



**Asia-Pacific
Economic Cooperation**

**Impact of Performance Based Remuneration Systems on
Productivity Performance of Local Industries
Compilation Report**

**APEC Human Resources Development Working Group
Labour and Social Protection Network**

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Abstract

The research on the “Impact of Performance-based Remuneration Systems on Productivity Performance of Local Industries was carried out by the economies of Korea, Malaysia, The Philippines and Chinese Taipei. Each economy selected 2-3 local industries namely SMEs and carried out an in-depth analysis via interviews and guided questionnaires on Performance-based Remuneration Systems practiced in selected companies and the impact it had on improving productivity/performance.

Through this study, it was found that SMEs played an important role in economic performance in all these economies. It was therefore crucial that to be competitive performance measures had to be introduced. All the companies selected, gave emphasis on enhancing performance and had developed their own set of performance measures that were able to gauge performance improvement. The impact of implementing Performance-based Remuneration Systems was positive. From the analysis, the companies selected had indicated performance improvement in terms of profits, productivity, improved attendance, staff morale and motivation.

This report provides an overview of the each economy’s economic situation and the importance of SMEs in their economies. It also provides information of the types of performance systems used in each economy. Finally, it describes in detail the system applied by each company and discusses the impact of using Performance-based Remuneration Systems in the selected companies.

Executive Summary

1.0 Performance-based Remuneration Systems

Performance-based Remuneration Systems are increasingly being implemented by SMEs. Most SMEs have realised the need to be competitive and one of the ways to ensure that it sustains its competitive edge is to make sure that any increase in remuneration is supported by performance improvement. This is evident in the studies carried out by Korea, Malaysia, The Philippines and Chinese Taipei. All these economies have also given emphasis to the growth of SMEs within their economies. Various plans and policies are emplaced to ensure that SMEs are on the same growth path as other industries in the economy as SMEs comprise more than 90% of business establishments in these economies.

In all the economies studied, Performance-based Remuneration Systems had been developed by the economies concerned. The systems used included the Balance Scorecard, Management by Objectives, Key Performance Indicators and benchmarks, High Performance Work Systems, Excellence Models and performance evaluation based on set objectives and targets. Basically, both the fixed component and the variable component were present. The fixed component comprises the basic wage or remuneration while the variable component or performance element is linked to productivity improvement, profitability or determined through specific performance measures.

2.0 Developing Key Performance Measures

In the economies mentioned, key performance measures not only determine performance improvement of the firm but also establishes the contribution of employees towards the improvement processes. As a result it was determined that the contribution of both management and employees through cooperation and teamwork will improve organisational performance. Among the key performance measures identified include job competency, targets and goals achievement, piece-rate, zero defect, cost savings, productivity based on set standards and targets, financial measures such as return on equity and profitability, job knowledge, job quality, communication skills, teamwork,

dependability, initiative, commitment, multitasking and innovation.

The key performance measures allowed for progressive growth and were specific, quantifiable, achievable as well as able to make long term projections. The overall business objectives and strategies were tied in with the measures set so that they can be cascaded down to all levels of the organisation for effective implementation.

3.0 Performance Based Rewards

Based on the two components in such remuneration systems, the variable component of such schemes could include cash incentives, shares and the concept of self-funded performance bonuses. However, any incentive given should not be an over-skewed compensation where there is no internal equity and the payout has no linkage to performance. As for long term incentives such as gains sharing options, it is considered as an opportunity for companies to attract talent and often recommended as a tool for firms to support their improvement programmes. In the concept of self-funded performance the payout is based on the ability to pay. Therefore, the performance bonus should only be given out from profits earned for superior performance.

Other forms of rewards may be linked to the performance assessment where quantitative targets are set and independently computed by the supervisor that solicits inputs from peers, subordinates and clients which will determine the increments, bonuses and promotions. Some firms also linked quantitative and qualitative aspects of evaluation which were weighted in terms of importance to determine the competence of employees in areas of strategic thinking, business acumen, drive and resilience, innovation and change agents.

4.0 Practices among SMEs of Selected Economies

The common features of Performance-based Remuneration Systems among SMEs in these economies include systems that are target based. Merits or incentives that are awarded are based on what is achieved. The threshold is also set so that performance below the threshold level will not qualify for any incentive. Most of the SMEs studied used job functions as a criteria to develop

their performance measures. These enabled the firms to identify their strengths and areas for improvement as well as reengineer business processes for continuous improvement.

The KPIs that were selected such as improving sales and revenue, customer retention and satisfaction were used to capitalise on expansion of market share. In all the firms studied the evaluation criteria and KPIs were reviewed from time to time. Both employers and employees engaged in sharing of information and transparency to ensure that there was no mistrust among them. These exemplary cases will enable other SME firms to adopt and adapt the systems mentioned and improvise on them for greater competitiveness.

5.0 Impact of Performance-Based Remuneration Systems

From the study on individual firms by the economies, vast improvements had taken place. Some firms had recorded an increase in profits by two fold within a short span of 2-3 years. Productivity improvements were more than double over a three year period. Other areas that impacted the implementation of Performance-based Systems included expansion of sales, reduction in the cost of sales through creative and innovative means, improvement to motivation and staff morale, and a sense of commitment and dedication. Pay for performance became an acceptable norm while multitasking to reduce unwarranted recruitment of staff were initiated. At the same time, result oriented teamwork, increased employee satisfaction and change in mindset and culture resulted in a more productive workforce.

The positive impact of implementing Performance-based Remuneration Systems was that both employers and employees cooperated. Through this system the sense of ownership and responsibility was instilled as rewards were real and reflective of performance. Each therefore found ways to support and contribute towards improvement which will ultimately lead to a better quality of life for all.

**I. Impact of Performance Based Remuneration Systems on Productivity
Performance of Local Industries:
Korea's Experience**

**By
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Korea**

1.0 Korea's Economic Development

The economy of Korea is the third largest in Asia and the twelfth largest in the world in terms of nominal GDP as of 2006. In the aftermath of the Korean War, Korea's grew from being one of the world's poorest countries to one of its richest. From the mid to late twentieth century, it has enjoyed one of the fastest rates of prolonged economic growth in history. The nation's per capita gross national product has grown from only \$100 in 1963 to \$24,500 in 2007. This phenomenon has been referred to as the "Miracle on the Han River." The three decades of extraordinary growth that transformed Korea from one of the poorest agrarian economies to the 11th largest economy and exporting country in the world, culminated in its accession to the Organisation for Economic Cooperation and Development (OECD) on December 12, 1996.

In recent years, Korea's economy moved away from the centrally planned, government-directed investment model toward a more market-oriented one. Korea bounced back from the 1997 East Asian financial crisis and carried out extensive financial reforms that restored stability to markets. These economic reforms, pushed by President Kim Dae-jung, helped Korea maintain one of Asia's few expanding economies with growth rates of 10% in 1999 and 9% in 2000. The slowing global economy and falling exports account for the drop in growth rates in 2001 to 3.3% but in 2002 Korea pulled out a very respectable 6.0% growth rate. Restructuring of Korea's conglomerates (*chaebols*), bank privatisation, and creating a more liberalised economy with a mechanism for bankrupt firms to exit the market remain Korea's most important unfinished reform tasks. Although the growth slowed down in 2004, a promising 5% growth was achieved in 2006 due to popular demand for key export products such as HDTVs and mobile phones. Increasing trade with the People's Republic of China is expected to boost Korea to a leading position among Asia's developed economies. It is also expected to lead the world in penetrating Japan's trade barriers.

Korea relies largely upon exports to fuel the impressive growth of its economy, with finished products such as electronics, textiles, ships, automobiles and

steel being some of its most important exports. Although the import market has liberalised in recent years the agricultural market has remained largely protectionist due to serious disparities in the price of domestic agricultural products such as rice with the international market. As of 2005, the price of rice in Korea is about four times that of the average price of rice on the international market and it was generally feared that opening the agricultural market would have disastrous effects upon the Korea's agricultural sector. In late 2004, however, an agreement was reached with the WTO in which Korea's rice imports will gradually increase from 4% to 8% of consumption by 2014. In addition, up to 30% of imported rice will be made available directly to consumers by 2010 where previously imported rice was only used for processed foods. Following 2014, Korea's rice market will be fully opened.

At the start of the 21st century, predicting that the Internet would become an important factor in the global economy, the government sought to make Korea the world's leading IT nation in just 5 years. With public funds the government began to actively support Korea's native IT industry led by flagships Samsung Electronics and LG Electronics. Success was seen at home in the following years with the development of Digital Multimedia Broadcasting (DMB) and Wireless Broadband (WiBro) technology and abroad with Korea's IT products and services capturing market share in key sectors such as semiconductors. With this technological background, Korea has been termed one of the 'Next Eleven' economies and at its current rate is expected to be equal in size to the economies of the United Kingdom and France by 2025. In addition to its advanced IT infrastructure, the government is now beginning to invest in the robotics industry. With the aim of becoming the "World's Number One Robotics Nation" by 2025, there are plans to put one robot in every household by 2020.

^{[4][5]} There are other ambitious plans to expand or create other sectors of the economy including the financial, biotechnology, aerospace and entertainment industries.

1.1 Korea's Globalisation (Segyehwa)

Under the comprehensive policy theme of *segyehwa* (globalisation) the government took an active role in participating in international economic

activities through the Uruguay Round of trade talks through its launching of the World Trade Organisation and through its membership in the Asia-Pacific Economic Cooperation. The government's effort culminated in Korea's accession to the OECD in 1996 which seemed to signal its entry into the rank of advanced countries. The future path of the country depends upon how prudently the political leaders, the government, the business leaders, workers and the public manage the current economic crisis. Current account surplus had been maintained since November 1997 with the help of increased exports and decreased domestic demand. The foreign exchange rate has stabilised at near pre-crisis level and the stock price index has recovered from its lows due to the resumption of foreign capital influx. At the same time, series of liberalisation measures are starting to take effect, especially in the corporate sector.

There has been active Merger and Acquisition (M&A) activities between foreign and Korean firms and foreign participation in Korea's bond market has increased. It is important to keep in mind that these reform processes did not begin with the breakout of the 1997 financial crisis. Instead, they were already in the process of being implemented under Kim Young Sam's globalisation policy exemplified by Korea's membership in the OECD. Therefore, the consensus for reform has existed in minds of Korean people. Furthermore, the election of the President from an opposition party created an adequate political environment to implement change allowing reforms to take place at faster pace. With sound infrastructure for market economy in place Korea will once again become the economic center of Northeast Asia with ample opportunities for investment. Korea's rich human resources history of miraculous development and unyielding commitment to liberal democracy all attest to its potential to recreate a robust economy in the decades to come. Some basic facts about Korea for the year 2007 are shown in Table 1.1 as follows:

Table 1.1: Data on Korea's Economy in 2007

Population (millions)	48.46
GDP (billions)	US\$ 969.9
Real GDP Growth (%)	5.0
GDP (PPP) per capita (\$)	US\$ 12,742.51
Consumer Price Inflation (%)	2.5
Unemployment Rate (%)	3.2
Labour Force (millions)	24.22

Source : World Competitiveness Yearbook 2008

1.2 Korea's Competitiveness

In terms of competitiveness, Korea is ranked 29th in the Institute of Management Development (IMD) World Competitiveness Yearbook 2007 and had slipped to 31st position out of 55 economies. It is a worrying trend and the challenges faced by the Republic on competitiveness as identified in the World Competitiveness Yearbook, 2008 are:

- Restore entrepreneurship through more aggressive deregulation
- Cut corporate, income and property tax rates to stimulate consumption
- Promote smaller and efficient government and fortify fiscal health in preparation for rapid population ageing
- Achieve labour-management peace by abiding by laws and principles
- Nurture world-class talent and give full autonomy to universities.

2.0 Labour Market Liberalisation

The labour market environment in Korea in the past has been characterised as "rigid." The legal system awarded workers substantial job security by limiting redundancy layoffs and temporary labour contracts. The conditions and procedures of redundancy, layoffs which were not clear in many ways placed an obstacle to flexible market adjustment as economic growth slowed in the 1990s and also as the economy shifted emphasis from quantitative expansion to qualitative enhancement with greater emphasis on knowledge-intensive and high-tech industries. The need for sectoral reallocation and downsizing increased but businesses often found their ability to do so greatly restricted.

Liberalised union activity since 1987 has increased rigidity in the economy. In the late 1980s, the government failed to control the illegal practices of unions, sometimes resorting to selective intervention for political gains. Furthermore, market forces could not discipline industrial relations in large firms and *chaebol*, as most people in Korea believed that large firms will never go bankrupt. The "too-big-to-fail" expectation stemmed from a series of past industrial policies favouring large firms.

In particular, enterprise unions in *chaebol* became stronger and more militant, and dismissals became virtually impossible. The economic crisis of 1997 provided an opportunity to enhance labour market flexibility and restore market mechanisms. It is understood that there is a need for a more flexible labour market in which labour allocation and wage determination are efficiently governed through market mechanisms. The government has made several announcements stating that while unlawful layoffs will not be tolerated, economic restructuring will take precedence over job security. In February of 1998, the government passed legislation legalising redundancy layoffs and also relaxed the previously restrictive legal provision relating to manpower leasing services. Firms now facing labour demand can adjust employment more flexibly and at a considerably lower cost which is a major step toward economic recovery.

To form a consensus on labour-related issues, the Tripartite Committee was formed among the representatives of labour, business and government. The committee established rules for an equitable sharing of both economic and non-economic costs and attained public consensus for the restructuring. The committee accomplished an accord which contained a considerable number of measures to enhance corporate governance transparency and to increase unemployment benefits and labour market flexibility.

2.1 Korea's Labour Force Trends

Korea was known for having the world's longest working hours. In 1986 the Korean worker averaged about 54.7 hours a week. This situation was the natural consequence of the low wage system that necessitated extended hours and extra work to earn minimum living expenses. There were however, dramatic increases in wages in 1988 and 1989. Labour stoppages in the manufacturing sector coupled with a scarcity of labour led to 20% salary increases for workers in the manufacturing sector in 1988 and 25% salary increases in that sector in 1989. These increases later spread and increased wages across the entire economy by 18.7 % in 1989.

By 1989, some of Korea's economists were worrying about the effect that skyrocketing wages would have on the cost of domestic made goods and the consequent impact on export prices. The wave of market liberalisation along with the political democratisation since 1987 ignited strong and violent labour disputes as well as tremendous wage hikes which have far exceeded the rise in productivity. In the 1990s wage hikes averaged 18% annually. In addition to such excessive wage hikes, high financial costs, excessive administrative regulations on business activities and low social overhead capital investment have afflicted industrial competitiveness and entrepreneurship.

The situation was especially worrisome because the wages paid to workers in Korea's major competitors were growing far more slowly. Average annual household income is 39,013,596 won (USD42,108) as of 1Q 2007 (Korea National Statistical office). The percentage change in output per hour, hourly compensation, unit labour costs and related measures in the Manufacturing Sector among selected APEC economies for the period 2005-2006 as reported by the Bureau of Labour Statistics, Washington DC, are shown in the table below:

**Table 2.1 Labour Statistics of Manufacturing Sector in
Selected OECD Countries**

Economies	Output Per Hour	Employment	Total Compensation	Unit Labour Costs (USD)
USA	2.0	-0.5	3.4	0.5
Canada	-0.1	-1	1.0	9.0
Australia	0.3	-1.2	4.1	4.1
Japan	1.9	1.5	0.9	-8.4
Korea	10.8	-0.4	4.5	3.5
Taiwan	6.9	1.1	2.5	-1.3

Source : NEWS-Bureau of Labour Statistics, Washington DC, Feb. 28, 2008

From the table, it can be observed that Korea's total compensation growth of 4.5% is the highest amongst the more developed APEC economies. This high compensation growth had led to increasing unit labour costs of 3.5% which could have affected its competitiveness.

2.2 Selected Labour Force Statistics¹

Selected employment, labour force and productivity data and rank from the World Competitiveness Yearbook (WCY) 2007 and 2008 are presented below:

**Table 2.2 Korea's Competitiveness: Employment Indicators,
WCY 2007, 2008**

	WCY 2007		WCY 2008	
		Rank		Rank
EMPLOYMENT				
Total Employment in Millions	23.15	14	23.43	14
Percentage of Population	47.93	20	48.36	21
EMPLOYMENT-GROWTH				
Estimates: Percentage change	1.29	39	1.22	44
EMPLOYMENT IN THE PUBLIC SECTOR				
Percentage of Total Employment	3.57	4	3.55	3
UNEMPLOYMENT RATE				
Percentage of Labour Force	3.60	8	3.20	4

¹ Institute of Management Development, World Competitiveness yearbook, 2008

	WCY 2007		WCY 2008	
		Rank		Rank
LONG TERM UNEMPLOYMENT				
Percentage of Labour Force	0.03	1	0.04	1
YOUTH UNEMPLOYMENT				
Percentage of Youth Labour Force (Under the age of 25)	10.00	12	8.80	12
EMPLOYMENT BY SECTOR				
Agriculture (% of Total Employment)	7.9	28	7.7	28
Industry (% of Total Employment)	26.8		26.3	
Services (% of Total Employment)	65.2		66.0	
LABOUR REGULATIONS				
Labour Legislation (hiring/firing practices, minimum wages etc.) do not hinder business activities	3.24	45	2.06	54
UNEMPLOYMENT LEGISLATION				
Unemployment legislation provides an incentive to look for work	5.54	16	4.22	35
IMMIGRATION LAWS				
Immigration laws do not prevent your company from employing foreign labour	4.50	49	3.84	54
WORKING HOURS				
Average number of working hours per year (hours)	2,439	1	2,305	3
LABOUR RELATIONS				
Labour relations are generally productive	3.35	55	2.97	55
WORKER MOTIVATION				
Worker motivation in companies is high in your economy	5.33	33	5.70	30
INDUSTRIAL DISPUTES				
Working days lost per 1,000 inhabitants per year (Average 2003-2005)	23.23	37	22.47	38
EMPLOYEE TRAINING				
Employee training is a high priority in companies	6.02	24	6.89	11

**Table 2.3 Korea's Competitiveness: Labour Cost Competitiveness,
WCY 2007, 2008**

	WCY 2007		WCY 2008	
		Rank		Rank
LABOUR PRODUCTIVITY (PPP)				
Estimates : GDP (PPP) per person employed per hour (US\$)	19.78	34	21.64	32
LABOUR PRODUCTIVITY (PPP) GROWTH				
Percentage change of GDP (PPP) per person employed per hour	-0.51	34	3.74	18
COMPENSATION LEVELS				
Estimates : Total hourly compensation for manufacturing workers (wages + supplementary benefits) US\$	14.58	32	14.70	33
UNIT LABOUR COSTS IN THE MANUFACTURING SECTOR				
Percentage change	-5.60	2	-0.48	11
REMUNERATION IN SERVICES PROFESSIONS				
Gross annual income including supplements such as bonuses in US\$				
• Bank Credit Officer	40,200	35	40,200	36
• Department head	55,600		55,600	
• Primary school teacher	43,300		43,300	
• Personal assistant	25,800		25,800	
• Call center agent	12,900		12,900	
REMUNERATION OF MANAGEMENT				
Total base salary plus bonuses and long-term incentives, US\$				
• CEO	298,531	21	346,138	20
• Engineer	80,720		86,273	
• Director Manufacturing	146,517		152,424	
• Human Resources Director	111,349		137,186	

**Table 2.4 Korea's Competitiveness : Labour Force Indicators,
WCY 2007, 2008**

	WCY 2007		WCY 2008	
		Rank		Rank
LABOUR FORCE				
Employed and registered unemployed millions	23.98	16	24.22	15
	WCY 2007		WCY 2008	
		Rank		Rank
LABOUR FORCE				
Percentage of Population	49.65	26	49.98	28
LABOUR FORCE GROWTH				
Percentage change	0.99	33	0.99	36
PART-TIME EMPLOYMENT				
Percentage of total employment	8.97	31	8.80	32
FEMALE LABOUR FORCE				
Percentage of total labour force	41.71	40	41.67	39
FOREIGN LABOUR FORCE				
Percentage of total labour force	1.46	32	1.77	28
SKILLED LABOUR				
Skilled labour is readily available	6.35	11	4.26	43
FINANCE SKILLS				
Finance Skills are readily available	5.71	42	4.85	44

Table 2.5 Republic of Korea's Competitiveness: Availability of Skills, WCY 2007, 2008

	WCY 2007		WCY 2008	
	Scores	2007	Scores	2008
ATTRACTING AND RETAINING TALENTS				
Attracting and retaining talents is priority in companies	6.28	34	7.70	7
BRAIN DRAIN				
Brain drain (well-educated and skilled people) does not hinder competitiveness in your economy	5.89	19	5.11	27

	WCY 2007		WCY 2008	
	Scores	2007	Scores	2008
FOREIGN HIGH-SKILLED PEOPLE				
Foreign high-skilled people are attracted to your country's business environment	3.78	48	4.46	32
INTERNATIONAL EXPERIENCE				
International experience of senior managers is generally significant	4.26	49	4.32	48
COMPETENT SENIOR MANAGERS				
Competent senior managers are readily available	4.68	41	3.92	46

Note : For detailed labour statistics by the Korea Labour Institute, please refer to Appendix 1

From the WCY 2007 and 2008 data and rank on employment, labour and productivity, it can be concluded that there are many avenues that Korea had to relook in order for competitiveness to be enhanced. Recognising this, the Government had since 2005, instituted various reforms including labour market reforms.

2.3 Towards Wage 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, and export surplus, and fairly equal distribution of income characterise 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 and seniority-based wages in a closed internal labour market switched to the performance-based system practiced in United Kingdom and the United States of America.

The financial crisis of 1997 was regarded as a sign that the current employment system needed fundamental revision (Kim and Kim, 2003). Employers argued that the labour market should be made more flexible to adjust their workforce according to sudden decreases in output during the crisis. They succeeded in persuading the government to review the labour laws to introduce the practice of layoffs. Employers also wanted to change the wage system so that worker ability and performance, rather than seniority, would determine wages. Companies admitted that the seniority-based wage structure which does not link wages to productivity and/or performance was affecting competitiveness as well as the financial situation of the company. The aging workforce was another factor that led to the call for the change in the wage system by employers.

It has now become socially understood in Korea that if a company is in a difficult financial situation it has to retrench some of its employees. As in the case of Japan, under the seniority-based salary system, senior employees with higher wages were more susceptible to being laid off. However, in Korea, it is the middle-aged worker who is faced with less employment stability because the overall dismissal rate is higher. A recent survey by a newspaper in Korea showed that Korea's management-level employees believe that actual average

retirement age is 47 (Ee-hwan Jung and Byung-You Cheon, 2003).

In the current economic situation, characterised 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 needs 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.

2.4 Wage System in Korea: Employees Perspective²

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 a 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 while the bonus may also be determined by performance of an individual, group or corporation. Based on the Survey of Workers' Perception on Compensation Scheme conducted by the Republic of Korea Labour Institute (KLI) in 2004, analysis was done on the areas of norms on compensation and work-related values that might impact workers' preference for a pay structure. These include workers ideal compensation scheme and type, the acceptable range of wage differentials resulting from different levels of performance, preference between individual versus group performance-based salary, willingness to trade off between better working conditions (including employment and working hours) and part of the salary, the acceptable range of such trade off and the desire to have a greater say in wage-related matters.

2.4.1 Preferences regarding the Pay Structure

In the survey, employees were asked to select one out of eleven categories of "What is the most important thing about work?" Of these, the intrinsic values are learning opportunities, variety, interesting work, job match and autonomy and the extrinsic values include interpersonal relations, promotion opportunities, working hours, job security, good pay and physical working conditions. Overall, it was found that job compatibility ranked first, followed by job security, human relations and salary. It is interesting to note that salary was ranked fourth.

Fairness was another important variable related with workers preference for a pay structure. To the question, "What would be the fairest standard when

² Adapted from research paper entitled Wage System in Korea: What do workers want? Kim, Dong-Bae, 2005

differentiating the amount of pay”? the response selections were living expenses (“necessity”), individual abilities and accomplishments (“equity”), and equality. It was found that majority of workers (63%) favoured “equity” indicating that the workers are prone towards being paid according to their performance. As for preference between individual and group performance-based compensation plans, workers who put greater value on “equality” are likelier to lean toward group performance based scheme while those who emphasise “equity” favours individual performance-based scheme.

The research also found that workers favour a comprehensive mix of criteria rather than a single criterion for determining both the base pay and bonus. Among the base pay determinants mix favoured by workers are seniority, performance and job value while for determining bonus, workers are attuned to the mix of individual, team, department and company performance. When faced with the risk of unemployment, workers entitled to competency or job-based pay schemes are more likely to give up a part of their salary than those who are covered only by a seniority-based scheme. Likewise, employees of a company with a team performance-based remuneration system show greater willingness to do so.

Work related values and the fairness criteria have a substantial impact on workers’ preferences for a pay structure. Specifically, workers who are highly educated, young or hold office/managerial positions are more apt to place a greater importance on intrinsic values and equity; factors that are directly correlated with a job-based or performance-based compensation scheme. The result from the study indicated the possible existence of sub-cultures among Korean workers and its reflection of the generation gap among workers. The fact that the young and highly educated are less disposed toward the traditional seniority-based compensation scheme spells possible conflict between the older and younger generations. The overall preference is still for group performance based scheme (62.8%) over individual performance (37.2%), indicating that the culture of collectivism still looms large in Korea.

2.4.2 Implications for a Better Compensation Scheme

Since the financial crisis, companies in Korea attempted to improve the pay structure by increasing the performance-based factors within the existing pay structure, the best example being the “annual salary system”. For individual companies, converting the current automatic pay raise scheme into a performance-based scheme will help ease the rigidity of the current pay structure. The prerequisite is that fairness must be ensured when evaluating performance. Responsibilities should also be allocated appropriately to allow equal opportunities for all individuals to make the best use of their skills and talents and adequate investment should be made to develop necessary human resources. Improvement in the overall work system should precede the move toward broader implementation of the performance-based pay structure.

Workers acceptance of a revised pay structure should be ensured by encouraging their participation in the process. No pay structure can be successful without the support from the workers. Listening to individual workers is important but if there is a representative group, sufficient discussion should be held with the group prior to implementing a new scheme. It should be noted that to encourage dialogues between the management and the workers on pay structure at the individual company level it is necessary to first promote labour-management dialogue at the national level. *(For the full research findings, please refer to e-Labour News No. 40; Wage System in Korea : What Do the Workers Want?, Kim, Dong-Bae, Research Fellow, Korea Labour Institute)*

3.0 Productivity Practices of Current SMEs in Korea

In 2005, the share of SMEs in terms of number of firms, number of employees, output and added value was 99.4%, 76.3%, 49.7%, and 51.6%, respectively. The share increased rapidly until 2000 but stabilised after that. (Table 3.1)

Table 3.1 The share of SMEs in terms of No. of Firms, Employees and Added Value in Korean Manufacturing (%)

		1980	1990	2000	2005
No. of Firms	Total	30,823	68,872	98,110	117,205
	SME	29,779 (96.6)	67,679 (98.3)	97,379 (99.3)	116,547 (99.4)
No. of Employees	Total	2,014,751	3,019,816	2,652,590	2,865,549
	SME	1,000,044 (49.6)	1,864,189 (61.7)	1,962,908 (74.0)	2,186,348 (76.3)
Output	Total	362,791	1,773,088	5,648,341	8,517,890
	SME	115,709 (31.9)	757,130 (42.7)	2,675,619 (47.4)	4,237,591 (49.7)
Added Value	Total	118,566	709,245	2,194,246	3,127,920
	SME	41,683 (35.2)	314,318 (44.3)	1,101,508 (50.2)	1,613,824 (51.6)

Sources: Korea Statistical Information System (KOSIS) Notes: Output and value added are in 100 million Korea Wons.

3.1 Recent Trends of SME's Productivity in Korea

Labour productivity growth in Korea's manufacturing industry is shown in Table 3.2 by firm size and industry for the period 1999-2003. The growth rates are different across firm size and industry and SMEs have grown as much as large sized firms to become a large part of the economy..

Table 3.2 Per Capita Added Value Growth (%) in Korean Manufacturing by Firm Size and Industry (1999-2003)

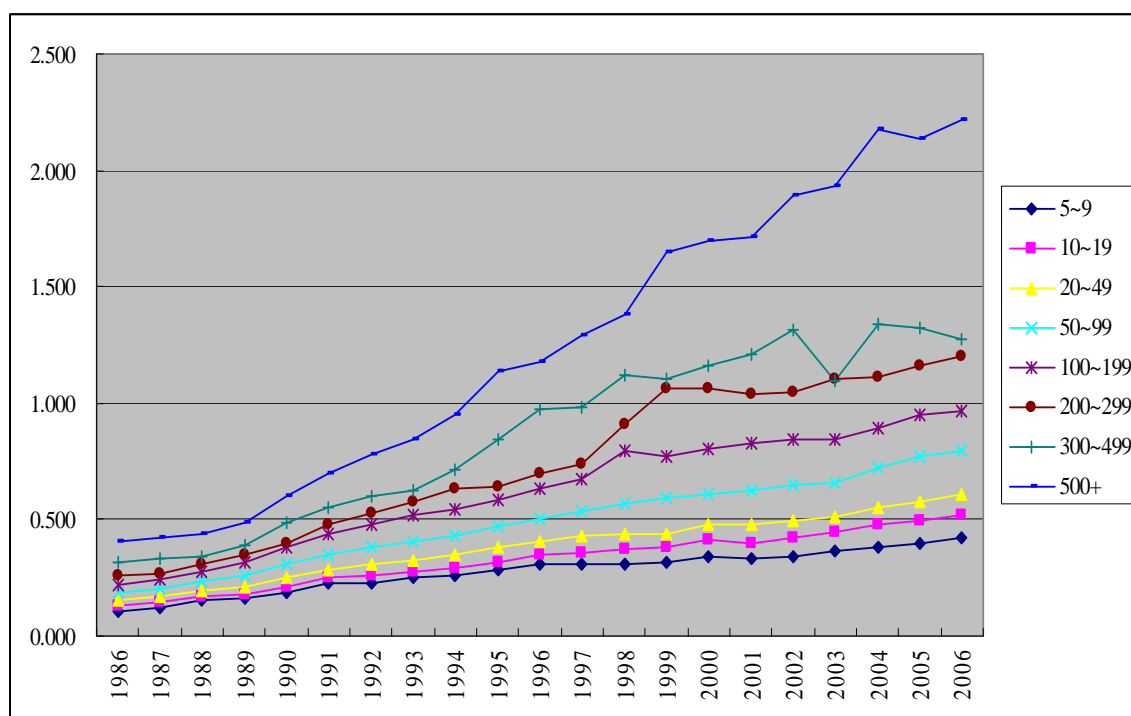
Industry	Total	5~19	20~99	100~299	300~499	500+
Total manufacturing	3.9	6.1	5.9	4.2	2.3	6.5
Food	0	7	3.7	-2.2	-4.5	7.8
Tobacco	4.2	-	21.7	7.3	-20.4	8.8
Textile	0.7	7.2	3.6	1.1	-7.5	-8.6
Clothing	12.2	7.2	14.6	13	12.1	19.4
Leather & Footwear	7.6	5	10.3	0.7	25.4	13.6
Wood	0.9	4.1	1.8	5.1	-	-7.1
Paper	2.2	4.2	2.5	3.8	11.3	1.6
Printing	2.7	5.3	4.4	8.8	9	-3.8

Industry	Total	5~19	20~99	100~299	300~499	500+
Oil	-5.7	-10.6	-0.1	36.8	-	-3.8
Chemical	5.9	4	4.9	10	2.5	11.2
Rubber & plastic	1.7	4.9	4.7	2.7	-3.1	1.6
Non-metal	6	8.6	7.5	8.6	5	5.7
Basic metal	6.8	7.6	5.9	2.5	11.8	10.6
Fabricated metal	2.4	4.6	3.7	1	-6.4	7.6
Machinery & equip.	6.1	6.9	5.9	6	6.4	12.4
Computer	1.5	7.7	5	-5.1	-6.4	3.9
Electronic machinery	2.2	5.4	6.3	0	3.5	3.6
Electronic parts	1.9	4.6	5.8	8.1	0.7	3.2
Medical & precision	3.8	5.7	5.9	0.7	16.3	10.9
Automobiles	9.5	6.1	6	8.9	5.6	12.4
Other transportation	1.7	11.5	6.2	-0.4	-13.1	3
Furniture	3.8	5.1	4.4	5.7	7.4	4.2
Recycled	5.9	7.2	4.4	-	-	-

Source : Kim (2005)

Labour productivity of SMEs was 45.7% of that of large firms in 1993, gradually decreasing to 38.4% in 1997, and only 33.1% in 2005 (Figure 3.1 and 3.2).

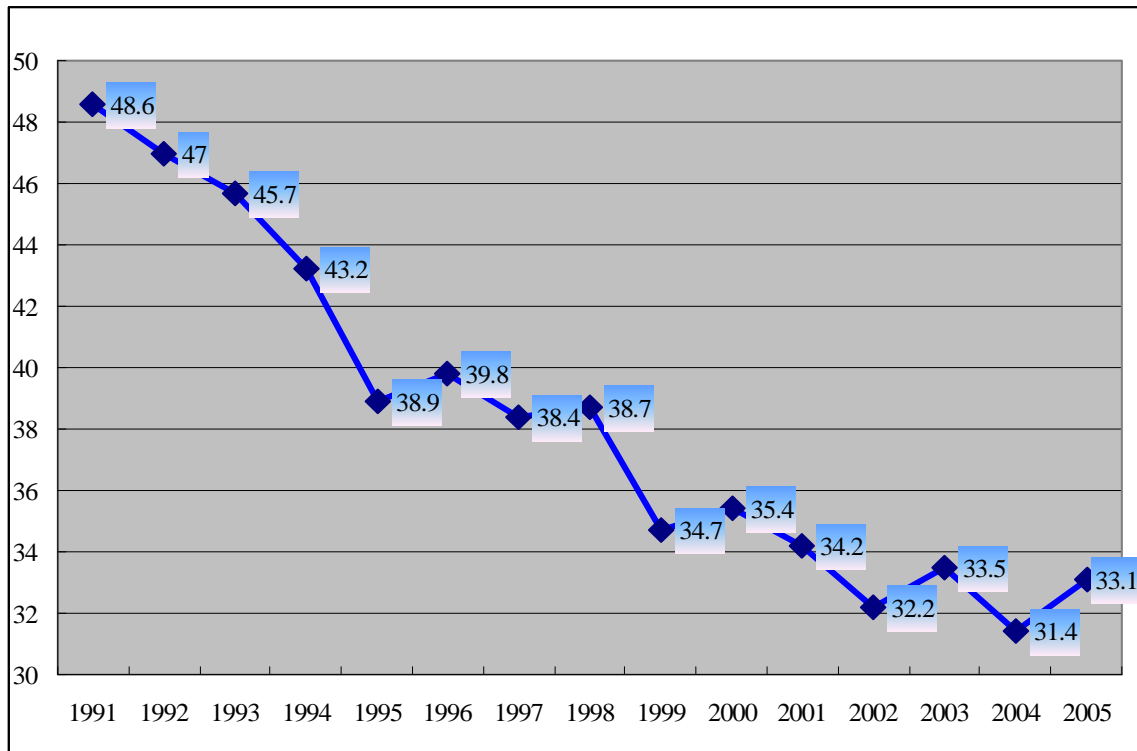
Figure 3.1 Labour Productivity growth by firm size in Korea (1987-2006)



Source : Korea Statistical Information System (KOSIS)

The ratio of labour productivity of SMEs to large firms dropped by about 20% in the earlier half of 1990s and was stable in the later half and it further decreased after the financial crisis in 1997. This continuous decline in the labour productivity was caused by slower growth of investments among SMEs.

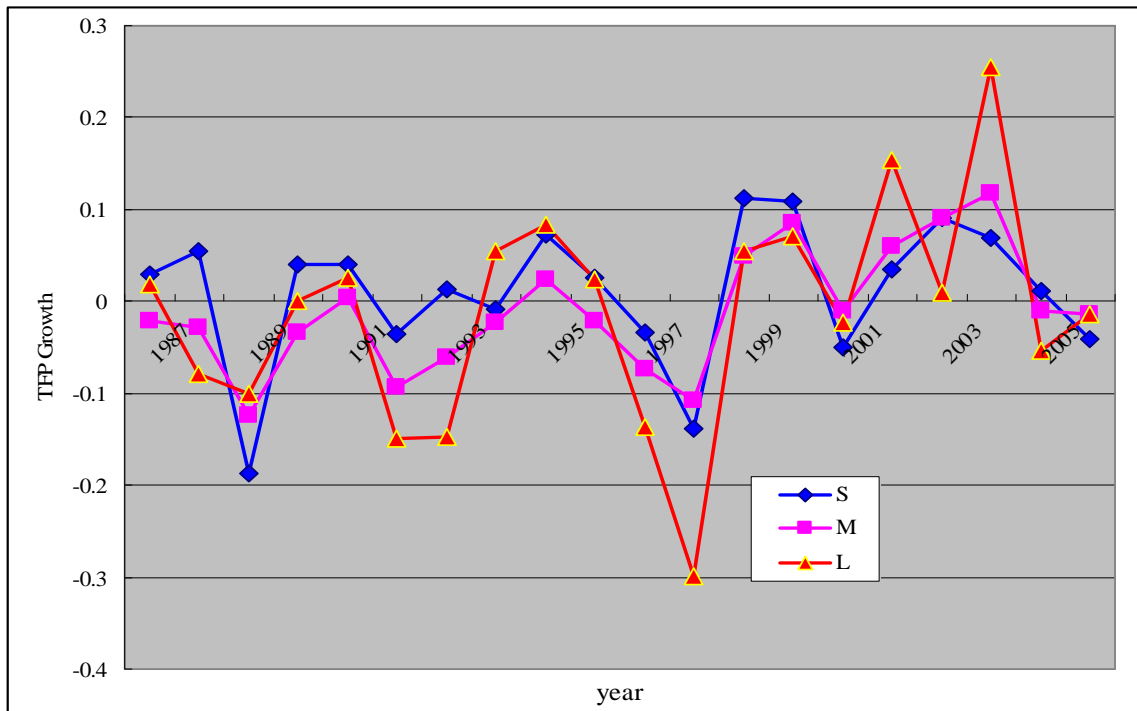
Figure 3.2 Change in the ratio of Labour Productivity of SMEs to large firms in Korea



Source: Ju and Cho (2006), p. 5

TFP growth in SMEs became much lower than larger firms after the crisis while TFP growth in SMEs was not slow compared with larger firms until the financial crisis. Thus, relatively low capital investment was the main reason behind the low labour productivity of SMEs and lagging TFP growth for Korean SMEs after the crisis (Figure 3.3).

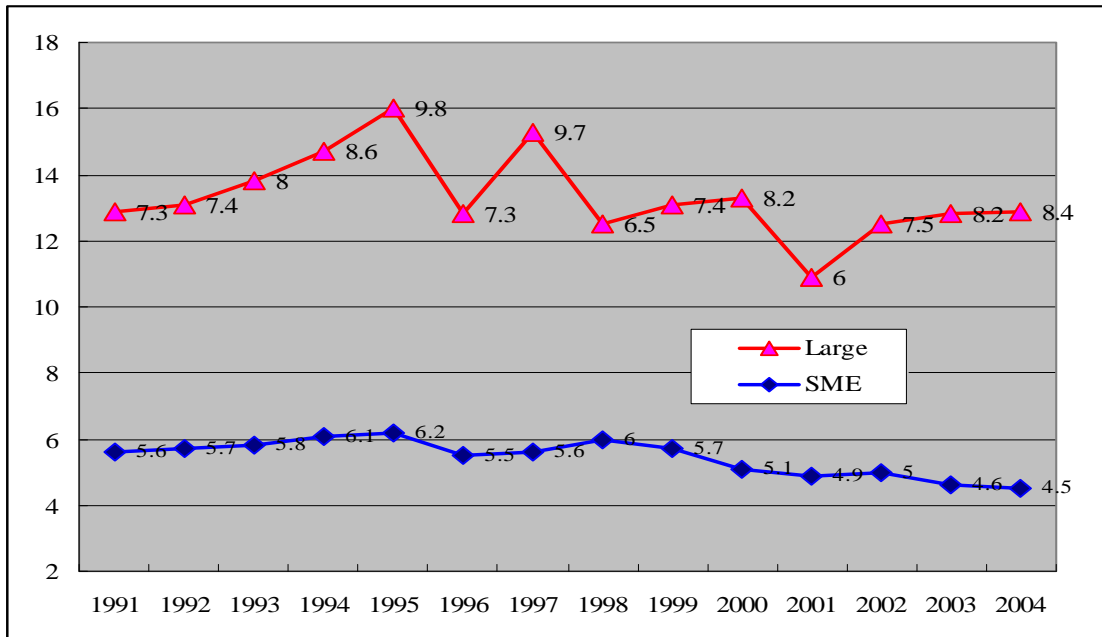
Figure 3.3 Evolution of TFP Growth by firm size in Korea (1987-2006)



Source : Computed from Korea Statistical Information System (KOSIS) data

Capital Accumulation in SMEs along with increasing labour cost lowered operating profits of SMEs in Korea which further deteriorated the profit of SMEs. In addition, slow investments were the result of off-shoring parts and components of large firms that took advantage of low wage of emerging economies, downward pressure of sub-contract supply price, and slow technological change due to low R&D investment.

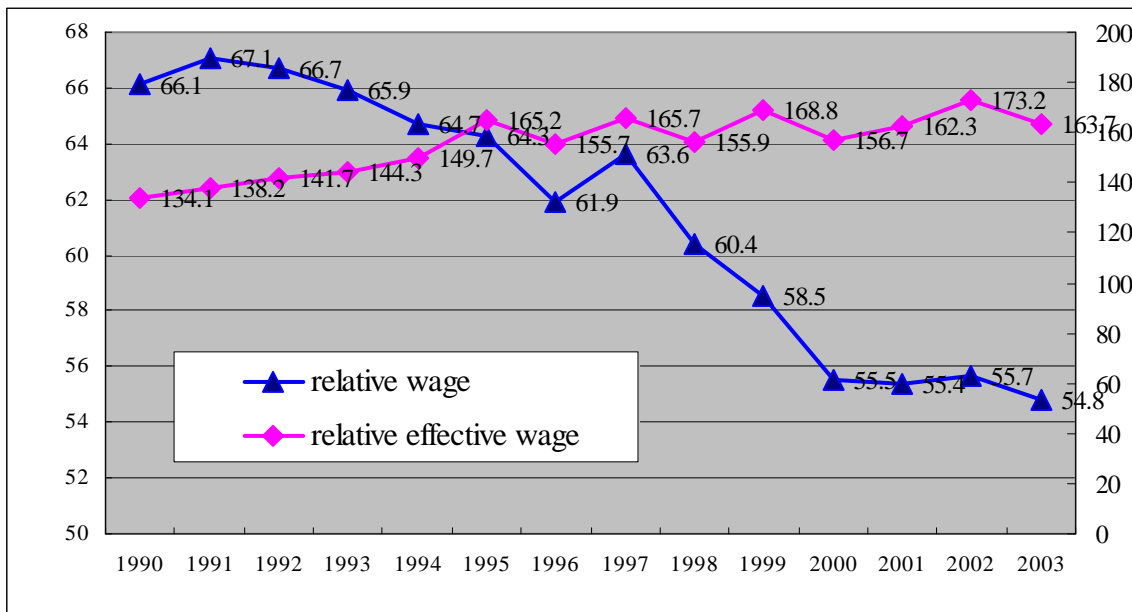
Figure 3.4: Changes in the ratio of operating profit to net sales by firm size in Korea, 1991-2005



Source : Cho (2005), p. 28

As a result, relative wage of SMEs to large firms (=100) slowly decreased from 66% in 1990 to about 55% in 2003. However, this decline in relative wage, cannot compensate for the even greater decrease in labour productivity, therefore, relative effective wage of SMEs to large firms (=100) jumped from 134 in 1990 to 164 in 2003 thus, deterring investments in SMEs. It is expected that the Performance-Linked Payment System will alleviate this burden for SMEs (Figure 3.5).

Figure 3.5 Changes in relative and relative effective wage rate of SMEs in Korea (1991-2005)



Source: Cho (2005), p. 31

3.2 Stylised Facts about SMEs in Korea

- **Capital Investment and Innovative Capacity**

After the financial crisis, capital investment had declined to a very low level that even affected the potential growth rate. This had especially hurt SMEs that lack financial resources. The lack of investment was the problem after the crisis, while over investment and over capacity was the problem before the crisis. The government should restructure the financial system to help SMEs to invest in production facilities. While creating new firms is actively pursued in Korea, this creation should be concentrated more on high value-added manufacturing industries as SMEs are currently concentrated in the declining traditional sectors, causing the problem of excess competition and excess capacity.

