

## Theory to Practice

### Commentator

### Article

### Authors

*Howard Risher, PhD, is a private consultant who focuses on pay and performance in government, higher education, and healthcare. He has assisted clients at the federal, state, and local level. He is the author of Managing Employee Performance: Planning a Best Practice Approach, An IQ Report (International City and County Managers Association 2008), Pay for Performance: The Road to Success, An IQ Report (International City and County Managers Association 2007), and Pay for Performance: A Guide for Federal Managers (IBM Center for the Business of Government 2006).  
E-Mail: h.risher@verizon.net*

## Public Administration Review

Howard Risher, PhD

## Back to the Future? Performance-Related Pay, Empirical Research, and the Perils of Persistence

James L. Perry, Trent Engbers, and So Yun Jun

**M**Y views on performance-related pay and those expressed by Perry, Engbers, and Jun in the extended e-version of their article are not far apart. However, I am far more optimistic about the use of pay-for-performance systems in the public sector than they are. As background, I work as a consultant to both the public and private sectors. On two occasions, I also managed executive and employee compensation programs in a for-profit healthcare company and in a highly diversified corporation. I have dealt with pay for performance at all levels of government. I have had opportunities to discuss the concept with government officials in the United States and from a number of countries (as a consultant to the U.N.'s International

Civil Service Commission), as well as with union officials. I have been a student of the subject in the business literature and have followed the academic literature through colleagues. My writing has largely been for a practitioner audience.

That experience has convinced me that Perry, Engbers, and Jun are correct in some ways. To restate their conclusion, "performance-related pay [is] destined for a sequel," although the original story never ended. My reasoning is based on the following points that should be considered in planning future research.

**Performance-related pay serves an organization better than the alternatives.** Of course there have been prob-

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lems, but the alternatives are worse. The research has failed to consider the deleterious effect of the alternatives: step increases or across-the-board increases. Every employer has an ongoing need to adjust salaries in response to labor market trends. That forces all employers to make a choice: they can either treat every employee the same or they can differentiate, and if they choose to differentiate, they need a credible rationale. It seems no one is defending or for that matter questioning step-increase policies. There is a reason why the federal community and perhaps others use derogatory phrases like "living and breathing" in referring to the step system!

**The performance-pay philosophy is deeply entrenched in the U.S. culture.**

My point is not to argue that the philosophy is good or bad but rather that it is reflected in every aspect of our lives. The word *meritocracy* was coined long ago to describe this aspect of our culture. Hard work and good performance are to be recognized and rewarded. We select, celebrate, and honor "most valuable players" throughout our society. Characters like the fictional Walter Mitty and J. Pierrepont Finch appear regularly in literature, and the media constantly cover people like Bill Gates who have succeeded in their careers. People do not necessarily expect to "get rich" from their accomplishments, but financial rewards at some level are commonly associated with career success. As Perry, Engbers, and Jun note, public employees regularly express a preference for performance-related pay. The problems emerge following implementation.

**The pressure to improve government performance is not going to lessen.** Over the past 20 years or so, corporations have

reemphasized performance and results. Performance-related pay has increased in importance in the broad private sector. That philosophy is, of course, pervasive in sports and entertainment as well. That trend perhaps explains the support for the New Public Management (NPM) and the pressure for improved public agency performance. In that context, I have argued that public agencies have largely adopted the management practices proven in the private sector (such as the Balanced Scorecard). If agency performance is to continue to improve, public employers will need to explore strategies to realize gains through improved employee performance. Research has confirmed that employees can perform at significantly higher levels. Research some years ago showed that employers who adopt a new work management paradigm can expect productivity increases of at least 30 to 40 percent. Reports in the business press throughout the last decade confirmed companies were experiencing dramatic gains (Macy and Izumi 1993). Performance-related pay is widely perceived as a tool to tap that potential.

**Performance-related pay is virtually universal outside of government.** It is very difficult to identify a sector of the U.S. economy where performance-related pay is not the dominant policy. Most of the critics of the practice in the academic world work under policies that reflect the importance of recognizing and rewarding their accomplishments. I can imagine the reaction of the faculty if a university were to revert to a policy that relies solely on job tenure to grant salary increases. In sports and entertainment, we appear as a society to be very comfortable with paying the "stars" far higher salaries. Even the smallest "mom-and-pop" businesses rely on the practice in paying employees.

