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INCENTIVES AND RECOGNITION

An evidence review

**Practice summary and
recommendations**

January 2022

The CIPD is the professional body for HR and people development. The registered charity champions better work and working lives and has been setting the benchmark for excellence in people and organisation development for more than 100 years. It has more than 160,000 members across the world, provides thought leadership through independent research on the world of work, and offers professional training and accreditation for those working in HR and learning and development.

Practice summary and recommendations

Incentives and recognition: an evidence review

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① Introduction

Although pay is a fundamental right in employment, reward more broadly can be used to motivate employees and improve performance. Put simply, above-average reward *'signals to employees that they deserve to be rewarded for superior contributions'*.[1]

If employers are to maximise this opportunity, they have several decisions to make. At the level of strategy and principles, views differ on what should be prioritised. For example, whereas some emphasise the importance of fairness, others argue for a need to be able to set reward individually to attract and keep the best people. At an operational level, views differ about the most effective methods of using financial incentives, or indeed whether they are the best approach at all. In particular, non-financial forms of recognition are a related practice that can be used as a supplement, or replacement, to financial incentives.

In a previous CIPD review, we took a broad look at the behavioural science of reward and we have also published various reports on the drivers and problems of excessive executive pay. In this report, we take a deeper dive into two specific questions that have important implications for how to motivate staff and maximise performance:

• How do different forms of financial incentive affect motivation and performance?

• What are the effects of non-financial forms of recognition?

In answering these, we cover related questions, including what incentives and recognition are, how they are supposed to work, and what moderating factors influence their impacts.

An evidence-based approach

We live in an age of information overload, in which it is easy to be swayed by the latest fads or received wisdom. Effective decision-making can be difficult – it requires us to critically question our assumptions, not be biased by anecdote and avoid cherry-picking the evidence that confirms our world view. Evidence-based practice gives well-established approaches to help with this. Hard proof is elusive, but we can identify the best available evidence, including the most promising options to achieve our desired outcomes. Employers and HR professionals need to take note of this if they are to identify best bets for action.

This evidence review summarises the best available scientific research on what works in financial incentives and non-financial recognition. It is based on two rapid evidence assessments (REAs), a shortened form of the systematic review. To read about our methodology, technical information, and study references, see the accompanying scientific summaries at cipd.co.uk/evidence-incentives

② What are they and how do they work?

Incentives and rewards

The term 'incentives' is often used to refer to any rewards or punishments related to performance. But although the terms are often used interchangeably, *incentives* can be considered forward-looking, in that they are set in advance (for example, on condition of meeting sales targets). On the other hand, *rewards* are often viewed as retrospective, meaning employees do not know what they will be in advance.

Two explanations stand out for how incentives work. The first is 'reinforcement theory',[2] which argues that we are more likely to repeat behaviour if the consequences are favourable and less likely if they are unfavourable. The second, 'self-determination theory',[3] builds on this to describe two mechanisms:

- controlled or **external motivation**, which is when we do tasks in order to achieve desired outcomes, and which is driven by prompts that are not part of the activity itself, such as financial incentives

- autonomous or **intrinsic motivation**, which is when we carry out tasks not because of what they might achieve, but because we find the activity inherently interesting or enjoyable.

Incentives and recognition are clearly designed to leverage external motivation, but this does not necessarily mean that they are unrelated to intrinsic motivation – in particular, some argue that rewards can erode our inherent enjoyment of tasks. We discuss the evidence on this in section 3 and section 5.

These are the dominant theories, but there are also other theories that help explain incentives. These include goal-setting theory,[4] which we discuss in our evidence review on performance management; and expectancy theory[5] and agency theory,[6] which we discuss in our previous review of the behavioural science of reward. For more discussion of work motivation more generally, see our evidence review on employee engagement. For further information on types of incentive, see the CIPD's factsheets on bonus and incentives schemes and performance-related pay.

Recognition

By 'recognition' we mean personal non-monetary rewards given to employees to acknowledge and reinforce their efforts, behaviour or achievements. They are usually set retrospectively, so are unexpected, and are relational and unconditional. Examples include giving personal compliments, positive feedback or thanks, announcing achievements, or presenting awards. They can be given verbally, via a thank-you card, company newsletters or noticeboards, or even with emojis. Traditionally, recognition has been top–down, simply decided by managers, but more recently approaches have been developed that take into account a wider set of views, including those of colleagues and other stakeholders. The extent to which there is a climate of recognition in an organisation can be measured with simple survey items asking employees how well recognised they feel by their manager or organisation – see the accompanying scientific summary for detail.

