

IS CONTRIBUTION-RELATED PAY A BETTER PROPOSITION THAN PERFORMANCE-RELATED PAY (PRP) OR COMPETENCE -RELATED PAY? – A THEORETICAL PERSPECTIVE

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ABSTRACT

The present paper aims at highlighting the basic philosophy of both 'performance- related pay' and 'competency - related pay' and spelling out the intricacies of these two systems of pay pointing out how the 'contribution-related pay' system is better than the aforesaid two pay systems. It has been pointed out that while the performance- related pay is an output driven approach, the competency- related pay is an input- (Competence-) oriented approach. Whereas the performance- related pay approach suffers from the drawbacks like over- emphasis on quantitative, and often unrealistic targets, financial incentives are short lived, difficulties in measuring individual performance objectively, and so on, the competence-related pay approach presents two typical questions, viz. Are we paying for 'competencies' (i.e. how people behave), or 'competences' (i.e. what people have to know and be able to do to perform well), and then how to measure all these? The other question is: Are we paying for the possession of competence or the use of competence? These questions create a lot of confusion.

However, the 'contribution-related pay approach' is the combination of the output driven approach of performance- related pay and the input- (competence-) oriented approach of competence-related pay, and is an attempt to embrace the advantages and exclude the shortcomings of the aforesaid two pay systems. It has therefore, been proved to be much more convincing than either performance- or competence-related pay.

Key Words: Competences, Competencies, Competence, Contribution

INTRODUCTION

Whether an employee should receive 'performance-related pay' (PRP) or 'competence related pay' (CRP), has always been a debatable issue. However, it should be known that both PRP and CRP are two major types of contingency pay, the other types being contribution-related pay, skill-based pay, shop- floor incentive and bonus schemes, salesforce incentive schemes, executive incentives and bonus schemes, employee and executive share schemes, team rewards, gain sharing, profit sharing, profit-related pay and other cash payments⁽ⁱ⁾. Thus, contingent pay covers the various forms of additional financial rewards i.e. which are in addition to the base rate of pay. ⁽ⁱⁱ⁾

Anyway, in the present paper, an attempt has been made to discuss at length the difference between performance-related pay (PRP) and competence-related pay (CRP)

besides highlighting the various issue related to performance-related pay (PRP) and competence-related pay (CRP) and spelling out how contribution-related pay is a better proposition than the performance-related pay (PRP) and competence-related pay (CRP)

Performance - Related Pay

Despite negative reports from many research projects and opposition from many trade unions, performance pay is quite popular and continues to be a traditional constituent of the pay packet of (i) most sales personnel who get it in the form commission based on their performance, (ii) shop- floor employees who get it based on the quantum of their output, and (iii) executives who get it normally in the form of bonus/ profit-related pay/ gain sharing/ profit sharing/ etc.

Performance-related pay links pay progression to a performance rating which is usually conducted during a performance review though some organizations conduct it

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at a different time exclusively for performance-related pay purposes.

Performance is usually applicable in the case of individuals though attention is also being paid to performance criteria related to team work.

Before spelling out objectives of performance-related pay, it may also be pointed out that there is distinction between 'performance' and 'contribution'. While 'performance' refers to what an employee achieves, 'contribution' refers to impact made by that employee on the performance of the team and the organization. ⁽ⁱⁱⁱ⁾

OBJECTIVES

Coming to objectives, it may be mentioned that the main objectives of performance-related pay may comprise: (i) to motivate every employee to perform better and put his heart and soul into his job, (ii) to attract and retain high quality employees who are hard working, (iii) to make employees result and performance -oriented and change the work culture accordingly, (iv) to reduce supervision, (v) to focus on the key performance issues, (vi) to reduce cost of production, (vii) to help in raising the standard of living of employees, (viii) to encourage teamwork and innovation etc, (ix) to reward employees according to their contribution, and (x) to make obvious to the employees that the organization is genuinely concerned with output/ performance.

Why PRO is Criticized?

Despite several advantages of PRP, it is not without its criticism. The main disadvantages include: it has been often observed that financial incentives are short lived and lose their momentum in the long run; since the additional payments as per PRP schemes are not very significant, they do not attract quite a good number of employees especially those who are not hard working or who are less confident; in the urge to earn more, some employees work beyond their capacity which may affect their health adversely; in order to earn more, employees care only for the quantum of their output and do not pay adequate attention to the quality of their

product; some employees pay less attention towards reducing wastage and damage to the plant, machinery and equipment, because their priority is to increase output; at times, it may also affect teamwork adversely; and finally, in a good number of cases, it is not possible to measure individual performance objectively and accurately.

