3. Wages and Salaries

3.1 Workers Salary

A salary is a form of periodic payment from an employer to an employee, which may be specified in an employment contract. It is contrasted with piece wages, where each job, hour or other unit is paid separately, rather than on a periodic basis. From the point of a view of running a business, salary can also be viewed as the cost of acquiring and retaining human resources for running operations, and is then termed personnel expense or salary expense. In accounting, salaries are recorded in payroll accounts.

Salary is a fixed amount of money or compensation paid to an employee by an employer in return for work performed. Salary is commonly paid in fixed intervals, for example, monthly payments of one-twelfth of the annual salary.

Salary is typically determined by comparing market pay rates for people performing similar work in similar industries in the same region. Salary is also determined by leveling the pay rates and salary ranges established by an individual employer. Salary is also affected by the number of people available to perform the specific job in the employer's employment locale.

Salary and other forms of payment today

Today, the concept of a salary continues to evolve as part of a system of the total compensation that employers offer to employees. Salary (also now known as fixed pay) is coming to be seen as part of a "total rewards" system which includes bonuses, incentive pay, commissions, benefits and perquisites (or perks), and various other tools which help employers link rewards to an employee's measured performance.

Compensation has evolved considerably. Consider the change from the days of and before the industrial evolution, when a job was held for a lifetime, to the fact that, from 1978 to 2008, individuals who aged from 18 to 44, held an average number of 11 jobs. Compensation has evolved gradually moving away from fixed short-term immediate compensation towards fixed + variable outcomes-based compensation.[citation needed] An increase in knowledge-based work has also lead to pursuit of partner (as opposed to employee) like engagement.

Negotiation of salary

Prior to the acceptance of an employment offer, the prospective employee usually has the opportunity to negotiate the terms of the offer. This primarily focuses on salary, but extends to benefits, work arrangements, and other amenities as well. Negotiating salary can potentially lead the prospective employee to a higher salary. In fact, a 2009 study of employees indicated that those who negotiated salary saw an average increase of $4,913 from their original salary offer. In addition, the employer is able to feel more confident that they have hired an employee with strong interpersonal skills and the ability to deal with conflict. Negotiating salary will thus likely yield an overall positive outcome for both sides of the bargaining table.

Perhaps the most important aspect of salary negotiation is the level of preparation put in by the prospective employee. Background research on comparable salaries will help the prospective employee understand the appropriate range for that position. Assessment of alternative offers that the prospective employee has already received can help in the negotiation process. Research on the actual company itself will help identify where concessions can be made by the company and what may potentially be considered off-limits. These items, and more, can be organized in to a negotiations planning document that can be used in the evaluation of the offers received from the employer.

Effects of perspective

The same 2009 study highlighted the personality differences and negotiation mind-sets that contributed to successful outcomes. Overall, individuals who are risk-averse (e.g., worried about appearing ungrateful for the job offer) tended to avoid salary negotiations or use very weak approaches to the negotiation process. On the contrary, those who were more risk-tolerant engaged in negotiations more frequently and demonstrated superior outcomes. Individuals who approached the negotiation as a distributive problem (i.e. viewing the a higher salary as a win for him/her and a loss to the employer) ended up with an increased salary, but lower rate of satisfaction upon completion. Those who approached the negotiation as an integrative problem (i.e. viewing the negotiation process an opportunity to expand the realm of possibilities and help both parties achieve a “win” outcome) were able to both secure an increased salary and an outcome they were truly satisfied with.

Gender differences

Salary disparities between men and women may partially be explained by differences in negotiation tactics used by men and women. although men and women are equally likely to initiate in a salary negotiation with employers, men will achieve higher outcomes than women by about 2% of starting salary studies have indicated that men tend to use active negotiation tactics of directly asking for a higher salary, while women tend to use more of an indirect approach by emphasizing self-promotion tactics (e.g. explaining the motivation to be a good employee).Other research indicates that early-childhood play patterns may influence the way men and women negotiate. Men and women tend to view salary differently in terms of relative importance. Overall level of confidence in a negotiation may also be a determinant of why men tend to achieve higher outcomes in salary negotiations. Finally, the awareness of this stereotype alone may directly cause women to achieve lower outcomes as one study indicates. Regardless of the cause, the outcome yields a disparity between men and women that contributes to the overall wage gap observed in many nations.

