

## REWARD SYSTEMS

Employees don't work for free. Most businesses are not volunteer services, so you have to compensate them in some way for their time and effort.

What used to be called “pay” and then became “remuneration” is today often termed “reward”. It refers to all of the monetary, non-monetary, and psychological payments that an organisation provides for its employees

How can you put all this together? There is no magic, one-size-fits-all solution: it should vary in different organisations. Here we shall go through a few of the key concepts, to help you make sense of this complicated area.

### Types of reward

Many managers believe that people only work for money. However, you must remember that there are two basic types of reward.

There are *extrinsic rewards*, which cover the basic needs of income to survive (to pay bills), a feeling of stability and consistency (the job is secure), and recognition (my workplace values my skills). In Maslow's Hierarchy of Needs, these are at the lower end. We could also call these the financial rewards.

On the other hand, there are *intrinsic rewards*, the most important of which is probably job satisfaction, a feeling of completing challenges competently, enjoyment, and even perhaps the social interactions which arise from the workplace. These are at the upper, self-efficacy end of the need hierarchy. We could also call these psychological rewards.

### Objectives

Reward systems have three main objectives: to attract new employees to the organisation, to elicit good work performance, and to maintain commitment to the organisation.

#### *Attraction*

A reward system is intended to attract and retain suitable employees. An employer who develops a reputation as “cheap” is unlikely to be desirable in the job market, because potential employees will think it does not reward effort. Such an organisation is likely to end up with the people that nobody else wants.

#### *A great performance?*

Rewards are also intended to maintain and improve performance. As we have stated *in earlier articles*, nobody can truly motivate: employee motivation can only come from within. But the promise of a bonus or a pay rise is intended to encourage employees to motivate themselves to reap the rewards.

Performance-related pay is very popular in today's organisations. In Canada, over 70 per cent of companies offer it in some form. Some companies have three different kinds of performance-related pay: individual, team, and organisation.

The main problem with individual performance-related pay (IPRP) is that it assumes that pay alone motivates workers, but this is not correct. Consider the intrinsic rewards or psychological rewards mentioned earlier. A worker with high pay but who receives no intrinsic rewards will probably go elsewhere.

#### *Commitment*

The reward system also serves to maintain and strengthen *the psychological contract*. It indicates what behaviour the organisation values, i.e. what is paid for. For example, if your company values teamwork, then there will probably be a team bonus of some kind. The psychological contract will partly determine what employees perceive to be "fair" in terms of reward for the work they do.

Disruptive behaviour such as theft in the workplace is often an attempt to restore "fairness" to remuneration. Violation of the psychological contract is far more likely to cause problems with employees more than any other single factor.

### **Direct vs indirect pay**

Direct pay is what an employee receives in their bank account: base wage/salary, overtime, commission, merit pay, paid leave, bonuses, company profit-sharing.

Indirect pay, often called "benefits", refers to that part of the total reward package in addition to direct pay, such as: health & life insurance cover, retirement & pension plans, company car, health care, health club memberships, mobile phone, subsidised meals, subsidised entertainment (movies, opera, museums, etc).

Common wisdom suggests that benefits attract, retain, and motivate employees, but there is little research to support this.

### **Government and pay**

In Europe and North America, the government has a very strong influence over employee reward. Taxes reduce the size of the direct pay received by employees. Yet even indirect pay can be taxed: in some countries, such as Finland, the tax on benefits such as company cars is so high, that many employees who qualify for them prefer to opt out.

Government also has an indirect influence over pay. Fiscal and monetary policy will affect the economy, and change worker income. For example, more government subsidies to small businesses may decrease unemployment; as unemployment approaches zero, the cost of labour will rise as it becomes more scarce. In addition, the public sector, which typically employs a lot of people in western democracies, can impact pay trends by exercising tight control over their own pay levels. And, of course, all organisations must follow government legislation when paying employees.

Trade unions are not government per se, but their own rules and ties to official legislation sometimes dictate the wage range allowed.

## Summary and conclusion

This has been a fairly simplistic presentation of the basics of reward systems, focusing on the main components of organisational reward systems. There has been no discussion of the ties of reward systems to business strategy, how to properly establish levels of reward in an organisation, or how to maintain reward competitiveness. These are very complex issues, beyond the scope of these short essays. I leave you to the web links and references to find out more.

To recap:

There are two types of rewards: financial (extrinsic) and psychological (intrinsic).

A good reward system responds to market forces: what is an employee worth to the company? But it is also affected by social and psychological factors, including the employee ideas of “fairness” and “trust”. A system perceived to be fair is one of the key components of the psychological contract. It also needs to comply with government regulations, today’s uncertain business environment, and organisational goals. In other words, it must be flexible, like a gymnast.

Mission impossible? As Richard Johnston, the Human Resources Director of Flowpak Engineering dryly remarked: “There is no such thing as a good pay system; there is only a series of bad ones. The trick is to choose the least bad one.”

Are you up to the challenge?

Some related links (copy-paste into your browser):

*Employee reward systems at the Free Management Library*  
[http://www.managementhelp.org/emp\\_perf/rewards/rewards.htm](http://www.managementhelp.org/emp_perf/rewards/rewards.htm)

*The Ivey Business Journal on designing reward systems*  
[http://www.iveybusinessjournal.com/view\\_article.asp?intArticle\\_ID=619](http://www.iveybusinessjournal.com/view_article.asp?intArticle_ID=619)

*Article on the causes and prevention of employee theft*  
<http://www.allbusiness.com/management/688487-1.html>

Next time, we will be discussing the end of employment: when people leave their jobs.

*References:*

Bratton, J., & Gold, J. (2007). *Human resource management: Theory and practice*. (4<sup>th</sup> ed.). Basingstoke, Hampshire, UK: Palgrave Macmillan.

Torrington, D., Hall, L., & Taylor, S. (2005). *Human resource management* (6<sup>th</sup> ed.). Harlow, Essex, U.K.: Prentice-Hall.

Richard Johnston's quote at the end of the article is from the Bratton and Gold text.

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