

LSE Research Online

David Marsden and Ray Richardson Performing for pay? The effects of 'merit pay' on motivation in a public service

**Article (Accepted version)
(Refereed)**

Original citation:

Marsden, David and Richardson, Ray (1994) Performing for pay? The effects of 'merit pay' on motivation in a public service. *British Journal of Industrial Relations*, 32 (2). pp. 243-261. ISSN 1467-8543

DOI: [10.1111/j.1467-8543.1994.tb01043.x](https://doi.org/10.1111/j.1467-8543.1994.tb01043.x)

© 1994 Blackwell

This version available at: <http://eprints.lse.ac.uk/4030/>

Available in LSE Research Online: January 2016

LSE has developed LSE Research Online so that users may access research output of the School. Copyright © and Moral Rights for the papers on this site are retained by the individual authors and/or other copyright owners. Users may download and/or print one copy of any article(s) in LSE Research Online to facilitate their private study or for non-commercial research. You may not engage in further distribution of the material or use it for any profit-making activities or any commercial gain. You may freely distribute the URL (<http://eprints.lse.ac.uk>) of the LSE Research Online website.

This document is the author's final accepted version of the journal article. There may be differences between this version and the published version. You are advised to consult the

Performing for pay? The effects of 'merit pay' on motivation in a public service.

David Marsden and Ray Richardson

London School of Economics and Centre for Economic Performance ¹

Introduction.

Performance related pay has been very strongly on the increase in the UK, in both the private and public sectors. In the private sector, where it has long been a feature of managerial pay, it is being extended to a much wider range of occupations. In the public sector too, a large variety of performance related pay systems can be discerned and, over the last few years, they have been extended to practically the whole of the Civil Service. There also seems to be no prospect that the present Government will back-off from performance related pay. Although the extension of the new arrangements may have been somewhat retarded by the 1.5% public sector pay limit in the 1992/3 pay round and the prospective wage bill freeze in 1993/4, the Government has given no public indication of any shift in its view that extending performance related pay is an integral part of its policy of improving public services.

Given this, it is only natural to ask whether the recent experiments in performance related pay in the public sector have been successful. This, surprisingly, seems to be a question which has rarely been addressed with any seriousness, whether in the UK (Cannell and Wood 1992, Thompson, 1992), or even in the US, where performance related pay in the Federal civil service has been in use for much longer (Milkovitch and Wigdor, 1991). In particular, although there exist a small number of evaluations of schemes for managerial staff,² we know of no evaluation study of PRP for public service non-managerial staff, for whom PRP is a relatively new practice.

Despite the growing use made of a whole range of performance related schemes, their true impact remains largely a mystery. This article, a case study of the scheme introduced into the Inland Revenue in 1988, is an attempt to reduce the area of mystery. The scheme is a fairly typical UK public sector performance pay scheme, and conforms to many of the canons of good practice as outlined by ACAS (1990).

We begin by describing the scheme, and then go on to discuss some evaluation difficulties. There is more than one way in which to seek to evaluate performance related

pay. Many studies have focused on schemes in organisations where output can be measured objectively. But most of the PRP schemes spreading through the public services rely on subjective measures based on staff appraisal of one kind or another (Milkovitch and Wigdor 1991). Because of the specifics of the Inland Revenue situation, we were not able to gauge the impact of its scheme on any objective measure of employee performance. We therefore had recourse to its likely impact on employee motivation, which we assess through a variety of employee and management opinions and attitudes, as expressed in the more than 2,000 responses to a questionnaire we distributed. Our conclusion is that performance pay in the Inland Revenue is very unlikely to have significantly raised employee motivation, indeed may, on balance, have been demotivating. If it did not improve employee motivation it is hard to see how the scheme could have enhanced employee performance.³

Performance Pay

Performance Related Pay was introduced in the Inland Revenue in the 1988 Pay Agreement.⁴ This scheme, known as Performance Pay, was a form of merit pay, under which staff could be awarded either accelerated increments or 'range points', i.e. up to three increments added on to the top of the incremental scale. An award rested on judgments about a staff member's performance made through a system of staff appraisal, the version of which that was in operation at the time of the research dating from the mid-1980s. Under this, individual staff were annually rated on a scale of one to five, the so-called "Box markings". Staff getting a Box 1, the top score, received an accelerated increment if they were not already at the top of their scale, and a 'range point' if they were at the top of the scale. Staff who got two consecutive Box 2s could also get an award, but only if they were already at the top of their scale; they then moved up the equivalent of half an increment⁵. The main difference between the Inland Revenue scheme and similar ones for non-managerial employees in other parts of the civil service was that it restricted awards to those who had obtained a Box 2 or above (see, Kessler 1993).

The size of the increment varied by grade. For the lowest grades, Typists and Revenue Assistants, the maximum reward for sustained outstanding performance under the scheme was a pay rise of 22% for a succession of Box 1s. For the intermediate grades of Revenue Officers and Revenue Executives, the corresponding increases were 20% and 15% respectively, while Inspectors could earn an extra 12%. A succession of six Box 2s could qualify for roughly half these amounts.⁶

This form of reward meant that performance related pay elements were virtually permanent, i.e. were analogous to normal service-related increments. They could in principle be withdrawn after a period of unsatisfactory performance but this was, apparently, almost unknown.

