

Performance Related Pay: Fad or Answer to Performance Challenges

Professor Andrew Likierman, (2005) casts doubt on the efficacy of performance related pay (PRP) for executives and observes that the scheme is based on two flawed assumptions. Firstly, that PRP has an effect on behaviour, and secondly, that credible performance measures can be found and linked to a relevant time period. He notes that the evidence linking PRP and change of behavior is weak and that most schemes fail to take into account the lag factor. A dramatic example for this is the case of a well known regional utility company.

Flash back to 2000/1 when this company received accolades for the quality of its service and its progressive Human Capital Management practices. In recognition the management of the utility was rewarded with earnings commensurate with “exceptional performance”. Fast forward to 2008 and the company is currently experiencing major challenges in service delivery. This leaves one in the “dark” regarding the criteria used in awarding substantial bonuses to the management of said company.

This apparent disconnect between performance and pay forms the basis of this week’s article. Does pay for performance deliver on its promise? Academics and Human Capital Management practitioners alike could say that that the jury is still out on this one.

Duncan Brown (2005) observed in his presentation at the Chartered Institute of Personnel and Development (CIPD) Reward Management Seminar that many employers rush to link pay to individual performance in the absence of any evidence that it would work for their organization. He also identified ‘the engagement gap’, where employees simply don’t understand or trust decisions on pay, and line managers lack of the skills necessary to deliver new reward systems effectively, particularly when it comes to improving performance. Managers who have introduced new reward systems will agree with these observations and attest to the fact that the implementation of pay for performance schemes is fraught with many pitfalls.

Botswana experience with variable pay schemes

Organizations in the public and private sectors in Botswana have kept in step with world trends in terms of reward management practices; for instance the public service has introduced an incentive system under the name Performance Based Reward Systems (PBRS); the quasi government sector and the private sectors have variants of pay for contribution at various life cycle stages.

The major challenges faced by organizations in Botswana in their efforts to implement pay for performance or contribution are similar to those faced elsewhere in the world and these include design and implementation challenges. Design challenges include failure to consult and sell the proposed system to key stakeholders, failure to assess need and readiness for the system, and poor project management. Implementation is hampered by inadequate and ineffective development programmes, inefficient communication, and poor or lack of evaluation of the impact of the schemes.

Given the plethora of systems available to the manager which system should the organization adopt? One can choose from variable or contingent pay, individual or team performance related pay, or pay for contribution, among other systems. Lawler, Schuster, and Zingheim (2003) that a suitable reward management system is one that is; strategic, business-aligned, flexible, performance-driven, distinctive, and integrative of the actions of employer and employee. In light of this the best system is one that addresses business needs. Having designed a suitable system the organization ought to invest in line management who will make or break the system.

Line managers as reward management ambassadors

In my opinion it is the front-line managers who make all the difference to the way reward management policies are perceived and put into practice. As the old adage runs “a chain is only as strong as its weakest link.” Accordingly, it is critical that front line managers buy-in and understand the system to the extent that they become the system ambassadors. These ambassadors will require training and support to boost their understanding of the system so that they can communicate with their constituency with conviction, and carry out their HR responsibilities, such as performance management and appraisal effectively.

Implementing effective variable pay schemes

Murlis (2005) provides hints on the design and implementation of effective performance related pay schemes. On design, Murlis suggests that organizations ought to consult those involved, design a scheme that integrates business needs with what individuals or teams can control, link variable pay to a small balanced set of credible measures and check the quality of performance management. Murlis emphasizes the need for organizations to assess the capability of their line managers, and the provision of development and coaching for those managers and leaders who find these areas difficult. In addition organizations ought to communicate why they are introducing variable pay, what the benefits will be, how decisions will be made and how individuals will be told about their awards.

In order to exploit the vast potential of performance related pay to unlock shareholder value managers must have the courage to experiment with reward systems. They ought to realize that implementation of initiatives like pay for performance requires the adoption of a long term view of things and a dose of patience. It also requires management persistence and insistence on evaluating the impact of reward management initiatives on company performance.