

## Effect of Compensation on Motivating Employees in Public and Private Banks of Peshawar(BOK and UBL)

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### ABSTRACT

The research focuses on the effect of different components of compensation on motivation of employees. Compensation is divided into three basic components, namely Fixed Pay, Flexible Pay and Benefits. Vroom's Expectancy theory is selected for measuring motivation in this research. Two of the prestigious banks of the country were selected as the target for study namely; United Bank limited and Bank of Khyber Ltd. A 20 item questionnaire was developed for the testification of the hypothesis in the study. One of the objectives of the study was to check what component of Expectancy theory has an effect on the motivation level of employees; be it Effort-Performance, Performance-Outcome or Valence of Outcome and secondly to check what component of Compensation Based Pay is effecting motivation level of employees; Fixed Pay, Flexible Pay or Benefits. Validity of the Questionnaire was tested by using Cronbach's Alpha. It was calculated to be 0.832, which by convention is greater than 0.7 and hence reliable. Convenient Sampling was used to gather data from both the banks. A total of 95 Questionnaires were collected, 45 from United Bank Limited and 51 from Bank of Khyber. Regression and Chi-Square was applied to check the results. Regression established that there is a strong relationship of compensation with motivation; whereas, Chi-Square was used for individual relationships of each component (variable) with motivation (eg: Flexible pay with Valence). The result showed that employees are not motivated because of believe in their skills neither are they motivated when told that they would be rewarded on the other hand, they get motivated if rewarded by something they value

**Key words:** Compensation, Motivation, Vroom's Expectancy theory, Fixed Pay, Flexible Pay, Benefits, Expectancy, Performance Outcome, Valence

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### 1. INTRODUCTION

Compensation is one of the primary reasons for employees to seek employment. They are rewarded for their services and efforts that they exert for their organizations. They can be compensated in many ways for example salaries, holidays, bonuses etc. There are two basic compensation models; performance based pay and components based pay. In the former paradigm, employee's compensation is either tied to the way he performs; if he performs better he would be rewarded accordingly (performance based pay) and on the other hand, non performance based pay; where, employee's performance is not tied to getting rewards, rather the employee is paid or rewarded even if its performance is not up to the mark e.g fixed pay and salaries etc. (Taylor, F.1911) see diagram-1.

The first model works best in factories and production units where labor is cheap and performance is tied to the rewards directly. The second model is used for decades in corporate sector, in this model compensation is divided into three components namely; Fixed Pay, Flexible Pay and Benefits (Beard, 1986). The model that would be used for this research study is Compensation Based Pay.

Motivation is the drive of an individual to act and achieve. Psychology gives us different rationales regarding the nature of motivation. For this reason, there are many theories relating to motivation, as to what motivates human beings and how to manipulate that process for organizational needs. Major theories are Process, Content and Reinforcement motivation theories. The theory that is selected for this research is Expectancy motivation theory, which is a subtype of Process theory. The theory is about motivating employees based on three important factors, motivation due to self-belief, motivation due to outcome and motivation due to valence (Vroom, 1964). Simply, it can be said Motivation = Expectancy X Instrumentality X Valence. Expectancy means that employees will be motivated if they believe their effort will result in performance, in other words, if they believe in their skills they will be motivated. On the other hand, Instrumentality means that employees will be motivated if they believe their performance will yield rewards. This factor determines that

trust of employee's on management is very important for their motivation. Lastly, Valence means that employees will be motivated if they are rewarded with rewards they value and not just any reward.

