

# **Performance Evaluation and Development Systems A Comparative Study**

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## Executive Overview

American businesses are implementing increasingly sophisticated processes designed to improve individual and group performance through combining formal and informal feedback on employee and team behavior with an analysis of output. These systems reflect a belief that increased productivity and competitive advantage can be achieved through reviewing and providing feedback on an individual's and/or team's production output and work behavior. These systems range from the simplistic and static appraisal processes that have been used in some form for more than forty years, to team based goal and open feedback systems that incorporate many data points other than the traditional management perspective.

## Evaluation and Development

Most performance systems must reconcile and balance an essential tension between the need to evaluate past performance against the need to develop individuals and units for improved performance. This study found an overall trend toward the creation of performance systems that both evaluate and develop an individual/team. Interestingly, the trend is toward systems that focus more on development, have direct links to compensation, and focus on eliciting team behaviors to improve performance, moving away from individual assessment.

## Performance Management System Requirements

It is clear from this study that performance systems should be planned and developed as a key internal driver of the overall company/unit strategy. And, that these systems work best when linked to all other human resource processes, including compensation (base pay and bonus), training and development, recruitment, promotion/career development, and succession planning.

Certain key elements are required to develop a performance system that effectively supports an organization's short and long-term strategic goals:

1. Mission/Purpose – The mission/purpose of a performance system should be clearly understood. Is it:
  - Linked to the organizations strategic and operational objectives?
  - Designed for evaluation or development or both?
  - Intended to drive an organization's culture and/or measure it?
  - Long term focused (performance migration over a number of years) or short term results focused?
2. Criteria Model – A model for evaluation and development needs to be developed for these systems to function optimally. A skill/competency model that captures and assesses the characteristics of an individual's/team's ability to influence productivity is critical to the efficacy of any performance system that aspires to do more than measure past production. In an integrated "Ten Point" system (such as that employed by Microsoft), the model incorporates all aspects of the organization's strategic initiatives, while most skill/competency based systems focus solely on individual work behavior.

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3. Process/Scope – The process and scope of a performance system needs to be clearly determined and aligned with the many parts of an organization on which these systems have an impact. The degree to which technical and administrative processes are of performance systems is a critical consideration. Most of the companies surveyed reported that automation on an Intranet is helpful in simplifying the process, and improving use, accessibility and response.
  - What specific outcomes are desired?
  - What needs to be measured?
  - What data needs to be collected and what/who will be the source?
  - Will the manager be the sole reviewer and, if not, how much of the 360° view around the individual will be included?
  - How will the system be automated?
  - Who will support the system from a human resource and technical perspective?
4. Instrument Design – Once the above 3 parameters (mission, model and scope) are determined, the instrument(s) used to capture and report data should be constructed so that it clearly defines the characteristics on which feedback is desired, is not time consuming, and is easy to understand and use.
5. Feedback Process – The methodology for creating and delivering feedback is critical. The degree to which points of view from multiple perspectives, the depth and weight of those perspectives, and the responsibility for delivering the feedback should be determined. Two key questions need to be answered:
  - Should the feedback system be “open” (comments and ratings are shared with the reviewee) or “closed” (only selected comments and/or some form of summary data is shared)?
  - Should the data be attributed (identifying the person giving the feedback) or non-attributed?
6. Follow-up – A method of follow-up is critical to the success of a performance system.
  - How will the output of the review be used to guide future development and performance improvement efforts?
  - Will career steps be outlined , further detailing the developmental “need”?
  - Is a formal written development plan required?
  - Will there be a periodic review of development progress?
  - Should there be a mid-cycle review?
7. System Impact – Productive linkages that should be considered include compensation, career development/promotion, training, succession planning, and other human resource systems.
  - How will the performance system be linked to other systems (both technically and as a working process)?
8. Training – Comprehensive training should be a requirement for all participants -- managers, and feedback providers and recipients.

