

# ISSUES IN DELIVERY OPERATIONS - CAN VARIABLE PAY SCHEMES REALLY WORK?

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# ISSUES IN DELIVERY OPERATIONS – CAN VARIABLE PAY SCHEMES REALLY WORK?

## ABSTRACT

Ongoing changes in business objectives increasingly result in implementation of different business strategies striving to improve the workers' performance. In that context, variable pay schemes have been utilised to increase employees' motivation and productivity. Unlike the sales and warehouse sector, a number of issues emerge with respect to the variable pay schemes in delivery operations. The paper aims to examine issues and challenges associated with the introduction of variable pay schemes in the field of delivery operations. In this paper, we illustrate and analyse a case study from delivery operations of the FMCG sector in the market of Bosnia and Herzegovina. In this sense, the paper addresses the following research questions: What is the intended purpose of variable pay schemes? Which variables affect delivery operations? Why delivery performance should be carefully monitored? Which external factors influence delivery driver productivity? Can variable pay schemes attract, motivate or retain employees? Can variable pay schemes really work in delivery operations? The discussion presented in the paper has important practical implications related to workforce management and may be useful to managers and other subjects involved in designing pay and reward structures.

**Keywords:** Delivery operations, variable pay, workforce management, FMCG sector, Bosnia and Herzegovina

## 1. Introduction

The traditional distribution supply chain of an industrial company is characterized by the direct delivery of large orders from factory to customer and the use of distributors, agents or wholesalers for the delivery of small orders to customers on a geographic basis (Waters, 2010). As a result, logistics activities can be heterogeneous and are also intangible, e.g. the storage or delivery of goods, and perishables, e.g. a lorry leaving on its delivery route. In light of this, Waters (2010) emphasizes that the Business-to-business (B2B) environment is more

stable than the Business-to-customer (B2C), with a more defined customer base and a better understanding of demand patterns.

Nowadays, traditional pay systems have been revised in response to changing business objectives and new forms of work organisation (Arrowsmith et al., 2010). In that sense, Yeh et al. (2009) emphasize that today performance-based pay systems are commonly implemented in workplaces as a business strategy to improve the workers' performance and reduce labour costs. Consequently, organizations are increasingly using variable pay plans to reward employees for the results that they achieve (Miceli,

Heneman, 2000). The increased use of variable pay can also be explained by the growing internationalization of product and capital markets (Kurdelbusch, 2002). In general, a major difference between fixed and variable pay is that the former is a risk-free option while the latter involves uncertainty and risk (Dohmen, Falk, 2010).

It is often argued that variable pay links pay and performance but may also help firms to attract more productive employees (Eriksson, Villevall, 2008). In spite of the growing use of variable pay schemes in firms to increase employee motivation and productivity, Burke & Hsieh (2006) emphasize that the choice between fixed and variable pay affects the firm's employee productivity, operating leverage, market risk, cost of capital, and cash flows. Although variable pay is commonly associated with many positive individual and organisation level outcomes, the literature suggests that variable pay plans in general are failing to provide individual performance results (Ducharme, Podolsky, 2006).

Unlike the sales and warehouse sector, a number of issues emerge with respect to variable pay schemes in delivery operations. Using a case study from the FMCG (fast-moving consumer goods) sector in the market of Bosnia and Herzegovina, the paper aims to examine issues and challenges associated with the introduction of variable pay schemes in the field of delivery operations. To this end, the paper is structured as follows. Following the introduction, the second section provides insights into variable pay schemes. The third section deals with a case study comparing delivery performance with regard to employees' fixed and variable pay and their impact on the employees' performance. Finally, the paper closes with conclusions drawn from the study.

## **2. Insights into variable pay schemes**

Variable pay has been identified as a method of rewarding employees for the results they achieve in organizations (Heneman, 2002). Recognizing the limitations of base pay, employers are embracing variable compensation as a means of aligning employee behaviour with organizational goals (Smilko, Van Neck, 2004). Likewise, Armstrong (2002: 19) highlights the ability of variable pay to form a partnership between employees and the organization, to vary pay costs with performance, and to create the need for high levels of teamwork and collaboration. According to Hill (2001), there are four pri-

mary reasons why companies are introducing variable pay programmes: (1) to thank employees, (2) to address pay equity, (3) to reduce fixed salary costs, and (4) to create value/share gains. However, managers and employees need to consider the potential gaps between the intended purposes of variable pay schemes and their actual implementation to assess whether they are of potential benefit (Trif, Geary, 2016).

