

Applied Merit Pay Challenges

By

Jason Creighton

MPP Essay

Submitted to

Oregon State University

In partial fulfillment of
the requirements for the
degree of

Master of Public Policy

Presented June 10th, 2013

Commencement June 15, 2013

Master of Public Policy essay of Jason Creighton presented on June 10th, 2013

APPROVED:

Denise Lach, representing Sociology

Patrick Emerson, representing Economics

Scott Akins, representing Sociology

Jason Creighton, Author

Applied Merit Pay Challenges

I. Introduction

From an organizational perspective, economic incentives are often used as a tool to induce behaviors which align the goals of individuals with the organization. As a fundamental concept, varied types of merit pay have been utilized to keep organizational and individual motives in sync. This can be illustrated in contracts that base wages on commission. Many small businesses and individuals have their compensation tied to how effective their organization runs. However, when the ultimate goal is to enhance productivity, does merit pay produce the optimal environment that enables workers to achieve their potential? This essay will attempt to investigate that question through analyzing the motivational perceptions of skilled workers who were considering a merit pay policy at Oregon Health and Sciences University (OHSU).

II. Background

OHSU was once a state agency that has transitioned into a public corporation. While many administrative structures have changed, the employee union has remained in tact. Current pay models use collectively bargained contracts which standardize employee pay for all union employees. This pay structure is suited toward the union goals of equality and shared prosperity. OHSU management has sought to stimulate productivity among their workforce and has been in negotiations with union representatives to implement merit pay.

OHSU is an academic research institution as well as an organization that provides medical services to the community. It employs approximately 14,000 individuals and is located in Portland, Oregon. Out of this work force, several groups were identified as potential pilot groups to test the feasibility of introducing a merit pay program. The Special Projects Administration (SPA) volunteered to

participate in this pilot study as an aid to the investigation. SPA is an analyst group consisting of approximately 20 individuals facilitating the administration of private and public grant funding to the various departments within OHSU.

The responsibilities of the workers within this group consist of interpreting guidelines from, and reporting information to, the sponsor agencies which provide funding; distributing funds and information about the grants to the recipients of the funds; collecting internal accounting data for OHSU; and ensuring that the organization is in compliance with the requirements of the grantors. The composition of the SPA workforce is relatively diverse in terms of age and gender. It has a wide age range and relatively experienced employees. The newest member had been working there for over three years while the most experienced employees had over 20 years of experience. Both genders are represented at employee and management levels with a relatively even split among the workforce.

III. Related Literature

a. Principal – Agent Model and Merit Pay

The principal-agent problem as described by Grossman and Hart (1983) outlines some of the fundamental concepts that impede the unison of purpose between the individual and an organization. As the principal, the organization compensates the agent for their labor. When agents seek to minimize their transaction costs, they may execute the contract using methods that do not coincide with the intent of the principal. This difference between the intended execution of the contract desired by the principal and the method that the agent uses can undermine organizational effectiveness. Therefore, principals may seek to structure labor contracts in a manner with incentives for agents to fulfill the contract as the principal wishes.

However, human motivations and actions are complex and unpredictable. While the principal-agent dilemma presupposes that self-interested individuals enter into contracts to maximize their

economic outcomes, it becomes complicated by individual valuations of the services provided. In some instances, it may be possible that economic incentives do not motivate some individuals. Also, monitoring progress and adherence to the contract can prove costly to achieve. Attempting to quantify performance may over-simplify an aspect or misrepresent it altogether. Productivity may be impractical to measure in many scenarios. All these issues complicate evaluation and require being addressed by the metrics used to define performance when implementing a merit pay program.

b. Institutional Rational Choice and Satisficing

Institutional rational choice theory assists in the analysis of how individuals interact within institutional systems in relation to the rules and norms (Ostrom, 1999). While organizations prioritize effectively accomplishing their mission and individuals prioritize receiving compensation for the work they perform, a merit pay policy might improve the conditions for both. However, due to the discriminating traits of merit policies that select high performers for reward, the perceived valuation of employees that are rewarded and neglected by merit based pay will vary between individuals.

Also, the goals of enhanced productivity may prove to undermine competing interests such as quality or creativity. Results from Kachelmeier et. al (2006) found that attempting to provide incentives for either creativity or production resulted in a lower rated score of the competing category. Furthermore, self-determination theory suggests that the monitoring and bureaucracy required to record performance may also conflict with the optimum environment for employee performance (Ryan and Deci, 2000).

Simon (1956) attempted to explain why an individual would take part in a large organization and argued that collaborating with social organizations reduces net transaction costs, often at the expense of individual preferences. Simon describes this process as satisficing. Some of the individual's preferences are sacrificed in order for organizational goals to be accomplished, which attains more productive outcomes than either could accomplish without the other. This dissonance between

individual and organizational goals is the impetus for management to create incentives to increase the alignment between them. Under this premise, a merit pay system would be seen as a great motivational tool for employees. Rational choice theory implies that individuals have a natural inclination to be utility maximizing (Simon, 1955). Therefore they adjust their behaviors to meet organizational goals in order to receive greater rewards.

c. The Motivational Impact of Merit Pay Policies

Empirical outcomes with merit pay policies suggest that rational choice models may be insufficient for understanding how decision making works with merit pay. Murnane and Cohen (1985) cited priorities that differ from strictly economic motivational reasoning in their interviews with teachers and administrators in their study which found that merit pay policies did not change teacher instructional practices. Pearce, Stevenson, and Perry (1985) found no association between merit pay and organizational performance on a study that monitored a performance pay program in the Social Security Administration. Deci (1975) suggests that performance pay undermines intrinsic sources of motivation that are derived from autonomy and self-efficacy, which may decrease performance in organizations that employ merit pay incentives. Vroom (1964) discusses three different associations hypothesized by theorists: a model with a linear association where motivation and performance increase equally; a diminishing returns model where as motivation increases, performance increases at a decreased rate; and a parabolic model where motivation and performance have a positive association until increased motivation begins to have a negative association with performance.

