PayScale

THE IMPORTANCE OF INCENTIVES

WHAT, WHY, AND HOW INCENTIVES WORK AT ENTERPRISE ORGANIZATIONS

Every human being on the planet wants to find fulfillment in their work. When a person is properly incentivized, you see increased motivation, performance, and engagement. How do you incentivize your workforce across the entire enterprise in a shrinking labor market?

Answer (unsurprisingly): A well-executed incentives plan. We'll discuss how below.

THE PAY FOR PERFORMANCE MYTH

Your goal is to drive the most performance possible out of your workforce. A secondary goal is to attract, motivate and retain your talent — so you can continue to drive performance against the overall organizational goals. Both goals can be accomplished with a proper incentives program. You incentivize your people, and they perform better. Sounds simple, right?

However, something's in the way. Despite investments in your people, you might be seeing lags in performance indicators. This has led many organizational leaders to conclude that pay for performance is no longer effective.

Similarly, technological advances and attitude shifts toward performance management have provided lackluster results. In fact, for years leaders have said that "performance management is dead," according to a strong myth prevailing in the market.

The truth is, these narratives are just that: myths. Pay for performance with a thorough incentives program absolutely works — and we have the data to prove it — but it needs to be thought through and executed well.

In this white paper, we'll explain what incentives compensation is, examples of how it works, its benefits, some potential pitfalls in such a program, and some tips for implementing and improving an incentives compensation plan at your organization.

Let's dig in.

WHAT IS INCENTIVES COMPENSATION?

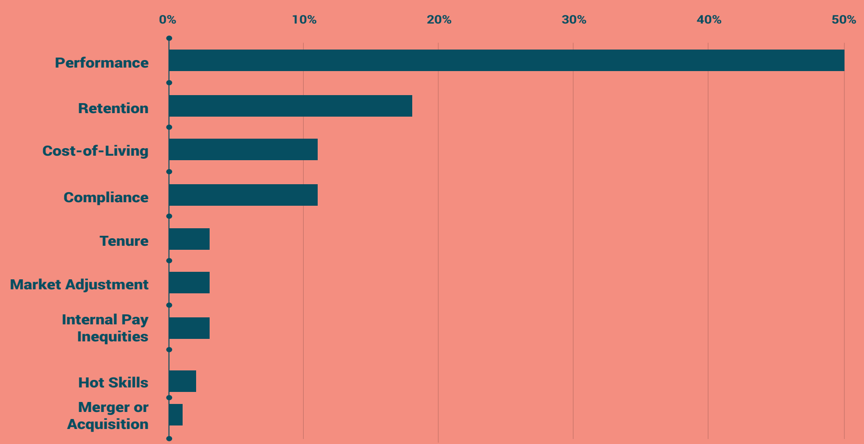
First, we need to understand what incentives are before we can begin to build an effective plan. Broadly speaking, incentives come in two types: monetary and non-monetary.

Monetary incentives are typically some kind of financial benefit above and beyond one's base pay. These could look like hiring bonuses, performance bonuses, raises (above adjustments for cost of living and inflation), and skills premiums.

Additionally, many companies offer more creative monetary rewards like profit sharing, company-wide bonuses, stock options, student loan reimbursements, tuition assistance, and healthcare incentives.

Our data from the Compensation Best Practices Report (CBPR) show the motivations for these incentives vary, but the most common reason is to reward performance goals.

TOP REASONS FOR RAISES IN 2018



Non-monetary incentives, often called perks, fall into many categories, but some widely-used non-monetary incentives include flexible work schedules and unlimited PTO, transportation and commuter benefits, gym and spa memberships, free lunches (literally), and learning and development opportunities, among many others.

One employer we know "kidnapped" his employees, then transported them to a local electronics store where they were given gift certificates for $200 and told they had to spend it — now! Years later, employees were still talking about how much fun they had. Other creative solutions, some of which are free, include:

- Six-month sabbatical after three years
- Passes to sporting events
- Catered lunches for winning teams
- Days off after meeting big deadlines
- Choice of work assignments
- Development opportunities
- Lunch with the CEO
- Remote work or flexible work location

You may not have the authority (or hutzpah) to go that far. Research from our CBPR shows what types of incentives were offered by how many organizations, so you can confidently color inside the lines.

BENEFITS ORGS OFFERED IN 2018

Employer-paid medical, dental, vision, etc	77%	Gym membership or reimbursement	23%
403b or 401k (or other retirement contributions)	72%	Transportation allowance	16%
Accrued or granted PTO	60%	Pension	14%
Accrued or granted sick	48%	Equity	13%
Education or tuition reimbursement	45%	4-day work week	10%
Remote work	44%	Unlimited PTO	9%
Accrued or granted vacation	44%	Unpaid sabbatical	6%
Flex-time	37%	Communiting allowance	6%
Paid family leave	32%	Paid sabbatical	4%
Tuition reimbursement	30%	Commute time	3%
Paid vacation (reimbursed)	23%	Paid childcare	2%

Many organizations use a combination of these categories to drive enterprise-wide performance in their people. So, what does that look like?

