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# Are Performance Appraisals & Reward Really a Contributory Factor to Service Quality?

## Abstract

The purpose of this research is to provide new empirical evidence with which to clarify the role of performance appraisals & reward, and how these techniques can support service quality in varied types of service business. A questionnaire survey and in-depth interviews were conducted. Analysis of the questionnaire data revealed that, although there was a moderate association between service quality and performance appraisals & reward in mass services, the relationship was not statistically significant in technological services. The interview data explained these results, highlighting important differences between mass and technological services. In technological services, partly due to the hybrid nature of the business, performance appraisals & reward did not seem to focus primarily on service quality. Hence, these techniques were not one of the absolute necessities in improving service quality. In mass services, the use of performance appraisals & rewards was identified as being very problematic due to difficulties in measurement of services, and in setting criteria for service performance of front-line staff, especially in the qualitative aspects. This research has identified that the actual contribution from performance appraisals & reward to service quality varied, and has explained the reasons behind the diverse contributions in each type of service business.

**Paper type** Research paper

## Introduction

Performance appraisals & reward might play an important role as a technique to support service quality. This is because, performance appraisals & reward are used to give direction to the workforce (Nevling, 1992): performance appraisals can allow greater management control by identifying employee's desirable performance, and a reward system which is linked to customer satisfaction can be a very powerful tool to guide employees' behaviour (Palmer, 2011). In the current economic climate, service quality is paramount if businesses are to compete effectively. Yet, there may be vary limited scope for increasing employee pay so that careful use of performance appraisals & reward system is vital if employees are to remain motivated and deliver excellent quality service. The purpose of this paper is to provide empirical evidence with which to clarify the role of performance appraisals & reward in the service sector, and the extent to which these techniques support service quality in different types of service businesses. A questionnaire survey of UK service business was conducted in order to examine whether performance appraisals & reward support service quality in two types of service businesses: mass services and technological services. The usefulness of performance appraisals & reward, and variations between the different service businesses were investigated further by means of in-depth interviews with managers who are responsible for the promotion of service quality.

**Literature review**

There is an on-going debate about the role and usefulness of performance appraisals & reward. One of the TQM pioneers, Deming (1986) is strongly against performance appraisals & reward, because upon receipt of unsatisfactory appraisals, the employee is very likely to be de-motivated (Margerison, 1976; Ryan and Pointon, 2007), and reward tends to encourage competition among people for the same reward. Oakland (1993) argues the drawbacks of financial incentives as reluctance to share better/improved methods: the longer they keep improvements to themselves, the greater the reward for them; workers may cut corners on the specification where rewards are not applied; and conflict over the allocation of good and bad jobs. Moreover, there is debate about whether reward is truly a motivational factor to improve performance or simply becomes part of basic pay expectations (Palmer, 2011). There are, however, a number of authors who stress the benefits of performance appraisals & reward when designed and used properly, and support the use of these techniques (Elmuti et al., 1992; Nevling, 1992; Omachonu and Ross, 2004; Wilkinson et al., 1994; Murphy and Cleveland, 1995; Snape et al., 1995; Edmonstone, 1996; Redman and Mathews, 1998; Wilson et al., 2008; Zeithaml et al., 2009). The most important single purpose provided by performance appraisals is to give employees feedback on their performance compared with management expectations (Elmuti et al., 1992; Boice and kleiner, 1997; Spinks et al., 1999) in order to improve future performance (Latham et al., 1993; Simmons et al., 1995). In fact, several authors regard performance appraisals as identifying, the scope for performance improvement (Edmonstone, 1996; Spinks et al., 1999) and employees' training and development needs (Dubinsky et al., 1989; Nevling, 1992; Thomas and Bretx, 1994; Boice and Kleiner, 1997). The benefits therefore are firstly, enhanced productivity and quality (Shadur et al., 1994; Simmon et al.,

1995; Spinks et al., 1999), secondly, via appraisal feedback improved communication between management and employees (Edmonstone, 1996 Spinks et al., 1999; Omachonu and Ross, 2004), and which in turn increase employee motivation (Pettijohn et al., 2001), commitment and satisfaction (Wiese and Buckley, 1998). Performance appraisal is also necessary in order to set remuneration, to determine the level of reward, and to advance employees' careers (Anderson and Oliver, 1987; Dubinsky et al., 1989; Nevling, 1992; Omachonu and Ross, 2004; Thomas and Bretx, 1994; Murphy and Cleveland, 1995; Simmons et al., 1995; Edmonstone, 1996; Wiese and Buckley, 1998; Spinks et al., 1999).