Economic analysis of merit pay systems can provide insights into how merit pay structures might interact with rational actors, but may be limited in their ability to predict what individuals may value. Revealed preference theory (Samuelson, 1948) is a form of *ex post facto* value derivation which tells us how much we value something based on previous actions, but is limited in that it is incapable of describing how the values were formed. Without the knowledge of how values are formed, it is difficult

to predict why incentive pay systems may have costs that exceed the benefits to the individual who are monitored by them. For these reasons, it is necessary to highlight how intrinsic and extrinsic sources of motivation may impact individuals who are operating within a merit pay system.

Self-determination theory put forth by Ryan and Deci (2000) attempts to understand how intrinsic motivators allow for optimal functioning. This model of intrinsic motivation states how there are several necessary conditions that must be present in order to ensure that workers are capable of self-motivation: autonomy, relatedness, and competence. The monitoring nature of incentive systems would negatively impact autonomy by requiring increased supervision. Also, short-run merit pay efficiency incentives may be perceived as coercive when the goal is to change behaviors, thus inhibiting the sense of autonomy further. Also, increased monitoring could potentially be perceived as an attack on an individual's competence by conveying a lack of trust in an individual's ability to accomplish their work.

Finally, individuals not rewarded by incentive pays may perceive the lack of pay increase as a rebuke of their competence, creating a negative outcome for these individuals. Overall, merit pay structures appear to be relatively incompatible with intrinsic motivators that self-determination theory proposes are important to optimal performance. These intrinsic motivators may be necessary for jobs that require creativity and problem solving (Amabile, 1997; Herzberg, 1987). However, it may be possible to limit the negative consequences of merit pay monitoring and reward by structuring a system in a way that limits perceived negativity. This would require monitoring the perceptions of those evaluated by merit pay systems. Another potential mitigation tool that this theory could foster is allowing employees to craft and monitor the evaluation system. This would emphasize a reliance on their capability and judgment to design evaluation metrics and also make them responsible for the outcomes associated with measurement.

Merit pay also aligns with McGregor's theory X assumptions (1960). Under this premise, workers require coercion and supervision in order to be productive. These ideas are reinforced in the implementation of merit pay structures and have created problems in jobs where creativity and problems solving are valued. Theory Y assumptions are characteristics that thrive in environments that allow for internal motivation. More freedoms and less monitoring allow for these types of productivity to flourish. Unfortunately, merit pay is unable to motivate this type of productivity according to Theory Y. Theory Y productivity is dependent upon the internal ability of the individual.

Maslow's hierarchy of needs (1943) displays the types of motivators that impact behaviors. The financial incentives encompassed within merit pay serve to meet needs associated with physiological and safety needs such as material necessity and financial security. Higher order needs such as social and self-actualization needs may be neglected by merit pay systems. Esteem needs may be a double-edged sword in that you are likely to provide positive reinforcement to the individuals receiving merit pay while also providing negative reinforcement to those not receiving merit pay.

Altogether, these motivational theories suggest that merit pay requires contextual circumstances to be organizationally productive. Attempting to increase productivity through merit pay may even be counter-productive in certain types of labor, especially if the principal-agent contract increases the amount of monitoring and stress placed on the agent.

d. Perceived Legitimacy of Merit Pay Policies

One of the focal points associated with merit pay has been the difficulty with increasing the perceived legitimacy of merit pay systems. Legitimacy is a crucial aspect of expectancy between a performance and outcome since it dictates the projections an individual would have regarding the outcome. Hanshaw (2004) describes legitimacy problems as one of the largest reasons why merit pay

systems fail. If merit pay systems are perceived to be reliable and fair, it would introduce more certainty into the expectations of the individuals who are eligible for merit pay.

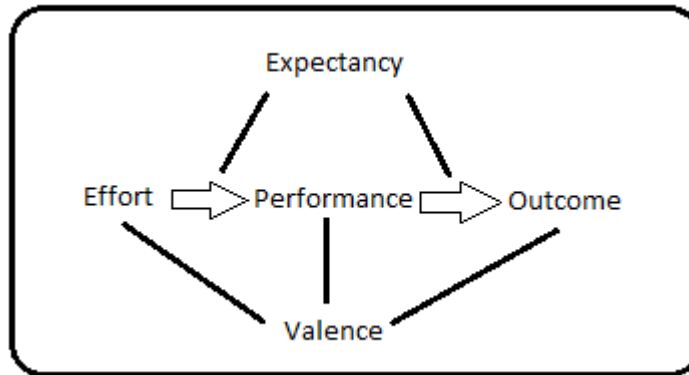
Reliability refers to the likelihood that merit measurement consistently has the same results. Fairness refers to the likelihood that merit measurement is equitable among the individuals being measured. Lowery et al. (1996) collected attitudinal data on the legitimacy of merit pay and concluded that employee fears about merit pay systems were focused on these two qualities. A system that lacks one of these components increases the likelihood that a merit pay policy will have unintended consequences resulting in behaviors that do not meet the goals of the organization.

