

# Part 1

## The fundamentals

It is appropriate that we begin our journey by considering those ideas, concepts, propositions and debates that are fundamental to a rounded understanding of employee performance and reward management and, equally, to well-informed and effective practice in these fields.

The three chapters in part 1 are devoted to this end. Chapter 1 seeks to clarify the meaning, nature and purpose of our two focal human resource processes: performance management and reward management. While our treatment of the ‘what’ and ‘why’ of performance and reward management is written from an explicitly prescriptive–descriptive perspective, the treatment is neither wholly management-centred nor uncritical.

Building on this foundational knowledge, the two accompanying chapters consider, respectively, the psychological, motivational and strategic basics of performance and reward management. These chapters offer frameworks for practising performance and reward management in both a psychologically aware and a strategically informed manner. The development, implementation and maintenance of effective performance and reward management systems require simultaneous attention to each of these fundamental dimensions.

By ‘psychological’ dimensions we mean the attitudes, perceptions, values and emotional (or ‘affective’) states that prefigure the observable actions – or behaviour – of individual employees, or at least that seem to predispose individuals towards certain behavioural actions rather than others. While ‘motivation’ is undoubtedly the most widely acknowledged and theorised of all work attitudes, as we shall see, there are others that may be no less salient or influential, including those that are grounded more in perception and in deeply held values and emotions than in dispassionate or rational cognition.

By ‘strategic’ dimensions we mean the plans, processes and actions involved in establishing and maintaining an alignment between an organisation’s purpose,

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structure and objectives, on the one hand, and the individual and collective behaviour and achievements of its employees, on the other. You will notice that, on the basis of these definitions, employee behaviour is *the* key bridge between the psychological and the strategic.

Before considering these themes in detail, it is necessary for us to examine the general nature and purpose of performance and reward management.

## 1

# Performance and reward basics

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As a way of mapping the general terrain of performance and reward management, this chapter overviews the general meaning, nature and purpose of performance and reward management practice. We begin by examining the definition and dimensions of employee performance. Next we consider the possible purposes of performance management. Following this, we investigate the main requirements for the effectiveness of a performance management system. Attention then turns to the definition of employee reward, the non-financial and financial reward elements covered by a ‘total reward’ approach, and the three main categories of financial reward or ‘remuneration’. Finally, we examine the general objectives of a reward management system.

## ■ ‘Performance’

What is ‘performance’? The trite response is that it depends on who you ask. A critical post-structuralist may say that performance is whatever the dominant management discourse says that it is. To a pluralist, the answer will depend on the stakeholder concerned: a shareholder is likely to equate it with share price improvement and annual dividend payments, a manager on a profit-sharing plan may nominate annual net profit, a production manager may suggest labour productivity, and a customer might suggest product quality or cost-attractiveness, while to a production line employee performance may equate with job and income security and workplace health and safety. Such responses do indeed highlight two important facets of performance: first, it is a subjective, constructed (and hence frequently contested) phenomenon; second, and relatedly, it is open-ended and multidimensional. In short, what is important about performance is not just how ‘high’ or ‘low’ it is but also how it is defined and measured, by whom and for what purpose.

However, while these are important points in a general descriptive sense, they do not get us very far in a practical or applied sense. To conceptualise ‘performance’ as a manageable human resource phenomenon (and hence with prescriptive ends in mind), it is perhaps most useful to view performance in ‘cybernetic’ terms; that is, as a process-based work ‘system’. Adapting insights offered by Wright and others (Wright & McMahan 1992; Wright & Snell 1991) on what has been described as the ‘open system model’ of human resource management, we can conceptualise work and

