OPM 99-67

DATE: October 15, 1999

TO: All Appointing Authorities

FROM: Oscar B. Jackson, Jr., Administrator
and Cabinet Secretary of Human Services

RE: **Oklahoma Senate and House Interim Studies - Pay for Performance**

Senate Bill 464, the Classification and Compensation Reform Act of 1999, was unanimously passed by the Oklahoma Legislature and signed into law by Governor Frank Keating on June 10, 1999.

A key proposed pay movement mechanism in this law, Pay for Performance, was not included in the final bill due to concern about what pay for performance is, and how it would affect state employees and state government.

In order to study this compensation methodology more closely, *Senate Interim Study 99S-021 and House Interim Study 99H-043 on Pay for Performance* were established. The first meeting of the Senate Interim Study Committee occurred on Thursday, October 7, 1999 in the State Capitol. The Office of Personnel Management provided information to members on what pay for performance is, how is it used across the country by other organizations, and why it can work in the State of Oklahoma. In addition, Gary Jones, Executive Director of the Oklahoma Public Employees Association, and two agency administrators, Howard Hendrick and Mark Coleman, Department of Human Services and Department of Environmental Quality, respectively, made presentations voicing their support for pay for performance.

OPM shared information on two specific research efforts conducted by OPM: an extensive literature research on the topic of pay for performance, resulting in a nineteen-page research paper; and the results of a forty-nine state survey, conducted in August 1999. See enclosed "Report to the Legislative Interim Study Committees on Pay for Performance".

Committee members will be reviewing the information provided by OPM and the guest presenters, and will determine what additional information they require to decide if pay for performance for State of Oklahoma employees will be recommended for consideration during the 2000 Legislative Session.

Enclosure

State of Oklahoma
Office of Personnel Management

Report to the Legislative Interim Study Committees On Pay for Performance 99S-021 and 99H-043

Oscar B. Jackson, Jr., Administrator and Cabinet Secretary of Human Resources
Office of Personnel Management

October 1999

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Report to the Legislative Interim Study Committees On Pay for Performance

Executive Summary

This report presents the Interim Study Committees on Pay for Performance with current information and analysis of the compensation practice of using pay for performance.

In December 1998, OPM submitted the Classification Compensation Reform Project Report (CCRP) to the Governor and Legislature. The report recommended adoption of a classification system based on job families that incorporated a wide variety of jobs, broad pay bands, and pay movement mechanisms which provide agencies with the flexibility to help address recruitment and retention needs, and a performance management system that requires managerial accountability and supports a pay for performance culture.

This report begins with a discussion of what pay for performance is, within the context of a comprehensive compensation system. It cites scientific and professional texts, articles and experts that found that:

- Pay motivates performance.
- Pay for performance enhances retention of better performers.
- Recruitment and retention will be crucial future issues.
- Pay for performance is widely used in the private sector.
- Pay for performance is becoming more widely used in the public sector.
- Pay for performance will be more critical in the new broad band classification system.

A review was conducted of the professional literature to determine if scientific evidence and/or current practices support pay for performance as positively influencing employee behavior and productivity. Notwithstanding a few critics noted in the report, it was found that there is wide scientific support for pay for performance as an effective employee motivation/compensation practice. Pay for performance is almost universally used by private and public sector employers.

<u>Important Findings</u>

- OPM conducted a survey of the other 49 states to determine how many use pay for performance or some form of pay for performance. OPM found that 34 states use pay for performance; 26 of those states provide performance pay to employees that either meet or exceed performance standards.
- Ninety-six percent of the Fortune 1000 companies have merit [performance] pay. Performance pay is increasing in the public sector.