The perceived legitimacy of a merit pay plan is contingent upon the measurement tool. In quantitative production, ensuring that the amount of merit awarded is consistent with the actual effort of the individual builds perceived legitimacy. In qualitative measurement such as managerial review, ensuring that each individual is perceived to receive fair evaluation from their supervisor is essential to legitimacy. In work where the quality of the labor is defined through subjective means, it could lead to varying perceptions on what is meritorious performance. Where performance is standardized and comparable between subgroups, the metrics used to gauge performance are likely to be consistent as well.

e. Expectancy Theory

Expectancy theory posited by Vroom cites some of the fundamental cognitive processes that individual workers may face in a merit pay system (1964). This theory is based upon the premise that motivation is a byproduct of utility maximization where individuals seek to increase pleasure while avoiding negative emotions. Vroom links effort, performance, outcomes, expectancy, and valence in relation to motivation (see Figure 1).

Figure 1: Expectancy Theory Conceptual Model



Valence refers to the preferences of individuals relating to their efforts, performances, and outcomes. Vroom describes an individual as having positive valence when they prefer an event to occur and negative when they are averse to it. For example, if an individual enjoys baking, that will increase their valence toward exerting the effort of baking a cake. Conversely, this preference for baking could decrease their valence toward buying a cake. From an organizational perspective, the introduction of merit pay into employee compensation may increase employee valence toward the outcome of receiving greater financial reward, but the cognitive costs associated with more monitoring and pay variability could have latent consequences according to Self-determination Theory (Ryan and Deci, 2000).

Expectancy refers to an individual's projections about the likelihood that an event will occur after their effort leads to a performance and outcome. This is directly linked to an individual's motivation based on their belief in how likely they are to achieve a desired outcome. If a person believes they are incapable of performing, or that their performance will not be acknowledged with a reward, it may undermine their motivation to accomplish a task.

Expectancy can also be influenced by the perceived capabilities of the individual judging the situation. If an individual attempted to accomplish a task and was not rewarded, the experience may have negative feedback on subsequent actions since expectancy is a derivative of past experiences. This

may undermine the self-confidence of the person neglected by merit pay. Also, the expectancy between a performance and outcome is largely dependent on the measurement tools that record performance. If an individual believes that their performance is worthy of the expected outcome, it could undermine the legitimacy of the measurement tools if they are perceived to be incorrectly monitoring performance.

Vroom proposes that these concepts are the elements that impact an individual's motivation to act. The interdependence and feedback between these elements may interact with a merit pay program in ways that may vary from individual to individual. A merit pay system might positively impact performance assuming that the following conditions are met: increased effort will result in a better performance (expectancy between effort and performance); the superior performance will be rewarded (expectancy between performance and outcome); the reward will satiate some desire (valence toward outcome); the individual desires to improve their performance (valence toward performance); and that the effort exerted is worth the reward that is given (valence toward effort). These assumptions are contextual to the situation and the individual who is valuing them and may explain why merit pay results tend to be varied.

Vroom's expectancy theory (1964) highlights the importance of perceived legitimacy on a merit pay system. If an individual believes that their actions will not lead to legitimate and fair measurement of their performance, there will be no incentives for specific behavior irrespective of merit pay plan goals. Worse, demotivating consequences of others being rewarded for work perceived to be of lesser quality may encourage rebellion against the merit pay plan in an attempt to undermine the legitimacy of the system further (Murnane, 1985).

IV. Methods

The theoretical perspectives suggest that the interactive effects of context specific variables will impact the perceptions an individual may hold regarding merit pay incentive structures. Even variation within similar jobs may be significant enough to alter the perceptions of the employees due to discrete differences of management or other workplace environmental factors. As a result of these constraints, participant-observation methods were used to generate qualitative data. The research process consisted of 3 components: individual interviews, e-mail correspondence, and a work group meeting approximately 2 months after the initial interviews to discuss how the work group felt about the introduction of merit pay.

As a facilitator, my input was limited to guiding discussions on the best methods for measuring employee performance to introduce a potential merit pay program. The construction of new evaluation metrics was conducted by the employees themselves. After a brief introductory presentation to describe the merit pay project, data were gathered through unrecorded individual interviews where notes were taken during the interviews. The interviews ranged from 15 to 45 minutes and were conducted during the employee's work day. Some employees were unavailable due to staggered schedules which made their participation impractical.

The questions primarily focused on understanding the perceptions of employees regarding current evaluation tools as well as their understanding of SPA specific job responsibilities. They were also asked about their perceptions of potential measurement methods such as feedback from customers and peers. A total of 13 interviews were conducted with three supervisors and ten employees. All employees volunteered to give their input on current and proposed evaluation metrics, which has resulted in a non-random sample of convenience.

The contents of these interviews were transcribed, and email was used as a secondary method of communication, which allowed for feedback on proposed evaluation metrics after the initial interviews. Then, this led to collaborative discussions between the workgroup on how to best design additional

metrics that could potentially be used for merit pay policies. Finally, the group meeting was held where all available personnel attended a discussion with the objective of amending proposed evaluation metrics and considering how comfortable the analysts felt with the new evaluation methods.

Expectancy theory will be the main method of analysis regarding these qualitative data.

Expectancy theory is a model which can be used to predict how different situations can influence the likelihood of an individual being motivated to act. With the introduction of merit pay into OHSU, new motivational scenarios may alter the behaviors of the individuals working there. Using the concepts of expectancy and valence, I will analyze their comments in order to determine the impact of merit pay policies on an individual's motivation. Expectancy theory is a suitable framework to model the cognitive processes which result in employee motivation.