**Generation Y employees will expect performance-related pay.** This may not be proven at this point, but the argument is that these workers have grown up with video games that provide instantaneous feedback and rewards for good performance. Parents and teachers have lavished praise for their successes. They are accustomed as "latchkey children" to functioning with little supervision to solve problems. They are not going to wait patiently for tenure-based pay increases and promotions. Performance-related pay will be an issue in recruiting these workers.

These realities convince me that performance-related pay is not a "flavor of the month." It will see increased acceptance in the public sector—despite the internal opposition and the external critics. There will undoubtedly be setbacks, such as the decision at the Department of Homeland Security to halt implementation. But it will continue to gain acceptance in other agencies and other jurisdictions.

### **Direction of Future Research**

I also agree with Perry, Engbers, and Jun that a goal of research should be to determine why the policy is successful in some organizations and not in others. All employers would benefit if research led to a strategy that makes the policy change a win-win for employees and the organization. The implicit assumption in virtually all of the research is that all "merit pay" policies are the same. That is simply not true. The philosophy and the basic model—salary increases (and/or lump-sum payments) linked to performance ratings—are a constant, but the "contextual factors," to use the authors' phrase, make each organization different. Actually, following their argument, it would make sense to shift the research focus to the context in which the policy is implemented.

In defense of my conclusion, it is important to appreciate the dramatic changes in the way work is organized and managed, and the impact those changes have had on performance management practices and on performance pay. Managers and supervisors from the 1960s and 1970s would hardly recognize the world of work today. The changes started with the 1990 recession. The thinking behind performance pay is indicative of the changes. Not too many years ago the threat of denying an increase was the "incentive" to be a "good" employee; now the focus is on extra money for the high performers. The former naturally triggers anger and resentment. In hindsight, I find any conclusions based on research before perhaps 1990 suspect—the context has changed that much.

As Perry, Engbers, and Jun note, several researchers have concluded that the evidence is "mixed." I interpret this to mean that some employers maintain successful policies. One that stands out in my mind is Charlotte, North Carolina, which has linked pay increases to performance for more than a decade. The context there is very important—the city is managed "like a business," according to a former human resources (HR) director. The policy also was successful in the "China Lake" Naval research lab. A conversation with the lab's HR director some years ago suggested that the commanding officer may be the reason. He was the champion for the changes. Understanding the reasons for these and other successes would help public agencies develop strategies to make the transition. Interestingly, researchers have not paid much attention to the "successes."

One of the important questions, of course, is what is meant by "success." Perry, Engbers, and Jun use that word at several points in

this article. They and others have assumed that success means a "positive impact on employee motivation." I interpret that to mean the policy is intended as an incentive to "work harder." Significantly, consultants who deal with performance pay argue that the intent is to help employees focus on management's priorities. The phrase "work smarter, not harder" is sometimes used. In the discussions and decisions to define the criteria for assessing an employee's performance, the employee learns what he or she needs to do to earn a pay increase.

The expectation, of course, is that performance pay will contribute to improved performance. That unfortunately is difficult to confirm. In the private sector, the policy is too universal to develop comparative empirical evidence. The former HR director for Charlotte, William Wilder, contends that the transition to performance pay was important to that city's success. It would be useful to identify others who have been in leadership positions in organizations with a performance-pay policy and have "lived with" the policy for two or more years to see how they view the impact on the organization.

Perry, Engbers, and Yun note that when cash incentives are linked to results, performance improves. That is true with both individual and group incentives. Several years ago, I helped the Federal Supply Service, then the General Services Administration bureau that managed much of federal contracting, to plan and install a "goal-sharing" incentive plan. That is a group plan—all employees earn a payout—that links payouts to achievement of mission-related goals. It was a solid success. Charlotte has similar plans. Research on such plans in the business world confirms that incentives do work when the payouts are based on measurable results (National Research Council 1991). There is no reason to think the outcome

would be any different in other public agencies.

