

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

MALAYSIA'S EXPERIENCE

By

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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

Criteria		%age 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

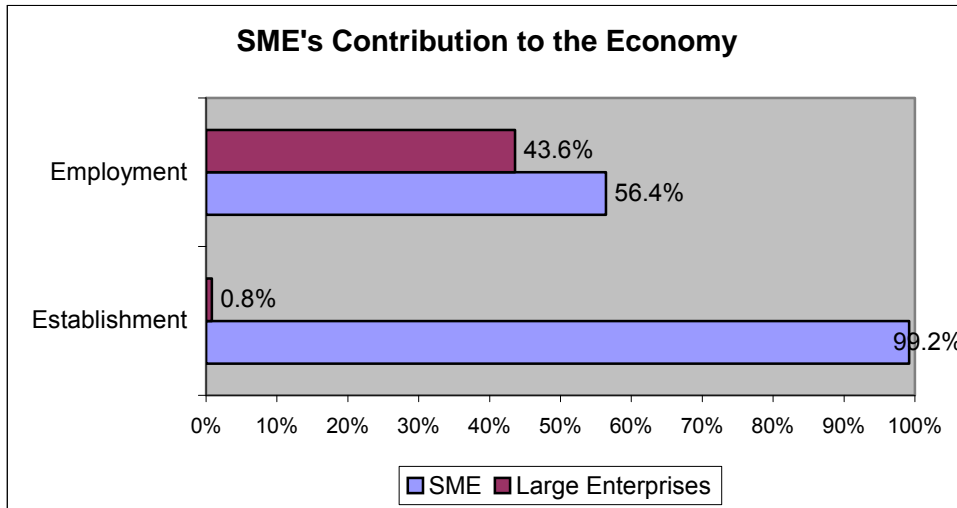
Source: IMD World Competitiveness Yearbook, Various Issues

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

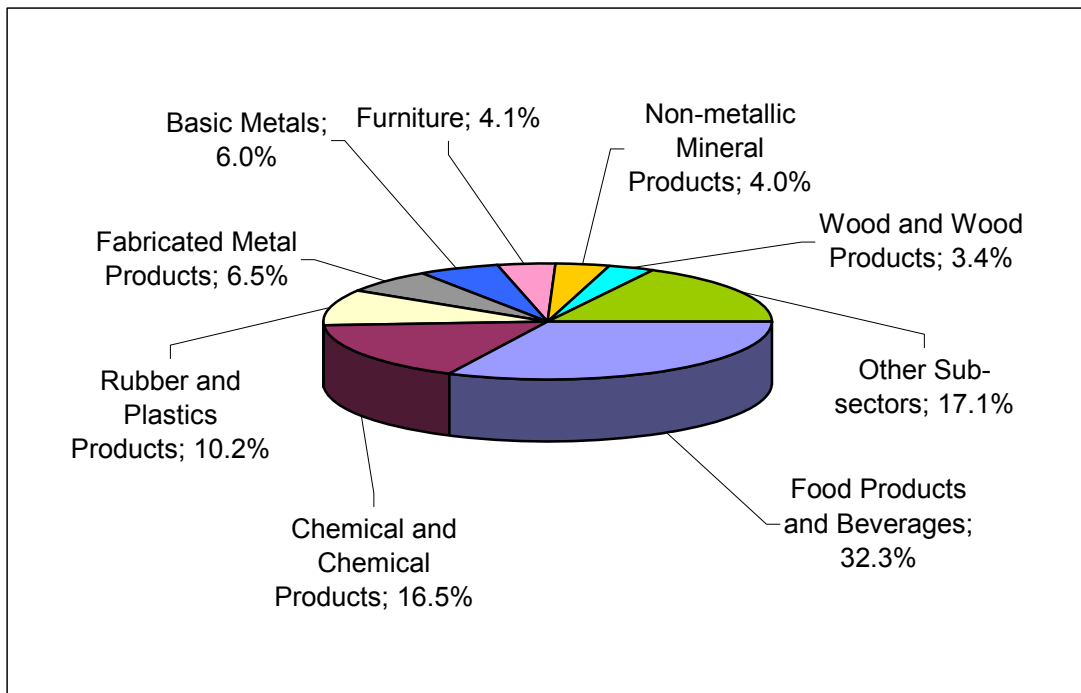
	Value Level*		% age Share of Manufacturing Sector		Growth (%)
	2006	2007	2006	2007	2007
Total Output	88,266	94,356	29.31	30.74	4.91
Value Added	17,798	19,251	25.66	26.33	8.16
Employment	402,496	413,397	31.21	31.62	4.91

