METRO

Metro Council

Issues to Consider in Implementing a Pay-For-Performance Program

May 2004

A Report by the Office of the Auditor

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OFFICE OF THE AUDITOR

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To the Metro Council, Chief Operating Officer and Metro-area Citizens:

In 2003 the Metro Council decided to move Metro toward a performance-oriented compensation program and requested the Metro Auditor study pay-for-performance (PFP) compensation programs employed by other public sector organizations. This accompanying report provides the Metro Council with the results of that study. The findings are intended to provide both the Metro Council and agency management with useful guidance as they formulate and implement their own PFP program in the coming year.

As with all compensation programs, successful PFP programs contain not a few, but dozens of elements. When these elements are coordinated and implemented soundly, they can lead to significant individual and organizational improvements. Our research reveals that successful implementation of PFP is never guaranteed. Complex human dynamics within organizations can often undermine well-intended and otherwise well-designed compensation programs of all kinds.

The report identifies attributes of sound performance management systems, PFP success factors commonly found in public entities, factors that inhibit PFP success in public entities and strategies to proactively address those potential failure factors. Some identified strategies include:

- offering enough base-pay to attract talented, dedicated people;
- giving people an important mission to accomplish; and
- creating ways other than financial incentives to tell people they are winners.

In the end, PFP succeeds in public entities only when the political climate is right, employees accept it, managers are trained to implement it fairly and consistently and agencies monitor it regularly.

Very truly yours,

Alexis Dow, CPA
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Purpose, Scope & Methodology

The Metro Council has decided to implement elements of a performance-based compensation system. The process began in August 2003 when a Metro Council resolution established performance goals and measures for Metro's Chief Operating Officer for fiscal year 2004, including an assignment to link a portion of employee pay to performance measures.

Our study and this report was undertaken in response to the following suggestion from Metro Council:

> "Evaluate Pay-for-Performance Programs in Public Sector Organizations: Identify and evaluate programs at other public sector organizations which link staff compensation to job performance. Suggest program elements, which have been effective elsewhere and identify those that have not been successful elsewhere, and define potential applicability to Metro."

This report identifies factors to be considered by the Metro Council and management as they design and implement a performance-oriented pay program. The report summarizes acknowledged success factors and factors that inhibit success in implementing pay-for-performance (PFP) programs. It was prepared by reviewing more than 35 studies and consultant reports on the subject of PFP, and draws on work done in conjunction with three other Metro Auditor reports on PFP.[1]

The Metro Council and Metro management may find the case examples in the Appendices useful. Appendix A contains five case studies involving local government entities and Appendix B contains five examples of where the federal governmental has implemented PFP. Appendix C summarizes the sources of PFP information researched for this report.

1 Metro Auditor reports: (1) *MERC'S PFP Program Implementation Is Not a Model For Metro*, October 2003; (2) *MERC's Accountability Processes Need to Be Strengthened*, October 2003; *MERC Employee Performance Agreements Need Improvement*, October 2003

Background

PFP

Pay-for-Performance, or PFP, is a system of employee compensation in which pay and rewards are defined by individual behaviors and individual and organizational results. An organization defines performance standards that are consistent with the organization's strategically defined goals and objectives. Employees are then rewarded for meeting or exceeding these standards. This type of program uses financial incentives as part of the total pay package. PFP awards can be:

- One-time lump-sum bonuses that are commonly distributed during the year
- Spot awards, or one-time rewards that provide immediate recognition of exceptional performance
- Pay increases added to base pay.

PFP programs in the public sector are largely an outgrowth of developments in the 1990s, including new management approaches at the local, state and federal levels. In 2001, a survey by the International Public Management Associations for Human Resources found that 45 percent of respondents reported having some type of variable pay plan[2], and of these, four in five reported using PFP-based plans.[3]

Purposes PFP Is Intended To Accomplish In The Public Sector

PFP programs in the public sector generally focus on three goals related to the organization's functions:

- **Improved efficiency and productivity** – Private-sector pay programs assume that rewarding employees for meeting financial goals will improve efficiency and productivity. Some public-sector PFP programs use the same principle.
- **Improved constituent services** – To the extent that employee performance can be improved through pay-related incentives, constituents benefit from improved government services and lower costs.
- **Creation of new organizational culture** – PFP can also be used to help public agencies redefine their culture. In traditional pay systems, rewards often center on the length of time spent in an organization. PFP looks at the added value employees bring to the organization.