A good explanation of the value of recognition comes from social comparison theory. This argues that we compare ourselves with others to build our self-esteem: it is nice to see that we at least measure up to our peers. Recognition makes use of this fact to make people feel good (in scientific terms, 'induce positive affect') and it is our desire for such acknowledgement that motivates us.

Blending the two

In practice, the distinction between incentives or financial rewards and recognition or non-financial rewards may not always be clear cut. For example, an employer may introduce a noticeboard to celebrate success, or some other mechanism for colleague recognition, which also gives people the opportunity to allocate or nominate colleagues for a small financial reward. It may not be clear in such a situation to what extent the value lies in the recognition or the reward; or it may be that one enhances the other and they work together. However, this may not matter. As we shall now see, both types of intervention have a positive impact.

③ What's the impact on motivation and performance?

Incentives clearly help performance

There is a strong body of research showing that, overall, financial incentives have a positive effect on employee motivation and consequently performance. Studies tend to show that this effect is moderate (meaning an expert or careful observer could easily spot the difference it makes) to large (anybody can easily see the difference). According to one high-quality meta-analysis, using incentives *doubles* the improvements seen in performance.[7]

This clearly refutes Frederick Herzberg's 1950s argument, still popular today, that pay is a 'hygiene factor' – that is to say, that poor pay demotivates, but higher pay does not motivate.[8] (Indeed, as much as Herzberg's two-factor theory might seem to make intuitive sense, it has long been discredited – to read more on this, see our evidence review on work motivation.)

We can also dispense with another popular idea: that financial incentives tend to 'crowd out' and reduce intrinsic motivation. Many in the field of management – both academics and popular authors[9] – have argued that financial incentives reduce the innate pleasure that we can get from work and, as such, can damage performance. However, the best research evidence does not support it; there is no such generalisable effect. There are exceptions to this – in particular when incentives are seen as exploitative and unfair, as we discuss later – but it is not a general feature of incentives.

… as does recognition

We also have a strong body of research to show that, in general, employee recognition and non-financial rewards have a positive impact on intrinsic motivation and performance. As with incentives, the impacts are moderate to large in size, so substantial enough that managers across the board should take note.

Recognition is also seen to affect other related outcomes, including employees' interest in and enjoyment of work, attendance, and to some extent employee retention, commitment, and work engagement. What's more, if an employee is given recognition, it can have a knock-on effect, improving not only their own performance, but also that of their colleagues or team as a whole (see section 7).

What approaches work best?

This is a hugely important question. Meta-analyses do a vital job in drawing together large numbers of studies to show what the overall impacts of interventions are, but single effect sizes can mask a great deal of variation. The context in which an intervention takes place and the methods that are used can be all-important. So, what can we tell from the research evidence about what types of incentive or recognition are most effective, or how they can be improved?

The body of research points to various factors to consider when designing incentives. We have less evidence on the success factors for non-financial recognition, but can still draw some recommendations. What's clear for both is that although incentives and recognition generally have positive impacts, care should be taken, as there are cases where they do not and in some cases they may even backfire, harming motivation and performance.

Figure 1: Factors affecting the outcomes of incentives
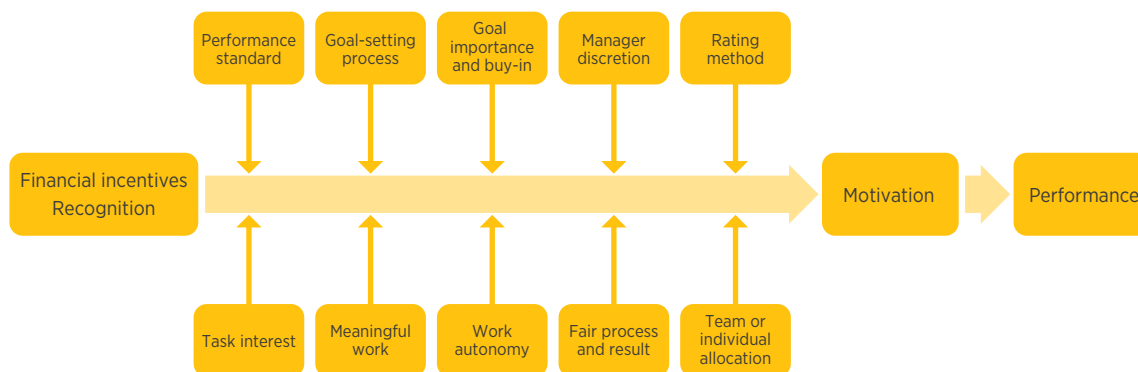
In the following sections, we discuss the main factors of influence (or 'moderators') of incentives and recognition, grouping them into four areas:

- how performance goals are set
- the types of tasks being encouraged
- how fairly employees view the process and outcomes
- approaches to allocating rewards.

