Learning Before Earning
How to Incentivize Frontline Employees to Deliver Great Customer Experiences
WHY THIS MATTERS

Pay for performance has become a popular component of corporate compensation plans. In many cases, even frontline employees' paychecks depend in part on performance-based metrics like store sales or customer satisfaction ratings. As customer experience management has become more operational and customer feedback has become more pervasive, customer satisfaction scores are having a bigger impact on frontline pay.

But as many companies are now discovering, tying frontline compensation to customer feedback scores can produce unintended consequences that sometimes get in the way of delivering a great customer experience. Drawing on a Medallia Institute survey of 1,000 frontline employees, as well as other research, we weigh the costs and benefits of tying frontline pay to customer ratings and make recommendations for designing more effective programs.

KEY FINDINGS

While tying frontline compensation to customer satisfaction ratings has some benefits, companies should consider the potential downsides as well. These drawbacks include:

- **Risk aversion**: Employees feel that customer ratings put their compensation at risk, so they may become less likely to put themselves out there and try new things.

- **Cheating and dishonesty**: Employees take shortcuts or engage in unethical behavior to attain performance goals, which undermines corporate learning.

- **Mixed messages and unexpected consequences**: Monetary incentives may crowd out already positive motivations that are important for creating a great customer experience and authentic relationships with customers.

When frontline employees view customer feedback as a way to earn rather than as a way to learn, many of the benefits of customer feedback disappear. To ensure that customer feedback continues to deliver its primary benefit—helping companies adapt quickly to changing customer expectations—we recommend tying frontline incentives to behavior-based metrics rather than outcome-based metrics.
Great Customer Experiences Produce Better Business Outcomes

Research consistently demonstrates the link between customer experience and consumer behavior.

- A study by Harris Interactive and RightNow Technologies found that 86 percent of US adults will pay more for a better experience when making purchasing decisions.1
- The same Harris Interactive study showed that 89 percent of U.S. adults report switching to a competitor because they had a negative experience with a given brand or provider.2
- The Medallia Institute found that in transaction-based businesses, customers with the best experiences will spend up to 140 percent more than those with the worst.3

Because the quality of the customer experience has such a significant impact on customer loyalty and purchasing behavior, numerous studies have shown that it also ends up affecting corporate revenue, operating profits, and stock performance.4

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Companies that understand the link between customer experience and business results go to great lengths to motivate and reward employees for delivering great service. Incentive systems for customer-facing employees are particularly important because frontline employees interact with customers directly and can strongly influence how they experience the brand.

More employers are adopting variable pay-for-performance systems, according to Aon Hewitt’s 2015 annual survey on compensation trends.5 While basing a percentage of total pay on specific performance targets is a mainstay of executive compensation, Aon Hewitt reports that these variable pay schemes are spreading further down the ranks.

Incentive systems generally take one of two forms:

- Outcome-based, focusing on metrics like total store sales, other key financial indicators, and customer satisfaction ratings
- Behavior-based, focusing on actions an employee takes, like following up on customer complaints and documenting the root cause of customer problems

Tying a portion of pay to customer satisfaction ratings is becoming more common in frontline incentive plans. Basing frontline compensation on CX ratings appeals to many companies because they believe it:

- Focuses employee attention on the overall customer experience
- Establishes clear expectations about performance
- Enables managers to set concrete targets
- Gives employees a greater sense of purpose and ownership
- Increases effort and, ultimately, performance in serving customers

Some of this is certainly true. In many sales, service, and support roles, tying customer satisfaction ratings directly to the employees who interact with customers may increase accountability. When surveys capture actionable information relevant to an employee’s work, they may also help to improve future customer interactions.

But practitioners and academics alike have found that tying frontline compensation to customer satisfaction ratings can increase a variety of undesirable behaviors as well, including gaming and cheating.
To understand how employee attitudes and behaviors can be affected when companies base pay—at least in part—on customer ratings, the Medallia Institute surveyed 1,000 customer-facing employees to learn more about their work practices (including compensation), behavior, and satisfaction at work.

“Incentives can be a blunt instrument.”

On the positive side, we found that when some portion of frontline pay is based directly on ratings from customers, employees report knowing more about their company’s business objectives. Specifically, they are significantly more likely to say that they can state their company’s goals and objectives accurately. This is not surprising: incentives direct attention and signal what an organization values. When compensation is tied directly to an employee’s customer satisfaction ratings, companies send a clear message about what they value: customer ratings.

