



# **Asia-Pacific Economic Cooperation**

**APEC HRD03/07**

**Developing Key Performance Indicators and Productivity/Performance  
Benchmarks for Performance Based Remuneration Systems Report  
Kuala Lumpur, Malaysia**

**Human Resources Development Working Group (HRDWG)  
Labour and Social Protection Network  
Asia-Pacific Economic Cooperation**



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## **Executive Summary**

### **1.0 Performance Management Systems**

Performance Management Systems is increasingly being implemented to enhance productivity and competitiveness at the firm level. This is evident in the studies carried out among selected APEC economies of Australia, Korea, Malaysia and Chinese Taipei. This report documents the economic development, competitiveness, productivity and wages, performance management systems, performance based remunerations systems and case studies of companies who have implemented such systems. The impact, issues and challenges faced by organizations who have implemented performance based systems are well reflected.

#### **1.1 Developing Key Performance Indicators**

The performance management process consist of three main steps of defining the job and developing evaluation criteria, performance appraisal; providing evaluation feedback. There is also a need to determine specific measurable goals or key performance indicators. Key performance indicators (KPIs) are comprehensive, organization-wide goals established to gauge whether the targets had been established. KPIs have to be specific, measurable, acceptable, realistic and timely. The main objective is to manage, direct and measure performance to implement and realize corporate strategies.

#### **1.2 Linking Remunerations to Performance**

Performance-based remunerations schemes comprises of two components, a fixed component and variable component. Some of the schemes include: Long term incentives which are used to encourage executives to focus on business activities which can lead to improved organizational performance; Sales compensation plans which are intended to motivate and align goals with those that are of most benefit to the organization; Gainsharing plans which motivate employees to use their skills to boost company performance. Payouts are made

periodically in accordance with overall company performance improvements; and productivity linked wage system which links the payment of wages to enhanced productivity performance.

### **1.3 Practices among Selected APEC Economies**

The common features of performance based systems among the four selected APEC economies of Australia, Korea, Malaysia and Chinese Taipei includes the increasing emphasis by organizations on performance. Various performance monitoring systems such as the Balanced Scorecard, McKinsey Seven-S Model, Management by Objectives, Key Performance Indicators, Excellence Models and Productivity and Wage Systems are being increasingly implemented at the firm level. Among the benefits of such systems are enhanced performance as indicated in the various financial indicators as well as enhanced productivity and competitiveness.

### **1.4 Conclusion**

When designing an effective compensation plan, organizations need to take into account the overall package offered to employees. "Total Rewards" is a generic term used to describe such compensation and incentive packages and may include; pay, bonuses, incentives, core benefits, and recognition. The Total rewards package should comprise a fixed component that provides income stability and a variable component which reflects the contribution and performance of the employees. In this era of intense competition, performance based remunerations systems had been identified as an important initiative to be implemented at the organisation level to enhance productivity and competitiveness.

**I. Developing Key Performance Indicators and  
Productivity/Performance Benchmarks  
for Performance Based Remuneration Systems  
in Australia**

**By  
MS IRENE PAGE**

## 1.0 Australia's Economy

As of 2006, Australia's GDP amounts to \$ 743.7 billion. Inflation rate is at 3.9 % per annum. The country exports coal, iron ore, non-monetary gold, crude petroleum, and bovine meat with an estimated income of \$114 billion for the period of 2005-2006 alone, with major markets including Japan, China, Korea, and the U.S. Similarly, Australia imports passenger motor vehicles, crude petroleum, computers, medicaments, and telecommunications equipment from major suppliers such as China, U.S., Japan, Singapore, and Germany amounting to \$125 billion for 2005-2006.

Australia's advanced market economy is dominated by its services sector, (72% of the GDP) yet it is the agricultural and mining industries (8% of the GDP combined) that account for the bulk of its goods and service exports. The manufacturing sector has experienced continuous decline in production for several decades, but is now steady at 10% of the GDP. In the 1980's, the Australian Government have instituted significant structural reforms to transform Australia into an internationally competitive, export-oriented country. Key reforms include:

- a) Reduction of tariffs and other barriers;
- b) floating the Australian dollar exchange rate;
- c) deregulating the financial services sector;
- d) liberalizing access for foreign bank branches;
- e) restructuring the highly centralized system of industrial relations and labor bargaining;
- f) better integrating the state economies into a national federal system;
- g) improving and standardizing national infrastructure;
- h) privatizing government-owned services and public utilities; and
- i) reforming the taxation system, including the introduction of a broad-based Goods and Services Tax.



Australia is now in its 16<sup>th</sup> year of uninterrupted economic expansion and enjoys a higher standard of living better than any G7 country other than the U.S. The Australian Government has zero net debt, and through “Future Fund”, is building a net asset position to deal with future liabilities springing from an aging population.

Australia has completed Free Trade Agreements with Singapore and Thailand, and is currently pursuing similar Agreements with the U.S. (commenced January 1, 2005) and other Southeast Asian countries. Australia’s current economic standing is a result of a commitment to best-practice macroeconomic policy settings which include the delegation of the conduct of monetary policy to the independent Reserve Bank of Australia, and a broad acceptance of prudent fiscal policy where the government itself aims for fiscal balance over the economic cycle.

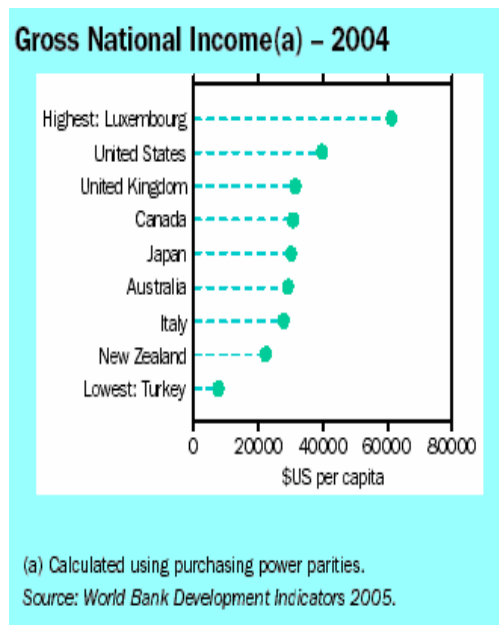
Aside from this, the country inculcates a Strong Ethical Framework – a nation free of corruption, where intellectual property rights are respected and protected, consumer and supplier protection is strengthened, and the environmental standards are high. Education played a key role in contributing to the economic prosperity and the social fabric of the nation. It rates as 6<sup>th</sup> in place in terms of its population’s educational attainment up to the secondary level following the Korea, Japan, Canada, US, and New Zealand.

## **1.1 Inflation**

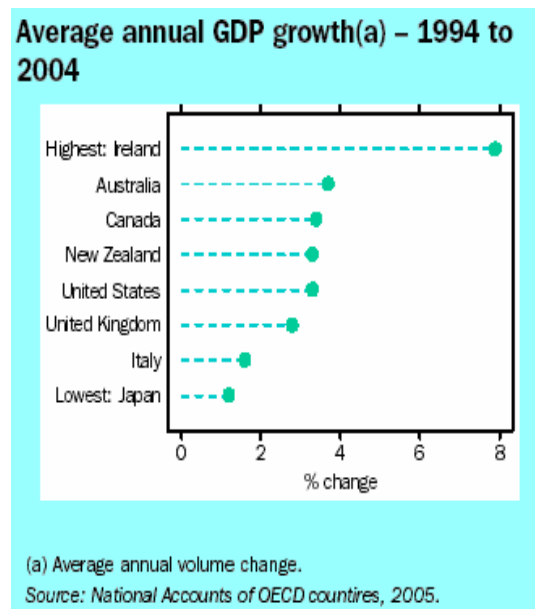
In terms of inflation, Australia has maintained a low trending since 1990s and this contributed to the improvement of its international competitiveness. Also, improvements in productivity and increased competition in goods and services markets are thought to have contributed to low inflations. Since inflation can have significant economic effects, the relative rates of inflation in Australia and overseas affect international competitiveness. A low and stable rate of inflation is

desirable for health and economy and for individual welfare. For Australia, trends from 1950 to 2005 have been clearly defined. Inflation was relatively low from the mid-1950s to the late 1960s. Then a sharp rise in inflation in the first half of 1970s was experienced as this was influenced by higher oil prices, wage growth and other factors. These inflationary pressures persisted until the 1980s, partly due to a second oil price shock. Although at relatively high levels, inflation was fairly stable during the 1980s. It began to slow down in the early 1990s. As of 2006, Australia's inflation rate is at 3.9% per annum.

**Diagram 1: Gross National Income Growth, 2004**



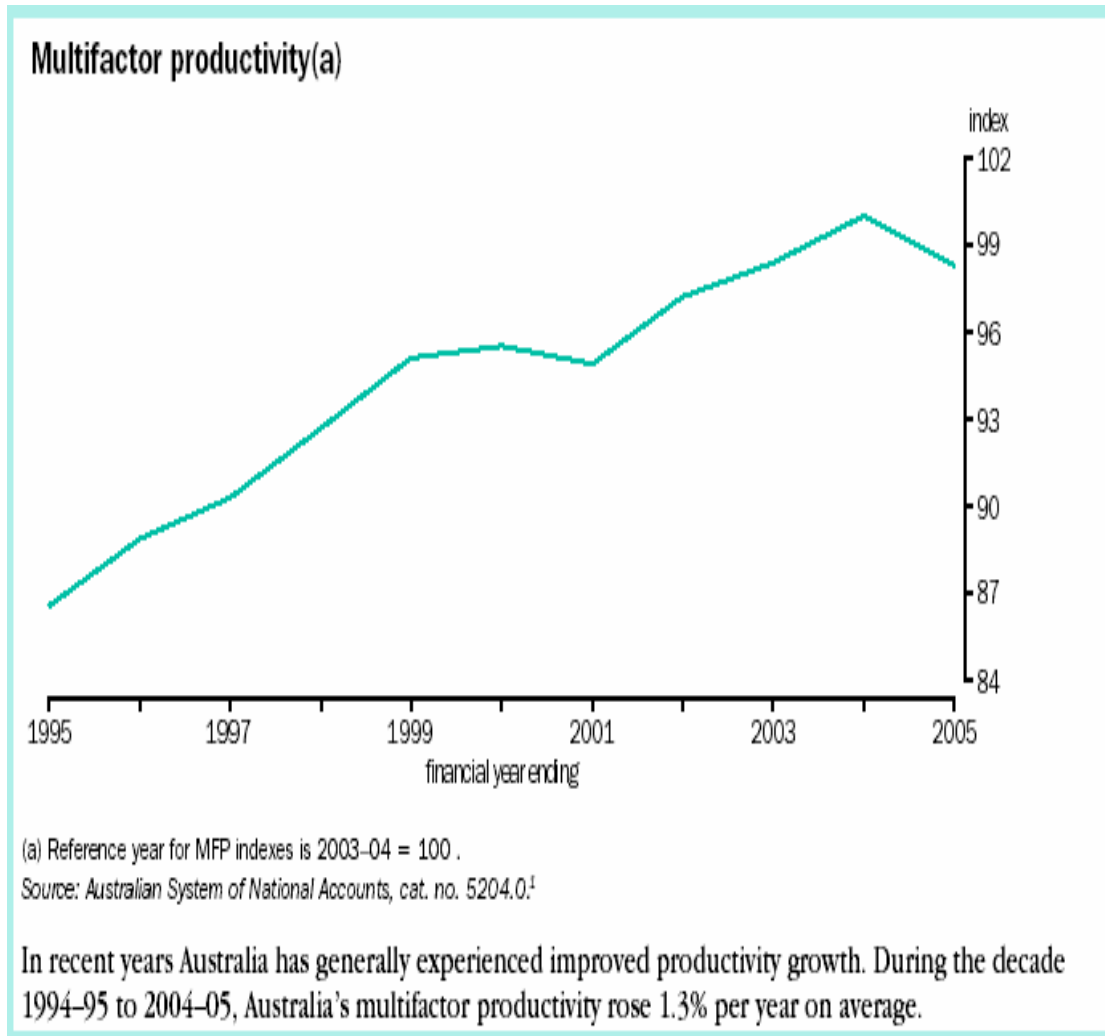
**Diagram 2: Average Annual GDP Growth, 1994 - 2004**



## 1.2 Productivity

In terms of productivity, over the past half-century, the country's productivity has been mostly between 75 and 85 percent of that of US.

**Diagram 3: Australia's Multifactor Productivity**



Economic reforms of the recent decades have helped Australia narrow the gap, which manifested itself as an increase in Australia's productivity growth rate. Below is a sample trending of the country's labor productivity for the period of 1994 to 1995 to 2004 to 2005.

**Diagram 4: Australia's Labour Productivity**

<b>Labour productivity(a), average annual growth rate – 1994–95 to 2004–2005</b>	
<b>Industry(b)</b>	<b>%</b>
Agriculture, forestry and fishing	6.2
Mining	0.9
Manufacturing	3.0
Electricity, gas and water supply	1.3
Construction	1.6
Wholesale trade	4.2
Retail trade	2.4
Accommodation, cafes and restaurants	1.6
Transport and storage	2.8
Communication services	4.4
Finance and insurance	2.4
Health and community services	1.1
Cultural and recreational services	1.6
<b>All market sector industries</b>	<b>2.1</b>

(a) Gross product per hour worked. (b) Estimates are not available for Property and business services, Government administration and defence, Education, and Personal and other services.  
*Source: Australian System of National Accounts.<sup>1</sup>*

### **1.3 GDP and Gross National Income (GNI)**

In the period of 1994 to 2004, annual average growth in GDP was at 3.7%, the 7<sup>th</sup> highest of OECD countries. From this period also, it rates 2<sup>nd</sup> to Ireland in terms of annual growth in volume change. GDP can be defined in three ways, the sum of labour incomes, net profits, and depreciation; the difference between the gross outputs and intermediate consumptions; and the sum of consumption expenditures, fixed capitals formation, changes in inventories, and net exports.

As of 2004, it rates 6<sup>th</sup> in Gross National Income, following Luxembourg, US, UK, Canada and Japan. GNI measures the total domestic and foreign value added claimed by residents. Growth in Financial Consumption per capita as of 2004 to 2005 rose by 2.6% a year. FCE is the acquisition of goods and services used for direct satisfaction of individual and collective wants. Over the past decade, growth in final consumption per capita has been quite strong, as illustrated in the table below.

**Table 1: Real Household Final Consumption per capita**

<b>Real household final consumption(a) per capita</b>			
	1994–95	2004–05	Average annual growth rate
	\$	\$	%
Food	2 549	2 784	0.9
Alcoholic beverages and tobacco	975	1 007	0.3
Clothing and footwear	786	995	2.4
Rent and other dwelling services	3 532	4 388	2.2
Electricity, gas and other fuel	404	514	2.4
Furnishings and household equipment	1 009	1 470	3.8
Health	1 082	1 289	1.8
Transport	2 198	2 989	3.1
Communication	319	734	8.7
Recreation and culture	1 919	3 079	4.8
Education services	682	847	2.2
Hotels, cafes and restaurants	1 554	1 900	2.0
Miscellaneous goods and services	2 531	3 449	3.1
<b>Total</b>	<b>19 376</b>	<b>25 447</b>	<b>2.8</b>

(a) Volume measures; reference year 2003–04. Components may not sum to totals.

Source: Australian System of National Accounts.<sup>1</sup>

## **2.0 Conditions of Work**

Unemployment rate has continued to decline in Australia. The average annual unemployment rate in 2005 is 5.1% and currently, is at its low at 4.6%.

### **2.1 Award (Wage) Conditions**

An award is an order of an industrial relations tribunal that sets out minimum conditions of employment. The following below are its types:

**Federal awards** – handled by the Australian Industrial Relations Commission; apply all throughout Australia.

**State awards** – handled by state industrial tribunals in the states of New South Wales, Queensland, South Australia, Western Australia and Tasmania; apply only to respective states.

\*In Victoria, the Australian Capital Territory and the Northern Territory, only federal awards apply.

Under the Work Choices legislation, all federal and state awards are to be combined into a national system designed to cover constitutional corporations, thus, for a time, awards will be duplicated, awarding both constitutional corporations and non-constitutional corporations and their employees.

## **2.2 The Work Choices Act**

The Australian Government has committed to ensure that high productivity, increasing real wages, choice and flexibility remain the central focus of the workplace relations reform program. Although reforms continue as an enduring task, the complexity of the system must be addressed to increase its accessibility and effectivity.

Since May 26, 2005, the Australian Government has committed to:

- a) establishing the Australian Fair Pay Commission (to protect minimum and award classification wages);

The AFPC has been established to set minimum wage rates and wage rates contained within awards, as well as set and periodically adjust a single adult minimum wage, non-adult minimum wages, and minimum wages for award classification levels and casual loadings. Minimum and award classification wages will be protected at the level set after the inclusion of any increase mentioned in the 2005 Safety Net Increase (See Working Conditions, Fair Award Safety Net).

Though the AFPC can raise wages upward (guided by parameters set in legislation), they will not be authorized to lower such.

- b) enshrining minimum conditions in legislation

The Government has set out in legislation the key minimum conditions for employment: i) annual leave; ii) personal/carer's leave; iii) parental leave; and iv) maximum hours of work.



- c) introducing the Australian Fair Pay and Conditions Standard (to protect workers in the bargaining process)

The legislated minimum conditions of work, together with the minimum wages established by the AFPC form the Australian Fair Pay and Conditions Standard.

This will serve as a basis for employers and employees for their respective agreements' comparison.

- d) simplifying the agreement-making process in the workplace

The introduction of workplace agreements has provided workers and businesses with greater flexibility in negotiating working conditions and helped ensure that wage rises are underpinned by productivity improvements. Previously, every Australian Workplace Agreement (AWA) was handled by Australian Industrial Relations Commission, then assessed by the Office of the Employment Advocate (OEA) before approval, creating uncertainty for the parties involved in the said agreements.

A streamlined, simpler, less costly agreement making process has now been introduced. All collective and individual agreements will still be directed to the OEA, however, the process has been simplified. If approved, all agreements will take effect on the date of lodgement rather than the date of certification or approval, to reduce delays and uncertainty. The maximum duration of new agreements will now cover 5 years (except greenfields arrangements with a maximum of 12 months).

- e) providing modern award protection for those not covered by agreements

The Award Review Taskforce is now responsible for rationalizing existing awards and award classification structures. The Government will continue to ensure the award system is reviewed so it maintains relevance in a modern system.

- f) ensuring that the Australian Industrial Relations Commission has an ongoing role

The Australian Industrial Relations Commission's role has changed into a commission concerned with dispute resolution and further award simplification.

- g) balancing the unfair dismissal laws

The Australian Government will exempt businesses that employ up to 100 employees from unfair dismissal laws, so as to generate jobs in the small to medium businesses. It will also continue to have provisions for unlawful termination on the basis of discrimination, union membership and so on (see Conditions of Work, Unlawful Termination).

For businesses with over 100 employees, those covered must have a minimum of six months of employment before they can pursue an unfair dismissal remedy (see Working Conditions, Unlawful Termination).

- h) introducing a national system of workplace relations

From having six different workplace relations systems, the Government is working toward establishing a national workplace relations system that is projected to cover 85% of Australian workers.

However, the reforms will not:

- cut minimum and award classification wages
- abolish awards
- remove the right to join a union
- take away the right to a strike
- outlaw union agreements
- abolish the AIRC.

### 3.0 Measures of Australia's Progress

Based on ABS Report 2006, there are three key principles to considering progress:

1. Progress (in its broadest sense) is life getting better.
2. Progress is multi-dimensional, and measuring each dimension is necessary.
3. Assessments of whether Australia is on balance progressing and at what rate depends on the personal evaluations placed on the relative importance of progress in each dimension.

In the development of MAP, the dimensions of progress are:

**Table 2: Australia's Dimensions of Progress 1**

<b>Economic Progress</b>	enhancing the nation's income while maintaining or enhancing (if possible) national wealth
<b>Environmental Progress</b>	Reducing of threats to the environment and improvements to the health of Australian ecosystems
<b>Societal Progress</b>	increases in the well-being of the population, a reduction of threats to and increases in social cohesion, protection and enhancement of democratic rights

Another way of clustering such dimensions (as to be discussed in this report) is through the following as in Table 3:

**Table 3: Australia’s Dimensions of Progress 2**

	Headline Dimensions	Supplementary Dimensions
<b>Individuals</b>	Health, Education and training, Work	Culture and leisure
<b>Economy and Economic resources</b>	National income; Economic hardship; National wealth; Housing; Productivity	Competitiveness and openness; Inflation
<b>Environment</b>	The natural landscape; The air and atmosphere; Oceans and estuaries	
<b>Living together</b>	Family, community and social cohesion; Crime; Democracy, governance and citizenship	Communication; Transport

Most, if not all of these dimensions are linked.

### **3.1 Progress to Individuals**

#### **3.1.1 Health**

Low Socioeconomic Status (SES) and a lack of education bring about poor health and vice versa. Australians are healthier than they were a decade ago; life expectancy has increased by 2-3 years.

### **3.1.2 Education and training**

Higher Education supports economic development, specialized skills increase levels of productivity and extend the range and quality of goods and services, improves the capability to address wider range of health and welfare issues, and also improves outcomes in employment (Increased qualifications, more career growth opportunities). The percentage of Australians aged 25-26 with vocational or higher education has grown in the past decade.

### **3.1.3 Work**

Increased Unemployment is associated with higher levels of crime and poorer health, produces higher risk of financial hardship, is a lost opportunity for producing goods and services, and lowers levels of social cohesion. Economic growth is observed to be very strongly influenced by changes in labor force participation.

Australia's unemployment rate has continued to decline since the 1990's. The average unemployment rate in 2005 was 5.1% of the population. It is now at an all-time low of 4.6%.

## **3.2 Progress to the Economy and Economic Resources**

### **3.2.1 National Income**

National Income is equated to the capacity to acquire goods and services for consumption. It is also a determinant of material living standards. A strong influence to national income is the production of goods and services. Production increases if the factors of production –capital, labor, and non-produced assets are built up (savings) or used (consumption) more efficiently.

Final consumption expenditure (FCE) is a measure of consumption most relevant to progress. It is the acquisition of goods and services for the direct satisfaction of individual or collective wants. Growth in FCE per capita in the past decade has been strong. This is indicative of the improvement in Australian spending power, directed to especially Communication expenses(8.7% annual average FCE growth per capita), as well as Recreation and Culture(4.8%) .

Increased income produces improvements in health and education (and vice versa). However, more income-generating activity increases environmental degradation, and consequently, more funds are allocated to restoration. The income dimension is strongly linked to work. Income growth may result from longer working hours and reduced leisure.

Australia's average annual GDP growth from 1994-2004 is around 3.7%, second only to Ireland (7.9%) among OECD countries. Australia's income growth (3.0% growth of real net national disposable income per capita) between 1994-95 and 2004-05 may be associated with the growth of the Australian workforce during the said time period; which is an observable difference from the preceding 20 years. However, when compared to other OECD countries, Australia's GNI is only around the median (\$29,200).

### **3.2.2 Economic hardship (standards of living)**

Low material standards of living are associated with problems such as lack of participation in work, substance abuse, poor health, poor education, poor housing, crime, social exclusion, and; lack of opportunity for children. As mentioned above, income is a determinant of material living standards. Over the period 1994-95 to 2003-04, the real income of low to middle income (22%) and middle income groups grew. This sets high standards of living that increase the quality, not only of day-to-day life, but also, of the goods and services provided by the country.

### **3.2.3 National wealth**

National wealth refers to the net worth (or the equivalised assets less the liabilities) of a country. The most relevant measure is the real national net worth per capita of a country, which is the amount by which a nation's net worth is compared to the rest of the world. An increase in national wealth signals an increase in buildings and infrastructure used to deliver health, education and other services. Between 1995 and 2005 real net worth per capita increased by 0.9% per year on average.

Machinery, buildings and other fixed assets are inputs to the production of goods and services, otherwise known as capital stock that produce capital services. An increase in capital stock leads to an increase in capital services per unit of labor output, which contributes to and increases of labor productivity. In both June 1995 and 2005, Australia's fixed assets contributed to 47% of the total value of its assets. Throughout this time period, Australia's net capital stock grew on the average of 2.0% per annum on a per capita basis.

### **3.2.4 Productivity**

Productivity is the ratio of the volume of outputs (goods and services produced) to the volume of inputs (labor and capital). Growth in productivity means more output from inputs rather than the absence of such. Much of Australia's output growth results from increases in input, thus, the most comprehensive Australian measure of productivity is the Multifactor Productivity growth (the growth in output that cannot be explained by additional input).

National productivity may improve with a shift of labor, capital and other inputs to other firms or industries that are more productive. Such changes may be

prompted or assisted by a change in the overall economic environment (such as increased levels of domestic cooperation, reduced barriers to resource allocation and greater openness to the international marketplace. It can also improve with the introduction of new technology and its applications (knowledge and innovation).

At the level of the individual firm or industry, key influences to productivity growth include technological advances and improvements to the quality of labor, or to management practices and work arrangements. During a period of productivity growth, it is possible to raise real wages and other income without inflationary pressures. Also, businesses or industries with higher rates of productivity growth enhance their competitiveness. Over the past decades, successive Australian governments have enacted reforms that have sought to create an economic environment favorable to increased competition, better allocation of resources, and more innovation.

### **3.3 Competitiveness and Openness**

International competitiveness affects international trade, and thus, influences national production, employment and income. A fall in competitiveness indicates difficulty for products and services to find buyers abroad. A country's competitiveness can be measured in terms of: a) changes in domestic prices relative to prices in competitor countries; and b) exchange rate movements.

Three factors have an important influence to international competitiveness:

- a) Movements in wages compared to other countries;
- b) Movements in labor productivity relative to other countries;
- c) Changes in the exchange rate relative to other country's currencies.



Australia's international competitiveness has been observed to fluctuate in the past decade, however, decreases in unit labor costs likely resulted in increases in competitiveness in 2004-05. Openness is the interaction of an economy to other economies. Increased openness indicates a wide range of goods and services patronized and preferred by consumers. On the other hand, openness results in access to new innovative technologies that may improve productivity. The government<sup>1</sup> has passed reforms regarding openness to other economies, with key reforms focusing on tariff reductions and more provisions for international investors.

### 3.3.1 Australia's Competitiveness Ranking : World Competitiveness Yearbook, Institute of Management Development, Switzerland

**Table 4 : Competitiveness Ranking**

<b>Domestic Economy</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
<b>Overall Competitiveness (ranks)</b> Total number of countries 51 in 2003, 51 in 2004, 51 in 2005, 53 in 2006, 55 in 2007	(7)	(4)	(9)	(6)	(12)
<b>GDP (PPP)</b> Estimates; US\$ billions at purchasing power parity	(16) 574.53	(16) 609.38	(16) 646.34	(16) 663.34	
<b>GDP per capita</b> US\$ per capita	(22) 26,409.06	(22) 31,779.25	(19) 34,960.66	(15) 36,677.16	

<sup>1</sup> World Competitiveness Yearbook, Institute of Management Development (IMD), various issues

<b>GDP (PPP) per capita</b>					
Estimates; US\$ per capita at purchasing power parity	(14)	(13)	(17)	(16)	
	28,911.74	30,331.05	31,777.25	32,201.87	
<b>Real GDP Growth</b>					
Percentage change, based on national currency in constant prices		(37)	(43)	(47)	
		3.6	2.6	2.7	
<b>Real GDP Growth per capita</b>					
Percentage change, based on national currency in constant prices		(47)	(47)	(52)	
		1.73	1.4	1.08	
<b>Overall productivity (PPP)</b>					
Estimates: GDP (PPP) per person employed, US\$	(15)	(15)	(22)	(17)	
	60,737.49	63,238.09	64,910.81	65,342.71	
<b>Overall productivity</b>		(23)	(23)	(22)	(17)
GDP per person employed, US\$		55,476.89	66,257.47	71,413.51	74,423.80
<b>Productivity in industry (PPP)</b>					
Estimates: Related GDP (PPP) per person employed in industry, US\$		(9)	(8)	(13)	(14)
		71,563.26	72,425.24	74,482.99	74,241.36
<b>Productivity in services (PPP)</b>					
Estimates: Related GDP (PPP) per person employed in services, US\$		(23)	(19)	(23)	(20)
		58,560.90	61,263.96	62,688.30	63,529.53

**Table 5 : Employment Ranking**

	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
<b>Employment</b>					
Total number of countries 51 in 2003, 51 in 2004, 51 in 2005, 53 in 2006, 55 in 2007					
<b>Employment</b>	(29)	(29)	(27)	(26)	
Total employment in millions	9.46	9.64	9.96	10.15	
<b>Employment</b>	(17)	(15)	(13)	(14)	
Percentage of population	47.60	47.96	48.96	49.28	
<b>Employment – growth</b>	(3)	(3)	(21)	(21)	
Estimates: percentage change	3.52)	3.52	2.21	2.31	
<b>Employment by sector/Agriculture</b>					
Percentage of total employment	4.46	3.95	3.79	3.66	
<b>Employment by sector/Industry</b>					
Percentage of total employment	21.17	21.46	21.39		
<b>Employment by sector/Services</b>					
Percentage of total employment	74.88	74.75	74.95		
<b>Employment in the public sector</b>					
Percentage of total employment	15.9	(27) 15.4	(20) 14.8		
<b>Unemployment rate</b>	(23)	(21)	(19)	(19)	
<b>Percentage of labor force</b>	6.05	5.53	5.10	4.98	
<b>Unemployment legislation</b>					
Unemployment legislation provides an incentive to look for work	5.77	(21) 5.58	(25) 5.11	(8) 5.98	(8) 6.13

<b>Youth unemployment</b>					
Percentage of youth labor force (under the age of 25)	(19) 12.21	(17) 11.60	(15) 10.81	(13) 10.29	
<b>Part-time employment</b>	(3)	(3)	(3)	(3)	
Percentage of total employment	27.91	27.91	27.10	27.30	

**Table 6 : Labour Market Ranking**

<b>Labor market</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
<b>Labor Market(ranks)</b> Total number of countries 51 in 2003, 51 in 2004, 51 in 2005, 53 in 2006, 55 in 2007	10	13	14	11	16
<b>Labor regulations</b> Labor regulations (hiring/firing practices, minimum wages, etc.) do not hinder business activities (IMD WCY Executive Opinion Survey based on an index from 0 to 10)	5.40	(24) 5.01	(31) 4.20	(18) 5.98	(10) 6.96
<b>Labor relations</b> Labor relations are generally productive (IMD WCY Executive Opinion Survey based on an index from 0 to 10)		(23) 7.19	(22) 6.98	(18) 7.15	(6) 7.85
<b>Labor productivity (PPP)</b> Estimates: GDP (PPP) per person employed per hour, US\$	(22) 34.57	(17) 35.99	(21) 36.94	(15) 36.91	
<b>Unit labor costs in the manufacturing sector</b> Percentage change	3.40	(44) 3.29	(49) 4.96	(32) 2.8	
<b>Labor force</b>	(29)	(28)	(28)	(26)	

Employed and registered unemployed millions	10.09	10.24	10.52	10.71	
<b>Labor force</b>	(16)	(19)	(15)	(14)	
Percentage of population	50.79	50.99	51.74	52.00	
<b>Labor force growth</b>	(22)	(25)	(5)	(17)	
Percentage change	1.87	1.50	2.73	1.81	
<b>Female labor force</b>	(28)	(29)	(24)	(26)	
Percentage of total labor force	44.72	44.64	44.95	45.04	
<b>Foreign labor force</b>	(3)	(3)	(3)		
Percentage of total labor force	24.64	24.64	24.64		
<b>Skilled labor</b>					
Skilled labor is readily available (IMD WCY Executive Opinion Survey based on an index from 0 to 10)	(28) 7.39	(28) 6.83	(40) 5.64	(34) 5.63	(43) 4.44
<b>Finance skills</b>					
Finance skills are readily available (IMD WCY Executive Opinion Survey based on an index from 0 to 10)	(8) 8.00	(4) 8.37	(17) 7.54	(18) 7.44	(19) 6.84
<b>Brain drain</b>					
Brain drain (well-educated and skilled people) does not hinder competitiveness in your economy (IMD WCY Executive Opinion Survey based on an index from 0 to 10)	(27) 5.89	(29) 5.95	(29) 5.64	(23) 6.10	(29) 5.32
<b>Working hours</b>					
Average number of working hours per year	(13) 2,152.00	(13) 2,152.00	(13) 2,152.00	(13) 2,130.19	
<b>Compensation levels</b>					
Estimates: Total hourly compensation for manufacturing workers (wages + supplementary benefits), US\$	(43) 15.39	(43) 19.66	(44) 24.87	(39) 24.60	

**Table 7 : Remunerations Ranking**

<b>Remunerations</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
<b>Remuneration in services professions/Bank credit officer</b> Gross annual income including supplements such as bonuses, in US\$	(34) 19,600.00			(37) 37,500.00	
<b>Remuneration in services professions/ Primary school teacher</b> Gross annual income including supplements such as bonuses, in US\$	(34) 24,300.00			(37) 38,000.00	
<b>Remuneration in services professions/Personal assistant</b> Gross annual income including supplements such as bonuses, in US\$	(34) 18,900.00			(37) 29,500.00	
<b>Remuneration in services professions/Department Head</b> Gross annual income including supplements such as bonuses, in US\$				(37) 26,800.00	
<b>Remuneration of management/CEO</b> Gross annual income including supplements such as bonuses, in US\$	(23) 178,313.09	(24) 209,082.14	(28) 290,336.47	(28) 336,993.97	
<b>Remuneration of management/</b>	(23)	(24)	(28)	(28)	

<b>Engineer</b> Gross annual income including supplements such as bonuses, in US\$	68,846.22	81,835.37	87,243.48	89,233.31	
<b>Remuneration of management /Human resources director</b> Gross annual income including supplements such as bonuses, in US\$	(23) 101,477.25	(24) 120,853.06	(28) 131,341.17	(28) 137,128.55	

**Table 8 : Business Efficiency Ranking**

<b>Business Efficiency</b> IMD WCY Executive Opinion Survey based on an index from 0 to 10	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
<b>Foreign high-skilled people</b> Foreign high-skilled people are attracted to your country's business environment	(10) 7.19	(11) 6.59	(9) 7.27	(6) 7.87
<b>Competent senior managers</b> Competent senior managers are readily available	(17) 7.22	(20) 6.30	(20) 6.54	(22) 5.97
<b>Large corporations</b> Large corporations are efficient by international standards		(13) 7.77	(15) 7.68	(16) 7.54
<b>Small and medium-size enterprises</b> Small and medium-size enterprises are efficient by international standards		(9) 7.44	(14) 7.14	(13) 7.18
<b>Attitudes toward globalization</b> Attitudes toward globalization are generally positive in your society	(16) 6.89	(8) 7.28	(11) 7.07	(13) 6.94

<b>Ethical Practices</b>				
Ethical practices are implemented in companies	(4) 7.92	(2) 8.23	(8) 7.61	(3) 8.00

### 3.3.2 Australia's Competitiveness Ranking: The Global Competitiveness Report 2006-2007

<b>Indicators on Wages and Labour Relations</b>	<b>Rank (125 countries)</b>	<b>Score</b>
<b>Flexibility of Wage determination</b> Wages are (1 = set by a centralized bargaining process, 7 = up to each individual company)	95	4.6
<b>Cooperation in Labor-employer relation</b> Labor-employer relations are (1=generally confrontational, 7 = generally cooperative)	50	4.8
<b>Pay and Productivity</b> Pay is (1=not related to worker productivity, 7 = strongly related to worker productivity)	30	4.6
<b>Extent of Incentive Compensation</b> Cash Compensation of Management (1=is based exclusively on salary,7 = includes bonuses and stock options, representing a significant portion of overall compensation)	10	5.5



## **4.0 Improving Business Management Processes to Enhance Performance Practices in Australia**

This report covers the different processes that are implemented in enhancing performance practices in Australia;

1. Business Excellence Models
2. Business Management System
3. The Balance Scorecard

### **4.1 Business Excellence Models**

Business excellence models are frameworks to guide organizations towards achieving success in various forms across the world. The GEM Council Members represent a group of organizations who have created an Excellence Model that meets the business and cultural needs of their country. The Australian Business Excellence Framework describes the principles and practices of high performing organizations and contains collective intellectual capital and business wisdom gathered over 15 years. The Framework has been designed to assist organizations to measure current performance and build a pathway to long-term success. Leading Australian and Australian-based organizations use the Framework to: improve management and leadership practices, assess the performance of their leadership and management systems, build those results into strategic planning processes, and benchmark where their organization stands in terms of the marketplace and competitors.

The Framework was developed in 1987 and was one of the first four global excellence frameworks. It was initially developed in response to Commonwealth Government and general industry calls for Australian enterprises to be more efficient and competitive. The Framework is reviewed and updated annually by a Committee formed of management and leadership experts to reflect the latest in

management thinking and practice. The Framework was developed with the objective of describing the principles and practices that create high performing organizations. The criteria could then be used by organizations to assess their performance and drive continuous and sustainable improvement in their leadership and management systems. The Framework is also used as the assessment criteria for the Australian Business Excellence Awards. Through the Awards, organizations can be recognized for their achievements in excellence and improvement.

## **4.2 Business Management System**

In today's complex and globally competitive business environment, organization objectives such as growth and profitability have been joined by a new imperative - risk management. Organizations are now choosing to operate within a comprehensive risk management framework that protects profit margins and other critical stakeholder interests. Many organizations have found success in achieving this outcome by implementing an integrated management approach through a Business Management System, which is recognized worldwide as ISO 9001, the Quality Management System standard.

A research project conducted by Monash University's Australian Supply Chain Management Research Unit confirms that the ISO 9000 quality management system continues to have a positive impact on the performance of Australian organizations. Currently, there are over 35,000 organizations with JAS-ANZ accredited certificates for ISO 9001 in Australia, New Zealand, and internationally.

The ISO 9001 is the best-known Business Management Standard since its approach offers a comprehensive framework on which to build processes that help ensure key business objectives are achieved. ISO 9001 has received widespread international recognition as almost one million certificates worldwide

have been issued. ISO 9001 compliant business management systems have been adopted across all industry types, from manufacturing through to professional service organizations. This level of recognition and acceptance is a reflection of the flexibility and proven practical value it offers a variety of businesses.

### **4.3 The Balance Scorecard**

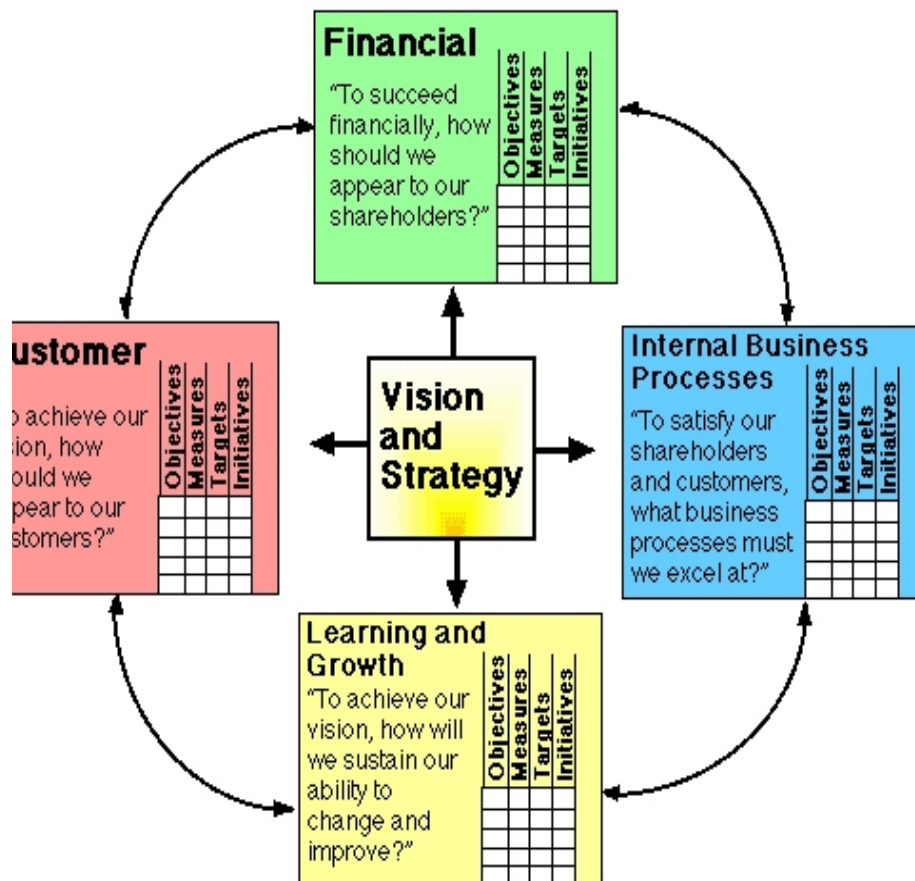
In 1992, Robert S. Kaplan and David Norton introduced the balanced scorecard, a concept for measuring a company's activities in terms of its vision and strategies, to give managers a comprehensive view of the performance of a business. The key new element is focusing not only on financial outcomes but also on the human issues that drive those outcomes, so that organisations focus on the future and act in their long-term best interest. The strategic management system forces managers to focus on the important performance metrics that drive success. It balances a financial perspective with customer, process, and employee perspectives. Measures are often indicators of future performance.

Since the original concept was introduced, balanced scorecards have become a fertile field of theory and research, and many practitioners have diverted from the original Kaplan & Norton articles. Kaplan & Norton themselves revisited the scorecard with the benefit of a decade's experience since the original article. The earliest Balanced Scorecards comprised simple tables broken into four sections - typically these 'perspectives' were labeled "Financial", "Customer", "Internal Business Processes", and "Learning & Growth". Designing the Balanced Scorecard simply required picking five or six good measures for each perspective. Many writers have since suggested alternative headings for these perspectives, and also suggested using either additional

or fewer perspectives: these suggestions being triggered by a belief that 'better' designs will come from use of different headings. The major design challenge faced with this type of Balanced Scorecard is justifying the choice of measures made. The balanced scorecard suggests that we view the organization from four perspectives, and to develop metrics, collect data and analyze it relative to each of these perspectives:

- Learning and Growth
- Business Process
- Customer
- Financial

**Diagram 5: The Four Perspectives**

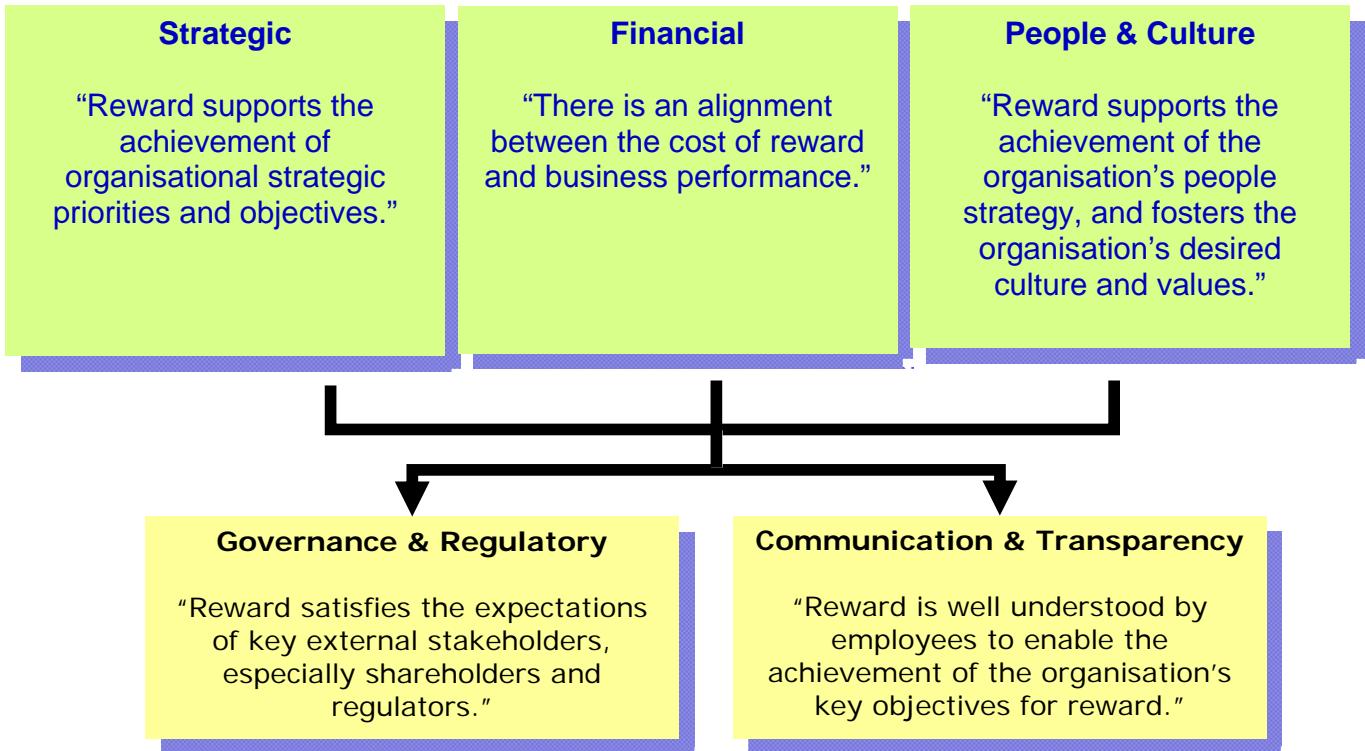


## **5.0 Performance-Based Remuneration**

Employee compensation schemes, including bonus payments and other rewards, are used to recompense workers for their services in accordance with their performance, and as a means of motivating them towards achieving organisational goals. In most organisations there is a need to balance, often significant, labour costs against the need to pay competitive rates. A well designed compensation scheme may be used to motivate employees toward achieving more ambitious goals and also play a vital role in attracting and retaining top talent within an organisation. Employers must seek to reward employees through a combination of monetary and non-monetary benefits and thereby tap into the cooperative strength of workers to create an enthusiastic and satisfied workplace.

## 5.1 A Strategic Context for Reward

Diagram 6 : Aligning reward practices is paramount...

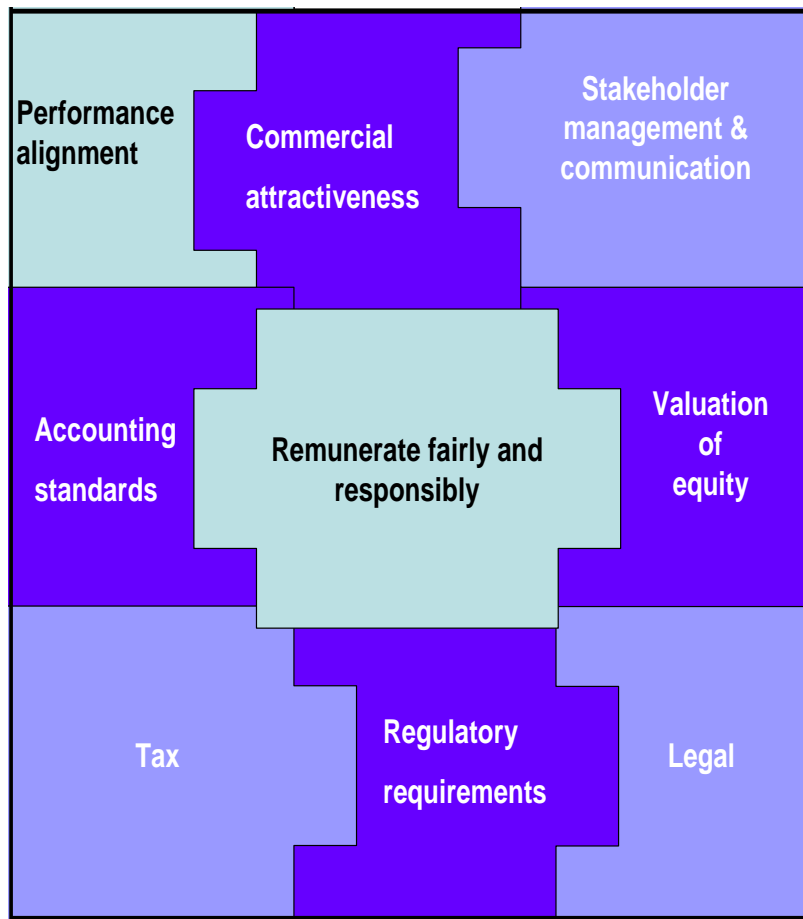


**Strategically**, because reward supports the achievement of organisational strategic priorities and objectives i.e. Balanced Scorecard perspectives. **Financially**, because there should be an alignment between the cost of reward and business performance. With respect to **People and Culture**, reward supports the achievement of the organisation's people strategy, and fosters the organisation's desired culture and values. Strategic, Financial, People & Cultural alignment contribute towards

**Governance & Regulatory** requirements, where reward satisfies the expectations of key external stakeholders, especially shareholders and regulators; and **Communication & Transparency**, where reward is well

understood by employees to enable the achievement of the organisation's key objectives for reward.

**Diagram 7 : A Rewards Framework**



In formulating a sound remuneration philosophy it is important to link employee incentives to the overall strategy and mission of the organisation; and frequently evaluate design of existing programs. One of the most important roles of management is the motivation of staff. In regard to this, Adrian Furnham, Professor of Psychology at University College, London, states that the concept that *“better paid people are more productive and happy does not tie in with the*

*evidence found in the workplace, and states 4 key reasons to support this statement”...*

**Money as a de-motivator;** there is no simple correlation between pay and performance. Perceived low pay often leads to considerable dissatisfaction and de-motivation, but not vice versa. The effects of any pay increases will very soon wear off, and any improvements are likely to be temporary.

**Total remuneration** – this includes extrinsic & intrinsic rewards, that I will discuss further in another slide.

**Absolute salary vs. comparative salary;** if pay increases significantly but in concert with the rest of the work group there is likely to be little change in behaviour. This crucial factor relates to an essential problem associated with performance related pay. If employees believe, with or without evidence, that they are not equitably and fairly paid, they will become de-motivated.

**Money is not everything;** Employees are often happier with more time off, or greater job security, and are prepared to trade these for money. Essentially once employees have enough they grow weary of the game. I would like however, to emphasise that this concept depends on Maslow’s Hierarchy of Needs.

Efficiency improvements need to be measured, processes understood, goals/targets set and achievements rewarded. If there is no clear relationship between the effort extended, and rewards received, either by individuals or by teams, then there is little point in implementing incentives encouraging employees to be more productive.

Talented people want to work for organisations that recognise their value and which provide opportunities to move ahead. For organisations to win the war for talent, they have to compete for labour in a tight market, which drives



remuneration. Studies indicate that there is a global trend to adopt pay-for-performance policies. However, many of the compensation and reward systems that are in use today are based on assumptions that have not been tested for many years. There are other alternatives that focus less on individual wage increases and introduce group incentives, such as incentives related to a common goal. Group incentives have proved to be effective in practice and employees generally like them. Pay for performance systems need to be closely overseen and owned by the organisation's managers i.e. not by its HR department.

It is also wise to involve employees in the planning and design process of compensation schemes because this best develops in them a sense of ownership. Employees who are to be covered under proposed pay-for-performance systems can be used in focus groups or task forces to fine tune proposals. These employees will then tend to serve as valuable communication channels among their co-workers. They will be able to explain the reasons for decisions and be trusted by their colleagues. Pay for performance is most effective at obtaining the desired behaviours when it is related to a management process and when it truly matches the goals of the organisation.

To manage human relations effectively and achieve desired performance levels, organisations must motivate its employees. Motivation though is a complex psychological process in which needs lead to drives aimed at goals or incentives. Attaining the goals or incentives reduces the intensity of the drives and fulfils the needs. The needs are really the mainspring of the motivation. For example, if you have a need to complete a project on time (or want to be recognised or rewarded for doing so), your behaviour aimed at satisfying that need may be to work more hours. The goal may be to get a bonus, pay rise and/or promotion, and if achieved, your drive will be less intense and your need satisfied. Consequently, after the project is complete, your need for rest or a holiday might seem more important than your need for achievement

To motivate people is to see the world the way they do. Employees may be motivated by challenging work, good wages and salaries or fringe benefits, and each individual will seek to satisfy personal needs... which supports the concept that "Money is not everything". To understand what motivates people is to understand what their secondary needs are. This will vary between cultures and the economic state of a country. In Australia, employees needs are between Esteem and Self-Actualisation.

## **5.2 Pay for Performance Schemes**

Having set performance expectations, Pay for performance schemes can include:

**Sales Compensation Plans** which are intended to modify the behaviour of sales people and to align their goals with those that are of most benefit to the organisation. Deriving the highest possible return from sales compensation plans requires that managers strike the right balance between economics and the organisation's strategic priorities.

**Gainsharing** plans which motivate employees to use their skills and efforts to boost company performance. Under Gainsharing a proportion of any savings made are awarded to the employees as a bonus, and the remainder is retained by the company. Pay-outs are made periodically in accordance with overall company performance improvements. Gainsharing is both a popular and effective group-incentive program. No improvement means no gain, and no gain means no bonus, and this simple fact can strongly drive employee behaviour. Bonuses under Gainsharing programmes are essentially self-funded by the incremental productivity and quality improvements that Gainsharing generates.

**Long Term Incentives** are used to encourage executives in particular to focus on business activities which can lead to improved organisational performance.

Long term incentives can also be used to minimise fixed costs to an organisation. Total Rewards covers extrinsic rewards i.e. monetary and intrinsic rewards which impact on self-motivation.

### **5.3 Current remuneration trends in Australia**

**Increased remuneration levels** – recent review of salaries show that certain industries are setting new benchmarks, thereby putting the pressure on others to reassess their offerings to remain competitive in attracting people to work in their industry. In WA for example, there is a skill shortage in some industries because people prefer to work in mining due to higher pay.

**Increased variable pay** –Focus on performance not quantum; Alignment of variable pay with business strategy ; Increased pressure on performance ; Long Term Incentive reward outcomes in relation to business performance. Increasing influence of stakeholders

#### **5.3.1 Expected future developments**

##### **Executive “push back” to long-term incentive (LTI) performance targets**

Long term incentives are used to encourage executives in particular to focus on business activities which can lead to improved organisational performance. Long term incentives can also be used to minimise fixed costs to an organisation. Examples include: **Stock Option Plans**; which give employees the right to buy stock at a designated point in the future at the issue date's price. If the stock price increases the employees can benefit by exercising this option. Alternatively should the stock price fall below the issue price, and the option expires, then the employees will receive nothing.

**Service-Based Restricted Stock Plans**; which can be used as an alternative to stock options, or instead of complex incentive schemes. For service-based

restricted stock, the employee receives the value of the stock at the time of investing as long as the agreed service requirement has been met.

**Performance Share Plans;** which reward executives for having a positive impact on performance including company financial performance/stock price performance. Using performance share plans, executives are offered the ability to earn shares based on pre defined performance measures.

**Reducing acceptance of relative total shareholder return (TSR)** – higher and immediate return on investment

#### **5.4 Components of remuneration**

When designing an effective compensation plan organisations need to take into account the overall packages offered to employees. "Total Rewards" is a generic term used to describe such compensation and incentive packages and may include: *Pay, bonuses, incentives; Core benefits such as health, dental and vision, and motor vehicle for private use; Recognition; Pensions/Superannuation; Voluntary benefits i.e. discounted rates for car and home insurance; Training and development, career opportunities and; Workplace culture and the work environment.*

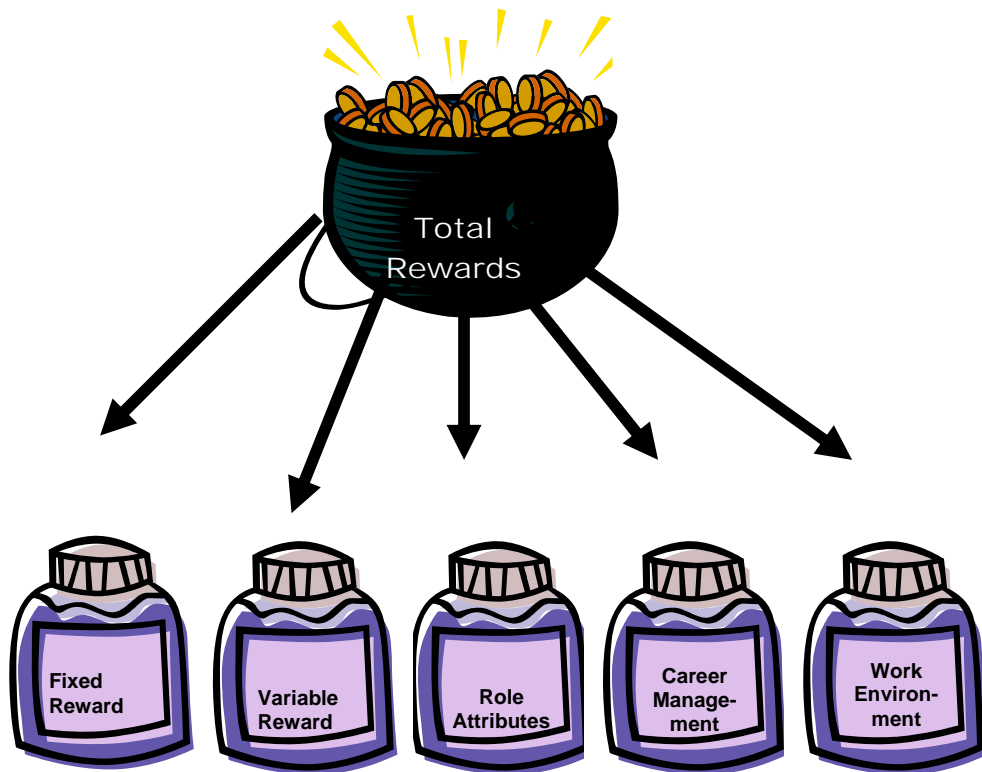
##### **5.4.1 Aligning remuneration**

It is prudent for organisations to focus upon setting those goals which are critical to achieving its success; and as part of this process ensuring that its employees understand how success will be measured, and how personally they can influence the outcomes that lead to success. Goal setting and measurement are central elements of incentive plans, and in particular for the design of executive compensation plans. The primary objective of goal setting and measurement is the selection of instruments which align with business strategy. The most

common goal-setting approaches involve linking incentive goals to annual budgets, or to longer term business plans.

### 5.4.2 Managing Rewards

Diagram 8: Managing Rewards Beyond the Pay Packet



Challenges  
High performance versus High Potential  
ROI or EVP  
Balance fixed variable  
Cash versus equity

**Managing rewards beyond the pay packet**

**Total rewards**

- Extrinsic rewards
  - Monetary
    - Direct compensation
      - Base pay
      - Incentives
    - Indirect compensation (benefits)
      - Pension programs
      - Employee services
  - Non-monetary (voluntary)
- Intrinsic rewards (self-motivation)
  - Role attributes
  - Career management
  - Work environment

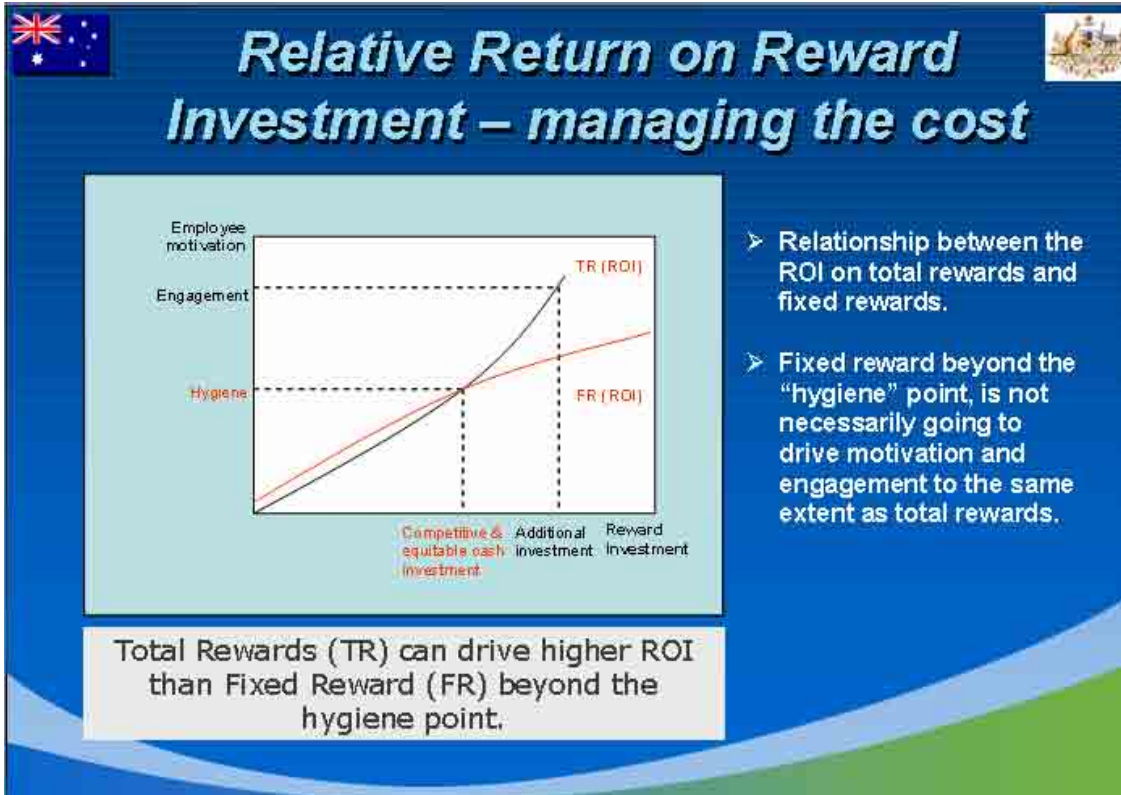
**Challenges**

- High Performance versus High Potential
- ROI or EVP
- Balance of Fixed versus Variable
- Cash versus Equity

Adapted from American Compensation Association, 1999

Managing rewards beyond the pay packet includes intrinsic rewards (which contribute to self-motivation) such as role attributes, career management and the work environment, among others. The challenges however include balancing between:

- High performance and High Potential
- ROI and EVP (Equity Value Proposition)
- Fixed and Variable pay
- Cash and equity



- Management theorists believe that fixed reward beyond the hygiene point, is not necessarily going to drive motivation and engagement to the same extent as total rewards.
- Total rewards can drive higher return than fixed reward beyond the hygiene point.