These are illustrated in Figure 1. As noted, we find more evidence on incentives than recognition, but we draw insights into the latter where possible.

Recommendations for practice
- Both incentives and recognition are well worth using for effective people management.

- Don't assume that one 'carrot' is as good as another; consider factors that maximise the impact of incentives or recognition.

- Managers should not back away from introducing financial incentives due to fears that they will crowd out intrinsic motivation. Incentives or recognition are only likely to demotivate if they are seen as unfair or exploitative.

④ Connecting rewards to performance

There is strong research evidence for a point that may seem obvious: where they are used, financial incentives and recognition should be clearly linked with performance standards. This will help demonstrate to employees that their contributions are important and appreciated and their efforts have been worthwhile. When this link is not made – that is, when rewards are given for simply completing a task – incentives and recognition are actually likely to harm work performance.

We also have good evidence that incentives are more motivating when people believe the goals they are linked to are important. This tallies with other research into goal-setting, as discussed in our evidence review on performance management, and shows that mechanisms like incentives and recognition do not work in isolation but tie in with other motivations, like finding our work meaningful.[10]

Related to this, in the current review we find (albeit weaker) evidence that involving employees in goal-setting makes incentives more powerful. There are various potential reasons for this, which are likely to be connected. It could be that employees feel more *ownership* of the goals because they have been involved; it could be employees feel it's a *fairer* way of setting targets because they have had their views heard; or it could be that goals are more *relevant* or appropriate to the job because employees have added their expertise and contextual knowledge.

However, it's important to note that the research on employee participation in goal-setting is mixed, with other research[11] finding that supervisor-set goals are more powerful than self-set goals. Overall, the important point is that goals require buy-in from employees and thus need to be socialised, whether that is through participative approaches to setting them, or other means – for example, investing the time to explain why the goals in question are important to the organisation.

Recommendations for practice

- For financial incentives to work effectively, they should be linked to the achievement of performance standards or targets.

- Managers must make sure they socialise performance goals and get employee buy-in.

- An obvious approach to socialising goals is through concerted communications on why they are important for the organisation.

- It might also help to actively involve staff in setting objectives. However, we do not advise simply getting employees to set their own goals. It may be worth giving guidance or training so that employees and their line managers can effectively set goals jointly.

(5) Types of work tasks

A major point of discussion and research on incentives and recognition is how their impacts change with different types of work tasks.

Task complexity and interest

Overall, as we discussed in section 3, the body of research does not support the argument that incentives or recognition reduce or crowd out intrinsic motivation. However, a more nuanced version of the argument is also commonly put forward. This states that incentives improve performance in simple routine tasks, but undermine it in complex or interesting tasks. The concern in the case of the latter is that, although incentives and recognition may bolster performance in the short term, people's motivation quickly becomes reliant upon them, such that *'performance and interest are maintained only as long as the rewards keep coming'*.[12]

In considering the evidence on rewards for complex and interesting tasks, it's worth noting the difference between the two (see Box 1), as the research on them gives different messages. For job complexity, despite all the rhetoric, we can unambiguously say that rewards do not harm intrinsic motivation. We find strong evidence that financial incentives are even more effective for complex tasks than they are for simpler ones.

Box 1: Task complexity versus interesting work

Task complexity concerns the extent to which a job requires that one applies logic or skills in a staged or non-straightforward way. **Simple tasks** are typically routine and predictable: one knows in advance what actions a job requires and how they need to be completed (including, for example, the order in which tasks need to be done and what challenges are likely to be encountered). **Complex tasks** are less predictable, in that one may have to collect and assess information and make decisions based on that judgement, before completing the target activity. A job can be complex or simple for various reasons, including:[13]

- the number of components or sequences to be completed or information cues that need to be considered

- the degree of co-ordination needed between the different components

- how dynamic the task is: that is, whether task requirements change over time.

