Magic Workbooks

Business Survival Manual

BONUS SYSTEMS

OR

Life in the Incentive Lane

Sooner or later, most companies experience a short, passionate love-affair with a bonus system. In most instances the passion soon evaporates and the bonus system turns into one of those institutions we think we have to live with – like a marriage for form's sake. Only very rarely does a company manage to keep the bonus torch aflame and the incentive system a vital and successful part of translating company policy into payroll reality.

Why is that so?

Let's start out by looking at the overall goals of incentive payment systems:

Bonus Pay: the Ethical Perspective

Reward industriousness, inventiveness and initiative whenever they occur, and, by doing so, create an atmosphere of industry, invention and initiative-taking that will spur the mediocre masses on to greater achievements.

Bonus Pay: the Economic Perspective

Let's divide payroll into 80% fixed and 20% variable or bonus pay and then distribute those 20% according to individual performance. Total payroll will still be the same amount but total performance (and by extension: company profit) will be substantially higher.

Ergo: a bonus system is a sound economic proposition.

One or both of these perspectives, usually a mixture of both, are at the bottom of every incentive pay recommendation.

And both share a crucial problem: that age-old bit about Quantity vs. Quality or the whole needing to be greater than the Sum of its Parts.

Any bonus system can serve to increase individual output (i.e. the sum of all parts) but does it necessarily increase company profit (i.e. the whole)?

Let's have a close look at a bonus system in action in two companies:

Threadmill Corp. has instituted an incentive pay system for its 200 employees.

At the beginning of the year each employee has a talk with his/her supervisor during which up to 5 separate goals are fixed which need to be achieved by the end of the year to earn the bonus. The bonus is set at 20% of the employee's basic salary. Another talk is scheduled for the middle of the year to evaluate the achievements up to that point.

At the end of the year the management looks at the results: about a quarter of the employees have earned all or part of their bonus, the other three quarters are grumbling – and company profit has not risen significantly.

During the same period,

Mpower Inc. has used a similar bonus system with totally different results:

75% of all employees have earned all or part their bonus, no one is grumbling – and company profit has increased notably.

Does this mean that Threadmill Corp. has stupid, lazy employees and Mpower Inc. has smart and industrious workers?

Statistically unlikely.

Does it mean that Threadmill Corp.'s supervisors have judged their employees more harshly than those of Mpower Inc.?

Also unlikely – because company profit should have increased due to a decrease in payroll expenses.

Does it mean that there was something wrong with the goals set by Threadmill Corp. supervisors and something right with the goals set by the Mpower Inc. management?

You're getting warm…

The success of a bonus system depends on the art of setting goals.

That is the crucial factor. Don't bother checking five different bonus systems against each other – they will all be more or less usable. For example: It is not really relevant whether you have a fixed amount or a percentage of basic pay or a percentage of company profit as the basis for the incentive system. It does not greatly matter whether you have one, two or twelve prep talks scheduled between supervisor and employee. All that really matters is setting "good" goals.

So, what exactly is a "good" goal?

Example: The Churnover Corp. has a serious problem with its Accounts Receivable which are 20% higher than industry average and keep on growing.

Your first guess for a good goal might be to set the goal of 10% reduction in A/R to all employees in that department. And that would be dead wrong.

The way to get to a good goal is this:

Start by asking all the A/R people for the reasons behind the growing amounts of outstanding money. You will probably hear a lot of reasons that have nothing to do with the A/R department e.g. shoddy customer screening in the sales department, or problems with the financial software. Do not make the mistake of dismissing these reasons as evasions! Very often some type of inter-departmental trouble is at the root of bad performance in one department. If you want to solve that problem you have to go inter-departmental too. In this case, how about assigning the 10% reduction goal to one person in A/R, one person in Sales and one person in Central Purchasing (or whoever is responsible for the financial software).

