

An organization's long-term success in meeting its strategic objectives rests with its ability to manage employee performance and ensure that performance measures are consistent with the organization's needs. Consequently, performance management—also called *performance evaluation*, *performance appraisal*, or *performance measurement*—is becoming more of a strategic issue for organizations than in the past. The term *performance feedback* will be used frequently in this chapter to stress that the performance management system needs to be understood and accepted by the organization's employees and must provide them with meaningful information if it is to be effective. Effective performance management systems require employees and supervisors to work together to set performance expectations, review results, assess organizational and individual needs, and plan for the future. On the other hand, the terms *performance appraisal* and *performance evaluation* imply a one-sided judgmental approach to performance management, where employees have little involvement in the process.

Traditional performance appraisal simply involves evaluative supervisory comments on past performance. Such a process does not involve any kind of management, per se, as the only performance that can be managed is present and future performance. Performance appraisal involves hierarchical, downward communication from supervisor to subordinate concerning the value the supervisor places on the subordinate's performance. Feedback involves a mutual exchange of information that both parties share, discuss, and jointly assess in planning future work activities. Appraisals often put employees in a defensive position, whereas feedback is usually perceived as more neutral and a process over which employees have some control and influence. Exhibit 10.1 summarizes the key differences between performance feedback and performance appraisal.

Performance management systems need not be formal to be effective, although a recent survey conducted by the Society for Human Resource Management found that 98 percent of employers have a formal performance management process.<sup>2</sup> The most important concern in designing a performance management system is its fit with the organization's strategic objectives, and the most important concern in providing performance-related feedback is its fit with the organization's culture. SAS, an international, 8,000-employee software company headquartered in Cary, North Carolina, decided to do away with formal performance feedback entirely. Instead, SAS opted for a system that provides continuous dialogue on performance-related matters. Executives report that the system works well because it is built on the values of open communication, trust, and

## EXHIBIT 10.1

## Performance Feedback Versus Performance Appraisal

	Performance Feedback	Performance Appraisal
Time period	Past, present, and future	Past
Focus	Link employee work activities to specific business objectives and strategy	Create records; document performance problems
Nature of communication	Two-way	One-sided, downward, directive; "rebuttal" sometimes allowed
Employee role	Active participant	Passive
Formality	Informal, verbal	High formality, written forms with signatures
Timing	Spontaneous, ad hoc needed	As prescribed (usually annual)
Basis of relationship	Collegiality	Power
Role of supervisor	Coach, motivator, partner	Authority figure
Outcomes	Participation; enhanced, targeted performance; improved relationships	Compensation decision; task directives

self-motivation of employees to do their best. Moreover, any performance-related issues are dealt with in a timely manner because the lack of formality in the process allows feedback to be provided on an ongoing basis.<sup>3</sup>

The trends toward more streamlined organizations and hierarchies with fewer employees having broader job assignments have resulted in performance feedback taking on a more critical role than it has assumed in the past. Organizations today cannot afford to have weak links or unproductive employees. More than ever, organizations need broader measures of employee performance to ensure that (1) performance deficiencies are addressed in a timely manner through employee development programs that meet the changing needs of the organization and its markets; (2) employee behaviors are being channeled in the appropriate direction toward performance of specific objectives that are consistent with the work unit and the organization's strategy; and (3) employees are provided with appropriate and specific feedback to assist with their career development. The importance of performance management for organizations has led to the establishment of an American National Standard, developed by the Society for Human Resource Management and approved by the American National Standards Institute. This standard provides employers with guidance and suggestions relative to the development and analysis of performance standards, goal setting, and performance improvement.<sup>4</sup>

An effective performance management process can be conceptualized as one that connects three time periods, as illustrated in Exhibit 10.2. It utilizes data about past performance to set goals, plans, and objectives for the present that should result in high levels of performance in the future. However, a number of critical strategic issues must be addressed to establish an effective performance management system, as will be discussed in the following sections.

