Compensation – incentive vs bonus

[Finance](), [Investment]()

A bonus plan is one where the bonus is awarded after the fact and typically has very little or no incentive value. The employees typically come to see it as an entitlement. An incentive plan is a variable pay plan that is tied to some level of performance. The employee is rewarded with a payment that is predefined and non discretionary. The reward is paid when actual performance meets or exceeds predefinedgoals. incentive| Any form of variable payment tied to performance. The payment may be a monetary award, such as cash or equity, or a nonmonetary award, such as merchandise or travel.

Incentives are contrasted with bonuses in that performance goals for incentives are predetermined. Generally nondiscretionary and can be paid at any time of the year| bonus| An after-the-fact reward or payment (may be either discretionary or nondiscretionary) based on the performance of an individual, a group of workers operating as a unit, a division or business unit, or an entire workforce. Payments may be made in cash, shares, share options or other items of value. In the context of sales compensation, a defined, pre-established amount ofmoneyto be earned for achieving a specified performance goal.

Planned bonus amounts commonly are expressed as a percent of the incumbent's base salary, salary range midpoint, percentage of target cash compensation or incentive compensation, or a defined dollar amount. See also discretionary and nondiscretionary bonus| Bonus versus Incentive - What is the Difference? Here is how our Glossary defines them: Incentive: Additional pay (above and beyond the base salary or wage) awarded to an employee, such as stock options or a contingent bonus plan, that is 'forward looking'. Bonus: Plans that award cash or other items of value, such as stock (or stock options), based on accomplishments achieved.

While incentive plans are 'forward' looking' bonus plans are 'backward looking'. An incentive that is dangled to entice certain behaviors may include cash or prizes or perquisites or anything that activates the motivations of the performers. A bonus is " something extra" which is usually cash and is always non-guaranteed. The two terms can obviously overlap: job security in unsettled times can be an incentive for some people to work harder, while a contingent bonus premised on specific outcome results can also be an incentive to achieve those objectives.

Most of the time, the amount of the commission at goal (or " quota") is high if the quota is higher - so if one sales person has a $1M quota and another has a $1. 5M quota, then one has a target commission that is 150% that of the other. Whereas in a " bonus" world, the target incentive is fixed for the role (e. g. , $40k per year) and is paid for hitting quota, which may vary from one person to the next.

Of course there are myriad nuances and variations, including the possibility of " personal commission rates" which communicate a" bonus" as if it were a" commission," etc. But that gets at the gist of it. All that said, I do have a current client with a business that is very weather-dependent (agrichemicals), to the extent that performance of the sales people can only be assessed retrospectively - did they create value for the company, sell well, cement relationships with customers, and achieve solid results given the opportunities that came their way during the year?

Because the business itself is so volatile, the sales person's compensation must be less incentive-rich at target than most in similar roles, and performance can only be evaluated fairly in retrospect. However, this is only noteworthy because it is so highly unusual. Wherever possible (and it usually is possible), sales people have clear financial goals with formulaic compensation opportunities tied to how well they do against those goals.