

SAP White Paper  
Compensation

## Once Is Not Enough

# Infusing Continuous Rewards Into Your Compensation Strategy



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**It's a perpetual struggle: What's the best way to reward and encourage performance? If your company is like most, you draw from an arsenal of tools that includes a range of variable pay options. While organizations have halved spending on salary increases from 5.5 to 2.8 percent of payroll over the past 25 years, they have tripled funding for bonuses from 4.2 to 12.8 percent of payroll.<sup>1</sup> Indeed, 93 percent of U.S. companies hand out bonuses<sup>2</sup> often as annual payouts.**

1. "The Shifting Landscape of Variable Pay." Workspan. Apr. 2017.

2. "Short-Term Incentives Are Playing Larger Retention Role." SHRM.org. Aug. 11, 2015.

# Building a Great Workforce Demands Rewarding People Through the Year

This statistic raises another important question: Is a yearly bonus the best way to recognize and reward performance?

Not really. At least not by itself alone. While you might be showing some appreciation for your people throughout the year in nonfiscal ways, an annual bonus can take too long to financially motivate and recognize employees for their work. Which explains why a survey of HR professionals reveals that only half said that annual incentive programs effectively boost performance levels.<sup>3</sup> As Laura Sejen, global practice leader for Willis Towers Watson, told SHRM.org, “Traditional pay-for-performance programs, primarily annual merit pay increases and annual bonuses, are falling short in the eyes of many employers.”<sup>4</sup>

Traditional pay for performance is falling short in the eyes of many employees too. Newer generations of workers crave more frequent and instant feedback and recognition. Not long ago, research showed that 41 percent of millennials (and 30 percent of nonmillennials) prefer to be rewarded or recognized for their work at least monthly.<sup>5</sup> And while there are numerous ways to acknowledge people for their work, once a year is simply not often enough when it comes to monetary rewards.

Does this mean that you should ditch annual bonuses? No. They can — and often should — have a rightful place as part of total compensation packages because yearly rewards are often an effective retention tool. Furthermore, as long as companies operate in annual financial cycles, there is likely to be an annual aspect to compensation as the largest single operating cost for many companies. However, building a talented and motivated workforce demands expanding pay practices that shorten the line of sight between rewards and achievement as they occur throughout the year.

Some businesses are already doing this — a WorldatWork survey shows that 61 percent of companies offered spot awards in 2016, up from 43 percent six years prior.<sup>6</sup> While continuous rewards can be an important means to recognize and reward performance, it's critical not to overuse them. It's also critical to recognize that they will work best when part of a holistic strategy that includes a full range of monetary and non-monetary rewards and recognition efforts.

Here's what you need to know as you think about introducing more frequent rewards and recognition into your compensation strategy.

3. “Employers Seek Better Approaches to Pay for Performance.” SHRM.org. Feb. 8, 2015. <https://www.shrm.org/resourcesandtools/hr-topics/compensation/pages/better-pay-for-performance.aspx>
4. “Employers Seek Better Approaches to Pay for Performance.” SHRM.org. Feb. 8, 2015. <https://www.shrm.org/resourcesandtools/hr-topics/compensation/pages/better-pay-for-performance.aspx>
5. PwC's NextGen: A global generational study. PwC, the University of Southern California, and the London Business School. 2013. <http://www.pwc.com/gx/en/hr-management-services/pdf/pwc-nextgen-study-2013.pdf>
6. Bonus Programs and Practice. WorldatWork. July 2016. <https://www.worldatwork.org/adimLink?id=80398>

# Why Now?

## TECTONIC SHIFTS IN TECHNOLOGY

In the past, businesses awarded annual bonuses almost exclusively to top executives. As war upon war for talent impacted companies over the past 30 years, employers discovered that they could use variable pay to counteract strains related to increasing fixed costs, while attracting and retaining talent throughout the enterprise.

Unfortunately, the lack of technology got in the way. “Given the time and resources needed to pay annually, it was understandable that organizations limited bonuses to once a year,” explains Steve Hunt, senior vice president of human capital research for SAP® SuccessFactors® solutions. “Maintaining a program for spot bonuses across a large company would have been extremely difficult to do in Excel.” Consequently, the annual reward remained just that out of necessity for corporate HR and finance functions.

