

The Merits of Performance-Based Pay

This paper addresses performance-based pay, with an emphasis on the ways in which this pay system presents clear, measurable benefits to call centers and other technology-based environments. Two additional pay systems—status-based pay and merit-based pay—are discussed as well, focusing on the ways in which both fail to correlate job performance with pay awarded beyond an employee's base salary. The analysis of these three pay systems details the numerous ways in which performance-based pay can most effectively help maximize employee performance.

Status-based pay is the most widely used pay system, and is characterized by paying employees competitive wages within the industry. Salaries are determined by pertinent employee factors, as well as economic factors that impact pay—such as inflation, cost-of-living, competition within the workforce, etc. Compliance with annual industry salary surveys helps to ensure that an organization remains competitive, paying employees neither too much nor too little. An employee's salary is properly aligned with the job and the person who performs the job (McAdams, pg. 92). This pay system is tantamount to an entitlement program; once an employee's base pay is decided, pay generally remains unchanged within a pay range (unless economic conditions necessitate a change). As a result, this type of pay system commonly fails to recognize and effectively reward employees for on-the-job performance.

Merit-based pay is founded on the principle that an employee receives a fixed-percentage one-time bonus (often annual) on top of his or her base pay. In the last five years, the average employee bonus received within this system has been 3% to 6% of base pay (McAdams, pg. 97). However, it is difficult to link merit-based pay to actual employee performance. This is because an employee's merit-based payout is dependent on factors that are not directly related to his or her personal job performance. Besides an employee's personal performance, achieving organizational and departmental objectives are often required for actually receiving a merit-based system's 3% to 6% bonus.

This system, therefore, limits the possibilities for enhancing an employee's personal performance and production. If it is apparent that either the department or the organization, or both, are not going to meet expected goals, it is likely that an employee will have little desire to exceed his or her performance expectations, since it is unlikely that he or she will be rewarded for doing so. As a result, although it is the intention of a merit-based pay system to relate pay to performance, this system generally does not succeed in motivating employees to improve and achieve greater performance.

Aside from a merit-based pay system's inability to directly reward employees for individual performance, this system is quite often unsuccessful due to ineffective management. Managers are imperative to the success of any pay-for-performance system. Merit-based pay especially requires hands-on management, as payouts are delivered upon the analysis of team performance as a whole.

After years of participants of this system receiving relatively small fixed payouts due to marginal organizational success, employees generally tend to *expect* a pay reward, regardless of whether they deserve one. Making past

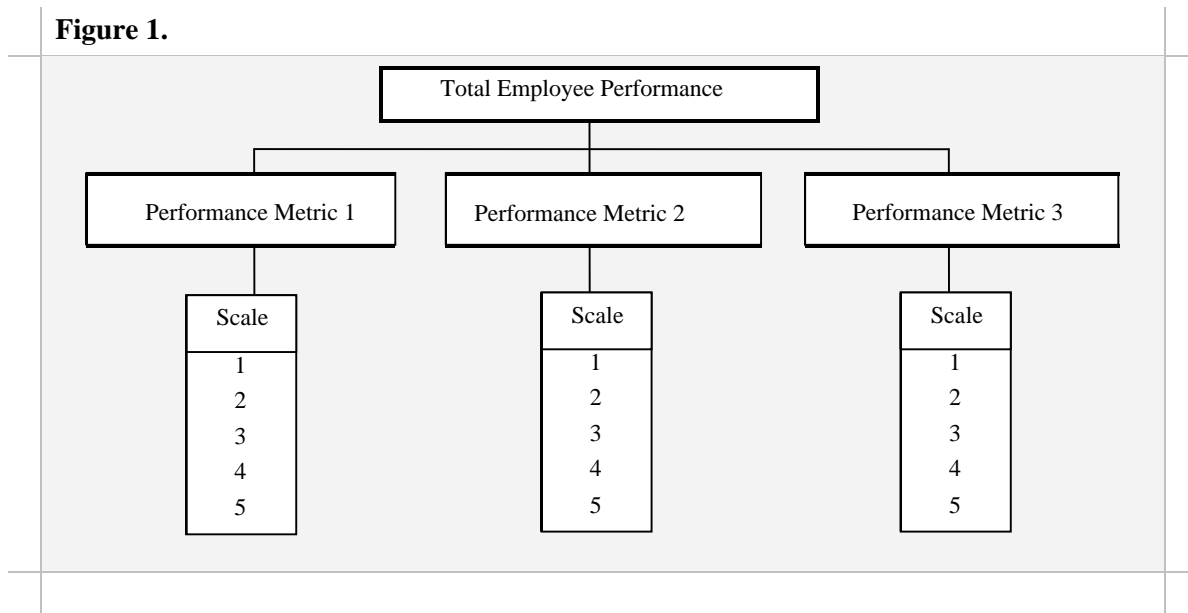
merit payments part of an individual’s base salary creates an annuity. As long as someone stays with an organization, he or she is paid for past performance. This means that an individual can be a poor performer for several years, after having been a good performer, and still be highly paid (Lawler, pg. 72).

