

Lecture System

4: Incentives

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For Students of I Master, HRM

Course: Wages and incentives Management 2

Learning Objectives

- Define Incentive Plan
- List different Types of Incentive Plans
- Understand different incentives plans aspects

Incentive Definition

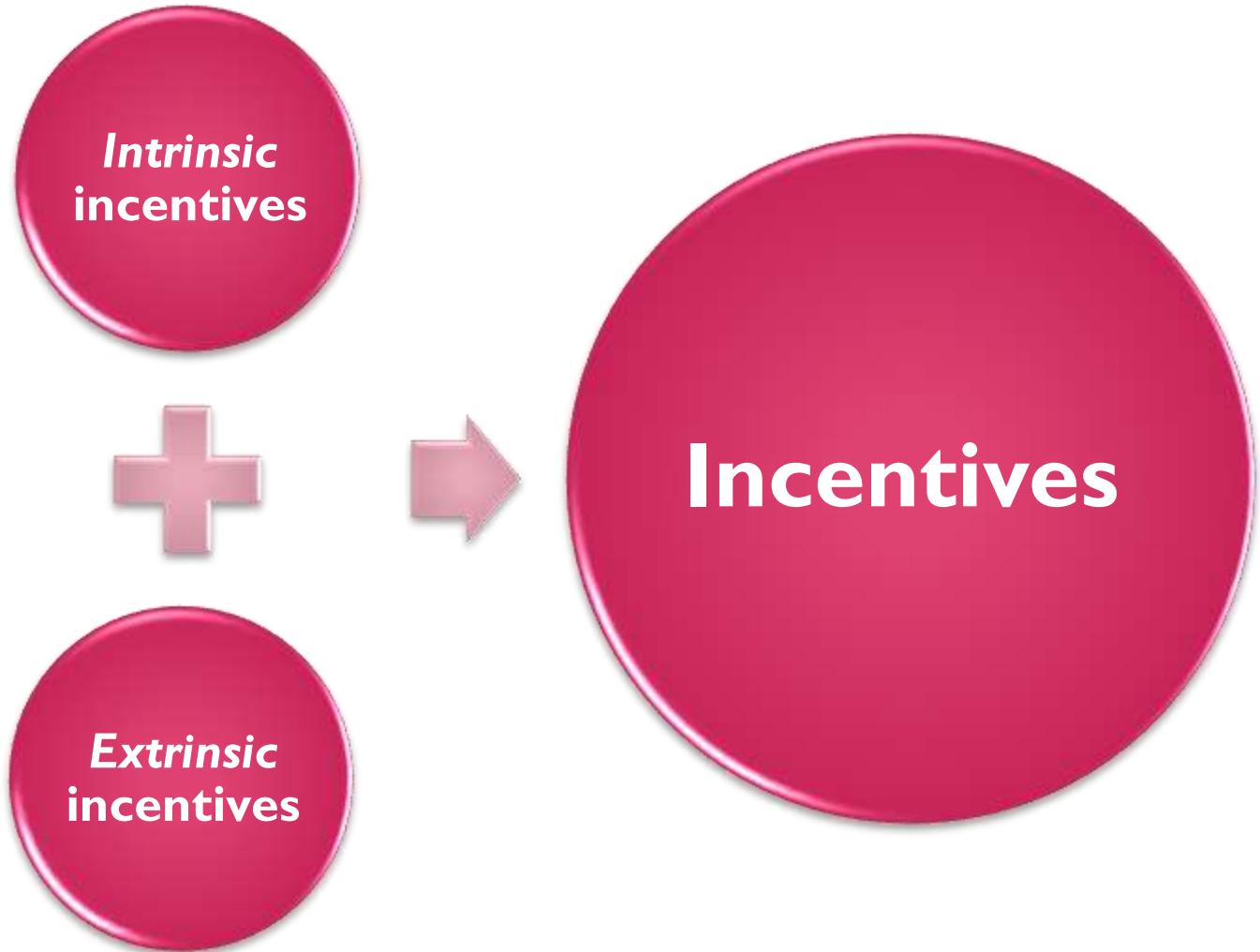
- The term “**incentive**” (from Latin *incentivum* “something that sets the tune”) indicates a tangible and/or intangible reward that motivates people and creates favorable environmental conditions to maximize performance and/or to achieve specific goals in organization or competition or society.
- The concept of incentive in management and economics is developed from behavioral sciences (psychology, psychobiology, and cognitive science) to analyze and explain what motivates people in organizations and/or competition.

