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Pay for Performance: Evaluating Performance Appraisal and Merit Pay Increase in the University of Education, Winneba.

Abstract

The study assessed the effectiveness of the performance appraisal scheme as a compensation tool in granting merit pay increase (annual increment). The Expectation Theory Model was used to understand the trend in high performance rating. It appeared that the performance appraisal system is unable to discriminate effectively among different levels of performance and that merit award (annual increment) to staff was automatic. The subject of rewarding staff in the University should be given greater attention.

Background

Charges about the productivity and efficiency of the public sector are still being raised by scholars and practitioners. Government agencies have also intensified efforts to improve performance and productivity by introducing private sector management tools. Under the reinventing government movement, pay-for-performance systems have become important tools. Such a merit system established a standardized relationship between performance and rewards for individual employees and organizations (Ingraham 1995).

Performance appraisal has become a general description for a variety of activities through which agencies provide feedback to their employees, develop competencies, enhance performance and distribute rewards (Grote, 2000). An agency's performance appraisal system impacts individual and organizational operations by guiding decisions about compensation and merit increases, training and development opportunities, performance improvement, termination and promotion.

Moreover, in an ever more competitive business environment both locally and internationally, many companies today are attempting to identify innovative compensation that are directly linked to improving organizational performance. In particular, greater emphasis has been put on performance appraisal and reward systems, which are seen as mechanisms to align employees' actions with output delivery (Newberry & Pallot, 2004; Poole et al., 2006). The schemes usually used for rewarding performance vary and may include tenure schemes, long term contract, salary increments and promotions. The growing use of incentive systems that link pay to performance is not a new concept. For many years, incentive compensation in one form or the other has been a common feature of employment contracts. This paper would base its discussions on the award of annual increment as a scheme for rewarding staff in the University of Education, Winneba.

The University of Education, Winneba, cognizance of rewarding staff based on performance has designed appraisal schemes to assess the performance of staff. Merit increases are allocated based on performance appraisal score. Determining pay level and appraisal scores are critical part of the process of allocating merit pay increases based on employee performance in the University. The University's policy is that new members of staff will be appointed within the starting salary range. Pay progression is normally by the receipt of the annual increment up to a maximum point on the main salary scale for the grade. There is therefore an annual review of salaries for staff. This notion is expressed in the Condition of Service of Senior Members of the Public Universities of Ghana and in appointment letters of administrative staff of the University. Clause 2.1 of the Condition of Service of Senior Members states "…each additional year of relevant experience will, from the date of appointment, attract increment based on performance.

Also paragraph 2 of the appointment letters of Junior/Senior Staff states "…the award of an annual increment is at the discretion of the Vice-chancellor and is subject to his receiving satisfactory reports on your work and conduct…" This pattern of salary administration is well articulated in the Conditions of Service for Unionized Staff of Public Universities in Ghana. For instance Article 12.02a states "increment will normally be granted as an increase to pay to which an employee is entitled for efficient performance of duty".

It is clear from the above background that, the compensable factor in the grant of annual increment in the University of Education, Winneba is "performance." Performance appraisal has long been the matrix for measuring performance and for the award of merit increase (annual increment). Recognizing that one of the difficulties with performance appraisal stems from the variety of objectives the appraisal is supposed to address as outlined above and that salary decisions account for nearly 80% of appraisal use (Mathis & Jackson, 2006); the questions that remain to be addressed are: Is there a difference between the amount of increase a staff receives and his rate of performance? Does the appraisal scheme follow the principles of pay for performance? Do employees of the University perceive the related procedures as fair?

Statement of the Problem

Employer compensation practices are intended to provide fair compensation based on performance. The relative success of pay for performance depends on appraisal process that is perceived to be administered fairly and accurately and a clear link between appraisal and level of performance. It seems that though the University operates a performance appraisal scheme, the above principles are not clearly practiced.

Purpose of the Study

The purpose of this study was to evaluate the effectiveness of the appraisal scheme of the UEW as a compensation tool and to gain a better understanding of the "pay-for-performance" perception. Such knowledge may allow for improvement in the effectiveness of incentive compensation plans.

