cooperation or COMPETITION?

WHAT MESSAGES ARE OUR MEASUREMENTS SENDING OUR STAFFS ABOUT WORKING TOGETHER?

By Dan Hill, CMA

Something has puzzled me over my 25-year banking career. Although employees cooperate with one another on the surface, there's an unsettling undercurrent of us vs. them. One department against another. Instead of teaming up to beat the competition, we spend too much time trying to beat each other. Could this adversarial behavior be related to the way companies use financial management information to measure employee performance? Perhaps Pogo was right: "We have met the enemy, and he is us!"

ILLUSTRATION: CATHY GENDRON

I'm concerned about the unintended consequences of current financial management practices that lead to dysfunctional employee behavior, particularly the breakdown of cooperation. I'd like to suggest an alternative that uses financial management information to encourage employee cooperation and a shared interest in creating company value.

PERFORMANCE MEASURES ARE TO BLAME

Responsibility accounting systems establish profit or cost centers that measure how effectively company resources are consumed. This is a great aid to management. But problems arise when employee behavior is evaluated by that same system.

Generally a handful of financial metrics measures employee success or failure. Most often the measures are local, or departmental, in nature. Employees work hard to maximize their local measures, and why shouldn't they? Local measures are the yardstick on which their raises, bonuses, and recognition are based.

But suboptimization is the unintended consequence: Employees focus on their performance measures rather than the business at hand.

PROFITABLE *high-net-worth and commercial* **CUSTOMERS** *experience impatient, somewhat* **RESENTFUL,** *and less-than-helpful branch* **STAFF.**

BANKS GO DYSFUNCTIONAL

A case in point is how employees are measured at bank branches. Bank branches cater to individuals and families along with small business customers. To a lesser degree, they service customers from other areas of the bank, such as high-net-worth (rich) customers and large commercial customers.

Bank responsibility accounting systems credit customers to the branch or department that manages those customers. A family that opens checking, savings, and home equity accounts at a branch will be recorded on the balance sheet of that branch. This family is a direct customer of the branch, and the profitability of the family's accounts is reflected in the branch's financial reports.

But branches are often called on to service customers whose loans and deposits are booked in centralized departments. For example, the revenues of high-net-worth or large commercial accounts are credited to centralized departments, even though these customers consume branch resources. (For an example, see Figure 1.)

Employees measured against branch profitability come to resent customers from other departments who add costs but no revenues. Profitable high-net-worth and commercial customers experience impatient, somewhat resentful, and less-than-helpful branch staff. Animosity builds between branches and the departments where these customers are booked. Cooperation begins to break down. One department against another. Us vs. them.

A WHOLE NEW LEVEL

Using local financial metrics to reward employees leads to another unintended consequence: manipulating department financial statements. Branch managers have been known to help another branch's customer and then submit paperwork to transfer that customer's accounts to their own profit center. It's commendable that the manager is taking such good care of this customer. But transferring customer accounts costs the bank without bringing in any additional revenue. It improves the "helpful" branch manager's financial statements, of course. But it also creates tensions with the branch manager who lost the profits from this important customer.

Manipulation of department financial statements is taken to a whole new level when entire departments scour branch customer lists for those who fit a particular profile. Commercial and high-net-worth departments are big abusers of this practice. Customers who fit these departments' profiles are transferred in the accounting system en masse from the branch network to the acquiring departments' balance sheets.

This looks like robbery to the branch folks; they've worked hard to acquire and keep these valuable customers. The branch's balance sheet suffers—and its profits drop—while the acquiring department's financials improve. The irony is that most of the transferred customers will continue to consume the same branch services they always have, even though the acquiring department is now overstaffed because it's anticipating all those "new" customers to service.