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## Study Methodology

This study was undertaken to better understand the current state of human resource performance systems in the financial services industry. It incorporated two research methodologies, a review of the current literature and interviews within fifteen companies (*see chart below*); eight were in financial services, three in professional services (consulting/accounting) and four other companies in various select industries. The interview data was compiled into this report. Each company's data is provided in the next section, *Comparative Study Company Profiles*.

A comprehensive interview guide (*see page xx, Interview Guide*) was developed to capture key performance system parameters, including:

- Overall System Description
- Responsibilities of Human Resource Departments, Management and Employees
- Evaluation Criteria
- Review Delivery
- Performance System Ties to Other Key Human Resource Systems
- Training
- General Assessment of System's Effectiveness

This review and analysis is solely intended to provide insight to current practices in order to both raise awareness and guide the thinking and development of human resource performance systems as the issues of evaluating and developing individuals becomes increasingly complex. This study is not meant to represent a definitive analysis or an evaluation of these companies' performance systems.

**Table of Study Participants by Industry**

<b>Financial Services</b>	<b>Professional Services</b>	<b>Other Corporations</b>
Citigroup	Ernst & Young	AT&T
JP Morgan	McKinsey & Co.	Motorola
Merrill Lynch	PricewaterhouseCoopers	TimeWarner
Morgan Stanley		Unilever
Paine Webber		
Putnam Securities		
Sanford Bernstein		
SBC/UBS		

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## Survey Findings

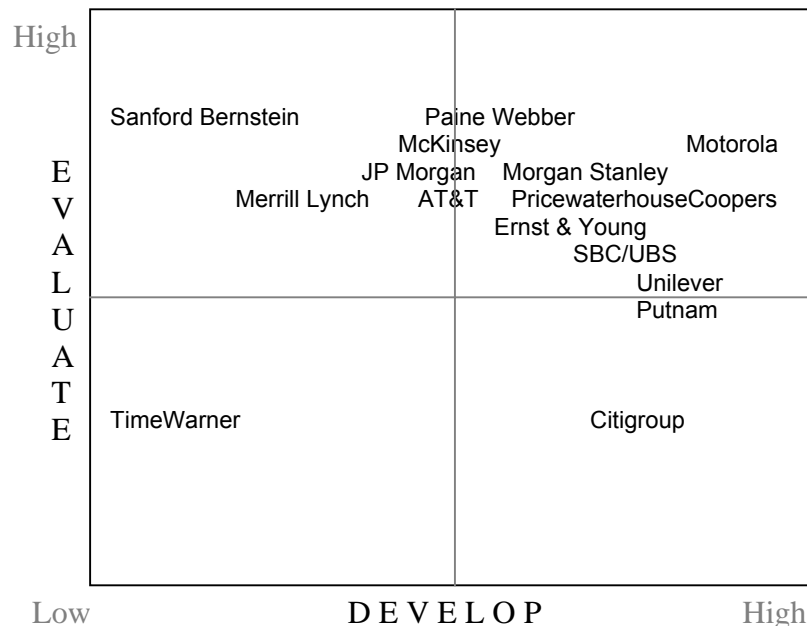
All the firms surveyed have established a performance management system. Most have devoted substantial amounts of time, money and other resources to the development and implementation of their systems, indicating that these systems are regarded as critical to the firm's success. There is a considerable amount of variation among the systems surveyed (*see "Comparative Study Company Profiles" for details*), reflecting differences in:

- Objectives;
- Underlying philosophy;
- Judgments of the efficacy of certain techniques;
- Firm organization; and
- Resources available.

There is no clear pattern to associating any industry with a particular method of performance analysis. Simple, unencumbered systems appear to be more useful and successful.

A fundamental characteristic of a performance management system is the degree to which it places emphasis on the evaluative and developmental functions of the system (*see "Executive Overview" discussion of evaluation and development*).

### The Degree of Evaluation and Development in Study Participants' Systems



Evaluation in these systems focused on the measurement of work performance over a specified period, with the goal of letting an employee know where they stand in relation to the organization's standards and expectations, very often in comparison with similar employees.

