

## **COMPETENCY-BASED PAY AND SERVICE QUALITY: AN EMPIRICAL STUDY OF MALAYSIAN PUBLIC ORGANISATIONS**

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### **ABSTRACT**

*A higher number of complaints have been filed by the public due to delays by public sectors in taking action and providing services to the public. This suggests that service quality is not being delivered as expected by customers. With competency-based pay being offered in the public sector under the System Saraan Malaysia (SSM), which aims to produce capable workers who are responsive to customers' demands by providing quality services, one would expect that there would be an improvement in the general quality of the services rendered. Thus, this research aimed to investigate the relationship between the extent of competency-based pay practices and service quality. The findings suggest that there is a positive relationship between competency-based pay practices and service provision, one of the SERVQUAL dimensions found in this study. Thus, Malaysian public organisations should offer this type of pay as frequently as possible in order to motivate civil servants to provide quality services to the public.*

**Keywords:** pay, competency, service quality, public service, Malaysia

### **INTRODUCTION**

From 1999 to 2006, the Public Complaints Bureau (PCB) (<http://www.bpa.jpm.my/>) registered a high number of complaints filed by the public regarding delays in the actions taken and services provided by the employees of public organisations. Notably, three ministries – the Ministry of Home Affairs, the Ministry of Finance, and the Prime Minister's Department – and three states in Malaysia – Selangor, Johor and Perak – received the most complaints (PCB, 1999–2006). Newspaper headlines also highlighted complaints from the public regarding their dissatisfaction with the services provided (*New Straits Times & Berita Harian*, 2005–2007), suggesting that service quality is low and does not match customer expectations. This is a matter of dire concern for the public, who as taxpayers expect good services to be provided (Abdullah, 2004). Thus, it seems that Total Quality Management (TQM), client charters, and MS ISO 9000

as practiced in the public sector are not sufficient to ensure the provision of high-quality services to customers (Wan, 2004).

In Malaysia, competency-based pay systems are being implemented in the public sector under the Malaysian Remuneration System (*Sistem Saraan Malaysia, SSM*) (Putra & Hizatul, 2004). The SSM aims to produce capable workers who are responsive to environmental changes and customers' demands by providing quality services (PSDM, 2002). As the public sector is labour-intensive, with the new reform of human resource management practices and especially the introduction of competency-based pay, we expect that this new practice will enhance the quality of the services delivered by the public sector as public servants will be paid based on their competencies and this will surely ensure that quality public services will be delivered. However, even bearing in mind that all public organisations are practicing this method with no exception, it remains true that the extent to which the practice has been adopted still differs across different public organisations. Thus, we expect that there is a positive and significant relationship between the extent of competency-based pay practices and the level of service quality in Malaysian public organisations.

## **LITERATURE REVIEW**

### **Competency-Based Pay**

Competency is the brainchild of McClelland (1973), who posits that vocational success is not a function of education or grades (that is, intelligence) but rather that it is a result of one's competencies. In HRM, the concept of competency provides a common language used to integrate practices so as to reach organisation-wide objectives, i.e., to maximise human performance and eventually the organisation's performance (Wood & Payne, 1998).

One competency-based human resource practice is competency-based pay. Competency-based pay is a method that determines the amount an individual is paid based on competency or performance (PSDM, 2004). As such, it is an alternative method of payment that rewards employees for their skills, behaviour and attitudes in performing their job roles (Jahja & Kleiner, 1997). Competency-based pay is essential to compensating a highly skilled, competent and professional workforce. It aims to provide an incentive for employees to grow and enhance their capabilities (Risher, 2000). It was initially proposed as being more advantageous than conventional pay.

This was due to some weaknesses that are inherent in the conventional pay system. For instance, conventional pay is based on past individual assessments

and only given to some number of employees (via a quota). Therefore, it is inflexible and unresponsive to changing organisational needs. Furthermore, it downplays or ignores the future effectiveness of individuals. The conventional pay system also does not adequately reflect differences in professional growth and contribution. Moreover, different task performance is not a credible means of evaluating individual values. In fact, it rewards seniority, qualifications and past performance. In short, it focuses more on jobs, i.e., completed tasks or fulfilled roles, or what the job-holders possesses, instead of emphasising the individual's capabilities and future development (Armstrong & Brown, 1998; Risher, 2000; Zingheim & Schuster, 2003).

