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# MEDIATING EFFECT OF EMPLOYEE EFFORT IN EMPLOYEE INFORMATIVENESS AND PERFORMANCE

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## ABSTRACT

*Contract Theory explains the problems that may arise in designing incentive contracts and the possible solutions for those problems. One of the problems mentioned to the principal agent contract problem is moral hazard and the reason for that problem is the lack of sufficient information. Employee Informativeness is suggested as a solution to alleviate the moral hazard problems which will help in inducing the effort decision in employee and thereby improves the performance. This paper attempts to check whether the employee informativeness influences the effort of the employee and thereby performance. Here effort is considered as a mediating variable in the relation between Employee Informativeness and Performance. The study is conducted among 117 sales personnel in Automobile dealer industry where incentives contribute as a major part of their compensation. The tools used in the analysis is Spss tools and process macro. The study reveals that Employee effort act as a mediator in the relation between employee informativeness and employee performance.*

**Keywords:** Employee Informativeness, Moral hazard, Effort, Employee Performance, Contract theory.

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## 1. INTRODUCTION

A major result in contract theory is the informativeness principle (Holmstrom (1979), Shavell (1979), Gjesdal (1982), Grossman and Hart (1983), Kim (1995)). This Nobel Prize winning theory speaks about the solutions to alleviate the problems of Moral hazard, Risk Aversion and Adverse selection. One of the major solutions to these problems is Employer/Employee

Informativeness. Employee Informativeness is equipping the employee with the right amount and kind of information which is required to do their actions in a desirable manner.

Greater effort states either to effort focused towards the performance of the task, which is supposed to lead to immediate performance increases, or effort directed towards learning, which is thought to lead to delayed performance increases (i.e. improved performance on later actions). Increases in effort directed toward existing performance are taken as changes in effort direction, effort duration, and effort intensity, whereas effort directed towards learning is considered as strategy development (Bettman, Johnson, & Payne, 1990; Kahneman, 1973; Kanfer, 1990; Locke & Latham, 1991). Effort duration denotes the length of time an individual dedicates intellectual and physical resources to a specific task or activity (i.e. how long a person works). In the automobile sector, incentive contracts typically are based on relatively long periods of time, such as a year, and the performance measures that try to measure persistent effort over those periods. There are many performance indicators which measures the performance of sales personnel.

Both expectancy theory and agency theory propose that the incentive contracts affect the utility of various outcomes, and that effort affects the probability of achieving these outcomes. Thus the optimal incentive contracts will induce a positive spur to increase performance (Bonner & Sprinkle 2002). Locke, Shaw, Saari, and Latham (1981) proposed different ways in which incentives can affect effort via goal setting. This goal setting is possible only if the employees have the right information regarding the process of performance appraisal and the incentive systems offered to them. That is possible through Employee Informativeness.

Agency theory (e.g. Baiman, 1982; Eisenhardt, 1989), says that individuals are always trying to maximize their expected utility, which adds further structure in explaining the incentive systems on effort. A change in informativeness may alter the optimal effort level. It is well known that solving for the optimal effort level in addition to the cheapest contract that induces a given effort level is extremely complex (see, e.g., Grossman and Hart (1983)), and thus many papers focus on the implementation of effort. Pierre et.al (2014) states that the effect of informativeness on effort depends on its differential effects on the values of the options when working and the options when not.

Since all the studies referred here say that the employee informativeness will lead to employee effort and the employee effort leads to employee performance, this study tries to check whether the effort can act as the mediating variable between employee informativeness and employee performance.