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The organizations surveyed reported using the results of the evaluation for many purposes, including:

- Acknowledging and recording an individual's most significant accomplishments;
- Articulating the organization's values, goals, and standards of performance;
- Identifying individuals who are candidates for advancement or not meeting the expectations of their role; and
- Determining salary, bonus, and other forms of compensation.

These are matters of vital concern to both the organization and the individuals involved and are, on their own, well worth the effort that it requires to design and implement a system that can evaluate employees thoroughly and fairly.

The developmental function in these systems is focused on those characteristics that contribute to effectiveness in role and on the steps that can be taken -- by the individual/team and the firm -- to improve individual (and, in a couple of cases, team) performance in the future. The developmental approach looks at the pattern of individual/team strengths and areas for improvement across a number of discrete aspects of job performance, guided by a model that reflects the skills and competencies the individual's/team's work requires. The developmental approach looks back toward previous assessments of these strengths and improvement areas as a baseline, and looks forward toward the steps that can be taken to realize the individual's/team's potential productivity.

This study has illuminated a particular dilemma for the financial services community in that most of these organizations are structured with individual "star" performers in mind who are thought to drive productivity through their expertise, intuition, experience, relationships, etc. These companies have found it difficult to create more open team based performance management systems.

All the organizations surveyed had established procedures to evaluate their employees. Some, however, have yet to fully develop the necessary procedures to support employee development. Those firms that have begun to strengthen the developmental aspect of their performance management system have encountered both powerful synergies between the two functions (especially ways in which effective evaluation can support development) and some intrinsic tensions between them.

## Key Elements

1. Mission/Purpose -- Those organizations that have specifically tied performance to a higher strategic purpose have experienced less resistance, more buy-in and substantial improvements in productivity in a relatively short (3-year) period of time. There have been no controlled studies to test whether this alone guided this change.
2. Criteria Model -- Most organizations are leaning towards system-wide application of criteria with some unit flexibility. Many firms employ a common set of performance criteria for all levels and functions as a universal (firm-wide) currency for understanding performance; a few have developed evaluative criteria that are tailored to specific functions (e.g. marketing, research and development, etc.). It is clear from this study that a model of performance (production and work behavior) is critical to the success of a

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performance system (success being defined as improved productivity). While a criteria model is a critical factor in a developmental system, it requires other elements, including linkages to other human resource processes, follow-up coaching, and so on.

3. Process/Scope – The process/scope of a system was never attended to as completely as outlined in “*Performance Management System Requirements*” earlier in this report. All firms surveyed attended to at least some aspect, as follows:
  - *Performance Data* -- Production measures of performance are increasingly being supplemented by behavioral criteria based on models that capture the specific skills and competencies that the firm believes determine success on the job. One of the organizations surveyed has such confidence in the ability of their behavioral model to capture the drivers of production that they are considering not including production data in the performance analysis. In some financial services companies, performance systems focus on the non-commission parts of the company, leaving the assessment of commission based units solely on the rate of production.
  - *The 360° View* -- Increasingly, the manager’s assessment of the behaviors, skills, and competencies that an individual has demonstrated during the evaluation period is being supplemented by those of peers, clients, suppliers, and, somewhat less commonly, subordinates, providing a broader and richer view of the reviewee’s performance. This richness, however, comes at a price. Many firms experience a dramatic increase in the:
    - Overall workload associated with the performance management process (many firms are struggling to limit the number of reviews solicited in order to ensure that reviewers can give useful feedback); and
    - Complexity of the task of integrating the feedback to create a coherent “message” for the reviewee.
  - *The Reviewer* -- The manager is most often the individual responsible for weighing and interpreting the performance data (80% of those companies in the study). In 70% of the systems, the manager is also responsible for deciding what will be communicated to the reviewee. Some firms are beginning to define a distinct role for a “coach” or “counselor” who may not be the reviewee’s day-to-day supervisor/manager. This individual is charged with the responsibility for helping the employee interpret and understand the data on their performance and create a plan for their personal development. In one of the systems examined, the responsibility for data interpretation and feedback belongs to the team. In two of the systems, the manager is responsible for providing an unbiased 360° view; these systems are heavily supported by Human Resources who either closely monitor the analysis or complete the analysis and provide it to the manager and subordinate for discussion.
  - *The Review/Evaluation Committee* – Two firms require that initial evaluation drafts be discussed and approved by a group in which the basis for the proposed review is presented and the reviewee’s performance can be compared with that of similar employees. The firms that employ this practice believe that it accomplishes a number of purposes, including:
    - Correcting for manager/evaluator bias;
    - Controlling “grade inflation” (a reviewer providing an inflated response in order to avoid a potential negative);
    - Normalizing the distribution of ratings in each employee class;

