National Association of State Personnel Executives | 859.244.8182 | lscott@csg.org | www.naspe.net

PERFORMANCE OR PAY? WHICH MATTERS MORE, OR LESS?

ABSTRACT

Public sector organizations continue to face human resources challenges. These well-documented issues include imminent retirements, competing for and attracting new employees in a multi-generational workforce, motivating and retaining talent, and perceptions of an out-of-balance compensation and benefits system. Public sector organizations are also held to high standards for achievement and are expected to always meet their goals. States in particular, with their large, diverse, and often decentralized workforces, have used a number of business tools to help encourage their staffs. This paper will explore the extent to which a presumably key motivational tool has been used, is currently used, and if it even should be used in the future.

INTRODUCTION

"Pay for Performance" is commonly understood as a system for organizations to motivate their people to do their best. Foundationally, it links (or should link) positive outcomes to some kind of reward; it measures against achieving established goals, and usually delivers a financial payout. Yet, it is defined and applied differently depending who you ask. It has been a regular topic of discussion among NASPE members as States develop ways to address their human resources challenges. Because there are so many different definitions and approaches, the Corporate Council, upon a suggestion from NASPE members, commissioned this research paper to help understand how Performance and Pay can work together in State government. What do the words mean, and how do the words link together to define a reward system for employees in State service.

We set out with a hypothesis that Pay for Performance is a good business practice, and together with Performance Management systems, can help set goals and measure against them. Again, there are many varieties of these systems, however we thought there may be a connection to how States in particular use these tools to support their goals and objectives. We also realized there are many stakeholders involved, political and non-political, and there are many impacts to the organization's cultures and technologies depending on how "pay" and "performance" systems are designed and used. How is "performance" defined? Are the "rewards" associated with the system financial in nature or non-financial? Are there penalties for poor performance? Does the system have internal support from leadership, managers, and employees? Was the system designed with broader objectives in mind?

To gather information for our study, we asked NASPE members to participate in a qualitative survey of their existing performance management systems, describe their State's cultures and stakeholders, and tell us how, if any, differentiated programs are in place to recognize and reward employees' performance (financially, or non-financially through training and development programs and other types of recognition). That is, what does, "Rewarding for Performance" mean? Is it a trend in State government that bears watching? Is pay and performance treated collectively or singly? Does it matter, or has it run its course as a system?

Response was strong; we received contributions from the following 21 States:

Alaska	Maine	Ohio	Utah
Colorado	Montana	Oklahoma	Washington
Delaware	New Jersey	Pennsylvania	West Virginia
Georgia	New Mexico	South Carolina	Wyoming
Louisiana	North Carolina	South Dakota	
	North Dakota	Tennessee	

CULTURE

Broadly speaking, an organization's culture is its behaviors, its approach to addressing and resolving problems, and its way of working both with each other and with its stakeholders. A majority of survey participants from the responding States recognized that the systems currently in place for recognizing and rewarding performance (good or bad), are driven and supported by their State's culture. They mostly agreed that recognizing positive results was a good idea, either monetarily or non-monetarily (what we term generally as "reward"), and that if any changes were to be made in the recognition, performance management, and/or pay system(s), the culture would also need to change. Support from the Governor for culture and reward changes was viewed as critical; three responding States identified they had this level of commitment.

Some respondents link "Pay" and "Performance" together very tightly, so it really defines the culture of what's valued and what's paid for. Indeed, for one "…rewarding means merit increases…," and for another, "…the code enables it…so a mid-acceptable or higher rating ←on an employee's annual review→ gets a merit increase." Elsewhere, one respondent noted that more research is necessary to develop objective criteria that could be used to set goals, measure against them, and match up suitable rewards. We have found in our research that these tight linkages in turn create a culture of expectancy, where the "reward" translates directly to an annual pay raise (if the defined level is met). If there isn't a good attitude present where better performance, or any performance, will result in any meaningful changes in anything (the work, the money, etc.), then it's likely that change just won't happen.
Of course, the absence of funding for many respondents means that any performance management system tied to rewards matters little to employees; this too affects the attitude and culture.

Decentralization and union environments also have an effect on an organization's behaviors. One respondent pointed out that without a centralized approach to measuring against broader goals, and with each agency running their own system, the unevenness can discourage high levels of performance. Hard-fought negotiations on other important issues not related to job performance (e.g., benefits, working conditions) can also create an attitude where meeting high goals, or any goals, is not as valued, therefore not as strongly pursued.

Technology and systems also play a part in how employees react to and work in their environment. One respondent said, "…there's no tracking for reviews" and "…managers aren't accountable." This combined with lack of funding for any meaningful increase in pay makes it hard to change attitudes and for the organization to show its commitment. On the other hand, another State is blending tailored competencies and clear job goals into ratings and regular reviews that feed salary calculations. The opinion is that applying "serious money" to salary increases is encouraging employees to go above and beyond formal job requirements (that is, they apply discretionary effort) and they stay committed to the organization. This appears to be a reaction to a monetary reward; the literature is rich with instances of how we behave when money is at stake.