Today, technology makes it possible to appreciate and reward people in far more ways than in the past, providing organizations like yours with opportunities to rethink their approach to compensation. “Technology now gives us the ability to manage, govern, and layout the framework and guidelines to drive desired behaviors through continuous rewards in a simple, streamlined, and transparent fashion,” says Joshua Hill,

pay for performance solution adoption advisor for SAP SuccessFactors solutions. Modern software is mobile, cloud-based, flexible, customizable, configurable, and agile, all of which enables integrating goals, payouts, approvals, and other data points to maintain a successful continuous rewards and recognition program.

## CONTINUOUS PERFORMANCE MANAGEMENT

Given the ever-increasing pace of change, businesses are finding that one or two formal discussions during the year are not enough to effectively coach employee performance. As a result, enlightened companies are moving toward including more frequent conversations and constant attention to performance management.

A recent study by HR consultancy Mercer reveals that 10 to 15 percent of companies say they are eliminating traditional end-of-the-year manager performance ratings.<sup>7</sup> From Adobe to Accenture to Gap and beyond, organizations are abandoning, or at the very least reconfiguring, traditional performance processes in favor of ones that emphasize more continuous connections between performance, recognition, and rewards. Indeed, management consultant Josh Bersin estimates that 70 percent of multinational corporations are moving toward ongoing performance management processes.<sup>8</sup>

7. “Mercer’s 2017 Compensation Planning and Performance Management Webcast.” Mercer. 2016. <https://www.mercer.com/content/dam/mercer/attachments/global/webcasts/gl-2016-talent-compensation-planning-performance-management-mercer.pdf>

8. “The Performance Management Revolution.” Harvard Business Review. Oct. 2016.

The same Mercer research also shows that the vast majority of companies continue to link pay and performance. It's therefore logical that pay practices, rewards, and recognition should inter-weave and evolve in ways that complement the move toward continuous performance management.

### EVOLVING EMPLOYEE EXPECTATIONS

Unfortunately, a key problem with an annual bonus cycle is that by the time there's a payout, employees lose sight of achievements earlier in the year. So do managers, who are more apt to evaluate work done closer to decision making regarding bonuses (a.k.a. "recency effect"). This effect can become especially troublesome when individuals report to different managers over the course of a year, which happens more and more often due to increasing levels of organizational restructuring.

Your company also can incur risk if you place too much variable pay into a yearly bonus, which can

result in both disengaged and talented workers hanging around just to earn the payout. People may mentally quit the job in October, but wait until January to collect their annual bonus before actually leaving. This is another reason to reward people at the time of significant accomplishments.

While many employees value stability and a sense of corporate commitment to their long-term careers, other workers are more transient. More people today have nontraditional career paths that involve temporary or contract work. By 2020, as many as 43 percent of the U.S. workforce will be freelancing in some capacity (though not necessarily full-time).<sup>9</sup>

Therefore, when designing pay packages, it's important to keep in mind that there's no one-size-fits-all approach. A blend of rewards and recognition that includes yearly and continuous rewards, as well as other initiatives, is truly the best strategy to engage your entire workforce.

Pay practices, rewards, and recognition should inter-weave and **evolve in ways** that complement the move toward continuous performance management.



9. "The Gig Economy: 2020 Freelance Workforce Predicted to Rise to 43%." Nasdaq.com. June 14, 2017. <http://www.nasdaq.com/article/the-gig-economy-2020-freelance-workforce-predicted-to-rise-to-43-cm803297>

# It Pays to Pay Continually

More continuous pay strategies can significantly improve the motivational value of compensation, but only if the strategies are well—designed and effectively implemented. The following are a few things to consider when moving toward more continuous pay.

## FLEXIBILITY TO DIFFERENTIATE TALENT

It is both fair and effective to invest more compensation in employees who contribute more to the organization. It is important to distinguish and reward talent through compensation, but annual bonuses and merit increases often fall short. In one study, just 32 percent of HR executives said that their merit pay program is effective at differentiating pay based on individual performance and only 20 percent found it to be effective at driving better individual performance.<sup>10</sup>

Annual bonuses do enable greater differentiation—at least in theory. However, in practice, organizations have experienced no greater success in differentiating rewards by performance level under variable pay than they've had through salary increases.<sup>11</sup> In fact, 82 percent of top performers do not receive a significantly differentiated salary increase and bonus payments.<sup>12</sup>

Many businesses award annual incentive payouts even to employees who fail to meet performance expectations.<sup>13</sup> This practice can be especially troublesome since it strips money away from top performers.

