Reengineering Performance Management

How companies are evolving PM beyond ratings

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INTRODUCTION

The NeuroLeadership Institute (NLI) has been closely studying the move away from performance ratings, since 2011. At that time, only a few organizations had publicly made the shift. By fall of 2015, between 50 and 70 large companies had abolished ratings-centric performance management (PM), including Accenture, Deloitte, and GE.

As others consider following suit, they naturally have questions about the challenges, benefits, and implementation of non-ratings-based PM. The experience of a small number of these companies has been catalogued, but few larger-scale analyses of PM innovators have been done.

What becomes possible when you insist performance management is more than ratings?

This report is one of the largest field studies to date of organizations who have made the leap beyond appraisal scores. It discusses trends identified by the NeuroLeadership Institute from in-depth interviews with 33 large organizations who redirected their PM practices away from ratings.

The bigger story is that these companies are revamping their performance management entirely. Instead of focusing on ratings, next-generation PM centers on quality conversations about growth and development designed to improve engagement and performance. This is done according to companies' unique values, objectives, and culture, without compromising the HR function. This report is about companies who have not only asked, "What happens when you remove performance ratings?" but are also exploring the question, "What becomes possible when you insist performance management is more than ratings?"

SURVEY OF PM INNOVATORS

Whom we talked to

The NeuroLeadership Institute identified 52 PM change leaders who had eliminated appraisal scores as their primary performance management tool. We conducted in-depth interviews with 33 of these companies. Our interviewee sample directly paralleled the larger set of the 52 PM innovators across several demographic factors (Figures 1–4), suggesting representative experiences. We purposefully focused on larger organizations, inferring that their practices would inclusively address key challenges and possibilities faced by smaller firms.

Interviewees included CHROs, CTOs and talent directors, and CLOs—people directly involved in the implementation and/or management of the reinvented PM approach.

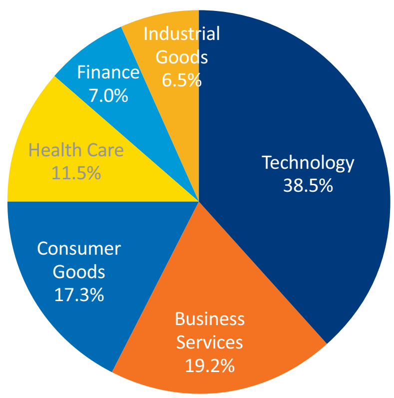

Figure 1: Companies by sector

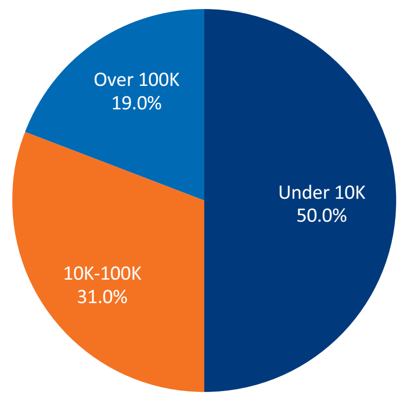

Figure 2: Companies by number of employees

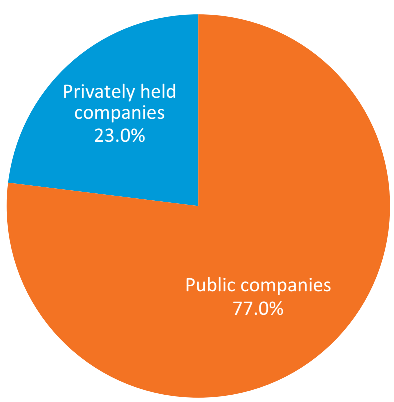

Figure 3: Companies by public vs. private sector

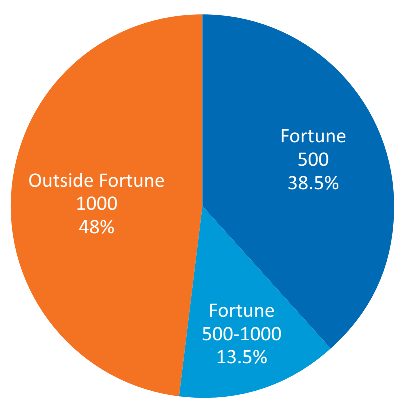

Figure 4: Companies by Fortune 1000 ranking

What we asked

We explored organizations' intentions, philosophies, implementation, and their observations about results.