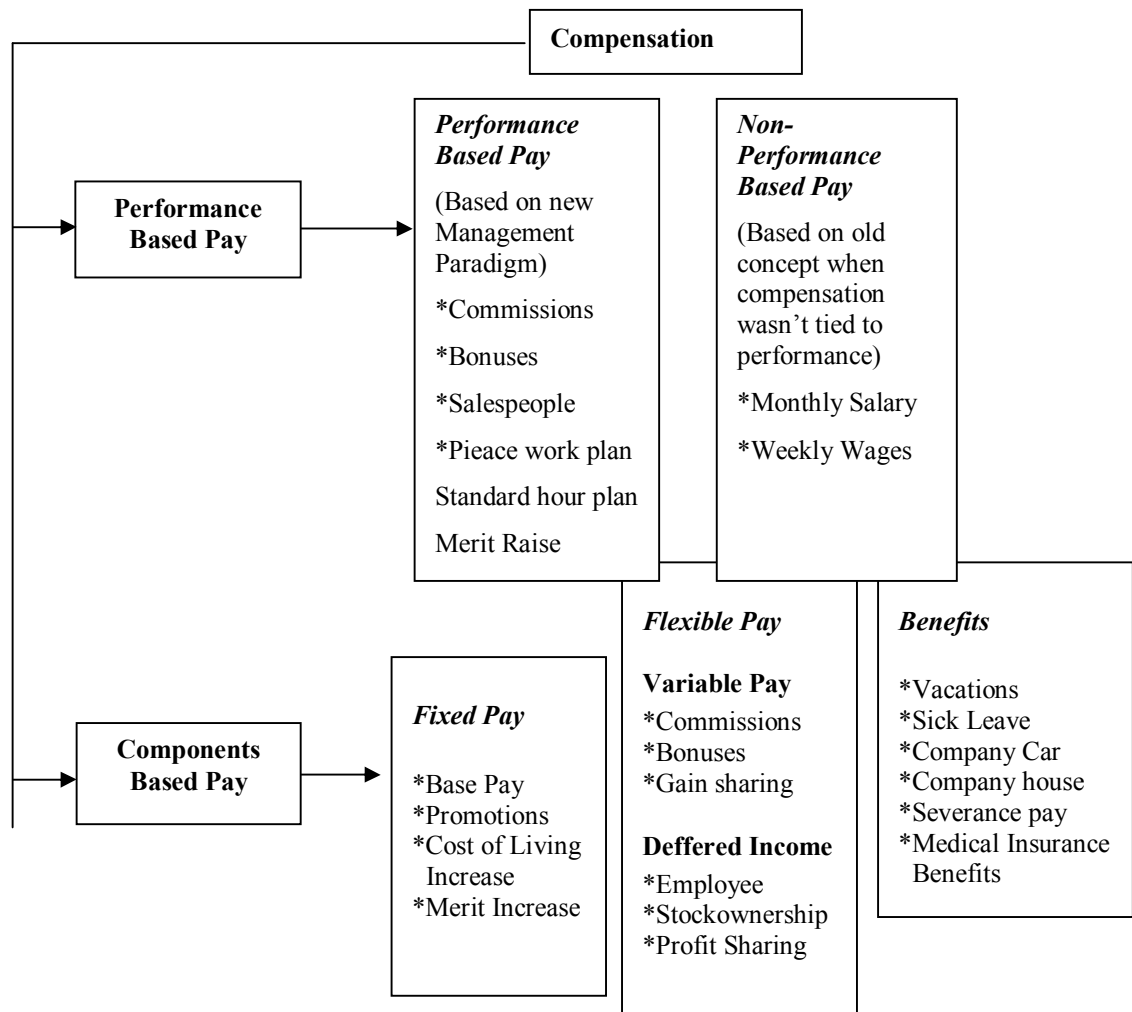
## 2. LITERATURE REVIEW

### 2.1 Compensation

Dessler, (2005) defines compensation as all forms of payments or rewards given to employees which arise from their employment. Compensation can be divided into various parts. One way is to break it down into three parts namely, Fixed-Pay, Flexible Pay and Benefits (Beard, 1986). The other way is to divide Compensation in to two parts, Performance-based pay and Non-performance based pay (Taylor, F.1911). First approach of classification of compensation would be used in this research.

In the first classification, Fixed pay is the compensation given to employees as their base salaries e.g promotions, merit increase and cost of living increase. These come under fixed pay because all of them become part of the employee's base salary after its effect. Flexible pay consists of two components in it self, variable pay and deferred Income. Variable pay relates to commissions, bonuses, gain sharing, goal-based pay etc: where, the amount of pay is variable or its distribution is not certain, which is given usually to salespeople. Deferred income is long-term organization pay schemes e.g. profit sharing, company savings plans employee stock ownerships etc. Finally we have Benefits, which include things like vacations, sick leave, company car, company house, severance pay, medical insurance, retirement benefits etc.

