Incentives for change
Rewarding performance in national government networks

John Makinson
Acknowledgements

This has been a collective project from the outset and I owe a considerable debt to those who have worked with me to develop the recommendations in this report. The agencies and departments involved have contributed expertise and enthusiasm, generating many of the ideas in this document and ensuring that whatever we recommended was capable of practical implementation. I thank in particular all those who participated in the project’s steering group.

The project received helpful support from HM Treasury and The Cabinet Office. Their advice ensured that our recommendations were consistent with the direction of policy elsewhere in the public sector.

Many other organisations, most of them listed in Annex B, gave generously of their time and experience. Their co-operation allowed us to learn from both the mistakes and the successes in the public and private sectors. The report would have been a lot poorer without their help.

My colleagues on the Public Services Productivity Panel have contributed many useful suggestions, as have several other wise individuals who kindly took the time to review the report in draft form. Many of these suggestions have been incorporated in the final document.

Finally, I should like to thank four people by name for the simple reason that without them this report might never have seen the light of day. Steven Flanagan was both a highly effective co-ordinator of the project and a constant source of great ideas. Delia Bushell, Andrew Midgley and Susan Taylor, all of them colleagues at Pearson, somehow found the time to undertake the fieldwork, correct my mistakes, write the Annexes and generally contribute a wealth of expertise to the project. My sincere thanks to them all.

John Makinson.
Foreword by the Chief Secretary to the Treasury

Successful public services lie at the heart of a successful economy and society. At their best they respond quickly to their customers, operate efficiently and set the highest standards of quality and probity. In practice there have been wide variations in quality and in some areas ineffectiveness and waste have been tolerated. Modernising government – the drive to achieve better, more responsive government and public services – means raising all services to the standards of the best and recharging our public organisations with fresh vigour, incentives and ideas.

As part of its comprehensive plan for modernisation, the government has recruited a team of top private sector managers to the Public Services Productivity Panel – with a remit to advise on improving efficiency and productivity. The focus on productivity is linked in particular to the Public Service Agreements (PSAs), now published for all government departments, which enable the government to track performance, improve accountability, sharpen responsiveness and inform investment. The role of the panel is to support departments in raising standards to achieve or out-perform their PSA targets, providing a source of practical ideas and new approaches.

Each member of the panel is focusing on a different area, working with individual government departments and agencies to identify solutions that will increase productivity. In doing so, the panel recognises that there is no monopoly of wisdom in the private sector about how to raise productivity. Instead, it is the blend of fresh ideas and learning from good practice in our public services that can provide the spur to improvement. The findings of each project will be published and the government aims to draw together the overall lessons of the panel’s work during the first half of 2000.

John Makinson, Group Finance Director of Pearson plc, has taken a close look at performance incentives in the four big networks of offices through which most people come into contact with in the government. He has made radical recommendations which, I believe, will help unlock the potential of the public sector to improve services to the citizen, with significant benefits to staff and taxpayers alike.

Our challenge now is to translate these findings into clear and meaningful public benefit. Expectations of all who use public services are rightly ambitious. By involving valuable private sector experience in our drive to modernise government, our promise is to match that ambition with excellence for the many, not the few.

Rt. Hon. Andrew Smith MP
Chief Secretary to the Treasury
Chapter one
Summary of conclusions

This report begins with two simple assumptions: the first is that performance incentives can improve productivity within the public sector; the second is that most incentive arrangements in place today are ineffective and discredited. These assumptions frame the agenda for this document. While the narrative will reflect the doubts and qualifications that are unavoidable in such a complex project, it is worth stating at the outset my conviction that a reform of incentive structures can and should result in a better service to the customer at a lower cost to the taxpayer.

The scope of the project

This project was conceived in March 1999 as part of the work of the Public Services Productivity Panel and was developed in consultation with the four large government departments and agencies that are the subject of the study: the Benefits Agency; HM Customs & Excise; the Employment Service; and the Inland Revenue. Our remit was to analyse the operation of performance-based incentives within the four organisations and to make recommendations about how they might be improved. The focus of the project was pay-based incentives, although we also considered other ideas for motivating staff. The strong affinities between the four agencies in this study make them the natural starting point for an exploration of new incentive ideas within the public sector.

Why performance incentives?

Before embarking on any analysis, it may be useful briefly to review the purpose of performance incentives and the question of whether or not they work.

The majority of private and public sector organisations in the UK operate performance-related pay schemes. Their application has grown considerably over the past decade and, when operated successfully, they have the following merits:

- They clarify objectives and engage employees more directly with the goals of the organisation
- They motivate employees by linking an element of compensation to the achievement of targets rather than length of service
- They reward achievement and identify areas of under performance
- They foster a culture based on teamwork and fairness.

These schemes have delivered real benefits in the past:

- Bullock and Lawler’s 1984 study of 33 plans found that 75% reported a rise in productivity and/or quality with gains ranging from 4.5% to 23.7%.
- Sun Life Assurance saw controllable cost reductions of 30% and improvements in turnaround of 45% after the introduction of team incentives in its processing activities.

These attributes are generally recognised by employees within the four agencies. A recent large scale study of employee attitudes towards performance-related pay found widespread support for the principle of paying for performance within both the Employment Service and the Inland Revenue, the two government agencies participating in the study. Within the Employment Service 72% of respondents agreed that the principle of relating pay to performance was a good one, while the comparable percentage at the Inland Revenue was 62%.
Yet the research also showed that the operation of performance-related pay was not effective in either organisation. This was evident in answers to a wide range of questions but, by way of illustration, a large majority of respondents in each agency thought that performance pay had helped to undermine staff morale and had failed to increase either the commitment of staff or the quality of their work. This stark contrast between approval of the principle and disenchantment with the practice of performance pay may be attributable in part to the availability of funds and design flaws within the schemes themselves but, in the view of all four agencies, it also reflects weaknesses in execution and the absence of a clearly defined performance management framework.

The framework for incentives

All of us who have worked on this project have recognised the danger of placing the cart a long way in front of the horse. An incentive scheme can only operate successfully within a system of performance management which has the following characteristics:

1. Managers must have the skills, experience and delegated authority to implement the scheme.
2. The overall compensation structure must be flexible and motivational.
3. Management information systems must measure performance quickly and accurately.
4. Funding arrangements must permit the benefits of achievement to be shared with employees.
5. Targets must reinforce the psychological motivation of employees and be clearly communicated.

None of these conditions is fully present within the four agencies and there is consequently a risk of designing a scheme which is incapable of effective implementation. We have tried to recognise the practical limitations in framing the key recommendations set out below.

