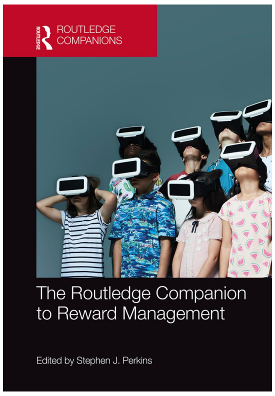

The Routledge Companion to Reward Management

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Psychological perspectives on reward management

Publication details
https://www.routledgehandbooks.com/doi/10.4324/9781315231709-4
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Published online on: 21 Nov 2018

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PSYCHOLOGICAL PERSPECTIVES ON REWARD MANAGEMENT

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Introduction

Psychology tries to explain and predict human experience and behaviour to develop evidence-based interventions that support people, organizations, and the society as a whole. Psychological knowledge about how people perceive and react to reward systems and practices in different contexts and cultures can therefore inform reward management to attract, retain, and motivate those employees needed for the achievement of company goals and sustainable company development within and across different labour markets and societies.

This chapter begins by examining the psychological concepts of work motivation and work behaviour from a simplified recursive model of action phases (Heckhausen and Gollwitzer 1987), which is related to reward management and leadership behaviour. In so doing, we first describe valence–instrumentality–expectancy theory and discuss its implications for reward management, particularly for attracting and retaining employees. Next, we examine goal-setting theory, which is focused on stimulating high individual and team performance. Then, we discuss organizational justice theory and psychological contract theory and their implications for pay system design to achieve pay satisfaction, and reduce employee turnover.

Linking motivation theories to reward management based on an action phase model

Work motivation theories try to explain the direction, the intensity, and the persistence of work behaviour as an interaction of employee motives and situational characteristics; so-called incentives. Why does a person accept an offer to work as a HR manager in an IT start-up company, and reject the alternative offer to work in a hospital? Is it because the person needs money to buy a house for his family, and the IT company pays more than the hospital and offers additional stock options, or is it because the IT company offers flexible working hours and sabbaticals allowing a better work–life balance? Valence–instrumentality–expectancy theory (Vroom 1964) explains these deliberative processes and predicts such decisions between action alternatives better than it predicts the degree of intensity and persistence the person will show later on the job (Ambrose and Kulik 1999).

Proof

Heckhausen and Gollwitzer (1987) have highlighted in their Rubicon model of action phases that different psychological processes characterize the deliberative pre-decision and evaluative post-action phase compared to the pre-action phase and action phase, where one commits oneself to goals and tries to implement them. Based on this action phase model, motivational processes in the pre-decision and evaluative post-action phase, and volitional processes in the pre-action phase and action phase, can thus be differentiated within a broader sense of the concept of motivation.

Pre-action phase and action phase questions are for example: Why does an employee commit himself to work on difficult goals? Why does an employee work hard trying to achieve milestones despite unforeseen difficulties, while other employees leave work on time, although they will then not meet their goals? Goal setting (Locke and Latham 1990) and self-regulation theory (Latham and Locke 1991) provide answers to these types of questions. They also have clear implications for the design of reward systems and practices to support goal implementation and achievement, such as how to design variable bonus systems contingent on the degree of goal achievement.

However, none of these theories can explain why a person is dissatisfied despite receiving the bonus as promised upon goal attainment. A person might even decide to look for another job, when noticing that a colleague gets paid more for a comparable performance. The social comparison process between one's own input and reward, and another person's input and reward relationship, is explained by equity and organizational justice theories (Adams 1963; Colquitt 2012). Social comparison is not only a retrospective evaluation process, but also feeds forward to the negotiation of future goals and rewards, or to the next job contract decision.

Evaluative processes might not only be based on social comparison, but also on the reciprocity of social exchange. Social contract theory (Rousseau 1989, 1995) explains what happens if an employee perceives that an organization breaks a psychological contract based on mutually given explicit or implicit promises; for example, if a supervisor does not appreciate the extra effort he or she has invested to finish a project in time.

