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Incentive Systems: Issues and Challenges

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Abstract: *This paper aims to study the fundamental issues in the administration and implementation of incentive schemes by Human Resource Department. Burack and Smith has defined an incentive scheme is a plan or programmes to motivate individual or group performance. An incentive scheme is frequently built on monetary rewards but may also include a variety of non-monetary rewards or prizes. The research uses a descriptive research design to explore employee's perceptions about incentive systems. The primary data is collected from 120 employees of organizations in Information Technology Enabled Services (ITES) Sector in Delhi Metropolitan Region using questionnaire. The questionnaire is analyzed with the help of mean analysis, cross tab, coefficient of variation and factor analysis. The data was analyzed using factor analysis. Data Analysis revealed four components that acts as challenges in implementation of competent incentive system in ITES sector are 'Timely implementation and communication of incentives', 'Transparency and monitoring of incentive schemes', 'Inequity and Relevancy' and 'Consistency'.*

Key Words: *Incentive system, HR functions, Implementation of incentive schemes, Challenges of incentive systems, ITES Sector.*

I. Introduction

Incentive systems refer to performance linked compensation paid to improve motivation and productivity of employees. They are designed to stimulate human efforts for improvement in the present and for the future goals. An Incentive is extrinsic reward that motivates an employee, manager and team to achieve business goals on top of their intrinsic motivation. It is a factor aiming to shape or direct behaviour of employees in the desired direction. Employees should be remunerated well for their dedication and determination towards work. Incentives are a subset of rewards. Incentive can help to create a climate of healthy competition within employees. Incentives motivate the employees to work harder as it encourages competition amongst the staff, which in turn creates a self-perpetuating increase in results and goal achievement. Further, it will reduce absenteeism and turnover. There are however, a number of disadvantages associated with incentives also. Sometimes if the employees feels that the incentive which were awarded were unfair then it can have negative affect as well on the employees' enthusiasm and can reduce their productivity. The sense of inequity can tremendously affect the emotions of an employee and it becomes very difficult for an organization to make their employees understand why this inequity has been created.

This study will try to explain the various issues faced by an organization in administrating and implementing competent incentive system. The research has been done on Information Technology Enabled Service (ITES) companies of Delhi Metropolitan Region but the results can be used and verified for other industries as well and for the companies situated in different regions. The aim of the study was to understand the underlying issues in administering the incentive system like conflicts, evaluation, transparency etc. On the basis of these factors questionnaire is made and administered with 120 employees of Information Technology Enabled Service (ITES) sector. The questionnaire is analysed with the help of mean analysis, cross tab, coefficient of variation and factor analysis. Cross tab shows details about how scores vary with gender and found that female are more satisfied with current incentives as compared to males. The grouping of variables is done by comprising all variables into 4 main components which are completely independent of each other through factor analysis. The four main components which are perceived to be main issue for administrating and implementation of incentive system are:

1. Timely implementation and communication of incentives,
2. Transparency and monitoring of incentive schemes,
3. Inequity and Relevancy and
4. Consistency (with respect to performance).

II. Review Of Literature

Moshik Lavie and Christophe Muller (2011), analytically investigates the incentive scheme of perpetrators of violent conflicts. It provides a rational equilibrium framework to elicit how monetary incentives and survival concerns shape a participant's decision to participate in a conflict. In the model, a leader decides to award soldiers with financial incentives. Civilians finance the militia via donations and soldiers decide on the

actual fighting and indulge in looting. Authors explored the scheduled decision-making that takes place on the path toward a violent conflict and study the principal–agent relationship that exists between the leader and the militia. In addition, they analyzed the effect of several internal factors (productivity and survival risk) and external factors (relative economic resources, opponents' military strength) on the intensity of the conflict. This research paper proposes the model in which the relationship was drawn between soldiers fighting decisions were set on the basis of personal mortality risk and the level of identification with the cause of war. Further, the results were linked between monetary incentives and participation in fighting and demonstrate a substitution effect of looting and donations as monetary incentives.

According to Allison A. (2010) stated that while executing an incentive plan, various concerns are needed to be confirmed that the plan becomes successful. However, it is important to note that incentive plans cannot ensure employee productivity; it must be coupled with effective human resources practices in order to ensure a successful work environment. HR practices like suitable reward system, inaugurating all-inclusive performance management systems, extensive and effective communication are to be kept in mind with incentive systems and also the top management should support the compensation plan.