Continuous rewards and recognition can give companies like yours more opportunities to distinguish performance financially. It is potentially easier to differentiate through spot awards than with small merit increases because they are awarded individually throughout the year.<sup>14</sup> Managers should be trained and encouraged to recognize individual employee's contributions when they happen and avoid giving out awards just to make people feel appreciated. When it comes to using compensation to drive motivation, "not everyone should get a trophy just for participating," says Steve Hunt. Spot bonuses are designed to be tied to actual accomplishments.

Workers can easily develop a sense of entitlement about receiving year-end bonuses that aren't clearly connected to performance. They may feel that such awards are expected rather than earned.

10. "Employers Seek Better Approaches to Pay for Performance." SHRM.org, Feb. 8, 2015. <https://www.shrm.org/resourcesandtools/hr-topics/compensation/pages/better-pay-for-performance.aspx>

11. "The Shifting Landscape of Variable Pay." Workspan. Apr. 2017.

12. "The New Pay for Performance." Workspan. Apr. 2017.

13. "North American Employers Not Expecting to Fully Fund Annual Bonuses in 2013, Towers Watson Survey Finds." Willis Towers Watson. Aug. 15, 2013. <https://www.towerswatson.com/en-US/Press/2013/08/North-American-Employers-Not-Expecting-to-Fully-Fund-Annual-Bonuses-in-2013>

14. "Employers Seek Better Approaches to Pay for Performance." SHRM.org, Feb. 8, 2015. <https://www.shrm.org/resourcesandtools/hr-topics/compensation/pages/better-pay-for-performance.aspx>

Continuous rewards rely on a more direct line of sight that ties goals, results, and payouts in ways that motivate people by recognizing and rewarding accomplishments on a more timely basis. “The shorter the distance between effort and reward, the more likely you will see a repeat of that behavior,” Joshua Hill explains. Indeed, a WorldatWork survey shows that more than 60 percent of respondents say that incidental (including spot) bonuses positively impact employee engagement, motivation, and satisfaction.<sup>15</sup>

#### **ADAPTABLE TO ANY PERFORMANCE MANAGEMENT MODEL**

Moving to more continuous compensation methods does not mean your company has to get rid of annual merit increases and bonus plans. Just as a continuous performance management model can still incorporate annual reviews, so too can it include a mix of annual and continuous bonuses. That’s because when done well, regardless of whether your company maintains a conventional approach to reviews or is moving away from performance ratings, spot awards serve as an effective type of feedback.

“In most cases, the purpose of spot bonuses is not to compare people against each other,” Steve Hunt explains. “It’s about tangibly recognizing people who go above and beyond.” Spot bonuses are probably best thought of as complements to more traditional annual compensation methods, not a replacement to them.

#### **INCREASED EMPLOYEE ENGAGEMENT**

While most workers recognize that a slew of compensation calculations transpire behind the scenes, the workers like to feel as if they have actual influence over their earnings. Yet research shows that 67 percent of employees say they don’t understand the connection between performance and pay.<sup>16</sup>

Spot awards are a prime opportunity for companies like yours to boost employee engagement by clearly linking work with rewards. Done well, they help to elevate accountability and transparency in simple ways that make sense to employees who want to feel real sway over their pay. Effective use of spot awards requires delineating clear guidelines and communication about how to use them — and monitoring how they are used to ensure managers are applying them consistently and fairly.

15. Bonus Programs and Practice. WorldatWork. July 2016. <https://www.worldatwork.org/adimLink?id=80398>

16. “The New Pay for Performance.” Workspan. Apr. 2017.



## Key Considerations

While broadening your compensation strategy to include continuous rewards and recognition clearly has its benefits, it does come with a range of concerns and questions that should be reviewed.

### WHICH BEHAVIORS AND ACCOMPLISHMENTS SHOULD WE RECOGNIZE AND REWARD?

Consider what superior or optimal performance looks like at your organization and what it means for workers to go above and beyond. Ideally, you want to reward people not for day-to-day work they'd accomplish anyway, but for special achievements that advance your company's mission and values.

