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THE PERCEIVED IMPACT OF SHORT TERM EXECUTIVE FINANCIAL INCENTIVE SCHEMES

Mark Herbert Raymond Bussin

A research report submitted to the
Faculty of Management,
University of the Witwatersrand,
Johannesburg, in partial fulfilment
of the requirements for the degree
of Master of Management.

1994

ABSTRACT

Organisations in South Africa are paying out millions of Rands in financial incentives to executives without knowing conclusively whether or not company performance actually improves as a result of financial incentive schemes. Unions, the media, workers, politicians and others are paying increasing attention to the levels of compensation that executives receive. The question being asked is whether these levels are really necessary.

This, the first research of its kind in South Africa, surveys the views of 121 top managers, from 17 organisations using incentive schemes, on the impact of these schemes. There is convincing evidence that they are perceived to increase motivation and company performance, build teamwork and are effective in aligning the interests of managers and shareholders. The schemes are valuable in attracting, retaining and motivating executives. Given the complexity of setting executive remuneration, it is submitted that there be no interference in the level of incentive scheme payouts.

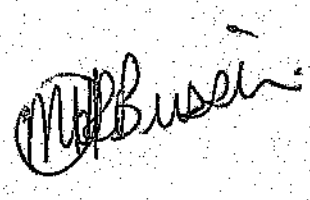
The factor analysis yielded a four factor solution, which was interpreted in terms of the literature review and constructs in the questionnaire. The first factor revealed that incentives are a motivator and increase company performance. They build teamwork and are effective in aligning the interests of managers and shareholders. The second factor stated that incentives should be underpinned by openness and transparency. A fundamental principle behind this is that the relevant financial position should be known by all participants. It was also stated that the whole organisation i.e. all levels, should be on an incentive scheme. The third factor highlighted risk aversion in these executives and that basic salary is most important. The fourth factor, locus of control, stressed the importance of the scheme to the individual personally in terms of motivation, focus, reward, retention of services and the ability to control the incentive scheme payout. The surprising finding was the extent to which SA executives were risk averse and just how important the basic salary is.

Guidelines, based on the factor analysis, content analysis and correspondence analysis conducted on the questionnaires, are offered to the designers of incentive schemes. Without correctly designed and aggressive incentive schemes the owners of organisations could expect very mediocre, "9 to 5" type of commitment from their top management team.

Incentive schemes play a vital role in the design of competitive remuneration systems. Their importance should not be underestimated.

DECLARATION

I declare that this research report is my own, unaided work. It is being submitted in partial fulfilment of the requirements for the degree of Master of Management in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in any other University.



Mark Herbert Raymond Bussin

28th day of February, 1994.

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Note on Format of Research Report

This research report is being submitted in the format of a journal article, together with an extended literature review. The article is written in the format required by the South African Journal of Business Management, to which it will be submitted for possible publication.

THE PERCEIVED IMPACT OF SHORT TERM EXECUTIVE FINANCIAL INCENTIVE SCHEMES.

"A world without A's, praise, gold stars, or incentives? No thank you, Communism was tried and it didn't work".

(Stewart, 1993)

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Guidelines, based on the factor analysis, content analysis and correspondence analysis conducted on the questionnaires, are offered to the designers of incentive schemes. Without correctly designed and aggressive incentive schemes the owners of organisations could expect very mediocre, "9 to 5" type of commitment from their top management team.

Incentive schemes play a vital role in the design of competitive remuneration systems. Their importance should not be underestimated.

ABSTRAK

Maatskappye in Suid Afrika betaal miljoene rande in finansiële voordele aan uitvoerende amptenare sonder dat hulle weet of 'n maatskappy beter presteer as gevolg van finansiële skemas. Unies, die media, werkers, politici en ander bestee al hoe meer aandag aan die vergoedingsvlakke van uitvoerende

amptenare.

Die vraag of hierdie vlakke werklik noodsaaklik is, word hier gevra.

Hierdie navorsing is die eerste van sy soort in Suid-Afrika - is 'n meningsopname van die perspektiewe van 121 topbestuurders wat voordeleskemas ontvang van 17 maatskappye, met die doel om die impak van finansiële skemas te bepaal. Daar is oorweldigende samestemming dat die persepsie bestaan dat dit motivering en maatskappyprestasie verhoog, spanwerk bou, en effektief is om die belange van bestuurders en aandelehouers in ooreenstemming te bring. Die skemas is waardevol om bestuurders te trek, te motiveer en te behou. Gegewe hoe ingewikkeld dit is om die vergoeding van uitvoerende amptenare te bepaal, word hier aanbeveel dat daar aan die vlak van voordeleskema-betalings verander word nie.

Die faktorontleding het 'n vier faktor oplossing opgelewer, wat in terme van die literatuurstudies en konstrukte in die vraelys geïnterpreteer is. Die eerste faktor toon aan dat voordele 'n motiveerder is en maatskappyprestasie verhoog. Dit bou spanwerk en is effektief om die belange van bestuurders en aandelehouers in ooreenstemming te bring. Die tweede faktor dui daarop dat voordele deur oopheid en deursigtigheid onderlê moet word. 'n Basiese beginsel hier is dat die stand van sake aan almal bekend moet wees. Dit word ook gestel dat die hele organisasie deel moet wees van 'n voordeleskema. Die derde faktor beklemtoon risikovrees by Suid-Afrikaanse uitvoerende amptenare en hoe belangrik basiese salaris is. Die vierde faktor, locus van beheer, beklemtoon hoe belangrik die skema vir die individu persoonlik is, in terme van motivering, fokus, beloning, retensie van dienste en die vermoë om beheer oor die betaling van die voordelepakket uit te oefen. Die verbasende bevinding was die mate waartoe Suid-Afrikaanse uitvoerende amptenare risikobevrees is en hoe belangrik basies salarisse vir hulle is. Riglyne word aan ontwerpers van voordeleskemas voorgestel wat gebaseer is op die faktorontleding, inhoudsontleding en korrespondensie-ontleding wat deur middel van die vraelyste gedoen is. Sonder behoorlik ontwerpte en meedingende voordeleskemas kan die eienaars van ondernemings 'n trae, '9-5' toegewydheid

van hul topbestuur verwag.

Voordeleskemas speel 'n belangrike rol in die ontwerp van kompeterende vergoedingstelsels, en die belang daarvan moet nie onderskat word nie.

INTRODUCTION

"What role - if any - should incentives play in the workplace?" (Harvard Business Review, Nov-Dec 1993, p. 37) This issue is vital in providing direction to shareholders and managers in organisations, and politicians considering legislation that will impact on executive pay. The research aims to contribute towards the scant body of knowledge concerning the impact of incentive schemes on company performance, by gathering empirical data from the participants themselves.

There is little doubt that the world is in an extremely protracted recession. Organisations are currently under severe pressure to provide shareholders with the handsome returns that they were capable of producing in the past. Many have implemented executive financial incentive schemes in an attempt to bring directors' and managers' performance in line with shareholders' high expectations (Ross, Westerfield and Jaffe, 1990). Short term incentive schemes are used in an attempt to link managerial performance and remuneration to the results of the organisation (Milkovitch and Newman, 1984).

A widely held belief is that a financial incentive scheme will motivate or "incentivise" executives to work harder and produce better results. However, there is little evidence that these schemes actually raise company performance. This research canvassed senior managers' views on the impact of financial incentive schemes on senior managers and on company performance.

Importance of the research

Organisations in South Africa are paying out millions of Rands in financial incentives to executives without knowing conclusively whether or not company performance actually improves as a result of these incentive schemes (P-E Corporate Services, Salary Surveys, 1993). With very little evidence to prove that incentive schemes boost performance levels, top management hire compensation experts to design and implement comprehensive financial incentive packages (Crystal, 1992; Delacroix and Saudagaran, 1991; Jensen and Murphy, 1990).

There are several reasons for focusing on executive incentive schemes only. Firstly, it is usually a company's executives who commission the design and implementation of the incentive scheme. Secondly, in South Africa there are very few organisations that have such schemes throughout all levels in the organisation; and thirdly, it allows one to focus on the decision makers of the business. This research explores whether or not the participants feel there is a positive impact due to the implementation of executive financial incentive schemes.

Apartheid has led to many inequities in society, one of them being the difference in remuneration levels between black and white employees on the same job level (P-E Corporate Services South African Salary Surveys, 1993). Most organisations are still run by white male executives. Unions, media, workers, politicians and others are paying increasing attention to the levels of compensation that executives receive (Brownstein and Panner, 1992; Culpan, Murti and Culpan, 1992; Holtzman, 1992; Jensen and Murphy, 1990). The question being asked is whether these levels are really necessary when thousands are losing their jobs (Holtzman, 1992; Spooner, 1979). Should these executive bonuses be stopped and the money distributed more widely and evenly? Many people have real trouble understanding just what any corporate executive can possibly be doing to earn a seven-figure pay package (Kraus, 1980). This research answers some of these burning questions.

Definitions

- **Short term** refers to the period of one year or shorter.
- **Executives** refers to the top management team in the organisation. This is often known as "Exco" in organisations.
- **Financial incentive schemes** refer to any money that is paid out over and above guaranteed basic salary and bonuses, for superior performance or for exceeding company performance measures (Engel, 1985).

LITERATURE REVIEW

Benjamin Franklin once said: "If you want to know the meaning of money, try borrowing some". Executives generally downplay the importance of money in analysing their own motives, and overemphasise rewards in managing their subordinates (Ehrenfeld, 1992; McLaughlin, 1990).

Components of the remuneration package

It is not uncommon to find payroll costs running as high as 40 to 70 percent of the total cost of doing business (Lawler, 1990). Pay is thus an important cost to organisations and the components of the remuneration mix must be used to their fullest advantage.

Most of the theory (Milkovitch and Newman, 1984; Lawler, 1983; Lawler, 1990; Armstrong and Murlis, 1991) suggests that there are four components of the remuneration mix namely; basic pay, fringe benefits, short term incentives and long term incentives. A properly designed reward system can be a key contributor to the effectiveness of the organisation (Bell and Hanson, 1987; Lawler, 1983; Lawler, 1984; Florkowski and Schuster, 1992; Kaplan and Norton, 1992; Schuster, 1985; Walker, 1992). Reward systems can influence the following factors, which in turn, influence company performance:

- Attraction and retention of better performers;
- Motivation to perform in particular ways;
- Culture fostered in the organisation;
- Reinforcement and definition of organisation structure;
- Cost of the payroll.

One of the strategic decisions that needs to be made in the design of any reward system is whether or not to base it on company performance (Lawler, 1984). Short term financial incentive schemes are viewed as the most effective component of the remuneration mix in creating competitive advantage, motivating executives and linking executive pay to the performance of the company (Gerhart and Milkovitch, 1990; Jensen and Murphy, 1990; Ellig, 1982).

The fundamental question as to what determines the level of executive pay and the sensitivity of these levels to executive performance also need to be considered. Hipkin (1993) performed extensive calculations including regression analysis, to arrive at the factors that best predict executive remuneration. His study revealed several good predictors which could be used in any combination, for example, company sales, net profit, number of employees, value of tangible assets and level in the organisation. The research also found that the market pricing of executive pay relied on several integrated factors and should not be left to chance.

