**Merit Pay Increase Considerations & Options**

Fiscal Year 2017

**Overview**

Performance based rewards are an important component of Total Rewards at the University of Minnesota. Annual salary increases based on merit and individual contributions are essential to creating a culture of operational excellence and continuous improvement.

**Design Considerations**

Each academic and administrative/support unit at the University of Minnesota is afforded flexibility in how merit increases are awarded. The following consideration and approaches are being provided by OHR in response to recent requests for more guidance on this subject. Please work with your OHR Consultant, senior leadership team, finance and communications to address the following considerations and steps:

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| Step 1 | Review and update your performance review tool to ensure it will:* Effectively measure the behaviors and work outcomes you wish to reward
* Provide information and/or ratings you will need to differentiate low from high performance
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| Step 2 | Clearly identify the group of employees whose performance will be compared. * Will performance of all employees within a college be compared (college-wide performance comparison)
* Will smaller groups be used for comparison within the college (department, unit, etc)
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| Step 3 | Determine how much money you have for each merit comparison grouping. Simply multiply your merit increase percentage times total salaries of the employees in the group being reviewed. Be sure to include salaries from open positions in this calculation.* Units may exceed the 2.5% increase pool only if there is a need to address documented market challenges or exceptional performance results, and is permitted by the budget.
* Units may deliver an increase pool lower than the 2.5% recommendation if facing significant financial stress, defined as permanent loss of revenues and/or a recurring structural budget deficit, and insufficient carry-forward plans. The alternative plan and supporting documentation regarding the financial constraints must be detailed in the unit’s budget/compact submissions, or a supplement to those materials. Final submissions must be dated no later than May 6, 2016. This proposal will be considered for FY17 only, not for subsequent years. A written response to proposals will be sent from the Budget Office based on a final decision by the President and in time for implementation of increases for FY17.
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| Step 4 | Select the approach you will use to award performance-based increases* See next section on “Three Approaches to Merit Pay” for sample models
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| Step 5 | Agree on how you and senior leaders in your unit will conduct a joint review to calibrate performance ratings, ensure legal compliance and adhere to University policies and guidelines. |

Please note that employees who are paid above their salary range maximum must receive their annual increase in the form of a lump sum payment, rather than applied to their base salary. In situations where an employee will be paid over the range maximum after receiving his/her merit increase, the employee can have the merit increase applied to his/her base until the point his/her salary reaches the range maximum. Any further portion of the merit increase must be awarded as a lump sum increase.

**Three Approaches to Merit Pay**

There are limitless ways to award performance-based increases. This guide highlights three common approaches that you may wish to consider. The options are arranged from least to most structured. Please note that the success of any merit increase model is highly dependent on the ability to:

1. Identify and sort people into unsatisfactory and low performance categories
2. Award increases to top performers that are 75-80% higher than the 2.5% increase. This translates to an increase of 4-5%.

***MODEL 1: UPSIDE POTENTIAL (BONUS OR INCREASE) FOR HIGHEST RANKED PERFORMERS***

*Best used when:*

* A simple approach to budgeting, administration and communication is desired
* There is less than fully optimal structure around job assignments and/or related market data
* The unit is distributing a merit increase pool that is below, at, or above the University-Wide recommended merit increase

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| --- | --- |
| 0% | Given to unsatisfactory and low performers |
| 2% | Given to all employees who are performing proficiently and beyond expectations |
| Additional Increase\* | Given to the highest performers in the college / unit |

\*The additional increase percentage should be determined by identifying the remaining dollars in the merit increase pool, determining the award amount the unit would like to provide to the highest level performers, then dividing the remaining pool by the desired dollar amount. This will tell you how many employees can receive this additional increase. The increase could be added to base or awarded as a lump sum depending on the unit’s ability to pay.

***MODEL 2: PERCENT INCREASE AWARDED BASED ON PERFORMANCE RATING***

*Best used when:*

* A simple approach to budgeting, administration and communication is needed
* There is less than fully optimal structure around job assignments and/or related market data
* The unit is distributing the University-Wide recommended merit increase or a larger percentage

***Using 3 Sort Categories***

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| ***Lowest 1/3******0-1% Increase******(0% for unsatisfactory performance)*** | ***Middle 1/3******At/Slightly Below 2.5% Increase*** | ***Top 1/3******4-5% Increase*** |

***Using 4 Sort Categories***

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| --- | --- | --- | --- |
| ***Unsatisfactory******0%*** | ***Requires Improvement******1%*** | ***Proficient******At/Slightly Below 2.5%*** | ***Exceeds Performance / Outstanding******4-5%*** |

***Using 5 Sort Categories***

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| --- | --- | --- | --- | --- |
| ***Unsatisfactory******0%*** | ***Requires Improvement******1%*** | ***Proficient******At/Slightly Below 2.5%*** | ***Exceeds Performance******4%*** | ***Outstanding******5%*** |

***MODEL 3: PERCENT INCREASE AWARDED BASED ON PERFORMANCE RATING AND RANGE POSITION***

Best Used When:

* There are well-established and accepted job assignments and related market data
* The unit is distributing the University-Wide recommended merit increase or a larger percentage

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| --- | --- | --- | --- | --- | --- |
|  | Performance is Unsatisfactory | Performance Requires Improvement | Performance is Proficient | Performance Exceeds Expectations | Performance is Outstanding |
| Salary is High In Range | 0% | 0% | 1.5% | 2.5% | 2.5% |
| Salary is Mid-Range | 0% | 1% | 2.5% | 3% | 4% |
| Salary is Low In Range | 0% | 1% | 3% | 4% | 5% |

**Create An Implementation Plan**

Once you have your performance review tool, merit increase percentage and employee peer groups identified, work with your OHR Consultant, senior management of your unit, and communications to create a merit pay implementation timeline that includes:

1. Clear assignment of roles and responsibilities
2. Creation of communications, forms and supporting documents
3. Dates when preliminary performance reviews will be completed
4. Dates when senior leadership will meet to discuss preliminary reviews and distribution performance among employees
5. Financial analysis - Translation of performance rankings into merit increase amounts
6. Dates when final reviews and merit increase awards will be communicated to employees
7. Training dates for managers and supervisors on the tools and process, as well as how to effectively determine the merit amount and communicate the results to employees
8. Training dates for employees on how performance will be evaluated, how increases will be determined and timing of the merit increase cycle
9. Handoffs with payroll and HRMS at the local and central level to ensure appropriate and efficient processing of increases.