NeuroLeadership Institute
INDUSTRY RESEARCH

Is Transforming **Performance Management** Worth It?

Data from 27 Companies in Year 2 and Beyond

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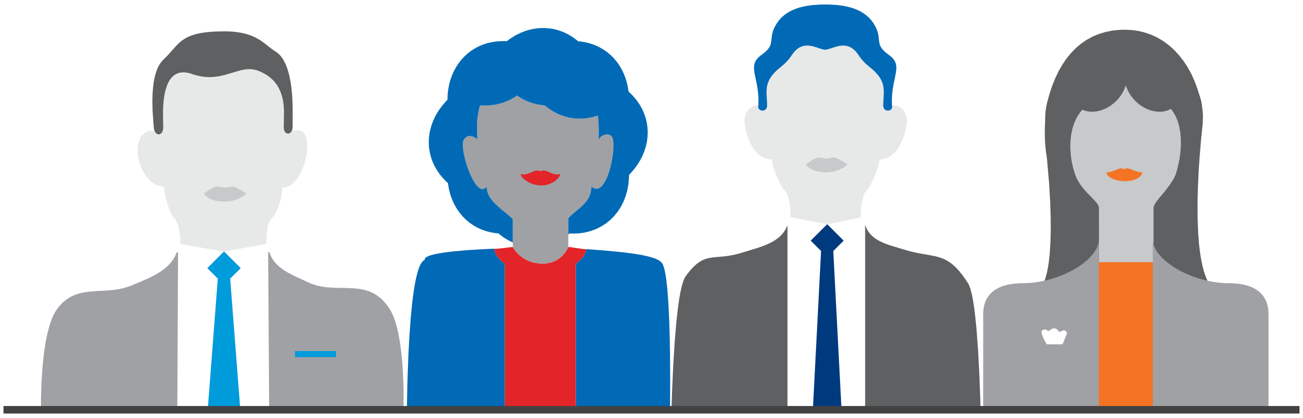


INTRODUCTION

With global markets, work cultures, and technology evolving in unprecedented ways,[1] HR and business professionals have been taking a hard look at performance management (PM) to better support individual and organizational performance. In today's organizations, work priorities change frequently, and employees often work in cross-functional teams without direct oversight from their managers.

A growing number of companies are finding that traditional performance management—largely centered on a single end-of-year appraisal to encapsulate an employee's contributions—isn't meeting expectations. Up to 96% of HR leaders have reported dissatisfaction with aspects of their current PM process.[2] In response, as many as 83% of organizations are considering or have made changes to their PM.[3] This includes up to 150 larger companies, such as GE, Accenture, Microsoft, and Goldman Sachs, that have redesigned their PM processes—and, in so doing, eliminated end-of-year ratings that rely on a single number (or letter).

1 See, e.g., Accenture. Technology Vision 2016: *People First: The Primacy of People in a Digital Age,* 2016; ADP. *The Evolution of Work: The Changing Nature of the Global Workforce,* 2016; Deloitte. *Global Human Capital Trends: The New Organization: Different by Design,* 2016

2 CEB Corporate Leadership Board. *The Real Impact of Eliminating Performance Ratings: Insights from Employees and Managers.* CEB, 2016

3 *The Real Impact of Eliminating Performance Ratings,* 2016

For the past two years, the NeuroLeadership Institute (NLI) has studied organizations that redesigned their PM approach. These companies no longer focus on a single year-end performance review. Instead, they are turning to more-frequent performance conversations throughout the year and placing value on PM processes they believe can lead to higher business impacts.

Given that this approach to PM aligns with key neuroscience findings about the principle drivers of human motivation, we have focused our studies to date on companies that have removed end-of-year ratings. It's an early trend in performance management but one that continues to gain momentum.

Our 2015 study[4] looked largely at companies in their first year of a new PM process. This year's report describes the experience of 27 companies in Year 2 or later after transforming their performance management approach. These organizations had positive experiences with their PM transformations and were thus perhaps more willing to discuss their experiences openly. But they were also candid about their challenges. Even still, each company remains convinced that the new PM approach addresses gaps and limitations of their previous framework. We believe the experiences of these companies can offer valuable insights to any organization considering changes or improvements to its performance management.

4 David Rock, Beth Jones, and Camille Inge. *Reengineering Performance Management.* NeuroLeadership Institute, 2015

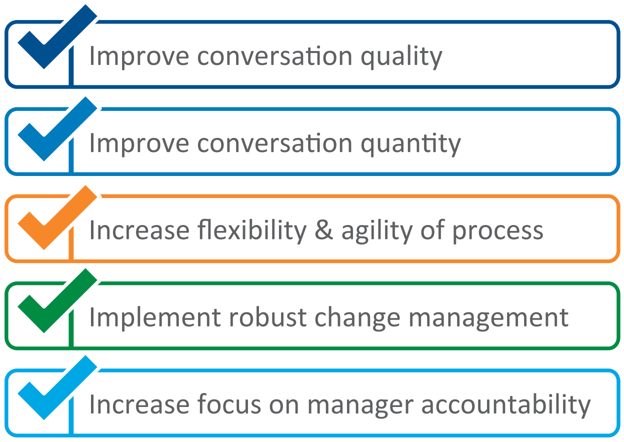


Figure 1. What companies say must be done for successful performance management after removing year-end alphanumerical ratings

Of companies tracking **conversation quality, 100% report improvements** or sustained positive results

(N=25) p. 5

PM: So much more than end-of-year ratings

Much of the discussion about performance management in the past few years has centered on end-of-year numerical ratings and whether or not to remove them. The NeuroLeadership Institute recognizes that, in and of itself, removing year-end ratings offers no guarantee of improvement over conventional PM. Yes, there are science-based reasons why traditional end-of-year ratings may be less effective, as we've discussed elsewhere.[5] Still, to focus discussions about PM solely on ratings is to miss the point. Any company embarking on a PM redesign has a bigger vision—to better match the way work gets accomplished in today's organizations and to support and drive performance in real time. For some companies, this has meant investing in a new PM architecture and culture, of which removing ratings represents but one (however impactful) component.

A recent study by the CEB Corporate Leadership Council, *The Real Impact of Eliminating Performance Ratings,* described challenges a few companies had faced in removing year-end ratings.[6] Building on the conclusions of that study, the NeuroLeadership Institute agrees that organizations should only consider removing end-of-year numerical ratings if they commit to three things: (1) to increase the frequency of performance conversations throughout the year, (2) to include a future focus in performance conversations, and (3) to create and maintain foundations for the culture shift, with strong change management.[7] The companies we interviewed agreed with, and expanded on, this list (Figure 1). By their view, an effective PM redesign requires:

- Increased conversation quality
- Increased conversation frequency
- Increased focus on manager accountability
- Increased flexibility and agility of the PM process
- Robust change management

5 *Reengineering Performance Management,* 2015; see also Discussion, p. 21

6 *The Real Impact of Eliminating Performance Ratings,* 2016

7 David Rock. *Don't Remove Performance Ratings (Unless You Are Willing To Do Three Things Well).* LinkedIn, 18 May 2016

METHODOLOGY

Our research looked at the aggregate experience of 27 companies that reengineered their performance management approach. For the current study, we invited companies interviewed for our 2015 report. In addition, we invited dozens of organizations that we had determined from press announcements and other sources to have removed end-of-year ratings from their PM.

We held closed-group workshops and conducted one-to-one interviews with HR leaders from a total of 55 companies. The interviews were open-ended dialogues based on 25 questions about architecture, successes, and challenges in HR processes and outcomes. Data was drawn from notes and transcriptions from workshops and interviews, as well as internal survey results from the companies themselves. Where possible, we augmented our data with publicly available information from recorded webinars, business press articles, and additional reports and materials provided by the interviewees.