### 5.5 Strategic Performance Measurement

According to a joint study by Watson Wyatt Worldwide and the Cranfield School of Management (in the UK), the relationship between Strategic or Business Performance Measurement systems (e.g. Balanced Scorecard, Key Performance Indicators, etc.) and reward processes in organisations is an issue that remains unclear. This issue exists despite the extensive research dedicated to each topic; and despite the fact that, at present, many organisations are establishing a link between these two systems.

Studies have indicated that around half of large US and European organisations and 35 per cent of Australian organisations are now using a strategic performance measurement (SPM) system such as the Balanced Scorecard for measuring their business performance. There is also evidence suggesting that just under half of those firms using a strategic performance measurement system are linking it to their compensation practices. However, beyond this data, the relationship between SPM systems and reward systems in organisations is not well understood.

### **5.5.1 Survey Findings on SPM**

A number of findings from the joint study by Watson Wyatt Worldwide and the Cranfield School of Management change their perception on what earlier studies indicated. KPIs are by far the most commonly used performance measurement system in the survey. The frequency of use of the Balanced Scorecard is lower in the survey than has been previously reported. Previous surveys have suggested the Balanced Scorecard is used in about half of larger organisations. Survey results suggest that the Balanced Scorecard is popular, but not as widely used as KPIs.

This result may have occurred because the survey asked questions about performance measurement systems usage and did not purely focus on the Balanced Scorecard. The inclusion of KPIs as a type of measurement system may have provided the respondents with an alternative to the Balanced Scorecard for their responses. KPIs are different to the Balanced Scorecard and this suggests that companies are balancing financial with non-financial measures, but not in the same proportion as one would expect in the Balanced Scorecard. The balance is between financial and non-financial, rather than one financial perspective with three non-financial perspectives.



The results also suggest that there is a much stronger link between performance measurement and reward than has been previously reported. In the survey two-thirds of those surveyed made the link. Even those companies that did not have a formal performance measurement system still linked reward with a mixture of financial and non-financial objectives. Companies who did not have formal performance measurement systems relied more heavily on personal objectives to reward individual performance. KPIs and the Balanced Scorecard have, in much of the management literature, replaced Management by Objectives (MBO).

However, the results of the survey show that along with the Strategic Performance Measurement system and meeting Budget, Management by Objective (MBO) is still a dominant factor for rewarding senior executives. The main benefits from linking reward with the measurement system are to increase the focus and understanding of the key strategic objectives. This goes beyond rewarding short-term financial objectives by rewarding the implementation of the strategy for achieving organisational sustainability and long-term success. This suggests that companies are becoming more confident in their belief in how long term success is achieved and that they believe that rewarding pure financial performance may lead managers to be too short-term in their outlook.

### **5.5.2 Summary**

In summary, in terms of variable pay a careful balance is necessary to be achieved between the way in which employees would like to be compensated and the business performance for which they are compensated. Employees are not necessarily motivated to be more productive or in fact happier in their role by the level of monetary compensation alone. Organisations need to regularly re-assess compensation plans to ensure that they are continuing to meet the intended objectives, and importantly, that they are effectively motivating employees. An effective compensation programme requires goals to be set that enable employees to focus upon the issues and activities that are most important

for achieving organisational success. For this reason goal setting and measurement are central elements of an effective incentive plan.

The design and effectiveness of compensation plans has a direct bearing on the retention of an organisation's best and most productive staff. In addition it is desirable to minimise turnover expenses as these can equate to a significant proportion of annual compensation costs. The loss of good employees is also associated with customer service disruption, loss of morale, and a loss of valuable knowledge from the organisation.

## **6.0 Case Studies on Performance Based Remuneration Systems**

Below are some case studies, practical business set-ups and how they implement their performance-based remuneration: The following are samples taken from the different Australian business communities.

### **6.1 Public Sector Organization – Council**

The organization is a large diverse public sector organization which delivers construction and maintenance of infrastructure, transport services, community facilities and services, and utility services. The 8000 strong workforce is unionized and consists of both white and blue collar, predominantly permanent, but with a range of other employment arrangements. Generally, the organization is pitched midrange in terms of salary when compared with the market, but is highly regarded in terms of its flexible working arrangements.

For the majority of staff (wages and salaried staff), there is no link between performance and pay. They are instead covered by awards, and the organization's Enterprise Bargaining Agreement (EBA). Pay is linked to the value of the job being performed, as assessed by an independent process i.e. not a direct link to individual competency or contribution. These employees are covered by a performance management process, which focuses on agreed goals

and achievements; behaviours; learning and development; and career development. Whilst the focus is on planning for performance, there is no direct link to remuneration.

Performance is formally assessed on a regular basis (6 monthly). Those employees who achieve adequately may progress through the performance scale within their band level (related to the value of the job). And those employees who fail to perform adequately may have the pay progression withheld for a period, and go through a poor performance management process. Individual high performers are not rewarded through this process, but may however, be recognised and rewarded in a limited way through Reward and Recognition strategies.

For those staff who are part of the Executive Service (approximately 150), an Executive Performance Planning system applies (the executives are not covered by the Enterprise Bargaining Agreement). This process does link performance to pay, through a bonus system, comprising up to 15-20% of nominal salary. Each of the executives has a number of objectives to achieve – corporate; divisional/branch; individual, with a weighting for each objective. Depending on the level of achievement of each objective, a cumulative bonus of up to 15-20% can be achieved. It should be noted that targets that are set corporately or divisionally must be achieved collectively for individual executives to receive the benefit.

The Enterprise Bargaining Agreements, which have been part of the landscape since the 1990s, have provided reasonable pay increases at each level of the classification structures within the Awards. These pay increases reflected pay movements in the general community. During the late 1990s, the organisation attempted to have performance measures in the earlier versions of Enterprise Bargaining Agreements, linked to the performance of work units and divisions. Bonus payments were made on the satisfactory achievement of key performance

indicators. However, this approach has been discontinued due to the difficulty in choosing cost-effective measures which reflect actual performance, and also measuring the direct contribution of an individual (individuals received a bonus based on the performance of the larger group). The current Enterprise Bargaining Agreement is about commitment to collective improvement, and working towards achieving important organisational agendas.

Current initiatives are exploring changes to some arrangements. For example, some executives (generally those in high demand occupations and critical roles) may be moved to a retention type bonus, rather than a performance based bonus. In other words, paid at the end of a three year contract rather than annually. Another initiative is looking at a remuneration strategy that helps attract and retain staff into hot skill areas, through a revamped remuneration package for designated individuals and roles. This is in response to market demands and the need to attract and retain staff in key occupational groups. Initially, it is not proposed to include a performance based component, but could so in the future.

## **6.2 Large Multinational Organisation**

The company is part of a large multi-national organization which manufactures and supplies product to the building and automotive industry. Its business management system is based on ISO9001: 2000 and manufacturing excellence practices i.e. Lean Mfg & the Toyota Production System. The Balanced Scorecard is used as the basis for measuring business performance.

### **6.2.1 Performance Management - Award Covered Staff**

Employees are covered by the relevant Industry Award as well as Collective or Enterprise Bargaining Agreements (EBA), which provides for wages (based on skill level and competency) and other benefits (i.e. training allowance) that are above those set in the Award. Currently, performance management may or may not be part of an EBA. However, there are plans to standardise and include this in future EBA negotiations.

Where performance management is included as part of the EBA (i.e. primary product manufacturing), employees are covered by an incentive scheme i.e. Profit Share, which provides performance-based pay where performance targets are exceeded i.e. for every \$10m above the target, a percentage for incentive is attached to every \$. The scheme defines a pro-rata payment based on the percentage exceeded on the performance target and on job groups i.e. Management, Operators, Maintenance, Admin, etc.

Performance measures and target include Safety, Yield, Productivity, Waste, Quality, including quantity of acceptable product, and Attendance. Each measure has a weighting and is based on what an employee can control and/or influence. Targets may be stretched but are not impossible.

### **6.2.2 Performance Management – Evaluated Staff (Employees on fixed salary)**

Evaluated employees are entitled to the same performance-based pay incentive scheme (as Award Covered Staff) with the following percentage depending on the level of management.

- Administration & Management staff - up to 10% of base salary
- Senior Management - 15% up to 60% of base salary

In addition, the performance of evaluated staff is also measured against the following:

- Administration staff – achievement of broader-based targets i.e. team or departmental objectives
- Management- achievement of individual and team or departmental objectives

A Management Incentive Plan (MIP) is also given to senior management. It is based on:

- Financial performance of the business i.e. operating profit (35%), Net cash (20%), Working Capital (15%)
- Achievement of personal targets\* which will be not less than 3 measurable key results agreed with the immediate manager (30%)
- Assessment of the overall effort and contribution to the business

For more senior management i.e. Executive management, short term (STI) and long term incentives (LTI) are offered, and are also performance-based as well as linked to business growth/wealth creation and share price earnings. (This is further discussed in case study 6).

### **6.2.3 Salary Evaluation using the HAY system**

The organization uses the Hay Point Method to evaluate jobs. Its widespread use and the consistency of the job size numbering scale enable it to provide the basis for valid pay comparisons between organizations, both nationally and internationally. The Hay Guide Chart-Profile method is based on observations of the elements common to all jobs, namely:

- Outputs - all jobs exist to produce end results - Accountability
- Inputs - to deliver these end results, job holders require the appropriate knowledge and skills - Know How
- Process (management and improvement) - in utilizing know-how to achieve end results, job holders must address and resolve problems - Problem Solving
- For any given job, a relationship will exist between these three factors. Therefore, jobs can be characterized by the size or level of each factor and the balance between the jobs which reflects the 'shape' of the job (otherwise referred to as the Job Grade).

\*Job Grade

The outcome of Salary Evaluation is grading of the job, which then determines the salary range (lower and upper limits) of the job.

### **6.2.4 Remuneration Policy - Base Salary & Fixed Benefits**

In this approach, Base Salary is fixed and some additional benefits (below) are provided. The employee has no choice in the amount of Base Salary and cannot elect to reduce/increase Base Salary for increased/decreased benefits. The approach was based on comparison against other organizations such as: AMCOR, BASF, Bluesteel, Capral Aluminum, Coca-Cola Amatil, Ford Motor

Company Holden, Kimberly-Clark, Kraft Foods, Mitsubishi, National Foods, Pacifica, Philip Morris, Rheem, Southcorp, Toyota, Uniliver and others.

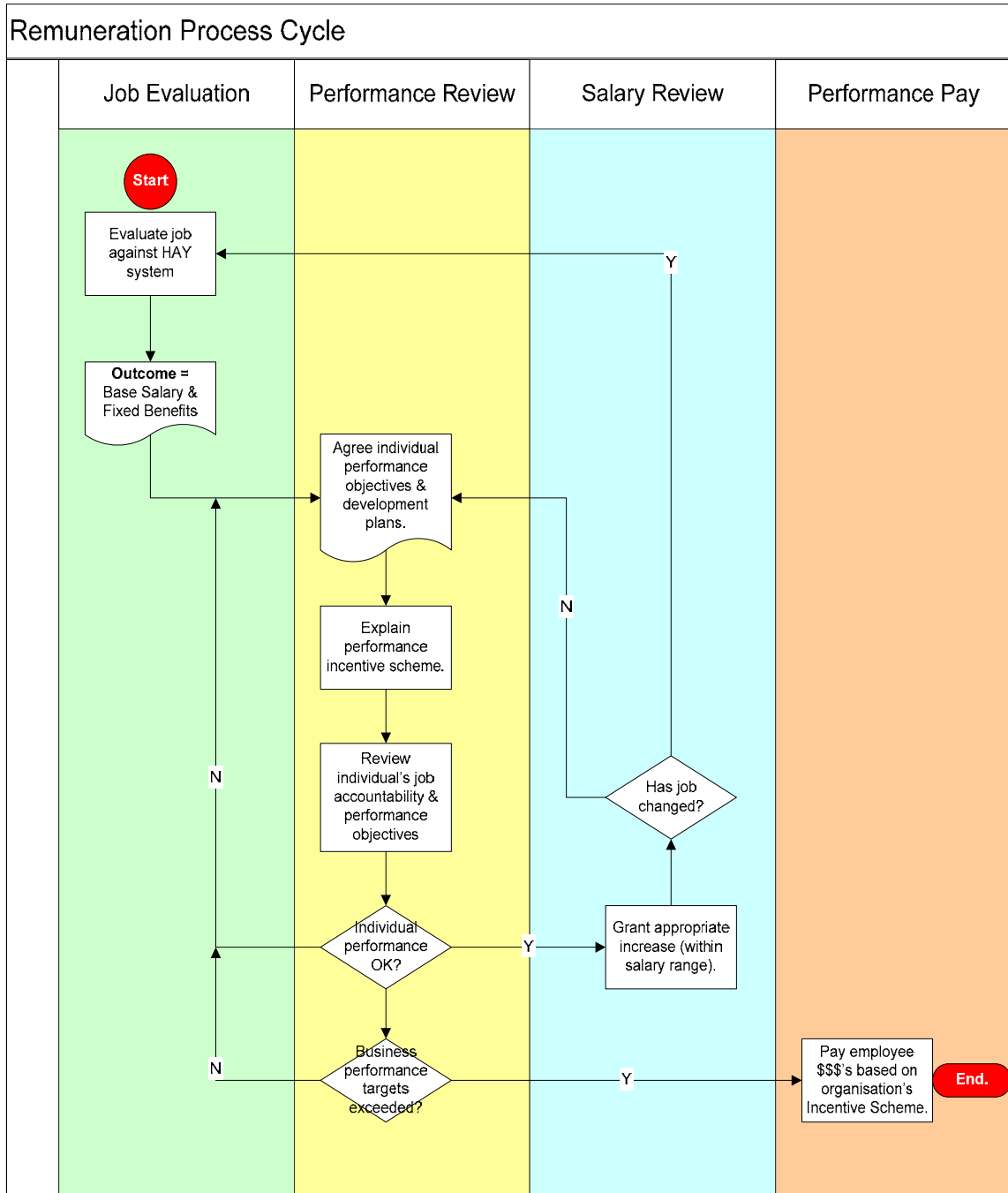
#### \*Salary Review

Salary review is linked and follows the yearly performance review. Salary increases when appropriate, are granted according to ratings, position within the Hay salary range and correction of any anomalies.

The overall picture of the Remuneration Process Cycle is illustrated in the diagram below.



**Diagram 9: Remuneration Process Cycle**



### **6.3 Products and Services for Homes and Buildings**

The company employs more than 1300 employees in Australia, New Zealand, Fiji and PNG and provides products and control systems for homes and buildings. The organization has a flat and responsive structure that ensures responsibility and accountability is devolved to managers, team leaders and teams. The company drives these strategies through its ISO9001-based Business Management model and measures their performance against the Australian Business Excellence Framework.

Their people strategy includes the following initiatives : Flatter organization with fewer levels of management , Empowerment of employees through the empowerment card, Focus on teams and teamwork, Entitlement of a minimum of five days training for all staff, Involvement of a large number of employees in the planning process, and Improving internal communication processes. Since 1995 the company has implemented an Employee Opinion Survey which looks at employee's perceptions of what is important and how the company is performing on these items.

The factors measured relate directly to the Business Management Model and the ABEF criteria, thus enabling comparison of results and benchmarking of key areas for improvement. Standardized applications and systems are in place to provide data to employees and communicate both operational matters and overall company performance.

Process control concepts are employed to ensure that the scope of the measurement system provides data for process improvement and understanding at the operator level. There is evidence of widespread understanding and ownership of process brought about through various improvement initiatives and the application of mature certified quality management systems within the Business Units.

The company's people management, development, communication and involvement processes are comprehensive, well planned and effectively implemented. Recognition and reward systems provide a variety of award programs linked to the achievement of key strategies and organizational goals. In line with the organization's Key Success Factor of employee well being there has been developed a proactive, company-wide approach to Occupational Health and Safety.

### **6.3.1 Performance Management**

Employees at all locations, including overseas assignments, receive an annual Performance Effectiveness Review which encompasses a review of current performance against objectives set the previous year, career planning, development and training plans, and individual objectives for the following year. The Performance Effectiveness Review process includes a 360 degree review for directors, managers and team leaders. There is widespread use at other levels. The process can involve customers and staff from other divisions.

A set of 12 core competencies aligned to the Vision and Values have been identified and are the basis for multi-rater reviews. Pay for performance is assessed on the basis of achievement against personal objectives derived from annual business plans. There is evidence that staff value the recognition and reward systems which provide for a wide variety of awards with a particular emphasis on customer service and the achievement of organisational goals.

### **6.3.2 Process**

Performance management is the way the contribution of people to achieving organizational objectives is managed and evaluated. The company approaches performance management from a number of perspectives: Performance Effectiveness Review System, Career Development, Pay for Performance, and Recognition and Reward.

## **6.4 Large Manufacturer**

### **6.4.1.Strategic Planning**

The planning is carried out by senior management. They comprise the corporate planning team and a process expert. The focus for their planning is to zero-in on 1/2 dozen things that must be done right over the medium to long term.

The firm has two corporate objectives:

- to achieve a satisfactory return on capital
- to achieve a satisfactory long term profit growth

There are only two Corporate Performance Indicators (CPI's):

- RoC (return on capital)
- EBIT (earnings before interest and tax)

As part of the plan, targets and forecasts are set . Minimum targets are set (Tmin) but satisfactory targets (Tsat) are what they want to achieve. Forecasts: where they expect to be. This is done by examining the past, making opportunistic and pessimistic forecasts and having a high recognition of the variability of future outcomes. This is particularly important to the firm as their biggest product is subject to both cyclical and seasonality.

Progress against the plan is checked on a monthly basis. This consists of a monthly meeting of the corporate planning team. The plans are formally reviewed on an annual basis. The planning process is tightly tied to the budget process. The entire planning process runs for approximately nine months, beginning in September for the preparation of plans for the new financial year.

Action plans are derived from the strategic plans. Many of the action plans involve cross functional teams of which there is a high emphasis at the firm. The General Managers who have responsibility for seeing through the cross functional initiatives do not get rewarded for achieving these initiatives. It is considered as part of doing the job.

#### **6.4.2 Process Improvement**

The firm has a process improvement framework and methodology using team approach and the ISO9001 process model. The major outcomes from the improvement cycle are:

- improved process
- understanding of customer needs
- improved customer satisfaction
- reduced waste
- involvement of people working in the process
- adoption of a structured approach to the introduction of change, team work and problem solving.

#### **6.4.3 Gain Sharing – linked to performance**

Gain sharing came about as a result of asking people to continually improve, of people wanting to know what to improve and how well they are contributing to overall business performance. Gain sharing is a focus on company performance, a mechanism for employee involvement, aligned with commercial strategies, under employees direct control, is focused on teams, and dependent on continuous improvement.

Calculation of the amount received under gain sharing is done via the gain sharing plan matrix and involves performance against a set of KPI's. Each employee receives the same amount of money. The highest received so far has been \$1000. It is not a proportional system, i.e. linked to salary.

## **6.5 Small Engineering Service Company**

The company is one of Australia's SME's, and it does not operate a conventional Performance-based Pay system. Instead, it has a bonus system based on customer satisfaction ratings. The operation of a single work group constrains the awarding of reward to individual employees. Performance management and assessment is carried out on the group as a whole and is based on customer survey results and organisational performance indicators such as recall rates and productivity.

The use of a group reward system is due to the fact that everyone's tasks are interrelated with other employees in the group. The approach taken towards a group reward scheme ensures that no employee loses touch with the concept of internal customers and fails to recognise that achieving customer satisfaction is everyone's responsibility not just the people that come in contact with any individual customer. Adjustments are made for any special causes which affect the outcomes achieved. Rewards given for achievement are:

- Monetary bonuses
- Non-monetary bonuses such as weekend away with accommodation paid for.

The company has a philosophy that if employees are nurtured and rewarded for exceptional performance in providing customer service then the whole company will prosper as they are the key to success. All staff is publicly acknowledged where they have done something outstanding which enhances or improves how they do things in its business. Career development in the company is unconventional due to the fact that its organizational structure has only two levels. Career development in the company therefore consists wholly of increasing the skills and capability of its employees in the following areas:

- Multi-skilling
- Improving technical skills
- Improving customer relations
- Improving management capability

Performance appraisal is also applicable to the directors when employees complete Rate Your Organization Questionnaires.

## **6.6 Investa Property Group**

Share-and-unit based Investa Property Trust and Investa Properties Limited united to form **Investa Property Group** (IPG), founded on 1 December 2000. IPG is a property company that is also into residential and commercial development, through its residential division, Clarendon Residential (formerly Residential Developments).

With a market capitalization of \$ 3.3 billion, IPG is among the Top 100 organizations in the Australian Stock Exchange. IPG is a global leader in sustainability and was recently rated number one in the Dow Jones Sustainability Index both in the real estate sector and the financial services “supersector”; as well as being one of only three Australian companies to be part of the Global 100 list of sustainable corporations at the World Economic Forum in January 2007.

### **6.6.1 Financial Particulars**

As of December 2006, Investa Property Group had assets under management amounting to \$ 7.0 billion; including an Australian commercial office portfolio of \$ 4.0 billion and external funds worth \$1.7 billion.

### **6.6.2 Vision and Core Values**

Investa Property Group aims to become Australia's most respected real estate company through core values:

- a) Customer Focus;
- b) Team;
- c) Performance;
- d) Can Do;
- e) Nimble;
- f) Accountability;
- g) Empowerment;
- h) Innovation;
- i) Integrity;
- j) Every Job Counts; and
- k) Personal Growth.

### **6.6.3 Investor Information**

Currently, Investa Property Group has approximately 24,500 security holders, from large institutions to private investors. As customer service is a focus of IPG's management, Investa prides itself on providing up-to-date information (financial results, investor presentations and company announcements) to securityholders.



#### **6.6.4 Sustainability**

For the Investa Property Group, sustainability equates to utilizing business strategies and practices to meet the needs of the group and its stakeholders while protecting human and natural resources for future consumption. To achieve this, IPG management integrates measurable, accountable and enduring sustainability practices into their business platform; which results in enhancing shareholder value.

Such practices are targeted at:

- a) Fostering innovation;
- b) Improving identification and management of risks;
- c) Elevating recognition of changes in the business environment;
- d) Strengthening employee alignment and motivation; and
- e) Reinforcing access to capital through greater disclosure.

Over the past three years, Investa has reduced the utility expenses of its office buildings (electricity by 14%, water by 28% and gas by 37%). It is also recycling more than 50 percent of its office waste, and continues to maintain its 5-star rating (highest rating) from the National Safety Council of Australia. This is an offshoot of Investa's commitment to achieving workplace health and safety excellence. Investa is at the forefront of utilizing the latest innovations to address corporate responsibility. These innovations (and their respective progress) are chronicled in their annual sustainability reports.

A recent example is the Green Lease Guide, which is a partnership between the Department of Environment and Conservation (NSW); the Institute for Sustainable Futures (at UTS), the coastal cities of Sydney and Melbourne, and Investa. This program involves helping tenants who appreciate productive and environmentally friendly workspaces the value of collaboration.

### **6.6.5 Corporate Governance**

At Investa, corporate governance influences how the organization's objectives are set, how risk is monitored and assessed, and how performance is optimized. This is the responsibility of the Investa Board of Directors.

### **6.6.6 Risk Management and Mitigation**

IPG views the management of risks to its people, assets and all aspects of its operations as a fundamental responsibility. Risk management is to be instilled throughout the organization's day-to-day operations and investment decisions, as directed by the Managing Director and other Senior Managers and carried out by each employee.

Investa will be launching Risk Management Programs throughout the organization, as outlined in IPG's Risk Management Guide. The delegation responsibility for carrying out aspects in these initiatives is also mentioned in the said guide.

### **6.6.7 Performance Planning and Review**

- I. Preparing for Performance discussions
- II. The Performance Review and Development Plan
- III. Planning for the coming financial year
- IV. Establishing Performance Objectives
- V. Setting Incentive Weightings
- VI. Writing Performance Objectives
- VII. Establishing Performance Measures
- VIII. Writing Development Plans

## **I. Preparing for Performance Discussions**

It is essential for a Manager to ask their team members about the following before launching the performance review and planning process:

- a) Clarity of Position Description ;
- b) Tasks done or delivered well since the last formal performance review;
- c) Areas for improvement (Work Performance);
- d) Focus for individual development.

## **II. The Performance Review and Development Plan**

The contents of the Performance Review and Development Plan of the Investa Property Group include the following:

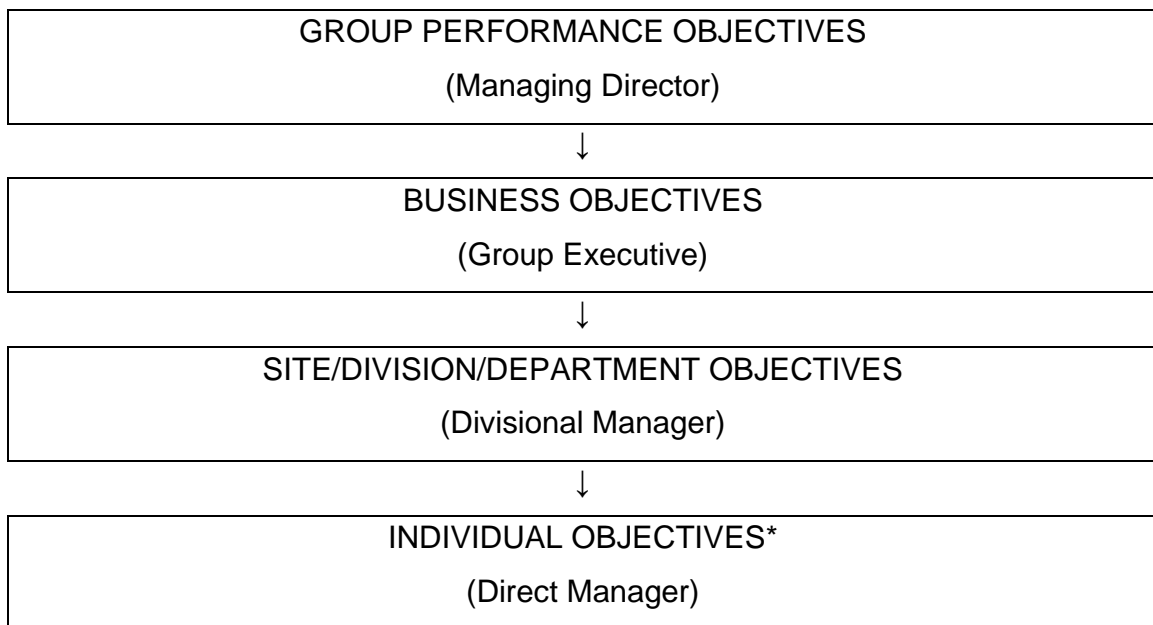
- a) Position Description;
  - indicates the Purpose, Key Accountabilities and other Aspects of the team member's job; has a timeframe beyond current year
- b) Performance Assessment – Key Behaviors;
  - assessment of how the employee has been going about his work, important in relation to culture, sustainability and growth
- c) Annual Scorecard;
  - specific annual targets, consistent with the Position Description, but focused on one year
- d) Performance Review – Overall Rating and Comments;
  - overall rating and summary of all aspects of performance (Key Behaviors, Annual Scorecard, ongoing performance and development)
- e) Development Plan
  - combines evidence from past performance with career aspirations; necessary for success in current job and future career.
- f) \*Sign Off

### III. Planning for the coming financial year

Manager and team member write down three key projects for the team's next financial year.

### IV. Establishing Performance Objectives

A certain process (involving key figures in the organization) is followed in establishing the performance objectives in different levels.



\*These individual objectives are set to capture the Key Performance Indicators of the team's outcomes.

## **V. Setting Incentive Weightings**

The Incentive Weighting will depend on the role (position) of the employee. The divisions are as follows:

- a) Group measure;
- b) Business unit measure;
- c) State / Department measure; and
- d) Personal measure.

## **VI. Writing Performance Objectives**

A Performance Objective must be accurately defined and measurable. They must contain: a) Outcome (what needs to be delivered); and Measures (variables to assess whether the outcome has been achieved)

\*Measures will accompany one or a combination of time, budget (costs and or revenue) and standards/compliance variables.

## **VII. Establishing Performance Measures**

Three levels of measurement used to rate each objective in the Annual Scorecard are: Target (reflects the planned outcome); Stretch (reflects a substantially better outcome); and Base (recognizes a reasonably good level of performance but not quite to target).

## **VIII. Writing Development Plans**

Each Development Plan which should be completed by September 30<sup>th</sup> of each year. When thinking of Development, each manager should consider:

- a) issues arising from Objective Setting and Achievement of objectives;
- b) previous performance reviews; and
- c) feedback and comments (in relation to career aspirations).

For each development action, a range of activities should be utilized (on-the-job training, self-directed learning, projects or secondments, broadened row responsibilities, formal training and education), considering the Divisional budget for training and development.

## **7.0 Issues and Challenges in Implementing the Performance Based Remuneration among Australian Industries**

### **7.1 Motivating employees, especially when "money is not everything"**

Australian culture like other countries still considers financial rewards as the primary motivator of performance. In reality, intrinsic rewards also play a major role in encouraging employees to excel and continue to do their best. At times, one needs to go one step backwards to eventually move double or triple steps in one's career. Example, on the job training to prepare someone for greater responsibility may not necessarily provide monetary rewards immediately but is an important investment for a key performer identified with leadership potential to learn the ropes without an increase. Once the training is completed with flying colors that is the time to reap the possible financial reward.

Australian culture sometimes does not encourage this arrangement as immediacy of the rewards is crucial

## **7.2 Difficulty in choosing cost-effective measures which reflect actual performance, and also measuring the direct contribution of an individual**

The challenge is to be able to measure and link contribution specially of the support group to the bottom line. But some functions are difficult to measure. Like performance counseling done to boost performing employees' morale or to encourage those who can not shape up to ship out can not be linked directly to the bottom line but is an important function of Human Resources in tandem with the line.

## **7.3 Selecting the appropriate "Pay for Performance" scheme**

Just like in training when a training needs analysis is needed, the appropriate rewards scheme is dependent on a particular need of team in an organization and the nature of business the company is in. One needs to also be creative to think of unorthodox schemes to incentivize both the young and old employees

## **7.4 Finding the balance between intrinsic and extrinsic rewards**

Both intrinsic and extrinsic rewards are important but finding the right balance is a continuous challenge. For marketing and the sales people on commission basis, proportion of extrinsic reward over intrinsic may be higher as immediate results will dictates immediate grant of rewards. For other functions, mostly support and those in relatively higher positions expect a 50 50 proportion between the 2.

Since Australia is experiencing an aging population and also allows people to work late in life, up to age 65 or more, the balance becomes more challenging.

## **7.5 Aligning performance with strategy and use of a formal performance measurement system**

Current performance management for some key Australian companies still follow a behavior based performance appraisal system with unclear linkage to corporate objectives and over-all strategy. While others already adopt a performance balance scorecard appraisal system, not everyone has appreciation of the company's over-all's strategy map, leaving the corporate plan only to a few. Thus, the deliverables are not directly linked to the corporate strategy causing misalignment and confusion. Individual performance measures do not necessarily support the corporate goals/objectives

## **8.0 Summary and Conclusion**

The Commonwealth of Australia is currently enjoying its 16<sup>th</sup> year of economic expansion, second to the U.S. in terms of high material living standards among the G7 countries. Its income (\$743.7 billion in 2006), in terms of GDP growth, increases around 3.9% annually which again places it in the top bracket in comparison to other countries.

Australia's soaring economy lies in its advocacy of increasing competition (both domestic and international) by making legislative reforms such as decreasing tariffs, increasing its accessibility to foreign investors, and privatizing public utilities; to the effect of improving the quality of services and products the country is known for. Also, addressing the areas for improvement in the Australian workplace (working conditions, awards and wages, office policies and infrastructure) and providing solutions for such, lead to increased employee satisfaction and labor efficiency. These improvements increase Australia's competitiveness, which, in turn, influences national productivity.



Among Australia's best practices also, as included in this report, are the measures of its progress, business management processes that enhance performance, and performance-based remuneration, and case studies. A hypothetical investment in all listed Australian Business Excellence Award recipients generated a significantly higher return than that of the market benchmark, Standard and Poor's Accumulated Index.

Over the period 1990 to 2003, a portfolio of Business Excellence Award recipients generated a 169 percent return, outperforming the Standard and Poor's Accumulated Index benchmark of 113 percent. The portfolio further grew from A\$44,113 invested on 10 March 2003, to A\$118,447 by 30 June 2006.

Table 9 below presents a summary of the results (THPR is Total Holding Period Return).

**Table 9: 1990-2006 Australian Business Excellence Award Winners versus Standard and Poor's Accumulated Index**

	TOTAL A\$ Investment 31 October 1990	TOTAL A\$ Value 10 March 2003	TOTAL A\$ Value 30 June 2006	THPR % Since 2003	THPR % Since 1990
Award recipients	\$12,192	\$44,113	\$118,477	168.58%	871.76%
Standard and Poor's All Ordinaries	\$12,192	\$21,251	\$45,197	112.68%	270.71%

Business Excellence Award-winning organisations outperform the Australian All Ords by over 3 to 1  
(for full Report contact [bes@sai-global.com](mailto:bes@sai-global.com))

The Framework was developed with the objective of describing the principles and practices that create high performing organizations. The criteria could then be used by organizations to assess their performance and drive continuous and sustainable improvement in their leadership and management systems. The Framework is also used as the assessment criteria for the Australian Business Excellence Awards. Through the Awards, organizations can be recognized for their achievements in excellence and improvement.

An organization can use the Business Excellence Framework to:

- Achieve stronger financial performance.
- Create visionary and inspirational leadership.
- Drive innovation in products and services.
- Focus on customer service and satisfaction
- Increase market penetration and revenue.
- Create effective business planning processes.
- Raise productivity and reduce operating costs.
- Engage teams in the process of improvement and increase staff satisfaction.
- Improve its decision-making capabilities.
- Increase its capacity to manage change.
- Be recognized for its achievements in excellence and best practice through the Australian Business Excellence Awards.
- Demonstrate to key stakeholders (i.e. customers, shareholders, boards, community, employees) that it has a structured and systematic approach to improving and achieving best practice and excellence.

Additionally, the BEF provides an umbrella under which a number of business initiatives can be integrated to form one coherent, cohesive organizational system. Business initiatives that fit comfortably within the BEF include the following:

- ISO 9000 series
- Six Sigma
- Balanced Scorecard
- Enterprise Resource Planning
- Triple/Quadruple Bottom Line reporting
- Corporate Governance
- Risk Management

In line with the above, it is important for organizations to link payment of remunerations to performance measurements. The case studies demonstrate that performance based remunerations will attract, retain and motivate employees while aligning to organizational objectives and excellence. Pay for Performance systems are typically compensation plans in which the pay opportunities of employees are indexed both to the organisation's and the individual's performance.

Pay for Performance systems tend to be self-funding and have the following objectives; to increase the profitability of the organisation, to fairly share profits with owners, customers, and employees, and to create a highly responsive open reward system. Another type of pay-for-performance programme is called Gainsharing which is used to motivate employees to use their skills towards boosting company performance. Gainsharing is used to award a proportion of the savings, or profits, made by an organisation back to its employees.

The sum of all the rewards given to employees comprising both monetary and non-monetary compensation are commonly called "Total Rewards" packages, which in addition to pay, bonuses, and incentives include; core benefits such as health, dental and vision, motor vehicles for private use; recognition; pensions; training and development, career paths and; improvements to the workplace environment itself.

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**II. Developing Key Performance Indicators and  
Productivity/Performance Benchmarks  
for Performance Based Remuneration Systems in Korea**

**By  
PROFESSOR DR JISOO YU**

## **1.0 Korea's Economy**

Since the early 1960s, Korea has achieved an incredible record of growth and integration into the high-tech modern world economy. Four decades ago, GDP per capita was comparable with levels in the poorer countries of Africa and Asia. In 2004, Korea joined the trillion dollar club of world economies. Today, its GDP per capita is equal to the lesser economies of the European Union. This success through the late 1980s was achieved by a system of close government/business ties, including directed credit, sponsorship of specific industries, and a strong labour effort. The government promoted the import of raw materials and technology at the expense of consumer goods and encouraged savings and investment over consumption.

The Asian financial crisis of 1997-99 exposed longstanding weaknesses in Korea's development model, including high debt/equity ratios, massive foreign borrowing and an undisciplined financial sector. Growth plunged to a negative 6.9% in 1998, then strongly recovered to 9.5% in 1999, and 8.5% in 2000. Growth fell back to 3.3% in 2001 because of the slowing global economy, falling exports, and the perception that much-needed corporate and financial reforms had stalled. Led by consumer spending and exports, growth in 2002 was an impressive 7.0%, despite anemic global growth. Between 2003 and 2005, growth moderated to about 4%. A downturn in consumer spending was offset by rapid export growth. The GDP and GDP per capita of Korea is as follows:



**Figure 1 : GDP and GDP per Capita of Korea**

<b>GDP and GDP per Capita of Korea</b>	
GDP	US\$ 679.67 billion
GDP Annual Growth	4.64%
GDP per capita	US\$ 12,742.51
GDP per capita growth	4.14%

(source : IPS National Competitiveness Research 2006 Report)

## **2.0 Towards Labour Market Reforms**

In 2005, the government proposed labour reform legislation and a corporate pension scheme to help make the labour market more flexible, and new real estate policies to cool property speculation. Moderate inflation, low unemployment, an export surplus, and fairly equal distribution of income characterize this solid economy. Since the Asian financial crisis of 1998, the Korean economy opened up quickly to the outside world and Korean companies were pressured to downsize their workforce due to low profitability and excessive debt ratios. Many companies which traditionally followed the Japanese system of life-long employment, in a closed internal labour market switched to the performance based system practiced in United Kingdom and the United States of America.

Companies admitted that the seniority-based wage structure, which do not link wages to productivity and or performance was affecting competitiveness and companies financial situation is affected. In the current economic situation, characterized by shortened life cycle of knowledge, companies need to

continuously restructure to remain competitive. This would involve displacement of non-performing workers. The Government however is under pressure to provide social support to those who have been forced to leave their jobs and address the issue of an aging working population. This had created a conflict of interest between companies and the Government.

There is a need for collaborative efforts between industries and the Government in such a situation. For the industry, it is urgent that they flexibly implement and pursue a performance-based wage system to resolve the management issues created by life-long employment. To initiate this, there is a need for the Government to initiate provide administrative support and financial incentives to induce businesses to adopt such a system. However the issue of mandatory retirement age need to be first resolved before the performance based system can be successfully implemented. This would involve investment in training and retraining of retrenched workers so that they can be re-employed more easily into the labour market.

An alternative would be to ensure the mandatory employment of middle-aged workers and extend their employment in a seniority based wage structure by introducing the “wage-peak system”. This system adjusts the wage level of middle-aged employees lower in accordance with their productivity. This could bridge the conflict between labour and management. Different systems are being used in different situations to suit the needs of the environment. The mandatory retirement system is being used in Korea as a means of employment adjustment in a situation of congestive personnel management and under the pressure of wage costs within a closed internal labour market structure. It also implied that the labour unions could have tacitly agreed to this situation. Therefore there is indeed a trend towards the implementation of a wage system that is linked to productivity and or performance to enhance competitiveness and ensure employment stability.

### **3.0 Employment Issues**

#### **3.1 Aging Working Population**

Among the Labour Market Changes<sup>2</sup> is the issue of the aging working population and youth unemployment. The recent employment-related issue that has risen to the forefront in Korea in relation to Korea's aging population is the mandatory retirement system and the transition to a system that does not consider age as a criterion for personnel management. Two economic considerations could be raised with regard to this issue. First, there is the need for a more efficient use of the aging population as human resources given the current demographic changes where the aging population grows larger and the number of youth drops. Further, with globalization, more importance is put on the efficiency of flexible employment and the rapid adaptation to external shocks rather than efficiency from nurturing firm-specific human capital through life-time employment. Therefore, the second consideration is the need for labour market flexibility in this market environment.

To draw up laws and institution which promote the employment of the aged, there is a need for comprehensive plans and policies within the overall cycle. Considering the low status of middle-aged and aged employees in the labour market, business should not be the sole player to undertake the responsibility of aged employment, and neither can the government take matters entirely into its own hands. Given the features of the middle-aged and aged labour market and the lack of a multi-lateral system to ensure security for the old aged, it is imperative to create laws and institutions which can address the issues faced by aged employees from a comprehensive perspective. While aged population of today find much of their support coming from the National Pension Scheme, retirement pay, private pensions, savings and help from their children, these alternatives are not sufficient. Therefore, there is a need for policies to pursue short- and long-term plans in order to promote the employment of the aged. This

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<sup>2</sup> KDI Annual Report, Feb. 2005

would include a comprehensive policy direction for the seniority-based wage system, the wage peak system, retirement pay, and old-aged pension in relation to the paradigm of the Japanese senior employment law, as Japan and Korea share a similar labour environment.

### **3.2 Youth Unemployment<sup>3</sup>**

While the aging population is a concern for business fearing long-term labour shortage, the recent increase in youth unemployment has provoked public criticism on poor quality labour supply. The rate of youth unemployment rose from 4-5% in the mid-1990s to 12% in 1998, and has since declined to around 6-8% in the 2000s. In particular, the share of young population in the unemployed workers has exceeded 50% in recent years.

Youth unemployment is important in two respects. First, young workers accumulate their human capital through learning-by-doing during the early stage of their career. Thus being idle when young means less human capital later on, and it eventually reduces their productivity throughout their career. Second, a worker-job match is an important component in labour productivity, and job shopping during the early stage of a worker's career is an important mechanism through which the worker can improve his/her productivity match. Being idle during this stage means less-searching, and thus a lower productivity match.

One study results indicate that sectoral changes in employment and output have affected aggregate labour demand in favour of young workers, which rules out the possibility that youth unemployment has increased due to demand deficiency. The further supply of young workers has steadily fallen due to lower birth rates and increased education, which also rules out a simple supply explanation. There is a possibility, however, that the rapid educational upgrading among the young has caused a qualitative gap between labour demand and supply. The

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<sup>3</sup> *ibid*

rapid increase in college graduates are absorbed in the labour market mostly through occupational downgrading during the transition period, but the highly educated young workers may have not yet sufficiently adjusted their reservation wages to accept such a downgrading. This, though temporarily, may account for a part of the increase in youth unemployment.

More importantly, however, one will have to turn to institutional factors to explain most of the increase in youth unemployment. It is young “new” workers, not just young workers that suffer from fewer job opportunities. One study findings indicate that the exit hazard from unemployment to employment has fallen only among young “new” workers who do not have prior work experience. Further, the share of the young population among newly created jobs has been stable, but the share of young “new” workers has fallen. That is, new jobs are increasingly allocated to young workers with prior work experience, and that the increase in unemployment is concentrated among those who newly enter the market. It is also believed that high and fast-rising employment costs are the major causes for the increase in youth unemployment.

The rate of new job creation tends to be lower in the sectors with high wage growth. One interesting finding is that fewer jobs were destroyed in sectors with high wage growth rates. Given that high wage growth rates are associated with fewer new jobs, it can not be said that the phenomenon has been caused by demand shift. Instead, it must be interpreted as implying that employment adjustment was more difficult in sectors with higher wage growth rates. It also can be said that sectors with higher wage growth prefer the young workers with prior work experience.

#### **4.0 Outlook of Industrial Relations<sup>4</sup>**

Industrial relations in Korea have undergone rapid changes. From July 1987 till September 1987, a series of strikes broke out across the country. The so-called, "1987 workers' great struggle" encompassed 3,300 industrial disputes or more during the three months. In the aftermath of the financial crisis in 1998, workers went into a general strike, opposing the restructuring at workplaces and the revision of labour laws aimed at permitting layoff. Experiencing such extreme conflicts, more and more workers and employers began to realize that conflicting industrial relations were beneficial to neither of them. A consensus began to be formed on the importance of labour-management cooperation. Currently, companies operate various programs for labour-management cooperation for which the government is providing full support with keen interest. In the mid 1990s, the government started to recognize labour as partner in formulating labour policies.

Since then, labour policies have been made after consultations among labour, management, and the government through such channels as the Industrial Relation Reform Commission (1996) and the Tripartite Commission (1998). In particular, since 1998, the Tripartite Commission has functioned as a mechanism to resolve labour issues based on agreement of labour, management and the government. Along with this, basic labour rights in the public sector have been expanded with the establishment of teachers' trade union (in July 1999), over which many from home and abroad had raised questions and with the introduction of public officials' workplace associations (in January 1999). This progress has raised the status of trade unions and increased their roles. Although there remains aggressive labour movement by some trade unions of large companies, the extreme tension between labour and management shown in the early stage of labour movement is being replaced by the labour-management culture of settling disputes autonomously through dialogue and compromise.

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<sup>4</sup> From the home page of Ministry of Labor

The government has taken consistent stance to industrial conflicts on the basis of two yardsticks of Dialogue and Compromise and Law and Principle. Such policy direction has paved the way for an industrial relation where disputes are settled through dialogue and compromise, although in the first half of the year 2003, some major disputes broke out continually, destabilizing industrial relations. Illegal disputes have sharply decreased over the same period last year by strictly enforcing laws in accordance with law and principle. This shows that laws and orders of industrial relations are being entrenched.

#### **4.1 Mediation System for Industrial Disputes**

In the process of wage or collective bargaining between labour and management, when disputes occur between labour and management due to difference in opinions on matters related to the decision of working conditions such as wage, working hours, welfare, dismissal or treatment of workers, etc., in principle, labour and management themselves should resolve the disputes autonomously. However, in case the disputes are not settled autonomously by labour and management themselves, the parties can receive help from dispute mediation mechanism including the Labour Relations Commission in settling the disputes. The dispute mediation system in Korea can be categorized into two: the official mediation system by the Labour Relations Commission and the private mediation system by persons or groups other than the Labour Relations Commission pursuant to mutual agreements or collective agreements.

The key role of the Labour Relations Commission is to settle industrial disputes (unfair dismissals, unfair labour practices, labour disputes, etc.) that arise in the relationship between labour and management. The Commission is composed of members representing labour, management and public interest. In particular, public interest members are selected by labour and management representatives on the Commission. In addition to the Central Labour Relations Commission,

there are regional labour relations commissions in 12 major cities. The Central Labour Relations Commission is in charge of dealing with the industrial disputes which fall under the jurisdiction of two or more regional labour relations commissions and reviewing measures taken by a regional labour relations commission or a special labour relations commission. If the negotiations between labour and management fail to lead to an agreement, one of the parties may file an application for mediation to the Labour Relations Commission.

If the Commission receives such an application from general businesses, it should organize a mediation committee composed of three members each representing employers, workers and public interests, and begins mediation. In case of application from public interest services, a special mediation committee composed of three public interest members conducts mediation. In general businesses, mediation should be completed within ten days and in case of public services, within fifteen days after the request of mediation. After confirming the claims by each party concerned, the mediation committee should prepare a mediation proposal and recommend both parties to accept it. Although labour and management have a discretionary power to accept the mediation proposal, they should take part in the mediation in good faith. In case an agreement fails to be reached through mediation within the mediation period, workers can start industrial actions. Arbitration, not like mediation, is a legally binding process of settling industrial disputes. Industrial disputes are referred to arbitration, if:

- both labour and management agree to do so;
- one of the parties requests arbitration according to collective agreements or;
- a special mediation committee recommends referring disputes in essential public services to arbitration.



Once disputes are referred to arbitration, industrial actions are prohibited for fifteen days. The Labour Relations Commission organizes an arbitration committee composed of three public interest members. Because arbitration awards made by the Labour Relations Commission have the same effect as collective agreements, parties concerned must follow. If parties concerned consider that the arbitration awards rendered by a regional labour relations commission violate laws or go beyond its authority, they may apply for review of the case to the Central Labour Relations Commission within 10 days. If parties can not accept the arbitration awards or decisions subsequently made by the Central Labour Relations Commission, they can bring an administrative lawsuit within 15 days.

#### **4.2 Promotion of Labour-Management Council at Enterprise-level**

Apart from labour-management consultation through collective bargaining between labour and management, the system of labour-management council is put in place to increase productivity, enhance workers' welfare, and deal with grievance from workers. In addition, the Tripartite Commission established in 1998 functions as a channel for consultation on major labour policies at the national level. Labour-management councils have been formed at the enterprise level, with a view to promoting workers' welfare and achieving sound corporate growth through participation and cooperation of labour and management. Companies began to establish and operate labour-management councils in 1963. The Government enacted the Labour-Management Council Act in 1980, which made it mandatory for workplaces with trade unions or all business entities with more than 100 workers to set up a council.

The Act was amended in 1987 to expand the coverage to all businesses with more than 50 workers. The Act was developed into the Act Concerning the Promotion of Worker Participation and Cooperation in 1997 and enabled many more workers to participate and cooperate by establishing the following system.

The workplaces with 30 or more employees, regardless of the existence of trade union, shall establish a labour-management council. The worker member shall be elected by direct ballot of workers so as to strengthen the representation of workers on the council. In case of a workplace with a trade union composed of a majority of all workers, the trade union can select the worker member of the council. The council's role shall be strengthened by adding to the agenda for consultation, profit sharing, general guidelines for employment adjustment, management of working and recess hours, etc.

To ensure that employers implement decisions regarding key labour-management issues only after consulting the labour-management council in accordance with fixed procedures, matters which must be decided by the council have been newly established. Employers must report and explain their companies' economic and financial situation to the labour-management council. If they fail to do so, workers can request relevant information, thereby expanding workers' right to share business information.

Major functions of a labour-management council prescribed in the Act on the Promotion of Worker Participation and Cooperation are as follows:

**Table 1 : Functions of Labour-Management Councils**

<b>Matters subject to resolution</b>	<b>Matters subject to consultation</b>	<b>Matters subject to report</b>
<ul style="list-style-type: none"> <li>▪ establishment of a basic plan for workers' training and competency development</li> <li>▪ establishment and management of welfare facilities</li> <li>▪ establishment of an in-house labor welfare fund</li> <li>▪ matters not resolved by the Grievance Handling Committee</li> <li>▪ establishment of various labor-management committees</li> </ul>	<ul style="list-style-type: none"> <li>▪ productivity improvement and profit sharing</li> <li>▪ hiring, deploying, and training of workers</li> <li>▪ prevention of industrial disputes</li> <li>▪ handling of workers' grievances</li> <li>▪ improvement of working environments(safety, health, etc.) and promotion of workers' health</li> <li>▪ improvement in personnel and labor management systems</li> <li>▪ general guidelines regarding employment adjustment, such as dismissal</li> <li>▪ management of working and recess hours</li> <li>▪ improvement in wage payment method, system, and structure</li> <li>▪ introduction of new machines and technologies and improvement of work processes</li> <li>▪ establishment and revision of work rules</li> <li>▪ support for employee stock ownership plans and workers' other wealth accumulation</li> <li>▪ workers' welfare improvement</li> </ul>	<ul style="list-style-type: none"> <li>▪ matters regarding overall management plans and performance</li> <li>▪ matters concerning quarterly production plan and performance</li> <li>▪ matters concerning personnel plans</li> <li>▪ company's economic and financial situation</li> </ul>

	<ul style="list-style-type: none"> <li>▪ other matters relating to labor-management cooperation</li> </ul>	
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### **4.3 Background of Launch and Development of a Social Consultative Body**

The government has made its efforts to establish social and economic systems for actively responding to the changing international environments and domestically developing participatory democracy. The launch of the Tripartite Commission as the first social consultative body in our history following the 1997 overhaul of labor-related laws is of great significance to the history of industrial relations in Korea. In the aftermath of the financial crisis at the end of 1997, the public consensus was raised on the necessity to form a social consultative body to fairly share burden and profits in the process of overcoming the economic crisis and of structural reform through cooperation between social partners.

Against this social and economic background, the Tripartite Commission composed of representatives of labour, management, the government and public interests was organized and has since then largely contributed to overcoming the economic crisis. The Commission also made such a large contribution to reforms in the public, financial and labour sectors that it was recognized as the most successful social consultative body in Asia. Its achievement is so great that recently it has also been acknowledged as a successful example by the ILO and Social and Economic Council (SER) in the Netherlands.

#### **4.3.1 Development of a Social Consultative Body**

##### **The 1st period (January 15, 1998 ~ ): Political Consultative Body**

At the end of 1997, the Korean economy was hit by a series of economic and social problems such as skyrocketing interest rates and exchange rates, lack of foreign currency reserves, reduced industrial activities and the consequential rise

in the unemployment rate. Against this backdrop, a tripartite consultative body was formed and launched to overcome the crisis at the suggestion of the President. Agenda for discussion were measures to increase labor market flexibility, adoption of joint declaration for rising above the economic crisis, etc. On January 15, 1998, the Tripartite Commission was launched with the participation of representatives of labor, management, the government, public interests, and the party officials. And on 17 January, an agreement (Tripartite Joint Statement on Fair Burden Sharing in the Process of Overcoming the Economic Crisis) containing the will of the social partners to share the burden of the crisis was pronounced.

Since then, numerous meetings were held among labour, management, the government and public interest members. On February 6, 1998, the Tripartite Commission produced the historic Social Compromise for Overcoming the Economic Crisis, which contains 90 items concerning corporate restructuring, unemployment measures, etc. By carrying out what was agreed upon since then, the tripartite partners have been establishing new labour-management relations based on participation and cooperation.

### **The 2nd Period (June 3, 1998 ~ ): An organization established by a Presidential decree**

In the second period, a comprehensive framework was laid to stabilize industrial relations and effectively implement the matters agreed in the first period. But at the end of December 1998, the Korean Confederation of Trade Unions (KCTU) withdrew from the Tripartite Commission, citing the reason that the agreed matters were not being implemented. The Federation of Korean Trade Unions (FKTU) and the Federation of Korean Industries (FKI) followed suit, making the Tripartite Commission incapable for a considerable period of time. Agenda for discussion included cooperative measures for employment security and industrial relation development, and measures to overcome economic crisis.

The 2nd Tripartite Commission which started on June 3, 1998 focused its work on resolving labour-management conflicts surrounding the structural reform and employment issues and on intensively discussing various social and economic challenges and reaching agreements. Related legislative bills were produced to enhance basic labour rights such as granting teachers the right to organize, guaranteeing political activities by unions, etc. Regarding structural reforms in the public, financial and corporate sectors, more than 10 recommendations and proposals were adopted. The practices have been spreading in which social conflicts can be resolved through dialogue and cooperation rather than being expressed by clashes between labour and management or between labour and the government. In addition, the Tripartite Commission discussed cooperation mechanism to embody the Korean government's philosophy of parallel growth of democracy and the market economy and create the new industrial relations culture for the coming knowledge-based society of the 21st century.

### **The 3rd Period (September 1, 1999 ~ ) : An organization based on law**

With the legislation of the related law on May 24, 1999, the Tripartite Commission started to function as a legal body composed of the general meeting, standing committee, and special committee to discuss pressing issues such as measures to improve laws and systems on industrial relations. The Commission discussed issues such as the principle and direction of restructuring of the public sector and improvement of laws, practices, and mindset for developing industrial relations. At the request of the labour circle that the Tripartite Commission be made a permanent and legal consultative body, the Act on Establishment and Operation of the Tripartite Commission was enacted on May 24, 1999. Pursuant to the Act, the 3rd Tripartite Commission was launched on September 1, 1999.

In the third period, labour, management and the government, amid more mature culture of discussion, continued to discuss each matter at each sub-committee with enthusiasm. Thanks to such an effort, the Commission drew the following

tripartite agreements on areas such as labour-management relations, economic and social policies and structural adjustment, eventually contributing to stabilization of industrial relations. The special committee on working hour reduction set up on May 24, 2000 and the committee on measures for non-regular workers set up on July 23, 2001 reached an agreement on basic directions of working hour reduction and measures to protect non-regular workers.

But they failed to reach a final agreement due to difference in opinion on details. On July 25, 2003, the results of the discussions at the general meeting up until then were sent to the government. Although labour and management failed to reach a final agreement at the Tripartite Commission, the discussions at the Commission enabled the related parties to share opinions on the pressing issues and raised public awareness of such issues. The discussions at the Commission are significant in that they have formed a consensus between labour and management on the need for new policies and their basic direction. The Tripartite Commission formed, on September 3, 2003, Special Committee for Workers in Atypical Relations;»to discuss protection measures for workers in atypical relations such as insurance salespersons, teachers of learning aid companies, etc.

The Commission will focus its efforts to devise effective protection measures by legislating labour or economic laws through fact-finding researches and comparison with the cases of other countries. In the meantime, at a general meeting on July 25, 2003, a bill on Plan of Operation of the Tripartite Commission was prepared and is being promoted to help the Commission take root as more stable and stronger social consultative body by overcoming some of the problems shown in the process of operation of the Commission since its establishment in 1997.

The agenda for discussion are expanding the discussion items to cover economic and social policies, introducing the time limit for discussions, establishing multi-level consultative channels such as the Tripartite Commission by industry or region, etc. The Korean Tripartite Commission keeps in touch with the ILO, the NESC of Ireland and the SER of the Netherlands. Visited by tripartite organizations from other Asian and European countries, the Commission is internationally recognized as a consultative body which decides social and economic policies through tripartite dialogue between labour, management and the government, a trend spreading to all over the world.

**Table 2 : The Achievements of the Third Tripartite Commission**

<p><b>Settlement of current issues in the area of labor-management relations</b></p>	<ul style="list-style-type: none"> <li>▪ Wage payment to full-time union officials and multiple trade unions at enterprise level (Feb. 9, 2001)</li> <li>▪ Measures to ensure the effectiveness of collective agreements (Dec. 21, 2000)</li> <li>▪ Basic agreements on working hour reduction (Oct. 23, 2000)</li> <li>▪ Agreement to improve systems and practices of mediating industrial disputes(Nov. 21, 2002)</li> </ul>
<p><b>Expansion of social and economic policies</b></p>	<ul style="list-style-type: none"> <li>▪ Tax reform measures to promote workers' welfare (Jul. 25, 2000) and Enactment of the Basic Workers Welfare Act (Oct. 23, 2000)</li> <li>▪ Laying the foundation for enforcing the National Basic Livelihood Security Act more thoroughly (May 30, 2000)</li> <li>▪ Measures to protect human rights and working conditions for foreign workers (Jun. 29, 2000)</li> <li>▪ Building financial resources for workers' learning(Nov. 21, 2002)</li> <li>▪ Labor income tax reform(Nov. 21, 2002)</li> </ul>



<p><b>Support for structural adjustment</b></p>	<ul style="list-style-type: none"> <li>▪ Restructuring in the public sector <ul style="list-style-type: none"> <li>- Electric power(Jun. 29, 2000), Postal service(Aug. 4, 2000), Railroads (Dec. 14, 2000) Privatization of subsidiaries of Korea National Housing Corp.(Jul. 22, 2002) Privatization of subsidiaries of Korea Highway Corp.(Jul. 22, 2002)</li> </ul> </li> <li>▪ Restructuring in the financial service sector <ul style="list-style-type: none"> <li>- Directions for development of financial industry and financial reform (Jul. 12, Dec. 22, 2000)</li> </ul> </li> </ul>
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#### **4.3.2 Basic Direction**

Establishing labour-management partnership based on trust is more important than any task to respond to changing labour environment such as intensified international competition and the advent of the knowledge-based society, and realize the national visions in the 21 century: "the Northeast Asian hub" and "the era of GDP per capita U.\$ 20,000". Toward the end, the government devises and provides various labour-management cooperative projects that meet the characteristics of each workplace or industrial relation, in an attempt to help labor and management recognize each other as partner on an equal footing and achieve high performance and quality welfare through voluntary participation and cooperation.

