3P Approach to Compensation Management and its Implications for Employee Performance at Work

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This article provides a synthesis of the 3P approach to compensation management with a comprehensive explanation on how these approaches can affect an employee's performance at work. Through the theoretical lenses, the study looked into the 3P compensation system based on the fundamentals of paying for position, person and performance along with advantages and disadvantages of each. Subsequently, it identified different factors that are considered critical to the development of an organization's compensation policies on the basis of this 3P approach. In addition, this paper proposed some recommendations conducive to the emergence of high performing organization by reducing the shortcomings of this approach in aligning the compensation policies with its management practices and business strategies.

Keywords: compensation management, 3P compensation management, employee performance, job-based pay, skill-based pay, pay for performance, incentives, merit pay, merit bonus

INTRODUCTION

Compensation is the financial yield and benefits that employees receive in the form of salary, wages, incentives and rewards as a return of their membership within the organization in order to increase their performance at work (Holt, 1993). Brown (2003) defines compensation as a return in exchange between employees and employers out of the entitlement for being an employee of the organization, or as a reward for a job well done. Compensation Management is an essential function of Human Resource Management that enhances the productivity of an organization and carries out the design, implementation and maintenance of compensation system in order to increase organizational, team and individual performance (Armstrong, 2005). From all these definitions, it is evident that some components of compensation are membership-based whereas few other parts are linked with performance.

Employees are considered critical to the success of an organization as they commit their knowledge, skills, abilities, experiences and innovation to their employers (Rodriguezet al., 2002). Academics have been striving for establishing a functioning definition of excellent employees. Excellent employees are those individuals who can put well-directed effort to improve the productivity and worth of the organization they work for (Møller, 1994). Another concept describes excellent employees as the ones who show high "in-role" performance and high "extra-role" performance (Williams and Anderson, 1991). "In-role" performances are about fulfilling job description related duties with high standards whereas "extra-role" acts take place when they go beyond their regular responsibilities and perform additional tasks that improve the overall productivity of the organization. So, a high performer is an employee who can consistently exceed the expectations that have been sited on him at his workplace.

In an online article titled 'why great organizations hire high performers', the writer argues that today's competitive organizations focus on high performers as they can drive the company culture, lead by example, are team players and most importantly can grow a business (Thompson, 2017). Another research states "strategy implementation is best accomplished through high-performing people and therefore every organization must develop and retain its high-performing employees who are focused on giving target customers what they want" (Michlitsch, 2000).

Organizations that spend an extensive amount of time in continuous nurturing of the core competencies of their employees by investing on them which ultimately leads to enhanced organizational growth and performance are known as high performance organizations (Wood, 1999). Another research conducted by The Boston Consulting Group and the World Federation of People Management Association on more than 5,000 executives revealed that high-performance companies fill out 60 percent of top-management roles with internal candidates, while low-performance companies fill only 13 percent of those internally (Bhalla and colleagues, 2011). This means that such organizations give a platform to their employees where they can progress through the career ladder by continuously learning and showing a steady track of extraordinary performance. Therefore, we cannot deny the fact that to perform well financially or to create a social impact, an organization needs employees who can excel at what they do.

This paper reviewed the 3P approach to compensation management and analyzed how this 3P compensation system based on the fundamentals of paying for position, person and performance can lead to improved employee performance at work and help an organization progress one step towards becoming a high performing organization.

METHODOLOGY

The approach of theory synthesis have been followed to write this paper where it seeks to attain conceptual integration across extensive set of theories and multiple literature (Jaakkola, 2020). The goal was to look for a mutual ground on which new and enhanced conceptualization could be built upon. It has been identified that much research have not been conducted on this topic recently and there is further scope to explore how this 3P compensation management can transform a typical organization into a high performing one by influencing the performances of its employees.

SYNTHESIS OF THE COMPENSATION MANAGEMENT CONCEPTS

Compensation system performs a substantial role in upholding an organizations' strategic goals (Gerhart and Milkovich, 1992; Gerhartet al., 1996; Gomez-Mejia and Balkin, 1992; Lawler and Jenkins, 1992; Milkovich, 1988). Approaches related to compensation management can be amalgamated into a contemporary concept known as "3P Compensation System" where the three Ps stand for:

a) Pay for Position
b) Pay for Person and
c) Pay for Performance

The elaboration of these Ps could misled people easily with an impression that only the last P is associated with performance and organizations that follow the latter philosophy are merely the ones focusing on boosting its employee performance. While in reality, all these three Ps have direct or indirect implications for employee performance at work and the subsequent sections will focus on explaining this.

