IMPACT
(Investigating Merit Pay Across Countries and Territories)

JASON D. SHAW
Chair Professor
Associate Dean for Research and Postgraduate Studies
Co-director, Centre for Leadership and Innovation
The Hong Kong Polytechnic University

DANA MINBAEVA
Professor of Strategic and Global Human Resource Management
Founder and Director, Human Capital Analytics Group
Copenhagen Business School

RATIONALE

The project aims to answer several critical questions:

- What is the minimum incentive size that elicits behavioral reactions from employees?
- What is the optimal size of merit pay increases in terms of eliciting greater employee satisfaction and future effort?
- How should managers most effectively distribute limited funds to maximize positive outcomes?
- How can decision makers best manage employee expectations about the incentives they receive?
- What roles do employee perceptions about the fairness of the pay system play in terms of employee reactions to pay changes?

Theoretical background and research questions are included in the Appendix. For inclusion in the data analysis phase of this study, the data collection must have certain features that are detailed below.

RESEARCH DESIGN REQUIREMENTS

1. Merit Pay Increases: The data collection is focused on merit pay increases, defined as permanent increases to base pay (weekly, hourly, monthly, or annual pay levels) based on evaluation of past performance. Reactions to other types of incentives (e.g., spot rewards, year-end bonuses, team-based rewards, longevity- or seniority-based pay, gainsharing, profit sharing) frequently elicit different reactions and are beyond our focus. Please note that the system does have to be called “merit pay” as long as it fits the definition. Many organizations use multiple incentive plans. It is fine if the focal organization uses multiple incentive schemes, as long as merit pay is the focus of this data collection. We can control for whether multiple incentive systems are used, if necessary.

2. Pay increase information. It is necessary for this project to obtain actual merit pay increase information from the participating organization(s). Local research partners at
Copenhagen Business School (Human Capital Analytics Group) will ensure a double-blind process so that individual-level information stays confidential.

3. Survey data design—pre- and post-merit pay raises. The survey research part of the study will be a two-phase survey design before and after the receipt of the merit pay increase.

   a. Phase 1 (pre-merit pay increase). The Phase 1 survey includes measures of attitudes, expectations, confidence, control, and a variety of other factors. Because we are interested in expectations, minimum desired raise levels, and other factors which may condition pay-raise reactions, it is necessary to collect Phase 1 data before individuals learn what their raise level will be. Typically, Phase 1 is collected 1-2 months prior to the receipt of the new raise level.

   b. Phase 2 (post-merit pay increase). The Phase 2 survey includes additional assessments of job attitudes as well as specific reactions to the merit pay increase. It is necessary for individuals to have received a weekly, bi-weekly, or monthly “pay check” before completing the Phase 2 survey. That is, it is important to measure pay reactions after participants have experienced receiving the new pay level. Phase 2 is typically collected 1-2 months after merit pay increases have been received.

4. Measurement. The surveys can be administered in the local or preferred language. Translations are already available in English, German, Italian, Spanish, Finnish, Hebrew, Bahasa Indonesia, Danish, Dutch, Traditional Chinese, Simplified Chinese, Vietnamese, Malaysian, Hindi, and Portuguese.

Negotiable features

1. Additional measures. Additional measures can be included in the Phase 1 or Phase 2 questionnaire.

2. “Online” versus “paper-and-pencil” questionnaires. Most companies prefer data collection via online surveys; these are recommended. But, paper-and-pencil questionnaires can also be used.

DATA ANALYSIS AND FEEDBACK

1. Data analysis and writing. Once the data are collected in your company, the local research team at the Copenhagen Business School encrypts the data, ensuring confidentiality, and sends the final data set to Hong Kong in order to combine it with the data collected from the other companies in the study.

2. Company feedback: The research team will provide a feedback report on the results to participating organizations. There are a number of very practical outcomes that will result
from the analysis including (1) a better understanding of how individuals react to their pay increases in your company, (2) greater knowledge about optimal distribution patterns, especially for the most valued performers, and (3) potential feedback to the organization about ways to design. Detailed, customized written feedback will also include:
   a. Averages, distributions, correlations
   b. Local benchmarks (where possible)
   c. Answers to all additional questions
   d. Recommendations for improvement

In addition to the written report, a member of the research team can also deliver a presentation in your company for stakeholders.

