

Paying for Performance 2003-04

Survey Brief – May 2004

Survey of WorldatWork members by WorldatWork and Hewitt Associates

Introduction

For years, organizations have relied on pay for performance to reward employees for achieving business objectives. Today, a number of broad forces are making pay for performance an increasingly critical factor in organizations' abilities to achieve business objectives.

- *The down economy* is driving organizations to slash their compensation budgets, making it more essential than ever that compensation dollars are used wisely.
- *Intense corporate scrutiny of expenditures* is making it critical that the desired returns on reward dollars are achieved.
- *Corporate cost-cutting and downsizings* are leaving organizations in need of ways to boost employee productivity.
- *A tight job market*, expected to grow out of the coming economic recovery and baby boomer retirements, will make it crucial that organizations have tools for retaining their high and average performers.

This survey report reveals how organizations are paying for performance in today's business environment and highlights ways in which organizations can improve their pay for performance practices going forward.

Survey Methodology

WorldatWork and Hewitt Associates partnered to conduct this survey on paying for performance. The survey gathered information on current practices surrounding the context and objectives of pay for performance, and pay for performance communications, measures, rewards and effectiveness. Organizations were asked to answer the survey questionnaire based on their full-time, U.S.-based employees and to exclude practices associated with senior executives from their responses.

A representative sample of 5,800 WorldatWork members was sent a link to the electronic survey instrument in February 2004. During a two-week period, a total of 348 members responded, a response rate of six percent. Two hundred ninety of these organizations had pay for performance programs and were able to complete the entire survey. Respondent organizations represented a variety of industries and organization sizes (see demographics section at the end of the report).

Note: In some figures, percentage totals may not add to exactly 100 percent due to rounding.

Executive Summary

Evidence Pay for Performance Only Moderately Successful

The results of the Paying for Performance 2003-04 survey reveal that most organizations' pay for performance programs were "somewhat successful," but not "very successful," in achieving their 2003 objectives. Pay for performance programs had some of the desired behavioral effects on high, average, and low performers in 2003, but there is room for improvement.

The survey's findings that pay for performance programs in 2003 were only moderately successful are particularly noteworthy due to the fact that survey participants indicated that the primary objective of pay for performance programs was improving financial results. The overall grade of "somewhat successful" becomes even more significant when considering the other frequently cited pay for performance objectives: retaining top performers, improving customer service, improving quality, and using compensation dollars more effectively.

Specific Challenges Associated with Pay for Performance

While the survey results firmly established that paying for performance is considered a tool for attaining key business objectives, it also highlighted specific reasons why pay for performance programs were not more effective. For example, the survey results suggest that:

- The biggest challenge many organizations face in paying for performance is program administration.
- Organizations are also challenged by the funding and design aspects of paying for performance.
- Strong pay for performance programs and cultures are elusive for most organizations.
- Pay for performance program effectiveness metrics are absent at most organizations.
- Open communications about pay for performance are uncommon in organizations, especially with non-managerial employees.
- There are significant differences in the amount of pay for performance information that is shared with managers versus other employees.
- Differentiation of performance pay for high, average, and low performers is insufficient.
 - The slopes of pay for performance curves are not sufficiently steep.
 - Base salary increases are not varied enough according to different levels of performance.
 - High performer populations are twice the size suggested by most program designs.
 - Organizations use one-size-fits-all approaches to determining merit increase budgets.

- Merit pay objectives dictate that pay be overly distributed to average and low performers.
 - Organizations differentiate merit pay based on absolute performance or a hybrid/combination method, as opposed to differentiating based on relative performance.
 - Most organizations do not allow performance rewards to be customized.
- Most organizations are not taking action, or planning to take action, to increase merit pay differentiation. Among those organizations that are taking action or planning on taking action, most are not reducing the size of their high performer populations.

Ways to Make Pay for Performance Programs More Successful

A comparison of the organizations who self-reported that their pay for performance programs were “very successful” in 2003 versus organizations that indicated their pay for performance programs were “not successful” revealed that the two groups have substantially different approaches to paying for performance.

A review of the differences in these approaches suggests five actions that organizations could take to improve the effectiveness of pay for performance programs. A number of these pay for performance approaches or practices were significantly related to the success of pay for performance programs.

1. Instill a strong pay for performance culture throughout the organization.
2. Use an open, push, readily available approach to communications.
3. Tackle the insufficient funding challenge.
4. Improve differentiation of performance pay.
5. Establish metrics for evaluating pay for performance effectiveness and use them.

The complete survey results reveal more about the state of paying for performance in 2003 and suggest ways pay for performance programs can be improved going forward.

Detailed Survey Results

An initial screening question on the survey revealed that 15 percent of initial participants did not have a pay for performance program or culture. This report contains information about the 85 percent of participants who reported having a pay for performance program or culture in their organization.

This results report is organized in the following sections:

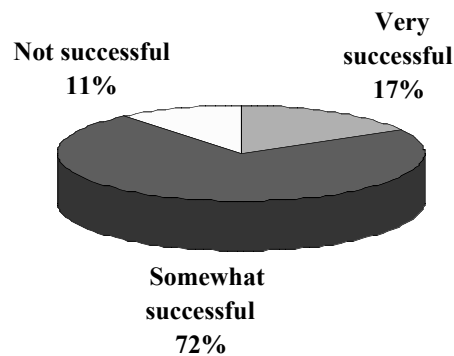
- A. Practitioner Perceptions: Pay for Performance Programs Were Only Moderately Successful in 2003
- B. Specific Challenges Associated with Pay for Performance
- C. Ways to Make Pay for Performance Programs More Successful
- D. In Summary
- E. Respondent Demographics

SECTION A – PRACTITIONER PERCEPTIONS: PAY FOR PERFORMANCE PROGRAMS WERE ONLY MODERATELY SUCCESSFUL IN 2003

Pay for Performance Programs Were Somewhat – but Not Very – Successful in 2003

Just under three out of four organizations (72 percent) reported their pay for performance programs were “somewhat successful” in achieving their 2003 objectives. The next most popular response, at 17 percent, indicated programs were “very successful” in 2003.

