One of the best things you can do for other people is to help them recognize how they can improve. – Wess Roberts

1.0 Introduction

1.1 Performance Appraisal System – A theoretical framework

As a result of competition in the commercial world in which the individual consumer of all classes is a controlling factor, the administration of industrial concerns to-day is becoming increasingly complex, and the closest attention to the efficiency of the product manufactured and to the cost of production is absolutely necessary if commercial existence is to continue.

As conventional sources of competitive advantage like technology and economies of scales become less important now than in the past, core capabilities and competence, derived from how people are managed is providing companies their cutting edge. Organizations are already moving to a stage where traditional personnel activities like recruitment, training and compensation are no longer isolated activities, but part of a mutually reinforcing, integrated system.

As competition increased and the conditions under which contracts were placed changed and became more stringent, manufacturers, recognizing
that the best results in the shape of output were not obtained under the
time system, and with the object of controlling labour costs, commenced
the practice of remuneration workers in accordance with the amount of
work done. This method has been used for many years now in different
forms, and with varying degrees of success; in some industries the
practice is almost universal, in others it is partially adopted, while there are
instances where its use is considered to be impossible.

This situation has put more focus on effectiveness, that systems and
processes in the organization be applied in the right way to the right
things: to achieve results. All of the results across the organization must
continue to be aligned to achieve the overall results desired by the
organization for it to survive and thrive. Only then it be said that the
organization and its various parts are really performing.

Every manager by now knows that employee productivity directly affects
company productivity; one of manager’s primary responsibilities is to
assure that each employee works as effectively and efficiently as possible.
Unfortunately, managers do not realize the pivotal role that a
comprehensive performance management system can play in improving
employee productivity. This enhanced productivity in turn leads to a
greater company-wide productivity and profit.

Supervisors have conducted performance appraisals for years. Employees have attended training sessions for years. Organization
members have worked long, hard hours for centuries. Processes, such as
planning, budgeting, sales and billings have been carried out for years in
organizations. But all too often, these activities are done mostly for the
sake of doing them, not for contributing directly to the preferred results of
the organization.
Performance appraisals, performance reviews, appraisal forms, whatever you want to call them, let’s call them gone! As a stand-alone, annual assault, they are universally disliked and avoided. After all, how many people in an organization want to hear that they were less than perfect last year? How many managers want to face the arguments and diminished morale that can result from the review?

Competent employees are the most valuable assets of an organization. Yet, the reality is that they remain under valued, under trained and under utilized. No matter how much technology and equipment an organization has, these things cannot be fully utilized until people who have been motivated, guide them. An organisation might have an abundance of resources but if the workforce is not willing to exploit its capabilities to the fullest, the organization would definitely head towards decline.

“The design and management of Performance based compensation system constitute one of the most difficult human resource management tasks for the general manager. Of all the policies areas in human resource management, this is where we find the greatest contradiction between the promise of theory and the reality of implementation”

1.1.1 Factors influencing Performance Appraisal System

Compensation systems have been revolutionized by heightened domestic competition, globalization, increased employee skill requirements, and new technology. Therefore, an outcome of today’s dynamic business environment is that managers have needed to change their pay philosophies from paying for a specific position or job title to rewarding employees on the basis of their individual competencies or group contributions to organizational success.
Payments in addition to the base rate can be related to performance, competence or skill. These are sometimes referred to as ‘variable pay’, but this has acquired the special meaning of payments in the form of cash bonuses which are not consolidated into basic pay.

**Performance based compensation system**, also known as Performance Pay establishes linkage between Rewards and Performance; increasing recognition of the need to raise productivity of labour has led to a growing interest in the possibilities of such systems. This system works on the principle that “an offer of additional money will motivate workers to work harder and skilfully for a greater part of their working time, which will result in a stepped-up rate of output.”

*Performance related pay* plays an important role in driving performance and behaviours, in co-ordination with fixed pay. It is actually a part of the overall reward strategy and hence should be integrated closely with the other elements. It is definitely not an independent programme that can be run in isolation.

