

09

Performance and reward

Key concepts and terms

- Incentive effect
- Performance management
- Reward value chain
- Sorting effect

Learning outcomes

On completing this chapter you should be able to define these key concepts. You should also know about:

1. The impact of reward on performance.
2. How reward impacts on performance.
3. The role of performance management in providing rewards and improving performance.
4. The use of rewards for attracting and retaining people.

Impact of reward on organizational performance

The assumption is that improvements in organizational performance will follow improvements in individual performance and that reward management can play an important part in achieving such improvements. This sounds reasonable but it is difficult to prove, although some US research projects have attempted to do so. Research by Huselid (1995) and Guest *et al* (2003) has established a positive association in the private sector between the use of a 'bundle' of HRM practices, including performance-related pay and employee shareholding, and the financial performance of the business.

The findings of the research conducted by Allen and Helms (2001) were that reward practices were significant predictors of performance and explained nearly

41 per cent of the variance in organizational performance. A relatively small number of reward practices explained the bulk of variability in organizational performance. These were: individual-based performance systems, employee share option plans (ESOPs), regular expressions of appreciation, and customer satisfaction monitoring tied to rewards. Team-based pay, flexible benefits and increased job autonomy were not significant predictors of firm performance.

A study by Brown *et al* (2003) explored the relationship between pay policy as indicated by pay levels and pay structure on organizational performance. The findings were that:

- pay level practices and pay structures interact to affect resource efficiency and financial performance;
- higher pay levels are associated with greater efficiency;
- there are diminishing returns for pay's effects on employee performance;
- no single theory can fully explain how pay relates to organizational performance, but the results show support for efficiency theory (the belief that high levels of pay will contribute to increases in productivity);
- higher pay can compensate for the negative effects of inequitable pay systems.

Data on pay satisfaction and organizational level outcomes was collected in the US by Curral *et al* (2005) from 6,394 public school teachers and 117 public school districts. The findings were that pay satisfaction was positively related to school district-level academic performance and negatively related to intention to quit.

Research carried out by McAdams and Hawk (1994) supported the premise that performance reward plans are instrumental in performance improvements, often with calculable returns. Just under half the companies in the study were able to attach a financial value to their plans. For these organizations, the value of the performance improvement translated into a 134 per cent net return on what was paid out to employees (excluding the costs associated with training, communications and consulting).

How does reward impact on performance?

The resource-based view as developed by Barney (1991 and 1995) is that it is the range of resources in an organization, including its human resources, that produces its unique character and creates competitive advantage. HRM delivers added value and helps to achieve this sustainable competitive advantage through the strategic development of the organization's rare, hard-to-imitate and hard-to-substitute human resources. As explained in Chapter 1, reward management is an important element in the HRM processes of engaging, obtaining and retaining

people. A distinction can be made between the incentive effect of financial rewards and what labour economists call the sorting effect.

Conceptually, the incentive effect enhances performance by motivating people and increasing levels of engagement by rewarding achievement, competence and skill. A reward value chain can be constructed that looks like this:

Reward strategy > Reward practice (performance pay) > Improved individual performance > Improved organizational performance

However, extrinsic rewards (ie those provided by the organization, especially financial rewards) are not necessarily effective as motivators and the value chain may not function well. This is where performance management as a means of motivating and engaging people has a role to play.

The sorting effect is equally important. Organizations are competing fiercely for the best employees and for the talent that will replace the retiring boomer generation, with increasingly more of that talent being recruited from the ranks of millennials (those born between the early 1980s and mid-1990s to 2000) every year. Organizations need to attract people by the competitive financial terms they offer and they need to retain people by providing them with acceptable and competitive financial rewards. Methods of doing so are examined later in this chapter.

