

Intrinsic and extrinsic compensation instruments commerce essay

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Compensation is the remuneration received by an employee in return for his/her contribution to the organization. It is an organized practice that involves balancing the work-employee relation by providing monetary and non-monetary benefits to employees.

Compensation is an integral part of human resource management which helps in motivating the employees and improving organizational effectiveness.

Components of Compensation System

Compensation systems are designed keeping in minds the strategic goals and business objectives. Compensation system is designed on the basis of certain factors after analyzing the job work and responsibilities. Components of a compensation system are as follows:

- Job analysis
- Salary structures
- Pay structure

Need of Compensation Management

A good compensation package is important to motivate the employees to increase the organizational productivity. Unless compensation is provided no one will come and work for the organization. Thus, compensation helps in running an organization effectively and accomplishing its goals.

Salary is just a part of the compensation system, the employees have other psychological and self-actualization needs to fulfill. Thus, compensation serves the purpose.

The most competitive compensation will help the organization to attract and sustain the best talent. The compensation package should be as per industry standards.

The financial assets of a company have always occupied central importance whenever it has come to management decisions. However world's recent plunge into financial crisis has raised this importance to critical level. This has particularly put direct effect upon financial sector such as banks. The fact that organizations cannot control their external environment in current period of recession has put direct emphasis.

Compensation management deals with the ability to effectively compensate the employees to work and create a competitive advantage through highly motivated human resources (HR).

Compensation is the cornerstone of an effective talent management strategy. The ability to enable consistent, reliable and standardized compensation processes that are linked to performance drivers of individual and organizational strategies can affect many facets of the business. Some of these facets include:

- (1) Improved employee morale and retention,**
- (2) Increased employee engagement and productivity,**
- (3) Strengthened governance and compliance with company and regulatory issues.**

Motivation is the set of reasons that determines one to engage in a particular behavior, having phenomenological and physiological dimensions. The term is generally used for human motivation but, theoretically, it can be used to describe the causes for animal behavior as well. This article refers to human motivation. According to various theories, motivation may be rooted in the basic need to minimize physical pain and maximize pleasure, or it may include specific needs such as eating and resting, or a desired object, hobby, goal, state of being ideal.

Employee satisfaction helps the company to maintain a standard & increase productivity by motivating the employees. As “ human resource” is the most important resource for any organization, so to study on employee satisfaction helps to know the working conditions & what are the things that affect them to work properly or otherwise.

These factors become really crucial when we talk about financial institutions that have nothing more than services and that also of financial basis to attract their customers. In this condition it becomes really important for them to deal in an effective and committed way to their customers. Because they have no real brand names to back them up, and also customers feel very protective while dealing with financial products, services or institutions.

The strength of any financial service provider lies in its human resources. It is logical that if you have a strength that can be your competitive advantage and is directly related towards your operations it will help in evading your threats in external environment. A satisfied and motivated workforce will have a convincing influence upon customers and can attract them even in most gruesome conditions as we can find nowadays.

2. OVERVIEW OF THE BANKING SECTOR IN PAKISTAN

Pakistan is a developing country, and being a developing country the recent financial crunch has the worst impact over it. Where developed countries like America and that of European Union managed to sustain their financial institutions through the strength of their governments. But it is evident that countries like Pakistan lack such government strength. So businesses and especially financial institutions in a country like Pakistan have no hope to control the effect of any such calamities through bailing out by factors like government from their external environment. So then what they must do? It is the question that has to arise. We have already discussed the problem of financial institutions for lacking any strong brand and having sensitive customers. In this scenario financial institutions may only count on the strength of their internal environment.

Observing financial sector of Pakistan, it becomes clear that banking sector dominates it. Banking sector for Pakistan has been somewhat static and slow moving for decades, until government let go of all banks except National Bank of Pakistan in private hands. This started a new revolution in banking sector, with changes erupting in almost every aspect of private banks. This <https://assignbuster.com/intrinsic-and-extrinsic-compensation-instruments-commerce-essay/>

brought about a serious competitive environment in the banking sector. But with all the positive impacts it also brought some big question marks and doubts. Doubts regarding employees and customer satisfaction. Question marks about who is the best. But with financial crunch these doubts have changed to which bank can survive, and who can still have trust of its customers. In banking sector if one name can't be ignored then it is National Bank of Pakistan, The bank that has not only the largest branch network nationwide but also in foreign country, largest reserves, highest authority and strong corporate brand position with government backing.

