Pearl Meyer

TRENDS & ISSUES

The Latest Performance Management Trend — Will it Incentivise?

There has been a lot of debate recently among HR practitioners and companies about a revolutionary trend in performance management. It is a possible alternative to laborious and largely ineffective performance management processes and systems in place at many organisations today.

This new trend proposes three main tenets.

1. Make performance management forward looking (development focused) instead of backward looking (assessment focused).
2. Make the feedback more regular (weekly, monthly, project-based, etc.) instead of merely at the time of the annual appraisal.
3. Get rid of the annual ratings and make the immediate supervisors and employees more accountable in managing their own development and performance on an ongoing basis.

They, of course, work in cohesion with supportive elements such as real-time social media and technology facilitation, simpler process frameworks and less red-tape, leading to more conversations than forms and fewer objectives. Companies like Accenture, Dell, Medtronic, Google and Deloitte have come out as flag-bearers in this movement (CEB recently reported that around 6% of the Fortune 500 companies have changed their performance management systems by getting rid of ratings in the last three years)[1].

These changes have come about due to myriad reasons. One of the major issues with current performance management frameworks has been its lack of relevance for employees (e.g., cascaded objectives). Most employees and managers feel disgruntled as a result. In fact, CEB research found that 95% of managers are dissatisfied with the way their companies conduct performance reviews[1]. This results in little meaningful improvements in performance and at times, possibly even a decline in performance and employee engagement. The current process itself is often viewed as too time consuming and expensive (e.g., Deloitte estimated spending two million man-hours on it each

As published on Croner.co.uk

[1] "In Big Move, Accenture Will Get Rid of Annual Performance Reviews and Rankings", *Washington Post*, July 21, 2015

year)[2]. Over time, this annual appraisal and ratings system, often managed through a forced ranking distribution, has become the primary focus and is characterised by difficult conversations and few positive outcomes.

The proposed changes are not necessarily misdirected. To some, they offer an alternative style to the manner in which business has been conducted so far. However, most of these changes appear to be targeting challenges at a superficial level only. The aim here is to place the spotlight on underlying core issues that can potentially lead to long-term individual and business performance improvements.

Based on our experience over the years, we believe a prudent approach to managing performance and driving results through people can be achieved. It is vital to keep in mind that there are innumerable skeins, which play an important role. However, these are the six key aspects of performance management that we have seen helping organisations achieve greater efficiency and better results.

1. Understand and articulate your company's purpose for performance management.

HR professionals often articulate the purpose of performance management in their organisations to be "to improve performance", "to determine salary and bonus payouts", "to improve governance and objectivity", and/or "to drive organisational goals". All of which are perfectly reasonable objectives. Yet, somehow despite these varied goals, many organisations essentially have the same performance management and reward frameworks in place. This perhaps implies that if you have a four to eight "cascaded" balanced scorecard type objectives grid, a three or five points rating scale, a forced distribution or some form of "calibrated" allocation, an annual appraisal cycle, and a 360 degree feedback mechanism, you should in effect be able to achieve anything.

The reality, however, is that, in many cases, companies employ it not because of a planned and thought through purpose, but simply because it is considered to be "best practice" by successful companies in the market. As a result, companies try and replicate the systems, processes, structures in totality, without first focusing on what "their" core business goals are and how this framework could help them achieve those goals.

Consider an example of a client who did go through such a process and the solution we developed for them. This mid-sized multinational business services organisation had three different, but related, businesses. They had no formal performance evaluation process in place and reward programmes were rather discretionary. This system worked well when they were relatively smaller, independently operated businesses. Managers and employees knew what was expected of them and exceptional performance was easily identified, acknowledged, celebrated and rewarded. As the organisation grew bigger, teams also got bigger, different businesses were acquired, and the relationship between individual effort, business outcomes and reward became increasingly blurred.

[2] "Reinventing Performance Management", *Harvard Business Review*, April 2015

The solution, intriguingly, was in not applying the market best practice in comparable organisations. It began with an understanding of employees' concerns, discovering the barriers in addressing those concerns and then using market insight to explore different ways in which they could bring down those barriers. Group discussions were conducted in addition to one-on-one meetings and blanket surveys, and, unsurprisingly, key themes emerged quite clearly from across the organisation.

