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ALLOCATION OF BONUSES BASED ON PERFORMANCE BASED REWARD SYSTEM

Abstract:

We consider the problem of allocating bonuses among workers in companies. For this allocation, most companies use a performance based reward system. At the end of each year, there is a performance appraisal conducted by the Human Resources department of each company. In this process, employers evaluate employees, and employees evaluate superiors. Usually these evaluations are conducted using some quantitative evaluation forms and the average score in the evaluation determines the performance of the workers. Based on their performances, some workers receive bonuses and some do not.

□ Usually companies set an eligibility criterion for bonuses: if a worker's performance score is above certain level, then he or she is eligible to receive a bonus. It is also true that each company has a limited budget that it would like to allocate among its workers as bonuses. While allocating this budget, no company allocates a bonus of more than some multiple of the monthly salary of the worker. Note that the salaries of the workers may differ: a senior worker most likely receives more salary than a newly employed worker. Therefore, the maximum amount of bonus each worker can receive may differ.

□ We study systematic way of allocating the budget of a company among the workers whose performance was sufficiently good (above the eligibility level). Since within each company there are different departments, and each worker works under a certain department, we can define a two-step procedure for allocating the bonus budget of a company among its workers: first the company allocates the money among departments, and later each department allocates the money it receives among its workers.

□ We call these systematic way of allocations as allocation rule and we consider rules satisfying good properties, such as efficiency, fairness, and strategy proofness. We characterize rules satisfying those properties.

JEL classification: D70, D78

Keywords:

allocation of bonuses, eligibility, reward system, fairness, efficiency

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