With regards to different stages of the organizational life cycle, rebalancing fixed and variable pay in the compensation structure can help organizations design an optimal compensation strategy for building competitive advantage (Madhani, 2010a; Madhani, 2010b; Madhani, 2011). Additionally, realigning cost in terms of appropriate balance of fixed and variable pay reduces operating leverage and hence mitigates negative impact of business cycle stages such as recession on the organizations (Madhani, 2011).

The investigation of variable pay schemes should also take into consideration cultural differences and the work environment as possible reasons for problems or misunderstandings in the workplace. As stressed by Hill (2001), the effectiveness of variable pay in any company will not be related to outside success, but rather to the company's own culture and work environment. Similarly, Brown (2002) argues that variable pay plans need to be tailored to the characteristics and culture of each country and organization. In that context, three universally essential requirements need to be fulfilled:

- (1) plans need to be introduced as part of a total rewards strategy aligned with the organization's goals,
- (2) plans must fit with the structural features and dynamics of the organization,
- (3) plans have to be developed and operated in conjunction with a comprehensive employee involvement and communications approach.

The study by Dell'Aringa et al. (2005) reveals that schemes of variable pay are more likely to be introduced where new work practices are in place. In addition, the presence of employees' representatives increases the probability of variable pay, but only when they co-operate with the management in decision-making. Further, by examining more

than 14,000 selling jobs and more than 4000 sales management jobs in five B2B industry sectors in five European countries, Rouzies et al. (2009) argue that B2B firms appear to use variable pay as a way to lessen the salary differential compression impact of high tax regimes on salesperson motivation.

Furthermore, Dohmen & Falk (2011) find that output is higher in the variable-payment schemes compared to the fixed-payment scheme and that this difference is largely driven by productivity sorting. In addition, they state that different incentive schemes systematically attract individuals with different attitudes, such as willingness to take risks and relative self-assessment as well as gender. Risk aversion has been recognized as a major factor reducing preferences for variable pay plans (Kurtulus et al., 2011). As regards risk preferences, Kuhn & Yockey (2003) reveal that variable pay was preferred more often when incentives were based on individual rather than collective (team or organizational) performance. In addition, women are significantly less likely to sort into variable payment schemes than male subjects, suggesting that women seem to dislike the uncertainty and/or competitiveness that is inherent to variable pay schemes (Dohmen, Falk, 2010).

Using a representative sample of German establishments, Heywood & Jirjahn (2014) show that those with foreign ownership are more likely to use performance appraisal, profit-sharing and employee share ownership than those with domestic ownership. Furthermore, Armstrong & Murlis (2007) argue that variable pay has always been the rule in executive pay, sales representatives' remuneration and payment-by-result schemes for manual workers. In addition, highly educated managers were more likely to use team and individual forms of variable pay schemes (Damiani, Ricci, 2014). It was also found that the performance evaluation-base for variable payments, variable pay calculation-base and goal setting for variable pay significantly predict job performance (Wickramasinghe, Wickramasinghe, 2016).

The importance of motivational effects of loss aversion was also explored in a heterogeneous sample of respondents subject to variable pay plans in their organizations within the US (Merriman, Deckop, 2007). It was found that variable pay framed as a loss

was associated with greater work effort and performance, and less deviant behaviour in the workplace. As regards absenteeism in the workplace, establishments that explicitly linked pay with individual performance were found to have significantly lower absence rates, and the effect was stronger for establishments that offered variable pay schemes to a greater share of their non-managerial workforce (Pouliakas, Theodoropoulos, 2012).

Bearing in mind the above mentioned issues, it can be observed that more related research is still needed to gain deeper knowledge about the topic. To advance understanding of delivery performance challenges in post-transition economies, the next chapter deals with a case study of a FMCG company in Bosnia and Herzegovina.

### 3. Case study: delivery operations

As sales departments in most distribution companies are faced with all the greater pressures on prices by their customers, that is, on the increase of discounts while keeping the sales prices constant, this loss of differences in the prices is all the more sought in other places. In such circumstances, orientation towards savings and rationalization of business dealings in logistic segments become common. Given that this striving for rationalization also includes thinking about the category of work productivity, variable pay becomes a possible element that is used with the aim of trying to achieve a higher degree of work productivity. Since using the variable pay models asks for certain assumptions, introduction of such a model certainly has some limitations, and hence it cannot be seen in the same manner in different segments of business.

The case study deals with the B2B concept of business dealings, in which the distribution company makes a delivery of goods to retail buyers on the grounds of orders created earlier. The delivery is thereby made within 24 hours, which implies daily commissioning and the plan for dispatching the created orders for the sake of delivery the day after.

