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Merit Season is Over; Here are Four Ways to Measure How Well it Went

Following the annual merit cycle, we encourage rewards managers to run four key diagnostics. The answers you get will reveal how well your pay-for-performance systems work.

For broad-based rewards professionals, annual merit cycles— where employee performance is calibrated and merit increases and bonuses are determined— is the penultimate exercise of a year. It’s where you hope to see the labor of creating a functional pay-for-performance system bear fruit. If you’ve just wrapped up your merit cycle, the temptation to take a well-deserved break is understandable. But don’t walk away for too long. If your team can assess what went well and what needs work while the experience is fresh in your minds, you’ll continue to improve and get even closer to achieving pay-for-performance nirvana (it’s not just an urban legend).

At Radford, we’ve put together a four-point checklist— informed from experience working with hundreds of technology and life sciences clients on making their merit cycles more effective— to help you answer the most pressing question after you’ve completed the annual merit process: How well did you do?

#1: Did you act on the findings of your external competitiveness and internal fairness assessments?

Most companies conduct a competitive assessment as they head into their merit cycle to see how they compare relative to the market. Furthermore, with new equal pay legislation passing in many states and cities, some companies are adding a pay equity audit to this process. Did your organization do any of these analyses prior to compensation planning? If not, it may be prudent to reevaluate that decision. If so, what did you do with this information? It may be worth conducting a before and after merit analysis to ensure your compensation dollars improved competitiveness and rewarded high performers. Meanwhile, if you fail to act on the findings of a pay equity audit, that can be seen (in the eyes of various new laws as well as your stakeholders) as worse than not doing the audit in the first place. In sum, don’t view assessments as check-the-box exercises; they must yield actionable insights ahead of each cycle.

#2: Can you accurately measure performance?

Do you have a systematic way of ensuring employees are rated against fair, consistent and objective measures? How do your perceptions of your performance management process compare with how employees feel after merit cycle results? While some companies are moving away from performance ratings, most companies still have

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some sort of formal process. And, frankly, it doesn't matter what your process is. What matters is that the process you use works in identifying the performance of your employees, including the identification of top performers and high potentials, and that employees have transparency into the process and feel it is conducted objectively and is free from biases.

In this era of pay transparency, where employees have more access to market pay data and internal salary ranges than ever before (thanks, in part, to fair pay legislation), it's important for companies to ensure they have an effective performance management program that employees understand. If your employee engagement process finds that a sizable amount of your workforce doesn't feel there is a link to their performance and pay opportunities, then you need to do further investigation to determine where in the process there is a disconnect and what can be done to make the process more fair and transparent.

#3: Are merit increases directly linked to performance?

Regardless of how big your salary and bonus pool budget, your team should be asking whether it did enough to differentiate pay for top performers. Assuming you value a pay-for-performance culture, how well did your merit cycle live up to your values? Do your superstars get paid better to the market vs. low performers? You might have to make sacrifices to be able to effectively differentiate merit increases. That can include reducing merit increase participation and/or reducing the size of the increase for your average performers. The tradeoffs here are often worth it: High performers drive your company's results.

To take this a step further, you also need to have a system in place to evaluate the effectiveness from the employee's point of view. That is, do your top performers feel adequately compensated? And did your high potentials receive the message that they are valuable to the organization? These measurements can be collected by engagement surveys. Many companies are moving to shorter and more frequent "pulse" surveys rather than only once a year, allowing engagement issues to be uncovered and addressed before they become a bigger problem.

#4: Are your underlying pay systems sound?

If you conducted a salary structure audit ahead of your merit cycle, are the midpoints of your salary ranges aligned to the market? And do they represent your base salary compensation philosophy? If not, how long has it been since you adjusted your structure? Is there appropriate midpoint progression between grades? Are the ranges wide enough to accommodate most employees, but still less than 60% wide?

A good way to check for structure effectiveness is to first ensure midpoints are aligned to market, and then check to ensure that approximately 60% of your employees cluster around the middle third of the range, with around 20% in the lower third and 20% in the upper third.

Next Steps

With so much time invested in the annual merit cycle, don't miss an opportunity to make it even better by conducting a thorough diagnostic of what worked and what didn't. These four steps will walk your rewards team through each of the major questions we ask when assessing whether pay and performance systems are functioning optimally, need a little fine tuning, or perhaps a complete overhaul.

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