Budgeting for Performance-Based Recognition Programs

Engage2Excel™

Corporate leadership teams will defend investments they believe will help grow the business and deliver profits to shareholders.

Recognition Budgeting

Each year, according to the Incentive Research Foundation, U.S. companies spend $77 billion to motivate and engage their workforce. Three quarters of all U.S. businesses leverage non-cash rewards for employee recognition programs, with 55 percent spending more than $100 per employee and 25 percent spending in excess of $300 per employee.[1]

Several trends are influencing increased spending on employee rewards and recognition programs. These include:

- Demographic Shifts: For the first time, there are more employees exiting than entering the workforce. Employee recognition programs have demonstrated a positive impact on retention rates.

- Employee Engagement: In the knowledge economy, companies increasingly depend on employees to do more than just their "regular jobs" and engage in non-core functions that ultimately determine the success of key strategic initiatives related to productivity, customer satisfaction and innovation.

- Analytics-Driven Decision Making: HR departments are now embracing analytics-driven decision-making models that have helped to significantly improve performance in IT, finance, marketing and supply chain management. Today, companies can target engagement and recognition programs to address specific performance problems or opportunities within any department or workgroup.

Make an Investment

Make your program an investment and not an expense. Recognition programs are most successful when they align with overall corporate strategies. Creating programs that tie into your organization's business objectives, mission, vision and values is more likely to be embraced by all levels of management.

Corporate leadership teams will defend investments they believe will help grow the business and deliver profits to shareholders. By linking your recognition strategy to your company's business strategy, it is much more likely that someone in upper management will act as your recognition champion.

[1]Incentive Research Foundation 2016 Trends in Incentive Travel, Rewards, and Recognition

Different "sub-audiences" in the employee population need to be acknowledged and rewarded for different results with different rule structures.

Budget Options

There are several ways to determine a budget for incentive and recognition programs. As employers realize that one program does not fit all, many are moving toward the trend of budgeting per program. Different "sub-audiences" in the employee population need to be acknowledged and rewarded for different results with different rule structures.

Common Ways to Budget for Recognition Programs:

Fixed budget. A dollar amount is budgeted for the program for a specified period of time, usually 12 months. The business rules of the program are then designed to stay within the confines of that budget.

Variable budget. Variable budgets are based on outcomes and vary according to the actual performance achieved. These budgets are usually determined by financially defining the outcomes and what they are "worth" to the company. To determine the business rules, you must first create a performance-based framework, where employees are both objectively and subjectively measured. This framework can yield greater business outcomes if it is properly designed. To budget for these programs, it is important to predict employee performance as it relates to the business rules of the program. This is similar to sales forecasting by product line.

Allocated budget. Using allocated budgets, each division, vice president, location or manager is allocated a budget for a specified period of time. Budgets are based on stated criteria, which might be:

- A pre-determined amount by employee (e.g., $200 per employee per year). Dollar amounts are translated into appropriate award or recognition currency, usually either points or access codes.
- A per-employee amount based on a percentage of payroll.
- A flat amount allocated to an organizational group or entity.

Non-redemption of points is another budget consideration in point programs. Not all points issued to employees are actually used to order awards. Non-redemption is usually in the 10- to 15-percent range and should be used in budget calculations.

Also consider whether your incentive/recognition partner is billing on a points-redeemed model or a points-issued model. While there are cost benefits to both, it is important to understand which model will work best with your budgeting needs.

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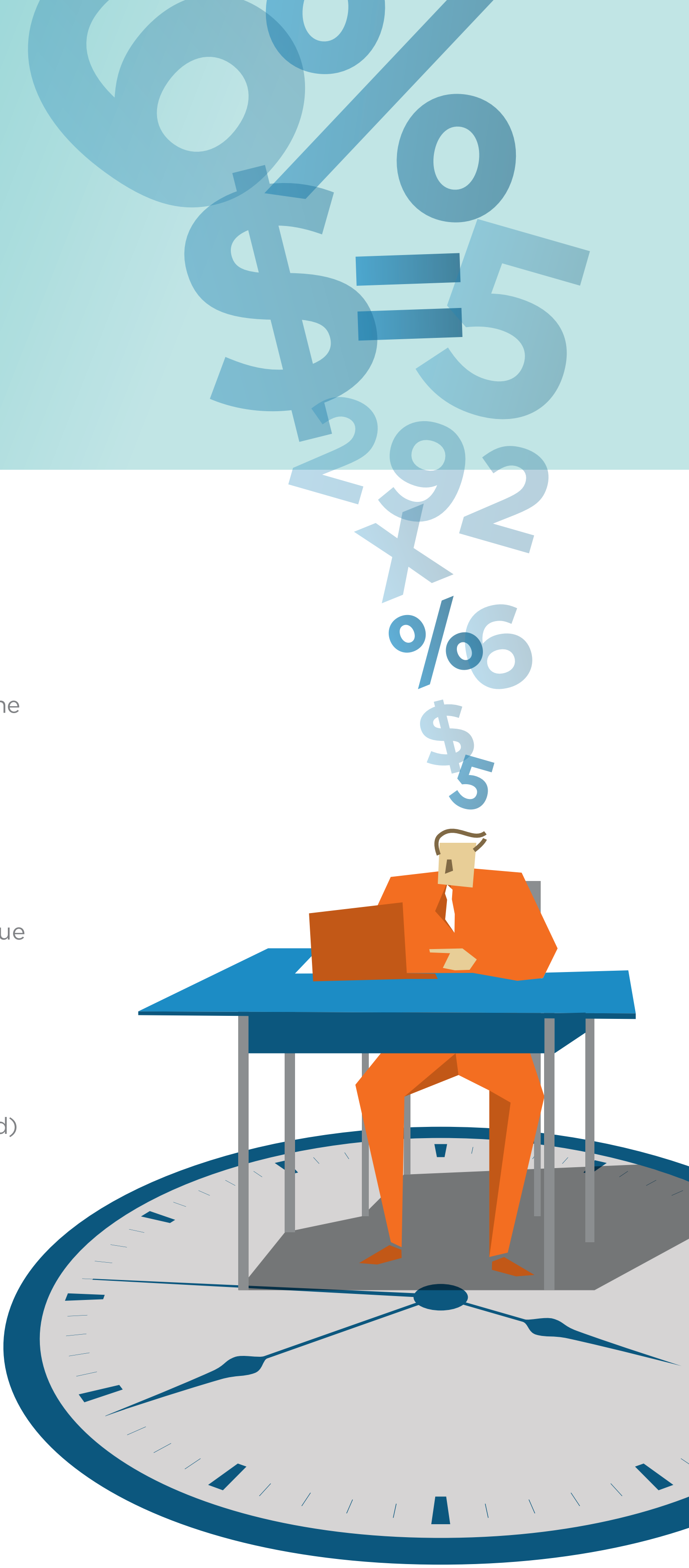