#### **4.4 Major Government Assistance to Labour-Management Cooperation**

Financial Assistance for Labour-management Cooperative Programs is a project where the government provides assistance to programs for labour-management cooperation implemented by workers, employers, or workers' or employers' organizations by industry or region. The project is aimed at entrenching

cooperative industrial relations at workplaces by laying the financial basis so that labour and management can improve their relations in a way that best suits the conditions of each workplace and increase labour-management cooperation autonomously.

According to the project first implemented in 2003, the government selected 68 out of 317 labour-management cooperative programs that had applied for the government assistance and has provided them with assistance amounting to two billion won. Service for Diagnosis of Labour & Personnel Management was launched in 2001 and has provided services to 48 workplaces. The project is aimed at assisting labour and management to raise awareness on the problems in their relations and improve the relations autonomously. To do so, the government entrusts specialized and impartial certified labour affairs consultants to select workplaces where industrial relations are not stable, examine overall labour relations under the labour-management agreement, identify the problems, and provide measures for improvement. Program for Workplace Innovation was launched in 2000 and has assisted 291 workplaces to innovate their workplaces. The program is to assist companies, with stable industrial relations and basis for growth, to develop into workplaces with high performance and quality welfare which can develop employees' capability, increase their productivity, and enhance their welfare. To achieve the goals, the government conducts consulting for industrial relations of these model workplaces and provides them with measures to advance industrial relations, and enables the leading companies to benchmark each other. Moreover, by adopting the system of Certification of Companies with New Industrial Culture, the government has, since 2000, certified 258 companies with good results in terms of industrial relations, human resources development, and contributions to the society. In addition, "leading companies, leading causes" is published annually to introduce the examples of best industrial relations to companies of home and abroad, in an attempt to spread the atmosphere for labour-management cooperation.

On the other hand, examples of companies closed their businesses due to industrial conflicts are also distributed to raise awareness of the importance of stable industrial relations. The government will continue to develop and support a variety of labour-management cooperative projects to spread new industrial culture based on the autonomy of labour and management, so as to maximize the interests of both labour and management by establishing advanced industrial relations.

**The Korea Labour Education Institute** was set up at the end of 1980s to promote various education and labour-management cooperative projects on the basis of a consensus among labour, management, and the government. They agreed that democratic industrial relations should be established to meet rapid changes in industrial relations environment and that the capability to resolve industrial issues should be increased to help develop the national economy. The Korea Labour Education Institute is in charge of developing and providing education programs for union officials, workers, and public officials. In addition, the Institute contributes to the development of the industrial relations in Korea by providing individual workplace with consulting service for its industrial relation, and providing financial assistance to labour-management cooperative programs.

In particular, the government plans to review the school textbooks of primary, middle, and high schools which have an influence on the formation of one's values, with a view to rectifying the biased views on industrial relations and help youths cherish the value of labour. In addition, the government is considering developing dispute prevention programs needed to foster mediation experts in an attempt to promote dispute mediation by labour and management themselves. The government is focusing on new projects to meet the changing labour environment such as strengthening education to advance industrial relations of the public sector which has great impact on the national economy and the daily lives of the general public.

## **5.0 Productivity and Wage Statistics**

### **5.1 Labour Productivity and Unit Labour Costs**

#### **Fourth Quarter and Annual Average, 2006**

In 2006, the index of labour productivity in mining and manufacturing (including electricity-gas and water) was 155.6(2000=100), and the growth rate of labour productivity was 12.3%, compared to the previous year. The growth of labour productivity was due to a 10.1 % increase in output and a 2.0% decrease in labour input. The quarterly and yearly growth rates of labour input, output, and labour productivity in mining and manufacturing (including electricity-gas and water) are shown in Table 3.

### **5.2 Labour Productivity**

In 2006, the growth types of labour productivity can be characterized as output increases and labour input decreases. The indices of labour productivity are classified for three main industries; i) mining, ii) manufacturing, iii) electricity-gas and water. For 2006, the characteristics of labour productivity growth are as follows;

#### **(1) Mining Sector**

In the mining sector, the index of labour productivity was 109.5 (2000=100), and it has decreased by 1.5% compared to the previous year. The growth was due to the 1.4% decrease in industrial production and the 0.1% increase in labour input (Table 3).

**Table 3 : Trends for Labour Productivity**

		%				
		I	II	III	IV	2006
Labour Productivity	Mining and manufacturing <sup>1</sup>	10.9	13.7	12.7	12.3	12.3
	Mining	-0.8	-6.4	-3.7	6.2	-1.5
	Manufacturing	11.5	14.4	13.2	12.7	12.8
	Electricity, gas and water	0.1	3.7	6.8	5.1	3.9
Output <sup>2</sup>	Mining and manufacturing <sup>1</sup>	12.8	11.5	11.3	5.2	10.1
	Mining	3.2	-6.3	-1.9	0.6	-1.4
	Manufacturing	13.4	12.1	11.8	5.6	10.5
	Electricity, gas and water	5.6	4.9	6.1	1.0	4.4
Labour Input	Mining and manufacturing <sup>1</sup>	1.8	-2.0	-1.2	-6.3	-2.0
	Mining	4.0	0.1	1.8	-5.2	0.1
	Manufacturing	1.7	-2.0	-1.2	-6.4	-2.1
	Electricity, gas and water	5.4	1.1	-0.7	-3.9	0.4

<sup>1</sup> Including electricity, gas & water

<sup>2</sup> Output refers to the quantity of industrial production

## (2) Manufacturing Sector

In the manufacturing sector, the index of labour productivity was 156.1 (2000=100), an increase by 12.8% compared to the previous year. Such growth in labour productivity was a result of the increase in output (10.5%) and the decrease in labour input (-2.1%). For some industries, the labour productivity growth has outdone the average growth rate (12.8%) of manufacturing as shown in Table 4.

In the case of Electronic Components, Radio, TV & Communication Equipment & Apparatus, the growth of labour productivity has been affected by the rapid increase of output (industrial production) at over 25%. In the case of Tobacco, Sewn Wearing Apparel & Fur Articles, and Coke, Refined Petroleum Products & Nuclear Fuel, the growth of labour productivity has come from the increase in

output and the decrease in labour input. In the case of Computer & Office Machinery, Tanning and Dressing of Leather, Manufacture of Luggage & Footwear, the growth of labour productivity has come from the decrease in output and the more decrease in labour input.

**Table 4: Major Sectors with an Above the Average Growth Rate of Labour Productivity in Manufacturing**

	Labour Productivity	Output	Labour Input
	%		
Manufacturing	12.8	10.5	-2.1
Electronic Components, Radio, TV & Communication	18.8	25.2	5.3
Sewn Wearing Apparel & Fur Articles	26.1	8.2	-14.2
Computer & Office Machinery	19.5	-0.1	-16.4
Tobacco	19.1	11.8	-6.1
Coke, Refined Petroleum Products & Nuclear Fuel	17.9	1.2	-14.1
Tanning and Dressing of leather, Luggage, Footwear	16.5	-0.5	-14.6

<sup>1</sup> Output refers to the quantity of industrial production

### **(3) Electricity, gas & water Sector**

In the electricity, gas & water sector, the index of labour productivity was 143.8 (2000=100), an increase by 3.9% compared to the previous year. The growth rate was 4.4% for output, and 0.4% for the labour input as seen in Table 3.

### **5.3 Output**

The quarterly growth rates of output (industrial production) for the main industries are also shown in Table 3.

- i) Mining (-1.4%)
- ii) Manufacturing (10.5%)
- iii) Electricity, gas & water (4.4%)

In terms of the industrial structure the output growth rate for the heavy-chemical industry was 12.6%, and that of the light-industry was 1.1%, compared to the previous year. In terms of firm size, the output growth of large business was 13.4%, and that of small and medium size business was 5.3%. Furthermore, the output growth of the IT sector was 23.6%, and that of the non-IT sector was 4.2%, compared to the previous year. To summarize, the growth rates of output tends to be higher for the heavy-chemical industry, for the large business, and for the IT sector.

### **5.4 Labour Input**

The quarterly growth rates of labour input (including the number of labour and working hours) in the main industries are shown in Table 5.

- i ) Mining (0.1%)
- ii) Manufacturing (-2.1%)
- iii) Electricity, gas & water (0.4%)

The growth rate of the number of labour was 0.9% in mining, -0.3% in manufacturing, and 1.4% in electricity, gas & water. The growth rate of working hours was -0.8% in mining, -1.8% in manufacturing, and -0.9% in electricity, gas & water. Accordingly the total labour input has decreased in mining and manufacturing (including electricity, gas & water) (Table 1). The decrease in terms of total labour input is mainly due to the decrease of working hours (-1.8%).

## **5.5 Value Added Labour Productivity**

In 2006, the index of value added labour productivity was 152.6 (2000=100) in mining and manufacturing (including electricity, gas & water), and the growth rate of labour productivity in value added accounting was 10.1%, compared to the previous year. In detail, the growth of value added labour productivity was due to the increase of real GDP (8.0%) and the decrease of labour input (-2.0%).

The quarterly and yearly growth rates of value added labour productivity, GDP, and labour input by sectors are shown in Table 5.

### **(1) Mining Sector**

In mining the index of value added labour productivity was 113.0 (2000=100), a decrease by 3.4% compared to the previous year. This decrease of value added labour productivity was due to the larger increase of labour input (6.3%) in comparison to the increase of output (2.7%).

### **(2) Manufacturing Sector**

In manufacturing the index of value added labour productivity was 153.8 (2000=100), an increase by 10.8% compared to the previous year. The index and the growth rate of output (GDP) was 149.6 (8.4%), and that of labour input was 97.3 (-2.1%).

### **(3) Electricity, gas & water Sector**

In electricity, gas & water the index of value added labour productivity was 139.5(2000=100), a decrease by 3.5% compared to the previous year. This growth rate was due to the larger increase of labour input (7.3%) in comparison to the increase of output (3.5%).



**Table 5 : Trends of Value Added Labour Productivity**

		%				
		I	II	III	IV	2006
Value Added Labour Productivity	Mining and manufacturing <sup>1</sup>	7.1	11.2	10.0	12.5	10.1
	Mining	8.2	-20.0	17.6	10.6	-3.4
	Manufacturing	7.7	11.9	10.3	13.0	10.8
	Electricity, gas and water	-1.9	1.3	3.8	1.4	-3.5
Output (GDP)	Mining and manufacturing <sup>1</sup>	9.5	8.7	8.7	5.3	8.0
	Mining	12.9	-4.0	1.6	1.2	2.7
	Manufacturing	9.9	9.3	9.0	5.7	8.4
	Electricity, gas and water	4.6	3.4	5.4	0.5	3.5
Labour Input	Mining and manufacturing <sup>1</sup>	2.2	-2.2	-1.2	-6.4	-2.0
	Mining	4.4	19.9	-13.5	-8.5	6.3
	Manufacturing	2.1	-2.4	-1.2	-6.5	-2.1
	Electricity, gas and water	6.6	2.1	1.6	-0.9	7.3

<sup>1</sup> Including electricity, gas & water

## 5.6 Unit Labour Costs

On the one hand unit labour cost which is defined as the wage cost per output has decreased by 4.7% in manufacturing compared to the previous year. Such a decrease of unit labour cost was due to the larger increase of labour productivity (12.8%) in comparison to the increase of hourly earnings (7.6%), as shown in Table 6. Some industries where the negative growth rates of unit labour costs have outdone the average manufacturing growth rate (-4.7%) are as follows;

- i. Electronic Components, Radio, TV & Communication Equipment & Apparatus (-11.9%)
- ii. Coke, Refined Petroleum products & Nuclear Fuel (-11.7%)
- iii. Sewn Wearing Apparel & Fur Articles (-9.6%)
- iv. Tanning and Dressing of Leather, Manufacture of Luggage & Footwear (-7.5%)

Thus the cost competitiveness is to be stronger, especially, in IT sector like as Electronic Components, radio, TV & Communication Equipment & Apparatus, and capital intensive sector like as Coke, Refined Petroleum products & Nuclear Fuel.

**Table 6 : Trends of Unit Labour Cost in Manufacturing**

	%				
	I	II	III	IV	2006
<b>Unit Labor Costs<sup>1</sup></b>	-7.6	-6.4	-7.4	24	-4.7
<b>Hourly Famings<sup>2</sup></b>	3.0	7.0	4.8	15.4	7.6
<b>labor Productivity</b>	11.5	14.4	13.2	127	128

\* percent change from same quarter last year

(1) Hourly earnings/labor productivity (regular employees)\*100

(2) Nominal earnings/total hours\*100

## 6.0 Changes of Pay Systems

Raising flexibility of compensation system is emerging as a big social issue as Korea is facing rapidly aging population and deteriorating corporate competitiveness. According to a survey conducted by Korea Labour Institute, highly educated and young employees prefer job-and-performance-based compensation to seniority-based one. The survey also found that employees like to have multi-factor pay systems. The factors may include seniority, performance, and job value. And the bonus may also be determined by performance of individual, group, and corporation.

### 6.1 Determinants of Pay

There are several reasons for pay differentials that are not associated with the specific skills or abilities of individual employees. The following are factors that are related to inter-industry pay differentials: characteristics of the industry product market, profitability of the industry, degree of capital intensity, and level of union density. Part of the pay differential comes from the market an industry

operates within. Generally, industries operating in less-competitive product environments pay higher compensation because of higher profit due to higher concentration ratio, entry barriers, and less foreign competition. This relationship, however, is affected by the quality of labour (for example, education) a firm may have in place.

The profitability of the industry can be used as another determinant of an industry's ability to pay high wages and, therefore, as a prediction for the existence of a wage differential. Several studies found that industries with higher profitability pay all employees a relatively high wage rate. In essence, they share some of the wealth with all employees and are thus able to be more selective in the labour market. A study of manufacturing, retailing, and distribution companies by KPMG Peat Marwick disclosed that high-performance companies pay their CEOs higher compensation than do low-performance companies.

Compensation Mix for CEOs in the U.S.

	Base Pay	Annual Incentive	Long- term Incentive
High Performance	20%	27%	53%
Low Performance	49%	13%	38%

The ratio of capital to labour is also a determinant of inter-industry wage differentials. The more capital-intensive industries pay a higher average wage than do less capital-intensive industries. In a review of data covering twenty-six years in the U.S., wage growth was significantly higher for industries with rising capital ratios.

Union density is defined as the proportion of employees covered by a union contract. The higher the union density, the greater the number of unionized employees is, and according to research, the larger the wage differential is. Union density is positively related to the wage of both union and non-union workers. The positive influence of union density is greater for non-union workers of large organizations than for those working for small organization. The perceived threat of unionization for the large non-union organizations is believed to be main reason for their high-wage policy. This is particularly true in the case of Samsung Group. Union density as a cause of inter-industry wage differentials should be approached cautiously. Research has not yet shown whether union density is a cause of wage differentials or just related to it. This caution can be illustrated by the presence of relatively high pay in the automotive industry before the industry became predominantly unionized.

Research on the inter-industry wage structure is extensive. Generally, the conclusions drawn from the research support the existence of a wage differential; employees in different industries receive different pay for jobs that are comparable. The specific reasons for the presence of wage differentials are more difficult to establish. But whatever the reasons behind them, these wage differentials have an impact on the compensation decision makers. They must take into account the industry within which they operate and the industries with which they compete in the external labour market as they attempt to exercise their discretionary power.

## 6.2 General Determinants and Components of Wages

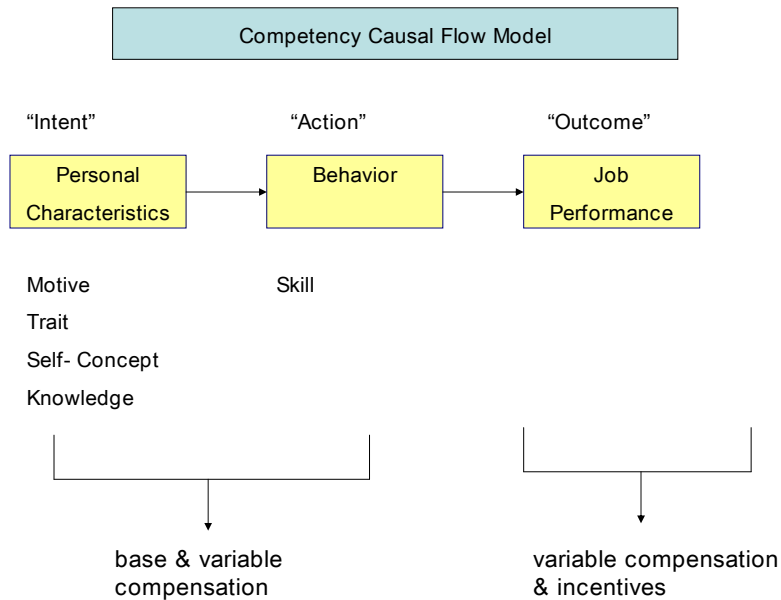
general determinants & components of wages and salary

determinants	evaluation items	reward components	remarks
job	performing duties, value of jobs, etc	base	needs job analysis and evaluation
competence	skill, attitude, leadership, problem- solving skill, planning ability, strategic- thinking, etc	variable	evaluation to be done by supervisor or 360 degree
achievement	completed projects/task/ action plan, financial achievement, etc	incentives	individual achievement is often combined with organizational performance. goal- setting process is necessary

A competency is an underlying characteristic of an individual that is causally related to criterion-referenced effective and/or superior performance in a job or situation. Underlying characteristic means the competency is a fairly deep and enduring part of a person's personality and can predict behaviour in a wide variety of situations and job tasks. Causally-related means that a competency causes or predicts behaviour and performance. Criterion-referenced means that the competency actually predicts who does something well or poorly, as measured on a specific criterion or standard. Examples of criteria are the dollar volume of sales for salespeople or the number of clients who stay "dry" for alcohol-abuse counsellors.

In other words, competencies are underlying characteristics of people and indicate "ways of behaving or thinking, generalizing across situations, and enduring for a reasonably long period of time." In the performance management context, evaluations would be undertaken for the following processes of competency causal flow model.

### 6.3 Competency Causal Flow Model



Corporations with multi-dimensional performance evaluation systems carry out evaluation for intent, action, and outcome. The evaluation results are basis for determining base, variable compensation, and incentives. Though corporations may take different design approaches, the typical pay systems would be linking base and variable compensation with personal characteristics and behaviour. Incentives and/or variable compensation would be linked with job performance.

## 7.0 Trend of Performance Management Systems in Korea

### 7.1 Performance Management Systems (PMS) Trend

#### 7.1.1 Industry Level

- In the 1970's, the private sector is leading the PMS development.
- The public sector, ministries and government divisions are found to be lacking in productivity.

- The government began subjecting public sectors to evaluation.
- The public sector used the private sector as a benchmark – a result of government initiative.
- The public sector is adopting the PMS of the private sector. Naturally the demand for consulting and educating is increasing.
- The management practices of the private sector are spilling over to the public sector.
- Today bureaucrats are changed and have a great evaluation system.

### **7.1.2 Corporate Level: Basis of PMS**

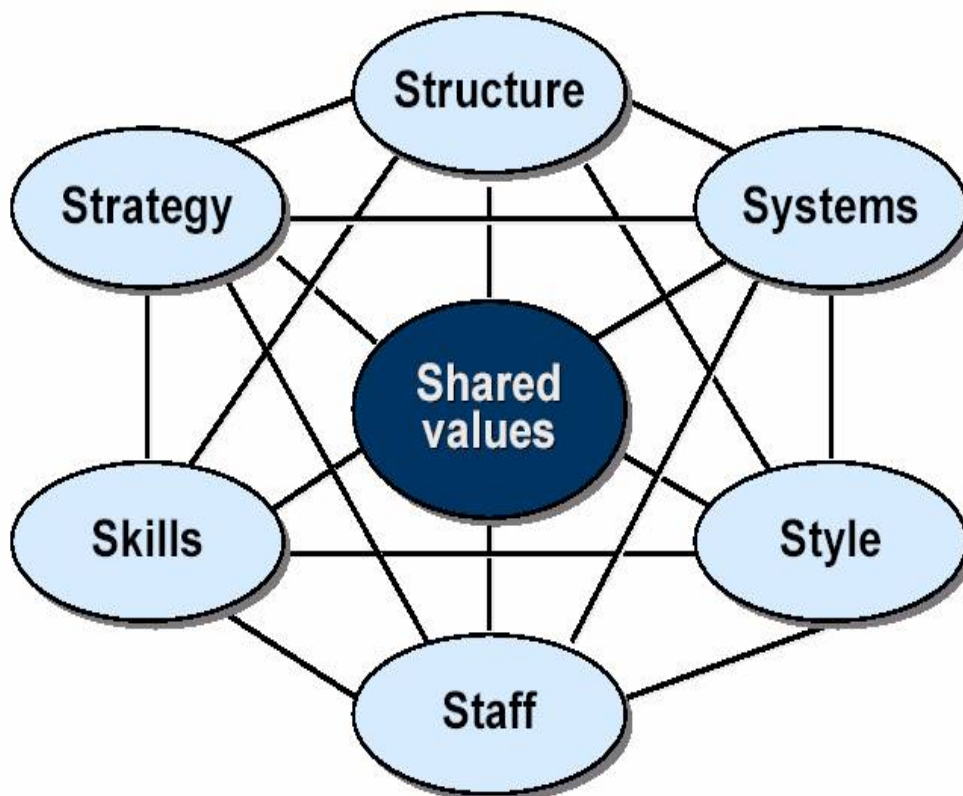
- The resource-based perspective is increasingly gaining support from academia and consultants in analyzing firm competitiveness vis a vie the competitive forces perspective.
- From the resource-based perspective, firms are heterogeneous with respect to their resources/capabilities/endowments. [“Dynamic Capabilities and Strategic Management,” Teece, D.J. et al. Strategic Management Journal, Aug. 1997, pp. 509-533.]
- What a firm can do is not just a function of the opportunities it confronts; it also depends on what resources the organization can muster. [ibid]
- The control over scarce resources is the source of the profit. Therefore skill acquisition, the management of knowledge and know-how, and learning become fundamental strategic issues. [ibid]

### **7.1.3 Common Structure of PMS**

- The PMS divides into two levels: the team level and the individual level.
- The team evaluation is based on the achievement.

- The individual evaluation has two components: achievement and competence.
- The remuneration is tied to the evaluation result.
- The McKinsey 7-S model is an example of a performance measurement system. The components of the McKinsey 7-S model are shown in Figure 1.

**Figure 1: The McKinsey 7-S Model**





## **8.0 Case Studies of Performance-Based Remuneration**

Two firm level case studies to demonstrate the implementation of the Performance-based remuneration are described. The two companies are:

1. LG Electronics
2. Taihan Corporation

### **8.1 Case of Korean Corporation: LG Electronics**

#### **8.1.1 History and Vision of LG Electronics**

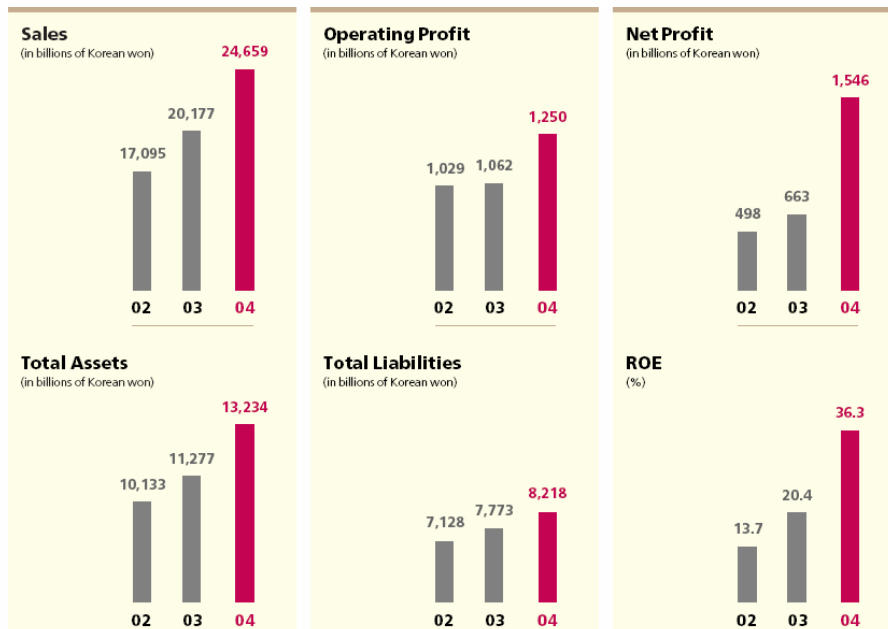
Established as Gold Star in 1958, LG Electronics has raised to the top of Korea's electronics and telecommunications industries by developing innovative technologies and products which push the state of the art. From a strong foothold at home, we have successfully advanced into international markets and have emerged as a major global player. LG Electronics is aiming at securing product competitiveness, as well as market leadership, both at home and abroad. Through heavy investment in research and development, aggressive global marketing strategies, and constant improvement of management practices,

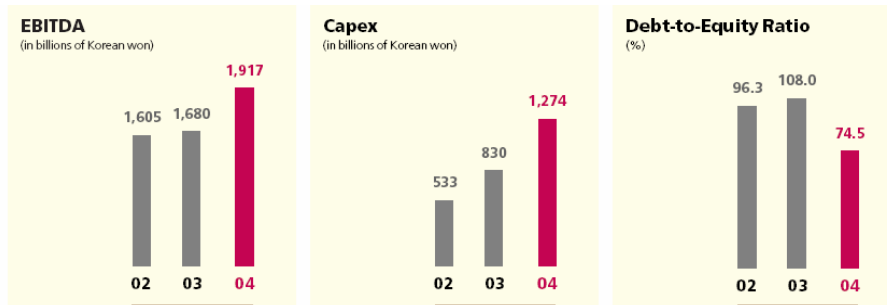
LG Electronics is breaking new ground in the global electronics and telecommunications industries. Its efforts centred on developing cutting edge digital products. This includes digital TVs, home Internet appliances, and next-generation mobile handsets. LG Electronics plans to be one of the top three electronics and telecommunications entities in the world by the year 2010. To fulfil this vision, it is focused on consolidating our competencies and fostering both mid and long-term innovations in every area of management. Human resource development, management strategies, overall organizational culture, all are being redeveloped in its pursuit of excellence.

LG Electronics has established a new vision of being among the global top 3 electronics and telecommunications companies by 2010. Mindful of this, the Company recently unveiled a guideline called "The LG Electronics WAY" to all of its employees. This guideline presents a new management system that will accomplish what is necessary to achieve the Company's vision, and ensure that ethical conduct and value will be shared by all Company employees. In 2004, with a strong commitment to the achieving of its goal, it carried out a broad spectrum of changes and innovations in every area of management.

### 8.1.2 Key financial results

LG Electronics achieved a net income of KRW 1.6 trillion, and total sales revenue of KRW 24.7 trillion, for the year 2004. This represented the best business performance ever reached in the Company's history. Its aggressive marketing in overseas markets of premium home appliances, digital TV, and mobile handsets, was the main factor driving the improvement in our 2004 results. These results are impressive considering the very challenging business climate in 2004.





To compare 2004 results appropriately with the previous year, LG Electronics have used pro forma full year 2002 numbers from January 1st to December 31st 2002 in the financial highlights and figures. It should be noted that it underwent a de-merger in April 2002, and its official financial statements are based on a nine-month period from April to December 2002.

### 8.1.3 Divisions of LG Electronics

#### Mobile Communication Division

Mobile Communications Division provides total information and communications solutions. It is rapidly emerging as a leader in the third generation handsets and systems following its successful breakthroughs in the CDMA and GSM handset markets. LG Electronics is seeking to lead in the global market through active marketing approaches, state-of-the-art handset development, and win-win partnerships with local telecommunications operators.

Its main products are CDMA handsets, GSM handsets, 3rd generation (WCDMA) handsets, wireless/wireline telecommunications systems, PBX, and Key Phones.

In 2004 the Division achieved KRW 9.5 trillion in total sales, and an operating income of KRW 636.2 billion. Total sales and operating income increased 55% and 99% respectively over the figures for the previous year. Due to the large increase in mobile phone sales in North America and Europe, sales revenue of

mobile handsets stood at KRW 8.4 trillion, up 61%. Its mobile phone sales have sustained a growth rate of greater than 45% for five years in a row.

### **Digital Appliance Division**

Digital Appliance Division creates innovative products that improve people's daily lives in countries around the globe. It is quickly rising to become a top force in the world market by expanding the reach of its premium home appliances. These include residential air-conditioners, microwave ovens, vacuum cleaners, side-by-side refrigerators, and drum washing machines. Its main products are Air-Conditioners, Air Cleaners, Microwave Ovens, Vacuum Cleaner, Refrigerator, Washing Machines, Dish Washers, Compressors, Motors, and Magnetrons.

Due to a strengthening export volume the Division achieved KRW 6.2 trillion in total sales, an increase of 10% over the previous year. Its residential air-conditioners have maintained its global the No.1 market share for five consecutive years. Furthermore, the microwave ovens and washing machines have become top products in the marketplace, positioning it for further growth.

### **Digital Display Division**

Digital Display Division produces products such as digital TV, PDP and OLED, among others. It has maintained the world best in technologies such as Single Scan technology of PDP, and digital TV core technology. LG Electronics has also developed the world's best technologies in the digital display arena by developing and producing a 55 inch LCD TV, a 71 inch PDP, and the world's first 76 inch PDP TV. Its main products are TVs (PDP TV, LCD TV etc.), PDPs, Monitors, Projectors, USB memory, Flash memory cards, and OLED. Thanks to an increase in digital TV and LCD monitor sales, LG Electronics' Display Division achieved KRW 5 trillion in total sales, up 19% from the previous year. Its LCD monitors, PDP modules, and PDP TVs held the second largest share of the global market, and LCD TV's ranked in the global top 5.

## **Digital Media Division**

Digital Media Division is responsible for carrying out advanced AV and IT businesses that embrace the manufacturing and sale of digital AV, optical storage, PCs etc. It is solidifying its position as a global leader in optical storage, DVD Players, and Home Theatre systems. It makes a concerted effort towards becoming a leader in digital convergence by developing new converged digital products, and enhancing strategic alliances with local telecom operators. Its main products are Home Theatre, DVD Recorder, MP3 Player, Optical Storage, Notebook PC, Desktop PC, and PDA. In the Digital Media Division, sales revenues came to KRW 3.8 trillion. This is a 7% decrease from last year due to the removal of the PC OEM business. Its optical storage system continued as the No.1 seller globally for seven consecutive years, and now Home Theatre and DVD Players have reached the top position as well.

### **8.1.4 Background of Personnel Management Principles of LG Electronics**

The 1997 financial crisis helped enable Korean corporations to rethink conventional wisdom and paradigm. The old system and philosophy was deeply rooted in Confucius teachings. Hi-tech corporations like LG Electronics needs to create challenging and creative corporate culture in order to compete in global markets. The conventional seniority-based system, for one, wreaked havoc on corporate culture. It was simply not possible to survive in fast-changing environment and cutthroat competition with Confucius' hierarchical thinking. Technology development was essential and achieving technological competence required attracting and retaining competent engineers and scientists.

Before the financial crisis, corporations in LG Group maintained identical reward system. LG Electronics produced sizable profit while another LG corporation suffered loss but employees in both corporations would have received similar reward. Discontent penetrated corporation due to irrational reward systems. But the external force of national financial crisis enabled LG corporations to overhaul

the pay system. New personnel management principles be the basis of pay system were introduced.

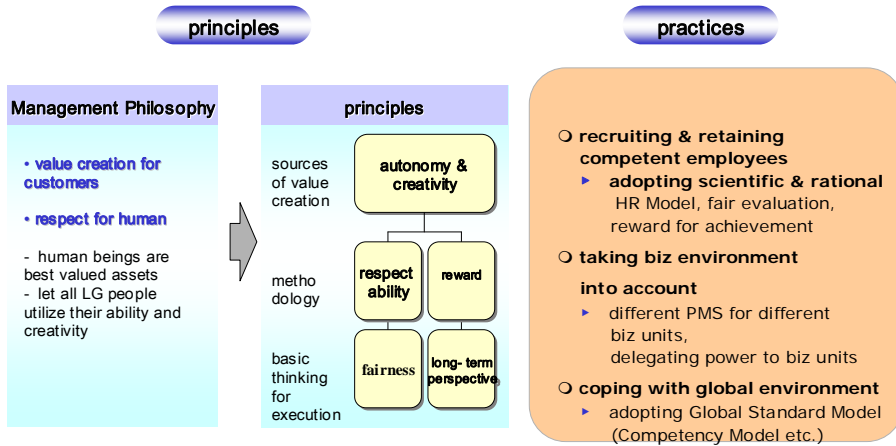
To introduce new pay systems, it required new performance management systems as well. Employees were increasingly demanded fair and rational performance evaluations. LG Electronics itself also needs to install effective system to evaluate and develop manpower. Needs for developing technological capabilities added more importance for system of identifying required manpower. LG Electronics determined to develop objective and fair performance evaluation systems. The systems will be instrumental to motivate employees by giving them adequate reward.

#### **8.1.5 Framework of Evaluation Systems**

The evaluation consists of competence and achievement or performance. Competence refers to knowledge, skill, techniques, behaviour needed to carry out jobs, and performance refers to work output.

Basic principles and practices of personnel management

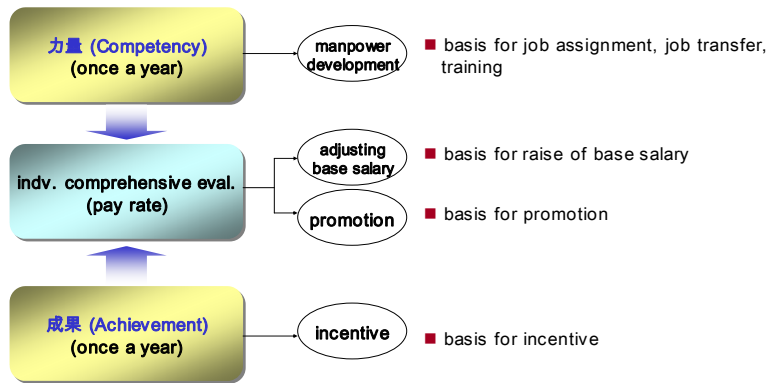
reinforcing organizational commitment; recruiting and retaining competent employees to undertake Digital LG vision by forming pleasant and challenging working environment



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composition



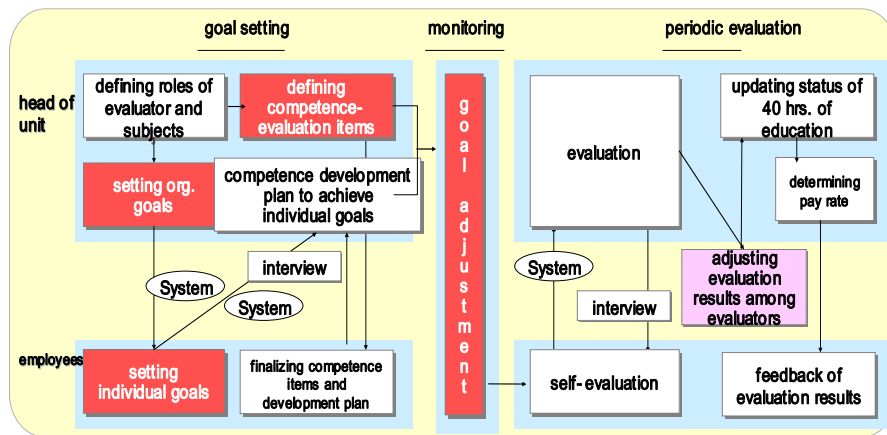
Evaluation for competency carried out once a year and its results are used for job assignment and education. Evaluation for achievement is also done once a year and its results are bases for determining incentives. Two evaluation results are consolidated into individual comprehensive results that become a basis for fixing base pay and its raise. The individual comprehensive results are also the referred data for promotion.

#### **8.1.6 Performance Management Systems**

One of the common mistakes the management commits in designing the performance management systems (PMS) is neglecting a consensus-building mechanism. LG Electronics institutionalized the communication process. The initial goal-setting is done by employees and adjustments are made accordingly through intensive discussions between evaluators and employees. Through this interaction, employees learn the systems and know what they should do to get good ratings. The evaluation results are fed back to rates in due course. Though the exercise may be time-consuming, evaluation transparency is ensured.

When the pay systems are determined solely by the achievement, the short-term perspective may become prevalent in the organization. People may neglect many things for short-term yield. To prevent this, LG Electronics has the Competency-Based Model in place. The Competency-Based Model consists of competency components that may not directly related to short-term gain but have importance for long-term corporate competitiveness.





- setting org. goals : reviewing current org. Mission/Role and setting performance indexes and work lists
- setting indiv. goals : setting goals for performance indexes along w. action plan
- defining competence-eval. items : defining competence-eval. items by the 1<sup>st</sup> evaluator
- monitoring : mid-evaluation to adjust individual goals
- periodic evaluation : adjustment of evaluation results to ensure fairness and validity

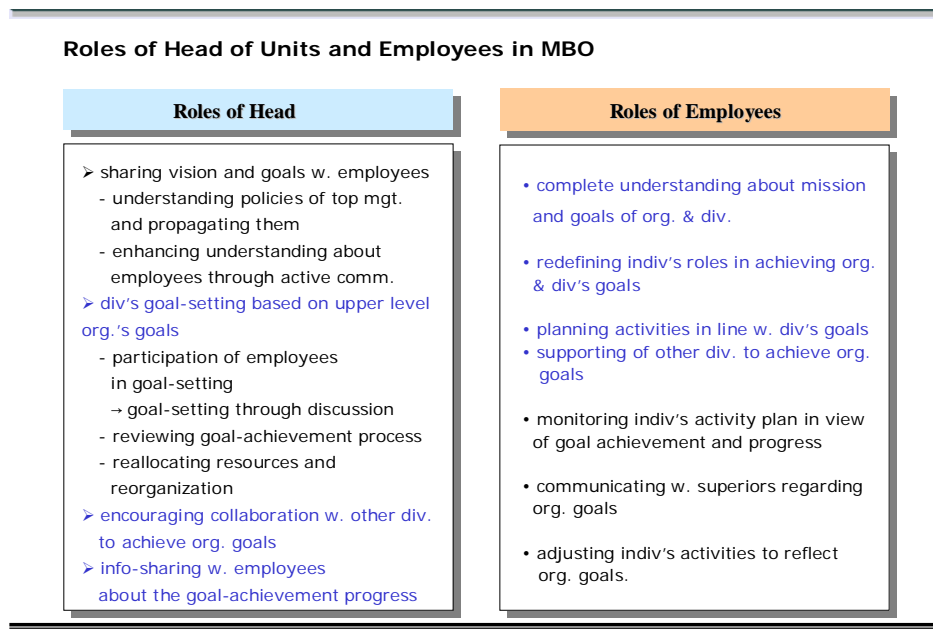
It has four categories of managerial competency, leadership competency, professional quality, and technical competency. Each category has four to seven competency elements. Some elements are defined as core competencies that must be included in evaluation of individual competency. Elements other than core are optional.

### 8.1.7 Different Roles of Management and Employees

To make PMS work, management and employees should perform their given roles. The main responsibility of management is communication. Communication is a bridge linking evaluators and employees. No matter how good the systems is, it would fail, if it is not accepted by employees,. Management should make continuous efforts to propagate what the organization is aiming for. It also encourages participation of employees in setting their

divisions or departments' goals. When needed, it also help employees set goals. Management should not take all responsibilities. Responsibilities should be shared among management and employees.

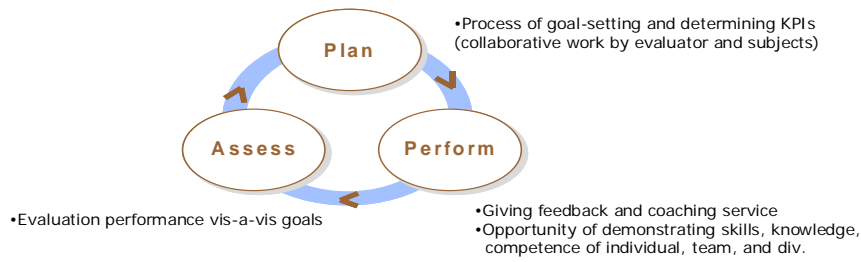
Employees understand vision and strategies of organization and division/ department and set their own goals. Action plans to achieve their goals must be put forward.



### 8.1.8 Process of Performance Evaluation for Division/Department

The evaluation process is basically following the Management-By-Objective (MBO). Goals are set by employees and achievement vis-à-vis goals are compared.

Carrying out performance evaluation founded on MBO



※ example of goal-setting

NO	Objective	KPI	Previous Result	Target	Action Plan	Weight	Rate
1	improving evaluation objectivity	satisfaction level for evaluation systems	3.17	3.30	<ul style="list-style-type: none"> <li>suggestions for improving systems( Feb. ~ March)</li> <li>application of suggestions(4~ 6)</li> <li>survey on satisfaction (July)</li> </ul>	60%	
2	Improvement of evaluator's evaluation	Completion Rate of Education	0%	50%	<ul style="list-style-type: none"> <li>Dev. of program for evaluator (Mar~ Apr)</li> <li>Carrying out education (April~ Oct.)</li> <li>Survey on implementation of education results (May~ Dec.)</li> </ul>	40%	



To illustrate how the system work, one example of evaluation for a supporting department is shown on the slide. The department is setting objectives of improving evaluation objectivity and evaluators' capability. KPIs are set for objectives and action plans are formulated along with weights. Ensuring objectivity is a key to success. Every objective must be described in detail and the measurability should be checked. Formula must be developed so that evaluation results can be provided in numbers. Since a similar approach is taken for evaluating achievement of individuals, no explanation is given for individual evaluation.

### 8.1.9 Competency Evaluation for Individual

In theory, a competency is an underlying characteristic of an individual that is causally related to criterion-referenced effective and/or superior performance in a job or situation. Academia is using the term of competency with a comprehensive meaning, that is, it includes personal characteristics, behaviour, and performance. LG Electronics uses the term in a more confined way. The competency excludes performance or achievement. LG Electronics makes distinctions between competency and achievement and has more weights on achievement. Having competency (behaviour and characteristics) reflected

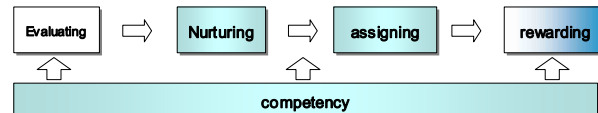
overly on evaluation, the evaluation becomes too subjective. To avoid this bias, LG Electronics put more weights on achievement than on competency.

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### Competency Evaluation

#### 1) Use of competency

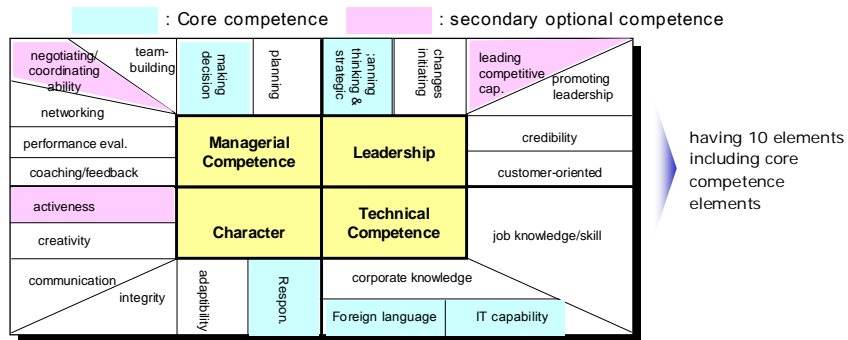
To define competency elements connected to corporate strategies and job requirements  
To utilize them in personnel management



#### 2) Selecting competency elements

- ① selecting competency elements required for job catgor. and job goups(4 job catgor., 18 job groups)
- ② having 5 skill levels for each competency element
- ③ setting expected skill level for each grade (identifying shortage or surplus manpower and planning for manpower development)
- ④ classifying competence areas as management competency, leadership competency, character competency, job competency
- ⑤ assigning competency elements of each area to org. units (common competency elements for corporate level and competency elements that each unit can select)

The evaluators must include five mandatory core competence elements, that is, competence of making decisions, sense of responsibilities, foreign language skills, IT skills, and strategic thinking. Besides five mandatory core elements, additional five competency elements should be selected from the suggested list of competence elements. Total of ten competency elements are used to evaluate individual competency level. The weights allocated on achievement and competency is 70% and 30% respectively.



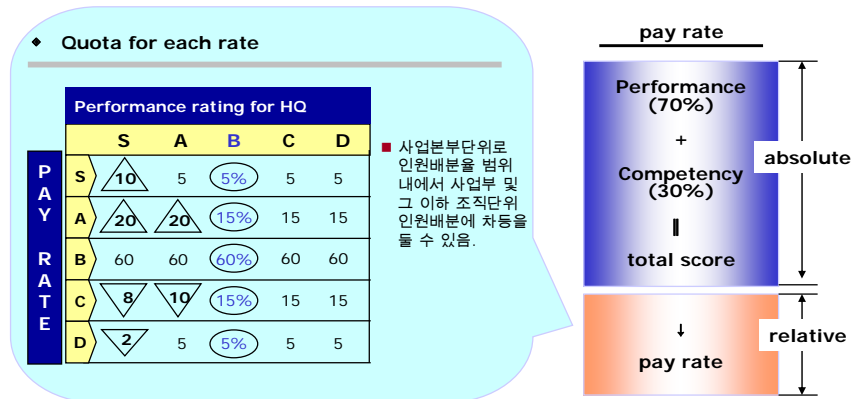
The evaluation score of achievement along with that of competency (7:3 weights) becomes the comprehensive score of individuals. For the comprehensive score, adjustment and normalization are conducted to eliminate differences among evaluators. The final score will be a basis for determining salary. The score will be reviewed both by evaluators and subjects before finalization.

### 8.1.10 Linking Individual Performance with Organizational Unit's Performance

Though individuals earned a good score of comprehensive evaluation, it does not guarantee the high pay rate. The determination of pay rate also depends on the performance of organizational unit which the individual belongs to. When they are rated highly, the organizational units have more quotas for high pay rate.

Linking individual performance w. organizational unit's performance

The individual salary rate will be determined by the total score and the quota for each rate.



For example, the performance rating for a unit is S, the highest rating, then 10% of total employees of that unit are entitled for the pay rate of S. The rating for the unit is A, then the quota for the rate of S is 5% and so on. Knowing that their pay will also be dependent on the unit's performance, employees will be motivated to collaborate. LG Electronics designed the pay system in a way to encourage the teamwork as well as the individual efforts.

8.1.11 Differentiation of Pay through Pay Band

To differentiate the pay among the same grad and the pay rate, LG Electronics is adopting pay band systems. For job grades L, S, J, and A, there are three bands. For each Pay Rate, the actual raise rate will be different depending on what grade you are in and what band you belong to. Individual's new salary will be determined by the base salary of the previous year and the pay rate along with the pay band.

$$\text{Individual new salary} = \text{base salary of previous year} \times (1 + \text{pay rate \& Band mix rate})$$

example

GRADE	Pay Band	Pay Rate	S (5%)	A (15%)	B (60%)	C (15%)	D (5%)
		Band 1	X* 1.5	X	X* 0.5	freeze	freeze
Band 2	X* 2	X* 1.5	X	X* 0.5	freeze		
Band 3	X* 2.5	X* 2	X* 1.5	X (basic rate)	freeze		

-For each grade, different raise rates are applied to three bands.

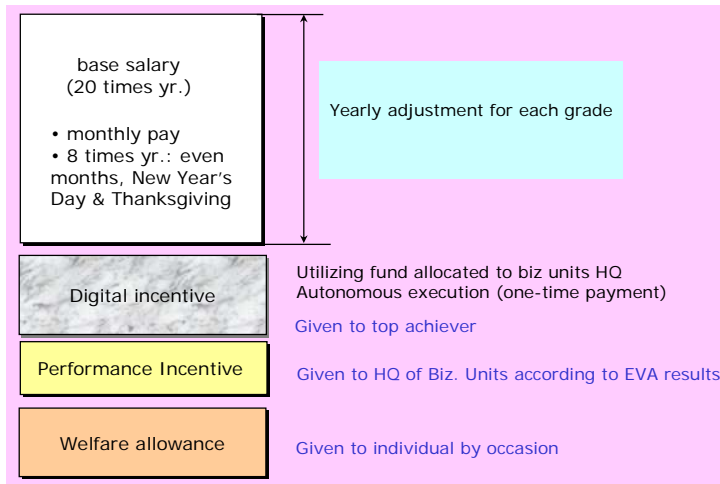
-Standard base raise rate has been set at the corporate level. But in future, only guidelines will be issued by the headquarter and each biz unit will decide raise rate that is feasible within the fund allocated to them.

grades: L, S, J, and A



### 8.1.12 Other Incentives for Individuals

Other than the base pay, the performance incentive can be given to the Headquarter of Business Units depending on the EVA results.

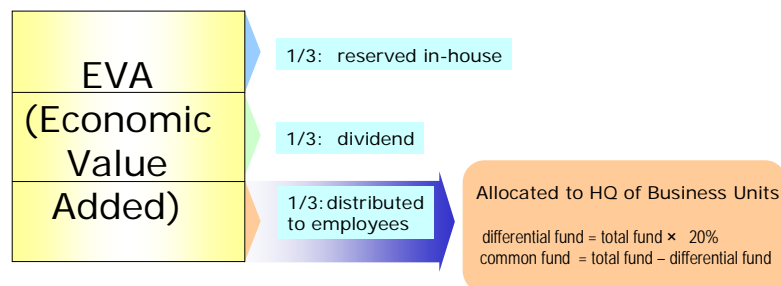


EVA is net operating profit minus an appropriate charge for the opportunity cost of all capital invested in an enterprise. As such, EVA is an estimate of true "economic" profit, or the amount by which earnings exceed or fall short of the required minimum rate of return that shareholders and lenders could get by investing in other securities of comparable risk. One third of EVA of the Business Unit is used as the Performance Incentive.

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### Performance Incentive

1. Calculation of total fund to be allocated to HQ of Business Units  
(operating profit after tax – net cost of capital invested directly to HQ) / 3
2. Fund allocated differently according to performance of HQ of Business Units
  - differential fund = total fund × 20%
  - common fund = total fund – differential fund



Presently the fund given to the Headquarter of Business Unit is allocated equally to the employees as the Performance Incentive. The Digital Incentive of which the term has no meaning is given to top achievers. This is a special incentive distributed to top employees of Business Units when the Units produce exceptional achievements. Since LG Electronics is a technology-intensive company, the recruitment and retention of highly skilled employees. To attract core manpower, LG Electronics has the incentives approved to each Business Unit. The Unit can extend stock grant, signing bonus and other incentives to maintain a pool of excellent manpower.



### 8.1.13 One Example of Performance Evaluation of Business Unit: Case of Digital & Display Media Division

Results of performance evaluation for Business Units affect the pay rate of individuals. Employees pay great attention to the process and the methodology of organizational performance evaluation. Therefore the performance indexes for Business Units must be set to be fair and objective. LG Electronics adopted three performance indexes namely main indexes, efficiency indexes, and strategic indexes. Main indexes reflect the financial performance. They include indexes like EVA, Sales, and market share.

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**Performance indexes are classified into main index, efficiency index, and strategic index. Different scales for each index will be applied.**

1. Main Indexes (EVA, Sales etc)
  - 120% achievement of basic-target set and 20% growth compared to previous year will get perfect point.
  - Market share will be used as supplement to sales volume. If the change of market share is more than 5%, penalty will be imposed.
2. Efficiency Indexes (productivity, quality, O/H Cost, etc)
  - 110% achievement of basic-target and 10% growth compared to previous year will get perfect point.
  - weights for basic-target achievement and growth will be differentiated.
3. Strategic Indexes ( Strategic Change Management projects, action programs for Patch Management Systems)
  - 100% achievement of target set will get perfect point. .
4. self-evaluation/ 1<sup>st</sup> evaluation / final evaluation
  - final grade will be given according to total weighted score
  - perfect grade for self-evaluation is 'A'  
(A >=90, B : 90> or >=80, C: 80> or >=70, D: >70 )
  - Heads of biz units who get A grade can be given the pay rate 'S'.

Efficiency Indexes are measuring performance of operational perspective. Productivity, quality, and overhead cost are included. Strategic indexes are related to change programs being undertaken by Business Units. For indexes, grading will be made through several stages of evaluation. The evaluation consists of self-evaluation by Head of Business Units, 1<sup>st</sup> external evaluation, and final external evaluation. The following slide shows how the evaluation is actually carried out for the Digital & Display Media Business Unit. It has three performance indexes and formulas are described how the scores are given.

Each department/team has its own indexes and formulas for evaluation. Supporting departments are not exception either. They also have indexed for evaluation. The evaluation results are being used for determining incentives.

#### Indexes and measurement scales of Biz Unit

indexes

EVA

GBU EVA  
 - additional point will be given depending on fund received/given from/to headquarter

sales/  
market share

Sales including internal sales (Won currency based)  
 Global market share, applicable to major five biz units including optical storage, monitor, TV, A/V, PDP  
 Reference of market share

Strategic  
CM

at least one registered plan of executing strategic change management

EVA

<weights : 60% >

Achievement of target	>120 %	>=110 %	>=100 %	>=90 %	>=80 %	80%<
	100	90	80	70	60	50

<weights : 40% >

Year-to-year comparison	>=20 %	>=10 %	>=0%	>=Δ 10%	>=Δ 20%	Δ 20%<
	100	90	80	70	60	50

Sales Turnover

< weights : 60% >

Achievement of target	>=120 %	>=110 %	>=100 %	>=90%	>=80%	80%<
	100	90	80	70	60	50

< weights : 40% >

year-to-year growth	>=20%	>=10%	>=0%	>=Δ 10%	Δ 10%<
M/S change stability*	100	90	80	70	60
deterioration	90	80	70	60	50

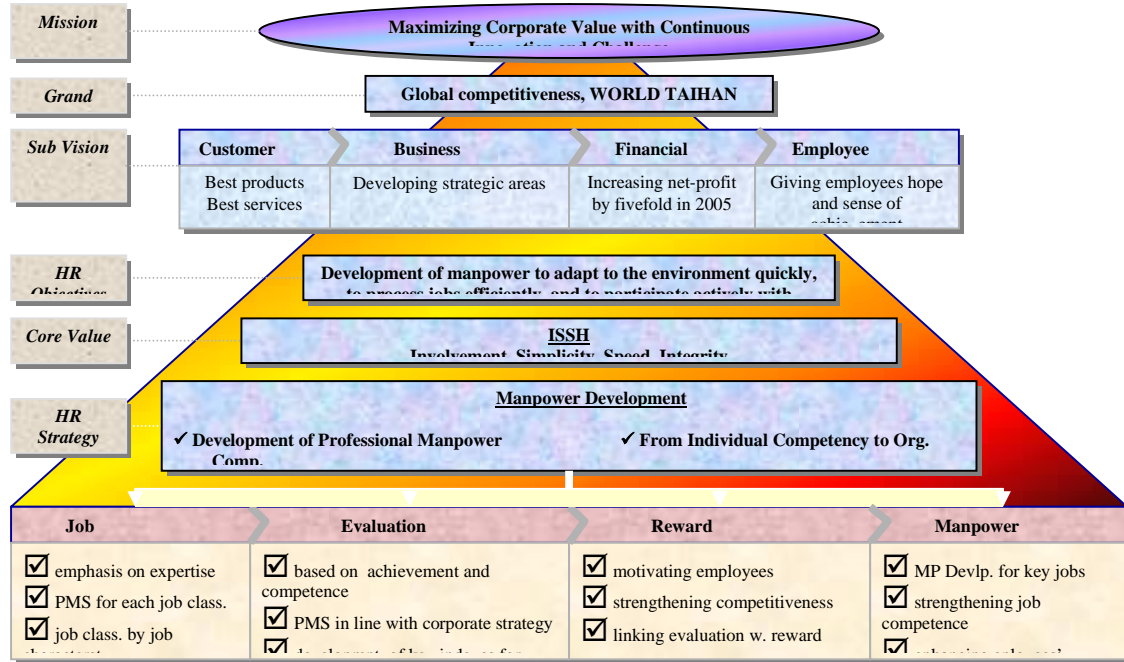
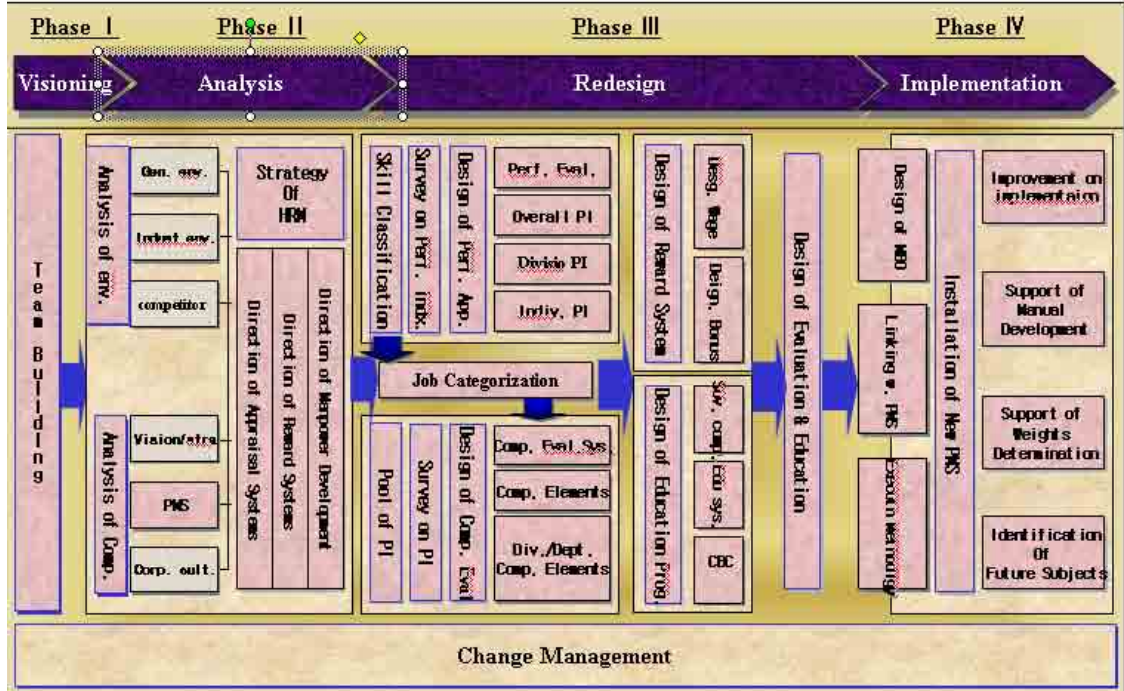
\* M/S stability : change rate within ± 5%  
 \*\* M/S is measured in units but if M/S can be measured in Won than measurement is done on 5:5

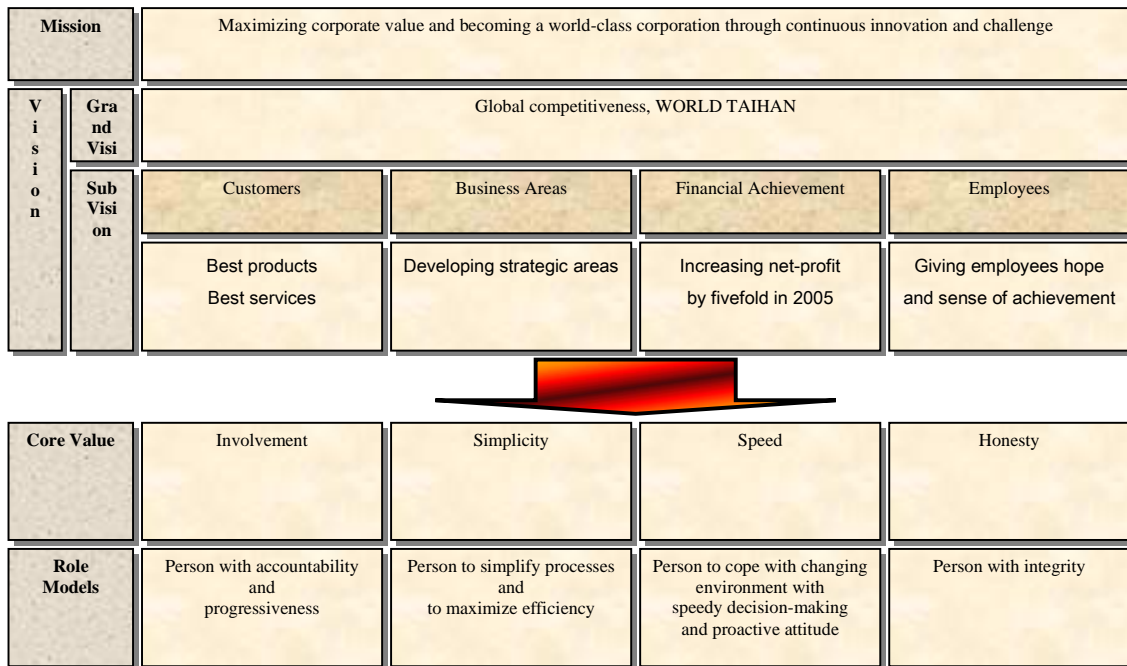
<exception> Due to retrenching businesses, it may not be possible to maintain certain level of sales and market share. In such cases, the target set could be readjusted when consensus has been reached by the subject and the 1<sup>st</sup> evaluator.