On the other hand, competency-based pay focuses on individuals, considering their skills and knowledge rather than their jobs or qualifications (Ledford, 1995; Risher, 2000). In short, it rewards what employees are able to do – their capabilities and how well they demonstrate these competencies. It also rewards the work process by considering how results are achieved and not just the results themselves (Heneman & Ledford, 1998). Furthermore, it pays for the individual's development, placing emphasis on his/her potential performance or capabilities and their potential effect on future successes, rather than just rewarding past results. Thus, salary decisions are no longer based on defined job duties or relative job value (Risher, 2000).

There are different salary schemes for competency levels, ranging from entry-level and standard to advanced and top (Risher, 2000). As a set of defined competencies for each career level increases, the base pay level increases irrespective of the person's work requirements. The level of the pay increase depends on the level of progress toward the desired level of competency for the job. Therefore, a high increase in pay will be given to individuals who demonstrate new or enhanced competencies (Risher, 2000; Zingheim & Schuster, 2003).

In order to implement competency-based pay, a few conditions have to be fulfilled. Firstly, competency criteria used should be well researched, designed, tested and understood (Armstrong & Brown, 1998). They also must be demonstrable as the basis of pay. Such a demonstration may be effected by rating the competencies demonstrated (in the form of behaviour or actions taken or tasks completed) as desired by the organisation on a given scale. Furthermore, other practices such as performance management (Heneman & Ledford, 1998) and career development should be implemented first, to effectively address issues concerning this type of pay (Zingheim & Schuster, 2003). It also must be carefully matched with the goals, culture and political realities of the organisation (Heneman & Ledford, 1998).

There are many advantages of competency-based pay compared to the traditional pay. First and foremost, incompetent and inexperienced employees are made aware of exactly what they need to do to get ahead, as they already know which competencies are rewarded. Therefore, employees are completely responsible for their personal development and preparation for career development. This is so because the focus has shifted from last year's performance to individuals' prospects and career advancement (Zingheim & Schuster, 2003, Risher, 2000). Consequently, the method eliminates the sense of entitlement to incremental salary increases that traditional pay usually features. It also ties workers more closely to the achievement of company goals. Therefore, the relationship between pay and performance is stronger, as the relationship between employee behaviour and performance is better defined (Cira & Benjamin, 1998).

### **Service Quality**

Complaints are the measure or indicator of service quality (Kouzman, Loffler & Klages & Nada, 1999). They also provide information regarding service quality performance (Black, Briggs & Keogh et al., 2001). According to Ray, Barney and Muhanna (2004), the customer complaint ratio correlates with the service quality measure that is provided by the SERVQUAL instrument developed by Parasuraman, Zeithmal and Berry (1988).

Thus, service quality is a proxy for organisational performance. It is a subjective performance indicator, whereby customers evaluate the outcome of service delivery (Brady & Cronin, 2001). Service quality is an outcome variable that is regularly related to the effectiveness of HRM in organisations (Schneider, 1994; Paauwe & Boselie, 2005). Quality is an important theme in HRM as the main objective of the organisations (Wright, McCormick, Sherman & McMahan, 1999), where the quality of services or products is seen as an important way to enhance organisational performance by attracting and retaining satisfied customers (Fang, 2001).

From the literature on service quality in the public sector, it is evident that the majority of studies (15 out of 31) have applied SERVQUAL in assessing the quality of services provided by public organisations (Ilhaamie, 2008). In contrast, only three studies have used SERVPERF (Arawati, Baker & Kandampully, 2007; Sanchez-Perez, Sanchez-Fernandez, Marin-Carrillo & Gazquez-Abad, 2007a; 2007b). Thus, SERVQUAL is the dominant instrument used in measuring service quality in the public sector.