The research examined the collective experience of 27 companies in their thirteenth month or later of reengineering performance management. This was not intended as a longitudinal analysis (although again, some organizations had also participated in our 2015 research). For the current study, 52% of interviewees were in Year 2, and the remainder in Years 3, 4, or 5+ (see Figure 2). The study population was similar to that interviewed for our previous report.[8] Half are large companies (50% with between 10K and 100K+ employees (Figure 3). Most are publicly held (85%); of these, 48% are Fortune 500 and 26% are Fortune 1000 (Figure 4). A range of industries is represented, including technology (33%), healthcare (19%), professional services (15%), media and communications (15%), consumer goods (11%), and financial services (4%; Figure 5).

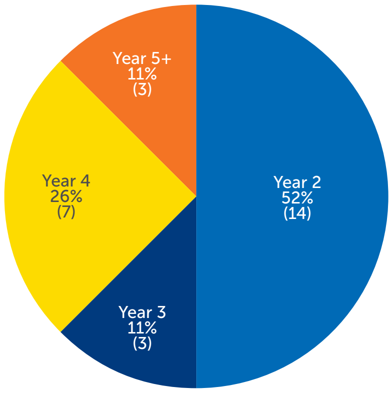


Figure 2. Companies by year of PM change*

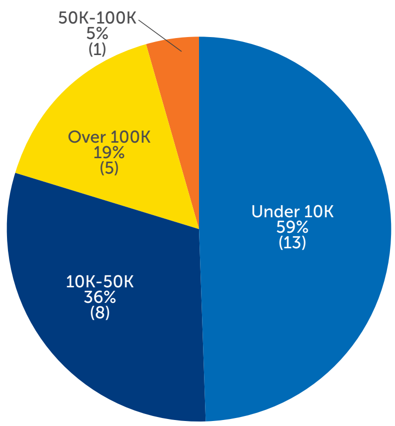


Figure 3. Companies by number of employees*

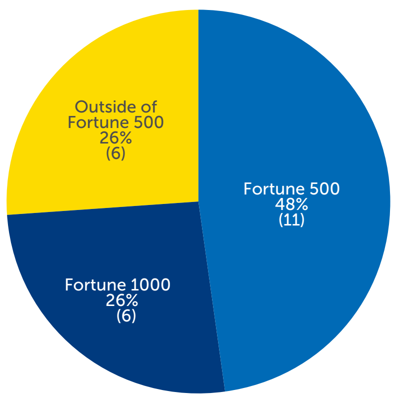


Figure 4. Companies by Fortune 1000 ranking*

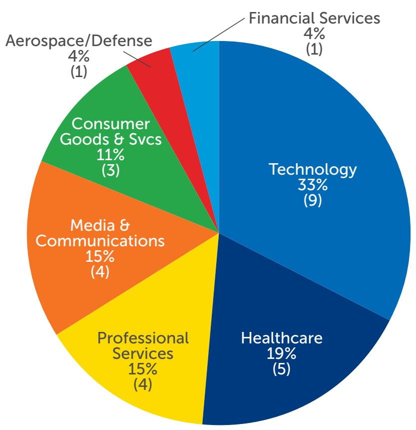


Figure 5. Companies by industry*

*Number of companies, in parentheses

8 *Reengineering Performance Management*, 2015

OUR FINDINGS

Year 2 and beyond of a new PM approach

What are the results?

1. **Conversation quality improves**
2. **Conversation frequency rises**
3. **Employee engagement goes up**
4. **Pay differentiation increases**
5. **Is it worth the investment so far?**

What's new?

1. Year 1 PM architecture passes the test
2. Year 2+ sharpens the focus on execution
3. Feedback is the new black
4. Manager capability takes center stage
5. Manager accountability is trending
6. Manager discretion is still alive and well
7. Evaluation gets enriched—not eliminated
8. Talent reviews get more attention
9. Change management is still the secret weapon
10. Documentation and compliance lighten up
11. Tools, training, and technology get simplified

What's next?

1. Technology is the big disruptor
2. Team performance gains momentum
3. Bias in PM deserves a fresh look
4. Compensation may need a rethink

SOURCE: NEUROLEADERSHIP INSTITUTE 2016

WHAT ARE THE RESULTS?

For this study, we focused our research on Year 2+ companies, as they were more likely to have data to describe the results of their investments in their new PM process. The majority of our interviewees are tracking specific measures to gauge the success of their PM transformation, including:

- quality of performance conversations
- quantity of performance conversations
- employee engagement
- pay differentiation

In addition, companies mentioned more nuanced success metrics specific to their unique business contexts. Technology and publishing companies, for instance, said it was important to reduce and therefore monitor voluntary turnover. One professional services company, who is already several years into its new PM approach, is tracking only one measure of PM success: the strength of its high-potential talent pipeline. Three additional companies highlighted talent agility as a key success metric of their new PM framework. These measures were tracked through engagement and pulse surveys, along with data supplemented from additional sources, including internal focus groups and reports from key organizational stakeholders such as business leaders and HR business partners (HRBPs).

1. Conversation quality improves

Of the 93% of interviewees actively tracking conversation quality, **100%** said conversation quality continues to trend upwards. Seventy-eight percent (78%) based their conclusions on their most recent engagement and/or pulse surveys,[9] from responses to such statements as "Conversations with my manager have had a positive impact on my performance" and "My manager gives me constructive feedback that enables me to grow."

The companies we interviewed that have looked at conversation quality longitudinally have generally seen an average increase of **2–3%** per year, by their particular measures. One striking exception is a 25% increase, reported by an engineering company, over a two-year period.

One senior partner at a global professional services firm offered her view as someone who had recently made a lateral move to join the company's PM team. From her dual perspective both as a "recent employee" and now new HR leader, "The contrast in conversation quality [from before the PM redesign] is so huge that if we were to go back to the old system, it would be reverse evolution. You simply don't go back."

Moreover, several HR leaders said they had received personal messages from employees to thank them for the PM change, such as the email below from one software engineer manager about the company's year-end wrap-up conversations:

> *I've had the most comfortable performance conversations this year since I've been a manager here, and I've heard the same from many of my peers. I have been able to clearly review engineers' results and identify any growth areas. Since we had monthly pulse and coaching training, we were in complete agreement—and I was able to get these conversations completed in record time. Did I tell you how much I appreciate your introducing this new process? Awesome!*

9 The remaining 22% tracked conversation quality according to qualitative data.

Sentiments like these were not uncommon. According to our interviewees, employees frequently indicated that conversations are now *more honest, open, two-way, forward-looking* and *more meaningful.* This included four companies that, during the course of reengineering their PM, had concurrently experienced organizational changes such as layoffs, mergers and acquisitions, or new executive leadership—disruptions that might well be expected to negatively affect survey scores, morale, or performance.

> "The contrast in conversation quality [from before the PM redesign] is so huge that if we were to go back to the old system, it would be reverse evolution. You simply don't go back."

While conversation quality increased across the board, every interviewee acknowledged that further progress is in order and that the ability to drive quality performance conversations is a skill that must be developed over time for many managers. As several said, continuous training and development—delivered just-in-time and targeted towards managers' specific needs—are critical for both quality conversations and broader PM success.

