
HBR CASE STUDY

Should Maher give his star performer star rewards—or risk her leaving?

Growing Pains

by Robert D. Nicoson

Waterway's CEO is rethinking his compensation policies. Maybe he should be rethinking his business strategy.

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"I'm challenged and motivated where I am, and I like the company. You know that. But I've got to say I'm interested in the opportunity you're describing because of the money and the equity position. For those reasons alone, it's tough to pass by. Let me think about it some more and call you in the morning. Thanks, Les."

That was the extent of the conversation Cyrus Maher, CEO of Waterway Industries, overheard when he came around the corner just outside of Lee Carter's office. She must have been talking with Les Finch, Maher thought. Here's trouble.

Of course, it didn't necessarily mean anything, Maher told himself as he passed the office, waving to Carter. Finch, a well-connected marketing consultant, had been the matchmaker between Carter and Waterway Industries to begin with. With the company in the fourth quarter of its best year ever, he certainly

wouldn't be encouraging her to leave. Would he?

Maher got a cup of coffee in the company's first floor kitchenette and deliberately took the long way back to his office, through the design room. As always, the atmosphere was upbeat, but these days he also thought he could detect a sense of purpose that had never before been a part of Waterway's organization.

Founded in 1963 in Lake Placid, New York, Waterway had started out as a small, high-quality canoe maker. Over the years, it had built a good reputation all through the Northeast and had acquired a base of customers in the Pacific Northwest as well. By 1982, Waterway was comfortably ensconced in the canoe market nationwide, and it had maintained a steady growth right up until 1990. Then, at the insistence of a friend who was the head of a major dealer and expedition company, Maher had decided to venture into kayaks. His friend

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had said that kayaks were the next big trend and that Maher would be a fool not to sign on.

Maher had done some checking and found the prospects promising. So by the end of 1992, Waterway had begun selling its own line of compact, inexpensive, high-impact plastic kayaks. Within one quarter, Maher had known that the move had been a smart one. Almost all of Waterway's existing canoe customers—mostly wholesalers who then sold to liveries and sporting goods stores—had placed sizable kayak orders. A number of private-label entities had also inquired about Waterway, and Maher was considering producing private-label kayaks for those companies on a limited basis.

For the most part, the staff had adjusted easily to the company's faster pace. The expanded business hadn't changed Waterway's informal work style, and people seemed to appreciate that. Maher knew that most of his employees were avid outdoor types who viewed their jobs as a means to an end, and he respected that perspective. On days when the weather was particularly good, he knew that the building would be pretty empty by 4 P.M. But he also knew that his employees liked their jobs. Work was always completed on time, and people were outspoken with new ideas and with suggestions for improving current designs and processes. There was no mistaking the genuine camaraderie.

Maher walked through the design room, stopping to talk with one of the two designers and to admire the latest drawings. Then he headed for the administrative suite. His thoughts returned to the company's recent history. Until 1990, Waterway's sales and revenues had increased with the market, and Maher hadn't been motivated to push any harder. But when he had decided to venture into kayaking, he also had thought he should gear up marketing—get ready for the big trend if it came. Until then, there had never been a formal, structured marketing department at Waterway. He had thought it was time. That's why he had hired Lee Carter.

Carter had gotten her M.B.A. when she was 31. To do so, she had left a fast-track position in sales at Waterway's major competitor in the canoe market to devote her full attention to her studies. Finch, who was something of a mentor for Carter, had told her that she would hit the ceiling too early in her career if she

didn't have the credentials to compete in her field.

In her final term at business school, which had included a full course load plus a demanding internship with the Small Business Administration, Carter had interviewed with Waterway. Finch had called to introduce her, but once Maher had met her and she had begun to outline the ways in which she could improve the company's sales and marketing efforts, Maher had needed no other references. He had thought from the start that Carter might be the right person to nurture the company's interest in the growing kayaking business and to run with it if the sport's popularity really took off.

