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What's Next for Performance Related Pay?

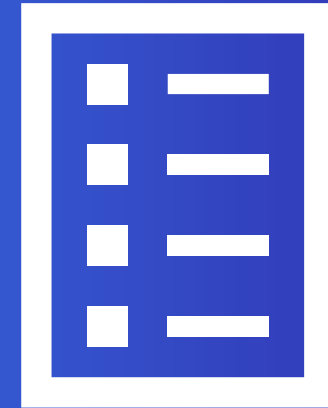# Today's Presenters

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Today's Agenda

- Intro: definitions and history

- Current practice on performance related pay (PRP)

- Today's challenges for PRP/merit pay

- What are the alternatives?

An Intro to Performance Related Pay (PRP)

Defining PRP

The concept of pay for performance is central to the compensation philosophy of many organizations and is rooted in the belief that **people should be rewarded based on their individual contributions**

PRP is a way of managing base pay by **linking salary progression to an assessment of individual performance**
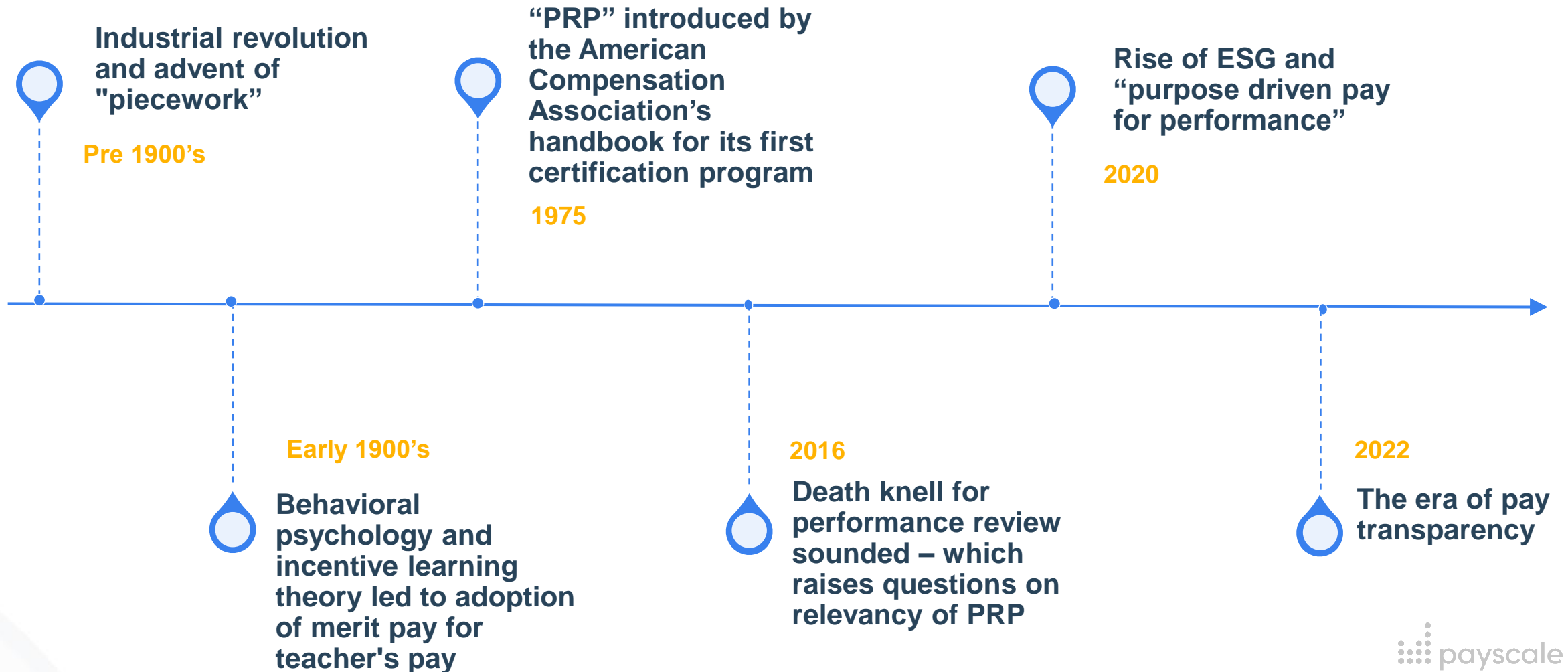
Pay progression based on **individual performance ratings only**
or
a general pay rise for employees **in addition to an element that is linked to individual performance**

