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Variable reward systems in Germany

Seminar work

TU-53.167 Reward System in Organizations

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Abstract

This seminar work is based on articles from German magazines describing the recent researches and studies concerning German reward systems. First, the historical background and current structures of basis pay in German reward systems is discussed. After a study including the varying use of variable reward components a methodological approach for the design and implementation of reward systems is described. The seminar work finishes with an estimation of several case examples in terms of characteristics presented in the above mentioned method.

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1. Introduction

Nowadays, the conformance of customers' wishes and desires is one of the most important factors for competitiveness. Not only flexible manufacturing conditions, technology, and high-level service are required for customer satisfaction, but rather qualified and motivated employees that participate in the production process by co-thinking and co-acting.

Thus, during the recent years, group and team work has become the most common form of work organization. Team work encourages entrepreneurial thinking and acting of employees combined with taking in account the corporate goals. According to this development and to new tasks and responsibilities emerging in these teams there is a need to reconsider the forms of reward systems in the concerned companies and to add variable, performance oriented reward components. An important question thereby is if the focus of these variable components, that is to say if they should emphasize the rewarding of team or individual performance or try to combine both equally.

The purpose of this seminar work is to provide the reader with an overview about the way of conceptualization reward systems in Germany and to depict tradition and legislation based specifications.

First of all, basis pay that constitutes an important part of reward systems, its historical background and its varieties are discussed. The study described afterwards demonstrates the recent tendencies and developments concerning the variable performance based components of reward systems. Further, an approach for a methodological design of variable reward systems is presented. A study of case examples from the German industry finalizes the seminar work.

2. Basis pay – historical background and need for changes

Performance based reward systems consist of basis pay and components depending on individual or group performance as shown in figure 1. Before the consideration of the variable components in the following chapters basis pay that is the largest part of the whole pay is discussed in this chapter. Thereby it is necessary to illuminate some specifications existing in the German system resulting from historical conditions and to describe the recent developments and changes.

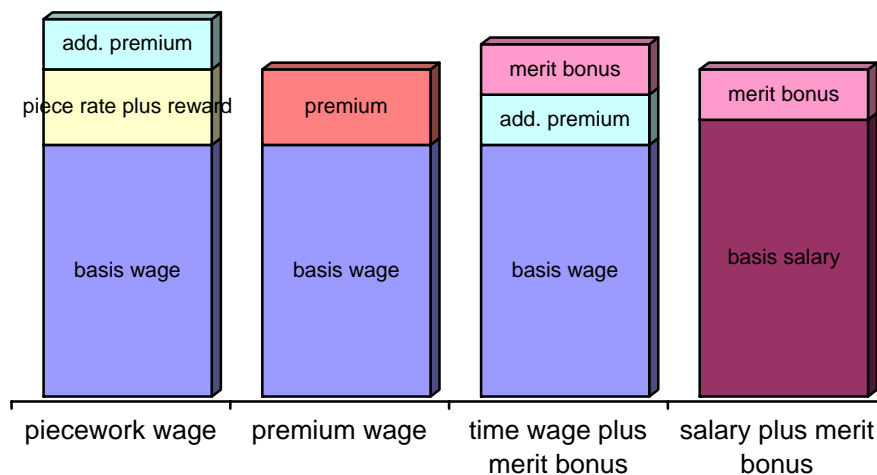


Figure 1: Types of performance rewards based on industrial tariff agreements for the metal and electro industries (Becker 1997, p. 18).

Increasing global competitiveness requires flexible reactions and actions of companies on market demands. In order to be able to construct, to produce, and to deliver diversified high-quality goods and services responding to customer's wishes and desires companies had to change their work organizations and to emphasize group work that is process oriented and spanned over several departments.

Thus, employees are involved in corporate interrelations and processes and are expected to develop entrepreneurial thinking and acting in order to participate in the processes. Tasks and requirements to employees become more

complicated and extensive. Therefore, nowadays reward systems are should be able to respond to these changes; wages and salaries should be adapted to recent developments. (Becker and Schultetus 1998, pp. 48-49)

According to Gryglewski (2003, p12), the existing industrial agreements are not up to date any more and cannot respond to the demands resulting from changes in environment and work organization. He argues that the current organizational concepts include the integration of wage-paid workers as well as salaried employees in groups and teams throughout the whole organization. Therefore, the industrial agreements have to be equal for all employee groups and facilitate the integration of common reward systems, which is especially important for the conceptualization of performance based rewarding.