Figure 1. “How successful was your organization’s pay for performance program in achieving its objectives in 2003?” (n=285)



Pay for Performance Having Some Desired Impacts, but There's Room for Improvement

More than half of the organizations in the survey reported that pay for performance boosted the engagement, productivity, and work quality of high performers, while either reducing or keeping turnover stable (see Figure 2).

Pay for performance programs also had positive impacts on the behaviors of average performers, but not to the same extent (see Figure 3). About one-third of all respondents (instead of half in Figure 2) reported that pay for performance had positive impacts on the behaviors of average performers. These behaviors include engagement, productivity, quality of work, and teamwork.

In contrast, pay for performance programs had either no impact or deteriorating impacts on the behaviors of low performers (see Figure 4). Turnover of low performers increased at some organizations, as might be expected and desired.

Figure 2. Behavior Effects of Pay for Performance on High Performers

	<i>n</i> =	Percent of Organizations		
		Up	Down	No Change
Engagement	229	57%	2%	41%
Innovation	227	44%	1%	55%
Productivity	228	61%	0%	39%
Quality of work	227	56%	0%	43%
Teamwork	224	42%	3%	55%
Turnover	228	11%	35%	54%

Figure 3. Behavior Effects of Pay for Performance on Average Performers

	<i>n</i> =	Percent of Organizations		
		Up	Down	No Change
Engagement	226	30%	4%	65%
Innovation	222	21%	2%	77%
Productivity	224	40%	2%	58%
Quality of work	225	36%	1%	62%
Teamwork	224	31%	4%	65%
Turnover	225	11%	17%	72%

Figure 4. Behavior Effects of Pay for Performance on Low Performers

	<i>n</i> =	Percent of Organizations		
		Up	Down	No Change
Engagement	225	12%	22%	65%
Innovation	221	6%	16%	78%
Productivity	219	19%	15%	66%
Quality of work	220	17%	15%	68%
Teamwork	220	12%	17%	71%
Turnover	227	37%	8%	55%

2003 Performance Improvement Strategies: Somewhat, but Not Very Effective

Of those organizations that attempted performance improvement strategies in 2003, more than half reported that across the board these strategies were “somewhat,” but not “very” effective. The performance improvement strategy receiving the most “very” effective ratings was high performer identification, but still, only 40 percent of organizations gave this rating.

Examples of “other” write-in responses include: “CEO communication of corporate performance” very effective, “individual performance-based bonus” very effective, and “did not have merit increases during 2003 due to poor business results” not effective.

Figure 5. Effectiveness of Formal Performance Improvement Strategies Used in 2003

	<i>n</i> =	Percent of Organizations		
		Very Effective	Somewhat Effective	Not Effective
High performer identification	220	40%	52%	8%
End of cycle performance reviews	263	31%	64%	5%
Performance measurement	278	30%	62%	8%
Performance-based pay differentiation	241	29%	60%	12%
Performance planning	234	26%	64%	9%
360-degree feedback	110	25%	55%	19%
Mid-cycle performance reviews	161	25%	53%	22%
Structured termination of low performers	166	21%	52%	27%
Career/succession planning	181	16%	65%	19%
Coaching/mentoring (not by immediate manager)	159	13%	71%	16%
Development planning	218	12%	75%	12%
Other	5	60%	0%	40%

Main Objective of Pay for Performance Programs Is to Improve Financial Results

Indications that pay for performance programs were only moderately successful in 2003 perhaps take on more significance when looking at the main objectives of organizational pay for performance programs.

Improving financial performance/revenue was most frequently cited as a primary objective for 2003 pay for performance programs.

Other major objectives reported by many organizations included:

- Retaining top performers
- Improving customer service
- Improving quality
- Using compensation dollars more effectively

It is worth noting that “reducing compensation costs” was cited by 60 percent of respondents as **not** being an objective of their pay for performance programs. A small number of organizations provided “other” write-in responses to this question. Examples of these responses included:

“safety,” “strengthen the employee-manager relationship,” “increase learning in the organization,” and “reinforce new sales training program.”

Figure 6. Objectives of 2003 Pay for Performance Programs

	<i>n</i> =	Percent of Organizations		
		Major objective	Minor objective	Not an objective
Improve financial performance/revenue	286	79%	13%	8%
Retain top performers	287	69%	23%	9%
Improve customer service	286	59%	27%	13%
Improve quality	285	57%	34%	8%
Use compensation dollars more effectively	286	56%	28%	15%
Reinforce culture and values	285	47%	34%	19%
Promote teamwork	286	35%	42%	24%
Improve engagement	285	34%	38%	29%
Increase fairness in compensation	285	34%	39%	27%
Encourage innovation	287	28%	40%	32%
Promote organizational change	286	22%	39%	39%
Terminate low performers	285	18%	44%	38%
Reduce compensation costs	286	14%	26%	60%

SECTION B – SPECIFIC CHALLENGES ASSOCIATED WITH PAY FOR PERFORMANCE

Program Administration Is the Biggest Challenge

Eighty-four percent of organizations indicated administration of programs was one of their most significant pay for performance challenges. Over half of all respondents (59 percent and 58 percent respectively) indicated that funding and design are also big pay for performance challenges.

Note: Participants were asked to select three challenges from a list. Figure 7 was created by collapsing the list of challenges into three broad categories (administration, funding, and design). The “other” category was omitted in creating this figure of collapsed categories, which is why the “n” in Figure 7 is smaller than the “n” in Figure 8.

Figure 7. Summary of Biggest Challenges in Paying for Performance (n=228)

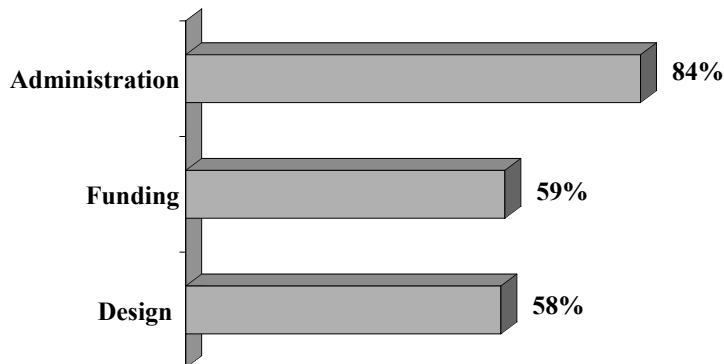


Figure 8 contains details about the specific aspects of administration, funding, and design that organizations found most challenging. The top two specific challenges, cited by half of all respondents, were “not having enough reward money to motivate” and “inconsistent administration.” The down economy was likely a major driver behind organizations reporting not having enough reward money to motivate their employees. Survey results, presented in the coming pages, suggest that insufficient performance differentiation may also have been involved.

