

**Compensation and Incentive System  
Design Study**

**Independent Analysis of Incentive Compensation at the  
United States Postal Service**

**Submitted to:**

**President's Commission  
on the United States  
Postal Service**

**June 6, 2003**



**President’s Commission on the United States Postal Service**  
***Compensation and Incentive System Design Study***

---

***a) Table of Contents***

<b>Section</b>	<b>Page Number</b>
a) Table of Contents	2
b) Executive Summary of Recommendations	3
c) Assignment Background and Objectives	4
d) Research Methodology, History of Incentives at the USPS, and Considerations	5
e) Incentive Compensation Plan Design Best Practices	8
f) Study Findings and Recommendations	12
g) Appendix	18



# **President's Commission on the United States Postal Service**

## ***Compensation and Incentive System Design Study***

---

### ***b) Executive Summary of Recommendations***

Watson Wyatt Worldwide is pleased to report the results of the Compensation and Incentive System Design Study we have conducted for the President's Commission on the United States Postal Service.

We believe it is possible to design an incentive compensation plan that will provide strategic direction and engage all employees in the goal of improving Postal Service productivity, reducing costs, enhancing customer service, and supporting the mission of the Postal Service. From our analysis, we believe that the current National Performance Assessment program (launched for fiscal year 2003 for USPS management), can be cascaded with some modification to the balance of the career employee workforce. The envisioned non-management program would be self-funded by operational financial improvement, calibrated by productivity and balanced against mission achievement.

The primary focus of a non-management program would be to reinforce and reward employees for:

- improvements in productivity
- teamwork, flexibility and responsiveness to meeting customer service levels, and
- implementing and supporting new management systems.

Our findings and recommendations are distilled from an analysis of broad USPS financial data, discussions with Postal Service associates at various levels along the spectrum, and Watson Wyatt's expertise in effective incentive plan design. At this stage of development, many of our positions are conceptual and provisional, requiring more specific Postal Service information, further modeling and testing. Significant work undoubtedly needs to be accomplished in the labor relations area. From our contact during this assignment with rank and file USPS employees, and with their bargaining unit representatives, we believe that employees appear to be more receptive to the idea of variable pay than are their union representatives.

The United States Postal Service is a complex business organization. Although change can be difficult to create within such an institution, the scale is so large that small individual improvements quickly aggregate to massive system benefits. We believe that a variable compensation program as we have described in this report can improve efficiencies in the system, and help accomplish the USPS mission on a more cost effective basis with a lower human capital content. Success will depend on proper implementation, communication, and the support of effective human resources processes such as training and performance management.



***c) Assignment Objectives and Project Background***

***Assignment Objectives***

Watson Wyatt was retained to assess the viability of an incentive compensation plan to engage all levels of the Postal Service workforce. The key issues addressed in our research and analysis is included:

- Can an all-employee incentive compensation plan work at the USPS?
- If an incentive plan is viable at the USPS, what are the fundamental drivers for engaging the workforce?
- What are the organizational and operational considerations for a successful incentive compensation plan?

This report provides answers to the above questions as well as a recommended incentive design framework. It also includes criteria for cascading performance goals to motivate and engage USPS employees in operational improvement objectives (productivity, efficiency, quality, use of resources and customer satisfaction). The report discusses important design considerations and criteria for success. To support our recommendations and criteria, we have used published USPS performance data to illustrate various elements of our recommendations.

This report is intended as a high-level feasibility assessment and a theoretical examination of fundamental improvements that could be achieved by using an incentive compensation plan. Watson Wyatt was not contracted to provide financial modeling, assessment and analysis of current cash compensation, development of plan documents, and plan implementation and employee communication.

***Background***

Executive Order No. 13278 established the President's Commission on the United States Postal Service (the Commission) for the purpose of examining the state of the United States Postal Service (USPS), and to prepare and submit a report articulating a proposed vision for the future of the USPS and recommending the legislative and administrative reforms needed to ensure the viability of the USPS. The Commission sought specialized assistance from Unisys/Watson Wyatt in designing a compensation incentive system that will engage all levels of the Postal Service workforce in the goals of improving Postal Service productivity, reducing costs, enhancing customer service, and supporting the mission of the Postal Service.