Becker and Schultetus (1998, p. 50-51) ascribe the current wage and salary systems to the historical developments. The roots for existing systems are to be found in the 19th century when workers received daily or weekly wages and clerks were paid monthly by salaries. These systems are based on technological and organizational conditions of the industrial production 20-30 years ago and still include differences between waged workers and salaried employees. One can also find these differences in the labor and social legislation, e.g. different pension fund institutions for waged and salaried employees. Only some years ago there were different cancellation periods for the two employee groups.

Novel forms of work organization unify planning and managing as well as executive actions. Thus, there are no more clear distinguishes in physical and mental jobs. The former distinguished functions of the two groups, waged and salaried employees, overlap increasingly and requirements and work conditions converge more and more. Hence, differences in industrial wage and salaries agreements are not up to date anymore and cause dissatisfaction among employees.

There are already some efforts observable especially in the metal and electro industries to align both, wage and salary agreements. Becker and Schultetus (1998, p. 53) suggests some fields of rewarding that should be considered for the process of alignment:

- Regulations of additional vacation bonuses
- Regulations of supplementary grant assurances
- Regulations of capital-forming merits
- Regulations for implementation of monthly paid salaries throughout employees groups

The ultimate result would be the alignment of waged and salaried employees in a common industrial tariff agreement. This step is already fulfilled in particular tariff sectors, e.g. chemical industry, sugar industry, brewery industry, oil mill industry, Rhenish brown coal mining, and particular company agreements. Some EU countries also have common industrial tariff agreements, e.g. Italy, France, and the Netherlands. The development of common reward regulations in Germany could use the existing experiences in this field. But it is necessary to consider the specific production and work conditions as well as reward traditions in order to increase the acceptance of the new regulations among the concerned employees as well as among managers.

3. Changing work organizations require changing reward systems

Becker and Timmer (2000) note that interested in higher flexibility in adjusting to customers' wishes and expectations companies decentralize their structures and change to team and group based forms of work organization.

Eyer and Stockhausen realized that there was no systematic study of team work supporting reward systems that could answer existing questions concerning the initial situation, goals, and experiences of the recent development in the field of rewarding groups. They initiated a survey including 71 companies operating in branches like mechanical engineering, electrical engineering, automotive, iron, and steel industries.

The results of this study revealed insights about the use of team work within the mentioned industries and about demands to the changing reward systems as well as their ability to satisfy the concerned employees.

Figure 2 demonstrates the clear emphasis of team work in manufacturing departments of the companies. Four-fifth of all team work systems are observed assembly and production. Thus, new, group work supporting reward systems can be found in the same areas. Around 90% of changed reward systems were implemented in assembly and production.

