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Performance Management:

Getting It Right From the Start

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Abstract

Establishing a company performance management system is a significant undertaking. HR practice leaders have grappled with this issue for decades, and academic and professional journals contain a plethora of ideas and approaches on this subject too numerous to count. Clearly, there is no one-size-fits-all solution for any organization. Each organization is unique and must find its own niche in the marketplace. However, most would agree that whether our organizations are large or small in revenue or in human capital, there are certain fundamental criteria that could apply equally. This article discusses certain "*critical success factors*" that every organization interested in *getting it right from the start* may wish to consider when formalizing a performance management system.

Performance Management: Getting It Right From the Start

Most would agree that establishing a company performance management system is a significant undertaking. But how can you ensure that you get it right from the start? HR practice leaders have grappled with this issue for decades. Academic and professional journals abound with ideas and approaches too numerous to count. Yet making recommendations and choices about program components from among a perplexing number of growing choices and their associated variables remain a dilemma.

What we do know for certain is that a steady shift has occurred over time in the workplace in relation to human resources. Work now requires more knowledge and skills than ever before, i.e., organizations are more dependent on human capital as an intangible asset (Figure 1).[1, 2] As a result, organizations are, or it would appear they should be, interested in optimizing the way this asset is managed. Establishing an effective performance management system is an organization's way of doing just that. After all,

> "*…a great deal of theory concerned with human motivation and human development argues that an effective performance management system should be a key building block of every organization's human capital management system. To tie performance to rewards (the key to motivating performance), organizations need to have accurate measures of individual performance. To develop, individuals need feedback about their strengths and weaknesses. Organizations, meanwhile, need performance information to direct their training and development resources to those individuals who can gain the most by them. Finally, organizations need performance information to correct performance problems and assess the effectiveness of their improvement efforts.*"[3]

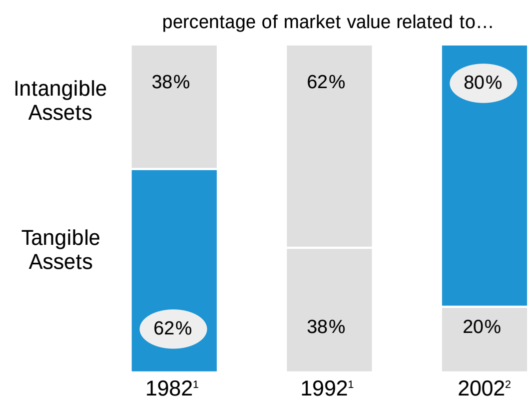
1 Blair, B. E., & Kochan, T. (2000). *The new relationship: Human capital in the American corporation.* Washington, DC: Brookings Institution Press.

2 Kaplan, R., & Norton, D. (2001). *The strategy-focused organization: How balanced scorecard companies thrive in the new business environment.* Boston: Harvard Business School Press.

3 Lawler, E., & McDermott, M. (2003). Current performance management practices. *WorldatWork Journal, 12, 2,* 49-60.

Figure 1 **Why Is It so Difficult to Execute Strategy?**

The source of value has shifted from tangible to intangible assets.



1. Brookings Institution analysis of S&P500 companies

2. Kaplan & Norton

Background

However, many of us have heard the adage, "the road is paved with good intentions." Based on a review of pertinent research studies, it would seem then that a parallel could be drawn between performance management systems and corporate business plans. According to Robert Kaplan and David Norton, the authors and developers of the Balanced Scorecard, less than 10% of all strategic business plans are effectively executed. Companies worldwide are facing unprecedented competitive pressures. Whether we are ready or not, competitive pressures will force the transformation of the performance management function in most organizations. In fact, the compensation function in organizations with high-performance work systems (HPWS) is already showing signs of change. These organizations understand that pay and performance management can play a strategic role in attracting and retaining key employees, and they are beginning to engage in innovative approaches to performance management to improve business performance. As a result, HR practice leaders specializing in total rewards management are now required to have a thorough understanding of the business in order to align performance reward programs properly.

Finally, while companies worldwide want their employees to perform well across the board, there is an increasing focus on key talent—those critical few employees who, by virtue of their skills, will and do play an important role in creating shareholder value. How will organizations go about identifying, rewarding and retaining this talent? These are the individuals who form and maintain pivotal relationships with customers, fulfill the vision for the organization, lead and motivate others, establish goals, remove obstacles, identify resources and tools, and know when it's time to move new leaders forward who can make a difference.

