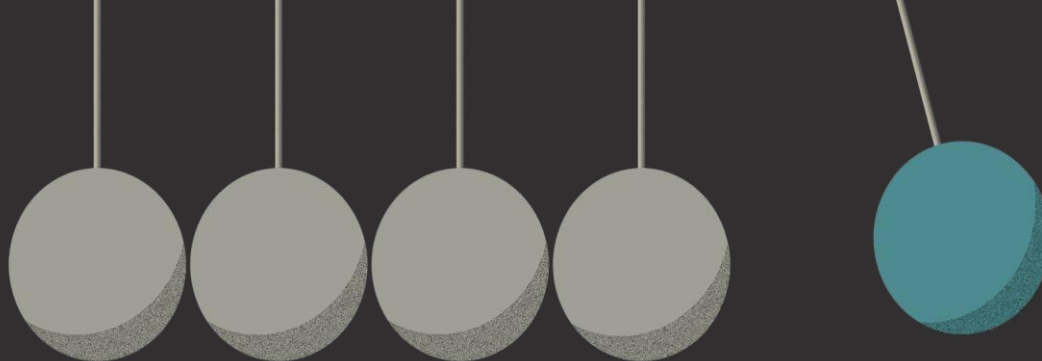




M | pact

G L O B A L

M | pact INSIGHTS

Does paying for performance work?

Sometimes – but there are cheaper ways to make your people unhappy.

We cannot talk about fixing Performance Management (PM) without talking about how pay-for-performance (P4P) fits in and whether it does what it promises: pay for and motivate people to perform.

A 2024 survey by WorldatWork indicates that 93% of companies globally use a form of P4P, and Korn Ferry's 2025 Workforce Insights indicates that many companies are revisiting their traditional P4P approaches towards something more holistic.

It seems like a good time to review the topic and explore what works - and not.

We assume pay causes performance

Almost every time I'm talking with companies about why they do PM, people respond 'so we can differentiate how we pay our high and low performers.'

Intuitively that makes sense – if we pay our high performers more than less effective performers, the high performers will be motivated and stay, and everyone else will aspire to become like them and performance will improve for everyone. Or so the thinking goes.

There's just a problem with that – **it's wrong most of the time.** Differentiated pay on its own doesn't lead to that.

There are three things that need to be in place to ensure that, and they are often overlooked.

This is but one example of what we believe we do – and what actually happens when we try and pay for performance.

The purpose of this paper is to provide more nuance to how we go about P4P and to help you make sense of what best contributes to improving performance.

Let's get a few things out of the way first

- ▶ Yes, of course pay has an impact on how people perform.
- ▶ Yes, pay motivates - some people more than others.
- ▶ It's a complex issue and one that's important to get right.
- ▶ Yes, there is a positive correlation between pay and performance but only for certain roles and contexts. Generally, more money doesn't generate more performance.

The problem I have is with a broadly held mindset about human beings and what motivates us – and how that drives how we incentivize people to perform in organizations.

We talk about pay-for-performance, but seem to mostly design for control, efficiency and compliance.

And we are often unaware of the consequences on motivation, behaviors and culture – and on whether we actually enable performance or not.

Turns out, mostly not.

Let's dive into what the problems are and why.

THE KEY INSIGHTS

The flaws in how we design P4P

- Organizations invest heavily in P4P but rarely ask whether it works. Few measure the ROI or whether their P4P generates the desired outcomes.
- Annual bonuses are delayed and do not affect daily performance effectively.
- Ratings are subjective but are used to drive objectivity in pay outcomes.

These structural blind spots create a system that's expensive, ineffective, and misaligned with how people actually perform and grow.

How beliefs – not data – drive P4P design

Many P4P schemes are based on a set of untested assumptions about human motivation:

- We assume pay causes performance.
- We assume people are motivated primarily by money.
- We assume performance is evenly distributed across a bell curve.

The challenge is that these beliefs are rarely right, rarely backed by data and often counterproductive.

The effects on people and culture

P4P is always well-intentioned but it can often backfire because we don't understand how it affects motivation, behaviors and culture.

