Strategic Performance Management
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Lecture – 34
Reward System – 2

Ok so welcome back to the next lecture that is 34th lecture and as you remember in the previous lecture we talked about the reward system and that is where we discuss that, you need to develop a reward system, which is going to be appropriate for the employees where employ feel that this reward is valuable so that they are motivated for higher performance. So, when you are going to design a reward system for organizations and you really want to link with the performance, we have to see that it is motivating in nature right. Because if people are not motivated to perform at a higher level, then you cannot expect a better performance and then whatever system you design because reward ultimately leads to motivation.

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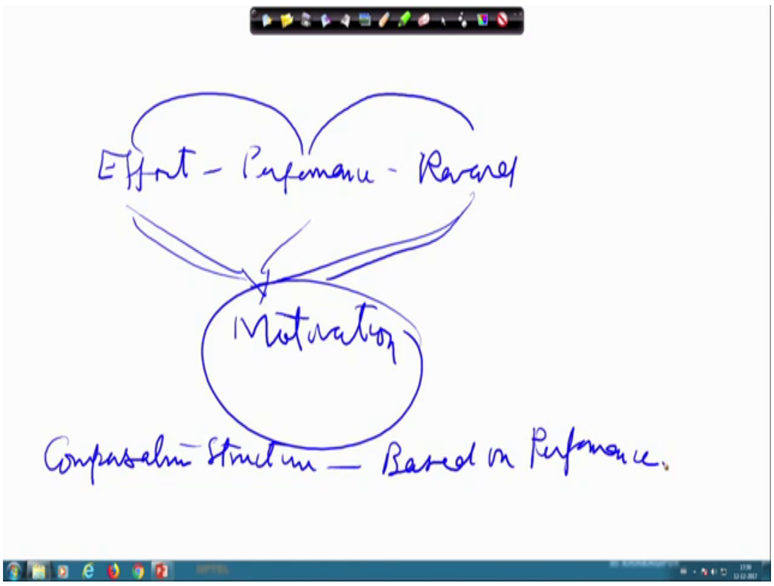

So, what I am discussing here is, I am taught I am trying to tell you here is that we are talking about we just discuss this factor that effort, performance, reward. And all this is related to what you call motivation. So you expect this motivation ok. So, effort leads to performance, performance leads to reward and then reward lead to what you call motivation to put in again more effort so it is a cyclic in nature right.

So, and you are going to design a compensation structure, which is based on performance. Now we have to see that how we can design a compensational structure which is based on performance ok. So, basically we have to see that how we can motivate employees through incentives or providing them financial or non financial rewards, ensuring that they are that is the intrinsically or intrinsically satisfied and all this depends upon the needs and expectations of the employees right. So, that is the first part.

In this part we will discuss some of the mechanism that talks about how organizations link their performance with the pay right. So, what we are going to discuss in this section is performance linked to reward system and here we will look into some of the issues and some of the mechanism that has been adopted by the organization to link performance with the reward. Now when we are going to link performance with the reward see what that is what we have been talking about.

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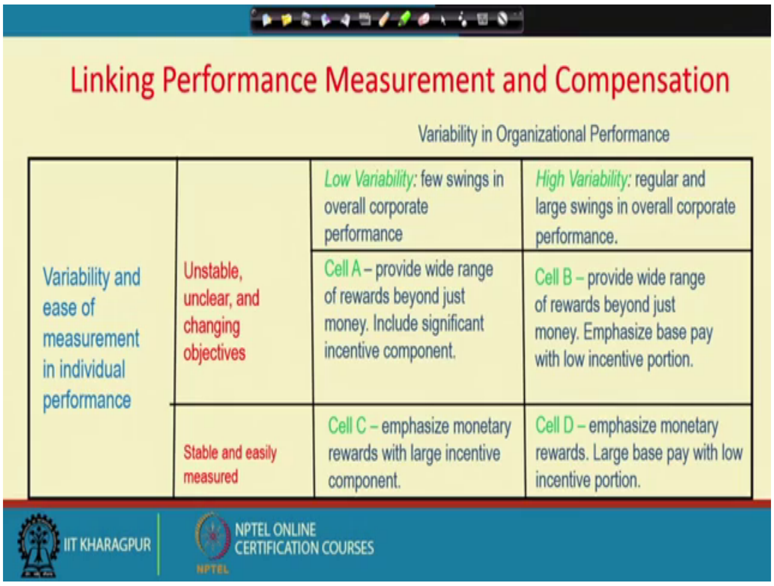

Now, if you look at these 6 what 6 cells you will find sorry 4 cells it talks about two factors. One is variability in the organizational performance and variability and ease of measuring performance of the individual right. So, you can have variability in the performance of the organization either it is going to very high or very low right because performance is variable right you cannot expect consistent performance across time right. Similarly if you look at performance of the individual that is also that is that is expected to be consistent, but there could be a variability ok.

So, this variability is designed for a derived from where? Especially when you are looking in measuring and the individual performance if you have stable at easily measured performance level then the variability is less, but if they are unstable, unclear and changing objectives relate to the performance and it is measurement both then the variability is very high right. Now low variability in performance means that it does not change over all corporate performance is more or less consistent it does not change much.

High variability means there is a larger swings in the corporate performance ok. So, maybe first quarter it is very good, second quarter again it is bad, third quarter it improves slightly and then fourth quarter it goes back again. So, if there is a high variability in organizational performance then what happens ok. Now if you look at these 4 quadrants that is cell A, B, C and D you will find that when we are trying to link performance with compensation what happens. Along these 2 dimensions of variability in performance of the organization and individual because individual performance need to be linked with organizational performance right because individual contributes to organizational performance.

