The Leader's Role in Pay Systems and Organizational Performance

Aubrey C. Daniels, Founder and Chairman
James Daniels, Vice President
Bill Abernathy, Vice President of Performance Measurement Systems
Aubrey Daniels International

Applying behavioral principles in pay-for-performance programs helps to ensure the programs' success.

Leaders try to create followers by providing good pay, benefits, and a comfortable place to work. However, these factors alone never capture discretionary effort—the hallmark of an effective leader. Pay and benefits are necessary but not sufficient. More often than not, these systems reward behavior other than what leaders want.

For leaders, compensation and benefits are usually seen as a means to motivate employees, but many leaders seem burdened rather than excited by them. Why? Almost all compensation and reward systems are designed from a financial perspective rather than a behavioral one. The caveat is that because no organizational result can be produced without human behavior, any organizational system that is designed without taking the laws of behavior into account will always perform below what is possible. To that end, managers and leaders must be expert in building systems and processes that are consistent with what is known about the laws of behavior.

It is difficult these days for the leader to know the laws of behavior because the term *behavioral science* seems to appear in every management journal, book, and newsletter. Unfortunately, what is called science is often far from it. When we use the term, we refer specifically to *behavior analysis*. Although relatively young as a science—it goes back more than 80 years—its goal is to be as scientific as chemistry, biology, or physics. Yet few people in business know that it exists, let alone know of its findings. Although there are not many laws of behavior with the standing of the physical laws such as the law of gravity, there is an extensive body of research that shows the highly consistent effects of behavioral principles over the widest range of human endeavors.

Keywords: *leadership; pay for performance; measurement; reinforcement; organizational performance*

DOI: 10.1177/0886368706288217

© 2006 Sage Publications

Behavior and Consequences

The closest thing we have to a behavioral law is that behavior is a function of its consequences. People do what they do because of what happens to them when they do it. There are two important considerations in behavioral consequences. One is that a positive consequence (positive reinforcement) produces the highest rate of responding. The second is that a behavioral consequence affects the behavior occurring when the consequence is received. If either of these facts is ignored in designing or implementing a process or system where human behavior is required, suboptimal results will occur.

Although the research is clear on positive reinforcement, most of the business press and many business books have either ignored it or trivialized it. It is without a doubt the most powerful interpersonal tool known. In spite of that, most businesses are still run primarily by negative reinforcement largely because executives don't understand the difference.

Exhibit 1 shows the four behavioral consequences and their effects on behavior. As you can see, only positive and negative reinforcement increase behavior. Therefore, these should be the only consequences of concern to compensation and benefits professionals. However, because negative reinforcement creates increases in behavior only sufficient to avoid punishment, or in this case loss of pay, it is not a viable option. That leaves only positive reinforcement as the way to maximize a return on compensation and benefits dollars.

Positive Reinforcement

The textbook definition of positive reinforcement is any consequence that follows a behavior that increases the frequency of that behavior. Given that definition, you can see that positive reinforcement always improves performance. The question is, "What performance?" If you positively reinforce the wrong behavior, you will get more of it. If pay functioned as a positive reinforcer for hard work, employees would work harder every time they got paid. Companies that pay weekly would get higher performing employees than companies that pay monthly. Of course, this is not the case because the way pay is delivered is not a positive reinforcer for performance.

Positive reinforcement carries five characteristics.