National Bank of Pakistan

National Bank of Pakistan was established under the NPB ordinance in 1949 and was 100% govt.-owned. NBP acted as an agent of the Central Bank wherever the State Bank did not have its own Branch. It also undertook Government Treasury operations. Its first branches were in jute growing areas in East Pakistan. Offices in Karachi and Lahore followed. In 1950 NBP established a branch in Jeddah, Saudi Arabia. By this time NBP had branches in London and Calcutta, in 1955. In 1957 NBP established a branch in Baghdad, Iraq. In 1962 NBP established a branch in Dar-as-Salaam, Tanganyika. In 1964 The Iraqi government nationalized NBP's Baghdad branch. In 1965 the Indian government seized the Calcutta branch on the outbreak of hostilities between India and Pakistan. In 1967 The Tanzanian government nationalized the Dar-Es-Salaam branch. In 1971 NBP acquired Bank of China's two branches, one in Karachi and one at Chittagong. At separation of East Pakistan NBP lost its branches there. NBP merged with Eastern Mercantile Bank and with Eastern Bank Corporation. In 1974 the

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government of Pakistan nationalized NBP. As part of the concomitant consolidation of the banking sector, NBP acquired Bank of Bahawalpur (est. 1947). In 1977 NBP opened an offshore branch in Cairo. In 1994 NBP amalgamated Tehran Bank (EST. 1991).

In 1997 NBP's branch in Ashgabat, Turkmenistan commenced operations. In 2000 NBP opened a representative office in Almaty, Kazakhstan. In 2001 State Bank of Pakistan and Bank of England agree to allow only 2 Pakistani banks to operate in the UK. NBP and United Bank agreed to merge their operations to form Pakistan International Bank, of which NBP would own 45% and United Bank 55%. Also that year, NBP closed its branch in New York. In 2002 Pakistan International Bank renamed itself United National Bank Limited (Ileana Gumby, 2009). The ownership structure of the UNB remained as before. The only change to the shareholding structure is that UBL had recently been privatized in Pakistan and was now owned 49% by the Government of Pakistan and 51% by a joint foreign consortium of Abu Dhabi. In 2003 NBP received permission to open a branch in Afghanistan. Today NBP has 1450 domestic branches nationwide spread over 23 regional segmentations. It has assets up to 350 billion rupees (NBP, 2011).

3. PROBLEM STATEMENT

This paper will look in to the perspective of compensation management system in banking sector by knowing about what motivates employees in banking sector. Nowadays banks have become extremely decentralized in nature and due to privatization of banks the level of competition has entered in a new dynamic phase, which directly has its effects over employees of

banks. Continuous increasing market demands have literally over loaded employees of banking sector and stretched their working hours in an absurd way. All of this has resulted in employee complaints about work pressure, stress, strain, lack of fulfilling family expectations etc which really have a bad impact over employee motivation of banking sector and ultimately their performance. To handle this situation banks are using different compensation (both intrinsic & extrinsic) and reward policies for motivating their employees. The question is whether banks are applying the appropriate compensation strategies with respect to their employees? Are these strategies achieving the desired results? Which type of compensation has more motivational effects? These issues if remained unaddressed then can lead to problems like de-motivation, dissatisfaction of employees and customer, high turnover etc and therefore needs to be studied with care.

4. RESEARCH OBJECTIVES

The paper will find out different aspects of a compensation system having motivational effects by finding what employees perceive to be the most motivating factor in their compensation system by the assessment of instruments used for extrinsic as well as extrinsic compensation through checking the effectiveness of different intrinsic instruments regarding job satisfaction and motivation to work among the employees of National Bank of Pakistan, Attack city.