When it had, he was proved right. True, the market was extremely favorable, but Carter had brought in more orders than even Maher had thought possible. Fortunately, the company had been able to keep up by contracting with other manufacturing companies for more product. Waterway had been extremely effective in keeping inventory in line with customer demand.

Maher was impressed with Carter's performance. From day one, she had been completely focused. She traveled constantly—worked so hard that she barely had time to get to know the staff. She came in on weekends to catch up with paperwork. Along with two of her direct reports, she had even missed the annual Waterway picnic; the three had been on the road, nailing down a large order. It was a dedication—a level of energy—that Maher had never seen before, and he liked what it said about his company.

Back in his office, Maher found that he couldn't concentrate on the product development report in front of him. That bit of conversation he had overheard outside Carter's office was troubling.

He certainly knew about the lucrative packages that were being offered in the sporting goods industry—even in Waterway's niche. He'd even heard that some sales managers were commanding a quarter of a million dollars or more. He had read enough of the annual reports of his publicly traded competitors to know that larger organizations created all sorts of elaborate systems—supplemental retirement packages, golden handcuffs, stock options, deferred compensation arrangements—to hold on to their top performers.

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Maier wanted to recognize Carter's contribution. She had been extremely successful in opening new sales channels, and she was personally responsible for 40% of the company's sales for the last two years. Before Carter, the majority of sales had come through the independent reps and distributors. The sales network had grown informally, and Maier had never really tracked it or thought much about building a sales force or developing a formal distribution plan. Those were areas he wanted Carter to concentrate on as director of marketing, but right now she really had her hands full because business was booming.

He thought about the rest of the company. Waterway employed 45 people. Turnover was low; there was hardly ever any grumbling from the ranks. Recently, though, both of his designers had approached him—independently of each other—to request salary adjustments. They had been looking for equity in the company—a cut of the profits if their designs did well. Maier had rejected the proposals but had given the more senior of the two a modest raise and an extra week's vacation and had increased the bonuses of both. They had seemed happy with their new arrangements.

Then there was his former CFO, Chris Papadopoulos, who had left last year to take a position with a power boat manufacturer in Florida. Papadopoulos had twice requested that Maier redesign his compensation package to include equity, and because Maier hadn't been persuaded, Papadopoulos had left for a better job. Waterway's current CFO seemed perfectly content with a base salary and bonus.

The phone rang, jolting Maier out of his thoughts. It was Pat Mason, his assistant, reminding him that his flight to the Watergear Association meeting in Seattle would leave in three hours and that he had things to do before he left.

What Is Fair Pay?

Upon arrival at SeaTac airport, Maier met up with Bryce Holmes, president of Emerald Rafting. Holmes had been a trusted colleague since Maier had entered the business. The two ran into each other frequently at industry and trade shows and tried to get together for a meal at association meetings whenever they could. They took a cab to a seafood restaurant near the Bainbridge Island ferry landing. As al-

ways, the conversation centered on the industry.

"Let me ask you this," Maier said, as the waiter served his salmon in white wine and caper sauce. "Do you think that we have to pay our new marketing people more than the industry standard? I mean, when is too much, too much? And who determines the standard anyway? I'd hate to think I would lose a really great marketing manager, but I don't know what to do."

Holmes nodded. "It's tough, because in today's business climate, marketers aren't loyal to one particular industry. Your marketing person would probably be just as happy working in the health club field or for a top-of-the-line jewelry company. Or in speedboats, for that matter. Or at a phone company. God help you if she gets an offer from the telecommunications industry. The skill is transferable—people go where the money is. And you, my friend, have a reputation for a tight wallet."

He said it with a smile, but Maier still grimaced in response. He mentally reviewed his payroll. Professional staffers received a salary and a year-end bonus—10% to 15% of their pay. The controller made \$65,000. The office administration manager was pulling \$39,000. One designer received \$48,000; the other \$53,000. Maier himself took \$150,000 annually, with a bonus if the company had a good year. And he was paying Carter \$51,000 plus a yearly bonus of between \$15,000 and \$19,000, to make up for not paying a commission on her sales.

