University of Economics, Prague

# Master's Thesis

2016                                                    Lukas Novotny

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Title of the Master´s Thesis:

# Reward Management in a small IT Business

Author:                Lukas Novotny

Supervisor:           prof. Ing. Zuzana Dvořáková, CSc.

## Declaration of Authenticity

I hereby declare that the Master´s Thesis presented herein is my own work, or fully and specifically acknowledged wherever adapted from other sources. This work has not been published or submitted elsewhere for the requirement of a degree programme.

Prague, December 8, 2016                                                                Signature

**Title of the Master´s Thesis:**
Reward Management in a small IT Business

**Abstract:**

The topic of this thesis is reward management and its application in a small-sized IT enterprise. Its goals are to properly document and describe current reward system in the company, evaluate the system and recommend improvements for the system. The first two goals are reached via thorough research of the company through semi-structured interviews, employee satisfaction survey, participant observation and document examination and the last one by applying principles from the current literature and education to the results of the two previous goals. The findings are that the reward system, despite growing organically instead of designed, is relatively effective in some areas, but needs improvement in other areas. The main improvement areas are motivation by contingent pay, communication management and performance management. Relatively well working rewards are especially non-financial reward connected to the work environment and work itself.

**Key words:**
HRM, reward management, reward systems, work motivation

# Contents

# Introduction

Reward management is a topic that affects almost all of us, one way or another. Most of us will never have to design or operate a reward management system, but essentially everybody will experience some form of reward management; be it at work or more broadly elsewhere in their daily life. Which is why I find this topic both important and interesting.

Additionally, the company that this thesis was essentially written for had a real issue. They knew something was wrong with their reward management and the way it motivates and satisfies people, yet being a relatively small company they lacked a dedicated resource to solve this issue. That is why an agreement was reached on a synergic relationship where the company obtains the analysis and solution it needs and the author gets real hands-on experience applying his own (and researched) knowledge.

That is why the topic of this thesis is to explore and evaluate a reward system in a small-sized Czech IT company.

The thesis, if properly thorough and applicable, is to be a first part of a reward system improvement project in the company, specifically the analysis. The reasoning behind that is that a currently unavailable amount of knowledge and expertise is necessary to properly document and evaluate the current system, based on which the design of a better system and finally implementation can be built.

The goals of the thesis stem from this purpose and are the following:

- Document and properly describe current reward system in the company
- Evaluate the current system both from theoretical and the employees' perspective
- Suggest initial improvement opportunities that can be taken into account in the design phase

The thesis consists of three parts: Practical part, Methodology and Practical part.

In the Practical part the current research and ideas that permeate the topic of reward management are presented. First the overview of motivation and its impact in a business setting from psychological perspective is explored as a foundation for many HRM frameworks. Then essential HRM and reward management concepts are presented in order to be able to build up a well-functioning reward system from nothing. These are psychological contract, total reward and reward strategy. Finally, explicit parts of the reward system, that is the topics of contingent pay, non-financial rewards, employee benefits and non-financial rewards are presented in detail as they are essential for the actual design of the reward system.

In the methodological part the way that the data for research purposes are collected and the reasoning behind their utilization. Especially employee survey, semi-structured interviews and participant observation will be discussed.

The final Practical part is meant to synthesise the outcome of both research and literature overview, present and evaluate the current condition of the reward system in the company and offer initial improvement recommendations. It is divided into three parts: First, the company under scrutiny is described including its size, market and structure. Second, its reward system is described via tools and concepts discussed in the theoretical part. Third the data gathered through research described in the second part are presented. Finally, the evaluation of the current situation is shortly summarised and improvement initiatives are recommended.

# 1     Theoretical part

In this part, all the necessary concepts, frameworks and data that will be built upon in the Practical part are introduced and presented. It is for all intents and purposes a literature overview.

The theoretical part begins broadly with introduction of motivation and psychological contract and their implications on reward management from psychological perspective. Then the purely HRM concepts of total reward and reward strategy are introduced. Following chapters are dedicated in turn to discussion of various available components of total reward. I.e. Base pay, contingent pay, employee benefits and finally non-financial rewards.

## 1.1   Motivation

This chapter first introduces necessary concepts of motivation and its sources, then moves on to work motivation and finally shortly introduces ways of measuring motivation in a work setting.
The purpose if this chapter is to provide a framework and explanations that are referred to in the following chapters.

### 1.1.1  Motivation of human endeavour

Armstrong defines motivation and its effect on people thusly:

 "A motive is a reason for doing something – for moving in a certain direction. People are motivated when they expect that a course of action is likely to lead to the attainment of a goal – a valued reward that satisfies their particular needs. Well-motivated people are those with clearly defined goals who take action that they expect will achieve those goals. "(Armstrong, 2006, p. 120)

From a wider perspective, the term motivation conveys the message that the human psyche is influenced by specific impetuses (motives) that are not always conscious or acknowledged. These motives focus or orient the human endeavour in a certain way or direction, then activate and fuel the effort in that direction. From the outside perspective, the effect of these motives is seen as a motivated activity. (Bedrnová, E., Jarošová, E., & Nový, I., et al., 2012, p. 226)

According to Bedrnová et al. (2012, p. 226) a key attribute of motivation is that people are influenced in three dimensions.
Dimension of direction focuses one's attention and then action in a certain direction and therefore away from other direction. This essentially answers the question: "*What* do I want?".
Dimension of intensity expresses the amount of energy one is willing to put into activity in a certain direction. It can be summarized by the question: "*How much* do I want it?"
Lastly dimension of persistence signifies how one reacts to adversity and both internal and external obstacles. High persistence means that one continues to act in a certain direction with the same level of intensity despite adverse obstacles or conditions.

It is vital then to define what a motive is. Bedrnová et al. (2012, p. 227) describe motive as a single internal psychic force. It can be understood as a single psychological reason for a certain behaviour that gives the behaviour a meaning and mediates its experience. The general aim of a motive is to reach certain final psychic state of satiation.

There are two types of motives: Terminal and instrumental.

Terminal motive is closely linked with an ultimate objective, on the other hand an instrumental motive does not have objective as such, but motivates toward certain long term activities (e.g. interest in HRM).

The key point about motives is that there are usually many motives influencing one's behaviour at the same time and these cannot be easily analysed or separated.

Final concepts to be explained in this subchapter are that of stimulation and stimulus.

Bedrnová et al. (2012, p. 228) define stimulation as an external influence on human psyche which produces certain changes in internal psychological processes especially in motivation. The difference then is that a stimulation is an external force as compared to motivation which is usually considered to be internal (see subchapter 1.1.3.).

Stimulus is any impulse that creates changes in one's motivation. It is sometimes divided into impulses, which are endogenous such as headache or exhaustion and incentives which are exogenous such as in our setting positive feedback or monetary reward. Naturally incentives are the focus of the business literature as something that the business can influence directly.

### 1.1.2 Sources of motivation

Now that we have defined motivation and motives in order to be able to understand and ultimately manipulate them we need to know where they come from. Bedrnová et al. (2012, pp. 228 -232) argue that there are 5 main sources of motivation and motives: Needs, habits, interests, values and ideals.

**Needs**

Needs are understood as a felt lack of something that is subjectively important for the person. It creates a feeling of tension which incites tendencies to dispose of that tension. The goal is usually to get rid of the need by its saturation.

Needs are usually divided into primary, that is biological or physiological (e.g. need to eat, drink, breathe) and secondary or social (e.g. need for self-realization, dominance).

It is also important to note that needs can also be divided in conscious and unconscious, i.e. it is entirely possible to feel a need but be unaware what exactly one needs.

Habits are certain repeated, automated actions that are usually repeated under certain circumstances.

According to Duhigg (2012) habits consist of three elements: cue, routine and reward. By creating a neurological pathway between the cue and the reward habits create intrinsic motives that are usually not even controlled or allowed by the person. Habits can arise both from nurture as well as one's formative activities.

**Interests**

Interest is a sustained focus on certain area which influences activity usually in a longer term. Bedrnová et al. (2012, p. 230) concludes that although interest is sometimes seen a source of motivation it is also often understood as motive by itself and states that the most important point of interests is the knowledge that they exist and influence one's decisions.

**Values**

Values are in business settings often considered to be a way of promoting a company and influencing its workforce, but we must not forget that all these come originally from human values. Everybody views the world through his personal subjective viewpoint, events are assigned importance, meaning and urgency that is judged or evaluated. Values is how we estimate this subjective importance.

It is important to note that firstly most of these evaluations are unconscious and very often we do not even know the true reason behind such evaluations or even notice the evaluation (Haidt, 2006). Secondly a value for a specific person can be almost anything and it is not necessarily easy or even possible to observe from the outside.

**Ideals**

Ideal is a certain idea or an ultimate condition that is subjectively needed, positively evaluated and which represents final objective or goal of one's striving. As with values ideals can be vastly different for different people, but a common characteristic is that ideals usually arise from groups and are shared by them.

### 1.1.3 Work motivation

All the theories of motivation are certainly interesting, however the most important to the HR practitioner is specifically the work motivation. That is the motivation to carry out work.

According to now classic work of Herzberg, Mausner and Snyderman (1959) The Motivation to work, there are two main types of work motivation: Intrinsic motivation and extrinsic motivation.
Intrinsic motivation refers to the "the motivation through work itself" (Herzberg et al., 1959). Which refers to motivation that essentially emerges from within oneself, such as need for autonomy, freedom to act or a chance to use or develop one's skills. Intrinsic motivation is usually harder to affect from the outside, but is thought to be stronger and more persistent (Armstrong, 2006, p. 121).
Extrinsic motivation is a motivation that comes from external factors and not from the work itself. Typically the most common is the need for money and security, but there are also other such as need for social contact or need for belonging. Extrinsic motivation is naturally easier to affect and is supposed to have strong immediate effects, but with low to no persistence (Armstrong, 2006, p. 121).

During the last century, many theories of the operation of work motivation have been proposed; In the following section the most relevant ones are summarised.

## Instrumentality theory

The oldest of presented theories, its roots lie in the Taylor's scientific management method. Instrumentality is the belief that if one does a certain thing it will lead to another (Taylor, cited in Armstrong, 2006, p.254). In its purest form, it proposes that employees will work purely for money and the effort they expend will be directly proportional to the monetary reward they receive (as long as the reward is linked directly to effort).
The theory has been heavily criticised due to its ignorance of any factors outside of monetary reward (Armstrong, 2007, p. 111).

## Reinforcement theory

Theory based on the work of Ivan Pavlov (of the learned reflex fame) and later B. F. Skinner and E. L. Thorndike it is in its conclusions very similar to the instrumentality theory. It proposes that people behaviour with pleasurable outcome is likely to be repeated and behaviour with unpleasant outcome is unlikely to be repeated. Through the process of learning the person (or in most of these studies an animal) learns which outcomes to repeat and which to disregard.
It's business implications are that rewards do motivate performance, rewards must follow right after the behaviour, behaviour that is not rewarded will not be repeated and increasing or decreasing reward will substantially affect performance.
The theory has been largely disregarded in business context for its unlikely assumptions of purely animal-like behaviour and ignorance of any intrinsic factors. (Shields, 2007, pp. 76 – 77)

## Maslow's hierarchy of needs

Although not strictly work motivation theory the Maslow's hierarchy of needs is worth mentioning as the most well-known theory of motivation in general. Maslow proposes that needs create a tension which is eliminated by the satisfaction of the need. The needs are mostly nature, but nurture also plays a role and the needs can vary up to a degree from person to person.
The key message of Maslow's theory is that needs must be satisfied in certain order (see figure 1.1).
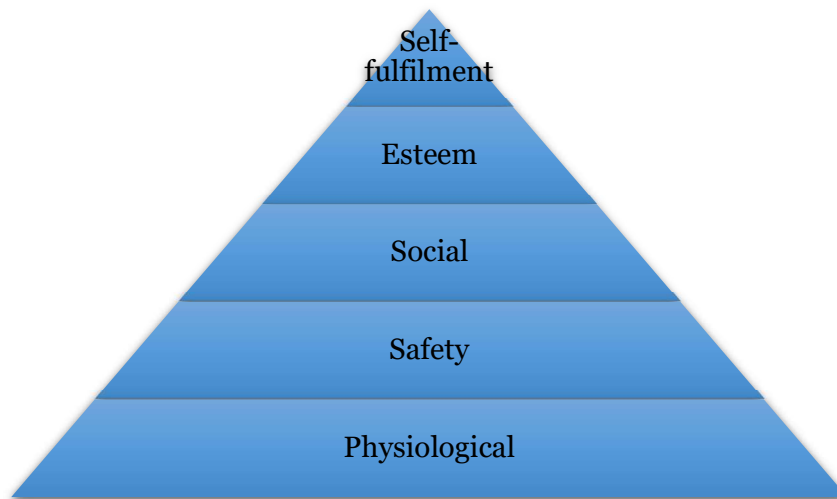
Figure 1.1 Maslow's hierarchy of needs
Source: adapted from Bedrnová et al., 2012, p. 96

## Herzberg's two-factor model

The second most cited theory after Maslow's hierarchy, the two-factor model proposed two sets of factors based on their effect on motivation: Dissatisfiers and satisfiers (Bedrnová et al., 2012, pp. 246).
Dissatisfiers (also called hygiene factors) are mostly external factors such as working environment or monetary reward that do not motivate, but if they cause dissatisfaction if absent or unsatisfactory.
Satisfiers (also called motivators) are mostly internal factors such as development, work itself or responsibility that if present actually motivate and if lacking do not cause dissatisfaction.
The theory has criticised frequently for its logical flaws, but still remains one of the most influential work motivation theories. (Armstrong, 2006, pp. 263)

## Harter's competence motivation theory

Originally created by R. W. White and elaborated and developed by S. Harter (1978), the theory proposes that people from the very young age desire to have a lasting effect on the environment which they do through competency.
Adults specifically desire to prove their professional competences in order to acquire respect, recognition and admiration from their peers.
The key managerial implication of Harter's theory is that employees should be given tasks slightly more difficult than their current skill level to be kept motivated and also develop (Bedrnová et al., 2012, pp. 247).

## McClelland's human motivation theory

McClelland (1988) proposes that people have three basic needs that motivate them: Need for achievement, need for affiliation and need for power.
Based on the theory each person has a dominant need, that dictates much of that person's actions.
The theory has attracted both theoretical and practical interest as the needs can be measured and applied to job selection. For example people with high need for achievement usually volunteer for difficult tasks, take personal responsibility and

require feedback while people with low need for achievement take on tasks that they are certain to successfully complete in order to avoid risk of failing (Bedrnová et al., 2012. Pp. 249).

## Equity Theory

The key concept of the equity theory as proposed by J. S. Adams is the phenomenon of social comparison. An employee tends to compare her work effort and qualifications (inputs) to that of her colleagues (with comparable job) and then compare the rewards (outputs) that she receives compared to them. If they perceive inequity they will be demotivated and if not they will stay motivated or neutral (Adams cited in Armstrong, 2007, pp. 126 – 127)

The key business implication is that rewards should be performance based and "just". Also, if one employee's performance is weaker, yet she receives the same rewards it will likely result in demotivation of the whole workgroup, i.e. there is a need to eliminate the free rider problem (Bedrnová et al., 2012, p. 249).

## Expectancy theory

Expectancy theory, which was originally proposed by V. Vroom, is regarded by many as the most practically usable motivation theory (Shields, 2007, p.77).

Its key assumption is that work behaviour is determined by likely consequences of such behaviour. I. e. it is based on the anticipated actions and rewards. More specifically in Vroom's model motivation depends on three subjectively evaluated properties: Valence, Instrumentality and expectancy.

Valence is the value that the employee places on the reward.

Instrumentality is the perceived link between performance and reward, i.e. the degree to which the employee believes that the behaviour will result in the reward.

Expectancy is the link between effort and performance, i.e. the probability that given effort will lead to necessary performance. It is essentially based on employee's confidence in her abilities.

The Vroom's model is summarised in figure 1.2



Figure 1.2 Original expectancy theory
Source: adapted from Shields, 2007, p. 78

The managerial implication is that effective contingency reward must maximise all three components. In other words, there must be a clear and plausible link between reward and effort, the value of the rewards must be seen as being worth the effort and the effort must be achievable. Another implication is that intrinsic motivation is often stronger, because its elements are more under control of the employee, although the theory does not distinguish between intrinsic and extrinsic motivation (Armstrong, 2007, p. 125)

The expectancy theory was further extended by Porter and Lawler to incorporate equity theory and further elements (Porter and Lawler cited in Shields, 2007, p. 79). All the elements are summarised in figure 1.3.
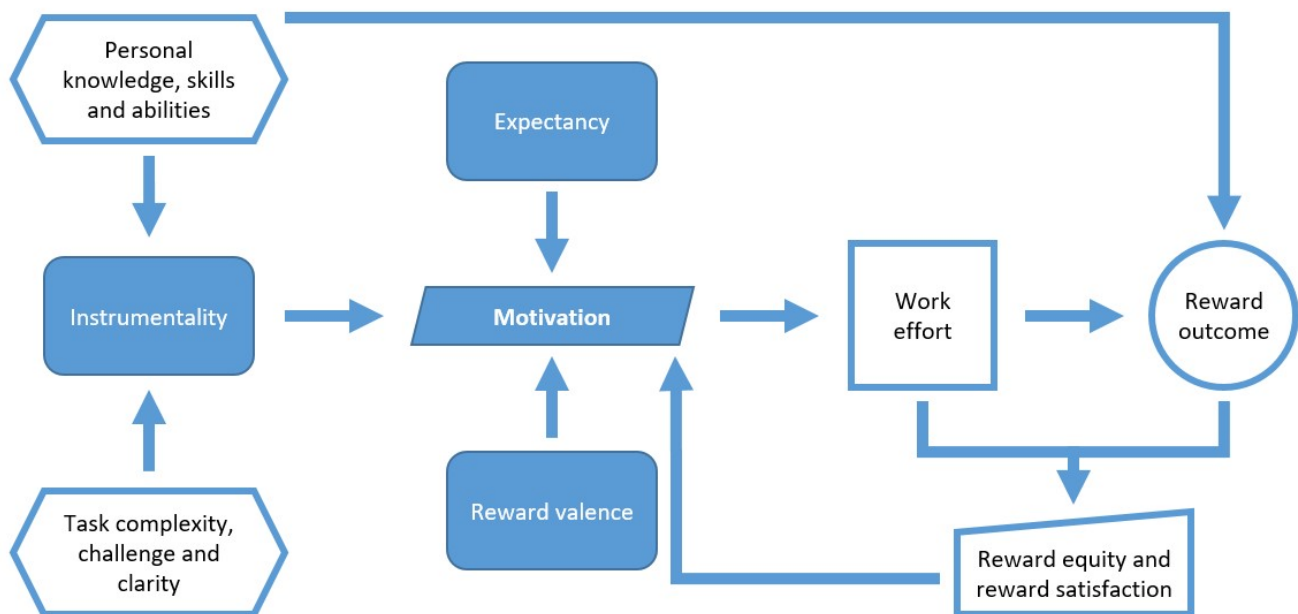


Figure 1.3 Extended expectancy theory
Source: adapted from Shields, 2007, p. 79

Firstly, the feelings of what is equitable or fair reward are compared to the actual reward to determine level of reward satisfaction and therefore motivation.
Secondly, Porter and Lawler take into account actual capabilities of the employee (as opposed to just employee's opinions) and the attributes of the task which affects the instrumentality (Shields, 2007, p. 79).
The key business implications are then that there must be a clear and plausible link between effort and reward, the task must be well defined and reasonably challenging and the rewards must be fair and equitable in work settings.
Despite the theory's perceived usefulness there are certain criticisms. As mentioned earlier it does not distinguish between intrinsic and extrinsic motivation, it assumes that work behaviour is rational and premediated, which it is more often not and it just assumes different valences without explaining how to determine individual valence (Shields, 2007, p. 79).

**Goal-setting theory**

Theory developed by E. Locke and G. Latham, it has come to occupy central position in both academic and practitioner thinking about motivation and performance (Shields, 2007, pp. 80 – 82).
The summary of the theory's elements can be seen in figure 1.4.
A goal per Latham and Locke (as cited in Shields, 2007, p.80) is "a level of performance proficiency we wish to attain within a specified time period".
It proposes then that employees will be most highly motivated when following conditions are satisfied: Specific and challenging goals are agreed upon, there is a strong commitment to these goals and the employee strongly believes that she can

reach the goal (self-efficacy).

The assumptions are that the more the employee knows about the performance requirements the stronger the identification with them and the more precise and timely feedback on how the employee is meeting the requirements the more motivated she will be.

The key managerial implications are that similar to expectancy theory there must be clear link between effort and reward and employees must have the necessary skills, equipment and abilities to perform to believe to be able to reach the goal. However also that difficult, yet attainable goals motivate more than easy goals, feedback enhances motivational effect, goals must be clearly defined and accepted by the employee (e.g. through mutual alignment) and that self-regulation of performance is more effective than external reward and punishment.

It should also be noted that the theory has been seemingly partly discredited by the often-failed use of management by objectives schemes in the late 20th century. However, the issue was often purely bureaucratical goal setting with no agreement or ownership from the employee (Armstrong, 2007, p. 126).
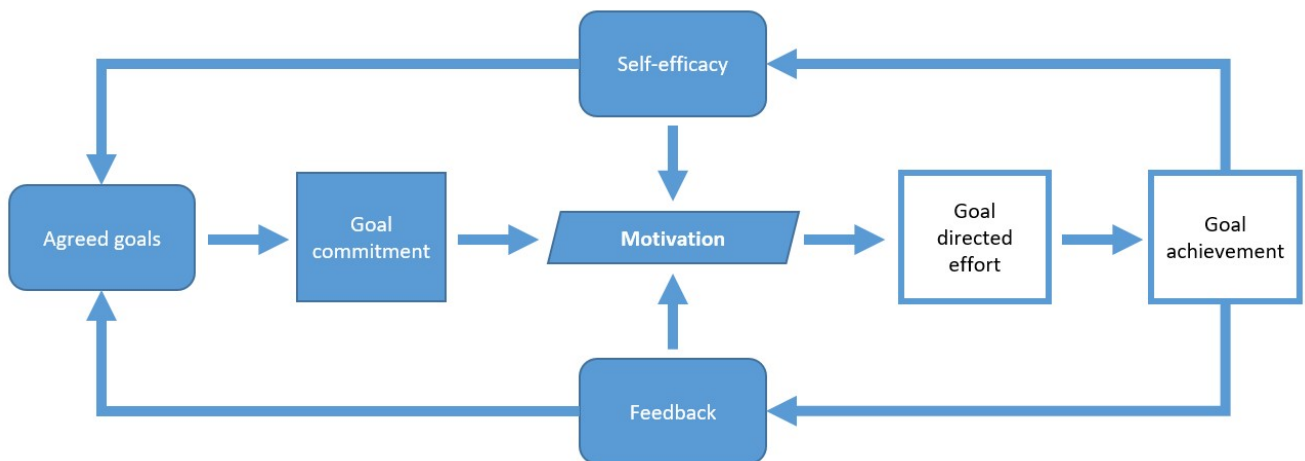


Figure 1.4 Goal-setting theory
Source: adapted from Shields, 2007, p. 81

As we can see, there are many theories with sometimes conflicting and sometimes converging recommendations. In the end the management must make a judgement call based on their experience and choose and pick elements from the theories that will work in their environment.

### 1.1.4 Relationship between motivation and performance

Motivation of employees in not a goal in itself, its purpose is primarily to increase or at least sustain performance (as well as to positively interact with satisfaction). What does then affect performance in relation to motivation?

Firstly, performance is a function of both motivation and the employee's abilities: her skills, knowledge and attributes. Even the most motivated employee who has no necessary skills will not perform well (Armstrong, 2007, p. 130).

Furthermore the assumption that more motivation is always better is likely myth as well. Bedrnová et al. (2012, pp. 237 – 238) argue that naturally too low motivation negatively impacts performance, but so does too high motivation. The reasoning is

that too high motivation creates high level of internal, psychic tension that actually hinders normal function of human psyche and therefore blocks effective usage of one's abilities. The matter is further complicated in that the optimal level of motivation differs based on the task at hand as well as the person attempting the task.

The relationship between motivation, performance and different types of rewards is discussed in each subchapter related to each reward in chapter 1.3 Total reward elements.

## 1.2  Psychological contract

This chapter introduces the concept of psychological concept, following by its significance, its development and change and finally practical model with managerial implications.

### 1.2.1  Definition of psychological contract

An employment contract is a legal document that defines employer-employee relationship in written form both for practical and legal reasons, it is usually relatively open ended referring to expected behaviour in a roundabout way rather than specific components.