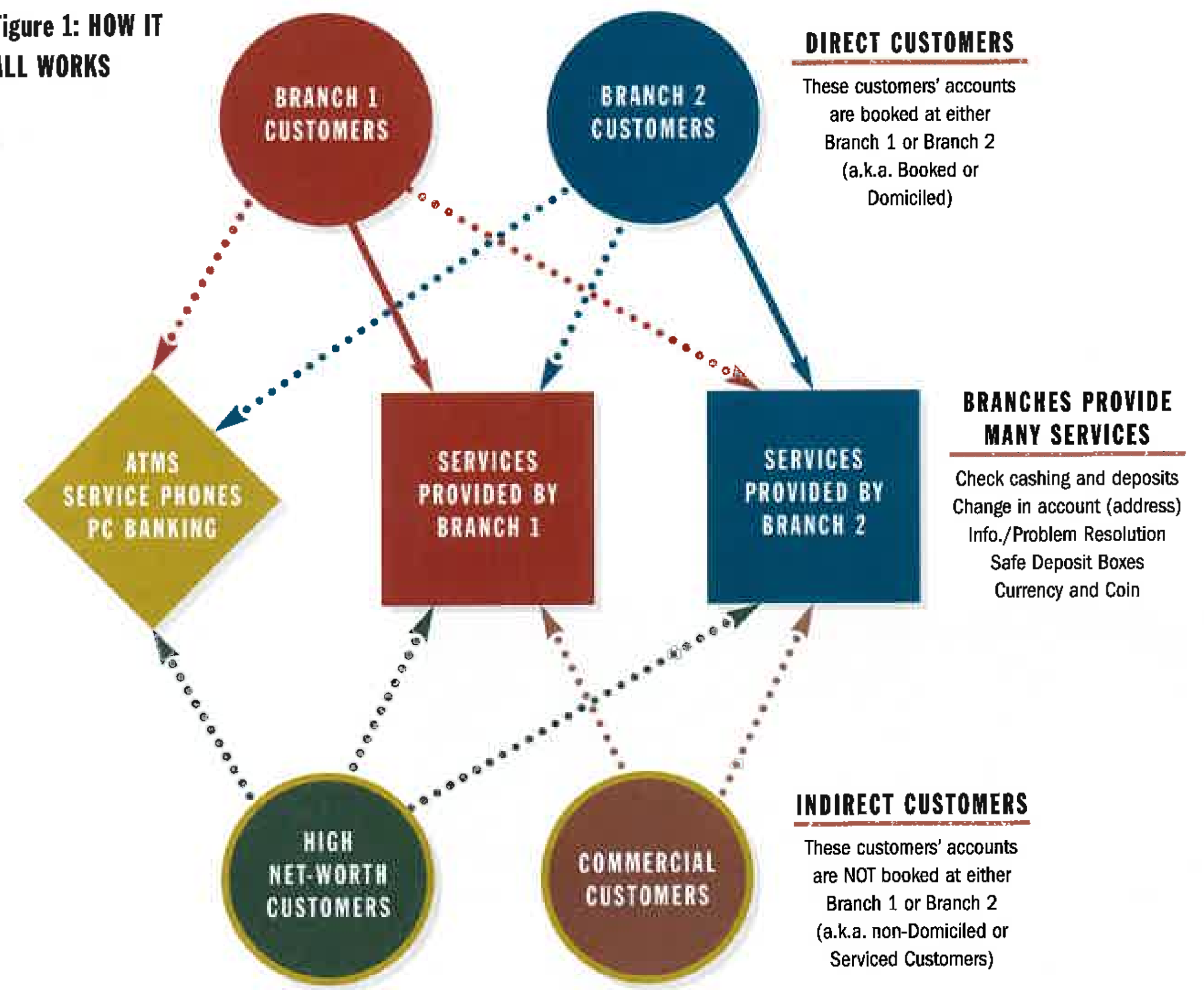
Rather than working together to bring their specialized products to the customer, branches and departments compete for all of the customer's business. Cooperation begins to break down. Once again, it's one department against another, us vs. them.

SELL, SELL, SELL!

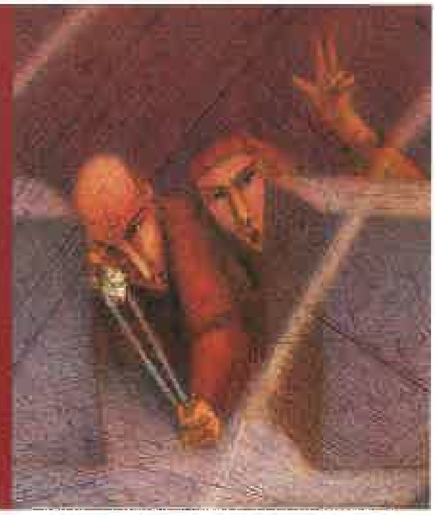
Managers of branch networks came to see the damage created by the use of local financial measures to reward employees. Then along came major deregulation of the banking industry in the early 1980s and with it consultants' admonitions that branches are retail stores and must focus on selling. Many banks followed the consultants' advice and implemented sales incentive systems to reward branch employees.

While it's true that branch staff service the retail public and must have a strong sales orientation, bank branches aren't like the normal retail store. In the banking business, when you sell a product you're selling the opportunity to service that customer's financial needs over time. It takes several months of interest and fee income just to recoup the costs of opening the account. In fact, breakeven points are six months or longer for many branch products.

Figure 1: HOW IT ALL WORKS



One quick way to **IMPROVE** *company results is to* **COOPERATE** *with other departments...to become* **PARTNERS** *in the quest for* **TRUTH** *and* **PROFITS.**



As you might expect, sales measures encourage the branch staff to focus on selling, often to the detriment of servicing income-generating—but already sold—customers. Income-producing customers suffer inconveniences from a hurried staff looking for the next sale. The bank's service to these important customers suffers as branch employees are rewarded to sell, sell, sell!