To sum up, in the next sections of the chapter the Rubicon model is used as a framework to explain pre-decision processes by valence–instrumentality–expectancy theory, pre-action and action processes by goal setting and regulation theory, and post-action processes by organizational justice and psychological contract theory, and to draw conclusions for reward management.

Valence–instrumentality–expectancy theory

Valence–instrumentality–expectancy (VIE) theory explains the preference for an action alternative based on a rational choice model that maximizes subjective utility (Vroom 1964). Similar to expectancy-value theories it assumes that people assess the probability (from 0% to 100%) to act successfully for each alternative to reach the desired outcome. For example, one person might be 100% sure that one can accomplish a task, while another person perceives a 50% chance of succeeding or might see no chance at all. The anticipated value of outcome of each action alternative meaning its valence. The valence of an outcome is assessed subjectively and weighted by the perceived expectancy to reach it in order to determine the motivational force to go for the outcome. This assumption implies for reward management that rewards might not only have different valences for different employees, but might also be weighted differently due to differing expectations to reach them. Furthermore, Vroom (1964) points out that the valence of an action outcome depends on its perceived positive or negative potential consequences and their respective valences, which an employee perceives to be more or less strongly linked to an outcome. The perceived linkage or cause–effect relationship between an outcome and a consequence is called instrumentality. An outcome can be seen as strongly furthering or hindering a consequence, and the perceived instrumentality can therefore vary between +1 and −1. For example, an employee who wants more time to care for his or her family might rather accept a job with stable income, allowing for reduced and flexible working hours, than a higher-paid job requiring overtime work on a regular basis. The employee accepts a lower-paid job, because he or she expects to be unable to regularly work overtime, and perceives overtime work negatively linked to family care. The combination of the valence of caring for one's family, and having a decent and stable income, might lead to a stronger motivational force than the prospect of earning more money, but not being able to care for one's family, particularly if the expectancy is low that one will be able to fulfil one's job requirements.

The major contribution of VIE theory to reward management is that people perceive different valences, instrumentalities, and expectancies for given action alternatives and decide between them based on a subjective comparison process. Offering the same rewards for everybody will not suffice. VIE theory describes a within-person decision model, which implies for reward management systems that supervisors have to find out about employees' intra-individual preferences to be able to offer attractive rewards. Depending on the employee's preferences financial rewards or non-financial rewards might be more effective. Financial rewards could be fixed and variable pay, and shared ownership. Alternative indirect and/or deferred forms of financial rewards could be benefits, e.g., pension plans or health programmes, or perquisites, such as onsite fitness centres, medical care or health facilities, and company cars. However, employees might also prefer non-financial rewards, such as appreciation, job security, and assigning interesting tasks. Given the multitude of potentially motivating financial rewards a cafeteria system allowing employees to choose between reward alternatives might be helpful (see also Cotton; Smith, this volume). Another implication of VIE theory is that clear and reliable contingencies between work outcomes and rewards are needed, and that supervisors have to care whether employees perceive these contingencies. Last, but not least, supervisors have to find out whether their employees feel able to fulfil their task requirements, and if they feel able to attain intended outcomes. Therefore, supervisors should strengthen behaviour–outcome expectancies by training, and/or by supporting employees' self-efficacy, so that they have the belief that they are able to be successful in their job.

Qualitative reviews (Gerhart and Fang 2014; Shaw and Gupta 2015) and meta-analytic studies (Cerasoli et al. 2014; Garbers and Konradt 2014; Jenkins et al. 1998) have shown that extrinsic rewards, such as financial incentives, can improve employee motivation and performance, and shape employee health (Giles et al. 2014) and safety behaviour (Mattson et al. 2014). But also, intrinsic rewards, such as offering an interesting task, can be motivating (Hackman and Oldham 1976). Although VIE theory is mainly focused on extrinsic rewards, intrinsic rewards can be integrated. An interesting task can be perceived as a valence of an action in itself, which might be perceived as instrumental for attaining other valenced intrinsic outcomes, such as increasing one's expertise, and feelings of competence and control.