PRP can also be delivered through **variable pay programs** such as STIPs, bonus, commissions, LTIPs, stock awards and profit share

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Poll Question 1: Do you use individual performance to determine base pay progression?

A. Yes, we only use individual performance to determine base pay progression

B. Yes, we use individual performance and market position (compa-ratio) to determine base pay progression

C. Yes, we use individual performance and other factors to determine base pay progression

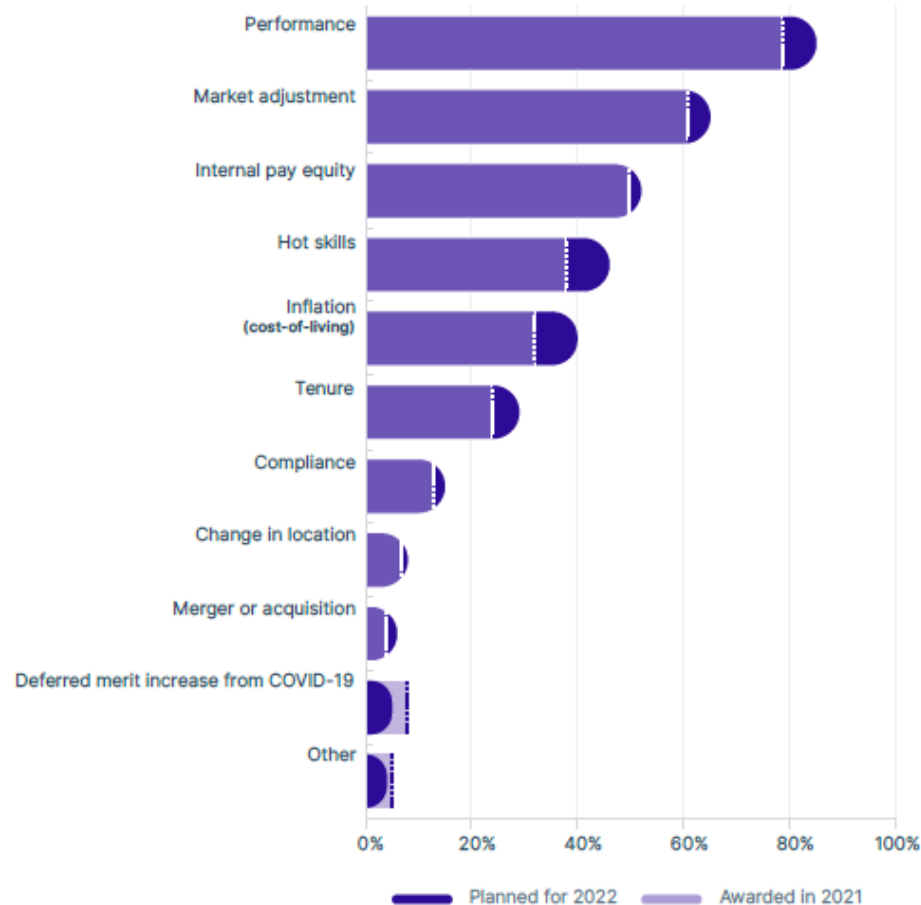D. No, we do not use individual performance as a factor to determine base pay progression