The appraisal system which was linked to this scheme involved a number of stages. First there was an annual discussion of individual work objectives (the 'job plan') for the coming year between each member of staff and his or her immediate supervisor, the 'Reporting Officer'. Secondly, there was supposed to be frequent review of achievements in relation to this job plan, which could in turn have led to the plan being revised. Finally, the Reporting Officer was asked to rate the performance of the staff member at the end of the year according to as many as thirteen work related criteria. These ratings, plus impressions from the preceding discussions concerning the job plan, then provided a basis for the overall Box marking of the member of staff.⁷

An important check on the whole process was provided by the "Counter-signing Officer" who had to vet the reports of each Reporting Officer, and who might ask for justification of particular Box markings given. Clearly, this made it possible to achieve consistency in appraisal standards among Reporting Officers, but staff could also have felt that it enabled management to overrule the award of good Box markings for reasons that had nothing to do with individual performance, for example, concern at the size of the overall wage bill.

The 1988 Pay Agreement which introduced Performance Pay reflected the Government's wish to control public expenditure. It therefore set a ceiling (para 13 vi) on the total amount which the Revenue could award each year for Performance Pay; "it is expected that if reporting and marking criteria are properly observed the cost [of Performance Pay] will not exceed (nor fall substantially short of) the cost of giving 25 per cent of the staff in the grades covered a range increase on the spine which they are on..". This statement perhaps reflects a lack of self-confidence in the principle of performance related pay but it is not an unusual feature of such initiatives. Cost ceilings of a similar magnitude were applied to a number of other Civil Service performance related pay schemes in force at that time.

In the year of our study, between about 30% and 15% of staff in the grades organised by the Inland Revenue Staff Federation (IRSF) were in receipt of Performance Pay, although percentages varied by grade: about 30% of Revenue Executives, and about 15% of

Revenue Assistants were getting it, with Inspectors and Revenue Officers in an intermediate position.

The design of the Inland Revenue scheme was in certain respects a considerable improvement on some earlier public service schemes. Unlike that introduced in 1987 for the 90,000 scientific and professional civil servants represented by the IPMS, for example, the Inland Revenue scheme had firm criteria for making awards, and was based on 'open reporting', with agreed work targets and staff being told the result of their appraisals (Kessler 1990).

Some evaluation issues.

In this study we are treating the new payment system as a management initiative and asking whether it was a success from management's point of view. The straightforward approach would therefore be to establish management's objectives for the scheme and then see whether these were realised. Unfortunately, management's objectives are not easily established. Indeed, it is far from certain that the Inland Revenue management themselves were enthusiastic about Performance Pay when it was introduced. It might well be the case that the drive to have performance related pay came much more from the Treasury or some other part of the centre. Certainly there were no objectives in the 1988 Pay Agreement itself which were explicitly tied to Performance Pay.

The very title of the scheme, however, means that management must have been hoping to use pay as an incentive to raise performance in some way. The logic of the scheme further implies that the performance in question must have been reflected in the appraisal process, for it was this which determined the making of awards.⁸ There is a difficulty here in that there were no fewer than thirteen work related elements referred to in the appraisal, not all of which were relevant to all employees and each of which may have had a different weight for the different grades. There is no source of objective evidence, certainly not one available to us, that would allow any monitoring of behaviour with respect to these thirteen elements. It was therefore not possible for us to evaluate the scheme by examining employee behaviour directly.

It was possible, however, to follow an indirect route. It would be very widely agreed that, from a management perspective, introducing any scheme of performance related pay makes little sense unless it motivates staff to work better in some respect or other. It is implausible, for example, that its objective would be simply to reward past performance,

unless this were also thought to encourage better performance in the future. The central justification for performance related pay must surely be that it somehow acts as a motivator.

Better motivation does not automatically translate into better performance. Revenue staff might be highly motivated but still perform badly because of a range of impediments, e.g. poor management, inadequate training or obsolete equipment. Motivation, then, is something that can lead to better performance, but only when other conditions are met. We treat it as a willingness or preparedness to do something, which means that it is a state of mind. Sometimes, researchers make inferences about levels of motivation purely by observing performance. This can be legitimate but, equally, can lead to difficulties when other things are changing at the same time and are independently affecting performance. We have chosen a different approach and have sought to measure possible changes in motivation from the responses of staff to a variety of statements about themselves and their fellow employees.

The second problem is motivation to do what? Given the detail in the appraisal process it was felt appropriate to ask staff about most of the thirteen aspects of performance included there. Some of these aspects were seen to be more important than others. Discussions with a variety of people in the IRSF and the Revenue led us to the view that the two most important dimensions of performance for appraisal purposes were very widely thought to be the quantity and the quality of the work done, but we explored a number of the others too. We also looked for motivational change with respect to some aspects of performance not specifically located in the appraisal form.

