Merit pay plans vs. performance: a study of income tax employees

Dr. Chris Joy

Dr. Jim Mirabella
Jacksonville University

ABSTRACT

The purpose of this study was to investigate whether, when given freedom to implement monetary incentives, a tax firm leader could train newly hired and returning seasonal employees to perform at a higher level in preparing tax returns. Approximately 100 employees who prepare taxes at 20 locations served as the population for the study. The independent variables for this study were whether an employee worked under a monetary incentive or not and whether the employee was new or returning. The dependent variables for this study were the mean daily tax returns completed and mean error rates for each employee.

For each group of employees, the use of a monetary incentive resulted in higher productivity of tax returns completed. Monetary incentives were demonstrated as effective for motivating both new and returning seasonal employees to not only produce greater output of work, but also to do so with greater accuracy. The hypothesis test results indicated that returning employees outperformed the new employees in throughput and error rates, whether or not a monetary incentive was used, and that seasonal employees as a whole performed better with a monetary incentive present.

The implications of this study are vast for not only the business world, but also for education. Business and education leaders can potentially improve their organizations by using incentives wisely. If teachers receive monetary incentives to generate better student performance, they could be motivated to put in extra time and effort to help their students succeed.

Keywords**:** merit pay, performance, income tax, incentives, seasonal employees

INTRODUCTION

It has been 100 years since Taylor's seminal work in management, and administrators still face problems motivating employees to perform productively. Thanks to research completed over the past century, businesses have benefited greatly. With each new generation of workers and each new industry, there is an ongoing need to learn how to motivate employees, which is a tool of leadership, and to find out what incentives will drive optimal performance (Mirabella, 1999; Yukl, 2012).

While it seems most people prefer a monetary reward in today's society, The concept of employee motivation is not new and countless studies have been conducted on merit pay plans and their effect on employee performance. The Hawthorne Studies were critical to this research, but by far, Frederick Taylor's scientific management studies involving money as a motivator were foundational in this area of study (Mirabella, 1999; Yukl, 2012).

Researchers from varying disciplines such as education, accounting, economics, communication, psychology, and sociology have conducted studies concerning incentive systems such as merit pay plans. Incentives and incentive systems could be fundamental for improved or better performance. Incentive measures have traditionally been motivating tools to improve performance (Rose, 2012). Compensation is one of the key motivators of employees, and professionals consider it a significant and vital instrument for organizations (Adams & Hicks, 2010).

Despite research and studies showing a relationship between employee motivation and rewards to improve work performance, some questioned the performance-based incentive pay scheme. Critics of rewards suggested that rewards produced temporary agreement rather than commitment or prolonged motivation (Kolbe & Struck, 2012). Complying with an incentive plan can create altered behavior that may result in unexpected or unwanted organizational problems (Rose, 2012; Wolfe & Loraas, 2008).

The income tax preparation industry employs thousands of income tax professionals and preparers during the tax season: these employees compute the taxes owed and the refund expected by the client. An error in the preparation of the tax forms can be costly in terms of money and time for both the client and the income tax service provider. A Treasury Inspector General for Tax Administration (TIGTA) report sampled 2011 returns completed by income tax service providers and found 61% of the filings were incorrectly prepared ("Tax Preparer Testing," 2011). The number of complaints filed against tax preparers was 1,473 in 2008, which significantly increased to 2,276 in 2009 (Vaughan & Pilon, 2010, para. 15). These incorrectly prepared returns may cause income tax firms to lose time and pay fees to resolve the problem.

In the tax industry, having the income tax service provider ensure accuracy in the tax forms prepared and submitted is of great importance. One approach is to initiate a performance-based incentive program to encourage employees to be more productive and accurate in preparing the tax forms. Employers have used incentives such as bonuses and salaries to motivate employees for years (Yaseen, 2013). The principle of an incentive pay scheme is that higher achievement will bring greater rewards (Marques, 2013).

Improvements in the employee's personal performance earns rewards in individually based, performance-related pay schemes. One example is the incentive pay scheme, which includes a bonus for achieving higher than required targets and objectives (Lloyd, 2009). Because the employee will earn rewards of additional money or bonuses for achieving an objective or a certain level of performance, the employee exerting effort to maximize performance seems logical (Rose, 2012).

