UNIT-8 REWARDS AND INCENTIVES MANAGEMENT

Structure

8.0 LEARNING OUTCOME

On studying this Unit, the learners will be in position to:

- Understand the significance of incentives in achievement of motivation and group morale;
- Distinguish between material and non- material incentives and emphasise their significance to organisation in general and management in particular; and
- Refer to types of incentive plans.

8.1 INTRODUCTION

The term 'incentive' is used to describe material and non-material benefits given to employees in addition to their normal salaries to induce them to go that extra mile towards promoting productivity and efficiency of the enterprise. It is generally felt that performance of personnel, either as individuals or as members of a group is below par when compared to their capabilities, skills and capacities. Finer, states that demonstrated performance generally never exceeds more than fifty percent of an individual's innate ability. Most individuals tend to halt efforts around an estimation of costs expended (time and energy) and relative benefits procured from work. This is where incentive administration assumes significance. According to Wendell French (1997), the purpose of incentive plans is to increase the morale and motivation of employees to contribute to further the goals of the organisation.

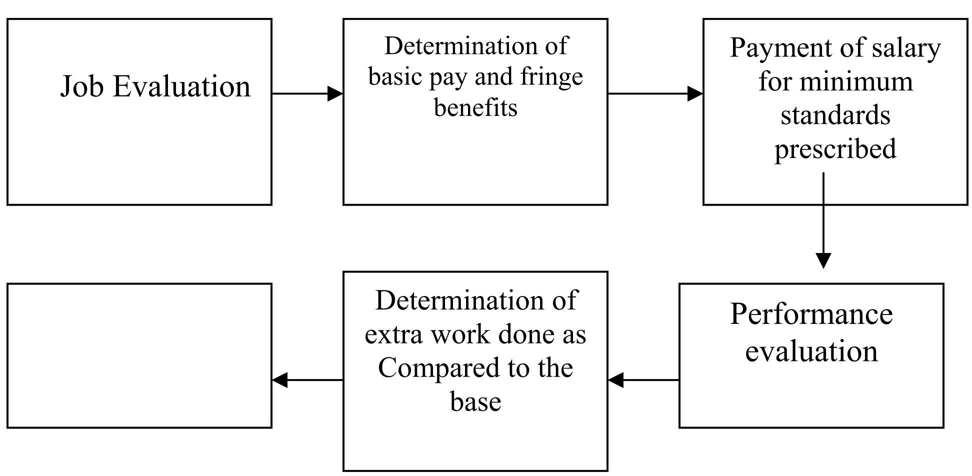
Incentive systems are meant both to motivate an employee to earn more by working hard and also reinforce positive behaviour on his part by rewarding good performance for healthier organisational climate. Hence incentive is to be understood both in the tangible and intangible senses, as aimed both at encouraging and sustaining better performance from employees. Material incentives may take the form of wage payments related to employees' performance in addition to the normal salaries given for standard work assigned, welfare related benefit programs, fringe benefits, rewards and recognition certificates.

Incentive administration must have a "base line" standard so that performance over and above the specified standard can be rewarded. These incentive plans are linked directly or indirectly to the standards of *productivity* or the *profitability* of the organisation or to both criteria. The study group of the National Commission on Labor, (1968) has recommended that, "under our conditions, a wage incentive is concerned with effective utilisation of manpower which is the cheapest quickest and surest means of increasing productivity. The only practicable and self-sustaining means of improving manpower utilisation is to introduce incentive schemes and stimulate human efforts to provide a positive motivation to greater output."

Megginson (1967) defines incentive wages as the extra-compensation paid to an individual for production over a specified magnitude which stems from exercise of more than the normal skill, effort or concentration when accomplished in a pre-determined way involving standard tools, facilities and' materials.

Currently, the emphasis in payment by results schemes is on team work more than individual effort.

Schematic diagram below depicts the process of incentive, offering financial inducements above and beyond basic wages and salaries.



8.1.1 Motivation and Incentives

Reiterating the importance of motivation, E.F.L. Brech states, “the problem of motivation is the key to management action; and in its executive form it is among the chief tasks of the General Manager. We may safely say that the working of an organisation is a reflection of motivation from the top”.