We have therefore not sought directly to connect the new payment system to changes in employee behaviour. We have instead tried to establish whether Performance Pay changed staff motivation, as measured by the opinions and beliefs of the staff involved. These, of course, are not objective data but it is our judgment that they give a reliable indication of at least some of the motivational impact of the scheme.

Data collection

Our work was initially stimulated by an approach from the IRSF.⁹ A draft questionnaire was piloted on, and small group discussions were held with, about 40 Revenue staff at one of their offices. In the summer of 1991 the questionnaire was sent to 4,000 Revenue staff in the grades represented by the IRSF. The returns were anonymous and

confidential, and were returned in sealed envelopes via the Revenue's internal postal system but addressed to us at the LSE. All the returned questionnaires that reached us did so in unopened envelopes and there is no reason to believe that the replies were influenced by the possibility of favourable or unfavourable judgments from either management or the IRSF.

Of the 4,000 questionnaires sent out, 2,423 usable questionnaires were returned, giving a sample response rate of slightly above 60%. This is a very satisfactory response rate, especially as it was not practical to send out reminders, and it may well reflect the interest which staff had in the issues being explored. Two sampling decisions were made prior to drawing the sample. First, the survey was confined to staff in the two largest sections of the Revenue, Taxes and Collection; the remaining sections are relatively small, which is why they were omitted from the survey, but in what follows their omission could conceivably be important. It must be noted, however, that our results very strongly suggest that staff views on the impact of Performance Pay are not different as between Taxes and Collection. We therefore feel more confident that the omission of the other Sections does not lead to any significant overall distortion. The second sampling decision was to sample the different job grades disproportionately, taking a higher fraction of staff in the smaller grades. This was done in order to maximise the chance of obtaining statistically significant results with respect to job grade within our overall sample size. It also turned out that response rate to the survey varied by job grade, with higher response rates coming from more senior staff. In order to obtain a representative picture of all staff in the population, therefore, the results were subsequently re-weighted to compensate both for the oversampling and for the differential response rates. All the results reported below use the re-weighted data.

Overall, the sample provides a good fit of the population values according to a number of characteristics of the Revenue's staff that could be checked independently (grade, gender, length of service, region and section). Also, and most importantly, there seems to be a good fit by Box marking, which suggests that the staff who replied had neither done particularly well nor particularly badly in comparison with staff as a whole. There seems to be no reason to doubt the representativeness of our data, whether by employment characteristics or by experience of the Performance Pay mechanics.

It is perhaps necessary to justify further our use of attitudes and opinions, and our concentration on the inherent characteristics of the scheme rather than its organisational and managerial context. Our survey recorded employee opinions and attitudes concerning their experience of PRP after the scheme had been in operation for two years. They had

therefore had long enough to become acquainted with it, and to have formed reasoned judgments about it. Although only a 'snapshot', our wide sample, pilot discussions, and interviews with senior management and IRSF staff gave no reason to believe that the views reported had been unduly influenced by external events, or that they might change radically without a change in the system.

An alternative method would have been to use a 'before' and 'after' study of motivation. This was not possible for us, because it would have had to start before implementation of the 1988 agreement. In any case, one cannot sensibly ask employees' detailed views of a particular scheme's effects on their own motivation before they have experienced it. Instead, we chose to infer the effects of PRP upon motivation from employees' judgments of their personal experience, and those of their reporting officers.

It would undoubtedly have been interesting to gather data also on objective measures of performance. But these were not available, and, certainly for many aspects on the appraisal forms, even the Inland Revenue did not keep them. We therefore confine our study to the first link in the chain between PRP and performance, namely, whether it increased employees' willingness to provide better performance.

The political and managerial contexts in which an agreement or a pay scheme are introduced may sometimes be important influences on how they work in practice. A unilaterally imposed suspension of long-accepted comparability or consensus could make workers resent a new scheme, and so see it as unfair, irrespective of its inherent merits. Kessler (1990) argued that the IPMS PRP scheme had been introduced in 'piecemeal and "half-hearted" way' because of union opposition, and that this was the reason for its poor results. We believe that such factors, although not entirely absent, were less important in determining the outcome at the Inland Revenue.

First, although the IRSF negotiators were told that unless they accepted PRP there would be no pay agreement, there is nothing unusual in negotiations for one or other side to issue such warnings. Indeed, the union's policy was to accept the scheme and work for its improvement. Secondly, despite union reservations, the scheme was more coherent and closer to the standard of best practice recommended by ACAS (1990) than the IPMS one. Thirdly, the results of our own survey showed that a clear majority of the staff agreed with the principle of PRP, and so presumably saw little reason to oppose it. There remains the budgetary constraint which led management to adopt a quota on payments, but such pressures are a normal part of any pay régime. It seems, therefore, that the

politics of its introduction did not greatly distort the working of the scheme at the Inland Revenue.

What do Revenue staff think about the principle of Performance Pay?

