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Coin Operated

Field Guide preview

Chapter One: Coin Operated

Explore the opening chapter, worksheets and completed examples.

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Chapter 1

Coin Operated

Chapter 1 of the book. Pay is the one instruction everybody checks against a bank balance, so a new chief executive starts by finding every plan and every exception, asking of each one whether the company would gain if everyone hit it, and warning the board in writing what changing them will cost. Instruments: worksheets 1, 2 and 3.

In most companies I've been handed, someone could give me EBITDA to the dollar on my first morning, and nobody could tell me how many pay plans we ran. The plans were in a dozen drawers, the exceptions were in payroll, and no one had ever laid them side by side. These three pages do it before anyone drafts a new plan: every plan, exception and person on variable pay, with last year's payouts against last year's EBITDA, then one question put to each plan out loud, then the strategy's own words set beside what the plans pay for.

At Halvorsen I had all three inside my first month. Larry Dunagan built the first, the leadership team marked the second in a morning, and a question from Andrea Sorrell produced the third the same afternoon. They cost nothing but patience: thirty days in which no plan changed, though several good people asked me to change something and I wanted to myself.

Skip them and you'll go after whichever plan draws the loudest complaints, which is seldom the one costing the most. You'll learn about the guarantee nobody wrote down from the person who loses it. And you'll sit through your first board meeting without an answer to the question my chair asked me on Day 0: what did we pay them for?

WHAT IT LOOKS LIKE WHEN IT IS MISSING

- Ask the controller how many pay plans the company runs and you get a range, then an offer to go and check.
- The payroll register carries commission payments that no plan document on file accounts for.
- Territory managers are credited with house accounts they have never called on, and their statements show it every quarter.
- A spiff started for one product push is still being paid, years after the push ended.
- The leaders' bonus runs on a scorecard of eight or ten measures, and it paid most of target in a year EBITDA fell.
- Nobody can say who set the commission rate, or in what year.
- The year's bonuses reach the board as one line in the pack, with no plan beside it and no change in EBITDA beside that.

The tell is a strategy deck that says margin on every other page and a set of pay plans in which the word never appears.

IN THE BOOK

Chapter 1 argues that pay is the loudest thing a company tells its people, the only part of its strategy that comes every payday with a figure attached, so the plan, not the deck, is the strategy people actually run. It names four ways a plan quietly contradicts the deck: commission on revenue in a business that wants margin, ten measures where the owner reads one, a cap on the sellers you most want selling, and a bonus that pays while EBITDA falls. Its instruments are the pay audit, which in the first thirty days finds every plan, every exception and everyone on variable pay and writes each plan's pay line, the everyone-hits-it test, and a page that sets what the company hopes for beside what it pays for. Then comes a one-page letter to the board, a promise and a price, sent before anything changes. Its rule is that people do what pay rewards, so the plan has to say what you mean. At Halvorsen the audit found seven plans, 61 exceptions and 86 people who had drawn $2,654,000 while EBITDA dropped by $1.1 million, and not one plan passed the test on purpose. Its Do This list, as a checklist:

Inside your first thirty days, get every plan, side letter and exception out of payroll, and count everyone paid anything variable.

Give each plan a one-sentence pay line: the measure it pays on, and how many steps lie between that measure and EBITDA.

Ask the everyone-hits-it question of every plan, aloud, before your leadership team and whoever wrote the plans.

Set last year's variable pay beside what EBITDA did last year, on a single page.

Leave every plan exactly as it is until each one has been rerun against last year's invoices.

Before any plan changes, put the promise and the price in a letter to your board.

WORKED EXAMPLE

Douglas Kinnaird met me on Day 0 with a single sheet, and its arithmetic is worth doing out loud. The eight leaders on the old scorecard had drawn 88 percent of their $564,000 of targets, about $496,000 between them. Clay Kroeger, the VP Sales, had a target of 40 percent of his $215,000 base, or $86,000, and drew 106 percent of it, about $91,000, because revenue had come in at $168.0 million against a $165.0 million budget, 101.8 percent. Meanwhile EBITDA had slipped from $19.6 million at the close, twenty months before, to $18.5 million. Douglas wanted to know what we had paid them for. I told him I'd know in a month.