### **Government is "Different"**

I am sensitive to the argument that government is "different." From my perspective, a difference that is often overlooked is the emphasis to this point on performance. In business, the proverbial "bottom line" is a significant difference, almost an obsession in many companies, that influences behavior at all levels. Every employee in a company understands the importance of continued profitability. Businesses have a number of practices that reinforce the importance of successful performance. Public agencies tend to be a few years behind in adopting those practices, but any resistance can normally be overcome. Gore's National Performance Review as well as Bush's initiatives, starting with the President's Management Agenda, confirm that "business" ideas will be accepted.

Another fundamental difference is the emphasis on confidentiality for personnel actions in most nongovernmental organizations. Corporate policies have changed over time, but companies still treat pay as a private concern. The Internet and websites such as salary.com have made pay information much more readily available, but it would be unusual to find employees in a company discussing their respective performance ratings or salary increases unless they are good friends. I am not at all sure how often those conversations actually occur in a public agency. When they do, I suspect the employees who are satisfied with their rating are not the initiators of the conversation.

The lack of confidentiality puts supervisors in a difficult position that is similar to that of teachers who know their grades will be posted. The "hard graders" always stand out. A difference, of course, is that students can-

not file grievances. That reality imposes a higher standard for appraisal practices in government.

A third difference that varies from state to state is the presence of labor unions. Pay for performance is a threat to unions. When pay increases are based on individual performance, it undermines the collective support that is important to union leaders. Private sector unions are now rare and the bargaining units commonly are limited to manual workers. My impression is that public sector unions can delay the introduction of performance pay, but the trend is still very much alive. The teachers' unions have not, as a current example, stopped the push to move teachers to performance pay—despite their resolute resistance. In conversations I have had with union leaders, several expressed a willingness to acquiesce and agree to performance pay if there is a quid pro quo. They certainly understand the need to respond to concerns about improved performance.

A closely related difference is that public employees always seem to have someone in an elected position who will support efforts to kill or change proposed policies or procedures. That is unique to government. Frequently, professional associations assume a role that is similar to a union. That makes the process and the initial discussions with stakeholders a key to gaining needed support for change.

There is also the argument that public employees are not driven by pay. I am sure there is an element of truth to that. I am convinced the motivation for public service is important. However, I lived in the Washington, DC, area for a period and had more than a few conversations with neighbors who worked for federal agencies. By the

time they reached mid-career, had a mortgage, and were looking ahead to the cost of college for their children, they were not disinterested in how much they were paid. Unfortunately, the media attention on the compensation of corporate executives, physicians, sports stars, and entertainers feeds their dissatisfaction.

Implicit in the Perry, Engbers, and Jun article is the notion that people working outside of government organizations are not motivated by the professional challenges they face. Their argument suggests public employees are the only ones who are inspired strictly by the opportunities to serve a "higher calling." From my perspective, generalizations across a diverse group of people are always suspect. I am convinced most employees want to do a "good job" and be viewed as valued employees. They want to grow in their jobs and experience job and career progress over time. Actually, Gallup survey data suggest public agencies tend to have fewer employees who are engaged—37 percent versus 30 percent—and committed to the success of their organization, which to me should be a focal concern of top management.

An important aspect of the problem is the Lake Wobegone phenomena—we are all above average in our own minds. That becomes an important aspect of the problem when employers switch to performance pay. With a step-increase policy, performance ratings effectively have no consequences—positive or negative—so it is not surprising that supervisors do not take their responsibilities seriously. Actually, government supervisors approach ratings very much like many professors and public school teachers—granting inflated ratings is now expected. Tough graders and tough raters are both unpopular.

However, when everyone is rated at a high level, it nullifies the concept of performance-related pay and undermines the credibility of the performance-rating process. Despite that, as long as an employer relies on step increases, it seems no one complains. It does not seem to matter, that is, until an employer decides to transition to performance pay and the new policy prompts the conclusion that honest ratings are important. Yes, inflated ratings are then a problem. The standard logic in planning a pay-for-performance policy is that "an average employee should get an average salary increase." Average in this context means they are performing at the expected level; they are meeting expectations. The real problem, of course, is trying to figure which employees are truly exceeding expectations. When employees and supervisors know ratings in other work groups are inflated, a supervisor who is honest is disadvantaging his or her people. Plus, of course, employees feel better when they are rated highly, even if they know it is not justified. All this makes the transition years difficult.

