

Effect of Compensation System on Employee Motivation: A Case Study of Pakistan Petroleum Limited

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Abstract

In today's competitive business environment, organizations are constantly struggling to improve productivity, which ultimately leads to better performance of the organizations as a whole. It is, at this point, that various compensation schemes come into play, to motivate employees, which would reduce factors like job turnover, absenteeism, productivity, etc. and in turn, reduce costs. This study attempts to investigate the effectiveness of cash and non-cash award, reward, and recognition programs and to provide strategic guidance that will assist the organization in knowing when and where to utilize such programs, how to determine the type of motivation and award program that should be used. This study has been carried out among Pakistan Petroleum Limited employees. An analysis of 60 employees has been done to explore interesting trends related with employee motivation and types of compensation, management level viz lower, middle and upper management. The conclusions developed through this study has focused on developing an effective compensation system at PPL by identifying and understanding what motivates employees at each level in terms of cash and non-cash based rewards and allowing greater involvement of employees in selection of these rewards.

Keywords: Compensation, motivation, employees, Pakistan Petroleum Limited (PPL), cash and non-cash rewards

1. Introduction

The compensation system of an organization has strong effects on employee motivation. This motivation however can be categorized as intrinsic and extrinsic motivation, and the compensations have different effects on both of them. Whereas, monetary compensation has a positive relationship with extrinsic motivation, intrinsic motivation is not affected by monetary compensation, but it is affected by growth and promotional opportunities. PPL, like most other organizations in the petroleum industry, uses both cash and non-cash awards, rewards and recognition programs to influence employee performance and motivation level.

This research is designed to investigate the effectiveness of cash and non-cash award, reward, and recognition programs and to provide strategic guidance for PPL that will assist the organization in knowing when and where to utilize such programs, how to determine the type of motivation and award program that should be used and to identify

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the management level via upper management, lower management and hence a set of guidelines on how organizations can efficiently and effectively develop and implement various award programs.

1.1. Research Objectives

This study is aimed at conducting a research study on the impact of compensation systems on employee motivation at PPL. The study aims at to identify the various types of cash and non-cash compensation programs and to investigate the effectiveness of cash and non-cash rewards on employee motivation. The study will also investigate which types or forms of rewards are most preferred by employees and the different preferences for cash and non-cash rewards among upper management and lower management employees.

1.2. Significance of the Study

Realizing the importance and dependence of Pakistan's economy on the oil and gas sector, as Petroleum products and gas consumption accounts for approximately 70 percent of modern energy supply in Pakistan, this study has analyzed the effect of different compensations on the motivation of employees at Pakistan Petroleum Ltd. This study will not only help PPL but also other organizations in this growing and challenging sector to develop more effective compensation systems.

2. Literature Review

2.1. Motivating Managers to Boost Staff Engagement

Managers have a profound influence on staff engagement levels, and therefore special attention should be given to provide incentives to managers to maximize the employee engagement of their team, which in turn leads to better coordination among them and produces better results.

The number one driver of boosting employee engagement is the belief among the employees that the managers are sincerely interested in their well being. According to a survey by Research from the Kenexa Research Institute, based on an analysis of data from its Work Trends survey, published in November 2007, only 29% of employee respondents survey believe senior managers have their well-being at heart, with more than 60% saying instead they feel senior management 'treats us as another part of the organization to be managed' or 'as if we don't matter'. (Furness, 2008)

2.2. The Four Drives of Motivation

The degree to which the following four drives are acquired affects the emotional status and also the behavior.

- i) The drive to acquire: This means that every individual has a drive to acquire

scarce goods which will improve the standard of living or well-being. This not only includes goods which are physical in nature, but also money, social status, promotions, appreciation and other benefits. 'That explains why people always care not just about their own compensation packages but about others' as well. It also illuminates why salary caps are hard to impose.' (Nohira, 2008)

- ii) The drive to bond.
- iii) The drive to comprehend and make sense of the surrounding: This tells us that employees are motivated by the jobs that challenge them and that make them learn and gives them opportunities to learn.
- iv) The drive to defend which makes employees resistant to change.