Motivation theory

Does money motivate? The age old question.

Ellig (1982) makes the point that the objective of a sound compensation programme is to pay correctly in relation to performance. Yet, for some enigmatic reason, the role of financial compensation in employee motivation and performance remains one of the most frequently discussed but under-researched areas in organisational psychology (Steers and Porter, 1985). When investigating the relationship between incentive schemes and company performance, one needs to consider whether or not the added remuneration really does motivate executives (Modise, 1993).

McLaughlin (1990, p. 61) maintains that "psychological theories of motivation have contributed to the confusion in industry about money and its effect on employee behaviour." For every theorist that says money is not a motivator, (Beer, 1992; Hertzberg, 1957; Maslow, 1954) there is a theory that shows some positive relationship between pay and motivation (Adams, 1965; McClelland, Atkinson, Clark and Lowell, 1953; Vroom, 1964; Skinner, 1969; Lawler, 1983; Steers and Porter, 1985). The popular misconception that money is not a motivator is debated by Stewart (1993, p. 37) who argues: "A world without A's, praise, gold stars, or incentives? No thank you, Communism was tried and it didn't work". Lebby (1993) is in agreement with this notion and poses the question, if there is no relationship between

incentives and performance, why do managers hold on to such ineffective methods? "Why is it that they refuse to provide those things that employees say they want, that directly relate to increased productivity, and that have little or no financial cost?" (1993, p. 42).

Motivation is seen as "the force on an individual to expend effort" (Lawler, 1983, p. 20). Lawler's theory states that an individual's motivation to behave in a certain way is greatest when:

1. The individual believes that the behaviour will lead to specific outcomes or rewards (performance outcome expectancy).
2. These outcomes or rewards are attractive.
3. The individual's perception of how hard it will be to achieve the outcome and the probability of success are within reach (effort performance expectancy).

Lawler states that in order for employees to believe that an incentive-based pay relationship exists, the above conditions need to be met. Lawler's (1983) and Adams' model (Adams, 1965) support the supposition that incentives will motivate executives to perform better if certain conditions are met, such as attractive rewards, a belief that behaviour will lead to rewards and a conceivable chance of success.

Agency theory and the role of incentives

Agency theory describes a situation where the shareholders are not physically running the organisation they own, having hired directors and managers to do so. It is argued that the interests of the managers are different from those of the shareholders (Crystal, 1991; Elliot, 1993; Olenick, 1989). Ross *et al.* (1990 p. 16) state that the "costs of resolving the conflicts of interest between managers and shareholders are special types of cost called agency costs." These agency costs are the "monitoring costs of shareholders and the incentive fee paid to managers" (Ross *et al.* 1990 p. 16). The primary function of executive incentive schemes is to control the conflict of interest between management and shareholders (Abowd, 1990; Culpan *et al.* 1992; Jensen and Murphy, 1990;

Kraus, 1980; Lambert and Larcker, 1990; Rappaport, 1986). Jensen and Murphy (1990, p. 149) make the point that "money is not everything, but non-monetary rewards often create the wrong incentives for CEOs".

This research obtained information from the managers on their perceptions of the role and function of the executive financial incentive scheme.

Perception theory

Perception is the way in which we interpret or give meaning to the world around us (Stanton, Etzel, Walker, Abratt, Pitt and Staude, 1992). Perception often depends on the object being perceived and on our past experiences. (Blake and Ramsey, 1951). Perception theory suggests that managers' perception about incentive schemes is based on past experience. In view of this it is acknowledged that the responses to the questionnaire may well be based on the respondents past experiences with incentives schemes and not the present scheme. This, however, does not detract from the main purpose of this study, which is to survey those perceptions.

A major difference between this study and others relating to incentive schemes and company performance is the very fact that it is the participants views being surveyed.

Prior research

Three empirical studies were found that examined the link between executive pay and company performance. For two of the studies remuneration data were gathered from the data bases of large remuneration consultancies in the United States of America. For the third study Annual Financial Statements and the data from the Johannesburg Stock Exchange were used. There is little agreement in these research projects with regard to the impact of incentive schemes on company performance.

The first of these three studies was conducted by Gerhart and Milkovitch (1990) in the United States of America on managerial compensation. The two objectives of their research were:

- To examine the extent to which organisations facing similar conditions make different decisions concerning managerial compensation with respect to basic pay, bonus pay and eligibility for long term incentives, and;
- To explore the consequences of these decisions for subsequent organisation performance as measured by return on assets.

Longitudinal remuneration data were used on approximately 16,000 managers in 200 organisations, and significant between-organisation differences in compensation decisions were evident. The study revealed that the least significant organisation effects were on the level of basic pay. The largest organisation effects were on the bonus levels and eligibility for the long term incentives. These results indicated that organisations tend to distinguish themselves on decisions about the level of bonuses given rather than on basic pay. Pay level was, thus, not associated with financial performance. However, larger incentives were associated with better company financial performance.

The second of these studies was conducted by Abowd (1990) in the United States of America in an attempt to determine whether performance-based compensation affected corporate performance. The remuneration data used were obtained from a compensation consulting firm and covered some 25,000 managers and 600 organisations over the period 1981 to 1986. The research was justified by the belief that performance based remuneration provides a viable solution to the agency problem (Culpan *et al.* 1992; Jensen and Murphy, 1990; Kraus, 1980; Lambert and Larcker, 1990; Rappaport, 1986). Abowd (1990, p. 68) concluded that "the results of the research do lend credence, however, to claims that benefits can be gained by increasing the pay-for-performance component of managerial compensation".

Modise (1993) examined the correlation, and if indeed one exists, between executive compensation and corporate performance in a sample of listed South African companies. Corporate performance was viewed from the shareholders' point of view in the form of increases in their investments and dividends. Executive compensation was defined as the sum total of directors emoluments

excluding shareholding. Incentives were not isolated in this study, but grouped in with the total package.

There were two major findings. The first was that the directors are compensated in such a way so as to align their interests with those of the shareholder. Secondly, the relationship between compensation and corporate performance was not very strong (r=.287 in 1991). Although correlation does not imply causation, the low correlation was explained by the fact that setting executive remuneration was more complex than just linking it to the share price.

None of these studies has researched how executives perceive financial incentives to impact on individual and company performance. This inquiry differs from any known research in that it aimed to establish how executives view the effectiveness of these schemes. In this study, managers were asked to state which measures of company performance they believe to be most affected by the incentive scheme. This was tied back to what the scheme was devised to do.

The research questions posed in this exploratory research cover the following issues:

1. Do managers perceive that executive financial incentive schemes contribute to positive company performance?
2. Which measures of company performance are perceived to be most positively affected by the scheme?
3. Do managers perceive the scheme as a motivator for better performance?
4. Are incentive schemes perceived to be an effective method of attracting and retaining the services of executives?
5. Do the perceptions differ across the various functional groups of managers?
6. Do the payouts differ across the various functional groups of managers?
7. Which components of the remuneration package are most important to executives?

8. What are the most important factors to take into account when designing incentive schemes?
9. Should the whole organisation be on an incentive scheme?
10. What would the implications be if there was any sort of legislation that limited the amount of incentive scheme payout?

RESEARCH METHODOLOGY

The survey method was used to gather data for this research. This is the most commonly used research method in social research (Groenewald, 1989; Leedy, 1989). The word survey means "to look or to see over or beyond the casual glance or the superficial observation" (Leedy, 1989, p. 141). The "looking" in this research was done by means of a questionnaire. Groenewald (1989, p. 55) states that "a survey provides a cross-section of the condition of cases at a given time". The researcher may, however, extrapolate what is likely to happen in the future under similar circumstances, by drawing conclusions from one transitory collection of data (Leedy, 1989).

The questionnaire design was based on a review of the literature to try to test the various prepositions. It was then enhanced in focus groups of users of incentive schemes, and in conjunction with experts and academics in the field of remuneration. A pilot run was conducted with potential users to check for comprehension of terminology, to iron out any uncertainties that users may come across and to identify further constructs.

The questionnaire consisted of two parts:

- The first part, was an organisational questionnaire comprising 10 open ended questions presented in Table 1. It was intended for the scheme administrator to complete and enquired as to the type of scheme and associated rules.
- The second part was for individual respondents, i.e. senior managers currently on incentive schemes. It comprised 3 biographical and demographic questions (1, 2 & 3); 4 open-ended questions (4, 5, 28 and 31); 3 questions requiring ranking (29, 30 & 32) and 23 statements

(statements 6 to 27 and 31) to be rated on a 5-point Likert scale. The statements and the raw responses are shown in Table 2.

One organisation questionnaire and a pack of individual questionnaires was sent to the contact person in the participating organisations, who then handed out the questionnaires to the top executive team. The contact person also arranged for the completion of the organisation questionnaire. The respondents to the individual questionnaires were senior executives in organisations known to have incentive schemes, and these executives were the head of organisations, and the head of major functional areas, division or departments. There were 121 completed individual questionnaires from 17 organisations. The method of sampling was two stage judgemental sampling from organisations known to have incentive schemes. Descriptive statistics, Factor Analysis, Correspondence Analysis and Content Analysis were used to evaluate the results.

Factor analysis

Factor analysis refers to a variety of statistical techniques whose common objective is data reduction and summarisation (Kim, 1978; Hair, Anderson, Tatham and Black, 1992). The basic aims of factor analysis are:

- To determine how many factors underlie a set of variables.
- To determine the extent to which each variable depends on each factor.
- To allow interpretation of the factors (Barnard 1991).

The questions in this research refer to incentive schemes and the responses to them constitute the observed variables. Factor analysis examines the interrelationships among these variables.

Campbell and Stanley (1963) believe that this type of design has led to valuable explorations of the generalisability or external validity of the summary statements.

The objective of this research was to identify the perceived impact of financial incentive schemes. It was possible to use factor analysis to describe the relationships between the various dimensions. The factor analysis was done

using the Number Cruncher Statistical System (NCSS).

Correspondence analysis

Correspondence analysis (Hair, *et al*, 1992; Snoyman, 1991) is a multivariate data analysis technique which enables researchers to transform ordinal data into interval data using rescaling methods. This is done in order to facilitate the use of other multivariate techniques, such as factor analysis, which require data to be at least interval in nature.

Content analysis

This was used to interpret the open ended questions. The objective of content analysis is to take a non-quantitative document and transform it into quantitative data (Mouton and Marais, 1990).

RESEARCH FINDINGS

This exploratory research was analysed in terms of what the scheme was designed to do from an organisational point of view and the participants' perceptions of the impact of the scheme.

Characteristics of the schemes in this research

The organisation questionnaire (Table 1) filled out by the scheme administrator provided the following information about the 17 incentive schemes.