The authors' argument that performance-related pay reduces intrinsic motivation seems to have emerged from laboratory studies that have little resemblance to actual work situations. First, salary increases are granted once a year and the actual difference between an average increase and that which might be granted to a star performer is nominal. For example, an average increase currently might be 3.5 percent and a "star" performer might see a 6.0 percent increase. That means a star with a \$50,000 base salary would earn a difference in weekly pay of \$23.55—that is before taxes. Pay increases, of course, compound over time so the advantage increases—high performance pays off—but it is difficult to understand how that undermines intrinsic motivation

throughout the year. This argument also assumes government jobs broadly are motivational. Public agencies have at least as many mundane jobs as industry. Actually, I would argue that jobs in organizations with performance goals and measurable results trigger greater satisfaction and motivation than those where the focus is on repetitious activities. The former are far more common in industry.

### **The Other Contextual Issues**

Aside from the legitimate differences noted above, however, it strikes me that the other contextual issues are "manageable": public organizations *can* take the steps necessary to overcome the resistance to the policy change. This is not meant to be a definitive list, but my experience tells me the following are important. If I were to suggest a research strategy, I would focus on how variations in the following influenced initiatives to switch to performance-related pay:

**Policy change champion:** Managers and employees need to understand that the change in policy is important to the organization. When there is a champion, he or she makes it clear that the change is a management initiative and not an HR initiative. David Walker, when he was the head of GAO, exemplified the importance of having a champion.

**Focus on performance planning:** When organizations develop strategic plans, install measurement systems, and adopt a cascading goal-setting process, it sends a message that everyone understands—performance is important. That contributes to a culture where performance is a shared priority. When an organization has realistic goals, employees generally want to contribute to the achievement of those goals. The phrase "line of sight" is used to de-

scribe the idea that employees can understand the linkage between their work efforts and the achievement of the goals.

**Manager and employee involvement:**

Traditionally, the planning for a new salary program or policy was done "behind closed doors." That has changed dramatically, but there is still a suspicion that employees should not be trusted. The level and nature of the involvement is a key consideration. Realistically, managers are the frontline for making the change a success. Managers need to "own" the system and/or process; they are in the best position to know what will be accepted. On a related issue, research some years ago by an Air Force group showed what may be obvious—job incumbents know their jobs better than anyone. They know what is needed for good performance. When managers and employees are involved in the planning, they will take "ownership" and help to "sell" the new system to their peers.

**Performance management versus performance appraisal:** There is a decided difference between these concepts. The traditional appraisal often was limited to a few checkmarks on a form and a brief meeting between a supervisor and one of his or her direct reports. Performance management starts with a planning session to define goals or performance standards early in the year, includes feedback and coaching throughout the year, and finishes with the completion of the form at year-end. If the manager has been effective, there are no surprises in the year-end review.

**Manager training:** Effective performance management requires the soft, behavioral skills to handle the planning, feedback, and year-end discussions. Too many employers limit manager training to an explanation of

the policy and instructions for completing the appraisal form. The training is an important investment.

**Performance pay for managers:** In industry, executives and managers have a lot riding on the success of the organization. They are rewarded well when their company succeeds. That gives them a reason to focus on the management of their people. They were expected to assume the responsibility when they first became a supervisor. They are not necessarily effective managers, but they are accustomed to managing staff performance and making the decisions governing their staff's compensation. Public agencies should reinforce the importance of this responsibility.

**Job-specific performance criteria:** Experience shows that the best basis for evaluating employee performance is an agreed-upon set of goals or objectives. People perform better when they have goals and it is relatively easy to agree on how the individual performed. That approach was first introduced over 50 years ago and has slowly been incorporated into the appraisal process for employees at virtually every level. Realistically, goal setting does not "fit" every job or every organization, but the track record confirms the value of investing in job-specific performance indicators. The same logic applies to the use of competencies so employees can identify with what is expected. The criteria through the 1980s were generally generic—for example, dependability, job knowledge, and teamwork. When supervisors are asked to evaluate an employee on generic criteria, it is not unlike evaluating beauty—the ratings are difficult to defend so they tend to be overly generous. The use of generic criteria as the standard of performance also suggests that performance management involves a compari-

son of employees, when the relevant assessment is how well an employee performed his or her specific job duties. The notion that it is a comparison is counter-productive.