On the basis of above definitions, it can be said that motivation is a tendency, which keeps a person attentively and purposefully engaged in achieving goals. Motivation arises from *obvious* and *tacit* factors that form employee psychology. It involves interactions and relationships in employee personal and work life referring to his existence as an individual, a member of society and a member of both the formal and the informal group of the organisation he works for. From a management perspective, motivation constitutes the base for management activities covering POSDCoRB functions. One of the biggest challenges to modern organisations is how to sustain productivity or efficiency standards while maintaining competitive advantage in the market place with emphasis on cost competitiveness. There is a danger of workers losing interest in work if they realise that extra interest or labour could not make any difference to them. Paul Rigors (1973) has rightly posed this challenge when he states, "a continuing challenge for management is how to share the gains from higher productivity in ways that will stimulate the interest of employees in improving their performance on-the-job and the productivity of the organisation as a whole.” One of the challenges of motivation theory is investigation into pathological phenomenon.

Questions like, why some employees feel alienated in an organisation? Why some resist their own skills and capabilities? Do they encounter emotional blockages? What can the management do?; Is retrenchment the only solution? Or; is the best? Why is there inertia in hierarchy?; Why employees of one organisation work more efficiently than others’?; and what makes certain employees achievement oriented and disciplined arise?;

These and such other questions have to be inquired into, if we have to grasp fully the meaning, nature and scope of motivation for both social and utilitarian purposes. It is obvious that mere possession of knowledge, skill and ability do not ensure best results as performance also depends on intangibles like human relations at work, motivation or will to perform. Empirical investigation into behavioural phenomenon is required to answer many of the questions addressed above to solve the perennial dilemma of motivation in management theory and practice. The most important task of the personnel department is to put across the point most emphatically and continually that personnel in an organisation are most important and also the key to development.

8.1.2 Justification of Incentives

The economic theory of motivation is based upon the argument that people feel motivated when rewarded with money. This gives a utilitarian orientation to incentive management. There is an assumption of direct correlation between monetary reward and performance. Dale Yoder, (1969) rightly remarks, “However, fascinating the individual's job assignment in a public agency or private firm, the employee expects to be paid. His wage may (and it is generally assumed that it does) affect the way he works how much and how well." Guellerman (1963) too regards money as an important motivator when .he states, "money may well turn out to be the costliest motivator of them all, but money may also prove to be the most potent motivator of all, at least in certain circumstances, and when used on a sufficient scale." Executives in organisations must look after material welfare of employees because despite human relations and behavioural assumptions, money is regarded as a potent motivator.

However to assume that financial rewards are the only sources of motivation would be an exercise in oversimplification. A positive incentive can be either financial or non-financial. Financial incentives satisfy primarily, employees' lower order needs viz., physiological, security, as per Abraham Maslow’s (1954) theory and wins his calculative involvement, that is, the person feels committed only to the extent of doing a fair day’s work for a fair day’s pay. On the other hand, non-financial incentives for example, praise, competitions, participation, etc., provide higher order need satisfaction, catering to social and psychological needs of a person, which make him more committed to organisational goals. As a result, a person realises his full potential. To quote Barnard,(1938) "material rewards are ineffective beyond the subsistence level excepting to a very limited proportion of men; that most men neither work harder for material things, nor can be induced thereby to devote more than a fraction of their possible contribution to organised efforts. The opportunity for distinction, prestige, personal power, and the attainment of dominating position are much more important than material rewards in the development of organisations, including commercial organisations."

It has, therefore, been conceded that economic gain may not be sufficient incentive. In this vein Allport (1943) observes, “Employees in an organisation are 'not economic men' so much as they are 'ego- men'. What they want, above all else, is credit for work done, interesting tasks, appreciation, approval and congenial relations with their employers and fellow workers. These satisfactions they want even more than high wages or job security.