Recommendations

The recommendations of this report are set out in more depth in the following section but they can be summarised as follows:

1. The size and structure of incentives will vary by level and function, but they should all reinforce the strategic objectives of the organisation and provide consistency of purpose from top to bottom.
2. The setting, monitoring and payment of performance incentives should be kept separate from the appraisal process in order to make a clear distinction between short-term performance and long-term career development. Similarly, performance awards should be clearly differentiated from basic pay, and from any adjustments made to basic pay for other reasons.
3. Performance reward should be one element in an overall approach to employee incentives which recognises the importance of other forms of recognition.
4. A high priority should be attached to consultation with employees, and their representatives, as well as to simple and regular communication.
Incentives for change

Targets and incentives

1. All incentives should be SMART (Specific, Measurable, Achievable, Relevant and Time limited), as well as Effective and Rewarding.

2. Every member of staff should have a bonus opportunity representing at least 5% of base salary.

3. Incentives should relate to targets already embodied in the Public Service Agreements (PSAs) of the respective agencies and no employee should be judged on a wide range of targets. As a rule of thumb, five targets should be the maximum for junior grades and eight targets the limit for more senior staff.

4. All incentive packages should include both financial and non-financial targets with the goal of yielding improvements in both customer service and productivity.

Distribution of incentives

1. No incentive scheme should prejudice the rights of employees who are delivering satisfactory performance to a fair rate for the job. The structure of basic pay should not act as a disincentive to improved performance. But the role of incentives is to encourage and reward ever better performance. Bonus differentials must be widened if that objective is to be achieved.

2. There is a role for both individual and team-based incentives within all of the agencies. But it may be unrealistic to combine the two for employees at the lower end of the salary range. Team-based incentives should become the norm for the great majority of employees working in national office networks.

3. Team-based incentives should in general relate to the performance of an individual office. The relative performance of offices and districts should be made widely available within each agency.

Funding of Incentives

1. Bonus payments should not be consolidated into base salaries and should not count towards salary for pension purposes. This will create funding headroom for more meaningful annual awards.

2. Incentives should be funded largely from improved productivity and the Treasury should be ready to share with agencies the benefits of financial achievement. The entitlement of individual agencies should be based on their overall performance. Conversely, funds which have been allocated for performance incentives should only be released if targets have been reached.

3. Extra funding for performance incentives should be released not just for making cost savings, but also for better than targeted service delivery and overall performance.

Timing and further work

Much work will need to be done in drawing up detailed systems based on these recommendations, both by the managers of the four agencies, and in consultation with their staff and their representatives. The active co-operation and support of parent departments, the Treasury, and the Cabinet Office will be crucial.

Several agencies have expressed a desire to pilot elements of the recommendations in the financial year 2000-01. If the trial period confirms that the recommendations in this report are capable of practical implementation then, with the right level of commitment, full implementation should be possible in the year beginning April 2001.
Chapter two
Analysis

The recommendations of this report should be seen against a background of innovation and activity. Annex A (Departmental Studies) describes the development of performance-related pay in each agency and recognises the considerable progress which has been made, as well as the challenges and constraints still being felt by senior management. The four agencies have natural affinities:

- Each employs a large staff, with a high representation of clerical and administrative workers earning relatively low salaries. Collectively the four agencies employ just over 200,000 people, the great majority of whom earn less than £20,000 a year. Trade union representation is high in each agency.
- Each has a direct relationship with the public through a national network of offices. The work of each agency is technically complex and fast-moving. Employees need to absorb frequent changes to the tax and benefits regime in what is often a stressful working environment.
- Each is addressing the impact of technology on service delivery. The telephone and, in time, the Internet will become more effective media for communication with customers. There is a resulting requirement for new skills and more flexible working hours.
- Each delivers a service to its customer, the quality and efficiency of which is susceptible to objective measurement. Moreover, some of the service is consistent across a national network, making it practical to benchmark the performance of individual offices and districts.

The characteristics of all four organisations also invite comparison with the private sector. High street banks and even supermarket chains share almost all of the attributes listed above and are a fruitful source of ideas and good practice.

The four agencies have a further and, for the purposes of this study, essential common characteristic. They are all organisations with a commitment to modernisation and with long experience of managing performance pay schemes. There is, as a result, a high level of relevant expertise within each agency, a positive attitude towards innovation within senior management and a fund of employee attitude data against which new ideas can be tested. Without the benefit of these resources it would not have been possible to develop the recommendations in this paper.

There is no doubt that incentive schemes are easier to create and administer in the private sector. The primary objective of the public company is to create value for its shareholders, a goal which is both simple and measurable. Once financial targets have been aligned with the interests of the shareholders, they can ripple easily through the organisation. The profit motive is plainly absent in the public sector and it is therefore much more difficult to set simple objectives which have a general application and command widespread respect.

Each agency needs to meet policy objectives which are often diffuse and occasionally contradictory. Particular emphasis on one measure of productivity can easily cause a loss of efficiency elsewhere. If staff at the Benefits Agency, for example, receive rewards based on increasing the speed with which claims are processed, the result may be reduced accuracy and higher processing costs. Securing a balance between speed and accuracy, or service and productivity, is not a problem unique to the public sector. But the need to serve a political as well as a commercial agenda can make it harder to get the balance right.

The political context also creates unwanted complexity. New policy objectives result in new agency targets but rarely in the disposal of old ones. Once a target has been publicly espoused by government it is difficult to discard even when a new one comes along. In order to address this problem, it may be necessary to differentiate more clearly between strategic and operational targets, as well as between data that needs simply to be collected and information that drives key objectives.
Public sector organisations also operate within more rigid funding constraints. In the four agencies, money which is made available for performance-related pay is part of a system of running cost limits and pay remits agreed with the Treasury in advance and not then increased to recognise outstanding performance or withdrawn if targets are not met. In the private sector, by contrast, performance incentives are generally more fluid. Once the overall arrangements have been agreed with shareholders, the rewards for exceptional performance can be much greater and the penalties for failure more marked.

These constraints help to explain why the appeal of performance incentives has gained ground only slowly in the four agencies. But there are also cultural factors at work. The principle of fairness and equality is firmly embedded and operates against wide differentials in performance pay, particularly when the information supporting the differentials is not objective. Money is also less of a motivating factor in organisations where the appeal of public service is very high. But it is important to recognise that properly constructed incentives will support the objectives of public service. If the outcome is an improved quality of service for the customer and a more cost-effective result for the taxpayer, no one is the loser.

There has been a tendency, in this highly unionised area of the economy, to see the traditional and positive values of public service as being opposed to the modernising agenda, with change seen more as a threat than an opportunity. Public sector trade unions have moved a long way in the direction of more flexible working arrangements in the past five years but, rightly or wrongly, they remain opposed to the principle of performance-related pay and suspicious of changes to more market-facing pay structures which are the norm in the private sector.

In preparing this report, we have conducted extensive interviews with other public sector agencies, privatised bodies and relevant private sector companies. There is no monopoly of wisdom within any of these sectors and there is much that has been implemented successfully in the private sector which would be neither practical nor desirable within the organisations that are the subject of this report. None the less, it would be unwise to suppose that we cannot learn from best practice elsewhere. Annex B (Benchmarking) analyses current trends in performance management across the UK economy as a whole and the principles of many current performance reward techniques have been embodied in our recommendations.

