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INTRODUCTION: SETTING THE SCENE

As the iconic Silicon Valley computer hardware firm Hewlett-Packard (H-P) discovered to its cost in the mid-1990s, the road to performance and reward hell is sometimes paved with good intentions. For years, H-P had prided itself on having an inclusive, high-trust work culture – known affectionately as the 'H-P way'. During the 1980s, H-P was lauded as an archetype of high-involvement people management. H-P's decision-making processes were inclusive and democratic, and its workers were rewarded generously via traditional 'merit'-based pay increases and egalitarian profitsharing and employee share ownership arrangements. The company also avoided the use of executive bonus payments, a further signifier of its egalitarian approach to reward management.

Then, in the early 1990s, under growing cost pressure from local and international competitors, and in a bid to lift plant productivity and performance, H-P rolled out a range of 'alternative' pay plans in more than a dozen of its American and European plants. Senior plant managers leapt at the chance to 're-engineer' their performance and reward management systems and proceeded to install a range of new pay practices, chiefly involving skill-based pay, team incentives, gain- or goalsharing and other group incentives, as well as some individual cash incentive plans. In several plants where teamworking was in place, peer evaluation was also introduced as a means of keeping team members on their toes. In large part, the new measures were intended to support the adoption of self-managed teams and a focus on team effort. *Prima facie*, the new plans also appeared to be compatible with the firm's celebrated high-commitment work culture and its focus on a high-skill, high-quality competitive strategy (Beer & Cannon 2004: 5–7).

Yet it was not to be. There were unintended consequences aplenty; the company was badly burned and continued to lose market share. Most of the plans impaired employee satisfaction and morale while failing to show a positive return on investment. In some plants, the competition for cash set team against team in a destructive cycle of talent hoarding, while peer evaluation caused a breakdown in intra-team relationships. Even those initiatives that appeared to have enhanced performance proved far more costly than anticipated. All but a few of the new pay plans were abandoned within a few short years. At H-P's San Diego site, employees even organised a party to celebrate the demise of management's experiment with skill pay and team incentives (Beer & Cannon 2004: 6–9).

So why did these seemingly laudable initiatives founder? Was it more a case of the wrong ideas full stop, the wrong ideas for the time and context, too much change too soon, naive optimism – faddism even – on the part of the management innovators, or just a case of good ideas badly applied? Some commentators (e.g. Kohn 1993a & b) argue that all incentive schemes – that is, reward plans that seek to elicit greater work contribution by promising higher rewards for higher contribution – are doomed to failure because they are based on supposedly invalid assumptions about the true wellsprings of employee motivation and effort. In essence, their argument is that once incentives come into play, employees are all too easily distracted from their real work responsibilities by the pursuit of rewards themselves. Others, like Beer and Cannon (2004), suggest that small-group financial incentive plans of the type applied at the H-P plants were incompatible with the company's once-prized high-commitment, high-trust culture, and that other means, such as expanded training and development programs, would have been a better choice for enhancing workforce capability and contribution. Still others contend that the problem lay not in the plans themselves but in the way they were conceived and applied. Heneman, Kochan and Locke (commentaries in Beer & Cannon 2004: 33–4, 35–7, 41–3) note that most of the plans were badly designed, were poorly communicated to line employees, team leaders and supervisors, were conceived and applied with minimal employee consultation, involvement and training, and were subject to arbitrary changes to team performance standards. Locke (in Beer & Cannon 2004: 41) is particularly critical of the attempt to combine performance incentives and skill-based pay, which, he suggests, sent conflicting signals to employees about what the firm valued most. Locke also contends that the devolution of responsibility for change management to the site managers also seems to have deprived the experiment of vital expertise and guidance that could have been provided by the corporate human resources department. So take your pick! – bad ideas *per se* or good ideas, badly applied?

Multinational firms are not the only organisations to have experienced the unintended consequences of experimentation with performance pay as a driver of organisational change. There are many examples of public sector experiments that have not gone according to plan. The Australian Public Service (APS) is a case in point.