This system is not limited to the workmen only; it covers the different level of employees in an organization, that is, “The Junior Staff, Middle Management, Senior Management and the Top Management”. It is increasingly being used as a tool to achieve company goals besides attracting and retaining people. It is impossible for the plan to succeed unless it is supported by all the functions in the organization.

A combination of Internal and External Factors can influence, directly or indirectly, the levels of pay.
i) **Intrinsic Value**

The concept of intrinsic value is based on the apparently reasonable belief that the rate of a job should be determined by reference to the amount of responsibility involved or the degree of skill or level of competence required to perform it. The responsibilities of a job are the particular obligations that have to be assumed by any person who carries out the job. Responsibility is exercised when job holders are accountable for what they do. The level of responsibility is related to the outputs job holders are expected to achieve and their contribution – the impact they can make on the end results of their section, department or the organization as a whole.

Rates of pay are influenced not only by the scope of the job in terms of its impact on results but also by the size of resources controlled, the amount of authority job holders possess, the degree of freedom they have to make decisions and to act, and the extent at which they receive guidance or instructions on what they should do.

The intrinsic value of jobs may also be related to the input and process factors of knowledge and skills and competencies.

ii) **Internal Relativities**

The problem with the concept of intrinsic value is that it does not take account of the other factors affecting value. There is no such thing as absolute value. The value of anything is always relative to something else and is affected by external economic factors as well as internal relativities.

Within an organization, job values are determined by the perceptions of the worth of one job compared with others. Internal differentials reflect these perceptions, which may be based on information relating
to the inputs made by job holders as reflected by the requirement to use different levels of knowledge and skill. Or more importance may be attached to outputs – the added value they create. Internal differentials are strongly influenced by differentials established in the external market from which the organization recruits and to which existing employees are tempted to return.

iii) **External Relativities**
A salary or wage is a price which, like an other price, represents the value of the service to the buyer and the seller: the employer and the employed. The external value of a job – the market rate – is primarily determined by the laws of supply and demand. We can assume that people occupying equal positions tend to be paid equally and as Kanter puts it: “The process is circular... we know that people are worth because that’s what they cost in the job market, but we also know that what people cost in the job market is just what they’re worth.

The market rate concept is in any case an imprecise one. Market rate surveys will always reveal a considerable range of rates which reflects the special circumstances of the organizations, including the level of people they employ and their policies on how they want their levels of pay to relate to market rates – their market stance or pay posture.

It is also important to bear in mind the concept of individual market worth. It means any employee individual has a price which is related to what other organizations are prepared to pay for his or her services.

iv) **Inflation and Market Movement**
Inflationary pressures clearly affect general trends in rates of pay and earnings. They underpin pay market movements.
Today, most of the organizations are accustomed to take into account inflation when adjusting their pay structures. They are prepared to increase rates by less than inflation in hard times and they have reserved the right to restrict increases to individuals to below the rate of inflation if their performance does not justify the retention of their real level of earnings. Increasingly, however, employers are basing pay reviews on movements in market rates; which are, in any case, responsive to the rate of inflation.

v) **Business Performance and/or financial circumstances**

The business or strategic aims of the organization and its plans for achieving those aims will provide the basis for developing pay strategies and policies. The resulting business performance and/or financial circumstances of the organization will influence the amount it can afford to pay and its pay policies on such matters as how it wants to relate pay to performance and market rates.

vi) **Trade union pressures**

Depending on their bargaining power, trade unions will attempt to pressurize managements into increasing pay by at least the amount of inflation. They will press for higher rates on the grounds of the organization’s ability to pay and trends in market movement and the going rate for specific jobs, and they may attempt to restore lost differentials.

As Kanter has stated: Major employing organizations are rethinking the meaning of worth itself. And as they are doing this, they are gradually changing the basis for determining pay from position to performance, from status to contribution.
1.1.2 Concepts of Performance Pay with reference to the Indian Manufacturing Industries

During the industrial age, from 1850 to about 1975, companies succeeded by how well they could capture the benefits from economies of scale and scope. Technology mattered, but, ultimately, success accrued to companies that could embed the new technology into physical assets that offered efficient, mass production of standard products.