***d) Research Methodology, History of Incentives at the USPS, and  
Considerations***

***Research Methodology***

Because of a compressed timeline, our research was limited to interviews at USPS headquarters, postal worker union representatives and randomly selected employee groups from Northern Virginia processing and distribution centers. We initially met with finance, human resources and labor relations executives at the Postal Service headquarters in Washington, D.C. to gather information on past and current incentive plans, operational data and labor union contacts. Next, we met individually with six labor union and management association presidents (or their designees) to discuss their viewpoints on operational improvement opportunities, the motivational effect of an incentive plan, and the overall viability of an incentive plan.<sup>1</sup>

To gauge employee perceptions, we visited the Merrifield, Virginia processing plant to conduct focus group meetings. In total we conducted four focus groups involving approximately 40 employees. The purpose of these meetings was to gather employee perceptions and advice on opportunities for improvements within their areas of activity and their reactions to incentive opportunities.<sup>2</sup> We spoke with small (approximately 8-10 employees), yet diverse, volunteer groups of clerks, mail handlers, letter carriers and supervisors. Focus group participants were forthcoming on issues such as productivity, customer service, employee engagement and incentive compensation.

Finally, we returned to Postal Service headquarters to meet again with finance, human resources and labor relations executives to gather more refined viewpoints and data on improving productivity, reducing costs and enhancing customer service.

***History of Incentives at the USPS***

The Postal Service has been a pioneer in incentive pay programs within the federal government. These programs, which were designed to link incentive compensation to employee and organizational performance, have successfully improved customer service levels and productivity. Postal Service incentive plans include:

***Striving for Excellence Together (“SET”) – Fiscal years 1991 – 1994***

Initially, this incentive plan was implemented within the mail handlers and rural carrier union represented employees and later extended to all non-bargaining employees. SET utilized two customer service measures and one organizational financial performance measure. Although the plan created organizational and employee alignment as evidenced by some employee and management collaboration, it was cancelled at its intended sunset. The payouts in the 1994 fiscal year proved to be less than meaningful to employees.

---

<sup>1</sup> See Exhibit 1 in Appendix for Union leader contacts

<sup>2</sup> See Exhibit 2 in Appendix for focus group questions



**President's Commission on the United States Postal Service  
Compensation and Incentive System Design Study**

---

***d) Research Methodology, History of Incentives at the USPS, and  
Considerations***

***Economic Value Added (EVA) Variable Pay Program and Individual Merit Pay  
Program – Fiscal years 1996 – 2001***

The EVA plan was developed and implemented to reinforce the organizational directive that the Postal Service should be managed similar to a business with the goals of improved customer satisfaction, reduced costs, and improved productivity. The plan was available to approximately 83,000 Executive and Administrative Schedule (EAS) and 800 Postal Career Executive Service (PCES) employees. According to USPS reports and studies, extraordinary accomplishments were realized while EVA was in place, including significant improvements in:

- Net income
- On-time delivery
- Labor intensity (total personnel costs as a percentage of operating expense), and
- Workday injuries per 200,000 work hours.

The EVA incentive compensation plan was a team-based, gain-sharing plan that was funded by audited financial performance, and had pre-established, objective goals and targets. Despite the EVA incentive compensation plan's success, according to USPS it was cancelled after the 2001 fiscal year due to outside criticism and political pressure.

***National Performance Assessment (NPA) – Effective fiscal year 2003***

Similar to the previous EVA plan, the newly implemented NPA plan is based on a balanced scorecard approach of organizational measures. Objective measures, including customer service, employee productivity, and business productivity, are pre-established and results are measured for each Performance Cluster, each Area, and nationwide. The plan will be funded through improved business performance. Plan rewards (including lump sum incentive payments and base salary increases) will be allocated based on individual performance assessment. An individual's performance will be assessed such that 70% of the evaluation will be based on contribution to corporate/individual success and 30% of the evaluation will be based on contribution to core requirements of the position.

Based on individual performance and the employee's salary level relative to the salary range maximum, salary increases can range from 0% to 14%. In addition, lump sum incentive payments (as a percentage of base salary) can range from 1% to 6% for those rated as contributors to as much as 15% for those rated as exceptional contributors. According to USPS representatives, incentive payments earned above the current statutory salary cap are deferred (determination of deferral payout timing to be determined by the USPS Board of Governors).

This plan is currently available to all PCES employees and may possibly be available to both EAS and PCES employees in fiscal year 2004. It should be noted that according to USPS executives, senior management has been willing to extend these programs to collectively bargained employee groups, but has met resistance by union leadership.