5. LITERATURE REVIEW

Swinton (2006) described a relationship between Maslow's hierarchies of needs with Herzberg theory. Maslow's theory state a person's needs

hierarchy with basic needs at base followed by security needs, social needs, esteem needs and self actualization needs. She is of the opinion that up to esteem needs level employee motivation or satisfaction can be maintained by factors which Herzberg called hygiene factors. This includes salary, benefits, job security, company policy etc while to deal with people at self actualization level factors known as motivators would be needed. This includes employee achievement, employee recognition, and employee growth. By keeping in mind this relationship among two basic theories of management organization may find it easy to manage their HR and other operations. Kidman and Golding (2006) are of the view that knowledge management system could play an integral part in increasing any organization's performance and can help it to compete in such highly competitive environment as today's. They say that knowledge management system if applied can bring improvements in decision making, increase in customer value, improving relationships with consumers and bringing new value in to sight by including the concept of innovation. Sureshchandar et al (2002) in their research studied banking sector of India and analyzed how different banks apply concept of total quality service in their functions. They found that these applications are inconsistent and incongruent with in all banks. Which makes it highly sophisticated sector. According to them banks of India can be divided into three groups based upon their perception about total quality services in operations. Barney and Wright (1997) describe that although human resources are accepted to be organization's most important assets yet organization's decision often depicts contradiction with this belief.

They further say that HR should not be neglected because they can bring competitive advantage to organization.

Therefore they should be managed with equal importance with other functions of the business. Hustled (1995) has emphasized on the fact that usage of high performance work practices i. e. comprehensive employee recruitment, Incentive compensation and performance management, extensive employee training and involvement programs surely increase competence of employees, it increase their motivation and reduce turnover. This results in retention of quality employees and also is a useful way to eradicate poor performers from the organization.

Nowadays organizations have been persuaded by competitive environment to apply a progressive HR strategy. As stated with the relevance of Pfeiffer (1996) the past decade has presented with many testimonials to the value of progressive HRM practices and system of such practices. In particular, employee participation, empowerment and job redesign, extensive employee training and performance contingent incentive compensation, are widely believed to improve the performance of organizations (John T Delaney and Mark A Hustled, 1996, Mark A Hustled, 1995). Human Resource management and productivity of organization has a direct relationship with each other.

If employees are managed appropriately i. e. job analysis, recruitment, training, motivational tools like compensation etc they are destined to give high performance in their operations so will improve the overall productivity of the organization (Casey Ichniowski et al., 1997). While Catanzaro (2001) described the effects of compensation over employee motivation, he stated

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that compensation has a profound effect over employee motivation. He also discussed several factors of compensation which include both intrinsic and extrinsic factors and their possible effects over motivation in detail. He also emphasized that monetary values are not the only motivators but non monetary factors have more importance towards motivating employees. In Hong Kong, base salary, merit pay, year-end bonus, annual leave, mortgage loan, and profit sharing were the most important factors to retain and motivate employees. In China, base salary, merit pay, year-end bonus, housing provision, cash allowance, overtime allowance, and individual bonus were the most important factors to retain and motivate employees (Randy K Chiu et al., 2002). Reward and recognition programs can positively affect motivation, performance and interest within an organization. While a little more problematic, team-based incentives, if designed appropriately, can also encourage and support a range of positive outcomes (Patricia Milne, 2007). Promotion and wages positively influence employees' work motivation.

A comparison of the relative strengths of the effects reveals that fair promotion was a more powerful motivator than wage level and wage increase. The reason why fairness in promotion was more effective than wage to motivate employees was discussed in light of the unique career system existing in Japanese companies and the agency problems between companies and their supervisors. Takahashi (2006) explores past and present attitudes of employees concerning work-related motivational factors. Understanding the factors that employees consider motivating lends insight to the rewards to which they more positively respond. It compares the results of four motivation surveys conducted in 1946, 1980, 1986 and 1992.

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The comparisons revealed that employees' motivational preferences vary over time. In addition, the results of the 1992 survey indicate that the factors that motivate today's workers are more extrinsic than they used to be. Although employees differ on how they rank these factors, they overwhelmingly selected "good wages" as the top motivator.

A good wage is an extrinsic reward with intrinsic potency. On the surface "good wages" seem to be purely extrinsic. Yet, at a deeper level, monetary rewards communicate what the company values and affect employees' emotional and familial wellbeing (Carolyn Wiley, 1997).

6. HYPOTHESIS

After conducting literature review the following hypotheses have to be tested.

H1: Compensation plans are significantly associated with extrinsic and intrinsic factors of motivation.

H2: Extrinsic factors are significantly contributing to the overall compensation plan.

H3: Intrinsic factors are significantly contributing to the overall compensation plan.

