Sibson Consulting

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Insights and Strategies

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Incentive Plans

Rebooted for Today's Workforce

For decades, many organizations dangled the prospect of generous incentive plan awards to motivate employees to deliver the results management wanted. Although the tactic performed admirably during the last century's long periods of sustained prosperity when incentive plans consistently paid off to a Baby Boomer workforce,[1] this outdated "carrot" has not fared so well in recent years.

The extreme economic volatility of the 21st century has made it increasingly difficult for today's workforce, which is made up primarily of Millennials and Gen Xers,[2] to earn incentive plan payouts. Performance goals set by management frequently are unreasonable or become unachievable because of unforeseen factors beyond the control of the employee. As a consequence, incentive plans no longer function effectively as stand-alone behavior motivators.

But, that does not mean you should discount the value of your incentive plans. As this article will demonstrate, Sibson Consulting's client engagements suggest that organizations that create and nurture organizationally unique Employment Value Exchanges and position their incentive plans appropriately within that value exchange can reap the desired outcome of employees who are engaged in and committed to the organization's success.

> "Incentive plans no longer function effectively as stand-alone behavior motivators."

[1] Researchers and scholars offer many definitions of the workforce generations. For this article, we will define them as follows: Baby Boomers, born between 1946 and 1964; Generation X, 1965 and 1981; and Millennials, 1982 and 2004.

[2] "Millennials surpass Gen Xers as the largest generation in U.S. labor force," Pew Research Center, May 11, 2015

Commitment to business outcomes is essential for organizational financial success.

Yesterday and Today

Back in the days when organizational performance was strong, incentive plans paid out with regularity and were “assumed” to be *the* vehicle to motivate and drive performance results. But, this is not so today.

Much of the current workforce of Millennials* and Gen Xers see incentive plans as nothing more than a management tool to control fixed costs — the employer pays low wages and offers lucrative incentives that rarely pay off because the awards are tied to unattainable goals. This negative perspective on incentive plans and employer intent contributes to workplace dissatisfaction and a disengaged workforce.

Recent Gallup engagement polls studies indicate that a little more than 30 percent of the active U.S. workforce is involved, enthusiastic about and committed to their workplace.** The longitudinal Gallup studies further suggest that engagement and commitment to business outcomes is essential for organizational financial success.

Sibson has reached similar conclusions as a result of our client work, which leads us to focus our clients on approaches (such as rebooted incentive plans) to improve employee engagement.