In contrast a psychological contract refers to a psychological phenomenon that is defined by Rousseau and Wade-Benzoni (1994) thusly:

*"Psychological contracts refer to beliefs that individuals hold regarding promises made, accepted and relied upon between themselves and another. (In the case of organizations, these parties include an employee, client, manager, and/or organization as a whole.) Because psychological contracts represent how people interpret promises and commitments, both parties in the same employment relationship (employer and employee) can have different views regarding specific terms."*

In other words psychological contract refers to the subjective expectations that employees hold for the employers and the employers hold for the employees. The expectations are usually implicit and much wider than the open-ended statements codified in the employment contract. It can refer for example to expectation of fair treatment, certain work-hours, specific workload from the employee's perspective or certain output and loyalty from the employers perspective (Armstrong, 2006, pp. 225 – 227)

### 1.2.2 The significance of the psychological contract

Why is the psychological contract important?
The answer to this question is essentially simple, yet enlightening: One might argue, that employees should just do and expect what is in the employment contract or business's internal documentation. However that would contradict the fact that people are by nature emotional subjective beings not depending more often on feelings than reason when evaluating their well-being or treatment.

Put differently the employees will have certain expectations and will expect the employer to fulfil them whether they were expressly stated or not (and they are usually not). In turn, employer will have expectations as well and though she might think that they are perfectly clear without communication that is usually not the case.

In this rift between each side expectations lies the foundation for misunderstanding, demotivation and at worst case mutual resentment.

Armstrong (2006, p. 226) advises that the management must realise that one of their core responsibilities is to manage employees' expectations in order to promote mutual satisfaction and work commitment.

### 1.2.3 Development and change of the psychological contract

The reason for development was already partly discussed. The employee starts working for an employer, she is given some amount of information from the job interview, work contract and possible internal documentation. However most of the information is not officially available, therefore she formulates her own expectations depending on her experience and the environment. The same happens for the employer as she most likely does not and cannot express all the expectations. This process is likely to develop unforeseen results in both sides.

Another contemporary issue according to Armstrong (2006, pp. 233 – 223) is that the contract is changing from both sides. As the workplace and general business world develops and becomes more flexible and adaptive the expectations of both the employees and the employers change significantly. This change is usually not communicated and can result in further misalignment between the two groups. This situation can also occur if the business develops naturally from a small company to a larger one or through other organizational changes.

### 1.2.4 Guest's extended model of psychological contract

Although the assumptions and conclusions of the psychological contract theory are relatively understandable, they are not necessarily practically applicable as-is.

That is why we explore the model of psychological contract from employees perspective created by Guest (1998).
The model is visualised in figure 1.5.



Figure 1.5 Guest's extended model of psychological contract
Source: adapted from Guest, 1998

Guest identifies three factor categories that are linked together: causes, contents and consequences.

Causes or inputs include both organisational and individual elements. Contents of the psychological contract have according to Guest three main components: Perceived trust-worthiness of the employer, sense of 'delivery on a deal' and felt-fairness (here we can see a link to the equity theory in chapter 1.1).

Consequences are presented in the form of mental attitudinal outcomes and following behavioural outcomes, which are the end-results that the employer is striving to promote.

Shields (2007, pp. 55 – 56) concludes that there are 4 main advantages of Guest's extended model. First by identifying the three specific perceptions of the employee we are closer to understanding her views. Second it shows that psychological contract doesn't exist in social vacuum and changing it is much more difficult than changing opinion of just one employee. Third it shows that many inputs are barely or not at all controllable by the employer, therefore the contract cannot be designed or willed easily. Fourth the model shows that as is noted earlier the psychological contract is not a static phenomenon, but rather evolving and ever-changing process.

All in all the understanding of psychological contract can help us in designing well-functioning reward system especially by forcing us to always consider the expectations and perception of the employee rather than designing in theoretical vacuum.

## 1.3   Total reward

The concept of total reward has recently gained a lot of attention in both practice and theory. This chapter introduces the concept, its significance, its elements and business implications. The detailed overview of total reward elements is provided in their respective chapters.

### 1.3.1  Definition of total reward

Total reward is simply all that the employer offers or can offer to attract, retain and motivate employees. Thomson (as cited in Armstrong, 2006, p. 631) defines total reward more verbosely:

*"Definitions of total reward typically encompass not only traditional, quantifiable elements like salary, variable pay and benefits, but also more intangible non-cash elements such as scope to achieve and exercise responsibility, career opportunities, learning and development, the intrinsic motivation provided by the work itself and the quality of working life provided by the organization."*

The key point of the total reward concept is that there are more elements to reward than just monetary rewards and these can be combined and aligned to create the best motivation possible. Armstrong (2006, pp. 629-632) suggests dividing these elements or components into transactional rewards and relational rewards as illustrated in figure 1.6.

| | Base pay | | |
|---|---|---|---|
| **Transactional rewards** | Contingency pay | Total remuneration | |
| | Employee benefits | | **Total reward** |
| **Relational rewards** | Learning and development | Non-financial/ Intrinsic rewards | |
| | The work experience | | |

Figure 1.6 Total reward components I
Source: adapted from Armstrong, 2006, p. 631

Shields (2007, p.31) suggests different division of the elements. Her division is illustrated in figure 1.7. It explicitly divides the components into intrinsic and extrinsic which can facilitate the shift from just monetary to total reward while illustrating the elements of extrinsic and intrinsic reward.

| | | |
|---|---|---|
| **Extrinsic rewards** | **Financial rewards or remuneration:**<br>• Fixed or base pay<br>• Direct benefits<br>• Performance-related pay | |
| | **Developmental rewards:**<br>• Learning, training and development<br>• Succession planning<br>• Career progression<br>• Other indirect or non-cash benefits | **Total reward** |
| | **Social rewards:**<br>• Organisational climate or management culture<br>• Performance support<br>• Work group affinity<br>• Work-life balance<br>• Other indirect or non-cash benefits | |
| **Intrinsic rewards** | **The work experience:**<br>• Job challenge<br>• Responsibility<br>• Autonomy<br>• Task variety | |

Figure 1.7 Total reward components II
Source: adapted from Shields, 2007, p. 31

Either view provides a framework which can help design proper reward strategy. Components of total reward are discussed in detail in their respective chapters.

### 1.3.2 The significance of total reward

The most significant point of total reward is as noted earlier that it allows the employer to recognize and utilize all the tools in his disposal rather than just selected few.

Armstrong (2007, p. 33) suggests four main benefits of the total reward concept:
First, the combined effect of the different rewards will create greater and longer lasting impact on the motivation and commitment of the employees.
Second, the use of both transactional and relational rewards will enhance the employment relationship by appealing more to employees.
Third, it is flexible to respond to and meet individual needs of the employees.
Fourth it can help win the war for talent. I.e. by utilizing relational rewards it can strengthen and improve the psychological contract thus attracting employees by other methods than just monetary rewards (e.g. becoming employer of choice).

### 1.3.3 The effectiveness of total reward

Naturally the total reward effectiveness is dependent on its components, but are all the components as important?
There is no simple answer to that. However, the research from WorldatWork (Payne, Cook, Horner and Shaub, 2010) suggest that all the elements are indeed at least relevantly important for recruitment, retention and motivation. They also elaborate that different components of total reward have different importance to each of the activities (recruitment, retention and motivation).
Based on their research in South Africa W. Smith, K. Stanz and M. Bussin (2015) also propose application of total reward has a positive impact on perceived organisational support and perceived supervisor support which in turn leads to increased motivation.

As A. Ludlow and A. Farrell (2010) argue one of the main reasons for inefficiency of total reward system is that employees are not actually aware of all the rewards. H. Brenton (2012) proposes an elegant solution of total reward statements for this issue.
A total reward statement is a piece of communication which in some way informs employees of all the relevant rewards. It can range widely in its form, but it is usually a document or presentation.
Brenton suggests that a good total reward statement should simple, relevant and engaging, so the employee actually pays the attention and the employer reaps the benefits. Additionally, she warns against showing of benefits of different groups together as that could lead to disillusion and demotivation.

Another issue that might hinder effectiveness of total reward is employing the same total reward strategy to vastly different work groups.
As Smith et al. (2015) propose according to their research the preferred components of total reward are different for different groups. For example managers prefer different rewards than employees. They also suggest that these differences are also largely age dependent as generation Y prefers more monetary rewards and stability

whereas generation X prefers chances for skills development and career advance as well as work-life balance.

All in all, it is clear that total reward is a vital concept for developing well-rounded and effective rewards strategy.

## 1.4  Reward strategy

If business recognizes that it does not utilize it reward system in the best possible way they need a plan and a framework in which to make any improvements. In other words, they need a strategy.

This chapter introduces the concept of reward strategy, elaborates on its structure and contents, goes into detail about designing the strategy and finally introduces and explains several practical challenges that may arise during its development and implementation.

### 1.4.1  Defining a reward strategy

Everybody in business is familiar with a strategy, usually its importance is recognized for defining both the means and the end of a process. However, where business strategy is commonplace formulated reward strategy is much less common (CIPD cited in Armstrong, 2006, p. 652)

First of all what does it mean to manage even HR strategically? Shields (2007, pp. 88 - 89) answers the question thusly:

*"In broad terms, it can be said that taking a strategic approach to people management requires the identification and application of those human resource management principles, policies and practices that best align with and support the strategic objectives of the organisation as a whole as well as those of the relevant division, department and/or business unit."*

More specifically Armstrong (2006, pp. 643 – 644) defines reward strategy followingly:

*"Reward strategy is a declaration of intent that defines what the organization wants to do in the longer term to develop and implement reward policies, practices and processes that will further the achievement of its business goals and meet the needs of its stakeholders."*

To sum up, a reward strategy in whatever form describes both the end, that is where we want to be and the means, i.e. how we want to get there of business's whole reward system.

### 1.4.2 The significance of a reward strategy

Why does a business need a rewards strategy? Armstrong (2007, p. 49) proposes four main reasons:

First, the business needs to know where it wants to go, how to get there and to realise when they get there. Rose (2014, p. 9) eloquently expresses this sentiment with an anecdote from Lewis Carrol's Alice's Adventures in the Wonderland:

*"Alice asks the Cheshire cat which way she ought to go. But when asked where she wants to get to, Alice says that she doesn't care much. In which case, says the cat, 'Then it doesn't matter which way you go."*

Second, pay costs are by far the largest expenses in most organisations. They can make up to 60% of all expenses or even more in labour-intensive markets. Therefore, it makes sense to manage them with a united strategy
Third, there should be a link between performance and reward, the business should think and plan how to improve and maintain this link
Fourth, reward strategy is a way to link reward systems with business and HR strategy in order to create synergies.

Rose (2007, pp. 15 – 23) adds one more important point. In his opinion the key impact of a reward is delivering a message. What he means by that is that the rewards essentially carry information about what is important to the business to the employees. If the business wants its employees to share its values, they must be in line with their reward system otherwise, they will cause internal conflict instead of synergy.

### 1.4.3 Structure and contents of a reward strategy
Reward strategy can have various structures as well as contents.

Regarding contents Armstrong (2006, p. 645 – 646) proposes two forms of the strategy: Broad-brush reward strategy or specific reward initiatives.


Broad-brush strategy as the name suggests uses relatively general statements to set a direction rather than specific strategy. E.g. an aim could be to utilize all elements of total reward in a synergic support of business strategy.

On the other hand, specific reward initiatives are specific ways of reaching a certain objective. They should be based on analysis and assessment of current business situation and its needs. A reward strategy can have more specific reward initiatives. An example is an introduction of performance management in formal reward structure.
The following subchapter focuses on development of the reward strategy in the form of specific reward initiatives.

Regarding structure, Armstrong (2006, pp. 644 - 645) proposes following elements:
A statement of intentions including reward initiatives that it is proposed should be taken.
A rationale explaining the proposal. It should explain the strategy's business case and link to identified employee and employer needs.
A plan, i.e. how, when and by whom should the strategy be implemented. It should include specific steps, timeline and prioritisation.
And a definition of guiding principles, that is the reward philosophy that further reward system adjustments should be based on.

### 1.4.4 Designing a reward strategy - approaches
It is clear then that a reward strategy in some form is necessary for ideal reward utilization, but how does a business go about designing and implementing it?

Shields (2007, pp. 88 – 105) suggests that there are two schools of thought regarding reward strategy design: Best-practice approach and best-fit approach.

**Best practice approach**

The best practice approach claims that there is a set of HR reward practices, that can be applied to any organisation and yield the best results. These practices usually depend on bundling of various components of total reward to create synergic effects. Most of the theories based on this approach are related to prescriptive models of HRM that are sometimes referred to as 'soft' or 'developmental humanist' (Shields, 2007, pp. 90)

The theories usually prescribe a best practice that includes some or all of following components: job-security, well-developed internal labour market and promotion system, job enrichment, employee participation and involvement in involvement in decision making, self-managed work teams, open two-way communication, extensive skill development, reduced status differences and reward practices that relay pay to employee skills or competencies (Hiltrop, 1996).

Based on Shields' evaluation of current research, the main weakness of this approach is that it firstly only focuses on internal environment, while ignoring external and secondly completely disregards differences between organisations.

**Best fit approach**

Shields (2007, pp. 94 – 95) explains that:

*"Best fit…proposes that far from there being one superior and universally applicable set of human resource practices, such practices should be tailored differently so as to 'fit' each organisation's specific internal and external circumstances."*

In other words, it proposes than in contrast to best practice approach there is no single best practice, but rather the reward system must be adapted to the business' unique circumstances and environment. Therefore, the best fit prescribes a combination of external and internal fit as is discussed further.

The advantages of best fit approach lie in its complexity and adaptability to unique circumstances. Of course, these same attributes also make it more difficult to design properly.

1.4.5  Designing a best fit reward strategy

Designing a complex reward strategy can a daunting task, but Armstrong and Cummins (2011, pp. 31 - 43) suggest a framework illustrated in figure 1.8 that should help organize and carry out this task.
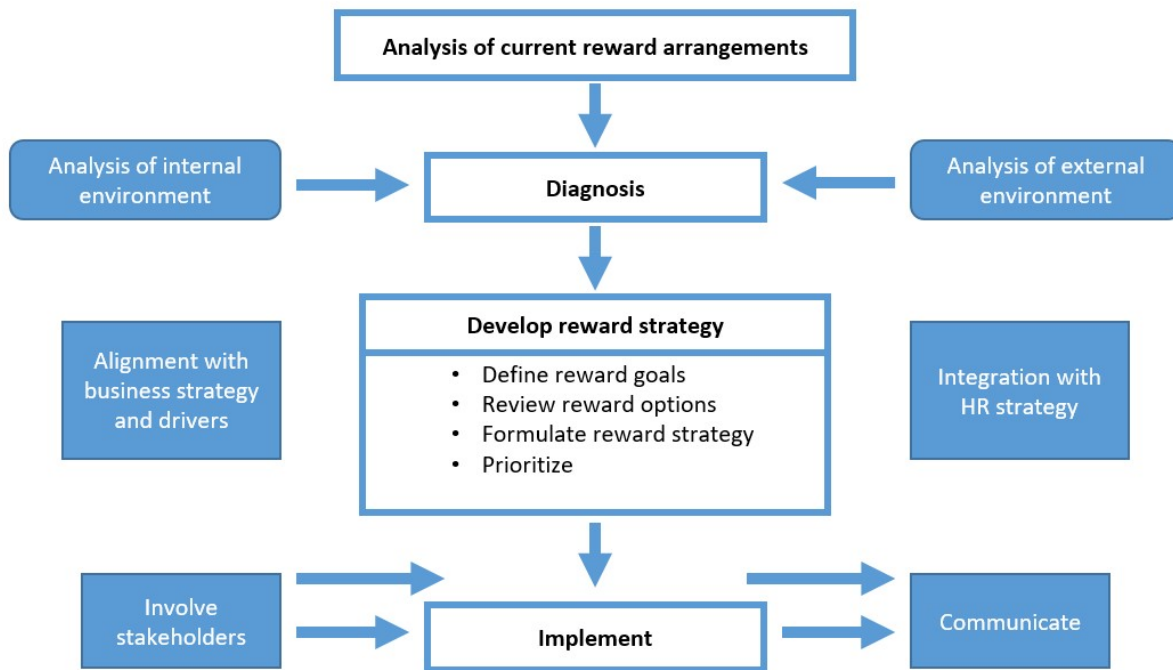
Figure 1.8 Reward strategy development framework
Source: adapted from Armstrong & Cummins, 2001, p. 32

Shields (2007, pp. 99 – 103) adds two points to the model.
Firstly, the analysis of external and internal environment usually takes form of a SWOT analysis which is ideal for both internal and external environment. Secondly, she also suggests a step of evaluation of the implementation of reward strategy and adjustments if necessary.

Rose (2014, pp. 40 – 43) elaborates on the components of internal and external environment that should be considered:

**Components of internal environment**

- Values of the organisation – reward strategy must be aligned with them
- Structure of the organisation – the rewards employed in one part of the organisation might be different from another, based on their specific needs. Also, a smaller organisation will generally deploy different and less rewards than a large organisation.
- Organizational change – the current and expected status of the organisation should be taken into account. E.g. expected merger or acquisition.
- Profitability – the extent to which the organisation is aiming to make a profit should be reflected in the reward strategy. E.g. in regard to such measures as employee profit sharing or other.

**Components of external environment**

- Legislation – legislation will always affect the reward system at least up to a point. Certain rewards might be either mandatory or forbidden by the law and this must be reflected.

- Taxation – taxation is relevant both from the employer and employee perspective. The organisation will want to utilize the rewards that are tax beneficial to reduce its tax and so will want the employee. E.g. it does not make sense to offer a reward that will increase employees tax burden more than its perceived value.
- Market sector – naturally wages and reward practices in the organisation's sector must affect its own practices. For example profit share bonuses are typical of financial sector.
- Market pay movement – Market pay changes must be considered in order to make the strategy viable over its period of activity. E.g. if the market pay increases by 10% every year a reward strategy that does not allow for change of remuneration will quickly become obsolete.

As we can see designing a reward strategy is a complex task, but not one that cannot be attempted or finished in a reasonable manner. However, there are some additional challenges that should be taken into consideration.

### 1.4.6 Challenges in development and implementation of reward strategy

Development and implementation of a reward strategy is naturally complex and intricate process, yet there are at least two specific challenges that should be recognized to avoid unnecessary complications.

**Rhetoric gap**

As noted earlier each reward carries a message, it is rather critical that the employee receives the same message that the employer intends to send.
Rose (2014, pp. 15 -17) reflects that that is very often not the case. He proposes a few examples to illustrate this point.

- Business strives to be customer focused. It tries to support this by introducing sales related bonus. The employee is however not incentivised to have a solid and fair relationship with the customer, but rather receives a message to sell as much as she can at any (reasonable) cost.
- Business claims that it values contribution and performance. However, the reward system offers service-based benefits and pension. Therefore, the employee does not perceive any message of actual value on performance or contribution.
- Business proposes that it involves all the employees in their decision making. However, there is no reward for fulfilling other than purely individual tasks and furthermore the employee has no choice in any part of the reward system.

It is important to always keep in mind how the employee will perceive the reward, rather than just what the business expects.

**Line management capabilities**

Armstrong (2006, p. 657) notes that there is a trend to push large parts of reward management to the line managers. He warns that this puts larger and sometimes unexpected requirements on the line managers. Some might rise up to the challenge, but some might only do the bare minimum or be altogether incapable of changing.

This shows that HR in the organisation must be ready to educate and develop the necessary skills in the lane managers or in the worst-case scenario replace those that cannot cope with the new challenges.

As this chapter shows, design and implementation of a reward strategy is rather complex process, but in the end, it is achievable and necessary to fully utilize the organisation's reward system.

## 1.5 Base pay

Base or fixed pay is the backbone of majority of positions. Whereas popularity of other forms of reward comes and goes base pay remains relatively stable.

In this chapter are first introduced key concepts for understanding of base pay: job evaluation and market rate analysis. Then the base pay is defined and concepts of grade and pay structures are defined and described. Most of these concepts are not explored deeply as most of the details are not relevant for a small sized business.

### 1.5.1 Job evaluation

Armstrong (2006, p. 660) defines job evaluation followingly:

"*Job evaluation is a systematic process for defining the relative worth or size of jobs within an organization in order to establish internal relativities. It provides the basis for designing an equitable grade and pay structure, grading jobs in the structure and managing job and pay relativities.*"

In essence job evaluation aims to establish an objective and comparable value of job based on its attributes in order to be able to design equitable and motivating base pay.

Job evaluation techniques are usually divided into two approaches: Analytical and non-analytical.

**Analytical approaches**

According to Armstrong (2006, pp. 660 – 663) main features of analytical approach to job evaluation are that it is systematic, judgemental, concerned with the person not the job and concerned with internal relativities.

In practice, analytical approaches usually assign a number of points to different factors concerning the job and then either compare or structure the jobs based on the results.
The advantage is the relative objectivity and complexity of the approach whereas the main disadvantages stream from costly and time consuming implementation and renewal.
According to Rose (2014, p. 99 – 100) the most well-known analytical approach is Hay Guide Chart Method which scores each job based on three main factors: Know-how, Problem solving and accountability.

**Non-analytical approaches**

In contrast to analytical approaches non-analytical approaches rank the whole job and not its components.

The most common non-analytical approach is the job classification, where jobs defined by jobs descriptions are compared to grade definitions and assigned accordingly (Armstrong, 2006, p. 664).

Other examples include job ranking, which simply ranks the jobs in the organisation in a hierarchy or internal benchmarking where new job is evaluated by comparison to the other jobs.

The advantage of these approaches is that they are relatively easier to implement and operate. However, they do not provide much valuable information on jobs and furthermore might be prone to sex discrimination (Rose, 2014, pp. 99 – 101).

### 1.5.2 Market rate analysis

Armstrong (2006, p.681) propose that:

*"To ensure that pay levels are competitive, it is necessary to track market rates for the jobs within the organization, especially those that are particularly vulnerable to market pressures because of scarcity factors. This is sometimes called benchmarking."*

In other words, the estimation of pay for a certain job has two parts. First the business needs to look internally as described in the job evaluation, but then the business must consider the external environment in order to create an attractive pay offer. Naturally when comparing externally each job must be matched to a as similar external job as possible.

The usual sources of the market rates are: online pay data, published reports (general, national, local, sector and industry specific), management consultants' databases, special surveys, club surveys and job advertisements (Armstrong, 2007, p. 232). Although likely rather imprecise the most used and cost-efficient source for small business is the research of job advertisements as there are no other useful freely available sources in our environment (the national and EU-level data is too broad to base any judgement on).

### 1.5.3  Definition of base pay

Finally based on internal job evaluation and external market rate analysis certain base pay can be established. But what exactly is a base pay?

Shields (2007, p. pp. 233 – 244) describes base pay as:

*"...the foundational component of total remuneration, and it can be defined as the part of an employee's direct remuneration that is not performance-contingent. It is commonly viewed as the 'fixed' or 'guaranteed' portion of pay in that it is chiefly time-based rather than performance-based. For each quantum of time worked, the employee receives a predetermined amount of pay."*

For our purposes we can view base pay as the part of total reward that is financial and non-contingent.

### 1.5.4 Grade and pay structures

The outcome of job evaluation and market rate analysis although useful by itself is not the final step in base pay design. The next step is to sort the jobs and different

levels of pay into logical structures that can be of further use in the HR reward processes. That is the purpose of grade and pay structures.

**Definitions of grade and pay structures**

Armstrong (2006, p.689 – 690) simply describes grade structures as *"consisting of a sequence or hierarchy of grades, bands or levels into which groups of jobs that are broadly comparable in size are placed."* In other words, it groups together jobs that are of comparative value.

Pay structure then:

*"defines the different levels of pay for jobs or groups of jobs by reference to their relative internal value as determined by job evaluation, to external relativities as established by market rate surveys and, sometimes, to negotiated rates for jobs. It provides scope for pay progression in accordance with performance, competence, contribution or service."* (Armstrong, 2006, p. 690)

Essentially a pay structure is a grade structure with pay ranges or points attached to its elements.