## 8.2 Case Study of Taihan Cable Corporation : Building Strategic HR Management (SHRM)

Taihan Corporation is an electrical company with nett sales of 2 billion USD, and a profit of 2 million. It has good labour-relations which is very important in Korea. The company uses visual presentation to explain the concept of PMS to employees. The following illustrates how the system is designed.

### 8.2.1 SHRM Framework



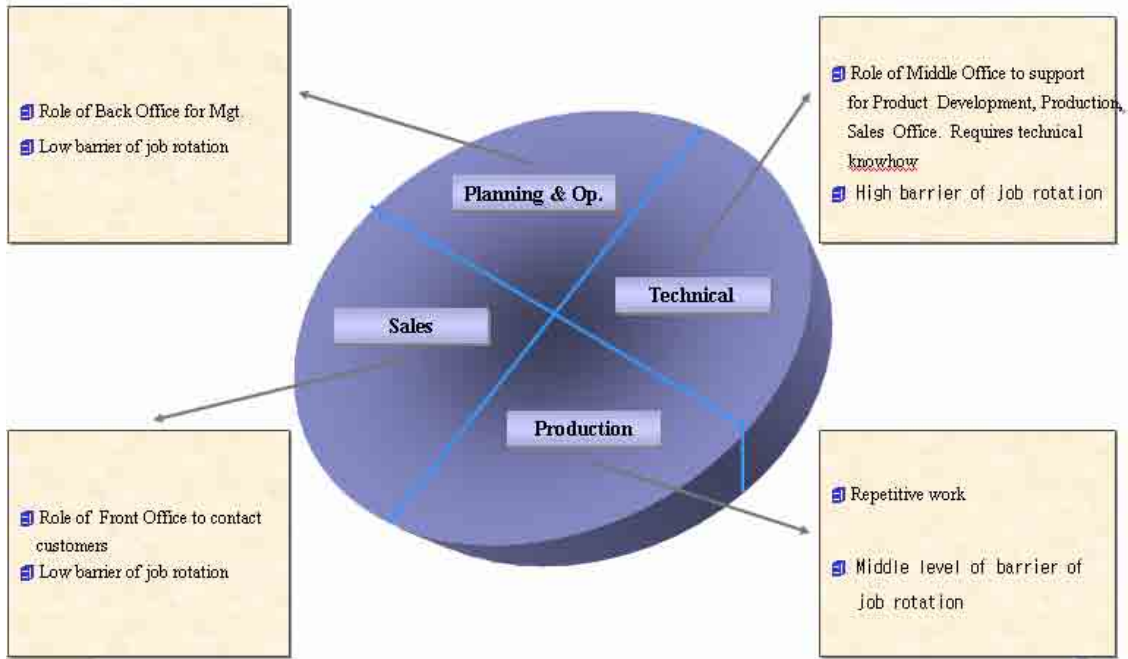


## 8.2.2 Job Categorization

### a) Job classification

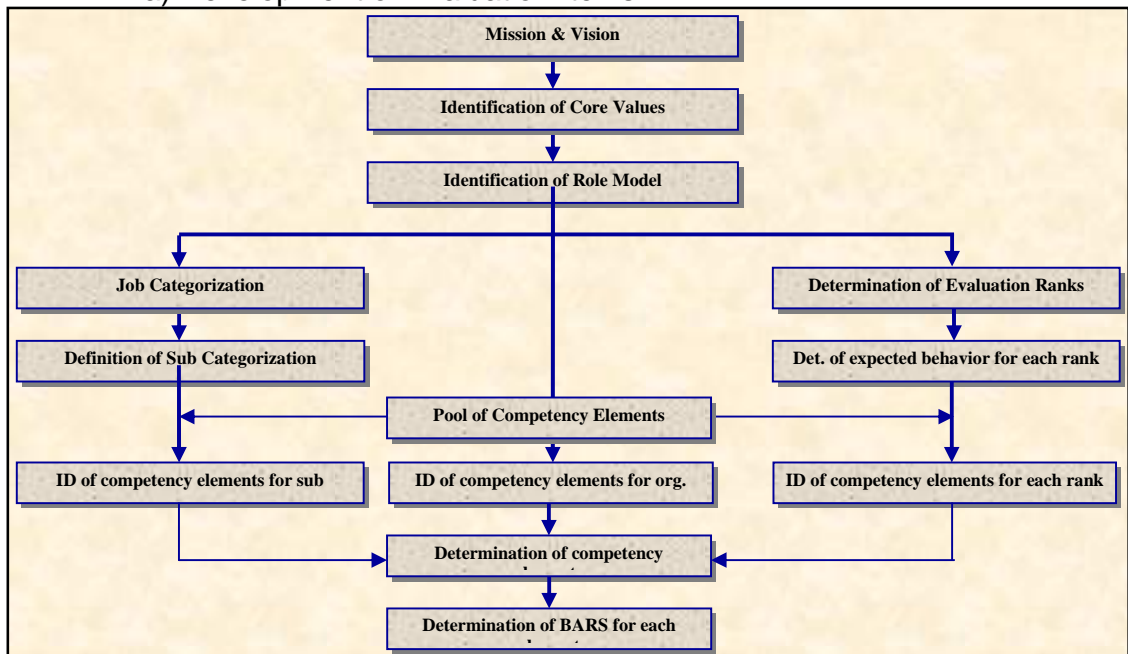
Job Cat.	Sub Cat.	Job Classification
<b>Planning &amp; Operation</b>	<b>Management</b>	Promotion, Planning, Manpower, Education, Foreign Exchange Mgt., Cash Management, New Project Development, Patent Mgt.
	<b>Supporting</b>	Accounting, Tax, Procurement, IT Planning & Operation, IT Development, External Cooperation, General Mgt., Emergency Planning, Administration
	<b>Production Supporting</b>	Production Mgt., Material Mgt., Logistics, Safety Mgt., Environment Mgt.
<b>Sales</b>	<b>Sales</b>	Sales for Government Procurement, Domestic Sales, Overseas Sales
	<b>Sales Management</b>	Sales Mgt., Mgt. of Overseas Corporations and Branches, Construction Mgt.
<b>Technical</b>	<b>Technical</b>	Development of Materials and Products, Product Design, Production Technology, Construction Planning, System Planning, Construction, Quality Inspection, QM, Facility Mgt., Process Mgt., Supporting Project
<b>Production</b>	<b>Production</b>	Manufacturing

### b) Job Categorization & Sub-categorization



### 8.2.3 Design of Competency Evaluation Systems

#### a) Development of Evaluation Items



**BARS: behaviourally anchored rating scales**

### b) Characteristics of each job category

<b>Planning &amp; Operation</b>	<b>Management</b>	Identifying the internal and external environmental changes, setting strategic direction, mapping out business plan, Planning manpower, machinery, and equipment.
	<b>Supporting</b>	Acknowledging various demands from departments and developing plans to coordinate and support demands.
	<b>Production Supporting</b>	Planning aggregate production plan, monitoring execution of production plan, assisting production staff to overcome Production problems
<b>Sales</b>	<b>Sales</b>	Identifying customer needs, forecasting market demand, taking actions to meet demand, and generating revenues
	<b>Sales Mgt.</b>	Supporting overall sales activities, aligning sales activities with corporate strategy, and compiling Sales-related information
<b>Technical</b>	<b>Technical</b>	Supporting sales and production through developing technologies, securing materials, and designing products
<b>Production</b>	<b>Production</b>	Engaging in daily manufacturing activities according to the production plan

### c) Expected Behaviour for Each Rank

<b>Team Leader</b>		<ul style="list-style-type: none"> <li>☞ Being aware of corporate goals and urgent tasks, and directing effort of team members toward strategic goals.</li> <li>☞ Acting as facilitator and coordinator for team members and developing skills and competencies of team members</li> <li>☞ Achievement required rather than self-improvement.</li> </ul>
<b>Team Member</b>	<b>Senior</b>	<ul style="list-style-type: none"> <li>☞ Recognizing team goals, identifying tasks to achieve goals, and creating teamwork among team members</li> <li>☞ Acting as mediator to prevent conflicts between team leader and team members, and assisting team leader to achieve goals</li> <li>☞ Execution capability required</li> </ul>
	<b>Junior</b>	<ul style="list-style-type: none"> <li>☞ Carrying out tasks assigned as directed by senior team members or team leader</li> <li>☞ Continuous self-improvement required</li> </ul>

d) Competency Elements

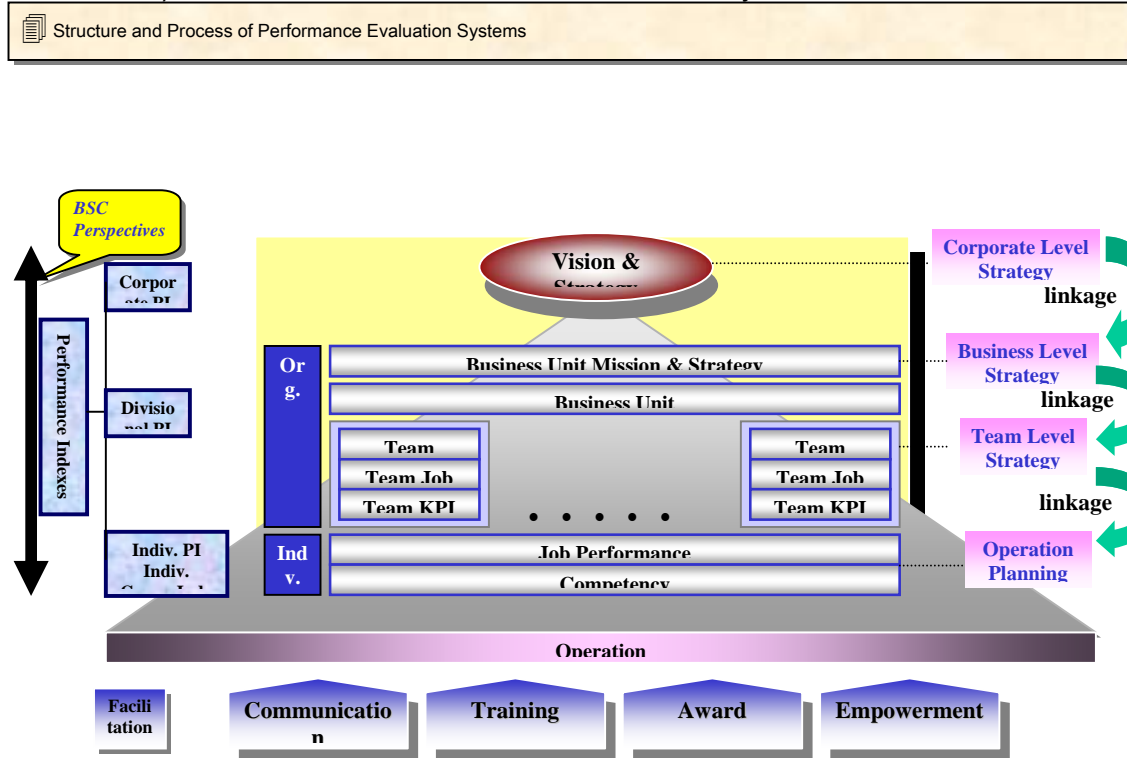
Common Elements	Exemplary	Innovation	Responsiveness	Trustworthiness		
	Planning & Operation		Sales	Technical		
Elements For Sub Cat.	Management	Supporting	Production Support	Sales	Sales Mgt.	Technical
	Mgt. Knowledge	Information Collection & Interpretation	Goal-Setting	Customer-Centric	Mgt. Mindset	Expertise
	Planning Capability	Mediating Capability	Information Collection & Analysis	Performance-Oriented	Planning Capability	Creativity
Elements For Each Rank	Team Leader		Team Members			
			Senior Level	Junior Level		
	LEADERSHIP		Execution Capability		Dependability	
	Prudence		TEAMWORK		Self-development	

e) An Example of BARS

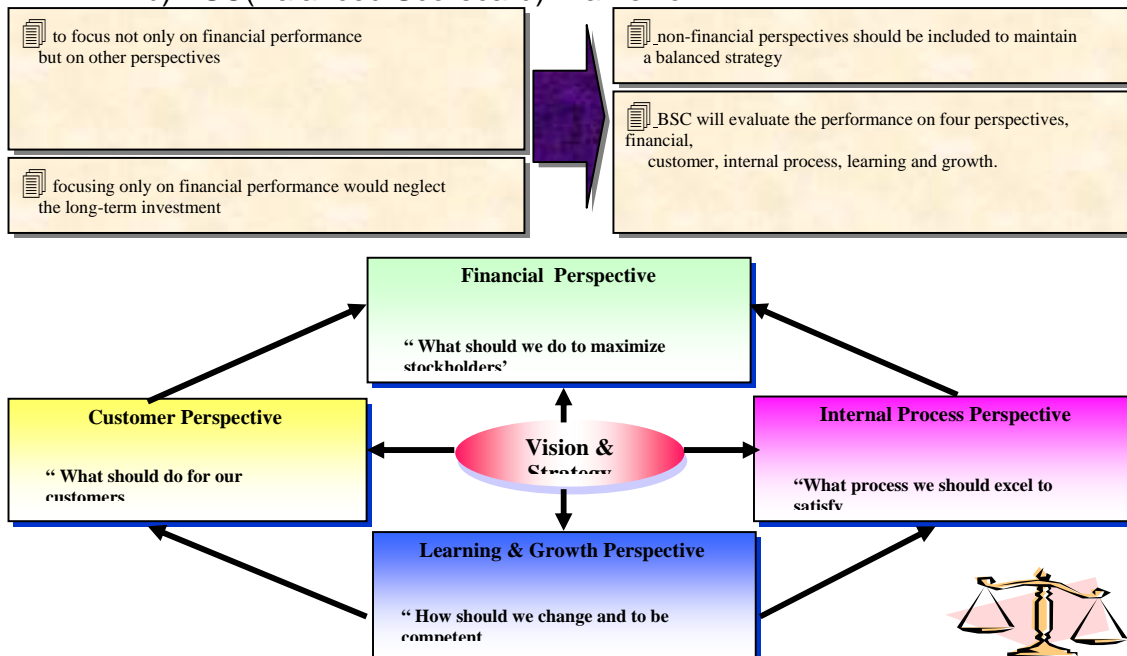
Indexe	Planning Capability	Subjects	Planning & Op. / Management
Definition	Capability of understanding directives and goals of company and team, and offering the team detail plans to achieve goals		
Evaluation	Rate	Behaviors	
	S	Subjects based on their knowledge and experience can make significant contributions to team strategy and develop an outstanding plan.	
	A	Subjects can contribute in formulating the team strategy and independently develop a feasible and realistic plan	
	B	Subjects can independently develop a plan that can be implemented with minor corrections.	
	C	Subjects do not understand team's goals and strategy, and devised plan has many drawback. Plan needs help of supervisor to be implemented.	
	D	Subjects can not develop a plan independently, and need help of supervisors with extensive corrections	

## 8.2.4 Design of Performance Evaluation Systems

### a) Framework of Performance Evaluation Systems



### b) BSC(Balanced Scorecard) Framework





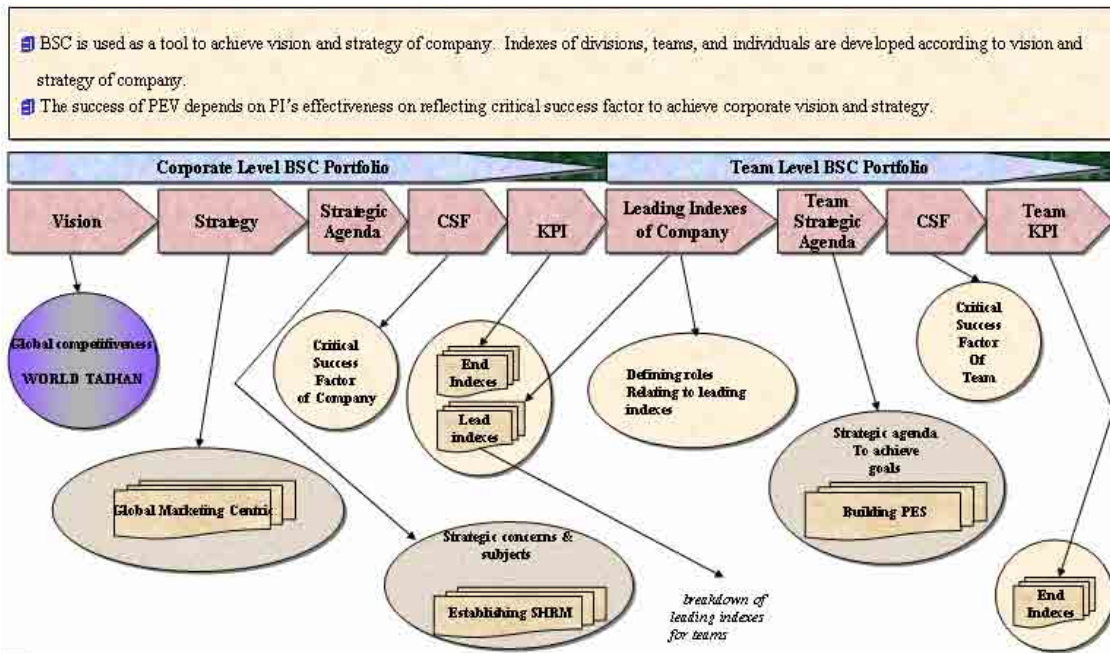
### c) Definition of Taihan BSC Perspectives

<p><b>Financial</b></p>	<ul style="list-style-type: none"> <li>▣ Bottom line of company</li> <li>▣ Indexes relating to the balanced sheet</li> <li>▣ growth ratio/activity ratio/stability ratio/productivity ratio/liquidity ratio</li> <li>▣ indexes of revenue, expense, profit</li> <li>▣ other financial ratios</li> </ul>
<p><b>Customer</b></p>	<ul style="list-style-type: none"> <li>▣ performance to increase the external customer value</li> </ul>
<p><b>Process</b></p>	<ul style="list-style-type: none"> <li>▣ efficiency of internal process to increase customer satisfaction and corporate performance</li> </ul>
<p><b>Learning</b></p>	<ul style="list-style-type: none"> <li>▣ activity to enable sustainable growth</li> </ul>

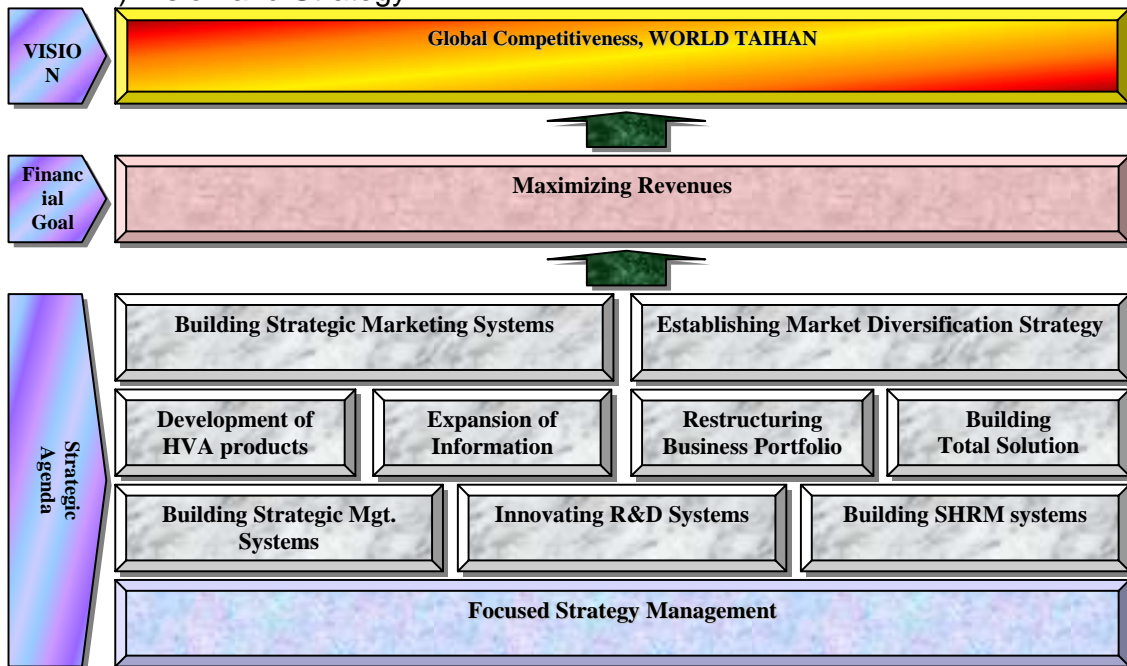
### d) Design of Performance Indexes for Each Level

<p><b>Overall Indexes</b></p>	<ul style="list-style-type: none"> <li>▣ Indexes to embrace the future management paradigm and to link with causes and drive for performance improvement</li> </ul>
<p><b>Team Indexes</b></p>	<ul style="list-style-type: none"> <li>▣ Team indexes should be linked with corporate vision and strategy</li> <li>▣ Team indexes should be developed with autonomy, reflecting the mission and team's own roles</li> </ul>
<p><b>Individual Indexes</b></p>	<ul style="list-style-type: none"> <li>▣ Individual indexes should be designed to increase job performance and eventually to achieve goals of company and team.</li> </ul>

e) Taihan PEV process



f) Vision and Strategy



g) Tracking Map



h) Company KPI for BSC

BSC		FINANCIAL		Weights for financial perspective		50%	
VISION		Global Competitiveness, WORLD TAIHAN					
Strategic Agenda		End KPI			Lead Index		
weight	Strategic item	weight	End KPI	Target	weight	Lead Index	
50%	Revenue Maximization	15%	Achievement of Sales Target	\$1.3Bil	35%	Sales Growth	
		20%	Achievement of Net Profit Target	-			
		5%	Cost Reduction Rate	5% reduction	5%	Cost Reduction	
		5%	Receivable Turnover	120 days	5%	Reduction of Receivable Collection Length	
		5%	Reduction of Default Receivables	0%	5%	Reduction of Default Receivables	

<b>BSC</b>	<b>CUSTOMER</b>	<b>Weight for Customer Perspective</b>			<b>15%</b>	
<b>VISION</b>	<b>Global Competitiveness, WORLD TAIHAN</b>					
Strategic Agenda		End KPI		Target	Lead Index	
weight	Strategic item	weight	End KPI		weight	Lead Index
10%	<b>Building Strategic Marketing System</b>	10%	Market Share	27%	2%	Enhancement of sales competency
					4%	Market expansion
					2%	Rebuilding sales network & improving service quality
					2%	Realizing cost leadership
5%	<b>Market Diversification Strategy</b>	5%	Rate of New Customers	-	5%	Expansion of market share

<b>BSC</b>	<b>INTERNAL PROCESS</b>	<b>Weights for INTERNAL PROCESS</b>			<b>15%</b>	
<b>VISION</b>	<b>Global Competitiveness, WORLD TAIHAN</b>					
Strategic Agenda		End KPI		Target	Lead Index	
weight	Strategic item	weight	End KPI		weight	Lead Index
5%	<b>Development of HVA Product</b>	5%	Achievement rate of target for new product development (in terms of numbers)	100%	2%	New Product Development
					1%	Upgrading facility
					2%	Sales expansion of specialized products
4%	<b>Expansion of Information Systems</b>	4%	Effectiveness of expansion of Information systems	-	2%	Introduction of ERP systems
					2%	Strengthening technology network
3%	<b>Restructuring Business Portfolio</b>	3%	Effectiveness of restructuring business portfolio	-	2%	Building outsourcing network
					1%	Enhancing engineering capability
3%	<b>Building Total Solution Systems</b>	3%	Effectiveness of building Total Solution Systems	-	1%	Maintaining expert pool of design, engineering, maintenance, etc
					2%	Boosting System Turn-Key PJT capability

<b>BSC</b>		<b>LEARNING &amp; GROWTH</b>		<b>Weights for L &amp; G</b>		<b>20%</b>	
<b>VISION</b>		<b>Global Competitiveness, WORLD TAIHAN</b>					
Strategic Agenda		End KPI		Target	Lead Index		
weight	Strategic item	weight	End KPI		weight	Lead Index	
10%	<b>Building Strategic Management Systems</b>	10%	Effectiveness of Strategic Management Systems	-	2%	Revitalization of organizational functions	
					5%	Process innovation	
					1%	Rebuilding corporate culture	
					2%	Regrouping business portfolio through analysis	
5%	<b>Innovation</b>	5%	Rate of Cost Reduction	14.3% (154 ky base)	3%	Securing cost-cutting capability	
					2%	Development of new material	
5%	<b>Building SHRM Systems</b>	5%	Satisfaction Level of Internal Customers	-	1%	Establishment of education systems	
					1%	Seeking CDP	
					3%	Developing fair evaluation and reward systems	

i) KPI Dictionary Example

Serial number	01				
Financial goals	Maximization of Revenue	BSC Perspective	Financial	Perspective Weight	50%
KPI	Achievement Rate of Revenue Target	KPI 가중치	15%	Target	
Evaluation Formula	$\bullet (\text{Actual Sales} \div \text{Sales Target}) \times 100$				
Evaluation Method & Criteria	<input type="checkbox"/> <target achievement rate criteria> : score = score for corresponding level × index weight <input type="checkbox"/> evaluated levels for achievement rates : ● S : $100\% + \alpha <$ ● A : $100\% < \sim 100\% + \leq \alpha$ ● B : $100\% - (\alpha/2) < \sim <= 100\%$ ● C : $100\% - \alpha < \sim <= 100\% - (\alpha/2)$ ● D : $\leq 100\% - \alpha$ <input type="checkbox"/> Refer to the quantitative table				

j) Moon Chart for Teams in accordance with Lead Indexes

BSC		FINANCIAL																				
Strategic agenda	Company Lead Indexes	Moon Chart for Team																				
		STS Division					Optical/Material					Domestic Sales Division					Overseas Sales Division					
		Prod. Mot. Team	신규	기초	신규	기초	신규	기초	신규	기초	신규	기초	신규	기초	신규	기초	신규	기초	신규	기초	신규	
Revenue Maximization	Sales Increase	75		75	100	100	50	50		75	100	100	100	100	100	100	75	100	100	100	100	75
	Cost Reduction	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
	Reduction of Receivables Collection Length				100	100				50	100	100	100	100	100		100	75	100	100	100	100
	Strengthening Mgt. of Default Receivables				100	100				75						100	100		100	75	100	100
구분	100%	Team with full responsibility for lead index										75%	Significant share of responsibility for lead index									
구분	50%	Sharing responsibility w. other teams for lead index										25%	Partially responsible for lead index									

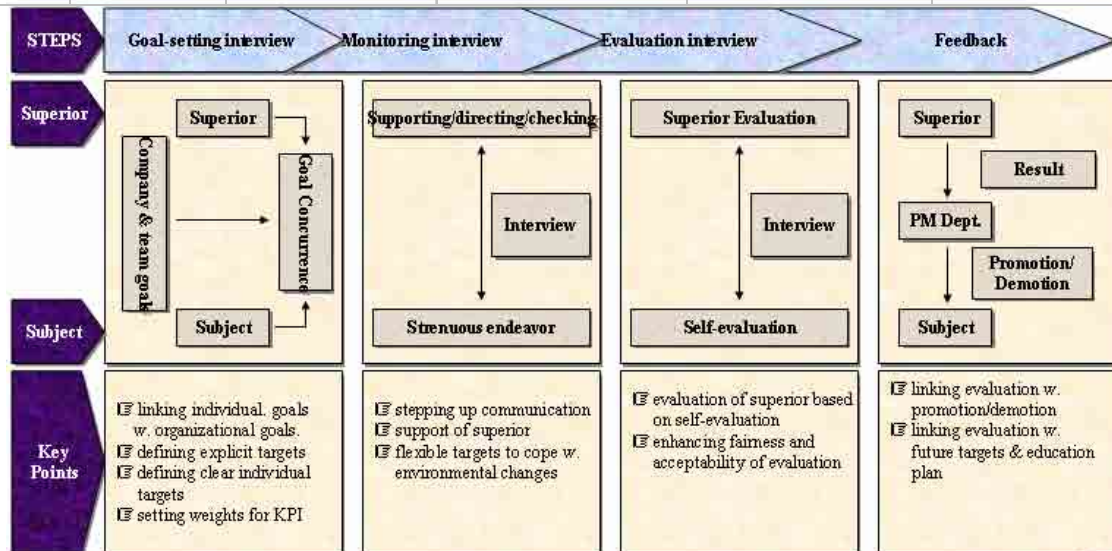
k) Team KPI for BSC Example (Example of Electricity Sales)

BSC		FINANCIAL		Team		Domestic Sales (Elect. Team)	
Strategic Agenda	Company Lead Indexes	Team Strategic Agenda		Team KPI		Target	Formula
		weights	Strategic Items	weights	Team KPI		
Revenue Maximization	Sales Increase	60.5	Expanding New Market w. New Products	60.5	Sales Target Achievement Rate		$\bullet \text{ (Actual} \div \text{Target)} \times 100$
	Cost Reduction	8.7	Cost Reduction	8.7	Cost Reduction Rate		$\bullet \text{ (Actual} \div \text{Budget)} \times 100$
	Reduction of Receivables Collection Length	8.7	Reduction of Receivables Collection Length	8.7	Days of Receivables Collection		$\bullet \text{ (Monthly Average Receivables} \div \text{Yearly Sales)} \times 365$

I) Example of description on individual performance indexes (example of electricity sales team)

Job Description		Accurate forecasting of customer needs and market changes, increasing sales through speedy response to		
code	task	key process	KPI	formula
	demand survey	collection of market	timely info. collection	collection date- target date
		information	information value	Does information latest? Does information useful for carrying out jobs?
			target achievement rate	(no. of collections/no. of target)x100
	bidding	post of bidding	timely acknowledgement	report date- post date
		bidding preparation	completeness of preparatio	Are there any unprepared items for the bidding? Is the cost estimate accurate? Is the business proposal reasonable and feasible? Is the business proposal accurate?
	Contract	review of contract terms	accuracy of contract terms	Are the terms reflecting the needs of the company? Are there any items omitted in the contract?
		contract changes	timeliness of contract changes	completion date - target date

The evaluation process consists of four steps: ① goal-setting, ② monitoring, ③ carrying out evaluation, ④ Feedback



## n) Summary of PES

<p>■ Evaluation T/F conduct the evaluation twice a year for four groups of subjects.</p>					
<p>■ Implementer : Planning Team</p> <p>■ Evaluation T/F members : executives</p> <p>■ Composition of Evaluation T/F</p> <ul style="list-style-type: none"> <li>☐ T/F Leader : CEO</li> <li>☐ Organizer : Team Leader of Planning Team</li> <li>☐ T/F Members : executives (external experts can join)</li> </ul> <p>■ Timing of T/F Formation : 3 weeks before evaluation</p> <p>■ T/F members</p> <ul style="list-style-type: none"> <li>☐ when necessary, external experts can be invited to raise the objectivity of the evaluation.</li> </ul> <p>■ Composition of subjects</p> <ul style="list-style-type: none"> <li>☐ Subjects will be divided into four groups.</li> <li>☐ Subject Groups : P/O, Sales, Technical, Production</li> </ul> <p>■ Interim Evaluation</p> <ul style="list-style-type: none"> <li>☐ Evaluation period: Jan. 1 ~ June 30 (once a year)</li> <li>☐ Evaluation timing : July</li> </ul> <p>■ Final Evaluation</p> <ul style="list-style-type: none"> <li>☐ Evaluation period : Jan. 1 ~ Dec. 31 (once a year)</li> <li>☐ Evaluation : Jan. the following year</li> </ul>	Subject Teams	<p>P/O group</p> <p>Planning, IT, QM, Fund, Acct. 1-2, General &amp; PM, Procurement, Operation, Sales Mgt.</p> <p><b>Total 10 teams</b></p>	<p>Sales Group</p> <p>Material Sales, STS domestic, STS overseas, Communication, Electricity, High Voltage, Retail, Overseas Sales 1,2,3 etc</p> <p><b>Total 19 teams</b></p>	<p>Technical Group</p> <p>Plant (Technical Team, Parts Team)</p> <p><b>Total 8 teams</b></p>	<p>Production Group</p> <p>Supporting (Logistics, Facility Maintenance)</p> <p>Plant (Production, PM, FM)</p> <p><b>Total 13 teams</b></p>
		<p><b>Scale</b></p> <p>Absolute Scale/Independent Evaluation</p>			
		<p><b>Criteria</b></p> <p>Based on team KPI points</p>			
		<p><b>Ratings</b></p> <ul style="list-style-type: none"> <li>■ Ratings</li> <li>☐ S : &lt;= 90 points</li> <li>☐ A : 80 &lt;= ~ &lt; 90</li> <li>☐ B : 70 &lt;= ~ &lt; 80</li> <li>☐ C : 60 &lt;= ~ &lt; 70</li> <li>☐ D : &lt; 60</li> </ul>			

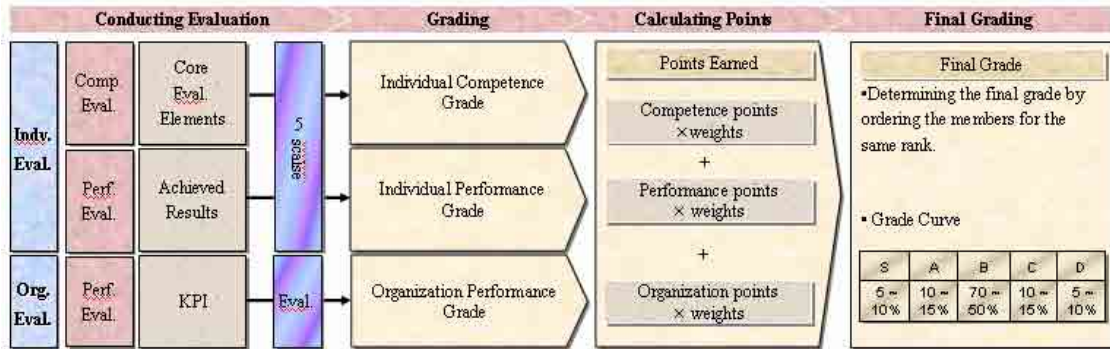
## 8.2.5 Structure of Evaluation Systems

### a) Individual Evaluation Systems

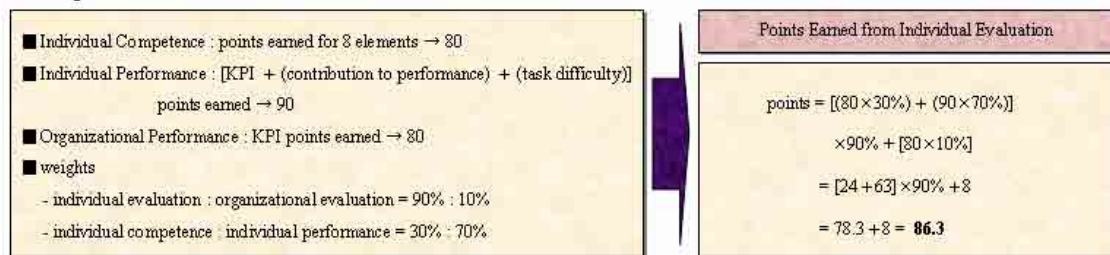
Class.	Methodology	Subjects																																																																
Performance Evaluation	MBO (Management By Objectives)	<ul style="list-style-type: none"> <li>■ Conducting evaluation and interviews once a year</li> <li>■ A team leader evaluates team members on a non-curve and adjusts the results on a curve.</li> <li>■ Executives evaluate team leaders on a non-curve and the T/F conducts the evaluation on a curve.</li> </ul>																																																																
Competence Evaluation	BARS (Behaviorally Anchored Rating Scale)	<ul style="list-style-type: none"> <li>■ Each employee is given the team average score (say 85) and conducts the self-evaluation.</li> <li>■ A team leader conducts the evaluation. All employees are subject to the evaluation for common elements.</li> <li>■ The individual evaluation are classified into two: job category and rank.</li> </ul>																																																																
Weights for elements (%)	Class.	<table border="1"> <thead> <tr> <th rowspan="2">Class.</th> <th colspan="3">Sales</th> <th colspan="3">Technical</th> <th colspan="3">Production</th> <th colspan="3">Planning &amp; Operation</th> </tr> <tr> <th>Team Leader</th> <th>Senior Member</th> <th>Team Member</th> <th>Team Leader</th> <th>Senior Member</th> <th>Team Member</th> <th>Team Leader</th> <th>Senior Member</th> <th>Team Member</th> <th>Team Leader</th> <th>Senior Member</th> <th>Team Member</th> </tr> </thead> <tbody> <tr> <td>Perf.</td> <td>80</td> <td>70</td> <td>50</td> <td>75</td> <td>65</td> <td>50</td> <td>70</td> <td>60</td> <td>50</td> <td>60</td> <td>55</td> <td>50</td> </tr> <tr> <td>Comp.</td> <td>20</td> <td>30</td> <td>50</td> <td>25</td> <td>35</td> <td>50</td> <td>30</td> <td>40</td> <td>50</td> <td>40</td> <td>45</td> <td>50</td> </tr> <tr> <td>Total</td> <td>100</td> <td>100</td> <td>100</td> <td>100</td> <td>100</td> <td>100</td> <td>100</td> <td>100</td> <td>100</td> <td>100</td> <td>100</td> <td>100</td> </tr> </tbody> </table>	Class.	Sales			Technical			Production			Planning & Operation			Team Leader	Senior Member	Team Member	Team Leader	Senior Member	Team Member	Team Leader	Senior Member	Team Member	Team Leader	Senior Member	Team Member	Perf.	80	70	50	75	65	50	70	60	50	60	55	50	Comp.	20	30	50	25	35	50	30	40	50	40	45	50	Total	100	100	100	100	100	100	100	100	100	100	100	100
	Class.	Sales			Technical			Production			Planning & Operation																																																							
		Team Leader	Senior Member	Team Member	Team Leader	Senior Member	Team Member	Team Leader	Senior Member	Team Member	Team Leader	Senior Member	Team Member																																																					
	Perf.	80	70	50	75	65	50	70	60	50	60	55	50																																																					
Comp.	20	30	50	25	35	50	30	40	50	40	45	50																																																						
Total	100	100	100	100	100	100	100	100	100	100	100	100																																																						
weights (%)	Class.	Individual Performance Eval. + Individual Competence Eval.																																																																
	weights	90%																																																																
		Organizational Performance Evaluation																																																																
		10%																																																																



## b) Example of Individual Evaluation

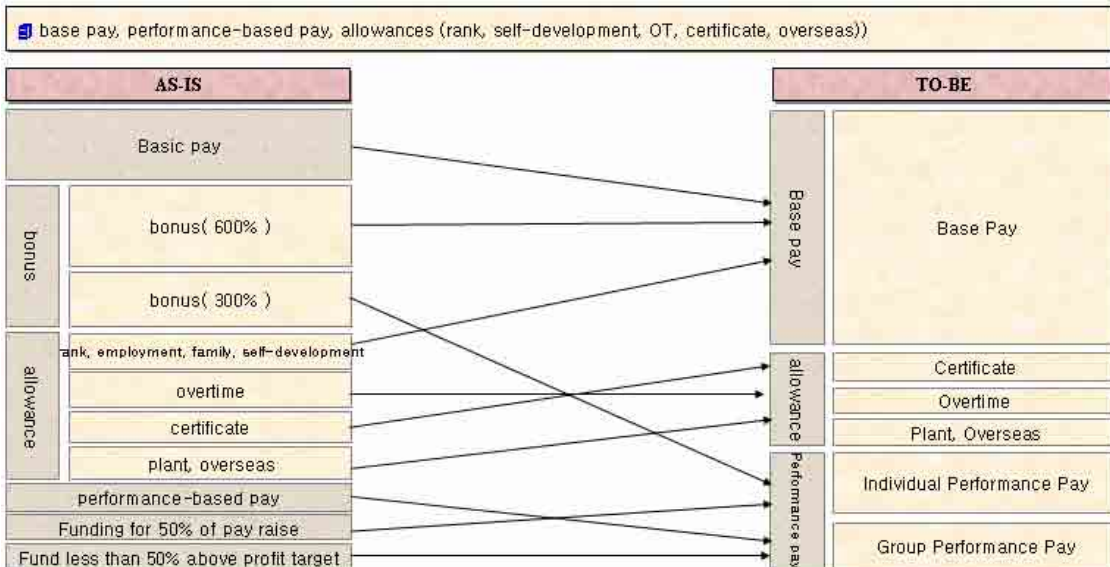


### × Example of senior team member at Sales Team



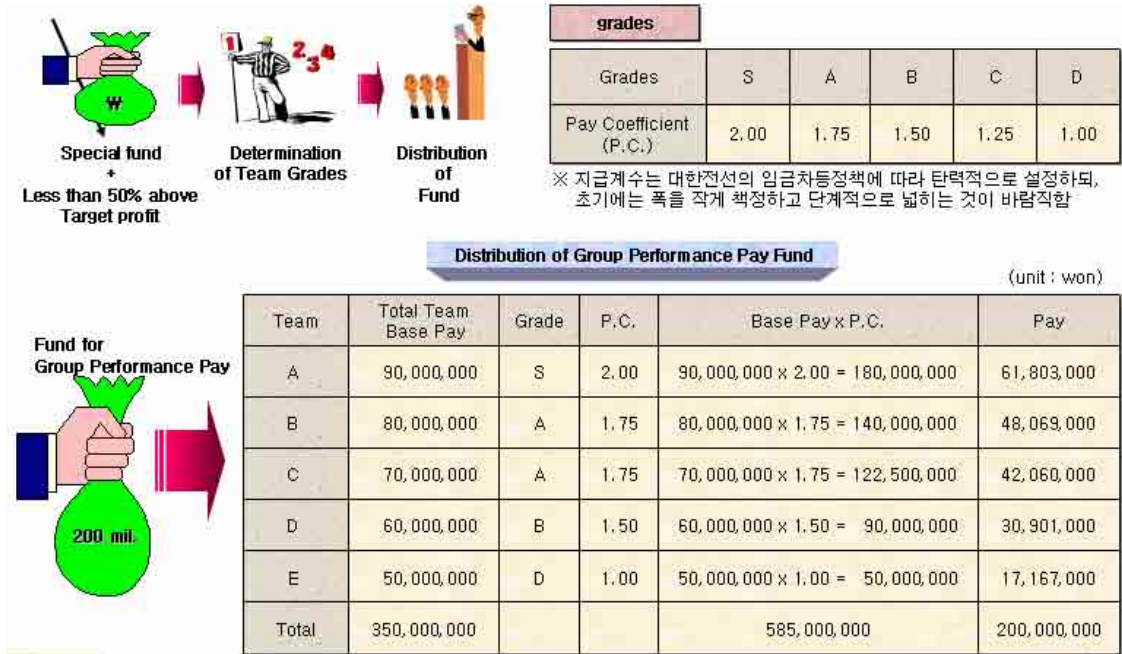
## 8.2.6. Design of Pay Systems

### a) Structure of Pay Systems

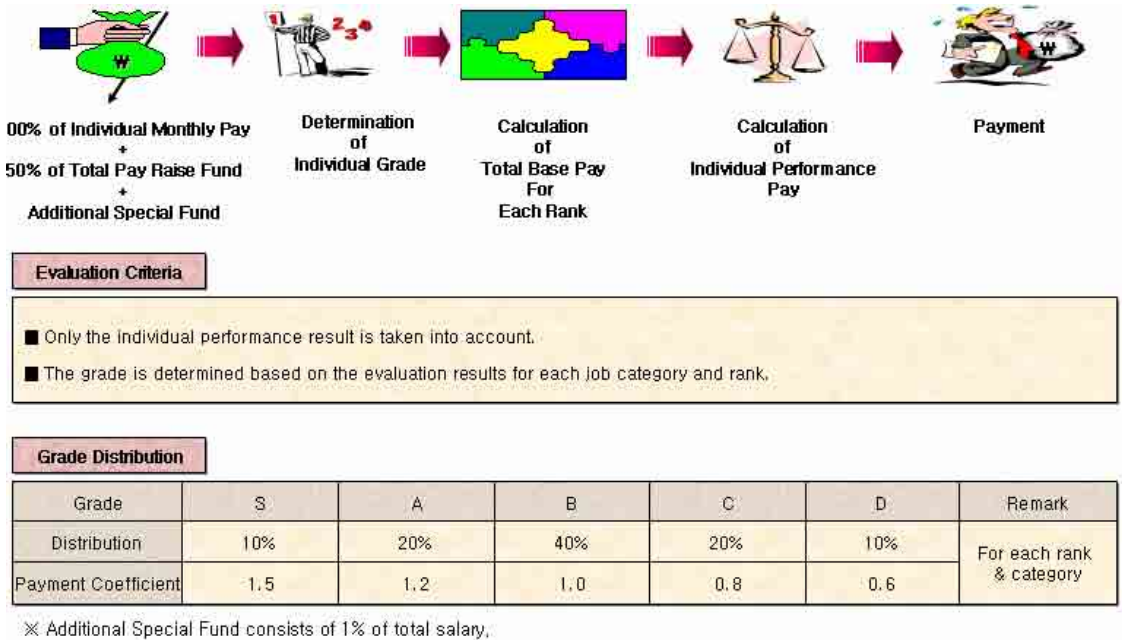


× Funding for Group Performance Pay is decided by the Board of Directors.

## b) Group Performance Pay



## c. Individual Performance Pay

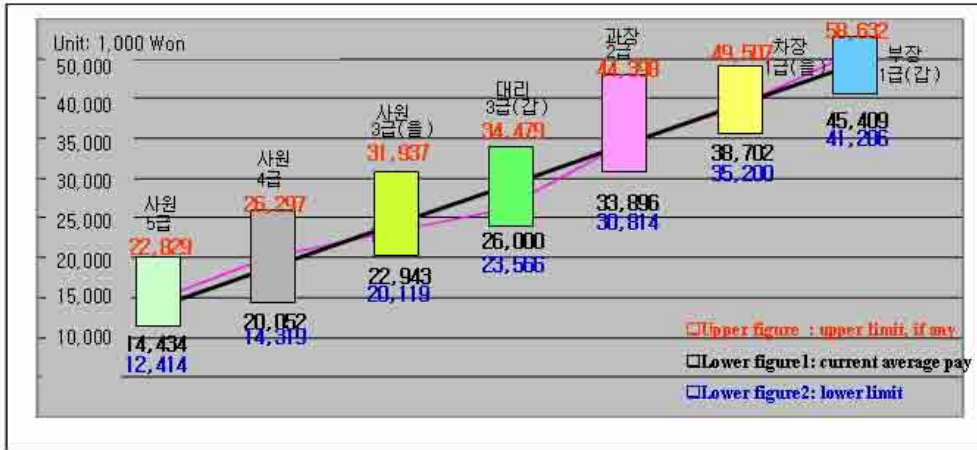


## d) Pay Range under new pay systems

- ㉔ The pay range has a lower limit but not an upper limit.
- ㉕ The data do not include allowances for overseas and plants.

Example) The upper limit is for "S" of individual performance grade and "S" for group performance grade.

- The group grade S gives 300% of monthly base pay as group performance pay.
- The data does exclude the automatic pay raise.



## 9.0 Success factors

### 9.1 Executives' Action

- Executives should eschew simplistic organizational solutions: when applied in isolation by the companies, popular techniques such as management incentives and key performance indicators were strikingly ineffective.
- High-performing companies must have a basic proficiency in all of the available practices; a conspicuous weakness in any of them drags down the overall result.
- Managers should concentrate most of their energy on a small number of practices that, introduced together, typically produces

the best results, ["Managing your organization by the evidence,"  
Leslie K., et al., The McKinsey Quarterly, No. 3, 2006. ]

## 9.2 Combination of management practices

- Not one management practice would enhance organizational competence.
- Combination of several management practices would bring desirable results.
  - Accountability or clear role definition
  - Clear sense of direction
  - Openness and trust

## 9.3 Is KPI a panacea?

- Certainly not!!
- KPIs without clear role definition let employees focus only on improving indexes, not necessarily performance.
- Incentive systems without knowing corporation's directions and goals would not produce good results.

source: Keith Leslie, Mark A. Loch, and William Schaninger, "Managing your organization by the evidence," The McKinsey Quarterly, No. 3, 2006.

## 10.0 Conclusion

10.1 Need for unique appraisal and pay systems for each company

10.2 Commonality

- Recognizing the importance of sustainable growth
- Consideration of **competence** and achievement

- Design of systems to promote teamwork
- Tying the evaluation to the pay

### **10.1 References**

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**III. Developing Key Performance Indicators and  
Productivity/Performance Benchmarks  
for Performance Based Remuneration Systems  
in Malaysia**

**By  
MR EDDIE ONG  
MS LEE SAW HOON**

## 1.0 Malaysia's Economic Development

Malaysia had made significant strides in nation-building, in developing its economy and in improving the quality of life of its people. Since independence, real gross domestic product (GDP) has grown by an average of 6.5% per annum for the period 1957-2005<sup>5</sup>, one of the highest growth rates achieved by sovereign nations of similar age and size. Within the same period, GDP per capita in current prices grew by 7.0%, which has translated into substantial improvements in the people's quality of life. The Malaysian economy grew at an average rate of 6.2% per annum for the period 1991-2005<sup>6</sup>. This strong rate of growth was achieved despite the challenges faced from events such as the 1997-98 Asian financial crisis, the September 11 incident in 2001, wars in Afghanistan and Iraq, outbreaks of Severe Acute Respiratory Syndrome (SARS) and avian flu, as well as increases in world oil prices.

Economic fundamentals remain strong. Growth was achieved with inflation averaging a low 2.9% per annum and similarly low unemployment averaging 3.1% over the period. Malaysia's economic structure continued to develop from manufacturing to services as shown in Table 1. Growth of knowledge-based service industries was expanded with the establishment of the Multimedia Super Corridor in 1996, followed by other initiatives such as the National Biotechnology Policy launched in 2005 and the Iskandar joint project carried & North Carrider Project launched recently.

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<sup>5</sup> Ninth Malaysia Plan, 2006-2010

<sup>6</sup> Ibid

**Table 1 : Structure of the Economy, 1990-2005**

	% to GDP	
	1990	2005
Services	46.8	58.1
Manufacturing	24.6	31.4
Agriculture	16.3	8.2
Mining	9.4	6.7
Construction	3.5	2.7

*Source: Department of Statistics*

The growth momentum of the Malaysian economy continued in 2006, with a GDP growth of 5.9%. This was attributed to the diversified economic structure, strong public and private sector expenditures, enhanced delivery system and an impressive trade performance. Malaysia had been registering trade surpluses since 1997, Strong fundamentals in terms of low unemployment, low interest and inflation rates further enabled Malaysia to strengthen amidst global volatilities. This strong economic background coupled with the intensified implementation of productivity and quality initiatives by industries have contributed to a productivity growth of 3.7%<sup>7</sup>. All sectors of the economy recorded an upward trend in productivity ranging from 0.5% to 4.5%.

## **2.0 Competitiveness Environment Factors**

The competitiveness environment of a nation can be seen through four main areas, namely; Macroeconomic Perspective, Government Efficiency, Business Efficiency and Infrastructure. The macroeconomic factor

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<sup>7</sup> Productivity Report, 2006



captures the macroeconomic evaluation of the domestic economy. It encompasses international trade, international investment, employment and prices. For this factor, Malaysia was ranked 11<sup>th</sup> position among 61 economies. Malaysia also performed relatively well in terms of exports and was ranked 3<sup>rd</sup>. Exports picked up strongly in 2006, rising by 11.4% to US\$140.9 billion from US\$126.5 billion in 2005. Malaysia's current account balance placed the economy in 4<sup>th</sup> position at 15.7% of GDP compared to the 61 country average of 0.3%.

<b>Competitiveness Input Factors</b>	<b>2006</b>	<b>2005</b>
	(61 economies)	(60 economies)
Economic Performance	11	8
Government Efficiency	20	26
Business Efficiency	20	25
Infrastructure	31	34

*Source : World Competitiveness Yearbook (WCY) 2006*

The Government Efficiency factor assesses the extent to which government policies are conducive to competitiveness. The sub-factors are public finance, institutional framework, business legislation and societal framework. For Government Efficiency, Malaysia improved to 20<sup>th</sup> position from 26<sup>th</sup> previously. Malaysia performed well and ranked 6<sup>th</sup> position in terms of perceptions on the Government Efficiency factor for the following areas; policy makers being able to understand economic challenges; exchange rate policy supporting the competitiveness of enterprises; and labour legislation which provides an incentive to look for work.

The Business Efficiency factor examines the extent to which enterprises are performing in an innovative, profitable and responsible manner. It is measured through the five sub-factors of productivity and efficiency,

labour market, finance, management practices, as well as attitudes and values. The ranking for Business Efficiency improve to 20<sup>th</sup> position from 25<sup>th</sup> previously. Labour cost in Malaysia continues to be competitive, as wage increase commensurates with productivity growth. Malaysia continued to record top ranking in unit labour cost in the manufacturing sector. The favourable increase in labour force growth of 4.1% compared to the 1.7% growth recorded the previous year led to Malaysia being ranked 3<sup>rd</sup>.

The Infrastructure factor looks at the extent to which technological, scientific and human resources meet the needs of business. It encompasses basic infrastructure, technological infrastructure, scientific infrastructure, health, environment and education. Malaysia improved its infrastructure ranking to 31<sup>st</sup> position from 34<sup>th</sup> position previously. For internet cost, progress in the state of information technology, telecommunications and internet capabilities, Malaysia is ranked 3<sup>rd</sup>. The role of science and technology in the economy, and more specifically in education was favourable and was also ranked 3<sup>rd</sup>. This is reflective of the perception that science in schools is sufficiently emphasized.

### **3.0 Human Resource Issues and Challenges**

The Industrial Master Plan (IMP3), 2006-2020, emphasizes two aspects of human resource requirements, namely, ensuring sufficient availability of the human resources, as well as providing a facilitative environment for the workforce to acquire the necessary skills in the professional and technical fields to drive the economy into higher value-added activities. Strategies for human resource management, including human resource planning and development, will focus on the roles of education, training, lifelong learning, capacity building and operating environment to enhance Malaysia's competitive position as outlined above. In the longer term,

strategies adopted on human resources will lead to a more equilibrium labour market, as well as more competitive business operating environment. Appropriate systems and structures for human resources planning will enable Malaysia to respond to the changing global environment and enhance competitiveness at the national and enterprise levels.

### **3.1 Human Resource Policy Thrusts**

Human resource development continued to be given priority in support of the implementation of a productivity-driven growth which required highly skilled, trainable and knowledge manpower. Emphasis continued to be given to increase accessibility to education to all levels in line with the democratisation of the education policy. In addition, the education and training programmes focused on improving the quality of teaching and learning materials, teacher training the educational support services. At the tertiary level, the capacity of public tertiary institutions expanded substantially. However, it was still inadequate to meet the demand. Consequently, enrolment in private educational and training institutions also expanded significantly, which was facilitated by the liberalization of the education sector.

A trained workforce with the potential and ability to optimize the use and development of new technologies and materials will continue to be important in ensuring the growth and resilience of the economy. There will be increasing investment in human capital, with greater emphasis on nurturing creativity and cognitive skills to provide the impetus for the K-based economy. The education and training system will be geared to produce multi-skilled and knowledge manpower that is versatile, willing to learn continuously. Entrepreneurial as well as with the ability to acquire

and apply knowledge particularly in modern technology. In this regard, the human resource policy thrusts will be as follows:

- Expanding the supply of highly skilled and knowledge manpower to support the development of a K-economy;
- Increasing the accessibility to quality education and training to enhance income generation capabilities and quality of life;
- Improving the quality of education and training delivery system to ensure that manpower supply is in line with technological change and market demand;
- Promoting lifelong learning to enhance employability and productivity of the labour force;
- Optimizing the utilization of local labour;
- Increasing the supply of Science and Technology manpower;
- Accelerating the implementation of the productivity-linked wage system;
- Strengthening labour market information system to increase labour mobility;
- Intensifying efforts to develop and promote Malaysia as a regional centre of educational excellence; and
- Reinforcing positive values.

To support the above, industrial harmony is of utmost importance. Concerted efforts by all parties involved in ensuring harmonious industrial relations in the country such as the Government, Employers and Employees is of paramount importance.

## **3.2 Human Resource Practices at the Organisational Level**

### **3.2.1 Managing and Enhancing the Value of Human Capital to increase Productivity**

### **Challenges of today's organizations**

- To demonstrate the linkage between employee resilience and business performance.
- To articulate best practices in diversity strategy and leadership.
- To explore the frontier of work-life integration.
- To shift the focus from financial capital to human capital.
- To attract and retain the best possible workforce.
- To motivate, satisfy and challenge the workforce.
- To define the workforce requirements to support organizational objectives.
- To improve client or shareholder value.

### **Creating value through people**

- **Repositioning of the HR function**
  - HR integral part of the senior executive team.
  - Role elevated to strategic business partner.
  - Introduction of HR consultancy or advisory model.
- **Shifting Organisational Culture**
  - Integral role of culture, values and principles.
  - Model has shifted from employment security to an “employability” model.
  - Integrated leadership and accountability.

### **Two sides to the coin .....**

- Employer branding
- A better work place

- growth

8

### **Brand Positioning**

Committed to delivering products and solutions that are :

- Designed around you
- Easy to experience
- Advanced

### **The pressure on HR .....**

- Lean – focus on outcomes rather than activities
- Not a cost centre
- Employee champions
  - Deliver competent and committed employees
  - ISO, HRPST, PBE, ICS
- Administrative experts
  - Deliver efficient HR practices
  - E-tools (salary planning, leave, requisition, HR policies & procedures, recruitment, talent track, job descriptions, etc.)
- Change agents
  - Deliver capacity for change in individual behavior and organizational culture
  - PPM, EES, talent management, rewards communication, value statements
- Strategic partner
  - Deliver business results

- Part of Executive Management Committee & Management Team
  - One page strategy supports Management agenda
  - Country BSC and HR BSC
- “Do more with less”

### **Building our employer brand from the inside out**

#### **Key Objectives:**

To be certain that we are able to attract, recruit and retain the sort of talent that will give our business competitive edge.

To be sure that our employer experience will enable and motivate our talent to work in a way that is “one Organisation”, providing maximum satisfaction for both the organization and the individual”.

#### **On-Line Interaction for New Employees**

The introduction period lasts 3 months and the new hire is supported by :

- HR, line manager and buddy
- CD-ROM
- Website / System

#### **What does it do?**

- Makes new employees feel welcome!
- Helps new employees get started quickly, by providing basic company information right from the start.
- Provides new employees with personal guidance by assigning them a buddy.
- Gives managers a proven, easy procedure for introducing new employees successfully.
- Clearly defines the roles and responsibilities of HR and line

management.