Examples of “other” write-in responses include: “recognizing teams,” “communicating targets,” “managers not able to implement,” and “poor goal setting.”

Figure 8. Biggest Challenges in Paying for Performance – Detailed Responses

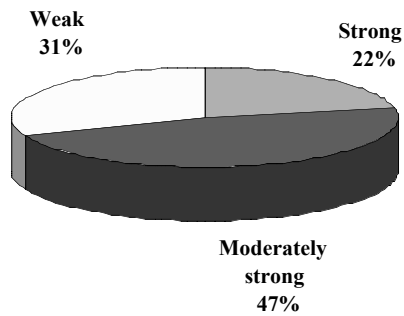
	Percent of Organizations
Not enough reward money to motivate	57%
Inconsistent administration	50%
Favoritism or perception of	42%
Not enough line of sight between action and reward	38%
Administrative burden	22%
Focus too much on individual performance	10%
Not enough customization	9%
Employees game the system	8%
Goals too short-term	8%
Too difficult for employees to achieve performance targets	6%
Too costly	3%
Too much emphasis on low-cost rewards	2%
Too much emphasis on noncash rewards	0%
Other	10%

(n=231; multiple responses)

Strong Pay for Performance Program and Culture Elusive for Most

Only 22 percent of organizations described their pay for performance program/culture as “strong,” while almost a third of respondents indicated theirs was “weak.”

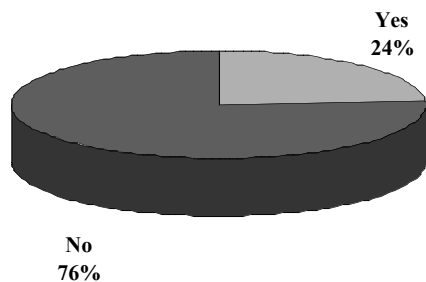
Figure 9. “Which of the following best describes your organization’s pay for performance program and culture?” (n=290)



Program Effectiveness Metrics Not Used at Most Organizations

Three-fourths of organizations (76 percent) reported they do not have formal metrics in place to gauge pay for performance program effectiveness. Yet, with 79 percent of organizations indicating improving financial results was a main pay for performance objective (see Figure 6), it is probable that more than 24 percent of organizations have some financial metrics available but were just not using them to evaluate pay for performance effectiveness.

Figure 10: “Do you have formal metrics in place to gauge pay for performance program effectiveness?” (n=286)



Open Communications Is Relatively Uncommon, Especially with Non-Managers

Only 54 percent of organizations described their communications with managers regarding performance-based pay as “open, push, readily available.” Even fewer (35 percent) described their performance-based pay communications with other employees as being this way.

Figure 11. Approaches to Communicating About Performance-Based Pay

	Percent of Organizations Using Approach With	
	Managers	Other Employees
Open, push, readily available	54%	35%
Somewhere in between	39%	47%
Closed, “need to know” basis	<u>7%</u>	<u>18%</u>
	100%	100%
	(n=284)	(n=285)

Big Differences in Pay for Performance Information Shared With Managers and Other Employees

On an aggregate level, non-managerial employees receive only a portion of the pay for performance information that managers receive (see Figure 12). Most notably, significantly fewer non-managerial employees receive information on rating distribution guidelines, merit increase budgets, and merit increase guidelines.

Figure 12. Most Significant Differences in the Types of Pay for Performance Information Shared with Managers versus Other Employees

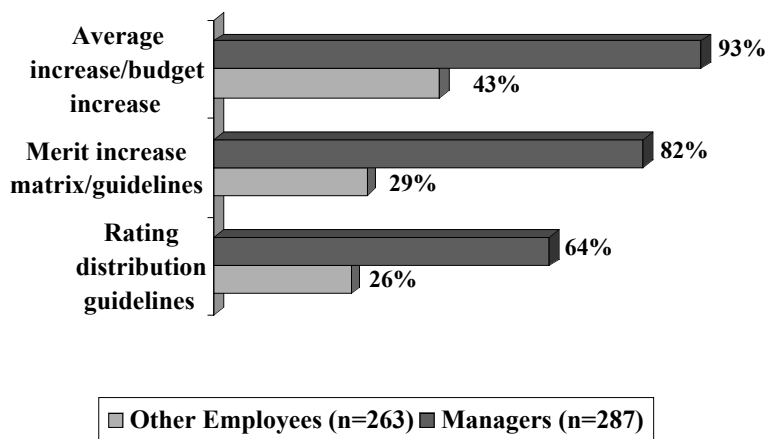


Figure 13 contains complete and detailed (non-aggregated) results regarding information that is shared with managers versus other employees. It highlights an additional finding that 30 percent of organizations do not share pay for performance philosophy and objectives with non-managerial employees, and 15 percent do not share this information with managers.

A few organizations provided “other” write-in responses to this question. Select “other” responses include: “CEO communicates corporate performance” and “management by objectives.”

Figure 13. Pay for Performance Information that Is Openly Shared – By Type of Employee

	Percent of Organizations Sharing Openly with	
	Managers	Other Employees
Average increase/budget percent	93%	43%
Mechanics of process (e.g., who, what, etc.)	92%	65%
Individual performance rating/level	87%	65%
Pay for performance philosophy/objectives	85%	70%
Merit increase matrix/guidelines	82%	29%
Salary range information (minimum, midpoint, maximum)	76%	46%
Formula/measures for variable pay plan	72%	47%
Spread/distribution of actual increases for own department/units	70%	5%
Rating distribution guidelines	64%	26%
Projected pay-out levels for variable pay attainment	55%	31%
Mid-cycle performance reports on variable pay attainment	30%	19%
Other	1%	1%
<i>(multiple responses)</i>	<i>(n=287)</i>	<i>(n=263)</i>

Mid-Cycle Performance Reports Are the Least Shared Type of Pay for Performance Information

Figure 14 indicates that 68 percent of organizations reported that they do not use mid-cycle performance reports on variable pay attainment. Additionally, 40 percent of organizations reported they do not share information regarding projected pay-out levels for variable pay attainment with employees. A few organizations provided “other” write-in responses to this question. Select “other” responses included: “moving from closed to open pay information system” and “trained all executives in 2003 and managers in 2004.”