**Guiding principles of grade and pay structure design**

According to Armstrong (Armstrong, 2006, p. 690) grade and pay structure should:

- Be appropriate to culture, characteristics and needs of the organisation
- Facilitate the achievement of equity, fairness, consistency and transparency in managing grading and pay
- Be capable of adapting to change
- Facilitate operational flexibility and continuous development
- Provide scope for rewarding performance, contributions and increases in skill and competence
- Clarify reward, career advancement and lateral movement opportunities
- Be constructed logically and clearly so they can be easily communicated to employees

**Types of grade and pay structures**

There are many types of pay and grade structures. Following list summarises the most common types as presented by Armstrong (2007, pp. 263 – 292) and Shields (2007, pp. 249 – 268):

- Narrow-graded structure – Consists of sequence of job grades into which jobs of comparable value are assigned. Each grade is assigned certain pay range which slightly overlaps with surrounding grades.
- Broad-graded structure – Is similar to narrow-graded, but contains much fewer grades with larger pay ranges. Rose (2014, p. 102 – 106) argues that this type is becoming more popular as it places more focus on development rather than just trying to reach the next grade.

- Job family structures – Contain several successive levels in defined functions such as IT, HR or sales. Each grade hierarchy can have independent pay ranges which then do not correspond to pay ranges in another function.
- Spot rates – Spot rates are not a type of grade structure per se, but rather refers to lack of such structures. Spot rates are pay ranges or points attached to specific jobs or even people.  They logically do not allow for a progression in a grade structure, but rather require re-negotiation if they are to be changed.

As noted earlier selected grade and pay structure must fit to the organisation. Rose (2014, pp. 115 – 116) argues that for small organisations either spot rates or very simple broad-graded structures are ideal. Since other method would be unnecessarily costly for implementation and operation.

As shown in this chapter base pay is usually the foundation of total reward in given organisation. Although it might not be currently in favour of terms of its motivational properties it must still be paid relevant attention to support and anchor the whole reward system.

## 1.6   Contingent pay

As we've seen in the previous every pay is contingent on something, ideally both on internal and external environment. But how does pay change over time and based on what? This chapter aims to answer that question.

It begins with definition of contingent pay with distinction of pay increase and bonus, follows with the approaches to contingent pay, descriptions of possible bonus schemes and finally discusses the general effectiveness of financial incentives.

### 1.6.1 Definition of used concepts

The concept of contingent pay is rather self-explanatory. It merely signifies that pay is related to or based on something. According to Armstrong (2006, p. 708) the most common types of contingent pay relate financial rewards to the performance, competence, contribution or skill of individual employees. Contingent pay may also be provided for teams or the whole business.

There are also two distinct uses of contingent pay. The first is the use of contingent pay to increase framework for adjustment of base pay or in other words provide way of assigning higher (or lower) grades in the grade and pay structure discussed in previous chapter. The second is to provide financial bonuses contingent on certain behaviour or results.

Armstrong (2007, pp. 336 – 337) suggests the distinction of concepts of reward and incentive. According to him incentive is meant to provide are meant to provide direct motivation by stating that by doing this one will get that. Whereas reward is meant to provide indirect motivation as they are meant to recognize achievements. However these two might be difficult to differentiate in practice as they both effectively reward past behaviour which the employee must have known would lead to a reward.

### 1.6.2 Aim of contingent pay and criteria for success

The aim of contingent pay is in the end almost always to motivate people. It can also affect employee satisfaction, retention and recruitment as a secondary goal, but performance via motivation is the key.

What are the criteria for successful application of contingent pay then? It is the satisfaction of the same criteria that were discussed in chapter 1.1 for various motivational theories. In summary following attributes are among the most important: Felt-fairness of the contingent pay, clear link between effort and reward, clear definition of reward, worthy reward, attainable reward and many other (see chapter 1.1).

### 1.6.3 Approaches to contingent pay

There are many approaches to contingent reward with various degrees of utilization, complexity and success. However, there is not yet a single best approach that can be readily applied to maximize employee motivation as with the whole total reward concept a combination and best fit are necessary to achieve the best results.

There are generally two types of approaches: individual contingence pay and group contingence pay. Approaches from both are shortly described with the main advantages and disadvantages. As the terminology is not entirely unified the division and description by Armstrong (2006, pp. 709 – 727) are primarily presented.

First, individual contingent pay approaches are summarised:

**Performance related pay**

By far the most common of all contingent pay approaches it measures performance based on a set of pre-agreed outcomes or measures. Based on reaching these goals a movement in the pay and grade structure or a financial bonus is assigned.

The key point of performance related pay as defined by Armstrong is that it rewards only the outputs of work that is the actual outcomes (visible in behaviour and reached objectives) and not the input (i.e. the attributes of the employee).

This approach has attracted both a lot of criticism and defence from its opponents and proponents. The main advantages are explicit links between objectives and reward and connected delivery of message of what is important. The main disadvantages are that it depends on subjective assessment and focuses only on individual outcomes. All in all performance related pay is relatively controversial, but if managed properly in a fitting environment can produce great results.

**Competence related pay**

In contrast to performance related pay, competence related pay rewards the inputs of given employee, that is her level of competency. Competency is essentially an ability to perform work at a certain level including personal attributes, skills and knowledge.

The key advantages are that it fits rather well into competency-based HRM programmes and can be measured more objectively than performance (albeit with more difficulty). The main disadvantage is obviously that it rewards the ability to perform rather than the performance itself.

The application is relatively uncommon and is generally used ony for progression in grade and pay structures.

**Contribution related pay**

Contribution related pay as introduced by Brown and Armstrong relatively recently in 1999 has gained a particular popularity. The approach combines performance and competence related model by rewarding employees based on both inputs and outputs.

The advantage is that it mainly counters the disadvantages of ignoring either inputs or inputs and therefore presents more rounded way of rewarding. However the disadvantages are the complexity and difficulty of design and implementation of such systems. It is mainly used to assign progression in the pay and grade structure.

There are also other approaches such as skill based or service-related, but due to limited relevancy these will not be discussed.

Second, below are presented the most common approaches to group based pay, for all of these, it is common that they usually provide rewards in the form of bonuses:

**Team based pay**

As the name indicates team based pay rewards the whole team instead of individual employees. The perceived advantages are that it should encourage cooperation and teamworking within teams as well as clarifying objectives. The main disadvantages however lie in the fact, that although this approach might be beneficial and motivating in well-functioning teams, it will most likely only lead to demotivation in already dysfunctional teams.

**Organization-wide approaches**

These approaches are based on the performance of the whole organisation. They are meant to motivate employees through shared goals and objectives while rewarding them for reaching organisational objectives. Naturally the main disadvantage is that there might not be a clear link between individual performance and the organisation's since most of the relevant conditions are outside of individual employee's control.

The most common examples are profit sharing, where employees receive certain bonuses based on organisation's performance or plans that allow employees to purchase company shares at advantageous prices.

### 1.6.4 Bonus schemes

Bonus for our purposes refers to a financial reward that is granted based on one of the above-mentioned approaches to the contingent pay. The subchapter presents an overview of available bonus schemes or types of bonuses with summaries of most relevant ones and simple framework for designing bonus schemes. The general effectiveness of bonuses as well as other financial incentives is discussed in the following subchapter.

Although most of the bonuses can be inferred from presented approaches, Rose (2014, pp. 150 – 153) presents a comprehensive overview of practical approaches in real organisations in table 1.1.

| Bonus type | Main features | Typical time frame | Usage |
|---|---|---|---|
| Individual bonus | Payable to individuals based on their achievements, often linked to annual objectives | Annual | As part of performance management to encourage and reflect individual achievement |
| Combination schemes | Individual bonus typically based on two or three factors in combination, such as individual, division and organisation performance | Annual | To encourage individuals to balance out their actions to meet their individual goals as well as support other achieve broader goals |
| Sales commission | Individual bonus paying on sales or sales revenue | Monthly or quarterly | To incentivize a sales person to maximize sales |
| Project bonus | Team or individual bonus for successfully delivering a project | End of project | To encourage the team to work together to achieve the project on time and to cost |
| Total reward | A discretionary bonus awarded as part of the annual pay review process in lieu of (some) salary increase | Annual | In place of part of a pay review for a high performer who is already on a high salary |
| Profit sharing | Group-wide bonus that pays a cash amount or a percentage of salary depending on the profit that is made | Annual | To encourage people in the business to focus on the success of the whole business rather than just their part |
| Goal sharing | Group bonus based on achieving broad, typically company or division wide goals | Annual | To get people behind one or more key corporate goals |
| Team bonus | Bonus paid to a team for their collective | Quarterly or annual | To encourage team behaviours to achieve a positive |

| Bonus type | Main features | Typical time frame | Usage |
|---|---|---|---|
| | achievement | | result |
| Gain sharing | Group-wide bonus based on a formula that relates bonus to improvements in productivity and performance which hare under the control of employees | Quarterly or annual | To bring people in the business together to share the value of improvements; part of cultural change |
| Pool base | Create a bonus pool and allocate a % share to participants, pool size varies according to some KPIs | Annual | To bring a management group to work together to achieve the KPIs |
| Spot bonus | Immediate low-level bonus to recognize particular success | Daily | To recognize a positive behaviour or output immediately |
| Deferred bonus | Executive bonus where part or all of the bonus is deferred for, typically, three years before it is paid | Annual with three year deferential | To help retain executives and tie them into the longer-term results of the business |

Table 1.1 Main types of bonuses
Source: adapted from Rose, pp. 152 – 153

As we can see there are many different bonuses that might be applied. As with the whole total reward even the bonus schemes might be combined for synergic results. When creating a bonus scheme one must take into account all the internal context that was described in the previous chapters, explore the available options presented here and conceive specific goals that the business wants to achieve through the bonus scheme.

### 1.6.5 Effectiveness of financial incentives
Both this and the previous chapters are concerned with designing systems that provide financial rewards to the employees in order to recruit, retain, motive them and ultimately make their performance as good as possible. But does money work as a motivational factor? After all some authors, as previously presented argue that financial reward is merely a hygienic factor or even that only extrinsic motivation is truly useful. In this subchapter, this question will be discussed based on available evidence.

Armstrong (2006 and 2007) generally doubts motivational effectiveness of financial incentives stating following issues:

- Money by itself cannot sustain motivation
- Not all people will react to financial motivation
- Financial rewards might demotivate those who do not receive them
- Contingent pay schemes can cause more demotivation than motivation due to poor design or implementation
- Usually not all factors related to reward are under employees control
- Failures in implementation usually stem from lack of ability or commitment of the employees to operate the reward system

Shields (2007, pp. 347 – 668) based on an extensive research agrees that financial incentives are difficult to implement, but overall provide valuable motivational tool.

The rest of the literature is usually divided as well. For example, Mafini and Dlodlo (2014) argue that according to a research in public organisations, that were defined by relatively low possibilities of career development, there was a clear link between extrinsic rewards and job satisfaction. In a similar setting Botha (2014) argues that job satisfaction directly translates into motivation as well as other positive results.

In an European context Igalens and Roussel (1999) have researched the effect of financial rewards on both exempt and non-exempt employees. They have found out that financial rewards tied to performance indeed increase motivation in exempt employees, but even for non-exempt employees job satisfaction is increased (provided the rewards are viewed as fair) even though the motivation is not. Furthermore they argue that variable pay by itself does not motivate or increase job satisfaction, but has to be tied to performance or other objectives. In a similar vein Urieşi (2016) based on his research in Romanian business claims that financial performance management programmes increase job motivation, though the increase is mediated by perceived fairness of the business.

In a comprehensive article Rynes, Gerhart and Minette (2004) set out to explain the discrepancy between self-reported value of financial incentives and effectiveness of financial incentive programmes. Their proposed explanation is that it is not socially acceptable to value financial rewards too much. Therefore employees in self-reported surveys either consciously or not answer differently than they actually feel. On the other hand a review of implementations of performance systems indicate successes in increasing performance in most reviewed studies. They conclude that financial incentives are very powerful tools and one should make sure that both base pay and contingent pay are utilized properly to reach the best possible results.

All in all research on contingent pay is not perfectly united, but it is mostly agreed that contingent rewards are valuable tools that can successfully motivate employees, given that they are properly designed and implemented.

## 1.7   Employee benefits

Employee benefits are a staple of total reward. They used to be available only to managers and differentiated by position, but the trends in late 20th and early 21st

centuries show that not only are employee benefits becoming commonplace, but they rea becoming more standardised for all employees as well (Shields, pp. 318 – 328).

In this chapter definition and usual objectives of employee benefits will be discussed, then their reason for usage will be summarised, several benefits will be introduced and their usage in the Czech Republic analyses and finally a short discussion on their effectiveness will be presented.

### 1.7.1 Definition and objectives of employee benefits

Benefits are the part of total reward that can be both financial and non-financial, but they are not performance contingent. They are usually provided to all employees, but can be differentiated by levels. In our context, the most conventional employee benefit is probably allowance for meals.

The objectives of employee benefits as presented by Armstrong (2007, p. 460) are usually to increase job satisfaction and commitment as well as showing that the employer cares about her employees. Shields (2007, pp. 318 – 322) adds that employee benefits increase membership behaviour, increase employee retention and can positively impact psychological contract.

### 1.7.2 Why use employee benefits

Apart from the mentioned goal of increasing employee satisfaction and retention there are two more reasons for their use: Taxation and legislation.

**Legislation**

Simply put, some benefits are mandatory. In the Czech Republic, they come almost exclusively from Labour Codex. Business will naturally know all of them already, but they include for example mandatory vacation time or maternity leave.

**Taxation**

Based on our tax legislation some benefits offer tax advantages. There are two tax advantageous types: Benefits that can be reported as costs and benefits that can be provided without paying income tax, medical insurance and social insurance.

The first kind is relatively scarce, but includes a few benefits such as work related medical procedures not covered by state insurance, 55% of allowance for meals and employee education (Zákon č. 586/1992 Sb., § 24).

The second kind is much more common and although not as advantageous if applied these benefits are still 24% cheaper for the employer and 32% cheaper for the employee than cash rewards (Kudrnová, 2014b). These include non-work related medical costs, recreation, cultural benefits and non-work related education.

### 1.7.3 Usage of employee benefits

Due to different cultural and legal backgrounds, specific benefits differ significantly between countries. For example, in a lot of western countries employers provide medical insurance as a benefit, whereas it is mandatory in the Czech Republic. Therefore we will focus on benefits offered in the Czech Republic with comments on other practices if relevant.

The latest research from NN insurance group spanning 110 Czech business conducted in 2015 shows the following benefits being used in table 1.2.

| Employee benefits | Businesses that offer the benefit, % | | | | | |
|---|---|---|---|---|---|---|
| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
| **Mobile phone** | 80 % | 84% | 75 % | 87 % | 89 % | **88 %** |
| **Education** | 70 % | 78 % | 82 % | 85 % | 81 % | **83 %** |
| **Kitchen & drinks** | 71 % | 79 % | 71 % | 82 % | 75 % | **81 %** |
| **Medical examinations** | - | - | - | 75 % | 78 % | **77 %** |
| **Contribution to pension scheme** | 60 % | 71 % | 74 % | 68 % | 68 % | **77 %** |
| **Work car** | 75 % | 80 % | 75 % | 76 % | 74 % | **73 %** |
| **Meal allowance** | 75 % | 68 % | 81 % | 82 % | 74 % | **72 %** |
| **Gifts/ one-time bonuses** | 57 % | 64 % | 64 % | 71 % | 71 % | **66 %** |
| **Contribution to life insurance** | 39 % | 54 % | 43 % | 53 % | 49 % | **60 %** |
| **13. salary** | 32 % | 37 % | 37 % | 39 % | 39 % | **47 %** |
| **Cultural vouchers** | 29 % | 28 % | 33 % | 41 % | 35 % | **42 %** |
| **Employee loans** | 31 % | 32 % | 36 % | 38 % | 34 % | **40 %** |
| **Health (drugs, recreation)** | 24 % | 31 % | 35 % | 36 % | 39 % | **36 %** |
| **Sport vouchers** | 33 % | 32 % | 39 % | 40 % | 42 % | **35 %** |
| **Sick day** | - | - | - | 30 % | 25 % | **33 %** |
| **Flu vaccination** | 24 % | 28 % | 25 % | 35 % | 27 % | **31 %** |
| **Holiday contribution** | 20 % | 24 % | 28% | 32 % | 27 % | **30 %** |
| **General allowance vouchers** | 14 % | 13 % | 12 % | 24 % | 26 % | **24 %** |
| **Contribution for travel to work** | 14 % | 20 % | 15 % | 22 % | 20 % | **14 %** |

Table 1.2 Most used employee benefits 2015
Source: adapted from NN pojištovna, 2015

The only benefit clearly missing is 5th week of vacation, but according to a different source, 88% of employers offer that as well (Stodola, 2013). Essentially all common benefits are offered in the Czech Republic. Some uncommon such as accommodation or additional severance pay, are not provided very often, but they do appear as well. Flexible working hours do not generally appear in the surveys, but that is more likely to differences in definition of benefits rather than actual lack of usage.

Some authors suggest that offering flexible benefit plans might be relevant for attraction and retention of new employees (e.g. Kudrnová, 2014b and Stranický, 2015). Koubek (2015) seconds this noting stating financial and non-financial advantages both on the employer and employee sides.

### 1.7.4 Effectiveness of employee benefits
It is clear, that benefits are used and create significant expense. But do they provide the results that they should?

As mentioned earlier Armstrong believes that they do in fact support acquisition and retention of employees. Shields (2007, pp. 318 – 322) laments lack of research in this

area, but suggests that employee benefits are meant not only to acquire and retain, but also motivate and help organisational change.

Yamamoto (2011) proposes based on his research in Japan, that employee benefits and especially family friendly (or work-life balance) benefits not only support employee retention, but also increase job satisfaction. Ko and Hur (2014) second the notion that job satisfaction is increased through benefits, but they also add that the relationship between satisfaction and benefits is moderated by management trust-worthiness and perceived justice. Moen et al. (2016) have researched specifically flexible work arrangements in an IT department of Fortune 500 company and also report that job satisfaction was significantly increased compared to the control group.

On the other hand, Pegg (2009) argues based on a research in UK that although benefits are often offered they are largely unutilised by the employees. He argues that this is due to a lack of communication where the employees do not even know about the benefits and lack of understanding of the employees view on the benefits. Walker (2014) notes that only roughly 20% of benefits are actually utilised and argues for an employee benefits statement as well.

In conclusion employee benefits remain a staple in the total reward system. It is however, necessary to survey what the employees need and want and properly communicate available benefits to be able to reap the rewards.

## 1.8  Non-financial rewards

In the past three chapters, all three transactional parts of the total reward as presented in chapter 1.3 were presented and explored. That leaves the relational rewards, which are the topic of this chapter.

Relational rewards are specific in that they essentially affect all the other areas in some direct on direct way and permeate the whole reward system for the better or worse. For example they are natively included in the employee benefits under employee education and work environment or in contingent pay as a mean of development. This chapter first focuses on two relatively distinct topics related to non-financial rewards: Recognition and performance management. Then it shortly discusses other types of financial rewards and finally finishes with a focus on feedback as an internal component of most non-financial awards.

### 1.8.1 Recognition

Rose (2014) defines recognition in the following way:

*"A process of acknowledging or giving special attention to a high level of accomplishment or performance, such as customer care or support to colleagues, which is not dependent on achievement against a given target or objective. It can be day-to-day, informal, or formal"*

In other words, recognition is not based on targets. That makes recognition a little bit different from other components of total reward, as they usually reward for reaching a certain premediated target or objective. The purpose of recognition should be to make people recognize and commend the good things whether planned or not.

Armstrong (2007, pp. 386 – 388) suggests three types of recognition: Day to day recognition, public recognition and formal recognition.

Day to day recognition is likely the least utilized and most important part of recognition. Rose (2014, p. 187) suggests starting with simple guidelines for line managers how to do this properly. It is essentially a form of positive feedback and should be applied on a daily basis (when relevant). The most common method would be a line manager saying good job for x to an employee.
Public recognition is essentially slightly more formal and a system such as employee of the month or other is utilized. The feedback effect is more diluted than with personal private recognition.
Formal recognition is usually based on guidelines and presented in a larger forum such as quarterly department meeting or other. In this case a financial reward might be also bestowed as part of the recognition.

The effect of recognition is discussed with the feedback in the subchapter 1.8.4. However, for example Rose (2014, pp. 182 – 195) argues that recognition provides lasting motivation and satisfaction for the fraction of costs of financial rewards.

### 1.8.2 Performance management

Armstrong (2007, p.391) defines performance management thusly:

*"Performance management is a strategic and integrated process that delivers sustained success to organizations by improving the performance of the people who work in them and by developing the capabilities of individual contributors and teams."*

Why then is performance management included in a chapter on non-financial rewards? Simply because, if operated properly, it facilitates and provides many of non-financial rewards.

First, let us shortly explore the process of performance management. Per Armstrong (2007, pp. 393 – 395) performance management is a cyclic process and includes following steps:

- Plan – agree on objectives, competences and behaviour required, prepare plan for personal development to enhance knowledge, skills, competences and required behaviour
- Act – carry out the work necessary to reach the plans
- Monitor – check on progress, ideally continuously
- Review – discuss the achievements in the last cycle and begin planning for the next one

Furthermore, financial bonuses should not be based on performance reviews in performance management.

Now it should be clearer how performance management motivates, Armstrong (2007, 396 – 399) provides a summary of motivational factors (rewards) provided:

- Recognition – it involves recognizing achievements and people can be formally or informally recognized for that

- Provision of opportunities to achieve – goals are jointly agreed and provide opportunity for enrichment of one's role
- Skill development – it offers both goals and help (usually coaching and other resources) to develop skills
- Career planning – it can explicitly show and discuss best possible career development opportunities
- Job engagement – it concentrates on intrinsic motivational factors by enabling people to take responsibility for their outcomes and state goals and objectives
- Job commitment – it promotes job commitment by integrating personal goals and objectives with the organization's

As we have discussed, well-managed performance management system can provide a variety of non-financial rewards for motivation of employees while following its primary goal of increasing the organisation's performance.

### 1.8.3 Other types of non-financial rewards
As mentioned earlier, there are other types of non-financial rewards as well. Those could include for example work environment, work relationship or the nature of work itself. However, these are not usually designed by themselves, but are rather attributes of different processes such as employee benefits or job design. Of course, one should always consider non-financial implications as well as financial when trying to affect employee job satisfaction and motivation.

### 1.8.4 Feedback and its effectiveness
What is feedback? Feedback is simply sharing information related to one's behaviour, ideas or plans. Feedback as a tool has gained considerable popularity in the business due to its low price and high effectiveness. This subchapter deals with feedback as it is an important part of many non-financial reward (integral part of both recognition and performance management described above) and a motivator in itself.

There are several types of feedback. The most common distinction is positive and negative or constructive feedback. It should be noted that constructive feedback should not be viewed as pure criticism (which is often the case in our setting). In contrast to feedback, criticism is person rather than behaviour centric and its purpose is usually to put someone down, rather than help them improve (Rao, 2014). Another useful distinction is between process and outcome feedback. Whereas process relates to behaviour or how things are done. Outcome feedback relates to the outcome that is whether an end was achieved (McAfee, Quarstein and Ardalan, 1995). Another way of categorisation is formal or informal feedback. Formal feedback is a part of certain system such as formal recognition or performance management, whereas informal is not. Informal feedback is essential as it is usually easier and better satisfies the conditions for successful feedback.

What then, are the components of successful feedback? According to Hibbert (2013) it is it timely, honest, clear, objective, specific and supportive. It is meant to create an atmosphere of shared understanding between the giver and receiver in order to facilitate personal development or effective solution of problems in any setting. The key message being that it must focus on a specific behaviour, explain giver's point of

view and suggest ways of improving. It should not be used as a pretence for criticism as that would defeat its purpose.

But why is feedback important? As mentioned earlier in this chapter feedback utilized as a means of non-financial rewards can have lasting motivational effects on employees and create a shared understanding which allows for effective communication.
Additionally, Sommer and Kulkarni based on their research (2012) propose that feedback not only leads to higher job satisfaction, but also to higher perceived respect and organisational citizenship behaviour. They argue, that even constructive or unfavourable feedback will have positive effect if it is perceived as just. McAfee et al. (1995) that if both process and outcome feedback is deployed job satisfaction will be significantly increased.

Of course, giving feedback, especially if not properly practiced before, can be challenging. Hesketh and Laidlaw (2002) propose the following barriers:

- Fear of upsetting the learner or damaging the earner-mentor relationship
- Fear of doing more harm than good
- Resistance or defensiveness from the learner when receiving constructive feedback – poor handling of a reaction to negative feedback can result in feedback being disregarded thereafter
- Generalised feedback or feedback that is unrelated to specific facts or observations
- Feedback lacking guidance for rectify the behaviour
- Inconsistent feedback from multiple sources
- Lack of respect for the source of feedback

In our setting, the misunderstanding of distinction between feedback and criticism might be a strong barrier for both sides. Furthermore, lack of previous experience with proper feedback can undermine effects of feedback as well. This can be possibly rectified by many available trainings for feedback.