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

Source: Productivity Report 2007

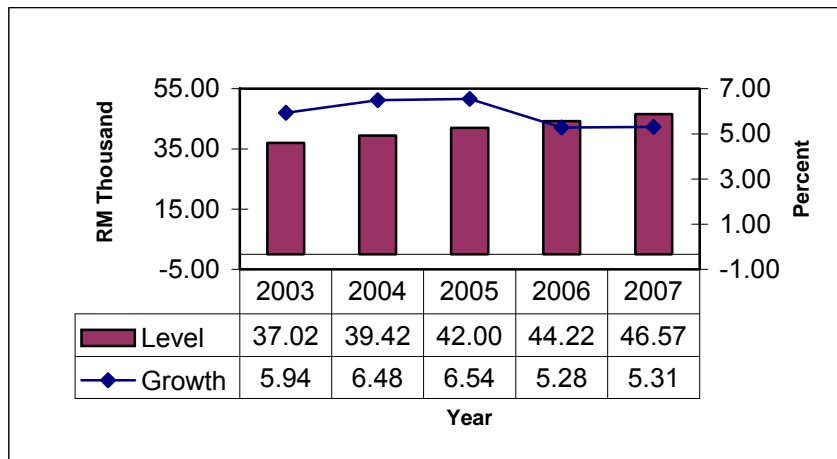
Given its size in terms of output, the food products and beverages sub-sector recorded the largest contribution among SMEs, accounting for 32.3% share of total output. This was followed by chemicals and chemical products (16.5%), rubber and plastic products (10.2%) and furniture (4.1%). These industries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

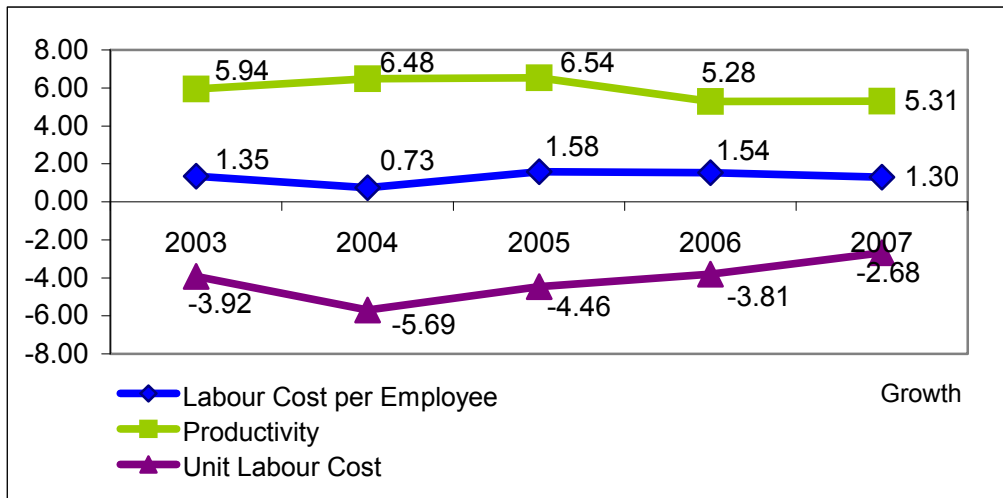


Source: Productivity Report, 2007

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-linked 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.

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.

