RESEARCH BRIEF

Center for Executive Succession

PAY DISPERSION, SORTING, AND ORGANIZATIONAL PERFORMANCE

Research that will appear later this year in the *Academy of Management Discoveries* shows that when pay-for-performance is high, that is pay is closely tied to performance, higher performers quit less frequently and lower performers quit more frequently. Further, the quit rates of lower performing employees in high pay-for-performance situations is associated with higher organizational performance.

Key Takeaways:

- When pay dispersion and pay-for-performance is high, poor performer quit rates are higher than when pay-for-performance is average or low.
- When pay dispersion and pay-for-performance is high, the quit rates of low performers leads to greater organizational performance.
- High performer quit rates are highest when pay is compressed and pay-for-performance is not used.

Using multiple surveys combined with archival data, research conducted using single unit grocery stores located in the United States found that high pay-for-performance resulted in lower quit rates for employees who performed in the highest 20 percent and higher quit rates for employees who performed in the lowest 20 percent. The highest quit rates for good performers occurred when pay was compressed and pay-for-performance was not used. In contrast, low performer quit rates were highest when pay dispersion and pay-for-performance were both high. Further the results show that pay dispersion is positively related to organizational performance, but only when pay-for-performance is high.

The research also found more complex relationships among the comparisons. When pay-for-performance was low and good performer quit rates increased, the good performer quit rates were not associated with organizational performance. Thus, the primary effect found in this study was that it was the quit rates of the low performers that mattered for organizational performance more than the quit rates of the higher performers.

The analysis statistically controlled for aspects of the environment (like unionization and discharge rates), the firm (like size and selectivity of staffing), and the employment conditions (like average pay). The author suggests that future research is needed to learn more about the differences between horizontal and vertical pay dispersion.

Source: Shaw, J. D., (2015). Pay Dispersion, Sorting, and Organizational Performance. *Academy of Management Discoveries*, In Press.