In conclusion, non-financial rewards in the view of total reward are as important or even more according to some motivational theories and they should be consciously designed to integrate with the financial creating the best possible synergic results.

## 2  Methodology

As shown in the previous part any project related to reward system should start with an analysis of current situation. This part shortly explains how data on the current situation were gathered and which methods were utilised.

It begins with the job satisfaction survey, continues with semi-structured interviews and concludes with participant observation.

### 2.1  Job satisfaction survey

Self-reported surveys are by far currently the most common method of research in this area. Rose (2014, pp. 25 – 27) argues that the method is both cheap and simple using available tools.

Bedrnová et al. (2012, pp. 256 – 258) provides some guidelines in design and usage of job satisfaction surveys:

- Written survey is cheaper and easier to manage, while oral survey is heavily dependent on experienced surveyor
- It might be harder to get as many replies with written survey
- Employees have a tendency to reply as they think they should reply
- The key condition for truthful replies is to explain the purpose of the survey and show the employees that it will be beneficial to them to be honest

The actual survey was designed with these principles in mind. It is based on the classical Job Diagnostic Survey by Hackman and Oldman (1975), while certain questions are added to adapt to the unique situation as well as demands from the organisation's management.

The survey is focused on job satisfaction and satisfaction with individual rewards and benefits. The survey was distributed anonymously to all current employees via Google Forms. The survey is available in the attachment.

### 2.2  Semi-structured interviews

Bedrnová et al. (2012, pp. 255 – 257) notes that motivation is inherently difficult to measure since the employees themselves usually do not actually know what motivates them. However, they propose that semi-structured interview is the second-best option in trying to understand employee motivation.

The interviews were carried out with the company management and focused on the same areas as the job satisfaction survey, but also included deeper questions about perceived motivation in the employees and management views on the situation and development.

The template for interview is available in the attachment. However, as the nature of semi-structured interview is that different and complementary questions are often asked, it does not necessarily reflect the exact questions asked.

## 2.3  Participant observation

Participant observation is the oldest scientific method, yet it remains popular in the areas that require more qualitative than quantitative approach. Bedrnová et al. (2012, pp 255 – 256) proposes that the participant observation, where the observer is part of the employee group and has a chance to observe natural behaviour of the other employees in longer period, achieves the best results in research on motivation. She further notes that the observer must take care to observe as objectively as possible and beware of subjective biases.

The author has spent considerable time working in the analysed collective and has actively participated in participant observation with a focus on motivation and employee satisfaction regarding rewards employed at least for 6 months.

Additionally, all the company's internal documents related to the reward system were scrutinised. These materials among other included recent market rate analysis comparing the company salaries for different jobs to market level based on job advertisements (as national and EU materials do not provide enough granularity to be of any use).

# 3 Practical part

In this part the findings of the research and recommendations for improvement are presented.

First, the company and its structure is shortly reviewed in order to provide necessary context. Second, the reward system is described from the total reward perspective. Third, the outcome of employee satisfaction survey and semi-structured interviews is presented and finally the results are shortly summarised and improvement initiatives are suggested.

The source of first two chapters are mostly interviews with the company two directors. Whereas the quantitative source of the third chapter is the job satisfaction survey with qualitative additions from semi-structured interviews with relevant line managers. The final chapter is based on synthesis and application of principles and theories presented in part 1 Theoretical part.

## 3.1 The company and its structure

This chapter describes the company, its structure and market. It begins by short description of the history of the company, follows with the internal structure and employee count and finishes with relevant information on the company's market.

### 3.1.1 History and description of the company

The company has been established by two young entrepreneurs in 1992 in order to develop high-tech solutions in their area. After a rocky beginning, it has gained popularity due to their innovation and state-of-the-art solutions that appealed to its customers. As the time went both the company and its market share grew until it managed to capture most of the market share and reach its current size.

The core product of the company remained the same software during its whole history. Naturally the software itself evolved and barely resembles its original now, but it's meaning and function has remained the same. The company also engaged in deliveries and modification of hardware that supports its core product. In the 21st century with the advent of cloud computing the company has transferred many of the customers from on-site solutions to partly centralized cloud solutions.
However the company has also occasionally developed and supported software that was partly based on the core product, but ultimately separated. These projects were usually larger and longer-running.

The customers of the company used to be mostly government owned or government supported organisations that required the software due to their unique functions. Later many privately-owned organisations purchased and use the software as well. Nowadays the levels of income generated from private and government-supported organisations is roughly the same. Notably the side projects were usually for the private companies.

The company is still growing, with regards both to profit and size, and remains the biggest player on its market. However, some say that it might be losing its technological advantage to newer rival software solutions.

### 3.1.2 Structure of the company

The company currently consists of the two original owners who act as directors and 37 employees (including part-time employees). The company structure is described in figure 3.1 and described further.
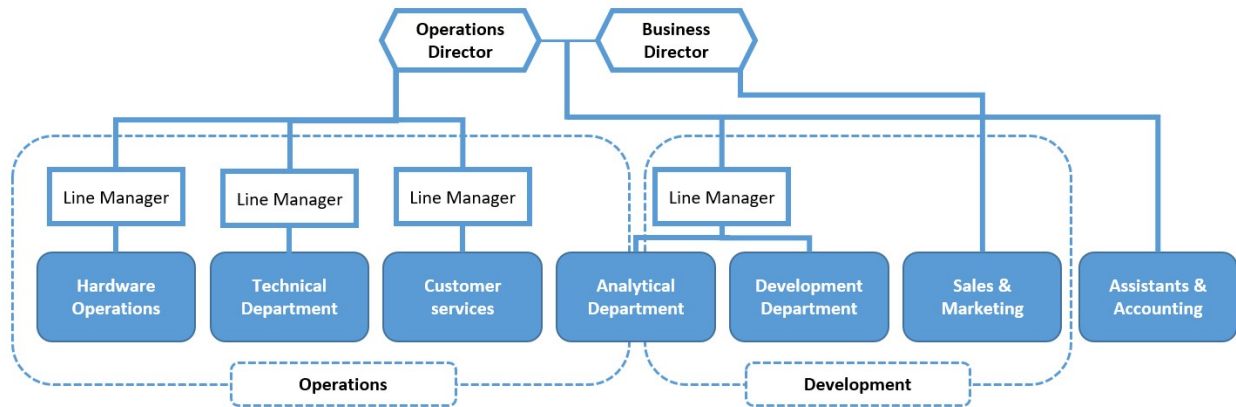


Figure 3.1 Company structure
Source: Author's research

The company structure is relatively flat with only 3 levels in total. It is roughly divided into Operations and Development. Operations mostly deal with day-to-day activities such as making sure that everything runs smoothly and providing customer support. Whereas development in oriented to the future, dealing with developing the software on the one hand and business development on the other.

**Directors**

The company's two owners act as equal directors in the company.
The director of operations is responsible for the hardware, technical department, customer service and partly analytical department. Their line managers report to him directly. He also handles most of high-level financial questions such as base pay negotiations and company costs.
The business director is responsible for the development part. He should focus both on software development in setting a vision and overall strategy as well as business development. He is acting as a key account manager for majority of the largest customers and also acquires most of the large customers.
It should be noted that the areas of responsibility are not in fact as clear cut and there is a lot of overlap and perceived differences in actual practice as opposed to the presented plan.

**Hardware operations**

Small, but vital department, consisting of 2 employees + a manager, that essentially takes care of all hardware in the company and for the customers. They are responsible for running the servers needed for cloud services as well as participating in development of hardware tools supporting the software.
They need relatively high technical competency and education.

**Technical department**

The technicians are essentially responsible for operation and partly implementation of the solutions for the customers. There are 4 technicians and their manager. They are responsible for customer hot-line where all the questions, problems and settings regarding the software are solved, then they are responsible for simple implementations (both hardware and software) that do not require development and finally they teach the customers how to operate the solutions. Customers must have valid technical support SLAs in order to utilize the hotline free of charge.
They need relatively lower, but still some technical competence and essentially no education as all the necessary skills and know-how can be taught in the company. Ideally they should be customer oriented, but that is not always the case.

**Customer services**

The company also offers other than technical services to its customers, this department deals with that. There are 5 employees and one manager.
There are essentially two responsibilities, first are accounting and marketing services related to the customer's use of software and the second is operation of end-customer hot-line (that is related to the customers of the company customers, who in the end use the software).
Both areas are essentially administration and do not require any special competences or education (that cannot be earned in the company). There should be clear customer focus as the department deals with customers and their customers daily.

**Analytical department**

The analysts are basically responsible for analysing needs or problems, devising solutions that they hand over to the developers, overseeing and testing developers' output and usually implementing the solutions. These activities are all included in company-wide projects, that the analysts lead. There are 7 analysts and one shared manager.
They also analyse and solve problems that the technical department cannot handle and create solutions back to them. Some of the analysts act as key accounts for the biggest customers.
With relation to the other departments they devise solutions for issues reported by technical or service department and deal with customer negotiations from the technical perspective.
There are high competence-related requirements for the analysts usually proved through higher education as well as some level of technical competence (higher than technicians, but lower than developers.

**Development department**

The developers are the coders that actually write the code and create the solutions designed by the analysts. There are 7 developers and a shared manager.
They cooperate mostly only with the analysts and usually do not meet the customers at all.
They are required to have the highest technical competence as well as knowledge of the software.

**Sales & Marketing**

Sales and marketing deal with exactly that. There are 3 employees in the department which is directly under supervision of the business director.
One employee is a typical salesperson, that deals with the whole process of acquiring and communicating with the customers. Although mostly the smaller ones as the large ones are covered by the business director. When they acquire a customer or a specific order, they hand it over to either the technicians or the analysts.
The other two employees deal with marketing of the company, partly support the salesperson and help with external and internal improvement initiatives usually initiated by the business director.
They need almost no technical competency, essentially only needing to know what the software can currently do. They of course need certain expertise in sales and marketing.

**Assistants & Accounting**

There are 2 assistants who operate the reception and help the directors with administrative tasks and one accountant who deals with the operational accounting such as paying invoices, pay, reporting to the state etc.
Neither require any technical competency, the administrators only need certain soft people-skills and the accountant naturally needs the full expertise in accounting.

As noted earlier the lines between responsibilities can sometimes become blurry, but it is necessary to consider the different groups in the company in order to effectively evaluate the reward system.

### 3.1.3 Company's market
The market has changed significantly over the existence of the company. In the beginning, it was rather empty in this area, but the competitors quickly started arriving. During the early 21st century the market was relatively stable with the market shares divided and no significant new entrants. However, during the last few years many new entrants with support of wealthy investors began aggressively entering the market and marketing their products. They have already gained a foothold with some former customers and threated to do even more.

### 3.1.4 Company's vision and mission
The vision of the company was always to be a number one on the market. This in practice meant that the solutions should be state-of-the-art and especially better than these of the customers and of course the market share in the relevant market should be the biggest.

However, in the past few years there was no clear strategy to achieve this. There is a certain dichotomy between the two directors, where each wants to focus on a different are and in effect there is no strategy that the employees could see and act by. Based on the interviews this is seen as one of the core problems causing difficulties in both operations and development.

## 3.2 The reward system of the company

In this chapter the reward system is explored and described from the perspective of the total reward. No judgements are offered on the perceived effectivity of the rewards, that is the purpose of the next chapter.

The reward system is structured in the same way as the Theoretical part in order to simplify the examination and allow for clear links between theory and practice. The structure is then: Base pay, Contingent pay, benefits and finally non-financial rewards. The subchapters always include description of the component of the total reward and its intended purpose.

### 3.2.1 Design of the reward system

It should be noted that the reward system was not fully designed as such. Almost all the components arose organically from the ideas of the management and suggestions of the employees. Until now, no structured examination of the rewards and their interconnections has been conducted.

Due to above reasons, there is currently no explicit reward strategy of the company.

### 3.2.2 Base pay

Base pay is the largest financial reward in the company. It makes up between 70% - 100% of the employee's financial reward, depending on the department and other factors. This subchapter explores its specifics.

**Job evaluation**

Although there was no formal process of job evaluation, the jobs in the different departments were informally evaluated against each other. This created certain relative sized of the jobs, that is still upheld today. The main criteria for the job evaluation were: Necessary technical competencies, necessary other competencies (e.g. people skills), overall responsibility and created value for the company.

Market rate analysis is executed occasionally, but it consists only of research based on job advertisements and connections in other companies.

**Grade and pay structure**

There is a combination of spot rates and job family structure illustrated in figure 3.2.

When a new employee is hired, depending on the department and position a certain range is deemed reasonable by the hiring party (usually one of the directors). However, then the employee is essentially given a spot rate, that should fit roughly in the pay structure, but might be a little bit off. For example, a new hire can receive higher pay for the same job as a current hire, that did not negotiate a pay increase.

**Movement in the pay structure**

There is a process where, when an employee is hired he is given the lower end of the pay scale for the first 3 months (the examination period) and then a raise, given he deserves it, but not yet to his agreed level. After first 12 months, the employee is given the rate that was agreed on during the hiring process, again given that he performs as expected.

However, there is no system for moving in the pay structure after that. If an employee wants a raise, she must specifically go to her manager and then one of the directors. Her performance is then evaluated and raise is given if relevant. Similarly, employees are not move from junior to senior positions by any system, but rather by stating that they want to and negotiating with the management. (Note, that the employees are generally already hired into both junior and senior positions.)
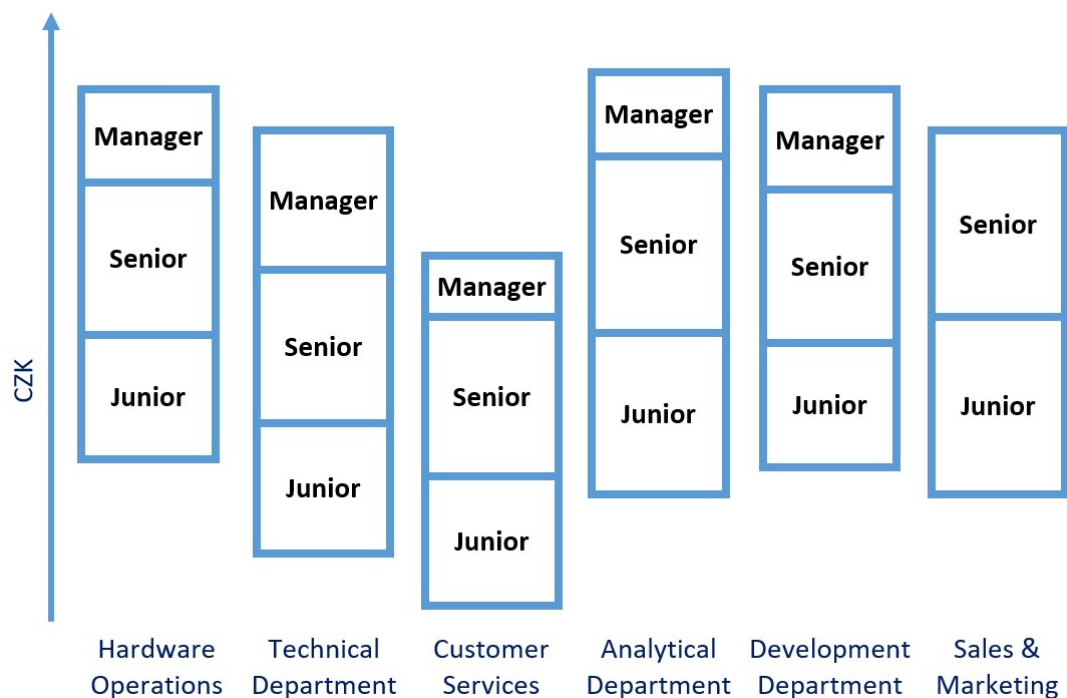
Figure 3.2 Illustration of grade and pay structure in the company
Source: Author's research

### 3.2.3 Contingent reward

As mentioned earlier, there are no formal procedures for contingent raise of base pay. Therefore, there are only bonuses, that are based on either personal or company performance. Each bonus scheme and whom it impacts is described below.

**Project bonus**

Most of the developmental work is divided into projects. These projects are assigned a leader – almost exclusively an analyst and a financial value. In specific ordered development, the value is the financial value of the order and in case of internally initiated development it is based on the expected workload.
Then, the project is assigned a total bonus based on its attributes, namely: technical difficulty, future usability and special.
When the project is finished, first of all the operations director evaluates how successful the project was. This is measure almost exclusively in whether it followed or exceeded its internal budget (as the chance that the project is not completed at all is almost unprecedented). If the project was successful full reward is paid, if not the reward can be lowered or taken away altogether.
In parallel to that, the project leader divides the reward between people who worked on the project. This should be based on the amount worked on the project modulated

by their responsibility and technical difficulty. Usually the analysts receive around 50% of the reward, the developers around 40% and the technicians around 10%. If other departments somehow participated they receive part of the reward as well. Lately in cases of especially marketing projects, the employees from marketing can also be project leaders and receive most of the bonus.

The bonus is then paid retrospectively each month for projects finished in the past month.

The purpose of this bonus was form the very beginning to reward successful completion of the projects (that is on time and cost) and motivate people to work together to reach that goal.

## Recurring SLA bonus

As noted above, the usage of customer hotline in the Technical department and certain services in the Customer services is based on SLAs with customers. Whenever such SLA is signed it generates monthly payment. From this payment is every month generated the same reward based purely on the size of the payment.

Additionally, when the SLA is signed it is allocated to one of the technicians (or rarely to an employee from the Customer services). Now the employee responsible for the SLA is given reward every month, that she can divide between others in the same way as the project reward.

Despite the similarity, there are several key differences. First, the responsible employee does not change, so in current situation the most senior employees are historically assigned the most valuable SLAs and receive most of the bonuses. Second, the reward is not performance contingent, the reward is the same no matter how much work was in fact done related to the SLAs in that month (even if there was no work at all). They are not even based on responsibility, because currently the technicians have no specializations and any technician responds to any customer based on availability. Additionally, no customer feedback is systematically gathered related to the SLAs. Although the responsible technician can distribute the reward from her SLA to another, most of the bonus is usually reserved for the holder. These bonuses are almost exclusively received by the technicians and some of the Customer services employees on the same principle.

The purpose of this bonus was originally to make a certain bonus scheme for the technicians as well, as the development areas already had the project bonuses and to motivate the employees to be customer oriented and perform as well as they could in relation to their SLAs.

## Recurring performance contingent profit-sharing bonus

This bonus is a combination of performance evaluation and company-wide profit sharing. Every employee except for line managers, Sales & Marketing and Assistants & Accounting receives the reward equally based on the following process:

- Each month a company profit for the past month is calculated
- % of that profit is assigned for performance bonuses

- Each line manager (or director) assign each employee a rating from 1 – 5, based on their performance last month
  - This rating should be based on exceptional behaviour or achievements in the past month (e.g. creative problem solving, notable dedication to work, outstanding teamwork or other)
  - There is no forced distribution of these rating, everybody can get a 1 or a 5
- The bonus is distributed to the employees based on their ratings

The bonus is paid monthly with the project and SLA bonuses.
It is somewhat unpredictable in size as the profit changes each month. Additionally, the employees are not aware of the formula for the calculation or the monthly profit.

The purpose of this reward is to encourage people to focus on the larger picture of the company success and motivate them to create value overall while focusing on their personal performance. Also, it is a tool for the line managers to financial reward exceptional behaviour or performance.

**Management recurring bonus**

Although this is almost a part of the base pay it is still considered a bonus by the company's leadership. The line managers do not receive the aforementioned profit-sharing performance bonuses, but they are compensated by a monthly bonus for managing employees. This bonus has a constant size and can theoretically be withheld, but that has not yet happened.

The purpose of this bonus is to reward the additional responsibilities that the line management has and in part supplement the profit-sharing performance bonus. As it is recurring in the same size, it is not actually performance contingent.

**Yearly profit-sharing bonus (Christmas bonus)**

The Christmas bonus is paid each year in December. A certain sum is calculated from the company's yearly profit and then distributed to the line managers. They then assign the bonuses among the employees as they see fit.
The purpose is generally to reward employees for their work during the year and motivate them to perform as good or better next year.

**Sales commission**

The one true salesperson does not receive any above bonuses except for the Christmas bonus. He does however receive a commission on each sale he successfully completes. The bonus is calculated and paid quarterly.
The purpose is naturally to motivate the employee to sell as much as he can. The effects of the sale or customer relationship is not considered.

**Accountant's bonuses**

The accountant does not receive any of the previous bonuses. But has her own special bonuses paid for specific achievements, such as correctly filling the tax return form and receives a yearly bonus at the end of the year.

The purpose is to motivate the accountant to perform well in her specific activities and provide fair treatment as she does not receive any other bonuses.

### 3.2.4 Employee benefits

The company offers a number of employee benefits as well. Although most of the benefits are available for everybody, some are only for selected employees.

Table 3.1 illustrates the available benefits, short descriptions and who can receive them.

| Benefit | Description | Receiving employees |
|---|---|---|
| Kitchen and drinks | Fully equipped kitchen with fridges, espresso coffee makers, microwave and tea makers | Everybody |
| Company Mobile phone | Mobile phone with free personal usage (up to a reasonable point) | Everybody who needs a mobile phone for work (almost everybody) |
| Company notebook | Notebook with possibility of personal usage | Everybody who asks for one (Most of analysts and technicians) |
| Food vouchers | 55% of food voucher value (100CZK per day) is paid by the company. | Everybody |
| English lessons | English lessons for beginners and intermediate. In the company premises, but not counted towards working hours. | Everybody, who wants to join. |
| Developmental workshops, courses and fairs | Any personal development courses up to a reasonable cost (no specific limits set). | Only analysts and developers based on their personal request. |
| Company events | One Christmas event and one overnight event in June, all expenses except for hard alcohol paid by the employer. | Everybody. Usually most of the employees participate. |
| Company sport | Certain sport is played once per week with expenses covered by the employer. | Available for everybody. Usually 6 – 10 employees participate. |
| Contribution to pension scheme | Up to 30 000 CZK per year. Half is covered by the employee, half by the company. | Available for everybody who worked for the company for at least 1 year. However only few employees use it. |

| Benefit | Description | Receiving employees |
|---|---|---|
| **Pause for smokers** | Employees can take several pauses a day, that are included in the work hours to smoke or carry out quick shopping. | Everybody who smokes |
| **Company car** | Car for work as well as personal use. | Only the salesperson. |
| **Cultural vouchers** | Vouchers for specific cultural events. Usually a theatre play or musical. | Everybody, but only upon personal request. Mostly used by analysts. |
| **Gift vouchers** | Once per year usually with the Christmas bonus a voucher is given for purchase of the company products for personal use. The size depends on the employee. | Everybody, who receives the Christmas bonus. |

Table 3.1 Employee benefits overview
Source: Author's research

One additional benefit is that recently the company moved from an old office-based premises into modern open-space premises. Where all the necessities and work environment was significantly improved.

The general purpose of all the benefits is to create a satisfying working environment and show all the employees that the employer cares about them. Some are also meant to reward and slightly motivate people to work harder (e.g. the company car).

It should be noted that benefits as well evolved organically and even the directors did not have full overview of the offered benefits. The employees were never fully informed of the benefits either.

### 3.2.5 Non-financial reward
The business director insists that the company cannot compete with large multinational organisations in base pay and therefore he proposes that the non-financial rewards are where they should both retain and motivate people.

This subchapter considers performance management and recognition programmes in the company and then moves on to general practice in the company.

**Performance management**

There is no formal performance management system and as noted earlier raise of base pay is not formally linked to performance either.
That said, each line manager deals with development of their employees based on their own judgement. Generally, the line manager of the analysts and developers does talk to the employees about developing their skills and competencies and tries to assign projects based that can help them develop. The other line managers either do not have the necessary mindset or competencies and do not generally behave in this way.

**Recognition**

There are no formal recognition awards.
Informally exceptional behaviour is recognised inconsistently among the departments. The line manager of the analysts and developers does try to recognise exceptional recognition or results, whereas the other line managers usually only recognise people via assignment of monthly rewards.

**Feedback**

There are no formal policies or systems concerning feedback.
There is no formal training or recognition of the importance and principles of good feedback which leads to feedback generally being perceived as or even actually being only criticism.
Perhaps due to this the prevailing feedback is mostly critical and general focus is on shortcomings and issues rather than celebrating success. Additionally, the feedback is often not entirely specific and lacks suggestion for future improvement, essentially making it just criticism. This is not consistent among the departments as some line managers do provide even positive feedback and suggestions for improvement.