## 2. CONCEPTUAL MODEL

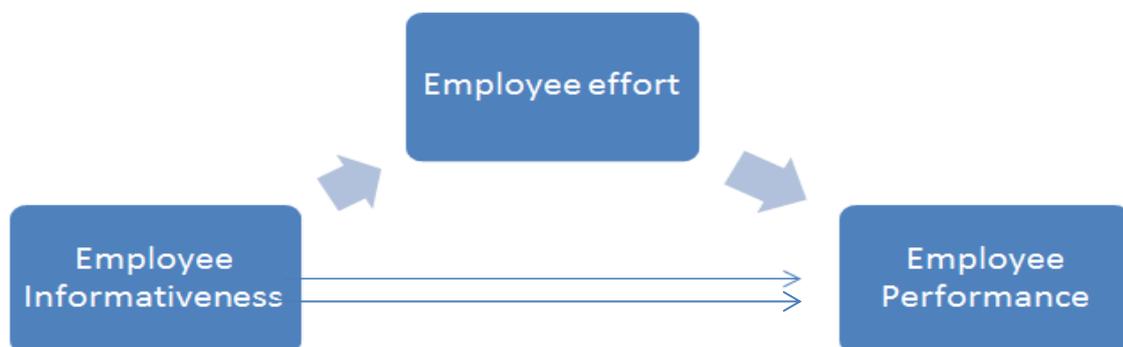


Figure 1 Showing the conceptual model

### 3. OBJECTIVES OF THE STUDY

- To check whether there is a relation between Employee Informativeness and Employee Performance
- To check whether Effort is related to Employee Performance
- To check whether effort mediates the relation between employee informativeness and employee performance

### 4. HYPOTHESIS

H1<sub>1</sub>-There is a significant relation between Employee Informativeness and effort

H1<sub>2</sub>-There is a significant relation between Employee effort and Employee Performance

H1<sub>3</sub>-Employee Effort mediates the relation between Employee Informativeness and Employee Performance

### 5. RESEARCH METHODOLOGY

The data collection is administered through a structured Questionnaire from 117 participants who work as sales personnel in automobile dealer industry. The sampling method used is convenience sampling. The questionnaire contains two parts, one is the general information about the participants including name, age, gender, educational qualification, experience, designation and the company they work for. The other part contains 5 point likert scale questions about the constructs Employee informativeness, Employee effort and Employee performance. The data collected is analyzed through Spss tools like Correlation and Regression analysis and the mediation effect is checked by the process Macro 3.3 version.

### 6. RESULTS AND DISCUSSIONS

#### Hypothesis 1: There is a Significant Relation between Employee Informativeness and Effort

F(1,115)=3.824,p<0.05,with an R<sup>2</sup> of .032

Independent Variable	Dependent Variable	β(standardized coefficient)	R <sup>2</sup>	B(unstandardized coefficient)	SEB(standard error)	t	p
Employee Informativeness	Employee Effort	.18	.032	3.162	.513	1.96	.04

The regression analysis has been done to find the relation between Employee informativeness and effort. Since the β value is significant, we could accept our hypothesis saying Employee informativeness will contribute to Employee effort.

#### Hypothesis 2: There is a Significant Relation between Employee Effort and Employee Performance

F(1,115)=4.739,p<0.05,with an R<sup>2</sup> of .04

Independent Variable	Dependent Variable	β(standardized coefficient)	R <sup>2</sup>	B(unstandardized coefficient)	SEB(standard error)	t	p
Employee Effort	Employee Performance	.19	.04	3.569	.334	2.18	.032

Here from the Regression Analysis, a significant value of β has got, so the hypothesis can be accepted.

### **Hypothesis 3: Employee Effort Mediates the Relation between Employee Informativeness and Employee Performance**

The mediation has done through the process Macro version 3.3

In the first step of EI to Effort, we get  $\beta$  value 0.1794 where p value  $<.05$

Total effect of EI on Performance is  $\beta=.3979$  with a p value .0001, that is it is significant. The direct effect is also found to be significant with a  $\beta$  value 0.3674 with p value .0003. But the indirect effect is not significant as the upper and lower level confidence interval includes zero. Since there is significant direct effect and total effect ,but there is no significant indirect effect, we could conclude that the variable Employee effort completely mediates the relation between employee informativeness and employee performance

## **7. CONCLUSION**

Employee Informativeness, which is required to reduce the asymmetry of information, which further decreases the moral hazard problem in incentive contracts, will help the employees to induce the right amount of effort required to achieve the desirable performance. This study considered employee effort as a mediator in the relation between Employee Informativeness and Employee Performance and it turned out as a complete mediation. Thereby it can be concluded that Employee Informativeness should be optimal in every organization which in turn results in the output of the employee.

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