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

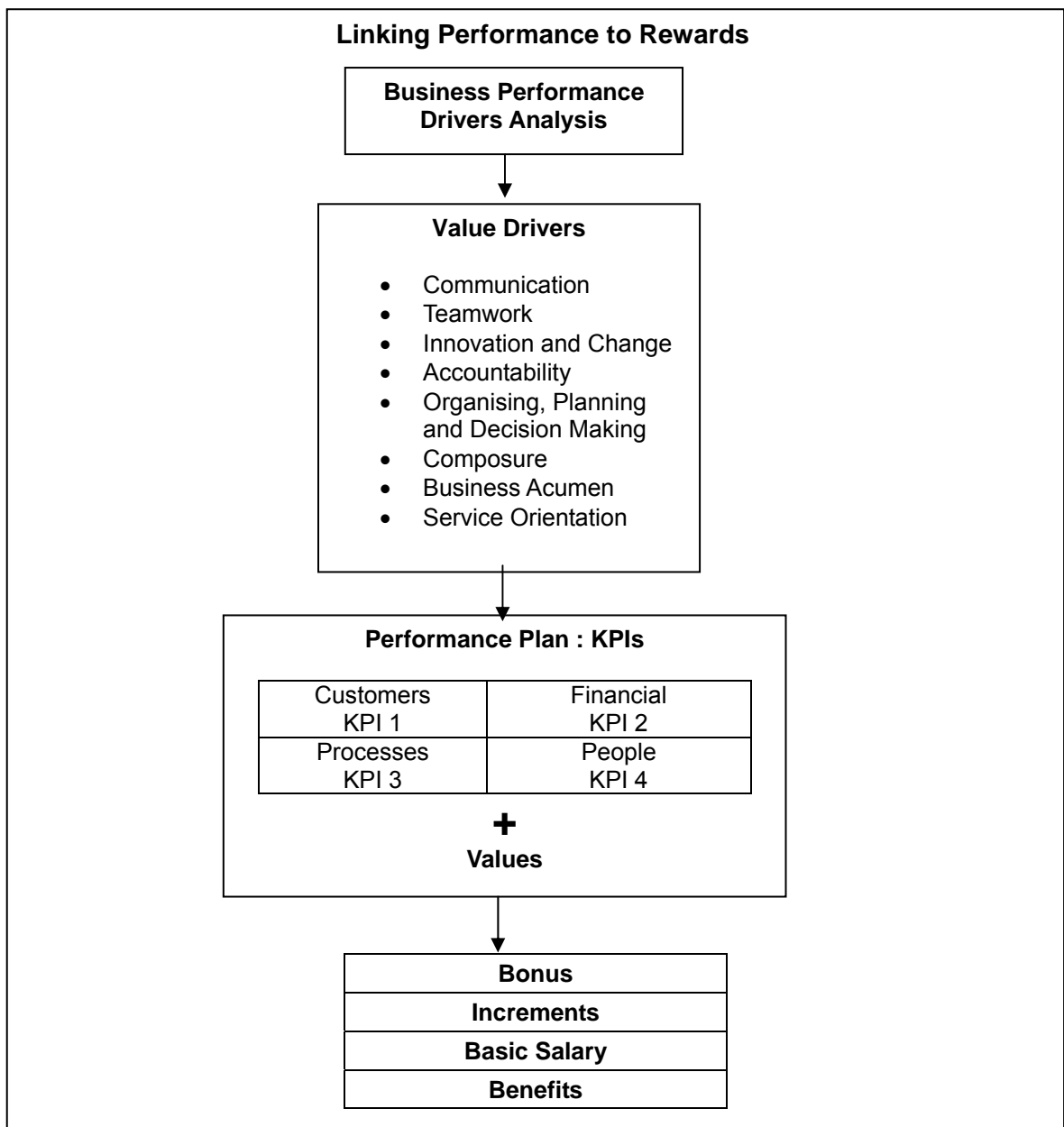
- IT Project
- HR Strategy Project

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	60,81 9	
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 will be at the discretion of management.

The Productivity Model

Companies can also adopt the productivity model. A variable productivity payment will be paid based on productivity improvement of the company or individual. Wage incentives for the year would be decided upon and commensurate with productivity improvement. An example of the Productivity Model is as follows:

Formulation: $T = A + P$

Where T = wage increase

A = annual increment

P = variable productivity payment

Year 1

If basic wage = RM1,000 per month, $A = 2\%$ and $P = 3\%$

Basic wage + $A = RM1,000 + 2\% (RM1,000) = RM1,020$ per month (built into basic wage)

$P = 3\% \times RM1,000 \times 12 \text{ months} = RM360.00$ per annum

Year 2

If basic wage = RM1,020 per month, $A = 2\%$ and $P = 4\%$

Basic wage + $A = RM1,020 + 2\% (RM1,040) = RM1,040$ per month

$P = 4\% \times RM1,020 \times 12 \text{ months} = RM489.60$ per annum

Annual Variable Payment at the end of year 2:

P for year 1 RM360.00

P for year 2 RM489.60

Cumulative for 2 consecutive years RM849.60

The Productivity/Profitability Matrix

This two dimensional model links profitability to productivity. The bonus payment made is dependent on both the companies profit and productivity. An example of the productivity/profitability matrix is show below:

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

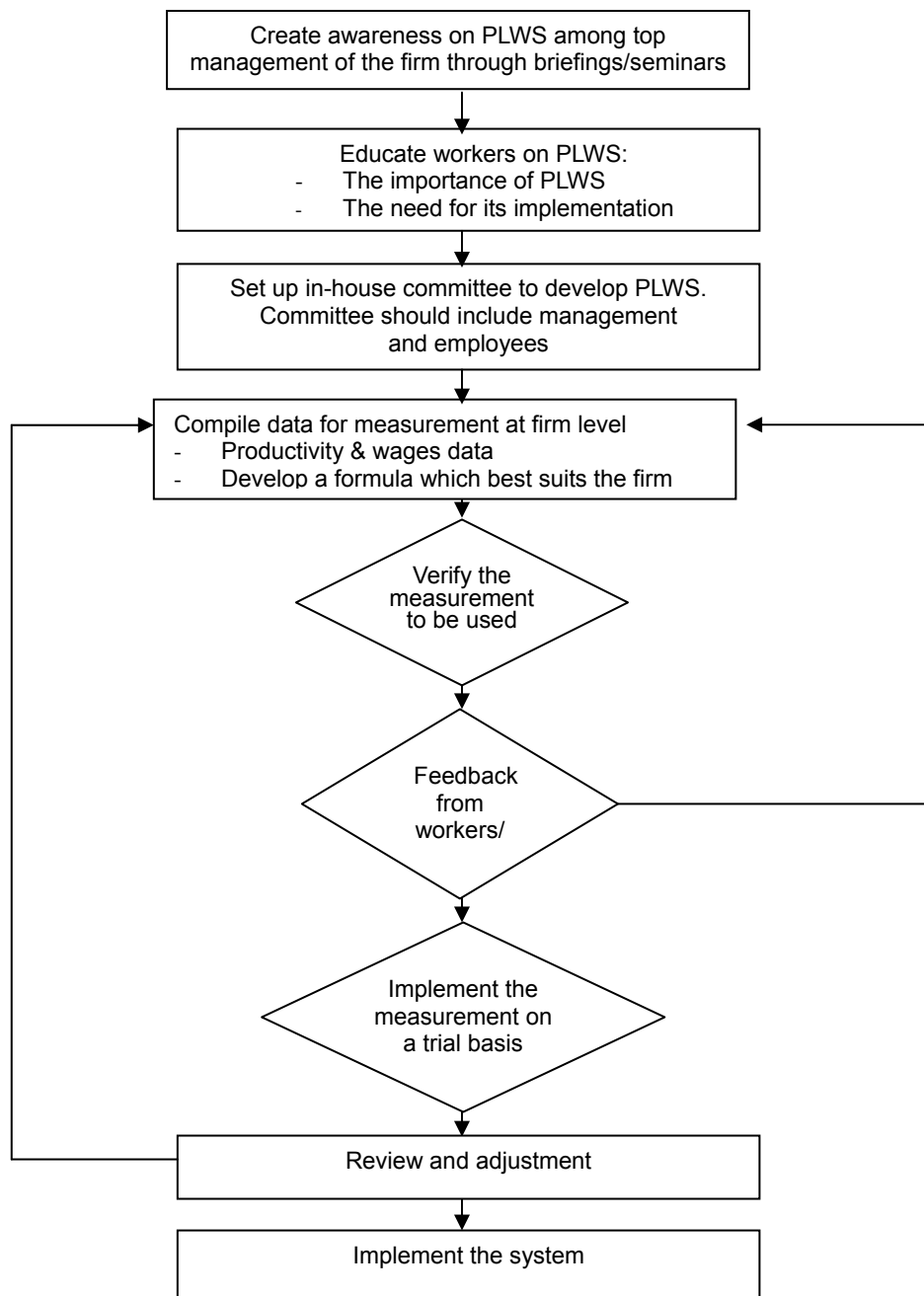
Companies should review their wage systems, and link it to productivity or performance, so that they remain highly competitive. It is certain, that a performance-based wage structure will reap more benefits as workers strive to improve their productivity, and performance to ensure better rewards for 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.