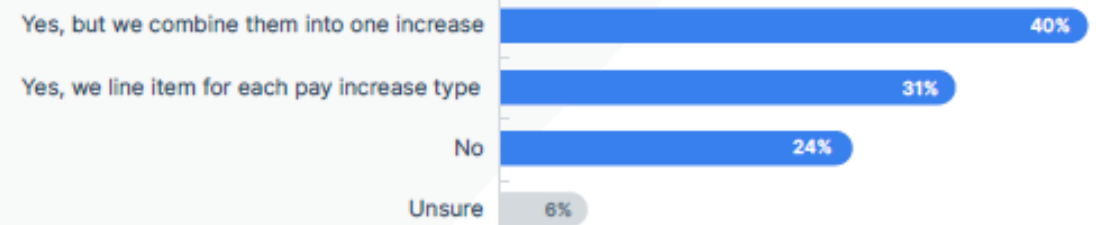payscale

A brief history of PRP base pay progression

Industrial revolution and advent of "piecework"

Pre 1900's

"PRP" introduced by the American Compensation Association's handbook for its first certification program

1975

Rise of ESG and "purpose driven pay for performance"

2020

Early 1900's

Behavioral psychology and incentive learning theory led to adoption of merit pay for teacher's pay

2016

Death knell for performance review sounded – which raises questions on relevancy of PRP

2022

The era of pay transparency

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What's the current state of PRP?

Which of the following is factored into base pay increases?

Category	
Performance	
Market adjustment	
Internal pay equity	
Hot skills	
Inflation (cost-of-living)	
Tenure	
Compliance	
Change in location	
Merger or acquisition	
Deferred merit increase from COVID-19	
Other	

Legend: Planned for 2022 | Awarded in 2021

When providing pay increases, do you make a distinction between merit increases, market adjustments, and increases for inflation?

Yes, but we combine them into one increase	40%
Yes, we line item for each pay increase type	31%
No	24%
Unsure	6%

We asked participants to select all the reasons that they give pay increases, both awarded in 2021 and planned for 2022. For both years, **the most selected answer is performance**, followed by market adjustments and maintaining internal pay equity.

However, in 2022 more organizations are putting an emphasis on adjusting for inflation and rewarding hot skills.

Payscale's Compensation Best Practices Report 22

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QUESTION

For each of the following employee groups, how are base pay increases typically determined? Please select all that apply.

RESULTS

	Collective bargaining/ works council regulated	Clerical/ technical/ operational	Professional/ management	Officers/ executives
n=	290	893	934	902
Education/certifications	8%	10%	11%	8%
General increase (everyone receives this same increase)	70%	20%	16%	13%
Individual performance against job standards	18%	73%	74%	64%
Market value of the position	17%	54%	56%	58%
Position in range	15%	54%	56%	44%
Skill or competency acquisition	11%	21%	20%	14%
Years of service	23%	13%	12%	10%
Individual performance against management by objectives (MBOs)	9%	24%	31%	40%
Other	13%	4%	4%	8%

"

Vast majority of organizations continue to vary base pay increases between top and bottom performers, with 20% of organizations citing an increase in the variation in pay increases between top and bottom performers in the past 12 months.

Most organizations (53%) publish a merit matrix for managers to use to determine actual salary increases. 36% say managers use it as a guide but have discretion to deviate if they deem it appropriate.

"

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World at Work Compensation Programs and Practices Report June 22

> It's time to re-think merit pay…Less than half of employers **(44%)** say that base pay programs are successful in driving higher individual performance.
>
> A closer look at the factors that determine base pay reveals a **complex decision-making environment** with organizations reporting that six or more factors impact base pay.
>
> Our findings suggest the role of base pay needs to be **redefined** for today's changing workplace.

Willis Towers Watson Getting Compensation Right Survey 2018

Figure 1. Organizations are operating in complex environments when it comes to factors affecting base pay decisions.

To what extent does each of the following factors affect individual employee base pay increases in the current design?

