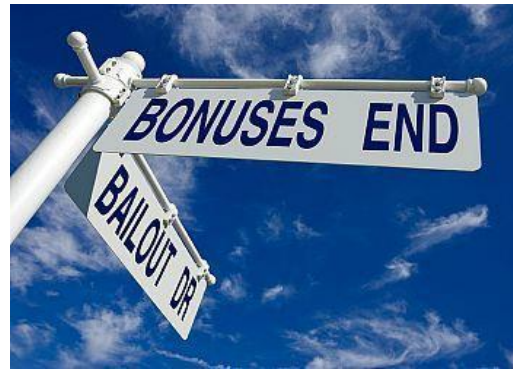


# MYTHS ABOUT BONUSES

## PART 1

There is an exceptionally high number of myths and delusions about bonus remuneration systems in circulation in Poland. The present remuneration policies are, at the same time, going through their well-deserved downfall. They are simply an ineffective management tool, and yet statistical facts still rarely shine through the wall of myths. Managers defend their bonus systems, since they claim them to be their basic tool and attribute in controlling workers, unaware of the fact that those tools and attributes have no strategic importance to the company, and are even harmful in many cases.



Bonus systems used in Polish companies are mostly **ineffective**. Many of them harm companies, or at least bring effects contrary to the interests of the managers. Business effectiveness of bonuses is an illusion. What is it really, then? If it is so, then what is the truth?

Below are the seven most important illusions regarding remuneration and bonuses.

### Illusion number one



**Remuneration motivates to work.** It is not true. Why do we fall under the illusion that remuneration actually motivates people?

We rightfully think that workers want to earn as much as possible. The majority of workers takes up work in consideration of the salary. This makes us conclude that salary motivates them to work. The truth is, however, that **salary motivates them only to take up the work**. That is a completely different thing. Let's take a worker performing simple construction works for an example. He was paid for overtime work. He consented, because remuneration is important to him, but the work is not pleasant in any way. The same worker could, instead of staying overnight, return home and mow his lawn, for instance. Which work would he be more motivated to perform? The one he does for money, but sees no point in? Or the one no one pays him to do? It is not the motivation that causes the worker to resign from mowing his lawn and staying overtime, but the money. **Money is the reason for deciding to take up work**, but it does not increase motivation to perform it.

Remuneration has an obvious impact on motivation to work. Unfortunately, **the impact is destructive**. Worker's motivation does not depend on the amount of remuneration, but on the difference between the remuneration received (or promised), and the remuneration expected. The difference between the expectations and their satisfaction, in sociological sciences called **deprivation**, is the key to understanding motivational bonuses. The level of motivation depends on the level of dissatisfaction, not - like many managers wrongly think - the amount of remuneration. The difference might be difficult to grasp for an amateur, since the concept of dissatisfaction level is not commonly used. We fall under these harmful illusions because we are unable to differentiate between the **motivational** character of expectations and a **discouraging** character of dissatisfaction. Remunerative expectations are almost always higher than the perceived level of their satiation. Do you know someone who claims that he earns more than he should? Perhaps such people exist - I have never met one.

So, almost all workers think they earn too little. Is it motivating? No. Dissatisfaction with remuneration causes constant discouragement and negatively impacts **work effectiveness**. And so the basic paradox of remuneration policy emerges: the salary motivates to take up work, but discourages from performing it effectively!

At present, I advise to many companies. Some of them pay twice or thrice as much as others for analogous positions. Even such drastic differences in remuneration have no significant impact on the engagement of workers. I have never heard someone say that "he works more efficiently than others, because they pay him much". Quite contrary - most people complain about low pays. Remuneration discourages to work. It does so more or less, but - except for extreme situations - it always discourages.



## Bonuses illusion number two

*Bonuses motivate to achieve better results, because workers want to earn more.* This is not true.

