Case Study: The Perils of Performance Pay

Performance-related pay (PRP) has become a fact of life for many workers in the private sector and parts of the public sector. The UK government now says it wants to extend this system to schools in England and Wales, and possibly to the National Health Service. Bargaining Report looks at the arguments for and against PRP, which are once again in the spotlight.

At the end of last month prime minister Tony Blair explained how the government aims to "modernise" public services. It wants a greater focus on outputs and new ways of delivering public services, in which "mediocrity" would not be tolerated. Blair said: "Increased pay must be tied to improved results. And that may mean taking on some sacred cows to make better use of the pay bill. Do we need greater differentials within the public sector?"

Should we decentralise pay more? What are the lessons of performance pay and where else should we be using it?" Although appearing to pose a series of questions, Blair had clearly already made up his mind that performance pay was the way forward for teachers. Two months earlier the government published its green paper on teachers' pay which placed performance-related pay at the heart of the planned pay structure.
Lessons of performance pay

While employees may be attracted by the idea of earning more for good performance, research shows they often find performance pay systems demoralising, divisive and unfair in practice. PRP can also be discriminatory.

Proposals to extend performance pay in the public sector have coincided with embarrassing evidence about discrimination at the Department of the Environment, Transport and the Regions. According to the IPMS professionals' and specialists' union last year's appraisal results (known as box markings) showed "ethnic minority staff to have been marked significantly lower than white staff; and women to have been marked significantly higher than men." The unions involved have protested at the implementation of pay rises on the basis of these results.

Many employers continue to use performance-related pay, but some have shifted their emphasis towards a "team" approach, and a greater "across-the-board pay" element in performance-based pay settlements. Other approaches such as competency and skills-based pay and market-related salaries are gaining more support.

Three other recent studies published by the London School of Economics (LSE), the Department of Trade and Industry (DTI) and the Institute of Personnel and Development (IPD) raise serious questions about the policy of extending performance-related pay amongst public sector workers.

What a performance, by David Marsden and Stephen French of the LSE, focused on performance-related pay in the public services. It looked at the Inland Revenue and the Employment Service; two NHS hospital trusts that have PRP schemes for the majority of staff; and head teachers in primary and secondary schools who have had PRP for several years.

The LSE study found support among employees for the principle of performance-related pay - except among school head teachers (who would be covered by the green paper proposals). Gains in productivity and quality were found although a large number of line managers in the organisations surveyed reported no such outcome. But this effect seemed to stem from improved goal-setting, rather than any positive motivating effect of linking pay to performance.

The study also revealed the down side of performance-related pay:
"Large numbers in the civil service and the hospitals believed morale had been undermined, that performance pay caused jealousies among staff, and that it undermined team working".

The individualisation of employment contracts in Britain, published by the DTI, looks at ways in which employment relations had been "individualised", including PRP, mainly in workplaces that have de-recognised unions.

The research "exposed predictable dissatisfaction" with performance-pay, although this hadn't put employers off or lead to the winding up of PRP schemes.

One personnel director said:

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"Money really is a demotivator. The best you can achieve is that it does not interfere with the management process - if things go wrong the anomalous pay levels can be disastrous for motivation".
At another company "the constant measuring of people against each other fed into staff's sense of job insecurity by generating 'evidence' of failure to meet job targets".

The DTI report revealed other problems with PRP. These included:
- a lack of transparency and consistency;
- the same performance rating in different areas within a firm resulting in different pay rises;
- favouritism;
- damage to team work; and
- problems being covered up in appraisals to avoid poor assessments.

At a conference organised by the Institute of Personnel and Development (IPD) earlier this month David Guest, professor of occupational psychology at Birkbeck College, said that the latest performance pay proposals are doomed to fail:

"Performance-related pay is an old idea that has a lousy record. I cannot understand why the government is so keen to introduce it into teaching and the NHS. The evidence shows that it simply doesn't work". Guest added that the government was guilty of a fundamental failure to understand public servants' motivation in thinking that pay could be used to manipulate performance.

A survey published early last year by the IPD seemed to show continued growth in the use of "individual performance-related pay" (merit pay or bonuses determined by agreed individual objectives). Three quarters of employers still believed it had a positive benefit on performance by encouraging employees to focus on organisational objectives (IPD 1998 Performance Pay Survey).

However, only 25% of companies and organisations in the IPD survey operated individual performance-related pay schemes for non-managerial staff. Managers were much more likely to be covered by PRP and get bigger PRP awards than non-management staff but, even so, 60% of organisations did not use it for this group either. (IPD Bargaining Report Feature February 1999)
1. a) Identify in the case the challenges that were experienced with performance related pay and provide some possible recommendations that could assist with addressing these issues. (12 marks)

b.) The Government of Barbados having reviewed literature on Performance Related Pay (PRP) in England has decided to consider implementing it as a test project in one of their ministries. They have hired you as the consultant to assist with the process.

Captured below is the administrative and professional team for this ministry.

<table>
<thead>
<tr>
<th>Salary Grades</th>
<th>Salary Ranges</th>
<th>Positions</th>
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<tbody>
<tr>
<td>Z1</td>
<td>24,000 - 36,000</td>
<td>Receptionist (1) 25,600</td>
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<tr>
<td></td>
<td></td>
<td>Accounts Clerk (2) 27,200</td>
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<tr>
<td></td>
<td></td>
<td>Admin Assistant (2) 32,000</td>
</tr>
<tr>
<td>Z2</td>
<td>33,000 - 50,000</td>
<td>Accounts Asst (2) 34,800</td>
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<tr>
<td></td>
<td></td>
<td>Client Service Rep (2)36,000</td>
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<tr>
<td></td>
<td></td>
<td>Personal Assistant (2) 45,000</td>
</tr>
<tr>
<td>Z3</td>
<td>43,000 - 80,000</td>
<td>Corporate Secretary (1) 54,000</td>
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<tr>
<td></td>
<td></td>
<td>Legal Officer (1) 65,000</td>
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<td></td>
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<td>Human Resources Manager (1) 75,000</td>
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<tr>
<td>Z4</td>
<td>75,000 - 135,000</td>
<td>Permanent Secretary (1) 97,000</td>
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<td></td>
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<td>CFO (1) 110,000</td>
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</tbody>
</table>

They have hired you to provide advice on how they should move forward.

I. Explain to them what is Performance Related Pay and how it works. (2 marks)

II. Calculate the midpoint for all of the salary grades. (2 marks)

III. Calculate the compa ratio for the following: (Provide the Formula) by using the compa ratio explain their position

- Receptionist
- Personal Assistant
- Human Resources Manager
- Permanent Secretary

(4 marks)

c.) Identify and analyse any four (4) challenges that this ministry would have to address to ensure the successful implementation of the performance related pay system. (10 marks)

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SECTION TWO

2. The Economic Research Institute argues that compensation management is multidisciplinary in approach. Explain any five (5) of the theoretical concepts they propose that influences the study of compensation management. (15 marks)

3. Evaluate the advantages and disadvantages of an organisation implementing a Flexible Benefit programme. Appropriate examples and cases should be incorporated in your answer. (15 marks)

4. a. Competency related pay and competency based pay is the same thing or is it? Answer using relevant supporting references. (5 marks)

   b. Examine the factors that would have contributed to the growth of competency related/based strategies. (10 marks)

5. "Companies must assume their top executive compensation will come under greater scrutiny from within and without". Discuss in light of recent world events. (15 marks)

6. Jon Hindman (Workforce Magazine, September 2008) argues that "Total compensation should be used as a recruiting tool". Evaluate the accuracy of this statement. (15 marks)

END OF EXAMINATION PAPER