Making Across-the-Board Incentives Work

When a reward goes to everyone in a company, it rarely has a big impact on individual performance. But don't tell that to the employees of Continental Airlines.

by Marc Knez and Duncan Simester

It's common practice in American business to offer incentives to all employees. The hope is that across-the-board rewards, whether in the form of profit sharing, employee stock ownership, or bonuses, will inspire people to work harder toward a company's goals. In practice, though, companywide incentives often produce disappointing results in big companies, at least in part because of what economists call the "free rider" problem. In any large group, individuals perceive that extra effort on their part is unlikely to make much of a difference in overall performance—and that whatever reward is earned by the population as a whole will accrue to them regardless.

The experience of Continental Airlines, however, demonstrates that a company-wide incentive program can make a difference—if it's done right. Until 1995, Continental was consistently one of the worst-performing airlines in the industry. On average, it ranked last among the ten major domestic airlines in on-time arrivals and baggage handling, and first in customer complaints. By 1994, the company's net losses had reached $613 million, and it was teetering on the brink of bankruptcy. As part of a turnaround plan launched by new leaders Gordon Bethune and Greg Brenneman, Continental introduced a group incentive scheme whereby each of its 35,000 nonmanagerial personnel would get a $65 cash bonus in any month that Continental ranked among the top five airlines for on-time departures. It was an ambitious program—and any economist would have predicted a massive free-rider problem. But the program worked. Employees exerted more effort, and planes took off on schedule much more frequently.

Why was the Continental scheme so successful? Through an analysis of the data and discussions with many Continental workers, we've identified four factors that contributed to the program's success.

The Right Performance Measure. Continental chose to tie its bonus to on-time departures, a measure that was attractive in several respects. First, it was an element of performance that could be accurately measured and easily compared with competitors' data. Arrival and departure times are recorded automatically when airplanes enter and leave gates, and this information is collected and reported by the U.S. Department of Transportation. Second, it was a measure that would be directly affected by the actions of crew members and air-
Finally, it targeted something that was clearly critical to the organization's competitiveness: Late flights lead to other difficulties, including delayed baggage and dissatisfied customers.

**Mutual Monitoring.** One of the best ways to avoid free riding is to encourage "mutual monitoring," whereby employees check up on one another and prod one another along. But no one expects this to happen much in large companies. Individuals incur personal risks—such as ostracism—when they watch over and impose sanctions on coworkers. The larger the group, the easier it is to rely on other people to do the monitoring and sanctioning. Mutual monitoring did take place at Continental, however—thanks to two factors. First, although the airline has tens of thousands of employees, the groups working at individual airports are relatively small and highly autonomous. Smaller teams are much more motivated to keep their members in line. Second, the work of all crew and airport employees is highly interrelated—everyone knows that poor performance by one group could endanger everyone's chance to get the bonus.

**Visible Rewards.** Administratively, it would have been easiest for Continental to roll the bonuses into employees' regular paychecks. But the airline recognized the much greater impact of having supervisors hand a separate bonus check to each worker immediately following the achievement. In fact, what the company did roll into employees' regular paychecks were the associated taxes and other withholdings, so that each worker saw the full promised reward—a nice, round $65. Management knew it would seem like more of a windfall that way, an occasion for buying some celebratory treat, and therefore would constitute a more effective incentive.

**Assured Early Momentum.** At the same time that Bethune and Brenneman launched the incentive program, they also enacted changes to the flight schedule, which made on-time performance easier to achieve. As a result, the incentive program was kick-started by positive results in the very first month. In fact, the schedule change was probably more important than the incentive in that first month. But the immediate performance improvement gave everyone the impression that the bonus was working. And once workers began to see that their colleagues were exerting greater efforts, they jumped on the bandwagon.

Continental's bonus program was a resounding success—so much so that after only ten months, management was compelled to raise the bar. Starting in 1996, the $65 payout occurred only if Continental ranked among the top three airlines. (If it ranked first, the reward was $100.) In addition to increased employee effort and mutual monitoring, management saw reductions in employee turnover, on-the-job injuries, and sick days. By the end of 1996, the bankruptcy threat was averted. And by 1997, Continental's profits climbed to $385 million.

There were, of course, many reasons for the turnaround, but it seems clear from our research that the bonus program made a major contribution to changing employees' attitudes and strengthening their performance. Any management team considering an across-the-board incentive scheme could learn a lot from Continental's experience.

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