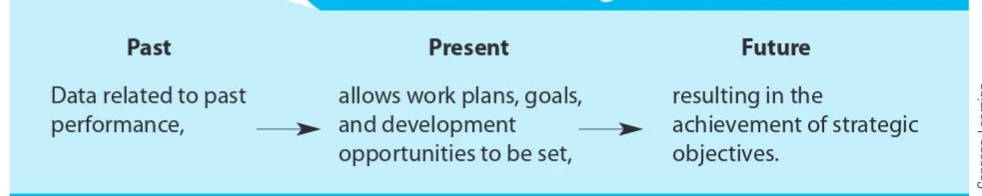
## Use of the System

An organization faces five strategic decisions in establishing its performance management system, as illustrated in Exhibit 10.3. The first is a determination of the purpose of the system and how it will be used. A performance management system can serve multiple purposes, and it is important for the organization to strategize why the system is being used before further design decisions can be made. If the system is developed to serve several purposes, the organization also needs to ensure that these purposes are at odds with each other and that any purpose does not undermine data collection for the other(s).

One purpose of performance management systems is to facilitate employee development. By assessing deficiencies in performance levels and skills, an organization can determine specific training and development needs. In fact, the performance feedback process can be designed to provide information to fuel the organization's training and development programs. Assessing individual and team strengths and weaknesses can allow employee and team development plans to be established. A reciprocal relationship exists between the two, as the desired outcomes of training and development initiatives must be incorporated into the performance management system, as