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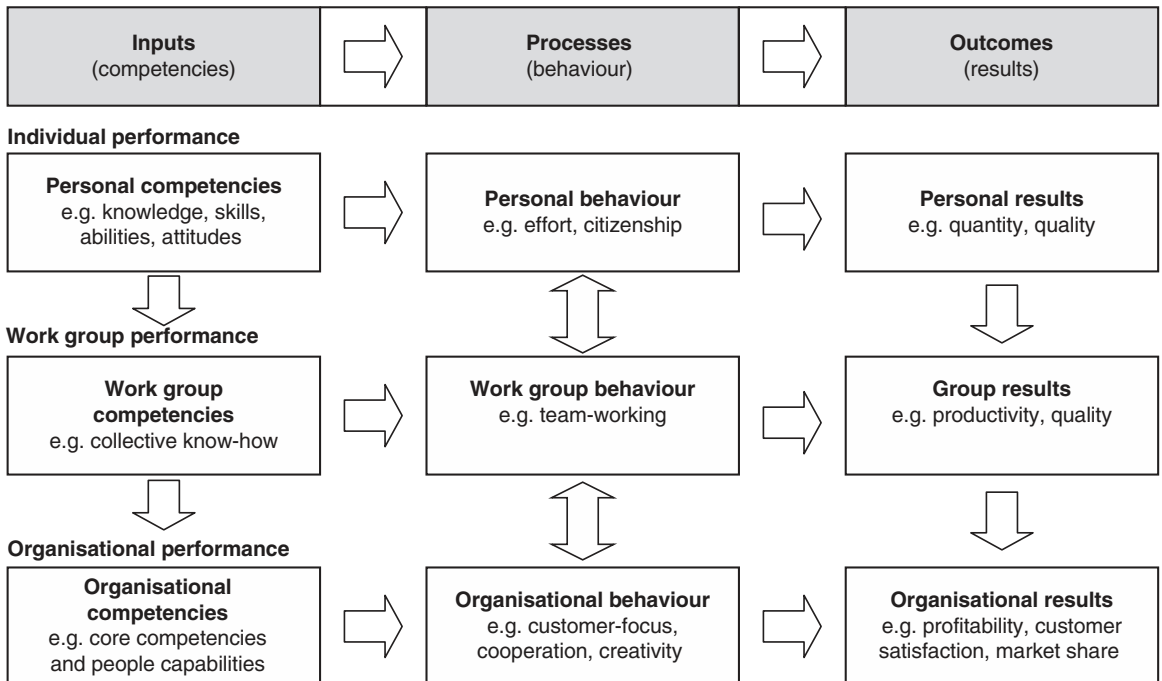
work performance as a system comprising three main elements arranged in a linear sequence:

- 1 'inputs', including employee knowledge, skills and competencies (i.e. abilities and attitudes), as well as other tangible and intangible 'resources'
- 2 human resource 'throughputs' (i.e. activities that transform inputs into outcomes, including, most importantly, work effort and other behaviour); and
- 3 'outputs', including outcomes from work behaviour (i.e. results).

So, an employee provides work inputs in the form of knowledge, skills, abilities and attitudes, applies these through effort and related forms of work behaviour, and produces a certain quantity of products or services of a certain quality within a certain period of time. Strictly speaking, inputs in the form of knowledge, skills and competencies are not tantamount to performance; they have to do with the employee's *potential* to perform. Since the early 1990s the competency-based approaches have become a prominent feature of performance management practice in many Western organisations.

Performance, however, is not just an individual phenomenon; as figure 1.1 suggests, it also has group and organisation-wide dimensions, each with inputs, processes and results that parallel those operating at the individual level. In this sense, performance can be thought of as having three horizontal (or sequential) dimensions and three vertical (or scalar) dimensions. So, for instance, a team or other work group might contribute a level of collective know-how (input), engage in cooperative

FIGURE 1.1 What is performance?



teamworking (behavioural process) and achieve a certain level of group productivity (result). At the organisational scale, inputs would include the collective know-how, productive capacities, cultural values and work attitudes of the entire workforce; processes would include such collective behaviour as cooperation, creativity and customer focus; and results would include such outcomes as corporate profitability, market share and customer satisfaction. As we shall see, all of these vertical dimensions fall within the ambit of performance and performance management.

Moreover, as figure 1.1 indicates, these performance variables also have important cross-dimensional linkages. Individual knowledge and skill feeds into work group know-how, which in turn flows into organisational productive capabilities. Similarly, individual results flow into group results, which in turn contribute to organisation-wide results. This is not to suggest that group and organisational inputs, behaviour and results are simply the sum of individual contributions. As we shall see, other factors are at work that will influence the transmission and strength of these vertical associations. You will notice, too, that the vertical linkages associated with behavioural processes are bi-directional. This is because collective behaviour arises from and shapes individual behaviour. Just as a misbehaving individual team member may disrupt team cooperation, so a behaviourally dysfunctional team will almost certainly further impair the behaviour of individual team members. Behavioural problems of this type constitute one of the major challenges of contemporary performance management.