Recently, organizations have been faced with challenges like never before. Increasing competition from businesses across the world has meant that all businesses must be much more careful about the choice of strategies to remain competitive. Everyone (and everything) in the organization must be doing what they’re supposed to be doing to ensure strategies are implemented effectively.

In our new knowledge and service-based economy, in which key skill shortages are increasingly apparent, people costs not only typically represent a much higher proportion of total expenditure, but those people really are your organization’s most important asset. If you do not reward them in the most effective way, ensuring that you recognize and reinforce what will make the business a success, and changing the former as the latter shifts, then you are increasingly likely to be put out of business by someone else who does. And this is true across all sectors – the cost, efficiency, recruitment and retention, and performance pressures are every bit as challenging in the public as in the private sector.

The conditions under which industry is now carried on are vastly different from those existing a generation ago; something akin to a revolution has taken place, both on the commercial and on the industrial side. Where contracts are concerned, the old method of “time and lime” payment, cost plus profit, has been discarded wherever possible. The common practice
today is that of firm tender, and here, because of the influence of competition, the margin for contingencies is often reduced to a minimum and, in some cases, is left out altogether, profit being affected in consequence.

**Knowledge workers**

Industrial age companies created sharp distinctions between two groups of employees. The intellectual elite – managers and engineers – used their analytical skills to design products and processes, select and manage customers, and supervise day-to-day operations. The second group was composed of people who actually produced the products and delivered the services. This direct labour work force was a principal factor of production for industrial age companies, but used only their physical capabilities, not their minds. They performed tasks and processes under direct supervision of white-collar engineers and managers. At the end of twentieth century, automation and productivity have reduced the percentage of people in the organization who perform traditional work functions, while competitive demands have increased the number of people performing analytic functions: engineering, marketing, management, and administration. Even individuals still involved in direct production and service delivery are valued for their suggestions on how to improve quality, reduce costs, and decrease cycle times. As the plant manager of a refurbished Ford engine plant declared, “The machines are designed to run automatically. The people’s job is to think, to problem solve, to ensure quality, not to watch the parts go by. Here, people are viewed as problem-solvers, not variable costs.”

Now all employees must contribute value by what they know and by the information they can provide. Investing in, managing, and exploiting the knowledge of every employee have become critical to the success of information age companies.
The transactional and transformational aspects of Performance Management

The Traditional Approach
Traditionally, the transactional aspects of Performance Management have predominated. These have been concerned with pay bargaining, the negotiation of individual contracts, the ‘effort bargain’ (a bargain between employees and employers as to what the former regards as a reasonable contribution and what the latter is prepared to pay it) and, more recently, the ‘hard’ performance agreements or contracts embodied in Performance Management ‘systems’ – the ‘management by contract’ approach. A strong transactional element is inevitable in most aspects of Performance Management, but there is a risk of overdoing it and treating it as a ‘system’ – a mechanism for converting inputs to outputs. And there is nothing mechanistic about Performance Management. It should be regarded as a constantly evolving process rather than a rigidly designed system. A ‘systems’ approach can also produce what are best described as ‘over-engineered’ performance pay practices which may be the pride and job of the HR function but are either unacceptable to the line management or unworkable or both.

The Transformational Approach
In contrast, a ‘transformational’ approach to performance pay tends to put the transactional aspects to one side (perhaps as a necessary evil) and emphasizes the role of performance pay as a change agent. This essentially is the new pay philosophy as advocated by Lawler and Schuster and Zingheim. They have made a valuable contribution by extolling the virtues of a transformational approach. But it can be taken too far. The naïve belief that such devices as performance-related pay can by
themselves act as ‘levers for change’ has been responsible for many of the failures in payment innovations over the last decade.