V. Analysis

a. Existing Evaluation Methods

The Special Projects Administration (SPA) currently uses two forms of evaluation for gauging employee performance. The first method focuses on the quantifiable output of each individual analyst. This in turn is processed through a complexity matrix, which assigns a numerical value to the expected number of hours anticipated to complete the work. All of these data are compiled and standardized where 100% represents the expected output that an analyst should attain. If an analyst exceeds the expected production of the work group, they would be assigned a number in excess of 100% (i.e. 115% for someone who completes 1.15 times the expected output).

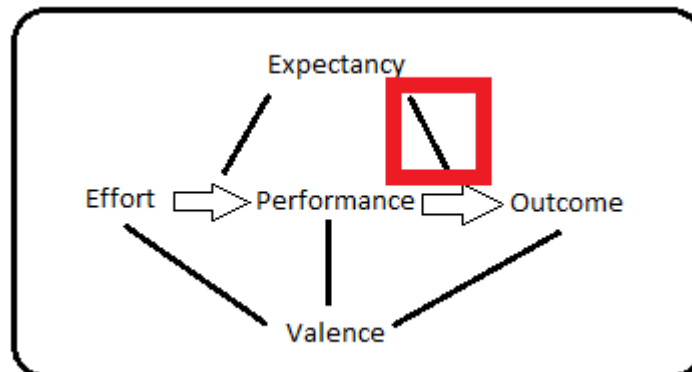
This form uses metrics that are broken down into subcategories of job aspects. Each of these responsibilities has recorded information associated with the job performance aspects that can be verified through quantitative means. For example, timeliness of completing work is measured through the ability of the analyst to complete projects within specific deadlines. Output quantity of reports

measures the volume of work completed within subsets of job responsibilities. In terms of standardization and comparability between individuals within the work group, this form was seen to be very reliable or the best method available for all analysts who participated in individual interviews (SPA Individual Interviews, November 2011). The department supervisor solicited feedback from the entire department to construct this metric in order to come to a consensus on the best way to gauge performance. As a result, the analysts were partially responsible for the metrics that they were judged on.

However, the inputs did have the potential to vary due to several reasons. Processing their forms is dictated by information received from the departments with which the employees work. Also, funding agencies can inhibit or slow processing times. These issues potentially complicate expectancy theory outcomes by removing the ability of the worker to directly influence how their work is accomplished when they rely on external sources to complete their tasks. Another confounding variable is the variation in the scope and timing of work associated with the requirements of individual projects. The number of projects and proposals underway by researchers at OHSU varies over time. Taken altogether, these difficulties complicate the review process and pose a risk to the legitimacy of the process. This difficulty required that a subjective review completed by management to assist the integrity of the process. Without the judgment necessary to be able to interpret the impact of variables outside the control of the employee, a rigid evaluation system has the potential to penalize a highly productive worker who was overwhelmed with work during periods of increased work volume. Also, different departments carry different requirements. For example, two employees noted that some departments were inexperienced with grant reporting requirements and regulations (SPA individual interviews, November 2011). This results in increased workload while attempting to train and convey sponsoring agency requirements to the departments.

The inherent strength of this evaluation method is that it provides some objective data on the quantity of work completed. This form could be seen as a fusion of managerial and objective measurement tools. Productive capacity is measured and then judgment is applied to gauge performance, which acts as a check against “gaming the system” as well as a check against managers making purely subjective review decisions. In regard to expectancy theory, this form and the contextual job responsibilities it monitors would be seen as a positive method for explicitly identifying employee benchmarks. Since it was widely viewed by respondents as an acceptable format and a legitimate tool to measure performance, it appeared to have a positive impact on employee expectancies between performance and outcome (See figure 2).

Figure 2: Expectancy Link between Performance and Outcome



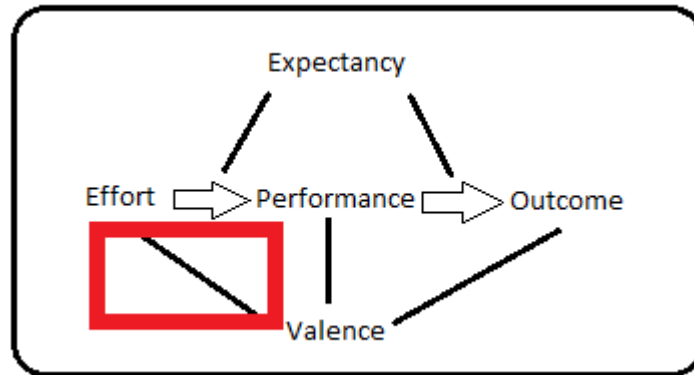
The second measurement metric is the standard OHSU evaluation form which is used within the “360” analysis. The 360 is a survey that garners input from management, employees, co-workers, and customers of each employee. Information regarding topics including ethics, professionalism, and productivity are included in this tool. This form is used throughout OHSU, which results in generalized information that can be used across the organization without the incompatibilities posed by contextual nuances of individual departments.

When analyzing these existing metrics in terms of expectancy theory, the generic “360” evaluation form provides for large amounts of asymmetric information. There is uncertainty in almost every aspect of the form since it does not relate to specific job functions, which Grossman and Hart identify as important to insuring contracts are executed as the principal desires (1983). However, the SPA-specific guideline directly contrasts with the former in that it ties specific evaluation criteria to the different functions that each analyst performs. The incorporation of employee feedback further enhances the legitimacy of the review.

b. Responsibilities of SPA

The main responsibility of SPA is to ensure the efficient processing of grant funds among the research departments at OHSU. Many core responsibilities are already encapsulated within the current evaluation tool. The measurement tool’s emphasis on productivity, timeliness, and capacity already capture many of the responsibilities shared by workers within this group. However, all analysts noted there were several absent aspects of job performance not measured by the current evaluation form when prompted (SPA Individual Interview, November 2011). One analyst mentioned that she believed that management incorporated customer service skills into their rating on the SPA evaluation form. This informal method of measuring performance adds additional measurement criteria, but may complicate the employee’s expectations of performance.

