

McLean, Koehler, Sparks & Hammond

Certified Public Accountants/Business Consultants

Industrial Manufacturing

Compensation, incentive plans bolster employee morale

Outsourcing to a low-wage country sounds like a great way to save money.



But, it won't work in the distribution and logistics sector, where you need hands-on people.

It's important to keep your best workers by letting them know how much they really earn and developing incentive programs that offer opportunities to earn still more.

Total payroll costs

With employees come payroll and related costs, including payroll taxes, workers compensation insurance, paid time off, health insurance contributions and retirement matching contributions.

You know all this, but employees on the warehouse floor and those driving from the loading dock often think only of their hourly wages. Sometimes they seek other jobs for higher hourly rates without considering the benefits offered.

For example, in one case, a driver took another job to make \$1 more per hour, but the new employer paid no health insurance. Result: The ex-employee had a lower net pay, and a replacement had to be hired and trained.

You can avoid a similar situation by ensuring your employees know what you are really giving them. You have a great opportunity to do this at annual review time. Your payroll department or accountant can prepare a calculation for each employee, showing total payroll plus benefits. Divide this by the actual hours worked for the year, and your workers will have a more accurate picture of their compensation.

Develop incentive programs to minimize costs, encourage productive behavior and keep quality workers.

If employees consistently work over 40 hours and earn overtime pay, this is an added benefit. Don't overstress this, however. If work slacks off and the overtime disappears, it may be seen as a benefit that has now been suspended.

Incentive plans

With competition reducing your margins and luring your best employees away, it is key to develop incentive programs to minimize costs, encourage productive behavior and keep quality workers.

Distribution industry margins are low, so let employees know how expensive damaged or lost inventory is. Assuming a 4 percent net profit, a loss of one box with a sales price of \$100 requires \$2,500 in revenue to offset it. That means workers must receive, stock, pick, load and deliver 25 boxes to make up for one damaged or stolen box.

Incentive programs must reward desired behavior. This seems obvious but they can sometimes create unintended costs.

For example, speedy deliveries can promote tickets and accidents, and speedy picking rates can promote errors. Incentives for desired behavior should be countered by disincentives for undesirable behavior.

Employees want to maximize incentives to increase their overall pay, so put yourself in their shoes. If you encourage workers to pull orders quickly, but then send them home as soon as they are done, they will slow their pick rate to prevent reduced hours (and wages).

All employees doing the same job must have equal chance at the incentive pay. If specific orders or delivery routes allow for greater incentives that are not a result of greater productivity, other employees will quickly find out. This could lower morale and possibly create friction between the haves and have-nots.

Some things to consider as you are setting up your incentive program:

- Can you accurately and quickly gather and disseminate the information for the incentive program?
- If your incentive program is based on items pulled, can your computer system track who pulled which items?
- Your accounting department may have to budget additional time (and cost) to collect and analyze the data to compute incentive pay.
- Does the incentive program create a net profit by reducing direct and indirect costs? If the increase in payroll costs exceeds an increase in revenues or a reduction of other direct costs, you can't afford it.

For example, suppose you pay for accurate orders, but you already have a driver committed for special deliveries. If the driver sits in the break room waiting for one special delivery that day instead of the five he or she would have done before the incentive program was instituted, you are not saving much in costs. More accurate orders will achieve some intangible benefits like increased customer satisfaction, but hopefully you can put the special delivery person to another use.

- Does the incentive program cause you to violate any federal or state labor laws? For example, if you pay minimum wage but have a generous incentive program with high penalty "disincentives," you need to make sure even your lowest performing employees do not earn less than minimum wage. Also, if your pay is strictly incentive-based, you must still track hours worked to make sure the minimum wage is met and that hours worked in excess of 40 receive the overtime premium rate.

Keep your good employees by making sure they know how much you really pay them.

A fair and easy-to-understand incentive program is a great way to reward your best workers while promoting proper behavior and penalizing costly errors. Call your CPA for assistance in developing a plan.

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