You also want to focus on the types of behaviors you're looking to promote, as well as recognize and reward people for attaining sufficiently challenging (and preferably quantifiable) objectives. After all, payouts for goals that aren't aspirational enough will essentially be akin to salary entitlements in the eyes of employees.

### HOW CAN WE ACCOUNT FOR INDIVIDUAL, TEAM, BUSINESS-UNIT, AND ORGANIZATIONAL GOALS?

Only 22 percent of privately held companies with short-term incentive programs reward for team or group performance, according to a WorldatWork survey.<sup>17</sup> That's at least partly because most current models for recognition and rewards have inherent contradictions.

On one level, there's the notion that an entire organization succeeds, and fails, collectively. When business is good, everyone reaps the rewards. When business is failing, rewards are not funded. However, on another level, goal-setting is a historically individualistic process by which very few organizations create group or team goals.

To envision how this contradiction can play out in practice, imagine that individual workers achieve their goals — while the organization fails miserably. At executive levels, where rewards are tied closely to overall corporate or business-unit performance, it might make sense to limit payouts in such a scenario. But, as Joshua Hill points out, "There comes a point in the hierarchy where goals cease to be 'all-for-one, one-for-all' and become very individual by design." Minimizing bonuses to people who have worked hard to accomplish their objectives risks demoralizing them.

"When rewarding success on a more frequent basis," Hill continues, "there is a greater chance that an individual's successes will be highlighted in ways that recognize that person in real time." Still, it's critical for companies like yours to carefully plan and design pay programs that factor in practical financial considerations and ensure that there are also sufficient rewards and recognition tied to team-based outcomes and initiatives.

17. [Incentive Pay Practices: Privately Held Companies. WorldatWork and Vivient Consulting. Feb. 2016.](https://www.worldatwork.org/adimLink?id=79934)  
<https://www.worldatwork.org/adimLink?id=79934>

## HOW SHOULD WE BALANCE SHORT- WITH LONG-TERM GOALS?

Recognizing short-term accomplishments without undermining long-term commitment to more far-reaching goals can pose a dilemma. On one hand, employee objectives are rarely year-long anyway. On the other hand, some are. Some are even longer than that. Focusing too heavily on the long term poses risks to decreasing motivation due to lack of financial recognition. While the reverse risks moving away from intrinsic

motivation to a more transactional mindset, whereby people are more interested in adding money to their wallets than value to the company.

“From a psychological perspective, this is potentially the single greatest challenge to the effective use of spot awards,” Hunt explains. “When companies start paying people for short-term accomplishments people can start to view short-term tasks from a financial standpoint.”

## CAN WE AFFORD LARGER SPOT AWARDS?

Throughout your company, managers are already likely giving out spot awards, sometimes out of their own wallets. Admittedly, most of them are probably relatively small — gift cards, company merchandise, meals, and so on. But when thinking about creating a program that encompasses bigger awards, you also need to start thinking about bigger questions of funding.

For starters, it's worth pointing out that continuous rewards can help pay for themselves through gains related to increased productivity as employees feel more motivated to strive for greater accomplishments.

Still, you can also pull money from the annual rewards budget, especially since it makes far more sense to spread out expenditures to drive employee engagement more consistently throughout the year. Yes, you run a risk that employees might be unhappy with a lower yearly payout, but they will instead benefit from a system that enables them to budget their finances more consistently throughout the year.

Secondly, you may want to consider drawing from money normally allocated to salary increases or the annual bonus pool. This logic ties salary more closely to market values for positions and uses variable pay more to recognize and reward performance. This can be a particularly attractive option since bonuses don't carry over into subsequent years like fixed salary costs. Again, the size of the award does not need to match the size of annual bonuses. For example, taking 10 percent from the annual bonus pool and funding year-long spot awards programs can provide amazing advances in employee motivation.

Ultimately, regardless of how you fund continuous rewards, you want to ensure that you're able to can measure their impact by embedding them into wider performance and recognition frameworks.

This short-term view can undermine people's internal sense of motivation toward work and create a more transactional mindset. On the other hand, failure to recognize accomplishments in a timely manner can make people feel unappreci-

ated and may undermine people's sense of commitment to the company.