Research Questions

The study was guided by the following research questions:

1. To what extent do performance ratings and distribution of rewards conform to what would be expected from an effective pay for performance system.
2. Is there a difference between the amount of increase a staff receives and his rate of performance?

Methodology

The paper used a review of the literature to evaluate the effectiveness of the performance appraisal system as a tool for granting merit increases to staff. This research used performance appraisal forms of staff of the University of Education, Winneba. Performance rating of employees was obtained from the performance appraisal form for the year 2010. Respondents were drawn from the four categorization of staff for the appraisal purpose based on job classification of the University as indicated below:

FORM	CATEGORY
Senior Members	For all non-teaching Senior Members
Senior Staff	For all Senior Staff
Junior Staff Form "A"	For all Clerks, Senior Clerks, Senior Typist, Head Porter, Porter and all equivalent grades
Junior Staff Form "B"	For all Messengers/Cleaners/Labourers

In all, 493 performance appraisal forms were selected and examined to ascertain their overall performance rating categories. Of this, 23 employees were of the Senior Member category, 118 employees were of the Senior Staff category, 352 employees were of the Junior Staff category.

Literature Review

In a globally competitive environment, where human resources must be effectively engaged, the appeal for pay for performance as a compensation scheme is obvious. Theories of motivation support the use of pay for performance. These theories encourage managers to tie important outcomes to desired behaviors. The message of the theories is clear: to sustain motivation, managers must demonstrate to employees a close link between performance and rewards. What then is pay for performance and what human motivation theory underpin such a compensation scheme?

Pay for Performance

Pay for Performance commonly called Merit pay refers to the process of distributing employee pay increases based on how well each employee performs at work-often determined by supervisory performance appraisal (Heneman, 1992). The merit of such a compensation scheme is that an employee is rewarded when his/her job performance exceeds the prescribed acceptable performance level of the organization. Pay for Performance plans relate adjustments in an employee's base pay directly to his or her job performance. These plans theoretically forge a link between pay expenditures and individual productivity and communicate useful message to the employee (Campbell, Campbell, & Chia, 1998). A well developed pay for performance instrument addresses the norm of distributive justice defined as the perceived fairness in the distribution of incomes (i.e. amounts of merit salary increases) based on the agency's performance appraisal system or the commonly held belief that individuals should be rewarded in proportion to their contributions. Writers advocate that PFP helps reflect employee's contribution to the organization, and provides a clear benchmark to distinguish employees (Martin and Bartol, 1998; Segal, 2000). They argue that PFP provides an opportunity for individuals who are exceptional performers to achieve a higher level of reward than that of average performers. This fits with the commonly held belief that individuals should be rewarded in proportion to their contributions (Campbell et al., 1998), reflecting the "norm of distributive justice".

A pay for performance plan moves from an entitlement orientation where all employees receive the same annual raise for simply showing up for work to a pay system that varies with individual performance. However, creating an effective, valid and legally defensible pay for performance plan requires three things:

1. Clearly defined job specific performance criteria that enable creation of an appraisal instrument that describes different performance levels from low to high.
2. A well defined appraisal interview process.
3. Equitable decision about how much of a merit increase will be given for different levels of performance (Milkovich & Newman, 2005).

Regardless of the form it takes, pay for performance's (PFP) popularity arises from a widespread belief that it makes pay contingent on objective measures of performance, rather than grade and seniority. The logic of PFP suggest that pay is a primary performance management tool because when properly administered, it can be an effective source of supervisory control of day-to-day behavior of workers (Vroom, 1964; Porter and Lawler, 1968; Lawler, 1987). Pay for performance offers an intuitively appealing approach to incentives because the supervisory hierarchy sets measurable performance standards and goals, conduct performance evaluations and consistently reward employees for achieving goals and maintaining standards.

According to Rollins (1988), besides motivational effects, other benefits attributed to PFP systems include the following:

1. Increase the probability that superior performers will feel valued and equitably compensated for their effort so they will be less likely to leave the organization.
2. Focus managers' attention on the importance of accurate performance appraisal based on objective standard and measured objectives.
3. Give supervisors a concrete and effective means of pressuring poor performers to improve or leave.
4. Encourage supervisors and their subordinates to communicate clearly and frequently about performance goals and expectations.
5. Improve public management's capacity to allocate limited financial resources in ways designed to improve productivity.