Indeed, payment policies and practices must respond to change and they can help to consolidate change and facilitate further change. But they cannot initiate change or act as the sole levers for change. They should be regarded as one of the instruments available to achieve transformations, working in conjunction with other instruments as part of top management’s overall strategy. Importantly, they must be integrated with the other key areas of business strategy to reinforce the achievement of corporate goals. As Gilbert has said, it is necessary ‘to keep internal processes in line with the way in which the business goes to market’.

But Performance-pay strategies can and should be developed and put into practice as part of a drive for corporate transformation, reflecting and supporting new plans, structures, processes and management practices, as well as underpinning cultural change.

As Stevens states:
Pay is switching from being a negotiating or ‘pay and rations’ issue and is becoming part of a web practices aimed at developing organizational outcomes by changing attitudes and actions. Pay is no longer treated simply as a motivator to achieve higher levels of effort. It is used to reward the acquisition of skills, the achievement of objectives, the development of careers and the adoption of particular types of behaviour.

Manufacturing companies are today facing intensified competition. The past several years have witnessed a growing awareness among Indian Managers of the central importance to competitive success of first-rate competence in the work of production. High-level competitive success
requires new responsibilities for and a changed attitude towards a company’s manufacturing function.

In a country like India, where the Indian worker is poor and the efficiency level is very low, there is a necessity to raise their productivity, without dragging the firm into a higher wage rate structure. The system of payment by results is a useful tool for securing better utilization of manpower, better production scheduling and performance control, and a more effective personnel policy.

The keenness of competition is such, that the manufacturer, is endeavoring to meet the requirements of the consumer, is forced to consider carefully the cost of production, and one of the chief elements in the cost of production is the cost of labour. Cost of labour is affected, amongst other things, by the worker’s rate of output, and this brings into reviewing his ability and willingness to produce at a satisfactory rate. The rate and cost of production must be such that will enable the products made to be offered for sale at a price which will attract purchasers, and at the same time, make it possible for a profit to be shown.

The main factors that affect the industry can be examined through the following considerations:

The consumer seeks – low prices – quick delivery
The Manufacturer seeks – large profit – repeat orders
The worker seeks – high wages – continuous employment

The problem in front of the manufacturer is to reconcile these contending interests so that neither will predominate to such an extent as to prejudice the other. The clash of interests would appear to be almost irreconcilable,
and while this is not really so, the experience of the past tends to suggest this.

1.1.3 Importance of an ideal Performance Appraisal based Compensation System

Achieving good performance is a journey not a destination

Kenneth Blanchard (1984)

Designing a sound pay-for-performance system is not easy task. Considerations must be given as to how employee performance will be measured. For example, measuring an employee's output on an assembly line may be relatively easy and objective but more difficult (and subjective) when the employee works in a service environment. Other concerns include the monies to be allocated for compensation increases, which employees to cover, the payout method, and the periods when payments will be made. A critical issue concerns the size of the monetary increase and its perceived value to employees.

Pay can play a significant part as an investment which will support the long-term success of the organization. As Flannery et al point out:

Organizations are beginning to understand that pay should no longer be considered only in terms of specific jobs and current financial results. Compensation must inextricably be tied to people, their performance and the organizational vision and values that their performance supports. It is an important tool for communicating and reinforcing new values and behaviours, supporting accountability for results and rewarding the achievement of new performance goals.
Best Practices in Paying for Performance

• Vision
Before any organization can hope to develop a successful pay-for-performance program, it must have a vision. While this may sound simplistic, without such direction, it is difficult to even identify the type of performance one should reward, never mind link that performance to various elements of compensation. What would success look like? And how would we know it if we saw it? Before we begin to answer these questions, we must know what the organization is trying to accomplish. Put another way, a clear corporate vision is the foundation on which all effective pay-for-performance systems are based.