2. Conversation frequency rises

Of the 27 companies we interviewed, 85% are actively tracking measures of conversation frequency. In Year 1 of their PM transformation, the majority of companies had set standards for recommended conversation cadences. Of those tracking, **83%** of our interviewees this year reported that conversation frequency increased over time, and the remaining **17%** said that conversation cadence has been maintained. Four companies tracking longitudinal data reported a **3–10%** increase per measurement period, across all types of PM conversations (e.g., performance, check-ins, career, goals, feedback). Overall, companies told us that things are moving in the right direction, with "more people following the new process" and "more people increasing key capabilities."

Seventy-eight percent of companies are assessing conversation frequency through engagement and pulse surveys[10] ("I have ongoing check-in conversations with my manager," or "My manager and I have performance discussions at least once a quarter"). In these surveys, companies are increasingly focusing on outcomes over activity: instead of continual pulse surveys that ask "Did you have a conversation with your manager this quarter?" companies more precisely inquire "Did you understand what is expected of you?" and "Have you received guidance and feedback this quarter that is helping you perform at a higher level?"

Every company continues actively to recommend "ongoing and as-needed" performance management conversations. Those that have guidelines for minimum conversation cadences nonetheless expect continual performance conversations throughout the year (see *Year 1 architecture passes the test,* p. 9).

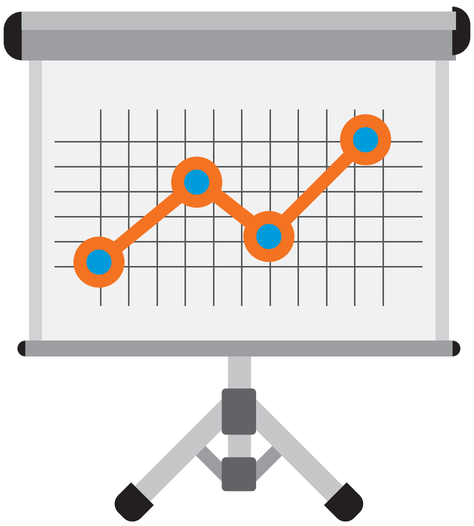
3. Employee engagement goes up

To assess the effectiveness of a new PM approach, a majority of companies look to employee engagement as an indicator. Of the 27 companies we interviewed, 81% are tracking employee engagement. (The remaining 19% did not report recent engagement data, as they either had a survey pending or their organizations do not conduct engagement surveys with regularity.) Among the companies tracking engagement measures, **73%** saw a longitudinal increase of engagement concurrent with the time frame of the new PM rollout. The remaining **27%** of companies that did not share year-over-year data reported positive engagement results according to their latest surveys.

It is common knowledge that engagement scores can correlate to many initiatives and factors within an enterprise. Only a handful of

10 The remaining 22% assess conversation frequency according to anecdotal data.

companies expressly included questions about performance management in their most recent engagement surveys. Still, considered in concert with other results they were tracking, engagement levels are valued by most of our interviewees as an indirect indicator of performance (with engagement relating to business performance, and performance management relating to engagement).



In its ninth study into the link between business performance and employee engagement levels, Gallup reported results of a comprehensive meta-analysis of workplace engagement at over 230 organizations spanning 49 industries and 73 countries. Gallup's latest analysis again confirmed a significant relationship between workplace engagement and business performance. Business and work units in the top half on employee engagement measures have success rates up to 78% higher than other units within their organization and up to 113% higher success rates across all business units analyzed in the study.[11] In addition to overall engagement, Gallup looked at factors that leaders and managers could have direct influence on, several of which directly relate to performance management:

- "I know what is expected of me at work"
- "In the last six months, someone at work has talked to me about my progress"
- "There is someone at work who encourages my development"
- "In the last seven days, I have received recognition or praise for doing good work"

Their results showed a highly generalizable direct relationship between engagement and several business outcomes, including productivity, profitability, customer metrics, and employee turnover.[12]

4. Pay differentiation increases

The experience of the majority of our interviewees confirms that pay differentiation increases without end-of-year ratings. When companies are in the early stages of rethinking PM and considering dropping year-end numerical appraisals, one of their biggest concerns is maintaining a pay-for-performance philosophy and ensuring ongoing differentiation. Our data shows that companies are finding ways to ensure that their original compensation philosophies remain intact. Of the 27 companies we interviewed, 89% are tracking pay differentiation.[13] (The remaining 11% reported that either they have chosen not to track this data currently or lack the resources to do so.)

Of those tracking pay differentiation, **80%** noted an increase in pay differentiation over time; the remaining **20%** said pay differentiation was maintained. One company said it "sees more discretion at the business unit level than there has ever been." Even companies that had strong pay differentiation before redesigning their PM reported continued improvements. This was the case of a Fortune 100 healthcare company whose "results were consistent with and/or better than our prior year"—even though it had already had "very good differentiation before eliminating ratings, providing managers with full discretion for compensation decisions and our highest contributors receiving the greatest rewards."

5. Is it worth the investment so far?

Of the companies in their second year or later after having transformed their PM, **100%** responded with an emphatic "yes" to the question

11 James K. Harter et al. *The Relationship Between Engagement at Work and Organizational Outcomes: 2016 Q12® Meta-Analysis: Ninth Edition.* Gallup, 2016.

12 The Relationship Between Engagement at Work and Organizational Outcomes, 2016

13 The results reported by our interviewees do not include employee perception.

"Has it been worth it so far?" Again, we recognize these were companies having positive experiences with their PM transformations overall. Despite the multiyear efforts and investments required for an enterprise change like PM, these organizations stand behind their choice. As one Fortune 500 e-commerce company said:

> *PM reengineering is complex. It's daunting to get leaders to take on this kind of thing, as they are responsible for business success. It is, however, a game changer that brings disruptions—in a positive way. And it has brought other human capital strategies and leader behaviors into a more future-forward posture.*

Our interviewees recognize that improvements overall must continue and that seeing the new PM approach through to its full potential requires ongoing investments—for example, into change management, technology, and training (see *What's New,* p. 9).

100% of companies tracking **conversation frequency** report **increases or sustained** cadence

(N=23)
p. 6

Still, each and every company remains committed to the new PM approach—again, including companies that implemented the PM change during difficult business cycles. As one HR leader said, "We made the right choice to eliminate ratings, even in a challenging climate. Now we're in a position to lean in and lean forward, from an operational stance, from an organizational perspective."

"A change in PM shifted the value back to our people and now better supports our business mission... It's harder than we thought—but it's an evolution and we need patience for continued improvement."

One company may have summarized the collective viewpoint of our interviewees best, noting that the PM change not only met the objectives the organization set when it implemented the change but should, furthermore, usher in unforeseen future benefits and possibilities:

> *We can already point to ways it's been worth it—but we can't even point to "how worth it" it is yet. In five years, this conversation will be very different. So far, seeing more and better conversations alone makes it worth it—and this impacts performance and business results. We have so much more data than we did before. For example, before we didn't have the best means to differentiate between people. Now we know much more about our people throughout the year. Over time, we anticipate even more organizational impact. This is only the beginning.*

WHAT'S NEW?

What changes—and what stays the same—in later years of evolving PM

Employee engagement improves or stays the same in **100%** of companies tracking this data

(N=22) p. 6

As companies continue into later years of their new performance management, the focus expands—from establishing the necessary foundations, to the execution of the new process and to addressing challenges that arise along the way.

1. Year 1 architecture passes the test

In Year 2+, companies keep the architectures they put in place in Year 1 of redesigning their performance management approach. (Architecture comprises type, content, and cadence of conversation; documentation requirements; employee evaluation criteria; degree of manager discretion, etc.) Among the companies we interviewed, **88%** reported no architecture change whatsoever from Year 1 (Figure 6). Minor to moderate changes were introduced by **8%**. Only one organization (currently in Year 6) reported any significant changes to its architecture over time, due mainly to changing organizational philosophies brought in by a new CEO.