Parasuraman, Zeithmal and Berry (1985) define service quality as the degree of differences between the normative expectations of customers regarding services and their perceptions regarding service performance (Parasuraman, Berry &

Zeithmal, 1991). SERVQUAL is comprised of five dimensions: tangible, reliability, responsiveness, assurance and empathy. Studies have shown SERVQUAL to be more accurate in identifying service shortfalls and deficiencies within an organisation, as compared to other instruments (Parasuraman et al., 1991).

### **Competency-Based Pay and Service Quality**

Until now, there has been no quantitative study done on competency-based pay and service quality as a measurement of organisational performance. There were three studies that investigated the relationship between conventional rewards and performance, wherein service quality was only one of the measurements of organisational performance in the private sector. Khatri (2000) and Tzafrir (2006) found that compensation based on performance has a significant and positive relationship with non-financial performance where service quality is one of the measures ( $\beta = .46, p < .01$ ); ( $\beta = .19, p < .05$ ). Meanwhile, incentives and pay were the most important determinants of performance in the service sector, such as among banks (Bartel, 2004). However, there was only one study that examined the relationship between conventional compensation and service quality. Tsaor and Lin (2004) found a significant and positive relationship between compensation practices and responsiveness ( $\beta = .31, p < .5$ ), assurance ( $\beta = .32, p < .5$ ) and empathy ( $\beta = .48, p < .01$ ) as dimensions of service quality.

At the same time, there has been only one study that has investigated the relationship between competencies and service quality in public service. Suhaila (2005) studied the relationship between employees' competencies and perceived service quality in a local authority in Malaysia, and found that interpersonal skills explained 46% of variance in perceived service quality. These data show that employees have used their interpersonal skills in terms of maintaining confidentiality, tactfulness, compassion and sensitivity in dealing with customers, all of which have constituted efforts to achieving high-quality service. Meanwhile, there was one study that found that the perceptions of providers have some implications for their competencies in providing quality services to the public, whereby they are to be given more training (either formal or informal). Furthermore, career-planning activities in their organisations have to be re-examined in order to provide their customers with higher satisfaction and motivation to deliver quality services to those customers (Rosli & Rosli, 2004).

However, there was also only one study that tried to investigate the relationship between competency-based pay and performance. Chris (1996) used a case study to determine that when competencies have been integrated into human resource practices such as recruitment and selection, training and, compensation and performance management, significant growth in terms of product distribution and

profitability have been achieved by the three divisions of Holiday Inn Worldwide in America, Europe/the Middle East/Africa and Asia-Pacific. Furthermore, strong hotel occupancy levels are reported along with lower-than-average labour turnover rates.

Thus, there is no study that has tried to examine the relationship between competency-based pay and service quality as a measurement of organisational performance; the gap in the span of the past studies is the impetus of this research.

## **THEORETICAL FRAMEWORK**

As explained and discussed in the first two sections above, there is certainly no study that has investigated the relationship between the extent of competency-based pay practices and service quality as a measurement of organisational performance. Service quality is an important dimension of organisational performance in the public sector, as the main output of public organisations is services (Hope, 2003). Making the maximum profit is not the ultimate goal of these public organisations (Harel & Tzafir, 2001), as they have to play many different roles, such as that of facilitator, pace-setter and socio-economical developer (Arawati et al., 2007).

The theory that underpins the concept of the relationship between the extent of competency-based pay methods and service quality is the resource-based view (RBV) of a firm, which asserts that the competencies of firm employees are the intangible resources of an organisation and that competency-based HRM practices, especially competency-based pay, are responsible for leveraging and managing these competencies and ensuring that the organisation can obtain competitive advantage, especially in terms of service quality. Different public organisations emphasise different competencies; hence, employees who are competent and at the same time possess the competencies needed by each organisation are the valuable and rare resources. Thus, they cannot be imitated and substituted for, and this promises that sustainable competitive advantage is achievable (Barney, 1991).