* “Millennials: Coming of Age,” Goldman Sachs, 2016

** “Employee Engagement in U.S. Stagnant in 2015,” the Gallup Daily tracking survey, January 13, 2016

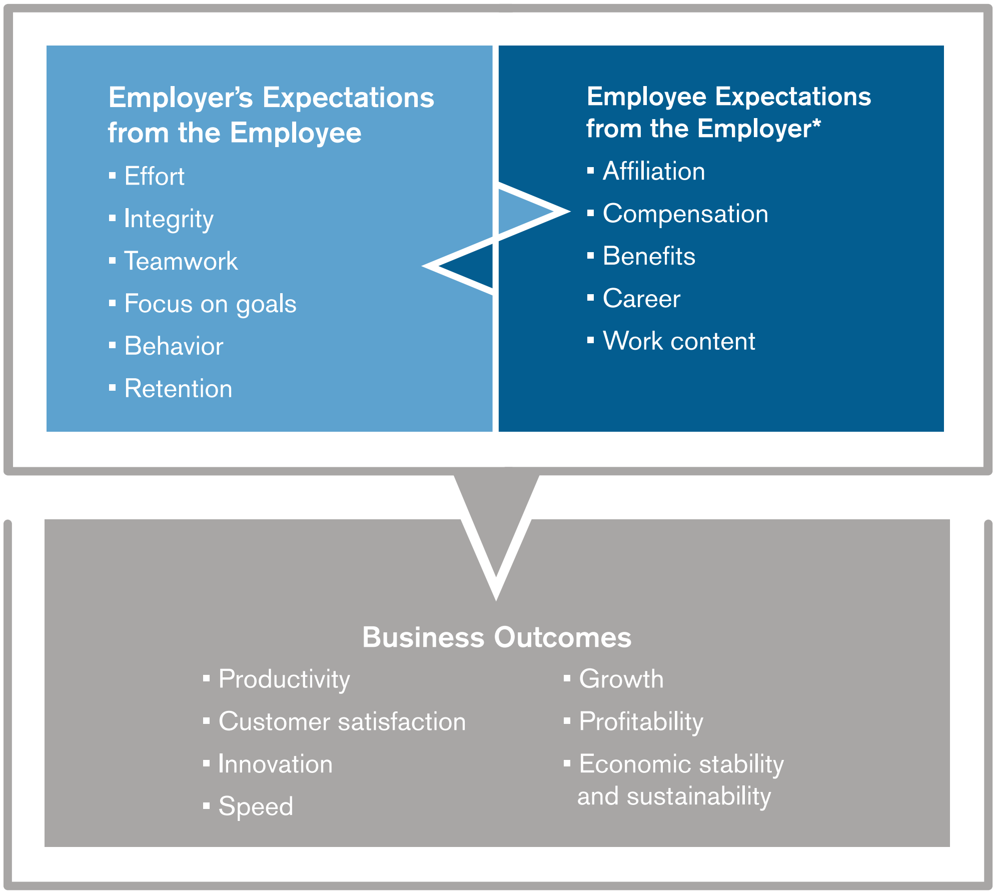
Source: Sibson Consulting

What Is the Employment Value Exchange?

Sibson believes performance in the fast-paced, technology-driven 21st century is derived from a unique, employer-specific value exchange between the rewards employees expect from the organization and what the organization expects in return from its employees. As illustrated in the chart on page 3, a balanced Employment Value Exchange creates an engaged workforce that drives performance because the employees care about the organization’s success and understand what and how they must contribute to ensure it achieves its goals.

Payouts from incentive plans are just a small subset of the Employment Value Exchange. In fact, many organizations that operate in sectors where incentive plans are uncommon (*e.g.*, nonprofits, higher education, hospitals) have been able to achieve sustainable success without incentive plans. These organizations have created and nurture a balanced Employment Value Exchange in which compensation, while fair, is not the prominent component.

A Balanced Employment Value Exchange



* **Affiliation** describes the feeling of belonging to an admirable organization that shares the employee's values. This includes organizational support, trust in management and organizational commitment. **Compensation** includes employee expectations and understanding about pay level and determination, pay delivery vehicles and pay-related processes and decision-making. **Benefits** include employee expectations and understanding about the specific benefit plans offered. **Career** includes the employees perceived and real opportunities for personal development, training and advancement as well as expectations about performance management. **Work content** goes beyond expectations engendered by the employee's job description. It includes expectations about the actual level of on-the-job autonomy and utilized skill variety as well as expectations about talent management.

Source: Sibson Consulting

Should You Abandon Your Incentive Plan?

If incentive plans are no longer the main driver of organizational performance should organizations simply abandon them? Sibson's answer is "no." Rebooted for today's workforce, incentive plans can be an important part of the employee compensation component of the Employment Value Exchange, as long as organizations do not expect the incentive plan to be the primary driver of performance and a substitute for fair base pay.

Further, our experience suggests that dollars delivered through a rebooted incentive plan are an important investment in the organization's top-performing talent. While the return on this investment is difficult to quantify, Sibson's client work suggests that the "return" is real and leads to improved, sustainable enterprise success and a committed, engaged workforce. (This is especially true in organizations that exhibit the senior leadership and mindset described in the sidebar below.)

Needed: A Strong Foundation

Before an organization can successfully reboot its incentive plan to encourage employee engagement in organizational success, two preconditions must be present. The first is senior leadership that openly assumes accountability for the organization's future direction and engages a broad cross section of the workforce to envision the future state. This leadership actively seeks and responds to candid input about such questions as:

- What must our organization accomplish to prosper economically and fulfill our mission?
- What are the specific metrics and milestones that measure our successful achievement of economic prosperity and the fulfillment of our mission? How must their achievement unfold over the next five years?
- What role, if any, should incentive plans assume to support, reinforce and reward the achievement of our goals?

The second precondition is an organizational mindset that embraces:

- The desire to share the organization's financial success fairly between the owners and the employees who deliver the results, and
- The belief that the rebooted incentive plan is an investment to support an engaged workforce, and that consequently the organization should be willing to make selected payouts even when the organization does not fully achieve its performance targets.

Source: Sibson Consulting

As illustrated in the two case studies that follow, a "this-is-*our*-organization" context pervades rebooted incentive plans that are part of a balanced Employment Value Exchange. There is a greater sense of employee engagement in and accountability for the outcomes that the organization achieves.

> "Dollars delivered through a rebooted incentive plan are an important investment in the organization's top-performing talent."