Efficiency of the delivery process is measured by certain performance indicators (KPI – Key Performance Indicators) that can be used in the process of creation of variable pay models. Table 1 gives an overview of the most frequently used KPIs.

**Table 1** *The most frequently used KPIs*

KPI	Calculation formula	Description
<b>Mileage</b>	Numerical state of the vehicle tachograph (start – finish)	The number of kilometres passed in a certain time unit
<b>Utilization of loading space in m<sup>3</sup> (in %)</b>	(Volume of delivery according to the logistic data for the items/the available delivery volume in m <sup>3</sup> )*100	The sum of volumes of respective items that are delivered in relation to the available volume of loading space
<b>Utilization of loading space in kg (in %)</b>	(Delivery gross weight in kg/the maximum load-bearing capacity of the vehicle in kg)*100	The sum of gross weights of respective items enlarged by the weight of pallets in relation to the maximum vehicle load-bearing capacity
<b>Point of delivery (POD)</b>	The sum of respective points of delivery according to the waybill	Number of rows on the waybill that arises from the dispatching plan
<b>Number of items in delivery</b>	The sum of all the items on the invoices that the waybill is made of	The sum of all the individual items on a certain route that arise from the dispatching plan

Source: Adapted from Krauth, E. et al. (2005). *Performance Measurement and Control in Logistics Service Providing, ICEIS 2005 - Proceedings of the Seventh International Conference on Enterprise Information Systems*, p. 244

Thus presented, the most frequent indicators serve at the same time as the elements of calculation of variable pay that can be organized in various ways, depending on the market circumstances, delivery structure, traffic infrastructure etc. Therefore, the attempt to create a variable pay model in this paper will solely represent a possibility of such an organization, and by no means the final and/or only solution.

The KPIs shown earlier are often used in literature (Weber, Wallenburg, 2010). However, the analysis of the respective indicators should be approached very seriously, given that the importance of certain indicators significantly varies among different companies, geographical regions, delivery markets, traffic legal regulations and the like. Therefore, it is hard to find even in professional literature the universally valid conclusions with respect to the optimal values of the respective indicators. This is mainly due to the fact that these indicators cannot be compared between certain markets, geographical regions and companies owing to a series of internal and external parameters that have an impact on them. Thus the structure of indicators of utilization of loading space, whether it be volume (measured in m<sup>3</sup>) or weight (measured in kilograms) will be significantly influenced by the structure of the goods that are transported. Depending on the types of individual items, this structure differs from company to company, which

makes one-hundred-percent comparison impossible. Further, it is often the case that the comparison of indicators between several delivery routes within the same company cannot be made, which is most frequently a consequence of geographical dispersion of the point of delivery, their traffic and infrastructural connectedness, limitations by the buyers during the unloading, etc.

All the above stated indicates the need to observe the KPIs with great caution. At the same time, it emphasizes the demanding nature of creation of a variable pay model in the delivery operations. Regardless of the huge number of possibilities in formulation of the variable pay model, it eventually has to be simple, understandable and functional, in order to achieve its main purpose of introduction, which is increasing the work productivity of the deliverer. Given that there is no universally applicable model, companies are advised to construct the model by the principle of attempts and errors, and under no circumstances should they copy the “blueprint” solutions from the developed markets, as the stated model ought to be adapted to one’s own environment and needs.

Creators and users of variable pay models in delivery operations certainly have to be aware of a series of external parameters that have an impact on the work productivity of the deliverer. Thus the traffic infrastructure together with the geographical dispersion of points of delivery have a major say

on what the average speed of the deliverer's movement between individual points of delivery will be. Further, the limitations during the unloading on the part of buyers that have been mentioned above (unloading only at a certain time, e.g. from 08:00 to 10:00) often cause the need to use non-optimal movement routes, which forces the deliverer and the whole company to make more kilometres in the course of the stated delivery. The tachograph lanes for the vehicles over 3.5t of the total allowed mass represent an additional legal restriction in the delivery, given that they enable maximum time of accumulated driving of 9 hours per day to the deliverers. This and similar restrictions represent external lim-

itations, which are beyond control of the company or the deliverer. Such restrictions have to be taken into account when measuring the work productivity of the deliverer by means of the instrument of the variable pay.

Before the very creation of the variable model of salary calculations, it is advisable to represent the initial state of the delivery statistics. As it was indicated above, the stated calculus represents the situation from the FMCG industry of a distribution company from the market of Bosnia and Herzegovina. Table 2 gives an overview of monthly statistics of the delivery of a branch office of that company.

