

What Do We Buy When We Pay for Performance: How to Make a Compensation System Work

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INTRODUCTION

Several guidelines will help make the performance appraisal process and the compensation system work congruently:

MINIMIZE SECRECY

Too often, “need to know” is the basis for determining what information is released about the compensation system. If an individual can’t prove a need for specific information, the request is denied and unnecessary confidentiality reigns. Reverse that model. Instead of asking, “Does the individual have a specific need for this piece of information?” ask the opposite question: “What good business reasons exist for withholding this information?”

One discovery many companies make when they consciously expand the amount of information they provide about the mechanics and philosophy of their compensation system is that most people already know a lot more than the organization suspected.

COMPARE YOUR COMPENSATION PLAN IN PRINCIPLE WITH THE COMPENSATION PLAN IN FACT

Many companies can’t specify the specific formula for giving merit increases since there is no actual formula, which is being rigorously followed. Managers may be given a range in which to allocate salary changes, and the actual decisions about why Mary got an 8 per cent raise while Harry got 5 may have little to do with their actual performance, position relative to midpoint, months since last salary action or other policy-related issue.

Here’s an easy test to determine whether your merit increase system is really rewarding merit. Ask the question, “If the company had to reduce staff by ten percent, could the decision be made comfortably on the basis of the last performance appraisal/merit review?”

SPECIFY THE COMPONENTS THAT CREATE THE AMOUNT AND PERCENTAGE OF THE RAISE

At a minimum, each employee receiving a salary increase should know what percent of it is related to an overall cost-of-living adjustment and what percent is directly related to merit. If some of the pay increase was determined by results-based pay measures (pay-for-performance or pay for achieving objectives in an MBO-type system), and another part of the increase was based on competency-based issues (performance factors or job behaviors or how the person achieved the results), this distinction should be made clear.

What should people be told? While an individual's pay is private information and should be kept private, employees need to know:

- How their jobs are evaluated
- What compensable factors determine the ranking of a job
- What competitors pay for similar jobs
- What measures are used to determine incentive payouts

IF YOU WANT TO USE MONEY AS A MOTIVATOR, THEN USE IT AS A MOTIVATOR

Money motivates when it comes in significant amounts for significant contributions, not in occasional nickels and dimes merely for showing up. Too often the actual dollar difference between the salary increase awarded the highest performer and that awarded to Joe Average isn't enough to feed a family of four one meal at McDonald's. Money can motivate – but pocket change merely insults.

ABOUT DICK GROTE

Dick Grote is Chairman and CEO of Grote Consulting Corporation in Dallas, Texas, and the developer of the GroteApproachSM web-based performance management system. He's the author of *The Complete Guide to Performance Appraisal*, *The Performance Appraisal Question and Answer Book* and *Discipline Without Punishment*. Dick's next book, *Forced Ranking: Making Performance Management Work*, will be published in 2005 by the Harvard Business School Press.

ABOUT GROTEAPPROACH, LTD.

GroteApproach, Ltd., is dedicated to delivering the technology, services and client care that transform organizations from best-effort climates into results-driven cultures. The GroteApproach web-based performance management system is the culmination of Dick Grote's mission to transform the way organizations manage and develop their most valuable resource - their people. It reflects best practices in strategy-based performance management as identified in Dick's 25 years of research and consulting with hundreds of sophisticated organizations throughout the world. Its combination of unrivaled expertise and superior technology make the GroteApproach system an ideal fit for organizations large and small.

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Grote Consulting Corporation is one of America's best-known and most respected specialized management consulting firms. Headquartered in Dallas, Texas, Grote Consulting helps sophisticated organizations, large and small, implement best-practice performance management systems. Its clients include some of the most prestigious organizations, public and private, in North America, Western Europe, and Southeast Asia.

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