**Performance management**

As we stated at the outset, performance incentives can only achieve their full potential when certain other conditions are present. It is worth reviewing them in more detail:

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Managers must have the skills, experience and delegated authority to implement the scheme

All four agencies are agreed that the quality and qualifications of line management, and the weaknesses of the performance management system, represent a potential obstacle to the successful implementation of any incentive scheme. This view has been corroborated by successive studies of employee attitudes toward performance-related pay. The most recent report identified rising concern about the ability of management to implement a fair and objective performance system. While the perceived quality of management is certainly an issue, so too are the limitations of the organisations themselves.

The size of each of the four agencies, the prevalence of a conservative business culture, the difficulty of securing funds for training and the shifting agendas created by political change have together made it almost impossible for senior management to establish a consistent set of goals and measures against which performance can be judged and managed.
The agencies are for the most part centralised organisations with a strong reliance on written procedure. This will make it difficult to devolve responsibility for the flexible implementation of an incentive scheme far down the management chain. None of these problems will be solved quickly or easily, so it will be important for the design of any incentive scheme to recognise the status quo. In the early years at least, this argues for simple and centrally managed schemes with a strong emphasis on objective assessment.

The active and visible support of the leadership of each agency will be critical to the success of any scheme. Delegation of responsibility for implementation exclusively to the human resources function, or the impression of half-heartedness on the part of senior management, will doom any scheme to failure. This is all the more true in organisations where performance-related compensation is often queried in principle and discredited in practice. A commitment to radical change in the operation of performance incentives must also be visible within the sponsoring departments of each agency and within HM Treasury.

The majority of civil service departments and agencies operate a salary structure which groups employees into a small number of bands with wide ranges. The employment profile of the four agencies is set out in some detail in Annex A. It is not uncommon for an employee demonstrating satisfactory performance to take 25 years to make the long journey from the bottom to the top of a particular band. A new recruit to the Inland Revenue would typically take nine years to reach a point 60% up the range of the pay band and a further 15 years to reach the 80% point. Since the skills required for the job can generally be learned within two or three years, the structure creates frustration and offers little opportunity for outstanding performance to be rewarded. Progress is determined, in practice, by length of service rather than individual merit in the great majority of cases.

While incentives may go some way towards addressing this problem, they cannot be a substitute for a more flexible salary structure. The agencies themselves regard improvements to the basic pay system as a prerequisite for staff acceptance of a new performance incentive structure. Several related issues need to be addressed if this problem is to be solved.

The banding structure should be made more flexible, allowing for more rapid progression, say within three to four years, to a market rate for the job, a level which can be calibrated through the use of benchmark data. Salaries could be adjusted to attract exceptional talent and movement between bands could be facilitated. This approach would, however, cause rapid bunching towards the top end of pay bands and breed resentment, particularly among employees who were in place before 1993, when the present arrangements were introduced, whose further progression would inevitably be curtailed. There would also be short-term funding implications which could be addressed, in part at least, through a wholesale move to non-consolidated bonuses.

The rigidity of the pay structure is reinforced by the box-marking system which is widely used across the Civil Service. Employees are assessed on a narrow range of markings, with the allocation of grades often agreed in advance. While the system should not penalise satisfactory performance, a quota-based approach discourages managers from differentiating between good and poor performance. In one representative agency, 80% of all staff are awarded a B marking, while only 1% receive a D marking. This ludicrous imbalance makes it difficult to address problems of under performance and where necessary make room for new blood. The problem is compounded by relatively low staff turnover in all four agencies. Retention rates average nearly 95% across the four agencies. However, there are strong variations both between localities and, markedly, between age groups. Of those leaving the Benefits Agency, 50% have been there for less than three years.
Incentives for change

A recent study by the Reward Group concluded:

“Although there are some regional variations within the civil service, they are certainly not as marked as in the external market. Some regions differ significantly from the external market, which could give cause for concern. For instance at SEO grade, regional variation within the civil service is roughly 5% either side of the [national] market, whereas for similar jobs in the external market the pay range is much wider, from 8% below to 24% above the average. HEOs working in the civil service in outer London can expect to receive average pay about 3% above the national average, and 6% above for inner London. Similar jobs in the external market would typically be receiving a premium of 8% in outer London and 24% in inner London.”

The compression in the pay system makes it harder to introduce specialist skills or private sector expertise at more senior levels within each organisation. Unless a concerted effort is made to create more movement in and out of the agencies, it will be difficult to stimulate a change in established attitudes and behaviour.

Individual pay and benefit packages are highly inflexible. Benefits, including pensions, can and should be made more flexible but it would also be desirable to offer employees the option of a more limited benefit package in exchange for a richer incentive opportunity. Employees might also choose to limit the duration of their contract by devoting their time to a specific project which offers a high bonus opportunity in return for lower certainty of future employment. Such arrangements should not be prescriptive but at present agency staff have little scope to tailor the balance of risk and reward to their own circumstances and outlook.

With the exception of a limited London weighting, there is no regional pay policy in place in the four agencies. The unsurprising result is that staff turnover rates are higher in areas with more competitive pay norms and lower elsewhere. Salaries in London and the South East are particularly uncompetitive. The highest documented rate of staff wastage is in Surrey, with 25% of clerical staff leaving annually, but this disguises variations at the level of individual offices. The complexity of the job requires a training period of 13 weeks, meaning that often the period of training exceeds the period an employee spends at work.

Regional variations in pay versus national average
Civil Service versus external market – HEO

Based on a 1999 study by the Reward Group

*HEO – Higher Executive Group

A recent study by the Reward Group concluded:

* Civil Service Rewards, The Reward Group, 1999
Pay is by no means the only contributor to high central London turnover rates but, as the average cost of recruitment and training in the Benefits Agency is £15,000, it is reasonable to assume that higher local salaries would pay for themselves through longer job tenure. There are sound arguments against the principle of regional pay, particularly where staff mobility is a key issue, but other national organisations with large office networks are moving steadily towards regional pay policy and there is a risk that agency salaries will become uneconomic in some regions unless this issue is addressed. The areas of greatest vulnerability appear to be London and cities with a high concentration of call centres. There is an urgent need to develop more market-facing pay structures in these locations as a possible first step towards a more comprehensive regional pay policy.

Management information systems must measure performance quickly and accurately

All four agencies are transaction-intensive organisations with very large data networks. The scarce resources available for investment in information technology have not surprisingly been focused on the collection and processing of data, rather than the creation of intelligent management information systems. As a result, while there is a wealth of data in each agency, little of it has been configured to monitor performance against targets.