Tax Considerations

When budgeting for performance-based programs, it is important to take into consideration the tax implications for the employee. Tax issues vary by state and by type of award and are subject to federal regulations.

To help with this expense, most employers “gross up” the awards to alleviate additional tax burdens on their employees. Best practices dictate that employers use Fair Market Value (FMV) calculations to reduce the taxable value of the award to the employee and therefore reduce the amount spent on gross up.

This calculation is usually done as follows:

- Cost of the award (amount paid to the supplier for the award) x 65 percent = FMV
- FMV is used for gross up

Example:
Employee A performs well in the program and uses his points to order a TV. Your company is invoiced $1,000 for the TV by your incentive/recognition partner. The tax gross-up rate for your company is 45 percent.

The FMV is calculated at $650 ($1,000 x 65 percent). The gross-up is calculated at 45 percent of $650 or $292.50. (This is instead of 45 percent of $1,000 or $450.)[2]

[2]Engage2Excel does not provide tax or legal advice, and these calculations are an example only. Your program including FMV calculations should be reviewed by your legal or tax department.

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Why Cash Awards Can Be Costly

When a company presents an employee with a cash award, the IRS requires that cash be treated as income by the employer. This can be costly for both the employee and the employer because of income and employment taxes.

If an employer wants an employee to receive a net bonus of $50, the employer will need to pay the employee $67.25 to cover the taxes. An additional $6.54 would need to be paid by the employer to cover its tax obligation toward workers' compensation and state unemployment taxes. Thus, a $50 bonus to an employee will cost the company $73.79.

Alternatively, if the company's intention is to give a gross $50 cash award, the employee will net only $37.18 in spendable cash. It will cost the employer an additional $4.87 to cover its tax obligations. This costs the employer $54.87, and the employee nets $37.18. The employee will also pay sales tax when using this money to make a purchase. The net purchasing power, therefore, ends up being less than $37.18.

The added cost of cash awards is why many companies choose to offer gift awards to acknowledge length of service and performance.

Many employees will say they prefer cash. The reality is, cash is abstract, equates to compensation and is not an effective motivator. Once it is spent, it's gone.

In fact, multiple studies have shown that when used as an incentive, tangible awards resulted in a 2.5 times greater output than cash or cash equivalents.

If an organization is building a service award or a performance-based program, there are several benefits to consider when using gift or points-based awards in them:

- Although an employer must pay sales tax, gift awards in a qualified plan do not incur most of the same tax and fee obligations as a cash award.
- Gift awards are deductible as a business expense to the employer.
- A gift item is less likely to equate a service or performance award with a specific dollar amount. It is more about the meaning behind the gift.
- Smaller cash awards will most likely be spent on necessities such as food or gasoline, and the emotional appreciation of the award will be quickly forgotten.
- A gift item is a tangible remembrance that the employee is more likely to keep. It helps to promote goodwill toward the employer.
- The employee has no income tax liability for a gift item award in a qualified plan.

Engage2Excel works with organizations that seek to plan successful employee recognition programs that stay within a set budget and produce measurable results for the organization.

Management Commitment

Once a budget has been established for recognition, it is important that all levels of management are committed to the success of the program(s). Providing training and tools in order to use the recognition program effectively will result in a consistent message being delivered across the organization. Being accountable for recognition must also be built into a manager's performance evaluation. They should be recognized and rewarded for their positive results, or coached and re-directed if the outcome is not meeting the company's expectation.

Measuring the Investment

Once programs have been budgeted, it's easy for an organization to continue funding them year after year. However, it's important to stop and reassess whether the money is being spent wisely. Measuring the results of your program and adjusting if needed are key factors in the life cycle of your recognition program.

Engage2Excel Technology Can Help

With Engage2Excel's flexible technology platform, our clients can use multiple programs for separate audiences and purposes. Within those programs, we can apply varying rule structures and different award currencies, including: award catalogs, bankable points, access codes, etc. Our flexible functionality makes us unique to the industry.

Engage2Excel has the expertise to develop, budget and manage an enterprise system running multiple programs, involving different audiences and using different budgeting methodologies.

We work with organizations that seek to plan successful employee recognition programs that stay within a set budget and are investments for the organization.

Measure, Manage and Improve Employee Engagement and Performance

What's missing from your employee engagement strategy and recognition programs? How about an ROI you can take to your CFO. Engage2Excel helps you measure, manage and improve performance with the industry's only ROI-based employee recognition solution while our Talent Acquisition division helps you infuse highly engaged employees into your corporate culture.

Learn more about industry-leading employee engagement solutions from Engage2Excel. Call 800.688.3024 or visit Engage2Excel.com.

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