Does Your Incentive Plan Overemphasize Motivation?

By Jason Adwin, Sibson

For the past two decades, nearly all employees, from executives to salespeople, have become eligible for pay-at-risk. There is good reason for this trend; well-designed and implemented incentive plans are compelling management tools. They control fixed compensation expenses and attract, retain and motivate talent — a hallowed mantra for many incentive plans.

Agreement on the first two components, attraction and retention, is nearly universal. Most organizations rely on a healthy mix of new and experienced talent to execute their business plans. The role of motivation, however, is subject to debate. In developing and promoting incentive plans, organizations should take care not to overemphasize the importance of motivation.

Whom Are You Motivating?
In the Merriam-Webster Dictionary, motivation is defined as, “the act or process of giving someone a reason for doing something.” In the case of incentive plans, pay is often used to incent high performance. This seems reasonable because there certainly are roles in most organizations where emphasizing motivation makes sense. Sales is one area where success in the job is, and has always been, directly aligned with incentives. Sales roles tend to attract people who are comfortable with at-risk pay. They like being able to influence their earnings, and they appreciate the upside earnings opportunity that sales plans offer (i.e., the incentive plan is motivating).

However, the same does not hold true for executive-level positions. CEO’s and other C-suite incumbents generally do not tie their level of effort to incentives (i.e., they are not going to work any harder because of incentive opportunities). The best leaders are self-motivated and manage to the longer-term interests of their shareholders. They pay little attention to the incentive implications of their day-to-day decisions. Many would be insulted by the inference that they require motivation or would manage differently because of an incentive plan.

Many employees in all types of jobs and at all levels think and act similarly. They have a natural drive to succeed and are motivated by other factors, most notably, recognition, career development, advancement and influence, in addition to pay.

Alternatives to Motivation
Organizations should consider emphasizing the following strategies in their incentive plan designs and communications:

1 | Goal Alignment: Organizations can use their incentive plans to improve goal alignment across the organization. Financial and non-financial organization-wide goals need to be established at the top and cascade down through the organization. Business unit and functional goals should be linked to the organizational goals and calibrated across the organization to reflect organizational priorities. Individual and team goals should then be linked to business unit or functional goals so that goals at every layer of the organization are synchronized. Goal alignment is critically important because it defines success across the organization, optimizes resource deployment and ensures all employees are moving in the same direction. Although rigorous goal alignment is possible without an incentive plan, it is more likely with an incentive plan.

2 | Success Sharing: Incentive plan designs need to share the organization’s success appropriately between the ownership/capital interests and the employees who deliver the results. In whatever manner the organization defines
success, the employees should share in its benefits, either through predefined formulas or within a range deemed to be acceptable. This “top down” view of incentive plans resonates with executives, the board and shareholders because it quantifies variable pay-for-performance, typically as a percentage of a profit measure (e.g., earnings before interest and taxes; earnings before interest, taxes, depreciation and amortization; or net income) and a percentage of fixed payroll cost. The appropriate levels, or sharing ratios, will vary by industry, phase of development/organization maturity, market competitive opportunities, debt vs. equity financing structure and the organization’s views on the prominence of incentive pay in the total rewards package. Once a sharing ratio is defined, it should become an internal benchmark for the organization to manage and assess its performance over time. Sharing value creation is a basic, but powerful incentive design tenet that most employees agree with and understand.

**Employee Recognition:** Well-administered incentive plans help organizations recognize their best performers through differentiated rewards. Constructive performance feedback on contributions and career potential is a compelling employee engagement tool. When these messages are reinforced with incentive dollars, it fosters employee goodwill and a stronger commitment to the organization though mutual respect and admiration between employee and employer. From an organizational perspective, incentive dollars are an investment in talent. Since resources are limited, organizations require a strategic approach to allocate incentive dollars so they produce the optimal return — the engagement of and continued contributions from top talent, which is difficult to quantify, but nonetheless real.

**Conclusion**

In working with organizations large and small, public and private, across industries and employee populations, the author has found that incentive plans have a higher organizational purpose and can create commitment among employees by recognizing the incentive plan is not the primary driver of motivation or performance. Organizations that focus their efforts on aligning goals, sharing success and recognizing their best employees will raise the level of dialog on the purpose of their incentive plan and greatly improve their overall results.

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