Chapter "XX"
Performance Management: What Are The Best Practices?

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In order to remain competitive, achieve strategic objectives and provide desired shareholder returns, companies employ strategies that convert concepts into reality. There is increasing evidence that demonstrates that the success of strategic plans is closely linked to the effectiveness by which people are managed. A research study of over 207 companies conducted by John Kotter and James Haskett at Harvard Business School found a very close correlation between the performance of companies and the practices that involve people in goal setting, focusing on results and rewarding performance.[1] This is fundamentally what the performance management process does. Kotter and Haskett referred to these practices as characteristics of the "performance-enhancing culture." There are many other studies that reach the same conclusion. However, in a major national study on the effectiveness of these practices by the Society for Human Resource Management and Personnel Dimensions International, the findings revealed that less than 40% of employees felt their performance management system provided clear goals, generated honest feedback and helped them improve.[2] If performance management is so important, why do organizations and managers struggle with the process?

The purpose of this chapter is to examine and understand the principles that are imbedded in highly successful performance management processes. In short we will examine "Best Practices" not in terms of who does what, but why some practices work and others do not. If one merely imitates what another company does, with the hope that these “Best Practices” will bring a similar value, failure is likely. There are many reasons why a particular element of the performance management process is successful. And, while there are many situational conditions that lead to success for some and failure for others, employing well established principles in the design and operation of one’s performance management process will significantly increase the likelihood of success.

Key Elements of the Performance Management Process

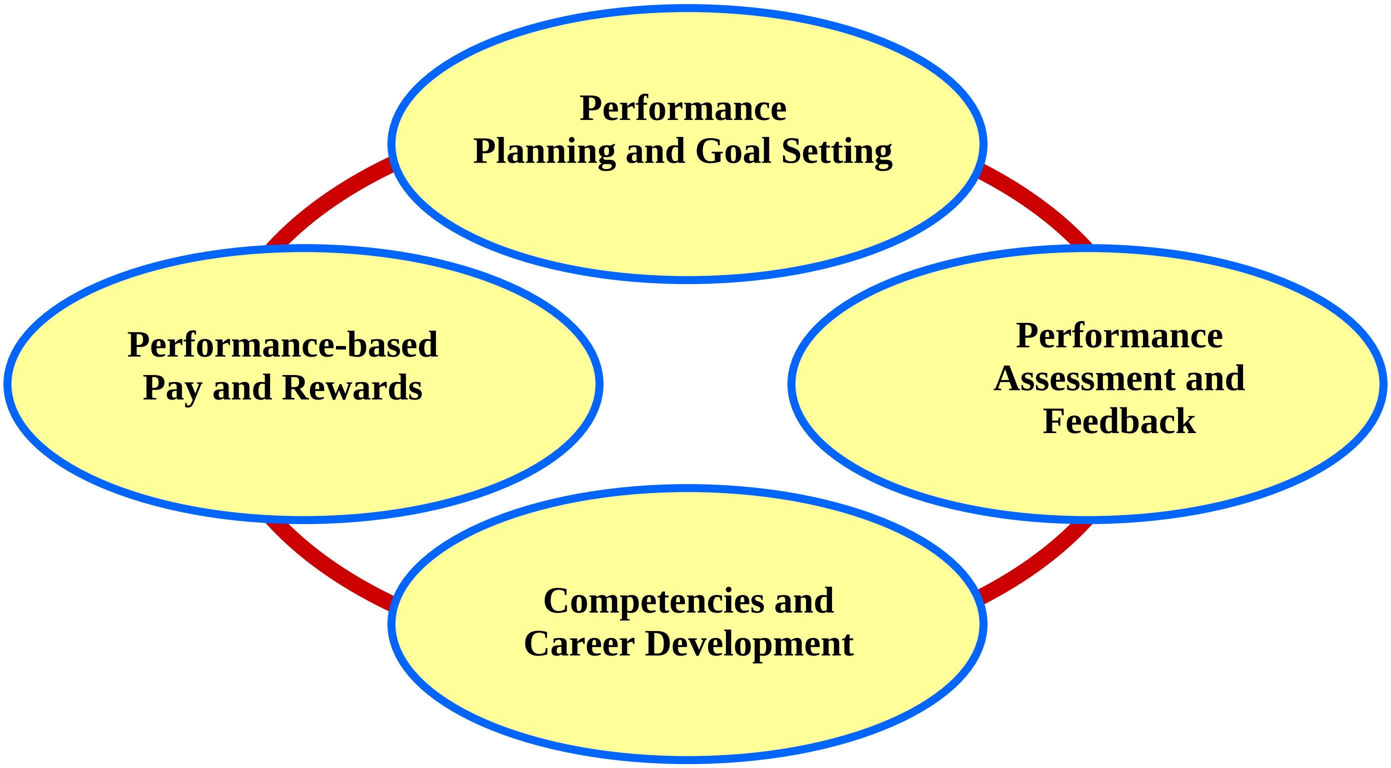
The process of performance management is well established. This is shown graphically in Figure 1. It contains the following four key stages:

