THE IMPACT OF REWARD MANAGEMENT ON PERFORMANCE MANAGEMENT EFFECTIVENESS

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Abstract

Organizations increasingly recognize employees as a critical source of competitive advantage. Consequently, effective performance management and reward systems have become essential tools for improving employee motivation, productivity, and organizational success. This paper provides a theoretical review of the principles of reward and performance management and examines the relationship between these two human resource management functions. The study analyzes the concepts, objectives, and components of performance management and reward management, including financial and non-financial rewards, total reward strategies, and performance-based compensation systems. The review also explores how organizational characteristics such as culture, size, and structure influence the design and implementation of reward and performance management practices. The findings suggest that aligning rewards with performance outcomes strengthens employee motivation, enhances organizational commitment, and improves overall performance. Furthermore, organizations that integrate reward strategies with business objectives and performance management systems are more likely to achieve sustainable organizational effectiveness. The paper concludes that a well-designed reward system is a key factor in maximizing the effectiveness of performance management and supporting long-term organizational success.

Keywords: reward management, performance management, employee motivation, total rewards, performance appraisal, compensation, organizational performance, human resource management.

Introduction

In the contemporary business environment, organizations face increasing pressure to improve productivity, attract talented employees, and maintain a competitive advantage. Human resources are widely regarded as one of the most valuable organizational assets, making effective employee management a strategic priority. Among the various human resource management practices, performance management and reward management play a central role in influencing employee behavior, motivation, and organizational outcomes.

Performance management is a continuous process that enables organizations to align individual and team performance with strategic objectives. Through goal setting, performance evaluation, feedback, and employee development, performance management contributes to improved efficiency and organizational effectiveness. However, the success of performance management systems often depends on whether employees perceive a clear connection between their efforts, performance outcomes, and rewards.

Reward management encompasses the policies and practices used to recognize and compensate employee contributions. Modern reward systems extend beyond traditional financial compensation and increasingly incorporate non-financial rewards such as recognition, career development opportunities, work-life balance initiatives, and employee well-being programs. Research suggests that employees are more motivated and committed when reward systems are perceived as fair, transparent, and linked to performance achievements.

The integration of reward management with performance management has attracted significant attention in both academic literature and organizational practice. Effective reward systems reinforce desired behaviors, encourage high performance, and support organizational goals. At the same time, organizational factors such as culture, size, ownership structure, and strategic priorities influence the design and effectiveness of these systems.

This paper aims to review the theoretical foundations of reward and performance management and to examine how reward systems contribute to the effectiveness of performance management. Particular attention is given to the role of motivation, performance-based rewards, and organizational characteristics in shaping successful reward and performance management practices.

Theoretical review of reward and performance management principles

Aguinis (2013) describe the performance management as a “continuous process of identifying, measuring, and developing the performance of individuals and teams and aligning performance with the strategic goals of the organization”. Performance management includes clarifying job responsibilities and performance criteria, reviewing and discussing achievements with employees (Dessler, 2010). According to Schuler, and MacMillan, (1984) establishing a relationship between individual achievement and consequences is one of the most important things that performance management systems can do. Performance management helps to: increase staff dedication to the company strategy; improve quality of the organization; ability to measure and improve individual and team performance; identify staff knowledge and competencies; design fair rewards strategy; develop a performance culture. A performance management system's effectiveness may be influenced by a variety of aspects, and many of them have been empirically investigated in the literature to assess their impact. For example, Edward and Lawler, (2003) in their research demonstrate that performance management effectiveness improves when continuous feedback is provided, predefined targets are specified, and trained rates are used. One of the possible indicators of effective performance management system effectiveness is the relationship between the results of the performance management system and meaningful rewards (Lawler 2000).

