Timing, Trust and Transparancy: Wage Restructuring at Glaxosmithkline

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This case is based on the following sources: interviews with Mr James Tan (formerly the Industrial Relations Office (IRO) of the union branch at the GlaxoSmithKline (GSK) Plant) and Mr Phua King Song (Director of Human Resources, GSK) and additional information (write-ups) provided by Mr James Tan and Mr Phua King Song.

Abstract

The economic ups and downs since the eruption of the Asian crisis in 1997 have prompted a wave of restructurings and job losses in Singapore and several other Asian countries. As a response, policy-makers (the Singapore government) have urged companies undertake wage reforms, and to adopt more flexible wages. The wage restructuring exercise undertaken by Glaxo Smithkline (one of the largest pharmaceutical companies in the world), in Singapore, in 2002, is studied in this case. Since the merger of Glaxo Welcome and SmithKline Beecham two years earlier, there had been consolidation, with the less efficient plants in the system closing down. Although the Singapore plants are well-performing, the impetus to restructure wages came primarily from a more competitive internal and external environment. Management believed that the introduction of Performance Bonus (PB) would lead to improved metrics and was essential for the company to compete in the changed environment. While the Union leadership was in broad agreement that the plant needed to remain competitive, it had (some initial) misgivings about the proposals put forth by management. This case charts the process of the wage restructuring exercise, illustrating some of the challenges that companies may face in implementing wage restructuring initiatives. We also examine the impact of different factors, as well as the process of implementation, on the success of such initiatives.

BACKGROUND – GLAXOSMITHKLINE

With annual sales exceeding Euros 21 billion, Glaxo SmithKline (GSK) is among the largest pharmaceutical companies in the world. The company operates a network of 96 manufacturing plants in different locations world wide, including two in Singapore—one at Pioneer Sector 1, and another one at Quality Road. The two plants in Singapore are 'primary plants' and produce different active ingredients which are shipped to other locations to be made into marketable (branded) products. The two plants employ about 600 people, 450 at Pioneer Sector 1 and 150 at Quality Road.[1]

At an overall level, the Singapore plants are well-performing. The workers in the Singapore plant are members of Chemical Industries Employees' Union (CIEU) whose branch acts as the interface between the management and the union members.

All the 96 manufacturing plants in GSK are part of a Global Manufacturing Supply (GMS) network. The technology and capital intensive nature of the pharmaceutical business means that wage costs account for a relatively small proportion of total operating costs.

BACKGROUND—WAGE RESTRUCTURING

Economists have identified a variety of benefits to flexible wages. One school of thought argues that if wages are perfectly flexible, an economy would experience full employment and firms may be able to reduce employment instability as well as to improve the match quality of workers. Since an economic downturn in 1986 and 1987 caused high levels of unemployment, the Singapore government has recognized the need for flexible wages and instituted the tripartite National Wages council (NWC, which includes representatives of the government, the unions and the firms) to recommend wage adjustments in response to changing economic conditions. While most employers as well as unions recognize the need for flexible wages, the exact process by which the restructuring exercise will unfold depends the context of the firm (e.g., historical wage structure; union-management relations) as well as the implementation policies adopted by the particular firm. In the following discussion, the contextual details as well as the organizational policies are identified for GlaxoSmithKline—a pioneer in implementing wage restructuring in Singapore.

PREVIOUS WAGE STRUCTURE AT THE GSK PLANT

Prior to 1992, the employees pay structure in the Pioneer Sector 1 plant consisted of the following components: monthly basic salary; up to 3 months variable bonus and 1 month Annual Wage Supplement (AWS). Annual increments, which consisted of base and merit increases (individual) were negotiated annually.

[1] While both plants now belong to the merged parent company, a distinction is made between the two plants since the process of wage restructuring unfolded differently in the two plants.

