



HEALTH WEALTH CAREER

EMPLOYEE REWARDS: IS YOUR INCENTIVE PLAN EFFECTIVE?



MAKE TOMORROW, TODAY



SIX WARNING SIGNS THAT YOUR PLAN MIGHT NOT BE HAVING THE DESIRED IMPACT TO ATTRACT AND RETAIN YOUR WORKFORCE FOR THE FUTURE.

Short- and long-term incentive plans are commonplace at most public and private companies. The goal of such plans is to drive increased attraction, retention and motivation, as well as desired behaviours in the workplace. However, these plans can be complex to grasp, administer, and assess for effectiveness. In addition, HR leadership is often overtaxed and so assessing the return on investment of incentive plans can become an afterthought.

With our breadth of experience helping Canadian organizations design effective incentive plans, at Mercer we have encountered a number of **warning signs** of an ineffective plan. Some typical warning signs include the following:

1. “WE DON’T UNDERSTAND IT” IS A COMMON REFRAIN IN THE CORRIDORS.

Have you heard these concerns? *“Every year, it takes days just for me to remind myself how it all works.” “They pay us in STI, and then again in LTI for the same performance. I don’t understand, but I’ll take it.” “I can’t keep track of all the measures; I just hope for the best, and it usually works out.”*

These are common sentiments we encounter when first discussing incentive plans with Compensation Committee members and senior management. This points to a lack of basic understanding of how an employee’s actions can drive both higher payouts and greater company success and is a clear sign that the incentive plan isn’t sufficiently motivating. In short, if the incentive plan doesn’t answer the question, “Why am I going above and beyond?” then it’s not effectively motivating your talent.

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2. THERE IS NO OBVIOUS CORRELATION BETWEEN COMPANY PERFORMANCE AND INCENTIVE PLAN PAYOUTS.

It doesn't take an in-depth analysis to see when payouts and personal performance ratings are divorced from company performance (e.g., consistently high, no matter how the company is doing), or when there are wild swings in performance assessment from year to year, driven by macroeconomic factors or "noise" that employees can't be expected to control. In many organizations, bonuses are generally consistent from year to year for most employees (e.g., +/- 10%), and employees may even speak of their bonus as though it were part of their base salary, something they simply expect. Therefore, the incentive plan may not be encouraging the right behaviours if employees do not feel as though they need to excel to earn it.

“Keep in mind, incentive plans are not just about paying more money for better results, they also can encourage managers to make the right choices that support the overall mission and strategy.”

3. THE STRATEGIC PLAN MAY NOT BE UNIVERSALLY UNDERSTOOD, OR NOT SUPPORTED BY THE INCENTIVE PLANS.

Senior leaders generally have the greatest visibility into strategy and how it is linked to employee rewards. It can be easy to overestimate the average manager's insights into these areas since they almost always receive less information, and get it much later in the compensation cycle. But giving employees a clear line of sight from strategy to incentive outcomes is a great means to get everyone pulling in the right direction, and

(especially if you grant equity), managing the business as if they owned it.

4. YOUR EMPLOYEES AREN'T TRACKING KEY PERFORMANCE INDICATORS (KPIs) THAT IMPACT THEIR COMPENSATION.

In many well-run organizations, KPIs are tracked regularly throughout the year (or in some cases, even "live" on screens in common areas). Items such as *cost per unit produced*, *days since last accident*, and *revenues* can all be communicated regularly for employees to rally around, with some of our clients reporting overhearing things like "Oh, we've started tracking a little high on cost, ask the team to be extra careful for the rest of the month." Try a simple test to see if employees are tracking their role in company performance: ask them in Q3 how they think their bonus is tracking for the year. If you get a blank stare or response that they're too busy to check, it suggests that the plan isn't motivating their decisions in a meaningful way. Incentive plans are also meant to answer the question "*What should I be focusing on if I'm working on a Saturday morning?*" They are meant to give leadership finer control over what the team is working on. Keep in mind, incentive plans are not just about paying more money for better results, they also can encourage managers to make the right choices that support the overall mission and strategy.

5. THERE HAVE BEEN MAJOR STRATEGIC CHANGES (MERGERS, NEW PRODUCT LINES, CHANGING REGULATORY OR COMPETITIVE ENVIRONMENT) SINCE THE LAST TIME YOU REVIEWED YOUR INCENTIVE PLAN.

If the business you are now running is materially different from the way it was the last time you updated your incentive plan metrics (including threshold, target and max levels), employees may be pursuing the wrong goals. For example, if you use a market share metric, you could even

be tracking the wrong market if changes in the competitive landscape are not reflected in your plans. If regulations have tightened (think financial services), your goals may be distorted or even impossible to achieve in the new landscape. We recommend an internal review/confirmation of your metrics each year, with a deeper dive when this raises red flags.

6. STRONG PERFORMERS ARE NOT DIFFERENTIATED FROM AVERAGE PERFORMERS.

Incentive plans are designed to differentiate outcomes by levels of [performance](#) – they are meant to pay more for those who contribute to success, and to recognize those contributions (“at least I’ll get a higher bonus”). If your payout results are “mushy” and everyone is more or less pulled to the same level, you may be doing more damage to motivation than good. Sometimes it is more important to be *fair* than to be *generous*.

“Unfortunately, many organizations know that something isn’t quite right with their employee rewards but are not sure how to effectively analyze and remedy the situation.”

LOOKING AHEAD

If your employees can articulate the value of your incentive plan, know their targets and [rewards](#), easily track KPIs, and are motivated to consistently outperform, your incentive plans are probably functioning well to attract your workforce for the future. Unfortunately, many organizations know that something isn’t quite right with their employee rewards but are not sure how to effectively analyze and remedy the situation.

As a good starting point, we recommend conducting a thorough, data-driven review

of your incentive plan. This could include a review of plan designs in your industry, key stakeholder interviews, [pay-for-performance](#) analysis or value driver analysis. This will help answer questions like: “How well is our pay aligned with the organization’s strategic needs and relevant talent comparators?” and “How are we tracking ROI to make sure we’re getting the best return on our incentive investments?”.

Mercer can work with you to answer these questions. Contact us today for a discussion about your concerns, current trends, and for an overview of our proven solutions.



ABOUT MERCER

At Mercer, we make a difference in the lives of more than 115 million people every day by advancing their health, wealth, and careers. We're in the business of creating more secure and rewarding futures for our clients and their employees – whether we're designing affordable health plans, assuring income for retirement or aligning workers with workforce needs. Using analysis and insights as catalysts for change, we anticipate and understand the individual impact of business decisions, now and in the future. We see people's current and future needs through a lens of innovation, and our holistic view, specialized expertise, and deep analytical rigour underpin each and every idea and solution we offer. For more than 70 years, we've turned our insights into actions, enabling people around the globe to live, work, and retire well. At Mercer, we say *Make Tomorrow, Today*.

HOW MERCER CAN HELP

Elevate your workforce with improved compensation and communication strategies. Draw from rigorous analytics and data-driven insights to increase the efficacy of your workforce. Mercer can help you design an incentive plan that appropriately recognizes your talent and inspires engagement.

For further information, please visit www.mercer.ca

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