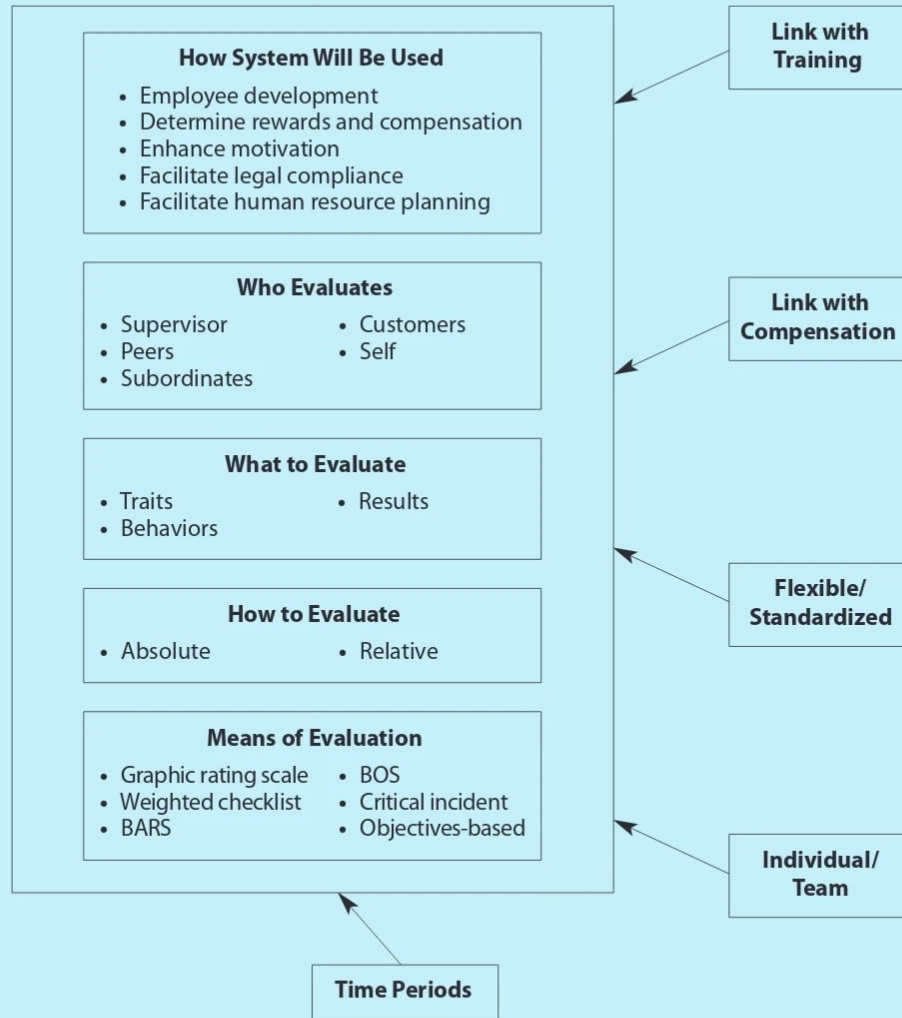
### EXHIBIT 10.2

#### Performance Management Timeline



## EXHIBIT 10.3

## Strategic Choices in Performance Management Systems



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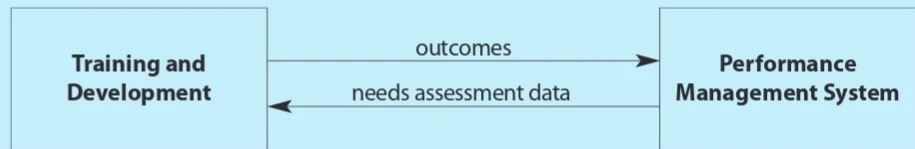
discussed in Chapter 9. At the same time, the performance management system provides data that impact the needs assessment of training and development, as displayed in Exhibit 10.4.

A second purpose of performance management systems is to determine appropriate rewards and compensation. Salary, promotion, retention, and bonus decisions are frequently based on data collected as part of performance measurement. Therefore, employees must understand and accept the performance feedback system as a prerequisite for accepting decisions made relative to rewards and compensation. Any perceived unfairness of the performance feedback system on the part of employees will result in a perceived unfairness of the compensation system.

A third purpose of managing performance is to enhance employee motivation. A formal process that allows for employee acknowledgment and praise can reinforce the behaviors and outcomes that are beneficial to the unit or organization. Employees can be told specifically what the

## EXHIBIT 10.4

### Reciprocal Relationship Between Training and Development and Performance Management



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organization's expectations for them are, and employees can inform their employers of the types of job assignments and responsibilities they desire.

A fourth purpose of performance management systems is to facilitate legal compliance. Claims of unfair dismissal and/or Title VII violations are best supported when the organization has documentation of performance deficiencies. Such information is often admitted into court to prove nondiscriminatory means of taking remedial action against employees and for termination of employment. Data showing unacceptable performance, particularly over a period of time, is a strong defense against such charges of unlawful bias.<sup>5</sup>

Finally, performance management systems facilitate the human resource (HR) planning process. Performance data can alert the organization to deficiencies in the overall level and focus of employee skills and can be used in critically planning for future staffing needs relative to the skills and abilities of current employees. Because performance feedback can perform multiple functions in any organization, the organization must determine how it will be used prior to developing the system. This will keep the system focused—rather than random—and allow the organization to determine the specifications of its design.

## Who Evaluates

The second strategic decision that must be made relative to the development of the performance management system concerns who provides performance data. Traditionally, performance evaluation was performed by the employee's immediate supervisor, who communicated to the employee the supervisory assessment of performance. This system offered very little opportunity for input or feedback from the employee. This approach, by itself, can be problematic for a number of reasons. Immediate supervisors often do not have the appropriate information to provide informed feedback and do not observe the employee's day-to-day work enough to assess performance accurately. It is also common in today's organizations for supervisors not to be current on the technical dimensions of a subordinate's work, which may be best evaluated by peers, customers, or other external constituencies. Technical line managers often have no training in or appreciation for the process and can see it as nothing more than an administrative burden. Finally, performance assessment is an inherently subjective process that is prone to a variety of perceptual errors by supervisors.