## ■ Performance management purpose

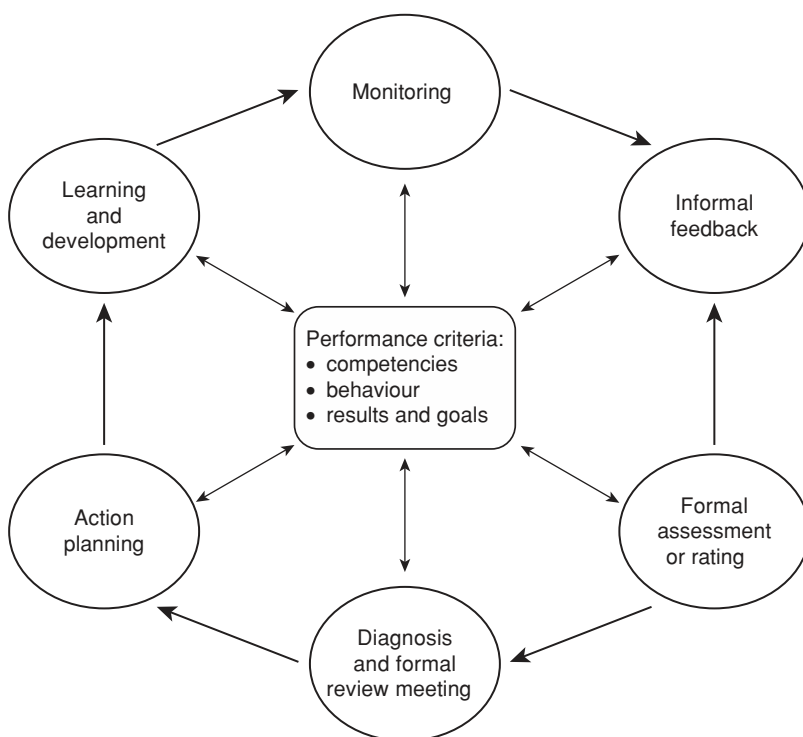
In the past, it was not at all uncommon for performance management to be thought of as a once-a-year event in which the supervisor passed summary judgement on the performance of each of their subordinates, filled out an appraisal form, informed each subordinate of the outcome, then consigned the record of performance to the corporate archive. Uncharitable commentators sometimes describe this as the empty ritual of once-a-year ‘tick-and-flick’ performance appraisal. Management thinker W. Edwards Deming, the pioneer of total quality management, even decried performance appraisal as one of modern management’s most ‘deadly diseases’ (Deming 1986). According to Deming, traditional appraisal ‘nourishes short-term performance, annihilates long-term planning, builds fear, demolishes teamwork, nourishes rivalry and politics’. Deming labelled performance appraisal a lottery, with individual ratings emanating largely from random factors outside individual control (cited in Carson, Cardy & Dobbins 1991). Other commentators have challenged the financial rationale of performance appraisal, arguing that combined, the ‘hard costs’ (direct and indirect expenses) and the ‘soft costs’ (meaning the time, energy and expertise of employees) outweigh any potential benefit accruing from the appraisal process (Nickols 2007). Further criticisms point out that, by focusing on short-term, individual performance and by reinforcing top-down management, performance appraisal per se is too narrow and non-strategic to provide a comprehensive approach

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to performance management (Bach 1999; Beer 1981; Flannery, Hofrichter & Platten 1996; Lawler 2000).

Today, it is far more common for organisations to regard performance management as a continuous, future-oriented and participative system; as an on-going cycle of criteria setting, monitoring, informal feedback from supervisors and peers, formal multisource assessment, diagnosis and review, action planning and developmental resourcing (Aguinis & Pierce 2008; Bach 1999; Biron, Farndale & Paauwe 2011; Williams 2002). The basic elements and phases in this cycle are illustrated in figure 1.2. The cycle itself may be annual, six-monthly, quarterly or even monthly in nature. As participants in this process, all stakeholders – human resource managers, line supervisors, fellow workers and employees themselves – are expected to act responsibly and to accept accountability for their contribution and assessments. Whether or not this does actually happen will depend in large measure on the level of support shown by senior management, on how well the system is resourced, and how effectively the system's purpose is communicated to all involved.

**FIGURE 1.2** The performance management cycle



Why is it necessary to ‘manage’ employee performance at all? On this count, at least, the prescriptive management writers and their ideological adversaries, the critical structuralists, appear to share some common ground (albeit with very different agendas in mind): without performance direction and recognition, employees will be at loss as to the nature and level of work effort required. Just imagine how work

would likely be undertaken in an organisation that made little attempt to define how it wished its workers and managers to behave, what it wanted them to achieve, and what it meant by ‘good’ and ‘bad’ performance, as well as how it proposed to treat star performers, on the one hand, and underperformers on the other. In today’s organisations, simply instructing employees to ‘get on with doing a good job’ is just not an acceptable option.