Making the Business Case

HR practice leaders have long held the belief that a company's performance management system can lay the foundation required to support the strategic planning efforts of the organization. Although the empirical research to support these hypotheses and demonstrate the economic impact of performance management activities is limited, there are credible research studies available to amply demonstrate what can be accomplished when a qualified plan is placed in motion. Four of these studies are highlighted here.

Corporate Culture and Performance Study

This groundbreaking 11-year study included more than 200 companies from 22 industries and compared financial and operational performance measures of companies with performance-enhancing cultures to those companies whose cultures did not exhibit performance-enhancing characteristics. It demonstrates how unwritten rules and/or shared values can either lead to the success or to a failure to adapt to changing markets and the environment (Figure 2).[4] As the authors point out, fundamental to the process of establishing a "performance-enhancing" culture is effective leadership.

High-Performance Work System Index

The second study, which was based on 429 firms in 1998, is actually the fourth biennial survey (i.e., prior survey years: 1992, 1994, 1996) representing a combined total of 2,800 firms. As with the previous study, this survey compared specific HR management policies and practices determined to influence the quality of high-performing employees over an extended period of time. Survey results for the bottom 10% of firms (42) versus the top 10% of firms (43) were compared. At the conclusion of the study, the results totaled $158,101 versus $617,576, respectively, in sales per employee, versus $3.64 to $11.06 market value to book value per share of stock, and a turnover rate of 34.09% to 20.87%, respectively. This distinction represents a 391% return on investment for the

Figure 2 Impact of Performance-Enhancing Culture on Corporate Performance

	Organizations With Performance-Enhancing Culture	Organizations Without Performance-Enhancing Culture
Revenue growth	682%	166%
Employment growth	282%	36%
Stock price growth	901%	74%
Net income growth	756%	1%

From "Corporate Culture and Performance," John P. Kotter and James L. Heskett, p. 78

4 Kotter, J., & Heskett, J. (1992). *Corporate culture and performance.* New York: The Free Press.

top 10% of firms. How was this accomplished? According to the authors, "*the most striking attribute of these comparisons is not any one HR management practice—it is not recruiting or training or compensation. Rather, the differences are much more comprehensive—and systemic … the very best firms in our sample are much more likely to have developed a clear strategic intent and communicated it effectively to employees.*"[5]

Current Performance Management Practices: Center for Effective Organizations / University of Southern California

This 2003 survey of 55 HR managers from medium and large companies, mostly members of the Fortune 500, was conducted by the Center for Effective Organizations at the University of Southern California (USC). As noted by the authors, there is little research data to establish the impact of many practices recommended in the writings on performance management, nor is there much information available to HR practice leaders about what companies are actually doing at this time. This study attempts to bridge the gap between these two voids. A representative sampling of the data collected and resulted is provided in Figure 3.[6] This particular dataset suggests that senior management plays an important role in the establishment of the performance management system in most companies. However, the findings also indicate that, as a general rule, there is little accountability in relation to how well managers may or may not do appraisals, nor are there "calibration meetings" in use for comparison purposes to ensure the validity of the system companywide. Interestingly, there is a strong direct relationship between leadership by senior management and ownership of performance by line management, and in favor of the use of calibration meetings as part of the performance management system. That is, the stronger the leadership by senior management, the more likely line management took ownership of their performance. As such, the authors concluded that senior and line management ownership in the performance management system should be fostered, to include accountability for the completion of the performance appraisals in keeping with company requirements, as well as their calibration corporatewide to check for rater bias.

5 Becker, B., Huselid, M., & Ulrich, D., (2001). *The HR scorecard: Linking people, strategy, and performance.* Boston: Harvard Business School Press.