**Table 2 Fixed salaries**

	Point of delivery (POD)	Number of items	Number of kilometres	Net salary (EUR)
<b>Driver 1</b>	289	5,517	3,539	450
<b>Driver 2</b>	177	6,523	4,513	450
<b>Driver 3</b>	187	7,337	3,561	500
<b>Driver 4</b>	204	6,430	2,694	450
<b>Driver 5</b>	230	4,143	4,112	475
<b>Driver 6</b>	250	6,712	1,758	450
<b>Driver 7</b>	177	4,375	740	450
<b>Driver 8</b>	220	2,590	5,225	450
<b>Driver 9</b>	173	6,671	1,185	500
<b>Driver 10</b>	219	4,662	4,920	475
<b>Driver 11</b>	150	5,356	953	450
<b>Driver 12</b>	93	789	4,255	475
<b>Driver 13</b>	134	1,128	5,849	500
<b>Driver 14</b>	230	2,599	6,229	475
<b>Driver 15</b>	76	4,637	3,300	500
<b>Driver 16</b>	273	6,204	4,480	450
<b>Total</b>	3,082	75,673	57,313	7,500

Source: Authors' calculations

On the grounds of the KPIs described earlier, the proposal of the variable pay model is being created according to the following formula:

$$\text{Variable pay} = \text{number of kilometres} * 0.1 \text{ EUR} + \text{number of PODs} * 0.01 \text{ EUR} + \text{number of items} * 0.04 \text{ EUR}$$

As it can be seen from the formula, variable pay consists of the combination of indicators of passed kilometres expressed in km, number of PODs, as well as the number of delivered items in the course of the calculation period.

For some deliverers, the variable part of the salary will increase with the increase in the number of passed kilometres in the course of the calculation period. How-

ever, the greater the number of kilometres a deliverer makes while driving via remote routes, the less time they will have to deliver a larger number of PODs, and this in turn largely decreases the number of items of their deliveries. Quite contrary, if a certain deliverer mainly delivers via the closer routes, they will have more time at their disposal to deliver a larger number of PODs, and thereby a larger number of items.

As it can be seen from the example, the time factor significantly affects all the indicators, because it represents a corresponding restriction in the delivery. Given that the indicators in the theory are mutually exclusive, it is to be assumed that a model set in such method should boost the corresponding motivation of the deliverers to do the deliveries they have accepted faster, which should result in greater work productivity.

Given that higher motivation moves the work activity towards a larger number of delivery points, and at the same time a greater number of items per delivery, the deliverers should deliver more goods measured in the utilization of the loading space, both in kilograms and the total volume. Such working engagement brings about a smaller number of vehicle units used in the delivery operations from the aspect of the company, which generates dou-

ble logistic savings through the number of vehicles needed on the one hand, and the number of engaged workers, on the other.

A theoretical model for the calculation of variable pay described in this manner certainly has its limitations in practice. Thus in the course of allocating individual delivery routes we are certainly not speaking about the perfect competitive market, on which every deliverer would fight against the rest of the market solely with his or her abilities. Given that in the organizational sense it is impossible for the deliverers to independently choose, that is, create delivery routes, certain parameters are surely given. Hence it is important to point out that the deliverers cannot completely influence the total delivery process; rather, they depend on the schedules created in advance. This is why it is very important to retain the relevant fixed part of the deliverer's salary, as it is suggested in Table 3. The ratio of the fixed and variable part of the salary certainly depends on a whole series of parameters and circumstances, and as such, it will always offer the relevant space for discussion.

For the needs of the practical application of the proposed model of variable pay calculations, we make use of the monthly statistics of the delivery of the company from the FMCG industry.

*Table 3 Data on fixed salaries, KPIs and salaries according to the variable model*

	Point of delivery (POD)	Number of items	Number of kilometres	Fixed part of pay (EUR)	Variable part of pay (EUR)	Total pay (EUR)
<b>Driver 1</b>	289	5,517	3,539	250	226	476
<b>Driver 2</b>	177	6,523	4,513	250	263	513
<b>Driver 3</b>	187	7,337	3,561	250	235	485
<b>Driver 4</b>	204	6,430	2,694	250	192	442
<b>Driver 5</b>	230	4,143	4,112	250	229	479
<b>Driver 6</b>	250	6,712	1,758	250	162	412
<b>Driver 7</b>	177	4,375	740	250	91	341
<b>Driver 8</b>	220	2,590	5,225	250	257	507
<b>Driver 9</b>	173	6,671	1,185	250	131	381
<b>Driver 10</b>	219	4,662	4,920	250	265	515
<b>Driver 11</b>	150	5,356	953	250	107	357
<b>Driver 12</b>	93	789	4,255	250	187	437
<b>Driver 13</b>	134	1,128	5,849	250	259	509
<b>Driver 14</b>	230	2,599	6,229	250	298	548
<b>Driver 15</b>	76	4,637	3,300	250	186	436
<b>Driver 16</b>	273	6,204	4,480	250	269	519
<b>Total</b>	3,082	75,673	57,313	4,000	3,357	7,357