Our questions centered on:

- business drivers for change
- objectives of the new approach
- structure of old process versus new
- frequency and focus of manager-employee performance conversations
- internal rebranding of the PM system
- implications for talent assessment
- implications for compensation and rewards

Responses were translated into itemized data points and analyzed by the NeuroLeadership Institute's Research team.

TRENDS: PM BEYOND RATINGS

Philosophy

1. Companies want better business performance from PM.
2. Most companies are rebranding PM.
3. Structure isn't going away.
4. There is no "one size fits all" model.
5. Companies are streamlining significantly.
6. Change management matters.

Conversations

7. More performance conversations are happening.
8. Conversations are more about growth.
9. Goals are getting more focus.

Evaluation

10. Both results and behaviors are being discussed.
11. Low performers are still being robustly managed.
12. Everyone still identifies top performers.
13. Performance and compensation conversations are separated.
14. Pay for performance is alive and well.
15. Pay differentiation is not at risk.
16. Manager discretion is coming back.

SOURCE: NEUROLEADERSHIP INSTITUTE 2015

1. Companies want better business performance from PM.

84% of the companies we interviewed set explicit objectives for their new PM process (Figure 5). Business performance was paramount (Figure 6), and companies sought to achieve this by focusing on individual development, accountability, and alignment. The idea to remove ratings was in some cases secondary to the internal realization that a company's current PM system just wasn't working. Some organizations expressly stated they didn't start out with the intention to remove ratings but instead to determine and implement a performance management framework that would best enable their desired business outcomes; removing ratings happened to be a key component to achieving those outcomes.

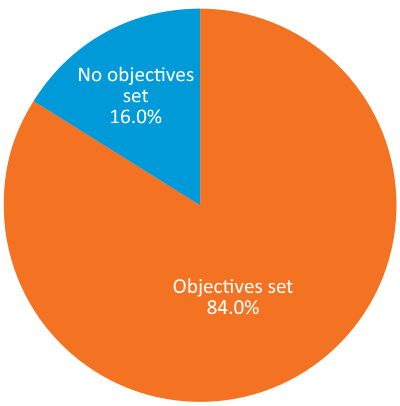

Figure 5: Companies that set explicit objectives for their new PM processes

Figure 6: Explicit objectives of new PM systems by frequency
Source: NeuroLeadership Institute Survey, 2015

TREND | Philosophy

2. Most companies are rebranding PM.

90% of the companies we interviewed (Figure 7) rebranded their PM using words that evoke growth, strengths, forward vision, and company niche (Figure 8). The retail company, GAP, for example, chose "GPS"—its NY Stock Exchange ticker symbol, an obvious navigation association, and an acronym for its new PM goals of "Grow, Perform, Succeed."

The rebranding was more than companies' nominal nod to their new performance management philosophies. Those who did choose to rebrand typically said it was a reflection of their commitment to a new culture focused on growth and development. The new PM brand represented a values refresh with regard to how these companies want to manage the people that work for them—by focusing on strengths and creating systems that engage and motivate employees to do their best work.

