



Testimony

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HUMAN CAPITAL

Using Incentives to Motivate and Reward High Performance

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Human Capital: Using Incentives To Motivate And Reward High Performance

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the role of incentive programs in motivating and rewarding federal employees to achieve high performance that supports agency missions and goals. An agency's workforce defines its character and its capacity for performance. Thus, if federal agencies are to make major improvements in performance-based management as envisioned by the Government Performance and Results Act (GPRA), they must strategically manage their most important asset—their human capital—to achieve results.

Incentive programs can be an important part of performance management systems because they can serve to align employee performance expectations with agency missions and goals as well as reinforce personal accountability for high performance. Effective incentive programs that motivate all employees, and reward those employees, teams, and organizational units whose performance exceeds expectations, can help federal agencies maximize the results they achieve.

My statement makes three main points:

- First, federal agencies have broad statutory and regulatory authority to design and implement a variety of incentive programs, including monetary incentives (such as performance and other cash awards) and nonmonetary incentives (such as plaques, trophies, and personal expressions of gratitude and support from superiors) to directly support their unique missions, goals, and organizational cultures. No one incentive program is optimal for all situations.
- Second, the use of monetary incentive programs has varied over time and across agencies. Over the past 5 years, agencies have decreased their use of performance awards and increased their use of other monetary incentives. The proportion of employees who received monetary performance awards varied by individual agency, ranging from less than 1 percent to as much as 75 percent of an agency's workforce. Little is known about the use of nonmonetary incentives, because they are more difficult to measure and are generally not adequately documented across the government. The variation in monetary incentive awards may be attributed to such factors as differing budgetary limitations and leadership support for these programs.
- Finally, some agencies regularly monitor and evaluate the effectiveness of their incentive programs; however, many others have reported that they

did not know whether their incentive programs were effective in motivating their employees to exceed expectations in support of missions and goals. In doing such an assessment, agencies may wish to consider the extent to which their programs incorporate the key elements of incentive programs used by high-performing organizations. These elements include leadership support; clearly defined and transparent criteria; use of multiple awards for both individuals and teams; targeting only high-performing teams and employees; publicizing awards; and regularly monitoring, evaluating, and if needed, updating incentive programs on a periodic basis.

My statement today is based on our ongoing and previous work reviewing the human capital management of federal agencies and high-performing private sector organizations.¹ We also reviewed information from the Office of Personnel Management's (OPM) Central Personnel Data File (CPDF) and recent reports regarding federal agencies' use of incentives as well as the current human capital literature.

Federal Agencies Have Broad Authority to Design Incentive Programs

Federal agencies have broad statutory and regulatory authority to design and implement incentive programs that make use of a range of incentives—both monetary and nonmonetary. No one incentive program is right for all situations, because no one program will motivate all employees under all circumstances. Agencies' authority allows them to develop multiple incentive programs that support their missions and goals; reflect their unique organizational cultures; appeal to employees' varying motivations; and provide the flexibility to reward individuals, teams, and other subgroups of employees.

Monetary Incentives

Federal agencies have broad authority to implement monetary incentives that motivate and reward employees for high performance.² Specifically, federal executive agencies can offer performance and other types of monetary incentives, as described below:

¹For examples of our recent examinations of human capital management in high-performing organizations, see *Human Capital: Managing Human Capital in the 21st Century* (GAO/T-GGD-00-77, Mar. 9, 2000), *Human Capital: Key Principles From Nine Private Sector Organizations* (GAO/GGD-00-28, Jan. 31, 2000), *Human Capital: A Self-Assessment Checklist for Agency Leaders—Discussion Draft* (GAO/GGD-99-179, Sept. 1999), and *Performance Management: Aligning Employee Performance With Agency Goals at Six Results Act Pilots* (GAO/GGD-98-162, Sept. 4, 1998).