- Studies have shown that voluntary turnover is usually highest among high and low performers, while being relatively low for average performers. The introduction of performance pay dramatically increases the probability that the high performers will stay and low performers will leave.
- Pay for performance is designed to improve selection and retention of quality employees. As employees see that hard and smart work will be rewarded, the more competent employees that might be in the process of leaving employment should be motivated to stay.
- Government workforces continue to shrink as a result of down-sizing, right-sizing or other political or economic forces that come to bear. It will be imperative that the workforce selected and retained be as productive as possible.
- Pay for performance is an effective, tried and proven practice that can positively motivate employees and lead to improved individual and group performance.
- Pay for performance is only one of many compensation tools managers use to build a comprehensive and integrated compensation strategy. The purpose of an effective compensation strategy is to attract and retain effective and productive employees. It is crucial to the employer that the compensation program is critically aligned with all other human resource functions.
- Pay for performance is an effective management tool Oklahoma state agency supervisors and managers do not currently have.

Senate Bill 464 (1999 Session), the "Classification and Compensation Reform Act of 1999," implemented the Classification and Compensation Reform Project Report recommendations with the exception of a pay for performance recommendation. Early versions of SB 464 included recommendations for the establishment of a pay for performance system, but the final version did not. It is hoped the information in this report will facilitate consideration during the 2000 legislative session to create a pay for performance system for Oklahoma state government.

Conclusions

The State of Oklahoma should adopt pay for performance because it is an effective, tried and proven practice that can positively motivate employees and lead to improved individual and organizational performance. Specifically:

- Pay for performance would be implemented for the State of Oklahoma effective July 1, 2000.
- Employees receiving ratings of "meets standards" and "exceeds standards" would be eligible for an increase.
- Agencies would determine whether pay for performance increases would be lump sum or added to base salary.

A Report to the Legislative Interim Study
Committees on Pay for Performance

by Joe Davenport, Director, Personnel Assessment Division and
Spencer Anthony, Personnel Administrator, Personnel Assessment Division

Office of Personnel Management
State of Oklahoma
October 1999

What is Pay for Performance?

Pay for performance, first and foremost, is a management tool. It should be used to manage the job performance of employees. It is also a compensation strategy, but at its most basic, it is a tool for managers to use to motivate employees and recognize and reward job performance. Robert D. Krebs, Chairman, President and CEO of Santa Fe Pacific Corporation says "Pay is one of the most effective tools available today for motivating an organization during a time of change" (Flannery, Hofrichter, & Platten, 1996). Pay for performance says in a concrete way that can have real value to employees, "if your productivity meets or exceeds established expectations, you will be rewarded."

The reward is most often money and the delivery method may increase an employee's base salary, or be a lump-sum bonus, or some other method or combination of methods. The key feature is that the job performance of employees determines which employees receive the reward. Pay for performance may be tied to the job performance of individual employees or groups of employees. The structure of the rewards may be such that employees whose job performance exceeds expectations receive higher rewards than those whose performance meets expectations. The ideas to be communicated to employees are that they hold the key to the rewards they will receive for their work and that those who deliver the best results will receive the best pay. Risher (1999) says that the goal of a pay for performance system is to use pay increases as a tool for focusing more sharply on performance and influencing or changing employee behavior.

The alternative to this system is to grant increases to employees regardless of their performance. If any raises are granted in a given year, it makes no difference whether you work the hardest and obtain the best results, or whether you give minimal effort; all employees receive the same or very similar raise. It is easy to see what this will do to employees who are willing and able to deliver better results. According to Risher, Fay,

and Associates (1997), organizations that do not reward good performance are inadvertently encouraging people to work at minimum performance levels.

Pay for performance is only one of many compensation tools managers use to build a comprehensive and integrated compensation strategy. An effective compensation strategy is also only one part of an overall effective human resources management approach. The purpose of an effective compensation strategy is to attract and retain effective and productive employees and compensate them in a manner that will facilitate both. It is crucial to the employer that the compensation program is critically aligned with all other human resource functions (Flannery, Hofrichter, & Platten, 1996).

To understand how pay for performance works as one component of compensation strategy, it is necessary to explain briefly those other components and how they all fit together to effectively maximize the whole compensation strategy. It should be noted that many of the compensation concepts discussed are used in both the private and public sectors, while some have specific use in Oklahoma state government.

