



FINAL REPORT

OF THE

REVIEW AND EVALUATION OF

PERFORMANCE-BASED MANAGEMENT

COMPENSATION

FOR THE

CITY OF PIEDMONT

August 2007

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KOFF & ASSOCIATES, INC.
Human Resource Consulting Since 1984

August 16, 2007

Mr. John Chiang
Ms. Nancy McEnroe
Council Sub-committee
City of Piedmont
120 Vista Avenue
Piedmont, CA 94611

Dear Mr. Chiang and Ms. McEnroe,

Koff & Associates, Inc. is pleased to present the final Review and Evaluation of Performance-Based Management Compensation Report. This report summarizes our data collection methodology and analysis of eleven (11) cities and three (3) towns that have pay-for-performance programs for their management team currently in place. The following includes information about the program structure, background, and best practices of the comparator agencies, as well as recommendations for City of Piedmont to consider if it decides to design a program of its own.

We would like to thank you and the rest of the project team for all the assistance and cooperation, without which this study could not have been brought to its successful completion.

We will be glad to answer any questions or clarify any points as you are implementing the findings and recommendations. It was a pleasure working with your City and we look forward to future opportunities to provide you with professional assistance.

Sincerely,

A handwritten signature in purple ink, appearing to read 'Katie Kaneko', is written over a light blue horizontal line.

Katie Kaneko
President

Enclosures

CC: Mark Bichsel, Finance/Human Resources Director
Nancy McEnroe, Mayor
John Chiang, Councilmember



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BACKGROUND

This review was conducted pursuant to a City Council-initiated request submitted in January 2007. The objective of this study was to evaluate the City's current management compensation practices by comparing and contrasting it to other public sector management pay for performance systems. The goal was to recommend compensation practices for the City that not only allow the City to retain qualified employees but also recognize each employee's individual performance and contribution to the City through a competitive, fair, and equitable compensation system. The City sought mechanisms consistent with public sector best practices that would reward individual efforts as appropriate in addition to being responsive to fluctuations in the Bay Area job markets.

In order to identify the appropriate comparators to be contacted for this study, we first looked at the list of comparator agencies that were used by the City in its last salary survey and determined through the review of MOU's which of these cities have performance-based pay programs for their management team currently in place. Additionally, we provided city management with some suggestions of cities in the region that we know to have performance-based programs and they provided some suggestions of their own. After some discussion about which agencies would be the most appropriate based on services offered by the city, budget, number of fulltime employees, etc., a total of fourteen (14) comparators were asked to participate in this study. The final comparators are listed below.

- City of Emeryville
- City of Lafayette
- City of Livermore
- City of Menlo Park
- City of Mill Valley
- City of Mountain View
- City of Pleasant Hill
- City of San Marino
- City of San Rafael

- City of Saratoga
- City of Sausalito
- Town of Corte Madera
- Town of Danville
- Town of Hillsborough

Information was then gathered from each agency by a combination of website review and telephone contact with high-level Human Resources personnel. We discussed with the comparators alternative methods for development of compensation programs that incorporate individual performance criteria, such as, but not limited to, an annual employee performance review, success in attaining individual position goals, and success in meeting general City goals. The aim of the interviews was to discover best practices in the implementation of such programs as well as strengths, weaknesses, and barriers to the implementation of each program.

SUMMARY OF FINDINGS AND ANALYSIS

Of the fourteen (14) comparator agencies that we contacted, we obtained information relevant to the current study from thirteen (13) of them. While investigating possible comparators and their current compensation structures, it was originally determined that the City of Mill Valley paid its department managers within ranges and it was up to the City Manager as to when and how much of a salary increase they would receive. After discussion with Human Resources at Mill Valley, it was discovered that this was not true, and that all employees in the City work on a standard step salary system. Therefore, this comparator was not be used in our analysis.