[2] Variable pay is non-recurring pay based on individual, group or organizational performance.

[3] The International Public Management Association for Human Resources represents more than 5,000 human resource professionals at local, state and federal levels.

Executive Leadership Is Essential In PFP

Executive leadership has a significant role to play in PFP. The most critical element of the performance management process is strategic planning that provides "top-down" guidance and direction. This is important because in PFP, all performance measures, organizational and individual, should be established in the context of the organization's strategically stated goals and priorities. In PFP, employees should be able to understand how their individual job fits into the organization's overall mission.

This effort to link organizational and individual goals is demanding, and it involves management's commitment to supply necessary resources to make the system work. For performance to be evaluated meaningfully, employees and supervisors need measures that are specific, measurable, achievable, time certain, and limited in number. Developing such measures can be difficult; in our review of MERC's PFP system, for example, we found that many measures were in need of improvement. In addition, an organization needs an effective starting point, or "baseline," for measuring incremental improvements.

Environmental Factors Conducive To Successful PFP Compensation Programs

Key Questions to Answer Before Embarking on a Performance-Oriented Compensation Program

Public-sector pay-for-performance programs are intended to improve efficiency, productivity and constituent services. PFP programs can help create a new culture but such programs are not needed by every public entity. Before implementing a PFP program, the agency should clearly and publicly answer several key questions:

- Why is a reengineered compensation program needed?
- How does a proposed PFP program compare with the previous system and why was that system deficient?
- What will the new program accomplish for employees and the organization?
- Can a partnership be created with union and employee associations and other stakeholders?
- What rewards will be meaningful?
- Will the program be funded adequately and consistently on a year-to-year basis?
- How will the program's accomplishments and effectiveness be measured?

Three Organizational Attributes that Improve the Odds of Successful PFP Adoption

Any organization, private or public, that chooses to implement a PFP program must do so with the understanding that it will trigger a series of changes, some intended, some unintended, in its underlying culture and staff behavior.

Among all the variables identified in PFP studies reviewed for this report, three organizational attributes stand out as offering the best possible set of conditions for successful PFP adoption:

1. Successful PFP programs derive their purpose from **a meaningful strategic planning process** that provides "top-down guidance" to direct a performance management process.

2. Directly related to the first attribute, successful PFP programs are most often found where **a modern, effective, credible and validated performance management process** is present to support pay and personnel decisions and to provide safeguards of transparency and accountability to ensure fair and consistent application of PFP practices. Such processes contain specific performance measures that align with the organization's strategic goals and employees are able to understand how their individual job fits into the organization's overall mission and key objectives.

3. Successful PFP programs are most-easily implemented and sustained by organizations in which **a performance-based reward culture already exists**, either formally or informally. PFP has also been implemented successfully in organizations that initially lacked an existing performance-based reward culture, but it is inherently more difficult, time-consuming and requires more change-management effort by management.

Ten Attributes of a Sound Performance Management System

Because a sound performance management system is a key component of successful PFP implementation, the Council should first ensure such a system is in place at Metro. This section summarizes the findings of several federal studies that have identified specific practices used by leading public sector organizations in their performance management systems to create a clear linkage – “line of sight” – between individual performance and organizational success. The key practices include:

1. **Aligning employee performance expectations with well-defined organizational goals.** An explicit alignment of daily activities with broader results helps employees see the connection between their daily activities and organizational goals and encourages employees to focus on their roles and responsibilities to help achieve those goals.

2. **Connecting performance expectations to crosscutting goals.** As public sector organizations shift their focus of accountability from outputs to outcomes (results and effectiveness), the activities needed to achieve those results often transcend specific organizational boundaries. High performing organizations use their performance management systems to strengthen accountability for results, specifically by placing greater emphasis on fostering the necessary collaboration, interaction and teamwork across organizational boundaries to achieve these results.