This presents a dilemma. While information systems can track data-related performance indicators, such as processing speed or accuracy, they are not designed to interpret that data and measure, for example, the cost-effectiveness of call centres in relation to physical offices. In designing any incentive scheme, it will therefore be important to test performance objectives against the availability and accuracy of the information being used to measure them. The poor quality of some of the information currently being used to determine performance-related pay has contributed to the low regard in which the present system is generally held. It has also allowed individual managers to exercise more discretion in interpreting data than would be possible with more robust management information systems. The press reported last year, by way of example, on the systematic artificial inflation of job placement figures by staff in the Employment Service.

The doubts felt by many employees, and their trade union representatives, about the validity of data will become an even more relevant issue if, as this report recommends, differentials in performance pay are widened. This argues for a system based on targets which can be reliably measured, even at the expense of selecting sub-optimal targets.

Funding arrangements must permit the benefits of achievement to be shared with employees

The allocation of funds to performance-related pay has traditionally been agreed through the annual planning round between the agencies, their sponsoring government departments, the Treasury and the Cabinet Office. Performance-related pay is one element of a package which also includes a cost of living increase and allowance for pay progression. This process has provided the agencies with little direct incentive to exceed their targets. Outstanding performance cannot be rewarded with additional money, even when the Exchequer is the beneficiary, while conversely, failure to meet targets leaves committed funds intact. So, while there may be performance incentives within each agency, the contract between the agencies and the Treasury itself has little incentive element.

As a consequence the agencies have received little encouragement to measure the benefit to the taxpayer of achieving, or exceeding, targeted improvements in productivity. Nor has it been necessary to try to measure the impact, however small, on the performance of an agency from the operation of pay-based incentives.
It is already clear that, even if the principle of non-consolidation is accepted, there will not be enough money available within existing spending limits to create meaningful incentives. The Treasury, not unreasonably, wants to understand how the return on any additional investment in pay will be achieved and measured, but is not opposed to the principle of a more flexible system.

In the recommendations, I suggest that this problem can be addressed by finding ways of recycling funds from productivity improvements to pay for incentives. Specific examples of how this might work are set out in Annex C (Financial Analysis of Recommendations).

There is room for discussion about the recycling by the Treasury of unbudgeted cash receipts in the following broad categories. The contract between the Treasury and the agency would need to be based in every case on existing PSA targets.

- **Agency level** – the success of central initiatives in such areas as purchasing and procurement, estate planning and management, and overall headcount control. The Inland Revenue, as an example, has undertaken to identify annual savings of at least £5m on estate planning by 31 March 2002. If the actual number identified by that date was instead £10m, it might be appropriate for a proportion of the excess to be reinvested in the agency.

- **Office networks** – the greatest opportunity for productivity improvement must lie within the national office networks. This is a partial list of productivity benefits susceptible to financial measurement: improvements in the cost efficiency of call centres; the surpassing of targets for fraud detection or debt recovery; the reduction in average days lost to sickness; reduced recruitment and training costs arising from improved staff retention.

- **Specialist activities** – specific incentives could be created to reward the success of individual projects centred in the specialist areas of an agency’s field of operations. Customs & Excise, for instance, is charged with achieving an increase of at least £80m in the revenue value of detected alcohol and tobacco fraud by March 2002.

Acceptance of the recycling principle would expose the Treasury to the possibility of abuse through soft budgeting, the manipulation of data, and a failure to distinguish properly between external factors (tax receipts rising because of a growing economy) and internal drivers (tax receipts rising because of faster, more accurate collection). These challenges are present in all private sector organisations, however, and should not be decisive.

Equally, the Treasury must accept that targets should be set in a way which leaves a real prospect of a bonus payment. Setting targets too high, in order to minimise costs, would be strongly demotivating.

The proliferation of policy initiatives within the four agencies can result in additional costs, to meet the new objectives, and in the diversion of resources away from other objectives which are the subject of PSA-based bonus targets. A recent example would be the introduction of the working families tax credit, which has led to major changes in the work programmes of the Inland Revenue and the Benefits Agency. This problem will have one of two undesirable outcomes: the appearance of unfairness, or a complex adjustment mechanism to reflect the impact of the new initiatives. I would recommend that targets be adjusted only in the most extreme cases, but it will be important for ministers to understand the impact of new policies on the achievement of established PSA targets.

The acceptance of a more flexible approach to department budgeting would be a watershed for both the Treasury and the agencies. Once the principle of ‘profit-sharing’ had been accepted, however, the idea could be applied to training budgets, IT investments and other areas of discretionary spending, as well as to performance incentives.
In the early stages at least, it may be helpful to provide for a third-party review procedure in the event that agency management and either the Treasury or the sponsoring department are unable to agree on the appropriate level of the initial objectives, or the agency's success in achieving them. Such a review could be conducted within the public sector, or by a private sector accounting firm.

The scheme might operate more coherently if the performance incentives of individuals with responsibility for the work of the agencies, either within the Treasury or the relevant departments, were themselves linked to the agency's performance.

There is, of course, a downside for the agencies. To the extent that overall agency performance fall short of target, funds which would otherwise have been allocated to incentive payments would be withdrawn. A move towards flexible contracts between the Treasury and spending departments would be innovative in the public sector but it is worth emphasising that this approach is well established and uncontroversial among public companies.

It would be essential to demonstrate not simply that the funds being recycled were being found through underlying gains in productivity, but also that the achievement of those gains was being assisted by the operation of a more stretching and rewarding incentive scheme. For this reason, if for no other, it will be important to measure the effectiveness of new incentive schemes through employee research and other behavioural analysis.

\textbf{Targets must reinforce the psychological motivation of employees and be clearly communicated}\n
It is essential in any organisation for people to feel that the goals they have been set correspond to their own view of the organisation's purpose. An incentive scheme based on targets that employees do not see as relevant will not gain acceptance. The importance placed by employees on the value of public service makes this a particularly complex issue for the four agencies. An incentive scheme which overwhelmingly rewards financial progress, for example, will be viewed as the creation of Treasury ministers, or worse still private sector advisers, and be comprehensively rejected. In the same spirit, incentive arrangements must reflect the priority employees attach to the principles of fairness and equity. So, while there is widespread recognition that differentials must be broadened if incentives are to be effective, it would be counter-productive to emulate the high concentration of rewards that characterise some private sector schemes. Finally, any incentive programme must acknowledge that money is not the primary motivating factor in public service and that other forms of recognition may have as much value to employees as performance pay.

The most successful incentive schemes generate pride in an organisation's achievement and strengthen the bonds between employer and employee. This has not been a feature of the agency schemes, in part because targets are perceived to have been imposed from above with little sensitivity to the concerns of employees. This argues that a high priority should be attached to consultation, with trade unions as well as employees, and to communication.