Incentives, however, can be a blunt instrument. Tying compensation to customer ratings signals that ratings, in and of themselves, are important. But what companies really care about is the experience customers have and their perception of the brand they walk away with. When incentives focus on ratings, not the actual experience, employees may be inclined to maximize their ratings, rather than optimize the customer experience.

Unfortunately, our findings suggest that this is often the case. Tying employee compensation to customer satisfaction ratings can have unintended consequences that run counter to the goal of creating better customer experiences.

Based on our results, we believe that organizations would be better off designing incentive systems that reinforce specific behaviors rather than specific outcomes. Companies that tie incentives to behaviors that benefit both customers and the organization can avoid many of the unintended consequences that occur when ratings become more about earning than learning.

The Downside of Tying Compensation to Customer Feedback Ratings

In our survey of frontline employees, we found that employees were less satisfied with their jobs when a portion of their pay hinged directly on ratings from their customers. In addition, they were significantly more likely to indicate higher levels of job-related stress and 1.5 times more likely to leave their company in the next six months relative to other employees (see Figure 1).

Why is this?

Customer ratings reflect many factors in addition to employee performance

While customer experience ratings are typically expressed as numeric values, they can ultimately reflect a wide range of factors. For example, one customer might provide a low satisfaction rating because she waited a long time to speak with a
service representative. Another might provide a low rating because she objects to the company’s environmental practices. A third customer might simply be having a bad day.

In aggregate, customer satisfaction ratings offer companies an accurate picture of how consumers overall are reacting to specific products and services. Ratings also provide feedback on how companies can improve the customer experience. But at the individual level, customer ratings can be less reliable. They tend to be broad in scope and subjective.6

What’s even more problematic is that the number of ratings for a given employee can be low. For example, a large telecom company wanted to track employee performance in its call centers on a monthly basis, but it discovered that employees were receiving only 10 to 15 customer ratings per month. The numbers were simply too low to provide reliable information about an individual employee’s performance.

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Aspects of the customer experience may be beyond an individual employee’s control

When customer ratings are tied directly to employee pay, employees can feel as if they’re being compensated—or not compensated—based on factors beyond their control. A technical support representative might, in fact, provide helpful advice to a customer trying to install a new software application, but if the customer had to wait 30 minutes to speak to the rep and consequently gives a low score, the rep’s strong performance will go unrecognized.

This dynamic can make employees feel as if their employer is treating them unfairly and devaluing their contributions. It sends a signal that what ultimately matters most is the customer score, not the employee’s effort or impact on the customer experience.

Risk Aversion

When employees feel their contributions don’t matter, their stress increases and their engagement declines. Instead of looking for ways to help customers and proactively address and solve problems (or avert potential problems), they act passively and avoid risk. For example, our study found that when employee compensation is tied directly to customer feedback ratings, employees are more likely to tell customers they can’t help with a problem when, in fact, they possibly could. Employees also say that they would be less likely to take on extra work when the situation calls for it.

Over time, this dynamic can create a number of negative consequences. First, when employees feel their compensation is at stake, it appears they are less likely to go out of their way or take chances to help customers. This can be especially true with difficult customers. Why should employees take on extra work or exert extra effort to help more demanding customers when they can simply avoid those customers or pass them along to others?

Previous research has found that when employee compensation is tied to customer feedback, salespeople are more likely to drop customers who complain.7 In an interview with Edmunds.com, a former auto sales manager with 20 years of experience said:

“If I had a really unhappy customer I thought would give us a terrible survey, I’d sometimes have to pass on the deal. I couldn’t take the risk of a terrible survey. I hated missing a deal because of a survey, but it could take 15 perfect surveys to make up for a single bad one.”8
Working with easier, less demanding customers certainly increases the probability of getting higher customer experience ratings.

When employees become less willing to take chances and more reluctant to take on extra work, they are less likely to look for new and better ways of satisfying customers. In addition, research has shown that monetary incentives may weaken an individual’s intrinsic motivation for a given task. As a result, employees may become less interested in going the extra mile to make customers happy. That means companies will experiment less, learn less, and innovate less.

Finally, when customer feedback ratings influence compensation, employees often begin to focus on managing the feedback process rather than managing the customer experience. They circumvent company policies or take actions that produce better customer satisfaction ratings but don’t actually benefit the company. For example, the easiest way to satisfy customers is to give them free services. But clearly this eats into corporate profit margins and can ultimately hurt the bottom line.

**Cheating and Dishonesty**

In some instances, employees may try to game or cheat an incentive system. When employees are rewarded based on their customer satisfaction ratings, they can fixate on the score itself rather than the behaviors, practices, and values that the ratings should ideally reflect.

