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## THE STUDY OF BOOSTING PRODUCTIVITY OF EMPLOYEES THROUGH PERFORMANCE BASED PAY

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### ABSTRACT

**T**he success of any organization greatly depends on its resources – money, material, machine and men. Man is considered to be the most significant resource as it handles all the other resources and also aids in becoming competitive, dynamic, innovative and productive. Yes, it is human resource which makes all the difference. Performance based pay (PBP) correlate employee pay directly with the employee output. It links the compensation of the employees to their performance and their contribution to the organizational goals. This paper explores how performance based pay increases productivity, the nature and the types of PBP, how PBP can be made more effective and their pros and cons.

**KEYWORDS:** Performance based pay, compensation, employee output.

### INTRODUCTION:

One of the latest strategies being followed in all sectors through out the world for motivating their employees to increase productivity is, “linking compensation to performance”, commonly known as “performance pay” or performance based pay”(PBP)

Performance based pay are non discretionary awards and based on pre established performance plans. Unlike bonuses, performance pay serves as an incentive for higher level of performance and

accountability through the use of specific performance goals and objectives. Performance based pay is not a part of salary; it is not guaranteed and is based on individual, group, or organizational performance. The periodic performance reviews provide the basis of performance related pay which helps the employer to pay the employee according to their productivity and hard work. Many organizations all over the world such as Maruti Suzuki, Larsen & Toubro, Genpact, Toyota, General Motors etc, are using PBP and they believe that pay is motivating their

employees to work and increase productivity. Yes! There exists a positive relation between PBP and productivity. How? The answer to this question needs to understand the PBP system in detail, the process of PBP, the types of PBP in various organizations and their pros and cons.

### THE PROCESS AND TYPES OF PBP

The employment contract is about an exchange relationship by which a specified amount of labor power is traded for various rewards as per of all motivation theories. The

