The Five Fundamentals of
Effective Performance Management

BY DAVID G. COLLINGS AND JOHN MCMACKIN

In this article the authors present the five issues that any organisation must tackle in order to design a performance management process that will prove effective for their organisation.

Performance management is a very hot topic. Unusually for an HR topic, coverage of developments in performance management has moved beyond academic publications and the business press to attract mainstream media attention in recent times. During 2015 alone, over 50 major US employers including Netflix, Microsoft, Accenture and Deloitte and GE announced that they were undertaking a radical overhaul of their performance management (PM) processes that included discarding the traditional annual performance "rating". There have been a number of drivers of these changes including the significant time involved in the process (Deloitte estimated that up to two million person hours were involved in their performance management programme annually), to frustration with the process from employees and leaders alike, to concerns over the effectiveness of the process. Additionally, expectations for more frequent and real time feedback amongst employees accentuated the shift.

Given that performance management practices had evolved incrementally over the past 50 fifty years or more,[1] these rather sudden and relatively radical developments present a challenge to senior organisational leaders. Indeed, practitioners continue to struggle with designing a consistently effective PM process. A 2014 study by the Chartered Institute of Personnel and Development in the UK found that almost a third of employees (30%) believed their current PM process was unfair. Recent findings from professional services firm Towers Watson showed that nearly half of companies say their managers don't see the value in performance management. But what evidence are organisation's basing their decision making on in revaluating their approach to performance management? We urge some caution in this regard and encourage some reflection before jumping on the bandwagon and ditching performance management.

Drawing on an extensive review of empirical research on performance management combined with recent research that we conducted on PM practice, we offer five fundamentals that should inform and guide any organisation's review of PM in light of the current hype around changes to traditional approaches to PM. We suggest that

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by following these fundamentals, organisations reduce the risk of throwing the baby out with the bathwater.

The Five Fundamentals of Performance Management

Fundamental #1: Clear Shared Understanding of the Purpose of PM Among the Key Stakeholders in the Process

The first requirement for any organisation wishing to optimise the return on their investment in performance management is to develop a clear and shared understanding of the purpose of PM among the key stakeholders in the process. Our research identified fit with organisational culture, strategy and adaptability to a changing context as core considerations in this regard.

In our experience organisations that report the highest levels of effectiveness of their PM process, and satisfaction with it, have a clear sense of the purpose of the PM process and this clarity is shared by line management, the HR function and the employees. While not exhaustive the following were the key drivers of PM processes for the organisations in our study:

Purpose #1: Align behaviour with strategy. The first key purpose which drove PM in organisations was strategy alignment and implementation. This is illustrated in the following quote from an executive: "The main purpose of performance management in our organisation is to align the work of the employees with the objectives of the company."

Purpose # 2: PM as Productivity Enhancement. Driving productivity was identified as the primary focus of PM in a second group of organisations. In these organisations the direct link to organisational strategic priorities was sometimes less evident. However there was a strong focus on driving individual performance in a high performance culture. This quote from an executive is illustrative: "To increase productivity is the bottom line. To get more from our people, for them to produce at a higher level, not just volume, but at a stronger level."

Purpose # 3: PM as the Development of Talent/Potential/Values. A third grouping of companies emphasised the development of

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talent as well as supporting employees to reach their full potential as the key driver of PM, as exemplified in the following quote: "It is the cornerstone of our entire HR strategy. What we call vitality. Do we have the talent we need to support the growth of the business, where the company, the Chairman and the board want the business in 5 years' time."

While executives report quite diverse perceptions about the purpose of performance management in their organisations, the key starting point was a clear sense of the aim of PM. While PM can and does serve more than one of these purposes, in reality multiple purposes cannot all have equal priority. It is also important to note that not all organisations appeared to have the same level of clarity about what the organisation was trying to achieve via performance management. It would appear that, for some organisations, the performance management process is built on a shaky foundation of ambiguous purpose and inconsistent implementation. Those with the greatest clarity of purpose and priorities are also those who say their process is most effective. The opposite is also true, with those organisations reporting ambiguity of purpose also reporting low levels of effectiveness for PM and dissatisfaction with the process. This is a key challenge to the effective implementation of PM.

Fundamental #2: Line Management Ownership of the Performance Management Process

While the HR team may lead and facilitate performance management, evidence strongly suggests that ownership of the process by line managers is critical if the process is to deliver on expectations.