A focus on outcomes over behaviors can sometimes inspire employees to move from passive attempts to influence outcomes (e.g., choosing not to pursue a sale) to more manipulative and destructive tactics.

The tendency for people to game incentive systems has been observed in many settings. One extreme example occurred in the early 2000s in Colombia. The newly-elected president decided to combat local guerrilla organizations by offering financial bounties to the country’s military forces, essentially rewarding them for the number of guerrillas they killed.

“**When employees are rewarded based on their customer satisfaction ratings, they can fixate on the score itself.**”

In an effort to manipulate the incentive system and maximize their bounties, some soldiers murdered innocent civilians, dressed them up in camouflage uniforms, and presented them as guerrillas killed in combat. According to one recent study, as many as 3,000 civilians may have died as a result of this poorly designed incentive scheme.

The world of business is filled with less extreme examples. Scott Adams, creator of the popular “Dilbert” cartoon, recounted one example sent to him by a reader. A Silicon Valley software company started offering small cash incentives to its employees for finding and fixing bugs in its code. Unfortunately, the employees responded to this incentive by deliberately writing more bugs, which were then conveniently monetized through the process of “finding” and “fixing” them.
Gaming incentive systems can happen in any number of ways. In our survey, employees who indicated that their compensation was tied to customer satisfaction ratings were almost twice as likely to report that their teammates actively prevented unhappy customers from replying to customer satisfaction surveys (see Figure 2). They were also 50 percent more likely to report that their teammates coached customers to give higher scores (see Figure 3).

Survey respondents shared numerous ways that employees could prevent dissatisfied customers from providing feedback. For example, they might purposely send unhappy customers to the wrong website, which clearly diminished the customers’ ability to share their negative experience. Or cashiers might point out the survey instructions on the bottom of a receipt to happy customers but “forget” to mention them to customers who seem dissatisfied.

“Survey begging,” as it is often called, also takes multiple forms. Frontline employees may display signs asking customers to give them positive scores, or they may ask for good ratings outright. They may also offer discounts in exchange for a good rating or indicate that they could get in trouble, or even fired, for a score below a certain level.

Kim Stiglitz, contributing author for VerticalResponse.com, described how employees at a major retailer used survey begging to manipulate ratings and protect their compensation. At one store, employees devised a scheme that offered customers a 20 percent discount in return for rating the store a perfect 10. Clearly the employees had learned the power of incentives.13
Not only do actions like these annoy customers, they also cover up real service issues by artificially inflating scores. As a result, they can reduce a store’s profitability and distort the information needed to make improvements.

**Mixed Messages and Unexpected Consequences**

When companies tie frontline compensation to customer ratings, they send an explicit message that customer satisfaction is important, highly valued, and rewarded. However, they may also send a more implicit message—that employees are not intrinsically motivated to deliver a great customer experience or can’t be trusted to do so unless they’re compensated.

While incentives can influence behavior, they often do it in unexpected ways. Monetary incentives in particular can backfire, producing unintended consequences that are at odds with a company’s primary goals. For example, research in psychology shows that compensating employees for a task that might otherwise be intrinsically motivating (e.g., satisfying customers) can actually reduce effort and motivation. The monetary incentives can “crowd out” intrinsic motivations that are important for sustaining behavior over time.

In addition, monetary rewards can change how employees perceive a task. By tying employee compensation to customer satisfaction ratings, a company may signal that high scores are difficult to achieve, that the work is unattractive, or that employees are not suited for it (and thus need the additional incentive).

Compensating employees for outcomes like satisfaction ratings can also reduce other motives for delivering great customer service. For some employees, achieving high levels of customer satisfaction reinforces their self-image and improves their reputation on the job. When monetary incentives are tied to their achievement, they may be perceived as “doing it for the money” and lose some of the cachet associated with their performance.

Finally, companies may face longer-term risks when they compensate frontline employees for their customer ratings. Research suggests that when companies make compensation contingent on achieving specific targets, and then reduce or remove the monetary incentives later, employee motivation can be diminished permanently. In fact, when the monetary incentives are removed, employee effort often drops lower than it was before incentives were offered.

**A Better Approach to Rewarding Employees**

Many companies believe that performance-based compensation plans are a valuable tool for motivating employees to achieve corporate objectives. In fact, Aon Hewitt reports that 90 percent of all U.S. companies use some form of “pay for performance” as part of their compensation plans. However, considerable research on compensation systems finds that incentive pay often leads to unintentional and dysfunctional consequences.

Tying compensation to specific behaviors—rather than ratings—minimizes these dysfunctional consequences and replaces them with productive feedback that fuels improvement.