Non-material incentives take the form of recognition of good work through appreciation letters, merit certificates, medals, more meaningful involvement in decision making, opportunity for self growth(‘associational attractiveness’ and ‘ideal benefactions’ by Barnard’s terminology). Such awards benefit employees indirectly that is, aiding promotion or nomination to higher posts. However, this comparison is rather meaningless because management needs both types of incentives. The real question, therefore, is not what type of incentives is required, but rather how to integrate the two types of incentives successfully. What is needed is a contingency approach that considers needs of workers, type of jobs, and requirements in the organisational environment. Only then can an optimum balance between financial and non-financial incentives be attained. (Tripathi, 2003)

R.K. Misra (1973) favours the judicious use of both monetary and non-monetary incentives to achieve productivity. While budgetary restrictions and temporary improvements in performance place a limit on the potency of financial incentives as motivators, non- financial incentives demand only human ingenuity as investment and also ensure relatively stable acceleration in output. Both are important and judicious mix of the two enriches organisational practice. The Administrative Reforms Commission (1968) has advocated the use of incentives to promote efficiency in organisation. Recommendation number 64 states:

1. Incentives for timely completion of a specific project may be provided through suitable awards such as a rolling cup or a shield. In individual cases, commendatory certificates may be issued;
2. Cash awards or one or two advance increments may be given to those who give valuable suggestions for simplifications of work leading to economy in expenditure or otherwise increase efficiency; and
3. Any exemplary or special achievement may be recognised by grant of medals as is practiced at present in the police department. It may now be in order to discuss incentive plans separately.

8.2 INCENTIVE PLANS

The incentive plans are discussed under two types, that is, material incentives and non-material incentives.

A. Material Incentives: Individual Incentive Plans

These plans award individuals or group of individuals, extra payment for the extra work performed. In order to encourage employees, different incentive plans have been designed. Same are recounted as; Taylor's Differential Piece Rate Plan, Gantt Bonus Plan, Halsey Plan, Emerson Efficiency Plan, Rowan Plan, etc. In these schemes minimum, daily or weekly rates of pay are guaranteed and personal effort and efficiency are linked with rewards.

Modern innovation metrics such as Return on Innovation Investment (ROI) aid in evaluating and rewarding new product teams and establishing a credible link between new product performance and corporate incentives

According to Louden, "the purpose of individual incentive plans is to offer financial incentive for a worker or group of workers to produce work of an acceptable quality over and above a specified quantity." According to Wolfe, "their primary purpose is to aid in obtaining minimum unit costs thereby contributing to enterprise profits." These individual incentive plans can be categorised into piece rate plans and production bonus plans. There are, however, problems in instituting individual incentive plans. The most pressing is the criteria by which work performance standards are to be set. It has also to be kept in mind that differential payment schemes might adversely affect social capital and lower group morale. It can also potentially affect the quality of work. Differential annual payout may be determined by a subjective evaluation of each person's performance.

Advantage is that differential criteria is adopted to reward performance which is just to more meritorious employees and individual performance is given recognition apart from group. There may also be a significant one-time payout if an employee has an extraordinary accomplishment for a year.

Disadvantages are that the payout may be subjective. It can be divisive and adversely affect the working of the informal organisation. Suggestion proffered to get around the problem is to encourage employees to make suggestions through a suggestion box for promotion of productivity and reduction of costs. This would also encourage employee participation in decision making in an organisation. Suggestions given by employees would be effective as they are expected to understand the functioning of the organisation better than supervisory personnel. However, care should be taken that suggestion plans do not lead to unsavory interference or role dilution with respect to the management function specifically policy making. Supervisory and professional employees are excluded from such plans as this forms part of their job profile.

Merit Pay

The merit increase program is implemented when funds are designated for that purpose by the institution's administration, dependent upon the availability of funds and other constraints. Its major advantages are that it **a**llows administration of differential pay to high performers, allows estimation of individual and company performance separately with a view to judge impact fairly, and allows compensation for outstanding achievements. Main disadvantage is that assessment criteria employed may be subjective. Robert and Masvin (1966) observe that there are several specific common-sense considerations in establishing any such plan:

1. Ensure that effort and rewards are directly related. The incentive plan should compensate employees in direct proportion to their increased productivity. Employees must also perceive that they can actually do the tasks required. Thus, the standards have to be attainable, and the employer has to provide the necessary tools equipment and training;
2. Make the plan understandable and easily calculable by the employees. Employee should be able to calculate easily the rewards they will receive for various levels of efforts;
3. Set effective standards: This requires several things. The standards should be viewed as fair by subordinates. They should be set high but reasonable and there should be about a 50/50 chance of success. And the goal should be specific – this is much more effective than telling someone to “do your best”;

4. Guarantee standards: View the standards as a contract with your employees. Once the plan is operational, great caution is to be used before decreasing the size of the incentive in any way. Rate cuts have long been the nemesis of incentive plan;
5. Guarantee an hourly base rate: Particularly for plant personnel, it is usually advisable to guarantee employees base rate. Therefore, they will know that no matter what happens they can at least earn a minimum guaranteed base rate; and
6. Get support for the plan: Group restrictions can undermine the plan; get the work group's support for the plan before starting it.

