# The way we manage employee performance is changing, but is the way we look at pay changing with it?

# About the authors

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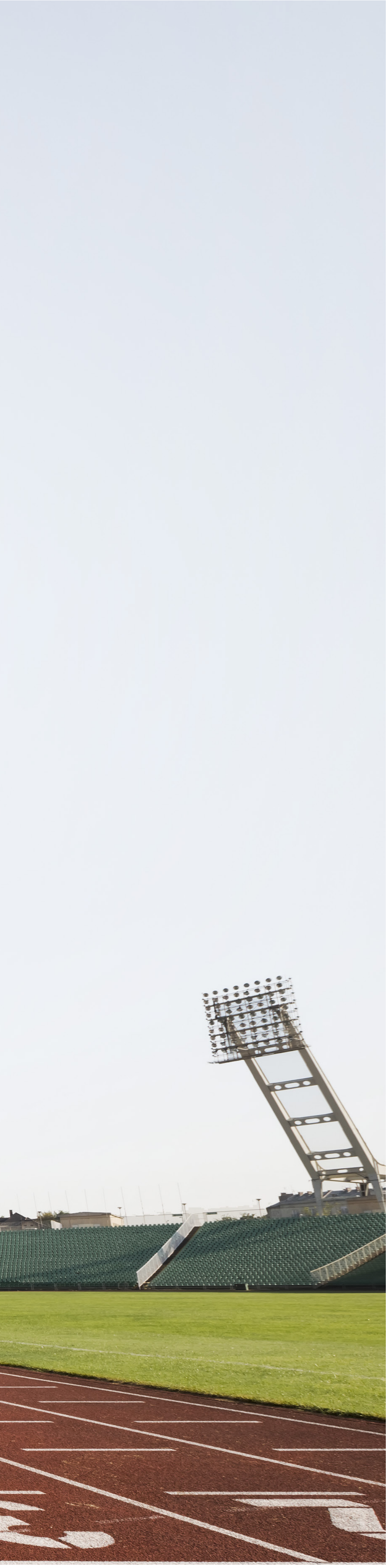
# The need to effectively link performance and pay

Companies are increasingly implementing new approaches to drive employee performance and contribution as traditional performance frameworks are falling short. The link between pay and performance is often used to improve performance but what happens when traditional performance approaches are challenged?



## Background into new approaches to performance frameworks

Recently a number of companies (including Deloitte) have reinvented their performance framework after realising that traditional approaches are not driving the desired employee performance and contribution outcomes[1].

Overall, there is a greater emphasis on transparency, simplicity and continuity in the process focussing on the employee experience and the 'how' (i.e. employee contributions, impact and behaviours) of achieving organisational outcomes.

## Shifts we are seeing in performance frameworks

| | From | | To |
|---|---|---|---|
| ✕ | Cumbersome annual performance ratings and calibration that do not accurately measure performance | ✓ | Frequent, quality performance conversations between managers and all team members |
| ✕ | Conversations based on a single performance grade that often has minimal bearing on future employee performance | ✓ | Coaching conversations focused on individual development |
| ✕ | High HR compliance efforts to facilitate the performance review process | ✓ | Conversations focused on personal growth and alignment of employee objectives to business growth |
| ✕ | Reactive performance feedback that has minimal impact on employee performance and development | ✓ | More frequent and 'live' feedback and coaching during achievement of organisational outcomes |

Some organisations are even reducing the use of ratings[2] (a major input to determining employee remuneration) and are de-coupling the link between performance conversations and financial reward for performance and individual contributions.

So, we know that performance frameworks are changing, but are we changing our approach to remuneration with it?

## With this in mind, what are the considerations to effectively link best practice performance frameworks and remuneration to drive workforce productivity?

We seek to unpack this question through 2 schools of thought:

1. Performance reviews should not be linked to base salary increases and different approaches to base salary delivery should be considered
2. Variable incentives and a flexible remuneration framework can be used to reward and drive performance

## Scope

This paper seeks to provide a leading point of view on effectively linking employee performance and remuneration by providing key considerations on where to start. This paper does not seek to provide technical remuneration advice or guidelines on how to effectively link performance ratings to remuneration (i.e. X% increase if rating is 'meets expectations').