6 Lawler, E., & McDermott, M. (2003). Current performance management practices. *WorldatWork Journal, 12, 2,* 49-60.

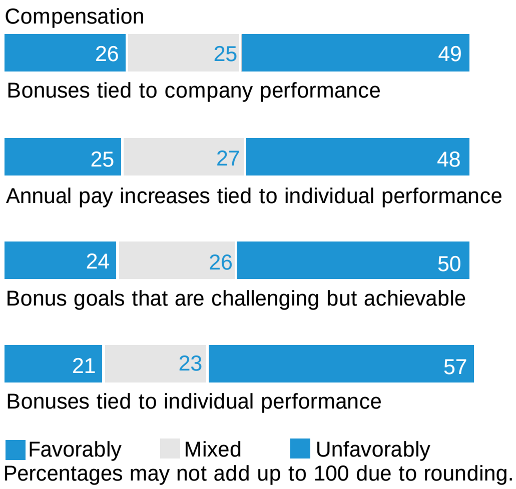
Figure 3 Managerial Behavior

	Percent Frequency						Correlation Coefficient	
	Little or No Extent	Some Extent	Moderate Extent	Great Extent	Very Great Extent	Mean	Perf. Management System Effectiveness	Differentiation Effectiveness
Leadership by senior management	5	13	16	35	31	3.7	.63***	.47***
Appraisal of how well managers do appraisals	54	15	22	6	4	1.9	.51***	.31*
Calibration meetings that compare ratings of the effectiveness of the system	24	18	18	20	20	3.0	.33*	.37**
Measures of the effectiveness of the system	20	36	15	18	11	2.6	.60***	.33*
Line management participation in system design and development	16	20	22	27	15	3.0	.39**	.25
Ownership of performance management by line management	6	19	28	31	17	3.4	.72***	.43***
Ownership of performance management by HR	9	16	22	31	22	3.4	.22	.08

Note: For Correlation Coefficients   * = Significant at the .05 level.   * * = Significant at the .01 level.   * * * = Significant at the .001 level.

Figure 4 **Employee Views of Pay**

Percent of employees rating company plan



Source: The 2003 Towers Perrin Talent Report.

Working Today: Understanding What Drives Employee Engagement—The 2003 Towers Perrin Talent Report

The fourth study, completed in April 2003, represents the views of more than 35,000 employees in U.S. companies, and updates and expands a prior study completed just two years ago. As noted in the study, engagement remains the ultimate prize for employers, and the "endgame" is the same for everyone: discretionary effort. Competitive advantage has become a difficult goal to achieve and an even more difficult advantage to retain. Building momentum through an engaged workforce takes more than an expression of management commitment—what leading employers are learning is that consistent management practices in a positive and challenging work environment, day in and day out, make the difference. Highlights from this report in relation to how employees view their pay and bonus programs are summarized in Figure 4.[7]

Performance Management—Critical Success Factors

Periodically, a question will be raised about why people are so fascinated with monitoring the popular press on which companies have topped the list of *America's Most Admired Companies (AMAC)*? By way of background, to be eligible for consideration, a company must be listed on the Fortune 500. From there, a questionnaire is sent to more than 12,000 executives within the companies, to include their respective board members, and the financial analysts who represent that particular industry. Ballot recipients then vote within their respective industry. The Most Admired Companies in America study ranks participants based on eight key attributes; a ninth is added for the Global Most Admired Companies Study (see Figure 5).[8] A company's final score is the average of all the scores that the company receives on the various attributes. If the financial indicators are separated, four out of the eight or nine remaining attributes speak to what the human resources or the human capital assets contribute to the organization: innovativeness, the overall quality of the management, the ability to attract and retain talented people, and the quality of the products or services. The success of each of these factors is ultimately dependent on the people that are engaged, the opportunities for growth and development offered to them, and the degree of focus the organization is able to maintain over time. But, getting back to the original question—over the last five years, shareholder returns for AMAC have been 26% versus 11% for their peer companies, or two and a half times the return.

Figure 5 **Fortune Survey of Most Admired Companies**

Eight key attributes:

1. Innovation
2. Quality of management
3. Long-term investment value
4. Social responsibility
5. Employee talent
6. Quality of products or services
7. Financial soundness
8. Use of corporate assets

Global organizations only:

9. Effective global business performance

Getting It Right From the Start

A number of parallels can be drawn between the findings of the AMAC study, in particular, and the research studies provided earlier in this article. There is no question that there are many paths that can be taken and serious commitments made to the design, development and implementation of

7 *Working today: Understanding what drives employee engagement—The 2003 Towers Perrin talent report.* Towers Perrin. Retrieved December 19, 2003, from www.towers.com/towers/webcache/towers/United_States/publications/Reports/Talent_Report_2003/Talent_2003.pdf

8 Stark, M. (2002). Five years of insight into the world's most admired companies. *Journal of Organizational Excellence, 22,* 1, 3-12.

a formal performance management system within one's organization. There are no *one-size-fits-all solutions* for any organization. Each organization is unique and must find its own niche in the marketplace. However, most would agree that whether our organizations are large or small in revenue or in human capital, there are certain fundamental criteria that could apply to all equally. The following "*critical success factors*" are recommended as ground zero for all organizations serious about establishing an effective performance management system and *getting it right from the start*.