The incentive schemes were divided into 3 major categories based on the type of measures used. The first category, individual measures, were defined as measures or objectives that applied to the executives personally. The second category, company measures, refers to financial measures for the organisation. Some organisations had a combination of individual and company measures, and this formed the third category. The split in categories was as follows:

1. Individual measures only (2 organisations, 9 respondents);
2. Company measures only (9 organisations, 60 respondents);
3. Combination of both (6 organisations, 47 respondents).

The individual measures comprised mainly personal objectives and behavioural factors. The company measures were all financial measures of some sort. The average payout was highest for the third category (21.6% of annual basic salary). The second highest average payout was in category two, company measures (15.8% of annual basic salary) followed by category one (7.4% of annual basic salary). By far the most popular financial measure was some percentage of profit (29% of organisations) as shown in Table 3. It was surprising to find that the second most common measure of performance was based on the discretion of the superior, which in most cases was the Chief Executive Officer (CEO) or Managing Director (MD).

Most organisations (64%) had only one or two performance measures. The highest number of factors in any one organisation was nine factors. Table 4 shows the number of performance measures by scheme. Incentives were funded in four different ways. The two most common methods (refer to Table 5) were to pay out a percentage of the amount by which targets were exceeded (42% of organisations), also known as super-profits, or to budget for the payout (32% of organisations). All but one organisation paid the incentive on an annual basis and 13 of the 17 organisations have had a payout every year for the last three consecutive years. Three schemes paid out for two of the last three years, and one organisation has quarterly pay outs and has paid out, to some extent, each quarter for the last three years.

The regulation and administration of the schemes was done primarily by the top management team/EXCO (47%), followed by the CEO/MD alone (35%). Only two organisations reported the use of a group remuneration committee or remuneration manager, which is the most popular method used in the United States of America (Crystal, 1988). Implementation of the scheme was left to line management in 29% of cases followed by CEO/MD (18%), Human Resource Department (18%) and EXCO (18%). This is in line with expectations as it is line management that has to explain the mechanics of the scheme in most instances.

Most organisations (76%) applied a limit/cap, see Table 6, to the amount the scheme could pay out. The most common limit or cap that organisations impose on the incentive scheme payout was 30% of annual basic pay, which is generally less than the limits in the United Kingdom and United States of America (Lawler, 1990; Armstrong and Murlis, 1991).

Payout amounts and level of satisfaction

The mean payout to respondents was 17.8% of annual basic remuneration. The propositions that the higher the level of the employee in the organisation, the higher the incentive payouts, and that line management get more than staff functions, was supported. Table 7 reflects in detail the payouts for each group. The higher level employee got an average payout of 24.0% of annual basic pay, whilst the lower levels averaged 15.8%. Line functions got an average of 20.8% of annual basic pay, and staff functions got an average of 15.1%.

Respondents were asked to indicate their level of satisfaction with previous experience involving incentive schemes (see Table 8). The Chi Square tests revealed that there was no significant difference in satisfaction between any of the groups despite the apparent inequities of the payout. There was, however, less of a difference in satisfaction (p=.561) with the CEO/MD/GM and other (lower levels), than there was between line and staff (p=.291). This signifies that executives find it more acceptable that incentive amounts differ by level in the hierarchy, and less acceptable for incentive amounts to differ between line and staff functions on the same level. By implication, teamwork and internal equity are viewed as important and executives on the same team would like to see more equitable rewards. There was also no significant difference (p=.946) between the levels of satisfaction and the type (individual measure, company measure, both) of incentive scheme. More than half the respondents were satisfied (45.5%) or very satisfied (10.7%) with financial incentive schemes and the reasons given are indicated in Table 9. It is interesting to note that on the negative side, more reasons were given when respondents checked very dissatisfied (11.6%) than only dissatisfied (12.4%). A total of 19.0% of

respondents felt neutral about their past experiences with incentives schemes.

When analysing the level of satisfaction and the amount of the last incentive payout that respondents received (see Table 8), the average payout amount goes up as the level of satisfaction goes up. Those who are most satisfied got by far the biggest payout. The average payout versus the level of satisfaction is; very unsatisfactory, average payout of 6.6%, unsatisfactory 8.2%, neutral 13.2%, satisfactory 21.8% and very satisfactory 29.5% of annual basic salary.

The question is, are they the happiest because they got the biggest payout? If one looks at the reasons cited for their satisfaction, it would appear not. Reasons given for their satisfaction were; "good performance was rewarded", "focus was provided", "one could influence the payout criteria", "the scheme was well designed" and "it provided motivation".

The reasons cited by unsatisfied respondents were; "poorly designed schemes which are subjective and not measurable", "goal posts moved", "payout too small and deferred", and "payout is at the whim of the CEO/MD". These respondents feel they have little or no control over their scheme and it is frustrating them. Motivation theory states that one would expect to see rewards commensurate with one's input (Adams, 1965; McClelland, Atkinson, Clark and Lowell, 1953; Vroom, 1964; Skinner, 1969; Lawler, 1983; Steers and Porter, 1985). These respondents got small incentive payouts, and they would probably view their input as being greater than the reward they got.

Factors that contribute to positive company performance

Respondents were asked what they considered to be the top 3 factors (refer to Table 10) contributing to positive company performance. These were:

- Motivated staff (15.6%);
- Reward systems and incentives (13.8%);
- Clear direction and goals (11.9%).

This tied up well with the reasons why respondents thought the organisation had an incentive scheme (see Table 11). Reasons cited were:

- To motivate employees (25.7%);

- To reward those who perform (20.6%);
- To improve financial performance of the company (19.0%).

Each scheme administrator was asked to document the purpose of their company's incentive scheme (see Table 12). The top 3 reasons cited were:

- To improve financial position of company (40.6%);
- To reward above average performance (15.6%);
- To share in the success of the company (15.6%).

The most notable difference between the reasons given by individuals and those given by administrators is that the most predominant factor listed by individuals, namely to motivate employees, did not feature nearly as strongly on the company list.

Factors underlying perceptions of incentive schemes

The matrix of frequencies of responses to the 21 statements on the five-point Likert scale was subjected to correspondence analysis. This involves converting the data from ordinal to interval in order to do the factor analysis. The Euclidian distance between scale points on the first two principal axes was used to create an interval scale ranging from 1 to 5. The interval scale which was developed displayed a scale quite unlike the numerical values of 1, 2, 3, 4 and 5 normally associated with the Likert scale. There is an unusual closeness between the Strongly Disagree and Disagree (1.000 to 1.380 as opposed to 1 to 2).

Factor analysis was then carried out on this scaled data, and a four factor solution was chosen using the eigen values in excess of unity. The results of factor analysis show the factor number and the statements that loaded on to that factor. The statements are then examined and an underlying theme or name is attributed to the factor. The factors were interpreted and named bearing the literature review and constructs in the questionnaire in mind. The rotated varimax factor loadings and the statements that loaded on to each factor are shown in Table 13. The statements in the questionnaire are shown in Table

2 and start with statement 6 (S6). The first five questions were biographical and open ended questions.

Factor 1: Incentives are a motivator and increase company performance

Statements 7, 8, 9, 14, and 18 as shown in the individual questionnaire load onto the first factor. All of these statements support the notion that incentive schemes work. A total of 89.2% of respondents agreed that financial incentive schemes are effective in increasing company performance (S7). It was perceived by 62.0% of respondents that organisations with incentive schemes perform better than those without schemes (S14). All five of these statements received a modal score of four which indicated agreement that incentives increase personal motivation and company performance, build teamwork and are effective in aligning the interests of managers and shareholders. This factor ties in with the literature review on motivation theory, agency theory and prior research indicating the positive link between incentives and company performance.

Factor 2: Openness, transparency and company-wide incentives

Statements 19, 20 and 21 load onto the second factor. The construct that underpins this factor is that the whole organisation should be on an incentive scheme and participants should have access to financial statements (see Table 2). A total of 68.6% of executives wants the whole organisation, all levels and job categories, on an incentive scheme (S19). A total of 62.8% of respondents would share financial information with all levels in the organisation if the incentive scheme was company-wide (S21).

Factor 3: Risk averse, basic salary is important

Statements 10, 11, 15 and 23 load onto the third factor. The underlying theme is the need for a stable and high basic salary and an aversion for risk. This result is an unexpected finding, but makes sense when viewed against the backdrop of the turmoil in which SA executives find themselves today. A total

of 65.0% of respondents believed that they would work as hard whether there was a scheme or not.

Factor 4: Locus of control

Statements 6, 8, 13, 22 and 24 load onto the fourth factor. The common thread to these statements is the personal importance of the scheme to the individual in terms of motivation, focus, reward, retention of services and the ability to control the incentive scheme payout. A total of 74.4% of respondents agreed that the incentive scheme is important in motivating them (S8).

It is interesting to note that the respondents who indicated dissatisfaction with the incentive scheme cited violations of the above factors in the scheme design. The most flagrant violation was the lack of individual control over the scheme which was indicated by reasons such as vague targets, factors that were not measurable and payout that was at CEO/MD discretion.

The discovery of these four factors provides clear direction to the designers of incentive schemes and highlights the fundamental principles of incentive scheme design. Incentive scheme design needs to be underpinned by the principles referred to in the factors, in particular the sharing of financial results and the importance of the participant having some control over the measures and factors in the scheme.

LINK TO LITERATURE REVIEW

The findings are related to the literature review to determine whether there is any connection between the two and to identify the unique findings relevant to the South African environment.

Company performance and incentive schemes

There is overwhelming agreement (89.2% of respondents stated agreement) indicated by statements 7 and 14 that organisations with financial incentive schemes perform better than those without. This is consistent with the findings

of prior researchers for example, Gerhart and Milkovitch (1990), and Bell and Hanson (1987). For this sample, see Table 2, return on sales was felt to be the most positively affected by the scheme. There was substantial agreement amongst respondents (indicated as percentage agreement) that, where applicable, the scheme positively impacted on: Return on equity (74.2%), Return on capital employed (68.1%), Earnings per share (65.7%), Return on sales (80.0%), Growth in sales (78.0%), Growth in equity (57.1%), Growth in profit (74.0%) and Dividends per share (63,8%).

Does money motivate?

Nearly three quarters (74.4%) of the respondents confessed to being motivated by the incentive scheme in place as shown by S8 in Table 2. It was an important part of 64.4% of respondents' remuneration package. This supports motivation theorists such as Adams, 1965; McClelland, Atkinson, Clark and Lowell, 1953; Vroom, 1964; Skinner, 1969; Lawler, 1983; Steers and Porter, 1985. One conclusion that could be drawn is that the conditions mentioned by Lawler (1983) were met by most of the schemes. Either way, participants believe that they are motivated by incentive schemes.

Incentives and shareholder interests

The agency theory was upheld by the responses to statements 18 and 24, where there was 74.4% and 52.1% agreement respectively. Respondents felt that the schemes aligned manager's expectations with those of the shareholder, and that they provided focus. Factor 1 includes the concept of agency theory and the notion that incentives are an important instrument for the shareholder was upheld.

Importance of incentives as part of the package

The findings that emerge from the factor analysis clearly indicate the importance of incentive schemes in the design of remuneration packages. This is supported by the incidence of incentive schemes in South African business

which is around 75% (P-E Corporate Services Salary Surveys, 1993).

