CMC Compensation Group

Do You <u>Really</u> Pay For Performance?

To answer this question most companies would say that, yes - they have a pay-for-performance (PFP) program. Such a statement is chic, politically correct and offers a wonderful message about how the company values its employees. What's to argue with? Paying employees on the basis of what they have contributed to the company makes sense, right? If they give more they receive more, right?

On the other hand, to answer that question in the negative is to suggest that you are not fair to your employees, that your idea of proper reward is to bypass individual performance in favor of treating everyone the same, regardless of contribution. However, as that acknowledgement would paint you as an insensitive employer, it's likely you'll fall in line and say "YES, of course we pay our employees for their performance."

But do they? Do you?

There is a tendency by many in management to believe that the granting of variable pay increases automatically means that their company provides pay for performance. However, if as is usually the case practically everyone receives some form of pay increase, is there really a distinction being made between high performers and those who merely occupied a chair for the past 12 months? Isn't such a practice (if we haven't fired you, then you'll get an increase) more like a modified attendance award?

The decision to adopt pay for performance strategy should include two critical elements:

- The decision <u>not</u> to pay if the employee hasn't performed
- The decision to make it worthwhile for an employee to be a high performer

One of the common pay practices that continue to hamper the effectiveness of PFP plans for base salary increases is the misuse of the annual merit pay pool through inflated performance evaluations and automatic increases. This practice will increase your costs, and in a manner that will not effectively reward employee performance.

Making PFP work for your company will require hard decisions from line managers who are otherwise accustomed to maintaining employee morale through the avoidance of objective performance reviews. We have seen that, while there is a shift to rewarding individual effort, more monies are not being provided as a result of that shift. So in order to more effectively use available salary increase dollars companies need to reward their high performers with money effectively taken away from (not granted to) those performing at lower levels.

This may also mean that average performers, the bulwark of so many companies, will receive less than they might otherwise expect (which is at least an average raise). What it comes down to is a company's ability to afford proper rewards for higher achieving employees (motivating and retaining them in the process) by reducing or eliminating rewards to those deemed as underperforming.

The risk exposure is that if managers, through the utilization of performance management programs, do not properly identify and restrict awards for non-deserving employees, the PFP budget will not have enough funds to afford appropriate rewards for high performers. So you should ask yourself, who is it you would rather disappoint? Who has less impact on your business and whose loss will be less disruptive to your operations?

While published reports clearly indicate a trend away from one-size-fits-all reward systems, one should look below the surface to learn whether employee performance is being appropriately measured and rewarded.

To effectively use a pay-for-performance system a company should:

- Educate employees as to *what* performance will be rewarded. This requires measurements, and that performance objectives align vertically in the organization (employee goals relate to supervision, whose own goals relate to management, and on upward to corporate goals);
- Provide a well-defined rating scale that helps managers distinguish between levels of performance
- Provide a clear distinction of reward between those who have delivered and those who have not. An employee who does not see a relative gain from working hard all year is a lot less likely to repeat their performance the following year.

So the next time you are asked whether your company rewards employees for their performance, perhaps your answer might not differ, but now you recognize the distinction being made by your employees. It is up to you whether to be satisfied with your answer.