But whatever is stated above is not the whole truth because it should not be forgotten that "the achievement of a reward is a tangible means of recognition and can therefore, provide a less direct but possibly longer-term motivation. ^(iv)"

What should be ensured Before Introducing PRP?

It is not that performance related pay can be introduced any fine morning. There are certain pre-requisites that should be ensured before launching the performance-related pay (PRP) system. For example, it should be ensured that PRP should not only fit the culture of the organization but also support it. PRP should also be able to act as a lever to change the culture as and when needed. Secondly, the top management should be firmly committed to PRP and able to work with the processes of PRP. Besides, not only the line managers should be staunch supporters willing to own PRP, the employees too should have a feeling that they will be benefitted if PRP is introduced. All the departments, especially the HR department, and management must have the confidence that they will make PRP work.

Thirdly, the organization should be in a position to evolve methods of measuring performance fairly and consistently. The management, especially the HR department, should have a clear understanding of the language of behavioural competences. Then, there should be a possibility of making the process of PRP an integral part of business planning. PRP should also have the support of the communication system of the organization. There should also be an efficient and effective process of performance management enabling the measurement and assessment of performance against the targets and standards prescribed.

Possibilities for evolving effective guidelines on how pay should increase within the pay structure already operational and, above all, there should be adequate chances of having desired control over PRP so that it works within reasonable costs.

Then the management should not only be capable of planning objectives appropriately in full agreement but also assessing levels of competence of personnel of the organization. The management should also be capable of meaning as well as rating the performance of the employees of the organization.

It is also necessary that the HR department of the organization should be competent enough of extending the guidance and providing necessary support besides making available the desired resources. The managers should be able to manage PRP in their departments at their own and should not depend much on the support of others especially the HR department. It is equally important that managers should be effective in “using the PRP as part of a total performance management process which will involve joint assessments and agreements of performance and individual development need.”^(v) It has also to be ensured that costs incurred on introducing the PRP are just and also capable of far exceeding the cost of the scheme.

It has also to be found out if PRP will be instrumental in accelerating performance of the organization concerned.

However “Armstrong and Murlis^(vi) have suggested the following factors to be taken into account while introducing PRP in an organization: matching the culture (i.e. successful PRP schemes need to match the culture and core values of the organization); linking PRP to performance management processes; balancing performance measures (i.e. a balanced mix of both input and process factors (skills and competences) and output factors (performance and contribution)); flexibility (in the criteria for reward and the method of payment); teamwork (i.e. the significance of teamwork should be recognized in structuring the scheme and also in designing critical success factors and

performance indicators.); avoiding short-termism (i.e. not to focus attention only on short - term results at the expense of more important longer - term objectives); involvement in the design process (of the PRP schemes); and getting the message across.

Thus, we see that there should be full scope for cost effectiveness besides the reward synchronizing with the expectations of employee concerned. It is also to be ensured that there exists a fair and effective mechanism for measuring performance and contribution made by the employees and that there is a link between performance-related pay and contribution of employees and subsequent reward to the employees.

Developing a PRP Scheme/ Programme

PRP is not a magic wand which will resolve all the motivational as also performance problems of an organization. Hence, no PRP programme should be introduced in a haste as it is a very sensitive matter. The top management should be made fully aware as to what PRP is capable of doing and what it is not capable of doing. The key considerations explained in the foregoing paragraphs should be taken due care of before venturing into the launching of a PRP programme.

“Although it is difficult to work out a rigid sequence of steps to be undertaken while developing a PRP programme, yet the sequence of activities being spelled out in the subsequent lines may prove quite useful and effective. First, the objectives of introducing a PRP development programme be clearly spelled out i.e. why do we want to introduce a PRP programme. What is it that we are looking for out of such a programme? Then we should find out whether the organization is ready for introducing a PRP programme. To answer this problem, we have to assess whether the culture of the organization is appropriate for introducing the PRP and in the same way whether the PRP is appropriate to the culture of the organization. We should go ahead only if the answer to both questions is in affirmative. The other questions to be answered in this

respect may include like: Are the attitudes of the employees and the management conducive for the initiation of PRP programme and further that whether there exists the performance management and other relevant processes wanted for the effective working of PRP'. It has also to be assessed whether the employees possess the required skills and resources. Again it has also to be ascertained whether the costs involved in developing and operating the PRP programme will be able to generate enough additional performance.

