Merit Pay: Increase or Hinder Performance?

Herman sofyandi[1], Rizal Ramdan Padmakusumah[2]

Abstracr: *Organizations or companies implement the merit system solely to improve the performance of its employees. This is because the reward system stimulates the motivation of work to improve their performance. Although merit pay is widely used by many organizations, in fact some businesses still question whether merit pay can improve employee and organizational performance. At present merit pay is still a contradiction. This article tries to understand the pros and cons of the implementation of merit pay as well as its positive and negative aspects. The final part of this article tries to understand how merit pay must be implemented by the Organization to make it more effective.*

Keywords*: Merit pay, improve, obstruct.*

I.   INTRODUCTION

Every organization designing a (reward) system is to motivate employees to improve their performance, as well as retain competent employees. By designing a good reward system at least a double impact to the organization, because on the one hand the rewards will impact on the cost of operation, on the other hand the reward will affect the behavior and attitude of employees ' work according to the Organization's wishes That employees can improve their performance. This can be understood because one of the objectives a person is working expects remuneration from the organization in which it works, while the company expects employees to deliver the best performance for the organization. Consequently, if the reward given to an employee is too high and does not reach the goal because the reward does not affect the employee's performance, it will be in vain. On the other hand, a reward that is too high will cost you an operation.

In order for this to happen, the management must trade off between the amount of reward for employees with the labor costs incurred by the Organization and ensure that the rewards paid can affect the performance of the employees (performance Based pay). Among others: Changes in job design, composition, and skills of labour increasingly complicate the performance assessment and accuracy of the performance assessment itself.

Performance based pay is one alternative to bridge the interests of both parties. Merit pay is a reward system associated with performance, because the higher the performance achieved by the employee, the higher the reward will be received. In fact, the merit pay system can not run in accordance with expectations, even many employees do not receive fully the existence of the reward system with merit pay, because there are still many shortcomings using the payment system.

Merit Pay Concept and Performance Assessment

The word merit means services, benefits, and achievements. As such, merit pay is a reward associated with the service or achievement of one's work and the benefits that have been given to the organization. Simply the concept of merit pay is a payment system that associates rewards with employee work performance. The implications of merit pay that someone has a good performance, it will earn higher rewards, and vice versa. That is, the higher the performance achieved by the employee, the higher the reward.

---

[1] *herman.sofyandi@widyatama.ac.id,*
Widyatama University

Merit pay Plan is a procedure to distinguish the salary based on performance, namely; Compensation system based on individual salary or salary measured over a certain period. For payment based on achievement or performance that is part of the regular payment system, the workers must be evaluated on a regular basis (performance appraisal). Employee performance assessment is an absolute requirement that management has to do for merit pay can be applied properly, because the common assumption in business that merit pay is rewarded to employees who have high performance, as well as granting Incentives for a continuation of good performance.

To know the performance of such employees high or low required a good assessment of the management. Because if the judgment system is not good, the implementation of merit pay will also not be effective. So, one of the key work of merit pay system will depend on how well the performance assessment system in the Organization (Brookes, 1993). It was proposed by Wilkerson (1995) that most of the performance assessments were not accepted because of weaknesses, namely:

1.   Staff workers, managers are tied to many systems, processes, and people. However, the focus of performance assessment is only in individuals, it generates an individual judgment rather than as a system in an organization.

2.   Performance appraisal considers the system in that organization consistent, and predictable. Whereas in reality the system and process is a subject that can change because consciously management should make changes according to its capabilities and demands of the business.

3.   Performance appraisal requires objective assessment process requirements, consistently trustworthy fair, but on the other hand the performance assessment will be visible to employees as a matter of sudden and based favoritism.

Schuler and Jackson (1999) advocated that before implementing a performance-based reward system had to make a thorough assessment of these questions. There are ten questions to answer before implementing the performance reward system, namely: (1) is the payment assessed by the employee. (2) Whether the goal will be achieved by the reward system based on performance. (3) Whether the organizational values are beneficial for the payment system performance. (4) Can performance be measured accurately. (5) How often performance is measured and evaluated. (6) What level of unity (individual, group, or organization) that will be used to distribute rewards. (7) How payment will be associated with performance (for example: through improved services, bonuses, commissions, or incentives). (8) Does the Organization have adequate financial resources to make payments based on meaningful performance. (9) What steps will be taken to ensure that employees and management are committed to the system. (10) and what stages will be taken to monitor and control the system.