An unexpected finding in terms of the literature review and prior research is the importance of basic salary. This component was ranked as the most effective in creating competitive advantage and in motivating executives (see Tables 14, 15 and 16). This result concurs with statement 10 and 15 on the Likert scale which indicated the desire to keep the basic salary at a constant level and not to drop it for a more generous formula on the incentive scheme. It is also congruent with factor 3 of the factor analysis which indicates a need for high basic salary and risk aversion.

In a society that is punch drunk with change, re-organisation and re-engineering it is not surprising that some sort of stability will be sought in terms of the remuneration package. This may explain the need for a high, secure basic salary for South African executives.

It is, however, fully acknowledged by respondents to S14 that organisations with incentives outperform those without. This response alludes to an element of self interest which is greater than an interest in the good of the company and shareholder. This also alludes to the premise that when the schemes were designed and communicated to employees there was little emphasis on the agency theory component of the scheme. No emphasis was placed on the shareholder. Comparatively, the situation in the United States of America or United Kingdom is more stable and, generally, there is a greater percentage of incentive or risk pay (Abowd, 1990; Armstrong and Murlis, 1991; Crystal, 1991; Ellig, 1982; Foulkes, 1991; Jenson and Murphy, 1990). Having control over one's destiny in terms of incentives was also one of the factors (factor 4), underpinning the argument for seeking control and stability.

It is widely acknowledged that remuneration systems need to be designed to attract and retain good staff. A total of 66.2% of respondents agreed that incentives help to attract staff. Executives also felt that incentives help to retain the services of employees (66.9% of respondents). Incentives, thus, form a vital part of remuneration system design, and the scheme design should not be left to chance.

The implications of legislation on schemes

The intense media campaign and public outcry regarding high executive salaries and bonuses has led to considerable debate. Governments find themselves caught in the crossfire, especially when there are calls for some sort of legislative intervention curbing lavish payouts.

Should governments intervene in the arena of incentives it could only be in one of two areas. Firstly, that there should not be any enormous payouts, or payouts over a certain limit; and secondly that organisations should share their profits with all levels of employee.

The first option goes against fact[illegible] of this research in that it is perceived that motivation would decrease, co[illegible]nies would not perform as well, teamwork would suffer and the interests of shareholders and management would not be aligned. Given the complexity of setting executive remuneration (Modise, 1993; Hipkin, 1993), it is necessary to reward top executives using well re[illegible]ched predictors of market rates, even when people are losing their jobs. The issue of large discrepancies in pay is more of a moral and not a legal, economic or remuneration issue. Government intervention would be nothing short of disastrous from all points of view if remuneration policy was tampered with.

There was, however, a very positive response to the second option in factor 2, which states that respondents felt that the whole organisation should be on an incentive scheme. Over and above that, it was expressed that there would be no problem with sharing the relevant financial information with all levels of employees. This would also help to satisfy the agency theory in that all levels of the organisation would be aligned with shareholder thinking. Motivation at all levels in the organisation would probably increase and all would share in the success of the business. Including all levels of employee on a company-wide incentive scheme would reflect the present changes in our country. This may also be a vehicle for a more meaningful method of solving business problems, improving company performance and all employees sharing in the fate of the business. Arguably, this is also a form of wealth

redistribution and spreading profits more widely.

Incentive scheme design considerations for the SA organisation

This research provides incentive scheme designers with guidelines on the crucial elements of any incentive scheme and remuneration system design for a South African environment.

In terms of performance measures and payout, far less emphasis should be placed on discretionary payouts of bonuses where it is at the sole discretion of the CEO/MD. Discretion was the second most popular performance measure and means of funding the incentive scheme (see Table 3). When respondents were very unsatisfied with incentive schemes a reason frequently mentioned was that the payout was at the discretion of the CEO/MD (see Table 9).

It would be advisable to reduce the dependence on budgeting for the incentive scheme payout, and make the shift to sharing over and above certain agreed upon levels. This would require shareholder education and may even require some minor changes to the financial reporting system. The suggested absolute minimum that the incentive scheme should aim at paying out is 15% above the guaranteed salary, (see Table 8) and ideally the payout should be 20% to 25% above guaranteed salary (Armstrong and Murlis, 1991; Crystal, 1992; Ellig, 1982; Lawler, 1984; Milkovitch and Newman, 1984; Rappaport, 1986).

Schemes should be designed to satisfy the factors mentioned in the factor analysis, namely:

- Openness and sharing the formulae, financial results and showing the scoreboard all the time;
- Basic salary is important and incentive schemes should not be used to make up deficiencies in this area;
- Inclusion of criteria that can be influenced by participants.

Other golden rules mentioned by the executives in the study include:

- Reward good and improved performance;
- Communicate the focus, intention and direction of the scheme thoroughly;

- Design a scheme that is simple and fair;
- Contract participation and clarify the motivation elements of the scheme.

To further enhance company performance, organisations should consider harnessing the factors that top executives think increase company performance. The most prominent of these were; motivated staff, reward systems and clear goals and strategies. Table 10 lists the other factors. These should not be seen to be mutually exclusive of any other interventions the organisation is planning or busy with.

The design of incentive schemes should ensure a close tie up as to why the organisation has a scheme and why participants think there is a scheme. More thought should be given to the motivation element of the schemes, as it would appear that the schemes in the sample are too financially driven. This implies more participation and commitment in the design of schemes. Scheme design should focus on the team where possible and, for best performance, there should be no difference in the earnings potential of line and staff functions.

The importance of basic salary in unstable times should not be underestimated. Variable pay refers to the concept where one is hired to do a job and only receive a portion of the salary in guaranteed earnings, for example 70 %. The balance of the package is paid out on completion of certain mutually agreed upon objectives. This is also known as risk pay and the concept appears to be a while off for South African executives.

The literature review indicated that of the four components of the remuneration mix, short term incentives are most often used to create competitive advantage. This research does not bear this out. South African organisations are more likely to differentiate themselves on the basis of basic salary. If organisations wanted to create competitive advantage in remuneration systems design, incentives would be the correct arena to do so (Gerhart and Milkovitch, 1990; Jensen and Murphy, 1990; Ellig, 1982). This notion is supported by 62.5 % of executives in this study who believe that organisations with incentive schemes perform better than those without schemes.

Limitations of this research

The population was limited to organisations known to have executive financial incentive schemes. Data gathering was done by means of a questionnaire and all the inherent problems of a survey apply. There may have been bias in the answers as the respondents knew the survey topic. It is acknowledged that there are many independent variables apart from incentive schemes that impact on company performance.

Implications for Future Research

The need for executive financial incentive schemes is irrefutable from a motivation, shareholder and company performance point of view. More information is required on this subject and recommendations for further research include:

- A study that includes all levels in the organisation;
- A longitudinal study that examines the financial performance of organisations with incentive schemes versus the performance of those without.

CONCLUSION

In this article a glimpse is provided of the thinking and perceptions of senior managers and the effect of incentive schemes. The evidence is overwhelmingly in favour of such schemes. Nearly all senior managers think that the scheme affects their organisation's performance positively. Incentive schemes should not be curtailed or market forces tampered with, but rather they should be extended to all levels of employee. However, basic salary is important and should not suffer at the expense of an incentive scheme. The results indicated a belief that the whole organisation should share in the success of the company. This bears a powerful message to our leaders.

The role that compensation plays in improving company performance is becoming increasingly important. Global markets are shrinking requiring South Africa to improve competitiveness. It is argued in this report that organisations

ignore, the importance of incentives in the achievement of this, at their peril.

TABLE 1

ORGANISATION QUESTIONNAIRE

QUESTIONS
1. Please state the name of your organisation
2. By what name/term is the company Executive Financial Incentive scheme known?
3. What is the primary purpose of the incentive scheme?
4. What are the performance measures of the scheme?
5. How is the scheme funded? i.e. How is the bonus pool determined? For example, budgeted, a percentage of profit, a percentage of some other target.
6. How often does the scheme pay out? 6.1 In terms of the scheme rules? 6.2 In practice over the past 3 years (on average)?
7. Who regulates and administers the incentive scheme?
8. Who was responsible for designing the Scheme?
9. Who was responsible for the implementation of the scheme?
10. For how many years has the scheme been in operation? (What month and year was the scheme introduced)
11. Is the scheme capped or limited in terms of payout potential? For example can one only receive, say 30% of ones annual basic salary in any one year?
12. If the scheme is capped or limited, what is the cap or limit?

TABLE 2

INDIVIDUAL QUESTIONNAIRE LEGEND OF STATEMENTS
(1 = Strongly Disagree & 5 = Strongly Agree)
(Questions 1 to 5 are biographical)
(The underlined number is the modal category)

STATEMENT	1	2	3	4	5
6. I believe that my own performance directly affects my incentive scheme payout.	7	13	11	59	30
7. Financial incentive schemes are effective in increasing company performance.	1	4	8	79	34
8. The financial incentive scheme is important in motivating me to strive for better company results.	4	9	8	56	34
9. A financial incentive scheme promotes top management teamwork.	3	21	27	57	22
10. I would prefer to receive a higher basic salary and no financial incentive scheme.	13	64	19	14	10
11. I would work as hard whether there was a scheme or not.	5	19	18	41	37
12. A financial incentive scheme helps to attract new recruits at top management level.	1	12	28	59	21
13. A financial incentive scheme helps to retain services at an organisation.	1	21	18	61	20
14. Organisations with financial incentive schemes generally perform better than those without schemes.	0	10	36	56	21
15. I would prefer to lower my basic salary and have a more generous formula on the incentive scheme.	19	35	31	26	11
16. Organisations tend to distinguish themselves from other organisations on decisions about the level of bonuses given rather than on basic pay.	5	30	43	39	4
17. There is a link between managerial effort and company performance.	1	1	2	49	68
18. Incentive schemes are effective in aligning the interests of managers with those of shareholders.	2	6	23	62	21
19. The whole organisation should be on an incentive scheme.	6	17	15	62	41

INDIVIDUAL QUESTIONNAIRE LEGEND OF STATEMENTS (Continued)

STATEMENT	1	2	3	4	5
20. Access to organisation financial statements is important when on an incentive scheme.	1	15	10	53	42
21. I would have no problem in sharing the financial information with all levels in the organisation if the incentive scheme was company wide.	3	25	17	50	26
22. The financial incentive scheme forms an important part of my total package.	3	24	14	61	17
23. I think that this company's results would be the same whether management were on a financial incentive scheme or not.	20	56	27	14	6
24. The scheme gives me focus in terms of shareholder expectations.	8	14	34	56	7
25. If I perceive the targets of the incentive scheme to be too hard, I do not try to achieve them.	20	59	12	28	2
26. The greater the incentive scheme payout, the harder I tend to work.	9	29	23	47	13
27. Our financial incentive scheme positively affects the following measures of company performance:					
1. Return on equity	2	7	12	50	22
2. Return on capital employed	4	9	13	46	18
3. Earnings per share	2	13	14	45	20
4. Return on sales	5	6	3	52	28
5. Growth in sales	2	11	10	51	27
6. Growth in equity	1	17	16	37	15
7. Growth in profit	3	11	9	47	30
8. Dividends per share	3	13	12	39	21

TABLE 3

PERFORMANCE MEASURES OF THE SCHEME
(As stated by the administrator)

PURPOSE	Count	Percentage
1. Profit	12	29,3
2. Discretionary	5	12,2
3. Individual Performance	4	9,8
4. Sales	3	7,3
5. Costs	3	7,3
6. Return on Capital/Assets	3	7,3
7. Debt/Equity ratio	2	4,9
8. Other (1 count each)	9	22,0
TOTAL	41*	100,0

* Organisations reflected more than one measure of performance.