Companies also continue to have the same mosaic of performance conversations they introduced in Year 1, including coaching, feedback, career and development, compensation, and performance.

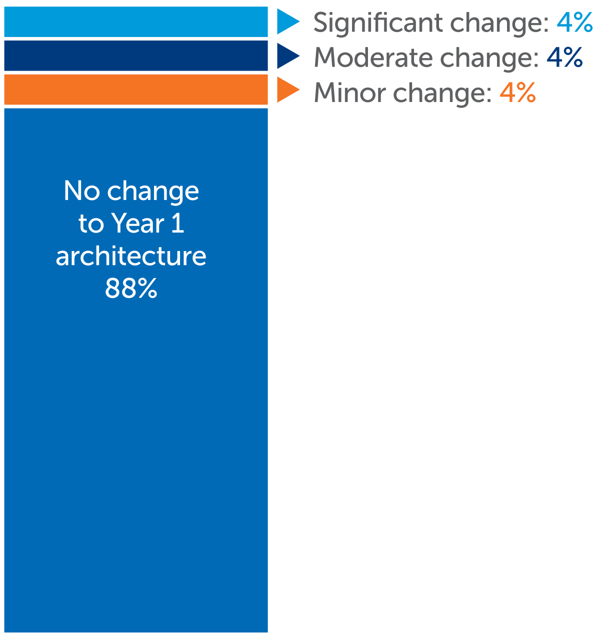


Figure 6. Companies retaining Year 1 architecture over time

Planning pays off

Before changing to a new PM process, companies may invest months to strategically plan their new PM approach: benchmarking with other companies' experiences, consulting relevant industry research and perhaps research on neuroscience and behavior, and gathering input from stakeholders, including employees. These investments appear to pay off. As one company described it, "We did a good job rolling out [the new PM framework] initially. The architecture has stood the test of time." Additionally, several companies said they were purposefully holding off on further changes to allow the new PM strategy to take root and its impacts to be assessed. One veteran has retained the same architecture from its initial PM change over eight years ago—and it reports continued positive employee engagement over the same time frame.

All companies continue to recommend an ongoing conversation cadence to keep managers and employees aligned on performance expectations and results (67% call for an absolute minimum of one conversation quarterly; 17%, at least twice annually; and 16%, at least three times a year).

Over half of those we interviewed (**58%**) eliminated formal year-end conversations and instead have year-end wrap-ups that are distinctly different from the formal performance appraisals of their previous PM approach. Instead, these conversations are high-level reviews of the previous year's performance. They also serve as an opportunity for managers and employees to plan how to take learnings from the current year and apply this learning going forward. Often, these conversations are also to generate "time capsule" content that employees can bring forward for future reference in environments where, as HR recognizes, employees are frequently assigned new managers. Only 15% of companies still conduct formal mid-year reviews, and even these organizations said the mid-year conversations increasingly take the form of check-ins about goal progress.

One company in particular observed that employees appreciated ongoing, more frequent conversations enough to be proactively requesting them. Two professional services companies said that employees still perceived the new year-end reviews as formal review "events"; even still, both companies observed that, when done effectively, ongoing conversations are not only sufficient to support employee performance and development but also make year-end evaluations less of a surprise to employees. As one interviewee stated, "The negative connotations around the end-of-the-year review were lifted." And to make clear that performance discussions are no longer the compensation-linked appraisals of the past, **93%** of companies we interviewed continue to separate performance conversations from compensation conversations.

2. Year 2+ sharpens the focus on execution

According to the companies we interviewed, Year 1 of a PM redesign is to roll out a new

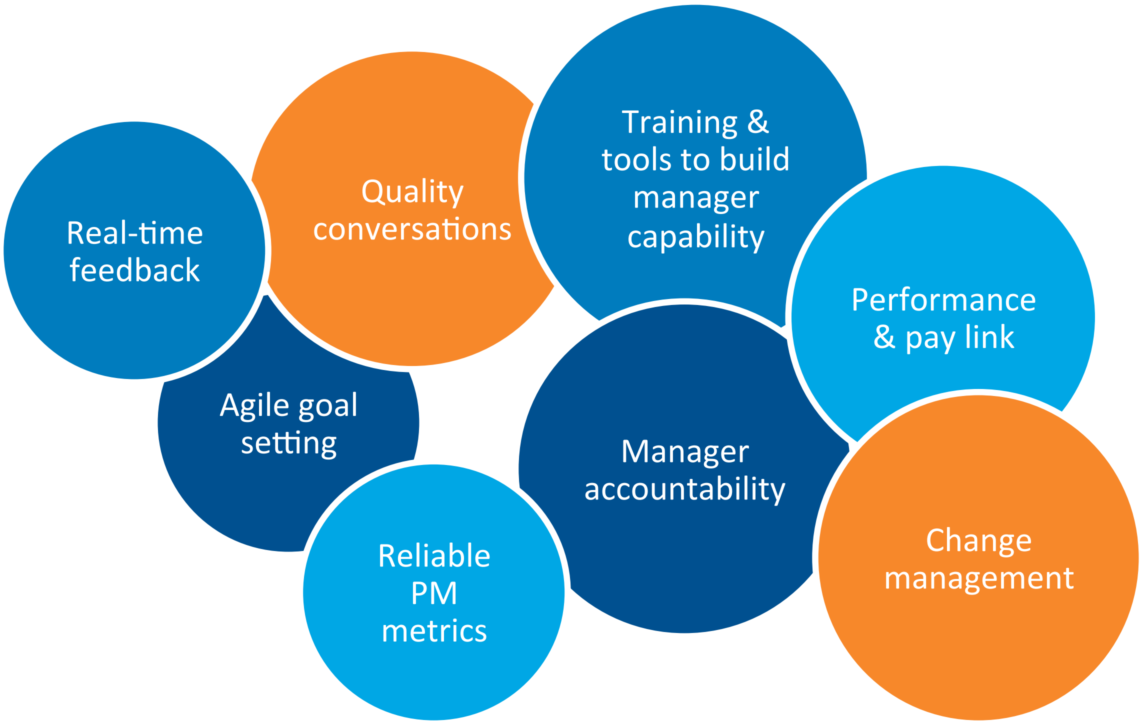


Figure 7. Companies in Year 2+ after a PM redesign focus on refining execution

Figure 8. Companies in Year 2+ invest in tools and training for better execution of the new PM approach

architecture and to help managers and employees understand and begin to use the new approach. The focus is on building baseline capabilities to support the architecture (see Figure 7, p. 10). In Year 2+, companies lean in to fine-tune execution of the process—to further increase adoption and effectiveness throughout the organization. (A crux of this is continued change management; see p. 15.)

Close attention is particularly paid to more effective conversations and real-time feedback, which companies support by continued ongoing training and additional tools. The aim is that both managers and employees feel confident—and become ever more competent—in executing the new PM process. All of our interviewees continue to invest in capabilities in these critical areas, through simplified, easier-to-access training and tools (including applications for mobile-enabled feedback and more-agile goal-setting and results tracking; see Figure 8).

In the new framework, employees are given ownership to actively participate in the PM process: 80% of companies we interviewed encourage employees to take more responsibility for performance conversation frequency. Employees are expected to proactively request conversations with their managers if they feel they aren't getting sufficient timely support or guidance.

3. Feedback is the new black

In many of our interviews, one type of performance conversation that gets specific attention in Year 2 and later is feedback. Ongoing, real-time feedback was consistently mentioned as a specific goal of a new PM approach, and companies are turning to technology to support this: **63%** of the companies interviewed are either considering new feedback technology or have already implemented such.

