The New Era of Pay for Performance: 6 Keys to Success

A Peoplefluent White Paper
The idea of compensating employees based on their performance, whether that is for number of sales made, items produced or customers served, is nothing new. While pay for performance programs were once cutting edge and considered a key differentiator in attracting top talent, they have since become commonplace, with the vast majority of employers having some degree of a pay for performance culture. However, the existence of a pay for performance program is simply no longer enough to encourage top talent to apply or keep high potentials engaged, and many employers find their programs unable to encourage or motivate employees to perform at their best.

The main problem with current programs is that they are focused mainly on the company itself – a one-size-fits-all approach. The organization typically sets certain goals, regarding such things as sales growth, profits or launch dates, and rewards employees when these objectives have been met. However, such a rigid, automated approach, in which individuals are compensated based on their ability to meet established corporate objectives, rather than focusing on individual performance goals that can truly spur motivation and encourage employees to work at their full potential, tends to yield underwhelming results. That is why most programs fail to make employees feel included and involved, and often neglect to inform employees on what they can do on an individual basis to help the company improve its performance.

To make pay for performance programs more relevant and effective, organizations need to rethink their programs and determine how they can become a differentiator once again via individual performance outcomes. Successful companies understand that in order for the program to thrive, in terms of motivating and engaging employees while attracting external talent to join the company, pay for performance needs to focus on employee goals and ensure they are in alignment with the organization’s business objectives. The program also needs to be dynamic and flexible to ensure it continually engages employees and keeps them motivated and working to improve their personal performance. Most importantly, it should facilitate conversations about employees’ individual performance and how it impacts the company, while bringing greater visibility and financial understanding to employee compensation and how salaries, bonuses, raises and promotions are determined.

Is Your Pay for Performance Program in Need of Improvement?

While the vast majority of organizations have a pay for performance culture to some degree, many of these programs are simplistic and fail to fully tie performance to compensation. Data from Peoplefluent’s extensive database of compensation records reveal key trends about how compensation relates to performance, showing significant room for improvement. Some highlights from this research include:

- Employers typically indicate the minimum and maximum salary guidelines for only about half of their positions. With no ranges set for the remaining half, it is difficult to incorporate performance in determining appropriate compensation.
- A review of more than 990,000 salaries showed that employees received an average salary increase of 2.52 percent per year. However, only about 150,000 of these salaries had both performance and compensation data qualified with maximum salary figures, meaning that most raises were determined without unbiased performance information to ensure salary increases were based on merit.
- Highlighting the objectivity often found in compensation programs, the data show that employees with middle performance ratings receive, on average, larger salary increases than their higher-performing colleagues.
The Shortcomings of Current Pay for Performance Systems

Having a pay for performance program that focuses mainly on company goals rather than individual objectives and motivations is bound to lead to several pitfalls. For instance, if an employee knows they will get a bonus for meeting an arbitrary sales number, like everyone on the sales team, what is to keep them motivated to exceed that goal? And, if the same standards are used throughout the department, less experienced employees may be frustrated thinking they will never achieve those goals. Indeed, reinventing the process to focus on individual growth and performance is the key. This enables employers to encourage their employees to work at their best through a fair process that recognizes their individual contributions while motivating others to improve their performance.

For pay for performance programs to be successful, they must drive employee performance and improve retention rates through a transparent process that everyone can understand, acknowledge and provide feedback on when appropriate. However, this is another area that most programs fail to recognize, because without a fair and visible program, organizations can struggle to retain their top performers. According to a study by the Corporate Executive Board on the top factors employees look for when seeking a new job, stability and compensation are the top two, emphasizing the importance of both to attract and retain talent.\(^1\) Meanwhile, research conducted by the Institute for Corporate Productivity (i4cp) identifies the top three reasons employers leave their current jobs as the opportunity to earn more money, a lack of promotion opportunities and because pay levels were perceived as unfair.\(^2\)

Given this insight, it becomes clear that employees are far more concerned with their own goals, career ambitions and compensation – and the level of fairness in which opportunities and compensation rates are determined – compared to the company’s ability to meet corporate objectives. Thus, to improve both on-the-job satisfaction and retention rates, the pay for performance program should ensure that all employees catered to before those of the company, as long as their individual performance goals are met.