# Performance reviews should not be linked to base salary increases and different approaches to base salary delivery should be considered

**Why do we say this?**

Research suggests that even if employees were able to decide how much they should earn, they would probably not enjoy their job more. In addition, the association between salary and job satisfaction is very weak and research indicates that base salary does not increase employee performance after a certain point in time. Despite this, most organisations still persist with utilising base salary as a means to drive organisational performance.

Why do organisations still do this? We believe organisations persist with this mechanism for a variety of reasons including the following:

- **Culture:** Current salary arrangements are rooted in the organisation and any change will risk demotivating and / or disruption to employees
- **Implementation cost:** Changes to all employee salary arrangements can result in a large time and monetary cost
- **Perception:** Further to the associated implementation cost, organisations often perceive the resources and effort required to implement these changes as too high and do not achieve the required result

However, different approaches to base salary delivery should be considered to effectively drive organisational performance.

## Where can you start?

**Define and clearly communicate what base salary consists of to ensure common understanding and transparency**

Establishing or adjusting base salary can be challenging as it must consider a vast array of factors including role requirements, industry and market activity. Base salary should be clearly defined and articulated in remuneration strategies and other relevant communication to promote transparency, fairness and trust.

*We define base salary as the amount of money that an employee receives for a role prior to tax implications, additional bonuses, commissions and deductions.*

**Align employees' salary to the right market indications to eliminate base salary as basis of concern**

We can't forget that base salary is a 'hygiene factor' and should compensate employees fairly for their work efforts. It is important that salary bands are mapped to relevant and accurate market data points, outliers are refused and employees are paid within 10% of your organisation's target salary band point (e.g. 70-75 percentile). Consider increasing employees' base salary annually in line with CPI changes and market activity.

**Do not increase base salary to reward or encourage additional performance contribution as it is ineffective over time**

Continuously increasing base salary to reward additional contributions from employees will not only be ineffective but will also be unsustainable for the organisation. Base salary should therefore not increase based on performance or promised to be increased if trying to retain employees who hand in their resignation as the association between salary and job satisfaction is weak.

**Separate performance and contribution discussions from remuneration discussions with employees**

Research has shown that discussion around remuneration often triggers an emotive response which negates open and honest discussion. Instead, separate these discussions and have a conversation around supporting employees to reach their potential. Talent review discussions should shift towards a greater focus on enabling employee growth and development rather than focussing on the monetary reward. Ensure managers understand and have the right information to support your remuneration strategy and to have effective conversations.

**Publish base salary bands to promote transparency and fairness**

Publishing base salary bands for roles can manage expectations and help employees understand how their base salary changes between roles. With the rise of company review websites (e.g. Glassdoor), salaries are no longer completely confidential, and this increases pressure on employers to be more transparent. It is important to consider that salary bands work where there are no outliers and all remuneration decisions adhere to the prescribed bands with mechanisms in place to manage outliers on a continual basis. A comprehensive cost impact, review of relevant industrial relations frameworks (e.g. EBAs) and other dependencies (e.g. contractual changes) is critical to understanding the actual business impact that remuneration changes would have on the organisation. If it is not feasible to align all employees to their relevant salary bands, be honest and communicate the intended approach (i.e. phased implementation) you will take to ensure alignment over time.

**Offer employees bespoke contracts and base salary conditions**

Offering your employees bespoke pay packages with the option of scaling up or down their base salary for other benefits, could increase employee engagement and empowerment. This gives employees control over reward types and the risk they can take for short term incentives.

# Variable incentives and a flexible remuneration framework can be used to reward and drive performance

**Why do we say this?**

Annual remuneration and performance meetings are a time intensive process often focused on scaling an employee's performance to fit to a distribution curve. Coupled with a robust performance framework and frequent feedback conversations, short term incentive programs can drive higher levels of performance rather than fixed salary increases. Companies are starting to base remuneration decisions on the competitive value of an employee and real-world market conditions. Research states that intrinsic motivation is a stronger predictor of job performance than extrinsic motivation. If organisations want to motivate their workforce, they need to understand what their employees really value and tailor the remuneration strategies around this.

Overall, variable incentives could reward more than employee performance. It can reinforce positive behaviours and employee contributions which drive business growth on a regular basis.