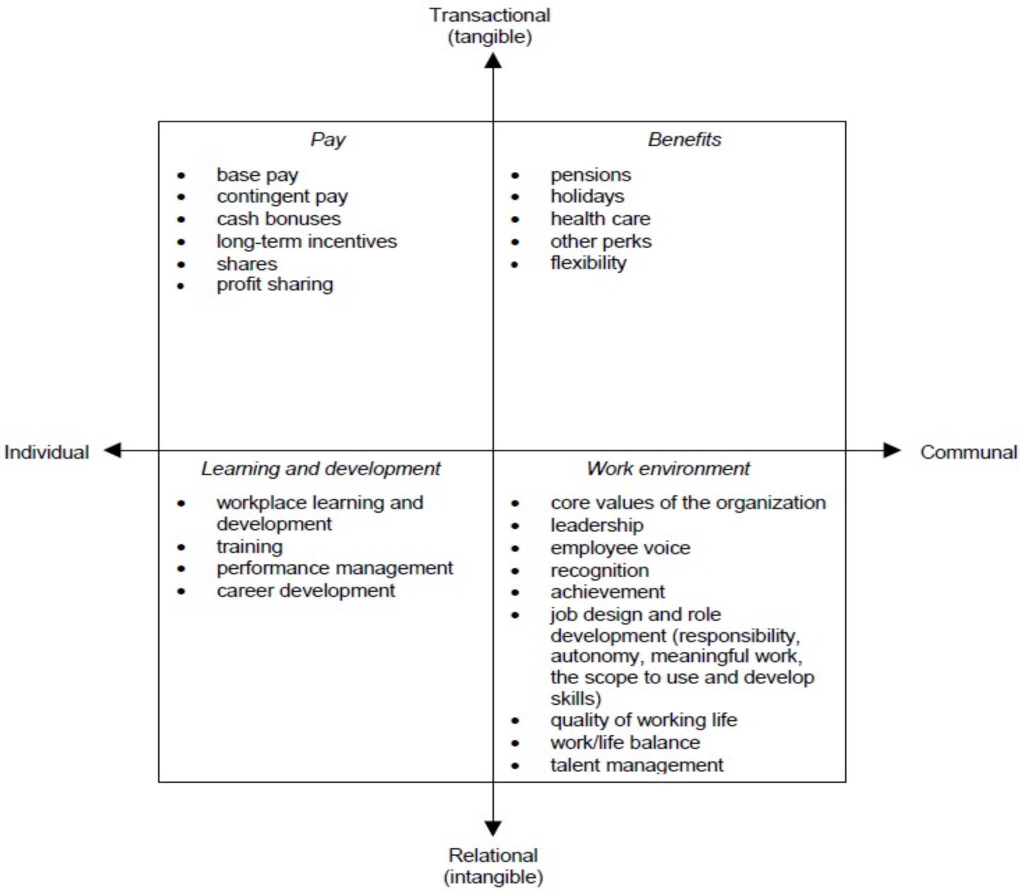
Rewards are a management technique that revolves around the constructs of motivation and commitment that influence performance (Jensen et al., 2007). Rewards management contains systems, programs and practices that encourage desired employees' behaviour. Pareke, (2005) concluded that reward management referred to strategies policies and processes necessary to secure that employees' contribution is acknowledged through financial and non-financial ways.

There are three key drivers of reward management is described in the literature: (1) *internal relativities* – fairness, job evaluation system, grading and pay structure; (2) *external relativities* – consideration of market rate pay to recruit and retain talent; (3) *performance* – affordability including achievement of annual objectives and long term contribution and potential. According to Gheno and Berlitz, (2011) and Marras, (2012) rewards consists of three factors: (1) functional payment, which combines job and salary plans based on the role; (2) variable compensation is based on the acknowledgment of worker's contributions; (3) benefits such as medical and life insurance, transportation, food and others. However, Sarvadi, (2010) mentioned also recognition and appreciation as an important component of the reward system. There are two types of rewards are discussed in the literature: *monetary* – rewards with cash value identity (base pay, contingent and variable pay, bonus pay, benefits etc.); *nonmonetary* – focus on people needs (recognition, achievement, autonomy, challenge, work-life balance, personal growth, trainings, etc.). Non-financial rewards also subdivided into: *individual extrinsic* rewards – praise, feedback; *collective extrinsic* – work-life balance, employee well-being, learning and development opportunities; *individual intrinsic rewards* – opportunity to grow, fulfilling work, autonomy; *collective intrinsic* – work system design, quality of working life. Rewards in the organisation can be distributed based on (1) *job based pay* – employee's duties and responsibilities; (2) *person-based pay* – employee's qualifications; (3) *performance based pay* – individual or group performance (employees' contributions to the organisation).