The fundamental purpose of reward is to recognise those individuals who provide an example of desirable behaviour towards the company's quality goals (London and Higgot, 1997). Hence, it can be an active communication method which management utilises to continuously encourage employees (Dale and Cooper, 1992), because management could guide employees via rewarding outstanding behaviour (Parasuraman, 1986; Palmer, 2011). Therefore, when reward is handled appropriately, it will help to create employee commitment, morale and involvement, because employees will have a direct interest in their own performance (Palmer, 2011), and hence it can aid quality improvement (Redman and Mathews, 1998). When performance appraisals & reward are carefully and appropriately designed, these techniques can have a positive effect on quality. Negative consequences of performance appraisals & reward would occur only when they are not appropriately designed (Wiese and Buckley, 1998; Van Looy et al., 2003).

**Research issues**

Since the association between service quality and performance appraisals & reward does not apply to a specific service, a wide range of service business could be targeted in this research. Yet, two distinctive characteristics of service businesses were chosen: mass and technological services. This is because their differing characteristics of business, the focus of performance appraisals & reward in these two services seems to be quite distinctive. Mass service is defined by a relatively high level of labour intensity with a limited amount of customisation (Lashley, 1997; 1998). This type of service is fairly standardised so that customer service needs are predictable; however, a fair amount of interaction between customers and employees is required (Haskett et al., 1990; Lashley, 1997; 1998). Therefore, in mass services, performance appraisals are based on customer satisfaction measured by repeat business and customer complaints (Lashley, 1997; 1998). Technological service, on the other hand, offers a high degree of customisation with a low level of labour intensity for service delivery (Schmenner, 1986; 1995). This type of service is often centred around technology, in which the service is delivered electronically with little contact between customer and service providers (Heskett et al., 1990). Hence, performance appraisals in technological services are based on technological skills, and compensation is often substantial but rarely involves high bonuses or other incentives for short-term performance, because incentives are thought to be hard to administer in jobs emphasising innovation and the design of software, mechanical devices, or electronic networks (Heskett et al., 1990). The purpose of this research is to investigate whether performance appraisals & reward support service quality in each service despite the differing focus in these techniques.

**Methodology**

*Quantitative Methods:* The strategy for data collection was initially by a postal questionnaire, and a variety of techniques were used to improve the response rate, e.g., paying return postage, personalisation, follow-ups and offer of a copy of the results. The FAME database (a computerised database containing company information as well as UK standard industrial classification of economic activities) was used to identify appropriate organisations. The content of the questionnaire on performance appraisals & reward was drawn from the survey items used in previous research and statements in the literature. Seven-point Likert scales were used to assess performance appraisals & reward. Service quality was measured by the performance only measurement using SERVPERF (Cronin and Taylor, 1992). This is because SERVPERF avoided the problem of SERVQUAL with regard to assessment of customer expectations (Clow and Vorhies, 1993; Iacobucci et al., 1994; Buttle, 1996; Van Looy et al., 2003), and is much easier to administer as well as the data are easier to analyse; hence, it is arguably more suitable to assess service quality (Cronin and Taylor, 1994; Buttle, 1996). Only 4 out of 5 dimensions of SERVPERF were used: items on 'tangibles' were excluded, because it did not seem to be affected by performance appraisals & reward. Extensive pilot testing was undertaken to ensure that the questions were both comprehensible and easy to complete. The pilot sample was analysed using exploratory factor analysis and reliability testing.

