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Next-Generation Performance Management: The Triumph of Science over Propaganda

ABSTRACT

Performance management (PM) is a common HR practice that affects high-stakes decisions about individuals. Despite decades of study it is seen as ineffective, providing little return for the significant investment by employees and supervisors, and the company. The failures of PM are rooted in an unclear purpose, ineffective practices based on outdated paradigms about how to motivate and control behavior, and an over-reliance on benchmarking to guide design versus rigorous scientific research. Organizations wanting to make real improvements to their PM processes should focus PM on direction, alignment, control and progress. Goals and progress should be at the center of PM instead of ratings, pay-for-performance and differentiation.

It is no secret companies are unhappy with performance management (PM). The headlines from the business press say it all: the *Washington Post* called it "kabuki"; three of *BusinessWeek*'s "10 management practices to axe" involved PM; and *Vanity Fair* blamed Microsoft's decade-long business decline in part on their PM process. Supervisors and employees devote significant time to this process and companies spend billions of dollars annually on merit pay and bonuses tied to PM evaluations. Despite this investment, a report by Mercer shows that only 8 percent of companies report their performance management process "drives high levels of value." After decades of study and constant tinkering by companies, we seem to be no closer to "cracking the code." Fixing PM will require more than tinkering with our practices. Traditional PM fails for four reasons: ineffective practices; outdated paradigms; an unclear purpose; and a reliance on propaganda instead of science.

A FAILURE OF PRACTICE

Most companies approach PM in the same way:

- Supervisors and employees set objectives at the beginning of the year.
- They meet to review progress mid-year and at year-end.
- Supervisors evaluate employee performance at the end of the year, typically assigning quantitative ratings.
- Supervisors make reward recommendations based on the employee's rating.

I call this "Last-Generation Performance Management,"or PM 1.0, for short, and benchmarking statistics give it a failing grade. Only 35 percent of employees feel their goals are aligned with the company's objectives; only 35 percent say they have been given useful feedback from their manager; less than half (49 percent) of employees see their performance reviews as accurate; only 47 percent say reviews motivate them to work harder; and only 40 percent say

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that when they do a good job their performance is rewarded.

A FAILURE OF PURPOSE

A recent book by expert Herman Aguinis lists 23 different purposes for PM. Companies expect this process to communicate expectations, to defend against litigation, to distribute rewards and make other HR decisions, and to motivate and engage employees. Because PM 1.0 tries to do everything, it fails miserably.

A FAILURE OF PARADIGMS

The problems with PM 1.0 run deeper than ineffective practices. It is based on flawed paradigms—flawed assumptions, beliefs, and mental models about how to motivate and control behavior and performance in organizations. The foundation of PM 1.0 comes from a handful of theories from economics and psychology: Classical economics; agency theory; tournament theory, the law of effect, expectancy theory; and control theory. The principles derived from these theories form the foundation of PM 1.0 (see Table 1).

Because PM 1.0 tries to do everything, it fails miserably.

Despite the revolutions in cognitive science in the 1950's and behavioral economics in the 1970's which overthrew many of these theories and ushered in new paradigms, the business world has held firmly to these outdated principles. They shape how HR and compensation professionals think about and design PM and reward systems and how they train business leaders to use them. When business leaders and HR professionals change their PM processes, these principles are taken as truths. We suffer from what change experts Stewart Black and Hal Gregersen call "a failure to see." The changes we make to PM fit our current mental models which is why they fail. Management scholar Chris Argyris called this problem "single-loop learning"—we try something and if it doesn't work, we try something else. Fixing PM will require "double-loop learning;" when our fixes fail, we confront the assumptions, beliefs and mental models behind our practices.

PROPOGANDA

Companies stick with PM 1.0 because everyone does it this way. They imitate top companies just like teenagers buy the jeans the popular kids are wearing. Benchmarking by consulting firms and HR think tanks make it easy to know what other companies are doing. As HR staffs shrink, companies are increasingly dependent upon these firms for information and insight. They have a virtual monopoly on communication channels to business leaders and HR professionals and information that reaches them is about "common" and "unique" practices, not necessarily "effective" practices. There is a difference. Effective practices have been shown by rigorous scientific research to be associated with important outcomes organizations value (performance, productivity, retention, engagement). Benchmarking has led to a homogenization of business practices across companies and over time these practices become institutionalized and taken for granted. Other companies imitate them to achieve legitimacy. We saw this with GE and forced ranking in the 1990s. Finally, organizations also begin to adopt a fatalistic attitude about PM after many attempts to fix it and they start to rationalize the noise they hear. They assume noise is inevitable ("good medicine tastes bad") and since poor PM processes are rarely fatal, they learn to live with the noise. A poor PM system is

