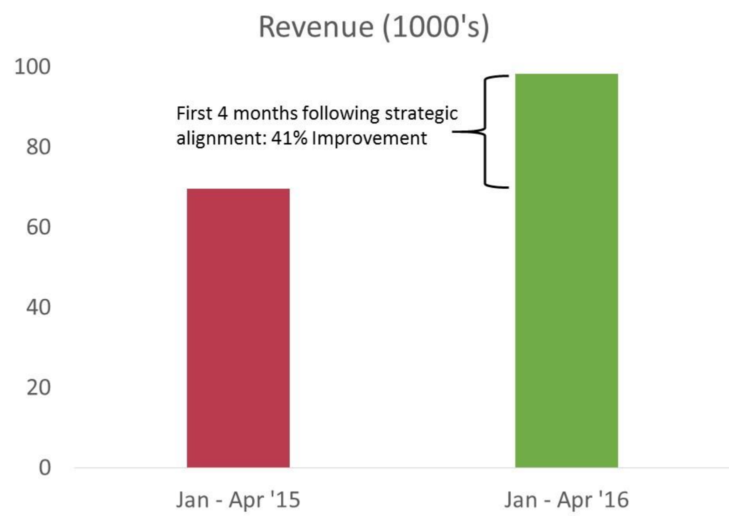
To conclude this section, this system does what conventional pay systems don't; it incentivizes acting in the best interest of the organization using positive reinforcement. In doing so, it encourages employees to go above and beyond the minimum required to keep the organization afloat. Further, it puts leadership on the same side of the front-line employees; they are no longer trying to pull them along to produce results for the organization, and are now partners in success. When one "side" wins, all sides win.

Case Study

In December of 2015, we began work with an architectural firm that had done just under $950,000 in business the prior year. The team consisted of one principal (the owner), a project manager, an admin, and nine architectural interns.

As the amount of time it takes to develop such a system is based more on the number of unique positions (as opposed to total number of employees), the scorecards were developed in a half day's consult, with an additional two hours to look at financials and set the multiplier. Further, because the nature of works is such that projects often include more than one person, with any one person often working on multiple projects with different people on each project, instead of creating individual scorecards, we created team scorecards and split the agency into two teams. We did this for two reasons. First, it allowed us to simplify data collection. When we looked at individualized measures, it became obvious that it would take six months to pilot a system where we were certain that we were getting reliable data that reflected organizational health. Second, we speculated that it would allow team members to leverage their relative strengths as projects progressed. For example, certain employees enjoyed communicating with customers and handling their concerns while others preferred to spend their time drawing. This provided incentive for teams to work it out amongst themselves who would focus more intently on which outcomes on the scorecard.

The data for the first four months of implementation are shown in Figure 3, and show monthly average revenue for those months. These revenue gains can be traced to substantial improvements in productivity. As revenue in this industry is generated at various milestones as projects progress, positive reinforcement for meeting milestones led to a substantial increase in meeting milestones and, therefore, revenue generation.



Conclusion

To summarize, organizations exist because they provide something that the environment needs or wants. Often enough, what the organization provides is valuable enough that it can survive the internal forces that work against its optimization. In some cases, it may even appear to thrive. However, true optimization results when internal processes are perfectly aligned with providing what the broader cultural environments needs and/or wants. By creating individual outcome measures that align with strategic measures, then positively incentivizing the performance that drives those measures, organizations can go beyond the predictable to produce unprecedented results.

Reference

Abernathy, W. B. (2000). *Managing Without Supervising: Creating an Organization-wide Performance System*. WB Abernathy & Associates.