

CONSIDERATIONS FOR AN EFFECTIVE INCENTIVE SYSTEM

Sung-Yong Chun
(sychun@hri.co.kr)

Incentive Systems Rare but Spreading

“**I**ncentive” has the meaning of “providing stimulus or encouragement”. More specifically, it refers to monetary or non-monetary benefits given to people to encourage production. An incentive system is an institution that provides rewards to employees by objective criteria.

There are three basic types of incentive systems: an annual salary system (performance-based pay), bonuses related to actual performance, and special bonuses as prizes. In addition to pecuniary compensation there are other various types of incentive, such as promotion, recognition, education and training, and flexible work-time.

Most Korean companies' wage systems are based on seniority. Generally, wage systems in Korean companies consist of basic salary, bonuses, various allowances, and fringe benefits. The incentive component in the current wage systems is very small and limited. However, some pioneering companies have begun to introduce performance-based incentive payment systems, which are becoming more and more popular among Korean firms. Among the various incentive systems, the annual salary system is a very popular one.

Incentive systems are spreading among many Korean companies as part of their efforts to overcome these difficult business times. It can help firms to appraise employees' performance correctly and reward them fairly. There is also increasing recognition of the value of the incentive system in enhancing

individuals' creativity and competence.

Cases of incentive system in Korea

Hyundai Electronics Industries: Performance-based Pay System

In 1999, HEI adopted a new performance-based pay system and enlarged the incentive range to up to 200% of standard annual salary. For example, if the standard annual salary is \$40,000, a total \$120,000 can be given to employees with a maximum \$80,000 incentive.

Samsung Group: New Incentive Practices

The Samsung Group recently adopted new human resource management practices. This means that the management perspective or emphasis has shifted from seniority to ability and performance, from equality-to equity and rational differentiation. More specifically, the company gives better posts to smart people and provides more pay and incentives to excellent performers. From March 1999, it adopted the new annual salary system for all hierarchical levels and enlarged the annual salary gaps by 30-40%.

Some pioneering companies have begun to introduce performance-based incentive payment systems, which are becoming more and more popular among Korean firms. Among the various incentive systems, the annual salary system is a very popular one.

More specifically, the incentive system comprises rapid promotions and financial benefits. Also the company is introducing stock options to the R&D workforce, core

Table 1. Cases of Incentive System

Company	Contents	Characteristics
Hyundai Electronics Industries Co., Ltd.	<ul style="list-style-type: none"> • Performance-based pay system • Strong incentive system 	<ul style="list-style-type: none"> • maximum incentive 200% of standard annual salary
Samsung Everland Inc.	<ul style="list-style-type: none"> • Annual salary system • Strong incentive system 	<ul style="list-style-type: none"> • annual salary gap 60% • 5% incentive out of employee's contribution
IBM Korea	<ul style="list-style-type: none"> • Group Bonus System • Cafeteria Fringe Benefit Plan 	<ul style="list-style-type: none"> • group bonus due to management result • fringe benefit according to employee's need
Hana Bank	<ul style="list-style-type: none"> • Stock option 	<ul style="list-style-type: none"> • applies to the president, directors, and first grade managers

managers, and excellent performers. Samsung Everland Inc., a member company, adopted a strong incentive system that enlarges the annual salary gap by 60% and gives an incentive of 5% of the sales growth which is attributed to its employee's contribution. For example, if a employee significantly contributes \$200,000 to company profit, he or she could get \$10,000 as an incentive.

IBM Korea: Group Bonuses and Cafeteria Fringe Benefit Plan

IBM Korea has a strong incentive system which is applied to the overall human resource management practices. It includes not only an

incentive pay system but also an incentive fringe benefit system among others. One characteristic is that it emphasizes team spirit or collective performance as well as individual perfor-

mance. Their bonus system is an example. The amount of bonus to each employee tightly depends on the company's performance, not just on his or her individual performance. For example, when the company set the basic bonus at 500%, if the company achieves its management goal, it provides 600% as bonus.

If the company does far better than management goals, it gives 700% as bonus to its employees.

The Cafeteria Fringe Benefit Plan gives employees the opportunity to choose out of a benefit menu depending on their needs and preferences. Under this plan, each employee can get various fringe benefits according to his or her needs.

Hana Bank : Stock option system

Recently, Hana Bank introduced a stock option system that applies to the president, directors, and first grade team managers. The exercise price is 10,200 won, and holding requirement is 3 years.

Considerations for an Effective Incentive System

An Incentive system is an effective way to motivate people and enhance organizational performance. In order to operate this system, however, a firm must design it carefully.

First, the company should be clear on its performance evaluation criteria for incentives and methods for providing incentives. Performance evaluation criteria for incentives ought to be objective as much as possible and related to performance. The methods of

The company should be clear on its performance evaluation criteria for incentives and methods for providing incentives. . . . the contents of incentives ought to reflect employees' needs.

CURRENT ISSUES

providing incentives must be defined as specifically as performance standard. The company must define clearly the method considering both the motivational effect on employees and actual feasibility.

Second, the contents of incentives ought to reflect employees' needs. The incentive system should analyze and accept employee needs properly since they often vary. The incentives themselves must be attractive to employees. For example, financial and non-financial incentives ought to be combined carefully depending on employees' preferences. As for R&D workforce, for example, it might be more effective to give non-financial incentives such as recognition or awards.

Third, the incentive system needs continuous improvement. Due to changes in the management environment and strategy,

the goal and direction of incentives will change. For effective motivation of people, it is necessary to correct or fine-tune the incentive system regularly. The company must consider a performance appraisal system, feedback, and organizational goal setting system. The incentive system should integrate these systems.

Finally, it is necessary to understand characteristics of organizational cultures. In general, Korean companies have until placed priority on seniority-based human resource management, emotional management practices, equality-centered morals, and human relationships. Therefore, for an effective and realistic incentive system, the company should consider these factors and combine them with the company's unique organizational policies. 