According to Graham (2003) total reward includes all aspects of reward system namely financial and non-financial; direct and indirect reward; intrinsic and extrinsic. CIPD, (2021) defines characteristics of total rewards strategy:

- Holistic – focuses how organisation attract, retain and motivate employees
- Best fit – focuses on culture and work process of the organisation
- Integrative – rewards strategy is integrated with HR policies, practises and performance management
- Strategic – rewards strategy lies with business strategy
- People-centred – focuses on employees needs and values
- Customized – provide choice in reward system
- Distinctive – uses a diverse set of rewards to create a powerful and unique employer brand
- Evolutionary – long-term approach based on incremental change

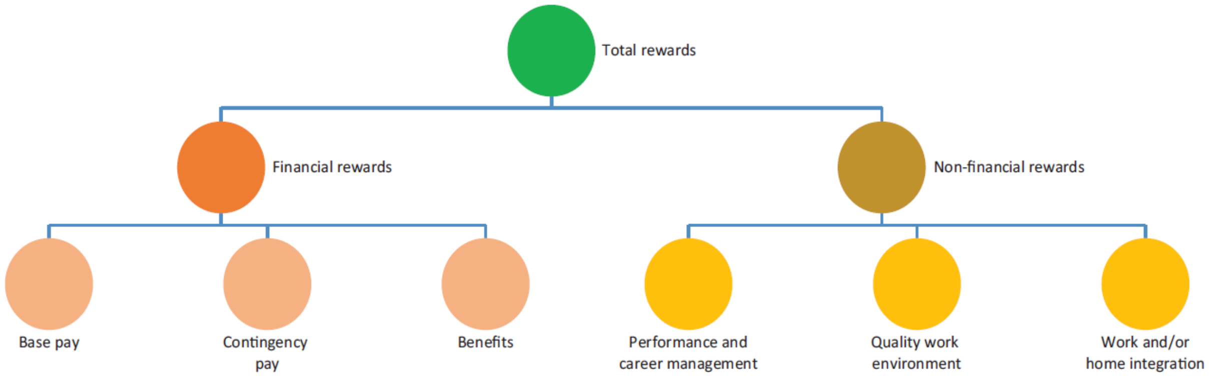
Total reward model:



Source: Armstrong, M., (2007).

Transactional rewards are represented by the upper two parts are pay and benefits. These factors are necessary for recruiting and retaining employees, they are easily copied by competitors. The relational (non-financial) factors generated by the lower two quadrants are critical for increasing the value of the upper two quadrants and are more difficult to copy by rivals. The most effective way is to mix both relational and transactional rewards models.

Total rewards components:



Base pay	**Performance and career management**
Monthly salary	Monthly communication sessions with management on business progress
Merit increases linked to personal performance	Constructive and honest feedback on performance
Merit increases linked to inflation not personal performance	Opportunities to rotate and experience different types of jobs
The ability to structure remuneration according to personal needs	Growth opportunities, learning and development
	Bursaries for tertiary qualifications
	Coaching and mentoring
	Formal and informal recognition
	Control over own work methods
	Career path planning aligned with personal goals and interests
	Challenging job that tests abilities
	Accountable for job outputs
	International secondments
Contingency pay	**Quality work environment**
Annual performance bonus	Good relationship with colleagues
Shares/share options	Comfortable working environment
Bonus allocations linked to personal performance	On-site fitness centre, restaurant, medical centre and convenience store
Bonus allocations linked to the team performance	Personal safety and security in the workplace
	Quality of co-workers in the team
	Management encourage team performance
Benefits	**Work–home integration**
Medical aid	Flexible working hours
Retirement & disability	Employer provides holiday programmes for children
Study leave	Subsidy for financially dependent parents
Sabbatical leave	Ability to log into the employer's network from home
Dedicated parking bay	Laptop and 3G card are required to perform optimally
Subsidised tuition for children	Phased in return to work after maternity/paternity leave
Financial assistance to buy a house	

Source: Nienaber, R., (2010).

Reward management helps in such areas as employee retention, recruitment, developing performance. The aim of reward management is to compensate individuals fairly, equally and consistently in a line with their contribution to the organization. Managers should develop a system to evaluate aspects for positive desired behavior (working overtime, taking initiative, teamwork, attendance, meeting deadlines, productivity, etc.) so that compensation is provided accordingly. When employees do not recognise a direct tie between job performance and the reward system they start to decrease their effort and performance and it is also may lead employees to leave the organisation. Employee performance and motivation may be increased by creating a clear relationship between employees input and reward by stating individual objectives, according to performance evaluation (Latham et al., 2005). Schwartz (1999) pointed out that reward helps to satisfy the needs that motivate individuals to work, however, the particular values that lead and influence employees' actions, behavior, and evaluations should not be overlooked. Values are defined as what a person finds attractive in various aspects of life, which guide their behavior, allow them to evaluate situations, and clarify their actions. In order to drive organisation performance above the market unique reward systems that is aligned with business strategy, structure and culture should be developed.