7. METHODOLOGY AND RESEARCH DESIGN

A case study research design was adopted by taking National Bank of Pakistan as special case. In fact case study is research, which is an intensive analysis of an individual unit (e. g., a person, group, or event) stressing

developmental factors in relation to context. Total 50 bank employees were interviewed, including officer cadre employees like branch managers and operation managers and non officer's cadre employees like cashiers, tellers and dispatchers of the branches located in Attack city, Karma, Makah and Ghorghushti of the district Attock.

Structured Interview technique was adopted as primary data collection tool. Five sub variables were developed for extrinsic compensation variable and four sub variables were developed for intrinsic compensation variable. Total 30 statements were asked from the respondents regarding both intrinsic as well as extrinsic compensation factors, which can motivate them, in such way that 17 statements were about intrinsic compensation and 13 statements were about extrinsic compensation. The statements were firstly scaled according to the Likert Scaling technique by assigning weights to it on poly-cot scale from

“ 1 strongly dis-agrees” to “ 5 strongly agree”.

The weights of each statement were added in such way that they were multiplied with total statements, that is, $(30 \times 5 = 150)$ to get total score of 150. Then low, medium and high categories were made. The score of (30-to 60) was considered as low score. The score of (70 to 100) was considered as medium score and the score of (110 to 140) was considered as high score.

The framework of the study consists of two main variables for the total compensation system, i. e. Intrinsic and extrinsic.

The intrinsic variable has been further divided in to five sub variables, i. e. salary, benefits, short term incentives, long term incentives and perquisite. On the other side, the extrinsic variable has been divided into four sub variables, i. e. job itself, career development, autonomy and delegation.

These factors are the motivational elements for the employees.

8. PRESENTATION AND ANALYSIS

The data has presented in shape of tables, in such way that the table, 1 is about the Demographic Characteristics of the respondents & Scores of the Respondents, and the table 2 is correlation Analysis for knowing the relationship between the intrinsic and extrinsic variables.

The above table shows the demographic characteristics of respondents as well as the scores achieved in each variable. The data shows that gender wise, there are more males' employees in the National Bank of Pakistan, Attock Branch. On other side age wise there are more employees in 20-25 years age as compared to other age groups. Marital statuses wide there are more married as compared to single employees.

The scores of the employees shows that gender wise females were more motivated both about intrinsic as well extrinsic compensation factors by having 137 out of 150 score as compared to counterpart males, who have got 119/150 score. Age wise the young employees in age category of 20-25 years had got more score i. e. 138/150, which mean that this age category was more motivated as compared to other age categories. Marital status

wise, the single employees had more score 131/150 as compared to married one.

The correlation analysis shows that there has been strong positive relationship between the both type's compensation factors used by the National Bank of Pakistan, Attock branches. The 1st sub variable, salary is highly positively correlated with job ($r: 0.78$), career development ($r: 0.69$), autonomy ($r: 0.73$) and delegation ($r: 0.64$). In same way " Benefits" is also highly positively correlated with job ($r: 0.81$) and career development ($r: 0.71$), but moderately positively correlated with autonomy ($r: 0.68$) and delegation ($r: 0.58$). In same way short " term incentives" is also is highly positively correlated with job ($r: 0.82$) and career development ($r: 0.78$), but moderately positively correlated with autonomy ($r: 0.73$) and delegation ($r: 0.67$).

So far as the " long term incentives" is concerned. It is strongly positively correlated with Job ($r: 0.76$) but moderately positively correlated with career development ($r: 0.67$), autonomy ($r: 0.64$) and delegation ($r: 0.59$). In the last there is " perquisite" which is strongly correlated with job ($r: 0.80$), but moderately correlated with career development ($r: 0.68$), autonomy ($r: 0.59$) and Delegation ($r: 0.62$). This moderate, and high correlation between the compensation variables show that in one or other way all of the compensation variables have impact on each other and they motivate the employees at the National Bank of Pakistan, Attack branch.

9. DISCUSSION

The Findings of this study shows that nine compensation factors have been used in the overall compensation strategy by National Bank of Pakistan and these factors have positive relationship with each other in such way that all of them are contributing positively towards development of motivation among the employees of bank.

The scores of the employees shows that female employees were more motivated by these motivating factors of compensation as compared to male employees, this could be because the female employees are more contended with their jobs and family lives and have less responsibility. On other side the young employees regardless of gender, in the age category of (20-30) were more motivated by these compensation factors as compared to other age groups.