INCENTIVE DEFINITION

Motivation Definition

- Motivation indicates the forces that energize, direct, and sustain behavior.
- Motivation is: *“The set of processes that arouse, direct, and maintain human behavior towards attaining some goal.”*

Incentives Types



Intrinsic incentives characteristics

- Intrinsic incentives exist in the job itself and give personal satisfaction to individuals, such as autonomy, reputation, self-confidence, trust, empowerment, expense preference.
- Intrinsic incentives can satisfy personal needs directly by creating an intrinsic reward for those who perform the tasks.

Intrinsic incentives

Intrinsic incentives effects in organizations and/or society

- Intrinsic incentives may be important for affective commitment, job involvement and motivation in organizations.
- Intrinsic incentives can be effective in deterring corruption.

Intrinsic incentives

Extrinsic incentives characteristics

- Extrinsic incentives are pay and fringe benefits, gifts, promotion, advancement opportunities, etc.

Extrinsic incentives effects in organizations

- Extrinsic incentives are important in relation to continuance commitment to organizations.

Extrinsic incentives

Extrinsic incentives effects in organizations and/or society

- Extrinsic incentives satisfy personal needs indirectly, because they lead to separable outcomes, such as monetary compensation.
- Extrinsic incentives can threaten the need for autonomy, competence, and relatedness, thus lowering intrinsic motivation (the crowding-out effect).

Extrinsic incentives

Incentive Strategy Formulation Process

- ➤➤ Organizations should first understand the need of incentive plans.
- ➤➤ It should set clear objectives as of why incentive plans are formulated, what are the objectives.
- ➤➤ These objectives should be in alignment with organizational goals and objectives
- ➤➤ Various options for individual and group incentive plans should be explored.
- ➤➤ Benefits and disadvantages of each plan should be considered and from the various options available one incentive plan should be chosen.
- ➤➤ Using the best incentive plan, compensation strategy should be formulated.

Types of Incentive Plans

1. Basic Rate System

**2. Incentive Schemes for
Individuals**

**3. Incentive Schemes for
Groups/Team Compensation**

4. Gain Sharing Incentive Plan

I. Basic Rate System

- Under basic rate systems a worker is paid in relation to a given period of time – an hourly rate, weekly wage or annual salary.
- Generally this rate is the established rate for all workers in one category, but there are often incremental scales which allow for progression, perhaps as additional experience and skills are obtained.

I. BASIC RATE SYSTEM

Suitability of Basic Rate System

- ➤ ➤ All workers do identical or similar work
- ➤ ➤ The volume or quality of work is difficult to measure, or where the workflow is uneven
- ➤ ➤ Where the volume and/or pace of work is outside the workers' control
- ➤ ➤ Where high output is not as important as other considerations (eg quality, stable production levels).

2. Incentive Schemes for Individuals

2.1. Payment by results (PBR)

2.2. Work-measured schemes & pre-determined motion time systems

2.3. Measured day work (MDW)

2.4. Appraisal/performance related pay

2.5. Market-based pay

2.6. Competency and skills based pay

2.1. Individual Payment by Results (PBR)

- Provide a direct link between pay and output
- However, traditional bonus, piecework and work-measured schemes have declined in recent years, as many employers have moved to all-round performance rather than simple results/output based pay.
- Many bonus schemes incorporate quality measurements or customer service indicators in the assessment to avoid the likelihood of workers cutting corners or compromising safe working methods in order to increase output.