Time is money, and in the retail business, more time spent by consumers shopping can be positive, as long as the customer is not spending that time searching helplessly, but more time spent by consumers paying for their goods is negative and could jeopardize how much time is actually spent shopping or whether those consumers will return to the store. In an era of fast food and express lines where consumers look for a speedy service, the checkout systems have become a significant concern for retail managers that cannot be taken for granted.

PROBLEM STATEMENT

Organizations face problems with employee performance in the workplace in that when employees become less productive, they complete less work and take more time to accomplish a task, thereby simultaneously driving up costs and driving down revenues of the organization (Schmidt, 2014). Employees want to be paid fairly for their productivity, relative to their co-workers (Bernardi & Guptill, 2008). With many studies tying reduced productivity in organizations to a lack of employee motivation (Adams & Hicks, 2010; Schmidt, 2014), monetary pay plan incentives have long been documented as potential solutions for improving performance (Lawler, 2005). Yet, several studies have identified problems resulting from the use of incentives because the results may be temporary or they may complicate the situation for managers (Kolbe & Struck, 2012).

McGregor (1960) used Theory X and Theory Y to describe theories regarding the workplace, suggesting that employees had an inherent dislike of work and would avoid it whenever possible (Theory X) or that employees sought responsibility and would be committed to the success of their organization if the job were satisfying (Theory Y). Both of these theories appear to devalue the use of monetary incentives because employees either do not want to work or are intrinsically motivated anyway. Herzberg (1966) theorized the presence of factors in the workplace that cause job satisfaction and factors that cause dissatisfaction; his theory put money as a dissatisfier in that it would not increase satisfaction, but getting underpaid would surely decrease satisfaction. The specific problem addressed in this study was whether a seasonal employee at a Northeast Florida tax firm could be positively motivated toward increased productivity through the use of monetary incentives, and whether the effects were different for new versus returning employees. Results from this study could be useful to inform practices in educational organizations where too many other variables could confound the relationship between merit pay and improved performance.

Using four weekly audits of income tax returns from all 100+ employees across all 20 locations during the 2015 tax season, employee performance was measured under different leadership styles and different incentive plans. The measurements addressed productivity and accuracy by capturing the volume of tax returns completed as well as the error rates on the returns. The use of each return from every employee at all locations eliminated any sampling concerns.

THEORETICAL FRAMEWORK

Herzberg's (1966) two-factory theory identified factors as being satisfiers/motivators or dissatisfiers/hygiene factors. Money was shown to be a dissatisfier, not designed to positively motivate, but as something that needed to be at a certain minimum level to avoid demotivating employees. While other theories supported this notion, Lawler (2005) contradicted it with his studies showing employees performed at higher levels when they earned compensation for

performance (Yukl, 2014). Following Lawler's breakthrough study, other researchers followed suit in support of the findings. Throughout all of the research, no one addressed motivating seasonal employees, nor was there a focus on the accuracy of the employees' work; this study addressed both of the factors and addressed whether Herzberg or Lawler was correct.

A seasonal business is comparable to an educational setting when summer classes are offered, wherein instructors are recruited to cover the needed classes for extra pay. Some of the summer faculty members are from the same school, some are from an outside school, and some are strictly part-time. Classes offered each summer vary from year to year with some constants, and wheras some faculty members are regularly rehired, others are newly recruited. The classes needed could be for students repeating courses, students taking courses in advance, or students taking optional courses to prepare themselves for SATs or other tests. A seasonal business experiences many of the same issues in hiring qualified personnel willing to work for a short period of time at whatever hours are needed. The lessons learned in such a business environment could easily be applied to many educational settings.

Employee errors on income tax returns can cause financial penalties and reduce the probability of retaining customers for future tax seasons. Because the profession is dependent mostly on human performance, the tax preparers must be skilled and must perform at the highest levels. Milkovich and Newman (2013) indicated this concept arose from Taylor's seminal research in 1911 on principles of scientific management, wherein management of employees could enhance productivity. Taylor advocated such management involved developing the best way to perform each task by selecting workers with the appropriate skills. Such management provided monetary incentives for increased productivity. Taylor also believed that non-incentive plans yielded low productivity among employees because they did not want to work at a faster pace, lest it become the new standard.