## **Considerations**

### **Prevalence of Incentive Programs**

Variable incentive designs have increased in popularity and prevalence nationally because they provide a means of controlling costs, supporting long-term cultural change efforts, and directing performance toward the accomplishment of business objectives. According to the 2002-2003 Industry Report on Technician and Skilled Trades Personnel Compensation report published by Watson Wyatt Data Services, 68% of survey respondents (or 996 organizations covering 405,302 employees) indicated they currently have a bonus or variable pay program in which technician and skilled trades personnel participate. Of the 405,302 incumbents for whom data were reported, 34.6% received variable pay awards in 2001 averaging 5% of base pay.

Although employers with collectively bargained workforces are not specifically segregated in the study, not-for-profit organizations (whose not-for-profit status may be likened to that of the USPS) are well represented. The report indicates that approximately 48% of not-for-profit organizations currently have a bonus or variable pay program. Additionally, in this same survey, another 14% of survey respondents (or 593 organizations) indicated that they will install new variable pay programs for technician and skilled trades personnel in the next two years. Not-for-profits reported an even higher rate of 18%.

The National Compensation Survey: Occupational Wages in the United States, January 2001 (released in January 2003) prepared by the U.S. Department of Labor Statistics indicates that among the blue collar occupational group, employees with wages that are at least partially based on productivity payments such as piece rates, commissions, and production bonuses earn approximately 12% more per hour than those workers whose wages are based solely on an hourly rate or salary. Although no conclusions are drawn by the Department of Labor on this differential, it might be indicative of higher overall pay for higher personal performance. In other words, those employees that are focused on performance objectives tend to achieve those objectives and are rewarded.

### **Incentive Plans in Collectively Bargained Environments**

The 2002 Employer Bargaining Objectives survey of establishments with collective bargaining agreements was conducted by the Bureau of National Affairs. Among other things, the survey examined the prevalence of incentive and variable pay plans in current contracts. According to their research (all employers, both manufacturing and non-manufacturing), 16% of employers utilize group incentive plans, 10% utilize gain-sharing plans, 9% utilize individual incentive plans, and 7% utilize profit-sharing plans. These percentages are approximately 50% higher for manufacturing (processing) concerns. Also, according to the research report 10% of the surveyed employers hope to establish at least one new incentive in their next agreement, and 7% will bargain to expand one or more current variable pay systems.

***e) Incentive Compensation Plan Design Best Practices***

***Role of Incentive Plans***

Rewards are fundamentally communication vehicles, sending messages that are consistent with, and that reinforce, other messages employees are receiving about business goals, desired behaviors and culture. Organizations that use incentive plans effectively recognize that an incentive plan is but one component of the total reward philosophy of the organization. Other essential components to engage and reward the workforce include wages, benefits and recognition programs, as well as opportunities for skill training, communications, performance management, employee involvement and safe working environments.

As organizations are pressured to achieve higher levels of performance and productivity, they are searching for ways to leverage limited resources. Variable incentive pay is the number one design used to influence short- to mid-term business results. Coupled with astute strategy, solid leadership and good working conditions, variable pay incentive designs can:

- Communicate priorities to indicate the relative importance of certain objectives and goals of the organization
- Engage employees in business success by sharing the gains realized from changed behaviors
- Reward valued skills and behaviors
- Create business literacy by educating employees on how and why their contributions will benefit them and their organizations
- Create esprit and solidarity through a common cause and renewed energy, and
- Contribute to a compelling place to work.

In highlighting the qualities of an effective incentive plan, it is also important to consider what an incentive plan cannot do. An incentive plan cannot:

- Replace trusted, quality leadership
- Create results where barriers exist that inhibit performance (for example, technology deficiencies or process inefficiencies)
- Fix an outdated or ill-conceived business strategy, or
- Meet all of an organization's human resources objectives.

Because the purpose of variable incentive plans is to energize and focus employee efforts, the design must "fit" the culture and specifically address the needs of the organization. To this end, the design process is often iterative and complex. An effective plan design must be based on a philosophical underpinning, clearly defined objectives, line of sight metrics, appropriate performance periods, reasonable investment returns and, most importantly, communication, coaching and performance management. More information about these and other factors is presented below.



***e) Incentive Compensation Plan Design Best Practices***

***Factors Influencing the Effectiveness of Incentives***

An effective incentive program motivates employees toward desired performance behaviors that translate into results for the organization and rewards for the employees participating in the program. An effective Postal Service incentive plan should cause employees to do something that they would not otherwise do if the plan did not exist.