What exactly do we mean by vision? Without getting bogged down in semantic definitions of “vision” versus “mission” versus “strategy”, we can perhaps best describe it as a clear sense of purpose. To be an effective part of the pay-for-performance process, a corporate vision does not have to be memorialized in Lucite “tombstones” or posted above every water cooler; however, it does have to represent a high-level understanding within the organization of where it would like to be next week, next month, and next year and beyond.

When such a vision exists, the remaining elements of an effective pay-for-performance program can begin to put in place. Without it, even the best-designed program will drift aimlessly. It may occasionally drive the correct behaviour, but it will most likely be by chance rather than by design.

• Alignment
If a company’s overall vision represents a destination, it still must figure out how to get from Point A (where it is today) to Point B (where it would like to be). Proper alignment of the pay program is critical because it helps
to ensure that the behaviours the organization is rewarding are the same behaviours that will help achieve the desired results. We often see companies become frustrated when, after spending significant resources rethinking their business strategy, they are not able to make that new vision a reality. Upon closer examination, however, it becomes clear that the behaviours the pay program rewards (either explicitly or implicitly) and the behaviours required to achieve the vision are very different.

Alignment, however, goes beyond simply identifying desired behaviours. It also requires proper calibration of compensation programs, to ensure that the levels of pay delivered are in line with the levels of performance that are actually achieved. A Research into the compensation practices of high-performing companies reveal that most use some sort of external validation in their pay programs. Such external validation is often both retrospective, to assess how the company actually performed compared to its peers, and prospective, to ensure that performance targets include an appropriate degree of “stretch”.

Consider a company that as part of its pay-for-performance philosophy provides high leveraged annual incentive opportunities with maximum payouts equal to two or three times an employee’s “target” award. Theoretically, the company should only be paying out the maximum bonus amount when actual performance is outstanding. But how outstanding is outstanding? By comparing performance targets to both the recent and expected performance of relevant peer companies, we can begin to determine if the plan’s definition of superior performance is, in fact, superior. Without such external validation, a company with a stated pay-for-performance philosophy risks overpaying for mediocre performance or perhaps underpaying for exceptional performance. In either case, pay and performance are not properly aligned, making it much more difficult for the
pay program to drive the appropriate behaviour and for the company to achieve its stated vision.

**A Holistic Approach**

Pay is just one aspect of human capital management. While proper alignment of a company’s pay programs is critical, other factors in the human capital equation must not be overlooked. Even more important, however, they cannot be managed discretely. Effective human capital management requires a holistic reward strategy that links pay programs, benefits, and career opportunities and understands the relationships between these various reward components.

A human capital framework recognizes several elements that go beyond traditional compensation and benefits programs, including people, work processes, management structure, information and knowledge, and decision making. By understanding the role that each of these diverse elements plays in executing the overall business strategy, one can begin to develop an optimal rewards mix that motivates, develops, and drives an organization’s talent as efficiently as possible. Such a holistic approach to reward strategy, in conjunction with a robust pay-for-performance program, can have a significant impact on both human capital decisions and overall business results.

**CEO / Proprietor commitment**

Even a properly aligned, holistic rewards program will disappoint if it lacks commitment from the highest levels of the organization. When a CEO demonstrates, in both words and deeds, that he or she is truly committed to a pay-for-performance philosophy, which sense of commitment will cascade throughout the organization. If the CEO is not personally committed to the program, and his or her actions do not support its stated
objectives (e.g., by not including senior executives in the same rigorous performance management process used at lower organizational levels), employees will quickly come to believe, - and rightly so – that any talk about “paying for performance” is more about style than substance.

How do CEOs at high-performing companies demonstrate commitment to a pay-for-performance compensation philosophy? They begin by identifying and communicating the highest standards of excellence, not just on the basis of historical performance, but also on the basis of achieving breakthrough levels of performance in both financial and non-financial terms. When CEOs take the lead in identifying and communicating performance criteria, there is a clear understanding of how the organization will measure success and how specific individuals can contribute to that success.