Most of the programs were implemented due to a desire by the City Council or City Manager to hold city personnel responsible for achieving goals and ultimately improving service delivery to residents of the city. There was a perception that the traditional step systems allow employees to perform a minimal amount of work and still get salary increases without any true accountability. They felt that recognizing high-level performance by attaching it to salary incentives was the best way to counteract this complacency. Although our investigation showed that no two programs were exactly alike, we found several trends that emerged in the data (See Appendix II for program specifics from each comparator).

Nine (9) of the comparators surveyed have a salary range system in place that includes a range minimum, where most employees would start out, and a range maximum. Another comparator, Mountain View, uses a slight variation on this structure in that they have control points for each classification. In this case, the minimum salary is 80% of that control point and the maximum is 120% for management employees and 85% to 115% for professional employees. Menlo Park, on the other hand, is on the traditional “step” system, but their managers and mid-managers are eligible for a lump sum bonus of up to \$5,000 based on annual performance appraisals in addition to step increases. In all comparators, employees are evaluated at least annually and the manager recommends merit pay or salary increases according to their rating.

There are several ways that each agency determines the allowable increase an employee can receive. First is the most standardized method in which there is already a predetermined percent increase range associated with the overall rating given to the employee. For example, the City of Pleasant Hill allows for a 4%-7% increase when the employee receives the highest ratings in at least one half of the rating criteria and no less than “meets standards” in all others. Plus, they must have achieved at least 75% of predetermined individual goals. If the employee receives “meets standards” or better in all ratings and has met at least 50% of predetermined goals, then they are eligible to receive 1% - 3%. Anything less and the employee will not get an increase that year. To further ensure equity and fairness in the rating process, many of these “standardized” programs include a system of checks and balances in which the reviews and increase recommendations are also looked at by Human Resources, the City Manager, and/or other department heads.

Second is a “semi-standardized” method in which there is either a maximum or average percent increase. In this case, the evaluating manager has the flexibility to give an increase as he or she sees fit as long as they stay within the set guidelines. For example, the City of Saratoga allows a 3% average increase for all employees involved in the program. This means that the evaluating managers can give their employees an increase as they see fit, as long as the average of all of increases comes out to 3%.

Lastly, there are several comparators who use a completely non-standardized method in determining how much increase employees are allowed to receive. In this case, the evaluating manager makes a determination as to how much he or she feels the employee should get and then the City Manager, Department Head, and/or Human Resources must approve that amount. Although there are no specified guidelines, the City has usually budgeted employee increases at the beginning of the fiscal year, so the final decision is usually based on fiscal capabilities. For example, the City of San Marino has a program that is only in use when the City has the ability to pay for it. Each department submits its budget for the next fiscal year that has to be approved by the City Council. For the last couple of years, however, the City has been unable to fund such increases, and therefore the program has not been used.

There was an expressed interest in obtaining information pertaining to the hours spent administering a pay for performance compensation plan: including goal setting, the performance evaluation process, and implementing salary changes as a result of the process. We were only able to obtain this information from eight (8) of the thirteen (13) agencies that participated. Although the information obtained indicates that the less standardized programs tended to require fewer annual man-hours per employee to administer, it is important to note that none of the agencies had a system in place to track the number of hours spent implementing these programs. These numbers are ‘educated guesses’ by our contacts in Human Resources and are pure speculation based on their experience. See Appendix II for specifics from each comparator.

Although there are many factors that affect recruitment and retention efforts, the programs with a higher level of standardization report that merit pay is a significant factor working to improve retention and recruitment. Most comparators, especially those using a range or control point salary structure, mentioned that the merit pay program has helped to improve employee retention

and recruitment because the program allows for greater flexibility in making salary accommodations for new employees and/or for quality employees threatening to leave. This is not the case in all comparators. For example, in the City of Saratoga it was reported that their highly standardized program does not currently improve retention due to limitations in how it is administered. Those involved in designing and implementing the program state that there was a disconnect between the Council and management that resulted in a restrictive average increase requirement that makes it hard to reward and differentiate those employees who are truly performing at a higher level than those who simply meet standards. On the other hand, the City of Menlo Park uses a non-standardized structure and reported that there is a clear connection to employee retention and the merit program. However, it was further admitted that despite the objectivity of the current City Manager (this program is only implemented at the department head level), there is no system of checks and balances to ensure that the ratings and the merit bonuses are being administered equally, which is an area for concern by the City Council that they hope to address in the near future.