**The meaning of work and autonomy**

The directors argue that the main non-financial reward and perhaps the most important reward at all is the meaning of work and relative autonomy.

What is meant by this is that the employees know what they are creating and have the autonomy to decide how to solve problems and how to create solutions. This should mean that their work has a clear meaning that they can be proud of and which should be fulfilling by itself. This is enhanced by giving employees large responsibility with the freedom as well. They argue that this is in contrast with large corporations and possible feeling of being 'just one cog in the machine'. Furthermore, by offering large range of activities for most employees they offer certain autonomy to choose the most fulfilling activities and to allow the employees to develop their skills and competencies.

**Education**

As mentioned earlier, education is available via certain benefits. It should be noted that formal education apart from the English lessons are relatively difficult to obtain and require negotiation with the management.

**Work atmosphere**

Last non-financial benefit per the directors is the general work atmosphere. As the employees all know each other and the work teams are relatively small, they argue that this, in connection with their focus on team cohesiveness in the hiring process, create well-functioning teams with the atmosphere of trust and shared responsibility. Line managers are meant to foster and improve the team atmosphere further.

## 3.3  Findings of the concluded research

In this chapter the reward system is evaluated from the perspective of the results of the employee job satisfaction and semi-structured interviews.

First the scope and amount of received answers for the survey and interviews are described. Then each of the identified areas of total reward is evaluated based on one or more questions. As mentioned earlier, some of the survey questions were added for other purposes than this research and are not evaluated here.

For each total reward area, the results of the job satisfaction survey question/questions are presented and different departments are distinguished graphically. Then the area is evaluated based on the survey as well as insights from the semi-structured interviews, observation and answers to open ended questions in the survey if relevant. Relevant differences between departments are noted as well. Employee benefits have slightly different structure due to their specifics and are considered the last.

### 3.3.1 Surveys and interviews concluded

The survey was sent to 34 employees from all departments. The excluded 5 employees were:

- The company directors for obvious reasons
- Two technicians as they joined the company less than a month ago and were considered not to have valid input
- The author of this work, as his results would be necessarily biased

The survey was anonymous for all the employees except the line managers. The survey was sent and endorsed by the business director with set deadline and promise of sharing of results. Perhaps due to this approach, all 34 surveys (100% response rate) were returned filled.

The semi-structured interviews were conducted with all 4 line managers and the two directors. Note that the interviewees did not know the results of the survey at the time of the interviews.

### 3.3.2 Base pay

The survey had two relevant questions/statements for the base pay. First is "How are you satisfied with your base pay?" illustrated in figure 3.3, second is "I know how my base pay is determined" illustrated in figure 3.4.
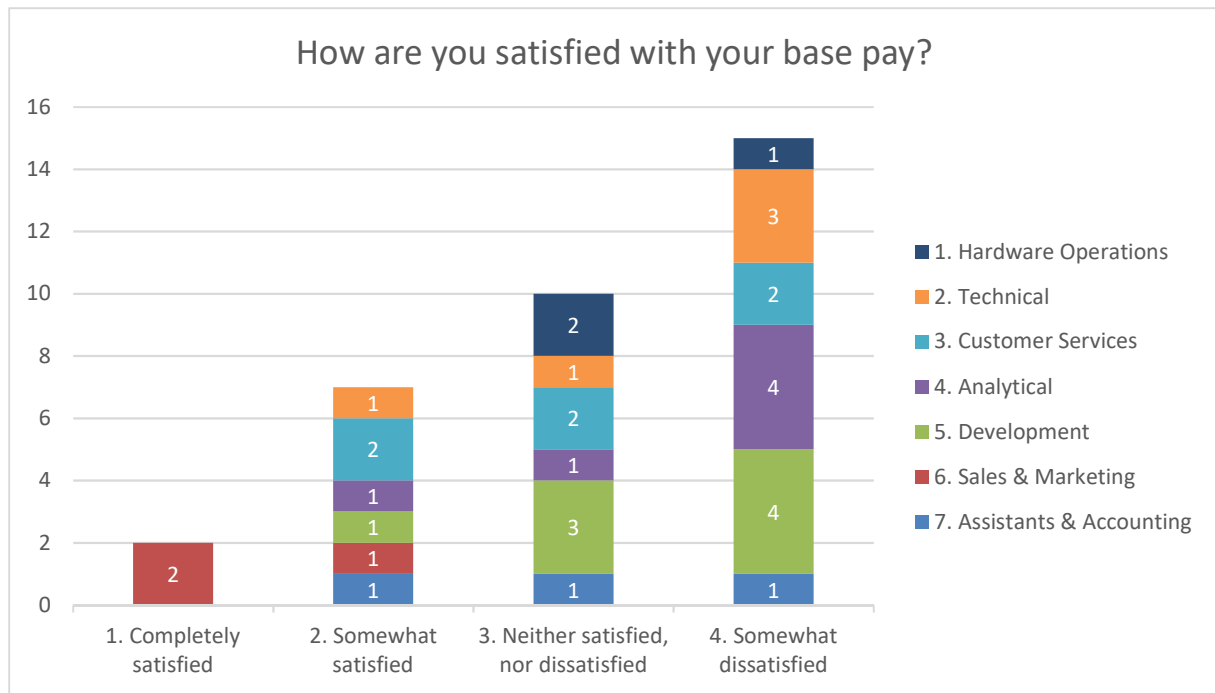
Figure 3.3 How are you satisfied with your base pay
Source: Author's research

As we can see employees are generally dissatisfied, with 15 employees dissatisfied, 9 satisfied and 10 undecided. Notably the Sales & Marketing department is the most satisfied and the analytical department most dissatisfied, with the other departments spread more evenly.

This is in line with the expectations of the management, who expected satisfaction with pay to be even more negative. However, line manager of the analysts and developers insisted that the analyst will state dissatisfaction with the pay due to their high perceived value despite being objectively better compensated than most of the company and especially the developers.

The effect of conforming the answers to the peer expectations should be considered here. Whereas in the Western context this leads to stating higher satisfaction with pay than actual, in our context where complaints about pay are much more common and socially acceptable the effect could be easily reversed. I.e. the employees complain about pay even if it is satisfactory specifically for them.

Based on the simple market rate analysis, following outcomes can be reached:

- The pay of Customer Services, Sales & Marketing and Assistants & Accounting is likely average to slightly above average
- The pay of Technical department is relatively hard to categorise, but likely about average
- The pay of analysts is average to slightly below average (obviously large multinational companies offer roughly 20% higher base pay)
- The pay of Hardware Operations is about average
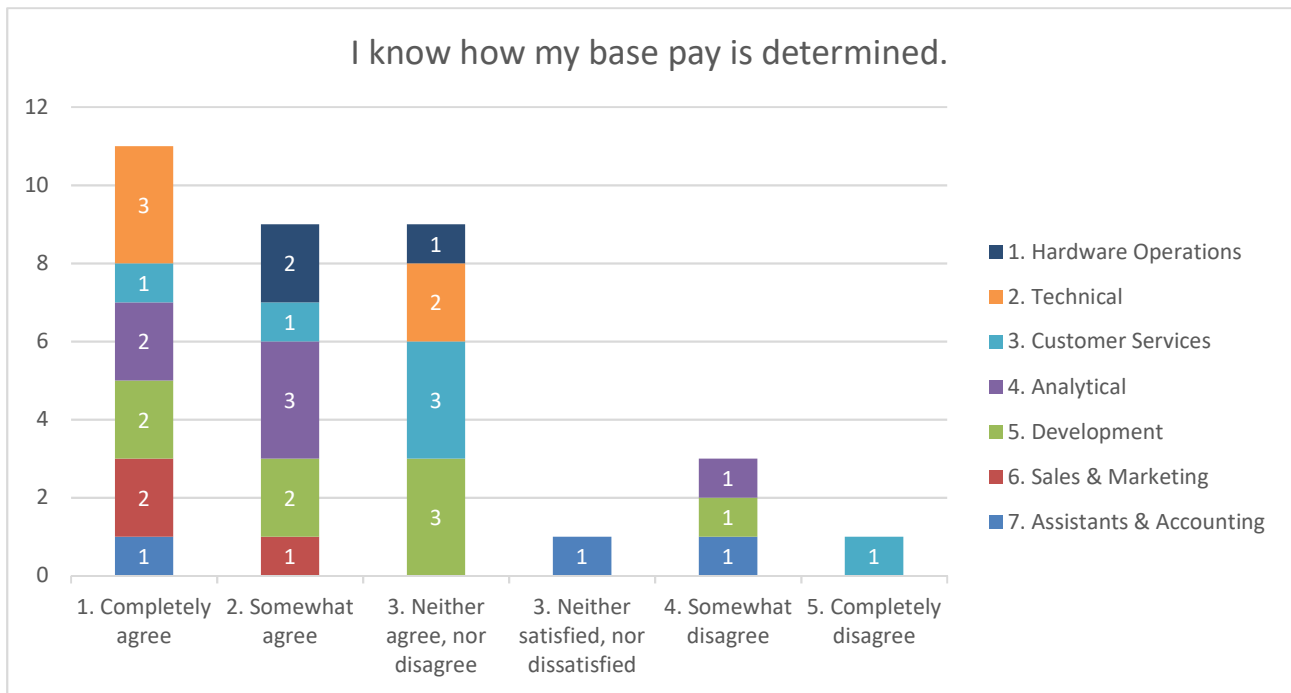- The pay of developers is slightly below average

Figure 3.4 I know how my base pay is determined
Source: Author's research

From the survey result, it is clear that most of the employees at least somewhat know how their pay is determined. The most ambiguous department is the Customer Services which has a large spread among all the levels.

This question is important due to perceived justice of the system and relation to contingent reward. If people know how the pay is determined they are more likely to perceive the results of the pay negotiations as fair even though they are not necessarily satisfied with them. Additionally, if people know how the pay is determined they should know what to do in order to increase the base pay (if the system allows it).

Additionally, employees often requested, in the open questions, that there should be some systemic way of increasing base pay, without having to ask and renegotiate every time.

### 3.3.3 Contingent reward

There are 5 survey questions relevant to contingent rewards. We will begin with general ones and end with two questions related to specific rewards – monthly bonuses and Christmas bonus.
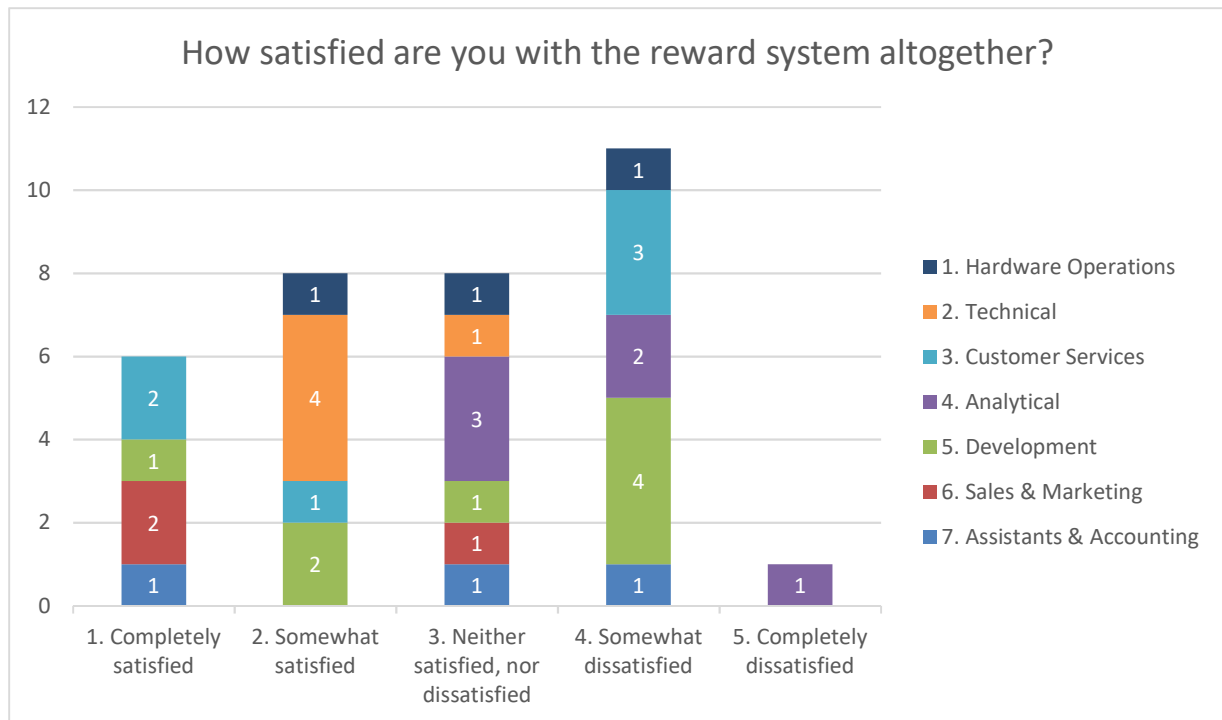
Figure 3.5 How satisfied are you with the reward system altogether?
Source: Author's research

The results show that the general opinion of the reward system is somewhat divided. The technical department is generally satisfied, this is arguably (based on the interviews) due to their access to the SLA monthly bonus. The Customer Services have diverging opinions as well, again it could be that the two employees who have access to the SLA monthly bonus are satisfied, whereas the rest is not. The analytical department is predictably unsatisfied. This was expected from their line managers as well, due to their general opinions of the SLA bonus. The Sales & Marketing are again generally satisfied. The other departments gravitate towards the average satisfaction.

The next two figures (3.6 and 3.7) show statements related to the fairness of the reward system: "My reward is reasonably linked to my performance" i.e. fairness in relation to the answering employee's reward and "The reward system (excluding base pay) is fair in relation to performance" i.e. the overall fairness of the reward system.
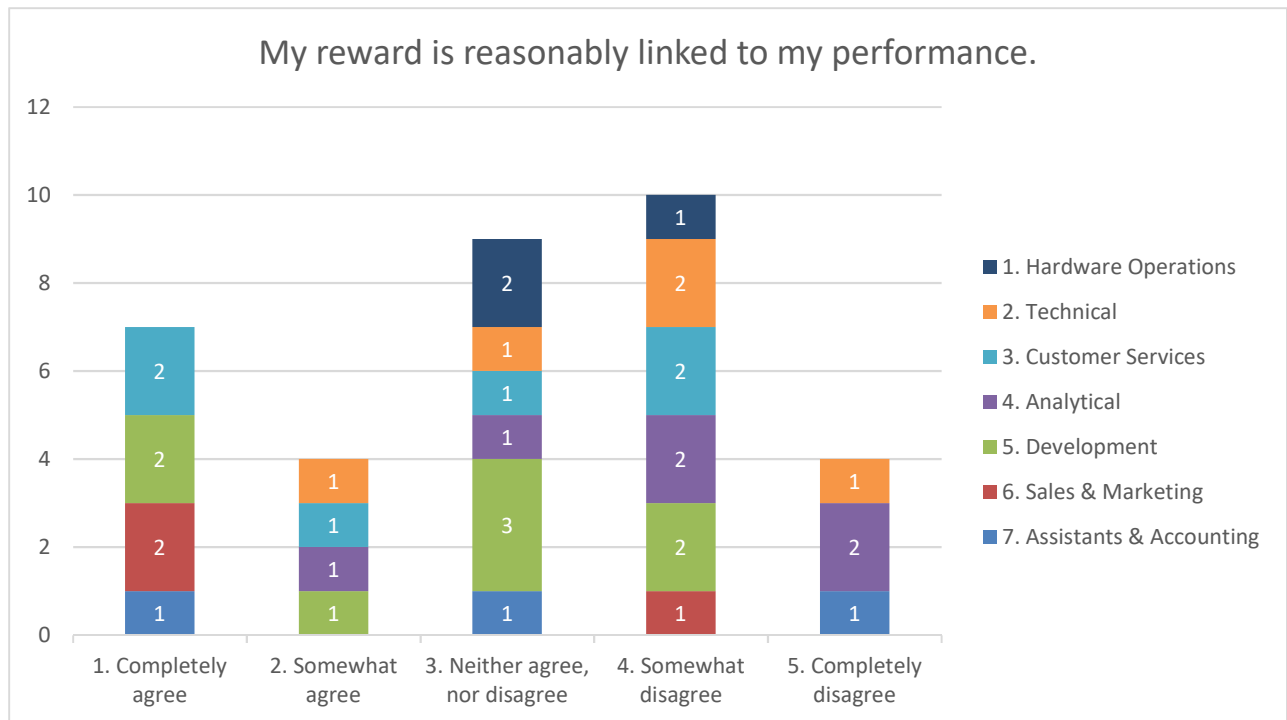
Figure 3.6 My reward is reasonably linked to my performance
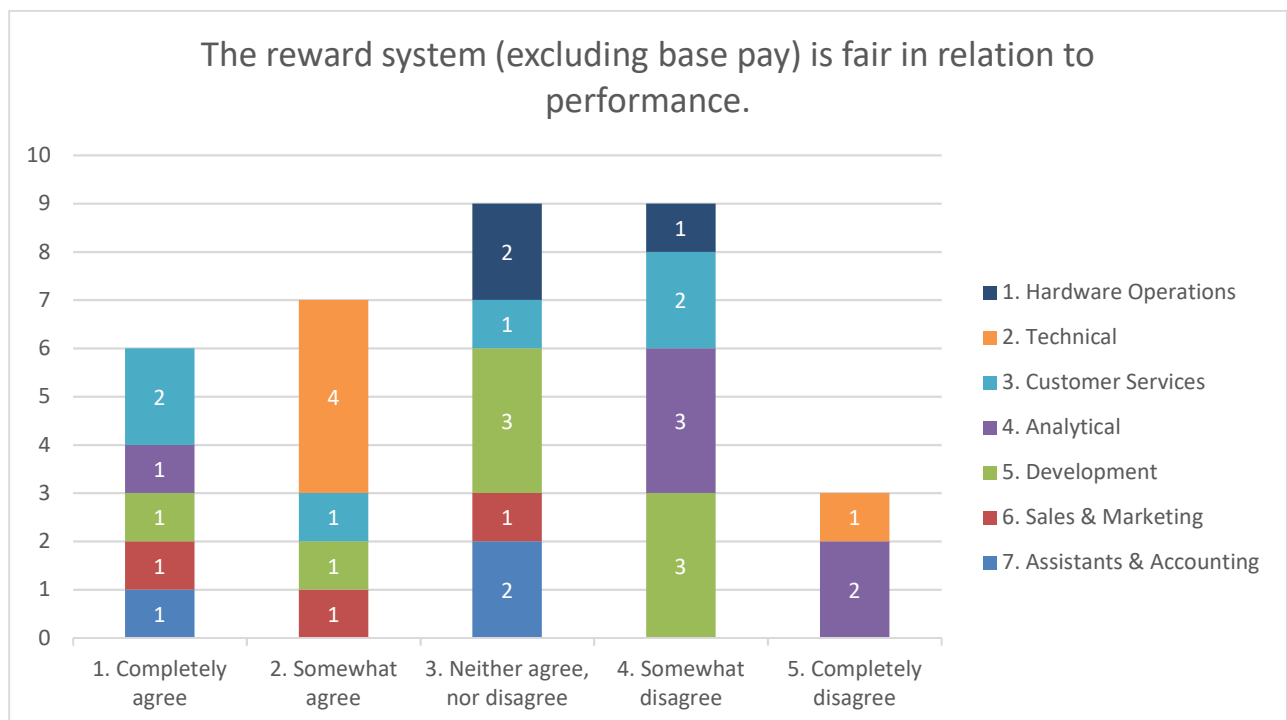Source: Author's research



Figure 3.7 The reward system (excluding base pay) is fair in relation to performance
Source: Author's research

The results from the first statement show that the employees have ambiguous attitudes towards the link between reward and performance in the company. Only 11 agree that there is a reasonable link, 9 are undecided and 14 disagree. This can be

partly explained by the question of base pay, where most are dissatisfied with their pay and could therefore think that their performance is not adequately rewarded and partly by the statement in figure 3.7.

Based on the results illustrated in figure 3.7 it seems apparent that the employees have differing perceptions of the general fairness of the reward system as well. 13 agree that it is somewhat fair, 9 are undecided and 12 disagree. Most of the departments have same general perception of the reward system for themselves as for the whole company, but interestingly most of the technical department shifted their answers to that of general fairness. This is in line with their answers in figure 3.5 and the explanation of the perceptions of the others is likely due to similar arguments as well.

The next two figures (3.8 and 3.9) show the answers concerning specific rewards: 3.8 shows the answers to a question of importance of monthly reward, i.e. both project and performance-profit bonus and 3.9 shows the perceived importance of the Christmas bonus.
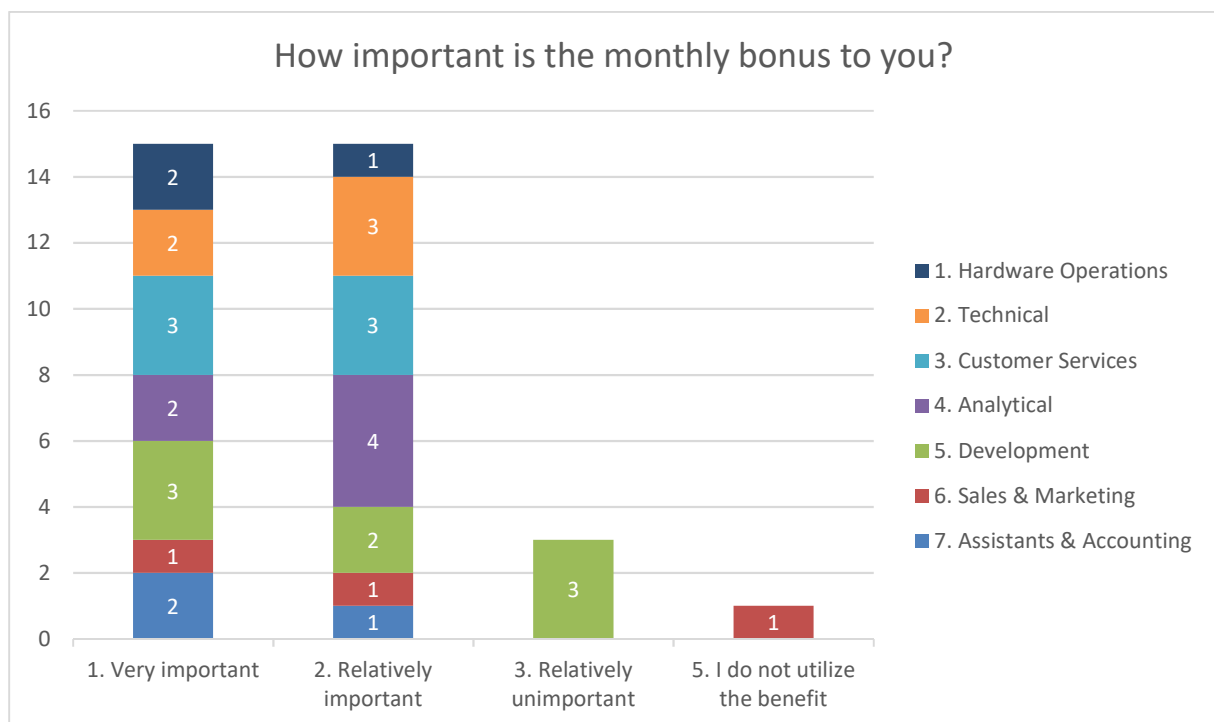


Figure 3.8 How important is the monthly bonus for you?
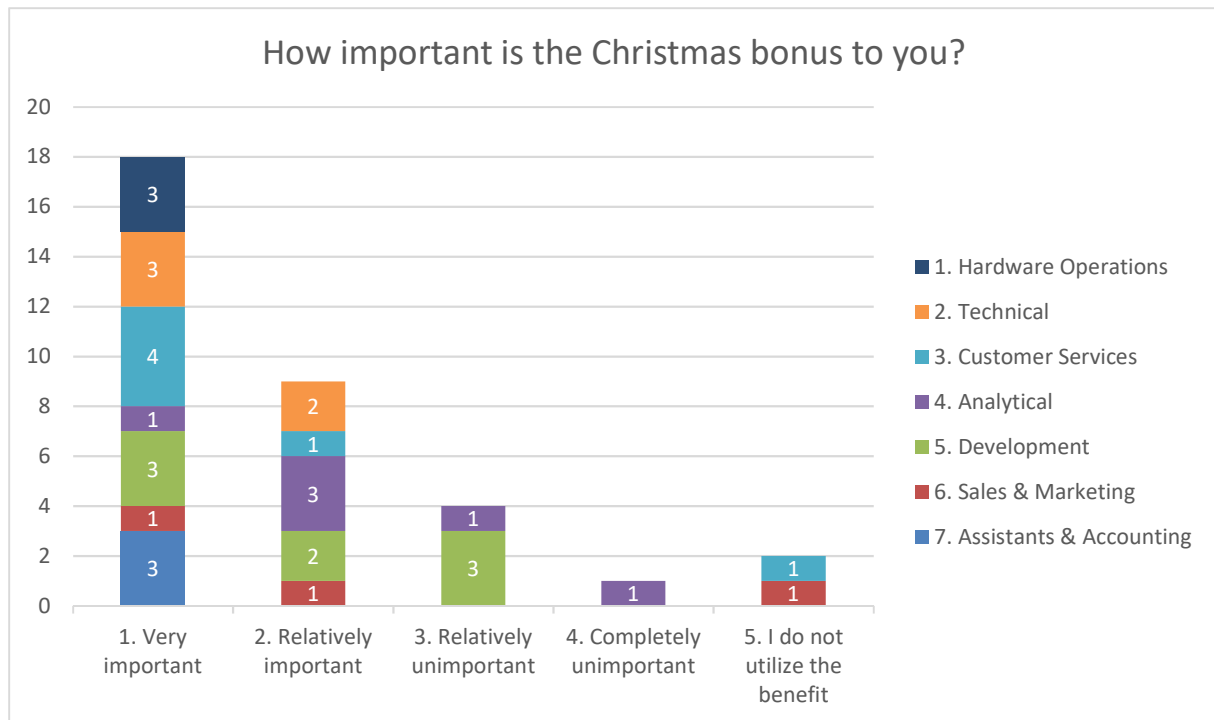Source: Author's research

Figure 3.9 How important is the Christmas bonus for you?
Source: Author's research

As expected everybody almost every employee claims that both financial bonuses are important for her.

