Individual Performance Management: Time for a Reset[1]

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The individual performance review ranks among the most loathed practices that companies use to manage talent. Human resource organizations such as the Corporate Leadership Council, Corporate Executive Board and Society for Human Resources Management have reported that an overwhelming percentage of managers and employees view their company's current performance review practices as ineffective, demotivating and unhelpful — in a word, broken. In the utility industry, a recent survey of Western Energy Institute (WEI) member companies showed that only 6 percent said that their performance management practices were highly effective at motivating employees, and only 12 percent said that these practices were highly effective at driving company performance (see Table 1). Yet, despite such views, performance review practices, as we use them today, have endured for decades.

Fortunately, this is changing. Companies across a broad swath of industries, including utilities, are implementing new and innovative practices intended to improve what today represent outdated models, and by some accounts, ones that create business liabilities.

Technology is facilitating this transformation. Mobile applications, for example, are being used to provide employees with real-time co-worker and supervisor feedback to shape ongoing performance. Online learning tools are also available that can be customized for individual employee needs.

In addition, most companies use established human capital management (HCM) systems that are slow to evolve and expensive to change. As a result, some companies are turning to smaller

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vendors with applications flexible enough to accommodate performance management practices that better align with business needs. Today, work processes are not necessarily limited by the capability of a host HCM system – quite the reverse. Management can design optimal processes and find an affordable, cloud-based or installed application to accommodate specific design parameters.

Table 1: WEI member companies' assessment of their performance management practices.[1]

Overall, how effective are your performance management practices at:	Not Effective	Somewhat Effective	Highly Effective
Motivating employees to perform their best.	**56%**	**38%**	**6%**
Driving performance of your company's business goals.	**44%**	**44%**	**12%**
Linking pay to performance.	**50%**	**44%**	**6%**

[1] 19 WEI member companies. Results apply to exempt-level positions only.

Why Are Companies Changing?

The practices that many companies use today have roots in an industrial-era when individuals' performance was much easier to observe and measure, where work was routine and mechanized, and performed in more predictable environments. New performance management practices are required in today's utility industry as jobs and roles evolve and modernize with the times. Not surprising, legacy models are simply too fixed and inflexible to keep pace with today's operating environment.

What's Changing?

Most companies' performance management models primarily rely on practices that follow a familiar cycle: Set individual performance goals, conduct a mid-year status review, conduct a year-end annual review, assign a performance rating, administer compensation and repeat this cycle the following year.

Today, however, the trend is toward eliminating this process altogether or enhancing it with features such as: (1) flexible goals that change during the year, (2) elimination of year-end ratings, (3) frequent performance feedback from multiple sources, (4) more-frequent coaching from line managers, (5) training employees to be effective consumers of this coaching, and (6) technology applications that provide employees with real-time feedback.

In addition, multipage written narratives that managers and employees dislike are being replaced with short summary statements, often one page or less. Also falling out of favor are forced rankings, and the bell-shaped performance-rating curve. General Electric, for example, eliminated performance ratings and forced rankings entirely, and adopted a model where employees receive frequent feedback from manager and coworkers throughout the year.

Many legacy performance management practices are seen as out of step with today's business environment or simply misguided. This is because they:

- Focus heavily on evaluations and ratings at the expense of employee development and growth;
- Ignore the positive impact of real-time feedback;
- Undermine leaders' responsibility to manage and develop talent;
- Contribute questionable value to organizational performance;
- Weaken employee engagement and retention;
- Are administratively burdensome; and
- Require that a disproportionate amount of time be spent on low performers.

Others have paralleled these trends, including Adobe, Gap, and Microsoft. Recent research has shown that rigid rating and ranking practices can actually damage employee morale and engagement.

Essentially, the tide has shifted from a model designed to *measure and assess* past performance to one that looks forward to continuously *improve* it. Traditional performance assessment still matters, but it's not the singular focus of the past.

WEI Member Company Trends

Change is also taking root among WEI member companies. A recent survey of WEI companies conducted in the winter of 2015 shows that almost half of the survey sample (44 percent) now require leaders to conduct frequent coaching sessions with their employees, and a third say they now set more-challenging performance goals (see Table 2).

Table 2: WEI member companies' performance management trends[1].

