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Well, I think I've been in the top 5% of my age cohort all my life in understanding the power of incentives, and all my life I've underestimated it. And never a year passes that I don't get some surprise that pushes my limit a little farther.

- Charlie Munger

SHARING THE SPOILS WITHOUT SPOILING IT

By Alida Malherbe

You will often read that pay does not drive people – and certainly does not buy happiness. Yet Charlie Munger, one of the most successful investors of our time, believes that incentives are an incredibly important consideration when choosing which businesses to back. How do we reconcile this?

Having recently read Work Rules! by Laszlo Bock, we believe that Google's learnings on individual and group psychology go a long way in doing just that. Bock, a former HR executive at Google who built and led the company's people function for ten years, shares fresh and powerful insights into many aspects of Google's culture. By applying homegrown insights (the company has libraries of data studying its people), Google has established something truly unique: a creative, highly productive and happy place that has led to a series of mega successes over its 23-year history. We consider a few of the key takeouts around incentivisation below. (The book is, of course, far broader. But we'll leave that for your holiday reading.)

PAY UNFAIRLY

Google rewards for contribution. While this principle sounds simple, establishing a true meritocracy becomes more complicated when you consider that it ignores job grades, seniority rankings or any other parallels between peers that aren't performance-based. But not doing so implicitly means undervaluing and under-rewarding your best people. So why design a system that makes your highest-potential people want to quit?

As Bock puts it: "Fairness in pay does not mean everyone at the same job level is paid the same or within 20 percent of one another. Fairness is when pay is commensurate with contribution. As a result, there ought to be tremendous variance in pay for individuals."

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Google believes that two people doing the same work can have a hundred times difference in their impact – and rewards accordingly. For example, there have been situations where one team member received a stock award of $10 000 and another working in the same area received $1 000 000. The company also cites many cases where people at more 'junior' levels make far more than average performers at more 'senior' levels.

Google notes that to make such extreme rewards work, you must make sure you can clearly evaluate the impact derived from the role in question. This is both so that you can strip it out from contextual factors such as market movements, the results of team-based efforts or the power of your brand, and so that you can clearly explain differences in remuneration outcomes. Equally as important is rewarding failure. The act of considered risk-taking itself should be valued – especially in the face of failure – or else people will simply stop taking the risks necessary to push boundaries.

MAKE THE PROCESS INCREDIBLY TRANSPARENT

To reward based on impact requires the willingness to be clear and honest with your staff. If you can't explain the basis for wide ranges of awards and give specific ways for individuals to improve their remuneration outcomes, you will only breed a culture of jealously and resentment. This becomes especially important when evaluating the performance of revenue generators and those enabling them: client-facing teams versus back-office staff, sales functions versus support functions or, in Google's case, technical staff versus non-technical staff. It's critical that you place both in the same bracket.

INCLUDE EVERYBODY IN SHARE SCHEMES

At Google, everyone is eligible for stock awards, at every level of the company and in every country. As Bock explains: "There are differences in the target award you're eligible for, based on your job and the local market, but the biggest determinant of what you actually receive is your performance. We don't have to include everyone, but we do. It's good business, and it's the right thing to do."

Awarding staff shares in your business encourages them to think and act like owners – what Google refers to as choosing to be a founder and culture-creator over simply an employee. Awarding all staff shares helps to entrench this attitude across your organisation, resulting not only in more intrinsically motivated staff but ultimately, better business and client outcomes.

GET BROAD INPUT

As many companies do, Google solicits input from subordinates and peers when assessing performance. But what it believes makes its review process distinctive is that final performance ratings aren't left solely to direct managers. A manager will assign a draft rating to a direct report. Before it becomes final, a group of managers meet to review all their team members' draft ratings together in a process Google calls calibration. While this adds a step to the process, Bock notes that it is critical to ensure fairness. "Calibration diminishes bias by forcing managers to justify their decisions to one another. It also increases perceptions of fairness among employees."

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The company also enlists staff to provide rewards, acknowledging that peers have a much better sense of who is really contributing to a project's success than managers do. At Google, any employee can give anyone else a spot cash bonus (set at $175 when the book was published), with no management oversight or sign-off required. Staff in engineering or product management can also nominate themselves for promotion.

IT'S NOT ALL ABOUT THE MONEY

Google rewards staff with gifts and experiences in addition to cash or stock. To evaluate their effectiveness, the company ran internal research by surveying staff who continued to receive cash bonuses and those who received non-monetary awards instead (trips, team parties and gifts). It found that not only were staff who received non-monetary awards 28% happier with them, but also that their happiness lasted longer. Bock notes that when surveyed five months later, cash recipients' levels of happiness with their awards had dropped by about 25%. In contrast, those who received non-cash rewards were even happier than when they first received them.

As Bock explains: "People think about experiences and goods differently than about monetary awards. Cash is evaluated on a cognitive level. A cash award is valued by calculating how it compares to your current salary, or to what you could buy with it. … Non-cash awards, whether they are experiences (a dinner for two) or gifts (a Nexus 7 tablet), trigger an emotional response. Recipients focus on the fact of what they get to experience, rather than calculating values."

He adds that public recognition is one of the most effective management tools and powerful remuneration, even though no money changes hands.

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Taking a few pages from Google's book, we can therefore see that pay simply forms part of a greater incentive framework that also includes recognition and purpose. And while pay alone is unlikely to drive true motivation, incentive can. Google has worked hard on recognition and is built on a clear purpose: the democratisation of information. By carefully crafting all aspects of its culture around this, the group under Alphabet (Google's holding company) has grown to be worth close to $2 trillion... and counting.

Happy holiday reading!

Alida