

ADDED INCENTIVE

A good incentive scheme is an effective way to help deliver results, but volatile market conditions can make it a minefield for many businesses. Susan Doughty explains why incentive schemes often fail and gives pointers on how to avoid the traps.



THE EFFECTIVENESS OF INCENTIVE schemes is an ongoing issue for most organisations. Constantly evolving business strategy, volatile market conditions and the desire to drive outcomes create a minefield for good incentive design. Therefore getting the design right and achieving an effective return on the incentive dollars spent is a top priority.

Here are our responses to some of your questions on this issue.

I'm a cynic about incentive schemes—I think they never deliver real results. What are the signs of an incentive scheme in distress?

The 'gaps' in incentive design can be quite subtle, but collectively have the ability to derail a good incentive scheme. Typical symptoms often include some or most of the following:

- There are too many performance measures and the reward pool is sliced too thin;
- Scheme calculation methodologies are excessively complex;
- There is an 'industry of administration' keeping track of scheme results;
- Measurement systems are flawed and fail to support the scheme adequately;
- Targets and goals have become unrealistic and unachievable;
- There is a disconnect between the cost of the scheme and profitability—the organisation is paying most of the profit on sales to staff in incentives;

- The performance measures are out of alignment with a new business focus or market conditions;
- The scheme is acting as a disincentive in the workplace and isn't engaging and motivating employees;
- Employees have adopted poor behaviours, eg, heavy discounting at the expense of profit to 'make the numbers'.

Just where do you start when you want to design an effective incentive scheme?

There are a number of key steps in designing any type of incentive scheme whether short- or longer-term. It's a bit like following a recipe where every step is critical to the final product. Consideration of the following points will provide a road-map for good design.

- **Objectives**—Consider the need for the scheme and what it is there to achieve. Focus on this as the foundation for your scheme design and avoid any attempts to compromise these objectives.
- **Eligibility**—Question who should be eligible to participate in the scheme and why. Not everyone's role has an impact on the desired objectives—and if they don't, they should not share in incentive rewards.
- **Performance measures**—Decide which measures should be part of the scheme and which ones should be reserved for the performance management system. Avoid

making the incentive scheme a proxy for assessing overall job performance.

- **Performance components**—Consider whether the scheme should focus on individual, team, company performance or a combination of these components. Line of sight and your ability to measure effectively will typically determine which components are best.
- **Thresholds**—At what percentage of target should payments commence? What performance message does this send? A lower threshold may communicate that you are willing to pay for under-performance and/or the target is unachievable.
- **Target setting**—How difficult is it to achieve the desired results? An overly ambitious target will quickly become a disincentive.
- **Maximums**—Decide whether the payment scale should be capped or left open-ended, to encourage 'sky's the limit' performance. Your approach will be determined based on the type of measures used and your appetite for risk.
- **Payment cycle**—As a rule of thumb, if measures are annual in nature then they will be paid annually, whilst KPIs that can be measured more frequently (such as gross sales) may be paid monthly or quarterly.
- **Scheme rules and governance**—Often overlooked but critically important to a

good design. Ensure that all contingencies are covered and well communicated.

- **Communication and implementation**—An appropriate communication strategy is vital to the successful roll out of your scheme. Keep it simple, simple, simple!

We are just embarking on a new scheme design. What are some of the traps we should look out for in our design process?

One of the most frequent traps is the tendency to develop schemes that are 'all singing and dancing'. Some organisations use their incentive scheme as a proxy for performance management and create schemes that have excessive numbers of performance measures and highly complex formulas for calculation. If your scheme document resembles a small novel—it is time to streamline your approach.

Another common trap is to try to implement an 'ideal' model design (that usually someone has used or seen elsewhere) and then try and leverage your business priorities into this model. This approach is bound to create a disconnect, often resulting in unsatisfactory compromises and a flawed design.

Our advice is to start with the business strategy and keep your design simple and transparent. **et**

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