This is not to say that the absence of any performance management and/or pay system creates bad attitudes, bad cultures, or low-performing organizations. Or that the promise of money creates positive attitudes or positive outcomes. To support our hypothesis, though, we were looking for some correlations between recognition and reward that can create a healthy, sustainable environment to help address States' current human resource challenges and working through encouragement and reinforcement, show employees that the culture of the organization truly values them for what they do. What we found is that the organizations' behaviors have a profound effect on the attitudes, performance, and engagement of the workforce.

FINANCIAL REWARDS

We believed that performance management and linking reward to performance are good business practices. Recognizing and rewarding performance can be appropriate through monetary compensation as a means to encourage and reinforce meeting or exceeding agreed upon performance expectations. The reward should be commensurate with performance and those who perform better than expectations should receive higher levels of reward and recognition. However, experience shows that the "reward" or "pay" part of pay for performance has been and continues to be the challenge. The responses from survey participants showed three main groupings of thought and experience regarding a financial reward for performance:

Group 1: States that don't deliver a financial reward and is unlikely to be implemented in the known future. The main reasons were a strong union presence, the lack of a sound performance management process, and a sense of "we haven't had money for employee compensation for years," so there was some expression of "why bother." This ties to the cultural aspects of organizations discussed above.

Group 2: States where linking a financial reward to performance is a priority of leadership, it has their commitment, and the implementation of this commitment is in its formative stages. Wisely, a number of these States are focusing on getting the performance management element of "pay for performance" working effectively before creating the link to pay. Also in this category are States that are delivering a financial reward for strong performance, but seek to have a greater differentiation between the level of performance and the reward. For example, in a State that has three levels of performance, when less than 1% of performance ratings is in the "needs improvement" rating category and the amount of pay for performance is the same for the other two ratings, they are assessing the value of this financial reward on motivation, attraction, and retention. That is, is this truly "pay for performance?"

Group 3: States that have successfully implemented pay for performance and deliver differentiated levels of financial reward, taking into account both the quality of performance and the current pay of the employee relative to market.

If this third grouping is an example of how to successfully link financial reward and performance, what are some characteristics of the design of their pay for performance programs that make them successful? Will it work everywhere? Survey responses supplemented by research shows that these programs have the following characteristics:

- The link between financial reward and performance is included as a clear statement in the State's compensation philosophy.
- Executive branch leadership works hard at educating Legislative branch leadership on the importance of funding compensation on a dollar basis, not on a percentage basis to enable true differentiation of rewards by performance level. One State said, "We needed to move away from percents as soon as it was known that the legislature had appropriated 3% for employee compensation; all employees had an expectation they would get a 3% increase."
- The performance management process continued to be used effectively, even in the "down" years when there was no appropriation for employee compensation.

- There are tools and support in place so the system is used.

To ensure that salary increase dollars recognize performance against standards, relativity of the employee's pay to the market, and provides for true differentiation, one State designed a pay delivery matrix. Here's how it works: an employee who demonstrates a high level of performance and is paid in lower quartiles than the expected market value for their job (or the "market policy position"), would receive a higher raise than an employee who didn't perform as well. This approach marries the market value of the job to the performance of the individual; it's an important connection that strongly supports a culture of engagement and monetary reward. It's also a flexible system: the percentages in the matrix can be varied each year depending on available funding, and the managers have discretion on the amount of award within a range. An example of such a matrix in current use is below.

	Overall Salary Increase (sum)				
Incumbent's Pay Relative to Policy (range midpoint)	Basic Salary Increase*	plus	If "Meets Standards"	or	If "Exceeds Standards"
Over Policy	0%		+2.0%		+4.0%
2nd quartile	0.0% - 1.0%				
1st quartile	1.0% - 2.0%				

**Note* : all increases contingent on "Meets Standards" performance level

NON FINANCIAL REWARDS

We acknowledge that non-financial rewards are not without cost, but they differ from monetary rewards in that they are intended to motivate employees to achieve higher performance through a non-cash method, such as personal recognition, awards, training and career advancement opportunities, and related forms of public and private recognition.

There is an abundance of literature with diverse and opposing opinions on what works best – monetary, non-monetary, both or neither – and what comprises the best mix for a total rewards approach and supports positive employee motivation. For non-financial awards specifically, the question may be whether an approach which can be tailored to address the motivational differences among a multi-generational workforce is an effective contributor to the total rewards package.

To identify whether, and to what extent, non-financial awards are being used in State government, the survey group was asked (i) what they were doing today to differentiate and reward performance; and (ii) whether they were using non-financial rewards (development, job design, promotions, non-financial recognition, etc.).

A majority of the survey respondents reported some form of non-financial reward system within some of their agencies across the State (one is under development); to break it down even further, the responses were categorized based on whether the non-financial reward system involved recognition and/or career development.

- The recognition programs centered on the use of awards, peer-recognition, manager-recognition, dinners, events, plaques, and certificates.
- The career development programs centered on job design, special project assignments, job growth, stretch assignments, training and promotional opportunities.