TABLE 4

NUMBER OF PERFORMANCE MEASURES USED

NO. OF MEASURES	Count (Organisations)	Percentage
1	6	35 3
2	5	29,4
3	2	11,8
4	2	11,8
8	1	5,9
9	1	5,9
TOTAL	17	100,0

TABLE 5

FUNDING OF THE SCHEME

HOW FUNDED	Count	Percentage
1. Super-profits (a % in excess of target)	8	42,1
2. Budgeted for	6	31,6
3. A percentage of profit	3	15,8
4. Bonus/points system	2	10,5
TOTAL	19*	100,0

* Two organisations reflected more than one method of funding the scheme.

TABLE 6

PAYOUT LIMIT/CAP AS A PERCENTAGE OF ANNUAL BASIC SALARY

PERCENTAGE OF ANNUAL SALARY	Count (Organisations)	Percentage
0-10%	1	5,9
11-20%	3	17,6
21-30%	6	35,3
31-50%	3	17,6
Unlimited	4	23,5
TOTAL	17	100,0

TABLE 7

RESPONDENTS INCENTIVE PAYOUT AS
A PERCENTAGE OF ACTUAL SALARY

PAYOUT PERCENTAGE	Count (Respondents)	Percentage of Total
0-10%	39	32.2
11-20%	24	19.8
21-30%	22	18.2
31-50%	15	12.4
51-70%	2	1.7
Blank or N/A	19	15.7
TOTAL	121	100.0

	TOTAL	CEO/MD/GM	OTHER	LINE	STAFF
Total Responses	107	26	81	51	56
Percentages		24.3	75.7	47.7	52.3
Percentiles					
25%	5.0	15.0	3.0	6.0	3.5
50%	16.0	20.0	15.0	20.0	12.5
75%	25.0	33.0	25.0	30.0	25.0
100%	70.0	70.0	50.0	70.0	50.0
Minimum	0.0	0.0	0.0	0.0	0.0
Maximum	70.0	70.0	50.0	70.0	[illegible]
Mean	17.8	24.0	15.8	20.8	15.1
Median	16.0	20.0	15.0	20.0	12.5
Mode	0.0	0.0	0.0	0.0	0.0
S.D.	15.2	18.3	13.6	16.9	13.2

TABLE 8

PERCENTAGE OF ANNUAL BASIC SALARY THE LAST INCENTIVE PAYOUT FOSHED VERSUS PAST EXPERIENCES WITH INCENTIVE SCHEMES

	TOTAL	V. UNSAT	UNSAT	NEUTRAL	SATISF'D	V.SATISF
Total Responses	107	12	13	19	50	13
Percentages		11.2	12.1	17.8	46.7	12.1
Percentiles						
25%	5.0	0.0	0.0	0.0	12.0	20.0
50%	16.0	3.0	6.0	14.0	20.5	25.0
75%	25.0	11.5	12.0	20.0	32.0	40.0
100%	70.0	29.0	30.0	50.0	66.0	70.0
Minimum	0.0	0.0	0.0	0.0	0.0	0.0
Maximum	70.0	29.0	30.0	50.0	66.0	70.0
Mean	17.8	6.6	3.2	13.2	21.8	29.5
Median	16.0	3.0	6.0	14.0	20.5	25.0
Mode	0.0	0.0	0.0	0.0	20.0	25.0
S.D.	15.2	8.8	9.1	13.3	13.6	20.0

TABLE 9

REASONS GIVEN FOR LEVEL OF SATISFACTION WITH SCHEMES

	Count-Reasons	Percentage
VERY SATISFACTORY		
1. Rewards good and improved performance	5	29,4
2. Provides motivation and focus	4	23,5
3. Can influence the payout	4	23,5
4. Other	4	23,5
TOTAL	17	100,0
SATISFACTORY		
1. Scheme pays well and regularly	16	26,7
2. Well-designed scheme - simple, fair, can influence it	14	23,3
3. Motivating effect	11	18,3
4. Other	19	31,7
TOTAL	60	100,0
NEUTRAL		
1. Poorly designed - inconsistent, subjective	12	50,0
2. Hard to achieve target, does not pay out	8	33,3
3. Do not know formula	2	8,3
4. Other	2	8,3
TOTAL	24	100,0
UNSATISFACTORY		
1. Poorly designed scheme - not measurable, subjective	10	34,5
2. Lack of mutual discussion and goal posts are moved	5	17,2
3. Too short term and vague	5	17,2
4. Other	9	31,0
TOTAL	29	100,0
VERY UNSATISFACTORY		
1. Poorly designed scheme - unrealistic targets, vague	15	40,5
2. Payout too small and deferred too long	7	18,9
3. Payout is on CEO whim and discretion	6	16,2
4. Other	9	24,3
TOTAL	37	100,0

TABLE 10

TOP FACTORS THAT RESPONDENTS THOUGHT CONTRIBUTE TO POSITIVE COMPANY PERFORMANCE

FACTORS	Count	Percentage
1. Motivated staff (dedication, commitment, determination, effort, attitude, productive staff, job satisfaction	59	15,6
2. Reward system and incentives	52	13,8
3. Clear direction, goals, objectives, vision, mission and strategy	45	11,9
4. Marketing/sales and service, customer care	42	11,1
5. Quality, right and good products and operations	31	8,2
6. Management team and leadership	31	8,2
7. High Quality, Well trained staff	28	7,4
8. Good staff relations, right atmosphere, culture, loyalty, trust	26	6,9
9. Good financial management (cost control, profits, asset management, cash flow management	26	6,9
10. Environmental factors (market)	20	5,3
11. Empowerment, innovation, flair, acumen, entrepreneurship, participation, participation, responsibility	18	4,8
TOTAL	378	100,0

TABLE 11

WHY RESPONDENTS THOUGHT THE COMPANY HAD AN INCENTIVE SCHEME

REASON	Count	Percentage
1. To motivate employees	56	25,7
2. To reward those who perform	45	20,6
3. To improve financial performance	42	19,9
4. To share in company success	16	7,3
5. To improve performance	14	6,4
6. To provide focus/shareholder alignment	13	6,0
7. To gain commitment and foster right atmosphere	11	5,0
8. To attract and attain good staff	9	4,1
9. To improve teamwork	5	2,3
10. Other	7	3,2
TOTAL	218	100,0

TABLE 12

PRIMARY PURPOSE OF THE INCENTIVE SCHEME
(As stated by the administrator)

PURPOSE	Count	Percentage
1. To improve financial position of company	13	40,6
2. To reward above average performance	5	15,6
3. To share in-company success	5	15,6
4. To motivate or improve staff motivation	2	6,3
5. To increase productivity	2	6,3
6. Other	5	15,6
TOTAL	32*	100,0

* The frequency of responses is more than the count of 17 organisations because some organisations reported more than one purpose of the scheme.

TABLE 13

VARIMAX ROTATED FACTOR LOADINGS
(S refers to the statement in the questionnaire)
(The factor loadings have been multiplied by 100)

FACTOR 1	FACTOR 2	FACTOR 3	FACTOR 4
- 78 S7	83 S21	81 S11	- 65 S22
- 63 S9	52 S20	57 S10	- 56 S6
- 61 S14	45 S19	52 S23	- 46 S24
- 58 S8		- 45 S15	- 44 S8
- 52 S18			- 42 S13

TABLE 14

ELEMENTS OF A REMUNERATION PACKAGE IN ORDER OF IMPORTANCE (PERCENTAGE OF RESPONSES)

(1 = Vitally important and 10 = of no importance)
Rank by percentage of respondents

ELEMENT	1	2	3	4	5	6	7	8	9	10	N/A
1. Basic Salary	62.0	9.9	12.4	4.1	1.7	0.8	0.0	2.5	0.8	5.0	0.0
2. Pension/Provident Fund	41.3	14.0	16.5	7.4	5.0	1.7	1.7	2.5	0.0	5.8	3.3
3. Company Car/Allowance	38.0	18.2	16.5	8.3	7.4	2.5	0.0	1.7	1.7	3.3	1.7
4. Medical Aid	28.1	9.9	20.7	9.9	10.7	2.5	2.5	4.1	0.0	5.0	5.0
5. Performance Bonus	25.6	19.8	17.4	5.8	5.8	5.8	2.5	0.8	2.5	6.6	6.6
6. Thirteenth Cheque	17.4	9.9	13.2	7.4	7.4	3.3	3.3	2.5	5.0	9.1	20.7
7. Housing Assistance	11.6	6.6	5.0	5.0	5.8	1.7	4.1	6.6	5.8	5.0	41.3
8. Entertainment Allowance	4.1	1.7	8.3	9.1	14.0	11.6	11.6	9.9	7.4	9.9	9.9
9. Education Assistance	6.6	5.8	5.8	6.6	7.4	3.3	4.1	9.9	5.0	4.1	40.5
10. Cheap use of Co. Assets	2.5	1.7	7.4	6.6	3.3	5.0	4.1	5.8	8.3	9.1	43.8
11. Directors Fees	1.7	0.8	3.3	1.7	3.3	3.3	0.0	2.5	9.8	6.6	69.6

TABLE 15

MOST EFFECTIVE COMPONENT IN REMUNERATION MIX IN CREATING COMPETITIVE ADVANTAGE
(1 = most effective & 4 = least effective)
Rank by percentage of respondents in each rank
(eg. 43.8% of respondents ranked basic salary 1)

COMPONENT	RANK			
	1	2	3	4
1. Basic Salary	43.8%	21.5%	16.5%	17.4%
2. Short Term Incentives	26.4%	24.8%	32.2%	15.7%
3. Long Term Incentives	20.7%	21.5%	16.5%	40.5%
4. Fringe Benefits	8.3%	31.4%	33.9%	25.6%
TOTAL	100%	100%	100%	100%

TABLE 16

MOST EFFECTIVE COMPONENT IN REMUNERATION MIX IN MOTIVATING EXECUTIVES
(1 = most effective & 4 = least effective)
Rank by percentage of respondents
(eg. 31.4% of respondents ranked basic salary 1)

COMPONENT	RANK			
	1	2	3	4
1. Basic Salary	31.4%	29.8%	19.8%	18.2%
2. Short Term Incentives	30.6%	24.0%	21.5%	23.1%
3. Long Term Incentives	25.7%	19.0%	18.2%	36.4%
4. Fringe Benefits	11.6%	26.4%	39.7%	21.5%
TOTAL	100%	100%	100%	100%

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THE PERCEIVED IMPACT OF SHORT TERM EXECUTIVE FINANCIAL INCENTIVE SCHEMES

EXTENDED LITERATURE REVIEW

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1. INTRODUCTION

The incentive scheme debate rages on. Executive incentive schemes without difficult targets are not easy to defend. They become ripe targets for scorn by probing journalists and academics, targets for shareholder dissatisfaction and, potentially, legal action against boards. The philosophy of executive incentives requires rethinking. If they serve no purpose other than ego satisfaction of executives who wish to feel they are being paid for superior performance, there must be a more defensible - not to mention less expensive - way of doing this. If they truly motivate superior performance, then it should be more demonstrable than it currently appears (Mahoney, 1985).

