Said Easier Than Done: A Contingency Approach to A Pay-for-Performance Reward System in Public Organisations

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Introduction

For any organisation, an effective reward system plays a crucial role in attracting qualified people to join the organisation, keeping them come to work and motivating them to achieve as high levels of performance as possible. Particularly for the public sector, on the one hand, it is increasingly difficult to compete with for-profit sector in recruiting talented and young people. On the other hand, it seems to be common for the public to hold the view that people working for the public sector - bureaucrats are generally less efficient, responsive and accountable in the supply of public service than are those in the private sector. For many decades, practitioners and academics have been concerned about attracting, retaining and motivating people to join careers in public service.

Responding to increasing demands for performance, governments in the United States, Canada, Western Europe, New Zealand, Australia, and in countries in Asia, Africa and Latin America have made performance measurement as a core component of public management reform (Behn, 2001; Kettl and DiIulio, 1995; Pollitt and Bouckaert, 2000). One of those solutions designed to address this issue is a 'duty and interest junction' approach, advocated by New Public Management Movement (NPM), which emphasizes the role of private sector man-

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agement techniques in the public sector (Flynn, 1990). It is an individualist approach to the design of institutions, such as competitive reward and pay-for-performance systems, which aligned public officials' self-interest and their public duties. There are varieties of names under an umbrella of pay-for-performance, say, incentive pay, merit pay and competitive reward, just mentioning a few. But a common feature is that they all has been constructed entirely around the assumption what Thomas Carlyle called the 'pig principle' - human beings, from the highest to the lowest, are inherently rational, opportunistic and self-regarding (Hood, 1998). It has been included in US Government Performance and Results Act (GPRA) and the United Kingdom's Nest Steps. Former US Vice President Gore planned to initiate changes in the civil service system by linking the pay of federal employees to their job performance in his Reinventing Government movement (Risher, 1999).

By employing some organisational behaviour theories of motivation and reward, this paper argues that the idea combining duty with self-interest in the design of a reward system in public sector may be an attractive slogan for some, but is deeply indeterminate or problematic in practise, and remains a contested debate. The immediate following section is intended to briefly explore the historical trajectory of pay-for-performance doctrine. The second section challenges the individualist assumption behind that idea. Two constraints, budget and performance appraisal, are discussed in the third and fourth sections respectively. The fifth section presents some consequences that are undesirable to the objective of pay-for-performance. And finally a conclusion is reached.

A Recurring Debate in Public Management: Management by New Names

That duty and self-interest junction doctrine is not a novel idea but a recurring debate among early political philosophers, the later scientific management school and contemporary New Right economists. Its genesis can be traced back as early as to an ancient Chinese political philosophy, legalism school. Lili (latter part of the fifth century BC) and Shang Yang (390-338 BC), two of the famous legalists, were respectively Prime Ministers of Wei and Chin Kingdoms (Pye, 1988). They emphasised the mutuality of the conditions under which human society carries on its affairs and thereafter elaborated a doctrine of rewards and punishments as a stimulant and deterrent to human actions. In the 18th and early 19th centuries, British utilitarian philosopher Jeremy Bentham held that high pay was one of the best ways to avoid malfeasance and corruption in public sector and thus building a whole philosophy and a body of schemes linking self-interest and public duty in public management (Hood, 1998).

Subsequently, at the end of the 19th century, the scientific management school guru Taylor applied engineering ideas into duty and interest junction doctrine in which he aimed at linking performance to pay on an individual rather than a group basis (Taylor, 1911). It was not until the second half of 20th century that some New Right economists who are intellectual sources of NPM, notably public choice school pundit Niskanen, picked up and transferred the idea to public management and proposed to design a number of alternatives to rewarding public employees.

