

## **The NGO Salary Dilemma** *To Pay for Performance or Not*

NGO's are non-governmental agencies. They include charities, professional associations and a variety of not-for-profit agencies.

In the 2004 OHRPA membership directory there are members listed from 457 separate organizations. 69 (or 15 percent) of these are NGO's. This is a significant number.

NGO's tend to stay below the public radar screen. Yet they are the fourth largest economic sector in Ottawa, after:

1. Government - federal and provincial
2. Broader Public Sector – known as MUSH (municipalities, universities, schools and hospitals)
3. Private sector – especially high tech
4. NGO's

NGO's face a dilemma when it comes to salaries. They are not government and they are not the private sector. They are in the middle. So what does their Compensation program look like? Do they pay like government? That is, annual step increases based primarily on tenure and experience. Or do they pay like the private sector? With a strong emphasis on performance and merit pay.

Many NGO's desire the productivity that pay-for-performance programs can generate. But they often lack the discipline and will power necessary to enforce such policies. Let's look at how the pay-for-performance dilemma was assessed at the ABC Agency, a fictitious NGO.

### **Performance Management at the ABC Agency**

A policy on Performance Management refers to the relative emphasis that the ABC agency (as a typical NGO) wishes to place on rewarding individual employee performance. For example, should one staff member be paid differently from another if one has better performance? How much differently? Should more productive teams of employees receive higher annual increases than less productive teams? This is a philosophical question that the management of this NGO must answer.

This article outlines the relative advantages and disadvantages of two different approaches to compensation philosophy; pay-for-performance (also called merit pay) versus straight across-the-board economic increases (also called COLA – cost of living adjustment). It assesses which type of program (or combination) might be most appropriate for ABC.

## Summary of Relative Differences

The following table provides a short point-form summary of the relative differences between two distinct approaches to annual salary increases; pay-for-performance versus straight economic increases (COLA). These can be viewed as being at opposite ends of a spectrum.

Element	Pay-for-performance	COLA
<b>Background Data Required</b>	Annual employee performance appraisals, plus the data noted on the right	Annual CPI movement for Ottawa, plus, data on average wage increases in Ottawa.
<b>Ease of Operation</b>	Complex	Straightforward
<b>Degree of Equity</b>	Adjustments vary by employee	Percentage adjustments are the same for everybody
	Rewards higher performers, does not reward low performers	Higher performers rewarded the same as low performers
<b>Erosion of Employee Salary Due to Inflation</b>	Higher performers receive an adjustment greater than inflation. Average performers “stay even”. Poor performers lag behind inflation.	All employees “stay even” by getting an annual COLA

## Existing Practice

It has been the practice of ABC to blend these two approaches. That is, to reward employees on the basis of performance (following an annual performance appraisal) by providing annual merit increases which effectively have a cost-of-living adjustment built in. Higher level performers receive slightly larger increases (i.e. 1 or 2 percent) than poorer performers.

The policy question for ABC is: Is their ‘monetary motivation’ of 1-2 percent sufficient? Does the organization wish to formally link rewards (annual pay increases) to the achievement of individual and organizational goals to a greater extent than the current practice?

The degree of emphasis to be placed on performance is an important policy decision, since it directly affects employees’ attitudes and work behaviours. Recognition of their contributions also affects employees’ perception of management’s fairness. They need to understand the basis for judging performance in order to believe that their pay is fair.

## Pay-for-Performance

Pay-for-performance (also called merit pay) links rewards to the achievement of organization objectives. It provides an opportunity for employees to receive re-earnable financial rewards (larger annual increases) based on the achievement of predefined, measurable performance goals related to ABC’s success.

A key guiding principle of a pay-for-performance program is alignment. There needs to be considerable alignment between:

1. The defined (and communicated) corporate goals of ABC;
2. The measurement of how these goals are accomplished (and communication of same);
3. Determination of the employee behaviours that are needed to support and drive these goals;
4. The identification and measurement of these behaviours through performance appraisal objective setting and assessment; and
5. The calibration of economic rewards (annual salary adjustments) to the performance appraisal results.

