UNIT-6 Rewarding Employees

Learning Outcomes

By the end of this unit the learner will be able to:

- ✓ Identify the motivational aspects of the reward system
- ✓ Explore the reward system
- ✓ Identify types of rewards and employee ownership

Unit 6

Rewarding Employees

Introduction

Reward systems have been studied intensely and have appeared in literature on economics, psychology, and sociology in particular. Other disciplines have also conducted studies on reward systems and the role they play in business. This is because reward systems have a strong impact throughout organisations. The design and context in which reward systems operate determines the impact of such systems. One must focus on the characteristics of an organisation and the pay system it has in place in order to understand the pay system.

Whenever there is a change in business practices or the business itself, a new approach to reward systems is necessary because the old ones will often be insufficient in a changing environment. An organisation must strive to ensure the reward system is fair across the board so that all departments have rewards that suit their workloads.

Motivational Aspects

The development, implementation and evaluation of the reward system are part of reward management. A large body of literature describes the relationship between reward systems and how participative management is practised. This type of management involves workers in the decision-making process.

Reward systems operate for a number of reasons. The major ones are motivation and the 'humanisation' of work for employees as this enables the employees to feel more satisfied in their work. There is an assumption here that organisations have a moral duty to make work as satisfying and enjoyable as possible. It is understood that employees who are happier at work will have higher motivation and productivity. Another reason concerns management and its ability to control the behaviour of subordinates more successfully. With these systems in place and the workforce appropriately motivated, management is better able to secure the achievement of organisational goals.

What is Motivation?

Motivation in business is a reason for producing or behaving in a particular way. It is about motives, which are the internal drivers of employees that direct their behaviour towards certain outcomes. For example, an employee may want to achieve a higher performance at work because he/she wants a new car or simply desires a feeling of achievement. Needs are usually more physiological. For example: "I'm tired and I need rest," or "I need the company of others and social connections." Another motivator might be self-esteem, e.g. an employee needing the respect of his/her peers.

The most important elements of designing a reward system are:

- Pinpointing the *strategic elements of rewards* and how they connect to other aspects of human resources.
- Assessing and revising the *elements that make up the reward package*.
- Creating *basic pay structures* through job evaluation systems, market tracking and competence assessments.
- Determining which aspects of *pay for performance* schemes should be used and under which conditions.
- Constructing a *benefits package* which suits the needs of both the organisation and the employees.

The Influence of Motivation Theory

Money is a major motivator for most people most of the time, but it is not so for everybody all of the time. Money can certainly be used to motivate people but only to a certain level, and this differs for each individual. In private enterprise especially, the aim is to motivate most of the employees through pay-for-performance schemes using their achievement of goals as the motivator. Within the public and voluntary sector, motivation is oftentimes linked with satisfaction related to the job. Here, the physiological needs are more prominent.

In order to have a motivated and loyal workforce, organisations must put into place competitive compensation and benefits schemes. An effective compensation scheme should include a pay philosophy that relates closely to the company's business strategy and reflects the company's culture and long-term goals. The decision on setting up salary types on the same level as your competitors in the field or establishing yourselves as top-notch employers who pay for good talent must be taken early on. If an organisation isn't able to compete on salaries alone, it may offer other benefits, more unusual but effective, that will distinguish it from others.

Reward Systems

The ability to reward members is an important attribute of a work organisation, the most important of these rewards being pay increases, promotions, fringe benefits and increased status. The ways in which rewards are allocated have a deep effect on the quality of work life for employees and the effectiveness of organisations.

Reward systems are mostly effective in four ways:

They:

1) Motivate employees to perform effectively
2) Motivate potential candidates to apply to join the organisation
3) Motivate employees to come to work, and
4) Motivate individuals by clearly showing their position in the organisation's structure.

Setting up an effective reward system relies on several principles:

- Giving value to the reward system. Employees usually prefer certain types of rewards and these can differ. Many employees prefer cash rewards. Some employees like to see their names in the company newsletter while others prefer public recognition and award ceremonies.
- Making the reward system simple to understand. Too many complicated procedures for evaluating performance, including form-filling and reviews by several levels of management, will lead to confusion. Unless the system is easy to understand, it will be ineffective.
- Decide on performance standards within the control of the team.
- Ensure the reward system is fair and effective.
- Ensure participation in the reward system.
- Involve people in the reward process.