> **Planning and Goal Setting**: This includes defining the individual’s goals and desired performance, using both quantitative and qualitative factors, linked to the performance expectations of teams, departments, and the corporation. This may include a direct line-of-sight to the company’s business goals or reflect the specific functions of a business unit or individual job within the organization.

> **Assessment and Feedback**: This includes tracking results, discussing how well things are going, and addressing factors that are inhibiting or propelling success. A discussion of results (i.e., what was accomplished) also need to include the process used (i.e., how they were accomplished). This may occur only at the end of a performance period, at one or two mid-year revues or as part of on-going communication. Finally, the outcomes of this examination may lead to adjusting one’s priorities and actions, as well as setting the stage for planning goals for subsequent performance periods.

Figure 1:

The Performance Management Process



Competencies and Career Development: Included in this stage is examining the effectiveness of the individual's knowledge, skills and abilities to perform their responsibilities to the organization. The process may focus on strengths and weaknesses in relation to performance and/or responsibilities as well as the degree one's unique abilities and competencies are being effectively utilized by the organization. This may also include specific plans for increasing the individual's capabilities, experiences and career advancement opportunities within the organization.

Pay and Rewards: The components of this stage include determining the level of rewards appropriate to the individual's performance and contributions. Rewards vary by organization and may consist of pay increases, bonus payouts, special awards, or other ways to directly recognize the degree to which the individual contributed to the company's (or business unit's) overall performance. For those who made little contribution or fell short of key performance goals, but not to the extent that continued employment is in question, then they will receive less than those who performed better.

These are the common stages of most performance management systems. The difference from one company to another lies in how these elements are performed. To understand the best practices we need to go deeper than just articulating overall elements of this process of management. We will therefore examine the underlying research on the key drivers of performance, and then outline guidelines needed to enhance the impact and effectiveness of the process.

Understanding Fundamental Principles of Performance Management

When one examines each stage of performance management process to determine what makes it successful, we find several common characteristics. When these stages are then integrated into a complete "system," then the process of performance management takes on an entirely different look and feel from traditional practices. These characteristics have been summarized into four (4) fundamental principles that are aligned with the stages as defined above.

1. **Goal Setting: <u>Effective goal setting is interactive and provides meaningful clarity, connections and commitments.</u>**

Goals are useful for defining the purpose of work, providing clear expectations and communicating priorities and focus for actions. They can help the individual see how her/his work is important to the broader organization and its customers, which is often a critical element of effective motivation. In the context of best practices, goal setting is the process that translates the organization's strategies, key success factors and priorities into actions that the individual can and should do. In many companies this is regarded as a "cascading" process, where one's goals are based on the performance necessary to achieve the goals of the next higher level organizational unit. This process creates the link between what the organization needs to be successful and how the individual can make an important, meaningful difference (also key to effective motivation).