Factor	To a great extent	Somewhat	Not at all
Achievement of individual goals	70	20	10
Final rating in most current year-end performance review	69	18	13
Concerns over market competitiveness	62	25	13
Demonstration of knowlege and skills required in current role	60	29	11
Criticality of the role	59	22	19
Possession of skills critical to the success of the future business model	59	24	17
Penetration in pay range for current role	57	27	16
Achievement of team goals	49	32	19
Concerns over internal equity	46	36	18
Perceived potential	46	35	19
Demonstration of company values	39	37	24
Addressing gender pay equality	23	34	43

■ To a great extent
■ Somewhat
■ Not at all

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What are the challenges today to the traditional merit pay?

Criticisms of PRP:
Issues with performance assessment

- There is much research that highlights **how bias plays out** in performance assessment systems. With a direct link to pay this bias must therefore impact pay allocation.

- **Lack of manager capability** to set and assess goals that are difficult but achievable, and drive business value (particularly for less quantifiable skills or values).

- Annual reviews **focus too much on past achievement** during the performance year rather than considering what employees should do going forward.

Criticisms of PRP:
Issues for base pay progression

- Typically, **not enough budget** to meaningfully differentiate increases for top performers.

- **Rewards past performance only** – need to use pay to not only recognize the value of an employees' contribution after the fact but also to future potential or market value.

- May have a **negative effect on teamwork** if employees feel they are competing.

- **Limited flexibility or scope** to change or respond to market trends.

- **Typically, a once-a-year event**. In today's dynamic labor markets is this enough?

- PRP **perpetuates inequality** when prior performance increases are baked into pay.

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Pay Equity and Performance

- When you start adding factors that change each year for individuals you quickly lose sight of why employees are paid differently