2.3. The Organizational Levers of Motivation

The drives mentioned above have to be satisfied by some organizational lever so that the employees can be motivated. The ways to satisfy these drives are:

Reward System is the easiest way to satisfy the drive to acquire mentioned above. 'How effectively it discriminates between good and poor performers, ties rewards to performance, and gives the best people 'opportunities for advancement'.' (Nohira, 2008)

The research gives an example of RBS when it took over NatWest. The example tells us how the former employees accepted the new owners and their achievement level increased due to the reward system introduced by RBS (Nohira, 2008)

In brief, the most ideal situation is to have a culture that supports teamwork and collaboration and also support values on openness and friendship between employees.

Job design is important and the best way to do this is to design jobs which are challenging for employees and gives them opportunities to learn.

2.4. Rewards

Rewards play an important role in motivating employees. 'By doing it immediately, the result is usually that desired behavior is remembered and repeated. Spur-of-the-moment recognition is also a great way to motivate employees, build team morale and increase productivity.' (Breckridge, August 2008)

The paper 'Using Incentives to Achieve A/R Goals' by John Kivimaki studies the behavior of accounts staff of Mary Rutan Hospital, Ohio. It states that there is good reason to pay employees more / give incentive rewards for above average performance because of the simple reason that 'incentives work'. Paying for a high level of performance motivates employees to achieve best practice accomplishments.

This paper also concludes that more frequent disbursement of incentive package is more effective. The paper states that incentives will work as long as they are fair,

consistent across the board and achievable. Ideally, incentives should be established for every position within a department. This incentive system, coupled with periodic communications to employees, thus prove that incentive packages such as this motivates staff to do better and adopt best practices to achieve their goals. (John Kivimaki, 2007)

2.5. Motivation, Participation and Performance

A study was conducted to analyze how motivations of different OSS developers are interrelated, how these motivations lead to performance, and how past performance leads to future motivations. The findings of the research were that motivations of developers are not independent but are related to each other, and that getting paid to achieve something is positively related to status motivation, but negatively related to use-value motivation. In short, the research proved that monetary compensation would enhance status motivation and increase performance levels. This will in turn lead to higher performance rankings, which results in higher subsequent motivation levels (Jeffery A. Roberts, 2006).

2.6. Monetary and Social Market

According to a research paper written by James Heyman and Dan Ariely, 'A Tale of Two Markets', the standard model of labor is one in which individuals trade their time and effort in return for monetary reward. However, this paper has concluded that there are two types of markets in which the interactions between effort and payment differ:

- i) Monetary Market
- ii) Social Market

The Monetary Market is one in which effort is strongly correlated with monetary compensation, as this market entails relationship in which economic exchanges take place. The findings of this research paper can be analyzed to conclude that managers should be careful to draw the line between the social and monetary relationships they share with their employees (Ariely, 2004).

2.7. Undervalued Package of Perks

Research shows conflicting views of the effects of incentive packages. While all the researches mentioned so far have shown that incentives increase motivation and thus performance, there is some research which shows that employees are now tending to undervalue their perks packages. This study analyzes that in some cases, monetary reward is not sufficient to keep employees satisfied. Healthy communication and relationship management are equally, if not more, important. (Block, Pelier, Schutz, 2005)

Another research article draws upon Frederick Herzberg's theory of hygiene and motivation factors. Essentially, reward and benefits are hygiene factors. If these are not present, the worker will be unhappy, but even if there is excess of them, it would not

necessarily keep the worker more engaged. Basic salary in today's world is hardly a motivator to keep the employees in the company. It is the extra bonuses and perks which keeps them going. (Block, Pelier, Schutz, 2005)

Another research mentioned that although perks are the ones that attract employees the most with engagement and retention, their long-term affect on employees is less significant than intrinsic factors such as training and developmental and learning opportunities. (Benfits, 2008)

John Von Harz (2008) in his research paper talks about labor shortage in the electrical construction industry in the US. There is increasing shortage of labor with required level of skill and education. The most important step is retaining good workers, and this is done through benefits such as health benefits, as well as providing a work-life balance by keeping flexible working hours. Thus, we can see that recruitment and retention of good workers can be done through a combination of extrinsic and intrinsic motivation.