²Agencies are also authorized to implement incentives that (1) attract and reward job candidates with unique skills who accept positions with the federal government and (2) retain and reward highly-skilled employees who could seek employment elsewhere. These incentives include recruitment incentives, relocation incentives, and retention incentives.

- **Performance awards** are monetary incentives that reward employees for performance exceeding expectations, as defined by their formal performance ratings of record during an appraisal period.

Other monetary incentives include the following:

- **Special act or service awards** are one-time, lump-sum monetary awards for employees whose specific accomplishments exceed performance expectations during the course of a year. Special act or service awards are limited in amount and can be authorized by first-line supervisors.
- **Quality step increases** are monetary awards that provide employees with faster than normal progression through the stepped rates of the general schedule and represent a permanent increase in basic pay.
- **Time-off awards** are awards granting employees leave without charging their annual leave or requiring that they forego pay.³
- **Gainsharing** is an incentive system that creates conditions under which management and employees benefit by working together to achieve improved productivity. Under a gainsharing system, an agency measures gains in productivity and distributes any associated savings to both employees and the organization.

Agencies have frequently used monetary incentives to motivate and reward employees' high performance, and federal employees have generally stated that they believe these incentives do motivate employees. However, some agency officials and employees have told us that there were some disadvantages to these incentives. For example, officials and employees alike have stated that monetary rewards can be an ineffective motivator because of the relatively low dollar amounts involved and the belief that these awards were not directly linked to performance. In particular, officials and employees have expressed concerns about the consistency and fairness of those monetary awards linked to ineffective performance appraisal systems. Monetary incentives may also foster internal competition among employees to the detriment of teamwork and the agency's ability to achieve its mission and goals. Moreover, monetary incentives that are consistently awarded over time may come to be viewed as entitlements for expected performance rather than rewards for

³Although time-off awards are not cash awards for employees and cannot be converted to cash, we have characterized these awards as monetary incentives because they can represent a significant dollar cost to agencies and because they allow employees to receive their normal pay without being charged annual leave for time off.

exceptional performance. Thus, care must be taken in designing and implementing monetary award programs to ensure that they are effective and to limit any unintended consequences.

Nonmonetary Incentives

Federal agencies also have the authority to implement nonmonetary incentives to motivate and reward employees. For example, agencies can offer employees medals, certificates, plaques, trophies, and other tangible incentives that have an award or honor connotation. Agencies can also provide intangible nonmonetary awards. For example, employees may have an incentive to perform at levels exceeding expectations if they believe that such performance will be rewarded when agency leaders make decisions regarding organizational priorities; the allocation of resources, including training opportunities; and the assignment of employees to meaningful, challenging, visible, or prestigious work. Nonmonetary incentives should not be overlooked or undervalued, because some agency officials and employees have stated that these incentives provide more motivation for high performance than do monetary incentives.

Federal Agencies' Use of Incentives Varies

Based upon a review of available data from an OPM database, we found that agencies' use of monetary incentives has varied over time and across agencies over the last 5 years.⁴ Governmentwide, agencies decreased their use of performance awards and increased their use of other monetary awards from fiscal year 1995 to 1999. Individual agencies provided different average award amounts to different proportions of their workforce. Little is known about the use of nonmonetary incentives, because these awards are not easily measured and are generally not documented.