Different types of rewards are used by different organisations. These types include recognition, money, plaques, citations, special assignments or parties, and celebrations. There are also other types of rewards. Many companies use pay, incentives and awards. Most people prefer bonuses in salary or wages. This pay system has rewards for the company as well as it usually (but, not always) increases employee motivation.

However, it is not only money that motivates people. Studies show that other things are important for achieving satisfying rewards. They are mentioned below:

1) Satisfaction with reward is related not only to how much is received but to how much the individual feels he/she should receive. If they receive less than expected, individuals usually feel dissatisfied. In some cases, when they receive more than expected, they may feel guilty and/or uncomfortable.
2) Comparison plays a big part, and people's feelings of satisfaction can be influenced by comparisons with what happens to others. These comparisons are made both inside and outside the organisations in which they work and are usually made with people in similar jobs.
3) As well as the obvious outer rewards received by employees (e.g. pay, promotion, status symbols), they also usually experience inner feelings that are rewarding to them. These include feelings of competence, achievement, personal growth, and self-esteem. Overall, job satisfaction is determined both by how people feel about their intrinsic rewards and by how they feel about their outer rewards.

4) The rewards people want and the importance of rewards to them differ from person to person. Some feel money is the most important thing, while others consider interesting work and job content to be important. People are often able to find examples to support their point of view.
5) Usually, the outer rewards such as pay and awards are important and satisfying because they will probably lead to other rewards or because, to some people, the symbolic value is of importance.

In order to be effective, reward systems must relate to performance. The criteria for receiving rewards must be very clear and employees must be able to tell whether they are on track to receive rewards. The perception of rewards as being fair is also essential. Those employees who work harder should receive greater rewards than poor performers. Furthermore, if a company is to attract, motivate and retain qualified and competent staff, it must offer rewards comparable to its competitors.

Types of Incentives and Rewards

Incentives and rewards are different things. Incentives are forward-looking, so to speak, while rewards are more reflective. Financial incentives provide direct motivation which equates to: “do this and you will get that.” They are tangible rewards and will continue to work as long as employees know that further excellent performance will bring more rewards. In some cases a team-based sum will be available but it will require the team involved to work co-operatively to achieve the target.

Competence-Related Pay

A way of rewarding people based on their competency level in carrying out their work can be defined as competence-related pay. This definition can be viewed in two ways:

a) Pay is linked to competence.
b) Employees can be rewarded according to their level of competence. Competence-related pay is not about acquiring the specific competence; it is about how the use of the competence produces added value. This type of pay relies upon an assessment of the competence levels.

Skill-Based Pay

Skill-based pay is connected to the level of skills used by employees while doing their jobs. It also includes the use of any additional skills learnt by the employee. Skill-based pay is different to competence-related pay. Skill-based pay usually refers to manual skills such as those of fitters and turners, machine operators and welders. Competence-related pay refers to the attitudes and behaviours an employee must have and use to perform a particular role effectively. These employees are then assessed on their competency and the skill. The pay schemes should be reviewed and/or changed as necessary because they may no longer be useful after a certain period of time if other changes have occurred. They must also be cost-effective.

Team-Based Rewards

Members of a team (that is formally chosen and recognised by the organisation) may receive team-based rewards when their performance has achieved the desired goals set by the organisation. These rewards will then be shared among all the members of the team. Rewards for individuals within the team can also be used in order to recognise especially good performances by certain members. An understanding of the nature of teamwork and how teams function is necessary in order to develop and manage team-based rewards.

Profit-Sharing

Profit-sharing is better known and is practised more than gain-sharing. Profit-sharing is a system in which the employees receive a direct share of company profits. It is a group-based system. The basic objectives of profit sharing are:

a) to use methods that inspire employees to identify more closely with the company by building a common concern for its progress;
b) to encourage more interest among employees in the concerns of the company as a whole;
c) to better boost co-operation between management and employees.

The rationale behind profit-sharing has two main purposes:

Firstly, it is a way of fostering a closer relationship between employees and their company. This will occur because staff will begin to think more like owners or, at the very least, have concern for the organisation's success. Secondly, labour costs will change according to the ability of the company to pay. This system is widely used in Japan. Companies can also use the profit-sharing plans to educate or train employees in the financial performance of their business.