Figure 3.8 shows that the bonus is not as important to some developers. Based on the interviews it might be due to that it is relatively small for them as they receive only project bonus and of relatively lower value. Interestingly many employees noted in the open questions that they do not know why the monthly bonus changes and what is it based on, many claimed that they would like to receive an overview showing from what is the bonus calculated.

Figure 3.9 indicates that the Christmas bonus was even more important. The three employees who rated 4. and 5. are likely new employees who did not receive the bonus yet. This is underscored by open questions and interviews where the employees claimed, that they were very pleased with the Christmas bonus. However, almost nobody knew that the bonus was directly based on the company's profit last year.

### 3.3.4 Non-financial rewards

The non-financial rewards are the backbone of the reward system and as such (and due to their diversity) the survey contained many questions for them. Not all results from these questions are shown as some might not be adding any value to the ones shown. This subchapter is divided into three areas containing evaluation of related questions or statements: Work environment, the work experience and feedback & personal development.

**Work environment**

The key determinants of the work atmosphere are the job relationships at work. That is why the survey focused on the areas of relationship with one's supervisor (figure 3.10), one's colleagues (figure 3.11), inter-departmental relationship (figure 3.12) and finally directly asked about the work atmosphere (figure 3.13).
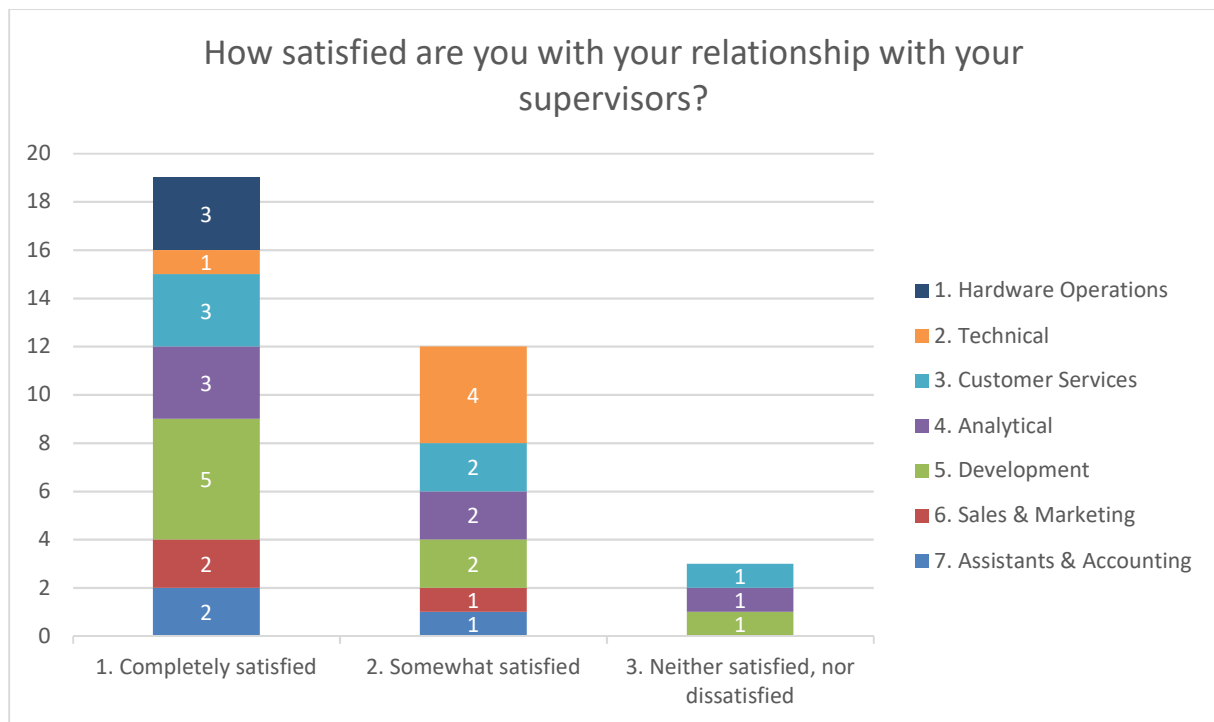


Figure 3.10 How satisfied are you with your relationship with your supervisors? Source: Author's research

The results clearly indicate that the employees are satisfied with their relationship. This is further illustrated by answers to statement "My supervisor is fair and treats everybody equally." (not illustrated) which showed 24 positive answers, 7 neutral and only 3 slightly negative. Based on interviews and observation it is evident that the managers have certain respect and employees believe that they honestly act in their best interests.
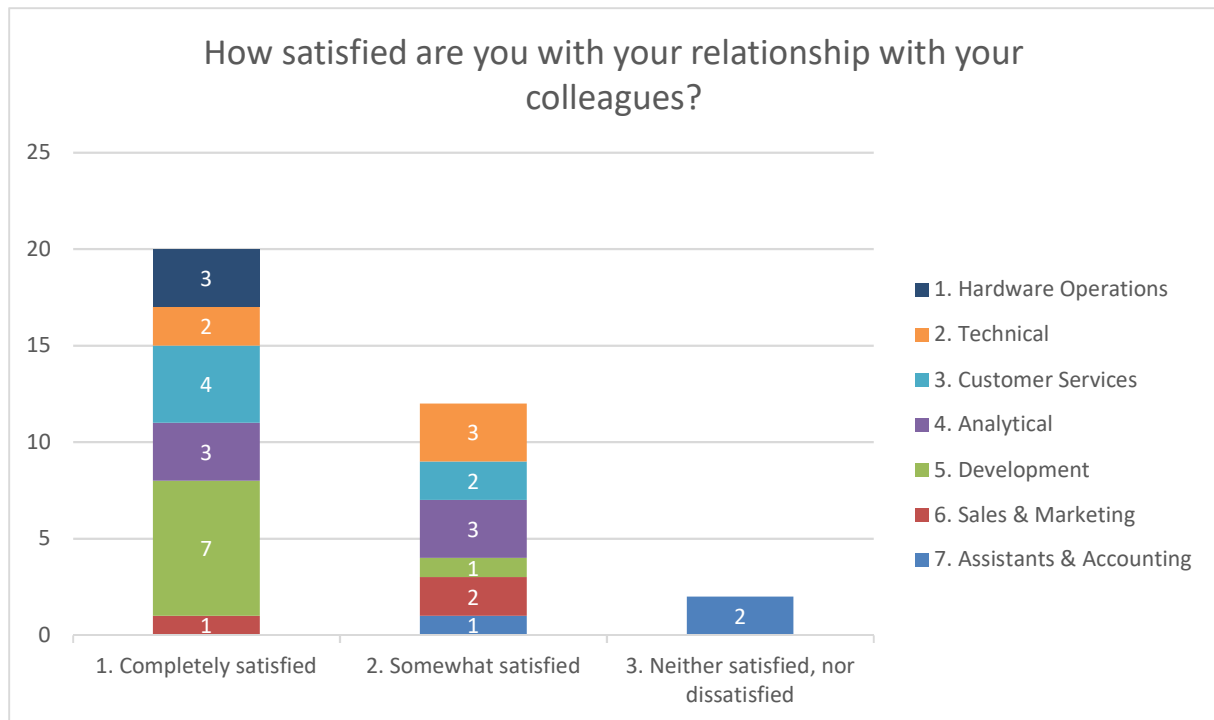
Figure 3.11 How satisfied are you with your relationship with your colleagues?
Source: Author's research

The results show that the employees are clearly satisfied with their relationships among themselves. The only exception is the Assistants & Accounting which is likely due to the fact, that they do not actually work together and cannot form much of a work relationship. Additionally, answers to statement "My colleagues are always willing to help me if necessary" (not illustrated) show 33 positive answers and only one neutral further supporting this result.

Based on the interviews and observation it is apparent that the departments function as cohesive units, where people are willing to help or give advice to each other if needed. The management adds that the rewards do not require any competition, but rather cooperation with the teams which should add to their effectiveness.
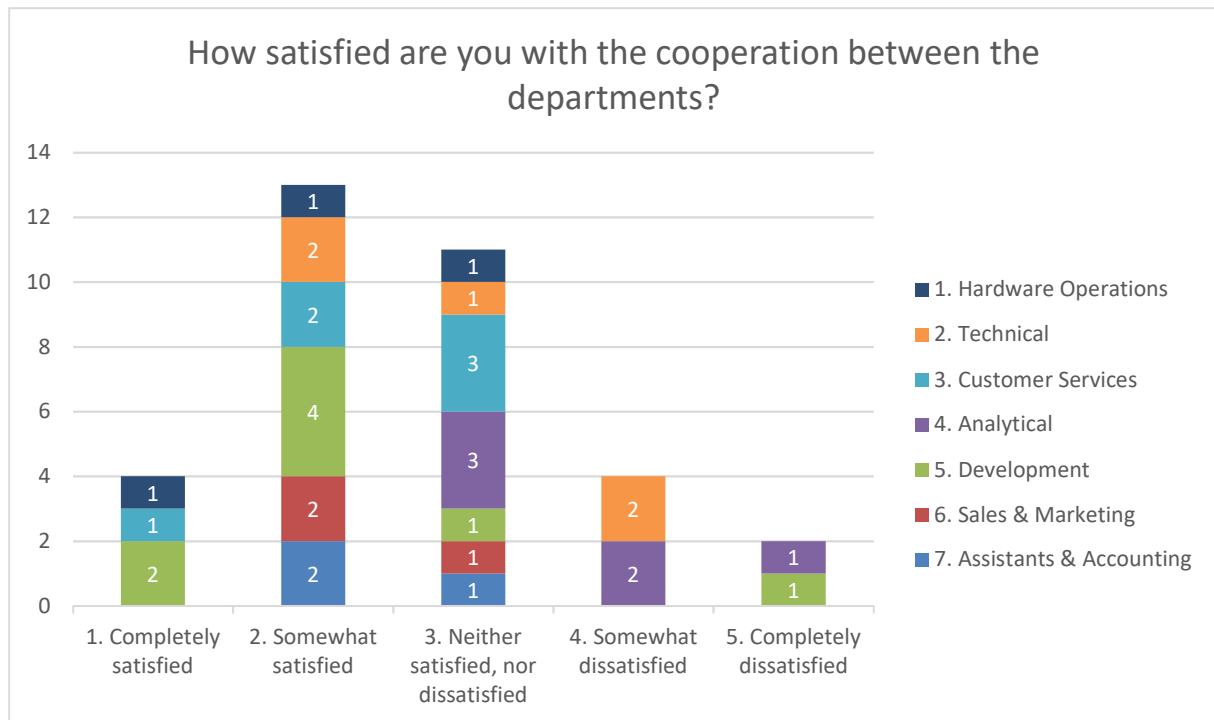
Figure 3.12 How satisfied are you with the cooperation between the departments?
Source: Author's research

Evidently, the cooperation between departments is perceived generally positively, but there are some differences. Most notably the analysts generally do not see the cooperation as satisfactory and the technicians have a large spread. The other departments are either clearly positive or somewhat neutral.

This is partially explained in the interviews and open ended questions, by the general opinion that the analysts and technicians do not cooperate as well as they should. The analysts claim that the technicians hand over all the work, even what they should be doing and the technicians claim that the analysts should not create issues (via development) in the first place and be more proactive in their solving. Additionally, other departments claim that the technicians do not have time to help with their (customer related) issues promptly enough or plan accordingly. The technicians counter this by insisting, that they have too much work already.
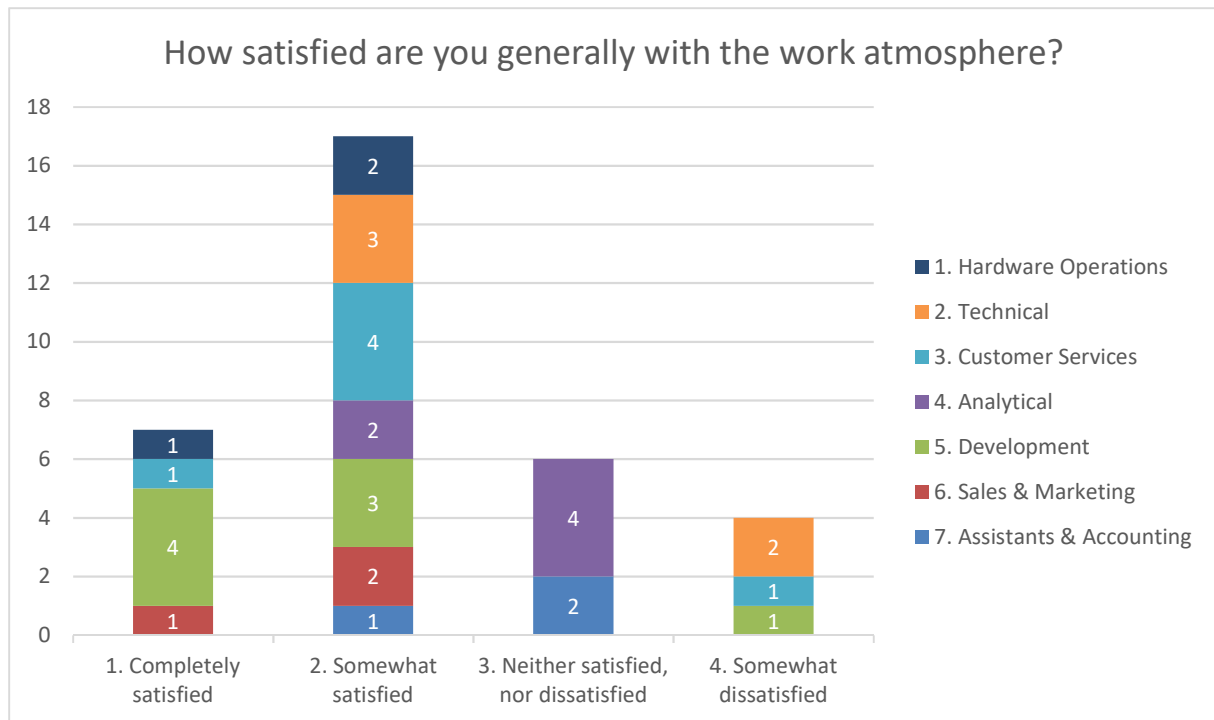
Figure 3.13 How satisfied are you generally with the work atmosphere?
Source: Author's research

The results indicate that the employees are generally satisfied with the atmosphere. The results of analysts and technicians is likely due to aforementioned reasons of difficulties in cooperation. The results are also supported by answers to a question: "How satisfied are you with your job security" (not illustrated), where 29 employees answered that they are satisfied and 5 answer neutrally. This might signify, that the employees are aware that the company is economically healthy and they expect it to survive.

**The work experience**

As the work experience is among the biggest non-financial factors many questions were targeted specifically for its measurement. First the nature and content of work is reviewed (figure 3.14), then the amounts of autonomy and responsibility for one's work (figure 3.15) and finally the meaning of one's work (figure 3.16).
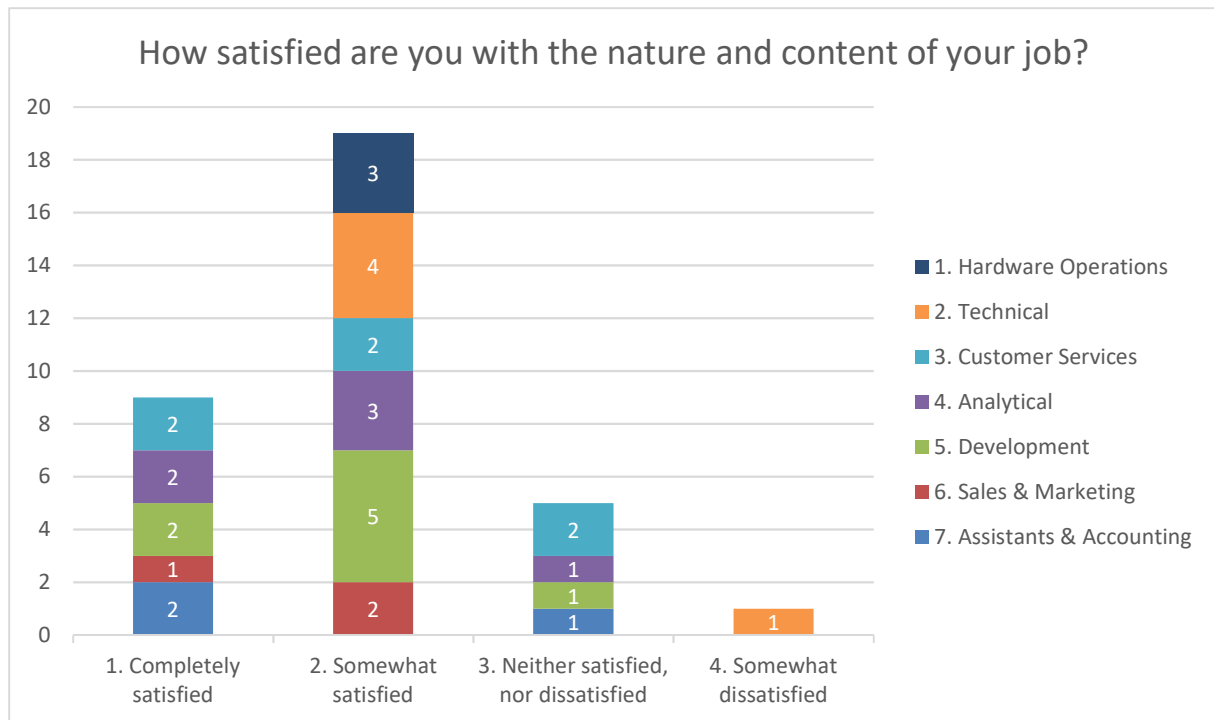
Figure 3.14 How satisfied are you with the nature and content of your job?
Source: Author's research

The results indicate that majority of the employees are satisfied with their work to some extent. Based on open ended questions and interviews it is mainly due to the evolving nature of work and for most range of interesting activities as well as reasons covered in the next few figures. When looking at the amount of work (question not illustrated) 19 employees are somewhat satisfied, 8 neutral and 7 somewhat dissatisfied. The spread is relatively even, but all technicians are either neutral (2) or dissatisfied (3) indicating, signalling their aforementioned perception of too much work.
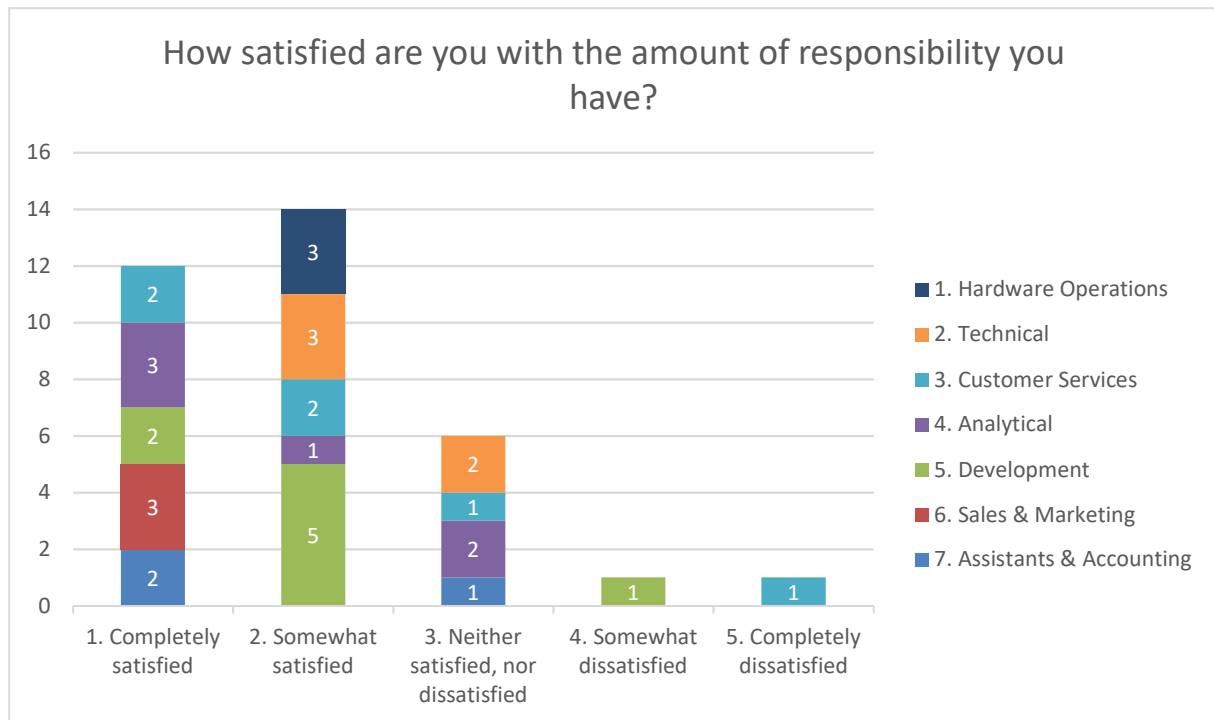
Figure 3.15 How satisfied are you with the amount of responsibility you have?
Source: Author's research

Based on the results majority of the employees is satisfied (26) with the amount of responsibility they have. This is due to several factors among other the management giving large freedom and responsibility for the tasks of the employees, but taking their capabilities into account. The one dissatisfied developer is actually their line manager who argues, that he has too much responsibility and too many direct subordinates.

The answers for a question "How satisfied are you with the amount of autonomy you have?" (not illustrated) indicate, that the employees are satisfied with the amount of autonomy as well, with the following results: 13 completely satisfied, 14 somewhat satisfied and 7 neither satisfied nor dissatisfied. Further indicating that the employees are satisfied with the amount of freedom and responsibility that they have at work.