WHAT ARE SOME EXAMPLES?

The new world of work has upended traditional management models, especially regarding compensation and performance, as we mentioned earlier. Now, organizations are completely rethinking how to reward their people for performance while saving labor costs.

In a popular article from *Harvard Business Review* called "The New Rules of Talent Management," management experts provided research and examples of some organizations who do this well.

Macy's, in one example, changed its practices to provide "spot bonuses to recognize contributions when they happen rather than rely solely on end-of-year salary increases." The authors noted how their research shows "that compensation works best as a motivator when it comes as soon as possible after the desired behavior." Spot bonuses are a great way to motivate employees who achieve straightforward goals.

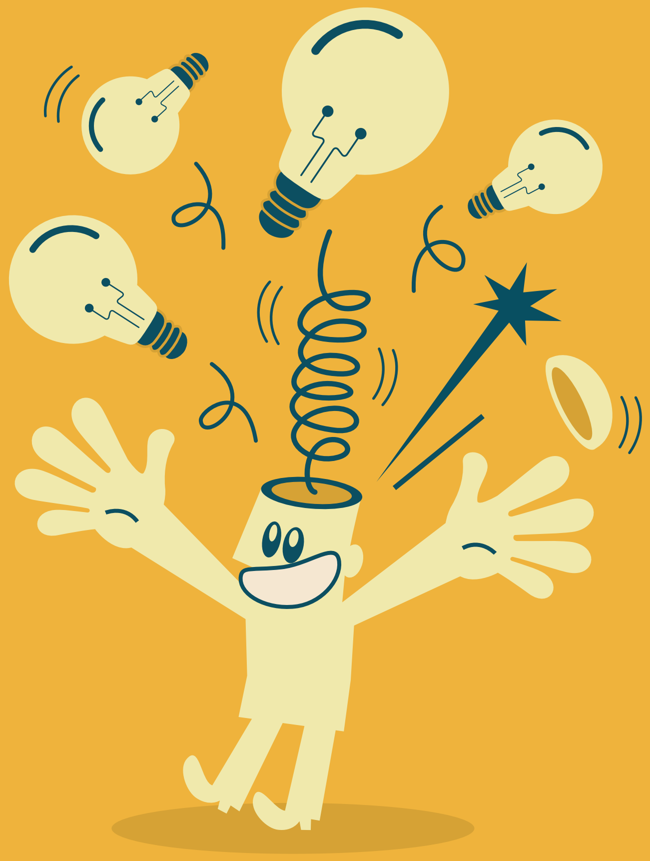
That may work in retail, but in more complex knowledge work, like when employees take on challenges at Patagonia, companies can adjust wages for each job based on skills and future market rates. Patagonia also "retains a budget for the top 1 percent of individual contributors," so their pay is commensurate with individual and organizational goals.

Even universities, as complex as these institutions are, use compensation to strategically align the organization to its long-range goals. Baylor University needed to benchmark the pay for its 1,500 positions against market rates, which took an entire year. But with some insight and great technology, the HR team needed only a week to do the same task. This move increased the team's efficiency, the confidence in HR's strategic decision-making and FLSA compliance resolution.

We should note that incentives aren't just for quantifiable performance. Some organizations use compensation practices to reinforce cultural values like learning and knowledge sharing.

Whatever the reason you choose to redesign your incentives compensation, it's important to understand the benefits of different designs as well as the end goals you're trying to reach.

Let's look at those now.



WHAT ARE THE BENEFITS OF INCENTIVES COMPENSATION?

Why incentivize your people with monetary and non-monetary rewards? It might be obvious that humans respond to rewards — even rats and dogs do that — but, going back to the previous point, the benefits of incentives look different depending on how you design your program.

We've written before about incentive plan strategy. To sum up those elements, you need to understand the unique aspects of your workforce, your organization as a whole and your overall organizational goals. We call this "compensation triangulation." By analyzing the composition of your talent — through demographic data like jobs, ages, genders, skills and industries, and psychographic data like, attitudes, opinions, beliefs and motivations — you can start to get a picture of the benefits of your particular compensation mix.