High-growing innovative SMEs should be promoted while low-growing SMEs should be restructured. Niche markets should be well defined for successful SME business. One of the initiatives is to be enhance the innovative capability of SMEs as this is would enable them to compete with other emerging low labour cost economies such as the CLMV economies (Cambodia, Laos, Myanmar and Vietnam). This requires cultivating new innovative SMEs

and enhancing innovative capacity of existing SMEs.

If innovative SMEs prosper, overall productivity of SMEs will increase. Thus, competitive market mechanism should be activated to encourage innovative SMEs to be established. However, the innovation capacity is related more with the firms' qualitative characteristics (firm's vitality, the leadership of CEO, motivation of employees) than quantitative ones (size, growth, profit rate, and history): Cho (1995), p.95. R&D investment of SMEs are less than 1%, compared to that of large firms which is more than 2% in 2003. Thus, innovative capacity remains relatively weak compared with larger firms in Korea (Table 3.2).

Table 3.2 Changes in R&D investment of SME and large firms in Korean Manufacturing

	Large firms			SMES		
	R&D Inv.	Sales	R&D/Sales (%)	R&D Inv.	Sales	R&D/Sales(%)
1997	4,467	286,322	1.56	814	129,130	0.63
1998	5,884	291,291	2.02	800	129,089	0.62
1999	5,333	301,295	1.77	767	163,240	0.47
	Large firms			SMES		
	R&D Inv.	Sales	R&D/Sales (%)	R&D Inv.	Sales	R&D/Sales(%)
2000	5,225	355,467	1.47	1,306	184,010	0.71
2001	5,429	357,140	1.52	1,819	183,693	0.99
2002	6,812	396,052	1.72	1,871	220,158	0.85
2003	8,448	18,224	2.02	1,901	243,768	0.78

Source: Cho (2005), p. 96

- **Adapting to Business Cycles**

As the Korean economy matured and becomes more technology-driven, SMEs often have to deal with restructuring problems. After the financial crisis, the

capacity utilisation rate of SMEs became much lower than the average rate of the manufacturing sector. SMEs have easier access to loans and invested heavily to deal with foreign competition during the boom before the crisis but they are the first ones to feel the financial pinch as banks cut back on their lending to SMEs during the recession after the crisis.

SMEs are generally slow to adapting to industrial restructuring as SMEs are operating in low profitable declining industries and therefore fail to move into more profitable rising industries. The industries in which SME's share is high are the ones in which profit rate decreased more (Table 3.3).

Table 3.3 Restructure of SMEs in Korea's Manufacturing Industries

	SME share			Share in total manufacturing		
	1993	2000	Difference	1993	2000	Difference
Food	10.1	11	0.9	8.1	7.2	-0.9
Tobacco	0.2	0.3	0.1	2	1.1	-0.9
Textiles	9.7	8.2	-1.5	7.1	5	-2.1
Clothing	5.1	3.4	-1.7	3.5	2	-1.5
Plastic	5.4	6.1	0.7	3.9	4	0.1
Sub total	42.7	38	-4.7	33.3	25.3	-8
Chemicals	9.5	11.2	1.7	9.9	9.5	-0.4
Non-metal	7.6	5.1	-2.5	5.6	3.8	-1.8
Basic metal	4.5	4.4	-0.1	6.9	6.3	-0.6
Fabricated	7	7.3	0.3	4.7	4.1	-0.6
Computer & office	0.8	1.1	0.3	0.9	3.3	2.4
E&E	3.6	5.5	1.9	10.5	17	6.5
Precision	1.6	2	0.4	1.1	1.1	0
Automobiles	4	4.9	0.9	7.8	9.4	1.6
Sub total	57.3	62	4.7	66.7	74.7	8
Total	100	100	0	100	100	0

Source: Yang (2002), p.60

- **Changing Size of SMEs in Korea**

There had been rapid increase in extremely small firms as reflected in the growth of firms with 5-19 employees. Firms who employ between 5-9 employees had more than doubled from 27,128 in 1992 to 58,379 in 2005, and that with 10-19 employees expanded from 21,288 in 1992 to 30,307 in 2005. However, firms with 50-299 employees decreased from 8,244 to 8,145 during the same period (Table 3.4).

Table 3. 4 Changes in firm-size groups in Korea's manufacturing industry

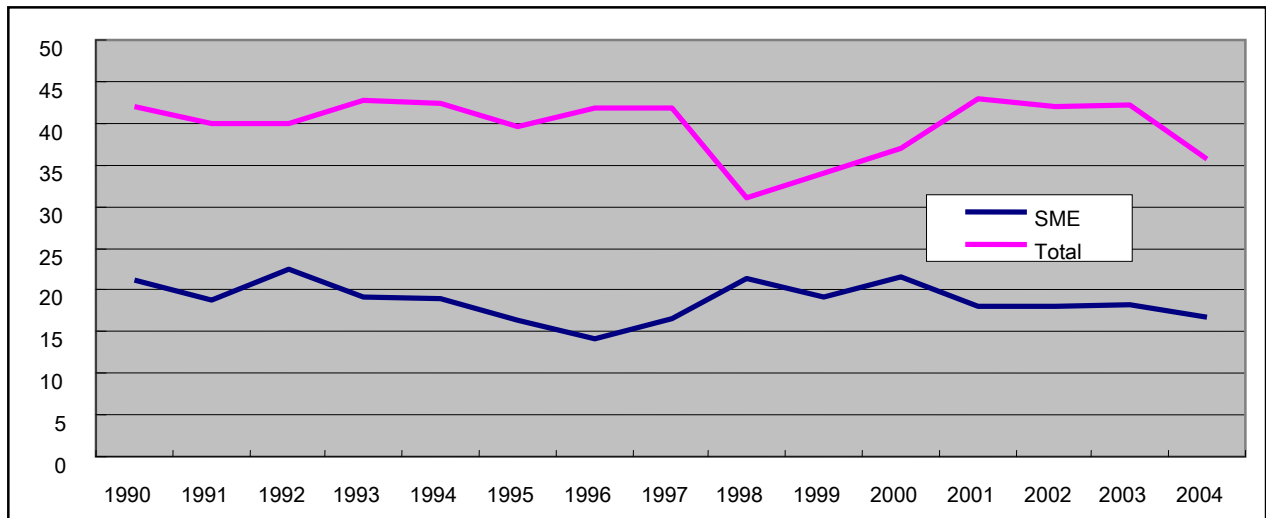
		No. of firms			No. of employees			Added value		
		1990	1996	2004	1990	1996	2004	1990	1996	2004
SME		98.3	99.1	99.4	61.7	69.2	75.7	44.3	47.2	49.4
Extra small	5~9	31.4	45.3	50.7	4.9	9.9	12.9	2.3	4.5	5
Small	10~19	29.2	27.1	25.3	9	12.2	13.7	4.7	6.2	6.7
	20~49	24.8	18.3	16.3	17.4	18.5	19.8	10.6	11.2	11.5
Medium	50~299	12.8	8.4	7.2	30.3	28.6	29.3	26.7	25.5	26.2
Large	300+	1.7	0.9	0.6	38.3	30.8	24.3	55.7	52.8	50.6

Source: Ju and Cho (2006), p.109

- **Internationalisation of SMEs in Korea**

To enable SMEs to expand their markets, there is a need to promote more exports among SMEs. As domestic demand had stagnated, SMEs need to sell more of their products in international market to sustain their growth. However, the share of SMEs in exports and the number of exporting SMEs had declined indicating that SMEs had to double their efforts to enter the challenging export market (Figure 3.6).

Figure 3.6 Changes in the ratio of exports to sales for SMEs in Korea (1990-2005)



Source: Cho (2006), p.41

- **Financial Support System for SMEs**

The current financial support system for SMEs is directed to improve “financial availability” and “financial accessibility” of SMEs as there is asymmetric information in the financial market that affects SMEs. Credit guarantee, business loans and investment financing systems are operated based on the government funds. Financial support for SMEs is implemented through various financial institutions, government agencies, local governments, public credit underwriters and national banks. Under the current system, many SMEs that have access to bank finance are also supported by SME financing which comprises entirely of indirect financing. As the size of SME financial support increases its adequate system is constantly debated.

4.0 Cases on Impact of Performance-Based Remunerations on Enterprises in Korea

4.1 Case A: Employee Evaluation System of Bohae Distiller Inc.

Bohae Inc. was founded in Mokpo, Jeonnam Province in 1950 which is located at the south western tip of the Korean peninsular with about a population of about 200,000. In 1935, the founder Mr. Lee, started a small wholesale business in Mokpo selling general merchandises such as household products and alcohol beverages. In 1945 his business grew and found a large trading company that dealt in seaweed, salt and alcohol. After the liberation of the Korean peninsular from the Japanese rule, he concentrated his business on alcohol trading and acquired a distiller in 1950 to establish K distiller, which preceded the current Bohae Inc.

Since then, the company has firmly established itself as a local distiller of various liquors and wines including soju, apricot wine and whiskey. In 1968, the founder built a factory that produced malt which is a major ingredient of soju that is the most popular Korean liquor with about 20% proof but the factory went bankrupt during the recession in 1978 and was put under court management. The local distiller was however, bailed out by employees efforts and support from the local population who wanted their favorite soju to be made by a local company. The soju market was then monopolised by dominant local producers competing with national player, Jinro Soju Inc. Royalty to Bohae soju was a main asset of the company to recover from the bankruptcy and maintain a huge market share of the local soju market with more than 90% throughout 1970s and 1980s.

In 1991, the company built a frontier distilling factory with capacity of 200,000kl in Jangsung, thus preparing for the second take-off. Currently, with the new facility and continuing introduction of new products, Bohae Inc. established itself as a strong medium local firm with total sales of about 130 billion Korean Won (about 0.13 billion USD). Bohae Inc. now comprises malt and food factory, trading, financing sub-companies, an educational foundation and produces soju,

wines, liquors and whiskey with total assets of 202.9 billion Korean Won (about 0.203 billion USD) with 469 employees. In 1994, the company started to export soju to Japan and export revenues totaled about 3.5 million USD in 2000. It expanded its export market to the US, China, Canada, Australia, New Zealand, and many East and South Asian economies.

Currently, Bohae Inc. has six affiliated companies including B&F, Bohae Apricot Farm, Bohae Mutual Investment Bank, Bohae Trading, Changhae Ethanol and Bohae Educational Foundation. B&F produces apricot beverages and the Bohae Apricot Farm supplies quality apricots to Bohae Inc. and B&F. Bohae Mutual Investment Bank provides banking services to small businesses and low income people and Bohae Trading was founded in 1989 to do international trade, mostly in alcohol beverages. Bohae Educational Foundation provides scholarships to students.

4.1.1 The Vision

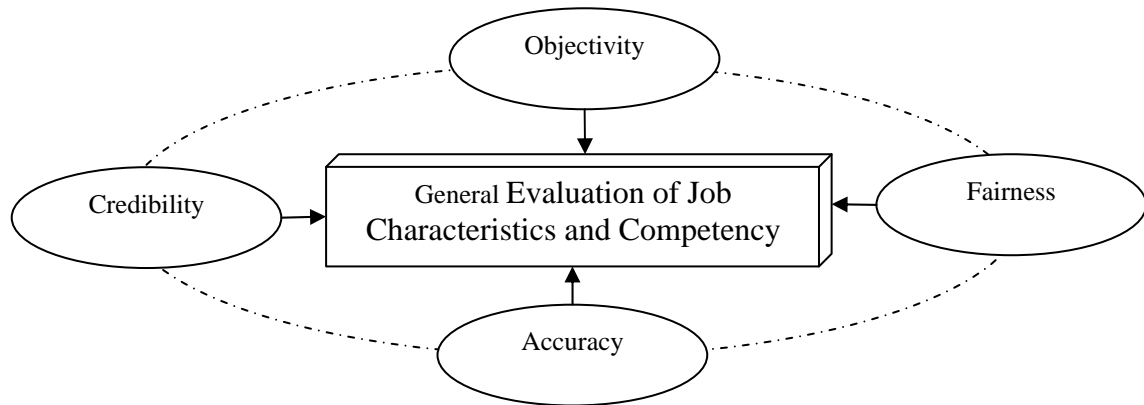
Bohae Inc. has a motto that says "To serve with sincerity, increase productivity, and develop with creativity." The company has a vision to develop a traditional alcohol brand of Korea that can compete with worldwide famous alcohol brands and do its best to internationalise soju. Its goal is to cultivate a new culture in the company, satisfy the consumers and serve the society.

4.1.2 Personnel Management Principle

- **Basic System of Personnel Assessment**

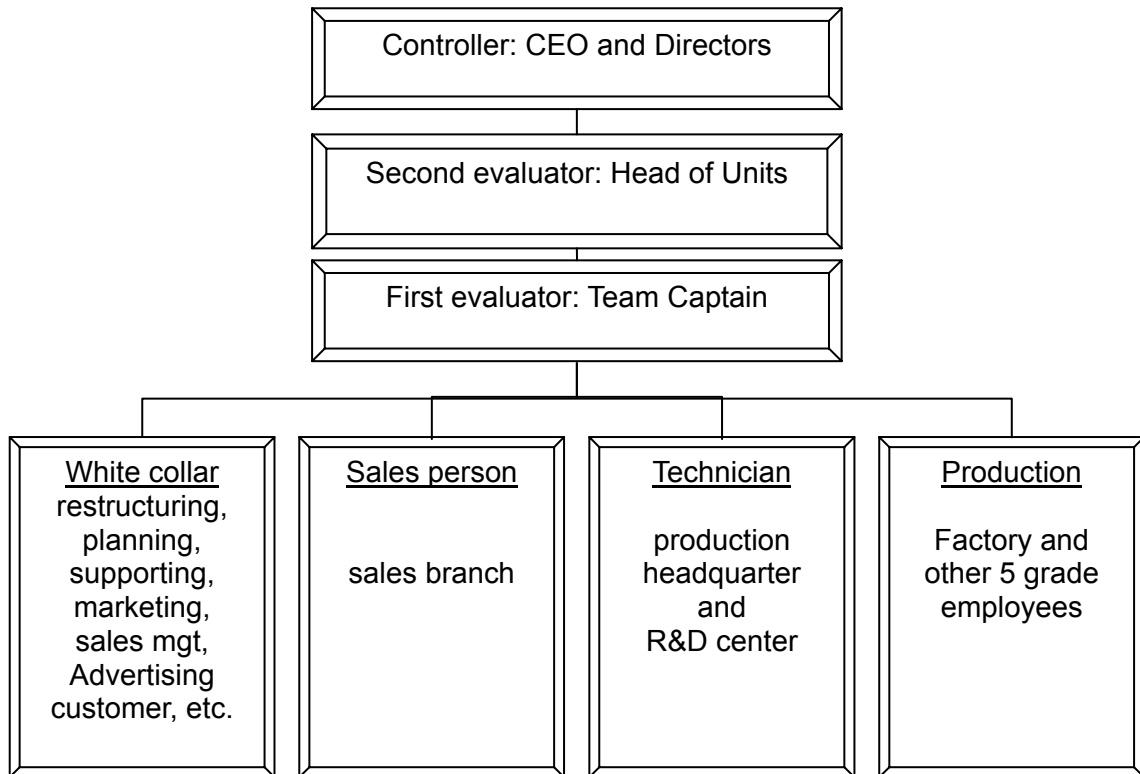
Bohae Inc. enacted a personnel assessment system in 1982 to evaluate employee's working attitude and achievement and linked it to promotion, bonus payment and job training. The company's assessment system has the following principles (Figure 4.1). The goal of the system is to evaluate general conditions required to achieve a basic job for every employee. The evaluation is based on official reports that are both accurate and fair, and implemented biannually in January and July.

Figure 4.1 Basic Principles of Personnel Evaluation



The controller of Bohae Inc. includes the CEO and board members and evaluations are implemented twice a year. For the evaluation of white-collar employees, evaluators including division chief manager, team captain and officers participate in the first assessment but there is no second assessment. For the assessment of sales person, branch manager and officers conduct both first and second assessments. For technician assessment, division and department head and officers evaluate only once, and for workers, department head and line operator are in charge of the first assessment, and division head and directors the second. Directors and CEOs become controllers in each case. Exceptions from the evaluation are acknowledged for new employees with less than three months experience, long-term absentees with more than three months leave and promoted employees with less than three months in the new positions. The basic personnel evaluation structure is as follows (Figure 4.2):

Figure 4. 2 Personnel Evaluation Structure



- **Development of Personnel Evaluation System**

The personnel evaluation system was introduced in 1982 and divisional assessment was implemented based on seniority merits, special merit and achievement evaluation in 1992. Competency evaluation was added to every job and rank but special merit was omitted in 2004. Director's discretionary adjustment was introduced in 2008 and self-development was also required to be incorporated in the report for evaluation. Work performance was evaluated based on mutually agreed goals between evaluators and employees through continuous communication. Evaluation of directors was added in 2008. The development of the system is summarised in Figure 4.3.

Figure 4.3 Development of Personnel Evaluation System

1982 -----> 1992 -----> 2004 -----> 2008 ----->			
Person in charge	Head of Personnel Department	Head of Personnel Department and CEO	Head of Personnel Department and CEO
Evaluation Items	Seniority merit Special merit Performance	Employed period Job attainment evaluation <ul style="list-style-type: none"> ▶ performance ▶ competence 	- Employment Continuance score - Job attainment score <ul style="list-style-type: none"> ▶ performance evaluation ▶ competence evaluation ▶ director's evaluation Self-development

Job achievement evaluation is based on five grades depending on the difficulty, quality and quantity of job. Competence and performance are weighted differently according to jobs. Table 4.1 shows the weights for final grading by job.

Table 4.1 Weights for Final Grading by Job in Bohae Inc.

Evaluation category	Office workers	Sales person	Technician	Production workers
Competence	50%	50%	50%	100%
Performance	50%	50%	50%	0%
Total	100%	100%	100%	100%

4.1.3 Specification of Evaluation Category

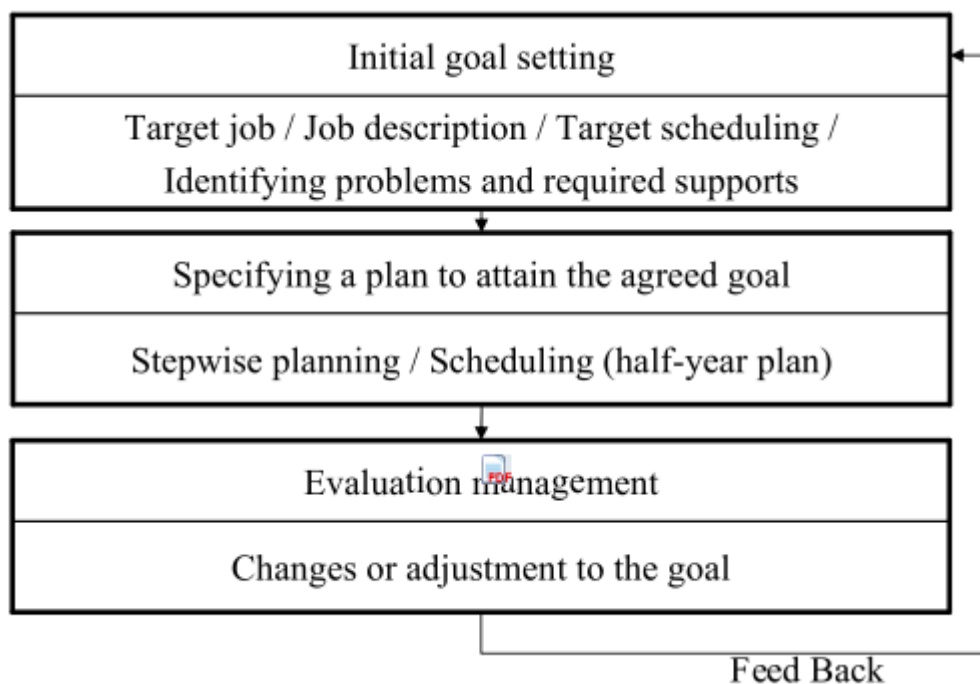
- **Seniority Merit**

Seniority merit gives 2-5 points according to 1, 2, 3 and more than 4 years and absenteeism, late reports, early departs and disciplinary actions are deducted. Employees who received awards, contributed to production increase and completed on-the-job-training are given additional points.

Performance Record

Performance record evaluation is classified into five grades according to work difficulty, quality and quantity, with varying weights to ranks. Competency evaluation comprises three factors of basic factor, job factor and organisational factor. The Director can adjust the total scores by considering two assessments within a certain margin. Job achievement and performance evaluation process is as shown in Figure 4.4:

Figure 4.4 Flow Chart of Goal Setting for Job Evaluation



Evaluation categories include basic factor, job factor and organisational factor and are specified as follows (Table 4.2):

Table 4.2: Competency Evaluation Specification

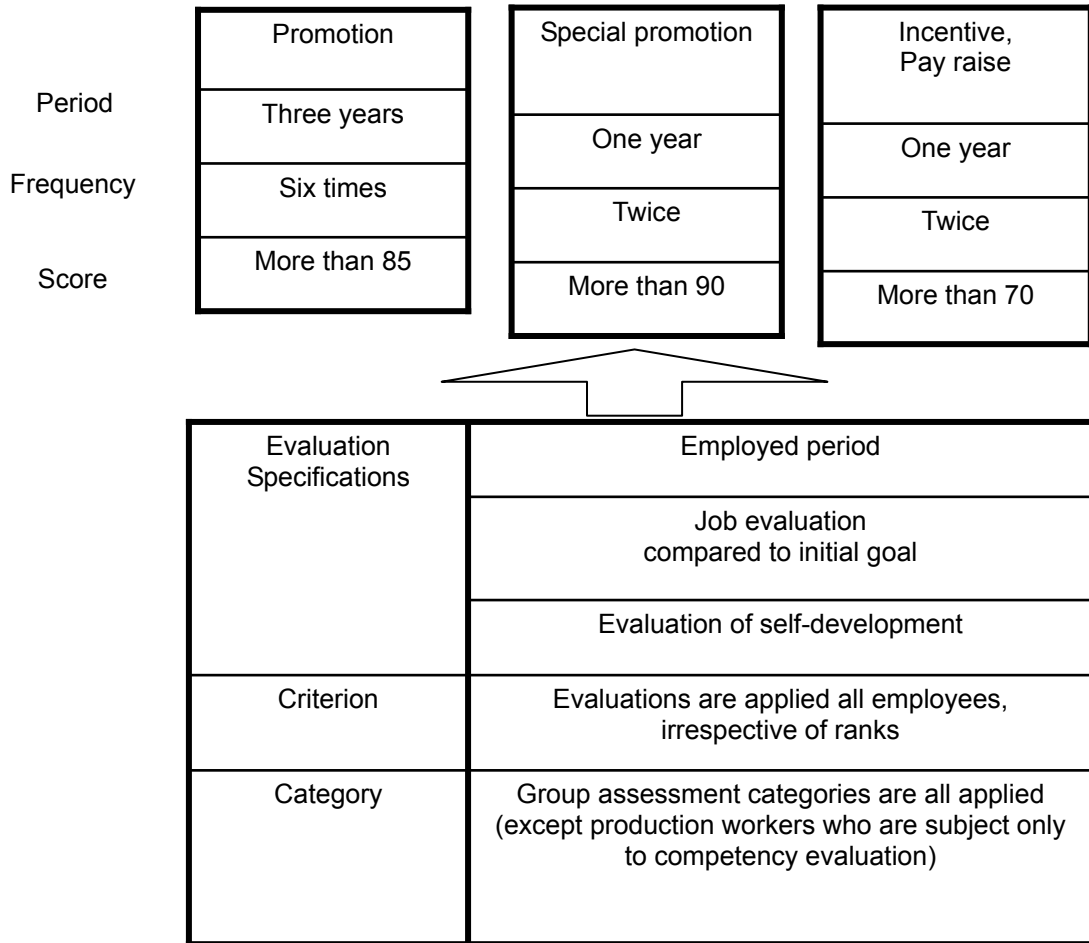
Category	Evaluation factor	Criterion
Basic Quality	Loyalty, Morality, Team spirit	Loyal enough to develop along with the company and moral enough not to pursue individual interest against company's. Does he/she have a good relationship with other employees?
	Managerial awareness	Aware of company's managerial knowledge and his/her role in it. Will he/she contribute to the company in the long run?
	Challenge minded	Adventurous and active enough to set goals and targets and willing to take risks under uncertainty to solve difficulties by him/herself.
Job Competency	Problem-solving ability	Active enough to solve existing problems for him/herself without help from others. Willing to suggest ways to achieve target to a team captain.
	Information gathering and utilisation	Collecting job related information like market trends, competition environments and managerial information, and analyses them to derive important task.
	Accounting and financial awareness	Try to learn accounting and financial knowledge and apply them to work.
	Job knowledge (for white-collars)	Continuously work to earn experience and acting knowledge to attain specialty required to job.
Organisational Competency	Learning	Participate educational program to develop him/herself and disseminate acquired knowledge to other employees.
	Idea suggestion and application	Actively provide issues and ideas to solve them in every area to improve job attainment.
	Communication	Try to keep intimate relationship with other employees and contractors.

The evaluation of self-development assesses job competency and placement, Evaluations are carried out by two evaluators and the controller provides the final grades.

4.1.4 Utilisation of Evaluation Results

Managers in charge of evaluation educate employees before every evaluation to implement the system efficiently. Evaluation is strictly confidential and is notified directly to the employees. Evaluation results are utilised in promotion and incentive payment. The following summarises its utilisation:

Figure 4.5 Utilisation of Evaluation Results



4.1.5. Impact of Evaluation System on Performance

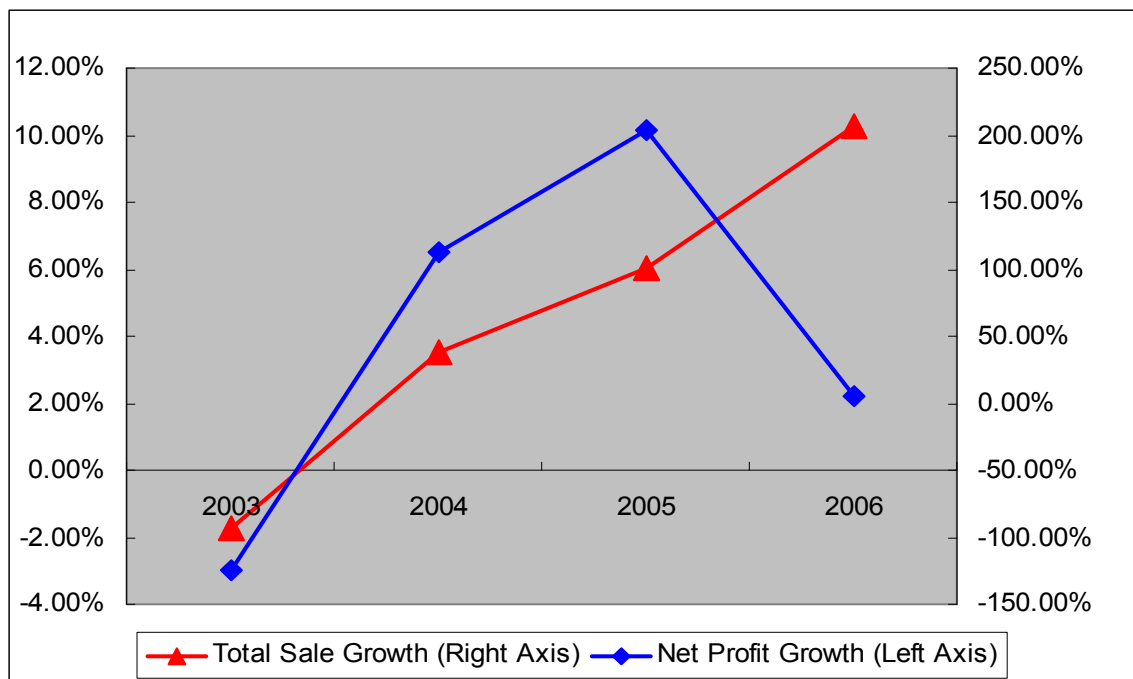
With the introduction of full-scale evaluation system in 2004, Bohae Inc. enjoyed increased sales and profit. Total sale of the company increased from 93.8 billion Won to 99.5 billion Won in 2005.

Table 4.3 Impact of Evaluation System on Performance in Total Sale

	2003	2004	2005	2006	2007
Total Sale (0.1 Billion Won)	906	938	995	1,097	1,267

The positive change is especially noticeable in Soju market as the sale of Bohae Soju, its Soju brand and main product reflecting about 60% of its total sales increased from 3.53% in 2004 to 6.03% in 2005 and the profit increased remarkably from 112.12% in 2004 to 203.78% in 2005 (Figure 4.6).

Figure 4.6 Impact of Evaluation System on Performance in Soju Market



4.1.6 Looking to the Future: Linking Payment to Performance

Bohae Inc. currently does not fully utilise the performance linked payment system but is trying to implement it within 2-3 years after noticing the impact of the evaluation system on productivity, according to a top manager interviewed. The company utilises performance evaluation system only, partially linking it to payment but it is very useful to understand that a local company tried hard to introduce an objective performance evaluation system itself. The company can still reap benefits with the introduction of the system. We have to consider that

the local company rooted firmly on the loyalty of local people is hesitant to link performance into payment especially when it is family oriented like Bohae Inc. The company provides a case that is on crossroads to link payment to performance.

4.2 Case B: Performance-Linked-Payment System of Harim Inc.

Harim Inc. started its business of a small chicken farm in Jeonbuk Province in 1978 and founded a food processing company in 1980. The company was later incorporated in 1990 and built the largest factory for hatching and processing chickens in Korea. The factory boasts the largest capacity even in Asia as it can process 300,000 chickens a day. In 1992, the company's products were accredited with KS (Korean Standard) from the Korean government for their high quality chickens and it was the very first time the certification was extended to farm and dairy products in Korea. In 1997, the stock of the company was listed on the Korean Stock Exchange. The company was later certified with ISO9001 and as a work place applying HACCP for its product quality and management excellence.

In 2003, Harim Inc. survived and recovered from a disastrous fire that burned its processing factory which was the greatest adversity in the company's history. In December of the same year the company was severely hit again by AI (Avian Influenza) that had spread rapidly through out the chicken farms and chicken farmers who were not prepared to cope with it. It was the first time AI broke out in Korea and the chicken industry in Korea was caught in deep depression as it had to dispose of large parts of its livestock and consumers turned away from chicken food. In 2005 however, the company prevented the epidemic greatly by the use of vaccine and other immune enhancing substances, environment-friendly farming equipment and improved waste processing systems, instead of using antibiotics.

Currently, Harim Inc. opened a research institute for bio-science to cooperate with a neighboring local university for both research and development and human resources development by granting scholarships to its students. The

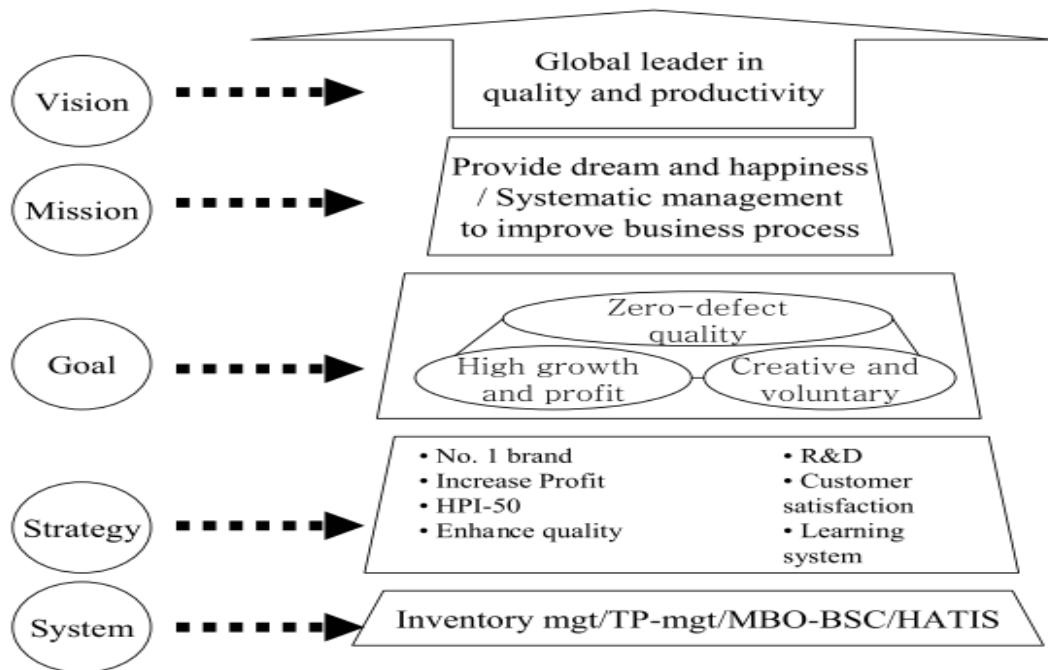
research institute is also pursuing 15 research projects that include a test medicine for cirrhosis, a health product from chicken liver, an anti-aging food and cancer preventing food products, and these projects were selected among applied researches from many university research centers throughout the country.

4.2.1 The Vision

Harim Inc. strived to be a global leader in quality and productivity, tried to build an organisational culture that provides dreams and happiness to its employees, and managed a system that can improve its business process efficiently. The company's goal is to be the best firm by ensuring zero-defect quality, going after high-growth and high-profits, making it the number 1 brand, improving quality and profit, and pursuing continuous research and development.

Harim Inc. wants to run an integrated management system in three areas of farm, factory and market (three-field management) by integrating farming, production and distribution to save cost and provide high-quality hygienic products to consumers. The company provides a vertical integration model of chicken processing business. The company provides a role model to compete with foreign firms based on stock farming that has been considered as small-size, outdated and uncompetitive compared to other global companies. Figure 4.7 depicts the vision, mission, goal and strategy and system of Harim Inc.

Figure 4.7 The Vision, Mission, Goal, Strategy and System of Harim Inc.



4.2.2 Business Divisions

Harim Inc. consists of three business divisions: farming (Division 1), fresh meat (Division 2), and processing (Division 3). Division 1 directly runs Grand Parent Stock, raising 50,000 chickens totaling 800,000 chickens a year under the technical support of special veterinarians. Division 2 operates the butchering factory that can process 350,000 chickens a day with waste and by-products processing and freezing facilities. Division 3 opened in 1997 and produces 100 tons of processed food in a day. Placed in Division 3 are frozen food production and supporting team, R&D team, education center, frozen/retort product, planning, computing and diplopic teams. As affiliated firms, there are C Forage, N Home Shopping, Food Catering Team and Food Company.

4.2.3 Harim Inc.'s Performance Linked Payment System

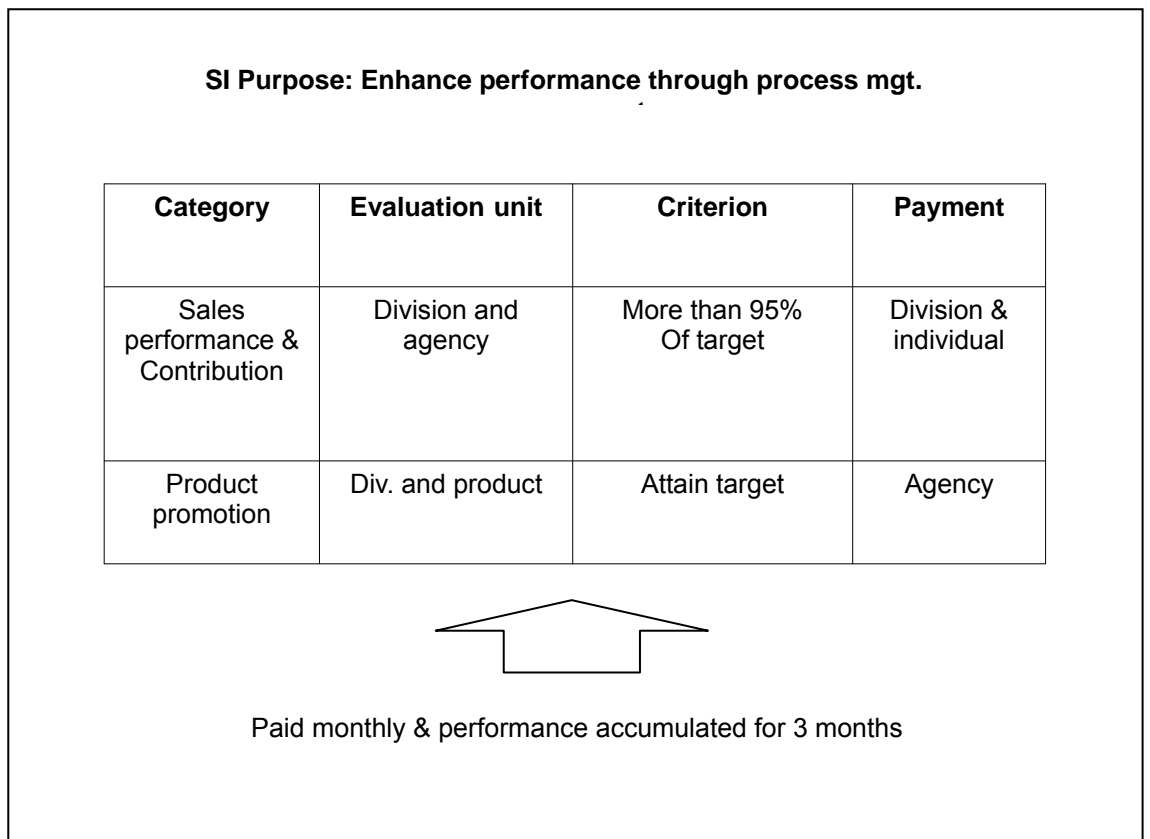
Harim Inc. introduced a performance-linked-payment system to all its employees on 25th December, 2004. The system comprises Sales Incentive (SI), Productivity Incentive (PI) and Profit Share (PS). Among these, SI is a monthly incentive paid to an individual and team that achieves more than 95% of their target after evaluating every sales team in three divisions. PI that is set

up to encourage innovation. It is a quarterly incentive linked to innovation performance and division and business departments are evaluated accordingly. PI also includes distribution of certain specified amount of annual operating profit to its employees.

- **Sales Incentive (SI)**

SI is to enhance performance through process management and the sales department of every division is assessed and paid if the performance target is attained. Evaluation is implemented every month by each division. Monthly assessment is accumulated for three months and incentives are provided in monetary terms, foreign market tour, education etc. SI applies both absolute and relative evaluation and is awarded to good performing employees and teams. SI is also awarded to its affiliated agencies (certified stores, restaurants and catering companies) after evaluating their target management and contribution to the company (Harim Inc.) every month. Particularly, SI for the promotion of new (or existing) product assesses target achievement for the main products. SI procedure is summarized as follows:

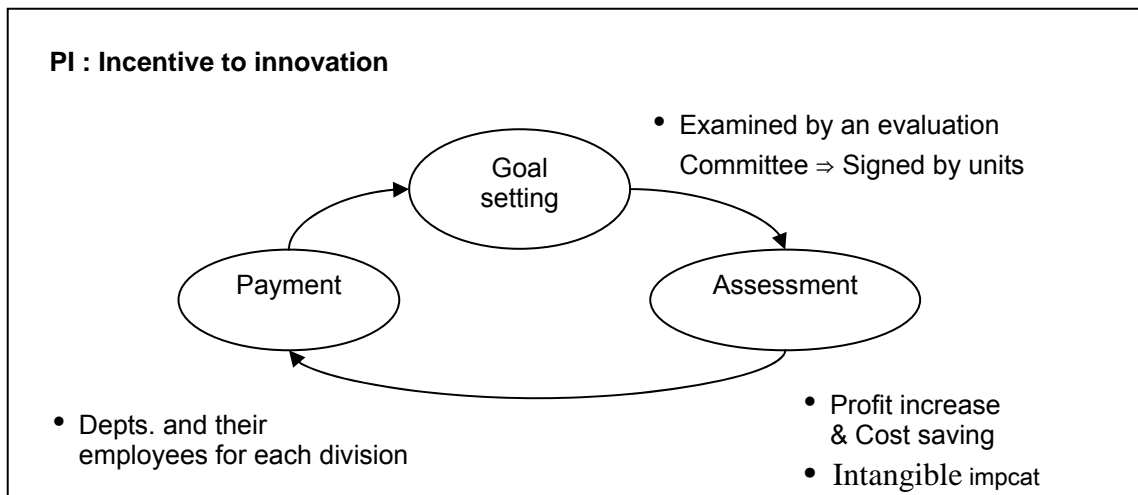
Figure 4.8 Sales Incentive (SI) Procedure of Harim Inc.



- **Productivity Incentive (PI)**

PI is an incentive provided for innovative activities that improve management performance through process innovation. It is paid quarterly to division and business departments but is limited to 50 million Korean Won (approximately 50,000 USD) in maximum. Every year, profit increase and cost savings are used as innovation indices to set the targets, and the incentive is paid to selected departments and its employees after quarterly, bi-annually and yearly evaluation. Target level is set for every department through examination and discussion by the evaluation committee. PI procedure is summarised as follows:

Figure 4.9 Productivity Incentive (PI) Procedure of Harim Inc.



- **Profit Share (PS)**

PS is a distribution of a certain amount of annual profit to employees. A maximum 20% of operating profit is allotted for distribution and is divided according to quarterly contribution of each division. PS is also paid to management employees, production workers, sales persons and part-time employees. Its payment scale is summarised as follows:

Table 4.4 Profit Share (PS) Payment Scale of Harim Inc.

Max. 20% of Operating Profit		More than 20 billion K Won	More than 1.5 billion K Won	More than 1 billion K Won	More than 0.8 billion K Won
Incentive	Administration Employees	200%	150%	120%	100%
	Production	200%	150%	120%	120%
	Sales/Part-time	500,000 Won	400,000 Won	300,000 Won	200,000 Won

Note: One thousand Korean Won is about one USD.

In evaluating PS, weights are given to four evaluation categories to allow for divisional difference (See Table 4.5). However, for over achieving divisional targets a separate compensation scheme will be developed.

Table 4.5 Evaluation Criterion by Division

Criterion	Weight	Division 1 (Farming)	Division 2 (Fresh meat)	Division 3 (Processing)	Headquarter/ Supporting Part
Growth	30%	Output	Sales margin, Sales rev.	Sales weight, Sales rev.	Long and medium term business direction Education/training program
Productivity	30%	Cost saving	Cost/Profit improvement	Cost/Profit improvement	System improvement
Profitability	25%	-Accuracy of expecting mkt demand-supply (supp/demand) -Material depreciation	Operating profit	Operating profit	Total company profit
Stability	15%	non-retrieved Bond, Advance payment	non-retrieved Bond, Inventory asset	non-retrieved Bond, Inventory asset	Bond, Inventory asset

PS grades individual employees by S, A, B, C and D, and pays accordingly. All employees except new employees who had worked less than a year and experienced new employees with less than 6 months on the job are graded. In addition, employees who worked less than 6 months due to education, long-leave and dispatch are exempted from assessment. All exempted are paid the lowest rates among the whole company. Production workers are paid according to the rates prepared by each division. Promotion or other workers employed on daily basis are paid a certain specified amount commensurate with their performance. Table 4.6 summarises the evaluation criterion for employees.

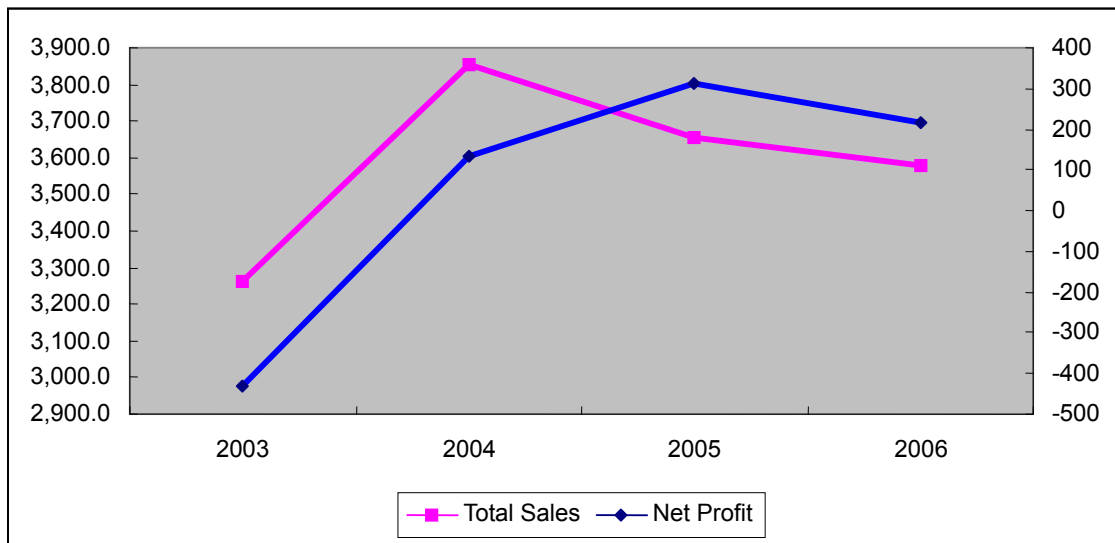
Table 4.6 Employee Evaluation Criterion for Profit Share of Harim Inc.