The APS, the administrative apparatus of the Government of the Commonwealth of Australia, comprises about a hundred agencies, both departments of state and statutory bodies, with a total of around 120,000 employees. Since the mid-1990s, a new performance 'paradigm' emphasising individual performance appraisal and performance-contingent rewards has been applied throughout virtually the entire APS. The emergence of this new performance model is attributable to a combination of political and economic pressures that compelled the APS to search for improved efficiency and performance and a more results-oriented culture (Grant, O'Donnell & Shields 2003). The model represents a fundamental shift in management approach to employee motivation in the APS. It also signifies an attempt to radically reshape the image and outlook of the APS employees themselves: from the traditional concept of loyal 'public servant' to that of innovative 'strategic contributor'.

The motivational centrepiece of the APS performance management model is performance-related pay. The traditional system for rewarding APS employees for superior performance involved merit-based promotion through a classification system and regular increments to base pay based on time service and seniority. Under the newer system, superior individual performance may be recognised through accelerated progression through the new classification system or via performance bonus payments. Since 1997 there has been a pronounced move away from semi-automatic seniority-based salary increases to increases contingent on appraised or measured individual performance. Pay-for-performance measures are now widespread throughout the APS, and in many agencies this has also been accompanied by a substantial reconfiguration of existing performance assessment practices, including a stronger emphasis on corporate values and strategic awareness and contribution.

However, there is now a solid body of evidence that, for many employees in APS agencies, the experience of the new performance and reward management practices has been anything but uniformly positive (O'Donnell 1998; O'Donnell & Shields 2002b; Grant, O'Donnell & Shields 2003; APS Commission 2005).

Initial research on outcomes from the APS performance management model highlighted employees' belief that supervisors' assessments were influenced by factors unrelated to individual performance. Employees were also concerned that performance ratings were being used by management to target individuals for dismissal on the grounds of under-performance or to facilitate staff reductions. Preliminary performance ratings by supervisors were frequently moderated or 'normalised' by means of forced distribution, ostensibly to ensure consistency across the organisation. However, employees suspected that the initial ratings were 'moderated' downwards for budgetary reasons to limit the overall cost of the performance management scheme. In addition, employees pointed to the potential for performance pay to rupture relationships between supervisors and subordinates. Although many of the new performance management systems introduced in APS agencies in the late 1990s contained appeal mechanisms, staff reported either being unaware of the details of the appeal process or considered more senior managers unlikely to alter the rating decision of their supervisor. Employees also reported being reluctant to appeal performance rating scores because they feared that doing so might damage their prospects for career advancement. Other employees expressed concern that the revised performance criteria were frequently imprecise and ambiguous and allowed supervisors undue discretion to make idiosyncratic and arbitrary judgements regarding employee behaviour and work performance. Linking assessment scores to short-term pay outcomes also generated increased conflict between supervisors and staff, and often created tensions among employees themselves (Grant, O'Donnell & Shields 2003).

Moreover, from a management perspective, in many APS agencies, initial outcomes were less than stellar. In some agencies, schemes failed to differentiate adequately between 'effective' and 'superior' job performance, with most agencies falling back on automatic annual 'merit' increments to base pay for all employees achieving an 'effective' performance rating. Indeed, some agencies abandoned performance pay for non-executive employees altogether, citing either their failure to motivate or the corrosive impact of performance-contingent pay on the performance management process itself (O'Donnell & Shields 2002b; Grant, O'Donnell & Shields 2003).

Of course, it could be argued that these findings simply reflect the 'teething' problems that are typical of any change process. However, more recent evidence confirms that the problems with the APS performance management initiatives are widespread and deep-seated. An employee survey undertaken in 2005 by the Australian Public Service Commission, and based on more than 3,600 responses obtained by means of a stratified random sample of 6,160 APS employees, reveals that only 43 per cent of respondents agree that their last performance review helped them to perform well. In this regard, one respondent (APS Commission 2005: 160) remarked: 'I have never been satisfied with our performance feedback system. Supervisors tend to use it as a tick and flick exercise – there is no detailed assessment of my performance. Worse, supervisors do not give enough feedback between formal assessments. In the case of my current supervisor, if he does give me informal feedback, it tends to be of the negative variety.'

