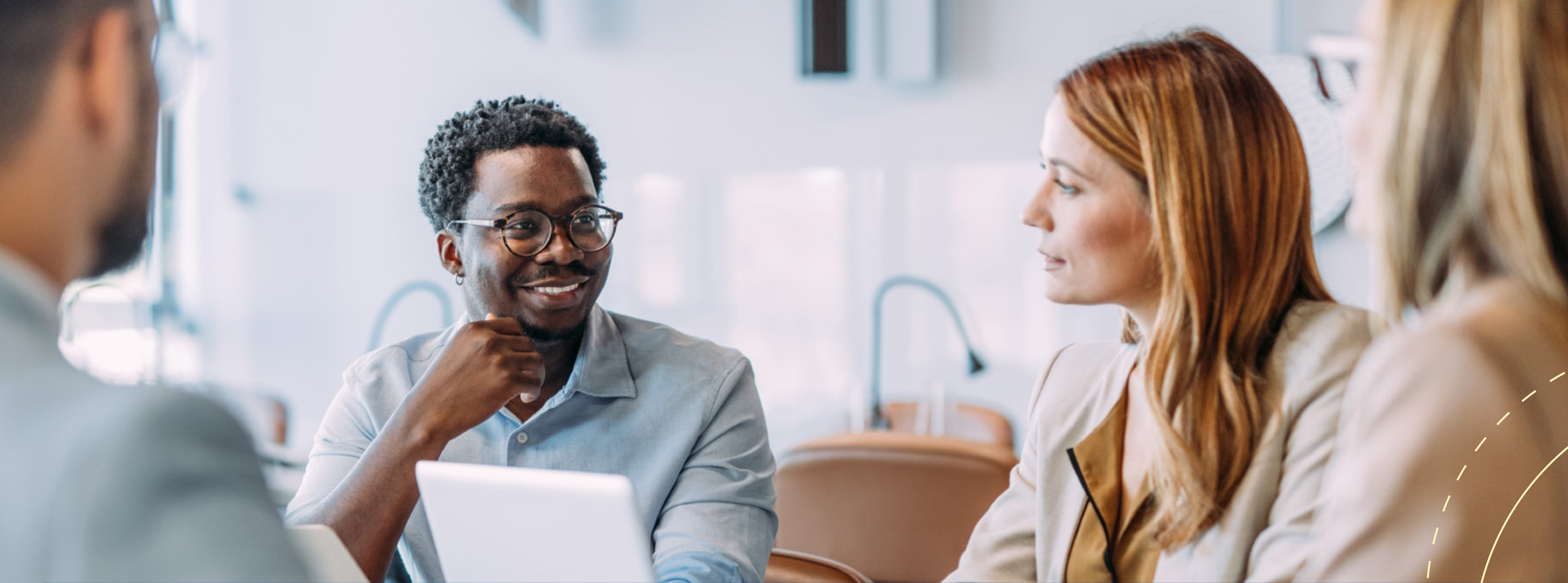

How to improve retention with a performance-driven compensation strategy

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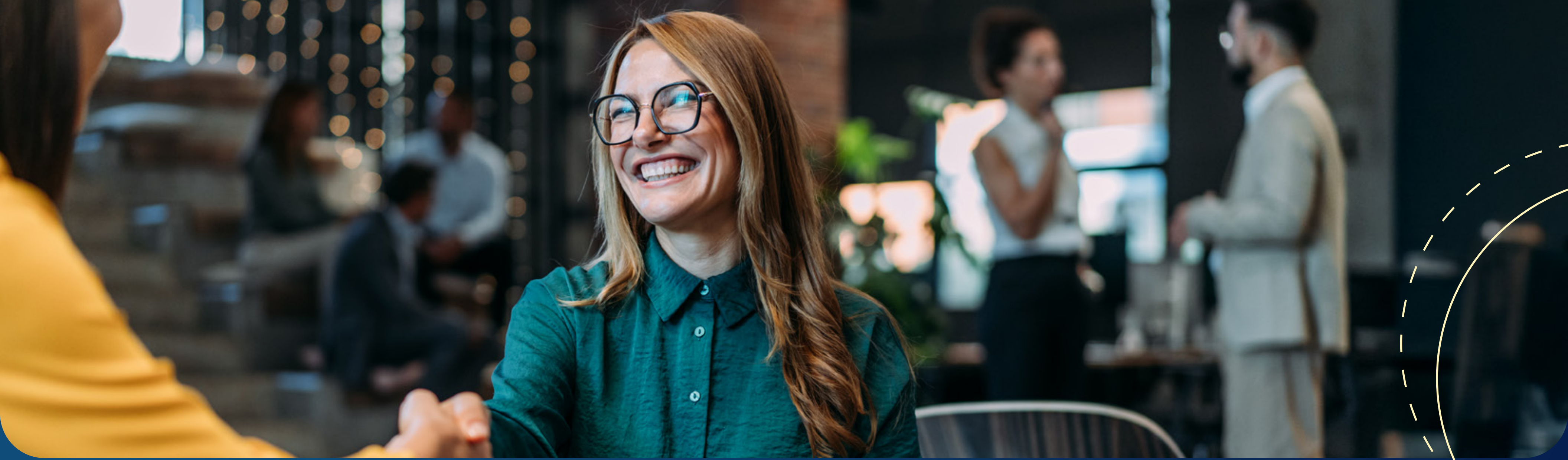