The Constitution of the Republic of South Africa 239 provides for the right to fair labour practices in terms of section 23. Section 9 of the Constitution makes provision for equality in the Bill of Rights, which an employee may raise in the event of an equal pay dispute. In terms of section 9(1) "everyone is equal before the law and has the right to equal protection and benefit of the law'" Furthermore, "the state may not unfairly discriminate directly or indirectly against anyone on one or more grounds, including race, gender, sex, pregnancy, marital status, ethnic or social origin, color, sexual orientation, age, disability, religion, conscience, belief, culture, language, and birth." South African employees who were in paid employment had median monthly earnings of R2 800. The median monthly earnings for men (R3 033) were higher than that for women (R2 340) - women in paid employment earned 77, 1% of what men did.

Role of weight

Research done in 2011 showed that the "weight double standard" may be more complex that what past research has suggested. This is not only relevant to women, but also to men. The smallest income gap differences occur at thin weights (where men are penalized and women are rewarded) and the opposite happens at heavier weights, where the women is affected more negatively.

3.2 Evaluation Performance

Performance Evaluation is a tool you can use to help enhance the efficiency of the work unit. This tool is a means to help ensure that employees are being utilized effectively. Employees can use it as a clear indication of what is expected of them before you tell them how well they are doing, and then as feedback of how well they did.

Purpose

Performance Evaluation is a multi-purpose tool used to:

•Measure actual performance against expected performance

•Provide an opportunity for the employee and the supervisor to exchange ideas and feelings about job performance

•Identify employee training and development needs, and plan for career growth

•Identify skills and abilities for purposes of promotion, transfer, and reduction in force

•Support alignment of organization and employee goals

•Provide the basis for determining eligibility for compensation adjustments based on merit

•Provide legal protection against lawsuits for wrongful termination

The primary purpose of Performance Evaluation is to provide an opportunity for open communication about performance expectations and feedback. Most employees want feedback to understand the expectations of their employer and to improve their own performance for personal satisfaction. They prefer feedback that is timely and given in a manner that is not threatening.

Benefits

Many benefits result from the Performance Evaluation process:

•Control of the work that needs to be done

•Enhancement of employee motivation, commitment, and productivity

•Identification of goals and objectives for the employee

•Satisfaction of the basic human need for recognition

•Identification of process improvement opportunities

•Identification of employee development opportunities

Requirements

North Dakota Administrative Code (NDAC) Chapter 4-07-10 contains requirements for performance management and evaluation:

4-07-10-02: Each agency, department, and institution shall adopt and use a program to provide for the development and management of the performance of each employee in a classified position.

4-07-10-03: Each employee in a classified position must be informed of the responsibilities assigned to the employee's position and of the level of performance needed to successfully perform the work.

4-07-10-04: Each agency, department, and institution shall use the criteria in one or the other of the following performance management program types:

1. Individual-based performance.

a. Performance reviews are conducted at least annually.

b. Performance reviews are based on individual job-related requirements.

c. A standard form or approach is used.

d. Performance standards, or goals and objectives are used.

e. The review includes a review of past performance.

f. The review includes a discussion of how performance may be improved or how an employee's skills may be developed.

2. Team-based performance.

a. Performance reviews are conducted at least annually.

b. Performance reviews are based on overall team performance and how the employee functions as part of a team.

c. The emphasis of the program is on improving the quality of a service or product, constantly improving systems and processes, and on preventing problems and eliminating them.

d. The program provides guidance for the education, training, and self-improvement of the employee.

Employee Involvement

Performance evaluation is most effective when employees are actively involved in open discussion about their own performance expectations and about how they are doing in meeting those expectations.

Involving the employee in the performance evaluation process will make it a meaningful, worthwhile experience for you, the employee, and the organization because employees:

•need and want to have their voices heard,

•are more likely to consider the system as being fair if they have involvement and understand the process, and

•are more likely to demonstrate genuine commitment to goals and performance.

Ultimate benefits realized by the organization will be increased productivity, efficiency, job satisfaction, and morale and decreased turnover.

Performance Expectations – The Basis for Effective Performance Evaluation System

As NDAC 4-07-10-03 states each employee must be informed of the level of performance that is needed to successfully perform his or her work. These are performance expectations describing the conditions that exist when a job is done well. They usually come from an agency's strategic plan and are communicated down through departmental goals, objectives, and individual position descriptions. Performance expectations should tie in with essential functions and qualifications required for the position as stated in the position description. (See The Position Description.) "Think SMART when developing performance expectations." Expectations should be Specific, Measurable, Achievable, Realistic, and Time-bound.

Specific – The performance expectation should be one that can be witnessed or observed, defined, and concrete.