In order for performance appraisal to be implemented with a good required method that meets the requirements below: (1) The measured is really accomplishment and not other factors, such as that of someone's personal concern. (2) Use a clear benchmark and that surely guarantees that the measurement is objective.) 3) understood, understood, and fully implemented by all members of the organization involved. (4) implemented consistently, and fully supported by the top leaders of the Organization (Ruky, 1996).

Implementation of Merit pay

The implementation of payment with Sstem merit pay is done with regular payment (one time) or increase in reward for high quality work. This payment can be a one-time bonus, an incremental extra (additional) or an additional percent of the regular wage (Pass, et. al., 1996).

Another aspect of merit pay has three key properties: This type emphasizes individual performance, the performance being rewarded is usually measured subjectively and this type gives a permanent increase, once the service increase is given, the basic salary Higher regardless of future performance. On the contrary, most payment methods for other performance are

scaled, namely; Payment given for a single performance event (performance may last a day, a week, a month, or during a project being worked on) and does not affect forever on the future salary. The next payment, determined by the amount of performance contributions. In this system the opportunity to get extra payments in subsequent performance episodes encourages employees to exert future efforts. Performance-based rewards refer to all performance methods that do not require a change in principal salary (Lawler and Jenkins, 1992).

Implementation of a performance-based reward system will have a positive impact for employees, as it can improve performance and work satisfaction. But in practice managers have many problems related to: **first**, the description and assess the performance of good employees, this is due to changes in the working properties of employees, the multidimensional nature of the work (Work is increasingly complex), the application of new technologies in the workplace and lack of training managers regarding good performance.

 Secondly, the difficulty in identifying reward that is valuable to the employee, because to identify the reward for employees need to be done in two stages, namely classify the type of reward both intrinsic and extrinsic. Intrinsic rewards have a dimension of occupational diversity, autonomy of employment, product identity, feedback on tasks, significance of the task. Dimension of time size, and time of reward should have significance. Adequate size in order to provide motivation as well as the faster reward given will be more meaningful. Thirdly, the difficulty in creating a less precise linkage or alignment between reward with performance, this relates to the failure to create a design alignment of rewards with employee performance. The creation of less precise alignment is that some employees, especially labour levels, do not want rewards that match the performance or manager's fault in understanding the Performance Assessment Report (*Performace Appraisal*).

To anticipate obstacles in implementing an effective reward system, management can clearly perform the description and performance measurements by creating performance dimensions, training and motivating managers to perform assessments Performance as well as identifying rewards that employees appreciate and creating linkages between performance in exchange for designing and implementing systems that truly reward the desired behaviour. If the obstacles in implementing the effective reward system can be overcome, so that any form of management decisions regarding compensation or rewards will have a double benefit for the organization.

Although the merit pay program is widely supported and its application is extensive, there is little evidence that its existence is effective. This is due to evaluate merit pay is quite difficult, because: (1) Required parameters of measurement of the actual merit pay practice, (2) necessary to obtain cross-level organizational performance data.

According to McGinty and Hanke (1992), problems faced management in the implementation of merit pay system include: (1) difficulties in defining and measuring individual performance, (2) Not exactly the assessment process relating to the merit pay system, (3) Trust gaps and management cooperation with employees, (4) merit pay is relatively insufficient for employees who use base pay, (5) skepticism of the employees where their payment is associated with the performance.

In addition to the application problems, to determine whether merit pay really reflects the level of performance, there are two things to note, namely: (1) The relative distribution of merit pay increases through the entire organization must differ significantly. Payment should reflect the difference in the reward level through the group of Job Variations, (2) in the Working Group of the payment distribution should differ significantly based on the relative performance.

Performance appraisal by supervisors should differ significantly between performance levels, as the assessment is the basis for determining merit pay. If every person in the department receives a payment that is equal to the same amount,

there is no correlation between the additional performance reward, because this is not the correct merit pay system (McGinty and Hanke, 1992).

Positive and negative side of Merit Pay

The question of whether merit pay really improves performance and contributes highly to productivity or not, most practitioners and academics agree that merit pay theory is a good idea (Brookes, 1993). Based on widely used views relating to expectancy theory, merit pay should allow organizations: (1) Encouraging an average level of individual work motivation, (2) enhancing individual-oriented outreach, (3) Maintain high assessments of high performance employees (Kopelmen, et.al., 1991).

Although the policy actually motivates the best employees is to have a clear and challenging goal, employees should feel that they are paid fairly for the achievement of the goal (Basset, 1994).