In the past, compensation based on behaviors, rather than measurable outcomes, tended to be operationally infeasible. Managers simply couldn't continuously monitor the behavior of all their employees. The development of more sophisticated enterprise feedback systems has made it much easier to document and assess employee behavior on an ongoing basis.

With behavior-based pay systems, companies can reward employees for behaviors that have a high probability of improving the customer experience. For example, a company might reward employees...
according to the number of times they follow up with customers or how often they document their learning from customer interactions.

This approach ensures that employees regularly take actions that have been proven to increase customer satisfaction. It also promotes greater employee engagement and greater organizational learning.

“Companies should consider rewarding different types of behavior at different points in their programs’ maturity.”

At the Westin Portland, for example, former general manager Chris Lorino wanted his associates to focus on satisfying guests, not earning incentives. He felt it was important to build a team of people who naturally wanted to serve guests at the highest level, according to Jeff Toister, author of Service Failure: The Real Reasons Employees Struggle With Customer Service and What You Can Do About It. In Lorino’s opinion, a reward system based on scores would simply get in the way.

So, Lorino decided not to tie associate pay to customer satisfaction ratings and instead used survey feedback to manage behaviors. For example, if an employee frequently received feedback saying that he was a little abrupt, managers would coach him on ways to create a better impression.

By creating an atmosphere in which employees encouraged each other to deliver the best experience for their guests—and coaching them on how to do it—Lorino was able to achieve consistently high guest experience scores, an achievement he directly attributes to keeping employees focused on good customer service, not survey scores.21

An effective behavior-based compensation system also recognizes and rewards employees for individual improvement. Instead of compensating employees based solely on how often they perform a desired action, a truly well-designed system encourages growth and development by measuring and rewarding improvement over time as well.

Dayton Semerjian, general manager of global customer success at CA Technologies, a $4.5 billion business software and solutions company, says that companies should consider rewarding different types of behavior at different points in their programs’ maturity. Early on, employees might be rewarded for participating in training or for establishing a baseline measure of customer satisfaction. Next, they might be rewarded for regularly logging in to review customer feedback and for closing the loop with unhappy customers. Later, they might be rewarded for the number of customer problems they resolve, for coaching other employees, or for proposing innovative ideas that are ultimately implemented.22

A behavior-based incentive program moves beyond scores by encouraging managers to learn how to fix underlying issues and resolve problems. As a result, it helps to create a culture of continuous improvement.

Conclusions

What many well-intentioned companies fail to realize is that tying employee compensation directly to customer satisfaction ratings can actually reduce or distort the customer feedback they collect. Employees turn their attention to managing the feedback system rather than managing the customer experience and learning from it.

Behavior-based compensation systems create a different dynamic. With a behavior-based approach, companies can use compensation systems to increase employee engagement, operationalize knowledge, and build institutional habits that continue to improve over time. Rather than undermining improvement efforts, the compensation system actually enhances them by ensuring a focus on learning, not earning.
Recommendations

Consider what unintended behaviors might result from relying too much on customer satisfaction scores and how those behaviors may impact customers. When performance targets are perceived as unfair or unrealistic, employees will focus more on managing the feedback process than on improving the customer experience. Don’t make frontline bonuses or other compensation components contingent on individual customer ratings when factors beyond the employees’ control may strongly influence the customer experience.

Identify specific behaviors that will produce better customer experiences and greater organizational learning. When companies identify behaviors that reliably improve customer satisfaction or lead to greater learning, they can motivate and engage employees more effectively and create incentive systems that are more tightly aligned with their overall objectives. When incentives are aligned to promote the right behavior, companies also reduce the likelihood that employees will try to game the system.

Tie individual compensation to individual behaviors, not scores. Rewarding behaviors will help to establish the institutional habits that companies need throughout the organization, thereby pleasing customers and meeting their needs. Tying incentives to individual improvement reinforces desired behavior and sends the message that customer feedback is a tool for learning, not for monitoring and control.

Consider other mechanisms for influencing employee behavior. An inspiring mission, supportive leadership, and strong customer-centric culture can have a greater effect on employee behavior than almost any compensation plan. The return on investment is also likely to be far higher.
The Medallia Institute conducted this panel survey in October 2015. The survey polled 1,000 customer-facing employees (supervisors and their direct reports) working in the U.S. automotive, banking and financial services, retail, telecommunication services, and travel and hospitality industries. Respondents were limited to individuals employed by companies with a minimum of 250 employees, with almost half of the employees in the sample working for companies with 10,000 or more employees.
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