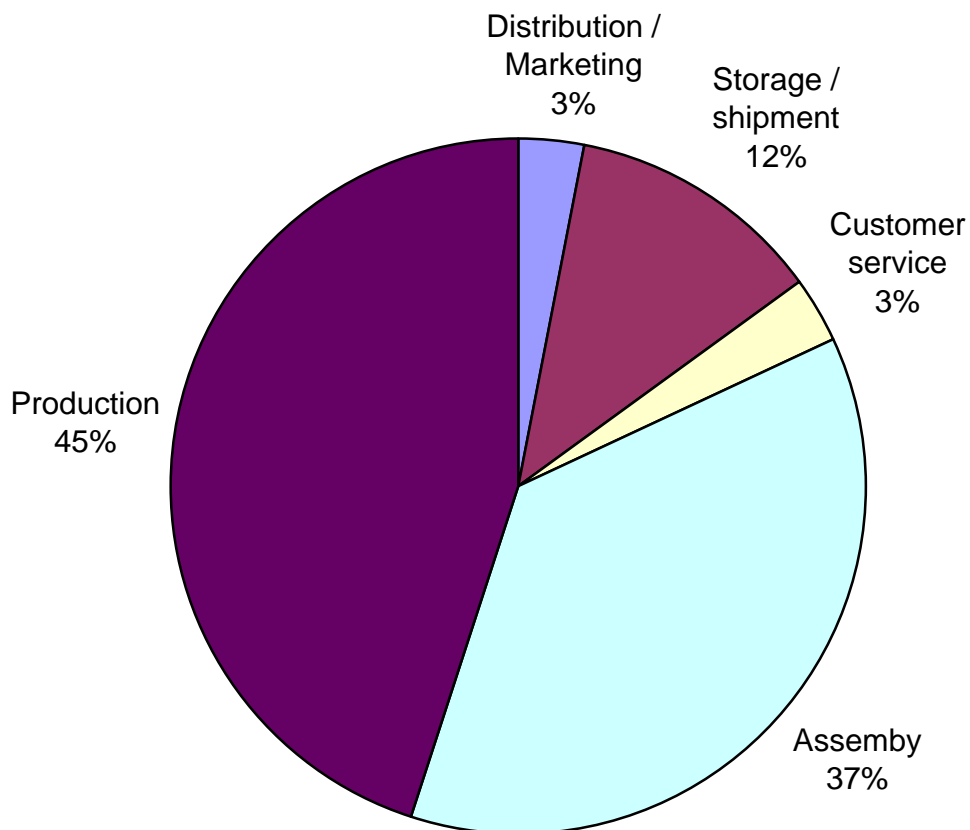


Figure 2: Departments utilizing team work

Most of the companies pay large attention to the implementation of team work but not really to the implementation of appropriate reward systems. While group work was implemented in 115 sectors there were only 62 of them changing their reward systems.

Companies seem to expect the new reward system to have a huge impact on the improvement of their situations. The following figure 3 depicts the most expected goals to achieve.

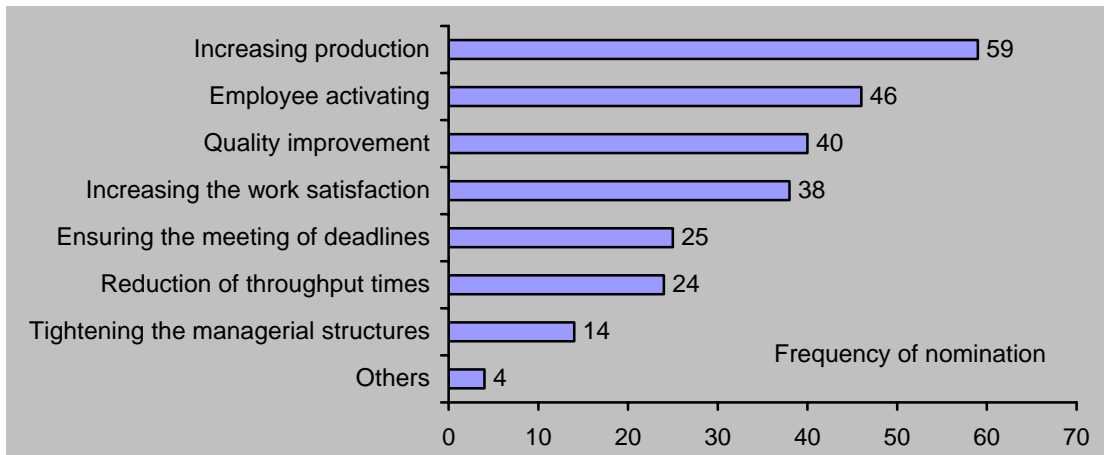


Figure 3: Goals of a new reward system

Implementation and utilizing of team work systems have influenced the structure of performance based reward systems concerning the type of variable reward components. Figure 4 demonstrates the recent development in the investigated companies and shows changes after the implementation of group work.

