

How to Create a Performance Bonus Plan

written by Rory L | February 21, 2023



Awarding performance bonuses can go a long way in boosting recruitment, retention, productivity, efficiency and morale. But companies and their HR directors also need the right bonus plan to maximize the return on their investment. While bonus plans are as variable as fingerprints, there are certain core elements any and every plan needs to be effective. So, whether you're structuring a new bonus plan or reviewing an old one, here are 5 crucial considerations to keep in mind.

1. Put It in Writing

The starting point is to put your bonus plan in writing, either as part of the employment contract/collective agreement if employees are unionized or as a freestanding policy, like the [template](#) on the HR Insider website that nails down the key details about whether, how much, how and when the bonus will be paid. The flipside is to steer clear of verbal and informal bonus agreements, which are apt to breed miscommunication, resentment, disputes and even litigation.

2. Decide What Type of Bonus to Offer

Next, decide how you want to spend your bonus dollars. There are lots of different types of bonus programs from which to choose, including:

- **Performance bonuses**, typically paid annually to reward employees who meet or exceed specific performance goals;
- **Signing bonuses** to reward key or highly desired employees to join your company;
- **Retention bonuses** to keep key employees in the fold, especially after a merger, acquisition or corporate restructuring;
- **Referral bonuses** to reward current employees for referring qualified job candidates that you end up hiring;
- **Discretionary bonuses** that a supervisor or manager decides whether to pay out;
- **Team or project bonuses** to reward a group for achieving collective business objectives;
- **Profit sharing** in which employees get a percentage of a company's profits; and/or
- **Ad hoc bonuses** handed out on the "spur of the moment" to employees for going above and beyond.

Note: Although this analysis focuses on performance bonuses, many of the principles apply equally to multiple types of bonus plans.

3. Let Employees Know About the Bonus Plan

For bonus incentives to work, employees need to know they're on offer. While this might sound obvious, experts say it's not unusual for bonus plans to remain buried in management file drawers without anyone on staff knowing about the plan's existence, let alone how it actually works.

4. Establish Clear Eligibility Criteria

The plan should explain which employees may qualify for the bonus with eligibility typically based on:

- Employment status, e.g., full-time vs. part-time;
- How many years they've worked for your company;
- Position or department; and/or
- Current base pay.

If you're offering a general, as opposed to individual bonus plan, you may want to consider excluding employees who are already eligible to earn performance bonuses under their individual employment contract or collective agreement. Some companies attach other conditions, like the requirement that the employee not be on the receiving end of any disciplinary action during the eligibility period.

5. Incentivize the Right Thing

It's crucial to clearly state what employees must do to earn the bonus. **Best Practice:** Don't incentivize "outstanding performance" or other qualitative, subjective or ambiguous factors and outcomes that are likely to breed disputes over whether the bonus was earned. Instead, tie bonuses to the achievement of specific, quantitative outcomes that can be precisely measured, such as systems grading performance on a numeric basis. Make sure those outcomes are tied directly to your company's business goals and objectives, e.g., sales, revenues, earnings, savings, etc.