iGlobal Strategic Guidance Series 4: Employee Incentives

Global bonus and commission plans – Annual review

Most US based global businesses use worldwide bonus, commission or long-term incentive plans to motivate and reward staff. As many of these plans run on a calendar year basis, the Fall is usually the time for a plan review, ready for the following business year. In many cases, the annual Fall review is essential for setting new targets and terms.

This edition of the iGlobal Strategic Guidance looks at the main issues and traps when operating these plans across multiple jurisdictions. A single 'one-size-fits-all' approach adopted from the centre has many administrative benefits but there are considerable local country risks which need to be understood and taken into account.

A 10 point checklist appears at the end.

What are the key issues?

Happy employees are motivated. Motivated employees usually achieve better results for the business. Great performance is worth paying for. All business decision makers know that. Bonuses, commission plans or long-term incentive plans are just some of the ways employers attempt to motivate key employees to outperform. Drafted correctly, these plans can yield tremendous dividends for both employer and employee.

But poor drafting can bring unintended consequences that cost a lot while giving little or nothing in return. Worse still, it can create rifts that leave employees disappointed and demotivated. While most disputes occur on termination, events such as annual leave, sickness or maternity leave, disciplinary matters, disagreements as to measuring performance or criteria ambiguity can cause problems during employment. The cost of inadequate documents can be huge. It is not uncommon for companies terminating senior employees in Europe to pay out more compensation under incentive plans than they pay as severance, without getting the benefit of any hard work.

Many US businesses have one-size-fits-all incentive plans issued to employees worldwide. These are usually in the name of the US parent company and stated to be governed by the laws of their chosen US state, say, New York. For US employees, these plans may well work brilliantly. But the act of stating that New York law applies does not necessarily make it so overseas. This matters, because rarely are these local country laws as friendly to business as their US equivalents.

In some jurisdictions, local laws govern the incentive arrangement regardless of the law stated as applicable in the plan. Hong Kong is an example: the Employment Ordinance law governing employment terms and benefits cannot be contracted out of.

In other countries it may be possible to apply US law to the plan overall but there are traps that will automatically apply the local law to some of its terms. Careless phrasing or, for instance, having the local subsidiary make payments direct, could mean that the local country law applies to the plan.

Some specific examples of the risks

Europe: many European jurisdictions in particular have extensive legislative and case law provisions governing incentives and variable pay. The vast majority of these provisions protect employee interests, or will construe any ambiguity or silence on a particular point in the employee's favour. For example, plans that try to give employers discretion not to pay or to downgrade bonuses even after targets are met are not welcomed. The kind of careful wording needed to tiptoe around some of the pitfalls is rarely found in one-size-fits-all plans, not least because the issues involved would rarely (or ever) occur in the US.

Latin America: in some Latin American jurisdictions, issuing the incentive plan via the US parent company risks employees filing claims for co-employment status against both the local subsidiary and the US entity. Heavily pro-employee judges are quick to take the employee's side.

Sick leave: in some countries an employee with a commission arrangement who goes on sick leave is entitled to 100% commission for the duration of their absence. The fact that they never got close to achieving that level of award while actually working is irrelevant. When you take into account that sick pay in some countries can last up to two years this could prove one very expensive 'incentive'.

Late issue of the Plan: in some countries (for instance France and Italy) issuing the plan late entitles the employee to 100% payment until they actually receive their performance targets.

Garden leave entitlements: in some countries (for example Germany) an employee on termination garden leave (often used for sales staff who have client contact in Germany as payment in lieu of notice is not possible) is entitled to 100% commission awarded for the duration of their notice – often 3 months, potentially 6 months or longer.

Notice entitlements: another possible sting in the tail for global employers is that a resigning or dismissed employee may still be entitled to payment or part-payment of commission/bonus. Failure by the employee to see out the Quarter or the financial year may not mean they get nothing.

Rules vary by country but some payment is often due even if it was the employee's own decision to leave. In most jurisdictions, 'salary' for the purposes of notice periods, severance payments and any post-termination non-competition payments will have to include commission. In countries like Canada or Germany where employees with significant tenure can expect long notice periods by law, it is easy for sums representing commission to mount up.