The third step may involve taking a decision whether to introduce PRP or not. For this, we will have to take into consideration all the issues discussed earlier under the head, "whether to introduce or not the PRP". In case the answers to all such issues are conducive, we should move towards the next step i.e. identifying the objectives of PRP. A discussion in this regard has already been undertaken in the earlier paragraphs. The next step in the direction of developing PRP, which is vital for the success of PRP programme, is involving the employees of the organization. They should be briefed about the intentions of the management and that what the management intends to get out of such a programme. The suggestions put forward by the employees should be taken due care of. Then comes the next and a very important step i.e. designing the programme. This involves choosing the criteria for determining PRP onwards. However, an appropriate mix of : Input criteria, Process criteria and Output performance can also be considered. ^(vii)

Designing the PRP programme involves consideration of a lot of issues like availability of performance measures, which form of rating system to be used, how to ensure the fairness and consistency of ratings, whether PRP review should be separated in time from performance reviews, how the costs going to be controlled, use of performance matrices, maintaining the PRP, evaluation of the effectiveness of PRP programme, policies on the rate of progression , limits to progression within the

existing pay ranges, finalizing the PRP programme, and so on.

The next step involves briefing and training the line managers on the PRP programme. It involves making the line managers understand the programme, how it will function, and what benefits are likely to accrue to them, and the like.

The next step is concerned with the implementation of the PRP programme. In this direction, PRP should be started with pilot scheme so that it may enable the management to understand the principles, advantages and problems. Only thereafter when necessary precautions have been taken, the PRP programme should be launched. In the initial stages, the PRP programme should be properly monitored so that the probable problems can be visualized and solutions worked out.

The next and final step in developing a PRP scheme programme is the evaluation of the scheme i.e. whatever was intended of the PRP scheme could be achieved or not. Whether the scheme could be monitored consistently well? Were the persons entrusted with the implementation of the programme could perform their job well? Who will be responsible for overcoming the problems and taking corrective steps? A detailed discussion in this direction is curtailed in the subsequent pages.

OPERATING THE PERFORMANCE RETAILED PAY (PRP)

As stated earlier also, the most typical PRP system usually uses valuable progression within a pay range. The main operational features of the aforesaid system, according to Armstrong and Murlis^(viii) ,may involve: basis characteristics, valuing aggregate, size of increase, progression rates and limits, progression guidelines, use of performance matrices, and control.

EVALUATING PRP

At the end of stipulated period, PRP programme should be evaluated to know whether the desired outcomes could be obtained or not and then taking corrective

steps. This can be achieved by finding out the extent to which the desired objectives of PRP programme have been achieved. How much costs were incurred on the implementation of the PRP and what advantages could be obtained i.e. how much PRP could be effective in implementing the performance of individuals, teams and organization as a whole. How do the organization personnel feel about the programme?

Whether the employees concerned feel that their expectations with regard to the quantum of reward have been met? Whether the rewards are linked to key and measurable areas of performance? Whether any modifications in the existing PRP programme are required? Whether the existing PRP programme should be allowed to continue as such or its alternatives should be identified? Such queries will go a long way in sustaining and improving the PRP programme developed and making it effective.

WHETHER TO INTRODUCE OR NOT THE PRP

Keeping in view the pros and cons of PRP, its introduction everywhere cannot be recommended point blank. There are many ifs and buts. Much depends on the objectives of the organization, cultural orientation of the organization, working environment of the organization, and so on. However, PRP may be deemed necessary in certain organizations because of market compulsions so as to secure an edge over their competitors. The very belief in the soundness of the contention that employees should be paid accordingly to their contribution, goes in favour of introducing the PRP. It is a different story whether their belief proves true or not. However, the very introduction of PRP in an organization gives an obvious message to the employees that the organization attaches a great importance to performance and therefore, the employees are supposed to focus on their output. All the same, there are several difficulties in the implementation of PRP as are obvious from the studies concluded by Purcell, ^(ix) Bowey and Kesslev. ^(x)

What is the alternative to PRP?