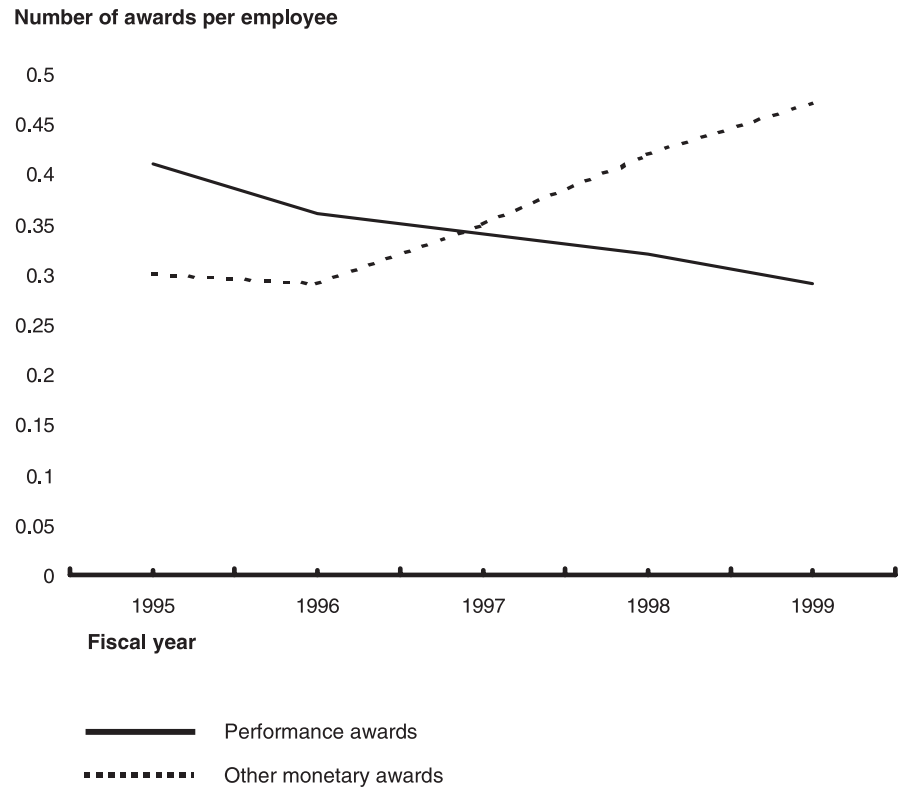
Agency officials have stated that the variation may be attributed to agencies' broad authority and flexibility to design incentive programs, as well as to the difficulty some agencies may experience in designing incentive programs that support their unique missions and goals. Agency officials who stated that they had difficulty in designing and implementing incentive programs said that several factors inhibited their efforts, including budget limitations and leaders' differing support for incentive programs.

⁴ We used the incentives information available from OPM's CPDF for the 24 agencies covered by the Chief Financial Officers (CFO) Act—these agencies employ approximately 98 percent of the federal government's total career civilian workforce, excluding the United States Postal Service.

Governmentwide Use of Monetary Incentives Varied Over Time

Federal agencies' use of monetary incentives has varied over the last 5 years. From 1995 to 1999, the 24 CFO agencies included in our review decreased their use of performance awards (including the number of awards given as well as the average award amount per employee), while they increased their use of other monetary awards. As shown in figure 1, agencies rewarded approximately 4 out of 10 employees on average with performance awards in fiscal year 1995 compared with approximately 3 out of 10 employees in fiscal year 1999. On the other hand, agencies rewarded an average of approximately 3 out of 10 employees with other monetary awards in fiscal year 1995 compared with nearly 5 out of 10 employees in fiscal year 1999.

Figure 1: Average Number of Monetary Incentive Awards per Employee for the 24 CFO Agencies, Fiscal Years 1995-1999



Note 1: We did not include SES awards in our calculations.

Note 2: We calculated the "average number of awards per employee" by dividing the total number of awards by the total number of employees eligible to receive the awards (not the number of employees who actually received an award) to facilitate meaningful trend analyses that would not be affected by the changing number of employees in the workforce over time.