Now, if you look at this and look at the first cell that is cell A and here we are talking about low variability it means organizational performance is more or less consistent it does not change much ok. But individual performance is unstable because the performance level is changing or the objectives of the performance is changing or for whatever reason it is not very stable ok. It means that there is a high variability ok. So, what kind of reward system is to be used here ok. So, if we are going to use only the money then it is not very effective ok. So, you have to see that what kind of incentives can be used to motivate employees to perform better right.

Similarly, if there is a high variability at the individual level, but sorry low variability at the individual level and high variability in the performance. Then, again you are going to use those rewards which are going to be satisfying in nature to the individual ok. Similar functional or monetary reward, a extrinsic rewards are not going to be always satisfied right. Now if you look at cells A where you take look at low variability and high stability in individual performance right. It means that individual performance is stable organizational performance is also consistent. Here you can go for providing monetary rewards including incentives, because both of them are doing well right and then you can go for profit sharing in these kind of things ok.

Now look at a cell D where you find high variability in organizational performance, but individual performance is more or less stable, means here again you can use monetary rewards basically pay and all this kind of a salary increase and these kind of things which is going to be satisfying in nature. Now, this if you look at these quadrants it has be it is based on the performance of the individual as well as performance of the organization. Because ultimately as a individual you are going to perform you are going to link it with organizational performance ok. So, if organization is going to perform well the only then which is going to reward you of well right. And if organizational performance is not good then the kind of reward mechanism that is coming would be different right.

So, we have to see that when we are going to design a compensation structure or a reward system for that matter, you look into both the individual performance and organizational performance because if organization is not able to perform well, then you are going to provide more incentives to the individual if it is going to perform well then you move to organizational level performance sharing like profit sharing, gain sharing ok. But if it is not performing well then you apply individual level performance criteria right like incentive giving incentives to individual who are performing well not everybody.

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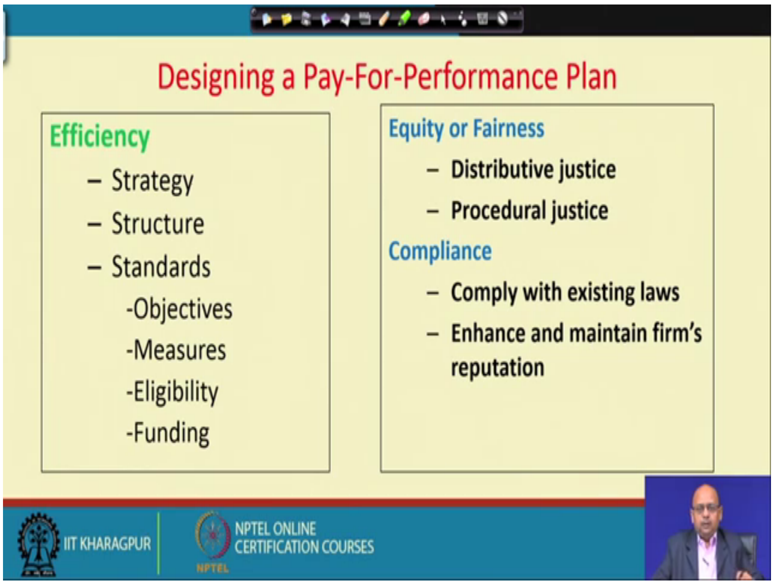

So, if everybody is performing well organization is also doing well then you move to organization right reward system. Otherwise you move to individual or group wise reward system. So, that is the basic objective of discussing this right. So when you are going to design a pay for performance plan it is based on what 2 factors: efficiency and equity and also compliance. Because if you look at compensation structure basically the idea of devising a good compensation structure is that it brings efficiency into the system. It means people work efficiently to produce more which could be linked with the reward right.

Now when we are talking about efficiency, bringing in more efficiency that is basically related to improving your operational efficiency at the workplace because if you are going to increase the operational efficiency; it would result in better performance right more productivity because efficiency is linked to higher productivity. Now in order to bring a higher level of efficiency you need to design your strategy and structure in such a way. So, that it supports higher productivity right. So, you have to see that what would be your a strategy for increasing your efficiency right and what kind of a structure you have in place. I am talking about the organizational structure ok.

So, ensure that your strategy and structure is aligned with each other ok, which leads to greater operational efficiency increasing in increased quality productivity and all kind of things. And then when it comes to measuring performance you also have standards performance standards are very very clear ok. So, you identify the objectives, you have measures for performance, you see that who is eligible for what and from where the money will come. For example, suppose you are going for a group based incentive say gain sharing plan right.

So, what is your, what is the basic objective of this gain sharing plan? The gain sharing plan actually is going to help a group who is going to work on a particular issue and suppose this group is going to solve a problem because of which the quality of the product has improved and because of this improved quality, there has been revenue gains right? And this revenue gain is going to be shared between the employer and the employees. Now some of the questions that you are going to look at is that what kind of performance standards you are looking forward to in terms of quality ok.

So, you need to define about the quality standards which is leading to increased gain right? You also see that how you are going to measure this, how much gain has been there, who is eligible for this kind of gain and how it is going to be shared? How it will be funded right? But we are before this you also need to discuss about the strategy what would be our strategy in gain sharing? How it is how it will be structured right? Which brings efficiency? So, when we are talking about efficiency the basic objective is that you are going to see that you are going to have more output with less input right? It means that increased efficiency. Your efficiency would increase only when your quality improves, your productivity goes up, down time in the is less right. It means that these are the some of the indicators of efficiency.

