How to Build an Incentive Compensation Plan

Attract, engage, and retain employees with a plan that rewards them for going above and beyond.

Namely HR for Humans

INTUIT

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INTRODUCTION

With everything else that HR has on its plate, building an incentive compensation program can seem like another daunting task on the checklist. However, providing the right incentives is key to driving employee engagement, productivity, and results. In this ebook, we've highlighted the areas to consider when implementing or revamping your incentive program.

What is incentive compensation?

Incentive compensation is supplementary payment given to an employee for a certain level of performance or productivity on top of their base salary. Incentive compensation programs can be beneficial for your recruiting, retention, and employer branding efforts.

What's the difference between an incentive and a bonus?

While incentives and bonuses fall under the same category of "variable pay," the similarities generally end there. Incentives are tied to a specific goal or plan, whereas bonuses are not. Incentive plans tend to encourage future results, whereas bonuses aim at rewarding past work.
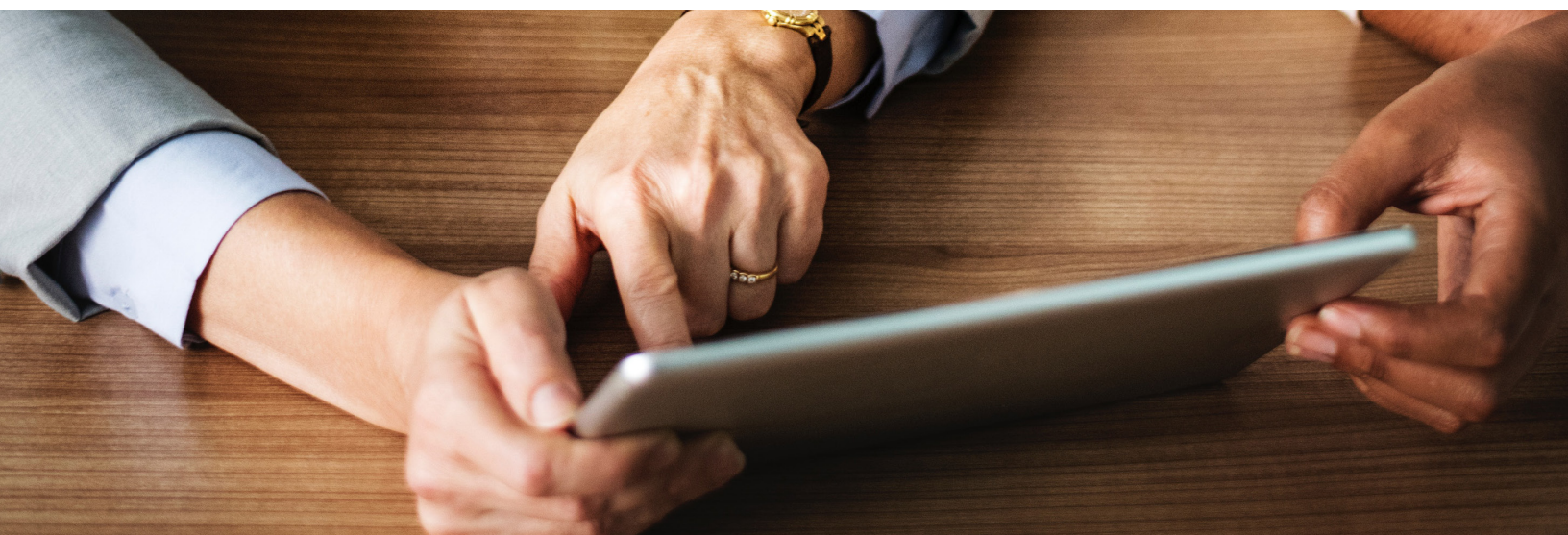
Advantages

Rewarding high performers on an individual or team level can have a strong correlation with overall organizational performance. Below are some of the advantages.

1. **It attracts and rewards high achievers.** Employee incentive plans are one of the most effective ways of attracting and retaining highly skilled workers.

2. **Motivation and productivity both increase.** Employees who get paid the same amount for their working hours, regardless of how much they're actually getting done, don't have much incentive to "work smart" or try out new strategies. Incentive programs motivate employees to go the extra mile.

3. **It boosts employee engagement and retention.** Employees are happier, more engaged, and loyal when you give them a reason to be.

4. **Teamwork is encouraged.** Offering group rewards for a job well done can double as a team-building exercise.

Disadvantages

Although incentive programs can be a great way to drive results, improperly designed plans can pose a number of disadvantages.

1. **Employees can become demotivated.** If the goals set are unattainable or too challenging, they can negatively impact employee performance.

2. **Subjectivity or bias can be a concern.** Quality of performance can sometimes become too subjective, relying heavily on the manager's perception.

3. **Competition is a double-edged sword.** Team spirit and morale can deteriorate if competition does not remain "healthy."

4. **Employee expectations might not be realistic.** Employees might begin to expect an additional payout year after year, which may not be sustainable for the company.

Determining Who is Eligible

Common criteria:
• Job category or department
• Length of service
• Job classification

Types of Incentive Compensation

Employees like to have control over their work environment, so why not offer them a say in their incentive options? Surveys are a great way to determine what motivates employees when crafting an incentive compensation plan. Consider offering a mix of incentives to keep the program exciting.

Financial Incentives:
• Cash-based
• Stock-based
• Prize-based

Beyond Financial Rewards:
• Flexible working options (flexible hours or telecommuting)
• Points (redeemable gift cards or time off)
• Learning and development opportunities
• Charitable donations
• Office perks

Timing

• **Annual:** An annual bonus is given to an employee in addition to their base pay. Annual bonuses are given once per year, usually at the end of the fourth quarter. These can be given for a variety of reasons, but are usually based on performance.