Diagram- 1



Performance Based Pay Source: Taylor, F. (1911)

Components Based Pay Source: Beard, P (1986).

## **2.2 Motivation:**

Motivation is the drive of a person to carry out a task which he desires to do so. Some link motivation to human basic needs like food; clothing and shelter (Maslow 1943, Herzberg 1959) other focuses on higher end concepts like; motivation due to self-belief etc: (Vroom, 1964). However, one can say Motivation is the activation of goal-oriented behavior whether motivation is intrinsic or extrinsic. Intrinsic motivation is something that comes from within the person e.g challenging task motivates some people while thirst for recognition motivates others and extrinsic motivation is motivation caused by external factors e.g pay, bonuses etc. The Focus of this research is on extrinsic motivation.

In the recent times, a lot of research is being done on what makes people motivated and how to motivate them by choosing the best option among many? At first employees were considered as a mere mechanical input to the organizational outputs (Taylor, 1911). But after the Hawthorne Studies, conducted by Elton Mayo from 1924 to 1932, this attitude changed and considered human values, dreams, aspirations and needs into account, (Dickinson, 1973).

Following are motivational theories discussed briefly, followed by the theory used in this research; Vroom's Expectancy theory. Vroom's theory is the most widely used theory for the purposes of compensation and motivation related work. (Kanfer, 1990)

Expectancy theory and equity theory both comes under the Process Motivation theory. Process theory is commonly used form of scientific research study in which events are said to be the result of certain input leading to a certain outcome, following a set process.

Although all of these theories provide great insight into behavior at organizations and how to motivate people but they lack research findings and are continued to be tested. However, Victor Vrooms Expectancy theory has a lot of research backing about its validity and its most used theoretical framework for work motivation related studies as compared to need, equity or goal setting theories. (Kanfer 1990), (Pinder, 1984)

Vroom's Expectancy theory says that people are motivated when they have a self-belief on their skills, belief in the promises of the management about getting the reward and the personal value they place on a specific reward (Vroom, 1964). The self-belief on skills is called "Expectancy", belief in getting the reward is "Instrumentality" and value on the reward is the "Valence". It is important to define each term further in order to be able to understand the hypothesis and theoretical framework coming later on. Expectancy: when Employees have a better perception of their skills they are more likely to try out difficult objectives. If they don't believe in their skills they won't be motivated. For example some one believes in himself; going in front of huge audience and delivering a lecture so his motivation to actually do it, would be more. Instrumentality: if employee's belief that they will be rewarded for their efforts they will be motivated to perform. Managers need to be honest and objective about what they can provide as a reward and to whom they can provide. Otherwise employees will be in state of confusion and won't be motivated. Valence: Every one place a different value on a certain reward. To some pay is of more value than other rewards and to others more intrinsic rewards like recognition, achievement etc. are of more value. Employer should take a personal interest in his employees to know them better so that he can identify which reward he values most.

Equation for Vroom's theory is as follows;

$$\text{Motivation} = \text{Expectancy} \times \text{Instrumentality} \times \text{Valence}$$

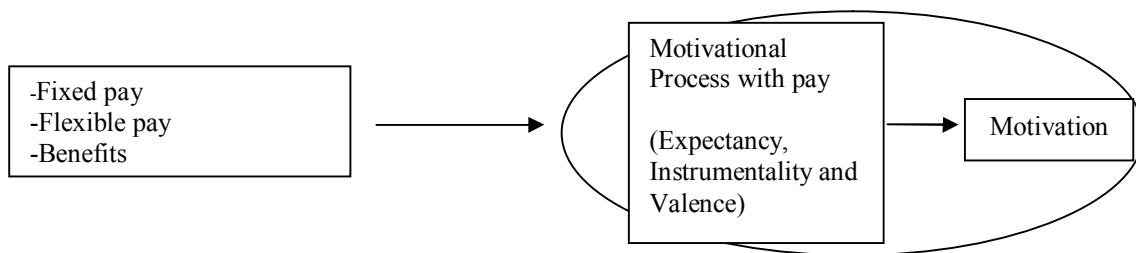
Expectancy theory remains the most widely used theoretical framework for empirical studies that concern motivation and compensation related research (Kanfer, 1990). That is why this model is chosen to measure the effect of compensation on Work Motivation as it is the most valid representation of the work-related attitudes (Pinder, 1984).

