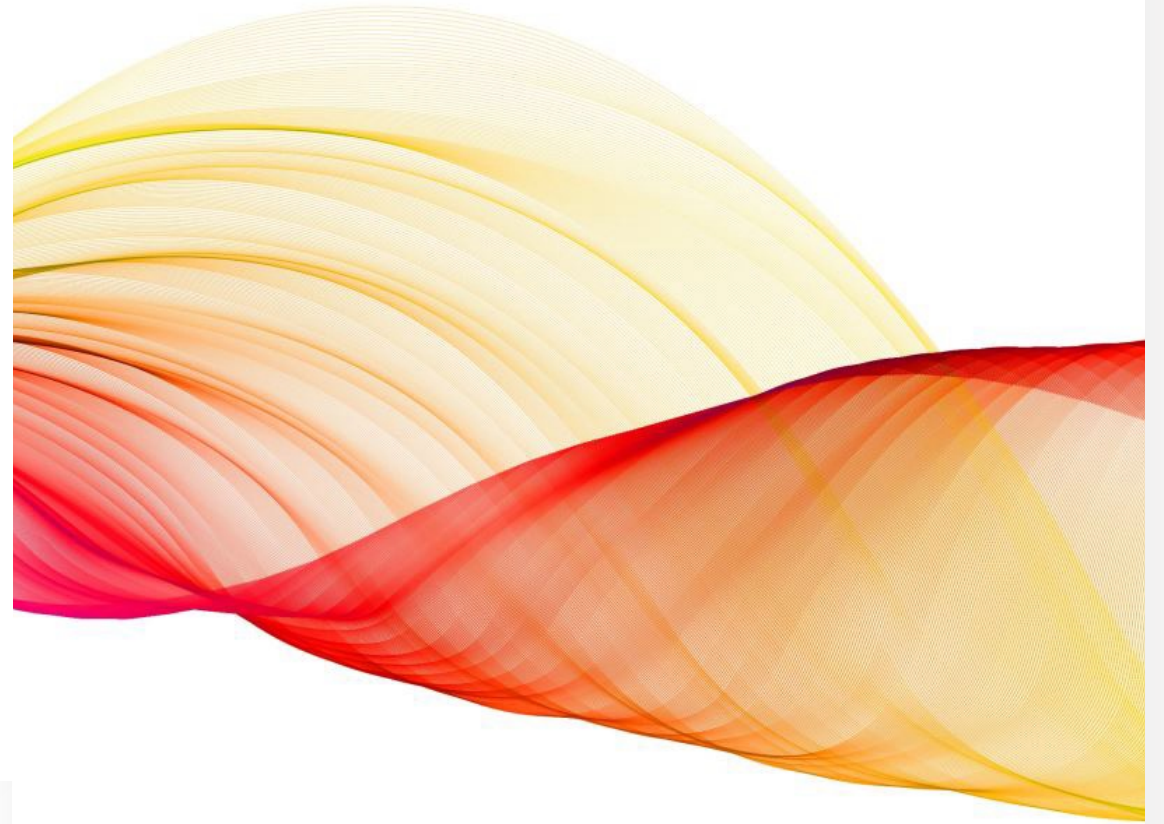


Pay for Performance: Performance Appraisal & Plan Design

4BE3

Week 8



Learning Outcomes

- ❑ Identify the three factors that determine employee performance.
- ❑ Describe the motivation theories that focus on content, those that focus on the nature of the exchange, and those that focus on desired behaviour.
- ❑ Discuss the ways in which compensation motivates behaviour.
- ❑ Explain four strategies to better understand and measure job performance.
- ❑ Describe at least five common errors in the appraisal process.
- ❑ Discuss the key elements of an effective performance appraisal process.
- ❑ Explain the three factors that determine the effectiveness of a pay-for-performance plan.

What Behaviors Do Employers Care About?

- ❑ Employers want employees to perform in ways that lead to better organizational performance
- ❑ Behaviors that compensation needs to reinforce:
 - ❑ Ensure compensation is sufficiently attractive to make recruiting and hiring good potential employees possible (attraction)
 - ❑ Make sure the good employees stay with the company (retention)
 - ❑ Build further knowledge and skills (development)
 - ❑ Find ways to motivate employees to perform well on their jobs (motivation)

Employee Performance and Motivation

- Employee performance = $f(A, M, E)$ where:

A = Ability, M = Motivation to perform and E = Supportive Environment

- Motivation involves three elements:
 - What is important to a person?
 - Offering it in exchange for some
 - Desired behavior

Motivation Theories

Content Theories (what is important to a person)

- ❑ Maslow's Need Hierarchy and Herzberg's Two-Factor Theory

Process Theories (the nature of the exchange)

- ❑ Expectancy Theory, Equity Theory and Agency Theory

Reinforcement Theories (desired behaviour)

- ❑ Reinforcement Theory and Goal Setting Theory

Do People Join Because of Pay?