### Where can you start?

**Implement a diverse and fit for purpose remuneration and reward strategy. Consider the use of long term equity to connect employees to long term organisational goals**

A robust and fit for purpose recognition and reward strategy will require full review of existing performance frameworks. It is important to consider employee's overall perception of fairness of remuneration, in terms of the pay value and pay fairness. To achieve sustainable long term business performance, long term incentives ('LTIs') or equity could be considered for incorporation into middle management and above positions. This encourages employees to demonstrate the right behaviours and commitment to long term goals. LTIs can also be used in conjunction with short term incentives and base salary.

**Allocate 'fixed' short term incentives for employees to draw from. Provide leaders with authority to distribute a pool of incentives in a way that drives high performance**

We know that short term incentives are more effective at driving performance than fixed pay. This can be supported through:

- Providing a pool of incentives in which employees, teams or functions can be rewarded from upon achievement of a well defined set of individual and / or team objectives. This can also be in the form of broader reward and recognition incentives that connect to what motivates individuals and / or are based on outcomes impacted by individual or collaborative efforts
- Ensuring leaders are trained in how to use a dynamic remuneration framework and when to reward individuals to ensure fairness and equity and minimal bias.

**Reward contributions throughout the year instead of annualised remuneration driven by distribution curves**

Removing annual distribution curves forces organisations to consider how to reward employees throughout the year – especially for outstanding high performers / potentials who may be driving additional business growth or coaching others to reach their full potential. Incentives can be paid on a quarterly, monthly or half yearly basis pending frequency of performance check points and the organisation's performance framework.

**Enable managers to allocate bespoke incentives to recognise and reward employees at their discretion**

On average, employee reward and recognition amounts do not drastically differ annually. Empowering managers to deliver bespoke ways to reward and recognise employees in their team at their discretion could increase individual team member's motivation and performance. A comprehensive business impact assessment is critical to understand the implications (including financial) of any changes.

**Link variable incentives to reward employee impact that drives business growth using multiple data points**

Identifying the critical quantitative and qualitative data points which drive performance can help you to determine variable incentive outcomes for employees. Consider data points beyond performance such as behaviours that support the culture and contributions that enable additional organisational growth. As such, there is a need to clearly define the characteristics of high performance and contribution unique to your organisation.

**Ensure leaders have the knowledge and capabilities to facilitate effective remuneration discussions**

Shifting away from annual performance evaluations toward a process of continuous coaching and improvement requires a new role for managers. Managers will not only need to have the capability to facilitate effective discussions but also understand the organisation's remuneration framework and how to communicate it effectively. Focusing on this will enable leaders to have productive, yet less formal conversations about performance and remuneration that will drive performance.

# Conclusion: The employee impact

Remuneration and reward strategies should focus on continuous, dynamic and bespoke mechanisms tailored to the organisation and its people.

### The research

Research shows that employees are motivated by autonomy, mastery and purpose. Intrinsically motivated employees are three times more engaged then extrinsically motivated employees.

### The risk

Remuneration strategies that focus primarily on the use of extrinsic rewards run a serious risk of diminishing, rather than promoting, intrinsic motivation.

### The implication

Consider ways to effectively balance extrinsic and intrinsic motivators within the remuneration and reward strategy. The values and behaviours that will be rewarded will ultimately drive productivity and determine the effectiveness of your remuneration practices. Therefore, these elements should require careful consideration. Being transparent around remuneration practices within your organisation can also support the development of a trusting and engaged workforce. Finally, technology and analytics can help you make the right remuneration decisions within the context of your organisation's culture and remuneration and reward strategy.

### How we can help

Deloitte has established expertise and experience in re-designing and implementing a new employee performance experience. We also have experience supporting clients effectively link pay and performance.

We utilise our deep expertise in HR and people strategy, culture transformation and HCM technologies to design and develop a tailored and well rounded performance solution that considers remuneration impacts and enables business strategy.

# Acknowledgements

The authors would like to thank **David Brown, Kate McDonald** and **Rob Jack** of Deloitte for their valuable contributions to this article.

# End notes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2. Global Human Capital Trends 2016, Deloitte

3. Reinventing Performance Management (2015) Marcus Buckingham and Ashley Goodall

4. Turn traditional performance calibration discussions into talent discussions that focus on succession planning and supporting employees reach their potential (2016) Basil Sommerfeld and Borbala Kiss