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# Show them the money: A case for incentive-based management.


**By John M. Collard**

Business owners willing to invest in realistic incentives that reward employee achievements are likely to reap the proceeds. The key to success is to set realistic goals and time frames, hold managers accountable for performance, and communicate measurement and reward methodology — then step back and let them perform. Always reward positive results when goals are achieved – but never give a reward when goals have not been accomplished. If goals are met, the cash will be there to pay bonus.

**Setting goals:** First, set the directive and goals, and then set the incentive structure to achieve them. The goal-setting process clarifies direction and eliminates confusion, unclear motives and misguided efforts. When employees can see dollar signs tied to clearly stated goals, their mindset changes and they become more creative. Include as many employees as possible as part of an incentive-based structure. Incentive compensation should reward performance and teamwork.

**Risk and reward:** Share profits in proportion to the risks being taken. When an employee's income is based purely on performance, as it is in sales, the risk-to-reward scenario is much greater than for a salaried employee. An employee working under an agreement or union contract governing work behavior and performance will receive a lesser bonus by comparison for achieving their goals. If they want the rewards, they should share the risk.

**Build the pool:** Develop an incentive pool based on the amount of gross margin and distribute bonuses based on a weighted average to the team. When the company does well, gross margin improves, thereby increasing the size of the bonus pool.

Pay management incentive compensation based 50 percent on what the employee is directly responsible for, 30 percent on how their performance impacts other key departments, and 20 percent on their ability to improve equity value or other elements within their control. The intent is to measure performance and, as importantly, cooperation between departments and personnel.

**Create scenarios:** Structure a bonus payment scale in accordance with "worst," "likely" or "best" scenarios. In worst case, you should pay few bonuses because employees met few goals. In the likely case, pay 40 to 60 percent of the full bonus rate. In best case, pay maximum bonus rates.

**Payment distribution:** Distributions should be on a year-to-date calculation, paid quarterly. So the company doesn't take all of the risk, pay two-thirds of the bonus at the end of the first quarter, 75 percent at the end of the second, 85 percent at the end of the third, and the remainder at the end of the year. This reserve within the company will avoid early payout for exceptional results without sufficient catch-up period if these results don't continue. Employees can share in the rewards as they occur rather than waiting until year-end, an added incentive.

**Support the selling process:** Put salespeople on a tiered commission structure to reward for new customers and value-added sales. Reward higher commission percentages for jobs from customers added in their first year with the company, and on a declining scale thereafter.

Chart to follow:

## Incentive-Based Management

| | | Incentive | | |
|---|---|---|---|---|
| **Function** | **Focus On:** | **50%** | **30%** | **20%** |
| **General Manager** | Company Value | Equity Value Improvement | Earnings Per Share [EPS] | Employe Motivation |
| **Sales** | Sales Revenue | Profitable Revenue Generated | Consistent/ Flexible Workflow | EPS/ Net Profit |
| **Estimating** | Profitable Work | New Business Win Ratio | Consistent Work Flow | EPS/ Net Profit |
| **Production/ Project Mgt** | Throughput, Project Profit | Gross Margin Resource Utilization | Billing Rate Overrecovery | EPS/ Net Profit |
| **Human Resources** | Employee Relations | Employee Motivation | Employee Satisfaction | Low Rate of Turnover |
| **Finance** | Financial Cash Flow | Timely, Accurate Information | Overhead Cost Control | Cash Availability |

### *About the Author*

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