Grade	S	A	B	C	D
Portion	5%	10%	70%	10%	5%
Range	$\alpha+10\%$	$A+5\%$	α	$\alpha-5\%$	$\alpha-10\%$

4.2.4 The Impact of Evaluation System on Performance

Harim Inc. witnessed a slowdown of its sale since 2003 when it was hit by two continuous disasters, AI outbreak and fire in its processing factory. Total sales of the company increased from 326.3 billion Korean Won in 2003 to 385.3 billion Korean Won in 2004 but decreased to 365.5 billion Korean Won in 2005 and 357.7 billion Korean Won in 2006. The decline of sales since 2004 is, however modest considering the depression in the chicken industry and loss of the production factory (See Figure 4.10). We can see resilience of the company by looking at net profit which increased in 2004 despite a loss due to the fire. It is worth note that Harim Inc. introduced the performance-linked-payment system in the middle of industry depression in 2004 and the system helped to bail out the company from depression.

Figure 4.10 Impact of Evaluation System on Performance in Harim Inc.



4.2.5 What Does a Performance-Linked-Payment System mean to a Local Firm?

Harim Inc. has a production process that integrates farming, processing and marketing and each of these processes is highly outsourced. Much of its chicken farming depends on contracts with farmers by paying them for raising chickens and providing them with chickens and forages. Thus, the quality and quantity of produced chickens can easily be evaluated according to chicken farms. Chicken farms that are run by the company are also subjected to evaluation through well defined standardised product quality. Besides sales incentive the company applies profit sharing and productivity incentives as an incentive system which is rare for a local company in the food industry.

The incentive system was an innovation introduced by a the CEO who was hired for his expertise and career in a major food manufacturing company in Korea. With the introduction of the incentive system in December 2004, Harim Inc. could successfully recover from the depression resulting from AI epidemic and the fire in its processing factory in 2003. Now Harim Inc. is one of the dominant players in the chicken processing industry, sharing 21.9% of the total market and the performance payment system has been influential in introducing innovation.

4.3 Case C: Performance-Linked-Payment System of Maeil Dairy Co. Ltd.

4.3.1 The History, Vision, Mission and Goal

Maeil Ltd. started its business in Gwangju in 1969 and became one of the leading daily products company in Korea after successfully constructing factories throughout the country. The company is an example of a company that was locally brewed and has grown to be Korea's leading total food company through successful expansion. Currently, the company produces cheese, wine, baby clothes, food service as well as milk products, fermented milk, baby food, beverages and soybean milk.

In 2008, the company introduced the new company identity and set up the 5 practical core visions such as: i) Customer Oriented, ii) Initiative and Challenge, iii) Social Contribution, iv) Talent Development, v) Confidence and Trust. It tries to be "the top health food company as the partner of our customer." To ensure continuous growth in the coming days, Maeil Ltd. increased investments in the related fields. The company is working hard to develop fresher milk products by introducing the ESL system and create high value added core business such as baby food products that became the first overseas exports and acquired HACCP. The company also tries to develop new products to meet the various customer needs and explore and foster new businesses to prepare future growth and be the global brand of the total food products company. Table 4.7 summarises the history of Maeil Dairy Co. Ltd.

Table 4.7 Major Milestone of Maeil Dairy Co. Ltd.

Feb 1969	Established Korea Dairy Processing Company
Dec 1973	Completed construction of Gwangju Factory
May 1974	Completed construction of Pyeongtak Factory
Oct 1978	Completed construction of Gyeongsan Factory

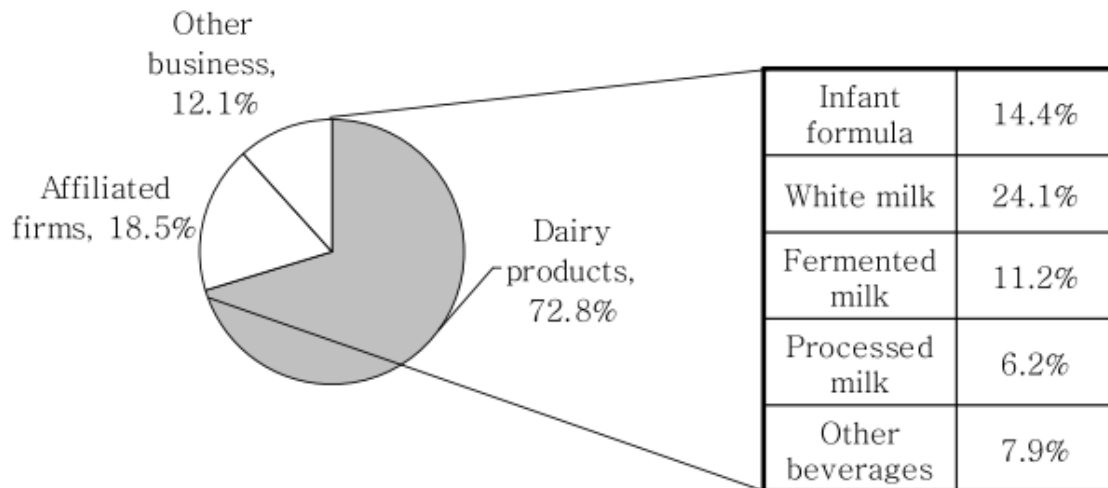
Nov 1989	Established Korea-New Zealand Cheese Corp.
Jul 1997	Established Korea Food Service Co., Ltd (KFSC)
May 1999	Stock listed in the KOSDAQ
Feb 2000	Established IDR International Co., Ltd
Apr 2000	Completed construction of Yeongdong Factory
Oct 2002	Introduced management innovation with ERP system
Feb 2003	Completed construction of Cheongyang Factory
Nov 2004	Completed construction of Gochang Cheese Factory
Feb 2006	Completed construction of Asan Factory
Jan 2007	Declared 2007 Mael Vision

Under the vision “Be the top health food company as the partner of our customers,” Mael Ltd. strives for the continuous growth by expanding to foreign markets, developing a business model that generates profits as well as to strengthen its core capacity as well as being respected by the customers shareholders and partners. The company’s mission is to “Create our customer’s health and happiness through the top quality products,” and its medium term goal is “To be the top 10 food product company till 2012 with 1.6 billion won of the total sales and 1.4 billion won of food products.”

4.3.2 Business Area

Mael Ltd. started its business in dairy products and expanded its business to broad areas in the food industry. Its original business of milk products form about 73% of total sales while the remaining sales comes mostly from other food and health food products produced by affiliated firms. Figure 4.11 depicts Mael’s composition of sales.

Figure 4.11 Sale Composition of Maeil Dairy Co. Ltd.



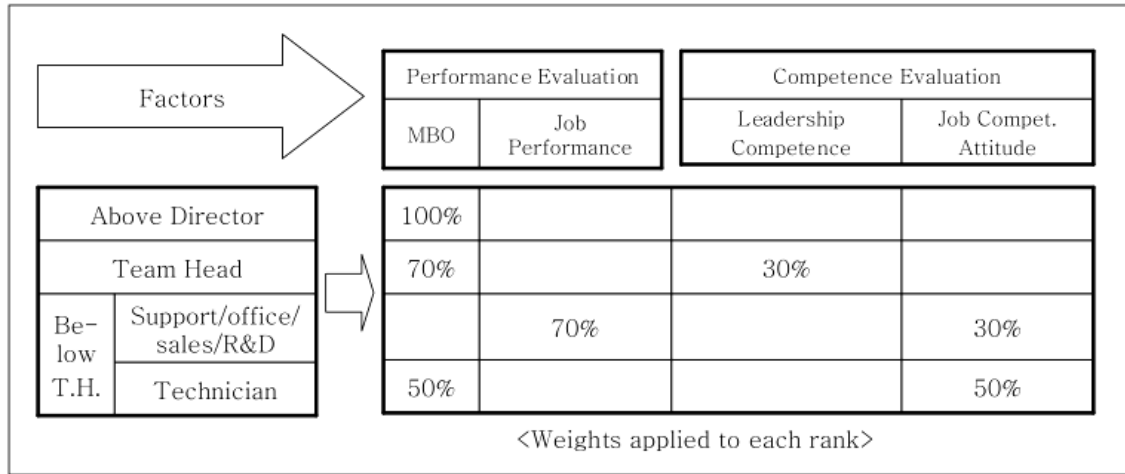
4.3.3 Performance Evaluation System

Maeil Ltd. has a personnel system focusing on employee development and tries to reform the system with an open-mind. In 2007, first year college graduates are paid annual salary of 27 million Korean Won along with 700% of monthly salary as bonus. Employees lower than deputy department manager are paid according to a seniority system in which the monthly salary increases is a pre-determined amount every year along with payment linked to performance. Employees above the rank are paid yearly fixed payments determined through evaluation. Newly hired employees are expected to be promoted to deputy department manager after three years, department manager after four years, deputy section manager after five years and section manager after six years.

- **Weighting System of Evaluation Factors**

Personnel assessment consists of two factors, performance and competence. The categories included in performance evaluation are MBO (Management by Objectives) and job performance, while those related to competence evaluation are leadership and competence/attitude. These factors are weighted differently according to rank. Figure 4.12 depicts the weighting system of evaluation factors of Maeil Dairy Co.

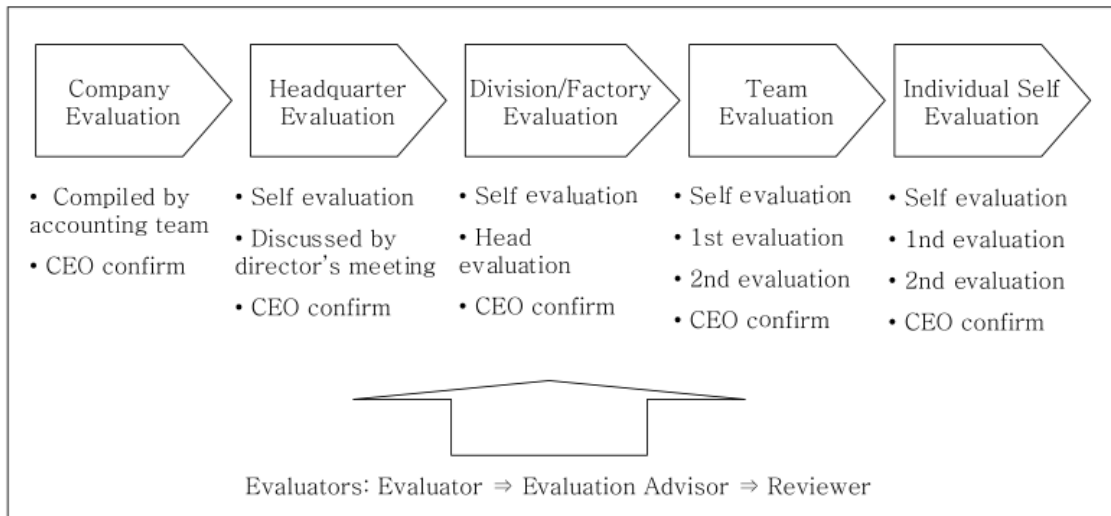
Figure 4.12 Weighting System of Evaluation Factors of Maeil Dairy Co. Ltd.



• **Evaluation Process**

The evaluation process comprises five stages: company evaluation, headquarters evaluation, division/factory evaluation, team evaluation and employee's self evaluation. Evaluation is compiled by an accounting team for company evaluation and headquarters evaluation goes through employee's self assessment and directors' discussion. At division/factory level, evaluation is carried out by head of division/factory and this evaluation is done together with the employee. For team evaluation and individual self evaluation phases, a two stage evaluation processes is implemented. Figure 4.13 shows the evaluation process of Maeil Dairy Co.

Figure 4.13 Evaluation Process of Maeil Dairy Co. Ltd.



For this process, evaluators play a very important role and their job and responsibility are clearly specified. Evaluators include evaluation advisors and reviewers. The evaluator's role is to grade the final evaluation for employees based on performance and competence assessments. Second stage evaluators review first stage evaluation to check the relevancy of evaluation and observance of the rule and can ask for reevaluation if there are any doubts about the evaluation results.

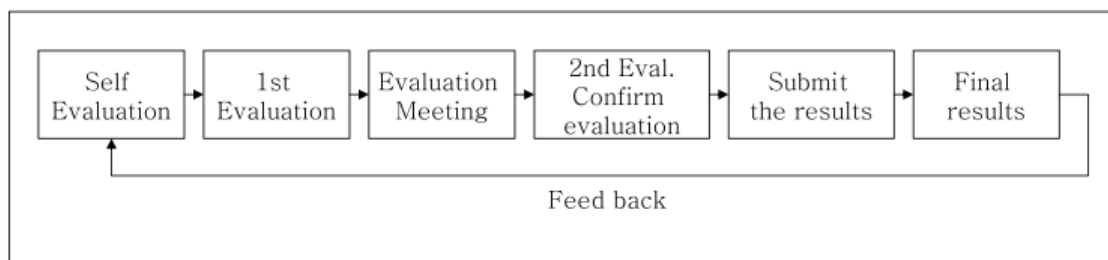
Evaluation advisors operate when team members are too many to handle or employees are out of jurisdiction of evaluators. Evaluation advisors deliver their assessment opinion to evaluators, and are chosen from employees who supervise employees. Finally, reviewers examine overall evaluation to check possible errors to ensure objectivity and could request reevaluation by evaluators if errors are found or adjustment is needed. Reviewers could also ask for change of the results if individual units performance should be balanced with overall evaluation results of their divisions. They can adjust individual employee evaluation and grade distribution. Employees under three months on the job are exempted from the evaluation along with employees who are newly employed, on leave, under contract and temporarily employed.

- **Individual Evaluation Process**

Individual evaluation is the final phase of evaluation process and comprises self evaluation, first evaluation and second evaluation. Main part of self-evaluation is to state his/her job performance and grading, and self-evaluation for competence and attitudes are not implemented. First evaluation measures employees' jobs achievement and grades and their competence/attitude. After evaluation, evaluator discusses the results with employees to derive consensus and provide advice and feedback.

Second evaluation is to confirm the evaluation results. Evaluators review the results and compare them with grades allowed for each division. Evaluation can be returned for further review or confirmed at this stage. Figure 4.14 illustrates individual evaluation process of Maeil Ltd.

Figure 4.14 Individual Evaluation Process of Maeil Dairy Co. Ltd.



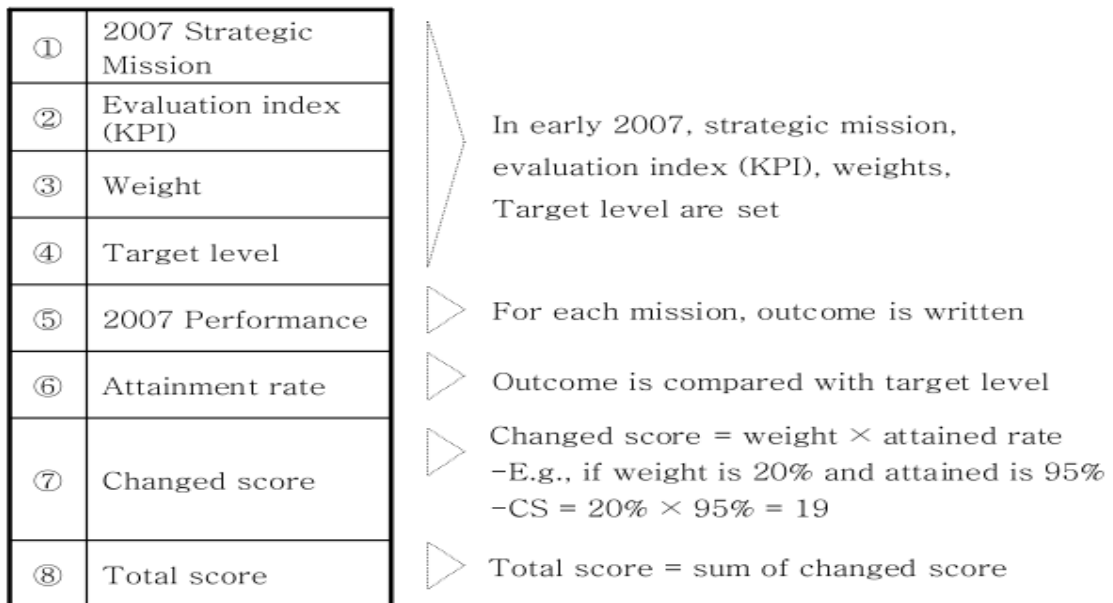
4.3.4. Example of Evaluation Implementation

Evaluation is classified into performance and competence, and performance is divided into MBO and job functions. Competence consists of leadership and job competence/attitude. First MBO and leadership competence is examined:

- **Example of MBO (Management by Objective) Evaluation**

MBO evaluation is applied to directors and heads of teams and use absolute grading against target. Figure 4.15 shows an example of MBO evaluation.

**Figure 4.15 Example of MBO Evaluation of Mael Dairy Co. Ltd.
Example of Leadership Competence Evaluation**



Leadership competence evaluation is applied to head of team and absolute grading is implemented based on leadership competence dictionary. Leadership competence has evaluation categories that include outcome-oriented, leadership and dedication to organisation etc. Evaluators assess and grade the behavior of employees during the evaluation period and competence dictionary is used as measuring standard. Total score is decided depending on the frequency of grade among categories and relative importance of each category. Table 4.8 shows an example of leadership evaluation category of Mael Dairy Co. Ltd.

Table 4.8 Example of Leadership Evaluation Category of Maeil Dairy Co. Ltd.

Category	Competence Definition	Grade				
		D	C	B	A	S
Outcome-oriented	<input type="checkbox"/> Interested enough to work hard and eager enough to challenge to the highest standards. Here, standards include past performance (works to improve), objective measure (results mined), others' performance (competitiveness), and challenge to the goal that nobody has ever reached (innovation).			√		
Leadership	<input type="checkbox"/> Competence revealed in an intention to take a leadership role in a team or other group, and involves a desire to lead others.				√	
Dedication to company	<input type="checkbox"/> Competence or will to behave according to company's objective and priority, act in a way to promote them, and adjust to the need of the organisation.				√	
Total Grade					√	

- **Calculating Final Grade**

For performance and competence evaluation categories, each category's changed score and its weight are used to calculate final changed score (=category changed score × weight), and the summation of these changed scores makes total final score. Evaluation is graded as S/A/B/C/D based on calculated total score according to grading rule. Figure 4.16 shows an example of final grading methods of Maeil Ltd.

**Figure 4.16 Example of Final Grading Methods of Maeil Ltd.
(Applicable to Supporting/Office, Sales, R&D Employees)**

Evaluation Category		Individual Eval. Changed score	Weight	Changed Score	
Performance	MBO				
	Job Performance				
Competence	Job Competence				
	Attitude				
Total Score					
Final Grade					
Evaluator's Opinion					
Grade	S	A	B	C	D
Score	120	110	100	90	80
Result	More th. 110%	100% ~ 110%	90% ~ 100%	80% ~ 90%	Less th. 80%

The final results are now subject to absolute and relative evaluation for review and adjustment. Depending on the results of affiliated division, individual evaluation grade is allocated (based on mixed method of absolute and relative evaluation). Table 4.9 depicts the method:

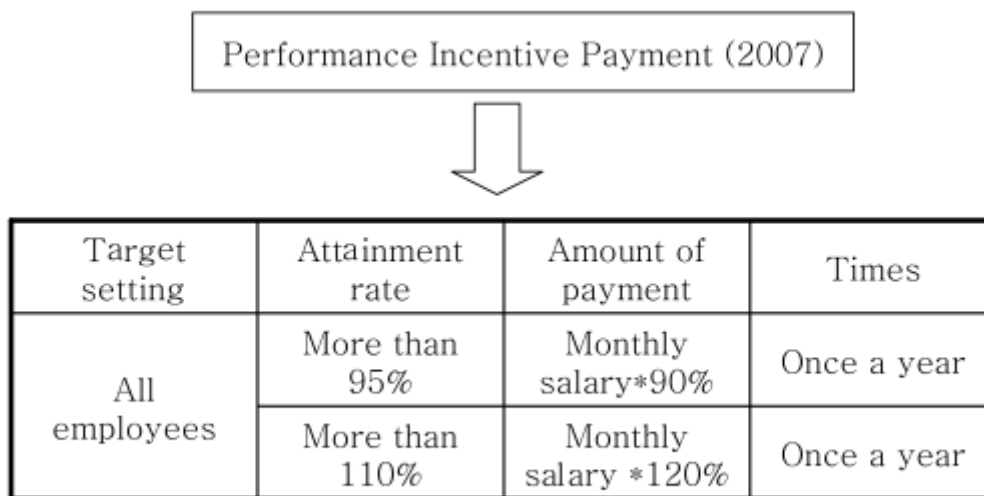
Table 4.9 Final Review of Evaluation Results of Maeil Ltd.

Div. \ Ind.	D	C	B	A	S
D	Absolute Evaluation			Max. 5%	
C				10%	
B				15%	
A				20%	
S				30%	

4.3.5. Performance-Linked-Payment System

Employees higher than deputy department manager are paid according to fixed annual salary that is partially linked to performance evaluation while employees above the rank are paid yearly fixed payments determined through evaluation. Besides this, the following uniform incentive payment applies to all employees regardless of their rank and work area.

Figure 4.17 Performance-Linked-Payment System of Maeil Ltd.



※ Applies to all employees regardless of position and area

4.3.6. Way of Installing a Performance-Linked-Payment System for a Local Firm

Performance evaluation system has long been utilised by Maeil Ltd but the company uses the evaluation system to determine annual salary of employees. This is the most popular system utilised by Korea's small and medium sized enterprises (SME). Many companies do not think they need other complex profit sharing systems because they often determine employee's annual salary based on performance evaluation (Paik, p. 92). Thus, performance-linked-payment system is narrowly implemented as annual salary payment system that revolves around employee performance. This system is more widely observed than profit-sharing payment system for Korean SMEs.

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**Impact of Performance Based Remuneration Systems on Productivity
Performance of Local Industries**

MALAYSIA'S EXPERIENCE

By

MR. YEAP CHIN CHONG

1.0 The Malaysian Economy

In 2007, Malaysia's real gross domestic product (GDP) expanded by 6.3%, driven mainly by strong domestic consumption which increased by 11% as a result of higher expenditure by both the public and private sectors. Private sector expenditure increased by more than 12%, while public sector expenditure increased by 6%. Despite a weaker external environment, the stronger growth achieved reflected the strengthening of macro-economic fundamentals of the country and benefits of a more diversified economic base.

Table 1.1 : Structure of the Economy : 1990, 2000, 2008

	% of GDP		
	1990	2000	2008
Services	40.7	41.6	46.2
Manufacturing	22.7	29.9	29.0
Agriculture	14.6	8.3	7.3
Mining	10.3	10.2	8.0
Construction	3.5	3.8	2.9

Source: Department of Statistics

While the contribution of the manufacturing sector remains substantial, the services sector has become the main driver of growth for the year, supported by new growth areas and domestic demand activities.

1.1 GDP and Productivity Growth

The growth in the economy was broad-based with economic sectors achieving better performance. The Services sector recorded an impressive 9.7% growth and was the major contributor to GDP, contributing a 46.2% share in 2007. The Construction and Mining sectors showed strong performance during the year. Propelled by vibrant domestic consumption and sustained exports, the Manufacturing sector registered a 3.1% growth. (Table 1.2)

Table1. 2 : GDP and Productivity Growth, 2007

	GDP(%)	Productivity(%)
National	6.3	4.2
Finance	12.2	4.9
Trade	11.2	4.5
Transport	7.4	5.7
Other Services	5.0	1.8
Utilities	4.6	3.9
Government	4.6	3.6
Construction	4.6	1.5
Mining	3.2	3.0
Manufacturing	3.1	2.7
Agriculture	2.2	2.8

*Source : Productivity Report 2007
Economic Report, Ministry of Finance*

1.1 Productivity Growth

In tandem with the impressive economic performance, productivity grew by 4.2%, the highest achieved since 2001. The improvement in productivity was attributed to vibrant domestic business activities facilitated by pro-business policies adopted by the government with the setting up of the Special Task Force to facilitate business (PEMUDAH). With the 4.2% productivity growth, productivity level of the Malaysian economy improved to RM48,133 in 2007. Among Asian economies, Malaysia's productivity level was higher than Thailand, Philippines, Indonesia, China and India (Table 1.3).

**Table 3 : Productivity Level and growth among Asian economies,
2007**

Asian Economies	Productivity Growth (%)	Productivity Level (at 2000 constant prices in US\$)
China	10.6	2,963
India	5.4	1,470
Malaysia	4.2	12,661
Indonesia	3.8	2,392
Korea	3.6	29,985
Hong Kong	3.2	67,374
Taiwan	3.3	39,948
Thailand	3.1	4,750
Japan	1.5	81,100
Singapore	-0.9	46,638

Source : Productivity Report 2007, computed from:

- *Economic Report, Ministry of Finance, various issues*
- *OECD Economic Outlook, December 2007, Vol. 82*
- *Country Data, Market Indicators and Forecast, The Economic Intelligence Unit*

The economic growth achieved is complemented with social development. The Malaysian Government's commitment to uplift the quality of life of its people is reflected in the increased expenditure on social programmes such as health, education and training, and housing. In relation to health, the main indicators of population per doctor, beds in government hospitals and special medical institutions and life expectancy rate at birth had improved. More quality healthcare is reflected in the reducing number of patients per doctor by 13.6% from 1,406 in 2002 to 1,214 in 2007 and increased number of beds in government hospitals by 3.5% to 35,739 beds in 2006. As for life expectancy in terms of average age for females, it registered an increase from 75.3 years in 2002 to 76.3 years in 2006. Similarly, the life expectancy for males also increased from 70.8 years to 71.8 years.

This strong economic background coupled with the intensified implementation of productivity and quality initiatives by industries have contributed higher productivity growth of 3.7% in 2006 and 4.2% in 2007³ and improved world competitiveness performance from a ranking of 23 to 19 out of 56 economies.

1.2 The Malaysian Economy, Moving Forward

The Malaysian economy enters this more challenging period following several consecutive years of solid growth averaging 6% per annum. The economy continued to register a strong growth of 7.1% in the first quarter of 2008, led by expansion in both private and public consumption spending, while investment activities remained firm. Growth was further supported by a strong contribution from external demand, following stronger growth arising from commodities exports and demand from non-US markets. Going forward, economic expansion would continue despite a potentially more difficult environment with slower economic growth and uncertainties in the international financial markets.

A number of factors are expected to provide support for growth and enable the Malaysian economy to weather this environment. These include the more diversified economic structure, with increased contribution to growth from the services, agriculture and commodities sectors and the resource and knowledge-driven industries; the strong base in the commodity sector further strengthened the linkages with downstream activities and resource-based industries which continue to benefit from demand from the regional economies; Malaysia's export markets and products are increasingly diversified and the sound macroeconomic fundamentals.

Uncertainties in the global economic environment remain, with overall global growth expected to moderate further. In this environment, the Malaysian economy is expected to continue to expand, supported by continued domestic demand and reinforced by expanding intra-regional trade. It is noteworthy that, according to the Malaysian Institute of Economic Research (MIER) forecast,

³ Productivity Report, 2006 and 2007

Malaysia's trade will exceed RM2.6 trillion by 2020, with RM1.35 trillion exports and 1.28 trillion imports. Given that trade accounts for roughly 200 per cent of Malaysia's GDP, this would translate into a GDP of about RM1.3 trillion in 2020⁴.

2.0 Employment and Wages

The domestic labour market continued to strengthen in 2007, as demand for workers rose during the year amidst faster economic growth. The unemployment rate remained low at 3.3% of the labour force; total employment expanded by 2.1% outpacing the growth of the labour force; total retrenchments continued on a downward trend which began in 2001, declining to 14,035 persons; and vacancy trends also pointed to positive employment conditions, as reflected in the high number of active vacancies reported and active job seekers registered via the Electronic Labour Exchange (ELX). There were positive job creations for all key sectors, with the highest rates of employment growth in the Services sector. Of significance, the Construction sector expanded its workforce in tandem with the recovery in the sector. Nevertheless, the moderation in manufacturing activities led to slower hiring and smaller job gains.

The stronger expansion of economic activities and labour demand resulted in some wage pressures, with executives in the private sector receiving a higher salary increase (5.9%) compared to non-executives (5.6%). The higher average salary increase reflected in part companies' policy in rewarding performance, and use of salary to attract and retain talent. The supply of talent, however, has not matched the pace of demand, resulting in skill shortages, which were felt more acutely in the area of experienced and professional workers.

⁴ Economic Openness, Volatility & Resilience, Malaysian Perspectives, Mohd Ariff

2.1 Salary Increase and Bonus for Executives⁵

In 2007, 233 member companies in the manufacturing and non manufacturing sectors covering 11,542 executives salaries in 117 benchmark positions participated in the survey. Table 1 shows the average minimum monthly basic salary for executives without prior working experience with Diploma to Master Degree. The salary are varies according to academic qualification.

Table 2.1 : Average Minimum Monthly Basic Salary

Qualification	2005(RM)	2006(RM)	2007(RM)
Diploma	1,226	1,241	1,261
Basic Degree	1,707	1,677	1,780
Basic Degree with Honors	1,866	1,895	2,016
Masters Degree	2,401	2,219	2,558

The average salary increase for overall executives in 2007 was 6.25% which is higher than the average salary increase of 5.90% in 2006. Table 2 shows the comparison of criteria adopted by respondent companies in determining salary increase of executives in 2005, 2006 and 2007. Most of the companies preferred salary increased based on employees performance followed by capacity to pay and market rate. More and more companies are moving away from giving salary increases based on seniority.

⁵ This report is based on the Malaysian Employers Federation Survey on Salary and Fringe Benefits for Executives 2007

Table 2.2 : Criteria Used in Determining Salary Increase

	Criteria	%age of respondents		
		2005	2006	2007
1.	Performance of the employee	93.2	94.0	94.8
2.	Comparing capacity to pay	67.4	62.0	64.2
3.	Market rate	49.6	52.3	59.1
4.	Company's profitability/productivity	46.6	48.1	47.7
5.	Job Grade / Size	30.5	25.0	30.1
6.	Increase in the cost of living	23.3	28.2	31.1
7.	Years of experience in the job	19.9	16.2	17.1

Almost 80% of the respondent companies granted salary increase based on workers performance in 2007 compared to 13% and 5.9% for across the board and company's performance respectively (Table 3). This indicates that companies are moving towards rewarding workers for their performance which is a positive sign towards encouraging companies to implement the Performance based systems.

Table 2.3 : Types of Salary Increase

	Types	%age of respondents		
		2005	2006	2007
1.	Workers Performance	75.2	78.3	79.3
2.	Across the board	18.0	16.0	12.8
3.	Company's performance	3.6	4.6	5.9
5.	Others	1.4	1.1	1.1

2.1.1 Bonus Payment

Almost 70% of the respondent companies give bonus to all executives compared to 23.4% for certain executives in 2007 indicating. In terms of types of bonus granted, 73.3% of the respondent companies give bonus based on

companies discretion and only 3.5% gives contractual bonus to their executives in 2007. Among the criteria for awarding discretionary bonus includes Performance and or productivity of the company and employees, seniority level and years of service (Table 4). It is interesting to note that companies are moving away fro seniority and contractual bonus towards performance and productivity based bonuses. The average contractual bonus granted to executives in 2007 was 1.36 months which is lower than 1.89 months in 2006. However, companies give higher discretionary bonus up to 2.15 months and 2.87 months for contractual and discretionary bonus in 2007.

Table 2.4 : Criteria Adopted In Awarding Discretionary Bonus

		Percentage of respondents		
		2005	2006	2007
1.	Performance / Productivity of the company	88.2	87.1	90.9
2.	Performance of the employees	79.5	83.2	76.4
3.	Seniority level	10.3	8.4	7.3
4.	Year of service	9.2	7.1	10.3
5.	Others	5.1	2.6	0.6

2.2 International Comparison Pay and Labour Relations

Among Asian countries, Malaysia ranked 3rd in terms of strongly related to worker productivity in the Global Competitiveness Index (GCI) 2007-2008. As for labour-employer relations, Malaysia ranked 8th. This rank indicates a level of cooperation among employee and employer in Malaysia.

Table 2.5 : Pay and Productivity and Labour-Employer Relations Rankings Among Selected Asian Economies

Economies	Pay and Productivity		Labour-Employer Relations	
	Rank (Out of 131)	Score (1-7)	Rank (Out of 131)	Score (1-7)
Hong Kong	1	6.0	4	5.9
Singapore	2	5.6	2	6.3
Malaysia	3	5.6	8	5.6
Taiwan	4	5.6	13	5.5
South Korea	9	5.2	55	4.7
Japan	13	5.1	6	5.8
China	15	5.0	89	4.3
Thailand	29	4.7	14	5.4
Vietnam	31	4.5	84	4.4
Philippines	39	4.6	69	4.5
India	46	4.7	56	4.7

Source: Global Competitiveness Report; 2007/2008

2.2.1 Compensation Level Among Asian Economies

As for compensation level, among Asian economies, Malaysia was ranked 6th in 2006. Its wage rate of US\$2.74 per hour per worker in the manufacturing sector was still lower than Japan, Korea and Singapore (Table 1.9). Internationally, Malaysia ranked 12th among 29 countries with population greater than 20 million in terms of wage rate (Table 1.10).

Table 2.6 : Compensation Levels (US\$ per worker per hour)*(Total hourly compensation for manufacturing workers)*

Country	Ranking	2004	Ranking	2005	Ranking	2006
Malaysia	3	2.37	3	2.57	6	2.74
Japan	7	21.96	7	21.54	10	20.19
Korea	6	10.82	6	12.74	9	14.70
Taiwan	4	5.97	4	6.41	7	6.43
Singapore	5	7.47	5	7.30	8	8.54
Thailand	-	-	-	-	4	0.92
Indonesia	-	-	-	-	1	0.33
Philippines	1	0.73	1	0.74	3	0.85
China	2	0.84	2	0.96	5	1.14
India	-	-	-	-	2	0.58

Source : IMD World Competitiveness Yearbook, Various Issues

2.2.2 Unit Labour Cost

Unit labour cost is an important criteria in determining Malaysia's competitive edge. In 2007, Malaysia is lowest in unit labour cost than other Asian countries (Table 1.11). Internationally Malaysia maintained low unit labour cost and ranked 1st (Table 1.12). The lower unit labour cost indicates Malaysia's ability to maintain labour cost competitiveness.

Table 2.7 : Unit Labour Cost – Manufacturing Sector*(% age change)*

Selected Asian Economies	Ranking	2005	Ranking	2006	Ranking	2007
Malaysia	1	-8.45	5	-0.66	1	-5.70
Japan	3	-1.12	4	-1.95	3	-2.32
Korea	5	0.19	1	-5.60	4	-0.48
Taiwan	4	-1.11	3	-2.37	2	-5.37
Singapore	2	-1.70	2	-3.50	5	2.60

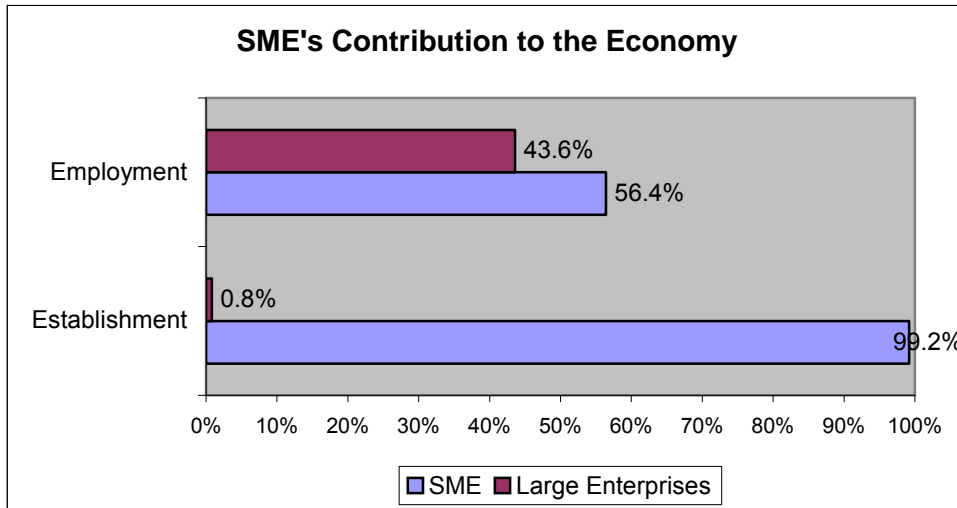
Source: IMD World Competitiveness Yearbook, Various Issues

One of the strategies to further improve Malaysia's competitive position is through the implementation of the Productivity-Linked Wage System (PLWS). This system will enable firms to sustain the growth in labour cost to be in line with its productivity growth. Firms, especially Small and Medium Enterprises should therefore make the necessary adjustments to their current wage systems and ensure that the new wage structure is productivity or performance based.

3.0 Small and Medium Enterprises in Malaysia⁶

With SMEs representing 99% of total business establishments and employing over 5.6 million workers, developing a competitive, productive and resilient SME sector is to support the government's aim of achieving balanced economic development and higher standards of living at all levels of society.

⁶ Based on Chapter Chapter 9, Productivity Report 2007 and Chapter 3 , Productivity Performance of SMEs, SME Annual Report 2007



Source: Census 2005

Small and Medium Enterprises (SMEs) stimulate private ownership and entrepreneurial skills; provide broad based sources of growth whilst also acting as incubators for developing domestic enterprises into large corporations. In developed Asian countries like Japan and China, SMEs' contribution to GDP is already over 55% compared to Malaysian SMEs of 32%. The Government has accorded high priority to the development of SMEs to fully realise the potential. The commitment of the Government is reflected in the national development agenda. Both the Ninth Malaysia Plan (9MP) and the Third Industrial Masterplan (IMP3), outline key strategies for SME development for the 2006-2010 and 2006-2015 periods respectively.

3.1 Productivity Performance of SMEs

Given the Government's adoption of a more comprehensive approach towards SME development such as increasing access to financing, strengthening enabling business infrastructure, enhancing the capacity and capability of SMEs including providing greater access to business support services locally and abroad, the way forward for SMEs is to move up the value chain to remain competitive. These measures have helped in part to raise productivity levels across the three main sectors of the economy. In 2007, 96% of establishments in the manufacturing sector were SMEs, contributing 30.7% of

total manufacturing output, 26.3% of total value added. In addition, more than 400,000 or 31.6% of the total workforce was employed in this sector.

Table 3.1: Total Output, Value Added and Employment of SMEs

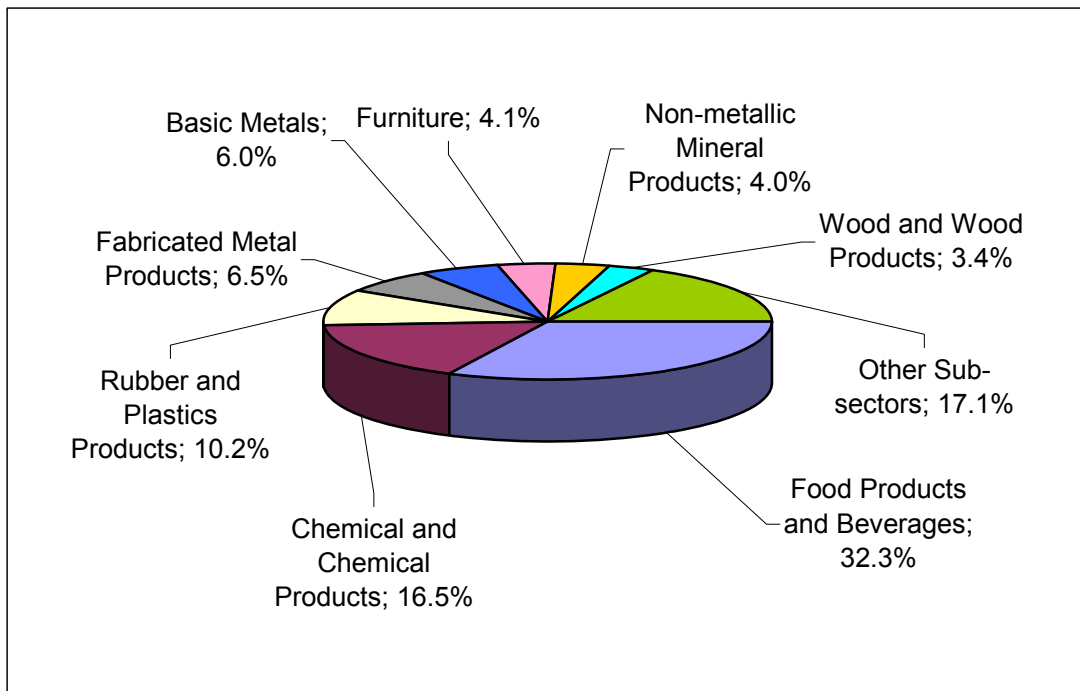
	Value Level*		% age Share of Manufacturing Sector		Growth (%)
	2006	2007	2006	2007	2007
Total Output	88,266	94,356	29.31	30.74	4.91
Value Added	17,798	19,251	25.66	26.33	8.16
Employment	402,496	413,397	31.21	31.62	4.91

Value Levels for Total Output and Value Added are in RM Million

Source: Productivity Report 2007

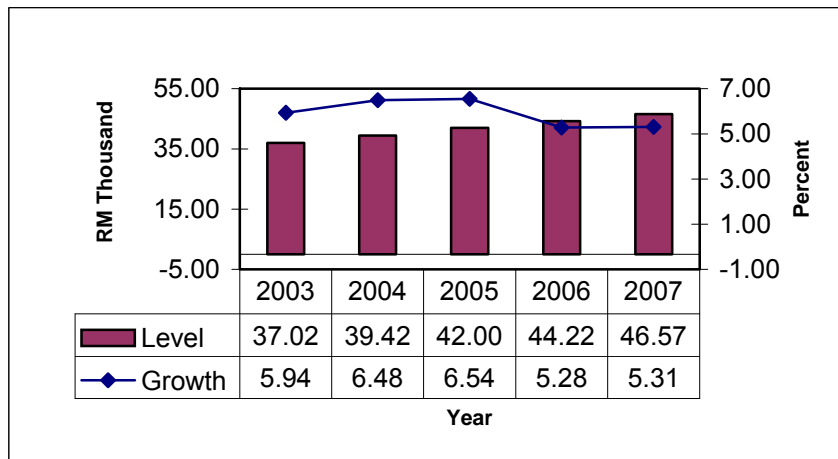
Given its size in terms of output, the food products and beverages sub-sector recorded the largest contribution among SMEs, accounting for 32.3% share of total output. This was followed by chemicals and chemical products (16.5%), rubber and plastic products (10.2%) and furniture (4.1%). These industries accounted for 63.0%, valued at RM59,487 million of SMEs total output in 2007 .

Figure 3.1 : Distribution of SMEs Output in the Manufacturing Sector



In 2007, the growth in productivity of SMEs stood at 5.3%, with a value of RM46.6 million up from RM44.2 million the previous year. The productivity gained was attributed to higher added value creation and capacity utilisation in selected sub-sectors. The high productivity growth mainly in the Chemicals and Chemical Products (11.4%) and Petroleum Products (8.4%) sub-sectors was due to continued investments in modern technology and advance production processes which led to the delivery of higher value added products and services.

Figure 3.2: Productivity of SMEs

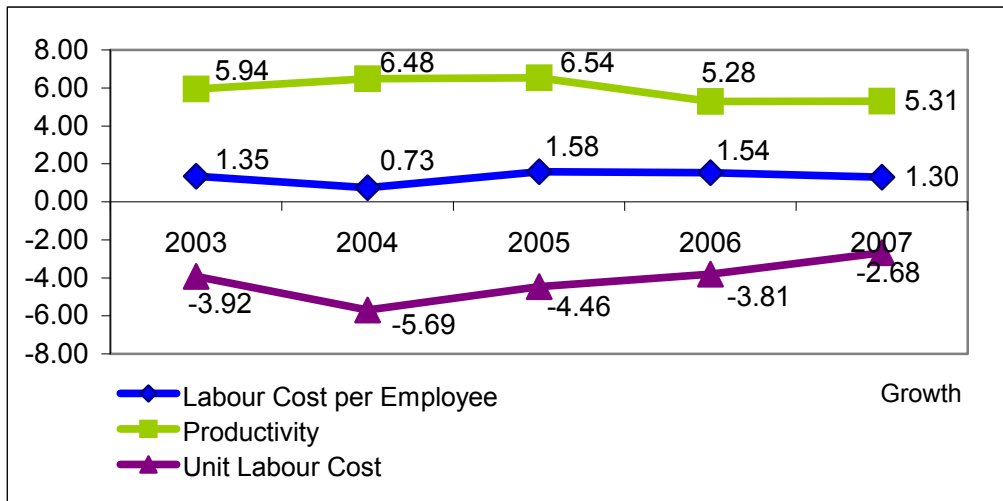


Source: Productivity Report, 2007

3.2 Labour Cost Competitiveness

Labour cost competitiveness of SMEs in the manufacturing sector continued to improve in 2007, with the decline in unit labour cost of 2.7%. This is shown by higher growth of productivity of 5.3%, as compared with labour cost per employee of 1.3%. The higher productivity growth compared to labour cost per employee indicates that the cost of producing one unit of output had improved. In line with Government strategies to build resilient and global competitive organisations, SMEs are encouraged to undertake initiatives such as Quality Environment (QE), continuous improvement (Kaizen), Innovative and Creative Circles (ICC) and Quality Management Systems, to enhance their productivity and competitiveness.