Nadler & Lawler (1977), conducted a research on process of motivation in relation to compensation and says that motivation can be defined in terms of three independent variables: effort-performance expectancy, performance-outcome instrumentality and valence. Last two variables can be further divided into six more variables three each. i.e., performance fixed pay instrumentality, performance flexible pay instrumentality, performance benefits, and valence of fixed pay, valence of flexible pay and valence of benefits.

Igalens & Roussel (1999) summed the work of previous researchers and came up with framework shown in diagram 2. The diagram shows relationship between total components of compensation (Fixed Pay, Flexible Pay, Benefits) with Vroom's Expectancy Theory.

## Total Compensation--Motivation frame work

**Diagram 2**

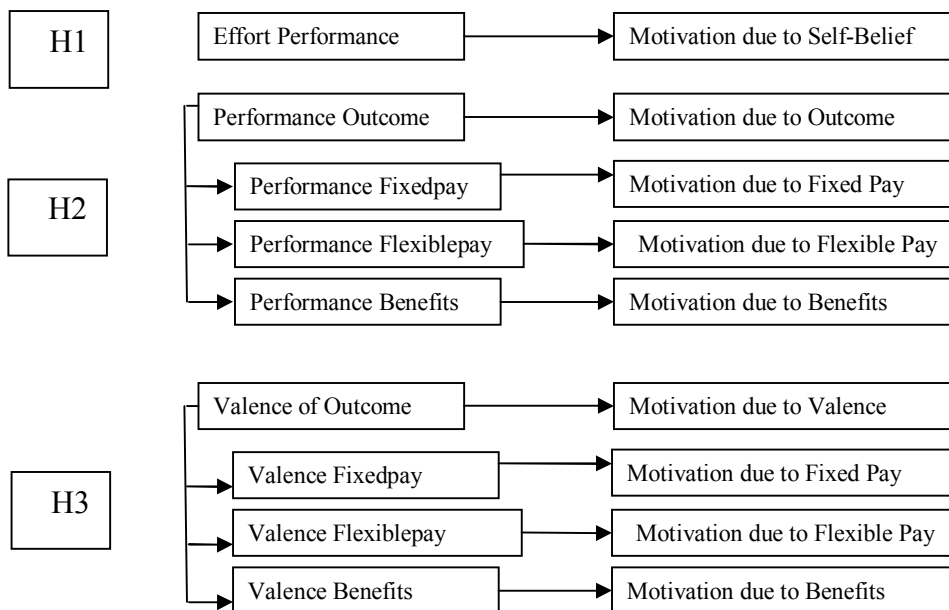


Source: Igalens, J. & Roussel, P.

### 3. Research Frame Work

A research design was developed to define the relationship of compensation with motivation. The Compensation Based Pay was incorporated in Expectancy theory. From this three hypotheses of the research were developed. First hypothesis was based on finding the relationship between Effort-Performance and Motivation due to Self-Belief. Second hypothesis was based on finding the relationship between Performance-Outcome and Motivation due to Outcome. Both the variables were further divided into three components namely, Fixed Pay, Flexible Pay and Benefits. Finally, the third hypothesis was based on finding the relationship between Valence of Outcome with Motivation due to Outcome. Again, both the variables here were divided into three components of Fixed Pay, Flexible Pay and Benefits. See Diagram 3 for illustration of the constructed Research Frame Work.

**Diagram 3. Research Frame Work**



Vroom's Theory: Motivation = Expectancy X Instrumentality X Valence

Components of Compensation = Fixed Pay, Flexible Pay, Benefits

Hypothesis-1; relates to the Expectancy part of Vroom's theory.

Hypothesis-2; relates to the Instrumentality part of Vroom's theory.

Hypothesis-3; relates to the Valence part of Vroom's theory.

In Hypothesis 2 and 3 Components of Compensation are incorporated to be able to measure the effect of individual components on motivation of employees.

**Hypothesis 1:** More the belief of an employee on his skills more will be his motivation level. There can be two variables in this hypothesis according to Vroom's Expectancy theory. One is the independent variable of Effort Performance Expectancy and other is the dependent variable of Motivation due to Self-Belief.

