

Performance-related pay definition and general features essay examples

[Business](#), [Company](#)



Is Performance-Related Pay a Proven Path to Improving Employee Performance and Job Satisfaction?

Introduction

This paper is aimed at understanding whether performance-related pay can lead to improvement in employee's performance and job satisfaction. In order to answer this question, it is first of all necessary to research the nature of this payment system, analyze the reasons why employers choose it for their organizations. It is also necessary to consider its types and analyze their advantages and disadvantages. Then, it will be possible to properly understand the ways, in which performance-related pay influences job satisfaction and performance of the employees. In order to do it properly, results of various studies will be analyzed. In the end recommendation on the choice of appropriate pay scheme will be offered and overall conclusions will be drawn to finally answer the initial question.

Performance-related pay (PRP) represents a kind of payment system that depends on the employee's performance. It can be completely or partially dependent on performance and usually it has a form of bonuses over some set sum of money (Heywood and Wei, 2006). There are different variants, on which payment can be based, such as performance of the whole organization, its division, team or individual results.

Usually PRP involves the following three stages: development of the criteria, with the help of which employee's performance will be assessed, defining whether employees meet the set criteria and link the achievements of employees to the payment structure. There can be different performance measures like knowledge, skills and some behavioral indicators.

The main arguments for PRP usage is that with its help motivation is increased, as well as cooperation is better established and firm's results are maximized. The main opposing arguments state that firm's risks are transferred in this way to the employees, which can affect their performance negatively. Advantages and disadvantages of PRP will be researched in detail in separate sections of this paper.

PRP schemes usually vary on the basis of different criteria, such as the area in which business works, the size of the company, different approaches to the choice of employees, etc. Still, it is possible to distinguish the following common features, which are characteristic practically of all the PRP schemes:

1. Performance is usually reviewed regularly (once a year or more frequently) and assessed on the basis of the agreed criteria or standards. This process is called performance appraisal.
2. When the appraisal is complete, usually employees are subdivided into separate groups on the basis of their performance rates. Reward is defined for each group.
3. Reward methods usually vary, but most often they involve a cash bonus and/or salary increase.

In order to properly describe the PRP concept, it is also necessary to understand the main reasons driving employers when they decide to implement such schemes into their practice. First of all, in this way it is convenient to identify the company's problems of underperformance and reward achievements. It is thought that in this way employees will become motivated towards better results and achievement of company's targets.

Objectives are effectively clarified in this way and employees start to better understand the firm's mission and goals. Flexible payment systems are introduced in this way, while retention and recruitment problems can be effectively solved. Peculiarities of PRP also depend on its types. Every organization has to understand which form is the most suitable in each particular situation and carefully select and develop the PRP scheme.

Types of Performance-Related Pay

The most widespread types of PRP are the following (McNabb and Whitfield, 2007):

1. Organization-wide incentives. In this type pay levels are usually based on the quantities measured for the whole company.
2. Piecework. In this case each unit of output is paid for separately. One of the most vivid and clear examples is bonuses of football players, who get them for scored goals.
3. Profit-related pay. Bonuses are based on the profit of organization. This type is widespread in the private sector.
4. Payment by output and time. Distinction between the payments by these factors has long been vague and today they are often combined.
5. Individual performance related pay. It is one of the recent developments, in which bonuses are based on appraisal or evaluation of employee's performance against agreed criteria.
6. Commission. In this case payments are calculated on the basis of percentage from turnover or sales. This type is the most appropriate for sales and other sectors of goods distribution.

7. Measured day work. It is a composite system occurring in a number of forms, but payment depends on the measured output.

8. Merit pay. Bonuses and payment levels depend on the general evaluation of employee's contribution to the whole firm's performance.

Individual schemes of performance-related incentives are usually aimed at facilitation of better performance of each employee, as it is considered that people perform better if they understand how their actions contribute to the actual sum of money they receive. Group schemes are usually directed at promotion of collective work for objectives achievement. In both cases there are certain advantages and disadvantages.