Research on the setting of goals has provided some very useful concepts that can be applied to the performance management process. In a research study on goal setting, three groups were charged with improving their performance. One group was told to just improve; there was little additional direction. A second group was assigned specific performance goals, and directed to achieve these results. The third group participated in a formal goal setting process where they were given general parameters on performance, but they worked together to set their goals. The results were very clear. The group that participated in goal setting consistently set higher goals than the group where goals were assigned. Further, the participative goal-setting group achieved significantly higher performance. Both participative and assigned goal groups achieved higher performance than the group that was told to "do your best."[3]

2. Feedback: <u>It works best when it is "real time", objective, provided while in progress and linked to goals and rewards.</u>

In a traditional view, feedback consists of the manager's assessments of an employee's performance. These judgments are often based on subjective criteria, biased conclusions and inadequate information. In addition, feedback is often given to an employee long after the performance period is over. It is like giving someone the score after the game has ended. It is always frustrating to receive feedback when one can no longer have an impact on the results. In contrast, many sports give individuals feedback about performance <u>before</u> they go into a game or event, so they can use this information to win.

To understand what makes feedback work, we turn to another important research study on feedback.[4] This research study examined 126 applications of feedback systems in organizations. The data clearly showed that feedback alone <u>does not</u> necessarily improve performance. Performance was consistent when feedback was associated with an effective goal-setting process. However, when feedback was associated with meaningful goals and positive consequences (e.g., pay, recognition, or special awards), performance improved to a much higher level than when feedback was given alone. This research also reveals that rewards will not necessarily drive individuals to higher performance until the feedback indicates that the prospect of receiving the reward is possible.

In the more current view of the performance management, the best kind of feedback is when there is actual data about current performance that is not filtered by the judgments of management, but instead provides information on the causes of the results and highlights factors that are within the individual's control. The data is combined with discussions that focus on the factors that helped and hindered the performance at both the team and individual level. Further, feedback that shows progress toward critical goals has more meaning than just data. A company's use of this real-time feedback is essential if it is ever to achieve better results. Therefore, people need to have objective and interim feedback if they are ever going to be able to win.

3. Learning: A learning environment where managers coach individuals will lead to performance improvements and individual growth

A successful organization achieves higher performance in part because it uses its experiences to improve the process, create more innovation, and respond quicker to changes in the external environment. In short, one of the most important elements of effective performance management is the learning process it facilitates.

In a study by the Gallup organization of 101 companies on talent and how well people feel their talents are being used by their organization, only 20% indicated they strongly agreed. Research work conducted by Peter Senge and many others found that learning does not occur in an environment of fear and judgment. Rather, it is fostered when people are encouraged to try new things and to succeed or fail in a manner that respects the actions as well as the results. Some organizations have paralyzed themselves by a continuous focus on concrete results without mistakes. In these organizations, employees tend not to take risks or seek to create breakthroughs. In these environments, the negative consequences of “failure” are often more important than positive consequences of “excelling” in performance.[5]

Furthermore, there is exciting research that shows a strong fit between the work one does and capabilities one has to high performance.[6] This means that when the unique talents of an individual are employed in the work they do, they are very productive; in contrast, little can be done to "motivate" an individual to high performance if what they are asked to do is outside their core competencies. In this context, the role of the manager shifts from being the judge of performance gaps to the coach that both understands and seeks to find the best fit between the requirements of the organization and the talents of the individuals who are part of his/her unit. The assessment of performance is focused on understanding how one's strengths can be best utilized to accomplish the goals of the organization, and how to minimize or reallocate work that requires one to perform tasks from their weaknesses. If there is a gap for the business unit, then the manager examines and adjusts the staffing to maximize the unit's performance by maximizing the utilization of the people's talents. Mapping talents to tasks leads to higher performance than trying to focus on weaknesses.

4. Rewards: <u>Rewards work when they are meaningful and truly earned.</u>

There is a common belief that if people are given clear goals and regular feedback, then that is enough to motivate the achievement of high levels of performance. As shown earlier, there is significant research that refutes this assumption. Instead, what works to achieve the best performance from individuals is to link meaningful rewards with the goals and feedback on performance, especially in areas that utilize her or her core talents. If individuals expect that they will be rewarded, intrinsically (by one's own internal criteria) and/or extrinsically (appreciation shown by others), then they will associate positive personal benefits with the work that they do. This is simply called positive reinforcement.

