

Research Topic Overview and Presentation

Pay for Performance

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Introduction

Personnel management has long been a challenge in the public sector. A fundamental of personnel management is that employees respond to the incentives offered by their employer, most importantly, the monetary compensation received as a result of their work. The following will address the concept of pay-for-performance as a compensation structure, its development and implementation in different industries, and how it relates to the public sector. The outlook of sole pay-for-performance may be grim, but it has the potential to evolve into a successful management tool if it is incorporated with other means of employee recognition.

The Concept and its Objective

Pay-for-performance (P4P) is the compensation structure by which employees are being paid with contingency to their performance, such that those with superior performance should be recognized and rewarded (Kellough and Nigro 2002). For example, if two workers are each working on a similar task and one worker completes the task with substantially higher standards than the other worker, this worker should receive more paid for his superior performance. The pay itself, however, can take different forms depending on how the organization measures the unit of work being completed. An organization can measure the work of a specific individual, a work group or division, both by quantity and/or quality of work and offer financial pay in the form of an increased based pay, a one-time bonus, or a combination of both (Kellough et al.).

The most typical P4P application is the merit pay approach by which an employee's performance is rewarded by a merit increase. The logic of the merit is that additional financial reward will lead to an employee's extra effort to produce more and better work. The ultimate objective of this pay structure is to reward high level of staff performance with monetary benefits, thus raising job satisfaction and improving work quantity and quality.

Historical Development

Pay-for-performance is a concept that existed since the beginning of trade. In the ancient days when farmers produced and traded livestock, their pay was performance-related. The more crops and better quality livestock they had available to trade, the more payment they would receive. In the age of industrialization, P4P was specifically used in compensating factory workers. Their performance was measured by the number of pieces they produced, and their pay was based on a receiving a specific amount per each piece of their production.

In the early 1990s, labor unions and collective bargaining became common in the workplace. They populated and demanded uniform wage increase for the entire workforce. In companies where wage is adjusted uniformly, little could be done to differentiate pay and performance (Lazear 2000). In recent years, changes in technology and business techniques allowed for workers with specific knowledge and technical skills to emerge. Employers began to specifically link performance to pay, motivating performers to soar and turning away those who made little contribution to the business.

Examples of Implementation

Pay-for-performance tends to have a positive impact on businesses where increasing sales and revenues are directly tied with its employees' performance. In the auto sales industry, employees are given a commission for each vehicle they sell. Those who do not perform well tend to leave the dealership within months of their employment, leaving only top performers working at the show-room, thus maximizing sale opportunities for the dealer.

In other industries, especially in the public and non-profit sector, P4P as the only compensation structure tends to have an adverse effect on job satisfaction. Beginning in the early 2000s, P4P became an emerging movement in the healthcare industry. P4P did reduce medical

errors and cut costs, but it did so without necessarily improving patient care (Rosenthal and Dudley 2007). From the employer's standpoint, P4P helped to improve the quality of care by shaping clinician behaviors and reducing medical errors. One such error was the rate of infections in out-patient care. However, due to the fact that patients sometimes were seen by various doctors in different specialty areas, the development of infection may not be linked directly to the patient's primary clinician or actions performed by the primary care taker. Some clinicians claimed that P4P had not been implemented fairly with accurate measures of performance. Some physicians might even reject performing certain types of risky procedures to avoid running into clinical errors, even if those procedures might improve the conditions of their patients (Rosenthal et al).

Pay-for-performance is also a heated debate in the education sector. Beginning in the late 1990s, schools across the United States began to engage in P4P programs. By 2002, 32 states provided performance based bonuses to teachers, staff, or funds for the schools to reward their employees for meeting educational goals. The establishment of the Federal No-Child Left Behind law also prompted legislature to offer schools financial incentive to improve performance (Kelley 2002). Results from a study by Kelley found that in the short run (one to two years), P4P tends to influence teacher performances by affecting the focus of their teaching to target specific academic goals. In the long run (three years or more), ongoing efforts to improve performance could be difficult without considering other resources, such as the need for new supplies, funding per student, etc. Some teachers also believe their primary motivation to teach includes intrinsic factor, such as public recognition or satisfaction in seeing their students achieve academic success (Burgess, Croxson, Gregg & Propper 2001). Pay-for-performance

might shortly alter teacher practices to focus on achieving certain academics goals, but it does not enhance job satisfaction or the motivation to provide quality education.

Implications for the Public Sector

In the early 1980s, P4P was viewed as crucial to enhance public employee morale and productivity. By the early 1990s, questions on the effectiveness of this compensation structure began to arise (Kellough and Selden 1997). Numerous studies found that P4P often creates problems concerning performance evaluation and the apparent reluctance of government to adequately fund the increases they promised. By 1993, the government terminated its Performance Management and Recognitions System (the federal merit pay system) and moved employees away from the performance based structure to the general schedule pay structure. While some states continue to employ a performance based compensation system, research suggests that most states are probably facing problems making P4P successful (Kellough et al).

Why is P4P creating problems in the public sector? Unlike businesses, the public sector does not set forth to generate sales or revenue. Most public agencies are working with a specific budget that includes little money set aside for merit increases. The increase maybe so little that it makes no significant impact on the employee's take-home pay. Performance goals in public agencies may also be more difficult to measure. Political viewpoint and budget issues may affect the accuracy of performance measures. With limited budget, some managers might be forced to give lower appraisals to avoid giving merit increases. In addition, many employees in the public sector are motivated by intrinsic factors, such as serving the public, receiving recognition, or acting on issues that could better their communities. Though a merit increase is appreciated, it does not necessarily increase an employee's job satisfaction or quality of work. Therefore, public agencies cannot rely solely on a compensation structure based on performance pay.

Future Viability

Many studies agree that Pay-for-performance will continue to evolve in the near future. Studies found that many organizations, both private and public, are aware of the issues of a simple performance pay plan and are working on revising their pay structure and incorporating fair performance measures and other means of employee recognition (Heneman and Werner 2005). Due to inflation and the constant increase in cost of living, employees would want and expect increases from their employers. Pay is a significant factor, though it is not the only factor, in an employee's continual effort to produce quality work. Performance pay should continue to take a part in an organization's compensation structure but it must do so with good and fair performance measures. In addition to pay-for-performance, employers should look into alternatives of employee recognitions to increase staff morale and job satisfaction. Achieving good employee performance often requires more than just offering monetary compensation. Employees would place high value on factors such as being appreciated and listened to, having a manager that is considerate and fair, or growth and training opportunities. An organization needs to recognize their employees' overall value, in addition to offering pay for performance.

Conclusion

The method of compensation is a crucial part of enhancing staff morale, encouraging employee productivity, and reducing turnover rates. Pay-for-performance is a pay structures that offers incentive to employees but it solely will not solve all personnel issues. Pay for performance may be effective as part of a compensation structure, but management must incorporate fair performance measures and offer other means of recognitions to show staff appreciation. When employees feel that they are being valued as a part of their organization, their morale will be strong and their work will achieve superior quality.

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