Piecework

- Piecework is the simplest method of PBR – workers are paid at a specific rate for each ‘piece’ of output. Pieceworkers must be paid at least the national minimum wage and there are special rules for working this out.

Bonus Schemes

- Other individual PBR schemes include incentive bonus schemes where for instance an additional payment is paid when volume of output exceeds the established threshold, or where there is an increase in sales which exceeds given targets.
- Variable bonuses can also be paid in relation to performances achieved against predetermined standards.

Individual Payment by Results (PBR)

2.2. Work Measured Schemes

- In these systems, a 'standard time' or 'standard output level' is set by rate-fixers, or by work study, for particular tasks.
- Work study calculates a basic time for a task by using laid down methods, observing workers performing the operation and taking into account their rate of working.
- Incentive payments are then linked to performance or to the output achieved relative to the standard, or to the time saved in performing the task.

Pre-determined motion time systems (PMTS)

- A synthetic time for a job is built up from a database of standard times for each basic physical movement. A common form of this system is Methods Time Measurement (MTM). Allowances for relaxation and contingencies are then added to the basic time to form the standard time for the task.
- Most schemes are 'straight proportional', which allow the reward to rise in direct proportion to the rise in performance.

PRE-DETERMINED MOTION TIME SYSTEMS (PMTS)

PMTS Considerations

- Schemes should include provisions covering the effects of downtime or other non-productive time on pay.
- Schemes should be controlled fairly and regularly reviewed to ensure there is no degeneration of work-measured standards. The operation of the scheme should be audited regularly.
- Arrangements need to be in place to accommodate changes in product, material, specifications and methods – re-measurement of the job may be necessary.

2.3. Measured Day Work (MDW)

- Measured day work (MDW) is a hybrid between individual PBR and a basic wage rate scheme. Pay is fixed and does not fluctuate in the short term providing that the agreed level of performance is maintained.
- Motivation comes from good supervision, goal setting and fair monitoring of the worker's performance. MDW is difficult and costly to set up and maintain.

MEASURED DAY WORK (MDW)

‘stepped’ MDW

- . A version of MDW is ‘stepped’ MDW. Under this scheme the worker agrees to maintain one of a series of performance levels and different levels of pay apply to each one.
- Movement between levels is possible, usually after a sustained change in performance.
- MDW is now relatively rare.
- It suits organizations where a high, steady, predictable level of performance is sought, rather than highest possible individual performance.

2.4. Appraisal/Performance Related Pay

- It is generally used to link progression through a pay band to an assessment of an individual's work performance during a particular reference period, often a year.
- The reward may be an additional sum of money paid in the form of a bonus.
- Assessments usually relate to an individual's achievements against agreed objectives relating to output and quality of work but may also include an element of evaluation of personal characteristics, such as adaptability, initiative and so on.

APPRAISAL/PERFORMANCE RELATED PAY

Considerations

- Any organization that chooses appraisal related pay should have good industrial relations and good communications systems in place.
- It is also important that the finance necessary to operate the scheme is available.
- It is important to monitor the appraisals, to pick up any drift from the overall distribution of ratings and to check the fairness and consistency of the ratings.

2.4. Market-Based Pay

- Market-based pay links salary levels, and progression through the scales, to those available in the market.
- It is rarely used as a scheme in isolation, but may be part of a reward strategy incorporating several performance elements.

2.5. Competency and Skills-Based Pay

- A direct link is created between the acquisition, improvement and effective use of skills and competencies and the individual's pay.
- It schemes measure inputs, ie what the individual is bringing to the job, unlike traditional performance based schemes which measure outputs.

