**Variable Pay Systems**

Major types of variable pay are bonuses, incentives, stock-options, and commissions. They are typically linked to performance of either the individual or the team, and are based on the philosophy--employees who perform better should be compensated differently and at higher levels.

The length of time in service should not have a bearing on variable pay but unfortunately it often does.

In the past, executives often received a long term reward such as stock options. Today this is also common for the professional level employee with highly sought after technical skills.

This approach to paying employees links strategic business goals and employee performance. Rewards should be tied as closely as possible to desired performance, for example--for enhancing organizational results. The success of the variable pay plan might include increasing sales, operational efficiency, and/or employee morale, as well as lowering costs.

There must be a process in place to measure performance linked to variable pay. More than one variable should be identified to measure performance. If a particular performance can't be measured, it should not be part of variable pay program. The organization must be clear that it does not guarantee an increase for additional compensation for merely working at the company and meeting basic objectives.

Variable pay programs are complex and HRM must work with department managers and accounting to devising correct formulas to measure variable pay. The HR department must be able to clearly illustrate to managers how to manage and reward different types of performance. Managers must be able to clearly explain future performance targets. And, devising variable pay measurement metrics is important.

More than 80% of Fortune 1000 firms use some form of performance-based compensation. Organizations following the variable pay philosophy are typically more productive than those who follow the entitlement philosophy.

Pay for performance is a concept embraced by many, but often executed poorly and ends up hurting morale, production, and retention. It must be properly executed.

Much can be learned from best-practice companies where base pay increases are truly earned based on demonstrated individual achievement.

Varying pay for performance produced can be a powerful driver of organizational change and success, with one condition--it cannot be confused with traditional merit pay systems.

High performers are attracted to companies that are committed to pay for performance. Low performers will self-select out of these organizations.

The pay system should seek to change behavior and to move people forward in their careers.

Decisions to implement a variable pay plan need to be well communicated so that employees realize that there will be no merit pay for people who aren’t performing. This will reward top performers more effectively over time and retain the talent that is actually driving success.