Figure 3: Expectancy Theory: Valence toward Effort



This absence could have a negative impact on effort valence in multiple ways. Since a job aspect which is viewed as an important job task remains unmonitored, it could potentially decrease employee valence toward prioritizing that aspect (See figure 3). All three managers who were interviewed believed that managing expectations and communicating grant requirements to the grantees were qualities that distinguished the most capable analysts (SPA Individual Interviews, November 2011). However, there are not quantitative metrics for either of these tasks and employees executing their duties have only latent indicators of this performance (i.e., show up when accounts go delinquent).

Interpersonal skills, which facilitate department and sponsor agency compliance, were viewed by all 13 respondents to be a strong indicator of an exceptional performer in the work group (SPA Individual Interviews, November 2011). Participants identified several potential sources that may be of use when attempting to collect information about interpersonal skills from impartial sources. Specialized workers who deal exclusively with set-ups and cash management were seen as ideal sources of feedback considering their breadth of interaction with all employees within the work group as well as their technical proficiencies with the requirements of their jobs. Also, department contacts who are the beneficiaries of grant funds were seen as another source of customer review, though less capable at identifying the requirements of analysts' jobs.

c. Employee Perceptions about the Responsibilities of SPA

During individual interviews, employees were questioned about their beliefs regarding their job responsibilities. Characteristics of high performing individuals and aspects of the job that are neglected in current review methods were specifically targeted as a tool for identifying potential metrics to include in future evaluations. Perceptions on what the core responsibilities of the position did have some variation from person to person, but a few themes remained relatively consistent across all interviews.

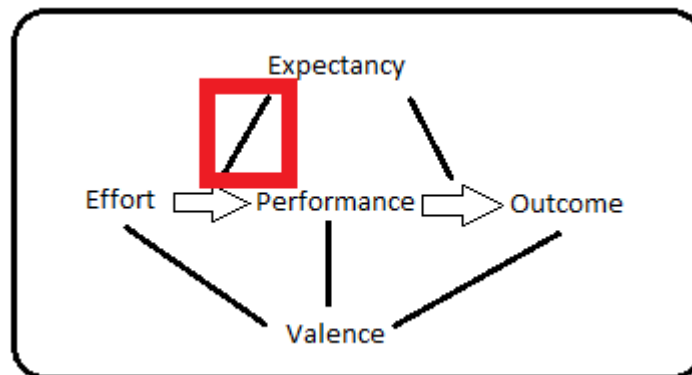
All three supervisors agreed that the largest amount of deviation between those who were thought to be high performers centered on their emotional intelligence. These skills were integral to managing the expectations of the departments with which they worked to gain compliance with the employee's requests. Five individuals mentioned topics such as "communication with departments" or "soft skills" as being important during individual interviews (SPA Individual Interviews, November 2011). When directly asked if these skills were useful to performing their job, all employees acknowledged its importance. There was also consensus on this skillset not being accounted for in current evaluation methods, although one person mentioned that the professionalism aspect on the 360 form may incorporate these traits. One employee believed that "[soft skills] would be difficult to measure" given their intangible qualities (SPA employee, individual interview, December 2011).

These comments bring to light several important implications. The first insight illustrates one of the inherent problems in principal-agent contracts: difficulties associated with measuring important characteristics as preferred by the principal. Measuring emotional intelligence in the workplace is a subjective task that may incorporate at least two types of bias in the process: any tool measuring this skill and the individual evaluating the skill. This is an inherent issue associated with all subjective review sources which may tend to inhibit perceived legitimacy.

Also, measuring these skills could be difficult due to the challenge of quantifying what may be perceived to be non-quantifiable or qualitative variables. This limits a measurement to an approximation using latent indicators, which could increase errors in the measurement method.

However, it becomes a pragmatic challenge to incorporate what everyone agrees is an important job aspect in order to create performance incentives. Ignoring these skills in evaluation creates the possibility for “gaming the system” where individuals may neglect customer service in favor of the readily (and easily) measured production variables. This could boost perceived performance quantitatively while negatively impacting comprehensive performance, which includes customer service. Inclusion or exclusion of these variables will require the judgment of the workgroup based on the specific needs of the organization.

A second characteristic that six of the ten analysts mentioned as important was prioritization of work responsibilities. One employee noted that “some people are set in their ways, and don’t prioritize their work like they should” (SPA employee, individual interview, December 2011). This comment focuses on the capability of the analysts, which fits in the expectancy between effort and performance.



Some individuals reported that differing prioritization may have been a consequence of variation in beliefs about how to best accomplish their duties. Expectancy theory suggests that standardization of expectations would lead to beneficial motivational outcomes due to a more reliable expectancy between performance and outcome. However, their valence toward a performance appears to contradict the standardization. Again, there are conflicting theoretical implications which may suggest that the outcome will be subject to the individual perceptions of the employee.

