

COMPENSATION MANAGEMENT

HRM3705

Study unit 5 Incentive pay

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Learning outcomes of study unit 5

Once you have completed study unit 5, you should be able to:

- Discuss how incentive pay and traditional pay systems differ
- Differentiate between the different types of incentive plans and evaluate their importance
- Discuss the incentive plans that reward individual behaviour
- Discuss the most broadly used company incentive pay plans
- Contrast between different individual and company incentive pay plans
- Design an incentive pay plan taking the company's goals, competitive strategy and culture into account

Incentive Pay

- Compensation fluctuates according to:
 - A pre-established formula
 - Individual or group goals
 - Company earnings
- Adds to base pay
- Controls costs
- Motivates employees

Dimensions of incentives

What is being measured? Inputs or outputs?



What period of performance does the payment reward? Short-term or long-term?



Does the payment reward individual performance or does it relate to team or organisational success?



Is measurement of performance based on a single factor, or multiple factors?



What form does the payment take: cash, company sharers, or non-financial?

Incentive Pay Assumptions

- Effective incentive pay systems are based on three assumptions:
 - Individual employees and work teams differ in how much they contribute to the company, both in what they do as well as in how well they do it.
 - The company's overall performance depends to a large degree on the performance of individuals and groups within the company.
 - To attract, retain, and motivate high performers and to be fair to all employees, a company needs to reward employees on the basis of their relative performance.

Incentive Pay Categories

- Individual—these plans reward employees whose work is performed independently
- Group—these plans promote supportive, collaborative behavior among employees
- Company-wide—these plans tie employee compensation to a company's performance over a short time frame

Individual Incentive Performance Measures

- Quantity of work output
- Quality of work output
- Monthly sales
- Work safety record
- Work attendance

Group Incentive Performance Measures

- Customer satisfaction
- Labor cost savings
- Materials cost savings
- Reduction in accidents
- Services cost savings

Company-Wide Performance Measures

- Company profits
- Cost containment
- Market share
- Sales revenue

Types of Individual Incentive Plans

- **Piecework plans**—reward workers for every item produced over a designated production standard
- **Management incentive plans**—award bonuses to managers when they meet or exceed objectives based on sales, profit, production, or other measures for their division
- **Behavior encouragement plans**—employees receive payments for specific behavioral accomplishments
- **Referral plans**—employees receive bonuses for recruitment of highly qualified employees

Individual Incentive Plan Advantages

- Helps relate pay to performance
- Promotes equitable distribution of compensation
- Helps retain best performers

Individual Incentive Plans Disadvantages

- May promote inflexibility
- Unrealistic standards may hamper employee motivation
- Setting performance standards is time consuming
- Factors beyond employee's control may affect outcomes
- May promote undesirable behaviors

Group Incentive Plans

- Reward employees for their collective performance
- Use has increased in industry
- Two types
 - Team-based or small group
 - Gain sharing

Types of Teams for Team Incentive Plans

- Work (process) teams—refer to organizational units that perform the work of the organization on an ongoing basis
- Project teams—consist of a group of people assigned to complete a one-time project
- Parallel teams (task forces)—include employees assigned to work on a specific task in addition to normal work duties

Gain Sharing

- Incentives based on company's improved productivity
- Based on open leadership
- Involves employee participation
- Includes bonuses

Company-Wide Incentive Plans

- Rewards employees when company meets performance standards
- Two Types
 - Profit sharing plans
 - Employee stock option plans

Profit-Sharing Plans

- Current profit-sharing plans
 - Financial reward for employees when company meets profit objectives
- Deferred profit-sharing plans
 - Right to purchase shares of company stock given to employees

Incentive Pay Considerations

- Based on individual or group performance?
- Acceptable level of risk?
- Replace traditional pay?
- Performance criteria evaluated?
- Appropriate time horizon?

Competitive Strategies

- **Lowest-cost**
 - Lower output costs per employee
 - Individual and group incentive plans
 - Behavioral encouragement plans
- **Differentiation**
 - Unique product or services
 - Creative, risk-taking employees
 - Long-term focus
 - Team-based incentives

END OF STUDY UNIT 5