What to Expect From Incentives

Many organisations are using bonuses and incentives to attract and retain staff. But these are performance management tools which should not be misused as de facto base salary.

Let’s be clear about what we mean by a bonus and an incentive. In our book, a bonus is an extra payment which is really discretionary. It's an after-the-fact, subjective reward. An incentive has a predetermined, mutually agreed performance target to aim for.

Incentives are much more effective motivators than bonuses because employees are generally more motivated by targets they know they need to achieve than by after-the-fact thank you’s. Employees might not exactly know what they've done to receive a bonus. But when they know how high the bar has been set for them to achieve an incentive, they can work towards that.

But neither reward is effective if the employee does not know what is being rewarded. Bonuses and incentives are meant to reward achievements which are over and above what is expected in the role. Without linking them clearly to performance, employers are simply increasing their costs without gaining anything in return.

There is no point in having an incentive scheme without effective performance management. Performance management should never be viewed as a human resources exercise. It is a management tool which starts with business goals.

Before handing out an incentive, employers should know what business needs the incentive will achieve and how they tie in to the overall business plan. Is the incentive meant to improve sales, increase productivity or enhance organisational performance? Is it tied to project completion?

Employees should not receive an incentive simply for meeting their operational budget, or be given a bonus just for doing their job. That is paid for with base pay, and even this should have its own KPIs assigned to it. Base salary is more than just "come to work" money.

Any plan which rewards over-and-above base salary should be self-funding. Since every dollar of remuneration should achieve something, incentives reward performance which has in some way increased business outputs.

For many businesses this presents a problem. They don't have proper performance management systems in place to directly link employee achievements with business productivity. The result is to give employees a bonus or incentive with no clear understanding as to why it’s being paid. In effect, employers are paying twice for the same work.

The easiest way to measure business impact is via simple KPIs; there are a few basic rules for establishing useful KPIs:

- Link them to the annual business plan. The ideal is that everyone's combined KPI's should achieve the annual business plan. At the Executive level, this should definitely be the case – why would you have an Executive KPI that did not directly contribute to the organisation’s business plan? And for the managers in each Division reporting to the Executive, it should also be the case, and so on; hence the term cascaded KPIs.

- Communicate clear and measurable KPIs, ideally quantifiable, as these are less subjective.

- KPIs should be transparent and predictable. Employees can then calculate their own potential incentive pay.

- Limit incentive-linked KPIs to three - more than three will dilute the focus.

Ironically, variable pay linked effectively to business outputs is an effective way to keep remuneration costs **down.** With an effective performance management strategy, your truly best employees will be rewarded and costs will increase only when business productivity increases.

It's easy to lose sight of the big picture when dealing with individual employee remuneration and managers pressuring you to recruit asap. But before paying out bonuses or incentives, be clear about what you want to achieve, because every job, and every dollar you spend on the person in it, impacts the business results.