Effort Performance Expectancy → Motivation due to Self-Belief

There are four items in the questionnaire related to Effort-Performance Expectancy and one item is related to Motivation due to Self-Belief. Their relationship is tested by Linear Regression.

**Hypothesis 2:** More the employee's trust on management's promises to reward him more will be his motivation level. According to compensation components, reward can be of three types, fixed pay, flexible pay and benefits. Therefore, there is a need to have more variables to test this hypothesis.

If the reward is fixed pay, it will motivate employees

If the reward is flexible pay, it will motivate employees

If the reward is benefits, it will motivate employees

'Performance Outcome Instrumentality' is the independent variable which is tested with the dependent variable 'Motivation due to Outcome'. Further, 'Performance Outcome' is divided into three components namely, Performance Fixed Pay, Performance Flexible Pay and Performance Benefits. 'Motivation due to Outcome' is similarly divided into three components namely, Motivation Fixed Pay, Motivation Flexible Pay and Motivation Benefits. The division is done to check the effect of individual components of compensation on motivation.

Performance-Outcome Instrumentality → Motivation due to Outcome

Performance-Fixed Pay → Motivation due to Fixed Pay

Performance-Flexible Pay → Motivation due to Flexible Pay

Performance-Benefits → Motivation due to Benefits

There are five items related to Performance Outcome including the components and four related to Motivation including the components. The relationship of Performance-Outcome with Motivation due to Outcome was tested by linear regression. The relationships of Components of Compensation with Motivation are tested with Chi square.

**Hypothesis 3:** If the employee is rewarded with something he values, more will be his motivation. For this hypothesis, there is a need of three components as well to test their individual effect on motivation. Therefore;

If the reward is fixed pay, it will motivate the employee.

If the reward is flexible pay, it will motivate the employee.

If the reward is benefits, it will motivate the employee.

There are two major variables. One is 'Valence of Outcome' which is independent variable and the other is 'Motivation due to Valence' which is the dependent variable. There are three variables for the components of compensation, namely Valence of Fixed Pay, Valence of Flexible Pay and Valence of Benefits. Similarly, 'Motivation due to Valence' is divided into three components namely, Motivation due to fixed pay, Motivation due flexible pay and Motivation due to benefits.

Valence of Outcome → Motivation due to Valence

Valence of Fixed Pay → Motivation due to Fixed Pay

Valence of Flexible Pay → Motivation due to Flexible Pay

Valence of Benefits → Motivation due to Benefits

There are four items related to 'Valence of Outcome' in the questionnaire, including the items related to components and there are four items related to 'Motivation due to Valence', including the items related to components.

#### **4. Scope of the Research:**

The impact of intrinsic factors such as effect of 'job satisfaction' or 'organizational justice' on employee's motivation cannot be underestimated. However, the scope of this study is limited to measuring the effect of compensation (extrinsic factor) on motivation.

The study uses 'Expectancy' theory of Motivation to develop the research design. It focuses on three components of Expectancy theory; Expectancy can also be called Effort-Performance and Instrumentality can be defined as Performance-Outcome and Valence.

### **5. MEASUREMENT AND METHODS**

Convenient Sampling method was used to collect the data from both the banks. There were total 100 questionnaires distributed in various branches of the banks in Peshawar, Out of which 95 were returned. 51 were taken from Bank of Khyber (BOK) and 45 were taken from United Bank Limited (UBL). The branches of BOK from which data was collected were Saddar Road Branch, University Road Branch, Khyber Bazar and

City Branch. The branches of UBL from which data was collected were University Road Branch, Saddar Road Branch, University Town Branch and Cantt Branch. A clear description and purpose of the questionnaire was attached with it to help out the employees in filling out the questionnaire.