Gain-Sharing

Gain-sharing is a system in which all employees of an organisation are eligible for a share of the company's profits or payments. It is a system of management that encourages better performance by involving the employees and allowing them to participate. As the company's performance improves, employees will share in the financial gains as well. Success will depend upon producing a feeling of ownership of the plan and the operations. In this way, employees begin to identify more with the company and their commitment is usually increased.

There are many potential benefits of gain-sharing. It helps employees focus their attention on the main issues that affect performance and enlists the support of all employees towards this goal. It encourages teamwork and co-operation on all levels. Gain-sharing differs from profit-sharing in at least three main ways. First, rewards are based on a productivity measure rather than profits under the gain-sharing system. The aim is to link pay to performance outcomes as this is something employees can control. Second, gain-sharing plans generally distribute bonus payments with greater frequency. For example, they can be distributed monthly or quarterly instead of annually. Third, gain-sharing plans distribute payments during the current payment period. Here, it is different as profit-sharing is usually deferred. Lawler (1971, 1990) has made a summary of the most common results found in research studies of gain-sharing plans:

- Coordination, teamwork, and the sharing of knowledge are boosted at lower levels.
- Participation and reinforcement of group behaviour is achieved as social needs are recognised.
- The focus is on cost-saving, not just quantity of production.
- There is a greater acceptance of change due to technology, market, and new methods because higher efficiency leads to bonuses.
- Changes in attitudes occur among workers, and they require more efficient management, better planning, and good performance from their co-workers.
- Employees try to reduce overtime and the goal is to work more efficiently rather than longer.
- Employees come up ideas as well as effort.
- When unions are present, more flexible administration of union-management relations occurs.
- When unions support the plan, they are strengthened because of better work situations and higher pay results.

Gain-sharing plans do have certain limitations, however. The most important limitation is differentially attracting and keeping the best performers. The problem here is that, since gain-sharing plans don't pay more for better performance, they are not a good motivator for certain employees to stay with an organisation. Bonuses are paid even if the organisation is not making a profit (which is different from profit-sharing). In addition, gain-sharing plans don't fit in well with every situation.

Stock Options

Stock options are the most popular long-term incentives. A stock option is the right to buy a specific number of shares in a company's stock at a specific price during a given period of time. The employee might buy the stock when it's equal to the market price at the time the stock option was given. The employee's gain would be equal to the market value at the time it is exercised, less than grant price. The notion here is that the price of the stock will increase or at the very least stay the same rather than decrease. Certain trends have improved the attractiveness of stock options as a long-term incentive and also as a retention tool.

Profit-sharing plans are similar to stock options in many ways. The pay-outs are based on organisational performance on the stock market. There are a few very important aims of the plan:

a) To motivate employees to act in the best interest of the organisation
b) To increase employee identification with the organisation, and
c) To ensure that labour costs change with the organisational performance.

Stock options have been a common programme for executives for a very long time now, and today many companies, such as Pepsi-Cola and Hewlett-Packard, grant them to all employees. The evidence shows that this approach is becoming more common.

Merit Pay

Merit pay is the most common approach to paying for performance. Merit pay schemes tend to give salary increases to employees based on their supervisor's appraisal of their performance. The aim of merit pay is to increase motivation and retain the best performers by clearly establishing a performance-reward relationship. Evidence suggests that most organisations' performance appraisals are deficient and therefore inaccurate. This results in measures of individual performance becoming non-existent.

Employee Ownership

Employee ownership plans comprise stock option plans, stock purchase plans, and Employee Stock Ownership Plans (ESOPs). In smaller organisations where participative management is practised, the chances of increasing organisational performance are good. In large organisations, which often have very little employee ownership, it is possible to positively affect the structure by integrating across the whole organisation if, of course, all employees are included in the ownership plan. Ownership often has a more positive effect on attraction and retention than profit-sharing. Employee ownership is useful, but it is likely to be highly situational. An example of this would be in small organisations where profit-sharing and gain-sharing may be unnecessary. When combined with a suitable approach to employee involvement, these approaches can contribute greatly to employee motivation. In large organisations they may improve the integration of the organisation and foster a positive culture.