Pay for Position

The traditional or job-based approach to compensation management is considered to be the oldest one where employees are paid for the jobs they perform. At an early stage of implementation, a prime challenge associated with this system was to ensure external and internal equity. Experts evaluated this issue for many years and finally could offer an ideal mechanism (Scarpello and Jones, 1996; Milkovich and Newman, 2008). They suggested compensation professionals to adopt job evaluation to solve internal equity issues and compensation surveys for managing complications related to external equity. Another parallel approach suggested to determine pay rates is market-based pay, which takes internal equity considerations as secondary to external equity concerns and pay is decided mostly through market valuations (Dulebohn and Werling, 2007; Milkovich and Newman, 2008). Compensation survey is a tool used by organizations to determine competitive compensation packages for its employees by carrying out a survey of what the other significant players in the industry are paying to similar level positions (Milkovich and Newman, 2008). The survey input data are collected from various companies of related or unrelated industries and output is the average or median salary for the key positions of an organization, taking into consideration the region, industry, company size, revenue, etc.

The epitome of pay for position concept is job evaluation and it is defined as the process of systematically determining the relative worth of jobs with the intention of creating a job structure for the organization (Milkovich and Newman, 1996). The outcomes of job evaluation are used in constructing remuneration system for an organization. According to Armstrong and Baron (1995), "Job evaluation is a systematic process for defining the relative worth or size of jobs within an organization in order to establish internal relativities and provide the basis for designing an equitable grade and pay structure, grading jobs in the structure and managing relativities". These definitions direct researchers towards the underlying philosophy of equal pay for equal work and summarizes the steps of creating job-based compensation management policies as following:

1. Conduct job analysis for all the jobs or positions within an organization
2. Develop job description (JD) for all the positions
3. Carry out job evaluation for these positions by following a method
4. Derive a hierarchy of positions as per the outcome of job evaluation
5. Prepare a compensation structure on the basis of the resulting hierarchy

As stated by a range of old and new scholars, job evaluation can be carried out by following three methods such as ranking, classification and point. Firstly, in ranking method, job descriptions are ranked from highest to lowest as per the global definition of their contribution to the fulfillment of organization's goal. The total compensation budget is then distributed proportionately by paying more to the high ranked job, moderately to the middle-ordered jobs and low to the lower grade jobs. Secondly, classification method compares all JDs against a standard (i.e. class descriptor) to offer a sequence of classes with a number of jobs in each class and respective pay range is decided for each of the classes. Lastly, point method assigns points to all the jobs within an organization by evaluating each JD against some predetermined compensable factors specific to the organization and corresponding pay rates are assigned from highest to lowest scored jobs. A popular point-based job evaluation method is Hay Job Grading which was developed in the early 1950s by E. N. Hay and Associates. It is an analytical method that evaluates the jobs within an organization on three universal compensable factors such as know- how (i.e. the requirement of technical and specialized job knowledge), problem solving (i.e. the requirement and ability to use the know-how in developing solutions) and accountability (i.e. the requirement and ability to attain desired outcomes) and segregates those in term of scope and breadth to construct a compensation structure for the organization (Hajji Muhammad Ali EL, 2015). Sometimes, a fourth factor named working condition is used while evaluating non-managerial jobs. Thus, job evaluation will provide an organization with a) a job structure ordering jobs from highest worth (i.e. rank, class or point) to the lowest and b) a compensation structure rightfully reflecting the job structure. Summary of all the aforesaid job evaluation methods is presented in table I:

TABLE 1
SUMMARY OF JOB EVALUATION METHODS

Method Name	Description	Merits	Demerits
Ranking	- a method of ordering the jobs/positions of an organization from the hardest to the easiest ones;	- easy to use by the employers; - easy to understand by the employees;	- cumbersome process to carry out for a large number of employees; - hardly measures the complexity of a job;
Classification	- a technique of comparing the job/positions of an organization against standards (i.e. class descriptor) and grouping them into homogenous classes (i.e. categories)	- easy to use by the employers; - easy to understand by the employees;	- success depends on creating meaningful descriptors; -hardly measures the complexity of a job;
Point	- a method of analyzing the jobs/positions by assigning points against a likert scale on some compensable factors (e.g. skill, effort, knowledge, accountability, etc.) set by the organization to determine the level of job difficulty; at the end of the process all the factor points are summed up for a job and thus a specific point is being attributed to a job;	- more relevant factors influencing the difficulty level of each job are taken into consideration; - analytical in nature in evaluating and describing the differences between jobs;	- extensive training is required in understanding, developing, and implementing this process; - evaluators need to have high extent of knowledge on all occupations, tasks, and positions etc. of an organization;

In position-based compensation system, a person designated to receive a certain level of pay can move to the next level of pay only by getting shifted to a higher rank in the hierarchy. Within an organizational framework, such movements are considered as promotions and only high performers are awarded promotions. This refers to the conclusion that position or job-based compensation management policies motivate employees to perform better so that they can achieve larger pay by getting promoted to the next superior grade. To explain further, under such compensation system, an employee holding a position in band D and entitled to receive an amount in between the range of $1000-$2000 per month can move to the next pay range of $2100-$3000 per month only when he is promoted to the next superior band which in this case is C. To be eligible for this promotion, that employee must do consistently well and fulfill other performance-related conditions sited on him by the organization. Hence, job-based compensation management too is encouraging an employee to perform better so that he can improve his compensation package.

Pay for Person

This is the theory of recent decades also to be known as skill-based compensation. Skill is referred to as "the dispositions and attitudes needed to ensure participation in the labour market" (Green, 2011). Breadth and depth of an individual's skill is the starting point of determining skill-based pay (Lawler and Ledford, 1985). Under this approach to pay, an individual's compensation is determined by the set of skills possessed by him or her. Here, salary is differentiated on the basis of job-related knowledge, skill and abilities acquired by individual employee. Such compensation management policies are established by following a series of steps such as:

1. conduct skill analysis
2. prepare skill blocks
3. carry out skill certification and
4. develop skill-based structures

Under the first 2 steps, all the skills required to perform tasks within an organization are identified and grouped into 3 skill blocks such as foundation skills, core electives and optional electives. For ease of understanding, all core electives are assigned with distinct points. In the next step, organization uses various certification methods like peer review, on-the-job demonstrations and formal tests to assess which employee holds which skills from these three blocks. At the final stage, pay rates are decided for a group of employees who have been certified to possess similar set of skills.

Even though training costs are presumed to increase under this system as puts a great deal of emphasis on skill enhancement (Ledford, 1990; Jenkins & Gupta, 1985; Gupta, Jenkins &Curington, 1986), there are instances that showed positive association between an organization's decision to use skill-based compensation system and the changes in the behavior of its employees in terms of attraction, attendance and retention (Guthrie, 2000). Moreover, experts argue that pay levels under skill-based compensation structure tend to be higher in comparison with job-based pay plans (Murray and Gerhart, 1998; Gupta and Shaw, 2001).

An indirect influence of person-based pay on employee performance can be attempted to be established theoretically. For example, a manager who falls under the employee group Manager-I by possessing certain skills and gets paid $500 per week, can move to the next level Manager II for which the weekly salary has been set to be $1000 only when she or he can acquire the common skill set that the existing employees of this workgroup (i.e. Manager II) have been certified to have. Such up-gradation of compensation by acquiring new set of skills motivates an employee to learn and implement novel skills at workplace. As a result, organizations would experience an improved level of performance in employees who are continuously developing themselves in the pursuit of procuring next level skills. The effect of person-based pay on employee performance has been established empirically as well. A study asked the Fortune 1000 companies to provide an overall rating of the success of their skill-based pay plans and sixty percent of the respondents rate their skill-based pay plans as successful or very successful in increasing their organizational performance (Lawler, Ledford and Chang, 1993). Therefore, it can be concluded that person or skill-based compensation system can also motivate an employee to be a better performer so that he can be upgraded to the next pay level.