After data collection, SPSS software was used to analyze data, respondent's demographics include; age, sex, education and tenure. Proper independent and dependent variables were made for each item in the questionnaire using five point Likert Scale. They were organized according to the questions asked from the respondents and all were tested using Linear Regression and Chi Square. First four questions were related to measuring Effort-Performance Expectancy. The Question that followed it was related to Motivation due to Self-Belief. Linear Regression was used to check the hypothesis by checking the strength of relationship (R square value) and value of significant ( $p < 0.05$ ). Likewise, consequent three items in the questionnaire were related to Performance Outcome and Motivation due to Outcome on which Regression was used. Next, Questions were related to specific components of compensation and their effect on motivation. For example, one question each of Performance Fixed Pay and Valence of Fixed was asked followed by Motivation due to Fixed Pay. Then their relationship was found using Chi square. Chi Square is used to find relationship between two categorical variables. The same procedure was done for Performance Flexible Pay, Valence of Flexible Pay, Performance Benefits, and Valence of Benefits with Motivation due to Flexible Pay and Motivation due to Benefits respectively.

## 6. RESULTS AND ANALYSIS

### 6.1 Results of Bank of Khyber (BOK)

#### i. Regression Results

S.no		Adjusted R Square	P- Value	Beta	Remarks
Hypothesis 1	Effort- Performance & Motivation	.046	.131	.235	weak, Insignificant & Positive Relationship
Hypothesis 2	Performance Outcome & Motivation	.000	.972 <sup>a</sup>	No Need	No Relationship, Insignificant
Hypothesis 3	Valence of Outcome & Motivation	.084	0.39	.216	Strong, Significant & Positive Relationship

The results of Regression for BOK showed that Valence of Outcome is the most motivating factor having a R Square value of .084. The value of R ranges from 0 to 1, higher the value, stronger the relationship between the tested variables. This shows 8% association between the variables. The other two associations are not that strong; Effort Performance is showing only 4% association and the Performance of Outcome is not at all related. Therefore, BOK should motivate employees based on what they value. They should be asked of what kind of rewards motivates them, then that specific reward should be incorporated into their compensation packages.

#### ii. Chi Square Results

S.no	Individual Components	Chi Square Value	Asymp. Sig. (2Sided)	Remarks
1.	Performance Fixed Pay & Motivation	10.315 <sup>a</sup>	.588	Insignificant
2.	Valence of Fixed Pay & Motivation	15.936 <sup>a</sup>	.014	Significant
3.	Performance Flexible Pay & Motivation	9.157 <sup>a</sup>	.0689	Insignificant
4.	Valence of Flexible Pay & Motivation	74.669 <sup>a</sup>	.000	Significant
5.	Performance Benefits & Motivation	6.153 <sup>a</sup>	.630	Insignificant
6.	Valence of Benefits & Motivation	26.990 <sup>a</sup>	.000	Significant

The results of chi square for Compensation components showed that Valence of Flexible Pay is the most motivating factor for BOK employees having a value of 74.669. Conventionally, higher the value of chi square more the effect. It means that opinions of employees should be asked to know what motivates the employees more among all the types of flexible pays and accordingly they should be rewarded with it. The second most motivating factor according to chi square value is Valence of Benefits Pay. This implies that employee's value benefits like vacations, pensions, etc: and are motivated by them. The least motivating factor (chi square value of 6.153) is Performance Benefits. It means if certain benefits are tied to the performance of employees then they see it as a burden and not a motivating factor.

## 6.2 Results of United Bank Ltd

### i. Regression Results

S.No		Adjusted R Square	P Value	Beta	Remarks
Hypothesis 1	Effort- Performance & Motivation	.008	.557	-0.131	Very Weak, Insignificant & Negative Relationship
Hypothesis 2	Performance Outcome & Motivation	.049	.144	No Need	No Relationship, Insignificant
Hypothesis 3	Valence of Outcome & Motivation	.470	0.000	.598	Strong, Significant & Positive Relationship

The results of Regression for UBL showed that Valence of Outcome is the most motivating factor having a R-Square value of 0.470. Compared to BOK, employees at UBL are motivated more by benefits they value. This shows 47% association between the variables. The other two associations are not that strong. Effort Performance and Motivation are associated by only 0.8%. The Performance of Outcome and Motivation are also related by 4.9%. Therefore, the employees of UBL should be asked of what kind of rewards motivates them, and then accordingly that specific reward should be incorporated into their compensation packages.