This is probably because the young employees are more energetic and have more involvement towards job as compared to old employees, who get fed up from job. Furthermore the young employees have less home as well as job related responsibilities as compared to old people who have tension of both family as well as job. Marital status wise, the single employees were more motivated with the compensation factors, most probably because the single employees have less familial responsibilities and less expenses as compared to married one, who have more familial responsibilities and expenses, and thus they remain under tight budget and their motivation level is less.

It was found that employees had general acceptance that their salary and benefits package are better. And a high level of satisfaction was felt and observed in employees regarding their extrinsic factors. However intrinsic factors of compensation were more important, like the permanent nature of the job. So employees can deliver their best with a sense of satisfaction. Employees who were interviewed strongly advocated that no other bank in Pakistan except National Bank of Pakistan keeps its employees this much close. Nor do they really do much for employee loyalty, and development. For instance regular promotions of employees cannot be observed in other banks like Habit Bank as quoted by several employees. Also creation and observation of this sense of belongingness to a prestigious organization to and by Employees of NBP cannot be seen else here.

Reason for this claim was related mostly towards privatization of other banks. From interviews it became a reality that National Bank's employees are one of the most loyal Human Resources an organization may find regardless of the fact that they have to work more hours and hectically than other banks. There were complaints about low staff distribution in many branches of small cities and long working hours disturbing employees' social life but even these overcame by the positive effects created by National Bank's compensation strategy upon its employees over the years.

10. CONCLUSION

The paper had concluded that Compensation management has a direct relationship with employee motivation and performance. Extrinsic benefit plans plays a delight role in perception of an employee towards its

organization and its work. And these factors play the role of satisfiers.

Instruments of intrinsic factors have a profound impact upon an employee's loyalty and an organization's turn over. Intrinsic factors play the role of motivators for the employees and associate them with their job and organization. They feel important and consider their performance as organization performance and image of organization as their own image.

It is recommended that banking sector must focus a lot upon the well being of its Human Resources by properly designing their compensation system. So that banks can achieve a competitive advantage through their employees and stand apart as well stand strong in such hard times as in current global financial crisis when financial sector is experiencing a tight squeeze in external environment. Intrinsic Instruments are strongly advised to be more aligned for the entire banking sector. The paper recommends extrinsic factors as the basis but intrinsic as the beauty as only the inner satisfaction can produce optimum quality. For the future research, studies which can find out the relationship of other factors of compensation, especially the subjective one, with motivation would be of great value.

11. THEORY AND PRACTICE

The final findings were compared with the Best Practices Compensation policies. This led to the following observations.

1. The bank offers very few pay incentives. Best Practices recommend little emphasis on pay and therefore the banks' policy is in line with Best Practices recommendations. Most employees however demand higher pay incentives.

2. The bank does not have any policy for rewarding individual level job performance. This is contrary to Best Practices Compensation recommendations
3. The Bank does not have any policy for rewarding team or group performance. This is in accordance with the Best Practices recommendations.
4. Most employees suggest that the bank should pay certain rewards on the basis of individual level job performance as does Best Practice theory.
5. Bank policy indicates an increased emphasis on seniority when it comes to pay decisions. This is contrary to Best Practices recommendations. Most employees also suggest that seniority should remain an important factor when it comes to pay decisions.

Although the Bank has based its policies on long-term goals but it appears that it is unable to implement this. It seems that short-term goals have been given priority in practice.

The Bank offers excellent benefits package in accordance with the Best Practices Compensation policies. However most employees want more benefits.

12. RECOMMENDATIONS

The following recommendations have been suggested in accordance with the Best Practices Compensation policies:-

1. The bank must device policies to reward individuals for the individual level performances. This could be in the form of performance bonuses, rewards or profit sharing.
2. The Bank must consider reducing the emphasis on seniority. Although it is not a matter of concern for most of the employees, but in the long run, this may adversely affect the performance of the Bank.
3. The Bank must continue with it exists benefit package in accordance with best practices.
4. The Bank must communicate the importance of its excellent benefit package to the employees of the Bank. This may help to increase the motivation level of the employees.
5. The bank must continue its policy for not awarding any incentive for group performance.
6. The bank must refocus its attention on long-term goals.