In 1993, the company consolidated the 3 months variable bonus and 1 month AWS into the basic pay of employees—essentially introducing a multiplier of 16/12 to the basic salary.[2] The employees were also eligible for a yearly, seniority-based, fixed service benefit ranging from $100 (for new employees) to $2150 (for employees with more than 10 years of service), payable in July. For the long-serving employees (almost 50% of the total), this payment ($2150) amounted to 0.56 months of salary and was perceived as guaranteed payment.

The medical benefits which were also rather generous covered all outpatient costs for the employee and his/ her family, and led to average outpatient costs per employee exceeding $1000 per year.

The wage system 'worked' since GSK was competing to hire/ retain skilled process technicians which were rather limited in number in Singapore, then. Many of its peers (pharmaceutical companies) in Singapore benchmarked their own compensation levels to GSK's. In the mid-1990s competition for skilled, experienced staff intensified with the establishment of Singapore plants by companies such as Schering Plough. Over the years, GSK has ensured that its wages are competitive to attract and retain quality employees.

IMPETUS FOR A PERFORMANCE BASED SYSTEM

The impetus for implementing a performance based system came primarily from a more competitive internal and external environment (e.g., loss of patent protection for some products), which increased the importance of costs management). The imperatives faced by a typical plant could be identified as follows:

- The merger between GlaxoWellcome and SmithKline Beecham in 2000 was predicated on cost savings (of the order of $1 billion per year versus the costs of the combined companies). As a consequence, there had been consolidation since 2000, with the less efficient plants in the system closing down.
- Product life cycle issues were also salient. Specifically when a particular ingredient lost patent protection, the profit margin of the company would be diluted leading to strong pressures to reduce costs which could often be achieved by moving production to locations that promised efficiency in manufacturing and supply.
- For instance, GSK's Quality Road plant was exposed to competition in late 1990s as the ingredient it was producing (Amoxicillin) faced patent issues in some countries.

The merger also brought a number of differences to the fore:

- Unlike GSK, which paid the service benefit, Beecham employees had a retirement account.

[2] Since the 3 months bonus and 1 month AWS were consolidated into the annual salary, the company was essentially paying 16 months of salary annually based on the old system. Since the new annual salary was paid over 12 months, the monthly salary under the old system was multiplied by 16/12 to arrive at the new monthly salary.

- Though the average age of employees at the Pioneers Sector 1 plant was much lower (over 30) than the Quality Road plant (over 40), the latter's average outpatient costs per employee appeared lower (although there were differences in the two schemes)

Even after the merger, separate management teams were in charge of the two plants initially. While some steps for linking pay for performance were proposed soon after the merger, they were not implemented until 2003, with the result that most people in the GSK plant continued receiving the maximum payout based on their seniority.

INTRODUCING PAY FOR PERFORMANCE

Negotiations for a new Collective Agreement (CA) did not start until April 2002 though the previous agreement had lapsed in December 2001. The introduction of performance based bonus had two broad motivations: to maintain a high level of performance at the worker level in terms of product quality, manufacturing efficiency, customer delivery and safety record; and to bring the compensation practice at the Singapore plant more in line with the global practices advocated by GMS. The performance bonus was based on two key criteria. Trading profit of the GMS, which carried a weight of 25%, and, the performance of the local operations, which carried a weight of 75%. The latter, in turn, was measured in terms of the following four Key Performance Indicators (KPIs): manufacturing variance, safety, quality and customer service (see **Figures 1 and 2** for the calculation of plant-level bonuses). In addition, the bonus paid to individuals was calculated as the simple multiplication of Individual Performance Moderator (IPM) based on the individual's performance rating (ranging from 0% to 120% based on the grades assigned to the individual) and the site bonus opportunity.