Over the next 2-3 years, how likely is your organization to:	Currently Implemented	Likely to Implement	Unlikely to Implement
Require leaders to conduct frequent coaching sessions with their employees.	44%	31%	25%
Set "stretch" or more challenging performance goals year-over-year.	31%	38%	31%
Ask employees to provide performance feedback to their immediate supervisor (and include in supervisor's appraisal).	19%	31%	50%
Allow leaders more discretion in deciding the amount of compensation awards given to their employees.	19%	31%	50%
Use peer-level feedback as part of performance appraisal evaluations.	12%	38%	50%
Eliminate individual performance review ratings.	6%	6%	88%
Force a distribution of employees' performance across rating categories.	6%	0%	94%
Change the way competencies are used as part of performance management.	0%	63%	38%
Force rank employees based on their performance.	0%	0%	100%
Eliminate the use of annual performance reviews.	0%	0%	100%

[1] Applies to exempt-level positions only.

One leading-edge organization is Tucson based WEI member company UNS Energy Corporation. UNS has adopted some of those practices pioneered in the innovative technology industry. For example, the company uses a robust workforce planning process to align employees' performance goals and personal development plans with the company's strategic objectives. They also encourage managers to conduct frequent coaching and performance discussions. And as the speed of business change accelerates, managers adjust goals as necessary throughout the year to keep pace with the ever-evolving direction of the business. While the company retains the use of performance ratings, they use calibration sessions to assure that employees' performance is assessed objectively across the organization.

On the technology side, UNS is beginning to explore technology options to support a more streamlined process concurrent with providing a deeper level of performance insight for managers and employees. According to UNS's Cathy Ries, VP of Customer Relations and Human Resources, "We have made an effort to stay abreast of evolving trends, and will decide in due course what further changes make sense for our business strategy and culture."

According to the WEI Member company survey, several traditional practices have fallen out of favor. Two common ones include: forced distributions across performance rating categories (the infamous bell-shaped curve), and a forced performance ranking of employees based on their performance. These findings are consistent with the broader trend away from performance management as an assessment vehicle, toward one of performance coaching, feedback, and continuous improvement.

Still, some legacy practices are slow to evolve. For example, the annual performance review rating is still used by most companies. The survey showed that 88 percent of WEI member companies are not planning to eliminate ratings, primarily due to their linkage to compensation and the need to support employment actions such as promotions and terminations.

A middle ground is also emerging. Gaining momentum is a trend to change the ratings distribution away from a normal bell-shaped curve to one that resembles something like a ski slope, or a J-curve, also (called a Paretian distribution - also known as a power law distribution). An argument can be made that the bell-shaped curve fails to represent the true performance distribution because the vast majority of employees perform adequately, (i.e., are at the top of the ski slope), yet a much smaller few are superstars (i.e., toward the flatter tail of the slope). Companies that accept this model adopt the logic that a small portion of employees (10 – 15 percent) produces 80 percent of the productivity.

Performance appraisal ratings:
Necessary practice or historical relic?

Few practices have received more attention than the annual appraisal rating. Here are some common arguments for retaining and eliminating them:

Retain

- Performance is always evaluated in some manner; companies just need to make the evaluation as objective as possible.
- Compensation, promotion and other employment actions are more objective and defensible with ratings.
- Ratings that differentiate employees' performance helps improve organizational performance.
- Contrary to popular opinion, research has shown that early career employees are highly competitive and want to know how they compare to peers.
- The alternatives to ratings may be worse.

Eliminate

- Rating scales are unreliable and invalid.
- Multiple managers evaluate the same performance differently.
- Performance is too variable to assign a single and meaningful rating; that is, a summary rating fails to capture the complexity of performance, especially over the length of an annual cycle.
- There's a weak relationship between employee performance and the ratings they receive; rating inflation is a confounding factor.
- Ratings do nothing to encourage high performance, and can damage morale, motivation, engagement and company culture.

The decision to retain or eliminate ratings can be a dilemma for most companies — a choice between undesirable alternatives. A better question might be: What are the essential outcomes the organization must achieve and how can we ensure that employees deliver against them? When viewed through this lens, the answer to retain or eliminate ratings becomes, "it depends," based on the organization's goals, strategies, openness to change, management philosophy, culture and other factors.

The Impact of Technology

Technology innovations are emerging in support of many of these changes and it is evolving quickly. In recent years, there has been a plethora of new software offerings designed to support practices such as: (1) flexible goal management, (2) real-time individualized performance feedback and communication, (3) tracking individual performance metrics, and (4) on-demand learning and training content.

General Electric, for example, has developed a proprietary smartphone app called PD@GE (Performance Development at General Electric), which enables employees to solicit or receive real - time feedback from co-workers and line managers. The idea is simple: Encourage employees to self-correct their performance proactively through more frequent and timely feedback. The application also compiles this feedback into a summary at year's end, thus reducing the administrative burden on line managers.