Entrance Salary

Entrance salary, also referred to as hiring rate, is the rate of pay most employees of a given job classification will receive when they start work. It is anchored to the relative worth of the job, the qualifications one must posses in order to successfully perform the work of the classification and the relative worth of the position to other jobs in the organization. Starting salaries are often determined by market surveys to assess what other organizations are paying for comparable jobs.

Salary Range (Including Starting Salary and Maximum Salary)

The salary range is the range of pay that denotes the full value of the job. Starting salary is the low end of the salary range and the maximum salary is the upper end of the range beyond which employees normally do not progress. The maximum salary is the upper limit of the value of that particular job within the organization and on the open market. The purpose of a salary range is to allow employees who successfully meet the work expectations of their job room to advance their salaries over time while staying in the same job classification. The salary range allows employees to advance their salaries in three important ways: First, it allows employees to periodically increase their earnings to counteract the effects of inflation; second, as employees stay with the same organization, they usually increase the scope of their competencies that will allow them to perform the more difficult aspects of their job, thereby increasing their worth to the organization; third, through the use of pay for performance, those who produce good results can be financially rewarded.

Cost of Living Increases

Cost of living increases are pay raises given to employees based solely on increases in the cost of living as indicated by the Consumer Price Index or some other index commonly known to employers. These increases are not associated with the productivity of employees, longevity of service or any other factor internal to the organization. They are usually given to all employees on a periodic basis (usually yearly) and most often as a percent of salary. This increase is usually added to base salary.

Market Adjustments

Market adjustments are pay adjustments to jobs based on changes to the supply and demand of jobs. Recent examples include jobs in data processing or information technology. High demand for the needed skills and short supply for this type of skilled worker have resulted in steep increases in starting salaries for these jobs. Organizations must increase the starting salaries of these jobs to remain competitive. Once organizations have increased the starting salaries of such jobs, they almost always increase the salaries of incumbent employees to retain them.

Midpoint or Market Rate

Midpoint refers to the midpoint of the salary range or salary band. It is the target point for salary advancements for recently hired employees and usually represents the market average pay for comparable jobs. It is interesting to note that Oklahoma's midpoints are, on average, 14% below the market average. The midpoint is most often considered the salary at which you will be able to retain employees. Hence, advancement to the midpoint is very valuable for most organizations.

Pay Movement Mechanisms for Oklahoma Government

Passage of SB 464, the Classification and Compensation Reform Act of 1999, gives State of Oklahoma agencies several new pay movement mechanisms. They include skills based pay and equity adjustments.

Skills based pay is related to the acquisition of additional skills and abilities which can be applied to the work to be performed and which will increase the value of the employee to the state agency. These skills or abilities must be verifiable through certification, licensure, diploma, or some other method and must be beyond the qualifications required in the job family descriptor for all employees in that job family level.

Equity based adjustments are pay mechanisms that may be made when individual employees are significantly underpaid relative to other employees in the same job family and level.

There are several other pay movement mechanisms relating only to State of Oklahoma government that were created by statute and administrative rulemaking when the Classification and Compensation Reform Act of 1999 was adopted. These include pay raises when employees successfully complete their probationary or trial status, promotions and career progression increases, lateral transfer adjustments, and market adjustments. Because they are so limited and specific to Oklahoma's personnel system, they will not be discussed here. For more information on these, see the Act and the OPM Administrative Rules Adopted September 10, 1999.

The Big Picture

Some of these compensation concepts (and practices) relate to the job an employee performs, i.e. starting salary, salary range etc. Some of the concepts apply to conditions relating to employment in the general sense, for example, giving cost of living increases to employees when inflation is substantial. Some of the concepts are event driven, such as getting a pay raise upon promotion or attaining permanent status after completion of a probationary period.

Most of the these concepts/practices are not directly within the everyday control of the employee. In other words, how hard or smart one works does not generate an outcome for these practices. Pay for performance is the compensation practice that has the most potential to directly affect performance of the employee. Since the job performance of the employee is that part of employment that is most directly a result of the behavior, a central question is whether pay (reward) motivates job performance (behavior).

