# RESEARCH BRIEF

Center for Executive Succession

## Pay-For-Performance's Effect on Future Employee Performance

Research conducted by Center for Executive Succession Research Director, Anthony Nyberg, recently appeared in the *Journal of Management*. This research shows that pay-for-performance affects future employee performance and that these effects are influenced by four key contextual factors: employee, job, and pay system characteristics, and pay system experience.

**Key Takeaways:**

- Pay-for-performance affects future employee performance as well as prior employee performance.
- Pay-for-performance effectiveness is influenced by employee, job and pay system characteristics as well as by the experience that an employee has in the pay system.
- Bonus pay appears to have a greater performance effect than merit increases.

Using 5 years of data on 11,939 employees from 517 different departments of a large U.S. based insurance company, researchers found that pay-for-performance is associated with future employee performance, but has important limitations. For instance, the bonus pay effect is stronger at lower levels of employee tenure than at higher levels, suggesting that employees are more sensitive to pay-for-performance earlier in their tenure. Similarly, the researchers found that the trend in pay-for-performance can mitigate short-term pay-for-performance effects, providing further evidence that an employee's history with the pay system matters in terms of the effects that the pay system has on employee performance. The research team also found that pay-for-performance effects were stronger when performance was more easily and accurately measured.

The research team also found that, contrary to conventional wisdom and traditional economic models of rational self-interest, employees appear to be more motivated to increase performance when bonus pay is used than when merit pay is used. They found that an increase in bonus pay awarded to an employee of $4,261 amounted to an increase in the performance value returned to the organization of $13,351 or a 213% return on investment.

Their analysis statistically controlled for aspects of the employee and the firm (like average performance, gender, age, average promotions, employee job level, and supervisor).

Source: Nyberg, A.J., Pieper, J. R., Trevor, C.O., (2016). Pay-for-Performance's Effect on Future Employee Performance: Integrating Psychological and Economic Principles Toward a Contingency Perspective. *Journal of Management* (42) 7: 1753-1783.