2.8. Intrinsic Motivation

Most of the organizations focus on the monetary rewards but intrinsic rewards is equally important for motivating the employees. 'Although monetary reward is an important motivator, it is not the only one. Employees may exert effort on behalf of an employer for any of several reasons.' (Prendergast, 2008, pg: 202)

Another study focusing on motivation of employees in multinationals in Pakistan focuses on Hierarchy of Need Theory. The theory given by Maslow in 1954 is a gradual stair like phenomenon which says that one need fulfillment leads to the origination of the next level of need, these needs are defined as Physiological, Safety, Social, Esteem, and Self Actualization. The Maslow theory of needs is although very famous but very general as far as its application is concerned. (Ahmed et al, 2005)

Although pay is thought to be the main driving force for motivation, it is clear that there are other factors and more importantly, they rank higher than pay as far as motivation is concerned. Employees are not just satisfied with the money or salary they get but they are looking for challenges and opportunities to learn new things and exploit their potential. Hence, interesting job patterns, recognition and development included in intrinsic motivation play their part. (Brown, 2008)

2.9. Role of Monetary Rewards

Stating the importance of intrinsic motivators, monetary rewards should not be completely ignored. While a lack of emphasis on pay and its links to performance can damage staff motivation, an over or sole emphasis on financial incentives can be detrimental to employers. (Brown, 2008)

Hence, after a review of various research papers and articles, the researcher concludes that compensation does affect motivation in addition to job satisfaction and turnover.

Compensation is important, both in extrinsic and intrinsic form, although intellectual developmental opportunities in the form of learning should be prized to motivate employees.

3.0. Research Methodology

The methodology adopted for this research was Case Study Approach supported by survey. PPL was selected as a case to study the impact of intrinsic and extrinsic compensation systems on employee motivation in an organization. In-depth interview and questionnaires were used as main sources of collecting the primary data.

Primary empirical data was supported by the secondary data comprising of review of existing literature /research incorporating findings from studies done on rewards and employee motivation in multinationals across the world. The sampling process comprised of convenience-based sampling .Secondary data was gathered through literature review, while primary data was gathered through a structured questionnaire distributed randomly among 80 employees at PPL Karachi office. The response rate was 75% resulting in a final sample of 60 employees with a breakup of 15 from the upper, 20 from the middle and 25 from the lower management. Semi-structured in-depth interviews were also conducted with one senior and one middle Human Resource manager to gather insight into the various cash and non-cash rewards offered at PPL and their effect on various levels of employees.

3.0 Data Analysis and Findings

Out of the 60 employees surveyed, 25 were from the lower management, 20 from the middle and 15 from the upper management levels. Results from the three levels showed distinct preferences for different types of rewards offered. The data was analyzed through descriptive statistics. Percentages and mean score values were calculated for all the questions and findings were studied for each level of management separately. After the analysis of the questionnaire and the interviews from the two HR managers, a final comparison was developed for the upper, middle and lower management to get a better understanding of the impact of different types of compensation for different hierarchy levels.

3.1. Preference for Cash / Non-Cash Based Rewards

While analyzing the data, it was observed that the lower management employees were strongly motivated by cash-based incentives. On a mean scale of 5, an above average score of 4.4 was obtained which showed that majority of the people belonging to lower management believed that cash-based incentives are important to motivate them. Among middle management employees, an above average rating of 3.9 on a scale of 5 was obtained as compared to the rating of 3.4 for non-cash showing that cash-based incentives were believed to be more important in motivating middle management. Responses from the upper management showed that these employees find non-cash incentives more important in motivating employees than cash-based incentives. An above average rating of 4 on a mean scale of 5 was obtained for non-cash rewards as compared to the rating of 2.46 for cash rewards.

Table 1: Preference for cash and non-cash rewards (mean score) - A comparison of Lower, Middle and Upper Management

	Preference for Cash Rewards	Preference for Non-Cash Rewards
Lower Management	4.4	3.28
Middle Management	3.9	3.4
Upper Management	2.467	4

3.2. Effectiveness of Cash/ Non-Cash Based Rewards

Almost similar trends were observed from the analysis about effectiveness of current cash and non-cash rewards and also their importance in the next five years from all the three management levels. The responses of lower management employees showed that most of them considered cash-based incentives more effective. 52% of these employees were of the opinion that cash based rewards were the most important role in motivating employees. While at the lower level of management, non-cash rewards were not very popular to independently motivate employees (4%), however, 44% of the employees believe that if cash and non cash rewards are coupled together, they can play an important role in motivating employees at this level. A majority of 70% of the middle management employees considered both cash as well as non-cash incentives are important, while 25% and 5% respectively believed in sole effectiveness of cash and non-cash rewards. The responses of the upper management level clearly showed that these respondents considered that non-cash incentives were most effective in motivating employees. Around 67 % of the respondents said that non-cash incentives were most effective in motivating employees, and 20 % cent of respondents stated that both are equally effective.