Larry Dunagan found out from payroll. I'd asked him for everyone who drew a dollar of variable pay in Year 0, names from the payroll register, each dollar traced to the plan or exception that paid it. The plant leads' bonus alone cost him two days: it sat in a spreadsheet at the plant, outside the personnel files, and it took that long to learn who had signed off on it. By Day 30 he had seven plans, 61 exceptions and 86 people (50 in sales, 8 leaders outside it and 28 plant leads). Add the seven plans' Year 0 payouts, $496,000 + $91,000 + $144,000 + $225,000 + $1,580,000 + $24,000 + $94,000, and you get $2,654,000, roughly one dollar for every seven of EBITDA, handed out in a year when EBITDA shed $1.1 million. The territory plan was $1,580,000 of it by itself, 2.0 percent of $79.0 million of territory revenue, and nobody could say who had set the rate.

Plan	People	Paid on	Paid in Year 0	Steps to EBITDA
Leaders' scorecard	8	Ten measures, EBITDA one of them	$496K	Crooked
VP Sales	1	Company revenue vs budget	$91K	Revenue only
Regional managers	4	Region revenue vs budget	$144K	Revenue only
Key account managers	5	0.6% of account revenue, capped at $45K	$225K	Revenue, capped
Territory managers	24	2.0% of territory revenue, uncapped	$1,580K	Revenue only
Inside sales spiffs	16	Product pushes	$24K	None
Plant leads	28	Units shipped vs standard, attendance	$94K	Volume only
86 people			**$2,654K**	

61 exceptions beneath the seven plans. EBITDA fell $1.1M the same year.

Fig. 01-01: Seven plans at Halvorsen, Day 30: $2.65 million of variable pay, and not one plan with a short, straight line to EBITDA.

On Day 28 the seven plans were taped side by side in the old conference room. Clay was there, and so were Milo Eckert, Andrea Sorrell (then our HR director), the plant manager, the VP Engineering and Larry. Larry read the sentences out, one plan at a time, the room marked each one, and two of the marks took an argument before they settled. By the end of the morning five plans read only by accident and two read no. None read yes. Clay, paid 106

percent on revenue, put it more plainly than anyone: the plan had asked his people to sell, and they had. Milo said the same of his plant leads, who were paid for units and had shipped them, the losing Quad 4 orders among them.

The plan	If everyone hit it exactly…	Better off?
Territory managers: 2% of revenue	Revenue up, margin down, more Quad 4 orders	Only by accident
Key account managers: capped at $45K	Orders slide into January once the cap is hit	No
Leaders: ten measures	Five or six measures hit, bonus paid while EBITDA falls	No
VP Sales and regional managers: revenue vs budget	Paid above target in a year profit fell	Only by accident
Inside sales: spiffs	This month's product pushed, whatever the customer needs	Only by accident
Plant leads: units shipped	More of everything shipped, including orders that lose money	Only by accident

The question: if everyone achieved exactly what this plan rewards, would the company be better off?

Fig. 01-02: The everyone-hits-it test, run on Halvorsen's seven plans: none of them passed on purpose.

Then Andrea wanted to know whether the strategy had ever been laid next to the plans. It hadn't, so that afternoon we did it on a second sheet. Margin showed up twice on the left and nowhere on the right. Put Larry's totals beside the right-hand column and you can see why. The VP Sales, the regional managers, the key account managers and the territory managers were all paid on revenue, $91,000 + $144,000 + $225,000 + $1,580,000 = $2,040,000, more than three of every four dollars of variable pay, and not one dollar rode on margin. The letter went to Douglas on Day 30, with the board five days off: three sentences of promise, and two of price, that some of our best-paid people would take home less for the same invoices and a few would go.