- ❑ Key factors influencing a person's decision to join a firm: level of pay and pay system characteristics
- ❑ Job candidates look for organizations with reward systems that fit their personalities
 - ❑ Materialistic – concerned about pay level.
 - ❑ Low self-esteem – want little pay for performance.
 - ❑ Risk takers – want pay based on performance.
 - ❑ Risk-averse – want less performance-based pay.
 - ❑ Individualist – want pay based on individual performance.
- ❑ Reward systems should be designed to attract people with desired personalities and values.

Do People Leave Because of Pay?

- ❑ Factors impacting turnover
 - ❑ Pay based on individual or group performance
 - ❑ Level of employee satisfaction with pay
 - ❑ How organizations pay
- ❑ Other rewards that influence the decision to stay
 - ❑ Work variety and challenge
 - ❑ Development opportunity
 - ❑ Social
 - ❑ Status recognition
 - ❑ Work importance

Do Employees More Readily Agree to Develop Job Skills Because of Pay?

- ❑ New skills will help employees on current and future job demands
- ❑ Skill-based pay is intended to pay employees for learning new skills
- ❑ Evidence indicates that pay for skill may not increase productivity, but it does focus people on believing in the importance of quality and in turning out significantly higher quality products

Do Employees Perform Better on Their Jobs Because of Pay?

- ❑ A well-designed plan linking pay to behavior generally results in better individual and organizational performance.
- ❑ Substantial evidence indicates pay should be tied to performance.
- ❑ Failure arises if incentives work too well – employees may exhibit rewarded behaviors to the exclusion of other desired behaviors.

Role of Performance Appraisals in Compensation Decisions

- ❑ Performance appraisal is the process of evaluating or appraising an employee's performance on the job.
- ❑ Performance must be accurately measured in order to assess if compensation efforts are working .
- ❑ Performance reviews are used in a wide variety of decision in organizations: one is to guide allocation of merit increases.

Role of Performance Appraisals in Compensation Decisions

- ❑ The biggest complaint from employees and managers is they are too subjective. There lurks the possibility of unfair treatment by supervisors.
- ❑ Strategies to facilitate managers' ability to accurately assess performance:
 - ❑ Improve appraisal formats
 - ❑ Select the right raters
 - ❑ Understand how raters process information
 - ❑ Train raters to rate more accurately

Strategy 1: Improve Appraisal Formats

Two categories of evaluation formats are:

Ranking

- ❑ The rater compare employees against each other
- ❑ Methods include straight ranking, alternation ranking, and paired-comparison ranking

Rating

- ❑ Requires evaluating employees on some absolute standard rather than relative to other employees
- ❑ Each performance standard is measured on a scale whereby appraisers can check the point that best represents the employee's performance.
- ❑ Examples: standard rating scale; Behaviorally anchored rating scales (BARS); management by objectives (MBO)

Strategy 2: Select the Right Raters

360-degree feedback is rare in appraisals or pay decisions.

- ❑ Supervisor as Rater: more than 80% of input but prone to halo and leniency errors.
- ❑ Peer as Rater: undistorted perspective but may have no appraisal experience, creating group tension or yields to leniency.
- ❑ Self as Rater: ratings may be too lenient and unreliable.
- ❑ Customer as Rater: may be surveyed, or rated by the customer service process.
- ❑ Subordinate as Rater: more reliable if anonymous.

Strategy 2: Select the Right Raters

- ❑ Focus on who might conduct the performance reviews and which of these sources is more likely to be accurate
- ❑ 360-degree feedback
 - ❑ Assesses employee performance from five points of view: supervisor, peer, self, customer, subordinate
 - ❑ Improves employee understanding and self-awareness
 - ❑ Promotes communication between supervisors and staff
 - ❑ Promotes better performance and results

Strategy 3: Understand How Raters Process Information

- ❑ The rater
 - ❑ Observes the behavior of a ratee
 - ❑ Encodes ratee behavior
 - ❑ Stores information in memory
 - ❑ When evaluating a ratee:
 - ❑ Reviews performance dimensions
 - ❑ Retrieves stored observations to determine relevance to performance dimensions
- ❑ Information is reconsidered and integrated with other available information as rater decides on final ratings

Common Errors in Appraising Performance

- ❑ Errors in the rating process
- ❑ Errors in observation (attention)
- ❑ Errors in storage and recall
- ❑ Errors in the actual evaluation

Criterion Contamination

Several factors lead to inaccurate appraisals:

- ❑ Guilt
- ❑ Embarrassment about giving praise
- ❑ Taking things for granted
- ❑ Not noticing good or poor performance
- ❑ The halo effect
- ❑ Dislike of confrontation
- ❑ Too little time spent on preparation

Strategy 3: Understand How Raters Process Information

Errors in observation (attention)

- ❑ Raters are influenced by:
 - ❑ general appearance – gender and race.
 - ❑ patterns and variability of performance.
 - ❑ improved/declining performance.

