Expectancy theory

Expectancy theory says that the attractiveness of any job is a function of valence, instrumentality and expectancy.

Expectancy theory says the attractiveness of any job is a function of valence (the desirability of the reward to a person), instrumentality (performance is perceived as securing the reward) and expectancy (the belief that his or her efforts will affect performance). This explains behaviours (job performance) at work in terms of the expectations people have in the workplace. Expectancy theory of motivation argues that the effort people make at work is based on the availability of a desired reward and the expectation that successful job performance will result in the achievement of this reward. Their job performance is then influenced by three factors: their ability to perform to this standard, a clear perception of their role, and the necessary organisational resources and support to perform their role. It follows, therefore, that good job performance could be motivated by providing rewards that are desired by people and by rewarding behaviours that contribute to organisational success. The achievement of desired rewards, however, is not sufficient to provide job satisfaction. Job satisfaction depends on the extent to which people believe the rewards they achieve are equitable. In circumstances where rewards are not regarded as equitable and job satisfaction is adversely affected, employees' efforts could be reduced.

Although expectancy theory implies that linking an increased amount of rewards to performance will increase motivation and performance, some authors have questioned this assumption, arguing that monetary rewards may increase extrinsic motivation but decrease intrinsic motivation. Extrinsic motivation depends on rewards (e.g. pay and benefits) controlled by an external source, whereas intrinsic motivation depends on rewards that flow naturally from work itself (e.g. performing interesting work).[13] In other words, paying a child to read books may diminish the child's natural interest in reading and the child may, in the future, be less likely to read books unless there are monetary incentives. Although monetary incentives may reduce intrinsic motivation in some settings (e.g. education), the evidence suggests that such effects are small and isolated in work settings. Therefore, while it is important to keep in mind that money is not the only effective way to motivate behaviour and that monetary rewards will not always be the answer to motivation problems, it does not appear that monetary rewards run much risk of compromising intrinsic motivation in most work settings.[14]

Agency theory

Principal in agency theory, the owner of a business; in HR management, may refer to a manager.

Agent in agency theory, a manager or one who acts on behalf of an owner (principal); in HR management, may refer to an employee.

This theory focuses on the divergent interests and goals of the organisation's stakeholders and the ways in which employee compensation can be used to align these interests and goals. We cover agency theory in some depth because it provides especially relevant implications for compensation design.

An important characteristic of the modern corporation is the separation of ownership from management (or control). Unlike the early stages of capitalism, where owner and manager were often the same, today, with some exceptions (mostly smaller companies), most stockholders are far removed from the day-to-day operation of companies. Although this separation has important advantages (e.g. mobility of financial capital and diversification of investment risk), it also creates agency costs—the interests of the **principals** (i.e. owners) and their **agents** (i.e. managers) may no longer converge. What is best for the agent, or manager, may not be best for the owner.

ATTRACTING AND RETAINING TALENT

Retaining talent with salary packaging

In some circumstances salary packaging is one way of making employees' salaries tax efficient and it can also be part of an effective attraction and retention strategy. It enables employees to exercise power over the way they receive their rewards. The most popular items included in salary packages are benefit vehicles (including novated leases), laptop computers, PDAs and employer superannuation contributions above the minimum superannuation guarantee scheme.

Optus and the Spastic Centre in New South Wales have both used salary packaging as a means of attracting and retaining employees. Optus developed its salary packaging arrangement when the company moved to a purpose-built campus at Macquarie Park. The childcare centre, gym, eight food and drink outlets and a licensed restaurant on the campus were added to the salary packaging offering. The legislation enables people to sacrifice for sustenance—not alcohol—consumed on the worksite. Optus leases the food outlets and the employees participating in the salary packaging scheme are able to swipe their ID cards at the point of sale. As a result, a withdrawal from their payroll is made and the food outlets are paid for the food. Employees pay $1 a week to access the scheme. Providing food on the new site was seen as the most important benefit for employees, and salary packaging was a way of meeting this need.

The Spastic Centre is a not-for-profit organisation and is allowed to offer up to $16 500 per year in salary-sacrificed expenses on anything, including a meal entertainment allowance. The Spastic Centre has had salary packaging for more than 12 years. Initially, it was introduced as a way for the organisation to pay at least market rates comparable to NGOs. It was also used to reduce turnover and it has been very effective in achieving this.

McDonald's: the power of recognition

McDonald's Australia is one of Australia's largest employers. The company and its franchises employ about 75 000 people. In 2008 it won an award as one of the best companies to work for in Australia, following a study by the Great Place to Work Institute.

McDonald's has a strong culture of developing its future leaders. Three of its managing directors of the last 30 years started as young 15-year-old employees. About 80 per cent of the restaurant managers started with McDonald's as part of a crew in the restaurant. Bringing people through the ranks of the company means they have a strong understanding of the focus and purpose of the business. A high proportion, about 70 per cent, of McDonald's staff are school students aged between 14 and 18 years. These staff provide a large pool of potential managers and leaders for the McDonald's organisation.