WORKSHEETS

The chapter's three worksheets find what the company pays for, test each plan against what the company needs, and set the strategy's words beside the plans'.

Worksheet 1

The pay audit — every plan, every exception, every person on variable pay

Every plan, every exception and every person paid anything variable, on one page beside last year's EBITDA. The controller builds it from payroll in the first thirty days, and the chief executive reads every line.

As of, months covered, and built by

Every plan, the small ones too, names from the payroll register. Steps to EBITDA: none on company EBITDA, one on gross margin, two on revenue, a bend per measure on a scorecard. However you count, tie each total to the ledger.

Plan	People	Paid on	Paid last year	Steps to EBITDA	Keep, fix or end

Total paid, and people on variable pay

Every exception, read in the payments, not just the files. A column for each kind, the count in the first row and who signed them in the second.

House accounts	Split credits	Guarantees and draws	Spiffs still running	Side letters

Variable pay last year, beside EBITDA's change

Halvorsen's version
Larry Dunagan built it from payroll by Day 30 and found 61 exceptions beneath seven plans (22 house accounts, 14 split credits, 11 guarantees and draws never reconciled, 8 spiffs, 6 side letters). Year 0's $2,654,000 was about a seventh of EBITDA, which ended the year $1.1 million lower.

Plan	People	Paid on	Year 0	Steps to EBITDA
Leaders' scorecard	8	Ten measures, EBITDA one	$496K	Crooked, ten bends
VP Sales	1	Revenue against budget	$91K	Two
Regional managers	4	Region revenue against budget	$144K	Two
Key account managers	5	0.6 percent of revenue, $45K cap	$225K	Two, capped
Territory managers	24	2.0 percent of revenue, no cap	$1,580K	Two
Inside sales spiffs	16	Product pushes	$24K	No line
Plant leads	28	Units against standard, attendance	$94K	Volume only
Total	86	Seven plans	$2,654K	

Worksheet 2

The everyone-hits-it test

One question put to every plan, out loud, with the people who wrote the plans in the room, and one of three marks for each. The chief executive asks it, the controller reads the sentences, and the leadership team marks them.

Date, room, and who was in it

Who read the sentences aloud

The question. For each plan in turn: suppose every person on it lands exactly on what it rewards, no further and no shorter. Is the company better off? Finish the sentence with what would happen on the invoices, not what you'd like to happen. Three marks only, and a reason beside each.

Plan	If everyone hit it exactly, we would …	Yes, only by accident, or no	Why	What it pays for that we don't want

Count: yes, only by accident, no

Marks argued over, and how each settled

Each plan's author in the room, or shown the sentence first
Nothing changed on the strength of a mark, pending the rerun

Halvorsen's version
Day 28, the old conference room, one sheet to a plan. Larry Dunagan read the sentences out, and Andrea Sorrell, Clay Kroeger, Milo Eckert, the plant manager and the VP Engineering marked them with me. Two marks took an argument. Five plans came out only by accident, two no, none yes.

Plan	If everyone hit it exactly, we would …	Mark
Territory managers, 2 percent of revenue	grow revenue and lose margin, with more Quad 4 orders	Only by accident
Key account managers, capped at $45K	watch orders slide into January once the cap was hit	No
Leaders, ten measures	hit five or six of them and pay the bonus while EBITDA fell	No
VP Sales and regional managers, revenue against budget	pay above target in a year profit fell	Only by accident
Inside sales, spiffs	push the month's product, whatever the customer needed	Only by accident
Plant leads, units shipped	ship more of everything, the money-losing orders too	Only by accident

WORKSHEET 3

What we hope for and what we pay for

The strategy's own words down the left, what the plans pay for, by the dollar, down the right, and every gap between them named, in both directions. The leadership team builds it in an hour, the head of people runs the room, and the controller brings last year's totals by plan.

Strategy document and date, built by, on

Left, then right. Copy each thing the strategy says the company wants, in its own words: margin, the best customers, cash, new products, whatever it names. Beside each, every plan that pays for it and the dollars riding on it. Where nothing does, leave the right side blank.