So, you need to develop a strategy make sure that those structure facilitates. You also define the standards of efficiency ok. This is the level of efficiency that you want to achieve and then you see that how it is to be measured, who will be achieve eligible for the gain because of this efficiency that has been achieved and how it will be shared between the employer and the employees right? That is the first part. Now you look at the second part .When you are going to design a performance based pay plan you also need to look at some other factors like equity or fairness. Make sure that those who are performing well, they are going to be paid well whether we have talking about financial performance or whether you are going to talk about non financial performance sorry rewards right.

So, where it does not matter what is the reward, but make sure that you follow the principles of justice and fairness in rewarding employees. So, that we are able to discriminate and are differentiate between high performing employees and low performing employees. So, you follow certain equity principles. Equity principles say just what? That you have to be just and fair in allocating rewards to the employees ok. So, you need to identify certain standards ok. And here 2 kind of justice is very very important, that is distributive justice and procedural justice. Distributing justice that is how are you going to allocate rewards and procedural justice is that what processes you are going to follow to distribute rewards ok.

So, at the first place when we are going to talk about distributive justice you have to see that you are going to distribute justice or distribute reward based upon the level of performance right? But now the question is that how do you decide about the level of performance right? And here comes the procedural justice that what processes you have identified to distribute the rewards. Who will be rewarded more and what how who will be rewarded less. For example, suppose we are talking about the preset of system and you say that we are going to follow preset of system to distribute rewards ok.

So, what will happen those who are going to produce more they are going to be rewarded better, if you follow equity principle it means you are talking about distributive justice right. So, suppose a person is producing x units and or say 10 units and the rate per unit is 100 rupees. So, 100 multiplied by 10 right. So, this is the equity part it means that depending upon the number of units that you are going to produce you are going to be rewarded ok. So, the how this is how the reward is going to be distributed.

Now, another issue is that how you decide that this would be the process. What is the process? How to decide that the rate per piece is going to be 100 rupees that is to be justified right so, that you are fair in distribution of reward. In addition to this equity and fairness issues you also look into other issues like compliances legal issues. That means, you know that you need to follow certain performance based laws sorry reward based lot right? For example, in Indian context you have minimum wages act equal remuneration act, payment of wages act, payment of bonus act.

So you need to comply with the, these existing laws in Indian context. Because if we are going to comply with this these kind of say wage laws then what will happen you will be able to maintain the reputation of the from that is you are complying with all the static trade norms of the state or the country while deciding about the compensation structure of the organization right. So, efficiency and equity and compliance these are the 3 factors which is important in designing the pay.

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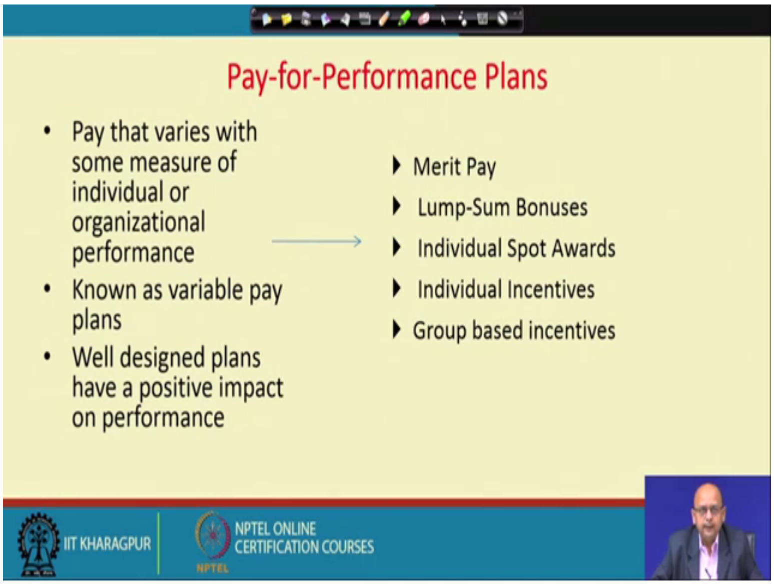

Now moving further is that what are the different kind of pay for performance plans that is given by the organizations right. Now what it will happens when you are going to have a performance based plan that yes depending upon the performance of the individual the pay varies right. So, it says that pay that varies with some measures of individual organizational performance right. So, any kind of performance based pay plan is going to be variable in nature. If there is a variation in the performance there is going to be a variation in the reward right. Why you are going to discriminate based on a performance a reward based on performance is that you want to motivate who are performing well, so that they can sustain then there that level of performance.

Similarly, you also want to motivate those who are not performing well to move to higher level of performance so that they get could get better reward right. So, the idea is that when you design a pay for performance based structure you make sure that it is having a positive effect on the performance. Now if you look at this with different kind of variable pay plans it include merit pay, lump sum increase in the bonus ok, individual incentives or group based incentives ok. So, what we are going to about here is the different kind of schemes which are planned by the organization.

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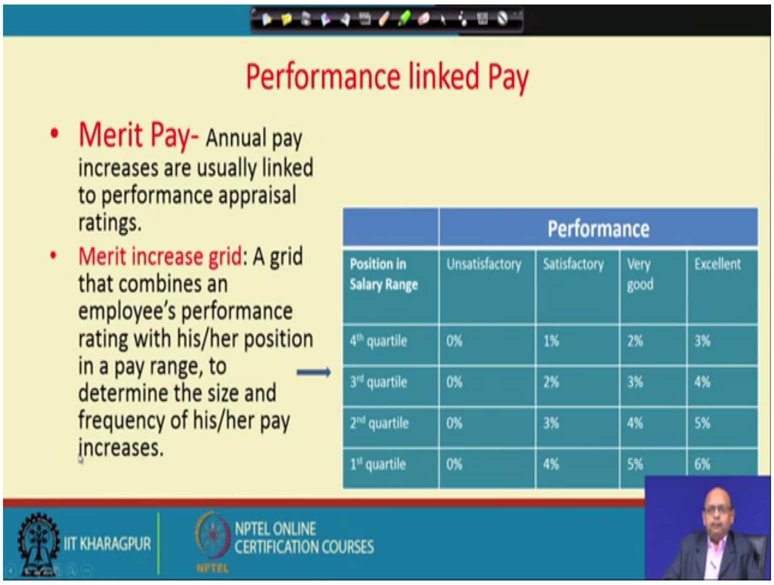