According to Saeid Aarabi et al., (2013) motivation is a crucial element of the performance model. This is because more effort leads to increase in performance, and greater performance leads to higher rewards. The performance may fall if this relationship is not recognized (Murray and Gerhart, 1998). According to motivation theories, if an organization does not enable employees to keep or exceed their expectations, emotions of dissatisfaction may arise what in turn may decrease performance and, as a result, fall in organizational goals achievement. Employees are most motivated when they confident that their actions will result in desirable outcome. As a result, motivation is the best explanation for the reward and its impact on performance. According to Vroom (1964), the reward is significant to each individual and should be provided based on personal values. Vroom's Expectancy Theory concludes that workers will behave in such way that they believe will result in the achievement of specific outcomes they value. According to Lawler, (2000) proper way of pay for performance may increase employees' motivation to perform well. Extrinsic reward that is when clearly and directly related to performance behavior is one of the quite powerful methods to inspire and motivate staff. According to MacKenzie, Podsakoff and Paine, (2000) feedback on performance may also improve motivation and cooperation due to the fact that feedback develops communication between supervisors and employees, promotes organizational openness and increases employees trust and loyalty.

Henderson (1989) in his research identified two key performance characteristics that are related to reward systems: results – how planned goals are met; and how results are accomplished in terms of output quality, competencies, and professional growth. While, Hakala, (2008) and Armstrong, (2006) developed the additional factors for evaluating employees performance: customer satisfaction; timeliness – how fast work is done by the employee; absenteeism; achievement – exceeding the targets. According to Maund, (2001) rewards can be used to enhance performance (exceed the goals). Literature proves that when employees are valued and appreciated, they approach increasing performance. Thomson and Rampton, (2003) mentioned that frequent rewards considerably rise performance. It was also highlighted that personalizing reward system is more valued by employees compared with team compensation. It is acceptable to suggest that tying rewards to performance evaluation results would lead to more effective performance management systems. Managers will be more interested in providing a good outcome since the result of the appraisal will have a substantial influence on their ability to assign performance-based rewards and encourage employees.

However, several constraints to practical implementation of performance assessment have been identified in the literature (Beer and Cannon, 2004; Latham et al., 2005): (1) asymmetry information issues occur between the assessed and the evaluators; (2) wrong metrics and targets; (3) situational limitations, which are beyond the control of individuals; (4) improper communication strategy; (5) rise organizational challenges (e.g., perceptions of fairness and justice in assessments), as well as interpersonal interactions that lead to workplace conflicts.

According to Datta, (2012) unproductive rewards system may lead to the following consequences:

- decrease in motivation and performance that leads to decline in total organisational productivity and effectiveness;
- increased of staff turnover rate;
- rise of inequity feeling among employees;
- internal conflicts;
- lost in trust and loyalty towards organisation;

Performance appraisal is a key element in performance management that helps to define employees performance. Performance appraisal usually used for making personnel decisions (promotion and pay) and employee development (feedback and training). According to Boyd and Ken (2004) and Weiss (2001) one of the main purposes of performance appraisal is to find out employee's work results as a way to come up with justified compensation. Lawler (2003) concluded that connecting rewards to performance appraisals leads to more effective performance management systems. He pointed out that performance appraisals which are related to salary and bonuses increases are more effective.

Influence of organization's characteristics on reward and performance management strategies

Reward strategy as well as performance management vary depending on organizational size and characteristics such as culture, structural characteristics, and others.

Organizational culture is an important aspect due to the fact that it offers employees a unified understanding of the behaviors that the company values and will reward. According to Kirkman and Shapiro, (1997) in organisations with collectivistic cultures it is more effective to use team-based compensation system. Compensation system is an important part of company strategy since it should ideally complement and reinforce the organization's mission (Milkovich, 1988). The connection between rewards and organizational strategy promotes to an organisational performance by highlighting and rewarding behaviors relevant to the organization's objectives.