The illusion comes from the fact that workers really do care about money. We then think that - like in case of basic remunerations - they will do anything to increase their salary or increase the chances of achieving it. We then present the terms: "if you work more efficiently, the bonus will be higher". Employers set up bonus awarding terms in such way that a higher bonus is paid to workers **achieving higher results**, hoping for performance improvements. Workers are indeed ready to do something extra for a bonus, but only provided that the bonus is really big, and is paid immediately. Therefore, the overtime mechanism works pretty effectively. Whoever used it knows, however, that even doubling remuneration is not always enough to motivate the worker to additional work.

From the worker's perspective, a bonus is something quite different. Workers care about receiving it **at smallest cost possible**. If the cost is too big, then the worker will resign from the bonus. The bonuses, from the worker's perspective, are low, and encumbered with numerous terms and limitations, with the most often used one being deferred payment. The thing that we award the bonus for - the increase in effectiveness - requires that the workers leave the work comfort zone they grew used to, change their habits, or put in additional effort, meaning: they have to pay a price, which usually significantly exceeds the profit from the bonus. Workers are then not willing to work more effectively to receive „**symbolic**” bonuses. They will be making attempts to receive higher remuneration, but not at the cost of changing their habits and working harder, but rather by taking sham actions, such as manipulating data, production or sham sales (i.e. selling to the wholesale outlet), etc.

Bonuses not only do not effect in increased effectiveness, but in fact lower it. The reduction in effectiveness is caused by negative, often unnoticed side effects of bonuses. One of these mechanisms of discouraging workers by awarding bonuses is the **increase in salary expectations**. The mechanism goes as follows: "if I could get extra remuneration for additional effort, then I also want a bonus for diligent work". Work effectiveness is then lowered by workers, or because the bonuses are unsatisfactory ("I am not going to work harder for such small money"), or to enforce the granting of bonuses. Manipulating results and pressure on lowering the expectations is a less costly method of achieving bonuses than raising effectiveness. The mechanism is impossible to identify in individual cases. Even the workers themselves do not notice it. In large companies, the mechanism of influencing the results by the workers and management may go as far as to completely halt development of work effectiveness. In longer perspective, limitation of effectiveness is more profitable for workers than the higher effectiveness rewarded with bonuses. An increase in effectiveness does give a chance for receiving a bonus, but in consequence leads to **raising expectations, reducing changes** for future bonuses, and, what's most important - **worsening of working conditions**.

I know a large company that has operated a sophisticated bonus system for three years. The bonuses are high. Despite using the bonuses, results from the last three years have been as low as circa 85% of quotas. Due to bad working conditions, the workers often do not receive a bonus. It is commonly known, and confirmed by an analysis performed, that the **results could be much higher if the bonus system was removed**. The structure of algorithms and the principle of collective responsibility of workers cause that, despite the high level of frustration, it still is more profitable for them not to get the bonus, than to achieve the quotas. Millions of zlotys are lost.

An additional mechanism that nearly completely eliminates the relation between motivation and a performance bonus is that the impact of subordinates on the results is much lower than their superiors think. Performance bonuses cause only frustration and negatively impact the quality of their work.

The increase of motivation of managers and workers for achieving results by tying the amount of bonus with the results is an illusion. This illusion is unfortunately common among managers, as well as auditors.

## Illusion about managerial bonuses number three

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*Correlating managerial bonuses with the company result means that managers will raise productivity of the teams they manage.* This is not true.

The amount of managerial bonuses may be easily tied to the result. This results in a completely wrong conviction of managers and auditors that it allows them to create a reverse correlation, meaning that **the result will depend on the premium**. In other words, they think that bonuses will effect in that the managers will take additional short-term/long-term actions for the development of productivity and improving the results. The reverse correlation almost never takes place, unfortunately.