Figure 3.3: Labour Cost Competitiveness of SMEs (2003 – 2007)



Source: Productivity Report, 2007

In view of current situation of increasing competitiveness and globalisation, SMEs need to position themselves and shift towards higher and more efficient technology utilisation by moving up the value chain and focusing on higher added value activities. To compete successfully in the global market and sustain competitiveness, SMEs are encouraged to capitalise on outward investment opportunities, adopt best business practices and be more resilient in the face of greater competition. SMEs should also venture into the identified new sources of economic wealth such as halal products and services, franchising and ICT.

3.3 Issues and Challenges

Since human capital development is expected to further spur the development of business start-ups and increase the supply of skilled and knowledge workers, SMEs need to improve its capacity and capability by investing in appropriate new technologies and intensify the training and retraining of human resources. 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.

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 liberalisation of the education sector.

3.4 Human Resource Policy Thrusts

A trained workforce with the potential and ability to optimise 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;
- Optimising the utilisation 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.

As SMEs assume an important role in the economic growth of the country, the government has put in place various measures to enhance their efficiencies and competitiveness. Various programmes including incentives in the form of grants and soft loans are made available to develop SMEs to encourage development of innovative products and to automate processes, to keep pace with global demand for high quality and competitively priced products and services. SMEs can continue to thrive by accelerating its re-invention and repositioning of business strategies to find new markets and avenues for growth. Reengineering of processes would also be required to better manage the higher costs of production.

The key is for SMEs to use their inherent flexibility and agility to create new products and reorient themselves to better reap the gains from these developments. In the light of increasing customer expectations and demand, SMEs must further enhance the quality of the products and services to penetrate the global market. One area which tends to be overlooked by SMEs

is the importance of enhancing productivity and quality at the organisational level. Thus the initiative which needs to seriously pursued is to enhance the competitiveness and productivity of SMEs through the implementation of a Performance-based remuneration systems, specifically the Productivity-Linked Wage System among SMEs in Malaysia.

4.0 Performance Based Remuneration System

A remuneration system linked to performance will contribute towards enhancing the competitiveness of the organisation and performance-based measures are needed to promote continuous improvements in productivity and quality for sustained competitiveness especially among Small and Medium Enterprises. Various National Development Plans had also emphasised the need for linking wages to productivity. These have been outlined in the Third Outline Perspective Plan 2001-2010, the Ninth Malaysia Plan 2006-2010 and the Third Industrial Master Plan 2006-2020. Details of the plans are as follows:

- **Third Outline Perspective Plan, 2001-2010 (OPP3)**

“It is critical that wage increase commensurate with increases in productivity so that competitiveness of the economy is further enhanced during the OPP3 period. Wage increases, which reflect productivity gains, will ensure that there is no undue pressure on prices and erosion of real incomes. In this regard, the adoption of the Guidelines for a Productivity-Linked Wage System Reform System established in 1996, to ensure a closer link between wages and productivity performance, will be intensified through efforts such as seminars, workshops and company visits”.

- **Ninth Malaysia Plan 2006-2010**

In order to enhance competitiveness and economic resilience, labour productivity will be increased through efficient utilisation of labour, skills upgrading, improving management capabilities, intensifying R&D and innovation activities as well as increasing utilisation of technology and ICT in all sectors of the economy. Firms will also be encouraged to implement the productivity-liked wage system. **High Performance Culture**. As the nation progresses to become a developed nation as envisioned in Vision

2020, efforts will be intensified to develop **knowledge workers who are competitive, flexible, dynamic and performance-oriented.**

- **Third Industrial Master Plan 2006-2020 (IMP3)**

Work systems are evolving towards high performance, self-managed, cross-functional teams, with greater transparency and information sharing. More decision-making is delegated and employees are more empowered. Under flexible work systems, the remuneration system is increasingly linked to the performance of employees and corporations. This requires a flexible system of remuneration, based on productivity and performance.

4.1 Performance Based Remuneration System among Government Linked Corporations (GLCs)

In response to the call by the Government, a Guidelines for implementation of Performance Linked Compensation was developed in 2004.

“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 institutionalised 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.”

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

The focus of the Guiding Principles⁷ 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 of KPI Design, Base Pay, Performance Bonus and Eligibility:

4.1.1 KPI Design

As a business foundation, any organisation 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 overemphasised and has to be developed with the corporate strategy and mission in mind:

- 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

⁷ 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.

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.

4.1.2 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.

4.1.3 Performance Bonus

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. 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.

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. 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. 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.

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needs to be earned from improved market price of the shares in the future rather than existing shareholders at the present.

4.1.4 Eligibility

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 organisation structure. What is key is that this group of people has 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.

The principles of performance linked compensation must be applied to all levels of the organisation. It is however recognised 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-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.

4.1.5 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.

4.2 Implementation of Performance Compensation : The Case of a GLC, Performance Management System of Corporation Era Baru

This organisation was corporatised in 1996 originally to provide computer services to the Group and all its subsidiaries. The Corporation however aspires to become a global player and to realise their full potential through competent leadership. In 2001, the Corporation spread its wings by marketing computer hardware and IT solutions not only to Government Agencies but also to the Corporate sectors. The overall objective is to achieve a minimum 15% dividend from investments through enhancing service quality delivery and be competitive in terms of ICT services.

Realising that to better serve the Corporate sectors, the organisation had to transform itself into a value-added organisation with high performance culture. Thus the organisation initiated the performance approach which is based on:

- The overall Group's business strategies and the primary factors that impact the Group's success
- Business Performance Driver Analysis

The organisation's core competencies are analysed and key performance indicators (Organisation Scorecard) developed to link to succession planning; career development; performance management system and reward system.

4.2.1 Performance Management System of Corporation Era Baru

Performance Management is a shared responsibility between the organisation, staff, reporting managers and reviewing managers. An employee, who is the appraisee, takes responsibility for self in the process, seeks feedback on performance and uses organisational resources for self development. The Reporting Manager who is the direct superior of the appraisee is accountable for his/her performance evaluation and the reviewing manager who is the direct or indirect superior of the reporting manager is responsible for the overall performance of the business unit/group function and department. The focus is on results (Key Performance Indicators), behaviour and skills (competencies).

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:

$$\text{Performance} = \text{KPIs (60\%)} + \text{Competencies (40\%)}$$

Results Based Goals (KPIs)

Competency Indicators

Financial

- ROE
- Revenue Growth

Customer

talent

- Customer Satisfaction Index

Internal Process

- Cost to income ratio
- **Learning and Innovation**
- Employee Engagement Index
- High Performer Attrition Rate

Communication

Teamwork

Innovation and Change

Leadership & nurturing

Drive & resilience

Cultural sensitivity

Business Acumen,
negotiation & deal making

Strategic thinking

Project Goals

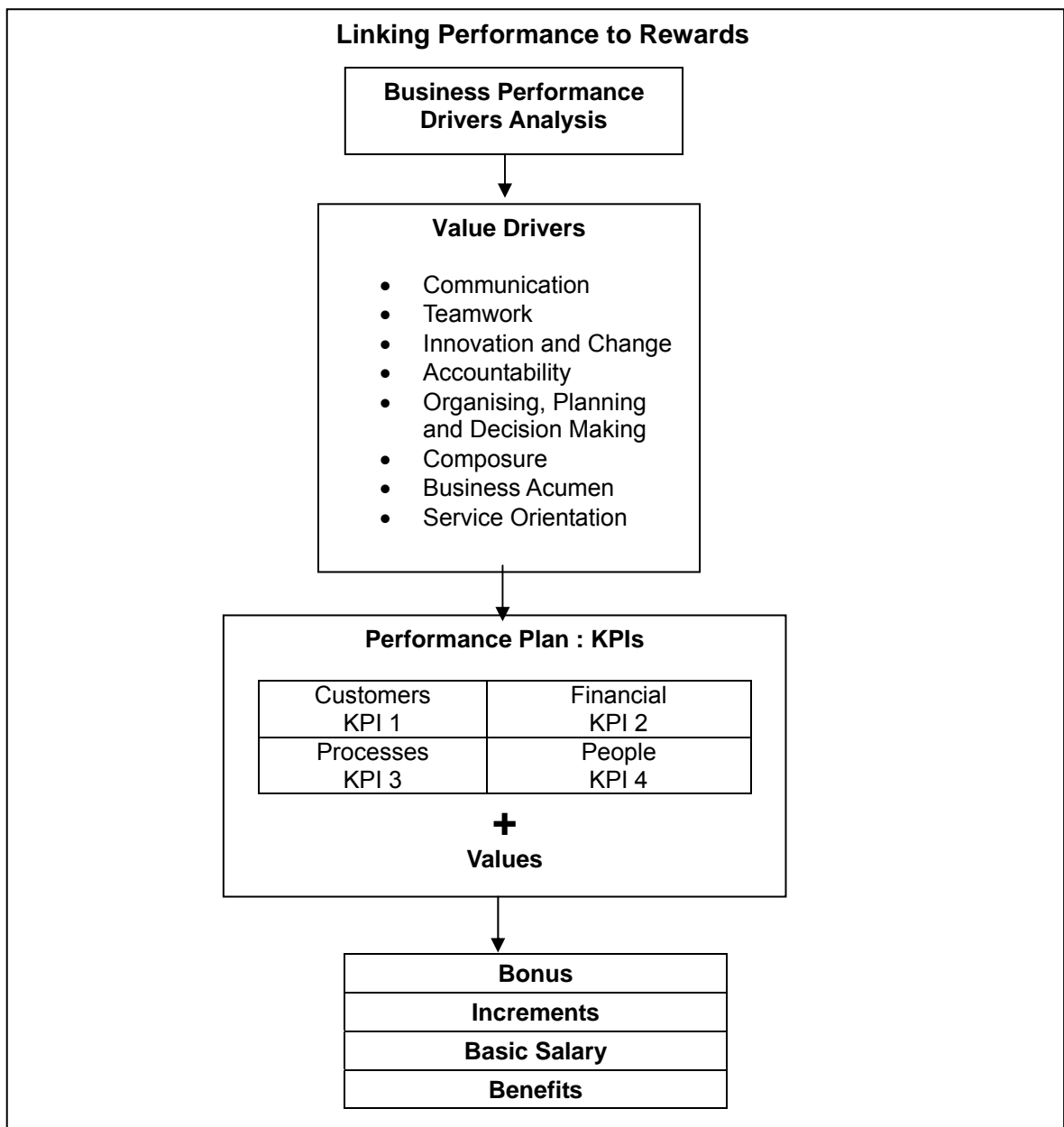
- IT Project
- HR Strategy Project

The Corporation believes that measuring results help strengthen the link between individual goals and business strategy; measuring competencies increases the focus on employee development to enable to achieve individual goals and align their behaviour to the organisation's values and both of these outcomes increase employee motivation to improve business performance. The Performance Management System Cycle consists of 3 main steps of Performance Planning where business goals, KPIs and targets are set upfront and cascaded down the organisation; Performance Assessment where

quantitative targets are independently computed, supervisor solicits inputs from peers, subordinates and clients and Performance Rewarding where performance results will determine annual increments, bonuses and promotions. The Corporation had implemented this system since 2005.

4.2.2 Linking Performance with Rewards

The value drivers at the business unit level which comprises communication; teamwork; innovation and change; accountability; organising, planning and decision making; composure; business acumen; service orientation are “translated into focused performance objectives. These are then measured and linked to the reward:



To link overall Performance to payment of Salary, a perfor

To link overall Performance to payment of Salary, a performance matrix based on a performance range of 1-5 is used as follows:

Performance Matrix

1.0 – 1.5	1.6 - 2.5	2.6 – 3.5	3.6 – 4.5	4.6 – 5.0
Needs most Improvement	Needs some Improvement	Meets Requirements	Exceeds Some	Exceeds All

Each goals/target is assessed according to the employee's level of achievement; both quantitative goal which is the %age of target achieved and qualitative goal based on the assessment of goal and to what extent it was achieved. An appropriate rating (1-5) is assigned for each goal and the weight rating for that category is derived. An example of the performance calculation for a Manager is as follows:

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
	100%	TOTAL		4.1
		KPI Score		2.46

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+	3
Strategic Thinking	A1+	4
	Total	30
	Average Score	3.7
	Competency Score	1.48

The overall rating would be the KPI Score of 2.46 + Competency Score of 1.48, giving the total score for the manager at 3.94. This score 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”.

4.2.3 Impact of the Performance Linked Reward System

The Performance Linked Reward System has both tangible and intangible impact on the employees and the organisation as a whole. Among the intangible impact are that the system demonstrate that the performance management is a shared responsibility between the employer and staff; 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 and increase focus on evaluating actual performance; increase focus on ongoing feedback and coaching; Identify opportunities for staff development; and improve the linkage between individual staff performance

and rewards

- **The tangible Impact of the System**

Since 2005 when the performance system was implemented, the organisation had seen many tangible results. Though it cannot be conclusively drawn that the system is directly and fully the reason for the improvements, the organisation believes that the performance system has direct impact as shown:

Business Performance of Era Baru, 2006-2008

RM'000				
Operational Results	2008 (Planned)	2007 (Actual)	2006 (Actual)	
Income within The group (Captive Mkt)	65,000	46,834	45,587	
Income Outside The group (External)	50,000	26,641	15,232	
Total Income	115,000	73,475	60,819	
Less Cost of Sales	32,000	22,582	23,637	
Gross Income	83,000	50,893	37,182	
Less Operations Cost	32,000	22,000	20,650	
Operating Income	51,000	28,893	15,532	
Less administrative Cost	5,000	4,500	3,710	
Profit Before tax	46,000	24,393	12,822	

Among the quantitative impact are:

- **Profit before tax** almost doubled from 12.8 million in 2006 to 14.4 million in 2007 and is expected to further increased to 46 million in 2008.
- In line with the objective of getting a **bigger proportion of external sales**,

to be more self reliant, external sales as a proportion of total business had increased from 25% in 2006 to 36% in 2007 and is expected to reach 43% in 2008.

- **The Cost of Sales** as a %age of income had been decreasing reflecting more creativity in attracting sales. Costs of sales decreased from 38.8% in 2006 to 39.7% in 2007 and is expected to decline to 27.8% this year.
- In tandem with the increase in profit levels, the **average bonus payments** had also increased from an average of 3 months per employee in 2005, 3.5 months in 2006 and 5.0 months in 2007.

Morale and staff motivation had also increased as is shown by the reducing number of days of Medical leave. Since implementation of the performance system, the medical leave had been reduced by 39.5% from 43 days of medical leave in 2005 to 26 days in 2007, based on a unit comprising of 12 employees which recorded the following:

2005	43 days medical leave
2006	38 days medical leave
2007	26 days medical leave

4.3 Wage Reform towards Performance Based Systems

Malaysia needs to enhance competitiveness and be more responsive to the challenges of globalisation. The economy will be more competitive if companies rationalise costs through higher productivity. With higher productivity, employees and firms will benefit from higher returns which will ultimately improve the standard of living. It is therefore timely that companies address the twin issues of wages and productivity to ensure that wage increases commensurate with higher productivity. If wages increase faster than productivity, unit labour cost will increase, thus making it more expensive to produce one unit of output of goods and services. By linking wages to productivity, Malaysia will be able to improve its cost competitiveness and withstand economic challenges.

Since 1996, the government has initiated a tripartite taskforce comprising the government, trade unions, and employers to develop a system of linking wages to productivity. The taskforce developed a set of Guidelines on Wage Reform which was adopted by the National Labour Advisory Council (NLAC) on 1st August 1996. The objectives of these guidelines are to establish a closer link between wages and productivity so as to enhance competitiveness and promote employment stability; to enable employers to develop a wider and systematic approach towards a improving productivity and wages through the active involvement and cooperation of their employees; and to enable employees to obtain a fair share of the gains that arise from productivity growth and performance improvement thereby promoting equity, social cohesion and enhancing the quality of life as well as developing improved skill-related career paths and increasing job satisfaction.

4.4 Linking Wages to Productivity⁸

Recognising the importance of enhancing productivity through a wage system that is linked to performance and productivity, the Malaysia Productivity Corporation had developed the Productivity-Linked Wage System (PLWS). The PLWS provides a formal framework of linking wages to productivity. It comprises of a fixed and variable component. This type of wage structure will ensure that wages will not increase faster than productivity. The fixed component comprises of the basic wage which provides income stability, acts as an indicator of the job value in the market and reflects the cost of living. The variable component provides the variability determined by performance of the economy, workers productivity, and company's profitability.

The main features of the PLWS are that wages would cover a combination of monthly or other frequent payments, annual increments, an annual or other infrequent bonus; wages shall comprise of a fixed component which includes basic wage and an additional component in the form of variable payment;

⁸ Reference : Malaysia Productivity Corporation's various publications on Productivity Linked Wage System and Performance Based Remuneration System

changes in the basic wage shall take into account factors including changes in the cost of living; fixed wage component should reflect the value of the job and annual increments paid is in recognition of the employees length of service and experience; and the variable component of wages could be determined in relation to productivity and performance of the individual, work group or organisation. The indicators used must be transparent and measurable and consideration must also be given by parties to the timing of payment of the variable wage component.

4.4.1 PLWS Models

The key elements of PLWS are the fixed component and the variable component. The Fixed Component comprises of:

- Basic wage
- Annual increment
- Contractual bonus (where applicable)

The Variable Component comprises of:

- Wage increases for the year is based on productivity/profit sharing formula.

Three generic models have been developed for companies to adopt and adapt. These are the Profitability Model, the Productivity Model and the Productivity/Profitability Matrix or the Combined Model, which links productivity to profitability. A description of each of the models and examples are illustrated as below:

The Profitability Model

In this model, the fixed component includes the basic wage and an annual increment. The variable component will be determined using a profit-sharing formula where:

- The formula is to be agreed upon between the management and union and reviewed periodically;
- Wage incentive is paid if profits exceed a pre-determined or threshold level which can be calculated based on absolute or relative form or average profit earned over a number of years as follows:

(a) Absolute form, RM Quantum of profit:

- Trading/operating profit
- Net profit before tax
- Profit after tax

(b) Relative form:

- Return on sales
- Return on equity
- Return on assets

The majority of companies that adopt the profitability model pay bonuses when profits have exceeded a pre-determined or threshold level. Historical data of between 3-5 years is normally used.

The variable component which is the amount of bonus to be paid is related to the magnitude of the profits. Bonus is paid if actual profits fall within predetermined ranges or bands. The link between the amount of variable payment made in relation to profits made is shown below:

Payment of Bonus According To Different Profit Levels

Profit After Tax (Million RM)	Bonus Month(s) Salary
Less than 1.5 (threshold)	0
1.5 – 1.9	0.5
2.0 – 2.4	1.0
2.5 – 2.9	1.5
3.0 and above	2.0

For example, if profit after tax is RM2.7 million, based on the payment set out, a bonus of 1.5 months will be paid. However, if profits fall below RM1.5 million, no bonuses will be given for that year. The variable component is usually a one-time, non-cumulative payment. The payment may also be subject to the negotiations between management and union. In a non-unionised environment,

Payment of Bonus According to Different Profitability and Productivity Levels

Annual Profit (RM Million)	Months Of Basic Wage					
	Above 1.49	1.00	1.00	1.25	1.50	1.75
1.00 - 1.49	0.75	0.75	1.00	1.25	1.50	1.75
0.70 - 0.99	0.50	0.50	0.75	1.00	1.25	1.50
0.50 - 0.69	0.25	0.25	0.50	0.75	1.00	1.25
Below 0.50	0	0	0.25	0.50	0.75	1.00
Productivity ratio	<1	1-2.49	2.5-4.99	5-7.45	7.5-9.99	>10

For example, if annual profit of the company is between RM1.00-1.49 million and productivity is between 2.5-4.99 then the bonus payment for that year will be 1 month basic wage. If profit is below RM0.50 million and productivity is between 1-2.49 no bonus will be paid for that year.

4.4.2 Elements of Productivity Linkages in Collective Agreements⁹

Based on the 2005, 2006 and 2007 Collective Agreements deposited and taken cognisance of by the Industrial Court a total of companies had incorporated the Productivity-Linked Wage System (PLWS) in their collective agreements. These involve full systems whereby the fixed and variable components are present. Among the models used are Performance-based Incentive System, Performance Merit Scheme, Performance-based Increment Scheme and Performance Bonus System.

⁹ Malaysia Productivity Corporation carries out annual surveys on PLWS in Collective Agreements

Table 4.1: Productivity-linked Wage System in Collective Agreements

Sector	Total Number of Collective Agreements			Number/%age of Collective Agreements with Performance-based Elements					
	2005	2006	2007	2005		2006		2007	
				No.	%	No.	%	No.	%
Manufacturing	130	217	187	73	56.1	129	59.4	117	62.6
Services	101	144	116	47	46.5	90	62.5	68	58.6
Agriculture	8	12	11	8	100	12	100	11	100
Total	239	373	314	128	53.6	231	61.9	196	62.4

4.2: Types of Performance-based Elements Incorporated in Collective Agreements

Performance-based Elements	2007 (%)
Company/Individual Performance	33.4
Commitment Incentives	16.6
Productivity/Merit Increments	13.4
Bonus Based on Merit	12.1
Service Incentives	5.7
Skills Incentives	3.2
Individual and Group Targets	2.0

There are various elements in Collective Agreements that indicate a firms move towards a wage system that is productivity or performance linked. These elements are decided upon by management and employees and are

incorporated into their Collective Agreements for a three year period and subject to review at the end of the period. The main elements of productivity linkages that are widely used by firms are as follows:

Non-contractual bonus

- Unlike the contractual bonus system where management fixes the quantum of bonus, the non-contractual bonus system is more flexible and is determined at management's discretion or through negotiations with employees, The quantum of bonus to be paid is not fixed and can vary from less than one month to more depending on the organisation's profit level or employees performance or both. As a result most collective agreements do not have a specific scale for bonus payment and the amount paid may vary among employees.

Contractual cum Non-contractual bonus

- The system incorporates a contractual bonus element and a variable component which is above the contractual bonus payment to be paid at management's discretion. The employee will therefore receive a fixed quantum of bonus plus an additional bonus payment that is either pre-determined based on profit level of the company and or individual performance. For example:

Fixed Bonus: The company shall pay an annual guaranteed bonus equivalent to one month of the last drawn basic salary.

Variable Bonus: Should the company make a profit of **RM1,500,000 – RM2,500,000**, the company shall pay one and half months (1.5) of the last drawn basic salary as bonus.

Profits exceeding RM2,500,000, bonus payment shall be two (2) months of the last drawn basic salary.

Notwithstanding the above, the guaranteed bonus of one month, based on the last drawn basic salary, shall continue to be applicable.

Bonus Based on Profit Level

- Companies that use this system normally stipulate the amount of bonus to be paid depending on profit level of the company. As a result bonuses will be paid if profits exceed the pre-determined or threshold level. Profits are usually defined as profit before tax, profit after tax, return on assets, return on equity or return on average working capital. An example of bonus payment based on profit level is as follows:

Pre-tax profit	Bonus
RM1 million < 3 million	1.5 months
RM3 million – RM 6 million	2.0 months

For each additional RM1 million profit declared, the company will pay an extra 0.25 months bonus. If profit is less than RM1 million in any one year then the amount of bonus to be paid will be based on management's discretion. Profits may also be determined in various forms. Among them are the Return on Investment. For example:

$$\text{ROI} = \frac{\text{Audited Profit After Tax}}{\text{Shareholder's Fund}}$$

Shareholder's Fund

Payment of Bonus According to ROI Achievement

Return on Investment	Bonus Paid (months)
< 0%	0.5 months (minimum)
0% - <30%	0.5 months (minimum)
30-<60%	0.6 – 0.8 month
30% - < 60%	0.6 – 0.8 month
60% - <100%	0.8 – 1.0 month
More than 100%	1.0-1.5 months

In the example above, if ROI achieved for the year is 65% then the bonus paid out for that year will be in the range 0.8-1.0 month. The final quantum of bonus to be paid in a specified range is left to management's discretion.

Piece-rate system

- This is essentially a system whereby payment is based on the number of articles produced. Any output over and above the basic target will be entitled to an incentive payment. Piece-rate systems are commonly found in the agriculture sector and textile and garment industries. Some examples of piece-rate system include the individual straight piece rate system where an employee is entitled to the piece-rate multiplied by the amount of output for the shift. In cases of production after normal working hours the worker will be paid more per piece rate produced for example one and a half times the normal piece-rate.

Group or individual Target

- Group or individual target is derived from an individual's or group 's performance which may be based on the quantity, quality or time utilisation in the production process. This may be also applied to sales personnel who reach a minimum amount new sales acquired or debts collected within the shortest time. For example, companies will pay an incentive bonus based on the group's or individual productivity if their performance exceeds the criteria set out by the company.

Increment Based on Merit

- This type of increment is usually based on the workers performance that is related to devotion of duty, general aptitude and ability. Nevertheless more and more companies are now linking annual increments to company and individual performance. An example of such a system is as follows:

Increment Incentives

Company Performance (Return on Investment)	Individual Performance			
	Grade A	Grade B	Grade C	Grade D
0%	2% or minimum RM20 whichever is higher			
>0 - < 30%	5%	4%	3%	2%
30%-<60%	6%	5%	4%	3%
60%-<100%	7%	6%	5%	4%
100% or more	9%	8%	7%	6%

Based on the table above an if company performance is between 60-100% and an employee achieves a Grade C performance then he will receive a 5 % increment compared to a grade A performer who will receive 7% increment.

4.5 Benefits of PLWS

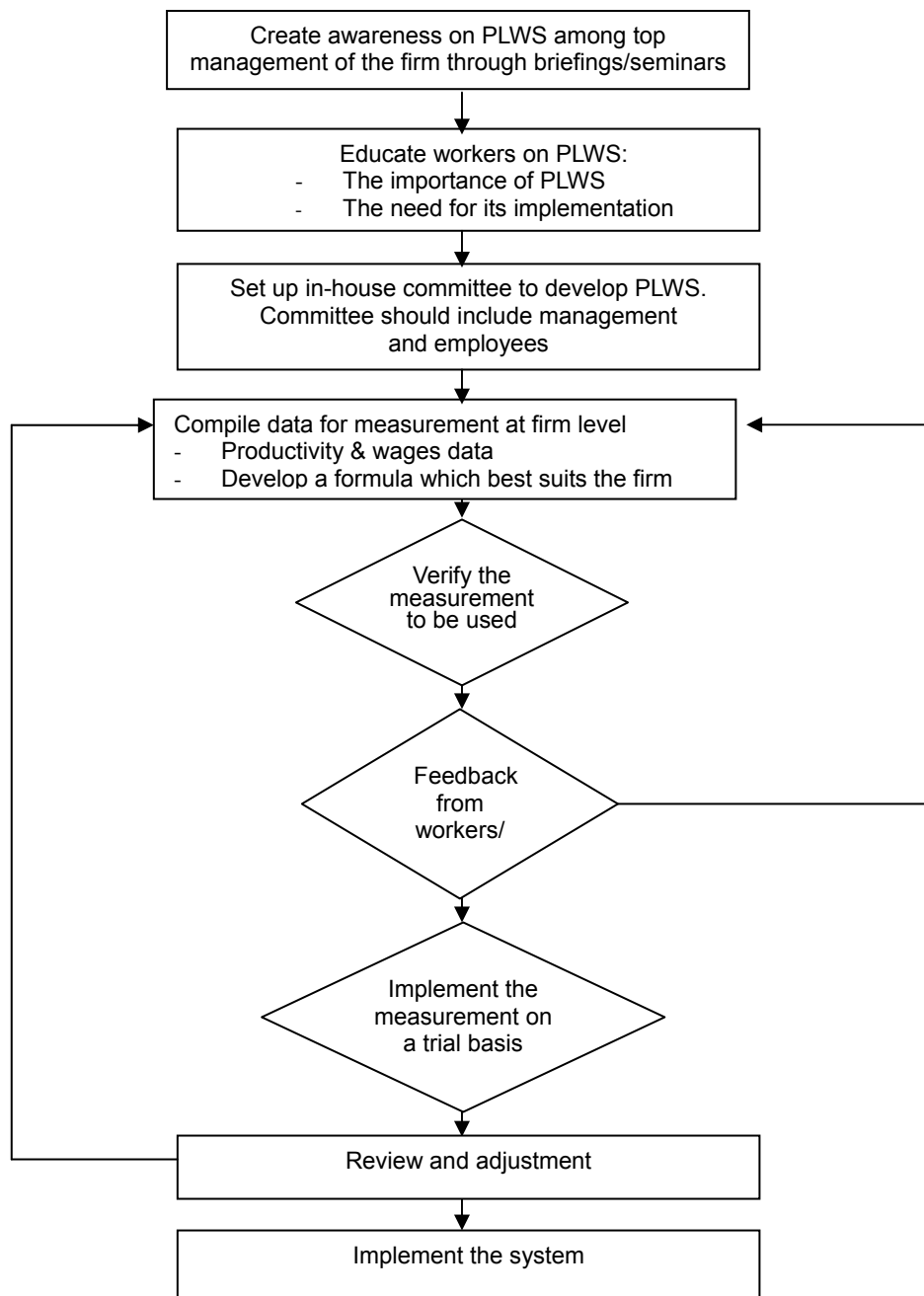
Companies should review their wage systems, and link it to productivity or performance, so that they remain highly competitive. It is certain, that a performance-based wage structure will reap more benefits as workers strive to improve their productivity, and performance to ensure better rewards for both employers and employees. The Productivity-Linked Wage System has been proven to be of benefit to companies who have implemented the system. Among the benefits that can be derived are:

- Ensures Productivity and Competitiveness at the firm level.
- Provides job stability and reduces the possibility of retrenchment in the event of an economic downturn.
- Ensures continuous improvement through the implementation of productivity and quality initiatives at the firm level.
- Provides motivation and job satisfaction as remuneration is linked to individual and organisational performance through the commitment of both employers and employees.
- Improves communication and cooperation between employers and employees as both parties strive towards enhancing performance.

4.5 Steps in Implementing the 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 4.1).

Figure 4.1: Steps in Implementing PLWS



Source:
Handbook on Productivity Linked Wage System, National Productivity Corporation, 2005

4.6.1 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 organisation 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 organisational 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: Implementing the 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.

5.0 Impact of Performance Based Remunerations System: Case Experiences of Local Enterprises

5.1 Case of a Malaysian Specialist Hospital (MSH)

This local private hospital manages thirteen private hospital in Malaysia, three 3 in Indonesia and one in Dhaka Bangladesh. This Specialist Hospital was the brainchild of a group of 14 Medical Specialist who saw the need of setting up a private hospital to meet the comprehensive healthcare needs of patients. outside the Capital city and the surrounding region. The hospital commences its service in 1991 and is an integral part in the group successful efforts to prove that corporate-driven healthcare management has an important role to play in complementing Malaysian Government aim to provide the best medical care for all Malaysians.

Providing Primary/preventive care, Secondary/Tertiary care and Rehabilitative care, MSH started with 106 inpatient beds growing to 206 as at today and it is expected to increase inpatient beds capacity to 270 by this year. With the support of 33 Resident Medical Specialist, 35 Visiting specialist couple with 360 Nursing, 180 non-nursing and 60 student nurses under its sponsorship program. MSH is managing an average per annum of 150,000 outpatients, 15,000 admission and 6000 surgeries. Its total revenue per annum averages around RM85 Million. Fueling this growth with almost two decades of continuous dedication to caring for life, MSH continue to drive and improve the quality of its healthcare services in line with its group corporate mission “Deliver quality Healthcare services to our customers”.

MSH has embarked on many productivity and quality initiatives and developed several measures to consistently strive for improvement in the quality care to its customers, which is certified through its quality improvements programs and activities. This includes motivating the employees through a reward system which is performance based. To be able to develop a reward system that is performance based, first MSH reviewed the challenges faced so develop appropriate KPIs for linking to the reward system.

5.1.1 Challenge to Healthcare Services

- **Change in Health Needs**

Our world today is very different from the world we remember a decade ago. Changes are now so radical and so fast that we are sometimes bewildered, so as are policy makers in other business arena. Policy decisions very often have to be made between dilemmas. Healthcare is no exception. It is true that scientific advances are progressing in leaps and bounds. Developments in information technology and their impact on our everyday life and societal value especially on our younger generations are almost beyond our imagination. On the other hand, the gap between the rich and poor is widening. Pollution and global climatic changes are getting worse. With all the above produces the change in disease pattern and health needs. People are living longer and yet not necessarily happier. They are more vulnerable not only to chronic physical diseases that accompany longevity, but also to depression as a result of the socio-economic changes that individuals have to face and yet may fail to cope. Injuries, both intentional and unintentional, are growing while infectious diseases are not yet out of our way.

- **Change in Patient Behavior**

The exponential growth in information technology has changed the mentality and thus the behavior of our clients. Internet has empowered patients and their families in decision-making. While this definitely improves their involvement in the care process, it also fuels consumerism where the consumers will wrest ever more control from providers and payers. Patients nowadays are more demanding, as well as more informed. We won't be

surprised if they come with piles of literature downloaded from the Internet, some of which may even be new to the doctors. The doctor-patient relationship is more leveled. Furthermore, caring in the present day world is not a one-way business. The patient's health status improves not only by virtue of treatments given to him, but also his own and his relatives' commitment and participation in health and in the care process as well.

- **Ethical Issues**

With advances in genetic engineering and decoding of the human genome, there will be emergence of what can be called predictive medicine. Such development will surely open up many ethical issues that society is ill-prepared to handle. The limiting factor will not be advances in technology, but the abilities of society in tackling important questions on humanities, which are currently progressing at a slow pace. Even in the day-to-day clinical practice, ethical issues like 'to treat or not to treat' or 'Who's responsibility is it?' are frequently asked. We are now not only talking about the cure of diseases, but also on the Quality of Life that is subject to a lot of value debates.

- **Speed**

Every aspect of business and the connected organisation operates and changes in real time. Waiting time between diagnosis and treatment or surgeries should be speed up. Delays will not only require patients to live with pain and peril, but can also worsen clinical outcomes.

- **Connectivity**

The evolution of telecommunication, satellite technology, and mobile telecommunication has all combined to make instant connectivity available throughout the world. The Internet is rapidly growing and becoming a rich environment for exchanging information and conducting wide variety of businesses. So many different businesses are now connected through Internet. Business trades and services that used to be isolated are now spread rapidly in other areas through the Web, everything is becoming electronically connected to everything else: products people, services, companies' countries etc were making new product, goods and services available and adding value to the old ones.

- **Intangibles**

Every organisation has both tangible and intangible economic value. In the new information age new capabilities for competitive edge “Physical assets and financial assets are no longer a source of sustainable competitive advantage”, Intangibles such as good governance, loyal customers, strong brands, a culture of innovation, well-managed human capital and exemplary environmental practices are what now driving long-term value creation. The fact is that the intangible is growing at a faster rate.

With the accelerating trend of globalisation, no place is immune to the mega-trends. Growing and aging population will increase the demand for services resulting in increasing workload and waiting time’s issues. Change in disease pattern towards chronic illnesses has also called for changes in the mode of care delivery, with growing need for rehabilitation services, outreach services and educational programs to reduce the risk profile of the population towards these conditions. Rising community expectation, as well as the more informed public, while facilitating stronger community partnership in the care process, has also generated considerable pressure on the demand for quality. Healthcare services can no longer be confined to the clinical setting. It is not an easy task. In short, our key issue is how to maintain and continually improve our service quality in the face of increasing financial constraints and service demand. Thus, MSH set about to design a performance based system to ensure superior service quality is constantly provided by all employees.

5.1.2 The Performance Reward System at MSH

The essence of Performance Management at MSH is to create teamwork between the employees, the specialists and the patients, which is truly focused on quality service care. It is a process that aligns the employee’s personal objectives with that of the organisation and business. Performance focuses on what has been achieved (results) and also how it has been achieved while development focuses on employees becoming better at their respective job functions, currently and in the future.

The process adopted at MSH is simple, starting with a development of Key Performance Indicators based on the Objectives to be achieved, followed by

self evaluation by the employees. 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. With objective and clear and measurable Key Performance Indicators, the employees would have a clear understanding of how they can contribute to realising business goals; know what is expected from them in their jobs and learn to what extent they meet these expectations. An example of a performance review is as follows:

- Key Areas of Responsibility – detailed listing of key job functions
- Self Evaluation of previous year’s performance eg my key job functions are similar to that of the previous year. However this year I am able to enhance by service quality as reflected by the increase number of accolades received from the patients.

	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

- Development of personal measurable targets in line with the objectives and strategies developed at the company level an example of which is as shown:

Personal Objectives (including Measurable Targets)

	Employee review	Supervisor's feedback
Target 1	To provide patients service amounting to at least 2 million worth of treatment for the year starting Jan 2007 to Dec 2007	
Rating	Partially Met	
Comments	Have achieved 1.89 million Which is a bit short of the targeted 2 million	
Objective 2	Improve client satisfaction to 8.5 out of 10 as measured by the annual customer survey in Q4, 2007.	
Rating	Met.	
Comments	This year, our client satisfaction was 8.88. This is already significantly higher than last year, when our score was 8.0. Also, we received informal feedback from our patients who expressed their satisfaction with our service.	

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

Summary of Evaluation

Please click in the grid to indicate your proposed rating.

Manager comments regarding performance and promotability.

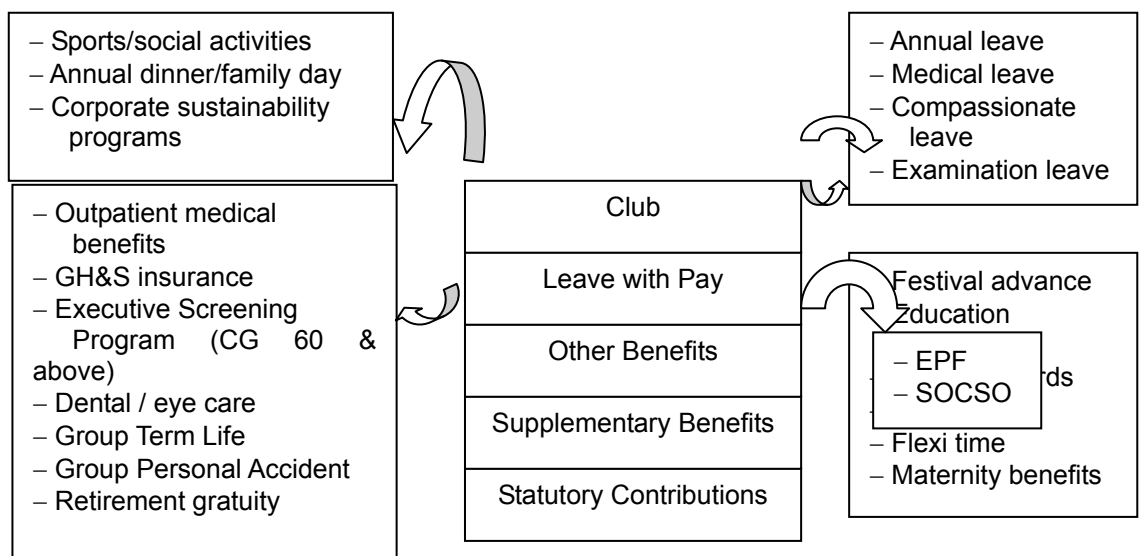
	Excels	Exceeds	Fully Meets	Partially Meets	Requires Action	
Fast Track						
Growth Path						
Well Placed						

The Performance Management will be carried out throughout the year to work on development and to define KPIs and objectives. This system will be reviewed from time to time and made more flexible for HRM manager in creating and importing calibration grid at all times so that the HRM manager will not be burdened by the administrative details.

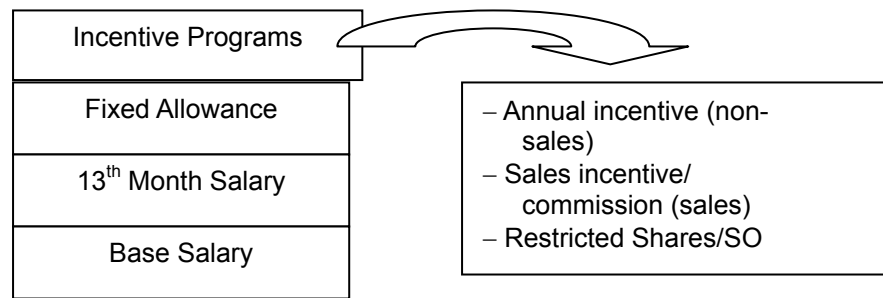
5.1.3 Linking Performance Management to Rewards

The rewards programmes offered consist of both indirect rewards in the form of benefits and the direct rewards which is monetary in nature:

Indirect Rewards (Benefits)



Direct Rewards (Monetary)



5.1.4 Impact of the performance System

With the implementation of performance reward system, intangibles from clinical nurses had resulted in tangible outcomes, as follows:

- A staff nurse alerts management about a safety breach avoiding several medical errors. She saves patients from the heartache of living with permanent disabilities, and your organisation avoids millions of dollars in litigation expenses.
- Nurses give a warm welcome to newly hired nurses and improve nurse retention. This results in your HR expenses decreasing annually and reduces training expenses and minimises the lowered productivity of new employees.
- Clinical nurses discover potential patient complications early. This elevates your reputation in the community, attracting the best nurses, physicians, and other staff. Your beds stay full, and the accrediting agencies give you high marks.
- Intangibles assets were able to mobilise employee skill and motivation for continuous improvement in process capabilities, quality, and response times thus produces high quality services to develops customer relationship that retain loyalty to existing customers.

On a business level, the impact comes in the form of meeting company objectives and strategies and had resulted in the following:

- **Wider Distribution Network**

It is hoped that through a well-organised service distribution network care can be delivered cost-effectively and patients' access to service can be improved. Currently we have taken into account factors like demographic changes pattern. The main purpose is to streamline the organisation of service across acute and extended care hospitals to ensure coordinated care for patients at different stages of their illness. **From a single hospital, MSH had expanded its distribution to 13 Malaysian Hospitals and four offshore hospitals.**

The performance system had also enhanced our service networking, the aim is to tackle service gaps and duplications to ensure provision of adequate service coverage for individual clusters. For highly specialised services requiring advanced technological support, provision of services is limited to a few institutions. MSH wide networks are therefore developed in the form of designated specialized service centers. Access to these highly specialised services is provided through cross-cluster referrals and coverage to patients needing these services in all our group hospitals.

Service network also operates at local level to help pool and share resources amongst hospitals so as to complement each other in their service profiles within the network. Experts of the same clinical specialty contribute towards formulation of territory-wide service network in our Specialty Coordination Committees. **We have targeted to promulgate such plans of all major clinical specialties with the installation of our clinical information system.**

- **Improved Care Process and Service Quality**

Apart from addressing the volume issue and improving the hardware of our system through a better-organized distribution network, we also strive to improve the software of our system, i.e., our care process and service quality. This is a difficult task particularly against the backdrop of increasing community expectation in the face of resource constraints. We have focused on two aspects: care delivery systems and mechanism to ensure quality of care. In addition, with the advances in medical technology, a number of day-procedures

are now made possible that not only saves cost but also improves convenience to both the patients and their families.

Community care is also being strengthened through public education, better interface with other service providers and enhanced training for health providers. With the public getting more educated and the growing popularity of the Internet, the public can be equipped with information and knowledge of different fields. We need to tap into the vast community resources that can help us provide better care to our patients. On the mechanism to ensure quality of care, we have been developing guidelines and protocols with major emphasis on the establishment of clinical pathways for specific disease conditions.

We also see the need to strengthen our professional accountability to ensure the provision of specialist-led services, timely senior staff coverage at all hours and proper supervision of trainees by qualified staff. Besides, tools like Balance Score Card (BSC), clinical audit, risk management and complaint management have been put in place to ensure proper clinical practices and reduce potential risks. **Through our annual survey on customer satisfaction, we found that the service quality had exceeded the targeted score of 8.5. In the last five years, our service quality had consistently exceeded the excellent score of 8.0.**

- **Enhanced Productivity**

MSH still has to face the resource issue internally. This is not new since we have produced very substantial productivity savings against the huge increase in service volume in the past years. In order to achieve these savings, we have continuously rationalised our services where possible to achieve economies of scale. External recruitment is minimised and administration units are downsized. Processes are re-engineered and automated. Non-core services are contracted out. Group synergy and integration of organisation structure, system, strategy, staffing skill and style best practices were being shared to strengthen our value chain in delivering value propositions. Being a healthcare service institution, the productivity indicator used are varied, both in terms of qualitative terms as well as quantitative measures. **The main quantitative productivity measure**

used by us is Revenue per employee. In the last five years, productivity had been growing at an average rate of 10.2% as follows:

2003	2004	2005	2006	2007
6.5%	6.8%	9.5%	13.3%	15.9%

- **Human Resource Capabilities and Management**

With the need for change in the traditional paradigm and the more leveled relationship with patients, our doctors, nurses and allied health staff need to have a holistic understanding on the social, cognitive and emotional aspects of the patients' needs. We need to establish true partnership with our patients. For this to be done, we need to change the mindset of our healthcare professionals by including them in our various clinical and management committees. Modern healthcare emphasises integrated care and multi-disciplinary approach. It was on this premise that the Clinical Management Teams were set up. Efforts are being made to improve the functioning of the teams by developing a model to guide the teams' future development.