It should also be noted that at least three individuals mentioned themes of complacency, which may have been attributed to the protections that a labor union bureaucracy provided them. The current principal-agent contract includes employee protections fought for by the labor union that represents these employees. As a result of the current incentive structure within the contract, some employees may lack appropriate motivation to act as the principal desires. Whether or not these new proposed amendments to the evaluation system and the incentives implied by them will correct these motivational deficiencies remains speculative at this time.

d. Additions to the Review Process

After being provided with feedback on aspects of the job that were not accounted for in current evaluation structures, employees suggested several potential qualitative metrics for inclusion in the employee performance review. Respondents reported that current evaluation metrics lacked insight into how they actually accomplished their job, which included educating their contacts on the requirements of the funding organizations, dealing with the sponsor agencies, and general customer service responsibilities. When confronted with individuals who lacked an awareness of funding rules, for example, the amount of work that an employee would do could increase dramatically and not be accounted for in current evaluation methods.

Customer and peer review questionnaires were drafted and amended by the work group through collaborative discussions and email. Several proposed questions were altered or removed due to employee feedback. For example, multiple employees noted that they lacked information on coworker's job performance needed for the peer review. (SPA Workgroup Meeting, January 2012). Since the work group did not collaborate on a regular basis or work in a team, they saw monitoring their coworker's performance as difficult. This led to the peer review form being reduced to inter-personal questions related to workplace professionalism that peers felt they could answer about their colleagues.

The final survey consisted of several questions that incorporated the most valuable co-worker attributes and asked each worker to select the two employees they felt exhibited these traits the most. The employee was required to select someone other than themselves.

The customer review monitored employees' responsiveness to the needs of customers. Respondents were asked to provide specific information rather than generalities so that comparisons could be made across responses. For example, if the respondent was asked "how long does it take for your analyst to respond to your email," the respondent would be prompted to provide specific information (e.g., "within the same day"). Three of the employees questioned the neutrality of the people they serve since SPA also provided oversight of their department contacts (SPA Workgroup Meeting, January 2012; SPA Individual Interviews, November 2011). They feared that this information could be used as a weapon of retaliation. However other analysts expressed the belief that most of their contacts would be fair, (SPA Workgroup Meeting, January 2012). Respondents proposed that methods of eliminating exceptional cases through impartial means be used; one example would be removing responses several deviations from the norm. However, with sample sizes as small as three or four cases for some workers, this technique may be unrealistic. The final metric in its current form consisted of an analyst's combined mean scores combined from all the reviews which were submitted.

These comments reflect uncertainty about the reliability of measurement tools used to gauge employee performance. It is also possible that some employees are uncomfortable with subjective feedback, even if it is accurate and specific, as it was not a priority in previous performance evaluations. Expectancy theory suggests that introducing peer feedback appears to have complicated the expectancy between performance and outcome for at least some of the employees who work in SPA.

e. Employee Perceptions on Additions to the Review Process

Following the individual interviews, a meeting was called at which the workgroup discussed the concerns about the proposed evaluation methods. This meeting was intended to supplement the e-mail comments and build consensus on evaluation metrics moving forward. At the onset of the meeting the workgroup was asked about their opinions on the proposed evaluation tool, and one employee asked, “Why can’t we just use open-ended questions to get feedback?” (SPA employee, workgroup meeting, January 2012). The methods of why the surveys were structured with closed-ended questions were debated with concerns about how to fairly compare the survey results. Three employees also expressed an unprompted preference toward non-financial rewards as a method of acknowledging individual contributions, suggesting that rewards such as days off, increased flexibility of work schedules, and symbolic acknowledgement may have net motivational impact in some instances. One employee provided an explicit definition of satisficing when declaring, “I can work within whatever system OHSU gives me” (SPA employee, individual interview, December 2011). This employee expressed a great deal of self-efficacy in his belief that he could meet organizational needs regardless of the ways that the organization measured his performance. His expectation was that his effort would lead to a performance desired by the organization. This comment illustrates how personal motivation differs between individuals.

One SPA employee raises issues behind their hesitation with trying to measure performance (Email Correspondence, January 2012):

Although I am more comfortable with the revisions I still strongly believe this does not showcase “exceptional” performance, which may lead to a bonus situation and quite honestly, I’m not sure I understand the definition of exceptional. To me, it seems like a popularity contest. In my opinion, there isn’t enough here to substantiate the responses, which I feel is important due to the nature of our job. If we aren’t willing to go this route then I would say I am most likely not in favor of this review

system. This is a big deal and a big change and I think it needs a little more TLC in order to be effective.

There are a couple of points this employee makes that could have negative implications for the peer review system within this workgroup. Subjective review systems are based on a sense of trust; employees expect an evaluator to be fair and unbiased. If the employee believes that the questions are not collecting information directly related to the job performance, the effectiveness of the tool is undermined. If peer review is limited to strictly interpersonal questions, answers may vary by personal experiences, personalities, and expectations. Inclusion of this tool could be counterproductive for some individuals.

However, not all individuals viewed the new evaluation instruments as controversial. "I like the changes to the analyst survey. I'm comfortable sending these out." (SPA employee, email correspondence, January 2012) Homogeneity of motivational outcomes may be an unrealistic expectation of any merit pay structure. Expectancy theory provides a very individualized method for analyzing the thought processes of the workers that may be subjected to a merit pay system, and the comments that were received appear to suggest that some people are far more flexible to the motivational inputs a merit pay system might bring.

VI. Discussion

Expectancy theory helps us understand how different aspects of employee motivation can be affected through merit pay policies including the methods used to measure and reward employee performance. Any changes in measurement or new reward structures will have consequences that alter the valence or expectancy of the individual. Merit pays directly impact an individual's preference for an outcome by creating different rewards. The expectations of how a performance will lead to that

outcome associates those rewards with different levels of performance. As a result, merit pay's effectiveness is largely dependent on how valuable the outcome is to an individual and how valid the measurement of performance is perceived to be overall.