Some workers are suspicious of, or hostile to, the principle of relating some part of their pay to performance. Others see nothing wrong with it or are actively in favour. Our first task was to gauge the views of the Revenue staff on this issue of principle. Table 1 highlights some of our results.¹⁰

TABLE 1 ABOUT HERE

These results are not far out of line with those in the Next Steps report, which reported that 70% of Civil Servants supported the general principle of rewarding good performance with better pay (Next Steps, para 17). Revenue staff look to be somewhat less favourably inclined than this but, on balance, were clearly in favour of the principle of some link between pay and performance. As is documented below, however, many of them had deep reservations about the operation of these links in the Revenue scheme. It may well be that these reservations caused some people to be more hostile to the principle than they would have been if the operation of the Revenue scheme was seen to be more satisfactory. This interpretation is supported by the different response to the first two statements in Table 1. The second statement effectively asks respondents to take both principle and practice into account, and generates less support for Performance Pay.

It is also worth emphasising that a significant minority of Revenue staff had very strong objections to the principle of performance related pay. Those who expressed strong disagreement with the principle of Performance Pay in the above statements were always more numerous than those who expressed strong agreement.

Our first conclusion is that a majority of Revenue staff supported the principle of Performance Pay but that a significant minority felt very hostile to it.

Did Performance Pay motivate staff at the Inland Revenue?

In seeking to establish how people felt the scheme had changed their motivation to perform at work, the relevant section of the questionnaire started with the following preamble: Now we would like to know how the existence of the Performance Pay arrangements have affected you personally. There followed a set of sixteen statements which the respondent was asked to comment on. The sixteen reflected the content of the appraisal form plus a few other possible forms of behaviour. A typical statement was as follows: the existence of Performance Pay has made me willing to increase the quantity of the work I do. Table 2 provides a summary of the overall responses to some of the statements.

TABLE 2 ABOUT HERE

We also asked a general question about whether people thought that Performance Pay had significantly raised their motivation at work. 12% said that it had, while 76% said that it had not.

It is clear from these results that, on their own assessment, relatively few Inland Revenue staff members felt that Performance Pay had provided them with an incentive, or a motivation, to change their behaviour at work at all significantly. The results are especially disappointing for the crucial areas of motivating staff to improve the quality and quantity of their work, with fewer than 15% perceiving any positive change. It is also notable that staff felt that Performance Pay had had a negligible effect in motivating them to become more effective in their dealings with the public, with only 9% seeing a change. This last result is potentially of importance because of the Government's hopes laid out in the Citizens' Charter.

Not all groups of staff had quite the same reactions to Performance Pay. It was easy for us to look at the differential responses by sex, grade, length of service and whether the staff member had received a Performance Pay award. The overall picture is that although, on

our measures, Performance Pay did have some differential motivational effects amongst groups, in no case was there a profound positive effect. Those who were most strongly affected in a positive direction were the most junior grades, and those with the shortest service. However, even among these groups, the majority of staff replied that there had been no motivational effect to most of the questions. Among the more senior grades and the longer serving staff, the effects on motivation were generally the weakest, and the reports of jealousy and lower morale associated with Performance Pay were the most frequent.¹¹

It is possible that individuals are not always the best judges of their own behaviour, or indeed of their motivation. An alternative source of evidence is the judgement of those Inland Revenue staff who have to carry out staff appraisals, i.e. the Reporting Officers. We asked these, about 20% of our total sample, to respond to a number of statements on how they thought Performance Pay had affected staff. The results are highlighted in Table 3.

TABLE 3 ABOUT HERE

These results certainly give no comfort to those who feel that staff might understate the extent of positive motivational change. They fully confirm the earlier findings that Performance Pay had a very limited effect on positively motivating Inland Revenue staff. Indeed, the Reporting Officers were, if anything, even more sceptical of the system's success in this respect. Only on the impact of Performance Pay on the quantity of work done were Reporting Officers more sanguine than staff as a whole, and even there the difference was unimpressive.

So far we have been looking for the existence of positive motivational effects. There must, however, be the possibility that at least some Revenue staff found the new arrangements to be actually demotivating. This might have happened because some thought the whole principle unfair or because they felt, rightly or wrongly, that they had been cheated out of an award to which they were entitled. One pointer in this direction is the element of strong disagreement with the principle of Performance Pay, noted above in the discussion of Table 1. Another might be inferred from the detailed results lying behind that Table. If someone disagrees with a statement that Performance Pay has had a positive motivational effect, he or she might believe either that it has no effect at all or that it has a negative, demotivating one. Those who just express disagreement might feel that it has had no effect. Those who express strong disagreement may well be indicating

the stronger, negative effect of demotivation. It is notable that for many of the statements in Table 1, the number of people who expressed strong disagreement exceeded the total of those who expressed any measure of agreement at all. We would not wish to push this inferential line of reasoning too far but neither do we think that it is entirely without force.

The likelihood of an element of demotivation is also indicated by the responses to some of the statements elsewhere in the questionnaire where we asked staff to respond to a series of statements about the effect of Performance Pay not on themselves but on staff as a whole. Some highlights are given in Table 4.