Quality, service in modern-healthcare goes beyond the clinical activity. We as healthcare professionals need to be sensitive to human feelings and societal values. We need to be able to tackle important questions on medical ethics. Besides being competent in the application of knowledge, skills and technology, we need to be able to improve the organisation of care process and teamwork, make good quality decisions and be able to communicate with both the patients and staff.

We need to develop leadership to manage interface problems and be able to build trust amongst those we encounter in the care delivery process. Enhancing the right attitude amongst our staff and equip them with the ability to learn. We are working to achieve it through training that emphasises not only technical skills and knowledge, but also on management/ communication, complaints management and also inter-personal relationship. With the growing popularity of web-based technology, we will attempt using such technology to facilitate learning and dissemination of knowledge. Yet, training alone is not sufficient. To change mindset of healthcare professionals, we need to transform the value

and culture of the organisation and all these are being put to test.

We are proud to say that we have been successful in the implementation of the Performance Management System and had **achieved our vision as “The Preferred Provider in Healthcare Services through its mission of delivering Quality Healthcare Services to our Customers.**

5.2 Case of a Ceramic Tile Manufacturer (CTM)

CTM is a ceramic tile manufacturer incorporated in 1973 as a family owned concern. It has now expanded to have an employment size of 1,120 workers, operating two manufacturing plants in Malaysia and one in China. The average workforce per plant is 373 employees. Domestic sales comprise 85% of total sales. The company used to practice a wage system which comprises fixed annual increments irrespective of performance.

However, with greater competition, and the need to improve productivity to sustain its competitive edge, CTM has developed a wage system that links performance of employees to annual increments, and bonuses. The system developed has identified Key Performance Indicators (KPIs) which are quantifiable, and are used as benchmarks to determine performance/productivity of the individual. To initiate the productivity linked wage system, the company started off with productivity measurement which entails studying the processes at the plant as well as the functions of various internal departments. A Wage Committee which comprises of representatives from each of the department was formed to identify the Key Performance Indicators and measurements.

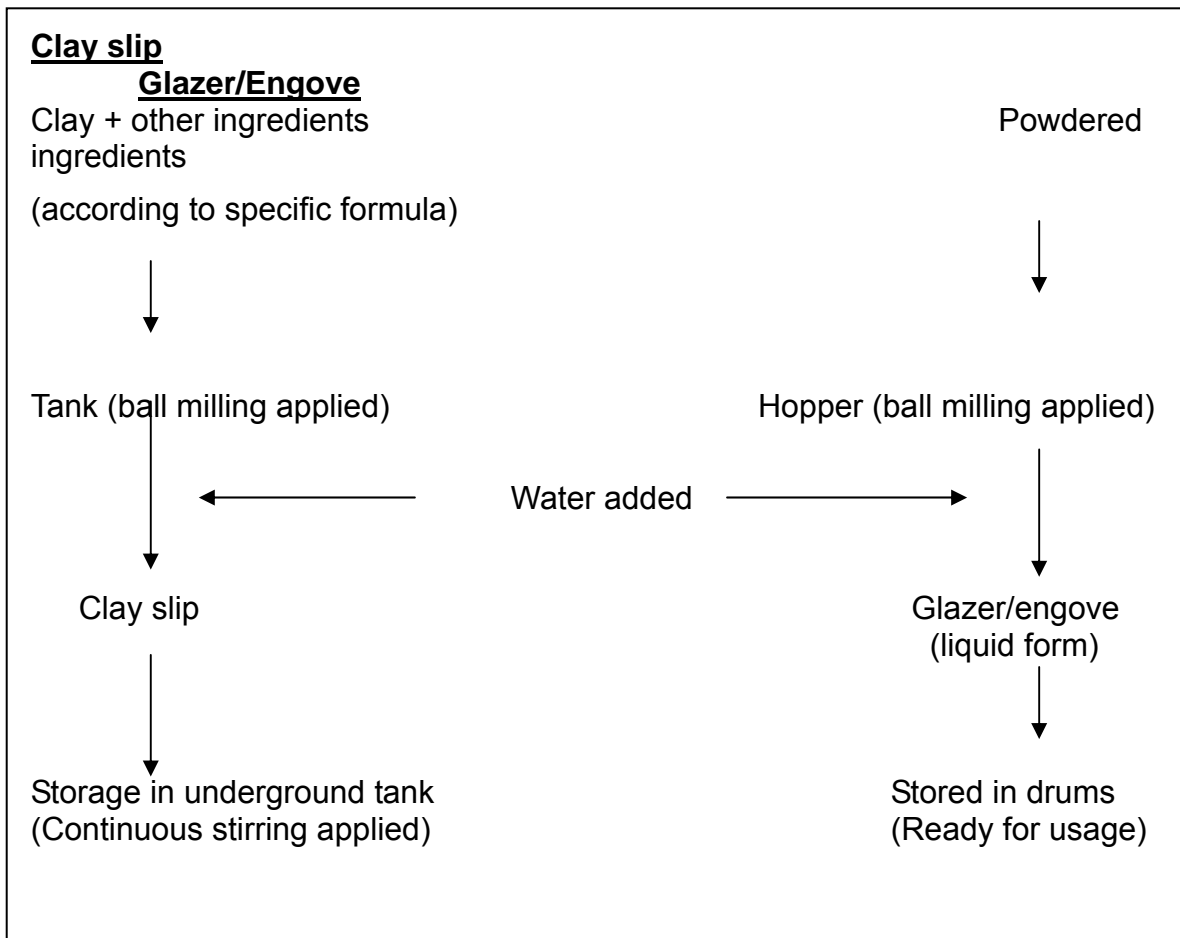
5.2..1 Production Process in CTM

A detailed study of the production process was carried out to develop appropriate performance indicators. The production process involves the body/wet preparation and Pressing:

The Body / Wet Preparation

This involved the preparation of the raw materials such as clay slip and the necessary coloring required. The initial preparation involved mixing the raw materials according to the formula for making either walls or floor tiles. Clay as the main ingredient is mixed with other ingredients in a ball mill mixer. This will reduce the whole dry ingredients into fine powder. Water was then added and the mixture is converted into a slurry or clay slip. This is stored for later use in an underground tank with continuous stirring. The preparation of Glazers and Engove are usually made a few days before its utilisation. The ingredients for the glazer and the engove are placed in a separate hopper and ball milling being applied to reduce it into fine powder. Water was then added to form a uniform slurry glazer and engove, and this is stored into drums. Glazer and the engove are sent to QC to check for conformation and suitability for usage. The processes involved in the body/wet preparation is as shown:

Figure 5.1: Processes involved in the Body Preparation



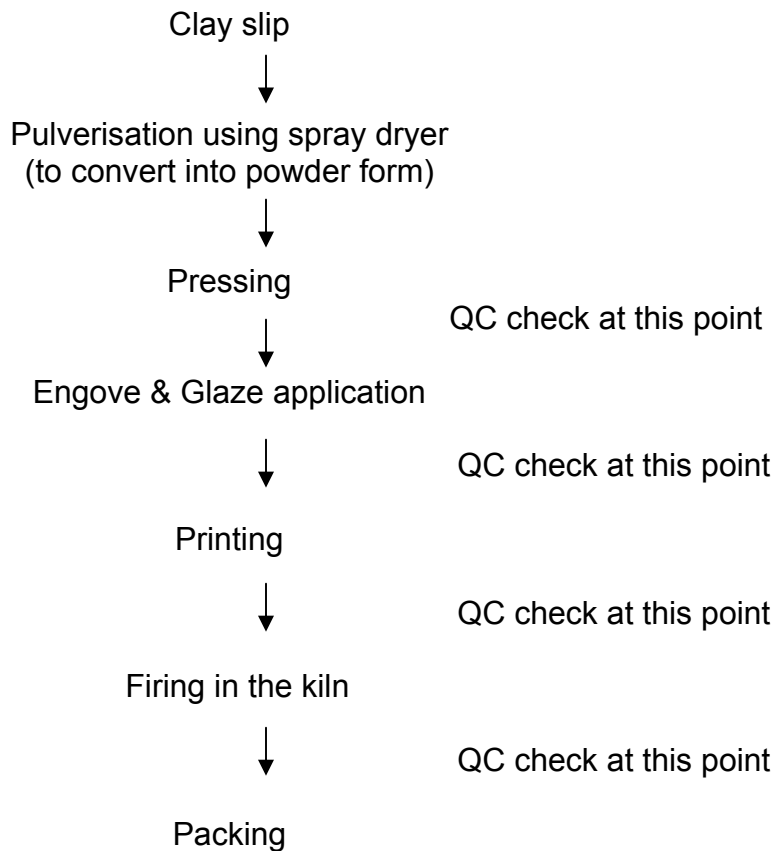
The Dry Preparation

The dry preparation involved several processes such as pulverising (conversion into powder form), pressing, glaze and engobe application, printing, firing and packing. The clay slip is pumped into a silo containing a spray dryer in it. Coming out from the spray dryer, the clay slip is exposed to a high heating temperature resulting in the water being evaporated and a fine powder collected at the bottom of the silo. This is then transported into a storage silo. During the pressing process, the first stage ceramic tile is formed. The powder from the silo is pumped and a certain quantity of it is dropped into a slab moulds. The powder is then compressed by applying high pressure to form a ceramic tile. For this process, the company engaged eight lines to conduct the pressing activity.

The raw ceramic tiles are passed through an applicator machine for engobing followed by glazing. The applicator machine can either be bell-shaped or as screen applicator. At this point the ceramic tiles are checked for any visual defects and being removed from the processing line. The ceramic tiles are then printed with the desired designs. Printing can be done using either screen printing or rotor colour printing. The ceramic tiles are then loaded onto the 'kiln car' for firing process in the kiln. Firing in the kiln will take between 40 – 45 minutes depending on product types.

The tiles on the 'kiln car' are unloaded onto the kiln conveyor which moved at the pace set according to the required drying time. From the point of unloading, the heating temperature increase gradually until a maximum temperature of about 1000 °C is reached before cooling off take place. At this point the tiles coming out from the kiln is checked again for colour homogeneity and any visual defects before packing. The final products are automatically packed at the end of the line. The final products are either of the prime or second grade and they are separately packed for storage before delivery.

Figure 5.2: The Dry Preparation



5.2.3 Key Performance Indicators (KPIs)

Based on the production processes mentioned above, a set of indicators which are quantifiable and applicable in a wage system that is linked to productivity are developed as shown in **Appendix 1**. The wage system developed by CTM is based on productivity measurement at the production level using the Saleable output as follows:

a) Total Output

The output of the plant should be based on **Saleable Output (Total Output – Rejects)** as recorded by the selection and packing section as this represents the pulse of the factory and last process in the production line. To increase the saleable output, both the management and workers will have to increase efficiency and reduce rejects. This will ultimately ensure cost saving on wastages and higher returns to both employers and employees.

b) Input

Input refers to total machine man hours used to produce the total output.

Formula:

$$\text{Total Machine Man Hours per Shift} = \frac{\text{Total Head Count Used per Shift} \times \text{Lines Programmed}}{\text{Hours per Shift}}$$

$$\text{Productivity Index} = \frac{\text{Output (Saleable Output)}}{\text{Input (Total Machine Man Hours Used)}}$$

Calculation of Productivity Index

A tile manufacturing company produced both floor tiles and wall tiles with an ideal plant capacity of 20,000 m²/day and 90% efficiency and 6% reject rate. The company's production process has 4 lines and 2 shifts for walls tiles and 2 lines and 3 shifts for floor tiles with mean headcount of 90 people per shift. However the company's practical standard is 65% efficiency and 8% rejects. The calculation of the productivity index is shown below.

i) Ideal Standard

Output (in square meters)

Plant capacity a day	20,000 m ² /day
28 working days	560,000 m ²
Target 90% efficiency	504,000 m ²
6% reject	30,240 m ²
Saleable Output (84% yield)	473,760 m ²

Input

Machine hours	2,783.2 hours
[4 lines x 2 shifts (for walls tiles) + 2 lines x 3 shifts (for floor tiles)] X 7.1 hours x 28 days	
Target mean Headcount	90 people per shift
Total machine man hours used	250,488 hours

$$\begin{aligned}
 \text{Productivity Index} &= \frac{\text{Saleable Output}}{\text{Total Machine Man Hours Used}} \\
 &= \frac{473,760 \text{ m}^2}{250,488} \\
 &= 1.89
 \end{aligned}$$

ii) Practical or Starter Standard**Output**

Plant capacity a day	20,000 m ² /day
28 working days	560,000 m ²
Target 65% efficiency	364,000 m ²
8% reject	29,120 m ²
Saleable (57.0% yield)	334,880 m ²

Input

Machine hours	2,783.2 hours
[4 lines x 2 shifts (for walls tiles) + 2 lines x 3 shifts (for floor tiles)] X 7.1 hours x 28 days	
Target mean Headcount	90 people per shift
Total machine man hours used	250,488 hours

$$\begin{aligned}
 \text{Productivity Index} &= \frac{\text{Saleable Output}}{\text{Total Machine Man Hours Used}} \\
 &= \frac{334,880 \text{ m}^2}{250,488} \\
 &= 1.34
 \end{aligned}$$

Using the productivity measurement developed by the Company, a factory which operates at 90% efficiency would reach a productivity index of 1.89. However, productivity incentives will be paid out when the productivity index reaches 1.34 which is at 65% efficiency. The incentives can be used as a measure for overall company performance, and incentives are extended to all departments in the company as their functions are interrelated. A sample of calculation made by CTM is as shown below.

**Productivity Index Calculation
Current Production Scenario with CISB Standard Operation Hours**

No	Items	MO	MIS	MO + MIS	KF	HT	KF + HT	Overall
1	Plant Capacity/day	14600	6100	20700	8200	6000	14200	34900
2	Output/month (28 working days)	408800	170800	579600	229600	168000	397600	977200
3	Target at 95% efficiency	388360	162260	550620	218120	159600	377720	928340
4	3% reject from Kiln	11651	4868	16519	6544	4788	11332	27850
5	Saleable Output/month (target)	376709	157392	534101	211576	154812	366388	900490
6	Actual Saleable Output	383146	175722	558868	189047	134518	323565	882433
7	# of lines (glazing)	8	4	12	4	3	7	19
8	# of shift	2.5	2	2.35	3	3	3	3
9	# of hours/shift (CISB Standard operation hours)	6.5	6.5	6.5	6.5	6.5	6.5	6.5
10	# of working days/month	28	28	28	28	28	28	28
11	Target men headcount (peopleon/shift)	89	25	114	41	35	76	190
12	Target men headcount (include Supervisors)	94	25	120	43	36	79	198
13	Machine hours	3640	1456	5096	2184	1638	3822	8918
14	Total machine hours used (8x2.5x6.5x28x89)	325173	35915	361088	89544	56784	146328	507416
15	Total machine man hours used (include Supervisors)	343373	36885	380259	93184	58968	152152	532411

No	Items	MO	MIS	MO + MIS	KF	HT	KF + HT	Overall
16	Productivity Index (Current Ideal) (Saleable output/Total machine man hours used)	1.16	4.38	1.48	2.36	2.73	2.50	1.77
17	Productivity Index (include Supervisors – current ideal)	1.10	4.27	1.40	2.27	2.63	2.41	1.69
18	Productivity Index (actual)	1.18	4.89	1.55	2.11	2.37	2.21	1.74
19	Productivity Index (include Supervisors – actual)	1.12	4.76	1.47	2.03	2.28	2.13	1.66

Set of KPIs developed

No.	Corp Objective	Category	Key Objectives identified	Functions	KPI	Computation / Measurement Formula	Expected Performance Targeta	Variance
1.	Revenue	Performance	Achieve Sales Target	Sales & Marketing	Sales Target	Actual sales figure (RM) / Target Sales Figure (RM)	100%	-5%
2.	Image	Performance	Achieve Customer Satisfaction	Sales & Marketing	Customer satisfaction Index	Average of ratings given by customer a scale of 1-5	4	-0.5%
3.	Profitability	Efficiency	Meet customer delivery date	Sales & Marketing	Meet requirement dates as specified by customer	No. of times meeting requirement dates / Total no. of sales	100%	-5%
4.	Profitability	Efficiency	Accurate sales forecast	Sales & Marketing	% of forecast accuracy		60%	-5%
5.	Profitability	Efficiency	Efficient processing of request -	Admin	% on time response	No. of request response within 48 hours / Total no. of request	100%	0
6.	Profitability	Efficiency	Strengthen group's risk mgmt capabilities	Admin (Corp Devt)	No. of projects carried out under yearly risk management plan	Actual no. of projects	100%	0
7.	Profitability	Efficiency	Overall cost saving of the whole group	Admin (Corp Devt)	Amount saved	Amount in RM	On going	0

No.	Corp Objective	Category	Key Objectives identified	Functions	KPI	Computation / Measurement Formula	Expected Performance Target	Variance
8.	Image	Efficiency*	Minimize customer complaint	Manufacturing (common applicable to production, QA production lab, maintenance)	Compensation value	Compensation value / Total sales value	<0.2% of total sales value	<1.0%
9.	Profitability	Productivity	Achieve yearly saleable outputs budgeted	Manufacturing (common applicable to production, QA production lab, maintenance)	Monthly budgeted saleable output	$\frac{\text{Actual output}}{\text{Targeted output}}$	95%	0%
10.	Profitability	Productivity	Kiln efficiency	Manufacturing (common applicable to production, QA production lab, maintenance)	Kiln utilization	$\frac{\% \text{ of actual output}}{\text{Standard output}}$	95%	0
11.	Profitability	Productivity	Improve premium percentage	Manufacturing (common applicable to production, QA production lab, maintenance)	Premium %	$\frac{\text{Tot. no. of premium}}{\text{Total output}}$	90%	-5%
12.	Profitability	Efficiency*	Reduce reject percentage	Manufacturing (common applicable to production, QA production lab, maintenance)	Overall finished goods reject %	$\frac{\text{No. of reject pieces}}{\text{Total output}}$	5%	2%

No.	Corp Objective	Category	Key Objectives identified	Functions	KPI	Computation / Measurement Formula	Expected Performance Target	Variance
13.	Profitability	Efficiency	Regular product launching	Manufacturing (common applicable to production, QA production lab, maintenance)	No. of launching	Minimum 3 launch per year		0%
14.	Profitability	Efficiency*	No. kiln production downtime	Manufacturing (common applicable to production, QA production lab, maintenance)	No. of kiln hours downtime	Hours downtime	<24 hours per month	0
15.	Profitability	Performance	Reduce factory accident cases	Manufacturing (common applicable to production, QA production lab, maintenance)	No. of factory accident cases	No. of cases	45 cases per year	5
16.	Profitability	Efficiency	Meet customer delivery date	Manufacturing, Logistics (Plan)	Meet customer delivery date	No. of codes meeting planned dates / Total no. of codes in frozen list	99%	1%

No.	Corp Objective	Category	Key Objectives identified	Functions	KPI	Computation / Measurement Formula	Expected Performance Target	Variance
17.	Profitability	Cost saving	Minimize stock holding cost	Purchasing	<ul style="list-style-type: none"> • Stock turnover ratio for the raw materials • Stock turnover ratio for the spare parts 	Total consumption / Total purchase	>0.02	
18.	Profitability	Cost saving	Discount on purchase	Purchasing	Amount of saving from purchase	% of RM Saving / Total purchase	<0.25%	
19.	Profitability	Efficiency	On time purchase	Purchasing	On time delivery	% of delivery	100%	
20.	Profitability	Efficiency	Accurate purchase	Logistics (SPS)	No. of purchase due to wrong purchase	Actual number	<1 time per quarter	

No	Corp Objective	Category	Key Objectives identified	Functions	KPI	Computation / Measurement Formula	Expected Performance Target	Variance
21.	Profitability	Efficiency	Improve stock level accuracy	Logistics (Warehouse)	Stock adjustment value	Actual number	1%	0.50%
22.	Profitability	Efficiency	No. wrong delivery	Logistics	No. of customer complaint	Actual number	<2 per year	1
23.	Profitability	Efficiency	Pick cycle time within 45 min for own collection	Logistics (FG Warehouse)	% on time	Actual number	98%	-1%
24.	Profitability	Efficiency	Support to relevant department - No. SAP downtime : No. email downtime	IT	Total system hour downtime	Hours of downtime	45 hours per server per annum	0
25.	Learning	Performance	Upgrading of skill / knowledge	HR	Training hour per employee per year	No. of training hour per employee per year	3 hours per employee per year	0
26.	Learning	Performance	Maintain a pool of productive and skill full employees	HR	Average labour turnover rate		<5% per month	

No.	Corp Objective	Category	Key Objectives identified	Functions	KPI	Computation / Measurement Formula	Expected Performance Target	Variance
27.	Profitability	Efficiency	Supporting Sales/Marketing dept Customer's service - provision of statement of reflect customers monthly transactions with the company by 4 th working day of the month	Fin	On time provision of required data	No. of late delivery of data	100%	
28.	Profitability	Efficiency	Working Capital management - provision of monthly aging list to sales personnel to ensure prompt collection, minimize working capital (AR) and reduce credit exposure/risk.	Fin	On time provision of required data	No. of late delivery of data	100%	
29.	Profitability	Efficiency	Up to date management information Update on performance/management information for decision making by 8 th working day of the month	Fin	On time provision of required data	No. of late delivery of data	100%	

No.	Corp Objective	Category	Key Objectives identified	Functions	KPI	Computation / Measurement Formula	Expected Performance Target	Variance
30.	Profitability	Performance	Safeguarding of company asset	Security	<ul style="list-style-type: none"> • No. of theft cases reported • No. of retrieved items 	Actual number of occurrence	0	0
31.	Image	Performance	Brand recognition	M&C	% increase in market share	Percentage	5% increase in market share (or depends on management's decision)	
32	Profitability	Cost saving	New launched products	R&D	New products for the market	No. of new products launched	On going	On going

Suggested KPI for the General Department = average of all departments' KPIs
= $\frac{\text{Total value of KPI for all departments}}{\text{Number of departments}}$

General Department with no KPIs comprise of cleaners, drivers, dispatch workers, office boys and general clerks.

KPI not driving. These are routine duties which must be done

1	Reduce non-conformance leading to downgrade of product	QA	% of non-conformance
2	Trial run finished product met customer request	QA	% of non-conformance
3	Customer satisfaction	QA	Investigation report within 3 working days
1	Minimum 2 designs per launching	PD	No. series
2	Reduce number of screen used in decorative tiles	PD	Reduction in screen cost
1	Complete preventive maintenance as scheduled	Maintnce	No. of job delayed
2	Attain to maintenance job sheet within 30 minutes	Maintnce	% within 30 minutes
1	Reduce occupational health cases	SHE	No. of cases

5.2.4 Impact of the system

As the company is in the transition period of implementation of the wage system which is linked to productivity measurement, the full impact of the system cannot be gauged. However, in the first 6 months of implementation, there are visible signs that improvements have taken place in the following areas:

- The productivity index had been improving from an index of 1.34 when the system first started to an average index of 1.58 in the last six months. The aim of the company is to draw closer to the ideal productivity index of 1.89;
- The reject rate had reduced from 5% to total output to the benchmark level of 3.0%, representing a savings of approximately 20,000 pieces of tiles and at an estimate cost of RM1/- per tile, a cost savings of RM20,000 is achieved in the 6 months period.
- The motivation and morale of workers had also improved as reflected in the lower staff turnover. In the last few years, the staff turnover stood at 4.2% per month and this had been reduced to 3.3% in the first 6 months of this year. This could be attributed to the better teamwork amongst the employees.

Conclusion

Linking remunerations to productivity and or performance is crucial amongs Small and Medium Enterprises as it will ensure a Win-win situation for both employers and employees. As can be seen from the case experiences above, the impact on productivity and performance are manifolds, ranging form intangible aspects of motivation and morale boosting to tangible aspects of cost reduction,

enhanced productivity and profitability as well as expansion of markets and networking.

In Malaysia, the specific tool that had been developed by the Malaysia Productivity Corporation for implementing the Performance-based Remuneration System is the Productivity-Linked Wage System (PLWS). The PLWS had enabled enterprises to adopt a systematic approach in linking wages to productivity and to sustain labour cost competitiveness.

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Impact of Performance Based Remuneration Systems on Productivity

Performance of Local Industries

The Philippines Experience

By

Monina Macavinta

Philippines

1.0 Economic Development in Philippines

1.1 Key Economic Trends

Today we reach the halfway mark for this current year 2008, and everybody knows it's been a challenging year for the Philippine economy so far. Based on most recently available data on the economy, below are 10 key indicators that provide a good picture of how the economy has fared this year so far:

Prices are rising rapidly. The inflation rate has already hit double-digits outside of Metro Manila (10.2%) with food showing the steepest price rises at 14.3% nationwide. Surging oil and food prices have been the primary culprit and while this has been a global phenomenon this gives little comfort to the average Filipino whose wages are being left even farther behind by the soaring cost of living.

Large numbers of jobs are being lost. The April labour force survey reported a net loss of 168,000 jobs over the past 12 months with the industry sector taking the worst hit with 244,000 jobs lost. Agriculture actually gained 46,000 jobs while services produced 30,000 net new jobs.

Domestic production and overall income have slowed down across the board. The industry sector slowed down the most, with construction (particularly government construction) and manufacturing slowing down the most. Agricultural production likewise slowed down and actually declined by 0.8% from last quarter's level. Services continued to lead the economy's growth but its growth has also moderated to 6.9% from last year's 8.4%. Communications posted the slowest growth in recent memory which at 4.3% is a far cry from the double-digit growth the industry had been accustomed to in past years. Water transport

(sinking ferries notwithstanding) actually zoomed at 26% and air transport at 13.3%.

Personal consumption spending slowed down dramatically. The drastic slowdown is more obvious on a quarter-on-quarter basis from an average 1.3-1.5% quarter-on-quarter growth in recent years (implying 5.2-6% annual growth). Personal consumption grew only 0.3% in the first quarter implying an annual growth of only 1.2%. Surging inflation is the clear culprit. Rising prices always slows down people's spending and slower wage remittances did not help either. When people slow down on their purchases the rest of the economy also slows down.

Fixed investment has rebounded. This is one of only two positive developments in this list. Private construction and durable equipment growth (led by electrical machinery, water transport equipment, agriculture machinery, road vehicles, aircraft, and mining equipment) has managed to offset the steep drop in public construction. Last year, election-related government spending propelled the unusual surge in economic growth and the latest revisions on last year's growth data show just how dramatic this factor was. The 2007 second quarter (i.e. election period) growth in public construction was upped further from the earlier-reported 39.7% to a whopping 59.4%. Public spending has now returned to more normal levels (hence the recorded drop of almost 10%) but it is genuinely good news that private investment spending has managed to more than compensate for this.

Foreign direct investments dropped steeply. What makes the above even more good news is that overall investment growth happened despite the fact that net

inflows (per BSP data) of foreign direct investments have dropped rather steeply this year (-75% in contrast to last year's 195%). This indicates all the more that private investments by Filipinos saved the day for us. They not only offset the big drop in public investment but also the even bigger drop in foreign investments as well.

The Government has reduced its spending. As indicated above public construction dropped steeply and government consumption spending has likewise gone down by 1%. The Government had vowed to balance the budget this year but this was clearly being pursued more by cutting back spending rather than by improving tax collection. It therefore gives little comfort that the government has posted surpluses in the last two months keeping the budget deficit down to P18.8 billion so far.

Exports have reversed dramatically. Last year's export growth of 11 % is now mirrored by a drop of 11%. Imports meanwhile dropped even more steeply than they did last year. While Business Process Outsourcing (BPO) still managed to grow it slowed down to half (7.6%) of last year's growth (14.7%).

Growth in net income inflows remained high. This is not so much because of a surge in inflows but because of the steep drop (-23%) in outflows. Wage remittances actually slowed down from last year. This is a trend worth watching closely especially as the host economies of Filipinos abroad brace for even worse times.

Gross international reserves grew by nearly half. BSP bought close to \$11 billion last year bringing reserves to \$36.2 billion or more than six months worth of imports from just \$25.6 billion a year ago or 4.6 months worth of imports. This

was largely to prevent the peso from appreciating faster, a problem which has now reversed itself as the doubling in oil prices within the past year has led to currency depreciation anew.

Overall, the year so far has been so much unlike last year and Filipinos everywhere can feel it in their pockets. The year is only half way through and unfortunately things aren't exactly looking up.

Experts Foresee Economic Growth In 2007

Entitled “What Lies Ahead for The Philippines in 2007: An Economic Forecast”, members of the Philippine Association of National Advertisers (PANA) looked into the general landscape of the Philippine economy and the advertising industry from different perspectives such as market research, government, and the SMEs.

Ms. Aggie Mañalac of ACNielsen presented the Filipino pulse based on recent consumer spending behavior studies and trends. “There is a positive outlook for the Philippine economy in 2007 brought about by a significant increase in consumer confidence levels towards the areas of job prospects and personal finances.” She said, however, that in spite of such increase in consumer spending, the market remains critical with their money-spending behavior. She lists convenience, affordability and value for money as key attributes in consumer spending activities and registers the following markets as sales prospects: “millennium moms” or working moms, mature markets, “housebands” or household husbands and “NetGens” or those born during the internet era.

Mr. Dante Sy, Deputy Director of the Department of Finance, provided an economic forecast from a political point-of-view. His forecast supported that of Mañalac's. Both foresee a positive outlook for the Philippines in the coming year. He states the following precedents to support his claim, 1) the forthcoming May elections are set to generate more jobs for the Filipino people, 2) there is an increase in exports particularly in the areas of shipping, R&D and training, ICT, electronics, healthcare and wellness, and steel, 3) the ratification of the 2007 budget, 4) the World Bank to invest \$300 billion in Philippine infrastructure, 4) the restoration of tax benefits for investors in Subic and Clark as approved by Congress and 5) the continued strengthening of the Philippine peso.

Brother Ben Quiñones of the Coalition of Socially Responsible SMEs shared his forecast on the Philippine economy in two perspectives, "All is well except for investments," he said. He analysed the Philippine economy as a system governed by corporations, the banking industry and the government. "What hinders equitable wealth distribution are the vicious cycles of booty capitalism, poor governance, poverty and social chaos, situating the Philippines at the roster of "high-risk" investment spots for foreign investors," he said. He persuaded the PANA general membership to take on the following steps in solving this problem: 1) look beyond macroeconomic policies and consider the various laws and regulations that hold back the productivity of industries and 2) increase investments in the manufacturing sector.

1.2 2008 ECONOMIC FORECAST and CONSUMER TRENDS

At the 10th PANA General Membership Meeting held at Merk's Bar last October 25, Professor Leonor Magtolis-Briones of the National College of Public Administration and Governance in UP Diliman presented "Fearful Forecasting for 2008". Prof. Briones claimed that in developing countries like the Philippines, forecasts at this time of year are laden with uncertainties. First reason is that 2007 is an abnormal year, it being an election year which will make it difficult to use as the basis for 2008 projections. Another factor is the planned balanced budget policy to be implemented in the coming year. She further said that, "Economic performance largely depends on how the government handles the succession of crises it must deal with." This is in reference to the current issues being hurled at the government. Unfortunately, the government's explanations on the cash gifts to the public officials and the explosion that killed 11 persons and injured a hundred others remain unsatisfactory. Professor Briones further stressed that, "The main issue here is governance."

Based on the Diokno analysis of the Philippines' economic performance in the last 10 years, Professor Briones highlighted the improvements in the economy but mentioned that the growth is not enough to reach and significantly improve the lives of the people at the bottom of the economic ladder. She said that for companies whose target market are people in the countryside, it is important to note that the decline in the agricultural sector will have an implication in this market's purchasing power. Further, Professor Briones pointed out that 2007 being an election year, government expenditure is quite high but the same cannot be assumed for 2008 because of the balanced budget implementation scheduled for next year.

Other social indicators presented by Prof. Briones were the poverty threshold, Educational Development Index (EDI) and healthcare index. Data shows that in 2003, 26 million Filipinos are living below poverty threshold and 13% of the population is living in extreme poverty. Education and health care are suffering as well. All the key indicators on the quality of education in the country are down while government spending on basic health care is also being neglected. The professor challenged those companies in the health care industry to do something about this. Professor Briones recommended more involvement from the private sector in governance. She said that governance is not just the business of the government, it is the business of all the sectors of society. "If your principals play a more active role in governance and in other concerns of the country through advertising, perhaps 2008 will not be as fearful or even fearsome," she concluded.

On the other hand, Ms. Russel Adra-Hidrosollo, Director of Consumer Panel Services - ACNielsen (Philippines) Inc., shared with the PANA members the result of their study on FMCG and Key Consumer Trends for 2008, using the consumer panel method. She revealed that there was an increase in spending for food and non-food items with tea drinks and hair treatment topping their respective categories.

There are three factors contributing to the growth in the market of products. First is the increasing concern by consumers for health, wellness and youthfulness. Consumers want products that are healthful and beneficial to them. They also want to look good and feel good thus there is a proliferation of spas and water refill stations as well as the increase in the demand for body cleansing and

personal paper items. To support the claim that present consumers are concerned about health, Ms. Hidrosollo presented data showing that Filipinos are more worried about getting diseases as compared to people from other countries. This trend spells out opportunities for pharmaceutical companies.

The second factor is the increasing patronage for convenience. Consumers want quick and easy-to-use goods. Third, is the consumers' continuing need for value. Households would rather spend on essential items than on products which do not belong to the consumer basket. Moreover, consumers who cannot afford to buy even the essential items before are now able to do so because of the presence of more affordable alternatives or smaller/lower-priced packaging.

Ms. Hidrosollo stated that these three trends will go beyond 2007. There will be continued focus on eating healthier and looking better. Consumers will still need products that will make their lives easier and they will always want to get their money's worth in the products that they buy.

Some basic facts about The Philippines for the year 2007 are as follows:

Capital	Manila
Land Area (km square '000)	300.0
Exchange rate (per \$)	46.15
Population (millions)	90.5
GDP (billions)	US\$ 144.1
GDP (PPP) per capita (\$)	3,225
Real GDP Growth (%)	7.3
GDP (PPP) per capita (\$)	US\$ 12,742.51
Consumer Price Inflation (%)	2.8
Unemployment Rate (%)	6.3
Labour Force (millions)	35.9
Current Account Balance	2.9
Direct Investment:	
Stock Inward (\$billions)	16.0 (2006)
Flows inward (% of GDP)	2.0

Source : Asian Institute of Management Policy Centre for World Competitiveness Yearbook 2008

1.3 Global Competitiveness: The Philippines¹⁰

The Philippines was ranked 71st position out of 134 economies in the Global Competitiveness Report 2007-2008. In terms of stage of development, the Philippines had been identified to be in the Factor Driven Stage where companies compete on the basis of price and sell basic products or commodities

¹⁰ Based on the Global Competitiveness Report, 2007-2008 and 2008-2009 (World Economic Forum) Country Profile on Philippines

with their low productivity reflected in low wages. Maintaining competitiveness at this stage of development hinges primarily on well-functioning public and private institutions, appropriate infrastructure, a stable macroeconomic framework and a healthy and literate workforce. In addition, the Philippines has seen an improvement in its macroeconomic stability since last year with a shrinking government budget deficit and lower public debt.

On the other hand, the main obstacles to greater competitiveness are related to the quality of the country's public institutions and a lack of efficiency in its labour market. The institutional environment is characterised by the perception that government spending is highly wasteful (ranked 120th), a lack of evenhandedness in the government's dealings with the private sector (117th), and general concerns about corruption in the public sphere. In addition, the threat of terrorism imposes significant costs on businesses in the country (ranked 125th).

With regard to labour market inefficiencies, last year's report showed that the Philippines was ranked 100th with a severe brain drain problem, little flexibility for firms in wage determination, excessively high firing costs and reducing the incentive for hiring. This year, labour market inefficiencies points towards wages are not flexibly determined by companies (108th), regulations impede firms from freely hiring and firing workers (101st), and firing costs are excessive (ranked 108th). The labour market inefficiencies highlighted had hindered job creation. It is encouraging however to note that the ranking of Pay and Productivity in the Philippines ranked at the 57th (Table 1.1) position is among the highest in terms of performance on labour market efficiency.

It is therefore important that the Philippines review its labour market policies and this research on determining the Performance Related Remuneration Systems will reveal pertinent practices among Small and Medium Enterprises in the Philippines and which can be best practiced by other Small and Medium Enterprises for wider dissemination and implementation. The details of the Philippines ranking in the 7th pillar of labour market efficiency are as shown in Table 1.1.

Table 1.1 : Rankings of Labour Market Efficiency¹¹

Indicators	Rank/134
Cooperation in labour-employer relations	71
Flexibility of Wage Determination	108
Non-Wage Labour Costs*	24
Rigidity of Employment*	61
Hiring and Firing Practices	101
Firing Costs	108
<i>Pay and Productivity</i>	57
Reliance on Professional Management	40
Brain Drain	116
Female Participation in labour force*	86

Source : Global Competitiveness Report 2008-2009

* Indicates hard data

¹¹ Global Competitiveness Report 2008-2009 on The Philippines Pg. 227

2.0 SMALL and MEDIUM ENTERPRISES in the Philippines

In the Philippines, 99.1% of the businesses are small and medium enterprises (SMEs) and only 0.99% are large enterprises. Republic Act No. 9501, The Magna Carta for Micro, Small and Medium Enterprises (MSMEs), signed by President Gloria Macapagal Arroyo on 23 May 2008 defines micro enterprises as entities with total assets of not more than Php 3,000,000, small enterprises as companies with Php 3,000,001 to Php 15,000,000 worth of assets and medium enterprises as firms with total assets of Php 15,000,001 to Php 100,000,000. The said assets exclude the land on which the firm's office, plant, and equipment are situated. The new law, R.A. 9501 amends the 17-year old R.A. 6977 or the Magna Carta for Small Medium Enterprises.

2.1 The Philippine Setting: SMEs Data, Government Incentives & Laws and Other Issues

2.1.1 General Information and Data

An SME is any business activity or enterprise engaged in industry, agri-business and/or services whether single proprietorship, partnership, cooperative or corporation whose total assets inclusive of those arising from loans but exclusive of the land on which the particular business entity's office, plant and equipment are situated must have value falling under the above mentioned categories. SMEs are perceived to have greater linkages to micro-enterprises (backward linkage) and medium and large businesses (forward sub-contracting links). Among the rationale for developing SMEs in the Philippines includes the fact that they use resources more efficiently than large enterprises. The Philippines' advantages in terms of investment environment includes having an open market

economy, reliable infrastructure support, available special economic zones and strategic location, hospitable lifestyle, competitive investment incentives and quality human resources.

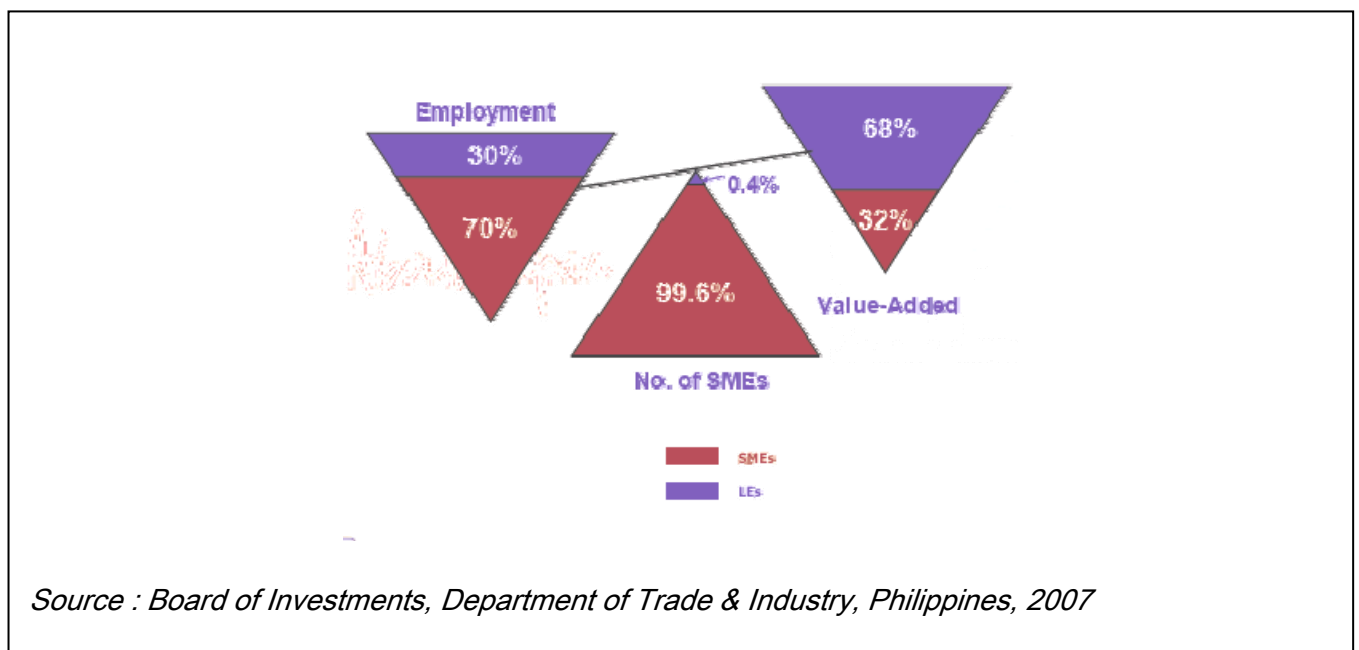
Philippine SMEs usually join a bigger organisation, cooperative and association.

In the Philippines, SMEs are acknowledged to have the following major roles:

- Substantial contribution to national economic activity
- Major source of economic dynamism, economic and social functions at all levels of society
- Major source of provision of outsourcing products and services
- Major contribution to regional, local and community economic development.

Figure 1.1 below illustrates the Philippine SME share, its composition and comparative data with other Asian Countries (Source: Board of Investments; Department of Trade & Industry, Philippines 2007).

Figure 1.1 Philippines: SME Share



SMEs in the Philippines are also categorised by sector and by its size, as illustrated in Table 1 below (Data as of 2007).