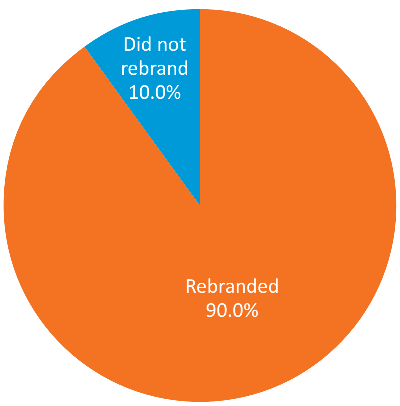

Figure 7: Companies rebranding their PM process after abandoning ratings

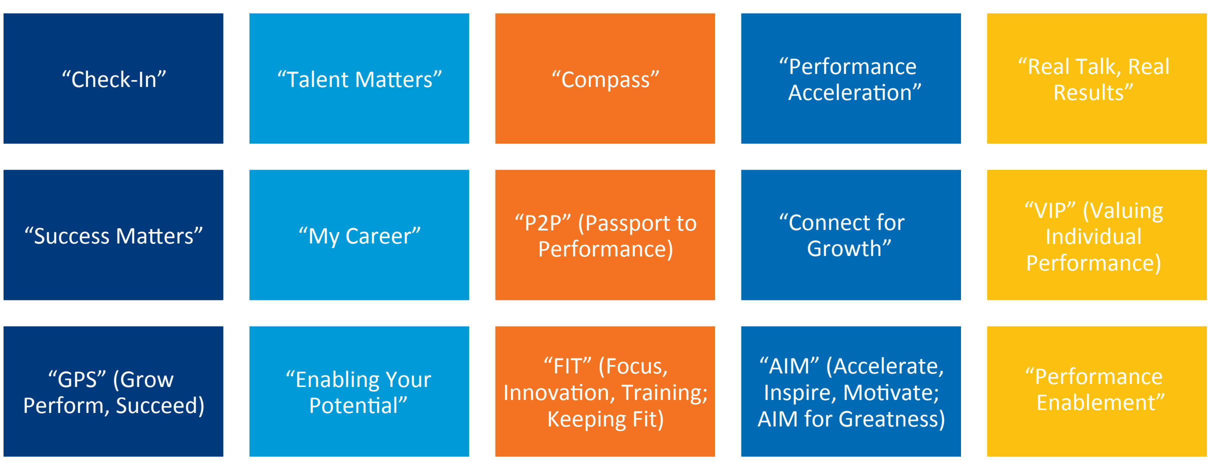

Figure 8: Examples of companies' rebranded PM initiatives

TREND | Philosophy
3. Structure isn't going away.

Before making the decision to remove ratings, companies are often concerned about how they will continue to manage evaluation and compensation. But companies who have made the shift are successfully figuring out how to assess, compensate, and reward their people (including pay for performance and pay differentiation). In addition, even though managers are given more discretion over the frequency of performance conversations, the number of these conversations throughout the year typically increases. Ratingless PM does introduce logistical challenges, but companies who make this choice are designing ways to tackle them.

TREND | Philosophy
4. There is no "one size fits all" model.

Companies are creating customized performance management structures that meet their unique needs and cultures. Benchmarking is often done to build the business case for eliminating ratings. But instead of using other organizations' experiences to identify a hard set of best practices, companies are adapting what they learn to develop performance management strategies and practices they can apply to their own unique and changing PM needs.

"It wasn't just a new process but the best new process for us."

"As we grew, performance management was no longer 'one size fits all,'" one executive said. Another noted that the "hallmarks of our new performance management system are speed, agility, and constant learning; it's 'one size fits one.'"

The takeaway is that there is no "templated" right approach to revamping PM. The organizations we interviewed stressed that new PM infrastructures reflected their specific identity, culture, and business aims. As one company described, it wasn't just a new process but "the best new process for us."

5. Companies are streamlining significantly.

A full **93.3%** of PM change leaders expressly reduced administrative load by lightening performance documentation: **63.3%** required less documentation, and **30%** eliminated formal documentation altogether (Figure 9).

Companies like Deloitte and Adobe have elsewhere reported that the entirety of their former PM processes represented an enormous time input. Deloitte determined it was investing over two million hours per year to evaluate its 65,000+ employees.[1] Adobe calculated the equivalent of 40 full-time positions annually for its performance management processes.[2] Performance management is too significant an investment to retain traditional approaches that fail to deliver the desired business outcomes.

The intention was not only to improve cost-benefit results. Rather, the opportunity was to proactively create opportunities for more-meaningful conversations. One company discouraged its managers from taking "copious notes, so they can instead be present and develop insights." Another reported, "We weren't focused on the right pieces of the process. We wanted to shift our focus from the piece of paper to the person. It's easier to coach without having the formal ratings process—without having to document it on a piece of paper."