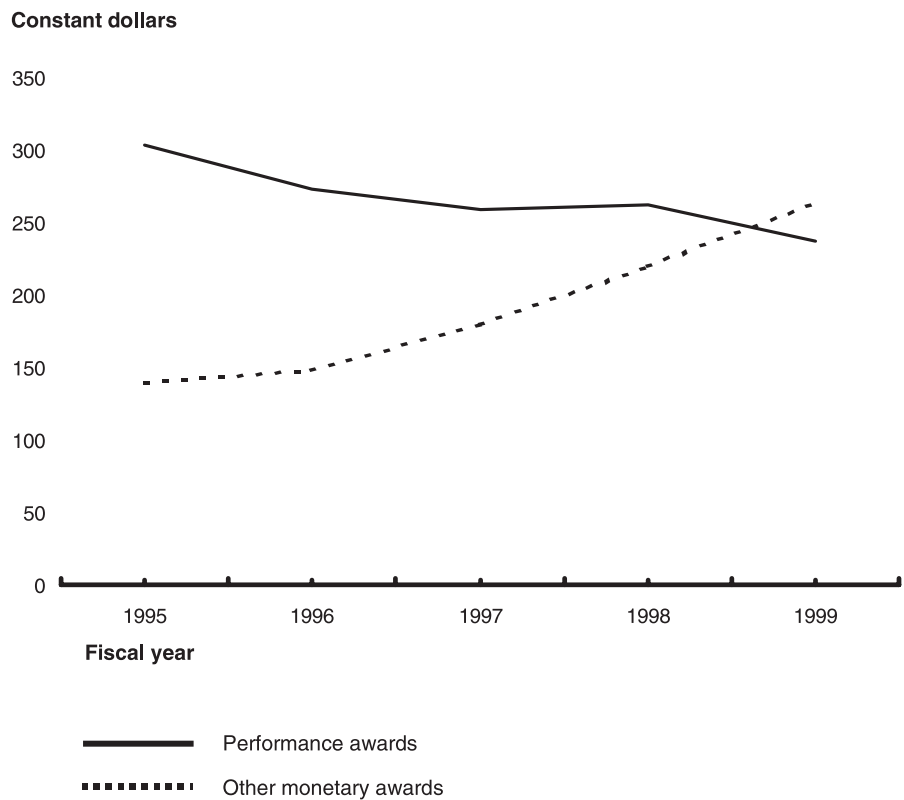
Note 3: "Other monetary awards" include gainsharing, suggestion, invention, special act, and quality step increase awards. We did not include time-off awards in the calculations because they were measured in hours rather than dollars.

Source: GAO calculations based on OPM data.

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Similarly, as shown in figure 2, agencies' spending on performance awards decreased from an average rate of about \$300 per employee in fiscal year 1995 to an average rate of about \$240 per employee in fiscal year 1999.⁵ Over the same period, agencies' spending on other monetary incentives increased from an average rate of about \$140 per employee to an average rate of about \$260 per employee.

Figure 2: Average Dollar Amount of Monetary Incentive Awards per Employee for the 24 CFO Agencies, Fiscal Years 1995-1999



Note 1: We did not include SES awards in our calculations

Note 2: We calculated the "average award amount per employee" by dividing the total dollar amount of awards by the total number of employees eligible to receive the awards (not the number of employees who actually received an award) to facilitate meaningful trend analyses that would not be affected by the changing number of employees in the workforce over time.

Note 3: "Other monetary awards" include gainsharing, suggestion, invention, special act, and quality step increase awards. We did not include time-off awards in the calculations because they were measured in hours rather than dollars.

Note 4: Dollar amounts were calculated using fiscal year 1999 constant dollars.

Source: GAO calculations based on OPM data.

⁵ We calculated the "average award amount per employee" by dividing the total dollar amount of awards by the total number of employees eligible to receive the awards (not the number of employees who actually received an award) to facilitate meaningful trend analyses that would not be affected by the changing number of employees in the workforce over time.