A side benefit to such applications enables companies to conduct sophisticated workplace analytics. Sears, for example, uses data obtained through feedback tools to map and analyze interactions across and within the organization, called "social network analysis." This can be useful when cross-functional collaboration is important but may not be fully optimized. Others use it to understand performance trends of individuals and how key events occurring in the organization may enhance or degrade their productivity.

On the learning side, through the integration of e-learning applications with big data and prescriptive analytics, companies can create dynamic learning and career paths that provide personalized guidance and made-to-order development planning. These platforms offer highly customized recommendations for content, courses, and developmental experiences based on the skills, interests and aspirations specific to individual employees.

With dozens of "new-entrant" technology vendors now selling innovative next generation applications, some established enterprise-level software providers are struggling to keep up. Most remain focused on prescriptive process models. But with many companies looking to consolidate talent management applications into an integrated suite that links recruiting, succession and career management, competency profiles and compensation, established vendors might eventually have an advantage simply through size and scale. While the technology landscape is increasingly fragmented with partial solutions, eventually the market will consolidate. But it's too early to predict how or when this might happen.

Companies that wish to update their performance management practices have many technology options, including adding specialized applications or choosing a solution that operates within the confines of an established platform.

Implications for Compensation

In most companies, performance management and compensation are inextricably linked. Therefore, the impact of new performance management models on compensation is of great concern. Companies on the leading edge offer learnings that could be replicated. For example, a Midwest utility company implemented a rating scale similar to the J-curve mentioned above. It assumed that the vast majority of employees perform adequately, less than 1 percent perform poorly, and a small percentage (10-12 percent) deliver a disproportionately high amount of value. Retention of employees in the latter category is thus critical and losing them would impact organizational performance significantly. Accordingly, their merit compensation matrix was adjusted to provide a much higher award to these superstars, while still rewarding the majority of employees adequately. Consequently, their overall merit budget remained in check, yet they rewarded these superstars handsomely.

The utility also positioned the top of the J-curve, where most employees were rated, as a reflection of perfectively acceptable performance. The small number of poor performers were taken out of the rating and compensation systems entirely and placed on performance improvement plans or asked to exit the company.

Another company, PricewaterhouseCoopers (PwC), eliminated ratings and allowed employees a choice of awards, including bonuses. Employees can select awards such as cash, gift cards, product packages, or even matched charitable contributions. Other companies have adopted a similar model and implemented the use of "spot bonuses," which are awarded for good performance anytime during the year. Another company awards individual employees "points" for exceptional performance, which accumulate into an annual bonus award. Funding for this is combined with the merit budget to avoid labor cost overruns. In essence, a clear trend is emerging where companies are increasing the use of variable compensation plans that are linked to individual performance, and doing so regardless of the presence of formal ratings.

Companies that have eliminated ratings altogether also implement process controls to manage compensation awards. For example, use of group calibration sessions where managers review their employees and justify pay decisions to peers and executives is becoming increasingly common. Likewise, managers are also increasingly being given more discretion over the amount of an award, although within budget requirements and guidelines. One technology company, Autodesk, for example, allows line managers access to compensation survey "banding" data specific to the jobs they supervise. Managers then use these data to determine employees' annual salary action.

Even with these changes, the reality remains that under a pay-for-performance philosophy, as most companies espouse, the lack of formal ratings means that new ways to justify pay decisions must be adopted, and frequently this involves process-based solutions versus restrictive rules-based ones.

Launching a Performance Management Reset: Is it the Right Move?

Is a sweeping performance management reset the right move for a company? The short answer is, it depends. Any change to a major talent practice is a significant event, especially one that impacts employees' careers, pay and standing in the organization. Making this leap means making a highly disruptive change that involves risk, resource dedication and time. Required is a well-designed and executed strategy and change-management plan in addition to unwavering leadership support. Not all organizations have the appetite to commit to this level, and if not, it's better to table the effort for another time.

Assuming that the time is right, the positive impact can be significant. Case study research from early adopters shows that these updated practices impact metrics such as employee engagement, attrition, knowledge and skills, goal performance, accountability, communication and leadership effectiveness. In addition, using technology, richer workforce data is available that enables better insights into organizational dynamics such as cross-functional collaboration and internal networking.

Given the major changes underway in the utility industry, combined with these broader performance management trends, it behooves companies to consider leveraging some of these updated practices to their advantage. To use a colloquialism, the genie is out of the bottle.

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