12 Elements of an Effective Performance Incentive

Nobody works for money alone. But people always like to win, and they like to feel that their efforts to help the company win are appreciated and rewarded. Nothing says "thank you" like several weeks' extra pay. Design your incentive plan so everyone wins with these tips:

- **Simplicity.** The plan should be simple and straightforward.
- **Equatability.** The bonus program should be fair across the whole company.
- **Timeliness.** Lower level employees should get bonuses in every paycheck, mid-level managers should be bonused quarterly and senior executives should be bonused annually.
- **Relevance.** It should be meaningful to everyone – the management and the employees.
- **Materiality.** The amount of bonus must be significant enough to make a difference. Anything less than a potential extra paycheck is NOT an incentive
- **Gradiation.** Create multiple levels so employees always have higher levels to strive for. Structure the bonus so the lowest levels are achievable but the rewards are small, so almost everybody get something, and everyone is motivated to achieve higher levels of reward.
- **Objectivity.** Make the bonus based on measurable results, not subjective opinions.
- **Reinforcement.** Share progress against goals as frequently as possible.
- **Strategic.** Change bonus plans every quarter based on what the business needs at that time.
- **Above and beyond.** Don't bonus people for things that are part of the scope and responsibility of their position.
- **Controllability.** People have to be able to see how they impact the results directly to be motivated by a performance incentive.
- **Transparency.** Bonuses should be issued publicly. If a person isn't interested in the competition and transparency, they probably shouldn't be in a bonus-based position.

Beware these Pitfalls.

From thought leaders on Open Book Management, Bill Fotsch and John Case, here are four ways incentive plans go wrong:

1. The plan is based on individual rather than team performance. Big mistake. Business is almost always a team sport. Nobody wins unless everybody wins.

2. The plan is imposed from the top, with no input from the troops. If you involve employees in designing the plan—people will know what it's about, and they'll trust the whole idea.

3. The plan is invisible. At the end of the year, there may or may not be a bonus. **Compare that to specific targets that everybody understands and can track on a scoreboard every week. Watching the numbers, people learn what makes them move in the right direction. That's when they begin to think like businesspeople and come up with ideas to improve results.**

4. The plan isn't self-funding. People hit the goals! Only trouble is, cash is tight…

We always recommend that bonus plans be linked to key financial results, such as gross profit, or to indicators that have a direct and immediate effect on financial results, such as billable hours in an engineering firm. A good incentive plan should result in more money for everyone, company and employees alike.

Final Warnings

No Cliffs!

To be clear, I'm talking about the kind of cliff that plays an unfortunate starring role in many reward programs; the incentive plan with the all-or-none (or nearly so) singular award hurdle, very often set against prior year performance. The one that can essentially shut down any hope of actual awards.

I bump into plan after plan where this feature, which always sounds like a good idea in theory, has become an unnecessary morale-buster and veritable fountain of unintended consequences.

With a Cliff – Once someone knows they can't hit the target, they slowdown or sandbag.

With a Cliff – If market or economic conditions make the target impossible to achieve, morale tanks instead of focusing on effective strategies to remain profitable and lead the market.

With a Cliff – The temptation for short-term thinking is overwhelming – especially if a long-term investment that makes the company stronger and more competitive for the next five years also means missing the profit goal for the year – and the bonus tied to this target.

Bottom line: Incentive plan triggers and hurdles play an important role. They protect the company from paying out award dollars when it cannot afford the expenditure or when it simply doesn't make sense. The trick is incorporating them not only into a thoughtful plan design, but also into a well-balanced overall reward program.

Set Stretch Goals with Caution

1. Stretch goals can be terribly demotivating.
2. Stretch goals have a dangerous tendency to foster unethical behavior.
3. Stretch goals can also lead to excessive risk taking.

No Caps!

Design a program so that the higher the performance, the higher the reward. Too often, bonuses are flat amounts based on hitting different targets, and once team members have 'maxed out the bonus' they are no longer motivated by it. As long as the company keeps winning, they keep winning!

Excerpts from:

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