In the workplace, incentives are the total income of the employee, with payments, both monetary and non-monetary, determined according to different rules and conditions (Adams & Hicks, 2010). Salaries, secondary benefits, recognition, and intangible rewards are incentive measures organizations have commonly used to motivate employees to improve performance (Firestone, 2014). Incentives can come in the form of monetary incentives, tangible non-monetary incentives, and intangible non-monetary incentives (Koerselman, 2013).

Some research has suggested that the use of incentives motivates employees to perform better. A study conducted by Condly, Clark, and Stolovitch (2003) showed that incentive programs had the potential to improve performance up to 44% and to increase the employee's level of engagement by about 27%. The study results further revealed that employees who earned rewards for exceeding targets were likely to invest more effort and time on a task, leading to satisfaction.

By incorporating certain aspects of the theories of motivation, the investigation within the current study showed how monetary incentives influenced employee motivation and performance in the context of tax preparation employees. Certain demographic characteristics likely affected motivation, which consequently might have affected performance. Collection and examination of demographic characteristics such as location and tenure of the employees was important in this context. The nature of a job naturally aome into play. For this reason, the research included only employees within a specific context by focusing on tax employees and considering only their average daily tax returns prepared and error rate. Extrapolating these findings could inform other settings in which fewer specifics complicate the results.

RESEARCH QUESTIONS

The objective of this study was twofold: (1) What relationship, if any, is there between a leader's implementation of monetary incentives and the motivation of employees to perform at a high level of productivity in a Florida-based tax return preparation firm?; and (2) What relationship, if any, is there between a leader's implementation of monetary incentives and the motivation of employees to perform at a high level of productivity in a Florida-based tax return preparation firm?

METHODOLOGY

The study population was the employees who prepared taxes at the 20 locations of a Northeast Florida tax firm. Ten (50%) of the income tax firm locations were designated as Region A and the other 10 were designated as Region B; a total of 103 employees comprised the study sample investigated. Because each hypothesis tested the difference in the mean of a dependent ratio variable across two categories of an independent variable, a t-test for independent samples was used to test all of the hypotheses.

The intent of this posttest-only control group quasi-experimental study was to determine whether, when given the freedom to implement monetary incentives, an organizational leader could effectively motivate employees to perform at a higher level of productivity. Using four weekly audits of all income tax returns from all 100+ employees at a single Florida-based tax firm during the 2018 tax season, employee performance was measured under different leadership styles and different incentive plans. The measurements addressed productivity and accuracy by capturing the volume of tax returns completed as well as the error rates on the returns.

The use of all returns from all employees at all locations with at least two weeks of experience at this tax firm eliminated any sampling concerns. Performance measurement focused on the average number of tax returns prepared per employee per eight-hour shift as well as their average error rates. Secondary information from this investigation underwent evaluation to determine whether incentives could increase productivity based on the completed returns per eight-hour shift and a reduced or constant error rate.

This study took place in a Northeastern Florida tax firm, utilizing all 103 employees under the leadership of its two regional managers, each using a different approach to motivating employees with pay incentives. Detailed records of all transactions and audits of all employee work were retained per IRS legal requirements, and no special instruments for data collection were necessary. Managers and general managers using the detailed system shown in Appendix A performed the audits. After the audit was complete, the data were collected and then computed by IRS approved Universal Tax system (UTS) software to diagnostically check the error rate.

Accuracy is essential in the income tax preparation business because errors are costly for both the client and the firm. Results of the study may help income tax preparation service providers to improve the productivity and level of service provided to clients. The empirical data of this study may also benefit other organizations. Whereas the setting in the study was specific to an income tax preparation business, results may easily be applicable to other organizations, such as educational institutions.

ANALYSIS & RESULTS

The two research questions guiding this study concerned the relationship between the use of monetary incentives and their effectiveness for the increased productivity in completing tax returns by new and returning seasonal employees. Six hypothesis test were conducted to address these research questions.

Table 1 shows the descriptive statistics of the tax returns sampled. The error rates for the employees ranged from 1.4% to 11.2%, with a mean of 5.36% and a median of 5%. The completed tax returns ranged from 8.5 to 15.5, and had a mean of 12.02 and a median of 12.1. The closeness of the means to the medians was indicative of data that were not greatly skewed.