Measurable – You should be able to assess, evaluate, and distinguish between different performance levels. The end result can be identified in terms of quantity, quality, time lines, acceptable standards, or procedures. Many say the work they do is not measurable. But if it is not measurable, how then do they know if a goal has been met and if their contributions have value? Definitive results can be identified for all work.

Achievable – Each performance expectation should be one that can be achieved by the employee without barriers that hinder its completion. However, it should not be so easily achieved that the employee is not challenged nor so difficult that the employee becomes frustrated. It should be reasonable.

Realistic – Each expectation should be an actual requirement of the employee's job and within the parameters of the position description.

Time Bound – Each expectation should have a time frame associated with it – daily, weekly, etc.

Some factors for which expectations may be set forth and measured are:

•Job Knowledge

•Quality of Work

•Quantity of Work

•Work Habits

•Cooperation or Ability to Work with Others

•Oral and Written Communications

Steps of Effective Performance Evaluation

- Review

Look at the previous evaluation for:

•**Previous deficiencies in performance.**

Have they been corrected or do they continue to be a problem? If deficiencies continue, note them in the evaluation. Omitting a continued deficiency in subsequent evaluations can be interpreted as a sign that the deficiency has been corrected.

•**Dramatic change in performance.**

Determine whether your rating of the employee is consistent or whether the performance actually has changed. When there is a significant negative change in performance, the supervisor should give the employee notice, prior to the annual evaluation, that the next evaluation will be significantly lower unless substantial improvement is made.

- Analysis

•Analyze performance to identify gaps between expected performance and actual performance

•Analyze the causes of gaps ◦Organization or work environment-related causes

◦System or process-related causes

◦Personal causes

•Select and design an action plan to close the gaps – a plan that meets business needs, performance needs, training needs, or work environment needs

•Implement the plan

•Follow up - Measure and evaluate the impact of the plan on the performance.

Analyzing Causes of Gaps

Management often assumes that where actual performance falls short of expected performance, employees must try harder. However, it is very important to analyze why a gap exists between expected performance and actual performance to determine if there is a cause other than inadequate employee efforts. Most causes will fall into three categories:

•**Organization or Environment-Related –** These gaps can stem from the organizational culture, leadership style or management practices, organizational structure, reporting relationships or chain of command, inadequate resources (funds, staff, equipment, training, information, etc.) and so forth. Some examples: employee reports to more than one supervisor, performance expectations were not communicated, or expectations were not met because the employee was overburdened due to staff cuts.

•**System or Process-Related –** System or process-related causes can relate to any process within an organization that becomes a roadblock to an employee meeting performance expectations. Some examples: time frames or procedures are burdensome, procedures conflict, someone else didn’t meet their time frames, or the information reporting system is inadequate.

•**Personal –** These are gaps that are within the employee's realm of control. They can, for example, deal with situations that are going on in home life that affect work performance or depend on the employee's physical or emotional abilities. Lack of effort, motivation, or concern for the agency's efficiency can also fall under this category. Exercise caution when dealing with personal issues – remember to keep it job related, focusing on how job performance is affected. If an employee alleges that a medical condition is the cause of poor performance, contact your human resource officer or legal counsel at once. Do not attempt to resolve employees' personal problems.

The cause of a performance gap may overlap a couple categories. It is imperative that you and your employee communicate to identify the cause of the gap and arrive at solutions to eliminate or minimize the gap.

The Evaluation Meeting

Before the performance evaluation meeting:

•At least one week in advance, schedule a meeting with the employee and inform him or her of what to prepare for, i.e. self-appraisal, etc.

•Complete your review and documentation of the employee's performance, considering observations, records, and feedback from others. Focus on what the employee did and didn't do, not the employee's character or personality, unless the character or personality affects job performance and the employee's effectiveness to the organization.

•Arrange for a private office or room free of distractions for the meeting.

During the meeting:

•Put the employee at ease through informal conversation. This will enhance the free exchange of information. You can also discuss the purpose of the meeting and what you hope to accomplish.

•Go through your evaluation. Be specific and candid in presenting your evaluation. Listen to employee feedback, take notes, and ask questions.

•Share feedback received from others.

•Explore areas of disagreement and attempt to reach consensus so that the employee will be motivated to change his or her behavior.

•Discuss areas for improvement and performance expectations for the next period.

•Establish a realistic and appropriate improvement plan if performance is below expectations.