TABLE 1. PM 1.0 PRINCIPLES

General • The employee-company relationship is adversarial, with inherent structural problems, conflicts and risks • The relationship between a company and an employee is best viewed as contractual • Motivation is something that is external to the person, controlled by reward and punishment contingencies **Planning** • Alignment of employees with company priorities is externally mediated by contracts, contingencies, consequences, and threats • Goals are contracts that specify outcomes and other important terms and conditions • Goals have instrumental value. They are important only insofar as rewards and other outcomes are tied to them. They specify what outcomes will be rewarded and how **Feedback** • Monitoring and surveillance is necessary to ensure employees are fulfilling the terms of the contract • "Keeping score" is important; employees need to know the score and where they stand • Feedback is primarily negative, correcting employees when they get off track	**Evaluation** • Employees want to be evaluated and compared with others • Ratings, rankings and relative comparisons motivate employees • Competition is essential for motivation • Supervisors can accurately and consistently measure employee performance **Rewards** • Money motivates • Behavior and performance are best controlled by external reward contingencies • Rewards need to be contingent upon individual performance • More differentiation of performance and rewards is better for motivation

like having a pebble in your shoe; while it can be annoying, you can still function pretty well.

NEXT-GENERATION PERFORMANCE MANAGEMENT, OR PM 2.0

Fixing PM will require us to adopt new paradigms and practices that are based on rigorous scientific research instead of propaganda. The essence of PM 2.0 can be summarized in a few key ideas:

• Design PM to be a key part of the organization's management process.
• Focus on "direction" and "connection"—making goal setting, alignment, and progress the backbone of PM.
• Stop the formal evaluation of performance.
• Stop differentiating individual rewards (and making other HR decisions) based on individual performance.

PURPOSE

Performance management 2.0 starts with a clear purpose grounded in sound organization design. At its core, PM 2.0 is a management and governance processes. Its core purpose is to translate business strategy and priorities into individual priorities. It provides direc-

At its core, PM 2.0 is a management and governance process. Its core purpose is translate business strategy and priorities into individual priorities.

tion for employee efforts, aligning their efforts with important workgroup, organizational and company goals. It acts as a control system, ensuring employees stay focused on the right activities, and as a support system, helping employees make progress against their goals. It is not designed to support rewards, talent identification, promotion or succession decisions, nor is it designed to help with communication, engagement, development, legal defensibility or other objectives. This doesn't mean these objectives aren't important; it simply means we find other more effective ways to address them.

"DIRECTION"

The foundation of PM 2.0 is clear direction and alignment. Goals and objectives are the source of motivation not contracts tied to financial rewards and incentives. The science is clear—goals drive higher performance. They direct and energize; they cause people to persist and they require people to think, plan, and strategize. People with specific, challenging goals perform better, particularly when they are committed, are confident they can achieve them, and when they get feedback on progress.

Employees want their efforts to be part of something bigger than themselves. Over the last 10 years there has been a growing movement to put purpose and meaning at the center of people's lives. This movement and the research behind it shows that people need meaning and purpose in their personal and work lives and experience a variety of positive outcomes (motivation, engagement, performance, well-being, and health) and fewer negative outcomes (dissatisfaction, disillusionment, stress, strain) when they have it. Dan Pink highlighted the power of purpose as a motivator in his book *Drive: The Surprising Truth About What Motivates Us,* and research by Harvard professor Teresa Amabile shows how important "making progress in meaningful work" is to employee engagement and productivity.

Good leaders know this as well. Transformational leadership research shows that leaders who foster and inspire a sense of purpose have more satisfied and better performing employees. A recent survey by Deloitte showed that organizations get poor grades in this area. Sixty-eight percent of employees and 66 percent of executives believe that businesses are not doing enough to create a sense of purpose and to show they are making a meaningful impact. People who can fulfill these needs at work are better off than those who can't, and those who aren't getting these needs met at work are searching for it outside of work. Performance management 2.0 puts purpose and meaning at the center of this process instead of at the periphery.

> Transformational leadership research show that leaders who foster and inspire a sense of purpose have more satisfied and better performing employees.

"CONNECTION"

Employees need more than purpose and direction. They need feedback to know if their efforts are hitting the mark and they need it all year not just at mid-year and year end. While employees need feedback, it's clear they don't always get what they need. Research by psychologists Avi Kluger and Angelo DeNisi shows feedback does not uniformly improve performance. Feedback helps only when it is tied to the work and framed in the context of an employee's goals. When feedback gets personal it can actually undermine performance. The science is also clear that we should put more focus on positive feedback. A "positive offset" (more positive than negative feedback) is consistently associated with higher satisfaction and performance.

Performance management 2.0 goes beyond feedback; it views the supervisor's role as helping employees make progress against their goals. We frequently hear leaders and HR professionals say "people want feedback…they want to know where they stand." This is a common fallacy. Employees don't want feedback… they want to know if they are on track to achieving their goals. Progress is the "magic elixir" driving happiness, engagement and performance. Progress against goals is more important in driving happiness than actually achieving goals. Researchers who study affect (e.g. emotions, mood) in organizations find that people's emotional responses to events that happen to them are determined by how they see these events affecting progress toward their desired goals. Progress leads to positive affect and blockages lead to negative affect. This is important because people who display more frequent positive affect are more successful in work and in life—happier people are more successful. This is the premise behind Harvard professor Teresa Amabile's research, described in her book *The Progress Principle*. Employees are most engaged when they are making progress in meaningful work. Performance management 2.0 takes a cue from her work and sees PM as "progress management."