TABLE 4 ABOUT HERE

With a majority agreeing that the scheme had undermined morale or caused jealousies between staff, and a quarter agreeing that Performance Pay had made staff less willing to assist one another, the likelihood of some element of counter-productive demotivation is evident.

Our overall conclusion is that the positive motivational effects of Performance Pay, as it was practised up to the time of our research, were at most very modest. It is hard to see that they had been felt to any degree by more than a small minority of staff. Further, the number who felt motivated to a powerful degree, as shown by the number who expressed strong agreement with any of the relevant statements, was always negligible. Even worse, there is clear evidence of some demotivation. Although we cannot be sure of this, it would be very easy to conclude that the net motivational effect was, although small, actually negative.

What explains the motivational impact of Performance Pay?

There are many strands in the academic literature purporting to explain motivation and employee performance, or the lack of it. Our data allow us to use two of these strands to shed light on why Performance Pay in the Revenue seems to have had such a disappointing motivational impact.

One strand, expectancy theory (see, e.g. Lawler, 1971), stresses the importance of a series of links between behaviour and the rewards accruing to that behaviour. For there to be a heightened motivation to perform, someone:-

- (a) has to feel able to change his or her behaviour,
- (b) has to feel confident that a change in the behaviour will reliably produce the rewards, and
- (c) has to value the rewards sufficiently to justify the change in behaviour.

Our results suggest that these three conditions are not all met for a large number of Revenue staff. Expectancy theory would therefore point to only modest motivational improvement, or to demotivation.

Did staff feel they could change their behaviour? We asked whether individuals felt capable of doing what was necessary to get an overall Box 1 or 2 marking in the future. This, it will be recalled, was a necessary condition for a Performance Pay award to be made. Only 6% felt that they were not capable of such a performance level, as against 81% who believed that they were. The first condition of expectancy theory was, therefore, clearly met.

Were staff confident that a change in behaviour would reliably produce the rewards? No fewer than 45% of our respondents were of the view that, even if their performance were good enough to merit a Box 1 or 2, it was doubtful that such a grading would be given; only 40% believed that a good enough performance would produce the correct Box Marking. This belief, whether justified or not, substantially reduces staff motivation to change their behaviour, and suggests a potent source of disillusion.

Did staff value the rewards sufficiently? Obviously, most staff want the money that an award would bring. The key question is whether the amounts available justify, in their minds, the extra effort involved. Only 17% of our respondents felt that the financial reward from Performance Pay was a sufficient inducement for them to change their behaviour; 71% felt that it was insufficient.

Thus, two of expectancy theory's three conditions were not met for the Revenue's system of Performance Pay, which provides a strong reason for its failure to motivate staff. Other findings from the survey re-inforce this conclusion and point to possible reforms that should be contemplated if motivational change is to be secured. Perhaps the single most important issue is not so much the amount of money involved but the way it is allocated via the appraisal system.

We asked a number of questions about the appraisal system in the Revenue. Table 5 highlights some results. There is a consistency of response between these answers and those referring to individual feelings as to whether they would get the Box marking they felt they deserved if they were produce the appropriate performance. There was a widespread doubt about the fairness of the appraisal system. Worse, there was manifestly a view that the system of Performance Pay had undermined the integrity of the long-standing and well-established appraisal system. As was noted above, the mechanics of Performance Pay were bolted on to the existing appraisal system. It is clear that very many staff felt that the appraisal system had been abused and that they were less likely to get the appropriate Box marking.

TABLE 5 ABOUT HERE

This belief is very likely to have been reinforced by the fact that the frequency of Box 1 and 2s had fallen after 1988, for all grades. As an example, the proportion of staff on the Inspector (S) grade who were given a Box 1 fell from 12% in 1988 to only 5% in 1991; the corresponding figures for Box 2s were 63% and 43%.¹² The reasons for these declines are not obvious but it seems extremely unlikely that they reflect a widespread deterioration in staff performance. It is true that Revenue staff had previously been paid somewhat more than comparable Civil Servants for a number of years; it is also true that Civil Service staff outside the Revenue seem often to qualify more easily for Performance Pay Awards, reflecting perhaps the different rules on performance related pay in their particular pay agreements. It is possible that the Revenue used its system of Performance Pay in part to deny high Box markings and control its wage bill more aggressively than other Civil Service employers.

If this was so it must have been all the more damaging given the psychological importance staff attribute to their Box marking. 63% of our respondents agreed that the personal satisfaction they derived from work was a sufficient incentive for them to do what was necessary to get a Box 1 or 2; only 26% disagreed. The right Box marking was for many a highly important signal, confirming them in their self-esteem and in their belief that they were doing their work to the right level. For this to be jeopardised by a particular method of awarding performance related pay is potentially serious for management.

We are not claiming that the appraisal system necessarily was unfair, did operate a quota or was characterised by undue overruling from above. Our information does not permit us to make an authoritative judgment on these issues. But for staff motivation, what is important is what employees think, and their thoughts were heavily in a negative, cynical direction.

