

## Employee Incentive Plans Everybody Loves Getting The Money -- But Where Are The Results?

Over half the insurance companies in the US have some sort of employee incentive plan. Sounds great, doesn't it? These companies appear to understand that motivating employees to produce above average results is a good thing, maybe even necessary for survival in today's marketplace. But even with these good intentions the sad truth is that the vast majority of these plans are ineffective and, unfortunately, a waste of money. They have little or no positive effect on the business results of their companies.

Why aren't they effective? Following is a list of design characteristics that we have found are either absolutely necessary for a plan to work well or will have a major impact on the results you can expect to attain. The problem with ineffective employee plans usually lies in one of these areas.

**1. Designed to Improve Business Results.** The best employee incentive compensation plans are designed to focus each department, team or unit on those things they control and then to reward them for attaining outstanding or excellent results. These plans are designed to encourage the behaviors, decision-making and actions that create the business results your stakeholders need, want and expect. These plans are "up close and personal." Employees know exactly what results they need to attain to earn a bonus. They also understand and accept that they have control over these results and can determine the amount of incentive they will earn.

This is a very powerful concept. It can transform a company from a standard performer where people come to work to just do their job into one where excellence and outstanding results become everyone's goal and nothing less than this is acceptable.

At the other end of the spectrum are those companies that pay incentives to employees as a way of sharing the company's good fortune when they either attain or surpass corporate goals. It is usually a little something extra at the end of the year for everyone so everyone can feel a part of the good results of the company. These aren't incentive plans because they do not incent. They tend to create an entitlement culture.

It's interesting that most companies that pay employee incentives based on corporate goals usually have poor, incomplete and unbalanced success measures below the corporate level. It takes a fairly significant amount of work to change this, but it's always worth it.

**2. Employees Have Clear Line of Sight.** One of the key concepts underlying all incentive plans is to reward people for behaving in ways beneficial for the company and for surpassing quantifiable business goals. Line of sight is the concept that makes this work. Line of sight means that each employee or team of employees can clearly see the action they take, the result this action creates and the reward they receive for attaining good results. In other words they have direct control over their results and the incentive payment they receive.

Having control over the specific success measures that determine if and how much you will receive in an incentive payment is critical to the success of any employee plan. If your plan pays for overall corporate results and you have more than 50 employees in your company, you do not have line of sight.

You can tell if your plan has effective line of sight by just asking your employees a few simple questions. What's their next incentive payment going to be? What did they do to earn it? What are they doing to continue earning incentives? If they can't answer these questions, your plan probably has little line of sight.

**3. Pays For Surpassing Business Goals.** Incentive plans can and should be intense motivators for everyone involved. For this to work well, the goals that everyone strives to attain must be core business goals. The best plans are based on each department's, team's or unit's core success measures. In other words, employees are rewarded for attaining their "balanced scorecard," assuming you've done a good job in creating your scorecard.

If you don't base your plans on measures that are this fundamental, you run a risk of having highly motivated employees expecting to receive incentive payments for attaining things that aren't important or that actually distract them from more important work. The key question to ask when establishing your plan's goals and benchmarks is . . .What behaviors will these goals encourage? If you like the answer, it's probably well designed.

4. **Encourages Team Results.** There are a lot of different ways to make payments. The best approach, and the easiest to administer, is to encourage team results by paying everyone in the department or team the same percentage of their compensation earned in the period.

This makes everyone "equal" and eliminates all concerns about fairness and favoritism. It also recognizes that almost everyone (except for a few executives and specialists) make their contribution as a part of a team, workflow or another group type activity. Since this common percentage is then applied to the salary and other compensation earned, the payments are appropriately "unequal." This assumes, of course, that your salary structure appropriately reflects the value each job and employee brings to the company.

Basing payments on individual goals and performance never works. It's too cumbersome to administer, creates perceptions of unfairness and doesn't encourage teamwork.

5. **Payments Made At least Quarterly.** Executive plans usually pay annually. This works well. Company financials are usually brought together annually and everyone feels comfortable with paying bonuses at the end of the year. Managers have a fairly long term attention span so annual payments seem to work well for them. But annual payments do not work well for other employees. Rank and file employees have a much different situation and attention span. Plans for employees must pay incentives at least quarterly to be effective. Anything less frequent is a waste of money.

Many companies understand this but simply don't know how to do the metrics and other calculations so they can pay quarterly and feel comfortable that they're paying for real results. We can help you with this. There are proven techniques that can bring these needs together in a way that works well.

6. **Plan Is Self-Funding.** The life expectancy of incentive plans where you have to budget the payments is relatively short. After a while someone always believes they can attain the same results without paying the incentives and that they can better use this money to hire more employees or to fund some other improvement.

The answer is to make your plan self-funding. This means clearly establishing each plan's financial connection so incentive payments are funded from excess profits earned. This is accomplished by making each area it's own profit center, regardless of what they do. And not all of these excess profits will be needed to adequately fund your incentive plan. In fact, most should be returned to the company, as a way of ensuring that the plan is always seen as beneficial to the stakeholders. This ensures it will continue.

Profit center management is a wonderfully exciting and motivating concept for business people. It is also difficult to accomplish unless you have a little experience. Difficult but necessary.

7. **Payment Amount and Method Are Appropriate.** Employees will become motivated to do the extra work to earn incentive payments when they see they can fairly consistently earn at least 6% to 8% of their total compensation. Anything less than this tends to fall flat. This doesn't mean you should design you plan to pay this amount. Instead, you need to design your plan so employees are capable of earning this amount when they do an above average job. 8% isn't intended to be a maximum available. The maximum should be rather open ended with a practical top of around 20%.

This doesn't apply to executives, who normally require significantly more compensation to change behaviors. If executives participate in an employee plan you will almost always need a second or supplementary plan for them to reach appropriate levels.

The amount paid should also be expressed as a percentage of total compensation. This will help you avoid potential problems with the Fair Labor Standards Act for non-exempt employees.

If you'd like to know more about how to create or improve an incentive plan for your employees, please call me or visit our website at [McDonaldConsultingGroup.Com](http://McDonaldConsultingGroup.Com). We'd love to help. It's what we do.