Research on human behavior is very clear and overwhelming: When individuals associate a positive consequence with the goals and feedback and see the probability of achieving this consequence as high, they respond. They often take greater discretionary effort when the consequences are viewed as positive, desirable, and meaningful. However, an entitlement culture emerges when people lose the connection between their performance and the rewards they receive. [7]

In the context of best practices in performance management, we need to look beyond pay raises as the primary reward mechanism, especially since the increase amount is minimal for most organizations (between 3.0% and 5.0% of salary). Consider what people really value from their work environment: public recognition, private appreciation, greater job challenges, expanded responsibilities or control over resources, promotion, professional development, work schedule flexibility, bonus payouts, participation in equity programs, etc. If one earns these rewards when they achieve desired results and/or make desired contributions, then they will tend to find more meaning and value in their work. This leads to greater commitment, enjoyment, growth, and success.

Integrating Best Practices into Performance Management

If an organization wants to develop a model for performance management based on these best practices principles, one will need to assess the current policies, programs and practices in light of the information presented above. Then, implement a design and development process to devise a new model engages executives, line managers and employees. While the scope of this chapter does not permit a full discussion of the tactics for achieving this change, the guidelines outlined below offer some assistance to this effort. These guidelines can serve as a decision-making framework for developing an enhanced approach to performance management.

1. The purpose and approach should reflect the company's core strategy and values.

It is common knowledge that executive leadership involvement is critical to the success of any management process. When the performance management process is seen as providing value, a return that far exceeds its requirements, it is more likely to be used effectively. Therefore, the basic design of performance management needs to be structured in ways that resonate with key executives as well as with managers and employees. The approach should resolve several key questions about how performance will be managed within the organization. To be specific, will the process address:

a. Individual or team performance?

b. Results (what) or behaviors/process (how)?

c. Job responsibilities or individual competencies?

In most cases, an organization wants to say "both", e.g., results and process. The challenge is then how to effectively integrate these factors into a simple to understand and use process. For example, let's examine the question of results versus process. Most managers want systems to focus on results, but most of the performance problems they face relate to behaviors individuals use to achieve certain objectives. The process needs to find the right balance on each. To understand this parameter, consider the following:

One should place a major emphasis on results when:

- The team members are fully competent to achieve the results;
- There is a short time duration between the actions of team members and the results;
- The results are a clear function of the team members' actions, with limited external influences.

One should place a major emphasis on behaviors or actions when:

- People are implementing new processes or learning new skills;
- There is a long delay between the individual's actions and the results; or
- There are many factors that influence results that are out of the control of the individual.

2. The criteria for measuring performance should "personalize" the firm's strategy, goals and business priorities.

Performance measures and goals are at the heart of every effective performance management process. Without clear and meaningful measures, the effective use of feedback, reinforcement or rewards cannot be provided. In the ideal model, measures provide direction and create opportunities to monitor progress and reinforce achievements. Further, they provide a line of sight between what an individual or team does and the competitive strategy of the business (e.g., revenue growth, customer satisfaction, costs, delivery performance, quality). In this context, the nature of the measures and how they are used need to be determined. Consider the following:

a. Will performance assessment be based on goal achievement or assessed against a set of performance criteria? Objective measures are those that reflect the number of units produced, the time it takes, and the resources (i.e., people, money and materials) used.

Judgment or criteria-based measures are those in which someone outside of the team is assessing how well an outcome was achieved. These measures are used for project milestones, the acceptance of a product or service, and to determine whether certain procedures were followed.

b**.** Will goals be based on improvements from the previous period, in relation to an external reference or standard, or a strategic requirement of the company? This means determining the frame of reference for the goals and measuring performance are critical to creating meaningful, credible expectations.

c. How will people be involved in setting goals? The research shows that involvement leads to commitment which leads to higher performance. But, in some work settings and jobs, the requirements are very clear and dictated by the commitments of the organization – to customers, to regulators, to shareholders. In other jobs, there is a great deal of flexibility about how work is performed, but the goals need to be met. The key question is how. The level of involvement by individuals should be based on the degree of flexibility permitted by the work—jobs with greater flexibility require people to be highly involved in setting goals and performance standards.