Retaining top talent has become a growing priority for executives.

Many organizations have responded by upskilling employees, increasing flexibility, and improving work-life balance. While these efforts have made strides in employee satisfaction, they fall short of addressing one of the leading causes of attrition: compensation.

Despite being a primary driver behind employee turnover, compensation is frequently overlooked in retention strategies. For example, when year-end bonuses fell in 2023, some companies experienced a talent exodus. A recent SHRM survey also revealed that uncompetitive compensation was the biggest hurdle in acquiring talent for 40% of respondents.

Yet nearly one in two organizations (45%) don't have a formal compensation strategy (or are unsure if they do). While cost and complexity concerns are common, as this playbook will show, investing in compensation is easier and more profitable than you think — and it can significantly reduce turnover.

Companies rated highly on compensation have 56% lower attrition rates. But revamping your compensation strategy isn't just about numbers — it's about creating a culture where employees feel valued for their performance and motivated to contribute.

This playbook outlines how to increase employee loyalty by implementing a performance-driven compensation strategy. Read on — and incentivize accordingly.

The connection between compensation and retention

Compensation is one part of the bigger picture, but an important one, says Glizcel Ditto, executive director of client solutions at HRSoft. Data shows that 87% of workers say fair compensation should be the top priority for current employers, and 14% of companies report workers quitting when they see higher compensation elsewhere due to new transparency laws.

Compensation also goes far beyond what we traditionally think about, including how an organization rewards its employees — monetary or not. "When you look at the whole package, it paints a picture of the employer brand, about everything you are from a culture perspective, and everything you're offering employees to make it a great place to work," Ditto adds.

Including financial incentives as a part of your compensation strategy is critical to keeping your employees happy and can reduce voluntary turnover by 31% when part of a structured recognition program.

HRSoft CEO Joe Poxson also notes, "one reason is that employees innately want to be rewarded for their performance. And if organizations aren't transparent about how they measure and reward employees, you'll naturally face retention issues."

Additionally, rising living costs are making compensation more significant for employees. Experts note that investing in incentives can pay off. According to McKinsey, "a one-off investment of $50 million in incentives can generate $1 billion in recurring value above business-as-usual performance."