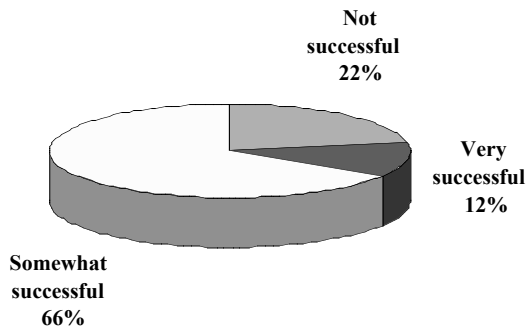
Figure 14. Types of Pay for Performance Information Shared and Not Shared with Employees

	<i>n</i> =	Percent of Organizations	
		Shared	Not Shared
Mechanics of process (e.g., who, what, when, etc.)	279	96%	4%
Individual performance rating/level	274	95%	5%
Average increase/budget percent	285	94%	6%
Pay for performance philosophy/objectives	280	89%	11%
Merit increase matrix/guidelines	276	86%	14%
Salary range information (minimum, midpoint, maximum)	277	81%	19%
Formula/measures for variable pay plan	276	77%	23%
Spread/distribution of actual increases for own department/units	273	73%	27%
Rating distribution guidelines	274	68%	32%
Projected pay-out levels for variable pay attainment	268	60%	40%
Mid-cycle performance reports on variable pay attainment	273	32%	68%

Performance Pay Differentiation Is Insufficient

Just 12 percent of organizations reported they have been “very successful” in achieving their goals for differentiating the pay of high, average, and low performers. The vast majority (66 percent) said they have been “somewhat successful.”

Figure 15: “Over time, how successful has your organization been in achieving its goal for differentiating the pay of high, average and low performers?” (*n*=283)



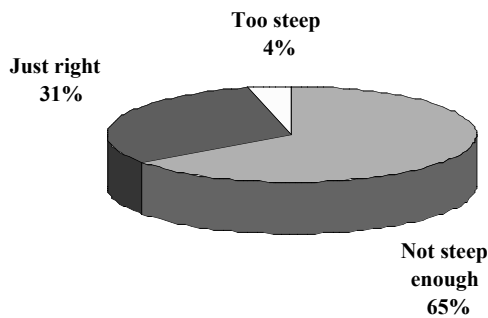
The survey results suggest a variety of reasons why performance pay differentiation is not more effective. The remaining analysis in this section covers these reasons, most of which relate to:

- The slope of pay for performance curves
- Base salary increases
- High performer populations
- Approaches to determining merit increase budgets
- Merit pay objectives
- Methods of differentiating merit pay
- Customization of performance rewards

Slope of Pay for Performance Curve Is Not Steep Enough

Roughly two-thirds of organizations in the survey (65 percent) indicated that the current slopes of their organizations’ pay for performance curves are not steep enough for motivating desired employee behaviors.

Figure 16: “How adequate is the current slope (degree of leverage/differentiation) of your organization’s pay for performance curve for motivating desired employee behaviors?” (n=270)



Base Salary Increases Are Not Varied Enough

Reports of 2003 average base salary increases for managers, exempts, and nonexempts show little differentiation (see Figures 17-19). According to the data, high performers received less than two times what average performers were awarded.

Figure 17. Average Base Salary Increase for Managers in 2003

	High Performers (top quartile)	Average Performers (middle 50th)	Low Performers (low quartile)
Mean	5.07	3.16	1.16
Median	5.00	3.00	1.00
n=	245	247	241

Figure 18. Average Base Salary Increase for Exempt Employees in 2003

	High Performers (top quartile)	Average Performers (middle 50th)	Low Performers (low quartile)
Mean	4.90	3.07	1.09
Median	5.00	3.00	1.00
<i>n</i> =	249	253	247

Figure 19. Average Base Salary Increase for Nonexempt Employees in 2003

	High Performers (top quartile)	Average Performers (middle 50th)	Low Performers (low quartile)
Mean	4.59	2.97	1.07
Median	4.75	3.00	1.00
<i>n</i> =	242	249	243

High Performer Populations Are Twice the Size Stipulated by Most Program Designs

The average percentage of employees reported in the high performer category was 23 percent, a figure higher than what is anticipated by most pay for performance program designs (see Figure 20). Typically, pay for performance programs designs recommend an average of 10 percent of employees to be captured in the high performer category.

Having twice as many employees grouped in the high performer category is likely one driver behind organizations' reports that pay for performance dollars are stretched thin and insufficient for motivating desired employee behaviors.

Figure 20. Percentage of Full-Time, U.S.-Based Employees by Type of Performer

	High Performers (top quartile)	Average Performers (middle 50th)	Low Performers (low quartile)
Mean	23%	68%	9%
Median	20%	70%	10%
Minimum	2%	0%	0%
Maximum	100%	97%	40%
<i>n</i> =	248	248	248

Most Use a One-Size-Fits-All Approach for Merit Budgets

Sixty-six percent of organizations said they determine an overall merit budget based on organizational performance and external competitiveness, and then apply it uniformly to all groups. Only 21 percent of organizations determine an overall merit budget based on organizational performance and external competitiveness, but adjust it for groups based upon their specific financial and industry pressures (see Figure 21). Most frequently mentioned in the "other" responses were "no merit budget" or "no merit increases."