Other questions support this assertion. Statement "I do not mind taking personal responsibility for my work" received 33 positive answers and 1 neutral indicating general willingness. This is also confirmed by the interviews up to a point. Furthermore, the statement "I am fully responsible for the final outcome of my work" earned 31 positive answers and just 3 neutral.
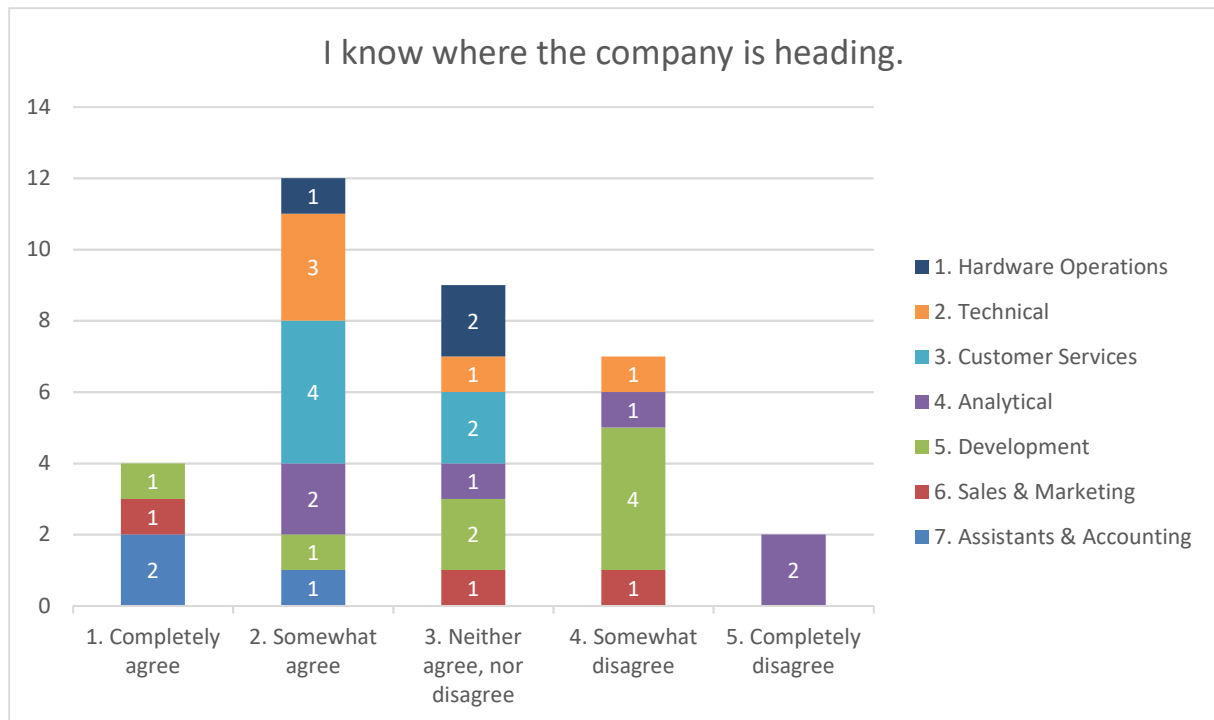
Figure 3.16 I know where the company is heading
Source: Author's research

The results in figure 3.16 indicate that the employees are not certain about the strategy and future orientation of the company. Interestingly most of the unsure answers come from the developers and analysts who should be creating the future for the company. This is likely due to the aforementioned fact that the management has not formulated a strategy and company focus for certain time and the two directors show visible dichotomy in the directions they would like to go.

However, despite the inconclusive outcome of the previous statement the following two have clear answers:

- "I am fully aware what final results my work yields." Received 30 positive and only 4 neutral answers (spread evenly among the departments).
- "I am fully aware of the meaning of my work" Obtained 29 positive and 5 neutral answers (spread evenly among the departments).

These answers are vital, because as the theoretical part reveals the knowledge of the result of one's work and the connected meaning of one work is among the best predictors for job satisfaction and intrinsic motivation. This is supported by the interviews and observation where the employees display pride of their work despite often complaining about it.

**Feedback and personal development**

In this subchapter answers to survey questions related to personal development and feedback are presented and evaluated.

First in figures 3.17 and 3.18 satisfaction with the opportunities to personally develop and the importance of such opportunities is illustrated.
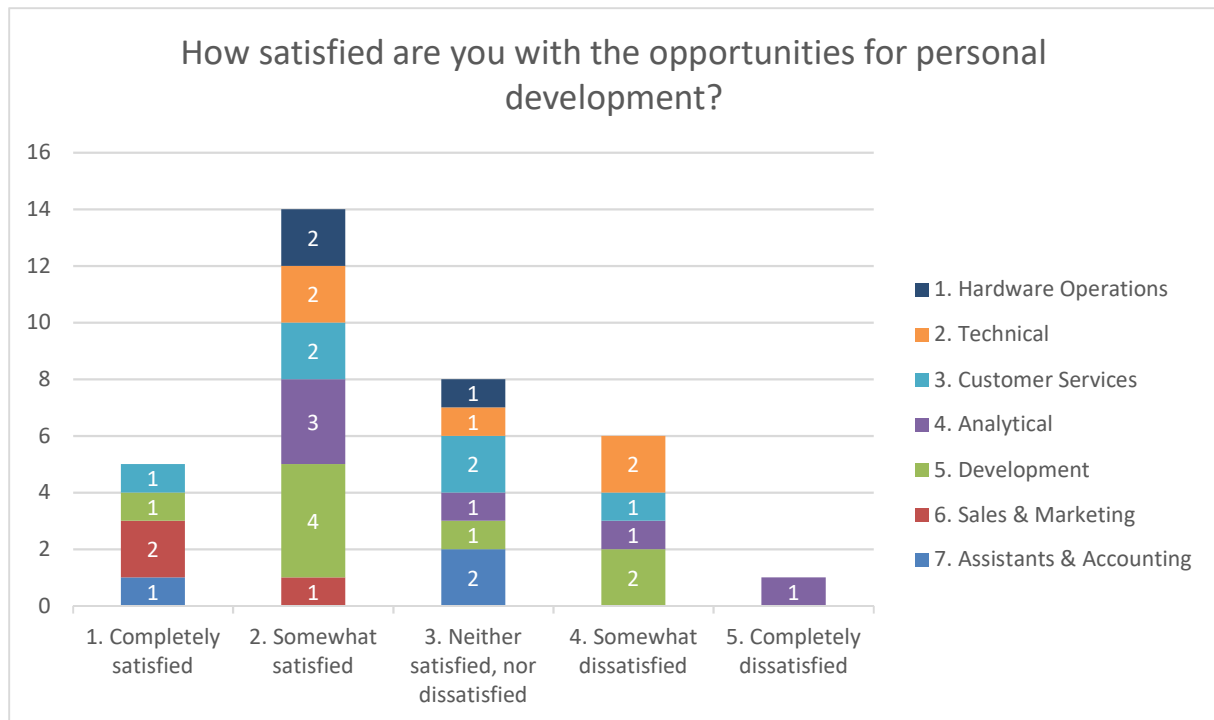
Figure 3.17 How satisfied are you with the opportunities for personal development? Source: Author's research
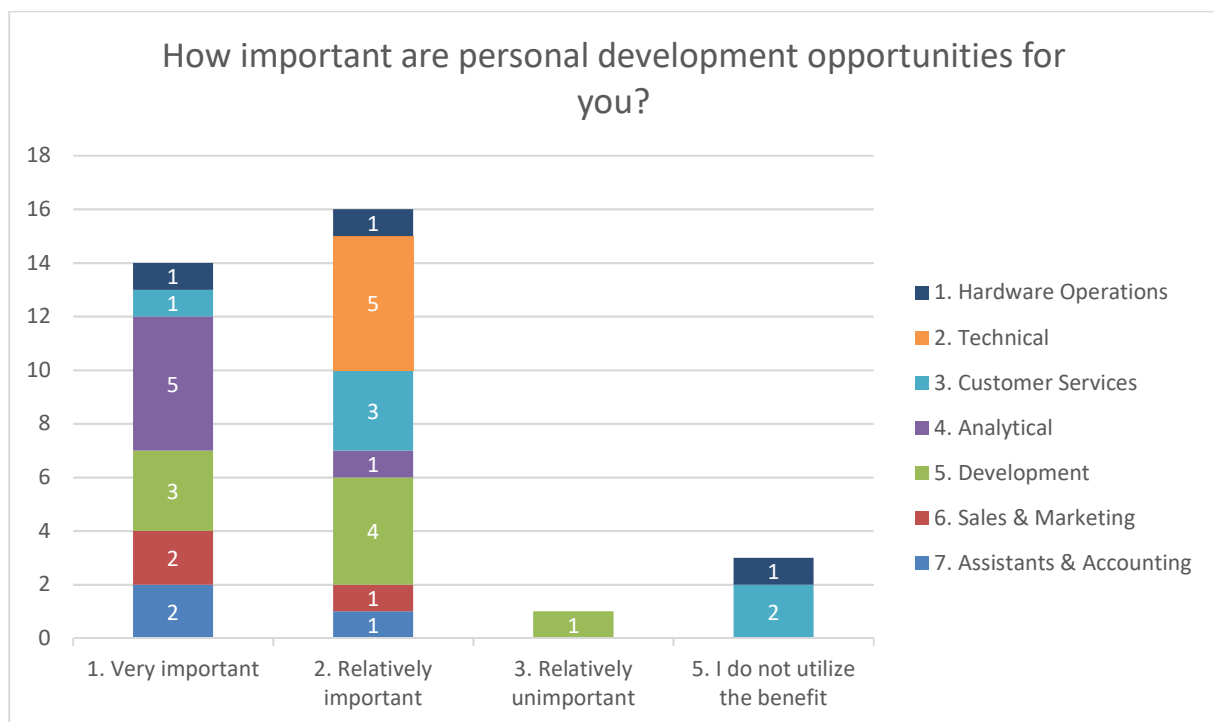


Figure 3.18 How important are personal development opportunities for you? Source: Author's research

Based on the results employees claim that personal development is important for almost everybody. This is in line with the expectations of the management. However, it seems that not all employees are satisfied with their personal development opportunities - 19 employees are at least somewhat satisfied, 8 neutral and 7 dissatisfied. There is relatively equal distribution among the departments, but

notably the technicians, analysts and developers are most divided about the issue. Additionally, results for question "My supervisor cares about my personal development" (not illustrated) show following: 16 employees at least somewhat agree, 14 are neutral and 4 somewhat disagree. Interestingly, almost all developers agree, while all the technicians are either neutral or disagree (the other departments are about equally distributed). This is partly explained by the director of operations who claims that the technicians have a repetitive, mundane job with no opportunities for development. That is however, not supported by the previously stated results, where the technicians claim that they are rather satisfied with the contents of their jobs.

Second, figure 3.19 shows the answers to a statement "I receive clear and timely feedback" and the following paragraphs show the results of related questions.
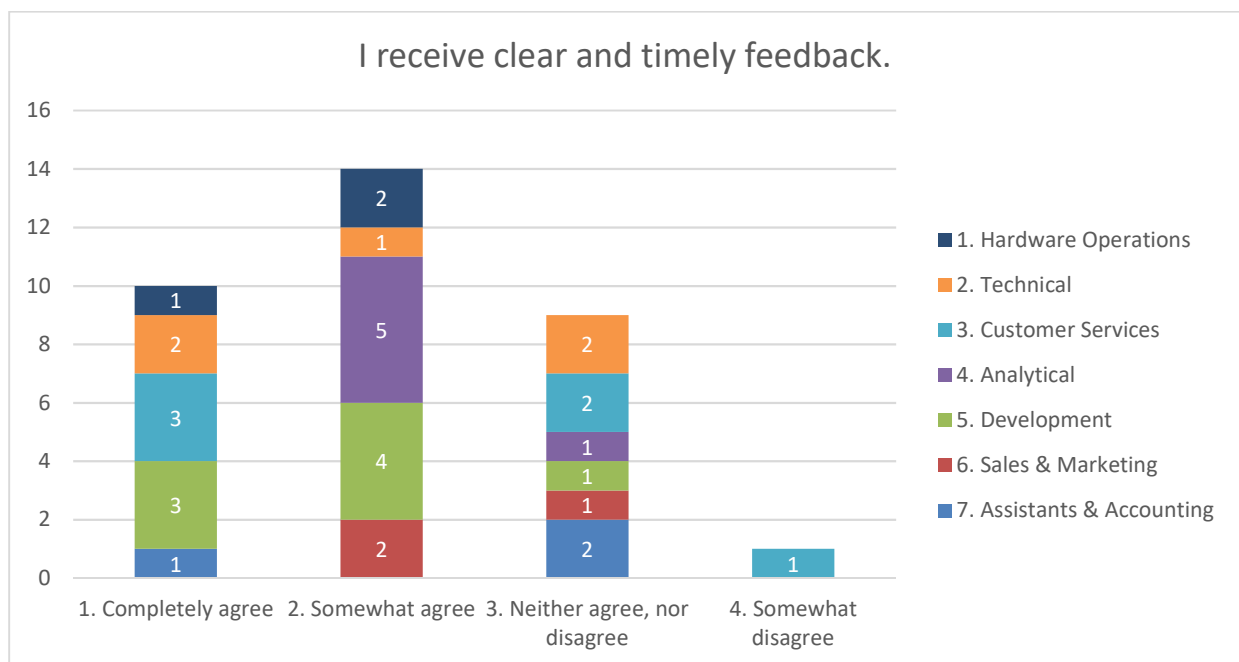


Figure 3.19 I receive clear and timely feedback.
Source: Author's research

The results indicate that most of the employees (24) believe they receive feedback at least in somewhat correct manner. Most of the results are to be expected based on the interviews, the reason for having Customer Services and Assistants & accounting in column 3 is mostly that due to nature of their work they do not have much need or reason to cooperate closely with the others. Interestingly the opinions of the Technical department are quite spread, considering they have the same line manager and all do the same work.

The answers to a statement "My supervisor is interested in the opinions and ideas of his subordinates" (not illustrated) reveal following: 14 employees completely agree, 12 employees somewhat agree and 8 neither agree, not disagree. The spread between the departments is even. This implies that the line managers are also willing to take feedback themselves or at the very least listen to their reports.

It is interesting to compare the figure 3.19 with figure 3.20 showing the results for a statement "If I do a good job, I receive a praise/recognition".
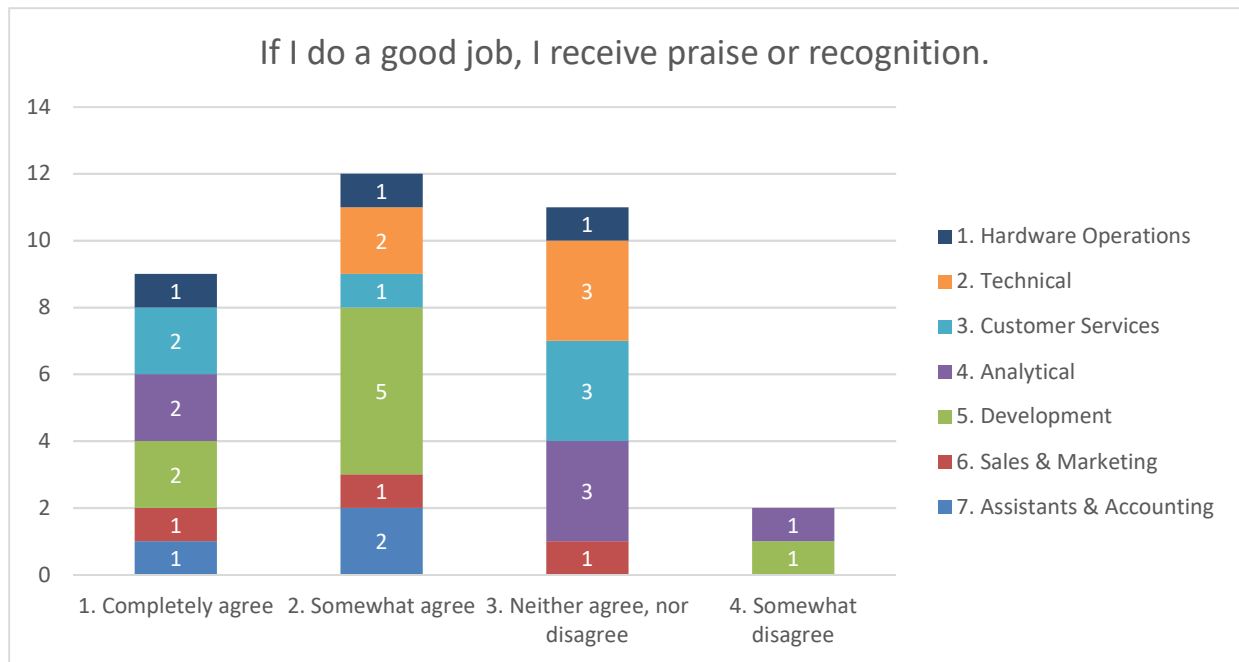
Figure 3.20 If I do a good job, I receive praise or recognition.
Source: Author's research

The results are similar to figure 3.19, but slightly fewer people agree with the statement (only 21). However, there is shift of technicians and partly analytics to the neutral answer. Based also on observation and interviews, these results have two implications: Firstly, most of the employees feel recognized, but not all. Secondly, for some they might receive a lot of feedback, but it is mostly negative. This is especially apparent for the technicians who receive a lot of feedback/criticism from the customers, but relatively rarely positive feedback. This is highlighted in answers to statement "I regularly receive positive feedback from the customers" (not illustrated) where all the technicians answered neutrally or negatively. (The other answers were mostly positive for those departments, that are actually in contact with the customers.)

### 3.3.5 Employee benefits

The area of employee benefits, had several questions dedicated to it in the survey. First in figure 3.21 the overall satisfaction with employee benefits is taken into account. Then in figures 4.22 and 4.23 the utilization and relative importance of the benefits is explored and finally in figure 3.21 the results of what other benefits the employees would like to receive is answered.
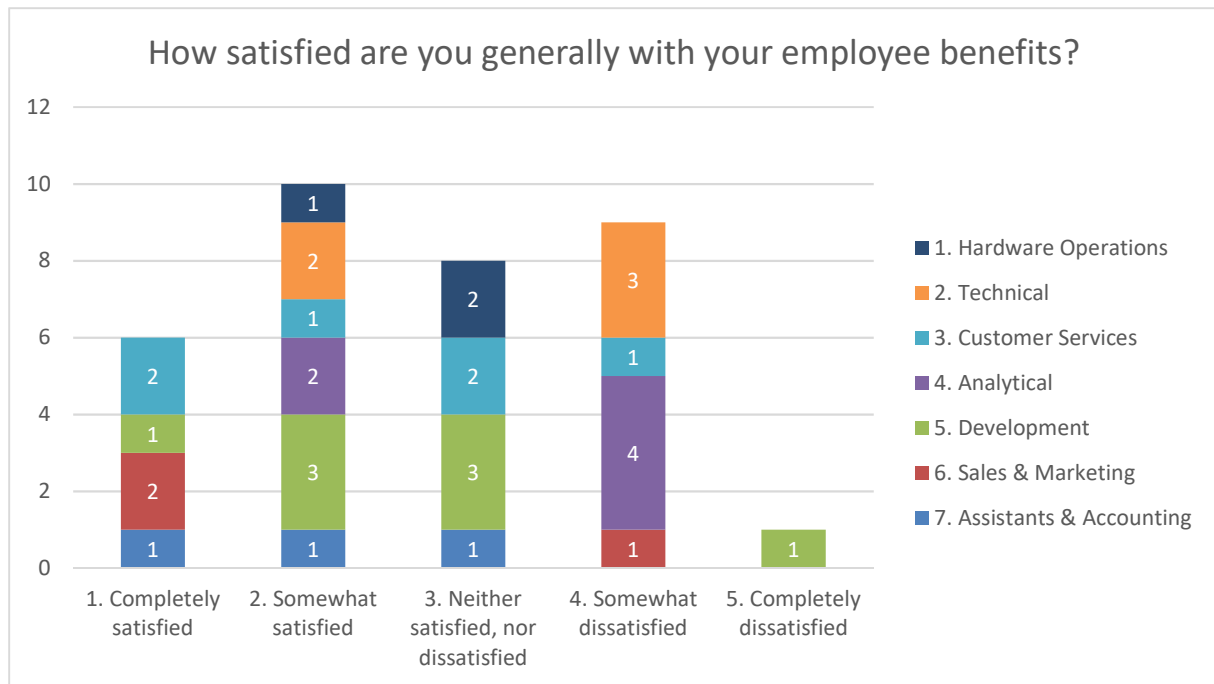
Figure 3.21 How satisfied are you generally with your employee benefits?
Source: Author's research

The results show that the employees have divergent opinions on the benefits with the general opinion leaning towards satisfaction. Some departments such as development lean more towards satisfaction, whereas other such as analysts more toward dissatisfaction. It should be noted, that the employees are not at all familiar with the HRM terminology and received no benefits overview so far, so they might be considering the whole visible reward system rather than just what is considered benefits in this work.


Figure 3.22 How many employees use each benefit.
Source: Author's research

Figure 3.23 How important are benefits for their users.
Source: Author's research

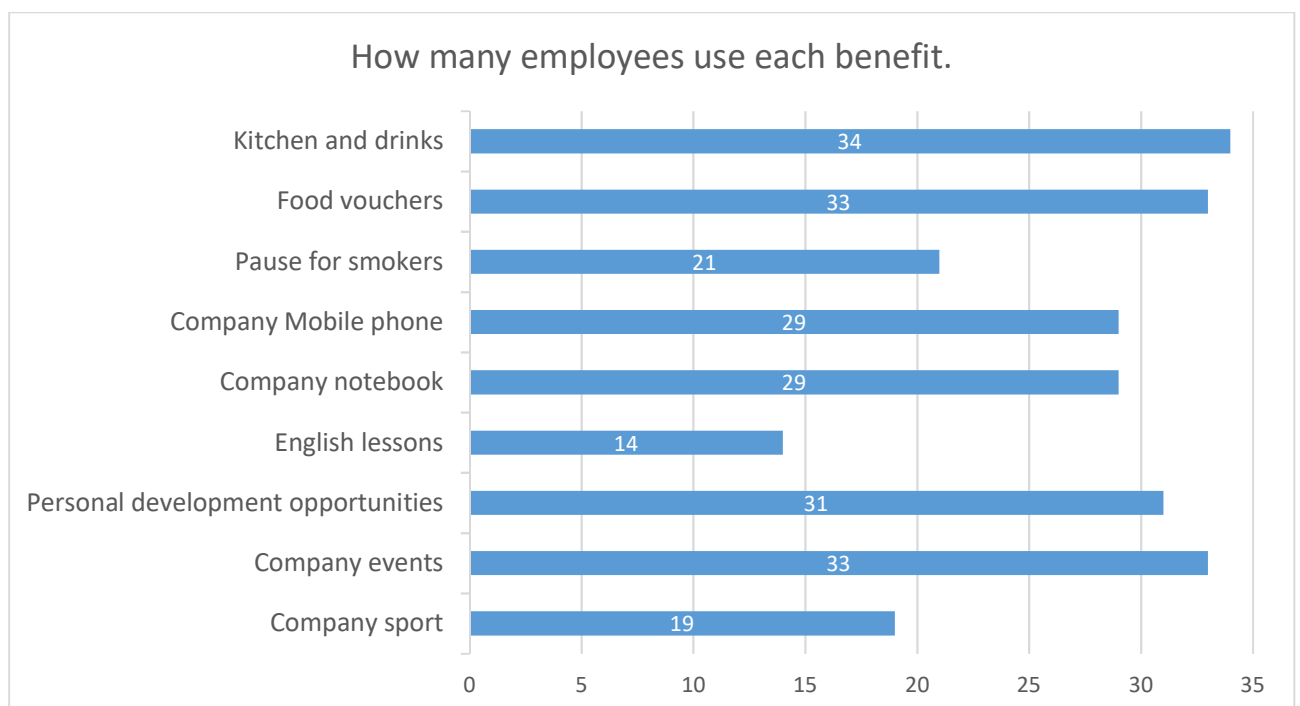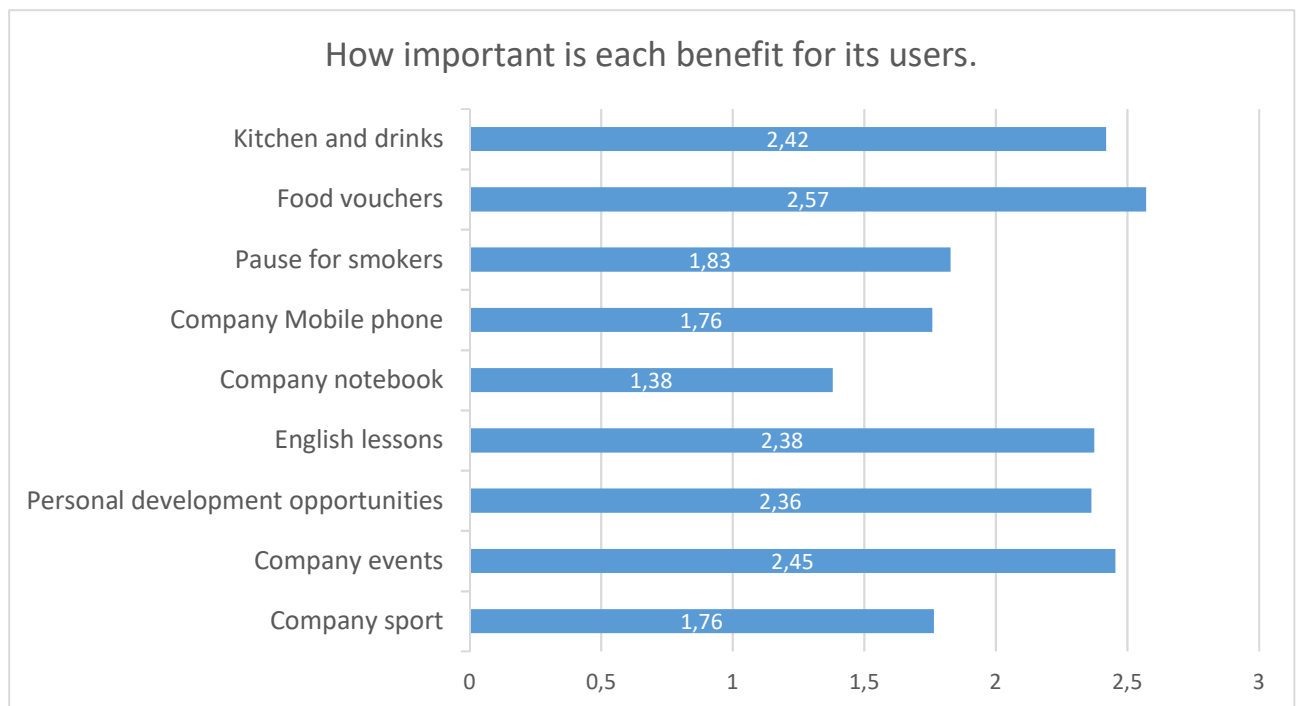From figure 3.22 it seems apparent, that most of the employees utilize most of the benefits. The notable exceptions are English lessons, company sport and pause for smokers. These come from their nature, as for the first two the employees actually have to be interested and decide to participate and for the last one it is oriented at a specific group in the company.

