PERFORMANCE AND REWARD BASICS

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LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- describe the main dimensions of employee performance
- explain the core aims of a performance management system
- explain how validity, reliability, cost-effectiveness and felt-fairness each contribute to performance management system efficacy
- describe the concept of 'total rewards' and the role of financial, developmental, social and intrinsic rewards in this way of thinking about reward management and the 'employee value proposition' more generally
- compare and contrast the main elements of financial reward: base pay, benefits and performance incentives.
- explain the core aims of a reward management system
- appreciate the importance of the book's four focal 'reality check' themes: strategic alignment, employee engagement, workforce diversity and organisational justice.

PREVIEW

This is a book about two of the core activities integral in the field of human resource management: managing employee performance and managing how employees are rewarded. As we shall see throughout the book, there is a close and complex inter-dependence between these two activities; so much so that it makes little sense to consider them in isolation from each other. Equally, while the book's central concerns are with performance and reward practices and processes, attention is also paid throughout to recognising and analysing the interconnectedness of these and other aspects of human resource management. Performance management systems provide

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inputs into other HR functions such as training and employee development, as well as evaluating HR decisions such as recruitment and selection.

In this introductory chapter, we introduce you to those ideas and concepts that are fundamental to a rounded understanding of employee performance and reward management and, equally, to well-informed and effective practice in these fields. We begin by exploring some of the most basic facets of each field: What is 'performance'? What are 'rewards'? What, at the most general level, should 'systems' in each of these fields seek to do? We also introduce you to the four 'reality check' themes to which we will continue to refer and provide practical examples throughout the book: (1) strategic alignment; (2) employee engagement; (3) workforce diversity; and (4) organisational justice. The end of chapter case study is intended to provoke you to think constructively critically about the pros and cons of performance rating.

PERFORMANCE AND REWARD MANAGEMENT: PROMISE AND PERIL

Done well, performance and reward management practices have the potential to attract/retain/motivate/engage employees in a felt-fair and effective way (see, for example, Ferraris, Santoro & Dezi 2017 on the role of human resource systems in achieving flexible work practices). In realising this potential, human resource professionals and organisational executives need to be mindful of strategic purpose (Boxall 2018). At the same time, they should also reflect on the needs and expectations of employees (Soderquist, Papalexandris, Ioannou & Prastacos 2010) as well as other key stakeholders, such as shareholders in the case of corporations (Beer, Boselie & Brewster 2015) or citizens for public sector organisations (Lee & Wilkins 2011).

Unfortunately, along with the many success stories, organisational life is also littered with instances of performance and reward systems that have gone horribly wrong. The consequences include demotivating good employees and causing them to leave, eroding workplace trust and morale, poisoning the relationship between employees and their supervisors, and damaging product and service-provision quality. Perhaps more so than other facets of human resource management, the management of employee performance and rewards is a strategic, attitudinal, emotional and behavioural minefield. Ill-chosen, badly designed or poorly implemented performance and reward management systems can communicate entirely the wrong messages as to what the organisation expects from its employees (Franco-Santos & Otley 2018). 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 (see Wright 2018 for a discussion of the 'dark side' of reward management).

So performance and reward management is fraught with challenges for all concerned – employees, managers, clients/consumers and business owners. Consequently, the overarching proposition guiding this book is: *managing employee performance and reward is very easy to do badly AND difficult – but also vital – to do well.* Some argue that we should not bother at all, at least with the practices of earlier decades. For instance, it is said that assessment/appraisal of individual performance is completely counterproductive and out of place in today's fast-paced world (Pulakos & O'Leary 2011; O'Leary & Pulakos 2011). Likewise, critics of incentive plans and other forms of performance pay suggest that it serves to inhibit rather than enhance employees' deepest motivators (Pink 2011). However, if these criticisms were universally true, this would have turned out to be a very thin book! Instead, we believe that such negatives need to be set in context. Performance and reward practices are neither inherently good nor bad. How, and how well (or poorly) they perform depends on a range of contextual, configurational and communication factors; factors to which we shall return shortly.

