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# Purpose-Driven Pay for Performance

BY LORI WISPER

In 1975, “pay for performance” was introduced to the world of compensation professionals through the American Compensation Association (now WorldatWork) handbook for the first certification program that showed the then-new concept of “salary increase guide charts” that used “a performance appraisal technique and salary range position” to inform a “personnel administrator where to position guidelines for the average increases.” Hence, the merit matrix was born.

Over 40 years later, organizations continue to struggle with how to make this process more effective. Setting aside the difference between salary budgets in 1975 compared to what they are in 2019, the challenge of the pay-for-performance process living up to its name continues to plague us. As Figure 1 illustrates, a recent study by Willis Towers Watson showed that only about one-third of organizations report that base pay programs are effective at paying for performance and most are either seeking to improve these programs or scrapping them altogether.

It may not be surprising to most that “merit pay” continues to be a challenge, but annual incentive pay doesn’t seem to fare much better than base pay programs. The same research study suggests that most employers also struggle to use incentive pay as a tool to reward performance in a highly differentiated way (See Figure 2).

If organizations and compensation professionals have struggled with these programs for some time, what’s different now? With the labor market tightening, jobs and work being redefined, and the need to attract and retain not only critical talent, but diverse employee



groups, examining the traditional methods of pay process and governance seems not only appropriate but necessary. And, with many organizations focusing on defining their unique employee experience and how reward programs can impact it, the time to think about pay for performance in a different way is now.

### Why Start with Purpose?

The basis for thinking of pay for performance in a different way should start with purpose. Much has been written about organizational “purpose” of late, but none as impactful as the letter that Blackrock’s Larry Fink sent to CEOs of the firm’s investment portfolios. Fink’s message is that without purpose, no organization can achieve its full potential. In his 2019 letter to CEOs, Fink wrote:

“Companies that fulfill their purpose and responsibilities to stakeholders reap rewards over the long-term. Companies that ignore them stumble and fail. This dynamic is becoming increasingly apparent as the public holds companies to more exacting standards. And it will continue to accelerate as Millennials — who today represent 35 percent of the workforce — express new expectations of the companies they work for, buy from, and invest in.”

The current focus on purpose could not be more relevant for organizations seeking to improve the pay-for-performance process. Fink further expands on this point by stating, “Purpose is not the sole pursuit of profits, but the animating force for achieving them.” The definition of performance is broadening to consider a spectrum of stakeholders emphasizing sustained performance through thoughtful environmental (E), social (S) and governance (G) programs and policies. Shareholders are keenly interested in not only value creation, but

defining and emphasizing the inputs to value creation. ESG are inputs moving to the “top of the list,” as factors not only to be considered in assessing performance, but as key inputs to driving culture and shaping purpose.

Ultimately, what Fink is talking about is organizational performance, and ideally, the pay-for-performance process is meant to engage employees in just that. Therefore, by starting with purpose, pay-for-performance design can be grounded in a way that aligns the organization’s reason for being (i.e., corporate purpose) with an employee’s reason for being there to make it happen (i.e., individual purpose).

Providing further perspective on linking organization purpose with an employee’s individual purpose, Willis Towers Watson’s John Bremen and Amy Devylder wrote in the May 2019 edition of *Workspan*:

“Clearly, it is important for organizations to articulate purpose in today’s environment, as it helps create meaning, clarity and an emotional connection for employees as to why they work where they do. At the same time, most employees also have individual purposes that go beyond earning a paycheck or keeping a job. Companies have found it powerful to help talent discover and articulate their individual purpose and its connection to the organization’s purpose as a means to create greater engagement and meaning from their contributions. Through this effort, organizations are equipped to align their total rewards strategy and programs with both organizational and individual purposes.” (See “[Modernizing Total Rewards to Drive Human Capital Sustainability](#).”)

Organizational purpose outlines why a business exists and the work-related purpose for most individuals explains their profession of choice. Connecting organization purpose and individual purpose is what Bremen and Devylder advocate for enabling organizations to have talent and performance sustainability over time, and the pay-for-performance process can — and some would argue *should* — be a strong driver of just that.

### **Driving Performance with Purpose**

What would “purpose-driven pay for performance” look like? Ultimately, it is about the organization’s expectations for how individual employees contribute to the organization’s purpose and determining how to optimally reward for that contribution.

To do this, start by outlining all the ways you expect employees to contribute to the organization’s purpose. (See Figure 3.) What you will discover is that these expectations are multidimensional, and while each dimension is important to contributing to the organization’s purpose, rewarding for each contribution in a different way presents a unique opportunity to effectively communicate to employees how their contributions matter, thereby strengthening the connection between individual and organizational purpose.