"What role - if any - should incentives play in the workplace?" (Harvard Business Review, Nov-Dec 1993, p. 37) This issue is vital in providing direction to shareholders and managers in organisations, and politicians considering legislation that will impact on executive pay. This research aims to contribute towards the scant body of knowledge concerning the impact of incentive schemes on company performance, by gathering empirical data from the participants themselves. What role do the executives of large corporations play in corporation dominated society and, are they being sufficiently motivated by the lure of gain?

There is little doubt that the world is in an extremely protracted recession. Organisations are currently under severe pressure to provide shareholders with the handsome returns that they were capable of producing in the past. Many have implemented executive financial incentive schemes in an attempt to bring directors' and managers' performance in line with shareholders' high expectations (Ross, Westerfield and Jaffe, 1990). Short term incentive schemes are used to try to link managerial performance and remuneration to the results of the organisation (Milkovitch and Newman, 1984). The idea of making

workers share in profits is a very attractive one and it would seem that it is from there that harmony as between Capital and Labour should come. But, the practical formula for such sharing has not yet been found (Fayol, 1949). Several decades later the formula still seems to be illusive. An objective of this research is to establish guidelines for designing effective remuneration and incentive systems.

A widely held belief is that a financial incentive scheme will motivate or "incentivise" executives to work harder and produce better results. However, there is little evidence that these schemes actually raise company performance. This research canvassed senior managers' views on the impact of financial incentive schemes on senior managers' and on company performance.

Importance of the research

Organisations in South Africa are paying out millions of Rands in financial incentives to executives without knowing conclusively whether or not company performance actually improves as a result of these incentive schemes (P-E Corporate Services, Salary Surveys, 1993). With very little evidence to prove that incentive schemes boost performance levels, top management hire compensation experts to design and implement comprehensive financial incentive schemes (Crystal, 1992; Delacroix and Saudagaran, 1991; Jensen and Murphy, 1990).

There are several reasons for focusing on executive incentive schemes only. Firstly, it is usually a company's executives who commission the design and implementation of the incentive scheme. Secondly, in South Africa there are very few organisations that have such schemes throughout all levels in the organisation; and thirdly, it allows one to focus on the decision makers of the business. This research explores whether or not the participants feel there is a positive impact due to the implementation of executive financial incentive schemes.

Apartheid has led to many inequities in society, one of them being the difference in remuneration levels between black and white employees on the same job level (P-E Corporate Services South African Salary Surveys, 1993). Most organisations are still run by white male executives. Unions, media, workers, politicians and others are paying increasing attention to the levels of compensation that executives receive (Brownstein and Panner, 1992; Culpan, Murti and Culpan, 1992; Holtzman, 1992; Jensen and Murphy, 1990). The question being asked is whether these levels are really necessary when thousands are losing their jobs. (Holtzman, 1992; Spooner, 1979). Should these executive bonuses be stopped and the money distributed more widely and evenly? Many people have real trouble understanding just what any corporate executive can possibly be doing to earn a seven-figure pay package (Kraus, 1980). This research answers some of these burning questions.

Definitions

- Short term refers to the period of one year or shorter.
- Executives refers to the top management team in the organisation. This is often known as "Exco" in organisations.
- Financial incentive schemes refer to any money that is paid out over and above guaranteed basic salary and bonuses, for superior performance or for exceeding company performance measures (Engel, 1985).

The literature review covers the theory base relating to the research topic. While much has been written about remuneration and motivation theory, there is little evidence of prior research on incentive schemes as a motivator to increase company performance.

The theory base to be covered includes:

1. The components of a remuneration package and how short term incentives fit in

2. Types of incentives and their applicability and implementation

3. Motivation theory

4. Agency theory and the role of incentives

5. Measures of company performance

6. Perception theory

7. Prior research

2. COMPONENTS OF THE REMUNERATION PACKAGE

It is not uncommon to find payroll costs running as high as 40 to 70 percent of the total cost of doing business (Lawler, 1990). At executive level at least 40% of the total cost of employment is paid out as fringe benefits and incentives. Pay is thus an important cost to organisations and the components of the remuneration package or mix need to be used to their fullest advantage. Lawler (1983) states that a properly designed reward system can be a key contributor to the effectiveness of the organisation. Reward systems can potentially influence the following factors, which in turn, influence company performance:

- Attraction and retention of better performers
- Motivation to perform in particular ways
- Culture fostered in the organisation
- Reinforce and define organisation structure

- Cost of the payroll

There are variations in opinion as to the number of components which comprise the remuneration mix, but most of the theory suggests that there are four components (Milkovitch and Newman, 1984; Lawler, 1983; Lawler, 1990; Armstrong and Murlis, 1991). In broad terms these are;

- Basic pay;
- Fringe benefits;
- Short term incentives;
- Long term incentives.

Gerhart and Milkovitch (1990, p. 5) state that "employers are seen as price takers" meaning that they must pay the going rate if they are to be competitive. It is the level of basic salary that is referred to here. The point is that the basic salary does not differ widely across organisations of the same size in terms of company sales, assets, number of employees and level in the organisation. It is submitted that competitive advantage in remuneration package design thus needs to be gained through the use of the components that align closely to the performance of the company i.e. short term incentive schemes. This portion of the package may vary with company performance and competitive advantage lies in the hands of the executive if the scheme is well designed.

Short term financial incentive schemes refer to schemes that operate over a one year period and are viewed as the most effective part of the remuneration mix in creating competitive advantage and motivating executives. (Gerhart and Milkovitch, 1990; Jensen and Murphy, 1990; Ellig, 1982). This research tests this supposition against the perceptions of managers on the schemes. The importance of the incentive schemes needs to be identified for remuneration package design, and the relative importance of each of the components of the package carefully considered. Information is sought on the relative importance

of the various elements of the remuneration mix and conclusions are drawn as to how one should design effective remuneration packages for the SA executive.

3. TYPES OF INCENTIVE SCHEMES

Organisations should choose and design schemes that provide the closest links to their business strategy. Schuster (1985) views incentives as the most powerful communicators of priorities in the top performing companies. Top managers often refer to the remuneration system as a strategic lever to encourage the desired actions and behaviours from executives. These schemes, normally operating on an annual basis, form part of this research. The most common forms of these annual or short term incentive schemes are referred to in industry as:

- Profit sharing schemes;
- Individual performance bonus;
- Group performance bonus;
- Gain sharing schemes.

An important consideration in incentive scheme design is the balance between quantitative and qualitative performance factors. Quantitative factors are usually financial measures used in company financial statements. Examples of these measures are profit, costs and shareholder value. Individual measures usually encompass some form of qualitative factors such as personal objectives. When categorising incentive schemes for analysis, the type of scheme is important.

Remuneration and motivation theory states that any scheme is only an incentive when one has direct control over the elements that go into making it up (Lawler, 1983). Most schemes cover a wide variety of financial measures such as profits, costs, sales targets, budgets and specified returns. To comply with

motivation and remuneration theory, participants should have influence and control over these measures. This research tests the importance of having control over one's destiny and being able to influence the measures on the scheme. Respondents are asked to indicate their level of satisfaction with past experiences with incentive schemes. They are also asked to provide reasons for the indicated level of satisfaction and this is linked to the literature.

The importance of design

Scheme design is important when doing research of this nature. Questions are asked as to what the performance factors are, how the scheme is funded and whether or not there is a cap or limit on the scheme.

The analysis of results must take scheme design differences into account as there may be differences in perception between executives on the various schemes. An example of this might be the difference in perception between executives on a scheme that has individual measures that is capped versus the perception of someone on a scheme that is company orientated with no cap. The intention of this research is to identify whether or not there are differences in perception between the various schemes. This has implications for the recommendations on scheme design.

4. MOTIVATION THEORY

When investigating the relationship between incentive schemes and company performance one needs to consider whether or not the added remuneration really matters in motivating executives (Modise, 1993). If so, how much more remuneration is required to motivate executives. The extent to which executives believe to be motivated by money is asked in this research. Extensive research and enquiry has been conducted as to how much an incentive scheme payout should be for it to motivate. In this research the level of satisfaction with incentive schemes will be analysed in conjunction with the last payout that the executive received and conclusions drawn as to whether or

not there is any link. This section covers some of the well known remuneration motivation theories and how they tie in with this study.

4.1 Maslows need hierarchy theory

This theory states that human needs form a hierarchical progression, through five levels (Biesheuval, 1984; Steers and Porter, 1987). Maslow proposed that one moved up the need hierarchy and one could not move from one level to the next until the lower order need had been satisfied. The hierarchy of needs in ascending order are as follows: physiological needs, safety needs, belongingness or love needs, esteem needs, and the need for self actualisation (Maslow, 1954). Relating pay to this theory, it is postulated that money is more inclined to motivate at the lower levels of the needs hierarchy. This theory would not support the notion that money really motivates executives unless there were substantial amounts of money.

According to Maslows theory, executives would be half way up the levels on the hierarchy, which is the level describing safety needs. From a remuneration point of view, safety needs relate to the level and importance of garuanteed pay, often associated with basic pay. Executives will be asked to indicate the relative importance of the components of a remuneration package. An analysis of the answers will give some indication of the need for safety

4.2 The Herzberg two factor theory

Herzberg refers to two sets of needs called the Hygiene and Motivator needs (Herzberg, Mausner and Snyderman, 1957). The Hygiene needs are concerned with a person's "biological nature, with gratification of basic physiological survival drives, with the avoidance of pain, and the removal of frustrating circumstances" (Biesheuval, 1984, p. 59). Hygiene factors are generally not associated with the job itself but with the environment in which the job has to

be performed and include conditions of service, labour policies and the remuneration the employee receives for doing the job.

The motivators relate to the job itself and its content; the scope offered; the exercise of skills, intelligence and responsibility; for opportunities to achieve and receive recognition, and grow as a person. Herzberg believes that it is only the motivators that can have a lasting effect on motivation. These two factors do not form a continuum and should be viewed separately.

From a pay point of view the postulation is that money can only relieve pain and reduce dissatisfaction. It can not motivate as it is the motivators that perform that function. This theory of motivation would not support the proposal that financial incentive schemes positively enhance company performance or motivate executives to work harder.