Critical Success Factors:

- ***Mirror your corporate culture and values***—Ensure that the core values and beliefs important to your organization are fully integrated into your performance management system.
- ***Design development and planning phase***—Make provisions for executive involvement by having ***visible CEO and senior management*** support from the outset. This will facilitate buy-in and companywide acceptance for the process. Include management and employees in the design phase to ensure that they understand the process from the ground floor up and are active contributors.
- ***Focus on the right company performance measures***—Agree as a team on those **"*vital few*"** measures (the core 10 to 20) that will give your organization a clear *line of sight* and the highest degree of confidence it needs to determine how well it is doing in relation to major goal achievement. These are the measures that should be shared with line management and synchronized with other reporting processes to keep the entire organization informed of its progress in relation to all other supporting goals and objectives.
- ***Link job descriptions to the performance management system***—Ensure that your employees can see the ***direct relationship between the job competencies*** they are required to bring to the job, their job descriptions, and the goals and objectives targeted in their performance plan; if the link is unclear, this document should be brought into alignment and re-visited at least annually thereafter at each performance review.
- ***Differentiate performance fairly and objectively***—The ability to differentiate performance is critical. Performance differentiation requires the appraiser to acknowledge that there will, in all likelihood, be gradations of employee performance. For example, the vast majority of employees may perform their jobs according to expectations based on their level of experience and time in service. However, some may far exceed expectations and others may fall far short of required expectations. Companies are more likely to achieve the results that they desire when they are conscientious about assessing the talent of their employees fairly and objectively in accordance with clearly delineated standards of performance and/or in terms of relative contribution (i.e. essentially compared to the contribution of others) that can be defended by the organization.
- ***Train managers in performance management***—Make an ***upfront investment* in training** to ensure that managers have the skill sets required to participate fully in the performance management system planning process. This should include all members of line management to ensure that everyone is on the same page, is speaking the same language, and are using the same tools and techniques.
- ***Link compensation to the performance management system***—According to the USC study previously referenced, the relationship between rewards system practices and performance appraisal effectiveness is strong for all performance management items. The study found, however, that the strongest relationship item is appraisal results and salary increases. "Apparently, tying the results of performance appraisals to financial rewards does lead to the performance appraisal system being effective. The finding that **effectiveness is higher when rewards are tied to appraisal results** is important, because it contradicts the frequently made argument that appraisals are more effective when they are not tied to financial rewards."[9]
- ***Differentiate linkage to total rewards system***—If there is a secondary or tertiary *total rewards* component to your performance management system, it is imperative that this aspect of the plan be communicated and linked effectively *right from the start.* A 2002 study by the Hay Group uncovered the following findings: 90% of organizations have a written compensation policy, even though many employees do not under-

9 Lawler, E., & McDermott, M. (2003). Current performance management practices. *WorldatWork Journal, 12, 2,* 49-60.

stand it; 73% of organizations did not reveal information about their pay system to employees; only slightly more than half of the managerial and professional and less than 25% of the other employees know their own salary range; and 61% said they were not effective or even marginally effective at motivating employees by promoting their pay program. To be effective, reward programs must be aligned with performance, must be communicated and must be understood to have a motivational effect.

