Making Incentive Programs More Cost-Effective

Time to Rethink the Year-End Cash Bonus

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Executives at a large company in Boston figured out an easy way to increase the size of their annual year-end bonus without actually earning it. The CEO of the company would personally distribute the checks at the annual holiday party, but the amount of the bonus was highly "negotiable," explains an executive compensation consultant who worked with the company.

"The other executives learned that if they got another Scotch into him at lunch, then the checks were a lot bigger," says Jim Moniz, president of Northeast VisionLink, who casts a skeptical eye on cash bonuses. "So if you're looking at it as an investment, we're not talking about a real return here."

The CEO's alcohol-inspired generosity might not be a common scenario, but it illustrates just how arbitrary critics say annual bonuses can be.

Cash is king in the current economic climate. But business leaders, executive coaches and human resources consultants mostly agree that the traditional cash bonus is not an effective way to reward and retain top talent. If used, a cash bonus must be tightly based on performance metrics, most say, but lower-cost alternatives to the year-end check often pay higher dividends.

The Trouble With Bonus Checks

More than half of small businesses that handed out bonuses in 2007 decided not to last year because of the recession, according to a December, 2008 survey of 75,000 small business customers of Palo Alto-based payroll management software company PayCycle Inc. Moniz says it's still a common practice among employers that can afford it. Meanwhile, recent research by HR consulting firm Watson Wyatt International shows no trend away from cash bonuses by large corporations.

Regardless, critics of the cash bonus insist that the one-time reward usually is quickly forgotten; becomes expected each year as opposed to appreciated; is often inconsistently applied; and ultimately does little to motivate or retain. And if a company suddenly stops its bonus program but fails to replace it with something else, it can be demoralizing to the staff, Moniz says.

"A lot of companies will say they're going through trying times, and then they'll stop things in a preemptive fashion," Moniz says. "If you take away a reward without replacing it or doing a great job communicating it, that person will feel betrayed."

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That betrayal comes from a sense of entitlement, says Chicago-based author and consultant Babs Ryan, who draws from her experience working in both the automobile and banking industries. "Both are crumbling despite high wages and massive bonuses," she says, due primarily to an unwillingness to use the stick – i.e., terminating low performers – along with the carrot. Simply firing "anti-change" employees, Ryan says, is much more effective than handing out bonuses to top performers.

Besides, top performers aren't even motivated by money, says Milan Yager, executive vice president of the Arlington, Va.-based National Association of Professional Employer Organizations (NAPEO). Instead, he says, top performers prefer non-monetary recognition and developmental perks, such as a high-profile assignment or a paid membership to a professional organization. Canadian career coach Linda Lopeke strongly agrees.

“I can assure you cash bonuses are not nearly as motivating as doing things that raise one’s perceived status among peers,” says Lopeke, of Lexicorp Services Inc., based in Mississauga, Ontario. “The money is pretty much meaningless otherwise and is quickly spent and soon forgotten whereas one’s reputation as an up-and-comer is the stuff of corporate legend.”

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Yager touches on another criticism of annual bonuses – the time lag between the act or acts deserving of the bonus and the year-end bonus check. Similar to how a pet dog responds more favorably when instantly rewarded after performing a command, he says, “You want to recognize the work with the reward when it occurs and not wait.” He says handing out a bonus at the end of the year usually fails to reinforce the behavior and results in a lost opportunity.

Attaching the Right Strings

Cash bonuses based on the proper metrics, however, can be effective, argues Laurie Bienstock, a practice leader with Watson Wyatt Worldwide’s strategic rewards practice. Bienstock admits that her experience is limited to primarily to Fortune 500 corporations, as opposed to small businesses, but she says linking bonuses directly to individual and company performance is “probably the best tool we have.”

The majority of corporations surveyed by Watson Wyatt have some kind of variable pay program (performance-based compensation) in place, says Bienstock, who is based in San Francisco. Variable pay programs might be based on profits or return on equity, she says, but startups can base such bonuses on market share or other non-monetary but measurable data.

Moniz says performance-based bonuses are effective only if the supervisor first understands what the company is trying to accomplish, what kind of performance will bring about the desired goals and which metrics will adequately track the performance. Also, he adds, reviews need to be done regularly and not just once a year in order to keep employees on the right track, bonuses aside.

But basing bonuses on metrics that bring about unintended consequences – overemphasizing one business goal to the point of throwing the organization out of balance – is one reason why bonuses often don’t work as planned, says John Seiffer, a small business consultant based in Milford, Conn.

“In a company of any size, things are so complex that almost anything that gets more effort does so at the expense of something else getting less effort,” Seiffer says. “That something else may not be as easy to measure but is usually just as important to the overall health of the company.”

Still, Seiffer says it’s much easier to track performance and tie bonuses to specific metrics in a smaller organization than a larger one, simply because the sheer size of a large corporation makes unintended consequences much more probable. Also, he says, it is much easier for employees of smaller companies – as well as their supervisors – to gauge the direct impact of each individual’s contribution.

Better Than Cash?

John Wilkerson, who runs Atlanta-based business consulting firm Bellwether Services, says that year-end cash bonuses only motivate workers until the next paycheck. So he decided to do things differently in 2009. Instead, he plans to offer company-paid carbon offsets for home energy use, greater name recognition among his high-performing employees through published white papers and speaking engagements, and trips to outdoor vacation spots for top-performers.

“All are intended to drive eco-efficiency awareness and improve mid-term performance,” Wilkerson says.

Symbolic recognition for a job well-done can go a long way, too, Lopeke says. Not only do recipients relish the chance to be acknowledged in front of their peers – especially when compared to the private nature of monetary compensation – but it motivates those who would like to be honored in the future, she says. Lopeke compares this to Hollywood’s coveted Academy Award (or “Oscar”), which is valued much more than the high fee for any particular movie role.

"Of course, once you've won an Oscar, the latter is pretty much guaranteed. It's the same in business," Lopeke says.

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Employment attorneys and HR managers advise employers to steer clear of implementing any age- or generation-specific bonus plans, but today's youngest workers are generally more motivated by a sense of social responsibility, says one consultant based in Tyler, Texas. Instead of a cash bonus, Brian Brandt, founder of Summit Solutions Group, suggests offering time off to volunteer or a donation to a charity.

Other suggestions include gift cards, weekend getaways, tickets to sporting or entertainment events, access to executive clubs, first-class airfare, a better office location and even tuition for continuing education.

"Maybe a weekend away or a night out allows them to recharge their batteries in more meaningful ways," says Fred Landis, senior marketing manager with San Jose-based Callidus Software Inc., which sells benefit-management software. "It's much more tangible and meaningful, and frankly it's a lot easier for companies to motivate employees."