

# Designing an incentive system

Business



Designing a compensation plan is one of the most complex tasks for most organizations as it affects job satisfaction, employee turnover, productivity and the overall company effectiveness. If not properly managed, this may lead to high employee turnover, low productivity, among other problems which is especially true for a large service-oriented firm like McDonald's.

McDonald's first-line managers deal directly with customers along with the front-line crew and it is crucial to draw up an effective compensation plan that will keep them motivated to work hard.

Financial incentives can motivate managers by satisfying their needs but only to a certain extent. According to Maslow's hierarchy of needs, once a lower level of needs has been satisfied, it will no longer serve as a motivating factor for the managers. As such, satisfying their higher level of needs is required. Therefore, in the context of McDonald's, once the managers are satisfied with their basic needs (pay), the monetary incentives will no longer motivate them. There is a need to provide managers with non-financial incentives such as promotion, increased autonomy and recognition so as to fulfill their esteem needs.

Thus, it is necessary for McDonald's to identify the needs of the first-line managers and incorporate suitable financial and non-financial incentives into the compensation package.

## 2.2 Remuneration System

Generally, there are two types of pay systems; the fixed-pay system and the performance-based pay system. The former guarantees managers a fixed salary regardless of their performance. This may be a disadvantage as it encourages managers to develop a complacent attitude and hence shirk from their responsibilities.

An advantage of having a fixed pay is that managers are guaranteed ' OFF a stable Income.

Under the performance-based pay system, which emphasizes incentive bonus, managers' pay varies with their performance. This may be beneficial to the company as it motivates managers to put forth maximum effort in their work. However, it may face objections from managers as it does not provide them with the assurance of a stable income. Therefore, when designing the compensation plan, McDonald's need to weigh the advantages and disadvantages of both systems before deciding which system to use. . 3 Bonus Basis Another factor McDonald's has to consider is whether to base bonuses at the many level or solely at the business unit level.

Awarding bonuses at the corporate level induces collaboration and teamwork among different units and hence promotes the interests of McDonald's collectively. However, there are factors in the corporate level such as shifts in management philosophy and competitive pressures that are beyond the control of managers at the business unit level. Managers may not be happy that their bonuses are being based on factors they cannot control.

On the other hand, where managers' bonuses are based at the business level, onuses are tied to the store performance. It will strengthen the link between rewards and performance thus motivating managers to strive harder towards attaining their unit goals.

The disadvantage is the lack of teamwork among the store. 2. 4 Performance Measures In designing the compensation plan, appropriate performance measures should be used in the compensation plan to evaluate manager's <https://assignbuster.com/designing-an-incentive-system/>

performance. When selecting the performance measures to be used, McDonald's needs to ensure that these measures align managerial behaviors to the company's goals.

For instance, McDonald's should use measures that are congruent with organizational goals such as the application of quality, service, cleanliness and value (SC&V).

Furthermore, there is a need to use more than one measure with different weights to give a fair evaluation of manager's performance. A benefit of using multiple performance measures is that it reduces managers' bonuses dependency on uncontrollable factors such as changes in market demand. McDonald's has to consider the degree of subjectivity of the various performance measures.

The higher the subjectivity in the performance measure, the harder it is to assure managers' performance accurately. Managers may feel that their performance are not fairly evaluated and thus will not be motivated to work for the incentives.

Largest Another factor that McDonald's needs to consider when drawing up managerial compensation plan is to ensure that targets set are achievable. Targets that are set too high may be considered as unattainable by managers, making them unmotivated to work towards the targets. If the targets are set too low, it will cause managers to adopt an indolent attitude as the targets are easily achievable.

Thus the targets would be set within an attainable range. McDonald's can consider using internal and external benchmarks such as master budget, company's past performance and industrial standards to determine a reasonable target for each performance measure.

2.6 Design Care should be taken to ensure that managers understand the compensation plan design. Time will be wasted trying to explain complicated plans to the managers. In addition, they will not be motivated to work hard if they do not fully understand the plan. Therefore, the compensation plan designed should be simple and impermissible.

McDonald's can consider allowing managers to participate in the design of the compensation plan. Credibility with the managers is more critical than the design features of the compensation plan and managers' involvement recognizes the inextricable link between the managers and the company. Neither party can be successful at the expense of the other party. When managers are more motivated towards achieving corporate objectives, it will lead to goal congruence. 2.

7 Communication After the plan has been designed, senior officers need to communicate the plan to the managers.

The compensation plan may be in jeopardy if it is not effectively communicated to the managers. 3. FIRST-LINE MANAGER'S VIEWS ON THE PLANS 3.1 1972 Plan In addition to receiving a fixed salary, the 1972 Plan offers many avenues for bonuses. For instance, a manager will be entitled to a bonus of 5% by meeting the optimum labor crew expenses, the food and

paper cost objective or getting a quarterly average of “ B” in the monthly Quality Service Cleanliness (SC) evaluation.

The maximum bonus that he can receive is 20% of his base salary plus an additional 10% of his alarm as a result of the increase in volume.