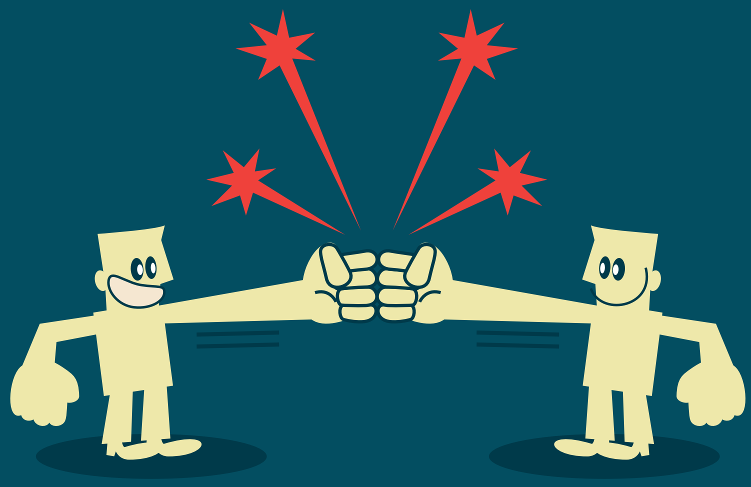
Incentive program are made up of a variety of elements; organizational goal alignment, compensation mix, workforce characteristics, speed of business and communication. You know younger workers want more pay, career stability, and learning opportunities. So, you can create incentive programs based on recognition and feedback about how they're performing in your company. This incentivizes a positive feedback loop, where they feel comfortable and secure in their place within your organization, which generates greater productivity over the long term.

Sometimes it's difficult to connect the dots between pay for performance programs and actual performance. How do you know which is correlation and which is causation? You can, however, reverse engineer an organization's performance: In our latest CBPR, we asked top-performing organizations what they did to build a pay "brand" with their employees to better understand what works and what doesn't.

Here are seven correlations between top performers and pay. Top-performing organizations:

- Are more likely to pay more for competitive jobs.
- Give base pay increases.
- Are also more likely to use variable pay.
- Are likely to use a greater variety of tactics in order to reward high performers.
- Get a pulse on employee engagement more frequently.
- Have plans to develop their staff.
- Are confident in their managers' ability to have tough comp conversations about pay.

If you want to dig into more of the data, see our CBPR results here.



WHAT ARE SOME POTENTIAL PITFALLS?

Let's say you're ready to rethink your incentives program. What are some classic mistakes we see at the enterprise level?

Failing to appreciate a growing threat.

The first mistake we see large organizations make is failing to see the bigger picture about their employees: They are growing more confident about their ability to find another job. Ipso facto, they aren't afraid to leave you.

"With a stronger economy," a 2019 retention report from the Work Institute says, "job creation is expanding at a record pace and unemployment has declined to historic lows." Voluntary turnover has exploded in this setting, where 27 percent of employees left their jobs in 2018 and 35 percent are predicted to leave their employers each year by 2023. Associated turnover costs, according to this study, is estimated at $600 billion, most of which was controllable had employers taken the necessary steps.

You don't need to be afraid of these phenomena either, as long as you understand that it's a thing and will continue to be a thing for years to come. There are proven steps you can take to improve retention through compensation.

Failing to communicate compensation clearly and transparently.

The internet is a wonderful tool. On the one hand, your employees can find any information their hearts desire. On the other hand, your employees can find any information their hearts desire. This includes information about their pay and the market rate for their skills and experience.

Whether you admit it or not, your employees are constantly checking free tools to compare their salary against their peers. The moment those two numbers are misaligned, you can have a problem on your hands.

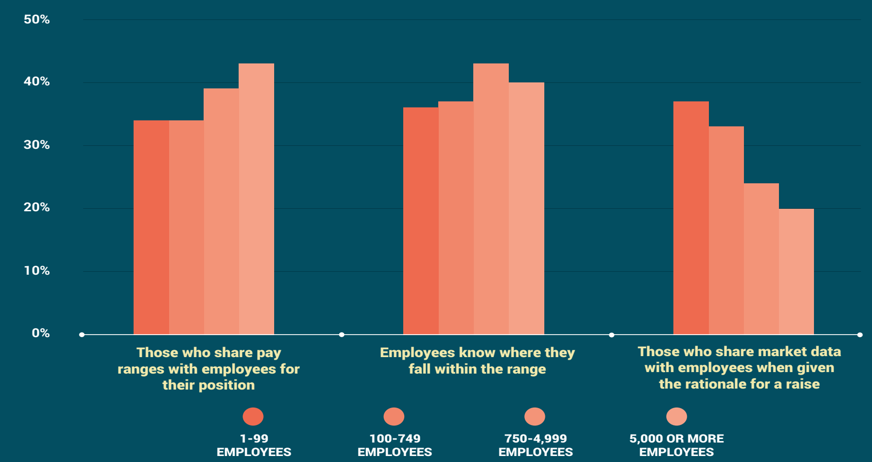
So, it's best to communicate why you pay your people the way you do. This mitigates those fears ahead of time, providing your employees more context behind your decisions. We call this the pay transparency spectrum, which you can see here. Many employers feel compelled to provide this information because, frankly, employees are going to find out anyway. It can only help you in the long term.