3. The timing and process of providing feedback **<u>needs to be real-time, meaningful and multi-dimensional.</u>**

Feedback is essential to providing business units and individuals with information to encourage them to continue or adjust their actions. Feedback means data that is communicated in a manner that is understandable and relevant to individuals and the actions they take. Consider the following issues in determining what and how this information is delivered:

a. Will the feedback be ongoing data (e.g., hourly, daily, or weekly reports on results), be based on critical incidents (e.g., when internal or customer-based problems occur, or milestones are achieved), or a summary of data from a variety of sources?

b. What will be the sources of feedback data? In traditional appraisals, the source is the manager's judgment. In best practices performance management, feedback comes from multiple sources. Many companies are exploring feedback from peers, as well as other staff and subordinates. This is often referred to as 360-degree feedback because the information is coming from all directions. When data comes from multiple sources, it provides rich information for determining achievements and the causes for meeting or missing the desired performance.

c. How will feedback information be provided? Feedback that is data-oriented and generated from reports is usually provided to the team directly and then discussed. This feedback may relate to the quality of products/services, on-time delivery performance, financial performance, or similar information. When the manager summarizes, synthesizes the data and interprets its meaning or importance, the dialogue will be about what led to achievements or what barriers prevented the achievement of desired performance.

d. When will the feedback be provided? The timing involved in providing feedback should relate to the nature of the data, but the data must be provided as often and quickly as it is available. Obviously, the timing depends on what is being measured. The dynamics that enable timely, effective feedback include the particular level of data that can be shared, as well as the systems within the organization to collect, process and distribute this information.

The key objective is that feedback must provide employees with information they can use and keep in focus as they do the work. Feedback needs to be linked directly to the goals of the unit and the company. In addition, feedback should create opportunities to reinforce progress, and to learn or pursue alternative actions. Finally, feedback can be the catalyst for important discussions and great fun if used creatively and constructively. This increases the connection between the feedback and reinforcement or positive consequences one receives from examining this information.

4. **<u>Identify current learnings and opportunities for developing the person's unique abilities.</u>**

Earlier in this chapter we discussed how the feedback creates opportunities for learning. Reviewing the performance is perhaps one of the most critical aspects of the performance management process. It is where all the feedback data are examined to create understanding, learning, and commitment to action. There are several dimensions to making the "learning" process effective.

a. What is the purpose of review meetings? In the ideal performance management model, the purpose is to analyze the data, learn from the experiences, identify ways to improve performance and celebrate achievements. This means they are not just done annually, but are integrated into the communication process of the unit and manager.

b. What should be discussed in review meetings? This depends on what data are available and what is important to the learning process and improving performance. In this new approach, the managers and teams should capture multiple sources of feedback and discuss their meanings and implications. The focus will be on understanding root causes, problem solving and action planning. The manager's job is to help individuals understand the significance of the information and the strategies for improvement.

c. Should a review meeting include a discussion of ratings, rankings or summaries of performance? Traditional year-end review meetings often focus on a composite of performance. Some organizations use a number, other letters, and others use words. This single rating was used to determine the merit pay increases. The next section will discuss how to make the pay decision, but at this time, one needs to determine how the performance can be summarized in a manner that supports effective decision making about rewards.

d. What documentation is needed and why? The documentation of review meetings is part of the normal process of summarizing key points, learnings and commitments. Documentation can be an important reminder of agreements made by the manager and the employee. It should not become a legal document, but care must be taken to assure the information is appropriate if it is reviewed publicly or used for employment decisions.