• **Quarterly:** Quarterly bonuses are metered out on a per business quarter basis. Sales organizations are common adopters of the quarterly bonus structure.

• **Spot:** Many organizations choose to offer incentives "on the spot" for achievements that merit particular notice. These bonuses are generally given in recognition of an employee exhibiting exceptional productivity.

Budget

How much should your business be budgeting for employee incentives? For some companies, incentives might account for as much as 10 percent of overall payroll. However, on average, incentive budgets sit at around 2 percent of an organization's total payroll. Even at times when revenue may be low, be sure to continue incentivizing employees in a way that resonates. After all, a business can't succeed without the hard work of its employees!

Who Cuts the Check?

Payroll isn't always routine especially when incentives and commission come into play. These are considered "supplemental wages" by tax authorities. If you've ever received or processed a bonus in the past, you'll notice that it often displays as a separate line item on the employee pay stub.

Supplemental wages carry a much heavier tax burden than regular payroll. For administrators, there are two acceptable ways to handle these taxes:

1. A **percentage-based** approach applies a federal flat rate (22% for 2018) to the bonus. Keep in mind that other taxes, like Social Security and Medicaid, will also need to be deducted.

EXAMPLE: AN EMPLOYEE RECEIVES A $1000 BONUS
Calculated in California, Based on Percentage Model

State - 10.2%
Medicare - 1.5%
FICA - 6.2%
Federal - 25%
SDI - 0.9%
$102.30
$62.00
$250
$562.20
Net Pay - 56.2%
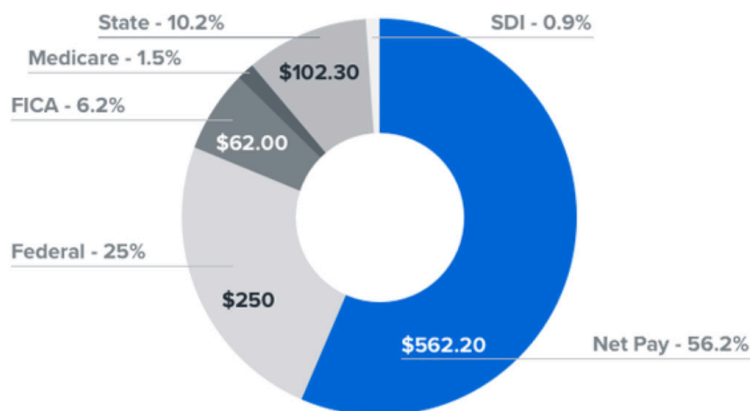
2. An **aggregate** approach is much more complex. For clarity's sake, this method is best described in steps:

a. Add the bonus amount to the employee's most recent paycheck.
b. Take the sum and determine the regular federal withholding amount.
c. Subtract the usual withholding amount from the combined withholding amount.
d. Withhold the difference from the bonus.

Measuring Success

Choosing metrics for success is critical not only to implementing an effective incentive compensation plan, but also to moving the overall business forward.

First, determine your ideal outcome. Goals might include:
• Improving performance
• Creating focus and driving productivity
• Encouraging ownership and improving company culture

The measurements of success should correlate with the goals you have in mind for the program. You might track:
• Net revenue
• Quota achievement
• Customer satisfaction
• Project completion

How to Ensure Succcess

Watch out for these common "traps"
• Employees aren't motivated by the incentive offerings.
• The performance or productivity goals were unclear or unrealistic.
• The performance standards or plan, in general, were changed midstream.
• The success factors were not objective.

Instead, be sure to:
• Explain in detail how the incentives work, and how to achieve the bonus.
• Check in with employees regularly to gauge their satisfaction with the plan.
• Determine the appropriate metrics to measure success.
• Communicate the program in detail with leadership and employees.

CONCLUSION

How to Get Started

1. Identify the goals of the program and ensure they are attainable. A good incentive plan is aligned with goals and results that are tied to the larger company objectives. Do you need to increase production? Are you looking to drive additional revenue?

2. Consider your eligibility criteria. Who is eligible for the incentive and what is necessary for an employee to achieve the benefit?

3. Determine what incentives are best for each team. What motivates one team may not motivate another. Rewards come in many forms and crafting a mix that motivates the various members of your organization will keep employees more engaged. Conduct surveys to discover what would best motivate them.

4. Communicate effectively and frequently. To reap the full benefits of an incentive program, employees must be fully in-the-know on the goals of the plan, what it takes to reach the incentive, and ongoing progress.

5. Determine the measurement of success. Understand the goals your organization would like to achieve and identify metrics that correlate.

6. Leverage technology to help calculate and track incentives. Determine what resources are necessary to manage the program at your organization for each department.

ABOUT THE AUTHORS

Namely

Namely is the first HR platform that employees actually love to use. Namely's award-winning, powerful, easy-to-use technology allows companies to handle all of their HR, payroll, time management, and benefits in one place. Namely is used by over 1,000 clients with over 175,000 employees globally.

Inuit

Intuit is dedicated to powering prosperity around the world with its intuitive web, mobile, and cloud solutions. Industry-leading products like Mint, QuickBooks and TSheets help consumers, small business owners, and the self-employed achieve their dreams. TSheets by Quickbooks is a top-rated employee time tracking and scheduling solution that helps small businesses save time and money on payroll.

Additional Resources:

Employee Bonuses 101

Payroll Guide: Definitions, Compliance, and Software

What is Incentive Compensation?

Designing and Managing Incentive Compensation Programs

6 Ways to Avoid Total Rewards Disaster

Employee Incentive and Recognition Programs That Work

Incentive Programs That Don't Cost Much But Can Maximize Returns

The 5 Elements of a Good Incentive Plan

Ten Reasons You Need An Employee Incentive Program

How To Implement Incentives That Actually Work