

SETTING UP A BONUS SCHEME

Having a fair and well-designed bonus scheme as part of your wider reward and recognition strategy can be an effective way to increase your staff's productivity and so your bottom line. If you want to set one up, what do you need to consider?

Designing your scheme

When designing your scheme the first thing you have to consider is why you want to introduce one. You may have a single target in mind or may be looking to reward a number of different activities. Typically, bonus systems will want to address issues of Reward, Recognition or Business performance. They are all valid reasons for setting up a scheme and may include the following drivers:

- Do you want to change your employees' behaviour so it follows your company objectives/culture?
- Do you want to motivate and retain all (or key) staff and reduce repeat recruitment costs?
- Do you want to recognise staff's performance or positive behaviour that is above the norm?
- Do you want to increase productivity and achieve more sales / customers? If so, do you want to reward staff for getting new business, developing existing business, getting sales from a particular company / sector / industry, or increase your customer's minimum spend?
- Do you want to reward someone for meeting a specific objective/project?
- Do you want to promote improved management skills or team working

When you understand what you want to achieve you should then consider what factors the bonus scheme should be based on:

- Individual performance
- Team performance
- Overall company performance
- A combination of individual or company performance

Bonus Schemes can be single-factor or multi-factor. A single factor scheme will focus on one specific goal, e.g. an individual employee achieving more sales. A multi-factor scheme includes other goals and is multi-layered (but don't make it too complicated!).

Bonus scheme structure

Whichever type of bonus you want to apply, you need to clearly define how you will measure success and what the employee needs to do to earn it. Make sure you document your criteria so everyone is clear. Make realistic goals / objectives / triggers to be reached, which can be adjusted over time. A few examples of typical measures are below:

Type of Bonus	Target	Measure
Reward for business contribution	Increase in customer sales	% or monetary increase in sales value
	Increased customer satisfaction	% increase in customer satisfaction survey
	Productivity and output, extent of workload	increased no of products delivered in specific period of time
	Quality of work	% decrease of re-work undertaken

Recognition of effort or achievement	Successful delivery of large project	On time and within budget
	Safety record	no lost time incidents in specific period
	Attendance at work	100 % attendance over calendar year
	Achievement of qualification	
Celebration of business performance	Financial performance	Meeting specific financial targets
	Reaching a significant milestone	Reaching growth markers

To devise an effective scheme you need to understand the employee’s activities and what is involved. You then need to agree with them how their performance is going to be measured.

Don’t set targets that are too easy to achieve, or on the other hand impossible to achieve – consider how easy is it for you to get new customers and the amount of work that is needed by your staff to secure new sales. For example for new sales a realistic target may be to improve revenue by 5-10% over a year. Or it can be based on the need to make four sales a month, so anything over four sales gets £X commission / bonus. (See our separate guide to [Writing Smart Objectives](#))

Consider also what timescale you want to have for you staff to earn the bonus. It can be a monthly, quarterly, or annual bonus. It is often better to set short-term (quarterly) goals and compensate regularly as this is more attractive to the employee so they will be more motivated. Quarterly is also better so you can evaluate what the employee is doing and make adjustments to the scheme and its priorities if necessary.

Annual bonuses are often used when schemes are based on business profit. Or you can offer an annual bonus based on a calendar event such as end of financial year or a Christmas bonus!

How much bonus to pay?

When considering how much to pay, it needs to be manageable for you from a financial perspective. For example make sure they don’t bring in new business which you pay all back to them – it should only be paid when the costs of employing the employee and their overheads and the bonus are covered by the new business.

The amount must be relative to their annual earnings and their role and should be meaningful and ‘matter’ to the employee.

The bonus payment can be based on the following:

- A % of salary
- A flat rate payment
- A % of their new sales
- A % of sales based on expectations
- A % of gross profit of their sales
- A % of invoice value
- A split of gross profit (25/75, employee gets 25%)

Profit related bonuses should include a threshold profit level that much be reached before any payments are made. To design a self-financing system you need to consider what sort of increase you

need and at what profit. Also, do you know what your industry norm is for bonus levels? Your decision must be based on your normal margins / profitability.

Some Employers offer complicated bonus schemes that 'weight' several factors. Others offer schemes with a sliding scale of commission (e.g. profit up to £3,000 generates a 10% commission; profit between £3,000-£8,000 generates 20% commission; profit of £8,000 upwards generates 30% commission).

Make sure your scheme is not too complicated to administer; it must be easy and not time-consuming for you. Bonus schemes work best when the employee can easily calculate what he/she is going to earn.

Employment law considerations

Put all the details of the Bonus Scheme in writing so the terms are easily understandable. Make sure the scheme is separate to the contract of employment so it can be easily reviewed and amended or updated as necessary. You should evaluate the scheme regularly to see if it is producing the results you want. Make sure you have plans in place in case targets are not being reached.

Generally, bonuses can be 'guaranteed' or they can be 'discretionary', ie paid out only at the employers discretion, but this may not produce the motivation to earn it that you require. Another type of 'discretionary' bonus is when a bonus will be paid but the amount to be paid will be discretionary (e.g. depending how much financial objectives are met). If you do this then you must make this clear.

We suggest that the bonus scheme should be described in writing as discretionary, non-contractual, reviewable and that it can be withdrawn by the Company at any time.

Bonuses can also be described as 'variable' if its value can change from one period to the next.

From October 2014 any regular bonuses you pay must be taken into account when calculating 'average' holiday pay. (See our separate guide on calculating holiday pay). It can also have an effect on calculating a 'weeks' pay for some statutory benefits.

Frequently Asked Questions

What are the disadvantages of having bonus scheme?

Over time employees may come to expect cash, rather than seeing the bonus as a recognition for performance above and beyond the norm; so over time it may be less effective at motivating. It is important to regularly review your scheme for signs of this behaviour. If the scheme is failing to achieve the change/actions you required you will need to think how you can adapt it or if it is working at all?

Also, where targets are set on a team basis keep in mind that employees may not be able to influence team behaviour so this may not motivate them; and some staff may not be able to alter their own behaviour to reach the bonus targets.

When should I pay the bonus?

We suggest you work out when is the best time for you to pay the bonus? What timescale suits your business? Will it be one, two or three months after the end of the bonus period? This is important for sales related bonuses to ensure you are not paying out bonus money on business you may not have been paid for yourself! It also gives you time to assess the quality of the new business and that it did not cost you money to deliver it.

Should bonuses be capped?

Sales bonuses are often uncapped to drive further sales/performance. If you set a capped bonus (e.g. you can only earn £x bonus per period) then once the employee has reached their target they may stop trying or slow down.

If you are using the bonus scheme more as a recognition tool then a cap may be a sensible idea.

What happens when an employee leaves?

When you design the scheme, think ahead to this scenario. For example, make it clear in the scheme documents whether they will be entitled to receive a bonus payment during their notice period, if they move to a competitor or if you have dismissed them.

You can stipulate that bonus payments are conditional on an employee being employed by you and not serving notice (where notice is given by either party). If you pay them in lieu of notice then you need to decide whether they will be entitled to bonuses in that situation too.

Can I include Contractors on my Bonus Scheme?

We advise that you do not as you may muddy their employment status by including them in an employee bonus scheme. Normally, their base remuneration rate will reflect their contract status and will often be higher than permanent staff. Set clear short term targets to help manage their performance and keep them motivated.

Can a discretionary bonus take on a permanent benefit status?

If a bonus has been paid for several years the employee could argue they have an implied contractual right to it and it may therefore be viewed by an Employment Tribunal as having a contractual effect.