As before, however, the most negative employee attitudes are those concerning performance pay. Most significantly: only 39 per cent of respondents agree that their agency's performance pay system 'operates fairly and consistently'; only 36 per cent agree that it 'acts as an incentive to perform well'; and only 31 per cent agree that it 'contributes to a workplace which upholds the APS values'. Of still greater concern is the fact that only a fifth of respondents agree that their performance pay system 'accurately reflects differences in individuals' performance', 'provides appropriate rewards for top performers' and 'contributes to a workplace culture in which individuals work together effectively'. A comparison of survey results for previous years indicates that far from employees being won over to performance pay, in attitudinal terms the situation throughout the APS is actually deteriorating: 'This year's survey results add to the evidence presented in last year's report that the credibility of performance pay systems amongst employees is not high in most agencies and the gap is widening.' (APS Commission 2005: 161, 164.)

So, what is the underlying problem here? Is this also a case of a bad idea gone predictably wrong or, alternatively, of good ideas being poorly applied? Well-designed and administered performance appraisal has for decades been a vital element of merit-based promotion and pay progression in public service contexts. Yet there is evidence that performance-contingent pay may be a poor motivator in public sector contexts and may even have dysfunctional consequences (Marsden & Richardson 1994; Marsden 2004). It may also be that public service employees are motivated chiefly by a sense of public purpose and promotion-based status and achievement rather than by short-term pay outcomes (Gaertner & Gaertner 1985). Alternatively, it may be that the APS plans are a good idea badly applied. Could good system design and implementation have anticipated and forestalled many of the concerns raised by APS employees themselves?

Either way, as these two cases make abundantly clear, performance and reward management is fraught with peril. Despite their many differences, the H-P and APS experiences are instructive examples of how not to go about altering an organisation's performance recognition and reward practices. Perhaps more so than other facets of human resource management, the management of employee performance and rewards is an attitudinal, emotional and behavioural minefield. Ill-chosen, badly designed or poorly implemented performance management systems can communicate entirely the wrong messages as to what the organisation expects from its employees. An ill-conceived reward system may not only fail to elicit desired behaviour; it may also encourage behaviour that is dysfunctional, deceptive or even destructive; that is, it may give rise to endemic organisational misbehaviour.

The challenges and potential problems associated with performance and reward management are certainly not lost on human resource managers themselves. Survey data on Australian human resource managers' perceptions of the efficacy of performance management systems in their organisations indicates that while such systems have become more complex and strategically focused since the 1990s, only 49 per cent of human resource managers rate their current system as 'effective', while just 20 per cent believe that their system is 'highly effective'. The same study also suggests that manager satisfaction with system effectiveness has actually declined since the early 1990s (Nankervis & Compton 2006: 99).

Clearly, from both a management and an employee perspective, managing employee performance and reward is something that is difficult to do well – and very easy to do badly. Yet both the stakes and the potential are simply enormous. As we shall see in subsequent chapters, whether wittingly or unwittingly, performance and reward practices can play a powerful role in shaping and reshaping employee work attitudes and perceptions of trust and fairness, and especially in determining the state of that complex constellation of employee cognitions known as the 'psychological contract'. And this is one of the main reasons this book has been written: to offer readers a balanced coverage of both the potential and the possible pitfalls of performance and reward practice. The driving purpose of this book is to equip readers with the knowledge and critical insight necessary to make their own informed judgements and choices about these two pivotal human resource processes. Equally, the book aims to provide readers with the analytical tools required to avoid the all-too-common problems of performance and reward mismanagement.

While the book's central concerns are with performance and reward processes, attention is also paid throughout to recognising and analysing the interconnectedness of these and other human resource processes, including staffing (i.e. recruitment and selection) and employee training and development. As we shall see, misalignment between any of these four key functional areas can be very detrimental to both organisational effectiveness and employee well-being. Figure 0.1 (p. 8) illustrates the mutual interdependence of these four key human resource management functions. We shall return to these cross-functional synergies throughout the book.