Survey findings indicated a fairly even split among the group in terms of the type of program offered, with two agencies offering both recognition and career development programs. Some programs were somewhat informal, and others were more structured. There were a small number of responder comments on the costs associated with non-financial rewards, with one agency stating that some organizations may be hesitant to use them for that reason. In those agencies reporting career development rewards, there is an underlying theme with respect to job growth and promotions for strong performers, with one agency commenting that "it is difficult to consider other types of non-financial rewards in the current anti-public employee culture."

In both program areas, there was an absence of responder comments on any barriers linked to implementation of these programs within a union environment; one agency commented that their recently implemented advancement tool was "a very new cultural idea for unions and some of the legislature." This may signal a trend that may be related to shared challenges in these environments (i.e., attraction and retention).

Finally, in both program areas, there were multiple comments that agencies were doing a good job in being creative and making these types of rewards work in an environment where limited funds are available to acknowledge performance. This may suggest that State governments with these types of non-financial reward programs are effectively adapting them to meet the needs of agencies with diverse operations and services.

ENABLERS AND DISABLERS OF EFFECTIVE SYSTEMS

Even if we all agree that recognizing and rewarding positive performance is a good business practice that supports employee motivation and organization culture, it can still be challenging to implement and use. While many enablers and disablers of effective pay for performance have already been mentioned, following is a summary of what we heard from the States that participated in the survey and what percentage mentioned each:

Enablers	%	Disablers	%
1. Supportive executive and legislative branches	58%	1. No linkage between performance and reward	58%
2. Technology supporting Performance Management	53%	2. Unsupportive work culture	53%
3. Training/education for all	32%	3. Lack of funding	47%
4. Holding supervisors/managers accountable for Performance Management	26%	4. Lower priority than other initiatives	11%
5. Effective Performance Management process in place	21%		
6. Ability to tailor approach by agency	16%		
7. Utilize both cash/non-cash rewards	16%		

While the opposite of each enabler and disabler could also be listed, the table shows how the States categorized their responses as either one or the other.

Even though general comments ranged from, "Pay for performance is a bad idea," to, "Rewarding performance is viewed as an investment in the future," most were on the former's side of the spectrum. So, the near-term challenge is getting the appropriate support and in the long-term it's sustaining that support.

There have always been two views relative to what motivates employees:

1. One is external, where employee motivation is driven by rewards and fear and is focused on money
2. The other is internal or intrinsic, where employees strive to do the best they can since their job provides them a sense of purpose

The best solution, as in many situations like this, depends on the culture of the organization and may lie somewhere in between quantitative rewards and intrinsic motivation. Everyone knows of high-performing employees in the non-profit sector that rarely get merit increases, much less incentive payouts. What drives them to perform? It's certainly not cash compensation, but may very well be recognition and/or career advancement. On the other hand, the culture of an investment bank tends to be all about the money and if employees don't understand that they won't be there long. This is not a public/non-profit sector phenomenon – many segments of the private sector have struggled mightily with the notion of pay for performance, even today.

This we know, both from the States' responses and from anecdotal experiences: Some enablers and disablers are more critical than others. If a State does not have a culture that is supportive of pay for performance, executive and legislative leadership that support performance-based differentiation of (cash and/or non-cash) rewards, and managers that will be held accountable for making tough performance decisions, then they won't have an effective pay for performance program.

Interestingly, while lack of funding was pretty high on the list of disablers, we have seen State governments time after time find money in their budgets for initiatives they consider worthwhile. This speaks volumes about the importance of executive and legislative support to any kind of program like this. Even though the lack of linkage between performance and reward was equally high as a disabler vs. executive and legislative support as an enabler, lack of linkage is more of a by-product of an unsupportive culture, executives and legislature than a true driver of the initiative.

SUMMARY

We found that most States have expanded their definition of the word "pay" to mean "reward." And not just financial reward, but non-cash based recognition programs that at once show the employee that their contribution is valued and that the organization is committed to acknowledging this good work because of its (changing) supportive culture. In the face of a transitioning workforce, with shifting demographics and continued strong challenges from stakeholders, some States are finding ways to encourage and then recognize their employees. We found that there is broader recognition that performance-based reward programs can help achieve goals, and we found that the enablers of such programs can outweigh the disablers. On the other hand, if an organization is not willing to garner the commitment of executive and legislative leadership to support this – and to start changing the culture where needed – it will likely be a huge waste of time, effort and money. If that commitment is secured though, the organization can achieve some remarkable things.

Contributors:
Ron Keimach, Hay Group
Neville Kenning, Kenning Consulting
Deborah Owen, CPS
Bill Reigel, Hay Group
Alaska-Nancy Sutch
Maine-Sam McKeeman
Ohio-Stephanie Loucka
Utah-John Mathews
Montana-Randy Morris
Oklahoma-Natasha Riley
Washington-Mark Sullivan
Colorado-Kim Burgess
New Jersey-Grace Kelly
Pennsylvania-James Honchar
West Virginia-Sara Walker
Delaware-Amy Bonner
New Mexico-Justin Najaka
South Carolina-Sam Wilkins
Wyoming-Erin Williams
Georgia-Candy Sarvis
North Carolina-Paula Kukulinski
South Dakota-Kevin Forsch
Louisiana-Byron Decoteau
North Dakota-Ken Purdy
Tennessee-Danielle Barnes