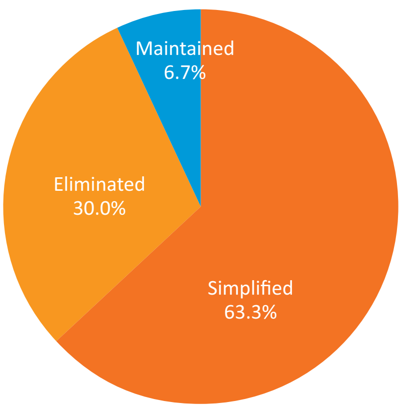

Figure 9: Companies that modified documentation requirements for performance conversations

1 Marcus Buckingham and Ashley Goodall. Reinventing performance management. *Harvard Business Review,* April 2015.
2 Stacia Sherman Garr. *Abolishing Performance Scores: A Practical Guide.* Bersin by Deloitte, July 2015.

6. Change management matters.

Companies who did not invest in change management say they regretted it.

Companies are designing change management initiatives to usher in their new PM systems and saying this is critical to successful early adoption of PM change by managers and employees.

A key element was arriving at a solid business case. Some organizations, for example, benchmarked and sought out subject matter experts in learning and behavior change (including the NeuroLeadership Institute and other sources). According to these companies, a pivotal next step was to educate line executives about the business case for revamping the PM practice; these execs then became naturally inclined to advocate for both the significance and time-urgency of the proposed PM change.

The companies who did not invest in dedicated change management and who instead prioritized rollout of their new PM systems within quick time frames reported that they regretted it. Contrast this with the experience of one organization that reported sustainable **91%** participation in its new, non-mandatory manager training and development processes—a success rate that the company credits largely to its change management initiative to introduce the new PM framework.

TREND | Conversation

7. More performance conversations are happening.

Without exception, companies abandoning ratings-centric PM are implementing more performance conversations. In conventional PM practices, performance dialogues were typically once-yearly (**76%** of companies); after a PM revamp, the required norm was "at least quarterly" (reported **68%** of interviewees) or "biannually or triannually" (**24%** of organizations). Figure 10 depicts the clear increase in valuing greater conversation frequency.

A sharp majority of companies (**87.9%**) are also recommending additional performance conversations beyond the mimimum required: **56.7%** suggest "ongoing" conversations for in-time feedback as needed, and another **13.5%** of companies recommend additional dialogues at least biweekly (Figure 11). One company described its new PM system as encouraging "the right conversation at the right time."

In that spirit, the frequency of additional recommended conversations beyond the base requirements was not policed; instead some companies say they are "empowering managers to make the right decisions and allowing for their discretion."

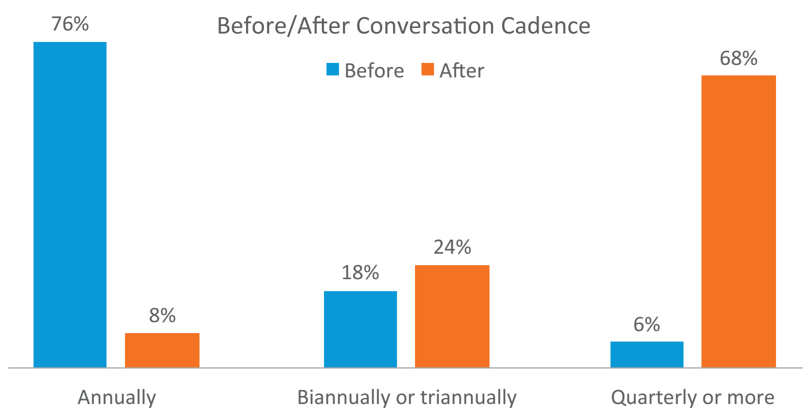

Figure 10: Comparative performance conversation frequency before and after removing ratings
Source: NeuroLeadership Institute Survey, 2015