Jayant Kale (2009) studied the issue of managerial retention by examining the relation between managerial incentives and voluntary turnover. Author's research has found that firms have a higher inequality in their compensation schemes were more likely to have higher turnover rate. Author has also studied that mangers not only compare their compensation internally with their peers but also they compare in the markets as well. Both internal and external factors are responsible for the turnover rate. The likelihood of resignations is also affected by the mix of short-term and long-term compensation, equity ownership in the firm, and the overall level of compensation inequality among top executives.

Dan Ariely (2006) stated that employees are paid as per their performance in various types of jobs, which is usually seen as an enhancing factor for productivity of an employee in comparison to the employees who are receiving non contingent pays. However, psychological research suggests that excessive rewards can also result in a decline of performance. Research has been conducted as a set of experiments in the U.S. and in India to test whether very high monetary rewards can decrease performance. In this research the subjects worked on were different tasks and received performance-contingent payments that varied in amount from small to very large relative to their typical levels of pay. With some important exceptions, very high reward levels had a detrimental effect on performance. These results challenge the assumption that increases in motivation would necessarily lead to improvements in performance.

Martin Holtmann and Mattias Grammling (2005) Well-crafted incentive schemes can have positive and powerful effects on the productivity and efficiency of the employees. Conversely poorly developed schemes can have serious negative effects. Incentive schemes must be transparent so that employees who are directly affected can easily understand the calculation of payments. Thus the system should not be overly complex. Furthermore, the "rules" should be made known to everyone and should not be changed arbitrarily. In addition, it is essential that the incentive scheme should be perceived fair, so that the goals set out by the scheme must be attained, and better performing employees must indeed be rewarded with higher salaries. Author explains the golden rule that everyone must be able to achieve a higher compensation by working better and harder.

Ruth W. Grant and Jeremy Sugarman (2004) had conducted a research which considers that whether there is ethical appropriateness of doing research in incentives with human subjects or not. Authors have worked on determining whether incentives are considered unethical form of undue influence or coercive offer. Research explains that understanding the ethical issue of undue influence. By doing so author found that, for the most part, the use of incentives to recruit and retain research subjects is harmless but in some cases like incentives become problematic when conjoined with the following factors, singly or in combination with one another: the subject is in a dependency relationship with the researcher, where the risks are particularly high, where the research is degrading, where the participant will only consent if the incentive is relatively large because the participant's aversion to the study is strong, and where the aversion is a principled one. The factors were identified and the kinds of judgments they require differ substantially from those considered crucial in most previous discussions of the ethics of employing incentives in research with human subjects.

Edwin A. Locke (2004) stated that, every experienced executive knows the importance of rewarding good performance and also how difficult it is to design an incentive system that works as it is supposed to. A recent article in the Wall Street Journal reported that Hewitt Associates found that 83 per cent of companies with a pay-for-performance system said that their incentive plans were "only somewhat successful or not working at all."

III. Research Methodology

3.1 Research Design and Sampling

The research design taken for this study was descriptive in nature. Quantitative research was used in the study. All the employees who were provided with incentives are the universe sample for study. Sample unit which is taken for this study is a single respondent who was working in the private sector in ITES companies and who receives incentives in their pay structure.

3.2 Sampling Technique and Sample Size

Convenience sampling is used in the study. Pilot study was conducted by taking sample size of 30. Pilot study showed that all the responses are valid and the questionnaire is reliable. Later, the sample for this study was 120 respondents from Information Technology Enabled Services (ITES) Sector operating in NCR region. Firstly, the questionnaire was distributed to employees. The filled questionnaire were received back and analysed.

3.3 Tool for Data Collection

Primary data as well as secondary data were collected for the study. The tool for primary data collection was Questionnaire filled by the employees to explore their perception on incentive systems. Questionnaire is used to analyse issues underlining in administering competent incentive systems. The questionnaire consisted of close ended questions which helped the researcher in knowing their views on aspects of incentive system. For the purpose structured questionnaire was formed. A five point Likert scale is used on the scale of 1-5 where 5: strongly agree while 1: strongly disagree. Secondary data was collected from Journals, research papers, articles, and internet.