## Considerations for Creating Purpose-Driven Pay for Performance



How do we expect our employees to contribute to our purpose/mission:

- Be really good at their jobs by serving their immediate constituents (i.e., customers, other employees, owners, etc.) to deliver on our promise/purpose
- Focus on the results (both long- and short-term) we need to achieve to sustain our market position, remain a viable organization, and continue live out our purpose
- Demonstrate behaviors that exemplify our values every day and in every way. These include:
  - Collaborate and team effectively
  - Be open and inclusive to all views ensuring we get the best ideas moving forward
  - Act with integrity and honesty
  - Learn by doing and teach others no matter where you sit
  - Balance risk with agility with the aspiration that decisions are made at the appropriate pace to the need and circumstances

### 1. Examine the purpose of each pay element.

As we saw in Figure 3, how an organization defines performance expectations is multidimensional, making the connection between organizational purpose and individual purpose challenging, to say the least. To help clarify that, begin by outlining the purpose of each pay element. Figure 4 is an example of reward program purpose definitions.

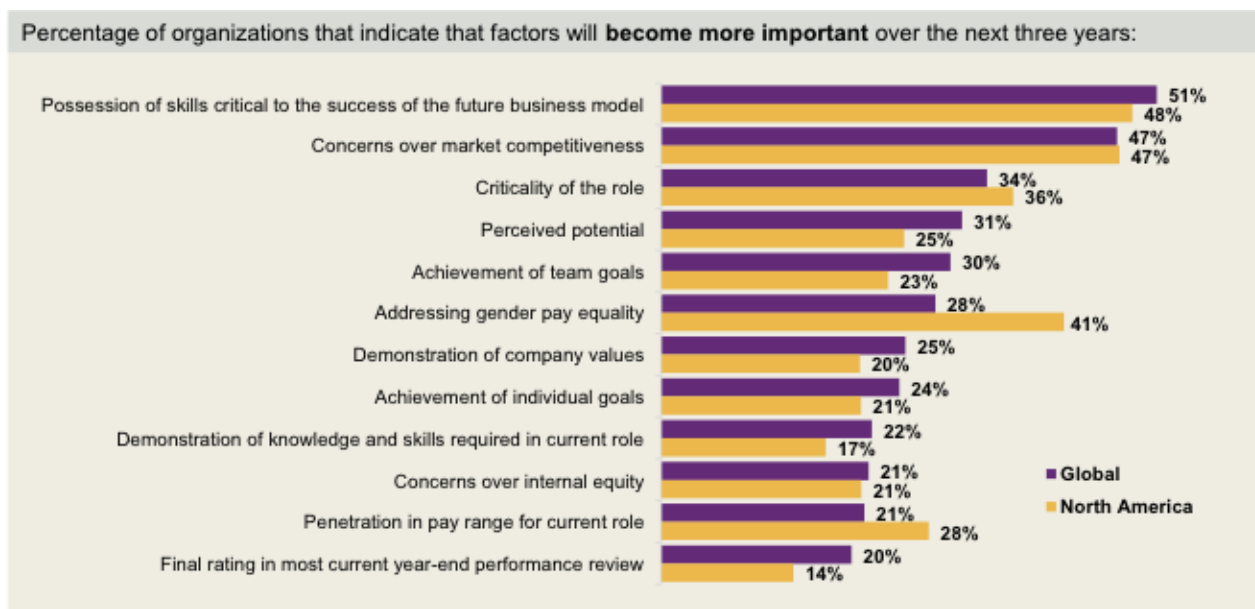
Reward Program	Purpose
Base salary	Acquire skills, experience, education in anticipation of doing a job as expected and needed to get every day work done
Annual increases to base salary	Protect initial investment in employee in anticipation of continuing to do the job as expected
Additional increases to base salary (may be promotion)	Reward the demonstration of skills and abilities that exceed expectations for the job (e.g., doing the next higher level job, often defined as "potential")
Annual cash incentive	Link a time-based and measurable outcome to a cash award—not meant to reward sustained performance over time
Annual equity grant	Reward the demonstration of leadership skills in pursuit of longer-term measurable outcomes. Also used to reward for potential
Special recognition award	Reward for the demonstration of behavior that is not easily measured or communicated in advance. Often given publically in order to model these behaviors to others and encourage them to be repeated ("we caught you doing something right and want you to repeat it")
Benefits	Part of the package used in the acquisition of talent; also used to protect investment in employee in anticipation of doing the job as expected

### 2. Align each reward element purpose with performance expectations.

By going through the exercise of defining the purpose of each pay element, it becomes

apparent that some pay elements will better align certain performance dimensions than others. If the goal is better clarity on the connection between organizational purpose and individual purpose, it makes sense to use each pay element in a way that helps to solidify that connection. For example, asking the question “What dimension of performance should we use base pay to reward for?” brings the focus directly to the purpose of base salary, as shown in Figure 4. If the purpose of base pay is to acquire the skills, education and experience necessary to do a specific body of work (or job), then it makes sense to use base pay increases to protect that investment on an ongoing basis, as long as the expectations that the skills to do the job will continue to be met.

