Why Link Pay to Performance?

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If you expect to attract and retain the best people, you must have market competitive pay. Additionally, you have to be willing to accept some level of employee turnover. The key is to design your pay so that you have targeted turnover; i.e. you induce turnover of low performing personnel while re-enforcing a culture of high performance, enabling you to retain top performers. This is why every company should consider linking pay to performance.

The problem for many companies is the minimal spread between high and low performers. Most companies design their pay around a merit matrix that looks like this:

	<- - - - - - - - Quartile Range - - - - - - - - >			
Performance Level	1	2	3	4
Exceptional	3.5%	3.5%	3.0%	3.0%
Exceeds Expectations	3.0%	3.0%	3.0%	3.0%
Effective	2.5%	2.5%	2.5%	2.0%
Development Needed	2.5%	2.5%	2.0%	2.0%
Unacceptable / Poor	2.5%	2.0%	2.0%	2.0%

In the above example, the spread between the best and worst performers is a mere 1.5%. In today's world where companies are fighting to attract and retain top talent, you must be much more aggressive with your merit matrix so that it looks more like this:

	<- - - - - - - - Quartile Range - - - - - - - - >			
Performance Level	1	2	3	4
Exceptional	6.5%	5.5%	5.0%	4.0%
Exceeds Expectations	6.0%	5.0%	4.0%	3.0%
Effective	5.0%	4.0%	3.0%	2.0%
Development Needed	2.0%	1.0%	0.0%	0.0%
Unacceptable / Poor	0.0%	0.0%	0.0%	0.0%

In this example, people who don't perform get no increase. This sends a strong signal to everyone that performance matters and for those who do perform, you will get a serious merit increase. This is one of the most powerful statements any company can make when it comes to retaining the best people. You should also think about the limited money you have to spread around. You want to allocate your limited resources to those people who deliver results. A merit matrix that has very distinct difference between low and high performances will do more to communicate and create a culture of high performance than any speech or memo you will issue.

“Variable pay budgets and spending have nearly doubled in the last 20 years, subsequently emerging as the pay-for-performance vehicle of choice now and for the foreseeable future. In a more robust job market, competition for talent exists in every sector. As a result, we are seeing industries that have traditionally shied away from providing bonuses, such as agriculture, higher-education and the federal government, realizing they must establish variable pay programs to compete for and retain the best talent.” - Ken Abosch, Compensation Leader for Aon Hewitt.

Trying to retain the best people is becoming increasingly difficult. According to a 2015 survey conducted by WorldatWork, over 80% of the people surveyed indicated they plan to leave their job. Contrast this to five years ago when the percentage was 60%. High performers are not going to stick around for the usual 3% raise while others get 1%.

A final point concerns the traditional performance review. If you link pay to performance, you need to rely more on 360 degree feedback that has some anonymity. This provides an objective, open and honest review process that serves as your basis for administering your merit matrix. Additionally, your review process has to be on-going and not just once a year. It should be a cumulative reflection on how well someone has helped the company meet department and company goals. And the review process should be both quantitative and qualitative. For example, the Marketing Manager was able to help the company meet its sales targets (quantitative), but he also mentored and grew the capability of our marketing team (qualitative). If you can have a robust back-end review process coupled with a serious merit matrix (as described in this article) and combine this with a competitive benefits package, then you have established the foundation that should enable a high performing workforce.