HaRe Group newsletter: **16 February 2012**

Subject: **Is a buck in the hand worth two in the books?**

By this stage of the year, many people managers may be wondering:

Did our 2011 bonus scheme actually work?
Is this cost bubble really giving us a decent return?
Is variable pay for performance the best approach for us?

The business case for a financial incentive plan is well known: ***offer employees more pay based on achieving agreed objectives and they will focus their efforts on what's important and help improve business results***. The theory is sound, but the practice is often flawed. In many cases, the performance objectives agreed at the start of a year are too hard, too soft, or become irrelevant as the year develops. Sometimes the measurement system is subjective or sloppy or perceived as biased. Only in the best circumstances will a generous incentive plan have a good chance of success.

Of course, some companies feel compelled to have an incentive plan because it's such common industry practice – eg. in the financial services sector. However, in many industries, the use of "at-risk" remuneration management may be counter-productive.

In its simplest form, at-risk remuneration involves "withholding" a part of an employee's pay until a particular profit target has been met. When applied to many employees, a company can save significant costs during the year until its annual profit performance is known. The down-side of this approach is the negative impact on employees: their remuneration is measurably less than normal rates, and they have little, if any, control over the profit outcome. This situation relates to "a bird in the hand is worth two in the bush" – employees will feel dissatisfied with their poor come-to-work pay and will be more susceptible to other offers of employment. Good people will be the first to leave.

In my experience, employee attraction & retention is diminished more by low fixed/base pay, than attraction & retention is improved by the prospect of incentive pay. Independent research also indicates that the introduction of incentive plans usually has negligible impact on staff turnover rates.

While industry prevalence can be a strong pull into employee incentive plans, it is more important for the Reward Mix (of fixed/base pay and incentives) to be aligned to business strategy and preferred organisation culture. In general, incentives only make sense when:

- Objectives are properly resourced by the employer and not subject to any perceived external interference
- Outcomes will deviate within a range controlled by participating employees
- Funding reflects the organisation's bottom line performance
- Measures are quantitative, impartial and respected by employees

Market leaders are now finding that it's sometimes more effective (ie. greater employee engagement with less pain) to commit more remuneration to fixed/base pay that is properly differentiated by work value, industry alignment, job family practice and employee performance.

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