- Fairness (within and across businesses)
- Transparency (mechanism and application)
- Better linkage between role, effort and outcomes (at all levels)

These themes were then used as the cornerstones for a new performance-related reward framework. While it took six months to build and roll out and a year to operationalise the ideas and methods, slowly but surely performance results started to show significant improvements. Engagement scores improved by over 40%, turnover rates stabilised, business results improved, and, consequently, so did individual earnings.

2. Set simple, measurable objectives throughout the organisation.

Another big complaint from employees and HR practitioners is around goal setting. Many companies set overall company objectives and are able to keep them measurable and objective at the top, and perhaps a level or two below that as well. Quite often, companies use largely financial metrics, such as shareholder return, revenue, profit, volume, growth, market share, cash-flow, etc which makes goals and performance relatively easier to measure. Non-financial metrics where used, typically have low(er) weighting, especially where measurement is difficult. Once these are set, organisations typically have their respective business or functional heads "cascade" the same objectives down through to their departments. Systems, processes and messages are all designed around this paradigm. However, this often proves problematic as relevance, line of sight and an individual's ability to influence results begin to diminish.

For instance, the HR department is given a cost metric to build efficiencies, as improving profit margin is a key measure for the company. Every team from training and development to compensation and benefits to recruitment, are all given this objective. Subsequently, when the training manager, for instance, tells the staff that they need to cut training costs, it can lead to:

- Manager complaints around productivity issues or a lack of skills;
- Employees voicing disapproval about lack of development and growth opportunities, greater pressure and a lack of support;
- Customers feeling a drop in service or quality; and
- Revenue and profits starting to dip.

What has the company ultimately achieved and who is to blame? This becomes the "million-dollar" question.

In a recent case, we flipped the question on its head. The task of developing the HR team's scorecard started with what it was that they were supposed to do, then moved to the development of measurable "enhanced employee experience" based metrics for evaluating the HR teams' performance, and finally incorporated both cost savings and productivity measures into the scorecard. What is the difference between this scenario and the previous training cost-cutting example? The starting point. When the focus is cost — or anything else that is not directly the purpose of the job — the focus gets blurred and consequently the chances of success are marginalised.

3. Link objectives and goals to reward outcomes.

Quite often, reward outcomes, bonus awards and merit-based salary increases are linked to a ratings distribution. It is easy to place blame on ratings and the overall performance management system when employees are unhappy, despite the company spending a sizeable amount of money on what is internally branded as a performance-related reward. There are four main elements that need to be considered when linking reward to performance.

1. Setting goals that employees have an ability to influence.
2. Setting targets that are perceived to be achievable.
3. Providing meaningful sums of money in reward, especially for over-performance.
4. Ideally, funding pay-outs from profits rather than accruing a fixed expense.

Here is an example of how this was applied in practice with a client.

- Clear measurable goals were set for each team and level that were relevant and related to their job (e.g., within HR, the talent head had budget management, training take-up, training quality and productivity improvements as their goals, whereas a co-ordinator in the team had number of trainings on schedule, ease and speed of the sign-up process and staff feedback as their goals).
- Calibrated targets were then set against those goals at levels based on historical and projected performance, assigning threshold and stretch targets as well.
- The performance to payment ratio was then modelled for a higher proportion of the spend on over-performance than on under-performance (staying cost neutral).
- The weighting for overall company performance to team and individual performance reduced as you went down the organisational hierarchy.
- Non-financial performance goals were funded as a budgeted percentage of overall profits.

Interestingly, because employees understood their goals — both as individuals and as members of a team — and the links to the overall outcomes for the business, they accepted a controversial minimum company profitability threshold before any bonus was paid out.

4. Give employees the tools, support and freedom to achieve them.

Another common theme in many organisations is the clarity around goals and expectations. Employees often do not fully understand what would constitute the different ratings beyond what the standard HR guide suggests. At the end of the year, managers struggle to explain the rationale behind an average rating, as against a top rating. This causes disappointment. The company having spent time, money and resources on the performance management and calibration process, plus the resultant bonus and merit increase costs, may actually achieve very little, as many employees simply see it as an unfair consolation prize.

A large consumer goods company we worked with acknowledged this and worked hard to change it. They held a number of sessions with managers at all levels in all parts of the organisation to explain how the performance management system actually worked.