Research finds strong evidence that the use of rewards as a performance motivator has a level of unpostwar as the consistency of outcomes. Annual reward adjustments are based on the pay for performance policy of increasing rewards discrepancies, not consistently motivating high performance. Employees must associate businesses in return for a way to create hopes that his business should be appreciated for the increase in reward payments to be fair (Basset, 1994).

The main problem of the merit pay program is the sheer design, ineffective implementation, and systematic measurement methods associated with productivity (McGinty and Hanke, 1992). Therefore, this payment system, associating the performance achieved by an employee, with high performance will be the higher the reward increase that the organization provides to it.

Thus, payments with this system can be done if you have data on the performance of employees that have been achieved in the past. This is a disadvantage of merit pay because it only focuses on past performance without regard to future performance, when it is not always happening.

Surveys that have been conducted by McGinty and Hanke (1992), show that most workers do not see much to do between the rewards they receive with how well their work is. Most of the employees are treated alike, they are rewarded only based solely on the time spent on work.

Failure causes of *Merit Pay* Program

According to Wilkerson (1995), the merit pay system is now deemed unfair and has no relation to performance and only considers the renewal of rights to employees. Therefore, many merit pay programs are unsuccessful. The results showed that there are two things that are the cause of the work merit pay:

1. From the angle statistic the implementation of merit pay refers to the Bell-Shape Curve which is normal distribution. The implications of this form of distribution are that all employees have the same ability, so that employees ' work achievement is considered randomly and the business of Human resources department to improve performance is not beneficial. Such as employee selection system, training, education enhancement, and promotion or other. In fact, employee achievement is different according to the ability and experience of work. As a result, employees who have below-average performance are less then through training, as well as other performance enhancement efforts undertaken by the company. So should that be used is a distribution that is squeaked right, not on the basis of normal distribution form. This mistake would have implications on the management and created a dilemma for the supervisor to do three possibilities, namely: (1) to rank employees lower than the actual performance to conform to their budget, (2) Rate employees higher and should explain why the increase in rewards does not match the rankings, (3) raise the budget of merit.

2.   The difference of merit pay between high performance and the low is so small and no incentive value, and it is clear how one earns higher and lower rewards that can be obtained fairly, so for employees It is difficult to decide if the reward is actually associated with performance.

The opinion was supported by Filipowski (1991), although most employees were informed that his salary increase was based on work performance, but only a third believed it. This is due to many programs that are not systematically designed,

The Survey conducted by Don Eskew and Heneman (1996) aims to answer the basic questions for executives in making strategic decisions in line with the use of merit pay, namely: success of Merit pay plan, criteria used to measure Success and success of merit pay. Survey results show that merit pay plan is now seen as significant marginalized, while the previous survey shows moderate merit pay. So, during the period of 10 years between research now with the previous shows there is a decline in the impact of merit pay on employees ' performance. The success of merit pay here is measured in the form of improvement of employee attitudes and behavior, and success due to the performance assessment system has been improved and the success of merit pay program depends on the clarity of seeing the relationship between payments Performance, as well as seeing the fairness of procedures used. The results of this survey stated that merit pay program is still required, but there must be much narrower focus in the organization.

The merit pay Program should be used to support highly specific behavioral objectives (teamwork, customer service) and does not cover on issues that are more oriented towards the outcome of a reward program that emphasizes the completion of results, such as reduction Employee cost and productivity. Add again to the role that further restricts planning and strategic yarget in the total compensation program, the merit pay plan needs to be corrected to be more effective and can be applied to support the reward-giving strategies such as: Gainsharing, team-base pay and profit sharing.

If merit pay leads to the improvement of employee behaviour and attitudes, then it is not only the amount of reward increase that should be seen in its fairness, but also the procedure justice, because the procedure fairness is used to build perception About the procedures, as the current organizational practice shows. Research conducted by Lowery, Petty, and Thompson (1996) against 8000 employees, apparently 4788 respondents responded that the employee agreed to the concept of merit pay, but there was a problem in its implementation. Employees value opportunities assessed with merit pay, reward offers with the program as well as incentives to improve performance. Employees also pay attention to the quality of the purpose designed and the equality of justice or perception of pavoritism in the set of rewards.

In this research the company implements a new payment system that is given to employees with two basic payments based on performance. Prior to implementing a new reward program, the employee's performance was assessed by combining the combination of merit and seniority, which allowed employees to improve through the position classification basis and reward tiers in Annual adjustments. Bonus incentives have advantages compared to merit pay as it can better reflect the current performance (Lawler, 1990). The Bonus is not an annuity, because the payment of the consecutive year is a connection to the level of performance, as in the case of increased merit. The results of this research thoroughly support the concept of merit pay. The employee's response shows that employees believe the idea behind the merit pay program is very good, but the main problem lies in its implementation. So the organization can maintain the merit pay, the origin of the application must be directed to the satisfaction of the Keryawan so as not to cause failure. According to Simamora (1997), the factors that caused the failure to apply merit pay, are:

1.   The value of reward incentives offered is underlow. A person who earns merit of five percent of his income will only get a slight increase in salary after tax.