Although a variety of issues can impact the effectiveness of an incentive plan, the items below constitute key elements that should be considered when assessing the Postal Service's ability to translate an incentive plan idea into a viable, robust reward tool. The greater the degree to which these elements exist in the USPS, the more likely it is that an incentive plan will produce the desired performance and a reward that is considered worthwhile by participants.

***Plan Design***

- The plan design effectively aligns strategic operating priorities with desired employee behavior
- Performance metrics appropriately balance competing priorities, including productivity and quality
- Stakeholders concur that targeted performance levels are realistic and potential incentive payments are fair, thereby creating a “win-win” work environment

***Simplicity***

- The plan design (including measures, relevance to employee behaviors, and payout potential) must be easy to understand by all employee levels
- The plan should be simple enough that it easily engages employees to work toward USPS objectives (simplicity must relate to complexity of jobs participating)

***Implementation and Communication***

- The design and related implementation communications are pre-tested for clarity and understanding
- Communication of performance results and progress toward goal attainment is comprehensive and clear
- The measurement, tracking and reporting process is regarded by all as credible and reliable

***Line-of-Sight***

- Employees must believe they are able to make an impact on the objective being measured through their performance
- An action causes a reaction (positive or negative) – individual performance or impact is recognized by the immediate supervisor



***e) Incentive Compensation Plan Design Best Practices***

- Employees understand and embrace the performance measures
- Performance measures should cascade down through the USPS (i.e., narrower in scope with each descending responsibility level, but still aligned with the strategies supported by the NPA plan)

***Integration of Plan with other Organizational Processes and Systems***

- The incentive plan performance measures are integrated within a rigorous performance management process that sets expectations, measures performance, and provides feedback to employees about how well they are meeting expectations
- The performance management process translates, encourages and reinforces behaviors that lead to positive results
- A process exists for employees to provide feedback regarding barriers to performance improvement and to participate in problem solving aimed at eliminating barriers and improving business performance

***Return on Investment***

- To be successful, the plan must generate more return for the USPS than is paid to employees
- Positive financial returns must be carefully balanced against other non-financial measures

***Culture and Organizational Context***

- A level of open communication and trust exists among peer employees and between levels within the USPS
- Units, divisions and departments embrace teamwork, especially where work processes cross such boundaries
- Consistent messages are sent about what's important and required from employees in terms of results and behaviors

A well designed and implemented incentive plan can actually facilitate a change of culture over time. For example, an incentive plan that focuses on measures that span work groups, encourages employees to think about work beyond their own team and to focus on the “hand-offs” that occur from one group to another.

***The Design Process***

As indicated earlier, the design process is iterative. While there is a logical, sequential design process to follow, individual design decisions often overlap and should not be considered final until all design features have been finalized. Following is an outline of the primary design steps:

**President’s Commission on the United States Postal Service  
 Compensation and Incentive System Design Study**

***e) Incentive Compensation Plan Design Best Practices***

<b>Design Step</b>	<b>Key and Design Issues</b>
Develop Philosophical Underpinning	<ul style="list-style-type: none"> <li>• Where does variable incentive pay fit into USPS total reward philosophy?</li> <li>• When do we use it and what is the value proposition to employees? To the organization?</li> </ul>
Establish Plan Objectives and Purpose	<ul style="list-style-type: none"> <li>• Overall purpose and expected outcomes of the design</li> </ul>
Select Plan Participants	<ul style="list-style-type: none"> <li>• Eligibility, including collectively-bargained employees</li> <li>• Impact on cross-organizational processes</li> </ul>
Develop Performance Measures/Metrics	<ul style="list-style-type: none"> <li>• Desired results / work behaviors</li> <li>• Business success factors</li> <li>• Line-of-sight; simplicity</li> </ul>
Perfect Targets, Leverage and Administrative Mechanisms	<ul style="list-style-type: none"> <li>• Formulas (based on stretch performance)</li> <li>• Modifiers / triggers</li> <li>• Performance period and payout frequency</li> <li>• Performance tracking and reporting capability</li> </ul>
Assess Plan Funding and Return on Investments	<ul style="list-style-type: none"> <li>• Budget</li> <li>• Evaluation of effectiveness</li> </ul>
Prepare for Plan Implementation and Ongoing Performance Management	<ul style="list-style-type: none"> <li>• Communications</li> <li>• Coaching and feedback</li> <li>• Integration with other operating and performance management initiatives</li> </ul>

It is critical to include in the design process ample time to adequately identify, evaluate and balance performance metrics. The performance metrics must be properly matched to employee level for engagement purposes. It would not be prudent to establish performance metrics for craft employees that bear no relation to their everyday responsibilities (i.e., no line-of-sight).



