

# incentive pay

## Short-term Change Agent or Long-term Success?

**M**ost business professionals readily acknowledge that incentive plans can motivate a change in behavior. But, how permanent is the change? There are a lot of great incentive plans — designed with high levels of employee involvement, creating focus on important metrics under employee control — that don't seem to motivate anyone much past the second year. How long does it take until the excitement of incentive pay becomes an

entitlement, or until the value of this extrinsic reward is overwhelmed by the intrinsic value of the work experience? What can organizations do to keep employees motivated in the long-term?

### Intrinsic Versus Extrinsic Rewards

There are two factors working against the lasting motivational effects of incentive pay. The first is the seemingly infinite capacity for employees to become entitled. In conducting

By Brad Hill and Christine Tande,  
Tandehill Human Capital

#### QUICK LOOK

- ➔ Most incentives fail to keep employees motivated for even one year.
- ➔ Sometimes a short-term behavioral success is OK, and a one-year success is better than no success at all.
- ➔ To achieve long-term success, incentives must reinforce the organization's work culture and the intrinsic rewards that engage employees.



research for his article, *Now it's a fact: Money doesn't buy happiness*, Matthew Herper, senior editor at *Forbes* magazine, concluded that "Getting a chunk of unexpected money registers as a good thing, but as time passes, the response wears off. The central problem is that the human brain becomes conditioned to positive experiences. An expected paycheck doesn't bring any buzz at all." Similarly, David Russo, former head of human resources at SAS Institute, observed that "A raise is only a raise for 30 days. After that, it's just somebody's salary."

The second is the relative impact on motivation of extrinsic rewards. When considering ways to motivate employees, incentive pay is typically the first approach to consider (see *Lessons From Second Grade Soccer: A True Story* on page 64). But, a Watson Wyatt survey of 1,700 high-performing employees — as identified by their employers — found that several factors reportedly had far more impact on motivation than their extrinsic-reward counterparts. In fact, it found that top performers rated a desire to maintain a positive reputation as the most important factor in their motivation, being appreciated ranked second, belief that their work is important ranked third and interesting work assignments ranked fourth. Financial rewards finished far down the list.

### Three Levels of Motivational Incentives

How long an incentive plan can help motivate employees depends on whether incentives are purely an extrinsic motivator, or whether they support the intrinsic value of the job or working for the organization. Incentive plans address motivation at three levels, with three time frames for success. Employees working under all three levels may be motivated

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to perform better. However, only employees working at the third level can be expected to stay motivated for more than a couple of years.

#### Level I: Work-Harder Incentives.

The purpose of Level I incentive plans is to motivate employees to work harder at their jobs. The incentive plan is typically developed by management and tries to focus employees on the tasks or goals that management wants them to work harder at. This type of plan often accompanies a belief that employees do not work as hard as they can and that an inducement will help. The most obvious examples of Level I plans are piece rate plans or sales incentives, but most annual incentive plans fall into this category because organizations keep the jobs and work processes at the same, but set goals that demand a higher level of results. Although these plans often create short-term productivity gains from employees working harder, in the longer term employees usually return to a work pace that is comfortable to

them based upon the work processes and job conditions. Time frame of success: up to 1 year.

#### Level II: Work Smarter Incentives.

The purpose of Level II incentive plans is to motivate employees to improve the systems and processes that involve their jobs. The incentive plan is developed with employee input and designed around factors that employees can control. Such plans often foster higher levels of employee involvement and begin a shift toward an empowered work culture. Level II plans include performance sharing and other plans that directly support process improvement initiatives. These plans often generate a burst of improvement as employees initially get involved in improving work processes. But once the low-hanging fruit has been picked, organizations often lose their appetite for the training and employee meeting time that may be necessary for ongoing success. As a result, the performance gains diminish and employees lose energy. Time frame of success: 1 to 2 years.

### **Level III: Work-Culture Incentives.**

The purpose of Level III incentive plans is to reinforce the organization's work culture and the intrinsic rewards that serve to engage the employee. These plans recognize that employees are fundamentally motivated by the work culture, that is, performing meaningful work, receiving ongoing recognition for a job well done, being included in important decisions that affect their work, being provided opportunities to learn and grow, connecting with the vision/mission of the organization and so on. The role of the incentive plan is to provide motivated employees with a fair return on the energy and effort that they invest in the organization — in effect, to keep them motivated. Time frame of success: ongoing.