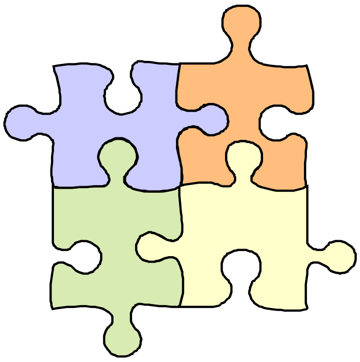
By doing so, you have killed several birds with the same stone: you have taken the complaining employees seriously (always a good idea), you have broken down barriers between departments (another sensible thing to do in times of trouble), and you have created a common objective for employees from different departments (thus enabling them to work together which they would not or could not do by themselves).

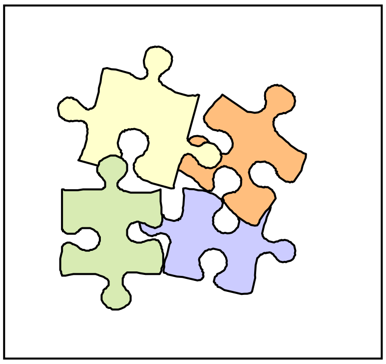
So, to summarize and generalize a bit: Setting a "good" goal takes time, thought and unprejudiced listening to the employees. It is NOT something to be scribbled down hastily at the end of a thirty-minute conference with an employee.

At this point, you might object to all the above by saying, "Quit dreaming! In my company I'm lucky if my supervisor listens to me at all. If I suggest that kind of breaking down of barriers between departments, he'll probably have me committed."

Point taken. But ponder this: if a company is not able to deal with inter-departmental problems in a supra-departmental effort, then what is the company good for? It might as well be a collection of small shops bound together by a number of contracts, each small shop increasing its profit at the expense of one of the others. And if that is the case, no bonus system will ever work satisfactorily.

Have you ever tried to lift a jigsaw puzzle off a table?





It will usually collapse into all the little pieces you spent so much time putting together. Only the very highest quality puzzles can stand that kind of tension – those are the ones with the seamlessly interlocking pieces.

Keep that in mind as a metaphor for company success and profit. It's not so much the quality of the individuals but their ability to interact seamlessly – to network – that makes a company great.

If you look at the task of goal-setting with a view to company success as a whole you will come up against a number of further questions:

How can you be sure that the goals you set at the beginning of the year will not be outdated by the end of the year?

How do you prevent "bonus hunters" from neglecting their regular duties?

How can you switch people to other temporary assignments when necessary without having endless discussions about how this affects their bonus points?

In short:
How can you manage a bonus system without being ruled by it?

There is no perfect answer to all these questions because every company will need to work out its own equilibrium between the flexibility needed in a rapidly changing business environment and the dependability and standardization required to inspire employee trust in the system.

There is, however, a basic organizational method that can help solve a number of problems:

Use the following three major segments for evaluation:

1. Fixed Income Performance
2. Individual Goal(s)
3. Extra Credit

The Category **"Fixed Income Performance"** allows you to measure basic job performance, say on a scale from 50 to 150%. This gives you an instrument to evaluate bonus hunters that do not perform as well as expected in their regular job duties: they may get 100% on their individual goals but they will also get a deduction from their Fixed Income Performance.

The third category **"Extra Credit"** is meant for innovative and profitable measures discovered or introduced by the employee. This is the category that leaves room for individual efforts – especially those that have not been set as goals but are nonetheless valuable for the company.

Within the scope of these three categories, most organizational problems that cause dissatisfaction with bonus systems can be solved.

The Bonus System in a Nutshell

A Bonus System must be easy to understand.

If your staff does not understand it, how can it be motivated by it?

A Bonus System must be easy to handle.

If its handling costs more money than increased staff performance saves, it is a waste of time and money.

A Bonus System must be flexible.

If it does not allow for changes and innovation, your employees will not come up with innovative measures.

The following MagicWorkbook® contains a complete bonus system matrix with an appraisal form template and automatically generated graphic and charted evaluations:

BonusManager **for up to 150 employees**

Visit us for more information and a lot of interesting tools and reporting aids for your business survival:

www.magicworkbooks.com Turning Data into Information