Employee Benefits

Employee benefits are elements of remuneration that are given in addition to several forms of cash payment. They deliver a measurable value for individual employees. They may be deferred or contingent as in the case of a pension scheme, insurance cover or sick pay, or they may provide an immediate benefit such as a company car. Elements that are not, strictly speaking, remuneration, such as annual holidays, are also included. In general, benefits exist not in isolation but as part of a comprehensive compensation package offered by the organisation. Below are the objectives of employee benefits:

a) To improve the employees' commitment to the organisation
b) To show that the company cares for its employees' needs
c) To ensure the personal security and personal needs of all employees, and
d) To guarantee that benefits are cost-effective in terms of commitment and improvement in recruitment and retention rates.

Benefits represent a bulky share of total compensation and therefore have huge potential to influence the employees, the unit and the organisational outcome variables. The literature shows that benefits do have effects on employee attitudes, on retention, and sometimes on job choice. It also seems to be the case that individual preferences play a very important role in establishing employee reactions to benefits. As a result, many organisations have implemented benefit plans that allow some degree of employee choices in the hope of finding a better match between preferences and benefits, perhaps even at a lower total cost to the company.

Statutory and Voluntary Benefits

Employee benefits may be placed into two categories: statutory and voluntary. The organisation must give statutory benefits to the employees irrespective of its own wishes. Examples of these include sick pay and maternity leave. The number of voluntary benefits offered by employers to employees is quite astonishing, and they come at a significant cost to the employer. The main voluntary benefits are vacations, holidays, special leave, sick leave, health insurance, educational assistance, employee discounts, medical benefits, facilities for recreation, subsidised meals in canteens, credit cards and mobile telephones.

Flexible Benefits

There are considerable individual differences in benefit preferences. These individual differences lend more weight to the need to offer employees a choice in the design of their benefits package. A flexible benefits plan will control costs and improve employee satisfaction. When employers consider offering benefits to employees, one of their foremost considerations is to keep costs down.

In the past, employers tried to do this by offering a slate of benefits to their employees regardless of need or use. Organisations realised, in due course, that these benefits did not motivate their employees much at all, nor did they provide an incentive to be more productive. Employees perceived benefits as “given.” This, as well as the rising costs of benefits and a wish to allow employees to choose what they wanted, led employers to look for more flexible benefits.

The term ‘flexible benefits’ refers to a system whereby employees are given a set of benefits and are asked to choose, within monetary limits imposed, which benefits they want. The goal of flexible benefits programmes is to grant particular advantages to both the employer and the employee. The employees are free to choose benefits that are tailored to their exact needs. This can motivate employees and lead to increased morale in some cases. It helps employers to decide the nature and extent of benefits, and to manage the costs more effectively. It also helps them attract and retain quality employees. There are certain disadvantages of flexible benefits:

a) selection of wrong benefits in some cases
b) keeping up with changing benefit needs of employees, and
c) the administrative complexities in actual operation.

Trends in Employee Benefits

- Less attention to tax avoidance
- Simplifying the benefits packages
- Individual needs receiving more attention
- More emphasis on individual choice
- A move towards cash rather than benefits in kind
- More concentration on assessing the cost/effectiveness of total benefit package
- More attention to communicating the benefits package.

Reward Strategies

Reward strategies are mostly about aligning the company's payment arrangements and wider reward systems with its business objectives. This means developing systems which improve the chances of all employees attempting to contribute to the achievement of company goals. If an improved quality of service is the main business aim, this should be reflected in a payment system which rewards front-line staff as they are the ones who provide the best standards of service to customers.

A 'statement of intention' is one of the first required steps. The organisation must explain what the reward strategy is aiming to achieve and which reward initiatives have been selected to fulfil those core aims. The next step is to expand these ideas on a more detailed basis, clarifying the aims in more depth and demonstrating how the elements of the company's reward policy supports the attainment of those goals. This is really a statement of the business case that reinforces the strategy. Therefore, the clarification must include a list of benefits that will accrue and indications of how the strategy will be used to gauge its success. The third step is to explain the guiding values that are being used to develop the initiatives and will be used to modify them in the future.

The final element is to implement a plan and set out exactly what initiatives are being introduced and when, who is responsible for their introduction, and what the costs will be.

Employer Objectives

Reward strategies and the initiatives developed as part of those strategies are best rated according to how exactly they meet certain core objectives and to what extent.