3. **Providing and using performance information to track organizational priorities.** High-performing organizations provide objective performance information to employees to show progress in achieving organizational results and other priorities and help them to manage during the year, identify performance gaps, and pinpoint improvement opportunities.

4. **Requiring follow-up actions to address organizational priorities.** High-performing organizations require employees to take follow-up actions based on performance information. By tracking follow-up actions, these organizations hold employees accountable for making progress on their priorities.

5. **Using competencies to provide a fuller assessment of performance.** High-performing organizations define the skills and supporting behaviors that employees need to effectively contribute to organizational results.

6. **Linking pay to individual and organizational performance**. High performing organizations seek to create pay, incentives, and reward systems that clearly link employee knowledge, skills, and contributions to organizational results.

7. **Creating valid performance measures.** For performance to be evaluated meaningfully, supervisors need to establish performance criteria that are specific, measurable, achievable, time certain, organizationally aligned and limited in number. Organization-wide measures of performance, such as financial improvements and customer satisfaction levels, should be evaluated against a pre-PFP program baseline to determine PFP program effectiveness and areas needing mid-course corrections.

8. **Making meaningful distinctions in performance.** Effective performance management systems achieve three key objectives to produce meaningful distinctions in performance:
   - They provide candid and constructive feedback to help employees maximize their contribution toward the goals and objectives of the organization,
   - They provide management with the objective and fact-based information it needs to assess results and determine appropriate rewards,
   - They provide the necessary information, documentation and authority to deal with poor performers.

9. **Involving employees and stakeholders to gain ownership of performance management systems.** High-performing organizations have found that actively involving employees and stakeholders in developing performance management systems and providing ongoing training on the systems helps increase their understanding and ownership of organizational goals and objectives. A wide range of stakeholders, including employees and employee unions or associations, should be engaged early in the process and encouraged to provide ongoing feedback.

10. **Maintaining continuity during transitions.** Successful cultural transformations and change management initiatives in public and private organizations can often take 5 to 7 years to fully implement, outlasting the terms of many elected officials and political appointees. High-performing public organizations use performance agreements as a part of their performance management systems to reinforce accountability for achieving organizational goals during times of leadership transitions.

PFP in the Public Sector vs. Private Sector

There exist basic philosophical and factual differences between private and public sector compensation practices, as summarized in the following table:

Table 1

Private Sector	Public Sector
• Market data – primary role	• Market data – limited role
• Competitiveness is critical	• Affordability is critical
• No external approval is required	• Adjustments are subject to external (legislative) approval
• Public perception is not important	• Public perception is important
• Pay-for Performance is a common element of corporate compensation philosophy	• Most states have formal performance evaluation systems
• Many organizations use performance as a primary determinant of pay progression	• Most states use summary ratings, following standard rating patterns
• Two-thirds of all companies offer at least one PFP plan for non-sales employees today, compared to about half in 1990	• Most states use PFP linkages, similar to those in the federal sector
• Proportion of overall payroll expenses represented by variable pay has doubled from about 4 percent to about 8 percent	• Payment to individuals based on individual performance
• Most popular basic PFP plans are incentive awards based on meeting organizational goals and individual employee recognition awards	• Payment on top of base pay (no "pay-at-risk")
	• Tight agency-imposed limits on individual award values
	• Limited managerial discretion to vary individual award values

PFP succeeds in public entities only when the political climate is right, employees accept it, managers are trained to implement it fairly and consistently and agencies monitor it regularly.

Twelve PFP Success Factors Commonly Found in Public Entities

PFP success is not "guaranteed". Complex human dynamics within organizations can often undermine even well-intended and otherwise well-designed compensation programs of all kinds.

Many studies have been performed to identify PFP successes and failures in the public sector. Based on our review of such studies, we conclude that a PFP program's success or failure is largely dependent on how well it is designed, implemented and refined over time. PFP programs that are thoughtfully designed, carefully implemented and consistently administered result in employees more likely embracing and reinforcing its objectives within the organization's formal and informal cultural systems.

The following factors are those commonly associated with successful PFP implementations:

1. **A compelling, well-defined, fully articulated and fact-based business need**. The organization needs well-reasoned and strategically defined goals to support moving to PFP and to assert how PFP will help meet those goals to the benefit of the organization.