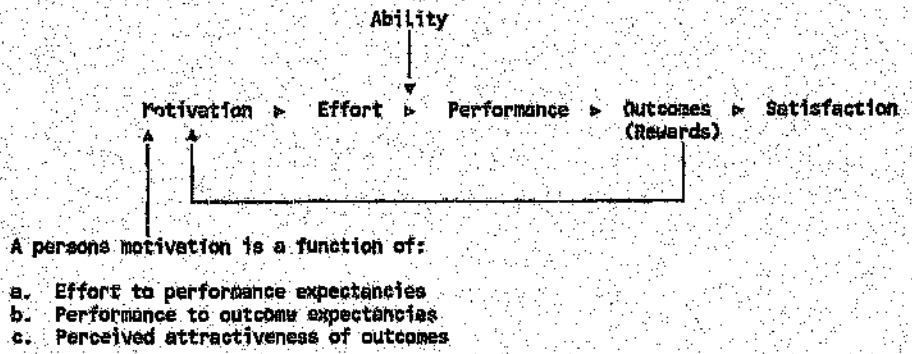
4.3 Expectancy theory model

Porter and Lawler developed the expectancy theory model; "motivation is seen as the force on an individual to expend effort" (Lawler. 1983, p. 20). This theory states that an individual's motivation to behave in a certain way is greatest when:

1. The individual believes that the behaviour will lead to specific outcomes or rewards (performance outcome expectancy).
2. These outcomes or rewards are attractive.
3. The individual's perception of how hard it will be to achieve the outcome and the probability of success are within reach (effort performance expectancy).

Lawler states that in order for employees to believe that an incentive based pay relationship exists, the above conditions need to be met. The model is shown in figure 1.

Figure 1 The expectancy theory model



This model would support the supposition that incentives will motivate executives to perform better if the conditions mentioned above were right. The first condition is that the effort expended by the executives will lead to some outcome or reward. This emphasises the need for incentive scheme rules that are available for participants to see. The targets in the scheme should not be moved or changed, as this will change the expected outcome and reward.

The second condition that needs to be met is that the incentive reward will be meaningful. It is here that the debate begins because there is no absolute value for "meaningful". Theorists have suggested that a meaningful reward for extra effort is 15% (Biesheuval, 1984; Crystal, 1992; Ellig, 1982; Lawler, 1984; Milkovich and Newman, 1984; Armstrong and Murlis; 1991). An analysis will be done in this study that compares the level of satisfaction with the incentive scheme and the amount of payout that the respondent received. This can then be compared to the theory base.

The third criteria that needs to be met is that the targets are within reach. From an incentive scheme point of view, unrealistic targets that require too much effort to reach, dilutes the executive's drive and motivation to strive for the target. For this reason the targets need to be set with the participant and some negotiation may be required. Without this, the participant may give up the chase.

4.4 Adams equity theory

Adams equity theory states that individuals strive to maintain a balance between their inputs to the organisation and the output/reward received in return (Adams 1963). Graphically this is shown in figure 2.

Figure 2 Adams Equity theory

INPUT	OUTPUT
Age	Pay
Experience	Fringe benefits
Education	Job satisfaction
Skills	Status
Effort/Performance	Freedom

If an individual perceives an imbalance between the two sides of the scale it is suggested that the individual will take steps to rectify the situation. In terms of a financial incentive payout, this theory would support the notion that the individual would try and increase the input side of the equation. This would include increasing the effort and personal performance with a view that the outputs will also increase. In other words, be motivated to work harder and produce better results for more money. In the event of the effort and performance going up for a period of time and the reward never materialises, the theory states that the participant will reduce the input to match the output.

5. AGENCY THEORY AND THE ROLE OF INCENTIVES

Agency theory describes a situation where the shareholders are not physically running the organisation they own and have hired directors and managers to do so. It is argued that the interests of the managers are different from those of the shareholders. Ross *et al.* (1990 p. 16) state that the "costs of resolving the conflicts of interest between managers and shareholders are special types of cost called agency costs".

These agency costs are the "monitoring costs of shareholders and the incentive fee paid to managers" (Ross *et al.* 1990 p. 16). The primary function of executive incentive schemes is to control the conflict of interest between management and shareholders (Abowd, 1990; Jensen and Murphy, 1990; Kraus, 1980; Lambert and Larcker, 1990). Jensen and Murphy (1990, p. 149) make the point that "money is not everything, but nonmonetary rewards often create the wrong incentives for CEOs". In other words, the money is important and what gets rewarded gets done.

This research seeks to obtain information from the managers on their perceptions of the role and function of the executive financial incentive scheme. The perceptions will then be related back to the agency theory as well as input from the scheme administrator as to what the organisations purposes are for having the incentive scheme. According to the agency theory, the link to the shareholder should be a fundamental design principle in an incentive scheme that is communicated in detail to the participants on the scheme. The responses to this question will indicate the level of shareholder awareness amongst participants.

6. MEASURES OF COMPANY PERFORMANCE

There are many different measures of company performance. This research will show which measures managers perceive to be most positively affected by their incentive scheme. The measures chosen are commonly used in South African literature when comparing the performance and size of organisations (Greenblo, 1993). The performance measures were also chosen based on the likelihood that the top management has had access to them.
For this research executives were asked which of the following measures of company performance are most affected by their scheme:

1. Return on equity
2. Return on capital employed
3. Earnings per share
4. Return on sales
5. Growth in sales
6. Growth in equity
7. Growth in profit
8. Dividends per share

The extent to which executives can control each of these measures differs by the nature of the company, the level and function in the organisation. The answers in this section need to be tied back to the motivation theories. Information will be gathered as to what the incentive scheme was designed to do and the perceived impact on the various measures of company performance

7. PERCEPTION THEORY

Perception is the way we interpret or give meaning to the world around us (Stanton, Etzel, Walker, Abratt, Pitt and Staude, 1992). Our perceptions often depend on the object being viewed and our experiences so that when we

receive information the mind compares it with a large store of images in memory and provides an interpretation. Blake and Ramsey (1951) state that the goals of perception are to achieve environmental stability and create definiteness. Our perceptions attempt to achieve for us a world that is relatively stable by excluding as much contradictory evidence as possible. It provides us with some "anchorage".

Perception theory suggests that much of the managerial perception about the incentive schemes will be based on past experience. It will be important to get some input as to what the managers' past experiences have been. It also suggests that the managers' perceptions will be close to their reality and would want the incentive schemes to work as they have been designed to do. This study intends to assess whether the participants perceive the incentive schemes to be doing what they were designed to do.

8. PRIOR RESEARCH

Gerhart and Milkovitch (1990) conducted research in the United States of America on managerial compensation which had two purposes. The first part examined the extent to which organisations facing similar conditions make different decisions concerning managerial compensation regarding basic pay, bonus pay, and eligibility for long term incentives. The second part of the research explored the consequences of these decisions for subsequent organisation performance as measured by return on assets. Longitudinal remuneration data from a large compensation consultancy was used from approximately 16,000 managers in 200 organisations, and significant between-organisation differences in compensation decisions were found. The study revealed that the smallest organisation effects are on the level of basic pay. The largest organisation effects were on the bonus levels and eligibility for the long term incentives. The results thus showed that organisations tend to distinguish themselves on decisions about the level of bonuses given rather than

on basic pay. Pay level was thus not associated with financial performance, however, larger incentives were associated with better financial performance.

This research focuses on managerial perception regarding the use of the components in the remuneration mix for creating competitive advantage and motivating executives. Their study did not cover this and it is recommended as further research.

Abowd (1990) conducted research in the United States of America investigating whether performance-based compensation affected corporate performance. The remuneration data used were obtained from a compensation consulting firm and covered some 25,000 managers and 600 organisations over the period 1981 to 1986. The reason for the research was justified in the belief that performance based remuneration provides a viable solution to the agency problem. Abowd (1990, p. 68) concluded that "the results of the research do lend credence, however, to claims that benefits can be gained by increasing the pay-for-performance component of managerial compensation". This research intends to establish whether managers perceive this to be so and the extent of their belief.

Modise (1993) examined the correlation, and the extent of the correlation if one existed between executive compensation and corporate performance in a sample of listed South African organisations on the Johannesburg Stock Exchange. Corporate performance was viewed form the shareholders point of view in the form of increases in their investments and dividends. Executive compensation was defined as the sum total of directors emoluments excluding shareholding. It did not isolate incentive schemes specifically, but grouped it with the total package.

There were two major findings. The first was that the directors are compensated in such a way so as to align their interests with those of the

shareholder. Secondly, the relationship between compensation and corporate performance was not very strong (r=.287 in 1991). This was explained by the fact that setting executive remuneration was more complex than just linking it to the share price. The difficulty of setting executive remuneration is indeed borne out by research done by Hipkin (1993).

9. CONCLUSION

The literature review has shown that the role that incentives play in organisations has far reaching implications for the captains of industry and politics.

Incentives are not merely hand-outs to those in control. They serve many purposes.

- Executives are motivated by incentive schemes and believe that organisations with incentives perform better than those without schemes.
- Incentives provide focus in terms of shareholder expectations. They are powerful levers for the owners of businesses to guide the behaviour of their appointed directors. The intelligent use of incentives is an important strategy for aligning organisational and individual goals by treating employees as partners in both the risks and the successes of the business.
- Determining the levels of executive pay is not an arbitrary calculation, and is strongly influenced by economic and market factors. Incentives assist in achieving these levels and are integral in attracting quality executives to the organisation.
- Incentives help to retain the services of top performing staff. They are effective in fostering and reinforcing the desired culture in the organisation. Organisations that have highly motivated staff often save on payroll costs in the long term, indirectly enhancing company performance.

Perhaps organisations should be asking: What is the cost of not using an incentive scheme to drive your business?

Equity is becoming a powerful force in decision making worldwide, not only

influencing trade laws between major powers, but also questioning the pay scales of many companies.

The public spotlight is highlighting large incentive payouts at a time when thousands of people are losing their jobs. Feeling the pressure from all sides, governments are being forced to consider official intervention.

Previously, scheme design has been slavish to the old reliable theories of motivation, remuneration and economics.

But how do the participants themselves view the subject? Is this not one of the most important variables? Yet the amount of research aimed at investigating scheme participants' opinions is minimal.

This research will enhance that body of knowledge and provide decision makers with some answers.

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APPENDICES

Appendix 1

Mark Bussin
P.O.Box 8550
Johannesburg
2000
15 November 1993

Dear Sir/Madam,

I am undertaking research on the perceived impact of short term executive financial incentive schemes. This research could be vital in providing direction to shareholders in organisations, managers and politicians considering legislation that would impact on executive pay. It also forms part of a technical research report for the completion of a Masters in Management degree at the Wits Business School.

The research aims to contribute towards the scant body of knowledge concerning the perceived impact of incentive schemes on company performance, by the participants themselves. The questionnaire will take approximately twenty minutes to complete and, if you wish to receive an Executive Summary of the findings, please complete the attached request form and return it with the questionnaire or under separate cover.