An equally important element of CEO commitment is the CEOs willingness to drive the change throughout the organization. As organizations continue to reposition themselves in light of changing economic realities, CEOs are spending more and more time on the performance management process, personally setting goals and evaluating performance for those who will carry out the new strategy. Importantly, this personal involvement is not limited to the CEO’s half dozen direct reports but extends to a broader group of executives and delivers a clear message to those executives that a rigorous performance management process is critical to the company’s success. Those executives, in turn, can then drive that message even deeper into the organization.

• Accountability

Personal accountability is in many ways the hallmark of an effective pay-for-performance program. A well-aligned program with a rigorous
performance evaluation process means nothing if, at the end of the year, individuals are not held accountable for meeting agree-upon goals.

Traditionally, a strong sense of accountability has meant that “the numbers tell the story”. At the beginning of each performance period, companies set specific financial targets that support their overall business objectives. At the end of each period, actual performance is evaluated against the original target and individuals are held accountable for their performance through compensation and future career opportunities. While this notion of “black and white” results is common (numeric targets are either met or they are not), we increasingly see high-performing companies recognizing that shades of gray can also exist without sacrificing accountability.

One approach that is becoming more common is the use of non financial measures in incentive plans. This can take the shape of a formal “balanced scorecard” in which performance is evaluated in specific areas such as financial results, people management, customer satisfaction, and intellectual capital development, or it can simply involve basing a portion of an annual incentive award on non-financial criteria such as quality or diversity. In either case, the measures remain quantitative, but they give a more appropriate picture of overall performance than rigidly adhering to a single financial metric such as earnings per share.

A second way some leading companies are moderating their approach to accountability is to continue to set specific, measurable targets in a variety of areas, but to refrain from attaching specific payout formulas and weightings to the various goals. Instead, they assess the various factors retrospectively, in light of the actual market conditions that existed over the course of the performance period. We can describe it as “qualitative assessment of quantitative performance”.
To be effective, accountability does not have to mean rigid inflexibility, in which missing a target by one unit or 0.1% results in zero reward, regardless of any extenuating circumstances; however, there does not have to be a clear cause-and-effect relationship between results and rewards. Strong performance should be rewarded; poor performance should not.

- **Balance**

One of the most challenging aspects of any pay-for-performance program is striking the right balance among various compensation elements and performance measures. As organizations grow and become increasingly complex, their multiple objectives are not always compatible. When a company says it pays for performance, what type of performance is it talking about? Absolute performance? Or relative?

### 1.1.4 The Existing Payment Mode and the Challenges therein

Pay being equal – employees need a better reason to get up in the morning!!

In manufacturing, production employees who are asked to generate valuable ideas to improve operations are still responsible for operating machinery and fixing breakdowns. If firms want employees to be diligent on the production line (one task) and to generate ideas for long-term improvements in production equipment (a second task), the firm will need to adopt and balance multiple human resource management policies that address incentive issues for the different tasks.
For example, it may be optimal to design combined pay plans so that objective pay plans applied to simple tasks are combined with subjective pay plans applied to difficult-to-measure tasks. Thus, Holmstrom and Milgrom (1994, p. 990) conclude their multitasking model with the observation that “the key according to our theory is to evaluate [employment practices and incentive devices] not in isolation, but as part of a coherent incentive system.”

Productivity should be a measure of a team, of a company, of a society. Individuals should not be the focus of a productivity measurement because measures and rewards for individuals can work at cross purposes to what the organization is trying to achieve. Productivity improvement means the growth of the organization and of all its members. Therefore, the measures and rewards should focus individual efforts on what is best for the total situation.

That does not mean we can neglect individual champions. We should not neglect the quality of life in the workplace. How can we focus on the productivity and quality of products and services and neglect the quality of life of those people producing the goods and services? In a productive world class business, the overall process is important. To achieve dramatic productivity growth, we must give people the opportunity to grow personally. They must feel enriched at work; challenged every day to continually improve and look at things from a fresh perspective. They should be free to look for problems, to investigate and to solve them – not to avoid them.

