

Competency-based Pay

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Introduction

According to Brown (1998), competency frameworks have a role in main HR functions in as many as 70 per cent of organisations. However, competencies are used mainly in performance management, recruitment and selection, and training and development, according to the *Competency and Emotional Intelligence Benchmarking Survey* (2002). Only a minority of organisations have decided to make a link between pay and competency.

In this paper we describe the use of competencies in reward systems and highlight both the attractions of such an approach and the potential problems and pitfalls that may have contributed to its limited application.

Definitions of competence/competency

The term competency was brought into the public arena in the USA in the early 1980s by Boyatzis (1982). Boyatzis defined *competency* as 'an underlying characteristic of an individual which is causally-related to effective or superior performance'. This definition is quite distinct from the way the term *competence* came to be used in the new suite of vocational qualifications introduced by the UK Government in the later 1980s. These awards National Vocational Qualifications (NVQs) are based on nationally determined occupational standards or competences and focus on the desired outcomes of work performance. So whilst one term (NVQ competence) was a label for the ability to perform the other (Boyatzis's competency) described the behaviour needed to perform a role with competence.

However, this distinction is not always clear in the subsequent literature, or certainly in practice.

Armstrong (1999), for example, talks about 'hard' or work-based *competences* which are expectations of work performance and the standards and outputs that people carrying out a role should attain: in other words the NVQ description of 'something which a person in a given occupational area should be able to do'. He also refers to soft *competences* as 'behavioural or personal

characteristics which people bring to their work roles' – analogous to the Boyatzis definition of *competency/cies*.

Some commentary makes a distinction between three possible uses of competency and/or competence: input (the capacity within people to do job well – knowledge, skills and personal attributes); process (the behaviour required to convert inputs into outputs), and outputs (the actual performance in the job). Armstrong (1999) points out that different organisations use different combinations of one, two or all three of these definitions when employing the concept of competency in their human resource strategies.

What is competency-based pay?

In addition to variations in language and the ways that terms are applied, gaining an understanding of what is meant by competency-based pay is also complicated by the variety of different pay arrangements that are given the label. Some of these systems are indistinguishable from skills-based pay, in that they involve payment on the acquisition of knowledge or skills seen as necessary for the effective delivery of a job role. Others are basically performance-related pay by another name, in that they measure and reward competency in terms of the performance that competency produces.

For the remainder of this paper, the focus will be on systems that in some way reward the *use* rather than the *acquisition* of competency. Systems that reward the acquisition of competency are best described as skill-based pay and have been covered in an earlier Research Network paper.

In principle, there is also a clear distinction between competency-based pay and individual performance-related pay. Suff (2001), citing Armstrong and Baron, gives the following as some of the distinguishing features of competency-based pay:

- it is based on an agreed framework of competencies
- it is not based on the achievement of specific results, such as targets or projects completed. However, it is concerned with the attainment of agreed standards of performance.

The difficulty of getting an agreed description of competency-based pay is reflected in Brown and Armstrong's (1999) definition:

'Competency-based pay can be defined as paying for the development and application of essential skills, behaviours and actions which support high levels of individual, team and organisational performance.'

Here we see the use of not just behaviours, but also 'skills' (akin to harder competencies?) and actions. The latter is hardly

distinguishable from individual performance-related pay. And if the performance judgement is at team or organisational level then competency-based pay becomes indistinguishable from team-based pay or employee financial participation schemes.

In practice, as discussed later in this paper, competency-based pay systems are rarely used in a pure form as the only means of determining reward. Most, instead, combine the assessment of two or more of: inputs, processes and outputs. Brown and Armstrong's (1999) distinction between competency-based pay and competency-related pay is helpful. They make same point that many pay schemes involve competencies without these being the primary focus of reward (hence 'related'). They have also developed the concept of 'contribution-related pay' to describe approaches that combine recognition for both inputs and outputs – *ie* how results are achieved as well as the results themselves. This approach is a formal combination of competency and performance-related pay. Brown and Armstrong believe that contribution-based pay is a desirable approach precisely because it covers both inputs and outputs in a way that is reflective of most jobs. Using the term contribution-based pay is also a recognition that a number of organisations, though describing their pay system as either competency-based or performance-related, are actually a combination of both. Suff's research (2001) confirms that most competency-based pay arrangements could equally be described as contribution-related and that systems that are entirely competency-based are very much in the minority.

How are reward and competency linked?