Communication, like training, is a discretionary component of any organisation's budget. Yet the experience of the private sector is that effective communication of incentive schemes is a prerequisite of success.\textsuperscript{1}

\textsuperscript{1} See, for example, Jane Steele \textit{Wasted Values: Harnessing the Commitment of Public Managers}, Public Management Foundation, 1999
Chapter three
Recommendations

Introduction

My intention is that the recommendations in this report should be specific enough to be of practical value but not so detailed as to be restrictive. Any incentive proposals need to allow for flexible implementation and, in considering the needs of four separate agencies employing almost a quarter of a million people, it would be absurd to pretend that a one-size-fits-all approach will work. The primary focus of the report is the large number of employees (over 150,000) working in the national office networks. Many of the ideas should be applicable to senior management grades and to specialist groups within each agency but not all will be.

In developing these proposals I have been able to benefit from related initiatives elsewhere in the public sector. The Modernising Government White Paper\(^6\) has provided a valuable policy framework, while the work undertaken by the Civil Service Management\(^7\) Committee’s group on performance management has been of direct relevance and value to this report.

In view of the practical limitations that apply to performance management in the agencies, I have attempted to frame recommendations from several different angles:

- There is scope to communicate more clearly the attractive features of existing compensation packages. Benefit arrangements, for example, are already fully competitive with those available in the private sector but their value is not well understood.
- Recommendations must recognise practical limitations. We must only try to measure what is measurable and set targets which correspond both to the individual goals of employees and the strategic objectives of the organisation. This is one factor leading in the direction of team-based rewards, since public sector employees take pride in collective achievement and collective progress is generally easier to measure and benchmark than individual achievement. Conversely, the report has steered away from long-term incentive schemes since, although they encourage a feeling of ownership among employees, I do not believe they could currently be implemented with success.
- Changes must be made to performance management systems and compensation structures if new incentive schemes are to fulfil their potential. I have not as a result felt shy about discussing the opportunity for more radical change in the public sector approach to performance management and compensation. Not all of these ideas are endorsed by all of the agencies, but there is a general recognition that, for the recommendations in this report to be implemented with success, new skills and attitudes must be fostered in tandem with a higher level of investment in people and technology.

Performance framework

Recommendation 1 – a hierarchy of targets

The public sector is not short of targets. The Public Service Agreements established last year between the Treasury and other government departments contain 600 targets, of which 200 relate to internal productivity. Many of these targets identify detailed operational objectives in individual departments and have considerable local value. But there is plainly a risk that the plethora of targets will create a confusion of priorities. In developing proposals for performance incentives, it will be important to focus initially on the key strategic objectives of each agency and to ensure that the selection of individual targets will help deliver those objectives.
While the goals of senior management will be less operational than those of individual offices, there
must be a hierarchy of goals which is internally coherent. This will help to ensure the scheme's credibility
as well as its effectiveness. If managers are rewarded for the achievement of targets which are not seen
as relevant to the goals of more junior employees, it will be difficult to secure widespread support.

Recommendation 2 – pay and appraisal

There are different views and practices within the public sector about the relationship between targets
that are set for the purposes of performance pay and personal goals that form part of the personal
development review process. In most cases, the review of pay and the appraisal of performance are
combined in a single discussion between an employee and his or her immediate boss. There are sound
practical reasons for this. The experience of the four agencies is that, when the two are separated,
the motive for undertaking a performance review is weakened and appraisals are often forgotten.

Best practice, at least in the private sector, suggests that the two discussions should be separated for
the simple reason that the inclusion of a conversation about money will result in a less open and honest
appraisal. It must also be sensible to make a structural distinction between short-term performance,
which should drive the pay discussion, and longer-term career development objectives, which should
form the basis of the appraisal review. The credibility of performance appraisal is already suspect within
the agencies because of the common perception that performance marks – from A to D – are allocated
according to a quota system with box A awards being reserved for senior staff.

It may not be practical within each agency to make a quick and complete distinction between pay and
appraisal. None the less I do recommend that the design, monitoring and payment of performance
incentives be kept as separate as possible from the mainstream pay and personal development process.
This proposal is supported by three related recommendations in the report:

- Performance rewards should be based on the objective measurement of progress against targets.
The appraisal review, and indeed any general discussion of pay progression, should involve a more
subjective assessment of an individual’s strengths and weaknesses. To confuse the two would throw
into question the legitimacy of the performance-pay scheme.

- Performance rewards should recognise achievement in a particular year and should not be
consolidated into pay scales. Discussion of performance rewards should therefore be kept separate
from the review of pay progression.

- Performance payments should wherever possible aim to reward team achievement. If this
recommendation is accepted, staff can be expected to attach even more importance to their individual
performance review. But this should not become the principal forum for a discussion of team progress.

Recommendation 3 – non pay-based incentives

The report comments elsewhere on the limitations of pay as a motivating factor within the public sector.
Individual agencies have experimented with different forms of non pay-based incentives with varying
degrees of success. Some such incentives will of course have a financial cost. Examples would include
a reward scheme for innovation or the recognition of an individual office through an increase in the training
budget or the redecoration of the facility. Others will have little direct cost to the agency but will absorb
management time. There is little substitute for saying ‘thank you’ in person, but the time has to be found.

Other than to emphasise the potential value of non pay-based incentives, and the importance of making
budgetary provision for them, this report deliberately makes no firm recommendations. Reward and
recognition schemes do not travel well. What works in one organisation will not necessarily be effective
elsewhere. Moreover, while we are suggesting a centralised approach to performance rewards, non
pay-based incentives rely for their success on local flair and imagination as well as personal contact
and immediacy.
Incentives for change

14

It is critical that any new performance-reward scheme enjoys a higher degree of grass-roots support than its predecessors. I recognise that some key recommendations of this report, particularly the emphasis on team-based rewards and the proposal not to consolidate bonus payments, will provoke a sceptical initial response. It will therefore be important to consult widely, with both individual employees and with trade union representatives, before the details of any scheme are agreed.

The importance of consultation is well understood within each agency. The close relationship which has been developed with trade unions over recent years should permit new ideas to be discussed in an open and constructive fashion.

Every employee needs to hear from his or her agency chief executive or chairman, where possible in person but if not via some other personal means of communication, why the agency has introduced a new incentive scheme and what the benefits could be for the participant.

This initial communication should be supported by regular updates on performance against target. Here the public sector has a clear advantage over its private sector counterpart. Wide and regular dissemination of performance data is impossible within the quoted private sector because of the regulations governing the selective distribution of price-sensitive information. Public sector organisations suffer no such constraints and have an opportunity to publish data and comment on performance as they choose.

It would be desirable, by way of illustration, for the key recommendations of this report to be tailored to the circumstances of each agency and then sent to all members of staff, with a message of support from the chairman or chief executive, in a format which is attractive to read and easy to understand.