Attracting Staff

Reward packages should be sufficiently attractive. The organisation will then be able to secure staff capable of providing the specific services required. More applications will be received from candidates seeking an attractive package, thus giving the organisation more choice when filling vacancies. The more attractive the package, the more high-calibre people will become available. This, obviously, would not be the case for mediocre or poorly communicated packages. It is important to note here that different packages are considered attractive depending on the type of labour market. Therefore, it is necessary to determine the target market values and then tailor a suitable package.

Retaining Staff

The cost of recruiting and developing/training people, as well as the growing importance of specialist organisational knowledge in creating value and preserving competitive advantage, means that keeping effective performers is a main aim of a reward strategy in an organisation, especially those competing in knowledge-intensive industries where highly qualified people are scarce. Here, a package which is attractive enough to stop people becoming dissatisfied and looking elsewhere for career development opportunities is essential. It is also necessary to develop policies that reward seniority and, thus, provide an incentive for the staff to stay when they might otherwise consider looking for alternative work.

Motivating Staff

Motivating staff is important for recruiting and retaining the most effective performers in an organisation. The reward package must also do this; i.e. it positively motivate rather than demotivate valued employees.

Occupational psychologists have long debated whether money can positively motivate, many of them accepting that the motivational power of monetary rewards is limited, particularly over the long term. In contrast, there is no doubt about the power of poorly designed or poorly implemented reward practices to demotivate people, especially if employees view them as inequitable in some way. The ultimate goal, of course, is to design a reward package which actually rewards people and creates the conditions in which employees are ready to work hard to help achieve the employer's goals and also to show how much effort they put in of their own accord. It is safe to say that employers would like their workforces to be positively engaged with their work and to be willing participants in any improvement programmes as well as working beyond what their contracts oblige them to. Employers must therefore offer reward packages which, as far as possible, motivate the staff positively. Hence, the total reward concept mentioned above has a lot to offer, combining both intrinsic and extrinsic motivators.

Driving Change

It is possible to use pay as a tool to underpin change management processes. The method is one of tying higher basic pay, bonuses and/or promotion to the expansion and improvement of new behaviours, skills or attitudes in employees. Simply appealing to people to improve is not enough. Pay, however, can offer a material incentive to people, who have a natural tendency to resist change. It is also a powerful tool for employers as it clearly shows the seriousness of their intentions with regard to proposed changes.

Corporate Reputation

In general , many organisations are keen to establish a very positive corporate reputation. They must also maintain this reputation as good employers. In many cases, prestige is something to aim for as part of a business strategy that intends to produce high quality and innovative goods and services. Other companies consider it important to maintain an ethical reputation in order to appeal to and retain a strong customer base. For example, some companies don't test on animals. No matter which of the above is the most important to an organisation, it is the delivery that is connected in part to the company's reputation as an employer. If an organisation doesn't pay well or is perceived to have unfair policies, its reputation will be undermined even if it is considered prestigious or ethically or socially responsible.

Affordability

The above-mentioned objectives are attractive for companies and their reward strategies are based on them. However, in the HR area there are restrictions in terms of affordability which can limit what can be done or offered at any time. The affordability of a particular objective often varies over time and is also unpredictable because much depends on the current financial performance of the company. If money were no object, companies would be able to create and offer ideal reward packages which pay above market rates. The best people would thus be recruited and retained, and the linkage of pay to individual and collective achievement would maximise performance and effort.

Employee Objectives

There is a common belief that employees' sole aim regarding rewards is to earn as much as they possibly can. Some theorists believe that employees are especially interested in maximising the amounts they earn while exerting minimal effort to achieve those earnings.

Wage Structures

The Basic or Flat Rate

This refers to the amount of money paid for an hour's work; it is sometimes called the 'hourly rate.' Time rates are predetermined rates per hour which are paid at the end of the week or month.

Payment by Results Systems

Payment-by-results systems can take the following forms:

1. **Straight Piecework:** This a system under which the employee is paid according to output. The process works either by agreeing on a fixed amount of money for the production of each item, or by allowing a specific period of time to make the item. In the latter, which is also called the 'time allowed' system, if the employee finishes the work in less time than planned, he/she is still paid for the original time and is therefore able to increase earnings by finishing more of the pieces. The bonus

is calculated based on the difference between the time allowed and the actual time expressed as a percentage of his/her wage.