•Encourage the employee to record his/her comments about the evaluation, and have the employee sign the copy to be filed. If the employee refuses to sign, the agency head or the agency head's designated representative should, in the presence of the employee and a witness, indicate on the copy that the employee was shown the material, was requested to sign acknowledging that the material was read, and that the employee refused to sign (NDCC 54-06-21). By signing the copy, the employee does not indicate agreement – only that the material has been read.

•Provide the employee with a copy and place a copy in the employee's official personnel file.

Strategies and Techniques

Not all performance evaluation methods work equally well in every organization – one size does not fit all! It is important to consider the categories of employees to be appraised (i.e. managers vs non-managers), the types of jobs performed, the nature of the relationship between employees and managers, the purpose(s) which the evaluation is intended to serve. Other factors are the availability of in-house expertise, developmental costs, and how easy is it to use.

At the core of all successful evaluation formats are clearly defined and explicitly communicated standards or expectations of employee performance. Employees must understand what is expected of them.

Descriptions of the various performance evaluation methods can be found in the Appendix of this section.

You, as a supervisor, should visit with your human resources office or a representative from Human Resource Management Services regarding implementing a strategy or using a technique that will best serve your needs.

Common Evaluation Errors

There are many errors that supervisors unconsciously make during performance evaluation. A few of the most common are:

•**Central Tendency –** Rating everyone at or near the middle of the scale to avoid the need to justify extreme positions.

•**Positive/Negative Leniency –** Rating higher or lower than the employee deserves because you want to motivate them to do better or because you think there is always room for improvement.

•**Halo (or Horns) Effect –** A single favorable or unfavorable incident colors the evaluator's judgement of the employee's overall performance.

•**Recency Effect –** A recent event colors the perception of the employee's performance for the entire period.

•**Similar to Me –** The tendency to rate employees similar to yourself higher and those not similar lower.

Frequency

NDAC 4-07-10 requires that performance evaluation be done at least annually. But annual feedback alone may not be appropriate for every situation. As stated earlier, employees want feedback in a timely manner. They don't want to hear in June about how well they did last August. They want to know now while it's fresh in their mind and they can revel in their success.

Annual feedback fails to correct inadequate performance or unacceptable work behavior at the most effective time – when it occurs. It is not effective for employees to hear in June about inappropriate behavior that occurred last August. And it's not fair – the employee didn't have the opportunity to learn from what was wrong and improve during the time from the occurrence to the evaluation. Immediate feedback is the most effective method of managing performance. Day-to-day feedback is critical to obtaining immediate behavior improvement.

A continuous feedback process addresses the basic needs of the employer to provide frequent feedback to employees. Desired performance is identified and reinforced. Undesirable performance is identified and dealt with promptly - at a time when change can be made more easily. The process also addresses the basic needs of the employees to know how they are doing.

More formal performance feedback should be conducted at least annually, although semi-annually or quarterly would be better. When feedback is provided on a more frequent basis, the feedback discussions can focus more on the present and the future – not the past as in traditional annual discussions.

Conflicting Purposes of the Evaluation Process

As you saw at the beginning of this Chapter, there are many purposes for performance evaluation. Because time may be scarce and performance evaluation is seen as time consuming, the same management tool may be used for many purposes. Sometimes those purposes conflict. For example, if the employee has inadequate performance and is not eligible for a salary increase, it will be difficult to get the employee interested in discussing training and development opportunities. The employee is concentrating on how s/he can get the supervisor to increase their salary. A technique to emphasize the performance-related aspects of the evaluation process is to conduct performance evaluations at a time that does not coincide with annual salary adjustments in July. Alternatives to conducting performance evaluations in June or July are the employee's employment anniversary date, a calendar year schedule, or another notable date.

Another conflict in the evaluation process is when an employee is rewarded with a promotion based only on good performance, without focusing on the requirements of the new job versus the employee's qualifications. If you are using performance evaluation as an indicator of future performance, ensure that the factors that were evaluated in previous positions are reflective of what is required in the new position.

Legal Considerations

Many of the same laws listed in the Employee Selection section, apply during any phase of the employment process or relationship – including performance evaluation. To minimize the risk of violating legal requirements:

•Ensure that the evaluation is accurate and truly reflective of the employee's actual level of performance.

•Ensure that the evaluation encompasses the entire review period and reflects performance variations during the period.

•Ensure that evaluations are based on what employees are actually required to do as stated on the position description or as otherwise assigned.

•Be cautious in making subjective judgements.

•Stick to facts that can be documented. Keep a record or notes in a working file, if need be, of occurrences that might be disputed.

•Avoid the appearance of prejudice or discrimination. Never say anything that could be interpreted as meaning that the evaluation was based on a favorable or unfavorable reaction to the employee’s race, color, religion, age, sex, national origin, veterans status, marital status, etc.