### *f) Study Findings and Recommendations*

#### *Can an all-employee incentive compensation plan work at the USPS?*

From Watson Wyatt's point of view, an organization-wide incentive program with set targets and cascading performance goals designed to motivate individuals and engage all USPS employees in specific behaviors related to improving productivity, reducing costs and enhancing customer service makes very good sense. We believe, if designed correctly, it could result in improved financial performance and help illuminate improvement opportunities between operating units engaged in collection, processing and delivery. We are of the opinion that an organization-wide incentive design would also enhance solidarity among the ranks and serve to create line-of-sight for employees between their contributions and attainment of USPS's operating objectives.

Obviously, there are important considerations in evaluating the viability of an all employee incentive plan, such as union and employee support. Further, the plan must be designed to be self funded.

#### *If an incentive plan is viable at the USPS, what are the fundamental drivers for engaging the workforce?*

Inasmuch as the National Performance Assessment Program has recently been put in place for USPS management, we have focused our recommendations on the creation of a complimentary, cascaded design for the 754,000 USPS field career employees. Our preliminary incentive design criteria for these employees are that the plan would be:

1. Self-funded
2. Calibrated by productivity and mail volumes
3. Triggered by mission achievement.

Following are recommended design criteria:

1. **Self Funded:** The new plan should be self-funded, which means that USPS shares a portion of improved economic gains with employees.
2. **Calibration:** We believe that metrics that correlate with improved financial results should be used to set targets, track progress and determine award values for employees. From the USPS 2002 Annual Report we calculate that fully 79% of USPS's 2002 operating costs are related to the provision of compensation and benefits for employees. Therefore, we believe that good measures for tracking improved financial results are those associated with improved productivity and efficiency. For this reason, we believe that a target set around "Pieces per Employee" that move through the postal service system will appropriately track and report operating efficiencies for employees engaged in mail collection, processing and delivery. As a safeguard for service quality, it is anticipated that

### *f) Study Findings and Recommendations*

a second measure, such as percentage of ontime delivery, would serve as a “trigger” or threshold under which productivity improvements would be penalized.

Total Factor Productivity (TFP) which the Postal Service has used to track productivity for several years, is an alternative metric to Pieces per Employee. However, as it incorporates labor and capital productivity, it is further removed from the labor component of the productivity equation. Further, even when process improvements are achieved via, for example, new technology or other capital investments, eventual cost reductions (a key goal) are primarily realized by lower labor content.

We believe that the Pieces per Employee measure has several very functional attributes:

- It is simple to understand by all employees
- Its line of sight is short, relating to the work of nearly every Postal Service field employee
- The numerator of the formula, i.e., pieces of mail processed through the system, and the denominator, employees, are currently tracked and publicly reported by the Postal Service
- Employees are likely to trust the reported numbers
- The measure is the essence of productivity; performance can be enhanced by processing more with static resources and/or reducing resources, and
- The measure could be the foundation of a communication program to educate employees on the interrelationships between employees and departments/units on getting the mail collected, processed and delivered.

One of the few shortcomings of this measure is that its relation to cost reduction or revenue generation is indirect. That is, individual and group productivity can improve in an environment of escalating costs for compensation, benefits, equipment, etc., and the improvements are obscured.

3. **Mission:** According to USPS officials, failure to achieve on-time delivery service levels over a period of time is predictive of decreased mail volume and heightened customer dissatisfaction. Inasmuch as achievement of the USPS's universal distribution mission is financially bolstered by first class mail and package services, customer loyalty is an important component of the USPS business model. As such, our recommendation is to use achievement of customer



# President's Commission on the United States Postal Service

## Compensation and Incentive System Design Study

### *f) Study Findings and Recommendations*

service guarantees at current national levels as a “proxy” for customer loyalty and satisfaction and to set a performance threshold below which the plan does not pay, regardless of improvements in productivity.