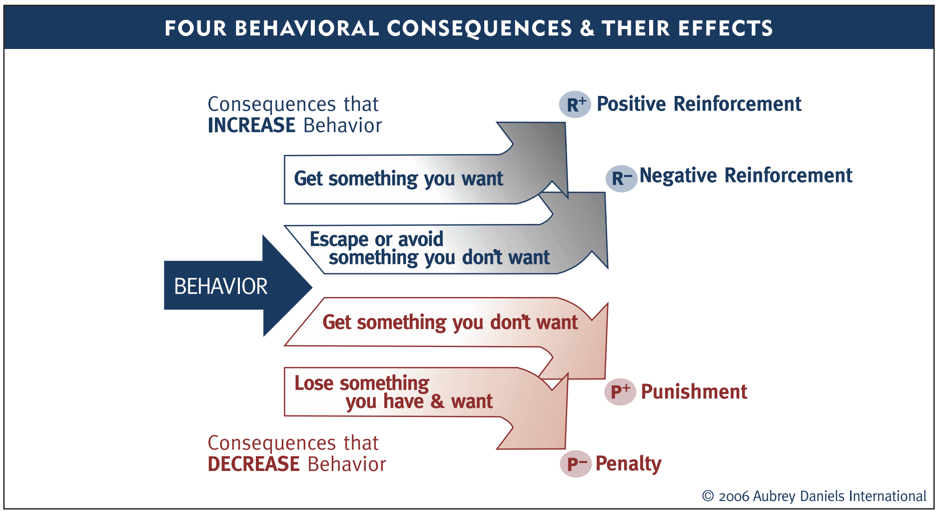
Positive reinforcement is personal. No one thing is a positive reinforcer to everyone. Leaders must know what followers value as individuals. Nothing that is done across the board will be reinforcing to all employees. Positive reinforcement is really about relationships. When leaders demonstrate everyday that they like, value and appreciate the followers as individuals, almost everything they do will be reinforcing. If the followers don't like the leader, nothing that the leader says or does will have the desired effect. Because many leaders don't have the respect of their followers, considerable money is wasted on raises, bonuses and increased benefits. Money is usually impersonal. There are an increasing number of people who want a job they can love, not just one where they make a lot of money. You cannot love a job where you don't feel valued. If money is the only way you have of determining your value to a company, then it usually becomes an issue.

Positive reinforcement is immediate. Many people who are not acquainted with behavior analysis find it difficult to accept that positive reinforcement strengthens the behavior that is occurring when you get it. When laborers are paid by the week, although a person might miss work during the week, he would surely show up on payday. In this case, the behavior of "showing up" was the behavior that was reinforced, not what they engaged in to earn the money. These days, with direct deposit you don't always get showing up. When positive reinforcement is delayed even by a few seconds, learning is made very difficult. How difficult would it be to use a computer if your keystrokes appeared on your screen 10 seconds after you made them? If positive reinforcement didn't strengthen the behavior that is occurring when you get it, there would be no such thing as superstitious behavior. Superstitious behavior comes about from the accidental pairing of a reinforcer and a behavior, but there is no causal connection.

Money cannot be used as an effective positive reinforcer because it is not practical to deliver it immediately and of course the amount you could give would probably not have a reinforcing effect. This is why compensation and benefits are necessary—few would work without them—but not sufficient. To achieve maximum results, something else is needed.

Positive reinforcement is earned. In the science of behavior analysis, the term *contingency* occurs frequently. In this context, it refers to the necessary and sufficient conditions for

EXHIBIT 1
Four Behavioral Consequences and Their Results



reinforcement. To say that a bonus is contingent on performance means that the only way that you can get the bonus is by behaving in some appropriate way to produce results.

The biggest problem with compensation and benefits as a motivational device is that they are rarely contingent on behavior. Once a salary has been agreed to, all you have to do to get full salary and benefits in the average organization is to do enough to keep from getting fired. Any time you give an across-the-board raise, benefit, or cost of living adjustment, you will be reinforcing behavior that you don't want. There must be a direct relationship between behavior and pay to get the most out of it.

When people are paid for results, it is difficult to know the extent they were responsible for the results. Pay for performance has not fared very well in many organizations because the systems do not have a direct link between the pay and the performance.

Positive reinforcement needs to be frequent. The research tells us that more, smaller reinforcers are more effective than fewer larger ones. This does not mean however that dividing an annual bonus by 12 would be more effective than the single bonus because in some cases one twelfth of an annual bonus would be insignificant to the recipient and it still would not be earned. When bonuses are calculated by a mathematical formula and divided among a group of people, no one knows what behaviors are being reinforced.

Positive reinforcement needs to occur every day, not every month or every year. When social reinforcers are delivered daily and pay is based on the behavior of an individual, you have the most effective motivational system known.

Most positive reinforcement is not financial. No one can argue that money is not a reinforcer for most people. The problem is that as used in most corporations, it has serious limitations in getting people to perform at their potential. Therefore, other kinds of reinforcers must be used to offset the limitations of financial rewards.

Social reinforcers are clearly the mainstay of reinforcement in an organization. These are the ways that management and other employees let those working with them know that they are liked, valued and appreciated every time that something is done to move the organization toward its goals. When social reinforcement is a daily affair, a properly designed compensation and benefits program is made even more powerful.