"I know business could stand to pay more," Maier said, "but I don't want to get into the habit of paying now for results down the road. Too many people have gotten into trouble that way."

Holmes held up a warning hand. "I'm just telling you," he said, "that this is something we're all struggling with. I don't want to have to increase compensation costs for the people who seem satisfied now, either. You take someone who is making 60K a year, and you bump them to 85 with a package deal because they get wind of another offer, and what do you have? Not someone who is satisfied, that's for sure. You have someone who doesn't trust you anymore because they thought you were being fair at 60 and evidently you weren't. So now they think they can't trust you at 85. You see what I'm getting at?"

Holmes continued. "We're actually thinking

"The business could stand to pay more," Maier said, "but I want to avoid the habit of paying now for results down the road."

of outsourcing marketing and sales. I'd guess that our pay scales aren't much higher than yours, and it seems that all we've been doing for the last two years is training employees for other companies. And although I shouldn't say this, my friend, I feel that I have to: The rumor mill says that Lee Carter is being tempted to leave Waterway even as we speak."

Maher nodded. "I know that. But, frankly, I'm not sure what to do about it."

More Money, More Growth?

Back in Lake Placid the following Tuesday, Maher had an appointment with Kate Travis, head of the commercial lending department at CenterTrust. Waterway had been doing its banking with CenterTrust for years. Travis showed Maher into her office and got out the company file.

"It looks as though kayaking really did take off," she said, studying the most recent report. "Based on your interim financials, you seem to be on target with your projections. Now, as I understand it, this additional line of credit would be to cover you for accounts receivable, is that correct?"

Maher nodded. "The sales are even better than we had anticipated," he said. "We're outsourcing to a certain extent, but we would also like to gear up production in-house. The increased credit would also give me a chance to look at the forest instead of the trees, if you will."

Travis took notes as they spoke. "Tell me a little bit about your sales," she asked. "What enabled you to do this well? Sales seem to be ahead of your projections."

"In a word, Lee Carter. She's our new marketing department, to put it simply. She's the best hiring decision I've ever made. The market has been agreeable, of course, but without Carter, we wouldn't have been able to take advantage of it."

"I did note that your operating expenses are higher than you had anticipated. Travel and entertainment, in particular."

"A natural outgrowth of our new marketing strategy," Maher said.

Travis continued. "You're also paying out more commissions to your reps and distribu-

tors than you ever have before. Now, I know that you have limited your exposure on some costs by outsourcing the manufacturing of certain boat models, but I really think..."

"We've also used consultants and temporary employees to handle short-term back-office and accounting support."

"Yes. I wonder if there isn't some more you can do along those lines before reaching for additional credit. Have you analyzed the increase in your sales and marketing costs?"

The two spoke for more than a half an hour, then Travis closed the meeting. "I'll get back in touch with you," she said.

Late that afternoon, Maher tried to finish up the short speech he was planning to deliver at the local Rotary meeting that evening. He couldn't concentrate. His conversation with Travis had raised some doubts in his mind about redesigning Carter's compensation package. With the new line of credit, would he be spreading himself too thin? Suppose he offered Carter a commission arrangement. That might keep her from taking any of those offers being waved in her face right now. But she *would* leave when the kayak boom eventually played out—unless by then Waterway was already pursuing the next hot product market. At the moment, Maher had no idea what that product would be. Chasing fad markets hadn't ever been part of his plan, and although his foray into kayaks was working well for the time being, he had never thought until now that the cutting edge was where he wanted Waterway to be.

Kay Henry, president of Mad River Canoe in Waitsfield, Vermont, and *Lisa P. Kirkwood*, a loan officer at Cape Cod Bank & Trust Company in Hyannis, Massachusetts, were contributors to this HBR case.

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