By focusing on expectancies, instrumentalities and valances, VIE theory highlights the importance of individual human cognition and anticipation for an informed behavioural choice between action alternatives. It informs reward management to design incentive and reward systems that allow supervisors to respond to individual preferences and to strengthen perceived instrumentalities and expectancies. In contrast, a behaviouristic approach relies on objective reinforcement contingencies to shape employee behaviour by rewards (see also Fish, this volume). VIE theory has the anticipative and cognitive approach in common with goal setting and self-regulation theory, which are described in the next section.

Goal-setting theory

Goal-setting theory (Locke and Latham 1990, 2002) takes goals as immediate regulators of human behaviour. With respect to the Rubicon model (Heckhausen and Gollwitzer 1987), goal-setting theory describes pre-action and action processes. Goal-setting theory states that, given adequate ability and commitment to the goal, difficult and specific goals will lead to higher performance than easy or 'do best' goals. This linear relation between performance and goal difficulty has been confirmed by hundreds of studies, which have shown that performance only levels out at high levels of goal difficulty if goal commitment drops and when the limits of an employee's ability are reached (Latham and Locke 1991).

Besides ability and goal commitment, feedback is a necessary precondition moderating the effects of goals on performance. Setting a high goal creates a discrepancy between the status quo and the desired state, and mobilizes the person in a feed-forward process to reach this goal. Feedback helps to regulate the effort to attain the goal. Assigned or participatively set goals, as well as feedback and rewards, are therefore key elements of performance management (Latham and Locke 1991). Even though goal setting works on the individual, group, and organizational level, the majority of research has focused on the individual level. At the meso and macro level processes get even more complex, as additional variables come into play influencing performance, such as intragroup and intergroup cooperation, and information exchange (Locke and Latham 1990).

Rewards linked to the degree of individual, group, or company goal attainment, such as variable contingent pay systems, e.g. piece-rate pay, bonus systems or profit sharing, can strengthen goal commitment via increasing goal attractiveness. In contrast, bonus payments for attaining difficult goals might lead to goal rejection, as people perceive that they may not be able to reach the bonus (Locke and Latham 1990). Besides strengthening goal commitment, financial rewards induce persons to set higher goals and thus increase goal difficulty leading to higher performance. People offered financial rewards performed better than those being offered only recognition, even when goal difficulty and commitment were controlled for (Locke and Latham 1990; Wright 1992). Even within financial rewards direct cash rewards lead to better performance via goal difficulty, as people selected more difficult goals, than non-cash incentives, such as earned points with an equivalent retail monetary value (Presslee et al. 2013).

To sum up, goal-setting research informs reward management that linking rewards to the degree of goal attainment can improve performance, particularly, if cash rewards are used. Rewarding the degree of goal attainment works better than rewarding just goal attainment, as difficult and specific goals might be rejected if people believe they won't be able to attain the rewards. Rewards seem to work as they make goals more attractive, stimulate people to choose more difficult goals and strengthen goal commitment. However, the effects of rewards might differ depending on employees' fairness perceptions, which are discussed in the next section.

Equity theory and organizational justice

Equity or inequity theory (Adams 1963) proposes that employees respond with dissonance or tension, such as pay and job dissatisfaction, when they perceive to be treated more or less favourably than a referent other. They try to reduce this tension, e.g., by improving or lowering their performance to achieve equity or by leaving the situation causing inequity. Perceptions of inequity or distributive justice are based on social comparison processes of exchange relationships. Inequity is perceived if one's ratio of outcomes to inputs is unequal to the ratio of outcomes to inputs of the referent other. Perceived outcomes can be financial or non-financial rewards, such as pay or status. The propositions of the theory are well supported regarding the effects of undercompensation, but not regarding overpayment (Ambrose and Kulik 1991).

Lawler (1971, 1973) suggested that social comparison processes influence employees' perception, about what they should receive, compared to what they actually receive, and that this discrepancy influences their pay satisfaction. A meta-analysis (Williams et al. 2006) testing key assumptions of Lawler's discrepancy theory (1973) shows that increasing pay discrepancy is associated with decreasing pay satisfaction. Also, internal and external pay comparisons, i.e., with employees within the same or with employees of other companies, were strongly associated with pay satisfaction. Unfortunately, the design of the primary studies did not allow for testing the assumed mediating role of pay discrepancy regarding the relation between equity perceptions and pay satisfaction.