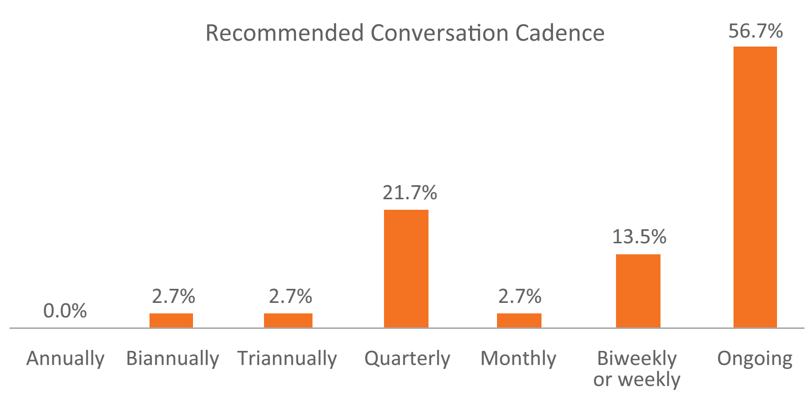

Figure 11: Recommended additional performance conversation cadence after removing ratings
Source: NeuroLeadership Institute Survey, 2015

TREND | Conversation
8. Conversations are more about growth.

Performance dialogues in revamped PM focus on goals, growth, and development through a coaching approach. Companies are shifting their performance conversations from assessment to development, focusing on goals and forward-facing action (Figure 12). One organization summarized its new approach as "providing feedback in ways that empower individuals, drive performance, support development, and create a sense of purpose."

Figure 12: Conversation focus by frequency in performance dialogues after removing ratings
Source: NeuroLeadership Institute Survey, 2015

All companies adapted a variety of performance conversations to best suit their needs. New approaches included a mix of conversations about goal setting, performance progress, career development, etc.

Companies reported that their refocus on quality conversations was well received by employees and managers alike. One company said that focusing dialogues on development and not just assessment "changed the conversation in a positive way. Instead of talking about the rating label that people had received, management talked about the contribution the individual made. Employees loved it, and the managers loved it."

TREND | Conversation
9. Goals are getting more focus.

Without ratings, companies are rethinking the number of goals they expect their people to achieve and are moving to fewer goals that are more actionable. Organizations are no longer expecting delivery on a cascade of goals assigned to managers and passed down to employees. Instead, managers are being given more flexibility to set goals with their people throughout the year, allowing for more-agile responsiveness to the work they're doing at the time.

TREND | Evaluation

10. Both results and behaviors are being discussed.

Companies that eliminate ratings make a shift to evaluating employee activities in light of business impact. They depart from evaluating solely against goals and standard competencies. Enterprise contribution is then assessed based on a broader range of criteria, such as level of stretch goals, direct and indirect support of team members, levels of innovation, and thoughtful risk-taking.

TREND | Evaluation

11. Low performers are still being robustly managed.

100% of companies have clear processes in place to identify low performance (for example, "on track/off track" designations). Once low performers are identified, a more-structured, more-documented performance improvement plan is put in place for those individuals.

TREND | Evaluation

12. Everyone still identifies top performers.

100% of companies say they are identifying and rewarding top performers accordingly. Even the few who use corporate-wide modifiers to adjust annual base pay have additional incentives for high performers, such as cash bonuses and/or stock.

TREND | Evaluation
13. Performance and compensation conversations are separated.

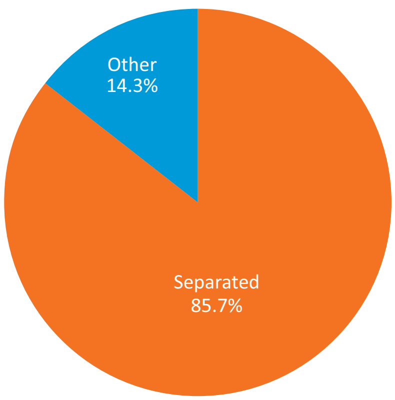

Figure 13: Companies separating performance from compensation in manager-employee dialogues

85.7% of interviewees formally decoupled compensation discussions from performance conversations (Figure 13)—chronologically (over time lapses), conceptually (with respect to conversation topic), and/or procedurally (using separate tools). As one company observed, distinguishing compensation dialogues from performance dialogues "allows for a more-honest conversation. People don't feel like they're suddenly reduced to a number or a letter."