The Management perspective

The management of the plant strongly believed that the introduction of Performance Bonus (PB) was essential to compete in a changed environment. It would lead to improved metrics in terms of key outcomes. Mr Phua, Director of Human Resources, said that "*The old scheme was targeted at seniority, not performance*" and if the Singapore plant was not competitive "*there would be no new products and no jobs*". While he recognized that transition would be difficult due to the cultural change involved and the fact that the service scheme had been longstanding, he was forthright in the need for a new system. He said: "*We are in business, driven by competition. We have to fight for our own piece of cake and nobody owes it to us*." Mr Phua, again, explaining the management's perspective: "*Management staff appreciated better the need to deliver – they have a worldview, also because of their responsibilities. More open to need for change, and they realized that onus was on them.*"

View from the ground: The Union leadership and the members

Though the (Union) branch leadership was in broad agreement that the environment was changing and the plant needed to remain competitive it had several misgivings about the proposal put forth by the management. With regard to the Key Performance Indicators (KPIs), though there was broad agreement (on their appropriateness) it had several key concerns including the following:

- The branch wanted a safety net—something that ensured that the workers would not lose out. If the plant performance was good they would get at least an amount equivalent to the service benefit. This concern could be attributed to two factors. First, the formula for calculating the rewards in the proposed system was not clear at the outset—sometimes even management was not fully clear about the nuances of the formula. Secondly, since the Union lacked data regarding past performance of the factory on the KPIs, they were not clear about the level of rewards if they maintained past performance.
- There was also a strong concern about older employees and poor performers. In the previous system, as much as 50% of the workers had received the maximum service benefit based on their tenure with the company
- The branch also wanted the employees to benefit if the company performed well.
- The branch was concerned that emphasis on individual performance would affect teamwork and also wanted the same indicators to apply to management so that everybody was working towards the same goals
- Another key concern included the Individual Moderator.

At the ground level, the Union members were even more skeptical (than the Union leadership) about the proposed changes and many workers (particularly older ones) wanted the service benefit to stay, especially since it rewarded loyalty. They were not convinced about the need for the changes due to three key factors. First, they believed that the company was profitable and performing well, and felt that sharing of profits should be on a group basis where all should be rewarded equally. Secondly, they argued that the annual increment was already tied to performance and there was no need to introduce an additional performance-based measure. Thirdly, they were also concerned about the attainability of the 96% performance level (especially in the absence of data regarding the performance levels achieved in the past years), below which bonus payment would not be triggered.

There was considerable animosity among the workers, especially since early meetings between the Union leadership and management were closed-door, but inevitably word still got around about the proposed changes.

IMPLEMENTATION PROCESS AT THE TWO PLANTS

At the Pioneer Sector 1 plant, the Union held a series of meetings with its members (in the later part of the negotiation process)—2 meetings with each of the 4 teams before the CA was agreed on and 1 after the CA. Early meetings were emotional since there was resistance to change and information was lacking. In these meetings, the Union leadership emphasized the employability issue (the plant losing out to competitors), arguing that they must work with the management to ensure sustainability.

Several other factors reduced the resistance of the Union members. The management agreed that it would work together with the weaker employees to help them improve. By the end of September (3 months after the meetings started) the Union had received the necessary information from the management. According to Mr. James Tan (the Industrial Relations Officer of CIEU at GSK at the time), "*there was quite a lot of difference between the first formula proposed, and the final formula adopted*", suggesting accommodation of worker's concerns by the management which led to improved acceptance by the Union members. The numbers made it clear that employees would benefit if the performance of the previous 3 years was maintained, with an average employee receiving a bonus of 7.75% of annual salary instead of the 5.6% that older employees were receiving under the old system. The new performance based system was expected to cost the company an additional $1 million every year. The management also agreed to discuss the performance targets with the union at the beginning of the assessment period, thus adding a sense of transparency to the process. It (management) also agreed to provide the list of poor performers to the union at mid-term and to work with union to address their performance gap. Finally, it was clarified that the management's bonus would also be assessed under the same model.

In the last meeting, the Union members agreed to try the formula since they felt that it was the right thing to do. The Chairman of CIEU and the then MD of GSK (Mr. Tan Kay Yong) met informally. The Executive Secretary of CIEU, Mr Seng Han Tong, also had meetings with the GSK MD. As a follow-up, the Union and the management held a series of talks and Q&A sessions to sell, or communicate, the package to the employees.