STOP EVALUATING PERFORMANCE

Performance management 2.0 isn't just about adopting new paradigms and practices, it's also about abandoning paradigms and practices that aren't effective. In fact, what isn't a part of this process is almost as important as what is. The first thing PM 2.0 abandons is a formal quantitative evaluation of performance. The science couldn't be clearer; supervisors cannot (and will not) accurately and consistently evaluate the performance of their employees. The latest review of this research finds that only between 8 percent and 32 percent of the variation in performance ratings is due to individuals and their achievements. Performance ratings say more about the supervisor doing the rating than the employee doing the performing. While there have been many efforts to improve rating quality (e.g., scale improvements, rater training, calibration processes, 360-degree feedback, and forced distributions) these efforts have largely been ineffective. Ratings fail because raters are flawed. Their observations and judgments can be very inaccurate and they display many different biases that affect their decisions. Even if supervisors could make accurate ratings, research suggests many wouldn't. Supervisors have many motives for the ratings they assign.

Companies stick with ratings because they assume employees want to be rated and that ratings motivate them. Once again, the science suggests this isn't necessarily the case. It is not at all clear ratings and rankings motivate employees to work hard, especially in more collaborative work environments; they appear to hurt often than they help. While it is sobering for companies to consider getting rid of ratings, many companies have begun to move in this direction. These companies face the daunting task of figuring out how to make other downstream decisions without performance ratings as input. Companies have several choices:

- Stop using individual performance information as input to these decisions (e.g. rewards decisions).
- Use other information in place of PM ratings (e.g. objective assessments).

Performance ratings say more about the supervisor doing the rating than the employee doing the performing.

Transformational leadership research show that leaders who foster and inspire a sense of purpose have more satisfied and better performing employees.

• Develop special performance evaluation procedures in cases where organizations feel they need performance input into a decision.

END THE USE OF MONEY, PAY-FOR-PERFORMANCE, AND DIFFERENTIATION TO MOTIVATE

Performance management 2.0 uses purpose, goals and progress to motivate. This is perhaps the most difficult change for business leaders and HR professionals to accept. More than 90 percent of companies have pay-for-performance (P4P) philosophies and corporations spend billions of dollars annually on cash and non-cash incentives to motivate, engage, and retain their top talent. A key part the mental model associated with PM 1.0 is an extrinsic motivation bias; we overestimate how much other people care about extrinsic features of a job, such as pay, and underestimate how much people are motivated by intrinsic job features such as challenge and purpose. We assume everyone is motivated by money. The science shows it simply doesn't work this way. For example, people willingly work for no money as volunteers or forgo higher-paying jobs for jobs in lower-paying industries (e.g., teaching, not-for-profit). Research also shows there is a weak relationship between pay and happiness, job satisfaction, and retention.

It isn't that people don't care about money…obviously they do. The problem is individuals adapt very quickly to changes in income (so a pay raise loses it motivating power very quickly) and relative income is far more important than actual income. We care less about how much money we make as long as we make more than our neighbor. Money also attracts people to a company so compensation needs to be an important part of any company's employment value proposition. However, once employees are on board, the motivational power of money and P4P programs is weak. These programs simply haven't been broadly beneficial for employees or organizations, nor have they been widely effective in other contexts—healthcare, education and public sector management for example. In organizations these programs work in a narrow range of circumstances: Simple jobs; jobs where performance can be measured quantitatively; jobs that are boring or noxious; and jobs where paying attention and working harder can improve performance. These programs have not been broadly successful in improving performance, reducing turnover or improving creativity and innovation. And even when they do work, they can have undesirable side effects and unintended consequences like increased competition, reduced intrinsic motivation, and other bad behavior.

I realize it is terrifying for organizations to consider abandoning these programs but there are good alternatives:

• Base salary increases on market factors
• Base bonuses on team, organizational, and company performance (e.g. gain sharing and profit sharing programs).

These programs work and they are immune to many of the toxic side-effects of individually-based P4P programs. These programs are much less popular and PM 1.0 thinking is to blame. Economic principles suggest individuals are "self-maximizing", that if individual rewards are disconnected from individual efforts, they will "free-ride" on the group. Once again, the science shows this simply doesn't happen in typical organizational circumstances or is easily mitigated.

- Develop more differentiated job structures that give employees more opportunities for promotion and to increase their pay over time.
- Tap into other ways to motivate employees, focusing on needs like purpose, mastery, autonomy and belonging using jobs to motivate.

Strategies to meet these needs are not as easy as throwing money at employees but they are more effective in the long run.

CONCLUSION

Performance management is an important management process for companies. It does not need to be "blown up" or replaced as many have called for. It needs to be focused and designed around important management functions to enable individual and organizational performance. Implementing next-generation performance management will not be easy and it will take time; PM 1.0 is firmly entrenched in organizations.

Organizations moving in this direction will incur transition costs in the short-term as they move away from established practices but they will experience less pain and higher performance in the long-term. Freeing ourselves from PM 1.0 thinking and paradigms might also usher in an entirely new wave of innovation in PM practices.

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