All of the comparators stated that they preferred merit-based pay programs over the traditional “step” systems, although both have positives and negatives. The most common complaint with the “step” system was that it allowed poor performers to continue to advance through the range at a pace equal to those employees performing at a high level. This is not only detrimental to the organization, but also frustrates the high performers and ultimately causes reduced motivation to be successful. From an administrative standpoint, most comparators preferred the “step” system because it is structured and easily understood. However, the merit-pay programs that have defined guidelines, detailed rating criteria, and specific increases associated with performance ratings reduced ambiguity related to the program, which increased the ease of administration. Furthermore, the consensus is that the more standardized the program is, the more the city benefits from its implementation in terms of attaining city-wide goals and objectives. It was stated on several occasions that having detailed guidelines and procedures helps to create an environment that allows managers to set clear and identifiable goals for the individual that fit closely in line with city-wide directives. This process fosters a sense of ownership of these goals, and ultimately makes the employee accountable for achieving them.

RECOMMENDATIONS

The information gathered in this study leads us to recommend that the City of Piedmont should implement a standardized performance-based pay program. Of the agencies we spoke with, the overwhelming consensus was that, although there may be defects inherent in the design of the programs, the overall benefits, in terms of employee retention and recruitment, and the achievement of individual and City-wide goals and objectives, outweigh any flaws in the design. In fact, even in those cities that had programs that were less standardized, many of them stated that there were discussions within the city on program improvement and standardization, but none of them mentioned that abolishing the program was ever in consideration.

Pay for performance programs are relatively new to the public sector and we are finding an increased interest in moving towards this direction as the market becomes more competitive due to labor shortages.

The findings of this study also suggest that Piedmont should create a program ingrained with clearly defined standards and guidelines. Doing this provides several advantages such as ease of administration, greater ability to assess the progress toward goals throughout the year, and an enhanced ability to maintain objectivity and sense of fairness throughout the process. In our experience, there are several essential elements to the development and implementation of a program in order to be well received by all stakeholders and provide for the City's enhanced ability to achieve its goals and objectives. The following are our recommendations for creating a successful, standardized performance-based compensation program:

- **Create a Standardized Evaluation Process Based on Clearly Identifiable Behaviors** – When creating a performance evaluation program, it is easy to overlook the importance of objectivity and implementing standards that hold constant throughout an organization. Standardizing the evaluation process provides several advantages to the City. First, it ensures that all employees are evaluated based on values that the City deems critical to the achievement of its mission. These values are assessed by clearly identifiable behaviors that the manager can witness the employee displaying (See Appendix I for an example). Additionally, both managers and employees should be oriented to the evaluation process to help them understand ratings and expectations, as well as to train managers on review process and organizational criteria.

Objectivity is the second advantage of a standardized evaluation process. Removing as many of the outside influences and personal prejudices that can often influence these types of evaluations will help protect the City against grievances and the perception of varying criteria from one evaluation to the next. The removal of subjectivity in performance evaluation is a near impossible task, but there are steps the City can take to make its evaluations as objective as possible. First, provide managers with very specific guidelines as to what they should be focusing on in each of the criteria as well as what each rating on the scale means. This way, there is no room for individual interpretation of each rating. Managers know the level of performance necessary to get a specific rating, and the criteria is consistent for all employees. Second, there should be a mechanism for checks and balances built into the process. This could be as simple as having an objective third party within the City review the completed evaluation for consistency before it is given to the employee, or the City could go as far as implementing a 360 degree feedback process, similar to that in the Town of Danville, in which the employee, manager, and one or two peers all evaluate the employee's performance. These evaluations are more time consuming, but the more feedback obtained, the less likely there will be the perception of inequity in final ratings from employee to employee.