So, we move with the first one that is a merit based pay merit based pay is that when you have annual pay increase linked to your performance appraisal rating right. So, now, you look if you look at this data you can see that this is this is known as Merit increase grid. Now what is this merit increase grid ok? So, you look at the performance of the employees and how much increase is there in the performance and accordingly you decide what would be his, the pay or the salary of the employee's right.

So, merit increase will basically is agreed that combines performance ratings with the position or the pay range, to determine the size and frequency of his pay or increase in the pay right. Now if you look at this the performance is being measured at 4 different level that is unsatisfactory, satisfactory, very good and excellent ok. Now at each quartile you are going to measure the performance right. So, the first quartile what happens? Second quartile what happens? Third quartile what happens and the forth quartile what happens ok.

So, you will find that for fourth quartile what happens from one percent or from unsatisfactory performance it lead leads to it is moved to 3 percent ok. Similarly in third quartile it moves from 0 to 2, 2 to 3 quartile. It means there is a increasing progression from unsatisfactory to excellent performance depending upon the salary that you have. So, at the position in the salary range right. Now the idea is that if you perform well you are going to be rewarded accordingly and this is decided with organization that how much increase is going to be there in a reward and this is it this is prefix sometimes or the employee also know that if he is going to perform at this level what would be his reward right. So, this is what we know as merit based pay. Merit based means if you are performing better then you are going to pay better right. And it is administrative decision which is linked with your performance appraisal data.

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So based upon your performance records the organization decides that how much increase is going to be there in your salary on an annual basis right. So moving from a merit increase we have to see that, what are the other systems? But before we move to other systems we have to say what are the criticism of this kind of metric based pay programs ok. What is actually happen, happening here that you are going to rate individual performance, but the individual performance is also dependent on other factors, which is not being considered. For whatever reasons if the individual is not able to perform well then he is not going to get any kind of merit increase right.

Now, since it is based on individual performance those it is going to discourage basically teamwork because everybody would like to look at his performance and you would like to make effort to improve this performance. So, if you are working as a team and if you are not following team performance norms and you are going to reward individually each one of them then everybody would be concerned about his performance in the team not the overall performance of the team. So, this basically discourages the teamwork and that is why you should not go for merit based pay program for team right it could be more suitable for individuals right.

Now, another issue that comes out is that when we are going to decide about merit based program. Who is going to do this kind of rating? It is done by the supervisor's right. So, if you are going to only rely on supervisors for ratings of the individual performance and if supervisor is biased he is not been able to rate accurately, then what happens? Intensely or unintentionally, unintentionally sometimes supervisors are biased or make certain errors in the ratings. So, if they are going to make their some errors in the rating of the performance the person is going to be affected ok.

So, if you are going to exclusively rely on supervisor for performance rating then, it is not going to help the individual because in that case you are not going to properly or accurately rate his performance and link it with the individuals performance right? Similarly if you are going to increase the merit and that is not very valuable or it is insignificant, a too small. Then again it is not going to motivate employees for higher performance. So, the idea here is that when you are going to decide about merit based program keep certain things in mind that is you look at individual performance that is ok, but do not only rely upon supervisors rating. You also ensure that the rating that is given by the supervisor is correct and that is why you remember you talked about training of the supervisors. So, that they do not go for any kind of biases unintentional or intentional.

And make sure that these kinds of increases are significant because if it is insignificant that it is the then it is not going to motivate employees for higher performance right. Sometimes what happens this merit pay lead to an entitlement mentality? What I am trying to tell you here is, what is this entitlement mentality? Suppose you have I have got some kind of increase then next state again I expect that this is my entitlement I must get some kind of increase in my pay ok. So, if we are in the rewarding individually the every time he is performing well he expect better rewards.

So, this leads to some kind of mentality where you feel that yes you are entitled because you have performed well. Whether the organization is in a position to provide you reward or not ok. So, these are some of the issues because of which this merit based pay programs have been criticized traditionally. Now moving from this we are talking about individual incentive plans ok. So individual incentives, as I told you earlier also is based upon your productivity, productivity is linked with pay right.

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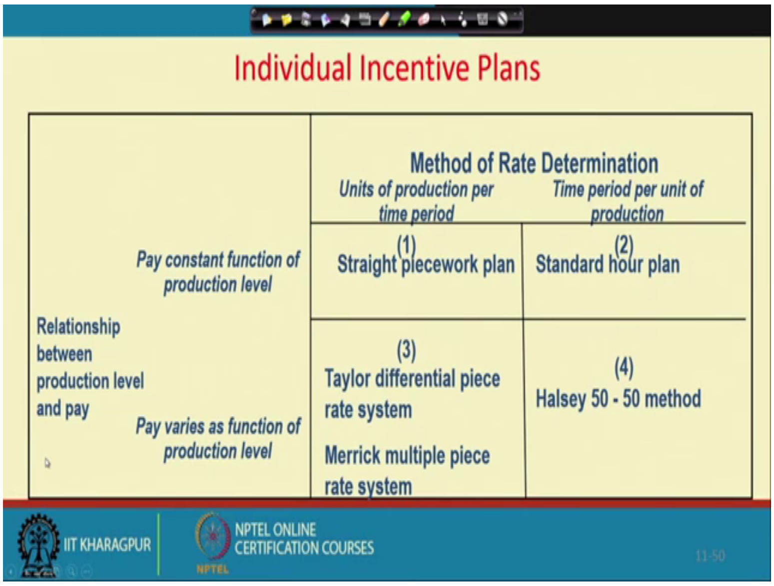

Now, if you look at this there are different kinds of plans that have been discussed. How the rate is determined ok. So, there are 2 though 2 principles that is followed based on time and based on units that is produced right. So, units put unit of production per a time period and time period per unit of production right. Now if you look at this you suppose you are going for piece rate of production that is nothing else, but what you call units or production per time period right.