Does Pay Motivate Behavior?

The answers to this question come from two directions. One is the theoretical; i.e., the theoretical underpinnings and scientific evidence supporting the concept, and the other is the practical, or what employers do as a matter of practice.

The Theoretical Side

There are several theories of motivation that relate to this issue. The most relevant are Equity Theory, Expectancy Theory, Goalsetting Theory, and Reinforcement Theory. Although the scope of this paper does not allow an extended discussion of these various theories, several texts give very good explanations of the theories and how they relate to the issue of performance pay (Milkovich & Newman, 1996; Risher, Fay, & Associates,

1997; and Gerhart & Milkovich, 1992). Although different experts on compensation and psychological theory attach some caveats, the overall consensus is that pay can motivate job performance (i.e. Lawler, 1990; Risher, Fay, & Associates, 1997; and Milkovich & Newman, 1996). Gerhart and Milkovich (1992) say that pay for performance can work if employees can perceive the pay for performance link; i.e., that they are rewarded for good performance and see that poor performance is not rewarded.

Not all experts agree on this issue. Some have said (Risher, Fay, & Associates, 1997; and Milkovich & Newman, 1996) that the work of the early theorists Maslow and Herzberg concentrated on needs fulfillment as the primary driver of human behavior. Edward Deming and A. Kohn (Kohn, 1993) have criticized pay for performance systems as ineffective or counterproductive. From our research and practices observed over 30 years, we believe the experts have shown that money motivates human behavior and the critics have been refuted in both theory and practice.

The Practical Side

Private enterprise is the biggest supporter of pay for performance. Many organizations have been using it as a practice for decades. Many academic studies note the importance of pay for performance to the organizational culture. The authors of these direct quotes use the term "merit pay" as synonymous with "pay for performance" as we have been describing it in this paper.

> Virtually every major U.S. corporation states a core principal of pay for performance – it supports virtually any business strategy and it feels so right. In addition, research in this area clearly shows that individuals believe that pay for performance is a good idea (Lawler, 1990, p. 43).
>
> It is also important to appreciate that merit pay [i.e. pay for performance] is the organizational norm in the United States (Risher, Fay, & Associates, 1997, p. 213).
>
> Merit pay commonly called "pay for performance" is perhaps the most widely used means by which U.S. organizations determine employee pay increases (Seltz & Heneman, 1993, p. 1).
>
> Merit pay is effectively taken for granted in the private sector. It is virtually universal and aligned with the shared values of corporate leaders (Risher & Randow, 1998 p. 41).

A survey by Heneman (1992) reports on a series of surveys showing that more than 80 percent of private sector employers use merit pay or performance pay plans. A survey by the American Compensation Association (ACA, 1995) reports that of 3,667 organizations

surveyed, 83 percent of the respondents had merit pay programs for their nonexempt employees, and more than 87 percent had them for their exempt employees. Milkovich and Newman (1996) cite four surveys that report that 90 percent of US firms use pay for performance.

These same experts (in the references noted herein) that support pay for performance as successful in the private sector believe it can and does work in the public sector. In fact, many of those noted references describe its success in both areas.

Performance and Turnover

Several studies have examined the relationship between voluntary turnover and performance pay (Boudreau, Sturman, Trevor, & Gerhart, 1999; Trevor, Gerhart, & Boudreau, 1997; Williams & Livingstone, 1994). These studies have shown that voluntary turnover is highest among the high performers and the low performers, while being relatively low for average performers. The introduction of performance pay changes this relationship. Williams and Livingstone (1994) combined data from 55 separate analyses with over 15,000 subjects and concluded that "poorer performers were more likely to leave when rewards were contingent on performance and were more likely to stay when they were not" (p. 285). They went on to state that "this pattern suggests that employers who choose to reward good performance can encourage better performers to stay and poorer performers to leave" (p. 287).