- **Set Clearly Defined Individual Goals and Objectives** – The behavioral evaluation above is based on values that the City would like to instill in all of its employees, but it is also important to recognize the uniqueness of each position within the organization and establish specific goals and objectives relative to the function. Therefore, it is our recommendation that each employee is provided with individual goals that are S.M.A.R.T.: Specific, Measurable, Attainable, Relevant, and Time bound. We mention that the goals should be S.M.A.R.T. in order to direct employees toward developmental

and organizational goals and at the same time ensure that the accomplishment is realistic within an evaluation period.

There is a tendency to create overly ambitious goals that can work to counter the objectives of a pay for performance program. For example, one comparator shared how their individual goals are always additional projects or programs over and above the day-to-day tasks of the position. Many employees struggled to achieve these goals because the day-to-day workload was legitimately overwhelming on its own. This threatens the employee's ability to maintain a high level of quality in daily work and service delivery, as well as inhibits the employee's ability to achieve the additional goals. On the other hand, underestimating what an employee can achieve results in goals that don't challenge the employee or aid in the advancement of department- or city-wide goals.

One comparator shared a story about a previous employer who required its employees to generally implement or improve a program each year. Because the goal was not specific, and was not related to larger organizational goals, it ultimately resulted in constantly changing programs and procedures, causing turmoil throughout the organization due to the continuous need to relearn the revised programs. Additionally, it was reported that these changes were usually only minor updates to programs created by the employee in previous years, so the employees were only marginally challenged to achieve them.

Furthermore, we recommend that managers meet with each employee at least bi-annually to discuss, agree upon, and modify the goals the employee should achieve throughout the year. The first of these sessions should occur during the annual performance evaluation. This should be a discussion that not only allows the manager to set directives for the employee, but also provide the employee an opportunity to present his or her own ideas and voice any concerns about expected achievements. Creating this open exchange of ideas fosters a sense of ownership in the employee, and establishes expectations. The second meeting should occur approximately six months into the year. This is a chance for the manager to evaluate the employee's progress to date, and for the employee to discuss any significant changes or barriers to accomplishing the goals. If the manager feels it's appropriate, goals can be modified or removed to accommodate unexpected changes.

It is up to the City to decide how often these "check-in" meetings should occur. For example, the Town of Danville has similar meetings once per quarter (i.e., four times per year), but managers have met this practice with some contention because each evaluation takes up quite a bit of their time to complete. The important thing is to make sure that everyone knows what is expected of them throughout the year, and that management is aware of the progress so that appropriate action is taken to aid in the achievement of goals.

- **Create Specific Guidelines for Salary Increases** – This recommendation serves to remove subjectivity from salary recommendations as well as aids in the administration of the process. As discussed earlier in this document, there are several ways in which the comparator agencies determined salary increases. It is our recommendation that the City

create very specific guidelines that tie ratings to a specific percentage increase, while still providing a level of flexibility to accommodate special circumstances.

- **Remain Competitive to the Market** – While the determination of salary increases should be based on individual manager performance, it is still important that the salary ranges remain competitive to the market. Periodic market studies and/or annual COLA increases should be applied to the ranges, if appropriate, not to the individual salary.

Several of the comparators reported that despite having what they felt are strong performance-based compensation plans; the inclusion of an annual COLA increase to individual salary may be a deterrent to the success of the program. They stated that having both a COLA increase and merit increase removes the incentive that a purely merit pay program provides to employees. Certain employees took advantage of the COLA increase and did not go out of their way to try to excel.

- **Communication** – Clear communication is the impetus for change. All of the other recommendations above are based, in one form or another, on the idea that communication cultivates a climate of understanding and acceptance. Looking at each of the programs studied, standardized program development and the implementation of specific guidelines are keys to a smooth implementation process, but clear communication should be a part of the process every step of the way. In addition, an open mind to constructive criticism and re-evaluation is also essential. The City of Saratoga is a prime example of a well-designed program at a disadvantage from the onset due to lack of communication between City management and the City Council. As a result, the program was approved and implemented in a manner that, although it has all the elements to be successful, has only marginally improved productivity and has become a point of contention to the employees, rather than an incentive.