These errors include the halo effect, in which the rater allows one positive or negative trait, outcome, or consideration to influence other measures (e.g., if an employee is often late for work, that fact may impact ratings having nothing to do with tardiness); stereotyping or personal bias, in which the rater makes performance judgments based on characteristics of the employee rather than on employee performance (e.g., a bias that older workers are more resistant to change, less mentally agile, and less capable than younger workers of working longer hours); contrast error, in which the employee's assessment is based on those being given to other employees; regency error, in which the

evaluation is biased toward events and behaviors that happened immediately prior to the time the evaluation is completed, with little or no consideration given to events occurring earlier in the evaluation period; central tendency error, in which the evaluator avoids the higher and lower ends of performance assessment ratings in favor of placing all employees at or near the middle of the scales; and leniency or strictness error, in which employees are generally all rated well above the standards (making the supervisor look effective and/or attempting to appease employees) or well below the standards (making the supervisor look demanding). Personal biases and organizational politics may have a significant impact on the ratings employees receive from their supervisors.

There may also be a number of reasons why supervisors might intentionally inflate or deflate employee ratings. For example, an empathetic supervisor might inflate the rating given to an employee having difficulties with personal matters. Conversely, a supervisor who sees a subordinate as a threat to the supervisor's job might intentionally deflate performance ratings. The performance management process can be inherently political in many organizations. In most instances, when supervisors conduct performance evaluations, they personally have job and career issues at stake in the ratings they give to their employees.

In addition to these errors, supervisors and subordinates may agree on levels of performance but disagree on the causes for such performance. Research has shown that supervisors are much more likely to place the responsibility for poor performance with the employee, whereas the employee is likely to cite organizational factors outside his or her control for performance deficiencies.<sup>6</sup> Employees are much more likely to attribute their own job success to their own behaviors rather than to external factors, such as easy job assignments or assistance from others.

For these reasons, organizations have been moving away from traditional means of performance feedback where only one assessment of an employee's performance is conducted and completed by the immediate supervisor. In addition to supervisory input, performance feedback can also be sought from peers, subordinates, customers, and/or the employee. Feedback from peers can be useful for developmental purposes, but peer feedback systems must be administered with care. They can be very political and self-serving in organizations where employees compete with each other either formally or informally. When a peer has personal gain or loss at stake in the assessment of a colleague, he or she can hardly be expected to exercise objectivity. Competitive organizational cultures could cause a peer evaluation system to raise havoc throughout the organization by escalating conflict. This could have detrimental effects on morale and teamwork. Peer feedback systems can only be effective when political considerations and consequences are minimized (meaning that peers have nothing at stake in their assessments of colleagues) and employees have a sense of trust in the organization and its performance measurement system.

### Peer Assessment at Coffee & Power

Coffee & Power is a small San Francisco, California—based start-up where individuals can “buy and sell” small jobs. As part of its performance management and rewards process, each of its 15 full- and part-time employees is annually given 1,200 stock options to distribute to their coworkers in whatever way they see fit. Options may be given entirely to one individual or distributed to as many other coworkers as an employee decides. The only restrictions are that employees cannot give shares to themselves or to the company founders.

The system is designed to reward employee contribution, which might not always be recognized by management and also holds workers accountable for managing relationships with coworkers, a critical success factor in small start-ups where employees work closely together over long hours. Because the company is still privately held, the options only hold paper value at the present time. However, individual employee cash bonuses are tied in to this allocation system. Employees learn of the options and bonuses they receive but not who rewarded them. The owners prepare a distribution curve of all bonus grants without attaching individual names to allow employees see the highest and lowest bonuses as well as where they fit individually within the company distribution.<sup>7</sup>

Performance feedback from subordinates can provide insights into the interpersonal and managerial styles of employees and can assist the organization in addressing employee developmental needs, particularly for high-potential employees. Subordinate evaluations are also excellent measures of an individual's leadership capabilities. However, subordinate evaluations can suffer from the same political problems as peer evaluations. They can also be used by either the supervisor or subordinates to retaliate against each other. However, in assessing an employee's ability to manage others, valuable performance data pertaining to behavior and skills can be uniquely provided from subordinates.