2.   The link between performance and reward is very weak. If the performance is calculated in yearly on a single measurement scale, the employees will remain unclear as to what the reward is awarded. Also, when the salary of Merit has a small or irrelevant impact to the performance of the desired behavior.

3.   Union contracts affect the salary decision of the decided performance within and between organizations. Many years of contracts created pressure on other level salaries and for employees of non-unions. Failure to match trade unions in the period of 3 – 4 years (especially in the high inflation period) will invite the disputes and turnover of employees.

4.   The issue of annuity problem because at the time of payment of merit is then put into the salary of the individual, payment form annuities (a sum of money received at regular intervals) and allow the previously productive individuals to be years and still get a high salary. Annuities also cause other problems, namely topping out. After a long period of time in a job, individuals often reach the top of the salary range of their work. As a result, salary no longer serves as a motivator because the salary no longer increases due to a performance.

Effectiveness of *Merit pay* system implementation

The most important question in implementing merit pay is that the program is suitable for anyone. Merit pay is only suitable for employees who have a high achievement attitude. Usually this system is more suitable for management of top level, such as director, Manager, or staff whose performance can be seen in a concrete view. In addition, the implementation of Merit pay program should change, as Wilkerson (1995) stated below.

Table 1.   *Plan System Design*

Change this element	From	To
Primary goal	Avoiding pay cost disadvantage	Competitive advantage
Organizational principle	Hierarchical control, stability	Fast, lean, employee, change
Level reinforced	Individual	Individual, team, buseiness unit
Role of market	Determinant of pay	Point of departure
Cost focus	Compensation pieces	Total pay cost organization total output cost
Who control?	Staff, corporate	Line, business units
Administration	Precise, complex	Sloppy, simple

Source: Wilkerson (1996)

Although a substantial performance-based system can substantially increase productivity, design, and poor implementation, it can suppress its potential effectiveness. For effective performance-based reward systems should relate to three key issues: determination and measurement of performance, reward determination must also get employee acceptance (Kohn, 1993). Therefore, all performance assessment issues should be aimed at systems that connect payments with very effective performance. If the performance measurement system concentrates on one component of performance, and incentives are given for different components, then the employee will be confused, and the managers will wonder why the incentives are unsuccessful.

For payment based on effective performance, according to Schuler and Jackson (1999) in designing the reward system required three conditions, namely: (1) Determining and measuring performance, (2) determining rewards (acknowledgment or money, amount of reward, Payment), (3) Get employee acceptance. Meanwhile, Simamora (1997) recommends that effective merit pay system can be done as follows:

1.   To create a high standard of performance, because low expectations tend to be the fulfillment of their own predictions and the pinnacle of achievement rarely results from moderate expectations.

2.   Develop an accurate performance assessment system and have focus on outcome-oriented and job-specific criteria.

3.   Training supervisors in work assessment mechanisms and in the art of giving feedback to subordinates, while ineffective performance should be managed constructively.

To associate closely with the performance and use of the semi-annual performance assessment to provide or reject the improvement of merit.

Using a wide increased merit range and making salary increases more meaningful.

According to Schuler and Jackson (1999) a performance-based reward program may be successful if: (1) The program is communicated clearly, understandably, the bonus is easily calculated; (2) Employees participate in establishing and executing programs, and they believe that they will be treated fairly; (3) Employees believe they can trust the company and the arena it feels safe in working; (4) Bonuses are given as soon as possible after the desired performance is visible.

On the other hand, Simamora (1997) proposed that managers need to consider the following issues along with *merit* salary:

Consult the provisions of the Union contract regarding who should be involved in the planning, implementation of *merit pays* system and complaints procedure.

Carry out a careful job analysis to capture work behaviour and the work that is used to assess performance. These analysis results with job holders and achieving consensus on the requirements of the work before proceeding further.

Create a salary range for each job class.

The middle point of a salary range is the basis for comparing employees in relation to their salary level. The salary level represents a proper salary level for an experienced employee who works satisfactorily.

Inexperienced employees of newly appointed tires are paid at the minimum point of the salary range. However, the job market adjustment may cause the initial salary level above the minimum point for a particular job.