- ***Hold managers accountable for the communication process***—Although communication is everyone's job, ultimately someone must be responsible. Require managers to ***actively search out, offer and acquire performance feedback on a regular basis.*** By taking the lead in the ongoing communication process and demonstrating the behavior required to make the system work effectively, line management will also be functioning as a coach and mentor to the employees under their supervision.
- ***Set clear expectations for employee development***—Employee development will be crucial to the success of the performance management system. With flatter organizations and narrower spans of control, it will be essential for today's organizations to seek alternative ways to develop employee talent through ongoing skills mastery, special projects and assignments, team leadership opportunities, and formal education and training. As such, it is not unusual for organizations to establish a required minimum number of employee development hours per annum per employee to facilitate this process.
- ***Track effectiveness of performance management system***—To determine the effectiveness of the performance management system, an evaluation of the system is required. The system should be structured to ensure that company and employee performance goal alignment can be confirmed at any point in the performance management cycle, and the probability of meeting targeted performance objectives can be calculated. This will permit confirmation of cost management and ROI goals and objectives, which should be preset throughout the reporting cycle.
- ***Adjust performance management system as required***—Based on the results of the periodic analysis of the company performance management system, the system measures ("vital few") should be adjusted for each requisite reporting period. This information must be communicated back, in turn, to line management in a timely manner. This step is a critical link in the effective communication and implementation of the program and brings the performance management process full circle by reinforcing the employee behaviors required to achieve the goals and priorities of the organization on a continuing basis.

10 Lawler, E. (2000). *Rewarding excellence.* San Francisco: Jossey-Bass Publishers.

Performance Appraisal—Some Choices

According to Edward Lawler, "Performance appraisals should be driven by a *hierarchical process* in which supervisors evaluate their direct reports at all levels in the organization. All too often, however, senior executives in an organization are not appraised and do not appraise their subordinates. The result is that performance appraisals become something the people at the top tell middle management to do to lower-level employees."[10] To the extent possible, HR practice leaders should strive to reverse this trend and encourage the active inclusion of senior management in the performance appraisal process.

Bearing in mind that the performance management system is intended to serve multiple purposes, the importance of the performance appraisal process to the success of your performance management system should not be underestimated. Performance appraisals will and can impact a host of critical human resource delivery systems and must be viewed within the context of the total performance management process. Based on their design, performance appraisals have the potential to influence career progression, succession planning, organizational training and development, retention, total compensation and other key human capital asset investment programs. As such, the implementation of such programs will require careful planning and integration, to include a provision for ensuring that they are meeting the needs of the organization philosophically, strategically, and in full compliance with all internal and external company requirements. Examples of performance appraisal systems include:

Graphic Rating Scales (GRS)—GRS lists a number of factors, including general behaviors and characteristics (such as attendance, dependability, quality of work, quantity of work, and relationships with people) on which an employee is rated by the supervisor. Supervisors rate individuals on each factor, using a scale that typically has three to five gradations (e.g., unsatisfactory, marginal, satisfactory, highly satisfactory, outstanding). Thus, the system allows the rater to mark the performance of an employee on a continuum. Because of its simplicity, graphic rating scales tend to be one of the most frequently used forms of performance appraisal.

Ranking—Ranking consists of listing all employees from highest to lowest in order of performance. The primary drawback of the ranking method is that the extent of the differences in performance among the individuals is generally not well defined. Points may be assigned to indicate the size of the gap to overcome this drawback.

Forced Distribution—In forced distribution, the ratings of the employees in a particular group are disbursed along a normal bell-shaped curve. The supervisor would apply a certain percentage of the ratings within his or her group to each performance level on the scale, based on the number of employees within his or her group. In order for this method to be fair and equitable, it must assume that the widely known bell-shaped curve exists in a given group in relation to job performance. As a general rule, the spread of performance appraisal ratings does not typically resemble the normal distribution of the bell-shaped curve. Instead, 60% to 70% of the workforce of an organization rates in the top two performance levels. While this pattern could reflect above average to exceptional performance on the part of many employees, it could also reflect leniency bias, i.e., a tendency by the supervisor to rate at the high end of the rating scale.

Behaviorally Anchored Rating Scales (BARS)—BARS attempts to assess an employee's behaviors instead of characteristics. Descriptions of possible behaviors are matched against those that the employee most commonly exhibits. The assessment tool contains sets of specific behaviors that represent gradations of performance used as common reference points or *anchors* for rating employees on various *job dimensions*. Developing a BARS assessment tool is expensive and time-consuming. It is based on extensive job analysis and the collection of critical incidents (examples of very good and bad performance information) for a particular job.

360-Degree Feedback—360-degree feedback is the process of collecting perceptions about a person's behavior and the impact of that behavior in the workplace from that person's work associates. These individuals typically include an employee's supervisor and other members of line management, direct reports, fellow co-workers, internal and external customers, and vendors and suppliers. Other names for 360-degree feedback are multi-rater feedback, multisource feedback and group performance review. This form of assessment is favored, in particular, for employee development purposes.

