Code: 0413-4102

# Compensation Management

# Incentive Pay:

## Design incentive pay programs suitable for various organizational contexts

Incentive pay is a form of compensation that provides employees with additional financial rewards when they achieve predetermined performance targets or contribute to organizational success.

Incentive pay = Extra pay for achieving extra or desired performance.

It is different from basic salary or wages.

# Example

Suppose a salesperson receives:

- Basic salary = Tk. 30,000 per month
- Commission = 5% of sales above Tk. 500,000

If the salesperson makes Tk. 700,000 in sales:

Sales above target = Tk. 700,000 – Tk. 500,000 = Tk. 200,000

Commission = 5% × Tk. 200,000

= Tk. 10,000

Therefore:

Total monthly earnings = Tk. 30,000 + Tk. 10,000 = Tk. 40,000

The additional Tk. 10,000 is incentive pay.

# Major purposes

## 1. Motivate employees

Employees may work harder when better performance produces additional rewards.

## 2. Increase productivity

For example, a factory may reward workers for producing more units while maintaining quality.

## 3. Improve quality

Incentives can be linked to reducing defects, customer complaints, or production errors.

# Major purposes

## 4. Attract and retain employees

Well-designed incentive systems can make compensation more competitive.

## 5. Align employee and organizational goals

Employees understand what the organization considers important.

## 6. Reward exceptional performance

Employees who contribute more can receive greater financial rewards.

# Basic Structure of an Incentive Pay Program

An effective incentive system generally contains five elements:

**Performance → Measurement → Target → Reward → Feedback**

For example:

**Salesperson**

Target: Tk. 1,000,000 sales

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Actual sales: Tk. 1,200,000

↓

Performance above target: Tk. 200,000

↓

Commission: 5%

↓

Incentive: Tk. 10,000

## Important principle

Employees should clearly understand what performance will produce what reward

# Major Types of Incentive Pay

Incentive pay can broadly be classified into:

## A. Individual Incentives

Rewards depend primarily on an individual employee's performance.

## B. Group/Team Incentives

Rewards depend on the performance of a team or work group.

## C. Organizational Incentives

Rewards depend on the performance of the organization as a whole.

# Individual Incentive Plans

Individual incentives are appropriate when an employee's contribution can be measured relatively easily.

## A. Piece-Rate Pay

Employees are paid according to the number of units they produce.

**Formula**

**Earnings = Number of units produced × Rate per unit**

# Individual Incentive Plans

## Example

A garment worker receives Tk. 20 for every acceptable piece produced.

If the worker produces 500 acceptable pieces:

500 × Tk. 20 = **Tk. 10,000**

If another worker produces 600 pieces:

600 × Tk. 20 = **Tk. 12,000**

**Suitable for:**

- Manufacturing
- Garment production
- Packaging
- Data processing
- Certain agricultural activities

# Sales Commission

Sales commission is one of the most common forms of individual incentive.

Employees receive a percentage of sales or profit generated.

## Example

A sales representative receives:

Basic salary = Tk. 25,000

Commission = 3% of sales

Monthly sales = Tk. 1,000,000

Commission:

3% × Tk. 1,000,000 = **Tk. 30,000**

Total earnings:

Tk. 25,000 + Tk. 30,000 = **Tk. 55,000**

# Sales Commission

## Suitable for:

- ❑ Retail stores
- ❑ Insurance
- ❑ Real estate
- ❑ Pharmaceutical sales
- ❑ Consumer goods companies

# Merit Pay

Merit pay provides permanent or periodic increases in base salary based on an employee's performance.

For example:

An employee earns Tk. 40,000 per month.

After an annual performance evaluation, the employee receives a 7% merit increase.

New salary:

Tk. 40,000 × 1.07 = Tk. 42,800

# Incentive pay vs. merit pay

| Incentive Pay | Merit Pay |
| --- | --- |
| Usually linked to specific performance | Usually linked to overall performance |
| Often variable | Usually becomes part of base salary |
| May be short-term | Usually long-term |
| Example: sales commission | Example: annual salary increase |

# Bonus

A bonus is an additional payment given when predetermined performance or organizational objectives are achieved.

## Example

A company announces:

Employees will receive a bonus equivalent to 10% of annual salary if the company achieves its annual profit target.

# Bonus

If an employee's annual salary is Tk. 600,000:

Bonus = 10% × Tk. 600,000= Tk. 60,000

## Types of bonuses

- Performance bonus
- Annual bonus
- Production bonus
- Attendance bonus
- Project completion bonus
- Sales bonus

# Designing Incentive Pay for Different Organizational Contexts

**There is no single incentive system that works for every organization.**

- The appropriate incentive depends on:
- Nature of the job
- Measurability of performance
- Organizational objectives
- Employee skills
- Team interdependence
- Industry
- Organizational culture
- Financial capacity
- Risk level