To make matters worse, many sales incentive systems reward higher incentive points to the more profitable products. That means that instead of selling the product that's right for the customer, employees sell the product that earns them the most incentive points. This is a prescription for disaster: sell the wrong product to a customer and then provide poor service thereafter. Accounts are closed and customers are lost while the branch staff is rewarded for a great sales month.

As you can see, we reward employees to maximize their local metrics, which often works at cross-purposes to what we really want—superior company performance. We want our departments to cooperate with one another in selling and servicing our customers, but we reward them to compete over whose balance sheet the customer's accounts will reside on or who'll make the next sale.

Using local measures to reward employees encourages an inward bias. As a result, employees will take an adversarial position with other departments in their never-ending struggle to maximize those local measures.

UNLOCKING COOPERATION

Being critical is easy. Building something of value is hard. So here's an alternative—a financial management measurement system based on three principles that encourage employee cooperation and a shared interest in creating company value:

1. Base employee rewards on overall company results,
2. Ensure that all employees participate in the reward system, and
3. Provide an information feedback loop that reaches all employees. (See "Three Core Principles.")

This cooperative information system rewards employees based on overall company performance. Otherwise known as team-based rewards, these plans come in many flavors from stock options to gainsharing to Employee Stock Ownership Plans (ESOPs). And they're gaining in popularity. For example, the number of ESOP plans has grown fivefold over the last 20 years and now includes 10 million employees, according to the ESOP Association in Washington, D.C. The use of stock options in technology start-ups is the stuff of legends.

Team-based rewards encourage employees to look out for the good of the company rather than focus on local measures alone. One quick way to improve company results is to cooperate with other departments

THREE CORE PRINCIPLES

The Cooperative Information System

ONE: Focus

- Employee rewards based on overall company results
- Employee rewards not based on local metrics

TWO: Motivation That's Fair

- All employees share in company's wealth creation
- Meaningful rewards for superior company performance

THREE: Ability to Succeed

- Comprehensive information feedback loop
- Information for improvement, not measurement

RESULT

- Cooperation and the unlocking of untold resources!

and to look for solutions together—to become partners in the quest for truth and profits.

Do team-based rewards work? Douglas L. Kruse of Rutgers University thinks so. His research shows that firms with ESOPs have average productivity increases twice those of other companies. And private companies with strong ownership cultures grow 8% to 11% faster than other companies.

EVERYBODY COME IN AND PLAY!

It's important that all employees—not just management—participate meaningfully in the incentive system. With the potential to earn substantial financial rewards based on company-wide results, employees are encouraged to work together to improve overall company performance.

There's one potential problem area. Employees who feel they don't impact overall company results might ignore the reward system and continue to behave in the same old fashion. The only way to counteract this ineffective mind-set is to provide meaningful financial rewards that are shared by everyone.

Many performance-based incentive systems have come to an end because companies haven't rewarded employees sufficiently. So cutting costs mustn't be the underlying objective of team-based incentive systems. The goal is to build a thriving and growing enterprise that creates wealth as it moves forward. Shareholders will increase their own returns by sharing with employees the wealth they create jointly.

Employees won't need to manipulate local information if it isn't being used to determine their bonuses. Instead, they'll use the information feedback loop to help them learn from their successes and their failures. The information feedback loop calls for all types of information—financial, operational, and external—tailored to each department's needs and desires and available to all employees.

My point is that local strategic information shouldn't be used to measure and reward employee performance. Rather, it's used to help employees understand what adds value and what doesn't. Local information for *improving* performance, not *measuring* performance.

LET'S DO IT

Directly linking employee rewards to local performance measures is intuitively appealing but deceptive in its simplicity. Local performance measures, which are very good for strategic information, aren't so good when measuring employee behavior.

Basing employee rewards on local strategic metrics encourages employees to look inward and focus on their local measures. Although this can lead to heroic individual efforts, too often it encourages internal bickering, conflict, and the never-ending jockeying for advantage in maximizing local measures. Cooperation is too often the casualty when departments' objectives collide.

It's time to disconnect local strategic metrics from employee rewards. It's time to encourage employee cooperation through a financial management system that bases employee rewards on overall company results, ensures that all employees participate in the reward system, and provides an information feedback loop that reaches all employees.

We need to get employees to band together as they drive the company to succeed. We need to use information to guide, educate, and improve, not to measure behavior. We need to create a spirit of cooperation. Cooperation, not competition. ■

Dan Hill, CMA, is a vice president of finance at a large international bank. You can reach Dan via e-mail at dnhill@mindspring.com.