

## Steve Kerr: Reward Systems

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Steve Kerr's *Reward Systems: Does Yours Measure Up?* is my favourite business book of 2008.

This is a book for managers, not just compensation professionals. There are many elements of a good reward system, but the critical thing is what specific outcomes and behaviours are rewarded. This is where organizations have the most trouble and Steve shows an intelligent way to make the reward system work.

Steve is famous for his work in leadership development in GE with Jack Welch and more recently at Goldman Sachs where he now has the wonderfully non-constricting title of "Senior Advisor".

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### **DC: Your recent work has been in leadership, why are you writing about reward?**

SK: I've always been interested in reward and I'm probably best known for an Academy of Management article I wrote many years ago called "On the folly of rewarding A, while hoping for B."

Reward is incredibly important in guiding what happens in organizations. Just to take something topical: the original bailout package for the financial system was rejected but a very similar version passed a week later. Why did that happen? In the second version there was—whether you like it or not—pork for members of the Senate. What

happens or doesn't happen depends on the reward system.

### **DC: It's rare to find interesting books about reward, but I found your book very fresh.**

SK: I wouldn't claim that any of the ideas are original; these are timeless ideas. But sometimes you write a book to remind people of what is known but not practiced and perhaps present it in a new way.

### **DC: Where do you start in designing rewards that result in the behaviours you want?**

SK: First you have to decide what it is you want. If you want the company to be more innovative then be clear about that. If you want people to stop being so short-term focused write that down.

I recommend beginning with your stakeholders: customers, shareholders, employees and so on. Identify what they expect from you and that's your starting point.

### **DC: How do you go from a general goal like innovation and turn it into something you can reward.**

SK: I use the bull's-eye exercise. Draw three concentric circles and put your mission or general goal in the outside ring. In the centre you want specific employee behaviours needed to achieve the mission.

To get from the general to the specific you say “Imagine it is a year from today and we are celebrating the accomplishment of our goal. What is different? What are people doing more of? What are we doing less of?”

The middle ring in the bull’s-eye is a place to put thoughts and emotions that are more specific than the general goal, but not actually the specific behaviours that belong in the bull’s-eye.

**DC: Can you give me an example?**

**SK:** If your overall goal is to be more innovative put that in the outer ring. Then as you have that discussion about what will have changed you’ll come up with specific outcomes and behaviours like ‘willingness to disagree with the boss’, ‘more copyrights and patents’, and ‘a higher % of sales from products didn’t exist three years ago’.

The next step is to look at how to measure those specific outcomes and behaviours.

**DC: Just before we get into measurement, how do cascade the goals to get alignment across the organisation?**

**SK:** If the goal was innovation, at the CEO’s level it might lead to three outcomes in the bull’s-eye:

- Have fresh thinkers hired from non-traditional sources.
- Have courses that help people be more creative.
- Have compensation structures that reinforce innovation.

As head of learning that second goal, developing courses, would come to me

and I’d put that in the outer ring of my bull’s-eye and go through the same exercise to operationalize it. It would cascade that way through the organization.

By the way, many organizations suffer terribly from lack of a clear common direction. There is just a vague mission and each unit interprets it in its own way. At GE Jack Welch was very insistent that we all had the same overall goal. He’d say “If our Titanic sinks, no rowboat is making it to shore.” No one at GE was having a separate game, we would all win or lose together.

**DC: You’ve helped with translating general objectives into specific goals and cascading that through the company. Now let’s go back to the very difficult problem of measurement.**

**SK:** Without measurement the reward system won’t work. So having identified what would be different if you had achieved your goal, you then ask: Which of these changes cannot be detected by any existing measure. If we had more patents would we know? The answer to that probably would be ‘yes’. Would we know if people are disagreeing with the boss? Probably not. So the next step is deciding how these things will be measured.

In the case of people disagreeing, you would probably use some kind of employee survey to get a measure.

And then we get to the point of asking what will happen to people who do well on those measures. Are people rewarded for what we want more of and discouraged from doing what we want less of?

You are likely to find the existing reward system is not encouraging the right things and that important things are not being measured.

**DC: Measuring important things is notoriously difficult. In the book you mention that professors are judged on their publications, but if you just count the number of publications you will get a lot of low quality papers published in lousy journals.**

SK: You have to measure what matters not what is easy. So yes you do count the number of papers published, seven is better than four, but you also assess quality. An article in the Journal of Finance is better than four articles in some lesser journal.

**DC: It will be hard to create an algorithm that accurately balances all the different aspects of quantity and quality.**

SK: One of the things I say that people don't like is that there is no such thing as an objective measure. You have to use judgment. We take advantage of whatever quantitative yardsticks are available, but you cannot be owned by them. There is always judgement but it is informed judgement. Over and above that you use tools like 360s so that you are guided by judgements other than your own.

If you don't include room for judgement you'll end up with mindless quantitative formulas of things that don't matter.

**DC: You've resolved one of the biggest problems managers have with reward systems. But what about the fact that it can be hard to capture all the important aspects of the job in three to five key measures.**

SK: It's rare to find a job that can be adequately captured in a small number of measures. It's true you should try to keep the number as low as possible, but you also need to have measures on everything that matters. Consultants say that you lose focus if you have more than a few measures, but I'm not saying you treat all measures equally. You set priorities. Some goals will have stretch targets and some will have maintenance targets. Don't let consultants tell you to go with fewer goals than you need to capture everything that is important.

I know we are at the end of the interview but let me just add one point. The reward system isn't just about monetary rewards, non-financial rewards matter too; we'll have to get into that in another time.

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Steve Kerr's *Reward Systems: Does Yours Measure Up* is available from Amazon.com.

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If you know managers who complain about the behaviours their reward systems drives then send Steve's book or this article to them.

David Creelman writes and speaks on human capital management. Learn more at [www.creelmanresearch.com](http://www.creelmanresearch.com)