

A Study on Variable Compensation and the Other Benefits

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Abstract:

Variable pay programs are an increasingly popular mode of compensation in today's business world. These programs, which are also sometimes referred to as "pay-for-performance" or "at-risk" pay plans, provide some or all of a workforce's compensation based on employee performance or on the performance of a team. Variable pay proponents contend that providing tangible rewards for superior performance encourages hard work and efficiency and serves as an effective deterrent to mediocre or otherwise uninspired work performance.

Variable pay programs are made up of a variety of different compensation methods. In the broadest sense, variable pay programs include annual incentives or bonus payments; individual incentive plans; lump-sum payments; technical achievement awards; cash profit-sharing plans; small group incentives; gainsharing; and payments for newly acquired skill and knowledge. Some analysts argue that variable pay programs should be defined far more restrictively, but most agree that all of the above share a common emphasis on recognizing achievement, which is the ultimate goal of variable pay plans.

Introduction

Variable pay is employee compensation that changes as compared to the salary which is paid in equal proportions throughout the year. Variable pay is used generally to recognize and reward employee contribution toward company productivity, profitability, teamwork, safety, quality, or some other metric deemed important by senior leaders.

The employee who is awarded variable compensation has gone above and beyond his or

her job description to contribute to organization success.

Variable pay is awarded in a variety of formats including profit sharing, bonuses, holiday bonus, deferred compensation, cash, and goods and services such as a company-paid trip or a Thanksgiving turkey.

Variable pay is an expected employee benefit if you are going to excite and retain employees. They want the opportunity to earn variable compensation to bolster their basic salary. And, today's employees are also looking for more when they decide to come on board and work for an employer.

It is no longer enough for a company—even a global company—to offer the same generic benefits to every person they hire. Employees now expect comprehensive benefits packages that are tailored to their own personal needs—not just to broadly defined demographics.

However, personalizing benefits packages starts with employers truly understanding what their employees value and need. In other words, benefits are only as valuable as each employee views them.

As such, the greater the flexibility and variety of the benefits program, the more likely all of your employees are to feel appreciated.

Employer Costs in Pay and Variable Pay

According to the Bureau of Labor Statistics, "Employer Costs for Employee Compensation (ECEC), a product of the National Compensation Survey, measures employer costs for wages, salaries, and employee benefits for nonfarm private and state and local government workers."

Supplemental pay benefit costs for private sector employees in December 2016 averaged \$1.15 per hour worked or 3.5 percent of total compensation. Supplemental pay includes employer costs for employee overtime and premium pay, shift differentials, and nonproduction bonuses.

In December 2016, the largest component of supplemental pay costs for private industry employers were nonproduction bonuses, averaging 83 cents per hour worked or 2.5 percent of total compensation. Nonproduction bonuses are given at the discretion of the employer and are not tied to a production formula. Common nonproduction bonuses include end-of-year and holiday bonuses, referral bonuses, and cash profit sharing.

A Critical Step Is Explaining Employee Benefits

Employers must present both the intrinsic and the extrinsic value of the benefits they offer in an easy-to-read and understandable format to employees. Conveying benefits packages in layman's terms is not an easy task. Efficiently relaying this information is a time-consuming—but critical—task.

From health insurance to retirement plans to variable compensation, one company may offer many types of benefits for employees. Some of these benefits can confuse employees.

(Most everyone has wondered how much to contribute to a 401(k) or what is a reasonable deductible.)

Make sure your system gives employees access to a resource to ask questions in real-time about which plan makes the most sense for them or their families.

Employers should also offer an explanation as to why they offer certain benefits upfront. For example, a younger employee may not see the point in life insurance and view it as a wasted benefit. But if the employer provides information on how many employees are near retirement and place great value on having life insurance, those younger employees will likely be more receptive.

All employees see the benefit of variable compensation, but employers need to be very clear

about how an employee can earn it, how much they are paying, and who is eligible to receive it.

If the employer communicates particular goals, levels of productivity required, or quality standards to achieve, for example, it is critical that every employee who achieves the goal receive the rewards.

In the same vein, it makes sense for employers to openly share information about the cost of benefits. Benefits are costly, especially if a company provides a wide range of unique benefits, but most employees don't realize this. Your average employee has no idea about the percentage his compensation is increased by the value of his benefits.

If an employer is clear about how much the company is investing to make its employees happier and healthier, those employees will have more appreciation for the benefits offered.

Ask Questions, Make Changes

One of the most difficult challenges for HR departments—especially as they start to add new and unique benefits—is having an open line of communication with employees. Explaining benefits well is only half the battle.

Companies should also consistently survey their employees (quarterly is recommended) to understand their benefits satisfaction. If a company realizes that a particular benefit isn't working or isn't valuable to employees, they should announce the benefits changes they will make to address the dissatisfaction. Employees will see that the company cares about their feedback.

Bottom Line: Flexibility + Engagement = A Happier Work Environment

It is impossible to develop one single benefits solution that will take care of every employee, especially if you consider the diversity of location, family, health, financial, and travel needs. Employees need to understand the value of the personalized benefit program that you offer to them.

A modern, cutting-edge rewards experience can help position your employer's brand as an industry leader. It will allow your employees to understand and enjoy their benefits package and variable pay opportunities to their fullest degree - and you will reap the reward of satisfied employees.

ADVANTAGES AND DRAWBACKS OF VARIABLE PAY

Most criticisms of variable pay can be traced to concerns about the nature, implementation, and execution of such programs rather than the theories upon which they are based. In practice, many companies fail to make variable pay programs meaningful to individual employees, which in turn robs the program of much of its power to facilitate increased productivity.

In a report published by the Institute of Management & Administration entitled *Companies Are Not Getting Full Value from Variable Pay Programs*, the findings showed, as the title implies, that companies report very mixed results from variable pay programs. The survey reported on in the Institute of Management & Administration article was carried out by the firm Hewitt Associates. The Hewitt data showed that about half of companies with single-digit revenue growth believed that the cost of their variable pay programs outweighed the benefit. Companies with double-digit revenue growth, however, almost all reported positive outcomes from their variable pay programs. "The fact that many companies don't benefit from variable pay plans is a significant issue, as they're spending more than \$54 million a year on this type of pay. We've found that companies achieving high-revenue growth have successful programs because they provide the appropriate amount of administrative, communication, and monetary support. These organizations know that if this type of pay plan is implemented correctly, it will reinforce a performance culture."

One of the key differentials between companies with a positive and those with a negative experience with variable pay programs was the selection of appropriate performance measures. Those measures are the primary motivation for employees and they communicate to employees what the objectives of the company are. Companies that focused variable pay measures on the ability to reduce costs reported less satisfaction with the

programs than those companies using increases in sales as the measure upon which variable pay was linked. According to Paul Shafer, a manager with Hewitt Associates, "If a company wants growth, it can't reward for cutting costs. Cost reduction and growth can be competing, rather than complementary, goals, so by blending the two, companies run the risk of confusing employees and, in all likelihood, accomplishing neither."

Despite these mixed results, business consultants agree that well-designed variable pay programs that truly reward individual performance can be helpful. The purpose of a good bonus program should be to make the company stronger, more competitive, able to react quickly to change and prosper through growth. A good bonus program draws people into that process. It drives the value of the company by educating people, not with formalized training sessions but through the work they do every day. It provides employees with the support and tools they need to make wise decisions. It provides them with business knowledge they can use to enhance the prospects of the company as a whole as well as their own professional lives.

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