On the other hand, traditional resources that are linked to markets, financial capital and economies of scales have been weakened by globalisation and environmental changes (Youndt, Snell, Dean & Lepak, 1996). Furthermore, they are easy to imitate as compared to an employment system with a complex social structure. Therefore, organisations that possess competent workers are the organisations that have complex social structures, which are difficult for competitors to understand and imitate (Collins & Clark, 2003). Hence,

sustainable competitive advantage is developed, especially in term of service quality, as the promise of these intangible assets. Therefore, we hypothesised that:

H<sub>1</sub>: The extent of competency-based pay is positively and significantly related to service quality.

## METHODOLOGY

This study was carried out by examining Malaysian public organisations that provide a diverse range of services to customers as part of their responsibilities as regulators (Bryslan & Curry, 2001). The population of the study is composed of the public organisations that provide services to external customers, including the Department of Registration, Immigration, et cetera. Based on the listing made by the Public Services Department of Malaysia (PDSM), we identified 444 public organisations throughout Malaysia that serve external customers. Thus, the unit of analysis is at the level of the organisation.

A mail survey was employed using a simple random sampling technique in order to ensure that each public organisation located in Malaysia had an equal chance of being selected as a respondent. Two sets of questionnaire were distributed to the human resource managers or top public officers in charge of human resources for 300 public organisations throughout Malaysia (questionnaire A) and their respective external customers (10 for each public organisation selected, Tsaur & Lin, 2004) (questionnaire B). This amounted to 300 copies of questionnaire A and 3,000 copies of questionnaire B (Table 1).

Table 1  
Total number of questionnaires distributed

Questionnaire	Set A	Set B
Respondents	Human Resource Managers or top public officers in charge of human resources	External customers
Number of questionnaires	300	300 × 10 customers = 3,000

Service quality was measured using the SERVQUAL instrument (Parasuraman et al., 1991), which contained 22 items regarding each expectation and perception in a two-column format, where six items on competency-based pay were developed from the PSDM manual (2004). Service quality is measured using the formula (Perception minus Expectation, Parasuraman et al., 1991). Therefore, if perceptions exceed expectations, service quality is understood to be very satisfactory. If perceptions equal expectations, service quality is seen as

satisfactory. However, if expectations exceed perceptions, service quality must be poor.

## FINDINGS

A total of 140 responses were obtained, yielding a response rate of 46.67%. The majority of the respondents were (27.10%) local authorities, followed by (23.60%) federal departments and (22.90%) land and district offices. The majority of respondents (18.60%) were located in Kuala Lumpur.

Table 2 exhibits the profiles of the respondents. The majority of respondents were Malay males. As for the public servants who completed the first set of questionnaires of this study, or set A, the majority of them (49.3%) were in between 46 and 55 years old and 68.6% possessed bachelors degrees. As for the customers, the majority of them (32.10%) were in between 26 and 35 years old, and 37.80% were SPM holders and others.

Table 2  
*Respondents' profile*

	Total		Percentage	
	Set A	Set B	Set A	Set B
<b>Position</b>				
HR Director/Deputy Director	25		17.80	
HR Manager/Assistant Manager	22		15.70	
Head/Assistant Administration Officer	21		15.00	
Diplomatic Administrative Officer	22		15.70	
Executive Officer	23		16.40	
Others	25		17.90	
Customers (Set B)		992		100
<b>Gender</b>				
Male	101	538	72.10	54.20
Female	39	436	27.90	44.00
<b>Age</b>				
Below 25 years	0	242	0	24.40
26 to 35 years	44	318	31.40	32.10
36 to 45 years	27	223	19.30	22.50
46 to 55 years	69	167	49.30	16.80
56 years and above	0	28	0	2.80
<b>Race</b>				
Malay	130	843	92.90	85.0
Chinese	4	86	2.90	8.70
Indian	4	33	2.90	3.30
Other	2	16	1.40	1.60
<b>Education</b>				
Diploma	16	293	11.41	29.50
Degree	96	244	68.60	24.60
Masters Degree	22	48	15.70	4.80
PhD	1	5	0.70	0.50
Others	5	375	3.60	37.80