The literature mentions that organisational size has directly influence on rewards and performance system. As an organization grows in size, its structures get more complex, specialization and coordination mechanisms are increase (Daft, 1995). It was concluded by the researcher that small companies are able to do introduction and monitoring team compensation systems more effectively than larger organisations. Small organizations have a lower budget compared to large ones, which in turn forces companies to react and adapt to market transformation more quickly in order to stay competitive in the market. Considering market position for small or medium-sized companies, it can be concluded that it is almost impossible to compete with big organizations and apply a leading market position. Small or medium-size companies may choose match the market or lag position. However, in order to be attractive and retain talents it is recommended to apply match market position (wages correspond to market prices). Low budget also affects on the company resources availability such as expenses on operational costs, inventory, equipment, employees' salaries and others. A small budget does not allow the company to provide high salaries to employees and has an influence on the number of staff hired, which in turn affects the workload and stress of each employee. Performance management seems to be easier for small companies, due to the fact that it is simpler to recognize the contribution of individual employees, mark out valuable staff, and reward and recognize employees' efforts in a small team than in big organizations. Individual contribution might be unnoticed or not rewarded properly in large group environment which in turn leads to performance and motivation decrease.

Size and ownership also effect on grade and pay structure of the organisation. A grade structure is a series or hierarchy of grades, bands, or levels into which groups of jobs or roughly equivalent size are classified (Armstrong and Murlis, 2007). According to CIPD, (2019) "a pay structure is a collection of wage grades, levels or bands that link related jobs within a hierarchy or series, providing a framework to implement reward strategies and policies". Pay structure includes grades number within the structure and the scale of each group (the percentage difference between grades). Pay and grade structure is usually used by big organizations due to the fact that in small companies, the list of jobs that could be placed within each grade may not even exist – the first and main factor for grade and pay structure.

A pay structure is used for:

- align the reward system with the intended organizational design, defining distinct levels of job and compensation ranges;
- organize and clarify the process of handling wage raises and career growth;
- provide opportunities for wage advancement based on performance, competence, contribution, or service;
- assist in ensuring fairness and legality in payment.

In small and private organizations, all the mentioned factors above may work in an informal way. For example, career growth and wage increase can be discussed and agreed with the owner of the firm without clear pay structure system.

CIPD (2019) conducted the research of using pay structure by sectors and size of the organisations. From the table, it can be concluded that small companies use a pay structure less compared to large ones, and payments in such companies are more informal.

Table 1: Who uses pay structures? (%)

NOTE: Figures throughout the tables presented on this and the following pages are percentage of cases – that is, percentage of respondents who answered that question/combination of questions.

	Yes	No
All	60	40
By sector		
Manufacturing and production	47	53
Private sector services, of which:	51	49
Retail, hospitality, catering, leisure and cleaning	63	38
Legal, financial, technology and other professional services	43	57
Other private sector	53	47
Public services	93	7
Voluntary, community, not-for-profit	72	28
By size		
SME (<250)	46	54
Large (250–9,999)	79	21
Very large (10,000+)	92	8

n=465

The organizational setting is the most crucial component. By choosing the pay structure system the organization's culture, the types and diversity of individuals employed must all be considered, as well as the amount to which they are ready for and will embrace change when it arrives. In addition, the organization's ability to develop, launch, and manage a new structure, as well as the money available to finance its adoption, must be addressed.

Conclusion

The review of the literature demonstrates that reward management and performance management are closely interconnected and mutually reinforcing organizational practices. Performance management provides a framework for defining, measuring, and improving employee performance, while reward management creates incentives that encourage employees to achieve desired outcomes and contribute to organizational success.

The findings indicate that employees are more likely to demonstrate higher levels of motivation, commitment, and performance when rewards are directly linked to individual and team achievements. Both financial and non-financial rewards play important roles in satisfying employee needs and supporting positive workplace behavior. The total rewards approach, which combines monetary compensation with recognition, development opportunities, and work-life balance initiatives, offers a comprehensive strategy for attracting, motivating, and retaining talent.

The review also highlights that organizational context significantly influences the design and implementation of reward and performance management systems. Factors such as organizational culture, size, structure, and available resources determine the suitability of specific reward strategies and performance evaluation methods. Therefore, organizations should avoid adopting standardized approaches and instead develop reward systems that align with their strategic objectives, workforce characteristics, and organizational values.

In conclusion, the effectiveness of performance management can be substantially enhanced through the implementation of fair, transparent, and strategically aligned reward systems. Organizations that successfully integrate reward management with performance management are better positioned to improve employee engagement, strengthen organizational performance, and achieve long-term sustainable growth.

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