Niskanen recommends three types of reward systems (Niskanen, 1973). The first is a personal rewards system that allows senior managers to appropriate such as personal income some proportion of the difference between the approved budget and the costs of supplying the approved quantity of services. It is a kind of bonus scheme. The second type of reward system would pay bureaucrats for their especially efficient management when they left office. It is a deferred prize. The third type of reward system is a discretionary budget. It would permit bureaucrats to spend a proportion of the difference between the budget that the agency receives from its sponsor and the minimum cost of producing the output level that will satisfy the sponsor, which gives public managers somewhat more managerial discretion to reward their subordinates (Niskanen, 1973).

Milkovich and Wigdor (1991) further establish a two-by-two matrix to categorize the different pay-for-performance schemes. The matrix is based on one dimension of individual versus group level of performance and the other dimension of whether or not the incentive compensation is added to an employee's base salary.

		Level of Performance	
		Individual	Group
Contribution to base salary	Added to base	Merit plans	Small group incentives
	Not added to base	Piece rates Commissions Bonuses	Profit sharing Gainsharing Bonuses

Merit plans are the most common type of public sector performance pay plan in which pay is tied to individual base salary. The compensation systems of piece rate originated from Frederick Taylor's scientific management movement. They are based upon the amount of output an employee generates. Profit sharing and gainsharing plans are similar in rewarding group-level performance by redistributing earnings. Small group incentive plans add rewards to an employee's base pay.

An Inadequate Understanding of Human Motivation

A fundamental flaw with a merit pay scheme stems from its inadequate understanding of human motivation. Pay-for-performance schemes are grounded in organisations theories of expectancy and goal setting. Expectancy theory postulates that levels of effort and performance are linked with level of compensation (Milkovich and Wigdor, 1991). A manager can achieve the desired level of effort and performance from an employee through formulating a worthy reward. Theory of goal setting states that employee performance is likely to improve when employees believe that goals are attainable (Locke and Latham, 1990). Rational choice is integral to these two theories. They assume that individual employees as rational decision makers will first evaluate the worth of reward and gauge their effort accordingly and second discern between goals that are attainable and those that are beyond accomplishment at a given level of effort.

In spite of different orientations, all the organisational behaviour studies have concluded that people as a social species has multi-fold of physiological, safety, social, ego and self-fulfilment needs and should be rewarded both extrinsically and intrinsically (McGregor, 1957). It is inadequate to motivate employees with a sole reliance on an extrinsic reward like money that satisfies low-level needs. Even economics teaches us that a principle of diminishing return applies when the more money one earns and the less utility he maximises. Hays (1999) reports that a study released by the Loyal Institute of Aon Consulting in Chicago ranked pay only 11th as a reason for employees to remain with an employer.

With regard to public sector employees, an excessive and uncritical reliance upon a narrowly defined motive is problematic and at least is not wholly compatible with the values and beliefs that have served as the foundation for public service. Most rational analysis takes behaviour to be instrumental: to be motivated by and directed toward some purposes or objectives, for example, people work for getting paid. But behaviour may also be experiential, for instance, people do things because they feel good and take pleasure in the activity for its own sake. Public sector employees have a broad range of instrumental and experiential motives. Perry and Wise (1990) identify three kinds of public service motives:

rational (participation in policy making, personal identification with public programmes and advocacy on behalf of special interest); norm-based (a desire to serve the public interest, loyalty to duty and to the government as a whole and social equality); affective (commitment to a programme of social importance and patriotism of benevolence).

Some empirical studies validate those claims. Low pay has long been perceived as an impediment to attract young and talented people to public service career. But a survey of 477 first-year graduate students in public affairs, those civil servant hopefuls in US, finds out that three factors have influence on MPA students' decision to join a Federal career: altruism, affluence/assurance and self-actualisation (Adams, 2000). Those who want to have impact on national policy issues, seek job security, and advance a personal growth and new skills, are far more inclined to join a federal career. A lengthy, arduous and complicated application process, not a low pay, is identified as a major impediment to attracting young people to Federal careers (Adams, 2000).