The basic mechanism that blocks an increase in productivity is beyond remuneration. Managers usually are unable to translate the result into operating actions. They are not able to define for themselves, nor to explain to the subordinates what additional actions they must take, and what changes must be made to work methodology to achieve the extra result for which bonuses are rewarded. Most often, **they merely reduce pressure** on the subordinates, without changing the method of achieving results. When implementing MBO, I realize that this difficulty is common among almost all managers.

Inability to translate additional expectations into concrete changes, professionally called **operationalization**, does not only result from lack of professionalism in management. Managers sometimes know how to improve the work of their teams, but the bonus pressure is only temporary. The result must be improved immediately, and the increase in effectiveness requires planning, defining, and a long-term implementation process. Under performance pressure, managers often take actions that are **chaotic, short-term** and often **irrational** in longer perspective. They usually never go beyond increasing pressure on their subordinates - and on the managers, to reduce plans and expectations. All this comes at the cost of organization development.

Despite a frequently seen lack of competences, managers also have important reasons not to improve their productivity. Increased performance is related with huge costs in the area of relations with subordinates and work comfort. Forcing subordinates to an even higher effort is for most of them a higher cost than the profits from receiving a potential bonus - if it is paid at all. Managers do not improve the results despite the bonus incentive, and if they do improve them, then they do so for reasons other than the bonus - because they really want it (internal motivation), or because they have to do it.



## Illusion number four

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*High bonuses are more effective.* This is not true for at least three reasons.

Bonuses are often increased at the cost of basic remuneration. This causes reduction in **social security** of workers, and effects in reduction of their subjective **value**. This may

discourage workers from taking risky and unconventional actions, which, in case of managers and specialists, will limit their innovativeness and hinder development of productivity.

Another reason is an increase in salary expectations. Nominally high bonuses cause workers' lasting dissatisfaction in case they are never paid. **The higher the bonus, the larger the discouragement.** High and timely paid bonuses will obviously satisfy workers, but, as we all know, the dissatisfied always outnumber the satisfied. The illusion that bonus increases engagement comes from a commonly made mistake consisting in not noticing the discouraging effect of remunerations:

"if workers want to earn more, then - if we give them higher bonuses - they will be more satisfied with their remuneration". This is not true. If it were so, then it would be profitable for companies to constantly raise bonuses in exchange for rising productivity. As we know, the reality is different.

The third reason for which it is not profitable to raise bonuses is the subjective and relative perception of their amount. By raising bonuses, we raise the company's - not the workers' - costs and standards. It is the company that has to pay more. This, by principle, **lowers remuneration profitability.** The amount of bonus for the worker is much lower than the cost for the company. Higher bonus is not likely to result in higher motivation.

A person I know recently told her client that "I won't even get up from bed for less than \$10.000". The same person was, not so long ago, willing to work passionately for a whole month for a remuneration below the national average. Raising remunerations does not increase motivation and engagement of workers.



## Illusion number five - bonus pool

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*Distribution of bonus pool according to the results achieved by the workers effects in that they will be striving to achieve higher results to receive higher bonus (larger part of the bonus pool).* This is not true.

Many companies in Poland use solutions based on the bonus pool, which is a predefined amount of bonuses to be paid to the workers. The principle of bonus pool consists in the limitation of money for dividing. The bonus system's only purpose is then just distribution of the limited amount of money. Bonus pool is divided as follows: whoever works more, gets the larger part of the "cake".

The illusion is that we think that the basic correlation is the relation between the effects of the worker's work and the amount of bonus. It is apparently profitable for workers to put more effort into work in exchange for the bonus. In reality, there is a much stronger correlation: **between the damage caused to collaborates and the amount of bonus.** It is much easier and more costly to harm others by e.g. undermining their results or making it more difficult for them to perform than working one's own success - especially that one's bonus (one's success) is worked at the cost of his collaborate's bonus. Competition and mutual antagonisms are therefore a natural consequence of such remuneration policy, and a rational choice of workers. Applying bonus pools causes **worsening of relations in the organization and loss of work effectiveness.** Negative effects of bonus pool mostly apply to talented, ambitious workers, who understand the mechanisms of business.