Because our economy is becoming increasingly service oriented and because many organizations emphasize customer service as a key competitive and strategic issue, customers are increasingly being sought for feedback on employee performance. In most instances, customers can provide the feedback that is most free from bias: They usually have little or nothing at stake in their assessment of employees. Feedback from customers can be critical for facilitating employee development and determining appropriate rewards because it is most clearly related to the organization's bottom line.

Self-evaluations allow employees to provide their own assessments and measures of their own performance. Although it should be obvious that self-evaluation can be self-serving, allowing employees to evaluate their own performance has at least two important benefits for organizations. First, it can be motivating because it allows the employee to participate in a critical decision that impacts his or her employment and career. Second, the employee can provide insights, examples, and a more holistic assessment of performance than that provided by supervisors or peers, who generally spend a limited time observing and interacting with each employee. Individual employees are far more likely to remember significant examples of effective performance than their supervisors, and they can often provide specific examples of behaviors and outcomes rather than the generalities often cited by supervisors. Individual employees may also be able to provide performance information of which others may be unaware.

Performance management systems that solicit the input and advice of others besides the immediate supervisor are referred to as multirater systems or 360-degree feedback systems. These systems can be beneficial because the organization and employee gain multiple perspectives and insights into the employee's performance. Each of these sources of performance feedback can balance each other relative to any inherent organizational politics that may be at play in the process. However, there is a cost to such systems: They can be very time consuming and laborious to administer. Data from numerous sources need to be analyzed, synthesized, and, occasionally, reconciled. There is inherently a cost-benefit aspect to any type of multirater performance feedback system. The more performance data collected, the greater the overall facilitation of the assessment and development of the employee. At the same time, larger volumes of data are costly to collect and process. At some point, the collection of additional data will undoubtedly provide diminishing returns.

### Performance Management at Otis Elevator

Farmington, Connecticut-based Otis Elevator is the world's largest manufacturer, installer, and servicer of elevators, escalators, moving walkways, and other vertical and horizontal passenger transportation systems. Otis's products are offered in more than 200 countries worldwide, and the company employs more than 63,000 people. Among its many installations are the human transport systems of the Eiffel Tower, Sydney Opera House, Vatican, ON Tower (Toronto), and Hong Kong Convention Center.

For years, the company had an ineffective performance management system that was excessively time consuming and inspired little confidence among employees or managers. In revamping its performance management, Otis moved toward a system that provided performance feedback based on critical strategic competencies related to the company's new focus on project teams. For this realignment into project teams to be successful, managers were required to demonstrate specific competencies in both team leadership and project management as well as remain accountable for the financial and operating results of projects.

Realizing that critical feedback in these areas could not come exclusively from immediate supervisors, Otis had a custom-designed 360-degree feedback system developed that provided managers with feedback from those most directly affected by their performance: their subordinates, peers, and customers. The system provides ratings on several critical core competencies and is administered entirely online via the company intranet. The online system is easy to use, employs encryption technology to secure all data, and allows a performance review to be completed in 20 minutes. The system allows Otis to provide performance feedback in tandem with the organization's strategic objectives; is far more efficient than the previous paper-driven system; and, perhaps most importantly, has restored employee faith in the company's performance feedback system.<sup>8</sup>

The popularity and use of 360-degree feedback programs have increased dramatically in recent years: More than 65 percent of organizations now use some form of multirater feedback, despite the fact that 360-degree feedback programs have been associated with a 10.6 percent decline in shareholder value.<sup>9</sup> The reason appears to be that many organizations have jumped on the 360-degree bandwagon without careful planning and strategizing about why and how the program is being used within the organization. Unless each rater has a consistent view of effective performance relative to the organization's strategy, disagreements can cause unexpected conflicts and problems and result in communication breakdowns that require time to resolve. Despite their popularity, 360-degree feedback programs can create severe problems if not designed, implemented, and managed carefully. The organization's strategy and culture must support such a system. Otherwise, the organization runs the risk of performance problems that will inevitably impact bottom-line profitability and value.