It is interesting that some of these worries find an echo in the section of the questionnaire which was answered only by Reporting Officers, i.e. those who carry out staff appraisals. Table 6 gives some results. Reporting Officers saw the need for review by their superiors in order to secure consistency between Officers. However, they were also uneasy at the extent of overruling; they felt that more than mere consistency was involved here. There was also a recognition that the new financial link raised problems; fully 33% expressed strong agreement with this viewpoint, which implies that the increased difficulties were by no means trivial for the Officers concerned.

TABLE 6 ABOUT HERE

Our conclusion on this point is that the links between the appraisal system and the Revenue's system of Performance Pay in practice seem, to a degree, to have alienated many staff. They may well have helped to degrade a system which, for other purposes, was entirely suitable. Further, the scepticism which staff were acquiring about the integrity of the appraisal system provides an explanation for the very limited motivational improvement that Performance Pay induced.

Expectancy theory provides one framework to assist in understanding why the positive motivational response to performance related pay in the Revenue was so muted. A second framework is given by Goal Setting Theory, which stresses the virtues of managements setting clear, acceptable and achievable work goals (see, for example, Latham and Locke, 1991). Table 7 sets out some of our results.

TABLE 7 ABOUT HERE

These are rather mixed results. Goal setting theory predicts improved performance if goals are set more clearly, as long as the goals are agreed and believed to be achievable.

The responses to the first statement in Table 7 suggest only a modest improvement in this respect; those to the second statement suggest a more widespread improvement. Those to the other two statements, however, strongly imply no change. Goals may have become clearer but the vast majority of workers felt that they were already working to the appropriate standard. This may or not be true in objective terms but even if it is not true, our results strongly imply that management had not been able to convince their staff to the contrary. Without a commitment to new and more appropriate goals, goal setting theory would suggest a zero or very modest impact.

Replies to two further questions support this conclusion. 31% of staff believed that the very nature of their job made it hard for them ever to be awarded a Box 1 or 2. In addition, no fewer than 46% of the Reporting Officers agreed that staff had insufficient control over their work to make performance related pay a sensible idea.

Conclusions and Policy Implications.

Our findings in this paper are based on the views of a large and representative survey of Inland Revenue staff. To our knowledge, it is the first study of performance related pay of its kind for public sector white collar workers in the UK. For this reason alone, it deserves to be taken seriously. It is given added importance by the Government's declared intention of making performance related pay a more important feature of public sector pay arrangements in the future.

Although the principle of relating pay to performance was widely accepted among Revenue staff, our results strongly suggest that the system as it operated had, at most, only a small positive motivational effect on staff. The small effect was found both in staff replies on general motivation, and from detailed questions relating to aspects of work that were assessed in the appraisal system. Moreover, the small motivational effect was recorded both in the replies of individual members of staff and in the judgments of Reporting Officers concerning the behaviour of staff. Finally, these small improvements have to be set against certain changes in the other direction. The net effect on staff motivation could well have been negative. If motivation was not improved at all significantly, or deteriorated, it is hard to see why performance should have been changed for the better.¹³

Why should Performance Pay have had so little general effect on motivation when 57% the staff reported being favour of the principle? First, and most importantly, it was widely

judged to be unfair in its operation. Many staff believed that there was a quota applied to the Box markings awarded, and that even if their work performance was good enough, they would not be awarded an appropriate Box marking. Indeed, among the latter, 80% believed that there was a quota in operation on Box markings. About a third of the staff also believed that favouritism influenced Box markings. Objective evidence to support staff views on this matter is provided by the fall in the number of Box 1 and 2 markings being awarded in the first few years of the new scheme's operation. In this context, it is not surprising that staff perceived that the appraisal system had been twisted for purposes that had nothing to do with actual performance.

Another cause cited for the feeling of unfairness of operation was that the Box marking took insufficient account of job allocations, i.e. of the detailed tasks that different staff were required to do. Further, about a third thought that their job gave them little opportunity to achieve a Box 1 or 2. The latter view was given support by the replies of Reporting Officers.

It might be claimed that, in spite of these findings, Performance Pay had nevertheless been a success from management's viewpoint. True, only a small fraction of the staff seem to have been stimulated to perform better, but the cost of Performance Pay in terms of the fraction of the overall pay bill paid out was also fairly small. In net financial terms, it might have 'worked'. This may be correct, and certainly we do not have the data to disprove it. However, one should also consider possible hidden costs in terms of loss of motivation elsewhere, and in the damage to established management systems. Three main potential costs stand out: possible damage to the work atmosphere; reduced staff confidence in the reporting system; and reduced motivation among more senior and longer service staff.

Many of our respondents said that Performance Pay caused some deterioration in the atmosphere at work, producing a degree of staff jealousies and a decline in morale. Erosion of staff confidence in the reporting system is attested by the widespread belief that a quota was in operation of Box markings so that no matter how well people worked, many would not be given a Performance Pay award. As the reporting system had other important uses, including clarifying staff's work objectives, and as high Box markings brought intrinsic rewards, its discredit among the staff could have been quite serious in the longer run. Finally, as was noted above, longer service staff and those in higher grades were more likely than junior staff to indicate 'strong disagreement' with questions on the motivational impact of Performance Pay. Although our questions on motivation mainly asked whether Performance Pay had increased motivation, and strictly speaking even a

strong "no" answer does not imply actual loss of motivation, the possibility seems quite serious.