Figure 21. Approach for Determining Merit Increase Budget in 2003

	Percent of Organizations
We determine an overall merit budget based on organizational performance and external competitiveness and apply it uniformly to all groups	66%
We determine an overall merit budget based on organizational performance and external competitiveness but adjust it for groups based upon their specific financial and industry pressures	21%
We develop separate merit budgets based on group performance and external conditions	5%
Other	9%
<i>(n=282)</i>	100%

Merit Pay Objectives Overly Distribute Pay to Average and Low Performers

Predictably, on the continuum between offering no merit pay differentiation at all and offering all merit pay to high performers, most organizations indicated they fall somewhere in the middle (see Figure 22). However, this finding may suggest that organizations are aiming for some, but not enough merit differentiation.

Figure 22. Merit Pay Differentiation Objectives in 2003

	Percent of Organizations		
	Managers	Exempts	Nonexempts
Distribute all pay for performance merit dollars to high performers	4%	1%	2%
Distribute majority of pay for performance merit dollars to high performers, some to average performers, and none to low performers	39%	39%	36%
Distribute some pay for performance merit dollars to each group, with the greatest portion going to high performers and the smallest portion going to low performers	53%	55%	54%
Equally distribute pay for performance merit dollars among high, average, and low performers (no merit differentiation)	<u>5%</u> 100%	<u>5%</u> 100%	<u>8%</u> 100%
	<i>(n=283)</i>	<i>(n=282)</i>	<i>(n=277)</i>

Differentiating Merit Pay Based on Relative Performance Is Uncommon

According to the survey, most organizations differentiate merit pay based on an absolute performance rating scale or using a hybrid/combination method. Only about 15 percent of organizations differentiate merit pay based on rankings or relative performance. The majority of “other” write-in responses indicated the organization did not offer merit pay in 2003.

Figure 23. Method of Differentiating Performance in 2003

	Percent of Organizations		
	Managers	Exempts	Nonexempts
Absolute performance (rating scale; compared to set standard)	38%	38%	39%
Hybrid/combination (rank within rating groups)	30%	30%	27%
Relative performance (ranking process; compared to others)	15%	15%	14%
No formal process	11%	11%	13%
Other	<u>6%</u>	<u>6%</u>	<u>8%</u>
	100%	100%	100%
	(n=285)	(n=284)	(n=278)

Customization of Performance Rewards Is Not Common

Overall, only about half of organizations (49 percent) allow some customization of pay for performance rewards. As Figure 24 demonstrates, many more allow customization of pay for performance rewards for high performers than for average or low performers.

Figure 24. Allow Customization of Pay for Performance Rewards – By Type of Performer

	Percent of Organizations		
	Managers	Exempts	Nonexempts
High performer	47%	39%	30%
Average performer	18%	16%	12%
Low performer	12%	12%	10%
(n=290)			

Majority of Organizations Are Not Increasing Merit Pay Differentiation

Although many organizations indicated there is room for improving pay for performance differentiation, only about one-third of organizations reported they are currently taking action or planning on taking action in the next year to increase merit pay differentiation.

Figure 25. Taking Action or Considering Taking Action to Increase Merit Pay Differentiation

	Percent of Organizations		
	Managers	Exempts	Nonexempts
Yes	37%	36%	31%
No	<u>63%</u>	<u>64%</u>	<u>69%</u>
	100%	100%	100%
	(n=287)	(n=284)	(n=283)

Reducing Size of High Performer Population Is Not a Top Goal for Organizations Seeking Increased Differentiation

Even though organizations appear to have high performer populations that are larger than most pay for performance designs recommend, few reported they are currently reducing or considering reducing the size of their high performer populations (see Figure 26).

Instead, organizations that are currently acting or planning on taking action to increase merit pay differentiation are taking other initiatives that tend to be centered on improving pay for performance administration. Among these initiatives are training managers on differentiating performance and setting more aggressive performance targets.

Figure 26. Specific Actions to Increase Merit Pay Differentiation

	Percent of Organizations	
	Taking Action Now	Planning on Taking Action
Training managers on differentiating performance	69%	74%
Setting more aggressive performance targets	68%	67%
Reducing/eliminating increases for lesser performers	57%	51%
Using a more aggressive, highly leveraged merit increase grid	31%	36%
Reducing size of top performer population	17%	19%
Moving from ranking guidelines to forced rating distribution	12%	17%
Moving to variable timing from annual cycle	12%	6%
Moving from rating calibration to forced rating distribution	5%	12%
Other	1%	4%
<i>(multiple responses)</i>	<i>(n=75)</i>	<i>(n=84)</i>

Figure 27. Specific Actions Being Taken Now to Increase Merit Pay Differentiation – by Employee Type

	Percent of Organizations		
	Managers	Exempts	Nonexempts
Training managers on differentiating performance	71%	47%	40%
Setting more aggressive performance targets	62%	58%	51%
Reducing/eliminating increases for lesser performers	54%	56%	62%
Using a more aggressive, highly leveraged merit increase grid	34%	29%	26%
Reducing size for top performer population	18%	18%	13%
Moving to variable timing from annual cycle	9%	12%	13%
Moving from ranking guidelines to forced rating distribution	10%	12%	9%
Moving from rating calibration to forced rating distribution	6%	3%	4%
Other	1%	2%	2%
<i>(multiple responses)</i>	<i>(n=68)</i>	<i>(n=66)</i>	<i>(n=53)</i>

Figure 28. Specific Actions Planned in Next Year to Increase Merit Pay Differentiation – by Employee Type

	Percent of Organizations		
	Managers	Exempts	Nonexempts
Training managers on differentiating performance	76%	49%	41%
Setting more aggressive performance targets	61%	60%	52%
Reducing/eliminating increases for lesser performers	47%	54%	52%
Using a more aggressive, highly leveraged merit increase grid	35%	33%	32%
Moving from ranking guidelines to forced rating distribution	18%	16%	14%
Reducing size for top performer population	18%	16%	19%
Moving from rating calibration to forced rating distribution	12%	13%	10%
Moving to variable timing from annual cycle	5%	4%	5%
Other	4%	2%	2%
<i>(multiple responses)</i>	<i>(n=74)</i>	<i>(n=70)</i>	<i>(n=63)</i>

SECTION C – WAYS TO MAKE PAY FOR PERFORMANCE PROGRAMS MORE SUCCESSFUL

A comparison of organizations that indicated their pay for performance programs were “very successful” in 2003 and organizations that indicated their pay for performance (PFP) programs were “not successful” revealed a powerful finding – the two groups had substantially different approaches to paying for performance. A review of these different approaches suggests five actions organizations could take to improve the effectiveness of pay for performance programs.