- Using current performance to explain differences is difficult, as it is past increases that often explain them
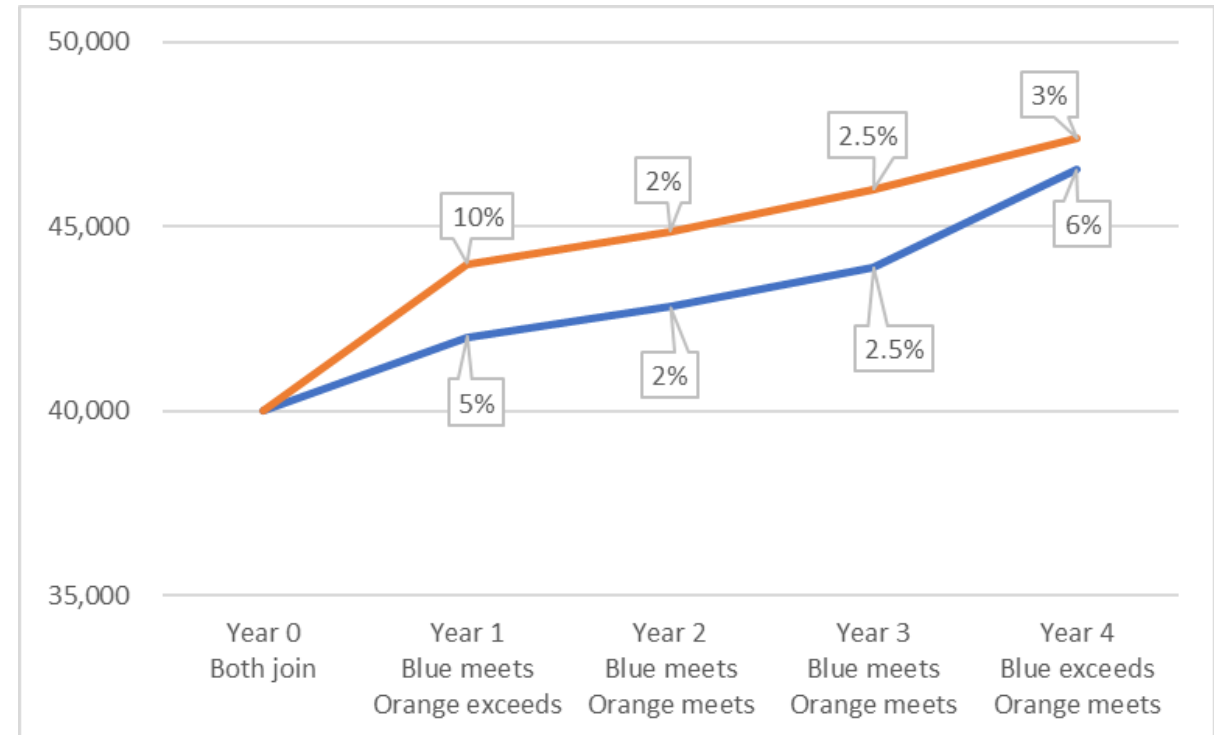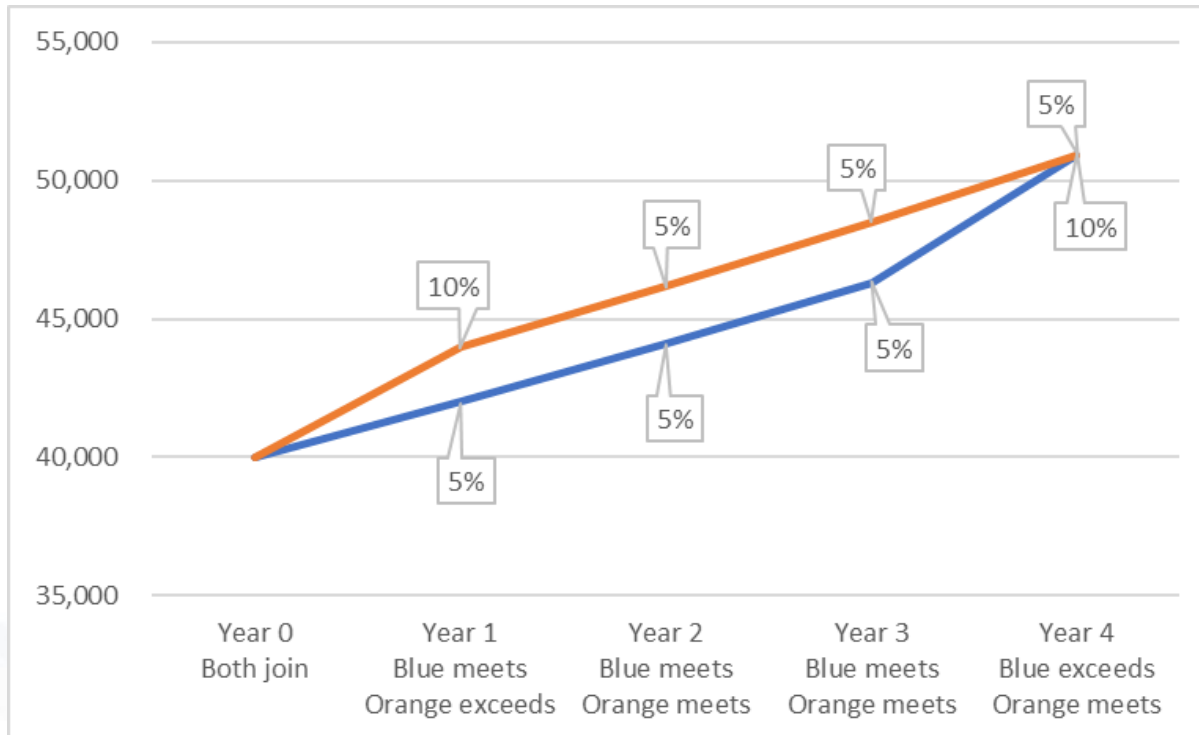