Trevor, Gerhart, & Boudreau (1997) described this relationship in more detail with data from 5,143 subjects over a four year time frame. Figure 1 shows that the probability of staying is low for poor performers regardless of salary growth. For high performers with low or mean salary growth, there is also a low probability of staying. However, when salary growth is high (1 standard deviation above mean salary growth) high performers are very likely to stay. This supports the conclusions reached by Lawler (1990) when he stated:

> ...an organization that fails to pay effectively for performance runs the risk of losing its best performers to those organizations that do. One the other hand, it will rarely lose its poor performers, because they cannot do as well on the outside. Over the years this can have an exceedingly negative effect on the organization's performance (p. 29).

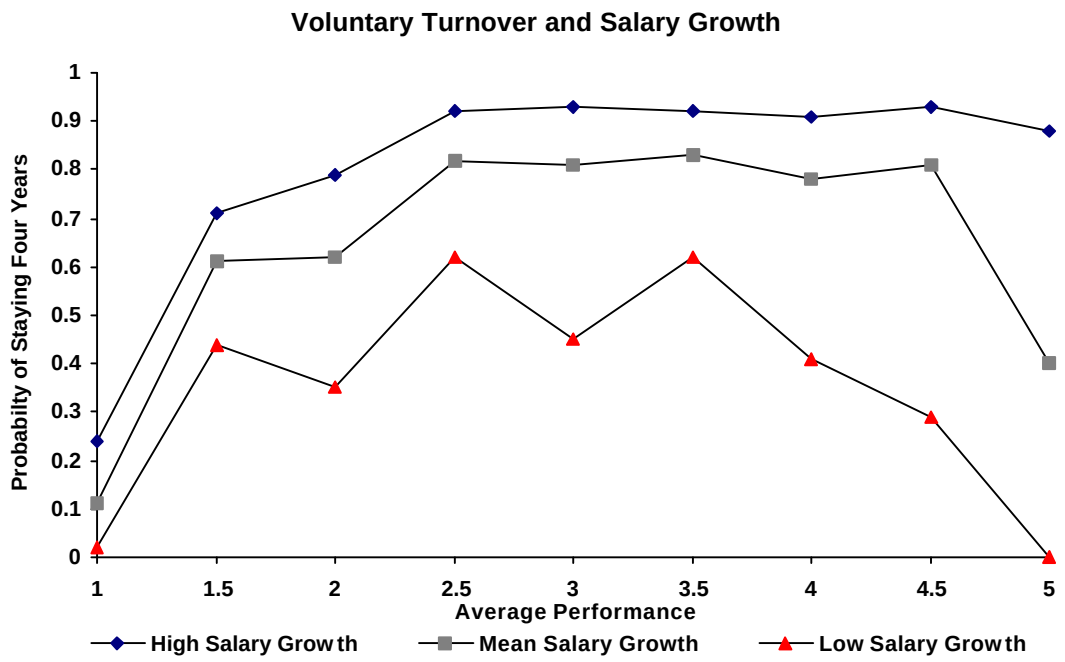

Figure 1. The probability of staying in the job based upon salary growth and performance level. Data from Trevor, Gerhart, & Boudreau (1997)

Boudreau, Sturman, Trevor, & Gerhart (1999) demonstrated that this kind of turnover (high performers staying, low performers leaving) can have real financial benefits for an organization. They examined estimates for the cost of replacing employees that leave and the value that those employees have to the organization. They demonstrated sizable dollar savings by using a performance pay program over the four-year period. These three studies also emphasize the utility of performance pay for encouraging low performing employees to improve their performance or leave the organization.

Performance Pay in the Public Sector

As mentioned previously, performance pay is the norm in the private sector. As Risher and Randow (1998) have stated, "Hard work and "extra effort" will always warrant recognition in [the public sector]" (p. 42). Lawler, Ledford, and Mohrman (1989) found that 96% of the *Fortune* 1000 companies have merit pay. Public sector employers are not as likely to have performance pay, but trends suggest that performance pay is increasing in the public sector as well.