Despite the advantages of multirater systems, collecting additional performance data results in a greater economic cost (relative to opportunity cost of the time of those involved in the process) and a more complex process in attempting to process and analyze the data to provide meaningful feedback to employees. If not designed and implemented carefully, 360-degree feedback systems can result in the collection and processing of excessive amounts of information that provide no benefit to either the organization or the employee. Such data overload can cause the most relevant, critical performance data to be lost or obscured in the process.

## What to Evaluate

The next strategic question that needs to be addressed involves determining what is to be evaluated. Essentially, employee evaluations can be based on their traits, their behaviors, or the results or outcomes they achieve. Traits-based measures focus on the general abilities and characteristics of the employee. They might include dimensions such as loyalty to the organization, industriousness, and gregariousness. Although assessment of traits can often allow the organization to determine how the employee fits with the organization's culture, such measures ignore what the employee actually *does*. Traits-based measures, therefore, are of limited use or value; the subjective nature of such nonperformance-related criteria would probably not hold up well in court in a discrimination complaint.

Behavior-based measures focus on what an employee does by examining specific behaviors of the employee. Factors assessed here might include the employee's ability to get along with others, punctuality, willingness to take initiative, and ability to meet deadlines. Behavioral measures are very useful for feedback purposes because they specify exactly what the employee is doing correctly and what the employee should do differently. This is critical as work-related behaviors are generally within the control of most employees. Of particular attention to most employers is the behavior of leaders, as discussed in Reading, 10.1, "Effective Leadership Behavior: What We Know and What Questions Need More Attention." However, it is possible for employees to engage in appropriate behaviors but not achieve results for the organization. Although employees may do the right things, their performance may not make a difference for the organization in terms of performance that relates to strategic objectives.

The third basis for performance feedback is to assess outcomes or results. Results-based measures focus on specific accomplishments or direct outcomes of an employee's work. These might include measures of number of units sold, divisional profitability, cost reduction, efficiency, or quality. Unlike traits and behaviors, results-based measures are often criteria that can be measured objectively. More important, results are generally more meaningful to the organization due to their more direct correlation with performance relating to the divisional or organizational strategy.

Although results may be a more significant measure of performance than traits or behaviors, there are some limitations to the utilization of results-based feedback measures. First, it may be difficult to obtain results for certain job responsibilities. Any tasks that involve dealing with the future (i.e., forecasting and planning relative to competition or assessing other dimensions of the external environment) will not show immediate results nor will the quality or accuracy of the work be assessable until sometime in the future. Second, results are sometimes beyond an individual employee's control. Budget cuts and resource availability may be at the discretion of others, but they may impact the employee's ability to generate specific performance objectives. Third, results—taken by themselves—focus on the ends or outcomes while ignoring the means or processes by which the results were obtained. An employee might achieve targeted goals but do so in an unproductive way by incurring excessive costs, alienating coworkers, or damaging customer relations. Finally, results are limiting in that they fail to tap into some critical areas—such as teamwork, initiative, and openness to change—of performance for modern organizations. The need for organizations to remain flexible and responsive to change in their environments requires them to have internal processes to facilitate internal change. Results-based measures would ignore these processes.

As can be seen, all three types of performance measures have some limitations. However, the strengths of one approach can offset the limitations of the others. Nothing prevents an organization from utilizing any combination of traits, behaviors, and results-based measures in attempting to develop a performance feedback system that is in sync with the organization's strategic objectives. In short, the decision of what to evaluate is contingent upon what the organization seeks to achieve.

