

# i-View : Creating an effective and fair link between Pay and Performance



Workers at every level in any organisation should be rewarded in proportion to the real value of their contributions  
(Hutton 2011)



Linking pay and performance is not an easy thing to do. A recent mini survey by *People Management* (2011) found that almost 45% of those surveyed said their organisation was “ineffective” or “very ineffective” at linking pay and performance. So why do companies bother at all – why not just pay everyone the same? After all, it would certainly be easier. Pay review would be a simpler process, bonuses wouldn't be needed, appraisals could really just be about development and constructive conversations etc. The public and voluntary sectors have typically resisted it, in the main due to concerns about the implications for morale (demotivating those who are not seen as great performers) and the ability to apply performance related pay fairly.

But how valid are these concerns? Can companies really get the best from their employees when they treat them all the same? And do employees feel motivated to outperform in their role if they will get paid the same as the “slacker” sitting next to them? A study by the (*CIPD*) suggested that the majority of employees (in the private sector) do want to be paid based on how well they perform.

Linking pay to performance, when done well, can be a hugely motivating tool for employees and consequently beneficial from a productivity perspective for businesses.

With the economy predicted to potentially face another recession, and pay budgets remaining tight, more businesses are wising up to the fact that their ability to differentiate pay awards – in both base pay and bonus - is just not effective in really rewarding high performers vs those who are average. So how do you ensure that you get the link between pay and performance right, and especially when budgets are tight and every penny counts?

In our experience, there are three main “culprits” that companies don't focus enough attention on:

- 1) The actual link mechanism in place does not work. Many companies use appraisal ratings to steer base pay performance increases, but the translation to salary is just not meaningful enough. How can you expect an outstanding performer to be happy with a 3% increase if an average performer gets a 2% increase?
- 2) The link between the bonus received and the effort involved is not clear. Many companies continue to pay bonuses on measures that lost relevance years ago.
- 3) Lack of managerial capability to actually manage performance. The system stands or fails by the quality of line managers - how can employers be sure that managers are equipped to manage performance?

## So how can you create an effective link?

Firstly, **get strategic** and review the way performance links to reward. What are you trying to

achieve? Do your structures / reward frameworks allow you to differentiate high performers from average performers?

Should those who are below average performers get an increase at all in order to fund larger increases for high performers? Be brave – you may need to make tough decisions.

Take the opportunity to review your Reward and Performance principles and make some clear distinctions:

- How is pay for performance distinguished between base pay (paying someone to do their job) and bonus (actual achievement) in your organisation?
- Are you double counting i.e using the same performance rating to award base pay and bonus, and if so, think about considering a wider basket of measures when reviewing base pay. These could include relativity to the market, competence, comparison to peers, risk of leaving the business or value added to the business. The recent *CIPD* Reward Management survey (2011) suggested that in profit based organisations, there is an emerging preference for a combined approach to base pay progression, with individual performance, competency skills, market rates, and employee potential common factors used. However, there are still many organisations that give no consideration to market / pay range relativity when differentiating pay between individuals. Consider therefore at the end of the day how much **return on investment** you get for continuing to overpay an average performer compared to underpaying a great performer?

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- What is your market stance? Is it the same for all populations and should it be? Are there critical groups in the business where high performance delivery is crucial to business delivery and should this population be rewarded in a different way?
- Is your bonus scheme fit for purpose? It is not uncommon for bonus schemes for example to have little or no line of sight between the effort an individual puts in and the outcome they receive. In our experience, some organisations find that a scheme they implemented years ago has simply become custom and practice but in reality has no impact on performance because it is paid out on measures that are no longer relevant and employees are so used to receiving it. When budgets are tight, it's time to really understand what you spend and be sure that the money that is invested in bonus is really recognising good performance.

As part of the strategic review, step back and review what you actually spend on reward and really challenge if you are getting **value for money**.

Finally, you need to understand how effective your performance management system is. Do your employees regard it as an annual chore or is it a meaningful, ongoing conversation? And most importantly, is it seen as **worthwhile and fair**? In order to establish an effective link between pay and performance, employees need to feel that the outcomes of their performance are not only recognised, but done so in a fair way.