What are the alternatives to PRP?
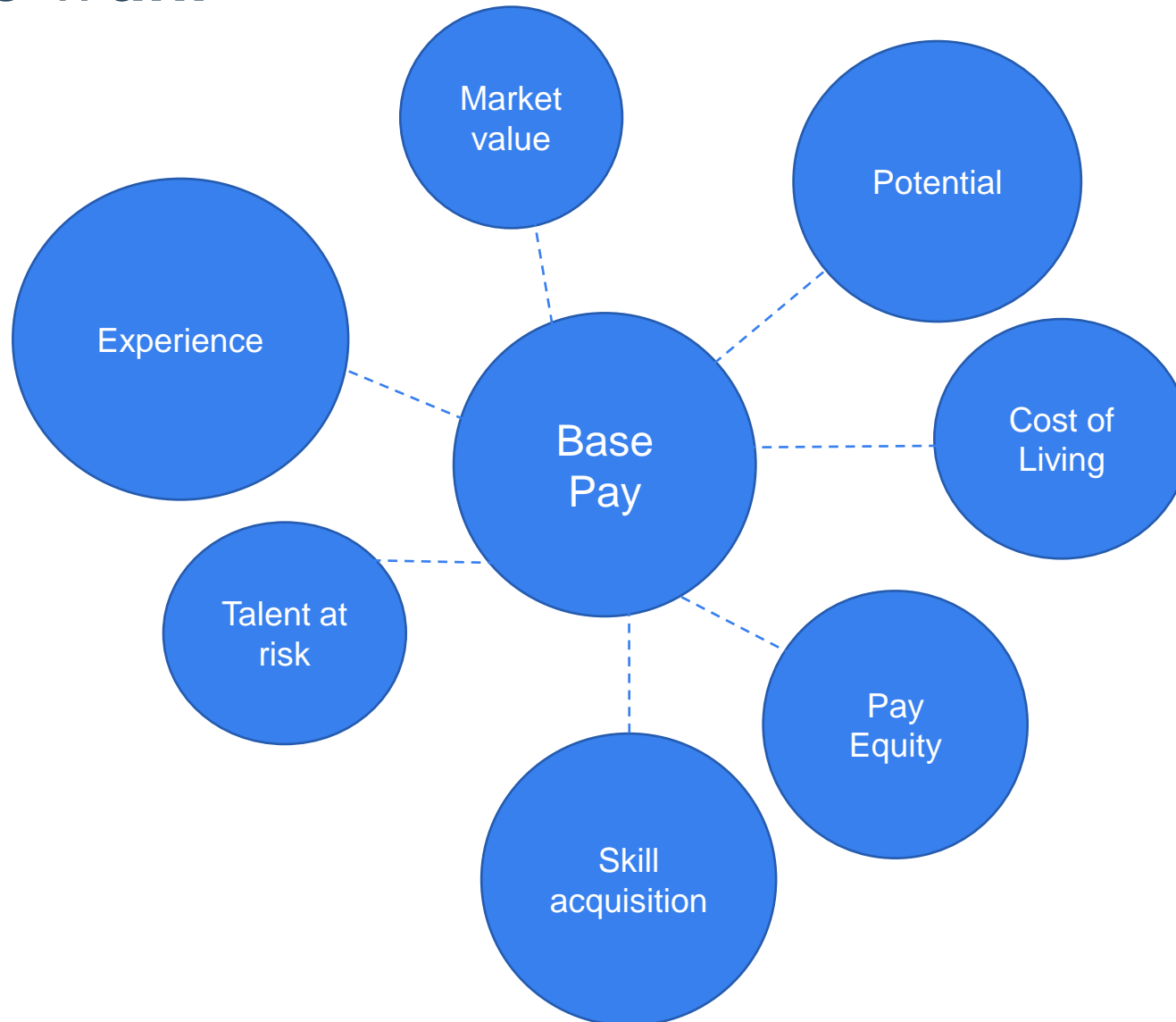
Poll Question 2: Which of these compensable factors would you like to consider in base pay?