What we hope for, in the strategy's words	Plan that pays for it	Dollars on it last year	Gap

Then the other way. Weigh every plan by last year's dollars, whether or not the strategy asks for what it pays.

Paid on revenue last year, and share of all

Paid on gross margin or on EBITDA

Paid for things the strategy never names

Hopes no plan pays anyone to deliver

The left column copied from the strategy, never rewritten to fit the plans
Every gap carried into the rerun and the bridge

Halvorsen's version
Andrea Sorrell's question on Day 28 produced it that afternoon, in the same room, on a second sheet. Margin appeared twice on the left and nowhere on the right. Weigh the right side by Year 0's dollars and it reads like this.

What the plans paid for	Plans	Year 0
Revenue, by the dollar or against budget	VP Sales, regional, key account and territory managers	$2,040K
Ten measures, EBITDA one of them	Leaders' scorecard	$496K
Units against standard, and attendance	Plant leads	$94K
Product pushes	Inside sales spiffs	$24K
Gross margin	None	$0
Total	Seven plans	$2,654K

RUNNING IT WITH THE TEAM

The audit is a desk job for the controller and the payroll lead, and it takes the month. Give them one instruction (names from the payroll register, every dollar traced to a plan or an exception) and one rule: nothing changes while they count. Read every plan document yourself, in the original, as the pages come in. Have the controller do one

plan's year by hand before anything faster touches the rest, so that a wrong total looks wrong. Meet for an hour each week, the controller, the head of people and you, and add each new exception to the page the day it turns up.

The test takes a morning. In the room: you, the leadership team, the VP Sales, the controller, the head of people and, wherever they're still with the company, the people who wrote the plans. Tape every plan to the wall, one sheet each, the small ones included. Open by saying what the morning is for. Plans are being described, nobody is being graded, and nothing changes today. Then the controller reads each plan's sentence and the room marks it.

The head of people runs that room. The job is to hold the marks to three (someone will reach for a fourth, "mostly yes," and it means only by accident), to write the reason beside each mark as it's agreed, and to stop anyone who starts defending a plan or its author. When a mark splits the room, have each side finish the sentence out loud, with numbers. The arithmetic usually settles it. Then you close: read the marks back, say again that nothing changes yet, and name the dates for the rerun, the letter to the board and the next meeting.

Do the hope-and-pay page after lunch, in the same room, while the morning is still fresh. The head of people brings the strategy document and copies its words onto the left exactly as written, and the controller brings last year's totals by plan for the right. It takes about an hour. If anyone wants to reword the left side so the plans look better, stop them. The gap is the finding.

The letter is yours alone, one page in two halves, written that week and sent before the board meets. What goes wrong the first time? The list of names comes from the managers, and payroll turns up a dozen more. A plan's author hears the mark as a verdict, and the room starts softening marks to spare him (it helps to have someone like Clay Kroeger there, paid well under the old plans and plainer about them than anyone). Somebody proposes fixing the worst plan by Friday, and you have to turn down a good idea at the wrong time. And the sentences come back as hopes, "we would grow profitably," instead of what would happen on the invoices.

THREE QUESTIONS FOR MONDAY

1. If your chair asked tomorrow for the number of pay plans you run and the exceptions beneath them, who would answer, and would the count come from payroll?

2. Which of your plans would you mark yes out loud, with the person who wrote it sitting across the table?

3. What does your strategy say it wants that no plan pays anyone to deliver?

BEFORE YOU MOVE ON

You should now have, on paper:

Worksheet 1 — every plan, exception and person on variable pay on one page, names from payroll, totals tied to the ledger

Last year's variable pay set beside last year's change in EBITDA

Worksheet 2 — a sentence and a mark for every plan, with the reason written beside each

Worksheet 3 — the strategy's words against what the plans pay for, every gap named

Each plan marked keep, fix or end, and nothing changed yet

Your letter to the board, the promise and the price, with the date it went