What is merit pay?

Author: Taurai Masunda . August 2020

Merit pay is a performance-related pay which provides bonuses or base pay increases for employees who hit the target or perform their jobs effectively, according to measurable criteria over a predetermined period of time. The origins of the merit pay lie in behavioural psychology and incentive theory. These theories are based on the belief that people respond to incentives, and that with the right stimulus you can increase performance.

With a typical merit pay increase, employees receive a compensation adjustment based on the results of their performance evaluations.

Merit pay example

Below is an example of a merit pay example with performance ratings, pay compa-ratio and the distribution of merit increases.

With the right merit pay system in place, all merit increase budget will be spent.

Merit Pay Distribution Example

Merit-pay plans using differing criteria and reward systems have been implemented and evaluated around the United States. Although the research base is small, evidence suggests that compensation plans that reward teachers for student achievement lead to improved student performance (Figlio & Kenny, 2006; Ladd, 1999; Podgursky & Springer, 2006).

They are several considerations that must be considered first to effectively implement merit pay systems.

1. Provide policies which are straightforward and consistent.

You will need to effectively communicate your company's policies to your employees. Ensure that each individual understands and agrees to these policies.

2. Agree on a compensation plan and the purpose of its components.

Merit pay should be based on the sustained individual performance of regular duties, and not on projects unless otherwise stipulated. Individual and team goals and the methods of measurement and evaluation need to be defined and agreed.

3. Do not include merit pay with other compensation increases.

Merit pay should be different and separated from general increases for all employees or salary adjustments for market changes.

4. Define employee performance and credible ways to measure and evaluate it.

Use multiple information sources for this so that you can consider all aspects of employee performance as well as develop accurate and credible ways to evaluate performance.

5. Train managers and supervisors to communicate clearly on the performance evaluation of employees.

Supervisors and managers should be held responsible for the successful implementation of merit pay systems and the delivery of these systems to employees objectively and transparently.

6. Occasionally get feedback form employees.

Talk to your employees, especially those who are leaving the company, about the effectiveness of your merit pay system and measure the results.

7. Use of right technology.

Managers' administrative duties may be eased by providing compensation tools integrated with talent management and business analytics.

Is merit pay a good idea?

Commonly-cited advantages of merit pay include:

- Increased effectiveness as a reward is tied to performance
- Better company standards due to the recruitment of employees with the skills and confidence to work within a performance-related pay system
- Increased retention of key employees who benefit from a pay system that rewards
- Enables the employer to differentiate the high performers by giving them a higher pay
- If exceeding targets/expectations employees can be rewarded fairly.

Why is merit pay bad?

- The merit pay system is subjective and may be biased
- Employees develop a tendency to expect consecutive pay raises
- Competition between employees and acting in self-interest rather than in the interest of the company
- Determining measurables and merit budgets uses time and resources that could be better spent elsewhere. The amount of time and energy that companies spend in trying to make performance measurable for merit pay, including skills development, metrics, performance baselines, and so on, is better spent on providing customer service. Organizations have generated several hundred-

page documents that set out what merit means in different jobs. The benefits are often just not worth all of that time and effort.

- Merit pay may create problems in employee relationships due to jealousy, fear, favouritism, negative competition, and insecurity.

In conclusion, there is no single ideal merit-pay plan. Plans can and should be tailored to each situation.

Taurai Masunda is a Business Analytics Consultant at Industrial Psychology Consultants (Pvt) Ltd a management and human resources consulting firm. https://www.linkedin.com/in/taurai-masunda-b3726110b/ Phone +263 4 481946-48/481950/2900276/2900966 or email: t

https://thehumancapitalhub.com/articles/What-Is-Merit-Pay