A total of 2,495 questionnaires were distributed to named managers who were responsible for the promotion of service quality in UK businesses with 100 or more employees. 371 useable responses were returned which made the response rate a little under 15%. In order to assess the construct validity and refine items where necessary, the total sample was evaluated with confirmatory factor analysis using AMOS. The total sample was divided into two sub-samples. The literature specifies that mass services include distribution, financial services, hospitality,

transport, retail, and wholesale (Schmenner, 1986; 1995; Oakland, 1993; Lashley, 1997; 1998; Silvestro, 2001), while technological services comprise construction, maintenance and repair companies including computer and network repair firms (Schmenner, 1986; 1995; Hesket et al., 1990; Rafiq and Ahmed, 1998; Silvestro, 2001). Therefore, in the analysis which follows, the size of the sample for mass services was 188, and for technological services, 119. In order to establish whether the following results could be confounded by the influence of company or respondent demographics, all items on the questionnaire were tested by One-Way ANOVA (with Post Hoc Test). This showed that there were no differences in the results by size of organisation, the level of turnover, or the respondents' job titles.

*Qualitative Methods:* The sampling frame for qualitative research was drawn from the list of the questionnaire respondents from those in mass and technological services. Stratified purposeful sampling was used to determine participants. The method of data collection was through in-depth semi-structured interviews. In order to ensure questions were comprehensible to respondents, three pilot interviews were conducted. A total of 18 interviews (11 from mass services – referred to as M1 to M11, and 7 from technological services – referred to as T1 to T7) were conducted. At this point, there was sufficient information to clarify the issues, and hence, the interview study ceased. All interviews were fully transcribed, and a full transcription was sent to each interviewee shortly after the interview in order to ensure the accuracy of interpretation.

**Results and discussion**

*The association between service quality and performance appraisals & reward:* T-test revealed that the mean values on performance appraisals & reward, and on service quality were

not statistically different between mass and technological services. However, the association between service quality and performance appraisals & reward in technological services appeared non-significant while it was moderate in mass services (Table 1).

Looking at the cross loadings, both sets 1 and 2 in the two sub-samples were negative so that their relationship was direct which indicates that performance appraisals & reward did not undermine service quality.

Table 1. Canonical correlation

| Set 1 Service quality | Cross loadings Mass | Tech | Set 2 Performance appraisals & reward | Cross loadings Mass | Tech |
|---|---|---|---|---|---|
| Reliability | -.355 | -.249 | Performance | -.223 | -.227 |
| Responsiveness | -.426 | -.206 | Improvement | -.363 | -.218 |
| Assurance | -.383 | -.363 | Facilitation | -.367 | -.363 |
| Empathy | -.352 | -.287 | Feedback | -.385 | -.303 |
| Canonical correlation | .453 | .370 | | | |
| Canonical $R^2$ | .205 | .137 | | | |
| Wilk's | .742 | .801 | | | |
| Chi-square | 41.554 | 23.007 | | | |
| DF | 16.000 | 16.000 | | | |
| Significance | .000 | .114 | | | |

Performance appraisals & reward could become more difficult to apply when services were more customised and more intangible. Therefore, both mass and technological services could face a problem in setting criteria for performance appraisals & reward, because of the highly intangible nature of mass services (Lashley, 1998), and the high customisation of technological services (Heskett et al., 1990; Schmenner, 1995; Lashley, 1997; 1998). Yet, the above statistic indicates that only in technological services was it the case that the relationship between service quality and performance appraisals & reward appeared non-significant. This may imply that performance appraisals & reward were not one of the supporting factors to service quality in technological services. The levels of service quality may not be affected by the degree of

utilisation of performance appraisals & reward; therefore, service quality could be achievable regardless of the utilisation of performance appraisals & reward in technological services. In mass services, although performance appraisals & reward did not seem to have made a strong contribution to service quality so far, these techniques did at least have some recognisable effect on the level of service quality. Hence, higher utilisation of performance appraisals & reward in mass services helped to achieve a higher level of service quality to some degree. The differing results between mass services and technological services were further explored in the in-depth semi-structured interviews.

Interview results: The reasons for the non-significant association in Technological services

*(i) Performance appraisals as an identification of training needs:* Performance appraisals may not have been initially focused on staff performance towards customers/service quality, but primarily concentrated on the technical skills of front-line staff in order for them to be "more proficient at their job" (T7).