Task interest can be thought of as part of intrinsic motivation (see section 2). Indeed, one established way of measuring intrinsic motivation is through self-reported task interest (another is by assessing how much time people spend on not-mandated tasks, or how well they perform, during 'free-choice periods').[14] Task complexity and interest may overlap in many jobs, as with complexity may come greater variety, but they are distinct: jobs could be interesting yet simple, or complex yet boring.

When it comes to how interesting tasks are, we do get a more mixed picture. For uninteresting tasks, it is clear: rewards do a great deal to motivate people and improve performance. For interesting tasks, it's less clear: any contribution to performance is smaller and in some cases rewards can indeed harm performance. Intrinsic motivation being crowded out is a potential reason for this, but it should be noted that the evidence here is inconclusive.

As we note in Box 1, job interest and job complexity may be related but are not the same thing. Overall, it's clear that HR professionals should not be concerned about the impact of rewards in complex jobs. There is no serious cause for concern for interesting jobs, but if there is a choice, it may make more sense to direct rewards towards those jobs that are less interesting.

However, HR should consider how the targets set for any incentive might impact on employee discretion, and try to make sure that goals are not too prescriptive. Employees need to be afforded space and autonomy in the approaches and speed with which they tackle their job roles.

Work autonomy

There is a relationship between the impact of rewards and how much autonomy or discretion people have in their jobs – that is, when managers hand over a degree of control to workers to make decisions about how they do their job (see Box 2). We find that if employees feel that the targets linked to incentives are so prescriptive that they restrict their autonomy – in stating methods, dictating work pace and so on – then those incentives do less to support performance.

Autonomy is an important motivator in general, so is to be encouraged in its own right. This is because it supports our sense of having self-determination as humans and a clear identity as professionals, and also because it enables us to establish the best way to go about our jobs. In addition to this, we can add that, while linking rewards with performance is important (as we discuss in <u>section 4</u>), managers should not make that link too rigid.

> **Box 2: What is work autonomy?**
>
> Work or job autonomy has been defined as the extent to which a job gives *'substantial freedom, independence, and discretion to the employee in scheduling the work and in determining the procedures to be used in carrying it out'*.[15] The three main components of autonomy are:[16]
>
> - work criteria: what tasks we do
> - work methods: how we carry out tasks
> - work scheduling: how fast and in what order we carry out tasks.

Meaningful work

Another relevant factor is meaningful work, a psychological construct that includes whether people feel they have found their niche in life and their job makes a useful contribution to society (see Box 3). We find that when work is not felt to be meaningful, employee recognition has a large positive effect on performance, but when it is high, recognition only has a limited effect. However, research suggests the same is not the case for another related aspect of work: when people believe that their targets are important for their personal values or objectives, incentives are more effective. It may be that rewards do little if we are motivated by serving wider society, but magnify our drive when we are more focused on ourselves.

> **Box 3: What is meaningful work?**
>
> There is a rich and varied vein of research into the meaning that people find in their work and there are various definitions.[17] Meaningful work is often seen as the opposite of feeling alienated from one's work. Core components of the meaningfulness of work are:
>
> - employees' perceptions of the significance of their work, including whether it serves a satisfying purpose and makes a useful contribution to the world
> - the extent to which employees feel they have found their niche in life – for example, a job in which they apply their strengths and develop personally
> - employees' sense of belonging, relatedness and being part of something bigger than oneself.

Of course, as far as possible, employers should try to create jobs that feel meaningful to staff, just as they should try to enrich them by giving autonomy. But it is a reality that some jobs will inherently feel more meaningful than others – either because people operate at a higher level of impact, or use a greater range of skills, or because the work is more strongly targeted at 'making the world a better place'. Given this, an implication of the research is that people managers and HR leaders may do well to prioritise rewards among workers with less meaningful jobs.

Recommendations for practice
- Although the effectiveness of rewards varies to some extent with the nature of jobs, people managers and HR professionals should not in general be concerned that they will harm motivation.

- All the same, where there is the option or need to direct rewards to certain jobs, it is sensible to prioritise jobs that are either more complex on the one hand, or less interesting or meaningful on the other hand.

- To support this – and to inform wider activity to enrich jobs – it may help to gauge the perceptions of your staff on aspects including job complexity, meaningfulness of work, and job interest. Measures of these can be found in the CIPD's Good Work Index.

