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OF RATINGS AND FORMS IN PERFORMANCE MANAGEMENT

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Move beyond the forms and ratings. Instead, embrace the idea of development and coaching.

Business success often depends upon faster innovation, cross-company collaboration and a highly motivated workforce. But many companies apply an overly structured, forms-bound and ratings-dependent performance management process that prevents the successful execution of their strategy.

According to 2014 research by the Corporate Executive Board (CEB), only 3 percent to 4 percent of companies recognize this danger. They are significantly redesigning their performance management processes and eliminating ratings and rankings while changing how they set goals and distribute rewards.

Critics cite that performance management takes too long, doesn't deliver the intended benefits, and managers and employees hate it. Further CEB research reveals that although 96 percent of companies have a defined performance management process, 86 percent dislike it and consider it a time-wasting ritual.

Those dissatisfied with a traditional approach but cautious about eliminating ratings must understand the current thinking and learn what progressive companies have done to reinvent performance management, which is detailed in this article.

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Current Thinking

Three points of view are moving organizations to make bold changes.

1 Traditional performance management shuts people down. Neuroscientist David Rock points to "brain pain" from using traditional performance appraisal processes, particularly those with rankings or bell-curve requirements. This often sets off alarms, triggering a "fight or flight" mode that stifles learning and creativity.

2 Make the time spent worthwhile. Marc Effron, author of "One Page Talent Management," advocates simplifying complicated performance management processes. He favors one-page templates for performance management and advises managers to trade one hour of structured year-end meetings for quarterly 15-minute, informal discussions that enhance the quality of feedback and focus on future performance.

3 Traditional performance management doesn't fit 21st-century business conditions. PeopleFirm's Tamra Chandler contends that traditional performance management is grounded in outdated assumptions borne out of post-World War II bureaucracies when companies seemed compelled to put people and jobs in narrow boxes with predictable outputs that could be measured. This "organization-as-machine" approach led to the standardized, complex, unwieldy and underperforming performance management process still widely used. But work and the workforce have changed demanding agility, speed and flexibility.

Alternative Perspectives on Pay for Performance Without Ratings

Why Compensation Professionals Embrace Performance Ratings

Employers often proclaim, "We pay for performance," yet most employees' cash compensation tells a different story. Base pay varies insignificantly by performance, but rather by cost of labor or internal job value. A core competency of compensation departments is to create and manage a job-worth hierarchy based on either market value or job content.

A pay-for-performance philosophy is a statement to justify a rewards distribution system. The compensation function has embraced and supported this with structures, processes and systems, heavily relying on performance ratings to steer almost all cash compensation programs. These programs include guidelines for promotions, demotions, new hires, high-potential assessments and succession criteria that are all dependent on ratings.

Like their HR colleagues, CFOs find comfort in the assurance that fixed cost increases (wages) are based on quantifiable models and formulas. How a budget is distributed (according to ratings) seems less important than it being done without exceeding the bogey.

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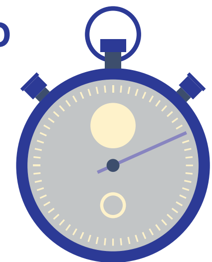

Do Ratings Matter?

Performance ratings and compensation decisions do not always correlate. For example:

- Long-term compensation (e.g., equity or cash) typically considers a performance rating as only one key input. Other inputs include potential, succession plans and key skills. Compensation with a longer-than-annual horizon is not dependent on an annual rating.
- Sales incentives are often most directly correlated to volume (e.g., revenue, units) and a total cash compensation focus frequently exclusive of the kind of annual objectives found in performance appraisals measured through a ratings scale.
- Some production jobs have either piece-rate or volume-oriented pay schemes. Unionized environments may have a single- or step-rate type compensation system controlled by contractual terms. In both cases, performance ratings are less relevant to total cash compensation.

Alternate Approaches

One alternate performance management approach views employees as investments that will yield dividends. "Buy low" and develop the investment while paying competitively commensurate with increasing knowledge, skills and abilities to avoid forcing base-pay changes against annual objectives. It can be viewed as increasing the value of the person in the job relative to his/her value in the market.

Another idea is to retreat to simpler times before pay ranges, midpoints, merit grids and compa-ratios and embrace a straightforward concept that links base pay to labor market movement and job value. This retro concept emerged at a company whose management did not want (or could not afford) to fund the traditional merit program (i.e., the pay for performance objective) yet insisted that pay for performance was

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a vital business driver. The disconnect between philosophy and practice was clear to employees and exposed the false notion that expecting every compensation program to fall under the pay-for-performance umbrella was unrealistic.

Redefining Rewards Intent

Without performance ratings, bell curves, salary ranges and merit matrices, pay for performance can be reconstructed with ***four focused elements of a common compensation strategy*** *that still achieves the desired results:*

1. Use a **group reward plan** (e.g., profit-sharing) to reward most employees for achieving overall company objectives.
2. Adjust **base salaries** for changes in market rates.
3. Use **cash bonuses or stock** to recognize outstanding results of top contributors and deliver competitive long-term compensation.
4. Fashion a **robust recognition program** that enables manager and peer recognition of behaviors that align to company values, culture and goals.

This led to the birth of Index Pay — a process beginning with assigned market pay rates for jobs and linking salary adjustments more closely to labor market movement and development of competencies to perform the job rather than budgets and bell curves. Its intent wasn't to eliminate performance ratings, but to create a different approach to managing base pay that would create higher levels of employee engagement and satisfaction once the variability of executive budget priorities and manager subjectivity was eliminated. This freed the process from performance ratings and inadequate merit budgets.

As the market moves, steps are adjusted annually and individual pay rates are similarly adjusted to maintain the current step. Assuming ongoing contribution, employees may advance one step up to the market rate. Most employees' pay will track the market rate when rates are adjusted. Exceptional employees demonstrating high levels of expertise may advance a step or two beyond the market rate. If the labor market doesn't move appreciably in a given year, no adjustments would be made to the established pay rates, yet employees' rates would be adjusted as they grew their skills and competencies.

Early Adopters See Positive Change

There is ease and comfort in rating employees, but escaping the tyranny of ratings and forms is worth it. According to the Institute for Corporate Productivity, "The good news for those organizations that are thinking of moving to a performance management system without ratings, organizations such as Expedia, REI, Adobe and Juniper Networks have done so successfully. In fact, all four of those organizations have seen increases in either bottom line revenue or employee engagement, or sometimes both."

Changing your performance management system requires objectivity, clarity of goals and new ways to assess employee value and distribute rewards. Managers must learn to regularly communicate clear goals and expectations; spend more time coaching and developing; think more carefully and rigorously about employees' impact and their rewards; and be able to talk intelligently about these concerns. ws

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