

Getting to grips with linking base pay and performance

Using performance to determine pay progression can be challenging. A number of organisations grapple with how best to embark on this route, as it requires a strong commitment to establishing robust performance management and remuneration systems.

To implement a successful performance related base pay system, the organisation must be clear of its rationale for adopting this approach, for example:

- § Moving from archaic, tenure or cost of living based pay systems
- § Wanting to differentiate between employees, e.g. paying for the level of individual contribution to the organisation
- § Using pay for performance as an avenue for achieving organisational change.

Linking base pay to performance – while not the only motivator - provides a powerful vehicle for sending clear organisational messages on what is expected and valued in terms of performance.

So what is involved in linking base pay to performance?

It goes without saying that performance related pay systems require a sound methodology for performance measurement. Therefore a strong performance management system must be in place to assess performance on a fair and consistent basis. This is often the most challenging part of the process but it can provide a tool to:

- § Directly link objectives to the business plan and cascade these down the organisation
- § Clearly outline expectations in terms of outputs and results
- § Provide employees with focus and clarity
- § Provide a basis for communication and discussion on performance

So how can you measure performance objectively and fairly? The key lies in ensuring that performance measures are well developed and defined, and based on clear organisational objectives and rationale.

While it's relatively straight forward to describe clear outputs and expected results for sales or project based roles, it's not always easy to quantify the outputs of roles which are advisory in nature. However it is possible to describe how an aspect of the job looks when it is well done and to agree objectives in the form of performance standards or targets.

Translating Measures into Ratings

Having developed measures for performance outputs and results, it is necessary to translate these into ratings that, in turn, will determine pay.

The most common rating systems have a scale of points and/or descriptors. Contemporary systems use rating scales of 1-3 or 1-5. These streamlined rating scales provide for greater demarcation between descriptors, reducing subjectivity as a result. Rating systems have their disadvantages, but are essential if base salary increases are driven by performance.

Example of Performance Rating Scale and Descriptors

Performance Rating	Performance Descriptor	Performance Criteria
5	Outstanding	Outstanding performance. Requirements of the role significantly exceed expectations in all areas.
4	Highly Competent	Performance is well above normal job requirements. Level of contribution far exceeds that normally expected in the role.
3	Competent	Performance requirements were fully met. Good all round performance that meets the normal requirements of the role.
2	Developing	Performance generally met general requirements of the role, however a number of areas of improvement were identified.
1	Needs Improvement	Performance in the role was well below acceptable levels. Constant guidance required and issues relating to quality, timeframes, outcomes were identified.

Inconsistency of assessments is often viewed as a contentious part of performance management systems. Organisations need to invest time and energy in training managers in effective appraisal techniques and to develop moderating systems that check and challenge the consistency of assessments across the organisation. Typical methods used to decrease subjectivity of ratings include:

- § Forced Distribution – based on a ‘Bell-Curve’ or normal distribution which forces ratings into categories
- § Ranking – places all employees in order of merit ratings and then determines the pay increases to be awarded to defined sections of rank order, e.g. 5% increase for the top 5% of employees, 4% for the next 15% of employees, and so on
- § Normalising –distributions of ratings are adjusted artificially to conform to a ‘correct’ pattern of distribution.
- § Moderation Team or Committee – a team of senior managers takes an organisational view of ratings against performance levels.

While all of these approaches have pro’s and con’s, best practice would indicate that a moderation team or committee may provide the most effective approach to balance how individual managers assess performance across teams or departments and to provide an opportunity to debate and justify recommendations put forward.

Developing Pay for Performance Guidelines and Distribution of Rewards

Once assessments are completed and ratings for employees are established, reward decisions can be made. Determining how an individual should be positioned in a pay range will depend on a number of factors including:

- § Level of performance in the role, i.e. developing expertise, fully competent or demonstrating exceptional performance
- § Work experience of the individual and the “value” which they add
- § The individual’s current earnings
- § Competency levels
- § Supply and demand (market pressures) for certain “hot” skills.

The following guidelines will assist organisations to determine the relevant pay for an individual:

- § Progression within a range should be determined based on demonstrated performance
- § Pay in the region of the mid-range will, typically, represent competent performance
- § Pay close to the minimum will typically represent lower performance levels, or less experience in the job. When a person is recruited into a position, it may well be at the lower end of the range so that progression is possible as competence is developed and demonstrated
- § Pay towards the top of, or above the range will, typically, represent consistently outstanding performance
- § Employees paid towards the minimum whose performance is above average should receive larger percentage increases than those paid near the maximum of the range
- § Employees paid above the maximum would need to be performing consistently well above expectations to receive an increase.

Conclusion

Whichever approach you use, linking base pay to performance can be a powerful tool to assist an organisation in managing the pay progression process effectively. Before embarking down this route, here are some of the recommended guidelines:

- § Ensure your performance management system is structured well, implemented and tested.
- § Implement an effective communication programme on the performance management system and its link to pay progression
- § Train managers in effective performance appraisal techniques and keep training up to date for new managers entering the organisation
- § Implement a monitoring process and review the consistency of ratings on an annual basis
- § Review the system to ensure consistent application across departments
- § Ensure that the difference between performance relating to base pay increases and bonus/incentive pay is well documented and understood by all staff
- § Link performance outcomes to the business plan and overall company success.