- While financial incentives and recognition schemes should be linked to fair performance standards, they should not lead to overly prescriptive styles of management that reduce work autonomy.

⑥ Fairness in rewards

Employees' perceptions of fairness (see Box 4) can have a major impact on the effectiveness of many aspects of people management, such as feedback and performance. Indeed, we have strong evidence that treating employees in ways that they feel are unfair or arbitrary has a damaging effect on their motivation and performance.

Rewards should be fairly distributed
Unsurprisingly, we find strong evidence that fairness is an important factor in incentives and recognition. This is the case for distributive justice: if employees feel this allocation is fair, the incentive does more to motivate them to perform. It is also the case for procedural justice: incentives are more effective if the procedures and how managers apply them are seen to be fair. Managers clearly have an important role to play in this, as they can use their discretion to decide who, and how much, they reward.

Box 4: What's fair?

What do we mean by fairness? There are a number of theories and definitions of the nature of fairness, but the dominant lens in organisational psychology is that of 'organisational justice'. This can refer to:

- distributive justice: how fair the outcomes of a decision or allocated resources are

- procedural justice: how fair the processes or approaches used to make decisions are, for example because they are seen as open to input (positive influence) or subject to bias (negative)

- interactional or social justice: how fairly people are treated when procedures are implemented.

The issue of fairness in reward goes wider than incentives and recognition, most notably including equality and pay gaps, and excessive CEO pay. For more information on this, see the CIPD factsheet on pay fairness and pay reporting. For a more in-depth appraisal of approaches to fairness in organisational life, see our report, _The Changing Contours of Fairness_.[18]

Methods of assessing performance

We also find interesting research on how perceptions of fairness are formed and influenced. In particular, where ratings are used to gauge performance and allocate incentives, the rating method used makes a difference. If a greater number of categories is used in the rating segmentation (for example, five), employees are more likely to feel that it's fair. (Incidentally, this can also lead to greater self-efficacy and higher goal-setting among employees.)

The research on subjective measures of performance gives a more nuanced picture. Although they are generally seen as prone to bias, research suggests that not including them may be detrimental and cause employees to perceive the rating process as unfair. However, performance evaluation that puts a lot of weight on subjective measures is also considered by staff to be unfair. Overall, this is clearly an aspect in which a balanced approach is optimal, with some use of subjective assessment.

Bake fairness into reward schemes

Given the importance of fairness to the success of incentives and recognition schemes – and indeed more broadly in motivating people – it's important that HR professionals properly understand the different aspects and how they are influenced.

Insights into fairness can be applied in all aspects of rewards. This can be applied in linking rewards to performance targets: clear communication from leaders should help employees understand what their employer expects of them and what they can expect from their employer. HR should help the organisation review and assess that employee incentives and recognition are being distributed fairly. One way to do this is through pay gap analysis and equal pay audits. And as already noted, HR professionals should emphasise the importance of fairness to guide managers' decisions on incentives and recognition.

Understanding employees' views on distributive and procedural justice is also important. HR professionals should consider using surveys, staff forums and employee representatives to explore employees' opinions of the decision-making on rewards. These may prove valuable sources to help improve processes, identify where there is room for improvement in how people managers treat people, and prioritise line manager training and guidance to where it's needed most.

Recommendations for practice

HR professionals should carefully think how to make incentives and recognition feel fairer to employees:

- Familiarise yourself with the components and dynamics of fairness, reflect on how they relate to your organisational context and communicate these insights to people managers.

- Support distributive justice by assessing the fairness of rewards, for example through pay gap analysis.

- Use surveys, focus groups or forums to gauge staff views on whether the processes and decisions on incentives and recognition are fair, and use these insights to inform change.

- Make some use of subjective measures to assess people's performance, without overly relying on them.

- If using performance ratings to allocate incentives, consider giving a greater number of categories to assess employees (for example, five).

(7) The allocation of rewards

There are various options for designing incentives and recognition schemes, including how competitive the allocation is and whether they are distributed to individuals or teams. In part, these considerations build on the theme of fairness and both areas have clear implications for how effectively rewards motivate employee performance.

How competitive should rewards be?