3. **Global feedback report**
   a. Detailed results of global project, when available
   b. National benchmarking and for the MNCs also the host country benchmarking

Contacts:
Jason Shaw [jason.shaw@polyu.edu.hk](mailto:jason.shaw@polyu.edu.hk)
Dana Minbaeva [dm.smg@cbs.dkn](mailto:dm.smg@cbs.dkn)
In an exhaustive review more than 20 years ago, Heneman (1992) concluded that there were positive, but quite modest relationships between the use of performance-based pay and employee performance, a conclusion later confirmed by meta-analyses (e.g., Jenkins, Mitra, Gupta, & Shaw, 1998). As a result, the near-universal use of merit pay in North America and increasing growth worldwide has been accompanied by waves of criticism about its effectiveness. Merit pay can be expensive and difficult to implement and maintain and therefore it is important to understand employee reactions to these incentives. In this study, I, along with my research partners, will evaluative several theoretical perspectives on the relationship between merit pay raises and employee outcomes. My attempt will be to understand why, how, and when individuals react positively and negatively (or not at all) to their merit pay raises and, in addition, to address how these reactions vary across individuals across cultures.

From a theoretical point of view, four issues appear to be particularly important. First, a growing line of thinking in the financial incentives area comes from research on the psychophysics of “just noticeable differences” in pay levels (e.g., Mitra, Gupta, & Jenkins, 1997; Mitra, Tenhiala, & Shaw, 2013). If minimum psychophysics-based thresholds exist, merit raises may fail to achieve objectives simply because many raises go essentially unnoticed. Second, other researchers have speculated that differences in values or attractiveness standards may play a role in how individuals interpret rewards in organizations (Locke, 1976). Individuals therefore use valued pay increase levels as a reference point for determining their reaction to merit raise values. This approach is particularly salient in the context of cross-cultural investigations because existing research on pay dispersion (e.g., Shaw, 2014), work values (e.g., Kirkcaldy, Furnham, & Martin, 1998), and rewards, in general (e.g., Shaw, in press), provide some evidence that attitudes toward money, attractiveness standards, and the value of financial incentives may differ across cultures. Third, met-expectations theory offers another way of looking at reactions to merit increases. It is well known that pay raise expectations are an important reference point for employees (e.g. Schaubroeck, Shaw, Duffy, & Lockhart, 2008). A social psychological view of met expectations suggests that under-met expectations are more surprising when individuals believe they have control over outcomes, but over-met expectations are more surprising when individuals have little control (Teigen & Keren, 2002). Thus, control and the differential surprise generated from under- and over-met expectations should determine reactions. Fourth, a second expectations-based view suggests that individuals not only set expectation levels preceding an event, but also assign a confidence interval around the expectation level (Coughlan & Connolly, 2001; Mellers, Schwartz, Ho & Ritov, 1997). Thus, expectation confidence, or lack thereof, can be used to heighten the explanation for why individuals react strongly or mildly to under- and over-met expectations. Moreover, perceptions of control and expectation confidence can also be influenced by specific cultural factors, country-specific attitudes, and prior company experiences. The general propositions and more general research questions derived from the 4 perspectives are detailed below.

**SAMPLE RESEARCH QUESTIONS**

**Alternative Theory 1: The psychophysics view**
**Proposition**: There is a “just noticeable difference” threshold for employee reactions (behavioral intentions and affective responses) to the size of pay increases.

**Research Question**: Does the JND pay raise threshold differ across countries?

**Alternative Theory 2: The value-discrepancy view**

**Proposition**: The relationship between merit pay raises and employee reactions depends on minimum attractiveness standards for pay increases.

**Research Question**: Do attitudes related to financial incentives (meaning of money, materialism) vary significantly across countries and influence merit pay raise attractiveness standards?

**Alternative Theory 3: The extended expectations model**

**Proposition**: Perceptions of control over outcomes moderate individual reactions to under-and over-met expectations in the context of merit pay raises.

**Research Question**: Do expected raise levels and perceptions of control differ across countries and do the sources of these expectation differences differ across countries?

**Alternative Theory 4: The expectation confidence model**

**Proposition**: Expectation confidence moderates individual reactions to under- and over-met expectations in the context of merit pay raises.

**Research Question**: Do expected merit pay raises and expectation confidence levels vary across countries and do the sources of these differences also vary across countries?