The data obtained from the two sets of questionnaire were subjected to factor analysis in order to validate the instruments. Principle Component Factor Analysis was employed to summarise a large number of original variables and to isolate a small number of factors for prediction purposes in the subsequent multivariate analysis. Furthermore, the Varimax Rotation technique was used to obtain simpler and more interpretable factor solutions. The minimum cross loading used is .17 (Costello & Osborne, 2005), employed to identify items with high loadings for more than one factor for each item. After seven items were dropped, three factors of the service quality construct were extracted from the factor analysis on the basis of their having an eigenvalue more than 1 in order to ensure that the factor loadings would be significant (Hair, Anderson, Tatham, & Black, 1998; Hair, Black, Babin, Anderson, & Tatham, 2006). These factors can be labelled as service provision, tangible and empathy (Table 3), whereby the factor loading coefficients vary from .74 to .83, .72 to .91 and .68 to .91, respectively. Service provision is the combination of the three SERVQUAL dimensions, which are reliability, responsiveness and assurance. Sharifah (2001) identifies the same combinations found in this study. However, she did not rename the combinations of these three SERVQUAL dimensions.

Table 3  
*Factor analysis results on service quality construct*

<b>Items</b>	<b>Factor 1</b>	<b>Factor 2</b>	<b>Factor 3</b>
Employees provide prompt service to customers.	<b>.83</b>	.27	.23
Employees are always willing to help customers.	<b>.83</b>	.26	.30
Employees are consistently courteous with customers.	<b>.80</b>	.24	.24
Employees' behaviour instils confidence in customers.	<b>.79</b>	.20	.34
Show a sincere interest in solving customers' problem.	<b>.79</b>	.34	.15
Provide services at the time when they have promised they will do so.	<b>.78</b>	.25	.25
Do things by a certain time as promised.	<b>.75</b>	.39	.16
Employees tell customers exactly when services will be performed.	<b>.75</b>	.24	.18
Customers feel safe in their transactions.	<b>.74</b>	.23	.39
The equipment is up-to-date.	.17	<b>.91</b>	.16
The physical facilities are visually appealing.	.50	<b>.76</b>	.13

*(continued on next page)*

Table 3 (continued)

<b>Items</b>	<b>Factor 1</b>	<b>Factor 2</b>	<b>Factor 3</b>
Materials associated with the service (such as pamphlets or statements) are visually appealing.	.42	<b>.72</b>	.21
Employees give customers personal attention.	.15	.04	<b>.91</b>
Give customers individual attention.	.49	.26	<b>.69</b>
The operating hours are convenient for their customers.	.39	.35	<b>.68</b>
Eigen values	6.41	2.79	2.46
Percentage of Variance	42.74	18.62	16.42
Bartlett	0.00***		
KMO	0.95		

*Note:* Factor 1: Service Provision, Factor 2: Tangible, Factor 3: Empathy

On the other hand, two items have been dropped from the factor analysis of competency-based pay, thus limiting it to four items (Table 4). The coefficients of the factor loadings vary from .80 to .86.

Table 4  
*Factor analysis results regarding competency-based pay*

<b>Items</b>	<b>Factor 1</b>
Determine pay based on employees' job behaviours required to accomplish specific job tasks.	<b>.86</b>
Determine pay based on the current level of individuals' competence.	<b>.84</b>
Pay top performer more than average performer.	<b>.82</b>
Pay for competency in the form of potential to deliver in the future.	<b>.80</b>
Eigen value	3.22
Percentage of variance	16.10
Bartlett	0.00***
KMO	.90

*Note:* Factor 1: Competency-based pay

Table 5 features the reliability coefficients of the main variables of the study. All four variables are above .70 (Hair et al., 1998, 2006), and this shows that the reliability among the items is consistent. Consequently, the validity and reliability of the instruments, as provided by the factor analysis and reliability test, serve as good foundations for further hypothesis testing.

Table 5  
Reliability coefficients of the main variables

Variable	Number of Items	Cronbach alpha( $\alpha$ )
Competency-based pay	4	.89
Service provision	9	.96
Tangible	3	.87
Empathy	3	.84

Table 6 shows that competency-based pay is being practiced to a moderate extent. However, service quality is low and is not satisfactory, as it is negative. The satisfaction score of less than  $-1$  shows that the Malaysian public is being realistic in its evaluation of the service quality of Malaysian public organisations (Curry & Sinclair, 2002). Nevertheless, this indicates that public organisations should take action to solve this problem.