The research evidence suggests there is no difference between competitive schemes, in which only the highest performers are rewarded, and non-competitive schemes, where all employees whose performance increased receive an incentive. However, given the importance of perceived fairness, highly competitive schemes that are seen as 'winner takes all' may well demotivate people. In a similar way, our evidence review on performance management found that the use of competitive 'forced ranking' in staff appraisal tends to backfire, due to perceived unfairness. On balance, it seems competitive approaches to incentives can be used to an extent, but there may be little point in condensing rewards in highly competitive systems, as this approach is no more effective than more equitable rewards and risks backlash.

Team and individual rewards

There is strong evidence to show that team-based incentives do more to drive performance than individual ones. However, this does not mean that everyone within a team should be rewarded the same: distributing rewards *equitably* within teams – that is, fairly considering individuals' contribution – is more effective than distributing them *equally* or uniformly. On the one hand, employees like to be recognised for their collective achievements rather than being singled out for individual praise, and rewards are a key opportunity to emphasise the need for positive team behaviours, such as collaboration and support. On the other hand, employees still enjoy seeing their contribution to the greater whole recognised. In this sense, procedural and interactional justice, where decision-making processes and the treatment of people within those processes are fair, are preferable to distributive justice (see Box 4).

The upshot is that a balance needs to be struck, such that people are incentivised within teams, yet also depending on their individual performance. The key principle HR professionals and managers should bear in mind is to look for ways to emphasise both positive group processes (for example, fostering a climate of psychological safety) and individual contributions.[19] This means appraising and giving feedback on performance at a global team or unit level and for each individual.

We get a slightly different picture when it comes to non-financial recognition in teams. Individual recognition can have positive and negative consequences. On the one hand, singling out a team member for recognition – in particular one who is seen as central to the team – not only motivates that individual, but also has a knock-on or spill-over effect, increasing the motivation of others in the team and improving team performance as a whole. On the other hand, there is some (albeit limited) evidence that public recognition of individuals can foster envy and resentment among colleagues, demotivating teams. This could in turn lead to discomfort on the part of high performers, potentially undermining the motivational benefits intended.

Given the potential for both resentment and positive spill-over, it's clear that the framing or messaging of recognition should be handled with care. To raise awareness and facilitate a spill-over effect, HR professionals or people managers should communicate who has been recognised, why, and when to a broad audience. At the same time, it should do so

in a way that also emphasises the importance of the work of the team as a whole. People professionals should also be open in explaining the rationale of how rewards have been allocated to avoid envy and resentment.

Team composition

A complication is that it is not always clear where the boundaries of a team really lie. The effects of team-based rewards are most positive when the team is highly interdependent and relatively homogenous. When this is not the case (in disparate or highly heterogeneous work groups), it's easy to lack clarity on the nature of team effectiveness and thus precision on what constitutes high performance.

So while team-based financial incentives are to be prioritised as especially impactful, the composition of those teams should not be in any way arbitrary. HR and other leaders shouldn't create teams that don't make sense in terms of how the organisation, work, and jobs are designed. It may be helpful here to consider Hackman's model of team effectiveness. This describes enabling conditions that include being a genuine team that is interdependent, clearly delineated, and stable, not a nominal one; it also describes other factors, including a compelling direction, structure, and processes that support teamwork, a supportive climate, and effective coaching.[20]

Team size

Related to team composition, we find that the effects of team-based rewards are greater in smaller teams and become diluted in larger ones. Clearly, the structure of teams within organisations should reflect the needs of the business and should not be broken up artificially purely to maximise the impact of an incentive scheme. If teams are larger, therefore, HR should explore ways of giving incentives and recognition to sub-team units. We cannot prescribe specific numbers of individuals that should be in a team, but when it comes to incentives, the evidence suggests the smaller the number, the better.

Forming meaningful and cohesive teams

These findings may prompt HR leaders and other senior managers to reflect on something that may not be clear: the logic to how teams work, both in their composition and how they are structured across the organisation. Understanding this and ensuring that team structure reflects it consistently would seem to be an important condition for motivating and maximising performance. Once business leaders have ensured this, people managers and HR professionals can then focus on how to give incentives and recognition that acknowledge people both as individuals and as part of a team.

Recommendations for practice

- Prioritise team-based rewards over individual ones, but within teams prioritise equity (or fairness) over equality. This requires a balanced approach that highlights the value created by a team and gives individuals due recognition of their personal contributions.

- Consider the size of teams: their composition and structure should reflect the needs of the business, but incentives and recognition should be allocated to as small groups as possible.