Still, if an employee achieves a goal—or a significant benchmark toward that goal—earlier in the

## THE ROLE OF SUBJECTIVITY

Some managers are better than others at recognizing and rewarding their people. Different managers with different expectations will likely reward employees different amounts at different frequencies for different accomplishments. All those differences can breed resentment and hostility if employees begin to feel a lack of fairness.

Granted, some level of subjectivity is an intrinsic part of every approach to rewards, recognition, and performance management — that's simply what happens any time you have people evaluating people. Still, there are ways to increase objectivity.

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### Calibration Sessions and Multirater Feedback

Calibration meetings and multirater feedback are common elements of many performance management frameworks that you can also use to foster alignment around continuous rewards and recognition. Meanwhile, it can help to consult with compensation analysts and other experts to help inform your decision-making process.

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### Developing Dialogue

Perhaps the best way to minimize subjectivity is to encourage dialogue among managers to create understanding of the company's rewards, recognition, and compensation philosophy. "We sometimes try to hide behind processes as though compensation is solely a measurement problem, a simple formula," Hunt explains, "but it's really all about judgment values.

The more you get managers to discuss their views about recognition and rewards, as well as train them to give feedback — something many don't know how to do—the more meaningful, consistent, and effective your compensation and performance management practices become."

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### Truth in Transparency

All these tips can help boost transparent decision making, which is fundamental to employee perceptions of fairness. When workers understand more clearly how they are getting paid and how these decisions are made, they are less likely to scoff at how much they are getting paid. People may not always like the rules of the game, but they want to understand them.

year, you might consider giving that person a partial payment at the time, saving the rest of the reward for year-end. Doing so helps recognize and reward specific accomplishments, rather than all at once, thereby decreasing line of sight and placing a stronger emphasis on successfully meeting objectives.

Inevitably, though, balancing short- and long-term recognition is probably as much an art as a science. It will vary based on company culture and the nature of an organization's workforce. Ultimately, the key to successfully incorporating spot awards is to ensure you are recognizing and rewarding people for meeting a mix of objectives and milestones toward reaching those objectives.

#### HOW BIG SHOULD AWARDS BE?

Spot bonuses should be large enough to motivate performance—and what is financially meaningful differs based on the type of employee. They shouldn't be too large, though. "That can encourage a transactional mindset that

doesn't motivate people to add value to the organization," Hunt explains. "You want to be sure that even if someone who didn't do anything worthy of spot bonuses during the year, that person is still recognized as a solid contributor." If people start to view spot bonuses as an important part of their total compensation package, then they will lose their value as a form of spontaneous recognition.

Spot awards should be only one element of a comprehensive compensation strategy that includes a variety of monetary and non-monetary initiatives, from tuition reimbursement to 401(k)s to good old-fashioned verbal praise. After all, money is inherently a temporary motivator. Focus too heavily on money as motivator, and you might create a mindset that diminishes the value of other forms of recognition that aren't preceded by dollar signs. Fundamentally, the key is figuring out what combination of rewards and benefits fits best with your company's unique culture.

Fundamentally, the key is figuring out what **combination of rewards and benefits** fits best with your company's unique culture.



## Like Planting a Garden

As compensation practices continue to evolve across a range of industries and businesses, it's clear that variable pay will clearly play an increasingly prominent role. While the annual bonus isn't going away anytime soon, it is an insufficient tool for recognizing and rewarding for performance. Continuous rewards and recognition can effectively step in to help improve motivation, morale, engagement, and productivity.

To inject spot awards into your strategy, start by defining strategic business objectives and identifying behaviors and values unique to your company. In the end, a solid continuous rewards program should include quantitative and qualitative

measures, be easy to comprehend, rely on valid data, and must include a variety of controls to promote objectivity. All of which is also, ultimately, how you get buy-in from employees, senior leadership, and other stakeholders.

Finally, as Steve Hunt suggests, "Begin by piloting a program. Build a process, if not a perfect one just yet. Acknowledge that you'll face a learning curve, and be willing to figure it all out through the right conversations. Think of it like planting a garden: You have a general sense of expectations, but as it grows, you trim and change it over time. Embrace that philosophy."

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