

Designing Effective Compensation Plans

Your employees are one of your most valuable assets. In fact, they may be the backbone of your business. That is why management consultants say that hiring and keeping good employees should be a high priority for every manager or business owner. But attracting and retaining qualified, loyal employees are also among the most difficult challenges for any business today. To meet this challenge, businesses must compensate each employee in ways that rewards them fairly and motivates them to improve.

Years ago, employers commonly paid their workers through weekly salaries or hourly wages. The amounts were based primarily on experience, title, and length of service to the company. In effect, they based pay levels on seniority. Then they noticed that more seniority does not always result in more productivity. So, in recent years, employers have been moving to new compensation methods, basing pay more on performance.

This shifts the focus to results achieved (output) and away from experience and qualifications (input). And it allows the employer to see compensation as an investment that provides a return, rather than seeing it as just a major on-going expense.

To get the most return for your money, you should clearly communicate to each employee what is expected of him or her. With the employee's participation, set goals for the upcoming year and put them in writing. Let each worker know how he or she will be rewarded for reaching each goal. Be sure they agree that the goals are reasonable and the rewards for success are fair. Let them know how and when they will be evaluated.

During and after the year, sit down with each employee again and ask how he or she is doing. To a great extent, each individual should evaluate his or her own performance. When you reward an employee with cash, be cautious about giving a salary increase. Remember that salary increases are practically permanent. You may not be able to continue the higher pay rate during slow periods, or the employee may not continue to

perform at that higher level. For these reasons, cash bonuses often serve as a good alternative to salary increases. A bonus paid promptly rewards the employee for an accomplishment, and he or she can link the reward to the performance.

Paying Bonuses

Be cautious about paying bonuses every year at specific times. Employees may perceive the bonuses as regular compensation, instead of as a reward for exceeding expectations. They will begin to feel entitled to the bonuses and may even spend the money before they receive it.

The best bonus system is often the simplest one. For example, each worker in a group could simply be promised a set dollar amount, or a set percentage of his or her base pay, if the group meets a well-stated goal by a certain deadline. This type of goal can be tied to overall company performance to encourage teamwork.

For example, one company offered a \$1,000 bonus to every full-time and part-time employee if the budgeted net income was achieved one quarter. A chart was posted so everyone could see how they were progressing during the quarter. Employees pulled together and encouraged each other. Some even called the homes of absent co-workers to find out why they did not show up for work. For many, the money was a big motivator. Others were more energized by the simple desire to succeed. Americans love a contest and they love to win.

Employers who try this type of incentive plan are often surprised at how effective a simple bonus plan can be. But when setting goals, be very careful what you promise to pay for, because you will surely get more of it. Be sure you pay for results and not just for effort.

Other Ways to Incentivize Workers

You can also reward employees in ways other than by cash payments. Each of the following ideas has been used successfully by various businesses.

- The most powerful reward for a job well done may be the simple expression of appreciation, and that can be provided with almost no cost. People are motivated when they know their work is recognized and appreciated! Post a notice in the office acknowledging someone's special achievement.
- Thank an employee's spouse for being supportive when the employee has been traveling or working extra hours.
- Many employees cherish having flexibility in their work schedule. Work hard to offer this to your best performers. But be cautious about agreeing for employees to work at home. Only well-disciplined people are able to stay focused at home because there are many interests competing for their attention there.
- In addition to company-wide goals, every person should have personal goals. Otherwise, you may not be able to reward individual effort. The best goals are those which can be quantified, so progress can be measured. Restaurant gift certificates usually work well in rewarding small achievements.
- Pay particular attention to loyal employees. Loyalty is so rare among workers these days that you need to reward it. An extra day of paid vacation (when business is slow) usually works well.
- Recognize and reward positive attitudes and teamwork because they are contagious. Hand-written notes are great for this. These notes are powerful because they are used so seldom in business. (When was the last time one of your hard-working employees received a hand-written thank you note at home?)
- Benefits such as long-term care insurance, life insurance, child care, and retirement plans are highly valued by most employees. Many of these benefits can be obtained with some attractive tax breaks for both the employer and the employee. Group discounts help make some of them more affordable.
- Training is a valued benefit for many. Consider offering basic training in personal financial planning at no cost to the employees. (Many Americans do a poor job with their household budgets and their financial problems can affect their on-the-job performance.)

- Wellness programs have become popular and generally provide a good return for their cost. The program may include incentives as simple as cash rewards for employees who take the stairs up one flight and down one or two flights, instead of riding the elevator.
- Everyone wants to be heard. Give every employee access to management (and you may be surprised at what great ideas are laid out before you). One of the best ways to do this is by spending the time to give each employee a brief quarterly evaluation, and genuinely asking for feedback at that time.
- Do what you say you are going to do. Without this you will lose your employees' respect and trust, which are essential for a good work-and-reward environment.

How Not to Reward Employees

There are also some inappropriate ways to reward employees. For example, any business owner should be extremely careful about giving an ownership interest to an employee. Ownership will give that employee certain legal rights, perhaps including full access to the company's financial records. That employee may retain those legal rights, even if he or she leaves and goes to work for your competitor.

Also, do not allow grade inflation on performance evaluations. How many people can really be "above average?"

Some managers have given high marks to poor performers, in hopes that it would inspire better performances. But that approach does not work; it only serves to discourage the better, more valuable workers.

When employees ask for unreasonable raises, remind them that no one should want to be overpaid. After all, those who are overpaid have the least job security.

Poor Performers

Okay, so how to deal with an employee whose performance is disappointing? First, try some honest feedback. No one likes to deliver bad news but that is part of running a

successful business! Promptly point out precisely what is wrong and how it can be improved. Take time to also mention positive points. Be patient with those who are behind yet are trying hard – attitude is king. But remember that you *must* restrict pay for those who do not measure up, or you will not have enough in your budget to reward the better performers.

Final Thoughts

Employees are a strategic investment, not an overhead expense. And now that our lagging economy is presenting your business new financial challenges, this may be the time to improve your compensation plan. Be sure your pay system not only retains the most valuable workers, but also motivates them to achieve their very best.

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