Summary of Oklahoma's Survey of States on Pay for Performance

In August 1999, the Office of Personnel Management conducted a survey of the other 49 states to see which states currently have pay for performance. Thirty-four states (69%) stated that they currently have some form of pay for performance or merit increases. Of

the remaining 15 states at least five of them are currently considering a pay for performance system in their states. Of the remaining 10 states that do not have pay for performance or are not considering implementing performance pay, five utilize automatic step increases as a way of increasing salaries and retaining their employees. This leaves only five states that do not have or are not considering a mechanism to increase employees salaries other than by legislated general increases or promotions.

Of the 34 states that have performance pay or merit increases, 26 states (76%) reward employees at the meets standards level and above, and four states (12%) reward at exceeds standards only (for the remaining four states or 12% it is agency option or doesn't apply to their system). This shows that a large majority of the states have performance pay and give rewards both for meeting the expectations of the job and exceeding those expectations.

Of the states using pay for performance there is a mixture of methods in use. Many states make adjustments to employees base salaries, others give agencies the discretion to reward employees with either increases in base pay or lump sum increases. Many states allow increases in base pay up to the maximum of the salary band and reward employees at the maximum with one-time lump sum payments. Funding for performance pay is most often appropriated by the state's legislature, but some states fund it through existing agency budgets. Other states fund performance pay through a mixture of legislative appropriation and agency savings.

Of particular interest are the programs in Colorado, Georgia, Michigan, and New Mexico. The programs in these states represent innovative pay strategies that may provide insight into future trends in pay for performance.

Colorado is currently phasing in a new compensation and performance pay initiative called **Colorado Peak Performance**. They have constructed new broader salary ranges that have a "job rate" which is 75% of the maximum for the range. Their performance system is a 3-level system with "needs improvement," "fully competent," and "peak performer" levels. Employees earning a rating of fully competent are eligible for an increase up to 5%. This may be a lump sum payment or an increase in base pay as long as they do not exceed the "job rate." Employees earning a peak performer rating are eligible for an increase of up to 10%. For peak performers, this may also be a lump sum payment or an increase to base pay as long as they do not exceed the "job rate," but they may also receive lump sum payments beyond the "job rate" as long as they do not exceed the range maximum. Another interesting component to Colorado's system is the provision that if neither the supervisor nor the second level supervisor complete the employee's performance appraisal the employee can complete the appraisal. Furthermore, a supervisor's failure to complete performance appraisals on all the supervisor's employees makes that supervisor ineligible for any performance award.

Georgia implemented a new salary structure and performance management system in 1996 called **GeorgiaGain**. The compensation system has 26 broad salary bands. The new performance system has 4 levels and performance increases are given to the base pay of employees for the top 3 levels. In Fiscal Year 1999, employees earning a rating of "meets expectations" received a 4% increase, a rating of "exceeds expectations" warranted an increase of 5½%, and a rating of "far exceeds expectations" earned an increase of 7%. In Fiscal Year 2000, employees received 3%, 4½%, and 6% respectively. If an agency's distribution of scores results in a budget overrun based upon these percentages, the agency may make a request to the Office of Planning and Budget to reduce these percentages. In all cases, agencies must award the same percentage to all employees that receive a given level. Employees cannot go above the maximum for their salary band.

Michigan is unique in that it actually has four pay for performance plans. Michigan awards merit increases to all non-union employees contingent upon them receiving a rating of meets standards or higher. In addition to this increase, employees in the unclassified Senior Executive Service are eligible for a maximum of a 5% increase in base pay and a maximum of 10% combined base pay and lump sum payments. Classified administrators and managers are eligible for an increase of 8% to base pay and 8% combined base pay and lump sum payments. Professionals have maximums of 5% base and 5% combined. Whenever an employee in any of these groups reaches the control point (similar to the job rate in Colorado's system) for their salary band, all increases must be in the form of lump sum payments. Additionally, when an employee in any of these three groups receives a rating of "needs improvement," they can have their salary decreased by the same limits as above (that is 5% for the Senior Executive Service and professionals, and 8% for classified administrators and managers). All increases over 5% are reviewed by the Michigan Department of Civil Service. While a system like this seems as though it would be incredibly difficult to administer, the Department of Civil Service reported that they receive very few complaints regarding these performance pay systems.