Table 1.1 : SMEs by Sector

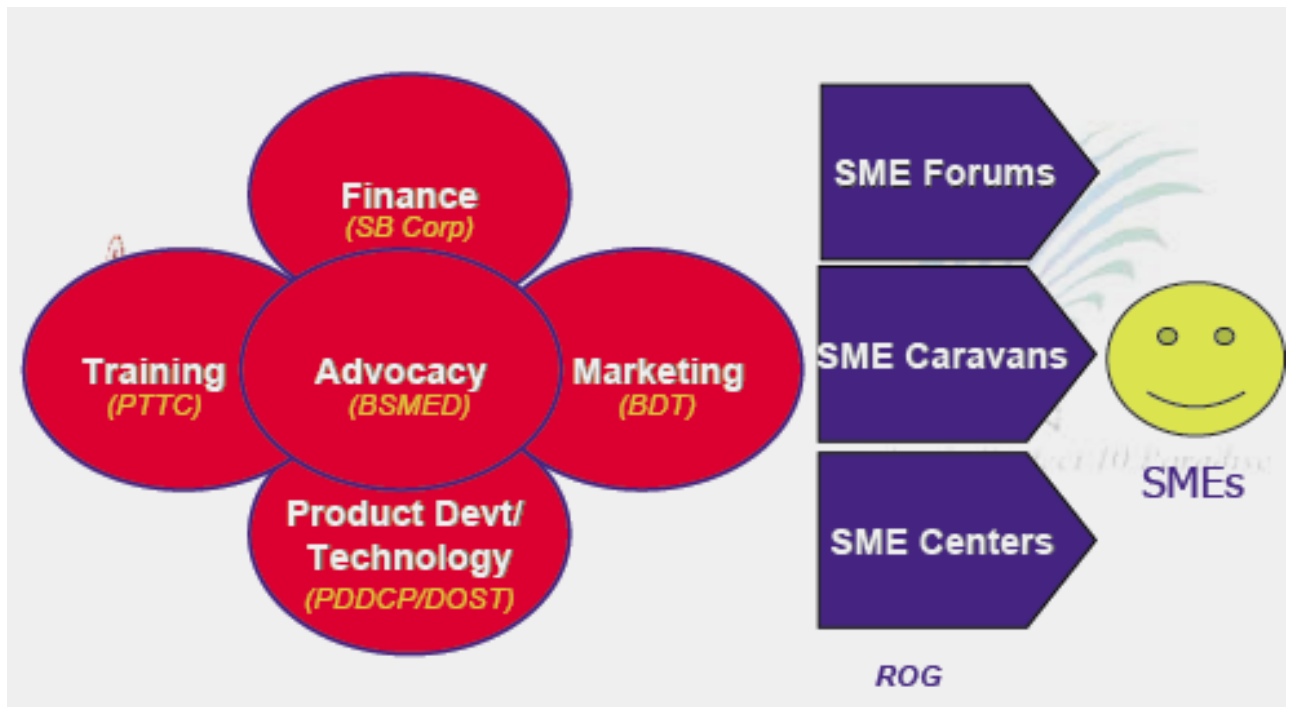
Industry	% of Total Establishments				
	Micro	Small	Medium	Total MSMEs	Large Enterprises
Wholesale & Retail Trade	95.7	4.2	0.1	99.9	0.1
Manufacturing	88.2	9.9	0.8	98.9	1.1
Hotels & Restaurants	92.0	7.7	0.2	99.9	0.1
Community, Social, & Personal Service Activities	94.3	5.5	0.4	99.9	0.1
Real Estate, Renting & Business Activities	88.4	10.0	0.7	99.1	0.9
Health & Social Work	94.7	4.6	0.4	99.6	0.4
Financial Intermediation	76.6	22.7	0.3	99.6	0.4
Transport, Storage and Communications	75.2	22.4	1.3	98.9	1.1
Education	52.8	41.7	3.1	97.6	2.4
Agriculture, Hunting and Forestry	47.0	45.9	3.2	96.1	3.9
Construction	55.6	36.4	3.9	95.9	4.1
Electricity, Gas and Water	39.6	43.5	8.9	92.1	7.9
Fishery	45.2	49.8	2.6	97.6	2.4
Mining and Quarrying	60.4	32.0	4.0	96.3	3.7

**Table 1.2 : Comparative SME Data in Selected Asian Economies
(values in %)**

	Malaysia	Thailand	Philippines	Korea	Japan	China	Indonesia
SME Establishments	94.4	98.0	99.6	99.0	99.0	99.7	99.99
Employment	40.4	55.8	69.1	69.0	88.0	74.0	99.04
Value-Added	26.0	n.a.	32.0	46.0	56.0	74.0	99.04

The National SME Agenda / Philippines Policy Environment for SMEs is one of the government's focus. SME Development is a priority in the "8-Point Program of the President" and the Department of Trade and Industry (DTI) has been appointed as its lead agency. Among its main tasks are the formation of SME Core Groups in the bureaucracy, Product development, Marketing, Financing, Training, among others. It uses a Comprehensive and Integrated Approach in running the program, as illustrated in the figure 1.2:

Figure 1.2 Comprehensive and Integrated Approach



SME's are defined in two major ways, by assets or employment size. DTI defines small and medium enterprises as provided under the Magna Carta of SMEs (R.A. 6977 as amended by R.A. 8289) as any business activity or enterprise engaged in industry, agribusiness and/or services whether single proprietorship, cooperative, partnership, or corporation whose total assets inclusive of those arising from loans but exclusive of the land of which the particular business entity's office, plant and equipment are situated, must have value falling under the following categories:

Micro	-	less than Php3, 000,001
Small	-	Php3, 000,001 up to Php15, 000,000
Medium	-	Php15, 000,001 up to Php100, 000,000

SMEs may also be defined by the number of employees.

Micro	-	regular employs less than 10 workers
Small	-	10 – 99 workers
Medium	-	100 – 199 workers

Additional statistics on SMEs are as follows:

- 99.6% of registered establishments are SME's
- SMEs generate 69.9% of jobs, contribute 32% of value while the remaining 68% are still contributed by large and multinational enterprises
- SMEs account for 32% of the total economic output of the country.

A 2003 ILO survey of SMEs based on geographical distribution across the country using DTI's "list of SMEs," shows that 92% are owned by Filipinos. Incidentally, the famous BMBE law appears to have caused a reclassification of many small enterprises into micro enterprises. In any case, of interest to HR practitioners, is the occupational employment patterns of SMEs based on the 2006 integrated survey by the Bureau of Employment Statistics (BLES) of the DOLE.

Current Regional Minimum Wage

Employers including small businesses may implement policies and impose terms and conditions of employment as they deem fit given their operating and profitability requirements. These policies and employment terms and conditions however must be consistent with mandated labour policies set forth in the Labour Code of the Philippines.

Under the Labour Code, employees are entitled to compensation or wages, overtime pay, holiday and premium pay, service charges and tips in service businesses, SSS, EC and NHI remittances, service incentive leaves, and retirement pay.

Regular Compensation

Employers must pay employees no lower than the minimum wage rates prescribed by law. The minimum wage rates are based on the normal working hours of eight (8) hours a day.

The current regional daily minimum wage rates as of June 2008, are set forth in the table below.

For non-agriculture:

NCR	P345-P382
CAR	243- 260
Region III	251-302
Region IV-A	236-320
Region IV-B	240-252

SUMMARY OF CURRENT REGIONAL DAILY MINIMUM WAGE RATES

Non-Agriculture, Agriculture

As of October 2008

(In pesos)

REGION	WO No./ DATE OF EFFECTIVITY	NON- AGRICULTURE	AGRICULTURE	
			Plantation	Non-Plantation
NCR a/	WO 14/June 14, 2008	P 345.00 - 382.00	P 345.00	P 345.00
CAR b/	WO 13/June 16, 2008	243.00 - 260.00	226.00 - 242.00	226.00 - 242.00
I c/	WO 13/June 22, 2008	220.00 - 240.00	220.00	195.00
II d/	WO 13/June 15, 2008	227.00 - 235.00	215.00 - 223.00	215.00 - 223.00
III e/	WO 14/June 16, 2008	251.00 - 302.00	236.00 - 272.00	216.00 - 256.00
IV-A f/	WO 13/June 01, 2008	236.00 - 320.00	216.00 - 295.00	196.00 - 275.00
IV-B g/	WO 04/June 19, 2008	240.00 - 252.00	198.00 - 207.00	178.00 - 187.00
V h/	WO 13/ July 1, 2008	196.00 - 239.00	207.00 - 217.00	187.00 - 197.00
VI i/	WO 16/ July 6,2008	240.00 - 250.00	218.00	208.00

REGION	WO No./ DATE OF EFFECTIVITY	NON- AGRICULTURE	AGRICULTURE	
			Plantation	Non-Plantation
VII j/	WO14/June 16, 2008	222.00 - 267.00	202.00 - 249.00	202.00 - 249.00
VIII k/	WO 15/June16, 2008	238.00	219.00	219.00
IX l/	WO 15/ July 3, 2008	240.00	215.00	195.00
X m/	WO 14/June 1, 2008	241.00 - 256.00	229.00 - 244.00	229.00 - 244.00
XI n/	WO 15/June 16, 2008	265.00	255.00	255.00
XII o/	WO 15/June 16, 2008	245.00	225.00	220.00
XIII p/	WO 09/June 20, 2008	233.00	223.00	203.00
ARMM q/	WO 11/ June 29, 2008	210.00	210.00	210.00

- a/ Granted a P 20 increase consisting of P15 basic wage & P5 COLA, The COLA shall be integrated into the basic wage on August 28, 2008.
- b/ Granted P P10.00 & 15.00 COLA per day depending on the area and industry classification.
- c/ Granted P 10.00 COLA.
- d/ Granted P 12.00 wage increase and integrated P8.00 COLA under WO No. RTWPB-II-09 into the basic wage.
- e/ Granted P 15.00 increase consisting of P5 basic wage & P10 COLA; integrated the P9 COLA under WO No. RB III-13 into the basic wage.
- f/ Granted P 12-20 wage increase as follows: P 16-P20 (Growth Corridor Area) P14 (Emerging Growth Area) P12(Resource Based Area)
- g/ Granted P 10 wage increase to all minimum wage workers & P5 COLA to non-agriculture sector only.
- h/ Granted P 13 COLA, the P6 from P13 COLA shall be integrated in the basic wage on January 1, 2009.
- i/ Granted P15 Emergency Relief Allowance (ERA) until October 15, 2008
- j/ Granted P P17.00 wage increase
- k/ Granted P10 COLA
- l/ Granted P 15 wage increase consisting of P5 basic wage and P10 COLA for a period of three months; thereafter, P5 out of the P10 COLA under WO No. IX-14 shall be integrated into the basic wage.
- m/ Granted P12 COLA & integrated the P16 COLA under WO No. RX-12 into the basic wage. The P10 COLA under WO No. RX-13 shall be integrated into the basic wage on November 16, 2008.
- n/ Granted P15 COLA & integrated the P16 COLA under WO No. RTWPB XI-13 into the basic wage. The P10 COLA under WO No. RX-14 shall be integrated into the basic wage on September 16, 2008.
- o/ Granted P 7-10.50 wage increase & P3-5 COLA.
- p/ Granted P13 increase consisting of P8 basic wage & P5 COLA.
- q/ Granted P 10.00 wage increase.

Source: National Wages and Productivity (Commission Updated: 08 October 2008)

Businesses Exempt from Minimum Wage Laws

If the company is a service establishment with not more than 10 employees, a distressed establishment with a deficit of 20% or more of current paid-up capital or a new business enterprise outside the National Capital Region (NCR) or is in an export processing zone, the company may pay employees below minimum wage rates on condition that a request is filed for exemption from compliance with wage orders with the National Wage and Productivity Council (NWPC).

If the company does not pay minimum wages, it will be subject under Republic Act No. 8188 to a fine not less than Twenty-five thousand pesos (P25.000) nor more than One hundred Thousand pesos (P100.000) or imprisonment of not less than two years nor more than four years or both such fine and imprisonment at the discretion of the court. You may also be ordered to pay an amount equivalent to double the unpaid benefits owing to the employees. Payment of this indemnity may not absolve you of criminal liability.

Computation of Wages

The salaries and wages of your employees depend on whether you pay them on a monthly or daily basis. Monthly-paid employees are those whom you pay every day of the month, including unworked rest days, special days and regular holidays. Daily-paid employees are those whom you pay for days actually worked and on unworked regular holidays.

The Equivalent Monthly Rate (EMR) of your employees is computed as follows:

Monthly Paid Employees

The formula for the EMR of monthly paid employees is:

$$\text{EMR} = (\text{Applicable Daily Rate} \times 365) / 12$$

The factor of 365 days consists of: 302 ordinary working days, 51 rest days, 10 regular holidays, and 2 special days.

Workers Paid by Results

Workers who are paid by results, including home workers and those who are paid on piecework, *takay*, *pakyaw*, or task basis, shall receive not less than the applicable statutory minimum wage rates prescribed under the Regional Wage Orders for normal working hours or a portion thereof.

Adjustments in the Applicable Minimum Wage rate (AMW) is computed as follows:

1. Amount of increase in AMW \div Previous AMW \times 100 = % increase
2. Existing rate/piece \times % increase = Increase in rate/piece
3. Existing rate/piece + increase in rate/piece = Adjusted rate/piec.

Apprentices, Learners and Handicapped Workers

If you have apprentices, learners or handicapped workers you would need to pay them no less than 75% of the applicable statutory wage rates. Apprentices and learners are those who are covered by apprenticeship/learnership agreements duly approved by the DOLE.

Additional Compensation

Holiday Pay

Companies need to pay employees holiday pay when you require them to work on legal declared holidays or special days.

Regular holidays include:

Date	Holiday
January 1	New Year's Day
Movable Date	Maundy Thursday
Movable Date	Good Friday
April 9	Arawng Kagitingan
May 1	Labour Day
June 12	Independence Day
Last Sunday of August	National Heroes Day
November 30	Bonifacio Day
December 25	Christmas Day
December 30	Rizal Day

Your employees who work on a regular holiday (for work within 8 hours) are entitled to twice (200%) their basic wage

Premium Pay

Companies need to pay employees premium pay or additional compensation if you require them to perform work on non-working days, such as rest days and special days.

The current premium pay rates are as follows:

Work	Premium Rate (of daily rate)	Total Rate
Work on rest days or special days	30%	130%
Work on rest day which is also a special day	50%	130%
Work on regular holiday which also a rest day	30% of 200%	260%

The company may opt not to pay your managerial employees, workers paid by results or field personnel the above premium pay.

Overtime Pay

If the company requires employees to perform work beyond eight hours a day the company would need to pay them additional compensation as follows:

Work	Overtime Rate
Work > 8 hours on ordinary working days	25%
Work > 8 hours on rest day or special or regular holidays	30%

Night Shift differential

If employees work at night between 10:00 pm and 6:00 am the company is required to pay them Night Shift Differential (NSD) as follows:

Work	Rate (of hourly rate)	Pay
Night shift (10pm to 6 am) considered regular work	-	-
Ordinary day	10%	110%
Rest day, special day or regular holiday	10% of rest day, special day or holiday rate	110% of rest day, special day or holiday rate
Night shift considered overtime work	-	-
Ordinary day	10% of 125%	110% of 125% of basic rate
Rest day, special day or regular holiday	10% of rest day, special day or holiday rate	110% of rest day, special day or holiday rate

If the company employs not more than five workers and you are a retail or a service establishment then there is no need to pay night shift differential. There is also no need to pay managerial employees and field personnel the NSD.

Service Incentive Leave (SIL)

If employees have been with the company for at least one year, whether service is continuous or broken, the company needs to pay them Service Incentive Leave (SIL) equivalent to five days. The SIL may be used for sick and vacation leave purposes. If the SIL is not used up within the year, it may be commuted or paid its money equivalent at the end of the year. In computing the SIL, the basis shall be the salary rate at the date of commutation. The availability and commutation of this benefit may be on a pro rata basis.

The company need not grant SIL if employees are already enjoying this benefit such as when they are already given a vacation leave of at least five days. The company also need not accord SIL to your managerial employees and field personnel. If the company is employing less than ten employees there is no need to also pay them SIL.

Service Charges

If the company is a service establishment such as hotels, restaurants and night clubs, the company may charge an additional 10% to your customer's bill for distribution to employees.

If the company collects service charges, employees are entitled to an equal share in the 85% of the total of such charges, except managerial employees. The company may retain the remaining 15% to answer for losses and breakages and for distribution to managerial employees at discretion.

The company must distribute the shares of the employee in the service charges no less than once every two weeks or twice a month at intervals not exceeding sixteen (16) days. If the company stops collecting service charges they are required to provide and integrate into the basic wage of your employees the average share previously enjoyed by them for the past twelve months immediately preceding such stoppage.

Tips

If the company does not collect service charges but practice the pooling of tips given voluntarily by customers to employees the company should ensure that the

pooled tips are monitored, accounted and distributed in the same manner as the service charges.

13th Month Pay

The company also needs to pay rank and file employees 13th month pay no later than December 24 of every year. One half of the required 13th month pay may be made before the opening of the regular school year and the other half on or before the 24th of December of every year. The minimum 13th month pay is not less than 1/12 of the total basic salary earned by an employee within a calendar year.

The "basic salary" includes all remunerations or earnings paid for services rendered. It does not include allowances and monetary benefits which are not considered part of the regular or basic salary such as the cash equivalent of unused vacation and sick leave credits, overtime, premium, night differential and holiday pay and cost-of-living allowances.

Retirement Pay

If the company has employees who have reached the age of 60 years or more but not beyond 65 years old the company needs to pay them retirement. However, if retail, service and agricultural establishments with no more than ten employees, the company is exempted from paying retirement pay. The minimum retirement pay is one-half (1/2) month salary for every year of service. A fraction of at least six (6) months is considered as one whole year. "One-half month salary" includes:

- 15 days salary based on the latest salary rate

- cash equivalent of 5 days of service incentive leave;
- one-twelfth (1/12) of the 13th month pay.

These benefits are over and above those granted by the Social Security System.

SSS Registration

The company is also required to enroll employees under the Social Security System (SSS) program which provides insurance and protection for private-sector employees including resident foreign employees. SSS benefits include disability pension, retirement, funeral benefit, sickness allowance, maternity and paternity leave and loans.

For single proprietorship business, the company should accomplish and submit SSS Forms R-1 (Employer's Data Record) and R-1A (Initial or Subsequent List of Employees). If the business is a partnership or a corporation, the company also needs to submit articles of partnership or incorporation. The company should also require employees to secure an SSS number and that they are reported for coverage under the SSS.

The company must report all employees for SSS coverage within thirty days from the date of employment by submitting an accomplished SSS Form R-1A (Employment Report) at the nearest SSS office. The company is also required to deduct from employees salaries the monthly SS contributions based on the schedule of contributions and remit these contributions to any SSS-accredited bank/SSS Head Office/ SSS selected branches on or before the 10th day following the month when the said contributions are due and applicable.

Maternity Benefits

The company must advance maternity benefits to female employees whether married or unmarried equivalent to 60 days for normal delivery, abortion or miscarriage or 78 days for caesarian section delivery. The rate is equivalent to 100% of the average daily salary credit. Your female employees should be SSS members at the time of delivery, miscarriage or abortion and must have given the required notification to the SSS through the company and the company must have paid at least three months of maternity contributions within the twelve-month period immediately before the date of contingency. Maternity benefits like other benefits granted by the SSS, are granted to employees in lieu of wages and is not included in computing the employee's 13th month pay.

Paternity Leave under Republic Act No. 8187

The company is also required to grant paternity leave or time off from work to all your married male employees regardless of employment status (e.g. probationary, regular, contractual, project basis) to allow them to lend support to their wives during the period of recovery and/or in the nursing of their newborn child. The paternity leave consists of seven (7) days with full pay for the first four deliveries of the employee's lawful wife. Availment of the paternity leave may be after the delivery without prejudice to an employer's policy of allowing the employee to avail of the benefit before or during the delivery provided that the total number of days shall not be more than seven days for each covered delivery.

Tax Compliance

Companies must also ensure that you are withholding the proper taxes due on the compensation, benefits and other taxable emoluments paid to all employees.

2.2 Total Employment and Occupational Structure

Total employment in the non-agricultural sector with 20 or more workers was estimated at 2.8 million as of payroll period ended June 30,2006. Of this number, 43% were employed in the industry sector and 57% in the service sector. In the industry sector, plant and machine operators and assemblers constituted the largest occupational group (37.5%) while clerks (17.8%) and service workers (21%) dominate the service sector. Low proportions of managers, managing proprietors and supervisors were noted. They accounted for just 7.9% of the workforce in the industry sector and 11.1% in the service sector.

Vital Occupations defined as occupations that employers considered as most vital to business success was also presented by the mentioned survey. It was felt that these occupations may require special interventions with respect to training and development of people in or about to enter these occupations. Survey results listed a total of 317 individual occupation titles perceived by employers as vital to business success. In the order of importance they are:

- Managers, managing proprietors and supervisors
- Professionals and clerical groups
- Technical and associate professionals
- Service workers
- Plant, machine operators and assemblers
- Trades and related workers

- Sales workers
- Labourers and unskilled workers.

Hard-to-fill occupations, on the other hand is defined in the survey as those which have presented employers with the greatest recruitment difficulties over the last three years. It gives an idea to HR practitioners in the SMEs of the relative availability of these skills in the labour market at the time. Recruitment difficulties were felt mostly in establishments engaged in manufacturing (32%), wholesale and retail trade (17%), real estate, renting and business activities (12%) and private education (10%).

On an average the median number of months that took employers to fill a vacancy considered as hard-to-fill positions was three months. A large majority of these hard-to-fill positions are on the high-end jobs, professionals (41%), managers, managing proprietors, supervisors (19%), technical and associate professionals (15%). Specifically, the top five hardest jobs to fill across sectors in the order of their importance were accountants, auditors, nurses, technical and commercial sales representatives, computer programmers, and mechanical engineers.

2.3 Incentives, Laws and Policies for SMEs in the Philippines

The Philippines' investment environment boasts of attractive Investment Incentives, among them are:

- 4 to 8 years Income Tax Holiday
- Special 5% tax rate on gross income after the lapse of ITH (for IT Park/Ecozone locators)

- Tax and duty exemption on imported capital equipment (for IT Park/Ecozone locators)
- 0% duty on imported capital equipment (E.O. 528)
- Exemption from 12% input VAT on allowable local purchase of goods and services (e.g., communication charges)
- Unrestricted use of consigned equipment
- Exemption from wharfage dues
- Employment of foreign nationals.

Employers including small businesses may implement policies and impose terms and conditions of employment as they deem fit given their operating and profitability requirements. These policies and employment terms and conditions however must be consistent with mandated labour policies set forth in the Labour Code of the Philippines. Under the Labour Code, employees are entitled to compensation or wages, overtime pay, holiday and premium pay, service charges and tips in service businesses, SSS, EC and NHI remittances, service incentive leaves and retirement pay.

Employees must not be paid lower than the minimum wage rates prescribed by law. The minimum wage rates are based on the normal working hours of eight hours a day.

2.4 Other Incentives, Laws and Policies / Philippine Policy for Small and Medium Enterprises

- **SME Development Plan (2004 -2010)**

The SME Development Plan (2004-2010) is a strategic development plan that builds on the gains of the National SME Agenda. Strategies for implementation are based on a 3-pronged approach which includes the Enterprise level, the Sector level and the Broad-based level. The Enterprise level provides comprehensive and focused support to enhance managerial and technological capability. It also provides business opportunities for development of new ideas that promote diversification of the industrial structure. The Sector level promotes sustained operations through directed sector services. It aims to Develop and promote services that will support industrial linkages between local SMEs and leading industries. Lastly, the Broad-based level aims to improve access of SMEs to financing. It promotes an enabling business environment and aims to improve access to programs and capacity-building for institutions.

- **Magna Carta for Small Enterprises (1997)**

The Magna Carta for Small Enterprises is a landmark legislation to foster a dynamic SME sector. It is guided by 3 major principles in setting the pace for SME development which includes:

- Minimal set of rules and simplification of procedures/requirements
- Private sector participation in the implementation of SME policies/programs
- Coordination of government efforts.

- **Barangay Micro Business Enterprises (BMBEs) Act (2002)**

The Barangay Micro Business Enterprises Act or the BMBEs includes the following:

- Major incentives
- Income tax exemption from income arising from operations of the enterprise
- Exemption from the coverage of the Minimum Wage law
- Priority to a special credit window
- Technology transfer, production and management
- Training, marketing assistance programs.

- **SME Unified Lending Opportunity for National Growth Program**

The program is a financing program under the National SME Development Plan with DTI as lead implementer. Among its objectives are to:

- Simplify and standardise the lending procedures to enhance SMEs access to much needed funds
- Shorten the list of documentary requirements to further facilitate the lending process
- Create a wider, borderless financing system that will afford the SMEs greater access to short-and long-term funds
- Lower the effective cost of borrowing by SMEs
- SMEs assistance also in terms of market exposure, human resource training and product development.

- **One-Town One-Product (OTOP) Program.**

Offers assistance on Product design and development, Skills and entrepreneurial training, Marketing assistance, Introduction of appropriate technologies, and Financing.

- **An Act Providing Assistance to Women (RA 7882).**

This particular legislation recognises the special role of women in development and supports women entrepreneurs who are engaged in manufacturing, processing, service and trading businesses. Under this program, Government Financing Institutions (GFIs) like the Landbank of the Philippines (LBP) and the Development Bank of the Philippines (DBP) are mandated to provide assistance to non-governmental organisations (NGOs) engaged in developing women's enterprises to a limit of P2M provided the NGOs has an operating track record of a year, existing women enterprises to the upper limit of P50,000 and potential women entrepreneurs with sufficient training up to a limit of P25,000 each.

- **Direct Tax (Income Taxation)**

This policy includes the provision of fiscal incentives to all registered Barangay Micro Business Enterprises (BMBEs) and exemption from payment of income tax for income arising from the operations of the enterprise. The LGUs are encouraged to reduce the amount of local taxes, fees and charges imposed or to exempt the BMBEs from local taxes, fees and charges:

- Exemption from advance payment of customs duties and taxes
- Duty free importation of machinery and equipment, raw material inputs and packages

- Tax credit for imported inputs and raw materials primarily used in the production and packaging of export goods which are not readily available locally
- A tax credit of 25 per cent of the duties paid on raw materials and capital equipment and/or spare parts. The credit is available to exporters of non-traditional products who use or substitute similar locally produced inputs
- A tax incentive.

Mandatory Allocation of Credit Resources to Small Enterprises

All financing institutions are required to set aside at least 6% and at 2% for small and medium enterprises respectively of their total loan portfolio.

Non-tax Incentives

The government also gives out non-tax incentives in the form of guarantee and financial facilities. Among the examples are:

- SME Force - SME Financing for Organisationally competent and Excellent Franchise Businesses is a franchise development financing facility that will be implemented with the participation of the franchisors' organisations. Coupled with the "Captains of Industry" it will be used as a strategy to develop backward and forward linkages among and between leading businesses and SMEs in the domestic economy.
- FIRST LIGHT - A financing program for the best business ideas that will contribute to the development of the five priority industries. The best ideas shall be competitively chosen from proposals endorsed by DTI through its regional/provincial offices.

- GUIDE - Guarantee Incubation for DTI Endorsed Enterprises is a P100 million direct lending facility of the Small Business Guarantee and Finance Corporation (SBGFC).
- Small Enterprise Financing Facility (SEFF) - SEFF was established to supplement the financial system's resources for small and medium enterprise development financing. Under the SEFF, accredited financial institutions (AFIs) which are in need of funds for small and medium enterprise financing may approach the SBGFC and apply for accreditation as lending conduits. Prospective SME borrowers may then directly apply with any of the AFIs under the SEFF. With SEFF, the SBGFC finances up to a maximum of 90% of the project cost with the AFIs co-financing at least the remaining 10%.
- Rediscounting Facility for Small Enterprise Loans - It is a credit window where accredited financial institutions (AFIs) may negotiate their eligible SME loans/credit instruments with SBGFC. AFIs, which wish to avail of loans from the window, can rediscount their promissory notes by assigning/endorsing with recourse promissory notes in favor of the SBGFC together with its underlying securities.
- Guarantee Program - This product was designed to encourage financial institutions to lend to SMEs by providing a guarantee cover of up to a maximum of 90% on the loans of qualified entrepreneurs. Such a scheme is aimed at increasing the flow of funds from the formal lending institutions to the small and medium enterprise sector especially those without collateral. The guarantee works as a collateral substitute or as a collateral supplement.

- Transactional Direct Financing Facility - This is a stop gap program which immediately addresses the credit needs of SMEs particularly in the export sector. Here, SBGFC coordinates with a network of industry associations to determine specific problem areas wherein SBGFC could directly intervene. SBGFC provides direct financing on a per transaction basis. The program aims to assist SMEs at critical periods such as in the production of outstanding confirmed orders or the liquidation of receivables to finance ongoing production. A variant of this facility was later launched to assist SMEs with requirements of longer-term maturities up to a year for business expansion and other working capital/fixed asset requirements.

- **Assistance in the Facilitation of exports/import**

Export Assistance Network (EXPONET) - serves as a trade facilitation office that provides real and immediate assistance to existing and potential exporters. Services include Export Trade Information Dissemination, Export Procedures and Documentation, Buyer-Supplier Matching, Export Financing and Incentives and Raw Material Sourcing, Tax and Duty-Free Importation of Raw Materials for Re-export, Institutional Linkages, Handling of Export Trade complaints, and Exporters Accreditation.

SME Centers - SME Centers are "one-stop-shops" located in various parts of the country that provide information, advisory and consulting services in the following areas: productivity, improvement, technology upgrading, market information, product and market development, trade promotion, credit, financing and entrepreneurial development.

SMEs, if properly nurtured and given necessary push and incentives, create the backbone of the economy – this is the very reason why governments around the world promote its development. Various government sectors and agencies have been created to handle SME creation, training and etc. and more incentives are created as well to further promote its growth. Despite the differences of countries' definitions of SMEs, below are a few of the commonalities observed:

- The SME sector provides the means of creating employment opportunities at relatively low capital cost and they also induce the establishment and growth of other industries which contribute to employment absorption and utilisation of available resources. It promotes employment in rural areas, as well.
- SMEs are training ground for entrepreneurial talent and enable risk-taking and motivated individuals to find avenues to new types of enterprises and innovations.
- SMEs can contribute to the strengthening of the industrial sector. They can complement large firms by relieving them of the necessity of making certain parts or performing certain operations which the smaller units can provide at a lower cost.
- SMEs are starting to also be aware of how to handle and formally manage their human resources.

The Development Bank of the Philippines, being the country's premiere development financial institution reaches into practically all of the fundamental sectors that fuel progress and development. Its efforts in connection with the development of SMEs are manifested in various support programs of the bank in the areas of financing and technical assistance. SMEs continue to receive a

substantial share of DBP assistance. This is cognisant not only of SMEs ingenuity, ability to respond to new market trends and create job opportunities, but also of their pivotal role as buffer during economic downtrends due to their ability to persevere hardships and bounce back during economic recessions.

SMEs in the Philippines are generally supported by the government through laws, policies and incentives. Among the incentives given are acts, regulations and laws in support of its development, tax incentives, loans and financing support, marketing and training assistance, program and project development, and others. The national government has also been very supportive of SMEs as evidenced by the policies, support structures and programs earlier discussed. SMEs in the Philippines are however beset with global competition problems. They are apprehensive about the adverse effects of trade and investment liberalisation where there is freer flow of trade and investments across national borders. In an open market, only the big corporations are expected to survive due to their ability to access market information and technical and managerial know-how. To keep SMEs afloat under this market scenario, frameworks that would mould SMEs into globally competitive enterprises were created. As a starting point, various policies for SMEs were legislated and embodied in the policies earlier discussed.

3.0 Performance-Based Remuneration Systems On Productivity Performance Among Local Industries

What kind of human resources system should one have in a family business? Family businesses comprise a big sector of SMEs and local industries in the Philippines. The most usual and simple advise of an expert in HR is for a family business to have a system that will ensure that the right number and quality of

people are present and are doing the right things at the right time in the right places. For this to be achieved, one can have a team of HR professionals with the organisation or outsource the HR function. Below are a few insights for entrepreneurs managing its human resources most applicable to local small or medium enterprise. A bulk of the discussion dwells on performance-based remuneration and its effect in ensuring an excellent organisation.

3.1 Basic HR for SMEs

3.1.1 Talent Management

Attracting and retaining talents is a basic issue for both SME's and large companies. The latter usually spend a fortune poaching and handcuffing talents. Talent attrition is a common phenomenon. The paradox in talent management lies in getting the right talent to work and stay with the company longer. A company will not have all the talents in the industry all at the same time. Scouting for talents should be likened to buying fruits, don't buy all the ripe ones at the same time, get those that will be ripe tomorrow and three to five days from now. If you can't get the best get the young ones who can be the best. Great talents leave if they feel useless. Talent utilisation is therefore important. When a business is still small there is a better chance of knowing everybody in the organisation. It is not good to hear that one department is talent-laden and the others are bleeding for talents.

3.1.2 Compensation

Some entrepreneurs think that all problems can be solved by money. They usually attract talents by paying high salaries and perks. When employees get disgruntled they give salary increases or bonuses. This does not work all the time. The people you attract with money will likely be attracted with more money by your competitors. Some talents are mercenaries. And money does not solve problems, not even money problems. Like cosmetics, money can hide the pimple, but not for long. So how do you compensate your people? This may sound simple but it is complicated. Pay only for creation of value that your customers are willing to pay for. Have a simple system of discriminating and differentiating people according to position, performance, person and potential. By the way, your HR manager doesn't have to do the payroll himself or herself, outsource payroll preparation and task the HR manager to help you find the next payroll money. Use compensation i.e. salary, benefits and incentives as a reward, not entitlement.

If you want to have an excellent organisation, pay for excellence and celebrate for excellence. Some organisations pay for aging, longevity pay and graduated benefits according to tenure. Some encourage laziness and pay more for people who take longer to complete tasks and overtime pay for working beyond regular hours. Knowing that people perform differently, some organisations still give pay increases and benefits across the board. This is the best way to kill motivation among talents.

Pay for performance is good. But you must ensure that there is a line of sight between what people are doing and the business results you want to achieve. It is pathetic if employees have great performance appraisals but the business does not achieve its goals. Henceforth, you should have only two types of employees – those who are serving the customers directly and those who enable them to serve the customers better. If somebody in your organisation has a job that does not enhance customer value then you are paying him/her unnecessarily.

Equality is not the essence of compensation – perhaps, equity is. But you can't go wrong if you discriminate and differentiate. We will have better talents working with us if we reward them for creating value that our customers are willing to pay for.

3.1.3 Career Development and Training

People want to grow in an organisation. When they stagnate or stop growing in your company they go elsewhere. Career development need not be sophisticated. Many SME's practice this well others don't. It is the responsibility of the head of the business organisation to ensure continuity of the business. People come and go, some earlier, others later. Learn to spot potential i.e. how far a person can go in the organisation. It is not true that everybody can become what he wants to become. If you ask your employees what they want to become many will want your job. In reality, not everyone is capable of stepping into your shoes. Be discriminating in developing your people. Training and development costs a lot, do not train everybody to replace you someday. Train everybody to be effective on their jobs and provide training. Train people with potential so that

they can assume positions of greater responsibility. Differentiate between need for training and discipline. If the problem is skills then train. If the problem is attitude then discipline.

3.1.4 Organisation Development

Have a simple way of diagnosing what's wrong with the organisation. You don't have to be full-time OD practitioners, you can get an OD consultant to occasionally look at what ails your organisation. Employee satisfaction surveys are just one of the ways to get the pulse of your people. Make the most out of teambuilding activities by being clear on what the teambuilding wants to resolve and see if it is resolved.

3.1.5 Employee Relations

There is really no need to memorise the labour laws but a basic understanding is a must. Talents don't leave the company, they leave their bosses. Make sure that bosses know how to respect employees rights, exercise their prerogatives in the right way, and discipline their people whenever necessary. Ensuring industrial peace and harmony in the workplace is not the sole responsibility of HR manager. Every manager and supervisor should be responsible for creating a working environment that makes people contribute their utmost. Managers and employees alike can't work in a hostile environment. You don't need a full-time employee relations manager. Get a consultant who knows the labour laws and can make management and labour agree. The HR profession (or practice) today has evolved into a level of sophistication that many CEOs can't make business decisions without consulting their HR managers for people implications. Whether yours is a small, medium or large enterprise, you can enhance business success

by making fundamental HR part of your business systems. You have a “make or buy” decision in your hands. For SMEs, a good compromise is having a full-time HR manager who can outsource many of the things discussed.

3.2 The Impact of Human Resource Practices and Compensation Design on Performance

In a research and analysis of family owned SMEs by the Journal of Small Business Management in 2006, it was found out that HRM practices such as high wages, incentive pay, promotion from within, among others (employment security, selectivity in recruiting, employee ownership, participation and empowerment, training, and skill development) are a few of the practices acknowledged as having great value to the organisation. Competitive compensation packages, training and development, recruitment package, maintaining morale, use of performance appraisals were more important for high sales growth performing firms than for low sales growth performing firms. In addition, high sales growth performing family owned SMEs used more cash incentive compensation at every level in the organisation and incentive compensation in the form of cash, non-cash and benefits and perks of employees.

HRM practices were compared within a sample of high and low performing family owned SMEs split based on sales growth. Effects on performance by primary HRM practices such as recruitment package, performance appraisal, compensation and benefits, maintaining morale and training and development have been examined. First, differences in importance placed on each of these human resource areas are explored and then their relationship to performance is

determined. Finally, differences in the use of various forms of compensation (i.e. cash incentives, non-cash incentives and benefits and perks) across different organisational levels and their effect on performance were explored. The study started by providing an overview of HRM practices and their link to organisational performance. Next, the importance of the HRM issues and compensation design was reviewed. Then, the differences in HRM practices for high and low performing family owned SMEs were empirically examined. The design of incentive compensation systems across high and low performing family owned SMEs were examined as well. Finally, based on the results, practical implications for the management of family SMEs were considered.

The study shows that HRM practices such as employment security, selectivity in recruiting, high wages, incentive pay, employee ownership, participation and empowerment, promotion from within, training and skill development have great value to the organisation productivity and performance of the organisation. Recent research has empirically shown the positive relationship between HRM practices and important organisational outcomes such as productivity, turnover, and firm performance.

3.3 Performance Management for Small and Medium-Sized Enterprises and Improving Competitive Capability of Companies

Marc Alba and others have studied the main concepts of a Global Performance Management for SMEs to improve the competitive capability of companies especially for small and medium sized enterprises.

As an introduction, they acknowledge that the new business ecosystem realities are the result of three major cyclones; globalisation, increasing competition moving more and more from enterprises to value chains and even increasing customer dictatorship which is introducing an enriched definition of business excellence, enhancing the traditional quality/cost/time variables with new views such as innovation and agility, eco-responsibility (environmental impact, green products and services) ethics and social responsibility (including gender issues). This new environment is increasing pressure on companies which are involved in the so called business visibility vicious cycle where large companies get bigger and bigger and small companies smaller and smaller and thereby less and less visible. This vicious cycle often ends with the small company being dismissed from the marketplace. To break this cycle, companies need to find a way to get visible even being small. The approach is necessary threefold: Companies must first of all improve their business excellence then they need to find a way to radiate this to the market (customers, consumers, competitors), finally there is a need for the market itself to enhance its end-to-end transparency.

Most Companies nowadays know the importance of measuring accurately their main KPIs (Key Performance Indicators). However, a review of the classic performance management methods is a clear must in the new business context. The goal is to develop a new paradigm named Global Performance Management (GPM) that combines two new performance management approaches, Extended Performance Management for Collaborative Networks and Virtual Organisations, and Enriched Performance Management.

Main concepts and the framework developed within the GPM-SME project especially designed to help SMEs to improve their competitive capability by the effective measuring of their innovation and their network visibility in collaborative environments. The main benefits that this set of methodologies, architectures and toolset that provides for a company are:

- *Enrich the measurement and management of performance* helping industrial companies in integrating new management concepts required by end consumers and new legislations.
- *Extend the measurement and management of performance* helping industrial companies in including more and more all internal and external agents involved in the value chain/network of each firm and increasing its visibility.
- *Provide ready-to-use and easy-to-use instruments* for industrial companies to improve on a daily basis the measurement and monitoring of their operations. This includes particularly the availability of open source and standards-based IT tools.
- *Enhance the level of homogenisation and consistency* of performance management across industrial companies through (even *de facto*) standard conceptual frameworks, reference models, indicators and methods.

3.4 SME Performance, Innovation for Local Economic System

Networking activities and R&D are also a few of the relevant and main drivers of productivity performance and output innovation for Small and Medium Enterprises (SME) playing in a local economic system. Give the intangible nature of many techno-organisational innovation and networking strategies, original

recent survey data for manufacturing and services are exploited. A methodological framework to empirically test complementarities among R&D and networking in a discrete setting was introduced in their study. Second to this, empirical evidence on productivity drivers and on complementarities between R&D and networking strategies with respect to firm productivity even without networking was also introduced in the study,

R&D is a main driver of innovation and productivity even without networking. This may signify in association with the evidence on complementarities that firm expenditures on R&D are a primary driver for performance. The complementarities with networking is a consequential step. Networking by itself cannot thus play a role in stimulating productivity and innovation. It can be a complementary factor in situations where cooperation and networking are needed to achieve economies of scale and/or to merge and integrate diverse skills, technologies and competencies. This is compatible with a framework where networking is the public good part of an impure public good wherein R&D plays the part of the private-led driving force towards structural break from the business as usual scenario. Managers and policy makers should be aware that in order to exploit assets complementarily and possibly transform it into competitive advantages, both R&F and networking are to be sustained and favoured. Our evidence suggests that R&D may be a single main driver of performance.

Since R&D expenditures are associated with firm size, a policy to sustain it is to be directed towards firm enlargement. After a certain threshold firms have the force to increase expenditures. The size effect is nevertheless non-monotonous.

Least important for majority of firms still remaining under a critical size threshold, policy incentives should be directed to R&D in connection with networking through which a virtuous cycle may arise. It is worth noting that it is not networking as such but the main engine. Networking elements are crucially linked to innovation dynamics, it is nevertheless innovation that explains and drives networking and not the often claimed mere existence of local spillovers or of a civic associative culture in territory. Such public good factors exist but are likely to evolve with and be sustained by firm innovative dynamics.

There are various performance productivity measures for SMEs and local industries. Most Companies nowadays know the importance of measuring accurately their main KPIs (Key Performance Indicators) to further improve productivity but essentially areas may be assessed on how to further improve performance and productivity. Among the items mentioned are improving capabilities of company to develop new paradigms in assessments, improve their competitive capability by the effective measuring of their innovation and their network visibility in collaborative environments, networking activities and R&D to drive productivity performance.

3.5 SMEs Performance and Compensation Management

New approaches for organisational performance measurement to assist small and medium enterprises (SMEs) better manage their business risk are constantly being developed. These enterprises which are considered vital to economic growth and job provision are susceptible to business failure primarily due to poor risk management associated with inadequately informed decision making. Improved performance measurement provides a basis for better

informed decisions for both control and improvement. It is recognised that SMEs are likely to be less financially stable and hence more likely to fail. Financial insecurity reflects the higher levels of risk exposure of SMEs, a consequence of the interactions of many size-related factors including:

- access to funding
- access to, and influence over, customers and markets, particularly export markets
- access to, and retention of, knowledgeable and competent staff, including managers
- access to, and influence over, both strategic and commodity suppliers
- influence over communities
- product and service mixes and volumes
- access to research and development
- access to technology
- productivity and quality of their value-added outputs.

Projects are also directed towards establishing a measurement-focused approach to managing organisational performance, consistent with quality management principles. Critical factors for success of the approach included:

- alignment with the enterprise's goals
- promotion of systems thinking to ensure integration and consistency
- relevance and practicality of measures to real business and organisational needs
- ease of adoption.

In studies, eight general themes have merged from the set of case studies with each theme providing opportunities for improvement of measurement as follows:

1. Design of an overall performance measurement system

Among the case study enterprises only those enterprises with some track record in quality management had some structure to their measurement system. All enterprises were able to demonstrate some degree of financial measurement but this did not necessarily mean that the financial information was well structured. For example, a number of small enterprises did not analyse cash flows on a regular basis thus relying on occasional 'back of the envelope' calculations. Financial summaries provided by accountants were supplied for mandatory reporting purposes rather than for financial management. Few of the measurement systems were structured to provide management with clearly differentiated strategic, tactical and operational information. Where structure existed, it tended to reflect simple aggregation rather than differing levels of management accountability. Only those enterprises with some history of quality management had any quantitative information about what their stakeholders thought of them, how their management system was working and whether their products and services were satisfactory. Sample Recommendation: Implementation of a structured measurement system will provide managers with an increased understanding of their business through both the discipline of development and the availability of relevant information.

2. Planning and decision-making based on information

Again, with the exception of those enterprises with some quality management history, the SMEs lacked formal planning, both strategic and business/operational. Where planning existed, it tended to be at the business/operational level and was not necessarily related to ongoing performance measures nor generally to explicit long-term goals. Performance indicators tended to be discrete events.

Example, 'The training program will be completed by July 1') rather than continuous measures. The quality-oriented enterprises were not necessarily good at 'relevant' measurement even when their planning was comparatively advanced.

3. Scope of information for decision-making

For those SMEs having a measurement system, lack of understanding of the requirements of the system at the design stage meant that the system had limited scope and depth. Availability of data across functions and core processes is patchy, presumably reflecting historical needs and reporting. Some functional managers in medium enterprises were clearly lacking appropriate data to do their jobs.

Sample recommendation: Measurement needs to cover all the information necessary for planning and control (e.g. markets, customers, staff, products, services, in-process variables, suppliers, inventories, system capabilities, etc)

4. Design of the management system

Small enterprises see little need for a formal approach to design of their management system. Medium enterprises realise the need for explicit management, but the system tends to grow reactively and spontaneously rather than as a result of planning and anticipation. It might be expected that 'fixing' the measurement system would largely address the issues to do with the management system. For example, accountabilities and responsibilities for functions, teams and individuals would be aligned through the measurement-related work.

Sample recommendation: Identify and address those aspects of the management system required to promote development of the performance measurement structure.

5. Data collection

The total amount of data available to the enterprise varies greatly. It may have some internal data (e.g. operational processes) but usually very little external (e.g. competitor's performance). Such data as are collected tend not to be operationally defined. In-process and supplier control standards are poorly defined and understood. Data quality is largely unknown. Measures are not checked for accuracy, repeatability and reproducibility. Management data tend to be collected after the fact for trouble-shooting rather than for prognostic purposes. Medium enterprises are likely to be collecting some operational data and aggregating them for management purposes. Enterprises with some quality management experience are likely to be superior in terms of data availability and reliability.

Sample recommendation: As recommendations 1 to 4 are carried out, implement measurement and start collecting data. Validate quality of data.

6. Data analysis

SMEs tend to lack resources required for good analysis and interpretation of data, competencies, tools and techniques. Enterprises with some quality management experience are likely to have developed some limited capability to turn data into information. Effectiveness is likely to be limited by the previously identified measurement related constraints.