In the new PM, companies say that continuous, timely feedback is critical to help employees navigate fast-changing workplaces, where "just-in-time" course correction is needed to stay on track with priorities and deliverables. Of our interviewees, **77%** expect continual feedback conversations throughout the year (19% specify an absolute minimum of once per year, and 4%, twice yearly; see Figure 9).

Approaches to strengthening feedback are multipronged. Several companies encourage managers and employees to regularly review feedback from many sources in order to identify patterns (rather than overemphasizing single-source data). Vocabulary is changed such that "feedback" is explicitly and formally renamed (to reduce employee perceptions of feedback as judgment or labeling, it is now called "insights," "input," or "perspectives"). And managers and employees alike are increasingly expected to be skilled at offering both constructive and positive feedback and to do so on a regular basis.

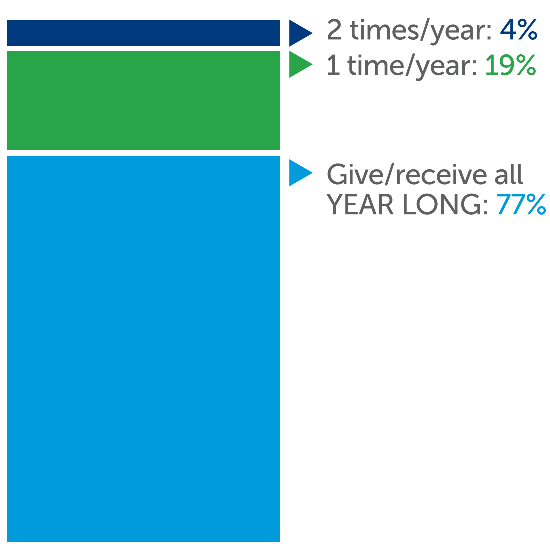


Figure 9. Companies in Year 2+ emphasize ongoing feedback throughout the year

Feedback is also becoming multidirectional, moving from the traditional manager-to-employee model to incorporate peer-to-peer and employee-to-manager input and, for certain roles, customer feedback. In addition, over **80%** of companies are explicitly empowering employees to take ownership of their growth and development. "Your career is in your hands," said one technology company in describing its philosophy about employee development; "if your manager doesn't reach out to you to schedule a conversation, you can reach out to them."

More than just multidirectional feedback, some companies are actively looking to create a "culture of feedback"—where inputs from many sources are viewed as necessary information to help work get done optimally. Rather than focusing on event-focused performance feedback, a feedback culture recognizes and demands that both constructive and positive inputs are simply part of regular communication across the company.

Just-in-time continuous feedback calls for more user-friendly, agile technology platforms, which as we noted above, 59% of companies recognize. The idea is to make it easy for managers and employees alike to give and review feedback "on the go." As one senior-level HR director shared, she values being able to give feedback to her team of over 50 direct reports through a mobile app—a task she can now complete in the time it takes to commute to or from work. A small number of companies (11%), though, are explicitly emphasizing face-to-face, in-person feedback versus inputs offered via technology platforms.

4. Manager capability takes center stage

As a recent CEB study acknowledged, without strong manager capability, a new PM approach's likelihood of success drops significantly.[14] Companies in the early stages of rethinking their PM process often express concern about their managers' ability to have effective performance conversations once year-end ratings are removed.

Those we interviewed have made manager capability a primary focus from the outset. They recognized early on that conversation quality is critical to PM success. Seventy-seven percent (**77%**) of our interviewees are actively focused on building and improving manager skill across a range of performance conversations. Eighty-

14 The Real Impact of Eliminating Performance Ratings, 2016

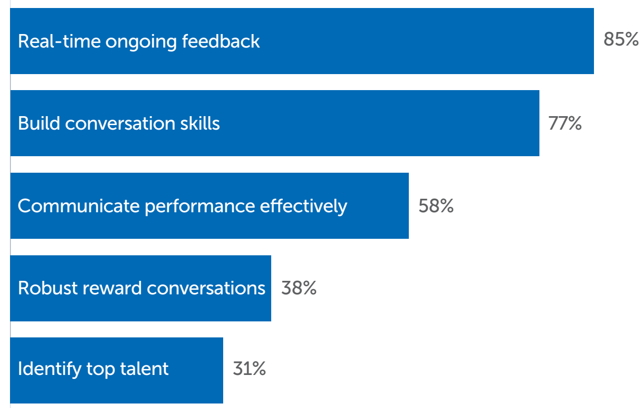


Figure 10. Areas of focus in building manager capability

five percent (**85%**) are specifically honing in on improving managers' ability to give real-time, ongoing feedback. And a small number of companies (**11%**) are going a step beyond to provide managers with coaching training and certification (Figure 10).

As we discuss in the section on change management below (p. 15), the majority of companies who embark on a PM redesign view the transformation not as a one-time process but, instead, a journey of several years. They believe that manager capability for effective performance conversations can be improved, and they commit to providing the training and tools necessary to support this. The majority of organizations offer reference materials (including checklists, conversation guides, and tip sheets), as well as resources via websites and portals, communications including blogs, and bite-sized learning in the form of micro-videos and research summaries. Training programs are shortened and offered virtually to be increasingly "just in time." Some companies said they are leveraging "learning communities" to boost manager coaching skills, involving peer catalysts, role playing, or training labs so that managers can become practiced in various performance conversations.

Close attention in particular is paid to reward conversations. As well as being able confidently to apply discretion in pay decisions, managers are expected to be able to clearly communicate to their direct reports the link between the latter's compensation and performance. This becomes a potentially more challenging task once managers can no longer "hide behind a rating" or "blame it on HR policy," as companies said of some managers when end-of-year ratings were still used. As our interviewees acknowledged, it can be more complex to describe employee performance effectively in purely qualitative terms. Even still, companies demand that managers figure out how to do so. In addition, managers are expected to help employees understand clearly how their individual goals link to broader organizational goals.

5. Manager accountability is trending

As companies move into later years of their PM redesign, they increasingly consider how to hold managers accountable for high-quality performance conversations as part of their jobs. It's not enough that managers feel confident in their abilities to execute a given PM process (though one interviewee does survey its managers to gauge how confident they feel to execute the new PM approach).

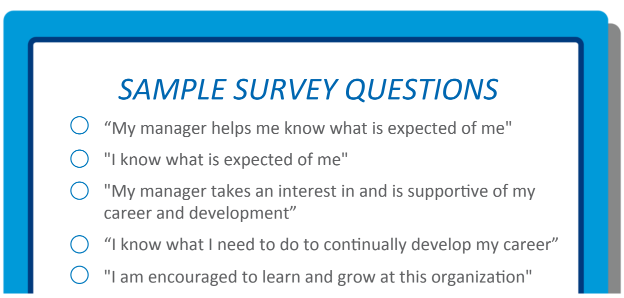


Figure 11. Companies hold managers accountable for successful execution of the PM process by surveying employees on manager activity and capability

With companies in their new PM framework placing more value on outcomes over activity, they actively assess manager skill and effectiveness. Of those we interviewed, **45%** actively assess manager accountability through pulse and engagement surveys. Employees are asked to rate both the quality and frequency of performance conversations with their managers (see Figure 11). Some companies focus on specific PM capabilities, like how well a manager is handling pay differentiation (through survey statements such as "Managers are comfortable allocating lower rewards to those who contribute to a lesser extent, in order to reward stronger contributors.")