The actual dollar amounts of both performance and other monetary awards increased over the 5-year period, and although their use was declining, performance awards were generally larger in dollar amount than other monetary awards. That is, on average, agencies provided larger performance awards to fewer employees in 1999 compared with 1995. The average performance award increased from about \$730 in fiscal year 1995 to about \$830 in fiscal year 1999, while the average for other monetary awards increased from about \$470 in fiscal year 1995 to about \$550 in fiscal year 1999.⁶

Agencies' Use of Monetary Incentives Varied

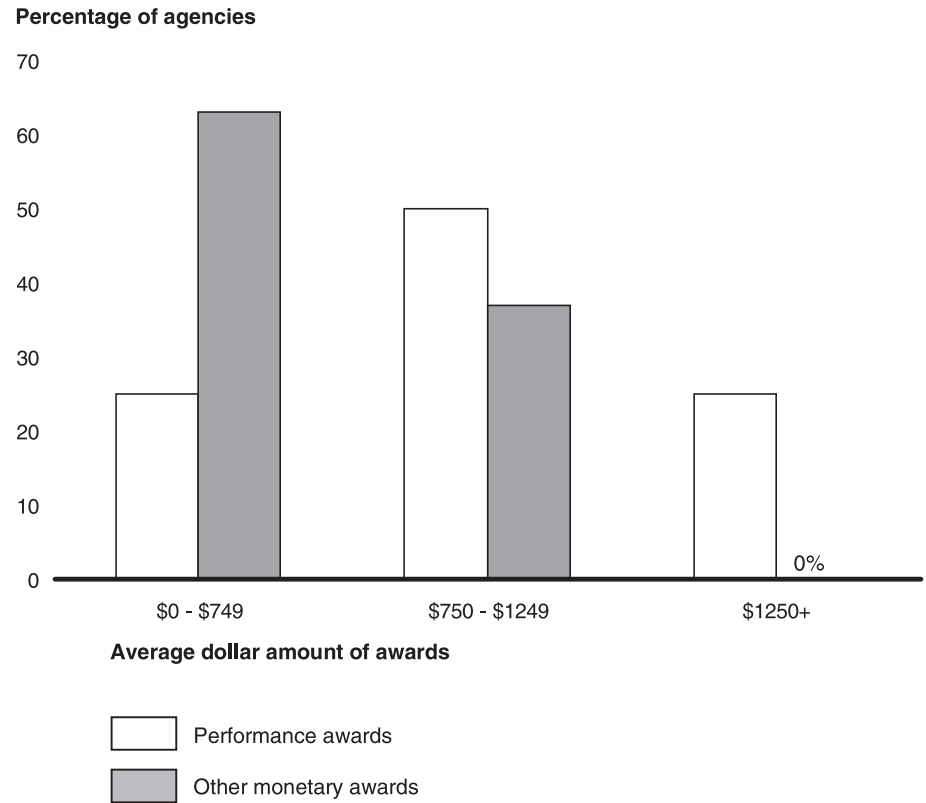
The individual CFO agencies differed in their use of the various monetary incentives in any given year. For example, in fiscal year 1999, the agencies' use of performance awards ranged from an average of fewer than 1 out of 10 employees receiving an award at one agency, to as many as 3 out of 4 employees receiving an award at another agency.⁷ Similarly, an average of 15 percent of employees received other monetary awards at one agency, while individual employees of another agency each received three of these awards on average.

The average award amounts also varied across the 24 agencies. Specifically, in fiscal year 1999, about 25 percent of the agencies provided performance awards that averaged less than \$750, about 50 percent provided performance awards that averaged between \$750 and less than \$1,250, and the remaining 25 percent provided performance awards that averaged \$1,250 or more. As might be expected, the average amounts of other monetary awards were somewhat lower than for performance awards. About 63 percent of the agencies provided other monetary awards that averaged less than \$750, and the remaining 37 percent provided other monetary awards that averaged between \$750 and less than \$1,250. Figure 3 shows how the average incentive award amounts varied for the 24 CFO agencies.

⁶ We calculated all dollar amounts using fiscal year 1999 constant dollars.

⁷ We do not specify the names of these agencies because we obtained the data from an OPM database, and we did not verify or discuss this data with the individual agencies.