- Workshops were conducted for leadership teams and managers, presenting the framework and brainstorming on appropriate goals.
- Events were held for staff that covered the overall structure, how it translated into specific individual goals, what the different ratings meant and how they would impact reward outcomes.
- Brief and easy to understand manuals were handed out.
- External training sessions were held to assist managers in better managing difficult conversations.
- A dedicated online query resolution portal was set up during the first cycle to offer support.

Another change happened in implementation. Once they agreed on team goals with respective managers and identified levers for increasing outputs, managers were given the freedom to implement the plan within their teams. As long as the goals were measurable and contributed to the overall team goals, managers had the freedom to agree the goals with their employees. Managers received monthly reports on progress, so they knew how employees individually and the team overall was doing and whether or not, at mid-year, they needed to be reviewed (eg reallocation within the team, target revisions). At year-end, an employee self-assessment against goals was done and discussed with managers (obtaining additional information if necessary), who then decided final employee ratings within the overall HR guidelines.

After a year:

- Employee and manager requests for calibration and rating adjustments went down;
- There was increased trust in the potential and fairness of the system;
- Employee's productivity improved, especially during the first three months post completion of the year-end cycle;
- Engagement went up, whereas previously it had been descending; and
- Business performance improved.

5. Regularly monitor and measure programme effectiveness.

The narrative of many HR practitioners and business heads is about the ordeal, (i.e., the performance management process). It is rare to come across instances of celebrating positive outcomes and business improvements achieved through performance management.

The perpetuation of the narrative is caused by two main themes.

1. Resources are so engrossed and overwhelmed by the "task-list" of the performance management "process" that they simply lose sight of the end goal, let alone ever measure it.
2. Where good outcomes actually are achieved, they often go unnoticed because relevant information is rarely collected and the correlations are hard to establish.

A technology services client with more than 1000 staff members rolled out a performance management and performance-related reward framework with very clear measures for success.

- Employee experience (not engagement)
- Performance against targets (at all levels)
- Productivity improvements
- Bonus spend to revenue/profit ratio year on year

The HR team did this not only at an overall company level, but at all levels of teams down the organisation. They believed if these measures showed improvement, they could use that to sell performance management as an idea for success to their staff and managers. They picked out all teams that had done better than before in the first three months, and championed them across the organisation. The numbers increased consistently over the remainder of the year.

6. Marry it with other HR programmes.

More often than not, especially as organisations get bigger, a lot of programmes and functions within HR tend to form a life of their own. As you grow, it is almost necessary to give each of those aspects specialist attention, but it is also imperative to connect the dots and build synergies. Using performance ratings to feed into pay and promotion decisions is the obvious opportunity that is commonplace — albeit often mis-implemented — but that is where collaboration usually ends. Rarely have organisations been noticed using ratings to feed into longer-term skill and training programme development, linking high performance with high value creation for the business.

In working with a large manufacturing organisation to identify ways of improving the overall effectiveness of the HR function, planning began with articulating what the actual and perceived responsibilities of each of the HR departments were. This was followed by mapping any interdependencies and working out how current policies, programmes and processes would feed off each other to ensure employee experience and value of the HR function was enhanced. First, information was identified that was already available and could be fed from one department to another, such as:

- Business value creating and critical skill-sets were identified through a new job evaluation approach;
- Roles were defined using that criteria;
- Pay budgets and market positioning was weighted in their favour;
- Skills assessments were conducted to identify resource gaps;
- Training programmes were then created to close that gap; and
- Ongoing resource gaps were managed through close coordination between the recruitment and resource management teams.

Second, the “it is not our responsibility” attitudes were broken down by making shared goals a part of the HR department’s core measures of success. This meant a three-tiered goal approach, starting at the overall functional level, then at the interdepartmental co-ordination and support level and finally at the core departmental level.

The commonality in the above core aspects is simplicity. A common reason for failure in frameworks and processes is not in the principles, but in application. If the basics are in place and there is clarity in purpose, implementation efforts become easier to align, and success all the more likely to achieve.

About Pearl Meyer

Pearl Meyer is the leading advisor to Boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in New York, Atlanta, Boston, Charlotte, Chicago, Houston, London, Los Angeles, and San Francisco.

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