2. **Differential piecework: This** is similar to the 'time allowed' system of piecework, the difference being that the amount of bonus earned (which comes from the time saved) is shared between the company and the individual employee, the wage cost is adjusted with output, and the company takes a proportion of the bonus as production increases. These types of schemes are also known as 'premium bonus schemes.' The employee has a choice with piecework on the level of output he/she wishes to achieve.

3. **Measured Day Work: This** is a system where the employee's pay is fixed on the understanding that he/she will maintain a specified level of performance. This level of performance, called the 'incentive level', is calculated in advance, and the employee is under obligation to try to achieve the level specified, as his/her pay does not vary in the short term. There are individual rates and bonus systems. In addition, there are bonus schemes that aim to provide a group incentive, to a work group or factory or unit-wide.

4. **Small group incentive schemes:** Usually, a bonus is given to group members when their output targets are achieved or exceeded. There are a large number of schemes which vary according to the timescale adopted for measuring output, the group's size, and the intergroup competitiveness that they encourage. The actual bonus payment can be either equal among the group's members or proportionate to an individual's earnings or status.

Developing Pay Structures

When the job evaluation is done, the data received become that basis for developing the organisation's pay structure. This means that pay rates are compatible to rank, classification or points received though job evaluation. The way in which the company structures its compensation packages is mostly a matter of company philosophy but, of course, market trends are important here. There are several options that the company can choose from. One of these options is the single-rate structure whereby all employees do the same work and receive the same pay. Alternatively, it might choose the tenure-based method which depends on how long an individual employee has been with the company. There can also be a blend of seniority- and tenure-based plans. Sometimes the pay is connected to productivity or performance. The job evaluation methods give the input for developing an overall pay structure for the organisation. Other sources of information can be used for the purposes mentioned above. They are:

- To conduct surveys
- To write reports
- Pay commission reports
- Reports of the wage boards

- Reports of the employee and employer
- Trade union journals etc.

Choice of the Structures

1) The nature (type) of organisation which includes things such as size, complexity, culture and tradition.
2) Formal organisational structures and internal relativities.
3) Degree of knowledge of workers.
4) Degree of formalities.
5) Degree of growth of the company.

Standard Salary Structure

The standard salary structure delivers fixed salary ranges for every different type of position for staff performing standard duties. The company should allow for variations and should therefore set up minimum and maximum levels within pay ranges to account for these variations in skills and experience levels. It is helpful for companies to determine where their organisation sits within their own industry when determining the base pay structure. It is also helpful to check competing industries which may have job opportunities available. Companies can thus gain an overall picture of salaries, enabling them to organise pay levels in a competitive way. They may otherwise risk losing valued employees to other companies and sometimes other industries. The Internet is an excellent place to search for industry standard salary levels for certain jobs in certain geographical areas.

Once a company's base pay structure is in place, a merit pay programme can be set up to take the employee through the salary range for their particular position at a performance-driven speed. This will be important when managers perform their **annual employee performance reviews**. In one sense, employees may begin to think they are sure to receive a salary increase; this is a disadvantage because their motivation to perform better will decline. Because of this, many organisations are using a reward-based compensation method which is also referred to as **Incentive Compensation**.

Incentive Compensation

It is more and more common for organisations to used incentive-based compensation. This is because there is more emphasis on performance and competition for talent. Employees are motivated to perform better by this type of compensation structure.

Hiring bonuses are also in place today, including work opportunities for new graduates. It is better to set a specific time period before the employees collect their bonuses because of the risk of employees leaving the company after receiving their first bonus. This would, of course, be costly in terms of all the money spent on recruitment, interviewing, training etc. Offering incentive compensation may well be advisable, especially if the organisation is in an industry where there is intense competition for good employees.

Base pay and incentive-based programmes require the same amount of research into the particular industries where companies are operating. Base pay levels will still be determined but they may be slightly lower and it will be necessary to build the annual (or quarterly) bonuses, commissions or shared cash compensation into that base.

Further Reading:

- ✓ **John Stredwick (2013),** ***An Introduction to Human Resource Management***
- ✓ **Nick Wilton (2011),** ***An Introduction to Human Resource Management***
- ✓ **Michael Armstrong (2006),** ***A Handbook of Human Resource Management Practice***