2. **Employees who are highly motivated by monetary rewards**. In circumstances where management wants the motivational force of PFP, it is useful to select people who clearly respond to money and/or recognition as prime motivators of performance.

3. **Clear links between the organization's objectives, employee performance, and pay.** Successful PFP programs recognize the importance of relating employees' work performance to the long-term mission of the organization. Adequate time should be spent discussing organization and/or work group goals and how each employee is expected to contribute to the achievement of the goals.

4. **Meaningful rewards consistent with individual, team and organizational achievements**. Meaningful rewards vary from one individual to another and one program to another. However, the basic concept is that incentives be sufficient to motivate employees toward desired performance objectives. If a program's design is appropriate for the organization and work environment, and goals are reasonably achievable, then meaningful rewards for successful performance will be effective in achieving the desired organizational goals.

5. **Structured and consistently-applied performance management systems.** Successful PFP programs depend on managers making fair and candid assessments of subordinates against predetermined performance measures. For performance to be evaluated meaningfully, employee measures must be specific, measurable, achievable, time certain, organizationally aligned and limited in number. The organization needs readily measurable results, directly related to its strategic plan that can be transferred from organizational levels to managerial levels and ultimately to work groups and individuals.

6. **The PFP program itself must be measured for success.** Tracking results before and after implementation allows managers to monitor not only the employee's progress but also the progress of the PFP system against specifically stated PFP program goals and the former compensation plan. Other factors that can be tracked include:
   - Stakeholder satisfaction with systems and services
   - Employee morale
   - Financial performance
   - New employee recruitment
   - Employee retention

7. **Employee participation in design, implementation and monitoring.** Managers and employees at all levels, preferably those who are seen as top performers, should play a role in planning the new PFP system.

8. **Full and consistent funding.** Adequate funding for the program on a recurring basis is essential. The organization must have a steady source of PFP funds because improving workforce performance requires a consistent, predictable reward system. To improve productivity in the long run, PFP programs must be designed to provide rewards for desired behavior over several years.

9. **Continuous training for new and existing managers and staff**. Managers must be appropriately trained to objectively evaluate their employees and critically differentiate performance. Extensive ongoing training for supervisors and employees should stress two-way communication, goal setting and performance planning. Training should be repeated at least once a year at all levels.

10. **Program proponents who lead by example.** New PFP programs demand leadership and commitment from top management. Successful performance management starts with the agency head doing a good job with the top tier of managers. In turn, managers and employees will usually mimic the behavior of the people to whom they report.

11. **The switch to performance-based compensation is positioned as an organizational development initiative.** Process and communications issues are far more important than technical considerations. The new PFP policy will change the organization and affect supervisor/subordinate relationships in planned and unplanned ways. Even with extensive and meaningful planning, it may take several years before merit pay is accepted and the organization realizes the benefits.

12. **Continuous flexibility and refinement.** Management should seek regular formal and informal feedback on PFP policies and be ready to refine the system based on lessons learned. A PFP program, as with any compensation program, is a perpetual work in progress.

Nine Factors that Inhibit PFP Success in Public Entities

PFP programs can trigger significant unintended negative consequences that undermine the organization's effectiveness and produce performance that is perceived or, in fact, worse than before. The following factors have been identified in both public and private sectors as being detrimental to the successful implementation or continuation of PFP programs.

Management teams who have successfully implemented PFP programs spent a majority of the planning and design phase analyzing and understanding how these factors could be minimized or avoided within the context of their specific organizations. In doing so, they actively sought extensive involvement by employees at all levels of the organization, especially those in key positions of influence and those expected to be the most directly impacted by the new program.

1. **Failure to link employee performance objectives to the organization's objectives produces weak support within the organization.** Successful PFP programs start with a clear mission statement, flowing into goals and objectives at the department and unit level, until managers identify the performance objectives of the employee. Unsuccessful PFP programs tend to be based on criteria that do not clearly connect to the organization's goals and objectives. For example, they may measure irrelevant performance or set performance goals that are not measurable.

2. **Invalid performance appraisals lead directly to program credibility problems**. PFP is only as good as performance appraisal is credible. A perception that the performance-appraisal system is biased or does not appraise actual performance destroys the connection for the employee[4].

