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Rewards Management: The Basis of Performance Management

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Abstract
In the contemporary world, rewards for better performance and success matter more than the actual achievement itself. Indeed, as the global financial crisis showed, rewards were everything for the bankers as they strove for more reckless bets and increasing risk taking. Because of the system of flawed incentives, rewards were seen to the ultimate prize that was greater than the actual process of winning. Hence, rewards management has to be seen in the context of what are proper and just rewards and what are disproportionate rewards. The point here is that rewards ought to justify the performance and not exceed them. What I mean by this is that it is okay to reward a high performer for his or her stellar performance but not to the point where in the pursuit of rewards, the individual throws caution to the winds and indulges in unethical behavior. For the present day generation, rewards matter more than the actual performance and this is reflected in their increasing demands from the employers for salary hikes and bonuses. If not anything else, the millennial generation believes that excessive rewards are their due. Though this is not to say that only this generation behaves that way (this pattern can be seen in the Generation X as well), it is the case that undue emphasis is being placed on the rewards alone as opposed to the fulfillment one gets by getting the job done in a proper manner.

Keywords: *Rewards Management, Performance Management, Total Rewards Management System*

1.0 INTRODUCTION

If the baby boomer generation taught us anything, it is that doing the job for fulfillment sake is more important than the reward system in place. Of course, it goes without saying that in a world of diminishing resources, everyone is concerned with earning as much money as possible, and hence some of this behavior is indeed justified. However, the point needs to be made that while rewards are one way to motivate individuals and incentivize good performance, they are not the be all and end all that everyone likes to believe. Hence, a proper reward system in organizations would be aligned with the correct strategic fit between internal motivation and external rewards and only when they are in balance can organizations grow in a healthy manner. Much has been written about how excessive CEO compensation is hurting the corporate world and hence, the debate over whether CEO's are being paid excessively is indeed justified in view of the ongoing global economic crisis. The point here is that a reward system that does not increase the gap between the CEO and the lowest paid worker by more than a ratio of 15:1 is the correct one according to studies done in this field. Hence, all possible efforts must be made to decrease the gap between the lowest paid employee and the highest paid employee. Of course, in practice this might not be possible completely due to entry-level salaries being much lower. Therefore, a way out would be to determine the gap according to each company's requirements and then pay the employees at all levels accordingly.

By now, it has become common for companies all over the world to use stock options to incentivize employees to perform better. The rationale behind using stock options is that employees are goaded to perform better because if they perform better, the company does well, which in turn raises the stock price of the company. In this way, the assumption is that employees would have a stake in the performance of the company rather than being merely salaried employees who would otherwise benefit only from bonuses and pay hikes. By making employees part owners of the company, managements all over the world believe that it would create a professional class of employees who would perform better since they stand to gain directly from the performance of the company.

1.1 Stock Options Alone are Not Enough

However, in recent years, there have been studies done to assess the impact that the practice of doling out stock options has had on employee performance. The studies point to the fact that share price movements are dictated by a host of factors including market movements, sectoral adjustments, and speculative frenzies. Hence, it is concluded that stock price movements are not entirely driven by the company's performance especially over the short term and the medium term. Because of this, outstanding performers in companies that are doing well but whose stock prices have not priced in the stellar performance might find themselves poorly rewarded and on the other hand, poor performers in companies that are doing ok might find themselves over rewarded, as the valuation of the company might be more than the actual performance.

1.2 Need for a New Compensation Model

The studies cited above make the case for a new form of compensation model that takes into account a holistic appraisal of employee and company performance and includes other measures of rewarding employees for their performance. The point here is that financial measures are important more so because money is one of the primary motivators of employee performance. However, the measures have to be such that they are based on how the employee has performed instead of on how the market thinks the company has performed. Hence, the need for profit sharing and dividend accumulation in addition to stock options can be thought of as an alternative. In any case, stock options are usually given with a lock-in period ranging from two to five years and hence, the employees stand to gain only in the longer term as opposed to the shorter term.

1.3 Motivation and Financial and Non-Financial Rewards

All of us need to be motivated to get work done. We might be motivated by the lure of financial rewards like bonuses, pay hikes, and other monetary benefits. We also might be motivated by recognition, reward, fame, and glory. Thirdly, there are some of us who are motivated by the fulfillment that comes from doing a good job. Finally, we might be motivated by altruistic desires of helping society and building a better world. This is the model of motivation that has been described by the legendary organizational behavior theorist, Abraham Maslow. The different levels of motivation in each case correspond to the different life stages that an individual goes through and hence, the level of motivation and the drivers of motivation vary from individual to individual. The Hygiene theory makes the case for the presence and absence of motivators. In this theory, we would be demoralized if the motivators are not in place and when they are in place, the base level of motivation is guaranteed. Hence, the implications of the theories of motivation are that rewards (financial and non-financial) play an extremely important role in motivating individuals.

