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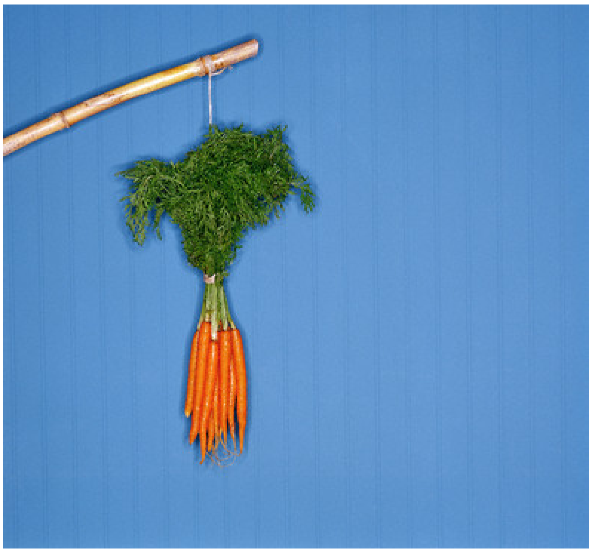

The Folly of Rewarding for A, Not Penalising B and Getting C

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In 1975, a seminal article entitled 'On the Folly of Rewarding A, While hoping for B' was written by Steven Kerr providing fascinating insight into the unintended consequences of reward strategy that promotes one behaviour even thought the rewarder hopes for another.

This article is a tribute to the original and provides recent examples, some of which have had devastating consequences and also asks questions around ethical behaviour. This article goes on to suggest ways that organisations can use techniques and approaches to minimise potential unintended consequences in the form of unwarranted behaviour when reward/penalties are used in the pursuit of goals and objectives.

Reverberation

As the dust continues to swirl around the sub-prime crisis, much recent criticism has been aimed at the bonus culture that has been identified as one of the main culprits in poor lending practice that has brought several banks to their knees and caused severe dislocation economically.

The inquiry into the blast at BP's Texas refinery in 2005 found that company audits were compliance driven rather than ensuring safety as the main objective. This led to a series of management errors which culminated in 15 people losing their lives.

Several months ago, the practice of 'patient stacking' of seriously ill patients in ambulances was found in a number of NHS Trusts in order to avoid missing Government targets. This achieved the double whammy of increasing health risks whilst at the same time tying up valuable resource.

The three examples given above show bizarre 'negative' behaviour/outcomes which an outside observer would shake his/her head in disbelief and ask, 'How come?'

Leadership, performance, reward and decision-making are a heady mix in organisational terms. Unfortunately they are a very toxic mix if you don't get them right with increasingly bad consequences. However, getting them right demands much thought and consistent monitoring. One should never underestimate human ingenuity when it comes to obtaining reward or avoiding the opposite, i.e. penalties even where this collectively has or will have a negative impact.

To understand why 'bizarre' things happen that seem counter-intuitive demands an appreciation of the organisational complexities at hand, the trade-offs that ensue and the impact this has on individual decision-making and behaviour, and, ultimately organisationally.

In 1975, Steven Kerr, then an associate professor of Organisational behaviour at Ohio wrote a seminal paper [1] which brilliantly highlighted the failings of reward systems on behaviour.

This article is a tribute to that paper, providing some more up to date examples and how through the advancement of HCM intelligence show how modelling analytics can help to identify potential misapplication when management or Government for that matter set performance objectives/targets with associated rewards (both positive or negative).

Kerr famously provided a number of examples which showed the inherent contradictions of various reward systems. He showed how the different reward systems at play for US soldiers between those involved in WWII and Vietnam led to far greater incidences of insubordination in the latter conflict because of the incompatability of the reward to individual survival. Further incongruencies in Medicine, Education and social work and evaluation of training were highlighted with exceptional insight.

The fact that similar incongruencies exist today with such huge implications for many suggest that we have not heeded what was said four decades ago in organisation terms. The military have long used a term for these types of scenarios – FUBAR[2].

The subprime meltdown in financial services

The current financial crisis engulfing many national economies has produced enough 'pointing fingers' and 'blame-games' to last for the foreseeable future. Unpicking the dynamics of this whole saga is a little more complicated and multifaceted. There are already a number of insightful papers providing context[3] to unravelling the causes and there are many whose reputations have been tarnished including the Lending Banks, Investment banks, Rating Agencies, Hedge Funds, Investors of CDOs, mortgage brokers, and even The Fed as well as homebuyers themselves.