IV. Data Analysis

Descriptive statistics in the form of arithmetic means and standard deviations for the respondents were computed for the multiple dimensions that have been assessed through the questionnaire are presented in Table 1. “I believe there is no monitoring on implementation of schemes” has the highest mean which states that the particular statement is agreed by maximum people whereas “I believe incentives are main reasons of jealousy and conflicts in the organization” has the minimum mean value which states that this statement has been agreed by least number of people.

Table 1: Descriptive Statistics Showing Mean and Standard Deviation

Descriptive Statistics			
Statements	**Mean**	**Std. Deviation**	**Analysis N**
The deliverable on my work is defiantly because of incentives I receive.	2.8000	1.192413	120
I believe incentives are never implemented in the company.	2.5500	0.89677	120
I believe incentives are not communicated to employees	2.5000	1.12014	120
I believe most of the employees remain unaware of the incentive schemes.	2.9000	0.99916	120
I believe there is no clarity in the schemes of incentives.	3.4000	1.18393	120
I believe there is an inequity with delivery of incentives.	3.3000	1.08155	120
I believe there is a lag of time between preferred incentives and reward relationship	3.2500	1.04721	120
I believe the incentive schemes are not relevant to job holders need.	3.6000	1.24617	120
I believe there is no monitoring on implementation of schemes.	**3.8750**	0.93091	120
I feel KPA/KRI`s never kept in mind while designing the incentives.	3.0000	1.32842	120
I believe biasness and prejudice are major hindrance for the incentive implementation.	3.0500	1.38327	120
Incentives have made me more reluctant to change my job	3.4750	0.92548	120
I believe there is a lack of transparency in administration of incentives.	2.7500	1.20398	120
I believe incentives are main reasons of jealousy and conflicts in the organization.	2.3500	1.15700	120
I feel incentives exert continuous impact on my performance	2.9250	1.10888	120

Table 2 indicates that females are more satisfied with the incentives as compared to males as most of the females (28 out of 45) having scores less than median. Whereas most of the males (that is 49 out of 75) are showing scores which are above the median value. This shows that males are not satisfied with the current incentive system as compared to the females. Same questionnaire was given to all the employees considered in a sample but the response of female employees regarding the incentive systems were more positive in comparison to male employees.

Table 2: Cross-Tab between Gender and Score of Respondents

		Gender		
		Male	**Female**	**Total**
Scores	less than median value	26	28	54
	median or more than median value	49	17	66
Total		75	45	120

The coefficient of variance which shows variance of a variable or question within the sample and can be compared to other statement or variables is represented in Table 3. For example: 'I believe there is no monitoring on implementation of schemes', this statement has least coefficient of variance which means that sample has shown maximum consent on this variable. This statement can be ranked as 1. Whereas 'I believe incentives are main reasons of jealousy and conflicts in the organization' can be ranked as 15 as it has the highest coefficient of variance which means for this statement sample has not shown a consensus. Sample has given mixed responses for this variable. Thus all statements or variables are ranked according to their coefficient of variance.

Table 3: Coefficient of Variance and Rank

Statements	**Coefficients Of Variance**	**Rank**
I believe there is no monitoring on implementation of schemes.	**0.239**	1
Incentives have made me more reluctant to change my job	0.266	2
I believe there is a lag of time between preferred incentives and reward relationship	0.323	3
I believe there is an inequity with delivery of incentives.	0.328	4
I believe most of the employees remain unaware of the incentive schemes.	0.344	5
I believe the incentive schemes are not relevant to job holders need.	0.347	6
I believe there is no clarity in the schemes of incentives.	0.348	7
I believe incentives are never implemented in the company.	0.35	8
I feel incentives exert continuous impact on my performance	0.378	9
The deliverable on my work is defiantly because of incentives I receive.	0.425	10
I believe incentives are not communicated to employees	0.44	11
I believe there is a lack of transparency in administration of incentives.	0.436	12
I feel KPA/KRI`s never kept in mind while designing the incentives.	0.443	13
I believe biasness and prejudice are major hindrance for the incentive implementation.	0.45	14
I believe incentives are main reasons of jealousy and conflicts in the organization.	**0.492**	15

KMO and Bartlett's test is computed and is represented in Table 4. This test gives forcibility of data into a particular component. A measure of forcibility of greater than 0.5 indicates that acceptable level of forcibility. The value of 0.661 indicates good level of forcibility of data to proceed for factor analysis.