Table 6  
Mean and standard deviation of the main variables

Variable	Mean	Std. Deviation	Maximum	Minimum
Competency-based pay	4.06	1.58	7.00	1.00
Service provision	-0.54	0.54	0.63	-2.52
Tangible	-0.63	0.64	0.60	-3.22
Empathy	-0.37	0.51	0.88	-2.89

Note: Likert scale 7 (1 = To no extent at all/Totally disagree; 7 = Practiced to a full extent/Strongly disagree)

Table 7 shows the results of the multiple regression analysis regarding the relationship between the extent of competency-based pay practices and service quality.

Table 7  
Multiple regression analysis results regarding the relationship between the extent of competency-based pay practices and service quality

	Service provision (N = 128)	Tangible (N = 125)	Empathy (N = 135)
Competency-based pay	.20**	-.36***	.06
F	2.83**	3.33**	2.83**
R <sup>2</sup>	.10	.12	.10
Adjusted R <sup>2</sup>	.07	.09	.06
Durbin Watson	1.85	2.04	1.95

Note: \*significant at .1 level, \*\* significant at .05 level, \*\*\* significant at .01 level

Thus, there is a positive and significant relationship between the extent of competency-based pay and service provision ( $\beta = .20, p < .05$ ). However, there is a negative and significant relationship between the extent of competency-based pay and tangible ( $\beta = -.36, p < .01$ ). Furthermore, there is no relationship at all between the extent of competency-based pay and empathy. These results are in line with Tsaur and Lin's findings from 2004, with the exception of the empathy dimension. However, they did not find a relationship between conventional compensation and reliability, which is an element of service provision and a service quality dimension identified in this study.

## **DISCUSSION**

The results of the surveys show that the extent of competency-based pay is positively and significantly related to positive attributes of services provided to customers, especially in terms of reliability, promptness and assurance, and but that it is not related to the tangible or the empathy-related aspects of services. This suggests that the Malaysian public puts a premium on actual service provision (reliability, responsiveness and assurances) rather than on the tangible elements like furniture and facilities and the empathy-related aspects and appearance of employees (Smith, 2000). The non-relationships could be caused by the fact that public servants are paid based on their competencies and their potential to perform in the future rather than based on their appearance. Furthermore, not all of them work directly with the public at the service counters (Ilhaamie, 2008). Thus, tangible elements and empathy are not important factors in terms of the extent of competency-based pay and its effects as found in this study.

If we know that it is the psychological aspect (service provision) rather than the physical aspect (the tangible) that matters to the public, the implication for public organisations is that they should use competency-based pay to the highest extent possible to reward public servants. Rewards should no longer be based on past success or results but should instead consider public servants' potential to perform in the future and their current level of competencies related to the fulfilment of specific job tasks. This will motivate employees to work harder and to perform well, especially in delivering quality services to customers. In doing so, they may also improve the perceptions of the general public regarding the responsiveness and efficacy of service provision by public organisations. In addition, competent employees should also be duly recognised on public notice boards within the departments or as employees of the month. This is because public acknowledgements are also considered intrinsic rewards.

## CONCLUSION

The extent to which the competency-based pay method is being practiced in Malaysian public organisations is moderate. However, this study found that the extent of competency-based pay is positively related to service provision, a combined dimension of SERVQUAL. Thus, this study justifies the public reform of competency-based pay as achieving its objective in terms of providing high-quality service to the public.

It has been observed that many public organisations have gone to great lengths to upgrade and renovate their physical appearance, and that such efforts have no positive and significant relationship to the extent of competency-based pay as found in this study, due to the moderate extent of competency-based pay practices. Thus, similar investments should also be made to enhance and reward the competencies associated with firms' human capital to the highest extent possible by using the competency-based pay scheme that is currently in practice. In this way, quality services will be consistently provided to the public and this will assure customer satisfaction and loyalty to the government.

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