Organizational justice research has shown that employees do not only rely on social comparisons between themselves and other employees, but also reflect on what has happened and could have happened to them or others, and thus develop referent cognitions by mental simulations, which influence their fairness perception (Folger 1986). Cognitive referent theory explains that people experience fairness or unfairness not only in situations affecting themselves, but also when they perceive how others are treated. Whether reward management is perceived as fair or unfair is therefore also dependent on how employees perceive how other employees are rewarded, even if they are not affected by these decisions (Greenberg et al. 2007).

Besides the distribution of outcomes, which is focused by equity theory, employees also assess the fairness of reward management, with respect to how they or others are treated in the exchange relationship (see Shortland and Perkins, this volume, on expatriate reward). Procedural justice has been further differentiated in interactional and informational justice (Colquitt 2012). Although the different aspects of justice are correlated, they show differential relationships with outcome variables (Colquitt 2001). For example, distributive justice seems have a stronger correlation with pay satisfaction than with procedural justice. In addition, pay satisfaction is negatively correlated with turnover intentions and voluntary turnover (Williams et al. 2006).

Research on the different aspects of organizational justice informs reward management not only about how people react to fair or unfair conditions, but also about criteria that can be used to design, implement, and practice reward systems that are perceived as fair. Employees typically perceive organizational practices as fair if they have control over the process, e.g., can directly or indirectly participate in pay system design and decisions, if it is possible to correct decisions, and if unbiased and accurate procedures are applied consistently in a way that people are treated with dignity, respect, and truthfulness (Greenberg et al. 2007; Colquitt 2012).

People also differ in their tolerance to inequity and consequently evaluate and respond to pay system characteristics differently. For example, in situations where information exchange about what people get paid is restricted, persons with a lower level of tolerance to inequity show lower task performance, while persons with a higher level of tolerance to inequity show higher task performance. These negative effects of pay secrecy on individual task performance can be explained in part by reduced perceived performance-pay contingencies, i.e., weaker instrumentality perceptions (Bamberger and Belogowski 2010). See also Arnold and Fulmer (this volume) on pay transparency.

Another example of how individual differences influence pay fairness perceptions shows the concept of promotion focus, i.e., whether people believe they have the opportunity to get better pay. Research shows that pay dispersion increases pay fairness perceptions when employees have a strong focus on promotion (Park et al. 2017).

To sum, equity and organizational justice theory informs reward management about how social comparison processes of exchange processes influence the perception of fairness and how reward systems should be designed and used to be perceived as fair. Exchange processes are also the core of psychological contract theory, which is described in the next section.

Psychological contract theory

Rousseau (1989, p. 123) defines a psychological contract as "an individual's belief regarding the terms and conditions of a reciprocal exchange agreement between the focal person and another party". Thus, the concept of psychological contract describes an individual's belief that mutual obligations exist between employer and employee. Within the psychological contract literature there is a strong agreement that contracts can be categorized into two types: relational and transactional (Conway and Briner 2005). Relational psychological contracts emphasize long-term personal, socio-emotional, and value-based mutual obligations, e.g., that job security is reciprocated with loyalty. Transactional psychological contracts are based on more specific, monetary, and economic short-term elements of exchange, e.g., pay increases in return for high performance.

The concept of psychological contracts is theoretically based on the ideas of exchange theory (Blau 1964) and the norm of reciprocity (Gouldner 1960). According to exchange theory (Blau 1964), individuals seek for balance in exchange relationships. Therefore, a promise made by one party obligates the other party to reciprocate. Rousseau and Ho (2000) underline the importance of psychological contracts within the context of employee reward systems. They expect psychological contracts to be mainly influenced by reward strategies and argue that the fulfilment of psychological contracts might influence employees' satisfaction.