•Avoid evaluation of personality traits and attitude. Focus on job expectations, i.e. behavioral, quantity, quality, etc.

•Make certain evaluations are consistent with other disciplinary or performance records.

Giving Constructive Performance Feedback

It is very difficult for a supervisor to address a performance issue with an employee without arousing some defensiveness. How then can you call attention to a performance deficiency in a way that is constructive?

•Express your concern – Communicate openly and clearly. Use "I-messages" such as "I’ve noticed a backlog in unprocessed applications." Avoid beginning with a question or a tone that appears you are judgemental and accusatory. Be tactful and direct – not so subtle that you create misunderstanding.

•Understand the whole story – Follow up your concern with a question that invites communication about the situation. For example, "What do you think is contributing to the backlog?" Listen carefully, ask questions, and confirm your understanding. Before you can solve the problem, you need to thoroughly understand the situation.

•Reinforce correct performance or behavior – Sometimes you may discover that poor performance is a result of good intentions. For example, suppose that the backlog of unprocessed applications is due to the fact that the employee reviews each application twice to ensure accuracy. Reinforce the concern for accuracy, while attempting to seek solutions to remedy the backlog.

•Discuss alternatives – Now you can discuss ways to rectify the situation. Draw out the employee’s ideas. If you have a suggestion or if there is only one course of action, state it. Openly discuss the pros and cons of any alternative(s).

•Develop a written plan of action – Agreeing on a workable solution leads both the employee and you to commit to resolving the problem. Putting the plan in writing ensures commitment to action.

•Follow up – Monitor progress and periodically provide feedback. This reinforces for the employee your commitment in resolving the situation.

Supervisory Management Development Program

The Supervisory Management Development Program is a three-part program covering communicating effectively, managing conflict, and developing people and performance management. The program was developed by Sterling Institute and Human Resource Management Services specifically for supervisors in state government and is conducted by Human Resource Management Services staff. To find out more about this program, please call Human Resource Management Services at 328-3290.

APPENDIX

Methods of Performance Evaluation

Each of the performance evaluation methods listed below may be used to varying degrees. We recommend that agencies analyze their specific needs and choose any combination of the following that best meets those needs. Human Resource Management Services will, upon request, assist agencies in their analysis.

- Multi-source Assessment (360-Degree Feedback, Full-circle Appraisal)

This method differs significantly from the traditional supervisor/subordinate performance evaluation. Multi-source assessment involves gathering information from a number of customers who actually deal with the employee providing feedback – both internal and external. Internal customers include the immediate supervisor, other managers, co-workers, and subordinates. External customers may include clients, applicants, consultants, staff from other agencies, legislators, etc. The basis of this method is to provide a broader assessment of how an employee is doing on the job. This method is viewed as an optimal tool for identifying areas for improvement, guiding behavioral change, and generally enhancing performance management capabilities because it is not dependent on a single individual's perceptions. It makes the employee much more accountable to the various customers because they now have input into the employee's performance rating.

- Self-Appraisal

Provides the opportunity for employees to evaluate their own performance and express how they think they've performed without being influenced by their supervisor's judgements. Supervisors also evaluate performance on the same factors and use that as a basis to compare responses. This can reveal areas of agreement or highlight differences of opinion. The advantage of this method is that it provides more interaction between supervisors and subordinates, greater agreement on performance expectations, and greater accountability for performance through increased employee participation in the review process. Supervisors still have the responsibility to write reviews and provide the employee with honest communication about performance. They must also be able to provide explanations for differences of opinion about performance so employees can understand what they are doing wrong and how they can do things better.

- Subordinate Appraisal of Managers (Upward appraisal)

Supervisors are reviewed by those they supervise. This method serves to provide feedback on the qualitative aspects of management performance – how well they communicate, provide direction, delegate responsibility, etc. Employees' fear of reprisal may inhibit them from honestly providing feedback on their supervisor's performance. However, providing anonymity and working with supervisors to handle constructive criticism may guard against that.

- Peer

This method involves coworkers evaluating an employee. It is based on the premise that individuals can relate to an employee as their equal and are in the best position to judge the employee's performance because they understand the nature of the job and are familiar with the activities of the employee. This method is particularly useful in organizations having self-directed work teams, but could be used in other settings as well. An advantage is that peer appraisal relates more to results than efforts. Disadvantages perceived are that peers are too lenient and tend to give high ratings to friends and low ratings to those they dislike.