New Mexico implemented a new performance pay system in 1997. The amount of performance pay an employee receives depends not only on their performance rating but also their current salary compared to the midpoint of the salary range. Employees with low salaries compared to the midpoint are paid higher percentages for ratings of exceeds and meets standards than are employees whose salaries are higher than the midpoint. This distribution, or matrix, is similar to what private sector companies have been using for many years. For Fiscal Year 1999, increases varied from 3% to 6½%, with the total cost for performance increases representing about 3% of personnel budgets. The pay matrix New Mexico used for Fiscal Year 2000 is shown in Figure 2.

Comparison to Midpoint⇨ / Performance Appraisal Rating ⇩	**92.9% of midpoint and below**	**93% to 106.9% of midpoint**	**107% to 119.9% of midpoint**	**At or above Salary Grade Maximum**
Exceeds Expectations	6.0% base increase	5.0% base increase	4.0% base increase	3.0% lump-sum increase
Meets Expectations	4.5% base increase	3.5% base increase	2.5% base increase	2.25% lump-sum increase
Needs Improvement	1.5% base increase	NO INCREASE	NO INCREASE	NO LUMP-SUM PAYMENT
Unacceptable	NO INCREASE	NO INCREASE	NO INCREASE	NO LUMP-SUM PAYMENT

Figure 2. New Mexico's performance pay matrix for FY2000.

Other Public Jurisdictions

The **Federal Government** has long classified its compensation program as a merit pay system. This is consistent with merit principles that state that "appropriate incentives and recognition should be provided for excellence in performance" [section 2301(b) of title 5 of the United States Code]. During the Carter Administration, increased emphasis was placed on the importance of merit in the pay system (Lawler, 1990). This emphasis has continued with the National Performance Review in 1993, which is now called the National Partnership for Reinventing Government. These initiatives have led to broader salary bands and more aggressive performance pay projects such as those at the Department of Defense and the Commerce Department (Friel, 1997).

Local jurisdictions are also using performance pay. The International Personnel Management Association's 1998 Compensation Survey found that "over half the public sector participants (54%) indicated that they compensate largely or entirely based on performance" (IPMA, 1999). They present several county and city jurisdictions that have comprehensive pay for performance plans. Notable among these are the County of San Diego and the City of Las Vegas, with features similar to those in the state systems discussed above.

Why Does the State of Oklahoma Need Pay for Performance?

Pay for performance is needed for the following reasons:

1. **Pay for performance is an effective management tool that currently state supervisors and managers do not have.** Since 1981, state managers and supervisors have not had the opportunity to reward superior job performance. Even though this reward mechanism has not been available, the need to reward the best employees (or lose them) has still been present. Focus groups interviewed by the Hay Group as part of the development of the new Performance Management Process (PMP) reported that

the way that many agencies rewarded superior performers was through promotions (legitimate or not) or by giving the employees the option of entering the unclassified service and then raising their salaries. These practices show that state agencies need to find ways to increase the salaries of their star employees. Utilizing pay for performance would give them that management tool. Having a true pay for performance system can raise the productivity of individual state employees and state organizations. All of this should facilitate a faster, more effective accomplishment of agency missions.

2. **Pay for performance should improve selection and retention of quality state employees.** As employees see that hard and smart work will be rewarded, the employees that might be in the process of leaving state employment should be motivated to stay. When the state as an employer attains the reputation for recognizing and rewarding superior job performance, quality applicants should be attracted to state employment. This will become a crucial issue for state employment as the baby boomer generation quickly begins to retire *en masse*.

   A survey by Workforce magazine and Scantron Technologies (Workforce, 1999) asked the question, "Of those business challenges originating outside the organization, which has been the greatest challenge over the past 18 months?" The most common answer was low unemployment rate and difficulty recruiting.