Challenges

- Employer’s Ability to Pay:
Pay levels are limited by earned profits and other financial resources available to employers. Thus an organization’s ability to pay is determined in part by the productivity of its employees. This productivity is a result not only of their performance, but also of the amount of capital the organization has invested in labour-saving equipment. Generally, increases in capital investment reduce the number of employees required to perform the work and increase an employer’s ability to provide higher pay for those it employs.

**Using Measurement to Boost a Unit's Performance**

Today, managers are drowning in statistics – Financial numbers, Operational data, Page after page of reports and tables piling up on their desk or hard drive. This information overload just gets worse as organizations install so-called enterprise resource planning systems, which provide real-time data on an ever greater number of variables.

Data doesn’t have to be the bane of our existence. In fact, it can be a tremendously powerful tool for managing one’s unit – if one knows how to sort through it and how to use it to improve their performance. Recent insights into the art and science of performance measurement suggest five key steps:

1. **Figure out the numbers that matter:**

   Any unit or functional department has to focus on only a few key measurements. More than a few, and pretty soon people get lost – or start finding ways to justify nearly any action on the grounds that it improves one or another metric. An HR unit might concentrate on average time required to fill a position, and on turnover rates. A product-development group might focus on development cost and time-to-market, both compared to plan. Any unit can come up with its critical indicators just by asking a few questions:
What should our goals be in light of our company’s objectives and needs?

One needs to analyze their organization’s situation and strategic objectives for the year. Is the company focusing on venue growth? Increased market share? Cost reduction? Introduction of new products? There may be ways the department can contribute to these goals – and if so, the targets that are set will be that much more meaningful for being tied in a big-picture objective. This process is easiest for a company who has already adopted a “balanced scorecard” or some similar system of explicit goal-setting. But even if it hasn’t, managers in healthy organizations generally know their company’s priorities and can choose key metrics accordingly.

What will happen if one focuses on a particular metric?

We can call this the “Vegetable Efficiency” test. For example: A fast-food chain gave lip service to many objectives, but what senior managers watched most rigorously was how much cooked vegetable its restaurants had to throw away (“vegetable efficiency”). What happened? As one restaurant operator explained, it was easy to hit a vegetable-efficiency target: just don’t cook any vegetable until somebody orders it. Customers might have to wait 20 minutes for their meal, and would probably never come back—but you’d sure make your numbers. Moral: a measurement may look good on paper, but you need to ask what behavior it will drive. One may be focusing on the wrong metric—or too much on only one of the right ones.

Are we checking leading indicators as well as lagging ones?

Financial results (or performance-to-budget figures) are “hard”
metric, calibrated in numbers and nearly always meaningful. The problem is that they lag their performance. They tell you how you did yesterday or last month, but not how you’re likely to do tomorrow or next year. For that you need “soft” or “perceptual” measures such as customer satisfaction and employee commitment. “Perceptual measures are often leading indicators in the sense that they’re highly predictive of financial performance.” For a particular HR department, soft indicators might be measures such as employee turnover or surveys of internal-customer satisfaction. If one tracks such measures today, they will find themselves worrying less about missing their budget tomorrow.

2. **Drill down to understand cause-and-effect connections**

Once the few key metrics to track have been chosen, the next challenge is to understand what the numbers are telling us. If defect rates have suddenly started to rise, is it because we have been receiving lower-quality materials? Or is it because we have recently hired several inexperienced employees? Most numbers worth watching are themselves the sum of many other numbers and one may need to “explode” the metric into its component parts so one can see what is driving the change.

For example: A large utility company faces the challenge to reduce the cost of delivering a particular product. It turned out that labour costs were far and away the biggest driver of overall expense. So the team handling the problem mapped out every component of the labor cost: wage rates, overtime, benefit costs, absenteeism, turnover, and so on. Breaking one “chunky” number – labour costs-into its component parts enabled the team to pinpoint, monitor, and then attack key areas of potential costs reduction.
If a unit is relatively large, the key metrics may in fact be made up of a cascade of numbers, for which individual groups and teams within the unit are responsible.

