



Paying for Performance:

Paying for performance has long been the ideal in managing an organization's compensation. The objectives tend to also include things like fairness, maximizing the impact of the salary spending, maintaining competitive salaries without overpaying.

Managing merit compensation can be complicated and time consuming without following a basic structure and automating wherever possible. The process is:

1. Establish a salary range for each position or pay grade
2. Establish a merit matrix defining increases based on performance and where the employee falls within the salary range.
3. Establish your compensation budget
4. Calculate the employees' compa-ratio (where they fall versus the mid-point of the salary range)
5. Calculate suggested increases based on performance, current pay, and budget
6. Provide suggested increases to managers for review and approval
7. Make any adjustments to the suggested increases and process

A few of these process steps warrant further discussion and tips.

Establishing salary ranges:

There are a number of approaches to establishing your salary ranges. The appropriate choice depends on the time and resources you have available and the size and complexity of your organization. Approaches include:

- Evaluate your current salaries for that position
- Research salaries for similar positions from your recruiters, industry organization, web-sites, etc.
- Purchase salary surveys or find them on the internet (i.e. <http://online.onetcenter.org/>)

Establishing a merit matrix:

Start by defining the x-axis as your performance rating scale (for example 1 through 5). The y-axis then is a measure of where the employee falls within their salary range. A common measure is the compa-ratio calculation with a compa-ratio of 1 meaning the employee falls at the mid-point of the salary range. Another measure can be where the employee falls within a quartile of the salary range.

The values of the cells in the matrix indicate what percentage increase the employee receives based on his/her performance and current pay. The cell values must incorporate the percentage increase in overall salary budget.

The intent of this matrix is that the highest increases are paid to high performers that currently have a salary that is low in range. In other words, they are underpaid for their contribution. A high percentage increase should move them up in their range. Conversely, a highly paid employee in range who is not performing well may not receive any increase at all.

Establishing the matrix may be the most difficult part of creating a fair and effective program. You may find it helpful to use a system or consultant that provides some “what if” analysis for creating the matrix. Standard matrices are available as a starting point.

Establishing a salary budget:

While your CFO and others may dictate this budget line item, consideration should be given to where the organization falls, on average, compared to your salary ranges. If you have established your ranges based on local and/or industry norms, you may need a larger budget in order to stay competitive when you are below the mid-point of your range on an overall basis.

Salary ranges and budgets generally are adjusted for cost of living/inflation.

Calculating suggested increases:

By this point, you have all of the raw material to calculate the suggested salary increases. This becomes a matter of finding each employee’s performance rating and where they fall in range. Go to the merit matrix to find the appropriate cell with the percentage salary increase.

An automated approach:

You will find that an automated compensation system (such as PDS’s Merit Compensation Tool) can simplify this process and save you a great deal of time. A good compensation tool can assist in defining your salary ranges, merit matrix, and compa-ratios. The system should have the ability to import employee data from an HRMS, Performance Management and/or Payroll system to provide required employee and salary information if available electronically. The system can then calculate suggested increases and create reports or spreadsheets to be reviewed by managers. The system can also assist by providing reports and graphs that help manage and analyze the compensation process and results.