*"Fairness requires fair processes as well as fair outcomes. People care passionately about the fair or due process by which decisions are reached, often showing considerable willingness to make sacrifices on outcomes in return for satisfying themselves that processes were fair" (Hutton Review of Fair Pay, 2011).*

One of the biggest challenges to creating fairness is the reliance on line management to **'know what to do'**. There is an implied assumption that with the title of "Manager" an automatic gift of being able to manage is endowed. The reality is somewhat different as demonstrated by a survey that indicated a quarter of UK managers question their own capabilities and 60% admit they didn't plan a career in management (*HR Magazine*). A further study by consultancy Threshold indicated that "Employees have little faith in their line managers, with less than half believing the feedback from their boss is helping them do their job better" (*HR Magazine* - April 2011). The same study also looked at the extent to which employees felt line managers clearly described the performance standards that they currently expected - only 42% felt that the performance standards that they were being evaluated against had been communicated to them. There is a general implied assumption in organisations that just because things have been communicated to line managers (usually by email / internet) that they understand them.

So how can we help line managers to deliver fairness when it comes to managing performance? Here are **some tips** that do not incur significant costs:

- Make things **simple!** Help your managers set and assess objectives by removing unnecessary rules and requirements. We see many companies stipulating a number of required objectives or forcing balanced scorecards on roles that end up making things up simply to complete the form.

- **Involving** managers and employees when reviewing your performance management system can help their understanding and engage them at the same time. Ask employees 'what does a good performer look like? How is that different to a great performer?' and help them to articulate the different performance levels with real examples of expected outputs or behaviours.
- If you don't already, think about including an element of **self rating** in your appraisal process. Not only will it give employees an opportunity to self reflect and contribute to the review process, it will help managers to understand in advance how the employee rates themselves and gives them a chance to prepare so they can effectively manage expectations if required.
- **Don't assume** all managers are at ease having difficult conversations or giving honest feedback. A manager's ability to communicate openly and constructively with staff also has a major impact on their likely rating standards. If a manager finds it difficult to articulate performance expectations and feedback, they are more likely to be lenient in their use of rating scales.

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- Provide opportunities **for open learning sessions** for managers to discuss potential issues they face managing performance. You don't have to run company-wide training, but inviting managers to 'managing difficult conversations' or 'giving honest feedback' sessions over lunch will not only help to skill your managers but will provide them with the opportunity to share their experiences (good and not so good!) with their peers.
- Run **consistency review** sessions. It is important to understand how line managers make decisions around performance, and to ensure those decisions are consistent and fair across the organisation, especially when there is a link to pay at the end. One process that can help to do this is by staging calibration or consistency reviews. Conducted with Line Managers in the room, the sessions provide an opportunity for managers to review potential performance decisions (ratings or scores etc) amongst their peer group. They can ensure that lenient and harsh scorers alike discuss their decisions to ensure a consistency of approach by challenging ratings given where there is evidence to do so. Ultimately, when employees are advised of their performance rating, they know that comparisons have been made across their functional area and managers have had to justify their decisions.
- Take reliance of recognition away from the pay review and give managers the opportunity to **recognise** great performance all year long. Other types of reward such as non cash recognition or allowing staff to leave early for the day provide managers with empowering tools to motivate teams in a timely manner. In fact additional time

off is a highly undervalued tool as recent research suggests that almost a third (31.4 %) of UK employees would sacrifice wages for more days off (*People Management*). At Innecto we have seen and implemented schemes empowering line managers to spend small amounts of cash (£50 limit) to buy ad hoc gifts where appropriate. Less formal than recognition schemes, good managers typically do this anyway (they just pay for things themselves). With some light touch guidelines on the kinds of things they may reward and what they might buy (e.g. cinema tokens for someone who had stayed late to get a key piece of work out) your managers will appreciate the flexibility and the option of an extra 'tool' to manage performance really well.

- Bear in mind that whilst distribution curves can be very helpful as a means to manage the spread of performance ratings, they can also be used by poor managers as something to hide behind, telling employees, "I didn't want to give you this rating but I had no choice!".

Forecasts indicate that the current levels of modest wage growth will continue into 2012, and even with inflation predicted to fall next year (*IDS*), the challenge of distributing tight pay budgets will continue for a while yet. With workers becoming increasingly unhappy in their job amid continuing job losses and "few and far between" pay rises (*RHR*, 2011) it is critical that businesses clarify their pay and performance links now to avoid losing their key talent, and in turn potential revenue.

## References

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