## Illusion number six regarding the SMART rule

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*Establishing realistic bonus targets motivates workers and effects in improved results.* This claim seems logical. Almost everyone believes it.

The mistake is not about the very idea of motivating to achieve realistic targets (which is correct), but the conviction that the targets are correctly (realistically) defined. Use of the above mentioned principle for several years causes a **natural decrease of expectations** (targets) and **slowing down of a natural, organic development of effectiveness** at work. Paradoxically, it is not the workers who are the main source of resistance to increasing expectations. It is medium level managers and specialists who are responsible for lowering results and promoting the anti-business principle of realism of targets. They are interested in maintaining status quo for two reasons. Firstly, they care for their relations with subordinates (whom they are often afraid of), and are thus unwilling to raise expectations. Secondly, their own bonus interest encourages them to lower the targets. In the maintaining of status quo they are supported by specialists, who are equally interested in creating labor-intensity reserves. In managing personnel, they often refer to the SMART principle, which says that goals should be realistic. This theoretically correct principle is commonly interpreted in a way that is detrimental to business. As an effect, establishing and rewarding realistic targets in long-time perspective leads to reduction in effectiveness of organization and unprofitability of bonus systems.

A certain manufacturing company used a sophisticated piece-work system for several years. Quotas were not raised, because effectiveness was slightly reducing, keeping on a level of around 95%. Its bonus system, based on "realistic targets", caused a **halt of organic work effectiveness development** in the company, and caused the company's **profitability reduction**. After removing the piece-work system, the productivity was drastically rising for several subsequent years, recovering from the losses caused by the bonus system.

Had the achievement of those targets not been rewarded with bonuses, the limitation in effectiveness described would have been much lower.



## Illusion number seven

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*Appreciation rewards are more effective, because they are more fair - more criteria are taken into consideration than in case of work code bonuses.* It is not true.

Appreciation rewards are indeed more fair sometimes. Their basic flaw is, however, that they **are paid post factum**. They might be a fair system of distributing money between workers. They do not have a positive impact on their actions and effectiveness in the subsequent bonus period, however. By granting fair bonuses, we fall under the illusion that the persons rewarded are encouraged to work harder, and the ones punished are discouraged from laziness. In fact, we only satisfy (and this only partially) their salary expectations caused by the rewards. Since, according to the principle of relative deprivation, we will not satisfy their expectations in whole, the award, as fair as it may be, will **always discourage from more effective work**. This is confirmed by commonly seen reductions in efficiency after payday.

One of my clients has just concluded a business year with a horrible row about annual awards. Millions of zloty paid "fairly" have only caused a severe wave of dissatisfaction and mutual reproaches, instead of improving atmosphere. Among the dissatisfied were those who were awarded, as well as those who were not. The worsening atmosphere in the team and the dissatisfaction will certainly have a negative impact on work effectiveness and the company's results in the next year.

### **Bonus cuts both ways.**

There are many more illusions regarding remunerations and bonuses. Here I have only described the most common ones. Remunerations and bonuses cut both ways. On one hand, they satisfy salary expectations; on the other - they create them. Additionally, they generate them on a level impossible to satiate. By offering bonuses, we encourage workers to take up work. In a very short perspective, the effect will be positive. At the same time, by offering bonuses we discourage workers, depriving them of satisfaction from work, and - paradoxically - of the pay itself. In long term, the motivational effect disappears, and what remains is

only discouragement. Managers still remain under the illusion that they are improving results and "motivating" workers. Bonuses effectively emphasize priorities and desirable actions, and support them. On the other hand, they depreciate the value of engagement and deprive people of the sense of work, creativity and development. A worker starts appreciating the value of only what is rewarded, at the cost of whatever would have given him joy and satisfaction without bonus incentives.

***Robert Reinfuss***

*Reinfuss Consulting*

*business advisor*