The traditional approaches to performance-related pay which involve rating performance against quantitative targets and using a formula to determine the pay increase, have met severe criticism from both trade unions and academics. Line managers too have doubted the practice of PRP. All such criticism compelled, specially in 1990s, to look out for the alternative and led to the emergence of the concept of 'competence-related pay' (CRP), a brief about which is as follows:

COMPETENCE RELATED PAY

In competence-related pay, employees receive financial rewards in the shape of increases to their base pay by reference to the level of competence they demonstrate in carrying out their roles. It is a method of paying employees for the ability to perform now and in the future. ^(xi)

There are several perspectives on what competences are and what they are supposed to achieve. Are they a skill that can be learned and developed, or, are they a trait that includes attitudes and motives? Do competences focus on the minimum requirements that the organization needs to stay in business, or do they focus on outstanding performance? Are they characteristics of the organization or of the employee? Unfortunately, the answer to all of these questions is "yes" ^(xii). There is no unanimity among the authors on several issues in this regard. Competences can therefore be a number of things and as a result of that, they stand in danger of becoming nothing. That's why, competency-based pay systems are rarely used in a stand-alone form as the only means of determining reward. Current practice in competency-related pay is diverse, with many different methods of linking competences to individual reward being used. Only a minority of organizations have chosen to link competency and pay. Overall, there is no evidence in recent years of a growth in the popularity of competency-related pay schemes.

WHAT IS COMPETENCE?

According to UNIDO (2002), competency is a set of skills, related knowledge and attributes that allow an individual to successfully perform a task or an activity within a specified function or a job. ^(xiii) Boyatzis' (1982) definition of competency states that "a job competency is an underlying characteristic of an employee - i.e. motive, trait, skill, aspects of one's self- image, social role, or a body of knowledge which results in effective and/or superior performance in a job."^(xiv)

Early conceptions^(xv) of competencies focused on the following five areas:

1. Skills (demonstration of expertise)
2. Knowledge (accumulated information)
3. Self- concepts (attitudes, values, self- image)
4. Traits (general disposition to behave in a certain way)
5. Motives (recurrent thoughts that drive behaviours)

However, TRW competency model^(xvi) classifies human resource competencies as (i) Human resource expertise (provide leadership and teach others to: attract, develop and retain only the best talent, champion process improvement and apply technology, implement creative rewards and recognition, and create internal environment second to none, (ii) Change management (Capture on organizational dynamics, mobilize the organization through the articulation of a vision, demand creative solutions and quick results, seek out and share the best practices, and make project management a core skill), (iii) Personal credibility (meet commitments and keep confidences, take accountability for results, communicate clearly and persuasively, collaborate and network to build relationships, respect and leverage diversity, model TRW's core values), and (iv) Global business partnership (regard the customer as paramount, drive actions based on competitor and industry knowledge,

influence organizational objectives, priorities and processes, insist on business and HR strategy integration, and consider the global impact on decisions).

What Information should be collected?

There are a number of schemes proposed for classifying competencies.^(xvii) For example, one of them uses three groups: (i) personal characteristics, (ii) visionary, and (iii) organizational specific.

RESULTING STRUCTURE

Usually, competency-based structures are designed with relatively few levels. There may be four to six, and relatively wide differentials for increased flexibility.

Of late, "increasingly organizations are finding that success depends on a competent workforce. Paying for competence means that organization is looking forward, not back."^(xviii) The overemphasis laid on quantitative, and often unrealistic, targets in performance-related pay (PRP) is avoided. Competence-related pay (CRP) appeals to employees because it rewards employees for what they are capable of doing, not for results over which they might have little control as, at times, other uncontrollable variables come into vogue.

Why Competency-Related Pay?

Competency -related pay is desirable because it encourages competency development and further that it also encourages employees to take ownership of their own development besides helping to integrate role and generic competences. More importantly, it focuses attention on the requirement of higher levels of competence.

Why Competency- Related Pay is not Recommended?

Competency-related pay is usually not recommended because in it costs are likely to go up if people are paid for competences they rarely use or do not use at all. Competency-related pay also involves considerable resources for training and support besides making high demands on the commitment and skills of line managers. Costs are also involved in terms of

assessment and documentation of competence levels as these are costly propositions as also time consuming, and so on.

Introducing Competence-Related Pay

Competence-related pay may be introduced only when the organization is ready for it which involves support from both top management and line managers and if frameworks for generic competence have been developed. It should also be ensured that the introduction of competence-related pay is likely to provide competence advantage and that effective performance management processes are in place. Besides, a broadband pay structure should also be in place and there should be involvement of employees in the development of competence-related pay program, and so on. Before introducing the competence-related pay, it should be ensured that all concerned like line managers, team leaders and employees are in line with the system and that all the intricacies of the system have not only been explained to them but also the system is acceptable to all. The competence-related pay should be introduced in phases and training programmes wherever required should also be chalked out. Monitoring of the programme at every stage and subsequent evaluation should also be attached due importance.

