

# When raises backfire: Research examines pitfalls of performance-based pay

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When it comes to retaining and motivating employees, raises may seem like a sure bet.

But a new study led by Tony Kong, an associate professor of organizational leadership at the CU Boulder Leeds School of Business, finds that performance-based pay can sometimes have the opposite effect—leading employees to withdraw and decrease productivity.

"Pay for performance is a double-edged sword," Kong said. "When used wisely, it can really motivate people and increase their sense of competence. But oftentimes employees feel like they choke under pressure."

Three-quarters of organizations currently leverage pay-for-performance compensation, including pay raises, bonuses and profit-sharing as part of their overall compensation plan, according to Salary.com.

But whether those incentives achieve the desired effects is a matter of some debate.

The research, [published](#) in April 2023 in the *Academy of Management Journal*, finds that how employees perceive pay for performance and react to it hinges on two factors: leader competence and warmth.

The study, co-authored by Sanghee Park, an associate professor at Hanyang University's School of Business in Seoul, South Korea, and Jian Peng, an associate professor at Guangzhou University in China, incorporated two surveys of more than 250 pairs of employees and leaders in 234 companies and organizations in more than 40 industries in south China that provide pay raises. Although the sample was from China, the results likely hold true elsewhere, Kong said.

Focusing on employees' perceptions of pay for performance, the researchers found that employees view the prospect of performance-based raises positively when they view their manager as competent. In this case, they rise to the challenge with increased work engagement and

performance.

Competence resonates strongly with employees because they rely on their managers as a resource to clarify tasks, achieve work goals and provide useful feedback.

"If my leader is very capable, then I feel pay for performance is a positive thing. I'm more likely to engage in my job and perform well. The other part is leader warmth—whether a leader is trustworthy, friendly and supportive," Kong said.

"Warmth" involves more soft skills and includes [emotional support](#), concern for employees' well-being, and buffering employees from negative stress at work.

"If my leader is cold, untrustworthy, unfriendly and unsupportive, then I'll perceive pay for performance as a threat," Kong said. "I'll be super stressed and withdraw from my work, maybe coming to work late and leaving early. I will perform worse because I'm disengaged."

How can organizations effectively use performance-based pay to motivate employees? Kong suggests the following:

1. Companies should carefully design their pay-for-performance system and help employees understand it. "They have to define pay for performance clearly and clarify pay raise amounts and percentages for employees," Kong said. "That system needs to be visible, understandable and consistent."
2. Once the pay-for-performance system is in place, employers must be transparent about how it works and apply it consistently across the organization. "No nepotism, no politics. All these things muddy the perception of the system," Kong said. "You can have a well-designed

system from an HR perspective, but if managers play politics, then [employees](#) do not see the system the way it's intended. Companies' investment in the system will be pointless."

3. Leadership training is vital since leaders play a critical role in implementation of a pay-for-performance model and can influence [employee](#) perception. "Companies need to develop competent and warm leaders. They need to know how to motivate people and how to demonstrate their competence and warmth," Kong said.

The bottom line: Employees' perception of pay for performance drives their motivation and behaviors, Kong said. Managers need to tune into that perception and ensure the link between pay and performance is clear. "If the link is perceived as ambiguous or biased, that's not good for the system. Employees and companies won't benefit," Kong said.

**More information:** Dejun Tony Kong et al, Appraising and Reacting to Perceived Pay For Performance: Leader Competence and Warmth as Critical Contingencies, *Academy of Management Journal* (2023). [DOI: 10.5465/amj.2021.0209](https://doi.org/10.5465/amj.2021.0209)

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