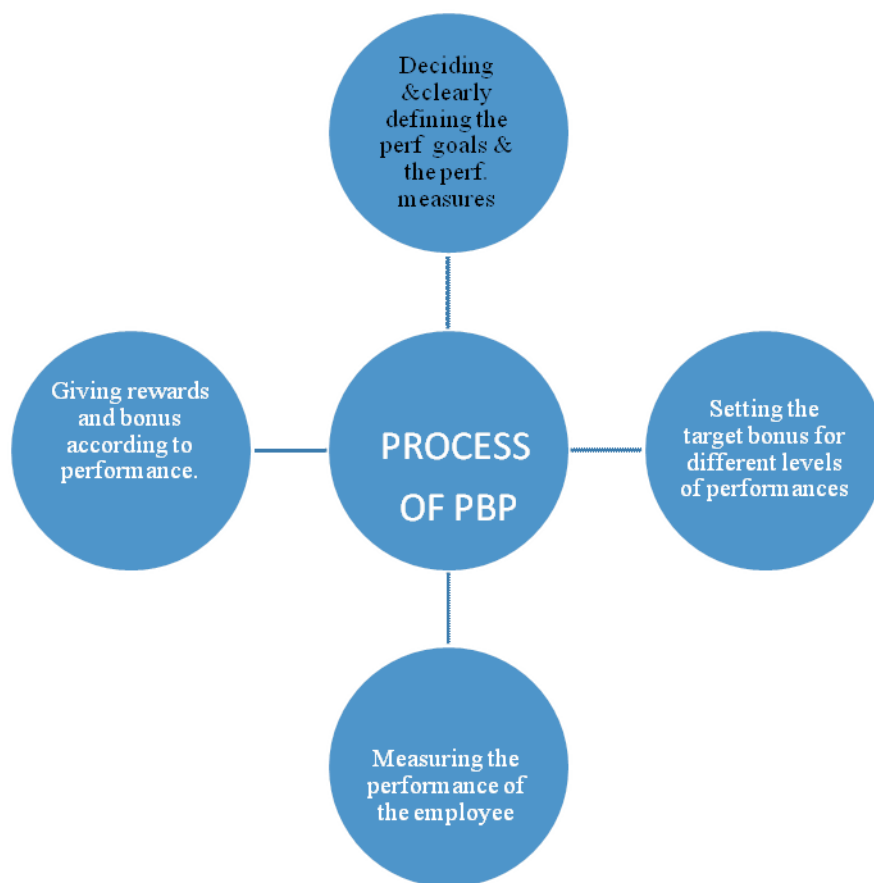


traditional approach to motivation emphasizes economic rewards linked to productivity i.e., scientific management. The human relations approach emphasizes non-monetary rewards as the prime motivating factor e.g., the Hawthorne studies while the human resource approach suggests that workers are motivated by many individualized reward systems e.g., theory X and theory Y, for almost all employees, the most important reward is monetary compensation.

Thus, effective PBP system should provide incentives that encourage distinguished, innovative and creative achievements to meet unusual challenges and opportunities when they arise. It should promote recruitment and retention of productive personnel.

**The process of performance based pay involves**

- + Deciding and clearly defining the performance goals and the performance measures
- + Setting the target bonus for different levels of performances
- + Measuring the performance of the employee
- + Giving rewards and bonus according to performance.



**Performance Based Pay Process**

**Types of Performance Pay**

Organizations should design variable compensation plans for various roles and positions in organization. They must seek to determine the right balance of rewards to keep workers motivated. The PBP should be fair, and does not impose undue amounts of stress. The following are some important types of PBP.

- Piece work plans-in this plan you pay the worker a sum called piece rate for each unit he or she produces. Straight piecework and standard hour plan are examples of piece work plans.

- Merit pay or Merit raise is any salary increase the firms awards to an individual employee based on his or her individual performance. The variable part of the salary is based on the periodic performance reviews.
- Incentives – Rewards for special accomplishments or fulfillment of the targets set such as sales commission. Some sales people get straight salaries, and most receive a combination of salary and commissions. Commission is not added to base pay. Usually the formula and the relationship between performance and the payment of the commission are known beforehand.
- Team or group incentive plan-a plan in which a production standard is set for a specific work group, and its members are paid incentives if the group exceeds the production standard.
- Profit Sharing – the plans in which all or most employees receive a share of the firm’s annual profit are popular today. The types of profit sharing plans are- Cash plans, the Lincoln incentive system and deferred profit-sharing plans. There is ample evidence that profit sharing plans boost productivity
- Gain sharing – is an incentive plan that engages many or all employees in a common effort to achieve a company’s productivity objectives. And the resulting cost-savings gains shared among employees. Sharing of gains as a result of the increased performance of the employees is gain sharing.
- Employees stock ownership plans (ESOP) - are company wide plans in which a corporation contributes shares of its own stock- or cash to be used to purchase such stock- to a trust established to purchase shares of the firm’s stock for employees. The firm generally makes these contributions annually in proportion to total employee compensation, with a limit of 15% of compensation. The trust holds the stock in individual employee accounts, and distributes it to employees upon retirement or other separation from service, assuming the person has worked long enough to earn ownership of the stock.

Other methods include On-the-spot awards, lump sum bonuses, online award programs etc.

**PBP at Public Sector and Private Sector**

<u>PBP AT PUBLIC SECTOR</u>	<u>PBP AT PRIVATE SECTOR</u>
PBP gets little attention,	PBP is a hot topic,
Affordability is critical,	Competitiveness is critical,
Public perception is important,	Public perception is not important,
Long term incentives are lacking and	Long term incentives can be found and
Managers typically have limited flexibility.	Managers can often manage to budget.