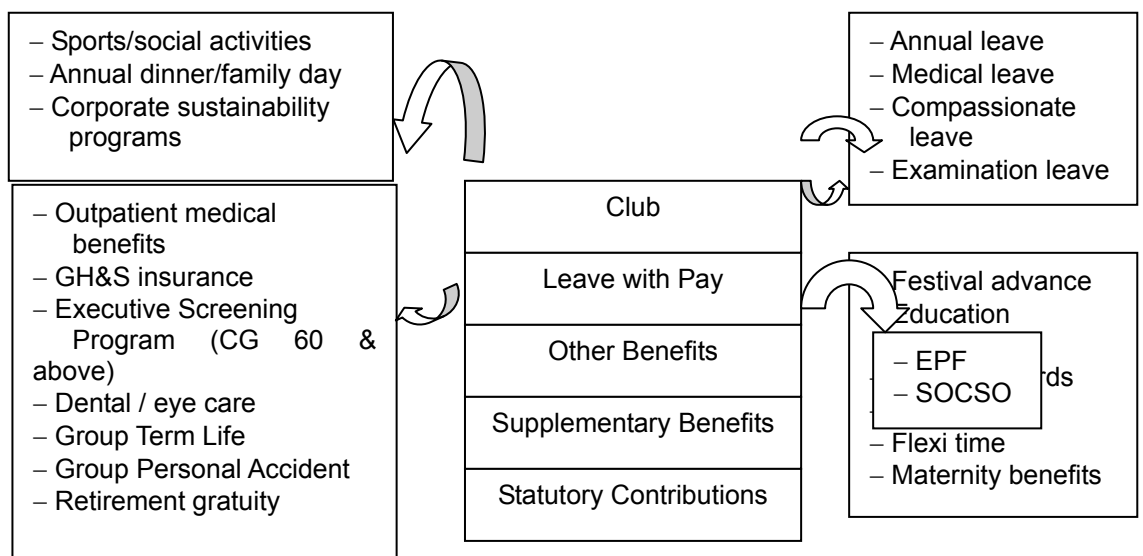
	Excels	Exceeds	Fully Meets	Partially Meets	Requires Action	
Fast Track						
Growth Path						
Well Placed						

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.

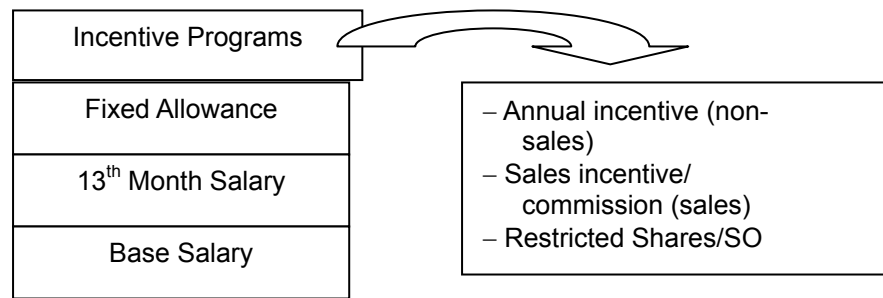
5.1.3 Linking Performance Management to Rewards

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.