In addition to traits, behaviors, and outcomes, one area that employers are beginning to measure is the job performance competencies the employee displays. Competencies can often be closely tied to an organization's strategic objectives and therefore provide a more critical measure of performance—as well as more valuable feedback for employees in their careers. A competency-based performance management program can take a tremendous amount of time to establish, must be communicated clearly to employees, and should also tie in with the organization's reward structure. A recent survey conducted by the Society for Human Resource Management found that 69 percent of employers utilize organization-wide competency models and 61 percent have developed organization-wide competency models, which allow variation in competencies by job level.<sup>10</sup> Core competencies should be limited in number to those most central to the organization's success, and corresponding opportunities should be established by which employees can obtain and build on these competencies. Exhibit 10.5 presents a sample competency model for managers that cuts across organization size and industry.

### Competency-Based Performance and Development at Capital One

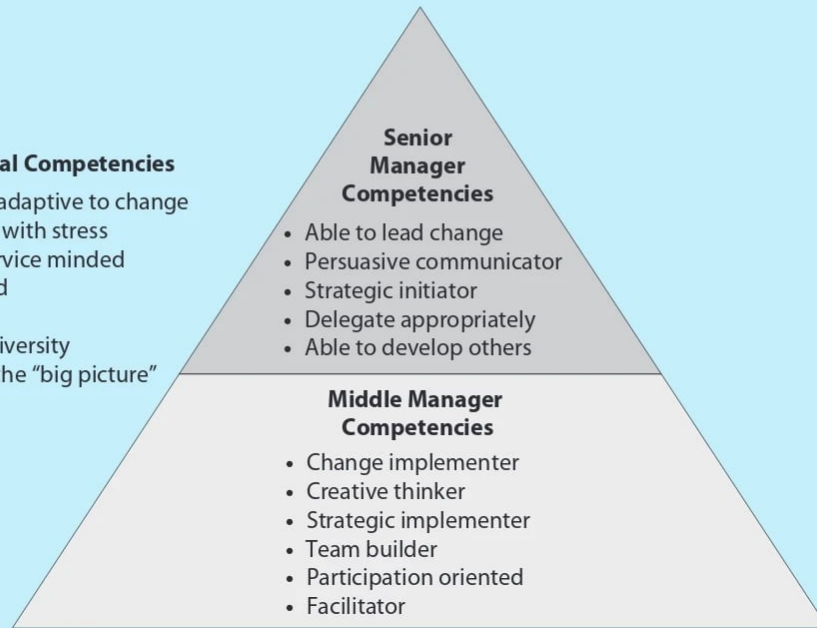
Capital One, one of the world's fastest growing consumer credit companies, utilizes a competency-based performance management system, known as the Success Profile, which is designed to support the organization's strategy and long-term growth objectives. The Success Profile is designed to provide specific measurable performance feedback as well as to allow employees to plan their own professional development activities. The Success Profile contains 23 competencies that are seen as critical to the mission and objectives of Capital One. These competencies are grouped together into five access factors, as illustrated in Exhibit 10.6. Each competency is measured on a behavioral-based rating scale containing up to four stages. Employees receive detailed performance feedback and work with their managers to develop a personal development plan for the future.

**EXHIBIT 10.5**

**Multilevel Corporate Competency Model**

**Core Managerial Competencies**

- Flexible and adaptive to change
- Able to cope with stress
- Customer service minded
- Open minded
- Team player
- Appreciate diversity
- Understand the “big picture”



Source: Adapted from Elmer Burack, Wayne Hockwarter, and Nicholas Mathys, “The New Management Development Paradigm,” 3rd ed., Human Resource Planning, Vol. 80(1), 1997, pp. 14–21.