A.   Market Value/Talent at risk

B.   Potential

C.   Experience

D.   Skills and skills acquisition

E.   Addressing pay equity/compression

F.   None of these

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**Options for determining base pay progression**

Segmented base pay budgets

A points system

Pay progression formula (like regression analysis)

Multi-dimensional Merit Matrix

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Multi-dimensional merit matrix
Payscale compensation planning

	ID	First Name	Last Name		Current market position	Performance Rating	Talent Rating	Attrition Risk	Guideline min %	Guideline max %	Proposed increase (%)	Proposed increase amount
☐	EE140	Martha	Alexander		Above market	Below expected			0.00 %	0.00 %	0.00 %	€ 0.0
☐	EE131	Donna	Gutierrez		At market	Exceptional			5.00 %	7.00 %	0.00 %	£ 0.0
☐	EE149	Mark	Ryan		At market	Exceptional			5.00 %	7.00 %	6.80 %	£ 2,244.0
☐	EE108	Jacqueline	Spencer		Above market	Good			3.00 %	5.00 %	0.00 %	£ 0.0
☐	EE128	Shirley	Martin		Above market	Good						
☐	EE143	Annie	Ramirez		Above market	Good			3.00 %	5.00 %	0.00 %	£ 0.0
☐	EE134	Arthur	Garrett		At market	Poor			0.00 %	1.00 %	0.00 %	£ 0.0
☐	EE146	Margaret	Banks		Above market	Poor			0.00 %	1.00 %	0.00 %	£ 0.0
☐	EE328	Edward	Brooks		Below market	Poor						
☐	EE137	Kathleen	Kelley		Below market	Strong			4.00 %	6.00 %	0.00 %	€ 0.0
☐	EE357	Kylie	Nichols		Above market	Strong			4.00 %	6.00 %	0.00 %	£ 0.0
☐	EE418	Ben	Ford		Below market	Strong			4.00 %	6.00 %	5.90 %	£ 1,062.0

Consider the impact of pay transparency!
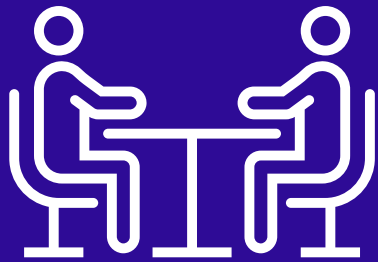
"Whatever you decide to pay for, this needs to be explained by managers and understood by employees"

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Options for performance recognition

Use **one-time incentive programs to deliver differentiated rewards**, such as bonuses, commission, LTIPS, profit share to reward outstanding performance

Consider that well-designed recognition programs are also an effective way to empower managers to **create a culture of rewarding performance year-round**

Leverage the power of careers. One of the more effective ways to deliver base pay growth to top performers is through **career growth combined with meaningful market-driven promotional increases**

Think more broadly to **the overall employee experience** (e.g., remote & flexible working)
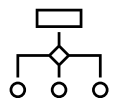
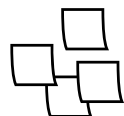payscale

Recommendations

Establish what you currently pay for today (and is this effective?)
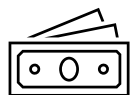
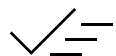Consider what you want to pay for (make pay your talent insurance)

Explore options for managing base allocation based on these factors

Model and stress test these options to understand potential impact

Review existing performance-based pay allocation for effectiveness and ROI

Consider other options for recognizing performance

Payscale Resources:

- Compensation Best Practice [Report](#) 2022. [Take part in our '23 survey](#) as well!

- Salary Budget Survey [Report](#)

- Compensation Strategy [Whitepaper](#): Responding to Rising Inflation & Cost of Labor

- [Whitepaper](#): How to Manage Pay Compression with Agile Comp

- Pay Transparency Legislation [Guide](#)

- Webinar: [Navigating Compensation Budgeting Season](#)

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Gain a competitive edge in a fierce talent market while building a more fair, equitable and transparent pay strategy

| Market Pricing | Pay Structures | Survey Management & Participation | Reporting & Analytics |
| Pay Equity | Compensation Planning | Total Rewards Statements | Job Descriptions Management |

Peer
A transparent & dynamic HR reported data network

Employee Reported
The world's largest real-time salary database

HR Market Analysis
A composite of analyst curated employer reported survey data

Q&A

Feel free to ask any questions in the chat!

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