COMPENSATION MANAGEMENT

CHAPTER 11 (Study unit 9)
Performance appraisals

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Chapter Topics

- Role of Performance Appraisals in Compensation Decisions

- EEO and Performance Evaluation

- Tying Pay to Subjectively Appraised Performance

- Promotional Increases as a Pay-for-Performance Tool

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The Role of Performance Appraisals in Compensation Decisions

- Used for several organizational decisions

  - To guide allocation of merit increases

- Performance ratings are influenced by:

  - Employee behaviors observed by raters

  - Organization values

  - Competition among departments

  - Differences in status between departments

  - Economic conditions

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- Employees often frustrated about the appraisal process

    - Appraisals are too subjective

    - Possibility of unfair treatment by a supervisor

- Experts argue that rather than throwing out the entire performance appraisal process, total-quality-management principles should be applied to improving it

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EEO and Performance Evaluation

Key Issues: Establishing a Performance Appraisal System

1 Provide specific written instructions on how to complete appraisal

2 Incorporate clear criteria for evaluating performance - Performance dimensions should be written, objective, and clear

3 Provide a rational foundation for personnel decisions via adequately developed job descriptions

4 Require supervisors to provide feedback about appraisal results to employees

5 Incorporate a review of performance ratings by higher level supervisors

**6** Consistent treatment across raters, regardless of race, color, religion, sex, and national origin should be evident

Pay Increase Guidelines with Low Motivational Impact

- Provide equal increases to all employees regardless of performance

  - General increase

  - Cost-of-living adjustments

- Pay increases based on a preset progression p

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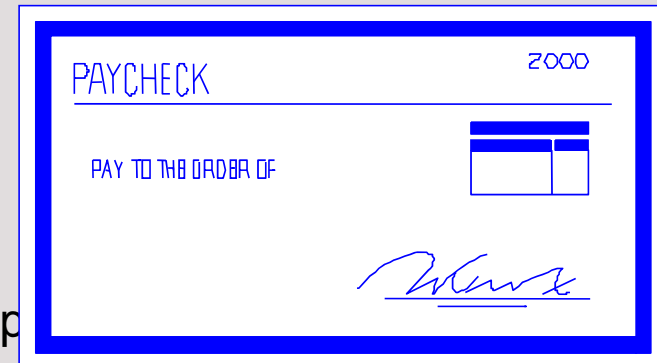
Requirements to Link Pay to Performance

- Define performance

  – Behaviors

  – Competencies

  – Traits

- Specify a continuum describing different levels from low to high on performance measure

- Decide how much of a merit increase is given for different levels of performance

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Exhibit 11.12: Performance-based Guidelines

EXHIBIT 11.12 Performance-Based Guideline

	Performance Level				
	1	**2**	**3**	**4**	**5**
	Outstanding	Very Satisfactory	Satisfactory	Marginally Unsatisfactory	Unsatisfactory
Merit Increase	6–8%	5–7%	4–6%	2–4%	0%

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Designing Merit Guidelines

Four Questions . . .

1 What should the poorest performer be paid as an increase?

2 How much should average performers be paid as an increase?

3 How much should top performers be paid?

4 What should be the size of the percentage increase differential between different levels of performance?

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EXHIBIT 11.14   Merit Grids

Merit grids combine three variables: level of performance, distribution of employees within their job's pay range, and merit increase percentages.

Example

1. Assume a performance rating scale of A through D: 30 percent of employees get A, 35 percent get B, 20 percent get C, and 15 percent get D. Change the percents to decimals.

A	B	C	D
.30	.35	.20	.15

2. Assume a range distribution as follows: 10 percent of all employees are in the top (fourth) quartile of the pay range for their job, 35 percent in the third quartile, 30 percent in second quartile, and 25 percent in the lowest quartile. Change the percents to decimals.

1	.10
2	.35
3	.30
4	.25

3. Multiply the performance distribution by the range distribution to obtain the percent of employees in each cell. Cell entries = performance × range.

	A	B	C	D
1	$.30 \times .10 = .03$	$.35 \times .20 = .035$	$.30 \times .10 = .02$	$.15 \times .10 = .015$
2	$.30 \times .35 = .105$	$.35 \times .35 = .1225$	$.20 \times .35 = .07$	$.15 \times .35 = .0525$
3	$.30 \times .30 = .09$	$.35 \times .30 = .105$	$.20 \times .30 = .06$	$.15 \times .30 = .045$
4	$.30 \times .25 = .075$	$.35 \times .25 = .1225$	$.20 \times .25 = .05$	$.15 \times .25 = .0375$

Cell entries tell us that 3 percent of employees are in the top quartile of pay range *and* received an A performance rating, 10.5 percent of employees are in the second quartile of pay range *and* received an A performance rating, etc.

4. Distribute increase percentage among cells, varying the percentages according to performance and range distribution, for example, 6 percent to those employees in cell A1, 5 percent to those employees in B1.

5. Multiply increase percentages by the employee distribution for each cell. The sum of all cells should equal the total merit increase percentage.

Example:

$$6\% \times \text{cell A1} = .06 \times .03 = .0018$$
$$5\% \times \text{cell B1} = .05 \times .035 = .00175$$
Etc.

$$\text{Targeted merit increase percentage} = \overline{\text{Sum}}$$

6. Adjust increase percentages among cells if needed in order to stay within budgeted increase.

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Promotional Increases as a Pay-for-Performance Tool

- Promotion should be accompanied by a salary increase - 8 to 12%

- Characteristics of promotional pay increases

  - Size of increment is approximately double a normal merit increase

  - Represent a reward to employees for commitment and exemplary performance

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Your turn

Answer the end of chapter 11 review questions

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