- Differentiation can motivate top performers but most often demotivates the majority, fosters internal competition, and erodes team cohesion.
- When pay dominates performance conversations, performance conversations become *a performance*, not about improving performance.
- Instead of designing to enable performance, we design for control, compliance, and efficiency.

No one intends to but our approaches easily undermine performance and drive disengagement, short-termism, and a culture where people optimize for their personal pay rather than what we need them to do.

I have a problem or two...

The problems I have with how many companies do pay-for-performance?

Quite a few, it would seem...

I see three overall problematic themes:

- The flaws in how we design P4P
- How beliefs – not data – drive P4P design
- The effects on people and culture

The flaws in how we design P4P

We have no idea whether we actually improve performance.

Do you know whether your P4P generates the behaviors you planned for? If you're like most companies I've met, you have no data to determine this.

Think about that for a minute: for all the money we spend on performance-related pay, many don't have a mechanism to determine whether it generates the desired outcomes.

Put very simply, a lot of P4P structures I've experienced have had an ambition to drive certain behaviors with the thinking 'if we pay for X, we'll get more X'. I'm yet to meet a company that methodically tests for this.

Companies seem to assume a lot when they design pay-for-performance structures.

The ROI nobody measures

One thing is whether we get more performance if we pay for it.

Another is what the ROI is of what we invest in P4P schemes. Interestingly, most companies I have talked with don't measure this.

Our conversations are often about how we improve P4P instead of looking at whether we would be able to get better returns through other means.

As you can see from the below table that quotes research by Lattice (2023); peopleHum (2025) and Boatman (2024), P4P can yield positive returns – just not as high as other performance-enhancing initiatives like feedback, goal-setting, and employee engagement programs.

Initiative	Estimated ROI per \$1 Invested	Key Outcomes
Pay-for-Performance (P4P)	0.50 – 1.30	Mixed results: short-term gains, long-term risk
Regular Feedback & Reviews	2.00 – 4.00	Higher retention, engagement, and productivity
Goal-Setting Frameworks	2.50 – 5.00	Improved prioritization and team alignment
Employee Engagement Programs	3.00 – 6.00	Lower absenteeism, higher customer satisfaction

This doesn't mean that we shouldn't do P4P – but if you rely solely or mostly on this to improve performance, you're unlikely to yield the highest returns of your investments.

It doesn't enable us to regulate behavior throughout the year

This may be as contradicting what I wrote above about how people will focus on delivering what we reward. But that is not the same as saying that P4P's an effective tool for regulating behavior in the day-to-day; here many P4P programs fall short.

Many companies regulate pay and bonuses once a year, meaning long after people have behaved one way or another. If what we're after is for people to improve performance every day, we know that immediate and frequent positive reinforcements work better than those that are delayed.

Annual performance bonuses are delayed and therefore don't reward behaviors as they occur but after a long while.

The thing is not that we should avoid P4P and bonuses, but that we need to rethink how we apply them to generate value throughout the year, and not just around bonus time.

It's subjective

The key input to determine pay outcomes in P4P is often a performance rating.

We know from research that they are highly subjective and say more about the rater than the objective performance (Scullen, Mount, & Goff, 2000).

What this means is then that if you use subjective ratings as your main input to determine rewards outcomes, you cannot get objectively fair outcomes.

We also know from research that people are ok with different pay as long as it's transparent and fair (Henn, Houghton, & Neck, 2025).

Using performance ratings as the main input may give you transparency if you explain how they are used to determine pay outcomes and ratings are easy to understand. The issue is that you cannot generate objectively fair outcomes if you use them as your main input.

What's more is that we don't need ratings to ensure fair pay and pay equity. More on that next week.

People don't perform according to a bell curve

Most P4P practices assume that people perform according to a normal distribution – what we also refer to as a 'bell curve'. We assume that performance is evenly distributed above and below the average.

Research by O'Boyle and Aguinis from 2012 indicates that that is not the case.

Instead, people perform according to the 'Power Law'.