Role of performance management

Performance management plays an important role in achieving the motivation and engagement of employees. It is defined as the continuous process of improving performance by setting individual and team goals which are aligned to the strategic goals of the organization, planning performance to achieve the goals, reviewing and assessing progress, and developing the knowledge, skills and abilities of people. If carried out properly, it can reward and therefore motivate people by recognition through feedback, the provision of opportunities to achieve, the scope to develop skills, and guidance on career paths. All these are non-financial rewards, which can encourage job and organizational engagement and make a longer-lasting and more powerful impact on performance than financial rewards such as performance-related pay. A description of what performance management can contribute was provided by Jones (1995) as follows:

- communicate a shared vision throughout the organization to help to establish and support appropriate leadership and management styles;
- define individual requirements and expectation of all employees in terms of the inputs and outputs expected from them, thus reducing confusion and ambiguity;
- provide a framework and environment for teams to develop and succeed;

- provide the climate and systems which support reward and communicate how people and the organization can achieve improved performance;
- help people manage ambiguity.

Performance management is associated with pay when it enables the performance of individuals to be rated in order to inform performance pay decisions. But it can be argued that it should really be about developing people and rewarding them in the broadest sense.

In any case, the practice of performance management has been much criticized. The following typical comment was made by Duncan Brown in 2010:

The problems [of performance management] are... not of ambition or intent, but rather practice and delivery. Low rates of coverage and even more frequently low-quality conversations and non-existent follow-up are commonplace, in the wake of uncommitted directors, incompetent line managers, uncomprehending employees and hectoring HR with their still complex and bureaucratic HR processes.

Although it is generally accepted that some form of performance appraisal is desirable there has been a number of examples of large organizations rethinking the way in which they operate performance management. There has, for example, been a move away from an annual performance appraisal meeting to more frequent and less formal 'performance and development conversations'.

Use of rewards for attracting and retaining people

Research by the Institute for Employment Studies (Rickard *et al*, 2016) on organizational practice in the use of financial and non-financial incentives for recruitment and retention purposes found that:

- Recruitment and retention challenges within organizations have increased in recent years, particularly among professionals, specialists and technical staff against a backdrop of strong employment growth in the UK.
- Common financial incentives used for recruitment include sign-on bonuses, which are typically used in the finance and insurance industries and in manufacturing, and are most common in very large organizations. Penalties or restrictions are often attached to these incentives to prevent early resignations. These bonuses are paid in an effort to influence decision-making and prevent acceptance of other job offers; however, their effectiveness is generally linked to the motivations of the candidate and their fit with the organization.
- A more informal recruitment tool is a cash incentive offered through an employee referral scheme. These rewards are either a set amount or rise commensurate with the seniority of the post being filled. Such schemes are considered more effective as a recruitment method in the private sector than

the public sector and are not viewed as particularly effective for the recruitment of specialist/technical or professional employees.

- Common retention incentives include increased pay, learning and development and job advancement opportunities, and around a quarter of employers are using retention bonuses. These bonuses are typically paid: to ensure business continuity during a critical time; for difficult-to-recruit or high-turnover positions; to counter competing job offers; in preparation for or following mergers and acquisitions in the private sector; or during organizational uncertainty.
- The use of long-term incentives, or golden handcuffs, are also considered an important retention tool by about a third of private-sector organizations, with the most popular ones being: executive share option schemes; company share option plans; share incentive plans; save-as-you-earn schemes; executive deferred annual cash-based bonuses; and executive restricted/performance share plans.
- About half of private sector organizations are operating special pay arrangements for technical or specialist staff. These include specific salary ranges, recruiting higher up the incremental scale; the payment of a market supplement, allowing additional discretionary payments at the upper end of pay ranges; and job family structures or technical ladders and career pathways.
- Non-financial recruitment and retention incentives are also being prioritized by employers including measures such as: career advancement and promotion opportunities; learning and development programmes; flexible work arrangements; better project opportunities; fast-track programmes; and formal recognition of leadership potential. Methods to increase organizational commitment among high-calibre employees also include providing clear career paths, greater decision-making authority, increased feedback and better communication.
- There was some evidence that non-financial rewards can help employees to feel valued, thus increasing their levels of engagement, motivation and satisfaction. But there was less evidence that they made a direct impact on retention.

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