In order to avoid this same pitfall, it is imperative that Piedmont develop an implementation plan that involves open communication between all of the stakeholders and ensures that everyone involved is fully informed and understands the specifics before the finalized plan is approved. Not only does this ensure that everyone is on the same page, but it also fosters understanding and acceptance from those who may not be comfortable with the idea of a purely merit-based pay program.

- **Provide Tools for Ease of Administration** - One of the biggest challenges to a successful Performance Management program is time. The best-intentioned manager may find it challenging to carve out the time to develop and assess their employees effectively amidst other critical responsibilities. Organizations that provide tools to make this process as simple as possible tend to achieve greater results. One suggestion is the use of performance management software which allows an organization the ability to
- standardize the performance criteria, provide a consistent rating scale, measure goals and objectives, and assist in providing meaningful feedback for development. Incorporating an automated Performance Management system will prove to be a valuable addition to a program.

We'd like to reiterate that this report and our findings are meant to be a tool for the City to use in structuring an equitable performance-based compensation structure. In our experience, as well as the experience of those organizations surveyed, the above components are critical to a successful performance-based compensation program. Compensation strategies are designed to attract and retain excellent staff. Performance-based strategies are designed to motivate as well as attract and retain. Financial realities must also come into play when determining appropriate compensation philosophies and strategies. The collected data represents best practices that will provide the City with a guideline to make future performance-based compensation decisions. There are multiple approaches to creating a specific compensation plan however it is critical to align them with defined compensation philosophies and strategies. As the City moves towards the next phase of determining the direction of their program and implementation, we can assist in providing specific recommendations and alternatives.

As always, it has been a pleasure to assist you. Please contact me, after you have an opportunity to review the report, so we can discuss more fully.

Respectfully Submitted,
Koff & Associates



Katie Kaneko
President

APPENDIX I

Example of Behavioral Evaluation Criteria

The following is a basic and generalized example of a behaviorally based performance evaluation criteria. A real evaluation should be more detailed and be specifically tailored to the vision and values of the City. This example is here only to demonstrate what this type of evaluation would look like and should not be specifically implemented.

LEADERSHIP

Rating:

The evaluator will consider:

- a. Ability to function independently and demonstrate proactive behavior
- b. Ability to clearly and effectively communicate directives to a diverse group of employees
- c. Ability to delegate tasks to the appropriate personnel

EXCEEDS EXPECTATIONS (3)

Clearly demonstrated a high degree of independent decision-making, resource management, and highly effective communication. Displayed a clear understanding of the importance of delegation and demonstrated a superior ability to identify and delegate key tasks while managing diverse team members. Demonstrated an extremely strong ability to use independent judgment in complex situations without much assistance.

MEETS EXPECTATIONS (2)

Demonstrated a satisfactory degree of decision-making, resource management, and effective communication. Displayed some understanding of the importance of delegation, but may not have done delegated tasks as efficiently and effectively as possible. Demonstrated some ability to identify key tasks while managing diverse team members. May have had minor confrontations with staff that were amicably resolved. Demonstrated a satisfactory ability to use independent judgment in complex situations, but sometimes required guidance to complete the task.

BELOW EXPECTATIONS (1)

Demonstrated an unsatisfactory degree of independent decision-making, inefficiently managed resources, and struggled to effectively communicate with staff and superiors. Displayed little understanding of the importance of delegation, and often tried to complete tasks without help from lower level personnel. Demonstrated a weak ability to manage diverse team members, and was often involved in confrontations with staff that needed intervention from superiors to be resolved. Demonstrated little use independent judgment in most situations and often needed direct assistance to complete the task.

APPENDIX II

Summary of Performance-Based Pay Program Details