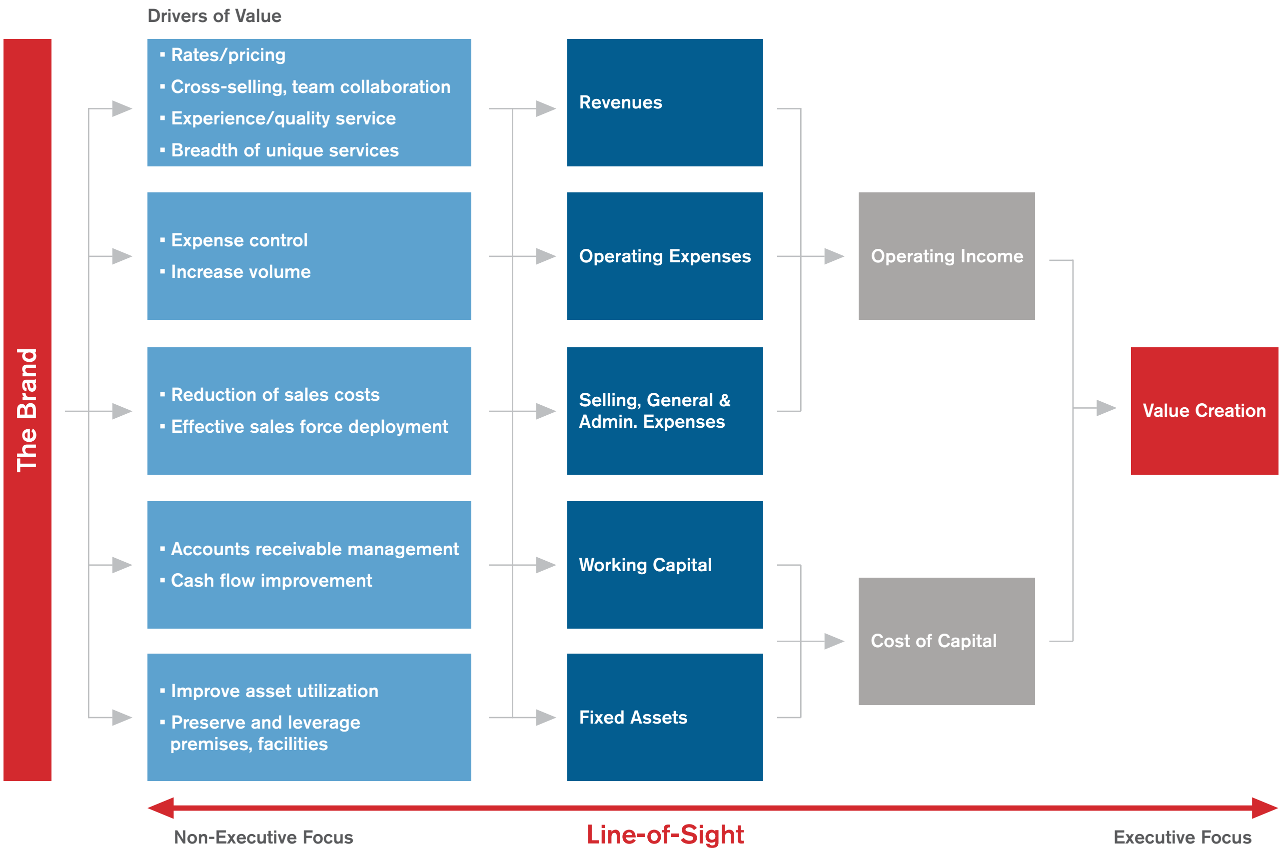
Case Study: Enterprise Strategy Linked to Employment Value Exchange

A high-profile hospitality/entertainment organization teetered on the edge of bankruptcy. Morale was low and bonus payouts had been non-existent since the 2008 recession. With Sibson's help, the new CEO sought input from the organization's employees as well as its external stakeholders to answer strategic and Employment Value Exchange-related questions such as "What do we have to do to become financially viable again?" and "How should we tie employee pay to this goal?"

From this broad-based input, the organization created and widely disseminated a three-year strategic plan that linked directly to its intended Employment Value Exchange. The critical theme that emerged was that the organization needed to restore its brand value to achieve the increase in EBITDA[3] required for financial stability. The organization also developed value trees,[4] which were discussed in small work groups so each employee could see how achievement of specific performance metrics within their direct line of sight ultimately would affect EBITDA. (See the example below.)

Value Tree — Translating Brand Value Creation into EBITDA

All employee levels are linked to brand value creation, which translates into EBITDA



Source: Sibson Consulting

[3] EBITDA is an acronym for earnings before interest, tax, depreciation and amortization.

[4] A value tree shows how higher-order objectives are linked to sub-objectives and eventually to performance measures or attributes within the employee's line of sight.

Regular, straightforward communications were (and continue to be) important to keep the workforce focused on each member's role in increasing EBITDA.

By the end of the first year, EBITDA had improved, but not to the extent needed to pay out full awards according to the plan formula. However, since the company considered its rebooted incentive plan as an investment in its future success, it allocated monies to recognize all employees for their contribution to the improved EBITDA and to provide an additional reward to those who made extraordinary contributions. Steady EBITDA growth improvement in subsequent years and the company's continued investment in the incentive program have resulted in a more financially stable enterprise with an engaged employee population.