The intention of performance-based pay systems, however, is not only to reward employees for better job performance, but to reward them in a way that specifically relates pay to performance. In contrast to merit-based pay, performance-based payouts do not result in bonuses determined from percentages of base salaries. Above the base salary, a performance-based pay system rewards employees solely on measured aspects of components of overall employee performance.

This method, then, drastically improves the evaluation process by providing employers with a way to scientifically reward employee performance. Considering that a merit-based pay system does not pay better performers significantly more in total compensation (Lawler, pg. 71), it is essential for organizations to utilize performance-based pay, because in this system bonus pay is only awarded for performance. Therefore, if an organization finds itself paying more in bonus rewards, it means the organization is consequently receiving better performance from its employees.

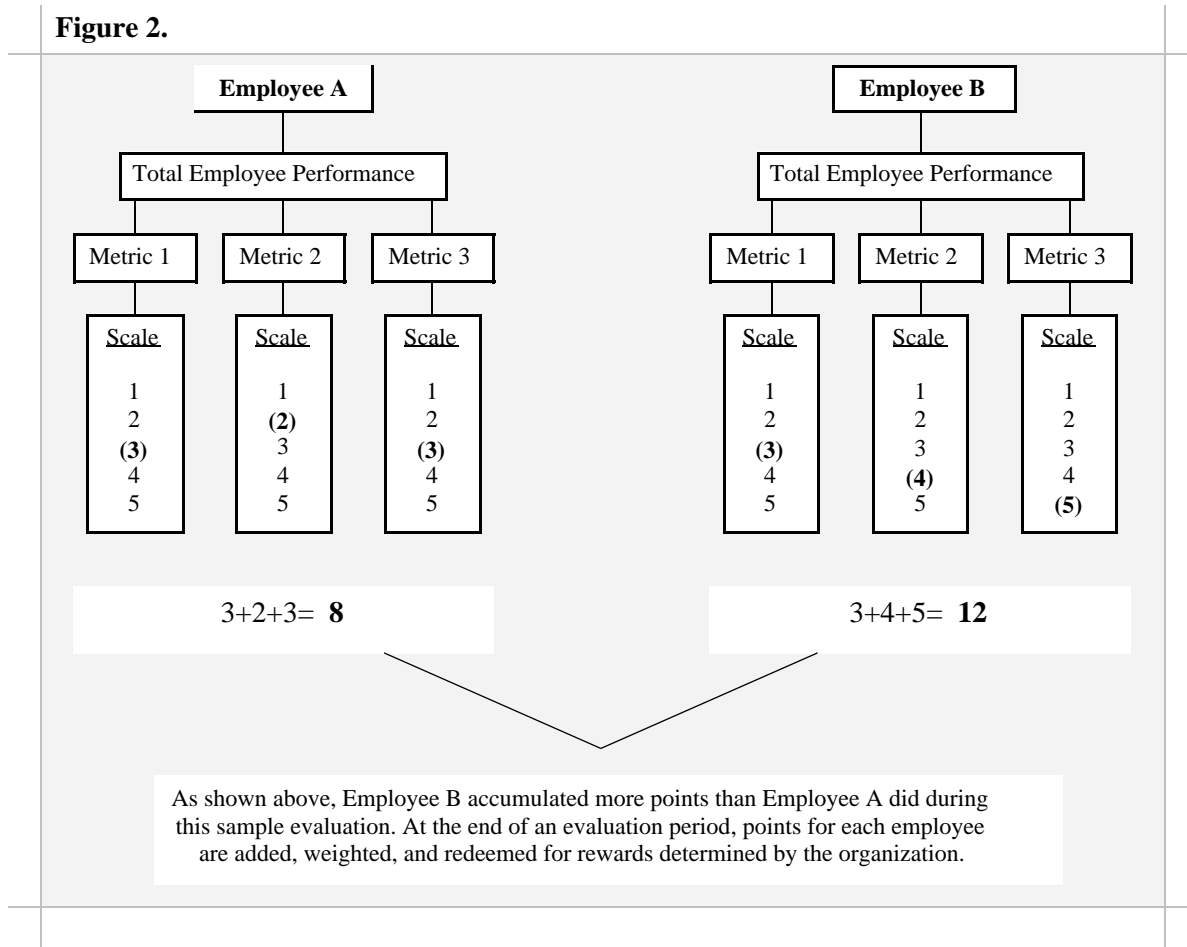
Integral to a performance-based pay system is the use of an alternative currency that becomes the instrument for describing performance. This is most effectively accomplished through the implementation of a system that uses points as a currency to differentiate performance. Total performance is broken-down into the various sub-factors that become performance metrics—the individual components (specific to organization requirements) that comprise employee performance in its entirety (see Figure 1).