**EXHIBIT 10.6**

**Capital One Competencies**

Success Factors	Competencies
<b>Builds relationships</b>	1 Communicates clearly and openly
	2 Treats others with respect
	3 Collaborates with others
<b>Applies integrative thinking</b>	4 Analyzes information
	5 Generates and pursues ideas
	6 Develops and shapes strategies
	7 Identifies and solves problems
	8 Applies integrated decision making
<b>Drives toward results</b>	9 Focuses on strategic priorities
	10 Organizes and manages multiple tasks
	11 Directs and coordinates work
	12 Gets the job done
<b>Leads in a learning environment</b>	13 Recruits talent
	14 Motivates and develops
	15 Builds and leads teams
	16 Influences others
	17 Promotes the culture

Success Factors	Competencies
Takes personal ownership	18 Takes responsibility 19 Learns continuously 20 Embraces change 21 Initiates opportunities for improvement 22 Shows integrity 23 Maintains perspective

## How to Evaluate

The next strategic decision that must be addressed in designing the performance management system is how to assess employees. Performance feedback can be performed on an absolute or relative basis. Absolute measures evaluate employees strictly according to the performance requirements or standards of the job; relative measures evaluate employees in comparison to coworkers. Relative measures may further involve slotting employees into categories, such as the top 10 percent of the employees in the work unit receiving an overall outstanding evaluation, similar to what is known in education as grading on a curve.

Relative assessment of employees can be useful in allowing the organization to identify overall top performers, much as high schools provide class rank to their students to facilitate college and university assessments for admission. However, if performance is not normally distributed, skewed results can provide misleading data: If all employees are outstanding performers, some will still be ranked poorly. Conversely, if all employees are deficient in performance, some will still be ranked as outstanding. For example, in a classroom setting, assume that there are 30 students in a class and that on a mid-term examination, all 30 students score 90 or above. If performance was ranked on a relative basis, a student who scored 90 would be ranked 30th out of 30, despite the fact that the student did “A” work in absolute means. Similarly, if on the final exam, the highest grade was a 55, that student would be ranked 1st out of 30, despite the fact that, on an absolute basis, the student failed the exam. Relative measures can easily facilitate distorted perceptions of performance when all employees are superior or deficient. Although they are useful in identifying the best employees, they should not be used without some supplementary absolute assessment and ratings that are specifically related to strategic objectives.

One popular—although controversial—means of relative assessment is forced ranking. Forced ranking, or forced distribution, involves placing employees into clusters or groupings based on a distribution schema. Forced ranking is premised on a social science theory that finds that human phenomena tend to distribute normally along a bell-shaped curve when measured by using sufficiently large samples.<sup>11</sup> Forced rankings ideally can help build a high-performance organization by ensuring that managers clearly distinguish among employee performance levels.

Forced ranking systems were pioneered by General Electric (GE) under former CEO Jack Welch. At GE, employees are sorted into three groups: the top 20 percent on whom rewards, promotions, and stock options are showered; the “high-performing” middle 70 percent with promising futures; and the bottom 10 percent, whose employment is terminated, either voluntarily or involuntarily.<sup>12</sup> Other large employers who use forced ranking systems include Cisco Systems, Hewlett-Packard, Microsoft, Sun Microsystems, and Pepsico.<sup>13</sup>

Those who favor forced ranking argue that it is the best way to identify both the highest-performing employees, who should receive generous incentives, and bottom performers, who should be helped up or out. It also provides data-driven bases for compensation decisions and forces managers to make and justify sometimes tough decisions and will not allow them to avoid giving employees needed feedback. Critics, however, argue that forced ranking can be arbitrary, unfair, and expose an organization to law suits.<sup>14</sup> Ford Motor Company abandoned its practice of forced rankings when it settled two class-action lawsuits for \$10.5 million.<sup>15</sup> To avoid some of the inherent subjectivity that might come with the final rankings, some employers outsource the final distributions to outside consultants who are able to analyze trends and correct biases in final ratings.<sup>16</sup>