Sample recommendation: Identify and develop resources appropriate to the ongoing needs of the enterprise for performance measurement and analysis.

7. Data presentation

Data tend to be presented in simple tabular form. Financial data may include some comparisons (e.g. vs last month, last year) and may include some aggregation (e.g. YTD). Enterprises with quality management experience may have started to develop graphical presentation of the information in the data. Reports such as monthly summaries are likely to be very limited in their scope and depth. It is unlikely except in enterprises with quality management experience that any non-trivial statistical work will have been done in regard to data collection, analysis and presentation.

Sample recommendation: Implement appropriate presentation of data.

8. Review of the overall performance measurement system

Except in enterprises with quality management experience there is no structure for a review of measurement. Even within this group measurement will only be reviewed as part of the bigger scheme of a general quality review. The fact that development of measurement is lagging may be noted but will only be acted upon in advanced quality-oriented enterprises that actually understand the implications of failure to adequately measure, analyse, report and act.

Sample recommendation: Implement mechanisms to ensure that the measurement system is itself subjected to regular assessment and review

Organisational performance measurement methodology has demonstrated its relevance to a significant number of SMEs in its case study program. For all cases in which a need for performance measurement was identified by the SME's, the methodology was considered effective in terms of outcomes and efficient in terms of resources, specifically time and cost. For those SMEs for which performance measurement was not an issue of specific interest, the outputs of the assessment were considered relevant but secondary to more pressing issues. In all instances, the methodology was considered as resource efficient and the results to be of interest. Further, new approaches for organisational performance measurement to assist small and medium enterprises (SMEs) better manage their business risk are constantly being developed.

4.0 Impact of Performance-Based Remuneration System on Performance and Productivity

Over the last years, the issue of rewarding and paying employees has become a subject of much study and research. However, despite the many theories and techniques developed, performance appraisal is still very much an art. SMEs are often perceived as low wage-payers because they are not large enough to use sophisticated and systematic wage techniques. But while SMEs are more conservative than large companies on basic or fixed wages, they are known to be generous when it comes to paying bonuses during good times. Unlike large companies, SMEs practiced “flexi-wage” long before it became popular and they also continue to lead their larger counterparts in performance appraisal.

In other words, there is no single formula which companies can adopt. Much depends on factors such as the work itself, the kind of individual and work behavior required, the stage of growth of the business or organisation, as well as the cultural characteristics and preferences of the owner and manager. In general, all companies have to pay wages according to the degree of job difficulty and how well the job is performed. Wage practices vary in the extent to which companies adhere to these fundamental principles of job difficulty, performance and skill scarcity.

Large companies prefer to use impersonal and systematic techniques such as job description, job evaluation, wage surveys and performance appraisal to decide how much to pay their employees. And while they are more systematic and better than SMEs in defining job worth they are seldom any better when it comes to appraising performance. This is where most of the problems arise.

Performance appraisal is an Achilles heel. It troubles most managers and supervisors because of the conflict between perception and expectation. It is almost impossible to get it right despite the use of sophisticated quantitative and qualitative measures. Considerable experience, trust and judgment are needed before a performance appraisal can be applied fairly and consistently.

Managers in large companies are usually in such a hurry that they do not take the time needed to build up on trust and judgment. They soon find out that it is easier to “play politics”, manipulate the numbers or rely on their authority to push things through rather than try to be honest and objective. This leaves many employees feeling that the management despite the systems and techniques still resorts to favouritism. Hence, it is who the manager likes which determines who gets the biggest bite of the cherry. As such, many “unrecognised” good performers leave large companies for smaller ones where they can be more effectively recognised and rewarded.

Traditionally, SMEs do not use job descriptions to clarify duties and responsibilities although most of them now do so because employees today expect greater transparency in what is expected of them. What SMEs lose out in job definition, the successful ones at least gain by trying harder in performance appraisal. Realising that performance appraisal will always be a judgmental process and not just a matter of setting targets and measuring outputs they set out to fine-tune the process by checking with colleagues, other bosses, and even customers and suppliers rather than rely on the numbers or immediate boss for performance input.

Smart SME bosses never lose sight of the real performers. They know who are the “fair-weather” performers, people who work only when the boss is around. They know that while it is possible to “fool the boss”, it is much more difficult to fool your colleagues, your customers or suppliers. From informal but often elaborate networks at grassroots levels as well as among other bosses and major customers and suppliers the SME bosses check around regularly on who is really contributing and who is not. This is what large companies call “360 degree performance appraisal” or “balanced scorecard” which many are now trying to develop, albeit, on a more systematic basis.

Thus, just as SMEs themselves are adopting the more sophisticated and systematic wage practices of the larger companies, paradoxically, the large companies are adjusting to the SMEs’ well-rounded judgments on performance and contribution. the large companies are adjusting to the SMEs’ well-rounded judgments on performance and contribution. Of course such an informal process may break down when companies grow bigger. This is often the reason why when SMEs grow, their wage systems fail because the bosses cannot continue to exercise this informal but rounded performance assessment judgment. In this respect small is still beautiful.

Four case experiences of successful SMEs in the Philippines are presented as follows:

- Micro/backyard business – Chicken Adidas on a Stick
- Small Financing Business in the province
- Figaro Coffee Company – medium enterprise
- Binalot - Medium

4.1 A Story Behind Adidas On a Stick – Sample of Micro Business

Adidas or chicken feet is just one of the many street food that we see everyday in just about any crowded place or busy street in the Philippines Metropolis. Other delicacies on the menu are helmet (chicken's head), gulong (pig intestines), barbeque and the very popular isaw (chicken intestines).

Leticia Llamdo or Ka Letty of San Miguel is just one of those who earn a living through selling of street food in their makeshift carts. According to the national Statistics (NSO), self employed workers like Ka Letty represent more than a third of 33.7M employed in the country as of Jan 2008

Selling isaw has been the main source of income of Ka Letty and her family for the past 7 years. Her husband Edwin has no regular job and both their 2 children are still studying. Most of the time people can see the whole family working together in their small business specially during weekends. The man of the house would set up a charcoal grill while the son Edgar and daughter Carla, prepare the sauce and vinegar for the street chow.

Ka Letty, a 54 year old Bicolana confessed that they started a mini store with a capital of only P500 or USD11 only. Up to now she cannot believe how such a small amount has managed to provide their daily needs for years. That is why she has committed herself to maintain and improve their livelihood. As early as 4.30am, she is already in the market to make sure that the chicken and meat she will get will be fresh. She also sells hotdogs and *inihaw na bangus*(milkfish) from time to time to add new entries in her menu. From 6 PM to 10PM, 7 days a week she is a regular fixture along the stretch of Lupang St. The only time you see her spot empty is when it rains.

Another thing that affects their street food business is when there is misunderstanding between family members. What Ka Letty does is to remind them of importance of their store. She would explain that this is their bread and butter and a day of not selling isaw means losing a minimum daily income of P300. It is a good thing that her words are enough to heal wounds. And just in time before sunset when their first customer arrives. When asked how she sees herself 10 years from now, Ka Letty does not mind still selling Isaw. Her priority is to ensure that her 2 children are able to finish college.

Ka Letty believes that her children have learned a thing or 2 in their small business, something that they can apply once they work in bigger companies with more employees and more professionally run a few years from now. She instills in their young minds the importance of passion, dedication and focus on what ever they do.

Simple measures of performance for this micro business is on the basis of number of sticks they are able to sell per day. To achieve a net profit of at least P 300 they need to sell minimum of 100 sticks at P 15 based on a mark up of 20%. Over the past 7 years they have increased their sales by around 20% yearly which they were able to achieve via diversification and ensuring quality of food they serve. They also get pre-orders for fiestas and parties not limiting their clientele to walk-ins. On peak days they are able to sell around 300-400 sticks. Because the Philippines is subject to typhoons which affect the business of Ka Letty, a portion of their daily income is saved so that they are able to meet their needs during such time.

While the Llamado family merely puts meat and chicken intestines on sticks daily there is more movements than meets the eye. Watching them do their thing, one can have sense a camaraderie that mirrors a company where the management and its employees work hand in hand to achieve business success. In every stick they sell hard work to achieve a dream is on its tip. Their meager income is used not just for their daily subsistence but to send their children to school for a better future. A lot of families in the Philippines survive through this simple family business. In fact, more and more banks are providing micro financing as part of their CSR(Corporate Social Responsibility). The likes of Ka Letty are given as low as P 5 K loan which they pay in affordable terms.

4.2 Financing company in the province – Sample of Small business enterprise

A corporation formed through the effort of 14 incorporators. The said corporation started its operations on 1 July 1987 with the amount of P10M as start up capital. The very nature of this corporation is financing with the objective of extending financial assistance to consumers in need by means of collateral loans like real estate and chattel mortgage loans and to extend credit aid to entrepreneurs in need of capital in putting up and or engaging in business dealings. It has 8 regular employees. The branch has 5 departments namely Loans, Accounting, Credit Investigation, Collection and Cash. The company being situated in the province does not discriminate in terms of age, sex and religion.

Since the beginning of the corporation, it mostly caters to individual accounts and is very aggressive in marketing to clients with acceptable loan collaterals

such as real estate properties, brand new trucks, heavy equipment, vans, cars whether for business or public transportation use, newly assembled reconditioned motor vehicles directly purchased from accredited and reputable assemblers and specialised equipments on a case to case basis. The loanable amount is 70% of the appraised value or market value whichever is lower.

The company has been operating for the past 21 years now. It primarily aims to extend credit to qualified applicants and has established credit procedures and standards that are responsive to the needs of qualified applicants while protecting the interest of the company as well. It also aims to produce sound and collectible loans and maximises the financial investments of the company. Companies like this help in encouraging small business entrepreneurs to contribute to the development of the sector's economy as well as providing jobs to the community.

General policies were also formulated to guide the company and personnel to perform a smooth flow of transaction and to provide service quality to the customers. The company personnel are expected to design credit accommodations based on applicant's capacity to pay without duly increasing the company's risk. Applicants are treated with utmost confidentiality and professionalism. Credit evaluation are within the established credit policy and based on appropriate valuation methods on the unit or property offered as collateral. Market research also is conducted periodically to maximise profitability. The company is also subject to the capital requirements as imposed by the Securities and Exchange Commission. Loan provided ranges from P25K to P400K depending on the collateral at 21% interest rate per year. Compared to

the bank the interest rate is higher whereas for the bank it is at about 12-15%. However, the banks have stricter terms and higher collateral requirements so most of the starting entrepreneurs loan from them.

Performance /productivity measures observed

Performance measure of the company – Target number of clients per branch at minimum of 50/month with a loan exposure of not lower than P6M. Collection efficiency is targeted at 60%. The company manages its capital to ensure its ability to serve its operating needs and to maintain strong credit rating and healthy capital ratio. Based on the actual data for the past years it is able to maintain 50 clients per month with P 5.9M release/month. Collection efficiency is at 40.22% lower than the standard 60%. Net income as of September 2008 compared to the same period of last year is down by around 5%.

Associate's performance measure and compensation practices

The company adopts a philosophy of equitable pay, paying higher for more difficult job based on the prevailing rate in the industry and the location. It has annual performance review using the following criteria: Quality of work, productivity based on set standards, Job knowledge, dependability, initiative and attendance and trait oriented dimensions like resilience, office decorum, team work. The individual rating of the employees determines the amount of bonus to be given yearly although no regular merit increases are given as it is also dependent on the performance of the company.

Aside from those mandated by law, they provide credit accommodation to employees, leaves, profit sharing and bonuses, clothing allowance and health

benefits. Profit sharing/annual privileges are given as tied to the company's performance as follows:

Incentive	Nature	If profits is at least within target	If 10% higher than target	If 15% higher than target
officers	PB(one time) Incentive	1-2 months Local trip	2-3 months Asian trip	4-6 months Australia/Europe
Staff	PB Incentive	.5-1 month No outing allowance	1-2 months Outing allowance of P500/pax	2-3 months Outing allowance of P1000/pax

The grant of yearly increases is not a practice since this becomes part of the carrying cost of the company and contributes to mediocrity. Increases follow those mandated per law. However, on a case to case basis, the Board decides to give yearly adjustments to deserving employees depending on individual performance and over-all company performance. Given the global slump and the experience with sub prime in the States, the company has instituted stricter credit requirements and terms and more aggressive effort in their collection.

Comparative Income Statement

Income	2008	2007
Interest income from Loans and receivables	P 21.9M	P 19.8M
Other income	1.3M	1.4M
Gross Income	23.2M	21.2M
Expenses		
Operating Expense	13.8M	12.1M
Compensation and benefits	5.1 M	4.7M
Income before Tax	4.3M	4.4M
Income tax expenses:		
Current	.372	.379
Deferred tax	(.100)	(.99)
Net Income	P 3.99M	P 4.1M

4.3 Figaro Coffee Company- Sample of medium enterprise

The idea of Figaro came to light over cups of coffee. It all began one Sunday afternoon in 1993 as Chit Juan, the founder and her friends were having their usual round of the brew that followed a weekly lunch gathering. As was usual of their get together the last of the granules had been scraped from the coffee jar. The social gathering quickly turned into an impromptu business planning session and soon after the Figaro Coffee Company was born. Pooling their resources, Chit and friends opened their first Figaro at Glorietta in Ayala Center. The small stall was a test, they wanted to see if they could find kindred among coffee lovers among the commercial district upscale population.

Was the country ready to upgrade from instant coffee? The response overwhelmed the Figaro owner because they were offering coffee concoctions way beyond what Filipinos were used to. Figaro was fast to capture the public's curiosity and recognition. Some espressos and cappuccinos had made their way into the after lunch, mid-afternoon and after dinner rituals of the mall crowd. The time for specialty coffee had arrived. Fourteen years later, Figaro has become synonymous with the best in local specialty coffee and has grown to a network of 52 cafes including 3 overseas branches.

The founder, Chit Juan found a creative outlet she was looking for, a venue where she can apply her marketing and selling skills. The company found ways of creating concepts that would make their coffee product more appealing to its target market. They were concerned in getting the pulse of the customers so Chit would personally talk to them to get feedback. From introducing specialty coffee, Figaro realised it had a new mission educating the public about coffee. Coffee was such an ordinary thing but nobody knew much about it. The company educated itself by joining tours abroad, attending seminars and all these learnings were translated into something simple that the employees and the customers can easily understand.

The customers good response to Figaro encouraged the Board to directors to branch out. One key element in Figaro's success is its astute financial management. Instead of spending their income for personal travels etc. the profits were plowed back to the business. The company's reach expanded strategically, their stores mushrooming all over Metro manila's key commercial centers. The employees were given conservative increases and minimum

benefits at the start but were made aware that they are partners and as the business grows they also grow with the business. They were involved and aware of the business direction and therefore the company survived being non-unionised over the years as the employees commitment also increased.

With appreciation for the success Figaro had amassed, its board sought ways to give back to the community that supports the business. The employees were given conservative increases and minimum benefits at the start but were made aware that they are partners and as the business grows they also grow with the business. They were involved and aware of the business direction and therefore the company survived being non-unionized over the years as the employees commitment also increased interest in coffee.

As a Filipino company, Figaro felt compelled to do its part in making the industry's plight known and reversing the downward spiral it was experiencing. They worked on convincing more farmers to go back to planting coffee from more profitable crops, building up the barako image(local Filipino coffee) as the national coffee and retelling the rich coffee heritage which was almost forgotten. Yearly coffee farm tours starting in 1999 were made to enable the Figaro patrons to have a wider appreciation of the farm-to-cup route coffee before it is enjoyed at Figaro cafes. The tagline is that for every cup, they are able to help the farmers and promote the coffee industry in the Philippines. The following year, the Figaro Foundation launched the "Save a barako campaign". Through information drives via brochures and store marketing, Filipinos were made aware of the fact that the barako or Liberica coffee farms only grow in 3 countries, one of which is the Philippines. Since coffee farms were being converted to golf

courses or being planted with more profitable crops, less and less farmers were planting the barako making it head for extinction. In the farms, the Barako campaign saw the Figaro foundation tree-planting activities for 5 straight years aimed at planting 100,000 barako trees. In Figaro stores, Barako coffee was sold as beans and in cups, with portions of the profits going toward this planting campaign. Such philanthropic activities continued. Thus in 2002, in recognition of the vision of its founder Chit Juan, she was tapped to co-chair the newly created national Coffee Development Board to oversee the development of the industry and the promotion of the Philippines coffee in the global market.

Today, Figaro Coffee Company is not known just as much for its efforts in revitalising the Philippines coffee industry as it is for its excellent coffee. There is a certain sense of nationalism felt in enjoying a cup of Figaro, knowing that with each cup one is supporting a worthy cause to make our country closer to regaining its place as a world supplier.

Apart from Figaro's role in local coffee, it also became known for its franchising to open opportunities to other entrepreneurs. With the help of a partner franchisee, Figaro was able to reach more target areas without spreading its resources too thinly. It allowed promising entrepreneurs to invest in a worthy business endeavor. The company formally opened its door to franchising in 1998 and to date has partnered to more than 20 franchisees.

Compensation and performance measures employed.

Figaro as a company has a very strong sense of values. Thus, the employees performance evaluation includes dimensions that focus on integrity, sense of ownership and love of Work and of God and good customer service. Compensation is paid according to job difficulty and risk. A cashier is paid higher than a waiter. However, just like in a restaurant business, Figaro shares the tips/service tax to its employees. Aside from the base pay, they enjoy variable pay in the form of tips.

Multitasking is also encouraged in the company. This enables the company to continue its operations in the absence of an employee. Model employees are also recognised based on attitude, openness to the demands of the job to be ready for multi tasking and his overall performance/productivity.

Aside from coffee, other products like pasties, doughnuts and cakes are also served in Figaro. Quality is an important performance dimension. This is measured on the basis of the number of rejects experienced from the customer. Zero reject rate is the target. Both speed and quality of service is important. The company keeps its ears open to customer complaints particularly in terms of service delivery

The level of commitment of Figaro employees is high because they are aware of service to the community that their company leaders espouse. Not only do their firm commit to revitalising the coffee industry in the Philippines and making them world class but they are committed to continue giving jobs to coffee farmers, planting barako trees, adopting farms and sharing the proceeds to farmer

growers. This is a classical example of an enterprise with a heart who does not only focus on profitability but enriching other's lives, particularly of the poor farmers with a strong sense of nationalism as it also aims to help the Philippines be recognised for its coffee industry. On the side, it encourages other entrepreneurs through franchising to help continue this vision while at the same providing employment .

4.4 BINALOT

Binalot started as an all-delivery concept to serve Makati and Mandaluyong business districts then eventually progressed into a dine-in and to go when their customers asked for a place where they can sit and dine. Owner Rommel Juan narrates their business quests and always listened to their market and tried to meet every need, as they are opening more outlets outside the mall to be able to reach more people. Being attentive to their customers needs, they have very competitive and affordable prices as he points out their commitment toward their patrons.

The Binalot menu includes a varied list of favorite Pinoy meals e.g. delicious Adobo, Tapa, Bistek, Tocino, Longganisa, all atop steaming rice and garnished with enticing sidings of either atchara or itlog na maalat and kamatis, all affordably priced. It's like eating in a fiesta with an urban twist—the concept which Rommel Juan and his brother Raffy along with a friend, Aileen Anastacio created in 1996 with Php50, 000 as an initial investment

They capitalised on their food packaging--banana leaves which they get directly from banana growers in Batangas and Quezon. The leaves are cleaned with a

food grade disinfectant; heated over with flame to sanitize it before serving. They get their supplies from where these products are done best e.g. beef from Batangas, red eggs from Pateros, tocino from Pampanga, bangus from Dagupan, and more.

In their aim to better serve their existing and prospective customers they have created a website that would also reach the surfing audience. Recently, they have redesigned their site that proves to be attractive and at the same time, sends the right message to its viewer. It has increased their visibility on the Net and they received more franchise inquiries online

Binalot has evolved from a family owned corporation to a professionally run organisation. Employee evaluation is based on performance – a required and measurable specific output according to his or her competency. There is an annual plan which establishes the Binalot vision that will guide the company and its employees for the year. It has to be clear for the employees as well where the company is heading. Ten years into the business, the challenge now is in growing the company, market share, and staying true to the initial vision.

5.0 SME's in the Philippines : Issues, Challenges and Way Forward

5.1 Promoting SME development : Issues and Suggestions

On several social and economic grounds, small and medium-sized enterprises (SMEs) are of overwhelming importance in most Asian countries including those in the Association of Southeast Asian Nations (ASEAN). It is also the biggest source of domestic employment providing a livelihood for over three quarters of

the region's workforce especially women and the young. The relative share of SMEs in total output and exports is generally much smaller i.e. one third or less. As such the SME sector will remain the backbone of virtually every economy in this region and for that matter of the world in the foreseeable future. A concerted push in support of SME growth and competitiveness moreover is no longer an option. SMEs and by extension all business firms have to manage growth and change in an environment where the pace, patterns and organisation of production have evolved fundamentally.

The new development context requires a change in both perception and practices, in other words, a new or different mindset in the promotion of SME development. As is apparent from the preceding discussion, competitiveness is increasingly man-made, furthermore, it can be leveraged by factors other than location and natural resource endowments. One lever is through the maintenance of on-going access to the available store of global information and knowledge including market standards, marketing opportunities and innovative technologies. Another is embodied in the large gains in collective efficiency and flexibility through participation (whether or not at arm's length) in clusters of firms, or in networks of inter-linkages backward with suppliers, laterally with other producers and providers and forward with users and consumers. Yet another leverage relates to the firm's own capabilities for ongoing learning and improvements in efficiency and flexibility, indeed, business enterprises (both large and small) must become and remain learning organisations under the new development paradigm. In general, SMEs will have to be assisted and facilitated to grow, multiply and replicate into a sufficient (critical) mass across industries and sectors. In the process, the level of competitiveness and dynamism of

domestic enterprises and by implication of the economy as a whole will be greatly enhanced.

5.2 RECOMMENDATIONS

As mentioned above, in general SMEs will have to be assisted and facilitated to grow, multiply and replicate into a sufficient (critical) mass across industries and sectors. In the process, the level of competitiveness and dynamism of domestic enterprises and by implication of the economy as a whole will be greatly enhanced. Among the Challenges and opportunities in Philippine SMEs and local industries is Human Resource Development and capacity-building. Among the areas that seen to have the need to be enhanced are SME sector skills in management and organisation, entrepreneurship development programs, and the fostering of SME capabilities for inter-firm networking and linkages. Philippine Policy in Enhancing SME Marketing Capabilities include enhancing SME capabilities in and reliance on ICT and E-Commerce and establishing inter-linked on-line networks for SME products and services.

5.2.1 Interventions Needed to Respond to These Challenges

- Review of the curricula of the courses in tertiary and vocational education to make them more responsive to the needs of the industry. The often heard “mismatch” between what the schools produced and what the industry needs has still to be addressed. Tesda’s “ladderized” educational system in coordination with CHED is a right move towards positively addressing this mismatch.
- Manpower skills development among the SMEs must be enhanced. HR plays a pivotal role in this endeavor.

- DOLE interventions through the conduct of more Jobs Fairs, strengthening of the Public Employment Service Office (PESO), and timely and relevant labour market information are needed.
- Overseas employment may be reviewed. While employment overseas should be encouraged to alleviate unemployment and generate much needed dollar remittance, the government should not ignore the needs of the industry. The suggestions of some quarters to impose a minimum years of service in the country before professional workers like doctors, nurses, physical therapists, engineers, etc. are allowed to work overseas should be seriously considered.
- The Labour Code and the other social legislations should be reviewed to respond to the worldwide trends on labour flexibility.

These external and internal interventions must be given impetus if we are to sustain the role of SMEs as the engine of economic growth. Three major issues that need to be addressed have also been raised by the Philippine government in order to achieve development and success among SMEs in the country:

- First, the fact that 60% of the labour force is employed by SMEs. These workers are not getting the kind of benefits that they should get because the big businesses get 75% of the sales value in the industry. Increasing the share of SMEs in the terms of volume of sales would mean a raise of income and benefits to the people.

- Next is readiness of SMEs for globalisation. It is foreseen that in the next two or three years the European business community will likely invest in companies that are ISO-certified. ISO is the organisation which presents standard management and production systems for the use of companies around the world.
- Third is improving the marketing campaign of the small and medium companies. The biggest problem of the SMEs is the Philippines, Gabor says, is marketing and not having access to credit as generally perceived. She believes that any local product can easily enter the world market but are not patronised because they are not known to people. She suggests that SMEs should be assisted in areas of marketing like packing, smart pricing, prompt deliveries, and others.

The Department of Trade and Industry (DTI) has also recognised the importance of SMEs in the country with its 32% contribution to the economy. They consider the SME sector as the backbone of the Philippine economy as it plays an integral role in the war against poverty. SMEs also distribute economic activities to the countryside and help ensure a more reasonable distribution of income in the country.

International organisations like the Asian Development Bank (ADB), the World Bank and the International Monetary Fund (IMF) are also aware of the significance of SMEs in nation building. The said groups believe that one way of helping in poverty alleviation is by supporting the small and medium businesses through various activities and programs.

The government, through R.A. No. 9178 known as the Barangay Micro Business Enterprise (BMBE) Act of 2002, has set a policy in promoting the establishments of BMBEs by giving benefits and incentives to enterprises. For its part, the DTI has formulated the National SME Development Agenda with the help of the key players in SME development, including other concerned government departments and agencies. The DTI has also launched projects like *Sulong Pinoy: Helping the SMEs and One Town, One Product (OTOP)* programs to promote entrepreneurship and create jobs. These projects benefit thousands of SMEs nationwide.

The Center for Industrial Competitiveness (CIC) of the DTI came out with new measures to improve the business environment in the country. CIC Executive Director Virgilio Fulgencio said that they have coordinated with Local Government Units (LGU) in efforts to simplify business registration procedures. Fulgencio cited faster business procedures, the reduction in the days and cost to register a property, and the creation of a credit information bureau as some of the improvements that would achieve great results in the long run. Fulgencio, speaking at the recent public forum on the 2008 World Competitiveness Yearbook, said that the country's 2010 goal of rising to the top third of the world's most competitive countries can be accomplished if the cooperation between the government and private sector continues. The study, released in the second quarter of this year by the Switzerland based Institute for Management Development (IMD), showed that the Philippines has moved to 40th place for last year's 45th out of 55 countries.

The Asian Institute of Management Policy Center reports that the country's strengths as a global competitor include a low cost of living, lower inflation rate,

an effective fiscal management, and an extensive labour market. However, the country still faces major problems such as sustaining economic growth and addressing unemployment. This is where SMEs can significantly help the country. If more small and medium businesses will survive and remain successful in the long haul, more jobs will be created and economic stability will be attained. An effective mechanism for building Philippine global competitiveness is sound people practices with the People Management Association of the Philippines (PMAP) is promoting. PMAP encourages owners and managers of both SMEs and large corporations to invest in human capital development that can be a key factor in their company's success.

5.3 SME Development Strategy

SMEs face various challenges in the area of human resource development, technology and R&D, access to financing, to name a few. These concerns are addressed in the "Philippine SME Development Strategy". The Strategy prioritises the following five strategic imperatives in SME development:

(1) Narrowing the focus by identifying priority sectors. Identify list of 5 priority sectors.

(2) Promoting mutually beneficial linkages among small and large firms. Promote industrial-subcontracting exchange schemes, strengthening SME associations, establishment of linkages and cooperation between small, medium and large firms.

(3) Strengthening technology and R&D initiatives:

Boost agencies' efforts in examining and promoting technologies that would

benefit SMEs, promote use of quality standards, and fast-track the full operationalisation of APEC Center for Technology Exchange and Training for SMEs (ACTETSME) as a resource center for information networking, mobilization of training opportunities, and upgrading technical know-how.

(4) Bolstering human resource development:

Create, expand and improve curricular training programs in entrepreneurship, management and technical skills for SMEs and develop appropriate materials for such training. Identify HRD requirements in specific industries. Provide facilities/resources for skills training in special economic zones.

(5) Improving access to finance

Develop innovative financing schemes using non-traditional sources and schemes such as cooperatives and associations and equity financing and venture capital, respectively.

SMEs will continue to need the support of the government in the challenges they constantly face. Among the Challenges and opportunities in Philippine SMEs and local industries is Human Resource Development and capacity-building. Among the areas that seen to have the need to be enhanced are SME sector skills in management and organisation, entrepreneurship development programs, and the fostering of SME capabilities for inter-firm networking and linkages.

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**Research on the Impact of Performance-based Remuneration Systems on
Productivity Performance of Local Industries**

Chinese Taipei's Experience

By

Dr. Minston Chao

Chinese Taipei

1.0 Background and Introduction

After several years of rapid and almost unhampered growth, the global economic landscape is changing. Rising food and energy prices, a major international financial crisis and the related slowdown in the world's leading economies are confronting policymakers with new economic management challenges. Managing a business through the downside of an economic cycle is challenging for multinational organisations. They must effectively manage the compensation and benefit costs of a global workforce during periods of intense profit pressure and divergent inflation rates.

Watson Wyatt's 2008 study on North American multinational organisations reveals that in the face of volatile market conditions they are most concerned with the impact of rising global inflation on people costs in non-United States operations. To manage pressures of profitability they are focused on the areas where they have immediate and direct control. Multinationals are planning to move more operations offshore to lower cost regions. They also plan to address the costs of governance and support by regionalising benefits, compensation and Human Resource (HR) staff in order to increase efficiency and stay close to the market.

Attracting, motivating and retaining top talent in an increasingly competitive global marketplace is an ongoing struggle. Multinational firms face varying challenges around the world. In some countries, tightening labour markets are exacerbating on-going cost pressures and causing companies to take a total rewards approach. In addition, firms are increasingly shifting to more centralised compensation and benefits structures. This helps ensure that key employees

and executives around the world share the same incentives. At the same time, CEO pay remains under the microscope. Companies are responding by deemphasising stock options while stressing actual share ownership. They are also taking a “portfolio” approach that mixes various performance-based incentives into a compelling and balanced total pay package. Increasingly, companies are adapting similar models further down the organisation chart in an effort to motivate and align workers at all levels.

In the changing environment, management focused largely on how to control costs without affecting talent and productivity and which remain as an important concern. Since then the stakes have changed. There is still a very real war for talent but it is now being waged in more uncertain economic landscape. Winning the talent war requires innovative and aggressive strategies for attracting and retaining high-performing individuals. These strategies are getting harder to implement in today’s economic climate. The primary reason some companies struggle to attract and retain critical-skills and top-performing employees is because they have not adopted long-term talent management strategies that allows them to stay ahead of competition.

Companies need to recognise the dynamics of the marketplace to better serve their talent needs. For example, salary effectiveness, delayed retirement for baby boomers, increasing immigration rates, untapped workforces in inner cities and outsourcing to foreign locales are all potential solutions to talent shortages. However, companies need to figure out how to leverage them. Executing a talent management strategy is the key to success and the point is those companies need to create a work environment where individuals thrive.

Organisations need to take a good hard look at themselves and develop programs that turn weaknesses into strengths as well as enable it to build its own brand.

The key to understanding what drives engagement and therefore what keeps people on board is simple; listen to employees, solicit feedback in a variety of ways such as surveys, focus groups and blogs. This will enable the dialogue to identify recruitment needs, career development and other programs that will identify retention strategies. In short, it is important to understand what these companies have done to address their need for talent. They have analysed their labour markets, gained an understanding of what attracts and motivates talent and focused their efforts on targeted programs to fit their needs.

2.0 Chinese Taipei's Economic Performance and Labour Cost

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 engineering, science, technology and high value-added manufacturing. Chinese Taipei's economy achieved considerably high economic growth from the 1960's to 1980's under import substitution industrialisation strategy, expansion of export-oriented labour-intensive light industries strategy and import substituting heavy industries strategy. The success of the strategy is reflected in the changing composition of production with the share of industrial products increasing while that of agricultural products had decreased. Exports grew at an annual average rate of 17.7% while GDP grew at an average rate of 9.3% during the transition from an agriculture-based economy to a production-based economy. However, the increasingly competitive global economy pushes firms to make use of all of their

available resources as a means of achieving competitive advantage.

In the early 1990's, service-based economy became prominent and thus supported Chinese Taipei's industrial structure. Nevertheless, the manufacturing industries comparative advantage was steadily slipping away. From 1987 to 1997 the industrial output as a share of GDP decreased from 47.1% to 34.9%, while for manufacturing industries, the share of GDP fell from 38.9% to 27.7%. During this period, Chinese Taipei found that the only avenue available was for industries to upgrade to higher technology with capital and technology intensity replacing the no longer viable labour intensity of the past. In view of this, the government launched the "Ten Newly Industries Program" which helped the economy towards hi-tech orientation.

To develop Chinese Taipei as a knowledge-based economy and recognise the rise in globalisation means that cost-savings in production can no longer support continuous economic development. At the beginning of the 21st century the government implemented a series of programs such as "The Challenge 2008 National Development Plan", "The New Ten Projects" and the "Plan to Develop Knowledge-based Economy" which would add value to high-tech and traditional industries as well as encourage innovation and foster new ventures as a means to maintain global competitiveness.

2.1 Economic Performance, 2008

Since 1979, the World Economic Forum's (WEF) annual *Global Competitiveness Reports* have examined the many factors that enable national economies to achieve sustained economic growth and long-term prosperity. Today's volatility underscores the importance of competitiveness supporting economic environment that can help national economies to weather these types of shocks in order to ensure solid economic performance in the future. A nation's level of competitiveness reflects the extent to which it is able to provide rising prosperity to its citizens. Their goal over the years has been to provide benchmarking tools for business leaders and policymakers to identify obstacles to improve competitiveness and stimulate discussion on strategies to overcome them. For the past several years, the World Economic Forum has based its competitiveness analysis on the Global Competitiveness Index (GCI), a highly comprehensive index for measuring national competitiveness which captures the microeconomic and macroeconomic foundations of national competitiveness.

WEF defined ***competitiveness as the set of institutions, policies and factors that determine the level of productivity of a country.*** The level of productivity in turn, sets the sustainable level of prosperity that can be earned by an economy. In other words, more competitive economies tend to be able to produce higher levels of income for their citizens. The productivity level also determines the rates of return obtained by investments in an economy. Since the rates of return are the fundamental drivers of the growth rates of the economy, a more competitive economy is one that is likely to grow faster over the medium to long term.

The concept of competitiveness thus involves static and dynamic components. Although the productivity of a country clearly determines its ability to sustain a high level of income, it is also one of the central determinants of the returns to investment which is one of the key factors explaining an economy's growth potential. The competitive performances of Asia Pacific economies continue to encompass the entire gamut, from highly competitive countries to the most challenged. Singapore, Hong Kong (11th) and Australia (18th) continued their ascent in the rankings while Japan, Korea (13th) and Chinese Taipei (17th) dipped in their positions. Nine Asia Pacific countries are among the top 30 led by Singapore and followed by Japan, Korea, Hong Kong, Chinese Taipei, Australia, Malaysia (21st), New Zealand (24th)—and this year China enters the top 30 displacing Thailand (34th).

Based on the GCI scores (Table 1), Chinese Taipei was at 17th place, down three places from last year, draws its greatest competitive strengths from its education sector and related business innovation. With regards to education, Chinese Taipei has high enrollment rates at all levels and the education system gets good marks for quality (although the quality rating is weaker than in past years). In addition, companies provide a high level of continuing on-the-job training, ensuring that the workforce can adapt to the rapidly changing economy. Relating to innovation, Chinese Taipei has a large pool of scientists and engineers and it benefits from high expenditure by companies on Research and Development (R&D) and strong collaboration between research institutions and the business sector in innovation. All of these have enabled Chinese Taipei to be first worldwide in terms of the patenting per capita of new inventions. On the other hand, Chinese Taipei's financial markets represent a comparative

weakness with concerns about the soundness of banks (ranked 117th) and the restriction of capital flows (78th). Similarly, public institutions could be further strengthened. The drop to three places in the rankings is due a large part to the deterioration of various aspects of the institutional environment, relatively low public trust in politicians, some concerns about a lack of judicial independence and increasing complaints about the regulatory burden faced by companies operating in the economy.

Key economic highlights of Chinese Taipei include:

- Total population (millions), 2007.....22.7
- GDP (US\$ billions), 2007.....383.3
- GDP per capital (US\$), 2007.....16,060.0
- GDP as share (%) of world total, 2007.....1.06
- Average unemployment rate from January to August 2008, is 3.93%.
- The Consumer Price Index (CPI) from January to September 2008, is 105.01, climbed 4.1%, markedly higher than the same period of previous year.
- Chinese Taipei's energy efficiency continued its steady rise with the natural resource energy consumption elasticity ratio down from 0.78% in 2004 to 0.73% in 2006, demonstrating the slowing growth rate of domestic energy consumption.

Table 1: Global Competitiveness Index, WEF, 2008

	Rank (out of 134)	Score (1-7)
GCI 2008-2009	17	5.2
GCI 2007-2008 (out of 131)	14	5.2
GCI 2006-2007 (out of 122)	13	5.3
Basic requirements	20	5.5
Institutions	40	4.7
Infrastructure	19	5.5
Macroeconomic stability	18	5.8
Health and primary education	20	6.2
Efficiency enhancers	18	5.1
Higher education and training	13	5.5
Goods market efficiency	14	5.2
Labour market efficiency	21	4.8
Financial market sophistication	58	4.5
Technological readiness	15	5.3
Market size	16	5.1
Innovation and sophistication factors	8	5.3
Business sophistication	12	5.3
Innovation	7	5.2

Source: The Global Competitiveness Report 2008-2009, World Economic Forum

From a list of 15 factors, respondents were asked to select the five most problematic for doing business in Chinese Taipei and to rank them between 1 (most problematic) to 5 (least problematic). The top 3 in Chinese Taipei are policy instability, inefficient government bureaucracy and inflation. The details are as the follows:

1. Policy instability.....	19.8
2. Inefficient government bureaucracy.....	15.8
3. Inflation.....	11.9
4. Tax regulations.....	11.0
5. Restrictive labour regulations.....	7.5
6. Government instability.....	6.7
7. Tax rates.....	6.3
8. Foreign currency regulations.....	5.3
9. Access to financing.....	4.9
10. Corruption.....	3.2
11. Inadequate supply of infrastructure.....	2.6
12. Inadequately educated workforce.....	2.0
13. Poor work ethic in national labour force.....	1.6
14. Crime and theft.....	0.7
15. Poor public health.....	0.7

2.2 Labour Cost Competitiveness in Chinese Taipei

Higher productivity and lower unit labour cost is essential for increasing a firm's competitiveness. During the last five years productivity in all industries in Chinese Taipei improved gradually. However, during the same period unit labour cost decreased. When the growth of productivity is positive compared to a negative growth in unit labour cost there is a possibility for wage increases.

Some in a society attribute job losses or gains to differences in compensation. People in some countries complain about losing manufacturing jobs to China,

Mexico and other countries. Table 2 reveals that the hourly wages for Chinese manufacturing work are 2.8% (\$6.43/hour) of those paid in the United States (\$23.82/hour). However, the value of what is produced also needs to be considered. Data from U.S. Department of Labour, Bureau of Labour Statistics shows that manufacturing productivity in China is about 10% of that of U.S. workers while Mexican workers productivity is 25% of U.S. workers.

Labour cost is increasing in Chinese Taipei but productivity is also increasing. In a highly competitive environment many businesses moved out of Chinese Taipei to China and other regions. The main reason is labour cost. This is the same situation as the United States. Labour cost in China is only 10% for those in Chinese Taipei.

Table 2: Hourly Compensation Costs for Production Workers in Major Manufacturing Countries (USD)

No	Country	Hourly Pay	Index
1	China	0.67	3
2	Philippines	1.07	4
3	Mexico	2.75	12
4	Brazil	4.91	21
5	Poland	4.99	21
6	Hong Kong	5.78	24
7	Hungary	6.29	26
8	Chinese Taipei	6.43	27
9	Czech Republic	6.77	28

No	Country	Hourly Pay	Index
10	Portugal	7.65	32
11	Singapore	8.55	36
12	Israel	12.98	54
13	New Zealand	14.47	61
14	Korea	14.72	62
15	Greece	16.10	68
16	Spain	18.83	79
17	Japan	20.20	85
18	United States	23.82	100
19	France	24.90	105
20	Italy	25.07	105
21	Canada	25.74	108
22	Ireland	25.96	109
23	Australia	26.14	110
24	United Kingdom	27.10	114
25	Luxembourg	27.74	116
26	Finland	29.90	126
27	Austria	30.46	128
28	Switzerland	30.67	129
29	Sweden	31.80	133
30	Belgium	31.85	134
31	Netherlands	32.34	136
32	Germany	34.21	144
33	Denmark	35.45	149
34	Norway	41.05	172

Source: U.S. Bureau of Labour Statistics, January 2008

3.0 Union and Labour Management Relations in Chinese Taipei

3.1 Impact of Government Policy on Firm People Management Strategy

- **Labour Pension Act (Executed in 2005 July)**

- Changed 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 where employee's monthly salary should 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 Agreements, yearly negotiations are made for annual increments and bonus quantum but it is rare in this case.

3.2 Labour Management Relations in Chinese Taipei

In Chinese Taipei labour management is based on the main 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 is 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 that strong and therefore have minimal bargaining power. Existing workers always rely on the state through the function of regulation instead of the unions through the mechanism of collective bargaining. For the past five years the organisation rate of industrial unions declined to around 49 - 50%.

- **Labour-Management Conference**

For enhancing employee and employer relationship the government linked this mechanism to overseas investment and IPO approval and working hour arrangements. It means that when a certain company wants to invest overseas or join the financial open market, if the company fails to run this mechanism or follow the regulations the authorities 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 it shall be with the prior consent of their trade unions. If there is no trade union in the business entity, then the agreement of the Labour-Management Conference will apply.

- **Labour Representative on Board**

According to the regulation, in the state-owned enterprise, trade unions can select their members to be a member of the Board. The number of labour representatives should not be less than 20% of the total position for the government share. When employees have a seat on 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 and collective bargaining is popular. Labour conditions are the core issue in bargaining events.

- **Labour Dispute and its Settlement**

As for the labour disputes, labour contract disputes are the most common. For settlement there are different kinds of procedures 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 among those in the 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 programs.

3.3 Employment and Labour Force Indicators¹²

Chinese Taipei had been ranked 13th position out of 55 economies in the World Competitiveness Yearbook 2008 for overall competitiveness which is an improvement of 5 positions from 18th in 2007. The employment and Labour Force Indicators are selected from the World Competitiveness Yearbook to show Chinese Taipei's competitiveness in the areas of employment, labour cost and labour market as follows:

Employment Indicators

EMPLOYMENT	WCY 2007		WCY 2008	
		Rank		Rank
Employment				
Total Employment in Millions	10.11	27	10.29	28
Percentage of Population	44.20	30	44.84	34
Employment-Growth				
Estimates: Percentage change	1.70	35	1.81	36
Employment in the Public Sector				
Percentage of Total Employment	9.67	13	9.24	11
Unemployment Rate				
Percentage of Labour Force	3.91	11	3.91	11
Long Term Unemployment				
Percentage of Labour Force	0.71	9	0.53	10

¹² Selected Competitiveness Indicators on Employment and Labour Force, World Competitiveness Yearbook, 2008

EMPLOYMENT	WCY 2007		WCY 2008	
Youth Unemployment		Rank		Rank
Percentage of Youth Labour Force (Under the age of 25)	10.31	15	10.65	19
Employment By Sector				
Agriculture (% of Total Employment)	5.9	49	5.5	49
Industry (% of Total Employment)	36.4		36.6	
Services (% of Total Employment)	57.7		57.9	
Labour Regulations				
Labour Legislation (hiring/firing practices, minimum wages etc.) do not hinder business activities	5.77	18	5.94	9
Unemployment Legislation				
Unemployment legislation provides an incentive to look for work	5.54	17	4.97	22
Immigration Laws				
Immigration laws do not prevent your company from employing foreign labour	5.62	35	4.68	43
Working Hours				
Average number of working hours per year	2,256	5	2,256	5
Labour Relations				
Labour relations are generally productive	7.10	18	7.42	9
Worker Motivation				
Worker motivation in companies is high	7.04	13	7.38	5
Industrial Disputes				
Working days lost per 1,000 inhabitants per year (Average 2003-2005)	0.00	1	-	-
Employee Training				
Employee training is a high priority in companies	6.49	17	6.77	13

- Indicators on Labour Cost Competitiveness

LABOUR COST COMPETITIVENESS	WCY 2007		WCY 2008	
		Rank		Rank
Labour Productivity (PPP)				
Estimates: GDP (PPP) per person employed per hour (US\$)	26.73	24	27.75	26
Labour Productivity (PPP) Growth				
Percentage change of GDP (PPP) per person employed per hour	6.12	13	3.82	17
Compensation Levels				
Estimates : Total hourly compensation for manufacturing workers (wages + supplementary benefits) US\$	6.30	23	6.43	24
Unit Labour Costs in Manufacturing				
Percentage change	-2.37	7	-5.37	2
Remuneration in Services Professions				
Gross annual income including supplements such as bonuses in US\$:				
• Bank Credit Officer	22,900	29	22,900	30
• Department head	62,000		62,000	
• Primary school teacher	22,000		22,000	
• Personal assistant	11,900		11,900	
• Call center agent	12,400		12,400	
Remuneration of Management				
Total base salary plus bonuses and long-term incentives, US\$				
• CEO	221,385	16	204,029	13
• Engineer	60,103		57,518	
• Director Manufacturing	116,215		111,431	

Remuneration of Management	WCY 2007		WCY 2008	
Total base salary plus bonuses and long-term incentives, US\$		Rank		Rank
• Human Resources Director	99,423		99,033	
LABOUR FORCE INDICATORS				
Labour Force				
Employed and registered unemployed millions	10.52	27	10.71	28
Labour Force				
Percentage of Population	45.99	36	46.66	37
Labour Force Growth				
Percentage change	1.46	23	1.82	20
Part-Time Employment				
Percentage of total employment	0.97	45	2.99	42
Female Labour Force				
Percentage of total labour force	42.45	35	42.91	35
Foreign Labour Force				
Percentage of total labour force	3.15	26	3.22	24
Skilled Labour				
Skilled labour is readily available	6.29	12	6.77	1
Finance Skills				
Finance Skills are readily available	6.41	27	6.71	16

- **Labour Market Indicators : Availability of Skills**

LABOUR MARKET : AVAILABILITY OF SKILLS	WCY 2007		WCY 2008	
		Rank		Rank
Attracting and Retaining Talents				
Attracting and retaining talents is priority in companies	7.48	18	7.03	24
Brain Drain				
Brain drain (well-educated and skilled people) does not hinder competitiveness in your economy	5.39	27	4.59	34
Foreign High-Skilled People				
Foreign high-skilled people are attracted to your country's business environment	5.00	29	4.90	26
International Experience				
International experience of senior managers is generally significant	5.48	27	5.68	21
Competent Senior Managers				
Competent senior managers are readily available	5.57	29	6.06	18

Among the employment and labour market areas where Chinese Taipei is strong at (in the top quartile of the ranking of 55 economies) and had contributed to Chinese Taipei's world competitiveness includes, Employment in the Public Sector, Unemployment Rate, Long Term Unemployment, Labour Regulations, Working Hours, Labour Relations, Worker Motivation, Industrial Disputes, Unit Labour Costs in Manufacturing, and Availability of Skilled Labour.