Pay for Performance

The core concept of performance-based or reward-based approach to compensation management mostly lie around incentives, merit pay and merit bonus. In other words, these are variable pay as the pay varies with the level of performance.

Incentives

The term incentive is defined as "a promise of pay for some objective, pre-established level of performance," which is often a physical output (Newman et al., 2017). The same research described it as "inducement offered in advance to influence future performance" (Newman et al., 2017). From the definitions, it is apparent that incentives are dispersed on achieving a pre-determined level of output and it can influence how an employee will perform over a period of time. Incentives are directed at refining the overall performance level of an organization. To exemplify, an employee who is promised to be paid $5 per unit for each unit above the standard 200 units he sells in a month or $1 per unit for each unit he produced above the regular 10 units in a day, will definitely thrive on hard work to break the bar. However, a number of studies have found that employees do not consider money as the most significant motivator, and in few instances, managers have found incentives to have a negative effect on employee performance

(Nyaribo and Nyakundi 2016). Therefore, it is suggested that companies should also introduce non-monetary incentives such as recognition, feedback, training, etc. along with financial incentives in order to increase employee efficiency (Dzuaranin, 2012).

Merit Pay

In this category of payments, an employee is given a percentage increase to her salary on the basis of her performance. Such increments are disbursed at the end of the assessment period based on the employee's overall performance exhibited throughout the period and are built into the employee's base pay. So, merit pay is the method of determining and disbursing increases in employee pay on the basis of how well each employee performs at work and is often determined through performance evaluation conducted by supervisors (Heneman, 1992). For instance, at the end of the year, an employee whose current base pay is $700 per month is given 15% increment on the basis of her performance throughout the year. This raise will make her base pay $805 for the next year.

Teacher Advancement Program (TAP) created by the Milken Family Foundation in 1999 is the instance of a system that uses merit-pay (Wallis and colleagues, 2008). Under this scheme, salary increments are given based on some important facets of teacher performance, evaluated by a combination of tools such as observations and student test scores. Such assessments allow teachers to focus on individual performance and build skills that will enhance the process of classroom learning.

The concept of merit pay is now being practiced by many small, medium and large firms to differentiate between the high and low performing employees at workplace. In most cases, as a starting point, Key Performance Indicators (KPIs) are mutually set for all employees and formally communicated with them. Throughout the evaluation period, employees perform at a level required to achieve these KPIs and get assessed by their supervisors at the end of the period. Consequently, they are allotted a certain increase in pay based on how well they could perform in accomplishing the targets that were set for them. Researchers have identified few contextual factors that might work as impediments for such compensation practices to positively influence employee performance. These problems include the struggle in developing meaningful targets and measures for individual performance in symbiotic work contexts, inadequate recompense budgets available for merit increases, as well as lack of understanding and training of supervisors in using performance evaluation tools (Campbell et al., 1998; Beer and Cannon, 2002; Perry et al., 2008; Kellough and Lu, 1993). In addition, according to a relevant research, the higher the level of employees' perceived politics in pay decision-making, the less effective the pay system becomes in achieving its objectives (Salimäki and Jämsén, 2010). Nevertheless, the findings from many related studies displayed that the ability of administrators to disseminate the facts related to merit pay structures openly, precisely and fairly to employees holding diversified positions led to superior work satisfaction (Agyare et al. 2016; Ahmed et al. 2016; Ali et al. 2014; Azadeh&Rast 2012; Darechzereshki 2013; Panggabean 2001).

Merit Bonus

Merit bonus is similar to the notion of merit pay except that it is not paid as a percentage but as a lump sum amount. It takes performance from three perspectives into consideration such as individual, team and organizational. To illustrate, an employee of Human Resources is promised to be paid $1000 as bonus if he can achieve a 4 out of 5 rating in this period's performance evaluation, his department can achieve 90% of the targets and the organization as a whole can achieve 80% of its strategic goals. This employee will definitely try to develop himself and others so that he can attain his bonus by demonstrating the required level of individual and group performance. Many organizations tend to prefer merit bonus over merit pay as the latter one increases an individual's base pay whereas the former one is distributed as one-time payment. Table II shows all the performance-based pay methods at a glance:

TABLE 2
SUMMARY OF PAY FOR PERFORMANCE METHODS

Method	Description	Advantages	Drawbacks
Incentives	-a type of performance-based pay that is dispersed on achieving a pre-determined level of output;	-less direct supervision needed once employees become dedicated; -direct labor cost can be calculated more accurately;	-possibility of resistance over adoption of new production method; -deteriorating quality level due to high focus on quantity;
Merit Pay	-a type of pay for performance that is disbursed as increases in employee pay on the basis of how well each employee performs at work and is often determined through performance evaluation conducted by supervisors;	-more structured as it is given out on the basis of evaluation that takes into consideration work, behavior and motivation related issues;	-success depends on meaningful KPIs ; -employees might take this pay as entitlements; -additional cost for employers as base pay rises substantially;
Merit Bonus	-a type of performance-based pay that similar to merit pay that is paid as a lump sum amount;	-does not impose any additional cost for employers as it is not merged with base pay but as a one-time bonus payment; -reinforces team work within the organization;	-viewed as less of an entitlement as employees are required to earn this every year; --since most bonus are group-based or contain team-based criteria, organization may suffer from free-rider problem;

Provided that the associated factors are taken care of, pay for performance would certainly motivate employees to perform better and help the organization reach its goal. The results of a recent research conducted on the public sector employees showed that the monetary incentives distributed with a merit logic depends on the employee performance and they are a stimulus for the next period of evaluation (Ponta, Delfino, and Cainarca, 2020). In addition, evidences obtained from the implementation of pay for performance schemes in the primary health care services delivered by UK health system confirmed considerable successes in terms of excellence, effectiveness, and efficiency of services.

SUMMARY OF FINDINGS

A summary table has been prepared to present the effects of 3P approach to compensation management on employee performance at work. In addition, a number of factors that are critical to the development of an organization's compensation policies on the basis of this 3P approach are identified. Finally, some recommendations to mitigate the negative impact of these factors in order to initiate the culture of building high performing organizations with high performing employees are offered as well. The synthesis of findings is presented in table III:

TABLE 3
COMPENSATION STRUCTURES AND THEIR IMPLICATION FOR EMPLOYEE PERFORMANCE

Theory	Critical Factor	Influence on Employee Performance	Suggestions
Pay for Position	• complete and correct JD • external and internal equity	employees can move to the next position with higher pay only by exhibiting higher performance;	conduct effective job evaluations so that pay can be decided as per comparative worth of each job or position;
Pay for Person	• comprehensive skill identification • mechanism for effective skill certification	employees thrive on acquiring and implementing new skills at work which ultimately results in better performance	ensure fair assessment of employees' current and new skills and determine present and future pay accordingly; training of employees to develop new set of skills
Pay for Performance	• relevant KPI selection • detailed employee communication	employees strive to perform better and accomplish the KPIs in order to obtain incentives, merit pay or merit bonus	extensive training for supervisors in setting meaningful KPIs and evaluating employees accordingly

CONCLUSION

Organizations practice various compensation plans to accomplish significant strategic results, such as higher employee productivity, superior workforce attitudes, and better membership behaviors (Dulebohn and Werling, 2007; Gerhart and Milkovich, 1992; Milkovich and Newman, 2008). Such qualities can build a high performing workforce which could lay the foundation of a high performing organization. Much intense dispute has centered on the philosophical variances innate in these 3P approaches to compensation management and their perceived benefits (Barrett, 1991; Dierdorffand Surface, 2008; Gupta and Jenkins, 1991; Lawler, 1991; Mahoney, 1991; Shawet al., 2005), but few empirical studies have focused on comparing various compensation management policies and their outcomes (Guthrie, 2000; Murray and Gerhart, 1998; Shawet al., 2001). This report has attempted to explain the compensation management practices developed on the basis of 3 Ps, establish their direct or indirect influence on the level of employee performance, identify the factors critical to the development of integrated compensation policies, and offered remedies for a proper execution of these policies.

This study focused on the 3P approach to compensation management and discussed each of the Ps in detail along with critical factors and corrective measures. Practitioners can review this analysis while deciding the appropriate compensation management policy for their organizations. Furthermore, future studies can take inputs from this study while evaluating other approaches to compensation management.

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