**Table 1**

**Sixth Pay and PBP**

The Sixth Pay Commission had carried out a study through the Indian Institute of Management, Ahmedabad, on a performance-based incentive system, to improve the performance outputs of central government employees. The study, according to the official website of the pay commission, was aimed at working out a model whereby a base salary is attached to each post based on skills and responsibility and simultaneously, a second component would be payable over and above the salary on the basis of the productivity and performance of employees, either individually or as a group. The study recommended an annual bonus of up to 20% to employees whose achievements exceed certain targets, which has been accepted by the cabinet.

### HOW PERFORMANCE BASED PAY INCREASES PRODUCTIVITY?

Studies indicate that PBP was successful in most of the organizations where it was implemented. There was an increase in productivity depending upon the situation and type of the plan adopted.

- Piecework plans are considered to be equitable in principle and can be powerful incentives since rewards are proportionate to performance.
- Team incentives often make a lot of sense. Performance here reflects not just individual but team effort, so team incentives make sense. Toyota is known for its team and work-group-based incentives which are successful not only in Japan but also in the U.S. plants. These plans reinforce team planning and problem solving, and help ensure collaboration. It reduces jealousy, make group members indebted to one another and encourage a sense of cooperation.
- Profit-sharing plans which were introduced in Ford Motors Co., and General Motors show ample evidence that they boost productivity. The employees get tax benefits. And the plan also includes suggestion system that pays individual workers rewards for savings resulting from their suggestions.
- ESOPs at Thermacare, Inc., and DTX. Research suggests that ESOPs encourage employees to develop a sense of ownership in and commitment to the firm. With ESOPs the company gets a tax deduction equal to the fair market value of the shares that are transferred to the trustee, and can also claim an income tax deduction for dividends paid on ESOP-owned stock
- Gain-sharing plans such as Scanlon and Rucker plans showed success in 30 cases out of 44 where it was implemented. The plan is sound, it gives the participants the real sense of participation and self esteem, and group cohesion and motivation are increased in anticipation of the reward. In each case savings or increased production is quantified on monetary terms and shared among the concerned people.

### Views of Employees on PBP EXL(I) PRIVATE LIMITED

At EXL there are basically two types of plans. They are Pay for Performance ( P4P) and Completion Incentive. The merits of the system are that the employees' monetary need is satisfied. They motivate the employees to improve their performance, become more efficient and help in improving the productivity of the organization. The demerits of the scheme are: To achieve completion targets, employees do not maintain quality. To attain the production hours and efficiency people have to compromise on personal front. If P4P does not come personal planning is disturbed because of low fixed pay.

### ABN AMRO BANK N.V.

The employees in the bank are rated under four categories such as T1-Exceptional performance, T2- Above expectations, T3-Meeting expectations, T4- Below expectations. The employees rated under T1 and T2 will get a certain amount of bonus decided by the bank. The employees are highly motivated with the scheme. Loyalty and integrity goes up, productivity is boosted. Employee becomes more confident and motivated for improved performances. Stress and pressure to attain targets will be there. As the number of employees are more, the raters have to rate a certain percentage of employees under the different categories, due to this certain border line performers may fall out leading to dissatisfaction and de motivation. Also there are chances of biased rating by the raters.

Which scheme is best? There is no such scheme, each situation must be studied in depth and a suitable scheme tailored for each situation. Also important is the history and culture of the organization. It is not advisable to introduce drastic changes suddenly. Money is motivating the executives the rewards should be meaningful and should vary with performance. Thus we can say from the above study that PBP improves productivity.

Having understood the process and the role of PBP in improving productivity in different organizations, we now pay our attention to the limitations of the PBP.