Adams (1999a), in a survey of competency-related reward, found that there are four main ways in which employers were making the link between competencies and pay:

- 76 per cent of organisations that used competency-based pay used competencies in design of the grading structure
- 80 per cent used them to determine promotions
- 88 per cent used competencies to determine pay rises or pay cuts
- 56 per cent used competencies to determine how an overall pay rise should be divided into pay shares.

Brown and Armstrong (1999) summarise two main ways of linking competency and reward – a job-focussed process, which uses competencies wholly or partly as a way to evaluate jobs; and a people-focussed process that links individual pay to level of competence. The first method commonly determines where an individual role is placed in the band. The second determines the link with pay: this may be via a bonus, but through a pay increase is more common.

A Towers Perrin European survey, cited by Brown and Armstrong, found that most companies have kept their job evaluation system, but, rather than replacing it with a system based on competencies, have modified the system – with 60 per cent considering the introduction of competencies. The typical rationale for such a change is that it will introduce greater flexibility into job evaluation and make it easier to measure job quality as well as size. Brown and Armstrong say that competency-related evaluation suits organisations with a predominantly professional workforce and non-hierarchical structure.

Current practice in competency-related pay is diverse, with almost as many different methods of linking competencies to individual reward being used as there are organisations practising them. However, approaches that make a systematic link between assessment of competency and individual pay often fall into the following categories:

- a matrix approach where pay increases are determined by competence assessment and position in pay range
- competence assessment, which determines incremental progression within pay ranges.

In the Anglia Housing Association Group (cited by Suff, 2001) individuals and their managers rate the employee against each competency listed in the job profile on a scale of 1 to 5. These scores are given values and weighted according to the importance of the competency for the job role. The resulting 'personal competency score' determines the employee's position in the pay band that is divided into increments.

- However, in a large number of organisations the link between competency and pay is looser. Competency assessment is just one in a number of factors determining pay, with others including market, internal relativities, and performance. For example, some organisations mix competence and performance assessment and assess staff both in terms of their performance against objectives and their competency, which they demonstrate in doing the job. In other words, these organisations use a type of contribution-based pay even if they do not describe it as such. Often, this means that an individual will primarily be assessed against their personal objectives, or other output-based factors, with a smaller proportion of their overall rating being derived from an assessment of their behavioural competencies.

Competency-based role profiles have been used to help determine pay in the UK Passport Agency since 1998. Managers assess their staff on a three-point scale. Assessment of individual behaviour is against the competencies specified in the individual's role profile, plus performance against specific targets (Suff, 2001).

- Brown and Armstrong (1999) describe a minority approach based on 'life-cycle' model that has been successful in some companies. This is based on the view that different kinds and levels of competence are required at different stages in an individual's career. Under this model pay levels are set with reference to the market for people at a particular career stage in the occupation concerned. Pay progression is based on achievement of the competences required for a particular career stage. However, this method is appears to be a skills rather than a competency-based approach.

How extensive is the use of competency-based pay?

A range of research evidence indicates that only a minority of organisations have chosen to link competency and pay. It also indicates that, whilst many organisations report considering the use of competency-based pay schemes, they usually decide not to implement this approach. Overall, there is no evidence in recent years of a growth in the popularity of competency-based pay schemes.

- The Towers Perrin 1997 European Survey, quoted in Brown and Armstrong (1999), found 20 per cent of participants linking skills and competencies with pay, with 70 per cent planning to introduce or extend such arrangements.
- An Industrial Society survey conducted in 1998, cited by Homan (2000), found that a third of employers had a competency-based pay system or had plans to introduce one within the following 12 months.
- The annual review conducted by *Pay and Benefits Bulletin* (PABB) indicated that in 2002 across the UK 17.4 per cent of companies were using competency-related pay, while 19 per cent of UK employers were considering the introduction of such a scheme. These figures have remained fairly static over the several years that PABB has conducted its annual review. For example, in 1999 one in seven companies was using competency-based pay
- According to research for the 2000/01 Competency and Emotional Intelligence Benchmarking Report, most employers use competencies for personnel processes in recruitment and selection and training and personal development, rather than reward. Just a quarter of organisations (24 per cent) had made a link between individual competencies and reward. By comparison, the survey found that grading and job evaluation was linked to competencies in a third of competency users (33 per cent). Public sector employers were much less likely to use forms of competency-related pay than their private sector counterparts in either services or manufacturing. The same survey repeated in 2002, included a matched sample from the previous study. Amongst this group there had been a small

decline in the use of competency-based pay. However, across the survey as a whole 29 per cent linked individual competencies and pay and 35 per cent used competencies in the grading of jobs.

