

Pay based on performance motivates employees – unless people think it's unfair

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Performance-based pay can have positive motivational effects on employee performance – but only if the incentive systems are clear and transparent, according to new research by Vienna University of Economics and Business (WU).

The study, conducted by Isabella Grabner from the Institute for Strategic Management and Managerial Accounting at WU alongside Melissa Martin from University of Illinois, investigated the effects of variation between salaries.

They analyzed data on pay dispersion and its effects on employees, working with a large healthcare provider with a workforce of 8,000 employees and 450 clinics across the United States.

They found that pay transparency can be an advantage for companies if it helps to give legitimacy to the compensation system and shows that individual incentives are well deserved, but only if it makes it clear to employees how their performance is linked to what they earn.

It could actually have negative consequences if employees feel the variation between salaries is unfair as employees not only look at their own salary but also compare it to what their coworkers earn.

“Pay transparency can have consequences in cases where poor performers perceive high disparities in pay levels to the point where it can make it more likely for such employees to leave the company. However, it can also be an advantage for companies if it helps to give legitimacy to the compensation system and shows that individual incentives are well deserved,” says Isabella Grabner.

The researchers recommend that companies should try to minimise any differences in pay that are not dependent on performance and communicate the reasons for different pay levels clearly to their employees.

The study was published in the journal Accounting, Organisations, and Society.

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