1. Instill a Strong Pay for Performance Culture

The survey results show a significant relationship between the success of an organization’s pay for performance program and the strength of the organization’s pay for performance culture. Two-thirds of “very successful” organizations reported their pay for performance programs and cultures were strong. Only three percent of “not successful” organizations answered similarly. Instead, 91 percent of “not successful” organizations reported their pay for performance programs and cultures were weak.

Figure 29. Description of Organization's Pay for Performance Program and Culture

	Percent of Organizations	
	Very Successful with PFP	Not Successful with PFP
Strong	67%	3%
Moderately strong	31%	6%
Weak	2%	91%
	100%	100%
	<i>(n=49)</i>	<i>(n=32)</i>

2. Use an Open, Push, Readily Available Approach to Communications

A significant relationship was also found between the success of an organization’s pay for performance program and the openness of the organization’s pay for performance communications. Organizations that self-assessed as “very successful” were much more likely to use an open, push, readily available approach to communicating about pay for performance with managers and other employees.

Figure 30. Approaches to Communicating About Performance-Based Pay with Managers

	Percent of Organizations Using Approach	
	Very Successful with PFP	Not Successful with PFP
Open, push, readily available	86%	26%
Somewhere in between	14%	48%
Closed, “need to know” basis	0%	26%
	100%	100%
	(n=49)	(n=31)

Figure 31. Approaches to Communicating About Performance-Based Pay with Other Employees

	Percent of Organizations Using Approach	
	Very Successful with PFP	Not Successful with PFP
Open, push, readily available	61%	9%
Somewhere in between	33%	53%
Closed, “need to know” basis	6%	38%
	100%	100%
	(n=49)	(n=32)

It is also important to ensure that certain types of pay for performance information get shared. More “very successful” organizations shared the following types of pay for performance information:

- Pay for performance philosophy and objectives – 35 percent more
- Mid-cycle performance reports on variable pay attainment – 24 percent more
- Rating distribution guidelines – 24 percent more
- Formula/measures for variable pay plan – 18 percent more
- Projected pay-out levels for variable pay attainment – 18 percent more

Notably, 38 percent of “not successful” organizations did not share pay for performance philosophy/objectives, compared to just two percent of “very successful” organizations.

Note: The percentages reported above are percentage point differentials not percent differences.

Figure 32. Types of Pay for Performance Information Shared and Not Shared with Employees

	Percent of Organizations					
	Very Successful with PFP			Not Successful with PFP		
	<i>n</i> =	Shared	Not Shared	<i>n</i> =	Shared	Not Shared
Pay for performance philosophy/objectives	49	98%	2%	32	63%	38%
Mechanics of process (e.g., who, when, etc.)	49	96%	4%	32	88%	13%
Individual performance rating/level	48	92%	8%	30	93%	7%
Average increase/budget percent	49	88%	12%	33	94%	6%
Formula/measures for variable pay plan	48	85%	15%	33	67%	33%
Merit increase matrix/guidelines	49	84%	16%	31	77%	23%
Salary range information (minimum, midpoint, maximum)	48	81%	19%	32	78%	22%
Rating distribution guidelines	48	79%	21%	29	55%	45%
Projected pay-out levels for variable pay attainment	47	70%	30%	29	52%	48%
Spread/distribution of actual increases for own department/units	48	69%	31%	29	76%	24%
Mid-cycle performance reports on variable pay attainment	49	43%	57%	31	19%	81%

3. Tackle the Insufficient Funding Challenge

Many more “not successful” organizations cited funding, and specifically not having enough reward money to motivate, as one of their primary pay for performance challenges.

Note: Participants were asked to select three challenges from a list. Figure 33 was created by collapsing the list of challenges into three broad categories: (administration, funding, and design). The “other” category was omitted in creating Figure 33, which is why the “n’s” in Figure 33 are lower than the “n’s” in Figure 34.

Figure 33. Summary of Biggest Challenges in Paying for Performance

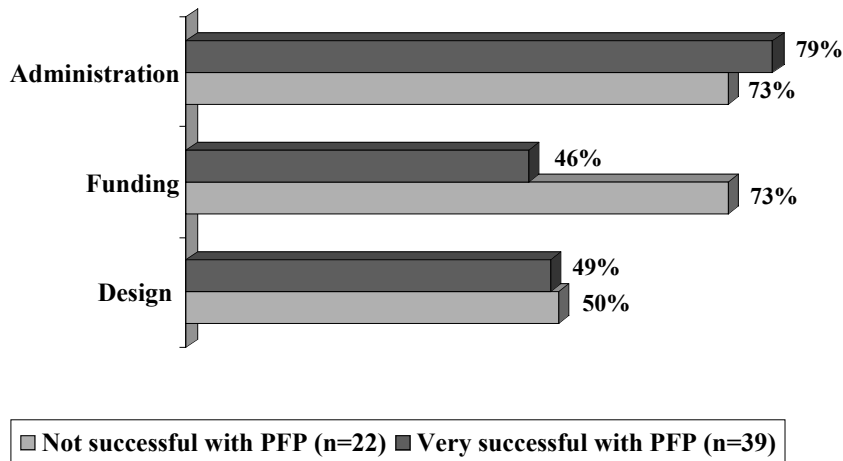


Figure 34. Biggest Challenges in Paying for Performance-Detailed Responses

	Percent of Organizations	
	Very Successful with PFP	Not Successful with PFP
Not enough reward money to motivate	45%	74%
Inconsistent administration	38%	39%
Favoritism or perception of	33%	39%
Administrative burden	35%	13%
Not enough line of sight between action and reward	28%	30%
Focus too much on individual performance	18%	4%
Too difficult for employees to achieve performance targets	15%	9%
Goals too short-term	13%	13%
Employees game the system	3%	4%
Not enough customization	5%	9%
Too costly	0%	0%
Too much emphasis on low-cost rewards	3%	4%
Too much emphasis on noncash rewards	0%	0%
Other	10%	13%
<i>(multiple responses)</i>	<i>(n=40)</i>	<i>(n=23)</i>

4. Improve Differentiation of Performance Pay

One way to tackle the insufficient funding challenge is to improve differentiation in performance pay. The survey results suggest that more “very successful” organizations have done this. Fifty percent of “very successful” organizations said they were very successful in differentiating the performance pay of high, average, and low performers, and 48 percent were somewhat successful. This compares to none of the “not successful” organizations reporting they were very successful with differentiation and only 38 percent reporting they were somewhat successful.