**"Calibration" committees:** This is a relatively new idea in industry, although it was used a decade or so ago in the demonstration projects to "test" performance pay in Department of Defense research labs. The role of the committee is essentially the same as a promotion and tenure committee in higher education. It reviews at least the high and low performance ratings. In some situations, managers are asked to present the evidence and defend their ratings. The committee provides quality control and consistency.

**Communications:** Pay for performance sends messages that inform employees of management priorities; the most obvious is that senior management wants to encourage good performance. Corporations tend to place more emphasis on employee communications than the typical public jurisdiction. They are more sensitive to the importance of marketing and "selling" important organizational changes. In high-performance organizations, communications are used extensively to highlight results and achievements and to recognize the contributions of employees. Employers of choice typically make this a priority.

**Performance management software:** There are a growing number of software products available for performance management. The systems are designed to facilitate recordkeeping, collect feedback from others, and record decisions.

In my opinion, the performance management process is the foundation for performance-related pay. To be sure, there are a

few other context issues, such as the level of trust. However, when an organization makes employee performance management a priority, it is far more likely that a pay-for-performance policy will be accepted. Yes, public employers do have a higher standard for their appraisal practices. On paper, both private and public employers need solid, defensible practices. However, private employers find it much easier to live with ineffective practices because there is no oversight and problems are handled one employee at a time.

The higher standard applies to the performance criteria. The best practice is to define in specific terms what is required to be rated as "meets expectations," "exceeds expectations," or "failed to meet expectations." The GAO performance management system is based on this idea, with the highest rating level referred to as "role model." This answer makes it more difficult to justify inflated ratings, increases consistency, and also informs employees what they need to accomplish to be stars. That is a best practice for all employers.

### **The Broader Change Problem**

One of the federal failures is the Performance Management and Recognition System (PMRS) that ran from 1984 to 1993 for managers in the GS-13 to GS-15 grades. Under the policy, the new system relied on salary ranges that mirrored these grades, except for the absence of steps. That made it very easy for a manager to compare what he or she would have been paid under the GS schedule. That direct comparison was known to contribute to the problem.

In contrast, in the same period the China Lake demonstration project involved a new and very different salary structure based on the concept of salary bands. It had a new market-based philosophy and performance-

related pay. Repeated employee surveys over the next decade showed a high level of satisfaction. The program was made permanent as the first alternative personnel system a few months after PMRS was terminated.

Those concurrent "experiments" highlight an important consideration in moving to performance pay—it is best to eliminate all vestiges of the former program that give employees a reason to think about "what would have been." The prospects for success will be decidedly better if the new program involves a new performance management system and a new salary program. Perry, Engbers, and Jun allude to research evidence that supports that conclusion.

That introduces another important consideration—that the introduction of the new program is best understood as organizational change. At one level, this might be seen as a simple policy change, perhaps similar to the introduction of a new travel reimbursement policy or the introduction of a new accounting system. Unfortunately, some public agencies have treated it that way.

At another level, however, the change in policy involves a change in the psychological contract between each supervisor and his or her staff. Those relationships will be redefined permanently. The success of the new policy rides on the supervisor's willingness to assume this new responsibility. Very few management practices are this decentralized. A mixed record of successes and failures should not be surprising. The "technical" planning issues are straightforward compared to the process considerations. It may be the most difficult organization change a public employer can undertake.

### **Despite All of This...**

Please do not misinterpret my comments—research is badly needed. We realistically

know little about the factors that drive the success or failure of a switch to performance pay. The research focus has not changed much in 50 years. I feel strongly that the research prior to the early 1990s is no longer relevant. An analogy might be studying telephone usage prior to the Internet and the cell phone and reaching conclusions about how individuals communicate.

Clearly the transition is not likely to be a smooth one for public employers. There are many potential potholes and even the best plans can run into unanticipated problems. The history of how an organization manages pay is often more of an impediment than any immediate issues. Employees are naturally uncomfortable with change and it seems that in every situation someone is ready to throw fuel on the smallest spark.

There are clearly success stories but only a few have been identified and those have not been systematically studied. More often the focus is on the failures. At the federal level, GAO invested several years of work developing a state-of-the-art performance system and planning a new pay system. Those efforts received relatively little attention. Almost after the fact, a small group of employees decided they were dissatisfied with the way they were paid under the new system. They voiced their complaints to Congress and the agency recently was forced to modify its plans. GAO and its new pay system have received more media attention in the past three or four months than in the prior three or four years.