COMPETENCY AND SKILLS-BASED PAY

Competency Based Pay

- Competency based systems have become more widespread because many organizations already use competencies in recruitment and in performance appraisal for non-pay purposes, such as development and training.
- Competency based pay is often used in conjunction with an existing individual performance related pay scheme and will reward on the basis of not only what the individual has done, but how they have achieved their targets.
- Difficulties may arise in defining the competencies valued by the organization.

COMPETENCY AND SKILLS-BASED PAY

Competency Based Pay

- Skills-based pay rests on workers gaining new and improved skills.
- Reward is given for skills that can be used in other jobs in the same job band, encouraging multi-skilling and increased flexibility.

3. Incentive Schemes for Groups/ Team Compensation

Team-Based Pay

**Plant or Company Based Pay
/ Enterprise Incentive Plan**

Gain Sharing Incentive Plan

3.1. Team-Based Pay

- While team-based pay has been around for some time - in the shape of departmental or group bonus systems - it has taken on more importance with the increased interest in team working.
- In team-based pay systems the payments reflect the measurable goals of the team.
- Team working may be most effective in situations involving high task interdependence and creativity, although it can be difficult to define the team, the goals, and the appropriate reward.

TEAM-BASED PAY

Objectives and importance

- The aim of team-based pay is to strengthen the team through incentives – building a coherent, mutually supportive group of people with a high level of involvement.
- The team achievements are recognized and rewarded.
- Peer group pressure can also be helpful in raising the performance of the whole team.

TEAM-BASED PAY

Considerations

- As with any other pay system, involvement of the workers who will be affected is crucial in the design of the scheme.
- They must be involved particularly in the way objectives are set, how performance is measured, and the basis on which team rewards are distributed.

3.2. Plant or Company Based Pay / Enterprise Incentive Plan

- Plant or company based performance pay schemes are based on larger groups than teams, for instance, divisional, plant or the whole organization.
- They may well use the same factors as team-based or individual performance schemes, or perhaps total sales within a set period, or comparative reductions in labor costs.
- The most common forms of plant or company based payment systems tend to be based on overall profits (profit sharing).

3.3. Gain Sharing Incentive Plan

- Gain sharing is a form of added-value pay scheme linking workers' pay to the achievement of organizational goals by rewarding performance above a pre-determined target.
- This may be in the form of a share in the profits generated by sales, or on measures of customer satisfaction, but is almost always led by measures of productivity, performance and quality.
- Performance measures and results should be made available and everyone encouraged offering suggestions for improvements.
- Open communications and exchange of information are crucial.

Gain Sharing Incentive Plan

Scanlon Plan

Rucker plan

Share Incentive Schemes

Other gain sharing / value-added schemes

Executive Incentives

Scanlon Plan

- This formula measures labor costs as a proportion of total sales and sets a standard ratio which will trigger some distribution of savings to a pre-established formula.

Rucker plan

- This is a refinement of the Scanlon plan which measures labor costs against sales less the cost of materials and supplies and provides a simple added-value calculation.

Gain Sharing Incentive Plan

Other gain sharing / value-added schemes

- ➤ There are several forms which further refine the calculations and link bonus payments to the increase in added value, above a given norm. Value-added deducts wages and salaries, administration expenses, services and materials from income derived, and thus represents the value added by the production or other process within the organization. The level of added value of an enterprise is an indicator of its efficiency.