Let me quote Josh Bersin's excellent article on this from 2014: 'It has *very different characteristics* from the Bell Curve. In the Power Curve most people fall *below the mean* (slightly). Roughly 10-15% of the population are above the average (often far above the average), a large population are slightly below average, and a small group are far below average. So the concept of "average" becomes meaningless.'

If you have ever tried to work with a bell curve in this context, you know the challenging conversations this often brings when we try and force people into a distribution that is not reflecting how people actually perform – 'I'd like to give you a 5 but because of the bell curve, HR will only allow me to give you a 3'.

It demotivates because it's nonsense.

How beliefs – not data – drive P4P design

It's about beliefs, not data

I have talked about how CEOs' and other executives' beliefs about people impact how PM is done in many companies.

That especially applies when we are talking pay. Whether you believe people are motivated primarily by money often has more to do with two things:

- *Whether you are motivated by money yourself.* Here's an interesting thing – money's a lust which means that the more you have, the more you want.

There is a reason why many executives believe money motivates people: *it motivates them...*

- *What your beliefs are about people.*

If you believe people will only do things if you pay them, you'll focus on designing a pay-for-performance scheme that is all about 'you do this, you get that' and focus less on creating an environment that enables people to perform at their best.

Does it work to pay for performance? Yes, but...

Yes, you can improve performance through pay.

Research by e.g. He et al. (2021) indicates that a well-designed pay-for-performance structure can boost both the organization's alignment and focus, engagement, performance, and retention.

There is also research by e.g. Kohn (1999) and Shields et al. (2020) that suggests that poorly designed structures have several downside consequences – for instance that it affects intrinsic motivation negatively, can undermine morale, foster inequity, and lead to short-termism.

There is no right or wrong here – research points to different approaches that can work for different aims.

I'm guided mostly by Alfie Kohn, Herzberg, Deci & Ryan and Aubrey Daniels. Kohn, Herzberg, and Deci & Ryan caution that pay-for-performance can erode intrinsic motivation, distort human behavior, and fail to inspire true engagement.

Daniels on the other hand argues that it can serve as a powerful positive reinforcement – if designed well.

And that's the thing – in Daniels' opinion, most P4P aren't. As he put it:

'There are cheaper ways to make your people unhappy.'

It only works in certain roles

Advocates for pay-for-performance often point to Sales or assembly lines when they argue for why it makes sense. And they are right – there is research (Forma.ai, 2025) that suggests that pay does improve performance in roles with tangible outcomes.

What they forget to tell is that research also indicates that this is not the case when we're talking cognitive work.

Cognitive work is what most white-collar work (and increasingly blue-collar work) is all about. In fact, in that context, *P4P has proven to be counterproductive and ineffective.*

What I mean? Look at the short video with Daniel Pink – link in the references below.

You get what you pay for – but only that

Yes, people are more likely to focus on delivering their targets if you tie a reward to it. The challenge is that research by Larkin et al. (2018) and Silverthorne (2018) indicate that you're more likely to get focus on what you pay for, and only that.

Anything that falls to the left or right of that – forget it.

Let me give you an example from a CEO, I once worked with. At a management event, he scolded the leaders for not collaborating.

We were losing business because people didn't do that. 'Why don't you just pick up the phone and collaborate?' was his challenge to the leaders.

The real reason they didn't? Because they were only rewarded for delivering their targets and collaboration was not one of them.

In fact, the leaders were struggling so much to meet their stretched targets, that even if they wanted to help someone else, they didn't have the time for it.

The effects on them for not collaborating? None.
The effects for not reaching their targets? Public scolding and lower bonus.

We wanted people to collaborate, but set individual goals, developed individuals and rewarded individuals.

Now, ask again why people didn't collaborate?

For the sake of completion, I should also mention that there is research by e.g. Pierce et al. (2002) that indicates that pay can boost focus and overall engagement without narrowing one's focus, if it's designed well.

The effects on people and culture

Differentiation motivates a few and demotivates the rest

- Many people assume that differentiation is an effective means to improve performance – and there is research to support that (e.g. Ogbonnaya, Daniels, and Nielsen (2017) and Künneke (2024)): Differentiation can lead to high-performers feeling recognized and rewarded – and hence stay.
- It provides a sense of fairness.
- It can spur competition and innovation, especially in roles with clear performance metrics (e.g. assembly lines).

