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Creating Incentives for Change by Keeping Score

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INTRODUCTION

"Here we go again!" Joe Philips said to Mike Brown as they were walking back from the company meeting. Mike grinned and said, "Just ignore it. This will fade away, just like every other 'new initiative' we've seen in the seven years that I have been here. It always has been, and always will be, about the almighty 'billable hour.' Don't believe any different!"

Joe chuckled and shook his head as he walked away towards his office. He had only been with Elite Engineering for four years and he had already been through two organizational restructurings, a leadership development training series, and countless meetings on the business team concept—the latest management fad being imposed on the consulting staff.

As a business team leader, he was expected to lead a dozen engineers from several different technical specialties and three locations. However, it was not clear what he was supposed to lead them to do. He knew that, in principle, the business teams were conceived to encourage multidisciplinary collaboration and were intended to promote new business development. In reality, everyone on his team felt that it was a waste of time—precious billable time—for them to get together.

Joe really couldn't blame them. Why hash over old projects when you had work that needed to be done? When it came down to bonus time at the end of the year, the dollars were going to be based on the amount of business that you brought in and billed. As Bob Martin, the company cynic, stated, "Management is pushing 'teams' but rewarding individuals."

COMPANY OVERVIEW

Elite Engineering (EE) is an employee-owned consulting company with approximately 50 engineering consultants on staff. Dr. Paul Johnson, an entrepreneurial metallurgist, founded the organization over 30 years ago. Since its modest inception, EE has grown to include more than a dozen practice areas, three locations across the United States, and extensive laboratory facilities.

With approximately $8 million in annual revenues, the company enjoys a national reputation for expertise in failure analysis. About 75% of the current revenues are based in the failure analysis area, with insurance companies and attorneys as the key clients. Looking to the future, however, EE executive management is concerned that this success is unsustainable, for two reasons.

First, the main impetus behind the business team leader concept is that the top rainmakers are approaching retirement age. There are no clear successors to lead the company, especially once the founder steps down as the chief executive. EE appointed seasoned engineers to head up business teams in an effort to cultivate the "next generation of leaders" in the company.

Secondly, EE anticipates changes in the competitive environment. The company predicts a significant decline in the demand for expert testimony on failure analysis with tort reform on the horizon and limits for punitive damages in civil lawsuits.[1] It would be extremely risky to continue to depend so heavily on this revenue stream. The business team concept is intended to address this risk by encouraging engineers to collaborate and cultivate industrial design work.

Founder and CEO Paul Johnson assembled all of the billable staff together for a meeting at the company headquarters to address the lack of traction in the business team concept from the previous year. In the meeting, he presented the following goals from the five-year plan developed by the executive team that reaffirmed the company's commitment to the business team concept:

- Achieve annual revenues of $25 million while maintaining excellence in our work.
- Maintain fiscal health with a strong cash flow.
- Diversify and balance our services.
- Operate the business with effective cross-discipline and cross-geographical teamwork.
- Expand our capabilities by aggressively recruiting and continually developing our people.

He hoped that sharing this vision with the consultants would motivate them to participate more actively in the business teams. It was hard to gauge the group's reaction, though. There was a question about EE's current cash position (16 days), and someone asked about the basis for the $25 million target (40% growth rate). The biggest interest seemed to be in Joe Philips' question about the bonus plan. When Paul assured him that it would stay the same, with the hope that the bonus pool would be larger as the company met the goals, Joe seemed satisfied. Other than that, there really did not seem like there was much interest.

For the past several years, EE paid bonuses at the end of the year. To be eligible, the engineers and technicians had to complete the year at 80% billable, based on 40 hours per week, 50 weeks per year. The executive team determined the pool based upon the year's profit. Although the formula was not published, the actual bonuses distributed were based on a combination of overall performance and pay.

Paul knew that there was a lot of resistance to the changes he was trying to institute. Everyone was busy doing what they enjoyed best, billable work. While some of the business team leaders said they understood that they needed to be working on business development for the future, they just were not making the time or engaging their team members as he had hoped. The idea of the business teams was clear: to promote that cross-discipline and cross-geographical collaboration. Paul was convinced that collaboration was the key to the company's growth and diversification.

"They could learn so much from each other, if they would just share project experiences," he thought. "They just might identify even better solutions, or a way to redefine the project from a failure analysis to a product redesign. Or if they would occasionally pull in an engineer from another location, instead of always working with the same few people, then that remote engineer might actually be in a position to develop similar business in his area. They just want to keep to their own expertise, working with the same clients and the same colleagues. I cannot seem to convince them that it is not enough to have a rapport with the attorney that officially hires the firm; the engineers need to make the connections with the insurance companies that hire the attorneys and with the manufacturers and builders who hire the insurance companies. If we do not leverage those relationships, we will never expand our industrial consulting."