So, you follow a straight piece or plan. What I am trying to tell you here is that you decide the rate per piece you see how much he has produced and you multiply the number of units with the rate and then you decide the increase the incentives that a individual is going to have. Second is that you also look at the number of hours the individual has worked and then you what you decide what would be the rate per hour and then the rate per hour plus the number of hours works that the individual has worked is multiplied and then you decide what would be his incentives right.

Now, this is basically where you are trying to link pay with the productivity right. Now since pay varies because of the production what happens ok. So, you go for differential piece rate systems what is differential piece rate systems? That is up to a certain level you have one rate if beyond that level you are going to increase the rate. For example, you think that beyond the standard performance if he is going to produce 5 units the rate would be 10 rupees. From 6 to 10 we are going to have 20 rupees, if he is producing beyond 10 units then the rate would going to be 25 rupees ok.

So, you are adopting a differential piece rate system ok. So, whether you adopted from Taylor or Merrick the idea here is that the you productivity if you are going for increase productivity level your pay varies ok. But there is a differential system because you identify that what would be the piece rate per system at certain levels right? And standard hour plan happens what happens if you look at this where you are going for variations, suppose you also say that the time period per unit of production right.

Here you are not keeping in mind that number of units that is produced, but you say if you are work for these hours and if we are going to work for extra hours how much you are going to pay ok? So adopt a 50-50 ok. You decide what would be the standard of payment for extra hour that the individual has worked and accordingly you decide what would be his increase as a individual incentive right. Now what next we are going to discuss is different type of variable pay plans. See since we are talking about pay for performance and pay for performance is always variable in nature, we have to ensure that we are going to follow this kind of system to better motivate people for your performance which is linked with higher rewards right.

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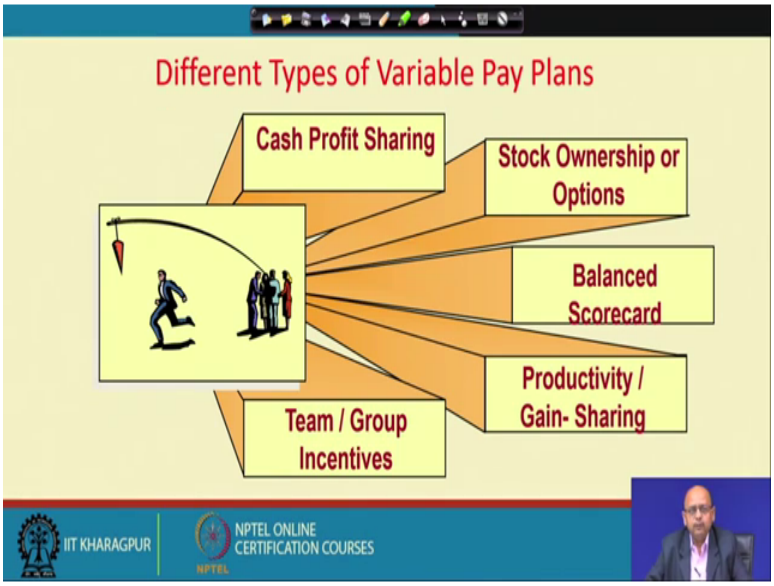

So, when you are going to design a variable or pay for compensation in addition to the performance standards and constant pay that the individual is getting right. So, there could be different kind of incentives we talked about individual incentives, there could be a group incentives ok, there could be stock ownership, balance scorecard or gain sharing or cash profit sharing also. So, these are the different kind of incentives that could be given to individual in individuals groups even at the organization also.

So, here we are talking about different kind of systems that organizations design at individual group at organization level right. Now if you look at this picture you find some a correct which is going to attract a individual. So, you will be motivated to that in order to perform well. Now the idea is that what mechanism you are going to use in order to ensure that this variable plan which is linked with performance and reward is going to remove successful and effective.

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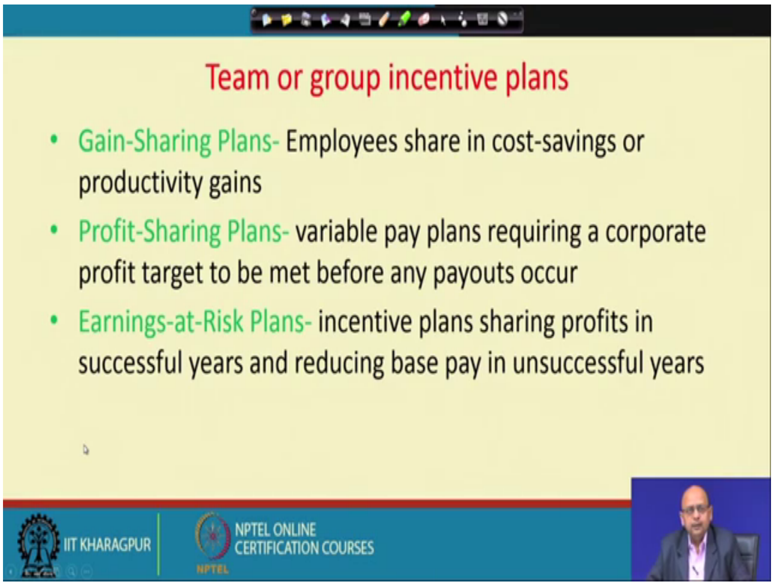

Now what we are going to do is discuss it one by one like team or group incentive plans right. Now first of all we are going to discuss about gain sharing plan. What is gain sharing right? Now if you look at this gain sharing plan it talks about the gain which is achieved by a group of employees it they could belong to a particular department or unit or they would might be working for a particular project right. So, what exactly happens in a gain sharing plan is something like this.