Implementation at the Quality Road plant was smoother since management and unions had had good relations for 30 years. Importantly, the negotiation process at Quality Road did not involve removal of an entrenched benefit as was the case at Pioneer Sector 1. There was one formal meeting between Branch Committee and management (lasting up to midnight) and one more meeting between the Branch and members, and everything was settled. According to Mr. James Tan (the IRO at the GSK Pioneer plant), "*At Quality Road plant, the performance figures were known when the proposals were raised, the figures were felt to be fair, and got easier acceptance from the Branch and the members"* A key difference across the Pioneer Sector 1 and Quality Road plants was that the Quality Road plant had older unionists who had the trust of both the management and the members. The branch (Union) leaders in Pioneer Sector 1 were younger, newer and were sandwiched between the management pressure on the one hand and response of the members of the ground on the other hand. He further argued that wage restructuring exercises cannot succeed without efforts on the part of both the Unions and the

management. He said "*There are 'push' and 'pull' factors in an exercise like this—while management may push, we need to 'pull' to get members to buy into the scheme*."
Reflecting on how the process could have been improved upon, Mr. Phua said: "*We could have done some simulation before hand. You can talk to people about concepts, but these could have been translated into models—people would have grasped it better"*. On the issue, Mr. James Tan said *"You need to 'facilitate' change, and there must be two-way traffic. Information was not so readily shared with the Union branch at the start of negotiations. We did not want relationships to sour, but the lack of information made things difficult to proceed.*"

In response to this, Mr Phua opined that the perception of a lack of information stemmed from the fact that the branch had difficulty understanding the proposed bonus scheme initially because it was new, and was not sure what information was relevant or necessary for them to make a judgement on the impact of the proposed bonus scheme. As negotiations progressed, they understood the scheme better, and asked for additional information necessary for assessment. This information was provided as requested.

Overall, Mr Phua felt that while there were difficult moments during the discussions at the Pioneer Sector site, the relationship was not unduly strained, not anymore than could be expected from difficult negotiations between two parties. Good sense prevailed on both sides during the process, and the parties understood that the broader issue at stake was one of ensuring business performance to enable job preservation.

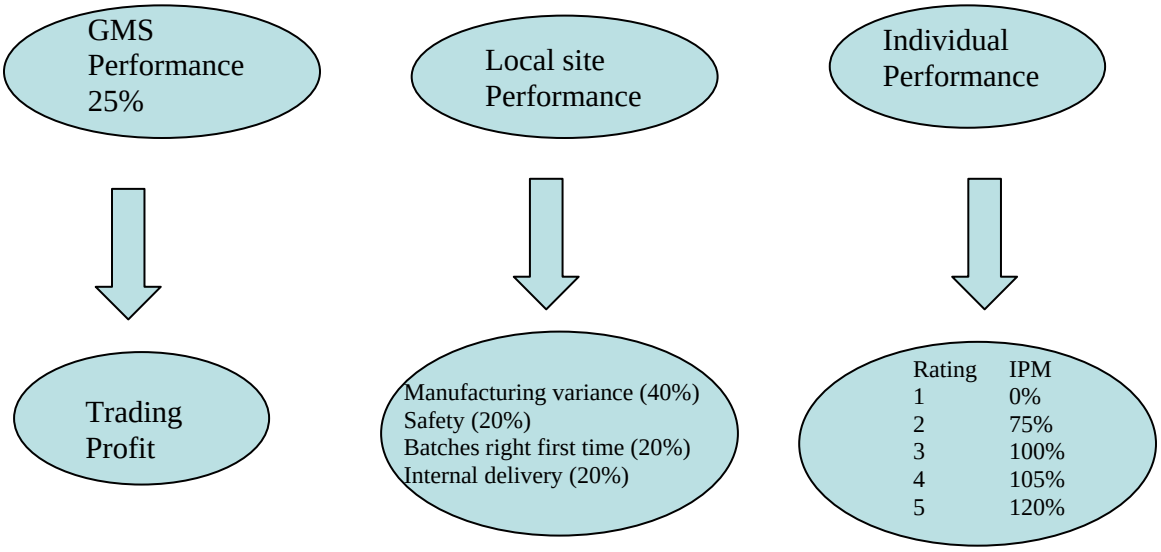
RESULTS

Starting 1st January 2003, the performance bonus was introduced to replace the service benefit. The assumption was that performance bonus would motivate performance by rewarding achievement and inducing positive behaviors. Concurrently, a Personal Development programme to promote career advancement and performance improvement was introduced, as was a renewed focus on healthier lifestyles which would also help contain medical costs.