A person believes that a promise has been made either explicitly or implicitly and that both parties are bound to a set of mutual obligations (Robinson and Rousseau 1994). Obligations based on promises are much more specific beliefs about what, when, and why something will happen than general beliefs about whether something will or should happen (e.g., general expectations or group norms), and therefore much more psychologically engaging (Conway and Briner 2005; Guest 1998). Hence, psychological contract breach, i.e. if an employee believes that the company or the supervisor has not fulfilled its promised obligations, he or she might have a negative emotional and affective reaction (Morrison and Robinson 1997). A meta-analysis confirmed a direct relationship between contract breach and affective reactions such as trust and job satisfaction (Hao et al. 2007), and negatively influences in-role and extra-role performance (Coyle-Shapiro and Parzefall 2008).

Psychological contract theory focuses on the employer–employee relationship (Morrison and Robinson 1997). Since supervisors are the key agents of employers, employees may perceive them as responsible for establishing and fulfilling psychological contracts. Therefore, employees may equate their supervisor with the organization and personify explicit promises made by their supervisor as reflecting promises by the organization (Rousseau 1995). Indeed, several studies suggest that leaders might influence employees' perception of psychological contracts (e.g. Brown and Moshavi 2002; Liden et al. 2005).

Particularly, transactional and transformational leadership behaviour seems to be relevant for establishing and fulfilling transactional and relational psychological contracts. The major aspect of *transactional leadership* is *contingent reward,* i.e., emphasizing clear relationships between performance and rewards (Bass and Riggio 2006). Transformational leaders communicate an attractive vision, provide meaning, and respond to an employee's values, needs, and goals (Bass and Riggio 2006). A plethora of studies have shown substantial positive and unique relationships between both contingent reward and transformational leadership, and employee job satisfaction and motivation (Judge and Piccolo 2004). Transformational leadership behaviour also influences employees' pay satisfaction by providing meaning to and understanding of the pay and wider reward system (Salimäki et al. 2009).

Research findings indicate that transformational leadership is related to pay satisfaction via the fulfilment of transactional psychological contracts, while the fulfilment of relational psychological contracts mediates the relationship between transformational leadership and job satisfaction and affective organizational commitment (Antoni and Syrek 2011). When pay systems are changed, the fulfilment of relational psychological contracts supporting long-term personal, socio-emotional, as well as value-based, and thus trustworthy employee–employer relationships, seem to play an even more important role. Research analysing the introduction of a performance-based bonus system shows that the fulfilment of relational psychological contracts mediates not only the effects of transformational leadership on job satisfaction, but also on bonus satisfaction. In contrast, transactional psychological contract fulfilment mediates the influence of transformational leadership on general pay satisfaction, but not bonus satisfaction (Syrek and Antoni 2017).

To sum up, psychological contract theory informs reward management about the implications of perceived mutual relational and transactional obligations for pay satisfaction and employee behaviour. Research has shown the key role of leadership behaviour for the development and fulfilment or breach of psychological contracts, and consequently for the effects of reward management systems.

Conclusions

In the last decades reward management research has seen significant progress, and studies based on psychological theories have contributed to these findings (Antoni et al. 2017; Cerasoli et al. 2014; Garbers and Konradt 2014; Gerhart and Fang 2014; Shaw and Gupta 2015). Nevertheless, reward management remains an under-researched area (Gupta and Shaw 2015). The financial crisis has highlighted the potential detrimental effect of rewards systems for individuals, companies, and the society as a whole (see Kornelakis and Gospel; A. Wright, this volume). Therefore, more research has to be done analysing under which conditions particular rewards are most effective or under which they lead to unintended consequences. To fully understand the underlying mediating and moderating mechanisms, linking reward practices to individual, team, and organizational behaviour and outcomes, more longitudinal and multi-level research is needed (e.g., Trevor and Wazeter 2006). Specifically, research on how team- and organizational-level variables, such as work structure, leadership behaviour, organizational culture, and corporate strategy influence the relation between different rewards and outcomes is missing. Conceptual papers on multi-level effects of pay variation (Conroy et al. 2014) or team pay-for-performance (Conroy and Gupta 2016) could stimulate future empirical studies. When looking at the enormous financial resources companies invest in reward systems and their potential detrimental effects, both more funding and support for empirical reward management research seems to be justified.

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