Whether wittingly or unwittingly, performance and reward practices can play a powerful role in shaping and reshaping employee work attitude, including perceptions of trust and fairness. This is one of the main reasons this book has been written and updated: 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.

We begin, then, by exploring some of the most basic features of the landscape in each field, starting with the definition of employee performance.

PERFORMANCE MANAGEMENT BASICS

As a way of mapping the general terrain of performance and reward management, this section overviews the meaning, nature and purpose of performance 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.

What is 'performance'?

What is 'performance'? 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; 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 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 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 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, values 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 other capabilities – or 'competencies' – are not tantamount to performance; they have to do with the employee's *potential* to perform. These inputs also link performance management directly to the two other key HRM functions: staffing and development. Here, the concern is with managing employee 'talent', 'capability', 'capital' or 'competency' so that the organisation has access to human resources of the right quality and quantity and at the right point in time.

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 teamworking (behavioural process) and achieve a certain level of group productivity (result). At the organisational level, 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.
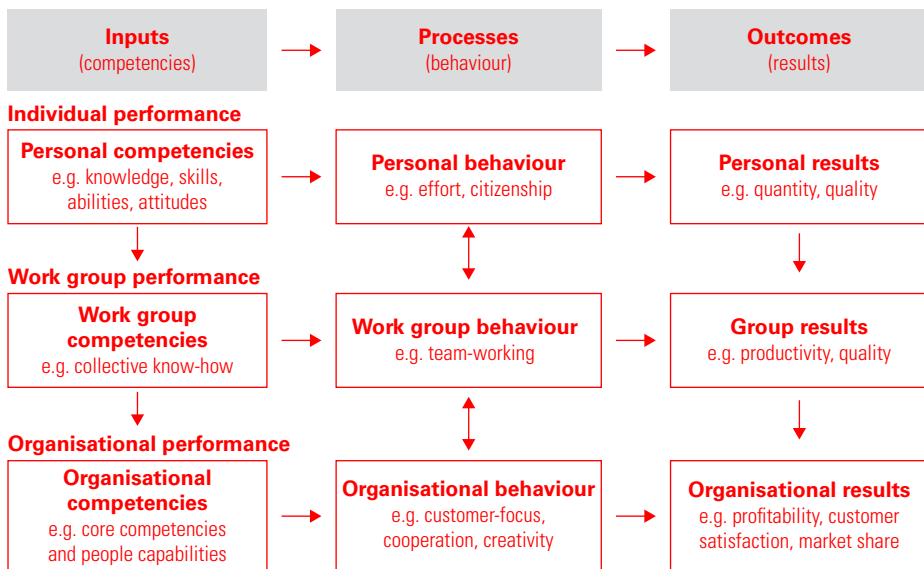

Figure 1.1 The dimensions of work performance

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 in later chapters, 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.