Introducing competency-based pay

In this section we will describe the various steps an organisation might wish to follow in order to introduce a competency-based pay scheme.

Establishing a competency framework

It is recognised that it is better to have a successfully operating performance management system in place *before* adding a link to pay. According to most major commentators therefore, the starting point for any competency-based pay system will be a well-established competency-framework that has been used effectively for other HR processes. A wealth of literature exists on developing an appropriate competency framework for an organisation. A detailed consideration of this process is outside the scope of this review. However, some summary points are worth making:

- The first task in introducing a competency framework will be to conduct an analysis of what constitutes organisational success and how individuals contribute to that success. Hence Homan (2000) describes competency-based pay as a means by which 'pay and recognition are used to communicate vision and values to employees and to reinforce desired behaviour and performance.'
- A competency framework is likely to combine both core competencies that are applicable to jobs across the organisation and competencies that are specific to particular jobs. In most organisations competency frameworks contain both 'soft' or behavioural competencies and technical/functional competencies, often known as 'hard' skills.
- Competency frameworks are typically developed via a process of internal research and consultation, with or without expert external assistance. Typical stages, as reported by Miller, Rankin and Neathey (2001) include:
 - individual interviews with senior managers, often at board level, to obtain their views on the current and future key issues and challenges facing the organisation
 - individual or group interviews with some other managers, to identify the characteristics associated with under- and high-performance of individuals
 - focus groups of managers and/or other staff, again to help identify key competencies, and

- benchmarking the draft competencies against the competency frameworks of relevant external comparators.

Assessment of competencies for reward purposes

The existence of a credible, tried and tested system of assessment is also a prerequisite for effective competency-based pay.

Competencies cannot be measured in quantitative terms, which makes assessment difficult. Armstrong (1999) recommends the development of profiles for roles against which individuals can be assessed. These 'do not eliminate subjectivity. However, they at least provide a framework within which more objective judgements can be made, especially when these cover the contribution and impact which can be measured by reference, not only to behaviour, but also to the results of that behaviour'.

Other approaches rely more strongly on subjective judgement. A typical approach is for managers to rate employees on a scale for each competency, which is then to produce a total score. Brown and Armstrong (1999) found that in broad-banded devolved structures, line managers were generally required to give only a single competency score.

Introducing the competency-based reward system

If an organisation has in place these structural requirements, and has decided that it would benefit from competency-based pay, Armstrong (1999) suggests a series of stages for its introduction. The following list draws on the steps set out by Armstrong:

1. Communicate the purposes and potential benefits of competency-based pay.
2. Obtain the views of line managers, team leaders and employees.
3. Set up a project team to develop the process. Armstrong advocates a team that is 'cross-functional and fully representational'.
4. Define the broad approach that is to be used, and decide what work needs to be done to develop it. This might include the development of a new or revised job evaluation scheme, the introduction of a broad-banded pay structure, decisions on how competency assessment will be linked to reward, and means of maintaining and controlling the scheme.
5. Develop the scheme whilst communicating and consulting with all stakeholders.
6. Communicate the details of the scheme to the whole workforce and show what it will mean to them as individuals and groups.

7. Introduce the scheme and develop and implement appropriate training for managers.
8. Implement training aimed at allowing individuals to increase their levels of competency and so to have access to opportunity for increased pay.
9. Monitor the introduction process.
10. Evaluate the results of the introduction.
11. Amend or improve the scheme as necessary.

All of these steps are applicable to the introduction of any reward scheme. However, some need greater attention than usual. For example, training and communication are especially important in what can be quite a complex method to operate. The design phase, number 4 on the list, is also trickier than in a simple performance-related pay system. Since the organisation has to decide how to link its competency framework to pay. Is it through a rating approach – this would be the most common decision. If so, do all the competencies on the list have an equal value or is there some degree of weighting? Are all the competencies in the framework to be used or only key items that are seen as particularly important for pay purposes? Finally, is there a transparent scoring system or does the manager just make an overall judgement?

Why do organisations introduce competency-based pay and what are its benefits?

Homan (2000), in a review of the literature, gives reasons why employers chose to introduce competency-based pay. She suggests that amongst the most frequently quoted objectives are the support of a change initiative, the pursuit of flexibility, and the need to build a broader skills base within the organisation.