Advantages of Performance-Related Pay

PRP has benefits in multiple fields both for employees and employers. First of all, let me describe advantages for employees (Rynes, Gerhart and Parks, 2005): 1) career boost: if effectively implemented, employees with the help of PRP can effectively monitor their own performance and further their careers. For those who perform well it is also possible to back their words up and prove that they deserve bonus or salary increase. 2) rewards: employees usually receive rewards in cash. 3) pay increase: in many cases employees receive minimal wage at first, but with the help of PRP they can considerably increase their profits. 4) satisfaction: the feeling that work is appreciated and rewarded can lead to increase in the level of job satisfaction.

For companies PRP has the following advantages (Weibel, Rost and Osterlok, 2009): 1) staff motivation: it is considered that by receiving bonuses for

actual results staff will be more result-oriented and motivated. 2) attraction of new talents: usually such approach attracts qualified professionals. 3) staff productivity increase: staff productivity can be significantly increased if appropriate PRP scheme is selected. 4) existing employees don't leave their jobs: employees who are performing well and are properly rewarded for this are likely to be loyal to the company. 5) goals achievement: by introducing PRP employers encourage people to achieve the company's goals.

Disadvantages of PRP

Various studies on PRP revealed problems in different areas. First of all, it is necessary to consider staff moral and motivation. In particular, the major problem is that often PRP schemes are not as effective as they are supposed to be. Frequently in the public sector it is conditioned by cash limits that rewards have, owing to which the amount of offered money just cannot motivate employees enough. Moreover, if managers are not properly trained or when communication is inadequate with staff, it can negatively influence the employees' morale. PRP influence on employee performance will be further developed in a separate section of this paper.

The fact that PRP schemes usually depend on individual worker's appraisal, which is often performed by the line managers, here personal favoritism and bias can influence results of payment decisions. If employees think that their work is evaluated unfairly, it can bring about negative results, such as decrease in performance not only of the offended individual, but also of the whole organization. Short term focus in this way is promoted and team work is undermined, which can lead people to believe that their pay doesn't

depend on performance, but instead – on the skills of establishing connection with supervisors.

Among the other disadvantages that researchers found there is a fact that PRP accentuates differences between the highest and the lowest paid workers (Lazear, 2000). It is also often difficult to design proper objectives so as all employees considered them to be fair and realistic. The measures of performance, especially in the case of individual incentives programs, are often costly to implement. It is often difficult to choose appropriate time frames for the rewards, as if they are too long-term, they can be not enough motivating for employees. If they are too short-term, it can contradict the interests of the organizations. If PRP schemes are not properly designed, they can interfere with the other company's programs and initiatives.

It is also possible to define certain drawbacks for individual and group PRPs separately. Thus, the first variant is problematic, as work team's output can exceed the amount of individual contributions. It is also difficult to properly evaluate each employee's contribution into the overall firm's performance.

Individual PRP schemes can also be implemented in inconsistent and arbitrary manner, which is why unhealthy competition can be facilitated, reducing output levels. It was also defined that work where continual changes are required can considerably suffer from PRP schemes, as employees' resistance to changes often increases, as those who already have bonuses and rewards understand that after changes this can stop.

As for the PRP schemes based on group incentives, their main disadvantage is occurrence of the so-called free rider problem (Che and Yoo, 2001). It happens because individual's lack of contribution can have little effect on the

general result. Thus, a person can do practically nothing for company's advantage, but still receive rewards owing to increased efforts of the rest of the staff.

PRP Impact on Employee Performance

There have already been conducted numerous researches on the actual influence PRP schemes have on increasing employees' performance. Their results often contradict one another, as rather often it is discovered that such schemes have absolutely negative impact, while other show considerable improvements in this area. It can be explained by various reasons, such as research of the firms with improperly selected PRP schemes and other peculiarities. For example, one of the studies conducted Ariely et al. (2005) showed that PRPs are effective only if purely mechanical work is involved. When at least rudimentary cognitive skills are required, the performance decreases significantly. If we take into account the drawbacks described in the previous section, it becomes clear, why employee's performance can be negatively affected by PRPs.