Experienced workers entering a working class are normally paid one salary level consistent with their experience (for example, at the midpoint of a salary range).

Satisfactory employees may climb from their initial salary level to the midpoint of their salary range or *merit* basis.

Above average employees can increase above the average increase towards the middle and maximum points.

Superior employees may increase to the maximum point of the salary range.

The success factor in implementing merit pay according to McGinty and Hanke (1992) will depend on how far management is willing to make repairs from the program, such as: (1) If the issue of merit payment is a result of payment not seen As a performance binder, management should be able to convince employees through improved communication that they are paid based on their performance relative to others within the company. (2) If the amount of merit pay is deemed insufficient, it must be raised. (3) If the assessment system is not trustworthy (reliability and validity) the difference between high performance and low, assessment instrument must be formed, ranging from collecting job information through job analysis. To ensure that the merit pay system goes on, it should be audited on a regular basis.

So basically, the concept of *merit pay* although in theory is considered good, but in practice it needs the requirements that must be met in order to improve the performance of employees. There are three elements that have to be interconnected in order to implement effective *merit pay*, namely: management, performance appraisal, employee. Management should design the task properly, so that the performance assessment provides accurate and fair results and determines the magnitude of the reward that is appreciated by employees as a result of their performance, so that the implementation of merit pay Exactly meet

the standards desired both sides. Therefore, management must socialize it and communicate to employees so that they know what the organization wants and can participate in the implementation of *merit pay*.

II. CONCLUTION

Although merit pay has advantages for both parties, the implementation has constraints relating to accurate and fair performance assessments, as well as the determination of the magnitude of reward for the performance of employees. On the other hand, the employee is difficult to understand why the rewards they receive differ, especially if the performance is attributed because employees are easier to understand the difference in rank and seniority than the difference in performance. For the implementation of Merit pay effective, then it is proper management socialize the program to employees, so that merit Paycan be understood by all members.

III. Refferences:

[1] Basset, Glenn, 1994, Merit pay Increases Are A Mistake, Compensation Benefit Review, March- April.

[2] Budman, Matthew, 1997, Is There Merit in Merit pay? Across the Board, June.

[3] Brookes, Donald, 1993, Merit pay: Does it Help Or Hinder Productivity, Human Resource Focus, January.

[4] Deming, 1986, Out of the Crisis, Massachusetts Institut Of Technology Center for advanced Engineering Study, Cambridge, Mass.

[5] Don Eskew and Heneman, Robert, 1996, A Survey of Merit pay plan effectiveness: End of the Line for Merit pay or Hope for Improvement?Human Resource Planning, 19.

[6] Filipowski, 1991, Perspective: Is pay Linked to Performance? Personnel Journal, Mei.

[7] Kohn, A, 1993, Why Incentive Plans Cannot Work, Harvard Business Review, September- October.

[8] Kopelman, Richard.E., Janet.L.Rovenpor, and Mo Cayer,1991, Merit pay and Organizational Performance: is there an Effect on Bottom Line? National Productivity Review, 10,3

[9] Lawler. E.E., 1990, Strategic pay, San FransiscoJossey Bass.

[10] Lawler. E.E., and Jenkins, 1992, Strategic Reward System, Handbook of Industrial and Organizational Psychology, Vol.3, Consulting Psychology Press.

[11] Lowery, Christover.M., Petty M.M., and Thompson, James. M, 1996, Assesing The Merit Pay of Merit pay: Employee Reactions to Performance – based pay, Human Resource Planning, 19, 1.

[12] McGinty, Robert.L., and John Hanke, 1992, Compensation Management in Practise – Merit pay Plans: Are They Truly Tied to Performance? Compensation anf Benefits Management, 8, 4. Pass. C, et.al., 1997, Collins Kamus Lengkap Bisnis, Terjemahan Sumarso Santoso, edisi kedua, Penerbit Erlangga.

[13] Ruky, 1996, Sistem Merit Dalam Kenaikan Gaji: Apakah masih tepat untuk Perusahaan di Indonesia? Usahawan, No.07, Juli.

[14] Schuler, Randall S., and Jackson Susan. E., 1999, Manajemen Sumber Daya Manusia, alih Bahasa Abdul Rosyid dan Peter Remy Yosy Pasla, Penerbit Erlangga.

[15] Henry Simamora, 1995, Manajemen Sumber Daya Manusia, Yogyakarta, Penerbit STIE YKPN, edisi ke-1.

[16] Wilkerson, James. L., Merit pay – Performance Review: They Just Don't Work, Management Accounting, June.