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David Longjohn
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Pay for performance, also referred to as merit pay, is a compensation system that rewards employees relative to their job performance. When needing or exceeding goals, individuals receive greater compensation compared to if they fall short of targets.

Advocates of PFP believe that compensation is a motivator and that greater quality and quantity of work can be incentivized by rewarding employees accordingly. Employees whose work does not meet goals may be incentivized to seek relevant training to strengthen skills or pursue a different role that is a better fit. Proponents believe PFP can lead to fairer compensation, strengthen skills or pursue a different role that is a better fit.

Opponents criticize PFP of evaluating complex jobs with simplistic measures, possibly undermining quality, productivity and engagement. An often-cited concern is the potentially subjective judgement of employee performance and the challenge of applying the PFP plan to roles more cognizant versus those that are mostly mechanical.

What is PFP?

Pay for performance depends upon efficiency, equity and compliance. PFP must be customized to individual jobs. No one size fits all.

Efficiency relies upon a strategy for the PFP plan to support organizational objectives, a structure decentralized enough to allow different operating units flexibility in developing variations of the plan, and standards to make good decisions regarding performance objectives and measures, eligibility and funding.

Equity refers to the distributive justice and procedural justice of the plan. The outcomes and the process must be perceived as fair.

Compliance is about minimizing legal costs and protecting the reputation of the organization.

Changing Philosophies

Historically, pay seen as entitlement, but in recent years there has been a major shift in compensation with larger share of pay tied to individual or organizational performance. This change in perspective is driven by increasing global competition with a need to lower costs and raise productivity. Fast-paced business environments necessitate nimble workers. A way to promote nimbleness is with PFP.

Pay for performance can be individual focused to incentivize higher productivity gains or group focused to improve team coordination. Most organizations that use PFP do a combination.

A Variety of Carrots

Pay for performance can take many forms, both long-term and short-term.

Merit pay links increases in base pay to how highly employees are rated on a performance evaluation. Keys to success are accurate performance ratings, enough budget and differentials across levels large enough to motivate employees.

Merit bonus is a lump-sum not added to base pay. It has less entitlement and controls labor costs but is less popular with employees because it must be earned every year.

Group PFP plans can be by work team, department, division or entire organization. Standards must be developed against which group performance is measured. Performance appraisals don’t work well for groups as those are more personal in nature.

In business school we are taught that labor is an expense to be managed, but in reality, people aren’t an expense, they are an investment, an appreciating asset – the more we invest in them, the more we see productivity, customer service, innovation and growth.”

Opting for professional development with merit compensation could result in greater productivity, boost morale, and increase enrollment.

Pay Can Get You This Far

What isMaslow’s theory is that wages can satisfy the deficiency needs (physiological and safety). Going beyond that to satisfy the growth needs (belonging, esteem, self-actualization) requires fostering a team spirit, periodic praise, designing challenging jobs, providing training, and encouraging creativity.

Maslow’s Hierarchy of Needs

Win – Win!

Conclusion

The most significant factor in quality and quantity of work is intrinsic to the individual rather than being prompted by compensation. Pay for performance may be motivational to a significant degree, but the extent still weighs greatly on the personalities involved. A person with little ambition may not be prodded greatly by PFP programs.

For any merit system to succeed, it must be thoughtfully designed and communicated well so that employees have a line of sight on how their behavior influences outcomes. If employees don’t feel the process was fair, then much is lost.

Designing and managing a PFP plan is a complex process and the funding challenges presented by budget constraints could render a fully developed system an impracticable commitment. Having a merit component that further incentivized professional development and job-related coursework may be a feasible way to reward practical personal growth and strengthen the institution.

References


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