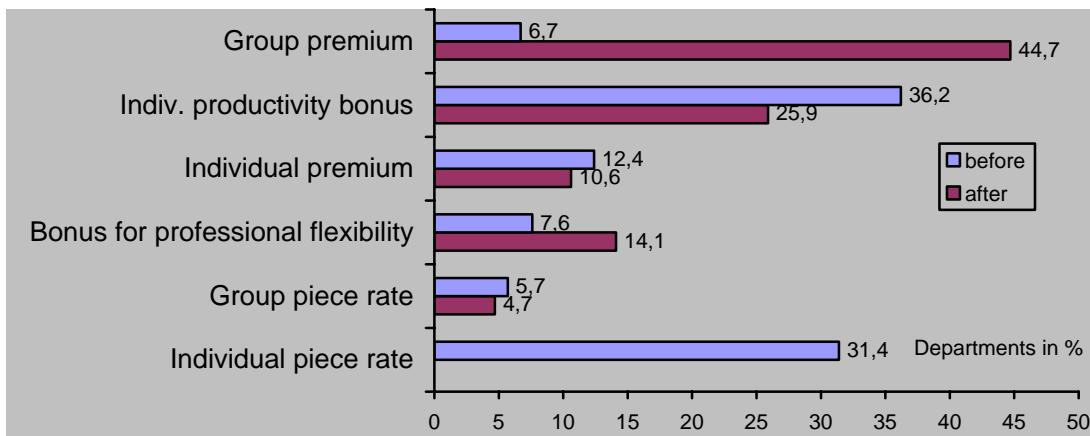


Figure 4: Spread of performance based reward components

There is often a combination of basic reward and performance oriented components. While these components emphasized individual bonuses and efficiency pays before the implementation of team work systems, afterwards companies tend to combine basic pay with team and flexibility bonuses. Figure 5 depicts the four most common combinations.

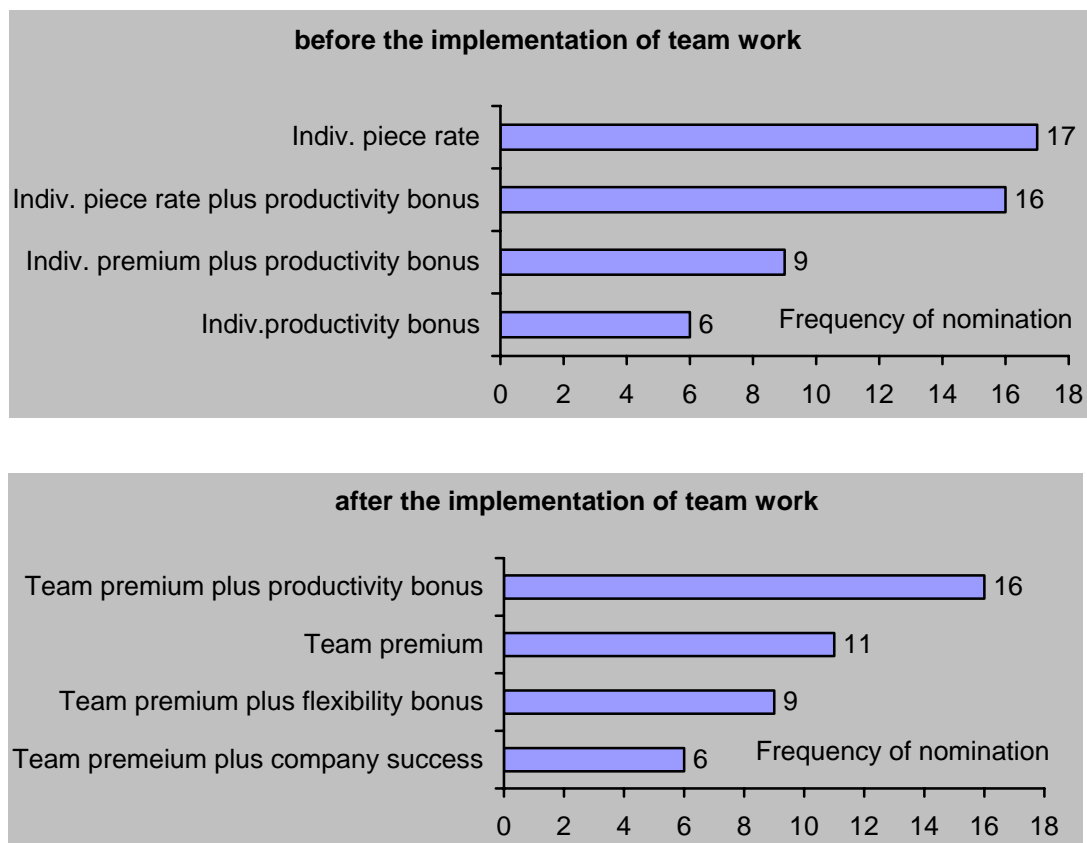


Figure 5: Combination of basic reward with variable reward components before and after the implementation of team work

The size of the performance based reward components has also changed after the implementation of new reward systems. While the proportion of these components was about 30-50% of the basic pay based on industrial wage agreements before, it declined to 20-30% after the implementation. Several factors play a role in this case. For instance, weak economical situation at the time of changing the reward systems or relation of employees to higher basic pay levels because of higher qualifications through team work. But according to the experiences of Eyer and Stockhausen, the overall reward level stayed nearly identical, providing better achievement of aimed goals like productivity and quality.