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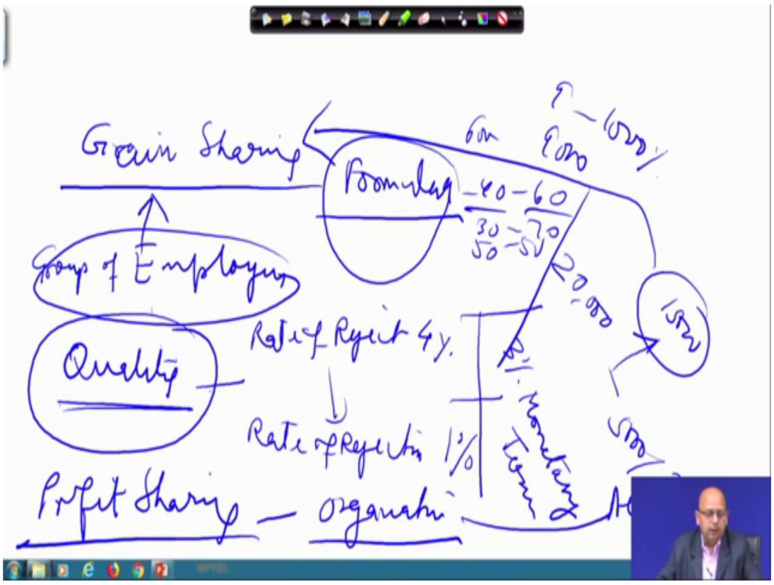

Suppose there is a gain sharing. Now in this gain sharing what happens is that suppose there is a group of employees? Working with a say quality in department right and the rate of rejection was 4 percent. Now because of their efforts they have been able to improve the product. So, the rate of rejection has gone to gone down to 1 percent right? It means the gain is three 3 ok. So, we are able to improve the quality of the product right?

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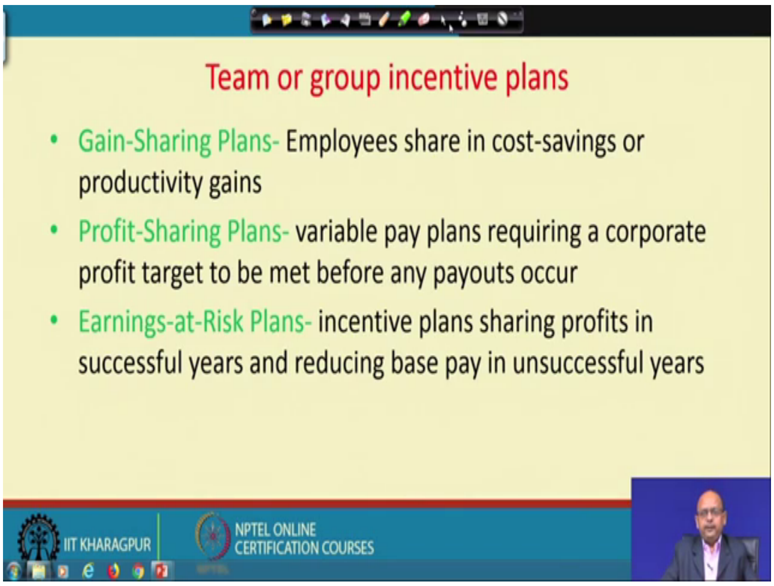

Now this gain that has been achieved has to be translated into monetary terms that how much it translate into monetary terms. Suppose you seen that with 4 percent rate rejections of the quality or the product you have been lost losing say 20000 rupees. That is a hypothetical example I am giving right? So, if there is a 1 percent then you are only going to lose 5000 ok. It means you have been saving 15000 because of improved quality of the product.

Now, this 15000 that has come out this is the gain for the organization which is made by a group of employees now right. So, this is what the gain sharing is. Now it is 15000 is to be shared between the employer and the employee's right. So, these gains sharing you identify the formula, for sharing the gain. Now this gain is to be shared between a set of employees who have worked for improving the quality others will not be a part of it and that is why we call it a team or group incentive plans.

Now, this formula could be 40 60 40 person will go to employee, 60 person will go to the employer it could be a 30-70 or it could be a 50-50 also. What I am trying to tell you is that whatever formula you adopt make sure that it is the acceptable to both the employers and the employee's right? And accordingly the revenue that is generated or the revenue that is gained because of this improved quality process has to be shared between the employees and the employers right.

So, you decide about the formula that is going to be acceptable suppose it is 40-60, so they will get 6000 and then employees will get 9000 rupees. So, suppose there are 9 employees, so each employees will get an additional increase in the salary that is going to be 1000 rupees right. So, that is how the gain sharing works ok. Now in addition to gain sharing we also have another concept that is known as Profit sharing. Profit sharing is an organizational wise plan ok.

