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Performance-Related Pay

Introduction

Many organisations are competing to maintain continuity in prevailing volatile and dynamic market environment. These organisations rely on motivation and performance of employees as the key tools for their outstanding long-term success (Amstrong 2006). Performance evaluation through appraisals is a critical element of any organisation's management, since it mirrors its progress and achievement. Pay is a vital scheme to induce motivation, since workers utilise it to attain their needs and wants (Dessler 2000). According to Lockwood (2004), performance-related pay (PRP) is simply a type of payment system that depends on assessed performance. Under the PRP system, payment can be based on variants such as performance of an individual, team, profit, merit, department or the whole organisation (Fisher 2005). The purpose of this assignment is to discuss and explore the value of performance related pay and how it relates to an individual, a team, an organizational motivation and productivity.

Definition and the Theories Underpinning Performance-Related Pay

Whitley (2002), defines performance-related pay as “ money paid to someone relating to how well he or she works.” For instance, insurance sales representatives, real estate brokers and software salespersons are often paid on the basis of this approach. The basic rationale behind performance-related pay is the simple proposition that most employees are motivated by money (Whitley 2002; Dessler 2000). In this regard, employees tend to work harder if rewards are tied directly to the results they achieve (Noe et al.

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2003). Productivity increases substantially when incentive schemes are new, although, the level or rate of increment is not always maintained. Several empirical studies have affirmed that productivity increases when a PRP system has been put in place (Banfield & Kay 2012). PRP systems are used in the belief that they yield increased output, minimize the cost of production and provide higher earnings for the workers concerned. Performance-related pay also creates a working environment where less supervision is needed to keep the output up.

Frederick Winslow Taylor put forward the idea that workers are motivated mainly by pay. In the 'Theory of Scientific Management', Taylor highlighted that workers should be paid based on the number of items they have produced within a specified period (Taylor 1911). This observation introduced the widely used concept of piece rate pay. The effect of this arrangement is that employees are motivated to put more effort and maximise their productivity.

For instance, a programmer will only turn up to work if his employer provides a reasonable level of pay, but this alone will not make work harder once he is there. PRP will motivate him to perform better as well retain him within the firm. PRP is a motivational effort, which translates to improved performance and productivity (Amstrong 2006).

Models of Performance-Related Pay

Performance-related pay models are based on individuals, work-group or organisation. Various models incorporate different types of PRP systems (Banfield & Kay 2012). The most popular model of PRP is the individual
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model in which an individual is subjected to an existing PRP system.

Piecework is the most outstanding type of PRP under this model. It is characterized by payment on each unit of output (Noe et al. 2003). An example is bonuses paid to basketball players for scored points. Bonuses are based on the appraisal of an employee's performance against the contractual criteria (Fisher 2005). In merit pay, rewards also depend on the performance level. Appraisal is the geeral assessment an employee's contribution to the performance of the whole establishment (Dessler 2000).

Organizational model is characterised by organisation-wide incentives. That is to say, rewards are based on the values or quantities measured for the whole establishment (Banfield & Kay 2012). An organization-wide incentive is often the basis of contract price or tender-led schemes in the public sector. Share options or bonuses are based on the profit performance of the organisation. Profit-related pay is popular in the private sector, where share options are vital to the key shareholders (Banfield & Kay 2012).

Individual and workgroup PRP model, which consists of payment, are based on the output of a team . Variants in this model include time and measured work output or results (Banfield & Kay 2012). Due to a small distinction in the definition of output and time, payments by these factors are often incorporated into a wide payment system. Commission is also a type of PRP in which payments or bonuses are calculated based on the percentage from turnover or sales(Noe et al. 2003). Commission is the most appropriate PRP type for sales and any channel of distributing goods. PRP can also be based on the daily measured work output. Measured qualities or values of output

for individuals or groups can also be used as variants or rewarding performance.

Individual performance-related pay (IPRP) incentives are typically aimed at improving the performance of each employee, since employees perform if they can draw a link between their efforts and pay (Banfield & Kay 2012). A team or an organisation based models are usually directed at achieving the objectives by promoting collective work. In both cases, there are certain advantages and disadvantages.