TREND | Evaluation
14. Pay for performance is alive and well.

Every company we interviewed retained performance-based compensation. The structure of compensation options (for example, base pay, merit increases, bonuses, equity, additional total rewards options) needn't change once ratings have been eliminated. What changed for these PM innovators was that they no longer tightly coupled decisions about pay, promotion, retention, etc., to a single annual performance rating.

As one company explained, "We're not walking away from pay for performance at all. Instead, employees are getting paid for a much broader definition of performance."

TREND | Evaluation

15. Pay differentiation is not at risk.

The ability to differentiate pay across talent, once ratings have been removed, is a common concern. Among the companies who were expressly tracking possible changes in differentiated pay in their post-ratings PM systems, most reported either no change or a slight increase in differentiation. And as one organization observed, its former ratings-based practice "didn't [even] differentiate the performance. Having a rating didn't ensure that higher performers were getting a higher amount."

"Having a rating didn't ensure that higher performers were getting a higher amount."

Up to **46%** of companies interviewed are refining their calibration approaches to differentiate pay, while **18.8%** have implemented either shadow ratings (informal ratings undisclosed to the employee) or merit matrices (tools to incorporate market value into assessments of performance for a given job title).

Our interviewees further reported that their philosophy behind calibration changed entirely; managers were no longer using calibration sessions to justify number ratings but instead to benchmark levels of contribution across the organization.

TREND | Evaluation

16. Manager discretion is coming back.

Each of the companies we interviewed allowed more manager discretion in determining the frequency of performance conversations. Many organizations also gave managers more discretion in compensation and reward decisions. The implicit—and typically explicit—intention was to equip managers with the outlook, support, and processes they needed to retain and develop their employees.

Once ratings have been abandoned in favor of conversation-based PM, the importance of managers' coaching skills is quickly highlighted. Supervisors in a coaching-based PM culture who are poorly skilled at engaging in quality conversations are a critical risk factor. The companies we interviewed recognized that managers need to be skilled in having quality performance and career conversations in order to achieve the goals of their new PM systems. These organizations realized that in addition to developing their new PM processes, it's essential to develop the people leading those processes. As one interviewee stated, "Manager discretion raises the stakes for managers to really know their people."

"Manager discretion raises the stakes for managers to really know their people."

The increase in manager discretion also calls for upping their capacities to mitigate bias. One company noted that its former PM system had been actively introducing bias into performance assessments. The challenge of bias exists whether PM includes ratings or not, but next-generation PM approaches can allow new opportunities to address bias more effectively.

THE NEUROSCIENCE OF REIMAGINED PERFORMANCE MANAGEMENT

Neuroscience research points to reasons why refocusing performance management beyond ratings may be advantageous. For the past 15 years, the NeuroLeadership Institute has tracked current neuroscience research into positive behavior change and learning. Three neuroleadership principles are particularly relevant to performance management:

- **SOCIAL THREAT & REWARD**
  How social interactions affect performance
- **INSIGHT**
  How to change behavior (ours and others')
- **GROWTH MINDSET**
  How beliefs influence our ability to develop

SOCIAL THREAT & REWARD

How social interactions affect performance

Humans are psychologically primed to detect threat before reward. Traditional performance management—an annual review and the reduction/synthesis of a person's performance and development into a single variable—can trigger a threat response across five drivers of human motivation. These drivers are described by the SCARF® model, which classifies social threats and rewards to one's sense of Status (relative importance to others), Certainty (ability to predict future outcomes), Autonomy (having a sense of choice), Relatedness (feeling safe and familiar with others), and Fairness (being treated justly compared to others).[3]

When people feel threatened, their capacity to make decisions, solve problems, and collaborate with others is hindered, which may explain the losses in engagement and increases in attrition some companies see following conventional annual reviews. Conversely, rewards in all five domains may be activated when employees feel their growth and development is firmly supported by frequent, informal, strengths-based conversations with their managers.