3. **Lack of adequate financial rewards and budget cycle barriers inhibit program success**. Individuals will perform and continue to perform as long as they are meaningfully rewarded for their efforts. A perception that the rewards are in jeopardy or are inconsistently available due to fiscal constraints undermines employee confidence in and commitment to the program.

[4] As noted in a previous Metro Auditor report: *MERC Employee Performance Agreements Need Improvement*, October 2003

4. **The performance-reward connection is not clear.** Compensation programs often face conflicting or inconsistent goals within and across the organization. In addition, employees sometimes have difficulty seeing and understanding the connection between their performance and their reward. Secrecy in pay leads employees to guess at this connection, usually inaccurately. If the connection is not comfortable to employees, they may act under the false assumption that it does not exist.

5. **The performance-effort connection is not clear**. The employee must feel he or she controls the important measures of his or her performance and must perceive that performance leads to outcomes that are clearly recognized. A PFP program assumes that performance varies among employees and that the degree of this variance is demonstrable and significant enough to justify different reward levels. But in many jobs, objectively measuring variation in performance between employees is impossible or is so small that it is unrealistic to use as a determinant for pay. Similarly, the efforts of an individual in a group project may not be separable from the efforts of the other members of the group.

6. **Money may not be a prime motivator for some employees**. This PFP downside involves the negative effect of extrinsic rewards, such as money, on intrinsic motivation. Offering to pay people more money in exchange for better performance is intended to create an incentive to perform better. But strong, and repeatedly demonstrated, evidence from social psychology shows that extrinsic rewards exert a countervailing negative effect on the behavior of people who are intrinsically motivated to perform a certain task. Increased extrinsic rewards might actually produce poorer performance among intrinsically motivated people in the public sector for two reasons:
   - Studies suggest that a larger proportion of government employees are more often intrinsically motivated to perform their jobs than their private sector counterparts. Thus, the de-motivating effect of extrinsic rewards can be greater among public employees.
   - The value of extrinsic rewards government is able to give consistently to high-performing employees is likely to be modest by private sector standards, thus reducing their relative incentive effect.

7. **PFP can become an administrative burden**. PFP takes a great deal of supervisory and managerial time and effort and must be designed and administered carefully. Failure to put forth the managerial and staff effort required will lead to a program that does not, in perception or fact, tie pay to performance and cause employs to lose trust in management.

8. **Faulty assumptions by PFP proponents lead to unmet expectations.** Two important assumptions underlie the motivation to implement pay-for performance programs in public-sector entities:
   - That the vast majority of public employees are not performing at a level sufficient to merit a performance bonus or merit raise.
   - That a small bonus or raise will be sufficient to motivate incredible jumps in performance.

   These two assumptions often lead to two defects in most government systems of paying people for performance: specifically and significantly limiting the number of people who can receive the bonus and providing small bonuses with raises.

9. **Finally, PFP systems have failed when participants, policy makers, media or others publicly criticized one or more aspects of the plan, subjecting the entire system to a level of scrutiny it could not withstand.** When money is used to reward a few people and not others in a public environment, it often leads to second-guessing by employees, journalists, auditors, inspectors general, PFP participants or legislators. Once people start second-guessing a significant number of the performance-pay decisions, the entire PFP program becomes at risk.

Six Ways to Proactively Address PFP Failure Factors

PFP literature contains a number of suggestions to proactively address PFP failure factors, including:

1. **Offer enough base pay to attract talented, dedicated people.** It is far easier to use money to attract people to *take* a job, than to get people to do a *better* job.

2. **Give people an important mission to achieve.** People work for a public agency more often because they believe the agency does something important and they want to make a contribution. That mission is something the agency can use to motivate its people.

3. **Find creative ways to tell people they are winners. Reliance on financial incentives is expensive and unnecessary.** Successful PFP programs create a wide variety of ways to publicly recognize people for their successful efforts.

4. **Reward teamwork within large and small subsets of the entire organization, in addition to the individual rewards.** Successful PFP programs provide for a mix of rewards that can be earned by specific teams or departments, individuals within departments and the overall organization. This creates an opportunity for every employee to experience a taste of the PFP reward mechanism, even if their individual performance has not yet earned them an individual performance-based reward.

