

INTEGRATION OF PERFORMANCE AND COMPENSATION MANAGEMENT SYSTEM IN CPSEs IN INDIA

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Abstract A primary HR tool that is used to affect motivation and performance is compensation (Lawler, 1971). Recently, more emphasis has been on the use of variable compensation schemes, instead of fixed forms of pay in order to increase employee productivity and thus firm performance. As per the pay-scale of the 2nd Pay revision for the Central Public Sector Enterprises (CPSEs) in India, the CPSEs will now have variable pay along with the fixed pay as an integral component of compensation structure. Keeping the 2nd pay revision in mind, the paper tries to explore the prospects of a transparent and robust performance management system in place and as well as to study the concept of performance related pay and its implication with respect to CPSEs in India to establish a performance oriented work culture.

Keywords CPSEs, India, Compensation Management, Performance management System, Performance Related Pay

Central Public Sector Enterprises in India, so far have been following a system wherein almost entire compensation is guaranteed, irrespective of the performance of the company or the individual. In private sector, a significant component of compensation is variable. Variable compensation is used in the private sector to motivate and bring about desired behavioral changes in the employees and to reward those employees who have made significant contribution to the company's performance.

On 20th November 2008, the union cabinet gave its nod for the pay revision of the executives of CPSEs, which is to be implemented with effect from 1st Jan. 2007. The pay revision is based on the recommendations of the 2nd pay revision committee, submitted to the government of India. As per the recommendations of the 2nd Pay Commission review committee for the CPSEs in India, the committee had recommended variable pay along with the fixed pay as an integral component of compensation structure in CPSEs in India. What makes this revision different from the earlier revisions is the introduction of Performance Related Pay for the first time. The PRP would vary from 40% of the basic pay at the level of E0 to 200% of basic pay at the level of CMD.

Table I : PRP as a percentage of Pay

Grade	Percentage of Basic
E0 to E1	40
E2 to E3	40
E4 to E5	50
E6 to E7	60

E8 to E9	70
E10	100
Director(C & D)	100
Director (A & B)	150
CMD(C & D)	150
CMD(A & B)	200

The 2nd pay revision intends to change the current pattern of compensation and bring in the component of variable pay as part of the total compensation. Keeping the 2nd pay revision in mind, the paper tries to explore the prospects of a transparent and robust performance management system in place and as well as to study the concept of performance related pay and its implication with respect to CPSEs in India to establish a sustainable performance oriented work culture.

Implications for CPSEs in India.

Linking compensation with performance which is commonly referred as performance related pay is been followed worldwide in all sectors for attracting, motivating and retaining talent. One primary HR tool that is used to affect motivation and performance is compensation (Lawler, 1971). Recently, more emphasis has been on the use of variable compensation schemes, instead of fixed forms of pay (Greene, 2003; Marks, 2001) In order to increase employee productivity and thus firm performance. A distinct advantage is that variable pay costs "flex in sync" with revenues when the plan is well designed (Greene, 2003).

Performance related pay links the compensation of the employees to their performance and their contribution to

the organizational goals. Therefore, periodic performance reviews play a vital role and provide the basis of performance related pay. It is because of this reason that the committee is emphasizing on the development of a robust and transparent performance management system. With the introduction of PRP it is very important that the CPSEs in India should have a robust and transparent performance management system in place.

Pre-requisites for implementation of PRP

PRP in the case of CPSEs will be based on the physical and financial performance and will come out of the profits of the CPSE. 60 % of the PRP will be given with the ceiling of 3% of profit before tax (PBT) and 40% of the PRP will come from 10% of the incremental profit. The total PRP however will be limited to 5% of the year's PBT, which will be for both executives and non-unionized supervisors.

The most important pre-requisite is the signing of the MOU with the ministry under which the CPSE belongs. The MOU rating will form the basis of PRP with all the Key Results Areas (KRA) identified in the MOU. CPSEs which do not sign a MOU with the ministry will not be eligible for PRP. Enterprises achieving excellent MOU rating will be eligible for 100% PRP. Similarly enterprises achieving very good, good, and fair ratings are eligible for 80%, 60% and 40% respectively. Enterprise achieving poor rating will not be eligible for PRP irrespective of the profitability of the CPSE.

The next important pre-requisite as already mentioned is the development of a robust and transparent Performance management system to pay PRP. CPSEs would adopt "Bell Curve Approach" in grading executives so that not more than 10% to 15% executives are graded as "outstanding / excellent". Similarly, 10 % of the executive should also be graded as "Below Par".

Last but not the least, all the enterprises are also required to constitute a remuneration committee headed by an independent Director. Enterprise without independent directors on their board will not be eligible for PRP. Remuneration committee will decide the annual bonus/ variable pay pool policy for the executives and non-unionized supervisors, within the prescribed limits.