Our results therefore suggest that the system required significant modification if it was to realise the full potential of a number of positive features it had in the eyes of staff. Many accepted its principle; it led to greater clarity in setting job targets for some staff; and it did succeed in motivating at least a minority. Our study indicated that what management needed to do in addition was to find some way of overcoming its perceived unfairness of operation among staff and to increase the amount of money involved. Both defects needed to be tackled simultaneously, as merely increasing the amount of money at stake could easily intensify feelings of unfairness. In fact, the scheme was modified very substantially in October 1992, after our research was carried out.

The Inland Revenue has now adopted a form of Performance Management which involves, inter alia, a new pay structure and grading scheme, and a new process of setting annual work targets (where possible of a quantitative form) each year with the individual member of staff. At the end of the year a judgment is made by the supervisor as to whether the member has met, exceeded or not met the agreed targets. In the 1993 wage round, staff members who were judged not to have met their targets received only the basic 1.5% increase in pay; those who met their targets got between 2.2% and 10%, depending on where they were in the new pay structure; those who exceeded their targets got even more, at least 2.7%. In the event, over 90% of staff were judged to have met their targets. On the basis of the first year's experience, therefore, any performance related pay quota would seem to be a thing of the past, and the sense of unfairness surrounding the system of relating pay to performance could, consequently, have been diminished. On the other hand, if more than 90% of staff get the standard performance payment, its incentive effect must also become diminished by being seen as close to automatic.

The new scheme's first year of operation might not be typical, however. There is, for example, already more than a suggestion that staff members' targets were ratcheted up at the end of the first year, implying that staff might well have to work progressively harder to earn any performance element in year two. The implication is that the scheme is evidently still evolving, and will repay further evaluation in the near future.

Endnotes.

¹ We would like to thank the IRSF for financial assistance in carrying out the research reported here, and Clive Brooke, Lorraine Denoris and Jim McAuslan of the IRSF for their guidance, time and patience. We also wish to thank the Inland Revenue management for their advice, and help in conducting the survey. They are in no way implicated in what follows.

² Recent evaluations of managerial staff in the UK include Bevan and Thompson (1992) on local authority managers (but with a view primarily to equal opportunities), and studies in Australia reviewed by Wood (1991), the US (Milkovitch and Wigdor 1991), and across a wider range of countries (Wood and Maguire 1993).

³ For a fuller version of the survey results, and details of the questionnaire, see Marsden and Richardson (1992).

⁴ More precisely, the 1988 Agreement led to its introduction for the staff grades covered in our analysis; these refer to virtually all the Revenue staff but exclude the most senior staff.

⁵ Under the agreement with the IRSF, there were in fact two pay spines, A and B, which were staggered, so that the equivalent of a half increment in some other pay systems was achieved by movement to the next highest point of the other spine. Thus Box 1s were rewarded with a linear upward progression along their current pay spine, whereas Box 2s progressed by zig-zagging between the two spines.

⁶ Over time, staff could combine performance awards for Box 1s and two consecutive Box 2s, but could not obtain more than three awards on each criterion, subject to the maximum additional reward under Performance Pay of three range points up the spine containing the member of staff's scale maximum.

⁷ Even then, Reporting Officers were not required to give an overall Box marking that was a simple average of the individual elements. Not only could certain elements be given a higher weight than others, additional factors could be taken into account.

⁸. It is also in principle possible that an award could have made the difference between someone staying in the Revenue and leaving -- this was not something we were able to explore.

⁹. We subsequently approached the Inland Revenue official side to ask whether they wished to make it a jointly sponsored union-management study. The official side chose not to participate, but they did provide a great deal of valuable help with background information, and they cooperated fully with the research. In particular, they agreed to draw the sample to our specifications from their personnel records, and they distributed the questionnaires through their internal mailing service. The authors would like to express their very sincere thanks to the official side for all their assistance.

¹⁰. In our questionnaire, we asked for responses on a five point scale, from strongly disagree, to disagree, to no view, to agree and to strongly agree. For convenience of presentation, we have combined strongly disagree with disagree, and strongly agree with agree. We have also ignored the 'no views', so that the percentages do not add up to 100. Finally, the statements in the Tables do not always correspond word for word with those in the questionnaire, again for convenience of expression.

¹¹ See Marsden and Richardson (1992) for the detailed results by type of employee.

¹². These figures were published in IRSF Assessment Pay Special, September, 1991.

¹³. It is sometimes argued that management may not change payment systems in order to raise motivation as such, but to signal a change in management style and work objectives, and to encourage staff to alter their work in an appropriate way. It could be argued that the role of performance pay in the Citizens' Charter was just this, to signal a change of orientation to public servants, that they should become more sensitive to the needs of ordinary citizens, and provide them better value for money. Our research did not address this issue directly. However, our findings suggest that the scheme has not reinforced the position of management, as reporting officers said they found that performance pay had made appraisal, an important means by which they can influence staff performance, more difficult (Tables 5 and 6). Secondly, our general findings in Tables 2 and 3 suggest that the scheme itself had little effect in inciting staff to work more according to the canons of the Citizens' Charter.