- Management by Objectives (MBO)

MBO is a form of results-oriented appraisal. It is commonly used for supervisors, but may be used for other employees as well. It requires that both the supervisor and the subordinate agree upon specific objectives in the form of measurable results. The objectives are the standards of performance. MBO is intended to motivate stronger performance on the part of managers and employees. It is assumed that if employees meet their goals, supervisors will meet their goals, and organizations will then meet their goals. MBO has the following components: (1) major objectives to be accomplished within specified dates, (2) action plans and milestones for accomplishing the objectives, (3) periodic meetings with the manager and employee to review progress and make corrections if necessary, and (4) an assessment of employee performance at the end of the MBO cycle. An advantage of MBO is that it is a participative approach in which employees have input in setting their own objectives, as well as being involved in decisions that affect the objectives of the organization. MBO has been criticized as being based on numerical quotas rather than continuous improvement process, and that it focuses on the performance of individuals at the expense of teamwork. It is also very time consuming, requiring a considerable amount of administrative work.

- Continuous Improvement Review

Concentrates on current day-to-day results that can be linked directly to organization-wide improvements in quality and productivity. However, the formal evaluation must accurately reflect the entire review period, i.e. probationary, annual, etc.

- Behaviorally-anchored Rating Scale

This is a method where standards are described in the form of behavior expected of an employee. The descriptions are based on critical incidents determined to be characteristic of the various levels of performance. The descriptions help to provide objectivity in rating. This tends to focus on activity rather than results.

- Trait Format

This format describes traits of an individual. Some examples are initiative, dependability, and cooperation. Be aware that while those traits may be factors affecting an individual's performance, to evaluate traits alone becomes subjective and is, therefore, difficult to defend.

- Critical Incident Method

This involves observing and recording information about unusually good or unusually poor behavior. It is usually used in conjunction with another rating technique to support the evaluation and provides specific examples to discuss with the employee. Documentation should be factual, objective, and job-related.

- Essay or Narrative Format

This format is a simple approach that requires evaluators to write or answer questions about past performance, strengths and weaknesses, training and development needs, etc.. This format is very suitable to jobs in which there are few quantifiable results, and it provides opportunity for considerable detail about performance issues. The format, however, is difficult to use for comparing performance with other employees.

3.3 Incentives

An incentive is something that motivates an individual to perform an action. The study of incentive structures is central to the study of all economic activities (both in terms of individual decision-making and in terms of co-operation and competition within a larger institutional structure). Economic analysis, then, of the differences between societies (and between different organizations within a society) largely amounts to characterizing the differences in incentive structures faced by individuals involved in these collective efforts. Ultimately, incentives aim to provide value for money and contribute to organizational success.

Categorizing incentives

Incentives can be too classified according to the different ways in which they motivate agents to take a particular course of action. One common and useful taxonomy divides incentives into four broad classes:

Remunerative incentives

Are said to exist where an agent can expect some form of material reward – especially money – in exchange for acting in a particular way.

Financial incentives

Moral incentives are said to exist where a particular choice is widely regarded as the right thing to do, or as particularly admirable, or where the failure to act in a certain way is condemned as indecent. A person acting on a moral incentive can expect a sense of self-esteem, and approval or even admiration from his community; a person acting against a moral incentive can expect a sense of guilt, and condemnation or even ostracism from the community.

Coercive incentives

Are said to exist where a person can expect that the failure to act in a particular way will result in physical force being used against them (or their loved ones) by others in the community – for example, by inflicting pain in punishment, or by imprisonment, or by confiscating or destroying their possessions.[citation needed]

Natural Incentives

Such as curiosity, mental or physical exercise, admiration, fear, anger, pain, joy, or the pursuit of truth, or the control over things in the world or people or oneself.

There is another common usage in which incentive is contrasted with coercion, as when economic moralists contrast incentive-driven work – such as entrepreneurship, employment, or volunteering motivated by remunerative, moral, or personal incentives – with coerced work – such as slavery or serfdom, where work is motivated by the threat or use of violence, pain and/or deprivation. In this usage, the category of "coercive incentives" is excluded. For the purposes of this article, however, "incentive" is used in the broader sense defined above.