### **What is the role of HR?**

- Recruitment phase
- Initiating the introduction process by entering the details of a new employee on the website and sending a welcome package.
- Running through administrative issues with the new employee on the first day.
- Explaining the buddy system and monitoring progress.
- Evaluate the introduction period after 3 months with the new hire.

### **What is the role of the Line Manager?**

- Assign a buddy to the new hire.
- Welcome the new hire on his or her first day.
- Introduce him / her to the organization, colleagues and department.
- Explain the organizational structure and strategy of the department.
- Formulate performance expectations.
- Discuss training opportunities.
- Evaluate the introduction period after 3 months.

### **What is the role of the Buddy?**

- The buddy should be a close colleague with a similar job grade (not to be confused with the role of a mentor, who is normally a more senior manager).
- The buddy is responsible for :
  - Welcoming the new hire on the first day (develop a first day schedule).
  - Helping the new employee with practical issues (resources necessary to start working, canteen, coffee machine, etc.)
  - Explaining social rules and customs.
  - Being available for questions.



- Keeping in Touch with the new hire on a regular basis.

### **A better workplace ..... The Organisation is you**

- Simplicity is the name of the game
  - HR automation
  - Performance Management
  - Learning
  - Our website
- Communicate! Communicate!
  - Organisation values
  - Leadership competencies
  - Business principles
- It's about being open
  - Compensation and you
  - Talent management
- Employee Engagement Survey

### **3.3 People Performance Management**

#### **3.3.1 The People Performance Management philosophy .....**

- The essence of PPM is to create quality dialog between the employee and manager, which is truly focused on an employee's performance and development.
- PPM is a global process that aligns the employee's personal objectives with those of the business.
- PPM is about looking back at the past period and looking forward to the coming period.
- Performance focuses on what has been achieved (results), but also how it has been achieved.
- Development focuses on the employee becoming better at their

current job and growing into other roles in the future.

- The PPM process starts with a self-evaluation by the employee and can include co-assessment (s).
- Calibration is used to ensure a fair and realistic assessment and to increase the level of objectivity.
- The performance rating is used as input for reward decisions.
- PPM is web-based.

### 3.3.2 What's in it for me?

#### As an employee

You have a clear understanding of how you contribute to realizing business goals.

You know what is expected from you in your job.

You learn to what extent you meet these expectations.

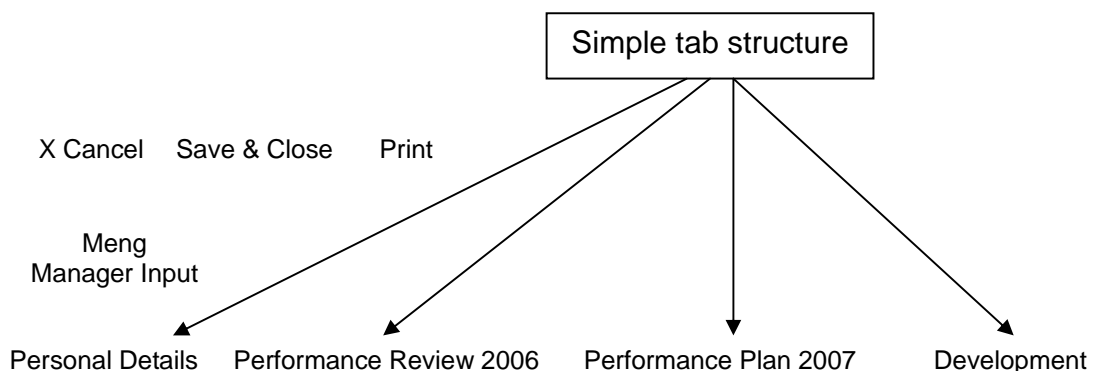
#### 3.3.3 As a manager

You deploy and realize business goals with your team.

You have the opportunity to improve the effectiveness of your team members and establish a performance culture.

You set clear objectives for your employee and evaluate your team members on what they do in their job and how well they do their job.

#### Performance Review



### 3.3.4 Key Areas of Responsibility

Leading account management team for product range X .

Planning and driving customer service initiatives for key accounts.

Setting the strategic direction for product range X.

Strengthen marketing capabilities in the organization for all new product launches.

Work together with ABC to identify product and marketing requirements for product range XYZ.

Take ownership for managing the commercial processes between business units and the different regions to achieve the business targets.

### **3.3.5 Employee comments on last year's performance**

My key areas of responsibility were the same as last year. However, this year I have been able to better lead my account management team as this is my second year in the job. Also, this year I focused more on identifying customer service initiatives for our key accounts. Based on client feedback I managed to create well received initiatives.

### **3.4 SMART Personal Objectives (including Measurable Targets)**

	<b>Employee review</b>		<b>Manager feedback</b>
<b>Objective 1</b>	Realize @ 8.2 million sales with accounts identified in the account plan 1/1/2006 and 31/12/2006		
Rating	Met		
Annual Incentive achieved	(Agreed maximum : 25)	25	(Agreed maximum : 25)
Comments	For all the key accounts I identified in my account plan, I achieved more than the @ 8.2 million sales this year.		
<b>Objective 2</b>	Improve client satisfaction for product range X by a full point to 4.3 as measure by the annual customer survey in Q4, 2006.		
Rating	Partially met.		
Annual Incentive achieved	(Agreed maximum : 15)	10	(Agreed maximum : 15)
Comments	This year, our client satisfaction was 4.1. This is already significantly		

higher than last year, when our score was 3.3. Also, we received informal feedback from clients who mentioned to be very satisfied. Based on this, I have partially met my objective.

**Objective 3**

Setting the strategic direction for product range X and deliver a strategic business plan before 1/3/2006 which is approved by the MT.

Rating

Met

Annual Incentive achieved

(Agreed maximum : 25)

(Agreed maximum : 25)

Comments

My strategic business plan was approved by the MT.

Minimum of entry boxes

Employee fields on the left side of the document manager fields on the right side

Via this button leveling guidance will be offered in terms of example behaviors in relation to corporate

The new Philips Leadership Competencies, in which the Values have been integrated, are now part of performance evaluation. Separate information will follow soon.

Leadership Competencies	Excels	Exceeds	Fully Meets	Partially Meets	Requires Action
✱ Pursue market insight	○	○	○	○	○
✱ Create innovative strategies	○	○	○	○	○
✱ Inspire commitment	○	○	○	○	○
✱ Leverage capabilities	○	○	○	○	○
✱ Champion people's growth	○	○	○	○	○
✱ Drive for results	○	○	○	○	○

**Employee review**

**Manager feedback**

Strengths

What went well this year, that

in my team sales objectives have been met. We created innovative strategies and I am aware of the market situation.

Areas of improvement

However, my area for improvement is my focus on client improving the client satisfaction score, I should focus more on this. Also, I could focus more on champion people's growth. Maybe best to share my views and learning from client situations with my team.

Focus on strengths and areas for improvement

### 3.4.1 Summary of Evaluation

Please click in the grid to indicate your proposed rating.	Manager comments regarding performance and promotability.
--	---

	Excels	Exceeds	Fully Meets	Partially Meets	Requires Action
Fast Track					
Growth Path					
Well Placed					

Minimum of entry boxes

### 3.4.2 Performance Plan

John Doe  
Manager Input

Manager can edit employee's proposal in order to define the final wording for the KARs and objectives

Personal Details    Performance Review 2006    Performance Plan 2007    Development

#### Key Areas of Responsibility New Period

Below you will find the adjusted key areas of responsibility as proposed by the employee. You can update these directly.

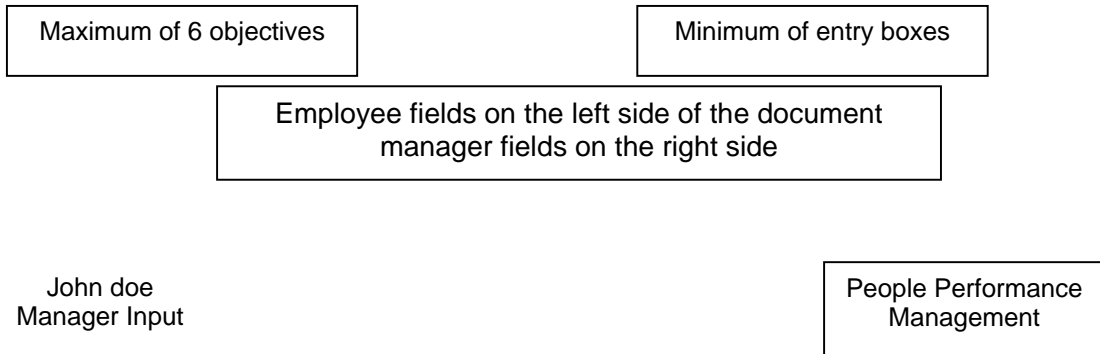
Leading account management team for product range X for the EMEA region.  
 Planning and driving customer service initiatives for key accounts in EMEA.  
 Setting the strategies direction for product range X.  
 Strengthen marketing capabilities in the organization for all new product launches.  
 Work together with ABC to identify product and marketing requirements for product range XYZ.  
 Take ownership for managing the commercial processes between business units and the different regions to achieved the business targets.

#### Proposed SMART Personal Objectives (including Measurable Targets)

Below you will find the personal objectives as proposed by the employee. You can update these objectives directly.

Employee review		Manager feedback	
	A1 Distribution 30		A1 Distribution 30
Realize @ 9.0 million sales with accounts identified in the account plan between 1/1/2007 and 31/12/2007.		Realize @ 9.0 million sales with accounts identified in the account plan between 1/1/2007 and 31/12/2007.	
Improve client satisfaction for product range X to 4.5 as measured by the annual customer survey in Q4,, 2006 and conduct a midyear client satisfaction survey to track progress.	15	Improve client satisfaction for product range X to 4.5 as measured by the annual customer survey in Q4,, 2006 and conduct a midyear client satisfaction survey to track progress.	15
Set up a system to share findings and learning within my team to be better prepared for client meetings.	10	Set up a system to share findings and learning within my team to be better prepared for client meetings.	10

Hold a bi-monthly meeting with the top 10 key accounts to inform them of the latest products.	25	Hold a bi-monthly meeting with the top 10 key accounts to inform them of the latest products.	25
Coach my account team by having regular meetings with my team members.	20	Coach my account team by having regular meetings with my team members.	20



Personal Details   Performance Review 2006   Performance Plan 2007   Development

### 3.4.3 Development

#### Development Activities Previous Period

- Follow the training “focus on the markets”
- Work together with the account manager for product range X in region APAC to learn from him.

Minimum of entry boxes

#### Employee review

I have followed a training “focusing on the markets” and based on that one of my objectives is to create regular meetings with key accounts. I also worked together with the APAC regional account manager. This was very successful and made me aware of a lot of important issues.

#### Manager feedback

#### Development Activities New Period based on strengths ad areas for improvement

Below you find the new development activities as proposed by the employee. These activities are based on the employees strengths and areas of improvement derived from

the employees (Functional) Competencies. You can update these new activities directly.

I can still develop myself by using what I have learned from the training “focusing on the markets”. Further on I want to develop myself on “champion people’s growth”. For this reason I will follow a training for coaching.

Manager can edit employee’s proposal in order to define the final wording for the development activities

Functional Competencies will be available via a web link to serve as inspiration for indicating the strengths and areas for improvement, but will not be rated anymore

Employee fields on the left side of the document  
manager fields on the right side

### 3.4.4 Career

#### Employee

#### Manager

#### Career Aspirations

#### Manager comments on career

I would like to grow to a role where I have the responsibility for product XYZ in the APAC region. I know the EMEA region very well and am very interested in working in the APAC regions because of the dynamics going in here.

#### My Mobility

Mobility           Regional  
Regions           Asia-Pacific Rim & Australia  
Restrictions

Minimum of entry boxes

#### Midyear development conversation

Please Indicate if you foresee the need for an additional specific midyear development conversation. *If the employee and / or manager indicate “yes” and email will be sent to both parties halfway the year to indicate them to start the development process.*

#### Employee

#### Manager

No

Yes     No



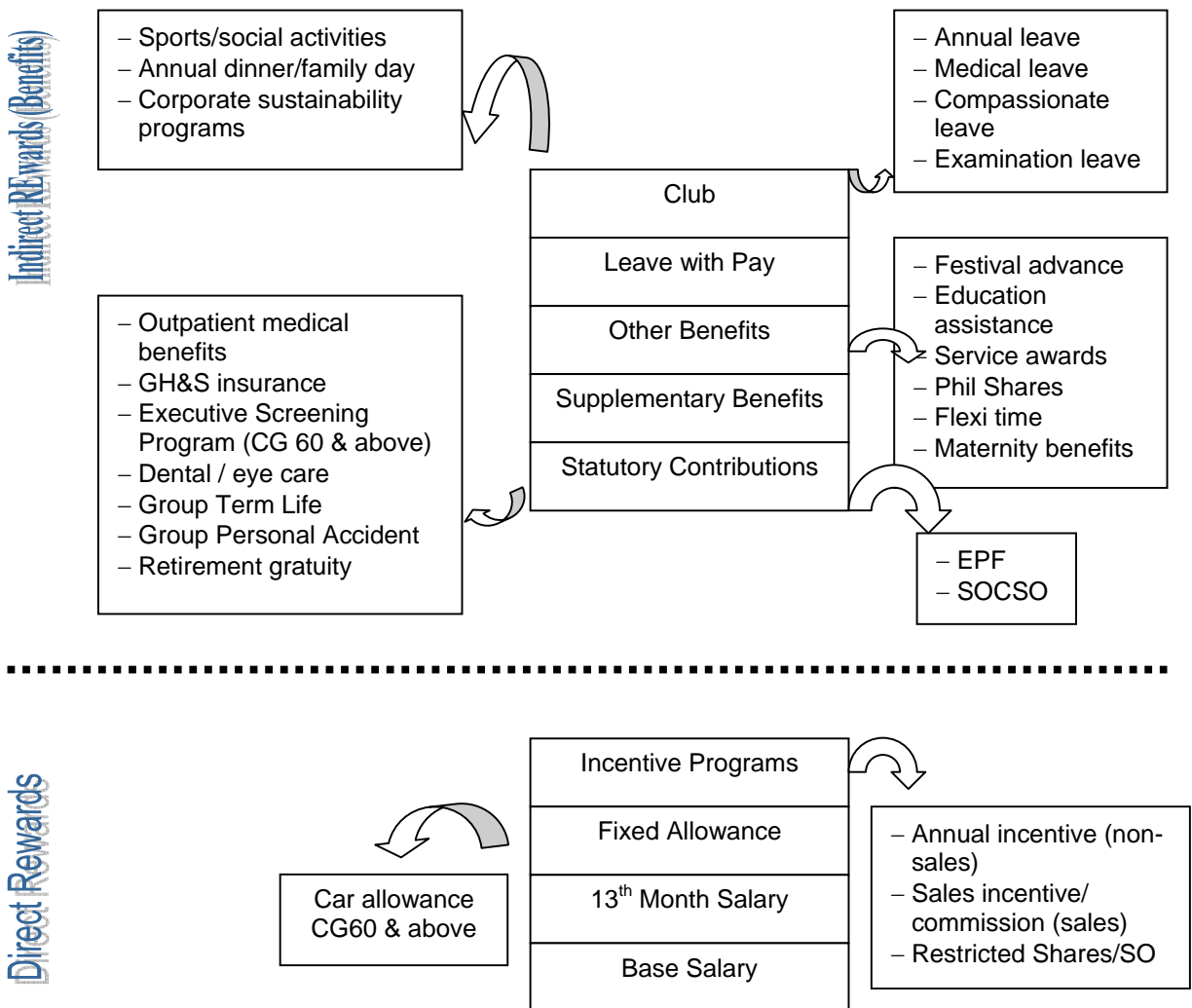
Default mode : end-year meeting focused on performance as well as development. There is an option to choose for an additional mid-year development meeting

#### 3.4.5 What else will be new?

- Tool will be **available throughout the year** to work on development and to define KPIs and objectives e.g. for new employees (manager formally accepts, HRM receives copy).
- **No colleague feedback** option anymore (only 9% made use of this).
- Co-assessor input will be much more focused and **co-assessor can start immediately** after employee has submitted input.
- More flexibility for HRM Manager in creating and importing calibration grid at all times before PPM meeting phase (administrative unburdening HRM managers).
- Please note all relevant data of the last PPM cycle **will be transferred** to PPM light.

### 3.5 Rewards & Communication

#### 3.5.1 Overview of rewards programs offered



## 3.6 Talent / Management Development

### 3.6.1 Developing talents

- Career planning with our Career Center
- Single website with all Philips' vacancies
- Offers hints and tips on career and development
- People Development
- Performance Management :  
Assess : not only what you do but also how you do it
- Core Curricula :  
'One Organisation' way of learning


### 3.6.2 The Management Development Process

- Who will fill our key positions now and in the future?
- Succession planning
- Performance reviews
- How have they performed against business objectives and competencies or values?
- Competencies
- Talent Identification: What is their potential? What steps do they need to take to develop?

### **Management Development is a Partnership with Joint Accountability between :**

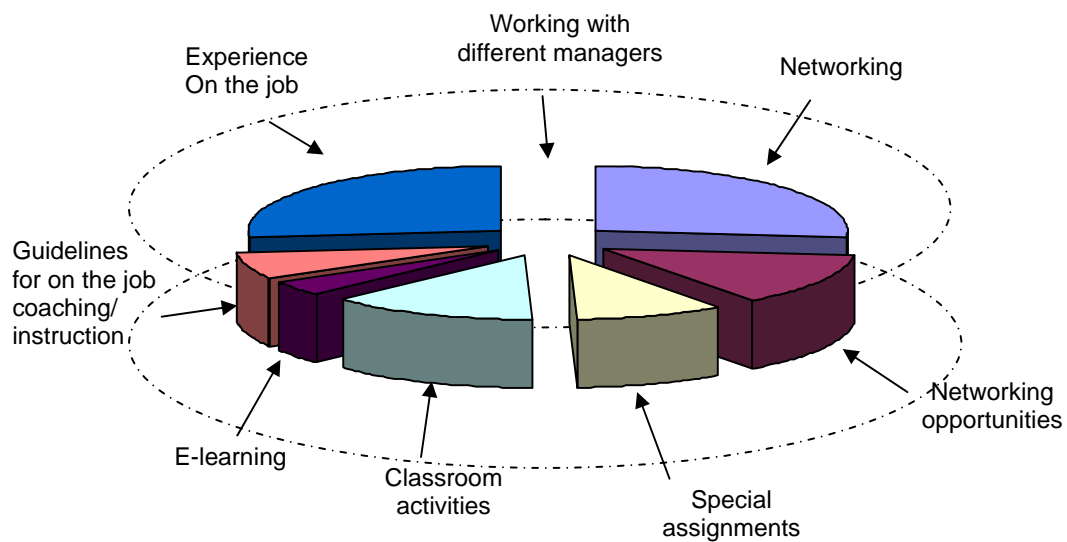
Company / HR	Provide tools, processes and systems to enable and support development and succession planning.
Managers	Recognize, plan, coach, develop and monitor the

skills and talents of employees.

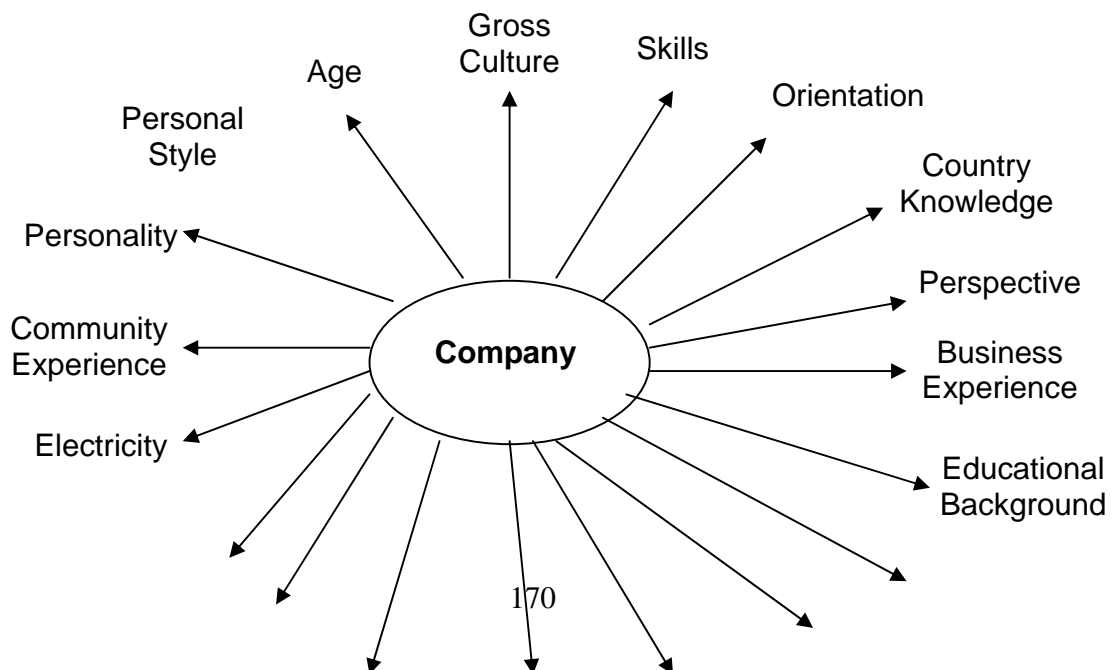
Employees  Contribute to and plan for the future. Have a self-managing mindset about careers.

### 3.6.3 Learning & Development

#### The total blended learning solution



### 3.6.4 Diversity & Inclusion



Physical  
Abilities

Faith  
Religion

Life

Experience

Language

- **Diversity** Thinking Gender Passion  
Style

The term “diversity” symbolizes our recognition that our workplaces, marketplaces and communities are made up of individuals: men and women from different nations, cultures, ethnic groups, generations, background, skills, abilities and all the other unique characteristics that make each of us who we are.

We can better understand our customers and better identify their needs when we have a diverse workforce that mirrors our worldwide customer base.

- **Inclusion**

The term “inclusion” symbolizes an environment where everyone can fully participate in creating business success, and where each person is valued for his or her distinctive talents (skills, experiences, perspectives, etc.)

An inclusive working environment engages people, enhances decision making and increases creativity and innovation in support of our vision and brand positioning.

### 3.7 Employee Engagement Survey

#### 3.7.1 Engagement is essential to achieve our business agenda

- As a company, we know where we want to be and what we need to get there.
- Engaged employees are, just like happy clients, a condition for

growth.

- Yet, there is a gap between where we want to be and what our people tell us.
  
- Topics that keep coming back are consistent through all sources; strengthen people leadership to get the best out of people, ensure alignment on direction and reduce complexity to enhance people ability to contribute, create an environment of trust and open dialog to offer space for people to add value, behave consistently to accelerate the pace of change.
- Improvement to be done in these areas is a key to increasing engagement.

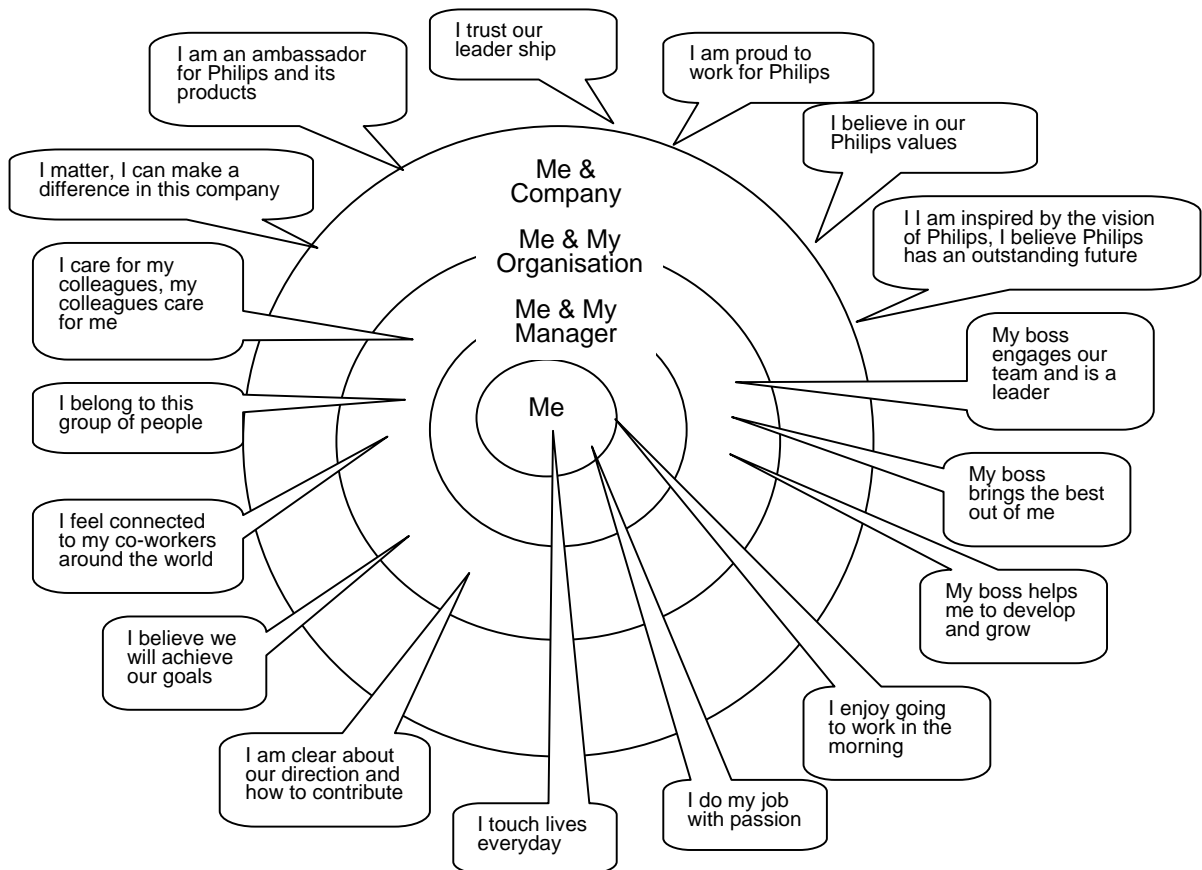
### **3.7.2 Positioning engagement?**

Engagement is about creating an inclusive and high-energy working environment, where all employees are aligned to and energized to contribute to our business success. An engaged workforce delivers a competitive advantage – our people are highly motivated to give their best every day.

Someone who is engaged typically :

- goes above and beyond the normal demand of the job
  - helps others with heavy workload
  - volunteers for extra duties
- looks for way to perform jobs more effectively
- has higher level of customer satisfaction

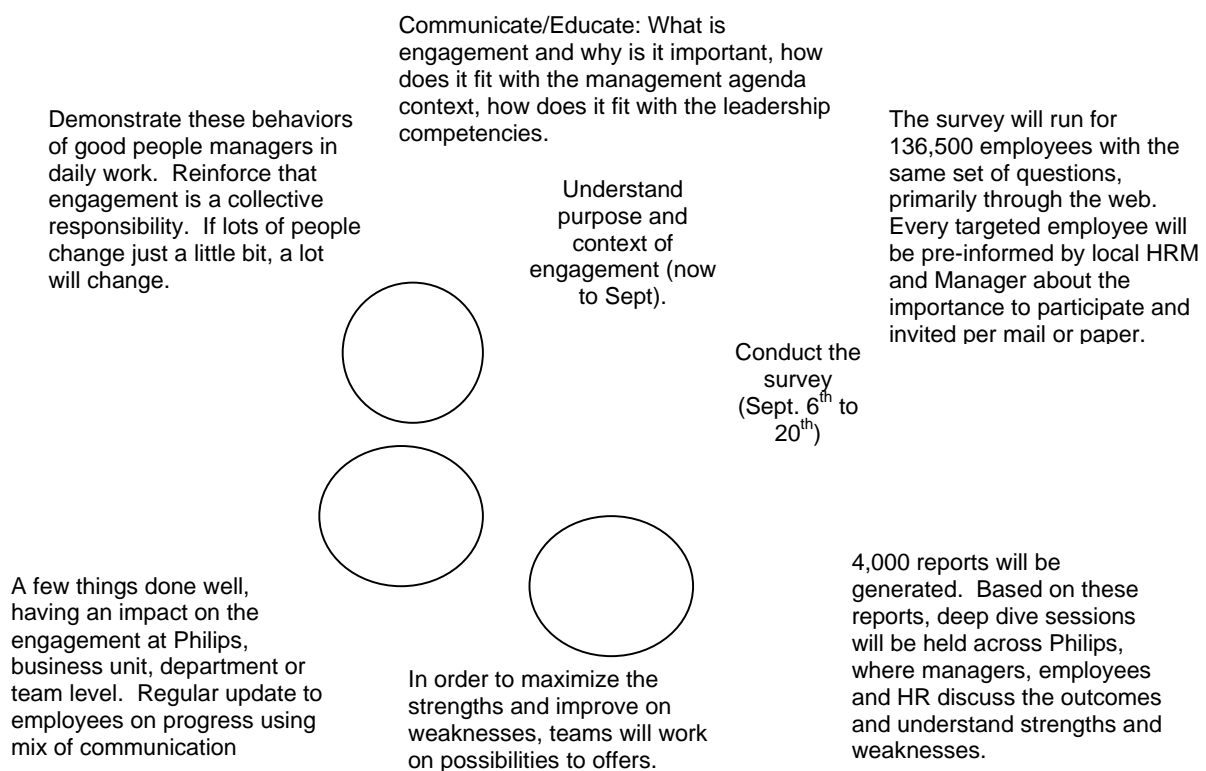
### 3.7.3 We need our workforce to say things like .....



### 3.7.4 Key themes of Engagement

Being passionate and proud	Bringing out the best in each other	Trusting and being trusted
<p>This is about being an advocate for Philips, believing in what Philips stands for and its future.</p> <p>This is about being outspoken, taking a stand for what we believe in.</p> <p>This is about having a positive attitude.</p> <p>This is about individuals</p>	<p>This is about making a personal commitment and using individual talent to play a role and contribute (Skill &amp; Will)</p> <p>This is about building on motives, values and goals of each individual to help them contribute to the best.</p> <p>This is about</p>	<p>This is about being authentic and consistent between what we say and do.</p> <p>This is about communicating and measuring progress on what we say we will do.</p> <p>This is about earning trust by acting as role model.</p> <p>This is about trusting</p>

### 3.7.5 Process of Engagement in 2006?



### 3.7.6 Whose responsibility is it?

- Engagement is a collective responsibility which needs to happen daily.
  - Be passionate and proud, bring the best in each other, trust and be trusted in all the things we do.



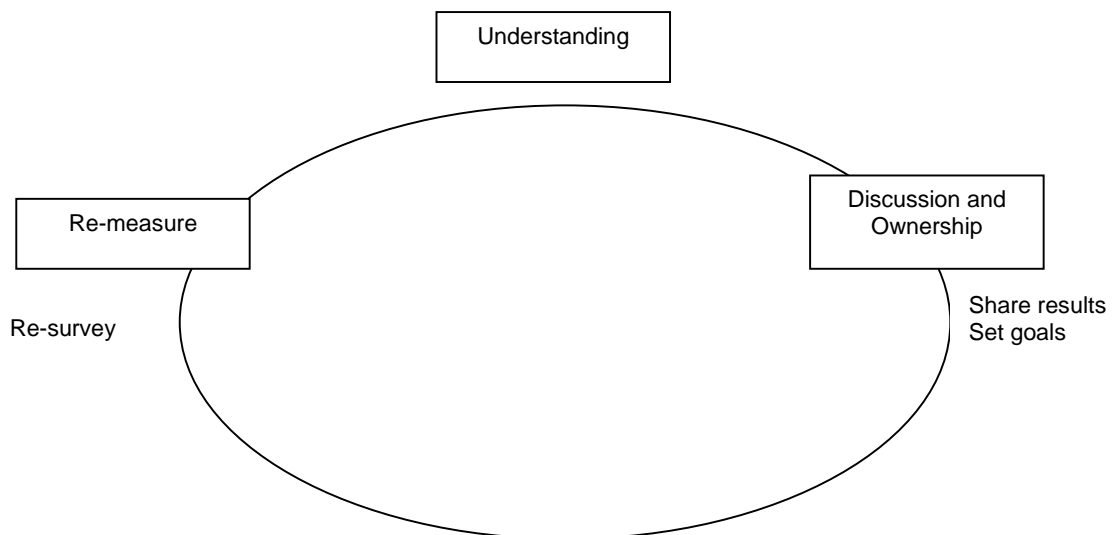
- Every individual can impact engagement within their own team.
- These changes at a local level then multiply to create significant organizational shifts.

### **3.7.7 List of Questions from the Engagement Survey**

1. I believe the company has an outstanding future
2. I trust the leadership of the Company
3. I trust my manager
4. My manager is an active role model for the company's values
5. The leadership of the company has communicated a vision of the future that motivates me
6. I have a clear picture of the direction in which the company is headed
7. My organization has a climate in which diverse perspectives are value
8. The management style in this organization brings out the best in employees
9. My management has acted on issues identified in the previous employee engagement survey
10. I feel adequately informed by my management on our business goals
11. There is good cooperation between my department and other departments
12. I rarely think about looking for a new job with another company
13. I would gladly refer a good friend or family member to the company for employment
14. Overall, I am extremely satisfied with the company as a place to work
15. I feel proud to work for the company
16. My job makes good use of my talents and abilities
17. I have the training I need to do my job effectively
18. My manager has facilitated my growth and development
19. My manager provides me with coaching that is helpful in improving my performance

20. I receive the information and communication I need to do my job effectively
21. In my organization there is open and honest two-way communication
22. My manager clearly communicates what is expected of me
23. My manager is usually receptive to suggestions for change from employees
24. I feel that I am part of a team
25. My ideas and suggestions count
26. My manager really cares about my well being
27. I am encouraged to come up with new and better ways of doing things
28. All employees in the company are treated as individuals regardless of age, race, gender, physical capabilities etc
29. I am involved in decisions that affect my work
30. I am given sufficient authority and freedom by the organization to do my job well
31. My manager provides me with timely and helpful feedback
32. I think my performance is evaluated fairly
33. I regularly receive appropriate recognition when I do a good job
34. My organization provides equal opportunities to all employees
35. The compensation plans of Philips reward outstanding job performance
36. In my current job, I am satisfied with my pay and benefits

### 3.7.8 How should the process look like?



Review

Monitor and support  
progress

Action and  
commitment

Develop an action plan  
Share the plan

### **As a result**

We create the readiness for the organisation to seize business opportunities and gain competitive edge through workforce globalization.

## **4.0 Labour Market Situation**

During the first half of the Second Industrial Master Plan (IMP2), 1996-2005, the manufacturing sector recorded a tight labour market, largely due to the full employment situation and the robust performance of the sector. The Asian financial crisis adversely affected economic growth and employment. In response, measures were undertaken to accelerate economic recovery and address unemployment. These included Government initiated programmes to improve employability through retraining and skills upgrading, as well as greater emphasis on productivity and competitiveness.

While Malaysia offers a pool of talented human resources, there is presently a shortage of skilled workforce in specialized fields in engineering, information and communication technology (ICT) and high technologies. To overcome this shortage, companies engaged foreign experts and specialists. As of 2005, there were 35,480 expatriates employed in Malaysia, with 18,679 (52.6%) in the services sector, 40.6 % in the manufacturing sector, 2.8% in the construction sector and 0.2% in the plantation sector. Expatriates were generally employed in the higher managerial category and specialized fields, such as oil and gas, biomedicine, research and development (R&D), ICT consultancy and

software management. To increase the availability of local experts, the Government implemented the Brain Gain Programme to attract Malaysian talents abroad to return.

A large number of foreign workers are employed in tasks which require lower skills. As at 2005, there were 1.8 million foreign workers in the country, with 581,379, or 32%, in the manufacturing sector, 26.1% in the plantation sector, 15.5% in the construction sector and 8.8% in the services sector. These workers were employed in jobs for which Malaysians were not available or not willing to fill.

#### **4.1 Industrial Relations in Malaysia**

Generally, the extent of unionization in Malaysia is low for two main reasons, first the predominance of small-scale manufacturing and services establishments; second the prevalence of contract labour. The Labour Law in Malaysia is well established. Among the Labour Laws in Malaysia are the Employment Act 1955, Workers Housing and Amenities Minimum Standards Act 1990, Workers Compensation Act 1952, Young Person and Children Act 1966, Wages Determination Council 1947, Weekly Holiday Act 1950, Employment Information Act 1953, Employment Limitation Act 1968, Industrial Relation Act 1967 and Trade Union Act 1959.

The extent of unionization in Malaysia is low for two main reasons, the predominance of small-scale industries and service establishments; as well as the prevalence of contract labour. The Congress of Union of Employees in the Public and Civil (CUEPACS) represent the public sector while the Malaysia Trade Union Congress (MTUC), registered with the registrar of societies functions as the voice of Malaysian trade unions at both the national and international levels. It also represents workers on

tripartite organizations such as the National Labour Advisory Council (NLAC),

Private sector employers in Malaysia are represented in the central organization known as the Malaysian Employers Federation (MEF). Established in 1978 following the dissolution of the Malaysian Council of Employers' Organisation, the MEF is registered under the Societies Act 1986 and includes both ordinary and associate members. The MEF advises its members on how to deal with trade union claims, helps to prepare counter-proposals and assists in negotiations of collective labour agreements. It also represents employees in the NLAC and Wages Council.

It is important to note that matters pertaining to labour and industrial relations come within the jurisdiction of the federal government as stipulated by the Malaysian constitution. Hence the Trade Unions Ordinance and the Industrial Relations Act apply throughout the country. Voluntarism is the basis of collective bargaining in Malaysia. When an employer or a trade union serves notice of its intention to commence collective bargaining, the receiving party is required to respond within 14 days. If the response is positive, collective bargaining should commence within 30 days of the reply. If negative or if the bargaining otherwise does not commence within the 30 days period, the party serving notice may notify the Director General of Industrial Relations who may then take the necessary action to persuade both parties to the commence bargaining. If there is still no success at that stage, then a trade dispute will legally exist.

## 4.2 Legal Environment for Employment

The present labour laws include:

<b>Act</b>	<b>Major Provisions</b>
Employment Act 1955	<ul style="list-style-type: none"><li>- all manual and non-manual workers earning RM1,500 and below;</li><li>- minimum benefits and rights of employees, including working hours, annual leave and public holidays, overtime rates and sick leave;</li><li>- issues such as termination and retrenchment</li></ul>

The act was amended in 1998 to allow, among others, for workers earning RM5,000 and below to complain to the Labour Department for violation by the employer of any term and condition of the employee's contract of service. The Act was last amended in 2000.

Industrial Relations Act 1967	Governs the relationship between employers and employees and their trade unions, and the prevention of settlement of differences of disputes arising from the relationship.
Social Security Act 1969	Covers workers who earn RM3,000 and below. The act provides for benefits and pension if a worker is injured or disabled during working

hours, or while traveling to and from work. It was last amended in 2005.

Occupational Health and Safety Act 1994

Protects the worker against unsafe work sites and unhealthy work practices.

#### **4.2.1 Industrial Relations Act, 1967**

The Industrial Relations Act regulates relations between employers and employees and their Unions. The main objective of the IR Act is to resolve trade disputes. The Act embodies four important principles:

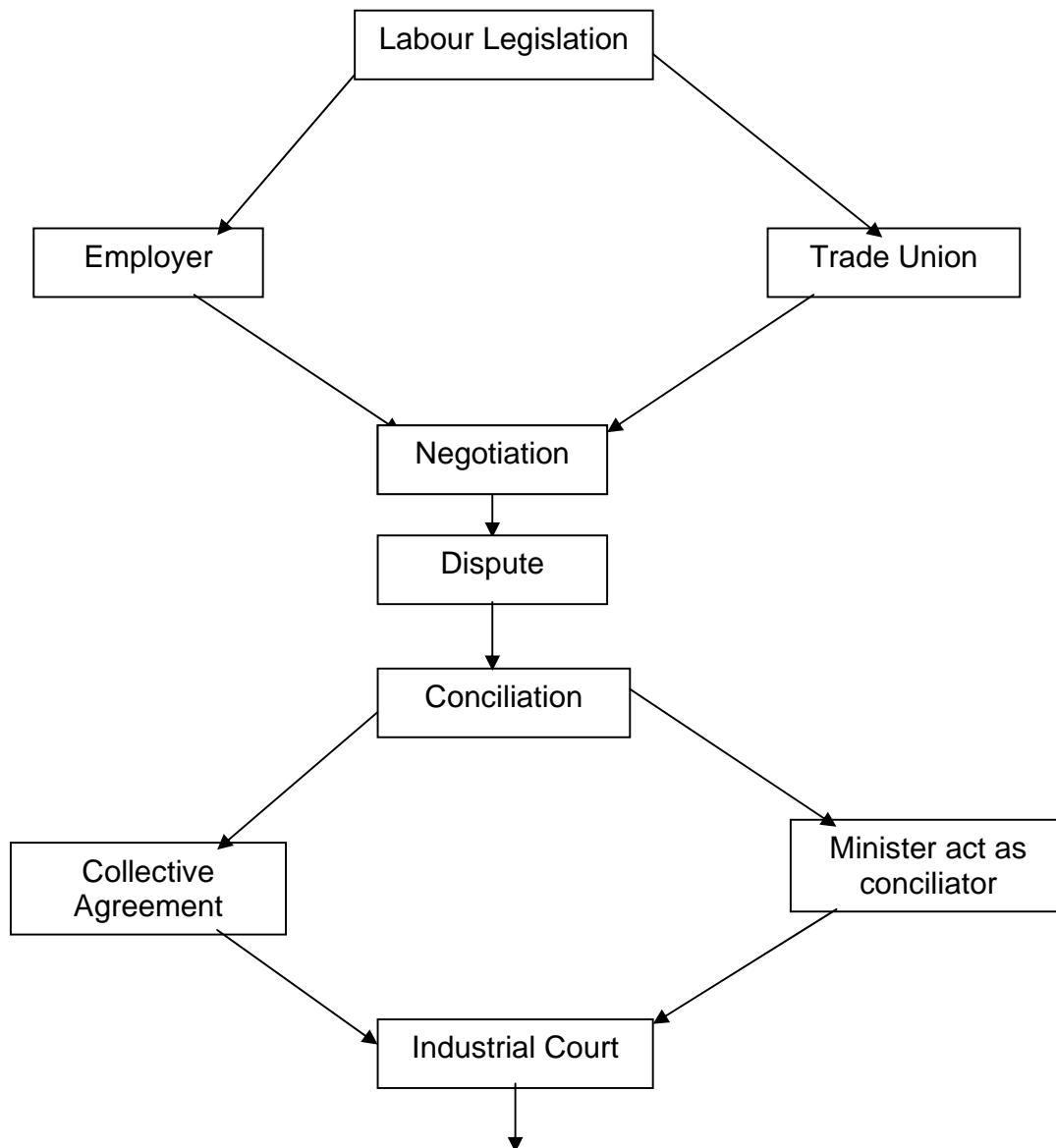
- The principle of trade unionism
- The principle of recognition
- The principle of collective bargaining
- The principle of resolving disputes

The Industrial Relations Act requires that a collective labour agreement be concluded and deposited with the Industrial Court every three years. Once the court takes cognizance of the agreement it becomes binding, and any violation of its provisions constitutes an offence under the law. However, before taking cognizance of the agreements, the court sends some of them back to parties for amendments.

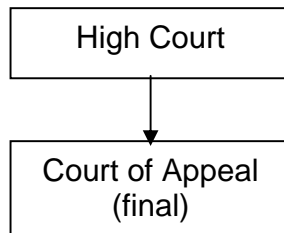
The dispute settlement machinery in Malaysia provides for conciliation and arbitration. The Industrial Relations Act empowers the Director General of Industrial Relations and the Minister of Human Resource to conciliate labour disputes. The Director-General can inquire into the causes and circumstances surrounding the dispute and bring the parties together or appoint an arbitrator if both parties agree. The Minister can intervene in any dispute for the purpose of conciliation and if appropriate, may refer the case to the industrial court of arbitration.

The Industrial Court, constituted under section 30 of the Industrial Relations Act, 1967, hears cases brought by the parties or referred by the Minister. The Court has jurisdiction over four types of cases : (a) unfair dismissed claims, (b) interest disputes, (c) interpretation of collective agreements or awards and (d) complaints of non-compliance. The mechanism through which labour disputes are heard by the Industrial Court is illustrated in Figure I.

**Figure 1**  
Industrial Relations Process in Malaysia







### **4.3 Industrial Relations: Issues and Challenges**

The industrial relations in Malaysia is increasingly moving towards cooperation and collaboration rather than confrontation. It has been recognized that in the context of changing times, there is a need to work together to survive. In any society, there is necessarily conflict in industry between employers and employees, between the owners of goods and services and those who work to produce these goods and services. The objective of Malaysia's industrial relations system is to direct the forces producing conflict towards constructive ends.

In accordance with this philosophy, employers and workers have grouped together to advance and protect their separate interests. Trade Unions have long been accepted as lawful, and the rights to strike and bargain collectively have been similarly recognized. Likewise, employers have been allowed to organize themselves into groups and to take legitimate action to protect their interests. It has also been accepted that the Government should provide the facilities to help the parties agree, but not to actively interfere to impose a settlement on them. The issues surrounding industrial relations should be centred on employability.

In the process, the following key challenge has to be resolved:

- **Enhancing Employability**  
In line with the human resource policy thrusts mentioned earlier, knowledge and skills of workers must be continuously enhanced.

Specifically, generic skills are a pre-requisite for employability and workers must be more oriented towards technical skills and utilization of high level technology. Management and Unions must work together to develop a trained workforce who has the potential and ability to optimize the use and development of new techniques and materials as this will continue to be important in ensuring the growth and resilience of the economy.

Human resource development facilities provided by both public and private sectors in ensuring that workers are adequately trained must be utilized. Negotiations between employers and unions must make this issue a priority.

- Information Sharing

There is insufficient sharing of information between employers and unions especially on financial issues. For the purpose of carrying out his functions, the Director General for Industrial Relations under subsection (4A) of the Act shall have the power to require the trade union of workmen, the employer or the trade union of employers concerned to furnish such information as he may consider necessary or relevant.

- Conflict in Collective Agreements

Trade Unions would normally maintain their rights as per collective agreement which is concluded once in three years. The Trade Unions main concern is to protect the workers in terms of wage increments and benefits while Employers normally plead understanding in the context of intense competition and affordability. The Government had proposed a wage system that is linked to performance as a fair way to accord wage increments and bonuses. There is also a call to review the Industrial Relations Act, to make it more in tune with the current economic developments.

- **Outsourcing and Mergers**

In the face of globalization and more intense competition, more and more firms are going for outsourcing and mergers. In the process, employees find that they have to cope with new environment, new conditions of employment and security of tenure. The industrial relations is currently inadequate in coping with this new trend. The Industrial Relations Department is thus undergoing a reorganization of their structure to be in line with the current economic scenario.

- **Minimum Wages**

The Malaysian Trade Union Congress (MTUC) has made a request to the Government for establishing a minimum wage. A decision on the matter is yet to be made. Another alternative to minimum wages is to establish a wage system that is linked to performance/productivity, where the wage system consist of two components; the fixed component that ensures wage stability and the variable component that ensures enhance performance.

## **5.0 Productivity and Wages**

### **5.1 International Productivity Comparison**

In 2006, the productivity growth of Malaysia at 3.7% surpassed many of the Organisation of Economic Cooperation (OECD) countries such as Sweden (2.8%), Japan (2.5%), Germany (2.0%), Denmark (1.8%), USA (1.5%), United Kingdom (1.7%), France (1.4%), Australia (1.0%), Canada (1.0%) and Ireland (1.0%). Amongst Asian countries, Malaysia registered higher productivity growth than Thailand (3.5%), Chinese Taipei (2.7%) and Singapore (1.2%). However, China (9.7%), Indonesia (6.4%), India (6.0%) experienced higher growth. The ongoing shift of the economy towards higher value added and knowledge based activities, adoption of

new technologies and innovations into business applications, strong economic growth, increasing inflow of foreign investment and intensive utilization of information and communication technology (ICT) had contributed to the productivity performance.

The productivity level of Malaysia at US\$11,716, was higher than that of India (US\$ 2,128), China (US\$2,885) and the Philippines (US\$2,914). However, highly industrialized and matured economies such as Japan, Norway, USA and Ireland with high GDP per capita, high degree of innovation and a large pool of educated workforce recorded higher productivity levels. Total research and development (R&D) expenditure as a percentage of GDP of the OECD countries such as Sweden (3.9%), Finland (3.5%) and Japan (3.2%) was higher than that of Malaysia (0.6%). In addition, almost all the selected OECD countries showed higher education achievement.

**Table 4.1 Productivity Levels and Productivity Growth, 2006**

<b>Country</b>	<b>Productivity Level (2000 Constant Prices, US\$)</b>	<b>Productivity Growth (%)</b>
<b>Malaysia</b>	<b>11, 9716</b>	<b>3.7</b>
<b>Selected OECD Countries</b>		
Japan	79,907	2.5
United States	77,989	1.5
France	58,190	1.4
United Kingdom	53,764	1.7
Canada	50,029	1.0
Australia	46,681	1.0

Korea	28,956	3.7
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**Selected Asian Countries**

Singapore	48,782	1.2
Chinese Taipei	38,622	2.7
Thailand	4,202	3.3
Philippines	2,914	1.6
China	2,885	9.7
Indonesia	2,128	6.4

*Source : National Productivity Corporation, Annual Productivity Report 2006.*

The productivity growth of Malaysia which was higher than the OECD countries was indicative that Malaysia is progressing towards achieving better competitiveness globally. Malaysia has to continuously ensure that productivity grows at a faster rate than the developed economies to achieve a higher productivity level which is on par with these economies.

**5.2 Labour Cost Competitiveness of the Manufacturing Sector, 2006**

The manufacturing sector continued to improve its Labour Cost Competitiveness by registering a 3.1% growth in Sales Value per Employee as compared to a 2.5% growth in Labour Cost per Employee (Table 2). Human resource development, cost rationalisation initiatives and productivity and quality improvement programmes undertaken by the manufacturing industries

contributed to this performance. Unit Labour Cost (ULC) which is the labour cost of producing one unit of product or service declined and thus enhanced competitiveness as it is now cheaper to produce a unit of output. Unit Labour Cost declined by 0.7%.

Table 4.2 shows the sales value per employee (proxy for productivity, Labour cost per employee (proxy for wages) and unit labour cost. It is observed that in situations where labour cost per employee grows faster than sales value per employee, unit labour cost will increase such as in year 2002. It is therefore imperative that wage increases should be commensurated with higher productivity growth to enhance competitiveness.

**Table 4.2: Labour Cost Competitiveness, Manufacturing Sector**

	2002	2003	2004	2005	2006
Labour Cost per Employee	4.47	4.42	3.14	4.42	2.5
Unit Labour Cost	0.68	-3.40	-12.04	-3.40	-0.7
Sales Value per Employee	3.69	8.11	17.24	8.11	3.1

Source : National Productivity Corporation, Malaysia

### 5.3 Wage System in Malaysia

In the private sector, the wage structure may be in the form of a salary scale. There is also a system of using the salary range. Minimum and maximum annual increment may or may not be pre-determined until the employee reaches the maximum in the salary range. In the unionized sector, employees have their wages and other conditions of employment determined through collective bargaining. At each renewal of a collective agreement there is always upward revision of the starting salary, followed by annual increments in predetermined steps which usually, but not necessarily, ends with a maximum. Besides the

annual increment there is also the salary adjustment at the end of each three-year period when a new agreement begins. An employee therefore receives an annual increment each year and a salary adjustment once every three years. The total increase over a six-year period was 81 per cent. The increase is not in any way related to the company's performance or the employee's productivity. The increase will be permanently built into the employee's salary.

The main weakness of such a wage system is its inflexibility of any adjustments either to the company or employee performance. Among the inhibiting features are:

- The general trend of wage increase is rapid and not related to productivity improvement;
- Collective agreements are usually fixed for a period of three years and binding on both parties. The phasing in of wage increments is often out of synchronization with economic reality at the time of implementation because of the protracted delays in many wage negotiations;
- Annual increments are pre-determined and are given automatically to all workers regardless of the level of performance;
- Remuneration is not related to company performance;
- Terms in the collective agreement cannot be reduced even when a new agreement is being concluded on the premise that once a benefit is granted, it cannot be subsequently withdrawn even through in lean times.

Recognising the weaknesses of the current wage system; the Government initiated a tripartite task force to develop guidelines on a Wage Reform System which is linked to productivity in 1997 and in 2004, a Guiding Principles for the implementation of Performance Linked Compensation among Government Linked Corporations (GLC) had been developed.

#### **5.4 Performance Linked Compensation: Guidelines and Implementation**

“From a human capital standpoint, the right Performance Linked Compensation (PLC) programme will enable corporations to attract, retain and motivate the best people. From a corporate viewpoint, PLC programme is consistent with the economic ownership model whereby ownership is institutionalized and management is left to professionals who are to be adequately incentivised to drive performance. The alignment of shareholder and management’s interest is in the interest of both. From a national perspective, the pressure for better accountability and performance in Corporations has never been greater. New engines of growth need to be identified and existing economic engines need to be competitive if we are to survive in the global economic order. In the period immediately following the financial crisis, we have spent much effort restructuring. But we cannot stop there; all the past efforts would be for nothing if we do not move on to the next level. By driving GLCs towards higher performance and global competitiveness, GLCs will lead the private sector in generating long term sustainable growth for Malaysia.”

Speech by YB Tan Sri Nor Mohamed Yakcop,  
Finance Minister II, Malaysia, 14 May 2004.



The focus of the Guiding Principles<sup>8</sup> has been on the implementation of Key Performance Indicators (KPIs), and the introduction of Performance Linked Compensation (PLC). PLC is not about compensation structure alone, it is an all encompassing process of:

- Identifying the strategic direction and targets for the company,
- Aligning management's focus towards these goals,
- The ongoing process of review and appraisal to keep the company on track, and
- In the process, sharing the success of the company in terms of rewarding employees.

The governance structure of each company will be the proper channel for implementing the PLC programme. There are four main areas:

- KPI Design
- Base Pay
- Performance Bonus
- Eligibility

#### **5.4.1 KPI Design**

Balanced and wholistic set of KPs

As a business foundation, any organization will have its corporate mission and strategy. In formulating the KPIs, there should be a clear link with corporate mission and specifically business plans. The choice and selection of the right KPIs cannot be overemphasized and has to be developed with the corporate strategy and mission in mind:

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<sup>8</sup> Performance Linked Compensation: Guidelines & Implementation by YB Tan Sri Nor Mohamed Yakcop, Finance Minister II, Culture of High Performance for Government Linked Companies, Seminar on 14 May 2004, Ministry of Finance, Putrajaya.

- i. KPIs selected must be actionable; that is they should be within the control of management and the outcome is capable of being influenced by management's action or inaction.
- ii. KPIs must be measurable. The objectivity of measurements is critical but it does not mean that KPIs should not include subjective areas. In areas such as customer satisfaction, independent surveys may be used as a proxy measure
- iii. Avoid KPIs that encourage short term outlook. KPIs design must allow for progressive growth. Do not for example, sacrifice efforts which bring benefits in the long-run such as training and research, just to show better results.

Targets should be benchmarked against industry peers, either domestically or if available, internationally. It is not sufficient that targets are based on historical trends if those trends have not been up to the mark. In many cases, industry-wide data are available as comparisons. The number of KPIs should not be too many to ensure clarity and focus. Best practice would suggest scorecards containing between five to eight KPIs. The KPIs selected should also be weighted to ensure that more important business objectives are given emphasis. Targets should be set annually in line with changes in business objectives. Where actual results to-date are behind targets, remedial action should be taken to review and address the situation.

#### **5.4.2 Base Pay**

As a guide, executives base pay should be set at the market average of comparator companies. The choice of comparator companies is critical as the results may be skewed depending on the companies selected. The companies selected should have common operational characteristics such as size and markets. There should not be indiscriminate use of data to justify higher

compensation without regard to the local conditions. Nevertheless, in the quest for specific talent, specific compensation package which is personal to holder could be offered; such situation should be referred to the major shareholder.

### **5.4.3 Performance Bonus**

#### **Achieving minimum threshold**

When setting performance threshold, there should be a minimum threshold below which no performance bonus should be made. There should not be a situation where an executive achieves 20% of the target and still be entitled to receive 20% of the performance bonus. The guidelines suggest that bonuses should not be payable for performance below 50% of the KPIs targets.

#### **Linking payout to KPI score**

There should be correlation between KPI score and payout. Nonetheless, a “modifier” should be introduced to limit the performance payout for exceptional situations arising in the year. For example, it may be decided that despite management achieving the KPIs, the business reputation has suffered as a result of a major negative event such as a major industrial accident that could have been avoided. In this situation, it is appropriate to limit the extent of the pay-out.

#### **Market Competitive Bonus**

To attract the best candidate and ensure the best performance, the performance bonus should be a real incentive. Good performance should be rewarded. However, there should not be an over-skewed compensation where there is no internal equity and the payout has no linkage to performance. Perverse behaviour focusing on short term gains, non-congruence of overall corporate goals and manipulation of results should be avoided.

#### **Use of Cash Rewards**

Rewards can be a combination of cash or shares and the concept of “self-funded” performance bonus should be used. The ability to afford the payout is a given. Hence, performance bonus should only be given out from profits earned out of superior performance. If the base financial targets are set at, say, 12% ROE, no performance bonus may be paid out if this is not achieved. The bonus pool established should be shared between executives and shareholders to preserve equity to the providers of capital.

### **Use of Shares**

Typically long term incentives comprise shares provided this is applicable to the company and the major shareholder can afford to dilute the shareholding. No discounts from market are to be given for share options under the scheme as the value to the staff needs to be earned from improved market price of the shares in the future rather than existing shareholders at the present.

#### **5.4.4 Eligibility**

##### **Senior Management**

Senior management typically comprises the CEO, the direct reports and those immediately below that. However, the definition of senior management will vary depending on the organization structure. What is key is that this group of people have a direct influence on the company’s performance. It is expected that the CEO and direct reports, should gradually become contract positions. The possibility of non-renewal of contract is one way to encourage performance; and any vacancies should be made available to internal and external candidates. Terminations should be exercised for non-performance.

##### **Other Employees**

The principles of performance linked compensation must be applied to all levels of the organization. It is however recognized that there is a difference in risk and return between management and other employees. Under the scheme, senior

management will be subject to employment contracts, a high variable element to wages and very much tied to the company's performance. Other employees whilst subject to performance will not be burdened with as much risk.

### **Non Executive Directors**

Non-executives such as non-executive Directors are not eligible under this scheme; however they may participate in the standard ESOS scheme. This prohibition is to ensure proper check and balance.

### **5.4.5 Implementation**

A project Steering Committee for the implementation of the PLC should be set up. This committee would report to the Board or Board of Remuneration Committee. The Guiding Principles should be used in the implementation and any variation has to be referred to the PLC Steering Committee for clarification and guidance.