Thus, behaviour implications of public service motivation for a pay-for-performance reward is as Perry and Wise (1990, pp.371) argues:

> "... public organisations that attract employees with high levels of public service motivation will not have to construct incentive systems that are predominantly utilitarian to energise and direct member behaviour. Where public service motivation is absent, individual utilitarian benefits may be the most effective incentives. In those instances in which organisational leadership incorrectly matches incentives to motives, the organisation is unlikely to reach its maximum potential performance."

Budget Constraint

Expectancy theory of motivation suggests that a meaningful performance reward must be valued by employees to be worthwhile to influence or change their behaviour and increase extra efforts (O'Donnell and O'Brien, 2000). Ingraham also (1993) argues that the financial resource available for the pay-for-performance system must be enough to ensure its significance to employees and stable enough to permit a long-term payoff to the organisation. Adequate financial resources, however, are difficult to ensure in the public sector because of pay bill constraints. Particularly in times of economic stress rewarding civil servants is not high on the priorities of political leader.

Some parts of the developing world have been troubled by more fundamental reform challenges, such as bloating of the public sector, redundancy in public sector employment and wage bills that consume too much government revenue (Lindauer, 1994). From this perspective it is even more difficult for those countries that have a gigantic bureaucratic machine like China. A 'dual bureaucracy' system exists in China, with the Communist party bureaucracy playing an important role in both service delivery and the direct management of the state bureaucracy. A two-fold organisation, both the government and the party keep their corresponding structures. This duplication requires people to pay double taxes to maintain the numerous bureaucrats. Therefore, before significantly simplifying the administrative structure and downsizing the number of staff in the dual bureaucracy system, a small marginal increase in civil servants' pay will be not only impossible because of the sheer size of the bureaucracy but also insignificant to ensure its effectiveness. In many developing countries, allocating more money to the public sector for performance pay plan is simply not an option.

Problematic Performance Appraisal

Katula and Perry (2003) illustrate a process of performance pay in a simple model:

Goal Setting ➔ Performance ➔ Performance Appraisal ➔ Reward Decision

In accordance with equity theory of motivation, employees must have a feeling of being treated fairly in performance appraisal (O'Donnel and O'Brien, 2000). Thus, the key issue facing both public and private sectors is more about manager's ability to objectively employees' performance than a merit pay system per se. However, performance appraisal in the public sector is a notoriously difficult and controversial endeavour (Katula and Perry, 2003). Practitioners and scholars have not yet reached a consensus on what an evaluation system should be.

There are three factors that are important for employees to have a feeling of fairness about a appraisal: first, performance objectives are measurable and clearly-defined; second, output is sensitive to the employee's efforts; and last, the level of risk that is beyond the employee's control is low. Clear-defined and measurable performance objectives are hard to attain in the public sector. The very nature of public service determines that public organisations produce generally intangible and long-term outcomes that are not easily measurable, as opposed to tangible and short term ones in private sector. Public organisation is also characteristic of undertaking multiple tasks that sometime conflict with each other. The output and efforts of workers in the public sector is not clearly correlated. The performance of public organisations and their staff is influenced by factors beyond their direct control. That is to say, the goal is sometimes set too high to reach. Many workers in the public sector also argue that much of their work is done in teams and cannot be assessed and measured to reward individual output (Margolis, 2000).

China has experimented an appraisal system in its civil service but assessing individual employee has proven difficult and has led to the uniform disbursement problem (Mukherjee and Manning, 2000). The Hong Kong government also considered a performance pay system, but eventually decided to against implementation because of inadequacies in current incentive structures (Perry and Frederickson, 1999).

A further concern with performance appraisal in a group setting is its potential to increase gender bias. Because men and women differ in their experience of socialisation and peer expectation, studies show that women are more likely to downplay their confidence and certainty than men do (Ivancevich and Matteson, 1999; Tannen, 1995). Gender difference adds more complications to performance evaluation, as Tannen argues (1995, pp.141),

> "...the outcome of the team's efforts may become associated with the person most vocal about reporting results. There are many women and men, but probably relatively more women, who are reluctant to put themselves forward in this way and who consequently risk not getting credit for their contributions."

