

Paying for Performance?

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When faced with the direction from senior management, what can human resource professionals do to evaluate the compensation structure of the organization, and propose cost-effective strategies that will impact the bottom line? This is an unfortunate conversation many companies are having in the current economic conditions of rising unemployment, declining company revenues, and lowering stock prices. The directive to reduce spending puts HR in the precarious position of balancing the reduction of overhead while retaining top talent and employee productivity.

When evaluating which measure to take, HR will play a critical role in ensuring all decisions are subject to meet requirements under various state and federal laws, such as the Fair Labor Standards Act, the Older Workers Benefit Protection Act, Fair Payment Act, and the Worker Adjustment and Retraining Notification Act. Before implementing any labor cost reduction initiative, employers must review handbooks, offer letters, and collective bargaining agreements to ensure changes in benefits or compensation will not alter pre-established contracts or agreements. Employers should also conduct analyses on all employment decisions to make sure they do not have an adverse impact on members of any class.

There are many different ways to control costs surrounding compensation. These include evaluating executive compensation packages, freezing salaries, reducing annual salaries, ceasing merit increases—or more nontraditional approaches such as sabbaticals or a shift to performance based compensation.

Much is said about performance based compensation being used as a way to keep salaries in line with company performance objectives, decrease the existence of low performers, and attract the best talent. In any performance based system there should be trained managers to conduct the evaluations, as well as a way to ensure everyone is being graded on the same scale. Connecting pay to performance may be more difficult than you think. How can you be sure performance is really the factor driving how much your employees are paid?

One tool that can be used to determine if you are actually paying for performance is a regression analysis. A regression is a statistical technique used to summarize the relationship of “predicting” variables, such as time in company, time in grade, level of education, previous experience, or performance rating on a “dependent” variable such as salary. If you were to plot these variables on a graph, the regression analysis would estimate the equation for a straight line that best fits the data.

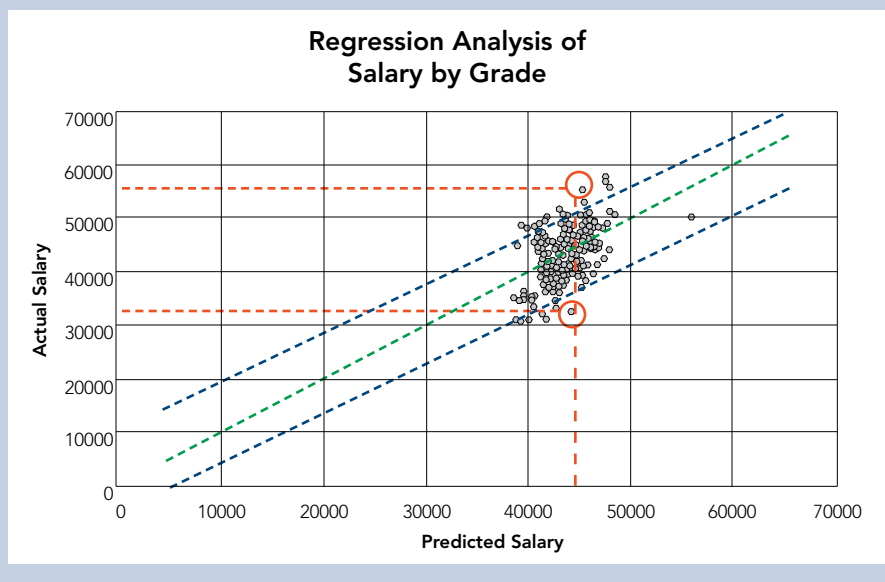
Reward the RIGHT Factor.

Control costs
surrounding
compensation.

From the regression line equation, we could determine:

- If the variables are positively or negatively related to salary
- How strongly they are related
- If they are significantly related

Expected vs. Actual Salary



A multiple regression would include multiple predictor variables, and estimate the impact of each factor on salary. Using the predictor variables you choose, you can build a regression equation to determine if these legitimate, nondiscriminatory factors can explain any differences in pay.

Building a pay for performance system is a painstaking effort. If an organization is unintentionally valuing the wrong factors, the integrity of the system comes into question. The initial goal of motivating top performers, eliminating low performers, and attracting top talent will be lost. Make sure your pay for performance system is truly rewarding the right factor.

For more information on building a balanced pay-for-performance system, or to find out about the laws and regulations surrounding compensation, please contact Berkshire Associates at 800.882.8904 or email bai@berkshireassociates.com.