In fact, Willis Towers Watson research supports the notion that base pay increases will become even more focused on skills related to jobs, whether those skills are being paid at a market competitive rate and how critical those skills are to the organization’s business or purpose, rather than the achievement of individual goals, as shown in Figure 5.\



If base pay increases are to align specifically to skill demonstration related to a job, what should incentive pay reward for? Since the purpose of base pay and base pay increases is being fulfilled, we can use variable pay to align most directly with variable performance. Annual incentive pay can reward directly for expectations you have for employees related to what you need them to do in a specific year. This not only provides focus on those shorter-term elements of performance but separates them from skill-based performance that builds on itself over time and needs to be sustained.

It can also magnify the connection between organizational and individual purpose to a degree that employees see how they directly impact the organization’s reason to exist. For example, an insurance company with a mission to “Take care of policyholders in their greatest time of need” may have an incentive plan for claims adjusters that links directly to



customer service quality. Those adjusters whose individual work purpose is to provide the best quality of service to their customers and that typically also receive the highest customer service scores are rewarded directly for that — while also helping the organization deliver on their promise.

While the skills needed to do the job of claims adjuster are also in play in this example (which is already rewarded in the base pay increase), the performance expectations for this element of the employee's efforts to serve customers may vary from year to year — and are likely expressed through their assigned customer service goals or targets — and incentive pay enables the flexibility to reward for this in the most effective way. At the same time, incentive pay communicates to the employee that this is what they need to focus on for that performance period.

### **3. Align with the organization's "language of performance."**

Speaking of communication, it is also critical to understand how purpose-driven pay for performance will “fit in” with how the organization talks about performance. Given that it is directly linked to the organization's purpose, you might think this would happen naturally, but that may not be the case. The first place to look is the organization's performance management process. Most HR professionals agree that performance management and pay for performance are “two sides of the same coin,” and if that is true, then the “language of performance” should be aligned in both.

How does the organization define performance in the performance management process? Many speak of it as “the what and the how.” A review of the performance expectations defined in Figure 3 might beg the question: How do these expectations figure into “the what and the how” and how would we use them to provide more transparency on how pay is determined?

Given that greater pay transparency is also what both outside forces (such as governments) and inside forces (employees) are demanding, it is incumbent upon HR professionals to work together to determine whether the organization's language of performance is sending the optimal messages. And, a desire for greater pay transparency regarding pay decisions appears to be on the horizon for many organizations already. (See Figure 6.)

### **Sustaining Purpose-Driven Pay for Performance**

As organizations change, their purpose for existing also may change. But it is unlikely that organizational purpose will vary greatly over time. However, an employee's purpose for working at an organization is likely to change, and often. Career advancement opportunities have become increasingly important in attracting and retaining key talent.

How employees may want to contribute to an organization and how that contribution can change over time is often what distinguishes the best organizations to work for from the rest because they make career advancement opportunities clear and available to their

## Is your organization planning to increase the level of transparency around pay decisions?

### Already taken action:



### Planning to take action this year:



### Considering taking action over next 3 years:



**48%** of employers globally are planning to take action this year or within the next three years to increase the level of transparency in pay decisions

employees. And in doing so, they sustain that contribution over time more effectively than others.

Greater contribution may include employees who are demonstrating a higher level of skill for a different job and that is often rewarded through promotional opportunities. What if, however, an opportunity to move up a career path is not available to the employee? How should the organization reward them in order to retain those higher-level skills? This is where the alignment between the purpose of certain reward programs and how they are used to pay for performance is the focus. Going back to Figure 4, what could be added to the list that would provide managers even more tools to reward for the many dimensions of performance? Would the employee value greater learning opportunities, a rotational assignment, an executive mentor, being sent to an outside conference or industry event?

Understanding what employees value and linking it to the pay-for-performance process is definitely something organizations should consider for strengthening the link between organizational purpose and individual employee purpose. It makes the connection more personal and has greater potential for modernizing the entire pay-for-performance process.

What started in 1975 with good intentions has evolved into a pay-for-performance process that most organizations believe is not effective at rewarding for performance and contribution in 2019. The time is right to think about how this process can be changed to address the needs of an evolving organization and workforce. Purpose-driven pay for performance can help build a unique platform for addressing these needs by linking organization and individual employee purpose to drive not only overall performance, but employee attraction, retention and engagement.

## About the Author

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