### **5.4.6 Performance Based Elements in Collective Agreements**

In 2006, the National Productivity Corporation<sup>9</sup>, Malaysia carried out a study to gauge the extent of performance-based elements adopted by unionised firms. It is encouraging to note that 61% of 373 unionised firms had incorporated performance criteria in their Collective Agreements as follows:

<b>Performance Elements</b>	<b>%</b>
Discretionary bonus that is based on individual, department or overall company performance	22.5
Commitment in ensuring timeliness, discipline	20.6

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<sup>9</sup> Performance Based Elements in Collective Agreements, NPC Malaysia, 2006

and ensuring quality of output

Merit increment whereby the quantum of increment Varies according to employees performance	12.8
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Profit-based Bonuses	10.2
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Service or performance incentives that are Distributed based on performance of employees	7.5
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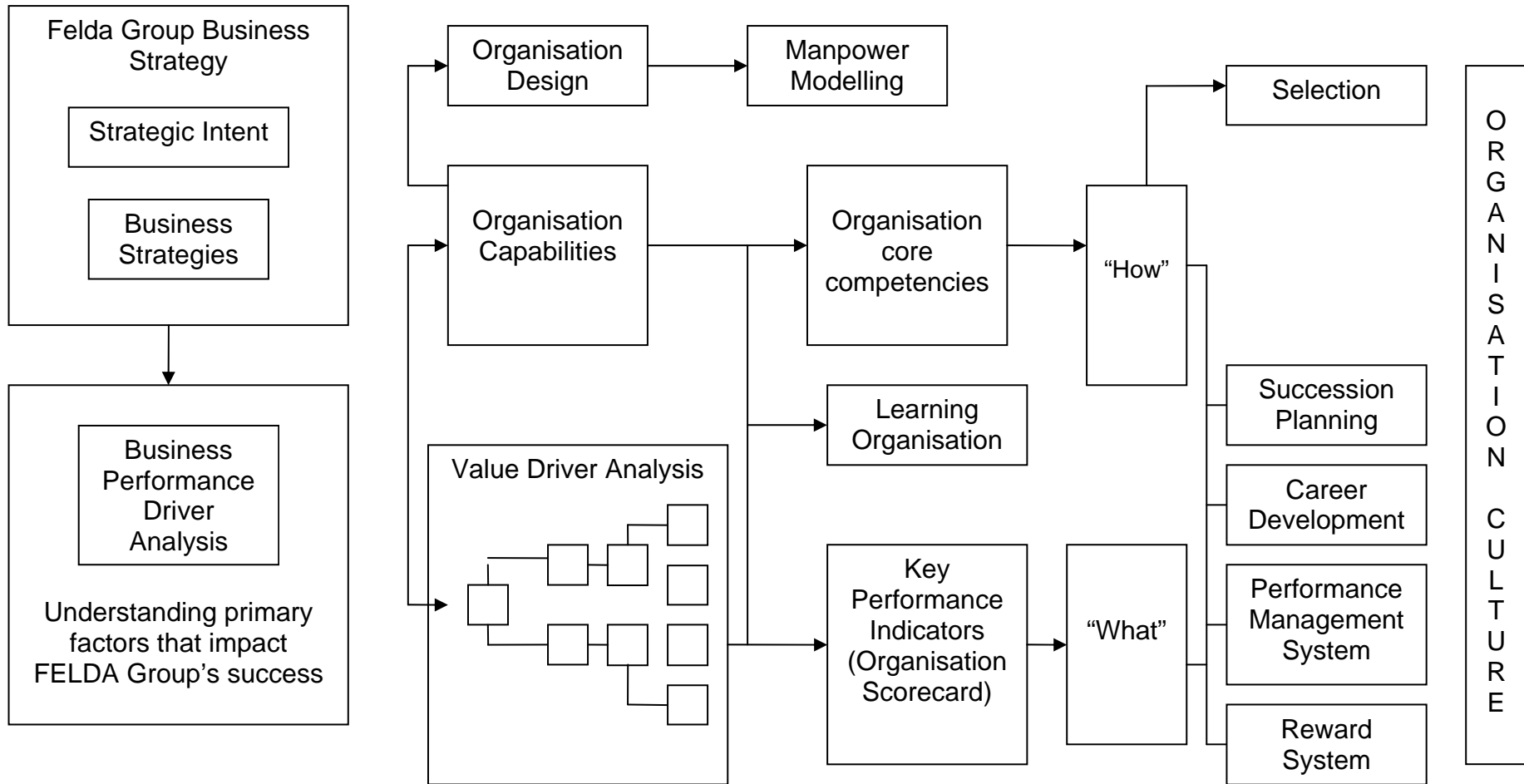
Skills allowance that provides additional incentives For utilization of skills and knowledge acquired	3.0
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## **6.0 Case Experience: Performance Management System of Corporation XYZ**

The challenges facing Corporation XYZ include:

- To be a global player
- To realize full potential of the Corporation with competent leadership
- To become a value added organization with high performance culture
- To sustain 15% dividend from our investment

### 6.1 OVERALL APPROACH OF THE GLC



Performance Management is a shared responsibility between the organization, staff, reporting managers and reviewing managers.

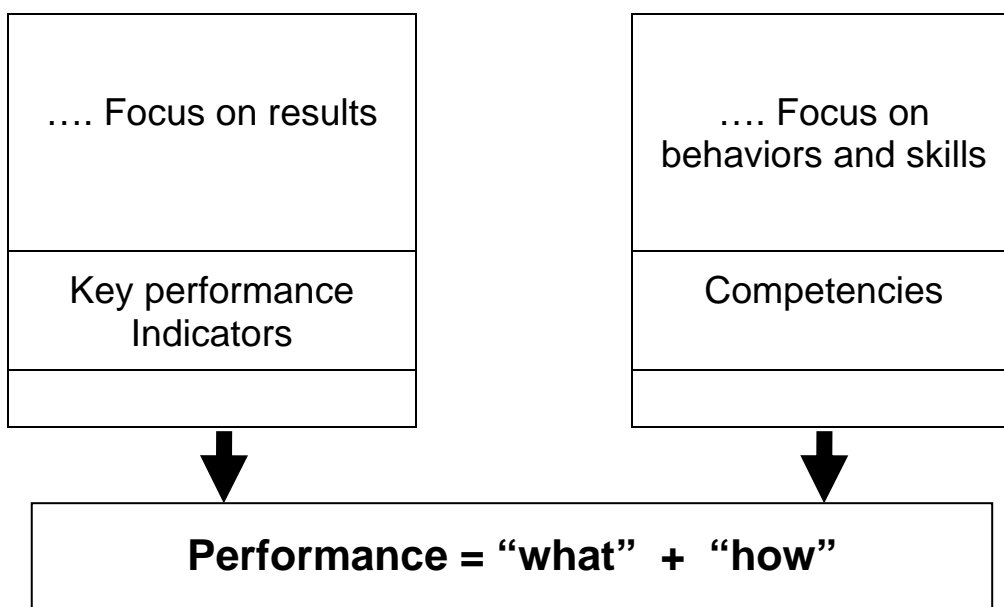
Staff who is the appraisee, takes responsibility for self in the process, sees feedback on performance and uses organizational resources for self development. Reporting Manager who is the direct superior of the appraisee and is accountable for his/her performance evaluation and reviewing manager who is the direct or indirect superior of the reporting manager and is responsible for the overall performance of the business unit/group function and department.

Performance management should reinforce the importance of both results and behaviours/skills. The focus is on both results (Key Performance Indicators) and behaviours and skills (competencies).

## 6.2 The “What” and “How” of Performance Management System

Performance Management (PM) should reinforce the importance of both results AND behaviors / skills

If what people achieve is important ...    If how people achieve it is important ..





Performance = KPIs (60%) + Competencies (40%)

### **Results Based Goals (KPIs)**

#### Financial

- ROE
- Revenue Growth

#### Customer

- Customer Satisfaction Index

#### Internal Process

- Cost to income ratio

#### Learning and Innovation

- Employee Engagement Index
- High Performer Attrition Rate

#### Project Goals

- IT Project
- HR Strategy Project

### **Competency Indicators**

#### Communication

#### Teamwork

#### Innovation and Change

#### Leadership & nurturing talent

#### Drive & resilience

#### Cultural sensitivity

#### Business Acumen, negotiation

#### & deal making

#### Strategic thinking

The Corporation's definition of performance includes both KPIs and Competencies in the PMS to ensure that both leading and lagging indicators of performance are measured which will lead to long-term sustainable performance:

- Measuring results help strengthen the link between individual goals and business strategy
- Measuring competencies increases the focus on employee development to enable the to achieve individual goals and align their behaviour to the organisation's values
- Both of these outcomes increase employee motivation to improve business performance.

## **6.3 The Performance Management System Cycle**

### **Step 1 : Performance Planning**

- Business goals, KPIs and targets set upfront and cascaded down the organization
- Competencies are reviewed and development objectives identified
- Mid-year reviews conducted

### **Step 2 : Performance Assessment**

- Quantitative targets independently computed
- Supervisor solicits inputs from peers, subordinates, clients

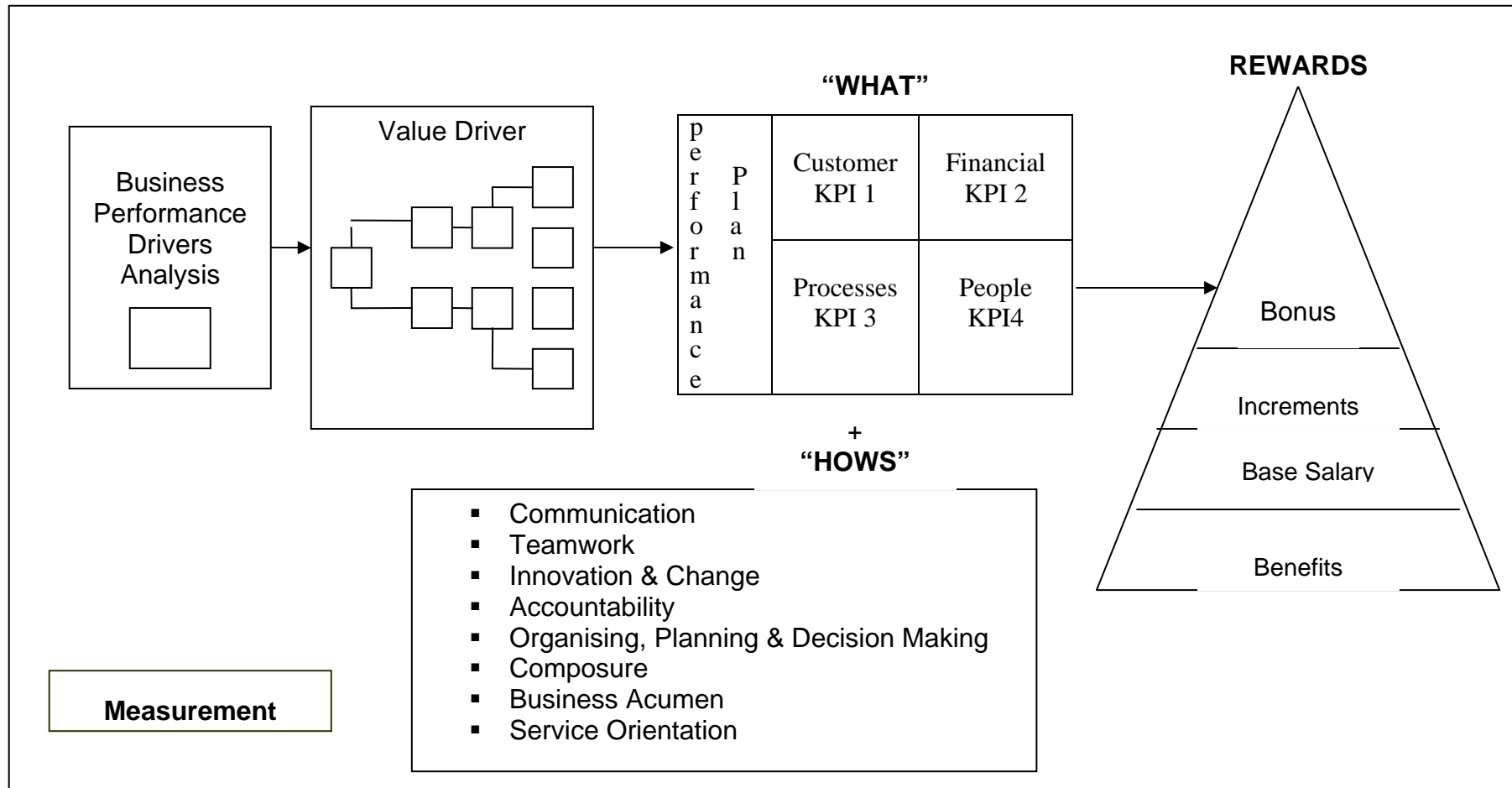
### **Step 2 : Performance Rewarding**

Performance results determine:

- Annual increments
- Bonuses and options
- Promotions

## 6.4 LINKING PERFORMANCE WITH REWARDS

The value drivers at business unit level are “translated” into focused performance objectives, which can be measured and rewarded.



#### 6.4.1 Overall Performance Rating for Salary Planning Purposes

The overall performance rating shall be based on the performance matrix ranging from 1.0 – 5.0:

Performance Range				
1.0 – 1.5	1.6 - 2.5	2.6 – 3.5	3.6 – 4.5	4.6 – 5.0
Needs most	Need some	Meets	Exceeds	Exceed
Improvement	Improvement	Requirement	Some	All

#### 6.4.2 Assigning Rating

Each goals/target is assessed according to the employee's level of achievement

- Quantitative goal : % of target achieved
- Qualitative goal : Assessment of goal and to what extent it was achieved eg; full, partial etc.

An appropriate rating (1-5) is assigned for each goal

Only whole number ratings to be assigned

The weight rating for that category is derived.

## 6.5 Simplified Example of Performance Appraisal Calculation : Top Management

### 6.5.1 Performance Goals (KPI Weightage : 60%)

KPI	Weight (Min 10%)	Actual Achieved	Rating (1-5)	Weighted Score
Profit before Tax	30%	13.1	5	1.5
Total Production	20%	1008	5	1
Yield	15%	21.9	3	0.45
Cost	15%	110	3	0.45
Participation	10%	95	4	0.4
Mechanisation	10%	5	3	0.3
	<b>100%</b>	<b>TOTAL</b>		<b>4.1</b>
		<b>KPI Score</b>		<b>2.46</b>

### 6.5.2 Competencies

#### Competencies Weightage : 40%

Competency	Required Level	Rating	Comments
Communication	A1+	4	
Team Work	A1+	4	
Innovation & Change	A1+	3	
Leadership	A1+	4	
Drive & resilience	A1+	4	
Cultural sensitivity	A1+	4	
Business Acumen	A1+	5	

Strategic Thinking	A1+	4
	<b>Total</b>	<b>32</b>
	<b>Average Score</b>	<b>4</b>
	<b>Competency Score</b>	<b>1.6</b>

### 6.5.3 Overall Rating

**KPI Score + Competency Score = Overall Rating**

$$2.46 + 1.6 = 4.06$$

The staff who achieves the overall rating of 4.06 falls into the category “exceeds some requirements” and the salary increment and the bonus for the year will be paid accordingly to pre-determined levels, which will be less than those who “meet all” but more than those who just “meet requirements”, “need some improvement” and “need most improvement”.

### 6.5.4 Success Criteria

The system enables the corporation to achieve the following:

- Demonstrate that the performance management is a shared responsibility between the employer and staff
- Increase focus on performance
- Align individual staff goals/KPIs with Group, Company and Departmental objectives
- Improve rigor and calibration when setting target for the KPIs
- Set mutual performance expectations
- Increase focus on ongoing feedback and coaching
- Identify opportunities for staff development
- Increase focus on evaluating actual performance
- Improve the linkage between individual staff performance and rewards

### **6.5.5 Common challenges faced:**

- Projects are often given in the course of the year
- Goals keep changing throughout the year
- Too many external factors beyond my control
- Inappropriate targets
- The boss keeps giving me new things to do

## **7.0 The Productivity Linked Wage System**

The Productivity-Linked Wage System (PLWS) has been recognized as one of the measures to enhance Malaysia's competitiveness. This system will ensure that wage increases commensurate with productivity increases. With higher productivity or performance, both employees and firms should enjoy higher returns in terms of wages and profitability respectively and ultimately contribute to higher standard of living and better quality of life. The PLWS takes into account workers' basic needs and recommends that those who excelled in productivity are rewarded for their efforts. Companies should strategize and link wages to productivity to ensure that they remain competitive in a globalised economy.

The importance of PLWS has been mentioned in several National Plans. One of the human policy thrusts in the Eighth Malaysia Plan, 2001-2005 emphasises the need to accelerate the implementation of PLWS to ensure that wages are closely linked with productivity. The Third Outline Perspective Plan, 2001-2010 (OPP3) stresses that wage increases should commensurate with improvement in productivity to enhance the competitiveness of the economy. It was also stated in the National Economic Recovery Plan (1998) that wage increases should reflect productivity gains of the country in order to remain competitive and

recommended the implementation of a flexible wage system that is linked to productivity/performance.

There is a need to accelerate implementation of the PLWS, so as to ensure that wages are closely linked with productivity. By implementing the PLWS, employers will be able to develop a wage structure that is able to withstand economic changes and improve its competitive edge. At the same time, a wider and systematic approach towards improving productivity and wages through the active involvement and cooperation of employees can be developed. The system also provides the motivating factor, as employees will be rewarded for their efforts and will obtain a fair share of the gains for productivity improvements.

### **7.1 Productivity-Linked Wage System Models**

PLWS provides a formal framework linking wage increases to productivity growth and comprises two main components namely the fixed and variable components. The fixed component comprises the basic wages and annual increment which provides income stability, acts as an indicator of the value for of the job in the market and reflects the cost of living. The variable components provide the variability determined by workers' performances, company's profitability and performance of the economy. Three generic models were developed for companies to adapt and adopt:

- Profitability model
- Productivity model
- Profitability/Productivity Matrix



### **7.1.1 Profitability Model**

In this model, the variable performance bonus payment is dependent on the company's profitability. The quantum to be paid will be determined by a profit-sharing formula that is agreed upon by management and union/workers representative which is reviewed periodically. Wage incentives are paid if profits exceed a pre-determined or threshold level.

### **7.1.2 Productivity Model**

Companies can also adopt the productivity model. A variable productivity payment will be paid based on productivity improvement of the company or individual. Wage incentives for the year would commensurate with productivity increases. The formula for productivity measurement should be discussed and agreed upon by both management and workers.

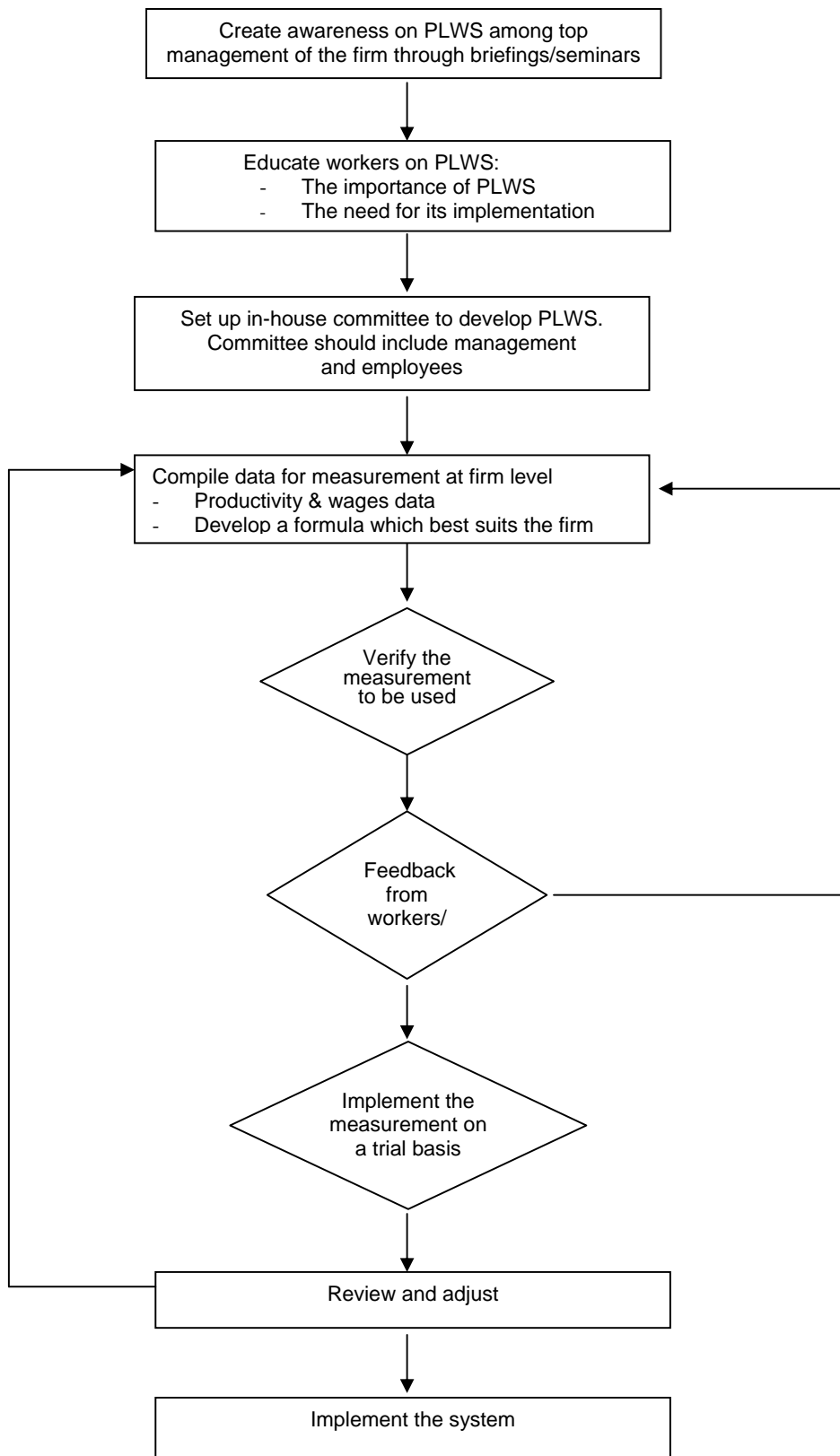
### **7.1.3 Profitability Productivity Matrix**

This two dimensional model links profitability and productivity. The bonus payment made is dependent on both the worker's productivity and company's profitability.

## **7.2 Steps in Implementing PLWS**

To encourage firm level implementation of a wage system that is linked to productivity or performance, concerted efforts from the government, employers and employees are required. There are various steps which a firm needs to fulfill before PLWS can be successfully implemented. The following flowchart will provide a guide for firms intending to implement PLWS (figure 5.1).

**Figure 5.1: Steps in Implementing PLWS**



**The steps in implementing PLWS are as follows:**

**Step 1: Creating Awareness of PLWS**

To encourage firms to adopt the PLWS, all employees must be made aware of the system and educated on the rationale of the benefits of the system. Employees must be convinced of the gains that will be shared by both parties in the long run. Frequent discussions need to be organized over a period of time to ensure that everyone in the organization is aware of the new system. A feedback mechanism must also be established to accept views and opinions from employees. An in-house /working committee or taskforce responsible for the implementation of the system should be set up to facilitate the process. Ideally, the committee should comprises representatives from different departments and different levels of employees to ensure that everyone's concerns are incorporated and understood.

**Step 2: Development of Measurement Tools**

One of the easiest ways to integrate productivity as part of an organizational culture is to constantly make reference to it in quantitative terms. When measurable, it becomes easier to monitor progress, provide feedback, evaluate performance and set quantifiable productivity objectives. Management and workers should work together to develop the best formula for linking wages to productivity. This can also be linked to their profitability or other performance indicators that are deemed suitable for the company. By having a measurement system in place, the variable component can be adjusted according to the company's performance. These measurements does not need to be too technical but must be agreed upon by both management and workers. The key for developing the measurement will be to identify the key areas for improvement and link them to the wage system. Any improvement in the key areas identified will lead to an increase in the variable component of wages. For firm level

measurement, National Productivity Corporation (NPC) has developed the Company Productivity Assessment (COMPASS) which is a software containing a host of measures for firms to adopt and adapt.

### **Step 3: Transition Period**

The transformation of the present wage system to a more variable one needs to be facilitated. A phasing-in period should be allowed to put the PLWS into practice and periodic reviews need to be made to rectify any discrepancies. Normally, during the phasing-in period, employees will not suffer any undue loss in income. Employees will still be getting wages from the present system while a simulation of the new system is being carried out. An effective communication channel needs to be established to keep employees informed of the development and to give feedback on any suggestions for improvements. Management and unions should appreciate the constraints in implementing the PLWS and should work together during the transition period to sort out any differences and allow provision for adjustments from time to time.

### **Step 4: Implementation of PLWS**

After the phasing-in period, increment in wages could be freely negotiated on an annual basis at firm level. By then, management and workers should have prepared themselves for such enterprise level negotiations and the wage determination formula and data would also have been developed by them. The choice of the method to link wages to productivity depends on the nature of the enterprise and on the consensus between employers and employees on the formula to be used. The following factors are relevant for the successful implementation of the system at firm level:

- There must be harmonious labour management relations and mutual trust, information sharing and understanding.
- Ensure annual increments are realistic after taking into account inflation, economic growth and productivity growth when determining annual increments.

- Document a formula to determine the variable payment. Any system developed must be simple to administer and the process of determining the formula should be consulted between employers and employees.
- The wage system should be applicable to the whole company. There must be sufficient dissemination for the employees on the formula developed, to ensure that employees understand how their variable payments are calculated.
- Allow for transition period where both the present and new systems run at parallel levels and are constantly monitored. During this period, there must be willingness to review and make adjustments and changes.
- Overall, the wage system should be specific, measurable, achievable, realistic and time specific.

### **7.3 Criteria for Successful PLWS Implementation**

- **Awareness and Commitment from Top Management**

Top management should be made aware of PLWS, and how the system can contribute to improve the company's competitive edge. Commitment from management is mandatory to ensure that the system can be successfully implemented at company level.

- **Information Sharing and Element of Trust**

Effective implementation of the system requires, management disclose relevant financial information, future prospects of the company as well as the company's and industry's performance. This is to avoid unwarranted union resistance and employees' suspicion.

- **Consideration for Workers Welfare**

A major concern among workers is job stability and stable income. The general consensus among workers is the unwillingness to change from a wage system which incorporates automatic wage increases to a system that is based on performance/productivity. An acceptable wage system should also take into account the workers' welfare and livelihood.

- **Reward for Improved Performance**

The PLWS basically consists of two components, the fixed component which comprises the basic salary and an annual increment plus an additional component in the form of variable payment. Thus, the fixed component would serve as the measure of stability while the variable component ensures that improved performance is properly rewarded.

- **Collaborative Effort**

The productivity/performance measurement should be collaboratively developed by both employer and employee. The key indicators to be used should be agreed upon by both parties to avoid any misunderstandings.

- **Assurance of the New System**

A transition period where the PLWS is phased-in is encouraged during the implementation of the system. During this period, the PLWS could be simulated and reviews should be made to ensure that the system is fair to both employer as well as the employee.

- **Global Competition**

Employees should be exposed to the reality of global competition and its effect on competitiveness at both national and firm level. Lack of knowledge and exposure of the international market scenario will create unnecessary resistance and rejection towards the system.

### ▪ **Human Resource Development**

Human Resource Development is important in ensuring that a wage system linking to productivity is successful. Staff training in areas of productivity improvement and skills enhancement will enable workers to contribute significantly to both output and productivity enhancement.

## **8.0 Company Case Experiences**

It is imperative for companies to enhance competitiveness. This can be achieved through the implementation of PLWS which link the payment of wages to productivity and or performance. Two case studies of companies who had implemented the system are presented:

- SKF Bearing Industries (M) Sdn. Bhd
- Maestro Swiss Management Services Sdn. Bhd.

### **8.1 SKF Bearing Industries (M) Sdn. Bhd**

#### **8.1.1 Overview of the Company**

SKF bearing industries (M) Sdn. Bhd. was established in 1992. It is a Swedish owned company that produces deep groove ball bearings and spherical roller bearings that are used in elevators, paper making machinery, electric motors, excavators, industrial fans, cars and household appliances. The products are marketed to Japan, the Asia Pacific and Europe. The company uses state of the art equipment for producing quality bearings. The company adopted the Total Quality Management (TQM) concept which emphasized on improving customer satisfaction and expectations. Among the TQM activities which were practiced by the company included Quality Improvement Teams, KAIZEN

activities, and the Just In Time system which resulted in cost and quality improvements.

To further improve these processes, the company benchmarked against other SKF factories around the world and is now a benchmark for many Malaysian industries. The company also emphasized the human factor which includes facilities for staff and allowances as well as opportunities for career advancements. An intensive start up human resource development programme for staff was provided for the employees in Europe while 2% of the company's budget is allocated for human resource development. The company has in-house trainers and provides on the job training. Employees are encouraged to contribute innovative ideas and rewards given for feasible ideas.

### **8.1.2 SKF's Wage System**

To improve productivity and company performance, the company has shifted from an automatic annual increment system to one that is linked to performance. The system comprised of the following:

**Total Salary = Base Salary + Fixed Bonus + Variable Bonus.**

The new model was developed in line with the SKF's group renewal mission "To contribute to SKF shareholders value expectation". In this model, bonus schemes were developed the both non-management and management groups.



## **Non-Management Group Variable Bonus**

The variable bonus was paid based on

- Company's Profits
- Business Operating Income (BOI)

And is payable at the end of each financial year.

### **Example of variable bonus calculation:**

Variable Bonus = BOI Threshold one month (X) + Over and above normal performance (Y).

The bonus is then determined on the X and Y factors. If for a certain year the company's profits are below par, then each employee will receive one month bonus. However, if the profit level is above the threshold level set, then the management will pay according based on the performance:

### **8.1.3 Performance Based Bonus System**

<b>Business Operating Income (RM Million)</b>	<b>Fixed Bonus (X)</b>	<b>Variable Bonus (Y)</b>	<b>Total Months)</b>
Less than 10	1	0	1
11	1	0.25	1.25
12	1	0.5	1.5
13	1	0.75	1.75
14	1	1.0	1.0
15	1	1.25	2.25
16	1	1.5	2.5
17	1	1.75	2.75
18	1	2.0	3.0

## **Management Group Variable Bonus**

**Total Bonus = Fixed Bonus + Variable Factors**

**Variable Factors and weighted and these include:**

- BOI
- Productivity
- Zero Accident
- Efficiency
- Working Climate Analysis : level of improvements

### **8.1.4 Factors for Successful Implementation**

- Objectives of the organization are defined to suit employees scheme
- Employees are encourage to develop their own performance level in line with business objectives
- Communication and transparency is important. This has helped employees accept the system
- Identify gaps in performance
- Performance gaps identified and human resource development undertaken to enhance performance.

## **8.2 Maestro Swiss Management Services Sdn. Bhd.**

### **Overview of the Company**

Maestro Swiss Group is a leading manufacturer and marketer of chocolates and chocolate products namely cocoa powder, cocoa butter, other cocoa based products including chocolate malt food drinks, sweets, wafers and other confectioneries in Malaysia. It has been in the business for over 27 years and currently, the group is ISO 9001 certified. Prior to 1999 it was known as Chocolate Products (M) Bhd. Among the brands that the company produces are “Vochelle”, “Darry”, “CP”, “Maestro Swiss”, and “Vico”.

The group has about 350 employees comprising 50% males and 50% females. Most of the employees have been with the company between 10 – 30 years and have vast working experience in the industry. The workers are unionised under the Food Industry Employees Union. The company’s wage system before the group was formed was based on fixed annual increments and the number of years of service.

### **Maestro Swiss Wage System**

Since the inception of the new group “Maestro Swiss”, the company embarked on a new wage system which takes into account productivity of the company and links this productivity to wage increments. This is to ensure that competitiveness of the company is sustained and employees are rewarded according to their performance. To calculate productivity the company adopts the Added Value concept.

## Added Value Concept

Added Value measures the wealth created through the production process and is distributed to those who have contributed to the value creation. The Added value formula is as follows :

$$\text{Added Value} = \text{Total Output with less Bought-in Materials and Services}$$

From this added value, productivity is calculated. The company uses labour competitiveness to obtain its productivity ration.

$$\begin{aligned} \text{Labour Competitiveness} &= \text{Added Value / Labor Cost} \\ &= \frac{\text{Added Value / Number of Employees}}{\text{Labor Cost/Number of Employees}} \\ &= \frac{\text{Labor Productivity}}{\text{Wage Rate}} \end{aligned}$$

For Example : If added value = RM1,650,000 and number of employees is 200, labour productivity will be :  $\text{RM1,650,000}/200 = \text{RM8,250}$  per employee

If labour cost = RM200,000 then average wage rate for each employee will be :  $\text{RM200,00}/200 = \text{RM1,000}$  per employee

The company's productivity will therefore be :

$$\text{RM8,250}/\text{RM1,000} = \text{RM8.25}$$

For every RM1.00 of labour cost, RM8.25 of value added is generated.

## Productivity Model

The Productivity model is used to link productivity to wage increments. The formula used is as follows : **T = A + P** where,

**T** = Salary Increment

**A** = CPI Adjustment Based on 2/3 of Average increase of last 3 calendar years of CPI x Basic Salary

**P** = % P (% variable increment x Basic Salary (Refer to Table 1) where maximum CPI taken for any particular year is

6.0%

### Example of Productivity Model

#### Year 1

If a worker's basic salary is RM1,000.00 per month and the CPI for the past 3 years is 2.5, 3.5 and 4.0 respectively and productivity improvement of the worker is >4-8% (Table 1), then based on the productivity model his salary increment will be as follows :

$$\mathbf{T = A + P}$$

$$A = (2/3 \times 3.33\% \text{ (average CPI for 3 years)}) \times \text{RM1,000.00 (base salary)} = \text{RM22.00} + P = (3\% \text{ (variable productivity payment)} \times \text{RM1,000}) = \text{RM30.00}$$

$$\mathbf{\text{New Salary} = \text{RM1,000.00} + \text{RM22.00} + \text{RM30.00} = \text{RM1,052.00}}$$

#### Year 2

Based on an average 3 years CPI of 3.5% and a variable productivity payment of >8-12% (Table 1), his salary increment will be :

$$\mathbf{T = A + P}$$

$A = RM1,052.00 \times (2/3 \times 3.5\% \text{ (average CPI for 3 years)}) + P = RM25.00 + (RM1,025 \times 5\% = RM53.00)$

**New Salary = RM1,052.00 + RM78.00 = RM1,130.00**

In year 2, productivity has improved, therefore, the increment is higher :

**Table 1 : Productivity Improvement / Variable Increment Table**

<b>Performance</b>	<b>Productivity Improvement (Current period vs. Previous Period) %</b>	<b>% P = Variable Increment</b>
Excellent	> 12	9
Good	> 8 – 12	5
Average	> 4 – 8	3
Improvement Needed	< 4 or = 4	1

Based on Table 1, if the company achieves a productivity improvement of between > 4-8% then an employee will receive a 3% increase in the variable payment. The higher the productivity improvement, the higher the variable increments thus rewarding an employee with a bigger quantum. No matter what the productivity increments, the employee is still guaranteed his basic salary plus annual increment which will not be less than 2/3 of the average increase of the CPI over the previous three year period.

Based on the above examples, the table for the Salary Structure is as follows:

SALARY STRUCTURE					
JOB GRADE	POSITION	MIN RM	FORMULA FOR ANNUAL INCREMENT	MAX RM	PROMOTION INCREMENT QUANTUM
1	Senior Technician 1 Senior clerk	900	$T = A + P$ where, $T$ = Salary Increment $A$ = CPI Adjustment based on 2/3 of average increase of Last 3 calendar years of CPI X basic Salary; $P = \% P$ (% variable increment : Refer to productivity table) X basic Salary;  Where maximum CPI taken for any particular calendar year is 6.0%.	2,000	120
2	Senior Technician II Senior Clerk II	800		1,800	100
3	Technician Clerk II	700		1,700	80
4	Clerk I Production Worker 1	600		1,400	50

### Factors for Successful Implementation

- Good relations with the union and continuous negotiations helped the company introduce the new wage system.
- The company was transparent in its dealings with the workers and this made the workers willing to accept the system
- The company used a step-by-step approach whereby the workers were given time to absorb the intricacies of the new system. The workers were also well informed of any changes to the new system.

## **9.0 Conclusion**

The implementation of the Performance based Remuneration System among enterprises in Malaysia had been identified as one of the initiatives to enhance productivity and competitiveness of the country. The economy will be more competitive if companies rationalize cost through higher productivity. Various national development plans had also emphasized the need for linking wages to performance, specifically the Productivity Linked Wage System (PLWS).

The PLWS will enable enterprises to adopt a systematic approach in linking wages to productivity and to sustain labour cost competitiveness. Three approaches had been developed to link wages to productivity based on Profitability, Productivity and the Productivity/Profitability Matrix. By implementing the PLWS, performance of the enterprise will improve and adjustments to accommodate changes in the business environment can be made promptly. The system will ensure a Win-Win situation for both employers and employees.



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**IV. Developing Key Performance Indicators and  
Productivity/Performance Benchmarks  
for Performance-based Remuneration Systems  
in Chinese Taipei**

**By**

**MR MINSTON CHAO  
MS CHUANG MEI CHUAN**

## 1.0 Chinese Taipei's Economy

The Chinese Taipei's economy over the past 50 years has benefited from a well-educated and highly motivated work force, especially in the areas of science, technology, and high value-added manufacturing. Chinese Taipei's economy achieved considerably high growth rates in 1960's to 1980's under import substitution industrialization strategy, expansion of export-oriented labor-intensive light industries strategy, and import-substituting heavy industries strategy.

The success of the strategy was reflected in the changing composition of production, with the share of industrial products increasing from 21% in 1951 to 27% in 1961, while that of agricultural products decreased from 32% to 27%, from 1960 to 1987. Exports grew at an annual average rate of 17.7% and GDP growth rate average 9.3, as the industrial structure from a agriculture-based economy changed to a production-based economy. However, the increasingly competitive global economy pushes firms to exploit all of their available resources as a means of achieving competitive advantage.

One resource was recently recognized for providing a source of competitive advantage is the human resources of the firm, and this recognition has resulted in an expansion of the field of Strategic Human Resource Management (SHRM). Considerable research has observed relationships between HR practices and various operationalizations of firm performance (Backer & Gerhard, 1996; Youndt, Snell, Dean & Lepak, 1996; Rogers & Wright, 1998).

## **2.0. The Chinese Taipei's Economic policy and Performance**

The Chinese Taipei's economy achieved considerably high growth rates in 1960's to 1980's under its import substitution industrialization strategy, expansion of export-oriented labor-intensive light industries strategy, and import-substituting heavy industries strategy. The success of the strategy was reflected in the changing composition of production, with the share of industrial products increasing from 21% in 1951 to 27% in 1961, while that of agricultural products decreased from 32% to 27%, from 1960 to 1987, exports grew at an annual average rate of 17.7% and GDP growth rate average 9.3, the industrial structure from agriculture-based economy to a production-based economy.

In the early 1990's, service-based economy became leading in The Chinese Taipei's industrial structure. However, manufacturing industries' comparative advantage, for several reasons, was steadily slipping away. From 1987 to 1997, the industrial output as a share of GDP decreased from 47.1% to 34.9%, while manufacturing industries' fell from 38.9% to 27.7%. During this period, Chinese Taipei found that only avenue open in industrial section was for industries to upgrade to a higher technological level, with capital and technology intensity replacing the no-longer-viable labor intensity of the past. So the government launched the Ten Newly Industries Program, helping the economy toward a hi-tech orientation.

Also, to develop Chinese Taipei as a knowledge-based economy, and recognize the rise in globalisation means that cost-saving in production can no longer support continuous economic development, in the beginning of 21 century, the government implementing a series of programs such as "the Challenge 2008 National Development Plan", "the New Ten Projects", and "Plan to Develop Knowledge-based Economy" that add high values to

high-tech and traditional industries and encourage innovation and foster new ventures as the way to maintain its global competitiveness.

## **2.1. Economic Performance, 2006**

In 2006, the global economy entered a phase of accelerated growth. According to estimates by the International Monetary Fund, the world trade volume expanded 9.2%, well above the 7.4% recorded in the previous year, while the global economic growth rate rose by half a percentage point to 5.4%. A boom in export trade boosted The Chinese Taipei's economic growth rate to 4.68%, an improvement on the 4.07% recorded in 2005, higher than the targeted 4.5%, and second best in the past six years to the 6.15% achieved in 2004. Per capita GNP climbed to NT\$535,993 (US\$16,471), US\$404 higher than in 2005. Other economic highlights of the year included:

- The expansion of external demand remained the main driver of The Chinese Taipei's economic growth, contributing 77.6% of the economy's growth.
- A 1.7% growth in employment, the second highest in twelve years, sustained the steady alleviation of the unemployment problem, with the unemployment rate falling to a six-year low of 3.91%.
- The consumer price index (CPI) climbed only 0.6%, markedly lower than the previous year's rise of 2.3%.
- The Chinese Taipei's energy efficiency continued its steady rise, with the energy consumption elasticity ratio down to 0.38 from 0.69 in 2005, demonstrating the slowing growth rate of domestic energy consumption. Moreover, by year-end 2006, 3,303 Chinese Taipei -made products, with a production value of over NT\$80 billion, had obtained Green Mark certification, reflecting the growing boom of green consumption in Chinese Taipei.
- Environmental sustainability indicators showed a solid year-on-year improvement, with the proper disposal rate of garbage at 99.77%, the garbage recycling rate at 35.41%, and 65.8% of the total length of major

rivers either unpolluted or only slightly polluted.

For 2006 as a whole, Chinese Taipei's real GDP still increased 4.68%. Unemployment rate is decreased from 4.99% in 2003 to 3.84% in May 2007. Overall competitiveness and economic performance is improving based on the IMD method (see table 2). However, after a brisk gain, global economy is forecasted to have moderate growth in 2007. Therefore, The Chinese Taipei's export expansion also is expected to decelerate. In the future, Chinese Taipei needs to enhance competitiveness and be more responsive to the challenges of globalization. How to create or earn more profit and control cost down is essential issue for companies. Among them, related to human resource, wage and labor management practices are the key.

**Table 2: Chinese Taipei's competitiveness ranking in the IMD World Competitiveness Yearbook for the past five years**

Item	2003	2004	2005	2006	2007
<b>Overall</b>	17	12	11	17	18
<b>Economic Performance</b>	33	24	17	25	16
<b>Government Efficiency</b>	20	18	18	23	20
<b>Business Efficiency</b>	11	7	6	13	17
<b>Infrastructure</b>	23	20	18	18	21

Source: [www.imd.ch/wcy](http://www.imd.ch/wcy); compiled by the Department of Economic Research, CEPD

**Table 3: Major Economic Indicators in Chinese Taipei**

Item	2003	2004	2005	2006	2007*
<b>Economic growth rate (real GDP increase) %</b>	3.50	6.15	4.07	4.68	4.38
<b>Gross national product (GDP) US\$ billion</b>	305.6	331.0	354.9	364.4	375.4
<b>Per person GDP US\$</b>	13,587	14,663	15,668	16,030	16,442
<b>Changes in consumer price index (CPI)</b>	-0.3	1.6	2.3	0.6	0.61
<b>Exchange rate (end of the year) NT\$ per US\$</b>	34.0	31.9	32.9	32.6	32.8
<b>Unemployment rate %</b>	4.99	4.44	4.13	3.91	3.84

\*2007 Jan.-May

Source: [www.dgbas.gov.tw](http://www.dgbas.gov.tw)

## **2.2. Labor cost competitiveness in Chinese Taipei**

Higher productivity and lower unit labor cost is essential for increasing firm's competitiveness. During the last five years, productivity in all industries in Chinese Taipei is improving gradually, however, at the same time, unit labor cost is going downward. When the growth of productivity is positive, compared to a negative growth in unit labor cost, there is a space for wage increasing.

## **3.0. Union and Labor-Management Relations in Chinese Taipei**

### **3.1. Government Influence on Firm Compensation Administration**

- Labour Pension Act (2004.06.30 Announced)
  - Change the pension system from Defined Benefit Plans to Defined Contribution Plans. Under Labour Pension Act, enterprise was forced to commit to deposit a fixed amount for pension.
- Labour Standards Act
  - Wage shall be negotiated by employer and employee.
  - Built a basic wage (minimum wage) system: employee's monthly salary could not be lower than NT\$17,280 (US\$526.83). It equals to US\$2.2 per hour.
- Collective Agreement Law
  - Collective agreements are usually fixed for a period of from one to three years and are binding on both parties.
  - Some companies, particularly in the state-owned, heavy industry, and transportation companies based on collective agreement, yearly negotiations are made for annual increments and bonus quantum, but it is rare in case.

### **3.2. Labor-Management Relations in Chinese Taipei**

In Chinese Taipei, labour management is based on the relative laws: Labour Standards Act, Labour Pension Act, Labour Union Law, Collective Agreement Law, The Settlement of Labour Disputes Law, and Convocation Rules of the Labour-Management Conference. Regarding the regulations, workers within the jurisdictional area of a labour union who have attained full 16 years of age, shall have the right and obligation to join and become a member of the labour union for industry or craft in which they are engaged. As a trade union, to conclude, revise, or abolish a collective agreement is one of the essential functions. If there is any dispute between employer and employee, both parties could follow the procedure that enacted in the Settlement of Labour Disputes Law. Moreover, a business entity shall hold meetings to coordinate worker-employer relationships and promote worker-employer cooperation and increase work efficiency.

- Trade union

In the private sector in Chinese Taipei, the trade unions are not bargaining power but existing workers always rely on the state through the function of regulation, instead of the unions through the mechanism of collective bargain. For the past five years, the organization rate of industrial unions declined continuously, maintaining at 49 - 50%.

- Labour-management conference

For enhancing the employee and employer can play this mechanism well, the government linked this mechanism to oversea investment and IPO approval and working hour arrangements. It means when a certain company who wants to invest overseas or join the financial open market, if the company fails to run this



mechanism following the regulation, the authority will reject the application. In addition, regarding the regulation of Labour Standards Act, if an employer wants to distribute the regular working hours to other workdays shall be with the prior consent of their trade union, if there is no trade union exist in a business entity, with the agreement of a labour-management conference.

- Labor representative on Board

According to the regulation, in the state-owned enterprises, trade union can select its member to be a member of the Board. The number of the labour representatives should be no less than 20% of the total position for the government share. When employees have a seat in the Board, they can express more ideas to improve the employee benefits.

- Collective agreement

Collective bargaining is still not so prevalent in Chinese Taipei's private sector. However, in the state-owned enterprise, trade unions are stronger than the private sector's, collective bargaining is popular. Labour conditions are the core issue in bargaining events.

- Labour dispute and its settlement

As to the labour disputes, labour contract disputes are the most common. For settlement, there are different kinds of procedure such as mediation, arbitration, or appeal to court to resolve the disputes.

- Gain sharing or ESOP option

Gain sharing, profit sharing or ESOP is common in Hi-tech industry. It is one of the important factors for Hi-tech industries to attract talents to work for them. Also, it is an essential tool for firms to support their improvement program.

## **4.0. Move toward Performance-Based Human Resource Management**

### **4.1. Key Performance Indicators and Performance Management**

Performance management means evaluating an employee's current or past performance relative to the person's performance standards. Evaluation involves: (1) setting work standards; (2) assessing the employee's actual performance relative to these standards; (3) providing feedback to the employee with the aim of motivating that person to eliminate deficiencies or to continue to perform well.

Why does an organization evaluate employees' performance? There are four reasons: (1) appraisals provide information upon which you make promotion and salary decisions; (2) provide an opportunity for manager and staff to review his/her work -related behavior, knowledge, and skills; (3) appraisal is part of the firm's career planning process; (4) appraisal help managers better manage and improve the firm's performance.

Evaluating performance is both a difficult and an essential supervisory skill. The manager, not HR, usually does the actual appraising. Manager must be familiar with basic appraisal techniques, understand and avoid problems that can know how to conduct appraisals fairly. HR executives serve a policy-making and advisory role. They provide advice and assistance regarding the appraisal tool to use, but leaves final decisions on procedures to operating division heads.

## **4.2. Performance Management Process**

The performance management process contains three steps: (1) define the job and set up evaluation criteria; (2) manager appraisal performance; (3) provide evaluation feedback. Defining the job means making sure that you and your subordinate agree on his/her duties and job standards. Appraising performance means comparing your subordinate's actual performance to the standards that have been set; this usually involves some type of rating form. After performance appraisal, manager should provide feedback to subordinates. The company makes plans for further development required.

Some times appraisal fails because subordinates don't know ahead of time exactly what you expect in terms of good performance. Others fail because of problems with the forms or procedures used to actually appraisal the performance. Other problems, like arguing and poor communication, undermine the interview-feedback session. To avoid the potential problems, managers have to set up performance criteria for subordinates to follow. The performance standards shall add values to operation performance rather than daily activities. They must be focused on task process.

## **4.3. Key Performance Indicators**

Managers have to set up specific measurable goals with each employee and then periodically discuss the latter's progress toward these goals. Managers should set key performance indicators (KPIs) with subordinates and providing feedback periodically. However, the term KPI generally refers to a comprehensive, organization wide goal -setting and appraisal program consisting six steps:

1. *Set the organization's goals.* Based on the company's mission, values, vision, and short-term, long-term strategic objectives, management team establishes a company wide plan for next year and set company goals.
2. *Set department goals.* Department heads take these company goals and, with their supervisors, jointly set goals for their departments.
3. *Discuss department goals.* Department heads discuss the company's goals and his department goals with all subordinates. Managers ask employees to set their individual goals. They may and may not have key performance indicators. But not each of them has KPIs. Some have KPIs and performance indicators (PIs).
4. *Define expected results.* Department heads and their subordinates set individual performance targets for further review.
5. *Performance review.* Line managers compare each employee's actual and expected performance.
6. *Provide feedback.* Managers review subordinates' actual performance base on his daily co-work. They should provide actual results and comments to employees. Then, they can improve them in the near future.

Setting up KPIs and PIs has to follow "SMART" rule. Be specific, measurable, acceptable, realistic, and timely. An example is, "increase number of key accounts in the 2007 financial year by 10% compared to the 2006 financial year."

# The main tool we use is a Strategy Map . . .



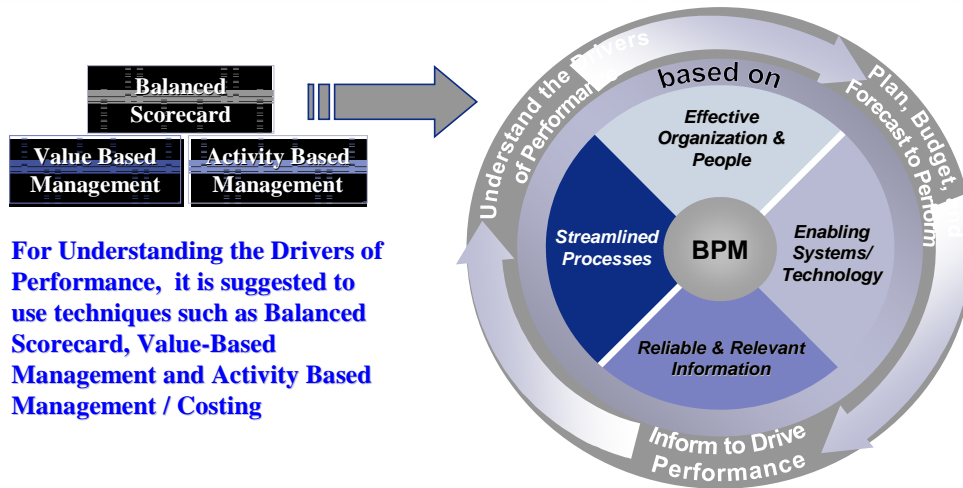
Based on the interviews conducted last week, a first cut Strategy Map has been drafted with the intention of starting and aiding the discussion

# For the Organizational and People strategic objectives to define . . .

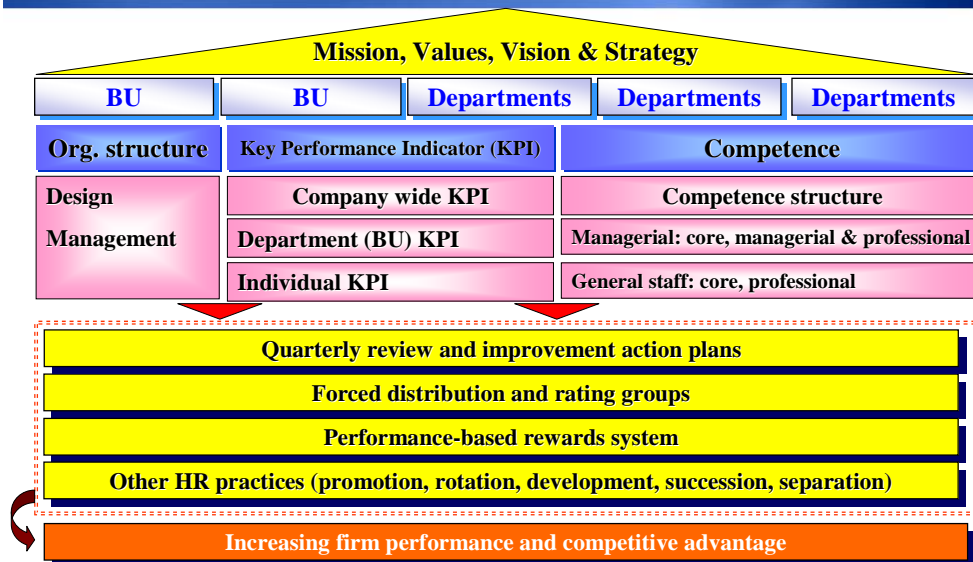


These should make the Strategic Objectives real and tangible

## Understanding the Drivers of Performance



## Performance Management makes Vision Happen



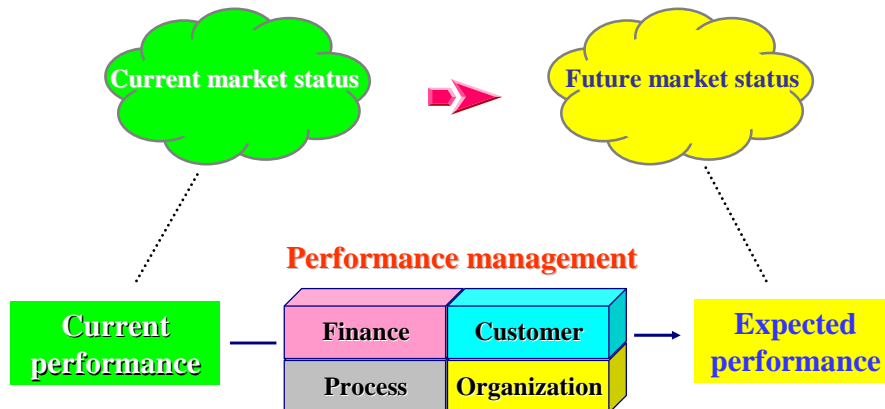
## Closing the gap between vision and realization

**Main Objective:**  
 ..... to manage, direct and measure performance in order  
 to implement and realize Strategies .....

“Less than 10% of strategies effectively formulated are effectively executed”  
*Fortune Magazine*



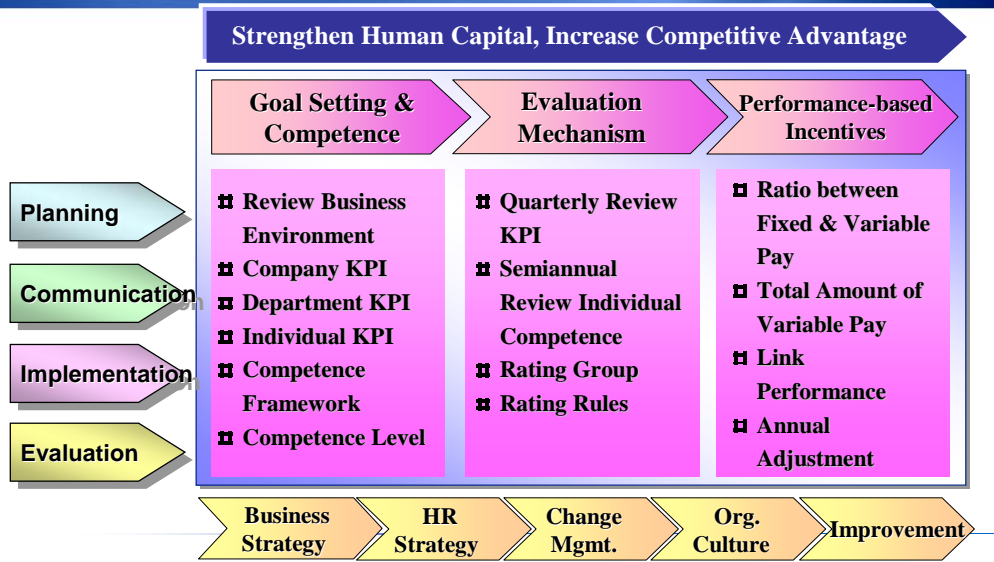
## Performance management turns strategy into results



## Performance management align with rewards



## Performance Management & Reward Design Methodologies

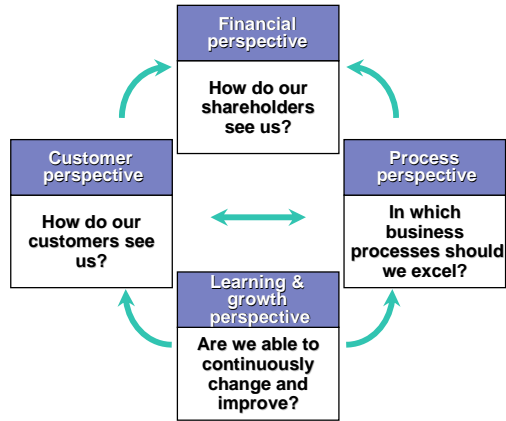




## The Balanced Scorecard is the instrument for managing the organisation from four perspectives

### The Balanced Scorecard

- Is a substantiation of the mission and strategy within four perspectives
- Provides insight into factors and performance indicators that determine results
- Introduces balance between the four perspectives
- Makes everyone's individual contribution to the strategy clear
- Stands for consistent management at each level



## Improving Performance Management: Developing the System

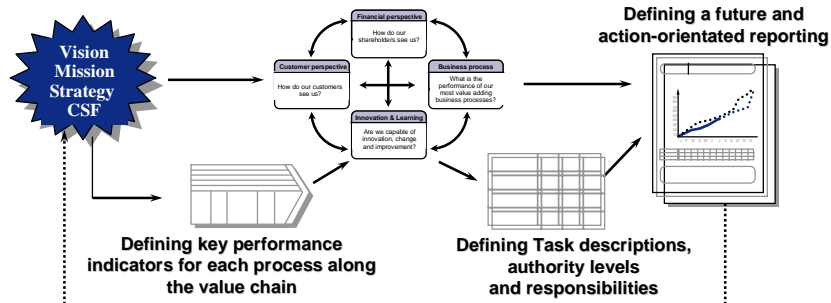
Key

Values and beliefs

Top management commitment

### Balanced Scorecard

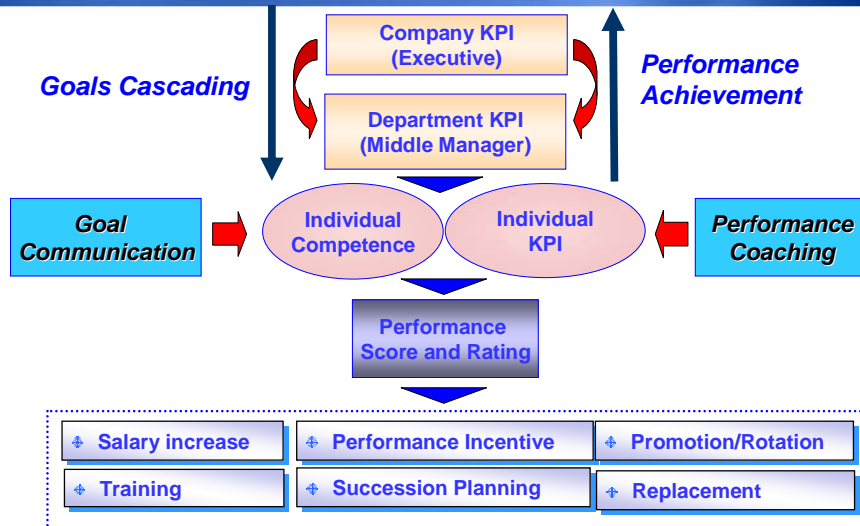
Selecting and balancing performance indicators on company level and for each area



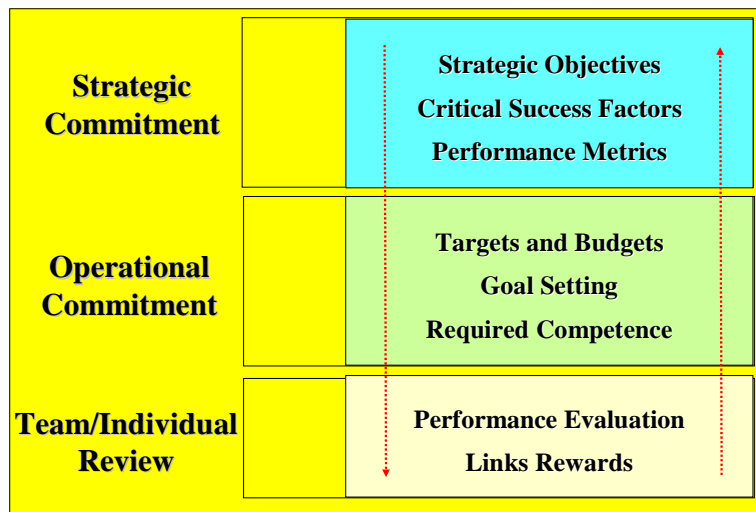
Training and communication: managing behavioral change

Performance Management, a management process along the processes and throughout the organization

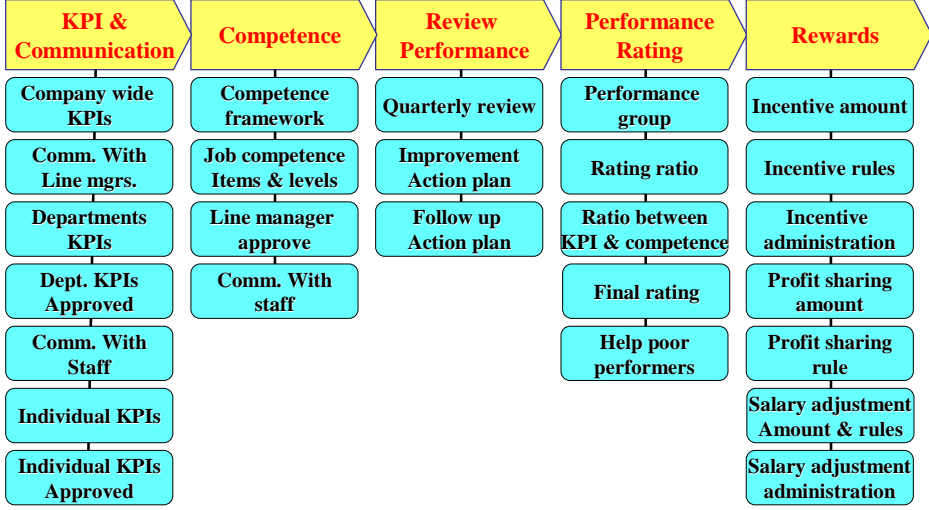
## Performance Management by Objective



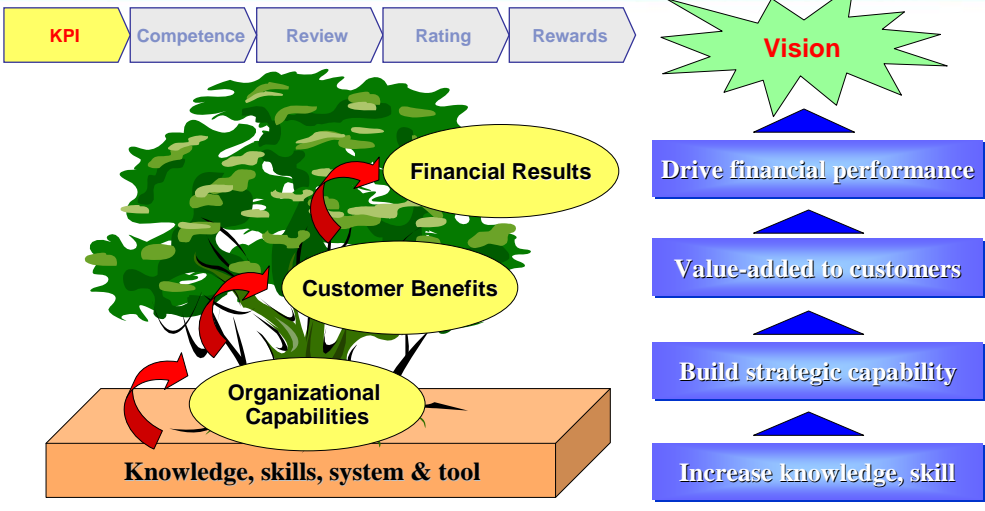
## Performance Commitment Framework



# Performance Management Process



# Develop KPIs



## Management in Accordance with the Strategy can be Best by Using Performance Indicators that are SMART

### Specific

- Is the indicator sufficiently specific and clear to everyone?