IMPLEMENTING PRP IN CPSEs: ISSUES AND CHALLENGES

Robust and transparent Performance Management System

According to Lockett (1992) "The essence of performance management is the development of the individuals with

competence and commitment working towards the achievement of shared and meaningful objectives within the organization, which supports and encourages the achievement." Performance Management is a process which is designed to improve the organization team and individual performance- it is shared/ participative process, an integrating process- based on agreements of accountability, measurement and review, feedbacks, development and improvements on continuous basis.

CPSEs have been following an obsolete system of performance appraisal in the form of annual confidential report. The concept of Performance Management System is not applied in most of the CPSEs. In order to implement PRP, the presence of a robust and transparent Performance Management System in place is a must.

Balanced Score Card as a suggested method of performance management

Performance management is a way of translating corporate goals into achievable objectives that cascade down through the organization to produce optimum results. In a PMS, training, appraisal, & rewards, are integrated & linked for the purpose of continuous organizational effectiveness. Thus, Performance Management is a process for establishing shared understanding about what is to be achieved, and an approach to managing and developing people in a way which increases the probability that it will be achieved in the short and long term.

The Pay revision has recommended BSC as a system of performance management that can be adopted by the CPSEs. CPSEs are in need of a system which will not just be a performance measurement tool but will serve as a strategic tool which can help them in maximizing performance and will help the CPSEs in maintaining results. In this regard it is felt that CPSEs like many private sector company in India and world should adopt the Balanced Scorecard. Balanced Scorecard has been implemented successfully in the public sector and non-profit organizations abroad so why not in the CPSEs in India. Definitely it would require proper planning and implementation. The BSC helps the organization to strike a balance between short, medium and long-term objectives. The BSC is a tested tool change processes.

The BSC is a tested tool change processes. The Balanced Scorecard (BSC) is a performance management tool which began as a concept for measuring whether the smaller-scale operational activities of a company are aligned with its larger-scale objectives in terms of vision and strategy.

The Balanced Scorecard (BSC) as a method of performance management was propounded by Robert S Kaplan & David P Norton in 1992. This strategic tool emphasizes on 4 aspects of performance indicates as represented below:

1. Financial Perspective: How do we look at shareholders?
2. Customer Perspective: How should we appear to our customer?
3. Internal Business process perspective: What must we excel at?
4. Learning & Growth perspective: Can we continue to improve & create wealth?

The financial indicator is referred as lagging indicator whereas the Customer Perspective, Internal Business process perspective and Learning & Growth perspective are referred as leading indicators. By focusing not only on financial outcomes but also customer perspective, learning and growth perspective, and Business perspective, the Balanced Scorecard helps provide a more comprehensive view of a business, which in turn helps organizations act in their best long-term interests.

GRADING OF EMPLOYEES ON THE BASIS OF PERFORMANCE:

Development of KRA and Bell curve:

The pay revision has recommended the grading of employees on the basis of individual's performance using a Bell Curve based on KRA (Key Result Areas). The bell curve follows the forced distribution principles. "Bell Curve" is the popular nomenclature for Normal Distribution also known as Gaussian distribution. It is popularly called as the bell curve because the graph of its probability density resembles a bell. It has evolved as an important tool to grade employees on the basis of their performance which is evaluated on the basis of their KPAs.

It is important to differentiate employees in terms of performance and grade them as excellent, very good, good, average and poor. The problem in organization is that managers tend to grade people too highly and this can make the process of grading and rewarding employees on the basis

of performance difficult to implement. One good way around the problem is to force a bell curve on your managers.

A standard bell curve distributes a small percentage (10 – 15%) at the top and bottom and the remainder in the middle. If an organization can use the bell curve concept to get their managers to focus on identifying the people at the top and the bottom it is a valuable tool.

While it is true that the average year-on-year increase in compensations are reported to be in the range of 14-15% in the executive cadres of private sector companies, it is also to be noted that these rises are directly linked to the performance standards of the personnel.

Notwithstanding the differences in the nomenclature used, all executives are reported to be ranked on a scale of 1-5 i.e. 'excellent', 'very good', and 'good', 'average' and 'poor'. Executives belonging to the 'average' and 'poor' are said to receive no increase in salaries. Executives categorized as 'good' and 'very good' are reported to receive increases ranging from 8-12% and 15-18% respectively. Executives ranked as 'excellent' are said to receive raise as much as 20-25%. It is also gathered that these rankings follow a deterministic profile like the 'excellent' category not crossing more than 5% while a minimum of 5% being ranked 'poor'. The category of 'good' employees is pegged at around 60% whereas the 'average' and 'very good' categories of employees constitute of 15% each.

The CPSEs in India also intend to follow a similar principle but in the case of CPSEs the PRP is linked to the following conditions:

- Profits of the company
- Grade of the executive
- MoU rating
- PAR of the executive
- Existence of remuneration committee in the company
- Of course, a robust and a transparent PMS.