Paul was a naturally optimistic person whose "can-do" attitude was an important driver behind EE's success. But he was getting tired of the inertia in the organization. He wanted to assure the company's success past his retirement. Everything else he had tried had not worked—this business team concept *had* to succeed.

THE OPPORTUNITY

Late in the day, after the meeting, Stuart Weismann, EE's chief operating officer (COO), approached Paul. Stuart did not have an engineering background, but had retired from a large technology corporation and went into consulting on organizational development. As a consultant, Stuart helped EE with some of the organizational changes made three years ago. After the engagement, Paul decided to hire Stuart to run the day-to-day operations of the business.

"May I speak with you privately?" Stuart asked. "Of course!" replied Paul, and the two men turned to walk back to Paul's office. "How do you think the meeting went?" asked Paul. "That's what I want to talk with you about," said Stuart, "I think we have a problem—or better yet, an opportunity."

As they settled in to the leather wing-backed chairs, Stuart continued, "I really get the feeling that the presentation of the goals was just a bunch of words to the engineers, particularly the more successful ones. They don't understand that we really need them to change what they do, in order for the company to change. Some of them don't even really buy into the concern that the litigation business is going to shrink. I know I have said this before, but I am going to say it one more time: We're missing congruence. The organization's goals and individuals' goals are not aligned. You know, "the folly of rewarding A when hoping for B.[2] We need to change the incentive structure around here..."

"But we have!" Paul interrupted. "Bonuses are not only based on billable hours, but also on the amount of business brought in to EE."

"Yes," Stuart agreed, "but those are still short-term measures that don't turn their attention to longer-term, more strategic business development. The consultants are still very focused on being eligible for the bonus, which means that they have to have been 80% billable [of 40 hours/week, 50 weeks/year] for the current year."

Seeing that Paul was about to protest again, Stuart quickly continued, "We need to translate the corporate goals into simpler, more measurable targets that the engineers feel are attainable and treat as time-sensitive. I think this requires a more balanced incentive system, to encourage investment in the future according to our business strategies while still maintaining solvency and current results. I have been doing some reading, and what I think we need is a "balanced scorecard." This is a way to combine financial measures with other operational metrics. Harvard has published a book by a couple of guys, Kaplan and Norton, who developed the idea. I have it here—see? They say that just using financial measures is like flying an airplane using only one instrument. Let me read this part to you:

The Balanced Scorecard (BSC) provides managers with the instrumentation they need to navigate future competitive success... The BSC translates an organization's mission and strategy into a comprehensive set of performance measures that provides the framework for a strategic measurement and management system. The BSC retains an emphasis on achieving financial objectives, but also includes the performance drivers of those financial objectives. The scorecard measures organizational performance across four balanced perspectives: financial, customers, internal business processes, and learning and growth. The BSC enables companies to track financial results while simultaneously monitoring progress in building the capabilities and acquiring the intangible assets they need for future growth.[3]

"You've articulated your vision into specific five-year goals. Using a BSC, we can try to translate the five-year goals into specific measurable objectives. Maybe some of the measures will be individually-based, but some could also be business team-based; some will be short-term performance metrics and others could reward business development investments. It would be a lot to keep track of, but it could help us reward consultants for more balanced performance. I really think it will pay off for us, and I'd like to give it a try."

Paul sighed. "I know you're right. Engineers, by nature, are critical thinkers. And our consultants are motivated by solving problems, not calling on clients and building relationships. This is going to be a hard nut to crack. We have to show them that we are really serious about this if this company is going to survive and thrive for the next generation. We have got to make this work.... OK. Go for it. Come up with a scorecard, and we'll discuss next steps."

"Great! I'll get right on it!" Stuart was elated and worried at the same time. This could make all the difference in moving EE to a new level of competition. It was going to be extremely important to identify measures that had credibility and for which the company could reasonably track the data. What would be meaningful for a consulting company? How could they avoid the problems with previous attempts at change with EE?

Stuart walked back to his office and started to sketch out a scorecard for Elite. He needed a draft, or a prototype, to explain the concept and get others' input. This was an approach that needed to make sense to a broad range of personalities. Thinking of some of the personalities, he stopped, smiled, and walked down the hall, looking for Joe Philips. Stuart found him talking with Mike Brown and Bob Martin just outside the electrical lab. "You three are just the group I need to help me with something," Stuart exclaimed. "Can I take you to lunch tomorrow and pick your brains about something?"