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- Generating qualitative comparative data and behavioral norms; and
  - Enabling managers to learn about the capabilities and accomplishments of a wide range of firm staff.
- *The Timing of Performance and Compensation Reviews*-- Some firms have attempted to enhance the developmental aspect of their performance management system by attenuating the connection between the annual performance review and an individual's annual compensation. This has been accomplished by separating the two in time (in some cases, placing the performance review at mid-cycle and the compensation review near the end of the cycle). Others have created a clear and direct link between the outcome of the performance review and some or most aspects of compensation.
4. Instrument Design – The design of the instrument used to collect feedback varies greatly firm to firm -- some utilize rating scales, others do not. All of the firms surveyed require commentary on some part of their form. There is a distinct trend to both automate and simplify the instrument used in order to reduce the labor for the reviewer and enhance and focus the feedback for the reviewee.
    - *Ratings and Comments*-- Where numerical ratings are collected, they are generally aggregated by source (e.g. peer, subordinate, client, etc.). None of the systems examined use an importance rating to determine if reviewers consider one criterion more important than another.
  5. Feedback Process -- The degree to which verbatim feedback is shared with participants varied greatly in this study. In the most advanced systems, feedback is freely shared in both attributed and non-attributed forms (the benefits of either have not been tested).
    - *Anonymity*-- In systems that gather multiple rater data, sources sometimes remain anonymous to the manager and almost always remain anonymous to the reviewee. Most systems are moving to a more open sharing of non-attributed feedback.
  6. Follow-up – Follow-up varies system to system. Many firms continue to have an annual review with a move towards creating a mandatory mid-cycle session. The more developed systems seem to enable an increased frequency of feedback over a given period (quarterly or more).
    - *Development Plans*-- Five of the firms surveyed require the creation of a written “personal development plan” or equivalent (specifying the characteristics that are targeted for development, the steps that will be taken by whom and by when, and the results expected), leaving this to the manager and/or reviewee.
  7. System Impact – The performance system's connection to other systems is a critical yet varying requirement. In most systems, the outcomes of the evaluative aspect of the performance management process are used to provide significant input to the compensation and promotion processes. Two systems rely on this process for its succession planning. The outcomes of the developmental aspect may act as a “needs” assessment and input to the organization's training and development plan (in one system it is a mandatory “tickler” for scheduling training).

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8. Training -- Though most firms offer training on the performance management process, it is typically optional and directed toward managers/feedback providers rather than the effected employee population.