Table 4: KMO and Barlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		0.661
Bartlett's Test of Sphericity	Approx. Chi-Square	1713.476
	Df	105
	Sig.	0

Communalities were computed and are represented in Table 5. Communalities indicate the amount of variance in each variable that is accounted. Extraction communalities are estimates of the variance in each variable accounted for by the components. All the values of communalities in this table are high, which indicates that the extracted components represent the variables well.

Table 5: Initial and Extraction Communalities

Communalities		
	Initial	**Extraction**
The deliverable on my work is defiantly because of incentives I receive.	1.000	0.801
I believe incentives are never implemented in the company.	1.000	0.834
I believe incentives are not communicated to employees	1.000	0.833
I believe most of the employees remain unaware of the incentive schemes.	1.000	0.784
I believe there is no clarity in the schemes of incentives.	1.000	0.848
I believe there is an inequity with delivery of incentives.	1.000	0.775
I believe there is a lag of time between preferred incentives and reward relationship	1.000	0.835
I believe the incentive schemes are not relevant to job holders need.	1.000	0.795
I believe there is no monitoring on implementation of schemes.	1.000	0.822
I feel KPA/KRI`s never kept in mind while designing the incentives.	1.000	0.569
I believe biasness and prejudice are major hindrance for the incentive implementation.	1.000	0.768
Incentives have made me more reluctant to change my job	1.000	0.759
I believe there is a lack of transparency in administration of incentives.	1.000	0.940
I believe incentives are main reasons of jealousy and conflicts in the organization.	1.000	0.349
I feel incentives exert continuous impact on my performance	1.000	0.752

KPA: Key Performance Area**, KPI:** Key Performance Indicator

Total variance was computed and is represented in table 6. The left most third section of the table contains initial Eigen values: the Eigen values of all possible components. The components are ranked in order of how much variance each component is account for. There are 15 variables or statements entered into the analysis, but that doesn't mean each variable is a component. For each variable, the total variance that it explains expressed as a percentage of all the variance. The middle part of the table contains information for those components with Eigen value more than 1: in Table 6 there are such 4 components. The value 76.434 implies that four extracted components as per shown in table explains 76.434% of the variance.

Table 6: Total Variance Explained

Component	**Initial Eigenvalues**			**Extraction Sums of Squared Loadings**			**Rotation Sums of Squared Loadings**		
	Total	**% of Variance**	**Cumulative %**	**Total**	**% of Variance**	**Cumulative %**	**Total**	**% of Variance**	**Cumulative %**
1	5.180	34.534	34.534	5.180	34.534	34.534	4.015	26.766	26.766
2	3.521	23.472	58.006	3.521	23.472	58.006	3.608	24.050	50.816
3	1.470	9.798	67.804	1.470	9.798	67.804	2.388	15.918	66.734
4	1.295	8.630	76.434	1.295	8.630	**76.434**	1.455	9.700	76.434
5	.910	6.070	82.504						
6	.828	5.521	88.025						
7	.596	3.971	91.996						
8	.401	2.675	94.670						
9	.255	1.697	96.367						
10	.176	1.175	97.542						
11	.152	1.015	98.557						
12	.076	.505	99.062						
13	.064	.427	99.489						
14	.052	.347	99.835						
15	.025	.165	100.000						

Figure 1: Screen plot showing Eigen values of questions

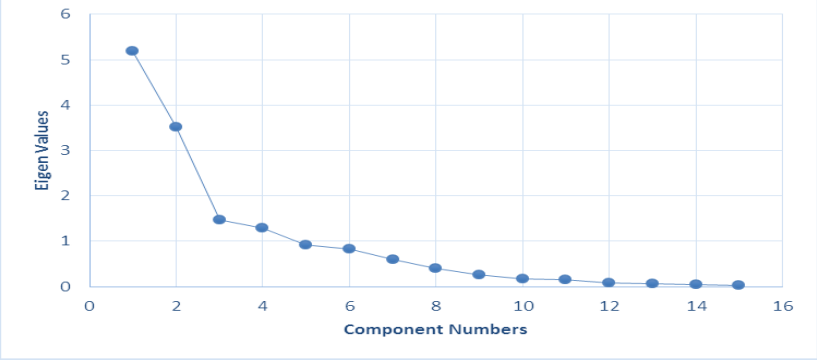

Fig 1 shows variables that are having Eigen values greater than 1, representing steep part of graph. Thus, the factors having values greater than 1 can be extracted as independent factors from the graph. The factors with the largest eigenvalue have the most variance and, down to factors with small or negative eigenvalues are usually omitted from solutions. Factors with eigenvalues of 1.00 or higher are considered to be worth analysing. A scree plot is interpreted as follows: the number of factors appropriate for an analysis is the number of factors before the plotted line turns sharply right.