- To facilitate these approaches, ensure there is a clear understanding of the nature of each team, what its role is, and how its members work interdependently to create value. This is important for the effective running of an organisation in any case, but will also help HR professionals to devise incentives that are relevant and increase motivation and performance.

⑧ Research limitations and outstanding questions

This review has uncovered a rich vein of research insights into what works best in incentives and recognition, but some outstanding questions remain. A general limitation of the body of research on incentives and recognition is that most of the high-quality studies involved artificial lab-type environments, rather than real-world employment settings. This means that we have limited evidence research on the impact of reward for different contexts and populations.

More specifically, there are some important aspects of designing incentives or recognition schemes on which we have not found good-quality research evidence. Nonetheless, although there appears to be a lack of evidence on these points, we can still make some reasonable assumptions about them based on the evidence we do have. We discuss three key aspects below.

Consolidated versus one-off rewards

First, we do not know how the impacts of 'non-consolidated' incentives[21] compare with those of 'consolidated' incentives like performance-related pay rises. For example, if an employer has a 3% pay budget, should it use that for bonuses or pay rises? Nonetheless, two principles are clearly relevant here. On the one hand, the opportunity for a non-consolidated bonus can be repeated, giving more opportunities to reinforce incentives and motivate staff, compared with consolidated pay rises that often present just one opportunity for the same pot of cash. On the other hand, staff may feel unfairly treated and become demotivated if they feel that pay rises are neglected. This is likely to be influenced by changes in the real-term value of pay due to inflation and rises in the cost of living. Balancing these factors will be important in making effective decisions on reward schemes.

Anticipated versus retrospective rewards

Second, we don't know whether anticipated incentives (based on targets set for future performance) are psychologically more or less motivating than unanticipated rewards (set retrospectively for past performance). However, there are practical considerations that may help decisions here. In particular, it is sensible to assume that anticipated incentives are more appropriate for some roles – for example, many sales-based jobs – in which it's relatively easy and convincing to link specific targets to individual employees or teams. In contrast, retrospective rewards may be more appropriate when individual or team performance is less clear, or more contingent on other factors than their personal work – for example, is heavily influenced by other teams or disruptions in markets. Often the situation will not be cut and dried, so there will be a judgement call to make – for example, retrospective rewards may also be appropriate in sales roles, to encourage less clear target areas such as desirable behaviour as acknowledged through customer feedback.

How big should rewards be?

Third, our search did not find clear evidence on the 'dose' or 'intensity' of incentives – that is, on what the optimal size of awards is. However, we do find evidence for an important principle: it should be guided by *'the extent to which higher performance can be created by additional effort'*, as well as *'the type of task, the performance measure, and team characteristics'*.[22] If incentives are leveraged too strongly, they may create excessive risk. As a result, they may either distort people's motivations by incentivising unintended or excessive behaviour, or weaken the motivating effect if people feel averse to the added risk. Rather, the size of incentives should be commensurate with what employees can reasonably do to increase their performance.

This is in line with insights we've discussed into other aspects – such as team composition and fairness. The broad message is that incentives should genuinely align with the nature of the job.

For more discussion of the size of rewards, see our publications on <u>executive reward</u>. For more discussion of unintended consequences of incentives, see our previous report on the <u>behavioural science of reward</u>.[23]

⑨ Conclusion

In Frederick Herzberg's hugely popular article on employee motivation, first published in 1968, he summarises: *'Forget praise. Forget punishment. Forget cash. You need to make their jobs more interesting.'*[24] His arguments for enriching the quality of jobs were undoubtably valuable, but in a very important way this statement is not only an oversimplification, but also clearly wrong.

Incentives and recognition are a staple of work motivation. It is true that if rewards are seen to be unfair, they can be demotivating, that in certain conditions they can cause resentment, and that for some jobs they may even reduce the motivation that stems from the inherent enjoyment of the work. But overall, the evidence is clear that the benefits to motivation and performance outweigh any 'costs'. Moreover, if HR professionals design and manage reward schemes in an informed and balanced way, the potential risks can be managed.

Employers should not overlook incentives or recognition in seeking ways to motivate staff and boost performance. On the contrary, they should set up systems that make the most of them and actively encourage managers and colleagues throughout the organisation to 'share the love'. The overriding principles to follow in this can be summarised as:

1 Design rewards that reflect the reality of the individual jobs and teams in which they are given.

2 Link rewards clearly and consistently to performance.

3 Make sure that reward schemes and how they are administered are seen as fair.

⑩ Notes

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