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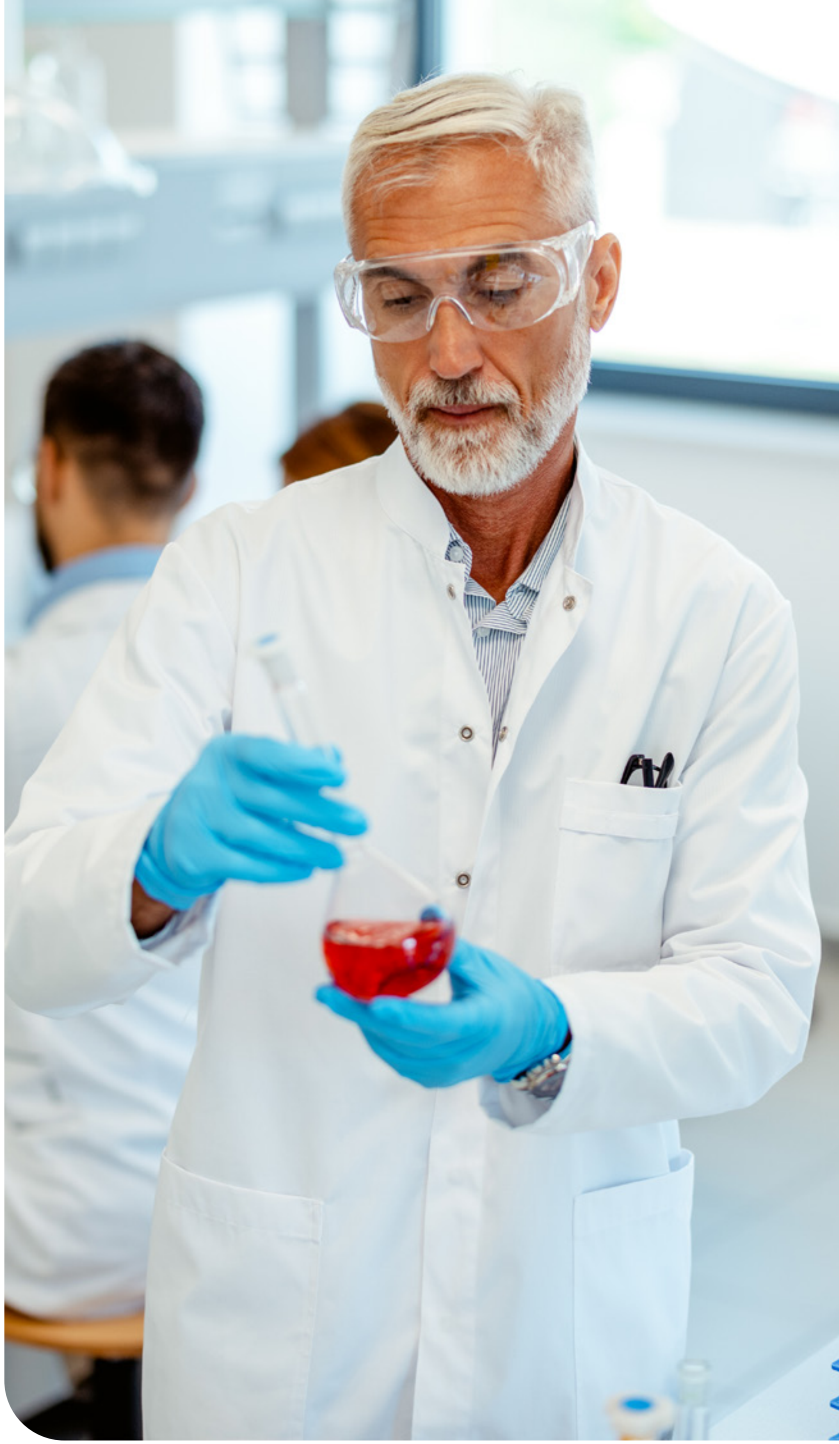
Exploring bonus and incentive options

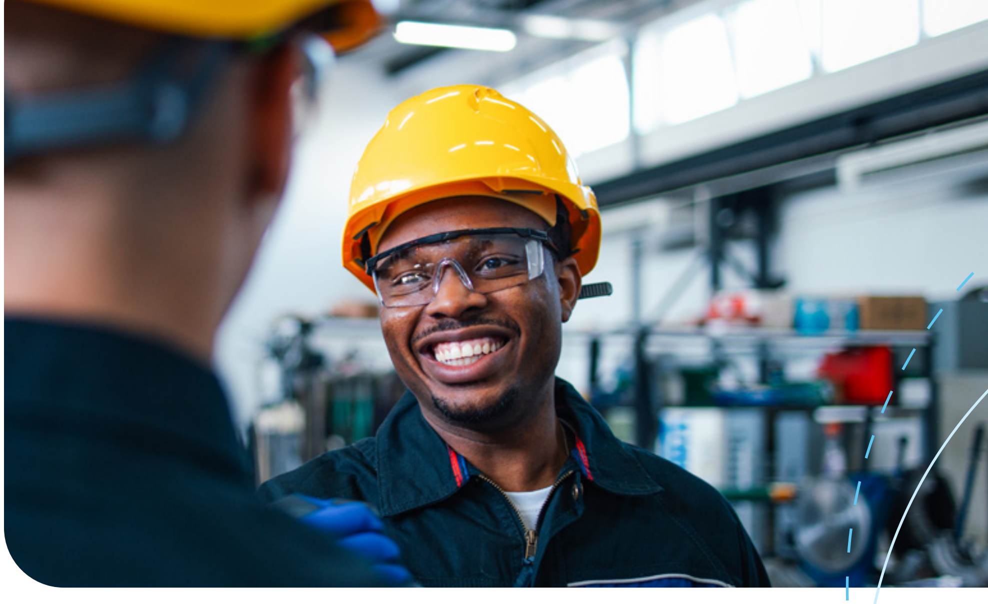
For this playbook, we focus on performance bonuses, but there are several short- and long-term incentives worth considering for your compensation strategy, including:

- **Cash bonuses** (Lump-sum payments for performance or contributions)
- **Performance bonuses** (Lump-sum payments for meeting specific goals)
- **Profit-sharing** (Share of company profits based on overall performance)
- **Referral bonuses** (Lump-sum payments for successful employee referrals)
- **Retention bonuses** (Financial incentives to keep employees long-term)
- **Spot bonuses** (Immediate rewards for exceptional work)
- **Stock bonuses** (Shares of the company's stock as compensation)
- **Stock options** (Right to buy company stock at a set price)

Other incentives that could be included in your total rewards program include student loan repayment, tuition reimbursement, wellness incentives, commuter benefits, child care assistance, and relocation allowances.



6 effective methods to revamp your compensation strategy



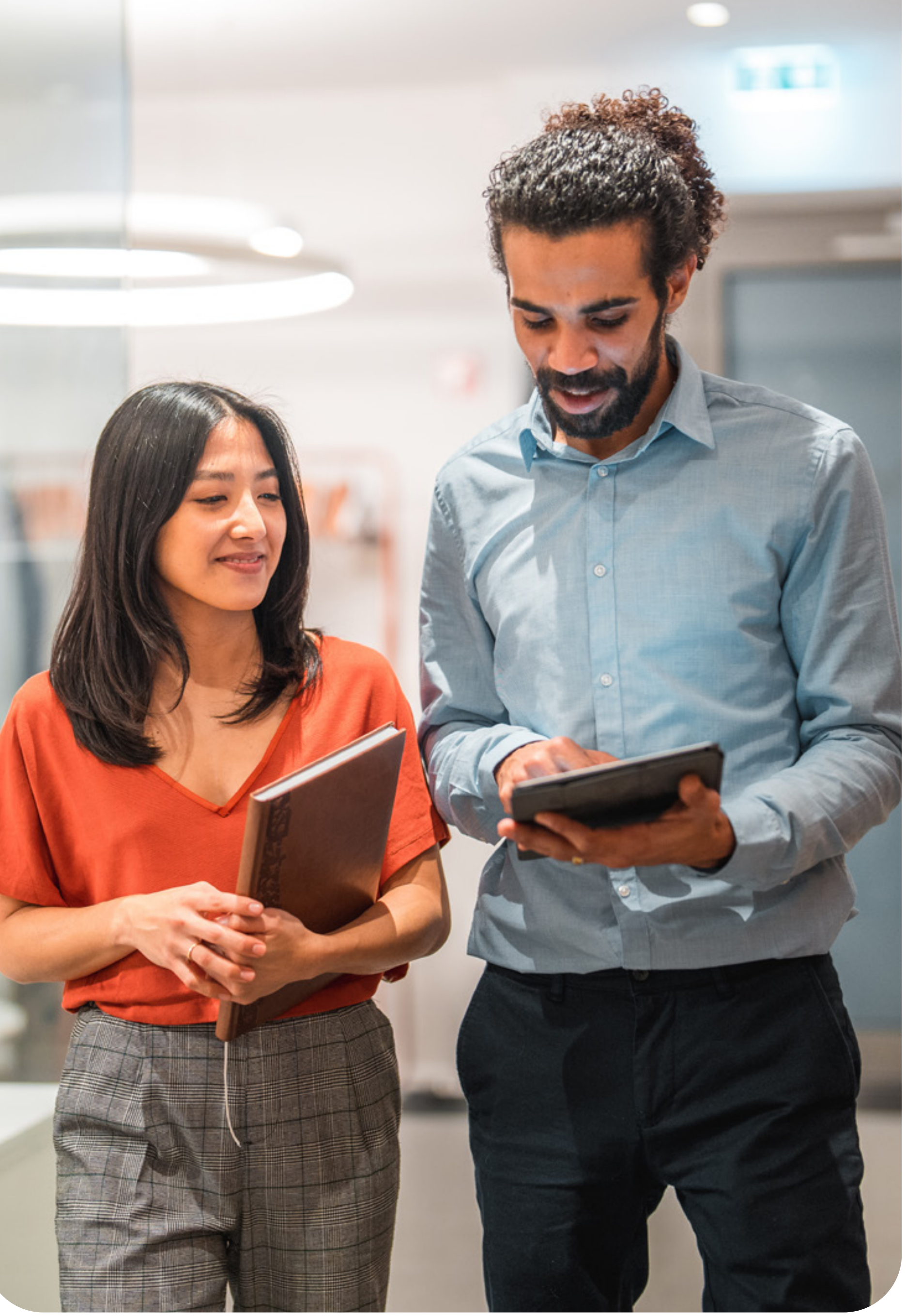
1. Offer performance-based incentives

According to Poxson, performance-based incentives are one of the most effective ways to enhance an organization's compensation strategy. "Performance-based incentives encourage employees to focus on outcomes rather than merely going through the motions," he explains. These incentives also boost discretionary effort, potentially addressing workplace challenges like 'quiet quitting' and 'resenteeism.'

To be effective, Ditto advises that performance-based incentives combine organizational, team-based, and personal goals. Organizations sometimes make the mistake of only focusing on company goals, which might not yield the desired results, adds Ditto. In contrast, a balanced mix gives employees a sense of purpose, a deeper connection to the company's mission, and personal responsibility.

One executive told McKinsey that incentives were "one of the best investments we made as a company" and explained that because they dispersed rewards only after the value was delivered, they wound up producing 100X more than what they paid out, making the program self-funded.

PRO TIP: Consider using a balanced scorecard to help you track results, a tool that Poxson and Ditto say is making a comeback.



2. Make your metrics make sense

For performance-based incentives to be effective, organizations must be clear about what metrics need to be hit. Be open about company goals and connect the dots so individual employees see how their efforts align with the broader mission — and how they'll be rewarded for their impact. Doing so:

- Helps employees feel more connected to the company's mission
- Makes employees feel more in control over their earning potential