Group Incentive Plans

Because of the pressure of unions, these incentive plans often become unpopular.

Group incentive plans are increasingly put into use, for example, bonus schemes, profit sharing, etc. The purpose of group-incentive plans is the same as that of individual incentive plans except that incentives are paid to a group rather than individuals engaged in a particular plan or aspect of organisational work.

Profit-sharing Plans

Profit-sharing plans are the most widely used incentive-pay programs. The purpose of profit-sharing is to distribute additional profit among employees as incentives in the form of bonus, which may be paid in cash or transferred to their account. The company contributes a portion of its pre-tax profits to a pool that is to be distributed among eligible employees. The amount distributed to each employee may be weighted by the employee's base salary so that employees with higher base salaries receive a slightly higher amount of the shared pool of profits. This is done generally on an annual basis. The amount credited to their account can be withdrawn only if the employees have worked for a minimum period of time. Profit plans work best at more established firms with relatively steady earnings. Large corporations widely employ profit sharing.

Advantages of a profit-sharing plan include, fostering team work, focus on profitability and sustainability to the enterprise. For smaller companies with erratic earnings, profit-sharing plans can frustrate and irritate employees by creating expectations that are not fulfilled. Criteria adopted for administering profit plans differs from organisation to organisation and need to be carefully defined in advance.

Wages received by employees are supplemented by payment of an annual lump sum called bonus, which is a type of profit sharing. Over the years, the concept of bonus has changed from one of profit sharing to one of deferred wages so that a minimum amount is payable irrespective of the profits. Bonus is regulated in India by the Payment of Bonus Act 1965, which is applicable to every factory and other establishments employing twenty (20) or more persons on any day during an accounting year. Newly set up establishments are not required to pay a bonus until they derive profits or for five accounting years following the year when they start selling their products on a regular basis, whichever is earlier.

The Payment of Bonus Act specifies a detailed method for computation of the bonus. Only employees drawing up to Rs 3,500 per month are entitled to a bonus under the act, but the bonus is calculated on the maximum salary of Rs 2,500 per month for a salary between Rs 2,500 and Rs 3,500. The amount payable varies from 8 percent (minimum) to 20 percent (maximum) of annual salary. However, the normal practice is to pay, ex gratia, some amount to employees drawing above Rs 3,500 per month also.

In addition to profit sharing and bonuses, some other incentive options are:

- *Salary-at-risk plans*; where employees receive their full base pay only if performance meets minimum goals, but a larger payout is possible; and
- *Gain sharing*, popular at some manufacturing firms, provides for a portion of increases in efficiency to be shared with employees. Gains are measured and distributions are made through predetermined formula. For example difference between actual and expected hours of work put in give hours gained. Since this pay comes into act only when gains are achieved, gain sharing plans do not entail extra cost burden.
- *Stock Options* entail the *'right' to purchase stock at a given price at some time in the future.* An option is created that specifies that the owner of the option may 'exercise' the 'right' to purchase a company's stock at a certain price (the 'grant' price) by a certain (expiration) date in the future. Usually, the price of the option (the 'grant' price) is set to the market price of the stock at the time the option was sold. If the underlying stock increases in value, the option becomes more valuable. If the underlying stock decreases below the 'grant' price or stays the same in value as the 'grant' price, then the option becomes worthless.

Stock options provide employees the right, but not the obligation, to purchase shares of their employer's stock at a certain price for a certain period of time. Options are usually granted at the current market price of the stock and last for up to 10 years. To encourage employees to stick around and help the company grow, options typically carry a four to five year vesting period, but each company sets its own parameters.

Stock Options are of two types:

1. *Incentive stock options;* (ISOs) in which the employee is able to defer taxation until the shares bought with the option are sold. The company does not receive a tax deduction for this type of option.
2. *Nonqualified stock options;* (NSOs) in which the employee must pay income tax on the 'spread' between the value of the stock and the amount paid for the option. The company may receive a tax deduction on the 'spread'.