Several interviewees said their HR teams share this feedback from employees directly with the managers themselves. This is both to hold managers accountable and to be able to support managers' improvement of weaker skills. A few organizations go a step further, to share this information about managers' PM execution capabilities with those managers' business heads. This allows companies to link PM capability with managers' performance otherwise (**10%** of interviewees incorporate this information into managers' evaluations to link this to their pay). Reporting on a manager's PM capabilities also brings capability overall to an organizational perspective, allowing HR to better identify "hot spots" (business units wherein leaders may not be executing the process well and may therefore require additional support.

6. Manager discretion is still alive and well

In **100%** of companies we interviewed, managers are given—and expected to use—their discretion to make compensation recommendations, using quantitative and qualitative performance data collected over the year. As one interviewee said, entrusting managers to handle compensation makes sense: "We hire smart people, and we trust them to make smart decisions about our business every day. They ought to have a voice in how to pay their people."

Ninety percent of companies in Year 2+ are providing training, tools, and resources to guide managers through the compensation process. At many organizations, managers will benchmark with one another during calibration sessions to create more clarity about various contribution levels. (A few companies did report that they loosened their requirements for calibration sessions, leaving it up to business units to decide if that process is helpful for them.) Some organizations offer additional coaching from HRBPs to support informed compensation recommendations. And compensation teams use back-end analytics to discourage "peanut buttering" (when managers may attempt to lighten their compensation-discretion responsibilities by simply spreading their compensation budgets across a pay group).

While a small percentage of companies (16%) continue to use behind-the-scenes shadow ratings, they stressed these ratings aren't proactively shared with employees and are instead meant only to support compensation decisions.

Managers continue to be given both budgets and the responsibility to allocate those budgets accordingly. In some cases, if managers find themselves out of budget, they can initiate a request for additional funds. For instance, when a large retailer we interviewed observed one of its business units consistently outperforming several others, it allocated a "spot bonus" with funds shaved from the enterprise's merit-increase pool. This was to allow managers in that one exemplary business to recognize their most valuable employees. As the company said, "Research shows that when you reward for high-performance behaviors in the moment, you get much better returns on investment," and the company insisted on ensuring managers' ability to do just that.

7. Evaluation gets enriched—not eliminated

A misconception about removing ratings is that evaluation is somehow also eliminated. The companies we interviewed all continue to effectively assess performance. They do so by using criteria they describe as more holistic and relevant, such as level of business impact, innovation, collaboration and teamwork, proactive self-development and skill building, achievement of stretch goals, and demonstration of specific values and competencies (see Figure 12).

Figure 12. In absence of year-end alphanumerical ratings, companies report a richer range of evaluation criteria

With more frequent conversations and feedback happening, **91%** of our interviewees reported that ongoing or end-of-year qualitative reviews of employee contributions are accompanied by richer data. Some further mentioned that this data availability might reduce the impact of bias in evaluations: in absence of ratings, managers must look to a more comprehensive view of performance. This could encourage decisions based more on data than preference or bias—quantitative metrics such as sales numbers, customer satisfaction scores, internal client satisfaction scores, billable hours, and percent project completion, as well as qualitative information that managers derive from ongoing conversations with their direct reports.

Processes downstream from evaluation

Although removing end-of-year ratings can potentially complicate adjacent HR processes, such as talent management, compensation, and succession planning, companies in Year 2 and later continue to figure out how to address these. Compensation, for instance, proceeds as usual and, again, becomes even more differentiated along performance lines (see *Pay differentiation increases,* p. 7). Equally, companies find ways to continue effective talent reviews, as we discuss below.

8. Talent reviews get more attention

Talent review is just as important in the new PM as before the redesign. The absence of a year-end rating may create new challenges, but our interviewees have found ways to continue to identify top talent and to develop and advance those individuals accordingly. In fact, some companies cited improvements in talent assessments now that talent processes no longer rely on year-end ratings. One major professional services firm, for instance, eliminated a scorecard that provided "an amount of detail we didn't think was helping us"; the ensuing new and simplified talent management allows managers to "get even deeper into how an individual is doing" with the result that "we're now person-centric instead of scorecard-centric," according to the firm.

Organizations in Year 2 or later still use a variety of tools to support managers with talent reviews and address any challenges introduced without year-end ratings. While 46% of companies we interviewed still use a traditional 9-box to inform talent discussions, others have either customized the 9-box or are applying tools developed in-house. In addition, a small number are increasing

Figure 13. Companies recognize that ongoing change management is needed for success of a new PM approach over time

the number of talent reviews they do, to better support manager discretion.

An additional positive consequence of eliminating year-end ratings from PM and, hence, from downstream talent review discussions is the possibility of more fairly identifying talent for promotion or stretch assignments. One professional services company said that, after having removed year-end ratings, it is now seeing a more diverse pool of managers among its promotion candidates. As a result, companies say they are seeing more talent agility. An e-commerce company we interviewed is now rethinking its definition of "high potentials"; as its HR leader said, "We no longer believe high potential is something you either have or you don't. We used to think people are coded that way, but it's increasingly apparent that each individual is different. Now we are focusing on mastery of role, learning agility, and personal motivation."

Another company currently four years into its new PM approach is revisiting what high performance means for its business—what constitutes key talent and how to measure it. This organization, like others, is capitalizing on the opportunity that a PM redesign affords to consider what levels of performance, potential, and skills leaders must demonstrate to be highly effective in a complex and fast-changing work environment.

9. Change management is still the secret weapon

The majority of companies we interviewed reported that change management remains critically important as they continue to deepen the integration of the new PM system across their organizations (see Figure 13). As one interviewee described, "It's a journey needing sustainment and continuous improvement. Habits and culture change slowly and through persistence." Another company phrased it this way: "The thing is, it's never done.?"

In embarking on a PM change, several companies invested the time to create systematic, multiyear change management strategies. One professional services company laid out an impressively detailed four-phaseplan to take the firm from implementation to "ubiquitous culture change," with purposefully timed executive roadshows, sponsor messages, training videos, new technology launches, and peer programs. Others companies have actively educated their senior leaders about the psychology and neuroscience of effective conversations. Across the board, companies noted the importance of continuing to simplify structure, ensure availability of the right processes and tools, provide ongoing support of manager capability, and to err on the side of over-communicating.

Most of the companies we interviewed said they understand the need to keep the new PM process top-of-mind for both managers and employees with continually fresh messages over time—through social media, new tools, new training opportunities, and ongoing and repeated reinforcement from company leaders. One organization well into its journey with a new PM approach (Year 6) still holds quarterly training webinars. The ultimate goal of the change management effort is to introduce and integrate the new PM into every aspect of how the organization functions; from new employee orientation, to new manager orientation, leadership courses, and monthly managerial meetings, down to the smallest details of daily work activities and interactions. In other words, the idea is to have performance management "infuse the DNA" of everything about the organization.

Given that PM reinvention demands a sustained commitment over years, ongoing reengagement of key stakeholders remains important. Several companies we interviewed specifically stressed the necessity of maintaining leadership buy-in and having leaders set the example to strengthen adoption of the new PM culture. As a major healthcare organization said, its change management plan "would not have been as successful without the energy and diligence shown by key leaders, including our EVP of HR."

To support this change from the bottom up as well as top down, some companies had also created stakeholder networks throughout the organization when they first introduced the new PM process. In Year 2 and later, those companies continue to look to these "change catalysts" or "change champions" to act as role models to build out the new PM approach. These change agents also serve as bidirectional communication channels, reporting back to HR on employee receptivity as well as conveying refreshed messages about the purpose and value of the PM redesign. As that same healthcare organization added, "Connecting the change in our PM approach to the 'why,' from both a business and a science perspective, gave our employees and executives a firm understanding of why we were changing and how we were going about it." According to the company, this added drive to its ongoing communications, benchmarking, and sustainment activities.