4.0 Performance Management and Development

4.1 Performance Management and Development Mechanism

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 organisation evaluate employees performance? There are four reasons:

- (1) appraisals provide information upon which promotion and salary movements are decided;
- (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 helps managers better manage and improve the firm's performance.

Evaluating performance is a difficult but essential supervisory skill. The manager and not the HR usually does the actual appraising. The manager must be familiar with basic appraisal techniques, understand and avoid problems that can in conducting 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 Measurement Process

The performance management process comprises three steps:

- (1) define the job and set up evaluation criteria;
- (2) manager appraisal performance;
- (3) provide evaluation feedback.

Defining the job means ensuring that you and your subordinate agrees 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 the manager should provide feedback to subordinates. The company makes plans for further developments required. Sometimes, appraisal fails because the subordinates don't know ahead of time exactly what is expected of them in terms of good performance. Others fail because of problems with the forms or procedures used to actually appraise the subordinate. 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 value to operation performance rather than daily activities. They must be focused on task processes.

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 provide feedback periodically. However, the term KPI generally refers to a comprehensive, organisation wide goal-setting and appraisal program comprising six steps:

1. Set the organisation's goals

Based on the company's mission, values, vision and short-term, long-term strategic objectives, the management team establishes a company wide plan for next year and sets 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 department goals with all subordinates. Managers ask employees to set their individual goals. They may and may not have key performance indicators. However, 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 work.

They should provide actual results and comments to employees so that they can improve them in the near future.

Setting up KPIs and PIs would require following the "SMART" rule. Be specific, measurable, acceptable, realistic and timely. An example is "increase number of key accounts in the 2008 financial year by 10% compared to the 2007 financial year."

4.3 Model of HR Strategy-Firm Performance Relationship¹³

HR strategy here is defined as the degree to which the firm utilises High Performance Work Systems (HPWS). The strategic human resource literature (Bamberger & Meshoulam, 2001) has generally identified two major HR strategic types:

- High performance work systems characterised by employee empowerment, selective employment policies, extensive training and development, pay-for-performance and
- Control-based work systems characterised by high levels of standardisation and centralised decision making, seniority-based pay, specific and limited job assignments, evaluation based on behaviours rather than outcomes and limited training.

There are variants on these themes but these typically involve some hybridisation of the high performance and control-based systems. This study analyses the impact of HR systems on firm performance. An important view in recent years has been the resource-based view of HR strategy which holds that crucial knowledge and abilities reside within the employees of the firm and that HR systems that promote the acquisition and utilisation of such knowledge will enhance organisational effectiveness especially in the highly competitive, dynamic and turbulent environment most organisations face in a period of globalisation and rapid technological change.

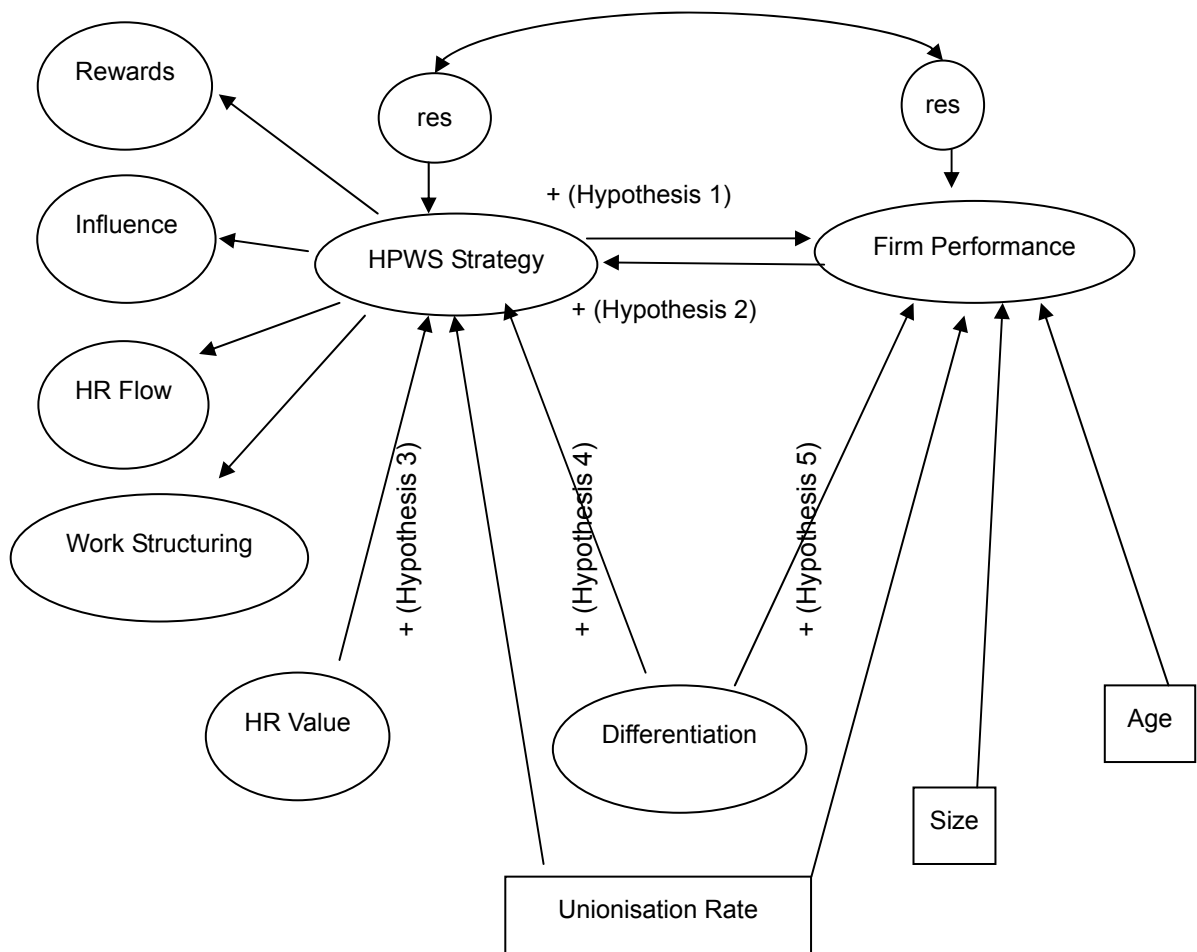
With Chinese Taipei's high level of economic development, workers, particularly younger ones, are more individualistic and less deferential to superiors so

¹³ Abstracted from the study on "Human Resources Strategy and Firm Performance : Taiwanese Firms in China and Taiwan" by Shyh-Jer Chen, John Lawler and Johngeok Bae.

cultural inhibitors to the effective implementation of HPWS are less prevalent. Although control-based work systems may remain dominant in Chinese Taipei many smaller-sized enterprises, newer and larger companies competing more extensively in the global market and involved in the high-technology industries being promoted by the government are more prone to view HPWSs positively (Huang 2001).

A model of the HR Strategy-Firm Performance Relationship was developed to evaluate the relationship between HR Strategy and firm performance using data from domestic and Chinese operations of firms in Chinese Taipei. The structural model is summarised in Figure 1. Firm performance and HPWS strategy are the principal dependent variables in the model, the circles marked “res” associated with each indicates the residual term. HR strategy is reflected in four broad HR sub-systems of HR Flow, Reward Systems, Employee Influence, and Work Structure. Following convention, the ovals represent latent variables, while the rectangles represent observed variables. The expected signs of the relationships are noted, along with references to hypotheses as appropriate.

Figure 1 : Model of HR Strategy on Firm Performance



The hypothesis is:

1. HPWS strategy will positively impact firm performance
2. Firm Performance will positively impact HPWS strategy
3. Perceived HR value will positively impact HPWS strategy
4. Differentiation will positively impact HPWS strategy
5. Differentiation will positively impact firm performance

The findings establishes that HPWSs contribute to organisational effectiveness in Chinese Taipei as the effect is strong and positive. Hence, the study provides support to the mounting evidence that HPWSs can work well in advanced East Asian economies.

5.0 Reward & Incentives Framework and Guidelines

For surviving and ensuring excellence, a 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 a happy and harmonious organisational climate can help attract employees to the organisation and retain those that the organisation wants to keep. Within an organisation, 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. Organisations use compensation to motivate people to:

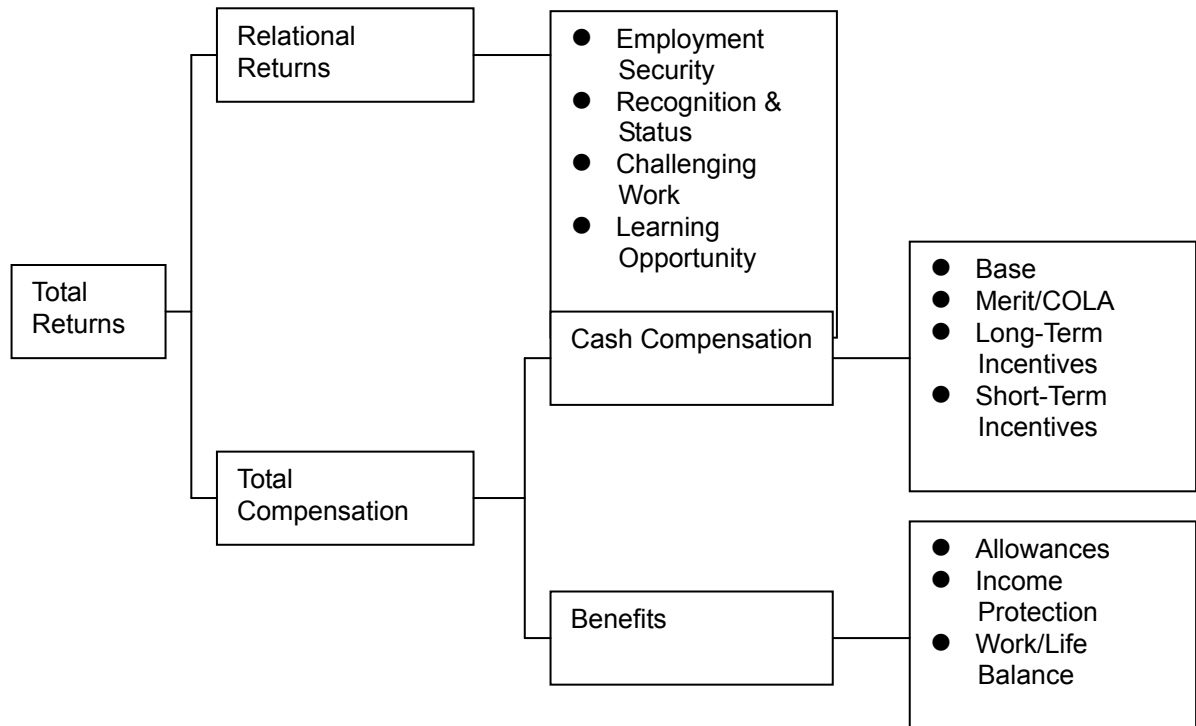
- (1) join the organisation;
- (2) stay with the organisation; and
- (3) to perform at high levels.

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. Secondly, output-based pay motivates workers to put forth effort instead of merely showing up for work. Mahoney (1989) pointed out that there are three basic determinants that should be included in a wage formula; job, performance, and person (including individual's skill, knowledge etc).

5.1 Reward and Incentives 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 (Figure: 2).

Figure 2: Total Returns for Work



Source: G. T. Milkovich & J. M. Newman (2008) *Compensation*

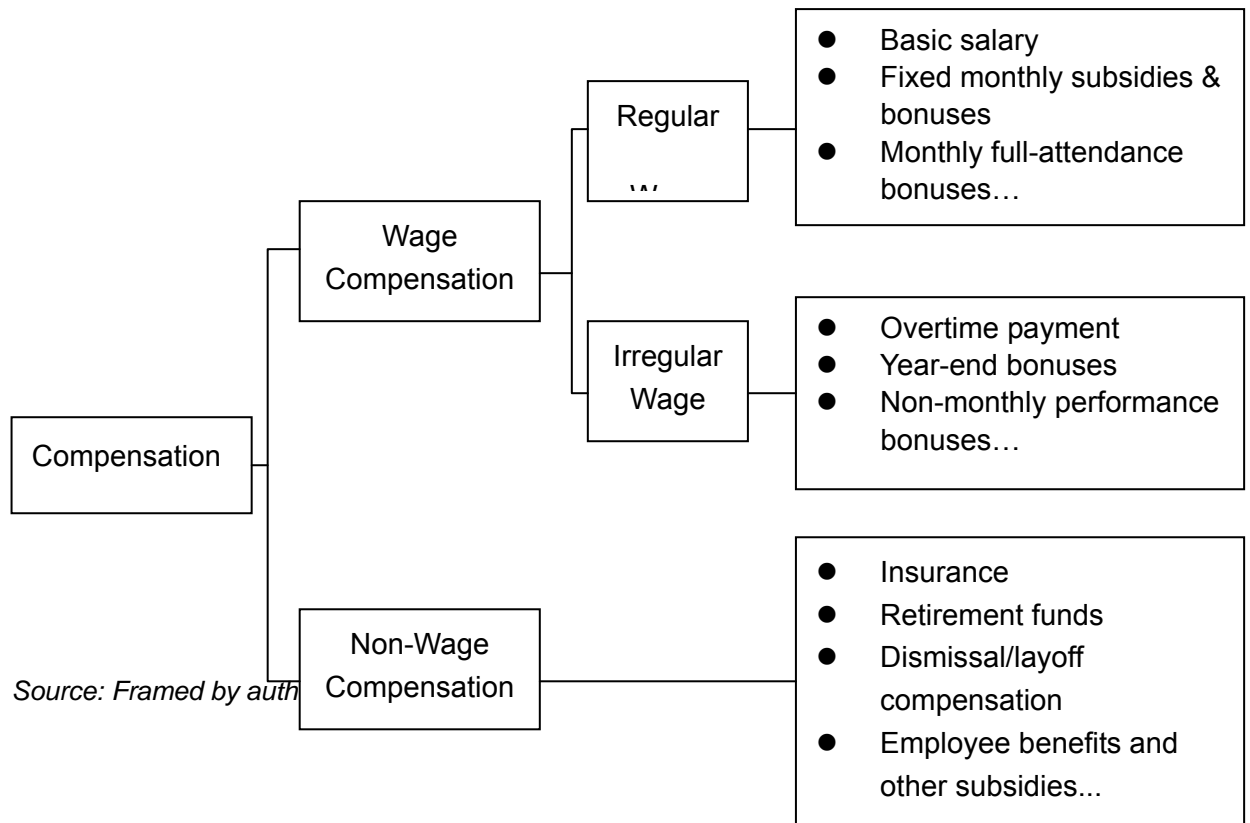
Bergmann, Scarpello & Hills (1998) provided a specific definition of compensation. They defined compensation as: Compensation = Salary + Employee Benefits + Non-recurring Financial Rewards + Non-pecuniary Rewards. Chu (2001) expanded Mahoney's model and demonstrated a four-factor model for Chinese Taipei's compensation theory. In his theoretical model, there are four key elements involving in job-based factor (focus on internal equity, compensation is reflected as 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 i.e. DGBAS and Watson Wyatt.

According to DGBAS¹⁴ 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 3).

¹⁴ DGBAS is the abbreviation of Directorate-General of Budget, Accounting and Statistics, a cabinet-level office, handles most of the duties of the nation's Comptroller's Office and Census Bureau combined in Taiwan.

Figure 3: 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 3 shows the proportion of regular and irregular wage to average monthly earnings by industry in Chinese Taipei.

Table 3: Proportion of Regular and Irregular Wage to Average Monthly Earnings by Industry in Chinese Taipei

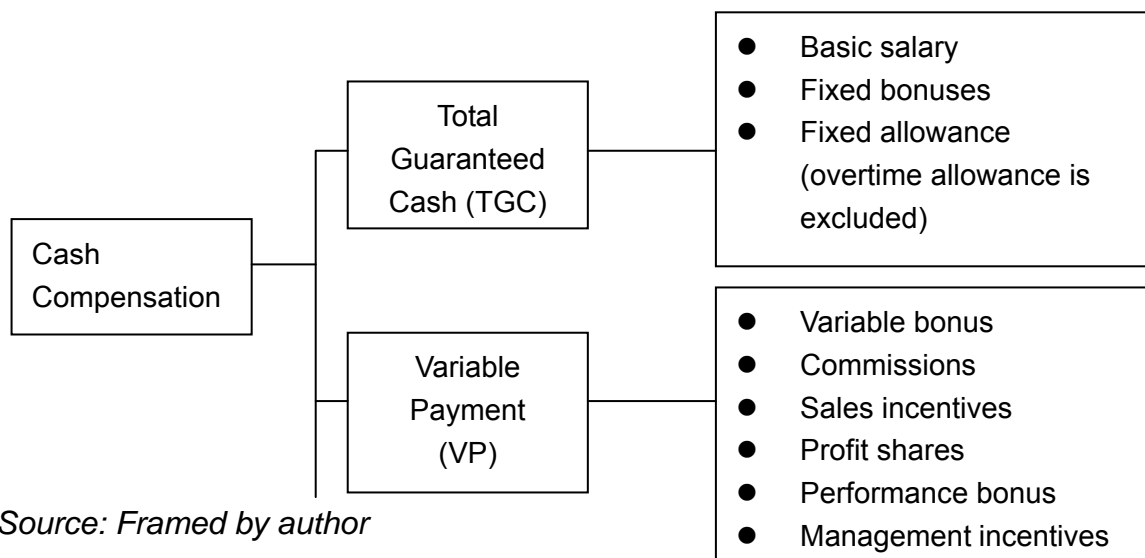
Unit: %

Industry	2004		2005		2006		2007		2008	
	RW	IW	RW	IW	RW	IW	RW	IW	RW	IW
Total	82	18	84	16	88	12	87	13	86	14
Industrial Sector	81	19	83	17	87	13	85	15	85	15
Mining & Quarrying	83	17	84	16	81	19	83	17	86	14
Manufacturing	86	14	87	13	89	11	88	12	88	12
Electricity, Gas & Water	80	20	82	18	80	20	78	22	78	22
Construction	70	30	69	31	68	32	67	33	66	34
Service Sector	91	9	92	8	92	8	92	8	90	10
Trade	86	14	87	13	87	13	86	14	83	17
Accommodation & Eating- Drinking Places	92	8	90	10	88	12	89	11	87	13
Transportation, Storage & Communication	80	20	80	20	78	22	77	23	75	25
Finance & Insurance	73	27	75	25	72	28	71	29	70	30
Real Estate & Rental & leasing	87	13	88	12	86	14	85	15	84	16
Professional, Scientific, Technical Services	85	15	89	11	87	13	86	14	83	17
Health Care Service	83	17	84	16	80	20	78	22	77	23
Cultural, Sporting & Recreational Services	88	12	92	8	86	14	85	15	85	15
Other Services	90	10	90	10	91	9	90	10	88	12

Source: Calculated by author with DGBAS, Earnings and Productivity Statistics data.

Referring to the human resource consulting firm Watson Wyatt's definition, there are two components included in the compensation model; total guaranteed cash and variable payment. The total guaranteed cash comprises basic salary, any fixed bonuses, and any fixed allowances, such as car allowance, and shift allowance, but does not include overtime allowance; the variable payment includes variable bonus, commissions, sales incentives, profit shares, performance bonuses and management incentives (Figure 4 – Compensation Model).

Figure 4: Compensation in Chinese Taipei based on Watson Wyatt's Definition



5.2 Reward and Incentives Guidelines

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 organisations. 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 that 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 organisations 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, organisations in the private sector are putting heavier proportion on performance-based payment than the public sector.

6.0 Performance-Based Remuneration in Chinese Taipei

Pay for performance programs are compensation plans that pay employees on the basis of some performance measure. This performance measures might include such things as individual productivity, team or work group productivity, department productivity, or the overall organisation'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 organisational profitability and employee professional goals.

To ensure 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 Chinese Taipei's organisations. The survey of Watson Wyatt found more than two-thirds of surveyed companies in consumer products, high-tech, financial services, 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.

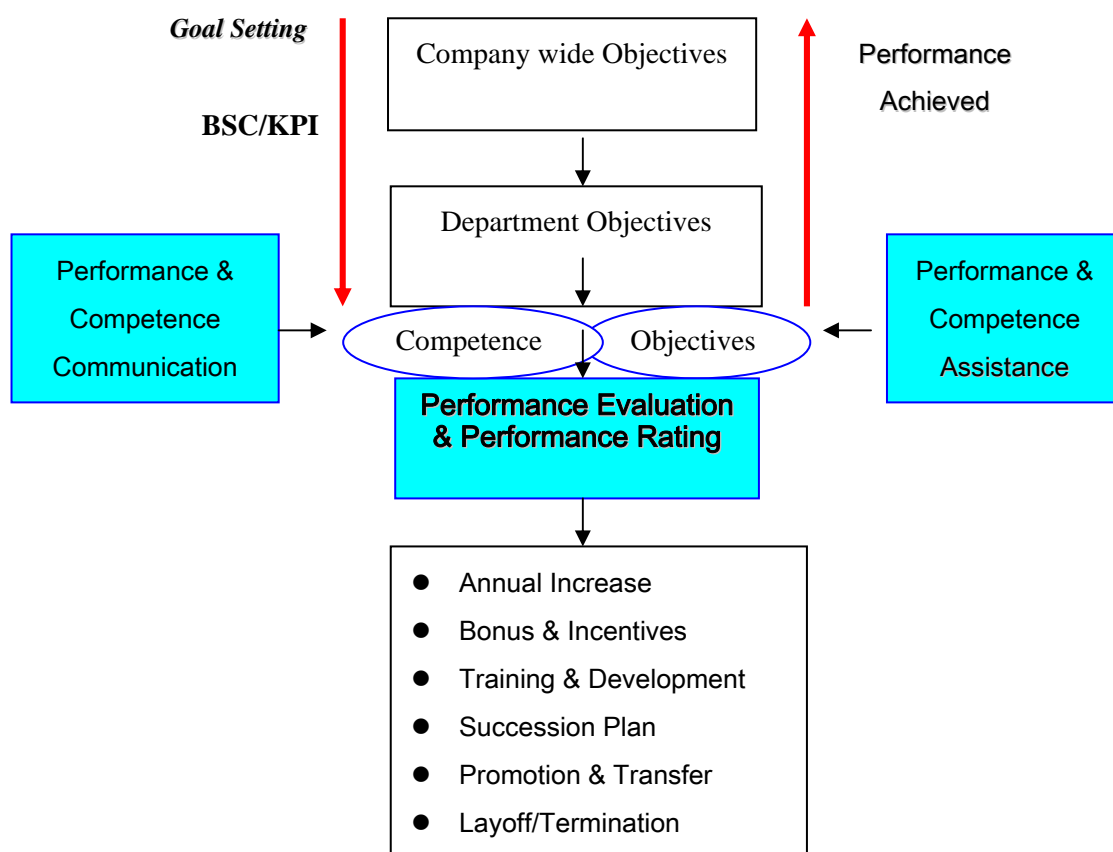
6.1 Impact of Performance-based Remunerations

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 or organisation's performance declines so too does the reward. This has led to enhanced performance and higher productivity. Thus, there is an incentive to keep efforts and motivation strong. Some of the motivating factors are reflected in the enhanced morale in terms of reduction in absenteeism, lower medical bills and less staff turnover.

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. It is also found that many performance-based incentives are based on cost reduction in terms of savings and reduction of wastages. As an example, if the department's utilities bills are reduced from US\$10,000 per month to US\$8,000 per month then the savings of US\$2,000 will be shared based on an agreed savings formula or if at the production floor, there are reduction of wastages in terms of raw materials, then the amount of reduction in wastages will also be shared between management and employees.

Performance measure and management is essential for implementing performance-based compensation system effectively and efficiently. If there is 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 shown in Figure 5.

Figure 5: Framework of Performance Measurement and Management



When a firm carries out a 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 extending 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 competencies and individual competencies and its level for employees. Ensure that each employee is clear about competence in terms of knowledge, skills, 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; and

(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. Management will organise 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 cases, there are only 3 levels for performance rating, outstanding, success and poor. The rating ratio in 5 levels model maybe is 10%, 20%, 40%, 20%, 10%; in 3 levels could be 15%, 70%, 15%. The final result of the performance review is to link to:

(1) compensation adjustment such as base salary increase (including annual or monthly increment), bonus such as profit share (including cash bonus and stock bonus), year-end bonus and for a few companies in hi-tech the bonus is based on performance and is 2 or 3 times more than the annual compensation (Table 4-6).

Table 4: Salary Increase Align with Performance

Compa-Ratio \ Rating	75%	Q1	Q2	Q3	Q4	125%
Excellent	12%	11%	10%	9%	8%	7%
Outstanding	10%	9%	8%	7%	6%	5%
Good	8%	7%	6%	5%	4%	3%
Fair	4%	3%	2%	1%	0%	0%
Need to Improve	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 5: 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 6: Profit Sharing–Stock Bonus Align with Performance

Seniority \ Grade	1yr	1-3yr	3-5yr	5-9yr	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

6.2 Experience of Manufacturing Industry

32 enterprises in Chinese Taipei were surveyed to focus on how enterprises implement their performance-based compensation scheme and maintain their excellence when facing global challenges and enhancing competitiveness. These target enterprises comprise those from petrochemical, high-tech, automobile and food. Among these companies, 46% have strong linkages of compensation to performance, 25% have a normal linkage and 29% are beginning to moving to performance-based system smoothly but are facing strong resistance from the trade union, employees or incompetent managers.

Regarding the performance management system, all the surveyed companies have a rule for carrying out the performance measurement and management. Many companies involved in this study need to select the essential factors for performance review which is similar to KPI but is worded in different terms. This was discussed and set at the beginning of the year then reviewed quarterly. Most of the performance indicators are tangible e.g. sales volumes, financial income, cost, productivity, turnover, complaints, and other countable objectives. HR managers, line managers, and employees were interviewed in this study. Around 50% of the surveyed companies used performance indicators and competence as a measurement to determine employees performance. The others relied either on indicators or competence only.

No matter how many rating levels they had the result of performance is to link salary increment, performance bonus or year-end bonus, profit share and human resource practice such as promotion, training, or replacement to performance. For example in some companies, when the employee was rated as outstanding and is a fast-track worker, these employees will be promoted to a higher position in 1 or 2 years compared to those employees who were rated as satisfactory will only be promoted in 3 to 4 years time.

Most of the companies surveyed do not have trade unions. Only 32% companies have in-house trade unions and 11% of them have collective agreements. Labour management conferences are being used in most of the companies and through these conferences both parties (employees and employers) have a chance to communicate with each other to focus on labour relations, working conditions and productivity issues.

6.3 The Case of a Petrochemical Company

The organisation is an 18-year-old private company located in north Chinese Taipei. Its core business is petrochemical. There are 320 employees and eight departments in its head office. Due to the business cycle every 5 years the company encountered a lot of challenges leading the management team to study the necessity and possibility of reengineering the operational process, organisational structure and to strengthen human resources in order to overcome the severe challenges. Union representatives asked the management team to communicate with them and get their approval on decisions pertaining to change in working conditions, salary increase and annual bonus.

Given the reality and difficulties mentioned above, to speed up the organisational change the CEO decided to invite the union to start the reengineering project. The project scope included company wide KPIs, department KPIs, individual KPIs, core competence, annual bonus scheme and salary increase mechanism.

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 advantage in the marine industry. Second, based on the strategy, the management team developed firm level KPIs as an infrastructure to implement departmental and individual KPI. Third, human resource professionals proposed performance-based compensation program to enrich the company's human capital and increase its competitive advantage. There were a lot of communications with union to reduce resistances.

Business Strategy

In the changing and uncertain environment, it is necessary to review current business strategy. CEO and management team redefined business strategy after diagnosing internal and external issues. We have labeled rapid growth from traditional operation to agile operation. As 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). The company

developed company wide core competence, innovation as an infrastructure to implement human resource practices and increase competitive advantage.

Performance Management and Development

Employees performance rating is determined through personal goals and individual competencies. At the year-end, managers set KPIs with employees based on company wide and departmental KPIs for the following year. At the same time, managers described the job competencies level based on employees annual performance rating which is based on 80% KPI achievement and 20% competence level. The company intended to build up a culture that both results and behaviors are important in the organisation. In another words, not only is the company expected to achieve its annual business goals but also needs to demonstrate the behaviors, attitudes, skills of employees based on their job and rank. Managers review employees annual performance based on the competence model and provide the feedback of the gap for the purposes of ensuring that employees improve within a certain period.

The company used balanced scorecard as a tool to manage its strategy and firm level performance. They set up company wide KPIs in 4 aspects namely, finance, customer, process, and organisational learning. The results of the KPIs are as the follow:

- Revenue increased 10% compared to last year
- Cost down 12% compared to last year
- Customer retention rate up to 90%
- Customer satisfaction rate 85%
- No lost time occupational injury accident

- 20 reengineering cases reported
- min 60 hours training/learning for each employee
- Key talents ready rate 70%

From the company wide KPIs they were cascaded to department and individual level as the respective department's KPI. In this issue the union did not have any comments. They understood that the KPI system is a key driver to increase the firm's competitiveness. However, they requested that employees with excellent results be given a fair share of returns in the form of bonuses, salary increase, benefits, and other working conditions for improvement.

Performance-based Compensation

The company adopted a performance-based compensation system to drive organisation and individual performance. A highly differentiated bonus and salary increase system were implemented. As introduced in the main part, top performers received 2 times bonus compared to normal performers. Low performers did not receive any bonuses. With regards to annual salary increase, a matrix of compa-ratio and performance rating were used in determining the individual's increase rate (Table 7).

Table 7: Matrix of Compa-Ratio

Compa-Ratio \ Rating	75%	Q1	Q2	Q3	Q4	125%
Excellent	12%	11%	10%	9%	8%	7%
Outstanding	10%	9%	8%	7%	6%	5%
Good	8%	7%	6%	5%	4%	3%
Fair	4%	3%	2%	1%	0%	0%
Need to Improve	0%	0%	0%	0%	0%	0%

Compa-ratio = individual's actual salary/his job grade's mid point salary

Until September 2008, the company's sales grew by 17.5%. Company wide KPI achievement rate is around 98.2%. Management believed they can achieve the challenging objectives. In 2007, the results exceeded the targeted objectives.

This case illustrates how performance-based compensation can help an organisations enhance and improve its business performance by implementing with business reengineering processes in a dynamic environment. Since human capital is embedded in individual employees the company can reengineer business models, business processes 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 performance-based compensation as a tool for managers to drive competitiveness.

Finally, organisation culture implies the importance of a shared understanding between the organisation and employees. Integrating organisational culture with reengineering process will enhance the company's competitive advantage which can be built in a unique way – “social complexity”. The organisational effectiveness depends largely on managers and employees. It is important for organisations to realise that organisational 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, a 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 and the skills of those people are critical. He also argued that the organisation, its employees and how they work are the critical success factors in the new economic world. In general, performance-based compensation is definitely the key to foster a firm's competitive advantage. The model is increasingly popular and is being used as the foundation of human resources management systems. Understanding the value of performance development and performance-based compensation model in various HRM systems will help firms to judge how best to apply them within the organisation.

6.4 Enterprise Level Survey of Performance-based Compensation System

Ten 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 ten enterprises comprise five from the service sector and five from the industry sector. Among these ten companies, five have strong linkages of compensation to performance, three have a normal linkage, one is beginning to move towards performance-based system smoothly while one is trying to move to performance-based system but is facing strong resistance from the trade union.

Regarding the performance management system, all the case companies have a rule for applying performance measurement and management. Some companies decided different rating levels for different job position. For example, for a manager, there are only three rating levels. However, the subordinates level has a five rating levels. Many companies involved in this study need to select the essential factors for performance review, it is basically a KPI but is explained in different terms. They will discuss and set it at the beginning of the year, then adjust or modify it monthly or seasonally. However, one company's performance review is decided by the leader of the department or unit and no indicators are developed among the companies that have performance indicators, 70% or 80% based their results of those indicators while the rest is based on competence or behaviour. In one of these cases, the performance is based on: employee potential 25%, track record (performance) 35%, others (including competence 15%, integrity and development 25%).

No matter how many rating levels they have, the result of performance is linked 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 in one of the case companies, when the employee was rated at an outstanding level, he is on the fast-track, he will therefore be upgraded to a better position within a 1 to 2 year period compared to an employee who is rated as satisfactory, would require 3 to 4 years to reach a higher level.

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) get a chance to communicate with each other to focus on labour relations, working conditions, and productivity issues.

These 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.

6.5 The Application of Competence-based HRP model: The Case of a Transportation Company

The organisation is a 50-year-old private company located in Taipei. Its core business is transportation focused in Asia. There are 200 employees and twelve departments in its head office, 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 capital 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 effective. Most of the employees and managers have not received annual bonus and salary increases for the past three years.

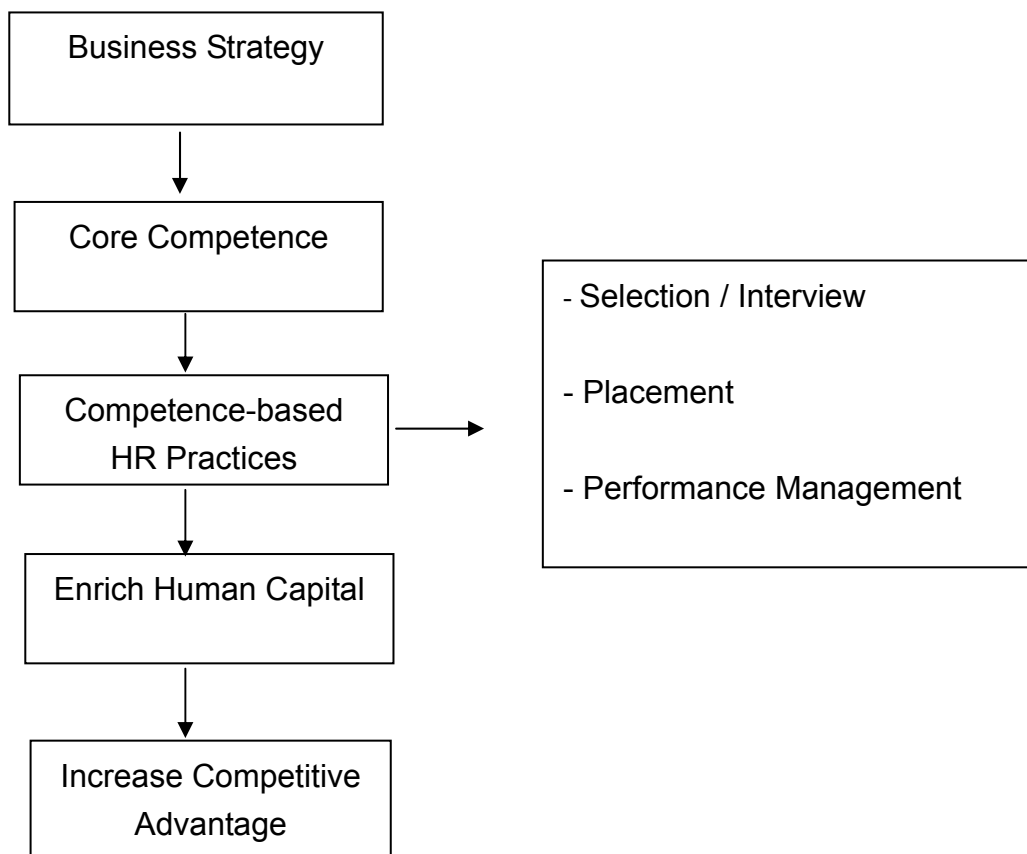
Given the reality and difficulties mentioned above, to speed up the organisational change, the CEO decided to invite external consultants to start the reengineering project in 2005. The project scope included business strategy, company wide core competence, competence-based human resource practices and increasing firm performance. The study addresses previously neglected areas of competence-based human resource practices role in the business reengineering process in an attempt to increase understanding of this increasingly important key topic. To accomplish this objective, several aspects were explored:

- What is human resource 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 improve the firm's human capital?

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 develop firm level core competence as an infrastructure to implement competence-based human resources practices. Thirdly, human resource professionals conducted several activities to train and help line managers to implement competence-based interview, placement, performance management and training programs. The final purpose is to enrich company's human capital and increase its competitive advantages (Figure 6).

Figure 6: Reengineering Process



Business Strategy

In an ever changing and uncertain environment, it is necessary to review current business strategies. The CEO, management team and consultants of the organisation redefined business strategy after diagnosing internal and external issues. We have identified rapid growth from traditional operations to agile operations, IPO in two years, and approach new clients (Figure 7).

Figure 7: Model of Core Competence



As 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, responsibility, result orientation, cost control &

management, industry knowledge and the ability to use English. The definitions are described as follows:

Customer orientation - Works to clarify and exceeds 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 cooperative. Makes every practical effort to meet customer needs. Is flexible and reacts positively to changes in instructions or plans. Is team spirited. Is supportive of other members of the team and helps them when necessary.

Initiativ - Is proactive and uses initiative to respond to customer needs. Is conscientious, reliable and meets commitments. Is keen to take responsibility.

Responsibility - Wiling to take the responsibility of personal decisions or actions. Result Orientation, effectively developing, utilising resources, methods, systems and processes. Using the most efficient ways to maximise investment return ratio.

Cost Control & Management - Understands and applies commercial principles. Finds 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.

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, and training and development. Competent human resource professionals recognise 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) as follows:

Intelligence + Education + Experience + Ethics + Interest = Competence

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 provide a basic framework for creating a 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).

Competence-based Selection and Interview

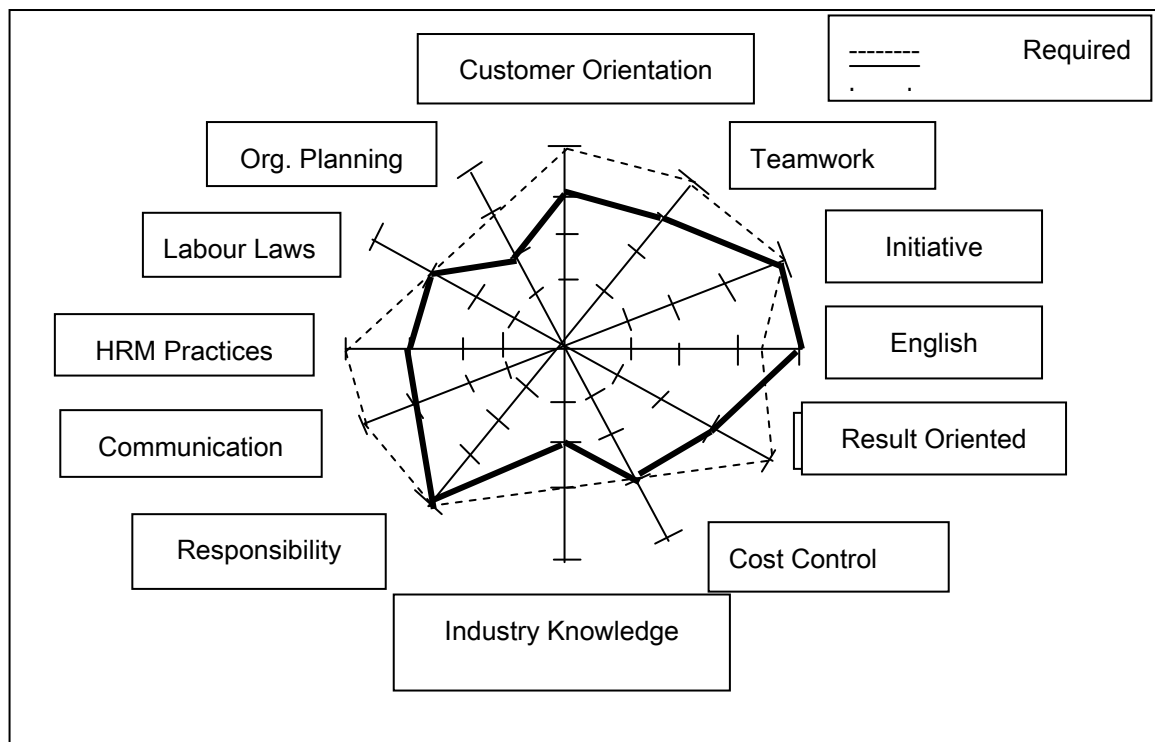
As mentioned, the company adopted competence models to select and interview candidates to identify their competency level. First, line managers will identify all job competencies and levels and send to his/her upper managers for approval. The Human Resources Manager will then work with line managers by conducting the interviews or through other selection tools. After the interview

process, they get together to identify the candidates competency level and the competency gap between the actual and the job required (Figure 8).

Competence-based Placement

The internal transfer, promotion, relocation, termination, succession, plan and other placement practices, uses the competence model to identify candidates competence level. Line managers and HR manager will 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 strengths and weaknesses to increase the likelihood of people-job and people-organisation fitness.

Figure 8: Candidates Competence Gap



Competence-based Performance Management

Employee's performance rating is determined by personal goals and individuals 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 employee's annual performance rating is determined. 80% is for goal achievement and 20% for competency. The company intends to build up a culture that both results and behaviors are important in the organisation. In another words, employees are not only expected to achieve their annual business goals but also to demonstrate their behaviours, attitudes and skills as required based on their job and rank. Managers will review employees annual performance based on the competence model and provide the feedback based on the gap and insist of improvement within a certain period.

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 to the sales team.

Human Capital and Person-Job / Person-Organisation Fit

Sound people management skills in organisations is the key to success. It is the core responsibility for line managers not just the human resources 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 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, Young & 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 the 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).

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 the socialisation processes (Chatman, 1989). Ideally, the two types of fit are important. Organisations should make an effort 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.

The Impact

After two years' of implementation, the Company's sales grew by 20%, 11% turnover for unfit staff, employee satisfaction increased to 23% and customer retention rate increased to 88%. The specific role that competence-based HR practices play in business reengineering processes is explored. It also helped to strengthen person-job/person-organisation fit in a dynamic organisation.

This case illustrates how competence-based HR practices can help an organisation to enhance/improve its business performance by implementing business reengineering processes in a dynamic environment. Since human capital is embedded in individual employees, even the company can reengineer the 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 function should provide competence-based HR practices as a tool for managers and subordinates to use. While standardising 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 by integrating organisational culture

with the 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 realise that organisational 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, a certain degree of fit on the individual, job and organisational level would be important to achieve organisational effectiveness.

As Prefer (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 advantages. 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 there is a need for a dynamic model on 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.

7.0 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 as follows:

1. Many employees, especially those in the services 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 employees but to or cut down the

labour cost. With this objective the design of the system is biased towards employers and thus when the system is implemented, 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 usually challenge and resist this system. If the firm fails to discuss and negotiate the system with the 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 than people-oriented. When a company employs performance-based system there is a fear that employees will only focus on performance and will not be committed to improving quality. This will in turn affect the overall development of company.

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