Textbooks on compensation (for example Hills 1987; Wallace and Fay 1983) generally define pay for performance systems as having the following characteristics:

1. Pay ranges are established for each job or group of similar jobs (the latter often established through job evaluation). These ranges, which have formal minimum and maximum are typically standardized (in percentage terms) across jobs or job groups.
2. Individual progression within the pay range (usually at fixed intervals, such as once yearly) depends at least in part on observations of the employee's performance.
3. Performance is usually operationalised through performance appraisal systems whereby employee behaviour is observed and then evaluated for its contributions to the organization.

Pay for performance systems have been described as one of the most effective methods of motivating and increasing employee performance (Levy &Williams, 2004; Moss & Martinko, 1998; Nadler, 1979; Podsakoff & Farh, 1989.) A well designed appraisal instrument helps an agency distinguish outstanding performers from those who are below average.

Although often assumed to be used as a direct motivator to improve individual employee performance, there are examples of PRP also playing a part in recruitment and retention of staff by enabling higher pay levels which are more representative of market rates to be paid over and above collective pay scales, and for various cultural and image-making purposes such as the pursuit of a non-union, individualistic culture with a reinforced line manager role (Armstrong, 1996). As such, PRP is typically inextricably linked with appraisal, although the potential corruption of developmental appraisal systems by adding a pay link, and the problems of maintaining objectivity in assessment criteria, has been well documented (Kessler, 1994; Randell, 1994).

Performance Appraisal

The glue that binds career development and pay systems together is performance appraisal. It is the central ingredient of effective productivity systems. Performance appraisal is believed to be capable of improving performance in two ways: through developmental feedback (directed primarily at improving ability to perform), and through administrative decisions that link evaluated performance to organizational rewards and punishment such as pay, promotion, or discharge (aimed primary at enhancing motivation). Performance appraisal is directly linked to incentive systems. It is the objective means of determining rewards.

Performance appraisal and reward systems are based on the assumption that employees' performance and motivation can be improved by establishing a clear link between efforts and reward through formalized and specified individual targets (Fay & Thompson, 2001). It is centered on the premise that rewards such as pay, should be contingent on some measure of an individual's performance in their jobs (Gunnigle et.

al, 2003) Performance can be measured via quantitative and qualitative criteria. When quantitative criteria are used, part of an individual's pay is linked to production (or service) performance, the organizations financial results or the attainment of broader business targets. When qualitative criteria are used an individual's pay is related to aspects of performance that cannot be gauged in terms of productivity such as qualifications or attitude. (Eironline,2004).

Theoretical Framework

The theoretical justifications for pay for performance are drawn from the moral philosophy that sees equity and social justice as best served by treating people differently according to their contribution and abilities, and the psychological theories of motivation that stress the role of pay such as expectancy theory.

Expectancy Theory

The logic that pay should be linked with performance makes a great deal of sense. Why should highly productive employees maintain high productivity if no reward is in the offering? A positive relationship between financial incentives and performance is deeply rooted in theories of motivation. This type of thinking undergirds Victor Broom's "expectancy theory".

In this perspective, employees are presumed to expect rewards for their contribution and to expect that rewards for current efforts will serve as stimuli for future productivity. If there is no payoff, employee performance will most likely decline. The theory posit that individuals will engage in behaviours that are likely to lead to valued outcome, as long as they perceive that they can successfully produce such behaviours. Thus, provided that a financial incentive is perceived as valuable and that increased performance is expected to lead to outcomes that are believed to result in financial rewards, financial rewards should enhance performance through increased extrinsic motivation and effort. The theory operates on three stages. First, employees must believe that if they put forth the requisite effort, they will perform well (the effort performance expectation). Second, employees must believe that good performance will lead to specific reward (the performance outcome expectancy). Finally, the employee must value the reward. From this perspective, it appears that if management is able to link positive outcomes (such as increased pay) to high performance levels, and employees see the connection and have the opportunity to perform, then motivation and productivity will be enhanced.