In the first year after the exercise, the plant met targets for KPIs. In the first payout of the CA, majority of the staff fared better than they had previously with the average performance bonus at over $3000—equivalent to Level 3 bonus.

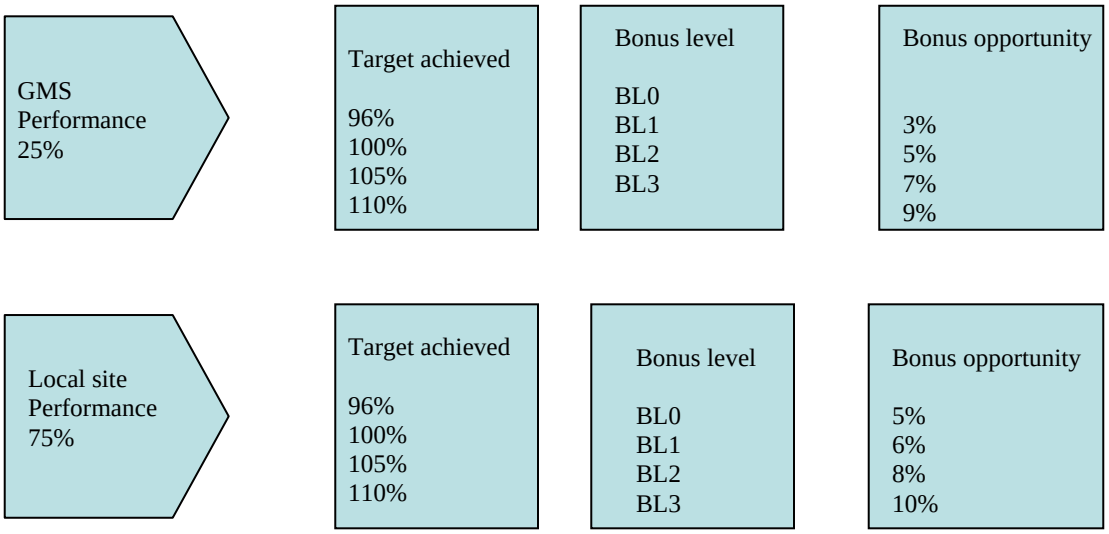
According to Mr. Phua, a variety of other benefits are also apparent. Speaking about employee behavior post implementation, he said: "*People are now more conscious of measures. When there is a batch failure, they know what it means. Also, they are aware of what makes a business succeed and how that affects what we get*." Speaking about the performance driven culture in the company, he said: "*People are more aware, more focused. We talk the same language--if we find things not going right, we get round to fixing it, we would warn each other of unusual incidents that may impact performance."*

Figure 1: KPIs at different levels impacting the bonus for individual employees



1. The figure shows the three different levels of KPIs affecting the bonus of employees including: Trading profit for the whole GMS (25% weight); Performance of the individual plant (4 criteria; weight=75%) and the Individual Performance Moderator (IPM).
    a. More details about the targets for GMS and site performance and their corresponding bonus levels are included in Figure 2
2. Based on a rating of 1 to 5 for the IPM, the multiplier for individual employees (influencing the % of bonus payable) could vary from 0% to 120% of bonus recommended for the particular plant.

Figure 2: Site Bonus Opportunity



Notes:

1. GMS Performance and Local Site performance refer to the performance of the Global Manufacturing System and the Local Plant respectively
2. BL0, BL1 etc. are acronyms for Bonus Level 0, Bonus Level 1 and so on.
3. Bonus Opportunity refers to the percentage of bonus (based on annual wages) payable to the employees.