For leaders to realize their return on compensation and benefits, they must understand and apply the laws of behavior. By designing compensation and benefits programs with full knowledge of the principles of effective positive reinforcement, a leader will see immediate and dramatic improvements in the performance of followers and ultimately in the organization as a whole.

Designing a Compensation Program

A compensation program that will actually improve and sustain key employee performances must conform to behavioral principles. Wages and salaries generally operate as negative rather than positive reinforcers. You receive your paycheck each pay period until you fail to perform.

Unfortunately, the term *pay for performance* is often applied to programs that do not conform to critical behavioral principles. As a result, they fail to either improve or sustain employee behaviors and results. The following are proven recommendations for designing or improving pay-for-performance programs through the application of behavioral principles.

1. Replace subjective performance measures with objective performance measures. The traditional performance review or appraisal is based on supervisor perceptions of an employee's performance rather than objective results. These perceptions are influenced by many nonperformance factors including employee likeability, employee busyness, personal prejudices, ease of management, conformance and previous mistakes or successes. Paying someone for "being cooperative" fails to specify or direct the employee to produce true business results.

2. Replace bonuses with pay for performance. Bonuses are after-the-fact discretionary payments to employees for a job well done. Although there is nothing wrong with this practice, it cannot improve or sustain employee performance because the employee is not told in advance what must be done to receive the payment.

3. Replace annual performance measurement with more frequent measurement. Requiring supervisors to rate an employee's past year's performance is asking them to judge performance in the absence of any real data and then to somehow average employee performance over 250 workdays. Performance measurement should be based on objective data, and feedback should be provided to employees at least monthly.

4. Replace large-group measures with small team and personal performance measures. Profit sharing and gainsharing plans are based on large-group results. Paying employees on large-group results is behaviorally unsound for two reasons. First, the employee typically has little or no control over the outcome. Large-group results fail to specify what the individual employee should do. Second, the payment is based on the performances of hundreds or thousands of employees. This makes the payment uncertain and unrelated to the individual's personal effort.

5. Replace broad financial measures with actionable measures. No employee should be evaluated or paid for results in which he or she has little or no impact on. Pay-for-performance plans that award payments to employees based on broad financial results such as return on equity, return on assets, return to stockholders and the like are paying for organizational performance, not employee performance. When designing a pay-for-performance plan, always ask, "How can the employee directly improve this measure's results through a change in personal behavior?"

6. Replace unbalanced performance measurement plans with balanced plans. One-dimensional performance pay plans often yield unintended results. For example, sales commissions based on revenue generation may cause salespeople to sell things to people that cannot pay, make promises that production cannot keep, and discount prices to an extent that produces minimal margins. Once a performance measure is defined, the next question should be what adverse impact could a total employee focus on this result produce? If such an impact is possible, this outcome must also be measured and included in the measurement plan.

7. Replace discretionary pay-for-performance plans with rule-driven plans. A successful pay-for-performance program must be as reliable and predictable as the traditional wage and salary program. A common mistake is to constantly change the program parameters and requirements. Employees will not invest time and effort in a program in which the measures, criteria and pay potential change frequently and unpredictably.

In recent years, several articles have appeared that argue that pay for performance is ineffective. The more likely case is that pay-for-performance programs are often designed, implemented, or administered ineffectively. A car may have design flaws, the owner may drive it poorly, or the required maintenance may not be performed. As a result, the car will perform poorly. This does not mean however that we should therefore return to the horse and buggy. Understanding and applying behavioral principles in the design, implementation, and administration of pay-for-performance programs will do much to ensure the programs' success.

Aubrey C. Daniels is founder and chairman of Aubrey Daniels International (ADI). Daniels is a leading authority on behavioral science in the workplace. He is the author of three best-selling books, including Bringing Out the Best in People *(McGraw-Hill) and his January 2006 release,* Measure of a Leader.

James Daniels is vice president of ADI and coauthor of Performance Management: Changing Behavior that Drives Organizational Effectiveness *(4th ed.) and* Measure of a Leader.

Bill Abernathy is vice president of performance measurement systems at ADI and a thought leader on performance measurement and performance pay. He is the author of two books: The Sin of Wages *and* Managing Without Supervising.