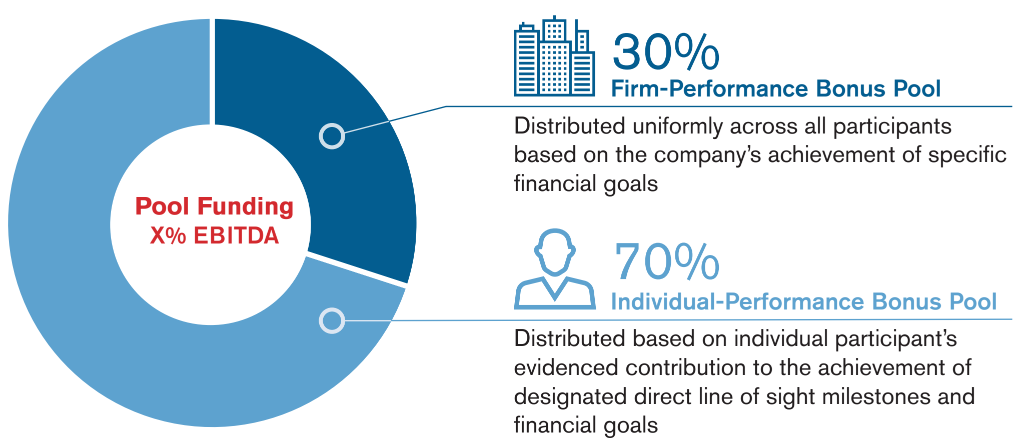
Case Study: Ownership in Organizational Success Linked to Employment Value Exchange

Based on broad employee input, the CEO of a $5+ billion, global financial services company had articulated eight strategic imperatives to be accomplished in the next five years. These imperatives were then expanded into 44 financial goals and milestone achievements.

Deploying a second round of broad input-gathering, the CEO considered how the company's incentive plan should support the "8/44" strategic plan. No one employee or group of employees had direct line of sight to all eight strategic imperatives and the 44 goals and milestones, yet, the harmonious, coordinated achievement of all of these goals and milestones was critical to the five-year plan.

Sibson guided the company as it rebooted its incentive plan to engage employees in the gargantuan task posed by the eight strategic imperatives and the 44 goals and milestones. The rebooted plan allocated the incentive pool disproportionately to reward individual performance. However, to ensure that shareholder interests were protected, a maximum incentive funding level was established as a percent of EBITDA.

Incentive Pool Allocation



Source: Sibson Consulting

While seemingly cumbersome to manage, the revised incentive plan has engaged the employees as "owners" in its success as evidenced by the company's increasing preeminence in several complex yet lucrative new market segments.

Key Takeaways

The underlying premise traditionally attached to incentive plans is simple: The bigger the realizable pay opportunity associated with the incentive plan, the harder employees will work; and the harder employees work, the better the organization's performance. Sibson Consulting's recent client work repudiates this premise.

Stand-alone incentive plans no longer work. They need to be integrated into an employer-specific Employment Value Exchange that uniquely balances what employees expect from that organization and what that organization expects from its employees. It is this Employment Value Exchange (not the incentive plan) that will result in an engaged workforce that is committed to the organization's success.

How Sibson Can Help

Beginning in the early 1990's with our groundbreaking Rewards of Work™ studies, Sibson has continuously enhanced our understanding of the forces that contribute to employee engagement. We have worked with organizations (both for-profit and nonprofit) to create their unique Employment Value Exchange and, where appropriate, develop or reboot existing incentive plans to support this value exchange.

Questions? Contact Us.

For more information about rebooting your incentive plan, contact the authors:

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Sibson Can Help with Your Performance & Rewards Programs

Sibson's Performance and Rewards practice helps clients develop effective pay and performance programs that address the specific needs of organizations and their employees. Rather than offering a pre-established solution, we partner with our clients to create customized pay and performance programs that align with their strategic objectives and help manage the performance and productivity of their employees. We have more than 50 years of experience in the design of client-tested programs that employees find easy to understand and both HR and managers find easy to administer.

Total Rewards Strategies

An integrated total rewards strategy offers advantages for employers and employees. It can:

- Drive organizational success through greater talent attraction, engagement and retention,
- Guide investment decisions for the employer while enabling informed choices for the employee,
- Clarify the employer-employee relationship,
- Build a distinctive employment brand, and
- Increase the return on rewards and create value for the enterprise.

Sibson Consulting can help your organization adopt a more strategic, comprehensive and integrated approach to total rewards that includes financial and non-financial rewards. Under this approach, we prioritize your rewards investments according to the needs and preferences of key talent segments in your organization.

Learn more about Sibson's Performance & Rewards services.

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