A sales department, for example, might have aggregate goals for gross revenues, gross margin, and selling expense; in this case, the overall goals would simply be the accumulation of goals for each product group or territorial team within the department. If the aggregate numbers don’t turn out the way they’re supposed to, it’s easy to drill down to the component parts and find out where the problem is.

3. **Set real goals, not arbitrary ones**

It should go without saying: a metric without a target to compare it against is worthless. But a metric without a meaningful target isn’t worth much, either. Too often, companies set goals simply by looking at last year’s performance and tacking on 5 per cent or 10 per cent for improvement. Or else they set “stretch” goals that turn out to be ambitious objectives plucked out of thin air.

One needs to set goals by analyzing one’s own past performance, one’s competitors’ performance, the performance of “benchmark-level companies in similar businesses,” one’s own capabilities (can we hit the goal given the resources available?), and input from employees and suppliers. “Competitors,” incidentally, should be interpreted broadly. A functional department such as HR or IT can compare the cost of the services it provides with the cost of outsourcing those services, and establish goals based on that benchmark.

It should also go without saying that the more people have a hand in setting a goal, the more they’re likely to work hard to attain it.
Goals imposed from above without a rhyme or a reason, rarely motivate people. Goals imposed with rhyme and reason may or may not motivate people. Goals developed by a group that understands their importance are the most powerful motivators of all.

Examining the Feasibility of Performance Related Pay (PRP) in the Government

Pay and allowances in the Government are linked to service-incremental salary scales and promotions under different service rules. Promotions have been used as a tool to provide incentive especially at senior management levels. Pay increases are based on annual increments and the salaries depend more on length of service and grades rather than the performance of an individual employee. Pay increases for both central and state government employees are currently based on annual increments, and salaries depend more on length of service and hierarchy than annual performance.

The sixth central Pay Commission (constituted in 2006) is examining the feasibility of introducing performance-linked salaries for government employees. Performance-linked pay is a marked departure from the present practice. If implemented, it will align government pay more closely to corporate sector compensation practices. The aim of the study is to examine the feasibility of working out a model whereby a base salary is attached to each post based on the conventional criterion of skills and responsibility; simultaneously, a second component is introduced that is payable as a percentage of the salary on the basis of productivity and the performance of the employees, either individually or as a group.

- Identification of metrics for five measures of performance viz.
  - (i) Competency/ skill
  - (ii) Effort /activity
• (iii) Result/ output/ value added measures
• (iv) Efficiency/ productivity, and
• (v) Quality/ customer satisfaction.

• Suggesting Modified Pay structure having flexibility to implement PRP viz. Pay structure having fixed and variable components with variable component linked to performance measures.

1.1.5 In closing
Traditionally organizations have measured performance on the basis of short-term financial results like sales, growth, profitability, and essential ratios such as return on investment, sales per employee etc. Departments were evaluated by their financial performance, and individual incentives were tied to short-term financial goals. But today, the focus is on Long-term perspective. Besides financial measures, organizations are looking at non-tangible results. It is the execution of corporate strategy, management credibility, research and development, branding, image, customer satisfaction and employees turnover that matters more.

There is no doubt that pay is one of the potent communicators of how much an organization values the contributions of an individual or a group.

A high performer must be differentiated among average performers and should be rewarded suitably. Pay for performance or variable pay is an easiest solution for this. Also performance related pay is frequently used to support a performance-oriented culture in organizations.

An organization’s “capacity to pay” finally depends on its financial performance. Any other basis of remuneration cannot last long. Hence, increasingly, they have to move towards a system of payment by results.
Pay for performance systems, also called Incentive systems, reward employee performance on the basis of three assumptions:

- Individual employees and work teams differ in how much they contribute to the firm not only in what they do, but also in how well they do it.

- The firm’s overall performance depends to a large degree on the performance of individuals and groups within the firm.

- To attract, retain, and motivate high performers and to be fair to all employees, a company needs to reward employees on the basis of their relative performance.