Aims of performance management

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. 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 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 ongoing 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 assumed 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, how effectively the system's purpose is communicated to all involved, and how committed participants are to upholding system integrity.
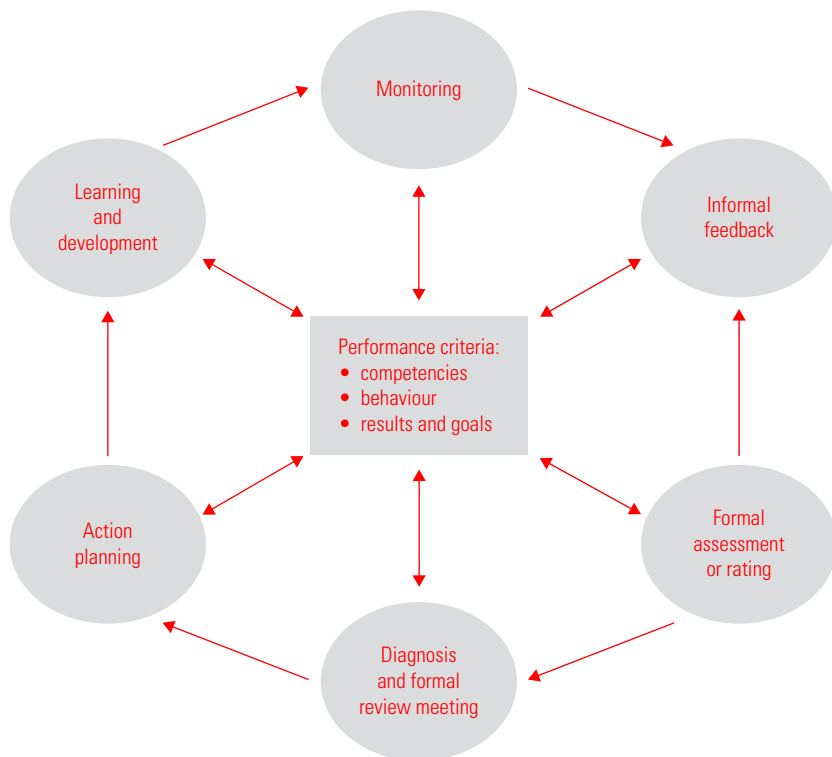

Figure 1.2   The performance management cycle

Why is it necessary to 'manage' employee performance at all? Why not just allow ('empower') employees to do their jobs with 'passion' and 'purpose', as some commentators (e.g. Pink 2011) propose? Without performance direction and recognition, employees are likely to 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, where technological change, task ambiguity and contextual uncertainty are more pronounced than ever before, simply instructing

employees to 'do your best' is not an acceptable option. The key design question, we argue, is not whether employee performance should be managed but how it should be managed and by whom.

This, of course, begs a cognate 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

Performance management has a vital role to play in organisational communication. 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). It is now very 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 can 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 multiparty 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 organisational culture (Nickols 2007).

Employee development

Performance management may serve a developmental purpose. When performance appraisals serve a developmental purpose, the focus is on identifying the employee's strengths and weaknesses for training needs and feedback (Jawahar & Williams 1997; Taylor & Wherry 1951). 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.

A traditional purpose of individual performance assessment has been to obtain numerical performance ratings that can then be used to determine performance-related adjustments to pay. The methods used to obtain these ratings can be the cause of serious practical and ethical concerns, which are investigated in subsequent chapters.

The rating of an employee's performance provides information for HR decisions such as selection, promotion and pay increases. The evaluative purpose also includes monitoring the effectiveness of other human resource policies, especially recruitment, selection, training and job evaluation.

Employees tend to receive higher performance ratings when there are consequences for reward outcomes, rather than when ratings are assigned for developmental purposes (Ellington & Wilson 2017; Jawahar & Williams 1997). Supervisors bias ratings upwards in reward-focused appraisal system to avoid providing negative feedback and to avoid negative consequences associated with low ratings (e.g. no pay increase) for employees. When ratings are used for employee development purposes, ratings are more stringent as managers are motivated to help employees accurately identify and correct performance deficiencies (Murphy & Cleveland 1995).

There can be a conflict between the developmental and evaluative purposes. As Murphy and Cleveland (1995) have noted using a performance management system to highlight differences *between* people (e.g. salary, promotion, validation) is at odds with using performance management to identify differences *within* persons (e.g. identifying developmental strengths and weaknesses). 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.

Critics of traditional supervisory performance appraisal, with its focus on once-a-year assessment of past performance, have argued that it privileges the evaluative purpose over strategic, relational and developmental considerations and is prone to system 'gaming' (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? Recent survey data suggests that this may be the case. As we discuss in our final chapter, this phenomenon needs to be seen particularly in the context of the information technology revolution, the rise of artificial intelligence, the transformation of work itself and the changing expectations and aspirations of young workers (e.g. Pelster & Schwartz 2017).

Basic requirements for effective performance management

Irrespective of specific purpose, what are the main requirements for the effectiveness of a performance management system? 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. 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).