Figure 1.



During evaluations, employee performance scores are determined for each metric using a numbered scale that qualifies and quantifies achievement. These points are then added individually for each employee at the end of an evaluation cycle.

Figure 2.



The resulting total number of points for each employee is compared to all other employees, and scores are weighted to correspond with the total number of points available. The accumulated points, then, may be redeemed for rewards defined by management (such as cash, time off with pay, travel, merchandise, gift certificates, concert tickets, etc.). The use of points as currency allows individual performance to become visible through the analysis of metric scores for one employee, or between employees, thereby providing a mathematical means for comparing and rewarding strengths and weaknesses.

Central to performance-based pay systems are the various goals that reflect an organization's multiple objectives. These include "improving performance, improving motivation, clarifying the position of a person's job, improving communication between the supervisor and employee, helping individuals develop their skills and abilities, and helping individuals perceive a sense of the organization's overall direction and thrust" (Lawler, pgs. 86-87). Therefore, by developing employees through training and supervision, a successful

manager continues to reinforce desired behavior through compensation directly related to performance that is congruent with desired employee behavior.

By rewarding employees for accomplishing tasks and successfully employing desirable skills, they are more likely to continue displaying the positive qualities that improve total job performance. Understanding not only what is expected of them, but also what is desirable on-the-job behavior, helps employees want to strive to succeed—knowing that they will be tangibly rewarded for their performance. Central to quality employee performance is for managers to clearly define objectives of jobs, and also to specifically detail the payout/reward system. For a reward system to be successful, it must create both a high level of awareness among employees, and be valued by both employees and the organization—and also possess a structure that is responsive to performance levels (McAdams, pg. 57).

While an older, recently replaced, business theory said that employees were nothing more than “cogs in a large organizational machine” (Flannery, Hofrichter, Platten, pg. 105), performance-based pay systems value employees, treating them as essential to organizational success—thereby providing rewards as a result of personal performance in the success of the team. Performance-based pay allows employees to share in the risks and rewards of an organization, giving employees a real sense of achievement, as well as a sense of responsibility for both the successes and failures of the organization. This is important because it instills organizational pride, which gives employees the incentive to work harder and to perform to the best of their abilities in all organizational endeavors. One of the most critical factors that improves an organization is the linking of an employee’s performance to that of the performance and ultimate success of the organization (Flannery et al. pg. 104).

Figure 3 shows an example of one way points can be used as a currency to evaluate metric performance.

Figure 3.

A	B	C	D	E
Performance Metric	Actual Rating (1-5 Possible)	Weight	Actual Points	Possible Points
Attendance	5	.30	1.5	1.5
Telephony Skills	2	.40	0.8	2.0
Product Understanding	3	.20	0.6	1.0
Accuracy of Data Input	5	.10	0.5	0.5
Total Possible				5
Total Actual			3.4	

Column A: The assigned metrics (key success factors for call center employees as determined by center management).

Column B: The rating of employee performance by call center management.

Column C: The relative importance of the assigned metrics.

Column D: The product of multiplying Columns B and C.

Performance-based pay can be a key contributor to an organization’s retention of its most important assets—its best workers. This system works best in discovering the commitment level of employees in the workplace. The best performers receive tangible rewards, while the poor performers do not. Therefore, “paying poor performers less can have the desirable effect of causing them to leave. Overall, then, paying for performance can lead to the right kind of turnover—good performers staying, poor performers leaving” (Lawler, pg. 71).

The bottom line is that performance-based pay makes the most sense for both employers and employees. This pay system can be seen as being cyclical, in that everyone involved obtains valuable benefits. Employees get what they want, in that they get a true sense of their worth and contribution to the organization—and they have the opportunity to make more money or receive other rewards for doing better work. This, in turn, results in giving employers what they want—satisfied employees doing the best work possible. The ultimate outcome of a performance-based pay system, then, is that quality performance equals quality pay, and that quality pay brings quality performance.

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