Given the background described above, organizations must evolve reward systems that motivate each individual according to his or her level of self-development and need for either monetary benefit or fulfillment imperative. In this context, it is important to note that many multinational companies have a financial component that motivates employees and a non-financial component like honoring the employees, publicizing their achievements, and making senior management talk to these employees for their contributions. The point here is that both financial and non-financial rewards are important for individuals to be motivated and organizations must design reward systems that take into account these aspects.

In many companies, it is the practice to earmark certain employees as those in the "Fast Track" or "High Potentials" and then devise specific reward systems for these employees. This is the practice in companies like Infosys where employees are identified early on and appropriate reward systems designed to ensure that they retain their motivation levels throughout their careers with the company. The important aspect here is that one need to stay focused and motivated throughout one's career and it is easy to lose focus and be demoralized at each stage of one's career. As those in the corporate sector would attest, once one loses focus and is distracted, the downward slope is swift and steep. After all, in many sectors, the last performance is the one, which counts, and hence, there is a need for individuals to stay focused throughout.

1.4 Excessive Executive Pay is the Problem

In recent years, the topic of excessive executive pay has been at the forefront of efforts to promote good corporate governance. This is because there have been understandable and genuine concerns about this aspect, which is leading to, some effects on the governance structures of companies. For instance, the CEO of Wal-Mart takes home a pay that is 150 times more than the lowest paid worker is. This is indeed a matter of concern as in an ideal scenario, the gap between the lowest paid worker and the CEO must not exceed double digits and that too within a multiple of 50. Further, the fact that greed leads people to do things that they would not otherwise do is a truism that has to be taken into consideration in this respect. Apart from this, excessive executive pay is having a corrosive effect on organizational cultures, which results in heartburn and a sense of powerlessness at the lower levels of the hierarchy.

1.4.1 Misalignment of Incentives

One of the reasons put forward for the ongoing global financial crisis is that the misalignment of incentives or the culture of unrestrained risk that was brought about due to greed manifested in the corrupt practices at the core of the financial crisis. The misalignment of incentives we are talking about relates to paying the bankers and the CEO's too, much, which led them to take greater risks in the hope of garnering ever-larger bonuses. As the aftermath of the crisis proved, with so much at stake and since the CEO's and the bankers are human after all, there was inevitable corruption starting from the top. Because the reward systems did not incentivize only performance measured in a broad index but rewarded humungous profits at the expense of everything else, there was a tendency to throw caution to the winds and indulge in risky behavior.

1.4.2 Some Strategies to curb Skyrocketing CEO Pay

A possible strategy to limit skyrocketing CEO pay would be to design a reward system that places performance at a premium but limits how much of it can be translated into monetary and non-monetary terms. For instance, making CEO's accountable for a broad range of performance measures like corporate responsibility, organizational dynamics like culture and wellbeing of employees, apart from profits and bottom line imperatives alone would be a reward system that is holistic in nature. Further, making the CEO's accountable to their shareholders in a more direct manner would place curbs on excessive CEO pay, which has been the topic of many heated debates in company AGM or Annual General Meetings.

2.0 FACTORS AFFECTING LEVELS OF PAY

2.1 Skills, Experience and Performance

This is the basic determinant of the pay that is given to an employee. This is the entry-level criterion wherein the skills of the employee are first determined and the pay fixed accordingly. Next, the performance of the employee during the appraisal period forms the basis for the salary hike and the bonus given to him or her. The point here is that when a person is hired, there is no way to determine whether he or she would fit within the company or would perform according to or exceed expectations. Hence, the skills and experience are used to determine the pay and subsequently the performance is used to hike the salary.

2.2 Position in the Hierarchy

I have discussed how the skills and performance of an employee is one of the determinants of pay. Apart from that, the position in the hierarchy is another key determinant of pay. For instance, in many companies, it is routine to raise the compensation by a quantum jump as soon as the employee is promoted to the managerial level. Further, there is a jump when the managerial level employee is promoted to upper middle management and senior management. What the companies are doing here is to reward these employees for making the successful transition from followers to leaders and from managers to executive positions. Hence, the position in the hierarchy is an important determinant of the level of pay that an employee receives.

