Year-end bonuses are still a common variable component of employee compensation for many firms, including subcontracting companies. These bonuses may come during the holidays or after year-end financial results have been tallied by the company’s auditors. The total amount of the bonus to be distributed is often based on profitability, company cash position and the amount of bonuses in prior years. Typical means of distribution are across-the-board by type of employee, a certain number of weeks’ pay, or it is often based on management’s subjective assessment of the employee’s effort over the prior year.

The payment of bonuses represents an extraordinary opportunity for management to tie individual rewards to measurable periodic results. Additionally, incentive (rather than subjective) bonuses can also explicitly relate corporate success to individual or team success. In these instances, bonuses can be termed incentive compensation because the amount of the bonus is tied to corporate and/or individual performance that is prescribed well in advance of the plan actually going effect.

Therefore, bonuses become incentive compensation when the actual payment represents a direct correlation between individual results and/or corporate profitability. When an incentive compensation program is properly designed and implemented, the company can expect significant returns on investments in its people.

All too often, however, managers are reluctant to convert their year-end bonus program into an incentive plan due to the following myths:

Employees have come to expect annual bonuses. An expectation of a bonus, regardless of the company’s profitability or individual results, often fosters a culture of entitlement, whereby employees have a deep-seated expectation that the company will always take care of them. Webster’s Dictionary defines a bonus as “anything given in addition to the customary or required amount.” Once employees assume that a bonus is forthcoming simply for showing up, the culture of the organization fosters mediocrity, as star performers move on to firms where their achievements will be recognized and rewarded.

In addition, when expected bonuses fail to materialize, remaining employees are often bewildered and angry, perceiving that management has violated an implicit contract.

Management rewards individual efforts based on a year-end assessment of employees. Many companies determine individual bonus amounts by allocating employee bonuses based on management’s judgment of individual performance over the course of the year. Though this is an admirable effort to tie performance into compensation, employees get no real feedback regarding their performance other than the size of their check relative to their expectations. In addition, assessment of employees is often qualitative, subjective, based on the last several months’ efforts and made by the owner rather than by the employee’s immediate superior. Finally, over the course of the
year, employees are usually unaware of what impact their actions will have on the amount of the bonus.

**Most of our employees are quite pleased with their bonuses.** Many employees who receive the traditional year-end bonus may indeed be pleased by it since they perceive that the bonus is truly a reflection of their contribution to the firm’s success over the course of the year. Others may be delighted by the bonus because its size overwhelms their expectations.

A third group typically is disillusioned and demoralized because their bonus is well below their perceived contribution. In addition, word will ultimately get around about the sizes of their colleagues’ bonuses, conveying an implicit message that they should somehow, in some vague way, strive to be more like them. They may perceive the process to be unfair, political and even rigged.

Unless bonuses are based on a carefully and thoughtfully crafted formulation, these three factions will inevitably develop. In addition, unless employees can reasonably approximate the amount of their bonus during the year based on both individual and company financial performance, there will be a polarization of employees after every bonus is paid.

**Webster’s Dictionary defines a bonus as “anything given in addition to the customary or required amount.”**

**It’s always been a part of our holiday season to distribute bonuses.** The spirit of the holiday season can still be maintained in ways other than the payment of bonuses. Distribution of small gifts and/or holding a holiday party would be appropriate.

The traditional year-end bonus is undoubtedly a magnanimous gesture on the part of management and may indeed foster some changes in performance, at least in the short term. A carefully crafted, objective, formula-based and well-communicated incentive compensation plan, however, has the potential to pay enormous dividends for the dollars invested in the program. It can serve to align employees with company goals and objectives, focus behavior and favorably effect change. The successful design and implementation of an incentive compensation plan may ultimately prevent a culture of entitlement and mediocrity and provide a catalyst for a driven, vibrant organization.

**About the Author**
Hank Harris is responsible for the management of all FMI consulting services to engineering, architectural and environmental firms. FMI, headquartered in Raleigh, N.C., is a management consulting firm specializing in the design and construction industry.