



## When competency-based pay relates to creative performance: The moderating role of employee psychological need

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### ABSTRACT

Although competency advocates argue that competency-based pay (CBP) can facilitate the implementation of business strategies and improve organizational performance, few empirical studies on the effectiveness of CBP have been conducted in the workplace. This study examines employees' perceptions of CBP and their creative performance, along with the moderating role of psychological needs in this relationship. A survey design with a sample of 219 Hong Kong Chinese employees from the hotel and service sectors was adopted. The results support that employee creativity is predicted by both CBP (reward for knowledge and reward for skill) and individual characteristics (need for achievement, need for power). In addition, need for power moderates the relationship between CBP (reward for knowledge and reward for skill) and employee creativity. The implications of the findings and directions for future research are discussed.

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Creativity has become a critical success factor for organizations in today's rapidly changing business environment (Amabile et al., 1996; Ford and Gioia, 2000; George, 2007; Woodman et al., 1993). Managers increasingly focus their attention and resources on enhancing employee creativity as they strive to build organizations capable of responding to dynamic competitive conditions in an effective and innovative manner (Amabile et al., 1996; Scott and Bruce, 1994; Shalley et al., 2009). Both research (e.g., Amabile et al., 1996; George, 2007; Shalley et al., 2004) and business practitioners (e.g., Kuhn, 2009; Nitin et al., 2008) frequently highlight the use of competency compensation systems to foster higher levels of problem solving and employee creativity. Competency advocates (Lawler, 1994; Zhou and Shalley, 2003) have argued that CBP can facilitate the implementation of business strategies and help build high-level creative performance organizations. Despite the widespread support of competency-based pay (CBP) systems to evaluate, reward, and promote employees (Kochanski and Risher, 1999; Lawler and McDermott, 2003), empirical evidence on the effectiveness of CBP is limited (e.g., Zhou and Shalley, 2003). Therefore, whether CBP can facilitate employee competence and enhance creativity in the workplace remains an open question. The current study aimed to respond to this question by examining the relationship between employee competencies and creativity in the hotel and service sectors.

According to the interactional theory (Amabile et al., 1996; Oldham and Cummings, 1996; Terborg, 1981), organization and situational factors are contingent on individual characteristics that influence creative performance. One of the practical applications of this basic tenet is CBP schemes in which pay levels are structured according to the competencies employees possess or demonstrate (Shalley et al., 2004; Zhou and Shalley, 2003). Under such systems, pay is contingent on an individual's psychological need to perform and not simply on the specific position occupied. Interest in CBP is growing in the workplace because organizations are increasingly seeking to develop the core competencies required to implement strategic human resource plans (Dierdorff and Surface, 2008; Lawler, 1994; Levenson et al., 2006). The increasing need for capable workers and the pressure to be more flexible and responsive to meet customers' needs have also made job tasks in the hospitality industry more dynamic. These developments indicate that introducing compensation systems that align employee competencies with remuneration will inevitably be a key factor contributing to the achievement of the strategic goal of maintaining long-term organizational success and effectiveness.

The current research, which is grounded on interactional theory, suggests that employee creativity is influenced by both personal and situational factors as well as the joint effects of such factors. This paper investigates two individual needs – the need for achievement and power – that may help to ensure that the CBP system actualizes employee competencies (Hon and Rensvold, 2006) and results in high levels of creative performance. The findings of this study support the belief in the hospitality industry that employee creativity is a complex product of personal attributes and situa-

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tional effects (Hon and Rensvold, 2006; Oldham and Cummings, 1996). Thus, one objective of this paper is to shed light on the separate and joint effects of CBP and individual characteristics in facilitating employee creativity.

Moreover, in the interests of broadening management theory in the hotel service industry (Hon and Lu, 2010) so that it has global (rather than only U.S.-based) relevance and contributes to the effective management of nationally diverse workforces, it is important to understand how CBP influences employee creativity in areas outside the United States, such as Hong Kong. Research in a new cultural setting can help to assess the generalizability of interactional and creativity theories developed in Western settings (Kim et al., 2009; Niu and Sternberg, 2002). In addition, many multinational companies such as those operating in the service sector are now relocating “knowledge-creating” jobs to East Asia (Chen et al., 2005; Farmer et al., 2003). Thus, another goal of the present study is the cross-validation of the linkage between CBP and employee creativity in an Asian setting. The following sections review how the dimensions of CBP and employees’ psychological needs affect creative performance. After this, the interaction effects of the two individual needs on the linkage between CBP and employee creativity are discussed.

## 1. Theory and hypothesis development

Researchers have studied employee creativity in recent decades because it offers the potential for more positive outcomes that benefit both individuals and organizations (Amabile et al., 1996; Ford and Gioia, 2000; George, 2007; Woodman et al., 1993). *Creativity* refers to an individual’s production of new and useful ideas (George, 2007; Oldham and Cummings, 1996; Shalley et al., 2004). Individual creativity can be the starting point and is a prerequisite for organizational innovation (Amabile et al., 1996). Put simply, employee creativity involves the generation of ideas at the individual level, while innovation includes both the generation of ideas and their implementation at the organizational level.