### THE PITFALLS OF PBP

- Quality “You get what you pay for”:- an incentive plan that rewards a group based on how many pieces they produce may lead to rushed production and lower quality. A plant wide incentive for reducing accidents may simply reduce the number of reported accidents.
- Performance pay can't replace good management Performance pay is supposed to motivate workers, but lack of motivation is not always the culprit. Ambiguous instructions, lack of clear goals. Inadequate employee selection and training unavailability of tools, and a hostile workforce or management are some other factors that impede performance.
- “Pay is not a motivator every time” Recall what the psychologist Frederick Herzberg says: Employers should provide adequate financial rewards, and then build others, more effective motivators like opportunities for achievement and psychological success in to jobs. More challenging jobs often make more sense than do financial incentive plans.
- Change: Rewards may undermine responsiveness. When employees' main focus is on achieving some specific goals like cutting costs, any changes or distractions make achieving that goal harder for the employees. Incentive plans can therefore mediate against change and responsiveness.
- Rewards punish: Employees may view punishment and reward as two sides of the same coin. They say” Do this and you'll get that” is not very different from”Do this or you won't get that”.
- Conflicts: Conflicts between different work groups occur when one group is dependent on another. Also there is a potential for conflict when norms have to be revised. Rewards rupture relationships. Incentive plans have the potential for encouraging individuals (or individual groups) to pursue financial rewards for themselves.
- Intrinsic motivation: Rewards undermine intrinsic motivation Edward Deci said that contingent financial rewards (incentives) may actually undermine the intrinsic motivation that often results in optimal performance. The argument is that financial incentives undermine the feeling that the person is doing a good job voluntarily.
- Unintended Consequences: Rewards can have unintended consequences. One expert says:”Tell people that their income will depend on their productivity or performance rating, and they will focus on the numbers. Sometimes they will manipulate the schedule for completing tasks or even engage in patently unethical and illegal behavior.

Keeping in view the above pitfalls, measures to make PBP effective should be taken.

### HOW TO MAKE YOUR PBP MORE EFFECTIVE

- Understandable: Make the plan easy for employees to understand. Employees should be able to calculate their rewards for various levels.
- Set Effective Standards: Make standards high but reasonable--there should be about a 60% to 70% chance of success. And the goal should be specific--this is much more effective than telling someone to “do your best”. Once the plan is working, use caution before decreasing the size of the incentive. Rate cuts have long been the nemesis of incentive plans.
- Relate Efforts and Rewards: Make sure effort and rewards are directly related. The incentive plan should reward employees in direct proportion to increased productivity or quality. Employees must also perceive that they can actually do the tasks required. The standard has to be attainable, and provide the necessary tools, equipment, and training.
- Link Incentive with Strategy: Decide how the incentive plan will contribute to implementing the firm's strategy and objectives. Whether to inspire higher performance, reduce costs or any of a range of results that fit your business and its strategic plan.
- Ask is effort clearly instrumental in obtaining the reward? Sometimes incentive pay doesn't make sense. For example: when employees are unable to control quantity or output Such as on machine-paced assembly lines. In general, it makes more sense to use an incentive plan when there is a clear relationship between employee effort and quantity or quality of output, the job is standardized, the work flow is regular, delays are few or consistent, if quality is important, employees can easily measure and control it.
- Get employees' support for the plan. Restrictions by members of the work group can undermine the plan.

- Use good measurement systems. The process used to appraise performance must be clear and fair.
- Emphasize long-term as well as short-term success. For example, just paying assembly workers for quantity produced may be shortsighted: longer-term improvements like those deriving from work-improvement suggestions are often equally important in increasing the firm's value.
- Adopt a comprehensive, commitment-oriented approach. From employee's point of view, incentive plans don't exist in isolation. For example, trying to motivate employees with a new incentive plan when they don't have the skills to do the job, or are demoralized by unfair supervisors, a boring job, or a lack of respect, might well fail. Therefore, it's best to install the program within a framework of HR-related practices that promote employees want to work and do feel like partners.

## CONCLUSION

Performance Based Pay has always been a topic of discussions and controversies with many arguments against it, but it has been proved from the studies that PBP is effective in motivating employees to perform better and earn. It also encourages learning, innovation, creativity, problem solving and empowerment. Thus, we can say that PBP can act as catalyst for boosting productivity, which has to be facilitated with good management, proper performance measurement & reviews and adopting the measures listed above to make the PBP effective.

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