The data gathered are purely for research purposes. Since questionnaires are not numbered, and are therefore confidential, they cannot be traced back to any individual. The questionnaire is targeted at the Senior Management of organisations that have financial incentive schemes.

As you are aware the number of companies in the research population in South Africa is limited. Therefore it is important that every questionnaire is returned. Please send the completed form to (contact name) in your organisation who is kindly coordinating the assembly of returns for me. The deadline date for the completed return is:

30 NOVEMBER 1993.

If you have any queries regarding the questionnaire, please contact me at:

Home (011) 884-5718
Work (011) 442-4334
Fax Work (011) 442-4758

Thank you for your participation in this study.

Yours sincerely

Mark Bussin

This confirms that Mark Bussin is a registered Masters student at the Wits Business School, and that the above project is being conducted as a requirement towards his degree. Your assistance would be very helpful.

Dr Mike Bendixen
Research Coordinator

Appendix 2

ORGANISATION QUESTIONNAIRE

EXECUTIVE FINANCIAL INCENTIVE SCHEME DETAILS

Kindly complete the following questionnaire as honestly and comprehensively as you can.

1. Please state the name of your organisation.

   _____

2. By what name/term is the company Executive Financial incentive scheme known?

   _____

3. What is the primary purpose of the incentive scheme?

   _____

   _____

   _____

   _____

4. What are the performance measures of the scheme?

   _____

   _____

   _____

Appendix 2 (continued)

5. How is the scheme funded? i.e. How is the bonus pool determined? For example, budgeted, a percentage of profit, a percentage of some other target.

6. How often does the scheme pay out?
   6.1 In terms of the scheme rules?

   6.2 In practice over the past 3 years (on average)?

7. Who regulates and administers the incentive scheme?

8. Who was responsible for designing the scheme?

9. Who was responsible for the implementation of the scheme?

_____

_____

10. For how many years has the scheme been in operation? (What month and year was the scheme introduced?)

_____

11. Is the scheme capped or limited in terms of payout potential? For example can one only receive, say 30% of ones annual basic salary in any one year?

_____

12. If the scheme is capped or limited, what is the cap or limit?

_____

13. Please complete the following table with the published financial results.

	1992	1991	1990
1. Return on Equity			
2. Return on Capital Employed			
3. Earnings per Share			
4. Return on Sales			
5. Growth in Sales			
6. Growth in Equity			
7. Growth in Net Profit			
8. Dividends per Share			

See next page for definitions

Appendix 2 (continued)

Definitions of terms in table:

1. Return on equity refers to the percentage return on pre-tax profit on shareholders' funds. i.e. on the issued ordinary share capital plus reserves (pre-tax profit divided by shareholders' funds).

2. Return on capital employed refers to the ratio of pre-tax profit to total net assets defined as share capital (including preference shares), plus reserves, plus creditors, plus any outside minority shareholdings in subsidiaries. (Pre-tax profit divided by total net assets).

3. Earnings per share refers to the profit attributable to ordinary shareholders (before extraordinary items) divided by the number of ordinary shares issued.

4. Return on sales refers to operating margin. (Pre-tax profit divided by turnover).

5. Growth in sales refers to growth in turnover. (Sales current year minus sales previous year divided by sales previous year).

6. Growth in equity refers to equity current year minus equity previous year divided by equity previous year.

7. Growth in net profit refers to average net profit current year minus average net profit previous year divided by average net profit previous year.

8. Dividends per share refers to total dividends paid divided by number of shares issued.

Appendix 3

INDIVIDUAL QUESTIONNAIRE

EXECUTIVE FINANCIAL INCENTIVE SCHEME DETAILS

("The scheme")

Please complete the following questionnaire as honestly as you can. The questions relate to your own perceptions. There are no right or wrong answers.

SECTION ONE

1. Please state the name of your organisation?

   _____

2. What is your position title? For example, Finance Manager, Human Resource Director.

   _____

3. What is the name of your division?

   _____

4. What in your opinion, are the top three factors that contribute to positive company performance?

   _____

   _____

   _____

5. Why do you think the company has an incentive scheme?

_____

_____

_____

SECTION TWO

Please complete the following questions using the five point rating scale shown below.

1 Strongly disagree
2 Disagree
3 Neither agree nor disagree
4 Agree
5 Strongly agree

Please reflect your answer by checking one of the blocks.

6. I believe that my own performance directly affects my incentive scheme pay out.

1	2	3	4	5

7. Financial incentive schemes are effective in increasing company performance.

1	2	3	4	5

8. The financial incentive scheme is important in motivating me to strive for better company results.

1	2	3	4	5

9. A financial incentive scheme promotes top management teamwork.

1	2	3	4	5

10. I would prefer to receive a higher basic salary and no financial incentive scheme.

1	2	3	4	5

11. I would work as hard whether there was a scheme or not.

1	2	3	4	5

12. A financial incentive scheme helps to attract new recruits at top management level.

1	2	3	4	5

13. A financial incentive scheme helps to retain services at an organisation.

1	2	3	4	5

14. Organisations with financial incentive schemes generally perform better than those without schemes.

1	2	3	4	5

15. I would prefer to lower my basic salary and have a more generous formula on the incentive scheme.

1	2	3	4	5

16. Organisations tend to distinguish themselves from other organisations on decisions about the level of bonuses given rather than on basic pay.

1	2	3	4	5

17. There is a link between managerial effort and company performance.

1	2	3	4	5

18. Incentive schemes are effective in aligning the interests of managers with those of shareholders.

1	2	3	4	5

19. The whole organisation should be on an incentive scheme.

1	2	3	4	5

20. Access to organisation financial statements is important when on an incentive scheme.

1	2	3	4	5

21. I would have no problem in sharing the financial information with all levels in the organisation if the incentive scheme was company wide.

1	2	3	4	5

22. financial incentive scheme forms an important part of my total package.

1	2	3	4	5

23. I think that this company's results would be the same whether management were on a financial incentive scheme or not.

1	2	3	4	5

24. The scheme gives me focus in terms of shareholder expectations.

1	2	3	4	5

25. If I perceive the targets of the incentive scheme to be too hard, I do not try to achieve them.

1	2	3	4	5

26. The greater the incentive scheme payout, the harder I tend to work.

1	2	3	4	5

27. Our financial incentive scheme positively affects the following measures of company performance:

Definitions of terms:

1. Return on equity refers to the percentage return on pre-tax profit on shareholders' funds. i.e. on the issued ordinary share capital plus reserves (pre-tax profit divided by shareholders' funds).

1. Return on equity

1	2	3	4	5	Don't Know

2. Return on capital employed refers to the ratio of pre-tax profit to total net assets defined as share capital (including preference shares), plus reserves, plus creditors, plus any outside minority shareholdings in subsidiaries. (Pre-tax profit divided by total net assets).

2. Return on capital employed

1	2	3	4	5	Don't Know

3. Earnings per share refers to the profit attributable to ordinary shareholders (before extraordinary items) divided by the number of ordinary shares issued.

3. Earnings per share

1	2	3	4	5	Don't Know

4. Return on sales refers to operating margin. (Pre-tax profit divided by turnover).

4. eturn on sales

1	2	3	4	5	Don't Know

5. Growth in sales refers to growth in turnover. (Sales current year minus sales previous year divided by sales previous year).

5. Growth in sales

1	2	3	4	5	Don't Know

6. Growth in equity refers to equity current year minus equity previous year divided by equity previous year.

6. Growth in equity

1	2	3	4	5	Don't Know

7. Growth in net profit refers to average net profit current year minus average net profit previous year divided by average net profit previous year.

7. Growth in profit

1	2	3	4	5	Don't Know

8. Dividends per share refers to total dividends paid divided by number of shares issued.

8. Dividends per share

1	2	3	4	5	Don't Know

28. Please state what percentage of your annual basic salary the last incentive payout formed.

29. Which component of the remuneration mix do you view as the most effective in creating competitive advantage in industry? (Rank from 1 to 4; 1 = most effective and 4 = least effective).

Basic Salary	Perks (Fringe Benefits)	Short Term Incentives	Long Term Incentives

30. Which component of the remuneration mix do you view as the most effective in motivating executives? (Rank from 1 to 4; 1 = most effective and 4 = least effective).

Basic Salary	Perks (Fringe Benefits)	Short Term Incentives	Long Term Incentives

Definitions of terms mentioned above:

* Basic salary refers to the basic salary received and does not include any form of fringe benefit or bonus.

* Perks refers to any fringe benefits received such as medical aid, company car and entertainment allowance.

* Short term incentive refers to any incentive scheme paid out on an annual basis for superior performance.

* Long term incentive refers to any scheme that operates over a period of many years for example a share incentive scheme.

31. In general, what have your past experiences been with financial incentive schemes?

Very Unsatisfactory	Unsatisfactory	Neutral	Satisfactory	Very Satisfactory

Please give reasons for your answer above.

_____

_____

_____

_____

32. Rate each of the following elements of a remuneration package in order of importance to you. Please circle a number between 1 and 10 for each element as shown. If you do not receive the element then circle Not Applicable (N/A). 1 = vitally important and 10 = of no importance.

Medical Aid	1 2 3 4 5 6 7 8 9 10	N/A
Pension/Provident Fund	1 2 3 4 5 6 7 8 9 10	N/A
Entertainment Allowance	1 2 3 4 5 6 7 8 9 10	N/A
Company Car/Allowance	1 2 3 4 5 6 7 8 9 10	N/A
Director's Fees	1 2 3 4 5 6 7 8 9 10	N/A
Thirteenth Cheque	1 2 3 4 5 6 7 8 9 10	N/A
Housing Assistance	1 2 3 4 5 6 7 8 9 10	N/A
Education Assistance	1 2 3 4 5 6 7 8 9 10	N/A
Performance Bonus	1 2 3 4 5 6 7 8 9 10	N/A
Cheap Use of Company Assets	1 2 3 4 5 6 7 8 9 10	N/A
Holiday Arrangements	1 2 3 4 5 6 7 8 9 10	N/A
Basic Salary	1 2 3 4 5 6 7 8 9 10	N/A
Loans	1 2 3 4 5 6 7 8 9 10	N/A

Appendix 3 (continued)

REQUEST FOR EXECUTIVE SUMMARY

Please send me an Executive summary of your findings.

Name: _____

Position title: _____

Company name: _____

Postal address: _____

_____

_____

_____

Postal code: _____

Appendix 4

PARTICIPANTS

1. Carlton Paper Corporation Ltd
2. Chemical Services Ltd
3. Council For Nuclear Safety
4. Klipton Ltd
5. Kohler Packaging Ltd
6. Nedcor Ltd
7. P-E Corporate Services (Pty) Ltd
8. Protea International (Pty) Ltd
9. Protekon
10. Rebuff (Pty) Ltd
11. Renfreight
12. Saficon Motor Holdings Ltd
13. Sandvik (Pty) Ltd
14. Supervision Food Services (Pty) Ltd
15. Trans Natal Coal Corporation Ltd
16. Van Leer Ltd
17. Vikon Skylite (Pty) Ltd

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