If the overall pay level would decline the reward systems would fail to satisfy the participants. Figure 6 provides evidence for the opposite.

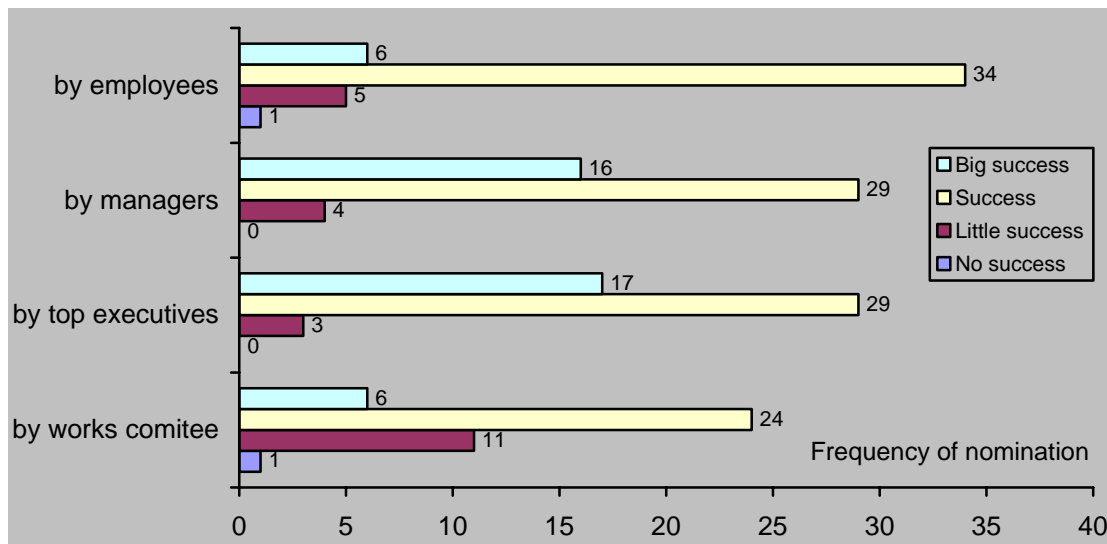


Figure 6: Appraisal of the new reward systems by different groups

4. Variable reward systems through methodology

Rösler and Hinrichsen (2004) note that the main objective of variable reward systems is to ensure that rewards are not merely linked to constant standards, but are also influenced by variable requirements like individual efforts and performance results. Thereby the reward level depends on the extent to which these requirements are fulfilled through predetermined calculation models.

Nowadays, variable reward systems include performance measure criteria like flexibility, team work or improvement of processes. Furthermore there is diversification of reward systems throughout all industries observable because reward systems are adjusted according to companies' operations and goals.

The authors have developed a methodological approach for designing an appropriate reward system that is described in the following chapters. First of all, the reader is introduced to the overview of the method and afterwards to the systemic approach.

4.1 Methodical design and implementation of variable reward systems

The method shown in table 1 is divided into four phases and each of them again in several work packages (WP).