THE DISCUSSION

Stuart summarized the issues to Joe and Bob as the waiter poured coffee. Earlier that morning, Mike Brown traveled to a site inspection of an automobile/truck collision and was not available to join the gathering. "The issue is goal congruence," Stuart stated. "We're rewarding one kind of behavior, when hoping for another. I really believe that if we can come up with a reasonable set of measures, Paul will be willing to implement a more balanced approach to the annual bonuses. What I am hoping is that with your help, these same measures will create the incentives that the engineers need in order to make the changes the company needs for business development."

Bob said, "I know if we had a lever big enough we could move the world, but changing some of these guys is going to be tough—especially the rainmakers that usually get a 'hands-off' approach from the executive team. What's going to happen with them?"

Joe responded, "It's my guess that some people will leave rather than change the way they do business. Is that an acceptable option to Paul?"

Table 1
Initial Scorecard for Elite Engineering

Customer Measures	• Customer Satisfaction Ratings at Project Closings • Number of Referrals from Existing Clients • Percentage of Revenue from New Clients • Number of New Clients for Industrial Consulting
Internal Business Process Measures	• Billability • Number of Project Reviews Performed per Business Team • % of Projects with Cross-Disciplinary Collaboration • $ of Project Write-off from Customer Complaints
Learning & Growth Innovation Measures	• Employee Turnover • Revenue Generated per Business Team • Number of Professional Development/Continuing Education Hours
Financial Measures	• Working Capital • Cash Flows from Operations • Total Revenue • Revenue Growth

Stuart smiled and took a sip of coffee. "You are both right. There are going to be some people who will not change. What I want us to focus on, though, are the people who want to be part of the new future of EE. These are the people that we can give incentives to change by keeping score."

"Well, don't say I didn't warn you," replied Bob. "OK, so how do we start making one of these scorecards?"

Stuart took some papers out of his inside coat pocket. He unfolded them and gave a sheet each to Bob and Joe. "Here is a table with some of my initial ideas."

"Now remember, this is just a draft. I expect you two to really chew it over. I want every measure to be clear for everyone in EE to understand. The measures also have to be objective and, of course, balanced between the short and the long term. And it's most important that people see the connections between what they do, the measures, and how well EE is achieving the five-year goals. There should be congruence in the engineers' goals and the company's goals."

There was a long pause as the engineers read the draft that the COO had prepared, as shown in Table 1. Looking up, Joe saw Stuart looking at him, waiting for a reaction. Joe leaned back and said, "This is going to take some time to digest. There are a lot of measures here. My initial reaction is a bunch of questions, like which of these is most important, or are they all weighted the same? Are these all individual measures, or are some of these team-based, or location-based, or for the whole company? And I'm not clear on how these relate to the five-year goals, either."

Bob quipped, "So, Joe, tell us how you really feel! Seriously, Stuart, can we afford to measure all this? Can engineers like me really affect all of these different things?"

Stuart smiled. "I knew that you two would have some great suggestions for me! Let me suggest a couple of action items. You two continue to think this over, and let me know of any additional concerns or questions. For now, I'd like to keep it between us. I'll brief Mike when he gets back into the office. I will work on extending this table and add columns so that for each measure, you can see its overall weighting, which goal or goals it connects to, where the information is going to come from, and what level of analysis will be used—i.e., whether it is an individual, business team, or overall organization measure. Sound good?"

The other men nodded their assent. There was a lot of work to do.

ENDNOTES

1 The 2003 Court Statistics project published by the National Center for State Courts (http://www.ncsconline.org) shows that population-adjusted tort filings declined from 1992 to 2001.

A 2004 report by the National Association of Mutual Insurance Companies (http://www.namic.org/newsreleases04/040108nrl.asp) reported that:

- "A total of 174 tort reform laws have been enacted by states in recent years.
- The majority of the reform laws passed address five key areas of tort reform: joint and several liability (35 states), collateral source rules and product liability (25 states each), non-economic damages (21 states), and punitive damages (18 states).
- The least commonly enacted tort reform measures are those that address common sense scientific evidence (1 state), intrastate forum shopping (2 states), jury service requirements (3 states), government contracts with private attorneys (5 states), and class action (7 states).
- In 2003, new tort reform laws addressing appeal bonds, private attorney retention, class actions, the collateral source rule, intrastate forum shopping and jury service were enacted in 15 states.

Tort reform bills introduced in 16 states during 2003 addressing joint and several liability, product liability, punitive damages, and prejudgment interest rates will be carried over for further consideration in 2004."

2 Kerr, S. (1995). "An Academy Classic: On the folly of rewarding A, when hoping for B." Academy of Management Executive, 9(1): 7-14.

3 Kaplan, R.S., and D.P. Norton (1996). The Balanced Scorecard. Cambridge, MA: Harvard Business School Press.

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