Thus, we find that though theoretically competence-related pay (CRP) system appears to be better but it is indeed difficult to carry it forward because of certain inherent weaknesses in this system pointed out earlier. Hence, there is a strong case for linking the pay to outcomes (performance) as well as inputs (competence). This gives rise to the concept of 'contribution-related pay.'

A Case for Contribution- Related Pay

Though theoretically, competency-related pay appears to have overcome some of the major shortcomings of performance-related pay (PRP) but simultaneously it gave rise to a number of practical difficulties and consequently, competency-related approach (CRP) has never really taken off. Hence, in

order to take care of the advantages of both performance-related pay (PRP) and competence-related pay (CRP) and also to eliminate the shortcomings of the two, towards the end of twentieth century there emerged a new approach, viz. 'contribution-related pay' and a case for contribution-related pay was made by Brown and Armstrong (1999). They stated that "Contribution captures the full scope of what people do, the level of skill and competence they apply and the results they achieve, which all contribute to the organization achieving its long-term goals. Contribution pay works by applying the mixed model of performance management: assessing inputs and outputs and coming to a conclusion on the level of pay for people in their roles and their work; both to the organization and in the market; considering both past performance and their future potential.^{xix} Soon, this approach became quite popular as is revealed by a CIPD survey (2003). This survey states that while a very few among respondent organizations had competence-based pay, around four times more of competence-related pay had performance-related pay, and around more than double of the organizations, if both the performance-related pay (PRP) and competence-related pay (CRP) are taken together, had contribution-related pay. However, there is no denying the fact that in addition to contribution-related pay, there are some other alternatives like spot rate system, etc.

What is Contribution- Related Pay?

As stated earlier, contribution-related pay is a holistic process involving pay decisions based on the outcomes of the work carried out by individual employees as well as the levels of competence and competency influencing these outcomes.

Though contribution-related pay too, like any other forms of contingent pay, has the shortcoming of relying on managerial judgment and that it is not easy to manage it, yet it may be considered as the best option in most of the cases as has been reflected in several surveys. Its main characteristic is that increases in pay or bonuses are linked to

inputs (i.e. competence) and outputs (i.e. performance). Further, its main advantage is that it rewards people not only for what they do but also how they do it. All the same, it may be difficult to measure contribution and also it is easy to manage it appropriately.

When Contribution-Related Pay to be Introduced?

The contribution- based pay is suitable only when a well- rounded approach covering both inputs and outputs is in place. It should therefore, be introduced when valid and reliable means of measuring performance are available in the organization and when it is expected that it will be instrumental in accomplishing the strategic goals of the organization. Similarly, it should be ensured that appropriate methods of evaluating levels of competence objectively are there and further that line managers are not only capable of and willing to assess contribution of employees but also capable of making as well as conveying contribution pay decisions. Besides, the employees should have faith and trust in the intentions of management and their trade unions accept the scheme and finally, there should exist effective performance management processes and procedures as also a competent HR department.

Developing and Implementing Contribution - Related Pay

In order to develop contribution-related pay, it is essential, first of all, to study and analyse the ongoing processes, procedures, pay structure, methods of progressing pay, method of according bonuses, work culture and strategy of the organization. It should be followed by involving line managers in identifying the relevant aims so that the strategic goals of the organization could be accomplished. Then take decisions how the scheme will be operated i.e. what measures and processes will be taken to measure contribution, how pay increases and bonuses will be walked out, and so on. Simultaneously, competence framework be prepared, role profiles be spelled out and the performance management processes be developed wherever desired. This done,

pilot-tests should be conducted and corrective steps taken as per requirement and thereafter, the scheme be launched and evaluation be carried out periodically and remedial steps be taken as and when necessary.

CONCLUSION

Thus, it is observed that contribution-related pay is a holistic process, taking into account all the aspects of a person's performance and competence. It is a good blend of performance-related pay and competence-related pay embracing the advantages and eliminating the disadvantages of both performance-related pay and competence-related pay, to a great extent. Hence, contribution-related pay is a better system than the performance-related pay and competence-related pay systems.

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