- Prevents misalignment of priorities across the organization
- Ensures everyone's marching in the same direction
- Creates more fairness and accountability
- Simplifies identifying top performers

Additionally, highlight how different teams play unique roles while reassuring your employees that every contribution is valued. "Employees must know that they're all in the same boat rowing together, even if their contribution looks different than someone else's," explains Ditto.

PRO TIP: To keep goals motivating and achievable, Ditto recommends focusing on 2-3 clear objectives per quarter. This cadence prevents employees from navigating too many mini-goals, which can dilute their impact.

3. Increase your payout frequency

Offer more frequent incentives to keep employees engaged rather than making them wait. “We’ve seen in the last several years that setting annual goals doesn’t cut it,” explains Ditto. Poxson agrees, noting that “employees, especially younger generations, don’t want to wait a whole year before they get recognized based on their overall performance in that year.”

And who could blame them?

Frequent incentives also make rewards feel more achievable than annual incentives. (Some of which still arrive through snail mail.) While quarterly incentives are popular, some executives are exploring monthly rewards. Whether you opt for monthly, quarterly, or semi-annual incentives, maintaining a consistent schedule ensures employees know what to expect — and when.

PRO TIP: Strengthen momentum by offering incentives shortly after goals are met. According to the Incentive Theory of Motivation, creating a clear and timely link between action and reward can reinforce desired behaviors. The link also boosts motivation by making the reward more tangible and immediate.

4. Expand eligibility to more employees

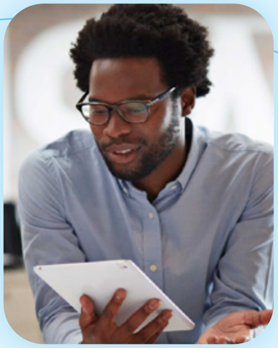
In many organizations, incentive programs have traditionally been limited to managers and higher. However, Ditto has seen a growing trend of expanding these programs to a broader range of employees. "Widening eligibility fosters a greater sense of responsibility among employees for their contributions to the company's success," explains Ditto. "That shift has been really helping from a retention perspective."

Some reports even suggest that restricting bonuses only for senior managers and CEOs has increased inequality in the workplace. Expanding eligibility helps mitigate this by making bonuses more inclusive and ensuring employees at all levels feel valued for their contributions.