With more and more women joining the workforce, the importance of gender bias in organisation behaviour cannot be underestimated.

Unintended Consequences

A merit pay reward, contrary to its purposes of attracting, retaining and motivating employees does not necessarily produce as positive incentives in public management as its proponents expected. There is a huge gap between the theory and practice, which can be attributed to constraints, some of which ironically emanated from its fundamental individualistic assumption of human beings' behaviour, self-interest and materialism.

First, to implement a pay-for-performance reward system effectively, managers should have the discretion and the authority to recognise and reward their employees adequately (Ingraham, 1993). But too much discretion given to the managers may produce some undesired outcomes. While employees are assumed to be prone to shirking whenever they have the chance, there is no way that one could guarantee that public managers as an individual would not misuse its discretion. The temptation is so great to use such discretionary authority to pursue personal goals, promote departmental interests, or uphold individual conceptions of organisational and social interests, which are all contrary to the intent of duty and self-interest juncture doctrine. Given the fact that employees at the lower organisational levels share a common suspicion and antagonism against the dominant managerial culture, no wonder some public sector employees regarded such an approach as being a tool primarily designed to enhancing managerial control (O'Donnell and O'Brien, 2000; Margolis, 2000).

Similar to Niskanen's three types of reward system, the Chinese government carried out two measures in the early 1980s designed to invigorate state-owned enterprises (SOE) by yielding a proportion of profits to them, namely profit retention and the profit contract (Gong, 1994). Profit retention allowed a SOE to set up an 'enterprise fund' by retaining 3-5% of its planned profit and 15-25% of its unplanned profit earned in excess of the planned target after it had fulfilled state targets - a bonus system. Under the profit contract system, a SOE and its administrative superior negotiated a basic profit figure the SOE would deliver to the state. Then this SOE was allowed to retain a high proportion of profits above the basic figure, with the retention rates increasing with the degree of over fulfilment

- a deferred prize system. A great portion of the retained profits generated by these two systems was used to expand SOE's managerial discretion aiming at rewarding SOE's managers and their subordinates if they performed well.

Nevertheless, as a large share of the retained profits was used as bonuses by managers to reward subordinates, it could create a patrimonial rulership, in the absence of an objective performance appraisal system (McCormich, 1990). It is based on material incentives and rewards because to whom the bonuses go and how much are decisions of managers. Leader-member exchange approach suggests that leaders differentiate their subordinates into in-group and out-group members. At best, a coaching relationship would be developed between managers and their subordinates. At worst, over time all these tend to produce an extensive patron-client network and favouritism: managers exercise personal authority as patrons obligated to give their clients favoured treatments, whereas subordinates act as clients who try to maintain good relations with managers to secure material benefits and personal favours. Patron-client ties also exist between managers. Junior managers often fall into the client role in relation to senior managers. They need to establish special connections to achieve favoured treatment.

Second, a pay-for-performance reward scheme may be detrimental to co-operation in public sector. Since most work in public sector is team-oriented, the effectiveness of any public sector organisation depends to a large degree on its manager's ability to elicit the co-operation of his subordinates. Against this principle, the organisational climate should be characterised by high levels of trust, based on common and shared values and objectives between executives and employees. Organisations are complex webs of social interactions that inherently tie one employee's performance to the actions of many others (Perry, 1986). But the danger of using a competitive reward system in complex, interdependent jobs requiring group co-operation is instances where there are distrust between the management and workers. It may conflict with an organisation's co-operative atmosphere and trust and thereafter making an organisation dysfunctional.

In particular, if employees had a strong feeling of injustice about the relative treatment of different employees, they would be motivated to reduce inequality by all means available according to equity theory. Motivated by their self-interest, it is possible for some employees to improve their rewards by influencing the behaviour, or reducing the output of their opponents. Horn (1995) concludes that a competitive reward scheme undermines incentives for co-operation and may even create incentives for sabotage because individual employees have an incentive to devote some efforts to undermining their opponents' chances of success. A survey of 300 American universities finds a negative relationship between the pay dispersion and output of collaborative research, in other words, the greater the pay dispersion, the smaller amount of collaborative research among academics. Another study suggests that a widely dispersed management pay results in a higher level of turnover (Cairncross, 1999).