It would be useful to identify where and why a pay initiative derailed. But it would be more useful to understand the steps that contribute to successful implementation. This research could be based on the logic of the analyses that try to explain the practices that contribute to company success. The study

design would have to take into account multiple factors, such as those listed previously, to determine which are important to the acceptance of the policy change. That would help the agencies that follow down the pay-for-performance road.

Public agencies broadly are looking for ways to improve performance. There are frequent conferences on that theme. At this point there are no new technological breakthroughs on the horizon. If the improvement is to be realized, the key is workforce performance. Research again has confirmed that with a new work management paradigm, there is a significant potential to reach higher performance levels. More effective performance management and financial rewards should be an integral component of that strategy. The government context does make it more difficult. However, there have been enough entities reporting significant gains to know that focusing on the relevant context considerations contributes to better performance.

### **Will Performance Pay Payoff?**

I am frequently struck by the difference in the cultures between businesses and public agencies. There is a difference in the pace of work, in the "water cooler" discussions, and in the level of attention to the organization's successes and failures. In the public sector, there is a high level of interest in creating a "performance culture." Significantly, I have never heard that phrase expressed in the business world—it is taken for granted. Performance-related pay is not by itself going to create a performance culture. At the same time, it is for me almost impossible to picture a culture that emphasizes performance and continues to rely on an automatic salary increase policy.

There are a number of management practices that focus on performance and thus con-

tribute to a performance culture. Performance pay is not just one of the practices; it is the only practice that is consistent in reinforcing the importance of individual performance. In the absence of a performance-pay policy, the only option is to rely on managers to recognize the contributions of their people and to find ways to use non-cash rewards. Some are good at that, some are not. If my experience is meaningful, many will ignore it. However they proceed, it will be inconsistent.

Performance-related pay requires an investment in making the transition a success. That is why it is important to have a champion at the senior-management level. It cannot be treated as "another Personnel Office initiative." It also will take time to effect the needed changes, the most important of which is the way managers plan and manage the performance of their people. I disagree strongly with critics like Jeffrey Pfeffer who has suggested that this type of policy change is based on "hope, fear, dearly held ideologies, what others are doing, and what they have done in the past" (Pfeffer and Sutton 2006a, 42; see also 1999, 2006b). Significantly, Pfeffer agrees that pay can influence employee performance. His basic point is not that money is not a motivator; he agrees that it does. His argument is that "more frequently...such systems effectively motivate the wrong behavior" (Pfeffer 2007, 3). He set forth his argument in several publications over the past decade and recently testified before a congressional committee in opposition to performance-related pay for federal workers.

The "wrong behavior" contention is widely acknowledged among practitioners who plan compensation programs. Steven Kerr (1975), who gained prominence when he was instrumental in creating General Electric's executive education center, published a

frequently cited article, "On the Folly of Rewarding A While Hoping for B." Kerr makes the point that employers need to think very carefully about what they reward. The classic story involves the piece-rate incentives that focused on speed and quantity but ignored quality. It is an argument for job-specific performance criteria. Public employers tend to be highly diversified with different missions, key performance indicators, management styles, and cultures. Some agencies are better suited to more rigorous management practices. The pay philosophy no doubt needs to be the same, but there is no requirement that all agencies rely on the same rollout strategy.

One of the overriding near-term realities is that all employers, public as well as private, will be competing for talent in tight labor markets. With Baby Boomer retirements, the replacements for senior managers and professionals will be difficult to find. Several years ago, McKinsey coined the phrase "war for talent" to refer to the problem. There are several job families where public agencies compete directly with private employers—accounting, technology, and certain engineering specialties are examples. There are others that are unique to government. Salary increase rates could be significantly different. Nursing salaries, as an example, are already increasing rapidly—6 percent or more a year in some markets. The argument is that the better talent will be attracted to employers who agree to pay them for their market value and performance. Under these circumstances, public agencies will have to both compete for qualified talent and respond to the public's interest in finding ways to improve performance. The requirements are largely unavoidable. A well-conceived and managed performance-related pay policy is the alternative that can satisfy both requirements.

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