What's key, however, is that research also shows two things which we often don't talk as much about:

1. Differentiation on its own isn't effective unless three pre-requisites are in place:
 - People trust management and the system.
 - The communication and criteria are clear and fair.
 - The work environment supports growth, not just competition.

I'm yet to meet a company that works as diligently to achieve these three elements as they are in how they design their approach to differentiating pay.

2. There are often overlooked downsides:

- *It demotivates the many.* Research by Wood, Leoni, and Ladley (2023) indicates that pay differentiation may motivate top performers but risks demotivating others, especially when contextual factors are overlooked. In other words, when we assume that performance is only about individual efforts and not about whether the context enables (or not) one to perform (Houldsworth & Brewster, 2011).
- It can foster internal competition, reduce knowledge-sharing and team cohesion and get people to focus on maximizing their own pay short term rather than the common good and long-term success (Gupta, Conroy, & Delery, 2023).

It becomes all about pay - not about improving performance

Whenever we tie PM and pay closely together, we run the risk of every conversation about performance really becomes a conversation about pay.

The problem with that is that it impacts how we improve performance.

We know what it takes to improve performance: creating meaningful work, continuous feedback, positive reinforcements and learning from successes and failures (and more). To improve performance, we need to be able to talk openly about what we need to improve, where we have messed up or had a near miss.

If being open influences your pay, openness dies.

The focus becomes about showcasing one's successes and with it, performance conversations become *a performance* instead of a genuine and transparent conversation about improvement.

So what?

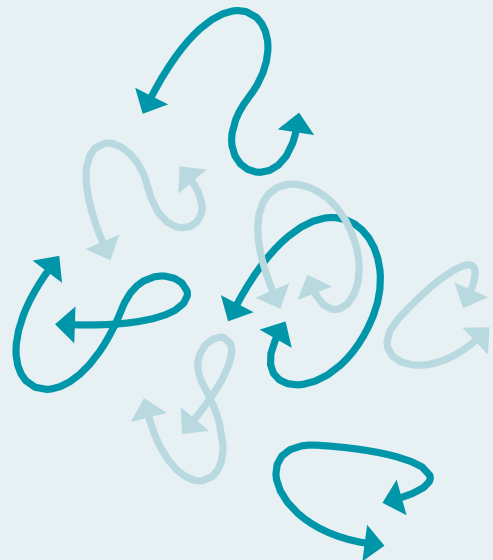
To sum it all up:

- Many companies assume differentiated pay drives performance but rarely test whether it actually does.
- ROI is modest at best (\$0.50–\$1.30 per \$1 invested), and often lower than other interventions like feedback or goal-setting.
- We assume performance follows a bell curve, but research shows it follows a Power Law, making forced distributions ineffective and demotivating.
- We design pay structures based on beliefs, not data.
- Tying pay to performance narrows focus: people deliver only what's rewarded, not what's needed.
- It undermines collaboration, openness, and long-term thinking - especially when individual targets dominate.
- Performance ratings are subjective, yet they're often the primary input for reward decisions. That makes it impossible to generate objective pay outcomes.
- Differentiation can motivate the few but demotivate the majority, foster internal competition, and reduce knowledge-sharing. Differentiation only works when trust, fairness, and growth are present.

- P4P works best in roles with tangible outcomes (e.g. sales, assembly lines) - but most work today is cognitive. There, traditional P4P can be counterproductive.
- Annual bonuses are delayed and disconnected from behavior; frequent, immediate reinforcement is more effective.
- When pay dominates performance conversations, genuine improvement takes a back seat to self-promotion. PM becomes *a performance*.

Many approaches to P4P are expensive and ineffective and designed in a way that ignores what research has told us long ago actually enables performance.

That doesn't mean P4P can't work or shouldn't be part of our approach to improving performance. It just needs to be designed well and not applied as the only or main vehicle to enable performance.



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