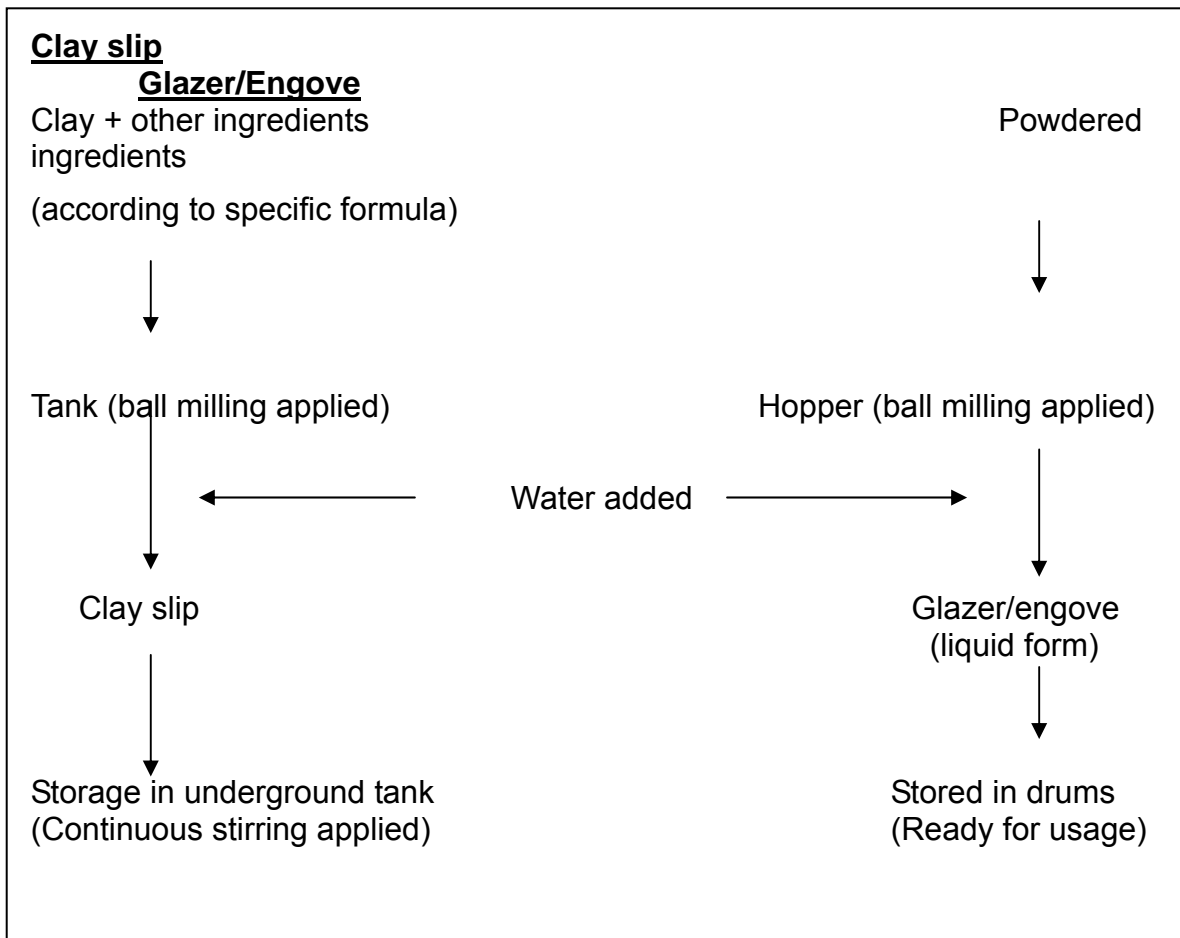
5.2..1 Production Process in CTM

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



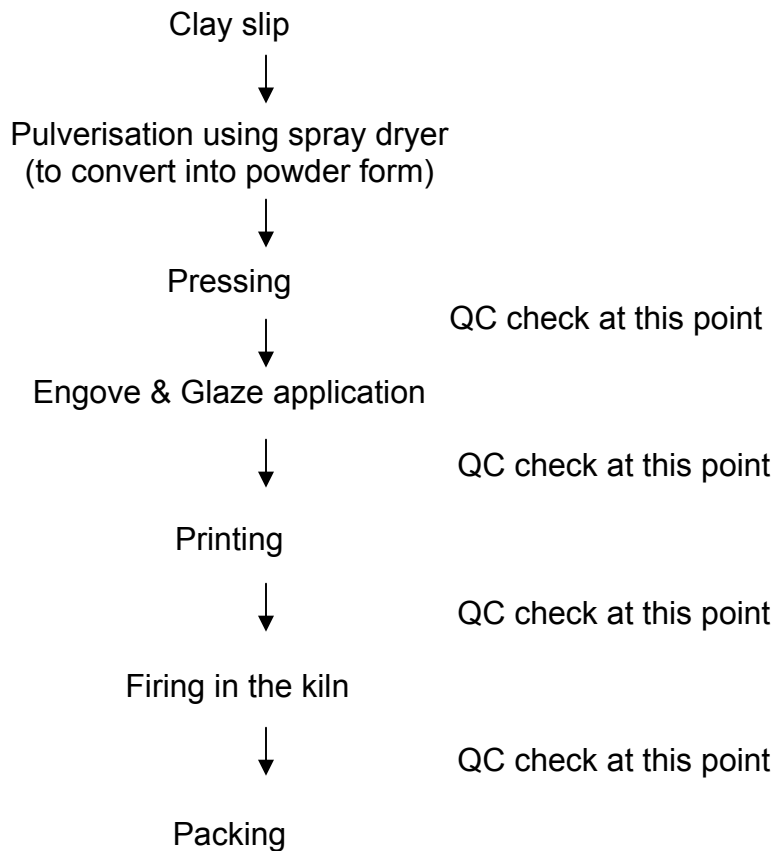
The Dry Preparation

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 engoving 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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