Frank McManus, senior vice president and director of people resources for McDonald's Australia, says that McDonald's has a culture that focuses on its people. McDonald's recognises that better-run operations, higher quality customer service, cleanliness and quality product result from investing in its people. Frank McManus says these result in higher return on investment.

Training and development is a very important part of ensuring McDonald's meets its standards and has the future leaders it requires. McDonald's Australia is a registered training organisation with an annual training budget of more than $40 million. A high proportion of this budget is spent on training the frontline crew. Succession planning is also emphasised. Succession plans are thoroughly examined at the quarterly business reviews. Frank McManus spends between 30 and 40 per cent of his time on executive development and talent management and argues that their approach to training is like building blocks.

McDonald's has a unique culture underpinned by five key strategies: people, products, place, price and promotion. A strong recognition culture has been instilled in the company. It has done this by running formal annual events and developing programs that operate at the restaurant and corporate level. The Crew Recognition Program operates at the store level. This program recognises crew members who have contributed to performance of the restaurant during their shift. High-performing staff are also recognised as employee of the month, quarter or year. These staff are named in the monthly staff magazine, WRAPT, and awarded a gift or discount card.

At the corporate level, there is an outstanding achievers award. Managers nominate employees who have either contributed significantly to the business strategy or delivered results above what is expected. The senior management team approves each recipient. The award is a $500 gift voucher and a formal recognition in front of their peers at the bi-annual staff meeting.

McDonald's seeks to be transparent in its HR processes. It has a structured approach to remuneration. This framework provides an objective framework for making pay decisions and provides a sound basis for explaining pay decisions to employees. It also provides equity between roles and ensures that individuals have a clear understanding of their total pay package.

continued

continued

The HR policies are building a strong company and an engaged workforce with the capabilities necessary to perform well. A national crew opinion survey found 92 per cent of staff believed they had received the training and information to do a good job. Almost as many, 84 per cent, said they had the opportunities to learn new skills at work. Managers are also very positive about McDonald's as an employer. A survey found 76 per cent of managers believed there were favourable career opportunities at McDonald's and that the person they reported to supported their training and development. A higher percentage believed they had access to the materials needed to support their development.

McDonald's promotes a strong team spirit. A number of HR policies and processes, including its award-winning recognition program, have developed a strong culture, which contributes to the attraction and retention of staff. It also contributes to maintaining a pool of potential leaders.

Source: Adapted from T. Russell, 2008, 'All packaged up', *Human Resources Leader*, 18 March, www.humanresources.com.au; C. Donaldson, 2009, 'A winning order', *Human Resources Leader*, 31 March, pp. 20–5.

CRITICAL THINKING QUESTIONS

1. Discuss how the recognition scheme supports the McDonald's culture and attracts future leaders in McDonald's.
2. Discuss which theory you think supports McDonald's recognition scheme.

Three types of agency costs arise in managerial compensation.[15] First, although shareholders seek to maximise their wealth, management may be spending money on things such as perquisites (e.g. 'superfluous' corporate jets) or 'empire building' (e.g. making acquisitions that do not add value to the company but may enhance the manager's prestige or pay). Second, managers and shareholders may differ in their attitudes towards risk. Shareholders can diversify their investments (and, thus, their risks) more easily than managers (whose only major source of income may be their job), so managers are typically more averse to risk. Thus, they may be less likely to pursue projects or acquisitions that have a high potential payoff. It also suggests a preference on the part of managers for relatively little risk in their pay (e.g. a high emphasis on base salary and a low emphasis on uncertain bonuses or incentives). Indeed, research shows that managerial compensation in manager-controlled firms is more often designed in this manner.[16] Third, decision-making horizons may differ. For example, if managers change companies more than owners change ownership, managers may be more likely to maximise short-run performance (and pay), perhaps at the expense of long-term success.

Agency theory is also of value in the analysis and design of non-managers' compensation. In this case, the divergence of interests may exist between managers (now in the role of principals) and their employees (who take on the role of agents).

In designing either managerial or non-managerial compensation, the key question is: how can such agency costs be minimised? Agency theory says that the principal must choose a contracting scheme that helps align the interests of the agent with the principal's own interests (i.e. reduces agency costs). These contracts can be classified as either behaviour oriented (e.g. merit pay) or outcome oriented (e.g. stock options, profit sharing and commissions).[17]

At first glance, outcome-oriented contracts seem to be the obvious solution. If profits are high, compensation goes up. If profits go down, compensation goes down. The interests of 'the company' and employees are aligned. An important drawback, however, is that such contracts increase the agent's risk; because agents are averse to risk, they may require higher pay (a compensating wage differential) to make up for the exposure to risk.[18]

Behaviour-based contracts, on the other hand, do not transfer risk to the agent; thus, they do not require a compensating wage differential. However, the principal must be able to monitor, with little cost, what the agent has done. Otherwise, the principal must either invest in monitoring and information, or structure the contract so that pay is linked at least partly to outcomes.[19]