



XpertHR Podcast

Original XpertHR podcast: 27 May 2016

- Laura Merrylees: Hello and welcome to this week's podcast with me, Laura Merrylees. Many organisations base their annual pay review on a measure of employee performance, but it is important that the process is managed fairly to ensure that the scheme meets its objectives.
- With me to discuss the challenges and benefits of using performance-related pay is XpertHR Managing Editor for Pay and HR Practice, Sheila Attwood. Just to be clear, Sheila, what do you mean by performance-related pay? [0:00:32.4]
- Sheila Attwood: Well this is where the employer will use reward to recognise employee performance, so perhaps through pay rises, incentive schemes, commission, bonus, profit share, and to some extent employee recognition schemes.
- Laura Merrylees: We're going to focus on performance-related pay rises here, so what are those specifically? [0:00:47.7]
- Sheila Attwood: Well what this is, is where the employer links the outcome of the annual pay review to a measure of the employee's performance.
- Laura Merrylees: And is this a common method of rewarding employees? [0:00:55.7]
- Sheila Attwood: Well let's put this into context. Every year XpertHR collects around 1,600 pay award details and around a quarter of these are going to be based on employee performance. So that's in contrast to where, say, everybody gets the same percentage pay rise in that year.
- Laura Merrylees: So why don't employers just give everyone the same pay award? [0:01:12.1]
- Sheila Attwood: Well there are two things really that employers are looking to do. They want to motivate their employees to perform at a higher level, but they also want to reward those employees that do so.
- Laura Merrylees: And is there any evidence to back that up? [0:01:21.7]
- Sheila Attwood: There is, yes. XpertHR has recently conducted a survey of how 132 organisations use performance-related pay and those two objectives come out as the top things that they're hoping that their scheme will achieve.
- Laura Merrylees: Okay, well that's interesting given that it's based on first-hand feedback from employers. In a nutshell, how does performance-related pay work? [0:01:39.5]

Sheila Attwood: Boiling it right down, an employee is going to have their performance assessed and then the outcome of that review is going to translate into their pay award.

Laura Merrylees: Okay, so let's go through some of that process in more detail, starting with how an employee's performance might be assessed. [0:01:52.2]

Sheila Attwood: Well the most common method is through an appraisal. So the employee's line manager will assess the employee's performance.

Laura Merrylees: Okay, and how does the appraisal measure performance specifically? [0:02:01.4]

Sheila Attwood: Well most commonly it's going to look at the extent to which some pre-agreed targets have been met, but there are a couple of points here to raise. These targets, they need to be specific in what the employee has to do, they need to be able to be achieved by the employees and it should be possible to measure the extent to which they've been met.

Laura Merrylees: Okay, and whose responsibility will it be to get that right? [0:02:21.2]

Sheila Attwood: So this is where line managers come in. They really need to have those skills to be able to set those achievable objectives for the employee. But also of course the employee needs to be clear on how they're going to meet or even go beyond what is set in those objectives.

Laura Merrylees: So what would the outcome of a performance review look like? [0:02:36.8]

Sheila Attwood: Well here we're likely to get a rating. So employers can choose how many they're going to have but probably between three and six is sufficient.

Laura Merrylees: Okay and what might those be? [0:02:44.8]

Sheila Attwood: So they're going to describe the extent to which the employee has met their objectives. So let's take as an example a scheme that has four ratings – that might be perhaps 'not met', 'part met', 'met' and 'exceeded'. Employers could be a little bit more descriptive, say running from 'unsatisfactory' up to 'exceptional' but for consistency it's important that there are clear definitions attached to each of those levels.

Laura Merrylees: Of course. How do those translate into a pay award? [0:03:09.2]

Sheila Attwood: Well there are a couple of options for employers here. At the very simplest level you could just have a rating and that translates to a single percentage pay award.

Laura Merrylees: Can you give me an example of how that would work? [0:03:18.9]

Sheila Attwood: Yes, so if we take the example ratings I've just mentioned, perhaps employees rated as having not met their objectives, they won't get any pay rise; those that have part-met their objectives might get 1%; and then moving on up, those assessed as having met their

objectives might get a 2% rise; and those exceeded would be awarded a 4% increase.

Laura Merrylees: Okay, so that seems a pretty straightforward mechanism.