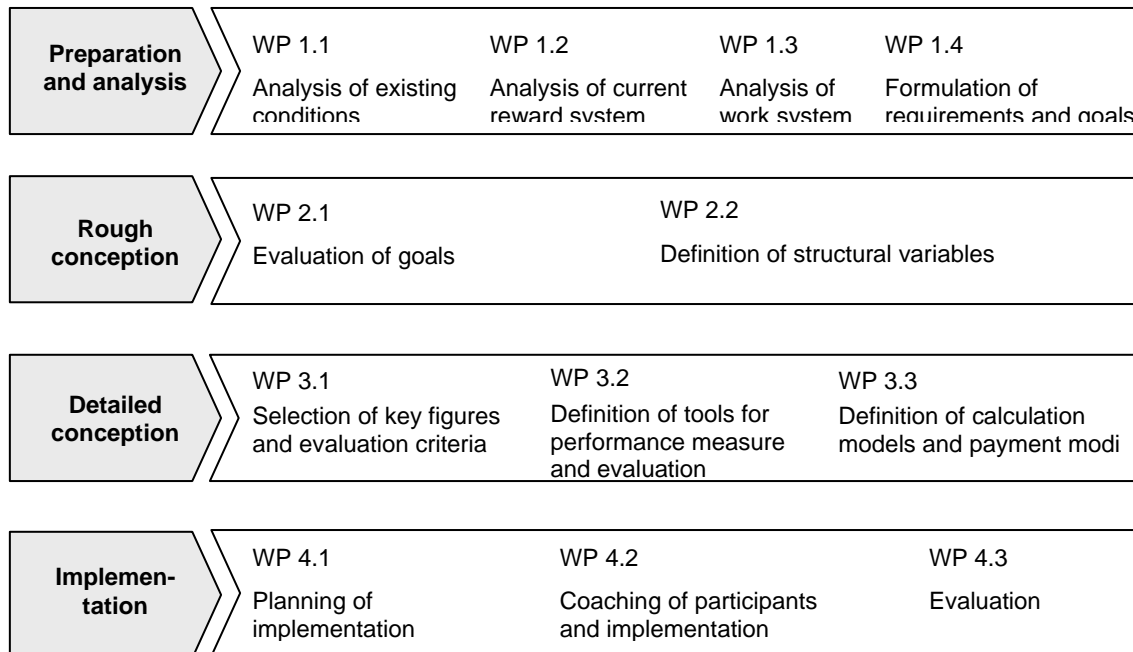


Table 1: Overview of the method for systematic design and implementation of variable reward components

Preparation and analysis phase

The analysis of existing conditions (WP 1.1) includes the company's characteristic structure (firm's goals, organizational, customer, and personnel structures, products, etc.), current industrial and corporate wage agreements, and budget.

Estimating the current reward system (WP 1.2) used in the company one can identify its weaknesses in order to avoid them while conceptualizing the new system. At the same time recognized strengths of the current system can be used for the further design.

Analyzing the work system (WP 1.3) one should identify its goals, tasks, and demands of internal as well as external customers to it in order to define the

structure of the variable component in the following phases. Additionally all possible indicators that can serve as measure and evaluation figures for the calculation of the variable component are to be gathered.

The last work package (WP 1.4) includes formulation of company specific demands to and goals of the variable reward system based on the result from the preceding analysis.

Rough conception phase

In this phase the variable component of the reward system is to be designed structurally based on the results of the preparation and analysis phase.

First of all, the formulated goals of the system are to be ordered in a ranking system and valued with points according to their importance (WP 2.1).

The morphological box described in the next chapter is a meaningful tool for the next step (WP 2.2). The box contains several characteristics constituting a variable reward component and their particular specifications. The most important characteristics are the kind of reference unit, the reference value, and the kind of evaluation indicators.

Once the necessary characteristics are chosen, each of their specifications is to be estimated in terms of the extent to which it supports the achievement of the reward component's predefined goals and to be valued with points according to this extent. Following, the points are to be multiplied by the goals' particular value points. Ultimately, summing up all the points for each of the specifications one chooses the specifications which fit most to the required reward component.

Detailed conception phase

The first work (WP 3.1) package in this phase is concerned with the definition of reward influencing measure and evaluation figures based on the indicators identified in the analysis of the work system. These figures are to be chosen under consideration of different requirements like interference of the criteria by the employees, their contingency with the company's goals, and the administrative costs.

The design of tools for performance measure and evaluation is the issue of the next step (WP 3.2). After they are designed detailed guidelines are to be formulated that support the implementation of the reward system and ensure the correct use of the tools.

Further, calculation models for the variable reward component are to be defined (WP 3.3). They determine the relationship between performance and the “cash” as well as the payment modi.

Implementation phase

After the definition of the implementation strategy (WP 4.1) with an activity catalogue and a timetable the participants are to be informed and coached in workshops and meetings (WP 4.2).

After a predefined running period the system is to be evaluated in order to modify particular parts of the concept. The effectiveness according to the formulated goals and requirements as well as the acceptance and satisfaction of employees are to be estimated.

4.2 The morphological box

Rösler and Hindrichsen designed in collective work with eleven reward experts a morphological box which provides a comprehensive overview of the currently used reward systems. The morphological box allows the systematical monitoring of the big number of specifications and supports the finding of innovative solutions in combination with existing approaches. Following, the characteristics and the particular specifications are described.