5. **Create specific steps to deal with under-performers.** Successful PFP programs contain specific processes to identify under-performance and take appropriate action if performance does not improve within a reasonable timeframe.

6. **Build a regular evaluation and refinement effort into the program itself.** No compensation system works precisely as planned. Seeking and welcoming on-going feedback from the PFP participants is the fastest way to identify areas needing improvement. Doing so also conveys to managers and employees the agency’s sincere desire and intent to continue the program and make improvements where necessary.

Appendix A

Five Examples of Local Government PFP Programs

Five Examples of Local Government PFP Programs

- Baltimore County, Maryland
- Concord, California
- City of Coral Springs, Florida
- City of Las Vegas, Nevada
- City of Shreveport, Louisiana

Baltimore County, Maryland

The County wanted a program that was largely designed by the employees. Money was not the primary motivator and the program was not sold as a way to save money, but to improve service and morale. The county employed the services of an HR/Benefits consultant to help carry out the gain-sharing plan. One of the first things the county did was to define gainsharing and what it would do for the county, making it clear that gainsharing wouldn't substitute for any other pay programs. No employee pay was at risk. Rather, the program represented an opportunity for employees to make additional money and improve the quality of their own job.

Pilot departments in the county were identified, design teams were named and a gainsharing committee and external "blue ribbon" review panel set the final parameters of the experimental program. A readiness assessment was taken throughout the county departments to gauge employee perceptions of gain-sharing. There were employee focus groups, an employee opinion survey and department briefings so employees and management would understand the objectives of gainsharing.

Pilot departments were selected for implementation of gainsharing based on the following criteria:

- Gainsharing was viewed as possible
- Opportunities for improvements in productivity, quality and service cost could be made
- Productivity and quality could be measured
- High scores were achieved in morale and trust surveys
- Management support
- Performance feedback
- Communication
- Understanding goals and leadership
- Teamwork
- Quality of work
- Empowerment.

During the following months, each pilot department had design team meetings to arrive at a final gainsharing plan. Once modifications were made, the plans underwent another outside panel review before final approval and implementation in July 1996.

Concord, California

The purpose of Concord's PFP Plan is to provide a strategic tool to assist the City in providing responsive, innovative local government services in the most efficient and cost effective manner. The PFP Plan has been designed to reward management employees of the City for exceptional performance of assigned program responsibilities and outcomes, and exceptional performance in the completion of special projects and studies.

Concord established policy standards stating that the PFP program would:

- Be fiscally prudent. The city's practice is to compensate employees in accordance with the City's financial condition. In determining this Concord will consider competing service priorities, reserves, revenue growth, and the Council's adopted budget policies.

- Attract and Retain Quality Employees. Concord's PFP Plan should provide the city with the ability to attract and retain high quality, innovative, motivated, performance-oriented individuals.

- Establish base pay criteria. The maximum base pay rates will reflect the economics of the market and serve as the foundation for variable pay. The market will be determined for each position or group of like positions and will typically include comparable sized public agencies located in the area, but may also include private sector employers, as appropriate. Maximum base pay rates will be competitive with the identified market(s) and will reflect the opportunity for above average performers to earn more than market rates through PFP.

- Establish a clearly defined PFP program. All management and executive employees will participate in a PFP plan that will reward the achievement of individual performance objectives, support Concord's strategically-defined goals and reward successful accomplishment of special team efforts. The PFP plan will include adjustments to base pay and lump sum bonuses.

- Establish the elements of a total compensation program. Concord will use the mix of base salary, PFP and benefits that is competitive with the labor market.

City of Coral Springs, Florida

The city developed a performance management system that tied the strategic planning process to performance measurement. The city defined its multiple missions and diverse activities. Elected and appointed officials in Coral Springs use performance data for strategic planning, resource allocation, policy formation, operational reviews of City-provided services and programs, assessing the City's quality initiative, and employee performance reviews and compensation changes. To show each employee how they relate to the City's goals, supervisors aid employees in setting up individual work plans each year tied to City strategic priorities and performance goals. At the end of the year, supervisors review performance on the work plans to determine pay increases. This process is used for managers at all levels. Performance data is also used for budgeting by the City Manager, who analyzes performance data from each department in preparing a budget for the City Commission.