Sheila Attwood: You're right. It is, but it actually doesn't allow for lots of flexibility in the pay scheme.

Laura Merrylees: In which case, how can more flexibility be incorporated? [0:03:46.7]

Sheila Attwood: Well another option that employers have is to specify a range of pay increases per rating. So let's take that example again. Perhaps those that have part-met their objectives, they could be awarded a pay rise of, say, up to 1% and then those that met their objectives, they could have anywhere between a 1.5% and 3% pay rise and so on.

Laura Merrylees: And in those circumstances would the line manager be making those decisions? [0:04:07.8]

Sheila Attwood: They would, yes, as they're probably the ones that have conducted the performance appraisal, but they would be within those limits, and of course you could give line managers complete discretion of where pay rises are awarded, but again back within the overall pay bill budget.

Laura Merrylees: Presumably this point about keeping within the pay budget is important? [0:04:23.8]

Sheila Attwood: It is, yes. That's where all these decisions will come back to, making sure that they don't overspend the overall budget. Of course there are other ways of introducing flexibility. Organisations could really target that spend within the budget by perhaps taking into account employee pay levels.

Laura Merrylees: Could you tell us a bit more about that? [0:04:39.7]

Sheila Attwood: Yes, this is where employers might want to think about pay progression, so how quickly employees are going to move up a pay structure. So here there might be higher pay awards for those at the lower end of the pay scale and then of course lower pay awards for those who are already at the very top of the pay scales.

Laura Merrylees: So it has the potential to be quite complex and there's really quite a lot for line managers to be on top of? [0:05:00.2]

Sheila Attwood: There is, yes, and line managers are really the hub of the success of a performance-related pay scheme. So there's quite a lot for them to get to grips with. They must have the capability to make consistent judgements on employee performance in those appraisals we talked about, and where there's this flexibility in the level of pay awards that are made, they've got to make fair decisions on those. And actually, unfortunately this is one of the problem areas that was identified by the organisations that we've surveyed.

Laura Merrylees: Okay, so presumably these pay decisions should be verified then? [0:05:27.5]

Sheila Attwood: They should be, yes, and most organisations will operate a system where higher-level managers and then ultimately HR are going to review these line managers' pay decisions.

Laura Merrylees: Sure. So where all of these processes are followed, do organisations actually achieve their scheme objectives as you mentioned earlier, to engage and then reward high performance? [0:05:44.8]

Sheila Attwood: Well on the whole employers feel that these scheme objectives are partially met, but actually they are more concrete on their views in that it ensures that poor performers are not rewarded and that they can make the best use of their pay budget.

Laura Merrylees: And so does performance-related pay lead to noticeable improvements in employees' performance? [0:06:00.7]

Sheila Attwood: Well not universally, according to our research. So the biggest impact is actually on the performance of those employees who are already performing at a high level in that their performance is most likely to increase further.

Laura Merrylees: Well that's very interesting. So what about everyone else in that case? [0:06:14.1]

Sheila Attwood: Well unfortunately in many cases it is shown to have little impact on the performance of those employees who are already performing at a fairly low level. But you know we should bear in mind employers shouldn't be using a performance-related pay scheme to address poor performance; they should really have other initiatives in place there.

Laura Merrylees: Yes. I guess as we're currently in a climate of low pay awards (I think the XpertHR figure is 1.7% for awards generally), the pay rises resulting from performance-related pay awards are quite low. [0:06:40.6]

Sheila Attwood: You're right – they are. And pay awards being too small to actually achieve this objective of motivating staff is a top issue cited by our survey respondents. And that's understandable. With 2% it's very difficult to make a marked differentiation between the pay award for the average performer as opposed to a top performer. So perhaps in those situations employers could think about other ways to reward and motivate their employees.

Laura Merrylees: Well on that note, listeners may want to listen to one of our podcasts from earlier this year on employee recognition.

Thanks very much, Sheila. You've given us a useful insight into the practicalities of running a performance-related pay scheme and raised some of the issues that employers should be aware of.

You can find more information in a brand new 'How To' on PRP on the site and of course the survey we've been discussing.

So that brings us to the end of this week's podcast, which you've been listening to with me, Laura Merrylees. We're back again next Friday but until then it's goodbye from us.