> "…individuals are set targets to achieve for their own personal improvement, and consequently company's improvements. …(performance appraisal) is to ensure that individuals are capable and professionally trained and skilled…" (T3).

*(ii) Lack of link between reward and service quality:* Targets are set by performance appraisals, and when they are met, there are some financial gains. However, since the targets are not based on service quality, hence, neither do rewards.

> "…we total up all the sales and if it hits the target, then they (members of a department) get a share (a bonus) according to how much they have exceeded the target" (T7).

In some cases, there is no reward even though their targets have been met.

"…there is no(t) such a positive carrot… (because) it's not considered to be clinical [practical] within the industry. …We have a number of people on a particular project. Some people move off the project before it's finished. …some people who contributed to the contract, are not there at the end of the contract. So it's just very impractical to consider… rewards" (T3).

The work of the construction industry is described as 'project-based nature' (Druker and White, 1997) so it would be difficult to allocate reward for an individual performance. Yet, failure to supply reward even after targets are met can be "counter-productive" (T1).

"…we have a history of performance appraisals which probably stopped about 10 years ago. The reason that they were ineffective is because they were not tied up to any salary increases or salary reviews. It was felt by the staff that sitting down for half an hour, three quarters of an hour a year going through an appraisal form and setting individual targets was not conducive to improving the situation within the company. …If the employee reached those targets, there was nothing in it financially for the employees. No reward at all, apart from well done" (T1).

Reward could be seen as a system to maintain and motivate quality/best staff (Snape et al., 1995; Wilson et al., 2008; Zeithaml et al., 2009) as well as their commitment towards quality (Bank, 1992). In technological services, staff turnover is generally very low (on average 12%), salaries of front-line staff are reasonably high (T3), front-line staff are very likely to be satisfied with their job (T1&T3). Hence, there may be no necessity to provide reward in order to retain or motivate front-line staff or to gain their commitment in technological services.

"There is no bonus, reward as such, but the company… has a policy of paying relatively well. So the incentive is to attract the right person by offering the right rates. One of the attractions of this industry… is that individuals get satisfaction from producing (buildings). …we offer good money for good people." (T3).

*(iii) Lack of awareness of the service element in their job:* Given the hybrid nature of the businesses (i.e., construction, maintenance and repair), it was problematic for some organisations in technological services to recognise service elements in their day-to-day activities. It is 'difficult to say we provide service, but try to satisfy clients' (T3). Some companies appear to be driven by figures rather than by service quality: '… the most important thing is… getting it built, getting you in, getting your money' (T4). 'If you look at our documentation, you'll often see that it's driven by numbers' (T6). In the service sector, there is a tendency for productivity, quantity or sales to be most often evaluated as these are categorised as hard data and thus easily measured (Wilson et al., 2008; Zeithaml et al., 2009). Hence, performance appraisals seem still to remain focused on traditional measurement of 'efficiency, return on capital employed and profitability' (Love and Holt, 2000, p408) than service quality.

The non-significant canonical correlation between service quality and performance appraisals & reward in technological services seems most likely to be the result of the hybrid nature of business, and therefore, companies did not employ one of, or either of, these techniques relating to service quality.

Mass service: Reasons why performance appraisals & rewards were not a more powerful supporter to service quality

*(i) Performance appraisals as identification of training needs:* Performance appraisals may not be a factor which directly improves service quality, but can be seen to support service quality indirectly by giving staff "motivation and guidance" (M3) for service quality improvement. It

was frequently stated that performance appraisals were utilised for setting targets and identifying training needs (M5, M8 & M10).

"Weaknesses are identified during appraisal and how we could address these weaknesses is considered. …That (the appraisal meeting)'s the chief mechanism for identifying what the training needs are" (M5).

"Training would be directly derived from performance appraisals. At the end of the appraisal, if they have to improve, we do that through training" (M8).