Table 1 - Descriptive Statistics of Tax Returns

	N	Min	Max	M	Mdn	SD
Error Rate	103	.014	.112	.0536	.05	.020
Tax Returns	103	8.5	15.5	12.024	12.1	1.429

Two-thirds of the sample represented new employees and one-third were returning employees. Half of the sample received monetary incentives while the other half did not (see Table 2). Of the 103 employees in the sample, 15 were returning without any incentives, 20 were returning with incentives, 35 were new without incentives, and 33 were new with incentives; thus all four subgroups were fairly represented.

Table 2 - Crosstabulation of Employee Status versus Incentives

		EmpStat		
		Returning	New	Total
Incentives	No	15	35	50
	Yes	20	33	53
Total		35	68	103

$H1_0$: There is no difference in the mean error rate of tax returns prepared by employees earning performance-based monetary incentives and by employees not earning performance-based monetary incentives. Using the t-test for two independent samples, the error rates for employees earning performance-based monetary incentives were compared to those not earning such incentives. With a p-value of .000 which is less than .05, the null hypothesis was rejected. It can be concluded that there was a difference in the error rates, with those under an incentive plan having a statistically significant lower error rate. The incentive plan appeared to be a factor in employee performance regarding their accuracy. Both groups had a similar mix of returning and new employees, so experience was not a contributing factor here.

Table 3 - Hypothesis test 1: error rate by incentive plan

Incentives	N	Mean	SD	t	Sig.
No	50	.0610	.0216	3.789	.000
Yes	53	.0466	.0163		

$H2_0$: There is no difference in the mean error rate of tax returns prepared by new employees and by returning employees under a monetary incentive plan. Using the t-test for two independent samples, the error rates for returning vs. new employees earning performance-based monetary incentives were compared. With a p-value of .000 which is less than .05, the null hypothesis was rejected. It can be concluded that there was a difference in the error rates, with returning employees having a lower error rate, probably due to their experience.

Table 4 - Hypothesis test 2: error rate by employee status under incentive plan

Employee status	N	Mean	SD	t	Sig.
Returning	35	.0348	.0090	-10.895	.000
New	68	.0633	.0175		

$H3_0$: There is no difference in the mean error rate of tax returns prepared by new employees and by returning employees under no monetary incentive plan. Using the t-test for two independent samples, the error rates for returning vs. new employees earning no performance-based monetary incentives were compared. With a p-value of .000 which is less than .05, the null hypothesis was rejected. It can be concluded that there was a difference in the error rates, with returning employees having a lower error rate. The experience and natural learning curve were likely contributors in the significant differences between the two groups, without an incentive plan influencing the results.

Table 5 - Hypothesis test 3: error rate by employee status under no incentive plan

Employee Status	N	Mean	SD	t	Sig.
Returning	15	.0398	.0103	-7.355	.000
New	35	.0700	.0186		

$H4_0$: There is no difference in the mean daily tax returns completed between employees earning performance-based monetary incentives and employees not earning performance-based monetary incentives. Using the t-test for two independent samples, the mean daily tax returns completed for employees earning performance-based monetary incentives were compared to those not earning such incentives. With a p-value of .002, which was less than .05, the null hypothesis was rejected. It can be concluded that there was a difference in the tax returns completed, with those under an incentive plan having a significantly higher completion rate. The incentive plan appeared to be a factor in employee performance regarding productivity. Both

groups had a similar mix of returning and new employees, and so experience was not a contributing factor here.

Table 6 - Hypothesis test 4: daily tax returns by incentive plan

Incentives	N	Mean	SD	t	Sig.
No	50	11.581	1.2693	3.187	.002
Yes	53	12.442	1.4567		

$H5_0$: There is no difference in the mean daily tax returns completed by new employees and by returning employees under a monetary incentive plan. Using the t-test for two independent samples, the mean daily tax returns completed for new and returning employees earning performance-based monetary incentives were compared. With a p-value of .000, which was less than .05, the null hypothesis was rejected. It can be concluded that returning employees having a statistically significant higher completion rate, likely due to their experience.

Table 7 - Hypothesis test 5: daily tax returns by employee status under incentive plan

Employee status	N	Mean	SD	t	Sig.
Returning	35	13.1530	.9429	7.677	.000
New	68	11.443	1.2842		

$H6_0$. There is no difference in the mean daily tax returns completed by new employees and by returning employees under no monetary incentive plan. Using the t-test for two independent samples, the mean daily tax returns completed for new and returning employees earning no performance-based monetary incentives were compared. With a p-value of .000, which was less than .05, the null hypothesis was rejected. As with hypothesis 3, the experience and natural learning curve were likely contributors in the significant differences between the two groups, without an incentive plan influencing the results.