Management by Objectives (MBO)—MBO is a process through which goals are set collaboratively for the organization as a whole, various departments and/or subfunctions, and each individual member. With MBO, individuals are evaluated, usually annually (although interim meetings to certify progress are recommended), on the basis of how well they have achieved the results specified by the goals. MBO, or goal setting, is particularly applicable to nonroutine jobs, such as those of managers, project leaders and individual contributors.

Certifying Your Performance Management System

Any organization making a concerted commitment to *performance management* has made a significant investment in time, effort and resources. As such, it will be crucial that this system be assessed on a periodic basis, just like any other resource of value in the organization.

The following self-diagnostic is offered as a resource in this effort. This tool can be tailored to meet the particular needs of your organization.

Periodic System Assessments

Is your existing performance management system (PMS) meeting the criteria set by your organization? An annual audit of your performance management system should be performed to ensure that it is aligned with its culture and business strategy. Using a graphical rating scale of 1 (strongly disagree) to 5 (strongly agree), rate your performance management system in relation to the following statements:

- Our PMS reflects our company's mission and values; it reflects our desired company culture.
- Our PMS has the full commitment and active participation of our CEO and senior management team.
- Our business strategy is clear, including our key business drivers and the metrics used to track

them (e.g., financial, operational, employee engagement, customer and client).

- Our managers understand how to cascade our company goals down through the organization to ensure that they are effectively linked to individual employee goals.

- Individual goals are truly linked to our business drivers, and effective two-way communication links are clearly established.

- Our performance appraisal process distinguishes between observable behavioral dimensions and the frequency of those behaviors (examples: appraisals based on core competencies or the mastery of certain behaviors).

- Our PMS incorporates feedback from multiple sources (e.g., 360-degree feedback and/or another form of multirater feedback).

- Our PMS outlines clear standards of performance and rewards eligibility for high performers, solid performers and marginal performers in the following scenarios:
  - Merit increases.
  - Annual incentives.
  - Long-term incentives.
  - Discretionary incentives.

- Our PMS provides an ongoing comprehensive training program for:
  - Managers conducting performance appraisals.
  - Individuals being appraised.

- Our PMS provides additional support services for professional and career development to managers and employees.

- We are able to accurately determine the ROI of the PMS.

- Our existing technology supports our PMS objectives as designed (i.e., in accordance with system requirements) to include:
  - The various raters and reviewers we wish to involve in the process.
  - The capture of information throughout the performance cycle (including planning, forecasting, progress review, end-of-year evaluation).
  - Sharing data across HR and other business applications (including pay, learning and development, workforce, and succession planning).
  - Providing the necessary level of data security and archiving.

- Our PMS is capable of real-time analysis of performance data to identify trends in relation to:
  - Performance differentiation.
  - Pay differentiation.
  - Performance gaps/developmental needs.

- Our internal business partners are able to access and use the PMS.

Upon completion of the self-assessment, you should have a good starting point to begin to weigh the strengths and weaknesses of your performance management system.

In Closing

As noted in the introduction, if an organization's performance management system is effective, it will be a "key building block" to its human capital management system. It should serve as the basis for accurate measures of individual performance and thus individual rewards. It should be designed to provide feedback to employees about their strengths and weaknesses and, therefore, recommendations on developmental opportunities that will impact career progression for the employee and succession planning for the organization. It should also serve as a viable feedback mechanism regarding training and development requirements for all competency and skill levels throughout the organization. Finally, it should be the central means by which performance challenges and opportunities are identified, solutions are implemented and the effectiveness of these efforts assessed.

These options are limited only by the imaginations and creativity of the individuals who are assigned, or who volunteer, to work on them. It will be up to the management of the organization to ensure that it does not stand in the way of progress, ensuring that the possibilities are effectively communicated to its employees, that recognition and rewards are forthcoming to them, and ongoing investments continue to be made in developing its most important asset, the people it employs.

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The SHRM Research Department researches and synthesizes the thoughts, practices and voices of today's HR professional, business and academic leaders on various HR topics and focus areas, and creates products of strategic and practical value for HR target audiences. The Research Department includes the Survey Program, the Workplace Trends and Forecasting Program, and the Diversity Program. These programs provide SHRM members with a wide variety of information and research pertaining to HR strategy and practices to both serve the HR professional and advance the HR profession.

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