The advantages of stock options are that they allow a company to share ownership with employees. Employees consequently feel more involved in organisational functioning. The disadvantage is that stocks are speculative with attendant risks, employee interference increases in the name of participation and their attention diverts to pecuniary matters rather than performance at work

Stock options are considered most suitable for small companies where future growth is expected and for publicly owned companies that want to diversify ownership.

Besides aforementioned schemes, other forms of incentives could be recounted as (HR Guide, 2005):

- Paid holidays
- Paid vacation
- Medical care
- Paid sick leave
- Life insurance
- Retirement plans
- Educational assistance
- Accident insurance
- Family benefits
- Paid personal leave
- Paid maternity leave

In addition to monthly salary or wages, various fringe benefits are also available to employees. Fringe benefits contribute significantly to the cost of hiring an employee. In general, it may be said that they represent approximately 50 percent of the monthly salary. The compulsory fringe benefits are as follows.

1 Annual bonus

2 Monthly contribution to a provident fund

3 Terminal gratuity

4. Contribution toward the employees' state insurance scheme.

5. House rent allowance to workmen.

(B) Non-material Incentive Plans

Non material incentive plans may take the form of appreciation letters, award of medals, certificates, etc. These incentive plans can be of great use in organisations where the service aspect is stressed more than the business or commercial aspect. In organisations, with welfare activities or law and order or defense functions, it may be difficult to compensate the hard work of employees with money. Here, one can make use of non-financial incentives, which sustain the morale of particularly hard-working employees.

8.3 SOCIAL SECURITY

According to P.C. Tripathi (2003), the connotation of the term ‘social security’ varies from country to country along with changing political ideologies. In socialist countries, the avowed goal is complete protection of every citizen from the cradle to the grave. In other nations, with less controlled economies, a measure of protection is afforded to all citizens with schemes evolved through the democratic process consistent with the resources of the state. According to the social security (minimum standards) convention number 102, adopted by the International Labour Organisation in 1952, following are the nine identified components of social security:

(i) Medical care

(ii) Sickness benefit

(iii) Unemployment benefit

(iv) Old-age benefit

(v) Employment injury benefit

(vi) Family benefit

(vii) Maternity benefit

(viii) Invalidity benefit

(ix) Survivor's benefit

8.4 SHORTCOMINGS OF INCENTIVE SCHEMES

Incentive schemes, if not properly implemented can create problems, for example, (i) there is a tendency amongst employees to improve quantity at the cost of quality; (ii) there is a danger that safety regulations might be disregarded by workers which result in higher accident rates; and (iii) there is a danger that workers undermine their health under strain of work; finally such schemes potentially generate misunderstandings and jealousy among workers because of differential earnings. Therefore:

(1) Employees must be taken into confidence in design the rewards and incentive plans so that they are aware of all parameters by which to avail of benefits.

(2) The plan should be simple and intelligible to all

(3) The plan should be equitable and flexible.

(4) The amount of rewards and incentives should be substantial so as to suit the stature of the person concerned.

(5) A feedback of incentive audit must be obtained to assess the benefits of the scheme.

8.5 CONCLUSION

The crux of the discussion is;

1. Rewards and Incentives are important to motivate employees towards excellence.
2. Rewards can be both material and non-material.
3. Non-material awards are easy to administer.
4. Awards and incentives must be based on well- defined principles.
5. Awards and incentives may be given only to deserving employees.

8.6 KEY CONCEPTS

Incentive: Incentives are offered to motivate employees towards better work performance and improved commitment towards the organisational purpose. Incentives are both material and non material incentives. Examples of non material incentives include meaningful participation in work, recognition, team work and identification with the purpose of the organisation etc.

Motivation: "Goal directed behavior" is motivated behaviour. Motivation study analyses human needs, motives and drives which create an achievement orientation in an employee. As part of management strategy it implies positive reinforcement of desired organisational behaviour. The Classical School of administrative thought took a limited perspective to motivation in that it understood and appreciated it, in monetary terms only. The Human Relations and Behavioral Schools inquire into cognitive processes of human beings with a view to studying tangible and intangible motivators that determine employee psychology and shape up to organisational behaviour.

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8.8 ACTIVITIES

1. Relate incentives with motivation. To what extent do material incentives motivate workers?

2. Discuss material and non material incentives currently in use.
3. What are the limitations of modern incentive schemes? List out the suggestions you would like to make for improvement.