Third, self-interest creates a risk of destructive collusion to the organisation. That collusion is a response to a managerial action that employees perceive as threatening and consolidated by sub-organisational culture. That is, if the employer were committed to paying a certain salary on the basis of an individual relative performance, the employees would be better off if they could reach an agreement among themselves to reduce their effort (Horn, 1995). By doing so, all employees would enjoy an easier life without affecting their individual prospect of reward. As a consequence, the total level of effort would be reduced without upsetting the relative effort level. Collusion of this kind brings about a reciprocity, which is well observed in Asia culture in which collectivism is favoured. Since not all employees could perform well all the time, it is thus rational for them to be easy in appraising the performance of others to ensure that those others would return the favour when needed.

Fourth, given that co-operation in public organisation is subject to sabotage, collusion and reciprocity stemming from the introduction of a competitive reward system, it is a rational strategy for public managers to use grade inflation to bolster internal co-operation. Public managers seek career security and advancement as well as circumstances that make it easier managing their employees. For example, most Chinese public managers are inclined to avoid creating controversies in performance evaluation and peer ranking. Inevitably, all employees would be rated, in most cases, as 'good' or 'fair'. If everyone gets a good rating, there is no incentive to perform above the average. The effect of a reward system is thus undermined to a large degree. Even in Canada, the United States and Australia, overrating senior managers' performance has been reported (OECD, 1993).

Last but not the least, one of the implications of reinforcement theory for an incentive pay is that compensating the employees based on what is measurable will encourage them to exert effort on the compensated task but shirk on other tasks. A pay-for-performance reward might reinforce risk-averse behaviour in public sector and reduce risk taking and innovation (Hays, 1999). An incentive pay is more effective on simple task but difficult to reward multiple tasks needed to perform in public sector. Medical technology would never be advanced if doctors were rewarded simply based on how success they treat patients. Along the same line of logic, a caseworker in social security administration would not be rewarded just according to how fast he processes cases.

Not surprisingly, even in the private, implementation of pay-for-performance runs into difficulties. Beer and Cannon (2004) studied 12 out of 13 pay-for-performance experiments at Hewlett Packard in the mid 1990s. They found that managers abandoned the performance pay plans on the ground that the costs of addressing various unintended consequences of these programs outweighed their benefits. Instead, managers they studied thought that alternative managerial practices such as leadership, coaching and training are more worthy investments.

Conclusion: Not A One-Best-Approach

We human being by nature is inherently normative, always seeking one-size-fits-all solution. But in reality, there is no panacea to kill all the diseases. The task of a social scientist is not to test any particular theory but to determine the conditions under which a particular doctrine works and conditions under which it does not. As a subset of NPM movement, performance pay schemes are essentially instruments that are used to tie public sector worker or work unit motivation, effort and performance to compensation. A brief historical review suggests that the practice of pay-for-performance reward system in public sector is not an innovation but a continuation of an individualist approach to organising people. Its successful implementation is contingent on many factors: complexity of human being's motivation, adequate funding, and objective performance appraisal. John Hicks, a British economist pointed out that the labour market differs from other markets in that it had both social and economic perspectives because people are endowed with unequal quantities of human capital (Cairncross, 1999).

This essay suggests a considerable discrepancy between theory and practise. We must fully confess our ignorance of possible consequences. A related difficulty is that remedy one problem may simply exacerbate another, producing some incentives for patron-client relationship, sabotage, destructive collusion, reciprocity, grade inflation and risk averse that in turn are detrimental to the efficiency of public service. Hence, such a doctrine is not a one-best-approach and universally valid in improving public service provision. Indeed, it was, is and will be a recurring debate in public management.

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