Table 8 - Hypothesis test 6: daily tax returns by employee status under no incentive plan

Employee status	N	Mean	SD	t	Sig.
Returning	15	12.698	.7025	4.953	.000
New	35	11.103	1.1547		

CONCLUSIONS

By applying six hypothesis tests, the two questions were answered adequately. The first hypothesis test found that the seasonal employees with a monetary incentive plan had statistically significantly fewer errors than those without such an incentive plan, thereby showing

that monetary incentives could be a positive factor in employee accuracy. The second and third hypotheses indicated that, whereas money was a factor, it was a more important factor for returning employees, and although returning employees outperformed the new employees in their error rates regardless of the use of incentives, both groups experienced improved results when money was a factor.

The last three hypotheses focused on production instead of accuracy. Looking at the mean daily tax returns completed, the fourth hypothesis indicated that those with monetary incentives completed statistically significantly more returns than did those without such a plan. The fifth and sixth hypotheses involved the breakdown of new versus returning employees and suggested that the returning employees had higher productivity than the new employees, whether or not a monetary incentive was used. Still, for each group of employees, the use of a monetary incentive resulted in higher productivity of tax returns completed.

In answer to Research Question 1, two of the hypothesis tests showed that a leader's use of monetary incentives could motivate seasonal employees to perform at a higher level of productivity. In answer to Research Question 2, four of the hypothesis tests showed that returning employees performed better than the new employees, whether or not monetary incentives were used, although both groups performed significantly better with the monetary incentives.

What can be concluded from these tests is that monetary incentives are effective with seasonal employees, and that leaders could have a valuable motivational tool to achieve more in less time, with fewer errors. These results supported the prior research cited in this study. The implications of this study are vast. Businesses that depend on seasonal help can potentially grow their production by using incentives wisely. Money has clearly been shown to be a factor for seasonal workers, as they have a limited time to earn money. Perhaps they could also be motivated by other means, such as time off or discounted merchandise. A temporary salesperson during Christmas season may be excited to get products at or below cost, and a cruise ship worker may be excited to earn a free cruise for his or her parents. Because it often costs less for a business to offer services or merchandise instead of cash, the employer could be more generous with incentives.

The implications of this study can be applied to education. Teacher performance is generally measured by student performance. If teachers receive monetary incentives to generate better student performance, and the measurements used do not allow for dishonesty, they can indeed be motivated to put in the extra time and effort to help their students succeed. More directly, if the measurements used were focused specifically on teacher activities, such as tracking their communications with parents, the level of feedback given to students, or the timeliness of their grading, the teachers could earn rewards without having to depend on student responsiveness.

A further impact of monetary incentives for teachers is that better quality individuals could be attracted to the profession. Teaching is one of the lower paid professions, despite it being one of the most important. The use of incentives as policy might not only attract better teachers but also deter lesser quality individuals who are concerned with having to meet such targets. If it is known that a pay-for-performance system is in place and clear measures of success drive pay, those who are confident in their abilities might want to teach to earn more money, just as sales people are motivated to work longer hours.

With a policy of pay incentives for teachers, opportunities could exist to motivate teachers to teach in more challenging schools or remote locations, or to learn new skills for their

classroom. The possibilities are infinite, but it would take experimentation to determine what specific incentives can motivate workers in different environments.

Using incentives to motivate is not a new concept. Negative motivation is common in many situations where threats of firing, suspension, pay cuts, or adjustments to work situations are used to drive performance. The cost could be negligible to management and the threat would be mitigated to motivate positively with incentives for excellent performance instead. If performance measurements are straightforward and achievable, employees could indeed be motivated for higher performance, which could turn into greater profits and fewer costly errors. Whether used in the business world to work with customers or in the academic world to work with students, leaders could gain much for a small investment. Not only could they realize better results, but they could also attract better workers and teachers, which would only serve to improve performance further. As the workplace environment continues to evolve, methods for motivation may continue to change, and it is up to leaders to be willing to investigate avenues for optimal performance.

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