City of Las Vegas, Nevada

The city developed a management compensation package that encourages its leaders to meet performance expectations, as well as achieve individual goals and objectives that increase personal and professional development. The program is merit-based, and consists of a Management Performance Review and Bonus Option. The Management Performance Review focuses on expectations such as:

- Developing and Managing People
- Task / Project Management
- Critical Thinking / Problem Solving
- Communication
- Customer Service

More specific expectations may be set for the manager, based upon assignment. Specific expectations may focus upon strategic alignment and improvement efforts. Managers who demonstrate a high level of success, and score well on the Management Performance Review, are eligible for participation in the Bonus Option portion of the program. Bonuses are awarded if the manager demonstrates a high level of success in meeting pre-established career development goals and delegated objectives. Goals and objectives may be structured to meet strategic management targets, enhance already existing strengths, or improve upon developmental needs.

Individual goals and objectives may focus on, but are not limited to: attainment of department goals, success in empowering employees, political astuteness, encouraging employee recognition and positive morale, increasing productivity and performance, and ensuring customer satisfaction. The amount of any bonus will be based upon the manager's measured degree of success in meeting goals and objectives.

City of Shreveport, Louisiana

The city installed a performance management system featuring a variable pay (PFP) program in January 1997. The program was developed through an intense participative process involving employees, managers, city council representatives and personnel professionals with facilitative assistance from a consultant. The system emphasizes the relationship between performance and rewards while striking a balance between permanent and at risk pay components. The simple, integrated system has been well received by managers, supervisors, workers and elected officials.

The city found that a participative, team-based approach proved ideal for design, installation and operational elements. The direct result is that pay is now more directly linked to both budget imperatives and personal contribution. A significant organizational implication is that for almost two years employee and management attention has been focused on linking performance and pay within realistic budget constraints. Awareness at all levels seems to be at an all-time high, and other common measures of attentiveness (attendance, absenteeism, discipline and grievance activity) support this.

Appendix B

Five Examples of Federal Government PFP Programs

Five Examples of Federal Government PFP Programs

- U.S. General Accounting Office
- Federal Aviation Administration
- Internal Revenue Service
- Office of Personnel Management Demonstration Projects
- Department of Defense

U.S. General Accounting Office

In January 2002, GAO implemented a new competency-based performance management system that is intended to create a clear linkage between employee performance and GAO's strategic plan and core values. It includes 12 competencies that employees validated as the keys to meaningful performance. The competencies include:

- Achieving results consistent with strategic plan
- Maintaining client and customer focus
- Developing people
- Thinking critically
- Improving professional competence
- Collaborating with others
- Presenting information orally
- Presenting information in writing
- Facilitating and implementing change
- Representing GAO
- Investing resources
- Leading others

These competencies are the centerpiece of other performance programs, such as promotions, PFP compensation decisions, and recognition and rewards. Under this system, pay-banded employees are placed in one of five pay categories based on their demonstrated competencies, performance, and contributions to organizational goals. GAO expects to regularly modify its banded system based on experience.

Federal Aviation Administration

Congress granted the FAA wide-ranging personnel authorities in 1996 by exempting the agency from key parts of compensation law. Among the initiatives FAA subsequently introduced were a pay system in which compensation levels are set within pay bands and a performance management system intended to improve employees' performance through more frequent feedback. The pay band system includes plans tailored to specific employee segments: a core compensation plan for the majority of nonunion employees; a negotiated version of the core compensation plan for represented employees; a unique pay plan for air traffic controllers and air traffic managers; and an executive pay plan for nonpolitical executives, managers, and some senior professionals.

Under its core compensation plan, all eligible employees can receive permanent pay increases, based on the FAA's assessment of the extent to which the entire agency has achieved its strategic annual goals. In addition, notably high-performing individuals may receive additional permanent pay increases based on supervisory recommendation.