The feedback received from SPA analysts was largely focused on the validity and reliability of the evaluation tools. This is likely due to two factors. First, there were no solidified merit pay outcomes written into the current labor contract. Budgetary funding was restricted due to a reduction in overall economic activity caused by the Great Recession. Furthermore, union labor contracts created a constrictive environment which made pilot program funding even more complicated. Second, the greatest amount of uncertainty that employees had to consider was measurement methods. During this process, their self-efficacy associated with expectations of how their effort would lead to a performance was comparatively more stable than their expectations of how their performances would be measured and rewarded. This was likely also the case for their preferences (valence) toward effort and performance. As a result, merit pay policies should strive to focus on creating valid and reliable measures of performance. Furthermore, it should ensure that this validity and reliability is relayed to the employees who are measured by it by communicating expectations and soliciting employee feedback on ways to improve performance measurement.

Also, the complexity of the job is likely to alter the expectations which increase motivation. As a skilled labor position, SPA analysts have a variety of duties which create difficulties having comparable performance evaluation. In general, simple standardized tasks will have greater amounts of perceived validity. Standardized tasks tend to be harder to game, and easier to compare in evaluation. As a result, merit pay incentives may be more conducive to unskilled positions such as a deliveryman whose productivity is measured by the number of packages delivered. Subjectivity that is introduced into performance measurement will create more opportunities for employees to question the validity of the

scale since subjective performance measurement validity is contingent on the trust that the employee has in the evaluator.

In this case study, the introduction of new customer service measurement tools will change how SPA employees prioritize their customer service responsibilities. However, the use of subjective customer feedback metrics does have the possibility to complicate the current motivational process for some individuals. It could result in the prioritization of customer service skills at the expense of productivity. If this loss in productivity created a net loss in organizational effectiveness, it would undermine the purpose of merit pay. Since the measurement tools are the proxy method of attaining an incentive, it may change how some employees prioritize their job responsibilities.

Also, constructing evaluation tools requires contextual knowledge about the position. The 360 evaluation form which is used for generic employee feedback provides limited information for employees to form their expectations. Its ambiguity does not emphasize what characteristics are important indicators of performance. This would create a great amount of uncertainty in the expectancy link between performance and outcomes for employees, which would then undermine their motivation. As a result, evaluation tools that focus on specific performance indicators are more likely to reinforce positive motivational outcomes.

With its emphasis on individual perception and motivations, expectancy theory lacks the focus necessary to define compromises between the organization and the individual. In an instance where there are job priorities that are integral to performance, yet counter-productive for expectancy, it does not provide clarification on the appropriate tools necessary to compare or prioritize a course of action. For instance, the increased amounts accountability in merit pay are necessary to evaluate performance, yet the monitoring necessary to evaluate performance may undermine an individual's sense of autonomy which can lead to less intrinsic motivation. Expectancy theory doesn't provide a framework to manage these conflicting concepts.

Expectancy theory also lacks the ability to help identify aggregate performance changes in merit pay. As a conceptual model, it outlines how an individual could process the elements of motivation. However, it does not offer any predictive insight on how a group of individuals might process their motivational inputs. In an organizational setting, the combined ability of the workforce is more likely to be prioritized in order to maximize organizational efficiency.

Study Limitations

The most prominent limitation to this study is the highly contextual nature of evaluation methods. The research conducted within this situation may not be comparable to even similar workgroups due to a variety of variables. Variation in several different aspects could impact expectancy theory projections such as: the type of work being conducted; the importance of job aspects; employee resistance to evaluation metrics; presentation or framing of proposed metrics; contrasting leadership styles of management; subjective employee interpretations of evaluation structures; the types of incentives offered; the availability of data on performance; and finally pragmatic methods of enhancing evaluation. The motivational outcomes within the analyst group itself will vary from individual to individual.

It should also be noted that this system had no direct incentive structure associated with measurement, only a proposed incentive plan that was subject to negotiations. How evaluation incentives would interact with employee motivation could potentially change once the introduction of incentives was complete. However, a method of evaluating performance precedes the outcome, so developing legitimate evaluation methods is a necessary precursor. Without evaluation methods in place, identification of performance is impractical and could be counter-productive should you reward people who are perceived to not be worthy of the incentive by using illegitimate evaluation.

Another large limitation is a lack of contrasting styles of labor. Much of the motivational literature suggested that certain types of labor may be impacted differently by varied types of

performance review. This varied according to the degree of intrinsic motivation required to perform the job. Including a more simplistic job with redundant tasking and standardized units of production would be an interesting contrast to this position which is comparatively more dependent on problem solving, analytical thinking, and communication skills.

Also, another limitation to these data is the lack of maturation of the new concepts being measured in the surveys. Once new outcome incentives are introduced, behaviors may change in ways which are unpredictable. This would require a longitudinal analysis of how behaviors adjusted once the measurement system and merit pay was finalized and implemented.

For Future Study

Understanding how different levels of performers conceptualize a merit pay program in reference to expectancy theory may allow researchers to understand the contextual perceptions of varying performance levels. The inclusion of contrasting styles of labor (skilled and unskilled) would help address the concerns suggesting that different styles of labor will require different processes to measure it. Also, the inclusion of actual financial incentives would provide additional insights, especially when attempting to investigate the potential unintended consequences of introducing merit pay structures into an organization. There are many questions which remain unanswered. Should the incentives have the desired effect, would those behavioral changes be static? Would complacency alter motivational factors? Would employees adjust their behaviors to minimize costs in other unintended ways? These concerns are best answered by longitudinal studies in future research.