Conceptual approach

Over the years, my own students have frequently decried the absence of cohesion in many standard human resource teaching texts. Their complaints are not without foundation. It is not at all uncommon to encounter teaching tomes on human resource management that amount to little more than an assemblage of prolifically illustrated but poorly connected chapter-length treatments of specific human resource functions. Such books generally have no identifiable integrative argument or thesis to offer, and hapless readers are left largely to tie the pieces together for themselves. Mindful of this, what I have sought to offer throughout this book is an explicit and sustained line of *argument* regarding key performance and reward management concepts, principles and practices. As a reader, you may ultimately disagree with the argument and recommendations proffered, but you will at least know where I stand on the matters in dispute.

There is always a danger in authors nailing their conceptual colours to the metaphorical mast at the outset, but to do so is, arguably, a core requirement of intellectual honesty and transparency. In the United States, virtually all of the major mainstream texts on 'compensation' (i.e. remuneration) are authored either by labour economists or by organisational psychologists. While these disciplines are of pivotal importance to the matters we are about to explore, a range of equally useful insights from other fields of intellectual inquiry is now available. To this end, this book draws on

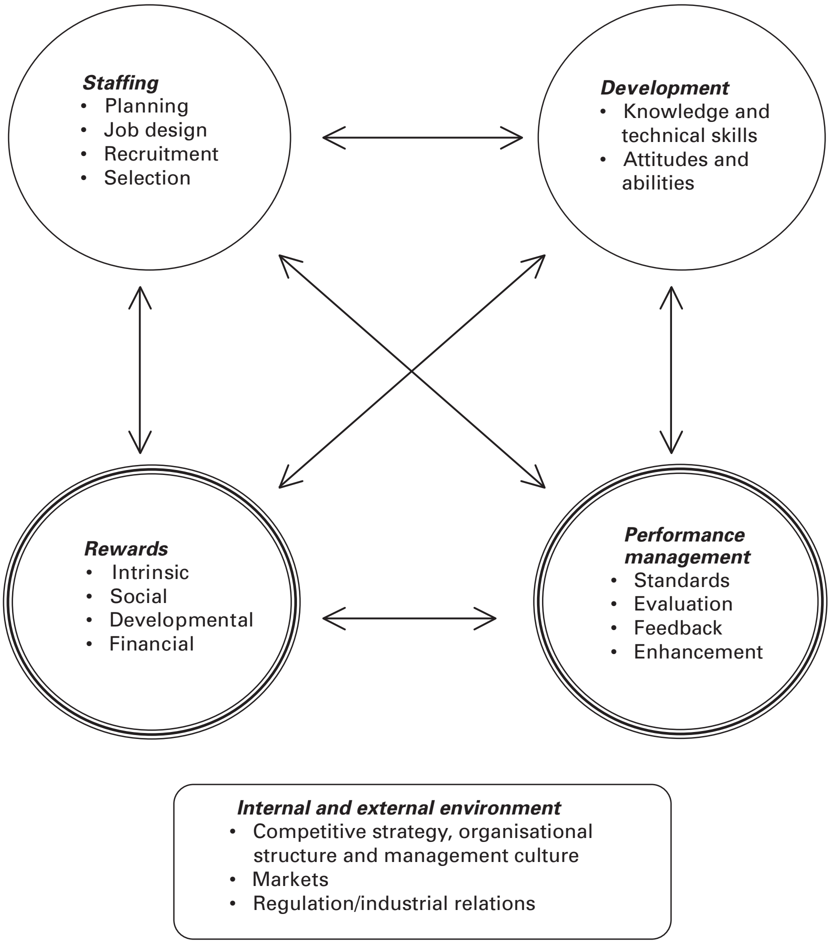

Figure 0.1 The matrix of human resource processes

multidisciplinary insights not only from labour economics and organisational psychology but also from organisational studies, strategic management and human resource management studies, corporate governance, industrial and employment relations, business economics, business ethics, sociology, business and labour history, cultural studies and critical management studies.

