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## Steps to a Great Incentive Plan

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July Benefits Installment by Jim Moniz

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A performance based incentive plan is one element of compensation that most companies recognize as vital to the remuneration mix, but developing such an effective program requires some thought and effort.

To get things moving, you first have to define the specific goals of an incentive plan – are you seeking increased sales, improved customer retention, certain margins? Before you put a rewards strategy in place understand what you’re trying to achieve.

Once key result areas have been determined, identify which employees are best positioned to make these results happen; not every employee will be able to fulfill these initiatives.

Next comes quantifying the value created if incentive objectives are met – in other words, what will be the financial result for shareholders? This process typically requires construction of a model that projects base, target and superior result thresholds.

Once the economic value has been determined, you have to figure out the amount you will share with those employees who helped create the upswing.

First determine an acceptable “target” pay-for-performance return and then earmark an achievable “superior” return. Once those two measures are identified you can better establish an incentive goal.

The next step is to determine a standard that defines the potential value in current terms. The potential reward, then, might be stated as a percentage of contributors’ current salary – of course, the big question is the percentage amount. Incentive plan targets that combine the short and long term will likely be in the 60% to 80% of salary range for top managers and between 40% and 80% for second tier managers.

Establishing tiers comes next. After all, not everyone had an equal part in creating increased value. A business needs to define tier levels and assign participating employees – by establishing different tiers you can assign greater potential value to those who will have the greatest impact.

Weighting – or determining how much of a reward should be assigned to the achievement of various categories of expectations – is the sidekick to the tier concept. Weighting should be based on how much of an employee’s role impacted categories.

Determining allocation is the next step. You need to decide when awards will be paid out...at the end of the quarter, end of year and/or sometime down the longer road. Typically, a percentage of total incentives are paid annually and a percentage rewarded in the future.

The final step deals with the long-term portion of the incentive plan. This could take any number of forms. For instance, it could be held in a pool; credited with interest or investment earnings; or treated as a stock or phantom stock incentive.
With this type of incentive program in place, shareholders know the precise value accrued before managers earn incentives; they know the percentage of future growth shared with the management team; and they also know managers will be rewarded for achieving specific and measurable results.

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**About our Benefits Installment Author:**

James E. (Jim) Moniz, CEO of Northeast VisionLink, a Massachusetts firm that specializes in structuring executive compensation. James E. Moniz is a national speaker on the topic of wealth management and on executive compensation.

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