A 1998 CBI Employment Trends survey found that, particularly amongst service-based companies, improving employee motivation was most likely to be cited as the foremost advantage of competency-related pay by service-based firms (CBI, 1998). Similarly, in the 1999 *Competency & Emotional Intelligence Quarterly* survey, employers reported that the main factor influencing introduction of competency-related pay was the desire to encourage better performance. This factor had been a consideration for 80 per cent of employers who had introduced competency-based pay.

Other influential factors in decisions regarding whether or not to introduce competency-related pay included:

- the need to increase flexibility amongst the workforce (72 per cent)¹
- to change behaviour (60 per cent)
- giving employees access to job progression (52 per cent), and
- to allow some form of progression within the job where no other form of promotion opportunities otherwise existed (36 per cent).

These results are similar to the slightly earlier findings of the CBI, which reported that the main benefits of using competency-related pay were greater motivation, assisting with the introduction of multi-skilling, and providing greater objectivity in pay determination (CBI, 1998).

The Volkswagen Group (UK) Ltd introduced competency-based pay because the previous performance-related pay scheme was ambiguous and provided limited incentive to improve. This is because applying a normal distribution curve to performance means that most staff are rated as average and there is little differentiation in pay awards. Their competency-based pay scheme describes the ten critical competencies required for each job family. Staff can be placed on three or four levels of achievement. This means there is a motivation to demonstrate the competencies and these are fully transparent. The system encourages flexibility and breadth, thereby helping the company get a broad base of experience.

As we have already established, competency-based pay is commonly just one means of determining individual pay and pay progression. Competency-based approaches are often introduced as a means of addressing limitations of existing reward practices. For example, Alan Fowler (cited in Suff) has suggested that competency-based pay is a more rounded or 'holistic' approach and so avoids some of the problems associated with individual performance-related pay. These include:

- difficulties in setting measurable performance targets for qualitative factors (such as team-building)
- difficulties in converting variable performance against a range of targets into a single assessment rating
- problems in taking into account factors outside of the individual's control in the achievement of targets
- manipulation of the system by employees to ensure that they receive high levels of performance pay
- adverse impact on team work objectives.

¹ The percentages given refer to the proportion of those responding who said they were using competency-related pay systems.

An example of the introduction of competency-based pay as a means of addressing perceived problems with individual performance-related pay is the Government Executive Agency Registers of Scotland (Adams, 1999b). Originally, pay in the organisation was linked to the annual appraisal, but there were concerns that the system was being operated inconsistently, with attendant concerns arising from its linkage to pay. These worries led the HR department to work with consultants to draw up a competency framework and ratings system to form the basis for a new performance and development system linked to pay.

The introduction of the scheme was supported by a series of workshops, training sessions and a telephone helpline. According to Adams, a key factor influencing uptake of the scheme was the fact that the new arrangements were negotiated with the relevant trade union, the Public and Commercial Services Union (PCS). The aim of the new scheme was to create a fairer reward system and to give better opportunities for pay progression. The company viewed the negotiations with PCS as constructive.

So in summary, organisations contemplate competency-based pay where:

- Link to business strategy
 - competitive advantage through the way people perform
- Importance of people development
 - provides incentives for development, especially where role definitions are flexible
- Replacement for performance-related pay
 - PRP has proved problematic and inappropriate in some settings
- Organisational re-positioning
 - structurally or culturally.

Many of the above points on the reasons to introduce competency-based pay are again common to many reward change projects and similarly the benefits tend to be the same. However, trying to change behaviours through signalling that certain competencies are important to the organisation is unique to competency-based pay. These can be linked to 'core' competencies or values, emphasising what is critical to organisational success or proper management. Links can be made between reward, recruitment, development and selection so that there is an holistic approach to people management, with competencies the unifying theme.

Competency-based pay also recognises that how the job is done is as important as the end result. It considers the whole person's performance. This is particularly evident in such areas as customer services. Appraising people through competency rating frameworks has advantages compared with some other approaches. It is an absolute measure of performance. This means

people can always improve – this is less true in ranking systems. In addition, there are clear measurement criteria, sometimes missing from performance ranking.

Competency-based pay gives more options than other schemes in that it can be used to determine progress up a pay band, to determine movement within or between bands. In allowing *through* progression in broad-banded structures without the need for formal job evaluation procedures competency-based pay systems may be seen as providing greater flexibility and responsiveness to changing business needs.

Other features relating to individual motivation, righting the wrongs of previous schemes could just as easily apply to individual performance-related pay or contribution-based pay schemes. Improving pay progression is also a frequently-found objective in renewing a remuneration structure.

When is it appropriate to introduce competency-based pay?