Targets and incentives

Recommendation 1 – SMARTER targets

Simplification has become a common theme in the setting of performance objectives and it is a theme we echo here. Most large organisations, including the four agencies, have moved to SMART objective setting. Targets must be:

- **Specific**
- **Measurable**
- **Achievable**
- **Relevant**
- **Time limited**

The SMART test is a useful benchmark for any objective and its principles are firmly embedded in the recommendations set out in this paper. In the context of the four agencies the two criteria which may cause greatest difficulty are measurability and relevance. I have commented already on the shortcomings in management information systems and the difficulty in generating measurement data which is timely and reliable. Having said that, the activities of all four agencies lend themselves readily to statistical analysis. This is not, interestingly, the view of employees themselves, at least as reflected in recent attitude research, but objectively it must be easier to measure the output of an organisation which raises taxes, distributes benefits or places people in work than it is to calibrate progress at the Foreign and Commonwealth Office or even, dare one say it, HM Treasury. In designing targets, therefore, I would recommend that strong emphasis be placed on regular and reliable measurement, validated in all cases by statistical analysis.
Relevance is also a key criterion. Members of staff need to understand and endorse the strategic objectives of the organisation and to believe that by meeting their own goals they are helping to realise those objectives. In future employee attitude research, it would be useful to understand more about how staff relate to the goals of their own organisation and to their own individual targets.

The target must of course be relevant to the organisation as well as to the employee. In other words, the achievement of the target itself must improve the effectiveness of the agency, whether financially, culturally or in relation to the quality of service delivered to the customer. To use the jargon of the trade, the input of the employee must result not just in improved output but also in a positive outcome. The target must, in a word, be effective.

Finally, targets must deliver meaningful rewards. A common criticism of current performance pay schemes in the public sector is that they do not produce worthwhile financial rewards for the recipient. The recommendations in this paper seek to address this problem by changing the approach to funding and by widening differentials. So targets need also to be effective and rewarding. At the risk of sounding glib, targets should be not just SMART, but SMARTER.

There has been wide debate over what makes a reward sufficiently meaningful to change behaviour. In the case of team-based incentives a bonus opportunity representing 3% of salary is commonly seen as the minimum, while the threshold for individual rewards is more like 5%.

I would recommend that every employee in the four agencies should be entitled, after a transitional period of two to three years, to an annual bonus opportunity equivalent to 5% of base salary, even if this is calculated by reference to team achievement. The transitional period is necessary to allow for the benefit of non-consolidation to accumulate, although it could be reduced by an element of pump-priming from the Treasury. Subject to a ceiling, the percentage opportunity might rise according to seniority.

The targets themselves should relate to goals documented in the Public Service Agreements. They will vary from agency to agency and I do not propose to be prescriptive in recommending specific targets. But two principles are important:

- There should not be too many targets. A single target would almost certainly result in a destructive distortion of behaviour. Members of staff would focus on achieving one objective at the expense of other important goals. The trade-offs between speed and accuracy, as well as between productivity and service, have already been mentioned. Conversely, a multiplicity of targets will cause confusion and lack of focus. An employee with 10 targets and a 5% bonus ceiling is unlikely to keep them all in his or her head, let alone find them motivating. I would therefore recommend that staff with a 5% bonus opportunity should have a maximum of five targets, each offering the possibility of a 1% addition to salary. At this level I would also recommend an equal weighting between individual targets. At more senior levels, with correspondingly higher bonus ceilings, I would recommend a maximum of eight targets and some modest weighting towards those targets of particular importance.

- In the private sector it is common for one or two financial targets to be common to all members of staff and for other targets to be tailored to more local or specialist objectives. While recognising that public sector organisations do not enjoy the same simplicity of purpose as their private sector counterparts, this seems to me a useful principle which binds everyone in the organisation to a shared agenda, and is worth exploring.
The Employment Service, for example, already adopts the balanced scorecard approach to targets, blending financial goals with other softer, though still measurable, indicators of performance. This approach seems essential in the public sector, given that an exclusively financial focus is unlikely to command support or indeed serve the balanced goals of the organisation. Some bias towards financial targets will none the less be essential if the agencies are to make progress in financial productivity and secure the support of HM Treasury for a more flexible approach to funding.

I would recommend that the twin cornerstones of agency incentives be financial performance and customer service. I have outlined in an earlier section some examples of how gains in productivity might be measured and shared between HM Treasury and the agencies. Customer service is also susceptible to measurement, whether in terms of speed, accuracy or customer satisfaction. Here, too, I am wary of being too prescriptive given the different financial goals of the individual agencies and the varying needs of their customers. There is, however, a natural affinity between the work of the Benefits Agency and the Employment Service on the one hand, and of HM Customs & Excise and the Inland Revenue on the other. And all four, as I said at the outset, have an overarching mission to deliver a better service to the customer at a lower cost to the taxpayer.

**Distribution of incentives**

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**Recommendation 1 – differentials**

Differentials in performance pay are, as I argued earlier in this report, extraordinarily narrow.

**Typical performance pay awards for clerical staff, 1999**

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<th>Benefits Agency**</th>
<th>HM Customs &amp; Excise</th>
<th>Employment Service</th>
<th>Inland</th>
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<tr>
<td>Best performance*</td>
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<td>Satisfactory</td>
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<td>£345</td>
<td>£400</td>
<td>£420</td>
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</table>

* Categories are generic and different systems operate in each agency.

** In addition to the performance award, Benefits Agency staff received a progression award of at least £165. Progression and performance are integrated in the payments at other organisations.

The culture of the public sector and the well-documented problems with performance management argue against moving to a highly differentiated basis for the distribution of rewards. None the less, even within the framework of the revised approach to funding I outline below, it is difficult to see how the agencies will be able to provide meaningful rewards for outstanding achievement without a significant increase in performance pay differentials.
A central weakness of the present performance pay system is the subjectivity of performance assessment, which gives rise to accusations of favouritism, and the inadequacy of existing performance management systems when they try to identify objectively the achievement of an individual. This is hardly surprising. Almost all individuals in the national office networks of the four agencies work as integrated team members and their individual contribution is difficult to distinguish from that of the team as a whole.

This problem is likely to be exacerbated by the increased interdependence of individual contributions as a result of advances in technology and by the rising complexity of the work itself. The development of call centres, for example, strengthens the case for team-based performance. There is none the less a strong preference among agency employees, forcefully expressed in attitude surveys, for an individual basis of performance assessment.

The principal argument advanced against team-based assessment is that it penalises performers and rewards passengers. This is a legitimate issue but one which can, I believe, be addressed through a more rigorous approach to individual appraisal combined with the opportunity to achieve career progression through appraised performance rather than length of service. Indeed, a team-based approach to performance rewards should help to enforce that rigour by exerting peer pressure on managers to address the problem of the passenger while advancing the progress of the performer. No incentive scheme will gain acceptance unless it forces management to address the problem of poor performance. A team-based approach is, in my view, the most practical way of achieving that goal.