In those organisations where PM was perceived to be most effective, HR's key role was in facilitating the process while line managers were viewed as the principal stakeholder
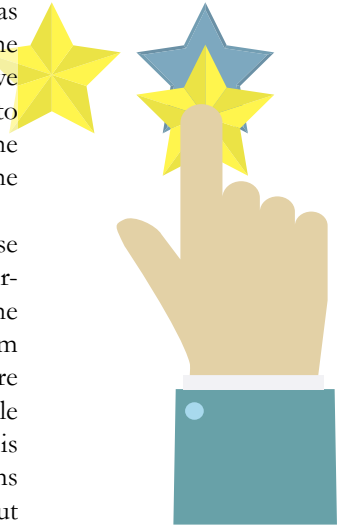
In those organisations that rated their performance management systems most positively there was a consistent focus on ongoing conversation and discussion.

in activating the process. As one executive describes it: "PM is very much a manager run process, rather than a HR run process……It is controlled by the business units."

Organisations reported very different levels of success in achieving this objective. For instance, a number of interviewees describe how senior line executives played a personal leadership role in the redesign of their PM process. However, in most cases once the new process had been rolled out, responsibility for the management and administration of PM (in particular ensuring that the process took place and evaluating effectiveness) was handed back to the HR function. So while in one sense PM in these organisations is led by line management, the perceptions of middle and supervisory management is often that it is a HR-owned process. The key role in successful PM is undoubtedly that of middle and supervisory management, who provide most of the feedback and conduct the reviews. Their perceptions concerning ownership of the PM process, and the perceptions of the employees they manage, are critical. This is one of the key challenges to be considered in not only the design but in the implementation of changes in PM.

Fundamental # 3: Goal Setting

Academic research provides very strong evidence about the value add from goal setting; several thousand published research studies provide clear evidence of the positive performance impact of setting challenging but achievable goals for any type of work. Better still, this research provides clear guidelines about the type of goal setting process to be used to

realise these performance benefits.[2] Most executives are aware that goals need to be SMART (Specific, Measurable, Achievable, Realistic, Trackable); and that to maximise commitment, the goal setting process must give employees a say in what goals are to be pursued. Recent executive interviews suggest that awareness of the importance of goal setting is widely reflected in practice; goal setting was a core element of the PM process for all of the organisations we studied. However, while goal setting is universally practiced, the way the process works varies significantly on three dimensions – the level of centralisation in the process, the scope of the process, and the relative emphasis on outcomes versus how they are achieved.

Level of centralisation. The process for setting goals ranges from top down, where goals are set centrally and "cascaded" down the levels of the organisation, to a more decentralised process in which local management work with teams and individuals to agree priorities and targets. More than half of the organisations in our study described quite a centralised, top down goal setting process. However, almost all of these organisations provide employees with some input before goals are signed off. A number of organisations also described how they use their IT system to create a "drop down menu" of goals that reflect strategic priorities, with local employees and managers typically empowered to customise these for local requirements. These organisations were generally the ones where the purpose of PM was to align individual goals and behaviours with corporate objectives and goals. This highlights once more the importance of clarity about the purpose of the PM process in deciding how it should work.

Scope of the PM process. Clarity of purpose will also inform the scope of the PM and goal setting process. In practice, the content of goals varies significantly, with some organisations focussing entirely on business results while others also place a heavy emphasis on employee development, as exemplified in the following contrasting quotes: "Personal development doesn't come into goal setting. That comes as a by-product of the behaviours and our vision of where they could be in 2-3 years. Goal setting is
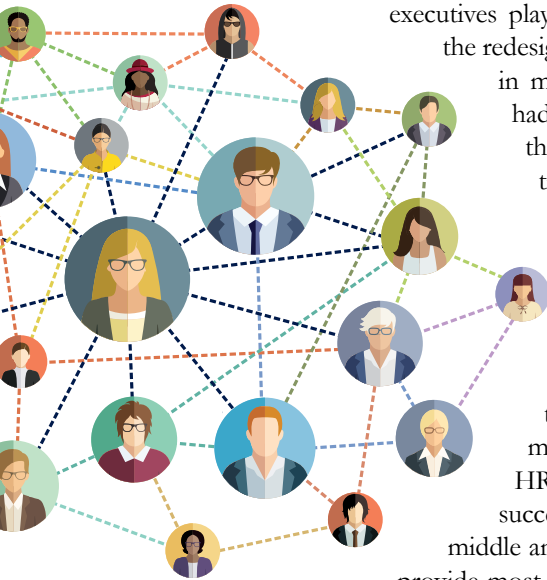
purely strategy driven" contrasts with "We have three tiers to our objectives and one of these is personal development. Every manager is required to ensure that there are at least three development objectives set for each staff member."

"What" versus "How" goals. A key trend in our study was an increasing emphasis on goals that focus on the "how" of performance and a shift beyond purely considering the outcome of goals. Indeed, in a number of organisations "what" and "how" goals were equally weighted in the performance discussion. In essence this recognises people for doing the "right things" and the fact that some factors outside of an individual's control may influence the achievement of outcome goals. This brings behaviours to the fore in performance management.

In sum, the inclusion of goal setting is necessary but not sufficient for effective performance management. This "fundamental" includes clarity about the level of local control of the goal setting process, the scope of the process and the relative importance of How versus What goals.