From an interactional perspective, creativity is the functional framework through which people interact with the environment (Oldham and Cummings, 1996; Shalley et al., 2004; Zhou and Shalley, 2003). The framework adopted for this study is based on the argument that employee creativity is a function of the employee’s psychological needs (the need for achievement and the need for power) and his or her perceptions of the work context (CBP system). The argument that personal and situational characteristics interact with one another essentially involves an assertion that certain contexts “match” individuals’ personal needs and that this match results in high levels of employee creativity. Thus, employees experience situational factors (e.g., CBP) that act as cues activating desirable outcomes such as creative performance. The theoretical model proposed here is shown in Fig. 1 and hypotheses are elaborated in the following section.

### 1.1. Competency-based pay (CBP): reward for knowledge and reward for skill

A compensation system that emphasizes individual competence is arguably the most significant human resource management scheme an organization can implement to encourage employee creativity (Eisenberger and Selbst, 1994; Hon and Rensvold, 2006; Zhou and Shalley, 2003). *Competency* can be defined as “the skills, knowledge, and behaviors that need to be applied for effective performance” (Brown and Armstrong, 1997, p. 37). These components of competency are important for enhancing personal contributions and for helping the organization to succeed. Competency advocates (Armstrong and Murlis, 1998; Berman, 1997) believe that indi-

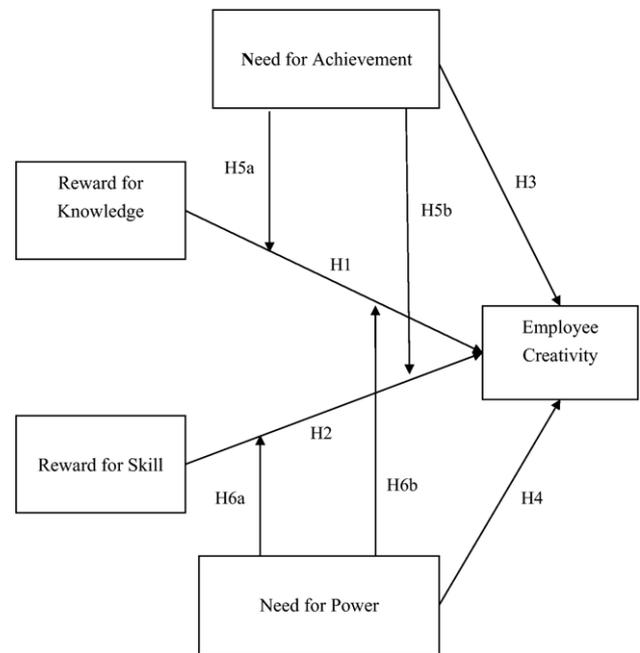


Fig. 1. A theoretical model of perceived CBP, individual needs, and employee creativity.

vidual skills and behaviors can be inferred from job tasks, while knowledge is acquired through education and work experience. In other words, personal competence is demonstrated when an individual has the necessary knowledge and skills to perform a task, and an individual’s skills and knowledge to perform such tasks are demonstrated by patterns of behavior. Given that competence represents performance in the workplace, it can be seen as a behavioral outcome that excellent performers exhibit more consistently and effectively than average performers (Eisenberger and Rhoades, 2001; Kochanski, 1997). Thus, CBP is one tool through which organizations can deliver the message to employees that their knowledge, skills, and consistent behavior are highly valued (Lawler, 1994). On the basis of these arguments, two aspects of CBP were developed in this study: reward for knowledge and reward for skill.

Knowledge is mainly acquired through education and work experience that enables individuals to apply their theoretical knowledge to practical job tasks; this kind of knowledge is referred to as tacit knowledge (Sternberg and Wagner, 1991). Human capital research has shown that learning and education increases employee knowledge experience and future earning potential (Lawler and McDermott, 2003). Researchers have also argued that individual creativity is a function of knowledge acquisition and motivation (Lawler, 1994). For example, in a complex job environment in which job tasks demand a high-level of involvement and creativity, a person can solve difficult problems by using personal knowledge, intelligence, and experience; in such cases, knowledge is more important in predicting superior performance (Gupta et al., 1986). More specifically, in a competence-oriented system that signals to employees that their knowledge and work experience are valued, people are likely to develop new ways of performing (Hon and Kim, 2007; Hon and Rensvold, 2006). Therefore, reward systems based on personal knowledge and experience can result in higher levels of creativity.

**H1.** CBP for knowledge is positively related to employee creativity.

An individual’s skill level may also help to facilitate creative performance. If an employee is competent at work, he or she is more likely to perform assigned tasks (Berman, 1997). Employees with

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