

Employee Incentive Plans -- The Three Most Common Mistakes

Banks and investment firms have done their best in recent months to give incentive plans a bad name. This is unfortunate because there is nothing as motivational or effective in helping a company attain its goals than a well-designed incentive plan. Unfortunately, a poorly designed plan is just as effective at making a real mess of things.

There are four general types of incentive plans in our industry. First are plans for technical experts who create benefits for your company through their own expertise and results. These include investment traders, some Information technology specialists and other experts. Agents and sales people could fall into this category but they are so large, specialized and unique that they deserve their own category. Third are executive plans. Lastly, there are incentive plans for everyone else in a company – Employee Incentive Plans. Plans for executives and investment specialists have been getting all the press recently. The abuses and poor designs of some of these plans have become apparent. Much of the current state of our financial system can be attributed to poorly designed and poorly managed incentives.

The two plans that have not been in the press are plans for agents and employees. Companies have recognized the importance of having effective incentives for their agents for a long time and almost always spend the money and time needed to keep them working well. In most insurance companies, the real opportunity for financial return – Yes, you should design every incentive plan to make more money for your company – lies in the last type of incentive plan; introducing or upgrading plans that encourage all employees to participate actively in your company's results. About half of the insurance companies in the US have one of these incentive plans. Unfortunately, most of these plans are poorly designed and are not producing results that make them worth keeping. Many are viewed by employees as entitlements.

Following are the three most common and most serious mistakes companies make in designing these plans . . . with comments on how to correct these deficiencies:

1. Companies use their corporate goals or core success measures to determine payments instead of team or unit measures.

They do this because it is easy. Most companies have corporate measures. They feel confident they are accurate, probably because they already use at least some of these measures in their executive plans. The problem is they do not work for other employees.

The whole point of having an incentive plan is to create and encourage behaviors that create better business results for the enterprise. This can only happen if the goals people are working towards are their specific goals, where they own and control the results they will be paid for. For the plan to be successful there must be a direct "line of sight" from the actions they take, to the results they attain and then to the rewards they receive. This never works if you use corporate goals.

When you use corporate measures, you create a profit sharing plan, instead of a behavior changing incentive plan. The payment becomes a gift, an entitlement, because employees cannot see what they specifically did to earn it.

2. Companies make a single, annual incentive payment instead of several throughout the year. This also never works. Employees need to receive payments at least quarterly to keep their attention and focus on creating results throughout the year.

When payments are made annually, employees will usually ignore the plan until shortly before a payment is due. If it looks like they might be close enough to earn some money, they will leap into action and start making improvements. This results, at best, in only three months worth of activity, instead of twelve months under a well-designed plan.

Companies like to pay annually because it is difficult to calculate team results accurately for many of the success measures every three months. Many measures need longer timeframes to project accurate and meaningful results. This is true, but you need to overcome these problems so you can pay quarterly. We can show you how to design your plan so you can do both, pay quarterly and get the short and long-term business results you need.

3. Many plan designs are not financially sound. Both the company and its employees must benefit from the success of these plans. If either is dissatisfied, the plans will fail.

Employees usually become dissatisfied when one of the following happens. The most common problem is that the payments earned are “token payments,” not large enough to keep everyone focused on creating above average results. Our experience (and the experience of most studies) indicates that employees must be able to earn incentives of at least 4% of their compensation to stay interested. Paying too much (more than 20%) is also a problem because employees rightly question if payments of this size will continue. Employees also need to be able to calculate and predict what their payments will be. This means their plans must be formula driven with no subjectivity. Employees always see subjective decisions about payments as unfair.

Companies discontinue these plans when they cannot clearly see the financial benefit from them. To overcome this, formulas used must include an assumption and calculation that ensures that most of the financial benefit returns to the company. We usually recommend at least 2/3 go the company but some measures require higher returns. This ensures that these plans pay for themselves. In most cases, incentive payments do not have to be budgeted. You pay them from additional profits, above plan. Again, we can show you how to do this.

The power from these incentive plans, when designed properly, is enormous. It creates and continues an environment where:

- No employee is satisfied with just doing a good job. Their new goal is to create above average results so they can earn a big bonus.
- Everyone continually tries to find and implement better and more efficient ways of doing their work because they own and have a personal stake in their results.
- Employees see their teams and units as mini-profit centers and manage both sides of the ledger, revenue growth and reduced expenses. This gives customer satisfaction a new dimension and importance.
- Everyone works on the right things because their team goals not only define what they do and why they exist, but they also support and integrate with the company’s goals. This ensures everyone is “pulling on the same end of the rope.”
- Profits and other corporate results get better and better as these plans take hold.
- Creativity and energy increases throughout the company from some of the most unexpected places and people.
- And . . . much more.

If you have an employee incentive plan, you may want us to look at it to see if it can be improved. If you do not have a plan, we would be happy to discuss various designs that may fit your needs. Please also visit our website at McDonaldConsultingGroup.com, where you will find further explanations of these ideas (and other exciting ideas) in our Concepts and Ideas section.