This, of course, begs a critical question: what should a ‘good’ performance management system seek to do? From a prescriptive perspective, a well-designed and well-accepted performance management system can be said to have a fourfold purpose: (1) strategic communication, (2) relationship-building, (3) employee development and (4) employee evaluation.

### ■ *Strategic communication*

It is now widely accepted that performance management has a vital role to play in organisational communication. In particular, clear, appropriate and comprehensive performance criteria can convey to individuals and work groups exactly what the organisation expects from them in terms of desired competencies, behaviour and results in order to achieve its strategic objectives. An effective performance management system signals not only that it wishes employees to ‘do a good job’; it also communicates to them what doing a good job actually entails in each position or role. In other words, a key aspect of strategic communication is facilitating ‘role clarity’. However, the ‘signalling’ dimension of strategic communication extends beyond an individual’s role. The nature of the performance management system also communicates to employees the values and culture of the organisation (Biron, Farndale & Paauwe 2011). Since the 1980s it has become much more common for performance management systems to be configured with an explicitly strategic purpose in mind. In large part, this reflects the centrality of the ‘strategic partner’ role in human resource management discourse and practice (Dunphy & Hackman 1988; Pritchard 2010; Ulrich 1998).

### ■ *Relationship-building*

By bringing stakeholders together on a regular basis to review performance achievements and plan for further development and improvement, systematic performance management stands to make a major contribution to the building of stronger work relationships within the organisation. This, in turn, can have a positive influence on work culture. Requiring supervisors, subordinates and peers to take an active, positive and accountable role in performance review and planning can help to widen multi-party dialogue and information-sharing, as well as enhance the level of interpersonal trust. However, there is also the inherent danger in poorly designed or implemented performance review systems that if they are not perceived as fair they may damage workplace relationships and negatively impact on organisational culture (Nickols 2007).

### ■ *Employee development*

Performance management may serve a developmental purpose. This may include: providing formal feedback on recent performance, including strengths, weaknesses and areas for improvement; maintaining and improving motivation and performance; providing guidance on career development; identifying barriers to improved performance; and assisting in human resource forward planning, especially regarding the development of personal skills and competencies. As figure 1.2 indicates, the performance management and staff training and development functions are mutually supportive. Performance review provides an important means of evaluating outcomes from staff training and development initiatives. At the same time, it is the major means of identifying deficits in employee knowledge, skills and abilities that may require remediation. For similar reasons, the developmental purpose also aligns with the job or role assignment decisions that are a pivotal aspect of the staffing function.

### ■ *Employee evaluation*

Performance management systems frequently also fill an evaluative purpose. In essence this has to do with determining individual ‘merit’ for selection, promotion and/or reward allocation. Assessment for job reassignment, promotion and demotion or retrenchment are among the most long-standing objectives of systematic performance management. The evaluative purpose also includes monitoring the effectiveness of other human resource policies, especially recruitment, selection, training and job evaluation. Another traditional purpose of individual performance assessment has been to obtain numerical ratings and rankings that can then be used as the basis for determining performance-related adjustments to pay. The methods used to obtain these ratings can be the cause of serious practical and ethical concerns – as highlighted by the performance appraisal and reward methods of those companies in the finance sector involved in precipitating the global financial crisis (GFC) of 2007–08 (Cascio & Cappelli 2009). Despite the attendant difficulties, the human resource processes associated with the performance-pay nexus are our central concern and the nature of this association will be a recurrent theme in the chapters that follow.

Yet the relationship between developmental and evaluative purposes is frequently a troubled one, and achieving and maintaining a harmonious relationship between the two is undoubtedly one of the single greatest challenges that awaits the unsuspecting human resource manager. In particular, employees may be left wondering whether the main purpose of their annual performance review is to help them to develop their future performance or to reward (or punish) them for past performance. The developmental objective recognises that the role of the manager is not just to evaluate and reward past performance but also to enhance employees’ present and future capacity, motivation and performance.