But intellectual orientation is not simply a matter of the disciplinary terrain traversed; it also has to do with ontological and epistemological considerations. In all areas of humanities inquiry, whatever the subject under investigation, the questions of ontology (What is the nature of 'being'? What is 'real'?) and epistemology (How are 'being' and 'reality' best understood?) warrant close consideration (Crotty 1998: 8–17). Put simply, ontology and epistemology have to do with our approach to characterising and explaining any phenomenon under investigation. For instance, should we regard employee and organisational 'performance' as objectively 'real', or is it more meaningful to see these as being facets of a number of subjectively determined 'realities'? Our conceptual choices here will influence how we go about relating 'performance' to other categories or factors that we see as being part of the same 'reality'. The same questions apply equally to every one of the other ontological categories that we shall be considering in this book: from 'employee' and 'manager' to 'organisation' and 'market'; from 'strategy' to 'practice'; from 'competency' to 'commitment'; from 'satisfaction' to 'reward'.

Thankfully, we have a few useful pointers to guide us through these philosophical questions. As Legge (1995a: 1–9) and others have noted, there are various approaches to understanding 'human resource management' and its proposed constituent parts, including 'performance management' and 'reward management'. Of these alternative approaches, the three most significant, we suggest, are: (1) the prescriptive, (2) the descriptive and (3) the critical (structuralist and post-structuralist).

The prescriptive approach, which is commonplace in the practitioner literature, is based on the premise that there are human resource 'problems', which are both knowable and amenable to analysis and solution by rational means through 'good' management practice. The focus of this approach is on prescribing the ways in which employees, as the objects of people management, *should* be managed to achieve organisational ends. It also assumes that it is possible to achieve outcomes that are mutually beneficial to employers and employees, and without 'interference' from 'third parties', such as industrial tribunals or trade unions. In the mainstream industrial relations literature, such an approach is usually described as a 'managerialist' or 'unitarist' frame of reference. As such, its orientation is essentially value-based or 'normative' in nature, although generally with little conscious reflection on the norms involved. In the field of reward management, the publications of US 'compensation' writers Edward Lawler (2000) and Patricia Zingheim and Jay Schuster (2000a) are typical of the prescriptive genre. Of course, the prescriptions themselves may differ, but the approach remains the same.

The descriptive approach, which is typical of much of the mainstream academic literature on human resource management, is evidence-based in nature and grounded in a 'positivist' epistemology. On this basis, human resource management is a phenomenon worthy of empirical inquiry – for its own sake. So, a researcher might wish to discover why and how a certain management 'problem' arises; or she may wish to establish why certain reward practices are more effective in certain types of organisation than others, and perhaps to identify the main predictor variables and mediating variables of pay plan effectiveness. Descriptive research of this sort is one of the mainstays of academic journal publishing, and it also plays an important part in the generation of management theory and models and, to a lesser extent, in giving rise to new management practices. In general, and in contrast to the unitarism typical of most purely prescriptive orientations, a descriptive approach is apt to acknowledge the legitimacy of a multistakeholder or 'pluralist' perspective on organisational life and, in particular, to see employees as having interests that are distinct from, yet overlapping with, those of the organisation and its managers. As such, the descriptive view is also likely to be open-minded about the possibility of mutual gains arising from people management practices. Two exemplars of the descriptive–positivist approach are University of London academic David Guest (1997, 1999, 2001, 2002) and University of Wisconsin academic Barry Gerhart (Gerhart & Rynes 2003; Rynes & Gerhart 2000). While both Guest and Gerhart do express strong views about appropriate and inappropriate human resource practices, their prescriptions are grounded firmly in solid research evidence.

A critical approach, by contrast, is one that eschews any supportive association with management purpose; rather it focuses, first, on analysing and critiquing the intentions and impact of management actions on employees and their families and, second, on exploring how employees respond individually and collectively. The critical approach is also premised on the assumption that the relationship between employee and employer is inherently antagonistic and unequal.

Beyond this, however, we encounter a significant complication, since there are actually two distinct variants of the critical approach. One, the critical–structuralist (or critical–realist) approach, tends to focus on the role of 'material' (i.e. economic and institutional) factors in reproducing inequalities in the employment relationship, on the indeterminacy of the relationship itself, and on the ways in which employees accommodate themselves