Expectancy theory is predicated on a belief that individuals will exert effort if they expect it will result in an outcome that they value (Van Eerde and Thierry, 1996). In the case of pay for performance, employees will work harder if they value monetary rewards and believe that those awards will result from their increased efforts. Thus, based on the logic of the above theory, one should expect that payout or financial reward is more strongly related to work performance under individual pay performance plan. Thus, two important elements for realizing the result predicted by expectancy theory *are rewards sufficient to motivate high performance and a system for discriminating among differing levels of employee performance.* According to expectancy theory, employees' willingness to supply the required effort depends on the perception of the link between performance and reward which will be influenced by the perception of management's fair dealing and its competence to measure their performance (Ambrose & Kulik, 1999).

Reinforcement Theory

Support for pay for performance is theoretically grounded in reinforcement theory (Perry, Mesch, and Paarlberg 2006). Reinforcement theory posits a direct relationship between a desired target behavior (e.g., performance) and its consequences (e.g., pay) and is premised on the principles and techniques of organizational modification (Luthans 1973; Stajkovic and Luthan 1997). Organizational Behavior Modification (OBMod) is a framework within which employee behaviours are identified, measured, and

analysed in terms of their functional consequences(i.e existing reinforcements) and where an intervention is developed using principles of reinforcement(Luthans & Kreitner, 1975; Stajkovic and Luthan 1997).
It suggests that pay can be used to create consequences for desired behaviors such as highperformance that will reinforce the behaviors (Perry, Mesch, and Paarlberg 2006). Reinforcement theory basically predicts that tying money to performance will reinforce performance (Komaki, Coombs, & Schepman, 1996). Accordingly, to the extent that the potential exist for an individual to receive a noticeable increment in his or her pay (DeMatteo, Eby, & Sundstorm, 1998), financial rewards can succeed in directing employee's behavior at what is needed to get the reward. There is evidence that when high performance results in high pay, performance is reinforced and more likely to be repeated. Jenkins et al. (1998) for instance conducted a meta-analysis of the relationship between individual financial incentives and performance quantity and quality in research context in which performance measures were used. Based on 39 laboratory, experimental simulation and field studies, Jenkins et al, (1998) found a significant positive relationship between financial incentives and performance quantity, but no relationship between incentive and performance quality.

Equity Theory

Another model of merit-based performance is that outlined in "equity theory". In this approach, it is assumed that employees continuously evaluate the relative fairness existing between their level of performance of perceived output and the level of perceived reward. Employees who perceive an imbalance or inequity between perceived effort and reward may alter their work habits so as to achieve equilibrium between these two variables. According to the theory, employees will perceive a practice to be fair or equitable when their input-output ratio is equal to that of a referent. When reward is paid in accordance to individual performance, it is likely that employees perceive fairness or justice in the ratio. Studies have shown that a rating based on individual performance and salaries based on the rating tend to enhance employee perceptions of distributive justice (Campbell *et al.*, 1998; Greenberg, 1990, 1986).

Employees usually like the idea of being compensated for their performance (i.e. pay equity) in comparison to distribution of reward equity or according to the needs of the employees (Chen, 1995; Chiang & Birtch, 2005; Mamman et al., 1996). For this reason, perceived pay equity (or distributive justice, Colquitt, 2001) is highly associated with pay satisfaction (Williams et al. 2006). Distributive justice refers to the extent to which employees perceive that the pay system rewards them fairly. Drawing on equity theory, it could be argued that the more inducement that an organization provides to an employee, the more that employee will reciprocate by becoming more effectively committed to the organization (Lee & Bruvold, 2003) and by performing at higher levels (Gardner et al., 2004).

The theories considered provide a clear message for the design of a compensation scheme. To sustain motivation, managers must demonstrate to employees a close link between performance and rewards and such rewards should commensurate with performance of staff.

A Model for the Distribution of Merit Pay Increases

A review of the literature identifies three elements to include in the development of a model for the distribution of merit pay increases. The models are pay differentials, forced distribution, and pay adjustment matrices (Martocchio, 2001). According to Milkovich and Newman (2005), those elements help to guide management decisions in delivering pay for performance salaries while safeguarding "redlining (i.e. an employee moving above the pay range for the particular job.) For the purpose of this paper, the researcher will discuss pay differentials because of its relevance to the purpose of the study.