References.

ACAS, (1990) *Appraisal Related Pay*. ACAS Advisory Booklet No.14, London: HMSO.

Bevan, S. and Thompson, M. (1992) *Merit Pay, Performance Appraisal and Attitudes to Women's Work*. IMS Report No.234, Brighton: Institute of Manpower Studies.

Cannell, M. and Wood, S. (1992) *Incentive Pay: evolution and impact..* London: Institute of Personnel Management-National Economic Development Office.

Kessler, I. (1990) "Flexibility and comparability in pay determination for professional civil servants". *Industrial Relations Journal*, 21:3, Autumn, 194-208.

Kessler, I. (1993) "Pay determination in the British civil service since 1979". *Public Administration*, 71, Autumn, 323-340.

Latham, G.P. and Locke, E (1991) "Goal setting - a motivational technique that works", in Steers, R. and Porter, L. (eds) *Motivation and Work Behavior*, 5th edition, New York: McGraw-Hill.

Lawler, E. E. (1971) *Pay and Organisational Effectiveness: a psychological view*. New York: McGraw-Hill.

Locke, E, Shaw, K, Saari, L, and Latham, G. (1981) "Goal setting and task performance, 1969-1980". *Psychological Bulletin*, 40, 125-152.

Marsden, D. W, and Richardson, R. (1992) *Does Performance Related Pay Motivate? a study of Inland Revenue staff*. Centre for Economic Performance, Discussion Paper, no.75, CEP, London School of Economics.

Milkovitch, G, and Wigdor, A. K, (eds) (1991) *Pay for Performance: evaluating performance appraisal and merit pay*. Report of the Committee on Performance Appraisal for Merit Pay for the Office of Personnel Management, National Academy Press, Washington D.C.

Thompson, M. (1992) *Pay and Performance: the employer experience*. IMS Report no. 218, Brighton: Institute of Manpower Studies.

Wood, R. (1991) *Performance Pay and Related Compensation Practices in Australian State Public Sector Organisations*, PUMA Occasional Paper, Paris: OECD.

Wood, R, and Maguire, M. (1993) *Private Pay for Public Work: performance related pay schemes for public sector managers*. Public Management Studies, Paris: OECD.

Table 1. Inland Revenue staff views on the principle of performance related pay

	percentages	
	Agree	Disagree
Performance Pay is good in principle	57	40
On balance, for all its faults, it is better to have Performance Pay than not	49	44
The idea of Performance Pay is fundamentally unfair	36	58

Table 2. Staff assessment of their own motivational responses to Performance Pay.

Performance Pay has led you to:	Percentages	
	Agree	Disagree
improve the quality of your work	12	80
increase the quantity of your work	14	78
work harder	9	71
work beyond the job requirements	21	70
give sustained high performance	27	63
improve your priorities at work	22	64
show more initiative	27	61
express yourself with greater clarity	13	67
be more effective in dealing with the public	9	68
improve your sensitivity towards colleagues	14	63

Table 3. The views of Reporting Officers on the impact of Performance Pay on their staff.

	percentages	
	Agree	Disagree
Performance Pay has caused many staff to work beyond the requirements of their job	15	79
Performance Pay has led many staff to give sustained high performance at work	14	77
Performance Pay has helped to increase the quality of the work of many staff	10	82
Performance Pay has led to an increase in the quantity of the work of many staff	22	71
Performance Pay has made many staff more committed to their work	12	79

Table 4. Staff views on the effects of Performance Pay on staff as a whole.

	percentages	
	Agree	Disagree
Performance Pay has helped to undermine staff morale	55	25
Performance Pay has caused jealousies between staff	62	21
Performance Pay has made staff less willing to assist colleagues	26	53

Table 5. Staff views on the Revenue's appraisal system.

	percentages	
	Agree	Disagree
Performance Pay has made staff question the fairness of the appraisal system	87	5
Staff are frequently denied the Box Marking they deserve because of a quota system	74	10
A good appraisal is too often overruled by someone higher up	63	16
People get a good Box Marking not so much because of their performance but because managers want to reward their favourites	35	45

Table 6. Reporting Officer views on the appraisal system.

	percentages	
	Agree	Disagree
The vetting of reports higher up is necessary to ensure consistency between Reporting Officers	77	16
Performance Pay has made Reporting Officers feel uneasy because their assessments are overruled by someone higher up	60	28
Performance Pay has made the appraisal system harder to operate because it is now tied to money	72	23

Table 7. Staff views on work goals.

	percentages	
	Agree	Disagree
Performance Pay has made supervisors set work targets more clearly	27	43
Performance Pay has raised staff awareness of the appraisal system's objectives	57	30
Performance Pay has had no effect on the quality of my work because it was already at the appropriate standard	82	8
Communications between staff and management have improved as a result of Performance Pay	9	72