2.2 Alignment of Attributes and Role

Perhaps the most important determinant of the pay given to an employee is the alignment between the individual's skills and attributes and the role that he or she is assigned. For instance, in many companies, a periodical evaluation of the match between the attributes and the role is carried out to determine whether the employee is doing justice to the role and whether the organization is doing justice to the employee by placing him or her in an appropriate role. After all, one cannot have the right person for the wrong job and the wrong person for the right job. In some companies, it is common for employees during the appraisal time to demand that they must be placed in another role and it is also common for the managers to move the employees into other roles. Indeed, as discussed in pervious articles, the match between the employee and the role is of crucial importance as the level of pay that an individual is getting depends on the role that he or she is playing. There is no point in rewarding nonperformers at a certain level when they are not delivering according to expectations. Similarly, there is no point in devaluing a performer by keeping him or her in a role, which is significantly lower than their skills and performance.

2.3 Reward Systems and Policies

Perhaps the most important aspect in any organization is the reward system in place. This is because employees are not providing their services for free and on the other hand, the organizations do not run a charity show.

What this means is that the contractual obligations between employees and organizations are about how much work is to be done and how much pay is to be paid for the work done. Hence, the reward policies must reflect this aspect. However, a significant aspect about the reward systems that is usually ignored is that employees have intrinsic needs other than monetary needs alone. This intrinsic need for recognition, better treatment, and rewarding of their good work forms the other pillar on which the reward system and the reward policies stand.

2.4 Monetary Reward Policies

The obvious and natural choice of any reward system is the provision of monetary incentives. This means that pay hikes, bonuses, and allowances that are monetary in nature play a key role in motivating employees. These extrinsic rewards cater to the basic needs of employees to sustain themselves and their families. An ideal reward system would provide for graded pay increases and bonuses that are in tune with industry best practices and are coordinated across the organization without discriminating against specific departments or divisions. Further, the monetary incentives should also not discriminate based on gender, ethnicity, or other aspects of identity. The reward policies must also take into account the fit between the employee and the role that he or she performs. There is no point in having a wrong person for the right job or a right person for the wrong job.

2.5 Non-Monetary Reward Policies

As discussed in the first section, a reward system that incentivizes the intrinsic needs of employees is an ideal system. This is not to say that extrinsic rewards like pay and bonuses are not important. Rather, the combination of external rewards and non-monetary rewards like recognition, awards, and publicity for the employee's good work is the key to actualizing performance. In other words, the ideal reward system manages to reward good performance both with monetary and non-monetary incentives. Some non-monetary rewards can also include benefits and benefits like memberships to exclusive clubs, company provided housing and transport, and advanced training and soft skill upgrading courses that motivate employees to self-actualize themselves. For instance, companies like Fidelity focus more on the package of benefits at senior levels, which includes a gamut of non-monetary rewards like the ones mentioned above. Further, periodical prizes and publicizing the efforts of top performers is done in many companies including IBM and Infosys.

3.0 DEVELOPMENT OF REWARD PROCESSES

The previous articles have discussed how reward systems must be put in place that would ensure that the internal skills and attributes of the employees are aligned with the external reward systems. This article discusses how reward processes have to be developed in organizations.

3.1 Involvement of Line Managers and HR

To develop effective reward systems, the line managers and the HR managers must act in tandem. What this means is that the development of the reward systems must not be left to the HR department or the line managers alone. This is because the HR managers would be able to take a theoretical stance whereas the line managers would be able to apply theory to practice and design reward systems that match the conditions of alignment and orientation. In particular, in the services sector there is a need for the direct managers of the employees to be involved in the process of development of reward systems as they would have the clear idea of what the work entails which the HR function alone cannot visualize.

3.2 Organizational Policies and Reward Systems

Broadly, speaking, organizational policies related to how employees are rewarded have a greater bearing on the development of the reward systems when compared with the inputs that the HR function and the Line Managers provide. In other words, the overall edifice of the reward systems stands on the foundation built by the organizational policies and the specifics are left to the HR function and the Line Managers. Of course, it goes without saying that whereas the basic components have to in tune with organizational policies, the variable pay and the components that are specific to individual bands of employees are at the discretion of the division or the group that the employees belong. Further, the yearly bonus and the pay hikes are again dependent on the organizational policies, which are broadly related to industry standards and the growth of the company in the previous year.

3.3 Reward Systems must be Market Oriented

The other aspect related to the development of reward systems is that they must be based on the prevailing market conditions and the demand and supply dynamics that the industry has with respect to demand for skills and availability of employees. Again, this is especially important in the services sector where competition for highly skilled employees is intense and hence the reward systems must reflect the market trends rather than what the organization thinks is a fair reward system.