#### *Measurement of Pieces Per Employee*

We recommend that the “Pieces per Employee” (PPE) performance be measured at the district or “cluster” level and be conducted on a quarterly basis. The performance bonus pool would be generated on a quarterly basis for PPE over a threshold and paid to employees within 30 days of quarter’s end. It is also our recommendation that the measurement of pieces of mail be done as it is currently. To convey the message that performance is in the control of front-line employees, it is recommended that the numerator of “employees” be defined as field career employees assigned to a Performance Cluster or appropriate district. Removed from this group are all employees participating in the National Performance Assessment, other headquarters personnel and all non-career employees.

#### *Illustration of Past Pieces Per Employee Results*

The following table, from data disclosed in the USPS 2002 Annual Report, shows the PPE for the last five years:

<b>Pieces Per Employee Results 1998-2002</b>				
Year	Field Career Employees <sup>3</sup>	Pieces of Mail (millions)	PPE	% Change from Prior Year
2002	743,000	202,822	273,000	+ 0.55%
2001	764,000	207,463	271,500	+ 1.23%
2000	775,000	207,882	268,200	+ 4.56%
1999	786,000	201,644	256,500	+ 1.75%
1998	781,000	196,905	252,100	

From our calculations, over a five year period, a compounded annual rate of improvement of 1.6% was accomplished with only the existing recognition and reward programs. From remarks of Postmaster General Potter in the 2002 Annual Report, the 2002 results contributed to Postal Service cost avoidance of \$2.8 billion. For illustrative purposes, the USPS might consider an annual PPE productivity improvement of 1.6% as a threshold level of improvement, at or below which no additional rewards should be made. The portion of financial gain above the threshold to share between employees and the USPS must be modeled.

<sup>3</sup> Exclusive of headquarters and non-career employees.



#### *Plan Cost and Return on Investment Illustrations*

To assess whether the underlying plan design concept is viable, it is necessary to illustratively model plan costs and return on investment. The modeling is based on information found in the USPS 2002 Annual Report.

Total direct compensation, i.e., salaries and wages, in 2002 were disclosed to be \$36.9 billion for all USPS employees. Based on our assumption that, on average Headquarters compensation is 120% of field career compensation, and non-career employee compensation is 20% of field career, we arrive at an average annual total pay for field career at \$47,800. This would include overtime pay. It is estimated that benefits would add an additional 30%, or \$14,400 to the average total annual cost per field career employee, for a total of \$62,200. A more detailed analysis can be conducted as the bonus plan design is refined.

Watson Wyatt surveys show that many organizations pay bonuses to employees below the management levels, as presented earlier. The average bonus as a percentage of salary or wages is shown to be very modest in some sectors, such as not-for-profit organizations. It is our belief that bonuses as little as 2.5% to 3% of wages can draw employees' attention and begin to encourage work-related behavior changes. At the other end of the reward spectrum, we do not believe it is necessary to award more than 7% to 8.5% of wages to achieve full employee involvement in the program. It is also essential that incentive payouts have noticeable volatility, including zero to avoid establishing an entitlement attitude among participants. With the population we have defined as eligible for the broad-based employee bonus plan, 3% of compensation is about \$1.07 billion and 7% is nearly \$2.5 billion.<sup>4</sup>

What level of productivity improvement or revenue generation is necessary to fund these payouts? Revenues achieved through postal rate increases must be removed from the bonus calculations. Further, revenues are a suboptimal measure since it is not clear how employees in the group we are addressing can drive demand, other than the practice of effective customer relations by those who have public contact.

The true leverage in the plan concept is to process the same or greater level of production with fewer resources. If mail volume declines, the human capital content must decrease more rapidly. All this must be accomplished either through improved individual productivity or advances in technology. Many employees we spoke with in the focus groups believe individual productivity can be improved.

---

<sup>4</sup> However, since the payroll includes overtime, these figures are likely overstated for a bonus plan that would be calculated based on straight-time salary or wages.



## President's Commission on the United States Postal Service

### Compensation and Incentive System Design Study

#### f) Study Findings and Recommendations

Static examples of productivity improvements necessary to fund bonus pools are calculated in the following table. Although we recommend that the unit of measurement be at a Performance Cluster or district level, until those figures are analyzed, we present calculations on a system-wide basis.