   Sam Ehrenhalt, Senior Fellow Rockefeller Institute of Government (Barrett & Greene, 1999) points out that the government workforce is far older than the private sector workforce. The proportion of government workers who are 45 or older has been steadily climbing and it is currently 44 percent. In the private sector, the proportion is roughly 30 percent. Thirteen percent of government workers are between the ages of 55-64 compared to 9 percent in the private sector. In Oklahoma, the average age of state employees is 45. The next round of potential retirees, those 45-54 make up 33 percent of government workers and only 25 percent in the private sector. The result is that government will have a harder time hiring younger workers than the private sector. The problem is magnified by the fact that as the government workforce continues to age, the numbers of younger workers entering the workforce will shrink by about 3 million between the years 1996 and 2006.

   Compounding these problems, the nation and the state are experiencing a robust economy and extremely low unemployment. A recent headline in the Daily Oklahoman screams STATE JOBLESS RATE REACHES 18 YEAR LOW (Hogan, 1999). It reports the state's unemployment rate at 3.4 percent, a level not seen since September 1981.

This constitutes the "triple whammy" because the government workforce is quickly aging, preparing to retire and the normal pool of younger workers (replacement workers) is shrinking. Adopting an effective compensation program that includes pay for performance should help recruitment and retention efforts.

3. **Having an effective compensation program that includes pay for performance should help maintain or increase the productivity of the resulting workforce.** The workforce in government continues to shrink as a result of down-sizing, right-sizing or other political or economic forces that come to bear. Therefore, it will be imperative that the workforce selected and retained be as productive as possible.

To summarize, we believe that pay for performance is an effective, tried and proven practice that can positively motivate employees and lead to improved individual and organizational performance.

How Pay for Performance Can Work in Oklahoma

With the passage of the Classification and Compensation Reform Act of 1999, it is imperative that the State of Oklahoma make provisions for performance pay. On November 1, we will replace our current job classes with many fewer job family descriptors. Many classes under the old system were developed simply to provide employees with pay raises. The philosophy behind this change is to more broadly define employee's jobs so that individuals do not require reclassification when their job duties change slightly. This will result in fewer promotions for employees. As stated earlier, promotion has been the main mechanism by which state employees can receive an increase to their salary.

Consistent with the research, we recommend that performance pay be implemented for meets standards and exceeds standards. A matrix such as Figure 3, would be a good method of focusing performance pay toward employees in the lower half of the salary bands. For example, if an employee earns a rating of "meets standards" and is below the midpoint of the salary band, the employee would be eligible for a performance increase of up to 4%. If that same employee's salary is above the midpoint of the band, the employee would be eligible for a 3% raise.

Above Midpoint (100% up to 125% of midpoint)	0%	3%	5%
Below Midpoint (75% up to 100% of midpoint)	0%	4%	6%
	Needs Improvement or Does Not Meet Standards	Meets Standards	Exceeds Standards

Figure 3. Proposed matrix for Oklahoma's Pay for Performance Plan.

Like the State of Georgia's system, an agency that could not fully afford these increases could opt for smaller percentages as long as employees in that agency receiving the same rating would receive the same percentage increase, and employees earning "exceeds standards" would receive a higher increase than employees who earned "meets standards." Agencies could determine if these increases were to be made to base salary or as lump sum payments.

If performance pay is successful, it should not be viewed as a mechanism to bring state employees salaries closer to market, but rather as a management tool to increase employee performance and to reward that performance.

In summary, we have examined what authors in the professional literature have to say about pay for performance and how it should be used. We have also examined how states and other public jurisdictions are using pay for performance. We have shown the advantages of implementing pay for performance as part of a comprehensive compensation strategy, and the positive effects it has on employee performance and retention. Finally, we have presented some recommendations for how pay for performance could be implemented in the State of Oklahoma. Pay for performance is many things; a management tool, a recruitment tool, a retention tool. However, more than anything else, pay for performance communicates that employee performance is important in state government and that it will be rewarded.

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