### Measurable

- Can the indicator be measured?

### Acceptable

- Has agreement been reached about the indicator to be used?

### Realistic

- Is the norm achievable?

### Timely

- Is there a clear deadline for the achievement of the stated norm?

### EXAMPLE

#### Goal

- Increase number of key accounts

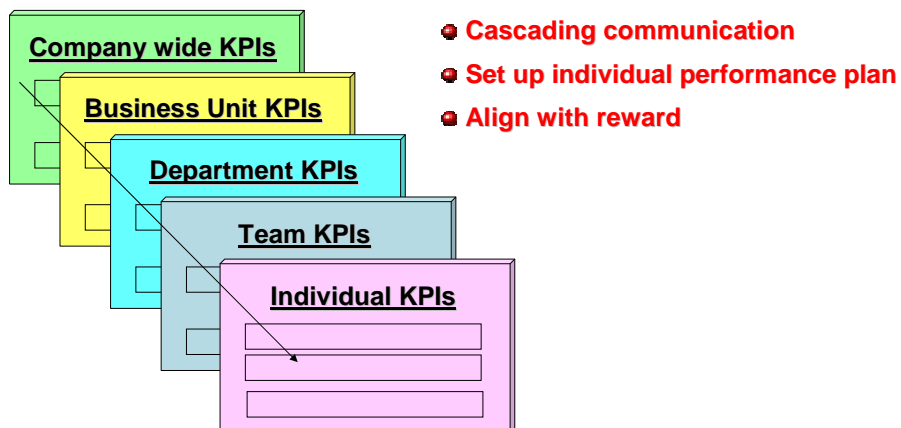
#### SMART performance indicator

- Increase number of key accounts in the 2007 financial year by 10% compared to the 2006 financial year

#### Not SMART performance indicator

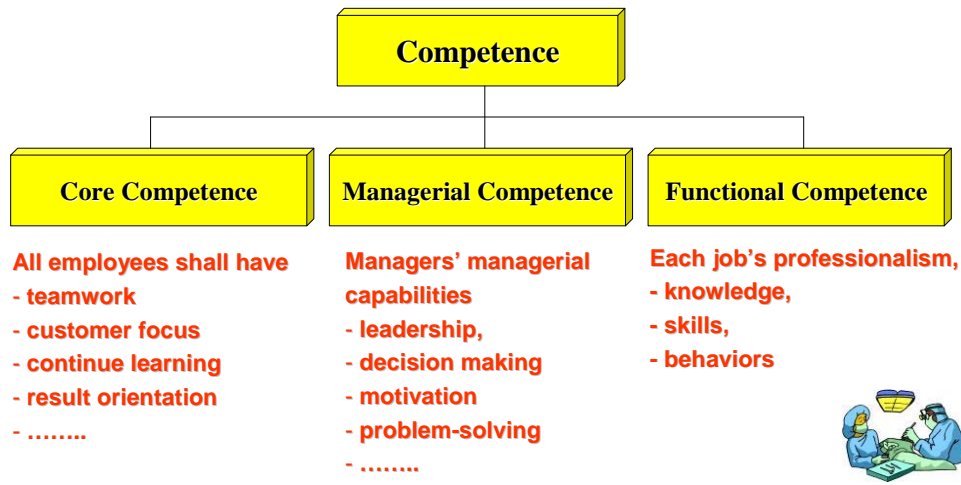
- Increase number of key accounts by 10%

## Execution

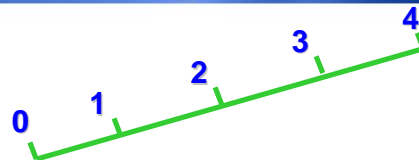


## 4.4 Competence Based System

### Competence Framework



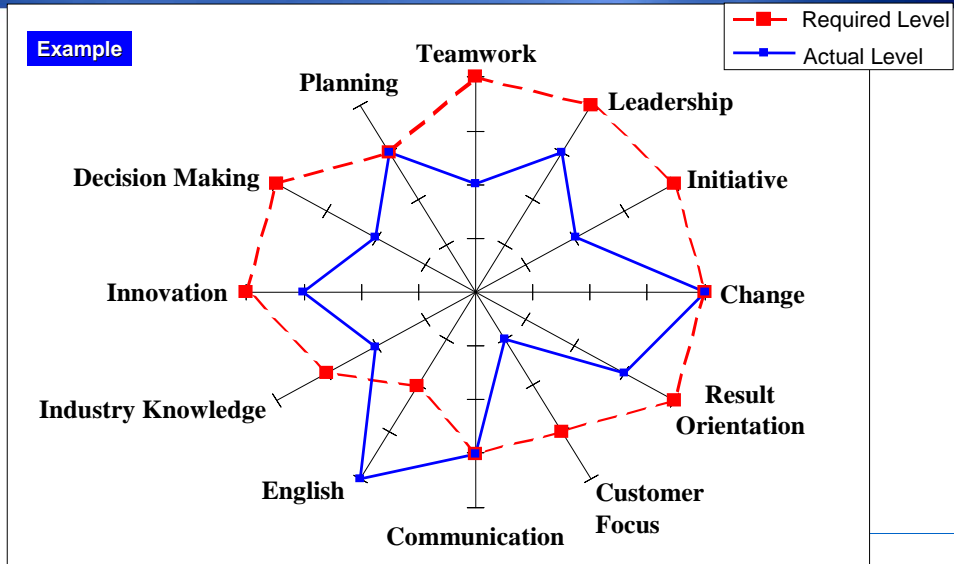
### Set up competence level



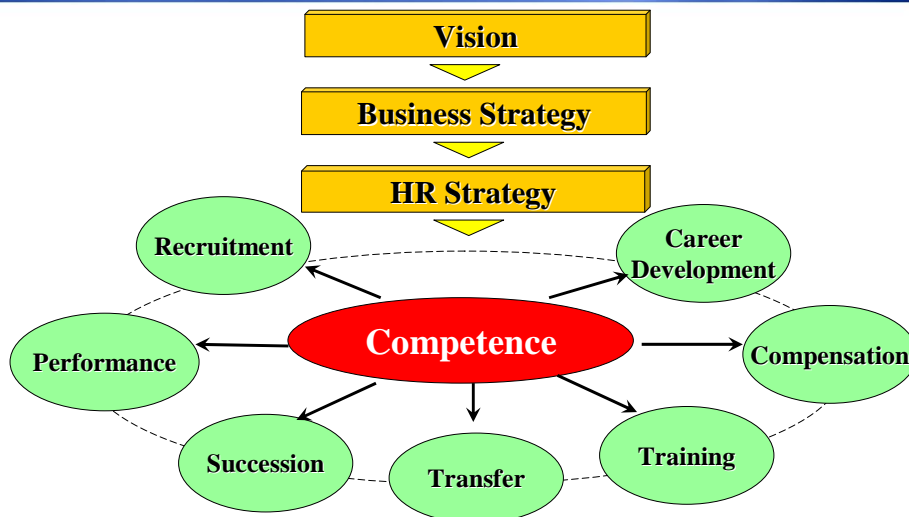
#### Competence level

- 0** :Has not demonstrated competency required at basic level
- 1** :Basic knowledge & skills
- 2** :Good knowledge & skills
- 3** :Highly developed knowledge & skills
- 4** :Exceptional knowledge & skills

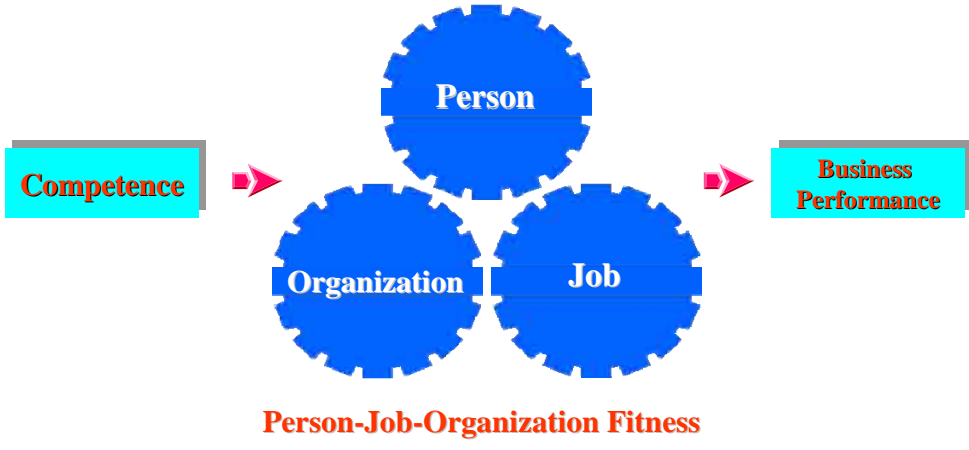
## Competence Chart



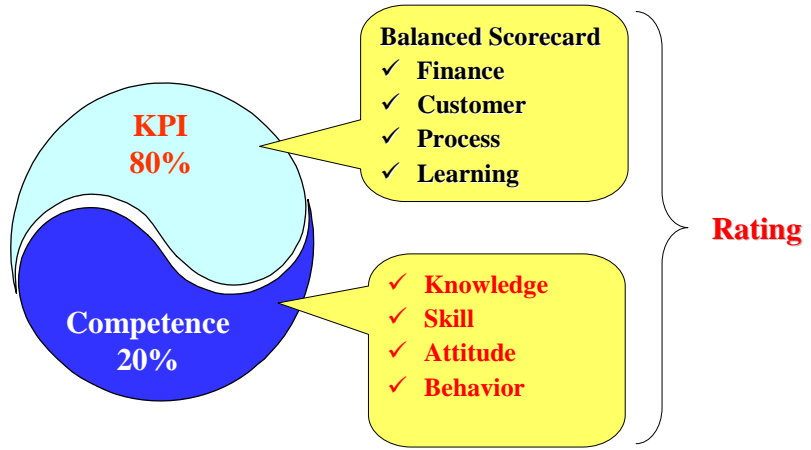
## Competence-based human resource management



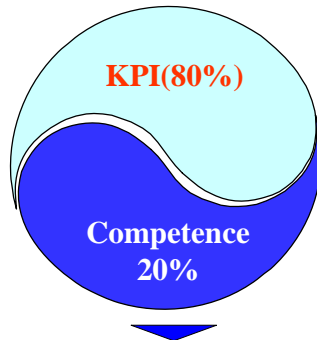
# Implement Competence: P-J-O Fitness



# Factors Decide Individual's Performance



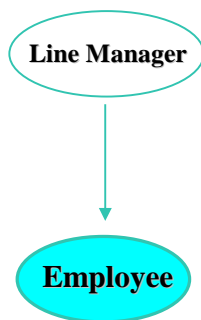
## Performance Rating-Forced Distribution



Outstanding	Excellent	Good	Acceptable	Need Improvement
10%	20%	40%	20%	10%

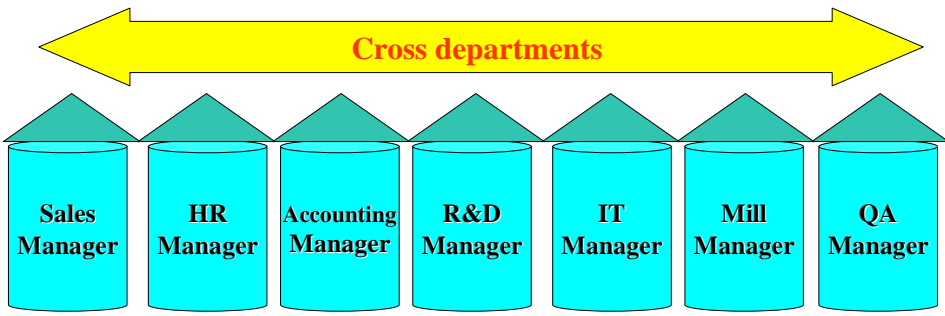
## Who rate? -- 360° feedback

### Traditional Evaluation

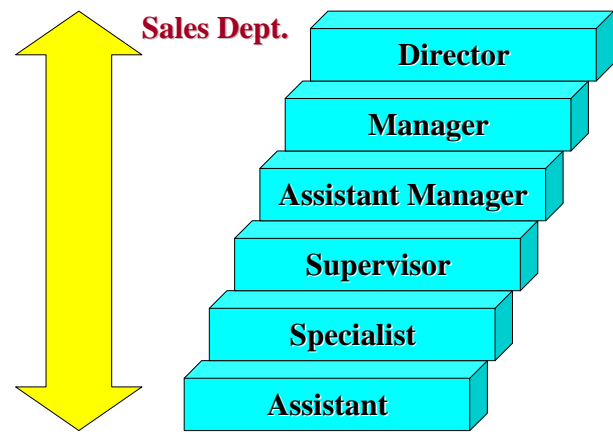




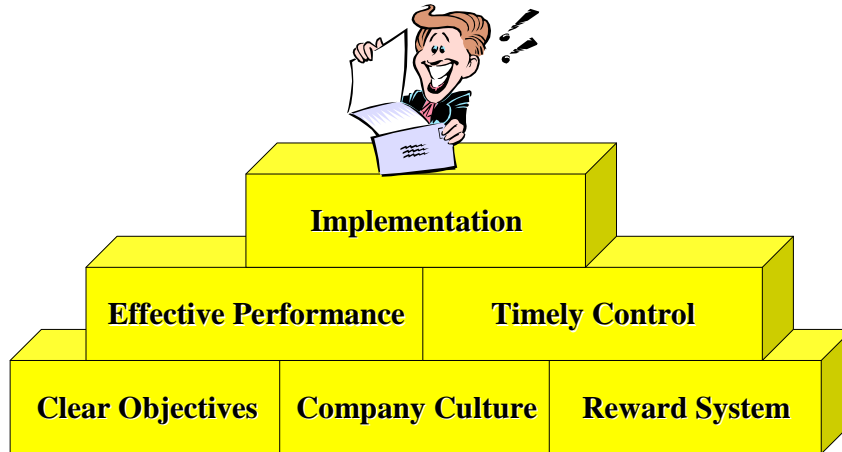
**Rating group**



**Rating group**



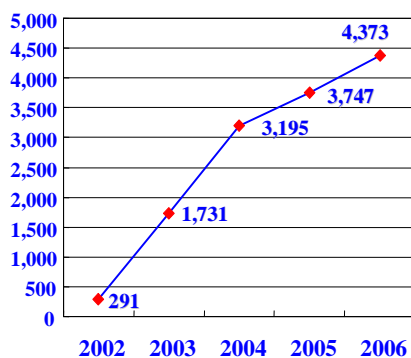
## Successful Factors for Performance Management



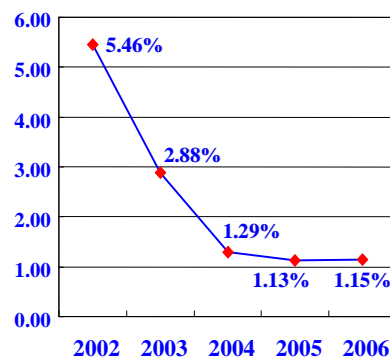
### 4.5 Case of a Commercial Bank

The implementation of Performance Management System at a commercial bank had brought about positive impact as follows:

#### Experience from Commercial Bank

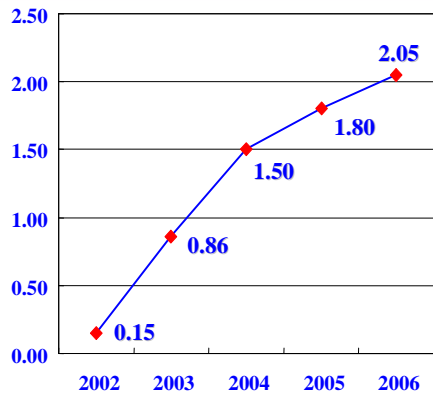


**Employee Productivity**  
(thousand NT\$/Individual)

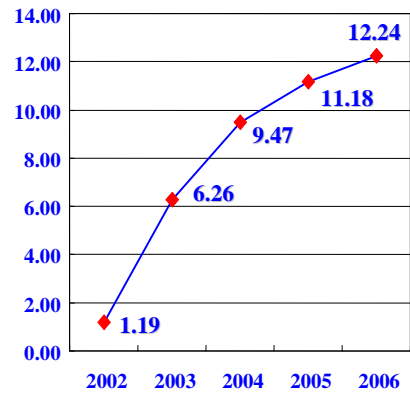


**Non-Performing Loan (NPL)**

## Experience from Commercial Bank

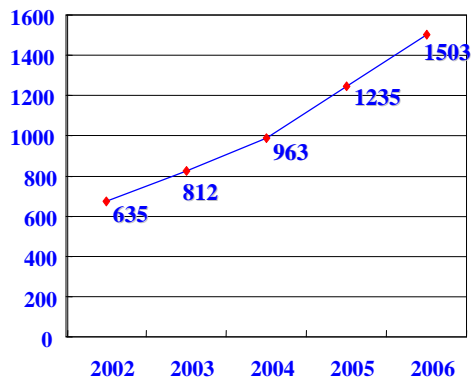


ROA(%)



ROE(%)

## Experience from Commercial Bank



Profit before tax (million NT\$)

## **5.0. Compensation Management Framework and Guideline**

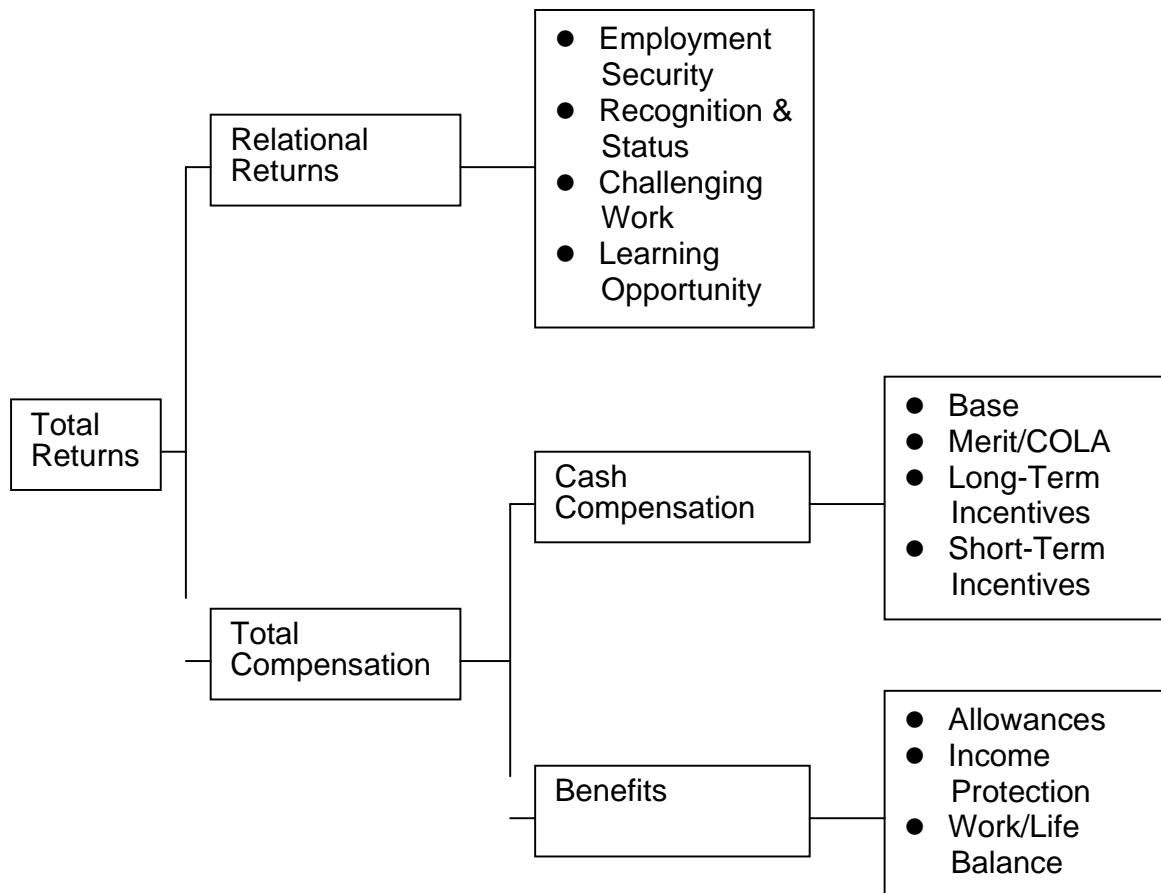
Organization uses compensation to motivate people to: (1) join the organization; (2) stay with the organization; and (3) to perform at high levels. For surviving and achieving excellence, company must be that much more competitive in their compensation practices to attract and maintain qualified people. Well-designed pay policies, forms, and levels and create a happy and harmonious organizational climate can help attract employees to the organization and retain those that the organization wants to keep. Within an organization, compensation can take many forms and can depend on the amount of time or effort spent on an activity, the performance achieved, or other indicators.

Lazier (1998) classified the payment to two different kinds: payment by input and payment by output. He argued that paying on the basis of output has advantages. First, output-based pay induces the good workers to stay and the bad workers to leave the firm. Second, output-based pay motivates workers to put forth effort instead of merely showing up to work. Mahoney (1989) pointed out that there are three basic determinants should include in a wage formula: job, performance, and person (including individual's skill, knowledge, and so on).

### **5.1. Compensation Management Framework**

Compensation has been defined in many ways. Milkovich & Newman (2008) defined it as all forms of financial returns and tangible services and benefits employees receive as part of an employment relationship (see Figure: 1).

**Figure 1: Total Returns for Work**



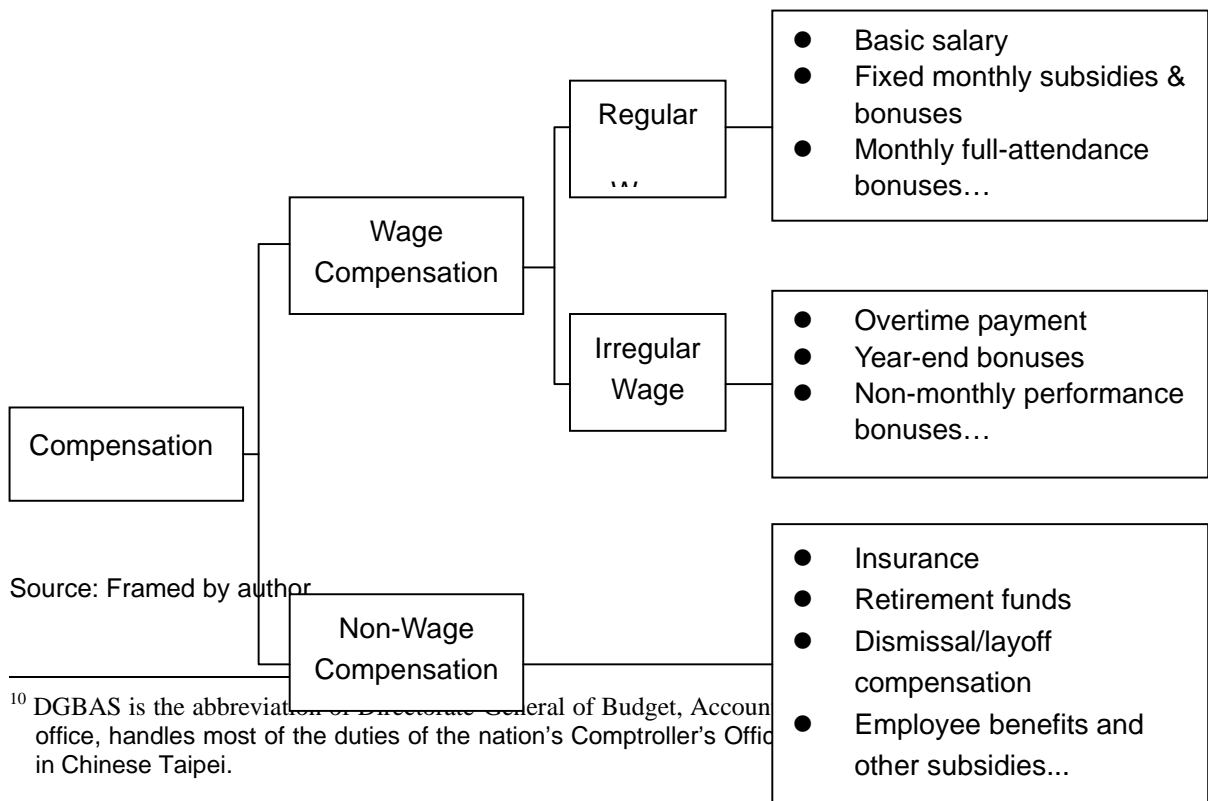
Source: G. T. Milkovich & J. M. Newman (2006) Compensation

Bergmann, Scarpello & Hills (1998) provided a specific definition of compensation. They defined compensation as: Compensation = Salary + Employee Benefits + Non-recurring Financial Rewards + Non-pecuniary Rewards. Chu (2001) expanded Mahoney's model and demonstrated a four-factor model for Chinese Taipei's compensation theory. In his theoretical model, there are four key elements involving in: job-based factor (focus on internal equity, compensation is reflected a certain job's comparable worth), performance-based factor (focus on motivation, compensation is linked to performance), skill-based factor (focus on motivation, compensation is referred to individual's KASO), and hygiene-based factor (focus on external equity, compensation is adjusted by cost

of living or labour market level). In practice, the component of wage/compensation system varies. However, there are two formulas used to describe the system in Chinese Taipei: DGBAS and Watson Wyatt.

According to DGBAS<sup>10</sup>, there are two parts included in the compensation model: wage and non-wage. The wage system should comprise regular wage and irregular wage components. Regular wage includes basic salary, fixed monthly subsidies and bonuses, and monthly full-attendance bonuses; irregular wage includes overtime payment, year-end bonuses, and non-monthly performance bonuses. Non-wage compensation includes the following benefits paid by the employers: insurance (including labour insurance, national health insurance, group insurance, and occupational accident insurance), retirement fund allocations, retirement funds, dismissal/ layoff compensations, employee benefits and other subsidies (see the compensation model as Figure 2).

**Figure 2: Compensation in Chinese Taipei based on DGBAS's Definition**



Based on DGBAS's definition and its survey, the compensation formulation is as follows: Compensation = RW (regular wage) + IW (irregular wage). Table 1 shows the proportion of regular and irregular wage to average monthly earnings by industry in Chinese Taipei.

**Table 1: Proportion of regular and irregular wage to average monthly earnings by industry in Chinese Taipei**

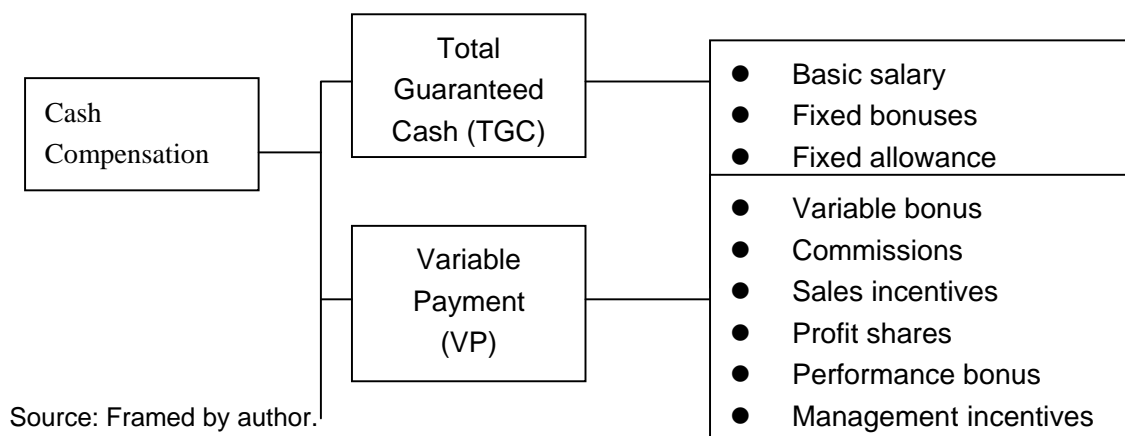
Unit: %

Industry	2003		2004		2005		2006		2007	
	RW	IW	RW	IW	RW	IW	RW	IW	RW	IW
<b>Total</b>	83	17	82	18	84	16	88	12	87	13
<b>Industrial Sector</b>	82	18	81	19	83	17	87	13	85	15
Mining & Quarrying	83	17	83	17	84	16	81	19	83	17
Manufacturing	84	16	86	14	87	13	89	11	88	12
Electricity, Gas & Water	81	19	80	20	82	18	80	20	78	22
Construction	69	31	70	30	69	31	68	32	67	33
<b>Service Sector</b>	91	9	91	9	92	8	92	8	92	8
Trade	86	14	86	14	87	13	87	13	86	14
Accommodation & Eating-Drinking Places	92	8	92	8	90	10	88	12	89	11
Transportation, Storage & Communication	80	20	80	20	80	20	78	22	77	23
Finance & Insurance	75	25	73	27	75	25	72	28	71	29
Real Estate & Rental & leasing	88	12	87	13	88	12	86	14	85	15
Professional, Scientific, Technical Services	87	13	85	15	89	11	87	13	86	14
Health Care Service	81	19	83	17	84	16	80	20	78	22
Cultural, Sporting & Recreational Services	89	11	88	12	92	8	86	14	85	15
Other Services	91	9	90	10	90	10	91	9	90	10

Source: Calculated by author with DGBAS, Earnings and Productivity Statistics data.

Referring to human resource consulting firm, Watson Wyatt's definition, there are two components included in compensation model: total guaranteed cash and variable payment. The total guaranteed cash comprise basic salary, any fixed bonuses, and any fixed allowances, such as car allowances, and shift allowances, but does not include overtime allowances; the variable payment included variable bonus, commissions, sales incentives, profit shares, performance bonuses, and management incentives (see the compensation model as Figure 3).

**Figure 3: Compensation in Chinese Taipei based on Watson Wyatt's Definition**



## 5.2. Compensation Management Guideline

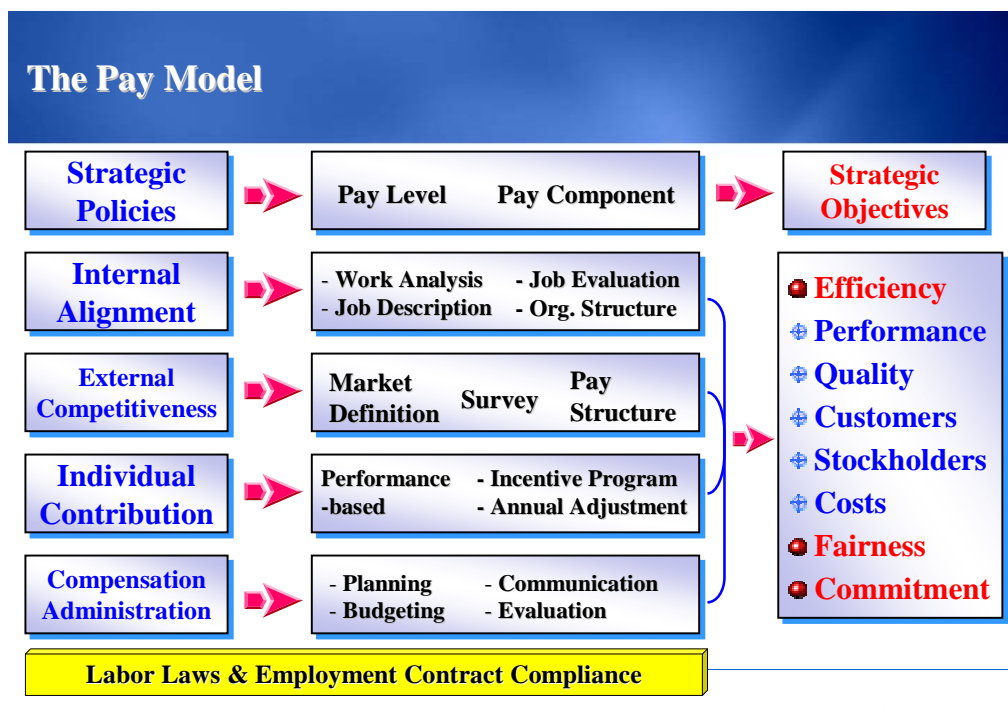
Compensation management includes decisions on pay grade, pay level, salary range, annual salary adjustment, promotion salary adjustments, performance-based incentives and linking other human resource practices. There are many different kinds of managerial practices in different organizations. However, compensation management in Chinese Taipei has general characteristics of: (1) salary curve is different among different position. For instance, the salary curve of a clerical position is flatter than a top management position; (2) nearly 90 % of the sample implemented pay grades measures, the job grade was divided into around



10; (3) salary range of clerical level position is within 20%-25%, however, top management level is increasing to 60%-120%; (4) nearly half of large-scale enterprise adopt an approach which refer to market level strategy for setting salary range; (5) annual salary review and increments refer to public sector salary adjustment, market wage, and firm performance. If there is no profit in a certain year, then there will be no salary review (Chu, 2001).

In addition, almost all organizations both in the private sector and the public sector adopted a mixed model (including job-based, skill-based, seniority-based, and performance-based payment) for managing their wage system. However, organizations in the private sector are putting heavier proportions on performance-based payment than the public sectors.

### 5.3 The Pay Model

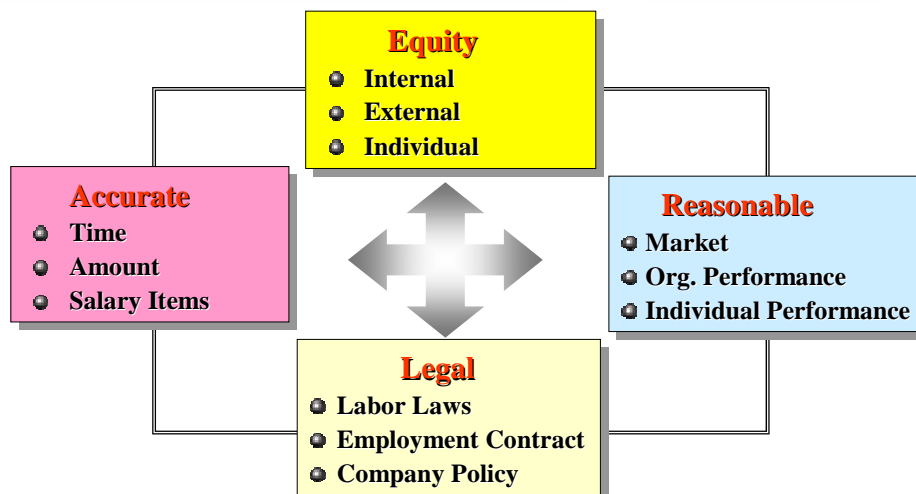


## Strategic Compensation Objectives

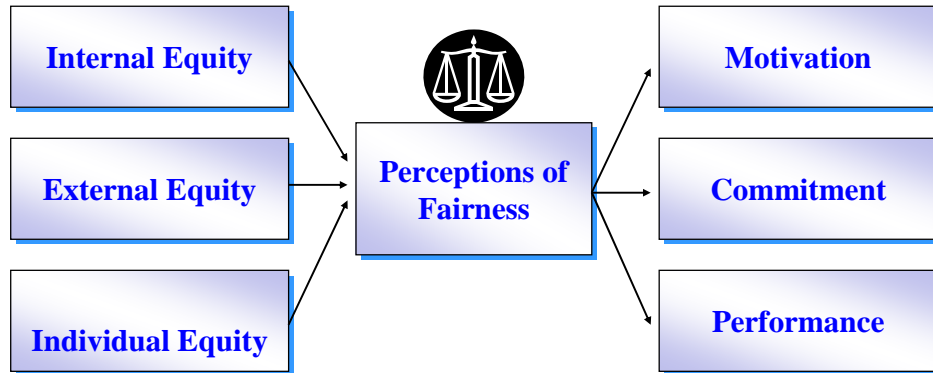
- † To reward employees' past performance
- † To remain competitive in the labor market
- † To maintain salary equity among employees
- † To mesh employees' future performance with organizational goals
- † To control the compensation budget
- † To attract top talents (new employees)
- † To reduce unnecessary turnover

### 5.4 Compensation Management

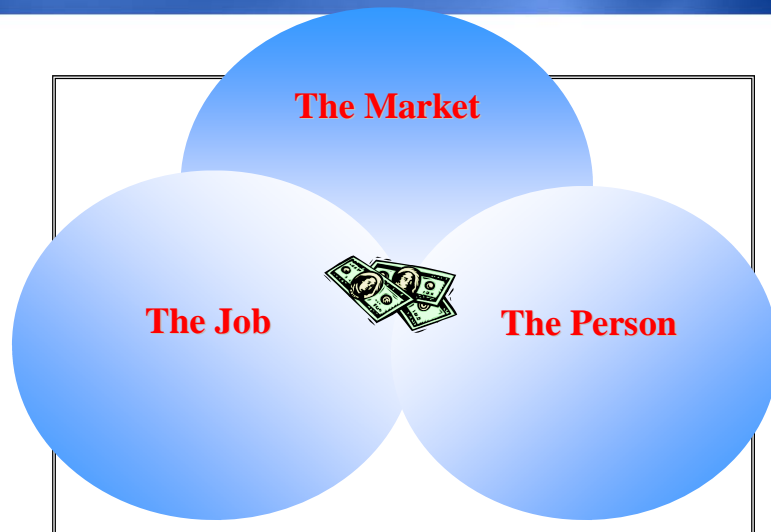
## General Rules of Compensation Management



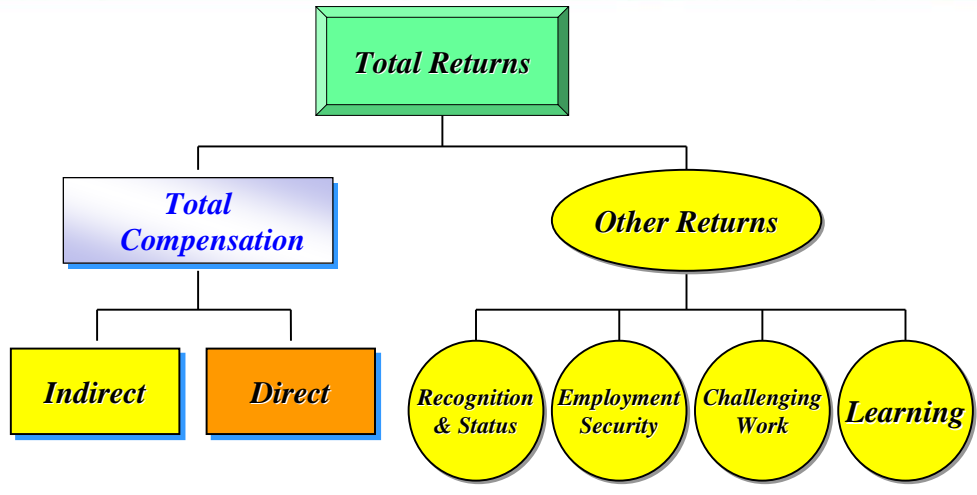
## The Impact of Equity on Output



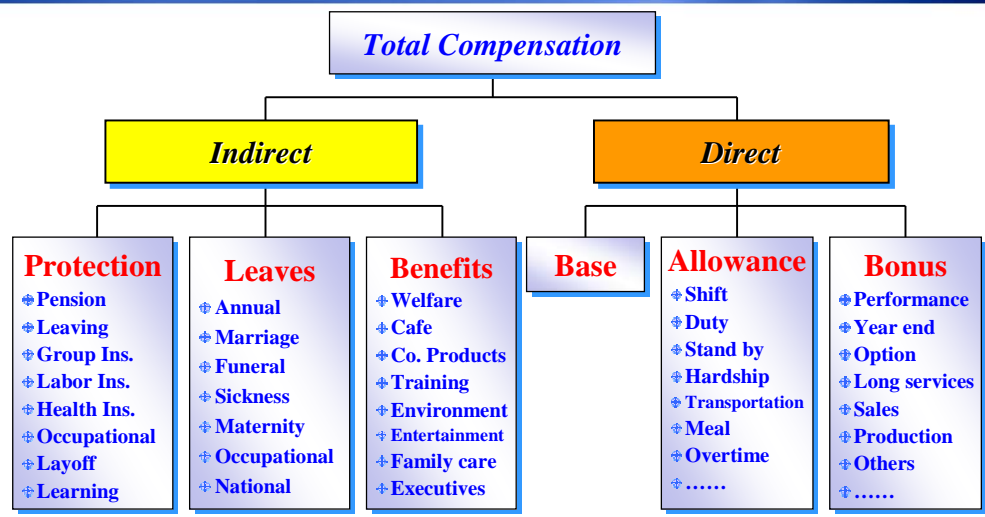
## Factors Determine Salary



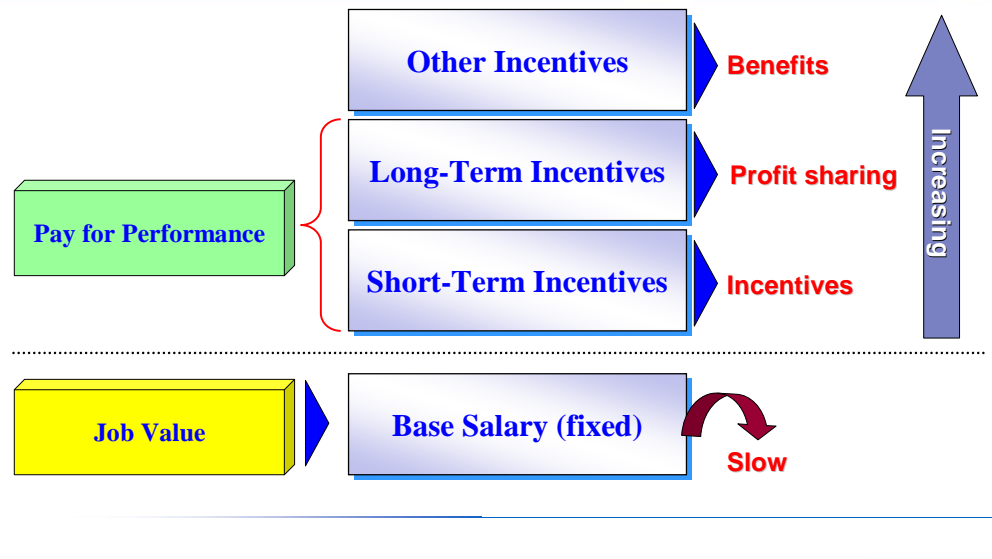
## Total Returns for Work



## Compensation Framework



## Strategic Perspectives on Total Compensation



### 5.5. Pay System Policy and Techniques

#### Pay System Policy

##### Internal alignment

- *Focus* : Comparisons among jobs or skill levels inside a single organization

##### External competitiveness

- *Focus* : Compensation relationships external to the organization: comparison with competitors

##### Employee contributions

- *Focus* : Relation emphasis placed on employee performance

##### Management

- *Focus* : Policies related to managing the pay system



## Pay System Techniques

Include methods used to operationalize policy decisions and link decisions to overall compensation objectives. Examples of techniques:

- **Internal consistency**
  - Job analysis
  - Job evaluation
- **External competitiveness**
  - Pay surveys
- **Employee contributions**
  - Performance Measurement & Management Mechanism
  - Incentive plans
  - Performance-based pay increases

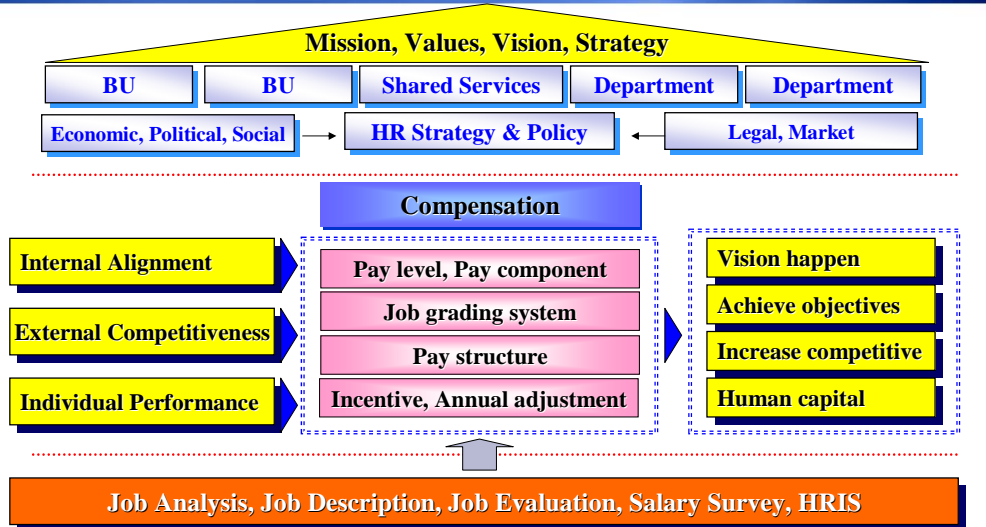


## Building a High Performance Culture through Reward Design

Attract , Motivate and Retain top talents



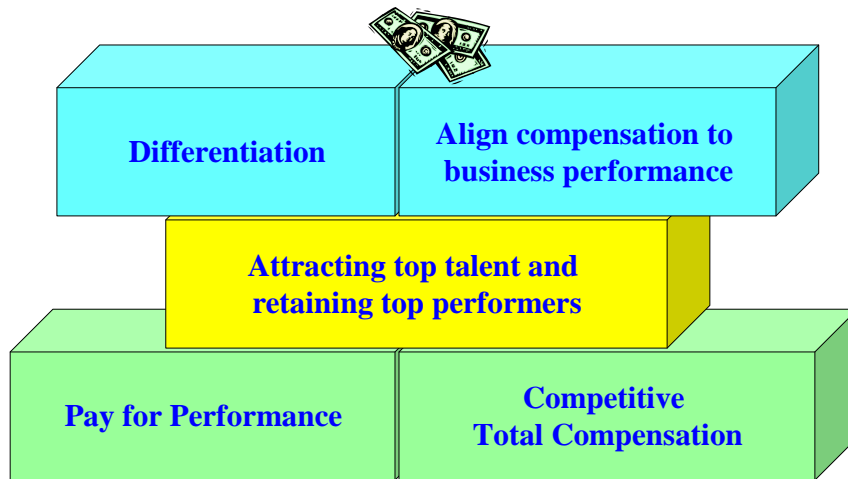
## Strategic Compensation Decision Model



## Framework for Reward Strategy

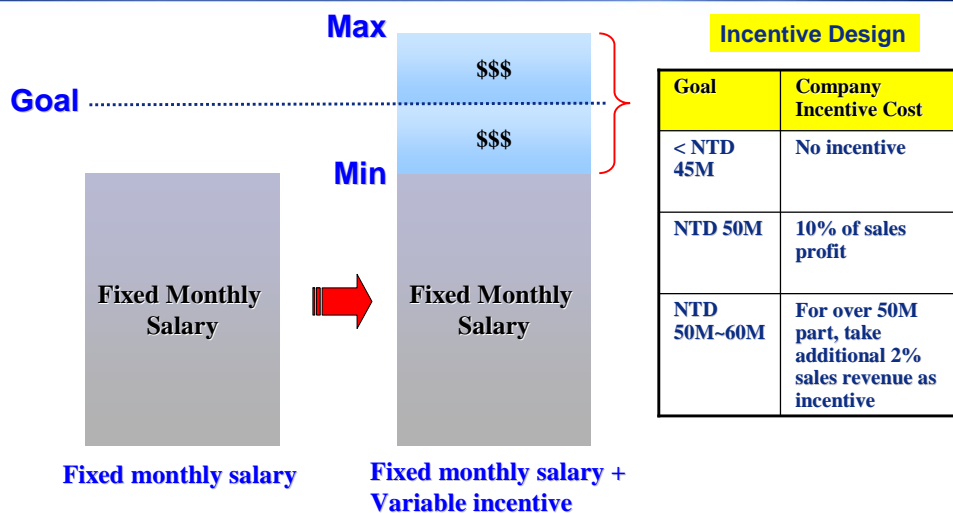


## Managing Compensation Rules



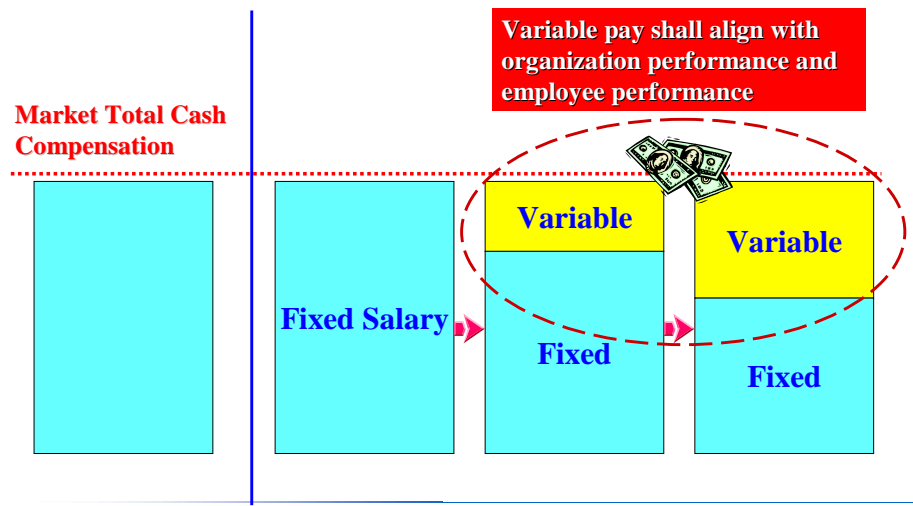
### 5.6. Performance Linked Incentive Design

#### Performance Linked Incentive Design

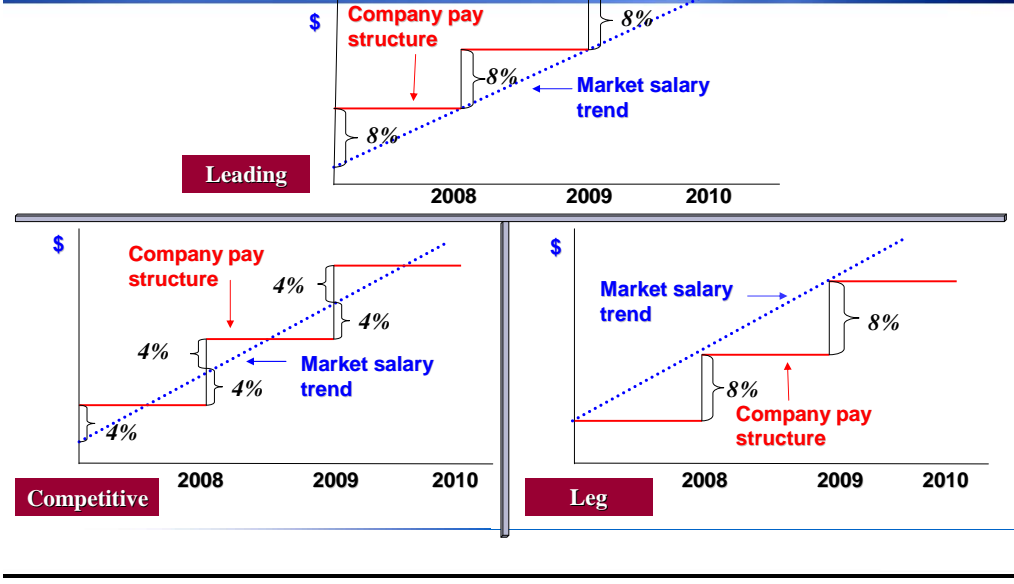




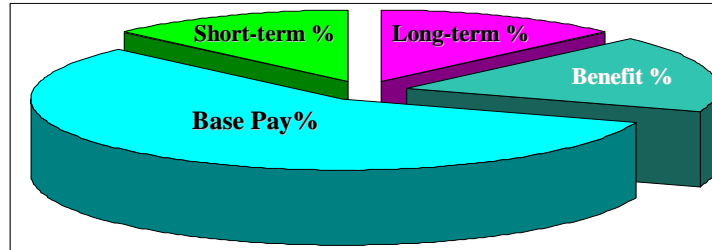
# Fixed and Variable Pay



# Company Pay Level Policy



## Build Compensation Component

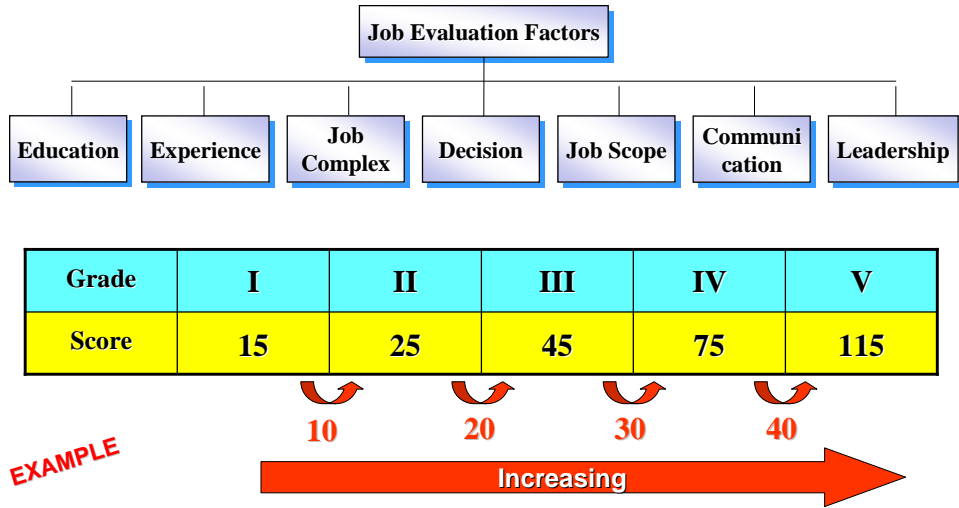


Salary component will be determined by job hierarchy, business function, what are the main issues?