Pay differentials

Pay differentials represent the varying levels of merit increases that are based on an employee's job performance (Milkovich & Newman, 2005). An agency should consider the pay differentials it uses when rewarding various levels of job performance. An agency could ask, “How much do we pay higher performers compared to the lower performer?”(Martocchio, 2001). For example, how much more does an employee receive if he or she “exceeds standard” compared to “meets standards”? The amount needs to appropriately distinguish the various levels of performance in order for the pay for performance system to correctly serve as a motivator for staff. In looking at this issue, researchers have suggested that an approximately 3% pay increases is needed between the levels of performance as perceived by employees (Arvey & Murphy, 1998).

In addressing pay differentials, researchers have also introduced the “just noticeable differences” (JND) concept (Henaman & Ellis, 1982; Katkowski, Medsker, & Pritchard, 2002). JND refers to the minimum pay increase that employees will receive as making a meaningful change in compensation and thereby enhances their motivation to improve job performance (Henaman & Ellis, 1982). JND as a concept also has been presented as “smallest meaningful pay increases” (Krefting & Mahoney, (1977). Rooted in psychological research that centered on identifying JND in sounds, weight, and other environmental stimuli, the JND concept has been used in agency compensation programmes to investigate appropriate levels of merit pay increase amount based on performance; (Katkoeski, Medsker, & Pritchard, 2002). It is evident from this model that the steps in developing a merit pay increase is the dividing of performance levels into categories(“exceeds standard”, “meets standard”, “below standards”) and a proposed recommendation of weight (percentages, step increases) given to staff that fall in any of the categories. It is to be expected that the compensation scheme of the University of Education, Winneba would follow a similar pattern so as to improve productivity and performance. A review of the performance appraisal forms will help address whether the University of Education, Winneba follows a similar pattern.

Principles of Pay for Performance

Three guiding principles in determining how to reward performance are: merit increase guideline, performance within categories and performance between categories (Quaye, 2008).

Merit increase guidelines

This is an increase granted as a result of improved or continued good performance. This is designated to differentiate between performance levels in order to recognize and reward best performers. It provides a percentage increase for each performance category.

Performance within category

During the appraisal of performance, each individual should be rated into one of performance categories for example, “exceeded expectation”, “achieved expectation”, “below expectation”

Performance between categories

This guiding principle is the heart of the compensation philosophy of pay for performance. There must be sufficient differentiation between performance categories.

For example “exceeded expectation” should attract a weight of say 8%, “achieved expectation” 3%, “below expectation” 0%.

Findings and Discussions

This portion of the study reports on the analysis of the findings on the research questions.

Conformity of performance ratings and merit pay

The job classification and salary schedule form the basis for the merit plan of the University. Every year, employees advance to the next step and receive that amount as their annual salary. Usually the basic criterion for the rating of performance turns out to be something like “doing an excellent job”, “doing a very good job”, “doing a satisfactory job”, “work needs to be improved” and “work is unacceptable” (See

Table 1). These step increases are essentially automatic and take place each year as long as the staff remains in the University. There is therefore no incentive or reward for good performance hence the whole appraisal process takes on a rather negative flavour.

The review of the performance appraisal forms for the year 2010 revealed the following:

Table 1: Category of performance ratings and suggested increase

Merit increase guidelines						
	Suggested increase when overall performance is:					
	Doing an excellent job	**Doing a very good job**	**Doing a satisfactory job**	**Work needs to be improved**	**Work is unacceptable**	**Total**
Junior Staff "A"	25	123	106	0	0	254
Junior Staff "B"	6	51	39	2	0	98
Total						**352**

The examination of the various performance appraisal forms revealed the following:

- The performance appraisal forms for Senior Members (non-teaching) did not have the portion for overall assessment for staff which is an important component of the performance appraisal process for the award of merit increases. There is also no weight assigned to performance ratings of staff and hence there is no merit guideline for the award of annual increment for this category of staff in the University.