To illustrate a Level III plan, we look to Nucor Steel, where employees in manufacturing are paid weekly incentives

based on the production of their work groups. Typically, these incentives are based on anticipated production time or tonnage produced, depending on the type of facility. The plan creates peer pressure for everyone to perform well, and the incentive can average payouts of 80 percent to 170 percent of the base wage. This incentive plan has changed little since 1972, not because of superior design, but because it fundamentally supports Nucor's No. 1 employee relations principle (see Nucor's "Employee Relations Principle").

Nucor operates one of the leanest corporate organizations in the nation, and this lean management structure supports strong employee relations. Their incentive payout is not founded on employees working harder or smarter, but on ensuring that employees will have an opportunity to earn according to their productivity.

## **Nucor's Employee Relations Principles**

1. Management is obligated to manage Nucor in such a way that employees will have the opportunity to earn according to their productivity.
2. Employees should feel confident that if they do their jobs properly, they will have a job tomorrow.
3. Employees have the right to be treated fairly and must believe that they will be.
4. Employees must have an avenue of appeal when they believe they are being treated unfairly.

### **Two Paths to Success**

Just because most incentive plans are not successful at motivating a behavior change for more than a year or two doesn't mean that they shouldn't be

## Lessons from Second-Grade Soccer: A True Story

When the eldest daughter was 8, she embarked on another year of park district soccer. She was a good sport, truly enjoyed the camaraderie of her teammates and looked forward to each week's action. But, during the games it often seemed that her objective was to get as close to the ball as possible — without actually making contact. After a couple of games, and dissatisfied with the experience of watching his daughter jog around the soccer field for an hour, the father decided to put his skills as a compensation consultant to work. He told her that every time her foot touched the ball she would earn \$0.25, and if she scored a goal she would earn \$2. She was excited with this plan and it worked. The next game she was a "player." She kicked the ball seven times (\$1.75) and seemed genuinely engaged. The game after that she kicked the ball nine times and scored a goal (\$4.25). The game after that she kicked the ball seven times and scored a goal (\$3.75). The plan had worked and for under \$5 the father could attend an enjoyable sporting event featuring his daughter. But his genius was short-lived. Over the next four games her production dramatically declined, and by the end of the season, her actions were identical to where they were at the start of the season. The money was no longer a motivator. She "just wanted to have fun playing soccer."

used or that they can't be effective.

Incentives may be a great way to thank employees for their role in the organization's success, to reduce fixed salary costs or to address market total-pay competitiveness. In addition, incentive plans will succeed at getting employees to work harder and smarter in the short-term and can be very effective in a variety of circumstances, including all of the following:


- Creating focus on a new organizational priority
- Getting employees involved in process improvement efforts
- Developing awareness around a new product or service offering
- Meeting a short-term customer need
- Creating a sense of urgency during difficult economic times.

If you are committed to using incentive plans to keep employees motivated on an ongoing basis, there are two paths to success:

1. Using incentives to periodically focus or energize employees. Change the "game" frequently to combat boredom and entitlement, and to keep employees engaged. Audit incentive plans on a regular basis and refresh the metrics to ensure that they emphasize the current priorities of the organization. In addition to changing the metrics, consider changing the performance period, the eligibility and the method of payout.
2. Using incentives to recognize and reward the motivated employee, to heighten the appreciation of the intrinsic value of the work and to reinforce the organization's core values.

### Summary: Culture Eventually Wins Out

Sometimes a short-term behavioral success is OK, and a one-year success is better than no success at all. Incentives

can be an effective motivator of short-term behavior change, but in the long-term it is the work culture (i.e., performing meaningful work, taking accountability, receiving ongoing recognition for a job well done, being provided opportunities to learn and grow, etc.) that must be the source of the motivation, and the incentive plan must keep employees motivated by providing them with a fair return on the additional energy and effort that they invest in the organization. 

#### ABOUT THE AUTHORS

Brad Hill, CCP, is a principal at Tandehill Human Capital and has been a WorldatWork member since 1985. He can be reached at [brad\\_hill@tandehill.com](mailto:brad_hill@tandehill.com) or 630-258-0295.

Christine Tande, CCP, is a principal at Tandehill Human Capital and has been a WorldatWork member since 1999. She can be reached at [christine\\_tande@tandehill.com](mailto:christine_tande@tandehill.com) or 630-836-0895.

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