The Need for a New, Rewarding Approach

As simply having a pay for performance program is no longer a differentiator, organizations need to rethink their strategies to ensure they work to attract new talent and keep current employees engaged. This is highlighted by the i4cp study, which shows that a pay for performance program has no differentiating factor between high- and low-performing organizations. Rather, it is the approach the organization takes in creating and executing the pay for performance strategy that will determine the level of success.

The value of a robust and effective pay for performance program focusing on rewarding the individual rather than the company as a whole is highlighted in a recent study by pay consultancy the Hay Group. According to its research, nearly 47 percent of high-performing organizations focus on recognizing and rewarding their high performers.\(^3\) The study also shows that the most focused on area for pay for performance programs among lower performing organizations was to “increase the likelihood of achieving corporate goals.” Yet, when that is the main priority, success can be limited. Organizations that approach pay for performance with the goal of motivating and rewarding employees based on individual performance goals and results will experience an increase in corporate goal attainment as a natural after-effect.

A main concern for companies in developing an effective pay for performance program is the need to ensure the program complies with all federal and state regulations. This is no easy task, as all too often such programs can introduce risk if they are not carried out on a legally defensible basis. Without a comprehensive, documentable plan for compensating or promoting employees based on their performance, the company opens itself up to lawsuits from employees who deem the pay for performance program as unfair or discriminatory. For example, without visibility and documentation into the program, it will be easier for employees to accuse the company of not offering bonuses, raises or promotions to certain demographics. However, with the right strategy in place, the company can ensure it considers employee performance on a fair scale, and that those ratings alone serve as the foundation of the pay for performance program.

The Path to Successful Pay for Performance

Developing a robust and effective pay for performance program won’t happen overnight; it takes ongoing commitment from stakeholders at all levels to ensure the company can create, implement and maintain the strategy. While the end result is a program that continuously motivates employees and can be used to attract new talent, getting to that state requires the following six steps.

\(^3\) Hay Group, “Retention of Key Talent and the Role of Rewards,” June 2012: http://www.worldatwork.org/waw/adimLink?id=62016
Step 1: Make the Program as Transparent as Possible

*Benefits: Increased employee participation, greater understanding of what they must do to receive raises or bonuses, ensures alignment between employees and performance goals, and eliminates the mystery surrounding the pay for performance process*

For the program to work, employees should be given complete visibility into the compensation process, including how their salary is determined and what they can do to receive bonuses or raises, as well as their impact on the business bottom line. By meeting with employees individually to highlight performance goals and explain what they will get in return for meeting certain criteria, employers can create a more transparent process. With greater communication and clarity about what they must do to receive bonuses, raises or promotion opportunities, there is no longer any mystery surrounding the pay for performance process. Moreover, keeping employees informed about opportunities to increase compensation can ensure complete alignment between the employees and their performance goals.

Step 2: Gain Buy-in from Employees

*Benefits: Employees will feel involved and that their opinions matter, the company can optimize the program based on feedback*

Despite the benefits of revamping the pay for performance program, as with any type of change, it can be met with resistance from employees. One of the biggest points of resistance is that employees may feel that the pay for performance plan is too simplistic, fearing that a basic cause-and-effect program doesn't take into consideration the many nuances of their jobs that can't be measured. For instance, performance for call center employees is typically measured by how many customers they serve, rather than how well they perform on their calls or their ability to solve the customer's problem.

Through a customizable pay for performance program that focuses on the employee, different performance criteria can be included for each job to ensure position-specific factors are considered. Sitting down with employees, especially “influential” ones initially, to review individual plans for performance reviews and the criteria they will include can help relieve their doubts and get them on board. To further garner acceptance, employees should be given the opportunity to voice their opinions about the program. Not only will this help them feel more engaged and bring greater transparency to the process, but it will also enable the company to gain more ideas on how the program can be optimized.

Step 3: Align Performance Management and Compensation Management

*Benefit: Ensure compensation is based on real results and not on subjective measures*

To ensure full alignment between individual performance and compensation, the performance management and compensation management systems should work together. While the performance management system keeps track of an employee’s strengths and weaknesses and successes and failures, the compensation management system ensures that
employees receive proper compensation based on mathematical formulas and data. When these two systems are fully integrated, whereby data from the performance management system is used to determine compensation, the employer can be confident that compensation is based on actual results and calculated by a fair, legally defensible process.