Figure 3: Average Dollar Amounts of Monetary Incentive Awards for the 24 CFO Agencies, Fiscal Year 1999



Note 1: We did not include SES awards in our calculations

Note 2: We calculated the average award amount by dividing the total dollar amount of awards by the total number of employees who actually received an award.

Note 3: "Other monetary awards" include gainsharing, suggestion, invention, special act, and quality step increase awards. We did not include time-off awards in the calculations because they were measured in hours rather than dollars.

Source: GAO calculations based on OPM data.

Agencies have stated that there may be several factors that account for their varying use of incentives. Specifically, agencies funded their incentive programs out of their discretionary operating budgets, and some agencies' budgets may have been more constrained than others over the last decade. In addition, agencies' leaders may have differed in their support for incentives versus other components of a performance management system for motivating employee high performance.

regularly evaluated their incentive programs, many others have said that they did not. Thus, agencies may be offering their employees “incentives” that could be discouraging rather than encouraging high performance. In fact, over 40 percent of employees who responded to a recent National Partnership for Reinventing Government (NPR) survey indicated that they were dissatisfied with federal incentive programs and felt that agencies’ use of incentives (1) did not sufficiently reward high performance in support of missions and goals, (2) were not clearly based on merit, and (3) failed to recognize creativity and innovation.⁸

For those federal agencies interested in improving the effectiveness of their incentive programs, a self-assessment of their programs offers them the opportunity to determine the degree to which their current use of incentives motivates and rewards employee high performance. For example, an agency might use our human capital checklist, which lists sample indicators that agencies can use as a starting point to develop a fact-based understanding of the effectiveness of their incentives.⁹ Completing a self-assessment on a periodic basis would better equip agency leaders to design and implement more effective incentive programs that they could then monitor, evaluate, and continue to improve upon in the future.

While no one incentive program will motivate all employees under all circumstances, agencies may wish to consider determining whether their programs contain elements that are common to incentive programs used by high-performing organizations. High-performing public and private sector organizations that used incentive programs to motivate and reward their workforces have said that they consistently build certain key elements into the design, implementation, and evaluation of their programs. Based upon a review of our previous human capital and incentives work, these key elements include the following:

- Leaders support using incentives to manage performance.
- Programs have clearly defined, transparent criteria that are explicitly linked to organizational mission and goals.
- Organizations use multiple, meaningful awards to recognize individuals as well as teams and organizational units.

⁸ The results of the Working for the Government: What Federal Employees Think—1999 Employee Survey were released on March 31, 2000. NPR reported that approximately 40 percent of the 32,265 full-time federal employees surveyed responded to the instrument.

⁹ GAO/GGD-99-179.

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- Organizations target only high-performing teams and employees for awards.
 - Organizations publicize incentive awards to the extent possible.
 - Organizations regularly monitor, evaluate, and update their programs as needed.

Secure Leadership Support

High-performing organizations told us that executive support for incentive programs was vital to ensure program funding, consistency, and overall effectiveness. Because incentive programs may include performance awards and other monetary awards that require the use of appropriated funds, executives must continuously and visibly support the program to ensure that sufficient resources—both time and money—are allocated to the design, implementation, and evaluation of these programs. Moreover, managers may have very different views about the use of these programs, and executive support for incentives can minimize disparities that employees working for different managers within the same organization might otherwise experience. Top leadership support of incentives for high performance also sends a clear message to employees that efforts that exceed expectations will be recognized and rewarded, which in turn can improve an organization’s overall effectiveness.

Use Clearly Defined, Transparent Criteria

High-performing organizations used clearly defined, transparent criteria that were explicitly linked to the organizations’ missions and goals. Moreover, the organizations told us that expectations and measures should reflect only those dimensions of performance that are within the control of employees. The organizations stated that such criteria were essential to establishing and maintaining employee confidence that incentive rewards would go only to those employees whose performance clearly exceeded expectations and supported organizational missions and goals.

