

You get what you pay for

Performance-based pay system can generate results

Question:

Over the past couple of years, our management team has spent a lot of time talking about whether our pay system is as effective as it should be. We've had a number of employees leave the company because they felt their pay didn't match up with their contributions. In some cases, we weren't disappointed an employee left. In other instances, we were losing very capable people. We didn't like that, particularly when it happened a second time, third time, etc.

We're confused about why this is happening. We feel like we're doing the right kinds of things. We have performance appraisals two times per year. Our process asks employees to rate their own performance, in addition to being

rated by their managers. We encourage our managers to talk about performance with their employees throughout the year, not just when it's time to do performance reviews. Some of our employees still don't like our pay system. Lately, we've been kicking around the concept of performance-based pay. What do you think of it? If we move to performance-based pay, what steps should we take?

Answer:

Performance-based pay is a method of compensating employees for the work outcomes that are produced. Compensation is based on demonstrable, measurable factors.

It is a straightforward process that goes like this:

Performance is demonstrated.

Ratings of the performance are made.

Monetary and other rewards are disseminated.

Examples of competencies:

LEADERSHIP
INTERPERSONAL RELATIONS
COMMUNICATION
SELF-MANAGEMENT
MOTIVATION
ORGANIZATIONAL KNOWLEDGE
ORGANIZATIONAL STRATEGY
ADMINISTRATIVE FACTOR
CRITICAL THINKING

Behavioral competencies are the basis for a performance-based system. Competencies may be defined as those characteristics that underlie performance or behavior at work. Competencies are typically some combination of knowledge (e.g., knowledge of the job), skills (e.g., critical thinking), abilities (e.g., interpret a financial statement), and personal attributes (e.g., styles, personality, interests, values, attitudes, etc.).

In building a competency model, the following 10 steps are normally undertaken:

1. Define the scope of the model.
2. Consider the roles to be included in the model.
3. Consider the stage of organization development.
4. Consider other relevant contextual categories.
5. Identify competency categories.
6. Select competencies.
7. Collect supporting information.
8. Revise and finalize the competencies.
9. Establish the relative importance and level of mastery for each

competency.

10. Create behavioral indicators for each competency.

Depending upon the organizational context in which you operate, various kinds of competencies will be identified. This is because the factors underlying success in one company may not be the same ones that contribute toward success in a second company. Competencies also may vary from job to job within a given company, reflecting the fact that different kinds of work demand different kinds of skills.

In a performance-based pay model, these competencies could be used as compensable factors—they could be the factors that are used to assign the pay rates the organization uses to compensate its employees.

Starting with the 10th step in building a competency model above and extending beyond it, let's see how that might work:

Step One: Operationally define the competencies.

Define the competency in such a way that measurement is possible. As an example, the competency of critical thinking might be defined as, "An individual's attitudes of inquiry, especially regarding the need for evidence regarding what is asserted to be true."

Step Two: Develop stratifications (i.e., levels) for the competencies.

Create a hierarchy of proficiency for each competency. For example, using the critical thinking competency, the following four levels might be established:

LEVEL ONE: Is aware of simple cause/effect relationships.

LEVEL TWO: Probes for deeper understanding of non-obvious issues, relationships, etc.

LEVEL THREE: Identifies and recognizes patterns in the environment.

LEVEL FOUR: Offers vision for creative development of new solutions, processes, etc.

**Step Three:
Assign points to the competencies and associated levels.**

Determine which competencies are most important to organizational success. Weigh most heavily those competencies (and levels) that are most important, weigh least heavily those competencies (and levels) that are least important.

**Step Four:
Match the competencies and associated levels with jobs.**

Identify which competencies and levels attach to which jobs. Add up the points for each job. Now you have a basis for equating jobs across the organization.

**Step Five:
Establish salary pay grades.**

Using the point totals from Step Four above create a distribution of jobs from low to high. Jobs with lower point totals receive less compensation; jobs with higher point totals receive more compensation.

**Step Six:
Gather performance data.**

Create a performance appraisal form that targets the competencies identified earlier, using behavioral indicators that allow raters to assess how proficient employees are. For example, for each competency you could create a rating scale that allows for ratings from “low” (i.e., lacks proficiency) to “high” (i.e., exceptionally proficient).

**Step Seven:
Offer performance-based compensation adjustments.**

Using the data from Steps Four through Six, performance-based compensation adjustments could be awarded to each employee. Raters could assess employees contributions based on the proficiency they have demonstrated. Proficient employees would score higher than non-proficient employees. Accord-

ingly, the most highly compensated employees would be the ones who occupy jobs with high point totals (i.e., more significant roles) and who demonstrate exceptional proficiency within a given rating period.

**Step Eight:
Monitor and fine-tune the system.**

Like any other organizational program, a performance-based pay system needs to be monitored. Of particular importance will be the distribution of scores that attach to the performance review. If there is an overly positive skew to the scores (i.e., most of the employees are rated as being exceptionally proficient), then the company is going to be making more compensation adjustments. This can be costly over time, especially if the employees are not as proficient as the ratings say they are. So, it is essential to deploy trained raters who apply the performance criteria uniformly across the company.

In the final analysis, a well-built performance-based pay system helps to ensure that compensation is equitable. It also is the foundation for performance management because it provides objective data, the means to set individual and team goals and a platform for daily supervision and performance coaching.



Daniel Schroeder, Ph.D., of Organization Development Consultants, Inc. (ODC) in Brookfield provides “HR Connection.” Small Business Times readers who would like to see an issue addressed in an article may reach him at (262) 827-1901, via fax at (262) 827-8383, via e-mail at schroeder@odcons.com or via the internet at: www.odcons.com.