But there are several more positive reasons for advancing the cause of team-based rewards:

- The public service ethos stresses the importance of collective rather than individual achievement. Team-based rewards would, if properly executed, reinforce this positive affinity and motivation
- Team-based rewards are more capable of measurement. There is an abundance of benchmark data available in each agency on the relative performance of individual offices on a variety of measures
- Team rewards would address concerns that individual performance measurement reflects biases against women, ethnic minorities and part-time workers
- It will be easier to integrate pay incentives with non pay-based recognition in a team framework. The ‘office of the month’, rewarded by a benefit in which everyone can share, is a less divisive idea than the ‘employee of the month’. It also provides an opportunity to recognise team behaviour
- Team rewards foster a spirit of internal competition between offices, which is more productive than internal competition within an office.

The most recent employee research on this issue is divided. On the one hand, approximately half the respondents in both the Employment Service and the Inland Revenue disagreed with the proposition that it would be better to base performance-related pay on the performance of groups. On the other hand, a majority in each agency considered that performance pay made staff less willing to assist colleagues experiencing work difficulties and caused jealousies between staff. The problem, it appears, lies more with the execution than with the principle.

Team rewards may not be the answer throughout the four agencies. In certain specialist areas, it may be more appropriate to recognise individual achievement. But these are probably the exception. In the office networks, and in central back-office functions, team rewards have overwhelming advantages.
It is of course possible to combine team rewards and individual incentives in a single scheme. But this will probably create the worst of both worlds. The impact of either will be diluted as relatively modest rewards would be split between the two pots. Moreover, the individual rewards would undermine the objective of encouraging team behaviour. The use of special bonus schemes for particular exceptional achievements, already in place but somewhat under-used in many departments and agencies, might still be appropriate.

In general, I would recommend that team rewards be based on the performance of individual offices, rather than the different work of teams within an office. This is partly to encourage a sense of identity with the goals of the office, but also to recognise that, given the close working relationships within an individual office, it may be arbitrary to reward one group at the expense of another. There may be cases, however, where the absence of reliable data, or the need to encourage co-operative working between offices, argues for another approach.

There are significant calculation difficulties in designing a scheme which fairly rewards the achievements of individual offices. Any incentive structure based on absolute measures of performance may fail to recognise the important social and demographic differences between particular regions. In central London, for example, the Benefits Agency has to manage a customer base including many applicants who are homeless and have substance abuse problems. This causes a high level of stress for employees in an area where salary scales are by no means competitive. It would not, therefore, be fair simply to compare the performance of a central London office with an office in a more settled community.

Conversely, a system based on relative performance runs the risk of rewarding the weak office, which has ample opportunity for improvement, at the expense of the office which is already performing close to the maximum of its potential. This argues for a sensitive performance mechanism which recognises demographic factors where this is appropriate.

I have not attempted in this report to suggest how team rewards would be allocated and whether, within a team, there would be differentials to recognise particularly strong or weak individual performance. But my recommendation would be to keep the scheme as simple as possible.

**Funding of incentives**

It is a premise of this report that the sums available for performance incentives must be significantly increased if the proposed new arrangements are to be effective. A more detailed analysis of the possible sources of funds is contained in Annex C but the headlines are as follows:

- Utilising the progressive impact of the non-consolidation of performance-related pay. As has been discussed, this will build over time to create significant bonus opportunities
- Using efficiency savings made while meeting PSA targets as an automatically agreed addition to pay
- Rewarding the achievement by an individual agency of an overall performance that exceeds the targets set out in the PSAs. This will result in the recycling by the Treasury of additional funds which will augment performance pay.

**Recommendation 3 – individual offices**

In general, I would recommend that team rewards be based on the performance of individual offices, rather than the different work of teams within an office. This is partly to encourage a sense of identity with the goals of the office, but also to recognise that, given the close working relationships within an individual office, it may be arbitrary to reward one group at the expense of another. There may be cases, however, where the absence of reliable data, or the need to encourage co-operative working between offices, argues for another approach.

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**Recommendation 1 – non-consolidation**

There is a tradition in the public sector that performance-related pay should be consolidated into salary and count towards pension entitlement. This seems to me to miss the point. Performance incentives should relate to the particular period over which the performance was achieved and should not, as a
result, carry on contributing to the compensation of an individual from the date of the achievement until retirement. Consolidation, of course, has precisely that effect. It has been impractical to divorce performance rewards from the consideration of overall compensation because it has been treated as one element of the overall package which drives pay progression.

I propose to sever that link by treating performance rewards quite separately from the rest of the compensation package and by recommending a more flexible ‘profit-sharing’ approach to performance incentives between HM Treasury and the agencies. I recognise, however, that this departure from previous policy will only be acceptable to staff members and their trade union representatives if reliable cost-of-living increases and sensible pay progression can be assured. It is with this in mind that I have suggested that thought be given to the narrowing of pay bands and the acceleration of progression to a market rate for the job.

There is a widespread and understandable concern in the public sector that the introduction of non-consolidated performance rewards will have an adverse impact on final pension entitlement. This problem has been addressed by Ofsted by allowing performance rewards to count towards pensionable salary in the final three years before retirement. This may represent a practical, if not altogether logical solution. In the same spirit, plans for the new Civil Service Pension Scheme allow employers to make contributions to the AVC scheme in respect of non-consolidated payments. Paying part of the bonus as an employer AVC might offer a way forward.

**Recommendation 2 – efficiency savings**

Under the current system of public spending controls, departments agree with the Treasury a set of PSA targets, a departmental expenditure limit, and, within that, a running cost limit, for the coming three years. Departments agree similar budgets with their agencies.

However, there is also a separate ‘pay remit’ system, by which departments must agree the details of pay awards with the Treasury. So, even if they meet their PSA targets at a lower running cost or with less departmental expenditure more generally, they cannot use these savings to fund performance rewards without separately asking permission.

This means that staff cannot know in advance that they will benefit from productivity improvements within the department. To give the maximum incentive effect, it should be agreed that any savings generated this way can be used to finance performance rewards automatically, and in addition to the pay remit.

**Recommendation 3 – Treasury funding**

The most significant source of additional funds proposed in the report is the creation of a bonus pot which will grow in size if HM Treasury allows agencies to recycle the benefit of non-consolidation into performance rewards as it already does in the case of Ofsted. Annex C illustrates in some detail how this would work.

The compounding effect of non-consolidated rewards should go some way towards addressing concerns about pensionability. But it is not, in my view, sufficient to create a genuine performance culture in the short term. I am, therefore, recommending that HM Treasury also agree with the four agencies arrangements under which the surpassing of targets should result in the release of additional funds for performance rewards.
Incentives for change

These arrangements will, as I have outlined in an earlier section, be hard to agree and I am the first to admit that they represent a radical departure from past practice. But it is hard to argue with the principle that if the efforts of a department result in unbudgeted receipts to the Exchequer, and exceptional improvements in service levels to the customer, then the benefits of those receipts should be shared in some measure with the people who created them. I would recommend that this additional release of funds should be agreed only at the level of the agency itself. In other words, the agency as a whole would need to exceed predetermined targets for the pot available for distribution to increase. These targets would for the most part be financial and be based on the collective achievement of individual units in meeting productivity targets. But there may also be cases in which the successful implementation of a particular change in policy, which will reap longer-term benefits to the taxpayer, should also be rewarded. By way of illustration, the success of the Inland Revenue in introducing a complex regime of self-assessment resulted in no additional payment to employees who worked exceptionally long hours often under considerable stress. Yet this reform will undoubtedly result in a significant and permanent reduction in the cost of tax administration in this country.