Merit pay policies appear to have the potential to generate additional motivation when certain criteria are met. While merit pay may not be ideal for every situation or style of work, it may standardize organizational expectations of employees and reward those who are best suited to the labor. Identifying which types of labor may be suitable for merit pay will be the challenge of future research.

Works Cited

- Alison L. Booth. 1985. "The Free Rider Problem and a Social Custom Model of Trade Union Membership." *The Quarterly Journal of Economics* 100:253-261.
- Baker, George P. 1990. "Pay-For-Performance for Middle Managers: Causes and Consequences." *Journal of Applied Corporate Finance* 3.3:50-61.
- Banker, Rajiv D., Seok-Young Lee, Gordon Potter, and Dhinu Srinivasan. 1996. "Contextual Analysis of Performance Impacts of Outcome-Based Incentive Compensation." *The Academy of Management Journal* 39:920-948.
- Bardhan, Pranab. 2002. "Decentralization of Governance and Development." *The Journal of Economic Perspectives* 16:21.
- Boser, Ulrich. 2000. "Teaching to The Test?." *Education Week* 19:1.
- Byrd, John, Robert Parrino, and Gunnar Pritsch. 1998. "Stockholder-Manager Conflicts and Firm Value.." *Financial Analysts Journal* 54:14-30.
- Calmes, Jackie. 2010. "Obama Defends Education Program." *The New York Times*, July 29 <http://www.nytimes.com/2010/07/30/education/30obama.html> (Accessed February 23, 2011).
- Gardner, Donald, Linn Van Dyne, and Jon Pierce. 2004. "The effects of pay level on organization-based self-esteem and performance: A field study." *Journal of Occupational and Organizational Psychology* 77:307-322.
- Grossman, S. J., & Hart, O. D. (1983). An Analysis of the Principal-Agent Problem. *Econometrica*, 51(1), 7-45.
- Hanshaw, Larry G. 2004. "Value-Related Issues in a Departmental Merit Pay Plan." *The Professional Educator* 26:57-68.
- Herzberg, Frederick. 1987. "One more time: how do you motivate employees?" *Harvard Business Review* 81:87-96.
- Hoerr, Thomas. 1998. "A Case for Merit Pay." *Phi Delta Kappan* 80.4:326.
- Lowery, Christopher M., M.M. Petty, and James Thompson. 1996. "Assessing the Merit of Merit Pay: Employee Reactions to Performance-Based Pay." *Human Resource Planning* 19:26-37.
- Maslow, Abraham Harold. 1987. *Motivation and Personality*. 3rd ed. HarperCollins Publishers.
- McGregor, Douglas. 1960. *The Human Side of Enterprise*. First. McGraw Hill Higher Education.
- Murnane, Richard J., and David K. Cohen. 1985. "Merit Pay and the Evaluation Problem: Understanding Why Most Merit Pay Plans Fail and a Few Survive.."

<http://www.eric.ed.gov/ERICWebPortal/contentdelivery/servlet/ERICServlet?accno=ED270842>
(Accessed February 12, 2011).

- Ostrom, Elinor. n.d. "Institutional Rational Choice: An Assessment of the Institutional Analysis and Development Framework." Pp. 35-71 in.
- Pearce, Jone L., and James L. Perry. 1983. "Federal Merit Pay: A Longitudinal Analysis." *Public Administration Review* 43:315-325.
- Pearce, Jone L., William B. Stevenson, and James L. Perry. 1985. "Managerial Compensation Based on Organizational Performance: A Time Series Analysis of the Effects of Merit Pay." *The Academy of Management Journal* 28:261-278.
- Podgursky, Michael, and Matthew G. Springer. 2007. "Credentials Versus Performance: Review of the Teacher Performance Pay Research.." *Peabody Journal of Education (0161956X)* 82:551-573.
- Pojman, Louis. 1999. "Merit: Why Do We Value It?." *Journal of Social Philosophy* 30:83-102.
- Ritter, Gary W., and Nathan C. Jensen. 2010. "The Delicate Task of Developing an Attractive Merit Pay Plan for Teachers. (Cover story)." *Phi Delta Kappan* 91:32-37.
- Runge, Carlisle Ford. 1984. "Institutions and the Free Rider: The Assurance Problem in Collective Action." *The Journal of Politics* 46:154-181.
- Ryan, R M, and E L Deci. 2000. "Self-determination theory and the facilitation of intrinsic motivation, social development, and well-being." *The American Psychologist* 55:68-78.
- Rynes, Sara L., Barry Gerhart, and Laura Parks. 2005. "PERSONNEL PSYCHOLOGY: Performance Evaluation and Pay for Performance.." *Annual Review of Psychology* 56:571-600.
- Samuelson, Paul A. 1948. "Consumption Theory in Terms of Revealed Preference." *Economica* 15:243-253.
- Simon, Herbert A. 1955. "A Behavioral Model of Rational Choice." *The Quarterly Journal of Economics* 69:99-118.
- Thayer, Frederick C. 1978. "The President's Management "Reforms:" Theory X Triumphant." *Public Administration Review* 38:309-314.
- Toch, Thomas. 2009. "The Perils of Merit Pay.." *Phi Delta Kappan* 91:99-100.
- Trevor, C, B Gerhart, and JW Boudreau. 1997. "Voluntary turnover and job performance: Curvilinearity and the moderating influences of salary growth and promotions." *Journal of Applied Psychology* 82:44-61.
- Vroom, Victor H. 1964. *Work and Motivation*. Reprint. John Wiley & Sons Inc.

Weber, Max, Peter R. Baehr, and Gordon C. Wells. 2002. *The Protestant ethic and the "spirit" of capitalism and other writings*. Penguin.