3 David Rock. SCARF®: A brain-based model for collaborating with and influencing others. *NeuroLeadership Journal* (1), 2008.

INSIGHT

How to change behavior (ours and others')

Insights—self-generated new realizations, or "aha" moments—have important benefits for learning, engagement, and lasting behavior change.[4] Encouraging others to have their own insights (as a manager might do with an employee in a coaching-based performance conversation) is best achieved by reducing another's perception of threat and then allowing them space and time for insights to arise naturally.

The PM innovators we interviewed recognized the value of generating insights. In conventional PM with annual ratings, managers typically inform an employee of his or her feedback rating and then instruct that employee on how either to maintain good performance or improve lesser performance. In coaching-based, exploratory dialogue, managers ask questions designed to encourage an employee's own insights about improving her or his own performance. Arriving at one's own insights tends to lead to lasting learning and to encourage positive behavior change—more so than if one were simply given the same information by someone else.

GROWTH MINDSET

How beliefs influence our ability to develop

Performance ratings tend to reinforce a fixed mindset—the (mistaken) view that intelligence and performance capacities are inherent and cannot be developed. Growth mindset, on the other hand, is a belief that capabilities can be developed.[5]

A fixed mindset is associated with less-effective learning. Those with fixed mindsets in the workplace may be motivated more by outcomes and other people's judgments than by a focus on their own learning and development.

Growth mindsets correlate with more-effective learning and better performance (for example, time management and cooperative collaboration). Companies that believe in the potential of all employees (not just high performers) to develop and to contribute to enterprise performance naturally demonstrate a growth mindset. These companies' PM frameworks focus on timely, forward-looking coaching feedback. Growth-mindset organizations avoid assigning numerical values to individuals. They value progress over perfection, build a culture of accepting, and learning from, mistakes, and facilitate more-effective leadership in others.

4 Josh Davis, Christine Chesebrough, David Rock, and Christine Cox. Why insights matter. *NeuroLeadership Journal* (6,) 2015.
5 David Rock, Josh Davis, and Beth Jones. One simple idea that can transform performance management. *People & Strategy,* 36(2), 2013.

CONCLUSION

Crossing the "line of courage"

This white paper captures the experiences of companies that removed ratings as the central focus of their performance management practices. The NeuroLeadership Institute has described removing ratings as "crossing the line of courage." Conventional performance management assumes a close association between individual ratings and enterprise performance. PM innovators are advancing what could be called a movement to abolish ratings and re-create performance management to better reflect their particular values and business goals.

These organizations understand that the evolution of performance management, for themselves and more broadly, is yet in its early stages. They realize, as forerunners, there are interesting challenges yet to be addressed, including:

- Clarifying the optimal link between performance and compensation in a no-ratings world
- Determining more-effective ways to conduct talent reviews, succession planning, and other HR processes in absence of ratings
- Improving real-time feedback tools and processes (an enormous culture shift for many companies)
- Developing manager capabilities with training and tools

Companies are meeting these challenges in ways that make the most sense for their unique cultures and business goals. While their approaches may differ, the common foundation is an awareness that developing and implementing any new performance management process is a journey—one of continuous and responsive innovation and never a "one and done" initiative. These organizations recognize that the ultimate goal of performance management is to attract, retain, and develop talent for enterprise value. Further research will elucidate emergent leading practices as more companies move to next-generation performance management.

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ABOUT US

The NeuroLeadership Institute (NLI) develops neuroscience research into actionable insights to make organizations better. With NLI's process-focused and outcome-driven frameworks and methodologies, organizations and individuals are able to facilitate positive change and lead more effectively. Our offerings span three practice areas—Performance Management, Diversity & Inclusion, and Learning & Change. NLI partners with leading companies and organizations in all sectors across the globe, with operations in North America, Europe, Asia-Pacific, South America, and Africa. Visit us at www.neuroleadership.com.

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