A. Expected improvement in PPE at annualized 1.6% (2002: 273,000 PPE $\times$ 1.016 = 2003 Minimum PPE)	277,400
B. Human capital reduction to achieve 2003 Minimum PPE [2002 Employees minus (2002 Pieces $\div$ Minimum PPE)]	12,000 employees
C. 2003 Pieces to achieve Minimum PPE (2002 Employees $\times$ 2003 Minimum PPE)	206.4 billion
D. Cost to fund 3% bonus pool (i.e., Threshold Bonus)	\$1.07 billion
E. Total human capital reductions to fund 3% pool [(\$1.07 B $\div$ \$62,200 cost per field employee) + 12,000]	29,200 employees
F. Threshold <i>quarterly</i> bonus for \$40,000 employee @ 3%	\$300
G. Cost to fund 7% bonus pool (i.e., Superior Bonus)	\$2.5 billion
H. Total human capital reductions to fund 7% pool [(\$2.5 B $\div$ \$62,200) + 12,000]	52,200 employees
I. Superior <i>quarterly</i> bonus for \$40,000 employee @ 7%	\$700

In the above example, presented for illustrative purposes only, a dynamic model would include a combination of mail volume volatility as well as human capital efficiencies. With static mail volume assumed in the illustration, the number of employees becomes dynamic. Clearly, headcount reductions cannot continue indefinitely at the USPS. Therefore, at some future point efficiency gains based on this incentive plan will stagnate and the incentive plan may need to be recalibrated. We would advise the Postal Service to carefully evaluate these issues annually.

In Line B above, the cost avoidance of \$62,200 for each of 12,000 employees is about \$750 million, approximately three-quarters of our estimate of the total increase in compensation and benefits for 2003. In Line C, an increase of 3.6 billion pieces, at an average rate of \$0.33 per piece (based on 2002 volume and revenues) would generate





# President's Commission on the United States Postal Service

## Compensation and Incentive System Design Study

---

### *f) Study Findings and Recommendations*

about \$1.2 billion of additional revenue. It is the cost avoidance or cost reductions above these levels that are expected to fund the employee incentive pool. In addition, depending on USPS's human resources strategies regarding increases in wages, it may be possible to divert these wage costs from fixed to variable expenses and assist in incentive pool funding.

It is expected that declines in service quality will severely affect the funding of the incentive pool. From an achievement of mission point of view, we believe it is prudent to set Performance Cluster/district on-time delivery levels as the threshold for plan payment. To the extent current levels cannot be maintained, the plan would not make incentive payments. This incentive plan design element will clearly communicate to employees the critical organizational objective of customer service and satisfaction.

#### ***What are the organizational and operational considerations for a successful incentive compensation plan?***

Setting performance targets is a crucial exercise in the operation of any incentive plan. If the probability of achieving some payment from the plan is seen as too low, it will not motivate participants to change behaviors. Indeed, it could have a damaging effect on employee morale and their attitudes toward Postal Service management. On the other hand, goals that are set too low provide inadequate returns to the organization and an entitlement expectation among employees, which may not be reversible without damage to morale. The definition of precise performance targets, triggers, performance periods and other administrative design elements requires data analysis and modeling with actual performance information.

Performance measurement periods need to be tied closely to process periods and the nature of the jobs covered by the plan(s). As a broad generalization, craft employees' individual and group performance should be measured and communicated frequently (daily, weekly, and monthly), whereas executive and management performance should be measured and communicated on a somewhat longer time horizon (monthly, quarterly, and annually). While the performance cycle for the employee group we are addressing should have a short time horizon, it must be long enough to gauge productivity properly. Until we know more about the measurement process and other ingredients of productivity in the Postal Service, we believe quarterly cycles balance these issues.



# President's Commission on the United States Postal Service

## Compensation and Incentive System Design Study

### ***g) Appendix***

#### ***Exhibit 1 – Union Leaders Participating in Study***

Mr. William Burrus, President	American Postal Workers Union, AFL-CIO
Mr. Gus Baffa, President	National Rural Letter Carriers' Association
Mr. William Young, President	National Association of Letter Carriers, AFL-CIO
Mr. Steve LeNoir, President	National League of Postmasters of the United States
Mr. Vincent Palladino, President	National Association of Postal Supervisors
Mr. Bruce Lerner, General Counsel	National Postal Mail Handlers Union

#### ***Exhibit 2 – Employee Focus Group Questions***

1. If you were to tell me that the USPS had a great year last year, what measures would you point to as proof?
2. Are employees as productive as they can be? If not, what are the obstacles?
3. Please provide your thoughts and ideas on measuring your work.
4. Why is customer service important? How do you know when you have met customer service expectations?
5. Would you like an incentive compensation plan? Why?