## Compensation Component

	Basic	Short-term	Long-term	Total	
CEO	100 90	70 75	120 150	290 315	 Benchmark
COO	100 90	60 65	100 125	260 280	 Tradition
Sr. Manager	100 95	50 55	60 80	210 230	
Middle Mgr.	100 95	40 45	45 60	185 200	
Junior Mgr.	100 95	30 35	20 35	150 165	
Staff	100 95	20 25	10 20	130 140	

## Job Evaluation Framework



## Organization Structure

G	Managerial	Marketing/ Sales	Manufacture/ R&D/Technical	Administration
9	General Manager			
8	Sr. VP/COO			
7	VP/Director CFO/CIO		Advisory Engineer	
6	Director Sr. Manager	Sr. Marketing/Sales Manager	Chief Engineer	Sr. Executive Assistant
5	Manager	Marketing/Sales Manager	General Engineer	Executive Assistant
4	Asst. Manager	Marketing/Sales Asst. Manager	System Engineer	Executive Secretary
3		Sr. Marketing/Sales Specialist	Sr. Specialist/Engineer	Sr. Specialist/Accountant/ Secretary
2		Marketing/Sales Specialist	Specialist/Engineer	Specialist/Accountant/ Secretary
1		Marketing/Sales Assistant	Assistant	Assistant

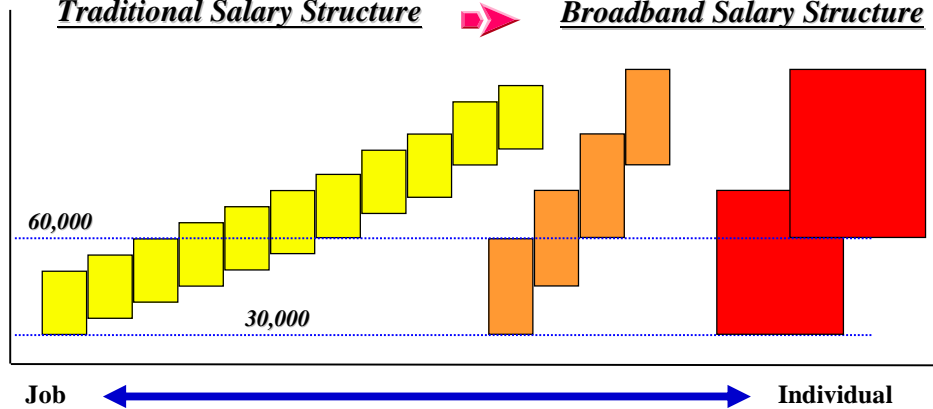
## Hierarchy and Broadband Salary Structure

The trend of compensation management: from Salary Grades to Broad Grades

*Traditional Salary Structure*



*Broadband Salary Structure*

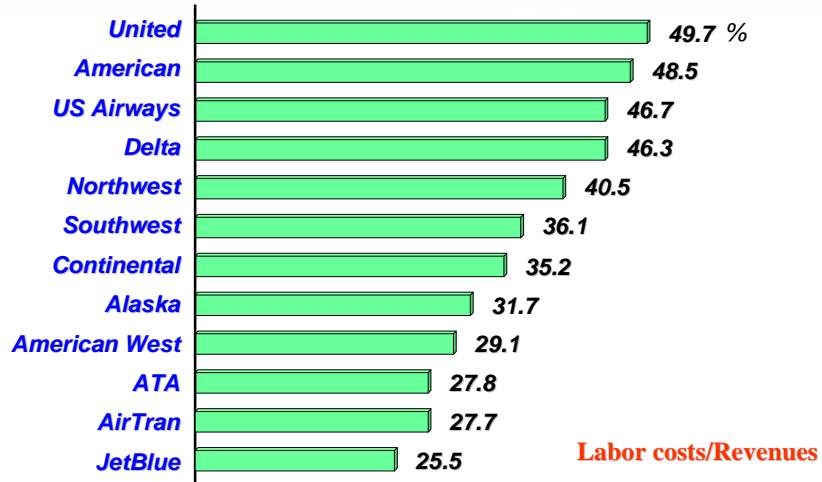


## Hourly Compensation Costs from Major Manufacture Countries Worker

No	Country	Hourly Pay	Index
1	CHINA	0.67	3
2	MEXICO	2.63	11
3	BRAZIL	4.09	17
4	POLAND	4.54	19
5	HONG KONG	5.56	24
6	HUNGARY	6.07	26
7	CZECH REPUBLIC	6.11	26
8	TAIWAN	6.38	27
9	PORTUGAL	7.33	31
10	SINGAPORE	7.66	32
11	ISRAEL	12.42	53
12	KOREA	13.56	57
13	NEW ZEALAND	14.97	63
14	SPAIN	17.78	75
15	ITALY	21.05	89
16	JAPAN	21.76	92
17	IRELAND	22.76	96
18	UNITED STATES	23.65	100
19	CANADA	23.82	101
20	FRANCE	24.63	104
21	AUSTRALIA	24.91	105
22	UNITED KINGDOM	25.66	109
23	LUXEMBOURG	27.68	117
24	SWEDEN	28.73	121
25	AUSTRIA	29.42	124
26	SWITZERLAND	30.50	129
27	BELGIUM	30.79	130
28	NETHERLANDS	31.81	135
29	FINLAND	31.93	135
30	GERMANY	33.00	140
31	DEMARK	35.47	150
32	NORWAY	39.14	166

SOURCE: U.S. BUREAU OF LABOR STATISTICS, November, 2006  
 HOURLY COMPENSATION COSTS FOR PRODUCTION WORKERS: IN U.S. DOLLARS

## Labor Costs: US Air line Industry



## Salary Differences between Grades

Grade	Position	AVG. Salary	Difference \$	Difference %
G6	VP	\$162,000	\$42,000	35%
G5	Director	\$120,000	\$27,000	29%
G4	Manager	\$93,000	\$20,000	27%
G3	Asst. Manager	\$73,000	\$14,500	25%
G2	Supervisor	\$58,500	\$10,500	22%
G1	Specialist	\$48,000		

**Increasing**

## Salary Survey :Why



## Salary Structure

Grade	Min(70%)	Mid-Point(100%)	Max(130%)
9	140,000	200,000	260,000
8	103,500	150,000	200,500
7	80,500	115,000	149,500
6	62,700	89,600	116,500
5	48,800	69,800	90,700
4	38,300	54,600	71,000
3	30,100	43,000	55,900
2	23,800	34,000	44,200
1	18,900	27,000	35,100

30%

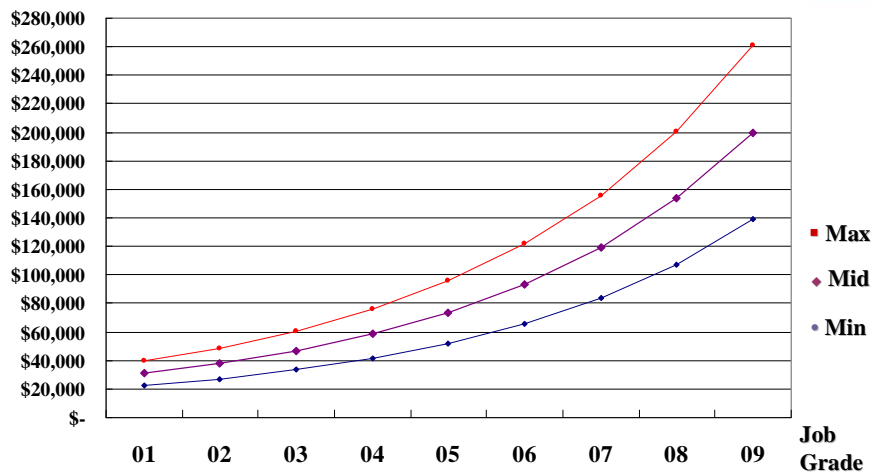
30%

EXAMPLE

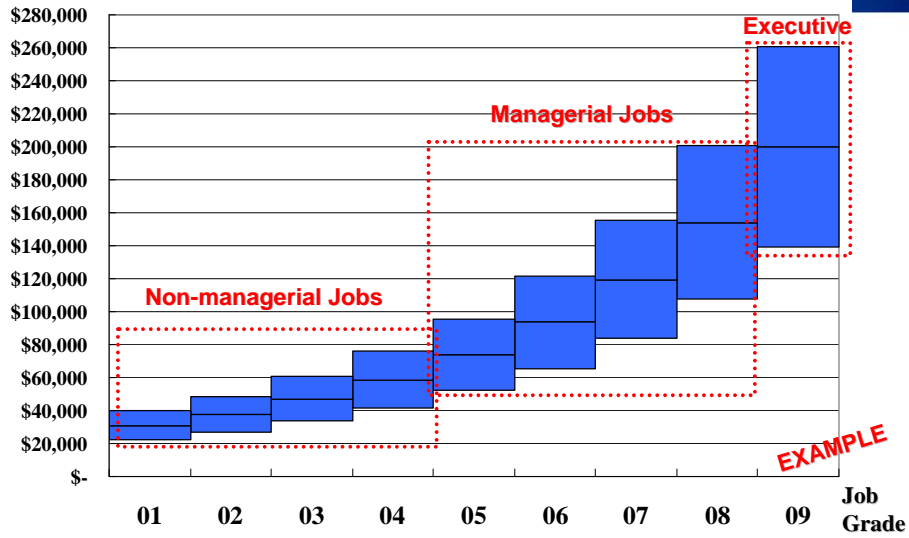
## Salary Structure

G	Managerial	Marketing/ Sales	Manufacture/ R&D/Technical	Administration	Min	Mid	Max
9	G Manager				150,000	200,000	250,000
8	Sr. VP				115,500	154,000	192,500
7	VP/ Director CFO/CIO		Advisory Engineer		89,300	119,000	148,800
6	Director Sr. Manager	(Marketing/Sales ) Sr. Manager	Chief Engineer	Sr. Executive Assistant	70,200	93,600	117,000
5	Manager	(Marketing/Sales ) Manager	General Engineer	Executive Assistant	55,400	73,800	92,300
4	Asst. Manager	(Marketing/Sales) Asst. Manager	System Engineer	Executive Secretary	44,000	58,600	73,300
3		(Marketing/Sales) Sr. Specialist	Sr. (Specialist/ Engineer)	Sr. (Specialist/ Accountant/ Secretary)	35,400	47,000	58,800
2		(Marketing/Sales) Specialist	Specialist/ Engineer	Specialist/ Accountant/ Secretary	28,500	38,000	47,500
1		(Marketing/Sales) Assistant	Assistant	Assistant	23,300	31,000	38,800

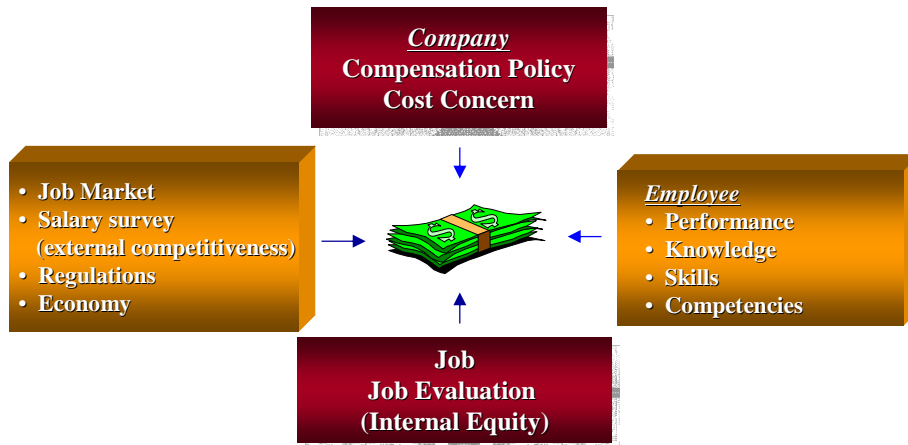
## Salary Structure



## Salary Structure



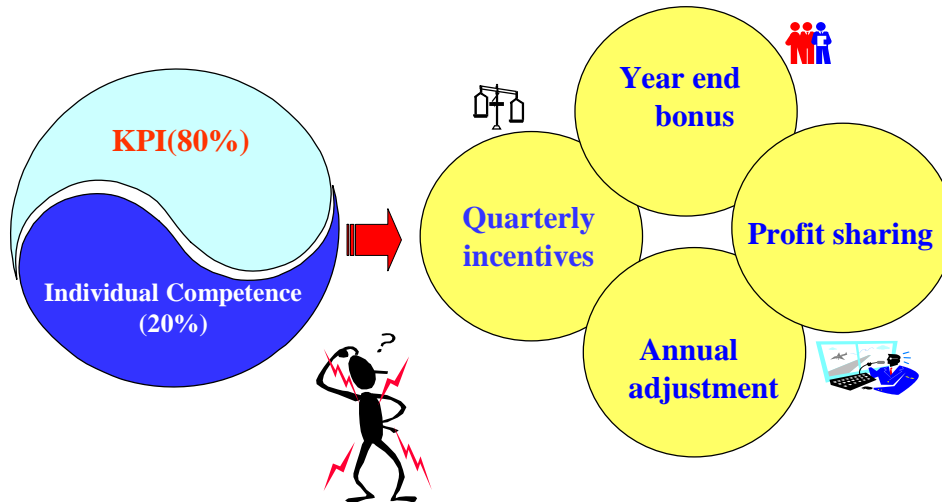
## Deciding Variable Compensation



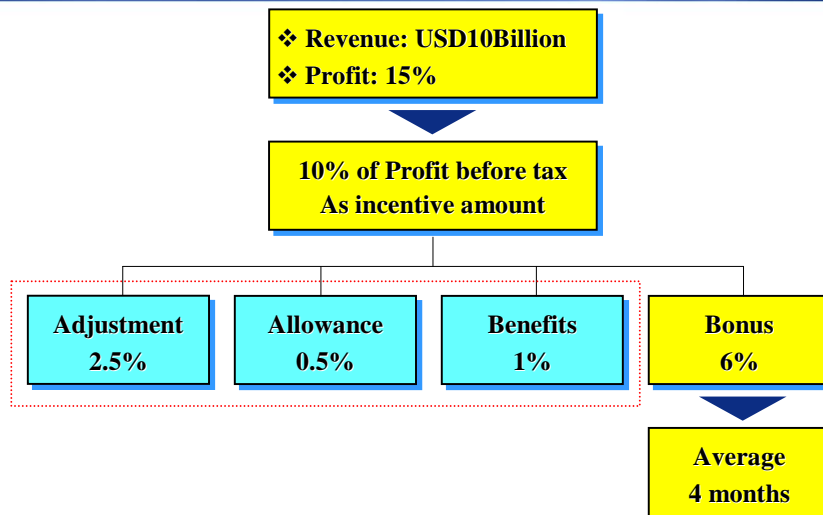


## 5.7. Linking Rewards with Performance : Pay for Performance Plans

### Rewards linked with Performance



### Performance-based Incentive Amount and Allocation



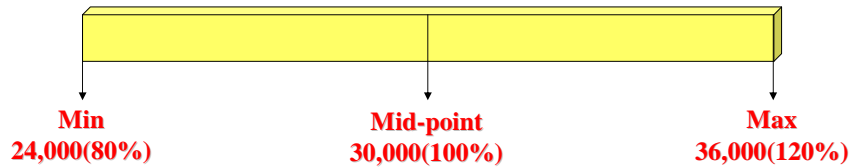
## Performance-based Bonus

Rating	Excellent	Outstanding	Good	Acceptable	Need Improvement
Weight	2	1.4	1	0.6	0
Bonus (months)	8	5.6	4	2.4	0



## Compa-Ratio, CR

Compa-Ratio: individual's actual salary/mid point of individual's job grade



- ❖ Tom's salary is 27,000 ,the Compa-Ratio is:  $27,000/30,000 \times 100\% = 90\%$
- ❖ Individual
- ❖ The same grade
- ❖ The whole department
- ❖ The whole company

## Performance-based annual salary adjustment

**Focus Areas (Low salary but high performance)**

CR Rating	<75%	75-85%	85-95%	95-105%	105-115%	115-125%	>125%
A(10%)	12 %	10 %	9 %	8 %	7 %	6 %	5 %
B(20%)	9 %	8 %	7 %	6 %	5 %	4 %	3 %
C(40%)	7 %	6 %	5 %	4 %	3 %	2 %	1 %
D(20%)	4 %	3 %	2 %	1 %	0	0	0
E(10%)	0	0	0	0	0	0	0

EXAMPLE

## Service Years and Performance Decides Profit Sharing

Grade \ Years	≤ 1 Yr	1-3Yrs	3-5 Yrs	5-10 Yrs	≥ 10 Yrs
9	160	320	480	640	800
8	130	260	390	520	650
7	110	220	330	440	550
6	90	180	270	360	450
5	70	140	210	280	350
4	50	100	150	200	250
3	0	60	90	120	150
2	0	40	60	80	100
1	0	20	30	40	50

Performance Rating	A	B	C	D	E
	* 1.3	* 1.1	* 1	* 0.9	* 0.7

## Summary

**Pay systems are tools, and like any tools, they need to be evaluated in terms of usefulness in achieving an organization's objectives.**

*Prof. George Milkovich, Cornell University*



### 6.0. Performance-Based Compensation in Chinese Taipei

Pay for performance programs are compensation plans that pay employees on the basis of some performance measures. These performance measures might include such things as individual productivity, team or work group productivity, department productivity, or the overall organization's profits for a given period (Robbins & Decenzo, 2002). There are many different determinants which firms use to make decisions on compensation. However, compensation experts agree that traditional formulas of paying employees on seniority or merit-pay basis fails to properly balance organizational profitability and employee professional goals.

To produce a win-win scenario, many companies introduce wage restructuring for improving the wage system to link with the firm goals and

much closely to focus on performance. Wage restructuring does not mean an across the board wage cut, it means linking workers' pay more closely with their performance, and making it less dependent on seniority in the job. When the government adjusted the pension system from defined benefit plan to defined contribution plan, for controlling and managing the firms cost, performance-based is prevailing for all industries.

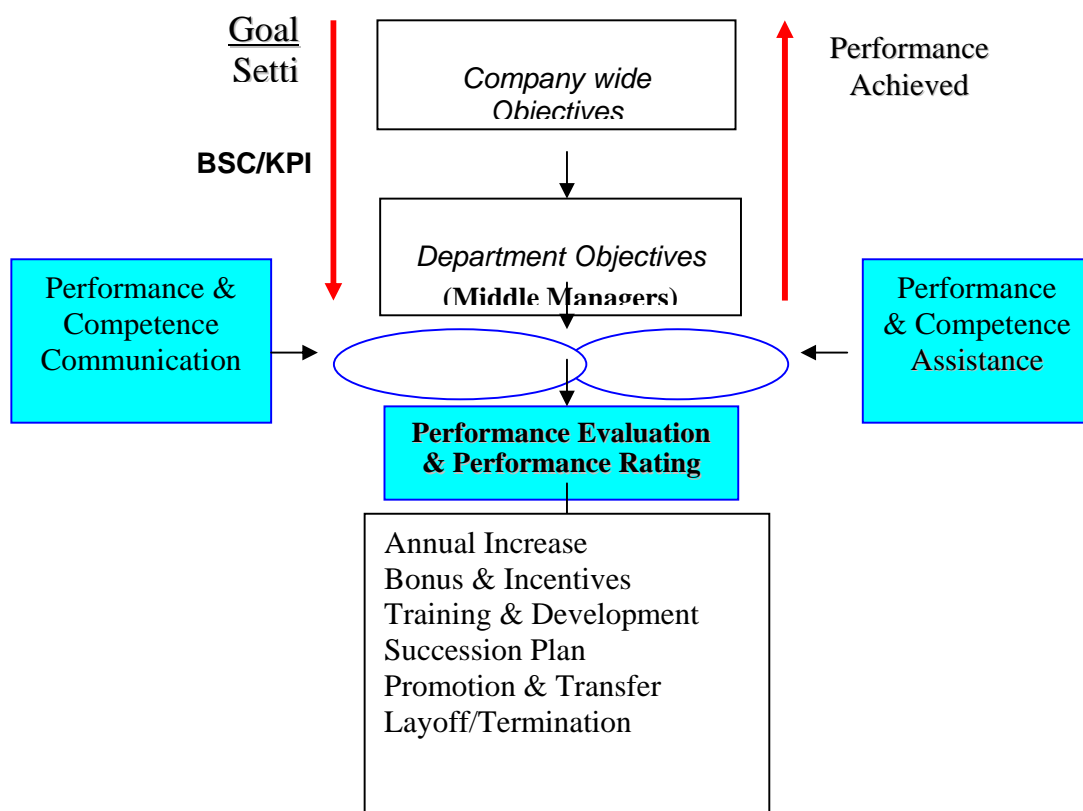
Pay for performance programs are gaining in popularity in the Chinese Taipei's organisations. The survey of Watson Wyatt found more than two-thirds of surveyed companies in consumer products, high-tech, and pharmaceutical industries paid a performance -related bonus to employees. Variable bonus was most notable in the chemical industry, where 90% of surveyed companies paid bonus. It is increasingly popular for companies to adopt a performance-based variable program in Chinese Taipei.

The growing popularity of performance-based compensation can be explained in terms of both motivation and cost control. From a motivation perspective, making some or a worker's entire pay conditional on performance measures focuses his or her attention and effort on that measure, then reinforces the continuation of that effort with rewards. However, if the employee's, team's, or organisation's performance declines, so too does the reward. Thus, there is an incentive to keep efforts and motivation strong. On the cost-saving side, performance-based bonuses and other incentive rewards avoid the fixed expense of permanent-and often annual-salary increases. The bonuses typically do not accrue to base salary, which means that the amount is not compounded in future years.

## 6.1. Framework of Performance Measurement & Management Practice

Performance measure and management is essential for implementing performance -based compensation system effectively and efficiently. If there are no evidence to show what the performance is and how it can contribute to wage, then it will not work to motivate employees? In general, large and middle scale firms in Chinese Taipei have a system for implementing their performance measurement and management. The main concept framework is as shown in figure 4.

Figure 4: Framework of performance measurement and management



When a firm carries out performance appraisal, there are several procedures to follow: (1) objectives & communication: the main issue of performance appraisal is to link employee productivity to organisational goal. In order to implement performance well, setting firm goal and down this target to each department, unit, and individual is the first thing to decide. When the goal is set, then it should be followed by communicating with key partners such managers and employees to make sure the goal is clear enough to them; (2) identify the competence and its level: according to firms core business and job analysis to develop the core competence and individual competence and its level for employee, make sure that employee is clear about competence in terms of knowledge, skill, ability, attitude, and behavior requirement; (3) decide the time period of performance review and develop improvement action plans for weak employees; (4) decide on appraisal ratings, including rating group, rating ration, performance indicator such as KPI and competence ration in a performance appraisal proportion distribution; (5) link performance result to compensation.

In Chinese Taipei, most of the companies review performance once or twice a year, while some review on a quarterly basis. To carry out the performance review, some enterprises review procedures using IT systems. Self-assessment of employee and direct supervisor review is the first step, before the final approval, managements will organize a cross-department/unit joint committee to review the results. If there is no joint committee for review, the result from the supervisor of the department or unit will be submitted to the right person for final approval.

The review result, in general, is divided into 5 levels: excellent, outstanding, good, fair, and need to improve. In some case, there are only 3 levels for performance rating: outstanding, success, and poor. The rating

ratio in a 5 level model maybe is 10%, 15%, 50%, 15%, 10%; in a 3 level maybe is 15%, 70%, 15%. The final result of the performance review is linking to: (1) compensation adjustment such as base salary increased (including annual or monthly increment), bonus such as profit share (including cash bonus and stock bonus), year-end bonus. A few companies in the hi-tech industry give bonuses based on performance 2 or 3 times a year rather than the annual compensation.

**Table 5: Salary Increase Align with Performance**

Rating	Compa-Ratio					
	75%	Q1	Q2	Q3	Q4	125%
<b>Excellent</b>	12%	11%	10%	9%	8%	7%
<b>Outstanding</b>	10%	9%	8%	7%	6%	5%
<b>Good</b>	8%	7%	6%	5%	4%	3%
<b>Fair</b>	4%	3%	2%	1%	0%	0%
<b>Need to Improve</b>	0%	0%	0%	0%	0%	0%

Note: 1. Q1: 75%-87.5% Q2: 87.5%-100% Q3: 100%-112.5% Q4: 112.5%-125%

2. Note: Data for illustration only

**Table 6: Year-end Bonus Align with Performance**

Rating	Bonus Weight	Year-end Bonus (Month)
Excellent	2	8
Outstanding	1.5	6
Good	1	4
Fair	0.5	2
Need to Improve	0	0

Note: Data for illustration only



**Table 7: Profit Sharing–Stock Bonus Align with Performance**

Seniority \ Grade	1yr	1-3yr	3-5yr	5-9	10yr
9	160	320	480	640	800
8	130	260	390	520	650
7	110	220	330	440	550
6	90	180	270	360	450
5	70	140	210	280	350
4	50	100	150	200	250
3	0	60	90	120	150
2	0	40	60	80	100
1	0	20	30	40	50

Excellent	Outstanding	Good	Fair	Need to Improve
*1.3	*1.1	*1	*0.9	*0.7

Note: Data for illustration only

## 7.0 Enterprise Level Survey

Eight enterprises in Chinese Taipei were interviewed to focus on how enterprises implement their performance-based compensation scheme and maintain their excellence when facing global challenges and enhancing competitiveness. These eight enterprises are made up of five from the service sector, and the other three from the industry sector. Among these eight companies, five have strong linkages of compensation to performance, two have a normal linkage, and one is beginning to move

into performance-based system smoothly, but is facing strong resistance from the trade union.

Regarding the performance management system, all the case companies have a rule for doing the performance measurement and management. Some companies decided different rating level for different job positions. For example, for manager, there are only three rating levels. However, subordinates level has a five rating levels. Many companies involved in this study need to select the essential factors for performance review, it seems to the idea of KPI but in different terms. They will discuss and set it in the beginning of the year, then review it quarterly. However, one company's performance management is decided by the leader of department or unit. Four companies have set up individual performance indicators and competence profiles for employees, while the rests are based on competence or behavior.

No matter how many rating levels they have, the result of performance is linking to salary increment, performance bonus or year-end bonus, profit share and human resource practice such as promotion, training, or replacement (except one case company). For example, one of the case companies, when the employee was rated in an outstanding level is a fast-tracker, will promote to upgrade position during 1 to 2 years compare to the employee who rated as success level is need 3 to 4 years).

Most of these companies do not have trade unions. Only three companies have in-house trade unions, and two of them have collective agreements. Labour management conferences are being used in most of the companies and, through the conferences, both parties (employees and

employers) got a chance to communicate with each other to focus on labour relations, working conditions, and productivity issues.

Two individual cases are highlighted to show the implementation of performance -based compensation at the firm level. The identity and data shown had been disguised for confidentiality purposes.

### **7.1 Case 1 : The application of competence-based HRP model**

The organisation is a 50-year-old private company located in Chinese Taipei. Its core business is marine transportation focused in Asia. There are 160 employees and twelve departments in its head office in Chinese Taipei, and around 60 contract-employees work at different ports. Due to the Asian financial crisis in late 1990s, the company encountered a lot of challenges, leading the management team to study the necessity and possibility of reengineering the business model, process, and organisational structure, and to strengthen human resources in order to overcome the severe challenges. But the reality and difficulties are, as an old bureaucratic organisation, it lacks not only the knowledge and skills, but also the momentum with which to make organisational change effectively. Most of the employees and managers have not received annual bonus and salary increase for the past three years.

Given the reality and difficulties mentioned above, to speed up the organisational change, the CEO decided to invite external consultants to start the reengineering project in 2001. The project scope included business strategy, company wide core competence, competence-based human resource practices and increasing firm performance. The study addresses previously neglected areas of competence-based human

resource practices role in business reengineering process in an attempt to increase our understanding of this increasingly key topic. To accomplish this objective, several aspects were explored:

- What is human resource's role in this reengineering process?
- How to develop firm's core competence?
- How to implement competence-based human resource practices?
- How can human resource practices increase the firm's human capital?

### **7.1.1 Reengineering Process**

Although the company has had its business strategies in the past years, it is obvious that those strategies have not worked out in terms of increasing or maintaining the company's competitive advantages in the marine industry. Secondly, based on the strategy, management teams developed a firm level core competence as an infrastructure to implement competence-based human resources practices. Thirdly, human resource professionals conduct several activities to train and help line managers to implement competence-based interview, placement, performance management and training program. The final purpose is to enrich company's human capital and increase its competitive advantages.

### **7.1.2 Business Strategy**

In the changing and uncertainty environment, it is necessary to review current business strategy. CEO, management team and consultants redefine business strategy after diagnosing internal and external issues. We have labeled rapid growth from traditional operation to agile operation, IPO in two years, and approach new clients.

An opposed to the product /market strategy, the core competence of a firm is a bundle of skills and technologies that represent the sum of learning across individual organisational units (Wright, McMahan, McCormick & Sherman, 1998). A core competence provides a competitive advantage through being competitively unique and making a contribution to customer value or cost (Prahalad & Hamel, 1990). Based on the above business strategy, the company developed a set of company wide core competence as an infrastructure to implement human resource practices and increase competitive advantage.

Management developed eight core competencies that included customer orientation, teamwork, initiative, responsible, result orientation, cost control & management, industry knowledge and English capability. The definitions are described as follows:

**Customer orientation:** Works to clarify and exceed customer's expectations. Shows concern for customers' problems. Is friendly and understanding. Encourages customer focus in others.

**Teamwork:** Effectively working with members within the department to achieve organisation's goals. Is helpful and co-operative. Makes every practical effort to meet customer needs? Is flexible and reacts positively to changes in instructions or plans. Is team spirited? Is supportive to other members of the team and helps them when necessary?

**Initiative:** Is proactive and uses initiative to respond to customer needs? Is conscientious, reliable and meets commitments? Is keen to take responsibility?

**Responsibility:** Willing to take the responsibility of personal decisions or actions.

**Result Orientation:** Effectively developing, utilizing resources, methods, systems and processes. Using the most efficient ways to maximum investment return ratio.

**Cost Control & Management:** Understands and applies commercial principles. Find ways of reducing costs. Is aware of market and competitor activity. Understand the business as a whole.

**Industry Knowledge:** Understands and applies commercial principles. Find ways of reducing costs. Is aware of market and competitor activity. Understands the business as a whole.

**English:** Can fluently read, speak, write and listen to gather information, communicate and learn.

### 7.1.3 Competence-based HR practices

The company used the above competence model to develop HR practices in the fields of selection, interview, placement, performance measurement and management, training and development. Competent human resource professionals recognize the requirements of the profession and are willing to invest in maintaining and improving their skills and knowledge during rapidly changing times (Losey, 1999). As Losey stated in his articles in this issue, developing competence is a combination of education, experience, interest, and raw capability (ethics).

Intelligence + Education + Experience + Ethics + Interest = Competence

The competence work provides a roadmap for the content HR practices. Wright (1998) argued that the most important type of horizontal fit among HR practices to organisations would be when the practices all promote the

same organizationally relevant outcomes. Recent emphasis on competence models provide a basic framework for creating horizontal fit. Such models identify a relevant set of behavioral competencies, and then HR practices can be designed to complementarily promote the selection and development of those competencies in individuals (Wright & Boswell, 2002).

#### **7.1.4 Competence-based selection and interview**

As mentioned, the company adapts competence models to select and interview candidates to identify their competencies level. First, line managers identify every job's competencies & levels and send to his/her upper managers for approval. Human resources manager works with line managers conducting the interview or other selection tools. After the interview process, they join together to identify candidates' competencies level and the gap between the actual and the job required.

#### **7.1.5 Competence-based Placement**

The internal transfer, promotion, relocation, termination, succession, plan and other placement practices use the competence model to identify candidates' competence level. Line managers and HR managers join together to decide the placement decision. The competence gap graph is helpful in clarifying the complexity inherent in each of these competencies. Furthermore, it helped management to diagnose individual's strength and weakness to increase the likelihood of people-job and people - organization fitness.

### **7.1.6 Competence-based Performance Management**

Employee's performance rating is determined by personal goals and individuals competencies. At the end of the year, managers set goals with employees for the next year. At the same time, managers describe the job competencies level that employee's annual performance rating is determined by 80% goal achievement and 20% competence level. The company intends to build up a culture that both results and behaviors are important in the organisation. In other words, they were not only expected to achieve their/ annual business goals but also to demonstrate their behaviors, attitudes, skills as required based on their job and rank. Managers review employees' annual performance based on the competence model and provide the feedback of gap to ask them to improve in certain period.

### **7.1.7 Competence-based Training and Development**

Within the framework, line managers identify their subordinates' training needs. Human resource professionals draft the training program for different functions, and different jobs. For example, the company develops leadership, decision-making, people management and business strategy programs for the management team. Negotiation, customer services, time management and industry development trends are provided for the sales team.

### **7.1.8 Human Capital and Person-Job / Person-Organisation Fit**

Sound people management skills in an organisation are a key to success. It is the core responsibility for line managers, not just the human resources professionals. Barney (1991) argued that sustained competitive advantage derived from the resources and capabilities a firm controls that are



valuable, rare, imperfectly imitable, and not substitutable. Those resources and capabilities can be viewed as bundles of tangible and intangible assets, including a firm's management skills, its organisational process and routines, and the information and knowledge it controls. A firm's human resources, including all of the knowledge, experience, skills, and commitment of a firm's employees and their relationships with each other and with those outside the firm can provide a source of competitive advantage (Barney & Wright, 1998; Boxal, 1998; Snell, Youndt, & Wright, 1996).

Human capital refers to knowledge that is embodied in people (Coff, 2002). Human capital is critical to maintain competitive advantage since organisational capabilities are created by transforming human capital into group or firm level knowledge (Nonaka, 1994). Though firm's human capital can be gained from "make-or-buy" strategy (Miles & snow, 1984). In general, firms often make and buy their human capital (Lepak & Snell, 1999). After discussing with consultant group and within high-level management team, the company decides to increase its human capital through implementing the competence-based HR practices-selection, interview, placement, performance management, and training & development.

Person-Job fit is concerned with finding a match between the skills, knowledge, and abilities needed to perform the relatively static technical aspects of a job and individuals who have these abilities (Werbel & Johnson, 2001). Person-organisation fit is conducted at the organisation level of analysis. It concerns the value congruence between the worker and the organisational culture and is concerned with organisational culture and is concerned with organisational socialisation processes (Chatman, 1989). Ideally, the two types of fits are important. Organisations should make efforts to address the types of fit given that each impacts employee

motivation and organisational effectiveness. Organisations would like to examine the person-job /person-organisation fit to evaluate their effectiveness.

The company implements competence-based HR practices to increase person-job -organisation fit that can achieve organisational effectiveness. After two years' implementation, the Company's sales grew up 20%, 11% turnover for unfit staff, employee satisfaction increased 23% customer retention rate increased to 88%. The specific role of competence-based HR practices play in business reengineering process is explored. It also helps to strengthen person-job/person-organisation fit in dynamic organisation.

After five years of implementation, the company's sales grew by 22%, 12% turnover for unfit staff, employee satisfaction increased 23%, customer retention rate increased 89%. In 2007, due to its excellent performance, the company was merged by a global liner group.

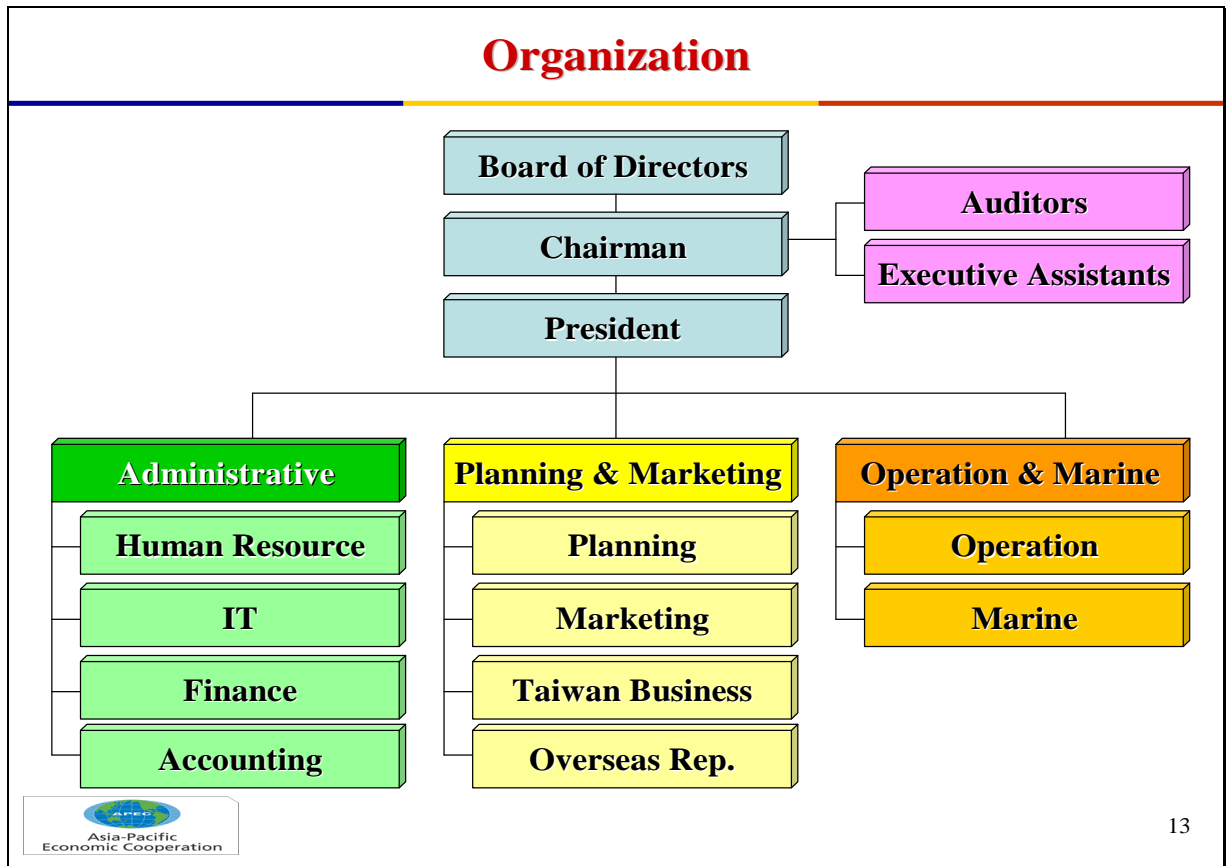
This case illustrates how competence-based HR practices can help an organisation to enhance/improve its business performance by implementing business reengineering process in a dynamic environment. Since human capital is embedded in individual employees, even the company can reengineer business model, business process, and initiate other managerial issues, its final success relies on "people", such as management skills and employees' commitment. One managerial implication of this study is that HR functions should provide competence-based HR practices as a tool for managers' and subordinates' to use. While standardizing the competence-based selection, interview, placement, performance management, and training & development seems attractive. For example, all employees know what is expected from their

performance, understand how they are currently performing, and receive consistent training and development.

Finally, organisation culture implies the importance of a shared understanding between the organisation and employees. It seems that integrating organisational culture with reengineering process so that the company's competitive advantage can be built in a unique way – “social complexity”. The organisational effectiveness depends largely on managers and employees. It is important for organisations to realize that organizational effectiveness is a multilevel construct. That is, individual characteristics (skills and abilities), organisational characteristics (organisational culture and value) all have critical impacts on organisational effectiveness. Thus, certain degree of fit on the individual, job and organisational level would be important to achieve organisational effectiveness.

As Pfeffer (1995) stated, competitive success is achieved through people, then the skills of those people are critical. He also argued that organisation, its employees, and how they work are the critical success factors in the new economic world. In general, competencies are definitely the keys to foster a firm's competitive advantage. The competence model is increasingly popular in being used as the foundation of human resources management systems. Understanding the value of a competence model to various HRM systems will help firms to judge how best to apply them in the organisation. However, Bonger, Thomas & McGee (1999) link competence to competitive advantage in different product markets and argue that the need for a dynamic model for competence. They point out that both individual and organisational learning processes must be managed in order to keep existing competences distinctive and to allow for the formation of new competences.

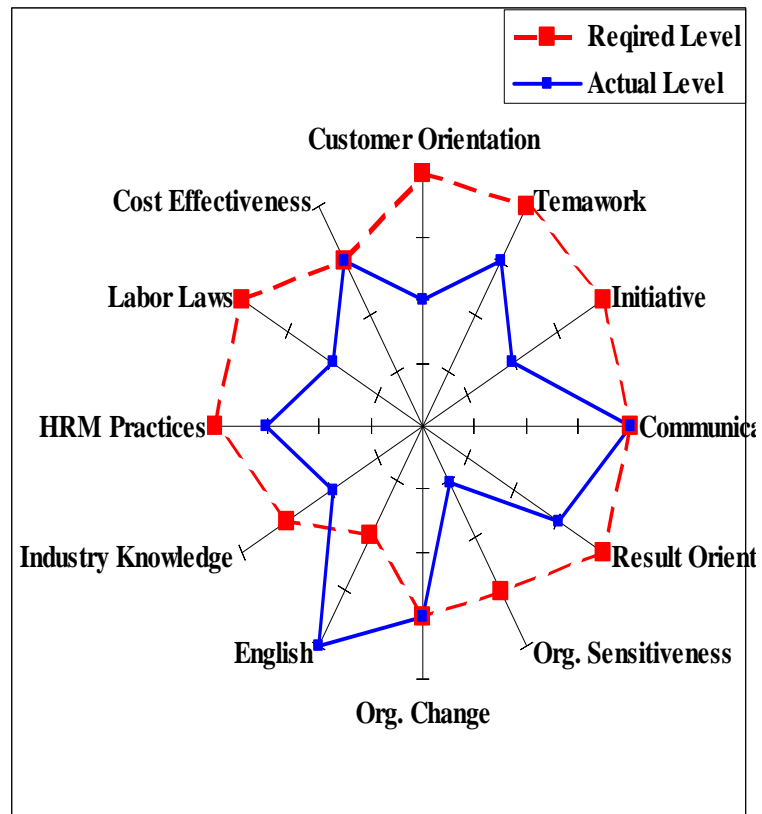
### 7.1.9 Organisation Chart



### 7.1.10 Competence Gap

The company uses the competence gap analysis to determine the performance of the employees. The variable pay component is based on the competence demonstrated by each employee in identified competence variables as shown in the competence gap chart. The other main purpose of the competence gap is to provide training and education to narrow the gap of employees.

## Competence Gap



### 7.1.11 Job Evaluation

In the job evaluation process, there are altogether 7 dimensions of:

1. Job Scope/Impact
2. Judgement/Decision
3. Job Complexity
4. Communication/Interaction
5. Leadership
6. Education/Knowledge

## 7. Experience/Skills

Each of the dimensions is further sub-divided into 25 categories and the job is evaluated based on a four-scale method.



### 7.1.12 Grade Conversion Table

Points are given to the employees based on the grades. For this purpose the grade conversion table is used and points range determined.

## Grade Conversion Table

Grade	Point Range
9	2105-2350
8	1855-2100
7	1605-1850
6	1355-1600
5	1105-1350
4	855-1100
3	655-850
2	455-650
1	255-450

*\* Data for Illustration Only*



### 7.1.13 Job Grade and Structure

The jobs are then divided into the various grades, with the highest post of the President in Grade 9 and the assistant in Grade 1.

## Job Grade & Structure

Grade	Managerial	Marketing/Sales	Operation/Marine	Administrative
9	President			
8	Vice President CFO, COO			
7	Director			
6	Sr. Manager			
5	Manager			
4	Assistant Manager	Sr. Specialist Sr. Sales Rep.	Sr. Specialist Sr. Port Captain Sr. Port Chief Engineer	Executive Assistant Executive Secretary Sr. Specialist
3		Specialist Sales Rep.	Specialist Port Captain Port Chief Engineer	Specialist Accountant Secretary
2		Specialist Sales Rep.	Specialist	Specialist Accountant
1		Assistant	Assistant	Assistant



*\* Data for Illustration Only* 17

### 7.1.14 Salary Structure

The salary structure is based on four quartiles, Q1 to Q4, with the starting salary of the grade in Q1 and goes on to Q4, reflecting the highest range of the respective grades.



## Salary Structure

G	Minimum	Mid Point	Maximum
9	139,000	200,000	261,000
8	107,500	154,000	200,500
7	83,500	119,000	155,700
6	65,600	93,600	121,600
5	52,000	73,800	95,600
4	41,500	58,650	75,800
3	33,500	47,000	60,500
2	27,200	38,000	48,800
1	22,300	31,000	39,700

*\* Data for Illustration Only*

### 7.1.15 Enterprise Level Performance-Based Compensation System

#### **Salary Increase Align with Performance**

<b>Compa-Ratio</b> <b>Rating</b>	<b>≤ 75%</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>≥ 125%</b>
<b>Excellent (10%)</b>	<b>12%</b>	<b>11%</b>	<b>10%</b>	<b>9%</b>	<b>8%</b>	<b>7%</b>
<b>Outstanding (15%)</b>	<b>10%</b>	<b>9%</b>	<b>8%</b>	<b>7%</b>	<b>6%</b>	<b>5%</b>
<b>Good (50%)</b>	<b>8%</b>	<b>7%</b>	<b>6%</b>	<b>5%</b>	<b>4%</b>	<b>3%</b>
<b>Fair (15%)</b>	<b>6%</b>	<b>5%</b>	<b>4%</b>	<b>3%</b>	<b>2%</b>	<b>0</b>
<b>Need To Improve (10%)</b>	<b>2%</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

● **Q1: 75%-87.5%**    **Q2: 87.5%-100%**    **Q3: 100%-112.5%**    **Q4: 112.5%-125%**




*\* Data for Illustration Only* 21

### 7.1.16 Performance-Based Bonus Payment

<b>Year-end Bonus Align with Performance</b>					
<b>Rating</b>	<b>Excellent (10%)</b>	<b>Outstanding (15%)</b>	<b>Good (50%)</b>	<b>Fair (15%)</b>	<b>Need to Improve(10%)</b>
<b>Bonus Weight</b>	<b>2</b>	<b>1.5</b>	<b>1</b>	<b>0.5</b>	<b>0</b>
<b>Bonus (Month)</b>	<b>8</b>	<b>6</b>	<b>4</b>	<b>2</b>	<b>0</b>

*\* Data for Illustration Only*



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### 7.1.17 Profit Sharing Practice

<b>Profit Sharing-Stock</b>					
<b>Seniority Grade</b>	<b>≤ 1 Yr</b>	<b>1-3Yrs</b>	<b>3-5 Yrs</b>	<b>5-10 Yrs</b>	<b>≥ 10 Yrs</b>
<b>9</b>	<b>160</b>	<b>320</b>	<b>480</b>	<b>640</b>	<b>800</b>
<b>8</b>	<b>130</b>	<b>260</b>	<b>390</b>	<b>520</b>	<b>650</b>
<b>7</b>	<b>110</b>	<b>220</b>	<b>330</b>	<b>440</b>	<b>550</b>
<b>6</b>	<b>90</b>	<b>180</b>	<b>270</b>	<b>360</b>	<b>450</b>
<b>5</b>	<b>70</b>	<b>140</b>	<b>210</b>	<b>280</b>	<b>350</b>
<b>4</b>	<b>50</b>	<b>100</b>	<b>150</b>	<b>200</b>	<b>250</b>
<b>3</b>	<b>0</b>	<b>60</b>	<b>90</b>	<b>120</b>	<b>150</b>
<b>2</b>	<b>0</b>	<b>40</b>	<b>60</b>	<b>80</b>	<b>100</b>
<b>1</b>	<b>0</b>	<b>20</b>	<b>30</b>	<b>40</b>	<b>50</b>

<b>Excellent</b>	<b>Outstanding</b>	<b>Good</b>	<b>Fair</b>	<b>Need To Improve</b>
<b>* 1.3</b>	<b>* 1.1</b>	<b>* 1</b>	<b>* 0.9</b>	<b>* 0.7</b>

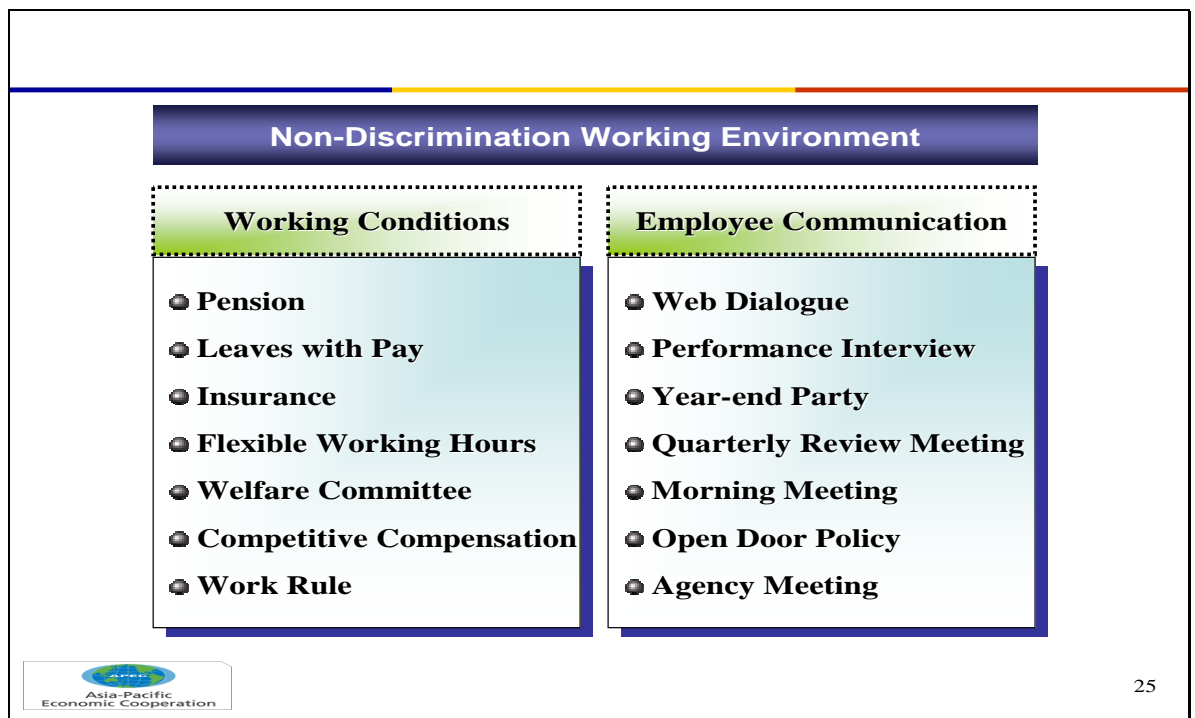
*\* Data for Illustration Only*


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### 7.1.18 about Management in the Company

- No Trade Union
- No Collective Agreement
- Less labour dispute
- Non-Discrimination Working Environment

The non-discrimination work environment is based on the working conditions and employee communication outlined below:



## 8.0 Case 2: Financial Institution

### 8.1 The Organisation and its Challenges

The organisation was established in China and restarted its business in Chinese Taipei. The company operates its business in Chinese Taipei for more than 40 years. Its core business is financial service (banking) focus

in Asia. There are 1,600 employees work at twenty departments and 52 branches in Chinese Taipei, and around 600 employees work at China and Hong Kong. The Chinese Taipei government opened banking industry into free market and deregulated for more than 15 years. Some banks were changed from state owned to privately owned. Some banks offer a wide variety of services to a diverse of customers; others offer a limited set of traditional services to a largely homogeneous set of customers. The industry is growing faster than the past years and is getting more competition. Due to Asia financial crisis in late 1990s, the company encountered a lot of challenges in finance, customer retention and new service development. The board of directors asked CEO and its management team to study the necessity and possibility of reengineering the business model, process, and organisational structure, and to strengthen its human capital in order to overcome the severe challenges. But the reality and difficulties are, as an old and bureaucratic organisation, it lacks not only the knowledge and skills, but also the momentums with which to make organizational change effectively for the most of the employees and managers.

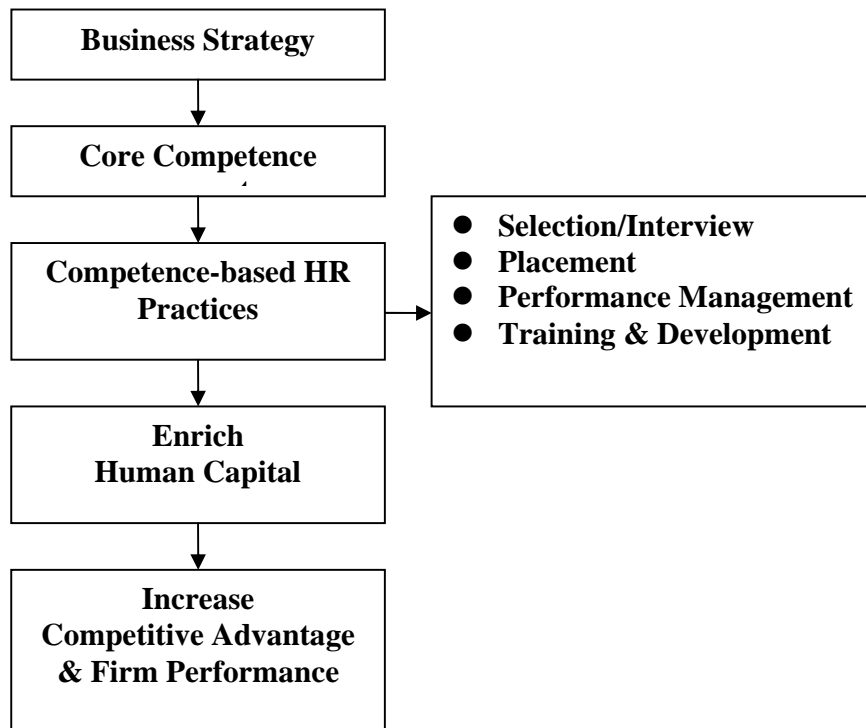
Given that reality and difficulties mentioned above, in order to speed up the organisational change, CEO decided to invite external consultants to start the reengineering project in 2000. The project scope included developing the bank's business strategy, key performance indicators, core competence, competence-based human resource practices. The study addresses previously neglected areas of competence-based human resource practices role in business reengineering process in an attempt to increase our understanding of this increasingly key topic. To accomplish this objective, we explore several aspects of the following research question: What is human resource's role in this reengineering process? How to develop firm's core competence? How to implement competence-

based human resource practices? How can human resource practices increase firm's human capital?

## **8.2 Reengineering Process**

Although the company has had its business strategies in the past years, it is obvious that those strategies have not worked out in terms of increasing or maintaining the company's competitive advantages. The first step is redefining corporate business strategy that can help the company gain sustain competitive advantages in the banking industry. Second, based on the strategy, management team develops firm level core competence as an infrastructure to implement competence-based human resource practices that can increase employees' human capital. Third, human resource professionals conduct several activities to train and help line managers to implement competence-based interview, placement, performance management and training program. The final purpose is to enrich company's human capital and increase its competitive advantages & firm performance (see Figure 5).

**Figure 5: Reengineering Process**



### **8.3 Business Strategy**

In the changing and uncertainty environment, it is necessary to review current business strategy. CEO, management team and consultants redefine business strategy after diagnosing internal and external issues. We have labeled rapid growth from traditional operation to agile operation, develop new product/service, and approach new clients (see Figure 6).

**Figure 6 : Business Strategy**



#### **8.4 Model of Core Competence**

An opposed to the product/market strategy, the core competence of a firm is a bundle of skills and technologies that represents the sum of learning across individual skill sets and individual organisational units (Wright, McMahan, McCormick & Sherman, 1998). A core competence provides a competitive advantage through being competitively unique and making a contribution to customer value or cost (Prahalad & Hamel, 1990). Based on the above business strategy, the company developed a set of company wide core competence as an infrastructure to implement human resource practices and increase competitive advantage.

Management developed six core competencies which included customer orientation, teamwork, initiative, responsible, result orientation, professional knowledge in banking industry. The definitions are described as followings:

- **Customer orientation:** Works to clarify and exceed customers' expectations. Shows concern for customers' problems. Is friendly and understanding. Encourages customer focus in others.



- **Teamwork:** Effectively working with members within the departments to achieve organisation's goals. Is helpful and co-operative. Makes every practical effort to meet customer needs? Is flexible and reacts positively to changes in instructions or plans. Is team spirited? Is supportive to other members of the team and helps them when necessary?
- **Initiative:** Is proactive and uses initiative to respond to customer needs? Is conscientious, reliable and meets commitments? Is keen to take responsibility?
- **Responsible:** Willing to take the responsibility of personal decisions or actions.
- **Result Orientation:** Effectively developing, utilizing resources, methods, systems and processes. Using the most efficient ways to maximum investment return ratio.
- **Professional Knowledge in Banking Industry:** Knowledge, skills that are necessary to daily operation. Employees can bring valuable benefit to clients through those knowledge and skills.

### **8.5 Competence and HR practices**

The company used the above competence model to develop HR practices in the fields of selection, interview, placement, performance measurement and management, training and development. Competent human resource professionals recognize the requirements of the profession and are willing to invest in maintaining and improving their skills and knowledge during rapidly changing times (Losey, 1999). As Losey stated in his article in this issue, developing competence is a combination of education, experience, interest, and raw capability (ethics).

The competence work provides a roadmap for the content of HR practices. Wright (1998) argued that the most important type of horizontal fit among HR practices to organisations would be when the practices all

promote the same organisationally relevant outcomes. Recent emphasis on competence models provides a basic framework for creating horizontal fit. Such models identify a relevant set of behavioral competencies, and then HR practices can be designed to complementarily promote the selection and development of those competencies in individuals (Wright & Boswell, 2002).

### **8.5.1 Competence-based selection and interview**

As mentioned, the company adapts competence models to select and interview candidates to identify their competencies level. First, besides the company wide core competence, line managers identify every job's professional competencies & levels and send to his/her upper managers for approval. Human resource manager works with line managers conducting the interview or other selection tools. After the interview process, they join together to identify candidates' competencies level and the gap between the actual and the job required.

### **8.5.2 Competence-based Placement**

The internal transfer, promotion, relocation, termination, succession plan and other placement practices use the competence model to identify internal candidates' competence level. Line managers and HR manager join together to decide the placement decision. The competence gap graph is helpful in clarifying the complexity inherent in each of these competencies. Furthermore, it helped management to diagnosis individual's strength and weakness to increase the likelihood of people-job and people-organisation fitness. Management makes decisions to promote, transfer, relocate, and terminate employees through the competence map.

### **8.5.3 Competence-based Performance Management**

Employee's performance rating is determined by personal goals and individual competencies. At the year-end, managers set goals with employees for the next year. At the same time, managers describe the job competencies level that employees are expected to perform/ behave. The combination ratio of goals and competence is 80:20. It means employee's annual performance rating is determined by 80% goal achievement and 20% competence level. The company intends to build up a culture that results and knowledge, skills & behaviors are important in the organisation. In another words, employees not only are expected to achieve their annual business goals but also expected to demonstrate their behaviors, attitudes, skills as required based on their job and rank. Managers review employees' annual performance based on the competence model and provide the feedback of gap to ask them to improve in certain period.

### **8.5.4 Competence-based Training and Development**

Within the framework, line managers identify their subordinates' training needs. They can realize what and why employees can not obtain their performance goals. At the same time, they can judge employees competence levels based on their goal achievement rates. Human resource professionals collect data from different functions and business lines, then draft the training programs for various jobs. For example, the company develops leadership, decision making, people management and business strategy programs to management team. Negotiation, customer service, time management and industry development trends are provided to sales team.

## 8.6 Human Capital and Person-Job Fit

Sound people management skill in organisation is a key to success. It is the core responsibility for line managers, not just the human resource professionals. Barney (1991) argued that sustained competitive advantage derives from the resources and capabilities a firm controls that are valuable, rare, imperfectly imitable, and not substitutable. Those resources and capabilities can be viewed as bundles of tangible and intangible assets, including a firm's management skills, its organisational process and routines, and the information, knowledge it controls. A firm's human resources, including all of the knowledge, experience, skills, and commitment of a firm's employees and their relationships with each other and with those outside the firm can provide a source of competitive advantage (Barney & Wright, 1998; Boxall, 1998; Snell, Youndt, & Wright, 1996). Human capital refers to knowledge that is embodied in people (Coff, 2002). Human capital is critical to maintain competitive advantage since organisational capabilities are created by transforming human capital into group or firm level knowledge (Nonaka, 1994). Though firm's human capital can be gained from "make-or-buy" strategy (Miles & Snow, 1984). In general, firms often make and buy their human capital (Lepak & Snell, 1999). After discussing with consultant group and within high-level management team, the company decides to increase its human capital through implementing the competence-based HR practices: selection, interview, placement, performance management, and training & development.

Person-Job fit is concerned with finding a match between the skills, knowledge, and abilities needed to perform the relatively static technical aspects of a job and individuals who have these abilities (Werbel & Johnson, 2001). Person-organisation fit is conducted at the organisational level of analysis. It concerns the value congruence between the worker

and the organisational culture and is concerned with organisational socialization processes (Chatman, 1989). Ideally, the two types of fit are important. Organisations should make efforts to address the types of fit given that each impacts employee motivation and organisational effectiveness. Organisations would like to examine the person-job and person-organisation fit to evaluate their effectiveness.

The company implements competence-based HR practices to increase person-job and person-organisation fit that can achieve organisational effectiveness. After three years' implementation, the Company's sales grew up 22.5%, 13% turnover for unfit staff, employee satisfaction increased 23%, customer retention rate increased to 85.6%. The specific role of competence-based HR practices play in business reengineering process is explored. It also helps to strengthen person-job and person-organisation fit in dynamic organisation.

The company set up a three-years financial goal which is US\$100 million. After the reengineering process, 2004 financial statement says the goal is completely achieved, US\$103.5 million.

## **9.0 Conclusion: Issues and Challenges**

It is clear that an inappropriately designed compensation scheme can be counter productive. Moreover, any company can move from paying equally to pay equitably, if not, they will not get loyal workers and there will be no alignment between workers and business results. However, in practice it had been proven that the variable component in the company's pay system has motivated the staff to perform and makes them aware of the company's business performance. The design of a good performance-

based compensation is fruitful and essential for companies to enhance competitiveness.

Chinese Taipei is now encouraging companies to move to the performance-based system to help enterprises and employees to achieve a win-win situation and to enable both the employers and employees to move together for success. However, companies should understand that the performance-based system is not to exploit employees but to foster employees as the human capital for the company. Although the move towards a performance-based system is a hot issue for all companies in Chinese Taipei to seek an opportunity to achieve a more flexible salary regime, there are several implementation problems that need to be addressed:

1. Many employees, especially in the service sector, are not in favor of the performance-based system as they are afraid that the performance level ascertained by the companies are not realistic and will not be achievable even if they perform well. There is also a belief that the system will add on to their workload without additional compensation.
2. The objective of most firms to implement the performance-based compensation system is not to motivate employee, but to or cut down the labor cost. With this objective, the design of the system is biased towards employers and thus when the system is implemented; it will lead to higher staff turnover.
3. Performance appraisal system and the skill to conduct this system is essential for implementing the performance-based compensation

system, however, many enterprises fail to deliver a good appraisal or review procedure which can appraise employees with transparency and equity. The performance factors developed for appraisal is often not measurable, and employees are wary about it.

4. If there is an in-house trade union, they will challenge and resist this system. If firm fails to discuss and negotiate the system with trade union and gain their acceptance, then the system will not be implemented.

5. Performance-based system is a challenge and requires commitment from both parties. Performance-based is task-oriented, rather people-oriented, when company employs performance-based system there is a fear that employees will only focus on performance and not on commitment or quality, this will in turn affect the overall development of company.

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