Holiday leave: in some countries (including the UK and New Zealand) employees who receive regular commission are entitled to be paid extra when they take paid holiday, so they do not lose out on commission when exercising their rights to annual leave. UK employees who did not receive their commission entitlements may be entitled to claim back two years' worth of missing payments.

Extra salary months: some countries (for instance Belgium, Italy, Portugal and others) apply the 13 or even 14 month salary year. Those extra months (often de facto vacation bonuses) also attract commission. These extra costs should be taken into account when setting incentive levels.

Disputes: generally employees are much more likely to challenge their bonus or commission award than their basic salary level. A bonus decision is a direct judgment on their performance. It is personal. Ambiguous or arbitrary criteria for calculating awards often lead to disputes and demotivation or, worse still, resignations and claims for constructive dismissal or discrimination. Clear, objective criteria should be used wherever possible so that employees can track expected earnings.

Clawbacks: many jurisdictions make it difficult to claw back commission or bonus already paid. Early pay outs of commission or bonus after, for example, a successful Q1 may not be recoverable if performance nosedives during the rest of the year. Some jurisdictions prevent clawback of commission paid out on closing a sale even if the deal falls through or the customer doesn't pay up. Similarly, some jurisdictions (such as Spain) will not allow clawback of incentives in the event of subsequent unrelated disciplinary proceedings: misconduct is handled through disciplinary proceedings, not financial penalties. It may be possible in some countries to protect the business through bespoke wording in the plan but the general rule is that it is easier to defer remuneration than to claw back payments already made.

Equality of treatment: treating employees equally around the world may be a noble 'one business' value but when it comes to incentives, it is extremely difficult. Even before the above issues with the one-size-fits-all approach, there is the question of income tax. An employee in Dubai who hits his targets and earns a $20,000 award will pay no income tax on it, whereas his colleague in Tokyo who worked just as hard will likely surrender over half to the Japanese revenue. A flat approach to incentives may not motivate everyone equally.

Some of the above issues are of course unavoidable (you cannot ignore tax obligations or labour laws) but some cost traps can be removed by taking the time to understand what the business needs to protect against in each jurisdiction. Getting it right before the plan is issued can pay for itself many times over. After all, just one wrong move with a high earning executive in a country like Germany could easily cost the business a six-figure sum in commission payments. The best course of action will depend on your business sector, industry expectations and the countries in which you have employees.

10 points to consider when operating a multi-country incentive plan

- **Annual plans** – consider rolling out plans year-by-year rather than using the same plan each year. It may help eliminate any problem provisions in jurisdictions where bonus or commission documents are contractual and amendment needs employee consent.

- **Issue on time** – employees should know what they are aiming for before the year starts. Lateness on a large scale could cost millions of dollars if employees challenge it.

- **Risk analysis** – identify the jurisdictions of high risk exposure when it comes to variable pay, either due to team size or number of employees on high variable compensation packages. Of those jurisdictions, check which ones are problematic if your existing US law plan were to be issued there.

- **One-size-fits-all** – does this work for your business? Consider whether to adopt a global, local or hybrid approach. Should you isolate problem jurisdictions from the others, with bespoke documents that address tricky local issues? In some cases flexibility may be achieved as much by how schemes operate in practice as by what is written on paper.

- **Employment terms** – take care what is written in employment contracts and offer letters – clumsy wording here can undo what is otherwise a smartly drafted incentive plan.

- **Commission levels** – avoid setting commission ceilings that are significantly above what is realistically attainable. Paying out more to sick or surplus employees than you give your star performers will annoy management and demotivate your best workers.

- **Problem jurisdictions** – here it may make sense to reduce risk by reducing the amount of commission offered compared to what is available in simpler jurisdictions such as the US or Singapore.

- **Award criteria** – ensure clarity on how awards are calculated and achieved. The more this can be determined by objective criteria, the less scope employees have to question or challenge it after the event.

- **Deferred payment** – consider whether there is legal or commercial scope for deferred payments – this would be much better than attempts to claw back money already paid out.

- **Other rewards** – think about other ways to reward your best performers that do not create the same exposure to absent or terminated employees, e.g. retrospective recognition awards.

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