Other factors are also needed:

- Demonstrable CEO and organizational commitment to the alignment of the five elements listed above. This is vital;
- The creation and nurturing of a corporate culture of goal setting, business planning, program measurement, and individual personal accountability. This is a hallmark of effective pay-for-performance systems; and
- A commitment to rewarding top performers, even when overall program objectives are not met, or when economic conditions are not supportive.

The advantages of a well run pay-for-performance system are as follows. It:

- Clarifies performance expectations;
- Improves individual performance;
- Rewards employees for achieving performance results and exhibiting behaviours that are aligned with the ABC's mission and goals;
- Improves employee satisfaction with work and pay;
- Rewards performance rather than seniority or skills;
- Provides rewards commensurate with contributions (i.e. Bigger pay increases for stronger performers, and very low increases for poor performers); and
- Assists in attracting and retaining highly motivated employees.

The disadvantages are:

- The effort required to manage the guidelines and factors outlined above;
- The work involved in upgrading ABC's performance appraisal process;
- Training supervisors and manager on the documentation and assessment of performance standards;
- Communicating the plan;
- Managing the process on an annual basis; and
- The process may be focused on the individual and does not necessarily reward team performance.

## Annual Economic Increases / Cost of Living Adjustments

By comparison, cost of living adjustments give employees the same percentage salary increase across the board. This is given to everyone, regardless of their performance.

Employees often compare their pay increases to changes in their cost of living. They may argue that increasing living costs justify equivalent adjustments in their pay by the employer.

It is important to distinguish among three related concepts:

- Change in an employee's cost of living;
- Change in the products and service (consumer) markets;
- Change in wages/salaries in the labour market.

Changes in an employee's cost of living are a function of their personal expense budget. Price changes over time in the product and service markets are measured by the Consumer Price Index (CPI). Tying salary changes to the CPI is called indexing. Changes in the labour market are measured through annual salary surveys.

It is up to ABC to determine a combined local labour market policy line and annual cost of living adjustment in their industry and geographic location.

The primary advantage of COLA is that employees feel their salaries are holding ground against the steady erosion of buying power caused by inflation. The main disadvantage is that ABC has no means by which to distinguish the rewards given to low versus high performers.

## Conclusion

The following points are worth highlighting:

- There are relative advantages to both of these approaches, merit pay and economic adjustments;
- ABC occupies "the middle ground". That is, as a not-for-profit organization ABC is neither in the public sector nor the private. ABC is not government, and is equally not driven by the profit motive;
- A pure pay-for-performance system is incongruous with ABC's culture, being an NGO;
- A pure COLA environment would not be in line with their existing policies; and
- There is a performance appraisal system in place. However a top down focus on the pay-for-performance factors and corporate alignment outlined above is not yet in place.

ABC may wish to adopt a Pay-for-performance philosophy along the following lines:

*ABC's pay administration program supports our overall management objective of:*

- *Attracting highly qualified employees;*
- *Retaining productive, effective and satisfied employees; and*

- *Providing an environment in which employees are encouraged to grow and develop their job skills.*

*Salaries are a large component of our operating budget and represent the major source of income for most employees. It is important that salary determinations are made in a thoughtful, sensitive way.*

*We strive to pay employees salaries that represent three perspectives:*

- *Internal equity - which ensures that differences in salary grades correctly reflect differences in the relative value of job responsibility;*
- *External equity – which ensures that salary ranges at ABC compare favourably to those of similar employers in the National Capital region from year to year; and*
- *The fiscal realities of the agency.*

*ABC is committed to rewarding employees on the basis of performance. The Agency will pay merit increases to meritorious employees each year. This presumes that individual differences in job performance are measurable and is based on the premise that superior performance will be encouraged and rewarded.*

This initiative would allow ABC to put a stronger pay-for-performance regime in place over time and improve its pay-for-performance linkages.



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