Table 7 shows rotated component matrix which explains the variable fits better in which component for example for Ques1 that is 'The deliverable on my work is defiantly because of incentives I receive' highest value among all components is for component number second that is 0.676. This variable fits best in component 2 group. In the same way for the last statement 'I feel incentives exert continuous impact on my performance' maximum rated value is 0.857 and this value lies in component 4. Thus this statement is grouped with the variables of component 4. In the same way grouping is done for all 4 components.

Table 7: Rotated Component Matrix

	Components			
	1	**2**	**3**	**4**
The deliverable on my work is defiantly because of incentives I receive.	0.077	**0.676**	0.516	-0.269
I believe incentives are never implemented in the company.	**0.866**	0.110	0.102	-0.248
I believe incentives are not communicated to employees	**0.873**	-0.092	0.204	0.145
I believe most of the employees remain unaware of the incentive schemes.	**0.785**	-0.266	0.085	-0.300
I believe there is no clarity in the schemes of incentives.	**-0.857**	-0.318	-0.082	-0.076
I believe there is an inequity with delivery of incentives.	-0.119	0.085	**-0.868**	0.012
I believe there is a lag of time between preferred incentives and reward relationship	**0.620**	0.193	0.501	0.404
I believe the incentive schemes are not relevant to job holders need.	0.495	0.041	**0.661**	-0.333
I believe there is no monitoring on implementation of schemes.	0.262	**-0.800**	0.034	-0.334
I feel KPA/KRI`s never kept in mind while designing the incentives.	-0.156	**0.539**	-0.504	-0.028
I believe biasness and prejudice are major hindrance for the incentive implementation.	-0.076	**-0.873**	0.026	-0.008
Incentives have made me more reluctant to change my job	0.343	**0.771**	-0.025	0.214
I believe there is a lack of transparency in administration of incentives.	0.531	**0.630**	0.479	0.177
I believe incentives are main reasons of jealousy and conflicts in the organization.	0.006	**0.467**	-0.353	-0.078
I feel incentives exert continuous impact on my performance	-0.068	0.097	-0.059	**0.857**

KPA: Key Performance Area**, KPI:** Key Performance Indicators

Data is analysed by means of principal component analysis and is shown in Table 8. The components that can be thought of as representing four different HR challenges are:

1. Timely implementation and communication of incentives,
2. Transparency and monitoring of incentive schemes,
3. Inequity and Relevancy,
4. Consistency (in relation to impacting performance

Table 8: Principle Component Analysis

Component 1	**Component 2**	**Component 3**	**Component 4**
0.873	-0.873	-0.8680	0.857
0.866	-0.800	0.661	
-0.857	0.771		
0.785	0.676		
0.620	0.630		
	0.539		
	0.467		

The most important challenge in front of HR professionals is component 2 that is Transparency and monitoring of incentive schemes as it has maximum number of variables under it.

V. Conclusions

An HR manager should keep in mind various steps in administration and implementation of incentive schemes. Development of incentive schemes should be relevant to the needs of employees and could be achieved by asking the employees to design their own incentives which can give clear idea about needs of employees. These schemes should be properly communicated to line managers and employees by clarifying them two points: how company value their contribution & what company are paying for. Basic training should be provided to all line managers regarding incentives. These schemes should be communicated timely without any gap between performance and reward relation. After designing incentive schemes it can be implemented by

thorough communication between the organization and employees. Incentives should be audited regularly to assess its effectiveness. Its relevancy to the present and future needs should be periodically checked by monitoring internal and external relativity. If incentives are properly communicated; implemented, continuously improved and employees feel that their organization is fair as per their pay and performance, it can lead to retention of employees and high productivity.

VI. Implications For Future Research

In order to derive any conclusions on issues underlying administering of competent incentive system, different samples from various organizations are needed to test to make the instrument standard. Secondly, interviewing the managers to know what could be done to minimize the discrepancies related to incentives. Third, developing a framework with the help of certain policies, procedures and methods to create a positive perception about incentives among the employees.

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