4.0 EVALUATION OF REWARD PROCESSES

4.1 Need to Evaluate Reward Processes

It is one thing for organizations to institute reward processes and it is another thing for them to evaluate whether the reward processes are being effective. In other words, organizations need to constantly evaluate whether their reward processes are serving the purpose for which they were instituted. For instance, despite high salary and perks, if the attrition rate is high, then organizations must check whether the reward systems in place are effective to guard against attrition. Next, there are many organizations that have good reward systems but are not doing well in the marketplace. Third, if quality talent is migrating to other companies, then the affected organizations must review and evaluate their reward processes. The easiest way to do this would be to obtain feedback from the employees about whether they are satisfied with the rewards and whether their contributions are being matched by the rewards.

4.2 Ways to Evaluate Reward Processes

These satisfaction surveys and assessments done in a confidential manner can be effective sources of evaluation of the reward processes. The key aspect here is that blind surveys must be carried out which means that the identity of the employees must not be revealed or know to anyone except for the HR personnel. The other aspect about evaluating the reward processes are the exit interviews conducted when employees quit the company. These exit interviews can have questions about whether the organization's reward processes are adequate and whether the rewards are too low for the contributions of the employees.

The evaluation of the reward processes can be done from the organizational perspective as well which means that instead of only asking employees about the adequacy of the reward processes, organizations can conduct market rate surveys and engage consulting firms to evaluate their reward processes. For instance, an external evaluation of the reward processes in an organization is objective and unbiased and hence, can be used to improve or fine-tune the reward processes. Apart from this, matching reward systems with performance is usually the key to reward systems. An evaluation of this can be done by checking whether the high performers are being rewarded or whether quality talent is languishing because of lack of rewards for their performance.

4.3 Role of Organizational Politics

In many organizations, politics plays an important role in the rewards process and hence, this is a crucial aspect that cannot be ignored. Without saying so much as that politics should be avoided, the intention here is that there must be a balancing act between the competing interests for rewards and the desirability of rewarding talent. In other words, while the practice of playing favorites by managers cannot be ruled out completely, efforts must be made to ensure that a proper evaluation of rewards for the employees is done which precludes those who are victims from not leaving the company.

5.0 CONCLUSION

It is better for the rewards to include financial and non-financial incentives in the form of other perquisites and benefits like vacation sponsorship, memberships to exclusive clubs, and other perquisites that go beyond mere monetary incentives and instead, create a sense of belonging and ownership with the company. In conclusion, the field of rewards management is undergoing dramatic changes in the recent past and the future portends more changes in the way companies assess and reward performance.

Organizations must match the reward systems with the motivational needs of employees and hence, the package that they offer to potential and existing employees must be a mix of financial and non-financial rewards. As economists would point out, the role of incentives in motivating employees is indeed high and hence the right kind of incentives must be rolled out. It is not simply enough if companies keep raising the salaries or giving higher bonuses. It is also not enough if companies flatter their employees and publicize their achievements. The key aspect is the match between the rewards that are offered to the employee and his or her inner needs.

Given the fact that excessive CEO pay has deleterious effects on organizational health and that this has contributed in some measure to the ongoing global economic crisis makes a compelling case for limiting the CEO pay. The reward systems must be designed in such a way as to incentivize performance but not excessive risk. Finally, the reward systems must take into account the fact that the CEO alone does not make the company exist but it is the combined efforts of all employees that keeps the ship afloat.

I have discussed the factors that determine the level of pay. As can be seen from the preceding discussion, both qualitative and quantitative parameters are used to determine the level of the pay that is paid to the employee. A separate topic is executive compensation, which in recent years has been driven by market sentiment rather than these determinants alone. The topic of executive compensation has been discussed in other articles.

It is not enough if employees are paid handsomely or they are recognized. The ideal reward system would incentivize the employees to perform to their potential by matching their intrinsic needs with the external rewards. Many companies have put in place rewards systems and reward policies that recognize this aspect of fit between the different needs and the alignment of an employee's skills with that of the role that he or she is performing

The bottom line of any organizational process is whether it is effective and efficient. Hence, as with other organizational processes, reward processes must be evaluated for their effectiveness periodically. Only then would organizations have an idea whether their reward processes are doing the job.

Finally, the non-financial component of the reward systems is an aspect that is organization specific since each organization has its own way of incorporating reward and recognition systems that are non-monetary in nature. For instance, it is common for multinational companies to have liberal non-financial reward systems in the form of special events and celebrations in resorts, annual day awards that bring glory to the employees etc. Indeed, this is something that the manufacturing sector pioneered where the trend was to have non-financial rewards that were grand when compared to the base salary and financial incentives.

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