### ii. Chi Square Results

S.no	Individual Components	Chi Square Value	Asymp. Sig. (2Sided)	Remarks
1.	Performance Fixed Pay & Motivation	15.191 <sup>a</sup>	.231	Insignificant
2.	Valence of Fixed Pay & Motivation	33.159 <sup>a</sup>	.000	Significant
3.	Performance Flexible Pay & Motivation	20.123 <sup>a</sup>	.065	Insignificant
4.	Valence of Flexible Pay & Motivation	43.810 <sup>a</sup>	.000	Significant
5.	Performance Benefits & Motivation	22.496 <sup>a</sup>	.128	Insignificant
6.	Valence of Benefits & Motivation	89.847 <sup>a</sup>	.000	Significant

The results of chi square for Compensation components showed that Valence of Benefits is the most motivating factor for UBL employees having a chi square value of 89.847. Conventionally, higher the value of Chi Square more the effect. This implies that employee's values benefits like vacations, pensions, etc: and are motivated by them. The opinions of employees should be asked as to what motivates them more among all the types of benefits and accordingly they should be rewarded with it. The second most important factor is the Valence of Flexible Pay and Motivation having Chi Square Value of 43.810. The least motivating factor to UBL employees is Performance based Fixed Pay. It means any fixed pay tied to the performance of employees does not motivate them.

## 7. Conclusion

The research design tested all three hypotheses for both the banks. Even though the values of regression and chi square for both the banks were different however; the results for all the hypotheses were similar. The results in the original study of Igalens and Roussel (1999) conducted in France were different from the research conducted here. There, Hypothesis 2 and 3 were disproved and hypothesis 1 was proved. But here Hypothesis 1 and 2 are disproved and Hypothesis 3 is proved. Clearly, there is a difference of perceptions (contextual differentiation) among employees of what motivates them and what not. According to the analysis, the employees of United Bank Ltd are not motivated because of Effort-Performance Expectancy and Performance-Outcome Instrumentality. Instead they are motivated because of Valence of Outcome. It means that employees of United Bank Ltd should be compensated only with rewards they value. They are least motivated because of the belief they place on their skills and the trust on the fact that they will be rewarded by management. Thus, Valence of Outcome is that component of Expectancy theory that has strong relationship with motivation of United Bank Ltd employees. Further, by same deduction it can be said that Hypothesis 1 and 2 are disproved and Hypothesis 3 is proved. On the other hand, component of Compensation that has more effect on motivation of United Bank Ltd employees is; Valence of Benefits. It means United Bank Ltd employees get motivated when the reward they get is benefits; that include vacations, severance pay, medical insurance, retirement benefits, etc.

Similarly, The Bank of Khyber employees are not motivated because of Effort-Performance Expectancy and Performance-Outcome Instrumentality. Instead, like the employees of UBL, they are also motivated because of Valence of Outcome. In other words, they are least motivated because of the trust they place on the

fact that they will be rewarded by management and the belief they place on their skills and are mostly motivated because of the reward they value. Thus, for this case too, Valence of Outcome, is that component of Expectancy theory that motivates the employees of the Bank of Khyber. Further, for this case; it can be said that Hypothesis 1 and 2 are disproved and Hypothesis 3 is proved. Lastly, the component of Compensation that has more effect on the motivation of employees is Valence of Flexible Pay. It means The Bank of Khyber Employees get motivated if the reward is Flexible Pay; that includes; employee stock owner Ships, profit sharing plans and commissions etc.

## 8. Future Recommendations

The study can be conducted for a larger sample size. More banks from private and public sector can be included as a sample. The area of study can be broadened, e.g. the study can be conducted for a single state, or even the whole country. Similarly, research can be conducted for different Organizations instead of banks.

Other motivation theories can be used to study the effect of compensation on motivation of employees. Theories like Two Factor theory can be used to distinguish motivation based on Extrinsic and Intrinsic factors.

Components of compensation could be divided into even further sub variables instead of seven variables e.g., it could have separate variables for Variable Pay and Deferred Income instead of putting them both under Flexible Pay. Similarly, separate variables for medical insurance and retirement benefits could be made instead of putting them under one variable of Benefits. By dividing the general variable into specific variables for each kind of compensation, effect of that variable could have been measured on motivation e.g. effect of medical insurance on motivation. But this could have increased the length of questionnaire and difficulty of making a Research Design.

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