<u>Characteristics</u>	<u>Specifications</u>				
Number of the variable components	One		Several		
Personnel scope	A part of employees (by function / hierarchy)		All employees (through all functions / hierarchies)		
Reference unit	Employee	Group / team	Organizational unit	Company	
Reference value	Performance behavior		Performance result		Success
Reference period	Reward according to performed reference unit		Reward according to expected reference unit		
Type of defining the relevant criteria	Predefinition		Agreement	Without predefined criteria	
Indicator	Qualitative (e.g. figure, goal realization level)		Quantitative (e.g. appraisal criteria)		
Type of data gathering	Measure		Counting	Evaluation	
Relation to basic reward	Relative (premium by percentage)		Absolut (absolut value)		
Coupling of reward and reference value	Proportional	Declining	Progressive	Staged	Combined
Upper earning limit	With upper limit		Without upper limit		
Payment modality	Chronological (e.g. monthly paid premium, bonuses at the end of a year)		Non-chronological (e.g. according to the number of produced pieces)		

Table 2: Morphological box for description and design of variable reward systems

Number of variable components

The number of components depends on the aimed goals of the reward system. Mostly these are individual and collective goals which cannot be achieved through one component. Furthermore, it is possible to emphasize the different importance of the goals by different evaluations of the particular components.

Personnel scope

This characteristic includes individuals, groups of individuals, or the whole company. Usually the scopes are defined relative to the functions of employees or their hierarchical position. The bigger the scope, the more important it is to adjust the criteria for performance measure or evaluation according to the functions of the particular employees.

Reference unit

The reference unit clarifies if reward influencing figures are to be collected and rewarded on individual or collective basis. Thereby, the extent of collectivism depends on the corporate goals and on the functions and tasks of the particular work system. The recent developments show a tendency to collective orientation because of the use of team work systems.

Reference value

Performance behavior, performance results and success are parameters that influence the size of the variable reward component dependent on the extent to which they are achieved. Performance is oriented on requirements and is, thus, a relative parameter depending on corporate goals and conditions. Performance behavior reflects the process of performing, e.g. engagement, whereas performance results concentrates on outcomes resulting from particular behavior.

Success (e.g. economical success in a market) is a parameter which can be hardly related to individuals or groups of individuals. The basic assumption of variable reward components is that employees can influence them. Therefore,

success as a reference unit is always to be combined with other parameters and to be emphasized less than the others.

Reference period

The reference period defines if the volume of a variable reward component depends on already finished performance or on the one that is expected to be contributed.

Type of defining the relevant criteria

This characteristic reflects if reward influencing criteria are defined on individual or on collective levels. Criteria can be predetermined by superiors and forwarded to the employees or result from agreements between superiors and the concerned team. Usually these criteria define an average performance level. Higher performance would mean increases of variable reward components. Furthermore, there can be criteria that are not predefined, e.g. when employees are ordered in ranking positions according to their performance.

Indicator

The extent to which performance behavior, performance results, and success are achieved can be measured by indicators, quantitative or qualitative, which need to be fixed in order to operationalize the parameters there are based on.

Type of data gathering

Measuring and counting is based on the linkage of reward influencing parameters and numbers. The relevant data are gathered during the performance. They can be related through defined calculating models and result reward influencing figures, e.g. number of produced pieces in relation to working time. Evaluation is based on observations of performance behavior that is to be encouraged by rewarding. Hereby, the authors prefer evaluation based on separate, predefined behavior characteristics rather than an overall one. It is important to coach the superiors who are usually evaluators.

Relation to basic reward

This classification of variable reward components includes relative and absolute relations to the basic pay. Relative bonus depends on the extent to which employees increase their performance and on basic reward. Absolute bonus means strict separation of basic and performance based pay.

Coupling of reward and reference value

The type of coupling depends on the aimed incentive influence. A proportional coupling means a constant increase of the variable reward according to the increase of performance. Progressive coupling is used when low performance increases are more important than high ones. In contrast, digressive coupling encourages high performance increases. Using a staged coupling means that the variable reward raises at a predefined amount after a level of higher performance is reached. Furthermore, there are possibilities to combine the mentioned coupling types, e.g. progressive-digressive.

Upper earning limit

The upper earning limit predetermines the maximum volume of the variable reward component. At the same time it limits the maximum above-average performance, because higher performance is not rewarded anymore. By using this limit reward systems avoid performance increases that go beyond the physical and psychical limits. At systems without the limit, the maximum performance levels off automatically after a certain period.

Payment modality

This characteristic defines if the variable bonuses are paid off chronologically or non-chronologically. The first, means rewarding higher performance monthly, quarterly or at the end of the year. The latter emphasizes bonuses after the achievement of predetermined goals.