### Key Findings from the Literature

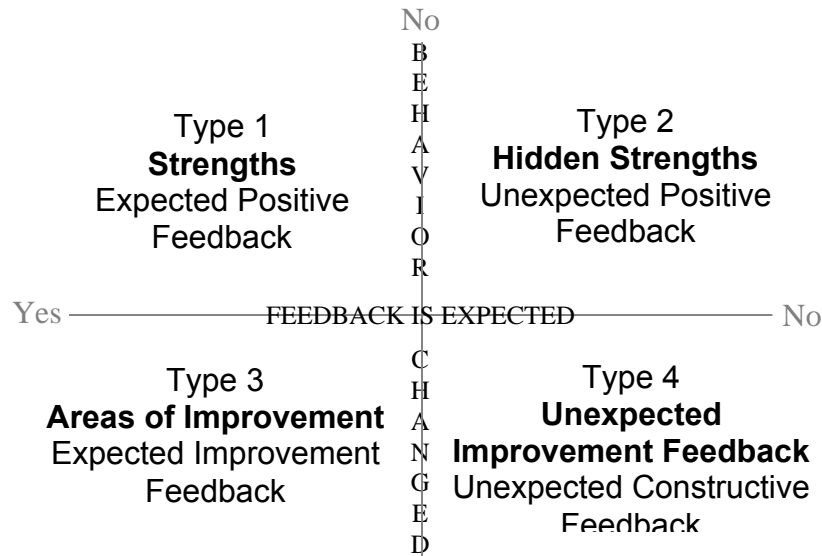
Recently, organizations have increasingly attempted to deploy systems that collect data from a broad circular view – from 360° around the team or individual being evaluated. These systems have enabled more open communications within an organizational system, breaking down barriers between departments, individuals, levels, functions, etc. Some organizations go as far as including suppliers and customers in the 360° to communicate a more complete, albeit biased, view to the organizational unit. Some firms have modified this approach taking a less encompassing view, eliminating one or more segments of the viewing circle (i.e., the subordinate view).

A typical 360° performance system will cull data from an individual's direct management, peers and subordinates to get a "picture" of the individual from all operating perspectives. Team based systems include further data from other teams/departments with which the team interfaces in order to understand the working relationships, service levels and overall satisfaction of these critical dependents. In the most successful 360° systems, two key outcomes are achieved:

1. Employees increasingly seek information (feedback on performance) on their own, dramatically enhancing communications, working relationships and productivity; and
2. The entire organization continually learns how to improve processes, resulting in improved productivity and an expansion of management's capacity to lead and manage.

The degree to which behavior and associated productivity actually changes is dependent on the ability of the individual to "hear" the feedback. In all performance feedback systems, there are four types of feedback, ranging from the expected positive feedback to the unexpected negative feedback.

### The Four Feedback Types



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Performance systems need to ensure that the methodology utilized in the delivery of feedback considers and, in fact, trains managers (reviewers) to help reviewees assimilate unexpected performance feedback (both positive and negative).

This review has shown the following as important considerations in the design and implementation of an integrated performance review system:

- There is a relationship between feedback (work behavior and production), development and performance.
- Integrated strategic performance systems (quality, work behavior and production goals) realize sustainable improved performance and role expertise sooner than non-integrated systems (work behavior).
- State-of-the-art systems incorporate open feedback (attributed and non-attributed) from a 360° perspective that includes suppliers and customers.
- The best systems are simple in design and execution and do not utilize complicated data collection and analysis.
- There is a movement towards team-based performance analysis and development.
- More systems are weighted towards balancing development and evaluation with some successful systems focusing more on development.
- Providing developmental steps for criterion on feedback forms enhances the developmental message for and the desired change in the reviewee.
- Linking performance systems to compensation systems (and other key human resource processes) is critical to achieving improved work behavior, performance and organizational change.
- Comprehensive training for all participants is important to integrating systems into the organization's culture.

### **Feedback as a Determinate of Performance over Time**

Research in this area has shown a remarkable relationship between the amount of feedback, and development and performance in role. Systems in which production and work behavior feedback have been integrated into a strategic development process experience dramatic improvement in productivity and systemic learning. Two key improvements occur in systems that employ open, 360° feedback systems:

1. Role expertise is achieved much earlier in an individual's development cycle (role proficiency is often achieved one to two years earlier); and
2. When feedback and development efforts are sustained, role performance continues to improve dramatically over time, where in typical feedback systems, feedback and development efforts begin to wane in the fourth year.

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## Best Practices

### State of the Art in Performance Management

There are numerous types of performance management systems ranging from those that focus more on the individual to others that focus more on the team-as-a-whole. The most interesting systems uncovered in this study employ an ongoing 360° analysis and development of individuals and teams integrating four areas:

1. Quality Improvement – utilizing some measure and ensuring interventions to improve the quality of both how work is accomplished and the output;
2. Performance Evaluation – the analysis and assessment of past performance (work behavior and production) during a set period of time;
3. Management-by-Objective – the process of establishing goals and reviewing the degree to which they are achieved; and
4. Performance Development – a formal developmental process in which steps are taken to improve quality, performance and achievement of objectives.