However, ten Donuts evaluation scheme may be complicated for managers as it encompasses many components and variables. Some components of the bonus evaluation scheme, such as the annual merit increase, are based on supervisors' subjective evaluation, which does not adequately recognize and reward managerial performance. In addition, the Management Visitation Report contains no proper definition and guidelines to follow, resulting in undue subjectivity. On top of these, the company placed great emphasis on sales volume which is beyond managerial control. 3.

Plan A A first-line manager will feel that Plan A is not as complicated as the 1972 plan. In addition, focus on long-term growth and incentive rewards for volume, profit and SC aligns managers to company objective and directs them towards achieving it. Plan A focuses on both quantitative and qualitative measurements which assess the managers more holistically. However, a weakness is its high subjectivity, leading to a lack of balance. This is because four of the six factors rated require the subjective evaluation by regional operation staff and all factors carry equal weights.

3 Plan B This plan may appeal to first-line manager because it offers an unlimited payout potential as the remuneration received by the managers from the second year onwards is based entirely on percentage of sales gain and profit. In addition, the subjective evaluation of SC by the regional  
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operation staff is excluded in this plan and this may appeal to the managers since it has been a source of contention. The first-line managers in areas with high sales growth will prefer this plan as there is a high chance that they will receive higher compensation.

The downside to this plan is that managers' remuneration is highly volatile due to the uncertainty in sales gain and profit. Moreover, this compensation plan may discourage managers in areas of low sales growth as they are not rewarded as much even if they put in the same amount of effort compared to those in high sales growth. 3.

4 Plan C If this plan is implemented, managers will push for high sales volume regardless of the expenses generated as the company places no emphasis on cost control.

This may lead to dysfunctional behavior where self-interested managers will be likely to incur higher cost to obtain the volume that will maximize their total bonus. Doing so will result in higher bonus for managers at the expense of profitability for the company. However, this plan rewards managers solely on sales volume which is not entirely within their control. Thus, uncertainty in sales volume may deter managers from choosing the plan. Similar to Plan B, this plan may also discourage managers in areas of low sales growth.

5 Plan D A first-line manager will not favor the plan as it is totally subjective based on his supervisor's evaluation. In addition, the compensation system is not internally consistent as the total available compensation increases faster through the addition of another person to the management team than it

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does through an increase in sales. 4. MANAGER'S PREFERENCE After evaluating all 5 plans, we believe that a first-line manager will most likely choose Plan A as it offers a base salary that Plans B, C and D do not offer.

A base salary is of paramount importance to managers as it provides stability and fulfills their lower level of needs.

Compared to the 1972 Plan, it is also easier to understand. In addition, Plan A also considers both quantitative factors, such as sales volume, and qualitative factors, such as training ability, which the other plans fail to adequately address. To a manager, these factors are needed so that their supervisors can give them a fair evaluation of their overall performance since it encompasses both the quantitative and qualitative aspects of their performance. Scooped 5.

SENIOR OFFICER'S VIEW After evaluating the different plans, Senior Officers will also find Plan A the best proposal. Firstly, it contains elements of objectivity making it a fairer evaluation of the managers' performance.

Secondly, emphasis placed on cost control will prevent managers from pushing for higher sales volume at the expense of profitability. Thirdly, this plan considers factors that the first-line manager can affect, and aligns him to important corporate goals, long term objectives and provide incentive for profit and volume.

Fourthly, the plan acknowledges the impact of SC, which is crucial for McDonald's long term success. Lastly, it considers manager's training ability and provides an adequate distribution of measurement to all the areas



important to the managers. This corresponds to both short-term individual utility maximizing and long-term corporate growth. .

1 Modifications to Plan A However the Plan should be modified to become a more effective compensation plan. Managers should participate in the design and establishment of profit and volume goals of their respective units.

A predetermined floor and ceiling of bonus paid for the achievement of business objectives should be incorporated into the compensation plan to protect ten company's Ana managers' Interest. 10 Improve ten objectivity of Plan A, a change in the weighted to the 6 factors is proposed. For example, the allocation of weights for SC can be lowered as it is highly subjective ND higher weights can be allocated to objective factors like profits. Finally, to make the plan more comprehensible, senior officers should communicate with the managers and explain the plan and seek their support before it is being implemented.

In addition, we recommend that a component of the bonus is based on the recognition for the most cost conscious manager. 6. Conclusion In conclusion, the purpose for implementing a compensation plan for the employees is to act as a control mechanism to reduce divergent objectives and information asymmetry and achieve goal congruence. An effective incentive plan results in sired performance from the employees and more importantly, motivate employees toward organizational goals.

However, we need to take note that incentive contracting is only one of the control mechanisms that the company can implement.

The other control mechanism to reduce agency problems is to monitor the employees' actions. References 1 . McDonald's Case: McDonald's Corporation, Designing an Incentive system 2. Claudia Engagement, Signs Sevenths, Stefan Gunner " McDonald's" Economics of Organizations A. Catalina, HECK 2001 3.

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