5. Case examples

This chapter provides the reader with an overview about the used reward systems in Germany. Therefore, five case examples are studied and classified in terms of characteristics in morphological box and their specifications described in the preceding chapter. The results of the classification are shown in table 3. Companies and conditions are briefly described for each of the case examples.

Case 1

The new reward system was implemented parallel in two firms that had similar changes in work organization development. First of all, the manufacturing department was segmented and team work was implemented. During the second step the segments developed into cost and profit centers. According to the mutual responsibility of the employees in the particular segments the performance based reward system for waged and salaried employees is to be bound to the achievement of team goals that result from segment and company goals. (Becker 1997).

Case 2

The company used the implementation of group work in order to respond to the new, changing market conditions: fluctuating work orders and hard deadlines as well as high quality demands by customers. The fluctuations could to be managed by flexible capacities resulting from flexible working times of groups. Former reward systems were replaced – piece-rate work as well as time wages combined with merit bonuses based on individual evaluation. (Becker and Timmer 2000).

Case 3

A medium-sized company that produces large-size devices implemented group work with decentralized responsibilities and flexibility in working times with high degrees of freedom. The main goal was to motivate employees to keep and to

<u>Characteristics</u>	Case 1	Case 2	Case 3	Case 4	Case 5
Number of the variable components	Two	Two	Two	Two	Three
Personnel scope	Employees paid by industrial agreements	Employees in production and assembly	Production + construction + work preparation	Employees in production	Employees in production
Reference unit	Individual + team	Individual + team	Individual + division	Individuals + team	Individual + division
Reference value	Performance behavior	Performance behavior + results	Performance behavior + results	Performance results	Performance behavior + results
Reference period	After performance	After performance	After performance	After performance	After performance
Type of defining the relevant criteria	Predefinition	Predefinition	Predefinition	Predefinition	Predefinition
Indicator	Qualitative	Quantitative (group) + qualitative (individual)	Quantitative + qualitative	Quantitative	Quantitative + qualitative
Type of data gathering	Evaluation	Counting + evaluation	Measure + evaluation	Measure + counting	Measure + evaluation
Relation to basic reward	Relative	Relative	Relative	Relative	Relative
Coupling of reward and reference value	Staged	Staged	Staged	Staged	Staged + proportional
Upper earning limit	With	With	With	With	With
Payment modality	Chronological	Chronological	Chronological	Chronological	Chronological

Table 3: Classification of example cases according to the morphological box.

under-run the overall time budgets depending on the order situation. (Becker and Timmer 2000).

Case 4

The company's business depends on deadlines set by customers. Thus, there are two season peaks per year with increases of the order volume up to 50%. There are also short-term daily variations between +30% and -20%. Resulting from these conditions the main goal of the new reward system was to facilitate working time flexibility for the employees in production and at the same time to motivate them to reduce their working times. This goal was achieved by delegating more decision freedom to employees in all positions and levels. (Abels 2002)

Case 5

The order and manufacturing structures of this company are typical for a make-to-order producer with orientation on specific customer wishes. According to the old reward system all employees got a merit bonus and an extra pay over tariff, 16% and 14 % of the industrial agreed wage. Data from past and as well as experience based and estimated values constitute the basis for the new reward system. (Fremmer 2000)

6. Conclusion

The conceptualizing of German reward systems is always consists of two components: the basis pay, which depends on tariffs based on industrial wage and salary agreements, and the variable performance based and performance encouraging component.

Even though, there is changes and new developments and tendencies concerning the basis pay this part, which serves as a minimum for rewards, is more stable and varies insignificant among different companies.

Thus, variable reward components are responsible for high diversification in the field of variable reward systems. As long as there are no regulative industrial agreements concerning this part of rewards, companies are free in their design and conceptualization efforts. But with an increasing number of reward systems including the variable component there are few common approaches observable that seem to serve the best to the achievement of goals of pay systems.

Hence, the presented approach to use methods for reward system design and implementation seems to be useful and provides a concrete guideline but at the same time leaves space for company specific conceptualization.

The main tendencies observable in several studies and case examples are emphasis on group and company goals and therefore increasing participation of all employees in the whole production process instead of being reduced to a small action area. Reward systems are supposed to be the source for motivation and incentives and, thus, to support this development.

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