Table 2: Effectiveness for cash and non-cash rewards - A comparison of Lower, Middle and Upper Management

	Lower Management	Middle Management	Upper Management
Cash Rewards	52%	25%	13.3%
Non-Cash Rewards	4%	5%	66.67%
Both	44%	70%	20%

3.3. Most Motivating Type of Compensation

The selection of the most motivating and effective form of compensation showed different choices from the different levels of management. The lower level employees selected mostly cash-based incentives and other rewards like medical allowance, petrol allowance, etc. which had extrinsic value, whereas the middle and upper level showed a preference for non-monetary rewards like recognition, long service benefits,

etc. but they also depicted a strong inclination towards various extrinsic value rewards.

A comparison of the most motivating type of compensation summarizing the difference in the preferred reward form has been discussed in the table below:

Table 3.1: Most Motivating Type of Compensation System - A comparison of Lower, Middle and Upper Management

	Lower Management	Middle Management	Upper Management
Cash Based	90%	90%	28%
Special Events	20%	35%	80%
Employee Recognition	20%	100%	93%
Long-Service Awards	24%	85%	93%

3.4. Involvement in Selection Rewards

An analysis of involvement of employees in the decision-making and choice of reward system showed that the employees were not as actively involved as they would like to be. From the lower level, only 8% had some sort of involvement. A similar trend was observed for the other levels with 5% and 8% each of middle and upper management employees participating in decision-making of their rewards. As compared to 65% of the middle management, a majority of 80% each from lower and upper level wanted a greater participation in the selection of rewards.

3.5. Key Findings

- It was observed that the lower management employees were strongly motivated by cash-based incentives, whereas middle management found both cash and non-cash almost equally important. However, upper level employees found non-cash incentives more effective.
- While selecting the various types of rewards given at PPL, the lower level employees selected mostly cash-based incentives and other rewards like medical allowance, petrol allowance, etc. which had extrinsic value, whereas the middle and upper level showed a preference for non-monetary rewards like recognition, long service benefits, etc. but they also depicted a strong inclination towards various extrinsic value rewards.
- Majority of the employees, irrespective of their management level, wanted to be more actively involved in selecting their reward programs.

4. Conclusion

The compensation system of an organization has strong effects on employee motivation. Through this research, it was established that employees, at different management levels, had different views towards the motivational effect of cash and non-cash incentives. The study showed distinct differences between the responses of the lower, middle and upper management levels. Responses of the lower management level showed that these employees were motivated the most by cash incentives, whereas the middle management level seemed to be interested in both cash and non-cash incentives. The upper management, however, was motivated most by non cash incentives. For them, non-cash incentives such as employee recognition, long service awards, health benefits, etc. were more important. Also, at all three levels, it was determined that employees were not that involved in the selection of their compensation packages. However, most employees at all levels wished to be more involved in the selection of their compensation packages.

The results presented in this paper have implications for the entire Compensation System. Based on the findings through the questionnaires and the interview, it is recommended that:

- i) In order to motivate employees, the organization should provide the lower management level with more-cash based compensation packages like medical allowance, etc. and the upper management level with more non-cash based compensation packages, e.g. employee recognition. The middle management level employees however, need to be provided with compensation packages which have a fair share of both cash and non-cash incentives.
- ii) It is also suggested that the lower management be provided only with cash-based incentives, nor do we suggest that the upper management be provided only with non cash incentives. The compensation package should always be a combination of the two, because we recognize the fact that at all levels, employees will be motivated by both cash and non-cash incentives.
- iii) It is also recommended that the organization should involve the employees more in the decisions regarding their compensation packages. In this way, they will find out more about the needs of the employees, and will be in a better position to know exactly how to motivate them. Greater involvement of employees in the choice of rewards will also enhance their motivation and commitment to the organization.
- iv) The insight into the importance given to various forms of rewards by different hierarchy level provides useful information for the organizations' human resource management. Knowing how to use this information in designing the various extrinsic and intrinsic compensation systems for each level of management is though complex but highly relevant in developing a long-term effective compensation system at PPL.

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