Microsoft, Motorola and Xerox<sup>1</sup> stand out as work environments in which these three components are integrated into comprehensive performance evaluation and development systems. For example, Microsoft evaluates and develops work units (and their members) quarterly, using a "Ten Point" system that includes criteria on production (i.e., total cost, output, profitability, etc.), customer satisfaction, work behaviors (skills and competencies), and quality. Within each "point," there is a three to five step development plan with specific training and development outlined for the unit (and individuals within) to move from one step to the next in the progression. In these systems, the team monitors the individual's contribution to improved team performance without an extensive performance analysis infrastructure.

These systems foster continuous learning by the individual and team and simultaneously guide individual performance, team productivity and unit/company culture towards key desired outcomes. In all of these systems, compensation is a direct result of the performance analysis.

### Best Practices for Evaluating and Developing Performance

The following are the best practices for developing and implementing a performance system derived from this study:

1. Mission/Purpose
  - Include and balance both evaluative and developmental objectives.
  - Articulate clear links to the organization's business strategy.
  - Define the performance system as a key component in a comprehensive human resource system.

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<sup>1</sup> Other companies in this study also utilize these same techniques, though not as ubiquitously as these three. For instance, all of TimeWarner's production facilities (magazine printing and audio/video production units) utilize similar processes. In addition, General Electric recently introduced the Six Sigma quality processes into their performance analysis with remarkable results.

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### 2. Criteria Model

- Model work behavior skills and competencies across the firm by function.
- Tailor the firm-wide model by allowing local focus on only 3 to 5 key areas of development.
- Integrate quality improvement, performance skill and competency evaluation and improvement, and management-by-objective systems.

### 3. Process/Scope

- Team based.
- Use production and behavioral data.
- Gather 360° feedback data, including suppliers and customers.
- Automate on Intranet or similar system.
- Limit reviewers to key work interfaces (determined by manager and/or team).
- Limit number of reviewers (no more than 15).
- Provide formal feedback as often as possible, i.e., quarterly. In the least, include a mid-year and end-of-year review. Some organizations are balancing the annual human resource management cycle by moving the "summary" review of a past period's performance to mid-cycle, providing more opportunity for an individual/team to act on short term developmental needs and goal achievement.

### 4. Instrument Design

- Control the demands imposed on an organization by limiting the number and type of evaluative criteria and reviewers.
- Include a sequence of developmental stages for each criterion.
- Provide clear definitions of all criteria, including illustrative examples.
- Limit evaluative scales to "meets" and "does not meet" expectations (and not applicable).
- Require actionable commentary as well as ratings on all criteria to identify areas for attention and the specific behaviors that require improvement.

### 5. Feedback Process

- 1:1 reviewer to reviewee in the review session.
- Share all feedback data with the reviewee ("open system").
- Force weighting of client (customer) data.
- Develop a system in which all "open" feedback is attributed. Since this process produces some initial resistance, an effective compromise is to make commentators anonymous to the reviewee and known to the manager.

### 6. Follow-up

- Review performance quarterly (if possible).
- Require mid-cycle reviews.
- Require written development plans.
- Modify development plans as new feedback is received.

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### 7. System Impact

- Use individual/team development plans to drive an organization's training curriculum for the coming period.
- Include the output of the performance system as a key and explicit component of compensation (some portion of compensation should be based on the performance results).
- Incorporate a developmental and next position perspective into the performance management system, thus documenting an individual's career trajectory and inputting to the firm's succession planning.
- Employ the performance criteria model in the recruitment process, describing the developmental stage expected for new hires, depending on function, and how development is managed.

### 8. Training

- Train reviewers on (and give explicit examples of) effective and actionable feedback.
- Train reviewers on delivering performance reviews.
- Train all employees on the performance model.
- Train all employees on the strategic intent of the performance system.