Performance-based Pay Does Not Work and Here is Why You Should Not Waste Time

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Performance-based compensation is the process of paying employees for a particular outcome or paying extra for work which goes above and beyond the usual call of duty. Organisations can potentially see great benefits with this approach, but there are major drawbacks. A performance-based pay system is not a straightforward program.

It is important to note that companies should not rely on performance-based pay because some employees are not motivated by a monetary reward but rather by other factors such as personal pride or satisfaction in my work or a personal desire to make a contribution. Also, conditions in the work environment such as limited funding to support performance-based increases or rewards scepticism about whether or not management will reward high performance have created a rather weak link between pay and performance.

Here are four reasons performance-based pay does not work and why you should not waste time:

Employee Commitment

In high commitment companies, performance-based pay systems are a waste of time because employees are loyal to their companies, employees are willing to work harder to meet deadlines, and thus making performance-based pay incentives an unnecessary expense. Research shows that in some instances, highly committed employees may even become offended by the company's introduction of performance-based pay, viewing the program as a form of bribery. Therefore, performance-based pay is rubbish.

Most successful performance-based pay systems are those that are implemented at low-commitment companies. In businesses where employees are highly committed to the company, performance-based pay initiatives are often not as well-received by employees as they are at low commitment companies.

In low commitment companies, employees view the opportunity to receive additional pay based on increased performance as a great way to make extra money, and their productivity increases as a result.

Manager Expectations vs. Employee Expectations

One of the main reasons performance-based pay systems fail is a lack of communication between management and employees. In order for a performance pay program to be successful at your company, you must ensure that employees and managers have similar expectations for the program. Some common points that must be discussed with employees include:

- How long will the program be in place?
- What are the reasons behind the program? (Are you attempting to meet a client deadline, beat the competition to market, temporarily push to fill a productivity gap, etc.?)
- How difficult will it be to see a pay increase based on the requirements of the program?
- How will outside factors affect evaluation? (For example, if an outside manufacturer is late with a delivery that one of your departments needs to continue with production, will the affected department suffer under the performance pay program's deadlines despite the fact that the delay was no fault of their own? If not, how will the rules be adjusted?)

If management does not discuss the ins and outs of the program with employees, then they are bound to encounter problems. For a performance-based pay program to be effective, it must also be fair, and in order for it to be considered fair, it must be completely understood by each and every employee who takes part in it.

It takes hours and hours of time for employees and managers to discuss performance-based pay, complete performance review forms, get them approved, set up performance review meetings and handle the paperwork. The next year, they do it all over again and this makes performance-based pay a waste of time.

Length of the Program

The length of your performance-based pay program will be a huge determining factor of its success. Research indicates that some of the most successful performance-based pay systems tend to be those that are implemented only temporarily.

The reason behind this is that when faced with an ongoing performance-based pay system, many employees adjust to it very quickly. After a time, employees become accustomed to receiving increased pay, and in the event that that pay is lowered (when performance objectives are not met), employees feel as if they have been cheated. This causes morale to drop, which can cause performance to decrease even more. As business researchers, Michael Beer and Mark Cannon remarked in their performance-based pay research, "A workforce that always expects additional pay for additional progress can become a liability."

Therefore, performance-based pay does not work.

Costs vs. return

Balancing costs and return is the most important component of your company's performance-based pay program. Most companies overestimate the benefits of performance pay systems and severely underestimate the costs. In order for your performance-based pay program to be successful, you must be realistic about the costs and return. It is very important to consider the following questions when evaluating costs:

- What estimated percentage of employees will receive increased pay under the program?

- How much of a pay increase will employees have to receive in order to sustain increased performance? Can the company afford that increase?
- Realistically, how much will the company benefit from increased employee performance?
- How long can the company sustain the program?
- How much time will management have to spend implementing, tweaking, and/or redesigning the program? How much will those adjustments cost the company?
- Could the predicted benefits of the performance-based pay system also be achieved through more conventional and less costly managerial methods like coaching, training, etc.?

Performance-based pay systems are not as straightforward as many companies think, so before implementing one at your business, it’s important that you try to learn from the mistakes of those who came before you and also consider looking for advice from experts. While performance pay programs can be extremely effective, they are unlikely to be successful if you do not perform thorough research before implementing them.

If a performance-based pay program is to succeed at your company, you must ensure that managers and employees communicate their expectations clearly, that you carefully research the best length of time for your program, and that you find the perfect balance between employee reward and company profit.

If you don’t, then like so many before you, you will likely watch helplessly as your performance pay program transforms from a promising productivity booster into a terrible failure and a large drain on company resources.

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