**Step 4: Get HR and Line Managers on the Same Page**

*Benefits: Greater collaboration between those responsible for determining compensation, more consistency regarding performance evaluations, easier to link actual performance with specific goals*

It's not just the systems that need to be in alignment; the personnel responsible for determining and managing the program must also be fully committed and well aligned. In determining pay for performance plans, the line manager has to understand clearly the criteria on which employees are evaluated. At the same time, HR teams must be clear about the program, such as how often information will be made available in the system and the frequency with which line managers should meet with employees to discuss performance. In addition, the two parties should put their resources together to identify top performers, recognize and properly record employee goal progression and link compensation calculations to specific, predefined goals.

**Step 5: Commit to Ongoing Improvement**

*Benefit: The company gains a dynamic program that can be adapted as necessary*

To ensure the pay for performance program is sustainable and continuously optimized, it is important for HR managers and other executives involved with compensation to make sure that formulas are constantly benchmarked against industry standards. Moreover, performance managers should review the accuracy of their evaluation data to ensure it is comprehensive and a fair representation of the successes and failures for each position.

**Step 6: Work with a Provider Experienced in Compensation Management and Performance Management**

*Benefits: Access to proven best practices, ability to automate complex compensation calculations, ensures employee performance is aligned with desired outcomes*

Rather than trying to reinvent the pay for performance program on their own, companies can benefit from working with a technology provider experienced in helping organizations develop effective performance management programs that drive positive results. The right provider understands the symbiotic relationship between performance and compensation and can help the company develop a unique, comprehensive and legally defensible pay for performance program that ensures employees are compensated based on their individual performance. Equipped with the right solution, employers can automate the complex calculations needed to determine accurate compensation, while ensuring employee performance toward their goals is aligned with the resulting outcomes. Moreover, the right provider should offer solutions that enable employees themselves to understand how their compensation is calculated, which can serve to keep them continually engaged and motivated.
Individual Performance Yields Company-wide Benefits

When the employer is able to establish a clear link between performance and rewards, employees at all levels, and the organization as a whole, stand to benefit. With a transparent and robust pay for performance program, employees can know exactly what they need to do in order to meet their unique performance goals, and achieve rewards for doing so. The increased visibility resulting from such a system leads to greater employee satisfaction and retention rates, which will ultimately improve company-wide performance.

At a time when data into all aspects of performance management are widely available, and employees demand greater visibility into workforce management processes, an outdated, one-size-fits-all pay for performance program won't attract or retain talent in an increasingly competitive environment. However, the organizations that create dynamic programs that account for job-specific and individual accomplishments will be able to keep their current employees motivated and engaged. Also, having an effective program in place can elevate the company's reputation and employer brand, ensuring it attracts top talent looking for opportunities with a company that values its employees and rewards their efforts. It's this kind of differentiation that truly gives companies the competitive edge today.

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<thead>
<tr>
<th>Old Strategy</th>
<th>New Strategy</th>
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<tr>
<td>Employee goals are aligned to corporate outcomes</td>
<td>Employee goals are aligned with individual performance</td>
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<tr>
<td>A one-size-fits-all approach for measuring performance of all employees</td>
<td>A dynamic and flexible strategy that accounts for each individual’s performance and personal goals</td>
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<td>Raises, bonuses and promotions are based on managers’ discretions</td>
<td>Compensation is determined by unbiased performance data</td>
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<td>Employers may be at risk of non-compliance if they cannot document compensation programs, or be accused of discriminatory practices</td>
<td>Complete documentation of pay for performance activities to show that compensation is based on actual results</td>
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<td>When pay for performance is focused mainly on company goals, there is no link between individual performance and compensation</td>
<td>Full integration between compensation management and performance management ensures employers compensate employees through a fair and accurate process</td>
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About Peoplefluent

Peoplefluent is the leading provider of talent management solutions designed to support the entire workforce. We provide the mobile enablement, social collaboration, information visualization and the domain expertise required to empower strategic decision making and true employee engagement. Our talent management software enables organizations to unlock each individual’s potential by removing the boundaries that limit the performance and productivity of your workforce. With the most comprehensive talent suite in the industry including solutions for talent management, workforce compliance and diversity, contingent workforce management, analytics and workforce planning, Peoplefluent offers a solution to optimize every step of the talent lifecycle.

Our solutions have helped over 5,100 organizations in 214 countries and territories successfully achieve their talent aspirations. Today, 80% of the Fortune 100 relies on Peoplefluent solutions as part of their talent management delivery strategy.

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