Fundamental #4: Feedback

The research evidence is unequivocal about the absolute requirement for feedback as a core element of performance management. Without feedback there can be no learning or improvement. However, there is significant variation in PM practice in terms of the frequency of feedback, who it comes from and how it is delivered. Feedback is the dimension of PM on which the recent high profile changes have focussed most heavily, partly reflecting new technological capabilities.

An effective PM process must provide ongoing feedback to employees, to support continuous improvement in performance. In our recent study, in those organisations that rated their performance management systems most positively there was a consistent focus on ongoing conversation and discussion.

Feedback frequency and focus. Most organisations already mandate interim reviews during the annual PM cycle. The number of "mandated" reviews varied with the average being three to four "interim" reviews. Recent innovations include more frequent "just in time" feedback delivered via apps; for example, in some organisations employees now receive immediate feedback on their performance after key events such as client meetings or presentations; this feedback is delivered via apps directly to the employees' phone, laptop and desktop, and is often framed around key behaviours specified in the organisation's competency framework.

Who feedback comes from. Traditional performance management was a dyadic process involving an employee and their manager. More complex processes such as 360 feedback were reserved for more senior executive development programmes, partly due to the costs involved. Technology now enables the provision of feedback quickly, cost efficiently and securely from a range of sources. This is a key factor in the adoption of 360 feedback much more widely in many organisations.

How feedback is delivered. As noted above, we see significant changes in how feedback is delivered. Traditional PM feedback emphasised interpersonal conversations backed up by appropriate documentation; as noted above, new practices involve many different ways of delivering feedback. Because many of these practices are so new, there is limited research evidence on which to base decisions in introducing these initiatives but it certainly seems that technology facilitates the provision of frequent and real-time feedback.

As with goal setting, feedback is a necessary but not sufficient condition for effective performance management. The "fundamental" on feedback includes clarity about the frequency with which feedback is to be delivered, who it should come from and the balance of electronic versus interpersonal communication. All of these choices will be informed by the strategy and culture of the organisation, the requirements of the business model and the purpose of performance management.

Fundamental #5: Alignment Between PM and Other HR Processes

Key evidence from HR research highlights the fact that no single HR process can have a significant impact on behaviour or results in isolation. No matter how well designed or implemented, individual HR practices such as performance management have very limited effects on employee

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Alignment between performance management and other linked processes of remuneration and talent management will be key to realising the benefits of effective performance management.

PM and Remuneration. One of the most contentious issues in PM design and implementation is unquestionably the link to remuneration. The sensitivity attached to this issue means it is the subject of ongoing debate in many organisations. We found very significant variance in the level of alignment between PM and remuneration within our sample. For some organisations, PM appears to have become a vehicle for lending at least the appearance of objectivity to the allocation of variable remuneration.

A key question which has recently emerged concerns how bonus and reward decisions are made in those organisations that have discarded performance ratings. One organisation in our recent study was ahead of the curve in doing away with ratings four years ago, and offered an interesting reflection on their experience with linking PM and remuneration: "Since we've abandoned ratings we haven't had any issues on pay increases. So I do think it's working really well. Because it was the numbers we fought about in the past, you tend to have open ended, honest performance discussions. So when it comes to the pay discussions, and the manager has been given a budget and they have a certain amount to allocate. They do that and we don't see push back." The linkages to the need for a shared understanding of the purpose of PM as discussed above are evident here.

PM and Talent Management. Respondents in our study reported surprisingly poor linkages between their performance management process and their talent management strategies; given the critical effects of PM on the experience of employees, this suggests a significant opportunity to enhance organisational effectiveness in attracting and retaining talented employees.[3] This was a somewhat surprising finding given the focus on performance and potential in talent management systems. However, it possibly reflects the lack of sophistication of talent management strategies in many organisations. One particularly interesting question to

emerge from the shift away from performance ratings is how organisations will evaluate talent in the absence of formal performance ratings. Overall it seems that there is potential for value generation through greater alignment of PM and TM in organisations.

It is clear that there is no "silver bullet" in deciding how linkages between PM, remuneration and talent management should operate. For any organisation aspiring to a highly effective PM process however, there seems little doubt that getting this right for their organisation is a critical success factor.

To Conclude

Recent media coverage has served as a reminder of the critical importance of performance management to organisational effectiveness. For many executives, aligning the PM process with the changing demands of business and employees presents a significant challenge; there may be a temptation to blindly adopt what are perceived to be "best practices" in the current environment. The reality is that effective PM relies on developing a process that is uniquely adapted to the strategy, culture and stakeholder needs of your own organisation. In this article we have highlighted what the evidence suggests are the five essential issues to consider in developing your own PM process. These can guide you to creating a performance management process that is not only effective but can become in itself a source of sustainable competitive advantage for your organisation. **EBR**

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