Other forms

These categories do not, by any means, exhaust every possible form of incentive that an individual person may have. In particular, they do not encompass the many other forms of incentive – which may be roughly grouped together under the heading of personal incentives – which motivate an individual person through their tastes, desires, sense of duty, pride, personal drives to artistic creation or to achieve remarkable feats, and so on. The reason for setting these sorts of incentives to one side is not that they are less important to understanding human action – after all, social incentive structures can only exist in virtue of the effect that social arrangements have on the motives and actions of individual people. Rather, personal incentives are set apart from these other forms of incentive because the distinction above was made for the purpose of understanding and contrasting the social incentive structures established by different forms of social interaction. Personal incentives are essential to understanding why a specific person acts the way they do, but social analysis has to take into account the situation faced by any individual in a given position within a given society – which means mainly examining the practices, rules, and norms established at a social, rather than a personal, level.

Social pressure

It's also worth noting that these categories are not necessarily exclusive; one and the same situation may, in its different aspects, carry incentives that come under any or all of these categories. In modern American society, for example, economic prosperity and social esteem are often closely intertwined; and when the people in a culture tend to admire those who are economically successful, or to view those who are not with a certain amount of contempt (see also: classism, Protestant work ethic), the prospect of (for example) getting or losing a job carries not only the obvious remunerative incentives (in terms of the effect on the pocketbook) but also substantial moral incentives (such as honor and respect from others for those who hold down steady work, and disapproval or even humiliation for those who don't or can't).

Economics

The study of economics in modern societies is mostly concerned with remunerative incentives rather than moral or coercive incentives – not because the latter two are unimportant, but rather because remunerative incentives are the main form of incentives employed in the world of business, whereas moral and coercive incentives are more characteristic of the sorts of decisions studied by political science and sociology. A classic example of the economic analysis of incentive structures is the famous Walrasian chart of supply and demand curves: economic theory predicts that the market will tend to move towards the equilibrium price because everyone in the market has a remunerative incentive to do so: by lowering a price formerly set above the equilibrium a firm can attract more customers and make more money; by raising a price formerly set below the equilibrium a customer is more able to obtain the good or service that she wants in the quantity she desires.

A strong incentive is one that accomplishes the stated goal. If the goal is to maximize production, then a strong incentive will be one that encourages workers to produce goods at full capacity. A weak incentive is any incentive below this level.

Incentives help people to make the right decision, or the one would like them to make. To accomplish things you want done in economics you must give the consumer or the producer incentives, without them they would have no reason to do what you ask.

Regulation in the utilities sector

Incentive-based regulation can be defined as the conscious use of rewards and penalties to encourage good performance in the utility sector. Incentives can be used in several contexts. For example, policymakers in the United States used a quid pro quo incentive when some of the U.S. incumbent local telephone companies were allowed to enter long distance markets only if they first cooperated in opening their local markets to competition.

Incentive regulation is often used to regulate the overall price level of utilities. There are four primary approaches to regulating the overall price level: rate of return (or cost of service) regulation, price cap regulation, revenue cap regulation, and benchmarking (or yardstick) regulation.

With benchmarking, for example, the operator's performance is compared to other operators' performance and penalties or awards are assessed based on the operator's relative performance. For instance, the regulator might identify a number of comparable operators and compare their cost efficiency. The most efficient operators would be rewarded with extra profits and the least efficient operators would be penalized. Because the operators are actually in different markets, it is important to make sure that the operators' situations are similar so that the comparison is valid, and to use statistical techniques to adjust for any quantifiable differences the operators have no control over.

Generally regulators use a combination of these basic forms of regulation. Combining forms of regulation is called hybrid regulation. For example, U.K. regulators (e.g. Ofgem) combine elements of rate of return regulation and price cap regulation to create their form of RPI - X regulation.

Incentive Rates are also prevalent in the utility sector, under any of the utility regulatory frameworks noted. Incentive rates are a vehicle for the utility to induce large commercial or industrial customers to locate or maintain a facility in the utility service territory. The incentive is provided in the form of a discount from the utility's standard tariff rates, terms or conditions. In the U.S., incentive rates (also known as Economic Development Rates and/or Load Retention Rates) are a common component of the utility strategy for supporting the economic development efforts of a particular geographic region or political entity.

Problems

Incentive structures, however, are notoriously more tricky than they might appear to people who set them up. Human beings are both finite and creative; that means that the people offering incentives are often unable to predict all of the ways that people will respond to them. Thus, imperfect knowledge and unintended consequences can often make incentives much more complex than the people offering them originally expected, and can lead either to unexpected windfalls or to disasters produced by unintentionally perverse incentives.