Internal Revenue Service

Congress granted IRS broad authority related to its human capital management through the IRS Restructuring and Reform Act of 1998. The Act gave IRS various pay and hiring flexibilities not previously available, such as the authority to establish new systems for hiring and staffing, compensation, and performance management. These flexibilities are intended to allow IRS managers more discretion in rewarding good performers and in making employees accountable for their performance.

IRS recently implemented new performance management systems for executives, managers and front line employees. As an initial step, IRS implemented a PFP system for senior executives emphasizing performance in determining compensation and making meaningful distinctions in senior executive performance.

Office of Personnel Management Demonstration Projects

Personnel demonstration projects provide a means for testing and introducing beneficial change in government-wide human resource management systems. Over the past 25 years, 17 demonstration projects have been implemented across the federal government, including twelve involving some form of PFP system. OPM reports that demonstration projects that have implemented PFP have shown increased retention of high performers.

Department of Defense

DOD implemented a personnel demonstration project covering members of its civilian acquisition, technology, and logistics workforce in 1999. Recognizing the need to reform and modernize its acquisition performance management system in order to perform efficiently and effectively, DOD designed a PFP project to provide incentives and rewards to multi-skilled personnel, allow managers to compete with the private sector for the best talent and make timely job offers, and provide an environment that promotes employee growth and improves local managers' ability and authority to manage their workforces. The project implemented a contribution-based compensation and appraisal system, which measures an employee's contribution to the strategically stated mission and goals of the organization.

DOD's PFP system is designed to enable the organization to motivate and equitably compensate employees based on their contribution to the mission. Salary adjustments and contribution awards are based on an individual's overall annual contribution compared to all other employees and their current level of compensation. Contribution is measured using a standard set of competencies that apply to all career paths, including: problem solving, teamwork/ cooperation, customer relations, leadership/supervision, communication, and resource management.

Preliminary data indicate that the attrition rate for high contributors is declining while the attrition rate for low contributors is increasing. DOD officials stated that increased pay-setting flexibility has allowed the organization to offer more competitive salaries, which in turn has improved recruiting.

Appendix C

Selected References

Selected References

Reports

U.S. General Accounting Office, *Results-Oriented Cultures: Using Balanced Expectations to Manage Senior Executive Performance*, GAO-02-966 (Washington, D.C.: Sept. 27, 2002).

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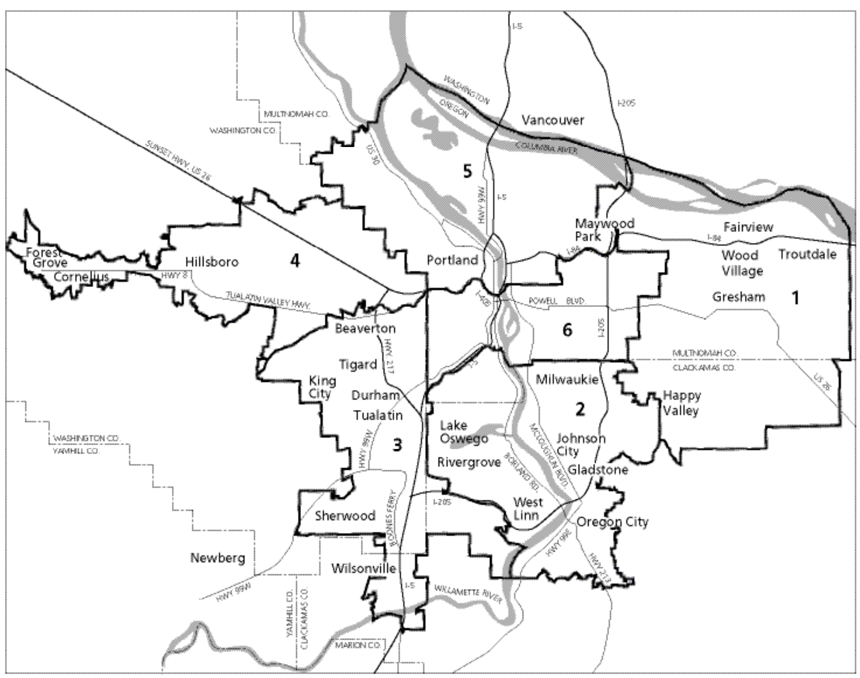

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Please rate the following elements of this report by checking the appropriate box.

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