Survey findings reveal a significant relationship between pay for performance program success and success in differentiating performance pay.

Figure 35. Success in Differentiating Performance Pay for High, Average and Low Performers – Organizations Very Successful with PFP (n=48)

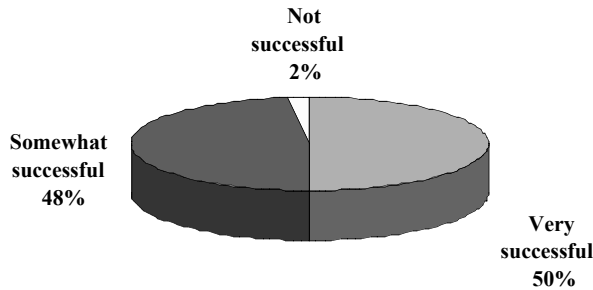
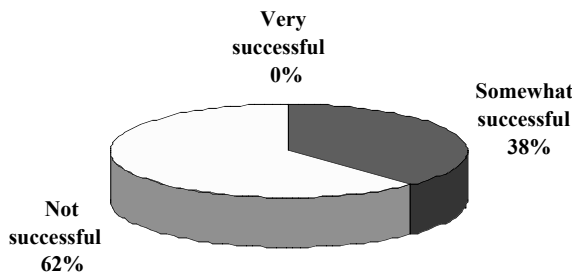


Figure 36. Success in Differentiating Performance Pay for High, Average and Low Performers – Organizations Not Successful with PFP (n=32)



Another way to achieve greater differentiation in pay for performance – and thus make better use of existing pay for performance reward pools – is to ensure the slope of the pay for performance curve is sufficiently steep. The survey results show a significant association between pay for performance success and the adequacy of the pay for performance curve. Nearly three-fourths of “very successful” organizations did this, reporting the slope of their pay for performance curve was “just right.” Conversely, over three-fourths of “not successful” organizations reported the slope of their pay for performance curve was “not steep enough.”

**Figure 37. Adequacy of Pay for Performance
Curve for Motivating Desired Employee Behaviors**

	Percent of Organizations	
	Very Successful with PFP	Not Successful with PFP
Just right	73%	7%
Not steep enough	23%	86%
Too steep	4%	7%
	100%	100%
	(n=48)	(n=29)

One tactic for increasing the slope of the pay out curve is by boosting the average base salary increase for high and average performers. In 2003, “very successful” organizations appear to have shifted base salary increase dollars from low to high performers. “Very successful” organizations had larger average pay out pools, but still paid less to low performers.

Figure 38. Average Base Salary Increase for Managers in 2003

Organizations	n=	High Performers (top quartile)	Average Performers (middle 50th)	Low Performers (low quartile)
Very successful with PFP	38-39	5.95	4.63	.97
Not successful with PFP	28	3.58	2.26	1.04

Figure 39. Average Base Salary Increase for Exempt Employees in 2003

Organizations	n=	High Performers (top quartile)	Average Performers (middle 50th)	Low Performers (low quartile)
Very successful with PFP	39-41	5.93	4.53	.93
Not successful with PFP	28	3.2	2.16	1.01

Figure 40. Average Base Salary Increase for Nonexempt Employees in 2003

Organizations	n=	High Performers (top quartile)	Average Performers (middle 50th)	Low Performers (low quartile)
Very successful with PFP	38-39	5.62	4.48	.94
Not successful with PFP	28-29	3.09	2.21	1.04

When distributing merit dollars, it is important not to over distribute merit pay to low and average performers. Survey findings uncovered a link between pay for performance success and merit pay distribution objectives. “Very successful” organizations tended to distribute all or the majority of pay for performance dollars to high performers, while “not successful” organizations tended to give some or equal portions of pay for performance dollars to each group of performers.

Figure 41. Merit Pay Differentiation Objectives in 2003 – Very Successful Organizations

	Percent of Organizations Very Successful With PFP		
	Managers	Exempts	Nonexempts
Distribute all pay for performance merit dollars to high performers	4%	2%	0%
Distribute majority of pay for performance merit dollars to high performers, some to average performers, and none to low performers	65%	65%	61%
Distribute some pay for performance merit dollars to each group, with the greatest portion going to high performers and the smallest portion going to low performers	29%	31%	37%
Equally distribute pay for performance merit dollars among high, average, and low performers (no merit differentiation)	<u>2%</u> 100%	<u>2%</u> 100%	<u>2%</u> 100%
	(n=48)	(n=48)	(n=46)

Figure 42. Merit Pay Differentiation Objectives in 2003 – Not Successful Organizations

	Percent of Organizations Not Successful with PFP		
	Managers	Exempts	Nonexempts
Distribute all pay for performance merit dollars to high performers	10%	0%	0%
Distribute majority of pay for performance merit dollars to high performers, some to average performers, and none to low performers	16%	26%	19%
Distribute some pay for performance merit dollars to each group, with the greatest portion going to high performers and the smallest portion going to low performers	58%	55%	58%
Equally distribute pay for performance merit dollars among high, average, and low performers (no merit differentiation)	<u>16%</u> 100%	<u>19%</u> 100%	<u>23%</u> 100%
	(n=31)	(n=31)	(n=31)

5. Establish Metrics for Evaluating Pay for Performance Effectiveness...and then use them!

Study findings also indicate a link between pay for performance success and the use of pay for performance metrics. More “very successful” organizations have metrics in place to gauge pay for performance effectiveness.

Figure 43. Formal Metrics to Gauge Pay for Performance Effectiveness?