As one of the purposes of performance appraisals is the identification of individual training and development needs (Edmonstone, 1996, Spinks et al., 1999), they were supporting service quality indirectly through training of front-line staff to remedy weaknesses in their performance. Thus, performance appraisals were seen to be a development review which did not improve quality with immediate effect. Once performance appraisals were conducted, weaknesses could be identified and then training could be given which in turn would lead to the improvement of service quality.

*(ii) Difficulties in measuring service performance:* Due to the nature of the service characteristics, measurement on quality becomes notoriously problematic (Cowling and Newman, 1995; Silvestro, 1998; Singh and Deshmuch, 1999). Measurement of customer satisfaction and/or staff attitudes towards customers is argued to be qualitative, judgemental and subjective (Silvestro et al., 1990). It was claimed that "it would be very difficult to measure service that is completely subjective" (M5), and reward was not used because "…it didn't work properly, purely because it became very subjective" (M1).

"…my perception of you providing a good service would be different to my colleagues' perception of … the service you provide. So I might put you forward to say '**** was excellent, because she did this and

I nominate you'. However, there is no gauge to say 'was it just you were doing your job or was it over

and above the service that you were supposed to provide?'" (M1).

Setting criteria for performance appraisals & reward seemed to be impracticable in some

situations. A restaurant manager revealed that because every customer is different, it would not

be appropriate to set rigid service performance criteria for front-line staff.

> "The classic example… is… two businessmen walk in and the last thing they want is somebody
>
> constantly coming back and saying… 'is everything alright?' They want to be left to their business. Then
>
> there will be another table where it is a family with children. What they really want is lots of attention…
>
> keeping the child happy… So what can be very attentive in one situation can be very intrusive in another
>
> situation. …I can give you ten different situations. If…(a) gentleman was just about to propose to the
>
> lady, they don't want a waitress saying, 'excuse me?' So it's very individual. That means you cannot
>
> prescribe. You can prescribe up to a certain point, but not entirely" (M7).

Front-line staff are therefore rewarded "not directly for service (performance, but) based on

sales performance, probably because it would be incredibly complex (otherwise)" (M7). Since

services and service quality are very subjective (Van Looy et al., 2003; Grönroos, 2007), it is

much more difficult to appraise soft, qualitative aspects of employee job performance, and

reward systems which do not link to hard data may also appear more subjective (Wilson et al.,

2008; Zeithaml et al., 2009). Therefore, although all relevant aspects of service quality should

be considered, it is not always possible to build every aspect into a reward system (Grönroos,

2007). Hence, reward might not appear as a dominant feature to support service quality.

*(iii) Reward at profit level:* When equal amount of a bonus is provided for front-line staff on

the basis of the company profit level (M11), this type of reward may not be directly affected by

the level of service quality which is provided by individual front-line staff. It was also declared that:

> "…we are only rewarded if the company has met its profit margins… (hence, although) it (reward) has its place, but …it's not an incentive. …if you continue to get it, then it becomes an expectation" (M6).

*(iv) Objections from trade unions and staff:* Another reason for the modest relationship between service quality and performance appraisals & reward could be that these techniques were not regarded favourably by unions and staff.

> "…we are high unionised and …the unions did not want any performance appraisals…. because they see performance tied in with pay. ….So if you don't do a good job, then you don't get it, and they don't want that. They just say sorry, we have never had appraisals. We get the pay for the job that we do and that's it. We don't want any appraisals" (M1).

Performance appraisals were found to contribute only indirectly to service quality improvement through the identification of training needs. In addition, the characteristics of services mean that it can be hard to measure performance/service quality with sufficient precision to enable a link with rewards to be established. "…in comparison to the other things (e.g., training, teamwork, communication), it's (performance appraisals & reward) not as important a factor" (Mass 11).