Given that if you wish to change your approach to remuneration there is a wide choice of different approaches, when would it be best to consider competency-based pay?

Armstrong(1999) suggests that there is a set of criteria that determine whether or not the introduction of some form of competency-based reward system is appropriate of an organisation. Armstrong's criteria are:

- a well-established competency framework already in use for development and recruitment
- established criteria for measurement/assessment of competencies
- the organisation has a specific objective of increasing the level of competence amongst its workforce
- the organisation plans to move to a broad-banded pay structure or already has such a structure in place
- the organisation wants to move to a flatter structure.

Homan (2000) adds to the last point that competency-based pay supports the move to more fluid job boundaries. It also provides ways of awarding those with high level professional skills but who do not have responsibility for staff or financial resources.

It seems competency-based pay might be launched together with wider structural change – delayering and broad banding. It might be appropriate as part of a wide-ranging people management initiative – integrating selection, development and reward processes. It might be used to deal with a specific

population or problem. This might be to deal with a particular type of workforce (eg research scientists) where outputs are difficult to measure and where previous performance-related pay schemes have not been satisfactory. Another context to the introduction of competency-based pay, is where it is seen as an integral part of a cultural change. Especially where this is strongly values driven, performance management may be used to signal behaviours that are encouraged and the pay system reinforces them.

How effective is competency-based pay?

As with so many pay schemes, systematic evaluation of the effectiveness of competency-based pay is thin on the ground. However, Armstrong (1999) suggests that where a scheme is introduced for the right reasons and in the right way, organisations can reap the following benefits from the introduction of competency-based pay. They can

- promote need for greater competence
- facilitate lateral career development
- encourage staff to take responsibility for own career development, and
- help to integrate role and generic competences with organisational competences.

Suff (2001) suggests that the experience of organisations using competency-based pay and the analysis of a range of commentators indicate other potential advantages arising from the introduction of competency-based pay. It can:

- boost co-operation and teamwork
- lead to a focus on the totality of the job rather than just what is achieved
- provide a framework for salary progression where promotion opportunities are limited
- increase employee satisfaction through the provision of development opportunities
- provide a link between reward strategy and overall corporate objectives.

These are indeed *potential* advantages of competency-based pay. What we lack is concrete evidence that introducing this form of remuneration will improve organisational performance. Of course, this is a tough requirement. It is hard to find true cause and effect. Even when performance has improved through greater productivity or better quality it is difficult to attribute the gain to one single HR initiative. It is more likely to be associated with a bundle of initiatives. Competency-based pay does have the

advantage of linking selection, performance appraisal and development. In that sense it is an integrative approach. But how much more effective is competency-based pay than individual performance-related pay in getting employees to work harder and smarter? Is team-based pay a better means of generating co-operative behaviour than rating staff on their teamwork competency and rewarding on the basis of the rating?

We do not know the answers to these questions because, unfortunately, practitioners tend to merge the answers to the questions of why introduce a scheme, what benefits does it offer and how effective is it. This is because we tend to hear more about success than failure, more about the honeymoon than the divorce!

Potential problems and pitfalls

Despite the potential advantages highlighted above, only a minority of organisations have introduced competency-based pay. So, although managers surveyed by Holbeche and Glynn (1999) were broadly supportive of the use of competency frameworks, many were opposed to their use in reward systems. The survey conducted by *Competency & Emotional Intelligence Quarterly* in May 1999 indicated that there was a range of reasons for employers choosing not to link pay to competencies. These included:

- the likely impact of competency-based pay on other competency initiatives (26 per cent);
- fears concerning employees' reactions (21 per cent), and
- doubts in general about linking competencies to pay (21 per cent).

Adams (1998b) has reported how, after introducing competency-based pay, ICL discovered that the new system emphasised pay at the expense of development and that in reality the system had few differences from a traditional grading system. Therefore, despite having been one of the first companies to introduce competency-based pay, ICL was now re-thinking the whole basis for their involvement with competency-based pay.

Concerns regarding employee reactions to such schemes are also perhaps not surprising. An Industrial Society report indicated that the involvement and support of employees was key to the success of introducing competency-based pay schemes (Industrial Society, 1998). The main factor determining successful introduction of the pay scheme at Registers of Scotland would appear to be the emphasis on support and communication during the implementation phase (Adams 1999b).