Interestingly, of the 27 organizations we interviewed, the two that had softened their focus on change management reported a slowed momentum of the new PM process. (In both cases, the reduction in change management efforts was due to business reasons unrelated to PM, such as earnings fluctuations or wide-scale organizational shifts.)

10. Documentation and compliance lighten up

In Year 1 of reengineering PM, companies dramatically streamlined documentation requirements to reduce administrative burden. Companies remain streamlined in later years of their new PM: **96%** of our interviewees continue with reduced and simplified PM documentation.

One interviewee said that any reintroduction of further documentation requirements would simply be a "backwards step." Another HR leader put it this way: "Mandating activities makes reporting for us easier on the back end, but does it really contribute to business outcomes? We believe giving the businesses flexibility to make decisions on their own will achieve the best results."

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Companies encourage documentation primarily to support managers' abilities to effectively manage employee performance. As one interviewee said, its managers are free to make notes on their performance conversations on anything they find most useful, be it a napkin or a Microsoft Word document. Another company stressed its emphasis on outcomes over activity in describing its experience tracking goals: despite only 28% of employees' voluntarily using this tool, 90% reported that they were clear what was expected of them. The organization said that, while it would like to see a higher usage rate with its goals tracker, it was satisfied that employees had a clear understanding of performance expectations.

Reducing PM administrative burden is accompanied by a move towards businesses being increasingly responsible for the PM process (and HR, decreasingly so). But this creates a tension: without documentation, how does HR track managers' performance management activity? Most of the companies we interviewed use engagement and pulse surveys to correlate outcomes with activity, as discussed above. With HR stepping firmly back from a policing role, compliance for compliance's sake is decreasing rapidly.

In keeping with an overall focus on simplicity and the desire to streamline documentation, 92% of Year 2+ companies expressly reported a shift from measuring activity to measuring outcomes (from surveys, focus groups, etc.). As one interviewee said, "We now encourage managers and employees to consider the business value [of a PM process] and use their judgment as to whether it's needed." According to another, "Previously, managers were focused on compliance and labels. Now our performance management is about how employees are making the business more successful."

11. Tools, training, and technology get simplified

The unifying theme across tools, training, and technology in the new PM approach is simplicity and ease of use and access. As one company put it, "Technology, when done right, should be invisible in the PM process." Although only **22%** of companies currently use real-time tracking platforms for things like goals and feedback, several are considering PM technology from newer vendors in the HR marketplace (e.g., BetterWorks, HighGround, Reflektive, and GuideSpark). These are expressly designed to bolt onto existing human resources management systems (HRMS) for increased agility and more real-time use. In addition, several interviewees have internally developed their own PM tools to achieve more configurable, flexible PM processes that in turn support more frequent, ongoing, real-time performance conversations.

Of the 27 companies we interviewed, **62%** say they have made their PM tools easier to use, and **58%** have made them easier to access through a variety of channels (see Figure 14). One company, for example, recognized that its consultants often can't make the time to log into the company's feedback platform when they are on-site with clients; so instead, email reminders are sent out immediately before key performance events throughout the year (e.g., before a quarterly check-in).

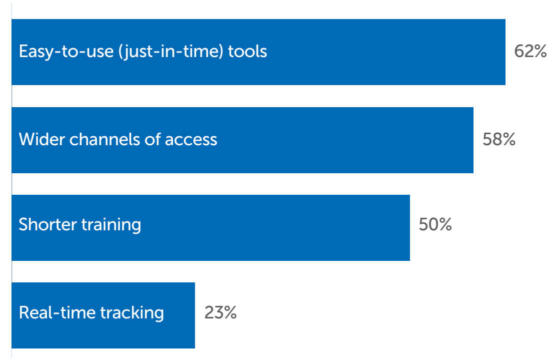

Figure 14. To support a PM that integrates seamlessly into everyday workflows, companies select and modify tools and training according to their specific needs

It's no longer enough that PM technology be convenient; any platform or app must both add value and integrate as seamlessly as possible into managers' and employees' workflows and work habits. Otherwise the technology simply won't be used to any extensive degree across an enterprise. One company we interviewed said that one of its PM reporting options wasn't being adopted because it required a mere "two clicks too many." As another HR leader observed, "Managers don't even like the simple form we created in our HRMS, which puzzles me. They seem to feel that even basic forms are too cumbersome."

In the same vein, **50%** of companies we interviewed are reducing the duration of trainings (e.g., moving to micro-videos) to make them more "digestible" to the individual as well as more efficient for the business. A small percentage (**15%**) are being even more aggressive in their technology approach, reducing the number of platforms and tools strictly to what they identify as most critical.

WHAT'S NEXT?

The experiences of companies we interviewed and the predictions of other industry thought leaders are incorporated into the following ideas about future possible refinements to performance management.

Companies tracking **pay differentiation** say it **increases (80%) or is maintained (20%)**

(N=24) **p. 7**

1. Technology is the big disruptor

We anticipate technology advances to have profound impacts on how performance is managed in the future. The estimated US$14 billion marketplace for HR platforms[15] is making PM more agile, social, and real-time—in setting and tracking goals, giving and providing feedback, training and development, and supporting downstream talent and compensation processes.

These technologies are creating an abundance of performance data that can be leveraged for talent analytics. A few organizations (including, among our interviewees, a global professional services firm and a multinational technology company) have begun to leverage performance data to gain deeper insights into their businesses, down to the level of individual employees. For most organizations, however, talent analytics is yet an evolving capability.

"More advanced" PM technology not only means more seamless integration into everyday workflows but more interoperability with technology purposed for adjacent organizational units, including learning and development, sales, and production. Performance management is likely to become both more precise in its execution and comprehensive in its scope. In this way, new digital ecosystems could powerfully redefine existing boundaries of how work gets done in an organization.

While technology will continue to be a disruptor, many organizations, from smaller businesses to large global enterprises, may struggle with keeping pace with technology evolution (which can represent a heavy capital expense and require large change initiatives to ensure adoption).

2. Team performance gains momentum

As organizations become more collaborative and globally networked, they are shifting their gaze to the performance of teams—whether physical, cross-functional, or virtual teams coming together for discrete phases of a project. For many individuals, teams have become the most proximal experience of an organization and, for many companies, the most basic unit through which contributions are made. Functional hierarchies are being replaced by networks of teams that, unlike networks of the past, must

15 Josh Bersin. The HR Software Market Reinvents Itself. *Forbes.com*, 18 July 2016.

be agile in unprecedented ways if they are to be successful. To one degree or other, fluid teams must now define their own missions, shape their own leadership, identify their own responsibilities, and build channels to share information so they can align internally and with other teams in the organization.

Yet most PM systems today still focus on the individual, even those that qualitatively account for team contributions. Only a few organizations we interviewed are accounting for both team performance and individual performance. One global technology company, for example, established a dashboard that allows leaders to view each team member's project status, connect team members to each other, and view real-time feeds of their team's activities. The same technology can be used to pulse survey for engagement levels. Instead of spending significant time and resources to conduct annual engagement surveys across the entire

organization, this company recognizes that "engagement actually lives at the team level" and is integrating its PM processes accordingly.

Another large professional services firm is advancing the evaluation of individual performance in the context of teams by integrating ongoing performance data into easily analyzable "snapshots" of any team contributor. This data incorporates results from brief surveys sent to other team members about their experiences in working with that person. Those survey results are incorporated into a scatter plot of quarterly performance that allows managers to get detailed individual performance data simply by clicking on a data point. This is to allow performance evaluation decisions around compensation, movement, and promotion to be based on current data within some context of team performance.