**Conclusion**

In technological services, the non-significant association between service quality and performance appraisals & reward meant that these features were not one of the absolute necessities in improving service quality among front-line staff in the main service. This was partly because, where performance appraisals were utilised, the techniques focused on an

individual assessment of technical skills. Moreover, where rewards were provided, they were not based on service quality, but often typically on sales. Some technological service organisations, in fact, did not utilise either technique. This was partly because rewards to individuals were considered to be inappropriate due to the project-based nature of jobs. Additional rewards were also thought to be unnecessary, because the salaries of front-line staff were generally high, and these relatively skilled jobs provided work fulfilment. Therefore, when no rewards were provided, performance appraisals did not generate the expected outcomes from front-line staff. As top management in technological services tended to focus on figures, some companies in technological services appeared to lack awareness of the service element of the businesses in which they were engaged, and this may also help to explain the absence of a close relationship between service quality and performance appraisals & reward.

In mass services, the association between service quality and performance appraisals & reward was not particularly powerful. This was partly because, in some companies in mass services, due to strong objections from trade unions and staff, these techniques were not used. When performance appraisals were adopted, they were used to identify training needs so that these techniques seemed to have an indirect impact on service quality through training. Moreover, mass services tended to focus on easily quantifiable targets as a basis for performance appraisals. Such measures are far from ideal, because staff may focus on areas unrelated to service quality. Nevertheless, this outcome was not entirely unexpected because of the difficulty in specifying service quality standards. Rewarding staff for output (e.g., sales, profit level) has not yet proved to be the best motivational method for service quality. Appropriateness is required not only in setting criteria but also in considering the ability of each individual member of staff in order to prevent them being unenthusiastic or under

pressure. In some organisations in mass services, due to great difficulty in setting criteria for performance appraisals & reward, rewards were provided, but based on the level of profit or of sales performance so that rewards were not directly linked to service quality. The moderate association between service quality and performance appraisals & reward may suggest that there is room for improving practice in this area.

**Implications for managers**

Partly due to culture of the organisation in technological services, performance appraisals & reward did not seem to focus primarily on service quality. These techniques could be one of the supportive features for service quality when awareness of the service element in their activities was increased, and a culture of service-orientation was strengthened. Therefore, the criteria of performance appraisals & reward could be restructured to support service quality.

The use of performance appraisals & rewards in some organisations in mass services was identified as being very problematic due to difficulties in measurement of services, and in setting criteria for service performance of front-line staff, especially in the soft qualitative aspects. There are some methods to assess qualitative aspect of services (i.e., customer satisfaction, staff attitude towards customers), and also organisations could provide a wide range of flexible criteria for assessing staff performance and for rewarding them. Reward systems which do not link to hard data have been seen to appear more subjective (Zeithaml et al., 2009). However, reward systems which are based only on hard data could encourage employees to focus only on output measurement while neglecting the possible negative consequences on the quality of the service delivered (Van Looy et al., 2003). Therefore, it

could be effective to adopt subjective measurement in conjunction with objective measurement.

In the case of objections from staff and trade unions for the utilisation of performance appraisals & reward, it might be necessary to communicate continuously to negotiate carefully, and to educate them properly in the purposes of, and the advantages of, performance appraisals & reward so that the resistance would be more likely to be overcome. A wide range of flexible criteria for performance appraisals and reward both of which consist of hard and soft criteria may further support service quality in mass services.

**Limitations and areas for further research**

As with all research, this project inevitably has some limitations. This research did not focus on variations within mass services or within technological services: organisations were treated as representative of either mass or technological services. This is because the purpose of the interviews was to facilitate interpretation of the quantitative data; hence, individual organisational characteristics, individual circumstances, or details of the service offered to customers are not considered beyond the category of either mass or technological services. Yet, it is possible that individual organisations might have different practices on performance appraisals & reward, and this may affect the promotion of service quality.

The limitations above suggest an agenda for further research. In order to examine whether individual organisations within mass or technological services have a distinctive emphasis on performance appraisals & reward of front-line staff, the association could be examined further via a case study looking at a specific service company.

This research has shown that performance appraisals & reward were not the predominant feature supporting service quality especially in technological services partly due to a lack of awareness of the service element of the business. Therefore, it would be useful in further research to examine whether performance appraisals & reward contribute more to service quality as awareness of the service element in these businesses increases. For mass services, there needs to be more research on the soft qualitative aspect of performance appraisals & reward in order to examine if a wide range of flexible criteria can be developed to further support service quality.

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