Some of the potential problems with competency-based pay systems include the following:

- They can be time-consuming and expensive to implement. The 2000/20001 *Competency and Emotional Intelligence Benchmarking Survey* found that the time, cost and resources involved were the main problems with the use of competencies in general.
- The objective measurement of competencies is difficult to achieve. Paul Sparrow (1996) has said that managers find it difficult to make complex assessment across a range of competencies. In the survey cited above, 59 per cent of employers had experienced difficulties with assessing competencies. According to James Kochanski and Howard Risher, reported by Suff, 'the assessment of results or in the case of competency-based pay, competencies, is often where otherwise well-defined systems break down'. Suff suggests that a focus on the evidence of what the individual has achieved and how this was done is central to effective competency assessment.
- If competency is linked with other means of determining reward, the link with pay may be unclear, which will reduce any motivational impact of competency-based pay. This is because they may be a poor line of sight between appraisal and reward due to multiplicity of assessment items.
- If not properly controlled, there is a risk of pay drift without performance improvement. This may happen where there is a through progression or 'soft' grading approaching.
- Competency-based pay systems make considerable demands on line managers, who require considerable training and support.
- One of the objectives of competency-based pay schemes can be to promote enthusiasm for training and development in order to acquire the additional competencies that bring with them the opportunity of increased pay. However, if not properly controlled this can lead to additional, unplanned, resource burdens on the organisation. Alternatively, the emphasis is too much on the pay outcome with development given lower priority than messages on reward.

Adams (1998a) reports how the introduction of a competency-based performance management system in a housing association led to greatly increased demand for training and development to assist individuals to move along newly-introduced salary bands (the salary bands being determined by levels of competency). The demand was so great that the housing association had to set up its own training and development unit in order to meet it.

- There is research evidence that raters become more lenient as time goes on. There is a risk of manipulation in appraisal scores that suits both appraiser and appraisee.
- There is a risk of gender and ethnic bias. For example, research conducted by IES for the Equal Opportunities Commission found that gender-role stereotyping is reinforced in the way

that competencies, such as those for managers, are defined. The result is that women are consistently rated lower than men in terms of leadership ability. In addition, the process of competency-based assessment and so the awarding of a pay increase is highly reliant on the role of the line manager and so is open to distortion by their individual views. Staff in many organisations, but particularly in the public sector, are concerned about inconsistent scoring.

These factors make it particularly important for organisations to monitor the impact of their competency-based pay systems by gender and ethnicity. As Adams (1996) has pointed out, without such monitoring organisations run the risk of:

- treating individuals unfairly
- wasting the talents of individuals and groups in the organisation, and
- exposing themselves to legal action including equal pay for work of equal value claims.

Conclusion

Competency-based pay is a term used to refer to a wide range of different pay arrangements, some of which are effectively skills-based pay and others that are individual performance-related pay by another name. In this paper, the focus has been on systems that link individual reward to the demonstrated use of competencies, either as the main source of pay progression, or, more commonly, combined with other forms of pay determination. In many cases, the arrangements defined by the organisations that use them as competency-based pay fall within the definition of contribution-related pay developed by Brown and Armstrong (1999), in that they reward both the way the job is done and the outputs of that behaviour.

Despite the popularity of linking individual competencies with, for example, recruitment and selection and training and development, only a minority of organisations have passed the 'final frontier' (Adams, 1999a) of linking competency and reward. Even fewer have done this in a pure form, *ie* without taking into consideration performance against, for example, work objectives. This may in part be because commentators associate the effective use of competency-based pay with particular organisational developments, including the move to flatter structures and the introduction of broad-banded pay arrangements.

Aegon UK's pay system has a competency link, but also performance against objectives is recognised.

Their system has three performance zones:

- Learning (c.75% to 90% of target rate)
- Competent (c.90% to 110% of target rate)
- Advanced (c.110% plus of target rate)

Pay progression is based on: the individual's competency zone; their personal and competency development; and their salary position relative to their target rate for the job based on market considerations.

In addition, Aegon UK has an incentive scheme based on performance against objectives, using a balanced business scorecard.

In addition, employers may be wary of the potential pitfalls of competency-based pay, which include escalating costs, heavy demands on management time, problems of assessment, employee resistance and equal opportunities considerations.

Nonetheless, competency-based pay has been found by some organisations to bring substantial benefits in changing organisational culture and in supporting broader HR strategies.

Competency-based pay may therefore be suitable in organisations where:

- there is an over-emphasis on outputs
- how you do the job is as important as the results
- alignment is sought with other HR processes through competencies
- fit with a performance appraisal is required
- a new values system has been introduced
- cultural change towards greater flexibility is sought.

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