Conversely, an agency which failed to meet targets agreed with the Exchequer would risk losing a portion of the annual pot available for performance rewards. This approach would have the positive effect of binding the performance of individual staff members and teams to the fortunes of the agency as a whole, while allowing the Exchequer to plan with greater certainty. Unbudgeted receipts which flowed from higher productivity would be shared with the contributors while shortfalls would be mitigated by a reduction in the release of performance-pay funds.

An example might be the Employment Service’s target for placing the unemployed in work. The ES estimates that each successful placing is worth a net £1,000 to £2,000. For 1998-99 the service had a target of placing 1,300,000 people in work. If ES were able to recycle £500 per placing above target, it could fund full bonus for all its staff this way (with a payout of £582 to the typical administrative officer) by placing an extra 50,000 people in work. This would, of course, be in addition to bonuses funded by building up a pot through non-consolidation.

The impact of non-consolidation

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To achieve this sort of improvement, our estimates suggest that ES would have to improve the performance of the two regions performing least well this year to the average level of all regions. That seems quite a plausible ambition.

Work on possible targets in other agencies is less well developed, but in all cases our judgement is that productivity improvements of the type needed to fund significant bonuses are possible.

These estimates, and the general proposals, are subject to detailed discussion within the Treasury and the agencies themselves and have not, as a result, been fully costed. The analysis in Annex C is, I hope, a reasonable proxy for how the scheme might operate but it should be seen as an illustration rather than as a firm financial proposal.
Chapter four
Wider implications

This report is part of the overall programme of work by the Public Services Productivity Panel. Several of its themes are relevant to other interests of the panel.

Business planning frameworks

The panel believes that there are five basic building blocks for an effective business planning framework:

- Bold aspirations for the future
- Long- and short-term targets that are consistent with each other and with the aspirational aim
- Ownership and accountability, with clear and specific responsibilities for delivering each target
- Rigorous performance review
- Reinforcement and incentives.

The specific recommendations in this report focus on the last of these issues. But all five elements of the planning framework need to be developed if the critical performance management issues outlined earlier in this report are to be addressed.

Several themes with a wider application have emerged from the work for this report:

- A good performance management system is dependent on the existence of real measures of success and good systems for monitoring progress. One of the reasons (though not in itself a sufficient reason) why I recommend implementing team awards at local office level is that information systems are relatively more robust there than at the level of the individual.
- Conversely, in the course of this project we have identified issues about how success should be measured and monitored. A key question is how to balance competing objectives between, for example, customer service and financial targets. A system that fails to strike such balances risks distorting behaviour towards the targets that are rewarded, at the cost of those that are not. The "balanced scorecard" approach provides a tool for tackling this problem.
- Similarly, performance incentives are both dependent on the commitment of staff and a way of achieving it. We have seen examples of the former in the concerns raised about the management of poor performers under the existing pay system. To gain commitment, performance-incentive systems have to be transparent, readily understandable, and set at a level that is worth achieving. They also require leadership, adequately skilled management, and a communications strategy that generates widespread acceptance.

Good practice

The annex on benchmarking sets out the data on good practice that we have gathered during this project.

Gathering this comparative information has been a valuable exercise. We found particularly useful experience in those organisations which had been forced to adapt to starkly changing circumstances, for example, British Airways, after privatisation, the Post Office, on gaining greater commercial freedoms, and the National Maritime Museum, in the face of a substantial reduction in grant aid. Such organisations would be a useful quarry for those running projects on management issues in the public sector, though the experience of private sector companies, whose market environment continually evolves, should not be ignored.
It was also very useful to be able to consult staff about performance rewards, management and motivation at an early stage. This sort of interview gave a vital extra perspective to the information gathered from the central management of the departments and agencies.

In seeking examples of good practice, we were sometimes hampered by a lack of knowledge of where to look. The establishment of the Cabinet Office database on good practice is therefore highly welcome.

**Wider applicability**

I have tried to identify specific proposals for the departments and agencies at its core. These four were chosen because of their common characteristics. Many other public sector organisations will be different, and the precise proposals here may not be applicable to them.

Nevertheless, the general principles set out in this report are of broad relevance, and are consistent with the *Modernising Government* framework. Where there are differences of emphasis, these need to be considered in the light of the particular circumstances of each department or agency. For example, the guidelines issued by the Civil Service Management Committee group on performance management emphasise the use of relative measures in determining performance awards, which makes sense where funding is fixed. This report puts more emphasis on absolute standards of performance, which is consistent with its proposals for flexible funding.
Chapter five
Implementation

If the recommendations in this paper are accepted, I would propose that each individual agency should set up a working party to develop more detailed proposals which could then be fed into a steering group representing as a minimum the four agencies as well as HM Treasury. The agencies will almost certainly want to draw on outside expertise in the detailed design of individual plans. It will be important to introduce project management disciplines in order to ensure that goals and deadlines are met.

The precise timetable for implementation of proposals will vary according to the regular pay rounds of each agency. Many of the proposals in this report represent a break with past practice, so it is important that they be well thought out, and that managers and staff have the necessary skills and knowledge to operate the system. That points to an implementation date of April 2001. That is also when the next round of PSAs will be introduced.

That does not mean that 2000 will be a quiet year. Much work needs to be done in developing, agreeing and piloting detailed schemes.

In particular, for the recommendations to be implemented effectively, departments will need to secure a commitment at all levels of the organisation. This will require:

- A clear and strong commitment from the very top
- Senior sponsors with the standing to ensure the new system is given the priority it needs
- Dedicated staff at the centre
- Project champions in all the offices where change is to take place
- Thorough consultation and communication at all stages
- Constructive support from all areas of central government.

Strong external interest will also help make sure change happens. I recommend that departments and agencies should be asked to report back to the Cabinet Committee on public spending in six months’ time to present their implementation plans. At that time, the Treasury should also explain what it has done to facilitate change. I would be happy to take part in a review at that stage.

A year after introduction, there should be a formal review of the scheme. Detailed evaluation proposals should be drawn up alongside the detailed proposals, but should certainly include:

- Comparisons of performance-pay awards before and after changes
- Estimates of the effects on subsequent target achievement
- Surveys of staff attitudes.

The success of this project will ultimately depend not on the quality of the recommendations in this report, but on the determination of all the parties involved to implement them in a positive and co-operative spirit.

John Makinson

January 2000
Further copies of this document and supporting volume of annexes are available from:

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