In the end, much of the buck will stop with the banks. In particular focus will focus on the performance-reward link and inevitably

[1] 'On the Folly of Rewarding A, While Hoping For B' by Kerr Steven, The Academy of Management Journal, Volume 18 Number 4, December 1975, pp 769-783

[2] FUBAR – a military slang acronym with several representations – a bowdlerised version being 'Fouled Up Beyond All Recognition'

[3] For example, see Subprime Meltdown: American Housing and Global Financial Turmoil, Rotemberg J, Harvard Business School case 9-708-042

the 'bonus culture' so prevalent. Much will boil down to the fact that, in many cases achieving performance targets in lending was not matched with the same ruthlessness in underwriting diligence, only a hope that underwriting would come out 'OK'. There is no doubt that in some cases leadership even accepted the 'potential risks', but the dangers of not continuing 'to dance'[4] seemed to outweigh them.

A case of rewarding for A (lending targets), not penalising for B (value underwriting) and getting C – in this case several banks no longer in existence (there may be more to come as unwinding continues), a number of ex-CEOs, thousands of ex-employees, hundreds of thousands of ex-homeowners and wider economic disruption.

BP and the Texas Oil Refinery incident

In BP's case, the inquiry and subsequent report[5] found a number of cultural issues that played a large part in the build up to the fatal incident. Serious concerns were raised around (i) the effectiveness of the safety management system, (ii) the effectiveness of corporate safety oversight and (iii) a corporate safety culture that allowed serious and longstanding deviation from good safety practice.

Given BP's long and mainly successful tenure in oil extraction and production, one could be forgiven for thinking that given the above observations, BP was an 'oil' novice. The accident at Texas was categorised as a process safety incident (as opposed to personal safety). The inquiry found that BP had focused on personal safety performance to the detriment of process safety, in that leadership had 'mistakenly interpreted improving personal injury rates as an indication of acceptable process safety performance'.

Over-reliance of this data, together with inadequate understanding of process safety creating a false sense of confidence. This was further compounded by management turnover and the existence of an operating culture that was not open and lacking in trust which limited the communication of any concerns at ground level.

Another factor was that there was no high ranking leader designated with overall accountability for safety dedicated to the refinery business despite there being safety representation at several levels. More seriously was the finding that process safety was not incorporated in management decision-making.

Most definitively the report stated that 'while accountability is a core concept in BP's Management Framework for driving desired conduct, BP has not demonstrated that it has effectively held executive management and refining line managers and supervisors.....accountable for process safety performance'.

Here is unfortunately the case of Rewarding for A (a mistaken proxy target), not penalising for B (accountability) and Getting C - in this case a very tragic incident that has had large ramifications.

Ambulance stacking in the NHS

A recent report providing data on NHS A&E treatment highlighted the practice of patient stacking in holding patterns – housing patients (some seriously ill) in ambulances stacked outside their respective hospitals. Lack of facilities and/or treatment time targets have been cited for this practice to have occurred. A number of press reports[6] detailed specific incidents and the serious condition of some of the patients.

Pressure from Government targets on A&E treatment seems to have been a particular factor as A&E units need to meet a four-hour treatment time. Thus, in the event that A&E departments are over-run and unable to guarantee treatment time within target then the order to 'stack patients' is given in arriving ambulances. Another unfortunate by-product of this practice means that ambulance resource is tied up and therefore unable to respond to further emergencies.

Of the seven (out of eleven) regional ambulance services who reported, in a fifteen month period, a total of 44,000 cases where ambulances were delayed for more

[4] With reference to the now (in)famous remarks by Chuck Prince, then head of Citigroup, made to Financial Times Japan in July 2007

[5] The BP US Refineries Independent Safety Review Panel, January 2007

[6] See for example 'Scandal of patients left for hours outside A&E' and 'The human cost of forcing ambulances to wait', both reported by The Observer, February 17 2008

than an hour (15 minutes is the standard) were recorded suggesting that this was widespread rather than a few isolated incidents.

The first thing to note is that for ambulances to be stacked requires the authority of a particular management level suggesting that this is an acceptable practice. The real issue is that the value of patient care, i.e. admittance to hospital is being over-ridden by the need to meet treatment time targets.