Include Multiple Incentives for Individuals and Teams

The incentive programs of high-performing organizations included multiple incentives—both monetary and nonmonetary—to enhance their ability to motivate as many employees as possible. Clearly, any incentive will motivate some employees, teams, or organizational units more than others. Some employees prefer monetary incentives, whereas other employees find nonmonetary incentives more meaningful. To avoid the risk of motivating some employees and not others to achieve high performance, the organizations indicated that they offered multiple and varied incentives to increase the probability of motivating all their employees according to their individual preferences. Moreover, offering a variety of incentives enhanced the organizations’ flexibility to tailor awards for specific circumstances. In particular, organizations that truly promoted teamwork

needed mechanisms for providing not only individual, but also team-based incentives.

Target Only High-Performing Teams and Employees

High-performing organizations' incentive programs differentiated between high-performing and other teams and employees in order to reward only those employees whose performance clearly exceeded expectations, met any established program criteria, and directly supported organizational mission and goals. These organizations stated that incentive programs that did not target high-performers for rewards would fail to effectively motivate employees and could even provide a disincentive for high performance. That is, employees who were rewarded for less than high performance might come to view such rewards as entitlements for meeting expectations rather than incentives to exceed expectations.

Publicize Incentives

High-performing organizations indicated that leaders or managers must publicize employee rewards and clearly communicate how the performance being rewarded exceeded defined expectations. The organizations indicated that employee confidence and belief in the fairness of incentive programs improved when they understood why certain employees were rewarded. Moreover, public recognition can serve as an additional motivation for employees to strive for high performance.

Monitor, Evaluate, and Update Periodically

Finally, high-performing organizations stated that regular monitoring and evaluation, as well as periodic updates, of incentive programs helped ensure that employees were effectively motivated to achieve high performance and support the organization's missions and goals. Sound management practices dictate that any human capital policy or practice must include regular monitoring and evaluation. The organizations indicated that program evaluations ensured that their incentive programs were administered efficiently and fairly, rewarded only high-performing employees, and continued to motivate employees. The organizations stated that program evaluations would indicate when certain incentives or rewards no longer served to motivate employees and needed to be updated to improve the effectiveness of the incentive program. The organizations further said that including employee input as a part of the evaluation process improved employee confidence in the incentive programs and therefore made these programs more effective.

Summary

In summary, Mr. Chairman, the federal government's human capital—its greatest asset—defines federal agencies' character and capacity for performance. If federal agencies hope to maximize their performance, ensure accountability, and achieve their strategic goals and objectives, they must, among other things, make effective use of incentives—whether

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monetary or nonmonetary—to motivate and reward their workforce in support of their results-based missions. Agencies that have yet to develop an effective incentive program, or that have reported implementation barriers to doing so in the past, might consider assessing their current use of incentives to determine whether their programs are likely to motivate employee high performance. Once agencies have a fact-based understanding of the incentives they already use, they will be better equipped to update their existing programs or design new ones, if needed, to support their missions and goals more effectively.

At GAO, we hope to encourage and facilitate the adoption throughout government of a greater human capital focus, as well as other performance management principles, and to “lead by example.” Right now, we are making our own human capital a top priority. Among other things, we are assessing our human capital systems from top to bottom for their alignment with our organizational mission, strategic goals, and core values. As a part of that assessment, we will be looking at our own use of incentives to determine whether they are aligned with our organizational mission and goals and are consistent with the key elements we identified from our review of high-performing organizations.

Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions you or other Members of the Subcommittee may have at this time.

GAO Contacts and Acknowledgements

For further information regarding this testimony, please contact Michael Brostek, Associate Director, Federal Management and Workforce Issues, at (202) 512-8676. Individuals making key contributions to this testimony included Jennifer Cruise, Thomas Fox, Rebecca Shea, and Gregory Wilmoth.

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