So, if whatever profit is made by the organization that is shared with all employees so, this is the difference between profit sharing and gain sharing right? Is a profit sharing in a organizational wise plan, where all employees is going to share the profit. Suppose organization has made a profit of ten percent right. So, part of that would be shared with the employees right, but in gain sharing only those employees who have work for that particular thing and because of that have there has been some revenue generation. So, that extra revenue that is generated or that is saved whatever it is going to be shared between the group of employees and the organization.

So, we talked about gain sharing plan and profit sharing right? Then earning at risk plans the this is the incentive again it is related to profit sharing only ok. So but it changes depending upon how much profit you are making from? The making more profit then you are successful, but if we are not making profit then we are at risk because in that case your earning is going to be changed or it is going to be on the downside right. So, suppose in a particular year organization has made better profit then organization is in employees are going to gain more or they are going to extra revenue that is generated by the organization would be shared in a better way.

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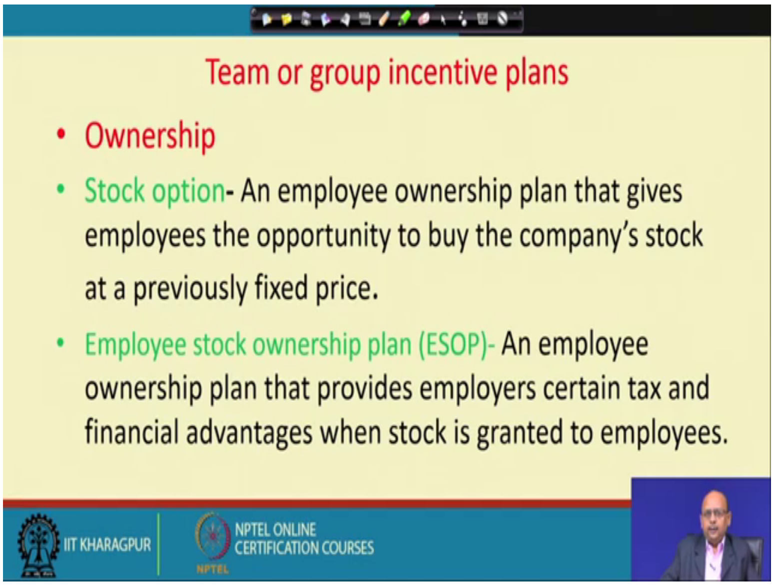

But suppose next year the organization has not made profit that much profit then this kind of sharing would be less. So, it is at risk it means that profit sharing sometimes is good and sometimes may not be good. Then another important incentive plan that is used by the organization is ownership right? That is a stock ownership stock option. So, employee ownership plan that gives the employee the positive to buy the company's stock at a fixed price ok, depending upon the stock what actually happens? The number of stocks that the employee had the value of that stock goes up or down ok; it depends upon the market actually right.

So, if you are talking about ESOP it is a very popular method and many IT companies or manufacturing companies use this to they provide the stock ownership to their employees and this is also a limited from a tax and those kind of things ok because it is in the form of money digital money because unless you cash it you are not going to pay taxes to that one right.

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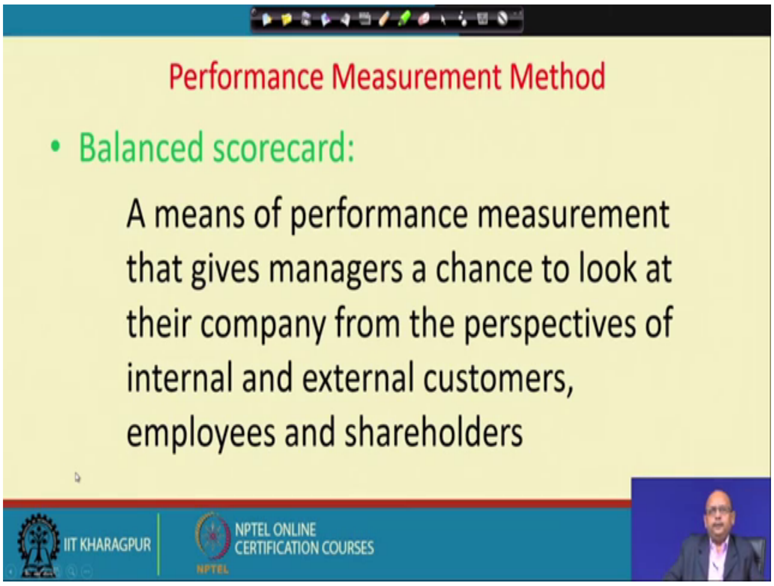

So, and this implies stock ownership actually is used to motivate employees ok. So, do you know that you feel a part of the employees. So, you go for better performance right and that is why this kind of incentive plans have been designed by the organization right. Then we have balanced scorecard. Balanced scorecard is another method that could be used for measuring the performance of the employees especially from a different perspectives like a internal customers, external customers, employees and stakeholders and see what is happening who is making profit right.

So, this balanced scorecard approach is also used for measuring performance of the employees and then it could be used for devising a suitable reward mechanism depending upon the level of performance that has been made by the company ok, using different stakeholders right internal stakeholders, external stakeholders, employees right and the shareholders. Now we have to see that how this profit linked plan is better or worse compared to other financial remunerations like salary right. See if you look at salary, it is structured it is paid in a definite cycle while we are when we are talking about performance link plan, it is not related to monthly, quarterly or quarterly or yearly it depends upon when you perform well right.