STATUS OF PMS OF CPSEs:

Table II: PMS in select CPSEs (based on presentation by the company before DPE during April 2010.)

Name of the company	PMS Status	Salient features of the PMS
Coal India Ltd.	Executive Evaluation Report Proposes to implement the system of Balanced score card linked PMS by 2011-12	Balanced score card based PMS
NTPC	PMS in place from 2004-05	Five stage PMS system: 1. Performance planning 2. mid year review 3. annual assessment 4. normalization 5. feedback, coaching and counselling

SAIL	Executive Performance management system	On line 360 degree appraisal and feedback system
BHEL	Moving Ahead through performance (MAP)	Online system based on Balanced score card
HAL	Online PMS system	Online system based on Balanced score card
ONGC	Online PMS system	<ul style="list-style-type: none"> • Forced Distribution' using Bell Curve approach • Standard KRAs / KPIs derived from Job Descriptions
SCI	New PMS in progress being worked by ERNST & YOUNG	<ul style="list-style-type: none"> A. Scorecard / Key Responsibility Areas B. Professional Attributes Rating C. Suggested Development Plan D. Overall Rating E. Comments by Reporting, Reviewing & Accepting Officer
BPCL	Online PMS system	based on Balanced score card
HPCL	Online PMS system	based on Balanced score card

The table clearly reveals that the CPSEs are all geared up to implement the performance related pay in their organizations and hence are in the process of developing a transparent and robust PMS in place.

ISSUES RELATED TO IMPLEMENTATION OF PERFORMANCE RELATED PAY (PRP)

Revision of Pay Scales for Sick and Marginally Profit Making Companies

- The Sick Enterprises that are making cash profit may be allowed to implement the Pay Revision
- If the Pay revision is not made in time all the competent executives / employees are leaving the Enterprise. This will make the enterprise sick further and it will not be possible to revive the Enterprise.
- For Sick PSEs as recommended by the 2nd Pay revision committee, the revival package has to be decided with in a specific time period.
- Even if the Enterprise is closed the employees shall be offered VRS based on the revised Pay Scales
- Most of the Workmen draws pay much higher than senior level executives. Executives have reached stagnation and their Basic pay is much below that of workmen

Pay for Profit Making Units of Multi-Unit Companies

If pay revision is not implemented in the profit making units of such PSEs, there can be two things.

1. The officers who are performing in the profit making units will be let down as they are denied their pay because of somebody else's poor performance.
2. There will be brain drain from the profit making units and finally those left behind will be only average and

below average officers who may not be able to sustain the profitability.

Additional benefit should be extended to those Board level and non-Board level executives if they are able to turn around the loss units (even reduction of loss made should be considered as profit).

Other Issues Pertaining Implementation of PRP

There are lots of confusion pertaining to the implementation of PRP and grading using Bell curve

PRP being new concept and because the identification between performers and non performers brought a cultural shift for Officers leading to apprehensions & uncertainty among officers and associations.

Shift from the concept of Annual Confidential Report to Performance Appraisal system took lot of time to change the mindset of the people and to establish new concept of Performance Appraisal.

Officers and supervisors expressed their dissatisfaction for distribution of performance rating under Bell Curve as earlier all the officers in the same grade were treated for similar financial benefits.

At Senior Level due to pay stagnation, Cafeteria Allowances get stagnated.

There is further erosion of Cafeteria Allowances due to ever rising inflationary pressure.

To establish Direct and Visible linkage between target achievement and PRP.

SUGGESTIONS

In view of the high incidences of 'Stagnation' which is going to affect more & more executives at the higher echelons, the

tenure of the present pay revision should be limited to 5 years only.

To ensure that PRP does what it was meant to do – “reward executives for better performance”

As an immediate measure ‘P’ in the PRP formula, instead of considering only the Basic Pay, should be replaced by ‘Basic Pay + DA’ – this would at least take care of the erosion in the purchasing power (due to inflation) of the amount received, and,

To ensure that executives do not limit their efforts to achieve just over 10% increase in profits, but to aim for as higher a growth as is possible – whole of 5% of PBT should be distributed amongst the beneficiaries (the executives & the non-unionized supervisors).

CONCLUSION

It is obvious from the above chart that CPSEs are all reared up to implement a transparent and robust PMS based on which they can implement PRP per se in their organization as recommended in the 2nd pay revision. Rigorous performance management systems will be in position in most of the organizations and performance related pay forms a significant part of the executive’s compensation package. Annual raises of remuneration and career improvement opportunities are made available only to the performing cadres based on rational and transparent evaluation processes.

Designing performance related pay system is conditioned by a variety of factors: such as, nature of business, type of technology, the attitude of unions, and human resource strategy of organization. Therefore no standard model can be recommended. It has to be customized. It has been increasingly realized that performance related pay if used in isolation, may have little impact on motivation for performance. Appropriate conditions have to be created in the organization for performance related pay system to be motivationally effective.

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