Companies like these, however, are the exception, not the rule. Most are still looking at how they can evolve PM to account for team performance at a time when organizations are seeing hierarchical structures collapse and more employees working in series of teams throughout the year to get work accomplished.

As team performance becomes more significant in PM, compensation may also see a shift to team-based rewards. The business unit of one large retailer we interviewed, for example, opted to allocate market-specific increases based on the success of individual stores. According to the company, this created a strong incentive for group performance, with that particular business unit now outperforming others within the organization on both engagement and profit measures.

3. Bias in PM deserves a fresh look

In the diversity and inclusion space, bias has long been an area of focus for many companies. In publicly describing the overhaul of its PM framework, Deloitte was one of the first companies to highlight the potential effects of bias in performance management discussions.[16] The firm took seriously the potential negative impacts of "idiosyncratic rater effects" (where ratings assigned by managers correlate more tightly to manager perception than actual performance of the employee).

A small number of our interviewees have begun intentionally to address bias in PM. Some said they expect talent reviews and calibration sessions to dampen bias effects. Many also recognize that the combination of increased frequency of conversations between managers and employees, as well as feedback from multiple sources, is generating more data to support PM and talent decisions. In theory, this should improve managers' abilities to make less biased decisions. Since many common bias mitigation strategies may not generate

16 Marcus Buckingham and Ashley Goodall. Reinventing Performance Management. *Harvard Business Review*, April 2015

the expected returns on investment,[17] tools and training that effectively mitigate unconscious bias in performance management processes may receive more attention in the coming years.

4. Compensation may need a rethink

Several of our interviewees expressed dissatisfaction with their current compensation approaches that require massive inputs of effort to differentiate the "middle of the population" and often without sufficient budgets to do so satisfactorily. Meanwhile, the very validity of

the performance bell curve that identifies the "middle" population and that forms the basis of conventional PM may be unfounded. Studies suggest that between 10 and 20% of employees are disproportionately responsible for a high percentage of business value (individuals whom Josh Bersin has described as "hyperperformers"[18]).

Performance management is likely to continue to yield new, richer, more precise data about the business impacts of individual performance. This includes making accurate sense of how individuals are functioning in fluid teams. Coupled with the new "network of teams" environment, organizations may increasingly take the opportunity of a PM redesign to reconsider their compensation processes (in the same way many interviewees said that reengineering PM catalyzed a reexamination of their talent reviews).

100% of companies who redesigned their PM say the **benefits are worth the investment**

p. 7

17 e.g., Frank Dobbin and Alexandra Kalev. Why Diversity Programs Fail. *Harvard Business Review,* July-August 2016

18 Ernest O'Boyle Jr. and Herman Aguinis. The Best and the Rest: Revisiting the Norm of Normality of Individual Performance. *Personnel Psychology, 65,* 79-119, 2012

DISCUSSION

Performance management—and specifically, whether to remove the single, year-end alphanumeric rating or not—has been a heated topic over the past year, with debates about whether the choice creates more value or more risk. While these discussions raise important points, they may overlook the key story—that a number of companies are seeing quantifiable benefits after investing in a new PM approach.

The research that the NeuroLeadership Institute has conducted over the past two years has been a qualitative deep dive into the experience of organizations that have had successful PM transformations. We have been intentional in exploring the success stories to discover the common threads. (Interestingly, many of our interviewees implicitly or explicitly acknowledged the benefits of applying key neuroscience principles when designing, implementing, and executing a new PM approach over time; see Appendix.)

The organizations we studied admit they met challenges along the way, such as ensuring manager accountability or effectively handling compensation recommendations and talent decisions that previously relied on a single end-of-year appraisal. But of all the companies we've interviewed, to date, not a single one has reverted to a performance management system that centers on the year-end rating.[19]

We believe that even companies who ultimately retain a more conventional performance management approach can benefit from the insights of the companies we've studied. By our research, removing ratings thoughtfully and strategically can be an enabler for more effective performance management that positions companies for positive business outcomes, as we've described herein. We expect a growing number of organizations to explore this approach, and we will continue to study their experiences as they do.

19 This excludes companies that have undergone mergers or acquisitions that involved a reversion to a ratings-based process

APPENDIX

The purpose of performance management is to support individual contributions towards positive business outcomes. Science suggests that a PM approach that expands beyond a focus on the year-end alphanumeric rating may best support performance. The kinds of performance conversations encouraged in redesigned PM may inherently:

1. **Leverage social threat and reward** (respect the neuroscience of social interaction)
2. **Generate insight** (set the foundation for positive behavior change)
3. **Foster a growth mindset** (influence others' approach to learning and challenge).

Leverage social threat and reward

To the brain, workplace interactions are either rewarding or threatening—with direct impacts on performance. We respond to social interactions (including with leaders and peers) as if they were physical threats or rewards, even if we are unconsciously aware of this. This can impact employees' abilities to think clearly, problem-solve, or be creative.

Traditional performance management—based on the single year-end review and the assigning of compensation based on past performance—can trigger a threat response across five drivers of human motivation. These drivers are described by the SCARF® model[20], which classifies social threats and rewards to one's sense of:

- **Status:** relative importance to others
- **Certainty:** ability to predict future outcomes
- **Autonomy:** a sense of choice and influence over outcomes
- **Relatedness:** a feeling of safety and familiarity with others
- **Fairness**: perception of being treated fairly in comparison to others

When others feel threatened, their capacities to make decisions, solve problems, and collaborate effectively are hindered. Conversely, rewards in all five SCARF® domains may be activated when employees feel that managers support their growth and development in frequent, less formal, strengths- based conversations.

Generate insight

Learning that stems from an "Aha moment" is more likely to last and be applied creatively in new situations.[21] Performance conversations can be structured to maximize the probability of insight.

20 David Rock. SCARF®: A Brain-Based Model for Collaborating With and Influencing Others. *NeuroLeadership Journal,* 1, 2008

21 Josh Davis et al. Why Insights Matter. *NeuroLeadership Journal,* 6, 2015

Encouraging insights in others is best achieved by reducing another's sense of social threat (i.e., applying SCARF® principles) and then allowing the other reflective space and time for insights naturally to arise.

Conventional PM centers on the end-of-year performance conversation—a single annual event in which a manager informs an employee of their performance rating. The manager may also explicit instruct the employee on how to maintain good performance or improve lesser performance. In a more coaching-based, exploratory approach, managers ask questions designed to encourage an employee's own insights about improving their performance. When employees come up with their own ideas on how to problem-solve, the learning is more likely to "stick."

Foster a growth mindset

A growth mindset is simply the belief that, with sufficient directed effort, anyone can achieve improvements in any area of practice. A growth mindset affects performance because it powerfully determines whether an individual will have either an effectual or ineffectual response to changes and challenges. Clearly this has profound implications for the workplace—particularly in today's organizations when businesses in every industry face accelerating changes and unprecedented challenges, as previously discussed.

Fostering a growth mindset in others supports their learning and highest performance.[22] The conventional year-end performance rating, which labels an individual and focuses primarily on the past, can easily reinforce a fixed mindset. In a redesigned PM approach, conversations typically aim to improve engagement and support development and achievement of personal and organizational goals; there is an implicit application of growth mindset. This can have practical impacts on how an employee meets challenges, problems, and decisions they face in the course of their everyday work.

22 David Rock, Josh Davis, and Beth Jones. One Simple Idea That Can Transform Performance Management. *Strategy & Business,* 36(2), 2013.

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ABOUT US

The NeuroLeadership Institute (NLI) synthesizes neuroscience research into actionable insights to help organizations be more effective. Our offerings span three practice areas—Performance Management, Diversity and Inclusion, and Learning. 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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