

Developing Performance Incentives and Sustaining Engagement in a Volatile Environment

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PARC and WorldatWork

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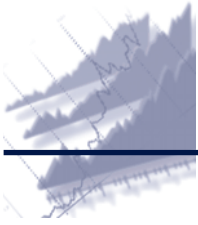
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B. Executive summary: what's the story?

- (i) Incentives are now commonplace and a key part of pay in the private sector. It is through incentives that executives have the opportunity to generate personal wealth. They are also increasingly important for other employees to fund essential major purchases. Measures have changed and become broader for many short-term incentives (STIs). Measures generally remain more narrow or have not been present in long-term incentives (LTIs). Various factors shape the design of incentives, including business strategy, market competitiveness, pay for performance, governance best practice, affordability and motivation/engagement.
- (ii) We review the principal theories of motivation and the findings on engagement. These indicate that, in general, incentives are not the primary driver of motivation/engagement. The influence of reward may vary with the type of employee and the organizational setting. On balance however, incentives do reinforce and support performance via communications and enhanced focus – and poorly functioning incentives can demotivate or disengage. Incentives have become a supporting element of the wider performance management system in many organizations.
- (iii) There has been considerable change to incentives over the last two to three years. Nearly one third of the companies we spoke to had made changes driven by the recession. Some of these involved discretionary 'workarounds'; others changed measures so the plan continued to be relevant and challenging but fair. Half our respondents had made changes for reasons other than the recession. Some were to improve risk management, some also to update plan measures, and others to introduce an individual performance element. Together, over three-quarters of companies had made significant alterations to their plans. The main emerging trend is towards using an increased number of measures.
- (iv) Several of our respondents were badly hit by the recession and, for some of these, a key factor in their changes was ensuring the continued motivation and engagement of their people. Especially in volatile situations there can be tensions between supporting engagement/motivation and a narrow focus on overall profitability.
- (v) The justification for incentive payments has to be financial: they must generate a return greater than their cost. The linkage need not be instantaneous but can be longer-term. Short-term incentives may legitimately include non-financial aspects of performance and also the making of payments that maintain engagement and motivation and so contribute to the longer term.
- Getting the nature and balance of targets right for the organization, the challenges it faces and the different types of plan participants is important. We suggest two additional ways of thinking about this balance for STIs: a dimension relating to how the plan operates: from 'if then' incentives to 'now that' rewards, and a second dimension considering what is rewarded: from 'pay for performance' to 'perceived fairness'.
- We conclude that well designed and effectively implemented STIs can do a good job in supporting both performance and engagement. However, it is less clear that long-term incentives currently do this and additional work is probably needed here.



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