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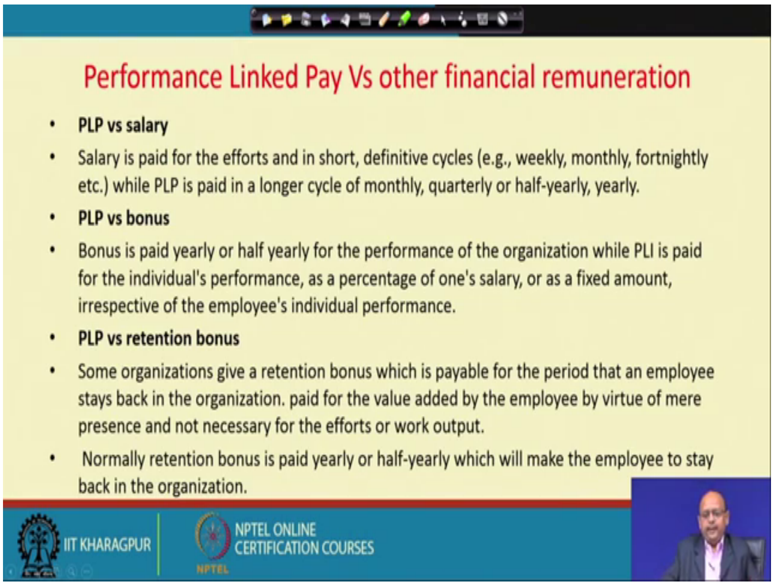

Now if you look at bonus, bonus is also paid yearly or half yearly because as for the government laws it has to be paid ok. But when we were talking about performance links incentives it depends it depends upon the performance of the individual. And you decide how much you are going to increase the salary of the individual right? Irrespective of the performance of the individual then we also have retention bonus right? Whether we want to retain high performing employees, you give them extra salary yeah yeah extra bonus ok. So, these a retention bonus is given for a period that, employees stay back in the organizations.

So, basically you want to stay want him to stay back with the organization ok because he is going to value at some kind of value ok. It is not related to basically effort that he is made making for higher performance, but since you want one to stay back you want to retain him with the organization, so you go for retention bonus right. So, it could be paid how yearly half yearly and the idea is that you are want to stay back you want employees to stay back in the organization and that is why if you are going for financial sorry performance linked pay it is much better than other financial remunerations that we are using to motivate employees.

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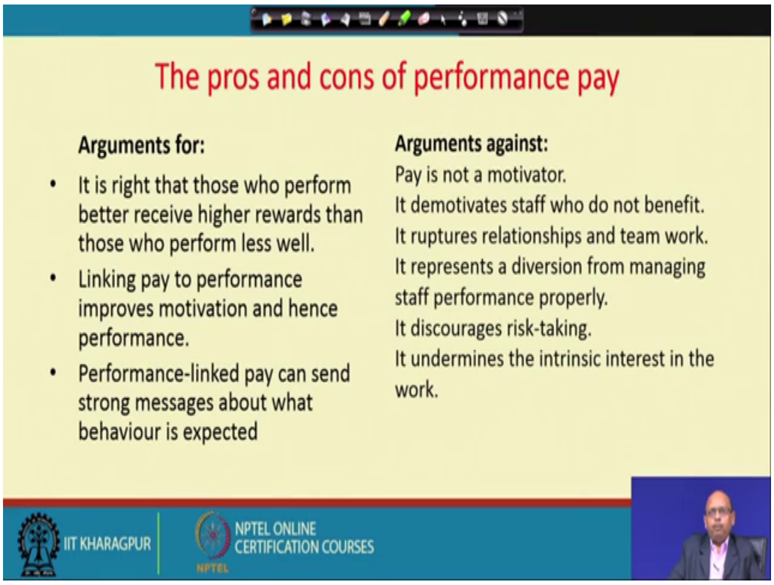

So, the objective of whether you are going for financial remuneration or performance linked pay. The objective in both cases is to motivate employees for higher performance right. Now, finally we are going to discuss what are the pros and cons of performance based pay right. Now if you look at the arguments that is given in favor is that yes, it is always good to reward those who are performing well compared to those who are not performing well because in that way you will be able to discriminate between high performing employees and low performing employees right first point.

Second point is that if you are linking performance with reward it is motivating in nature and this leads to higher performance provided the reward is perceived as valuable by the employees right. Third point that is in favor, that is that for linking performance with pay it gives you a very clear signal to other who are not performing well that what is expected of them. What level of performance achievement would help them to achieve this kind of reward right. So, you also giving a clear signal to those who are not performing well right.

So, this is performance related by the arguments given in favor of that. Now there are certain arguments, that is given against and many people say that pay is not a good motivator yes I do agree that up to a certain level it motivates, but beyond that it does not motivate. Now the question is that whether we are going for financial reward or non financial rewards. So, it is always good to use and go for more intrinsic and non financial rewards because that is always motivating in nature ok.

Similarly if you are one person who is performing well and one who is not performing well what actually happens? You are rewarding who is performing well right. So he is happy, but the other who is not perform well he will not be happy he will be demotivated because you clearly differentiate between high performing employees and low performing employees. Similarly also encourage discouraged teamwork right because everybody would be concerned to improve his performance because he it is linked with the pay right?

Similarly it also diverts, if there is a diversion basically from managing staff performance properly ok. Because managers would be in a, would have a lot of problems to look at each and every individual see how they are evaluated? What are the different performance standards? What are the rewards that is going to be available to them ok? And how they are going to evaluate their performance right and it does not allow risk taking. Because you know that if you take higher reason you are not able to perform well then what will happen ok. And it undermines the intrinsic interest. It would inter undermine the intrinsic interest only if you follow extrinsic rewards, but you follow intrinsic reward it does not undermine it.

So, it is always good to go for performance link pay whether you follow merit based pay, whether you go for individual incentive or group incentives or organizational wise incentives ok. Because that helps organization to motivate employees for better performance and if you provide suitable rewards then it is always good for the employees to perform well.

Thank you very much.