  The award of merit increase for this category of staff is therefore automatic irrespective of the performance of the staff and job schedule or classification. Performance rating and distribution of awards for this category of staff do not follow the principles of effective pay for performance.
- With regard to the evaluation of the appraisal form for Senior Staff, the findings of that of Senior Members apply. There is no overall assessment of staff and a guideline for the award of annual increment. There is no categorization of performance. As such there is no incentive for outstanding performance since all staff in this category and job classifications receive the same pay raise irrespective of their performance.

- For performance appraisal forms (A), there is evidence for the support for the principle of performance within categories. Staffs are rated into one of the performance categories. From Table 1 and with reference to form A, 25 members of staff were rated as "doing an excellent job", 123 members of staff were also rated as "doing a very good job" whiles 106 members of staff in this category were rated as "doing a satisfactory job". At the end of the appraisal period staff rated in any of these categories received the same annual increment. It is evident that, the appraisal form A does not support the principle of performance between categories which is the heart of compensation philosophy of pay for performance. There is no sufficient differentiation between performance categories. Since the University operates the step increase as merit increase principle, there should be weight assigned to the various categorization of performance. For example a top performer can be given a pay raise that reflect superior performance(say a grant of three incremental credits), a good solid dependable employee could be given two incremental credits, and a staff rated doing a satisfactory job is given one incremental credit.

- A look at the appraisal form for Junior Staff (B) reveals that 6 members of staff based on the job classifications were rated as "doing an excellent job", 51 staff rated as "doing a very good job", 39 rated as "doing a satisfactory job" and 2 members of staff in this category were rated as "work needs to be improved". There is rating of performance and the support for the principle of performance within categories but no support for performance between categories. It is worthy of note that at the end of the appraisal period, all members of staff in this classification received the same pay rise. The practice is definitely unfair based on the equity theory and theory of distributive justice. It can therefore be concluded that the award of a merit increase (annual increment) is automatic irrespective of the performance of a staff and therefore there is no incentive for higher performance. Staff are rewarded probably for the sake of completing annual performance appraisal forms.

Difference between increment and rate of performance

As pointed out earlier in Table 1, there is no suggested increase for any of the performance ratings. The year 2011 witnessed the across board directive for the award of annual increment from the Division of Human Resource without regard to recognition to high and low achievers. As seen from Table 1(Junior Staff Form "B"), the two staff whose works needed to be improved had the same step increase with the 39 that had satisfactory rating and the 6 that did an excellent job in this job classification.

From the literature, pay for performance actively discriminates between employees on the basis of their performance. The findings indicate that this is not the case for staff in the University of Education, Winneba. Hence since the performance appraisal system is unable to discriminate effectively, the link between high performance and monetary reward is weakened. This widespread distribution of merit increase and performance rewards could communicate to employees that financial rewards are available and do not require extraordinary effort.

Summary

This paper sought among others to examine equity and fairness issues in the performance appraisal schemes of the University with reference to the grant of annual increases. In sum the

1. performance appraisal system is unable to discriminate effectively among different levels of performance. The results indicate that merit awards or increases are automatic.
2. paper shows that the University uses the performance appraisal system for an evaluative function that is to link performance to pay but there is the problem of inequality in the distribution of rewards.
3. Pay for performance actively discriminates between employees on the basis of their performance but the findings did not indicate so.
4. Human motivation theories support the use of merit pay and encourage managers to link important outcomes to desired behaviours.
5. From the review of related material, there is the acceptance of the practice of pay for performance in the University of Education, Winneba.
6. Performance appraisal systems at UEW lacked one or more elements associated with the pay for performance distribution model.
7. Performance appraisal results were not used to make merit increase decisions.

Conclusion

The literature reviewed and the examination of the data suggests a possible threat to the theoretical logic that underpins pay for performance systems in the University of Education, Winneba.

Recommendation

Based on the conclusion drawn, the following recommendations were made:

1. Establish a high performance culture and improve employee motivation by discriminating among performance by rewarding high performing employees while not rewarding employees whose performance fall below an established standard.
2. There should be a uniform process for the development and the award of annual increment.
3. Performance appraisal rating and merit raise guidelines should be reviewed and consideration given to special recognition in the form of pay raise or special achievement or contribution to the University.
4. The design of the appraisal form for Senior Members(non-teaching) and Senior Staff in the University must follow the principles of pay for performance as well as the model for the grant of merit increase (annual increment).

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