PAY TRANSPARENCY SPECTRUM

	WHAT	HOW	WHERE	WHY	WHOA!
	1. Your organization tells employees when and what to expect on their paycheck	2. Your organization shares some market data with employees	3 Your organization has a comp plan and shares pay ranges with individual employees	4. Your organization's comp plan reflects org culture, drives talent strategy, and is open to EEs	5. Ranges and employee pay information is available to all employees
CURRENT PAY TRANSPARENCY	46%	23%	18%	7%	5%
DESIRED PAY TRANSPARENCY	22%	19%	28%	23%	8%

Opaque pay practices, on the other hand, may also lead to inequality — which then leads to lawsuits, or worse, distrust in your brand. A pay transparency spectrum can highlight biases and inequalities hiding within your organization.

PAY TRANSPARENCY ACTIONS BY COMPANY SIZE



Failing to compensate fairly.

Speaking of inequality, paying your people fairly — regardless of age, gender, religion, or ethnic background — is table stakes nowadays. Even reputable firms like Google and Goldman Sachs deeply struggle with pay equity, the latter of which has a UK office that appears to pay men twice what it pays women. Despite tech giants' annual diversity reports and equity guides (like Google's), there is still more work to be done.

Pay equity is table stakes nowadays because if you refuse to acknowledge the problem, you're sunk. Just ask Oracle: They were recently blasted in the *LA Times* for refusing to open up about their equity analyses. This can wreak havoc on a firm's pay brand. So, what's the problem?

In our Gender Pay Gap report, we noted how women are still underpaid relative to men in the same position $0.79 for every $1.00 paid to men. The same inequality can be found in racial groups as well: white men out-earn minorities by a considerable margin.

We have lots more to say about this. If you're looking to better understand pay equity, consult our Gender Pay Gap report and the tips we've written down in "Your Pay Equity Guide."

WHAT ARE SOME TIPS FOR IMPLEMENTING AND IMPROVING A PROGRAM?

So, with all this in mind, what can you do to bring a better incentives program to your enterprise? Here are a few tips we've learned over the years.

Differentiate bonuses from incentive pay. Bonuses are paid based on past outcomes. Incentives are intended to motivate future outcomes.

Match the incentive cycle to the work cycle. Consider linking incentives to the speed of work. For example, if your employee has just finished a six-week project, pay the incentive at the end of that six weeks.

Align your incentives at the individual, team and organizational level. Every objective is either met or missed because of actions taken at the individual, team and organizational level. Make sure your incentives reflect this reality.

Think about the mix of base pay to variable pay, depending on your organization's size, the types of jobs, your industry and so on.

Aim for self-funding, i.e., plan for incentives to come out of increases in sales or productivity.

Keep it simple. If your comp plan is too complicated, your employees won't understand it and won't be motivated by it. Plan administrators will struggle with it, too.

CONCLUSION

We hope this white paper has been helpful in reinventing your incentives program. If you're looking for more best practices and useful data to get your program off the ground, we're ready to help give you the data you need.

GET THE BEST INCENTIVES DATA

You've seen why and how to create a great incentives plan. All it takes is a little guidance and a lot of great data. Thankfully, we have both.

THE PAY BUSINESS IS REALLY PEOPLE BUSINESS

The best organizations use compensation to communicate their values, align their employees and drive results — tangible and intangible — for years to come. They show their values in their budgets by providing **transparent**, **fair** and **modern** compensation strategies.

TRANSPARENT
Tell them the truth.

FAIR
Pay them right.

MODERN
Comp for today and tomorrow.

That's why we built the best compensation data and technology on the market.

We are the change agent that seeks to transform comp, to pull it out of the shadows and into the future, where people know their worth, transparency fosters trust and employers know that paying people right is good business. We're armed with data that's strong and continually improving. Our products are people-centric, built to help organizations excel.

OUR MISSION IS CLEAR: BRING PAY FORWARD

We want to help you bring pay forward in your organization to thrive in 2020 and beyond. Let's get to work.

ABOUT PAYSCALE

PayScale offers modern compensation software and the most precise, real-time, data-driven insights for employees and employers alike. Thousands of organizations, from small businesses to Fortune 500 companies, use PayScale products to power pay decisions for millions of employees. For more information, please visit www.payscale.com or follow PayScale on Twitter at www.twitter.com/payscale.

Learn more about how getting pay right can positively impact your organization's turnover rates and allow you to be ef cient and strategic for your organization. PayScale provides compensation software solutions, as well as salary survey data, for every organization and every comp situation. Get out of spreadsheets and do the true work of compensation, from crafting your comp strategy to managing your pay brand to training your managers on how to talk about pay with their employees. The work of compensation is due for a transformation. It can be better, faster, easier.

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