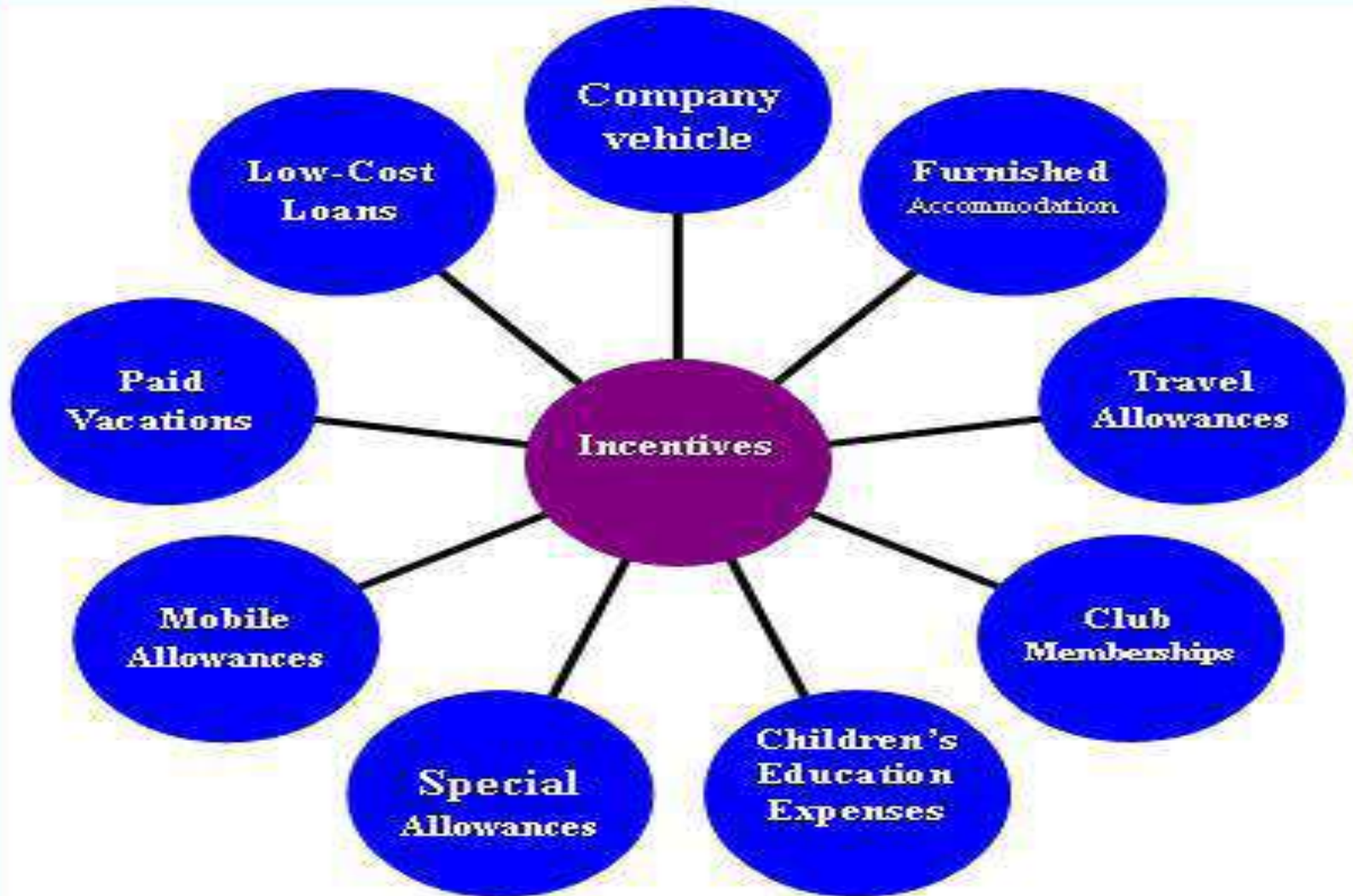
Share Incentive Schemes

- Share incentive schemes involve the provision of shares to employees - either by giving them direct or allowing them to be bought.
- The Share Incentive Plan (SIP) (previously the All-employee share ownership plan (AESOP)).
- Although share-owning schemes can appear attractive to employers it is not always helpful to a company's finances to have a constant turnover of shareholders. Companies therefore need to be clear about how much of the equity can be held in this way and how to create ways to get workers to keep their shares long-term.

Executive Incentives

- Organizations offer heavy incentives to executives to retain the talented workforce.
- Executive Incentives are more effective in the marketing segment as it results in more and more sales.

Executive Incentives



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Thank you for your attention