5. <u>Link meaningful rewards with contributions and achievements.</u>

Perhaps one of the most difficult, conflicting parts of the performance management process is determining whether and how performance should be linked with compensation. If they are linked, how can this be done so the non-compensation elements can be kept in balance? Let's examine the key decisions to determine the "right approach" to this linkage:

a. Should there be a direct link between performance and pay? If they are linked, the difficulty is that focus of year-end review meetings is all about justifying the pay increase. If they are not linked, then managers and employees wonder how the performance evaluations relate to pay decisions. Another approach that is gaining interest is to link pay and performance, but separate them in time. In this case the performance reviews are summarized, and a manager makes a recommendation on a performance rating or pay increase (before telling the employee). These ratings or recommendations are then collected, analyzed for their cost impact and justification, and then modified/approved. Then, the manager has another, briefer meeting with his/her employees to discuss the pay increase. This allows the organization to make pay increases where limited amount of dollars can be allocated more effectively than a process where pay guidelines are known up front, and the performance ratings are used to control merit pay increase budget.

b. Should performance be the basis for determining pay increases? In pay systems that base increases on competencies or skills, seniority, cost of living, or the external market, pay is more related to factors other than job performance. In the new model, the manager makes a judgment on the pay increase using a full range of considerations, such as the person's performance, his or her improvement in performance, pay relationships with peers, market competitiveness, and the available budget. The amount is up to the manager, as long as he/she does not exceed a pre-determined budget.

c. How can results based performance and individual competencies/talent be integrated? Although there are many facets to this question, a simple approach is to tie the base pay increase to a combination of results (i.e., what was accomplished) and individual competencies employed (i.e., how they were accomplished). This technique utilizes a salary-increase matrix with two dimensions--results performance and individual contributions. One dimension summarizes the performance achievements (clear outcomes) of the individual or team. The second dimension summarizes the individual's contributions or use of one's talents. The intersection between these two dimensions

> provides the “target” pay increase. The actual pay increase may differ because of external factors like spending plans, level in the salary range, etc. Another alternative used by some companies is to use both team/unit and individual performance to determine one’s bonus payouts, but use the merit pay to reflect the contributions one made to the group’s results or the growth in competencies employed. Hence, these firms integrate the bonus and merit pay systems into their performance management process, but keep the type of measures used by each reward system clearly distinct.

If this process is managed well, it can affect the organization's performance in very positive ways. The combination of factors determines the amount of pay increase that one would receive. This simple approach to adjusting pay increases the linkage between the person and the organization’s performance, but uses a broader view of the factors that lead to superior organizational performance. Plus, using the full range of rewards that are meaningful to the particular individual provides a more robust and effective process to linking performance achievements and rewards.

Summary

Albert Einstein once said that we cannot solve our problems with the same thinking we used to create them. Understanding the underlying principles of why things work is essential to building a process that works for the organization. These guidelines to performance management require leadership that goes beyond articulating a vision. This approach involves the active implementation of strategies, plans, and measures that provide a framework for people to receive feedback and be reinforced for their contributions. In short, this presents an action-oriented, “enhanced” model for managing people.

The focus of this effort is not on the outcome or evaluating or appraising performance. Instead, it is about the active management of the process and the ongoing learning opportunity. The process is not about motivation in some carrot and stick fashion, but it is about creating real circumstances where people are valued and rewarded for what they do. It changes the role of manager from judge to coach, the role of human resources from compliance officer to consultant, and the role of executives from goal setter to sponsors and leaders of competitive, purposeful strategies.

The new performance management process has been devised because organizations need the full commitment of their work force. They need to create conditions that reinforce the work force's contributions for those aspects of the firm that improve its ability to compete. The organization will thereby achieve or retain its leadership role in the marketplace, and people will feel truly valued for their contributions.

Footnotes

[1] Kotter, J., and Heskett, J., Corporate Culture and Performance, Free Press, New York, 1992.

[2] "Performance Management Study," by the Society for Human Research Management and Personnel Dimensions International, New York, 2000.

[3] Locke, E and Latham, Gary, A Theory of Goal Setting and Task Performance, Prentice Hall, New Jersey, 1990.

[4] Latham, G. P., & Wexley, K. N., Increasing Productivity Through Performance Appraisal. Reading, MA: Addison-Wesley, 1994.

[5] Peter Senge, The Fifth Discipline: The Art and Practice of the Learning Organization, New York: Doubleday/Currency, 1990).

[6] Buckingham, M. and D. Clifton, Now, Discover Your Strengths, Free Press, New York, 2001.

[7] Thomas B. Wilson, Innovative Reward Systems for the Changing Workplace, New York: McGraw Hill Professional Publishing Co., second edition, 2003).