PRO TIP: Look beyond short-term bonuses and consider expanding access to long-term incentives. This approach can create a deeper sense of ownership and encourage employees to stay with the company longer.

IN PRACTICE:

Microsoft offers stock-based compensation to a significant portion of its workforce, believing that employees are more likely to be invested in the company's long-term success when they have a stake in it. Starbucks even offers stock options to their part-time workers.



5. Offer flexible payment options

Don't just pay employees what they want; pay them how they want. Employees' financial motivations often vary based on personal preferences and life stage. For example, Ditto emphasizes how incentives are vital for retaining entry-level and mid-level talent. "Somebody early in their career is likely more dependent on their direct compensation than others."

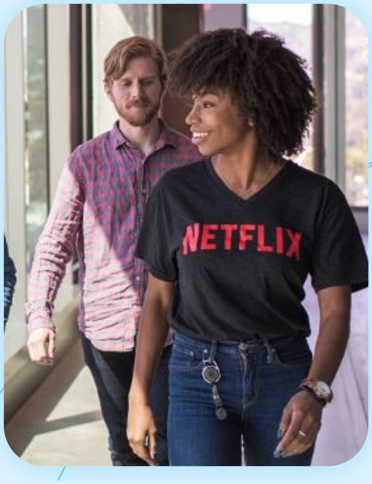
Research supports this view, with one study showing that younger employees are more motivated by monetary rewards. Under-compensating these employees leads to a sharper decline in job satisfaction compared to their older counterparts.

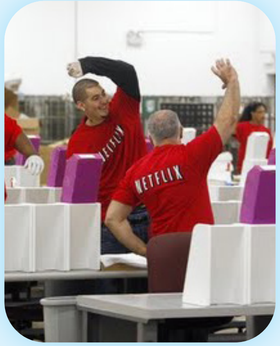
Beyond that, some individuals are generally more risk-tolerant than others. If given the chance, some may prefer to defer a portion of their compensation into long-term incentives, such as stock options.

PRO TIP: Remind your employees of their options. Compensation conversations usually only occur during annual reviews or recruitment, says Poxson, while maintaining an open dialogue throughout the year engages employees and keeps them informed.

IN PRACTICE:

Netflix customizes its compensation packages to meet the needs of its employees and aligns with individual employee preferences. This strategy has played a significant role in helping Netflix maintain an exceptionally low employee turnover rate of just 4%, well below the industry average.





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6. Make transparency a priority

Support retention by educating your staff on total rewards, including compensation strategy. This is especially critical now as data shows employees across all generations have a weaker understanding of their total rewards than five years ago.

Ditto points out that while many organizations are adopting pay transparency due to regulations, this often focuses only on base salary. To be effective, ensure employees understand the full scope of their compensation package.

"Employees don't often come in with that knowledge, and they want transparency," says Poxson. "They want to understand what's fair." According to McKinsey, financial incentives can boost the perceived fairness of variation in compensation and increase accountability.

What could transparency look like?

- ✓ Offering visibility into performance metrics
- ✓ Clearly communicating incentive opportunities
- ✓ Explaining your equitable pay practices

PRO TIP: Foster healthy competition with transparency. "The more transparency, the better performance you'll get because no one ever wants to be at the bottom," explains Poxson. This sentiment is echoed by a chief transformation officer who told McKinsey, "Winning is contagious. It becomes addictive, and people don't just want to sit on the sidelines."

Reap the rewards by issuing the rewards

Retain more employees — and get better outcomes — by revamping your compensation strategy and tying it to performance. The evidence is clear: employees are more likely to perform when they feel valued for their performance. By offering **clear, consistent,** and **measurable** incentives, you create a culture of success where employees are driven to stay and perform at their best.

Don't let challenges stand in the way of a strong compensation strategy. HRSoft specializes in the management and facilitation of your programs, ensuring they run smoothly and effectively. Remember, *companies that support their employees see the benefits in return*.

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HRSoft is the pioneering force in compensation lifecycle management software, offering an unmatched portfolio of compensation-focused solutions designed to simplify and optimize intricate compensation management, including:

- **Total compensation planning** – strategically plan and allocate all forms of compensation
- **Long-term incentive management** – automate the entire LTI and bonus deferral process
- **Total rewards communication** – understand the full value of employment
- **Pay for Performance** – tie performance to compensation
- **Carried Interest** – accommodate plans and implement updates as needed

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