

HaRe Group newsletter: 27 April 2004

Subject: Incentives from well-earned rewards

The original headline in the recent AFR was "Dangers of the unearned bonus" - a warning to employers of the cost of a bad bonus design. The flip side is that a well-designed variable pay plan will provide employees with an incentive to perform better - not necessarily to work harder, but to focus on the things that matter most to business success.

The mainstay of the AFR article was that bonus plans may encourage employees to protect their bonuses by hiding their mistakes. The prime example is the recent case of NAB's "rogue traders" who were paid large bonuses just before their huge losses were revealed. The most helpful elements of the AFR article include:

- NAB's trading bonuses will no longer be based on individual profits - now, in determining the payments to financial market employees, team & business unit performance will be coupled with "people leadership" measures;
- More objectivity will be required - NAB's product/ division heads will have less discretion in the size of individual payments;
- More than 90% of Australian companies have bonus/ incentive plans, despite the long reported problems with bonuses;
- More employees are becoming eligible for bonuses - eg. all IAG employees are eligible to receive 10% of pay as a bonus;
- Some employees may be encouraged to exploit weaknesses in the design of bonus plans - eg. negotiating very low performance targets;
- Everyone agrees that a well-designed short term incentive (STI) plan will help drive better performance.

In my experience, many successful organisations make regular improvements to their STI plans. They know the competitive advantages that they can build if they can motivate better employee performance. The main areas for attention include:

- Focusing on business goals and strategies - NOT copying an incentive plan from another company because it seems to work for them;
- Objective measures of short term and long term business performance that should be applied to short term and long term incentive payments;
- Balancing individual, team and business based incentives;
- The delivery of incentive payments - eg. deferred cash, equity, etc;
- Involving eligible employees in incentive design and review.

Simon Hare
HaRe Group