For example, decision-makers in for-profit firms often must decide what incentives they will offer to employees and managers to encourage them to act in ways beneficial to the firm. But many corporate policies – especially of the "extreme incentive" variant popular during the 1990s – that aimed to encourage productivity have, in some cases, led to failures as a result of unintended consequences. For example, stock options were intended to boost CEO productivity by offering a remunerative incentive (profits from rising stock prices) for CEOs to improve company performance. But CEOs could get profits from rising stock prices either (1) by making sound decisions and reaping the rewards of a long-term price increase, or (2) by fudging or fabricating accounting information to give the illusion of economic success, and reaping profits from the short-term price increase by selling before the truth came out and prices tanked. The perverse incentives created by the availability of option (2) have been blamed for many of the falsified earnings reports and public statements in the late 1990s and early 2000s.

Also there is the tradeoff of short term gains at the expense of long term gains or even long term company survival. It is easy to plunder the assets of a previously successful company and show spectacular short term gains only to have the enterprise collapse after those responsible have gotten their incentives and left the organization or industry. Although long term incentives could be part of the incentive system, they have been abandoned in the past 20 years. An example of an organization that used long term incentive programs was Hughes Aircraft and was highly successful until the government forced its divestiture from the Howard Hughes Medical Institute. Recently there has been movement on adopting the Benefit Corporation or B-Corporation as a way to change the trend away from short term financial incentives to long term financial and non financial incentives.

Not all for profit companies used short term financial incentives at levels below the president or very top executive levels. The trend to move financial incentives down the organization hierarchy started in the 1980s as a way to boost what was considered low productivity. Prior to that time the incentives were associated more with customer satisfaction and producing high quality products. Moving financial incentives down the corporate chain had the unintended consequences of subverting internal processes to save short term costs, forcing obsolescence at the lower levels as investment was deferred or abandoned, and lowering quality. Some of these issues are explored in the British documentary The Trap. This idea of financial incentives and pushing them to the lowest level common denominator has led to a new company structure or Organization#Ecologies where essentially everything is a standalone profit center with the only incentive being short term financial incentives.

Recessions

Though bonuses make an integral component of free market practices on human beings, continuing to pay them to executives by companies benefiting from US Government financial help as planned and as contracted is facing great criticism and opposition from politicians and media. The case of American Insurance Group is an example of how refused normal bonus incentives have become after the capital market meltdown.

A possible solution against the criticism of overpaying executives in boom times and underpaying them in recession times is by linking bonus targets to an operating Index. By doing so external effects (economic cycles) can be excluded from performance measurement. This makes incentive pay more fair or likely not certain as bonuses are based on performance relative to other companies in the peer universe.

While the notion of a fair system seems to be an equal deal, those who are outperforming by a large margin will feel slighted by this approach. Thus, a system based on individual company performance has been the standard.

3.4 Profit sharing

Profit sharing refers to various incentive plans introduced by businesses that provide direct or indirect payments to employees that depend on company's profitability in addition to employees' regular salary and bonuses. In publicly traded companies these plans typically amount to allocation of shares to employees.

The profit sharing plans are based on predetermined economic sharing rules that define the split of gains between the company as a principal and the employee as an agent. For example, suppose the profits are x, which might be a random variable. Before knowing the profits, the principal and agent might agree on a sharing rule s(x). Here, the agent will receive s(x) and the principal will receive the residual gain x-s(x).

Europe

Management's share of profits

The share of profits paid to the management, or to the Board of Directors is sometimes called the tantième. This French term is generally applied in describing the business and finance practices of certain European countries, including Germany, France, Belgium, and Sweden. It is usually paid in addition to the manager's (or director's) fixed salary and bonuses (bonuses usually depend on profits as well, and often bonuses and tantieme are treated as the same thing); laws vary from country to country.

USA

In the United States, a profit sharing plan can be set up where all or some of the employee's profit sharing amount can be contributed to a retirement plan. These are often used in conjunction with 401(k) plans.

Gainsharing

Gainsharing is a program that returns cost savings to the employees, usually as a lump-sum bonus. It is a productivity measure, as opposed to profit-sharing which is a profitability measure. There are three major types of gainsharing:

Scanlon plan: This program dates back to the 1930s and relies on committees to create cost-sharing ideas. Designed to lower labor costs without lowering the level of a firm's activity. The incentives are derived as a function of the ratio between labor costs and sales value of production (SVOP).

Rucker plan: This plan also uses committees, but although the committee structure is simpler the cost-saving calculations are more complex. A ratio is calculated that expresses the value of production required for each dollar of total wage bill.

Improshare: Improshare stands for "Improved productivity through sharing" and is a more recent plan. With this plan, a standard is developed that identifies the expected number of hours to produce something, and any savings between this standard and actual production are shared between the company and the workers.