

THE CONTROLLER'S REPORT

ISSUE 10-01

WWW.IOMA.COM/FIN

JANUARY 2010

Pay for Performance

MERIT RAISES AT 5.2 PERCENT FOR TOP EMPLOYEES IN FIVE-TIER PERFORMANCE SYSTEMS

An overview of strategies that companies use to contain the cost of their merit pay increases is available to controllers in the associated bar charts. Developed by **Buck Consultants** and published in its outstanding study *Compensation Planning for 2010*, these charts show average pay-for-performance increases by performance level, as well as the percentage of the employee population at each performance level, across a survey sample of 252 organizations. *Key point:* With this table, CR readers can determine how their organization's merit pay strategy compares to the overall market.

Background: In this survey, **Buck** examined 2009 salary budget increases for five employee levels: CEO, executives, directors, managers, professional exempt, and nonexempt. *Key point:* At companies that do not currently have salary freezes, merit increases for these five employee categories range from 2.5 percent for employees with performance rated in the 25th percentile to 3.5 percent to those ranked at the 75th percentile.

Observation: While many employees are happy simply to have a salary in this terrible economy, these findings imply that employers are doing a poor job distinguishing between the merit raises they give to subpar and superior performers—that is, a paltry 1 percent. Obviously, this modest apparent distinction in merit increases is hardly enough to motivate employees to “walk the extra mile” and do superior work.

In contrast, these bar charts show that most companies do provide a meaningful—albeit not huge—distinction in compensation increases between their highly valued and mediocre employees. *Background:* In the compensation systems used by most midmarket and large companies, managers are required to sort their employees by performance levels. This enables them to allocate more of the merit budget to their superior staffers.

For example, the bar charts show that companies with five performance pay levels give roughly 8 percent of employees their highest rating, 29 percent an above-average rating, 53 percent an average rating, 8 percent a below-average rating, and 4 percent a poor rating. At the same time, the average pay increases for superior performers at these companies is a meaningful 5.2 percent and much better than the 1.2 percent increase given to poor performers. *Upshot:* By distributing 2009 merit budgets across these five categories, managers at these businesses did an adequate job distinguishing the merit-pay increases of top and bottom performers.

CR emphasizes that these merit increases reflect decisions in 2009 when employers were determined to contain payroll costs. *Proof:* In 2009, **Buck's** respondents implemented payroll cost-containment measures such as base-salary cutbacks, 20 percent; pay freezes, 30 percent; hiring freezes, 60 percent; and job elimination, 80 percent. So how can controllers integrate these cost-saving measures with merit pay?

Says **Buck**, "Roughly two-thirds of respondents did not revise their methods of managing base pay in 2009 as a result of the recession. Instead, organizations opted for job elimination and pay freezes as the preferred methods to control labor costs. Here, job eliminations can be viewed as consistent with pay for performance provided a company retains strong performers and terminates underperformers. But a pay freeze has a

tendency to penalize strong performers, since they have more to lose in a pay freeze. . . . Even so, strong performers are usually willing to ride out a downturn, provided they perceive that an overall sense of fairness exists within the organization. But these strong performers may also be the most at risk once the economy improves, unless actions are taken to retain them."

(Source: **Buck Consultants**)

Pay Increase and Performance Distribution

AVERAGE PAY INCREASE BY PERFORMANCE LEVEL

THREE OR FEWER PERFORMANCE PAY LEVELS



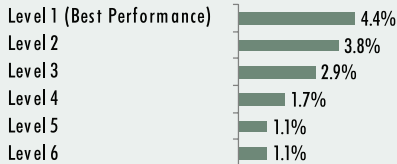
FOUR PERFORMANCE LEVELS



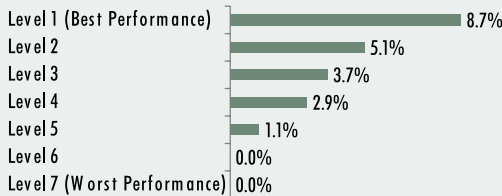
FIVE PERFORMANCE LEVELS



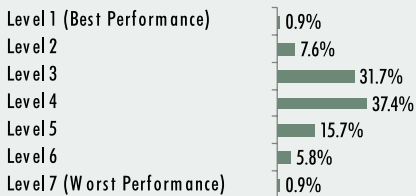
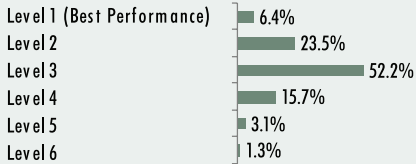
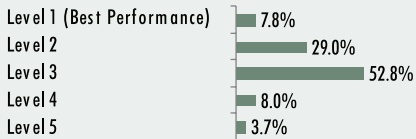
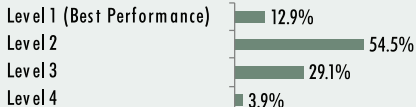
SIX PERFORMANCE LEVELS



SEVEN OR MORE PERFORMANCE LEVELS



EMPLOYEE POPULATION BY PERFORMANCE LEVEL



(Source: **Buck Consultants**)

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