Still, studies that mainly focus on middle income countries often prove that PRP schemes are very effective in terms of increasing performance (Muralidharan and Sundararaman, 2011). It can be explained by the fact that participants and authors of these studies are more concerned about signaling function that PRP schemes perform for the public (that lazy workers are punished). Maybe they are just more oriented towards the benefits PRP schemes have (Marsden, 2009).

If the results and conclusions of various studies are analyzed, it becomes

absolutely clear that more research is needed. One of the recent retrospectives by Perry et al. (2008), which covers 57 studies on this issue, shows that in order to get a clear picture, it is necessary to move beyond the simple evaluation of employees' perceptions and attitudes.

PRP Impact on Job Satisfaction

Different studies were conducted to establish how PRP influences job satisfaction level of employees. In particular, there were defined particular factors that positively influence job satisfaction. Among them there is a statement that employees enjoy work environments where their productivity is properly rewarded, which considerably increases their optimism. High-performance workplaces also contribute to the sense of employees' belonging, commitment and esteem. Studies by Bauer (2004) and Goddard (2001) in particular show positive connection between PRP and high job satisfaction level.

Still, there are reasons that account for PRP negative influence on employee satisfaction. The main reason is inappropriately selected or realized PRP scheme (Clark, 2001; Frey and Jegen, 2001). If workers feel dissatisfied with the fairness of bonuses distribution, or other aspects, described in the PRP disadvantages section of this paper, it is impossible for them to be satisfied with their workplace. The fact that such schemes can be implemented only as disciplinary measures, which in reality will result in the increased work effort and lower satisfaction, also accounts for negative influence.

In a study conducted by Green and Heywood (2008) many separate dimensions of job satisfaction problems were analyzed and determined. As a

result, evidence was provided that on the whole PRP tends to increase employees' job satisfaction and security. One of the concerns analyzed in the study is that PRP leads to work intensification, which can result in employees' dissatisfaction with work. Still, in this study no such concerns were backed up. Still, the authors of the study state that their results shouldn't be interpreted so that job satisfaction will definitely increase along with PRP schemes introduction, as results will differ on the basis of the selected schemes and their appropriateness in each particular case.

Recommendations on PRP Schemes Choice and Implementation

The above found results demonstrated how important it is to choose appropriate PRP schemes and to realize them wisely. Thus, it is possible to offer the following recommendations on how to choose and implement schemes so as to increase job satisfaction and performance of employees:

1. Transparency. At all the levels (collective and individual) the process of appraisal and rewards distribution should be clear and transparent.
2. Negotiability on design and objective. From the very beginning employees should participate in the development of criteria of future assessment and all the other important features.
3. Piloting. In order to make sure that the scheme is effective, it is necessary to have it piloted,
4. Training. Management and workers should receive appropriate training.
5. Adequate appraisal. Managers should always have enough time for appraisal.
6. Fairness in operation. Scheme realization process should be fair and clear

for the staff.

7. Realistic goals. It is necessary to define goals and objectives that can be really achieved.

8. System explanation. It is necessary to ensure that the PRP scheme is clear for all the employees and managers.

Conclusions

As a result of research conducted in the course of this paper writing, various studies on PRP were analyzed. With their help, it became possible to properly analyze the PRP schemes, define their types, advantages and disadvantages. The main pros of this payment system are employees' increased motivation and performance. What is interesting, there was discovered that the main drawbacks lie in the actual decrease of these indicators, which is related to the possibility of inappropriate choice of the PRP scheme.

On the whole, it was shown that the most important thing when introducing PRP is proper selection of the scheme and fair and reasonable implementation of it. If it is done in the right way, both employee satisfaction and performance will increase, bringing along even more positive results. Thus, for proper result it is essential to properly assess each detail of the firm's expectations and objectives to figure out what and how to implement within the PRP scheme framework.

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