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Stakeholder Pay:

An Alternative Compensation System that Reduces Unemployment and Stabilizes Profit Margins

By Bill Abernathy

According to the Bureau of Labor Statistics, as of March 2011, about 14 million people were unemployed and looking for work and about 8.5 million were receiving some kind of unemployment payments. In April there were 143,927 layoffs and a nine percent overall unemployment rate in the United States. Unfortunately, layoffs have become an accepted strategy for improving declining profitability.

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– Bill Abernathy

In the February 5, 2010 edition of Newsweek magazine the article "Lay Off the Layoffs" appeared.

> *University of Colorado professor Wayne Cascio lists the direct and indirect costs of layoffs: severance pay; paying out accrued vacation and sick pay; outplacement costs; higher unemployment-insurance taxes; the cost of rehiring employees when business improves; low morale and risk-averse survivors; potential lawsuits, sabotage, or even workplace violence from aggrieved employees or former employees; loss of institutional memory and knowledge; diminished trust in management; and reduced productivity.*

Recession, inflation, regulation, taxation, market demand, global competition, the minimum wage, cheaper foreign labor, technology, unions, and a changing workforce are some of the reasons given for layoffs.

Curiously, few researchers consider the way people are paid as a cause of layoffs and poor productivity. The wage and salary compensation system is viewed as a given and a fixed cost. But people earn a living under many other types of pay schemes. For example, wages and salaries do not apply to the self-employed; people paid by the job; straight commission salespeople; or piecework jobs.

An exciting alternative to the traditional wage and salary system is "Stakeholder Pay" in which employee pay is indexed to the profit of the company. The general idea was proposed in 1986 by M.I.T. economist, Martin Weitzman, in *The Share Economy: Conquering Stagflation*. Wages and salaries are indexed to the organization's monthly profit based on a three-month rolling average. For example, an employee may have a current salary of $3,000 a month. A profit index is constructed that varies, for example, between 75% and 150%. When company profits are low or absent the employee's pay is computed as $3,000 X 75% = $2,250. When profits are average the employee's pay is $3,000 X 1 = $3,000. When profits are exceptional the employee's pay is $3,000 X 150% = $4,500. The multiplier must offer a larger upside than downside (generally at least 3:1) for employees to be willing to participate.

Stakeholder pay differs from conventional profit sharing in that employees take a risk in exchange for a higher upside pay potential when profits improve. Because part of base pay is replaced by profit sharing, the plan must pay out monthly rather than the traditional annual profit sharing plan. Stakeholder pay makes a portion of pay a variable rather than a fixed expense therefore improving the organization's profit margin consistency and predictability. Consequently, stakeholder pay makes hiring new employees less risky and reduces the need for layoffs when profits decline. **Further, Stakeholder Pay can improve employee commitment to the organization as well as increase individual employee concern with holding down costs.**

An optimal Stakeholder Pay system also includes a mechanism for paying good performers more than poor performers. Performance scorecards are designed for individuals and/or small teams. Scorecard measures typically address sales, specific expenses, productivity and quality, cash flow, regulatory compliance, and customer service. The performance scales span -20% for performance below standard and 100% for maximum performance. The profit share loss or gain is then multiplied by the performance index percentage to compute the employee's performance adjusted pay.

> **The stakeholder approach to business sees integration rather than separation, and sees how things fit together.**
>
> — John Mackey

This plan not only ensures the organization a more consistent and predictable profit margin, but also reinforces employees for improving and maintaining key organizational results. High performers, perhaps for the first time, are paid fairly for their contributions. Poor performers are encouraged to improve. Including personal and small-team performance in the pay computation also gives employees more personal control over their earnings than group profit sharing. For more in depth information on these pay schemes refer to *The Sin of Wages* and *Managing without Supervising.*

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[About the Author]

BILL ABERNATHY, PH.D.

Author of The Sin of Wages, Pay for Profit, Human Performance Diagnostics and The Liberated Workplace, Dr. Bill Abernathy is best known for his contributions to performance measurement and performance pay.

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