Errors in storage and recall

- ❑ Raters store and retrieve information in traits, regardless of accuracy.
 - ❑ Memory decay – raters forget things.

Strategy 3: Understand How Raters Process Information

Errors in the actual evaluation

- ❑ Purpose of an evaluation influences results
 - ❑ Can send a political message.
 - ❑ If the purpose divides a fixed pot of merit increases, ratings are less accurate.
 - ❑ Providing face-to-face feedback to subordinates is daunting, leading to inaccuracies.
 - ❑ When required in writing, ratings are more accurate.

Strategy 4: Training Raters to Rate More Accurately

- ❑ Rater-error training
 - ❑ Goal is to reduce psychometric errors (leniency, severity, central tendency, halo), by familiarizing raters with their existence.

- ❑ Performance-dimension training
 - ❑ Exposes supervisors to the performance dimensions to be used in rating (e.g., quality of work, job knowledge), thus clarifying dimensions.

- ❑ Performance-standard training
 - ❑ Provides raters with a standard of comparison or frame of reference for making appraisals (what constitutes good, average, and bad).

The Performance Appraisal Process

- ❑ Provide a sound basis for establishing performance appraisal dimensions and scales associated with each dimension
- ❑ Involve employees in every stage of developing performance dimensions and building scales
- ❑ Ensure that raters are trained in use of appraisal system and that all employees understand how the system operates
- ❑ Ensure that raters are motivated to rate accurately
- ❑ Raters should maintain a diary of employee performance
- ❑ Raters should attempt a performance diagnosis to determine in advance if performance problems arise because of motivation, skill deficiency, or external environmental constraints
- ❑ Feedback to employees should be timely

Designing a Pay-for-Performance Plan

Effectiveness depends on : Efficiency, Fairness and Compliance

On Efficiency:

- ❑ Strategy:
 - ❑ The plan must support corporate objectives, should link well with HR strategy/objectives, and how much increase makes a difference?
- ❑ Structure:
 - ❑ Is organization structure decentralized, allowing flexible variations on a general plan?
- ❑ Standards:
 - ❑ The key rests on standards. Concerns include objectives, measures, eligibility, and funding.

On Fairness & Compliance

- ❑ There are two types of equity, or fairness:
 - ❑ Distributive justice – fairness in the amount that is distributed to employees.
 - ❑ Procedural justice – fairness of the procedures used to determine the amount of rewards.
 - ❑ A key element in fairness is communications.
- ❑ A pay-for-performance system should comply with existing laws.
 - ❑ Firms want a reward system that maintains and enhances their reputation.

Linking Pay to Subjectively Appraised Performance

- ❑ Equal increases to all employees regardless of performance provides low motivational potential
 - ❑ Across-the-board increase
 - ❑ Cost-of-living adjustments
 - ❑ Increases based on seniority

- ❑ To be effective, organizations need to define desired performance
 - ❑ Behaviors
 - ❑ Competencies
 - ❑ Traits

- ❑ Requires three things:
 - ❑ A definition of performance.
 - ❑ A continuum showing levels from low to high.
 - ❑ Awarded merit increase at each level.

Promotional Increases as a Pay-for-Performance Tool

- ❑ One of the most effective methods of rewarding good performance is a promotion accompanied by a salary increase
- ❑ Characteristics of promotional pay increases
 - ❑ Size of increment is approximately double a normal merit increase
 - ❑ Represent a reward to employees for commitment and exemplary performance

Summary

- The three factors on which employee performance depends are ability, motivation to perform, and the environment.
- Content theories focus on human needs that influence behaviour. Motivation theories that focus on the nature of the exchange look at the cognitive processes used to assess a situation and choose behaviour that yields the most satisfactory exchange. Goal-setting theory focuses on desired behaviour.
- Compensation motivates behaviour because it affects decisions about whether to join a firm, to stay or leave, to agree to develop job skills, and to perform better.
- Strategies to better understand and measure job performance include improving the appraisal format, selecting the right raters, understanding how raters process information and training raters to rate more accurately.

Summary (cont'd)

- Common errors in the performance appraisal process include halo error, negative halo error, first-impression error, recency error, leniency error, strictness error, central tendency error, similar-to-me error, and spillover.
- The key elements of an effective performance appraisal process are having a sound basis for establishing performance dimensions, involving employees in developing performance dimensions and building measurement scales, ensuring that raters are trained, ensuring that raters are motivated to rate accurately, ensuring that raters maintain a diary of employee performance, having raters attempt a performance diagnosis to identify solutions for performance problems, and feedback should be timely.
- The three factors that determine the effectiveness of a pay-for-performance plan are efficiency in supporting corporate objectives, fairness, and compliance.