Benefits and Limitations of the Models

Benefits of Performance-Related Pay

According to Noe et al. (2003), performance-related pay systems lead to a reduction in production cost which is achieved through increased individual or team productivity, lower levels of supervision and an improvement in quality. Introduction of PRP scheme also develops a performance culture. PRP significantly improves staff morale and motivation of the employees. Armstrong (2002), asserts that PRP is an effective tool for getting employees to work towards an organisation's goals and objectives. Goals are achieved through clear definition of individual targets for staff at appraisals that are connected to the organisation's goals and objectives. PRP is a direct incentive for the employees to meet the targets set where direct supervision is not effective. PRP also serves as a personal performance-monitoring tool that can boost career development. PRP systems create a feeling that work is appreciated and rewarded, consequently leading to an increase in the level of job satisfaction.

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Whitley (2002), shows how PRP can act as an attraction for new talents or qualified professionals. A good PRP system also retains existing employees subject to the fact that properly rewarded employees are likely to be loyal to an organization. It is worth noting that, if an appropriate PRP system is selected, staff productivity can be significantly increased.

Limitations of Performance-Related Pay

In spite of the numerous advantages observed, various studies on performance related pay have revealed problems in different sectors. First, Whitley (2002), asserts that employees can be de-motivated in the event that defined goals are hard to achieve. The effect PRP on staff motivation is uncertain because bonus payments are normally a very small percentage of an overall wage. Moreover, in the event that the management team is not properly trained or has poor communication skills, PRP will certainly have negative influence on the staff morale.

The fact that PRP is dependent on individual worker's appraisal, which is often carried out by immediate line supervisors, bias and personal favouritism can lead to doctored results of payment decisions if not audited (Amstrong 2006). A notion of bias in enumeration reduces performance. PRP scheme also tends to facilitate specialization and short-term focus. From this perspective, teamwork is undermined.

Among the other disadvantages is a fact that PRP may lead to serious disputes between employees subject to the fact that they receive different rewards for what is perceived to be the same effort (Lockwood 2004). One of the challenges PRP systems is complexity in measuring performance.
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Individual models are problematic, given that output by groups can exceed the amount of individual contributions. It is also complex to accurately compute each employee's contribution into the overall organization's performance. Individual PRP models can also be implemented in inconsistent and subjective way leading to unhealthy competition thus reducing productivity (Fisher 2005). As for the team or organizational based models, their main disadvantage is occurrence of the so-called free riding and loafing problem. Some individual's take advantage and not work hard, but still receive rewards owing to a hardworking workforce.

How PRP Relates to Individual, Team and Organizational Motivation and Productivity

Whitley (2002), defines motivation as the force that drives behaviour.

Productivity is simply the ratio of output to inputs. Performance is a function of motivation and the ability to do work. This implies that, motivation is a key element in evaluating performance at either personal or organisational level.

Whitley (2002), points out that motivation alone does not dictate all of a person's behaviour. PRP is motivation effort designed to improve performance and productivity.

Productivity can be enhanced by increasing the output or increasing the input if it proportionately raises the output. Academic work indicates that PRP systems encourage workers to increase their output/input (effort) if it proportionately raises output (pay). These observations have been specifically highlighted by Whitley (2002), in his work examining how motivation works. For instance, insurance agents output is driven by the

commissions and bonuses they are awarded. These rewards motivate the agents to work hard and the resulting in high turnover. According to a study by Fisher (2005), the results indicated that the most prominent corporations had major investments in paying high remuneration and employee satisfaction. These include IBM, Cisco system, Ford, Shell and Alcoa Inc. PRP results in employee motivation. Consequently, highly motivated workforce will definitely make higher profits and at the same time meet the customers' needs and satisfaction.

Conclusion

Organisations apply various approaches such as group-based incentives, rewards, merit pay piecework and commission for the overall employee motivation and performance. In order to achieve individual and organisational needs, the management team should carefully choose the appropriate strategy for long-term performance of the organisation. Appraisals should also be used to streamline the goals and objectives of each individual, group or department that will translate to sustainable performance and increased overall productivity. In drawing the conclusions about the positive link between PRP and organisational performance as well as sustainable organisational productivity, we must appreciate the fact that PRP is only cost effective to the organisation if the cost of monitoring is less than the productivity gain.