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‘Cash’ing In!

Cash incentives continue to be a critical factor in enhancing performance levels

HR professionals play a critical role in the overall framework of strategy formulation and its execution. In today’s knowledge-driven economy, the importance of strategic outcomes of HR activities is greater than ever before. This includes compensation management and related pay incentives.

Variable compensation for performance as a motivational tool is becoming increasingly popular as senior managers adopt means beyond the conventional compensation systems to reward performance. The prime focus is on aligning the reward mechanisms to the achievement of corporate objectives. Motivation and retention of key employees remains the main objective.

Incidentally, a majority of companies adopt the ‘pay-for-performance’ principle as the basis of their compensation system. To enable the success of such a system, the HR department should establish a well -defined link between performance and salary hikes. This is however, easier said than done.

The problem

A variable compensation system requires managers to benchmark levels of performance. However, they face various obstacles in the process. Firstly, the annual hike in salary is relatively minimal. Awarding the better performer two percent more than the cost of living does little to trigger motivation or recognition linked to it. Similarly, taking off two percent in the case of poor performers does not reflect much in terms of a negative consequence. As a result, most managers do away with the distinction between good and bad performers and everyone is entitled to the same increase.

Secondly, a majority of the performance appraisal systems are ‘afterthought’ appraisals. During the appraisal process, which normally is an annual activity, managers assess the performance of their staff. It involves a fairly objective and detailed analysis of the activity of each staff member, communicating the feedback to the employee concerned and recommending a performance-based pay hike or incentive whenever applicable. The typical avoidance behavior and indifference to good performance, however distasteful, is the result. Managers shy away from the appraisal process as if it were the plague. Though employees often claim to have a genuine interest in ‘knowing where they stand’, they are only interested in the outcome of the appraisal. Moreover, the employees are not concerned with understanding the metrics of performance evaluation – their interest lies in knowing their rating and the monetary impact linked with performance. This effectively negates the very purpose of performance appraisal systems.

Solving the problem

Organizations that need to resolve the issue do away with the merit system to adopt a variable compensation package, especially for middle and upper level managers in



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addition to teams and individuals lower down in the organizational ladder. Performance based pay takes the form of annual incentive bonuses that are proportional to the fulfillment of corporate and individual objectives in three areas, namely corporate revenues and gains, cost containment and behavioral changes. While the first two areas are quantitative in nature, the third area is qualitative in nature, and primarily involves the development of managerial and individual competence.

New corporate dynamics

Growing business rivalry

Free trade, mergers, takeovers and the urgency to adapt to the dynamic environment have made the trade market extremely competitive. In order to cope with the situation, organizations are trying to downsize and focus on certain lines of business only. Organizations are also providing subsidiaries and business units more opportunities to opt for products and services that have the highest performance potential.

Change in regulation environment

A new regulatory environment in entire industries like transportation and telecommunications is underlining the importance of performance. There is greater focus on recruiting and retaining top performing managers and individual contributors who can deliver 'bottom line' results.

Introduction of fee-for-service

A key future business opportunity includes fee-for-services. Most organizations are marketing their internal expertise such as information systems, along with services such as printing and consulting for third parties.

Profits

Shareholders and investors evince a keen interest in enhancing income and capital growth. As the management is considered to be the key factor behind the achievement of such increases, financial incentives are being used as a motivational tool for managers to attain difficult corporate objectives.

Differential benefits over direct competitors

As organizations clamor to gain competitive advantages over their market rivals, they expect the following from their management:

- Identification of the main performance priorities
- Alertness to performance difficulties before they reach alarming proportions
- Rectification of performance problems before they affect financial performance negatively
- Variable compensation pays for executives and managers who identify opportunities and/or methods for prudent and profitable new business initiatives
- Exact forecast of business variables in order to outsmart rivals during both upward and downward business cycles.



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The incentive pay scheme could be designed on the basis of any of the following models:

- An annual incentive scheme that recognizes participants in proportion to their contribution to the success of the organization and their individual performance.
- Incentives that are decided on the basis of impact on success at the corporate, unit and individual level.
- A system that enables the manager to measure his own performance.
- A system that uses the knowledge that individual managers desire to be compensated on the basis of their own performance levels.

Evidently, performance-based compensation incentives still play a major role in ensuring high levels of performance among employees in organizations. It thereby plays a vital role in the profitability of an organization. Non-monetary incentives may be gaining more popularity among the present workforce, but monetary gains still rule the roost.