Source: Authors' calculations

As it can be seen from the model used, the range between the lowest and the highest salary has significantly increased. Thus the highest salary of the calculation period is now EUR 548 in relation to the previous 500 EUR, while the lowest salary now amounts to a meagre 341 EUR. The range between the minimum and maximum in this case amounts to 60.72%, while the average salary in the calculation period is 459 EUR. Further, it is important to point out that eight deliverers are faced with positive, and the remaining eight with negative divergence in relation to prior valid fixed pay calculation, after the introduction of the variable model. What we have here is therefore a redistribution of the total income for the purpose of increasing the work productivity of the deliverers.

#### **4. Conclusion**

The issue of variable pay introduction in the context of delivery operations has been insufficiently explored in the existing literature. The objective of this paper was to indicate the specificities of the sector of delivery operations on the market of Bosnia and Herzegovina, via implications of introducing the variable pay model on the example of the distribution business dealings from the FMCG industry. Therefore, the paper aims to fill the aforementioned gap and contributes to the current body of literature on variable pay schemes in the field of delivery operations.

Moreover, it provides useful insight into the market of Bosnia and Herzegovina as an example of

post-transition environment. It should be pointed out that the introduction of variable pay in the field of delivery operations is not without difficulties. This is especially true for post-transition environments where every major change to existing working conditions is treated very critically. The case study emphasizes the demanding nature of the creation of a variable pay model in delivery operations. Consequently, the proposed model of the variable pay calculation system has its limitations that may raise questions regarding the deliverer's influence on the overall delivery process. Thus, the discussion presented in the paper has important practical implications related to workforce management and may be useful to managers and other subjects involved in designing pay and reward structures.

As emphasized earlier, there is a need for more research on variable pay schemes in the field of delivery operations. It is argued that reduced delivery times and adherence to defined delivery dates as well as completeness and accuracy of delivery are important criteria for increasing customer satisfaction through logistics services (Waters, 2010). However, quality related issues of delivery performance have not been addressed in the paper but deserve future investigations. With that in mind, greater emphasis should also be placed on various delivery performance indicators, e.g. service quality, driver efficiency, on time delivery, order-lead time, as well as job satisfaction, employees' motivation and pay satisfaction.



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## **PROBLEMATIKA POSLOVA DOSTAVE – MOŽE LI SUSTAV VARIJABILNIH PLAĆA ZAISTA USPJETI?**

### **SAŽETAK**

Kontinuirane promjene poslovnih ciljeva sve više rezultiraju implementacijom različitih poslovnih strategija kako bi se poboljšali rezultati radnika. U tomu kontekstu, varijabilne plaće koriste se kako bi se povećala motivacija djelatnika i njihova produktivnost. Za razliku od sektora prodaje ili skladištenja, javljaju se brojna pitanja u vezi sa sustavom varijabilnih plaća u poslovima dostave. Cilj je rada razmotriti probleme i izazove povezane s uvođenjem sustava varijabilnih plaća u području dostave. U radu se prikazuje i analizira studija slučaja poslova dostave iz FMCG sektora na tržištu Bosne i Hercegovine. U tom smislu, rad razmatra sljedeća istraživačka pitanja: Što se namjerava postići varijabilnom plaćom? Koje varijable utječu na poslove dostave? Zašto dostavne rezultate treba pažljivo pratiti? Koji vanjski čimbenici utječu na produktivnost dostavljača? Mogu li varijabilne plaće privući, motivirati ili zadržati djelatnike? Može li sustav varijabilnih plaća zaista uspjeti u poslovima dostave? Diskusija predstavljena u radu ima važne praktične implikacije povezane s upravljanjem radnom snagom i može biti korisna menadžerima i ostalima koji su uključeni u oblikovanje struktura plaća i nagrada.

**Ključne riječi:** poslovi dostave, varijabilne plaće, upravljanje radnom snagom, FMCG sektor, Bosna i Hercegovina