	Percent of Organizations	
	Very Successful with PFP	Not Successful with PFP
Yes	46%	16%
No	54%	84%
	100%	100%
	(n=48)	(n=32)

Just having the metrics in place is not sufficient. It is important to ensure that pay for performance is having the desired behavioral effects. The desired behavior effects of pay for performance programs, as outlined in section one of this report, were more pronounced among “very successful” organizations. Pay for performance was ineffective for any groups among “not successful” organizations.

Figure 44. Behavior Effects of Pay for Performance on High Performers

	Very Successful with PFP				Not Successful with PFP			
	n=	Up	Down	No Change	n=	Up	Down	No Change
Engagement	41	78%	0%	22%	27	26%	15%	59%
Innovation	40	80%	3%	18%	27	19%	7%	74%
Productivity	40	88%	0%	13%	27	22%	4%	74%
Quality of work	40	80%	0%	20%	27	30%	4%	67%
Teamwork	40	65%	3%	33%	25	8%	4%	88%
Turnover	40	20%	50%	30%	27	15%	11%	74%

Figure 45. Behavior Effects of Pay for Performance on Average Performers

	Very Successful with PFP				Not Successful With PFP			
	n=	Up	Down	No Change	n=	Up	Down	No Change
Engagement	41	63%	2%	34%	27	4%	22%	74%
Innovation	39	45%	5%	51%	27	0%	11%	89%
Productivity	40	65%	0%	35%	27	11%	7%	82%
Quality of work	40	60%	3%	38%	27	11%	7%	82%
Teamwork	39	67%	3%	31%	27	7%	7%	85%
Turnover	41	20%	34%	46%	27	15%	4%	82%

Figure 46. Behavior Effects of Pay for Performance on Low Performers

	Very Successful with PFP				Not Successful with PFP			
	n=	Up	Down	No Change	n=	Up	Down	No Change
Engagement	39	21%	26%	54%	27	0%	22%	78%
Innovation	38	11%	21%	68%	27	0%	11%	89%
Productivity	39	31%	18%	51%	27	0%	15%	85%
Quality of work	39	28%	21%	51%	27	4%	15%	82%
Teamwork	39	23%	21%	56%	27	0%	15%	85%
Turnover	41	54%	15%	32%	27	19%	4%	78%

SECTION D – IN SUMMARY

The survey results presented above indicate that most organizations self-evaluated their 2003 pay for performance programs as only “somewhat successful” – not “very successful.” The specific reasons provided by respondents for why pay for performance programs were not more effective in 2003 included: program administration, funding and design aspects, establishing strong pay for performance programs and cultures, and the lack of pay for performance effectiveness metrics. The survey also revealed that in many organizations pay for performance communications are not open enough and that the slope of the pay for performance curves are not sufficiently steep.

A comparison of organizations who self-reported that their pay for performance programs were “very successful” in 2003 versus organizations that indicated their pay for performance programs were “not successful” revealed substantially different approaches to paying for performance. “Not successful” organizations can potentially learn a lot from those organizations that have been more successful, including five specific actions such as: improving their pay for performance culture, the openness of their communications, and not over distributing merit pay increases to low and average performers.

SECTION E – RESPONDENT DEMOGRAPHICS

The following tables are for all participant organizations.

Number of Full-Time Employees

	Percent of Organizations
Less than 100	8%
100–499	9%
500–999	9%
1,000–2,499	13%
2,500–4,999	17%
5,000–9,999	14%
10,000–19,999	12%
20,000 or more	<u>18%</u>
	100%

(n=248)

Most Recent Fiscal Year Revenues

	Percent of Organizations
Less than \$10 million	7%
\$10 million– \$100 million	14%
\$100 million–\$1 billion	37%
\$1 billion –\$10 billion	32%
\$10 billion–\$100 billion	<u>11%</u>
	100%

(n=222)

Industry Classification

	Percent of Organizations
Manufacturing	23%
Professional, scientific and technical services	15%
Finance and insurance	14%
Health care and social assistance	9%
Information	6%
Utilities	5%
Retail trade	5%
Transportation and warehousing	4%
Public administration	3%
Real estate, rental and leasing	2%
Accommodation and food services	2%
Other services	2%
Wholesale trade	1%
Educational services	1%
Mining	0%
Administrative support, waste, and remediation services	0%
Arts, entertainment and recreation	0%
Other	<u>9%</u>
	100%
<i>(n=222)</i>	

Participant Organizations Compared—“Very Successful” with PFP Versus “Not Successful” with PFP Participant Organizations

Number of Full-Time Employees

	Percent of Organizations	
	Very Successful with PFP	Not Successful with PFP
Less than 100	11%	8%
100–499	9%	4%
500–999	11%	12%
1,000–2,499	11%	24%
2,500–4,999	11%	12%
5,000–9,999	17%	16%
10,000–19,999	6%	16%
20,000 or more	<u>23%</u>	<u>8%</u>
	100%	100%
	<i>(n=35)</i>	<i>(n=25)</i>

Most Recent Fiscal Year Revenues

	Percent of Organizations	
	Very Successful with PFP	Not Successful with PFP
Less than \$10 million	13%	5%
\$10 million–\$100 million	11%	20%
\$100 million–\$1 billion	21%	45%
\$1 billion–\$10 billion	37%	30%
\$10 billion–\$100 billion	18%	0%
	100%	100%
	(n=38)	(n=20)

Industry Classification

	Percent of Organizations	
	Very Successful with PFP	Not Successful with PFP
Health care and social assistance	23%	8%
Finance and insurance	20%	4%
Professional, scientific, and technical services	17%	8%
Manufacturing	13%	29%
Utilities	3%	8%
Retail trade	3%	4%
Public administration	3%	8%
Information	0%	13%
Transportation and warehousing	0%	8%
Real Estate, rental, and leasing	0%	0%
Accommodation and food services	0%	0%
Other services	0%	0%
Wholesale trade	0%	0%
Educational services	0%	0%
Mining	0%	0%
Administrative support, waste, and remediation services	0%	0%
Arts, entertainment, and recreation	0%	0%
Other	17%	8%
	100%	100%
	(n=30)	(n=24)

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