Consider that the penalty for 'stacking' was higher due to ethical values rather than the penalty for missing treatment targets (performance) would this practice happen.

The answer is obviously no. Having spoken to a number of HR professionals on this matter there is a look of horror at this whole saga. And I would doubt if any medical staff would really accept an ethical argument for not admitting patients in ambulances.

So the question begs why did it happen? What practice that seems to contradict the very foundations of The NHS value set is allowed to be sanctioned by management?

A case of rewarding A (meeting A&E treatment targets), not penalising for B (the disregard for patient care values) and getting C (patient stacking).

This article is not meant as an A-Z catalogue of misalignment of organisational performance and reward. It is merely to show well-documented examples from the world in which we inhabit where organisational practice appears to have badly gone wrong with differing outcomes – all serious in their own right.

How can organisations avoid these types of unintended consequences ('FUBARs')?

First of all, organisations need to have a good grasp of the current organisation dynamics. A starting point would be to define the achieving of various organisation objectives and their drivers with a classical I-T-O[7] model. However, many organisational I-T-O models today are more complex and systemic rather than linear and therefore various techniques and approaches need to be applied to provide realistic representation.

In many instances organisation scorecard-type projects inevitably touch on reward even though their focus has been primarily on drawing up a set of organisation metrics and targets through the use of strategy maps [8]. However, many have only been implemented at top level and have stopped short of migrating into more detailed modelling analysis that looks fully at the system dynamic of organisation operation.

From a people management perspective the interfacing between the various elements such as performance, reward, decision-making, management and communication that exists at various levels requires detailed investigation. Misalignment or conflict between these various elements can quite often occur serendipitously – 'an invisible mischievous hand' so to speak, with varying consequences.

The use of modelling analytics and forensics – the representation of quantitative and qualitative data and evidence can help to model various 'everyday' scenarios and provide insight into the potential for 'misbehaviour' occurring in the pursuit of goals and to what degree and what dynamics are in place for this to happen.

Many organisations have, of course, tried to control the incidence of unintended consequences through focus on values initiatives and in many cases to considerable cost. However, I would argue that attempts to instil organisation values across the board will meet limited success because of the conflicting pay-offs and cultural signs individuals face unless the use of modelling analytics is used to understand the dynamics at work. It is not that instilling values is a bad idea – it is that, too often, initiatives become too aspirational rather than realistic/pragmatic.

These types of organisational modelling exercises should form part of embedded organisational practice [9] in that they are organic and are subject to incremental and subtle changes that can result in much bigger (negative) impacts over time. An understanding of organisational dynamics

[7] Input-Throughput-Output

[8] See for example, 'Strategy Maps', Kaplan R S & Norton D P, HBS Press, 2004

[9] See 'The Enterprise-wide Application of Human Capital Management Intelligence, Journal of Applied Human Capital Management, Volume 2 Number 1 2008

from a people perspective is really where HR functions could be spending a fair proportion of the time in a very value-adding way. However, organisations can choose to buy-in expertise to assist. An internal appreciation from within coupled with external expertise can provide organisations in avoiding costly organisational 'FUBARs'.

Summary

Reward plays a big part (some would testify overly) in the achievement of organisational objectives. Ensuring that reward or penalty mechanisms work to achieve the results intended in the right way is a big challenge. For reward to work well requires due diligence in the area of setting objectives and targets which, I believe, is a much under-estimated area of organisational focus whether at individual or divisional level.

I am always struck by articles that profess insight into this area but examples contained in the narrative are limited, normally either in retail or sales. The organisational world is a far more complex place which demands attention in the right measure. More understanding of organisational dynamics can only be a positive thing.

Rewarding for A, not penalising B and getting C is unfortunately the end-result of inadequate think-through of the whole process. The problem is that the stakes seem to be higher today for organisations and senior managers with corresponding consequences.

As a CEO/CFO I would like to think that I don't need to be kept awake at night by the lurking FUBAR monster because enough attention wasn't paid to the groundwork and monitoring required in the objective/target-reward-decision making pyramid.

The FUBAR monster also doesn't take too much notice of reputations. And in a final tribute to Steven Kerr's original article any senior management executive who has not familiarised themselves with the content shouldn't be being rewarded at all.

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