Figure 3.23 illustrates the perceived value of the benefits. It takes into account only the employees that responded. The numeric values were created by assigning each response a value from 0 for completely unimportant to 3 for very important and the average of these values is shown. Most of the benefits are arranged around value 2 making them relatively important. The lowest value was assigned to company notebook, the likely reason is that not many employees use it for personal activities and it is not generally even considered a benefit by them. The most valuable benefit are the food vouchers, which is also used by almost everybody in the company. From the benefits that only a few use the English lessons are considered rather important, whereas the company sport and pause for smokers not so much.

Notably the benefit of contribution to pensions scheme, the reason is that most of the employees were not actually aware of it. It is included in figure 3.24 which shows what other benefit the employees would like to have.
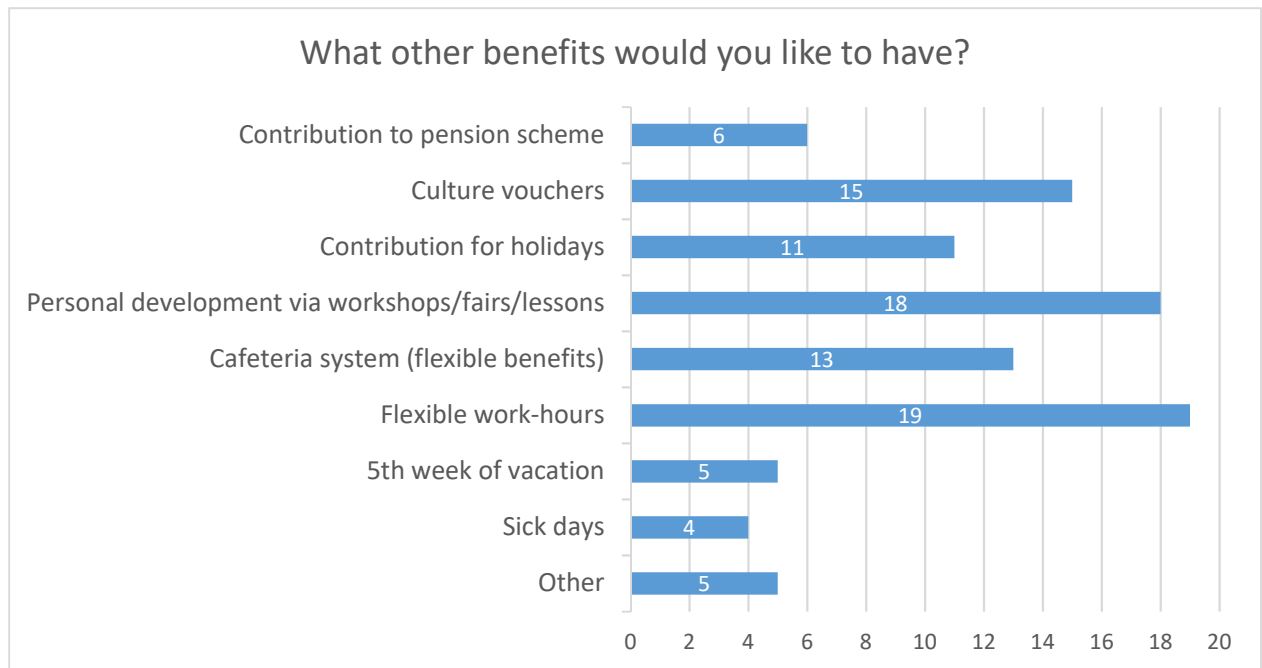
Figure 3.24 What other benefits would you like to have?
Source: Author's research

The ideas for new benefits were various, although nothing out of ordinary. Most of the employees would like flexible working hours, which was according to interviews already in a process of implementation. The results also signify, that personal development is very important to many employees and would like to pursue it also by formal events and education. Many of the employees additionally insisted that they would also like sick days and 5th week of vacation, but didn't consider the possibility when filling out the survey. In the other employees asked for various benefits such as professional literature, multi-pass (combination of vouchers for culture and sport) or teambuilding.

All in all, the employees seemed to be unaware of many of the benefits (as noted, they are currently not informed of them in any systematic way), but considered them relatively important and naturally would like to have more of them.

## 3.4  Evaluation and improvement recommendations

In this final chapter a SWOT analysis of the whole reward system based on both the literature overview and the research is presented and then its areas are further expanded upon in the following subchapters. First the strengths and weaknesses (as internal factors) are shortly summarized in the evaluation subchapter. Then the improvement recommendations based on the opportunities are presented. Lastly next steps in the reward system improvement project are suggested.

### 3.4.1 SWOT analysis

The SWOT analysis is presented in figure 3.25.
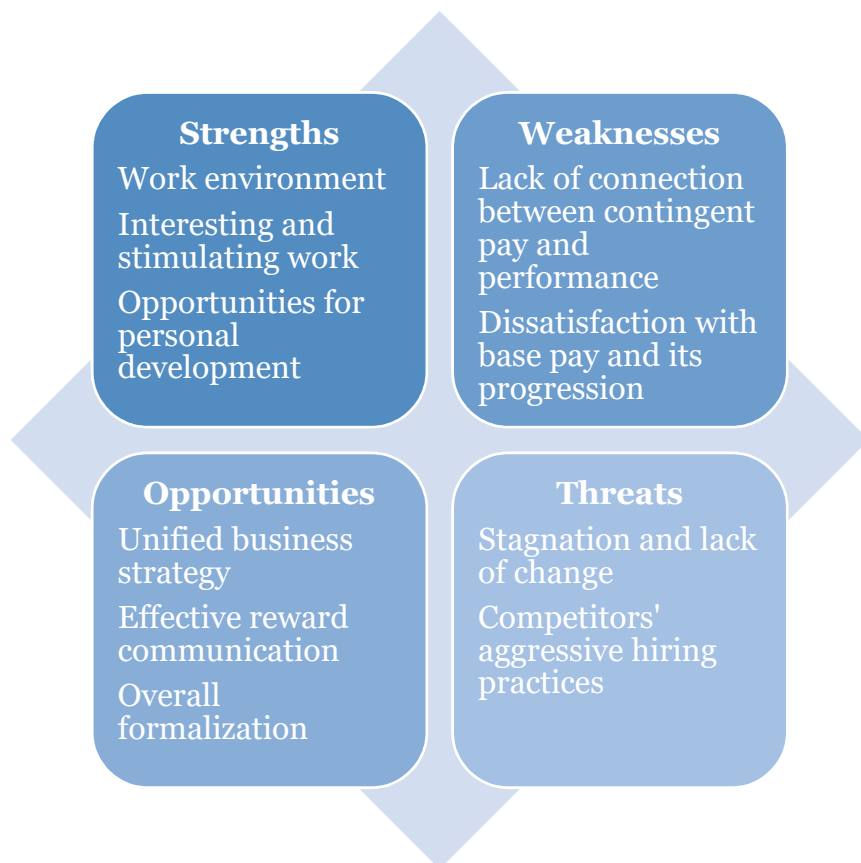


Figure 3.25 SWOT analysis of the reward system
Source: Author's research

The Strengths and Weaknesses represent the internal attributes of the reward system. Only the most important points from the author's perspective are considered, the overall summary of the evaluation is provided in the next subchapter.

The Opportunities present the ideas that are external to the reward system, yet could improve it in the future. These ideas are presented in detail in the subchapter 3.4.3 Improvement recommendations (the subchapter also includes improvement recommendations based on the internal attributes).

The Threats present the factors external to the reward system that could lower its effectiveness directly or indirectly. They are to some degree included in the other subchapters, but the two proposed factors are discussed here.

The stagnation and lack of change is a threat for two reasons. First it was clearly discovered that the current reward system is lacking in some areas and if operated as is will most likely result in sub-par performance with inefficient use of resources. Secondly, the employees now know that some steps in the improvement of the reward system were already taken and will expect positive change to happen. If nothing happens their trust in the management can be damaged.

The aggressive hiring practices refer to the fact, that many, especially large, corporations try to attract talent based on above average pay. The danger here is that since the pay in the company is average it could lure the talent away. As noted in the literature this is often disadvantageous for both the employer and the employee, because the employer loses talent and the employee often finds out that although the base pay is better the environment and the work itself is not what she expected or wanted.

### 3.4.2 Evaluation

This subchapter is divided into the same areas as the rest of the work. Each area is shortly explored summarising evaluation both from literature overview and concluded research. Both potential strengths and weaknesses of each area are presented.

**Base pay**

The grade and pay structure is reasonable for a company of this size which the employees second in their answers. However, there is lack of transparency of how to move in the pay structure as well as how the pay of new employees is determined (especially in comparison to current employees), perhaps making the link to performance weaker than ideal.

The base pay itself is viewed as slightly unsatisfactory, but as additional interviews imply, it is in a large part cultural belief never to show satisfaction with pay. The pay is likely average in the given segment. Additionally, employees perceive lack of systemic framework for progression in the grade and pay structure. This system evidently benefits more extroverted or self-assured employees.

**Contingent pay**

There are divided opinions on the contingent pay in the business. This concerns especially the project and SLA bonuses where the two most important departments – technicians and analysts clearly disagree on the fairness and effectivity of the bonuses.

Evaluation the effectiveness of the project bonus, the goals of supporting teamwork and on-time and on-budget delivery seem to be fulfilled. The question is whether the bonus is truly motivational as many employees do not even know how much they receive or why. Furthermore, it seems to be mostly awarded to the analysts, who are perhaps motivated enough by the work itself.

The effectiveness of the SLA bonuses seems rather low. There is almost no link to actual performance or behaviour making it a poor motivational reward in the perception of any theory. Additionally, it seems to provoke feelings of unfairness in

conjunction with the project bonus.

The effect of monthly profit-sharing performance bonus is rather dubious as well. Though the basic tenants of the reward make sense, the execution is lacking. Most of the employees do not actually know for what they are rewarded, thus inhibiting the creation of link between the expected reward and necessary behaviour.

The yearly profit-sharing bonus seems to be fulfilling its function of promoting companywide goals and cooperation, while increasing employee satisfaction.

## The work environment

The work environment is overall satisfactory. The teams perform well and do so in a cohesive constructive way. The trust in both colleagues and superiors is rather high and the overall atmosphere is conductive to good working relations.

The only issue here is the strenuous relationship between the technical and analytical department, which is perceived negatively by the whole company. Furthermore, the directors are not necessarily aligned in their strategy and operations.

## The work itself

The employees express large satisfaction with the work itself, their perceived level of responsibility, autonomy and amount of work. They also have a clear idea of the value they are creating and ultimately the meaning of their work. This is all supported by the management, who try to assign and design work to be as interesting and fulfilling as possible.

## Feedback and personal development

This area is perceived and objectively working properly as well. The employees suggest that this is important for them and the management focuses on it as well. There is general satisfaction, but some areas could be improved. There is no framework for personal development or feedback making them both ad hoc and heavily person dependent. Most of formal education is missing as well.

## Employee benefits

The benefits are difficult to evaluate completely as they have mostly indirect effects on the employees. Yet the employees seem relatively content based on both the survey and observation. Perhaps stirred by the survey they would like to receive more benefits mostly more holidays (5th week and sick days) or formal education (workshops, lessons, fairs).

All in all, the situation is somewhat controversial related to the contingent rewards, slightly negative about the base pay and somewhat positive about the non-financial rewards.

### 3.4.3 Improvement recommendations

In this subchapter improvement opportunities are suggested. They are not presented by area, but in a list form. Each presents the recommendation and the reasoning behind it based on this work so far. The recommendations are not action plans, but rather directions or ideas that the management can go in, they require further work, managerial discussion and possibly many iterations before they are fully implemented and operational.

**Create unified business and reward strategy**

Although this is rather broad task, only partly falling into the reward system, it is entirely clear that the dichotomy and surrounding confusion of the strategy and vision of the directors is negatively affecting the company environment and hindering overall effectiveness of the organisation. This first step needs to be taken in order to create a solid reward strategy, that can focus on rewarding and motivating the employees in order to work towards the vision based on the strategy.

**Improve communication from the company to its employees**

This recommendation is rather broad as it impacts almost all the areas.
The requirement for effective motivation in essentially any modern motivational theory is that the person knows of the link between the reward and the behaviour or effort. However as was shown in the previous chapters that is often not the case with many rewards of the reward system.

Based on this following measures are suggested:

- Create total reward statement showing all the possible rewards and what specifically needs to be done to reach them
- Create a benefit statement either as a part of the total reward statement or separately, in order to inform the employees of all the benefits they can utilize
- Explain how the monthly performance and profit-sharing reward works and based on what is the employee evaluated, then provide feedback as to why one was evaluated in such a way each month (or when relevant)
- Clearly explain that the Christmas bonus is a profit-sharing reward and how is it calculated thus providing motivation for the next year
- Clearly communicate the company's strategy and vision, as well as individual departments role and responsibilities in the company (when properly defined)

In focusing on further development of communication a solid bedrock on which the whole reward system can function effectively can be established.

**Make the monthly SLA bonus performance contingent**

The SLA bonus is debatable in itself, but its cancellation is highly unlikely due to current policies in the company and expected negative backlash. However, it should be at least transformed into an actual contingent reward that can motivate the employees. This can be achieved in several ways; the most feasible ones are presented:

- Create specializations in the technical department, so the technicians who receive the monthly bonus from a particular SLA is actually the final responsible person for the SLA fulfilment
- Evaluate the work performed under a particular SLA and only pay the bonus if relevant (all the actual work spend on SLAs is registered in the company IT system)
- Base the rewards partly on customer feedback – currently there is no systemic way of gathering customer feedback, therefore prohibiting wholesome

evaluation of the technicians as their goal is directly the satisfaction of the customers

In employing one or more of the suggested improvements, the monthly SLA bonus can be at least partly transformed from ineffective bonus to actual contingent reward.

## Create and implement clear framework for performance and profit-sharing monthly bonus

The monthly performance and profit-sharing bonus is working as intended only in selected departments and is currently entirely based on the skills of line managers. This is creating both inefficiencies as well as feelings of unfairness in the company.

It is suggested that a framework clearly explaining the process of evaluation both to the employees and line managers should be created. The framework should include following items:

- Explanation of how the bonus is calculated including a clear statement that the reward is partly profit-sharing (as mentioned most of the employees are unaware of this)
- Clearly state the criteria on which the performance is evaluated (e.g. in descriptions of behaviour/results etc.)
- State the required behaviour for the employee – e.g. it could be expected that an employee should propose that she should get a good rating for X if she believes it was exceptional
- State the required behaviour for the line manager – e.g. she should be able to give feedback on monthly performance (if relevant) and clearly explain why given rating was issued

In this way a somewhat working system can be transformed into an efficient motivational tool with relatively small time investment (compared to complete overwork).

## Create mutually beneficial way for base pay increase

It is neither economically viable nor entirely necessary to implement global non-contingent base pay increase as minor changes are not likely to change general opinion and the company cannot compete with large corporations on the basis of base pay anyway. However, there should be a systemic way to increase the base pay that is viable for both the company and the employees.

This way should be ideally a contribution based scheme, where clear goals are stated both for performance and competencies for a period and a base pay increase is promised if such goals are met. In this way, the employees will perceive a way to increase the base pay and the company will profit from the granted increases. This should improve the current system which many think unfair as well as provide motivation for the employees to improve.

Of course, this will be a longer project, where careful planning and change management will be necessary and some areas such as the pay grade structures will

need to be defined more clearly. It should prove both effective and efficient in the end though.

**Create performance management system**

Personal development is both a focus of the management of the company and a relatively well working reward. It is, however, entirely dependent on the line manager, making it much less effective in some departments. There should be a systemic way to foster and support personal development in the employees in order to both motivate them and increase their performance.

The performance management is that system. It should not be overly complicated as a simple system is likely to provide cost-effective benefits in this setting. The system should be based on the principles explained in the Theoretical part, yet somewhat simplified to fit the company.
In order to function properly it should include the following elements and links to other parts of the reward system:

- Create a personal development plan with clear SMART goals, required behaviour and measurement criteria
- Provide continuous feedback to the employees by:
  - The monthly profit-sharing bonus with feedback
  - Informal feedback and recognition when relevant
  - Formal progress touch points during the period
- Provide conductive work environment by assigning projects and tasks that will help develop toward the SMART goals if possible
- Provide additional relevant benefits if necessary, especially the educational workshops, fairs, literature and other
- Evaluate the goals and provide final feedback based on the progress during the period

The performance management system can be also partly connected and codeveloped with the framework for base pay increase in order to work towards the same goals and simplify the processes both for the line managers and the employees.

Naturally, there are many challenges connected to this, including development of the system, educating the line managers in proper feedback techniques, clearly explain the whole system to all the employees and providing new benefits, but if properly implemented it can make a satisfactory makeshift system into an excellent one.

### 3.4.4 Next steps
At this point the analysis phase of the reward system improvement project is concluded. Next step is to move into the design phase where the results are taken into account, the improvement recommendations are considered, discussed with the directors and line managers and refined into working components. Then the implementation plan should be developed and the implementation itself begin. It is expected that the rewards will go through many iterations, but hopefully in the end an efficient, effective and overall relevant reward system will be successfully operational.

# Conclusion

The purpose of this thesis was to explore and evaluate the reward system in the researched company and to suggest initial improvement opportunities.

The work begins with the Theoretical part. There the foundations for the exploration, evaluation and improvement recommendations are set. Motivational theories are presented from a psychological perspective as they in some way influence any reward in the reward system. Subsequently HRM concepts of total reward, psychological contract and reward strategy were presented in order to enable their design and evaluation. Finally, base pay, contingent pay, non-financial reward and employee benefits were described in detail as vital components of any reward system.

In the second part on methodology the research methods (apart from the literature overview) is presented. This includes the semi-structured interviews for the company management, employee satisfaction surveys for the employees and participant observation for both. Furthermore, the company internal documents are referenced.

In the final Theoretical part, the research was presented and evaluated. First the company is described including its structure, history and market. Secondly, the company reward system is documented and described in terms of concepts explored in the Theoretical part. Thirdly, the results of the employee satisfaction survey and semi-structured interviews are presented and evaluated. Finally, the evaluation of the reward system both from the perspective of the employees and the literature is shortly summarised and improvement opportunities are presented.

The first goal of the thesis, to document the reward system was completed directly in the thesis by the means of the research and subsequent writing of subchapter on the reward system in the company. The second goal of reward system evaluation was completed as well, by the means of semi-structured interviews and job-satisfaction survey in tandem with the evaluation presented in the Practical part. The last goal was fulfilled too by the creation of improvement initiatives based on the rest of the thesis at the end of the Practical part, although it is of course not exhaustive and further initiatives are likely to arise during design or even implementation phases.

The practical contribution of this work is naturally that the company has received the necessary analysis in reasonable depth with usable references to current theory that they gravely needed and at that with a fraction of resources usually necessary for such projects. The theoretical contribution is in providing a case study of the application of HRM theories in practice for an IT SME.

All in all the reward system in the company is performing perhaps even better than the directors expected. However, there are many illogical or non-systematic issues that usually stem from the organic conception and growth of the system that keep the system from being truly effective and efficient. If the knowledge and information provided in this thesis is applied it will surely ultimately lead in the right direction for the motivation and satisfaction of everyone in the company.

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# Attachments

Attachment 1 – Semi-structured interview template

Attachment 2 – Employee satisfaction survey

1. What is the medium or long-term strategy of our company?
2. What are the responsibilities of your department?
3. How much time per day do you usually spend by managing/leading people?
4. Do you give feedback regularly? That is do you praise or give advice how to improve?
5. Do you receive feedback? If yes from whom?
6. How satisfied, do you think, are your employees generally?
7. How are they satisfied with their base pay?
8. How satisfied are they with the reward system?
9. What do you think motivates them?
10. What would you improve in the reward system?
11. What can your department do to improve?
12. (Questions based on their answers in the questionnaire)

**Please select which department you are from**:

    a.  Hardware Operations
    b.  Technical
    c.  Customer Services
    d.  Analytical
    e.  Development
    f.  Sales & Marketing
    g.  Assistants & Accounting

**Are you a line manager?**

    a.  Yes
    b.  No

**How satisfied are you with each area/element of your work?**

| How satisfied are you with…? | Completely satisfied | Somewhat satisfied | Neither satisfied, nor dissatisfied | Somewhat dissatisfied | Completely dissatisfied |
|---|---|---|---|---|---|
| length of working hours | | | | | |
| amount of work | | | | | |
| the nature and content of your job | | | | | |
| amount of responsibility you have | | | | | |
| amount of autonomy you have | | | | | |
| job security | | | | | |
| base pay | | | | | |
| reward system altogether | | | | | |
| your employee benefits | | | | | |
| the opportunities for personal development | | | | | |
| your relationship with your supervisors | | | | | |
| your relationship with your colleagues | | | | | |
| the cooperation between the departments | | | | | |
| the work atmosphere | | | | | |

**Do you agree with the statement?**

| Statement: | Completely agree | Somewhat agree | Neither agree, nor disagree | Somewhat agree | Completely disagree |
|---|---|---|---|---|---|
| I know how my base pay is determined. | | | | | |
| My reward is reasonably linked to my performance. | | | | | |
| The reward system (excluding base pay) is fair in relation to performance. | | | | | |
| My supervisor is interested in the opinions and ideas of his subordinates. | | | | | |
| If I do a good job, I receive a praise/recognition. | | | | | |
| My supervisor is fair and treats everybody equally. | | | | | |
| I receive clear and timely feedback. | | | | | |
| My supervisor cares about my personal development. | | | | | |
| I do not mind taking personal responsibility for my work. | | | | | |
| My colleagues are always willing to help me if necessary. | | | | | |
| I am fully responsible for the final outcome of my work. | | | | | |
| I regularly receive positive feedback from the customers | | | | | |
| I usually manage to solve any customer complaints in mutually satisfactory way. | | | | | |
| I know where the company is heading. | | | | | |
| I am fully aware what final results my work yields. | | | | | |
| I am fully aware of the meaning of my work. | | | | | |
| Main objective of my work is the customer satisfaction. | | | | | |
| I would recommend the company as a good employer. | | | | | |

| Please indicate how important is each benefit for you. | Very important | Relatively important | Relatively unimportant | Completely unimportant | I do not utilize the benefit |
|---|---|---|---|---|---|
| Kitchen and drinks | | | | | |
| Food vouchers | | | | | |
| Monthly bonus | | | | | |
| Christmas bonus | | | | | |
| Pause for smokers | | | | | |
| Company mobile phone | | | | | |
| Company notebook | | | | | |
| English lessons | | | | | |
| Personal development opportunities | | | | | |
| Company events | | | | | |
| Company sport (currently floorball) | | | | | |

**Are you interested in any other benefits?**
  a. **Yes**
  b. **No**

**If yes, what benefits?**
**(open answer)**

**Do you have recommendations for the improvement of the reward system?**
**(open answer)**

**What would you like improved in order to be even more satisfied at work?**
**(Open answer)**

(Note that, as mentioned, the format of the questionnaire was Google forms, therefore the questionnaire was visually completely different, but with the same questions. Also, the introduction to the questionnaire was omitted.)