Critics of traditional supervisory performance appraisal, with its focus on once-a-year assessment of past performance, have long argued that it privileges the evaluative purpose over strategic, relational and developmental considerations



(Lawler 1994b; Mohrman & Mohrman 1995; Wilson 1994: 201–29). As we have seen, the preferred approach today is that of continuous ‘performance management’ (Aguinis, Joo & Gottfredson 2011). Does this mean, however, that the traditional evaluative purpose is becoming less important while the developmental is becoming more so? Survey data over time suggests that this is the case. A 2009 UK survey of performance management practices by the Chartered Institute of Personnel and Development (CIPD) asked ‘what other HR processes ought to link to performance management?’ Learning and development and career development were the most common answers given by the 507 respondents at 85 per cent and just over 80 per cent respectively. This compares to survey results in 2004, when 71 per cent of organisations surveyed operated performance management systems with a developmental focus (CIPD 2005b: 2).

While more recent Australian data is not available, an investigation of performance management practices in Australian organisations was conducted in 2006. The results of this investigation mirror the UK results showing that while the evaluative purpose remained strong, strategic and developmental purposes were also very much in evidence, with 89 per cent of respondents indicating the determination of training and development as an important purpose of their performance management practices – exactly the same proportion that nominated the evaluation of past performance as a major system purpose (Nankervis & Compton 2006). These responses also differ significantly from a comparable Australian survey undertaken in 1995 (Nankervis & Leece 1997), which found that only 58 per cent of respondents indicated staff development as an important consideration, compared to 94 per cent nominating evaluation of past performance as a major system purpose. In other words, in Australia, as in the United Kingdom, the relative importance of the developmental purpose has risen substantially since the 1990s, although the evaluative purpose has certainly not been eclipsed entirely.

## ■ Basic requirements for effective performance management

Irrespective of specific purpose, what are the main requirements for the effectiveness of a performance management system? Again, in prescriptive vein, the four key requirements are: (1) validity, (2) reliability, (3) cost-effectiveness and (4) felt-fairness.

### ■ *Validity*

Validity relates, first, to the criteria by which employee ‘performance’ is defined or ‘constructed’ in terms of desired standards and, second, to how accurately the performance measures or ‘indicators’ applied to these standards reflect or predict actual performance. The more valid the performance construct and the measures associated with it, the more closely and comprehensively these will relate to what employees are

actually required to do in their role. In other words, validity has to do with whether the standards set and the measures used are relevant to the specific work role involved, whether they measure enough of the right things, and whether the measures or indicators themselves accurately reflect or capture what is achieved in relation to desired standards (Drenth 1998: 68–9; Klein 1996).

In relation to performance measurement, validity can be disaggregated into three dimensions:

- 1 construct validity (= role relevance of performance standards)
- 2 content validity (= role representativeness of performance standards)
- 3 criterion-related validity (= the accuracy of performance measures or indicators used in reflecting and/or predicting the desired performance standards).

A performance management system is said to be construct valid if the performance standards and measures are directly relevant to what is required in the job, position or role involved; that is, construct validity is concerned with the role *relevance* of the performance standards and measures applied. The key system design question here is: are we really measuring the right things for this role?

Content validity refers to the extent to which the performance standards and measures provide a representative and comprehensive coverage of all desired facets of role performance. A system would fail the test of content validity if it recognised and measured some aspects of the job but ignored one or more other aspects that the job holder had been asked to address. So, for example, content validity would be compromised if the organisation desired to maximise both labour productivity and product quality but specified a standard and measure only for productivity. As such, the key system design question here is: are we measuring *enough* of the right things for this role?

Criterion-related validity refers to the closeness of the association between the performance measures used and what it is that the organisation actually says it wants from the employee. For example, a system would fail the test of criterion-related validity if it used, say, observations of personal grooming standards to measure the quality of customer service provided, or if it used observations of hours worked as a measure of work effectiveness. This is not to say that the measures used may not be valid in relation to other performance standards or criteria; the point is that in these instances neither measure is valid for the particular criterion specified. Here, then, the key design question is: are we really measuring what we say we are trying to measure?

## ■ Reliability

Reliability has to do with the consistency and accuracy of the measurement task itself as opposed to the performance criteria and measures used. Equally, reliable measurement will be impossible where the measurement criteria themselves are wholly or partly invalid. Yet reliability itself is an elusive ideal. Since information is necessarily partial and selective, we can never know the true reliability of any measurement instrument; only its estimated or probable reliability, expressed as a correlation coefficient between +1.0 for perfect reliability and –1.0 for total unreliability. A measuring